

Hydrocarbon Exchange Corporation

Financial Statements
For the Years Ended June 30, 2009 and 2008



**Hydrocarbon Exchange
Corporation**

Financial Statements
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Hydrocarbon Exchange Corporation

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Independent Auditors' Report

Board of Directors and Shareholders
Hydrocarbon Exchange Corporation
Dallas, Texas

We have audited the accompanying balance sheets of Hydrocarbon Exchange Corporation (the "Company") as of June 30, 2009 and 2008, and the related statements of operations, stockholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis of designing audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Hydrocarbon Exchange Corporation as of June 30, 2009 and 2008, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

BDO Seidman, LLP

October 20, 2009
Dallas, Texas

<i>June 30,</i>	2009	2008
Assets		
Current assets		
Cash and cash equivalents	\$ 2,910,290	\$ 1,656,455
Restricted cash	2,500,000	2,500,000
Natural gas futures contract account	2,616,343	2,199,012
Accounts receivable:		
Gas sales	15,802,459	81,409,394
Other	182	18,356
Imbalance inventories	525,163	1,886,371
Deferred income taxes	976	221,303
Prepaid expenses	609,526	289,363
Total current assets	24,964,939	90,180,254
Property and equipment		
Office and computer equipment	364,241	360,332
Leasehold improvements	25,543	25,543
Accumulated depreciation and amortization	(265,694)	(188,472)
Net property and equipment	124,090	197,403
Other assets		
Deferred income taxes	12,541	18,591
Deposit	4,430	4,430
Total assets	\$ 25,106,000	\$ 90,400,678

Hydrocarbon Exchange Corporation

Balance Sheets

<i>June 30,</i>	2009	2008
Liabilities and Stockholders' Equity		
Current liabilities		
Trade accounts payable and accrued expenses	\$ 10,900,579	\$ 60,535,890
Trade accounts payable - related parties	3,949,326	20,568,973
Income taxes and other tax payables	206,737	206,737
Total current liabilities	15,056,642	81,311,600
Deferred rent expense	18,418	18,418
Total liabilities	15,075,060	81,330,018
Commitments and contingencies		
Stockholders' equity		
Capital stock - no par value authorized 10,000 shares; issued and outstanding 6,000 shares	1,976,000	1,976,000
Stock subscription receivable	(1,000)	(1,000)
Retained earnings	8,055,940	7,095,660
Total stockholders' equity	10,030,940	9,070,660
Total Liabilities and Stockholders' Equity	\$ 25,106,000	\$ 90,400,678

See accompanying notes to financial statements.

Hydrocarbon Exchange Corporation

Statements of Operations

<i>For years ended June 30,</i>	2009	2008
Revenues		
Gas sales	\$ 455,116,236	\$ 570,709,615
Marketing fees	757,192	814,457
Total revenues	455,873,428	571,524,072
Cost of gas sales	452,065,157	566,973,899
Gross profit	3,808,271	4,550,173
General and administrative expenses	2,107,417	1,592,167
Depreciation and amortization	77,221	304,738
Total expenses	2,184,638	1,896,905
Income from operations	1,623,633	2,653,268
Other income (expenses)		
Interest income	47,013	286,902
Interest expense	(10,604)	(1,130)
Total other income (expense)	36,409	285,772
Income before provision for income tax	1,660,042	2,939,040
Provision for income tax		
Current	473,385	1,425,413
Deferred	226,377	(357,104)
Total provision for income tax	699,762	1,068,309
Net income	\$ 960,280	\$ 1,870,731

See accompanying notes to financial statements.

Hydrocarbon Exchange Corporation

Statements of Stockholders' Equity

	Number of Shares Issued	Capital Stock	Stock Subscription Receivable	Retained Earnings	Total
Balance at June 30, 2007	6,000	\$ 1,976,000	\$ (1,000)	\$ 5,224,929	\$ 7,199,929
Net income	-	-	-	1,870,731	1,870,731
Balance at June 30, 2008	6,000	1,976,000	(1,000)	7,095,660	9,070,660
Net income	-	-	-	960,280	960,280
Balance at June 30, 2009	6,000	\$ 1,976,000	\$ (1,000)	\$ 8,055,940	\$ 10,030,940

See accompanying notes to financial statements.

Hydrocarbon Exchange Corporation

Statements of Cash Flows

<i>For year ended June 30,</i>	2009	2008
Cash flows from operating activities		
Net income	\$ 960,280	\$ 1,870,731
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation and amortization	77,221	304,738
Deferred income tax	220,327	(357,104)
Changes in operating assets and liabilities:		
Natural gas futures contract account	(417,331)	328,145
Accounts receivable	65,625,109	(48,195,600)
Inventories	1,361,208	(1,573,135)
Other assets	(320,163)	(152,916)
Trade accounts payable and accrued expenses	(49,635,311)	38,497,510
Trade accounts payable - related parties	(16,619,647)	6,898,312
Income taxes and other tax payables	6,050	54,130
Net cash (used in) provided by operating activities	1,257,743	(2,325,189)
Cash flows from investing activities		
Purchases of property and equipment	(3,908)	(16,930)
Cash used in investing activities	(3,908)	(16,930)
Net (decrease) increase in cash and cash equivalents	1,253,835	(2,342,119)
Cash and cash equivalents, at beginning of year	1,656,455	3,998,574
Cash and cash equivalents, at end of year	\$ 2,910,290	\$ 1,656,455

See accompanying notes to financial statements.

Hydrocarbon Exchange Corporation

Notes to Financial Statements

- 1. Business Organization and Business Activities** Hydrocarbon Exchange Corporation (the “Company”) was formed on July 1, 2004. The Company, which is located in Dallas, Texas, markets natural gas.

The Company focuses on the purchase of natural gas supplies from independent producers and the resale of gas to industrial end-users, electric power generators, and large market aggregators located in Texas and Oklahoma. The Company anchors its operations on marketing gas produced in North Texas.

The Company has been formed as a Texas C corporation, and is owned by three stockholders. Each of the three stockholders owns a 33.3% share in the Company. Dividends to stockholders will be made at the Company’s discretion when declared. No dividends were declared during the years ended June 30, 2009 and 2008.

- 2. Summary of Significant Accounting Policies** Use of Estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of contingent assets and liabilities at June 30, 2009 and 2008, and revenues and expenses during the reporting period. Actual results could differ from estimates. Estimates included in the financial statements include the net realizable value of accounts receivable, inventory valuation, income taxes, depreciation and amortization, and mark to market of natural gas futures contract account. It is possible that these estimates may change based on actual results and other factors.

Cash and Cash Equivalents - For purposes of the statement of cash flows, the Company considers all highly liquid debt instruments purchased with an original maturity of three months or less to be cash equivalents.

The Company reports cash flows resulting from futures contracts as an operating activity as the transactions relate to cash payments that hedge a purchase or sale of inventory.

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Notes to Financial Statements

The Company is required to maintain a minimum cash balance of \$2,500,000 to remain in compliance with its credit facility agreement which is further discussed in Note 7.

Derivative Financial Instrument and Commodity Price Risk Management - Derivative financial instruments are accounted for under Financial Accounting Standards Board (“FASB”) Statement of Financial Accounting Standards (“SFAS”) No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended (“SFAS 133”).

The Company enters into certain derivative contracts in accordance with its risk management strategy that do not meet the criteria for hedge accounting. Although these derivatives do not qualify as hedges, they have the economic impact of mitigating commodity price exposures. These derivative financial instruments are accounted for on a full mark to market basis through current earnings. The Company continues to carry these derivatives at their fair value on the balance sheet and recognizes any subsequent changes in its fair value in earnings.

Accounts Receivable - Accounts receivable from gas sales consist of uncollateralized accrued revenues due under normal trade terms, generally requiring payment within 30 days of invoice date. No interest is charged on past-due balances. Payments made on all accounts receivable are applied to the earliest unpaid items. The Company uses the direct write-off method for recognizing bad debts, which approximates the allowance method. Accounts are written off when there is certainty as to their being uncollectible. No allowance was necessary at June 30, 2009 and 2008.

Imbalance Inventories - Differences between the volumes of gas purchased and nominated to customers and volumes actually delivered by the pipelines (imbalances) are included in the financial statements as inventory. The Company maintains an imbalance inventory valued at applicable spot market prices at various hubs located in Texas. All short imbalance positions are accrued.

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Notes to Financial Statements

Property and Equipment - Property and equipment are recorded at cost less accumulated depreciation and amortization. Expenditures for maintenance and repairs are charged to operations as incurred. When assets are sold or retired, the related cost and accumulated depreciation are removed from the accounts and any gain or loss is included in income.

Property and equipment are depreciated or amortized using straight-line method over the following estimated useful lives:

Office and computer equipment	1-5 years
Software	3-5 years
Furniture and fixtures	3-7 years

Leasehold improvements are amortized on a straight-line method over the shorter of the lease term or estimated useful life of the asset.

Impairment of Long-Lived Assets - Long-lived assets are reviewed for impairments whenever events or changes in circumstances indicate that the related carrying amount may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of such assets to future net cash flows expected to be generated by the assets. If such assets are considered to be impaired, the impairment to be recognized is measured as the amount by which the carrying amount of the assets exceeds the fair value of the assets.

Income Taxes - The Company follows the provisions of FASB Statement of Financial Accounting Standard No. 109, *Accounting for Income Taxes* ("SFAS 109"). Under the asset and liability method of SFAS 109, deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to the differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using the tax rate in effect for the year in which those temporary differences are expected to be recovered or settled. Under SFAS 109, the effect of a change in tax rates of deferred tax assets and liabilities is recognized in income in the year of the enacted tax rate change.

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Notes to Financial Statements

Revenue Recognition - Natural gas sales consist of sales to natural gas purchasers. All contracts in which the Company takes legal possession of gas are presented at gross sales less cost of gas sold. The Company accounts for its trading activities in accordance with the Emerging Issues Task Force Issue No. 02-3, *Issues Related to Accounting for Contracts Involved in Energy Trading and Risk Management Activities*, regarding the presentation of trading activities in the statements of operations. This rule prescribes that all trading contracts, whether or not physically settled, be recorded net upon settlement, rather than gross as a sale and cost of sale. Management has determined all gas purchases and sales to be non-trading and are, therefore, presented on a gross basis.

The Company recognized revenue when products are shipped and the customer takes ownership and assumes risk of loss, collection of the relevant receivable is probable, persuasive evidence of an arrangement exists and the sales price is fixed or determinable.

For marketing contracts in which the Company acts as agent to market gas on behalf of others, revenue is reflected as marketing fees during the period the service is rendered.

Shipping and Handling Costs - Shipping and handling costs are reported under the cost of gas sales on the statement of operations.

New Accounting Pronouncements - In June 2006, the FASB issued SFAS Interpretation No. 48, *Accounting for Uncertainty in Income Taxes – an interpretation of SFAS Statement No. 109* (“FIN 48”). This interpretation provides guidance for recognizing and measuring uncertain tax positions, as defined in SFAS No. 109, *Accounting for Income Taxes* (“SFAS 109”). FIN 48 prescribes a threshold condition that a tax position must meet for any of the benefit of the uncertain tax position to be recognized in the combined financial statements. Guidance is also provided regarding de-recognition, classification and disclosure of these uncertain tax positions. FIN 48 is effective for nonpublic companies for fiscal years beginning after December 15, 2007. During October 2008, the FASB approved the

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release of a proposed FSP for public comment that would defer FIN 48 for one more year for nonpublic companies. The Company does not expect the implementation of FIN 48 to have a material impact on its financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (“SFAS 157”), which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. SFAS 157 applies to other accounting pronouncements that require or permit fair value measurements. The Company adopted SFAS 157 on July 1, 2008, and the adoption did not result in a significant change in the method of calculating fair value of assets or liabilities or have a material impact on our financial statements. The primary impact from adoption of SFAS 157 was additional disclosures.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities-Including an amendment of FASB Statement No. 115* (“SFAS 159”). SFAS 159 permits an entity to elect fair value as the initial and subsequent measurement attribute for many financial assets and liabilities. Entities electing the fair value option would be required to recognize changes in fair value in earnings. Entities electing the fair value option are required to distinguish, on the face of the statement of financial position, the fair value of assets and liabilities for which the fair value option has been elected and similar assets and liabilities measured using another measurement attribute. The Company does not expect the implementation of SFAS 159 to have a material impact on its financial statements.

In December 2007, the FASB issued SFAS No. 141R, *Business Combinations* (“SFAS 141R”), which establishes principles and requirements for how an acquirer in a business combination recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest; recognizes and measures the goodwill acquired in the

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business combination or a gain from a bargain purchase; and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS 141R is to be applied prospectively to business combinations for which the acquisition date is on or after the beginning of an entity's fiscal year that begins on or after December 15, 2008. The Company is evaluating the impact of SFAS 141R, which also requires acquisition transaction costs to be expensed as incurred rather than capitalized as a direct cost of the acquisition. Depending on the size, nature and complexity of future acquisition transactions, such transaction costs could be material to its results of operations under SFAS 141R.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements* ("SFAS 160"), which establishes accounting and reporting standards that require the ownership interest in subsidiaries held by parties other than the parent be clearly identified and presented in the consolidated financial statements. This statement is effective for fiscal years beginning on or after December 15, 2008. The Company does not expect SFAS 160 to have a material impact on its combined financial statements.

Effective in July, we adopted SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities—an amendment of FASB Statement No. 133* ("SFAS 161"). SFAS 161 requires certain disclosures about the gains and losses associated with derivative instruments and hedging activities, the location of such gains and losses in the financial statements, and a description of related trading activities and their risks.

In May 2009, FASB issued Statement of Financial Accounting Standards No. 165, *Subsequent Events* ("SFAS 165"), which establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. SFAS 165 is effective for fiscal years and interim periods ending after June 15,

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2009 and is applied prospectively. The Company adopted the new disclosure requirements in the financial statements for the year end June 30, 2009.

Reclassifications - Certain reclassifications have been made to conform the prior period data to the current year presentation.

Subsequent Events - The Company has evaluated subsequent events through October 20, 2009, the date of the issuance of the audited financial statements.

3. Financial Instruments and Fair Value

The Company adopted SFAS No. 157, *Fair Value Measurements*. SFAS 157 defines fair value, establishes a framework for measuring fair value and requires additional disclosures about fair value measurements. The criterion that is set forth in this standard is applicable to the fair value measurement where it is permitted or required under other accounting pronouncements. SFAS 157 defines fair value as the exit price, which is the price that would be received to sell an asset or paid to transfer a liability in a transaction between market participants at the measurement date. SFAS 157 establishes a three-tier fair value hierarchy that prioritizes inputs to valuation techniques used for fair value measurement.

- Level 1 consists of observable market data in an active market for identical assets or liabilities.
- Level 2 consists of observable market data, other than that included in Level 1, that is either directly or indirectly observable.
- Level 3 consists of unobservable market data. The input may reflect the assumptions of the Company, not a market participant, if there is little available market data and the Company's own assumptions are considered by management to be the best available information.

In the case of multiple inputs being used in fair value measurement, the lowest level input that is significant to the fair value measurement represents the level in the fair value hierarchy in which the fair value measurement is reported. The adoption of SFAS 157 has not resulted

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in any significant changes to the methodologies used for fair value measurement. The Company uses derivatives for the purpose of mitigating exposure to market risk in commodity prices. The Company uses exchange-traded futures and options to hedge grain and natural gas commodities

The fair value of derivative assets is reflected on the balance sheet totaling \$2,616,000. The fair value measurements are performed on a recurring basis and the level of the fair value hierarchy in which they fall are as follows:

<i>June 30, 2009</i>	Level 1
Assets:	
Commodity derivatives – total fair value	\$ 2,616,343

4. Cash Flow Information

Supplemental cash flow information for the years ended June 30 are as follows:

	2009	2008
Cash paid during the period for income taxes	\$ 863,700	\$ 1,363,000
Cash paid during the period for interest	\$ 10,604	\$ 1,130

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5. Related Party Transactions

The Company has identified three related parties, Texas Energy Management Corporation (“TEMCO”), Gas Asset management, Inc. (“GAM”) and Texas Energy Midstream (TEMidstream), with which it shares directors and staff members. TEMCO, GAM and TEMidstream have appointed the Company to act on their behalf regarding certain Firm Intrastate Transportation Agreements and assigned contracts with various natural gas suppliers to the Company.

The Company has a long-term natural gas supply contract with TEMCO for resale of natural gas, at market price, in the normal course of business. The purchases from TEMCO totaled approximately \$96,460,000 and \$147,235,000 for the years ended June 30, 2009 and 2008, respectively, representing 22% of total purchases in 2009 and 27% of total purchases in 2008. The Company purchased transportation from TEMidstream for approximately \$1,221,000 and \$0 for the years ended June 30, 2009 and 2008 respectively, representing 7% of total transportation in 2009 and 0% in 2008.

At June 30, 2009 and 2008, the Company had a net payable to TEMCO of approximately \$3,630,000 and \$20,569,000, respectively and a net payable to TEMidstream of approximately \$319,000 and \$0, respectively.

The Company realized marketing fees of approximately \$424,000 and \$424,000 during the years ended June 30, 2009 and 2008, respectively, on resale of gas purchased from TEMCO.

The Company paid commissions of approximately \$899,000 and \$366,000 for the years ended June 30, 2009 and 2008, respectively, to two Companies that are wholly owned by the shareholders of Hydrocarbon Exchange Corporation.

Operating Leases - Beginning August 1, 2005, the Company entered into a new lease agreement with TEMCO for its office facilities. The rental agreement is for a period of 65 months and provides five

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months free rent and average monthly rental payments of \$4,430 after the initial five-month period. The Company recognized rent expense under the agreement of \$59,408 for the year ended June 30, 2009. Additional office space increased rent by \$950 per month effective March 1, 2008. The following is a schedule of the future minimum lease payments required under the operating lease:

Year Ending June 30,

2010	\$	66,893
2011		34,839

**6. Natural Gas
Futures Contract
Account**

The Company had deposits with its registered commodity broker of \$2,616,343 at June 30, 2009 and \$2,199,012 at June 30, 2008, that was pledged to secure outstanding natural gas futures contracts. The account includes a cash balance of \$2,654,014 at June 30, 2009 and \$3,470,627 at June 30, 2008, less unrealized losses or plus unrealized gains at fair value on natural gas contracts of \$37,671 at June 30, 2009 and \$1,271,615 at June 30, 2008 yet to be settled. Included in the gas purchases during the years ended June 30, 2009 and 2008, is mark-to-market valuation of \$34,800 and \$650,893, respectively, incurred on natural gas futures contracts that were used to hedge natural gas to be bought and sold during the future periods.

**7. Concentrations and
Economic
Dependency**

Deposits at one bank exceeded the \$100,000 federally insured limit at various times throughout the years ended June 30, 2009 and 2008.

At June 30, 2009, the Company had two customers that accounted for approximately 32% of the outstanding accounts receivable balance. Three customers comprised 36% of total sales for the year ended June 30, 2009.

At June 30, 2008, the Company had two customers that accounted for approximately 41% of the outstanding accounts receivable balance. Six customers comprised 57% of total sales for the year ended June 30, 2008.

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Management does not believe that the loss of any one customer would have a material adverse effect on the Company's results of operations or cash flows, as it believes it could readily locate other purchasers.

The Company had two vendors that comprised 71% of the outstanding gas accounts payable at June 30, 2009. Three vendors comprised 65% of total gas purchases for the year ended June 30, 2009.

The Company had three vendors that comprised 67% of the outstanding gas accounts payable at June 30, 2008. Three vendors comprised 66% of total gas purchases for the year ended June 30, 2008.

Management does not believe that the loss of any one vendor would have a material adverse effect on the Company's results of operations or cash flows, as it believes it could readily locate other vendors.

8. Credit Facilities

On May 1, 2009, the Company entered into an uncommitted revolving credit facility agreement (the "Facility") with a bank. The Facility expires on October 31, 2009. The maximum amount the Company can borrow under the Facility depends on certain provisions defined in the Facility, and was set at \$50,000,000 and \$63,500,000 at June 30, 2009 and 2008, respectively. The Company has no outstanding balance on the Facility at June 30, 2009 and 2008, respectively. Amounts outstanding under the Facility bear interest at varying rates based on the amount of time the advance has been outstanding. The interest rate on outstanding letters of credit was 3% and 2% at June 30, 2009 and 2008, respectively. The Facility contains certain covenants, the most restrictive of which require the Company to maintain certain net worth, working capital, debt to earnings before interest, taxes, depreciation, amortization ("EBITDA"), EBITDA to interest expense, and current ratios. For the years ended June 30, 2009 and 2008, the Facility is guaranteed by the three shareholders of the

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Company up to \$1,000,000 per shareholder. The bank holds a security interest in all of the assets of the Company. The Company has outstanding letters of credit of \$10,258,860 and \$25,557,031 at June 30, 2009 and 2008, respectively.

9. Other Commitments and Contingencies

The Company enters into various contracts to both sell and acquire natural gas in the future. The Company's ability to meet its commitment to sell natural gas to its customers in future periods is dependent upon performance by those vendors that have committed to provide natural gas in the same future period.

10. Retirement Plan

The Company has a 401(k) profit sharing plan (the "Plan") for the benefit of its employees. Eligible employees under the Plan consist of all employees who have attained the age of twenty-one. The Company made no profit sharing contribution for the years ended June 30, 2009 and 2008. In addition, the Company may elect to make matching contributions which will be determined by the Board of Directors annually. There were no employer matching contributions to the Plan for the years ended June 30, 2009 and 2008.

11. Income Tax

Provision for income tax for the years ended June 30, 2009 and 2008 consisted of the following:

	2009	2008
Income tax expense:		
Current:		
Federal	\$ 351,208	\$ 1,315,682
State	122,177	109,731
Deferred:		
Federal	226,377	(357,104)
	\$ 699,762	\$ 1,068,309

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Deferred taxes are determined based on temporary differences between the financial statements and income taxes bases of assets and liabilities as measured by the enacted tax rates, which will be in effect when these differences reverse.

Deferred income taxes consist of the following at June 30:

	2009	2008
Current deferred tax asset (liability):		
Unrealized (loss) gain on natural gas contract	\$ 976	\$ 221,303
Total	\$ 976	\$ 221,303
Non-current deferred tax asset (liability):		
Property and equipment, leasehold improvements and intangibles	\$ 12,541	\$ 18,591
Total	\$ 12,541	\$ 18,591

The income tax expense differs from the amount computed by applying the statutory federal income tax rate of 34% to income before income taxes primarily as a result of the state income taxes and disallowance of 50% of meals and entertainment expenses for income tax purposes.