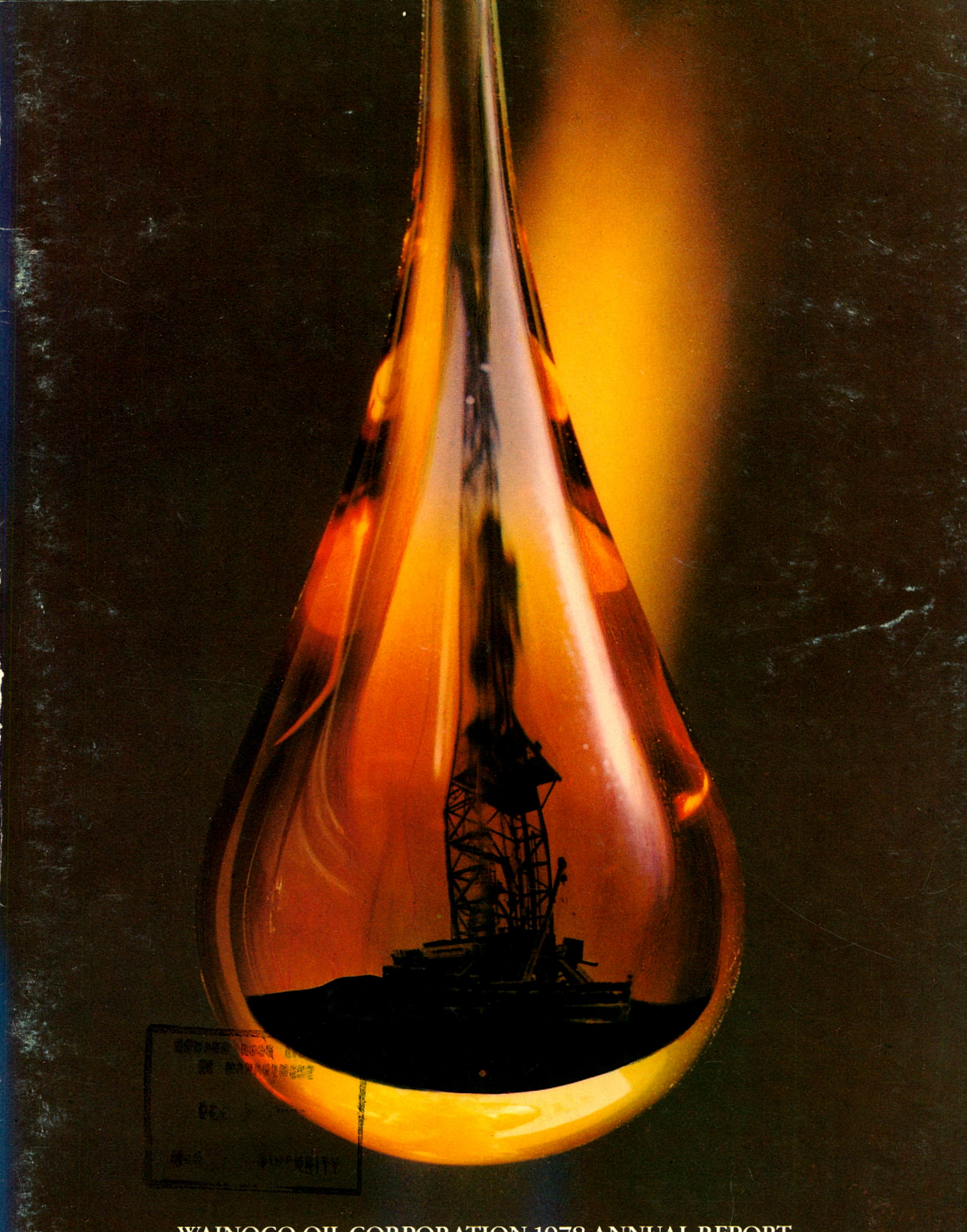


# WAINOCO OIL CORPORATION 1978 ANNUAL REPORT

## The Company's Business

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

## Contents



## Financial and Operating Highlights
### Oil and Gas Operations

| | 1978 | 1977 | Percent Increase (Decrease) |
|---|---|---|---|
| Financial | | | |
| Total revenue | $16,322,000 | $ 9,002,000 | 81% |
| Net income | 5,429,000 | 2,472,000 | 120% |
| Earnings per share | 1.40 | .75 | 87% |
| Funds provided by operations | 10,658,000 | 5,859,000 | 82% |
| Total assets | 79,948,000 | 44,374,000 | 80% |
| Shareholders' equity | 31,351,000 | 13,091,000 | 139% |
| Shareholders' equity per share | 6.95 | 4.09 | 70% |
| Shares outstanding | 4,509,423 | 3,202,797 | 41% |
| Production | | | |
| Oil and condensate in barrels | 407,000 | 336,000 | 21% |
| Natural gas in millions of cubic feet | 8,109 | 6,261 | 30% |
| Proven Reserves | | | |
| Oil and condensate in barrels | 2,164,000 | 2,351,000 | (8%) |
| Natural gas in millions of cubic feet | 160,866 | 109,515 | 47% |
| Land | | | |
| Gross acres | 6,500,000 | 13,315,000 | (51%) |
| Net acres | 1,434,000 | 3,145,000 | (54%) |

## Letter To The Shareholders

Considerable advances were made by Wainoco last year and are reflected in the financial statements, and the gas reserves reported as of December 31, 1978. Revenues of $16,322,000 were up 81% over those of 1977, and net income of $5,429,000 was 120% above that of the previous period. Cash flow from operations was $10.7 million, an increase of 82%over that in 1977. Assets of $80 million were 80% over those in the prior year and shareholders' equity of $31.4 million was 139% above that for 1977. It is encouraging to report that along with the increases shown on the financial statements, proved gas reserves of 161 billion cubic feet rose 47% over those of a year ago.

In October, $30 million of 10¾% Subordinated Debentures were sold along with 210,000 shares of stock. Net funds of $29,025,000 from sales of these units were applied toward working capital and the elimination of bank debt. This financing followed the June call and conversion of $10 million of 8% Convertible Debentures as a result of which 1,037,000 shares of stock were issued. At the end of 1978 there were 4,509,423 common shares outstanding, 41% more than at the end of 1977.

Gas reserves increased both in the U.S. and Canada. A significant portion of the increase is attributable to development drilling in the Monias field of northeastern British Columbia, a major property for the Company. There are now 15 wells at Monias in which Wainoco's interest averages 50%. A recent independent engineering report showed 89 billion cubic feet of gas reserves proved by 13 completed wells.

New rules for full cost accounting were defined in late 1978 by the Securities and Exchange Commission and will take effect in 1979 requiring the restatement of Wainoco's financial results for prior periods. As noted in the accompanying financial statements, a restatement of 1978 earnings as a result of such accounting rule changes will reduce net earnings and shareholders' equity, but there will be no effect on revenues, cash flow from operations or reserves.

Total drilling activities for 1978 involved 129 wells. Of these, 72 were completed as productive and 57 were abandoned.

Wainoco offered subscriptions to two limited partnerships last year, one in the U.S. and one in Canada. Funds of $17.6 million were received from partnership sales in the U.S. and $9.9 million of subscriptions were sold in Canada. Wainoco, as general partner and through subscribing to $2 million in each as a limited partner has a total ownership of 47% in the U.S. partnership and a 52% interest in the Canadian. Thirty-four wells have been drilled in the U.S. partnership of which 15 appear successful. In Canada, 16 successful wells have been drilled out of 28.

Again in 1979, the Company will offer subscriptions for two limited partnerships through the registration of $25 million in the U.S. and $15 million in Canada. Wainoco, expending its growing cash flow, intends to participate in each partnership with a substantial investment.

Capital expenditures in 1978, inclusive of partnerships, were $57,300,000, an increase of 100% over those in the previous year. As a result of the 1978 sale of debentures, Wainoco entered 1979 with a projected $50 million available in lines of bank credit, so that cash flow supplemented by bank financing plus limited partnership subscriptions should support the ambitious program planned for 1979.

Oil and gas revenues of $14.8 million were up 80% in 1978 even though gas sales were curtailed for about five of the warmer months in both the U.S. and Canada. With enactment of the Natural Gas Policy Act last fall, the surplus in the U.S. intrastate gas market should soon start ameliorating. In Canada, government approval of increased gas exports could reduce the surplus that exists in Alberta. The market for much of the gas produced in British Columbia is the U.S. west coast. This market should improve when the excess of Alaskan crude oil being shipped to the coast has been disbursed. We are optimistic that an affirmative decision will be made for more Canadian exports of gas and also believe that more efficient movement of Alaskan oil will be achieved, although neither event should measurably affect the Company's position this year.

It is expected that Wainoco's oil and gas revenues will increase at least 25% in 1979. This forecast includes no limitation of U.S. gas sales, but does provide for second and third quarter curtailments in Canadian gas markets.

Gas reserves that have been found in Canada for which no market is presently available are estimated to have a daily delivery capacity in excess of 20 million cubic feet over that which we expect to produce in 1979. This shut-in production volume illustrates the potential for revenue growth that has been generated by the Company in the last two years, as well as the extent of the present gas surplus in Canada.

The planned expansion of our staff in 1978 has resulted in 187 persons employed at this time, 56% more than reported last year. The addition of technical and support personnel and the move into new Houston headquarters allows us to more efficiently manage the Company's greatly increased operations.

Developments in 1978 have added considerable substance to Wainoco as it concentrates its search for oil and gas within the security of the North American continent. Our strong financial position and enlarged operating capacity assure continuation of Wainoco's growth throughout 1979.

John B. Ashmun
President

March 16, 1979

# United States Operations

Wainoco's 1978 operations in the United States involved participation in 72 wells of which 35, or 49% were completed as productive. Capital expenditures of $38,000,000 were made for the year, an increase of 78% over 1977. Oil produced in the U.S. in 1978 was up 16% and gas increased 70% over that produced in 1977.

## GULF COAST DIVISION

1978 was another excellent year for Wainoco's exploration efforts on the Gulf Coast. Drilling activity was up over last year with a total of 51 wells drilled; 25 in Texas, 25 in Louisiana, and 1 in Mississippi. The operations were all conducted in conjunction with Wainoco's limited partnerships. New projects accounted for 34 of the total, while the remaining 17 were drilled as development wells on previous discoveries or producing properties.

Of the 51 wells drilled, 25 completion attempts were successful, yielding an overall success ratio of 49%. Thirteen completions were in Texas, eleven in Louisiana and one in Mississippi.

STATISTICAL SUMMARY—
UNITED STATES OPERATIONS

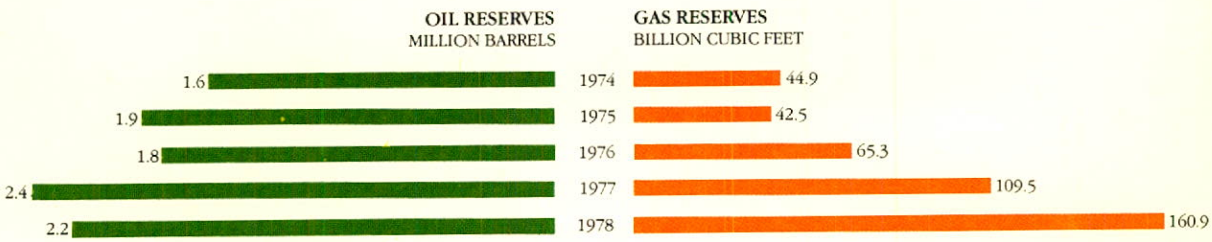
| | 1978 | 1977 |
|---|---|---|
| **Exploration & Development** | | |
| Wells Drilled | 72 | 60 |
| Wells Completed as Productive | 35 | 35 |
| **Production** | | |
| Oil & Condensate (bbls.) | 289,000 | 249,000 |
| Gas (mmcf) | 3,807 | 2,239 |
| **Proved Reserves** | | |
| Oil & Condensate (bbls.) | 1,131,000 | 1,268,000 |
| Gas (mmcf) | 13,272 | 10,851 |
| **Land** | | |
| Gross Acres | 445,000 | 465,000 |
| Net Acres | 126,000 | 127,000 |

### LOUISIANA

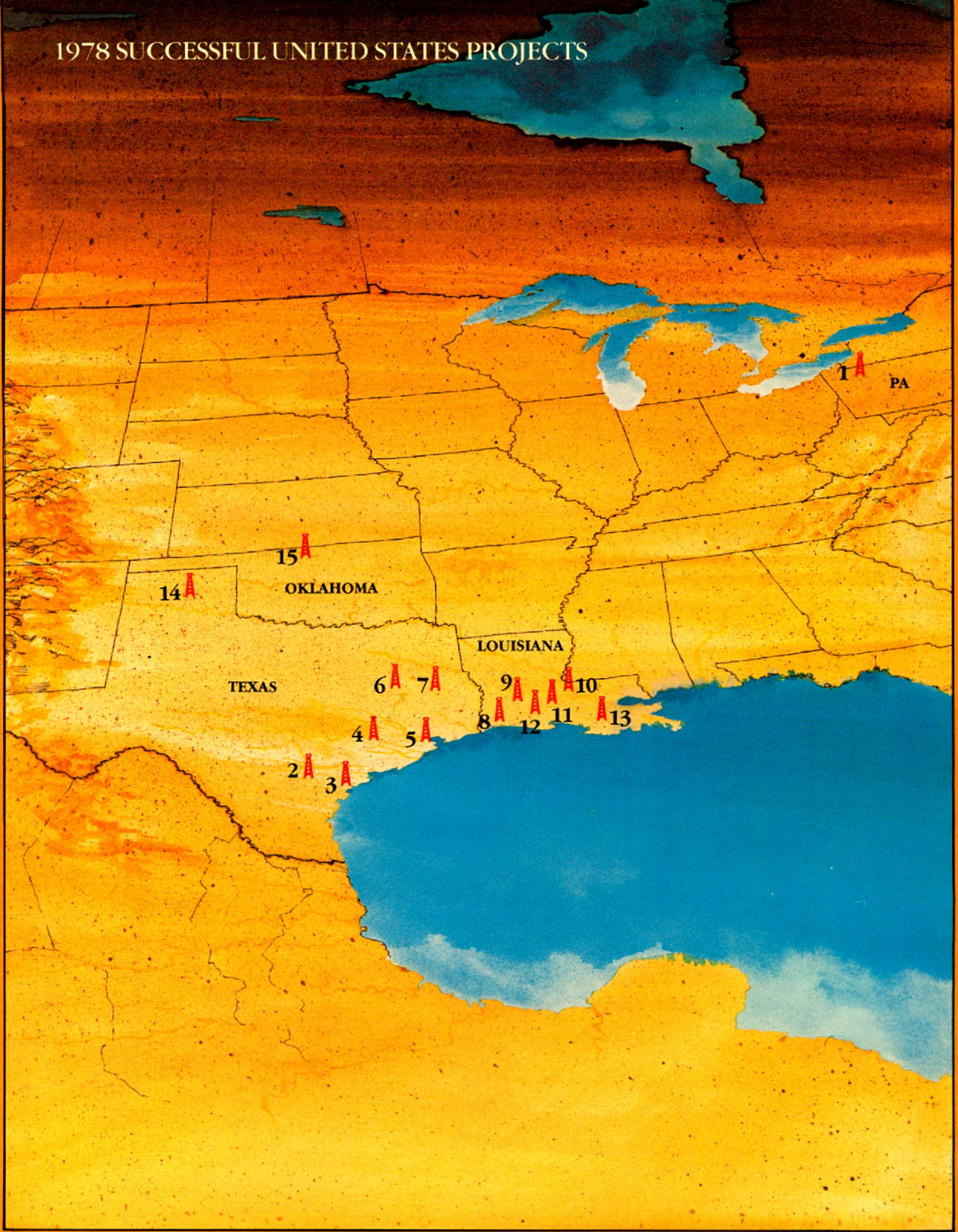
South Louisiana continued to be an active exploration area and several new prospects were undertaken by Wainoco 78 Company, the limited partnership formed for 1978 exploration and development drilling in the Gulf Coast area.

In the Rousseau field of Lafourche Parish, the No. 1 Richard was drilled to a depth of 15,420′ and encountered over 50′ of apparent pay in several Miocene sands. This well, in which the partnership owns a 50% interest before payout, is being completed and should be an excellent producer with at least one follow-up well to be drilled.

In St. Martin Parish, operations and further development were undertaken in the Bayou Bouillion Dome field. Previous drilling in this field dates back to the early 1900's, and production had ceased although the field potential was never realized and its limits were not defined. Wainoco successfully completed two new oil wells prior to year's end. The Lignum No. 1 was tested at rates in excess of 700 barrels per day, but will be initially produced at a regulated daily allowable of 204 barrels from a dolomite zone at 5,714′. The Lignum No. 2 was completed for 75 barrels per day from a pay sand at 2,966′. The



# 1978 SUCCESSFUL UNITED STATES PROJECTS




1. ATHENS
2. SAN CAJA
3. GUEDIN
4. SPEAKS
5. LEAGUE CITY
6. IOLA
7. LONG KING CREEK
8. CRAIN
9. WOODLAWN
10. BAYOU BLUE
11. BAYOU BOUILLION
12. MAURICE
13. ROUSSEAU
14. ROBLIPS
15. WAKITA

partnership owns a 68% interest until payout in a 1,900 acre tract in the field and several development wells and recompletions are scheduled for 1979.

At Woodlawn field, in Jefferson Davis Parish, the partnership owns a 25% working interest in the No. 1 Racca well, a Frio sand completion at 8,645-62′. The well is producing gas at a daily rate of 1.6 million cubic feet with 172 barrels of condensate. No further development is anticipated.

In Iberville Parish, at Bayou Bleu field, the Wainoco No. 1 Kurzweg was completed at a depth of 6,752′ and potentialed for 75 barrels of oil per day. The partnership owns a 100% working interest in this well and plans have been made for a confirmation test to be drilled early in 1979.

## TEXAS

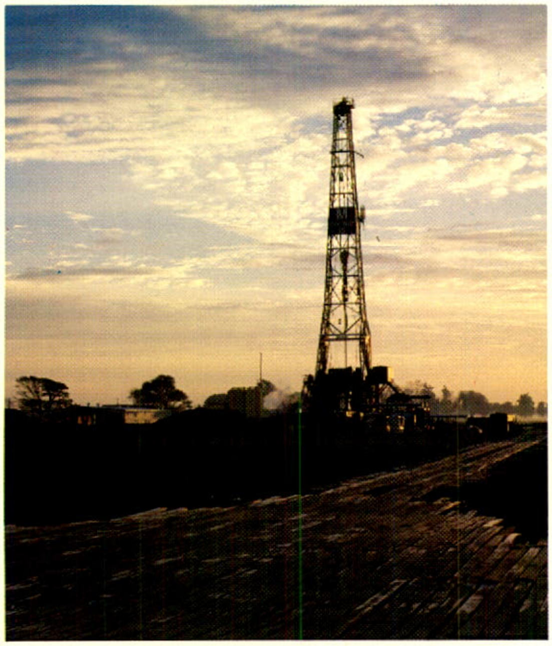
Drilling activity was stepped up in the Texas Gulf Coast and with this increase in activity a gratifying number of completions were made by Wainoco 78 Company.

In San Patricio County, the No. 1 Brannon well was completed from the Lower Herron sand at 10,535′ with a producing rate of 2 million cubic feet of gas per day plus 100 barrels of condensate. The partnership owns a 97% interest in this well and holds 5,067 acres of leases around the discovery. Two development well locations have been staked and other exploratory projects have been planned for 1979.

The No. 1 Butler in Galveston County was re-entered to a depth of 9,976′ and completion was made in the Middle Frio with a test that produced 432 barrels of oil and 3.3 million cubic feet of gas per day. The well is scheduled to commence production in the second quarter of 1979 at a regulated daily rate of approximately 200 barrels of oil and 1 million cubic feet of gas. An offset well is being drilled on the 393 acre block in which the partnership owns a 70% interest.

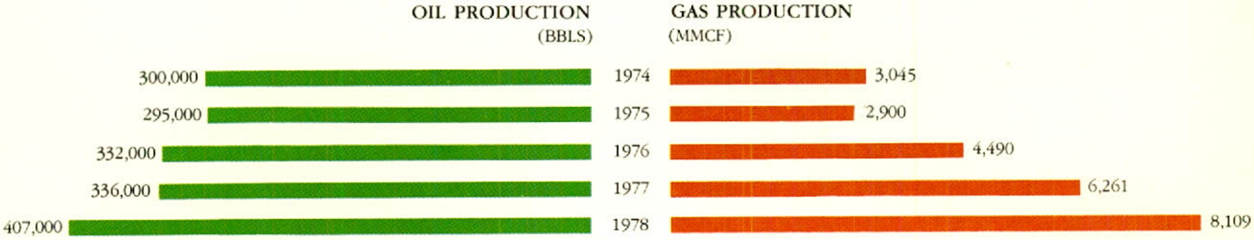
A well was completed in the Speaks field, Lavaca County. The No. 4 Eaves, in which the partnership owns an after-payout interest of 50%, is producing gas at a daily rate of 350 thousand cubic feet from a sand at 3,544′. Two additional wells are planned on this prospect.

In Polk County, the No. 1 Bergman well has been completed at Long King Creek in Yegua sand at 5,700′ with a flowing potential of 676 thousand cubic feet of gas per day. The partnership owns a 50% interest in this well



*Left: Drilling operations at the Schreiver prospect, La Fourche Parish, Louisiana*

*Right: Driller at the controls during a trip for a new bit*



and the surrounding 989 acre lease block.

In Grimes County, the No. 1 Ozell Davis has been drilled to a depth of 11,457′ with 30′ of pay indicated in the Woodbine sand at 9,430′ and 50′ in the Glenrose "B" at 11,365′. The partnership owns a 100% interest in the well and 704 acres of leases.

## MID-CONTINENT DIVISION

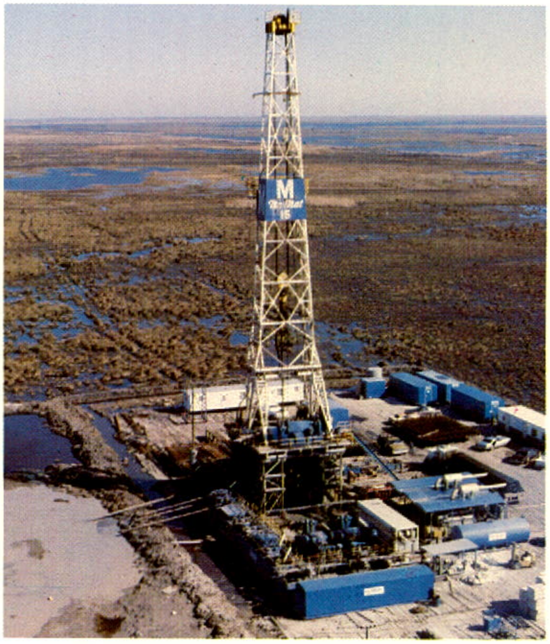
A Mid-Continent Division was formed to expand the Company's oil and gas reserve base outside Canada and the U.S. Gulf Coast. Present emphasis is being placed in the Anadarko Basin, the Appalachian Basin and the Rocky Mountain Basin. In 1978 Wainoco participated in the drilling of 21 wells. Four of these tests were in the Texas Panhandle, three in Kansas, five in Oklahoma, three in New Mexico and six in Pennsylvania. A total of ten completions were made for a 48% success ratio.

Wainoco commenced a ten well program to earn a 79% interest in a 10,000 acre block in Crawford County, Pennsylvania. This program will be concluded in April 1979 at which time Wainoco will have the option to drill 10 more wells to earn an additional 10,000 acres. Primary objective of the program is the Silurian Medina Sandstone at a depth of about 5,000′. Gas wells in this portion of the Appalachian Basin have relatively low producing rates and drain smaller reservoirs than many of those drilled in the deeper basins of the southwest and western states. However, the lower risks in finding reserves and the lower costs of drilling these shallow wells make this type of production economically attractive.

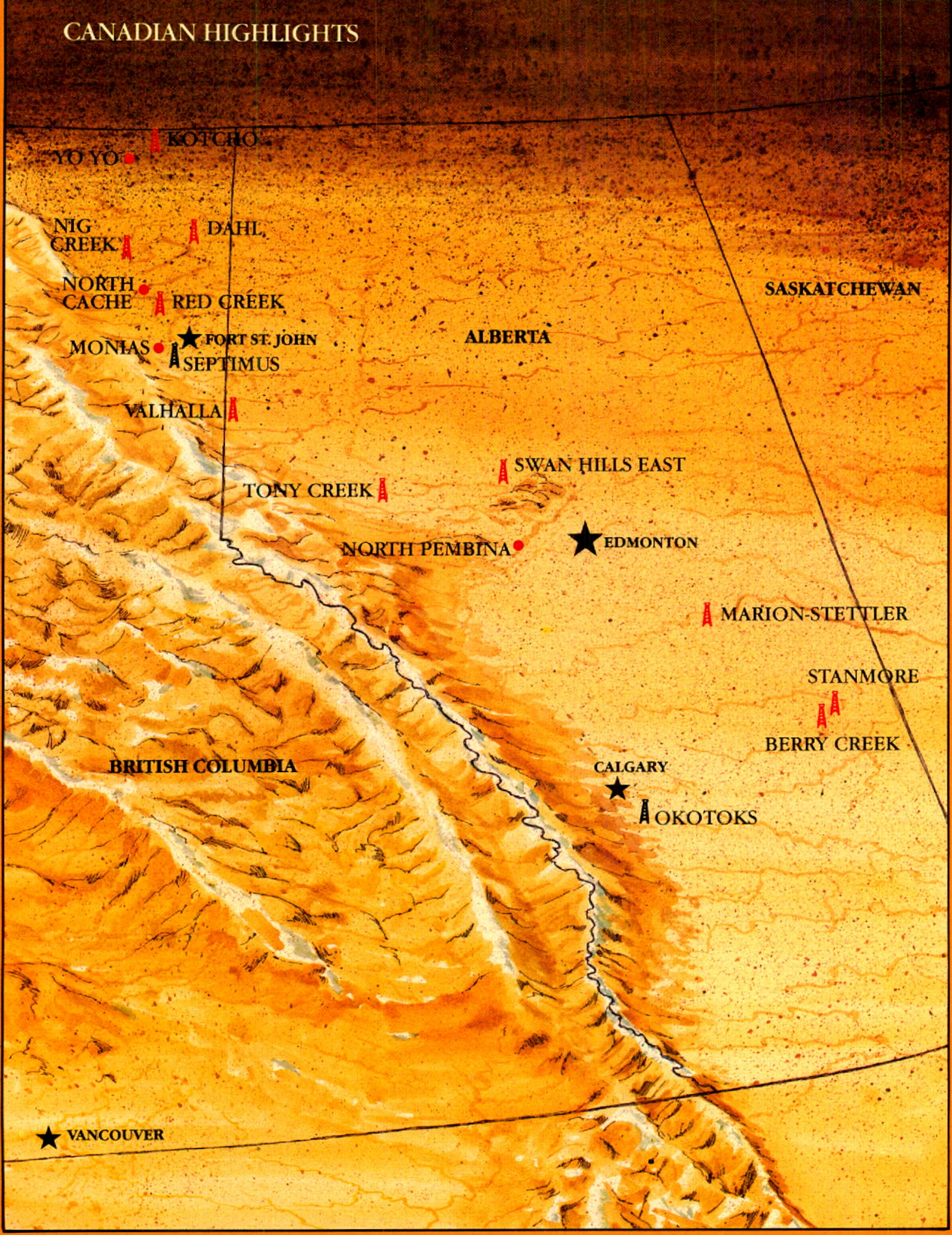
On the southwestern flank of the Anadarko Basin, the Company acquired a 50% interest in a 42,000 acre tract in Roberts and Ochiltree Counties, Texas. Drilling commenced on the Roblips prospect in the fourth quarter of 1978, resulting in two successful wells from a four well program. The No. 1 AA-Barbara Lips was completed for an open flow potential of 3.2 million cubic feet of gas per day from a Pennsylvanian Morrow sand at a depth of 8,400′. In early 1979 the No. 1 AD-Barbara Lips recovered 3,200′ of oil on a test of the Pennsylvanian Cleveland sandstone at a depth of about 7,350′. A second zone at a depth of 7,800′, the Pennsylvanian Oswego limestone, flowed 101 barrels of oil plus 777 thousand cubic feet of gas per day on production test. A 35 mile seismic program and additional drilling are planned in 1979.

Wainoco drilled three wells in the Red Fork Sand trend near Wakita in Grant County, Oklahoma. Two of the 5,000′ wells have indicated gas production in the Pennsylvanian Red Fork sandstone with the third well indicating gas production in the Mississippi Chat. Wainoco holds an 85% interest in the three wells and has the rights to earn a similar interest in seven more drilling locations in the 1,600 acre play.

In April 1978, drilling commenced on the American Quasar 1-18 Davis well, a 24,000′ Ordovician Bromide test located in Grady County, Oklahoma. Wainoco owns an 18.7% interest in the well for which it will pay an estimated 9% of the drilling costs. This test, located on an 8,000 acre lease block is now drilling below 13,000′ following several months' delay and is expected to reach total depth in late 1979.



*Drilling on the Crain prospect, Cameron Parish, Louisiana*




● AREAS OF SIGNIFICANT ACTIVITY

**WAINOCO 1978 CANADA PARTNERSHIP:**

DISCOVERIES

DRILLING WELLS

## Canadian Operations

Wainoco's Canadian oil and gas activities during 1978 were marked by dramatic increases in gas reserves and significant growth in oil and gas revenue. A $10 million limited partnership offering was successfully completed and a record exploration and development budget of $19,300,000, including partnership funds, was expended.

The Company participated in 57 wells of which 37 were completed as productive, resulting in a success ratio of 65%. In Alberta 36 wells were drilled of which 16 resulted in gas wells and 7 in oil wells. In British Columbia the drilling of 21 wells resulted in 13 gas discoveries and 1 oil well.

BRITISH COLUMBIA

The Monias property in northeast British Columbia has developed into Wainoco's most significant asset. During 1978 there were 5 gas wells drilled on the property, bringing the total to 14 in which the Company holds an average 50% interest. The proved reserves at year-end assigned to Wainoco from this property were 89 billion cubic feet, an 81% increase for the year. Continuous production from the property commenced in November and has been averaging approximately 10 million cubic feet of gas per day net to Wainoco. One additional gas well has been drilled on this property in 1979, one is now drilling and more wells are planned later in the year.

Two hundred miles north of Monias in the Clarke Lake area of N.E. British Columbia, the Company and its 1977 Canadian limited partnership completed a significant step-out discovery on the edge of the YoYo gas field. This well, which encountered 252′ of Devonian reef pay at a depth of 7,300′, is one of the best wells in the YoYo field. Reserves of approximately 28 billion cubic feet have been assigned to the well which flowed on production tests at rates up to 20.6 million cubic feet of gas per day. The 1977 limited partnership, in which Wainoco has a 40% interest, owns 63% of the well until payout, reverting then to a 32% interest.

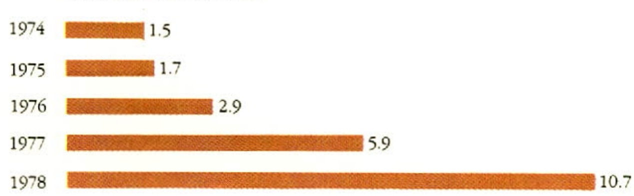
ALBERTA

The Company's North Pembina acreage located on the prolific Devonian Reef oil trend west of Edmonton, continued to attract attention during 1978. Of particular interest was an indicated oil discovery about one quarter

STATISTICAL SUMMARY—CANADIAN OPERATIONS

| | 1978 | 1977 |
|---|---|---|
| **Exploration & Development** | | |
| Wells Drilled | 57 | 64 |
| Wells Completed as Productive | 37 | 47 |
| **Production** | | |
| Oil & Condensate (bbls.) | 118,000 | 87,000 |
| Gas (mmcf) | 4,302 | 4,022 |
| **Proved Reserves** | | |
| Oil & Condensate (bbls.) | 1,033,000 | 1,083,000 |
| Gas (mmcf) | 147,594 | 98,664 |
| **Land** | | |
| Gross Acres | 815,000 | 706,000 |
| Net Acres | 269,000 | 242,000 |

FUNDS PROVIDED BY OPERATIONS
MILLIONS OF DOLLARS



mile south and west of Wainoco's 1,280 net acres. Of further interest is a well presently drilling one quarter mile north of the Company's acreage. A 9 mile seismic program was conducted on Wainoco's acreage during the year and, to further evaluate features of interest, 18 more miles of seismograph work are presently being done. If, as a result of this evaluation, a favorable drill site is found on Wainoco's leases, drilling on a test well could commence by late summer.

WAINOCO 78 CANADA

Subscriptions totaling $9.92 million were sold throughout Canada to 731 limited partners. This represents a 226% increase in partnership funds raised over those in 1977 when the Company's initial Canadian limited partnership was formed. To date, the partnership has drilled 28 wells including 13 gas wells and 3 oil wells for a success ratio of 54%. Drilling is presently underway on two remaining prospects.

A significant discovery was completed by the partnership at Kotcho, in northeast British Columbia 10 miles east of YoYo. This well was drilled to a depth of 5,000′ and tested 1.47 million cubic feet of gas per day from 60′ of pay in the Mississippian Debolt formation. The partnership has a 100% interest in the well until payout, after which it will own a 50% interest in the well and 7,400 acres of leases.

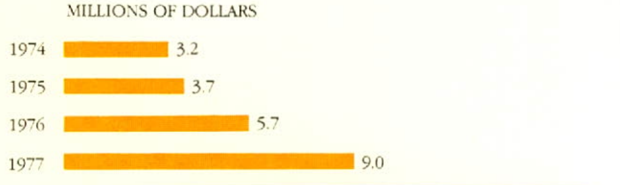
Another important well was drilled at Red Creek, 24 miles northeast of Ft. St. John, British Columbia. This well encountered 45′ of pay in the Triassic Halfway formation and flowed 1.7 million cubic feet of gas per day during a drill stem test. The partnership owns a 33⅓% interest in the well and 4,564 surrounding acres.

Additional partnership discoveries in British Columbia were at Nig Creek, where a partnership well flowed 1.04 million cubic feet of gas per day during production tests, and at Dahl where two partnership wells flowed 1.46 and .5 million cubic feet of gas per day, respectively, during drill stem tests.

In Alberta, a partnership well was drilled at Marion Stettler in the east central part of the province. This well was drilled to a depth of 4,091′ and tested 1.4 million cubic feet of gas per day from 27′ of pay in the Cretaceous Hackett sand. The partnership owns 87.5% interest in this well and 1,920 acres.

*East Swan Hills 4-5 oil well, Alberta*

REVENUE
MILLIONS OF DOLLARS

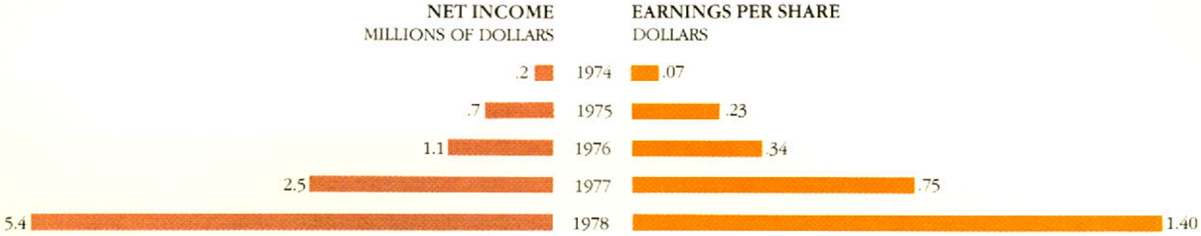


Thirty-six miles south of Marion Stettler the partnership drilled three successful wells in the Stanmore-Berry Creek area. Two gas wells tested 6.5 and 5 million cubic feet of gas per day, respectively, from the Cretaceous Basal Quartz formation. The partnership owns a 100% interest in the first and a 42% interest in the second of these two wells. A third well in the same area is a dual zone oil and gas discovery. The well is presently producing 30 barrels of oil per day from the Cretaceous Basal Quartz sand at a depth of 3,494′. The Viking sand at 2,861′ tested 2.4 million cubic feet of gas per day. This zone is presently shut-in pending contract negotiations. The partnership owns a 42% working interest in this well and 1,920 surrounding acres.

Drilling at Okotoks, in southern Alberta, and Septimus, in British Columbia, is now taking place on the last two partnership prospects to be tested. Other successful ventures in Alberta in which the partnership participated include two oil wells at East Swan Hills and an oil well at Valhalla. Additional drilling is planned at Valhalla.

*Left: Completion rig on location at Bear Flats 6-34, British Columbia*

*Right: Winter drillsite at Beatton Park, British Columbia.*



## International

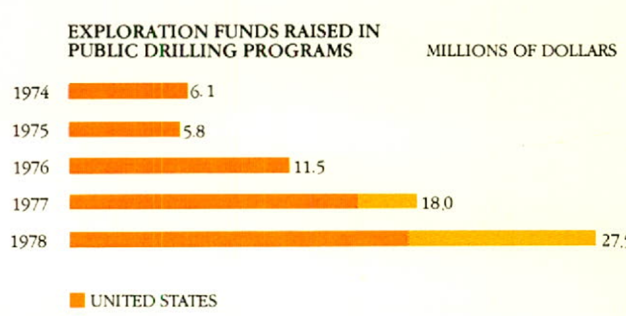
The Company's areas of exploration emphasis remain in the United States and Canada. Wainoco continues, however, to monitor international exploration activity and seek appropriate investment opportunities.

During the past two years, industry attention has again focused on the northwest shelf of Australia. Several new exploration permits have been awarded, seismic activity has been brisk, new exploratory wells are planned, and development drilling has commenced for offshore gas fields on the southern part of the shelf. In December, 1977, an exploration group in which Wainoco holds approximately a 20% interest was awarded block WA 103 P offshore Western Australia. This 5.2 million acre permit lies in the Bonaparte Gulf in water depths ranging from 150′ to 300′. During 1978, evaluation of the area consisted of seismic interpretation. The group plans to acquire approximately 1200 kilometers of CDP seismic during 1979.

Two oil exploration licenses, onshore and offshore Kenya, in which Wainoco held a 25% interest expired in June, 1978.

*Top: Upward view from rig floor during hoist for a connection*

*Bottom: Operations at Bayou Bouillon, St. Martin's Parish, Louisiana*



# Financial Review

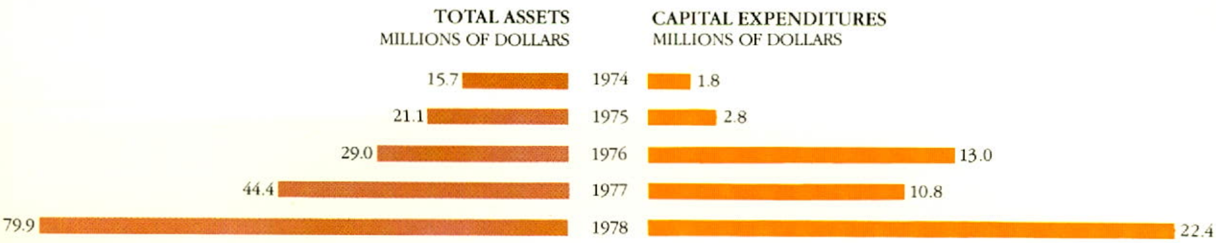
## FINANCING

Major steps were taken in 1978 to create a strong financial base for expanding operations. In June, a call was made for redemption of the Company's $10 million of 8% Convertible Subordinated Debentures. The conversion of these Debentures resulted in the issuance of 1,037,000 shares of common stock. In October, the Company completed the sale of $30 million of 10¾% Subordinated Debentures with 210,000 shares of common stock. These Debentures, now separated from the stock, are listed on the American Stock Exchange. The proceeds from this sale were used to retire bank debt and to add to working capital. This financing enabled the Company to enter 1979 with only $4.2 million in bank debt, so that with our existing credit lines and the 1978 reserve additions as new collateral, it is expected that there will be in excess of $50 million available in further bank credit lines for the year's capital requirements.

## CAPITAL EXPENDITURES

Corporate capital expenditures for 1978 were $22,400,000, of which 48% was financed by internally generated cash flow. Corporate funds plus those generated from the outside resulted in a total capital expenditure for the year of $57,300,000. A larger capital budget is planned for 1979. The amount will be dependent on sales of subscriptions in the 1979 partnerships in which Wainoco has committed for 20% of the interests in the U.S. partnership and $2 million in the Canadian partnership. Assuming that the full amount of subscriptions are sold, the limited partnership portion of 1979 expenditures will be $40 million, or 45% greater than the 1978 total.

*Drilling operations in shallow Gulf waters off the Texas coast*



## REGULATIONS

Crude oil pricing in the United States is regulated under the Department of Energy and the President is mandated to continue crude oil price controls under the Act which established that Department through May, 1979. His authority becomes discretionary after that time until the September 30, 1981, expiration of price controls. Wainoco's average price for U.S. crude oil is now $9.69 per barrel, which is well under the world oil price, so that any release of controls would result in an advance of price for the Company.

Gas pricing in the U.S. is regulated under the Natural Gas Policy Act passed in the fall of 1978. The Company's average price received for gas sold in the U.S. last year was $1.80 per thousand cubic feet. Escalation of pricing provided under the Act will have the effect of increasing the Company's average price.

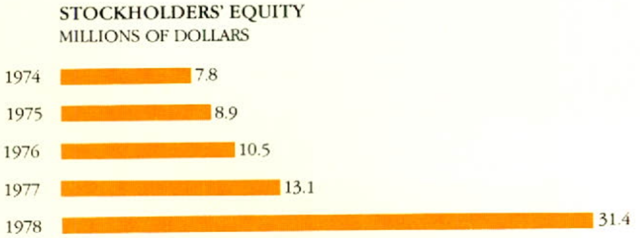
Pricing and production of oil and gas in Canada are both subject to federal and provincial regulations. The Company's average 1978 price in United States Dollars was $12.08 per barrel of oil and $1.16 per thousand cubic feet of gas. No price changes have been announced for 1979.

## ACCOUNTING CHANGES

In December, 1978, the Securities and Exchange Commission adopted rules to be followed by companies following the full-cost method of accounting for oil and gas producing activities. The implementation of these rules, which differ in certain respects from the accounting policies presently followed, will be required for full fiscal years beginning in 1979 by retroactively restating prior years' financial statements.

Although the implementation of these rules will result in a decrease in shareholders' equity as of December 31, 1978, they will affect neither our oil and gas reserve nor cash flow positions. Accordingly, we would not anticipate any changes in our operations, our capital expenditure plans or our goals of increasing oil and gas reserves.

*Drilling operations at the West Eagle 7-30 well, British Columbia*

WAINOCO OIL CORPORATION AND SUBSIDIARIES

# Summary Of Operations

For the five years ended December 31, 1978

| | 1978 | 1977 | 1976 | 1975 | 1974 |
|---|---|---|---|---|---|
| Revenues | $16,322,000 | $9,002,000 | $5,709,000 | $3,698,000 | $3,151,000 |
| Expenses: | | | | | |
| Oil and gas operating costs | $ 2,014,000 | $1,388,000 | $1,089,000 | $ 755,000 | $ 628,000 |
| General, administrative, and interest, net of interest capitalized of $179,000 in 1974 | 4,268,000 | 2,010,000 | 1,546,000 | 1,146,000 | 976,000 |
| Depreciation, depletion, and amortization | 4,101,000 | 2,275,000 | 1,778,000 | 970,000 | 932,000 |
| Mining prospects abandoned | — | — | — | — | 245,000 |
| Provision (credit) for losses on equipment inventory | 200,000 | (23,000) | 186,000 | — | — |
| Loss (gain) on translation of foreign currency | (491,000) | (53,000) | 21,000 | — | — |
| | $10,092,000 | $5,597,000 | $4,620,000 | $2,871,000 | $2,781,000 |
| Income from Continuing Operations Before Income Taxes | $ 6,230,000 | $3,405,000 | $1,089,000 | $ 827,000 | $ 370,000 |
| Provision for Income Taxes | 801,000 | 933,000 | 26,000 | 91,000 | 171,000 |
| Income from Continuing Operations | $ 5,429,000 | $2,472,000 | $1,063,000 | $ 736,000 | $ 199,000 |
| Discontinued Operations: | | | | | |
| Operating income | $ — | $ — | $ 393,000 | $ 791,000 | $ 900,000 |
| Gain on sale | — | — | 396,000 | — | — |
| Less — Applicable income tax | — | — | (353,000) | (395,000) | (450,000) |
| | $ — | $ — | $ 436,000 | $ 396,000 | $ 450,000 |
| Income Before Extraordinary Item | $ 5,429,000 | $2,472,000 | $1,499,000 | $1,132,000 | $ 649,000 |
| Extraordinary Item | — | — | — | — | 31,000 |
| Net Income | $ 5,429,000 | $2,472,000 | $1,499,000 | $1,132,000 | $ 680,000 |
| Primary Earnings Per Share: | | | | | |
| Income from continuing operations | $ 1.40 | $ .75 | $ .34 | $ .23 | $ .07 |
| Income from discontinued operations | — | — | .14 | .13 | .14 |
| Income before extraordinary item | $ 1.40 | $ .75 | $ .48 | $ .36 | $ .21 |
| Extraordinary item | — | — | — | — | .01 |
| Net Income | $ 1.40 | $ .75 | $ .48 | $ .36 | $ .22 |
| Fully Diluted Earnings Per Share | $ 1.30 | $ .74 | $ .48 | $ .36 | $ .22 |

# Management's Discussion And Analysis Of The Summary Of Operations

The following provides a brief explanation of certain financial information in the Summary of Operations. Reference is made to Note 1 to the Consolidated Financial Statements for a discussion of the Company's accounting policies used in reporting the results of operations, and the effect of the accounting change to be implemented in 1979.

## 1978 Compared With 1977

**Revenues** — Revenues from oil and gas sales increased 80% over 1977. Oil sales in barrels, increased 21%, while the weighted average price received per barrel increased 27%. Gas sales, in thousands of cubic feet (MCF), increased 30%, while the weighted average price received per MCF increased 49%.

Interest income rose 109% as a result of increased short-term investments throughout the year.

Other income, consisting of operations and supervision fees, increased 78% due to the higher levels of operations activities.

**Expenses** — Oil and gas operating costs increased 45% as a result of increased production volumes and inflationary cost increases.

General and administrative expense increased 130% due to a 56% increase in personnel and to inflationary cost increases.

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

Depreciation, depletion, and amortization increased $1,826,000, or 80%, reflecting higher production volumes.

**Earnings** — Income before income taxes increased from $3,405,000 to $6,230,000 or 83%. This figure, as a percentage of revenue, was 38% in both 1977 and 1978.

A decrease in the combined United States-Canadian tax rate from 27% to 13% is due to tax credits resulting from increased corporate drilling activity.

Net income increased by 120% from $2,472,000 in 1977 to $5,429,000 in 1978. When stated as a percentage of revenue, this figure increased from 27% to 33%.

Primary earnings per share went from $.75 in 1977 to $1.40 in 1978, an increase of 87%.

## 1977 Compared With 1976

**Revenues** — Revenues from oil and gas sales increased 58% over 1976. Oil sales in barrels were approximately equal during the periods, while the weighted average price received per barrel increased 3%. Gas sales, in thousands of cubic feet (MCF), increased 39%, while the weighted average price received per MCF increased 48%.

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

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

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

General and administrative expense increased 27% due to a larger number of employees and to inflationary cost increases.

Net interest expense increased 33% over the level of 1976. The increase in gross interest expense of 16% resulted from higher loan balances throughout the year. The interest paid was partially offset by interest charged on advances to the Company's limited partnerships; however, this amount decreased 16%.

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

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

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

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

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

WAINOCO OIL CORPORATION AND SUBSIDIARIES

# Consolidated Statements of Income

For the years ended December 31, 1978 and 1977

(Note 1)

| | 1978 | 1977 |
|---|---|---|
| **Revenues:** | | |
| Oil and gas sales | $14,760,000 | $8,192,000 |
| Interest income | 810,000 | 387,000 |
| Other | 752,000 | 423,000 |
| | $16,322,000 | $9,002,000 |
| **Expenses:** | | |
| Oil and gas operating costs | $ 2,014,000 | $1,388,000 |
| General and administrative | 2,547,000 | 1,107,000 |
| Depreciation, depletion, and amortization | 4,101,000 | 2,275,000 |
| Interest — | | |
| Long-term debt and other | 2,580,000 | 1,208,000 |
| Charged to associated partnerships | (859,000) | (305,000) |
| Provision (credit) for losses on equipment inventory | 200,000 | (23,000) |
| Gain on translation of foreign currency | (491,000) | (53,000) |
| | $10,092,000 | $5,597,000 |
| **Income Before Income Taxes** | $ 6,230,000 | $3,405,000 |
| **Provision for Income Taxes (Note 3)** | 801,000 | 933,000 |
| **Net Income** | $ 5,429,000 | $2,472,000 |
| **Earnings Per Share:** | | |
| Primary | $ 1.40 | $ .75 |
| Fully diluted | $ 1.30 | $ .74 |

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

WAINOCO OIL CORPORATION AND SUBSIDIARIES

# Consolidated Balance Sheets

December 31, 1978 and 1977

(Note 1)

ASSETS

| | 1978 | 1977 |
|---|---|---|
| **Current Assets:** | | |
| Cash, including temporary cash investments of $5,500,000 in 1978 and $6,985,000 in 1977 | $ 8,726,000 | $ 7,002,000 |
| Accounts receivable — | | |
| Joint operators (Note 2) | 9,510,000 | 3,299,000 |
| Current portion of amounts due from associated partnerships (Note 5) | 5,007,000 | 1,624,000 |
| Oil and gas sales (Note 2) | 1,926,000 | 846,000 |
| Other | 363,000 | 395,000 |
| Leases, at cost, and equipment inventory, at average cost, less allowance for inventory losses (Notes 2 and 5) | 3,087,000 | 2,864,000 |
| Unexpended investment in partnerships (Note 5) | 908,000 | — |
| Other | 824,000 | 71,000 |
| Total current assets | $30,351,000 | $16,101,000 |
| **Property and Equipment, at cost, partially pledged (Notes 2 and 6):** | | |
| Oil and gas properties | $54,186,000 | $32,496,000 |
| Furniture, fixtures, and other equipment | 1,062,000 | 430,000 |
| | $55,248,000 | $32,926,000 |
| Less — Accumulated depreciation, depletion, and amortization | 12,480,000 | 8,451,000 |
| | $42,768,000 | $24,475,000 |
| **Other Assets:** | | |
| Unsecured note receivable, interest at one percent above a bank's prime rate, due in 1980, pledged (Note 6) | $ 1,487,000 | $ 1,487,000 |
| Commissions and noncurrent advances to associated partnerships (Note 5) | 4,108,000 | 1,598,000 |
| Debenture issue expense, net of amortization (Note 2) | 1,090,000 | 621,000 |
| Other | 144,000 | 92,000 |
| | $ 6,829,000 | $ 3,798,000 |
| | $79,948,000 | $44,374,000 |

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

## LIABILITIES AND SHAREHOLDERS' EQUITY

| | 1978 | 1977 |
|---|---|---|
| **Current Liabilities:** | | |
| Short-term borrowings (Note 2) | $ 2,654,000 | $ 8,599,000 |
| Current maturities of long-term debt (Note 2) | — | 1,200,000 |
| Accounts payable and accrued liabilities | 7,378,000 | 3,338,000 |
| Oil and gas proceeds payable | 2,931,000 | 1,923,000 |
| Income taxes payable (Note 3) | 24,000 | 120,000 |
| Total current liabilities | $12,987,000 | $15,180,000 |
| **8% Convertible Subordinated Debentures (Note 2)** | $ — | $10,000,000 |
| **10¾% Subordinated Debentures, less unamortized discount of $3,077,000 (Note 2)** | $26,923,000 | $ — |
| **Long-Term Debt, less current maturities (Note 2)** | $ 4,218,000 | $ 2,900,000 |
| **Deferred Revenues** | $ 297,000 | $ — |
| **Deferred Income Taxes (Note 3)** | $ 4,172,000 | $ 3,203,000 |
| **Commitments and Contingencies (Notes 5 and 6)** | | |
| **Shareholders' Equity (Note 4):** | | |
| Common stock, no par, 10,000,000 shares authorized, 4,509,423 shares outstanding in 1978 and 3,202,797 in 1977 | $14,617,000 | $ 1,786,000 |
| Paid-in capital | 2,814,000 | 2,814,000 |
| Retained earnings (Notes 2 and 4) | 13,920,000 | 8,491,000 |
| | $31,351,000 | $13,091,000 |
| | $79,948,000 | $44,374,000 |

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

WAINOCO OIL CORPORATION AND SUBSIDIARIES

# Consolidated Statements of Changes in Financial Position

For the years ended December 31, 1978 and 1977

(Note 1)

| | 1978 | 1977 |
|---|---|---|
| **Source of Funds:** | | |
| Funds provided by operations — | | |
| Net income | $ 5,429,000 | $ 2,472,000 |
| Expenses not requiring current outlay of funds — | | |
| Depreciation, depletion, and amortization | 4,101,000 | 2,275,000 |
| Deferred income taxes | 1,077,000 | 1,112,000 |
| Other | 51,000 | — |
| Total from operations | $10,658,000 | $ 5,859,000 |
| Refinancings and long-term debt borrowings | 21,172,000 | 1,000,000 |
| Sale of 8% convertible subordinated debentures | — | 10,000,000 |
| Sale of 10¾% subordinated debentures | 26,872,000 | — |
| Proceeds from sale of oil and gas properties (Note 6) | — | 1,921,000 |
| Issuance of common stock | 12,831,000 | 75,000 |
| Noninterest-bearing note receivable | — | 225,000 |
| Deferred revenue | 297,000 | — |
| Other, net | (95,000) | 149,000 |
| Total source of funds | $71,735,000 | $19,229,000 |
| **Application of Funds:** | | |
| Additions to property and equipment | $22,414,000 | $10,948,000 |
| Payments on long-term debt and change in current maturities | 19,854,000 | 6,427,000 |
| Increase (decrease) in commissions and noncurrent advances to associated partnerships | 2,510,000 | (626,000) |
| Debenture issue expense | 1,108,000 | 643,000 |
| Conversion of convertible subordinated debentures, net of unamortized issue expense of $594,000 | 9,406,000 | — |
| Total application of funds | $55,292,000 | $17,392,000 |
| **Increase in Working Capital (Note 8)** | $16,443,000 | $ 1,837,000 |
| **Working Capital (Deficit), beginning of year** | 921,000 | (916,000) |
| **Working Capital, end of year** | $17,364,000 | $ 921,000 |

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

WAINOCO OIL CORPORATION AND SUBSIDIARIES

# Consolidated Statements of Shareholders' Equity

For the years ended December 31, 1978 and 1977

(Notes 1, 2 and 4)

| | Common Stock | | | | |
|---|---|---|---|---|---|
| | Number of Shares | Amount | Paid-In Capital | Retained Earnings | Total |
| **Balance, December 31, 1976** | 3,175,797 | $ 1,711,000 | $2,814,000 | $ 6,019,000 | $10,544,000 |
| Exercise of stock options | 27,000 | 75,000 | — | — | 75,000 |
| Net income | — | — | — | 2,472,000 | 2,472,000 |
| **Balance, December 31, 1977** | 3,202,797 | $ 1,786,000 | $2,814,000 | $ 8,491,000 | $13,091,000 |
| Exercise of stock options | 47,700 | 150,000 | — | — | 150,000 |
| Issuance of shares under stock purchase plan | 12,219 | 83,000 | — | — | 83,000 |
| Conversion of 8% convertible subordinated debentures | 1,036,707 | 9,597,000 | — | — | 9,597,000 |
| Issuance of common stock in connection with sale of 10¾% subordinated debentures | 210,000 | 3,001,000 | — | — | 3,001,000 |
| Net income | — | — | — | 5,429,000 | 5,429,000 |
| **Balance, December 31, 1978** | 4,509,423 | $14,617,000 | $2,814,000 | $13,920,000 | $31,351,000 |

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

WAINOCO OIL CORPORATION AND SUBSIDIARIES

# Notes to Consolidated Financial Statements

December 31, 1978 and 1977

## (1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES—

### Principles of consolidation—

The consolidated financial statements include the accounts of Wainoco Oil Corporation (the Parent), a Wyoming corporation, and its wholly owned subsidiaries, Wainoco Oil & Gas Company (Wainoco Company) and Wainoco Oil & Gas Limited (Wainoco Limited) (collectively referred to as Wainoco). All significant intercompany transactions have been eliminated in consolidation. Certain reclassifications have been made in the 1977 financial statements to conform to current classifications.

### Currency translation—

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

### Allowance for inventory losses—

Wainoco provides allowances for inventory losses if the cost of its equipment inventory exceeds its estimated market value. The allowance for such losses was $33,000 at December 31, 1978 and $10,000 at December 31, 1977.

### Oil and gas properties—

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

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

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

### Income taxes—

The Parent and Wainoco Company file a consolidated United States Federal income tax return. Wainoco Limited files a separate Canadian income tax return.

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 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, 1978, is approximately $900,000. Wainoco follows the flow-through method of accounting for investment tax credits received in the United States whereby the credits available each year are applied as a reduction of the United States tax provision.

### Earnings per share—

Primary earnings per share have been computed based on the weighted average number of common shares outstanding and assuming exercise of stock options during 1978 and 1977. The convertible subordinated debentures issued in September, 1977, were not common stock equivalents. The average common and common equivalent shares outstanding were 3,891,499 in 1978 and 3,291,793 in 1977.

Fully diluted earnings per share assume the addition of dilutive stock options and shares issuable upon conversion of the convertible subordinated debentures and the related reduction of interest expense, net of income tax effect ($376,000 in 1978 and $184,000 in 1977). The weighted average shares outstanding assuming full dilution were 4,456,188 for 1978 and 3,590,214 in 1977.

As discussed in Note 2, on June 22, 1978, the Parent called for the redemption of its outstanding 8% convertible subordinated debentures by July 31, 1978. Had all $9,970,000 of the debentures which were converted through July 31, 1978, been converted at January 1, 1978, primary earnings per common and common equivalent share for the year ended December 31, 1978, would have been $1.31.

**Accounting changes —**

In 1978, the Securities and Exchange Commission (SEC) issued a series of releases regarding accounting and reporting practices for oil and gas producing activities and announced that it would take steps to develop a method of accounting for oil and gas producing activities that recognizes valuations of proved oil and gas reserves in the balance sheets and income statements of oil and gas producers. During the interim period when this accounting method is being developed, which is expected to take several years, the SEC stated that the full-cost and successful efforts methods of accounting defined by rules adopted by the SEC would be continued as acceptable alternative methods. The implementation of one of these methods will be required for full fiscal years beginning in 1979 by retroactively restating prior years' financial statements. Wainoco intends to continue following the full-cost method of accounting for financial reporting purposes.

The SEC's full-cost accounting rules require, among other things, that full tax allocation accounting be followed for costs incurred in the acquisition, exploration and development of oil and gas reserves and that cost centers be established on a country by country basis. Wainoco's present full-cost accounting policies differ from the SEC's rules in that Wainoco uses a combined United States-Canadian cost center and recognizes interaction with statutory depletion. Wainoco estimates that the effect of implementing the SEC's full-cost accounting rules would be to reduce retained earnings at December 31, 1978, by approximately $1,210,000 and net income for the years 1978 and 1977 by $1,173,000 and $210,000, respectively.

## (2) SUBORDINATED DEBENTURES, LONG-TERM DEBT AND SHORT-TERM BORROWINGS —

**8% Convertible subordinated debentures —**

In September, 1977, the Parent issued $10,000,000 of 8% convertible subordinated debentures due September 1, 1992, with interest payable semi-annually. The debentures were convertible into common stock at the option of the holder at $9.625 per share. On June 22, 1978, the Parent called for redemption of the debentures by July 31, 1978. Debentures totaling $9,970,000 were converted at the option of the holders and 1,036,707 shares of common stock were issued upon such conversion. The balance of the debentures ($30,000) were redeemed at 110% plus accrued interest. Upon conversion, the principal amount of the debentures and accrued interest, net of income tax effect, through the date of conversion, less unamortized issue expense, were credited to common stock.

**10¾% Subordinated debentures —**

In October, 1978, the Parent sold $30,000,000 of 10¾% subordinated debentures due in 1998 with 210,000 shares of common stock. The issue price of the debentures and common stock ($30,000,000) and the related issue expense ($1,235,000) were allocated between the debentures and the common stock based on their fair market value. The portion of the issue price allocated to common stock ($3,128,000) constitutes issue discount which is being amortized over the life of the debentures. Amortization for 1978 was $51,000. Interest on the debentures is payable semi-annually and annual sinking fund payments of $2,500,000 begin in 1988. The debentures are redeemable at 110.75% beginning in 1978 and declining annually to 100% in 1988. The indenture covering the debentures provides, among other things, that Wainoco is restricted from paying cash dividends or acquiring its stock if the aggregate payments for such purposes, would exceed the sum of (1) consolidated net income earned subsequent to December 31, 1977, (2) net proceeds received from the issuance or sale of common stock subsequent to December 31, 1977, and (3) the aggregate of the net proceeds received from the issuance or sale of indebtedness (including the debentures) which is converted into common stock subsequent to December 31, 1977.

**Long-term debt—**

Long-term debt at December 31, 1978 and 1977, consisted of the following:

| | 1978 | 1977 |
|---|---|---|
| Note payable by Wainoco Company to a United States bank; due in monthly principal installments of $100,000 with the balance due in March, 1980; interest at the bank's prime commercial rate plus 1.75%; 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; paid in May, 1978 | $ — | $4,100,000 |
| Demand note payable by Wainoco Limited to a Canadian bank, not callable providing terms and conditions of the loan are met; due January 1, 1980; interest at the bank's prime commercial rate plus .75%; secured by substantially all Canadian oil and gas properties; guaranteed by the Parent (see discussion below) | 4,218,000 | — |
| | $4,218,000 | $4,100,000 |
| Less—Current maturities | — | 1,200,000 |
| | $4,218,000 | $2,900,000 |

The Canadian bank has agreed to provide Wainoco Limited with a revolving line of credit of $5,000,000 (U.S. dollar equivalent of $4,218,000 at December 31, 1978) which will bear interest at the bank's prime rate plus .75% on any portion drawn on the line and will mature January 1, 1980. An annual commitment fee of one half of one percent will be charged by the bank on any unused portion of the line.

Under the terms of the loan agreement for this line of credit, the bank has the option to review the secured oil and gas properties and make an annual determination of the credit to be made available to Wainoco Limited (the borrowing base). If the bank at any time, at its sole discretion, determines that the aggregate unpaid balance on the line is in excess of the borrowing base, then Wainoco Limited must either (1) provide additional security to increase the borrowing base to an amount at least equal to such excess, (2) repay any such excess, or (3) convert the outstanding balance to a six-year term loan repayable in equal monthly principal installments plus interest at a rate to be negotiated. Wainoco Limited has also agreed that it will not pledge its assets for any debt, guarantee, or obligation in excess of $1,000,000 Canadian per year. Although the advances on the line of credit are evidenced by demand notes, the bank has advised Wainoco Limited that it will not require repayment as long as the terms and conditions of the loan agreement are met.

**Short-term borrowings—**

Short-term borrowings include cash overdrafts of $2,233,000 at December 31, 1978, and $8,599,000 at December 31, 1977, which were paid in January, 1979 and 1978, respectively.

The maximum amount of short-term borrowings outstanding as of any month-end was approximately $5,000,000 in 1978 and $1,000,000 in 1977, the average amount outstanding was $2,100,000 in 1978 and $530,000 in 1977, and the average interest rate paid was approximately 10.2 percent in 1978 and 8.6 percent in 1977.

The Canadian bank has agreed to provide Wainoco Limited with demand loans of up to $1,500,000 (U.S. dollar equivalent of $1,265,000 at December 31, 1978) for lease bidding and working capital purposes. These loans will bear interest at the bank's prime rate plus .5%. Wainoco Limited has drawn $500,000 (U.S. dollar equivalent of $421,000) on this line of credit as of December 31, 1978.

The United States bank has agreed to provide Wainoco Company with a $1,500,000 revolving line of credit to June 30, 1979, which bears interest at the bank's prime commercial rate plus 1.5% on any portion drawn on the line of credit. The bank will charge an annual commitment fee of one half of one percent on the unused portion. The amount which can be drawn on the revolving line of credit is based on the lesser of $1,500,000 or 70 percent of the collateral value of Wainoco Company's equipment inventory and accounts receivable from joint operators. No portion of this line of credit was outstanding as of December 31, 1978.

### (3) INCOME TAXES—

The provision for income taxes for 1978 and 1977 consisted of the following:

| | 1978 | 1977 |
|---|---|---|
| Canadian income taxes— | | |
| Current | $ (310,000) | $ (299,000) |
| Deferred | 1,091,000 | 1,043,000 |
| | $ 781,000 | $ 744,000 |
| United States Federal income taxes— | | |
| Current | $ 34,000 | $ 120,000 |
| Deferred | (14,000) | 69,000 |
| | $ 20,000 | $ 189,000 |
| | $ 801,000 | $ 933,000 |

Deferred taxes result from timing differences in the recognition of revenues and expenses for tax and financial reporting purposes. Deferred Canadian income tax expense of $1,091,000 in 1978 and $1,043,000 in 1977 is primarily attributable to Canadian exploration and development expenses capitalized for financial reporting purposes and deducted for tax reporting purposes.

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

| | 1978 | 1977 |
|---|---|---|
| Provision for Canadian and United States income taxes at statutory rates | $ 2,990,000 | $1,634,000 |
| Increase (decrease) in provision resulting from— | | |
| Canada— | | |
| Royalties, rentals, and similar payments deducted currently for financial reporting purposes which are not deductible for income tax reporting purposes | $ 1,203,000 | $1,032,000 |
| Resource and depletion allowances | (1,238,000) | (990,000) |
| Provincial tax credits and rebates | (426,000) | (404,000) |
| Investment tax credit | (60,000) | (73,000) |
| Other, net | (88,000) | 107,000 |
| | $ (609,000) | $ (328,000) |
| United States— | | |
| Depreciation, depletion, and amortization of oil and gas properties for financial reporting purposes which are not deductible for income tax reporting purposes | $ 1,429,000 | $ 638,000 |
| Statutory depletion and depreciation of oil and gas properties for income tax reporting purposes which are not included as an expense for financial reporting purposes | (870,000) | (697,000) |
| Oil and gas exploration and development costs capitalized for financial reporting purposes and deducted for income tax reporting purposes | (2,195,000) | (314,000) |
| Investment tax credit | (82,000) | (115,000) |
| Minimum preference tax | 87,000 | 91,000 |
| Other, net | 51,000 | 24,000 |
| | $(1,580,000) | $ (373,000) |
| Provision for income taxes, as reported | $ 801,000 | $ 933,000 |

As of December 31, 1978, Wainoco had a United States tax depletion carry-forward of approximately $1,540,000 which is indefinitely available to reduce United States Federal income taxes payable. Since $510,000 of the depletion carry-forward represents permanent differences for which the tax effects have been recognized for financial reporting purposes, Federal income tax expense will not be reduced in the income statements of the periods when this carry-forward is utilized, but will be credited to deferred Federal income taxes. In addition, Wainoco Company has approximately $522,000 of investment tax credit carry-forwards available to reduce future Federal income taxes payable, of which $158,000 has been recognized as a reduction of deferred income taxes for financial reporting purposes through December 31, 1978. Wainoco Limited has an earned depletion base carry-forward of approximately $3,850,000 for Canadian income tax purposes of which $1,750,000 has been recognized for financial reporting purposes through December 31, 1978.

## (4) STOCK OPTION PLANS, STOCK PURCHASE PLAN AND DIVIDENDS—

### Stock option plans—

Wainoco has three stock option plans which authorize the granting of options to purchase 612,000 shares of common stock. Options under the 1968 plan are granted to Canadian employees at 85 to 90 percent of the market price at the date of grant and options under the 1973 and 1977 plans are qualified stock options under the United States Internal Revenue Code and are granted at not less than fair market value on the date of grant. Options under the plans are generally exercisable over a five-year period at the rate of 20 percent per year on a cumulative basis. No entries are made in the accounts until the options are exercised, at which time the proceeds are credited to common stock. As of December 31, 1978, options for 292,200 shares were outstanding at prices ranging from $1.38 to $17.63 per share and options to purchase 147,250 shares were available to be granted under the plans.

A summary of the 1978 and 1977 stock option activity is as follows:

| | 1978 | | 1977 | |
|---|---|---|---|---|
| | Number of Shares | Option Price | Number of Shares | Option Price |
| Balance, beginning of year | 198,500 | $1.38-$ 9.38 | 164,500 | $1.33-$4.13 |
| Granted | 146,000 | $6.69-$17.63 | 78,000 | $6.75-$9.38 |
| Terminated and lapsed | (4,600) | $4.13-$ 9.38 | (17,000) | $1.33-$8.29 |
| Exercised | (47,700) | $1.38-$ 9.38 | (27,000) | $1.33-$6.53 |
| Balance, end of year | 292,200 | $1.38-$17.63 | 198,500 | $1.38-$9.38 |

### Stock purchase plan—

In May, 1977, the shareholders approved an employee stock purchase plan under which an aggregate of 200,000 shares of common stock may be issued. All permanent, full-time employees who are employed for the full plan year are eligible to participate in the plan except those who own in excess of five percent of Wainoco's outstanding common stock. The plan allows each eligible employee to purchase Wainoco's stock at 85 percent of market value subject to certain limitations. There have been 12,219 shares purchased through the plan as of December 31, 1978. No entries are made in the accounts until shares are purchased, at which time the proceeds are credited to common stock.

### Dividends—

In March, 1979, Wainoco declared a cash dividend of $.12 per share for the year 1979. The first quarterly payment of $.03 will be made May 1, 1979 to shareholders of record on March 30, 1979.

## (5) ASSOCIATED PARTNERSHIPS—

The Parent and/or its subsidiaries are general partners in 14 public limited partnerships and have received management and other fees as consideration for services rendered certain of the partnerships. In addition, the general partners are reimbursed for direct, administrative and overhead costs incurred in conducting the business of all except two of the partnerships.

In July, 1978, Wainoco completed the sale of interests in Wainoco 78 Company, a Texas limited partnership, and Wainoco 78 Canada, an Alberta limited partnership. Wainoco subscribed for $2,000,000 of the limited partner interests in each of these partnerships. The unexpended portion of these contributions is included in current assets in the accompanying December 31, 1978, consolidated balance sheet. This unexpended contribution will be reclassified to oil and gas properties as the total limited partner contributions are expended.

In December, 1978, Wainoco Company formed Wainoco 79 Company, a Texas limited partnership, which has not yet commenced operations. Wainoco Company will subscribe for its own account a minimum of 20 percent of the limited partnership interests in this partnership. Certain leases and equipment inventory and other charges incurred in anticipation of the formation of this and other future partnerships are included in current assets in the accompanying December 31, 1978, consolidated balance sheet.

The general partners have (1) paid brokers' commissions on the sale of limited partnership interests in certain partnerships which are recoverable from partnership revenues otherwise attributable to the limited partners, and (2) advanced funds to certain partnerships to finance certain exploration and development expenditures which are recoverable only from future revenues of the partnerships. A summary of such commissions and advances at December 31, 1978 and 1977, is as follows:

| | 1978 | 1977 |
|---|---|---|
| | (In thousands) | |
| Commissions | $ 410 | $ 545 |
| Advances | 9,848 | 3,715 |
| | $10,258 | $ 4,260 |
| Less — | | |
| Amount transferred to oil and gas properties | 1,143 | 1,038 |
| Estimated current portion | 5,007 | 1,624 |
| Noncurrent portion | $ 4,108 | $ 1,598 |

Based on the most recent oil and gas reserve information on the partnerships' properties, the commissions and advances for certain of the partnerships exceeded the fair market value of their oil and gas properties by $1,143,000 at December 31, 1978 and $1,038,000 at December 31, 1977. These amounts have been included in oil and gas properties and are being amortized over the life of Wainoco's aggregate proved oil and gas reserves in the same manner as other costs invested in oil and gas properties. The amounts are included in oil and gas properties because the expenditures were discretionary in nature at the time they were made and are considered an integral part of Wainoco's oil and gas exploration and development activities. The amounts 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 within one year.

The general partners can be required to purchase the limited partners' interests in the partnerships in varying amounts, depending on the terms of the different partnership agreements. The purchase price will generally be based on the estimated discounted cash flow, after debt service, to the limited partners discounted for risk factors associated with developing and producing the reserves. At December 31, 1978, the partnerships formed prior to 1978 had been evaluated and the remaining partnerships were in the early stages of exploration and development, and accordingly, were not evaluated. The maximum purchase commitment as of December 31, 1978, for the evaluated partnerships was $25,500,000 and the maximum annual non-cumulative purchase commitment for all partnerships (assuming no prior purchases of the partnership interests) was $9,600,000 for 1979, $11,400,000 for 1980 through 1985 and decreasing amounts through 2000, the year in which all partnerships will have terminated. Of the total maximum purchase commitment for evaluated partnerships, Wainoco believes that approximately $18,300,000 would be available in borrowings secured by the oil and gas reserves attributable to the interests of the limited partners in these partnerships. In the future, these purchase commitments and the available borrowings may be more or less depending upon future estimates of each partnership's oil and gas reserves and net assets.

## (6) COMMITMENTS AND CONTINGENCIES—

**Pension plans—**

Wainoco's United States pension plan is noncontributory, open to all United States employees over 25 years of age with one year of service and has a normal retirement age of 65. Pension plan expense was $96,000 in 1978 and $77,000 in 1977, including amortization of unfunded prior service costs of $124,000 over 30 years. Wainoco's policy is to fund pension costs accrued. As of December 31, 1978, the pension plan's assets exceeded the actuarially computed value of vested benefits by approximately $262,000.

In 1977, Wainoco Limited's board of directors adopted a pension plan which is open to all Canadian employees over 25 years of age and provides for a normal retirement age of 65 and for voluntary employee contributions. Wainoco Limited accrued $54,000 in 1978 and $40,000 in 1977 as its contribution to the plan.

**Lease commitments—**

During 1978, Wainoco entered into two noncapitalized building lease agreements which expire in 1983 and 1988 and provide for total payments of approximately $4,883,000. The following is a summary of Wainoco's minimum annual rental payments as of December 31, 1978, under these lease agreements:

| | |
|---|---|
| 1979 | $ 354,000 |
| 1980 | 514,000 |
| 1981 | 539,000 |
| 1982 | 546,000 |
| 1983 | 498,000 |
| 1984-1988 | 2,432,000 |

**Other—**

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

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

The general partners are contingently liable for the liabilities of certain of the associated partnerships, including aggregate bank indebtedness of approximately $1,640,000 at December 31, 1978. The unsecured note receivable of $1,487,000 and certain of Wainoco Company's oil and gas properties serve as collateral for certain of this bank indebtedness.

**(7) UNITED STATES AND CANADIAN OPERATIONS—**

Wainoco is engaged in one line of business, the exploration, development, and production of oil and gas reserves. Wainoco's United States operations are primarily conducted by Wainoco Company and its Canadian operations by Wainoco Limited. Set forth below are the revenues and net income for the years 1978 and 1977 and identifiable assets as of December 31, 1978 and 1977, by country:

| | 1978 | | |
|---|---|---|---|
| | United States | Canada | Consolidated |
| Revenues | $10,138,000 | $ 6,184,000 | $16,322,000 |
| Net income | 3,057,000 | 2,372,000 | 5,429,000 |
| Identifiable assets | 45,366,000 | 34,582,000 | 79,948,000 |

| | 1977 | | |
|---|---|---|---|
| | United States | Canada | Consolidated |
| Revenues | $ 4,512,000 | $ 4,490,000 | $ 9,002,000 |
| Net income | 972,000 | 1,500,000 | 2,472,000 |
| Identifiable assets | 23,850,000 | 20,524,000 | 44,374,000 |

During 1978, Wainoco made sales to four major customers of $2,400,000, $2,100,000, $1,700,000 and $1,600,000 which accounted for 48 percent of consolidated revenues. During 1977, Wainoco made sales to two major customers of $1,800,000 and $1,700,000 which accounted for 39 percent of consolidated revenues.

## (8) CHANGES IN COMPONENTS OF WORKING CAPITAL—

Set forth below are the increases (decreases) in the components of working capital for the years ended December 31, 1978 and 1977:

| | 1978 | 1977 |
|---|---|---|
| Cash | $ 1,724,000 | $ 6,656,000 |
| Accounts receivable | 10,642,000 | 2,140,000 |
| Leases and equipment inventory | 223,000 | 1,186,000 |
| Unexpended investment in partnerships | 908,000 | — |
| Other current assets | 753,000 | (18,000) |
| Note receivable | — | (992,000) |
| Short-term borrowings | 5,945,000 | (6,803,000) |
| Current maturities of long-term debt | 1,200,000 | 1,400,000 |
| Accounts payable and accrued liabilities | (4,040,000) | (229,000) |
| Oil and gas proceeds payable | (1,008,000) | (1,408,000) |
| Income taxes payable | 96,000 | (95,000) |
| Increase in Working Capital | $16,443,000 | $ 1,837,000 |

## (9) SELECTED QUARTERLY FINANCIAL DATA (unaudited)—

| | Three Months Ended | | | |
|---|---|---|---|---|
| | March 31 | June 30 | September 30 | December 31 |
| | (In thousands, except per share amounts) | | | |
| 1978— | | | | |
| Revenues | $3,144 | $4,083 | $4,088 | $5,007 |
| Income before income taxes | $1,149 | $1,356 | $1,837 | $1,888 |
| Provision for income taxes | 252 | 191 | 189 | 169 |
| Net income | $ 897 | $1,165 | $1,648 | $1,719 |
| Earnings per share— | | | | |
| Primary | $ .27 | $ .33 | $ .40 | $ .40 |
| Fully diluted | $ .24 | $ .30 | $ .38 | $ .38 |
| 1977— | | | | |
| Revenues | $1,744 | $2,017 | $2,419 | $2,822 |
| Income before income taxes | $ 549 | $ 748 | $ 937 | $1,171 |
| Provision for income taxes | 159 | 247 | 226 | 301 |
| Net income | $ 390 | $ 501 | $ 711 | $ 870 |
| Earnings per share— | | | | |
| Primary | $ .12 | $ .15 | $ .22 | $ .26 |
| Fully diluted | $ .12 | $ .15 | $ .22 | $ .24 |

## Auditors' Report

To the Shareholders of Wainoco Oil Corporation:

We have examined the consolidated balance sheets of Wainoco Oil Corporation (a Wyoming corporation) and subsidiaries as of December 31, 1978 and 1977, and the related statements of income, shareholders' equity, and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the financial position of Wainoco Oil Corporation and subsidiaries as of December 31, 1978 and 1977, and the results of their operations and the changes in their financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

ARTHUR ANDERSEN & CO.

Houston, Texas
March 15, 1979

## DIRECTORS

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

## OFFICERS

John B. Ashmun
President
William A. Faubion
Vice President
Robert J. Leslie
Vice President
Charles C. Vines
Vice President
John H. Whorton
Treasurer/Controller

## REGISTRARS AND TRANSFER AGENTS

**Common Stock**

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

**10¾% Subordinated Debentures**

First City National Bank
Houston, Texas

## PRINCIPAL BANKS

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

## AUDITORS

Arthur Andersen & Co.
Houston, Texas

## COUNSEL

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

## SUBSIDIARIES

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

## COMMON STOCK

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

| | High | Low |
|---|---|---|
| **1978** | | |
| First Quarter | 15⅛ | 11⅞ |
| Second Quarter | 18⅛ | 13 |
| Third Quarter | 17⅝ | 14½ |
| Fourth Quarter | 17 | 11⅝ |
| **1977** | | |
| First Quarter | 9⅜ | 6¼ |
| Second Quarter | 8½ | 7 |
| Third Quarter | 9¾ | 7⅜ |
| Fourth Quarter | 15½ | 6⅝ |

## 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
1200 Smith Street
Suite 1500
Houston, Texas 77002

## ANNUAL MEETING NOTICE

The annual meeting of the shareholders of Wainoco Oil Corporation will be held Thursday, May 17, 1979, at 10:00 a.m. in the First City East Auditorium, 1111 Fannin Street, Houston, Texas

WAINOCO OIL CORPORATION 1200 Smith Street, Suite 1500 Houston, Texas 77002