

Syntroleum

1998 Annual Report

people are noticing...



Syntroleum Pilot Plant

. . . our strategic focus.

Syntroleum is the developer and owner of the proprietary Syntroleum Process for conversion of natural gas into synthetic liquid fuels and specialty products. Our process is designed to reduce both capital and plant operating costs, compared to earlier gas-to-liquids (GTL) technologies. Plants using the Syntroleum Process can produce superior diesel and jet fuels, as well as fuels for fuel cells and specialty products such as synthetic lubricants and high-value chemical feedstocks. These products offer performance and environmental benefits, since they will be virtually free of contaminants such as sulfur, aromatics and heavy metals normally found in products refined from crude oil. Our unwavering objective is to become the premier provider of GTL technology to the international petroleum industry.

... our continuing progress.

YEAR ENDED DECEMBER 31,	1998	1997	% Change
BALANCE SHEET			
WORKING CAPITAL	37,476	9,846	281%
TOTAL ASSETS	50,400	12,091	317%
STOCKHOLDERS' EQUITY	35,962	(1,242)	—
STATEMENT OF OPERATIONS			
JOINT DEVELOPMENT REVENUE	1,779	2,006	-11%
TOTAL REVENUE	4,479	2,007	123%
TOTAL OPERATING EXPENSES	17,498	11,972	46%
NET INCOME (LOSS)	(11,711)	(9,612)	-22%
ADDITIONAL DATA			
LICENSEES	6	4	50%
LAB REACTORS	20	12	68%
PATENTS ISSUED/PENDING	73	43	70%
EMPLOYEES	62	37	68%

SYNTROLEUM'S STRATEGY FOR ACHIEVING SUCCESS ENCOMPASSES FOUR PRIMARY COMPONENTS:

1. *Licensing the Syntroleum Process to others. Current licensees include ARCO, Enron, Kerr-McGee, Marathon, Texaco and YPF.*
2. *Building and owning specialty plants that produce high-value products via the Syntroleum Process. Our Sweetwater project under development with Enron is the first example of this activity.*
3. *Facilitating development of a service business to provide mobile GTL plants on a contract basis. Weak oil prices have hindered progress in this area during the past year.*
4. *Continuing to drive GTL capital and operating costs down as rapidly as possible through research and development, alone and with others. Improved reactor designs, new catalyst formulations and novel integration of plant components are recent examples.*

...our growing



Left to Right:
Kenneth L. Agee, Chairman/CEO
Mark A. Agee, President/COO

1998 WAS A PIVOTAL YEAR FOR SYNTROLEUM CORPORATION.

We concluded our 14th year in business and began our first year as a publicly traded corporation, making significant strides toward reaching our goal of becoming the premier gas-to-liquids (GTL) technology provider for the international petroleum industry.

Toward that goal, we completed the planned merger with SLH Corporation in August, providing us with approximately \$50 million in additional capital to develop key projects, fund ongoing technology development and attract talented scientists and engineers. While the availability of sufficient capital to build projects remains our biggest challenge, as a publicly held company we now have more options to obtain that capital. Also, as a publicly held company, current and potential shareholders, licensees, business partners and employees now have access to much greater information about Syntroleum, our strategy and our progress.

Today, throughout the world, environmental concerns are growing about the increase in greenhouse gasses resulting from emissions generated by hydrocarbons consumed in power plants, transportation vehicles and flaring of natural gas. Stricter emission standards are being developed in most industrialized countries, and even in some lesser developed nations, creating increased pressure for cleaner vehicles and cleaner fuels. Vehicle manufacturers and oil and gas refiners are working to develop new and better fuels to meet this demand. We believe fuels developed via the Syntroleum Process will be more competitive than other alternative fuels because they:

- *Inherently produce lower emissions than conventional fuels.*
- *Require virtually no changes to the existing fuels distribution infrastructure.*
- *Require no changes to the existing fuel systems in conventional vehicles.*
- *Can be competitive with fuels refined from conventional crude oil.*
- *Can be used in fuel cells when fuel cell technology becomes commercially viable.*

Additionally, Syntroleum technology could significantly help the environment by providing a way to eliminate much of the flaring of natural gas currently taking place in many oilfields throughout the world, thus reducing emissions of methane, CO₂ and other contaminants. This would not only mitigate harmful emissions, but could also convert valuable energy resources currently being wasted into over one million barrels per day of synthetic liquid hydrocarbons.

We think the Syntroleum Process is the most commercially viable GTL technology available today. Our air-based system eliminates the need for an oxygen plant as part of the facility, thus allowing substantial capital cost reduction compared to earlier

presence.

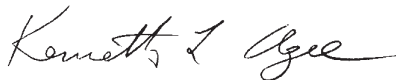
technologies. A menu of reactor and process configurations permits more flexibility in plant design - in sizes ranging from 2,000 barrels per day to more than 100,000 barrels per day. This gives licensees greater latitude for considering the GTL option in numerous situations around the world.

The current business climate within the oil industry, however, has had a negative effect on some GTL projects. Despite a healthy economy in the United States, certain overseas economies have faltered and, as a result of slackened demand for oil and excess production, inflation-adjusted oil prices fell to their lowest level in history. Collapsed oil prices, along with the oil companies' declining revenues and profits, are resulting in substantial oil industry consolidation. We believe that survival-mode priorities within the oil and gas industry will continue to slow considerations on all capital-intensive projects, including GTL, for the period immediately ahead.

In spite of recent low oil prices, the fundamental trends driving the need for GTL technology have not changed. The world-wide energy industry continues to face a great challenge in dealing with both the growing stranded gas reserves and increasing environmental pressures. Syntroleum offers a potential solution for both. Even in the face of low oil prices, a host of viable GTL projects remain. Specifically, those keyed to associated gas where flaring will no longer be permitted (West Africa, for example) will receive close study for possible GTL conversion facilities. Also, GTL's potential application to Alaska's North Slope gas is receiving more attention as the clock continues to tick toward the day when the Trans-Alaska Pipeline will no longer have sufficient crude throughput to maintain operation. Because these fundamentals have not really changed, we remain confident about GTL opportunities and our own future in the world energy arena.

Finally, we believe 1999 and beyond will bring much greater focus on the demand for super clean, environmentally friendly fuels that will "pull" GTL technology into a prominent role in the 21st century.

Working with our network of licensees, technology partners, employees and shareholders, we are confident that we can play a vital role in making GTL technology a significant part of the energy industry, and enabling the transportation industry to run on more environmentally friendly fuels. Thank you for your continued support and belief in our future.



KENNETH L. AGEE
CHAIRMAN AND CEO



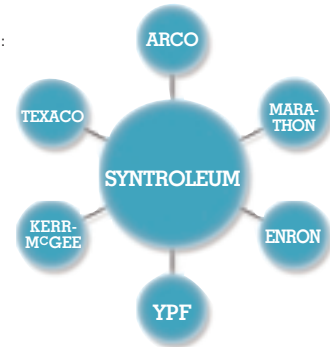
MARK A. AGEE
PRESIDENT AND COO

... our emerging markets.



Left to Right:
John Dolan, Manager of Pilot Plant Operations
Peter Snyder, VP Product Marketing
Chris Chen, Research Engineer

SYNTROLEUM'S CURRENT LICENSEES:



The demand for clean fuels, such as those produced by the Syntroleum Process, is increasing. Syntroleum technology can provide major environmental benefits upstream by helping eliminate much of the oilfield flaring of associated gas reserves. More importantly, downstream, the Syntroleum Process converts these otherwise wasted gas reserves into fuels that are cleaner than conventional fuels, by several orders of magnitude.

During 1998, Syntroleum began working to develop the necessary test data to submit its “clean diesel” to the Department of Energy for certification under the Energy Policy Act of 1992 and the Clean Air Act. This certification would give the company and its licensees access to a new, premium fuel market and provide more incentives for building GTL plants using the Syntroleum Process. If successful, Syntroleum’s “clean diesel” would meet requirements of certain United States cities and federal government fleets to burn 30 percent alternative (non-petroleum-based) fuels in their vehicles by the year 2010. By current estimates, this could account for 600,000 barrels per day of clean fuel demand. Most other alternative fuels have limitations that Syntroleum fuels do not have with regard to production, distribution infrastructure, toxicity and cost.



Syntroleum Corporate Offices



Syntroleum Pilot Plant

... our rising

Syntroleum has entered into agreements with several major oil and gas companies and others for various technical projects as part of our network strategy designed to mutually benefit Syntroleum and all its licensees.

With the input of our licensees and joint development partners, and their interactions with the Syntroleum technical staff, we have a unique and ever-strengthening development model. Within the last two years we have assembled an impressive group of companies, all aligned with Syntroleum in one aspect or another of GTL development: AGC, AMEC, ARCO, Bateman Engineering, Kellogg Brown and Root, Catalytica, Criterion Catalyst, DaimlerChrysler, General Electric, Kerr-McGee, Lyondell Chemicals, Marathon and Texaco. This model is designed to accelerate development of the Syntroleum Process and further scientific advances in GTL technology. It already provides perhaps the largest concentration of resources in the world that are collectively working on GTL development. Our business approach is not often seen in the energy industry, but is quite common in other high-tech arenas where leveraging technology development is absolutely critical to success. This network approach may be our biggest advantage over those who would attempt to develop a competitive GTL technology in single-company isolation.

Probably the least publicized, but most important happening within Syntroleum during 1998, was our continuing drive to build technical staff and expertise. In the past year, the company's staff grew from 37 to 62, plus a number of specialized consultants assigned to projects on a contract basis. Research, development and engineering account for more than 50 of our staff, 14 of whom have advanced sciences or engineering

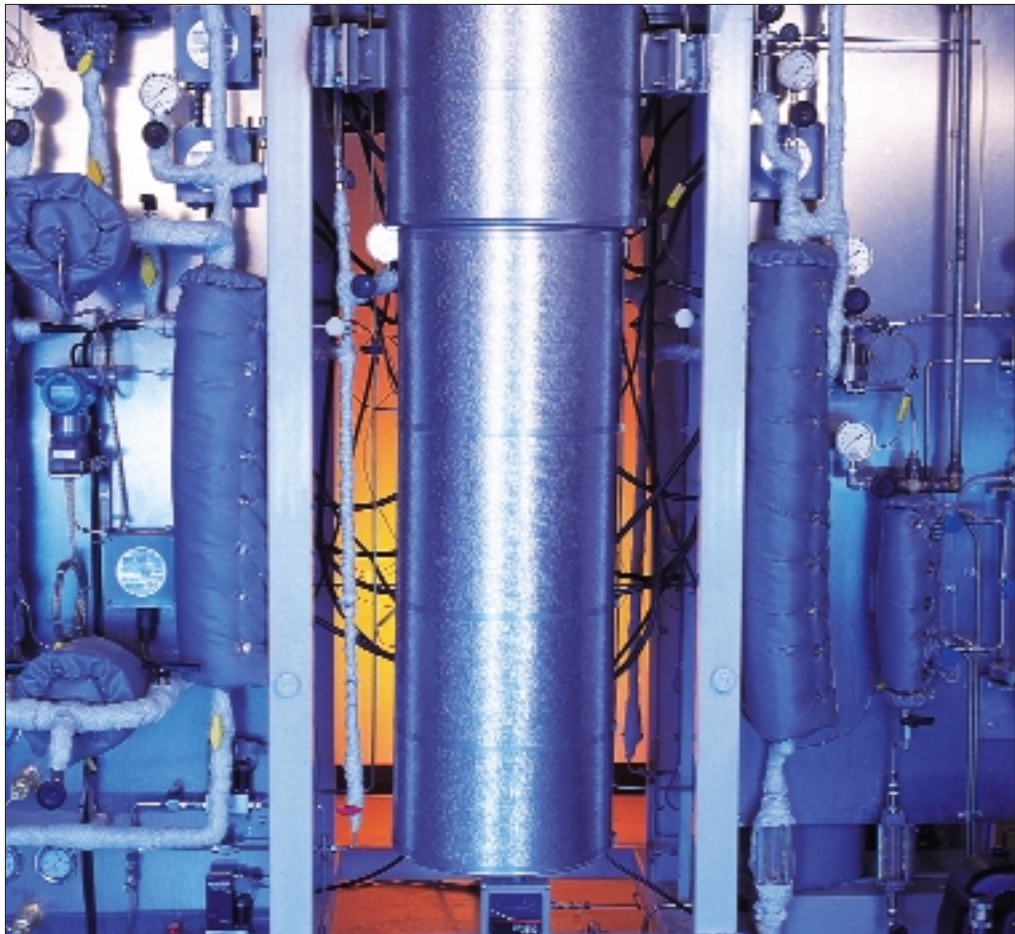
capabilities.



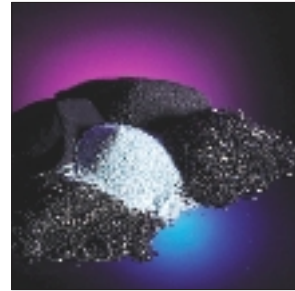
Left to Right:
Randall Thompson, VP Finance/CFO
Shelly McKenna, Associate Chemist
Hans Chew, Associate Chemist
Paul Kennedy, Chief Process Engineer
Dr. Paul Schubert, VP Research & Development



Synfuel Samples



Hydroprocessing Unit at Syntroleum Technology Center Laboratory



Catalysts

degrees - six with doctorates and eight with master's degrees in the sciences. All were carefully recruited from petroleum and research assignments around the world. In addition to their strong education credentials, these individuals all have previously distinguished themselves in successful careers with other companies.

Syntroleum has developed a flat organizational chart to foster creativity and loyalty. Dedicated teams focus on issues critical to the company's growth and success, such as moving-bed reactor designs for next-generation plants and catalyst development for each reactor design. To help attract and motivate the best talent, employees at all levels are eligible for stock options. The management team is aligned and focused on success through ownership of 30 percent of the company's stock.

In June 1998, Syntroleum purchased a 16,500-square foot laboratory facility and 95 acres of land in west Tulsa. The modern research facility is being used to expand the company's research and development activities. When fully equipped and operational, likely by year-end 1999, the new laboratory will quadruple Syntroleum's existing research and development facilities, already among the world's largest devoted to Fischer-Tropsch process research. The adjacent land will allow for consolidation and expansion of pilot plant activities that are integral to ongoing development of the company's gas-to-liquids technologies, enabling the company to more quickly commercialize process improvements.



...our developo

Left to Right:

Lynn Tomlinson, Senior Process Engineer

Diane Byrom, Legal Assistant

Dr. Branch Russell, Business Development Manager

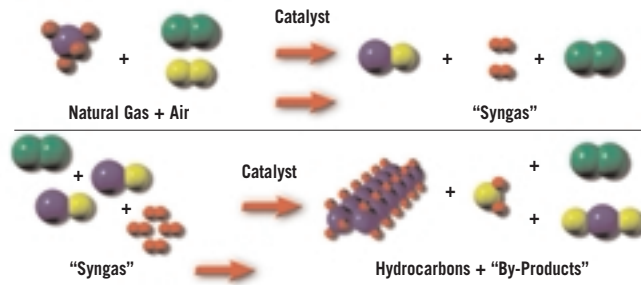


Dodge Power Wagon Designed to Run on Synthetic Diesel Fuel

oping projects.

ARCO Plant — The 70 barrels-per-day demonstration plant jointly developed by Syntroleum and ARCO has been assembled at ARCO's Cherry Point Refinery near Bellingham, Washington.

Syntroleum Corporation -
Developer and owner
of a proprietary process
to convert natural gas
into synthetic liquid
hydrocarbons (GTL)



The plant is scheduled to come on stream about mid-year. This design could be the model for plants of 20,000 barrels per day or larger for applications such as Alaska's North Slope and other locations worldwide.

Sweetwater Plant The 8,000 barrels-per-day specialty chemical plant, dubbed the "Sweetwater Project," announced last year with Enron as an equity partner, is in the preliminary design stage. Various sites are being evaluated with regard to pricing for gas feedstock and long term supply contracts. This plant will use the Syntroleum Process to convert natural gas into specialty products, including synthetic lubricants, drilling fluids and liquid normal paraffins.

DaimlerChrysler In October, Syntroleum signed a fuels testing agreement with DaimlerChrysler to test "designer fuels" for use in their new generation of compression-ignition (diesel) engines. DaimlerChrysler has introduced a new concept vehicle, the Dodge Power Wagon, to run on synthetic fuels converted from natural gas. This new breed of vehicles should run more efficiently and greatly reduce emissions.

Fuel Cells Syntroleum, working with Argonne National Laboratories and others, has initiated testing of Syntroleum synthetic fuels for use in fuel cells. Early work suggests these synthetic fuels provide fuel cells almost twice the hydrogen per unit volume of fuel than does methanol - and provide more vehicle range per fill-up. This is a rapidly expanding area of involvement for Syntroleum.

Financial Section. . .

Selected Financial Data	14
Management's Discussion and Analysis	15
Balance Sheet	23
Statement of Operations	24
Statement of Common Stockholders' Equity	25
Statement of Cash Flows	26
Notes to Financial Statements	27
Report of Independent Public Accountants	34
Directors and Officers	35
Corporate Data	36

The following selected financial should be read in conjunction with Management's Discussion and Analysis and the consolidated financial statements of Syntroleum and the related notes thereto included elsewhere in this annual report. The results of operations of SLH Corporation have been included in Syntroleum's consolidated statement of operations following the effective date of the merger of Syntroleum with SLH Corporation on August 7, 1998.

(in thousands, except for per share data)

	For the Years Ended December 31,				
	1998	1997	1996	1995	1994
STATEMENT OF OPERATIONS DATA					
Real estate sales revenue	\$ 2,416	\$ -	\$ -	\$ -	\$ -
Joint development revenue	1,779	2,006	616	45	60
Other revenue	284	1	-	-	-
Costs and expenses:					
Cost of real estate sold	2,387	-	-	-	-
Real estate operating expenses	267	-	-	-	-
Pilot plant, engineering and research and development	4,434	2,944	1,120	671	-
Catalyst services	-	4,800	-	-	-
General and administrative	10,410	4,228	1,421	580	397
Total operating expenses	17,498	11,972	2,541	1,251	397
Operating income (loss)	(13,019)	(9,965)	(1,925)	(1,206)	(337)
Investment, interest and other income (expense)	1,308	353	(12)	60	18
Net income (loss)	\$ (11,711)	\$ (9,612)	\$ (1,937)	\$ (1,146)	\$ (319)
Net income (loss) per share - basic and diluted*	\$ (0.46)	\$ (0.40)	\$ (0.08)	\$ (0.06)	\$ (0.02)

*Adjusted to reflect the exchange ratio for the Merger of 1.2899 shares of the Company's common stock for each share of Old Syntroleum's common stock. See "Management's Discussion and Analysis".

	As of December 31,				
	1998	1997	1996	1995	1994
BALANCE SHEET DATA					
Working capital	\$ 37,476	\$ 9,846	\$ 601	\$ (410)	\$ (65)
Property and equipment, net	3,210	1,245	521	507	89
Total assets	50,400	12,091	1,552	873	188
Deferred revenue	11,000	11,000	-	-	-
Long-term debt	-	-	1,000	-	-
Stockholders' equity	35,962	(1,242)	266	203	102

MERGER TRANSACTION

Pursuant to the Agreement and Plan of Merger dated as of March 30, 1998 by and between Syntroleum Corporation, an Oklahoma corporation ("Old Syntroleum") and SLH Corporation ("SLH"), effective August 7, 1998, (1) Old Syntroleum merged (the "Merger") with and into SLH, with SLH being the surviving corporation (the survivor of the Merger, together with its subsidiaries and predecessors, is referred to as "Syntroleum" or the "Company") (2) SLH changed its name to "Syntroleum Corporation," (3) the officers of SLH were replaced by the officers of Old Syntroleum, (4) six of the eight SLH directors were replaced by Old Syntroleum directors, (5) each outstanding share of Old Syntroleum's common stock was converted into the right to receive 1.28990 shares of the Company's common stock, and (6) the Company's Articles of Incorporation were amended to increase the number of authorized shares of its common stock from 30,000,000 shares to 150,000,000 shares and the number of authorized shares of its preferred stock from 1,000,000 shares to 5,000,000 shares. The Merger and related transactions are more fully described in the Joint Proxy Statement/Prospectus filed with the Securities and Exchange Commission on July 6, 1998.

The Merger was accounted for as a reverse acquisition using the purchase method of accounting. Although SLH is the surviving corporation in the Merger for legal purposes, Old Syntroleum is the acquirer for accounting purposes. For purposes of preparing its consolidated financial statements, the Company established a new accounting basis for SLH's assets and liabilities using the fair values thereof, based upon the consideration paid in the Merger and Old Syntroleum's costs of the Merger. For financial reporting purposes, the results of operations of SLH have been included in the Company's consolidated statement of operations following the effective date of the Merger. The discussion under "Results of Operations" below includes a comparison of the Company's results of operations for the year ended December 31, 1998 to Old Syntroleum's results of operations for the year ended December 31, 1997 and Old Syntroleum's results of operations for the year ended December 31, 1997 compared to Old Syntroleum's results of operations for the year ended December 31, 1996.

The following information should be read in conjunction with the information presented elsewhere in this Annual Report on Form 10-K (including Syntroleum's financial statements and notes thereto).

OVERVIEW

Syntroleum is the developer and owner of a proprietary process (the "Syntroleum Process") designed to catalytically convert natural gas into synthetic liquid hydrocarbons ("gas to liquids" or "GTL"). The Syntroleum Process is a simplification of traditional GTL technologies aimed at substantially reducing both the capital cost and the minimum economical size of a GTL plant, as well as plant operating costs. A unique charac-

teristic and primary advantage of the Syntroleum Process over competing processes is its use of air, rather than pure oxygen, in the conversion process. Although no commercial-scale GTL plant based on the Syntroleum Process has yet been built, Syntroleum owns and operates a nominal two barrel per day pilot plant in Tulsa, Oklahoma where it has successfully demonstrated certain elements and variations of the Syntroleum Process. Syntroleum believes that a significant opportunity exists for cost-effective GTL plants due to the large volumes of natural gas reserves worldwide that are currently not marketable because distance to market makes their utilization uneconomical.

Syntroleum's strategy for commercializing the Syntroleum Process involves the following key elements: (1) entering into agreements with oil and gas industry participants to license the Syntroleum Process for use in GTL plants designed to produce synthetic crude oil and liquid fuels; (2) establishing joint ventures with oil and gas industry partners and/or financial partners to design, construct and operate GTL plants designed to produce specialty products; (3) making available mobile GTL plants to customers on a contract basis through efforts with industry partners and others; and (4) continuing to reduce costs and develop process improvements through research and development activities and acquisitions. To date, Syntroleum has entered into master license agreements with Texaco, ARCO and Marathon, and has entered into volume license agreements with YPF, Enron and Kerr-McGee. Syntroleum received an aggregate of \$11 million and rights to certain technologies in connection with these license agreements. Syntroleum is currently in discussions with several other oil and gas companies and others with respect to joint ventures to develop specialty product GTL plants. Syntroleum has formed a joint venture with Enron with respect to the development of a specialty products plant, although the schedule for construction of this proposed plant has not yet been finally determined. Syntroleum has entered into joint development arrangements with Texaco, ARCO, Marathon, Bateman, AGC, GE Power Systems, DaimlerChrysler, Catalytica Combustion Systems and AMEC.

Because Syntroleum is incurring costs with respect to developing and commercializing the Syntroleum Process and does not anticipate recognizing any revenues from licensing its technology in the near future, the Company expects to operate at a loss unless and until sufficient revenues are recognized from licensing activities, specialty product GTL plants or real estate sales.

OPERATING REVENUES

GENERAL. During the periods discussed below, Syntroleum's revenues were generated from (1) sales of real estate holdings owned by SLH prior to the Merger, (2) reimbursement for research and development activities associated with the Syntroleum Process and (3) other sources, including rent generated by real estate holdings owned by SLH prior to the Merger. Because SLH had substantially reduced its real estate

inventory prior to the Merger, Syntroleum expects to receive lower levels of revenues from these sources in following periods. In the future, Syntroleum expects to receive revenue relating to the Syntroleum Process from five sources: licensing; catalyst sales; sales of products from specialty product GTL plants in which Syntroleum owns an equity interest; revenues from providing mobile GTL plants on a contract basis; and revenues from research and development activities carried out with industry partners. Until the commencement of commercial operation of GTL plants in which Syntroleum owns an interest, Syntroleum expects that its cash flow relating to the Syntroleum Process will consist primarily of license fee deposits, site license fees, catalysts sales and revenues associated with joint development activities. Syntroleum will not receive any cash flow from GTL plants in which it owns an equity interest until the first such plant is constructed. Syntroleum's future operating revenues will depend on the successful commercial construction and operation of GTL plants based on the Syntroleum Process, the success of competing GTL technologies and other competing uses for natural gas. Syntroleum's results of operations and cash flows are expected to be affected by changing gas, crude oil, fuel and specialty product prices. If the price of these products increases (decreases), there could be a corresponding increase (decrease) in operating revenues.

LICENSE REVENUES. The revenue earned from licensing the Syntroleum Process is expected to be generated through four types of contracts: master license agreements, volume license agreements, regional license agreements and site license agreements. Master, volume and regional license agreements provide the licensee with the right to enter into site license agreements for individual GTL plants. A master license agreement grants broad geographic and volume rights, while volume license agreements limit the total production capacity of all GTL plants constructed under the agreement to specified amounts, and regional license agreements limit the geographical rights of the licensee. Master, volume and regional license agreements require an up-front cash deposit that may offset or partially offset license fees for future plants payable under site licenses. Syntroleum has acquired technology, commitment of funds for joint development activities, services or other consideration in lieu of the initial cash deposit in cases where Syntroleum believed such technologies or commitments had a greater value.

Syntroleum's site license agreements require fees to be paid in increments when certain milestones during the plant design and construction process are achieved. The amount of the license fee under Syntroleum's existing master and volume license agreements is determined pursuant to a formula based on the present value of the product of (1) the yearly maximum design capacity of the plant, (2) an assumed life of the plant and (3) Syntroleum's per barrel rate, which currently is approximately \$.50 per barrel of daily capacity, regardless of plant capacity. Syntroleum's licensee fees may change from time to time based on the size of the plant, improvements that reduce plant capital cost and competitive market conditions.

Syntroleum's accounting policy is to defer all up-front deposits under master, volume and regional license agreements and license fees under site license agreements and recognize 50% of such deposits and fees as revenue in the period in which the engineering process design package for a plant licensed under the agreement is delivered and recognize 50% of the deposits and fees when the plant has passed certain performance tests. The amount of license revenue Syntroleum earns will be dependent on the construction of plants by licensees, as well as the number of licenses it sells in the future.

CATALYST REVENUES. Syntroleum expects to earn revenue from the sale of its proprietary catalysts to its licensees. Syntroleum's license agreements require Syntroleum's catalyst to be used in the initial fill for the licensee to receive Syntroleum's process guarantee. After the initial fill, the licensee may use other catalyst vendors if appropriate catalysts are available. The price for catalysts purchased from Syntroleum pursuant to license agreements is equal to Syntroleum's cost plus a specified margin. Syntroleum will receive revenue from catalyst sales if and when its licensees purchase catalysts. Syntroleum expects that catalysts will need to be replaced every three to five years.

SPECIALTY PRODUCT GTL PLANT REVENUES. Syntroleum intends to develop several specialty product GTL plants in which it intends to retain significant equity interests. These plants will enable Syntroleum to gain experience with the commercial operation of the Syntroleum Process and, if successful, are expected to provide ongoing revenues. The anticipated specialty products of these plants (i.e., synthetic lube base oils, synthetic drilling fluid, waxes and liquid normal paraffins) have historically been sold at premium prices and are expected to result in relatively high margins for these plants. Syntroleum anticipates forming several joint ventures with oil and gas industry and financial partners in order to finance and operate these plants. Syntroleum anticipates that its specialty GTL plants will include partners who have low-cost gas reserves in strategic locations and/or have distribution networks in place for the specialty products to be made in each plant.

REVENUES FROM PROVIDING GTL PLANTS ON A CONTRACT BASIS. Through joint efforts with industry partners and others, Syntroleum intends to make mobile GTL plants available to customers on a contract basis. Syntroleum believes that there is a significant market for users who need GTL plants for applications that do not justify the capital investment of a dedicated GTL plant. Such applications include: extended well testing in areas with stringent flaring regulations; conversion of small associated gas fields that are not large enough to justify the capital investment of a permanent GTL plant; and short-term use of a GTL plant on large fields to generate cash flow for the customer while a permanent GTL plant is being built or while awaiting pipeline hookup.

JOINT DEVELOPMENT REVENUE. Syntroleum continually conducts research and development activities in order to reduce the capital and operating costs of GTL plants based on the Syntroleum Process. Syntroleum conducts its research

and development activities primarily through two initiatives: (1) independent development utilizing its own resources and (2) formal joint development arrangements with its licensee partners and others. Through these joint development agreements, Syntroleum may receive revenue as reimbursement for certain research and development expenses. Under certain agreements, the joint development partner may receive credits against future license fees for monies expended on joint research and development.

REAL ESTATE SALES REVENUES. As of December 31, 1998, Syntroleum's real estate inventory consisted of (1) a seven-story parking garage in Reno, Nevada; (2) a 49.9% interest in a community shopping center in Gillette, Wyoming; (3) undeveloped land in Houston, Texas (341 acres comprising the "Houston Project"), Corinth, Texas (nine acres) and the Kansas City metropolitan area (two acres at the intersection of I-35 and 119th Street) and (4) an equity investment in a hotel being renovated located in Tulsa, Oklahoma. This real estate inventory was owned by SLH prior to the Merger and reflects the remaining assets of a real estate development business that was conducted by SLH in association with a previously owned life insurance company that was sold in 1990. The total real estate inventory had an aggregate carrying value at December 31, 1998 of approximately \$5.8 million. All of the real estate inventory is held for sale except for the investment in the hotel located in Tulsa, Oklahoma and the Houston Project, which is being developed for commercial and residential use. The timing of real estate sales will create variances in period-to-period earnings recognition. Syntroleum does not intend to acquire additional real estate holdings for development and/or sale outside its core business interests, and real estate sales revenues should decrease as the current real estate inventory is liquidated.

OPERATING EXPENSES

Syntroleum's operating expenses historically have consisted primarily of pilot plant, engineering and research and development expenses and general and administrative expenses, which include costs associated with general corporate overhead, compensation expense, legal and accounting expense and other related administrative functions. Syntroleum's policy is to expense pilot plant, engineering and research and development costs as incurred. All of these research and development expenses are associated with Syntroleum's development of the Syntroleum Process. Syntroleum has also recognized depreciation and amortization expense primarily related to office and computer equipment. Following the Merger, Syntroleum's operating expenses have also included costs of real estate sold and real estate operating expense. Syntroleum's general and administrative expenses have increased substantially as it has expanded its research and development, engineering and commercial operations, and these expenses are expected to continue to increase. In this regard, Syntroleum entered into a lease for office

facilities in August 1997 that has resulted in increased rental expense. Syntroleum also expects to continue to incur higher pilot plant, engineering and research and development expenses as it continues to develop and improve its GTL technology. In May 1998, Syntroleum acquired a 16,500-square-foot laboratory located on approximately 100 acres at which it intends to increase its laboratory and pilot plant operations.

Syntroleum expects to incur significant expenses in connection with the start-up of its GTL plants. For example, Syntroleum expects that its expenses will increase at the time of commencement of construction of specialty products plants in which it owns an interest. Upon the commencement of commercial operation of GTL plants in which Syntroleum owns an equity interest, Syntroleum will incur cost-of-sales expense relating primarily to the cost of natural gas feedstocks for its specialty plants and will incur operating expenses relating to such plants, including labor, supplies and maintenance. Due to the substantial capital expenditures associated with the construction of GTL plants, Syntroleum expects to incur significant depreciation and amortization expense in the future.

RESULTS OF OPERATIONS

1998 COMPARED TO 1997

REAL ESTATE SALES REVENUE. Revenues from the sale of real estate were \$2,416,000 in 1998, up from zero in 1997 when the Company had no real estate operations. This increase was the result of the sale of the final three condominium units at SLH's Quail Run development in Santa Fe, New Mexico, the sale of undeveloped land in Kansas City, Missouri and the sale of a boat slip in Florida.

JOINT DEVELOPMENT REVENUE. Revenues from joint research and development and pilot plant operations were \$1,779,000 in 1998, down \$227,000 from 1997 when they were \$2,006,000. The decrease was primarily due to the completion of construction of the hybrid, multiphase (HMX) reactor at the Company's pilot plant that was funded by Texaco under an on-going joint development agreement.

OTHER REVENUE. Other revenues were \$284,000 in 1998, up \$283,000 from 1997 when they were \$1,000. The increase resulted primarily from parking and retail rentals at the parking garage in Reno, Nevada.

COST OF REAL ESTATE SOLD AND REAL ESTATE OPERATING EXPENSE. The cost of real estate sold was \$2,387,000 in 1998, up from zero in 1997 when the Company had no real estate operations. The increase resulted from the sale of the condominium units in New Mexico, the undeveloped land in Kansas City and the boat slip in Florida. Real estate operating expenses were \$267,000 in 1998 compared to zero in 1997 when the Company had no real estate operations.

PILOT PLANT, ENGINEERING AND R&D. Expenses from pilot plant, engineering and research and development activities were \$4,434,000 in 1998, up \$1,490,000 from 1997 when these expenses were \$2,944,000. The increase occurred as a result of higher research and development spending and

higher outside engineering expense, partially offset by lower operating costs associated with the development of the hybrid multiphase reactor (HMX) under development with Texaco.

GENERAL AND ADMINISTRATIVE AND CATALYST SERVICES EXPENSE. General and administrative expenses were \$10,410,000 in 1998, up \$6,182,000 from 1997 when these expenses were \$4,228,000. The increase is attributable primarily to higher wages and salaries resulting from higher staffing levels, higher rent expense and higher expense for outside consultants. In addition, Syntroleum incurred a \$4,800,000 catalyst services expense in 1997 which is discussed under "1997 compared to 1996." No catalyst service expense was incurred in 1998.

INVESTMENT, INTEREST AND OTHER INCOME (EXPENSE). Investment, interest and other income increased to \$1,308,000 in 1998, up \$955,000 from 1997 when this income was \$353,000. The increase was primarily attributable to interest income from higher cash balances following the Merger.

PROVISION FOR INCOME TAXES. Syntroleum incurred a loss in both 1998 and 1997 and did not recognize an income tax benefit for such loss.

NET INCOME. In 1998, Syntroleum experienced a loss of \$11,711,000. The loss was \$2,099,000 higher than 1997 when Syntroleum experienced a loss of \$9,612,000. The increase in the loss is as a result of the factors described above.

1997 COMPARED TO 1996

JOINT DEVELOPMENT REVENUE. Revenues from joint research and development and pilot plant operations were \$2,006,000 in 1997, up \$1,390,000 from 1996 when they were \$616,000. The increase resulted from increased joint development activities with Texaco relating to the hybrid, multi-phase (HMX) reactor.

PILOT PLANT, ENGINEERING AND R&D. Expenses from pilot plant, engineering and research and development activities were \$2,944,000 in 1997, up \$1,824,000 from 1996, when these expenses were \$1,120,000. The increase resulted primarily from increased activity at the pilot plant relating to the hybrid, multi-phase (HMX) reactor development and higher laboratory costs associated with more laboratory reactors and the joint development efforts with ARCO in connection with the ARCO pilot plant currently under construction. In addition, a \$414,000 write-down of property and equipment occurred in 1997, which represented costs capitalized in 1996 as part of an anticipated commercial plant to be located near Odessa, Texas. In 1997, Syntroleum determined not to pursue this plant because an agreement was not reached with the owner of the proposed plant site. The costs were therefore expensed.

GENERAL AND ADMINISTRATIVE AND CATALYST SERVICES EXPENSE. General and administrative expenses were \$4,228,000 in 1997, up \$2,807,000 from 1996 when these expenses were \$1,421,000. The increase in general and administrative expense resulted from higher compensation expense due to

additional staff and increased travel and professional services due to increased focus on commercializing the Syntroleum Process. During 1997 Syntroleum incurred a \$4,800,000 catalyst services expense in connection with a transaction whereby (1) Criterion exercised a portion of an option and purchased 167,000 shares (on a pre-Merger basis) of Syntroleum's common stock for \$2,004,000, (2) Syntroleum and Criterion modified an agreement regarding future purchases of catalyst by Syntroleum, and (3) Syntroleum and Criterion entered into an agreement pursuant to which Syntroleum issued 400,000 shares (on a pre-Merger basis) of Syntroleum's common stock (valued at \$12.00 per share) to Criterion in consideration for all prior services rendered to and catalyst received by Syntroleum from Criterion and other consideration. Accordingly, this \$4,800,000 was expensed.

INVESTMENT, INTEREST AND OTHER INCOME (EXPENSE). Investment, interest and other income increased to \$353,000 in 1997, up \$365,000 from the expense of \$12,000 recorded in 1996. This increase resulted from higher interest income due to higher cash balances and lower interest expense due to the conversion of a convertible debenture into shares of Syntroleum's common stock. See "Liquidity and Capital Resources."

PROVISION FOR INCOME TAXES. Syntroleum incurred a loss in both 1997 and 1996 and did not recognize an income tax benefit for such loss.

NET INCOME. In 1997, Syntroleum experienced a loss of \$9,612,000. The loss was \$7,675,000 higher than 1996, when Syntroleum experienced a loss of \$1,937,000. The increase in the loss is as a result of the factors described above.

LIQUIDITY AND CAPITAL RESOURCES

GENERAL

As of December 31, 1998, Syntroleum had \$38,116,000 in cash and short-term investments and \$1,998,000 in current liabilities. Syntroleum does not currently have any material outstanding debt or lines of credit. Prior to the Merger, Old Syntroleum's primary sources of liquidity were equity capital contributions and prepaid license fees and its principal liquidity needs were to fund expenditures relating to research and development and pilot plant activities and to fund working capital. At December 31, 1998, the Company had \$602,000 in accounts receivable outstanding with its joint development partners relating to joint development activities.

Cash flows (used in) provided by operations were (\$12,112,000), \$6,748,000 and (\$1,659,000) in 1998, 1997 and 1996, respectively. The decrease in cash flows provided by operations in 1998 as compared to 1997 was primarily the result of the absence during 1998 of prepaid license and option fees, which the Company recognizes as deferred revenue, and higher salaries and wages related to higher staffing levels. Additionally, during 1998, the Company sold the final three condominium units in Santa Fe, New Mexico, which were

acquired from SLH. The increase in cash flows provided by operations in 1997 as compared to 1996 was primarily the result of the receipt of \$11,000,000 of prepaid license and option fees under Syntroleum's license agreements.

Cash flows provided by (used in) investment activities were \$35,242,000, (\$1,114,000) and (\$214,000) in 1998, 1997 and 1996, respectively. The increase in cash flows provided by investment activities in 1998 as compared to 1997 resulted from investments held to maturity that were acquired in the Merger, partially offset by higher spending on property and equipment. The decrease in cash flows provided by investment activities in 1997 as compared to 1996 primarily resulted from purchases of property and equipment. Cash flows provided by financing activities were \$1,693,000, \$3,642,000 and \$2,500,000 in 1998, 1997 and 1996, respectively. Cash flows in 1998 primarily reflected the investment by Enron in Sweetwater LLC and cash received in the Merger with SLH, each of which occurred in August 1998.

The construction of Syntroleum's specialty product GTL plants will require significant capital expenditures. Syntroleum's other efforts to commercialize the Syntroleum Process will also involve significant expenditures. Syntroleum intends to obtain additional funding through joint ventures, partnerships, license agreements and other strategic alliances, as well as various other financing arrangements. Syntroleum may also seek debt or equity financing in the capital markets. In the event such capital resources are not available to Syntroleum, its GTL plant development and other activities may be curtailed. Syntroleum estimates that construction and disposal costs to complete real estate projects in development will be approximately \$3 million.

In addition, effective December 31, 1998 the Company terminated its participation in a joint development agreement with Catalytica Advanced Technologies, Petro-Canada and Technociso, Inc., under which the Company was obligated to contribute \$400,000 per year for three years toward the cost of the development of a single-step natural gas conversion process. Through the date of termination of its participation in this project, Syntroleum had contributed approximately \$600,000 pursuant to this agreement. Syntroleum continues to work with Catalytica in catalyst development under the terms of a separate agreement.

Subsequent to December 31, 1998, the Company received \$6.0 million in satisfaction of a judgment in its favor. Rights to the litigation were owned by SLH and acquired by Syntroleum when it merged with SLH in August 1998. The monies received will be recorded as additional paid-in capital in the first quarter of 1999.

INITIAL SPECIALTY PRODUCT GTL PLANT

In May 1997, Syntroleum formed a joint venture through which Syntroleum intends to develop an 8,000-barrel-per-day specialty product plant.

Syntroleum has issued a site license and contributed a total of \$2 million to the joint venture formed to own and operate this plant. Syntroleum intends to contribute an additional \$15 million at the closing of the financing for the plant and, based on current plans, would retain a majority interest. In January 1998, Enron contributed \$1 million in exchange for a four percent interest in this joint venture and agreed to contribute an additional approximately \$14 million in exchange for an additional seven percent interest upon the satisfaction of certain conditions, including the execution of agreements which provide for the remaining equity and debt financing for the plant, the execution of fixed price engineering and construction contracts, and the execution of acceptable agreements for the sale of products produced at the plant. The capital costs of this plant are currently expected to be funded by a combination of project senior and subordinated debt and additional equity financing. Actual ownership percentages may vary from current estimates depending on the terms of subsequent financings. Additionally, Enron and Syntroleum entered into an option agreement which provides that, in the event of the completion of an underwritten public offering and the repayment of at least 50% of the senior term loan financing for this joint venture, Enron may elect during a period of two years to exchange its interest in this joint venture for a number of shares of Syntroleum's common stock equal to the quotient of the amount of Enron's contributions to this joint venture and 130% of the average market price of the common stock during the first 30 trading days following an underwritten public offering. The option agreement also provides that, if such repayment does not occur by the eighth year after plant start up, Enron may elect to purchase, during the 180-day period following such date, such number of shares in exchange for the amount of Enron's contributions to this joint venture. In addition, the option agreement provides that, if an underwritten public offering has not yet occurred following the later to occur of the fourth year after the plant passes certain performance tests and the repayment of at least 50% of the senior term loan financing for this joint venture, Enron may elect during a period of up to 10 years to require Syntroleum to purchase its interest in this joint venture for a price equal to three times the annual average cash distributions made to Enron by this joint venture during the preceding three-year period.

Syntroleum plans to fund the remaining estimated capital cost of this plant through project equity and debt financing. During the fourth quarter of 1998, Syntroleum continued to advance on development of the project through negotiations of terms relating to floor pricing of products produced at the plant, the sale of electricity and the purchase of natural gas. Syntroleum is currently reviewing preliminary design and cost estimates for the plant and exploring sources of debt and equity capital to fund final design and construction. However, there can be no assurance that the necessary capital for this project will be obtained. The schedule for construction of this plant has not yet been finally determined.

THE JOINT VENTURE GTL PLANT

In November 1997, Syntroleum, Texaco and Kellogg Brown & Root entered into a project development agreement for the development of a small GTL plant based on the Syntroleum Process. In July 1998, the parties extended the term of the agreement to July 15, 1999. During the third quarter of 1998, Kellogg Brown & Root informed Syntroleum of its decision not to participate in the project as an equity holder while expressing an interest in continuing to provide engineering and construction services to the project. The project development agreement provides that Syntroleum and Texaco will initially contribute up to \$1.5 million to the project in cash and that additional contributions may be made by the parties at or after the formation of the joint venture. To date, the parties have spent approximately \$1.3 million on the project.

The first phase of the project, which involved preparation of a feasibility study, has been completed. Because of the difficulty in attracting the necessary capital for the project in the current climate of low oil and gas prices, the project has been suspended. Syntroleum is currently reviewing smaller plant designs capable of achieving similar objectives of the original project and which Syntroleum believes would be capable of attracting the necessary equity and/or debt capital for design and construction. Several of Syntroleum's licensees have expressed interest in such a revised project. However, there can be no assurance that this project will be resumed or that the necessary capital will be obtained.

ADDITIONAL FINANCING REQUIREMENTS AND ACCESS TO CAPITAL FUNDING

Syntroleum has expended and will continue to expend a substantial amount of funds to continue the research and development of its technologies, to market the Syntroleum Process and to design and construct GTL plants. Syntroleum intends to obtain additional funds primarily through a combination of equity and debt project financing, collaborative or other arrangements with strategic partners and others and debt and equity financing in the capital markets. Financing may not be available when needed or on terms acceptable to Syntroleum. If adequate funds are not available, Syntroleum may be required to delay or to eliminate expenditures for certain of its capital projects or to license to third parties the rights to commercialize additional products or technologies that Syntroleum would otherwise seek to develop itself. If additional funds are raised by issuing equity securities, dilution to stockholders may occur. In addition, preferred stock could be issued in the future without stockholder approval and the terms of such preferred stock could include dividend, liquidation, conversion, voting and other rights that are more favorable than the rights of the holders of Syntroleum's common stock.

Assuming the commercial success of the plants based on the Syntroleum Process, Syntroleum expects that license fees, revenues from providing GTL plants on a contract basis, catalyst sales and sales of specialty products will be a source of funds for operations. However, Syntroleum may not receive

any such revenues, and such revenues may not be sufficient for capital expenditures or operations and may not be received within the expected time frame. If Syntroleum is unable to generate funds from operations, its need to obtain funds through financing activities will be increased.

ABILITY TO MANAGE GROWTH AND ACHIEVE BUSINESS STRATEGY

Syntroleum anticipates that it may experience significant growth as it commercializes the Syntroleum Process. Syntroleum's rapid growth to date has placed a significant strain on Syntroleum's scientific, technical, operational and administrative resources. As Syntroleum implements its strategy to commercially develop its GTL technology, demands on Syntroleum's scientific, technical, operational and administrative resources will continue to increase. Syntroleum's ability to implement its business strategy may be constrained, and the timing of such implementation may be impacted, due to insufficient resources. At March 1, 1999, Syntroleum had 65 full-time employees. Competition for personnel is intense, and Syntroleum may not be able to retain such personnel or attract and assimilate additional personnel. The failure of Syntroleum to continue to expand its resources or the occurrence of expansion difficulties could have a material adverse effect on Syntroleum's business, operating results and financial condition. In addition, Syntroleum does not have any experience managing the design, construction or operation of commercial GTL plants or any commercial plants, and Syntroleum may not be successful in doing so.

SYNTROLEUM'S LACK OF OPERATING HISTORY

Syntroleum was founded in 1984 and began efforts to commercialize the Syntroleum Process in 1993. Prior to the receipt of license fees in late 1996 and 1997, Syntroleum's only significant revenues were from joint development activities. Accordingly, Syntroleum does not have an operating history upon which an evaluation of Syntroleum's prospects can be based. Syntroleum's prospects must be considered in light of the risks, expenses and difficulties frequently encountered by companies seeking to develop new and rapidly evolving technologies. To address these risks, Syntroleum must, among other things, respond to competitive factors, continue to attract, retain and motivate qualified personnel and commercialize and continue to upgrade its GTL technologies. Syntroleum may not be successful in addressing such risks. Syntroleum has incurred net losses from inception through 1998. Although Syntroleum received significant license fees in 1997, such fees may not be sustainable and are not indicative of future operating results. There can be no assurance that Syntroleum will achieve or sustain profitability.

Syntroleum's anticipated expense levels are based in part on its expectations as to future operating activities and are not based on historical financial data. Syntroleum plans to increase its capital expenditures to fund the design and construction of GTL plants, increase its operating expenses

to fund greater levels of research and development and increase its marketing and operational capabilities. To the extent that such expenses precede or are not subsequently followed by increased revenues or cash flows, Syntroleum's business, operating results and financial condition will be materially adversely affected.

POTENTIAL FLUCTUATIONS IN ANNUAL AND QUARTERLY RESULTS

Syntroleum expects to experience significant fluctuations in future annual and quarterly operating results. These fluctuations are expected because of the unpredictability of many factors that impact Syntroleum's business. These factors include timing of any construction by Syntroleum of its GTL plants, timing of any construction of GTL plants by licensees, demand for licenses to the Syntroleum Process and receipt and revenue recognition of license fees, oil and gas prices, timing and amount of research and development expenditures, demand for specialty products, introduction or enhancement of GTL technologies by Syntroleum and its competitors, market acceptance of new technologies and general economic conditions. As a result, Syntroleum believes that period-to-period comparisons of its results of operations are not meaningful and should not be relied upon as any indication of future performance. Due to all of the foregoing factors, it may be that in some future year or quarter Syntroleum's operating results will be below the expectations of public market analysts and investors. In such event, the price of Syntroleum's common stock would likely be materially adversely affected.

POTENTIAL REQUIREMENT TO PAY PERSONAL HOLDING COMPANY TAXES

In the United States, a company is classified as a personal holding company in a taxable year if (1) five or fewer individuals own, directly or under certain constructive ownership rules, more than 50% in value of its outstanding stock at any time during the last half of such taxable year and (2) at least 60% of its adjusted ordinary gross income (as defined in Section 543(b)(2) of the Internal Revenue Code of 1986, as amended) consists of interest, dividends, royalties or other items of personal holding company income. Syntroleum believes that it will satisfy such income character component of the definition of a personal holding company only if deposits or other payments which it receives under its license agreements constitute items of personal holding company income. Although Syntroleum believes that such payments are not personal holding company income, the Internal Revenue Service may contest such position.

A personal holding company is subject to not only the regular federal income tax, but is also subject to an additional tax of 39.6% of its undistributed personal holding company income, which is generally taxable income reduced by

dividends paid and with the adjustments which are listed in Section 545 of the Internal Revenue Code. Syntroleum believes that it has no material exposure to the personal holding company tax for periods through the end of 1998 because the amounts which would have been undistributed personal holding company income for any such period if Syntroleum had been a personal holding company were not material for such periods.

Based on current levels of stock ownership, Syntroleum believes that slightly less than 50% in value of Syntroleum's common stock is owned (actually or under such constructive ownership rules) by five or fewer individuals. As a result, Syntroleum does not currently satisfy the stock ownership test for classification as a personal holding company. The five individuals with the largest ownership interests for this purpose are Blanche L. Agee (mother of Mark A. and Kenneth L. Agee), Robert A. Day, W D. Grant, R. Anthony Jacobs and James R. Seward. If at any time an individual acquires a sufficient number of shares of Syntroleum's common stock so that Syntroleum then satisfies the stock ownership test for classification as a personal holding company, and if Syntroleum then satisfies the personal holding income test for classification as a personal holding company, Syntroleum could be subject to additional taxation as a personal holding company.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Syntroleum had short-term investments in the form of U.S. Treasury securities as of December 31, 1998. The majority of these securities mature in less than 90 days. The Company's policy is to hold short-term securities to maturity which minimizes interest rate risk. The average interest rate on these investments at December 31, 1998 was approximately 4.9%.

Syntroleum does not currently conduct any material operations in foreign markets. Accordingly, Syntroleum does not have market risk related to foreign exchange rates.

Syntroleum does not purchase futures contracts nor does it purchase or hold any derivative financial instruments.

YEAR 2000 COMPLIANCE

Historically, certain computerized systems have used two digits rather than four digits to define the applicable year, causing them to not properly recognize a year that does not begin with "19." This could result in major failures or miscalculations and is generally referred to as the "Year 2000 issue." Syntroleum recognizes that the impact of the Year 2000 issue extends beyond traditional computer hardware and software to automated systems and instrumentation, as well as to third parties such as vendors, suppliers, customers, banks and securities markets.

Syntroleum's computer hardware and software and automated systems and instrumentation were acquired during the past two years. Based on the recent date of purchase and assertions made by the vendors of these systems, Syntroleum believes these systems are Year 2000 compliant.

With respect to external parties, Syntroleum is in the process of completing its assessment of the level of risk to Syntroleum of non-compliance by the external parties and, to the extent it deems necessary, has contacted those external parties deemed to be significant to Syntroleum's operations. Based on assertions made by these external parties, Syntroleum does not believe that a material uncertainty exists of noncompliance by an external party which would significantly affect Syntroleum's operations.

The total cost of Year 2000 activities to date has not been, and future costs are not expected to be, material to Syntroleum's operations, liquidity or capital resources.

Syntroleum's assessment of its Year 2000 issues involves many assumptions, and Syntroleum's assumptions may prove to be inaccurate and actual results could differ significantly from these assumptions. In conducting its Year 2000 compliance efforts, Syntroleum has relied primarily on seller representations with respect to its internal computerized systems and representations from third parties with which Syntroleum has business relationships and has not independently verified these representations. These representations might not prove to be accurate. A Year 2000 failure could result in a business disruption that adversely affects Syntroleum's business, financial condition or results of operations. Although it is not currently aware of any likely business disruption, Syntroleum is developing contingency plans to address certain potential Year 2000 failures and expects this work to continue through 2000. Syntroleum is also continuing to monitor Year 2000 risks and compliance and expects this work to continue through 2000.

CHANGE OF INDEPENDENT PUBLIC ACCOUNTANTS

At the time of the Merger, Syntroleum's independent public accountants were KPMG Peat Marwick LLP ("KMPG") and Old Syntroleum's independent public accountants were Arthur Andersen LLP ("Arthur Andersen"). On February 8, 1999, Syntroleum's audit committee recommended to the Syntroleum board of directors that Syntroleum engage Arthur Andersen as Syntroleum's independent public accountants and, on February 8, 1999, the Syntroleum board of directors approved the engagement of Arthur Andersen as Syntroleum's independent public accountants to replace KPMG.

During the years that ended December 31, 1997 and 1998 and the subsequent interim period preceding February 8, 1999, neither Syntroleum nor anyone on its behalf consulted Arthur Andersen regarding the application of accounting principles to specified transaction, either completed or proposed, or the type of audit opinion that might be rendered on Syntroleum's financial statements. The reports of KPMG on Syntroleum's consolidated financial statements for the years ended December 31, 1996 and 1997 did not contain an adverse opinion or a disclaimer of opinion and were not qualified or modified as to uncertainty, audit scope or accounting principles. During the years ended December 31, 1997 and 1998 and the subsequent interim period preceding February 8, 1999, there were no disagreements with KPMG. For the purpose of this annual report, the term "disagreements" means any disagreement between personnel of Syntroleum responsible for presentation of Syntroleum's financial statements and personnel of KPMG responsible for rendering KPMG's report on Syntroleum's financial statements on any matter of accounting principles or practices, financial statement disclosure or auditing scope or procedure which disagreements, if not resolved to the satisfaction of KPMG, would have caused KPMG to make reference to the subject matter of the disagreement in connection with KPMG's report.

NEW ACCOUNTING PRONOUNCEMENTS

In June 1998, the Financial Accounting Standards Board issued SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities. SFAS No. 133 establishes accounting and reporting standards requiring that every derivative instrument (including certain derivative instruments embedded in other contracts) be recorded in the balance sheet as either an asset or liability measured at its fair value. SFAS No. 133 requires that changes in the derivative's fair value be recognized currently in earnings unless specific hedge accounting criteria are met. Special accounting for qualifying hedges allows a derivative's gains and losses to offset related results on the hedged item in the income statement. Companies must formally document, designate and assess the effectiveness of transactions that receive hedge accounting. SFAS No. 133 is effective for fiscal years beginning after June 15, 1999, however, companies may implement the statement as of the beginning of any fiscal quarter beginning June 16, 1998. SFAS No. 133 cannot be applied retroactively and must be applied to (a) derivative instruments and (b) certain derivative instruments embedded in hybrid contracts that were issued, acquired, or substantively modified after December 31, 1997 (and, at the company's election, before January 1, 1998). As of December 31, 1998, the Company had no outstanding derivative instruments.

(in thousands, except share and per share data)

	December 31,	
	1998	1997
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 34,981	\$ 10,158
Short-term investments	3,135	-
Accounts and notes receivable	860	448
Other current assets	498	16
Total current assets	<u>39,474</u>	<u>10,622</u>
REAL ESTATE HELD FOR SALE	3,122	-
REAL ESTATE UNDER DEVELOPMENT	2,722	-
INVESTMENTS	1,180	-
PROPERTY AND EQUIPMENT, NET	3,210	1,245
OTHER ASSETS, NET	692	224
	<u>\$ 50,400</u>	<u>\$ 12,091</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	\$ 1,365	\$ 677
Accrued liabilities	633	99
Total current liabilities	<u>1,998</u>	<u>776</u>
OTHER NONCURRENT LIABILITIES	103	60
MINORITY INTERESTS	1,337	1,497
DEFERRED REVENUE	11,000	11,000
Total liabilities	<u>14,438</u>	<u>13,333</u>
STOCKHOLDERS' EQUITY:		
Preferred stock, \$0.01 par value, 5,000,000 shares authorized, no shares issued	-	-
Common stock \$0.01 par value, 150,000,000 shares authorized, 34,574,957 and 24,502,231 shares issued in 1998 and 1997, respectively, including shares in treasury	346	245
Additional paid-in capital	62,908	14,028
Notes receivable from sale of common stock	(699)	(699)
Retained earnings	<u>(26,516)</u>	<u>(14,805)</u>
	36,039	(1,231)
Less-treasury stock, 7,674,905 and 1,934 shares in 1998 and 1997, respectively	<u>(77)</u>	<u>(11)</u>
Total stockholders' equity	<u>35,962</u>	<u>(1,242)</u>
	<u>\$ 50,400</u>	<u>\$ 12,091</u>

The accompanying notes are an integral part of these consolidated balance sheets.

(in thousands, except share and per share data)

	For the Years Ended December 31,		
	1998	1997	1996
REVENUES:			
Real estate sales	\$ 2,416	\$ -	\$ -
Joint development revenue	1,779	2,006	616
Other	284	1	-
Total revenues	<u>4,479</u>	<u>2,007</u>	<u>616</u>
COSTS AND EXPENSES:			
Cost of real estate sold	2,387	-	-
Real estate operating expense	267	-	-
Pilot plant, engineering and research and development	4,434	2,944	1,120
Catalyst services	-	4,800	-
General and administrative	10,410	4,228	1,421
INCOME (LOSS) FROM OPERATIONS	(13,019)	(9,965)	(1,925)
INVESTMENT AND INTEREST INCOME	1,159	372	83
INTEREST EXPENSE	-	(22)	(95)
OTHER INCOME	118	-	-
INCOME (LOSS) BEFORE MINORITY INTERESTS	(11,742)	(9,615)	(1,937)
MINORITY INTERESTS	31	3	-
NET INCOME (LOSS)	<u>\$ (11,711)</u>	<u>\$ (9,612)</u>	<u>\$ (1,937)</u>
NET INCOME (LOSS) PER SHARE - basic and diluted	<u>\$ (0.46)</u>	<u>\$ (0.40)</u>	<u>\$ (0.08)</u>
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING	<u>25,466,737</u>	<u>23,953,347</u>	<u>23,207,216</u>

The accompanying notes are an integral part of these consolidated statements.

(in thousands)

	COMMON STOCK		ADDITIONAL PAID IN CAPITAL	NOTES RECEIVABLE FROM SALE OF COMMON STOCK	ACCUMULATED DEFICIT	TREASURY STOCK	TOTAL STOCKHOLDERS' EQUITY
	NUMBER OF SHARES	AMOUNT					
BALANCE, JANUARY 1, 1996	22,713	\$ 228	\$ 3,930	\$ (700)	\$ (3,256)	\$ -	\$ 202
SALE OF COMMON STOCK	906	9	1,991	-	-	-	2,000
NET INCOME (LOSS)	-	-	-	-	(1,937)	-	(1,937)
BALANCE, DECEMBER 31, 1996	23,619	237	5,921	(700)	(5,193)	-	265
CONVERSION OF DEBENTURE	120	1	1,116	-	-	-	1,117
SALE AND ISSUANCE OF STOCK	759	7	6,957	-	-	-	6,964
STOCK ISSUED FOR SERVICES	4	-	34	-	-	-	34
PURCHASE OF 1,934 SHARES OF TREASURY STOCK	-	-	-	-	-	(11)	(11)
PAYMENT ON NOTES RECEIVABLE	-	-	-	1	-	-	1
NET INCOME (LOSS)	-	-	-	-	(9,612)	-	(9,612)
BALANCE, DECEMBER 31, 1997	24,502	245	14,028	(699)	(14,805)	(11)	(1,242)
RETIREMENT OF TREASURY STOCK	(2)	-	(11)	-	-	11	-
MERGER WITH SLH CORPORATION	10,075	101	48,891	-	-	(77)	48,915
NET INCOME (LOSS)	-	-	-	-	(11,711)	-	(11,711)
BALANCE, DECEMBER 31, 1998	<u>34,575</u>	<u>\$ 346</u>	<u>\$ 62,908</u>	<u>\$ (699)</u>	<u>\$ (26,516)</u>	<u>\$ (77)</u>	<u>\$ 35,962</u>

The accompanying notes are an integral part of these consolidated statements.

<i>(in thousands)</i>	For the Years Ended December 31,		
	1998	1997	1996
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income (loss)	\$ (11,711)	\$ (9,612)	\$ (1,937)
ADJUSTMENTS TO RECONCILE NET INCOME (LOSS) TO NET CASH PROVIDED BY (USED IN) OPERATIONS:			
Stock issued for services	-	34	-
Stock issued for catalyst services	-	4,800	-
Interest on conversion of debenture	-	22	-
Minority interest in loss of subsidiary	(31)	(3)	-
Depreciation and amortization	306	76	19
Writedown of property and equipment	-	414	199
Equity in earnings of affiliates	(8)	-	-
Changes in real estate held for sale and under development	1,545	-	-
CHANGES IN ASSETS AND LIABILITIES:			
Accounts receivable	466	(429)	-
Prepays and other	(147)	(29)	(2)
Other assets	(215)	(85)	(42)
Accounts payable	348	485	14
Accrued liabilities and others	(2,665)	75	90
Deferred revenue	-	11,000	-
Net cash provided by (used in) operating activities	<u>(12,112)</u>	<u>6,748</u>	<u>(1,659)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchases of property and equipment	(2,173)	(1,114)	(214)
Maturity of SLH investments held to maturity	37,415	-	-
Net cash provided by (used in) investing activities	<u>35,242</u>	<u>(1,114)</u>	<u>(214)</u>
CASH FLOWS FROM Financing ACTIVITIES:			
Cash received in merger with SLH Corporation	713	-	-
Payments under capital lease	(20)	(12)	-
Minority interest investment in subsidiary	1,000	1,500	-
Proceeds from issuance of convertible debenture	-	-	1,000
Proceeds from sale of common stock	-	2,164	1,500
Proceeds from notes receivable	-	1	-
Treasury stock purchased	-	(11)	-
Net cash provided by (used in) financing activities	<u>1,693</u>	<u>3,642</u>	<u>2,500</u>
NET INCREASE IN CASH	24,823	9,276	627
CASH AND CASH EQUIVALENTS, beginning of period	<u>10,158</u>	<u>882</u>	<u>255</u>
CASH AND CASH EQUIVALENTS, end of period	<u>\$ 34,981</u>	<u>\$ 10,158</u>	<u>\$ 882</u>

The accompanying notes are an integral part of these consolidated statements.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:**BASIS OF REPORTING**

Syntroleum Corporation (the "Company" or "Syntroleum"), formerly named SLH Corporation ("SLH"), was incorporated in Kansas in December 1996. The Company's primary operations to date have consisted of the research and development of a proprietary process (the "Syntroleum Process") designed to convert natural gas into synthetic liquid hydrocarbons. Synthetic crude oil produced by the Syntroleum Process can be further processed into liquid fuels such as diesel, kerosene and naphtha, or specialty products such as synthetic lubricants, synthetic drilling fluid, waxes, liquid normal paraffins and certain chemical feedstocks.

The Company's current focus is to further demonstrate the commercial viability of its proprietary technology. The Company has sold license agreements to six oil companies and, in connection with its joint development efforts with certain of its licensees, operates a pilot plant in Tulsa, Oklahoma that has demonstrated certain elements and variations of the Syntroleum Process. The Company, through its majority-owned subsidiary, Syntroleum/Sweetwater Company, LLC, is developing a commercial-scale specialty products plant.

On August 7, 1998, Syntroleum Corporation, an Oklahoma corporation ("Old Syntroleum"), merged with SLH. In the merger, each outstanding share of Old Syntroleum common stock was converted into 1.2899 shares of SLH common stock. Accordingly, 24,500,236 shares of common stock of SLH were issued to the former holders of Old Syntroleum common stock. After the merger, SLH's name was changed to Syntroleum Corporation, and SLH management and six of the eight SLH directors were replaced with Old Syntroleum management and directors.

The merger was accounted for as a reverse acquisition using the purchase method of accounting. Although SLH is the surviving corporation in the merger for legal purposes, Old Syntroleum is the acquirer for accounting purposes. Under reverse acquisition accounting, the value of the transaction is determined based on the value of the accounting acquirer's shares issued, which in this situation was impracticable due to Old Syntroleum's status as a private company and the absence of a trading market for its shares. Accordingly, the fair value of SLH's net tangible assets has been used to determine the value of the transaction. For this purpose, the value of SLH's investment in Old Syntroleum was determined by calculating the implied value of the Old Syntroleum common stock held by SLH, which was determined based upon the market capitalization of the outstanding shares of SLH common stock minus the fair value of SLH's non-Old Syntroleum assets divided by the 5,950,000 shares of Old Syntroleum common stock held by SLH. This method of calculating the implied value of

the Old Syntroleum common stock is consistent with the method used in determining the merger exchange ratio of 1.2899 discussed above.

For purposes of preparing its consolidated financial statements, the Company established a new accounting basis for SLH's assets and liabilities using their fair market values, based upon the consideration paid in the merger and Old Syntroleum's costs of the merger. Although Old Syntroleum's equity accounts survive the merger, SLH's common stock survives. Accordingly, Old Syntroleum's common stock with a par value of \$.001 has been restated to reflect SLH's par value of \$.01 and to reflect the effect of the exchange ratio of 1.2899. The purchase allocations in relation to the merger are final except for the collection of a judgment in a pending lawsuit, which occurred during the first quarter of 1999. The monies received in satisfaction of the judgment will be recorded as additional paid-in capital during the first quarter of 1999 (See Note 15).

The results of operations of SLH have been included in the results of Syntroleum since completion of the merger on August 7, 1998. Unaudited pro forma results of operations for the twelve months ended December 31, 1998 and 1997, as though the merger had occurred on January 1, 1997, are presented below. The pro forma results of operations are not necessarily indicative of the actual operating results had the transaction been consummated at the beginning of the period presented below or of future operating results of the combined operations:

<i>(in thousands except per share amounts)</i>	DECEMBER 31,	
	1998	1997
REVENUES	\$ 12,028	\$ 19,350
NET INCOME (LOSS)	(7,771)	(519)
BASIC AND DILUTED EARNINGS		
(LOSS) PER SHARE	(0.31)	(0.02)

CONSOLIDATION

The consolidated financial statements include the accounts of the Company and its majority-owned subsidiaries. These subsidiaries include BMA Resources, Inc., Scout Development Corporation, Scout Development Corporation of New Mexico, Lot Development, Inc., Carousel Apartment Homes, Inc., 529 Partners, Ltd. and Syntroleum/Sweetwater Company, LLC. All subsidiaries except Syntroleum/Sweetwater Company, LLC were acquired through the merger with SLH. All significant inter-company accounts and transactions have been eliminated. Investments in affiliated companies of 20 to 50% in which Syntroleum does not have a controlling interest are accounted for by the equity method. Investments in affiliated companies of one to 20% are accounted for by the cost method.

REVENUE RECOGNITION

The Company recognizes revenues from joint development activities as the related expenses are incurred because the contracts provide that revenue is earned as the expenses under the contract are incurred. Substantially all of the joint development revenues for the years ended December 31, 1998, 1997 and 1996 have been from joint development activities with a single major oil company (see Note 13). All joint development activities during the years ended 1998, 1997 and 1996 were pursuant to joint research and development agreements where the Company expenses its research and development costs as incurred.

The Company recognizes revenue on the sale of license agreements by recording 50% of the license fee deposit as revenue when: (1) the license agreement has been formally executed, (2) the license fee deposit has been paid in cash and (3) the Company has delivered to the licensee the process design package for the licensee's initial licensed plant. Since 50% of the license fee deposit is subject to the Company's indemnity obligation with respect to the performance guarantee on the related plant, the remaining license fee deposit is recorded as deferred revenue in the consolidated balance sheets and will be recognized as revenue in the consolidated statements of operations after the related plant has passed certain performance tests. Option fees, which provide licensees the right to include additional geographic areas in its license agreement territory, are deferred until the earlier of the option being exercised or lapsing. As of December 31, 1998, the Company has deferred all amounts received related to license and option agreements.

CASH AND CASH EQUIVALENTS

Cash and cash equivalents consist of cash and highly liquid investments with an original maturity of three months or less.

REAL ESTATE

Real estate sales are recognized when consummated. Profit is recognized using the full accrual method when the down payment, continuing investment, and transfer of risk criteria have been satisfied. Payments received from buyers prior to recording of a sale are recorded as deposits. Real estate rentals and other revenues are accrued in the period when earned.

Real estate is valued at lower of cost, including development costs, or market. Development costs that are incurred during the period of development or construction are capitalized. Capitalized costs are charged to operations as properties are sold. There was no real estate under development sold during 1998, 1997 or 1996.

During 1998, the Company sold three properties for a total of \$1,560,000 and undeveloped land for \$856,000. These assets were acquired in the merger with SLH.

SHORT-TERM INVESTMENTS

Short-term investments consist of U.S. Treasury securities and debt obligations of U.S. Government agencies with original maturities between three and twelve months. Management determines the appropriate classification of these securities at the time of purchase and re-evaluates such designation as of each balance sheet date. At December 31, 1998 and 1997, the Company's investment portfolio consisted of debt securities classified as held-to-maturity and are presented at amortized cost.

RESEARCH AND DEVELOPMENT

The Company incurs significant costs for research, development and engineering programs. Such costs are charged to expense when incurred. Prior to 1997, substantially all costs were considered research and development costs.

INCOME TAXES

Income taxes are accounted for using the asset and liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities and of net operating loss carryforwards. Deferred tax assets and liabilities are measured using the enacted tax rates and laws in effect or that will be in effect when the differences are expected to reverse.

IMPAIRMENT OF LONG-LIVED ASSETS

The Company follows the provisions of SFAS No. 121 "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of." The Company makes assessments of impairment on a project-by-project basis. No impairment provisions were required in 1998, 1997 or 1996.

EARNINGS PER SHARE

The Company applies the provisions of SFAS No. 128, "Earnings Per Share." Basic and diluted earnings (losses) per common share were computed by dividing net income (loss) by the weighted average number of shares of common stock outstanding during the reporting period. Options to purchase 2,131,839 shares of common stock at an average exercise price of \$7.44 were not included in the computation of diluted earnings per share as inclusion of such options would be anti-dilutive. All share and per share amounts presented in the financial statements reflect the adjustment for the merger ratio of 1.2899.

RECLASSIFICATIONS

Certain reclassifications have been made to the prior years' financial statements to conform with the 1998 presentation. Such reclassifications did not impact net income (loss).

USE OF ESTIMATES

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

NEW ACCOUNTING PRONOUNCEMENTS

In June 1998, the Financial Accounting Standards Board issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS No. 133 establishes accounting and reporting standards requiring that every derivative instrument (including certain derivative instruments embedded in other contracts) be recorded in the balance sheet as either an asset or liability measured at its fair value. SFAS No. 133 requires that changes in the derivative's fair value be recognized currently in earnings unless specific hedge accounting criteria are met. Special accounting for qualifying hedges allows a derivative's gains and losses to offset related results on the hedged item in the income statement. Companies must formally document, designate, and assess the effectiveness of transactions that receive hedge accounting. SFAS No. 133 is effective for fiscal years beginning after June 15, 1999. As of December 31, 1998, the Company had no outstanding derivative instruments.

2. INVESTMENTS:

The Company has a 4.34% interest in a partnership renovating a hotel in Tulsa, Oklahoma having a carrying value of \$100,000. The Company also owns a 3.61% investment in a privately held venture capital limited partnership having a carrying value of \$507,000; and a preferred stock interest in Norian Corporation, a privately owned developer of proprietary bone substitute technology, which had a carrying value of \$750,000.

The Company has a 49.9% interest in a partnership that owns a shopping center having a carrying value of (\$177,000). The Company has guaranteed debt (with an unpaid balance of \$6,005,000 at December 31, 1998) of the shopping center partnership. Since the Company has guaranteed this debt, the investment is carried below zero to reflect the Company's pro rata share of the partnership's deficit. The Company's obligation is secured by a \$3.1 million U.S. Treasury note.

Summary financial information of the shopping center partnership is shown below:

<i>(in thousands)</i>	DECEMBER 31, 1998
RESULTS OF OPERATIONS	
REVENUES	\$ 798
GROSS PROFIT	446
NET EARNINGS (LOSS)	71

<i>(in thousands)</i>	DECEMBER 31, 1998
-----------------------	----------------------

FINANCIAL POSITION

CURRENT ASSETS	\$ 1,193
REAL ESTATE	4,343
OTHER ASSETS	189
	<u>\$ 5,725</u>
SHORT-TERM BORROWING	\$ 175
CURRENT LIABILITIES	77
LONG-TERM BORROWING	5,830
	<u>\$ 6,082</u>
PARTNERSHIP DEFICIT	(357)
	<u>\$ 5,725</u>

3. PROPERTY AND EQUIPMENT:

Property and equipment is stated at cost. When assets are sold or retired, the cost and accumulated depreciation related to those assets are removed from the accounts and any gain or loss is credited or charged to income. Depreciation of property and equipment is computed on the straight-line method over estimated useful lives of five to seven years. Property and equipment consists of the following:

<i>(in thousands)</i>	DECEMBER 31,	
	1998	1997
FURNITURE AND OFFICE EQUIPMENT	\$ 1,919	\$ 955
PROPERTY	807	-
LAND	118	-
LEASEHOLD IMPROVEMENTS	288	214
CONSTRUCTION IN PROGRESS	523	223
	<u>3,655</u>	<u>1,392</u>
LESS-ACCUMULATED DEPRECIATION	445	147
	<u>\$ 3,210</u>	<u>\$ 1,245</u>

4. NOTES RECEIVABLE FROM SALE OF COMMON STOCK:

Notes receivable from the sale of common stock consists of notes receivable from officers for the purchase of common stock in the Company. The notes bear interest at the rate of 6.10%, mature in May 2004 and are secured by stock pledge agreements.

5. ACCRUED LIABILITIES:

The components of accrued liabilities are as follows:

<i>(in thousands)</i>	DECEMBER 31,	
	1998	1997
ACCRUED WARRANTY	\$ 135	\$ -
ACCRUED VACATION	161	50
ACCRUED RENT	120	23
OTHER	217	26
	<u>\$ 633</u>	<u>\$ 99</u>

6. INCOME TAXES:

The Company has federal income tax net operating loss (NOL) carryforwards of approximately \$39 million at December 31, 1998. In connection with the merger with SLH, the Company obtained NOLs of approximately \$17.6 million and capital loss carryforwards of approximately \$4.6 million. These carryforwards generally begin to expire in 2004.

The Company recognizes the tax benefit of NOL carryforwards as assets to the extent that management concludes that the realization of the NOL carryforwards is "more likely than not." Realization of the future tax benefits is dependent on the Company's ability to generate taxable income within the carryforward period. The Company's management has concluded that, based solely on the criteria of SFAS No. 109 "Accounting for Income Taxes" and the historical results of the Company, a valuation allowance should be provided for the entire balance of the net deferred asset.

The Company has not recorded an income tax provision or benefit for the years ended December 31, 1998, 1997 or 1996, respectively. This differs from the amount of income tax benefit that would result from applying the 34% statutory federal income tax rate to the pretax loss due to the increase in the valuation allowance in each period. The valuation allowance increased by approximately \$13,177,000, \$3,609,000 and \$759,000 for the years ended December 31, 1998, 1997 and 1996, respectively.

Deferred taxes arise primarily from NOL carryforwards and the recognition of revenues and expenses in different periods for financial and tax purposes. Deferred taxes consist of the following:

<i>(in thousands)</i>	DECEMBER 31,	
	1998	1997
DEFERRED TAX ASSETS		
NOL CARRYFORWARDS	\$ 14,895	\$ 3,800
CAPITAL LOSS CARRYFORWARDS	1,759	-
DEFERRED REVENUE	1,710	1,710
OTHER	682	100
	<u>19,046</u>	<u>5,610</u>
DEFERRED TAX LIABILITIES		
DEPRECIATION	(268)	-
OTHER	(17)	(26)
NET DEFERRED TAX ASSETS BEFORE VALUATION ALLOWANCE	18,761	5,584
VALUATION ALLOWANCE	(18,761)	(5,584)
NET DEFERRED TAX	<u>\$ -</u>	<u>\$ -</u>

7. SUPPLEMENTAL CASH FLOW INFORMATION:

During 1997, a convertible debenture was converted into 120,036 shares of the Company's common stock (see Note 8) which was accounted for as a noncash financing activity. Also during 1997, the Company issued 515,960 shares of its common stock to a catalyst manufacturer which was accounted for as a noncash operating activity.

During 1998, the merger with SLH was accounted for as a non-cash investing activity. In conjunction with the merger with SLH, the following assets were acquired and liabilities assumed:

CASH	\$ 713
SHORT-TERM INVESTMENTS	40,550
REAL ESTATE HELD FOR SALE AND UNDER DEVELOPMENT	7,387
OTHER ASSETS	2,719
LIABILITIES ASSUMED	(2,454)
EQUITY ISSUED	<u>\$ 48,915</u>

8. CONVERTIBLE DEBENTURE:

During 1996, the Company entered into an agreement with an oil company whereby the oil company purchased a 9.5% convertible debenture from the Company in the original principal amount of \$1 million. During 1997, the oil company converted the principal of the debenture together with accrued interest in the amount of \$116,708 into 120,036 shares of the Company's common stock, representing a conversion price of \$9.30 per share.

9. LEASE COMMITMENTS:

The Company has entered into various, noncancellable leases for office space, equipment, land and buildings that expire over the next several years. Total future minimum lease payments under these agreements as of December 31, 1998 are as follows:

YEAR	AMOUNT <i>(in thousands)</i>
1999	\$ 1,173
2000	947
2001	809
2002	709
2003	302
THEREAFTER	5,631

10. FAIR VALUE OF FINANCIAL INSTRUMENTS:

The estimated fair values of the Company's financial instruments at December 31 are summarized as follows:

<i>(in thousands)</i>	1998		1997	
	CARRYING AMOUNT	ESTIMATED FAIR VALUE	CARRYING AMOUNT	ESTIMATED FAIR VALUE
CASH AND CASH EQUIVALENTS	\$ 34,981	\$ 34,981	\$ 10,158	\$ 10,158
SHORT-TERM INVESTMENTS	3,135	3,135	-	-
ACCOUNTS AND NOTES RECEIVABLE	860	860	448	448
INVESTMENTS	1,180	1,180	-	-
NOTES RECEIVABLE FROM SALE OF COMMON STOCK	699	699	699	699

The fair value of the short-term investments and accounts receivable approximates cost because of the short-term maturity of these financial instruments. The estimated fair value of the notes receivable were calculated by discounting scheduled cash flows using estimated market discount rates. The investments were acquired in the merger and at the time of the merger were valued at market. No significant changes in the estimated fair value have occurred since the merger.

11. CASH EQUIVALENTS AND SHORT-TERM INVESTMENTS:

At December 31, 1998 and 1997, all marketable debt securities were classified as held-to-maturity and carried at amortized cost. During 1998, 1997 and 1996 no securities classed as held-to-maturity were transferred out of held-to-maturity. Investments consisted of the following at December 31:

<i>(in thousands)</i>	CASH EQUIVALENTS	SHORT-TERM INVESTMENTS
1998		
U.S. GOVERNMENT SECURITIES	\$ 28,319	\$ 3,135
1997		
U.S. GOVERNMENT SECURITIES	\$ 9,739	\$ -

12. STOCK OPTIONS:

The Company maintains stock option and incentive plans for employees and directors and has reserved 4,591,186 shares of common stock for issuance under the employee and director plans, including one percent of the outstanding shares of common stock of the Company as of January 1 of each year (245,002 as of December 31, 1998) for the director plan. Under the terms of the plans, incentive stock options may be issued with an exercise price of not less than 100% of fair market value at the date of grant. All other options may be issued at an exercise price of not less than 75% of the fair market value at the date of grant. Options granted vest at a rate determined by the Compensation Committee of the Company's Board of Directors and are exercisable for varying periods, not to exceed ten years. At December 31, 1998, 1,873,747 shares were available for granting future options.

The number and exercise price of stock options granted are as follows:

	SHARES UNDER OPTION	WEIGHTED AVERAGE PRICE PER SHARE
OUTSTANDING AT JANUARY 1, 1996	454,690	\$ 0.36
GRANTED	12,899	5.75
OUTSTANDING AT DECEMBER 31, 1996	467,589	0.50
GRANTED	535,954	9.13
EXERCISED	(27,733)	5.75
EXPIRED	(274,104)	0.33
OUTSTANDING AT DECEMBER 31, 1997	701,706	6.95
SLH OPTIONS FROM MERGER	974,400	3.19
FRACTIONAL SHARE PAYOUT	(19)	6.94
GRANTED AT MARKET PRICE	445,430	16.70
GRANTED AT PRICE EXCEEDING MARKET	32,247	20.28
EXPIRED	(21,925)	10.42
OUTSTANDING AT DECEMBER 31, 1998	2,131,839	\$ 7.44

The following is a summary of stock options outstanding as of December 31, 1998:

OPTIONS OUTSTANDING				OPTIONS EXERCISABLE	
RANGE OF EXERCISE PRICE	OPTIONS OUTSTANDING	WEIGHTED AVERAGE EXERCISE PRICE	WEIGHTED AVERAGE REMAINING CONTRACTUAL LIFE	OPTIONS EXERCISABLE	WEIGHTED AVERAGE EXERCISE PRICE PER SHARE
\$0.39 - \$0.39	180,586	\$0.39	6.45	180,586	\$0.39
\$3.19 - \$3.19	974,400	3.19	4.60	194,400	3.19
\$5.75 - \$9.30	450,159	8.23	8.33	236,911	7.59
\$9.38 - \$18.44	457,130	16.59	9.33	12,900	16.89
\$18.85 - \$20.88	69,564	19.89	9.06	4,300	20.88
	2,131,839	\$7.44		629,097	\$4.45

The Company applies the disclosure-only provisions of SFAS No. 123, "Accounting from Stock-Based Compensation." Accordingly, no compensation cost has been recognized for the stock option plans. However, pursuant to the requirements of SFAS No. 123, the following disclosures are presented to reflect the Company's pro forma net income (loss) for the three years ended December 31, 1998 as if the fair value method of accounting prescribed by SFAS No. 123 had been used. Had compensation cost for the Company's stock option plan been determined consistent with the provisions of SFAS No. 123, the Company's net income (loss) and income (loss) per share would have increased to the pro forma amounts indicated:

	DECEMBER 31,		
(in thousands except per share data)	1998	1997	1996
NET INCOME (LOSS):			
AS REPORTED	\$ (11,711)	\$ (9,612)	\$ (1,937)
PRO FORMA	\$ (14,175)	\$ (10,261)	\$ (1,955)
BASIC AND DILUTED INCOME (LOSS) PER SHARE			
AS REPORTED	\$ (0.46)	\$ (0.40)	\$ (0.08)
PRO FORMA	\$ (0.56)	\$ (0.43)	\$ (0.08)

Because the SFAS No. 123 method of accounting has not been applied to options granted prior to January 1, 1995, the resulting pro forma compensation cost may not be representative of that to be expected in future years.

The weighted average per share fair value of stock options granted during 1998 was \$10.60 on the date of the grant using the Black Scholes option-pricing model with the following weighted average assumptions: expected dividend yield of zero percent, risk-free interest rate of 4.77% to 6.83%, expected volatility factor of zero percent prior to the merger and 124% after the merger, and an expected life of 5 to 10 years.

Subsequent to December 31, 1998, the Company granted options to purchase 550,552 shares of common stock to employees at an average exercise price of \$6.90.

13. SIGNIFICANT CUSTOMERS:

Substantially all of the Company's joint development revenue for the three years ended December 31, 1998 were from a single major oil company for testing conducted in the Company's pilot plant. The pilot plant testing was completed under this agreement in December 1998. In addition, the Company has signed master license agreements with three oil companies since 1996. The Company has also signed volume license agreements with three other oil companies. The license agreements allow the oil companies to use the Syntroleum Process in their production of synthetic crude oil and fuels primarily outside of North America. Syntroleum received an aggregate of \$9 million and rights to certain technologies in connection with these license agreements. The Company also received from a licensee a separate nonrefundable payment of \$2 million for options to add certain geographic areas not covered by the applicable license agreement. The amounts received under license agreements and the amounts received for options have been recorded as deferred revenue at December 31, 1998 and 1997.

Under these license agreements, a licensee obtains the right to use the Syntroleum Process and to acquire catalysts from the Company, secures pricing terms for future site licenses and obtains rights to future improvements to the Syntroleum Process. Generally, the amount of the license fee for site licenses under the Company's master and volume license agreements is determined pursuant to a formula based on the discounted present value of the product of (i) the annual maximum design capacity

of the plant, (ii) an assumed life of the plant, and (iii) the Company's per barrel rate. Initial cash deposits under the Company's license agreement are credited against future site license fees. (See Note 1.)

Through the Company's subsidiary, Syntroleum/Sweetwater Company, LLC, the Company and a licensee are developing a commercial specialty products plant using the Syntroleum Process. In addition, the Company conducts a portion of its research and development activities through joint development agreements with licensees and other industry partners. The terms of these agreements vary, but generally provide cost sharing arrangements.

14. STOCKHOLDER RIGHTS PLAN

Each outstanding share of the Company's common stock carries a preferred stock purchase right originally issued pursuant to a dividend distribution declared by SLH's Board of Directors in March 1997. The rights entitle the holder to buy one-sixth of one one-hundredth of a share of junior preferred stock, with a liquidation preference of \$600 per share, at a price of \$125 per one one-hundredth of a share. Generally, the rights become exercisable ten days after a public announcement that a person or group (an "acquiring person") has acquired, or made a tender offer that, if completed, would result in that person or group owning 25% or more of the common stock of the Company. If either of these events occur, each right will entitle the holder (other than the acquiring person) to buy the number of shares of the Company's common stock having a market value equal to two times the exercise price. The exercise price is \$125. The rights may be redeemed by the Company for \$.01 per right until a person or group becomes an acquiring person. The rights expire in January 2007.

15. EVENTS SUBSEQUENT TO DECEMBER 31, 1998:

Subsequent to December 31, 1998, the Company received \$6.0 million in satisfaction of a judgment in its favor. The litigation, originally brought by Business Men's Assurance Company (BMA) in 1986, alleged negligence and breach of contract arising out of the design and construction of the BMA office tower in Kansas City, as a result of marble panels detaching and falling from the building. The Missouri Supreme Court ruled in favor of BMA on February 9, 1999. Rights to the litigation were owned by SLH and were acquired by Syntroleum when it merged with SLH. The settlement will be recorded as additional paid-in capital during 1999.

To the Board of Directors and Stockholders of Syntroleum Corporation:

We have audited the accompanying consolidated balance sheets of Syntroleum Corporation (a Kansas corporation) as of December 31, 1998 and 1997, and the related consolidated statements of operations, stockholders' equity and cash flows for each of the three years in the period ended December 31, 1998. 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 generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit included examining, on a test basis, evidence supporting the amounts and disclosures in the 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 Syntroleum Corporation as of December 31, 1998 and 1997, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 1998, in conformity with generally accepted accounting principles.

ARTHUR ANDERSEN LLP

Tulsa, Oklahoma
January 15, 1999

SYNTROLEUM'S SENIOR MANAGEMENT TEAM BRINGS SIGNIFICANT EXPERIENCE FROM HIGH-LEVEL POSTS AT A WIDE RANGE OF OIL & GAS INDUSTRY LEADERS:

KENNETH AGEE, CHAIRMAN AND CEO

Prior to founding Syntroleum, Mr. Agee spent 15 years in crude oil refining and natural gas processing, working at Texaco, Cities Service and Transok Inc. He is an inventor on most of the company's 70+ plus patents issued and/or pending. He holds a B.S. degree in Chemical Engineering from Oklahoma State University.

MARK AGEE, PRESIDENT AND COO

Prior to joining Syntroleum in 1994, Mr. Agee spent 20 years in petrochemical, petroleum, computer and communications industries. He was President/CEO of Convergent Communications, Inc. which he founded. He also served as President/CEO of XETA Corporation, a computer company that he co-founded. He holds a B.S. degree in Chemical Engineering from the University of Tulsa.

RANDALL THOMPSON, VICE PRESIDENT AND CFO

Prior to joining Syntroleum in 1996, Mr. Thompson was with Tenneco Energy where he held positions of VP/Strategic Planning, and VP/Strategy and Business Development. Earlier he was with ARCO, holding positions of Senior Treasury Analyst, and Investor Relations Manager. He holds a B.A. Degree in Economics from the University of Colorado and an MBA from the Wharton School at the University of Pennsylvania.

LARRY WEICK, VICE PRESIDENT LICENSING AND BUSINESS DEVELOPMENT

Prior to joining Syntroleum in 1996,

Mr. Weick spent 20 years in the petroleum and electric utility industries. During this time he consulted for natural gas and electric utility management, and held positions with ARCO in finance, planning and business development. He also co-founded a horizontal drilling technology company. He holds a B.S. Degree in Electrical Engineering from the University of Nebraska, and an M.S. Degree in Engineering-Economics from Stanford.

DR. C.A. BAYENS, VICE PRESIDENT ENGINEERING

Prior to joining Syntroleum, Dr. Bayens was employed by Shell Oil Company, where he worked in various technical and business assignments. From 1991-97 he was President of Shell Synthetic Fuels Inc. where he managed commercialization of Shell's \$500 million suite of synfuels technologies. He holds a Ph.D. in Chemical Engineering from Johns Hopkins University.

DR. PAUL SCHUBERT, VICE PRESIDENT R&D

Prior to joining Syntroleum, Dr. Schubert worked 16 years in management and scientific positions. He served as Vice President of Instrumentation with Monitor Labs, Inc., Vice President with Catalytica, Inc., Senior Chemist, with Phillips Petroleum, and Senior Research Chemist with Engelhard Corporation. He holds a B.S. in Chemistry from the University of Arkansas and a Ph.D. in Inorganic Chemistry from the University of Illinois.

PETER SNYDER, VICE PRESIDENT PRODUCT SALES

Prior to joining Syntroleum in 1996, Mr. Snyder spent 18 years in the lubes,

chemicals and wax businesses, including as President of C&C Petroleum and Chemicals. He also worked for Moore & Munger where he was Product Manager of Synthetic Waxes, Director of Specialty Products and VP/Director of Marketing.

ERIC GRIMSHAW, VICE PRESIDENT/GENERAL COUNSEL

Prior to joining Syntroleum, Mr. Grimshaw was a partner with Pray, Walker, Jackman, Williamson, & Marler, P.C., specializing in corporate, partnership, and securities law, with focus on representation of issuers and investors involved in public and private financing.

CARLA S. COVEY, CONTROLLER

Ms. Covey joined Syntroleum as Director of Accounting in 1997. Earlier, Ms. Covey served as Accounting Manager/Human Resource Manager and Manager, Facility Operations for AGC Manufacturing Services, Inc. She holds a B.A. in Business Administration from Drury College and an M.S. in Management from Southern Nazarene University.

MICHAEL L. STEWART, VICE PRESIDENT OF INFORMATION SYSTEMS

Mr. Stewart joined Syntroleum in 1997 as Information Technology Manager. Earlier, he was a management consultant involved in data processing, systems operation, planning and organization. He also held the position of Vice President - Management Information Services for Convergent Communications, Inc.

BOARD OF DIRECTORS

KENNETH L. AGEE IS CHIEF EXECUTIVE OFFICER AND CHAIRMAN OF THE BOARD OF SYNTROLEUM.

He has served as a director of Syntroleum since its founding in 1984.

MARK A. AGEE IS PRESIDENT AND CHIEF OPERATING OFFICER OF SYNTROLEUM.

He became a director in 1985. Mr. Agee joined Syntroleum in 1994 from Convergent Communications, where he was President, Chief Executive Officer.

ALVIN ALBE, JR. was named a director in December 1988. He is Executive Vice President of the TCWGroup, Inc., a financial and business management firm in Los Angeles.

FRANK M. BUMSTEAD was named a director in May 1993. He is President of Flood, Bumstead, McCready & McCarthy, Inc., a financial and business management firm in Nashville, Tennessee.

P. ANTHONY JACOBS became a director in December 1996. He is President and Chief Executive Officer of Lab Holdings, Inc., a company engaged in the laboratory testing business.

ROBERT ROSENE, JR. became a director in March 1985. He is co-founder and President of Boyd Rosene and Associates, Inc., a natural gas consulting and marketing firm in Tulsa, Oklahoma.

JAMES R. SEWARD became a director in December 1996. He is President and Chief Executive Officer of Seward & Company LLC, a financial advisory firm in Prairie Village, Kansas.

J. EDWARD SHERIDAN was named a director in November 1995. He founded and served as President of Sheridan Management Corporation in Washington, D.C., a company that provides support services to businesses and industries with global markets for their products and services.

Corporate Data

FORM 10-K

THE ANNUAL REPORT ON FORM 10-K AS FILED WITH THE SECURITIES AND EXCHANGE COMMISSION IS AVAILABLE UPON WRITTEN REQUEST TO INVESTOR RELATIONS.

INDEPENDENT ACCOUNTANTS

ARTHUR ANDERSEN LLP
6450 SOUTH LEWIS
TULSA, OK 74136

SHARES TRADED

NASDAQ STOCK EXCHANGE
(TICKER SYMBOL "SYNM")

CORPORATE OFFICES

SYNTROLEUM CORPORATION
1350 SOUTH BOULDER AVENUE
SUITE 1100
TULSA, OK 74119
918/592-7900

REGISTRAR OF STOCK AND TRANSFER AGENT

AMERICAN STOCK TRANSFER
INVESTOR RELATIONS
40 WALL STREET
NEW YORK, NY 10005
800/937-5449

STOCKHOLDER COMMUNICATIONS

VISIT SYNTROLEUM ON THE INTERNET
WWW.SYNTROLEUM.COM

MARKET PRICE AND DIVIDEND INFORMATION

The Company's common stock traded on the National Market System of the NASDAQ Stock Market under the symbol "SLHO" from July 29, 1997 until the closing of the merger between the Company and Syntroleum Corporation. Prior to July 29, 1997, the Company's common stock traded over-the-counter through the OTC Bulletin Board and NQB Pink Sheets. Following the merger, the Company's common stock began trading on the National Stock Market System of the NASDAQ Stock Market under the symbol "SYNM".

The table below reflects the high and low bid prices for the common stock for each quarter during 1997 and 1998. Trading in the first quarter of 1997 did not commence until February 24, 1997. The information has been adjusted for a three-for-one stock split on July 21, 1997, and a two-for-one stock split on February 9, 1998.

YEAR ENDED DECEMBER 31, 1998:	BID PRICE		YEAR ENDED DECEMBER 31, 1997:	BID PRICE	
	HIGH	LOW		HIGH	LOW
FIRST QUARTER	\$ 35.50	\$ 25.50	FIRST QUARTER	\$ 5.17	\$ 2.66*
SECOND QUARTER	32.69	16.25	SECOND QUARTER	13.30	5.00
THIRD QUARTER	25.13	6.00	THIRD QUARTER	29.00	14.50
FOURTH QUARTER	12.38	5.25	FOURTH QUARTER	36.00	23.88

*Reflects when issued trading prior to the March 3, 1997 distribution date.

Cash dividends have not been paid since inception. The Company currently intends to retain any earnings for the future operation and development of its business and does not currently anticipate paying any dividends in the foreseeable future. Although Syntroleum is not currently a party to any agreement that restricts dividend payments, future dividends may be restricted by Syntroleum's then-existing financing arrangements.

FORWARD-LOOKING STATEMENTS

This annual report to our stockholders includes forward-looking statements as well as historical facts. These forward-looking statements include statements relating to the Syntroleum gas-to-liquids process and related technologies, gas-to-liquids plants based on the Syntroleum process, anticipated costs to design, construct and operate such plants, the timing of commencement and completion of the design and construction of such plants, obtaining required financing for such plants, the economic construction and operation of gas-to-liquids plants, the value, markets for and other characteristics of products produced by such plants the continued development of the Syntroleum process (alone or with partners), anticipated capital expenditures, anticipated revenues, the sale of Syntroleum's real estate inventory and any other statements regarding future growth, cash needs, operations, business plans and financial results. When used in this document the words "anticipate," "believe," "estimate," "expect," "intend," "may," "plans," "project," "should," and similar expressions are intended to be among the statements that identify forward-looking statements. Although Syntroleum believes that the expectations reflected in these forward-looking statements are reasonable, such statements involve risks and uncertainties and actual results may not be consistent with these forward-looking statements. Important factors that could cause actual results to differ from these forward-looking statements include the potential that the cost of designing and constructing commercial-scale gas-to-liquids plants will exceed current estimates, commercial-scale gas-to-liquids plants will not achieve the same results as those demonstrated on a laboratory or pilot basis or that such plants will experience technological and mechanical problems, the potential that improvements to the Syntroleum process currently under development may not be successful, the impact on plant economics of operating conditions (including energy process), competition, intellectual property risks, Syntroleum's ability to obtain financing and other risks described in this annual report.

SIGNIFICANT SYNTROLEUM ACHIEVEMENTS IN 1998 INCLUDED:

- Licensing the Syntroleum Process to Kerr-McGee.
- Licensing the Syntroleum Process to Enron.
- Beginning development of a specialty products plant with Enron.
- Expanding research and development laboratories and acquiring land for future pilot plant expansions.
- Merging with SLH Corporation, which resulted in Syntroleum becoming a public company with more ready access to greater capital resources.
- Developing, with Marathon and AGC, a new low Btu combustion technology for turbines.
- Initiating efforts to certify synthetic fuels made via the Syntroleum Process as alternative fuels under the Energy Policy Act.
- Signing agreement with DaimlerChrysler for testing of Syntroleum "designer fuels" for new generation of compression-ignition engines.
- Adding significantly to our technical staff.

SYNTROLEUM'S CURRENT PARTNERS AND THEIR CONTRIBUTIONS:

PARTNERS	SYNGAS	FT SYNTHESIS CATALYST	DEVELOPMENT REACTOR	HEAT INTEGRATION	PROCESS DESIGN	OTHER
TEXACO		●	●		●	
ARCO	●	●	●	●	●	
MARATHON				●		
BATEMAN				●	●	
CRITERION		●				● ISOM
KELLOG BROWN & ROOT	●		●	●	●	
AMEC					●	
GE				●		
CATALYTICA		●		●		
AGC				●		
LYONDELL						● ISOM
KERR-McGEE						● HYRDO-CRACKING
DAIMLERCHRYSLER						● FUELS



Clear, Clean Syntroleum Fuel



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