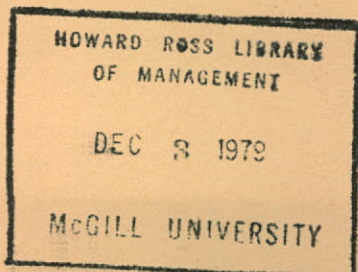
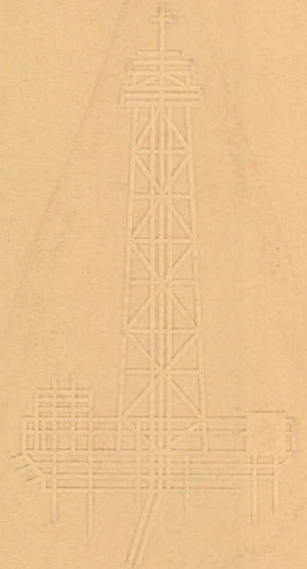


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WAINOCO OIL CORPORATION



1976 Annual Report

The Company's Business

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

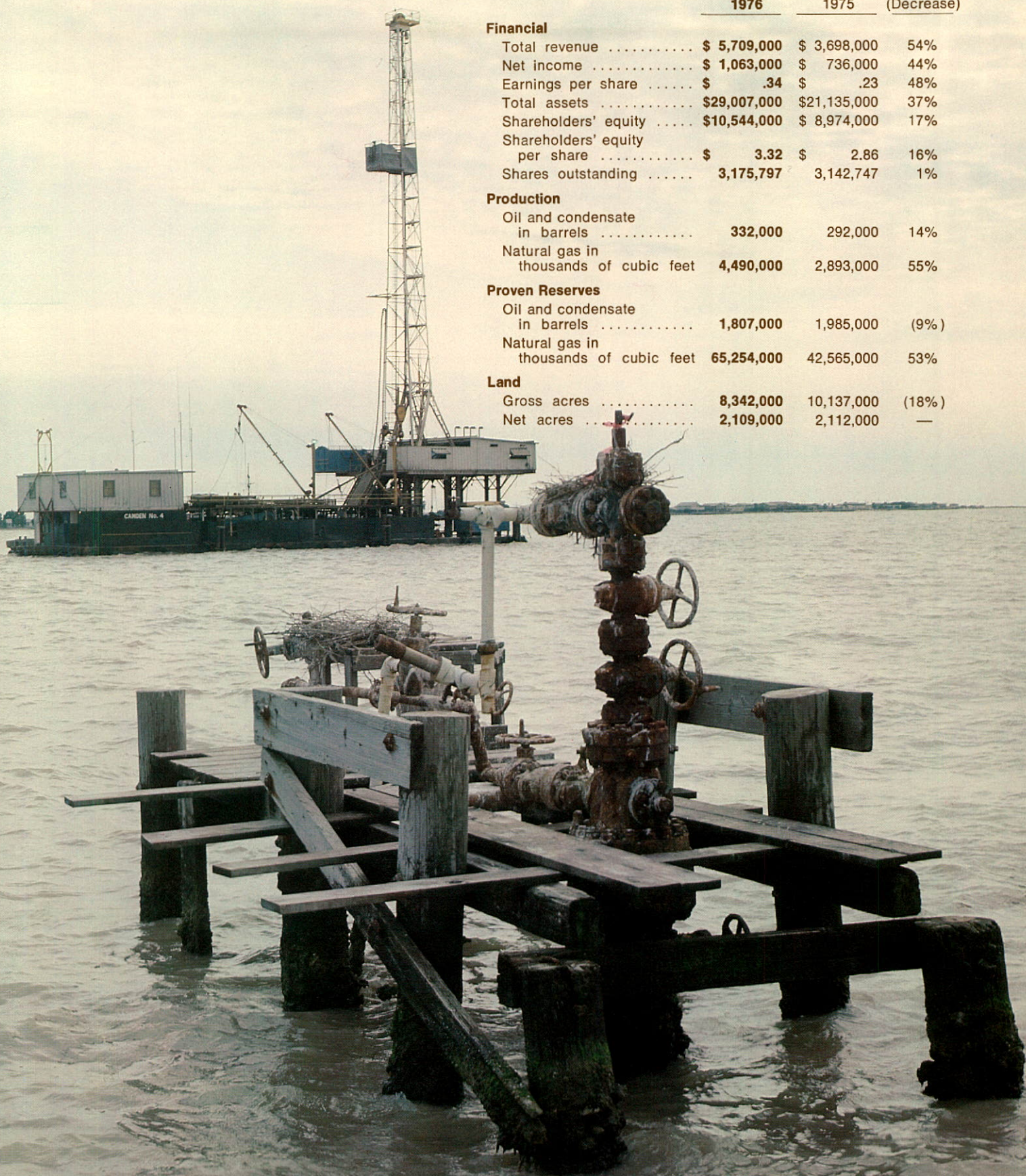
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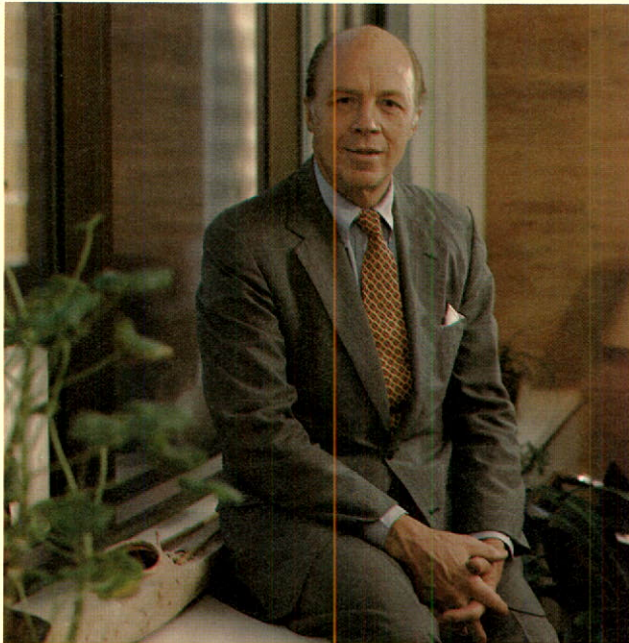
Financial and Operating Highlights

Oil and Gas Operations

	1976	1975	Percent Increase (Decrease)
Financial			
Total revenue	\$ 5,709,000	\$ 3,698,000	54%
Net income	\$ 1,063,000	\$ 736,000	44%
Earnings per share	\$.34	\$.23	48%
Total assets	\$29,007,000	\$21,135,000	37%
Shareholders' equity	\$10,544,000	\$ 8,974,000	17%
Shareholders' equity per share	\$ 3.32	\$ 2.86	16%
Shares outstanding	3,175,797	3,142,747	1%
Production			
Oil and condensate in barrels	332,000	292,000	14%
Natural gas in thousands of cubic feet	4,490,000	2,893,000	55%
Proven Reserves			
Oil and condensate in barrels	1,807,000	1,985,000	(9%)
Natural gas in thousands of cubic feet	65,254,000	42,565,000	53%
Land			
Gross acres	8,342,000	10,137,000	(18%)
Net acres	2,109,000	2,112,000	—



Letter to the Shareholders



Financial records were established by Wainoco in 1976 resulting in net income of \$1,499,000 or 48¢ a share, an improvement of 33% over the per share earnings of the previous year. Increased oil and gas sales as well as higher oil and gas prices caused the major portion of growth in revenues and earnings for the past year and provided a base for improvement in future years. Adding to the impact of higher revenues

on the Company's development was the consummation of three transactions which resulted in: the acquisition of reserves and acreage; the disposition of nonrelated oil and gas activities; and the domestication of Wainoco as a United States corporation.

The purchase of limited partner interests in Wainoco 70, 71 and 72 Companies added 24.9 billion cubic feet of gas and 154,700 barrels of oil to the corporate reserves. The acquisition of 29,000 acres of leasehold was also made through tenders for these interests. Total cost of the purchases was \$6,600,000 including the assumption of debt, and financing was arranged through a production loan with the Bank of Montreal.

The sale of Wainoco's chemical and vegetation control business to Reichhold Chemicals Limited resulted in a pre-tax gain of \$396,000, but more importantly, provided a substantial portion of the funds used in the purchase of partnership interests. It also has afforded full dedication of our efforts to the oil and gas industry.

The creation of a United States parent corporation with two wholly owned subsidiaries operating in the United States and in Canada, respectively, facilitates operations from our Houston headquarters. It also better represents the resident country of management and our more than 3,000 shareholders, 93% of whom reside in 46 of the United States.

Operating activity for Wainoco was at its highest level in 1976 with more than \$19.5 million generated for drilling and exploration. The Company participated in 144 wells, of which 101 have been completed for production and 43 have been abandoned. The areas of greatest drilling intensity were Texas, Louisiana and Alberta. Offerings of two public limited partnerships in the amounts of \$8 and \$3.5 million were fully subscribed for drilling in the southwestern United States. Funds received from the sale of a \$5 million interest in a large southeastern Alberta lease block which was explored and partially developed by Wainoco in 1972, were applied toward the drilling of 44 additional development wells. Corporate funds

in the amount of \$3,000,000 were expended toward drilling in addition to those derived from outside sources. Revenue flow from most of the successful wells drilled in the U.S. should commence by the second quarter of this year while the bulk of the productive wells in Canada will be on stream in the final quarter.

In late November, a filing was made with the Securities and Exchange Commission for the sale of limited partnership subscriptions in the amount of \$20 million for U.S. drilling in 1977. Plans for the filing of a \$5 million Canadian offering for 1977 drilling in western Canada were also formulated, marking the first time the Company has approached such public financing for exploration in Canada.

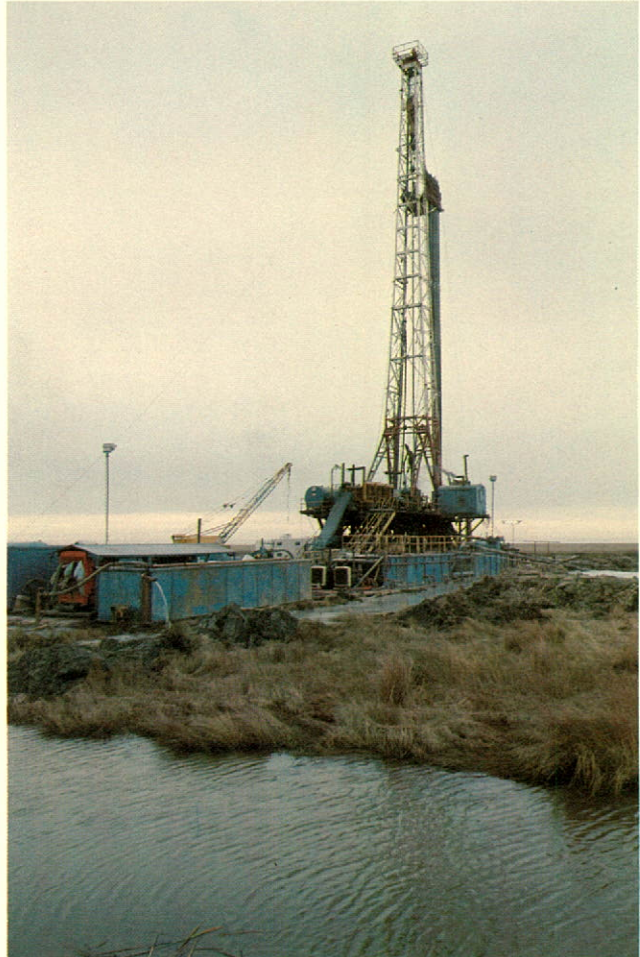
Realignment of exploration and production responsibilities was made to optimize our existing talents and to allow for the orderly expansion of both functions. United States operations are the responsibility of William A. Faubion, and operations in Canada are directed by Robert J. Leslie. Both men are Company officers resident in Houston who have been affiliated with Wainoco since current management acceded in 1968. One division office is located in Houston under the management of David J. Ewing, and another in Calgary is supervised by Eric C. Gronberg. Production and drilling operations for the Company are under the direction of Campbell M. Carothers in Houston. Additional staff has been recruited and office quarters have been expanded to accommodate greater business volume.

Growth of cash resources and increased gas reserves were matched in 1976 by organizational changes to continue the stronger pace of Wainoco's development. We look forward to future improvement as a result of this very good past year.



J. B. Ashmun
President

March 15, 1977



Review of Operations

United States

A concerted effort was made during the year to involve the Company in a larger volume of lower risk drilling ventures with a ready market outlet for the product at competitive prices. This was done without hampering the Company's participation in a percentage of prospects with higher return potential which are expected to produce a desirable growth curve.

The Company participated in the drilling of 44 wells in the United States. Of these, 27 were located in Texas, six in Louisiana, four in New Mexico, four in Kansas and three in Wyoming. A total of 24 completions were made: 13 oil wells and 11 gas wells for an average success ratio of 54%. In addition, the Company supported or farmed out acreage for another 20 wells.

Wainoco, as general partner, owns 40% interest in two limited partnerships, Wainoco 76 and 76B Companies, through which most of the year's drilling was done. The activities of these partnerships straddled the calendar years 1976-1977 and complete results do not appear in total well and reserve figures reported at year-end.

Gulf Coast

This area is designated to encompass all of the southern Texas and Louisiana coastal areas,



both onshore and in offshore state waters. Of all U.S. operations, this geological province produced results potentially of the most significance to the Company and will again demand a large share of the exploration budget for 1977. Twelve tests were drilled and production casing was set on six. At year-end one was a successful oil well and five were gas wells. The most significant completion was on the Company's Ocean View prospect in Cameron Parish, Louisiana. The renamed No. 1 Sandra Stream Trust well in which the Company and its limited partners own a 50% working interest, flowed gas from two zones at rates of 4.2 and 4.7 million cubic feet per day through $\frac{1}{4}$ " chokes and has respective calculated open flow rates of 24 and 50 million cubic feet of gas per day from each zone. An offsetting confirmation well was completed after year-end which further enhances the property's value. The No. 2 well encountered 20 feet of pay in two sands. The upper sand at 11,000 feet flowed 8.7 million cubic feet of gas per day plus 144 barrels of condensate through a 16/64" choke with a flowing tubing pressure of 3,750# p.s.i. The lower sand at 11,100 feet flowed three million cubic feet of gas plus 60 barrels of condensate through a 14/64" choke with 2,400# p.s.i. flowing tubing pressure. Wainoco and its limited partners own a 33 $\frac{1}{3}$ % working interest in this second well and in more than 2,600 acres underlying the prospect.

Three other completions were made in Vermilion, St. Landry and Cameron Parishes, Louisiana, as this state continues to be an attractive exploration area for the Company.

In the Texas coastal county of Aransas, the test well on the Fulton Beach prospect was completed as an excellent well in the Tertiary Frio sands. The State Tract 105 No. 1 flowed at a rate of 2.2 million cubic feet of gas per day through a 14/64" choke with flowing tubing pressure of 2,784# p.s.i. The calculated open flow for this well is 40 million cubic feet per day. The extent and size of the reservoir is not known at this time as it is located in a very complex, highly faulted area. The Company and its limited partners own a 37.50% revenue interest in 1,063 acres under this prospect and

have recently completed a successful second well to the west of the No. 1. This confirmation well encountered 52 feet of pay in eight sands and flowed gas at the rate of 1.9 million cubic feet per day plus 45 barrels of condensate from the lowermost sand through perforations from 8,772-8,786 feet. The flow was through an 18/64" choke with 1,327# p.s.i. flowing tubing pressure.

Other Areas

In the Austin Chalk trend in South Central Texas, Wainoco drilled seven wells and is in the process of production testing six of them to earn a 37.50% interest in 15,000 net acres. Although it is too early for the economics of this play to be assessed, two of the wells have been completed for potentials of 194 barrels and 159 barrels of oil per day.

The Company entered into an exploration program in north Texas. A total of nine wells were drilled in the counties of Palo Pinto, Wise, Young, Jack and Upshur. The majority of the wells were drilled to test the Pennsylvanian Bend formation at 4,500 feet and casing was run in six successful wells. With producing rates averaging from one to approximately two million cubic feet of gas per day, these are not large wells but the Company is confident they will make a meaningful contribution to cash flow through sales to an intrastate market.

Drilling in the Rocky Mountain States was primarily developmental in nature, although Wainoco supported a number of exploratory ventures with acreage contributions. A total of seven holes were drilled in which the Company had an investment. These wells were drilled in the states of Wyoming and New Mexico and four successful completions were made. Most of these tests were drilled and operated by others.

Canada

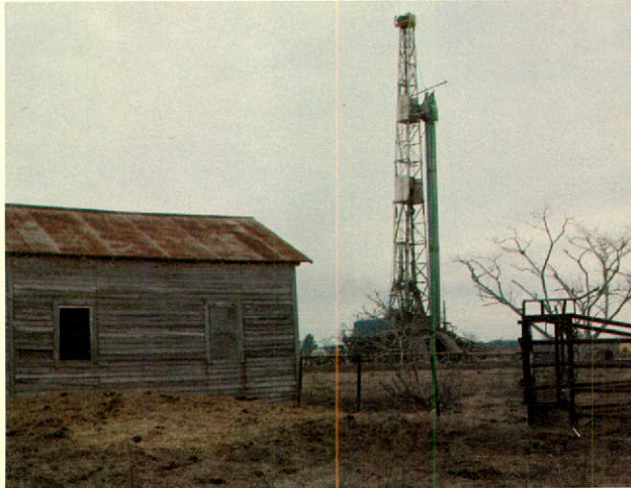
1976 was an active year for Wainoco in Canada. The Company participated in the drilling of 80 wells and had a success ratio of 86%. This included two major discoveries and two significant areas of developmental expansion.

In addition, five important gas properties were placed on production which, when combined with higher gas prices, resulted in a substantial increase in revenue.

Of major importance to the Company in 1976 was its participation in the discovery well and two successful followup wells on a broad Triassic geological structure near Monias in northeastern British Columbia, 18 miles southwest of Fort St. John. Proven reserves allocable to Wainoco's interest in these three wells total 12 billion cubic feet of gas. Wainoco owns 7,661 net acres out of a total of 15,322 gross acres at Monias where further drilling will take place in 1977.

At West Eagle, four miles north of Fort St. John, the Company recently participated in another discovery. This well was completed flowing 442 barrels of oil per day from the Belloy formation. Wainoco owns a sliding scale override ranging between 5 and 15% of the total production until the well pays out, after which the override reverts to a one-third working interest. It also retains interests varying from 33⅓% to 50% in 1,760 acres offsetting the discovery well.

In southeastern Alberta, the Company commenced further development of a 33,000 acre lease block in the Countess area as a result of negotiations with Sulpetro of Canada Ltd. The presence of shallow gas reserves had been proven by earlier Company drilling on this block. Wells in the area have a low daily producing rate ranging from 50 thousand cubic feet to 500 thousand cubic feet of gas and although drilling costs are relatively inexpensive, high-priced compression facilities are required to market the gas. Wainoco and its 1972 limited partnership sold an overriding royalty in October to Sulpetro covering approximately the south one-third of the block for a total consideration of \$5 million. Under the Sulpetro accord, Wainoco agreed to apply these funds to drill and complete 44 wells, build a gathering system, and erect a



compression plant. The agreement provided that Sulpetro receive 35% of the proceeds from the sale of gas until its investment has been returned, at which time its interest in the gas revenues will decrease to 15%. In the last three months of 1976 Wainoco completed the drilling program and purchased pipe and equipment for the gathering system and compression facilities. Plans call for this project to be on production in the fall of 1977 at an anticipated daily delivery rate of 10 million cubic feet of gas per day. A contract with Transcanada Pipeline Company has been signed for delivery at this rate commencing November 1, 1977.

Further drilling at Leo considerably extended the limits of this southeastern Alberta gas field where the Company operates two producing wells in conjunction with its 1971 limited partnership. Under the terms of a farmout agreement three successful wells were drilled by an independent company, and a fourth well in which Wainoco participated for a 50% interest was also completed. A 15% overriding royalty was retained by the Company on the three farmout wells, converting after payout to 50% of the original interest held by Wainoco. With six wells now in the field, it appears that more locations are prospective.

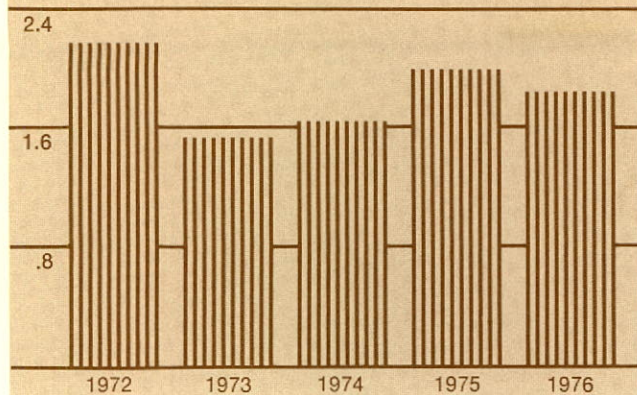
Three previously shut-in gas properties in British Columbia were placed on production

during 1976. Following start-up difficulties due to weather and a dangerously high hydrogen sulphide content in the gas, our well at North Cache commenced production in December. Also, the Currant well in which the Company owns a 15.5% interest was placed on production and is flowing at an average rate of 3 million cubic feet of gas per day. Sales from the Oak gas field commenced on May 8, 1976 at a daily rate of 12 million cubic feet of gas plus 175 barrels of condensate from four producing wells. In addition to the production from these gas wells, two oil wells on this property have been producing at a combined rate of approximately 300 barrels per day. An offset to these wells is planned for 1977. Wainoco owns a 41.5% interest in the gas wells and a 21% interest in the oil wells.

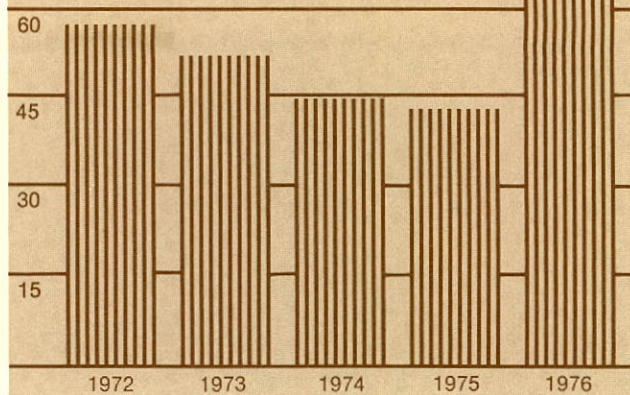
In Alberta, two significant properties were placed on production when the Company's Maple Glen gas plant became operational on March 2, 1976. These properties were at Maple Glen and Leo, where gas was discovered by Wainoco in 1970 and 1971. At Maple Glen, the initial unit production rate of approximately 3.5 million cubic feet will be increased to 5 million cubic feet per day by the recent completion of three new Viking sand wells. Wainoco owns a 41.3% interest in the 33,000 acre unit and is unit operator. On the Leo property, eight miles west of Maple Glen, the two original field wells are now producing gas at a rate of 4 million cubic feet per day, of which approximately 50% is Wainoco's share. Production from the four new wells drilled at Leo in 1976 will probably not be tied in for another year, pending Alberta's gas surplus. Because of this oversupply of gas, the Maple Glen plant was shut down for a 75-day period early in 1977 and is scheduled to be back on production by mid-April.

Commencing January 1, 1977, the price for new gas in British Columbia increased from \$0.55 to \$0.85 per thousand cubic feet, royalty free. At the same time the Alberta gas price increased from \$1.17 to \$1.26 per thousand cubic feet subject to an average royalty of 35.9%.

Proven Reserves of Oil and Condensate
Millions of Barrels



Proven Reserves of Natural Gas
Billions of Cubic Feet

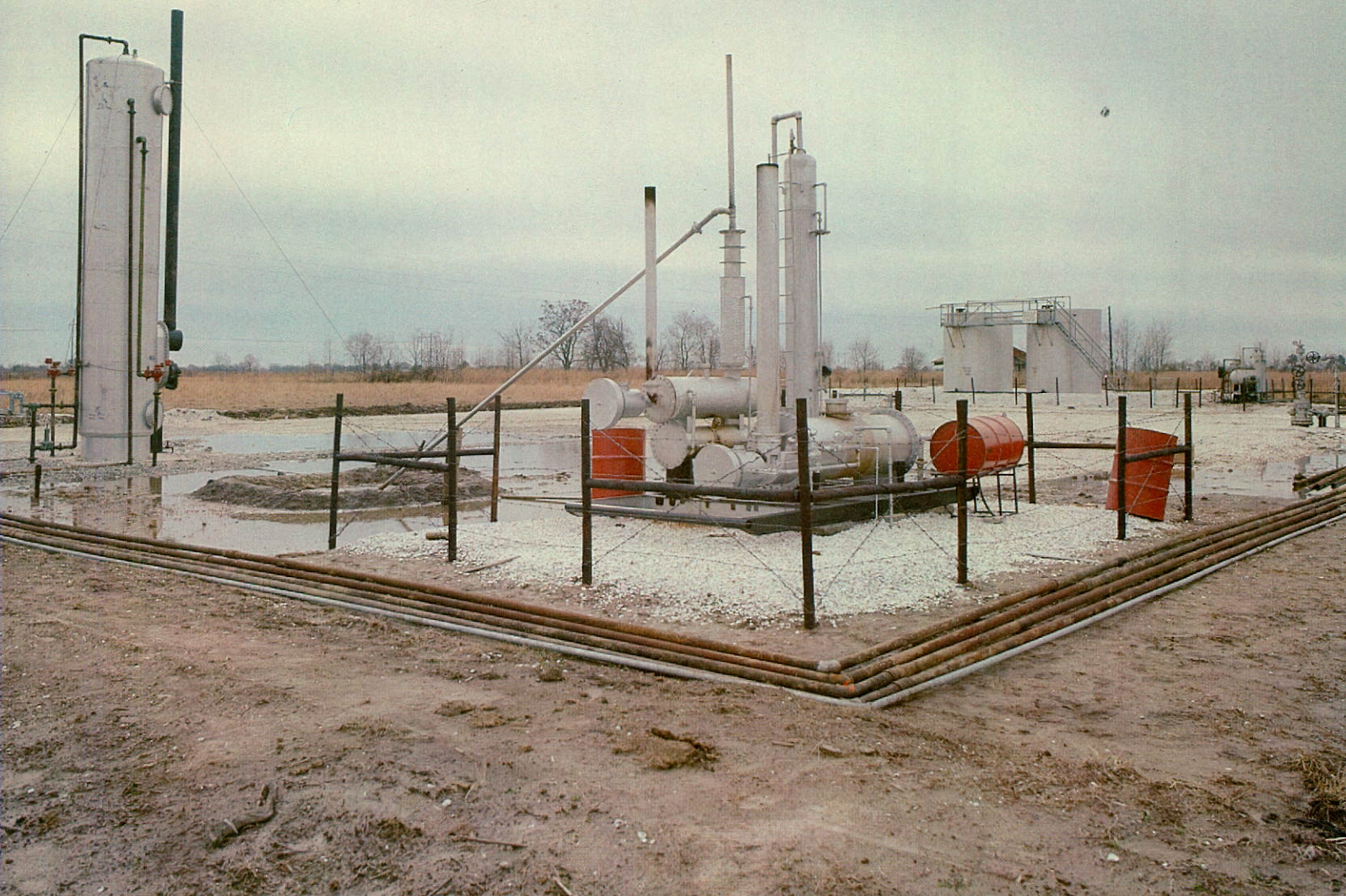


Acreage

	Gross	Net
United States	428,000	118,000
Canada	970,000	255,000
Kenya	6,944,000	1,736,000
	<u>8,342,000</u>	<u>2,109,000</u>

Production

	1976	1975
Oil and condensate — barrels	332,000	292,000
Natural gas — MCF	4,490,000	2,893,000

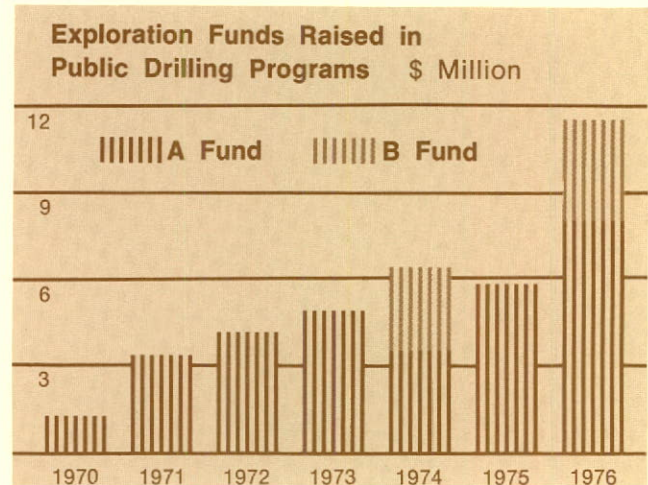


Exploration Programs

The funding of a majority of Wainoco's drilling since 1970 has been done through the sale of subscriptions to public limited partnerships formed in the United States. In the seven year period from 1970 to 1976, subscriptions totaling \$36,482,100 were sold in nine partnerships, including two each in 1974 and 1976. As general partner, Wainoco manages the partnerships, shares in costs of productive wells, and owns an interest (ranging from 30% in the early partnerships to the present 40%) in them. The limited partners obtain certain income tax savings from their investments in the partnerships as well as an interest in production revenue and reserves.

Offers totaling \$11,600,000 were made during the year by Wainoco to limited partners for their interests in the first three partnerships. Acceptances of these offers in the amount of \$6,600,000 were purchased by Wainoco.

A total of \$20,000,000 in partnership units was registered in late 1976 by Wainoco with the Securities and Exchange Commission for sales in 1977. It is anticipated that funds raised under this registration along with amounts contributed by the Company as general partner



will provide the basis for a diversified exploratory and development drilling program in the southwestern United States.

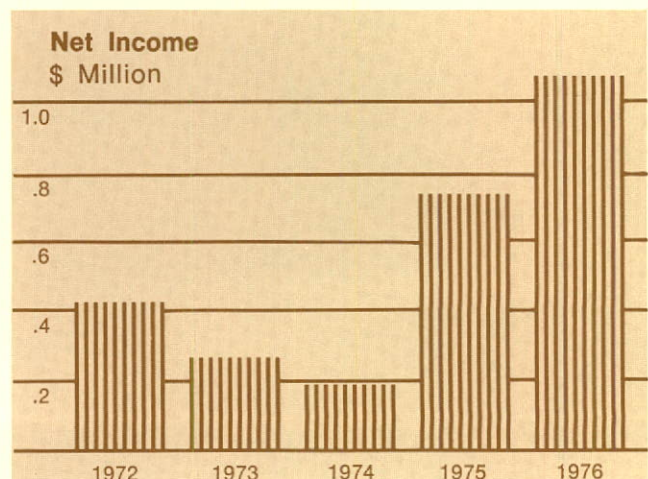
The registration in Canada of a \$5,000,000 public limited partnership for 1977 drilling was planned following recent changes in Canadian tax laws. A partnership similar to those which the Company has offered for the past seven years in the U.S. will be formed for operations expected to commence in the early summer.

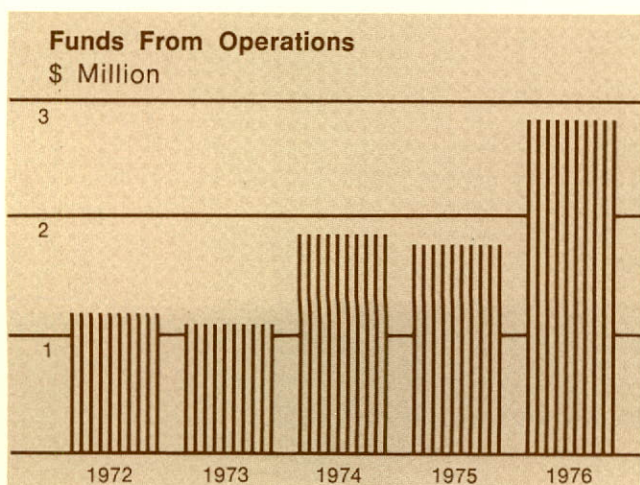
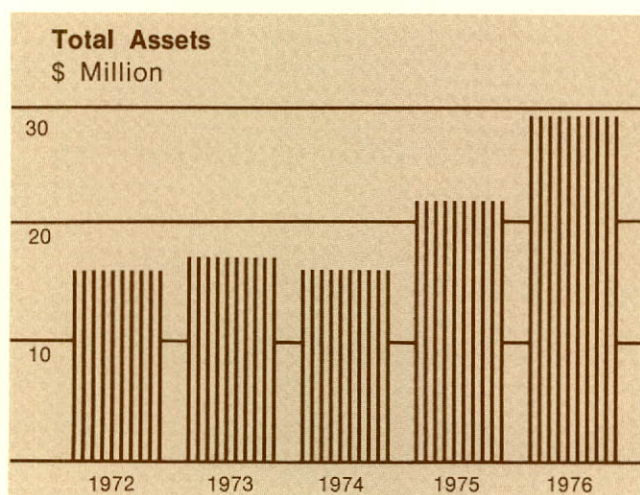
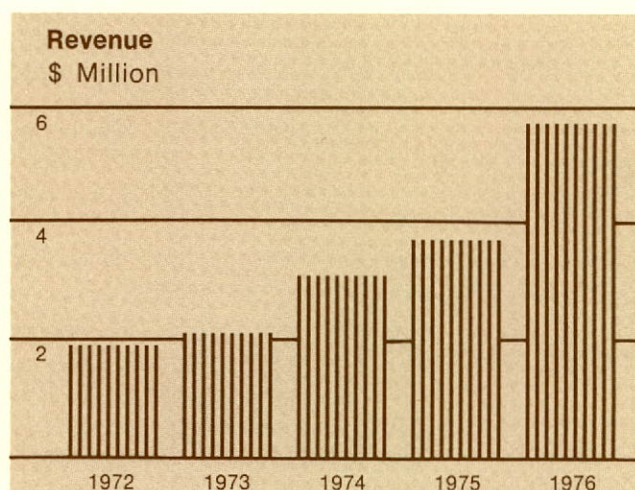
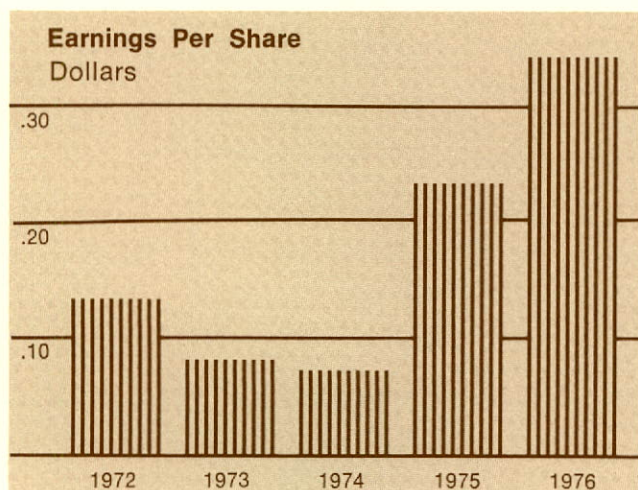
Financial Review

A significantly higher level of operating activity in 1976 and plans for further expansion in 1977 required that financial resources be expanded to accommodate growth and to continue the creation of a larger financial base. Capital expenditures approximated \$13,000,000, in excess of four times the level of 1975. These expenditures were concentrated on the acquisition of properties from three previous partnerships, investment in the two 1976 partnerships, and development drilling on corporate properties. The investment in oil and gas properties was \$23.6 million at the year's end. In addition to the oil and gas property expenditures, increased working capital was required to finance the current and anticipated operating levels.

In addition to the \$2.8 million generated from operations, \$2.5 million was received from the

sale of the Industrial Section, and \$2.1 million was received from the sale of an overriding royalty. The funds required over these amounts were





provided by additional commercial bank financing. Under agreements with the Company's two major banks, credit lines were increased from \$8.1 to \$16.1 million with some \$3.4 million undrawn at year end.

In accordance with the Company's decision to change the method of computing the depreciation, depletion, and amortization of oil and gas property costs, each quarter of 1976 has been restated to give effect to the change. A restatement, by quarter, is included in the Notes to the Consolidated Financial Statements. The results for the fourth quarter, as restated, are as follows:

Revenues	\$1,654,000
Operating costs	294,000
General, administrative, and interest	469,000
Depreciation, depletion, and amortization	492,000
Provision for losses on equipment inventory	126,000
	<u>1,381,000</u>
Income from continuing operations before income taxes	273,000
Provision for income taxes	7,000
Income from continuing operations	266,000
Income from discontinued operations	—
Net income	<u>\$ 266,000</u>

The revenues reflect a higher level of production in the fourth quarter than in previous quarters. While oil and gas operating expenses were

consistent with those of previous quarters, general and administrative expense increased during the quarter due to personnel additions and related administrative expenses. A provision of \$126,000 was recorded to recognize the cost in excess of market value of well and lease equipment inventory.

The Company enters 1977 with new operating levels of oil and gas production, a sound financial base with unutilized credit lines, and the management control processes for continuance of the growth experienced in the last two years.

Management's Discussion and Analysis of the Summary of Operations

The following information is provided to further explain certain financial information in the Summary of Operations. Reference is made to Note 1 of the Consolidated Financial Statements for a summary of the accounting policies utilized in determining the results of operations.

1976 Compared with 1975

Revenues from oil and gas sales increased 57% due to higher oil and gas production (14% and 55% respectively) and product prices. Interest income increased two-fold as short-term investments were made throughout the year. Significant cost increases were recorded due to a higher level of operating activity. Oil and gas operating costs rose 44% following increased production as well as major workover expenses on several wells. Although general and administrative expense was relatively constant for the year, interest expense increased \$483,000 due to greater borrowings. Higher interest expense was partially offset by the interest charged on partnership advances. The largest cost increment was in the provision for depreciation, depletion, and amortization. This increase was \$808,000, or 83%, which reflects a higher unit cost of exploration and development, the acquisition of properties from limited partners, and increased production. In 1976, a Provision for Losses on Equipment Inventory of \$186,000 was recorded. This provision was made due to the excess of the cost over the market value of well and lease equipment inventory.

A tax rate of 2%, compared to 11% in 1975, reflects the accounting for certain tax credits implemented by new Canadian tax regulations adopted during the year.

1975 Compared with 1974

Revenues of oil and gas sales increased 13% due primarily to higher prices. Interest income was received on the promissory note received from the sale of offshore properties. Other income, primarily management and operations fees, increased by 11%. The cost of operations which includes lease operating costs such as labor, lease rentals, taxes, etc., rose 20% over the previous year due to the Company's increased activity as well as inflation. General and administrative expenses decreased by \$73,000, or 8%, due to a leveling off of personnel additions and reductions in legal and other professional expense. The increase in depreciation, depletion, and amortization of \$38,000, or 4%, represented higher rates of per-unit cost of oil and gas exploration and development.

Interest expense increased \$176,000, or 46%, due to substantially larger borrowing. Further and sustained advances to partnerships gave rise to additional interest income which partially offset the increased interest expense. No interest was capitalized in 1975. In 1974 a charge of \$245,000 was made in connection with abandonment of a mining prospect.

The provision for income tax decreased from a combined United States-Canadian tax rate of 46% in 1974 to 11% in 1975. This decrease was due to more intangible drilling costs in the United States and the availability of certain tax incentives such as exploration credits and rebates in Canada.

Summary of Operations

For the five years ended December 31, 1976

	1976	1975	1974	1973	1972
Revenues:					
Oil and gas operations	<u>\$5,709,000</u>	<u>\$3,698,000</u>	<u>\$3,151,000</u>	<u>\$2,069,000</u>	<u>\$1,906,000</u>
Expenses:					
Oil and gas operating costs . .	<u>\$1,089,000</u>	<u>\$ 755,000</u>	<u>\$ 628,000</u>	<u>\$ 427,000</u>	<u>\$ 376,000</u>
General, administrative, and interest, net of interest capitalized of \$179,000 in 1974, and \$298,000 in 1973	<u>1,567,000</u>	<u>1,146,000</u>	<u>976,000</u>	<u>614,000</u>	<u>637,000</u>
Depreciation, depletion, and amortization	<u>1,778,000</u>	<u>970,000</u>	<u>932,000</u>	<u>784,000</u>	<u>492,000</u>
Mining prospects abandoned .	<u>—</u>	<u>—</u>	<u>245,000</u>	<u>—</u>	<u>—</u>
Provision for losses on equipment inventory	<u>186,000</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
	<u>\$4,620,000</u>	<u>\$2,871,000</u>	<u>\$2,781,000</u>	<u>\$1,825,000</u>	<u>\$1,505,000</u>
Income From Continuing Operations Before Income Taxes .	\$1,089,000	\$ 827,000	\$ 370,000	\$ 244,000	\$ 401,000
Provisions (Credits) for Income Taxes	26,000	91,000	171,000	(9,000)	(12,000)
Income From Continuing Operations	\$1,063,000	\$ 736,000	\$ 199,000	\$ 253,000	\$ 413,000
Discontinued Industrial Services Section Operations:					
Operating income	<u>\$ 393,000</u>	<u>\$ 791,000</u>	<u>\$ 900,000</u>	<u>\$ 836,000</u>	<u>\$ 781,000</u>
Gain on sale	<u>396,000</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
Less: Applicable income tax . .	<u>353,000</u>	<u>395,000</u>	<u>450,000</u>	<u>418,000</u>	<u>391,000</u>
	<u>\$ 436,000</u>	<u>\$ 396,000</u>	<u>\$ 450,000</u>	<u>\$ 418,000</u>	<u>\$ 390,000</u>
Discontinued Transportation Division Operations:					
Operating losses	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ (138,000)</u>
Net loss on sale of assets . . .	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>(123,000)</u>
Less: Applicable income tax benefit	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>131,000</u>
	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ (130,000)</u>
Income Before Extraordinary Item	\$1,499,000	\$1,132,000	\$ 649,000	\$ 671,000	\$ 673,000
Extraordinary Item	—	—	31,000	—	—
Net Income	\$1,499,000	\$1,132,000	\$ 680,000	\$ 671,000	\$ 673,000
Average Common Shares Outstanding	3,154,830	3,142,747	3,142,539	3,140,572	3,063,356
Earnings Per Common Share:					
Income from continuing operations	<u>\$.34</u>	<u>\$.23</u>	<u>\$.07</u>	<u>\$.08</u>	<u>\$.13</u>
Income from discontinued Industrial Services Section operations	<u>.14</u>	<u>.13</u>	<u>.14</u>	<u>.13</u>	<u>.13</u>
Loss from discontinued Transportation Division operations	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>(.04)</u>
Income before extraordinary item	<u>\$.48</u>	<u>\$.36</u>	<u>\$.21</u>	<u>\$.21</u>	<u>\$.22</u>
Extraordinary item	<u>—</u>	<u>—</u>	<u>.01</u>	<u>—</u>	<u>—</u>
Net income	<u>\$.48</u>	<u>\$.36</u>	<u>\$.22</u>	<u>\$.21</u>	<u>\$.22</u>

Consolidated Balance Sheets

December 31, 1976 and 1975

(Note 1)

ASSETS

	<u>1976</u>	<u>1975</u>
Current Assets:		
Cash	\$ 346,000	\$ 127,000
Accounts receivable —		
Joint operators, pledged, less allowance for bad debts (Note 3) ..	2,201,000	1,407,000
Current portion of amounts due from associated partnerships (Note 6)	862,000	790,000
Oil and gas sales (Note 3)	777,000	258,000
Other	184,000	—
Leases and equipment inventory, partially pledged, less allowance for inventory losses (Notes 3 and 6)	1,700,000	1,593,000
Direct costs and overhead incurred on behalf of future partnerships (Note 6)	31,000	35,000
Assets of discontinued operations (Note 2)	—	3,639,000
Noninterest-bearing note receivable, due in 1977 (Notes 2 and 3) ..	992,000	—
Other	36,000	45,000
Total current assets	<u>\$ 7,129,000</u>	<u>\$ 7,894,000</u>
Property and Equipment, substantially all pledged (Note 3):		
Oil and gas properties	\$23,581,000	\$12,738,000
Furniture, fixtures, and other equipment	430,000	421,000
	<u>\$24,011,000</u>	<u>\$13,159,000</u>
Less — Accumulated depreciation, depletion and amortization	6,288,000	4,558,000
	<u>\$17,723,000</u>	<u>\$ 8,601,000</u>
Assets of Discontinued Operations (Note 2)	<u>\$ —</u>	<u>\$ 1,486,000</u>
Other Assets:		
Unsecured note receivable, due in 1980, pledged (Note 3)	\$ 1,487,000	\$ 1,487,000
Commissions and noncurrent advances to associated partnerships (Note 6)	2,224,000	1,473,000
Noninterest-bearing note receivable, due in 1978 (Notes 2 and 3) ..	225,000	—
Other	219,000	194,000
	<u>\$ 4,155,000</u>	<u>\$ 3,154,000</u>
	<u><u>\$29,007,000</u></u>	<u><u>\$21,135,000</u></u>

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

LIABILITIES AND SHAREHOLDERS' EQUITY

	<u>1976</u>	<u>1975</u>
Current Liabilities:		
Bank indebtedness	\$ 1,796,000	\$ 2,455,000
Current maturities of long-term debt (Note 3)	2,600,000	1,530,000
Accounts payable and accrued liabilities	3,624,000	1,158,000
Liabilities of discontinued operations (Note 2)	—	1,471,000
Income taxes payable (Note 4)	25,000	327,000
Total current liabilities	<u>\$ 8,045,000</u>	<u>\$ 6,941,000</u>
 Long-Term Debt, less current maturities (Note 3)	 <u>\$ 8,327,000</u>	 <u>\$ 3,220,000</u>
 Liabilities of Discontinued Operations (Note 2)	 <u>\$ —</u>	 <u>\$ 432,000</u>
 Deferred Income Taxes (Note 4)	 <u>\$ 2,091,000</u>	 <u>\$ 1,568,000</u>
 Commitments and Contingencies (Notes 6 and 7)		
 Shareholders' Equity (Note 5):		
Common stock, no par, 5,000,000 shares authorized, 3,175,797 shares outstanding in 1976 and 3,142,747 in 1975	\$ 1,711,000	\$ 1,640,000
Paid-in capital	2,814,000	2,814,000
Retained earnings (restricted — Note 3)	6,019,000	4,520,000
	<u>\$10,544,000</u>	<u>\$ 8,974,000</u>
	<u>\$29,007,000</u>	<u>\$21,135,000</u>

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

Consolidated Statements of Income

For the years ended December 31, 1976 and 1975

(Note 1)

	1976	1975
Revenues:		
Oil and gas sales	\$5,185,000	\$3,294,000
Interest income	269,000	135,000
Other	255,000	269,000
	<u>\$5,709,000</u>	<u>\$3,698,000</u>
Expenses:		
Oil and gas operating costs	\$1,089,000	\$ 755,000
General and administrative	890,000	829,000
Depreciation, depletion, and amortization	1,778,000	970,000
Interest —		
Long-term debt and other	1,040,000	557,000
Charged to associated partnerships	(363,000)	(240,000)
Provision for losses on equipment inventory	186,000	—
	<u>\$4,620,000</u>	<u>\$2,871,000</u>
Income from Continuing Operations Before Income Taxes	\$1,089,000	\$ 827,000
Provision for Income Taxes (Note 4)	26,000	91,000
Income From Continuing Operations	<u>\$1,063,000</u>	<u>\$ 736,000</u>
Income From Discontinued Operations (Note 2):		
Operating income, net of applicable income taxes of \$185,000 in 1976 and \$395,000 in 1975	\$ 208,000	\$ 396,000
Gain on sale, net of applicable income tax of \$168,000	228,000	—
	<u>\$ 436,000</u>	<u>\$ 396,000</u>
Net Income	<u>\$1,499,000</u>	<u>\$1,132,000</u>
Earnings Per Common Share:		
Income from continuing operations	\$.34	\$.23
Income from discontinued operations14	.13
Net income	<u>\$.48</u>	<u>\$.36</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, 1976 and 1975

(Note 1)

	1976	1975
Source of Funds:		
Funds provided by continuing operations —		
Income	\$ 1,063,000	\$ 736,000
Expenses not requiring current outlay of funds —		
Depreciation, depletion, and amortization	1,778,000	970,000
Deferred income taxes	50,000	47,000
	<u>\$ 2,891,000</u>	<u>\$1,753,000</u>
Funds provided by discontinued operations (Note 2) —		
Income and gain on sale	436,000	396,000
Expenses not requiring current outlay of funds —		
Net non-current assets sold	961,000	—
Depreciation	93,000	200,000
Deferred income taxes	353,000	—
Refinancing and long-term debt borrowings, including liabilities of discontinued operations in 1975	8,451,000	2,942,000
Proceeds from sale of oil and gas properties (Note 7)	2,082,000	—
Issuance of common stock	71,000	—
Other, net	95,000	(29,000)
Total	<u>\$15,433,000</u>	<u>\$5,262,000</u>
Application of Funds:		
Additions to property and equipment, net —		
Purchase of limited partner properties and interests in associated partnerships (Note 6)	\$ 6,330,000	\$ —
Other	6,652,000	3,214,000
Payments on long-term debt and change in current maturities	3,344,000	680,000
Commissions and noncurrent advances to associated partnerships ...	751,000	872,000
Noninterest-bearing note receivable due in 1978	225,000	—
Total	<u>\$17,302,000</u>	<u>\$4,766,000</u>
Increase (Decrease) in Working Capital	<u>\$(1,869,000)</u>	<u>\$ 496,000</u>
Changes in Working Capital Components:		
Cash	\$ 219,000	\$ (323,000)
Accounts receivable	1,569,000	(854,000)
Lease and equipment inventory	103,000	(7,000)
Assets of discontinued operations	(3,639,000)	2,168,000
Other current assets	(9,000)	(16,000)
Note receivable	992,000	—
Bank indebtedness	659,000	138,000
Current maturities of long-term debt	(1,070,000)	(869,000)
Accounts payable and accrued liabilities	(2,466,000)	420,000
Income taxes payable	302,000	(161,000)
Liabilities of discontinued operations	1,471,000	—
Increase (Decrease) in Working Capital	<u>\$(1,869,000)</u>	<u>\$ 496,000</u>
Working Capital, beginning of year	<u>953,000</u>	<u>457,000</u>
Working Capital (Deficit), end of year	<u>\$ (916,000)</u>	<u>\$ 953,000</u>

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

Consolidated Statements of Shareholders' Equity

For the years ended December 31, 1976 and 1975

(Notes 1 and 5)

	Common Stock		Paid-In Capital	Retained Earnings	Total
	Number of Shares	Amount			
Balance, December 31, 1974	3,142,747	\$ 1,640,000	\$ 2,814,000	\$ 3,388,000	\$ 7,842,000
Net income	—	—	—	1,132,000	1,132,000
Balance, December 31, 1975	3,142,747	\$ 1,640,000	\$ 2,814,000	\$ 4,520,000	\$ 8,974,000
Issuance of common stock in connection with exer- cise of stock options ..	33,050	71,000	—	—	71,000
Net income	—	—	—	1,499,000	1,499,000
Balance, December 31, 1976	<u>3,175,797</u>	<u>\$ 1,711,000</u>	<u>\$ 2,814,000</u>	<u>\$ 6,019,000</u>	<u>\$10,544,000</u>

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

WAINOCO OIL CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 1976 and 1975

(1) Organization and summary of significant accounting policies —

Reorganization —

On December 31, 1976, Wainoco Oil Ltd. changed its jurisdiction of incorporation from the Canadian Province of Alberta to the State of Wyoming and changed its name to Wainoco Oil Corporation (the Parent). Concurrently with this change in jurisdiction of incorporation, the Parent transferred all of its assets and liabilities, except for its investment in its wholly owned United States subsidiary, Wainoco Oil & Gas Company (formerly Wainoco, Inc.), to its newly-formed Canadian subsidiary, Wainoco Oil & Gas Limited, in exchange for all the outstanding common stock of Wainoco Oil & Gas Limited. After this transfer, the Parent's individual balance sheet as of December 31, 1976, consisted of its \$10,544,000 investment in its two wholly owned subsidiaries (\$5,997,000 in Wainoco Oil & Gas Limited and \$4,547,000 in Wainoco Oil & Gas Company), which are accounted for on the equity method, and shareholders' equity. The Parent's investment in its wholly owned subsidiaries equaled its equity in the net assets of such subsidiaries at December 31, 1976.

Principles of consolidation —

The consolidated financial statements include the accounts of Wainoco Oil Corporation and its wholly owned subsidiaries, Wainoco Oil & Gas Company (Wainoco Company) and Wainoco Oil & Gas Limited (Wainoco Limited) (collectively referred to as Wainoco). All significant intercompany transactions have been eliminated in consolidation. Certain reclassifications have been made in the 1975 financial statements to conform to current classifications.

Currency translation —

Prior to 1976, Wainoco's financial statements were prepared in Canadian dollars. In connection with the change in jurisdiction of incorporation from Canada to the United States on December 31, 1976,

Wainoco began preparing its financial statements in United States dollars retroactive to January 1, 1976. The financial statements for 1975 and prior years have not been restated since the effect of translating these financial statements to United States dollars would not be material.

The 1976 financial statements include the effect of translating Canadian current assets and current liabilities into United States dollars at year-end exchange rates and property and equipment and other noncurrent assets at historical rates. Since Wainoco Limited's long-term debt is in United States dollars, no translation adjustment is required. Gains and losses on translation are included in the consolidated statements of income currently and are not material.

Oil and gas properties —

Wainoco follows the accounting policy of capitalizing all productive and nonproductive costs incurred in the acquisition, exploration, and development of oil and gas reserves. No gains or losses are recognized upon the sale or disposition of oil and gas properties, except in extraordinary transactions. As discussed in Note 6, \$6,330,000 of the increase in Wainoco's property cost during 1976 is attributable to the purchase of properties from certain limited partners in three associated partnerships.

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

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

Other property and equipment —

Furniture, fixtures and other equipment are carried at cost, and depreciation is provided on the straight-line method over estimated useful lives of three to 10 years. Gains or losses resulting from dispositions are included in earnings. Maintenance and repairs are charged against earnings when incurred. Renewals and betterments which extend the useful life of other property and equipment are capitalized.

Income taxes —

Certain amounts are deducted for United States and Canadian income tax reporting purposes in different periods than for financial reporting purposes. Deferred taxes are provided on timing differences between taxable and financial statement income to the extent that taxes which would otherwise have been payable are reduced. Wainoco Company recognizes interaction with statutory depletion in its United States oil and gas operations and, accordingly, does not provide deferred taxes on United States oil and gas exploration and development costs which are capitalized for financial reporting purposes

but deducted for income tax purposes so long as the estimated future tax deductions (including statutory depletion) exceed these costs. The amount of costs for which United States income taxes have not been allocated at December 31, 1976, is approximately \$2,000,000. Wainoco Company follows the flow-through method of accounting for investment tax credit received in the United States whereby the credits available each year are applied as a reduction of the United States tax provision.

Earnings per common share —

Earnings per common share are based on the weighted average number of common shares outstanding of 3,154,830 in 1976, and 3,142,757 in 1975. Stock options are common stock equivalents but have not been included in the weighted average shares outstanding since they are not material.

Allowances for bad debts and inventory losses —

Wainoco provides allowances for bad debts and inventory losses. The allowance for bad debts was immaterial in 1976 and 1975. The allowance for inventory losses was \$94,000 as of December 31, 1976. An allowance for inventory losses was not required prior to 1976.

(2) Discontinued operations —

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

Income from the Industrial Services Section for the six months ended June 30, 1976, and the year ended December 31, 1975, is shown as income from discontinued operations in the accompanying consolidated statements of income and is summarized as follows:

	Six Months Ended June 30, 1976	Year Ended December 31, 1975
Revenues —		
Chemical	\$5,533,000	\$10,606,000
Vegetation control	1,250,000	1,892,000
Other income	117,000	—
	<u>\$6,900,000</u>	<u>\$12,498,000</u>
Expenses —		
Cost of sales and operating costs —		
Chemical	\$4,587,000	\$ 8,877,000
Vegetation control	918,000	1,177,000
Selling, administrative, and interest	909,000	1,453,000
Depreciation	93,000	200,000
	<u>\$6,507,000</u>	<u>\$11,707,000</u>
Income before income taxes	\$ 393,000	\$ 791,000
Provision for income taxes	185,000	395,000
Operating income from discontinued operations	<u>\$ 208,000</u>	<u>\$ 396,000</u>

The gain on the sale was determined as follows:

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

(3) Long-term debt —

Long-term debt at December 31, 1976 and 1975, consisted of the following:

	1976	1975
Demand note payable by Wainoco Limited to a bank; due in monthly principal installments through 1982; interest at 2% above the bank's prime commercial rate; secured by substantially all Canadian oil and gas properties, the noninterest-bearing notes receivable and all other assets of Wainoco Limited; guaranteed by Wainoco Company	\$ 6,827,000	\$ —
Note payable by Wainoco Company to a bank; due in monthly principal installments of \$100,000 with balance due in April, 1978; interest at 2% above the bank's prime commercial rate; secured by substantially all United States oil and gas properties, equipment inventory, accounts receivable from joint operators, and the \$1,487,000 unsecured note receivable; guaranteed by the Parent	4,100,000	—
Notes payable to bank refinanced in 1976 (classified in 1975 based on the refinanced terms — see below) —		
Due in monthly principal installments of \$75,000 beginning January, 1976, with balance due in February, 1977; interest at 2% above the bank's prime commercial rate; secured by substantially all United States oil and gas properties and the \$1,487,000 unsecured note receivable	—	3,000,000
Due in March, 1976; interest at 2% above the bank's prime commercial rate; secured by equipment inventory and accounts receivable from joint operators	—	1,100,000
Other	—	650,000
	<u>\$10,927,000</u>	<u>\$ 4,750,000</u>
Less — Current maturities	<u>2,600,000</u>	<u>1,530,000</u>
	<u>\$ 8,327,000</u>	<u>\$ 3,220,000</u>

Wainoco Limited and a bank have made arrangements for the \$6,827,000 demand note to be repaid in varying monthly principal installments totaling \$1,400,000, \$1,200,000, \$1,225,000, \$1,325,000, \$1,425,000 and \$252,000 in the six years ended December 31, 1982, respectively. While this note is payable on demand and is subject to periodic and annual review by the bank, the bank has advised Wainoco Limited that it will not require repayment in advance of the arranged payment terms as long as the terms and conditions of the loan are met. The bank has agreed to provide Wainoco Limited with a line of credit of \$10,000,000 which bears interest at two percent over the bank's prime commercial rate, and provides for a standby fee of three fourths of one percent on the unused portion of the line of credit (\$3,173,000 as of December 31, 1976). The arrangements with the bank also provide, among other things, that Wainoco Limited will (1) restrict advances to its public limited partnerships to \$1,000,000 at any time, (2) maintain a ratio of present worth of future net income of all Canadian producing properties to the outstanding balance of the \$10,000,000 line of credit (\$6,827,000 outstanding at December 31, 1976) of at least two to one, and (3) pledge additional properties at the bank's request.

Wainoco Company's loan agreement for the \$4,100,000 note payable to a bank provides, among other things, that (1) Wainoco Company will not incur any additional indebtedness and (2) Wainoco and Wainoco Company will maintain a current ratio of at least one to one. The loan agreement also restricts Wainoco, among other things, from paying any cash dividends, merging or consolidating with another company and selling or otherwise disposing of a substantial portion of its assets. Wainoco was in violation of the minimum current ratio requirement and certain other covenants of Wainoco Company's loan agreement as of December 31, 1976, and at various times during the year, which were waived by the bank subsequent to December 31, 1976.

Wainoco Company also has a \$1,000,000 revolving line of credit with the bank which bears interest at two percent above the bank's prime commercial rate and provides for an annual commitment fee of one half of one percent of the unused portion of the credit line. The amount which can be drawn on the revolving line of credit is based on the lesser of \$1,000,000 or the collateral value of Wainoco Company's equipment inventory and accounts receivable from joint operators. The unused portion of this line of credit was \$200,000 as of December 31, 1976.

The 1975 notes payable refinanced in 1976 are described based on the terms actually in effect during 1975; however, the long-term and current maturities classifications at December 31, 1975, are based on the terms and conditions under which they were refinanced in 1976.

Maturities of long-term debt —

Maturities of long-term debt subsequent to December 31, 1976, are as follows:

1977	\$2,600,000
1978	4,100,000
1979	1,225,000
1980	1,325,000
1981	1,425,000
1982	252,000

Short-term borrowing —

The maximum amount of short-term borrowings outstanding as of any month-end was approximately \$2,400,000 in 1976, and \$3,000,000 in 1975, the approximate average amount outstanding was \$967,000 in 1976, and \$1,585,000 in 1975, and the average interest rate paid was approximately 10.0 percent in 1976 and 11.5 percent in 1975.

(4) Income taxes —

The provision for income taxes for 1976 and 1975 consisted of the following:

	<u>1976</u>	<u>1975</u>
Canadian income taxes —		
Current	\$(49,000)	\$407,000
Deferred	353,000	25,000
	<u>\$304,000</u>	<u>\$432,000</u>
United States Federal income taxes —		
Current	\$ 25,000	\$ 32,000
Deferred	50,000	22,000
	<u>\$ 75,000</u>	<u>\$ 54,000</u>
	<u>\$379,000</u>	<u>\$486,000</u>

The provision for income taxes has been allocated in the consolidated statements of income to continuing operations and discontinued operations as follows:

	<u>1976</u>	<u>1975</u>
Continuing operations	\$ 26,000	\$ 91,000
Discontinued operations	353,000	395,000
	<u>\$379,000</u>	<u>\$486,000</u>

Deferred taxes result from timing differences in the recognition of revenue and expenses for tax and financial reporting purposes. Deferred Canadian income tax expense of \$353,000 in 1976 and \$25,000 in 1975 is primarily attributable to Canadian exploration and development expenses capitalized for financial reporting purposes and deducted for tax reporting purposes. The United States deferred income tax expense includes deferred minimum preference tax of \$30,000 in 1976 and \$22,000 in 1975.

Set forth below is a reconciliation between the provision for income taxes computed at the statutory Canadian income tax rate (47 percent in 1976 and 50 percent in 1975) and the United States Federal income tax rate (48 percent) on income before provision for income taxes and the provision for income taxes as reported:

	<u>1976</u>	<u>1975</u>
Provisions for Canadian and United States income taxes	<u>\$ 900,000</u>	<u>\$ 796,000</u>
Increase (decrease) in provision resulting from —		
Canada —		
Royalties, rentals, and similar payments deducted currently for financial reporting purposes which are not deductible for income tax reporting purposes	883,000	187,000
Resource and depletion allowances	(614,000)	(86,000)
Provincial tax credits and rebates	(481,000)	(134,000)
Investment credit	(85,000)	(13,000)
Other, net	(51,000)	19,000
	<u>\$(348,000)</u>	<u>\$ (27,000)</u>
United States —		
Depreciation, depletion, and amortization of oil and gas properties for financial reporting purposes which is not deductible for income tax reporting purposes	\$ 435,000	\$356,000
Statutory depletion and depreciation of oil and gas properties for income tax reporting purposes which is not included as an expense for financial reporting purposes	(394,000)	(275,000)
Oil and gas exploration and development costs capitalized for financial reporting purposes and deducted for income tax reporting purposes	(213,000)	(375,000)
Investment tax credit	(45,000)	(14,000)
Minimum preference tax	55,000	40,000
Other, net	(11,000)	(15,000)
	<u>\$(173,000)</u>	<u>\$(283,000)</u>
Provision for income taxes, as reported	<u>\$ 379,000</u>	<u>\$ 486,000</u>

On January 1, 1976, certain Canadian Government legislation that amended the Income Tax Act went into effect. The Federal resource abatement that was in effect during 1975 was repealed on that date and a resource allowance was initiated for 1976. In addition, the Canadian Federal income tax rate applicable to oil and gas production profits was further reduced in 1976. The provinces of Alberta and British Columbia also enacted legislation in 1975 and 1976 which provided for certain tax credits and rebates applicable to oil and gas operations. The effects of the above legislation have been considered in computing the 1975 and 1976 Canadian income tax provisions.

As of December 31, 1976, Wainoco Company had a Federal income tax loss carryforward of approximately \$100,000 which will expire in 1978 and a tax depletion carryforward of approximately \$750,000 which is indefinitely available to reduce Federal income taxes payable after utilization or expiration of the tax loss carryforward. Since the operating loss and \$450,000 of the depletion carryforwards consist of timing differences between financial and tax reporting or represent permanent differences for which the tax effects have been recognized for financial reporting purposes, Federal income tax expense will not be reduced in the income statements of the periods when such carryforwards are utilized, but will be credited to deferred Federal income taxes. In addition Wainoco Company has approximately \$200,000 of investment tax credit carryforwards available to reduce future Federal income taxes payable, of which \$100,000 has been recognized as a reduction of deferred income taxes for financial reporting purposes through December 31, 1976. Wainoco Limited also has an earned depletion base carryforward of approximately \$800,000 for Canadian income tax purposes of which \$400,000 has been recognized for financial reporting purposes through December 31, 1976.

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

Stock option plans —

Wainoco has two stock option plans which authorize the granting of options to purchase 362,000 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 Plan are qualified stock options under the United States Internal Revenue Code and are granted at not less than fair market value on the date of grant. Options under both plans are generally exercisable over a five-year period at the rate of 20 percent per year on a cumulative basis. No entries are made in the accounts until the options are exercised, at which time the proceeds are credited to common stock.

A summary of the 1976 and 1975 stock option activity is as follows:

	1976		1975	
	Number of Shares	Option Price	Number of Shares	Option Price
Balance, beginning of year	165,800	\$1.33-\$5.00	109,800	\$1.38-\$6.44
Granted	78,250	\$2.55-\$4.13	75,000	\$1.33-\$2.19
Terminated and lapsed	(46,500)	\$1.33-\$5.00	(19,000)	\$2.00-\$6.44
Exercised	(33,050)	\$1.33-\$2.66	—	—
Balance, end of year	<u>164,500</u>	<u>\$1.33-\$4.13</u>	<u>165,800</u>	<u>\$1.33-\$5.00</u>

At December 31, 1976, options to purchase 99,650 shares were available to be granted under the plans.

Stock purchase plan —

In July, 1976, Wainoco's board of directors approved (subject to shareholder approval) the adoption of an employee stock purchase plan effective August 1, 1976. All employees will be eligible to participate in the plan except those who own in excess of five percent of Wainoco's outstanding common stock. The plan will allow each employee to purchase Wainoco stock at 85 percent of market value subject to certain limitations. The plan is to be submitted to the shareholders for approval in May, 1977.

Pension plan —

Wainoco's pension plan is noncontributory, open to all employees over 25 years of age with one year of service, has a normal retirement age of 65, and was designed to comply with the Pension Reform Act of 1974. Pension plan expense was \$34,000 in 1976 and \$52,000 in 1975, including amortization of unfunded prior service costs of \$99,000 over 30 years. Wainoco's policy is to fund pension costs accrued. The pension plan's assets were approximately equal to the actuarially computed value of vested benefits as of December 31, 1976.

(6) Associated partnerships —

Wainoco Company and/or Wainoco Limited are general partners in nine public limited partnerships. As general partner in four of the partnerships, Wainoco Limited received management fees of \$87,000 in 1976 and \$113,000 in 1975 as consideration for services rendered the partnerships. In addition, the general partners are reimbursed for direct, administrative, and overhead costs incurred in conducting the business of all except two of the partnerships. In November, 1976, Wainoco formed Wainoco 77 Company, a public limited partnership which has not commenced operations. Certain leases and equipment inventory costs, and direct costs and overhead incurred in anticipation of the formation of this and other future partnerships, are shown as current assets as of December 31, 1976.

Wainoco has (1) paid brokers' commissions on the sale of limited partnership interests in certain partnerships which are recoverable from partnership revenues otherwise attributable to the limited partners, and (2) advanced funds to nine partnerships to finance certain exploration and development expenditures which are recoverable only from future revenues of the partnerships. A summary of such commissions and advances at December 31, 1976 and 1975, is as follows:

	<u>1976</u>	<u>1975</u>
Commissions	\$ 545,000	\$ 601,000
Advances	3,191,000	1,662,000
	<u>\$3,736,000</u>	<u>\$2,263,000</u>
Less —		
Oil and gas exploration and development expenditures on partnership properties paid by Wainoco (see discussion below)	(650,000)	—
Estimated current portion	(862,000)	(790,000)
	<u>\$2,224,000</u>	<u>\$1,473,000</u>

At December 31, 1976, based on the most recent oil and gas reserve information on the partnerships' properties, the commissions and advances for two of the partnerships exceeded the fair market value of their oil and gas properties by \$650,000. This amount has been charged to the oil and gas properties account and is being amortized over Wainoco's aggregate proven oil and gas reserves in the same manner as other costs invested in oil and gas properties. The \$650,000 is included in the oil and gas properties account as it was discretionary in nature at the time the expenditure was made and is considered an integral part of Wainoco's oil and gas exploration and development activities. In addition, the amount could be increased or decreased in future years depending on the determination of the estimated fair market value of the partnerships' oil and gas properties from which the commissions and advances will be repaid. The estimated current portion of amounts due from associated partnerships is based on the estimated amount expected to be received net of expenditures by the partnerships from their oil and gas properties within one year.

The general partners can be required to purchase the limited partners' interests in the partnerships in varying amounts up to a total of approximately \$8,000,000 in any one year from 1977 through 2000, depending on the terms of the different partnership agreements. The purchase price will be based on the estimated discounted cash flow, after debt service, to the limited partners discounted for risk factors associated with developing and producing the reserves. In 1976, as a result of a tender offer, Wainoco Limited purchased properties and interests from certain limited partners in three associated partnerships for a total consideration of \$6,330,000.

(7) Commitments and contingencies —

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

In connection with the sale of Wainoco's interest in five offshore leases in 1974, a 10-year preferential right to purchase up to 3,000 barrels per day of Wainoco's United States oil production at competitive market prices was granted to the purchaser.

The general partners are contingently liable for the liabilities of the associated partnerships, which include aggregate bank indebtedness of approximately \$4,200,000 at December 31, 1976.

(8) Quarterly financial data for 1976 (unaudited) —

Summarized below is Wainoco's unaudited quarterly financial data for 1976 after restatement of the first three quarters of the year to give effect to the changes described in Note 1 regarding (a) translation

of previously reported amounts in Canadian dollars to United States dollars and (b) the change in the method of computing depreciation, depletion, and amortization.

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Year
	(in thousands, except per share amounts)				
Revenues	\$1,169	\$1,267	\$1,619	\$1,654	\$5,709
Income from continuing operations	\$ 267	\$ 247	\$ 283	\$ 266	\$1,063
Income from discontinued operations, net of income taxes —					
Operating income	\$ 120	\$ 88	\$ —	\$ —	\$ 208
Gain on sale(b)	—	228	—	—	228
	\$ 120	\$ 316	\$ —	\$ —	\$ 436
Net income(a)	\$ 387	\$ 563	\$ 283	\$ 266	\$1,499
Earnings per common share —					
Income from continuing operations	\$.09	\$.08	\$.09	\$.08	\$.34
Income from discontinued operations04	.10	—	—	.14
Net income(a)	\$.13	\$.18	\$.09	\$.08	\$.48

Notes:

(a) The changes described above, after income tax effect and the allocation of certain amounts among the individual quarters, resulted in increases (decreases) to previously reported net income and earnings per common share for the first three quarters of 1976 as follows:

	First Quarter	Second Quarter	Third Quarter
Net income	\$(29,000)	\$(77,000)	\$68,000
Earnings per common share	—	(.02)	.02

(b) The gain on sale of the Industrial Services Section was reported as an extraordinary item in the quarterly financial statements in accordance with generally accepted accounting principles followed in Canada. Since the Parent became a United States corporation on December 31, 1976, the gain on sale has been presented under discontinued operations in conformity with Accounting Principles Board Opinion No. 30.

Auditors' Report

To the Shareholders of Wainoco Oil Corporation:

We have examined the consolidated balance sheets of Wainoco Oil Corporation (a Wyoming corporation and formerly Wainoco Oil Ltd.) and subsidiaries as of December 31, 1976 and 1975, and the related consolidated statements of income, shareholders' equity, and changes in financial position for the years then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the financial position of Wainoco Oil Corporation and subsidiaries as of December 31, 1976 and 1975, and the results of their operations and changes in their financial position for the years then ended, in conformity with generally accepted accounting principles. Except for the change (with which we concur) in the method of computing depreciation, depletion, and amortization of oil and gas properties as described in Note 1 to the financial statements, in our opinion, the accounting principles were consistently applied during the periods.

ARTHUR ANDERSEN & CO.

Houston, Texas
March 18, 1977

Directors

John B. Ashmun
Houston, Texas
William A. Faubion
Houston, Texas
James S. Palmer
Calgary, Alberta
William Scheerer, II
New York, New York
Robert F. Smith
Calgary, Alberta

Officers

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

Offices

Houston, Texas
Calgary, Alberta

**Registrars and
Transfer Agents**

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

Principal Banks

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

Auditors

Arthur Andersen & Co.
Houston, Texas

Counsel

Vinson & Elkins
Houston, Texas
Burnet, Duckworth & Palmer
Calgary, Alberta

Subsidiaries

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

Common Stock

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

	High	Low
1976		
First Quarter	3¼	2¼
Second Quarter	4¼	2¾
Third Quarter	4	3
Fourth Quarter	6¼	3¾
1975		
First Quarter	2 ¹⁵ / ₁₆	1½
Second Quarter	4 ¹ / ₈	1¾
Third Quarter	3 ¹¹ / ₁₆	2 ¹ / ₈
Fourth Quarter	2 ¹¹ / ₁₆	1 ⁷ / ₈

Availability of Form 10-K

The Company's Annual Report on Form 10-K which is filed with the Securities and Exchange Commission is available upon request, and may be obtained by writing to:

Vice President-Finance
Wainoco Oil Corporation
1100 Milam Building
Suite 600
Houston, Texas 77002

Annual Meeting Notice

The annual meeting of the shareholders of Wainoco Oil Corporation will be held Monday, May 16, 1977, at 2:00 p.m. in the First City East Auditorium, 1111 Fannin Street, Houston, Texas.

WAINOCO OIL CORPORATION
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