Annual Report

THE EAGLE-PICHER COMPANY

AND SUBSIDIARIES

FOR THE FISCAL YEAR ENDED

NOVEMBER 30, 1949

A MODERN, DIVERSIFIED COMPANY SERVING HOME AND INDUSTRY

Annual Report

THE EAGLE-PICHER COMPANY
AND SUBSIDIARIES

To the Shareholders of
THE EAGLE-PICHER COMPANY:

The annual report of your Company for the fiscal year ended November 30, 1949, together with financial statements as reported upon by Messrs. Barrow, Wade, Guthrie & Company, independent accountants, is presented herewith in advance of the Annual Meeting of Shareholders to be held on March 28, 1950.

SUMMARY

Net sales of The Eagle-Picher Company and domestic subsidiaries for the year ended November 30, 1949, amounted to $63,349,821, compared with $79,478,724 for the year ended November 30, 1948, a decrease of 20.3%.

Net credit to surplus amounted to $2,747,147, equivalent to $3.09 per share, compared with $4,067,741, or $4.57 per share, in 1948. The net credit to surplus in 1949 was after a transfer of $4,704,441 from the reserve for future decline in inventory values, while in 1948 it was after an appropriation of $1,500,000 to that reserve.

At November 30, 1949, the net worth of your Company (i.e. Capital and Surplus) was $24,113,250, compared with $22,966,441 at the close of the preceding fiscal year. Net current assets decreased from $14,195,110 at the end of the 1948 fiscal year to $12,753,933 at November 30, 1949.

VOLUME OF BUSINESS

Consolidated net sales for the year ended November 30, 1949, amounted to $63,349,821, compared with $79,478,724 for the year ended November 30, 1948, a decline of 20.3%. A portion of the decline in dollar sales was due to lower metal prices. The average price of lead (New York) was 18.043¢ per pound in 1948 and 15.364¢ per pound in 1949; the average price of zinc (East St. Louis) was 13.589¢ per pound in 1948 and 12.144¢ per pound in 1949.

The volume of business handled by the Mining and Smelting Division was more nearly normal. Tri-State mills treated 2,618,917 tons of ore and produced therefrom 104,077 tons of concentrates. Corresponding figures for 1948 were 2,091,790 tons of ore and 88,177 tons of concentrates. Slab zinc production at the Henryetta, Oklahoma, smelter amounted to 42,398 tons. Operations at the St. Xavier mine and Sahuarita mill, near Tucson, Arizona, produced 20,419 tons of concentrates, compared with 18,658 tons in 1948. Operations in the Illinois mines were started in April, 1949, and to November 30 had produced 7,242 tons of concentrates. Currently, about 2,000 tons of concentrates per month are being produced in Illinois.

Sales in dollars in the Manufacturing Divisions of your Company showed a decline of 24.9%. The decline came at different times of the year in varying degrees for different products. For example, when the price of lead started to decline, the retailer of batteries, fearful that he might sustain inventory losses, sold out of stock. In turn, the manufacturer, wanting to reduce his inventory to a minimum, purchased less lead oxides than he was consuming. Consequently, even though sales to the public held up well in many lines where our products were used, the reduction in inventories caused a considerable decrease in our sales. Unseasonable weather also had an adverse effect on sales of some products, such as oxides used in the manufacture of replacement batteries, and on sales of home insulation and aluminum storm windows and screens.

We believe that our customers' inventories are at a minimum for the present rate of business and that our sales in 1950 should be at the approximate rate of sales to the consumer.

EARNINGS

Net credit to surplus for the fiscal year ended November 30, 1949 amounted to $2,747,147, equivalent to $3.09 per share, compared with $4,067,741, or $4.57 per share, for the fiscal year ended November 30, 1948. Several items in the statement of profit and loss and earned surplus merit explanation.

The large reduction in gross operating profit before depletion and depreciation is due, in part, to lower sales volume and, in part, to the fact that production and manufacturing costs in 1949 reflect the absorption of substantial inventory price declines.

For the year ended November 30, 1949, taxable profits required a provision for Federal and State income taxes of $1,364,000 and losses resulted in a carry-back credit of $1,731,000. The net of these two items — $367,000 — is a credit to the profit and loss and earned surplus account. Also during the year, we obtained clearance of our Federal income taxes for the years ended November 30, 1942, 1943, 1944, and 1945. The settlement released an excess provision in the reserve of $287,900 and this amount was restored to earned surplus by a credit through the profit and loss account.

Your management has long been cognizant of the fact that in companies such as Eagle-Picher, where raw materials are a major factor in costs and where principal commodities fluctuate widely at times, profits are abnormally high in rising markets and abnormally low in declining markets. A policy of providing a reserve for future decline in inventory values by appropriations from income was instituted in the fiscal year ended November 30, 1941. This reserve, which amounted to $1,300,000 at November 30, 1946, was increased at November 30, 1947 to $4,600,000, an amount sufficient to margin the metal content of inventories to 6.5¢ per pound for lead and 5¢ per pound for zinc. To maintain this margin, it was necessary to increase the reserve to $6,600,000 at November 30, 1948.

The metal content of lead and zinc in our inventories at November 30, 1946, 1947, and 1948, totaled 51,979 tons, 55,173 tons, and 42,896 tons, respectively. The latter figure was the Company's lowest inventory tonnagewise, with one minor exception, in the last twenty years and we entered the 1949 fiscal year in a most favorable position from a tonnage standpoint.

During 1949, prices of lead and zinc fluctuated widely, as shown by the following tabulation:

Price in Effect on	Lead New York	Price in Effect on	Zinc E. St. Louis
December 1, 1948	21.50¢	December 1, 1948	17.50¢
March 8, 1949	19.50	March 28, 1949	16.00
March 14	18.00	April 5	15.00
March 28	17.00	April 14	14.00
April 1	16.00	April 19	13.00
April 6	15.00	April 28	12.50
May 6	14.00	May 9	12.00
May 23	13.00	May 24	11.00
May 26	12.00	June 2	10.75
July 8	13.00	June 8	10.00
July 12	13.50	June 9	9.50
July 13	14.00	June 15	9.00
July 25	14.25	July 18	9.50
July 26	14.50	July 25	10.00
August 2	14.75	September 1	10.00-10.50
August 8	15.00-15.125	September 8	10.00
August 18	15.125	October 3	9.25
September 26	14.75	October 27	9.50
October 3	14.25	November 1	9.75
October 7	13.75	November 9	9.75-10.00
October 14	13.00	November 14	9.75
November 10	12.75		
November 16	12.50		
November 21	12.00		

From the above, it will be noted that lead was selling at 21.5¢ per pound at the start of our fiscal year on December 1, 1948. Beginning with March 8, 1949, there were eight price reductions to and including May 26, when the price became 12¢ per pound. This was a decline of 9.5¢ per pound or 44% in 80 days. It was the most rapid decline in the price of lead over the period of years for which statistics are available. From a low of 12¢ on May 26, it rose in eight successive steps to 15.125¢ on August 18 and declined to 12¢ on November 21, the price in effect at the close of 1949.

Fluctuations in zinc were similar to those in lead. Zinc was selling at 17.5¢ per pound at the start of the year. It was reduced to 16¢ on March 28 and reached a low of 9¢ on June 15. This was a decline of 8.5¢ or 48% in 80 days. At the close of 1949, zinc was selling at 9.75¢.

Initially, the reserve for future decline in inventory values was funded by investment in short-term U. S. Government obligations. When this fund had grown so large that investment in such low yield securities seemed to exact too great a penalty, the reserve was deducted from the value of inventories. Both of these procedures were adopted for the purpose of cushioning the effect upon working capital and current ratios of the price declines which it was felt certain would ultimately have to be sustained. In recent years, the Securities and Exchange Commission has expressed the opinion that this reserve should not be deducted from inventories but should be shown on the liability side of the balance sheet as a surplus reserve. As an alternative, we had the option of going on the so-called base-stock method, whereunder predetermined base-stocks are carried at fixed prices. This generally accepted accounting method, in effect, permits the application of reserves in reduction of inventories. Hence, as at November 30, 1949, we elected to adopt this method. At that date, the metal content of lead and zinc in inventories totaled 35,871 tons, consisting of 18,895 tons of lead and 16,976 tons of zinc. After careful consideration, your management fixed 15,000 tons of lead and 10,000 tons of zinc as base stocks, which should be minimums under almost any circumstances. To carry these tonnages of lead and zinc at 6.5¢ and 5¢ per pound, respectively, required a reserve at November 30, 1949 of $1,895,559, thereby releasing $4,704,441 of the previously accumulated reserve for credit to earned surplus through the profit and loss account.

We believe that the reserve method of accounting has given our shareholders a better picture of our operations than if we had not created and used the reserve for future decline in inventory values. The following table is interesting if one bears in mind that the prices of lead on November 30, 1946, and November 30, 1949, were 11.8¢ and 12¢ per pound, respectively, and the prices of zinc on the same dates were 10.5¢ and 9.75¢ per pound, respectively.

	1947	1948	1949	Total
Net Profit or (Loss) for fiscal year	$6,605,842	$5,567,741	($1,957,294)	$10,216,289
Transfer from (1949) and appropriations to (1947 and 1948) the reserve for future decline in inventory values	(3,000,000)	(1,500,000)	4,704,441	204,441
Net credit to surplus	$3,605,842	$4,067,741	$2,747,147	$10,420,730

From the above, it should be noted that the accumulated net profit for the three years, before any adjustments to or from the reserve, totaled $10,216,289, and the net credit to surplus, after adjustments to and from the reserve, totaled $10,420,730. The appropriations to the reserve in the two years ended November 30, 1947 and 1948, when prices were rising, totaled $4,500,000 and the transfer from this reserve in the past year of declining prices amounted to $4,704,441. So the three-year cycle of postwar adjustment resulted in a net charge of $204,441 to the reserve for future decline in inventory values. In other words, had no reserve been created, the net credit to surplus for the three fiscal years of 1947, 1948, and 1949 would have been $204,441 less than under the reserve method used.

While it is true that the procedures followed have had the effect of leveling earnings, particularly during the last three years, this was not the primary purpose. As consistently explained in previous annual reports since the inauguration of the inventory reserve, the real purpose was to set aside, from indicated earnings, profits realized solely from appreciation of inventories, which disappeared when the cycle reversed itself and inventory values declined.

FINANCIAL POSITION

At November 30, 1949, the net worth of your Company was $24,113,250, equivalent to $27.12 per share, compared with $22,966,441, or $25.83 per share at November 30, 1948.

Net working capital at November 30, 1949 amounted to $12,753,933, as compared with $14,195,110 at the close of the previous fiscal year, a decrease of $1,441,177. Current ratios were 4.4:1 and 2.4:1 at the respective balance sheet dates.

The decrease of $1,441,177 in net current assets is explained by the following:

Funds Provided			
Net Credit transferred to surplus			$2,747,147
Add:			
Provision for depletion and depreciation		$1,477,895	
Miscellaneous non-cash items, net		38,589	1,516,484
			4,263,631
Funds Applied			
Capital additions — less retirements, etc.		2,621,787	
Dividends paid		1,600,337	
Increase in investments in and advances to —			
Mexican subsidiaries	$843,613		
Associated company	203,000	1,046,613	
Increase in other assets, net		436,071	5,704,808
Decrease in working capital during year			$1,441,177

The increase of $843,613 in investments in and advances to Mexican subsidiaries substantially completes the investment necessary to place the mines at San Pedro and Parral in operation. Since operations there are in the preliminary stages, it is too early to forecast intelligently the results to be expected from these operations.

The net additions to the property account in 1949, after adjustments, exceeded depletion and depreciation charges by $1,089,076. Since the program of rehabilitation, modernization, and expansion of mining and production facilities, inaugurated several years ago, was practically completed during the past fiscal year, it now appears that capital expenditures in 1950 will probably be less than current depletion and depreciation charges.

At the close of the previous fiscal year, your Company owned a majority interest in the Alston-Lucas Company, manufacturers of paints sold principally under the Alston-Lucas brand name. In the early part of 1949, it was decided that a new line of interior and exterior paints, enamels, and varnishes should be produced and sold under the Eagle-Picher brand. In connection therewith, it became desirable to purchase the minority interest in the Alston-Lucas Company. This was done, the Alston-Lucas Company was liquidated, and the assets and liabilities were transferred to the Paint and Varnish Division of The Eagle-Picher Company.

DIVIDENDS

The regular quarterly dividend of 45¢ per share, inaugurated in March, 1948, was maintained throughout the year.

On January 24, 1950, your Board of Directors declared a regular quarterly dividend of 30¢ per share, payable March 10. Even though the Company is in a strong financial position, the directors felt that a reduction in the rate of the dividend at this time was prudent and to the best interests of all stockholders. During 1947, 1948, and 1949, dividends declared amounted to $4,534,287.60 or about 45% of earnings for those years. On the other hand, due to acquisitions and the expansion and modernization program, net current assets actually decreased during this period. It was felt, therefore, that dividends should be kept on a conservative basis and, if possible, working capital should be increased. With the capital expenditure program practically completed and with no additional acquisitions contemplated in the near future, should earnings exceed expectations and should working capital improve faster than anticipated, the Directors undoubtedly will give consideration to increasing the amount paid out in dividends.

There seems to be a rather general opinion that the volume of business activity in 1950, while probably somewhat lower than that in 1949, will be high and that many of those industries which have undergone sizeable readjustments in 1949 will do better in 1950.

The principal favorable factors in the business outlook for 1950 are: (1) building activity should be at a high level; (2) farm income, although somewhat lower than 1949, will remain large; and (3) government spending will continue at a high rate.

Many industries have passed through a period of wholesome postwar adjustment without impairment of confidence. Consumer income is high, liquid assets in the hands of the public are very large, and ready purchasing power will be increased further by the distribution of 2.8 billion dollars in insurance dividends to veterans.

On the other hand, our shareholders, our customers, and our employees undoubtedly are more interested in the long-term outlook rather than in the immediate future.

On the long-term favorable side, we believe that the most important influence will be the tremendous increase in population which has taken place in the past decade. It has been estimated that the 1950 census will show the population of the United States to be in excess of 151 million, or 19 million more than in 1940. This is the largest increase in population in any ten-year period in the history of the country, and there is no present indication that the rate of growth is slowing down materially. The tremendous economic significance of this increase in population cannot be discounted.

On the unfavorable side from the long-term viewpoint, the most important single factor, with the possible exception of the international situation, is the unsound fiscal policy of our Federal government. It seems inconceivable that the Federal government must run at a deficit in excess of 5 billion dollars in a year of high income and high taxes. If we must continually increase debts against the future, if we must continue to have waste and extravagan in government, then there can be but one answer — the purchasing power of the dollar will decline, our standard of living will be lowered, and democracy will have failed. We believe that the great majority of our shareholders favor a balanced budget. There are two possible ways that this can be accomplished: (1) by increasing revenue through higher or additional taxes or (2) by eliminating useless and unnecessary expenses. It would be most constructive from an economic standpoint if the latter possibility were given serious consideration by more of our representatives in Congress. It seems evident that what this country needs is a period of stability in which there is a slow but steady rise in the purchasing power of the dollar, based upon a steady increase in the efficiency of labor and a steady decline in the cost of government.

One thing is certain — competition in the next decade will be keener than in any other period in our history. In an attempt to be prepared for this competition, we have improved our mining and manufacturing facilities, we have continued to diversify our business, we have instituted cost reduction programs in all of our divisions, and we have emphasized the necessity of a capable, efficient, hard-hitting organization. As a result of this preparation, we believe that your Company is in a position to continue its progress in the era that lies ahead.

Your management wishes to take this opportunity to express its appreciation of the help, cooperation, and assistance which it has received from the Board of Directors and members of the organization without which the results accomplished would not have been possible.

y order of the Board of Directors.

Joel M. Bowlby
Chairman

T. Spencer Shore
President

CINCINNATI, OHIO
FEBRUARY 23, 1950

Consolidated Balance Sheets

ASSETS

	NOVEMBER 30, 1949		NOVEMBER 30, 1948	
CURRENT ASSETS:				
Cash in banks and on hand		$ 3,157,534.34		$ 5,527,541.40
U. S. Government obligations — at cost (market value at November 30, 1949 — $626,438.81)		625,000.00		625,007.30
Accounts and notes receivable	$ 5,168,837.30		$ 8,175,227.58	
Less: Reserve for doubtful accounts and notes	373,452.38	4,795,384.92	392,581.87	7,782,645.71
Inventories of raw materials, work in process, finished products and supplies:				
Ores, metals and metal-bearing products — Note 1	5,006,050.64		12,536,263.94	
Less: Reserve for future decline in values			6,600,000.00	
			5,936,263.94	
Other products, merchandise for resale, and manufacturing materials and supplies — at cost	2,920,257.93	7,926,308.57	4,045,520.81	9,981,784.75
		16,504,227.83		23,916,979.16
OTHER ASSETS:				
Repair parts and maintenance supplies	1,032,561.54		1,046,997.76	
Investment in and advances to associated company and sundry securities — at or below cost	270,872.43		67,959.43	
Miscellaneous accounts and advances	108,757.47	1,412,191.44	139,310.17	1,254,267.36
INVESTMENT IN AND ADVANCES TO FOREIGN SUBSIDIARIES NOT CONSOLIDATED—NOTE 2:				
Mexican subsidiaries	2,934,669.77		2,091,057.27	
Canadian subsidiaries	748,472.78	3,683,142.55	770,904.98	2,861,962.25
FIXED AND INTANGIBLE ASSETS:				
Mining lands and leases; mills, smelters and fabricating plants; and railroad and miscellaneous properties	41,919,810.58		40,160,810.20	
Less: Reserves for depletion, depreciation, etc.	29,586,707.94		28,916,783.38	
	12,333,102.64		11,244,026.82	
Cost of stocks of consolidated subsidiaries in excess of book value, at dates of acquisition, of net assets acquired	1,409,833.07		1,375,505.50	
Patents, goodwill, etc.	1.00	13,742,936.71	1.00	12,619,533.32
TREASURY STOCK—10,924 shares at cost		61,797.56		61,797.56
PREPAID AND DEFERRED CHARGES:				
Prepaid freight, insurance, etc.	213,824.50		180,737.05	
Miscellaneous deferred charges	394,768.24	608,592.74	203,221.39	383,958.44
		$36,012,888.83		$41,098,498.09

NOTE 1 — As of November 30, 1948, the inventories of ores, metals and metal-bearing products were valued at the lower of cost or market value of metal content plus manufacturing costs on materials in process and finished products. The reserve for future decline in inventory values, amounting to $6,600,000 at that date, was deducted therefrom.

As of November 30, 1949, the base-stock method of inventory valuation was applied to base quantities of 15,000 tons of lead and 10,000 tons of zinc at fixed prices based on 6.5 cents per pound for lead (New York) and 5 cents per pound for zinc (East St. Louis). The remainder of the inventory metal content was priced, as heretofore, at the lower of average cost or market. To effect this change, $1,895,559 was required to reduce the values of the base-stock inventories to their fixed values and the reserve for future decline in inventory values, amounting to $6,600,000, was eliminated. The net credit to earned surplus from these adjustments was $4,704,441.

On the basis of valuing metal content at the lower of average cost or market plus manufacturing costs on materials in process and finished products, the aggregate value of ores, metals and metal-bearing products was $6,901,609.64 as of November 30, 1949, comparable to $12,536,263.94 as of November 30, 1948.

AND DOMESTIC SUBSIDIARIES

at November 30, 1949 and 1948

LIABILITIES

	NOVEMBER 30, 1949		NOVEMBER 30, 1948	
CURRENT LIABILITIES:				
Accounts payable		$ 1,922,349.53		$ 4,148,369.51
Dividend payable		400,084.20		400,084.20
Accrued liabilities:				
Wages and salaries	$ 340,872.04		$ 551,963.47	
Taxes — other than taxes on income	202,038.77		258,692.37	
Other	244,630.78	787,541.59	340,198.57	1,150,854.41
Provision for Federal and State taxes on income — less refund claims		640,319.00		4,022,561.76
		3,750,294.32		9,721,869.88
PURCHASE MONEY OBLIGATION:				
Payable serially to March 1, 1952	663,994.56		937,384.71	
Less: Contingent obligation, payable from earnings of acquired subsidiary, if and to the extent earned, not in excess of	441,361.25		441,361.25	
Fixed obligation	222,633.31		496,023.46	
Less: Payments due currently (included in accounts payable)	88,272.25	134,361.06	273,390.15	222,633.31
THREE PER CENT NOTES—PAYABLE SERIALLY SEPTEMBER 1, 1953 TO SEPTEMBER 1, 1967		7,500,000.00		7,500,000.00
RESERVES FOR SELF INSURANCE:				
Workmen's compensation	386,508.80		375,466.41	
Fire and tornado	128,473.70	514,982.50	121,415.00	496,881.41
MINORITY INTEREST IN CONSOLIDATED SUBSIDIARY				190,672.43
COMMON STOCK — par value $10:				
Authorized . . . 1,000,000 shares				
Issued and outstanding . . . 900,000 shares		9,000,000.00		9,000,000.00
SURPLUS:				
Capital surplus	1,900,999.32		1,900,999.32	
Earned surplus — per accompanying statement — Note 3	13,212,251.63	15,113,250.95	12,065,441.74	13,966,441.06
		$36,012,888.83		$41,098,498.09

Note 2 — The equity of The Eagle-Picher Company and domestic subsidiaries in foreign subsidiaries not consolidated has increased $72,640.87 since dates of acquisition, as a result of profits, losses and dividend distributions. During the year ended November 30, 1949 such equity decreased $574,679.12 as a result of net losses of the foreign subsidiaries.

Note 3 — The 3% notes contain a covenant which, so long as any of the notes remain outstanding, restricts the amount which may be declared as dividends (other than those payable in stock of the Company) or applied in the purchase, redemption or retirement of the Company's capital stock. At November 30, 1949 the amount available for such purposes was $3,266,570.26.

THE EAGLE-PICHER COMPANY AND DOMESTIC SUBSIDIARIES

Consolidated Statements of Profit and Loss and Earned Surplus

FOR THE YEARS ENDED NOVEMBER 30, 1949 AND 1948

	NOVEMBER 30, 1949		NOVEMBER 30, 1948	
NET SALES		\$63,349,821.96		\$79,478,724.59
PRODUCTION AND MANUFACTURING COSTS		59,790,554.33		64,746,592.48
GROSS OPERATING PROFIT — before depletion and depreciation		3,559,267.63		14,732,132.11
EXPENSES:				
Selling	\$2,311,324.41		\$2,062,949.02	
Traffic, warehousing and shipping	577,583.79		717,523.50	
General and administrative	1,953,329.08	4,842,237.28	2,179,660.52	4,960,133.04
NET OPERATING INCOME OR (LOSS) — before depletion and depreciation:				
Mining and manufacturing		(1,282,969.65)		9,771,999.07
Northeast Oklahoma Railroad Company		462,485.63		385,843.54
		(820,484.02)		10,157,842.61
OTHER INCOME		94,404.11		204,275.52
		(726,079.91)		10,362,118.13
INTEREST PAID:				
On long term debt	225,000.00		225,000.00	
Other	55,988.30	280,988.30	11,936.94	236,936.94
		(1,007,068.21)		10,125,181.19
DEPLETION, DEPRECIATION, ETC.:				
Provision for depletion and depreciation	1,477,895.03		1,027,694.53	
Exploration and prospecting expenses and loss or gain on disposition of capital assets	127,231.24	1,605,126.27	238,069.92	1,265,764.45
NET PROFIT OR (LOSS) — before Federal and State Income taxes		(2,612,194.48)		8,859,416.74
FEDERAL AND STATE INCOME TAXES:				
Provision for year				3,360,000.00
Net taxes recoverable from carry-back of net operating losses	367,000.00			
Excess provision for prior years' taxes	287,900.17	654,900.17		
		(1,957,294.31)		5,499,416.74
MINORITY INTEREST IN NET LOSS OF CONSOLIDATED SUBSIDIARY				68,324.85
NET PROFIT OR (LOSS) FOR YEAR		(1,957,294.31)		5,567,741.59
CREDIT arising from transfer of reserve for future decline in inventory values, less adjustment to reduce base-stock inventories to their fixed values (1949-Note 1); and appropriation to reserve (1948)		4,704,441.00		(1,500,000.00)
NET CREDIT TO EARNED SURPLUS		2,747,146.69		4,067,741.59
EARNED SURPLUS AT BEGINNING OF YEAR		12,065,441.74		9,598,036.95
		14,812,588.43		13,665,778.54
DIVIDENDS PAID AND ACCRUED		1,600,336.80		1,600,336.80
EARNED SURPLUS AT END OF YEAR		\$13,212,251.63		\$12,065,441.74