ANNUAL REPORT

NATIONAL GYPSUM COMPANY

December 31, 1940
DIRECTORS
MELVIN H. BAKER          EDWIN F. GUTH
RALPH F. BURLEY          WILLIAM G. HOUCK
WILLIAM M. CURRIE        JOSEPH A. W. IGLEHART
ELMER E. FINCK

OFFICERS
MELVIN H. BAKER          PRESIDENT
RALPH F. BURLEY          VICE PRESIDENT
GORDON H. TARBELL        VICE PRESIDENT
JOHN C. BEST             VICE PRESIDENT
FRANK E. DAVIS           SECRETARY AND TREASURER
WALTER S. CORRIE         CONTROLLER
CHARLES E. MASTERS       ASSISTANT TREASURER
ROBERT O. WILLIAMS       ASSISTANT SECRETARY

TRANSFER AGENTS
BANKERS TRUST COMPANY—NEW YORK, N. Y.
THE MARINE MIDLAND TRUST COMPANY OF NEW YORK
NEW YORK, N. Y.

REGISTRARS
THE MARINE MIDLAND TRUST COMPANY OF NEW YORK
NEW YORK, N. Y.

MANUFACTURERS TRUST COMPANY—NEW YORK, N. Y.
To the Stockholders of
National Gypsum Company:

We are pleased to submit this report covering the fifteenth year of the Company’s operations.

In spite of greater taxes and rising manufacturing costs, earnings increased. During the year 1940 the Company earned $1,565,196. This compares with $1,455,237 for 1939.

After provision for Federal and Dominion taxes and payment of Preferred dividends, net earnings amounted to $1.03 per share of the Common stock. This compares with 94¢ for the year 1939.

As a result of operations for the year, earned surplus increased $478,956. This was after payment of 40¢ per share to the Common stock, regular dividends on the Preferred and deduction for expense incident to recent debenture financing.

Taxes continued to increase at an accelerated rate. Direct taxes including those deducted from income amounted to $828,362. This compares with $544,623 for last year. Taxes for the year rose 52% and amounted to 66¢ per share on the Common stock.

Labor and material costs also increased during 1940. Since it was not possible to make comparable advance in prices, profit margins were less. This situation was partially met with greater volume, more efficient production and economies from additional equipment.

This is a volume business built on a policy of supplying the consumer with better products at no higher price. To maintain this principle successfully, your Management has endeavored to sell at prices comparable to similar and substitute items. From now on, however, it is expected that further increases in manufacturing costs can be covered by the necessary increase in prices.

The Company increased its assets by $2,019,362 during the year. Total assets rose from $18,876,268 in 1939 to $20,895,630 in 1940. Working capital amounted to $5,054,816, of which $1,464,208 was cash.
There were some changes in capital structure. The previous issue of 3 7/8% debentures was replaced with a $6,000,000 fifteen-year issue at 3%. Besides the obvious interest savings, this move added $942,000 to cash. The Company also issued 1550 new shares of Preferred stock in part payment for property acquisitions.

56,930 shares of Common stock were still available under the Employees' Stock Purchase Plan. One-third of these shares may be issued in December, 1941, at a price of $7.00 per share. The balance may be issued in 1942 and 1943 at prices to be determined at the beginning of each year by the Board of Directors.

In 1940 the Company used $2,381,164 for additions and improvements to its eighteen mills. Part of this money was used to complete the Company's new board mill and rock storage in New York City. This project was begun and partially paid for in 1939. Completion of the New York Plant rounded out the Company's program for distribution of gypsum products into all markets east of the Rockies.

The paper mill recently purchased at Newburgh, New York, will give National's Atlantic seaboard mills a continuous supply of low-cost, high-quality paper essential to the manufacture of board.

At the close of the year, National assumed control, under long-term lease, of certain lime properties previously owned by the Chemical Lime Company of Bellefonte, Pennsylvania. The Reconstruction Finance Corporation, the lessor, has agreed to spend $350,000 for substantial plant improvements as directed by National. Under terms of the lease, the Company may purchase the property on favorable terms at any time during life of the lease. This property includes large deposits of excellent quality limestone. When improvements are completed, the Company will be in position to compete for a much larger lime market.

During the past four years the Company has been selling rock wool purchased from outside manufacturers. To support this rapidly growing market, negotiations have just been completed for the purchase of General Insulating and Manufacturing Company, makers of rock wool. Their product is well known in the building field. Sales last year amounted to approximately $1,200,000. The assets include plants located in Alexandria, Indiana; Dubuque, Iowa; and Dover, New Jersey, as well as deposits, patents, inventories, accounts and good will. In exchange for the business there will be issued 60,000 shares of Common stock and a number of Preferred shares, not to exceed 3500.

This fine product with its present distribution will strengthen National's competitive position in the insulation market. For more than twenty-five
years General Insulating and Manufacturing Company pioneered in the manufacture of rock wool for use in home insulation. Like insulation board, the product is distributed through building material dealers along with other wall and ceiling materials.

Demands on production increased during the fall months until most plant capacities were fully utilized. Plaster and metal lath facilities were the major exceptions and they were running at 60% of capacity. Fortunately, the New York City board mill was completed in time to relieve demands on the Atlantic seaboard. Improvements and extensions now in process at other mills are expected to materially increase speed and quantity of output without sacrifice of quality.

In addition to these acquisitions, the Company will benefit from several product improvements developed in its own laboratory last year. These include a new process for making a light-weight wallboard, a new kind of sound control tile and a new processed type of paper. These developments combined with a more complete line in rock wool and lime will increase prospects for greater volume.

The Company also developed new uses for present products—particularly to meet building requirements of the National Defense program. For example, gypsum sheathing, wallboard and insulation are used widely in the construction of barracks. There was also developed an ingenious acoustical assembly for controlling the high noise volume in airplane motor testing chambers.

Although sales for defense construction were only about 5% of the Company's total in 1940, these developments are important because many of them can be applied in private building.

The Company's principal market—home building—was responsible for the larger part of sales increase. As this report is written, home construction is increasing at a rapid rate. This is reflected in current sales now running about 40% ahead of last year.

The organization was confronted with many unusual and difficult problems during the past year. It is a tribute to their loyalty and efficiency that these situations were met successfully. Each department of the business is fully organized in anticipation of larger volume for 1941.

Respectfully yours,

[Signature]

President
## ASSETS

### CURRENT
- Cash funds and demand deposits: $1,414,035.73
- Time deposits, including interest: $50,171.97
- Notes, acceptances and accounts receivable, trade ($302,101.75 reserve deducted): $2,480,329.48
- Inventories—at lower of cost or market:
  - Products finished and in process: $1,624,610.47
  - Materials and supplies: $1,123,492.19
  - Total current assets: $6,692,639.84

### INVESTMENTS AND OTHER ASSETS
- Capital stock of inactive subsidiary not consolidated: $64,850.34
- Sundry accounts receivable, investments, claims, etc. ($21,291.77 reserves deducted): $92,731.48
- Securities (at cost—market $82,336.25) on deposit under self insurance agreements: $80,181.25
- Real estate not used in operations (including land at $142,668.00 subject to vendor's option to repurchase at same price)—at cost, less $50,000.00 reserve: $426,843.36
- Total investments and other assets: $1,880,80.09

### PROPERTY, PLANTS AND EQUIPMENT (Note A)
- Mineral deposits and timberland:
  - Owned gypsum and lime deposits: $953,914.82
  - Leased gypsum and lime deposits: $574,887.94
  - Owned timberland: $31,835.13
  - Total property, plants and equipment: $1,560,637.89
  - Less reserves for depletion: $158,260.97
  - Plant sites: $591,044.60
  - Buildings, docks, machinery and equipment: $13,144,019.76
  - Less reserves for depreciation: $2,118,068.39
  - Construction in process: $205,589.69
  - Idle plant: $1,000
  - Total property, plants and equipment: $13,224,963.58

### PATENTS, TRADE-MARKS AND COPYRIGHTS
- Cost less amortization: $58,972.76

### DEFERRED CHARGES
- Unexpired insurance premiums, prepaid taxes, royalties, etc.: $215,566.52
- Inventories of repair parts, etc.: $203,834.22
- Bond expense to be amortized: $72,810.22
- Total deferred charges: $492,210.96

**Total assets:** $20,895,630.50

See principles of consolidation and the notes.
BALANCE SHEET
COMPANY AND SUBSIDIARY
31, 1940

LIABILITIES

CURRENT
Accounts payable, trade and sundry...................... $ 698,239.67
Federal capital stock, state franchise and local
property taxes........................................ 66,087.07
Federal and state pay roll taxes...................... 65,876.99
Accrued interest, insurance and royalties............. 70,451.68
Federal (U. S. and Canada), state and provincial
taxes on income—estimated........................ 510,268.83
3% Sinking Fund Debentures required to be retired
in 1941.............................................. 226,000.00
3% SINKING FUND DEBENTURES (due December 1, 1955)
Authorized and issued................................ $6,000,000.00
Less amount included in current liabilities........... 226,000.00
RESERVES
For workmen's compensation self-insurance............ $ 50,000.00
For litigation and tax contingencies.................. 100,000.00
CAPITAL STOCK AND SURPLUS
Capital stock (Note B):
Cumulative Preferred Stock (without par value):
Authorized—100,000 shares
Issued and outstanding — series of $4.50
Convertible Cumulative Preferred Stock—
61,550 shares at involuntary liquidation
price ($100 per share).............................. $6,155,000.00
Common Stock ($1 par):
Authorized—2,500,000 shares
Reserved for conversion of $4.50 Convertible
Cumulative Preferred Stock (on basis of
current conversion rate)—313,548 shares
Reserved for issuance under Employees'
Stock Purchase Plan—56,930 shares
Issued and outstanding—
1,261,458.028 shares................................ 1,261,458.03
Surplus:
Capital................................................ $4,147,192.37
Earned (from January 1, 1936)—partly re-
stricted as to payment of dividends on
Common Stock (Note C)............................. 1,770,155.86
$20,895,630.50
notes referred to on a following page.
**CONSOLIDATED SURPLUS ACCOUNTS**
**NATIONAL GYPSUM COMPANY AND SUBSIDIARY**
*Year ended December 31, 1940*

<table>
<thead>
<tr>
<th>CAPITAL SURPLUS</th>
<th>EARNED SURPLUS (from January 1, 1936)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance December 31, 1939, and December 31, 1940 (no change)</td>
<td>$4,147,192.37</td>
</tr>
<tr>
<td>Add net profit for 1940</td>
<td>$1,291,199.63</td>
</tr>
<tr>
<td>Deduct: Dividends paid in cash:</td>
<td></td>
</tr>
<tr>
<td>On $4.50 Convertible Cumulative Preferred Stock ($4.50 per share)</td>
<td>$270,345.27</td>
</tr>
<tr>
<td>On Common Stock ($40 per share)</td>
<td>504,583.21</td>
</tr>
<tr>
<td>Premium, interest during redemption period and expenses, aggregating $199,146.98, in connection with redemption of 3⅞% Sinking Fund Debentures, plus $112,164.66 for unamortized balance of related bond discount and expense</td>
<td>311,311.64</td>
</tr>
<tr>
<td>BALANCE December 31, 1940</td>
<td>$1,770,155.86</td>
</tr>
</tbody>
</table>
### Consolidated Profit and Loss Statement
#### National Gypsum Company and Subsidiary

**Year ended December 31, 1940**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross sales less discounts, returns and allowances</td>
<td>$16,509,915.63</td>
</tr>
<tr>
<td>Cost of goods sold excluding depreciation and depletion</td>
<td>10,878,892.24</td>
</tr>
<tr>
<td><strong>Gross Profit before depreciation and depletion</strong></td>
<td>$5,631,023.39</td>
</tr>
<tr>
<td>Provision for depreciation and depletion</td>
<td>537,297.07</td>
</tr>
<tr>
<td><strong>Gross Profit</strong></td>
<td>$5,093,726.32</td>
</tr>
<tr>
<td>Selling, administrative and general expenses</td>
<td>2,647,192.02</td>
</tr>
<tr>
<td><strong>Operating Profit</strong></td>
<td>$2,446,534.30</td>
</tr>
<tr>
<td>Other income:</td>
<td></td>
</tr>
<tr>
<td>Interest earned</td>
<td>$9,653.65</td>
</tr>
<tr>
<td>Royalties</td>
<td>100,909.97</td>
</tr>
<tr>
<td>Canadian exchange</td>
<td>16,433.98</td>
</tr>
<tr>
<td>Sundry</td>
<td>18,199.82</td>
</tr>
<tr>
<td></td>
<td>145,197.42</td>
</tr>
<tr>
<td><strong>Other income</strong></td>
<td>$2,591,731.72</td>
</tr>
<tr>
<td>Other deductions:</td>
<td></td>
</tr>
<tr>
<td>Interest, discount and expenses on funded debt</td>
<td>$203,465.52</td>
</tr>
<tr>
<td>Interest and expense on bank loans</td>
<td>7,010.46</td>
</tr>
<tr>
<td>Provision for doubtful accounts</td>
<td>175,450.72</td>
</tr>
<tr>
<td>Provision for litigation and tax contingencies</td>
<td>100,000.00</td>
</tr>
<tr>
<td>Loss on disposals of capital assets</td>
<td>24,493.55</td>
</tr>
<tr>
<td>Sundry</td>
<td>9,511.37</td>
</tr>
<tr>
<td></td>
<td>519,931.62</td>
</tr>
<tr>
<td><strong>Profit before taxes on income</strong></td>
<td>$2,071,800.10</td>
</tr>
<tr>
<td>Taxes on income—estimated (Note D):</td>
<td></td>
</tr>
<tr>
<td>U. S. and Canadian federal, state and provincial normal income taxes (less $2,396.25 prior year adjustment)</td>
<td>$455,603.75</td>
</tr>
<tr>
<td>U. S. federal excess profits tax</td>
<td>51,000.00</td>
</tr>
<tr>
<td></td>
<td>506,603.75</td>
</tr>
<tr>
<td><strong>Net Profit</strong></td>
<td>$1,565,196.35</td>
</tr>
</tbody>
</table>

See principles of consolidation and Note D on the following page.
Principles of Consolidation

The accounts of the wholly owned Canadian subsidiary are consolidated, as in previous years. Transfer of profits of this subsidiary is subject to Canadian Exchange Control Board regulations and its accounts are translated to U. S. dollar equivalents at the Control Board rate of exchange, except as to property, plants and equipment acquired in previous years, which are included dollar for dollar. To facilitate comparison with prior years, its operating accounts are consolidated dollar for dollar, but a charge of $9,818.28 has been made against Canadian exchange income to reduce its net profit to equivalent U. S. dollars. All inter-company transactions have been eliminated. Consolidated net assets include $153,817.77 for net working assets and $817,610.18 for property, plants and equipment in Canada; consolidated earned surplus includes $122,820.44 for undistributed surplus of the Canadian subsidiary, and consolidated net profit includes $23,205.23 for its net profit.

Notes to Consolidated Financial Statements

Note A: Property, plants and equipment are carried on the basis of cost, less a write-down in 1932 the residual of which, as to present effect in the financial statements, is not relatively material.

Note B: On February 24, 1941, an application was filed for registration of 60,000 shares of Common Stock and up to 3,500 shares of $4.50 Convertible Cumulative Preferred Stock proposed to be issued for certain assets of General Insulating and Manufacturing Company.

Note C: Under the provisions of the Indenture relating to the 3% Sinking Fund Debentures, the balance of surplus at December 31, 1940, available for dividends on the $4.50 Convertible Cumulative Preferred Stock is not limited; however, the amount of such balance available for dividends on Common Stock is restricted to $1,297,844.65.

Note D: The provision for taxes on income has been computed on estimated taxable income after deduction of $311,311.64 for charges made directly to earned surplus. These charges to earned surplus had the effect of reducing the provision by approximately $71,000 for normal taxes and $112,000 for excess profits taxes.

Note E: On December 30, 1940, the Company leased the mining and manufacturing facilities of the former Chemical Lime Company, Inc. The lease (containing a purchase option to 1954) expires in 1956 and requires an annual rental of $85,000 plus taxes and insurance.

Litigation: With other litigation of lesser interest there are pending: (a) an action brought by the United States to have declared null and void two gypsum leases with the Tonawanda Nation of Indians and to have declared null and void Section 85 of the Indian Law of the State of New York; (b) an action brought by the Milcor Steel Company against New York City Housing authority, et al., charging infringement of letters patent relating to wall construction, in which the Company is not a defendant but has indemnified the defendants against any loss because of the use of its materials in a certain Government project (a motion by the defendants for summary judgment has been granted but the plaintiff has taken an appeal); (c) a criminal action brought by the United States of America alleging acts illegal under the Sherman Anti-Trust Act; and (d) two civil actions brought by the United States of America alleging violation of the Sherman Anti-Trust Act.

ACCOUNTANTS' REPORT

Board of Directors,
National Gypsum Company,
Buffalo, New York.

We have examined the consolidated balance sheet of National Gypsum Company and its subsidiary National Gypsum (Canada) Ltd., as at December 31, 1940, and the related consolidated statements of profit and loss and surplus for the year then ended, have reviewed the system of internal control and the accounting procedures of the companies and, without making a detailed audit of the transactions, have examined or tested accounting records of the companies and other supporting evidence, by methods and to the extent we deemed appropriate, including test of amounts receivable by communication with debtors and observation, at selected locations and dates, of procedures followed in inventory taking.

In our opinion, the accompanying balance sheet and related statements of profit and loss and surplus present fairly the consolidated position of National Gypsum Company and its consolidated subsidiary at December 31, 1940, and the consolidated results of their operations for the year, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

ERNST & ERNST

Buffalo, New York
February 25, 1941