Twenty-First Annual Report

The Pure Oil Company

Chicago

For the Year Ended December 31, 1934
The Pure Oil Company
GENERAL OFFICES, CHICAGO

OFFICERS

B. G. Dawes ...... Chairman of the Board ...... Columbus, Ohio
H. M. Dawes ...... President .......... Chicago
R. W. McIlvain ..... Vice-President ........ Chicago
C. B. Watson ..... Vice-President ........ Chicago
N. H. Weber ..... Vice-President ........ Chicago
F. S. Heath ..... Vice-President ........ Columbus, Ohio
Rawleigh Warner . . . . Vice-President and Treasurer . . . . Chicago
L. S. Wescoat . . . . Vice-President and Secretary . . . . Chicago
C. H. Jay ..... Asst. Secretary and Treasurer ..... Chicago
R. L. Milligan ..... Asst. Secretary and Treasurer ..... Chicago
A. M. Brereton ..... Comptroller ..... Chicago

DIRECTORS

B. G. Dawes
H. M. Dawes
I. B. Humphreys
Phillip R. Clarke
Rawleigh Warner

W. F. Burdell
W. C. Fairbanks
F. S. Heath
J. E. Otis
R. W. McIlvain

C. B. Watson
To The Stockholders:

Herewith is submitted the twenty-first annual report of The Pure Oil Company.

The long-term indebtedness of the company was reduced by the retirement of $2,000,000 of its bonds during the period. Coincident with this, the net quick assets decreased $629,081.02. Product sales increased slightly in volume and collections improved, the loss ratio showing a marked decline.

During the year discoveries of crude oil resulted in a material increase in reserves. As a result, the value of the company's property has been increased a substantial amount which is not reflected in the balance sheet and can not be accurately estimated at the present state of development in the fields. There was no material change in the price of crude sold and purchased as compared with those in effect at the close of the previous year. Product prices, however, notably gasoline, averaged lower.

An enduring institution must be built on a plan which is adapted to meet changing conditions. Flexibility in application is a requisite of any policy which is to make for permanence and ultimate stability. This is particularly true in the oil business. The discovery of new fields and a forced production which is the result of the underground flow of petroleum distorts certain of its operations so that at times they do not follow a conventional economic course. In addition to this ever present possibility, there is at this time uncertainty as to what extent the Government may act to control physical conditions which have not in the past been regulated. These things are, however, a passing influence subject to periodical recurrence, and the need of an adequate supply of crude oil is a permanent one. Its importance to both the safety and profit of every oil company is paramount.

CRUDE SUPPLY

The company's reserves of crude have been materially increased in the past year.

The supply of crude as a vital factor in producing permanent stability has been the first consideration in the development of The Pure Oil Company, but it could not have been obtained without due consideration to the other phases of the industry's operations. A condition has recently developed under which many companies who were devoting their activities exclusively to the production of crude have realized better results than has the industry in general. This is occasioned by the fact that the posted price of crude oil is just now relatively higher than that of refined products. This condition has been burdensome to the refining and marketing branches of the business. As a practical matter, however, the producer has not and is not now receiving a really adequate price for his product, and the low recovery prices which have been received for refined products are due to circumstances the marketer has been unable to control.

An independent company operating on a scale as large as The Pure Oil Company can not, under present conditions, sell more than a fraction of its production regularly in the general market in the form of crude. Those producers who have been able to market all of their crude oil at the posted price have had either a relatively small amount to dispose of or affiliations or contracts which are not available to the industry generally.

No substantial increase in the amount of oil now produced in the United States could, at the present time, be made without resulting in physical waste, and the prevailing restriction of production is justified for this reason alone, as well as on account of the general economics of the situation. Production is now in very fair balance with market demand. A reduction in the price of crude at this time would, therefore, not seem to be justified and the possibility of an increase would be much more reasonable.

The problem of developing the foundation base of crude supply consists not simply in the acquisition of leases and the drilling of wells, but involves the sale of the product both currently and over a long period in the most economical way, and present day conditions in the industry do not afford a market at the well for sufficient quantities to meet the company's needs. It has been, therefore, incumbent upon it to provide independent means of transportation, refining and marketing as an outlet for its crude oil production.

To an unusual degree, volume is essential to economy in the oil business as the construction cost of transportation facilities declines very rapidly in
position where its total reserves at the end of the year are very much larger than before this withdrawal took place.

CRUDE RESERVES

The crude reserves of the company are estimated at from 300,000,000 to 400,000,000 barrels of oil.

It is absolutely impossible to keep the development of each of these various phases of an integrated company perfectly in step, but it has seemed to the management of the company that the first and the most important step from which the others should start was the building of large crude reserves. We believe that this policy has been justified by results.

The company has the ability to produce from its existing wells an amount many times in excess of that which it is selling. Nevertheless, during the last year it bought a total of 4,102,404 barrels of oil, which it might have produced at only a fraction of the cost or the cash outlay that it was compelled to make. If in order to reduce its purchases of crude, the company had reduced its sales of products and had turned over a portion of its marketing outlets to its competitors, the situation would not have been materially improved as the authorities would then have correspondingly curtailed its own crude production. If the management had been so short sighted as to follow this policy, the company would have found itself with inadequate facilities to meet its needs when it was permitted to produce a more reasonable proportion of its oil. It would have, furthermore, by the reduction of volume, increased expenses per barrel sold.

As a result of the restriction upon its production the company has retained a larger proportion of its oil in underground storage, and the value of its properties has obviously not been decreased. It has, however, hampered the company in its current operations.

During 1934 the company produced 21,224,179 barrels gross or a net for its own account of 18,538,226 barrels of crude. Developments upon new properties, however, have put the company in position where its total reserves at the end of the year are very much larger than before this withdrawal took place.

DEPLETION

Depletion is the amount which is deducted from the earnings each year as representing the proportionate reduction in investment in oil producing properties on account of the volume of oil taken from the reserves.

On December 31, 1934, the net book value of the company’s producing properties subject to depletion, to be amortized over their productive life, was $30,439,636.96. The method of depletion used during the past year correctly reflects the current operating results and property values.

The subject of depletion has been treated in the industry in a variety of ways, many of which have had the effect of reflecting an incorrect impression in the current balance sheets as well as in the comparative operating results as between years.

Reserves and their valuation in property accounts must always be treated as a whole if the consolidated result at any given time is to be accurate. To base depletion on the cost of the oil from any particular lease or property without taking into account the reserves or costs of the other properties results in creating very large depletion charges in the years that the oil is withdrawn from the higher cost properties and a very low depletion charge in the years that it is withdrawn from the lower cost properties, and has no logical relationship with the rate at which the total properties are exhausted. Depletion should reflect the total average cost of the investment in each barrel produced. The combined method was applied to the production of the company in the year 1934, plus an additional estimated amount for future development expenses during the depletion period. If the method used in 1933 had been applied, the depletion would have been $4,698,534.66 larger than was set up. If the method used in 1934 had been applied to the year 1933, the depletion for the year 1933 would have been $698,522.09 less than was actually recorded.

A considerable study has been devoted to the preparation of this formula in the desire to reflect to the stockholders actual conditions. In this connection the stockholders should be advised that during the current year the company has developed new properties which comprise substantial reserves which have not been developed to such a point that they can be taken into account in the computation of depletion.

TRANSPORTATION

The company’s transportation is completely adequate.

During the past year it has not been necessary to make any important additions in the way of pipe lines or ocean or river transportation facilities. At
the present moment there appears to be no point at which substantial additional economies or profits could be made by further expenditures on this account. The minority ownership in the Ajax Pipe Line Company and the Great Lakes Pipe Line Company, coupled with the company's own facilities, has produced a condition by which it is able to transport its oil from the well to the consumer at a cost as low as that of its most favored competitor. This was brought about not only through a control of facilities but through an expansion of marketing planned to that end. At times in the history of the company it has been necessary, in order to secure the economical volume, to make expenditures on transportation construction which were in advance of the requirements of the producing department. At the present time the volume furnished by the production of the company is sufficient to bring about the best results, leaving the next step in the company’s evolution to the creation of necessary refining and marketing facilities of the requisite volume.

REFINERIES

The refining equipment of the company is in good condition. It is of moderate capacity as compared with the other phases of the company’s operations. Unlike production and unlike transportation, however, refineries can be developed at any time. The uncertainties involved in production and the volume problem of transportation and marketing do not apply to the operation of refineries. We have endeavored to keep our products at the forefront and believe we have done so with success as is indicated by their public acceptance. Because of the high rate of obsolescence and depreciation, the management believes that excessive refining capacity is especially undesirable.

MARKETING

The company showed increased sales in the period covered.

The Pure Oil Company has been built with the belief that the first foundation should consist of an adequate crude supply, upon which should be constructed a transportation system large enough to produce volumetric economy, and the marketing of its products up to the present time has been subordinated to these important considerations. Until such time as the marketing department could sell a sufficient quantity of products to meet the company’s necessities for disposing of producing and transportation capacity, it was necessary that it should concentrate on volume. Having reached this volume, and having brought about a condition which permitted the utmost economies in the other departments, it is now able to center its efforts upon that type of operation which it would naturally have followed if it had been carried on independently of the other necessities of the company.

The company during 1934 marketed over 500,000,000 gallons of gasoline which met the requirements of the other departments.

The additional cost of marketing 50,000 gallons over that required for marketing 5,000 gallons per month through the same station is immaterial. The ultimate goal of successful marketing is clearly the concentration of volume through the minimum number of outlets sufficient to meet the over-all requirements of the company. The company’s facilities have been developed to such an extent that it may now devote its energies intensively to their economical operation. This, taken with a general tendency in the industry to reduce margins to resellers, and the cumulative effects of previous years of consistent growth and evolution should improve conditions materially in the coming year.

With the price of crude oil reasonably stabilized on the basis of both conservation and economics, and the price of refined products disproportionately low to crude, it would seem that a general advance in gasoline and oil products should be anticipated.

GENERAL

Attention is called to the company’s tabulation submitted, herewith, which shows its equity interest in the net income of associated companies, which income is not taken into account on the general books or shown in the consolidated income account. It will be noted that the company’s proportion of these earnings aggregates $1,067,118.20.

The burdens imposed on the motoring public in the way of gasoline taxes have reached staggering proportions. It is estimated that the average per gallon tax on gasoline in the United States, applied to the amount of over 500,000,000 gallons marketed by The Pure Oil Company, would make a total tax of in excess of $25,000,000. in the last year.

The ultimate effect of much of the experimentation that has been proposed at the expense of the oil business recently has been generally overestimated. The experience of the last two years very definitely indicates that the most radical proposals are the least apt to be put into effect. It is becoming more evident that the weight of economic influences must always be the controlling factor. Upon the advantages of increasing cooperation within the industry as opposed to external regulation, it is hardly necessary to dilate.

Control over crude production in time of emergency is in a category by itself as it deals with a natural resource that is both irreplaceable and fugitive. It should not arouse the apprehension of those who depurate the undue interference of government in the affairs of the citizens.

Respectfully submitted,

HENRY M. DAWES,
President.
THE PURE OIL COMPANY TWENTY

CONSOLIDATED BALANCE SHEET

ASSETS

CURRENT ASSETS:

Cash in banks and in transit, working funds, etc. ........................................... $ 3,334,486.13
Notes and acceptances ....................................................................................... 605,828.79
Accounts ........................................................................................................... 5,729,227.32
Less—Reserve for doubtful receivables ............................................................... 329,555.32 6,005,500.79
Inventories, quantities and condition determined by the companies—
Crude and refined oils, and merchandise (Note 1) ........................................... 17,117,502.87 14,997,446.72 24,537,433.64

INVESTMENTS AND ADVANCES:

Subsidiary not consolidated, 75% owned, at cost (Note 2) ................................ 3,298,558.61
Capital stock and advances .............................................................................. 3,993,280.82
Deferred receivables, etc., less reserve of $198,842 ........................................... 819,969.14 8,071,808.57

EMPLOYEES' SAVINGS INVESTMENT FUND:

Fund Assets—
Cash ................................................................................................................. $ 44,202.37
Company's gold notes of 1940........................................................................ 150,000.00 par value
Company's 6%-cumulative-preferred stock................................................... 28,562 shares
Additional assets provided by company pending final settlements—
Cash .................................................................................................................. $ 8,777.78
Company's 6%-cumulative-preferred stock................................................... 4,678 shares
Other investments—at cost ............................................................................ 173,484.90 1,800,627.53

PROPERTY, PLANT, EQUIPMENT, LEASEHOLD RIGHTS, ETC.:

Parent-company assets appraised by company executives under authority of the
Board of Directors as of April 1, 1932 and stated by Board to be fair values at
that date; plus subsequent additions and subsidiaries' properties at cost and
minus subsequent retirements and provisions for depreciation and depletion.
Reserves are for depreciation and depletion, and include revaluation reserve:

CLASSIFICATION Gross Reserves (see accompanying certificate)
Producing .................................................. $101,559,284.30 $54,912,245.56
Transportation ................................................ 14,412,627.91 5,171,037.33
Manufacturing ............................................... 22,634,767.31 12,014,739.66
Marketing ................................................... 32,393,211.98 12,062,943.64
Other properties ........................................... 3,045,966.64 1,169,600.82
Total ......................................................... $174,045,856.14 $85,583,567.01
Net Total .................................................... $88,462,289.13 108,456,104.98
Contracts, rights, patents, trade-marks, etc. .................................................. 39,760,815.85

PREPAID AND DEFERRED CHARGES:

Debt discount and expense in process of amortization ................................... $ 963,117.06
Prepaid insurance, rentals, interest, etc. and miscellaneous deferred charges ...... 760,197.97 1,723,315.03
$144,589,289.75

NOTES:

(1) In accordance with the practice consistently followed by the companies, inventories are priced as follows:

Crude oil at average of market prices at dates of production or purchase.
Refined oils at refineries and terminals at recorded departmental cost which comprises crude oil at market quotations at time of transfer to refineries, plus processing costs;
Refined oils at marketing points at or below market prices at dates of transfer from refineries.
Transportation costs are included at tariff rates.

(Note—If quoted market prices at the end of a year are lower than above prices, inventories of crude and refined oils are reduced to market. In accordance therewith, refined oils are stated substantially at market as of December 31, 1934.)

Pricing inventories on the above basis involved in an amount of approximately $1,900,000 in excess of the lower of cost or market plus transportation at tariff rates, at December 31, 1933 and approximately $1,300,000 at December 31, 1934.

(2) The assets of this subsidiary consist mainly of underdeveloped concessions in Venezuela, South America. The subsidiary follows the policy of capitalizing carrying charges (which are advanced by the parent company) and therefore reports no profit or loss.
FIRST ANNUAL REPORT, 1934

(Ohio) and Subsidiaries

BALANCE SHEET—DECEMBER 31, 1934

LIABILITIES

CURRENT LIABILITIES:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank loans</td>
<td>$4,338,400.00</td>
</tr>
<tr>
<td>Other notes payable</td>
<td>502,517.27</td>
</tr>
<tr>
<td>Accounts payable</td>
<td>5,621,048.28</td>
</tr>
<tr>
<td>Accrued liabilities</td>
<td>1,899,965.48</td>
</tr>
</tbody>
</table>

**Total Current Liabilities:** $12,361,931.03

NOTE: Sinking-fund requirements on gold notes for year 1935 (either cash, or principal amount of notes) amount to $2,000,000.00

DEFERRED PURCHASE OBLIGATIONS: 1,269,769.89

TEN-YEAR 5% SINKING-FUND GOLD NOTES:

- Due August 1, 1937: $13,000,000.00
- Due March 1, 1940: $15,500,000.00

EMPLOYEES' SAVINGS INVESTMENT FUND (net cash receipts from employees on subscriptions to company's 6% preferred stock; payable at the option of the subscribers in stock prior to April 1, 1939, or in cash or stock on April 1, 1939):

- Due August 1, 1937: $13,000,000.00
- Due March 1, 1940: $15,500,000.00

DEFERRED CREDITS, AND OTHER RESERVES: 377,307.40

MINORITY INTERESTS IN CAPITAL STOCK AND SURPLUS OF SUBSIDIARIES (includes capital stock and applicable surplus of approximately $1,900,000 to be purchased over a period of years):

- Capital stock: $3,490,915.22
- Surplus: 1,636,421.93

TOTAL CAPITAL STOCK: 5,127,337.15

CAPITAL STOCK:

- Cumulative preferred—authorized, 900,000 shares, par value $100.00; issued 300,000 shares (including shares held in Employees' Savings Investment Fund):
  - Rate Shares
  - 5% 5% 2,360
  - 5% 4% 167,640
  - 5% 3% 130,000

  **Total Paid-in capital:** $30,000,000.00

- Common—authorized, 4,000,000 shares, no-par value; outstanding, 3,038,370 shares:

  **Common stock:** 30,383,700.00

SURPLUS (per summary attached):

- Paid-in surplus: $26,280,376.93
- Earned surplus (see accompanying certificate): 8,488,243.82

CONTINGENT LIABILITIES:

- Federal taxes for a number of years are subject to review by U. S. Treasury Department; reputable independent tax counsel for company state that, in their belief, the tax matters of such years will be finally settled without additional payments.

**Net Worth:** $144,589,289.75

TO THE BOARD OF DIRECTORS,

THE PURE OIL COMPANY:

We have made an examination of the consolidated balance sheet of THE PURE OIL COMPANY AND SUBSIDIARY COMPANIES as at December 31, 1934, and of the consolidated income and surplus accounts for the year ended that date. In connection therewith, we examined or tested accounting records of the companies and other supporting evidence and obtained information and explanations from officers and employees of the companies, we also made a general review of the accounting methods and of the operating and income accounts for the year, but we did not make a detailed audit of the transactions.

Beginning April 1, 1932, as of which date the parent company's properties were appraised by company executives under authority of the Board of Directors, the company provided for depletion by applying district rates (per barrel) to the number of barrels of crude oil produced by geographical operating districts, each comprising a number of leases. In 1934, the company changed its method and applied 2 to total barrels produced, an overall rate (per barrel) for all districts combined. This "lease" method of providing for depletion at a unit rate (per barrel) for each lease is used by many of the oil-producing companies. The "lease," "district" and "overall" methods contemplate the ultimate amortization of the investment in oil-producing properties, on the basis of estimated oil production, but each method results in a different yearly provision for depletion. If the "lease" method had been continued for the year 1934, the company's depletion provision of $2,377,398.78 would have been increased by $1,698,534.66 for that year; the net loss reported for the year 1934 would have been increased by the latter amount; and the reserve for depletion would have been correspondingly increased.

Subject to the comments in the preceding paragraph, in our opinion, based upon such examination, the accompanying consolidated balance sheet and related income and surplus accounts (including the notations appearing therein) fairly present, in accordance with accepted principles of accounting consistently maintained by the companies during the year under review, the financial position of the companies at December 31, 1934, and the results of their operations for the year ended that date.

Chicago, Illinois,
March 14, 1935.

ARTHUR ANDERSEN & CO.,
Accountants and Auditors.
# The Pure Oil Company and Subsidiaries

## CONSOLIDATED INCOME AND SURPLUS ACCOUNTS

For the Year Ended December 31, 1934

### INCOME ACCOUNT

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Operating Income (after elimination of intercompany sales)</td>
<td>$79,766,990.83</td>
</tr>
<tr>
<td>Costs, Operating and General Expenses (before taxes)</td>
<td>$68,731,741.00</td>
</tr>
<tr>
<td>Net operating income before elimination of intercompany sales</td>
<td>$11,035,249.83</td>
</tr>
<tr>
<td>Taxes (including Federal income taxes)</td>
<td>$2,578,767.52</td>
</tr>
<tr>
<td>Net operating income before depreciation and depletion</td>
<td>$8,456,482.31</td>
</tr>
</tbody>
</table>

**Other Income:**

- Dividends (including $216,300.00 from Great Lakes Pipe Line Company reinvested in capital stock of that company): $569,759.70
- Interest and discount earned: 251,808.10
- Profit on sale of capital assets, etc. (net): 40,039.12

**Total:** $9,318,089.23

**Other Deductions:**

- Interest on bank loans, etc.: $533,079.17
- Cash discounts allowed: 162,729.91

**Net profits before interest charges on gold notes, depreciation, depletion, etc.:** $8,622,280.15

**Interest and Discount on Gold Notes:** $1,924,410.98

**Net profits before depreciation, depletion, etc.:** $6,697,869.17

** Provision for Depreciation and Depletion: **$6,938,436.37

**Net loss before minority interests: **$240,567.20

**Income Applicable to Minority Interests: **$644,305.04

**Net loss carried to earned surplus: **$884,872.24

**NOTES:**

*Subject to the comments in the accompanying certificate relative to the depletion provision for the year 1934.

A loss of $350,696.81 on the sale of the capital stock of an insurance company (former subsidiary) has been charged direct to earned surplus.

Interdepartmental profits in inventories have not been eliminated. If inventories had been carried at the lower of cost or market plus transportation at tariff rates at the beginning and end of the year 1934, the net loss reported for the year would have been reduced by approximately $700,000.

### SURPLUS ACCOUNTS

<table>
<thead>
<tr>
<th>Description</th>
<th>Paid-in Surplus</th>
<th>*Earned Surplus</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance December 31, 1933</td>
<td>$26,249,106.42</td>
<td>$9,517,552.57</td>
</tr>
<tr>
<td>Add:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Parent company's net interest in earned surplus and/or deficit of subsidiaries not previously consolidated</td>
<td></td>
<td>206,260.30</td>
</tr>
<tr>
<td>Excess of par value of capital stock of certain subsidiaries not previously consolidated, over parent company's investment therein.</td>
<td>31,270.51</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>$26,280,376.93</td>
<td>$9,723,812.87</td>
</tr>
</tbody>
</table>

**Deduct:**

- Net loss for the year, per income account: $ — $884,872.24
- Loss on sale of capital stock of insurance company (former subsidiary): $350,696.81

**Total:** $1,235,569.05

| Balance December 31, 1934 | $26,280,376.93 | $8,488,243.82 |

*Subject to the comments in the accompanying certificate relative to the depletion provision for the year 1934.
### THE FOLLOWING TABULATION HAS BEEN PREPARED BY THE COMPANY

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Consolidated Operating Income Before Depreciation and Depletion</td>
<td>$8,462,053.49</td>
</tr>
<tr>
<td>Less—Depreciation and Depletion</td>
<td>$6,938,436.37</td>
</tr>
<tr>
<td>Consolidated Net Operating Income</td>
<td>$1,523,617.12</td>
</tr>
<tr>
<td>Add—Dividends, Interest, Discounts, Etc.</td>
<td>$856,037.74</td>
</tr>
<tr>
<td>Less—Interest on Bank Loans and Discounts Allowed</td>
<td>$695,811.08</td>
</tr>
<tr>
<td>Total</td>
<td>$1,683,843.78</td>
</tr>
<tr>
<td>Less—Minority Interest</td>
<td></td>
</tr>
<tr>
<td></td>
<td>$644,305.04</td>
</tr>
<tr>
<td>Consolidated Net Income Before Interest Charges on Gold Notes Per Income Account</td>
<td>$1,039,538.74</td>
</tr>
<tr>
<td>Add—Equities in Net Income of Associated Companies</td>
<td></td>
</tr>
<tr>
<td></td>
<td>$1,067,118.20</td>
</tr>
<tr>
<td>Consolidated Net Income Before Interest Charges on Gold Notes Plus Equity in Net Income of Associated Companies After All Charges</td>
<td>$2,106,656.94</td>
</tr>
</tbody>
</table>

**THE PURE OIL COMPANY,**

*Henry M. Dawes,*

*President.*
The Pure Oil Company

TRANSFER AGENTS
Guaranty Trust Company of New York, New York
City National Bank and Trust Company of Chicago, Chicago
The Provident Savings Bank & Trust Co., Cincinnati, Ohio
P. G. Miller, Columbus, Ohio

REGISTRARS
Central Hanover Bank and Trust Co., New York
Ohio National Bank of Columbus, Columbus, Ohio
First National Bank, Cincinnati, Ohio
Continental Illinois National Bank and Trust Company of Chicago, Chicago