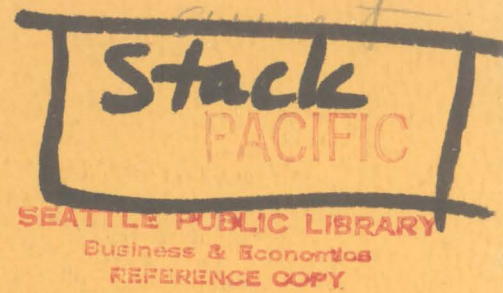
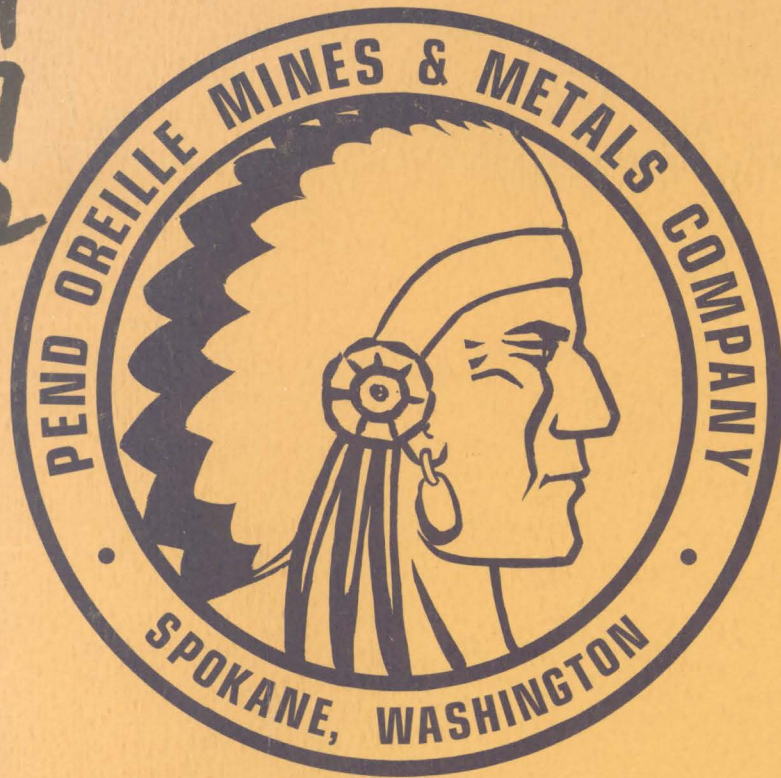


1972

Pend Oreille Mines
metals Co.

JUL 3 1973

PAC



FILE COPY

FOSTER & MARSHALL INC.

1972

annual report

Offices: Old National Bank Building Spokane, Washington



LEGEND OF LOGO

Historians disagree on the origin of the name "Pend Oreille", but translated from the French, it means "ear pendant". Fur traders of the Northwest Company, about 1809, gave the name Pend Oreille (pronounced Ponderay) to the Indians in the area as well as to a large lake in northern Idaho and to the river that runs through our properties. Some historians claim that the name originated because of the shape of the lake; others claim it originated from the characteristic ornamentation worn by the Indian inhabitants. Historians, to our knowledge, have never been able to settle this controversy.

FORTY-THIRD
ANNUAL REPORT
of the directors of

PEND OREILLE MINES & METALS COMPANY

for the year ended
DECEMBER 31, 1972

ANNUAL MEETING

The annual meeting of Shareholders will be held at Room 1218, Old National Bank Bldg., Spokane, Washington on Wednesday, May 2, 1973 at 2:00 P.M.

Notice of the meeting and proxy statement, proxy and return envelope are enclosed with this report.

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PEND OREILLE MINES & METALS COMPANY

Incorporated under the laws of the State of Washington, April, 1929
Capitalization — 3,000,000 shares of a par value of \$1.00 each (\$3,000,000)
of which 2,564,848 shares were outstanding at December 31, 1972.
MAIN OFFICE, 923 Old National Bank Building, Spokane, Washington
Mine Office Metaline Falls, Washington

Directors

ROBERT H. ALLEN Houston, Texas
ROBERT E. BROWN Kellogg, Idaho
WRAY D. FARMIN Spokane, Washington
R. R. McNAUGHTON Victoria, B.C.
WM. M. WOLF Houston, Texas
F. G. WOODRUFF Houston, Texas

Executive Committee

WRAY D. FARMIN, Chairman
F. G. WOODRUFF

Officers

F. G. WOODRUFF, President Houston, Texas
WM. M. WOLF, Vice President Houston, Texas
L. M. KINNEY, Vice President Mining Metaline Falls, Washington
D. D. WILSON, Secretary and Treasurer Spokane, Washington
J. L. NEFF, Assistant Secretary and Assistant Treasurer Spokane, Washington

Transfer Agent & Registrar

First City National Bank of Houston Houston, Texas

PEND OREILLE MINES & METALS COMPANY

Spokane, Washington
April 3, 1973

TO OUR SHAREHOLDERS:

We submit herewith the Annual Report for the year ended December 31, 1972, which includes the balance sheet, statement of operations and deficit, statement of changes in financial position and audit report by LeMaster & Daniels, Certified Public Accountants. The operations of the Company and its wholly owned subsidiary, Pend Oreille Oil & Gas Company are reported on a consolidated basis and the operations of Reeves MacDonald Mines Ltd., a 60.33% owned subsidiary, are being reported by the equity method. Individual reports for each subsidiary are also included.

PEND OREILLE MINES & METALS COMPANY

Operations — 217,383 tons of ore were mined and milled during 1972. To date, 13,487,844 tons of ore have been extracted from the property. 1972 production includes 21,443 tons from the Yellowhead orebody on the west side of the Pend Oreille River. This operation was conducted primarily to obtain information for evaluating the potential of the Yellowhead formation that is being explored and developed in the East Side Mine. The ore extracted provided a needed supplement to the production from areas presently being mined on the East Side.

Development & Exploration — Aside from normal stope development, the effort to develop new ore reserves was concentrated primarily in two areas — the Lower Dolomite area and the East Side Yellowhead formation.

A decline to the Lower Dolomite area intersected commercial value ore late in the second quarter and this area contributed substantially to production during the last half of 1972.

Diamond drilling from present workings on the 1700 level indicated the presence of a mineralized formation lying approximately 800 feet below. Core samples have the same characteristics of the West Side Yellowhead orebody. A 3,300 foot development decline to this area was begun in July of 1972 and is scheduled to reach the target area by mid-1973. Production costs for 1972 include about \$250,000 for this program.

Labor — Development and production schedules for the year were somewhat hampered by the shortage of available and qualified manpower.

In a NLRB supervised election held on Jan. 24, 1973, Pend Oreille employees voted to retain the Northwest Metal Workers Union as their bargaining agent. Subsequent negotiations produced a three year contract on February 27, 1973, granting wages and fringe increases of 78¢ per hour over the three year period.

Metal prices — Comparative "Metals Week" average metal prices for 1972 and 1971 are as follows:

	1972	1971
Silver (oz.)	\$1.68	\$1.55
Lead (lb.)	.151	.138
Zinc (lb.)	.177	.161
Cadmium (lb.)	2.56	1.97

Current prices (March 23) are: Silver 2.26, Lead .160, Zinc .206 and Cadmium 3.75. If the market can sustain present strength in metal prices, the Company could benefit substantially from increased revenue in 1973.

PEND OREILLE MINES & METALS COMPANY

COMPARATIVE OPERATING HI-LITES

	1972	1971
Tons Ore Milled	217,383	252,492
Pounds Lead in Concentrate	5,266,094	10,508,574
Pounds Zinc in Concentrate	13,398,954	11,734,257
Pounds Cadmium in Concentrate	57,222	48,880
Receipts from Concentrate Sales	\$1,602,849	\$1,762,126
Other Income from Operations	\$ 84,241	\$ 122,114
Loss from Operations	\$ 724,159	\$ 475,265

	1972		1971	
Detail of Operating Costs	Amount	P/Ton	Amount	P/Ton
Development	\$ 558,296	\$2.569	\$ 490,912	\$1.944
Mining	771,812	3.550	747,095	2.959
Milling	304,672	1.401	344,436	1.364
Other Direct Operating Costs	296,535	1.364	258,653	1.024
Administrative & General	61,633	.284	69,843	.277
Taxes, other than Income	131,971	.607	151,291	.599
Sub-total	2,124,919	9.775	2,062,230	8.167
Depreciation & Depletion	286,330	1.317	297,275	1.178
TOTAL	\$2,411,249	\$11.092	\$2,359,505	\$9.345

The preceding statistics are for Pend Oreille Mine operations only and before provisions for Federal Income Tax or credits.

PEND OREILLE OIL & GAS COMPANY

The Company announced at its annual meeting of shareholders on May 3, 1972, the formation of this wholly owned subsidiary for the purpose of participating in oil and gas exploration activities in the State of Louisiana and the Republic of Ecuador.

A 55% interest in a lease block of approximately 2,200 acres in the Melodia District of Lafourche Parish, Louisiana was purchased by the Company for the cost of drilling an exploration well, named Edna Ledet No. 1, to a depth of 16,300 feet. The well was completed in the Robulus 43 sand in mid-October. Absolute open flow potential of the well was calculated at 158 million cubic feet of gas per day plus 88 barrels of condensate per million cubic feet. Initial production is anticipated to average 8 to 10 million cubic feet of gas per day. A second well in the same lease block, the Paul Zeringue No. 1, is now in progress. Electric logs and side wall core samples have indicated two potentially productive zones in the Robulus 43 sand and the Plater A-1 sand. Drilling will continue to a depth of 16,300' before implementing a program to complete the well. A third well, the St. Charles Catholic Church et al No. 1, was spudded March 10, 1973 as a west offset to the Paul Zeringue No. 1 well.

A 20% interest in another lease block of 1230 acres was acquired by participation in drilling an offset well to Bradco Oil & Gas Company's No. 2 Libby Blouin productive well. This well, the Euel Zeringue No. 1, was completed and tested in January, 1973. Tests were disappointing and the well will probably be abandoned. 76,712 shares of Pend Oreille Mines & Metals Company stock were issued to acquire the 20% interest in this property.

The Company, in mid-1972, acquired a 25% undivided interest in two concessions for petroleum exploration and exploitation in Ecuador from Bradco Pacific Oil Company, in exchange for 100,000 shares of Pend Oreille Mines & Metals Company stock. The agreement includes an option to acquire an additional 25% for an additional 150,000 shares of Pend Oreille Mines & Metals Company stock and a provision for paying drilling costs by the issuance of from 100,000 to 125,000 shares of Pend Oreille Mines & Metals stock. Bradco Pacific Oil Company has not advised the Company of any immediate plans for drilling. Recent laws and regulations imposed by the government of Ecuador may result in the abandonment or cancellation of these concessions.

PEND OREILLE MINES & METALS COMPANY

REEVES MACDONALD MINES LIMITED

The complete annual report to shareholders of Reeves MacDonald Mines Limited, 60.33% owned, is reprinted as a separate section of this report. Pend Oreille's share of Reeves MacDonald operations is reported on an equity basis in the Pend Oreille audited statements. In 1971, Pend Oreille's share of Reeves MacDonald losses exceeded the book value of Pend Oreille's investment in Reeves which resulted in reducing the investment to zero on an equity basis. Reeves MacDonald recorded additional losses in 1972 of \$187,343. Reference is made to the auditors note No. 1 (to Pend Oreille statements) for explanation of how these losses will affect future financial reporting of Pend Oreille's equity in Reeves MacDonald.

A \$300,000 "Reserve for Decline in Value" was established at year end by Pend Oreille to reflect the possibility that Reeves MacDonald may not be able to repay the full \$850,000 in notes due Pend Oreille. These notes became due September 30, 1972 and are now payable on demand.

GENERAL

We report with regret the death, on October 20, 1972, of W. W. Witherspoon, who served as an officer and director of the Company since 1958. His expertise in corporate management was of great benefit to the Company.

Wray D. Farmin, director of the Company since 1949 and President from 1967 to 1971, has requested retirement from the Board of Directors at the annual shareholders meeting. Mr. Farmin's request is being accepted with reluctance and acknowledgement is given to his long and faithful service to the Company.

Respectfully,

F. G. WOODRUFF
President

PEND OREILLE MINES & METALS COMPANY

Consolidated Balance Sheet

ASSETS

	Years Ended December 31	
	1972	1971 (Note 1)
CURRENT ASSETS:		
Cash and interest bearing deposits	\$ 428,968	\$ 724,860
Commercial paper and U. S. Treasury obligations, at cost which approximates market.	—	452,735
Due from sale of concentrates	—	134,027
Other accounts receivable	201,376	23,255
Operating supplies (note 1)	240,791	218,686
Prepaid expenses	22,209	22,814
Refundable Federal income tax	—	147,027
Total current assets	<u>893,344</u>	<u>1,723,404</u>
INVESTMENTS (note 1):		
Investments in and advances to Reeves MacDonald Mines Limited, a Canadian subsidiary	550,000	850,000
Shares of other mining companies (nominal value)	<u>1</u>	<u>1</u>
	<u>550,001</u>	<u>850,001</u>
PROPERTIES, PLANT AND EQUIPMENT—at cost (note 1):		
Oil and gas properties	1,424,743	—
Mineral properties, plant and equipment less accumulated provision for depreciation and depletion: 1972, \$6,586,517; 1971, \$6,485,565	<u>1,482,964</u>	<u>1,630,915</u>
	<u>2,907,707</u>	<u>1,630,915</u>
OTHER ASSETS	<u>5,870</u>	<u>5,500</u>
	<u>\$4,356,922</u>	<u>\$4,209,820</u>

LIABILITIES AND STOCKHOLDERS' EQUITY

CURRENT LIABILITIES:

Notes payable to bank (note 2)	\$ 650,000	\$ —
Accounts payable	122,295	144,335
Payroll payable	27,177	26,111
Taxes payable	51,801	71,779
Advances on future production of concentrates	259,401	—
Equipment contracts (including \$33,587 due after one year)	72,087	—
Total current liabilities	<u>1,182,761</u>	<u>242,225</u>

COMMITMENTS AND CONTINGENT LIABILITIES (note 5)

STOCKHOLDERS' EQUITY:

Common stock — 3,000,000 shares authorized; \$1 par value; issued: 1972, 2,614,948 shares; 1971, 2,438,236 shares; held in treasury, 50,100 shares; outstanding: 1972, 2,564,848 shares; 1971, 2,388,136 shares (note 6)	2,564,848	2,388,136
Capital surplus (note 6)	3,053,689	2,895,151
Deficit	<u>(2,444,376)</u>	<u>(1,315,692)</u>
	<u>3,174,161</u>	<u>3,967,595</u>
	<u>\$4,356,922</u>	<u>\$4,209,820</u>

See notes to financial statements.

PEND OREILLE MINES & METALS COMPANY

Consolidated Statement of Operations and Deficit

	Years Ended December 31	
	1972	1971 (Note 1)
OPERATING REVENUES:		
Sale of concentrates	\$1,728,705	\$1,911,671
Deduct transportation charges and royalties	125,856	149,545
Net sales	<u>1,602,849</u>	<u>1,762,126</u>
COST AND EXPENSES:		
Cost of production	1,931,315	1,841,097
General and administrative expenses	193,604	221,133
Depreciation (note 1)	264,509	271,930
Depletion (note 1)	21,821	25,345
	<u>2,411,249</u>	<u>2,359,505</u>
LOSS FROM OPERATIONS	<u>808,400</u>	<u>597,379</u>
OTHER INCOME:		
Interest	63,627	99,406
Other	20,614	22,708
	<u>84,241</u>	<u>122,114</u>
LOSS BEFORE FEDERAL INCOME TAX CREDIT AND UNDERNOTED ITEMS ..	724,159	475,265
FEDERAL INCOME TAX CREDIT	<u>—</u>	<u>162,127</u>
LOSS BEFORE EQUITY IN LOSS OF UNCONSOLIDATED SUBSIDIARY, REEVES MacDONALD MINES LIMITED AND EXTRAORDINARY ITEMS	724,159	313,138
EQUITY IN LOSS OF UNCONSOLIDATED SUBSIDIARY, REEVES MacDONALD MINES LIMITED	<u>—</u>	<u>143,783</u>
LOSS BEFORE EXTRAORDINARY ITEMS	724,159	456,921
EXTRAORDINARY ITEMS (note 7)	<u>404,525</u>	<u>858,771</u>
NET LOSS	1,128,684	1,315,692
DEFICIT, BEGINNING OF YEAR	<u>1,315,692</u>	<u>—</u>
DEFICIT, END OF YEAR	<u>\$2,444,376</u>	<u>\$1,315,692</u>
NET LOSS PER SHARE OF COMMON STOCK (note 1):		
Loss before extraordinary items	30¢	19¢
Extraordinary items	16¢	36¢
Net loss	<u>46¢</u>	<u>55¢</u>

See notes to financial statements.

PEND OREILLE MINES & METALS COMPANY

Consolidated Statement of Changes in Financial Position

	Years Ended December 31	
	1972	1971 (Note 1)
SOURCE OF FUNDS:		
Issuance of common stock	\$ 335,250	\$ —
Payments on non-current receivables	300	200,300
	<u>335,550</u>	<u>200,300</u>
APPLICATION OF FUNDS:		
To operations:		
Net loss	1,128,684	1,315,692
Items not requiring funds:		
Equity in net income or loss of subsidiary	—	(143,783)
Depreciation and depletion	(286,330)	(297,275)
Write-down of investment in subsidiary	(300,000)	(858,771)
	<u>542,354</u>	<u>15,863</u>
Additions to properties, plant and equipment	1,563,122	19,652
Additions to other assets	670	—
	<u>2,106,146</u>	<u>35,515</u>
Increase (decrease) in working capital	<u><u>\$(1,770,596)</u></u>	<u><u>\$ 164,785</u></u>
CHANGES IN ELEMENTS OF WORKING CAPITAL:		
Increase (decrease) in current assets:		
Cash	\$ (295,892)	\$ 160,717
Commercial paper and U.S. Treasury obligations	(452,735)	(56,241)
Due from sale of concentrates	(134,027)	(24,669)
Other accounts receivable	178,121	(13,834)
Operating supplies	22,105	(38,919)
Prepaid expenses	(605)	(565)
Refundable federal income tax	(147,027)	132,031
	<u>(830,060)</u>	<u>158,520</u>
Increase (decrease) in current liabilities:		
Notes payable to bank	650,000	—
Accounts payable	(22,040)	(519)
Payroll payable	1,066	(4,263)
Taxes payable	(19,978)	(1,483)
Advances on sale of concentrates	259,401	—
Equipment contracts	72,087	—
	<u>940,536</u>	<u>(6,265)</u>
Increase (decrease) in working capital	<u><u>\$(1,770,596)</u></u>	<u><u>\$ 164,785</u></u>
WORKING CAPITAL (DEFICIT), END OF YEAR	<u><u>\$ (289,417)</u></u>	<u><u>\$1,481,179</u></u>

See notes to financial statements.

PEND OREILLE MINES & METALS COMPANY

Notes to Consolidated Financial Statements

1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES: PRINCIPLES OF CONSOLIDATION:

The consolidated financial statements include, for 1972, the accounts of Pend Oreille Oil & Gas Company, a wholly-owned subsidiary, organized in April of 1972, and the accounts of such subsidiary are included from that date. All intercompany accounts and transactions have been eliminated.

The Company's investment in a 60.33% owned Canadian subsidiary (Reeves MacDonald Mines Limited) is carried in the financial statements at cost adjusted for the Company's equity in accumulated losses since acquisition.

The Company's investment in, on the equity method, and advances to the unconsolidated subsidiary were as follows:

	1972	1971
Cost of 1,410,500 shares (estimated market value: 1972, \$846,300 1971, \$1,057,875)	\$639,065	\$639,065
Equity in net loss since acquisition	(639,065)	(639,065)
	—	—
Advances to subsidiary—represented by unsecured interest bearing notes	850,000	850,000
Provision for decline in valuation	(300,000)	—
	550,000	850,000
Total	\$550,000	\$850,000

The aggregate advances to this subsidiary of \$850,000 at December 31, 1971, have been reduced by \$300,000 to \$550,000 at December 31, 1972, based upon management's estimated realization to the Company of these advances.

The Company's equity in the net assets of Reeves MacDonald Mines Limited, excluding advances, was \$717,046 and \$821,771 at December 31, 1972 and 1971, respectively.

The financial statements for the year 1971, presented herein for comparative purposes, reflect the accounts of the parent company (Pend Oreille Mines & Metals Company) and include the operating results of Reeves MacDonald Mines Limited on the equity basis.

INVENTORIES:

Inventories of supplies are stated at the lower of cost (first-in, first-out method) or market.

OIL AND GAS PROPERTIES:

The Company follows the accounting policy of capitalizing all exploration and development costs, including the cost of non-productive drilling, surrendered acreage and delay rentals, relating to the development of its oil and gas reserves. Such capitalized costs will be amortized on a composite pool basis, on the units-of-production method, over the estimated productive life of its oil and gas properties.

In 1972, the Company, through specific performance of certain drilling operations under farmout agreements, earned a 55% and 20% working interest in leases covering approximately 2,200 and 1,200 acres, respectively, located in southern Louisiana. Of the three wells drilled in 1972, one was successfully completed, tested and shut-in pending negotiation of a gas contract; one was drilled and tested with inconclusive results; and the third well is presently being drilled and tested.

Drilling in 1972 resulted in proved net reserves applicable to the Company's working interest of 10,725,000 MCF of gas and 429,000 barrels of condensate, per a reserve study dated February 28, 1973, obtained from independent petroleum consultants. At December 31, 1972, the total capitalized cost amounted to \$1,424,743.

PEND OREILLE MINES & METALS COMPANY

Notes to Consolidated Financial Statements (continued)

MINERAL PROPERTIES, PLANT AND EQUIPMENT:

The Company's producing mineral properties and related buildings and equipment are carried at cost. At December 31, 1972 and 1971, respectively, the cost and related provisions for accumulated depletion and depreciation were as follows:

	1972		1971	
	Cost	Provision for Depletion and Depreciation	Cost	Provision for Depletion and Depreciation
Mining property, development and land	\$4,162,472	\$2,870,018	\$4,162,472	\$2,713,050
Buildings, plant and equipment	<u>3,907,009</u>	<u>3,716,499</u>	<u>3,954,008</u>	<u>3,772,515</u>
	<u>\$8,069,481</u>	<u>\$6,586,517</u>	<u>\$8,116,480</u>	<u>\$6,485,565</u>

The "units mined" method is used in computing depletion of producing mineral properties. Depreciation of buildings, plant and equipment is provided for by using the straight-line method over the estimated remaining useful life of the assets.

LOSS PER SHARE:

The loss per share is based upon the weighted quarterly average number of shares outstanding in each year.

2 - NOTES PAYABLE TO BANK:

In December, 1972, the Company obtained a short-term \$650,000 bank loan. The note is collateralized by 1,410,500 shares of Reeves MacDonald Mines Limited stock owned by the Company together with the stock and guarantee of the Company's wholly-owned subsidiary, Pend Oreille Oil & Gas Company. Such guarantee prohibits any secured encumbrance by the Subsidiary on any lease and leasehold interests until the note has been repaid.

3 - FEDERAL INCOME TAXES:

The Company anticipates that it will file, with its subsidiary, a consolidated Federal income tax return. At December 31, 1972, the Company has available, as a deduction from future income otherwise subject to income tax, aggregate carry-forward losses of \$875,000, of which \$151,000 may be carried forward to years through 1976 and \$724,000 to years through 1977.

4 - PENSION PLAN:

The Company (parent) has pension plans covering both hourly and salaried employees. Because of the availability of actuarial gains, no charges to income for pension costs were required for 1972 and 1971. The unfunded past service costs for the plans totaled \$47,927 at December 31, 1972. The past service liability for the hourly and salaried plans is being amortized over a period of 30 years and 15 years, respectively.

5 - COMMITMENTS AND CONTINGENT LIABILITIES:

The Company's wholly-owned subsidiary has a commitment in connection with turnkey drilling contracts incomplete at December 31, 1972, which total \$574,000. In addition, negotiations are in process on an agreement for drilling of a fourth well, the cost of which will approximate \$530,000.

6 - CAPITAL STOCK AND CAPITAL SURPLUS:

The Company (parent) issued 176,712 shares of its common stock in payment for certain turnkey drilling and Ecuadorian concession costs. The excess of the market value (\$158,538) over the par value of the shares of stock issued was credited to and increased capital surplus to \$3,053,689 at December 31, 1972.

PEND OREILLE MINES & METALS COMPANY

Notes to Consolidated Financial Statements (continued)

7 – EXTRAORDINARY ITEMS:

The 1972 extraordinary items consist of:

A \$300,000 provision for decline in valuation (without Federal income tax effect) of the Company's investment represented by a note receivable from Reeves MacDonald Mines Limited. This provision is based upon management's estimated realization to the Company of this investment (see note 1).

A write-off of \$104,525 (without Federal income tax effect) incurred by the Company's subsidiary, Pend Oreille Oil & Gas Company, of Ecuadorian concession interests due to the continuing political uncertainties in that country.

The 1971 extraordinary items consist of:

During 1971, exploration work which was carried on by Reeves MacDonald Mines Limited failed to prove the presence of ore zones which had previously been reported as indicated. Accordingly the directors of the subsidiary company determined that provision in the amount of \$1,600,000 be made to reduce the value assigned to mining properties to reflect its limited ore reserve position. The charge against income for the Company's equity in the extraordinary item was \$858,771.

AUDITORS' REPORT

To the Board of Directors and Stockholders of
Pend Oreille Mines & Metals Company

We have examined the consolidated balance sheet of Pend Oreille Mines & Metals Company as of December 31, 1972, and the related consolidated statements of operations, deficit and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. We did not examine the financial statements of Pend Oreille Oil & Gas Company, a consolidated wholly-owned subsidiary, or Reeves MacDonald Mines Limited, an unconsolidated Canadian subsidiary, which statements were examined by other independent accountants whose reports thereon have been furnished to us. We made a similar examination for the year ended December 31, 1971.

In our opinion, based upon our examination and the reports of other accountants referred to above, the aforementioned consolidated financial statements present fairly the financial position of Pend Oreille Mines & Metals Company and subsidiary at December 31, 1972, and the results of their operations and changes in their financial position for the year then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Spokane, Washington
March 19, 1973

LeMASTER & DANIELS
Certified Public Accountants

PEND OREILLE OIL & GAS COMPANY

Incorporated under the laws of the State of Delaware, April, 1972
Capitalization – 1,000 shares of a par value of \$1.00 each (\$1,000)
of which 1,000 shares were outstanding at December 31, 1972.
MAIN OFFICE, 923 Old National Bank Building, Spokane, Washington

Directors

ROBERT H. ALLEN	Houston, Texas
ROBERT E. BROWN	Kellogg, Idaho
WRAY D. FARMIN	Spokane, Washington
R. R. McNAUGHTON	Victoria, B. C.
WM. M. WOLF	Houston, Texas
F. G. WOODRUFF	Houston, Texas

Officers

F. G. WOODRUFF, President	Houston, Texas
WM. M. WOLF, Vice President	Houston, Texas
D. D. WILSON, Secretary and Treasurer	Spokane, Washington
D. M. ROSE, Assistant Secretary	Houston, Texas

PEND OREILLE OIL & GAS COMPANY

(A Wholly-Owned Subsidiary of
Pend Oreille Mines & Metals Company)

BALANCE SHEET – DECEMBER 31, 1972 (NOTE 1)

ASSETS

CURRENT ASSETS:

Cash	\$ 209,745
Account receivable from Bradco Oil & Gas Company	187,888
Total current assets	<u>397,633</u>

OIL AND GAS PROPERTIES, at cost (Note 2)	1,424,743
--	-----------

OTHER ASSETS	670
	<u>\$1,823,046</u>

LIABILITIES AND STOCKHOLDER'S INVESTMENT

CURRENT LIABILITIES:

Accounts payable	\$ 5,442
Non-interest bearing advances from parent	1,921,129
Total current liabilities	<u>1,926,571</u>

COMMITMENTS AND CONTINGENT LIABILITIES (Note 3)

STOCKHOLDER'S INVESTMENT:

Common Stock, \$1.00 Par; authorized and outstanding 1,000 shares	1,000
Retained earnings (deficit) – loss from operations for the period from inception (April 24, 1972) to December 31, 1972, resulting from a write-off of Ecuadorian concession costs . .	(104,525)
	<u>(103,525)</u>
	<u>\$1,823,046</u>

The accompanying notes are an integral part of this statement.

PEND OREILLE OIL & GAS COMPANY

(A Wholly-Owned Subsidiary of
Pend Oreille Mines & Metals Company)

STATEMENT OF CHANGES IN FINANCIAL POSITION FOR THE PERIOD FROM INCEPTION (APRIL 24, 1972) THROUGH DECEMBER 31, 1972

(NOTE 1)

SOURCE OF FUNDS:

Net Loss from operations	\$ (104,525)
Issuance of Common Stock	1,000
Non-interest bearing advances from Parent	<u>1,921,129</u>
	<u>\$1,817,604</u>

APPLICATION OF FUNDS:

Working capital, exclusive of non-interest bearing advances from Parent —	
Cash	\$ 209,745
Accounts receivable	187,888
Accounts payable	<u>(5,442)</u>
	<u>392,191</u>
Additions to oil and gas properties —	
Land and mineral properties	202,513
Intangible drilling costs	1,079,153
Lease and well equipment	<u>143,077</u>
	<u>1,424,743</u>
Other assets	<u>670</u>
	<u>\$1,817,604</u>

The accompanying notes are an integral part of this statement.

AUDITORS' REPORT

To the Stockholder and Board of Directors of
Pend Oreille Oil & Gas Company:

We have examined the balance sheet of Pend Oreille Oil & Gas Company (a Delaware corporation and a wholly-owned subsidiary of Pend Oreille Mines & Metals Company), as of December 31, 1972, and the related statement of changes in financial position for the period from inception (April 24, 1972) to December 31, 1972. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying balance sheet and the statement of changes in financial position present fairly the financial position of Pend Oreille Oil & Gas Company, as of December 31, 1972, and changes in financial position for the period from inception (April 24, 1972) to December 31, 1972, in conformity with generally accepted accounting principles.

Houston, Texas
February 28, 1973

ARTHUR ANDERSEN & CO.

PEND OREILLE OIL & GAS COMPANY

NOTES TO FINANCIAL STATEMENTS

December 31, 1972

1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Organization -

Pend Oreille Oil & Gas Company is a wholly-owned subsidiary of Pend Oreille Mines & Metals Company and was organized in April, 1972, primarily to participate with Bradco Oil & Gas Company in the exploration and development of oil and gas leases located in southern Louisiana. Gulf Resources & Chemical Corporation, through one of its wholly-owned subsidiaries, owns 35% of Pend Oreille Mines & Metals Company.

During the period from inception to December 31, 1972, the parent company advanced \$1,921,129 to the Company, which amount included \$335,250 of assigned value of 176,712 shares of the parent company's common stock advanced to the Company for its use in paying certain turnkey drilling and Ecuadorian concession costs. The Ecuadorian concession interests, which were acquired for 100,000 shares of the parent company stock (assigned value of \$100,000) and cash of \$4,525, were written off as of December 31, 1972, due to the continuing political uncertainties in that country.

Oil and Gas Properties -

The Company follows the accounting policy of capitalizing all exploration and development costs, including the cost of non-productive drilling, surrendered acreage and delay rentals, relating to the development of its oil and gas reserves. Such capitalized costs will be amortized on a composite pool basis, on the units-of-production method, over the estimated productive life of its oil and gas properties.

General and Administrative Expenses -

All general and administrative expenses, incidental to the management of the Company, have been absorbed by the parent company and Gulf Resources & Chemical Corporation.

Federal Income Taxes -

The Company anticipates that it will join with its parent in filing a consolidated Federal income tax return and will compute its Federal income taxes on a separate return basis. Intangible drilling costs which have been capitalized for accounting purposes as described in Note 1, will be deducted currently for income tax purposes.

2 - OIL AND GAS PROPERTIES

In 1972, the Company, through specific performance of certain drilling operations under farmout agreements, earned a 55% and 20% working interest in leases covering approximately 2,200 and 1,200 acres, respectively, located in southern Louisiana. Of the three wells drilled in 1972, one was successfully completed, tested and shut-in pending negotiation of a gas contract; one was drilled and tested with inconclusive results; and the third well is presently being drilled and tested.

Drilling in 1972 resulted in proved net reserves applicable to the Company's working interest of 10,725,000 MCF of gas and 429,000 barrels of condensate, per a reserve study dated February 28, 1973, obtained from independent petroleum consultants. At December 31, 1972, the total capitalized cost amounted to \$1,424,743.

3 - COMMITMENTS AND CONTINGENT LIABILITIES:

The Company's commitment in connection with turnkey drilling contracts incomplete at December 31, 1972, totaled \$574,000. In addition, negotiations are in process on an agreement for drilling of a fourth well, the Company's cost of which will approximate \$530,000.

In December 1972, the parent company obtained a short-term \$650,000 loan from a bank, which has been fully guaranteed by the Company. Such guarantee prohibits any secured encumbrance by the Company on any leases and leasehold interests until the note has been repaid. The parent has pledged the stock of the Company as collateral under the loan agreement.

REEVES MacDONALD MINES LIMITED

Incorporated under the Laws of the Dominion of Canada

Authorized Capital: 3,000,000 Shares of \$1.00 each

REGISTERED OFFICE

Suite 105, 465 Ward St.
NELSON, B.C.

DIRECTORS

WRAY D. FARMIN	Spokane, Washington
C. H. HAMILTON	Nelson, B.C.
R. R. McNAUGHTON	Victoria, B.C.
F. G. WOODRUFF	Houston, Texas

OFFICERS

F. G. WOODRUFF, President	Houston, Texas
R. R. McNAUGHTON, Vice President	Victoria, B.C.
L.M. KINNEY, Vice Pres., Mining	Metaline Falls, Washington
C. H. HAMILTON, Secretary	Nelson, B.C.
D. D. WILSON, Treasurer & Assistant Sec.	Spokane, Washington

MAIN OFFICE

Remac, B.C.

TRANSFER AGENTS

Canada Permanent Trust Company
Vancouver, B.C. Toronto, Ontario

AUDITORS

Thorne, Gunn & Company
Vancouver, B.C.

SOLICITORS

Davis & Co., Vancouver, B.C.

REEVES MacDONALD MINES LIMITED

March 30, 1973

To our Shareholders:

Your directors submit herewith the Annual Report for the year ended December 31, 1972, which includes audited financial statements compared with those for the year ended December 31, 1971.

Operations produced 180,188 tons of ore during the year as compared with 191,385 tons during 1971. Concentrates produced yielded 1,810,154 lbs. lead, 23,694,241 lbs. zinc, 280,588 lbs. cadmium and 284,971 ozs. silver. Total revenues for concentrates produced amounted to \$2,549,325, as compared with \$2,589,094 for the year 1971.

Additional operating statistics for 1972, as compared with 1971, are included in the following pages of this report.

A drift to the west on the 1250 level of the Annex, which was started during the first part of the year, intersected a mineralized zone of potentially commercial value. Development of this area was pursued during the latter part of the year including track installation and installation of a required second exit to prepare for mining. Limited production of commercial ore was achieved in December of 1972 and is continuing in 1973. The dimensions of this zone have not been established and there are no reliable ore reserve estimates available.

Drifting east in the 1000 level of the Annex, which was started in 1971, encountered mineralization approximately 2,200 feet east of the Annex shaft early in 1972. To further evaluate this zone a portion of the "Old Reeves" workings and the 240 drift under the Pend Oreille River, previously abandoned, were rehabilitated. The 240 drift was driven under the river to explore the East Annex mineralization at lower depths. Drifting and cross-cutting has intercepted scattered mineralization approximately 800 feet below the contact made on the 1000 East Annex drift. Lack of continuity in these interceptions has not allowed management to make a qualified estimate of reserves in this area. A 600,000 tons "probable" reserve figure has been used as a basis for computing depreciation and depletion and for projecting future operations.

Average metal prices for the years 1972 and 1971 are compared as follows. Prices are as quoted by "Metals Week" and are in U.S. dollars.

	<u>1972</u>	<u>1971</u>
Lead (lb.)	\$.151	\$.138
Zinc (lb.)	.177	.161
Silver (oz.)	1.68	1.55
Cadmium (lb.)	2.56	1.97

Current prices (March 2) are: Lead \$.160, Zinc \$.193, Silver \$2.48 and Cadmium \$3.75.

It is necessary and prudent that shareholders be reminded that much of the uncertainty for continued operation of the Reeves MacDonald property, as detailed in the annual report for the year ended December 31, 1971, still exists. Present strength for higher metal prices is definitely a plus factor. However, the development of other factors — labor costs, pollution control requirements, smelter charges, development of ore reserves, foreign exchange rates, etc. — will also affect the future of the Company.

We report with regret the death, on October 20, 1972, of W. W. Witherspoon, who served as director of the Company since 1958. His expertise in corporate management was of great benefit to the Company.

Wray D. Farmin, director of the Company since 1949 and president from 1967 to 1971, has requested retirement from the Board of Directors at the annual shareholders' meeting. Mr. Farmin's request is being accepted with reluctance and acknowledgement is given to his long and faithful service to the Company.

Respectfully,

F. G. WOODRUFF,
President

REEVES MacDONALD MINES LIMITED

OPERATING HI-LITES FOR THE YEAR ENDED DECEMBER 31, 1972 (with comparative figures for 1971)

OPERATING COSTS

	1972		1971	
	180,188		191,385	
	Amount	P/Ton	Amount	P/Ton
Tons Ore Milled				
Mining	\$1,684,689	\$ 9.34	\$1,412,730	\$ 7.38
Milling	244,510	1.36	277,706	1.45
Other Direct Costs	324,025	1.80	380,559	1.99
Administrative & General	29,932	.17	30,340	.16
Property Taxes	35,657	.20	34,522	.18
Interest	42,733	.24	61,092	.32
TOTAL	\$2,361,546	\$13.11	\$2,196,949	\$11.48

MINE STATISTICS

Drifting — Feet	9,422	8,023
Raising — Feet	1,461	1,525
Man Shifts worked	20,883	25,772
Diamond & Long-hole exploratory drilling — Feet	20,455	32,863

(Expressed in Canadian Funds)

REEVES MacDONALD MINES LIMITED

(Incorporated under the laws of Canada)
BALANCE SHEET AT DECEMBER 31, 1972
 (with comparative figures at December 31, 1971)

ASSETS

	<u>1972</u>	<u>1971</u>
CURRENT ASSETS		
Cash	\$ 377,216	\$ 235,414
Accounts receivable	12,059	5,637
Concentrate settlements outstanding	145,938	132,913
Stores and materials, at cost	118,116	132,400
Prepaid expenses	20,706	21,042
	<u>674,035</u>	<u>527,406</u>
 BUILDINGS, PLANT AND EQUIPMENT, at cost	 4,268,772	 4,219,330
less accumulated depreciation (note 1)	3,238,952	2,995,652
	<u>1,029,820</u>	<u>1,223,678</u>
 MINING PROPERTIES,		
at cost less realizations and depletion (Note 1)	292,622	329,957
 DEFERRED CHARGES		
Development and exploration expenditure less amortization (Note 1)	303,488	408,151
	<u>\$2,299,965</u>	<u>\$2,489,192</u>

LIABILITIES

CURRENT LIABILITIES		
Accounts payable and accrued liabilities	\$ 201,820	\$ 203,704
Notes payable (Note 2)	909,604	909,604
	<u>1,111,424</u>	<u>1,113,308</u>

SHAREHOLDERS' EQUITY

SHARE CAPITAL		
Authorized — 3,000,000 shares of \$1 each, issued and fully paid — 2,338,000 shares	2,338,000	2,338,000
 CONTRIBUTED SURPLUS		
Arising from conversion of no par value shares to par value shares in 1938	221,136	221,136
 DEFICIT	 1,370,595	 1,183,252
	<u>1,188,541</u>	<u>1,375,884</u>
	<u>\$2,299,965</u>	<u>\$2,489,192</u>

(Expressed in Canadian Funds)

REEVES MacDONALD MINES LIMITED

STATEMENT OF INCOME AND DEFICIT YEAR ENDED DECEMBER 31, 1972 (with comparative figures for 1971)

	<u>1972</u>	<u>1971</u>
OPERATING REVENUES:		
Gross value of concentrates produced less smelter charges		
1972 includes refund of foreign surcharge of \$76,446 relating to 1971)	\$2,731,222	\$2,825,652
Less transportation charges	<u>181,896</u>	<u>236,558</u>
	<u>2,549,326</u>	<u>2,589,094</u>
COSTS AND EXPENSES		
Cost of production	2,237,289	2,062,551
General and administrative expense	71,261	73,306
Interest on long-term debt	42,671	61,092
Amortization (Note 1)	101,163	204,075
Depreciation (Note 1)	243,300	462,923
Depletion (Note 1)	37,335	63,249
Outside exploration	<u>3,650</u>	<u>3,011</u>
	<u>2,736,669</u>	<u>2,930,207</u>
	187,343	341,113
Gain realized on foreign exchange	<u>—</u>	<u>12,090</u>
	187,343	329,023
Loss before income taxes and extraordinary item	<u>—</u>	<u>93,000</u>
Income tax recovery		
Loss before extraordinary item — 8 cents per share; 1971 — 10 cents	187,343	236,023
Extraordinary item	<u>—</u>	<u>1,600,000</u>
LOSS FOR THE YEAR		
8 cents per share; 1971 — 78 cents	187,343	1,836,023
Deficit (retained earnings) at beginning of year	1,183,252	(643,970)
Unclaimed dividends forfeited	<u>—</u>	<u>8,801</u>
DEFICIT AT END OF YEAR	<u>\$1,370,595</u>	<u>\$1,183,252</u>

(Expressed in Canadian Funds)

REEVES MacDONALD MINES LIMITED

STATEMENT OF SOURCE AND APPLICATION OF FUNDS YEAR ENDED DECEMBER 31, 1972 (with comparative figures for 1971)

	<u>1972</u>	<u>1971</u>
SOURCE OF FUNDS:		
Operations		
Loss before extraordinary item	\$ (187,343)	\$ (236,023)
Items not involving current funds		
Depreciation	243,300	462,923
Amortization	101,163	204,075
Depletion	37,335	63,249
Deferred income taxes	—	(93,000)
	<u>194,455</u>	<u>401,224</u>
Recovery of development and exploration expenditures	3,500	—
Unclaimed dividends forfeited	—	8,801
	<u>197,955</u>	<u>410,025</u>
 APPLICATION OF FUNDS		
Expenditure on buildings, plant and equipment	49,442	60,354
Reduction of long-term debt	—	1,123,604
	<u>49,442</u>	<u>1,183,958</u>
 INCREASE (DECREASE) IN WORKING CAPITAL	148,513	(773,933)
 WORKING CAPITAL (DEFICIENCY) AT BEGINNING OF YEAR	(585,902)	188,031
 WORKING CAPITAL (DEFICIENCY) AT END OF YEAR	<u>\$ (437,389)</u>	<u>\$ (585,902)</u>

(Expressed in Canadian Funds)

REEVES MacDONALD MINES LIMITED

NOTES TO FINANCIAL STATEMENTS YEAR ENDED DECEMBER 31, 1972

1 – DEPRECIATION, DEPLETION AND AMORTIZATION

The Company's policy is to provide for depreciation of buildings, plant and equipment, depletion of mining properties, and amortization of deferred charges over the estimated life of the mining property.

2 – NOTES PAYABLE

The Company has current notes payable to Pend Oreille Mines and Metals Company (parent) of \$909,604 (\$850,000 U.S.) currently bearing interest at 5 $\frac{3}{4}$ %. This amount includes an unrealized foreign exchange gain of \$63,323.

3 – INCOME TAXES

The Company has applied for the income from the Annex Mine to be exempt for three years from August 1, 1970, under the Income Tax Act.

4 – DIRECTORS' AND OFFICERS' REMUNERATION

The five directors of the Company received no remuneration for 1972. Of the five officers of the Company, one received remuneration of \$1,200 during 1972; two officers are also directors.

AUDITORS' REPORT

To the Shareholders of
Reeves MacDonald Mines Limited

We have examined the balance sheet of Reeves MacDonald Mines Limited as at December 31, 1972, and the statements of income and deficit and source and application of funds for the year then ended. Our examination included a general review of the accounting procedures and such tests of accounting records and other supporting evidence as we considered necessary in the circumstances.

In our opinion these financial statements present fairly the financial position of the company as at December 31, 1972, and the results of its operations and the source and application of its funds for the year then ended, in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Vancouver, B.C.
January 29, 1973

Thorne, Gunn & Co.
Chartered Accountants