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Levy Industries Limited

ANNUAL REPORT

For the Year Ended

December 31, 1985

Levy Industries Limited

PRESIDENT'S REPORT

To The Shareholders

Sales for 1985 increased to $28 million from $22 million in 1984. However, due mainly to provision for uncollectable advances and unforeseen expenses, the company had a loss of $743,000 or $0.77 per share before extraordinary items, compared to a loss of $1,806,000 or $1.61 per share in 1984.

The company is presently going through a difficult transition, as outlined in the notes to the financial statements. In order to improve its financial position, as requested by our bankers, the company has entered into negotiations towards the sale of certain subsidiaries. The company has also entered into a joint venture for the development of the Weston Road property. A 30% equity has been retained and the development is proceeding satisfactorily.

The intention of management is to improve efficiency and productivity by relocating its Auto Parts Division to suitable modern facilities.

Yours truly,

President

Toronto, Ontario
July 14, 1986

Levy Industries Limited

CONSOLIDATED BALANCE SHEET
December 31, 1985

ASSETS

	notes	1985	1984
Current			
Cash		$ 732,319	$ 616,367
Accounts receivable	2	2,845,527	5,448,635
Income taxes recoverable		2,531	703,900
Inventories		15,188,067	15,385,306
Prepaid expenses and sundry assets		372,549	836,515
		19,140,993	22,990,723
Due from parent company		7,049,745	3,401,536
Note receivable	3	291,200	391,040
Property, plant and equipment	4	23,078,891	25,328,054
Other	5	134,048	445,383
		$49,694,877	$52,556,736

LIABILITIES

	notes	1985	1984
Current			
Bank indebtedness	6	$10,812,434	$10,256,211
Accounts payable and accrued liabilities		4,042,392	3,525,027
Income and other taxes payable		197,107	366,459
Current portion of long-term debt	8	1,308,840	1,276,998
		16,360,773	15,424,695
Long-term debt	8	9,249,330	12,035,583
Deferred income taxes		170,370	171,274
Minority interest		1,689	1,689
		25,782,162	27,633,241
Continuing operations	1		
Contingencies	13		

SHAREHOLDERS' EQUITY

	notes	1985	1984
Capital and other equity accounts		23,912,715	24,923,495
		$49,694,877	$52,556,736

See accompanying notes

Approved on behalf of the Board

Morris P. Levy
Director

K.P. Foreht
Director

Levy Industries Limited

CONSOLIDATED STATEMENT OF INCOME
Year ended December 31, 1985

	note	1985	1984
Sales and revenues		$28,118,357	$22,107,428
Costs and expenses			
Cost of products sold		16,752,057	12,162,525
Other operating costs and expenses		9,272,296	8,229,384
Interest on long-term debt		1,296,050	1,087,301
Bank and other interest		1,092,605	1,860,926
Depreciation and amortization		448,644	477,305
		28,861,652	23,817,441
Income (loss) before income taxes		(743,295)	(1,710,013)
Income taxes:			
Current		—	41,216
Deferred (reduction)		—	(253,041)
		—	(211,825)
Income (loss) before undernoted		(743,295)	(1,498,188)
Research and development costs		—	307,500
Minority interest		—	(43)
Income (loss) before extraordinary items		(743,295)	(1,805,645)
Extraordinary items	9	119,797	133,825
Net income (loss)		$ (623,498)	$ (1,671,820)
Earnings (loss) per common share:			
Before extraordinary items		$ (0.77)	$ (1.61)
After extraordinary items		$ (0.68)	$ (1.50)

See accompanying notes

Levy Industries Limited

CONSOLIDATED STATEMENT OF DEFICIT
Year ended December 31, 1985

	note	1985	1984
Balance, beginning of year		$6,887,122	$5,649,613
Net loss		623,498	1,671,820
Dividends paid on Class "A" preference shares		114,433	—
Write off of share issue expenses		272,849	—
Unamortized appraisal excess applicable to property sold		—	(257,466)
Amortization of appraisal excess	1	(176,845)	(176,845)
Balance, end of year		$7,721,057	$6,887,122

See accompanying notes

Levy Industries Limited

CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY
December 31, 1985

		notes	1985	1984
Capital stock				
Authorized				
348,160	Class "A" preference shares, without par value, having a cumulative dividend rate of $.72 per share, redeemable at $12.48 per share			
1,706,033	Common shares, without par value			
Stated capital				
317,870	Class "A" preference shares		$ 3,814,440	$ 3,814,440
1,262,962	Common shares		8,435,959	8,435,959
			12,250,399	12,250,399
Contributed surplus		11 (a)	52,731	52,731
Purchase fund for Class "A" preference shares			276,348	276,348
Excess of appraised value of land and building over book value		1	19,054,294	19,231,139
Deficit			(7,721,057)	(6,887,122)
			$23,912,715	$24,923,495

See accompanying notes

Levy Industries Limited

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION
Year ended December 31, 1985

	note	1985	1984
Funds provided by (used for)			
Operations			
Income (loss) before extraordinary items		$ (743,295)	$(1,805,645)
Items not affecting working capital, principally depreciation, amortization and deferred income taxes		447,740	470,191
		(295,555)	(1,335,454)
Issue of long-term debt		—	5,000,000
Net proceeds from sale of land		2,119,797	806,000
Reduction of income taxes on application of prior years' losses		—	112,400
		1,824,242	4,582,946
Funds used for			
Retirement of long-term debt		2,686,413	691,749
Fixed assets and other (net)		160,995	76,094
Advances to parent company		3,648,209	69,296
Dividends		114,433	—
		6,610,050	837,139
Increase (decrease) in working capital		(4,785,808)	3,745,807
Working capital, beginning of year		7,566,028	3,820,221
Working capital, end of year	14	$2,780,220	$7,566,028

See accompanying notes

Laventhol & Horwath
Chartered Accountants

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AUDITORS' REPORT

To the Shareholders of
Levy Industries Limited

We have examined the consolidated balance sheet of Levy Industries Limited as at December 31, 1985 and the consolidated statements of income, deficit, shareholders' equity 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 December 31, 1985 and the results of its operations and changes in 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.

Laventhol & Horwath

June 30, 1986 Chartered Accountants

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 1985

1. SUMMARY OF ACCOUNTING POLICIES

Continuing operations

These financial statements have been prepared on the basis of a going concern. However, the company's bankers, because of the action taken by the Government of the United States (See note 13), have expressed concern about the company's ability to service its debt. In addition, the company is in default on its bank debt in instalments aggregating $500,000, due subsequent to the year-end.

The company's bankers have indicated that by August 1st, 1986 they require a commitment which will result in a paydown of $10 million of bank indebtedness within a reasonable period of time. The company is presently in negotiations, to divest itself of certain assets, as well as alternative financing.

Should the company be unable to satisfy the bank's requirements or obtain alternative financing, there would be a question as to the company's viability, which could result in significant downward adjustments to the amounts at which inventories and other assets are stated.

Management is of the opinion that it can meet the bank's requirements.

Consolidation policy

The consolidated financial statements include the accounts of Levy Industries Limited and all its subsidiaries.

Translation of foreign currencies

Assets, liabilities, revenues and expenses arising from foreign currency transactions are recorded in Canadian dollars at the exchange rate in effect at the date of the transaction. Monetary assets and liabilities outstanding at the balance sheet date, which are denominated in a foreign currency, are adjusted to reflect the exchange rate in effect at the balance sheet date. Gains or losses arising from such adjustments are included in net income.

Inventories

Certain types of inventories approximating $9.6 million, for which costs cannot be determined, have been valued on the basis of a percentage of historical selling prices. The other inventories have been valued at the lower of cost and net realizable value. This valuation is consistent with that used in preceding years.

Property, plant and equipment

Certain land and buildings are recorded at appraised values as at December 31, 1977. The excess of the appraised value over the book value is shown in the statement of shareholders' equity. A portion of the appraisal excess applicable to buildings is being transferred annually to deficit in amounts equal to the annual depreciation provided on such appraisal excess. The current year's transfer amounts to $176,845. Land and buildings acquired subsequent to 1977 and plant and equipment are recorded at cost. Depreciation is provided on the straight-line basis at the following annual rates:

Buildings	2½%
Machinery and equipment	10 - 20%

2. ACCOUNTS RECEIVABLE

	1985	1984
Trade	$ 2,771,247	$ 3,624,610
Insurance claim	—	1,824,025
Other	74,280	—
	$ 2,845,527	$ 5,448,635

3. NOTE RECEIVABLE

The note is receivable over a period of 4 years with interest thereon at 9½% per annum and is secured by a standby letter of credit from a Canadian chartered bank. The current portion of the note receivable, amounting to $99,840 (1984 — $99,840) is included in prepaid expenses and sundry assets.

4. PROPERTY, PLANT AND EQUIPMENT

	1985	1984
Buildings, at appraised values	$ 7,460,000	$ 7,460,000
Building additions, at cost	524,576	528,921
Machinery and equipment, at cost	5,131,371	4,974,939
	13,115,947	12,963,860
Less accumulated depreciation	5,692,555	5,291,305
	7,423,392	7,672,555
Land, at appraised values	14,750,000	14,750,000
Land, at cost	905,499	2,905,499
	$ 23,078,891	$ 25,328,054

5. OTHER

	1985	1984
Net investment in lease, current portion of $52,244 included in prepaid expenses and sundry assets	$ 74,339	$ 126,583
Share issue expenses	—	272,849
Sundry	59,709	45,951
	$ 134,048	$ 445,383

6. BANK INDEBTEDNESS

As security for the bank indebtedness the company has pledged accounts receivable, inventory and a fixed and floating charge debenture covering fixed and movable property of the company.

7. INCOME TAXES

The company and its subsidiaries have accumulated capital losses of approximately $1,200,000 and non-capital losses of approximately $2,472,000 for income tax purposes in current and prior years which may be used to reduce taxable income as follows:

$ 85,000 to 1986
$ 63,000 to 1987
$ 23,000 to 1989
$ 534,000 to 1990
$ 1,681,000 to 1991
$ 86,000 to 1992

The combined basic Canadian Federal and Provincial income tax rate for the company is 51%. These financial statements do not reflect an income tax provision (recovery), due mainly to tax losses for which no benefit has been recognized.

8. LONG-TERM DEBT

	notes	1985	1984
Levy Industries Limited:			
Bank term loan, secured by pledge of note receivable, prime rate plus 7/8%, maturing November 30, 1989	3	391,040	490,880
Levy-Russell Limited:			
Conditional sales contracts		—	69,558
Bank loan, secured by real estate, prime rate plus 1½% maturing August 31, 1990		893,040	965,540
Bank loan, prime rate plus 3/4%, maturing May 31, 1992	6	2,615,000	2,990,000
Bank loan, prime rate plus 1½%, maturing November 30, 1994	6	4,625,000	5,000,000
Russell Industries Limited:			
11% first mortgage loan		—	1,540,393
Levy Service Industries Limited:			
First mortgage loan, prime rate plus 1½%, maturing August 31, 1990		2,034,090	2,256,210
		10,558,170	13,312,581
Less amounts due within one year		1,308,840	1,276,998
		$ 9,249,330	$ 12,035,583

The aggregate amount of principal payments required in each of the next five years is approximately as follows:

1986 — $1,309,000
1987 — $1,333,000
1988 — $1,357,000
1989 — $1,373,000
1990 — $2,322,000

9. EXTRAORDINARY ITEMS

	1985	1984
Gain (loss) on sale of real property	$ 119,797	$ (201,600)
Reduction of income taxes on application of prior years' losses	—	112,400
Gain on settlement of insurance claim	—	324,025
Loss on sale of shares in subsidiary	—	(101,000)
	$ 119,797	$ 133,825

10. SEGMENTED INFORMATION
(in thousands of dollars)

	1985			1984		
	Automotive Parts	Cold Storage and Property	Total	Automotive Parts	Cold Storage and Property	Total
Sales and revenues	$ 25,104	$ 3,014	$ 28,118	$ 19,455	$ 2,652	$ 22,107
Operating income (loss)	$ 1,253	$ 392	$ 1,645	$ 1,408	$ (478)	$ 930
Interest			2,389			2,948
Income taxes (recovery)			—			(212)
Extraordinary items			(120)			(134)
			2,269			2,602
Net income (loss)			$ (624)			$ (1,672)
Identifiable assets	$ 41,289	$ 8,406	$ 49,695	$ 39,271	$ 13,286	$ 52,557
Depreciation, amortization	$ 103	$ 346	$ 449	$ 133	$ 342	$ 475
Capital expenditure	$ 7	$ 154	$ 161	$ 123	$ 202	$ 325
Export sales	$ 16,934	$ —	$ 16,934	$ 12,038	$ —	$ 12,038

The company operates two divisions: a plant for the cold storage of produce and foodstuffs and the automotive parts division which sells new parts and major components for heavy duty and specialized vehicles and builds shunter tractors for the moving of large containers in other industries.

11. SHAREHOLDERS' EQUITY

(a) The contributed surplus represents the gain on Class "A" preference shares, which were purchased in prior years for cancellation at a cost less than their par value.

(b) As at December 31, 1985, dividends on the Class "A" preference shares are $400,000 (seven quarters) in arrears.

12. RELATED PARTY TRANSACTIONS

(a) The company is a subsidiary of Seaway Multi-Corp Limited, which owns approximately 99% of its issued common shares. Management services provided by Seaway Multi-Corp Limited and its parent company amounted to $1,516,400 (1984 - $2,080,000).

(b) Sales commission advances aggregating $605,000 have been written off in the current year to other operating costs and expenses. These represent advances to corporations controlled by the family of the major shareholder of Seaway Multi-Corp Limited.

13. CONTINGENCIES

(a) In December 1985, charges were laid by the Attorney General of Ontario, alleging the unlawful conferring of benefits on two employees of the Department of National Defense, against a subsidiary, two directors and officers, an employee and the former president of the company. As a result, the Government of the United States has temporarily suspended the individuals and two subsidiaries of the company from contracting or subcontracting with it pending the disposition of the charges. The suspensions do not affect current orders. The possible loss, if any, of not being able to receive contracts during the suspension period, cannot be determined by management at this time.

(b) A 1982 indictment for violation of U.S. customs laws against the same subsidiary, an officer and a former employee were dismissed in 1984 because of lack of venue. This decision was reversed in April 1986 by a U.S. Court of Appeals in Virginia. Appeal procedures are being pursued by the company and the individuals to reinstate the original dismissal. Should the company's appeal not be successful, the possible effect on the company contracting with the U.S. Government cannot be determined by management at this time.

(c) A subsidiary company has guaranteed a director and officer's loan of $1,600,000 to accommodate his purchase of shares in this corporation.

(d) Revenue Canada has reassessed a subsidiary with respect to the years 1981 to 1983 for $805,000 including interest. The reassessment relates to a company that ceased operations in 1984 for which Revenue Canada has disallowed the claim for a terminal loss.
The subsidiary has filed Notices of Objection with Revenue Canada and the Ontario Ministry of Revenue. No provision has been made in the financial statements for the reassessment, as the outcome is not yet determinable.

14. COMPARATIVE FIGURES

Certain comparative figures for the previous year, in the statement of changes in financial position, have been restated to conform with the current years' presentation.

15. PENSION PLANS

The company has no liability for past services as the pension plans are fully funded.

16. SUBSEQUENT EVENT

Subsequent to the year end, a subsidiary, entered into a co-venture agreement for the development of the Weston Road property for residential and commercial use. It was agreed that the land be sold to the co-venture for a price to be determined, between $13,500,000 and $14,500,000.

The subsidiary will retain a 30% equity in the co-venture. The closing is subject to municipal approval and various conditions satisfactory to the co-venturer. Closing date for the transaction is December 31, 1986, but extension of the closing to fulfill conditions is permitted. The sale will not result in any material gain or loss to the company.

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