DOMCO

DOMCO INDUSTRIES LIMITED

CORPORATE PROFILE
116th YEAR

Since its founding in 1872, the Domco organisation has specialized in the design and manufacture of quality resilient floorings and the distribution, world-wide, of these and related products. Today, the Company exports approximately 25 per cent of the vinyl flooring materials produced in its plant at Farnham, Province of Quebec.

Domco employs over 600 persons. With its people, the Company's objectives are to satisfy the needs of its customers; to provide superior value to consumers; to develop a return on investment to shareholders and to give stable employment to its employees.

Total sales in 1986 were $112 million. The Company maintains Service Centres across Canada and in the United States and Australia.

Domco Industries Limited is a publicly owned company; its shares are traded on the Montreal Stock Exchange.

The Annual Meeting of the Shareholders will be held at 11:00 A.M. on March 5, 1987 at the Head Office of the Company, 10,050 Côte-de-Liesse, Lachine, Province of Quebec.

Printed in Canada

Si vous désirez recevoir ce rapport en français,
veuillez vous adresser au secrétaire,
10050 Côte-de-Liesse,
Lachine, Québec H8T 1A3

OFFICERS

Germain Perreault
Chairman of the Board
and of the Executive Commitee

Francesco Pace
President and Chief Executive
Officer

Alfred Magnus Kinsman
Vice-President

Gilles Leblanc
Secretary-Treasurer

DIRECTORS

Giancarlo Cappello
Zurich
Managing Director,
Curator Auditing

John Ney Cole
Montreal
Financial Consultant

Marc A. Donolo
Montreal
President,
Louis Donolo Inc.

***Joan Fobin**
Montreal
Vice-President,
Acmon Ltd.

Roger Caron
Farnham
Chairman of the Board,
Aronelle Création Inc.

Raffaele Girotti
Rome
Vice-President,
Acmon Ltd.

Alphonse Lepage
Montreal
Executive Vice-president and
Chief Operating Officer,
Canadian Reassurance Company

René Menkès
Montreal
Senior Partner,
Webb, Zerafa, Menkès
& Housden, Architects

***Francesco Pace**
Montreal
President and Chief Executive
Officer

***Germain Perreault, O.C.**
Outremont
Chairman of the Board and
of the Executive Committee

***Michael P.J. Rusko, Q.C.**
Montreal
Partner,
Lafleur, Brown, de Grandpré
Lawyers

Claude Simard
Montreal
President,
Clauremiand Limitée

*Member of Executive
Committee

HEAD OFFICE
10,050 Côte-de-Liesse, Lachine,
Quebec

PLANT
1001 Yamaska Street East,
Farnham, Quebec

SUBSIDIARIES
MANUFACTURERS HOLDINGS LIMITED
10,050 Côte-de-Liesse, Lachine,
Quebec

DOMCO SERVICE CENTRE PTY. LIMITED
Unit 2, 29 Victoria Ave.
Castle Hill, N.S.W. 2154, Australia

DIVISIONS
DOMCOR — DELTAL
26 Borden Ave., Dartmouth, N.S.
6150, des Grandes-Prairies Blvd.,
St-Leonard, Quebec
2665, Dalton Street, Ste-Foy,
Quebec
2770 Sheffield Rd., Ottawa,
Ontario
3545 Nashua Drive, Mississauga,
Ontario
1310 Mountain Avenue, Winnipeg,
Manitoba
4020 - 9th Street S.E., Calgary,
Alberta
16520 - 117th Ave., Edmonton,
Alberta
120 - 2471 Simpson Rd.,
Richmond, B.C.
1410-I-35 Plaza 35 Building "A",
Carrollton, Texas
1341 Howard Street, Elk Grove
Village, Illinois
7461 Brokerage Drive, Orlando,
Florida

TRANSFER AGENT & REGISTRAR
Trust Général du Canada
Montréal

AUDITORS
Hyde Houghton
Chartered Accountants

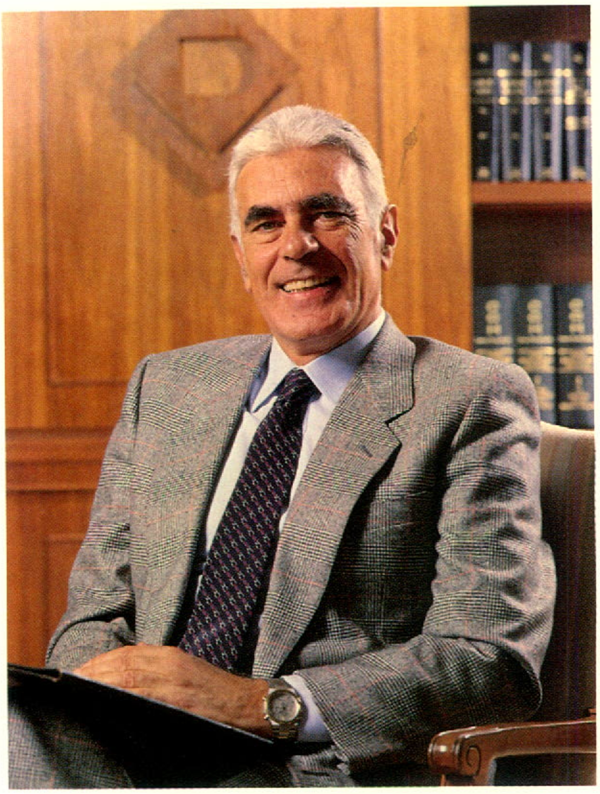
FINANCIAL HIGHLIGHTS

	1986	1985	1984	1983	1982
Earnings from operations (loss)	$ **9,615,312**	$ 10,540,989	$ 6,026,067	$ 3,377,736	$ (4,760,233)
Net earnings for the year (loss)	**5,527,712**	6,506,169	4,522,763	3,377,736	(3,928,233)
Earnings per share (loss)	**0.97**	1.21*	0.84*	0.62*	(0.73)*
Consolidated sales	**112,928,349**	100,540,030	86,387,039	78,064,405	57,720,178
Working capital	**32,271,382**	23,362,727	18,406,315	15,628,086	12,661,693
Working capital ratio	**2.58:1**	2.16:1	1.86:1	1.63:1	1.60:1
Retained earnings	**17,301,113**	15,923,094	11,216,521	8,133,435	4,755,699
Book value per share	**6.81**	5.32*	4.45*	3.88*	3.25*
Dividend per share	**0.67**	0.33*	0.27*	NIL	NIL

QUARTERLY RESULTS

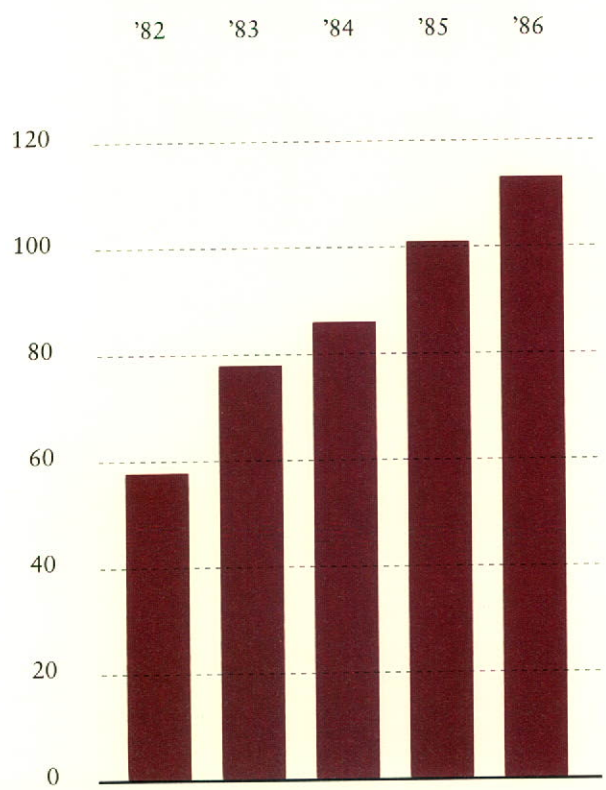
(in 000's) Fiscal Year Ended October 31, 1986	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Year
Sales	$ 21,910	$ 32,036	$ 25,813	$ 33,169	**$ 112,928**
Net earnings	647	1,416	586	2,879	**5,528**
Earnings per share	$ 0.12	$ 0.26	$ 0.11	$ 0.48	**$ 0.97**
(in 000's) Fiscal Year Ended October 31, 1985					
Sales	$ 19,081	$ 26,790	$ 26,030	$ 28,639	**$ 100,540**
Net earnings	820	1,345	1,535	2,806	**6,506**
Earnings per share	$ 0.15*	$ 0.25*	$ 0.28*	$ 0.53*	**$ 1.21***

**Restated to give effect to a three-for-one share split on March 31, 1986*



Francesco Pace
President and Chief Executive Officer

CONSOLIDATED SALES
$ millions



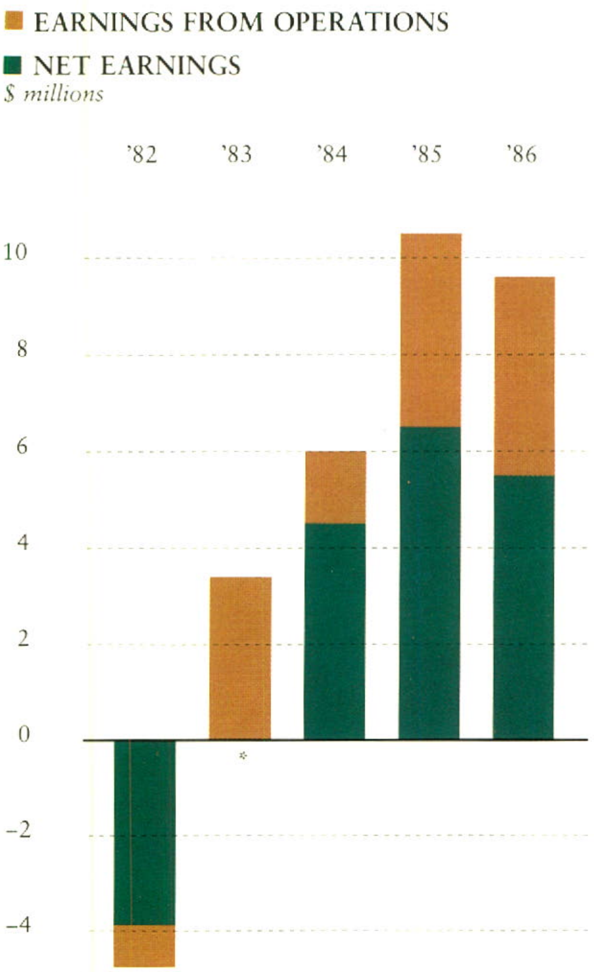
The Board of Directors has pleasure in presenting the Annual Report of the Company with the Consolidated Financial Statements and Auditors' Report for the year ended October 31, 1986.

FINANCIAL RESULTS

Sales in 1986 continued the upward trend experienced since 1983, rising to $112,928,000 which represents an increase of 12% over 1985. An increase of 18% in exports contributed to the overall growth.

Net earnings in 1986 were $5,527,712 or $0.97 per common share compared to 1985 earnings of $6,506,169 or $1.21 per share. The 1986 earnings per share reflected the issue of 1,000,000 common shares on July 25, 1986. The 1985 earnings per share were restated to reflect a three-for-one share split on March 31, 1986. These events are discussed later in this message.

The sustained efforts of the Company to branch out into new markets and to gain a greater share of existing markets did not come without cost. Marketing and distribution expenses were increased to develop and promote new lines and strengthen the Company's presence in the United States. A new distribution centre was opened in Australia and distribution facilities in Ottawa and Quebec were expanded. During the rapid growth of prior years, a heavy burden was placed on existing middle and upper management and administrative resources. In 1986, managerial and professional technical staff was added to provide the expertise required for the more complex and expanded operations. This is considered an investment to provide a base for future development and growth.



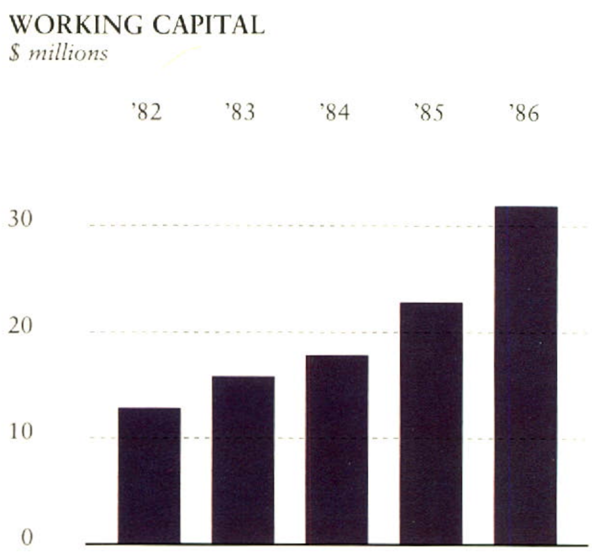
*Earnings from Operations = Net Earnings

Following the completion of a significant portion of the modernization project in Farnham in October 1985 and the early part of 1986, expenses for depreciation and amortization increased from $1,657,000 in 1985 to $2,432,000 in 1986.

Income taxes took a larger bite in 1986, as tax rates increased and certain tax advantages were removed. Also, previously accumulated income tax benefits were fully utilized in 1985. As a consequence, the effective tax rate rose from 38.3% in 1985 to 42.5% in 1986.

Working Capital in 1986 rose by $8,909,000 to $32,271,000. This increase was mainly caused by higher accounts receivable and inventories. The general sales growth, combined with increased activities in the commercial and contract sector required extended credit terms causing higher investment in receivables. Continuing tight controls over credit terms proved successful in keeping bad debts even lower than in 1985, despite the higher amount outstanding.

Inventories at the end of the 1985 fiscal year were at a level considered too low to sustain sales growth and, therefore, had to be increased. Inventories were added in the U.S. warehouses to ensure availability of stock for



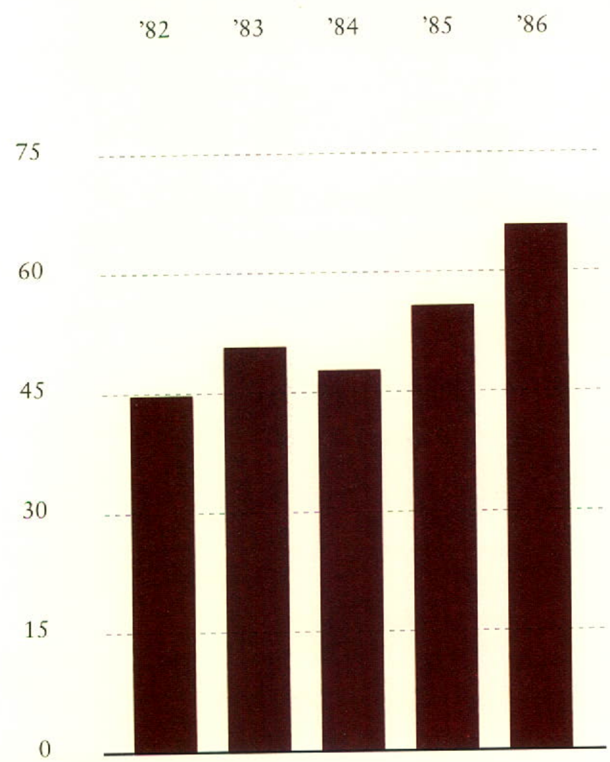
efficient service and continuity of a full range of vinyl products for new distributors. The Domco Service Centre in Australia had to be stocked with an initial investment in inventories, to provide reliable service. This is one of the strengths upon which the Company intends to build up the South Pacific market.

SIGNIFICANT EVENTS

One important event in the fiscal year was the issuance of 1,000,000 common shares on July 25, 1986. In preparation for the new stock issue, the existing common shares were split three-for-one on March 31, 1986.

The net proceeds of the new issue of 1,000,000 shares were $12,699,000, and were in part applied against the long-term bank debt of the Company, amounting to $8,070,000. The balance reduced short-term indebtedness. The new financing leaves the Company well poised for future investments or acquisitions should the opportunity arise.

TOTAL ASSETS
$ millions



On May 7, 1986 Sommer Allibert S.A., a publicly traded French corporation acquired a block of shares from Acmon Ltd., the principal shareholder in Domco Industries Ltd. Following this transaction Acmon and its associates, and Sommer each held at October 31, 1986, 25.89% of the outstanding common shares. This participation by Sommer does not affect the distinct autonomy of Domco Industries Ltd. whose own identity as a Canadian company remains intact.

Sommer Allibert is one of the major European manufacturers of textile and plastic floor and wall coverings as well as automobile plastic parts, garden furniture and bathroom fixtures. Its annual sales are approximately one billion dollars, Canadian.

Your Company has had a working relationship with Sommer for over two years and it is intended that this will now lead to wider diversification in Domco products.

Sommer will be represented on the list of candidates to be submitted for election to the Board of Directors at the Annual Meeting of Shareholders.

DIVIDEND

At a Meeting held on December 18, 1986, the Directors of Domco Industries Limited, based on the results approved for the fiscal year ended October 31, 1986, declared a dividend of $0.50 per share on the common shares of the Company, payable on January 30, 1987 to shareholders of record at the close of business on January 12, 1987.

The Directors also approved a Resolution stating that, beginning with the 1987 fiscal year, the Company intends to introduce semi-annual dividend payments based on current results, payable in July and January of each year.

LITIGATION

With respect to the litigation against Armstrong World Industries, Canada Ltd., damages in the principal amount of $4,725,000 were awarded on May 20, 1986. The parties were heard on July 29 and 30, 1986 on the question of whether or not the Company can recover interest on the principal amount. The final judgment has not yet been rendered and may be subject to appeal. Shareholders will be notified of any new developments.

ACKNOWLEDGEMENTS

On a personal note we were saddened by the death, in December 1986, of The Hon. Lazarus Phillips, O.B.E., Q.C., LL.D.

Senator Phillips was honoured and highly esteemed by the legal, business and philanthropic communities. He was a Director of the Company from 1965 and Chairman of the Board from 1965 to 1979.

Senator Phillips was endowed with a wealth of intelligence and he was steeped in culture to a profound degree. Anyone fortunate enough to have been associated with him could not fail to be intellectually stimulated.

Four Directors, Mr. John N. Cole, Mr. Roger Garon, Mr. René Menkès and Mr. Claude Simard will not be standing for re-election at the forthcoming Annual Meeting of Shareholders. We wish to express our thanks to them for their individual and valuable contributions over the years. It is interesting to note that between them they represent 42 years of service on the Board.

Continuing on a personal note, I want to thank our Chairman, Mr. Germain Perreault, whose long experience and keen judgment are invaluable and, to all Members of the Board I offer my sincere appreciation for their steadfast support.

Thanks are also due to our independent distributors and other customers at home and abroad and to all Domco employees for their enthusiasm and loyalty.

1987

In the last two years a number of important steps have been taken toward laying a foundation for growth.

In 1987 the corporate objectives will be to consolidate the Company's achievements to date and to capitalize on trade advantages whenever offered in the market places, wherever located.

If the economies in general do not flag and it is not widely expected that they will, 1987 should be a year of continued progress.

Francesco Pace
President and Chief Executive Officer

THE DOMESTIC MARKET

Moderate growth in the Canadian market for resilient vinyl floorings continued through 1986.

From industry data available, it appears evident that Domco cushioned sheet vinyl floorings, which account for over ninety per cent of all resilient floorings made and sold by the Company, out-performed the total domestic market essentially increasing market share.

If new housing is considered as an index for the resilient flooring industry which normally it is, the Company's increase in domestic sales, 1986 versus 1985, paralleled the increase in housing starts. These were the highest since 1979. Lower short term interest rates was one of the factors. In Ontario, housing construction was one of the several driving forces behind 1986 economic growth and Ontario and Quebec together accounted for 70% of new housing activity in Canada.

The Domcor Division of Domco Industries Limited primarily distributes across Canada at the wholesale level, the resilient floorings manufactured in the Company's plant at Farnham.

Domcor is also a major wholesale distributor of a wide selection of carpets which continue to be an important factor in the success of the Division. Growth in Domcor carpet sales in 1986 kept pace with the recently revitalised Canadian carpet industry. Domestic mill shipments continued to trend upwards and shifted to more expensive fabrics. Forecasts are for moderated but continuing growth in 1987.

The DOMCOR range of commercial carpet was expanded in 1986 and growth in the commercial sector is expected to continue.

The Deltal Group (which comprises the Contract Section of Domcor) continued to contribute significantly to the Division's success in supplying floorings and specialty wallcoverings for commercial projects. Important inroads were made in the Health-care and Education Market with Domcor/Deltal products being installed in numerous projects in every province in Canada.

Trade show participation in 1987 will continue at the 1986 level with particular emphasis on Hospitality and Food Services. Seminars will be held in Domcor distribution centres across Canada for the purpose of introducing new lines and also to certify technicians for the installation of specialty floor and wall materials.

INTERNATIONAL OPERATIONS

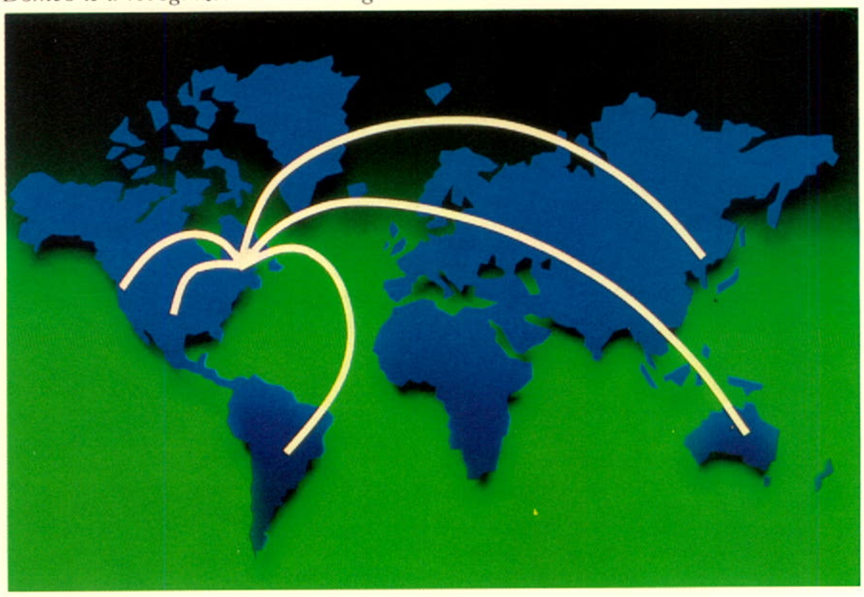
Where practical to do so, it is planned to open Service Centres abroad, with warehousing facilities and staffed by local marketing and sales specialists.

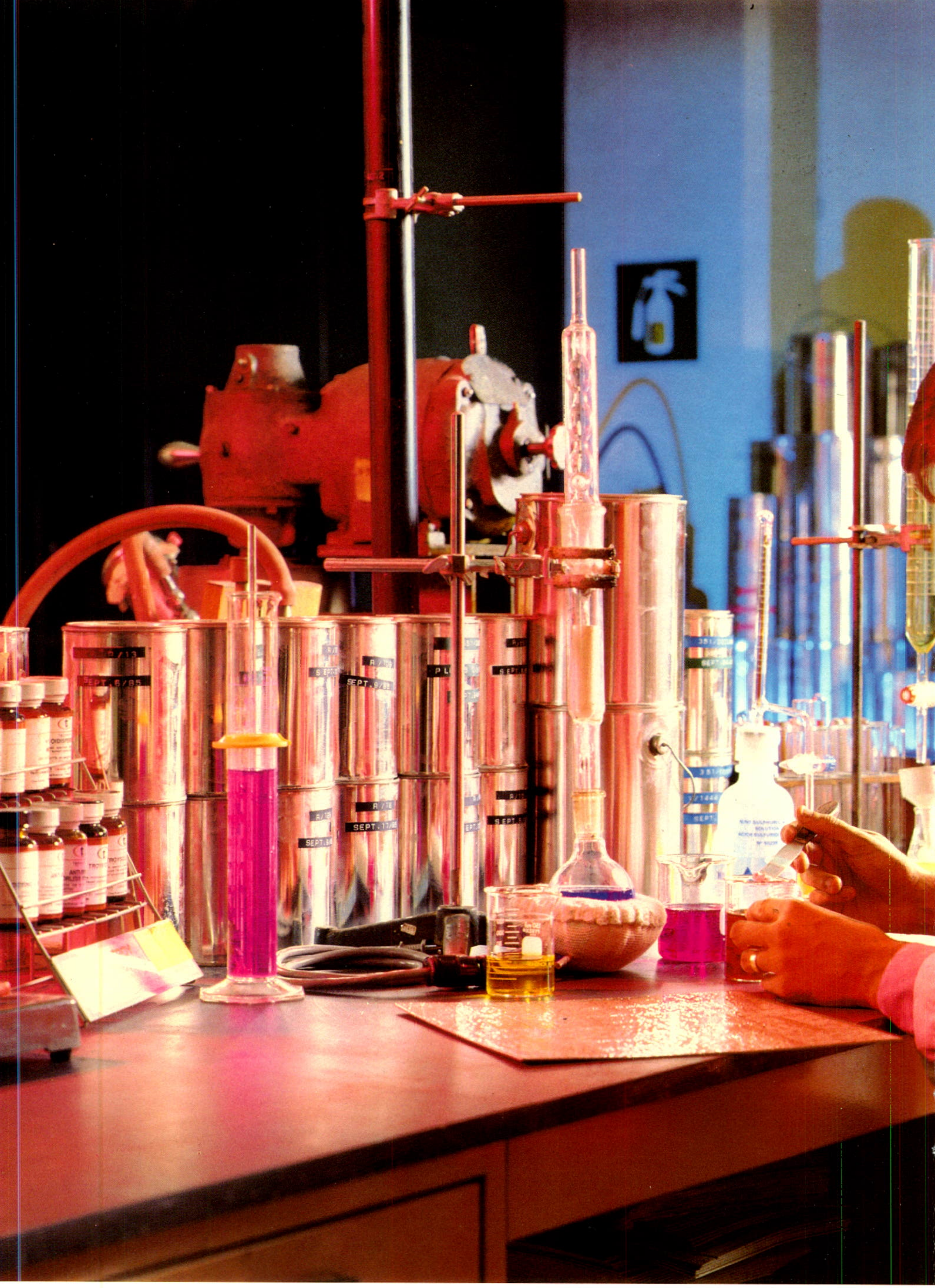
At the present time there are four Service Centres in the U.S. — Orlando (Florida), Chicago, Dallas and Seattle. In addition, a National Service Centre will be opening shortly in Dalton (Georgia). This latter will improve delivery services over an extensive area of the U.S. and facilitate inventory management. This demonstrates the Company's commitment to broaden its participation in the U.S. market. In the meantime the Company is fortunate to have enlisted there an enthusiastic group of distributors and sales growth is promising.

Using a like strategy to that in the U.S., a Service Centre has been opened and staffed in Australia and will serve as a springboard for expansion within Pacific Rim territories such as New Zealand, Fiji, Singapore etc...

In certain international territories where Domco is not represented but where Sommer Allibert has already established connections, co-operative arrangements are to be made when and where deemed advantageous.

Domco is a recognized name throughout the world.

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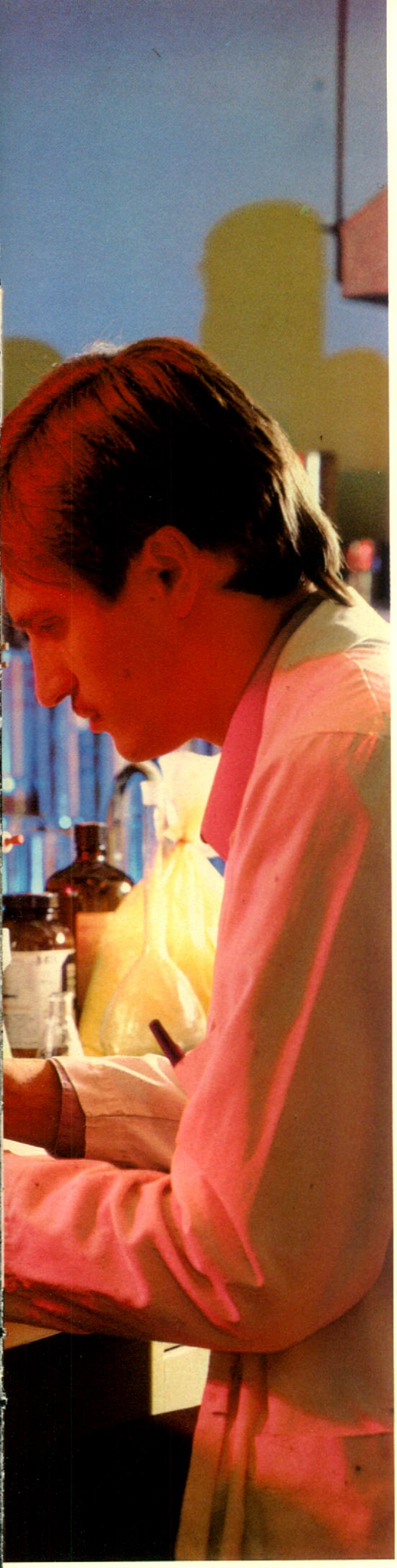


RESEARCH AND DEVELOPMENT

Creativity reaches into many areas of the resilient flooring industry.

It begins with inventive product constructions, thence to imaginative application of design and colour and finally to attractive product presentation and total marketing.

Domco Industries is well prepared in the realm of creativity having its own well-equipped chemical laboratories, pilot plant operations and in-house design studios — all professionally staffed.

Amongst many pursuits, these specialists are presently engaged in the development of floor and wall products oriented to the commercial sector of the market. There is a growing potential, particularly in Canada, for commercial resilient floorings. It is expected that, as new items are released, they will offer more scope to all distributors and be eagerly presented to the people who influence product selection in the contract field.

In the laboratories, up-to-date analytical instruments are used to control stringently, the quality of raw materials through all stages of the manufacturing process to the finished product.

This procedure combined with close co-operation with suppliers ensures high quality performance levels of Domco products.

People at work at the Plant.

MANUFACTURING

During 1986, the two-year capital investment program referred to in the previous Annual Report was substantially completed according to plan.

In 1987, while there will not be very significant additions to fixed manufacturing assets there will be installed in the plant additional anti-pollution devices designed to fulfill all present regulatory requirements.

In the meantime, the technological staffs at Farnham are concentrating upon fine-tuning the recently acquired production equipment — the bugs have already been worked out.

In the fine-tuning process there are three initial objectives:

- to consolidate efficiency gains;
- to increase capacity;
- to improve raw-materials handling & processing.

It will be possible as well to concentrate on the development of new concepts in manufacturing systems and, of course, to make new products to satisfy special market needs.

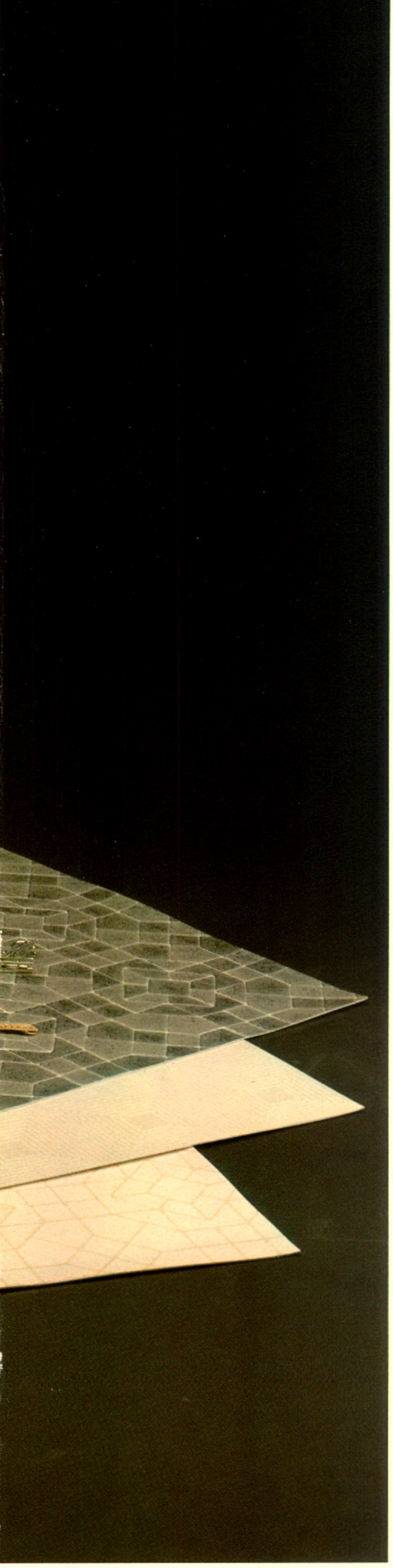
The Domco mill located in Farnham, Quebec.

FLOORS AND FASHION

There was a time when durability was the most important if not the only concern of flooring purchasers in selecting materials for residential or commercial use.

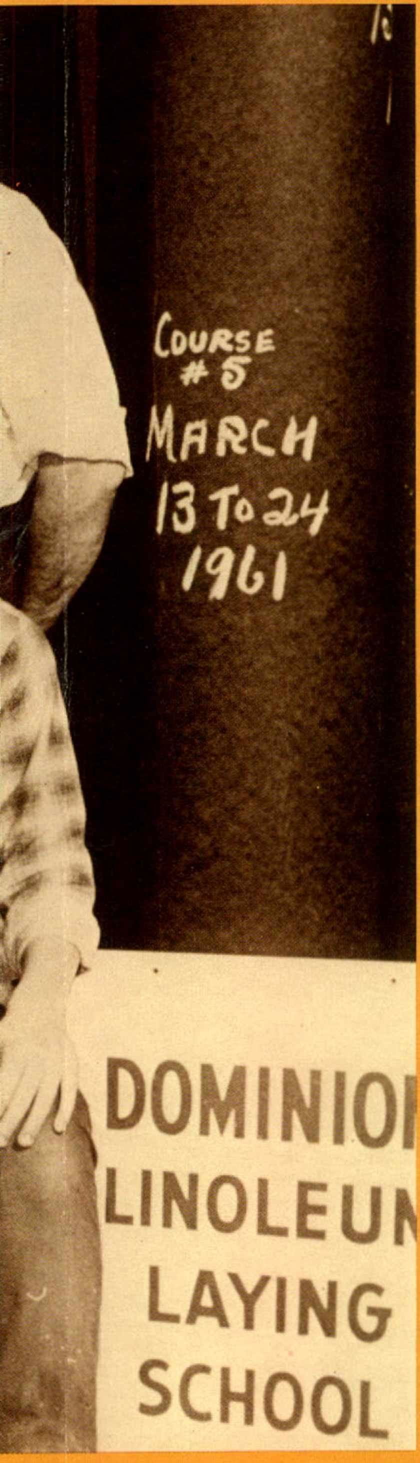
Today design — and — colour — i.e. STYLING — is very often the major consideration in the floor selection process. Domco designs are decorated in tomorrow's colour preferences because the Company's stylists use sophisticated colour-forecasting techniques. It follows that Domco styling is out in front.

Regardless of changing fashions, however, the Company is uncompromising in its commitment to quality control and to the intrinsic quality/value factor which characterizes all Domco products.



One of many designs from Domco's collections.


NOGRIP

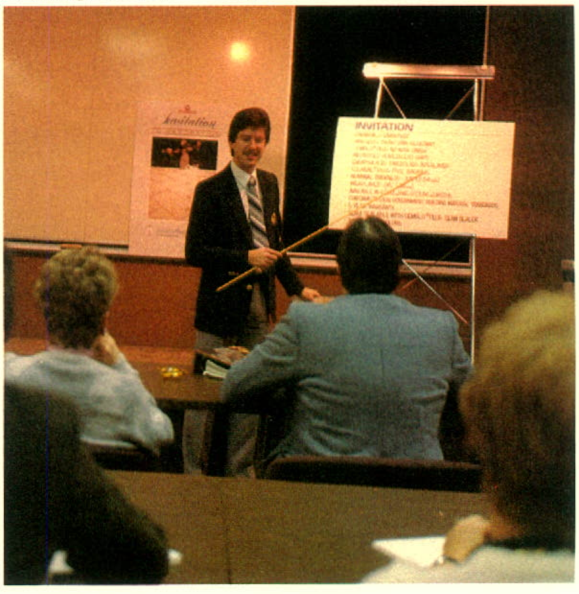


Domco is long on experience but it has also built up a tradition for the "added touch", making available to the trade many extra services — not always provided by other manufacturers.

Included in these services, the Company has long offered product installation courses so that applicators become expert in their trade, ensuring that Domco floorings are correctly installed. It is not recorded exactly when installation courses first began but one can be sure it goes back to when the Company first manufactured Linoleum in Canada eighty-three years ago. Commercial grades of Linoleum were then relatively expensive and professional installation was strongly recommended for product serviceability and lasting customer satisfaction. This training program has not changed except that methods have been refined for today's principal medium which, of course, is vinyl.

Further, in the learning process, the Company organises seminars for discussion and the dissemination of literature covering all areas of the marketing activity. These include product differences, selling techniques, sales promotion tools such as sample displays and their effective use. All the people who either install or sell Domco floorings are offered every opportunity to excel and the instruction seminars are well attended.

Training has been a long tradition at Domco.



MANAGEMENT REPORT

The consolidated financial statements contained in this annual report have been prepared by, and are the responsibility of the Corporation's management. They were prepared in accordance with generally accepted accounting principles. The financial information contained elsewhere in the Annual Report is consistent with that in the financial statements.

The auditor of the Corporation has the responsibility of auditing the said financial statements and giving an opinion on them. He has full access to the Audit Committee to discuss any matters related to the audit, financial reports, and internal controls and procedures employed by the Corporation.

The Corporation is required to have an Audit Committee which is composed of the five following Directors: Mr. Marc A. Donolo, Miss Joan Fobin, Messrs. Francesco Pace, Germain Perreault and Michael Rusko. The Committee reviews the financial statements of the Corporation before such statements are approved by the Board of Directors.

CURRENT VALUE INFORMATION

Guidelines issued by the Canadian Institute of Chartered Accountants in December 1982, require large publicly-held companies to report the effect of changing prices on certain aspects of financial disclosure. This disclosure is required as supplementary information only and is not to be considered as an integral part of the Financial Statements and notes thereto.

In order to qualify under the guidelines, a publicly-held company must have at the beginning of the fiscal year, either:

(a) inventories and property, plant and equipment (before deducting accumulated depreciation, depletion and amortization) totalling $50 million or more; or

(b) total assets (after deducting accumulated depreciation, depletion and amortization) of $350 million or more.

The company qualifies for disclosure under these guidelines by virtue of having inventories and property, plant and equipment totalling $58.7 million at the beginning of the fiscal year 1986.

It is the opinion of management that any adjustment for the change in the value of money would not result in a significant amount, especially during the recent periods of relatively low inflation, and that such disclosure would not add significantly to the understanding of the company's position. Consequently, this information is not disclosed herein.

AUDITORS' REPORT

To the Shareholders,
Domco Industries Limited

We have examined the consolidated balance sheet of Domco Industries Limited as at October 31, 1986 and the consolidated statements of earnings, retained earnings 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 and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the company as at October 31, 1986 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Hyde Houghton
Chartered Accountants

Montreal, Quebec
December 10, 1986

CONSOLIDATED BALANCE SHEET
as at October 31, 1986

	1986	1985
ASSETS		
Current		
Cash	$ 188,085	$ —
Accounts receivable (notes 2 and 5)	22,734,884	18,271,702
Inventories (notes 3 and 5)	27,645,817	22,906,041
Prepaid expenses	2,061,075	2,272,585
	52,629,861	43,450,328
Government assistance grant receivable	—	149,130
Land, buildings and equipment (note 4)	13,065,040	12,045,376
Goodwill	242,624	277,285
	$ 65,937,525	$ 55,922,119
LIABILITIES		
Current		
Bank indebtedness (note 5)	$ 3,846,000	$ 3,232,247
Accounts payable and accrued expenses	15,764,089	13,504,326
Income taxes payable	659,634	1,620,387
Current portion of long-term debt	—	1,730,641
Current portion of obligation under capital lease	88,756	—
	20,358,479	20,087,601
Long-term debt (note 6)	—	7,012,444
Obligation under capital lease (note 7)	387,835	—
Deferred income taxes	1,130,000	90,000
SHAREHOLDERS' EQUITY		
Capital stock (note 8)		
Authorized		
An unlimited number of common shares		
Issued		
6,469,608 shares (1985 — 5,398,788 shares)	26,760,098	12,808,980
Retained earnings	17,301,113	15,923,094
	44,061,211	28,732,074
	$ 65,937,525	$ 55,922,119

Approved by the Board of Directors

F. Pace, Director

J. Fobin, Director

CONSOLIDATED STATEMENT OF EARNINGS
Year ended October 31, 1986

	1986	1985
Sales (note 9)	$ 112,928,349	$ 100,540,030
Cost and expenses		
Cost of sales and production	72,509,688	64,710,076
Administrative, distribution and selling	26,451,192	21,947,184
Depreciation and amortization	2,432,026	1,656,842
Interest on short-term debt	889,751	887,187
Interest on long-term debt	588,712	455,749
Research and development	441,668	342,003
	103,313,037	89,999,041
Earnings before income taxes	9,615,312	10,540,989
Income taxes (note 10)		
Current	3,047,600	2,523,620
Deferred	1,040,000	1,511,200
	4,087,600	4,034,820
Net earnings for the year	$ 5,527,712	$ 6,506,169
Earnings per share (note 11)	$ 0.97	$ 1.21

CONSOLIDATED STATEMENT OF RETAINED EARNINGS
Year ended October 31, 1986

	1986	1985
Balance at beginning of year	$ 15,923,094	$ 11,216,521
Net earnings for the year	5,527,712	6,506,169
	21,450,806	17,722,690
Dividends	3,599,192	1,799,596
Costs of share issue, net of income taxes (note 8)	550,501	—
Balance at end of year	$ 17,301,113	$ 15,923,094

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION
Year ended October 31, 1986

	1986	1985
Operating activities		
Net earnings for the year	$ 5,527,712	$ 6,506,169
Items not affecting cash		
— Depreciation and amortization	2,432,026	1,656,842
— Deferred income taxes	1,040,000	1,511,200
— Loss on disposal of fixed assets	—	32,428
Changes in certain non-cash working capital items	(7,692,438)	(309,248)
Total cash from operating activities	1,307,300	9,397,391
Financing activities		
Proceeds of common share issue, net of costs (note 8)	13,400,617	—
Proceeds of long-term debt	612,117	4,128,960
Payments of long-term debt	(8,878,611)	(314,125)
Dividends	(3,599,192)	(1,799,596)
Total cash from financing activities	1,534,931	2,015,239
Investing activities		
Purchase of fixed assets	(3,417,029)	(6,024,820)
Proceeds of disposal of fixed assets	—	5,000
Government assistance grant receivable	149,130	(149,130)
Cash used for investing activities	(3,267,899)	(6,168,950)
(Decrease) increase in cash and equivalents	(425,668)	5,243,680
Cash and equivalents at beginning of year	(3,232,247)	(8,475,927)
Cash and equivalents at end of year	$ (3,657,915)	$ (3,232,247)

The Company has adopted the cash basis of presentation for the statement of changes in financial position. Cash is net of any bank indebtedness.

1. **Accounting policies**

The company is incorporated under the Canada Business Corporations Act and is engaged in the manufacture and distribution of floor coverings. The accounting policies of the company are in accordance with generally accepted accounting principles. Outlined below are those policies considered particularly significant.

Subsidiaries
The accounts of the subsidiary companies are included in these consolidated financial statements.

Inventories
Inventories are determined by actual count, weight or measurement and are valued at the lower of cost and net realizable value. Cost is determined on the first-in, first-out basis.

Fixed assets and depreciation
Land, buildings and equipment are valued at original cost, net of applicable government assistance grants and investment tax credits claimed.

Depreciation is provided for in the accounts at the following annual rates:

Buildings — 5% diminishing balance method
Equipment — general, 20% diminishing balance method
— vehicles, 30% diminishing balance method
— computers, 5 year straight-line
— cylinders, 10 year straight-line
— engraving rolls, 3 year straight-line
— leasehold improvements, over the lease term

No depreciation is provided for assets under construction.

Goodwill
Goodwill is the result of the excess of purchase price over fair market value of distributorships at the date of purchase and is being amortized on the straight-line basis over a twenty-year period.

Deferred income taxes
The company follows the tax allocation basis of accounting for income taxes under which the provision for income taxes is related to the accounting income for the year. The difference between this provision and taxes actually payable for the year is reflected in deferred income tax expense.

Foreign exchange
Current assets and current liabilities have been converted into Canadian dollars at the exchange rate prevailing at the end of the year. Revenue and expenditure items have been converted at the rate prevailing throughout the year.

2. **Accounts receivable**

Included in accounts receivable are amounts of $701,118 (1985 — $34,662) representing loans made to directors, officers and employees for the purchase of shares under share purchase plans and $99,169 (1985 — $596,516) representing amounts due from government assistance grants.

3. **Inventories**

	1986	1985
Raw materials	$ 2,674,566	$ 3,338,485
Work-in-process	2,018,179	1,326,881
Finished goods	22,953,072	18,240,675
	$ 27,645,817	$ 22,906,041

4. Land, buildings and equipment

	1986	1985
Land	$ 12,389	$ 12,389
Buildings	4,889,987	4,729,678
Equipment	32,651,670	29,343,768
Equipment under capital lease	561,077	—
Projects in progress	1,035,012	1,709,610
At cost	39,150,135	35,795,445
Less: accumulated depreciation	26,085,095	23,750,069
	$ 13,065,040	$ 12,045,376

5. Bank indebtedness

The company has provided security to its bankers under Section 178 of the Bank Act and by a general assignment of book debts.

6. Long-term debt

	1986	1985
Bank term loan — repayable in semi-annual payments of $410,000 together with current proceeds from government grants. Interest is payable at prime until October 1986; prime plus ¼% until October, 1988; and prime plus ½% thereafter. The loan is secured by a commercial pledge on capital equipment purchased in 1985 at a cost of approximately $4,000,000	$ —	$ 8,428,960
Department of Regional Industrial Expansion interest-free development incentive repayable on June 1, 1986	—	314,125
Total long-term debt	—	8,743,085
Current portion	—	1,730,641
	$ —	$ 7,012,444

7. Obligation under capital lease

The following is a schedule of the future minimum lease payments of a capital lease expiring November 1990, together with the balance of the obligation:

Year ending October 31, 1987	$ 138,989
1988	138,989
1989	138,989
1990	138,989
1991	51,226
Total minimum lease payments	607,182
Less: imputed interest @ 11¼%	130,591
Balance of obligation	476,591
Less: current portion	88,756
	$ 387,835

8. Capital Stock

The company obtained a Certificate of Amendment dated March 31, 1986 which authorized a three-for-one split of the outstanding common shares.

On July 25, 1986 the company issued 1,000,000 common shares for a total cash consideration of $13,250,000. Costs of this issue, net of income taxes, are shown in the statement of retained earnings. In addition, 70,820 shares were issued to employees under an Employee Stock Option Plan which was approved on March 14, 1986. Under the terms of the Plan, the monies used to acquire the shares were loaned to the employees by the company (note 2). No options remain to be exercised under this plan.

9. Segmented information

The company considers that its operations fall principally into one geographical area, since its manufacturing operations are located exclusively in Canada.

Export sales were $24,448,538 in 1986 (1985 — $20,695,500).

10. Income taxes

The company's effective income tax rate is made up as follows:

	1986 %	1985 %
Combined basic Federal & Provincial income tax rate and surtax	46.9	46.9
Decrease in income tax rate resulting from		
Manufacturing and processing profit deduction	(3.5)	(1.8)
Inventory allowance	(0.9)	(2.4)
Investment tax credit	—	(0.5)
Other	—	(3.9)
Effective income tax rate	42.5	38.3

11. Earnings per share

Earnings per share have been calculated using the weighted average number of shares outstanding during the current and previous fiscal year, after giving retroactive effect to the three-for-one split of the common shares referred to in note 8.

12. Commitments

The company is committed under operating leases on leased premises which require future minimum rentals for the next five fiscal years as follows:

1987	1988	1989	1990	1991
$ 1,392,523	$ 1,002,902	$ 685,415	$ 577,117	$ 403,839

13. Contingent gain

Following a judgment rendered by the Federal Court of Canada in March 1980 (upheld on appeal by the Supreme Court of Canada), the company was granted the right to damages for patent infringement by Armstrong Cork Canada Limited. Damages, in the principal amount of $4,725,000, were awarded on May 20, 1986 pursuant to a reference to the Federal Court with respect thereto. The Federal Court has not yet ruled on the question of whether or not the company can recover interest on the principal amount. The parties were heard on this matter on July 29, and 30, 1986. The final judgment has not yet been rendered and may be appealed. The company will account for the recovery of damages and related interest, less costs and associated income taxes, when the amount is received. No provision for such recovery has been made in the financial statements.

10-16 Light Misty
10-17 Powder Dust
10-18 Orange Aurora
10-19 Clove Rose
10-20 Mexicana
10-21 Caramel Cream
10-22 Desert Sand
10-23 Sand Bar
10-24 Buff
16-19 Cloud
16-20 Deep Fire
16-21* Cadence
16-22* Dauphin Pink
16-23* Iris Mauve
16-24* Antique Ruby
16-25 Auburn
ADOBE BEIGE
DOVE
LEVEE
ANCIENT BRONZE
GRECO BRONZE
SYROCO
NORWOOD
CELERY SEED
SPONGE GOLD
WILD HONEY
GOLDEN OCHRE
HARVEST
AUTUMN OAK
NEW COPPER
RICH CHOCOLATE
CHILI
RED BARN
REDWOOD
SMOKY BROWN
DARK BROWN
COBRA
SOLAR
HIGH POWER SOLAR CELL
DESK CALCULATOR