

Kerr Addison
Mines Limited

1985
Annual Report



Financial Summary:

	1985	1984	1983	1982	1981
Millions of Dollars					
Production revenue	\$ 48.0	\$ 48.7	\$ 47.5	\$ 55.0	\$ 67.6
*Net income	2.5	16.3	16.3	4.0	37.0
Working capital	47.0	26.0	49.9	51.1	21.7
Long-term debt	5.0	40.0	70.0		
*Shareholders' equity	336.2	341.7	335.5	329.1	195.8
Dollars Per Share					
*Net income	\$ 0.14	\$ 0.95	\$ 0.95	\$ 0.39	\$ 3.94
Dividends declared	.60	.60	.60	.60	.60

* 1981 to 1984 figures restated for the change in the method of accounting for oil and gas expenditures.

The Gold Picture:



Kerr Addison Mines Limited

DIRECTORS:

*Ian D. Bayer
President & Chief Executive Officer
Kerr Addison Mines Limited

*Jack L. Cockwell
Executive Vice-President
Brascan Limited

*P. S. Cross
Executive Vice-President &
Chief Operating Officer
Kerr Addison Mines Limited

J. A. Hall
Consultant
Noranda Minerals Inc.

K. C. Hendrick
President
Noranda Minerals Inc.

J. O. Hinds
Senior Vice-President
– Exploration & Development
Noranda Inc.

Gilbert Kerlin
Partner
Shearman & Sterling

†*James W. McCutcheon, Q.C.
Partner
Shibley, Righton & McCutcheon

†D. G. Neelands, Q.C.
Company Director

*J. P. W. Ostiguy, O.C.
Honorary Chairman
Richardson Greenshields of Canada Limited

†*Alfred Powis, O.C.
Chairman & Chief Executive Officer
Noranda Inc.

D. E. G. Schmitt
Company Director – Mining Engineer

*Member of the Executive Committee
†Member of the Audit Committee

OFFICERS:

James W. McCutcheon, Q.C.
Chairman of the Board

Ian D. Bayer
President & Chief Executive Officer

P. S. Cross
Executive Vice-President &
Chief Operating Officer

D. A. Lowrie
Vice-President – Exploration

A. H. Cross
Treasurer

J. B. Sage
Secretary

OPERATIONS:

J. K. Carrington
Manager of Operations

D. S. Douglass, Manager
The Kerr Addison Mine

HEAD OFFICE AND EXPLORATION OFFICE:

P.O. Box 91
Commerce Court West
Toronto, Ontario
M5L 1C7

TRANSFER AGENT AND REGISTRAR:

The Canada Trust Company,
Toronto, Ontario

CO-TRANSFER AGENT:

Registrar & Transfer Company,
Cranford, New Jersey and New York, N.Y.

ANNUAL MEETING OF SHAREHOLDERS

Friday, May 2, 1986, 11:30 a.m.
in Commerce Hall, Commerce Court West,
King and Bay Streets,
Toronto, Ontario

Directors' Report to the Shareholders

Net income for 1985 was \$2.5 million, or 14 cents per share, compared to restated earnings of \$16.3 million, or 95 cents per share in 1984. This reduction was a result of an \$11.9 million decrease in gains from the sale of investments. Operating profits increased modestly in 1985 because of improved results from the gold mine, whereas investment income declined as a consequence of the accounting treatment given to dividends received from Noranda Inc. Although operating in a disinflationary environment, with relatively low commodity prices, the Company improved its financial position during 1985.

Gold production from the Kerr Addison mine at Virginiatown, Ontario, was 47,200 ounces, up about 10 percent over 1984 because of the higher average grade of ore milled. Despite lower gold prices, operating profit at the mine, before deducting depreciation, amortization, and income and production taxes, increased to \$2.7 million in 1985, compared to \$0.3 million in 1984. This improvement can be attributed to the higher gold production and reduced costs. Estimated ore reserves increased by 195,000 tons to 803,000 tons at December 31, 1985, after milling 373,000 tons during the year.

Zinc slab production at the Canadian Electrolytic Zinc reduction plant at Valleyfield, Quebec, in which this Company has a 9.8 percent joint venture interest, was 240,000 tons, down slightly from 1984. The operating profit to Kerr Addison was \$3.9 million, a substantial decline from the

profit of \$7.2 million recorded in the previous year. Zinc markets, which were strong in 1984 and in the first quarter of 1985, deteriorated during the final three quarters of 1985, resulting in reduced operating margins and inventory write-downs. Although capital spending was restrained for the second consecutive year, two small projects were completed, one of which was a production facility to supply zinc shot to the electrogalvanizing industry.

Canadian Hunter Exploration Ltd., in which Kerr Addison has a 13 percent joint venture interest, is a major natural gas producer with its head office in Calgary, Alberta. Kerr Addison's share of Canadian Hunter's daily production averaged 15 million cubic feet of natural gas and 530 barrels of oil and liquids. Natural gas sales increased by 8 percent over 1984, although nominations by TransCanada PipeLines were restricted to 54 percent of contracted quantities because of surplus supplies in North America. Production of natural gas liquids also increased as the new Elmworth and Wapiti liquids extraction facilities began operations in June and October of 1985, respectively. Operating profit was \$12.8 million, down slightly from 1984 because of lower product prices.

In 1985, Kerr Addison changed its method of accounting for oil and gas activities by dividing its North American cost centre between Canada and the United States. This change, which was applied retroactively, resulted in a \$17.9 million reduction in the carrying value of the Company's interest in

oil and gas assets operated by American Hunter in the United States. As a consequence, 1984 net income was reduced by \$1.5 million, but 1985 earnings were not affected. This revised method is in accordance with the recommendation of an accounting standards task force of the Canadian Institute of Chartered Accountants. The Company considered it prudent to make this policy change in light of current conditions in oil and natural gas markets.

Anderson Exploration Ltd., in which Kerr Addison has a 32.6 percent equity interest, is also a major natural gas producer headquartered in Calgary. Anderson's daily production averaged 71 million cubic feet of natural gas and 1,400 barrels of oil and natural gas liquids in 1985. Natural gas production increased by 54 percent over 1984, when sales to northern California were restricted because of a high, regulated export price. Anderson's cash flow, net of interest costs, increased to \$28 million in 1985 and Kerr Addison's share of Anderson's loss declined slightly to \$2.2 million. Anderson has received approval from the Alberta Government to construct a deep cut plant to recover propane-plus liquids at its 47.5 percent owned Dunvegan field. This plant should be in production in the first quarter of 1987.

Dividends of \$6.1 million were received during 1985 from the Company's common share investment in Noranda Inc. However, these dividends were excluded from investment income and credited to the

investment account as Noranda incurred a loss from operations of \$71 million, or 88 cents per share. After writing down to estimated realizable value all assets of doubtful value under foreseeable economic conditions, Noranda's net loss for the year was \$254 million.

Mineral exploration expenditures increased to \$7.2 million in 1985 as the Company continued to emphasize its search for gold deposits. Of this amount, \$4.8 million was financed by issuing flow-through common shares. In 1985, Kerr Addison acquired a 23 percent equity interest in Consolidated Barrier Reef Resources Ltd. for \$2.9 million. Barrier Reef, in turn, has provided equity financing to Blackdome Exploration Ltd. which is bringing its British Columbia gold property into production by mid 1986 at a projected annual rate of 40,000 ounces.

Cash flow from operations and investments increased slightly to \$17.9 million for 1985 and proceeds from the sale of investments totalled \$65.1 million. Long-term debt was reduced by \$35.0 million to a balance of \$5.0 million at year-end. Cash and short-term notes increased by \$33.3 million during the year to \$36.7 million at December 31, 1985. Dividend payments to shareholders amounted to 60 cents per share, as in 1984.

Petroleum producers are facing a period of instability due to the recent dramatic decline in world oil prices. Natural gas prices have been falling for a number of years in North America because of surplus supplies and deregulation of markets in the United States. Prices may also come under further downward pressure as natural gas competes with cheaper oil, particularly in

Canada as markets become decontrolled later in 1986. It is difficult to predict what effect this environment will have on natural gas prices and sales volumes over the next couple of years. However, for Canadian producers, two important changes in the fiscal regimes under which the industry operates were announced in 1985. These will help cushion the impact of lower petroleum prices. In March 1985, the Federal government and the petroleum producing provinces reached an agreement of understanding regarding energy pricing and taxation, known as the Western Accord. The most notable impact on Kerr Addison is the phasing out of the revenue based petroleum and natural gas revenue tax (PGRT), which will be completely eliminated by the end of 1988. In June 1985, the Alberta government also announced reductions in its royalty rates of about 15 percent, to be phased in over a two-year period, as well as increases in royalty tax credits and royalty exemptions on new production. Canadian Hunter will benefit from increased natural gas liquids production from two new plants which came into production in 1985, whereas Anderson Exploration will have a new liquids extraction plant on-stream in the first quarter of 1987. Both companies have the flexibility to reduce activities to essential expenditures if conditions warrant a temporary change in strategy.

A year ago it was felt that the strong United States dollar was having an adverse affect on metal prices. The U.S. dollar has now fallen by 30 percent against major world currencies, placing North American mines in a more competitive position. Although metal prices are still generally at or below the levels of early 1985, the fundamentals continue to improve and prices should

gradually move higher. Gold markets, in particular, have recently firmed. Kerr Addison has an active mining exploration program planned for 1986, and expects to be diamond drilling on more than 15 gold projects. Also, the Company is well positioned to utilize its strong financial position to increase its mineral reserve base during these difficult times.

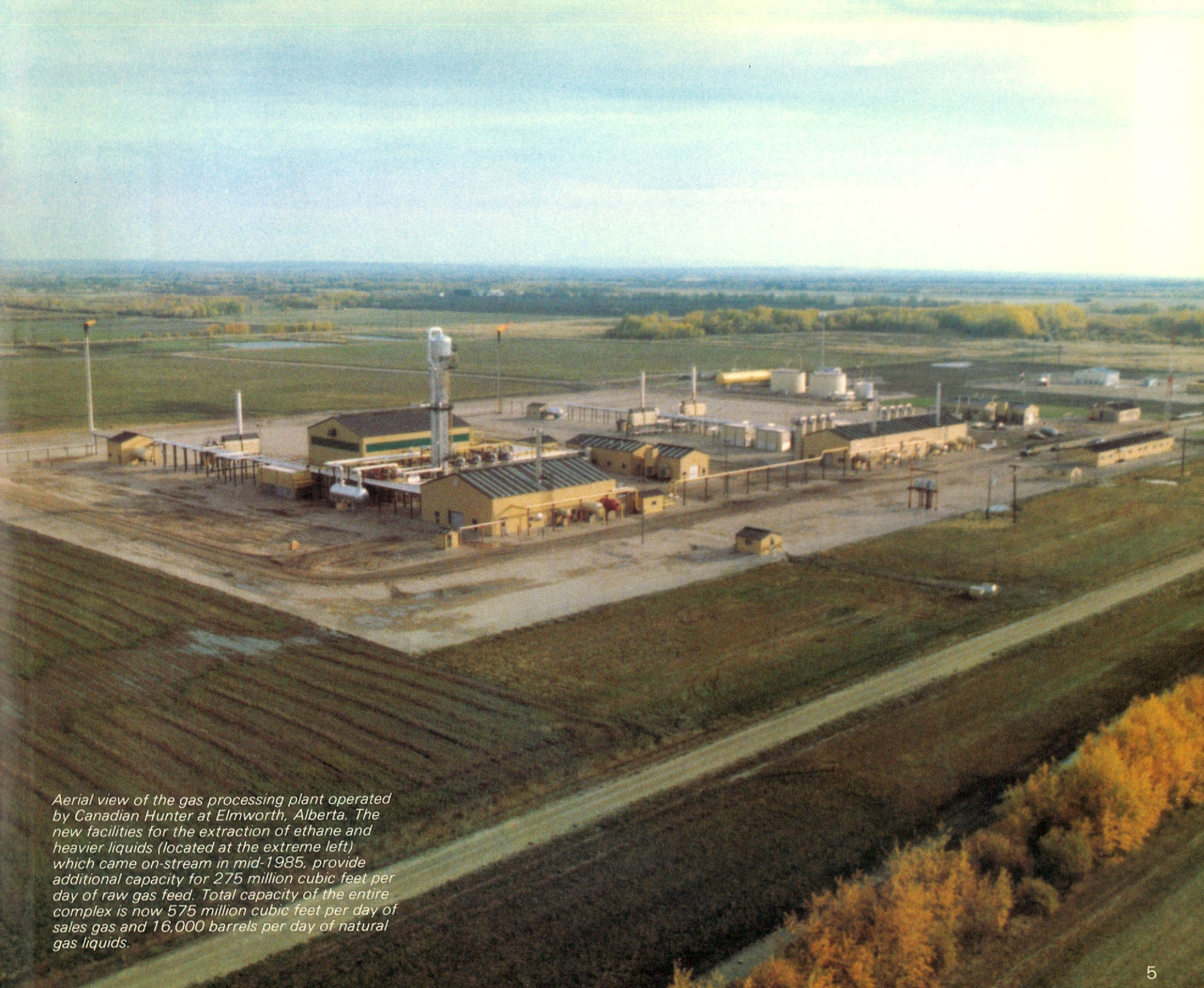
The resignation effective November 1, 1985 of Mr. John P. Fisher as a Director of this Company has been accepted by the Board with regret. As Mr. Fisher had taken a keen interest in the activities of Kerr Addison during his tenure, his contributions will be truly missed. He has been appointed President and Chief Executive Officer of Southam Inc., and we wish him every success in his new responsibilities. In this regard, we are pleased to announce the appointment of Mr. Keith C. Hendrick as a Director of the Company. Mr. Hendrick, formerly President of Noranda Sales Corporation Ltd., has recently been appointed President of Noranda Minerals Inc. and we welcome him to the Kerr Addison Board.

On behalf of the directors, it is a pleasure to acknowledge the continued diligence and efforts of all employees during the past year, particularly at the gold mine where significant productivity improvements were implemented.

On behalf of the Board,



Ian D. Bayer
President and
Chief Executive Officer
Toronto, Canada
February 25, 1986



Aerial view of the gas processing plant operated by Canadian Hunter at Elmworth, Alberta. The new facilities for the extraction of ethane and heavier liquids (located at the extreme left) which came on-stream in mid-1985, provide additional capacity for 275 million cubic feet per day of raw gas feed. Total capacity of the entire complex is now 575 million cubic feet per day of sales gas and 16,000 barrels per day of natural gas liquids.

Report on Mining Operations

The Kerr Addison Mine

The Kerr Addison gold mine, located at Virginiatown, Ontario, operated at capacity during 1985 milling 373,055 tons of ore, averaging 1,022 tons per day at a recovered grade of 0.127 ounces of gold per ton. In addition, 1,812 tons of custom gold ore were treated. Production amounted to 47,211 ounces of gold and 2,364 ounces of silver having a realized value of \$20.6 million or \$55.10 per ton milled. Overall recovery of gold was 97.44%. The average price received per ounce of gold sold during the year was \$429 Canadian compared to \$468 Canadian for 1984. The improved performance over the previous year was mainly attributable to the higher grade of ore mined which resulted from eliminating several low grade stoping blocks from the mining schedule, and to lower operating costs.

Mine development advance during the year totalled approximately 2,300 feet, about the same as in 1984. Development emphasis continued to be placed on preparing higher grade isolated ore pods for mining that have been identified by underground diamond drilling. Fifty-three holes were completed for a total footage of 4,596 feet. Development provided only 3% of the total ore mined.

Mining operations were carried on in 67 working places, in nine ore zones and on 19 levels between the 1,000 and 4,200 levels. Approximately 10% of production came from the internal No. 4 shaft, a decrease from 12% the previous year. Sources of ore broken were 21% square set, 41% cut and

fill, 27% shrinkage and 8% blasthole. Flow ore production amounted to 51% of the ore mined at a grade of 0.148 ounces of gold per ton, while the carbonate zones provided 49% at a grade of 0.105 ounces per ton.

Operating costs per ton milled decreased by 5% from those of 1984 although tonnage treated was slightly lower. Costs per ounce of gold produced decreased by 17% mainly as a result of the higher grade of ore treated. The combined labour and material costs decreased by 6.8% in 1985, with labour costs alone decreasing 10.4% resulting from a manpower reduction of 12%.

At December 31, 1985, the mineable ore reserves with dilution in all ore classifications were estimated at 802,890 tons having a grade of 0.127 ounces of gold per ton. After the milling of 373,055 tons in 1985, total reserves increased by 195,282 tons over those at the end of 1984. This substantial increase in reserves resulted from a thorough re-examination of the old workings throughout the mine, identifying ore remnants, pillars and isolated ore pods which were left behind in earlier mining but are economic under today's conditions. The deletion of some of the lower grade mineral inventory has resulted in a slight increase to the average ore reserve grade.

The work force at year-end stood at 329 compared to 374 at the end of 1984. The current collective agreement will expire on September 30, 1986. The accident frequency per 200,000 man hours worked was 2.9 compared to 3.9 for all Ontario

gold mines, and this was a significant reduction from 5.2 for the mine in 1984.

Production commenced at the Kerr Addison mine in May 1938. To the end of 1985, the mine has produced 10,174,578 ounces of gold and 560,758 ounces of silver, having a total historical value of \$602 million. This has been achieved from the milling of 37,521,121 tons of ore having an average recovered grade of 0.271 ounces of gold per ton.

Environmental

At the beginning of the year, rehabilitation work was being continued on the Company's three remaining shutdown mining properties.

At the Agnew Lake property near Sudbury, Ontario, the removal of the surface plant and site clean-up was completed. Environmental monitoring will continue for another three years.

Rehabilitation of the Normetal mine property in northwestern Quebec was completed during the year. The surface and mineral rights were sold by the end of the year, relieving Kerr Addison of any further environmental responsibilities.

Rehabilitation of the Blue Hill mine site in the State of Maine was also completed during the year. By year-end, all surface leases and several of the mineral leases had been terminated or sold. Remaining property and mineral holdings will be relinquished during 1986, concluding Kerr Addison's responsibilities for the Blue Hill property.

Exploration

The 1985 minerals exploration budget had been increased to accommodate new project expenses on additional land acquisitions in active exploration areas. Actual expenditures amounted to \$7.2 million of which \$4.8 million were financed by the issue of flow-through shares.

Expenditures were directed primarily towards the search for gold deposits with approximately 61% expended in Ontario, Quebec and the Maritimes, 15% in British Columbia and the Yukon, and 13% in western U.S.A. Extensive ground positions were acquired in the active gold exploration areas of Ontario, Quebec, British Columbia, Yukon and Nevada.

A total of 43,400 feet of diamond drilling, 70,000 feet of overburden drilling and 8,826 line miles of airborne and ground geophysical surveying was performed on 21 properties.

Several hundred property submissions were processed, examined and/or evaluated during the year.

Respectfully submitted,



P. S. Cross
Executive Vice-President
and Chief Operating Officer

Toronto, Ontario
February 25, 1986



Mineral exploration deep drilling for gold on the optioned property of Larder Resources Inc., just west of the Kerr Addison mine at Virginiatown, Ontario.

Report on Gas and Oil Investments

Kerr Addison's investment in the gas and oil industry is comprised of a 13 percent joint venture interest in Canadian Hunter Exploration Ltd. and a 32.6 percent equity ownership in the common shares of Anderson Exploration Ltd. Both companies are headquartered in Calgary, are major natural gas producers and have their main producing properties and gas plants in northwestern Alberta.

Canadian Hunter

Canadian Hunter's principal assets are its extensive land positions and developed natural gas reserves in the Elmworth and Wapiti contract areas of northwestern Alberta. Its gas production is contracted primarily to TransCanada PipeLines, which supplies natural gas to the eastern Canadian and mid-western United States markets. TransCanada's nominations increased to an average of 54 percent of contracted quantities during 1985, but large supplies of natural gas continued to overhang its principal markets. Kerr Addison's share of Canadian Hunter's average gas sales was 15 million cubic feet per day, up 8 percent over 1984. Crude oil and liquids production averaged 530 barrels per day.

Kerr Addison's expenditures on Hunter's properties and projects were \$5.9 million in 1985, net of \$2.5 million of proceeds from the sale of properties. Canadian Hunter participated in the drilling of 81 exploratory and development wells, compared to 74 wells in the previous year. This drilling

resulted in 27 oil wells, 27 gas wells and 27 abandonments. In 1986, the level of drilling activity is projected to be similar to 1985, with the focus on oil and gas opportunities in western Canada. Canadian Hunter has executed an agreement with Inland Natural Gas and Trans Mountain Pipe Line to conduct a \$30 million exploratory program in 1986. Inland and Trans Mountain together will pay one-half of the program cost to earn a one-quarter interest in certain properties.

Crude oil and natural gas liquids production increased in 1985 and, since the new Elmworth and Wapiti ethane and heavier liquids extraction facilities were placed on-stream in June and October, respectively, production is expected to increase further in 1986. The performance of the Hunter-operated Elmworth plant has been most satisfactory, and Sulpetro Limited reported that operations at the Wapiti plant were excellent at year-end. On the Primrose Air Weapons Range, the original 31 well pilot project and the 10 well expansion carried out in 1985 have performed substantially better than expectations. As a result, Hunter now has interests in two approved 25,000 barrels per day in-situ heavy oil recovery projects. The Dome Moore project, 15 percent owned, will be built in five 5,000 barrel per day stages. The Suncor Burnt Lake project, 8 percent owned, will be built in four 6,250 barrels per day stages. Development of the initial stages of each project will begin as soon as market conditions permit.

Kerr Addison's share of Canadian Hunter's proven reserves at December 31, 1985, before royalties, was 79 billion cubic feet of natural gas and 4.1 million barrels of oil and natural gas liquids. Proven plus probable reserves at the same date were 160 billion cubic feet of natural gas and 8.3 million barrels of oil and natural gas liquids. In addition, proven and probable heavy oil reserves were 6.5 million barrels at December 31, 1985. The previous years' calculations of proven natural gas and natural gas liquids reserves have been revised downward in recognition of up-to-date results of reservoir pressure testing and related well performance data, particularly with respect to the reserves assigned to the Falher tight sands and the Cadomin reservoirs. Future development drilling will focus on mapped areas of pools which are not being drained by existing wells. Canadian Hunter is also currently operating a multi-well pilot program to determine if the profitability of developing the Cadomin reserves can be improved. This will involve less expensive conventional drilling and completion techniques, horizontal drilling procedures and closer well spacing.

Anderson Exploration

Anderson is the operator and holds a 47.5 percent interest in the Dunvegan gas contract area in northwestern Alberta. It is primarily a natural gas producer with gas sales accounting for 80 percent of production revenues. Most of its production is contracted to Alberta and Southern Gas



Drilling a gas well on Anderson Exploration's property in the Hines Creek production area of the Peace River Arch, Alberta.

Co. Ltd., which supplies natural gas to the large northern California market.

Anderson's daily average production volumes, before deduction for royalties, were 71 million cubic feet of natural gas and 1,400 barrels of oil and natural gas liquids for 1985. Natural gas production increased by 54 percent over 1984 owing to the Federal government's implementation on November 1, 1984 of a market-sensitive pricing system for export sales to northern California. This allowed Canadian producers to compete with other sources of supply, namely California indigenous gas and interstate pipeline gas. Production of natural gas liquids increased as a direct result of greater gas production at Dunvegan. Oil production increased only modestly, as extensive drilling at Manyberries was not as successful as initially anticipated. Increased oil production for Anderson should be realized in 1986 as a result of its participation in several oil discoveries late in 1985.

During 1985, expenditures on exploration prospects and development totalled \$21 million. Anderson participated in 64 working interest wells, 36 operated by Anderson and 28 operated by other companies. This activity resulted in 27 oil wells, 16 gas wells and 21 dry holes. A comparable drilling program is planned for 1986. During the past year, a number of exploration prospects were generated and placed in three farm-out packages, with the two farmees being major oil companies. The farm-outs involve the drilling of 15 deep wells for the exploration of oil and gas in Devonian sediments of the Peace River Arch. All are wildcat wells with high risk, so a high percentage of dry holes in the deeper horizons can be expected. However, the potential rewards are high. The farmees

fund the drilling at little cost to Anderson, which retains no less than 50 percent of its original interest in the lands. Approval was received in late 1985 from the Energy Resources Conservation Board of Alberta for the construction of a deep cut plant to recover propane-plus liquids at Dunvegan. While no definitive marketing arrangements have yet been made, three parties have indicated a strong interest in purchasing the propane-plus liquids. The plant is expected to be in operation in the first quarter of 1987 and Anderson's share of the capital cost is projected to be \$7.3 million.

Proven reserves, before royalties, at Anderson's fiscal year end of September 30, 1985, were 438 billion cubic feet of natural gas and 6.0 million barrels of oil and natural gas liquids. Proven plus probable reserves at the same date were 638 billion cubic feet of natural gas and 16.2 million barrels of oil and natural gas liquids. The natural gas reserve figures are basically unchanged from the previous year end, whereas the significant increase in probable oil and liquids reserves resulted from the recognition of the additional natural gas liquids which will be recovered from the Dunvegan deep cut plant.

Toronto, Canada
February 25, 1986



Consolidated Statement of Operations

For the year ended
December 31, 1985
(with comparative
figures for the year
ended December 31, 1984)
(in thousands of dollars)

	1985	1984
Operations:		
Value of production	\$48,021	\$48,720
Cost of production (note 10(b))	26,089	28,357
	21,932	20,363
Dividends and interest income (note 1(b))	1,861	6,172
	23,793	26,535
Deduct:		
Administrative and general expenses	1,534	1,376
Outside exploration expenses	7,180	8,457
Depreciation and amortization	4,601	2,627
Interest on long-term debt	2,279	5,857
	15,594	18,317
Profit from operations before tax	8,199	8,218
Income and production taxes (note 7)	3,752	1,463
Profit from operations	4,447	6,755
Less share of loss of Anderson Exploration Ltd.	2,225	2,595
Profit before the following	2,222	4,160
Gain on disposal of investments and other assets (net of tax of \$492; \$1,189 in 1984)	236	12,114
Net income for the year	\$ 2,458	\$ 16,274
Net income per share (based on the weighted average number of shares outstanding 1985 — 17,208,751; 1984 — 17,152,164)	\$0.14	\$0.95

(See accompanying notes to consolidated financial statements)

**Kerr
Addison
Mines
Limited**

(incorporated under the laws of Ontario)

Consolidated Balance Sheet

December 31, 1985
(with comparative figures
at December 31, 1984)

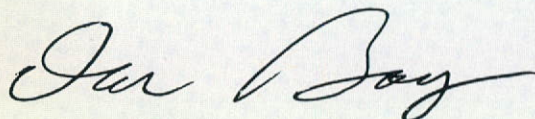
(in thousands of dollars)

ASSETS	1985	1984
Current:		
Cash and term deposits	\$ 36,723	\$ 3,397
Marketable securities, at cost (market value \$5,087; 1984 — \$16,457)	3,460	12,238
Concentrates, bullion and metals awaiting settlement, in transit and on hand	8,930	11,387
Accounts and interest receivable	7,840	5,549
Supplies and materials, at cost	1,855	2,489
Total current assets	58,808	35,060
Investments in associated companies:		
Noranda Inc. (note 2(a))	176,944	236,294
Anderson Exploration Ltd. (note 2(b))	74,861	77,086
	251,805	313,380
Property, plant and equipment (note 3)	78,039	76,655
	\$388,652	\$425,095

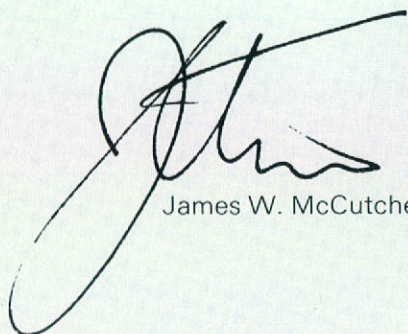
(See accompanying notes to consolidated financial statements)

LIABILITIES AND SHAREHOLDERS' EQUITY	1985	1984
Current:		
Accounts payable and accrued charges	\$ 9,671	\$ 8,689
Income and production taxes payable (note 7)	2,106	416
Total current liabilities	11,777	9,105
Long-term debt (note 4)	5,000	40,000
Provision for mine closures (note 5)	3,400	3,900
Deferred income taxes	25,704	21,817
Deferred revenue	6,598	8,544
	52,479	83,366
Shareholders' equity:		
Share capital (note 6)	180,534	178,225
Retained earnings	155,639	163,504
	336,173	341,729
	\$388,652	\$425,095

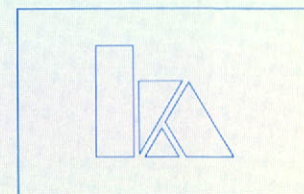
On behalf of the Board:



Ian D. Bayer, Director



James W. McCutcheon, Director



Consolidated Statement of Changes in Financial Position

For the year ended
December 31, 1985
(with comparative
figures for the year
ended December 31, 1984)
(in thousands of dollars)

	1985	1984
Sources of cash:		
Operations —		
Profit from operations	\$ 4,447	\$ 6,755
Items not affecting cash, primarily depreciation, amortization and deferred taxes	7,292	6,801
	11,739	13,556
Net change in non-cash working capital balances (receivables and inventories, less payables)	(463)	(3,448)
	11,276	10,108
Dividends from Noranda Inc. (note 1(b))	6,113	3,319
Proceeds from sale of investments and other assets	65,087	42,342
Proceeds from issuance of shares	2,268	230
	84,744	55,999
Applications of cash:		
Repayment of long-term debt	35,000	30,000
Dividends (excluding stock dividends of \$41; \$79 in 1984)	10,282	10,213
Additions to property, plant and equipment	6,136	13,745
	51,418	53,958
Increase in cash	33,326	2,041
Cash and term deposits, beginning of year	3,397	1,356
Cash and term deposits, end of year	\$36,723	\$ 3,397

(See accompanying notes to consolidated financial statements)

Consolidated Statement of Retained Earnings

For the year ended December 31, 1985
(with comparative figures for the year ended December 31, 1984)
(in thousands of dollars)

	1985	1984
Retained earnings, beginning of year, as previously reported	\$ 181,441	\$ 173,956
Adjustment for the cumulative effect on prior years of the change in accounting for gas and oil activities (note 1(e))	17,937	16,434
Retained earnings, beginning of year, as restated	163,504	157,522
Add net income for the year	2,458	16,274
	165,962	173,796
Deduct dividends (\$0.60 per share in each year)	10,323	10,292
Retained earnings, end of year	\$ 155,639	\$ 163,504

(See accompanying notes to consolidated financial statements)

Auditors' Report

To the Shareholders of
Kerr Addison Mines Limited:

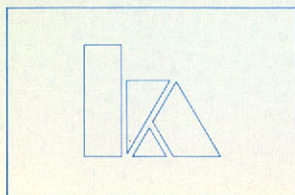
We have examined the consolidated balance sheet of Kerr Addison Mines Limited as at December 31, 1985 and the consolidated statements of operations, retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, 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 December 31, 1985 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, after giving retroactive effect to the change in the method of accounting for oil and gas expenditures as explained in note 1(e), on a basis consistent with that of the preceding year.

Toronto, Canada,
February 20, 1986.

Clarkson Gordon

Chartered Accountants



Notes to Consolidated Financial Statements

December 31, 1985

1. Summary of significant accounting policies

(a) Basis of consolidation —

The accompanying consolidated financial statements are prepared in accordance with accounting principles generally accepted in Canada and include, on a consolidated basis, the accounts of Kerr Addison Mines Limited ("Kerr Addison" or "the company") and its wholly-owned subsidiary companies, Kerad-amex, Inc. and Kerramerican, Inc.

(b) Investments in associated companies —

The company's interest in the common shares of Noranda Inc. ("Noranda") is being accounted for following the "cost method" whereby the investment is initially recorded at cost and earnings from the investment are recognized only to the extent that dividends are distributed from the net profits of Noranda arising subsequent to acquisition of the shares on September 30, 1982. Accordingly, dividends received from Noranda in 1985 and 1984 have been accounted for as follows:

	1985	1984
	(in thousands)	
Dividends included in consolidated earnings, being the amounts deemed to have been distributed from Noranda's accumulated net profits since September 30, 1982		\$3,319
Balance of dividends deducted from the company's investment in Noranda common shares, being the dividends in excess of Noranda's accumulated net profits since September 30, 1982	\$6,113	3,319
Total Noranda common dividends received	<u>\$6,113</u>	<u>\$6,638</u>

The company's interest in the common shares of Anderson Exploration Ltd. ("Anderson") is accounted for following the "equity method" whereby the investment is initially recorded at cost and the carrying value is adjusted thereafter to reflect the company's share of post-acquisition earnings or losses. The excess of the cost of the shares over net book value at date of acquisition has been attributed to oil and gas properties and is being amortized on the unit-of-production basis based on estimated proven and probable reserves at date of acquisition.

(c) Concentrates, bullion and metals —

Consistent with industry practice, the company records as revenue the value of production of concentrates, bullion, and metals awaiting settlement, in transit and on hand at estimated net realizable value. Purchased concentrates are valued at the lower of actual cost and net realizable value.

(d) Property, plant and equipment —

Property, plant and equipment is recorded at cost and includes previously deferred exploration and development expenditures on properties which have been brought into production. Depreciation of property, plant and equipment and amortization of development expenditures are provided at rates designed to write off the costs over the estimated service lives of the assets. Fixed assets are generally depreciated in equal annual amounts over their estimated service lives (which at December 31, 1985 range from 4 to 20 years) and development expenditures are amortized on a unit-of-production basis.

(e) Exploration and development expenditures —

Gas and oil

The company participates through joint venture agreements with Noranda Inc. and others in certain gas and oil properties held by Canadian Hunter Exploration Limited and American Hunter Exploration Ltd. as trustees.

The company follows the full cost method of accounting for these joint ventures whereby all costs relating to the exploration for and development of gas and oil reserves are capitalized. Such costs include lease acquisition costs, geological and geophysical expenses, carrying charges on non-producing properties and costs of drilling both productive and non-productive wells. These costs are accumulated on a country-by-country basis (see below) and are generally limited to the estimated value of future net revenues from production of proven reserves determined using current selling prices and current costs.

Capitalized costs are being amortized to income by the unit-of-production method based on estimated proven gas and oil reserves.

In 1984 and prior years, the company's oil and gas activities were accounted for as a single cost centre, North America. In 1985, in accordance with the recommendations of the Accounting Standards Steering Committee Task Force of the Canadian Institute of Chartered Accountants, the company changed its method of accounting by dividing its North American cost centre between Canada and the United States. This change has been applied retroactively and, accordingly, the previously reported consolidated financial statements for the year 1984 have been restated. The effect of this change is to decrease net income for the year ended December 31, 1984 by \$1,503,000 (\$.09 per share). There is no effect on net income for the year ended December 31, 1985. In the consolidated balance sheet as at December 31, 1984, the balance of property, plant and equipment is reduced by \$19,687,000, currency translation adjustment by \$1,750,000, and retained earnings by \$17,937,000.

Minerals

Mineral exploration and development expenditures are charged against current earnings unless they relate to interests in properties where the reserves have the potential of being economically recoverable, in which case the expenditures are deferred. Upon disposal or abandonment of such interests, the net gain or loss is reflected in the consolidated statement of operations. If the properties are brought

into production, deferred exploration and development expenditures relating thereto are reclassified with property, plant and equipment and amortized as explained in note 1(d).

(f) Income taxes —

The company follows the tax allocation method of accounting for income taxes. Under this method, timing differences between reported and taxable income result in deferred income taxes. The principal timing differences relate to exploration and development expenditures, capital cost allowances, and provisions for mine closures.

(g) Deferred revenue —

The company defers recognition of revenue received under contracts of sale of gas where the gas has not been delivered by agreement with the customer. The revenue will be recognized when the gas is delivered.

2. Investments in associated companies

	1985	1984
	(in thousands)	
Noranda Inc.	\$176,944	\$236,294
Anderson Exploration Ltd.	74,861	77,086
	<u>\$251,805</u>	<u>\$313,380</u>

(a) Noranda Inc. —

The company owns 10,226,981, or 7.9%, (1984 — 13,273,981 or 10.4%) of the total outstanding common shares of Noranda Inc. Noranda and its associated companies are engaged in businesses encompassing mining and metallurgy, manufacturing, forest products and oil and natural gas exploration and production. Condensed financial information of Noranda for the years ended December 31,

1985 and 1984 is set out as follows:

	1985	1984
	(in thousands)	
Operations—		
Revenue	\$3,462,065	\$3,400,078
Expense —		
including interest of \$244,763 (1984 — \$233,706)	<u>3,552,590</u>	<u>3,392,895</u>
	(90,525)	7,183
Income tax recovery and production taxes	5,200	4,345
Minority interest in earnings (losses) of subsidiaries	3,220	(12,450)
Unusual items (net), mainly reduction in carrying value of certain assets offset by gains on sales of investments in associates	(183,192)	
Share of earnings (losses) in associates	11,424	(3,529)
Loss for the year	<u>\$ (253,873)</u>	<u>\$ (4,451)</u>
Financial position—		
Current assets	\$1,937,484	\$1,783,954
Investments in and advances to associated and other companies	1,142,295	1,263,926
Fixed assets — net	2,869,647	2,944,881
Other assets	291,233	313,571
	<u>\$6,240,659</u>	<u>\$6,306,332</u>
Current liabilities	\$1,262,270	\$1,043,864
Deferred taxes and other	273,093	225,780
Long-term debt	2,251,397	2,287,210
Minority interest in subsidiaries	94,979	145,896
Shareholders' equity	<u>2,358,920</u>	<u>2,603,582</u>
	<u>\$6,240,659</u>	<u>\$6,306,332</u>

Notes to Consolidated Financial Statements (continued)

(b) Anderson Exploration Ltd. —

The company owns 1,125,993, or 32.6%, of the total outstanding common shares of Anderson Exploration Ltd. Anderson is engaged in the exploration and development of oil and gas properties in Western Canada. Condensed financial information of Anderson for the years ended December 31, 1985 and 1984 is set out as follows:

	1985	1984
	(in thousands)	
Operations —		
Revenue	\$ 63,953	\$ 46,977
Expense, including interest of \$10,193 (1984 — \$14,086)	42,133	36,077
	21,820	10,900
Income and production taxes	26,646	16,441
Net loss	\$ (4,826)	\$ (5,541)
Financial position —		
Current assets	\$ 16,997	\$ 10,057
Investments	11,863	14,266
Oil and gas properties	310,481	314,361
	\$339,341	\$338,684
Current liabilities	\$ 12,689	\$ 9,550
Deferred revenue	37,321	35,755
Long-term debt	93,281	107,967
Deferred income taxes	49,216	37,161
Shareholders' equity	146,834	148,251
	\$339,341	\$338,684

3. **Property, plant and equipment**

Gas and oil properties
Mining and smelting properties

	1985		1984
Cost	Accumulated depreciation and amortization	Net book value	Net book value
(in thousands)			
\$ 80,812	\$ 13,762	\$67,050	\$65,566
31,615	20,626	10,989	11,089
<u>\$112,427</u>	<u>\$34,388</u>	<u>\$78,039</u>	<u>\$76,655</u>

Payments of \$1,179,000 (1984 — \$1,152,000) earned during the year under the Petroleum Incentive Program have been deducted from the cost of oil and gas properties.

4. **Long-term debt**

The company has arranged with its bankers a line of credit which expires January 1, 1987. Existing advances are fully funded through bankers' acceptances. The effective interest rate payable on the bankers' acceptances is less than the bankers' prime lending rates. No assets have been pledged by the company as collateral for the line of credit.

6. **Share capital**

	Number of shares	
	1985	1984
Common shares without par value:		
Authorized	25,000,000	25,000,000
Issued and outstanding	17,298,629	17,158,377

During the year, 137,689 shares were issued to investors as "flow-through" shares. The portion of the subscription price relating to the shares (\$2,268,311) is included as capital in shareholders' equity at the value equal to the market value at the date of issue. The balance of the subscription price (\$2,560,000) is the value attributed to tax benefits transferred to the investors and is deducted from the provision for income and production taxes in the consolidated statement of operations.

During the year, 2,563 shares valued at \$41,082 were issued as stock dividends. No shares were issued under the employees' stock option and purchase plans. At December 31, 1985, options on 37,450 shares were outstanding, exercisable at prices varying from \$11.53 to \$18.02 for periods up to 1994.

5. **Provision for mine closures**

The provision for mine closures at December 31, 1985 includes estimated net expenditures to be incurred for reclamation, rehabilitation and closure of mining properties currently in operation or closed in prior years but for which these costs are still being incurred. The net balance of the provision at December 31, 1985 was \$5,679,000 (1984 — \$6,366,000) of which \$2,279,000 (1984 — \$2,466,000) is included in the consolidated balance sheet as part of accounts payable and accrued charges and \$3,400,000 (1984 — \$3,900,000) as provision for mine closures.

7. Income and production taxes

Income and production taxes consist of the following:

	1985	1984
	(in thousands)	
Income taxes — current	\$ 1,852	\$(1,875)
— deferred	2,957	2,045
Petroleum and gas revenue tax	1,143	1,068
Mining and capital taxes	360	225
Consideration received for tax benefits transferred to investors in "flow-through" shares	(2,560)	
	<u>\$ 3,752</u>	<u>\$ 1,463</u>

The difference between the above provision for income and production taxes and the amount computed by multiplying the profit from operations before tax by the applicable statutory tax rate is as follows:

	1985	1984
	(in thousands)	
Profit from operations before tax	\$ 8,199	\$ 8,218
Statutory tax rate	<u>48.6%</u>	<u>48.0%</u>
Profit from operations before tax multiplied by the statutory tax rate	\$ 3,985	\$ 3,945
Taxes provided (as above)	3,752	1,463
Difference to be reconciled	<u>\$ (233)</u>	<u>\$(2,482)</u>
Represented by the tax effect of —		
Crown royalties	\$ 1,488	\$ 1,392
Foreign exploration and amortization	437	1,528
Resource allowance	(1,933)	(2,341)
Depletion allowance	(1,280)	(1,053)
Non-taxable dividends	(516)	(2,947)
Other	68	(354)
	<u>(1,736)</u>	<u>(3,775)</u>
Petroleum and gas revenue tax	1,143	1,068
Mining and capital taxes	360	225
	<u>\$ (233)</u>	<u>\$(2,482)</u>

8. Segmented information

The company operates primarily in two industries — mining and smelting, and gas and oil, and in two geographic areas — Canada and the United States. The mining and smelting industry is comprised principally of the mining and sale of gold from the Kerr mine and the zinc reduction activities of the Canadian Electrolytic Zinc operation. The gas and oil industry comprises the company's interest in the Canadian Hunter and American Hunter joint ventures. Information regarding industry segments is set out in the table below. Revenues and identifiable assets in the United States are not significant.

	Industry segments					
	Mining and smelting		Gas and oil		Consolidated	
	1985	1984	1985	1984	1985	1984
Value of production	\$31,897	\$34,103	\$16,124	\$14,617	\$ 48,021	\$ 48,720
Cost of production	<u>22,772</u>	<u>26,666</u>	<u>3,317</u>	<u>1,691</u>	<u>26,089</u>	<u>28,357</u>
	9,125	7,437	12,807	12,926	21,932	20,363
Outside exploration expenses	(7,180)	(6,328)		(2,129)	(7,180)	(8,457)
Depreciation and amortization	(682)	(550)	(3,919)	(2,077)	(4,601)	(2,627)
Segment operating profit (loss)	<u>\$ 1,263</u>	<u>\$559</u>	<u>\$ 8,888</u>	<u>\$ 8,720</u>	<u>10,151</u>	<u>9,279</u>
Dividends and interest income					1,861	6,172
Administrative and general expenses					(1,534)	(1,376)
Interest on long-term debt					(2,279)	(5,857)
Profit from operations before tax					<u>\$ 8,199</u>	<u>\$ 8,218</u>
Identifiable assets	<u>\$21,436</u>	<u>\$24,016</u>	<u>\$72,921</u>	<u>\$70,158</u>	<u>\$ 94,357</u>	<u>\$ 94,174</u>
Corporate assets					294,295	330,921
Total assets					<u>\$388,652</u>	<u>\$425,095</u>
Capital expenditures	<u>\$ 640</u>	<u>\$ 696</u>	<u>\$ 6,089</u>	<u>\$10,599</u>	<u>\$ 6,729</u>	<u>\$ 11,295</u>

Canadian production includes exports of \$19,021 (\$25,382 in 1984) primarily to customers in the United States.

Notes to Consolidated Financial Statements (continued)

9. Related party transactions

The company participates in a number of transactions with Noranda Inc. and its affiliated companies (the Noranda Group). Details of significant transactions with the Noranda Group are set out below:

(i) *Canadian Hunter and American Hunter* —

The company has direct and undivided interests of 13.0% and 7.44% respectively in all of the gas and oil properties, production and related activities of Canadian Hunter and American Hunter. Noranda is the major holder and operator of both of these ventures.

(ii) *Canadian Electrolytic Zinc* —

The company has a direct and undivided interest of 9.8% in all of the properties, production and related activities of Canadian Electrolytic Zinc (CEZ) and the balance is owned by Noranda. The company's portion of zinc concentrate purchased on the company's behalf by CEZ from the Noranda Group amounted to approximately \$12,199,000 (1984 — \$13,918,000).

(iii) *Marketing and administrative services* —

The Noranda Group markets substantially all of the company's production and renders technical and administrative services to the company. During the year marketing fees were \$352,000 (1984 — \$340,000) and fees for technical and administrative services were \$150,000 (1984 — \$146,000).

(iv) *Short-term investment pool* —

The company participates in a short-term investment pool with the Noranda Group. The pool is operated to provide participating companies with the opportunity to invest or borrow funds on a short-term demand basis within the group. Over the year the company earned interest on these funds amounting to \$522,170 (in 1984 interest paid totalled \$19,000). At the year end, the deposit in the pool was \$3,000,000 (1984 — \$3,355,000).

10. Commitments and contingencies

(a) Capital expenditures for 1986 are estimated to be approximately \$9,000,000.

(b) As at December 31, 1984, based on actuarial valuations, the company's pension plans were overfunded by approximately \$8,000,000. In 1985, the company received approval for a return of contributions of \$2,680,000 which has been included in cost of production in the consolidated statement of operations. Because of the overfunding of the plans, no contributions to fund current pension entitlements have been made in 1985 or 1984.



