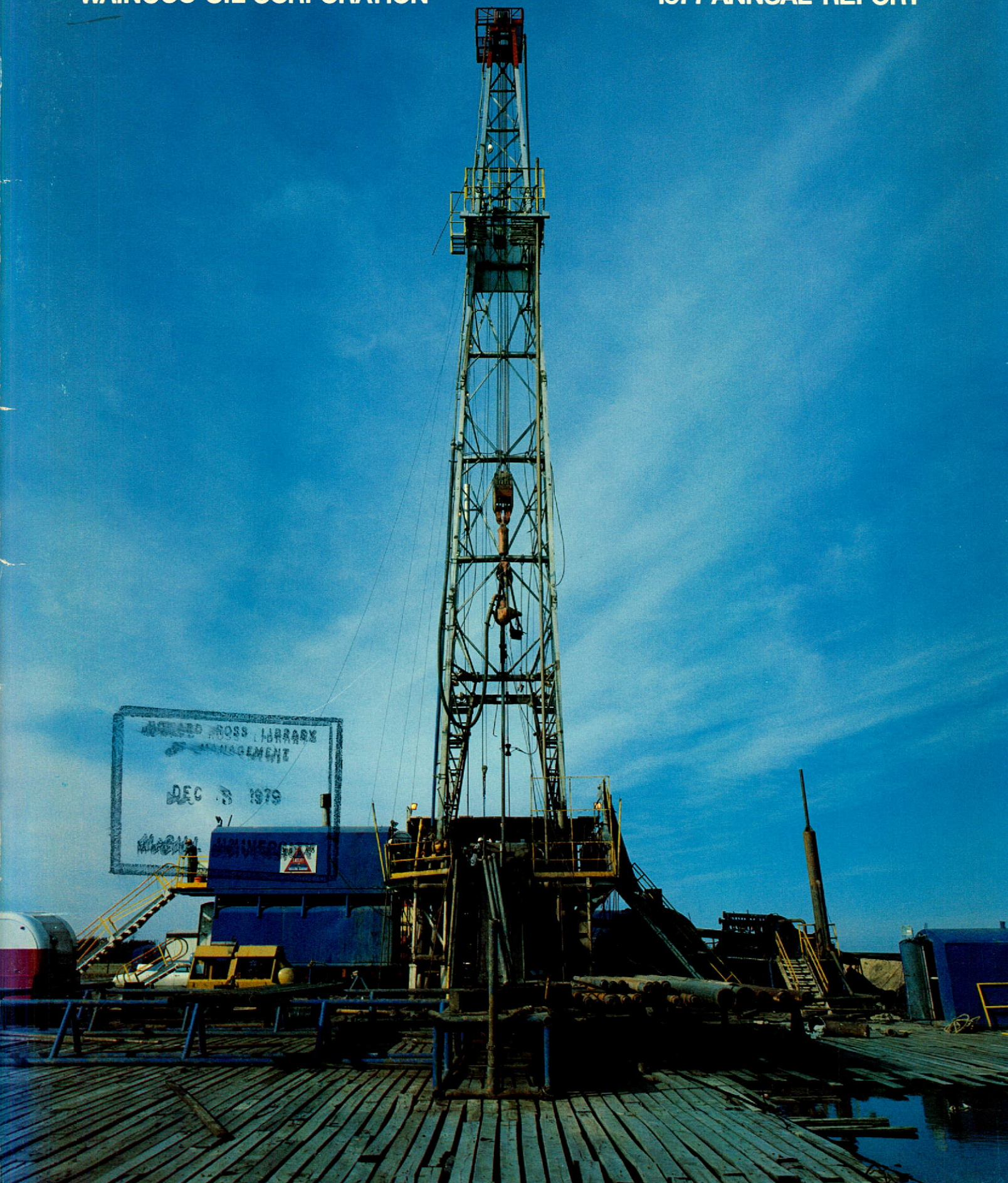


WAINOCO OIL CORPORATION

1977 ANNUAL REPORT





## THE COMPANY'S BUSINESS

Wainoco Oil Corporation explores for and produces oil and gas in the United States and Canada. Hydrocarbon reserves are acquired through drilling and by acquisition of producing properties. Operations are conducted through public limited partnerships as well as for the Company's own account.

## COVER

Drilling on the Wainoco-Celia  
Tupper Buller #2, Jefferson  
Davis Parish, Louisiana

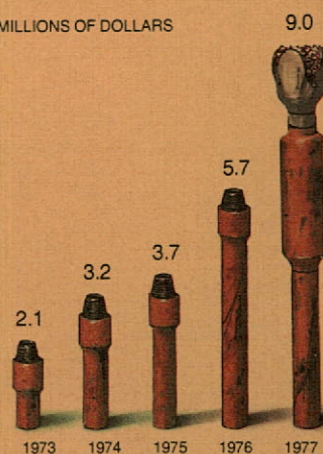
## CONTENTS

Five years of growth . . . .	1
Letter to Shareholders . .	2
Review of operations . . .	4
Financial review . . . . .	12
Summary of operations . .	16
Financial statements . . . .	18
Report of independent public accountants . . .	31
Corporate information . .	32



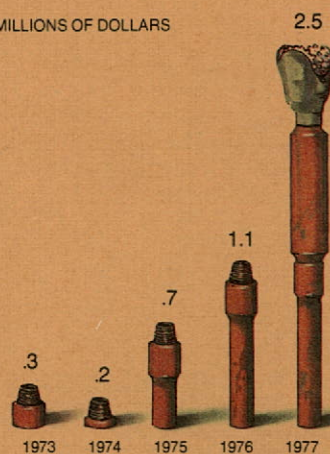
## REVENUE

MILLIONS OF DOLLARS



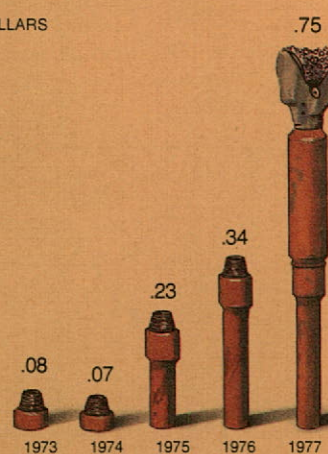
## NET INCOME

MILLIONS OF DOLLARS



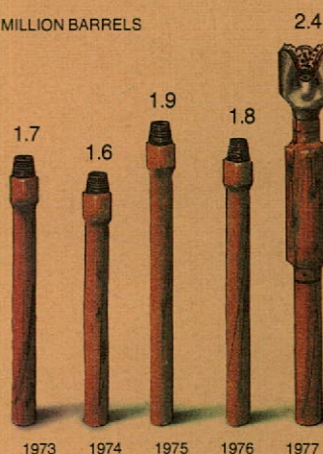
## EARNINGS PER SHARE

DOLLARS



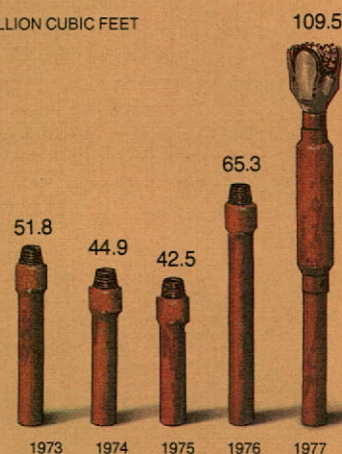
## OIL RESERVES

MILLION BARRELS



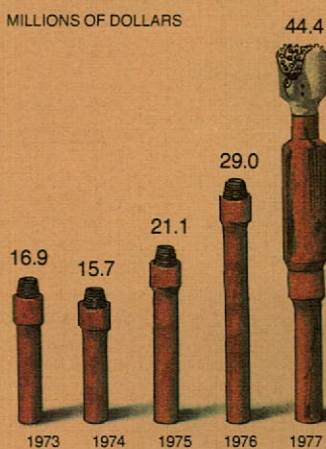
## GAS RESERVES

BILLION CUBIC FEET



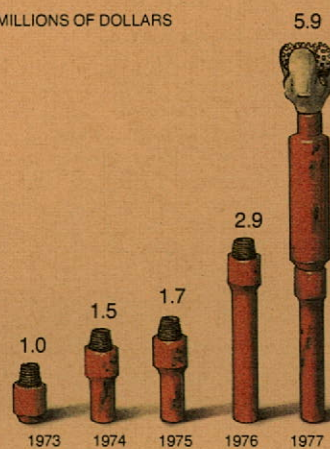
## TOTAL ASSETS

MILLIONS OF DOLLARS



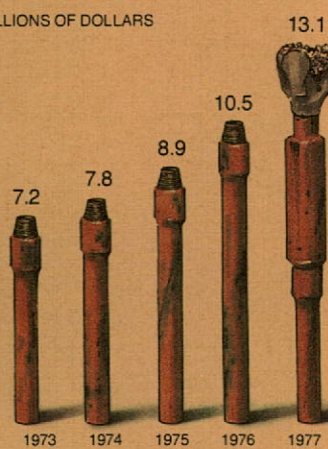
## FUNDS PROVIDED BY OPERATIONS

MILLIONS OF DOLLARS



## STOCKHOLDERS' EQUITY

MILLIONS OF DOLLARS





## LETTER TO THE SHAREHOLDERS

1977 was an eventful and an excellent year for Wainoco. Financial records resulted from increased sales and higher prices of oil and gas as well as from improved operations. Funds raised for drilling partnerships and for corporate purposes reached new high levels. Exploration and development drilling produced several new discoveries and important extensions of existing fields. Reserves of oil and natural gas were appreciably larger at year end, and production of natural gas was substantially increased. Recognition of the year's progress was evidenced through a quadrupling of trading activity in the Company's common stock.

Records achieved this past year will reflect in continued improvement for 1978. In addition to anticipated increases in revenues, earnings, and cash flow, capital spending will reach new highs.

Revenues were \$9,002,000, an increase of 58% over \$5,709,000 in 1976. The profit margin before tax was 38%, or double that of the prior year. Net income from continuing operations was \$2,472,000, or 133% higher than \$1,063,000 reached in 1976. Earnings per share of \$.75 from continuing operations were 121% higher than those of \$.34 in the previous period.

Three separate financings were completed in 1977. Two of these were offerings of subscriptions to registered limited partnerships organized for drilling operations. In the second quarter, \$15,000,000 of subscriptions were sold in the U.S. to fund a drilling program conducted in the southwestern states. In the last quarter of the year \$3,050,000 of subscriptions were sold in Canada for drilling in Alberta and British Columbia. The third financing consisted of the September sale of \$10,000,000 of 8% Convertible Subordinated Debentures due in 1992 and convertible into common stock at \$9 $\frac{5}{8}$  per share.

Wainoco participated in the drilling of 124 wells during the year, expending \$10,800,000 of corporate funds over and above the \$18,050,000 raised from limited partner subscriptions.

Of the wells drilled, 16 were completed as oil wells, 66 were completed as gas wells, and 42 were abandoned. Successful drilling in conjunction with Wainoco 77 Company, our U.S. limited partnership, included five key discoveries in southern Louisiana and south Texas. Canadian drilling, in addition to finding new production, developed larger oil reserves in the West Eagle field and greatly expanded the producing limits of the Monias gas field in British Columbia. The growing size and capacity of the Monias field, which is scheduled for initial production this summer, and Wainoco's 19,106 acre position in the area give it an important role in the Company's future.

Wainoco's proved reserves of crude oil increased 30% to 2.4 million barrels at December 31, 1977. Proved natural gas reserves at the same date were 109.5 billion cubic feet, some 68% higher than a year before. Annual production of natural gas increased from 4.5 to 5.7 billion cubic feet, or approximately 27%. The average price received for natural gas during 1977 rose from \$.63 to \$1.05 per thousand cubic feet.

Plans for 1978 include the registration with the Securities and Exchange Commission of \$20 million in subscriptions to a limited partnership for drilling in the U.S. Our second limited partnership in Canada will be registered for the sale of \$10 million in subscriptions to be used for Canadian drilling. Both offerings will be by prospectus only. A capital expenditure budget of \$25 million has been established for Wainoco to provide its share of partnership expenditures as well as other corporate exploration and development requirements. The present staff of 120 employees, now double the size of a year ago, is being expanded to implement our further growth plans.


The Company's primary areas of 1978 exploration will remain in the U.S. gulf coast and in western Canada. We continue, however, to develop capabilities in other oil and gas regions. Wainoco assembled a play late

last summer to test a deep structure in the Anadarko Basin of Oklahoma. The test well, in which Wainoco will retain a 20% interest, is to commence drilling in April to a projected depth of 24,000 feet. Wainoco was recently awarded a 20% interest in a 5.2 million acre concession located on the northwest shelf of Australia. Seismic evaluation will be conducted as a first step in exploring this permit which lies in the Bonaparte Gulf, 90 miles off the northern shore of Western Australia in 150 to 300 feet of water. Permit acquisitions and extensive exploration and drilling plans by several other companies along 1000 miles of Western Australia's coastline point to considerable action in the next few years.

Our favorable outlook for Wainoco is buoyed by numerous accomplishments and events since present management assumed control of the Company's operations 10 years ago. Early drilling successes are now being translated into cash flow as a majority of our properties have access to market. The building of a staff strong in exploration and production expertise has rewarded us with a growing number of discoveries and reserves. The financial base built by our production and reserves has provided a sound position from which to further Wainoco's development as an independent producer of two of the current world's most needed commodities — crude oil and natural gas.

The interest and support of an increasing number of shareholders is highly welcomed and regarded. Our employees are to be commended for their efforts and dedication in advancing Wainoco through this great past year of growth.

On Behalf of the  
Board of Directors,



John B. Ashmun,  
President

March 17, 1978







## REVIEW OF OPERATIONS • UNITED STATES

### EXPLORATION

Wainoco had a hallmark year in 1977. Activity in the United States was up for the year with increased drilling and a record number of significant completions. Concentration of exploration was in the gulf coast regions of Texas and Louisiana. The Company, on behalf of itself and its limited partnerships, expended a total of \$21,400,000 for exploration and development. Of this amount, \$5,600,000 was Wainoco's corporate share. A total of 48 wells were drilled of which 25 were in Texas, 13

in Louisiana, 2 in Mississippi, 2 in Kansas, 2 in Oklahoma and 4 in New Mexico. The results of this drilling were gratifying, with 5 successful oil wells and 20 successful gas completions of the total 48 drilled. The Company also supported the drilling of 12 wells by way of farmout or option.

**Louisiana** - In Jefferson Davis Parish, Louisiana, immediately west of the Elton South Field, a dual completion was made in the Tertiary Frio sand at 9,300 feet. The discovery well, the Wainoco

No. 1 Tupper Buller, encountered four Homeseekers sands with a combined net pay of 62 feet. The initial completion was made in the "D" sand which flowed oil at a daily rate of 549 barrels. This zone has recently been dually completed with the "C" sand which flowed at the rate of 6.1 million cubic feet of gas and 249 barrels of condensate per day. Two confirmation wells have been drilled on this property, and a fourth is now underway. The No. 2 Tupper Buller, immediately east of the discovery, was dually completed in the Homeseekers series "A" and "B" sands for a combined daily flow rate of 8.5 million cubic feet of gas and 553 barrels of condensate. Completion of the third well drilled west of the discovery is now being made in a fifth sand, the Tweedel. Wainoco owns a 29% revenue interest in the wells and in the 1,420 acre lease block. Additional development is planned for 1978.

In Cameron Parish, three miles southwest of Second Bayou Field, a significant discovery was made in the 12,000 foot Lower Abbeville Sands of the Tertiary. The discovery, State Tract 6930

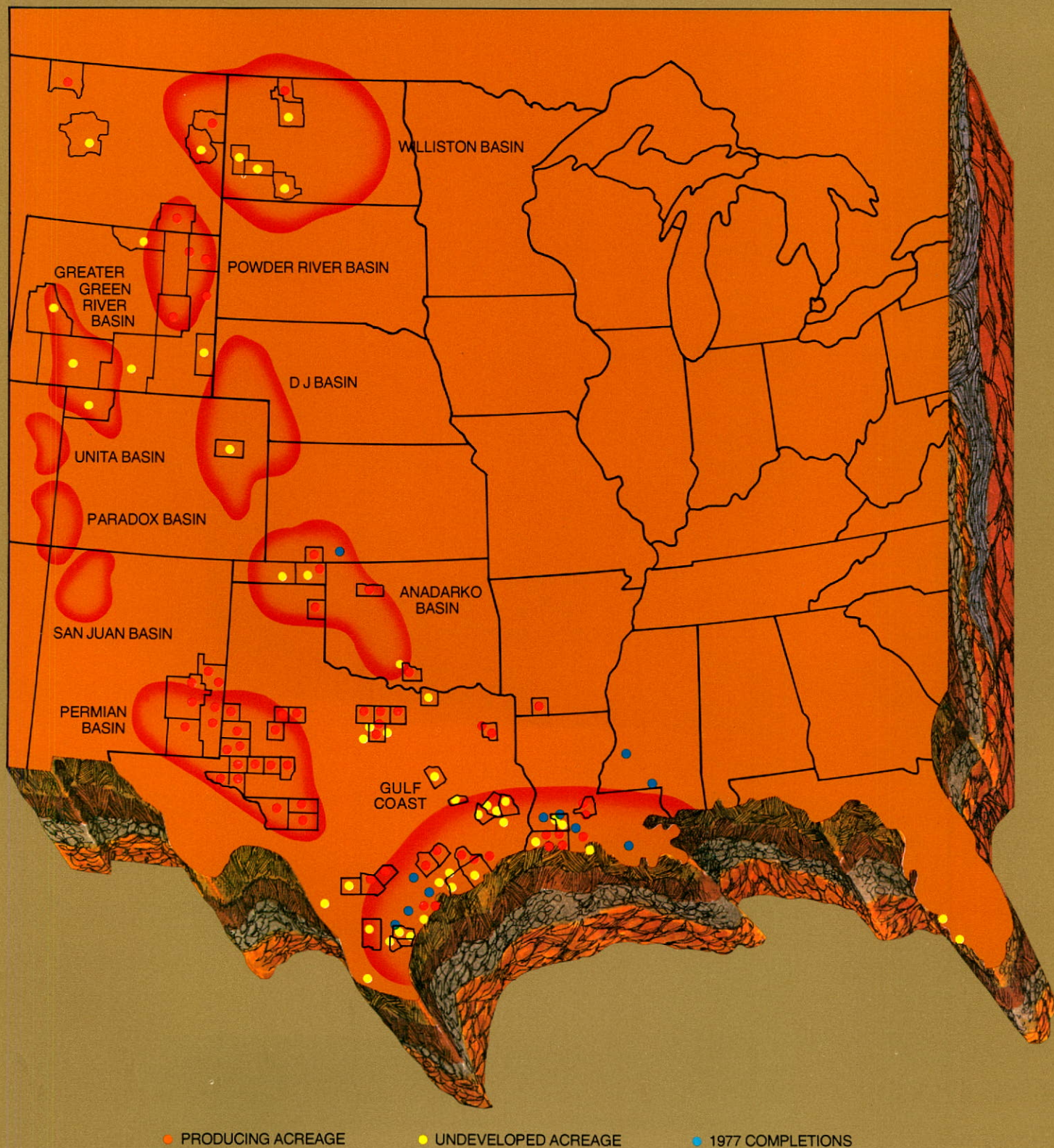
### STATISTICAL SUMMARY UNITED STATES OPERATIONS

	1976	1977
Exploration and development		
Wells drilled .....	44	60
Wells completed as producers	24	35
Production		
Oil and condensate-barrels ..	241,000	231,000
Gas-MMCF .....	1,480	2,208
Proved reserves		
Oil and condensate-barrels ..	1,071,000	1,268,000
Gas-MMCF .....	8,182	10,851
Acreage holdings		
Gross acres .....	428,000	465,000
Net acres .....	118,000	127,000





## WAINOCO AREAS OF INTEREST





No. 1, encountered two productive sands with a combined net pay thickness of 52 feet. The well was dually completed with the "A" sand flowing 9.2 million cubic feet of gas and 204 barrels of condensate per day, and the "B" flowing 7.6 million cubic feet of gas and 192 barrels of condensate per day. Wainoco owns a 15% revenue interest, before payout, in this well and the surrounding 2840 acres. The first of two development wells was spudded in March, 1978.

Development continued in a Cameron Parish, Louisiana field discovered by Wainoco in 1976. The Ocean View Beach Field is producing from

Terrebonne Parish, a gas and an oil well in Vermilion Parish and a second gas producer in Calcasieu Parish.

**Texas** - On the Texas coast near the city of Galveston, the Company participated in a Frio sand discovery two miles southwest of North Point Bolivar Field. The discovery well drilled at Pelican Island was completed from 25 feet of "Big Gas" sand at 11,800 feet. The well flowed oil at a rate of 960 barrels per day plus 900 million cubic feet of gas. An offset confirmation well to the northeast of the discovery was commenced in March, 1978. Wainoco owns a 15% revenue interest, until payout, in the well and 640 acres under the

million cubic feet of gas per day plus 92 barrels of condensate. Wainoco owns a 30% revenue interest in this well and 1411 acres of leases.

## PRODUCTION

During 1977, production attributable to the Company's United States properties totaled 231,000 barrels of oil and natural gas liquids and 2,208 million cubic feet of gas. This compares to 1976 production of 241,000 barrels and 1,480 million cubic feet. The large increase in gas production was primarily due to the June, 1977 commencement of gas deliveries from the Ocean View Beach Field. During the year facilities were completed and production began on 17 properties drilled in Texas, Louisiana and Kansas.

## LAND

Wainoco owned at year end a total of 465,000 gross and 127,000 net acres in the United States. This compares with 428,000 gross and 118,000 net acres held in 1976. The increase in holdings was mainly in the gulf coast area where exploration efforts will continue to be concentrated in 1978.

## PERSONNEL

To provide for an expanding exploration budget and to meet increased demands for installation and operation of production facilities, Wainoco has enlarged its technical staff in the Houston Division. The Company now has seven geologists, a geophysicist and three landmen. In the engineering and production section, the staff has been increased to seven engineers with support personnel and two area production superintendents in district field offices in Lafayette, Louisiana and Corpus Christi, Texas. Plans for 1978 include further additions to the technical staff in both departments. The Company has prepared to move into larger new downtown Houston offices in late 1978.



the 11,000 foot Lower Abbeville sands of the Miocene. A third well was drilled in the summer as an eastern extension and added considerably to the field's proven reserves. This well found a field pay, the Abbeville "A" sand, to be productive 375 feet low to the discovery well. The three wells are currently producing at a combined rate of 22 million cubic feet of gas and 325 barrels of condensate per day. Wainoco owns a 9% revenue interest in these wells and the 2200 surrounding acres.

Other successful 1977 completions in south Louisiana include a gas well in

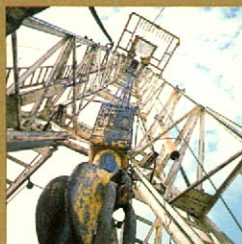
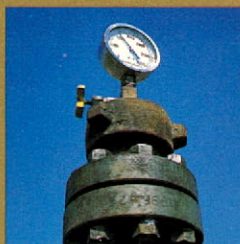
prospect.

In south Texas the Company completed gas wells on four prospects, two of which are scheduled for development drilling in 1978.

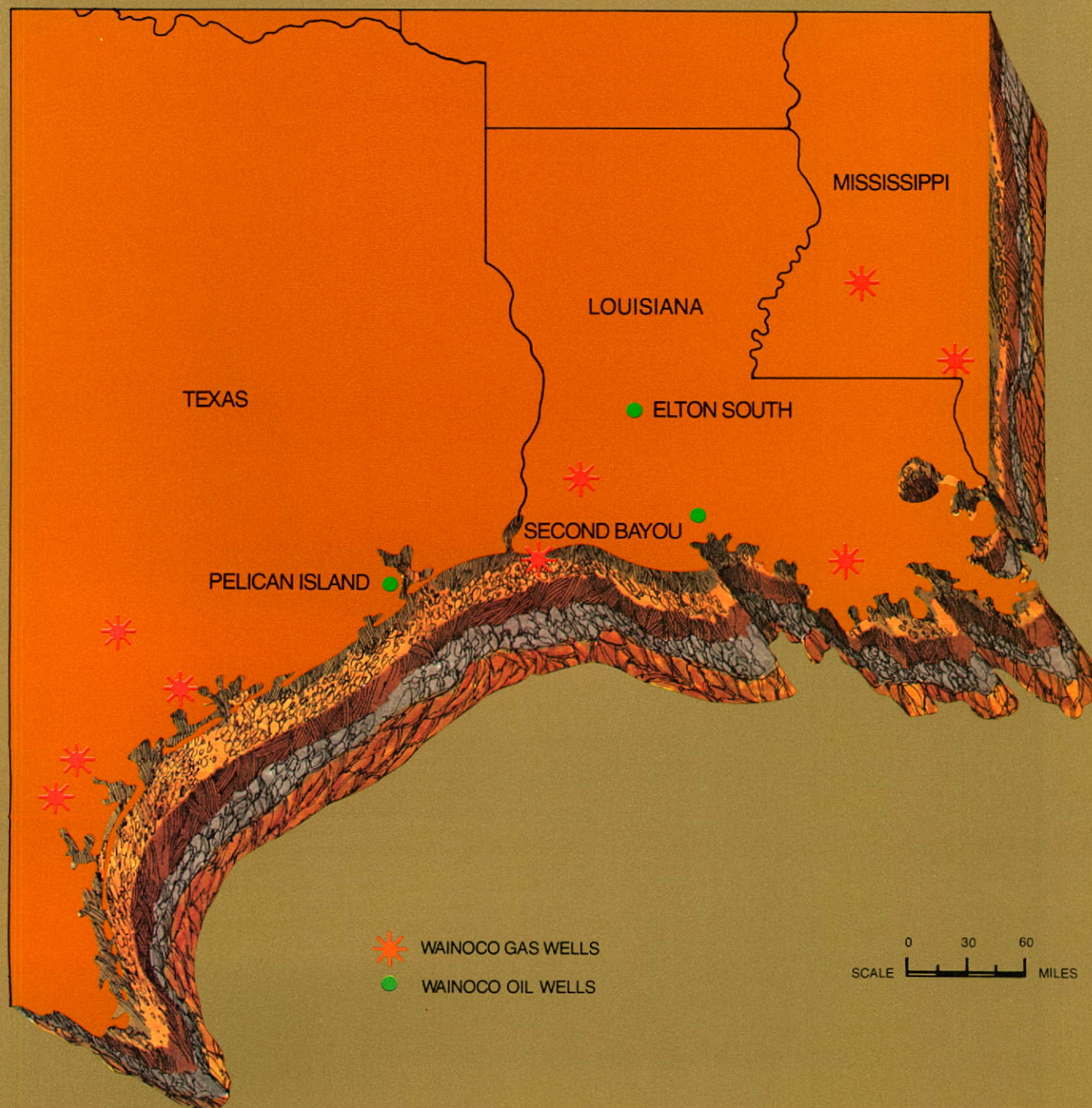
In Dewitt County, the No. 1 Felix Bade flowed from the 10,200 foot Lower Wilcox sand at a rate of 3.6 million cubic feet of gas and 64 barrels of condensate per day. The Company owns a 28% revenue interest in this well and the surrounding 938 acres.

In San Patricio County, north of Corpus Christi, Texas, the 10,300 foot No. 1 Shirley Taylor flowed gas from the Frio sand at a rate of 1.9





## WAINOCO 1977 EXPLORATION ACTIVITIES





## CANADA

Major increases in oil and gas revenues and reserves, the formation of a Canadian limited partnership, and the enlargement of Wainoco's staff highlighted a year of accomplishment in Canada. The Company expended \$7,200,000 for exploration and development operations, of which \$5,200,000 was the corporate share and \$2,000,000 was spent on behalf of limited partnerships. There were 64 wells drilled in 1977, of which 39 were in Alberta and 25 in British Columbia. Forty-one were completed as gas wells and six as oil wells.

**Alberta** - Wainoco, partici-

pating with its 1977 Canadian limited partnership, drilled 19 shallow gas wells in the Jenner area of southeastern Alberta. The wells average 1900 feet in depth and have potential gas-bearing sands in the Milk River, Medicine Hat and Second White Specks formations. The interest owned by Wainoco and the partnership in the wells and 6400 acres of leases is 100%, converting to 84% following payout. Gas reserves from wells in this area are typically produced at low rates of deliverability over a period of many years. A market for newly found gas in Alberta is

not expected until 1980 because of the present excess of gas in the province. Government restriction of exports and increasing development of new gas reserves are the principal causes of this surplus.

At north Pembina, 60 miles west of Edmonton, the Company owns 1280 acres of leases in the significant Pembina Devonian Reef oil trend discovered in 1977. Wainoco's leases are 34 miles northeast of the discovery well in the trend and six miles northeast of another significant discovery more recently reported. The play is cited as the most significant to occur in Alberta in the past decade as evidenced by prices up to a record \$20,500 per acre having been paid for leases at government sealed bid sales. Two and one-half miles to the southwest of our block, \$13,000 per acre was paid for 960 acres of leases, and cornering our land to the northeast, \$5,003 per acre or \$3,202,348 was paid for 640 acres. Wainoco is conducting a seismograph study to help determine the potential for drilling on these lands.

**British Columbia** - The outstanding property in Wainoco's Canadian opera-

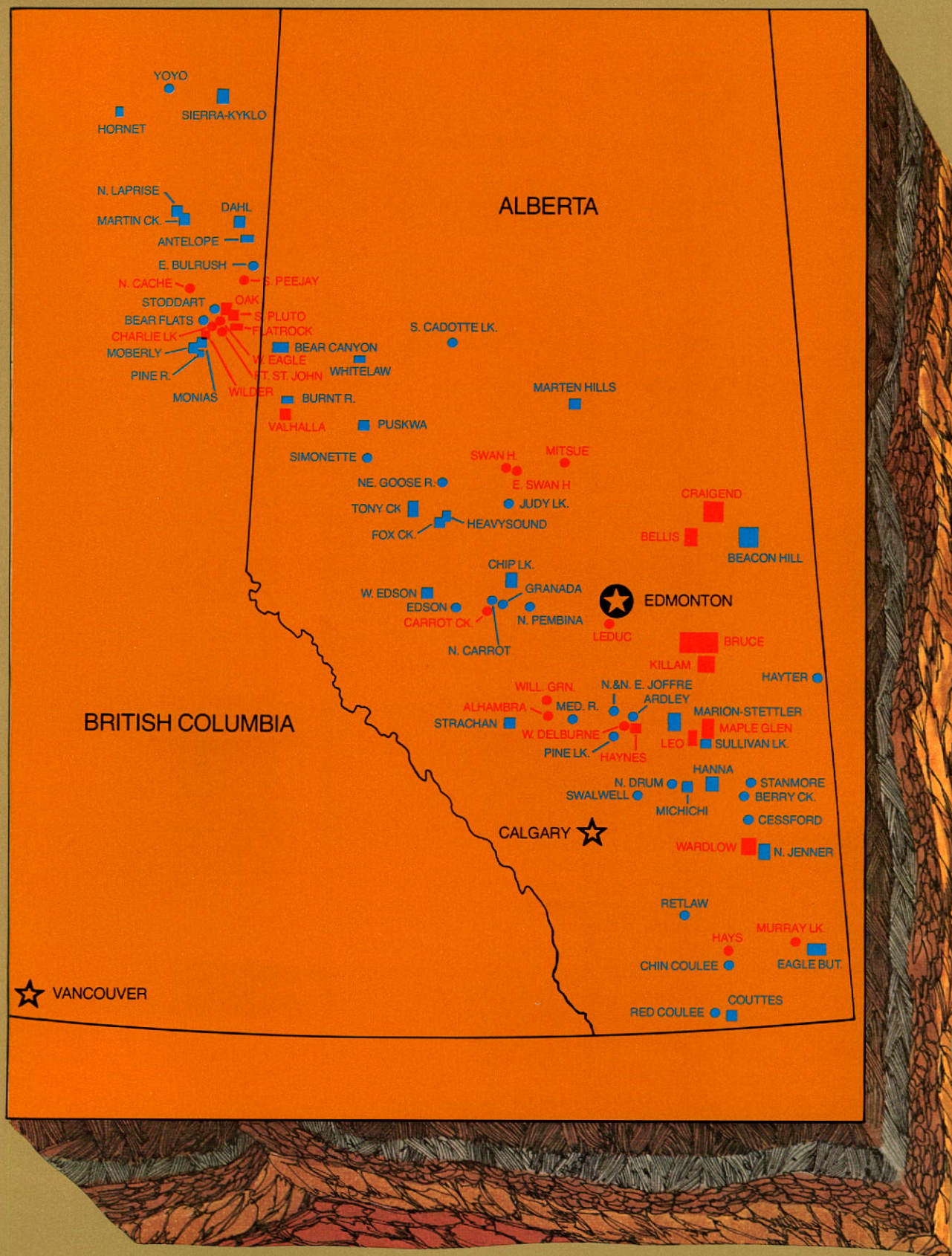
### STATISTICAL SUMMARY CANADIAN OPERATIONS

	1976	1977
Exploration and development		
Wells drilled .....	80	64
Wells completed as producers ..	69	47
Production		
Oil and condensate-barrels ....	91,000	84,000
Gas-MMCF .....	3,010	3,509
Proved reserves		
Oil and condensate-barrels ....	736,000	1,083,000
Gas-MMCF .....	57,072	98,664
Acreage holdings		
Gross acres .....	970,000	706,000
Net acres .....	255,000	242,000





## ACREAGE POSITION IN WESTERN CANADA



■ PRODUCING PROPERTIES

PRODUCING: GROSS 212,000/71,000 NET ACRES

■ NON-PRODUCING: GROSS 494,000/171,000 NET ACRES



tions is the developing Monias gas field 18 miles southwest of Fort St. John. The Company participated in five successful gas wells on this property during 1977 and now has interests ranging from 20% to 100% in eight potential producers. Proven reserves assigned to the Company's Monias wells are presently 49.5 billion cubic feet of gas, an increase of 37.5 billion cubic feet over last year. An 8-inch pipeline scheduled for completion in April is under construction from Monias to the sales delivery point near Fort St. John. Wainoco's expected daily delivery

resulted in an oil producer which tested 864 barrels per day and the second was a gas well which flowed at a daily rate of 2.5 million cubic feet. Wainoco and the partnership own a 100% interest in the oil well plus 1926 acres of leases, and a 50% interest in the gas well and 1920 acres of leases around it.

At West Eagle, four miles north of Fort St. John, a 1976 oil discovery was followed in 1977 by three successful development wells. These wells are each producing an average of 150 barrels of oil per day from the Permian Belloy formation at

similar to those which Wainoco sponsors in the U.S. was formed and subscriptions totaling \$3,050,000 were sold to 276 limited partners throughout Canada. The improved economics of oil and gas production in Canada, and changes favoring the tax treatment of individuals and entities expending funds for drilling were instrumental factors influencing the formation of this partnership. To date the partnership has drilled 29 wells, including 24 gas and two oil wells, with drilling presently under way on three remaining prospects. Present plans call for the registration of a \$10 million partnership in Canada for 1978.

**Pricing** - Over the year, the price received for new gas in British Columbia increased from \$.85 to \$1.03 per thousand cubic feet, royalty free, and the oil price increased from \$9.50 to \$11.50 per barrel with an average royalty of 25% on new oil. Over 90% of Wainoco's gas in the province qualifies as new gas. In Alberta, the gas price was increased from \$1.45 to \$1.70 per thousand cubic feet in 1977, subject to an average new gas royalty of 32%, and the oil price rose from \$10 to \$12 per barrel subject to an average new oil royalty of 29%. Additionally, Alberta provides various drilling incentive credits to help defray the costs of exploratory wells.

**Personnel** - To complement increased drilling and production operations, Wainoco has increased the size of its technical staff in Canada and moved its office to larger quarters. Presently the Company has 27 Canadian employees, including 6 geologists, 6 engineers, and 2 land personnel. Present plans call for further expansion in 1978.



through the line is estimated at between 10 and 12 million cubic feet of gas, royalty free. Two 100% wells have been licensed to be drilled by the Company in the second quarter of 1978 with additional drilling possible later in the year. Wainoco owns 19,106 net acres in a 40,896 acre block at Monias.

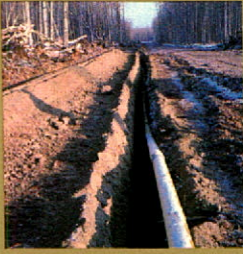
In the Flatrock area, 12 miles east of Fort St. John, Wainoco and its 1977 Canadian partnership participated in two successful prospects which are productive in the Triassic formation at a depth of approximately 5000 feet. The first well

approximately 6000 feet. Wainoco has a 33 1/3 % interest in the four wells on this property and additional development is planned in 1978.

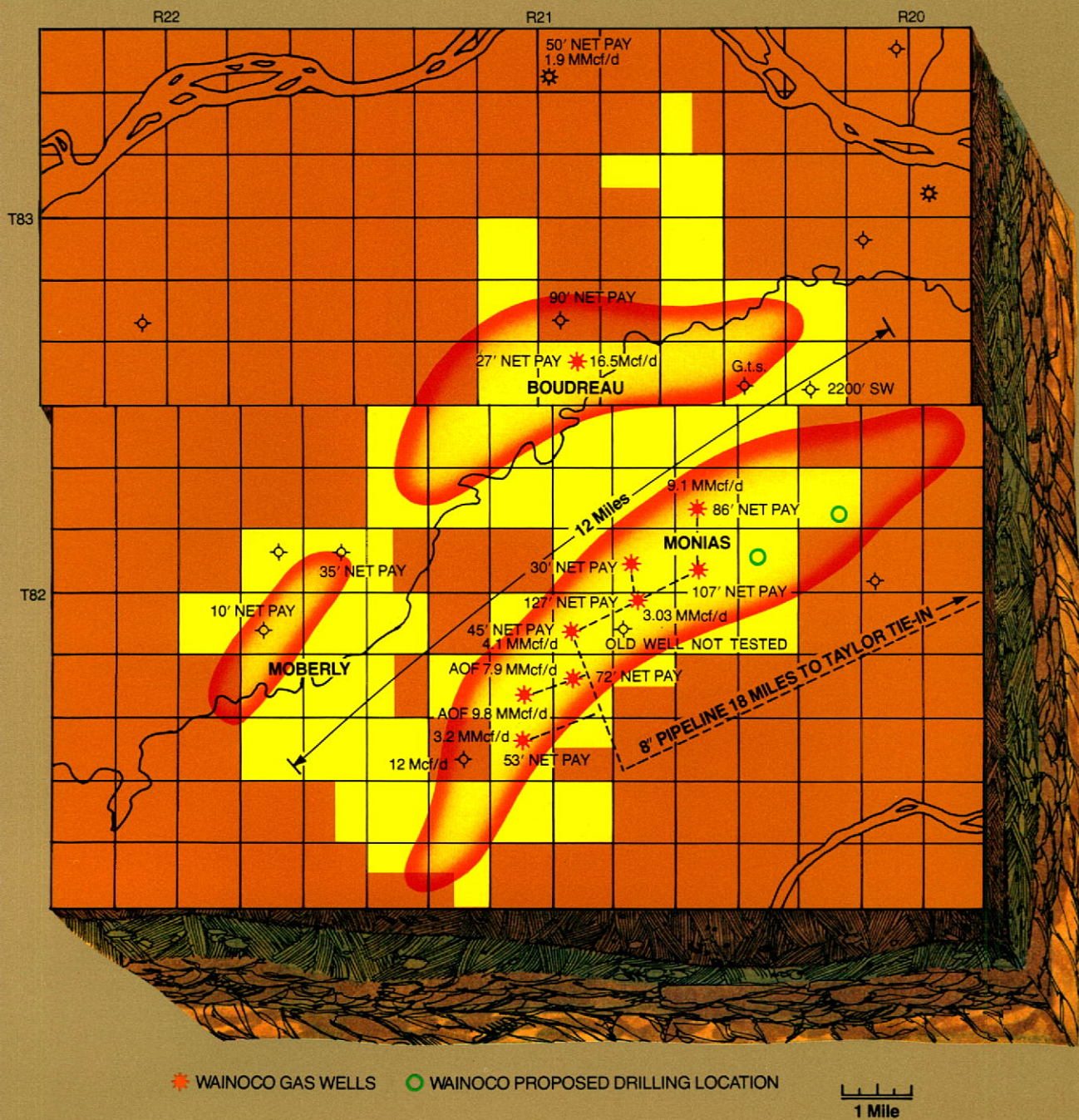
A successful step-out well was recently drilled on the Company's North Cache property in conjunction with its Wainoco 74B limited partnership. This is the third well on the property and three additional development wells are planned in 1978. Wainoco and the partnership own an average interest of 34% in the wells and in 4506 acres of leases.

**Wainoco 77 Canada** - An Alberta limited partnership





## MONIAS AREA HALFWAY STRUCTURE





## FINANCIAL REVIEW

### REVENUES AND EARNINGS

New records for oil and gas revenues, profit margins, and earnings were established in 1977. Revenues increased 58% over the 1976 level as a result of increased gas production and higher prices for both oil and gas. Due to higher levels of operating activity and added personnel, all of the costs of operation increased over those of the previous year. In

deferred due to the Company's increasing capital expenditures. Net income from continuing operations of \$2,472,000 represents a 133% increase over the \$1,063,000 recorded last year. The after tax profit margin increased from 19% in 1976 to 27% in 1977. The primary earnings per share from continuing operations increased 121% from \$.34 in 1976 to \$.75 in 1977.

the Monias gas field where \$1.2 million was expended on drilling and the construction of pipelines and production facilities. During the year the Company continued to increase its lease inventory and at December 31, 1977, had \$2.9 million invested therein.

For 1978 a capital budget of \$25 million has been established.

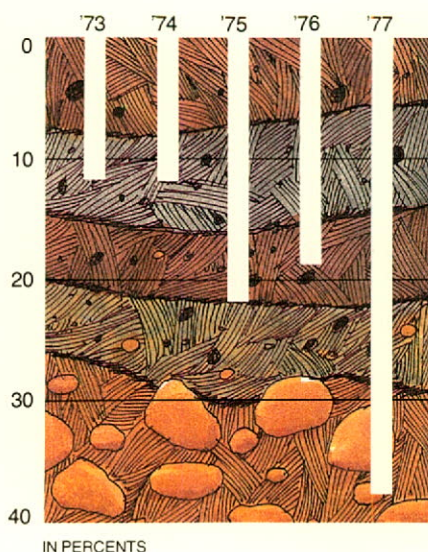
### CORPORATE FINANCING

In September, the Company completed its first public corporate financing since its founding with an issue of 8% Convertible Subordinated Debentures due in 1992. The bonds, which are convertible into common shares at \$9.625, were sold by a syndicate of forty-seven national and regional investment banking firms, and are listed for trading on the American Stock Exchange.

Wainoco had relied upon internally generated cash flow and commercial bank credit lines to fund its capital expenditures. Although these sources had been satisfactory to support its operations, during 1977 it was necessary to provide supplemental financing to continue an aggressive growth program.

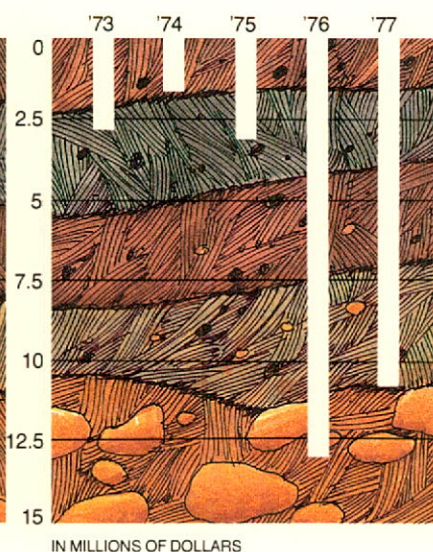
The proceeds of the debenture offering were utilized to retire certain commercial bank loans, and the then existing credit lines were reduced at Wainoco's request in order to provide for only near-term credit requirements. During 1977, some 54% of the \$10.8 million in capital expenditures was financed by internally generated cash flow; during 1978, it is anticipated that internally generated funds will provide for 55-60% of the \$25 million budget. Based on existing credit lines, and upon increased oil and gas reserves which may be

PROFIT BEFORE TAX AS A PERCENT OF REVENUE



IN PERCENTS

CAPITAL EXPENDITURES



IN MILLIONS OF DOLLARS

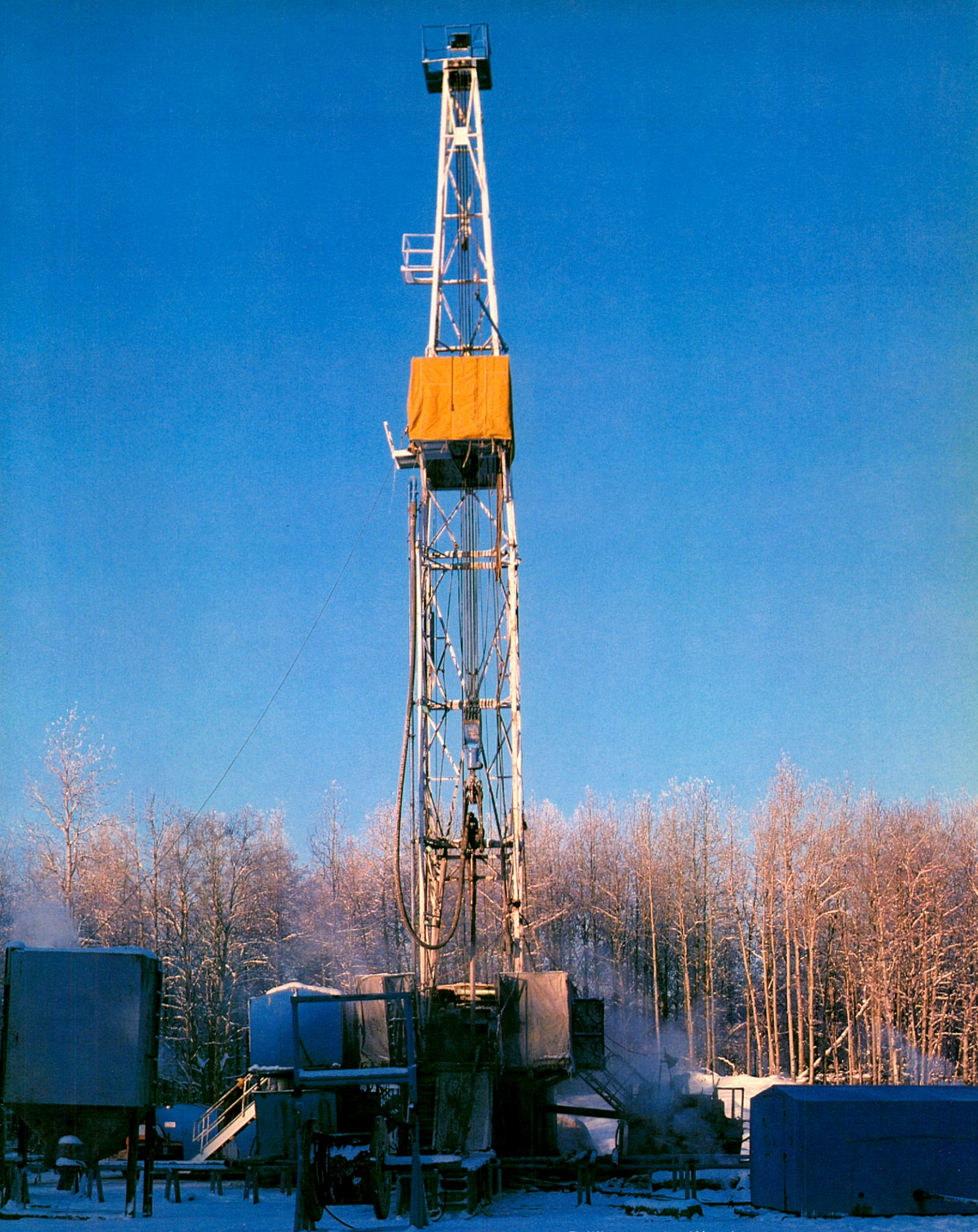
the aggregate, costs increased 21% over those of 1976; however, when compared to the revenue increases, a pre-tax profit margin of 38% of revenues doubled last year's margin of 19%. The higher profit margin is the result of higher product prices and lower operating costs of recently discovered wells placed on production.

Pre-tax earnings increased threefold over the 1976 level. The higher earnings required a consolidated tax provision of 27%, most of which was

### CAPITAL EXPENDITURES

During 1977 the Company expended \$10.8 million on oil and gas exploration and development. The Company expended \$5.6 million in the United States, most of which represented its investment in its partnerships. In Canada, \$5.2 million was expended. Of this figure, some \$.5 million represented investments in partnerships while the balance represented exploration and development expenditures on corporate properties. The largest concentration was in





Drilling on the Woods Wainoco Monias

6 - 26 - 82 - 21 W 6



pledged for additional loan advances, the Company has adequate liquidity and access to cash resources with which to finance its growth well into 1979.

### EXPLORATION FINANCING

Since 1970 Wainoco has received the majority of its exploration financing from public limited partnerships. Each partnership is organized,

In 1977, the Company's first Canadian partnership was formed. The subscriptions were sold only in Canada and the proceeds were expended for oil and gas exploration in the provinces of Alberta and British Columbia. It was among the first public limited partnerships to be offered in Canada.

In the eight year period from 1970 through 1977,

expenditures, will comprise a capital budget approaching \$55 million.

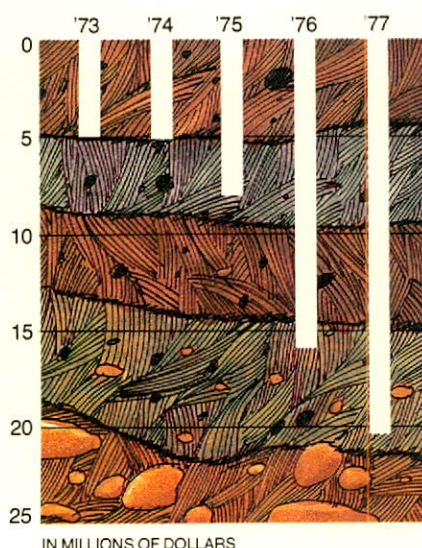
### SUCCESSFUL EFFORTS ACCOUNTING

In December, 1977, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 19 *Financial Accounting and Reporting by Oil and Gas Producing Companies* which requires that all oil and gas producers utilize a form of "successful efforts" accounting. Wainoco follows the "full-cost" method of accounting which provides for the capitalization of costs of acquisition, exploration, and development of oil and gas reserves. Under the "successful efforts" method of accounting, certain amounts, which are charged or credited to oil and gas properties under "full-cost" accounting, are recognized as current expenses or revenues.

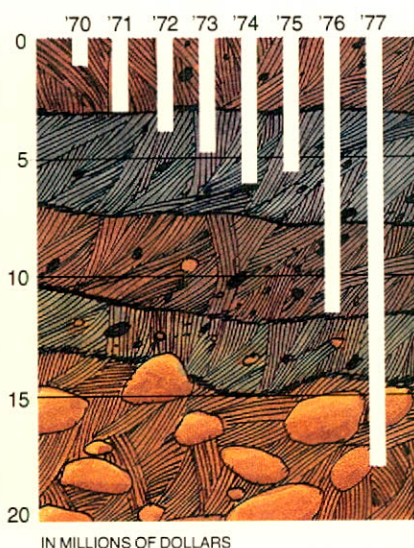
Wainoco does not agree with the concept of "successful efforts" accounting in that 1) it does not reflect the realities of the risks and economics of oil and gas exploration; 2) despite a comprehensive disclosure, it is potentially misleading to investors; and 3) it may have the effect of allocation of capital away from oil and gas exploration. We have actively opposed the change and will continue to do so until a final determination on its implementation is made.

Although we are opposed to the change, if it is implemented, we contemplate no changes in our operations, our capital spending plans, or our goals of increasing oil and gas reserves. The lifeblood of an oil and gas company consists of its reserves and its cash flow, neither of which will be affected by a change in financial reporting.

COMMERCIAL BANK CREDIT LINES



EXPLORATION FUNDS RAISED IN PUBLIC DRILLING PROGRAMS



offered for sale, and managed by the Company. The partnerships are registered with the Securities and Exchange Commission and the respective securities agency of each state where the partnership units are offered for sale. An investor in the partnership receives certain tax advantages as well as an interest in the production revenue and reserves. Wainoco serves as general partner, shares in the cost of successful wells, and receives an interest in the partnership properties.

Wainoco has formed eleven partnerships (two each in the years 1974, 1976 and 1977) and has raised a total of \$54.5 million. This exploration financing has provided a substantial exposure to exploration and development drilling and has afforded a means of achieving a rapid growth in oil and gas reserves.

During 1978 the Company plans a \$20 million partnership in the United States and a \$10 million partnership in Canada. If these partnerships are fully subscribed, the funds, when combined with corporate







## WAINOCO OIL CORPORATION AND SUBSIDIARIES

**SUMMARY OF OPERATIONS**

For the five years ended December 31, 1977

	<u>1977</u>	<u>1976</u>	<u>1975</u>	<u>1974</u>	<u>1973</u>
<b>Revenues</b> .....	<u>\$9,002,000</u>	<u>\$5,709,000</u>	<u>\$3,698,000</u>	<u>\$3,151,000</u>	<u>\$2,069,000</u>
<b>Expenses:</b>					
Oil and gas operating costs ..	<u>\$1,388,000</u>	<u>\$1,089,000</u>	<u>\$ 755,000</u>	<u>\$ 628,000</u>	<u>\$ 427,000</u>
General, administrative, and interest, net of interest cap- italized of \$179,000 in 1974, and \$298,000 in 1973 .....	<u>1,957,000</u>	<u>1,567,000</u>	<u>1,146,000</u>	<u>976,000</u>	<u>614,000</u>
Depreciation, depletion, and amortization .....	<u>2,275,000</u>	<u>1,778,000</u>	<u>970,000</u>	<u>932,000</u>	<u>784,000</u>
Mining prospects abandoned ..	<u>—</u>	<u>—</u>	<u>—</u>	<u>245,000</u>	<u>—</u>
Provision (credit) for losses on equipment inventory ...	<u>(23,000)</u>	<u>186,000</u>	<u>—</u>	<u>—</u>	<u>—</u>
	<u>\$5,597,000</u>	<u>\$4,620,000</u>	<u>\$2,871,000</u>	<u>\$2,781,000</u>	<u>\$1,825,000</u>
<b>Income from Continuing Opera- tions Before Income Taxes</b> ...	<u>\$3,405,000</u>	<u>\$1,089,000</u>	<u>\$ 827,000</u>	<u>\$ 370,000</u>	<u>\$ 244,000</u>
<b>Provision (Credit) for Income Taxes</b> .....	<u>933,000</u>	<u>26,000</u>	<u>91,000</u>	<u>171,000</u>	<u>(9,000)</u>
<b>Income from Continuing Opera- tions</b> .....	<u>\$2,472,000</u>	<u>\$1,063,000</u>	<u>\$ 736,000</u>	<u>\$ 199,000</u>	<u>\$ 253,000</u>
<b>Discontinued Operations:</b>					
Operating income .....	<u>\$ —</u>	<u>\$ 393,000</u>	<u>\$ 791,000</u>	<u>\$ 900,000</u>	<u>\$ 836,000</u>
Gain on sale .....	<u>—</u>	<u>396,000</u>	<u>—</u>	<u>—</u>	<u>—</u>
Less — Applicable income tax	<u>—</u>	<u>(353,000)</u>	<u>(395,000)</u>	<u>(450,000)</u>	<u>(418,000)</u>
	<u>\$ —</u>	<u>\$ 436,000</u>	<u>\$ 396,000</u>	<u>\$ 450,000</u>	<u>\$ 418,000</u>
<b>Income Before Extraordinary Item</b> .....	<u>\$2,472,000</u>	<u>\$1,499,000</u>	<u>\$1,132,000</u>	<u>\$ 649,000</u>	<u>\$ 671,000</u>
<b>Extraordinary Item</b> .....	<u>—</u>	<u>—</u>	<u>—</u>	<u>31,000</u>	<u>—</u>
<b>Net Income</b> .....	<u>\$2,472,000</u>	<u>\$1,499,000</u>	<u>\$1,132,000</u>	<u>\$ 680,000</u>	<u>\$ 671,000</u>
<b>Primary Earnings Per Share:</b>					
Income from continuing opera- tions .....	<u>\$ .75</u>	<u>\$ .34</u>	<u>\$ .23</u>	<u>\$ .07</u>	<u>\$ .08</u>
Income from discontinued op- erations .....	<u>—</u>	<u>.14</u>	<u>.13</u>	<u>.14</u>	<u>.13</u>
Income before extraordinary item .....	<u>\$ .75</u>	<u>\$ .48</u>	<u>\$ .36</u>	<u>\$ .21</u>	<u>\$ .21</u>
Extraordinary item .....	<u>—</u>	<u>—</u>	<u>—</u>	<u>.01</u>	<u>—</u>
Net income .....	<u>\$ .75</u>	<u>\$ .48</u>	<u>\$ .36</u>	<u>\$ .22</u>	<u>\$ .21</u>
<b>Fully Diluted Earnings Per Share</b>	<u>\$ .74</u>	<u>\$ .48</u>	<u>\$ .36</u>	<u>\$ .22</u>	<u>\$ .21</u>



## MANAGEMENT'S DISCUSSION AND ANALYSIS OF THE SUMMARY OF OPERATIONS

The following provides a brief explanation of certain financial information in the Summary of Operations. Reference is made to Note 1 to the Consolidated Financial Statements for a discussion of the accounting policies utilized in reporting the results of operations.

### 1977 COMPARED WITH 1976

#### REVENUES

Revenues from oil and gas sales increased 58% over 1976. Oil sales in barrels, decreased 5%, while the weighted average price received per barrel increased 13%. Gas sales, in thousands of cubic feet (MCF), increased 27%, while the weighted average price received per MCF increased 67%.

Interest income rose 44% based on the increased income received from short-term investments made throughout the year.

Other income, consisting of operations and supervision fees, increased 66% because of the accelerated operating activity in 1977.

#### EXPENSES

Oil and gas operating costs increased 27% as a result of higher production volumes of natural gas and inflationary cost increases.

General and administrative expense increased 18% due to a higher number of employees and to inflationary cost increases.

Net interest expense increased 33% over the level of 1976. The increase in gross interest expense was 16% resulting from higher loan balances throughout the year. The interest paid is partially offset by interest charged on advances to the Company's

limited partnerships; however, this amount decreased 16%.

Depreciation, depletion, and amortization increased \$497,000, or 28%, reflecting higher production volumes than in 1976.

#### EARNINGS

Income from continuing operations before income taxes increased from \$1,089,000 to \$3,405,000, or 213%. This figure, as a percentage of revenue, increased from 19% in 1976 to 38% in 1977.

An increase in the combined United States-Canadian tax rate from 2% to 27% is a result of greater profitability in both countries.

Net income from continuing operations increased by 133% from \$1,063,000 in 1976 to \$2,472,000 in 1977. When stated as a percentage of revenue, this figure increased from 19% to 27%.

Primary earnings per share from continuing operations went from \$.34 in 1976 to \$.75 in 1977, an increase of 121%.

### 1976 COMPARED WITH 1975

#### REVENUES

Revenues from oil and gas sales increased 57% over 1975. Oil sales, in barrels, increased 13%, while the weighted average price received per barrel increased 15%. Gas sales, in MCF's, increased 55%, while the weighted average price received per MCF increased 37%.

Interest income increased twofold as short-term investments were made throughout the year. The income from these investments represented approximately one-half of the interest income, the balance being the income received on the promissory note relating

to the sale of offshore properties.

#### EXPENSES

Oil and gas operating costs increased 44% due to increased production, inflationary cost increases, and major workover expenses on several wells.

General and administrative expense increased 7% due primarily to salary increases and personnel additions.

Depreciation, depletion, and amortization increased \$808,000, or 83%, reflecting a higher per-unit cost of exploration and development as well as increased production.

Interest expense increased 87% due to increased borrowings. The borrowings were used to acquire certain properties from three of the Company's partnerships. The interest charged to partnerships increased 51%, reflecting larger advances than in the previous year.

In 1976, a provision for losses on equipment inventory of \$186,000 was recorded. This provision was made to recognize the excess of cost over the market value of lease and well equipment inventory.

#### EARNINGS

Income from continuing operations before income taxes increased 32% over 1975.

A combined United States-Canadian tax rate of 2%, compared with 11% in 1975, recognized the accounting for certain tax credits implemented by regulations in Canada during the year.

Net income from continuing operations increased 44% over 1975.

Earnings per share from continuing operations increased from \$.23 to \$.34, or 48%.



WAINOCO OIL CORPORATION AND SUBSIDIARIES  
**CONSOLIDATED BALANCE SHEETS**

December 31, 1977 and 1976

(Note 1)

**ASSETS**

	<u>1977</u>	<u>1976</u>
<b>Current Assets:</b>		
Cash, including temporary cash investments of \$6,985,000 in 1977 . . . .	\$ 7,002,000	\$ 346,000
Accounts receivable —		
Joint operators, pledged (Note 3) . . . . .	3,299,000	2,201,000
Current portion of amounts due from associated partnerships (Note 6) . . . . .	1,624,000	862,000
Oil and gas sales (Note 3) . . . . .	846,000	777,000
Other . . . . .	395,000	184,000
Leases and equipment inventory, partially pledged, less allowance for inventory losses (Notes 3 and 6) . . . . .	2,917,000	1,731,000
Noninterest-bearing note receivable (Note 2) . . . . .	—	992,000
Other . . . . .	18,000	36,000
Total current assets . . . . .	<u>\$16,101,000</u>	<u>\$ 7,129,000</u>
<b>Property and Equipment, partially pledged (Note 3):</b>		
Oil and gas properties . . . . .	\$32,496,000	\$23,581,000
Furniture, fixtures, and other equipment . . . . .	430,000	430,000
	<u>\$32,926,000</u>	<u>\$24,011,000</u>
Less — Accumulated depreciation, depletion, and amortization . . . . .	8,451,000	6,288,000
	<u>\$24,475,000</u>	<u>\$17,723,000</u>
<b>Other Assets:</b>		
Unsecured note receivable, due in 1980, pledged (Note 3) . . . . .	\$ 1,487,000	\$ 1,487,000
Commissions and noncurrent advances to associated partnerships (Note 6) . . . . .	1,598,000	2,224,000
Debenture issue expense, net of amortization . . . . .	621,000	—
Noninterest-bearing note receivable (Note 2) . . . . .	—	225,000
Other . . . . .	92,000	219,000
	<u>\$ 3,798,000</u>	<u>\$ 4,155,000</u>
	<u>\$44,374,000</u>	<u>\$29,007,000</u>

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



**LIABILITIES AND SHAREHOLDERS' EQUITY**

	<u>1977</u>	<u>1976</u>
<b>Current Liabilities:</b>		
Short-term borrowings (Note 3) .....	\$ 8,599,000	\$ 1,796,000
Current maturities of long-term debt (Note 3) .....	1,200,000	2,600,000
Accounts payable and accrued liabilities .....	3,338,000	3,109,000
Oil and gas proceeds payable .....	1,923,000	515,000
Income taxes payable (Note 4) .....	<u>120,000</u>	<u>25,000</u>
Total current liabilities .....	<u>\$15,180,000</u>	<u>\$ 8,045,000</u>
 <b>Convertible Subordinated Debentures (Note 3) .....</b>	 <u>\$10,000,000</u>	 <u>\$ —</u>
 <b>Long-Term Debt, less current maturities (Note 3) .....</b>	 <u>\$ 2,900,000</u>	 <u>\$ 8,327,000</u>
 <b>Deferred Income Taxes (Note 4) .....</b>	 <u>\$ 3,203,000</u>	 <u>\$ 2,091,000</u>
 <b>Commitments and Contingencies (Notes 6 and 7)</b>		
 <b>Shareholders' Equity (Note 5):</b>		
Common stock, no par, 5,000,000 shares authorized, 3,202,797 shares outstanding in 1977 and 3,175,797 in 1976 .....	\$ 1,786,000	\$ 1,711,000
Paid-in capital .....	2,814,000	2,814,000
Retained earnings (substantially restricted — Note 3) .....	<u>8,491,000</u>	<u>6,019,000</u>
	<u>\$13,091,000</u>	<u>\$10,544,000</u>
	<u>\$44,374,000</u>	<u>\$29,007,000</u>

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



WAINOCO OIL CORPORATION AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF INCOME

For the years ended December 31, 1977 and 1976

(Note 1)

	1977	1976
<b>Revenues:</b>		
Oil and gas sales .....	\$8,192,000	\$5,185,000
Interest income .....	387,000	269,000
Other income .....	423,000	255,000
	<u>\$9,002,000</u>	<u>\$5,709,000</u>
<b>Expenses:</b>		
Oil and gas operating costs .....	\$1,388,000	\$1,089,000
General and administrative .....	1,054,000	890,000
Depreciation, depletion, and amortization .....	2,275,000	1,778,000
Interest —		
Long-term debt and other .....	1,208,000	1,040,000
Charged to associated partnerships .....	(305,000)	(363,000)
Provision (credit) for losses on equipment inventory .....	(23,000)	186,000
	<u>\$5,597,000</u>	<u>\$4,620,000</u>
<b>Income from Continuing Operations Before Income Taxes .....</b>	<b>\$3,405,000</b>	<b>\$1,089,000</b>
<b>Provision for Income Taxes (Note 4) .....</b>	<b>933,000</b>	<b>26,000</b>
<b>Income from Continuing Operations .....</b>	<b>\$2,472,000</b>	<b>\$1,063,000</b>
<b>Income from Discontinued Operations (Note 2):</b>		
Operating income, net of applicable income tax of \$185,000 .....	\$ —	\$ 208,000
Gain on sale, net of applicable income tax of \$168,000 .....	—	228,000
	<u>\$ —</u>	<u>\$ 436,000</u>
<b>Net Income .....</b>	<b>\$2,472,000</b>	<b>\$1,499,000</b>
<b>Earnings Per Share:</b>		
Primary —		
Income from continuing operations .....	\$ .75	\$ .34
Income from discontinued operations .....	—	.14
Net income .....	<u>\$ .75</u>	<u>\$ .48</u>
Fully diluted —		
Income from continuing operations .....	\$ .74	\$ .34
Income from discontinued operations .....	—	.14
Net income .....	<u>\$ .74</u>	<u>\$ .48</u>

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



## WAINOCO OIL CORPORATION AND SUBSIDIARIES

**CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION**

For the years ended December 31, 1977 and 1976

(Note 1)

	1977	1976
<b>Source of Funds:</b>		
Funds provided by continuing operations —		
Income .....	\$ 2,472,000	\$ 1,063,000
Expenses not requiring current outlay of funds —		
Depreciation, depletion, and amortization .....	2,275,000	1,778,000
Deferred income taxes .....	1,112,000	50,000
Amortization of debenture issue expense .....	21,000	—
Total from continuing operations .....	\$ 5,880,000	\$ 2,891,000
Funds provided by discontinued operations (Note 2) —		
Income and gain on sale .....	—	436,000
Expenses not requiring current outlay of funds —		
Net noncurrent assets sold .....	—	961,000
Depreciation .....	—	93,000
Deferred income taxes .....	—	353,000
Refinancings and long-term debt borrowings .....	1,000,000	8,451,000
Sale of convertible subordinated debentures .....	10,000,000	—
Proceeds from sale of oil and gas properties (Note 7) .....	1,921,000	2,082,000
Decrease in commissions and noncurrent advances to associated partnerships .....	626,000	—
Issuance of common stock .....	75,000	71,000
Other, net .....	128,000	95,000
Total source of funds .....	\$19,630,000	\$15,433,000
<b>Application of Funds:</b>		
Additions to property and equipment, net —		
Purchase of limited partner properties and interests in associated partnerships .....	\$ —	\$ 6,330,000
Other .....	10,948,000	6,652,000
Payments on long-term debt and change in current maturities .....	6,427,000	3,344,000
Increase in commissions and noncurrent advances to associated partnerships .....	—	751,000
Noninterest-bearing note receivable .....	(225,000)	225,000
Debenture issue expense .....	643,000	—
Total application of funds .....	\$17,793,000	\$17,302,000
<b>Increase (Decrease) in Working Capital .....</b>	<b>\$ 1,837,000</b>	<b>\$ (1,869,000)</b>
<b>Increase (Decrease) in Components of Working Capital:</b>		
Cash .....	\$ 6,656,000	\$ 219,000
Accounts receivable .....	2,140,000	1,569,000
Leases and equipment inventory .....	1,186,000	103,000
Assets of discontinued operations .....	—	(3,639,000)
Other current assets .....	(18,000)	(9,000)
Note receivable .....	(992,000)	992,000
Short term borrowings .....	(6,803,000)	659,000
Current maturities of long-term debt .....	1,400,000	(1,070,000)
Accounts payable and accrued liabilities .....	(229,000)	(2,020,000)
Income taxes payable .....	(95,000)	302,000
Liabilities of discontinued operations .....	—	1,471,000
Oil and gas proceeds payable .....	(1,408,000)	(446,000)
<b>Increase (Decrease) in Working Capital .....</b>	<b>\$ 1,837,000</b>	<b>\$ (1,869,000)</b>
<b>Working Capital (Deficit), beginning of year .....</b>	<b>(916,000)</b>	<b>953,000</b>
<b>Working Capital (Deficit), end of year .....</b>	<b>\$ 921,000</b>	<b>\$ (916,000)</b>

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



WAINOCO OIL CORPORATION AND SUBSIDIARIES

**CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY**

For the years ended December 31, 1977 and 1976

(Notes 1 and 5)

	Common Stock		Paid-In Capital	Retained Earnings	Total
	Number of Shares	Amount			
<b>Balance, December 31, 1975 ..</b>	3,142,747	\$1,640,000	\$2,814,000	\$4,520,000	\$ 8,974,000
Issuance of common stock in connection with exercise of stock options .....	33,050	71,000	—	—	71,000
Net income .....	—	—	—	1,499,000	1,499,000
<b>Balance, December 31, 1976 ..</b>	3,175,797	\$1,711,000	\$2,814,000	\$6,019,000	\$10,544,000
Issuance of common stock in connection with exercise of stock options .....	27,000	75,000	—	—	75,000
Net income .....	—	—	—	2,472,000	2,472,000
<b>Balance, December 31, 1977 ..</b>	<u>3,202,797</u>	<u>\$1,786,000</u>	<u>\$2,814,000</u>	<u>\$8,491,000</u>	<u>\$13,091,000</u>

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

WAINOCO OIL CORPORATION AND SUBSIDIARIES

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 1977 and 1976

**(1) Organization and summary of significant accounting policies —**

*Reorganization —*

On December 31, 1976, Wainoco Oil Ltd. changed its jurisdiction of incorporation from the Canadian Province of Alberta to the State of Wyoming and changed its name to Wainoco Oil Corporation (the Parent). Concurrently with this change in jurisdiction of incorporation, the Parent transferred all of its assets and liabilities, except for its investment in its wholly owned United States subsidiary, Wainoco Oil & Gas Company (formerly Wainoco, Inc.), to its newly formed Canadian subsidiary, Wainoco Oil & Gas Limited, in exchange for all the outstanding common stock of Wainoco Oil & Gas Limited. After this transfer, the Parent's individual balance sheet consisted of its investment in its two wholly owned subsidiaries, Wainoco Oil & Gas Company and Wainoco Oil & Gas Limited (which are accounted for on the equity method) and shareholders' equity. The Parent's investment equaled its equity in the net assets of such subsidiaries at December 31, 1977 and 1976.



#### *Principles of consolidation —*

The consolidated financial statements include the accounts of Wainoco Oil Corporation and its wholly owned subsidiaries, Wainoco Oil & Gas Company (Wainoco Company) and Wainoco Oil & Gas Limited (Wainoco Limited) (collectively referred to as Wainoco). All significant intercompany transactions have been eliminated in consolidation. Certain reclassifications have been made in the 1976 financial statements to conform to current classifications.

#### *Currency translation —*

Prior to 1976, Wainoco's consolidated financial statements were prepared in Canadian dollars. In connection with the change in jurisdiction of incorporation from Canada to the United States on December 31, 1976, Wainoco began preparing its financial statements in United States dollars retroactive to January 1, 1976. The financial statements for years prior to 1976 have not been restated since the effect of translating these financial statements to United States dollars would not be material.

The Canadian dollar financial statements of Wainoco Limited for 1977 and 1976 have been translated to United States dollars. Gains and losses on translation are included in the consolidated statements of income currently and are not material.

#### *Allowance for inventory losses —*

Wainoco provides allowances for inventory losses if the cost of its equipment inventory exceeds its estimated market value. The allowance for such losses was \$10,000 at December 31, 1977 and \$94,000 at December 31, 1976.

#### *Oil and gas properties —*

Wainoco follows the accounting policy (commonly referred to as "full-cost" accounting) of capitalizing all productive and nonproductive costs incurred in the acquisition, exploration, and development of oil and gas reserves. No gains or losses are recognized upon the sale or disposition of oil and gas properties, except in extraordinary transactions.

Prior to 1976, Wainoco computed the provision for depreciation, depletion, and amortization of oil and gas properties on an annual basis using the composite unit-of-production method based on equivalent barrels of proved reserves. In the fourth quarter of 1976, Wainoco changed to the use of the composite unit-of-production method based on dollars of future gross revenue attributable to proved reserves computed on a quarterly basis retroactive to January 1, 1976. Under the future gross revenue method, Wainoco computes the quarterly provision by multiplying the total unamortized cost of oil and gas properties by an overall rate determined by dividing (a) the quarter's oil and gas revenue by (b) the total future oil and gas revenues as estimated by Wainoco or a firm of independent engineers. Using the equivalent barrel method and an annual computation period, Wainoco's 1976 provision for depreciation, depletion, and amortization would have been increased by \$247,000 and net income decreased by \$212,000 (\$.07 per share) after income tax effect.

The change in 1976 to the future gross revenue method computed on a quarterly basis was made to implement a change in estimate for depreciation, depletion, and amortization as a result of (1) increased governmental regulation of the oil and gas industry's sales prices in the United States and Canada which has resulted in wide variations in prices of oil and gas production, (2) the economics of the purchase of properties from limited partners for \$6,330,000 in 1976, and (3) increased emphasis on interim reporting. Wainoco believes the future gross revenue method recognizes that the economic life of oil and gas properties is more accurately measured in terms of revenues generated from such properties under price controls, and, therefore, more accurately matches the cost of the properties with the revenues produced; and that the use of a quarterly computation period will generally minimize or eliminate distortions in interim financial statements which can result when an annual computation period is used.

#### *Income taxes —*

Certain amounts are deducted for United States and Canadian income tax reporting purposes in different periods than for financial reporting purposes. Deferred taxes are provided on timing differences between taxable and financial statement income to the extent that taxes which would



otherwise have been payable are reduced. Wainoco Company recognizes interaction with statutory depletion in its United States oil and gas operations and, accordingly, does not provide deferred taxes on United States oil and gas exploration and development costs which are capitalized for financial reporting purposes but deducted for income tax purposes so long as the estimated future tax deductions (including statutory depletion) exceed these costs. The amount of costs for which United States income taxes have not been allocated at December 31, 1977, is approximately \$1,000,000. Wainoco Company follows the flow-through method of accounting for investment tax credit received in the United States whereby the credits available each year are applied as a reduction of the United States tax provision.

#### *Earnings per share —*

Primary earnings per share have been computed based on the weighted average number of common shares outstanding during 1977 and 1976 and assuming exercise of stock options in 1977. Stock options were not assumed to be exercised in 1976 since the dilutive effect was not material. The convertible subordinated debentures issued in September, 1977, are not considered common stock equivalents. The average common and common equivalent shares outstanding were 3,291,793 in 1977 and 3,154,830 in 1976. Fully diluted earnings per share assumes the addition of shares issuable upon conversion of the convertible subordinated debentures and the related reduction of interest expense (\$184,000 net of income tax effect). The weighted average shares assuming full dilution were 3,590,214 in 1977.

#### *Accounting change —*

In December, 1977, the Financial Accounting Standards Board issued Statement No. 19, "Financial Accounting and Reporting by Oil and Gas Producing Companies," which, among other things, (a) requires oil and gas producing companies to follow a form of the "successful efforts" method of accounting for costs incurred in the acquisition, exploration, and development of oil and gas reserves and (b) prohibits the recognition of interaction with percentage depletion in accounting for income taxes on United States oil and gas exploration and development costs which are capitalized for financial reporting purposes but deducted for income tax reporting purposes. As discussed above, Wainoco follows the "full-cost" method of accounting and recognizes interaction with percentage depletion. Under the proposed "successful efforts" method of accounting, certain amounts which are charged or credited to oil and gas properties under "full-cost" accounting (such as gains or losses on property sales, management fees received from associated partnerships, exploratory dry hole costs, write-down of undeveloped leases, unrealizable partnership advances, and certain other exploration costs) will be recognized currently in revenues or expenses.

The Securities and Exchange Commission (SEC) has requested comments and intends to hold public hearings starting March 29, 1978, on whether it should rely on Statement No. 19 or some alternative accounting standards, for financial reporting purposes. If Statement No. 19 is ultimately accepted by the SEC, it will be effective for fiscal years beginning after December 15, 1978, and will be applied retroactively by restating financial statements presented for prior periods. Wainoco has not yet completed its study of the effect of restating its financial statements; however, Wainoco currently estimates that retained earnings at December 31, 1977, would be reduced by \$2,500,000 to \$4,500,000, and net income for each of the years 1977 and 1976 would be reduced by \$500,000 to \$1,500,000. These estimates may change after Wainoco completes its study to determine the effect of Statement No. 19 on its financial position and results of operations for 1977, 1976 and prior periods.

#### **(2) Discontinued operations —**

In June, 1976, Wainoco Limited sold its Industrial Services Section (Travis Chemicals and Molsberry Divisions) which was primarily engaged in chemical sales operations and vegetation control services. The total consideration received by Wainoco Limited was valued at \$3,706,000 (net of \$82,000 imputed interest discounted at 10.25 percent on \$1,250,000 of noninterest-bearing notes receivable) and consisted of \$2,538,000 in cash received at closing and noninterest-bearing notes receivable for \$1,000,000 (discounted to \$952,000) due January 1, 1977, and \$250,000 due January 1, 1978 (discounted to \$216,000) which was collected in December, 1977.



Income of \$208,000 from the Industrial Services Section for the six months ended June 30, 1976, is shown as income from discontinued operations in the consolidated statements of income and consisted of gross revenues of \$6,900,000 less expenses of \$6,507,000 and income taxes of \$185,000.

The gain on the sale of the Industrial Services Section was determined as follows:

Sales price —	
Cash proceeds .....	\$2,538,000
Notes receivable .....	1,168,000
	<u>\$3,706,000</u>
Net cost of assets sold and expenses of sale .....	3,310,000
Gain on sale before income taxes .....	\$ 396,000
Provision for income taxes .....	168,000
Gain on sale .....	<u>\$ 228,000</u>

### (3) Convertible subordinated debentures and long-term debt —

#### *Convertible subordinated debentures —*

In September, 1977 the Parent issued \$10,000,000 of eight percent convertible subordinated debentures due September 1, 1992, with interest payable semiannually. The debentures are convertible into common stock at the option of the holder at any time prior to maturity at \$9.625 per share. At December 31, 1977, 1,038,961 shares of authorized but unissued common stock were reserved for such conversion. The debentures are redeemable at 110 percent beginning in 1977 and declining annually to 100 percent in 1991, and require an annual sinking fund commencing in 1983 of 10 percent of the aggregate principal amount outstanding on August 31, 1982, subject to credits for subsequent conversions and redemptions. The indenture covering the debentures provides, among other things, that (a) payment of dividends and acquisition of Wainoco stock is substantially restricted and (b) any loans to subsidiaries must be evidenced by a note that bears interest at an annual rate not less than that specified in the debentures and must be assigned to and pledged with the trustee under the indenture.

#### *Long-term debt —*

Long-term debt at December 31, 1977 and 1976, consisted of the following:

	1977	1976
Demand note payable by Wainoco Limited to a bank, not callable providing terms and conditions of the loan are met; due in monthly principal installments through 1982; interest at 2% above the bank's prime commercial rate; secured by substantially all Canadian oil and gas properties, the noninterest-bearing notes receivable, and all other assets of Wainoco Limited; guaranteed by Wainoco Company .....	\$ —	\$ 6,827,000
Note payable by Wainoco Company to a bank; due in monthly principal installments of \$100,000 with balance due in April, 1978; interest at 2% above the bank's prime commercial rate; secured by substantially all United States oil and gas properties, equipment inventory, accounts receivable from joint operators, and the \$1,487,000 unsecured note receivable; guaranteed by the Parent .....	—	4,100,000
Note payable by Wainoco Company to a bank; due in monthly principal installments of \$100,000 with the balance due in March, 1980; interest at 1.75% above the bank's prime commercial rate; secured by substantially all United States oil and gas properties, equipment inventory, accounts receivable from joint operators, and the \$1,487,000 unsecured note receivable; guaranteed by the Parent .....	4,100,000	—
	<u>\$4,100,000</u>	<u>\$10,927,000</u>
Less — Current maturities .....	1,200,000	2,600,000
	<u>\$2,900,000</u>	<u>\$ 8,327,000</u>



Wainoco Company's loan agreement for the \$4,100,000 note payable to a bank at December 31, 1977 (which has terms similar to the \$4,100,000 note outstanding at December 31, 1976), provides, among other things, that (1) Wainoco Company will not incur any additional indebtedness and (2) Wainoco and Wainoco Company will maintain a ratio of current assets to current liabilities (excluding current maturities of long-term debt) of at least one to one. Wainoco is permitted to pay quarterly cash dividends equal to 10 percent of consolidated pretax income for the preceding quarter; however, such dividends for any year may not exceed the lesser of 10 percent of Wainoco's annual consolidated pretax income or \$500,000. The loan agreement also restricts Wainoco, among other things, from merging or consolidating with another company and selling or otherwise disposing of a substantial portion of its assets.

Wainoco Company also has a \$1,500,000 revolving line of credit with the bank which bears interest at the bank's prime commercial rate plus 1.75 percent on any portion drawn on the line of credit. The bank charges an annual commitment fee of one half of one percent on the unused portion. The amount which can be drawn on the revolving line of credit is based on the lesser of \$1,500,000 or 70 percent of the collateral value of the company's equipment inventory and accounts receivable from joint operators. No portion of this line of credit is outstanding as of December 31, 1977.

In September, 1977, Wainoco Limited's demand note payable to a bank was repaid with the proceeds of the convertible debenture issue discussed above. In November, 1977, the bank and Wainoco Limited rearranged the existing credit lines to provide for loans up to \$6,200,000 bearing interest from one half to three fourths of one percent above prime, secured by Canadian oil and gas properties and accounts receivable, and guaranteed by Wainoco Company. The bank will charge Wainoco Limited a standby fee of one half of one percent per annum on the unused portion of \$5,500,000 of the line of credit and no fee on the other \$700,000 of credit lines. No balances were outstanding on the lines of credit as of December 31, 1977.

#### *Maturities of long-term debt —*

Maturities of long-term debt subsequent to December 31, 1977, are as follows:

1978 .....	\$1,200,000
1979 .....	1,200,000
1980 .....	1,700,000

#### *Short-term borrowings —*

Short-term borrowings at December 31, 1977, represent cash overdrafts which were funded in January, 1978, with the proceeds of the \$6,985,000 of cash investments, a draw on Wainoco Company's line of credit with a bank of \$1,200,000, and working capital.

The maximum amount of short-term borrowings outstanding as of any month-end was approximately \$1,000,000 in 1977 and \$2,400,000 in 1976, the approximate average amount outstanding was \$530,000 in 1977 and \$967,000 in 1976, and the average interest rate paid was approximately 8.6 percent in 1977 and 10.0 percent in 1976.

#### **(4) Income taxes —**

The provision for income taxes for 1977 and 1976 consisted of the following:

	1977	1976
Canadian income taxes —		
Current .....	\$ (299,000)	\$(49,000)
Deferred .....	1,043,000	353,000
	<u>\$ 744,000</u>	<u>\$304,000</u>
United States Federal income taxes —		
Current .....	\$ 120,000	\$ 25,000
Deferred .....	69,000	50,000
	<u>\$ 189,000</u>	<u>\$ 75,000</u>
	<u>\$ 933,000</u>	<u>\$379,000</u>



The provision for income taxes in 1976 was allocated in the consolidated statements of income to continuing operations (\$26,000) and discontinued operations (\$353,000).

Deferred taxes result from timing differences in the recognition of revenues and expenses for tax and financial reporting purposes. Deferred Canadian income tax expense of \$1,043,000 in 1977 and \$353,000 in 1976 is primarily attributable to Canadian exploration and development expenses capitalized for financial reporting purposes and deducted for tax reporting purposes. The United States deferred income tax expense includes deferred minimum preference tax of \$24,000 in 1977 and \$30,000 in 1976.

Set forth below is a reconciliation between the provision for income taxes computed at the statutory Canadian income tax rate (48 percent in 1977 and 47 percent in 1976) and the United States Federal income tax rate (48 percent) on income before provision for income taxes and the provision for income taxes as reported.

	<u>1977</u>	<u>1976</u>
Provision for Canadian and United States income taxes at statutory rates	<u>\$1,634,000</u>	<u>\$ 900,000</u>
Increase (decrease) in provision resulting from —		
Canada —		
Royalties, rentals, and similar payments deducted currently for financial reporting purposes which are not deductible for income tax reporting purposes	\$1,032,000	\$ 883,000
Resource and depletion allowances	(990,000)	(614,000)
Provincial tax credits and rebates	(404,000)	(481,000)
Investment credit	(73,000)	(85,000)
Other, net	107,000	(51,000)
	<u>\$ (328,000)</u>	<u>\$ (348,000)</u>
United States —		
Depreciation, depletion, and amortization of oil and gas properties for financial reporting purposes which is not deductible for income tax reporting purposes	\$ 638,000	\$ 435,000
Statutory depletion and depreciation of oil and gas properties for income tax reporting purposes which is not included as an expense for financial reporting purposes	(697,000)	(394,000)
Oil and gas exploration and development costs capitalized for financial reporting purposes and deducted for income tax reporting purposes	(314,000)	(213,000)
Investment tax credit	(115,000)	(45,000)
Minimum preference tax	91,000	55,000
Other, net	24,000	(11,000)
	<u>\$ (373,000)</u>	<u>\$ (173,000)</u>
Provision for income taxes, as reported	<u>\$ 933,000</u>	<u>\$ 379,000</u>

As of December 31, 1977, Wainoco Company had a tax depletion carry-forward of approximately \$950,000 which is indefinitely available to reduce Federal income taxes payable. Since \$500,000 of the depletion carry-forward represents permanent differences for which the tax effects have been recognized for financial reporting purposes, Federal income tax expense will not be reduced in the income statements of the periods when this carry-forward is utilized, but will be credited to deferred Federal income taxes. In addition, Wainoco Company has approximately \$300,000 of investment tax credit carry-forwards available to reduce future Federal income taxes payable, of which \$150,000 has been recognized as a reduction of deferred income taxes for financial reporting purposes through December 31, 1977. Wainoco Limited has an earned depletion base carry-forward of approximately \$2,000,000 for Canadian income tax purposes of which \$1,000,000 has been recognized for financial reporting purposes through December 31, 1977.



## **(5) Stock option, stock purchase and pension plans —**

### *Stock option plans —*

Wainoco has three stock option plans which authorize the granting of options to purchase 612,000 shares of common stock. Options under the 1968 plan are granted to Canadian employees at 85 to 90 percent of the market price at the date of grant and options under the 1973 and 1977 plans are qualified stock options under the United States Internal Revenue Code and are granted at not less than fair market value on the date of grant. Options under the plans are generally exercisable over a five-year period at the rate of 20 percent per year on a cumulative basis. No entries are made in the accounts until the options are exercised, at which time the proceeds are credited to common stock. As of December 31, 1977, options for 198,500 shares were outstanding at prices ranging from \$1.38 to \$9.38 per share and options to purchase 225,150 shares were available to be granted under the plans.

A summary of the 1977 and 1976 stock option activity is as follows:

	1977		1976	
	Number of Shares	Option Price	Number of Shares	Option Price
Balance, beginning of year .....	164,500	\$1.33-\$4.13	165,800	\$1.33-\$5.00
Granted .....	78,000	\$6.75-\$9.38	78,250	\$2.55-\$4.13
Terminated and lapsed .....	(17,000)	\$1.33-\$8.29	(46,500)	\$1.33-\$5.00
Exercised .....	(27,000)	\$1.33-\$6.53	(33,050)	\$1.33-\$2.66
Balance, end of year .....	<u>198,500</u>	<u>\$1.38-\$9.38</u>	<u>164,500</u>	<u>\$1.33-\$4.13</u>

### *Stock purchase plan —*

In May, 1977, the shareholders approved the adoption of an employee stock purchase plan under which an aggregate of 200,000 shares of common stock may be issued. All employees are eligible to participate in the plan except those who own in excess of five percent of Wainoco's outstanding common stock. The plan will allow each employee to purchase Wainoco stock at 85 percent of market value subject to certain limitations. As of December 31, 1977, no shares had been purchased under this plan.

### *Pension plans —*

Wainoco's United States pension plan is noncontributory, open to all employees over 25 years of age with one year of service and has a normal retirement age of 65. Pension plan expense was \$77,000 in 1977 and \$34,000 in 1976, including amortization of unfunded prior service costs of \$99,000 over 30 years. Wainoco's policy is to fund pension costs accrued. The pension plan's assets were approximately equal to the actuarially computed value of vested benefits as of December 31, 1977 and 1976.

In 1977, Wainoco Limited's board of directors adopted a pension plan open to all Canadian employees over 25 years of age, which provides for a normal retirement age of 65 and for voluntary employee contributions. Wainoco Limited has accrued \$40,000 in 1977 as its contribution to the plan, which is to be effective January 1, 1977 and is subject to governmental approval.

## **(6) Associated partnerships —**

Wainoco Company and/or Wainoco Limited are general partners in 11 public limited partnerships and have received management and other fees as consideration for services rendered certain of the partnerships. In addition, the general partners are reimbursed for direct, administrative, and overhead costs incurred in conducting the business of all except two of the partnerships.

In November, 1977, Wainoco Company formed Wainoco 78 Company, a public limited partnership which has not commenced operations. Wainoco Company will subscribe for its own account a minimum of 10 percent (\$2,000,000) of the limited partnership interests offered in this partnership. Certain leases and equipment inventory of \$2,917,000 and other charges incurred in anticipation of the formation of this and other future partnerships are included in current assets in the consolidated balance sheet at December 31, 1977.



Wainoco has (1) paid brokers' commissions on the sale of limited partnership interests in certain partnerships, which are recoverable from partnership revenues otherwise attributable to the limited partners, and (2) advanced funds to certain partnerships to finance certain exploration and development expenditures which are recoverable only from future revenues of the partnerships. A summary of such commissions and advances at December 31, 1977 and 1976, is as follows:

	1977	1976
Commissions .....	\$ 545,000	\$ 545,000
Advances .....	3,715,000	3,191,000
	<u>\$ 4,260,000</u>	<u>\$3,736,000</u>
Less —		
Amount transferred to oil and gas properties .....	(1,038,000)	(650,000)
Estimated current portion .....	(1,624,000)	(862,000)
Noncurrent portion .....	<u>\$ 1,598,000</u>	<u>\$2,224,000</u>

Based on the most recent oil and gas reserve information on the partnerships' properties, the commissions and advances for certain of the partnerships exceeded the estimated fair market value of their oil and gas properties by \$1,038,000 and \$650,000 at December 31, 1977 and 1976, respectively. These amounts have been charged to oil and gas properties and are being amortized over Wainoco's aggregate proved oil and gas reserves in the same manner as other costs invested in oil and gas properties. The amounts are included in oil and gas properties because the expenditures were discretionary in nature at the time they were made and are considered an integral part of Wainoco's oil and gas exploration and development activities. The amount could be increased or decreased in future years depending on the estimate of fair market value of the partnerships' oil and gas properties from which the commissions and advances will be repaid. The estimated current portion of amounts due from associated partnerships is based on the amount expected to be received, net of expenditures, by the partnerships within one year.

Wainoco can be required to purchase the limited partners' interests in the partnerships in varying amounts, depending on the terms of the different partnership agreements. The purchase price will generally be based on the estimated discounted cash flow after debt service, to the limited partners, discounted for risk factors associated with developing and producing the reserves. The maximum repurchase commitment of Wainoco on an annual basis for the existing partnerships, which may be increased or decreased in the future depending upon future estimates of each partnership's net assets and oil and gas reserves (assuming no purchases), was \$7,500,000 for 1978 and \$9,000,000 for 1979 and thereafter.

#### **(7) Commitments and contingencies —**

In October, 1976, Wainoco Limited and an associated partnership agreed to sell an overriding royalty interest underlying 14,000 acres in Canada for \$5,000,000 (\$4,003,000 to Wainoco Limited and \$997,000 to the partnership). Under the terms of the agreement, Wainoco Limited received \$2,082,000 in 1976 to complete the drilling of sufficient wells to produce a minimum of 10 million cubic feet of salable gas per day, and received \$1,921,000 in January, 1977, for the construction of a gathering facility and compressor plant for the wells. The proceeds from the sale were credited to oil and gas properties cost and were approximately \$700,000 greater than Wainoco Limited's drilling and construction costs.

In connection with the sale of Wainoco Company's interest in five offshore leases in 1974, a 10-year preferential right to purchase up to 3,000 barrels per day of Wainoco Company's United States oil production, which exceeds current production levels, at competitive market prices was granted to the purchaser. Some of Wainoco Company's oil production is currently being sold to customers designated by the purchaser.

The general partners are contingently liable for substantially all the liabilities of the associated partnerships, including aggregate bank indebtedness of approximately \$1,500,000 at December 31, 1977.



**(8) United States and Canadian operations —**

Wainoco is engaged in one line of business, the exploration, development and production of oil and gas reserves. Wainoco's United States operations are primarily conducted by Wainoco Company and its Canadian operations by Wainoco Limited. Set forth below are the revenues, net income and identifiable assets by country:

	United States	Canada	Consolidated
Revenues .....	\$ 4,512,000	\$ 4,490,000	\$ 9,002,000
Net income .....	972,000	1,500,000	2,472,000
Identifiable assets .....	23,850,000	20,524,000	44,374,000

The prices Wainoco Limited receives for its Canadian oil and gas sales are controlled by the provincial governments of Alberta and British Columbia. In 1977, Wainoco Limited made sales to a customer in Alberta which accounted for 20 percent of consolidated revenues and to a customer in British Columbia that accounted for 19 percent of consolidated revenues.

**(9) Selected quarterly financial data (Unaudited) —**

	Three Months Ended			
	March 31	June 30	September 30	December 31
	(In Thousands, Except Per Share Amounts)			
1977 —				
Revenues .....	\$1,744	\$2,017	\$2,419	\$2,822
Income before income taxes .....	\$ 549	\$ 748	\$ 937	\$1,171
Provision for income taxes .....	159	247	226	301
Net income .....	\$ 390	\$ 501	\$ 711	\$ 870
Earnings per share —				
Primary .....	\$ .12	\$ .15	\$ .22	\$ .26
Fully diluted .....	\$ .12	\$ .15	\$ .22	\$ .24
1976 —				
Revenues .....	\$1,169	\$1,267	\$1,619	\$1,654
Income from continuing operations .....	\$ 267	\$ 247	\$ 283	\$ 266
Income from discontinued operations .....	120	316	—	—
Net income .....	\$ 387	\$ 563	\$ 283	\$ 266
Primary and fully diluted earnings per share —				
Income from continuing operations .....	\$ .09	\$ .08	\$ .09	\$ .08
Income from discontinued operations .....	.04	.10	—	—
Net income .....	\$ .13	\$ .18	\$ .09	\$ .08



## AUDITORS' REPORT

To the Shareholders of Wainoco Oil Corporation:

We have examined the consolidated balance sheets of Wainoco Oil Corporation (a Wyoming corporation) and subsidiaries as of December 31, 1977 and 1976, and the related statements of income, shareholders' equity, and changes in financial position for the years then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the financial position of Wainoco Oil Corporation and subsidiaries as of December 31, 1977 and 1976, and the results of their operations and the changes in their financial position for the years then ended, in conformity with generally accepted accounting principles consistently applied during the periods subsequent to the change made as of January 1, 1976 (with which we concur), in the method of computing depreciation, depletion, and amortization of oil and gas properties as described in Note 1 to the financial statements.

ARTHUR ANDERSEN & CO.

Houston, Texas  
March 16, 1978



## **DIRECTORS**

John B. Ashmun  
Houston, Texas  
James A. Baker, III  
Houston, Texas  
William A. Faubion  
Houston, Texas  
Peter T. Flawn  
Austin, Texas  
James S. Palmer  
Calgary, Alberta  
William Scheerer, II  
New York, New York

## **OFFICERS**

John B. Ashmun  
President  
William A. Faubion  
Vice President  
Robert J. Leslie  
Vice President  
Gary V. Woods  
Vice President

## **REGISTRARS AND TRANSFER AGENTS**

### **Common Stock**

First City National Bank  
Houston, Texas  
Montreal Trust Company  
Calgary, Alberta

### **8% Convertible Subordinated Debentures**

Continental Illinois National  
Bank and Trust Company  
of Chicago  
Chicago, Illinois

## **PRINCIPAL BANKS**

First City National Bank  
Houston, Texas  
Bank of Montreal  
Calgary, Alberta

## **AUDITORS**

Arthur Andersen & Co.  
Houston, Texas

## **COUNSEL**

Andrews, Kurth, Campbell  
& Jones  
Houston, Texas  
Burnet, Duckworth & Palmer  
Calgary, Alberta

## **SUBSIDIARIES**

Wainoco Oil & Gas Company  
Wainoco Oil & Gas Limited  
Wainoco International, Inc.

## **COMMON STOCK**

Wainoco Oil Corporation common stock is listed for trading on the American Stock Exchange in the United States and the Toronto Stock Exchange in Canada under the symbol WOL. The high and low quarterly sales prices for the stock on the American Stock Exchange are shown below:

	High	Low
1977		
First Quarter .....	9 $\frac{3}{8}$	6 $\frac{1}{4}$
Second Quarter .....	8 $\frac{1}{2}$	7
Third Quarter .....	9 $\frac{3}{4}$	7 $\frac{3}{8}$
Fourth Quarter .....	15 $\frac{1}{2}$	6 $\frac{5}{8}$
1976		
First Quarter .....	3 $\frac{1}{4}$	2 $\frac{1}{4}$
Second Quarter .....	4 $\frac{1}{4}$	2 $\frac{3}{4}$
Third Quarter .....	4	3
Fourth Quarter .....	6 $\frac{1}{4}$	3 $\frac{3}{4}$

## **AVAILABILITY OF FORM 10-K**

The Company's Annual Report on Form 10-K which is filed with the Securities and Exchange Commission is available upon request and may be obtained by writing to:  
Vice President-Finance  
Wainoco Oil Corporation  
1100 Milam Building  
Suite 600  
Houston, Texas 77002

## **ANNUAL MEETING NOTICE**

The annual meeting of the shareholders of Wainoco Oil Corporation will be held Thursday, May 4, 1978, at 10:00 a.m. in the First City East Auditorium, 1111 Fannin Street, Houston, Texas







