

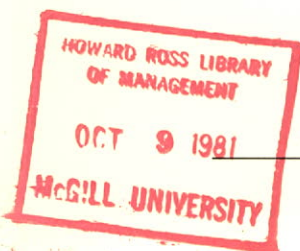
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WAINOCO

OIL CORPORATION



1979 ANNUAL REPORT



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

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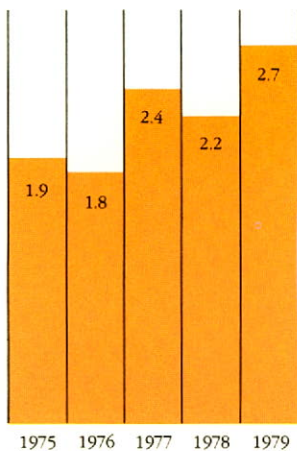
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FINANCIAL & OPERATING HIGHLIGHTS

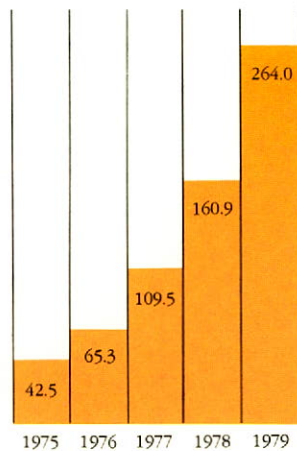
Oil and Gas Operations

| | 1979 | 1978 | PERCENT INCREASE |
|---|---------------|--------------|---------------------|
| FINANCIAL | | | |
| Total revenue | \$ 24,984,000 | \$16,861,000 | 48% |
| Net income | 6,015,000 | 4,256,000 | 41% |
| Earnings per share, fully diluted | .63 | .52 | 21% |
| Dividends per share | .075 | — | |
| Funds provided by operations | 15,669,000 | 10,658,000 | 47% |
| Total assets | 137,716,000 | 78,997,000 | 74% |
| Capital expenditures | 52,095,000 | 22,915,000 | 127% |
| Shareholders' equity | 36,133,000 | 30,141,000 | 20% |
| Shareholders' equity per share | 3.94 | 3.34 | 18% |
| Shares outstanding | 9,173,348 | 9,018,846 | 2% |
| PRODUCTION | | | |
| Oil and condensate in thousands of barrels | 428 | 407 | 5% |
| Natural gas in millions of cubic feet | 12,884 | 8,109 | 59% |
| PROVEN RESERVES | | | |
| Oil and condensate in thousands of barrels | 2,715 | 2,164 | 25% |
| Natural gas in millions of cubic feet | 264,007 | 160,866 | 64% |
| LAND | | | |
| Gross acres (000) | 18,938 | 6,500 | 191% |
| Net acres (000) | 7,309 | 1,434 | 410% |

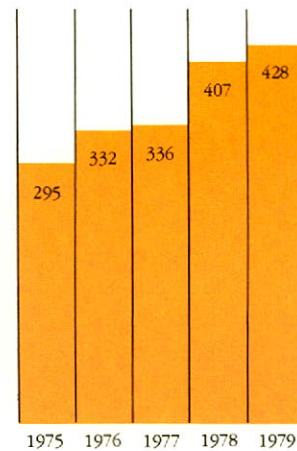
Oil Reserves,
Million Barrels



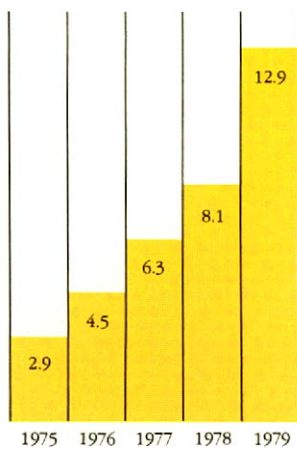
Gas Reserves,
Billion Cubic Feet



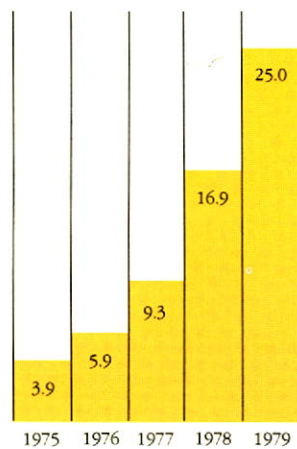
Oil Production,
Thousand Barrels



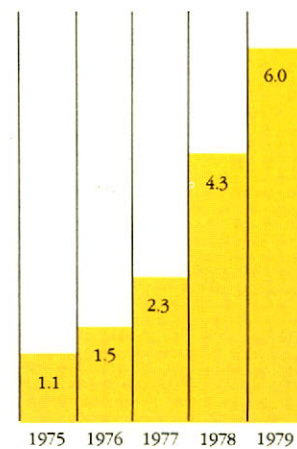
Gas Production,
Billion Cubic Feet



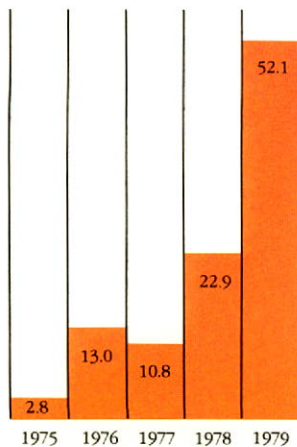
Revenue, Million Dollars



Net Income, Million Dollars



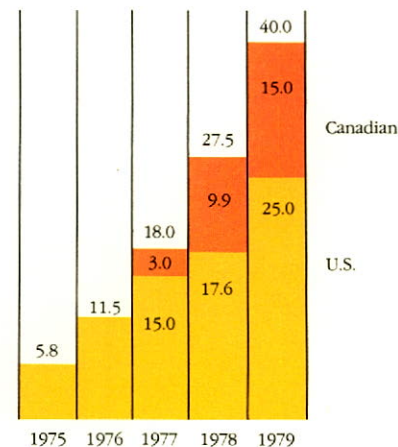
Capital Expenditures,
Million Dollars



Funds Provided by Operations,
Million Dollars



Exploration Funds Raised in
Public Drilling Programs,
Million Dollars



The significance of Wainoco's record of growth was again illustrated in 1979 by large additions to its reserves, lifeblood of the Company's future.

Proved natural gas reserves as of January 1, 1980, were estimated by an independent engineering firm to be 264 billion cubic feet, an increase of 64% over those at the prior year's beginning. The compound rate of growth of Wainoco's proved gas reserves over the past five years is 58%. Proved oil reserves increased 25% during the year to 2.7 million barrels. Both gas and oil reserve increases were achieved following record annual production in 1979 of 12.9 billion cubic feet of gas and 428,000 barrels of oil. As of year-end, Wainoco's future net income from estimated reserves in all categories, using escalation of prices and costs, is in excess of \$1 billion. The present worth of this future net income, calculated by discounting it at an annual rate of 10%, approaches \$400 million.

Higher rates of oil and gas production and higher prices during the year resulted in record revenues of \$25 million, a 48% increase over those in 1978. Net income also reached new levels at \$6 million, up 41% over \$4.3 million for the previous year. Fully diluted earnings per share were 63 cents, 21% over 52 cents (restated) for 1978. Cash flow from operations was \$15.7 million, 47% higher than that of \$10.7 million for the prior period.

Capital expenditures of \$86 million on behalf of Wainoco and its limited partners exceeded the budgeted amount by \$6 million and were 50.6% higher than that of the previous year. The Company's portion was \$52.1 million compared to \$22.9 million in 1978. Included in expenditures were proceeds from

\$40 million of subscriptions sold through two limited partnership offerings, the principal source of exploration funds for the year. In the U.S. a \$25 million limited partnership was formed for exploration and development drilling on 41 prospects in the Gulf Coast, Mid-Continent and Rocky Mountain areas. Wainoco owns a 52% interest in this partnership including a \$5 million limited partner subscription. In Canada, a \$15 million limited partnership was formed to drill 28 prospects in Alberta and British Columbia. Wainoco's 48% interest in the partnership includes the purchase of a \$2 million limited partner subscription. Of 84 wells drilled to test and develop these 69 prospects, 38 wells (45%) have been completed as productive, with 10 of the prospects remaining to be tested. Additional drilling, funded by partnership revenues and borrowings, will continue in 1980 to develop those prospects found successful.

Capital expenditures for property acquisition were \$11 million. Offers for limited partner interests in Wainoco 70, 71, 72, and 74B partnerships were accepted for a total cash consideration of \$2.2 million plus assumption of a share



of partnership debt in the amount of \$1.4 million. Other property purchases totaling \$7.4 million included producing wells and undeveloped acreage in Texas, Louisiana, Mississippi and Pennsylvania.

Development of Company properties in the Monias field of northeastern British Columbia and at Athens in northwestern Pennsylvania required expenditures of \$14.1 million. At Monias, where 60% of these funds were expended, proved reserves in the Company's largest gas property are now estimated to be 142 billion cubic feet. These reserves have been established primarily in the 5,000' Halfway sand formation by the drilling of 21 wells. The Company's large discovery in the 7,000' Belloy formation last September, plus recent drilling to the west of Monias, indicate the presence of deeper reserves underlying a broad east-west trend. The Company has responded by enlarging its holdings in an expanded area to over 33,000 net acres and by budgeting several tests to be drilled below the Halfway for 1980.

At Athens, the first 40 well drilling program was completed and construction of a pipeline and natural gas gathering system was finalized in early 1980. Commencement of sales scheduled for the second quarter of 1980 could increase the Company's U.S. gas sales volume by more than a third. Proved reserves in excess of 19 billion cubic feet have been established on about 15% of the Company's leases at Athens, signifying the potential of a sizeable source of revenues following further development drilling.

In seeking exploration opportunities offering high returns outside of North America, the Company extended its commitments in countries where accommodating political and economic climates exist. Wainoco International, Inc., a wholly-owned subsidiary for overseas operations, now has interests in over 17 million acres of exploration contracts in West Australia. In addition, an agreement has recently been made with Ecopetrol to explore a quarter of a million acres in southwest Colombia.

Wainoco has registered \$45 million of limited partnership interests with U.S. and Canadian regulatory commissions for sale in 1980. Of this amount, \$25 million is registered in the U.S. and \$20 million in Canada. Wainoco will again make a substantial investment in each operation.

The Company commenced cash dividend payments in March, 1979. The initial dividend rate was 3 cents a share, effectively doubled on October 31, 1979, when shareholders were issued an additional share for each one owned and the dividend rate was maintained at 3 cents per share.

Wainoco's entry into the eighties is viewed with an increased confidence in our ability to find and produce oil and gas reserves. This view reflects our opinion that, given the incentive of adequate profit, significant reserves remain throughout the world to be found and produced by competent operators. It is fortunate that through all the attempts by various governments to restrict returns to producers, there still exists profit enough to attract continued endeavor. This is not to say that we face the decade without fear of repeated interference, but that we remain survivors in a growing morass of regulations and reports, exacerbated by an unprecedented escalation of taxes. Our resolute search for reserves is stimulated by recognizing that the need for oil and gas must cause their values to outpace their costs.



John B. Ashmun
President

March 15, 1980



Canadian Operations

| <i>STATISTICAL SUMMARY</i> | 1979 | 1978 |
|-------------------------------|---------|---------|
| EXPLORATION AND DEVELOPMENT | | |
| Wells Drilled | 51 | 57 |
| Wells Completed as Productive | 37 | 37 |
| PRODUCTION | | |
| Oil & Condensate (mbbls.) | 153 | 118 |
| Gas (mmcf) | 8,960 | 4,302 |
| PROVED RESERVES | | |
| Oil & Condensate (mbbls.) | 1,120 | 1,033 |
| Gas (mmcf) | 222,859 | 147,594 |
| LAND | | |
| Gross acres (000) | 949 | 815 |
| Net Acres (000) | 318 | 269 |

The 1979 performance of Wainoco Oil & Gas Limited, Wainoco's wholly-owned subsidiary for Canadian operations, surpassed all previous years and was enhanced by an outstanding gas discovery at Monias in the third quarter of the year. Natural gas production rose 108% to 9 billion cubic feet, oil production was up 30% to 153,000 barrels and revenues of \$11.5 million increased 85% over those of 1978. These records were achieved with approximately one-half of Wainoco's gas delivery capacity shut-in due to limited markets, and with product prices well below those in the U.S. An alleviation of government policies which restrict access to gas markets and under-price producers' products would be of great benefit to Canada and its oil and gas industry, and certainly could improve Wainoco's most recent year's record performance.

British Columbia

The focus of attention remained on the Monias area which, at the beginning of 1979, contained major proved gas reserves for the Company as a result of discoveries in the Triassic Halfway formation at a depth of approximately 5,000'. In September 1979, a well drilled to extend the northeast side of the field and to test deeper horizons to 7,000' resulted in a multi-pay gas well that ranks as the Company's most important discovery to date. The well flowed gas in excess of 30 million cubic feet per day from two zones in the Belloy formation and tested additional pay in the shallower Halfway sand as well as two zones in the Charlie Lake formation. Proved reserves assigned to this well approximate 10% of Wainoco's entire proved gas reserves. In conjunction with drilling this well, an additional 3,260 acres of land offsetting it were purchased at government sales for \$6,900,000.

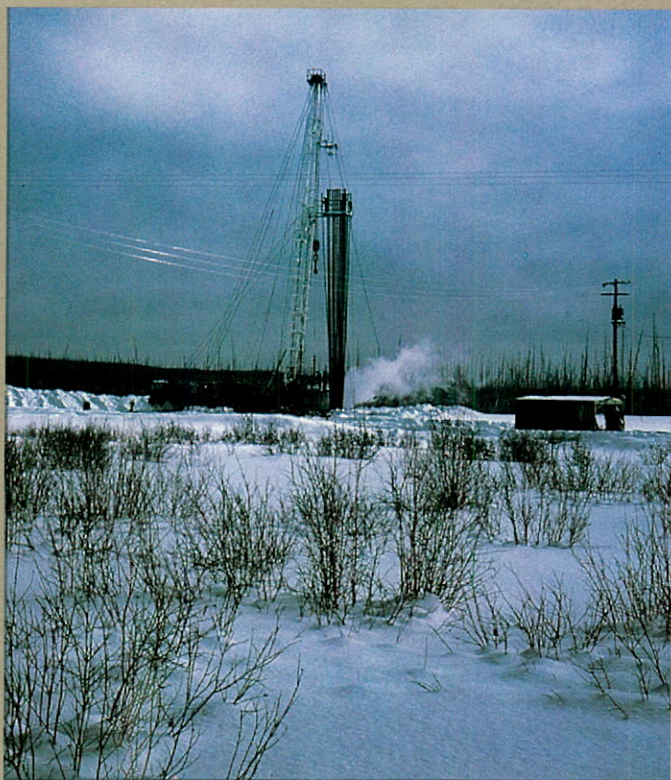
A well drilled by Wainoco 79 Canada, the 1979 limited partnership, five miles southwest of Monias, stimulated further interest in the deeper formations of the

area. The Amherst well encountered gas shows in the Mississippian Debolt formation at 10,900' as well as penetrating two other zones of interest at shallower depths. Results of the completion attempt on this well should be available in the second quarter of 1980.

A well of further significance to this development west of Monias was drilled by another company at Gates and was reported to have flowed substantial amounts of gas from the Belloy formation. This well, some 25 miles west of Wainoco's Monias Belloy discovery, plus reports from other tests in the area indicate a possible multi-zone trend of considerable size. Wainoco's interests at Gates include a 50% ownership in both a 640 acre lease and a 10,400 acre drilling reservation offsetting the reported Belloy test. A Halfway test is presently being drilled on the 640 acre lease four miles southwest of the reported Belloy well. A



Wainoco's 6-23 oilwell at Swan Hills, Alberta.



Completion at Wainoco's 11-26 Bear Flats well, British Columbia.

drilling budget of \$7 million has been allocated for Wainoco's 1980 participation in 11 proposed tests in the Monias-Gates area.

At Sikanni, 120 miles north of Monias, the 1979 limited partnership participated in drilling three successful Halfway gas wells. The partnership owns a 27% interest in the wells and 12,300 acres of drilling reservations purchased for \$4.5 million. Development on this important prospect for the partnership is continuing.

In the Grizzly area, a western extension of Alberta's large Elsworth gas play, Wainoco 79 Canada drilled a 13,000' well which is presently undergoing production tests. Results of the well are being held confidential as additional acreage is available in the vicinity. It is, however, located in one of the province's most active areas where prices paid for

exploratory acreage at the government's sealed bid sales have established recent records.

Alberta

An extensive seismic evaluation was completed on the Company's 1,260 net acres of leases at North Pembina, 60 miles west of Edmonton. Oil production has been established within a quarter-mile of the leases on this prolific Devonian reef play, and the Company plans to drill a well in the second half of 1980.

At Winfield, 50 miles southwest of Edmonton, Wainoco 79 Canada participated in a Glauconitic gas discovery at a depth of 5,700'. This well flowed 3.9 million cubic feet of gas from 14 feet of pay. The partnership owns a 100% interest in the well and 640 surrounding acres.

At Welch Creek, 20 miles south of Winfield, the partnership drilled a triple zone discovery well to a depth of 7,400'. The best zone in this well was the Ostracod sand which flowed gas at a rate of 2.4 million cubic feet per day. The partnership owns a 60% interest in the well and 640 acres.

A well was completed at Town Lake by the partnership flowing 255 barrels of oil per day from the Viking sand at a depth of 5,800'. The first development well offsetting this discovery is presently drilling one mile to the east. The partnership owns an average 53% interest in these wells and 1,920 adjoining acres.

At Valhalla, the partnership drilled a dual-zone gas discovery and a successful development well. The discovery tested at daily rates of 1.9 million cubic feet of gas from the Halfway sand and 1.8 million cubic feet of gas from the Doe Creek sand. The second well tested 1.1 million and 1 million cubic feet of gas per day from the same respective zones. The partnership owns a 100% interest in 1,280 acres around the wells which are presently shut-in pending negotiation of a gas contract.

At Beacon Hill, the partnership par-

Opposite: Gas flare at Wainoco's 7-30 Belloy discovery in Monias field, British Columbia.



ticipated in three successful Colony sand gas wells at approximately 1,800'. The partnership owns a 40% interest in 5,440 acres on this prospect and further drilling based on special seismic interpretation is planned.

In the Grouse area, 80 miles north of Beacon Hill, this same seismic technique resulted in the drilling of three successful gas wells. Three more wells will be drilled on another part of this 21,700 acre farmout.

At Blackfoot, 55 miles southeast of Calgary, the partnership drilled a well which tested 6.4 million cubic feet of gas per day from the Viking zone at a depth of 3,700'. Wainoco and its partnership own 100% in 1,440 acres on this play.

Beaufort Sea

In September, a major oil discovery was announced in the Canadian portion of the Beaufort Sea where Wainoco holds 71,762 net acres in four blocks totaling 167,840 gross acres. The well, which was reported capable of producing at a sustained rate of 12,000 barrels of oil per day, is 43 miles south of a 41,676 acre

block in which Wainoco has a 50% interest. A follow-up to this discovery, the Kenalooak N-94 well located 24 miles southeast of this block, was drilled to 7,054' during the 1979 drilling season and suspended. This well will be re-entered and deepened to 16,000' in the summer of 1980.

Canadian Limited Partnerships

Wainoco was one of the first companies to offer subscriptions to public limited partnerships for oil and gas drilling in Canada following a 1976 change in the tax laws. Since 1977, the Company has sold almost \$24 million in subscriptions to Canadian residents throughout the country and has drilled 90 wells of which 61 or 68% are productive. This method of financing has proved most effective for Wainoco and at the same time has met the aims of the Canadian government in encouraging its citizens to participate in the development of their natural resources. Wainoco 80 Canada has been registered with \$20 million in subscriptions to fund its 1980 operations.



Wainoco's gas compression plant at Dabl, British Columbia.



United States Operations

| <i>STATISTICAL SUMMARY</i> | 1979 | 1978 |
|-------------------------------|--------|--------|
| EXPLORATION AND DEVELOPMENT | | |
| Wells Drilled | 104 | 72 |
| Wells Completed as Productive | 76 | 35 |
| PRODUCTION | | |
| Oil and Condensate (mbbls.) | 275 | 289 |
| Gas (mmcf) | 3,924 | 3,807 |
| PROVED RESERVES | | |
| Oil and Condensate (mbbls.) | 1,595 | 1,131 |
| Gas (mmcf) | 41,148 | 13,272 |
| LAND | | |
| Gross Acres (000) | 490 | 445 |
| Net Acres (000) | 192 | 126 |



Wainoco Oil & Gas Company, Wainoco's subsidiary for U.S. operations, made significant achievements in the year just concluded. Milestones were crossed in all phases of the Company's activities. More money was expended for exploration and development, more wells were drilled, proven reserves and revenues increased, and an enlarged staff moved into expanded office space, making 1979 unusually productive.

The Company's capital expenditures, including amounts attributable to the Company's associated partnerships, were \$57.6 million compared to \$38 million in 1978. A total of 104 wells were drilled in the U.S. compared to 72 the previous year. Increased drilling activity resulted in 76 completions for a 73% success ratio. Also, as a result of this increased activity, proven gas reserves rose 210% to a total of 41 billion cubic feet, after deducting a record 3.9 billion cubic feet produced during the year. Additions to proven oil and natural gas liquid reserves were also positive with a 41% increase to 1.6 million barrels as compared to 1.1 million barrels in 1978. Oil production of 275,000 barrels was approximately equal to the production in 1978. Revenues for the year were higher at \$13.5 million up 27% over 1978.

Gulf Coast Division

Activity in this division involved a total of 53 wells drilled in conjunction with the Company's limited partnerships. Twenty-six wells were drilled in Texas and 27 in Louisiana. A success ratio of 51% was achieved with the completion of 27 producers.

Several wells were completed for Wainoco 79 Company, the 1979 limited

partnership in which Wainoco owns a 52% interest. The 560 acre Traylor Ranch prospect in Calhoun County, Texas, resulted in a multi-pay gas and condensate well which tested 1.2 million cubic feet of gas plus 33 barrels of condensate per day from a Frio sand at 8,000'. The partnership owns a 52% net revenue interest in the well. Several additional oil and gas sands appear productive and two development wells are planned for 1980. In Hidalgo County, Texas, another Frio sand completion, the A.M. Cardenas No. 1 on the 800 acre San Salvador prospect, was completed for a daily rate of 1 million cubic feet of gas from 8,600'. Additional drilling is planned adjoining this multi-pay well in which the partnership owns a 70% net revenue interest.

In Galveston Bay, Texas, an important Frio sand discovery was followed up by two successful development wells. These wells should contribute substantially to the partnership's revenues. The State Tract 258 No. 2 flowed at a rate of 262 barrels of oil per day from 9,800'. The State Tract 259 No. 1 flowed 653 barrels per day at 9,750'. The State Tract 258 No. 3 has recently reached total depth and appears productive. The three wells, in which the partnership owns an average 72% net revenue interest, should be on production by May of 1980. Additional drilling on the 1,680 acre block is under consideration.

On the Young prospect in Acadia Parish, Louisiana, the No. 1 Ashy well was productive from the Homeseekers A-1 sand at 9,250' and potentialed for 2.8 million cubic feet of gas per day plus 78 barrels of condensate. The partnership owns a 77% net revenue interest in this well and plans at least two development wells for 1980. Also in Louisiana, the Dommatti Constance No. 1 was completed in Cameron Parish flowing 5.9 million cubic feet of gas and 78 barrels of condensate per day. The partnership owns an 18% net revenue interest in this well.

These and other Wainoco 79 Company completions in Mitchell, Wharton, Hardin, Jefferson, Rusk and Kleberg Counties, Texas, and Vermilion and Allen Parishes, Louisiana, should all be on stream by mid-1980.

Upper left: Drilling in Athens field, Pennsylvania. Opposite: Drilling operations in Cameron Parish, Louisiana.



Effective November 1, 1979, Wainoco acquired the properties of Tejas Production Company for \$5.1 million. The properties are comprised of varying interests in 33 oil and gas wells and 30,000 acres of leases in Texas, Louisiana, and Mississippi. Daily production averages 100 barrels of oil and condensate and 7.4 million cubic feet of gas. Wainoco plans to drill a number of development locations in 1980. Earlier, in October, the Company acquired a producing gas property in St. Martin Parish, Louisiana, for \$2.1 million. Production from this property averages 3 million cubic feet of gas and 15 barrels of condensate per day.

Mid-Continent Division

The number of wells drilled in this division, in its second year since formation, increased considerably. Drilling was concentrated in the Pennsylvania portion of the Appalachian Basin, in the Anadarko Basin of Oklahoma and Texas, and also in Montana and Wyoming. Fifty-one wells were drilled and 49 were completed for a success ratio of 96%. This outstanding completion record was largely the result

of the low risk, shallow gas development program in the Athens area of Crawford County, Pennsylvania. The Company owns a 79% net revenue interest in approximately 66,000 acres and completed a total of 40 successful Medina sand gas wells at 5,000'. Twenty-six of these wells will begin producing in April, 1980, and the drilling of an additional 40 wells is planned for the current year. Delivery capacity of the first 40 wells is estimated at 8 to 10 million cubic feet daily; however, gas sales over the next 12 months are expected to be somewhat curtailed due to a near-term gas surplus.

In Roberts and Ochiltree Counties of the Texas Panhandle, the Company continued exploration on the 42,000 acre Lipps Ranch. Wainoco owns an undivided 50% interest in this prospect, and at year-end had drilled a total of seven wells, five of which are indicated to be successful. Two of these five, the Barbara Lipps AA No. 1 and the Barbara Lipps AD No. 1 are now producing. The AA No. 1 is currently producing at a daily rate of 1.2 million cubic feet of gas from the Upper Morrow at 8,400', and the AD No. 1 is producing 70 barrels of oil per day from the Oswego limestone at 7,800'. Testing is in progress on the AE No. 1, AF No. 1, and AF No. 2 wells, with commencement of production expected in the second half of 1980. Additional drilling is planned this year in conjunction with a seismic program.

At the end of the second year, operations continue on the No. 1-18 Davis well at the Company's North Marlow prospect in Grady County, Oklahoma. Difficulties in drilling this well, which was a proposed test of an Ordovician Bromide structure at 23,800', have required a dual completion attempt in the Mississippian Springer formations at 17,000' and 19,000'. Excellent gas shows were encountered in two zones of the Springer and, following a successful completion, a substitute Bromide test will be commenced later in the year. Wainoco owns a 19% interest in the well and 8,000 acres of leases.



Collecting samples from well in Bayou Boullion field, St. Martin Parish, Louisiana.



International



Wainoco International, Inc., a wholly owned subsidiary for overseas operations, expanded its interests in Australia and negotiated for exploration rights in Colombia.

Wainoco was granted a 50% interest in three exploration permits by the gov-

ernment of West Australia totaling 12.3 million acres. On the northwest shelf, approximately 250 miles northeast of the Rankin gas trend, Wainoco was awarded offshore permit WA-134-P and onshore permit EP-142. These blocks, in the Canning Basin, are contiguous and contain 4.7 and 3.8 million acres, respectively. Further south the third permit, WA-135P, is located in the offshore Perth Basin, approximately 75 miles south of the city of Perth. This permit contains 3.7 million acres and is located adjacent to an area where previous drilling has encountered gas shows. Review and evaluation of existing data has commenced on the permits to fulfill the first year work commitments.

On Permit WA-103P in the Bonaparte Gulf, awarded in 1977, the original participants revised their interests allowing an Australian company to earn a 25% interest by undertaking the major portion of the second and third year work commitments. As a result, Wainoco now holds a 12.5% interest in this 5.2 million acre block. An extensive evaluation of the economic potential of established gas reserves on the Petrel Structure was made and 375 kilometers of marine seismic work was conducted in 1979. A well is planned for drilling in late 1980.

The Company applied to the government of Colombia for the right to explore an area of approximately 250,000 acres near Tumaco on the Pacific Coast of extreme southwestern Colombia. As a result, Wainoco signed an Association Contract in early 1980 with Ecopetrol, the state oil company of Colombia. Terms of the contract call for Wainoco to shoot 100 kilometers of geophysical surveys and, pending confirmation of a drillable anomaly, to commence a test well by April, 1981. The Tumaco area has potential for oil and gas accumulations similar to those in the Pacific Coast Basins of Ecuador and Peru.

Record production and reserve increases in 1979 helped Wainoco achieve a 47 percent increase in internally-generated funds from operations, finalize committed bank credit lines in the amount of \$67 million, and maintain a strong working capital position, which amounted to \$21.1 million at the end of 1979.

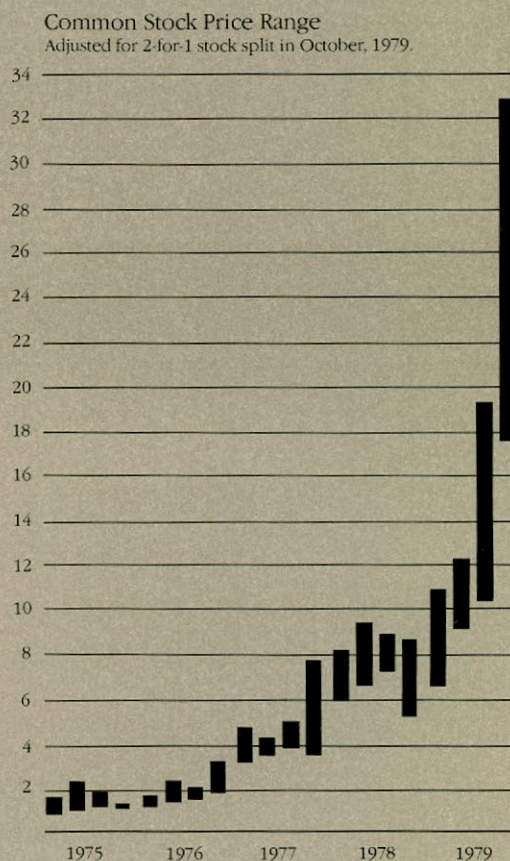
Cost, availability, and flexibility are key factors in Wainoco's bank credit facilities. Semi-annual revisions (April and October) of the borrowing base provided by reserves permit a matching of needs and availability. Record high interest rates will affect earnings levels, but management remains optimistic that internal funds flow, bank borrowings, limited partnership funds and other financing sources will permit the expanded capital expenditure program planned for 1980 and beyond.

Wainoco's common stock, listed on the American (Amex) and Toronto Stock Exchanges, experienced a sharp increase in activity in 1979. Trading volume on the Amex was 10.7 million shares, up 20% over 1978. The added liquidity for Wainoco's shares was welcome, and the 17% increase in shareholders of record during 1979 was most gratifying.

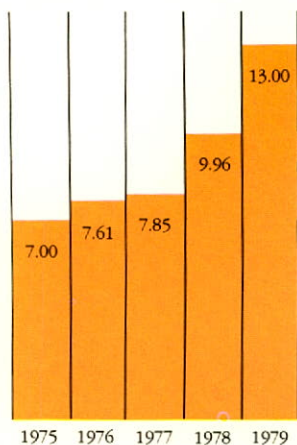
As noted in the President's letter, future net income from all categories of reserves was estimated to be in excess of \$1 billion as of December 31, 1979. The independent engineering firm that prepared this estimate employed assumed escalations of product prices and costs of 8% per year. Maximum prices for oil and gas were set at \$50 per barrel and \$6.50 per MCF, respectively. The actual future net income may be above or below this estimate, but an appreciation of the Company's 1979 growth is gained by comparison to the prior year's future net income of approximately \$350 million.

The following page of operating and financial graphs provides additional perspective on the Company's growth from 1975 to 1979.

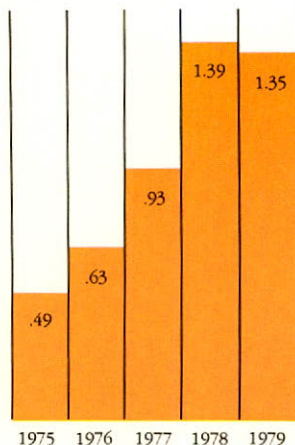
Financial Review



Weighted Average Oil Price
Per Barrel



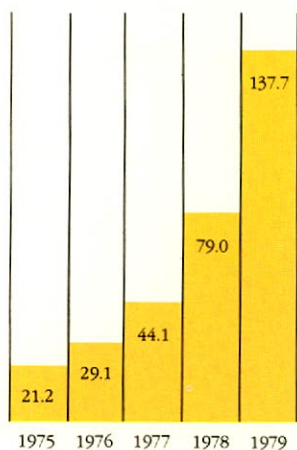
Weighted Average Gas Price
Per MCF



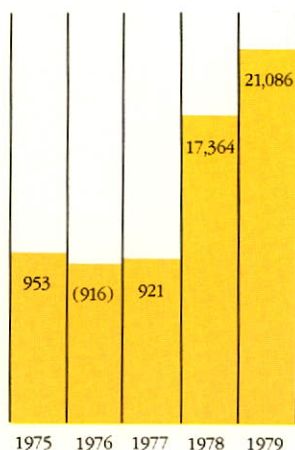
Production Cost Per Dollar
of Oil and Gas Sales



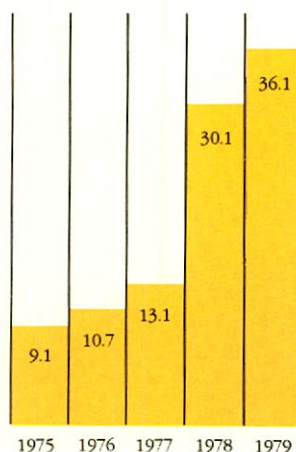
Total Assets,
Million Dollars



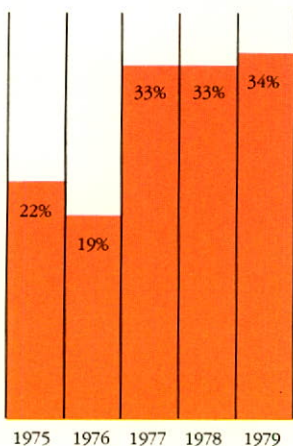
Working Capital,
Million Dollars



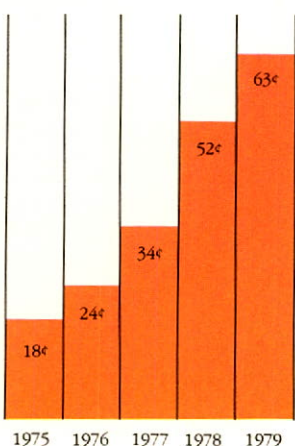
Shareholders' Equity,
Million Dollars



Pre-tax Margin,
Percent



Earnings Per Share,
Fully Diluted



Funds Provided by Operations
Per Share, Fully Diluted



1979 Financial Statements

WAINOCO OIL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

For the years ended December 31, 1979 and 1978

| | 1979 | 1978 |
|--|---------------------|---------------------|
| REVENUES: | | (Restated) |
| Oil and gas sales | \$22,972,000 | \$15,299,000 |
| Interest income | 1,036,000 | 810,000 |
| Other | 976,000 | 752,000 |
| | <u>\$24,984,000</u> | <u>\$16,861,000</u> |
| EXPENSES: | | |
| Production costs | \$ 3,951,000 | \$ 2,553,000 |
| Depreciation, depletion and amortization | 6,502,000 | 4,793,000 |
| General and administrative | 2,839,000 | 2,547,000 |
| Interest — | | |
| Long-term debt and other, net | 5,349,000 | 2,580,000 |
| Charged to associated partnerships | (2,471,000) | (859,000) |
| Provision for losses on equipment inventory | — | 200,000 |
| Loss (gain) on translation of foreign currency | 305,000 | (491,000) |
| | <u>\$16,475,000</u> | <u>\$11,323,000</u> |
| INCOME BEFORE INCOME TAXES | \$ 8,509,000 | \$ 5,538,000 |
| PROVISION FOR INCOME TAXES | 2,494,000 | 1,282,000 |
| NET INCOME | <u>\$ 6,015,000</u> | <u>\$ 4,256,000</u> |
| EARNINGS PER SHARE: | | |
| Primary | \$.64 | \$.55 |
| Fully diluted | <u>\$.63</u> | <u>\$.52</u> |

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

CONSOLIDATED BALANCE SHEETS

December 31, 1979 and 1978

| ASSETS | 1979 | 1978 |
|--|----------------------|---------------------|
| Current Assets: | | (Restated) |
| Cash, including temporary investments of \$2,065,000 in 1979 and \$5,500,000 in 1978 | \$ 3,098,000 | \$ 8,726,000 |
| Accounts receivable— | | |
| Joint operators, pledged | 17,038,000 | 9,510,000 |
| Oil and gas sales | 5,827,000 | 1,926,000 |
| Other | 490,000 | 363,000 |
| Current portion of advances to associated partnerships | 7,947,000 | 5,007,000 |
| Leases, at cost, pledged, and equipment inventory, at average cost, less allowance for inventory losses | 4,565,000 | 3,087,000 |
| Unexpended investment in partnerships | 868,000 | 908,000 |
| Unsecured note receivable, pledged | 1,487,000 | — |
| Other | 268,000 | 824,000 |
| Total current assets | <u>\$ 41,588,000</u> | <u>\$30,351,000</u> |
| Property and Equipment, at cost: | | |
| Oil and gas properties, on a full cost basis, partially pledged | | |
| Cost of properties being amortized | \$ 91,429,000 | \$47,492,000 |
| Cost of properties not being amortized | 13,672,000 | 6,694,000 |
| Furniture, fixtures and other equipment | 1,457,000 | 1,062,000 |
| | <u>\$106,558,000</u> | <u>\$55,248,000</u> |
| Less — Accumulated depreciation, depletion and amortization | 19,812,000 | 13,431,000 |
| | <u>\$ 86,746,000</u> | <u>\$41,817,000</u> |
| Other Assets: | | |
| Unsecured note receivable | \$ — | \$ 1,487,000 |
| Commissions and noncurrent advances to associated partnerships | 8,020,000 | 4,108,000 |
| Debenture issue expense, net of amortization | 1,026,000 | 1,090,000 |
| Other | 336,000 | 144,000 |
| | <u>\$ 9,382,000</u> | <u>\$ 6,829,000</u> |
| | <u>\$137,716,000</u> | <u>\$78,997,000</u> |

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

LIABILITIES AND SHAREHOLDERS' EQUITY

| Current Liabilities: | 1979 | 1978 (Restated) |
|--|----------------------|---------------------|
| Short-term borrowings | \$ 626,000 | \$ 2,654,000 |
| Accounts payable and accrued liabilities | 13,062,000 | 7,378,000 |
| Oil and gas proceeds payable | 6,814,000 | 2,931,000 |
| Income taxes payable | — | 24,000 |
| Total current liabilities | <u>\$ 20,502,000</u> | <u>\$12,987,000</u> |
| 10 3/4% Subordinated Debentures, less unamortized discount of \$2,874,000 in 1979 and \$3,077,000 in 1978 | <u>\$ 27,126,000</u> | <u>\$26,923,000</u> |
| Long-Term Debt | <u>\$ 45,648,000</u> | <u>\$ 4,218,000</u> |
| Deferred Revenue | <u>\$ 716,000</u> | <u>\$ 297,000</u> |
| Deferred Income Taxes | <u>\$ 7,591,000</u> | <u>\$ 4,431,000</u> |
| Commitments and Contingencies | | |
| Shareholders' Equity: | | |
| Common stock, no par, 10,000,000 shares authorized, 9,173,348 shares outstanding in 1979 and 9,018,846 in 1978 | \$ 15,221,000 | \$14,617,000 |
| Paid-in capital | 2,872,000 | 2,814,000 |
| Retained earnings | 18,040,000 | 12,710,000 |
| | <u>\$ 36,133,000</u> | <u>\$30,141,000</u> |
| | <u>\$137,716,000</u> | <u>\$78,997,000</u> |

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

CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION

For the years ended December 31, 1979 and 1978

| | 1979 | 1978 |
|--|---------------|--------------|
| Source of Funds: | | (Restated) |
| Funds provided by operations — | | |
| Net income | \$ 6,015,000 | \$ 4,256,000 |
| Expenses not requiring current outlay of funds — | | |
| Depreciation, depletion, and amortization | 6,502,000 | 4,793,000 |
| Deferred income taxes | 2,949,000 | 1,558,000 |
| Amortization of debenture discount | 203,000 | 51,000 |
| Total from operations | \$15,669,000 | \$10,658,000 |
| Long-term borrowings | 45,648,000 | 21,172,000 |
| Sale of 10 3/4% subordinated debentures | — | 26,872,000 |
| Issuance of common stock | 604,000 | 12,831,000 |
| Deferred revenue | 419,000 | 297,000 |
| Unsecured note receivable | 1,487,000 | — |
| Management fees from associated partnerships included | | |
| in oil and gas properties | 728,000 | 501,000 |
| Other, net | 77,000 | (95,000) |
| Total source of funds | \$64,632,000 | \$72,236,000 |
| Application of Funds: | | |
| Additions to property and equipment | \$52,095,000 | \$22,915,000 |
| Payments on long-term debt and change in current maturities | 4,218,000 | 19,854,000 |
| Increase in commissions and noncurrent advances to associated partnerships | 3,912,000 | 2,510,000 |
| Debenture issue expense | — | 1,108,000 |
| Cash dividends | 685,000 | — |
| Conversion of convertible subordinated debentures, | | |
| net of unamortized issue expense of \$594,000 | — | 9,406,000 |
| Total application of funds | \$60,910,000 | \$55,793,000 |
| Increase in Working Capital | \$ 3,722,000 | \$16,443,000 |
| Increase (Decrease) in Components of Working Capital: | | |
| Cash | \$(5,628,000) | \$ 1,724,000 |
| Accounts receivable | 11,556,000 | 7,259,000 |
| Current portion of advances to associated partnerships | 2,940,000 | 3,383,000 |
| Leases and equipment inventory | 1,478,000 | 223,000 |
| Unexpended investment in partnerships | (40,000) | 908,000 |
| Unsecured note receivable | 1,487,000 | — |
| Other current assets | (556,000) | 753,000 |
| Short-term borrowings | 2,028,000 | 5,945,000 |
| Current maturities of long-term debt | — | 1,200,000 |
| Accounts payable and accrued liabilities | (5,684,000) | (4,040,000) |
| Oil and gas proceeds payable | (3,883,000) | (1,008,000) |
| Income taxes payable | 24,000 | 96,000 |
| Increase in Working Capital | \$ 3,722,000 | \$16,443,000 |
| Working Capital, beginning of year | 17,364,000 | 921,000 |
| Working Capital, end of year | \$21,086,000 | \$17,364,000 |

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

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

For the years ended December 31, 1979 and 1978

| | Common Stock | | Paid-In Capital | Retained Earnings | Total |
|--|---------------------|--------------|--------------------|----------------------|--------------|
| | Number of Shares | Amount | | | |
| Balance, | (Restated) | | | (Restated) | (Restated) |
| December 31, 1977 | 6,405,594 | \$ 1,786,000 | \$ 2,814,000 | \$ 8,454,000 | \$13,054,000 |
| Exercise of stock options | 95,400 | 150,000 | — | — | 150,000 |
| Issuance of shares under stock purchase plan | 24,438 | 83,000 | — | — | 83,000 |
| Conversion of convertible subordinated debentures | 2,073,414 | 9,597,000 | — | — | 9,597,000 |
| Issuance of common stock in connection with sale of subordinated debentures | 420,000 | 3,001,000 | — | — | 3,001,000 |
| Net income | — | — | — | 4,256,000 | 4,256,000 |
| Balance, | | | | | |
| December 31, 1978 | 9,018,846 | \$14,617,000 | \$ 2,814,000 | \$12,710,000 | \$30,141,000 |
| Exercise of stock options | 132,060 | 438,000 | — | — | 438,000 |
| Issuance of shares under stock purchase plan | 22,442 | 166,000 | — | — | 166,000 |
| Net income | — | — | — | 6,015,000 | 6,015,000 |
| Cash dividends | — | — | — | (685,000) | (685,000) |
| Other | — | — | 58,000 | — | 58,000 |
| Balance, | | | | | |
| December 31, 1979 | 9,173,348 | \$15,221,000 | \$ 2,872,000 | \$18,040,000 | \$36,133,000 |

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

WAINOCO OIL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 1979 and 1978

(1) Summary of significant accounting policies

Principles of consolidation

The consolidated financial statements include the accounts of Wainoco Oil Corporation (the Parent), a Wyoming 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 1978 financial statements to conform to current classifications.

Currency translation

The Canadian dollar financial statements of Wainoco Limited have been translated to United States dollars. Gains and losses on translation are included in the consolidated statements of income currently.

Oil and gas properties

Wainoco follows the accounting policy (commonly referred to as "full-cost" accounting) of capitalizing 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.

Wainoco's investment in limited partnerships is accounted for on the proportionate consolidation method. Wainoco's proportionate share of the partnerships' assets, liabilities, revenues and expenses is included in the appropriate classifications in the accompanying consolidated financial statements. Substantially all of Wainoco's investment is attributable to oil and gas property costs.

Wainoco computes the provision for depreciation, depletion, and amortization (DD&A) of oil and gas properties on a quarterly basis using the composite unit-of-production method based on dollars of future gross revenue attributable to proved reserves. Under this method, the quarterly provision is calculated by multiplying the total unamortized cost of oil and gas properties (excluding the cost of significant investments in unproved and unevaluated properties) by an overall rate determined by dividing (a) the quarter's oil and gas revenue by (b) the total future oil and gas revenue as estimated by a firm of independent petroleum engineers or Wainoco.

Income taxes

The Parent and Wainoco Company file a consolidated United States Federal income tax return. The Parent charges Wainoco Company with an amount equal to the income taxes it would pay on a separate return basis. Wainoco Limited files a separate Canadian income tax return. Wainoco Company and Wainoco Limited provide deferred taxes on a separate return basis.

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 follows the flow-through method of accounting for investment tax credits received in the United States whereby the credits available each year are applied as a reduction of the United States tax provision.

Common stock

In October, 1979, Wainoco's Board of Directors approved a 2-for-1 split of the Company's common stock. All computations of shares outstanding and earnings per share for the years ended December 31, 1979 and 1978, have given retroactive recognition for this stock split.

In a special meeting in February, 1980, shareholders approved an increase in authorized common shares from 10,000,000 to 25,000,000.

Earnings per share

Primary earnings per share have been computed based on the weighted average number of common shares outstanding and assuming exercise of stock option shares during 1979 and 1978. The convertible subordinated debentures discussed in Note 3 were not common stock equivalents. The average common and common equivalent shares outstanding were 9,439,472 in 1979 and 7,782,998 in 1978.

Fully diluted earnings per share assume the addition of dilutive stock options and shares issuable upon conversion of the convertible subordinated debentures and the related reduction of interest expense, net of income tax effect (\$376,000 in 1978). The weighted average shares outstanding assuming full dilution were 9,492,268 for 1979 and 8,912,376 in 1978.

As discussed in Note 3, in June, 1978, the Parent called for the redemption of its outstanding 8% convertible subordinated debentures by July 31, 1978. Had all \$9,970,000 of the debentures which were converted through July 31, 1978, been converted at January 1, 1978, primary earnings per common and common equivalent share for the year ended December 31, 1978, would have been \$.52.

Interest capitalization

Wainoco follows the policy of capitalizing interest on the cost of significant investments in unproved and unevaluated oil and gas properties excluded from the capitalized costs to be amortized. In 1979, interest of \$689,000 was capitalized as oil and gas properties.

Accounting changes

In 1978, the Securities and Exchange Commission (SEC) announced that it would take steps to develop a method of accounting that recognizes valuations of proved oil and gas reserves in the balance sheets and income statements of oil and gas producers. During the interim period, the SEC requires companies following the full-cost method of accounting to adopt certain specified accounting rules for reporting periods ending after December 25, 1979, by retroactively restating prior years' financial statements. These methods require, among other things, that full tax allocation accounting be followed for costs incurred in the acquisition, exploration and development of oil and gas reserves and that cost centers be established on a country-by-country basis. In previous periods Wainoco has recognized the interaction of statutory depletion with book/tax differences and maintained one worldwide full cost pool.

All 1978 financial statements presented herein have been retroactively restated to conform with the SEC's full cost rules. As a result of this restatement, retained earnings as of December 31, 1978, were reduced by \$1,210,000 and net income for the year ended December 31, 1978, was decreased \$1,173,000 (\$.13 per share, fully diluted).

In October, 1979, the Financial Accounting Standards Board issued Statement No. 34 which requires the capitalization of interest for certain assets. The statement is to be applied prospectively for reporting periods beginning after December 15, 1979.

In the fourth quarter of 1979, Wainoco elected early adoption of Statement No. 34 retroactive to January 1, 1979. Accordingly, the net income and earnings per share previously reported for the first three quarters of 1979 have been restated as set forth in Note 9.

(2) Oil and gas properties, reserves and related financial data

Oil and gas properties

The following tables set forth (in thousands) the costs incurred in oil and gas producing activities for the years ended December 31, 1979 and 1978, and the capitalized costs and related accumulated depreciation, depletion and amortization (DD&A) at December 31, 1979 and 1978.

| | Year Ended December 31 | | | | | |
|-------------------------------------|------------------------|-----------------|-----------------|-----------------|----------------|-----------------|
| | 1979 | | | 1978 | | |
| | United States | Canada | Total | United States | Canada | Total |
| Capitalized costs incurred: | | | | | | |
| Property acquisition | \$ 6,816 | \$ 8,800 | \$15,616 | \$ 5,496 | \$2,651 | \$ 8,147 |
| Exploration | 4,497 | 1,758 | 6,255 | 3,816 | 2,976 | 6,792 |
| Development | 11,986 | 6,815 | 18,801 | 4,120 | 3,132 | 7,252 |
| Purchase of reserves-in-place | 7,404 | 3,567 | 10,971 | — | — | — |
| | <u>\$30,703</u> | <u>\$20,940</u> | <u>\$51,643</u> | <u>\$13,432</u> | <u>\$8,759</u> | <u>\$22,191</u> |
| Production costs: | | | | | | |
| Operating costs | \$ 1,676 | \$ 1,604 | \$ 3,280 | \$ 1,246 | \$ 768 | \$ 2,014 |
| Production taxes | 671 | — | 671 | 539 | — | 539 |
| | <u>\$ 2,347</u> | <u>\$ 1,604</u> | <u>\$ 3,951</u> | <u>\$ 1,785</u> | <u>\$ 768</u> | <u>\$ 2,553</u> |

Year Ended December 31

| | 1979 | | | 1978 | | |
|--|-----------------|-----------------|------------------|-----------------|-----------------|-----------------|
| | United States | Canada | Total | United States | Canada | Total |
| Capitalized costs: | | | | | | |
| Unproved properties | \$ 8,859 | \$ 7,760 | \$ 16,619 | \$ 5,466 | \$ 1,744 | \$ 7,210 |
| Proved properties | 50,916 | 37,566 | 88,482 | 24,334 | 22,642 | 46,976 |
| Total | <u>\$59,775</u> | <u>\$45,326</u> | <u>\$105,101</u> | <u>\$29,800</u> | <u>\$24,386</u> | <u>\$54,186</u> |
| DD&A: | | | | | | |
| Balance, beginning of year | \$ 9,708 | \$ 3,409 | \$ 13,117 | \$ 6,268 | \$ 2,227 | \$ 8,495 |
| Current year provision | 4,235 | 1,991 | 6,226 | 3,440 | 1,182 | 4,622 |
| Balance, end of year | <u>\$13,943</u> | <u>\$ 5,400</u> | <u>\$ 19,343</u> | <u>\$ 9,708</u> | <u>\$ 3,409</u> | <u>\$13,117</u> |
| DD&A per dollar of oil and gas sales | <u>\$.34</u> | <u>\$.19</u> | <u>\$.27</u> | <u>\$.36</u> | <u>\$.21</u> | <u>\$.30</u> |

At December 31, 1979, Wainoco had invested \$13,672,000 in unproved and unevaluated properties, consisting primarily of lease acquisition costs, which have been excluded from the cost of properties to be amortized since they had not been sufficiently tested to determine whether proved reserves were attributable to the properties or whether impairment had occurred. It is anticipated that exploration and development activities projected for 1980 will determine the final evaluation of these properties. It is not possible at this time to determine the potential impact on the amortization rate for inclusion of these costs and related reserves, if any.

Reserves and future net revenues (unaudited)

The following table identifies Wainoco's proved oil and gas reserves as of December 31, 1979 and 1978, as estimated by Ryder Scott Company, a firm of independent petroleum engineers. Crude oil includes condensate and natural gas liquids and is stated in thousands of barrels. Natural gas is stated in millions of cubic feet.

| | United States | | Canada | | Total | |
|---|---------------|---------------|--------------|----------------|--------------|----------------|
| | Oil | Gas | Oil | Gas | Oil | Gas |
| <u>1979</u> | | | | | | |
| Proved developed and undeveloped reserves: | | | | | | |
| Beginning of year | 1,131 | 13,272 | 1,033 | 147,594 | 2,164 | 160,866 |
| Revisions to previous estimates | 118 | 876 | 164 | (1,521) | 282 | (645) |
| Improved recovery | 70 | — | — | — | 70 | — |
| Extension, discoveries and other additions | 482 | 25,663 | 53 | 79,520 | 535 | 105,183 |
| Purchase of reserves-in-place | 69 | 5,261 | 23 | 6,226 | 92 | 11,487 |
| Production | (275) | (3,924) | (153) | (8,960) | (428) | (12,884) |
| End of year | <u>1,595</u> | <u>41,148</u> | <u>1,120</u> | <u>222,859</u> | <u>2,715</u> | <u>264,007</u> |
| Proved developed reserves: | | | | | | |
| Beginning of year | 1,131 | 13,272 | 1,006 | 92,674 | 2,137 | 105,946 |
| End of year | 1,595 | 31,976 | 1,096 | 143,097 | 2,691 | 175,073 |
| <u>1978</u> | | | | | | |
| Proved developed and undeveloped reserves: | | | | | | |
| Beginning of year | 1,268 | 10,896 | 1,100 | 99,618 | 2,368 | 110,514 |
| Revisions to previous estimates | 99 | 3,028 | (30) | 3,447 | 69 | 6,475 |
| Extensions, discoveries and other additions | 53 | 3,155 | 81 | 48,831 | 134 | 51,986 |
| Production | (289) | (3,807) | (118) | (4,302) | (407) | (8,109) |
| End of year | <u>1,131</u> | <u>13,272</u> | <u>1,033</u> | <u>147,594</u> | <u>2,164</u> | <u>160,866</u> |
| Proved developed reserves: | | | | | | |
| Beginning of year | 1,268 | 10,896 | 1,056 | 50,450 | 2,324 | 61,346 |
| End of year | 1,131 | 13,272 | 1,006 | 92,674 | 2,137 | 105,946 |

Presented below (in thousands) are the estimated future net revenue and present value of future net revenue (discounted at a rate of 10 percent per year) from proved oil and gas reserves at December 31, 1979 and 1978. This information is based on prices in effect as of December 31, 1979 and 1978 (considering possible future price escalations only to the extent provided by fixed determinable contractual arrangements) and future development costs. Current costs used in the computations assumed a continuation of existing economic conditions.

| | Estimated Future Net Revenue | | | | | |
|--|---|------------------|------------------|------------------|------------------|------------------|
| | Proved Developed and Undeveloped | | | Proved Developed | | |
| | United States | Canada | Total | United States | Canada | Total |
| 1979 | | | | | | |
| 1980 | \$ 17,655 | \$ 9,668 | \$ 27,323 | \$20,315 | \$ 10,431 | \$ 30,746 |
| 1981 | 12,614 | 12,280 | 24,894 | 14,323 | 12,837 | 27,160 |
| 1982 | 13,932 | 10,513 | 24,445 | 10,079 | 11,353 | 21,432 |
| Remainder | 67,924 | 190,394 | 258,318 | 47,458 | 124,578 | 172,036 |
| | <u>\$112,125</u> | <u>\$222,855</u> | <u>\$334,980</u> | <u>\$92,175</u> | <u>\$159,199</u> | <u>\$251,374</u> |
| 1978 | | | | | | |
| 1979 | \$ 6,846 | \$ 6,585 | \$ 13,431 | \$ 6,846 | \$ 6,996 | \$ 13,842 |
| 1980 | 4,704 | 6,836 | 11,540 | 4,704 | 7,349 | 12,053 |
| 1981 | 3,499 | 7,502 | 11,001 | 3,499 | 7,899 | 11,398 |
| Remainder | 10,531 | 92,853 | 103,384 | 10,531 | 58,235 | 68,766 |
| | <u>\$ 25,580</u> | <u>\$113,776</u> | <u>\$139,356</u> | <u>\$25,580</u> | <u>\$ 80,479</u> | <u>\$106,059</u> |
| | Estimated Present Value of Future Net Revenues | | | | | |
| | United States | Canada | Total | | | |
| Proved developed and undeveloped reserves: | | | | | | |
| 1979 | <u>\$68,918</u> | <u>\$100,564</u> | <u>\$169,482</u> | | | |
| 1978 | <u>\$18,645</u> | <u>\$ 52,832</u> | <u>\$ 71,477</u> | | | |
| Proved developed reserves: | | | | | | |
| 1979 | <u>\$61,311</u> | <u>\$ 83,557</u> | <u>\$144,868</u> | | | |
| 1978 | <u>\$18,645</u> | <u>\$ 46,238</u> | <u>\$ 64,883</u> | | | |

(3) Subordinated debentures, long-term debt and short-term borrowings

8% Convertible subordinated debentures

In June 1978, the Parent called for the redemption of its \$10,000,000 8% convertible subordinated debentures. Debentures totaling \$9,970,000 were converted at the option of holders at \$4.81 per share and 2,073,414 shares of common stock were issued upon such conversion. The balance of the debentures (\$30,000) were redeemed at 110% plus accrued interest. Upon conversion, the principal amount of the debentures and accrued interest, net of income tax effect, through the date of conversion, less unamortized issue expense, were credited to common stock.

10 3/4% Subordinated debentures

In October, 1978, the Parent sold \$30,000,000 of 10 3/4% subordinated debentures due in 1998 with 420,000 shares of common stock. The issue price of the debentures and common stock (\$30,000,000) and the related issue expense (\$1,235,000) were allocated between the debentures and the common stock based on their fair market value. The portion of

the issue price allocated to common stock (\$3,128,000) constitutes issue discount which is being amortized over the life of the debentures. Amortization for 1979 and 1978 was \$203,000 and \$51,000, respectively. Interest on the debentures is payable semi-annually and annual sinking fund payments of \$2,500,000 begin in 1988. The debentures are redeemable at 110.75% beginning in 1978, declining annually to 100% in 1988. The indenture covering the debentures provides, among other things, that Wainoco is restricted from paying cash dividends or acquiring its stock if the aggregate payments for such purposes would exceed the sum of (1) consolidated net income earned subsequent to December 31, 1977, (2) net proceeds received from the issuance or sale of common stock subsequent to December 31, 1977, and (3) the aggregate of the net proceeds received from the issuance or sale of indebtedness which is converted into common stock subsequent to December 31, 1977. At December 31, 1979, this amount aggregated approximately \$24 million.

Long-term debt

Long-term debt at December 31, 1979 and 1978, consisted of the following:

| | 1979 | 1978 |
|---|-----------------|----------------|
| | (In thousands) | |
| Demand note payable by Wainoco Limited to a Canadian bank of \$5,000,000 (Canadian); interest at the bank's prime commercial rate plus .75 percent; secured by substantially all Canadian oil and gas properties; guaranteed by the Parent; paid January, 1979 | \$ — | \$4,218 |
| Demand note payable by Wainoco Limited to a Canadian bank of \$29,900,000 (Canadian); secured by substantially all Canadian oil and gas properties; due July 31, 1981; guaranteed by the Parent (see discussion below) | 25,624 | — |
| Note payable by Wainoco Company to a United States bank; secured by substantially all United States oil and gas properties, lease inventory, accounts receivable from joint operators, the unsecured note receivable and payments receivable from a pipeline construction contract; due April 30, 1981 (see discussion below) | 18,500 | — |
| Wainoco's proportionate share of notes payable by associated partnerships, secured by the partnerships' oil and gas properties | 1,524 | — |
| | <u>\$45,648</u> | <u>\$4,218</u> |

A Canadian bank has provided Wainoco Limited with a revolving line of credit of \$40,000,000 (U.S. dollar equivalent of approximately \$34,300,000 at December 31, 1979) with interest at the bank's prime rate plus one half of one percent and an annual commitment fee of one half of one percent on any unused portion. Under the terms of the loan agreement, the bank has the option to review the secured oil and gas properties and make a determination of the credit to be made available (the borrowing base). If the bank, at its sole discretion, determines that the aggregate unpaid balance on the line is in excess of the borrowing base, then Wainoco Limited must either (1) provide additional security to increase the borrowing base to an amount at least equal to such excess, (2) repay any such excess, or (3) convert the outstanding balance to a six-year term loan repayable in equal monthly principal installments with interest at the bank's prime rate plus one percent. Although the advance on the line of credit is evidenced by a demand note, the bank has advised Wainoco Limited that it will not require repayment as long as the terms and conditions of the loan agreement are met.

A United States bank has provided Wainoco Company with a revolving line of credit of \$27,000,000 with interest at the bank's prime rate plus three fourths of one percent and an annual commitment fee of one half of one percent on any unused portion. The loan agreement provides, among other things, that Wainoco Company (1) will not incur any additional indebtedness, except as provided for in the loan agreement, which permits debt subordinate to the bank, senior debt up to 10 percent of the borrowing base, liabilities incurred in formation and operation of associated limited partnerships, and certain other exclusions, (2) will not sell or otherwise dispose of a substantial portion of its properties and (3) will maintain a current ratio (excluding current maturities of the bank's note payable) of at least one to one. During the term of the agreement, the bank will review

the secured oil and gas properties and make a semi-annual determination of the credit to be made available to Wainoco Company (the borrowing base). If the bank determines that the unpaid balance on the line is in excess of the borrowing base, then Wainoco Company must either (1) repay any such excess, or (2) provide additional security to increase the borrowing base to an amount at least equal to such excess.

Short-term borrowings

Short-term borrowings at December 31, 1978, include cash overdrafts of \$2,233,000 which were paid in January, 1979.

The maximum amount of short-term borrowings outstanding as of any month-end was approximately \$440,000 in 1979 and \$5,000,000 in 1978. The average amount outstanding was approximately \$550,000 in 1979 and \$2,100,000 in 1978, and the average interest rate paid was approximately 13.9 percent in 1979 and 10.2 percent in 1978.

The Canadian bank has agreed to provide Wainoco Limited with a demand loan of up to \$500,000 (U.S. dollar equivalent of approximately \$430,000 at December 31, 1979) for working capital purposes. This loan bears interest at the bank's prime rate plus one half of one percent. Wainoco Limited has drawn \$500,000 on this line of credit as of December 31, 1979.

(4) Associated partnerships

The Parent and/or its subsidiaries are general partners in fifteen 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 June and August, 1979, Wainoco completed the sale of interests in Wainoco 79 Company (a Texas limited partnership) and Wainoco 79 Canada (an Alberta limited partnership), respectively. Wainoco subscribed for \$5,000,000 and \$2,000,000 (Canadian), respectively, of limited partner interests in these partnerships. The unexpended portion of these contributions is included in current assets in the accompanying December 31, 1979, consolidated balance sheet, and will be reclassified to oil and gas properties as the total limited partner contributions are expended.

In February, 1980, Wainoco formed Wainoco 80 Company, a Texas limited partnership. Certain leases, equipment inventory and other charges incurred in anticipation of the formation of this and other future partnerships are included in current assets in the accompanying December 31, 1979, consolidated balance sheet.

The general partners have (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. 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 \$1,806,000 and \$1,143,000 at December 31, 1979 and 1978, respectively. These amounts have been included in oil and gas properties since the expenditures were discretionary in nature and considered to be an integral part of Wainoco's oil and gas exploration and development activities. Amortization is being computed on these amounts in the same

manner as other investments in oil and gas properties. The amounts may change in future periods depending on the determination of the estimated fair market value of the partnerships' oil and gas properties.

The general partners may be required to purchase the limited partners' interest in the partnerships in varying amounts, depending on the terms of the different partnership agreements. The purchase price will generally be based on the limited partners' share of (1) the estimated present value of future net income from oil and gas properties, discounted for risk factors associated with developing and producing the reserves, (2) the value of undeveloped acreage held by the partnerships, and (3) the value of other partnership assets and liabilities. At December 31, 1979, the partnerships formed prior to 1979 had been evaluated. The maximum purchase commitment as of December 31, 1979, for the evaluated partnerships was \$38,500,000 and the maximum annual non-cumulative purchase commitment for all partnerships (assuming no prior purchases of the partnership interests) was \$13,700,000 for 1980, \$16,200,000 for 1981 through 1985 and decreasing amounts through 2001, the year in which all partnerships will have terminated. Of the total maximum purchase commitment for evaluated partnerships, Wainoco believes that approximately \$26,900,000 would be available in borrowings secured by the oil and gas reserves attributable to the interests of the limited partners in these partnerships. In the future, these purchase commitments and the available borrowings may be more or less depending upon future estimates of each partnership's oil and gas reserves and net assets.

(5) Income taxes

The provision for income taxes (in thousands) for 1979 and 1978 consisted of the following:

| | 1979 | 1978 (Restated) |
|-------------------------------------|-----------------|--------------------|
| Canadian income taxes— | | |
| Current | \$ (455) | \$ (310) |
| Deferred | 2,067 | 1,030 |
| | <u>\$ 1,612</u> | <u>\$ 720</u> |
| United States Federal income taxes— | | |
| Current | \$ — | \$ 34 |
| Deferred | 882 | 528 |
| | <u>\$ 882</u> | <u>\$ 562</u> |
| | <u>\$ 2,494</u> | <u>\$ 1,282</u> |

Deferred income tax expense is primarily attributable to exploration and development expenses capitalized for financial reporting purposes and deducted for tax reporting purposes.

Set forth below (in thousands) is a reconciliation between the provision for income taxes computed at the statutory Canadian and United States Federal income tax rates on income before provision for income taxes and the provision for income taxes as reported.

| | 1979 | 1978 (Restated) |
|---|-----------------|--------------------|
| Provision for Canadian and United States income taxes at statutory rates | \$ 4,010 | \$ 2,658 |
| 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 | \$ 2,578 | \$ 1,203 |
| Resource and depletion allowances | (2,404) | (1,216) |
| Provincial tax credits and rebates | (684) | (426) |
| Investment tax credits | (172) | (60) |
| Other, net | 2 | (85) |
| | <u>\$ (680)</u> | <u>\$ (584)</u> |
| United States— | | |
| Statutory depletion in excess of tax basis | \$ (575) | \$ (435) |
| Investment tax credits | (315) | (422) |
| Other, net | 54 | 65 |
| | <u>\$ (836)</u> | <u>\$ (792)</u> |
| Provision for income taxes, as reported | <u>\$ 2,494</u> | <u>\$ 1,282</u> |

As of December 31, 1979, Wainoco has a United States tax depletion carry-forward of approximately \$2,800,000 which is indefinitely available to reduce United States Federal income taxes payable and, a United States net operating loss carry-forward of approximately \$5,200,000. In addition, Wainoco has approximately \$1,300,000 of investment tax credit carry-forwards available to reduce future Canadian and United States Federal income taxes payable, all of which have been recognized as a reduction of deferred income taxes for financial reporting purposes through December 31, 1979. Wainoco Limited has an earned depletion base carry-forward of approximately \$9,300,000 for Canadian income tax purposes of which \$3,600,000 has been recognized for financial reporting purposes through December 31, 1979.

(6) Stock option plans and stock purchase plan

Stock option plans

Wainoco has three stock option plans which authorize the granting of options to purchase 1,224,000 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 granted at not less than fair market value on the date of grant. 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, 1979, options for 699,040 shares were outstanding at prices ranging from \$.81 to \$27.00 per share and options to purchase 47,800 shares were available to be granted under the plans.

A summary of the 1979 and 1978 stock option activity is as follows:

| | 1979 | | 1978 | |
|----------------------------------|------------------|-----------------------|------------------|----------------------|
| | Number of Shares | Option Price | Number of Shares | Option Price |
| Balance, beginning of year | 584,400 | \$.69-\$ 8.82 | 397,000 | \$.69-\$4.69 |
| Granted | 328,900 | \$6.25-\$27.00 | 292,000 | \$3.35-\$8.82 |
| Terminated or lapsed | (82,200) | \$1.09-\$10.63 | (9,200) | \$2.07-\$4.69 |
| Exercised | (132,060) | \$.81-\$11.44 | (95,400) | \$.69-\$4.69 |
| Balance, end of year | <u>699,040</u> | <u>\$.81-\$27.00</u> | <u>584,400</u> | <u>\$.69-\$8.82</u> |

Stock purchase plan

In May, 1977, the shareholders approved an employee stock purchase plan under which an aggregate of 400,000 shares of common stock may be issued. All permanent, full-time employees who are employed for the full plan year are eligible to participate in the plan except those who own in excess of five percent of Wainoco's outstanding common stock. The plan allows each eligible employee to purchase Wainoco stock at 85 percent of market value subject to certain limitations. There have been 46,880 shares purchased through the plan as of December 31, 1979. No entries are made in the accounts until shares are purchased, at which time the proceeds are credited to common stock.

(7) Commitments and contingencies

Pension plans

Wainoco Company's pension plan is noncontributory, open to all United States employees over 25 years of age with one year of service and has a normal retirement age of 65. Pension plan expense was \$165,000 in 1979 and \$96,000 in 1978, including amortization of unfunded prior service costs of \$124,000 over 30 years. Wainoco's policy is to fund pension costs accrued. As of December 31, 1979, the pension plan's assets exceeded the actuarially computed value of vested benefits by approximately \$601,000.

Wainoco Limited's pension plan is open to all Canadian employees over 25 years of age and provides for a normal retirement age of 65 and for voluntary employee contributions. Wainoco Limited accrued \$84,000 in 1979 and \$54,000 in 1978 as its contribution to the plan.

Lease commitments

Wainoco has entered into four noncapitalized building lease agreements which expire from 1981 through 1990. The following is a summary of Wainoco's minimum annual rental payments (in thousands) as of December 31, 1979, under these agreements:

| | |
|-----------------|--------|
| 1980 | \$ 669 |
| 1981 | 754 |
| 1982 | 757 |
| 1983 | 795 |
| 1984 | 795 |
| 1985-1990 | 3,447 |

Other

The general partners are contingently liable for the liabilities of the limited partners of certain of the associated partnerships, including aggregate bank indebtedness of approximately \$2,490,000 at December 31, 1979, secured by substantially all of the partnerships' assets.

(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 (in thousands) are the revenues and net income for the years 1979 and 1978 and identifiable assets as of December 31, 1979 and 1978, by country:

| | United States | Canada | Consolidated |
|---------------------------|---------------|-----------|--------------|
| 1979 | | | |
| Revenues | \$ 13,534 | \$ 11,450 | \$ 24,984 |
| Net income | 2,088 | 3,927 | 6,015 |
| Identifiable assets | 81,712 | 56,004 | 137,716 |

1978 (Restated)

| | | | |
|---------------------------|-----------|----------|-----------|
| Revenues | \$ 10,677 | \$ 6,184 | \$ 16,861 |
| Net income | 2,002 | 2,254 | 4,256 |
| Identifiable assets | 44,726 | 34,271 | 78,997 |

During 1979, Wainoco made sales to two major customers of \$6,400,000, and \$3,800,000 which accounted for 41 percent of consolidated revenues. During 1978, Wainoco made sales to four major customers of \$2,400,000, \$2,100,000, \$1,700,000 and \$1,600,000 which accounted for 46 percent of consolidated revenues.

(9) Selected quarterly financial data (unaudited)

Summarized below is Wainoco's quarterly unaudited financial data for 1979 and 1978. Such amounts differ from the amounts previously reported to give effect to the accounting changes described in Note 1.

| Three Months Ended | | | | |
|--|----------|----------|--------------|-------------|
| | March 31 | June 30 | September 30 | December 31 |
| (In thousands, except per share amounts) | | | | |
| 1979(a)— | | | | |
| Revenues | \$ 5,378 | \$ 4,962 | \$ 5,984 | \$ 8,660 |
| Income before income taxes .. | \$ 2,069 | \$ 1,364 | \$ 1,584 | \$ 3,492 |
| Provision for income taxes .. | 579 | 332 | 553 | 1,030 |
| Net income | \$ 1,490 | \$ 1,032 | \$ 1,031 | \$ 2,462 |
| Earnings per share— | | | | |
| Primary | \$.16 | \$.11 | \$.11 | \$.26 |
| Fully diluted .. | \$.16 | \$.11 | \$.11 | \$.25 |
| Dividends per share | \$.015 | \$.015 | \$.015 | \$.03 |
| 1978(b)— | | | | |
| Revenues | \$ 3,236 | \$ 4,240 | \$ 4,259 | \$ 5,126 |
| Income before income taxes .. | \$ 1,107 | \$ 1,185 | \$ 1,627 | \$ 1,619 |
| Provision for income taxes .. | 334 | 343 | 377 | 228 |
| Net income | \$ 773 | \$ 842 | \$ 1,250 | \$ 1,391 |
| Earnings per share— | | | | |
| Primary | \$.12 | \$.12 | \$.15 | \$.16 |
| Fully diluted .. | \$.11 | \$.11 | \$.14 | \$.16 |
| Dividends per share | \$ — | \$ — | \$ — | \$ — |

Notes:

(a) The amounts presented for the first three quarters of 1979 have been restated to give effect to the early adoption of Statement of Financial Accounting Standards No. 34. As a result of this restatement, previously reported net income and earnings per share have been increased (decreased) as follows:

| | First Quarter | Second Quarter | Third Quarter |
|--|------------------|-------------------|------------------|
| (In thousands, except per share amounts) | | | |
| Income before income taxes . . . | \$ 92 | \$ 95 | \$ 151 |
| Provision for income taxes | (36) | (37) | (61) |
| Net income | <u>\$ 56</u> | <u>\$ 58</u> | <u>\$ 90</u> |
| Earnings per share— | | | |
| Primary | <u>\$ —</u> | <u>\$.01</u> | <u>\$.01</u> |
| Fully diluted | <u>\$ —</u> | <u>\$.01</u> | <u>\$.01</u> |

(b) The amounts presented for 1978 have been restated to give effect to the adoption of the SEC's full-cost accounting rules. As a result of this restatement, previously reported revenues, net income and earnings per share have been increased (decreased) as follows:

| | First Quarter | Second Quarter | Third Quarter | Fourth Quarter |
|--|------------------|-------------------|------------------|-------------------|
| (In thousands, except per share amounts) | | | | |
| Revenues | <u>\$ 92</u> | <u>\$ 157</u> | <u>\$ 171</u> | <u>\$ 119</u> |
| Income before income taxes | \$ (42) | \$ (171) | \$ (210) | \$ (269) |
| Provision for income taxes | (82) | (152) | (188) | (59) |
| Net income | <u>\$ (124)</u> | <u>\$ (323)</u> | <u>\$ (398)</u> | <u>\$ (328)</u> |
| Earnings per share— | | | | |
| Primary | <u>\$ (.01)</u> | <u>\$ (.05)</u> | <u>\$ (.05)</u> | <u>\$ (.04)</u> |
| Fully diluted | <u>\$ (.01)</u> | <u>\$ (.04)</u> | <u>\$ (.05)</u> | <u>\$ (.03)</u> |

(10) Reserve Recognition Accounting (Unaudited)

In September, 1979, the SEC adopted a requirement that all oil and gas producing companies include in their financial statements a supplemental earnings summary prepared on the basis of Reserve Recognition Accounting (RRA) beginning with fiscal years ending after December 25, 1979.

Under RRA, a valuation of the Company's proved reserves is recognized as an asset and net changes to the valuation are included in earnings as they occur. Under the full-cost method of accounting followed by the Company, oil and gas properties included in the accompanying Consolidated Balance Sheets

consist of capitalized costs incurred in the acquisition, exploration and development of oil and gas reserves, and revenues reported in the accompanying Consolidated Statements of Income are recognized as those reserves are produced.

Presented below are the Analysis of Changes in Estimated Present Value of Future Net Revenues from Proved Oil and Gas Reserves, and the unaudited Consolidated Supplemental Earnings Summary prepared on the basis of RRA for the years ended December 31, 1979 and 1978.

WAINOCO OIL CORPORATION AND SUBSIDIARIES

ANALYSIS OF CHANGES IN ESTIMATED PRESENT VALUE OF FUTURE NET REVENUES FROM PROVED OIL AND GAS RESERVES

For the years ended December 31, 1979 and 1978

| | 1979 | 1978 |
|--|------------------|-----------------|
| | (In thousands) | |
| Balance—beginning of year | \$ 71,477 | \$63,746 |
| Revisions to reserves proved in prior years | 34,278 | 2,199 |
| New field discoveries and extensions | 87,509 | 22,802 |
| Purchases of reserves-in-place | 9,867 | — |
| Development costs considered in valuation of proved reserves in prior year | (14,628) | (4,524) |
| Production, net of production costs | (19,021) | (12,746) |
| Balance—end of year | <u>\$169,482</u> | <u>\$71,477</u> |

CONSOLIDATED SUPPLEMENTAL EARNINGS SUMMARY

For the years ended December 31, 1979 and 1978

Prepared on the basis of Reserve Recognition Accounting (RRA)

(Unaudited)

| | 1979 | 1978 |
|--|----------------|----------|
| | (In thousands) | |
| Additions to Proved Reserves: | | |
| Revisions to reserves proved in prior years: | | |
| Changes in price | \$ 27,300 | \$ 1,913 |
| Other | (170) | (6,089) |
| Interest factor — accretion of discount | 7,148 | 6,375 |
| Total revisions to proved reserves | \$ 34,278 | \$ 2,199 |
| New field discoveries, extensions and purchases | 87,509 | 22,802 |
| Total revisions to proved reserves | \$121,787 | \$25,001 |
| Exploration and development costs: | | |
| Costs incurred during the year — | | |
| Acquisition of properties | \$ 15,616 | \$ 8,147 |
| Exploration | 6,255 | 6,792 |
| Development, net | 18,801 | 7,252 |
| | \$ 40,672 | \$22,191 |
| Changes in deferred costs | (9,409) | (6,075) |
| Future development costs considered in valuation of proved reserves | 14,628 | 4,524 |
| Total acquisition, exploration and development costs | \$ 45,891 | \$20,640 |
| RRA income before other revenues (and expenses) and income taxes | \$ 75,896 | \$ 4,361 |
| Other revenues (expenses) | | |
| Interest and other income | 2,740 | 2,063 |
| General and administrative expenses including depreciation on fixed assets | (2,839) | (2,547) |
| Interest expense, net | (2,878) | (1,721) |
| Gain (loss) on translation of foreign currency | (305) | 491 |
| RRA income before income taxes | \$ 72,614 | \$ 2,647 |
| Provision for income taxes | 24,000 | 1,200 |
| RRA net income | \$ 48,614 | \$ 1,447 |
| Earnings per share: | | |
| Primary | \$ 5.15 | \$.19 |
| Fully diluted | \$ 5.12 | \$.16 |

STATEMENT OF RRA POLICIES (Unaudited)

The following accounting policies have been followed where RRA presentations differ from generally accepted accounting principles (GAAP). The estimates of proved reserves and related valuations were developed by the Company's independent petroleum engineers in accordance with SEC rules and guidelines.

Recognition of assets and earnings under RRA

Under RRA, assets are recognized and earnings recorded when proved reserves are added through exploration and development activities. Proved reserves are valued as set out in Note 2. The SEC has acknowledged that the method employed does not necessarily yield the best estimate of the fair market value of a company's oil and gas properties. Any estimate of fair market value should take into account other factors, such as anticipated future increases in prices of oil and gas and any related development and production costs and probable re-

serves discounted for the risks associated with developing and producing such reserves. In the opinion of management, the fair market value of Wainoco's oil and gas properties could be substantially in excess of the RRA valuation of its reserves.

New field discoveries and extensions are included in earnings as they occur and represent proved reserves added from drilling exploratory and development wells. Subsequent revisions to the RRA valuation of proved reserves are included in earnings as they occur. The major factors causing revisions in proved reserves based on an annual RRA valuation are described below:

- (1) "Changes in Price" represents the approximate effect of increases from one period to the next in the prices and production costs used in the RRA valuation calculation.
- (2) "Other" primarily represents changes in engineering estimates of quantities and timing of production of reserves due to production history of the properties, additional

drilling, general marketing conditions and various other considerations.

- (3) "Interest Factor — Accretion of Discount" represents the effect of the passage of time on the discounted value of proved reserves which is equal to 10 percent of the RRA valuation as of the beginning of the year.

Exploration and development costs

Costs incurred during the year and expensed for RRA purposes include acquisition, exploration and development costs of properties evaluated in the current year. Because future development costs are considered in valuing proved reserves in the year of discovery, such costs are reversed in the year actually incurred to eliminate duplicate charges to expense. Costs of acquiring unproved properties and drilling exploration and development wells are deferred until the properties are evaluated, at which time they are charged to expense. All deferred costs are assessed for recoverability and any impairment is included in current expenses. Costs deferred at year-end were \$16,619,000 in 1979 and \$7,210,000 in 1978. Other exploratory and development costs are charged to expense when incurred.

Other revenues and expenses

The accounting policies followed for "Other Revenues (Expenses)" are the same as GAAP.

Income taxes

The provision for income taxes for the oil and gas production segment has been computed using the liability method. The

estimated liability at the beginning and end of the year is computed by applying the year end statutory income tax rates to the difference between (a) the RRA valuation of proved reserves and (b) the tax basis of proved oil and gas properties after taking into consideration the net operating losses, statutory depletion, resource allowances, investment tax credit carryovers and rebates. The provision for income taxes for other revenues and expenses has been computed under the deferred method as described in Notes 1 and 5.

Other considerations

Because earnings under RRA are recognized upon discovery of proved reserves and when the RRA valuation of proved reserves change, no earnings are reported as oil and gas are produced. Consequently, RRA earnings will differ substantially from funds generated or required by current exploration, development, and producing operations. For information on funds flow, see the Consolidated Statement of Changes in Financial Position.

The Company cautions against placing undue reliance on RRA results. RRA attempts to report the ultimate financial result of events which are not subject to consistently reliable evaluation. Estimates of proved reserves are subject to significant revisions as more data becomes available, particularly reserves attributed to new discoveries. Additionally, costs incurred in one year may lead to significant discoveries in later years and improved recovery techniques could significantly alter recoverable reserves from any given property. These and other factors should be considered in evaluating RRA data.

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, 1979 and 1978, and the related statements of income, shareholders' equity, and changes in financial position for the years then ended. Our examinations were 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, 1979 and 1978, 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 applied on a consistent basis after giving retroactive effect to the change (with which we concur) in the method of accounting for oil and gas producing activities as described in Note 1 to the financial statements, and except for the change (with which we concur) in the capitalization of interest as described in Note 1 to the financial statements.

ARTHUR ANDERSEN & CO.

Houston, Texas
March 14, 1980

SUMMARY OF OPERATIONS

For the five years ended December 31, 1979 (In thousands, except per share amounts)

| | 1979 | 1978 | 1977 | 1976 | 1975 |
|---|-----------------|-----------------|----------------|----------------|----------------|
| REVENUES: | | (Restated) | (Restated) | (Restated) | (Restated) |
| Oil and gas operations | \$24,984 | \$16,861 | \$9,260 | \$5,901 | \$3,877 |
| EXPENSES: | | | | | |
| Production costs | \$ 3,951 | \$ 2,553 | \$1,646 | \$1,281 | \$ 934 |
| Depreciation, depletion, and amortization | 6,502 | 4,793 | 2,636 | 1,752 | 940 |
| General and administrative | 2,839 | 2,547 | 1,107 | 869 | 829 |
| Interest, net of interest capitalized of \$689,000 in 1979 | 2,878 | 1,721 | 903 | 677 | 317 |
| Provision (credit) for losses on equipment inventory | — | 200 | (23) | 186 | — |
| Loss (gain) on translation of foreign currency | 305 | (491) | (53) | 21 | — |
| | <u>\$16,475</u> | <u>\$11,323</u> | <u>\$6,216</u> | <u>\$4,786</u> | <u>\$3,020</u> |
| INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES | \$ 8,509 | \$ 5,538 | \$3,044 | \$1,115 | \$ 857 |
| PROVISION FOR INCOME TAXES | 2,494 | 1,282 | 782 | 9 | 125 |
| INCOME FROM CONTINUING OPERATIONS | \$ 6,015 | \$ 4,256 | \$2,262 | \$1,106 | \$ 732 |
| INCOME FROM DISCONTINUED OPERATIONS, net of income taxes | — | — | — | 436 | 396 |
| NET INCOME | <u>\$ 6,015</u> | <u>\$ 4,256</u> | <u>\$2,262</u> | <u>\$1,542</u> | <u>\$1,128</u> |
| EARNINGS PER SHARE: | | | | | |
| Primary — | | | | | |
| Income from continuing operations | \$.64 | \$.55 | \$.34 | \$.17 | \$.12 |
| Income from discontinued operations | — | — | — | .07 | .06 |
| Net income | <u>\$.64</u> | <u>\$.55</u> | <u>\$.34</u> | <u>\$.24</u> | <u>\$.18</u> |
| Fully diluted | <u>\$.63</u> | <u>\$.52</u> | <u>\$.34</u> | <u>\$.24</u> | <u>\$.18</u> |
| CASH DIVIDENDS PER SHARE | <u>\$.075</u> | <u>\$ —</u> | <u>\$ —</u> | <u>\$ —</u> | <u>\$ —</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 Company's accounting policies used in reporting the results of operations, and the effect of the accounting changes implemented in 1979.

1979 Compared with 1978

Revenues

Revenues from oil and gas sales increased 50% over 1978. Oil sales, in barrels, increased 5%, while the weighted average price received per barrel increased 31%. Gas sales, in thousands of cubic feet (MCF), increased 59%, while the weighted average price received per MCF decreased 3%.

Interest income rose 28% as a result of increased short-term investments and higher interest rates throughout the year. Other income, consisting of operations and supervision fees, increased 30% due to higher levels of operations activities.

Expenses

Production costs increased 55% as a result of increased production activity. General and administrative expense increased 11% due to a 25% increase in personnel and to inflationary cost increases.

Depreciation, depletion and amortization increased \$1,709,000 or 36%, reflecting higher levels of production. When stated as a percent of oil and gas revenue, the rate decreased from 28% to 26%.

Net interest expense increased 67% over the level of 1978. The increase in gross interest expense of 134% resulted from both higher debt balances and interest rates throughout the year partially offset by capitalized interest of \$689,000 (\$.05 per share after income tax provision) in 1979 compared to none in 1978. The interest paid is also partially offset by interest charged on advances to the Company's limited partnerships, which increased 188%.

A loss on translation of foreign currency of \$202,000 (\$.02 per share) in 1979 compared to a gain of \$363,000 (\$.04 per share) in 1978, both after income tax provision, is an adverse difference of \$565,000. There were no losses on equipment inventory in 1979 compared to a loss provision of \$200,000 in 1978.

Earnings

Income before income taxes increased from \$5,538,000 to \$8,509,000 or 54%. This figure, as a percentage of revenue, increased from 33% in 1978 to 34% in 1979.

The combined United States-Canadian tax rate increased from 23% to 29%.

Net income increased by 41% from \$4,256,000 in 1978 to \$6,015,000 in 1979. When stated as a percentage of revenue, this figure decreased from 25% to 24%. Primary earnings per share went from \$.55 in 1978 to \$.64 in 1979, an increase of 16%.

1978 Compared with 1977

Revenues

Revenues from oil and gas sales increased 82% over 1977. Oil sales, in barrels, increased 21%, while the weighted average price received per barrel increased 27%. Gas sales, in thousands of cubic feet (MCF), increased 30%, while the weighted average price received per MCF increased 49%.

Interest income rose 109% as a result of increased short-term investments. Other income, consisting of operations and supervision fees, increased 78% due to higher levels of operations activities.

Expenses

Production costs increased 55% as a result of increased levels of production. General and administrative costs increased 130% due to a 112% increase in personnel and to inflationary cost increases.

Depreciation, depletion and amortization increased \$2,157,000 or 82%, reflecting higher production volumes. When stated as a percent of revenue, the rate remained 28% in both periods.

Net interest expense increased 91% over the level of 1977. The increase in gross interest expense of 114% resulted from higher debt balances throughout the year. The interest paid is partially offset by interest charged on advances to the Company's limited partnerships which increased 182%.

A gain on translation of foreign currency of \$363,000 (\$.04 per share) and \$22,000 (\$.01 per share), both after income tax provision, was recognized in 1978 and 1977, respectively.

Earnings

Income from continuing operations before income taxes increased from \$3,044,000 to \$5,538,000, or 82%. This figure, as a percentage of revenue, was 33% both in 1977 and in 1978.

A decrease in the combined United States-Canadian tax rate from 26% to 23% is due to tax credits resulting from increased corporate drilling activity.

Net income increased by 88% from \$2,262,000 in 1977 to \$4,256,000 in 1978. When stated as a percentage of revenue, this figure increased from 24% to 25%.

Primary earnings per share went from \$.34 in 1977 to \$.55 in 1978, an increase of 62%.

WAINOCO OIL CORPORATION



Area Maps

ATHENS • PENNSYLVANIA
MONIAS • BRITISH COLUMBIA

MARCH 1980

Athens







Pennsylvania

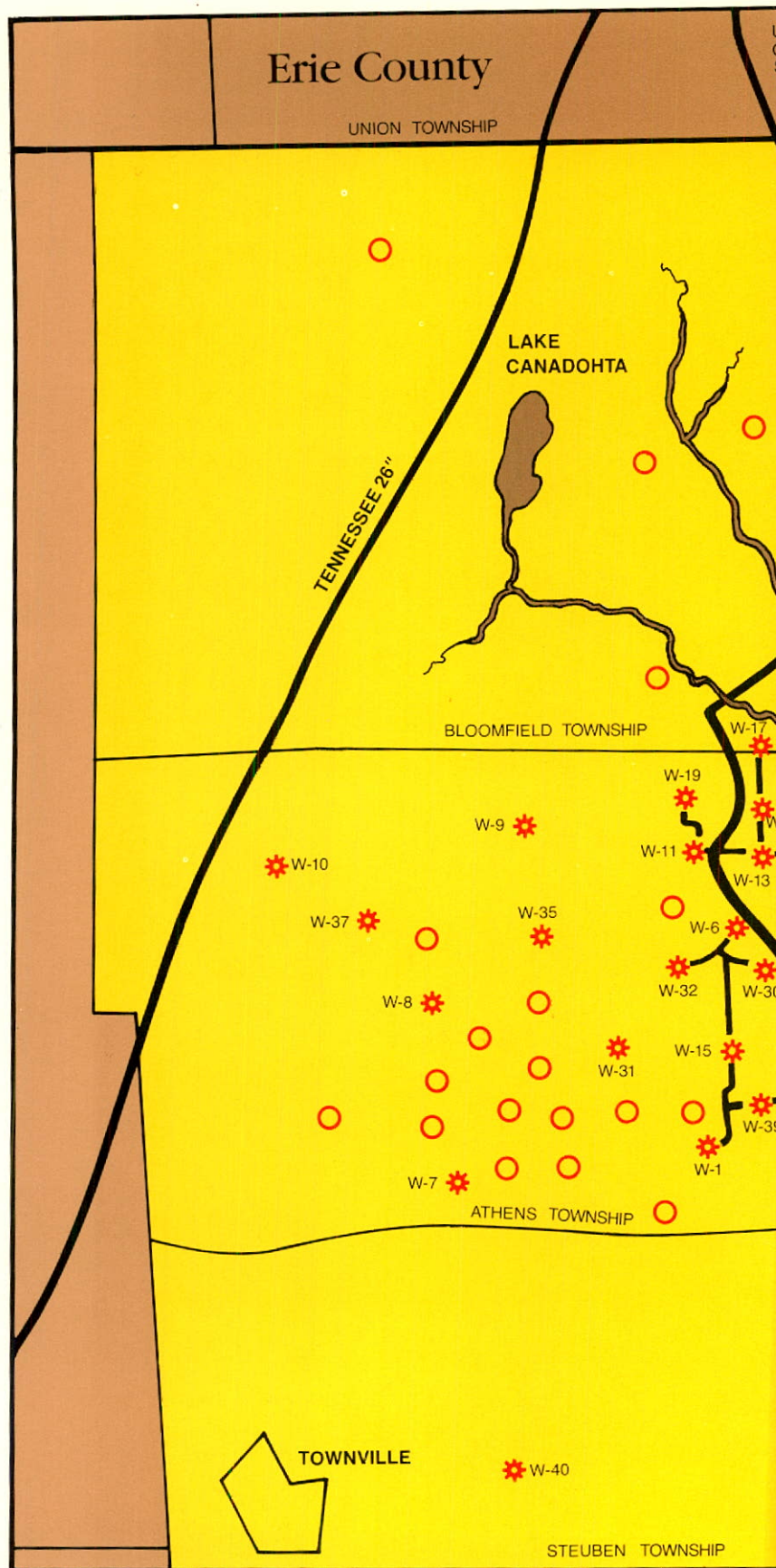
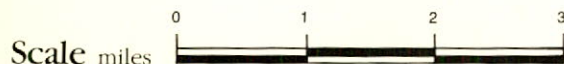
Wainoco Oil & Gas Company owns approximately 66,000 net acres of leases in Crawford County, Pennsylvania. The Company has drilled and completed a total of 40 gas wells from the Medina sandstone at 5,000'. Pipeline facilities have been constructed, and 26 wells will commence production in April 1980.

An additional 40 wells are planned for 1980, along with gathering facilities and pipeline extension to result in increased reserves and production on the Athens Prospect.



Legend

- Area of Wainoco Acreage 
- Existing Pipelines 
- Proposed Pipelines 
- Old Shallow Oil Field 
- Gas Well 
- Proposed Location 



ON CITY
PRESSOR
ION, 3 MILES
TH OF COUNTY
E.

CONCORD TOWNSHIP

Crawford County

SPARTANSBURG

Warren County

SPARTA TOWNSHIP

W-34

W-12

W-20

W-29

W-23

W-5

W-22

W-16

W-4

W-26

W-25

W-38

W-14

W-36

CENTERVILLE

W-24

PROPOSED PIPELINE

W-3

W-2

W-28

W-33

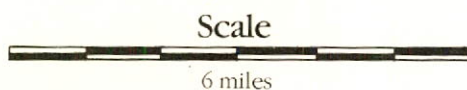
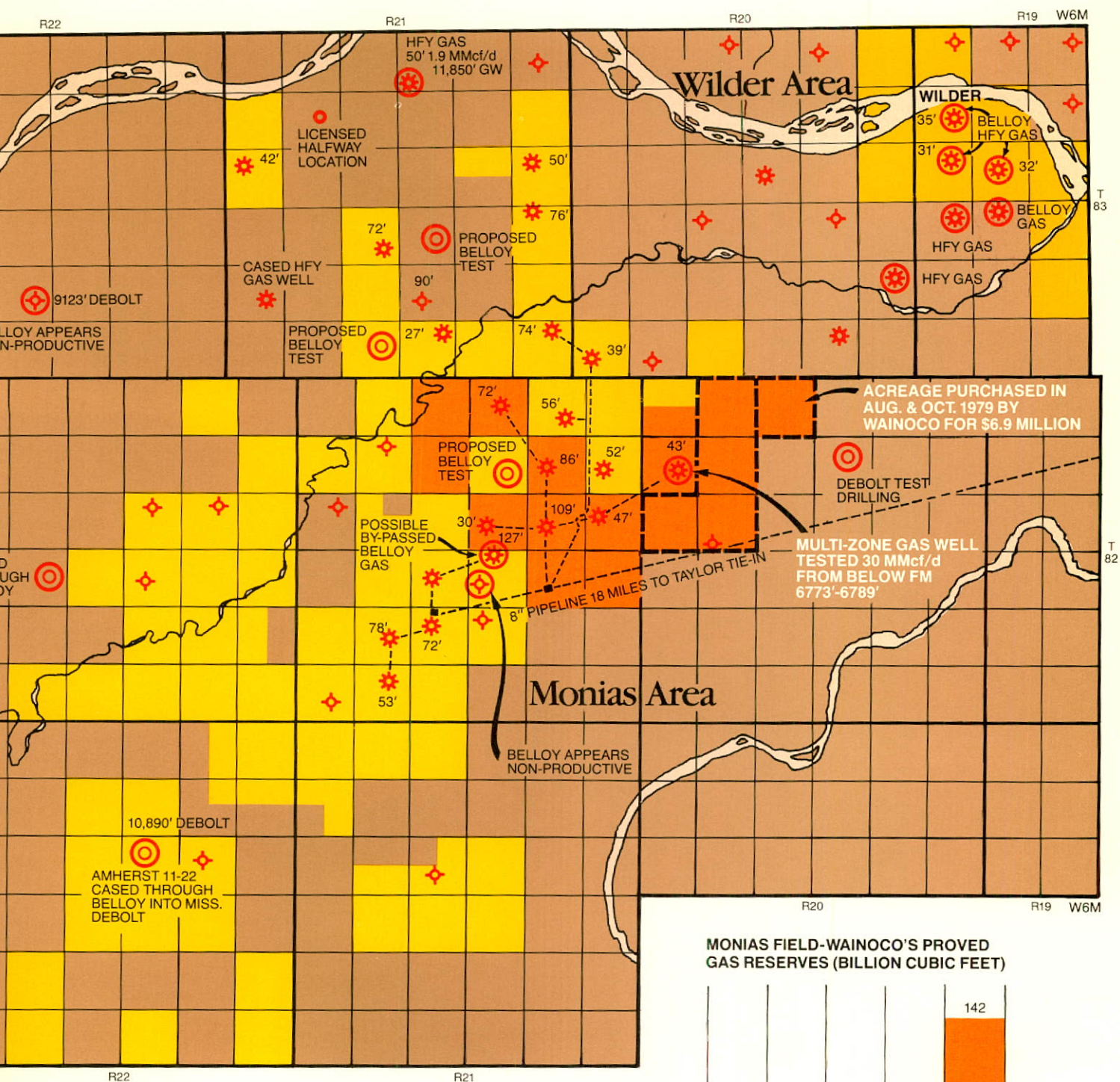
CHURCH RUN OIL FIELD

ROME TOWNSHIP

OIL CREEK

SITE OF ORIGINAL DRAKE
DISCOVERY WELL, 1859
5 MILES SOUTHEAST

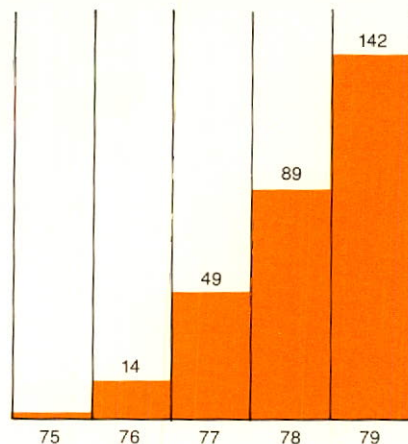
OIL CREEK TOWNSHIP



Wainoco Acreage Position

| | TOTAL AREA | WILDER AREA | GATES AREA | MONIAS AREA |
|-------|------------|-------------|------------|-------------|
| GROSS | 76,898 | 7,045 | 11,028 | 58,825 |
| NET | 33,648 | 1,041 | 5,514 | 27,093 |

MONIAS FIELD-WAINOCO'S PROVED GAS RESERVES (BILLION CUBIC FEET)

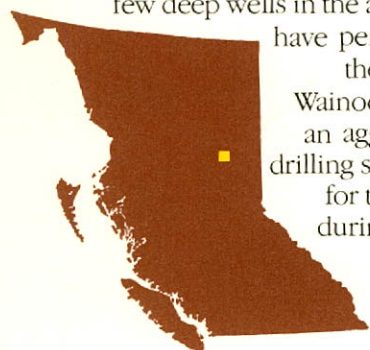


Monias







British Columbia

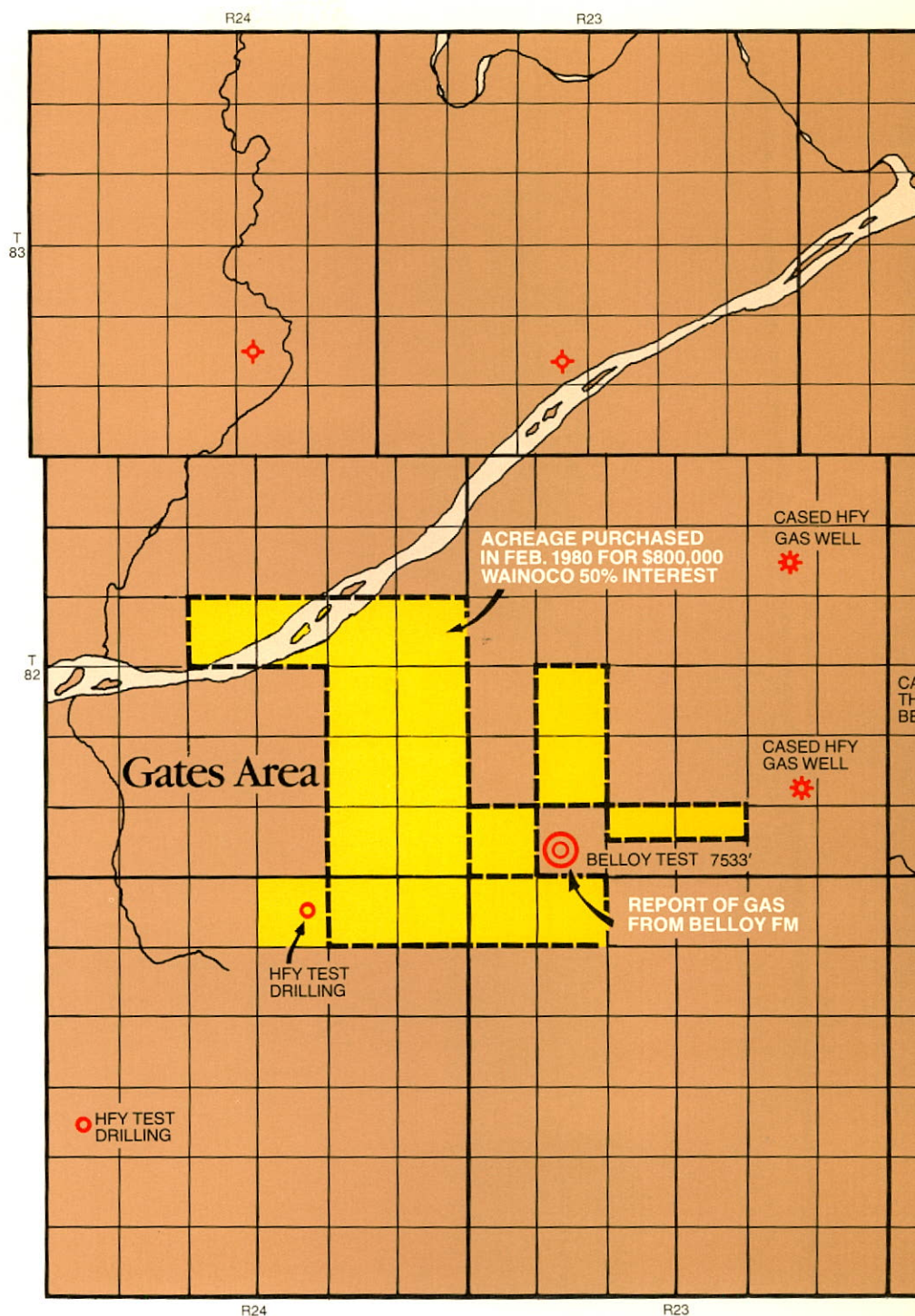
The Monias gas field contains slightly over 50% of Wainoco's entire proved reserves. In excess of 85% of this gas is contained in the Triassic Halfway sand at a depth of approximately 5,000 feet. Recent drilling has revealed exciting new potential in the Permian Belloy formation at depths of approximately 7,000 feet. This map shows the Halfway gas wells and additionally highlights the few deep wells in the area that

have penetrated the Belloy. Wainoco plans an aggressive drilling schedule for this area during 1980.



Legend

- Abandoned Well 
- Gas Pipelines 
- Triassic Halfway Gas Well indicating feet of Net Pay. 
- Belloy Control on or near Wainoco Acreage. 
- Wainoco owns 100% of Belloy rights, 50%-100% of other rights. 
- Wainoco owns 12%-50%. 



Monias, Wilder & Gates Areas Showing Halfway Gas Fields and Belloy Formation Control and Activity,



Wainoco Oil Corporation 1200 Smith Street, Suite 1500 Houston, Texas 77002