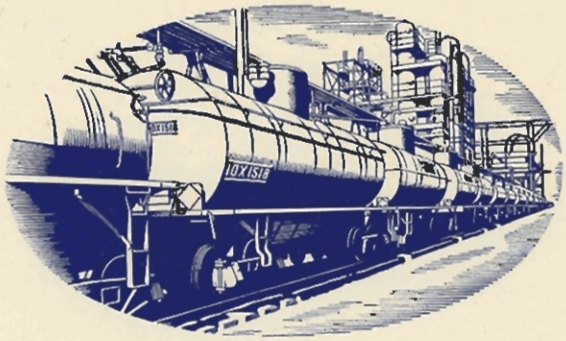

ANNUAL REPORT

IMPERIAL OIL LIMITED

for the fiscal year ended

DECEMBER 31, 1939

IMPERIAL
PRODUCTS

The death on March 3, 1940, of Mr. John McNeil, a Vice-President of Imperial Oil Limited, is recorded here with deep regret. For 34 years Mr. McNeil served the Company ably and faithfully in its marketing operations. His genial and kindly qualities won the affection of all who knew him and his passing caused profound sorrow to his fellow directors, his associates and other friends.

IMPERIAL OIL LIMITED

HEAD OFFICE, SARNIA, ONTARIO

•

President

G. HARRISON SMITH

•

Vice-Presidents

C. A. EAMES R. V. LESUEUR L. C. MCCLOSKEY HENRY H. HEWETSON

•

Directors

G. HARRISON SMITH C. A. EAMES R. V. LESUEUR
L. C. MCCLOSKEY HENRY H. HEWETSON A. E. HALVERSON

•

Comptroller

JAMES MCGRATH

Secretary-Treasurer

W. J. WHITLING

•

Transfer Office

56 CHURCH STREET, TORONTO, CANADA

•

Refineries at:

IOCO, BRITISH COLUMBIA
CALGARY, ALBERTA
REGINA, SASKATCHEWAN
SARNIA, ONTARIO
MONTREAL EAST, QUEBEC
IMPEROYAL, NOVA SCOTIA
NORMAN WELLS, NORTH WEST TERRITORIES

•

Divisional Marketing Head Offices at:

VANCOUVER, BRITISH COLUMBIA
EDMONTON, ALBERTA
REGINA, SASKATCHEWAN
WINNIPEG, MANITOBA
TORONTO, ONTARIO
MONTREAL, QUEBEC
HALIFAX, NOVA SCOTIA
ST. JOHN'S, NEWFOUNDLAND

•

Marketing Branches throughout Canada.

I M P E R I A L O I L L I M I T E D

SARNIA, ONT., April 15, 1940.

To the Shareholders
of Imperial Oil Limited:

The Board of Directors herewith submits the annual report of your Company's operations, together with balance sheet as of December 31, 1939, and statements of surplus and of profit and loss for the past calendar year.

Throughout 1939 the demand for petroleum products in Canada was at a higher level than in the preceding year and your Company enjoyed a larger volume of business. Sales of your Company's products aggregated 976,442,888 gallons and there was realized an average net profit of 53/100ths of one cent per gallon. Although petroleum product prices were lower than in 1938, the enlarged volume of business resulted in a greater gross income and this, coupled with lower unit costs, improved your Company's earnings from its Canadian refining and marketing operations.

With the outbreak of war in September costs were increased but while the problems resulting from higher costs were perplexing they were solved without appreciable increase in product prices and without curtailment of services.

Climatic conditions in the vast area served and the resulting pronounced seasonal fluctuations in Canadian consumption necessitate your Company maintaining large inventories. It will be observed in the accompanying accounts that the value of inventories as of December 31 last was $27,397,232.51, approximately five times as great as the net earnings from the Canadian refining and marketing operations for the year then ended. With such a large ratio of inventory values to earnings it is of great importance that adequate reserves be provided against any abnormal, war-inflated costs which are reflected in the inventories; otherwise, earnings under current conditions would be exaggerated and possible developments at the end of the war not guarded against. Abnormal costs included in inventory values as of December 31 last totalled $1,254,110.10, against which a reserve of equal amount was provided. The policy of your Company in respect of this reserve will be to increase or reduce it as abnormal costs fluctuate.

While there was an improvement in domestic earnings, there was a substantial reduction in income derived from your Company's investments. The reduced income from these sources was accounted for principally by a change in the dividend policy of your Company's subsidiary, International Petroleum Company, Limited, which had been paying a considerable part of its dividends from accumulated earned surplus. With an opportunity indicated for productive use of that Company's surplus funds in a large development in the Republic of Venezuela, as was noted in the last annual report, the International Petroleum Company, Limited, revised its dividend policy.

Approximately ten million dollars was expended during the year for additional investments in subsidiary companies and for extensive additions to plant and equipment. As a result the Company's cash position was reduced by this amount, and interest income on investment bonds declined. Partly from the disposal of investment securities to meet the expenditures referred to, but principally from provision to write down Dominion of Canada and other bonds to the basis of year-end quotations, there emerged a loss of $681,540.15 on capital account as shown in the accompanying statement of profit and loss.

[*Page Two*]

EARNINGS

After provision of $4,157,565.06 for Canadian income taxes, the net income of your Company from all sources was $19,250,071.33, as shown in the table hereunder, in which comparable figures for the preceding year are also presented:

	1939		1938	
	Earnings	Per Share	Earnings	Per Share
Canadian Refining and Marketing Operations (including Tank Car Department)....	$ 5,192,042.17	19.25¢	$ 3,366,033.04	12.48¢
Dividends from Subsidiary Companies and income from Miscellaneous sources. (Net)	14,058,029.16	52.13	22,593,547.18	83.79
Total.....	$19,250,071.33	71.38¢	$25,959,580.22	96.27¢

CANADIAN REFINING AND MARKETING OPERATIONS

As in the past, extensive work was done in the fields of research and engineering development and several notable additions were made to your Company's plants and equipment in 1939. At Sarnia a new dewaxing plant of unique and highly efficient design was placed in operation. This plant effects increased recoveries of waxes and of lubricating oils of improved premium quality particularly suited to the exacting demands of Canadian climatic conditions. The lubricating oils from this new plant also permit the manufacture of improved qualities of specialized greases in which they are incorporated. Further improvement in all grades of greases and extreme pressure lubricants was made through the operations of a new grease manufacturing plant with advanced features of design and precision control which were evolved by your Company's technicians.

At the Imperoyal refinery, in Nova Scotia, a unit combining crude distillation and cracking equipment was on full operating schedule during 1939, and at the Calgary refinery a new combination crude distillation and cracking unit was completed and running at the year end. These Imperoyal and Calgary units incorporate complete absorption, stabilization and debutanizing and continuous treating equipment.

The completion of a bauxite plant for the treatment of products from Turner Valley crude oil at the Regina refinery was an important factor in extending the Turner Valley crude oil market, in that it permitted the manufacture of gasolines and kerosenes comparable to what had hitherto been produced from low sulphur content crudes.

These and other developments are in line with your Company's policy of progressive improvement of quality, which is the basis of the consumer acceptance of its branded products.

In its marketing operations, the Company further consolidated its position and improved its facilities. The retail distribution system was strengthened by judicious modernization of many existing outlets. Arrangements effected by your Company with petroleum marketers in the United States, whereby tourists visiting Canada may use the courtesy cards issued by these United States marketers when purchasing products from your Company's dealers, helped to increase your Company's share of the tourist business. Public preference for the Company's branded products was again indicated by increased demand. There was a substantial increase in the sales of domestic fuel oil burners and a corresponding increase in the sales of domestic fuel oils. The market for heavier fuel oils in industrial and marine uses was considerably enlarged.

CANADIAN PRODUCTION

For many years your Company has evidenced its belief in the policy of increasing the production of crude oil in Canada by actively engaging in exploration and drilling with a view to establishing more adequate sources of crude oil supply. Consequently, the continued development of the Turner Valley oil field by the various interests operating there during 1939 was a source of considerable satisfaction. The enlarged consumption of crude oil from the Turner Valley in the past year was the result of more favourable conditions in the Prairie Provinces and of consistent effort to afford to the Valley the maximum economically available market. In this connection it is appropriate to review briefly some of the steps taken by your Company in past years to assure to the producers in Turner Valley a steady market at prices which would promote further development of oil production in this area with consequent benefit to petroleum consumers in the Prairie Provinces.

As the Turner Valley crude became available in sufficient quantities, the importation of crude for the Calgary refinery was discontinued, and when it became apparent that the supply in Turner Valley would exceed the Calgary refinery's needs, negotiations were conducted with the railways whereby a freight rate was established that permitted delivery of the crude to the Regina refinery and yet afforded to the producers an adequate return at the wells. As production exceeded the requirements of Alberta and of the territory normally supplied from Regina refinery, the Eastern economic fringe of the Regina refinery area was pushed farther out to the greatest distance practicable. Thus, Turner Valley displaced imported crudes at the Calgary and Regina refineries, and in a large part of Manitoba its products displaced products hitherto supplied from refineries in Eastern Canada. This accords with your Company's policy of using Canadian crudes as extensively as economic and geographic conditions will permit. It has been effected by an orderly procedure resulting in well prices adequate to ensure continued development of the field and in addition consumers in the territory served now enjoy the advantages of substantially lower prices for products.

Thirty-four producing wells were completed in the Turner Valley during 1939 and your Company's subsidiaries drilled 13 of these. When the year ended your Company's subsidiaries and affiliates owned or had a participating interest in 32 crude oil wells and 80 gas wells in the Turner Valley.

The total production in the Turner Valley for the year amounted to 7,556,029 barrels as compared with 6,691,075 barrels in 1938. The total owned production of your Company's subsidiaries was 1,143,221 barrels. In addition to this production, your Company purchased 4,405,643 barrels of Turner Valley crude oil and naphthas, and a further 1,662,350 barrels were handled mostly for the account of other interests.

In July the pipelines which gather crude oil and naphthas in the Turner Valley and transport them to Calgary were transferred by the Royalite Oil Company, Limited, to its wholly-owned subsidiary, the Valley Pipeline Company, Limited, a Dominion company with head offices at Calgary. This pipeline system was originally established as a private transport system but was enlarged from time to time so that adequate service could be provided to all producing interests in the Turner Valley and it thus developed into a common carrier. The transfer of the assets of the transport system to a separate company had been projected for some time and such transfer was made in 1939 in conformity with the recommendation of the Royal Commission which inquired into the Alberta petroleum industry.

Your Company is jointly interested in drilling a well on the Grease Creek structure, north-west of Turner Valley. This well had reached a depth of 6,390

feet when the year ended. Through a subsidiary, La Compagnie d'Exploration de Gaspé Limitée, your Company is engaged in drilling a well in the Gaspé Peninsula which had reached a depth of 1,136 feet at the end of the year.

At Norman Wells, near Fort Norman in the Northwest Territories, a steam still which had been operating since 1936 was replaced by a modern fractionating unit capable of producing high octane gasolines, motor gasolines, light and heavy Diesel fuel oils and bunker oil. This new plant has a capacity of 840 barrels of crude oil daily and is equipped with complete working and storage tankage to cope with the growing demand in the Great Bear, Slave Lake and Yellowknife areas.

SOUTH AMERICA

During the year 1939 your Company's subsidiaries in Colombia and Peru exported 22,753,191 barrels of crude oil as compared with 25,287,994 barrels exported in 1938. The Canadian refining operations absorbed 23.1 per cent. of these exports. Your Company's subsidiaries processed at their refineries at Talara, Peru, and Barranca-Bermeja, Colombia, a total of 9,491,810 barrels of crude oil as compared with 9,125,328 barrels during 1938.

Production of gasoline from natural gas in Peru, which amounted to 998,934 barrels in 1938, was 975,843 barrels in 1939. In Colombia natural gasoline production increased from 720,023 barrels in 1938 to 803,781 barrels in 1939.

Production of crude oil in Peru totalled 10,806,880 barrels as compared with 13,137,988 barrels in 1938. In addition the International Petroleum Company purchased and exported 538,318 barrels of crude oil from other sources in Peru, as compared with 379,754 barrels so purchased during 1938. In Colombia the crude oil production totalled 22,086,646 barrels as compared with 21,305,740 barrels in 1938.

During 1939 the International Petroleum Company's interest in the Mene Grande production in Venezuela represented 6,123,177 barrels as compared with 5,833,610 barrels in 1938.

The 16-inch pipeline to Guanta was completed during the latter part of the year and deep sea shipments of crude oil from the Eastern Venezuelan field commenced in December 1939.

IMPERIAL OIL SHIPPING COMPANY LIMITED

As of December 31, 1939, the fleet of the Imperial Oil Shipping Company, Limited, comprised 23 vessels of 159,152 deadweight tons. The total of crude oil and petroleum products transported by the fleet during the year was 37,688,198 barrels as compared with 35,344,874 barrels transported during 1938.

GENERAL

Special disbursements were paid to shareholders for several years past and were derived largely from the Company's accumulated earned surplus. Foreign exchange was required for the payment of dividends to a large and numerous interest in the Company's shares which is resident outside of Canada and, in November, the Foreign Exchange Control Board ruled that it would not provide exchange for that part of the special disbursement which represented withdrawals from the Company's surplus. Accordingly, and in view of the revised dividend policy of the International Petroleum Company, Limited, already referred to in this report, the special disbursement was reduced on December 1 last from 37-1/2¢ per share to 12-1/2¢ per share. The regular semi-annual dividends of 25¢ per share were paid.

For many years your Company has assisted its employees to provide for their dependents and for their future with retirement pensions, group insurance plans, co-operative investment trusts and sickness and death benefits. In March there was inaugurated an Employees' Thrift Plan which incorporates annuity and savings features. In brief, this plan encourages employees to assign from 3 to 13 per cent. of their earnings to a Board of Trustees and the Company contributes on a graduated scale to all deposits made with this Board. A minimum amount of the combined contribution is required to be used for the purchase of annuities and the balance may be held in a savings account or applied to the purchase of the Company's stock, as the employee directs. More than 90 per cent. of the employees are taking advantage of this thrift plan.

The present policy concerning employees who join His Majesty's Forces is to continue their service status with your Company, to assure them of re-employment when demobilized, and to pay to them the difference between the salary or wages they were receiving at the time of enlistment and the pay and allowances they receive on active service. This policy is subject to revision at any time should conditions require.

Your Directors believe that in personnel, equipment and resources, your Company is well fitted to discharge its reponsibilities to the national interest and to its shareholders in these critical times.

At a meeting of the Directors on March 11, 1940, Mr. Henry H. Hewetson was elected a vice-president of your Company to fill the vacancy caused by the death of Mr. John McNeil.

By order of the Board,

G. Harrison Smith,

President.

AUDITORS' REPORT TO THE SHAREHOLDERS

To the Shareholders
of Imperial Oil Limited:

We have examined the balance sheet of Imperial Oil Limited as at December 31, 1939, and the statements of profit and loss and surplus for the fiscal year then ended. In connection therewith, we have examined or tested the accounting records of the Company and other supporting evidence, and obtained all the information and explanations which we required; we have also reviewed the system of internal control and the accounting procedures of the Company, but we have not made a detailed audit of the transactions.

In accordance with section 114 of the Companies Act, 1934, we report that in the case of such subsidiary companies as incurred losses up to December 31, 1939, the parent Company's proportion of such losses has been fully provided for in the books of Imperial Oil Limited and in the attached balance sheet. In the case of all other subsidiary companies, profits have only been taken credit for in the accounts of Imperial Oil Limited, and in the attached balance sheet, to the extent of dividends received by the parent Company from such subsidiary companies; such dividends received in 1939 and included as income in that year exceeded the Company's proportion of the aggregate net profits of subsidiary companies for the year 1939 by $3,907,054.41 and to this extent were paid by these companies from surpluses previously earned.

In accordance with the Company's established practice, the inventories of crude oil and refined products have been valued in the attached balance sheet on the basis of cost of crude oil, which was lower than replacement value at December 31, 1939. The earnings of the year 1939 have been charged with an amount of $1,254,110.10 which has been set up as a reserve for future shrinkage of inventory values from present abnormally high costs caused by war conditions.

We report that, in our opinion, subject to the remarks above, the attached balance sheet is properly drawn up so as to exhibit a true and correct view of the state of the affairs of Imperial Oil Limited as at December 31, 1939, according to the best of our information and the explanations given to us, and as shown by the books of the Company.

PRICE, WATERHOUSE & CO.
Chartered Accountants.

Toronto, Ont.
March 30, 1940.

I M P E R I A L

BALANCE SHEET

ASSETS

Current Assets:			
Cash on hand and in banks		$ 5,340,080.58	
Dominion of Canada and other bonds valued on the basis of market quotations which was less than cost—plus accrued interest		10,278,963.85	
Trade accounts and bills receivable (less reserves)		14,148,746.08	
Other accounts receivable, including accrued interest on miscellaneous investments		169,074.68	
Inventories, determined and certified as to quantities and condition by responsible officers of the company:			
Crude oil and refined products (on basis of cost of crude oil, which was lower than replacement value)	$ 24,848,855.49		
Materials and supplies (at cost)	2,548,377.02	27,397,232.51	
			$57,334,097.70
Deferred Accounts Receivable, Mortgages and Miscellaneous Loans and Advances (less reserves):			3,401,656.53
Miscellaneous Investments:			
Bonds and debentures of other companies		$ 3,516,675.55	
Shares of other companies		1,134,102.25	
			4,650,777.80
Investment in subsidiary companies:			
Investment in shares (less reserves)		$ 50,557,325.20	
Indebtedness of subsidiary companies		6,812,825.24	
			57,370,150.44
Deferred and Prepaid Charges:			298,510.70
Goodwill, Patents, Copyrights, Trade Marks and Licences:			238.00
Capital Assets:			
Land, buildings, plant, transportation and other equipment (at cost)		$ 112,626,245.67	
Less—Reserve for depreciation		71,500,443.21	
			41,125,802.46
			$164,181,233.63

Note (1)—The figure at which the investment in shares of subsidiary companies is carried in the above balance sheet (after giving effect to revaluations shown under Capital Surplus) is less than the aggregate of the cost thereof plus the proportion of the undistributed earnings of such subsidiary companies since acquisition applicable to such shares.

OIL LIMITED

DECEMBER 31, 1939

LIABILITIES

Current Liabilities:		
Accounts payable	$ 5,208,197.13	
Amounts owing to subsidiary companies	3,006,062.57	
Reserve for income taxes and other accrued taxes in Canada	5,160,541.79	
		$13,374,801.49
Reserves:		
For fire, marine and other insurance	$ 9,802,620.38	
For employees' annuities	11,838,395.90	
For future shrinkage of inventory values from present abnormally high costs caused by war conditions	1,254,110.10	
		22,895,126.38
Capital and Surplus:		
Capital Stock:		
Authorized—32,000,000 shares of no par value		
Issued and outstanding—26,965,078 shares	$77,974,960.36	
Capital Surplus:		
Arising from revaluations (in 1915 and 1920) of investment in subsidiary company	15,264,192.26	
Earned Surplus, as per statement attached	34,672,153.14	
		127,911,305.76
		$164,181,233.63

Approved on behalf of the Board:

R. V. LeSueur, *Director*

L. C. McCloskey, *Director*

Note (2)—At December 31, 1939, the Company had outstanding contractual and contingent liabilities aggregating $1,645,484.40.

Note (3)—The auditors' report to the shareholders appears on page seven hereof.

IMPERIAL OIL LIMITED

STATEMENT OF SURPLUS
FOR THE YEAR ENDING DECEMBER 31, 1939

PARTICULARS	EARNED SURPLUS	CAPITAL SURPLUS	TOTAL
Balances at January 1, 1939	$45,938,547.86	$15,264,192.26	$61,202,740.12
Deduct—			
Adjustments affecting previous financial periods in respect of reserves for employees' annuities, investments, etc. (net)	3,551,388.05	——	3,551,388.05
	42,387,159.81	15,264,192.26	57,651,352.07
Add—			
Net Profit for the year ending December 31, 1939	19,250,071.33	——	19,250,071.33
	61,637,231.14	15,264,192.26	76,901,423.40
Deduct—			
Dividends paid	26,965,078.00	——	26,965,078.00
Balances at December 31, 1939, carried to Balance Sheet	$34,672,153.14	$15,264,192.26	$49,936,345.40

IMPERIAL OIL LIMITED

STATEMENT OF PROFIT AND LOSS
FOR THE YEAR ENDING DECEMBER 31, 1939

PARTICULARS OF INCOME		BEFORE PROVIDING FOR CANADIAN INCOME TAXES	PROVISION FOR CANADIAN INCOME TAXES	NET INCOME AFTER PROVIDING FOR ALL INCOME TAXES
FROM CANADIAN REFINING AND MARKETING OPERATIONS (including Tank Car Department) after providing for all selling, administrative and general expenses, and after setting up a reserve of $1,254,110.10 for future shrinkage of inventory values from present abnormally high costs caused by war conditions	$11,143,611.16			
Less—Provision for depreciation	3,875,367.78			
		$ 7,268,243.38	$ 2,076,201.21	$ 5,192,042.17
OTHER INCOME:				
Dividends from subsidiary companies, including dividends from subsidiaries whose activities are carried on outside of Canada, less losses of subsidiary companies for the year 1939		16,782,631.40	2,109,632.11	14,672,999.29
Interest on investments in bonds, loans, mortgages, etc., and other miscellaneous revenue (net) ...		38,301.76	*28,268.26*	66,570.02
		$24,089,176.54	$4,157,565.06	$19,931,611.48
Net Loss on investment securities, including provision to write down Dominion of Canada and other bonds on hand to the basis of market quotations as at December 31, 1939		*681,540.15*	——	*681,540.15*
		$23,407,636.39	$4,157,565.06	
NET PROFIT FOR THE YEAR, CARRIED TO EARNED SURPLUS		.....	.....	$19,250,071.33

NOTE (1)—The credit of $28,268.26 to "provision for Canadian income taxes" includes the allowance, for tax purposes, of a special cash payment in respect of employees' annuities.

NOTE (2)—The total amount deducted in the above statement in respect of counsel and solicitors' fees and salaries of executive officers, including all salaried directors, is $231,977.10; in addition, solicitors' fees, totalling $2,228.00 were charged to Capital Assets during the year 1939.

NOTE (3)—Dividends received from subsidiary companies, included in the above statement, exceeded the Company's proportion of the aggregate net profits of subsidiary companies for the year 1939 by $3,907,054.41.