To the Shareholders:

The net surplus earnings of The Pure Oil Company in the year 1940 were $8,718,057, an increase over the previous year of $427,639. Out of these earnings it disbursed $3,899,984 in payments to the preferred shareholders and $995,242 to common shareholders, and increased the earned surplus by $3,822,831. No changes of importance appear in the Consolidated Balance Sheet which accompanies this statement.

PRODUCTION

The net crude oil production of the Company after deducting royalties was 23,674,000 barrels, an increase of 1,431,000 barrels over the previous year. Due to new discoveries and developments, the Company finds itself with materially larger reserves than at the beginning of the year, notwithstanding this draft upon reserves. Among the new developments is the Cumberland field, located in southern Oklahoma about fourteen miles from the Texas border and thirty-two miles east of Ardmore. This field is at about the center of a 22,000 acre block of leases which is owned almost entirely by the Company, so that it may be developed as a unit with the corresponding savings and the elimination of unnecessary drilling and the increased ultimate recovery. Nineteen wells have been completed upon it to date, all of which are productive.

The production and development in the Michigan and Illinois fields have been eminently satisfactory. The development of the Company's Illinois fields has been determined by the Company's own necessities and the general economic conditions, and it has not been necessary for it to resort to uneconomic practices on account of offset drilling because of neighboring producers. This, of course, is due to the fact that before the Company commenced operations, it secured a very large, practically solid block of some 315,000 acres. While the total daily average production of the State at one time equalled about 500,000 barrels, it is at the present writing about 325,000 barrels. The general opinion seems to be that unless some unexpected developments take place, this figure will not be materially increased even if the state regulation of production should not be accomplished. The sudden and unexpectedly large develop-
ment of this Illinois area in the last three years has been, of course, a disturbing factor in the general situation. Under any circumstances, however, the discovery of a new field requires marketing arrangements which involve much greater readjustments than would be the case if the same increase in production were confined to established fields. To a great extent these readjustments have been accomplished. In addition to this, The Pure Oil Company concurs in the general sentiment which seems to favor regulatory laws by the State, both on account of the local situation and the desirability of bringing about proper cooperation with the other oil producing states.

REFINING

The refinery operations this year show a marked decrease in costs over previous years. There has been completed or is in process of construction equipment which utilizes both the thermal and catalytic polymerization processes which are designed for the primary purpose of maintaining the highest quality of our products. The constant demand for higher octane gasoline continues and has added materially, both in construction and operation, to the difficulties and expenses of refining, and probably will continue to do so.

MARKETING

It is a matter of satisfaction that the Marketing Division showed a profit in 1940 in spite of generally unfavorable price situations prevailing in the commodities which it handled. The year showed unusually wide variations in the price of all products. The price of the principal product, gasoline, began a decline in the early part of the year and continued, so that the 1940 average retail price of gasoline was the lowest it had ever been in any year since records were kept.

Gasoline prices were, of course, influenced by the disturbed world conditions, but in balancing the increased domestic demand against the less favorable foreign export and import situation, the conclusion is that the moral effect of uncertainty and nervousness in connection with the present emergency was a very disturbing factor. In addition to this, the prices and demand for the heavier commodities such as fuel oil increased, and a certain amount of gasoline which was put on the market was a by-product of these commodities. This situation has disturbed not only prices but inventories, but in the last few weeks of the year, there seemed to be evidence that the necessary adjustments were being accomplished through the natural laws of supply and demand.

In 1940 the Company's sales of gasoline were 681,500,000 gallons. The retail sales were 659,000,000 gallons, an increase of 5% over 1939. This is slightly less than the average for the industry, but it is made in spite of the fact that the Company withdrew from marketing in a number of eastern states as recorded in the last Annual Report. This indicates that increased sales through existing facilities more than made up the loss in volume which was occasioned by the disposal of these properties.

It is the conviction of the management that the greatest improvement in marketing gasoline must be through increased sales per unit of outlet rather than extension of territory and capital investment in facilities.
TRANSPORTATION

The operation of the pipe lines showed no material changes from the previous year. As a part of its efforts to meet the transportation problem in the most economical way under varying conditions, the Company has put in service this year a tanker for the transportation of petroleum products on the Great Lakes from our Toledo (Ohio) Refinery to a terminal at Superior, Wisconsin. We are in the course of constructing the first unit of a fleet to transport relatively large volumes of petroleum products from our Smiths Bluff (Texas) Refinery to points on the Mississippi and Ohio Rivers. The economies of this transportation over considerable areas is apparent, and it is possible that, with future developments, these barges may be operated to as distant a point from Texas as Minneapolis.

The gasoline pipe line in which The Pure Oil Company has a substantial interest and which was referred to in the last Annual Report is in operation from the terminal at Port St. Joe, Florida, to Bainbridge, Georgia. Its completion to the northern terminus near Chattanooga, Tennessee, can be accomplished almost immediately as soon as rights of way can be secured for crossings underneath the tracks of some of the railroads in Georgia.

PREPAREDNESS

Every industry and every individual in it must consider that his first obligation is to serve his country in time of stress. It is, therefore, appropriate that the extent to which The Pure Oil Company is prepared to meet this obligation should be disclosed to its shareholders. In discussing the Company's ability to meet a war-time situation, it will be observed that, incidentally, a reflection of its flexibility and strength as a commercial institution is necessarily made.

The most important single element involved in the supply of oil products is the matter of the immediate availability of crude oil supplies. As a result of the cooperative action of the authorities in the various oil producing states and the enterprise and self-restraint of the oil industry, there are today immediately available many times the amount of crude oil that the country could possibly use for both its current domestic needs and war-time demands. It would probably not be an exaggeration to say that the United States, out of its current capacity, could not only supply all of the needs of this country but the whole world. All that would be necessary would be to open wider the valves on existing wells.

In developing this condition, due regard to the needs of future generations has been observed as is evidenced by the fact that the total reserves of the United States are larger than at any time in its history. In regard to its available supply of crude oil, The Pure Oil Company is particularly fortunate, as it could produce several times its present total output for war emergency needs should it be necessary.

The fact that such an amount of oil could be produced from existing wells would be less important if the facilities for getting this oil from the point of origin to the point of need were in any way inadequate. Through the pipe lines built and owned by the oil industry, it is possible to mobilize all of the substantial producing and refining resources east of the Rocky
Mountains for delivery to any one point in that area or from any one of them to any particular place where they could be utilized for national defense. The only strategic section east of the Rocky Mountains which is not protected in this way is in the southeastern states. State legislation or the removal of railroad opposition would permit the operation of one pipe line in that section immediately and clear the way for the construction of another within a very short time, and the two would completely meet the situation. It seems hardly necessary to dilate upon the advantages of underground transportation and the uninterrupted and immediate volume that can be secured thereby. Such speed and safety, as well as economy, could not be measurably approached through surface transportation.

The stockholders have been apprised in previous reports and are aware of the adequacy of the transportation system of The Pure Oil Company to meet the situation either through its wholly owned facilities or those in which it owns an interest.

The refineries of the country are prepared to process this crude oil into the various products which may be required for combined domestic and war-time necessity. There are some special war-time products that will require refinery adjustments and new construction, but generally speaking this work is not only under way, but nearing completion.

Fear has been expressed that something might be done to essentially change the existing structure of this industry, which is the best prepared of all American activities to meet the emergencies of peace or war. This apprehension is probably not warranted, since the public, which is the final court of appeal, will not countenance discrimination against any one industry or any group. There is a certain pattern into which every industry should fit itself. This is the concern of its management, its labor, its owners and the public which it serves, and when, as is the case with the oil business, it conforms to its broad general principles, it is not the American way to interfere with the details of its operation.

In the coming year it is estimated that about $1,500,000,000 in taxes of various sorts will be paid either on properties used in the oil industry or upon the consumption of its products, etc. Surely no one could contend that it was not bearing its share of the tax burden.

The prices for its principal products have, through the years, shown a consistent decrease, and the average retail price for gasoline for the year 1940 was less than any year since records have been kept. The industry has met every demand for its products, which, in the case of gasoline, has increased five-fold in the last twenty years. The most intelligent criticism that has been leveled at it is that it has gone to too great lengths to cater to the convenience of the public through the great number of its service stations. The recoverable reserves of crude oil are the largest in history. The economical production and discovery of these reserves and the proper conservation thereof have been accomplished through the voluntary cooperation of the industry with the states from which the oil is produced. The remarkable progress that has been made in this respect is so great that those who would interfere with the present cooperation between the industry and the state authorities base their arguments on hypothetical statements as to what may occur in the future and ignore the progress that has been made in the past.
Because there are some in high places who wish to discuss and bring about certain internal detail adjustments, it would not be wise at this time to jump at the conclusion that in a time of emergency they intend to throw monkey wrenches into a satisfactorily operating machine.

If the industry were not discharging all of its public responsibilities in a superlative way; if there were the slightest question of its being able to meet emergency adjustments immediately; if either in price or in convenience of service it could be criticized; then there would be reason for apprehension which today seems hardly justified.

By Order of The Board of Directors,

Henry M. Dawes, President.
CONSOLIDATED BALANCE SHEET

ASSETS

CURRENT ASSETS:
- Cash in banks, in transit and working funds: $9,050,291
- Receivables:
  - Notes: $863,775
  - Accounts: $8,116,879
  Less—Reserve for doubtful receivables: $222,355
- Inventories:
  - Crude oil (Note 1): $3,635,209
  - Refined oils and merchandise (Note 1): $9,817,420
  - Materials and supplies, at current cost less allowance for condition: $3,322,764

INVESTMENTS, ADVANCES, ETC.:
- Investments in and advances to subsidiaries not consolidated, at cost (Note 2): $5,303,611
- Investments in securities of other companies (Note 3): $6,972,136
- Deferred receivables, etc., less reserve of $368,526: $1,929,488

PROPERTY, PLANT, EQUIPMENT, LEASEHOLDS, RIGHTS, ETC. (Notes 4 and 5):
- Classification: Gross Reserve
  - Producing: $129,088,745 $62,156,480
  - Transportation: $16,329,413
  - Manufacturing: $30,527,049 $14,019,941
  - Marketing: $34,865,691 $13,232,607
  - Other properties: $3,387,420
  Total: $214,198,318 $98,960,888
  Net total: $115,237,430
- Contracts, rights, patents, trade-marks, etc.: $9,667,936 $134,905,366

PREPAID AND DEFERRED CHARGES: $1,043,936

$184,738,520

The attached notes are an in
SEVENTH ANNUAL REPORT • 1940

-(Ohio) AND SUBSIDIARIES

-December 31, 1940

LIABILITIES

CURRENT LIABILITIES:

Purchase obligations, etc. ........................................ $ 462,935
Accounts payable ..................................................... 7,831,386
Dividends payable January 1, 1941 ................................... 977,066
Accrued liabilities ................................................... 2,612,289 $ 11,883,676

LONG-TERM DEBT:

Deferred purchase obligations, etc. ............................... 3,478,686

MINORITY INTERESTS IN CAPITAL STOCK AND SURPLUS OF SUBSIDIARIES
(approximately $700,000 under commitments for purchase over a period of years):

Capital stock .......................................................... $ 1,671,266
Surplus ................................................................. 737,188 2,408,454

CAPITAL STOCK AND SURPLUS:

Capital stock—
Cumulative preferred—authorized 1,000,000 shares, par value $100;
outstanding 725,431 shares (Note 6)—

Rate Shares
5% 442,434
6% 282,997

$ 725,431 $ 72,543,100

Common—authorized 10,000,000 shares, no par value
(Note 6)—outstanding 3,982,031 shares, assigned
value $10 per share .................................................. 39,820,310 $112,363,410

Surplus (per summary attached)
(Notes 4, 5 and 6)—
Paid-in surplus ..................................................... $ 28,207,088
Earned surplus ....................................................... 26,397,206 54,604,294 166,967,704

CONTINGENT LIABILITIES (Note 7)

$184,738,520

1 part of the above statement.
**THE PURE OIL COMPANY • TWENTY**

**THE PURE OIL COMPANY**

*Consolidated Income*  
*For the Year Ended*

**INCOME ACCOUNT**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>GROSS OPERATING INCOME</strong></td>
<td>$95,675,216</td>
</tr>
<tr>
<td><strong>COSTS, OPERATING AND GENERAL EXPENSES</strong> (exclusive of depreciation and depletion)</td>
<td>$73,379,455</td>
</tr>
<tr>
<td><strong>TAXES</strong> (including income taxes and $19,346 excess profits tax)</td>
<td>$3,788,191</td>
</tr>
<tr>
<td><strong>Net operating income before depreciation and depletion</strong></td>
<td>$18,507,570</td>
</tr>
<tr>
<td><strong>OTHER INCOME:</strong></td>
<td></td>
</tr>
<tr>
<td>Dividends</td>
<td>$1,451,089</td>
</tr>
<tr>
<td>Interest and discount earned</td>
<td>394,852</td>
</tr>
<tr>
<td>Profit on disposition of capital assets, etc. (net)</td>
<td>138,995</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$20,492,506</td>
</tr>
<tr>
<td><strong>OTHER DEDUCTIONS:</strong></td>
<td></td>
</tr>
<tr>
<td>Cash discounts allowed</td>
<td>$241,881</td>
</tr>
<tr>
<td>Interest on purchase obligations, etc.</td>
<td>186,198</td>
</tr>
<tr>
<td><strong>Net income before depreciation, depletion, etc.</strong></td>
<td>$20,064,427</td>
</tr>
<tr>
<td><strong>PROVISION FOR DEPRECIATION AND DEPLETION</strong> (including lease bonuses paid and $850,000 provided to cover estimated loss in connection with inter-refinery transfer of certain equipment)</td>
<td></td>
</tr>
<tr>
<td><strong>Net income before minority interests</strong></td>
<td>$9,274,835</td>
</tr>
<tr>
<td><strong>INCOME APPLICABLE TO MINORITY INTERESTS</strong></td>
<td>556,778</td>
</tr>
<tr>
<td><strong>Net income carried to earned surplus</strong></td>
<td>$8,718,057</td>
</tr>
</tbody>
</table>

The attached notes are an integral part of the above statement.
SEVENTH ANNUAL REPORT • 1940

VI AND SUBSIDIARIES

Surplus Accounts
December 31, 1940

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, 1939</td>
<td>$28,207,088</td>
<td>$22,574,375</td>
</tr>
<tr>
<td>Add—Net income for the year per income account</td>
<td>—</td>
<td>8,718,057</td>
</tr>
<tr>
<td>DEDUCT—Cash dividends declared on:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Preferred shares</td>
<td>—</td>
<td>$3,890,984</td>
</tr>
<tr>
<td>Common shares</td>
<td>—</td>
<td>$995,242</td>
</tr>
<tr>
<td>DEDUCT—Cash dividends declared on:</td>
<td>$ —</td>
<td>$4,885,226</td>
</tr>
<tr>
<td>Balance—December 31, 1940</td>
<td>$28,207,088</td>
<td>$26,397,206</td>
</tr>
</tbody>
</table>

The attached notes are an integral part of the above statement.

AUDITORS’ CERTIFICATE

To the Board of Directors and Shareholders,
The Pure Oil Company:

We have examined the consolidated balance sheet of The Pure Oil Company (an Ohio corporation) and its subsidiaries as of December 31, 1940, and the consolidated statements of income and surplus for the year ended that date. In connection therewith we have examined or tested accounting records of the companies and other supporting evidence and have reviewed the system of internal control and the accounting procedures of the companies by methods and to the extent we deemed appropriate, but we did not make a detailed audit of the transactions.

As set forth in Note 4 of the financial statements, the company, as of April 1, 1932, reflected an adjustment of its properties by a charge to paid-in surplus. In our opinion, the preferable treatment would have been to charge to earned surplus such portion of the adjustment as would have exhausted the balance in earned surplus at that date.

Subject to the comments in the foregoing paragraph and to the lower provisions to date under the method of determining depletion and depreciation of producing properties as explained in Note 5 of the financial statements, in our opinion the accompanying consolidated balance sheet and related statements of income and surplus fairly present the financial position of the companies at December 31, 1940, and the results of their operations for the year ended that date, in conformity with generally accepted accounting principles maintained by the companies on a basis consistent with that of the preceding year.

Chicago, Illinois,
February 24, 1941.

Arthur Andersen & Co.
NOTES:

(1) In accordance with a policy adopted as of December 31, 1937, inventories of crude and refined oils have been priced at cost, on the "last-in first-out" method computed on an annual basis beginning with the inventories at January 1, 1937. Inventories of crude and refined oils at December 31, 1940 are stated in the aggregate below market. Merchandise other than refined oils is stated at the lower of cost or market.

(2) Investments in and advances to subsidiaries not consolidated include (a) $3,663,220 representing 75% of the outstanding capital stock of and advances to a subsidiary whose assets consist mainly of undeveloped concessions in Venezuela, South America, and (b) $1,640,191 representing 99.11% of the outstanding common capital stock (presently nonvoting) and 73.45% of the preferred stock of and advances to a domestic marketing subsidiary. The South American subsidiary follows the policy of capitalizing carrying charges, which are advanced by the parent company, and therefore reports no profit or loss; the marketing subsidiary reported a relatively small loss for 1940.

(3) Investments in securities of other companies consist of (a) capital stocks of Hickok Oil Corporation at a cost of $1,003,047 of which $507,563 represents approximate market price of 5% preferred shares of that company received as dividends in prior years; (b) capital stocks of Ajax Pipe Line Corporation at a cost of $1,618,473; (c) capital stock of Great Lakes Pipe Line Company at a cost of $1,335,820; (d) capital stock and long-term installment notes of Southeastern Pipe Line Company at a cost of $475,000 and $1,144,750, respectively; and (e) other security investments, at cost or lower, of $1,305,046. The foregoing securities are not listed.

(4) As at April 1, 1932, the net ledger amount of the parent company's tangible properties was reduced (either directly or through the reserves for depreciation and depletion) to reflect fair value as determined in an appraisal as of that date by company executives under authority of the board of directors. Subsequent additions and the properties of subsidiaries are included at cost, and subsequent retirements and provisions for depreciation and depletion have been made on the basis of appraisal or cost values. Contracts, rights, patents, trade-marks, etc. are stated at values determined in the above-mentioned appraisal, plus relatively minor net changes since the appraisal date and are considered by the company to represent intangibles of a character which do not require amortization.

In reflecting such appraised values, the company charged the net amount of $28,083,743 to paid-in surplus. Had the company charged to earned surplus such portion of the above adjustment as
would have exhausted the balance in earned surplus at that date, the balance in the consolidated earned surplus account at December 31, 1940 would be reduced to $16,042,439 and the balance at that date in the consolidated paid-in surplus account would be increased to $38,561,855.

(5) Since January 1, 1934, the company has provided for depletion and depreciation of producing properties by applying to the total barrels produced an "over-all" rate (per barrel) determined by dividing the total amount of producing properties subject to depletion and depreciation by the net oil reserves (in barrels) estimated by the company’s production engineers. The “lease” or unit method of providing depletion and depreciation is used by many oil producing companies. Both the “lease” and “over-all” methods contemplate the ultimate amortization of the investment in oil producing properties on the basis of estimated oil production; however, the yearly provisions to date under the “over-all” method have been materially less than would have been the case under the “lease” method. This is due to the fact that a disproportionate amount of oil has been produced from leases having a relatively high book value. The application of the “lease” method to such production would require a depletion and depreciation provision on a basis believed by the management to be inconsistent with the company’s total oil reserves. Under the “over-all” method the provision for depletion and depreciation is computed upon the basis of the average rate for all producing leases.

(6) The 5% cumulative convertible preferred shares may be exchanged, at the option of the holders thereof, for common shares on the basis of 4 shares of common for each share of preferred through October 1, 1942, and 3½ shares of common for each share of preferred through October 1, 1947 when the conversion privilege terminates. At December 31, 1940, 1,769,736 common shares were reserved for such conversion.

So long as any preferred shares are outstanding, the company may not pay any dividend on its common shares which will (a) reduce consolidated current assets below an amount equal to twice consolidated current liabilities or (b) reduce consolidated surplus below an amount equal to two years’ dividend requirements of the preferred shares of the company and of the preferred shares of its subsidiaries held by minority interests.

(7) The companies are contingently liable under pending lawsuits, involving titles to properties and alleged damages of substantial amounts, and sundry other suits, all of which, in the opinion of Counsel of the company, are ordinary and routine in the oil industry and will result in an ultimate liability not exceeding $300,000. In addition, the parent company, jointly with various other oil companies, is defendant in certain treble damage suits involving substantial amounts, allegedly based on activities in violation of the Federal anti-trust laws. The company denies and is contesting liability on every such claim for damages and in the opinion of Counsel of the company, under present circumstances, an estimate cannot be made of the ultimate liability, if any, which may be fixed upon the company in these suits.

The audit certificate of Arthur Andersen & Co. appears herewith and it is the intention of the Directors to continue the services of these accountants for the year 1941.
THE PURE OIL COMPANY
GENERAL OFFICES, CHICAGO

OFFICERS

B. G. Dawes . . . . . . . . . . . . Chairman of the Board . . . . . . . . . Columbus, Ohio
Henry M. Dawes . . . . . . . . . . President . . . . . . . . . . . . . . . . . . Chicago
R. W. McIlvain . . . . . . . . . . Vice-President . . . . . . . . . . . . . . . . Chicago
C. B. Watson . . . . . . . . . . Vice-President . . . . . . . . . . . . . . . . Chicago
N. H. Weber . . . . . . . . . . Vice-President . . . . . . . . . . . . . . . . Chicago
Rawleigh Warner . . . . . . . . Vice-President and Treasurer . . . . . . . . Chicago
L. S. Wescot . . . . . . . . . . Vice-President and Secretary . . . . . . . . Chicago
C. H. Jay . . . . . . . . . . Asst. Secretary and Treasurer . . . . . . . . Chicago
R. L. Milligan . . . . . . . . . . Asst. Secretary and Treasurer . . . . . . . . Chicago
W. V. Keeley . . . . . . . . . . Asst. Secretary and Treasurer . . . . . . . . Chicago
Curtis Dawes . . . . . . . . . . Asst. Secretary and Treasurer . . . . . . . . Chicago
J. H. Botkin . . . . . . . . . . Comptroller . . . . . . . . . . . . . . . . . . Chicago

DIRECTORS

Sewell L. Avery
Charles S. Cheston
Philip R. Clarke
B. G. Dawes

Henry M. Dawes
J. A. Elkins
J. H. McCoy
R. W. McIlvain
L. S. Wescot

J. W. McIntosh
J. E. Otis
Rawleigh Warner
C. B. Watson

TRANSFER AGENTS

Guaranty Trust Company of New York, New York
The City National Bank and Trust Co., Columbus, Ohio
P. G. Miller, Pure Oil Building, Chicago

CENTRAL HANOVER BANK AND TRUST Co., New York
The Ohio National Bank of Columbus, Columbus, Ohio
City National Bank and Trust Company of Chicago, Chicago

The accompanying report and financial statements are submitted for the general information of the shareholders of The Pure Oil Company, and are not intended for use in connection with any sale or purchase of, or offer or solicitation of offers to buy or sell any shares or securities of this company.