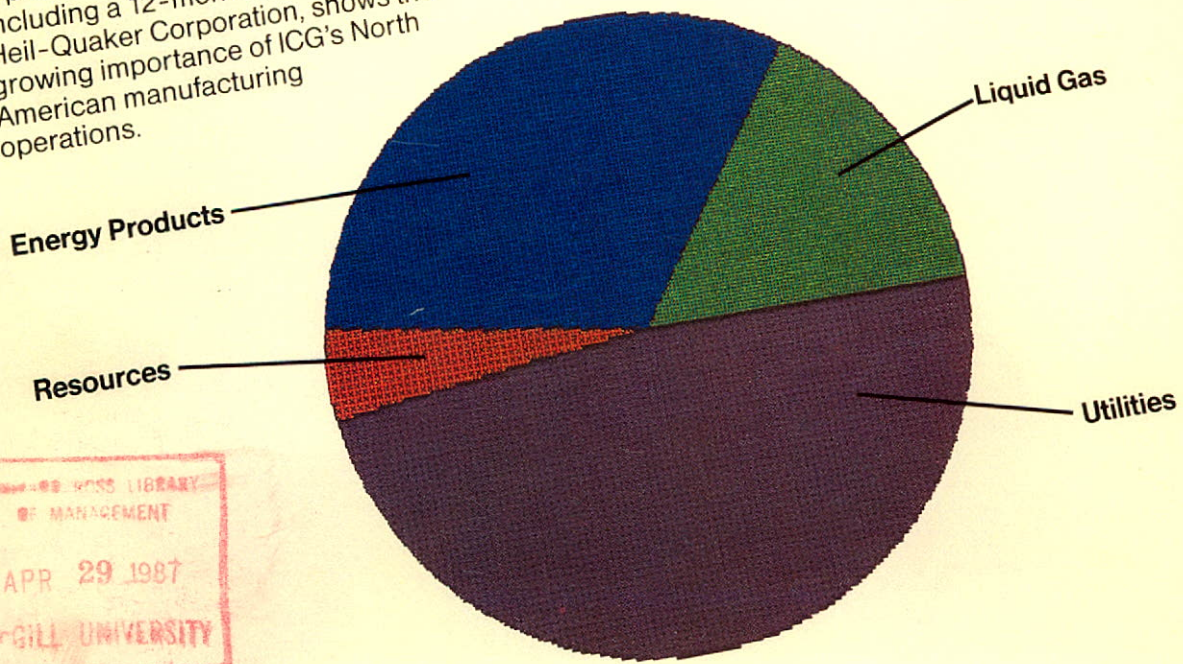


C

- ENERGY PRODUCTS
- LIQUID GAS
- UTILITIES
- RESOURCES



A pro forma breakdown of 1986 operating income, including a 12-month contribution from Heil-Quaker Corporation, shows the growing importance of ICG's North American manufacturing operations.



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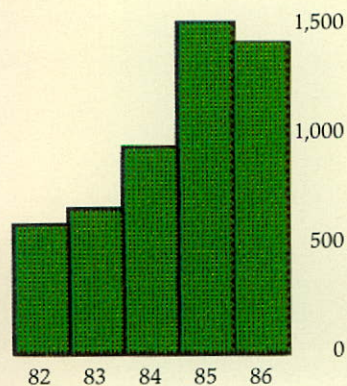
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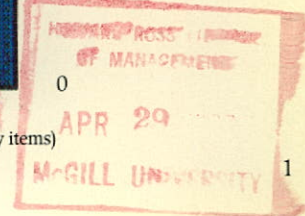
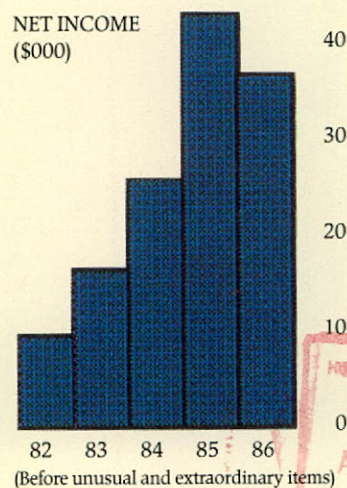
Financial Highlights

<i>(In Thousands of Dollars)</i>	1986	1985	1984
Operating revenue	1,428,517	1,541,376	940,821
Operating profit	141,414	167,157	109,626
Net income (loss)			
Before unusual and extraordinary items	37,265	43,168	26,042
Before extraordinary items	27,921	43,168	26,042
After extraordinary items	29,134	44,060	(2,331)
Cash flow from operations	139,983	97,692	55,575
Capital expenditures	154,879	195,290	115,902
Net income (loss) per common share			
Before unusual and extraordinary items	\$1.30	\$1.73	\$1.34
Before extraordinary items	\$0.80	\$1.73	\$1.34
After extraordinary items	\$0.86	\$1.77	\$(0.19)
Dividends per common share	\$0.60	\$0.50	\$0.40

OPERATING REVENUE
(\$000)



NET INCOME
(\$000)



Report to Shareholders

 **INTER-CITY GAS CORPORATION**

Robert G. Graham
President and
Chief Executive Officer



The past year was a positive and productive one for ICG – one which puts us in position for a major period of consistent growth. However, due to external factors, both sales and earnings were lower than 1985 levels.

While the operating report which follows provides specific details, in general, 1986 performance was impaired either directly or indirectly by the continued drop in world oil prices and by variations from traditional weather patterns.

Under the circumstances, our financial performance in 1986 was a significant operating achievement which reflected dedication to improve ongoing results through innovative technology and management.

RESOURCES

Not surprisingly, our Resources Division was adversely affected by developments in the world oil market. But, while many other companies were cutting back on exploration

and development, we mounted a program which generated increases in both production and reserves.

Our most notable successes were in the Joffre and Kidney areas of Alberta; however, reserve and production growth was also realized through a number of smaller plays in western Canada where our activities continued to be concentrated. Exploration successes have resulted in your Company now owning proved and probable reserves of 337.8 billion cubic feet of natural gas and 15.7 million barrels of oil and gas liquids at finding costs that are below industry levels.

UTILITIES

In our Utilities Division, the effects of unusually warm weather reduced both revenue and earned rates of return. Normal weather would have resulted in net income per share after extraordinary items being 23% greater than was realized. It was also a year of major change as the initial phases of deregulation were implemented.

In the year to come, we'll continue to respond to competitive challenges by seeking to build efficiency and cut costs – and by aggressively marketing natural gas in all segments. We'll do so under the assumption that governments and regulators will continue to protect the sanctity of our franchises and of the economic system under which our natural gas utilities have operated in the Canadian public interest for more than 30 years.

LIQUID GAS

In our Liquid Gas Division, our people continue to be exceptionally resourceful in creating new applications for propane. In the auto-propane market, pioneered by ICG, significant economies still exist in favour of propane as an automotive fuel. At the same time, lower gasoline prices have had to be offset by savings, through streamlined conversion

procedures, which are passed on to the commercial fleet market.

Perhaps the most important new propane application being tested is a program which will provide an economical alternative for diesel fuel for many truck operators. Potential sales growth in this market area is enormous.

ENERGY PRODUCTS

1986 represented a turning point for ICG's Energy Products Division as our long-term strategy of business development in the United States continued to unfold. While important strides were made in our existing operations, the major event of the year was the acquisition of Heil-Quaker Corporation.

Heil-Quaker is one of the leaders in the heating and air conditioning industry in the United States. It has annual sales volume in the area of \$400 million, advanced engineering and manufacturing facilities located in Tennessee, and a complement of over 2,000 experienced employees.

During the year, Donald S. Rogers, Executive Vice-President and Chief Operating Officer reached retirement age. We thank him for his important contribution to ICG. We also wish to acknowledge the many years of valued advice provided by George S. Solomon, who has retired from the Board of Directors.

On behalf of the Board of Directors,



R.G. Graham
President and Chief Executive Officer



Financial Discussion

ICG's operations during 1986 were carried out against a background of significant changes in the oil and gas industry. Reflecting world pressures, the average selling price for oil plunged almost 50% from the 1985 average price. Utility operations were affected by the impact of deregulation of gas prices.

As a result of these developments, the Company recorded a decline in earnings compared to the records set in 1985. In 1986, income before unusual and extraordinary items amounted to \$37.3 million compared to \$43.2 million in 1985 — a decrease of 14%. This represents \$1.30 per common share in 1986 compared to \$1.73 per common share in 1985. Effective October 31, 1986, ICG acquired all the issued and outstanding common shares of Heil-Quaker Corporation; however, results of its operations for the two-month period affected net income to common shareholders by less than one cent per share.

The Company has adopted the ceiling test provisions of the Canadian Institute of Chartered Accountants guideline with respect to full-cost accounting in the oil and gas industry. As a result, the carrying cost of U.S. oil and gas properties has been reduced by \$9.3 million. Consequently, net income after this unusual item, but before extraordinary items, amounted to \$28.0 million or 80 cents per common share.

During the year, ICG utility operations in Minnesota were sold for a gain of \$1.8 million, net of income taxes. In addition, the Company reviewed its investment in the gas utility operations on Vancouver Island. In view of the delay in obtaining a franchise to distribute natural gas to the area, there is uncertainty about the Company's ability to recover its investment — a provision for \$2.0 million, net of income taxes, was recorded as an extraordinary loss. After taking into account the income tax benefits of \$1.3 million realized from

utilization of prior years' tax losses, net income after extraordinary items was \$29.1 million in 1986 compared to \$44.1 million in 1985. On a per share basis, this represents a net income of 86 cents per common share compared to \$1.77 per common share in 1985.

The return, before extraordinary items, on shareholders' equity was 10.2%, compared to 14.7% in 1985 and 11.1% in 1984.

OPERATING REVENUE

Operating revenue decreased by \$112.9 million or 7% over 1985 as a result of sales declines in three of the Company's Divisions.

The decline of \$20.4 million in the Resources Division resulted from lower prices for all products, especially oil, partially offset by higher volumes. Revenues from gas plant operations were also below those of the previous year due to lower volumes and prices.

At ICG Utilities, operating revenue fell by \$117.1 million over 1985 revenue of \$978.7 million, due to the impact of lower selling prices, customers switching to alternative fuels, direct purchases by some industrial customers, warmer weather, and the sale of utility operations in Minnesota, partially offset by customer growth and rate of return increases on higher rate bases.

Propane volumes in the Liquid Gas Division decreased by 6% from 1,061 million litres to 994 million litres reflecting warmer weather, competitive prices in the U.S. and a reduced activity in the oil industry due to the decline in world oil prices. Auto-propane volumes increased by 49 million litres or 21%. The decrease of \$40.0 million in operating revenue was mainly due to lower volumes and

prices for propane, offset to some extent by higher gasoline volumes.

Of the \$64.0 million increase in the operating revenue for the Energy Products Division, \$50.9 million was accounted for by Heil-Quaker in the two months from the effective date of acquisition. Revenue growth of \$9.3 million at KeepRite was due to the increase in the sale of air conditioning products in the United States.

OPERATING PROFIT AND INVESTMENT INCOME

Operating profit decreased by \$25.7 million over 1985 operating profit of \$167.2 million, again primarily as a result of the significant decline in world oil prices.

In the Resources Division, operating profit declined by \$22.7 million. Higher production of oil and natural gas was more than offset by lower prices, and high depletion.

Operating profit in the Utilities Division decreased by \$3.6 million, largely because of warmer weather, sale of the Minnesota utility,

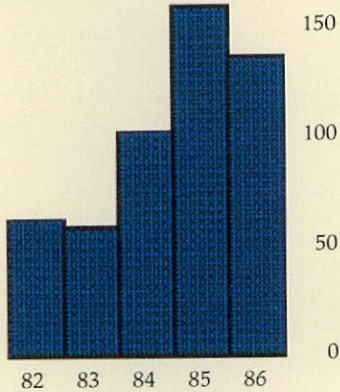
partially offset by customer growth and rate of return increases.

In the Liquid Gas Division, operating profit amounted to \$22.2 million, a decline of \$1.4 million over 1985, due to higher operating expenses, and lower volumes, partially offset by improved gross margins.

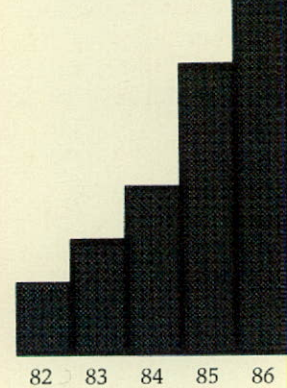
The Energy Products Division achieved an operating profit of \$10.6 million, an increase of \$2.0 million over 1985. Of this, Heil-Quaker contributed \$2.3 million from the effective date of its acquisition, with U.S. steel pipe manufacturing operations reporting an improvement of \$0.6 million. KeepRite recorded a decline in operating profit of \$0.9 million due to the impact of higher operating expenses from expansion in the United States.

The increase in investment income of \$1.8 million was mainly attributable to the gain on the sale of preferred shares in Gaz Metropolitan inc.

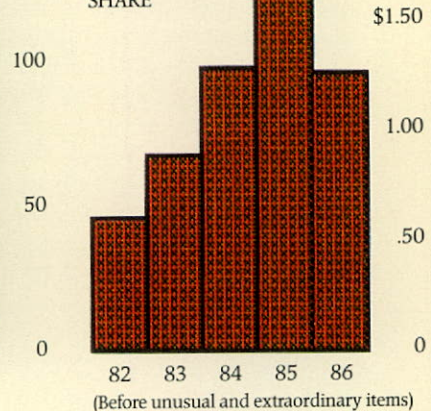
OPERATING PROFIT (\$000)



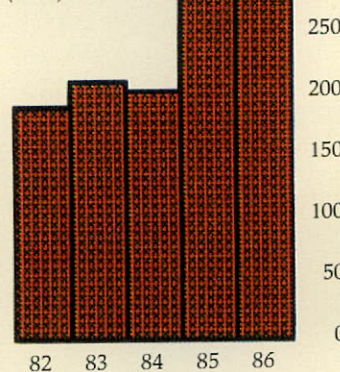
CASH FLOW FROM OPERATIONS (\$000)



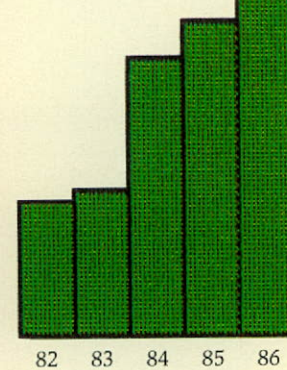
NET INCOME PER COMMON SHARE



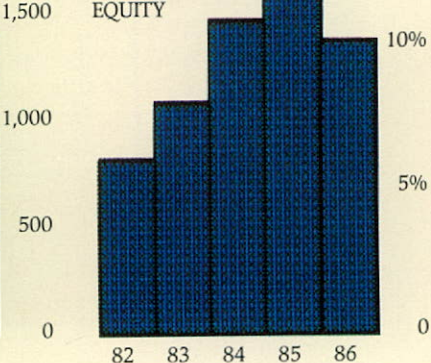
SHAREHOLDERS' EQUITY (\$000)



FIXED ASSETS (\$000)



RETURN ON COMMON SHAREHOLDERS' EQUITY



FINANCIAL EXPENSES

Financial expenses of \$93.9 million in 1986 (1985 – \$98.6 million) include \$2.6 million relating to the operations of Heil-Quaker. Financial expenses attributable to other divisions decreased by \$7.3 million, primarily due to foreign exchange gains and lower interest rates. Lower interest capitalized and increased borrowings reduced these gains.

PROVISION FOR TAXES

The provision for income tax decreased as a result of lower earnings, counterbalanced to some extent by an increase in the effective rate caused by the elimination of inventory allowance, and the introduction of surtax – amendments contained in the Federal Budget introduced in the early part of the year. The effective rate of income taxes for 1986 was 42.4% compared to 40.8% in 1985. Energy taxes in 1986 amounted to \$2.1 million – a reduction of \$5.4 million over 1985, reflecting the combined affect of lower sales in the Resources Division, and the elimination of energy taxes effective September 30, 1986.

LIQUIDITY AND CAPITAL RESOURCES

Cash flow provided from operations in 1986 grew to \$140 million (1985 – \$97.7 million), an increase of \$42.3 million over 1985 of which \$29.2 million reflects the contribution by Heil-Quaker. The remaining increase came from lower interest and income taxes. Of the cash provided from operations, \$27.3 million (1985 – \$20.5 million), was used to make dividend payments to shareholders and by subsidiaries to the minority interest, leaving \$112.7 (1985 – \$77.2 million) available for investment activities.

Net investment activity in 1986 amounted to \$246.8 million, and included the acquisition of Heil-Quaker for \$215.7 million, as well as additions to property, plant and equipment of \$128.4 million, net of customer contributions and grants in aid of construction. The Company also realized \$102.1 million from the sale of its investments in Gaz Metropolitan inc. and its utility operations in Minnesota.

Net cash flow from operations of \$112.7 million, together with \$109.4 million generated from financing activities, was below the amount required for investment activities and resulted in an increase in bank advances of \$24.7 million. Working capital at December 31, 1986 was \$46.7 million, compared to \$36.3 million in 1985.

The acquisition of Heil-Quaker was financed on a bridging basis with funds from a Canadian Chartered Bank. ICG recognizes

the need to raise permanent capital in the form of both debt and equity during the next 12 months. In addition, it expects the outstanding share purchase warrants to be exercised in December, 1987, providing the Company with \$36 million in common equity.

As of December 31, 1986 the Company has unutilized operating lines of credit of approximately \$217.1 million. These credit facilities, together with the cash flow projected to be generated from operations and other financing activities, will be adequate to meet expenditure and investment requirements in the coming year.

1985 COMPARED WITH 1984

In the following analysis, certain comparisons are made on a pro forma basis, assuming Northern and Central Gas Corporation had been acquired on January 1, 1984 and not September 30, 1984, the actual effective date. During 1986, Northern and Central changed its name to ICG Utilities (Ontario) Ltd.

Income before extraordinary items amounted to \$43.2 million compared to \$26.0 million in 1984 – an increase of 66% – or \$1.73 per common share in 1985 compared to \$1.34 per common share in 1984. After extraordinary items, net income was \$44.1 million compared to a net loss of \$2.3 million a year earlier. On a per share basis, this represented a net income of \$1.77 per common share compared to a loss of 19 cents per common share in 1984.

Operating revenue increased by \$93.2 million – an increase of 6% over the 1984 pro forma operating revenue of \$1,448.2 million. The increase was achieved in all operating divisions.

Operating profit increased to \$167.1 million in 1985 – an increase of \$36.0 million over 1984 pro forma operating profit of \$131.1 million. All divisions showed improvements in operating profit over 1984.

1987 OUTLOOK

ICG expects the business environment brought about by the decline in world oil prices and deregulation of natural gas prices to continue throughout 1987. Although there has been some firming up of oil prices since the latter months of 1986, natural gas prices have declined as a result of new gas contracts effective November 1, 1986.

Revenue and profits for Heil-Quaker will be included for a full 12-month period, compared to the two months in 1986, and a contribution to ICG's net earnings is expected in 1987.

Resources

ICG Resources is an integrated oil and gas exploration and development company headquartered in Calgary, Alberta, with involvement throughout North America. Current operations are concentrated in Canada's Western Sedimentary Basin.



ICG Resources acquired more than 2,500 miles of seismic information in 1986. Evaluation of the information is underway and a number of prospects have been uncovered that will be explored in 1987 and future years.



An aggressive exploration and development program generated increased production and reserves for ICG Resources in 1986.

ICG's long-term view of prospects for the oil and gas industry paid substantial dividends in 1986 as the Resources Division generated increases in production and reserves while much of the industry was idle in response to lower world oil prices.

With overhead and administrative expenses cut to the bone, the \$33 million invested in land, drilling, and exploration programs generated maximum benefits.

Net production of oil and natural gas liquids grew by more than 15% to 1.12 million barrels. Despite the Division's emphasis on oil exploration, net production of natural gas was up approximately 7% to 13.5 billion cubic feet.

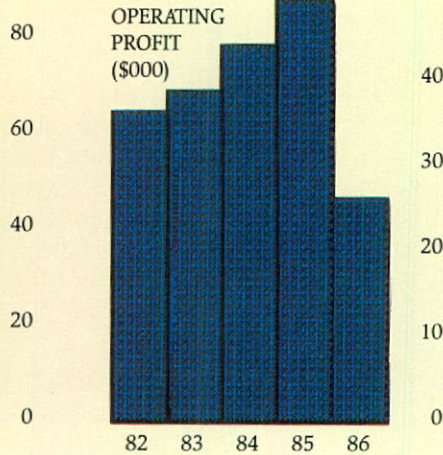
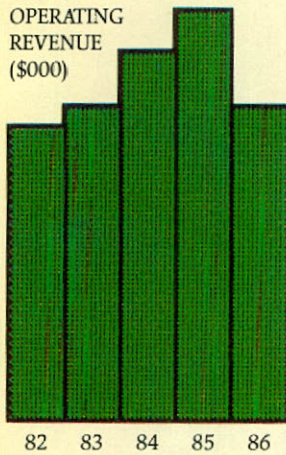
Even with higher production, by the end of the year net reserves had increased 14% for oil and natural gas liquids and 5% for natural gas as a result of reserve additions of 3.5 million barrels of oil and 23 billion cubic feet of gas during 1986.

Average cumulative finding costs for ICG properties, excluding the Arctic, are approximately \$4.50 per net barrel of oil equivalent with current operating expenses approximately \$3.35 per net barrel of oil equivalent. These figures will allow ICG to produce profitably at world prices at or below present levels – and thus to continue to explore and develop in the relatively low risk areas of the western sedimentary basin in Alberta, British Columbia and Saskatchewan.

Two of the major successes of 1986 were at Joffre and Kidney. At mid-year, ICG Resources announced its earlier Leduc oil discovery made in December of 1985 in the Joffre area. The initial well encountered 233 feet of oil pay in an isolated pinnacle reef on the west edge of the Bashaw Reef complex – a discovery that was delineated by a subsequent follow-up well.

One of the most prolific Alberta oil discoveries in recent years, the discovery well produced at 3,000 barrels per day, while initial production from the 2-27 development well is over 800 barrels per day. As a result of additional drilling in 1986, it's now estimated the reef contains upwards of five million

HIGHLIGHTS (\$000)	1986	1985	1984
Operating revenue	66,103	86,553	77,501
Operating profit	26,701	49,428	44,943
Capital expenditures	33,122	53,734	40,078
Total assets	388,196	393,456	349,641
Key volumes –			
Oil and gas liquids – (thousands of barrels)	1,122	975	875
Gas – (millions of cubic feet)	13,505	12,625	9,856



barrels of primary recoverable oil – a figure that could be doubled with the benefit of a secondary recovery scheme which is currently being evaluated.

At Kidney, ICG followed up on Devonian Keg River oil discoveries made in early 1985 with six successful wells. During 1986, another 17 successful oil wells were drilled before the first dry hole was encountered. As a measure of ICG Resources' enthusiasm over the play, 1986 Kidney activity represented more than 50% of the dollar value of ICG's drilling program.

To allow continuous production from the Kidney field and others along the Keg River trend, ICG is a partner in a consortium building the North Red Earth oil pipeline which will carry up to 14,000 barrels per day over more than 105 miles to a junction with the Rainbow Pipeline System. Completion of the line is expected by the Spring of 1987.

Taking maximum advantage of Geophysical Assistance Program subsidies available from the Alberta government, ICG acquired more than 2,500 miles of seismic information

It's estimated that the reef structure at Joffre contains more than five million barrels of recoverable oil. This figure could be doubled through a secondary recovery program currently being evaluated.





Concentrating on prospects in the Province of Alberta, ICG's \$33 million exploration and development program generated increases in both production and net reserves.

in 1986 – more than half of which was shot in the field during the year. In fact, ICG was one of the most active companies in Canada with ten crews working. Evaluation of the information is now underway and a number of prospects have already been uncovered that will be explored in 1987 and beyond.

As the map on page 10 shows, 1987 drilling activity will be concentrated in 3 main areas in the province of Alberta. While the majority of expenditures will be on oil producing areas, a greater emphasis will be placed on specific gas prospects now that the majority of ICG's current producible gas reserves are under contract or otherwise tied up.

In 1987, ICG Resources will participate in two delineation wells (C-09 and H-99) to be drilled on the Terra Nova structure offshore Newfoundland with the objective of evaluating the commercial viability of the oil field. If the wells encounter the anticipated reserves, the operator, Petro Canada, plans to move immediately toward field development beginning in 1991 or sooner with production from a floating system. Similar systems are currently in operation in other parts of the world.

Proven and probable recoverable reserves from the Terra Nova structure are estimated at 158 million bbl gross or 8.1 million bbl net to ICG. An additional 90 million bbl gross (5 million net) may be added by future drilling.

Overall, momentum developed in 1985 and 1986 will continue to build.

PROVED AND PROBABLE RESERVES

	1986		1985		1984	
	Gross	Net	Gross	Net	Gross	Net
Oil and gas liquids – millions of barrels						
Proved	18.1	14.5	15.8	12.7	14.4	11.3
Probable	1.6	1.2	1.6	1.2	1.2	1.1
Total	19.7	15.7	17.4	13.9	15.6	12.4
Gas – billions of cubic feet						
Proved	366.7	302.3	360.0	288.5	348.2	265.2
Probable	41.3	35.5	47.5	38.3	49.9	45.4
Total	408.0	337.8	407.5	326.8	398.1	310.6

This table summarizes the proved and probable reserves, excluding Arctic and offshore holdings, before royalty and net after royalty for our Canadian and United States interests, as at Dec. 31, 1986, 1985, and 1984.

DRILLING	Gross exploratory		Gross development		Gross		Net	
	1986	1985	1986	1985	1986	1985	1986	1985
Wells								
Oil	24	33	21	29	45	62	11.11	14.71
Gas	3	5	29	40	32	45	17.17	21.99
Abandoned	21	43	5	10	26	53	7.11	8.98
Drilling	9	7	3	4	12	11	2.81	2.38
Total	57	88	58	83	115	171	38.20	48.06

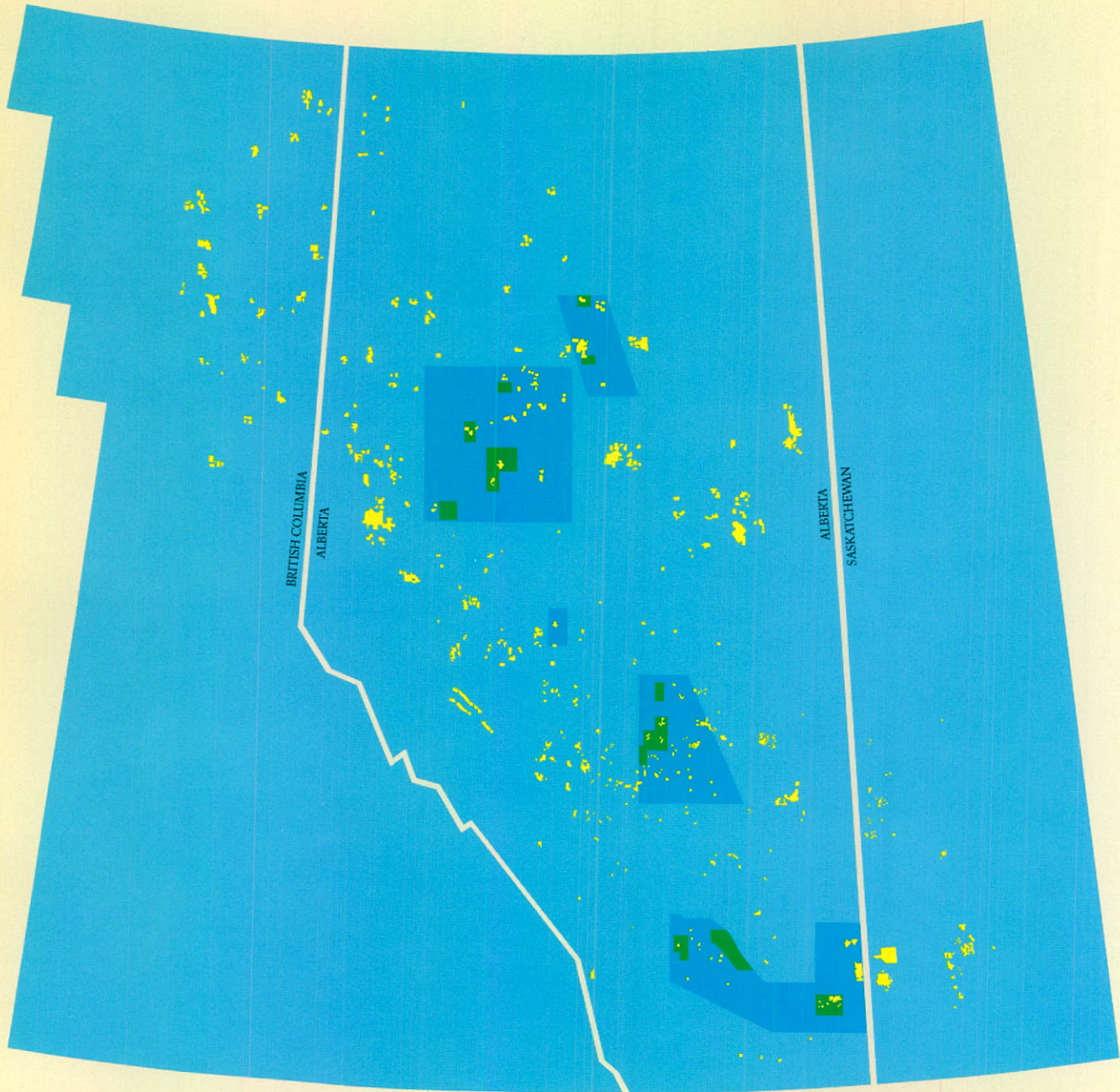
	1986	1985
Success ratios		
Exploratory wells	56.3%	46.9%
Development wells	90.9%	87.3%
Total wells	74.8%	66.9%

GROSS AND NET PRODUCTION	Oil and gas liquids (thousands of barrels)		Gas (millions of cubic feet)	
	Gross**	Net*	Gross**	Net*
1986	1,437	1,122	16,671	13,505
1985	1,296	975	16,256	12,625
1984	1,152	875	12,707	9,856

** Before royalty * After royalty

LAND HOLDINGS AS AT DECEMBER 31 (thousands of hectares)

	1986		1985	
	Gross	Net	Gross	Net
Canada				
Alberta	775	253	866	292
British Columbia	111	29	144	33
Saskatchewan	49	22	142	23
Manitoba	1	1	1	1
Arctic Islands	402	44	267	47
Hudson Bay	827	530	1,823	531
Terra Nova (East Coast)	214	21	214	21
	2,379	900	3,457	948
United States	52	12	68	14
	2,431	912	3,525	962

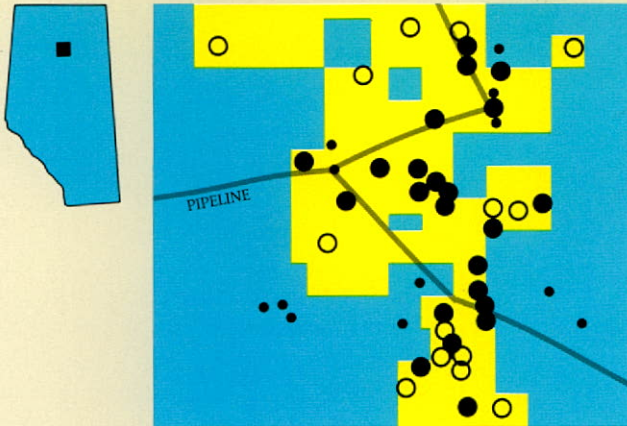


LEGEND

- ICG INTEREST LANDS
- OIL POOL
- AREAS OF GREATEST ACTIVITY IN 1987
- MAIN SEISMIC ACTIVITY IN 1986
- OIL WELL
- ★ GAS WELL
- 1986 OIL WELL
- PROPOSED 1987 DRILLING

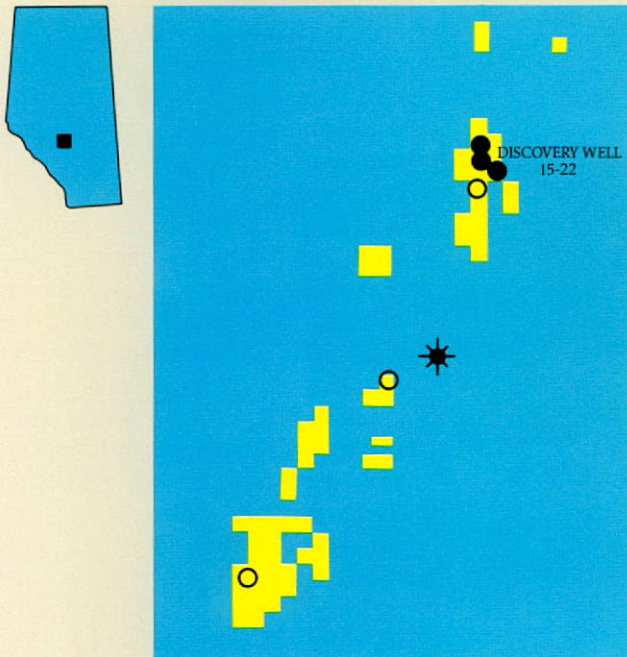
ABOVE: *A graphic overview of ICG Resources' holdings and activities in western Canada.*

AT RIGHT: *Three major plays which will be pursued in 1987.*



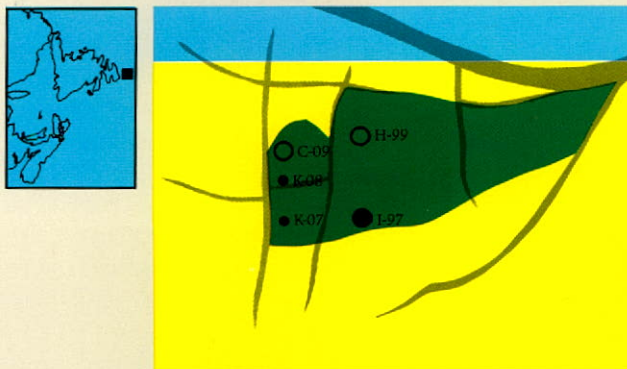
KIDNEY, North Central Alberta

In 1986, ICG drilled 27 wells resulting in 22 oil wells and four dry holes with one drilling at year-end. 1986 additions to net proven reserves were 1.4 million barrels of oil bringing total proven reserves for the area to 2.0 million barrels. Remaining probable and possible net reserves to ICG are 2.3 million barrels. Gross production capability (based on ICG's average working interest at 26%), was 2,400 barrels per day at year-end. A total of 14 exploratory and development wells are expected to be drilled in 1987.



JOFFRE, Central Alberta

After a significant discovery well in 1985, ICG participated in six additional wells in the Bashaw Reef Complex in 1986. Of these, one was completed as a Leduc oil well and another as a Nisku gas well. ICG also participated in acquiring 825 kilometres of seismic data along the trend in 1986. Through farmed lands and crown land purchases, ICG has acquired interests in approximately 7,600 hectares on which there are a number of promising oil and gas prospects, at least three of which are to be drilled in early 1987.



TERRA NOVA, offshore Newfoundland.

In 1987, activity will once again begin on the Terra Nova structure offshore Newfoundland. During the year, ICG Resources will participate in two delineation wells (C-09 and H-99) to evaluate the commercial viability of the oil field. Proven and probable recoverable reserves net to ICG from the Terra Nova structure are estimated at 8.1 million barrels. An additional five million barrels net may be added by future drilling.



Utilities

ICG Utilities is a major distributor of natural gas, serving more than 400,000 residential, commercial and industrial customers in British Columbia, Alberta, Manitoba and Ontario.



Operating profits at ICG Utilities were close to 1985 levels, despite mild weather and competition from lower cost alternative fuels.

Despite a year-over-year drop in revenue of 12%, ICG Utilities was able to maintain operating profits at close to 1985 levels.

At \$861.6 million, revenue was down as a result of discounts awarded through competitive marketing programs, greater direct purchases by large industrial customers, the mild weather (8.8% warmer than last year), and the sale of utility operations in Minnesota.

Operating profit decreased from \$86.8 million in 1985 to \$83.2 million in 1986. Beyond the weather, principal factors contributing to the shortfall were significantly increased insurance costs and property taxes, and switches by many interruptible customers to lower cost alternative fuels (to which ICG Utilities could not respond because of the absence of a more market-responsive price structure for natural gas).

At the same time, the Division added more than 11,000 new customers to the system (2.8% of the 1985 customer base), cut costs through staff reductions (2.0% lower than last year) and other programs, and enjoyed a considerable degree of success in marketing appliances (a 35% increase in unit sales). We will continue to pursue this opportunity in 1987 with the assistance of an extensive and developing dealer network.

In Ontario, 14 new appliance centres were opened in dealer outlets during 1986 — making natural gas appliances accessible in all major centres served by ICG Utilities. Dealer development is also progressing well in the Alberta and Manitoba Regions. New products such as natural gas fireplaces, enjoyed particularly strong acceptance by existing customers and in the new construction market.

In the area of new technology, a comprehensive testing program was set in motion for flexible piping systems which allows easier and less expensive installations of piping and gas appliances in the home. As part of the program, 20 new homes have been connected and are being monitored in an attempt to develop piping systems with lower installation costs which, in turn, will improve per customer appliance sales.

Research and development on radiant heat-

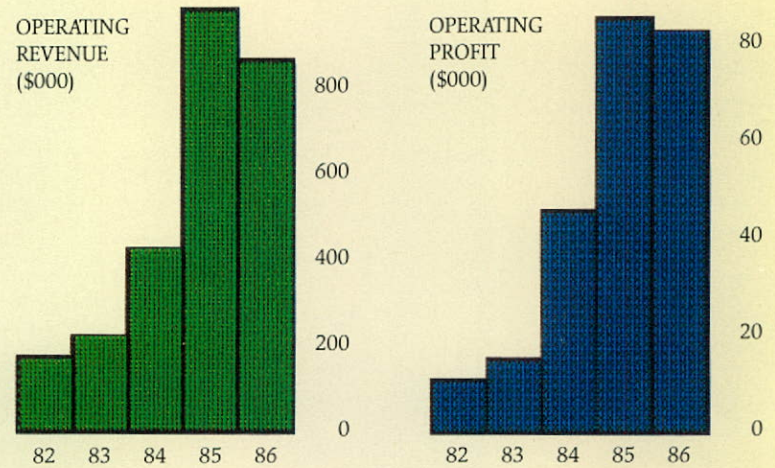
ing applications for new residential construction was also initiated during the year. Testing and monitoring is now under way at the first installation in North Bay, Ontario.

Capital projects for the year totalled \$71.6 million. After receipt of \$11.1 million from customer contributions and government grants, net cost to the Company was \$60.5 million. Major projects completed were Phase I and II of the Sudbury Loop and the final phase of the lateral system to serve the Blind River/ Elliot Lake area of Northern Ontario. Approximately one-half of expenditures were made to connect new customers.

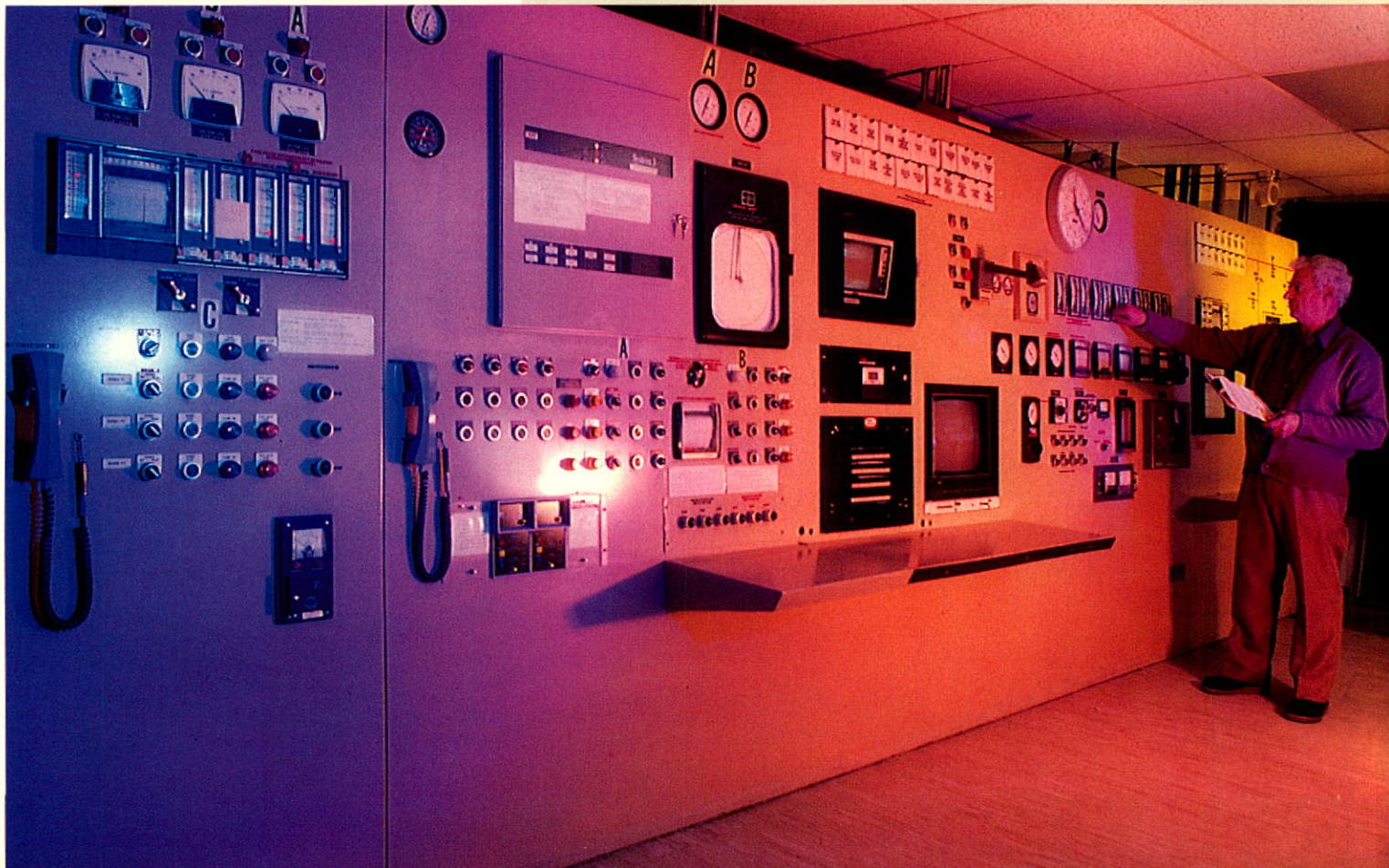
In May, the integration of Northern and Central Gas Corporation Limited into the ICG Utilities family was launched with an official change of name to ICG Utilities (Ontario) Ltd. As a result of a wide range of communications programs, the new name is now well established with customers throughout the franchise area.

A total of nine rate adjustment applications were submitted in 1986. Four of these dealt with gas supply costs, with the remainder

HIGHLIGHTS (\$000)	1986	1985	1984
Operating revenue	861,613	978,673	437,863
Operating profit	83,243	86,826	46,396
Capital expenditures	71,564	115,158	56,117
Total assets	879,016	909,117	814,633
Key volumes –			
Gas – (millions of cubic feet)	186,171	201,502	90,384



The control room at ICG's Hagar, Ontario liquified natural gas facility where up to 600 million cubic feet of gas is stored.





more comprehensive, covering all related costs. General rate applications, along with decisions on 1985 applications handed down in 1986, generated \$9.3 million in additional revenue. On an annualized basis, this represents an increase of \$10.3 million.

The rate judgment handed down in June by the Ontario Energy Board on an application made in September 1985 allowed a return on equity of 15%; however, rates were not implemented at the beginning of the year as had occurred in the previous two years.

In 1986, ICG Utilities' allowable rates of return on equity across Canada ranged between 13.75% and 16.25%. In 1987, the Division will place a major emphasis on earning its full allowable return through marketing and cost control programs.

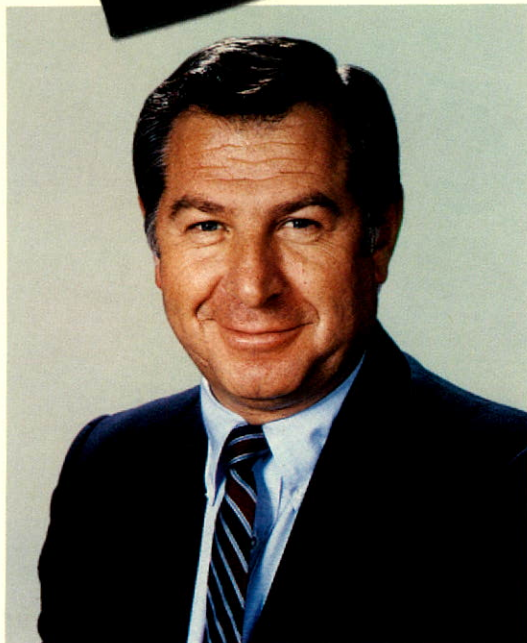
Late in 1986, ICG signed agreements with Western Gas Marketing, a subsidiary of TransCanada PipeLines, which would effectively set gas prices payable by ICG Utilities customers in Manitoba and Ontario beginning on November 1, 1986. The Ontario agreement, was approved by the Ontario Energy Board for a term of one year pending further review at that time. The Manitoba agreement is currently under review by the Public Utilities Board.

For the future, ICG remains convinced that, over the long term, deregulation will be the best path for the industry. It will be particularly advantageous for ICG Utilities in that it will offer a stronger competitive position in industrial markets. However, in the short term transitional period, a number of complex issues remain to be sorted out – making both planning and decision making more difficult.

In 1986, ICG Utilities added more than 11,000 new customers – nearly 3% of the overall customer base.

Liquid Gas

ICG Liquid Gas distributes propane and related equipment as well as a range of automotive fuels, from more than 1,000 branches and dealers from Quebec to British Columbia. The Division is a leader in Canada's auto propane industry.



Efficiency, cost controls, and a technological head start helped offset the negative impact of market factors at ICG Liquid Gas.

Substantial growth in auto-propane sales volume was offset by lower sales to residential and industrial customers in Western Canada. The decline was due to warmer than normal weather in the fourth quarter and substantial reduction in oil industry activity.

Propane prices fell with crude oil values resulting in lower operating revenues. However operating profit was held at close to 1985 levels by ICG Liquid Gas.

Propane sales for the year were 994,471 thousand litres, down from 1,061,211 thousand litres in the previous year, resulting in a reduction in revenue from \$320.7 million

to \$280.6 million. However, as a result of more efficient operations and tight cost controls, operating profit declined only marginally to \$22.2 million from \$23.5 million.

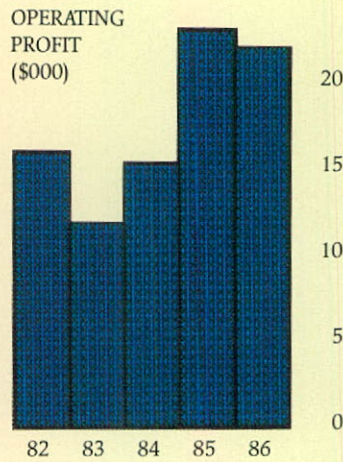
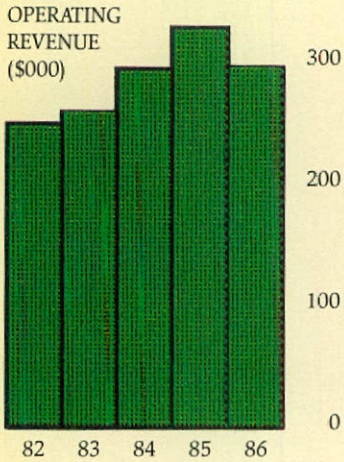
During the year there were many developments in the auto-propane market. With retail gasoline prices declining as much as 25%, commercial customers realized fuel cost savings without switching to alternatives. As a result, industry sales of propane conversions fell from 1985's record level.

However 1985's demand was abnormally high as customers rushed to have vehicles converted before the Federal Government's grant program expired. Excluding this blip in the growth pattern, ICG's increase in conversion sales over previous years was a significant accomplishment in the face of tough market conditions. Several factors contributed to this performance: a sharper marketing focus, Liquid Gas' leading market position and its head start on the conversion of electronic fuel injected engines.

These new, highly efficient motors now account for a significantly higher proportion of new fleet car sales. In fact, it's likely that within the next year the carburetor will be technology of the past for the auto industry.

Some years ago, ICG recognized this trend and with the help of equipment suppliers

HIGHLIGHTS (\$000)	1986	1985	1984
Operating revenue	280,632	320,670	284,659
Operating profit	22,175	23,529	15,034
Capital expenditures	37,509	20,882	13,779
Total assets	148,920	140,057	151,641
Key volumes –			
Propane – (thousands of litres)	994,471	1,061,211	908,536



began work to develop conversion systems for fuel injected fleet vehicles. As a result, when demand materialized, Liquid Gas was ready with tested and proven conversion hardware – an edge that will be maintained over the competition in years to come.

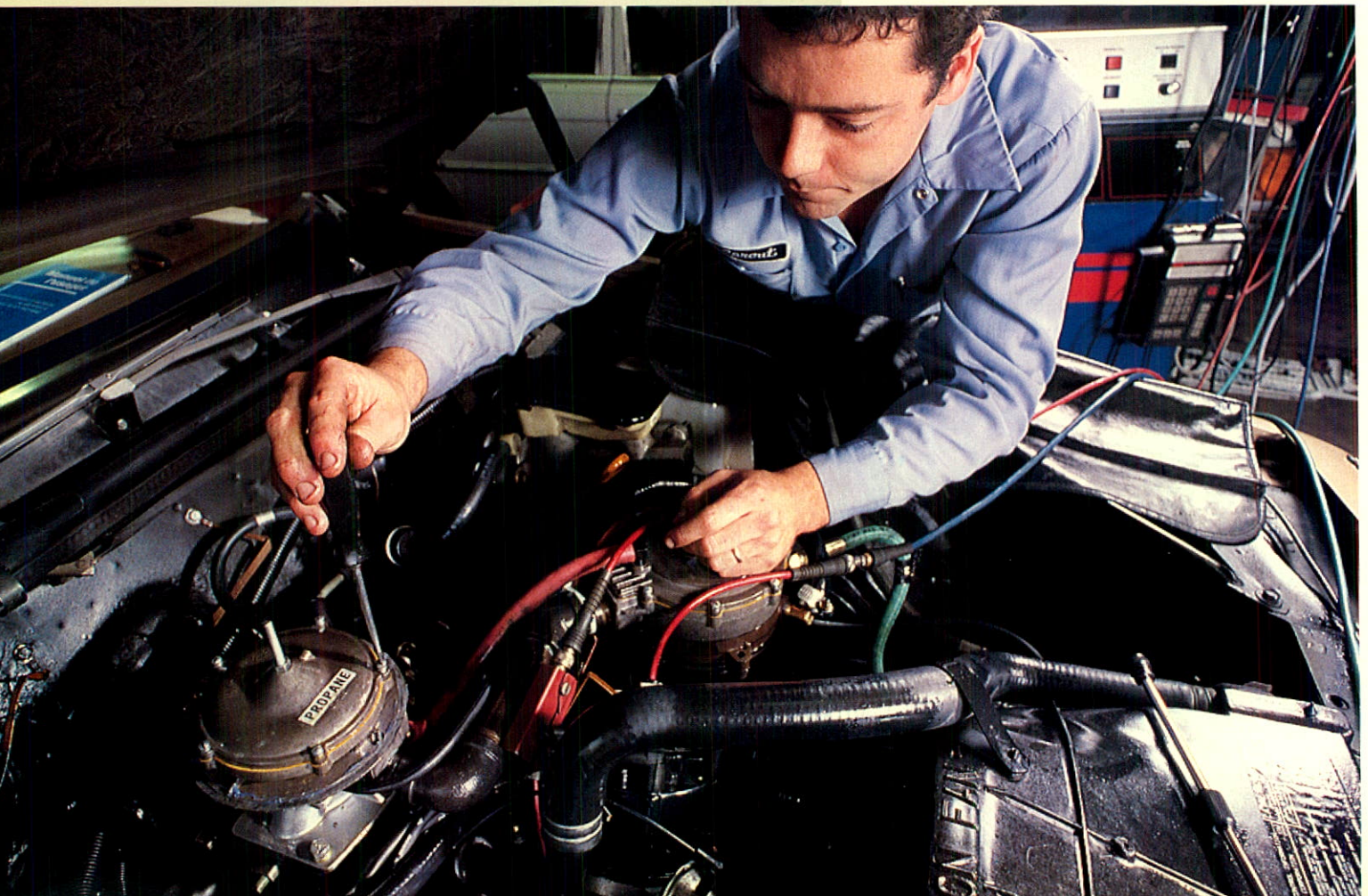
The shift to electronic fuel injection is also helping to reduce costs of conversion, now that engines automatically monitor and adjust for fuel/air mixtures.

To further improve the economic advantages offered by auto-propane, ICG has passed on cost savings generated by consolidating conversion equipment and procedures – and now offers both fuel and equipment in one package to fleet customers.

In more traditional markets, ICG continued to develop new applications and uses for propane. The drive behind these efforts is to find specialized niche markets that can be served over the long term.

In 1985, for example, Liquid Gas initiated marketing programs using high efficiency

Anticipating the trend toward electronic fuel injection for automotive engines – ICG Liquid Gas has developed hardware and software that provide a competitive edge in the market place.



computer-controlled burners for asphalt plants. This pioneering work paid off in 1986 with a 150% sales increase in this market. During the year, ICG also introduced to the agricultural market its new "Heat Venter" – a combination heating/ventilating unit developed in conjunction with ICG KeepRite.

In the past, livestock or poultry farmers operating in a confined building have had a constant problem with moist, bacteria-laden air in the barn. The Heat Venter provides pre-heated, fresh air to meet winter ventilation requirements recommended for healthy growth of confined livestock. Propane's clean-burning characteristics in a direct-fired burner delivers nearly 100% of the heating dollar directly to the barn interior, resulting in healthier and warmer animals and increased productivity.

Propane-powered generator sets, originally designed for the oil patch, were marketed in 1986 to forestry camps, fishing/tourist resorts and northern government services operations. Propane is now truly the only fuel a self-contained, remote operator need consider – to cook food, heat the camp, power vehicles and provide electricity for lights and equipment motors.

There are many other examples of ICG's technology and expertise in action in the propane marketplace; however, perhaps the most important is the move to convert highway trucks to propane, providing a more economical alternative to diesel fuel.

In 1986, significant strides were made as a result of a joint program in co-operation with the Ontario Ministry of Transportation, Communications and the Federal Ministry of Energy. In all, 54,000 kilometres of testing were compiled on a prototype vehicle which established propane's acceptability in terms of power and drivability – and its sound competitive position in both fuel economy and conversion costs.

The objective is a Canadian market estimated at 145,000 Class Eight trucks, each burning about 110,000 litres of diesel fuel per year, or a total of 16 billion litres of propane annually. This market should be accessible because, in addition to greater economy, propane offers more powerful acceleration, instantaneous response, reduced engine noise and cleaner exhaust.

Overall, 1986 saw a growing recognition by retail station operators and oil companies of

the value of dealing with a responsible and reputable propane supplier. ICG has always operated with only the highest equipment, training and safety standards – a fundamental commitment that is leading to business opportunities for Liquid Gas as oil companies look to improve management practices for their propane operations.

At the beginning of 1987, the division completed the installation of a new branch computer operated accounting and information system based on state-of-the-art personal computers. The system, which provides branch managers with up-to-date, detailed information about their operations, has already resulted in operating cost savings and improved customer service.



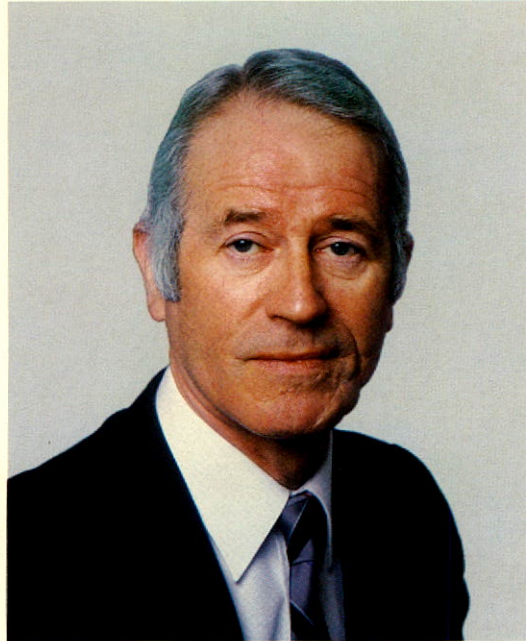
As a result of pioneering work done in 1985, propane sales to asphalt plants using high efficiency computer-controlled burners grew by more than 150%.



A testing program in co-operation with the Government of Ontario – in which 54,000 km were logged on this prototype vehicle – is proving the advantages of propane over diesel fuel for operators of large trucks. The total potential market is 145,000 Class Eight trucks which would burn approximately 16 billion litres of propane annually.

Energy Products

ICG'S Energy Products division is a leading maker of heating, refrigeration and air conditioning products, in addition to specialized industrial heat exchangers, packaged energy conservation products and spiral-welded water transmission pipe.



The Heil-Quaker acquisition has established a strong U.S. market position which will build Energy Products' sales and earnings in 1987 and beyond.

Most other developments in the Energy Products Division were dwarfed by the acquisition of Heil-Quaker, a subsidiary of Whirlpool Corporation, headquartered near Nashville, Tennessee, late in 1986.

Heil-Quaker holds a significant share of the U.S. residential and light commercial heating and air conditioning market with 1986 sales in excess of \$400 million (Cdn.).

With this acquisition, we have now positioned the Division as one of the top players in the North American comfort heating and cooling industry.

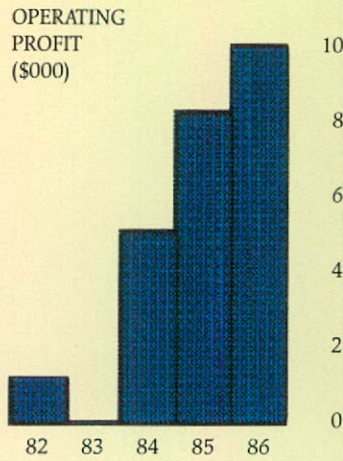
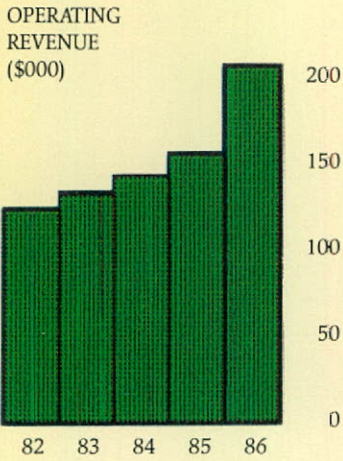
KeepRite increased its share of the Canadian residential furnace market in 1986 despite the fact that total industry shipments of furnaces were below 1985 levels. Sales of room air conditioners and unitary air conditioners were down somewhat from last year, primarily because of cool summer weather in most of the country.

During the year, we made further progress in developing our offshore customer base for the sale of finished goods and completely knocked-down (CKD) air conditioners for Third World countries. At year-end, six projects were under development in various parts of the world. While the program is still in its early stages, with the support of the Canadian International Development Agency (CIDA) there are encouraging signs that CKD will make a good contribution to export sales and earnings in future years and help KeepRite to establish a stronger presence in the international marketplace.

The bulk of ICG's heating and cooling products sold into the Canadian marketplace is now produced at our Brantford, Ontario plant where our focus continues to be on reduced manufacturing costs through improved manufacturing processes, better purchasing and smaller inventory levels.

At Unifin, the London, Ontario-based manufacturer of heat transfer products, success initiated in 1985 continued throughout the year. Sales, profits and productivity all showed significant gains. While the contribution to profits from successful initiatives in

HIGHLIGHTS (\$000)	1986	1985	1984
Operating revenue	219,468	155,430	140,522
Operating profit	10,613	8,642	5,604
Capital expenditures	10,085	1,479	1,690
Total assets	369,554	102,829	98,942
Key volumes –			
Air conditioners – (units)	149,781	152,771	123,483
Furnaces – (units)	83,967	31,913	31,992
Steel pipe – (thousands of kilograms)	9,225	5,146	8,318



China was not large, it was nonetheless an important door opener to further business developments for Unifin, KeepRite and ICG in the world's most populous country.

Apart from the Heil-Quaker acquisition in the U.S., it was another successful year for manufacturing and marketing packaged terminal air conditioners for the light commercial market. These products are manufactured in our Johnson City, Tennessee plant and are sold primarily under the ZoneAire brand name. In addition, the Division began to manufacture and market a new range of unitary air conditioning products, operating from a 40,000 sq. ft. leased building adjacent to our ZoneAire factory. This arrangement minimizes initial start-up costs by sharing existing assets and resources between the two plants.

Newly-acquired Heil-Quaker is a recognized U.S. leader in residential and light commercial heating and air conditioning.



Looking to the year ahead, management is excited by the prospects presented by the addition of Heil-Quaker which will enable us to pursue a bigger share of the approximately \$5 billion U.S. market available in North America.

The basic marketing strategy in Canada will remain the same – to increase share of the furnace market and to maintain the existing overall share of the room air conditioner and unitary air conditioner markets, selling under two distinctive brand names, ICG and KeepRite. The total market for these products in Canada is not expected to grow by any significant amount over the next few years, so the prime objective will be increased profitability through reduced costs via improved manufacturing processes and distribution efficiencies. The Division will also continue developing offshore markets operating from its Canadian base.

In the United States, markets for furnace heating and unitary air conditioning products are expected to be relatively close to

1986 levels. Forecasts are for modest improvement in our market share in each of these business segments due to Heil-Quaker.

Heil-Quaker markets its products under two labels – Heil and Whirlpool. Under the terms of the purchase agreement with Whirlpool Corporation, ICG has the right to use the Whirlpool brand name in the United States for a period of three to four years for products manufactured in the Heil-Quaker plant in Lewisburg, Tennessee. Plans are currently being developed to introduce a new brand name to replace the Whirlpool label.

Heil-Quaker products are sold to consumers through a network of approximately 200 independent Heil and Whirlpool distributors under franchise arrangements and a vast network of independent dealer/installers who also provide “in home” after-sales service and maintenance on an ongoing basis. In addition, Heil-Quaker sells a substantial proportion of production through Sears under the Kenmore brand name.

Plans are being developed to introduce a new brand name to replace the “Whirlpool” label for air conditioners and furnaces marketed in the U.S.





Sales, profits and productivity were up at Unifin. Groundwork was laid toward developing business in China.

In 1987, ICG will invest approximately \$20 million U.S. as the final portion of a \$60 million U.S. capital investment program initiated at Heil-Quaker. This capital investment is intended to improve the quality of Heil-Quaker products to reduce manufacturing costs and to improve distribution efficiencies. Looking further into the future, our objective for Energy Products is to increase its overall share of the North American comfort heating and cooling markets and to achieve a 10% operating profit on sales which will place us among the leaders in this industry.

THOMPSON PIPE & STEEL

At Thompson Pipe, 1986 was a year for record orders and margins. Orders booked increased from U.S. \$9.8 million in 1985 to U.S. \$24.3 million in 1986 – a 145% increase. This resulted in a U.S. \$14.5 million backlog as of December 31, up 310% over the previous year.

Operating revenue and profit for 1986 were \$19.0 million and \$1.1 million, representing increases of 24.9% and 144.4%, respectively, over 1985. Forecasts for 1987 point to another record volume year.



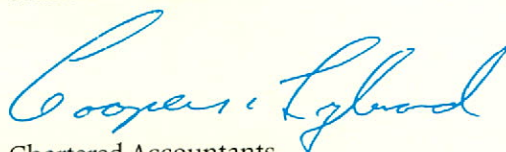
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Auditors' Report to the Shareholders

We have examined the consolidated balance sheet of Inter-City Gas Corporation as at December 31, 1986 and 1985 and the related consolidated statements of income, retained earnings and changes in financial position for the years ended December 31, 1986, 1985 and 1984. Our examinations were 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 Inter-City Gas Corporation as at December 31, 1986 and 1985 and the results of its operations and the changes in its financial position for the years ended December 31, 1986, 1985 and 1984 in accordance with generally accepted accounting principles applied on a consistent basis.



Chartered Accountants

Toronto, Ontario
March 5, 1987

Consolidated Balance Sheet

As at December 31, 1986 and 1985

Assets <i>(In Thousands of Dollars)</i>	1986	1985
Current assets		
Cash and short-term deposits	16,935	1,503
Accounts and notes receivable (less allowance for doubtful accounts; 1986 - \$6,428; 1985 - \$6,077)	271,076	283,362
Income taxes recoverable	4,529	3,297
Inventories	159,242	100,766
Prepaid expenses	8,830	3,320
	<u>460,612</u>	<u>392,248</u>
Investments		
Investments in related and other companies	126,576	194,326
Notes and mortgages	29,704	32,690
Employee share purchase plan loans	3,675	4,290
	<u>159,955</u>	<u>231,306</u>
Fixed assets		
Property, plant and equipment – at cost	1,701,339	1,472,156
Accumulated depreciation and depletion	409,928	356,494
	<u>1,291,411</u>	<u>1,115,662</u>
Deferred costs – at cost, less amortization	25,689	26,705
	<u>1,937,667</u>	<u>1,765,921</u>

See accompanying notes

On behalf of the Board



DIRECTOR



DIRECTOR

Liabilities *(In Thousands of Dollars)*

	1986	1985
Current liabilities		
Bank advances	103,755	63,587
Accounts payable and accrued liabilities	251,456	237,839
Income taxes payable	19,888	21,199
Current portion of long-term debt	38,845	33,290
	<u>413,944</u>	<u>355,915</u>
Long-term debt	883,599	784,052
Advances under natural gas sales contracts	13,498	14,299
Contributions and grants in aid of construction	103,623	93,074
Deferred income taxes	90,914	83,958
Minority interests in subsidiaries	41,750	45,390
	<u>1,547,328</u>	<u>1,376,688</u>
REDEEMABLE PREFERENCE SHARES	82,013	82,722
	<u>82,013</u>	<u>82,722</u>
SHAREHOLDERS' EQUITY		
Convertible preference shares	75,000	75,000
Common shares	180,287	178,779
Contributed surplus	8,250	8,250
Retained earnings	61,693	56,774
Foreign currency translation adjustment	1,692	6,304
	<u>326,922</u>	<u>325,107</u>
Common shares of the Company held by subsidiaries	18,596	18,596
	<u>18,596</u>	<u>18,596</u>
	<u>308,326</u>	<u>306,511</u>
	<u>1,937,667</u>	<u>1,765,921</u>

See accompanying notes

Consolidated Statement of Income

For the years ended December 31, 1986, 1985 and 1984

<i>(In Thousands of Dollars)</i>	1986	1985	1984
OPERATING REVENUE	1,428,517	1,541,376	940,821
OPERATING COSTS			
Cost of sales	985,153	1,095,096	635,556
Operating, selling and administrative	242,999	227,807	161,477
Depreciation and depletion	58,951	51,316	34,162
	1,287,103	1,374,219	831,195
OPERATING PROFIT	141,414	167,157	109,626
INVESTMENT INCOME	21,541	19,746	4,770
	162,955	186,903	114,396
FINANCIAL EXPENSES			
Interest on long-term debt	91,397	95,008	54,812
Other interest	7,664	7,118	9,243
Interest capitalized	(3,524)	(7,614)	(8,757)
(Gain) loss on foreign exchange	(2,424)	2,151	300
Amortization of deferred costs	815	1,964	1,304
	93,928	98,627	56,902
INCOME BEFORE TAXES	69,027	88,276	57,494
PROVISION FOR TAXES			
Income taxes	29,251	36,028	25,136
Alberta royalty tax credit	(2,753)	(2,000)	(2,000)
Energy taxes	2,059	7,452	7,214
	28,557	41,480	30,350
INCOME AFTER TAXES	40,470	46,796	27,144
MINORITY INTERESTS IN SUBSIDIARIES	(3,205)	(3,628)	(1,102)
INCOME FROM OPERATIONS BEFORE UNUSUAL AND EXTRAORDINARY ITEMS	37,265	43,168	26,042
Write-down of oil and gas properties, net of income taxes of \$6,840	(9,344)	-	-
INCOME BEFORE EXTRAORDINARY ITEMS	27,921	43,168	26,042
EXTRAORDINARY ITEMS			
Reduction of current income taxes on application of prior years' losses	1,343	6,045	327
Net gain (loss) on sale of business units, net of income taxes of \$5,272 (1985 - \$804)	1,842	(382)	-
Provision for investment in utility expansion companies, net of income taxes of \$1,973 (1985 - \$1,421)	(1,972)	(4,771)	-
Provision for investment in MICC	-	-	(28,700)
	1,213	892	(28,373)
NET INCOME (LOSS)	29,134	44,060	(2,331)

See accompanying notes

Consolidated Statement of Changes in Financial Position

For the years ended December 31, 1986, 1985 and 1984

<i>(In Thousands of Dollars)</i>	1986	1985	1984
OPERATIONS			
Cash Receipts			
Receipts from sales	1,517,746	1,515,608	863,043
Investment and other income	35,083	41,388	14,917
	<u>1,552,829</u>	<u>1,556,996</u>	<u>877,960</u>
Cash Disbursements			
Purchases and expenses	1,304,235	1,338,024	755,644
Interest	90,711	100,827	58,032
Income tax installments	17,900	20,453	8,709
	<u>1,412,846</u>	<u>1,459,304</u>	<u>822,385</u>
Cash provided from operations	<u>139,983</u>	<u>97,692</u>	<u>55,575</u>
CASH WAS USED FOR			
Dividends paid			
By the Company to shareholders	24,200	17,233	8,037
By subsidiaries to minority interests	3,076	3,294	1,097
	<u>27,276</u>	<u>20,527</u>	<u>9,134</u>
Cash available for investment	<u>112,707</u>	<u>77,165</u>	<u>46,441</u>
INVESTMENT			
Property, plant and equipment	156,043	190,803	120,653
Investment in new business unit	215,666	—	240,000
Notes receivable and other investments	103	23,511	33,451
Deferred costs and other	4,794	6,087	6,110
Customer contributions and grants in aid of construction	(27,668)	(37,549)	(29,064)
Proceeds on sale of business units	(27,445)	(55,414)	—
Proceeds on sale of investments	(74,689)	—	—
Cash used in investment activities	<u>246,804</u>	<u>127,438</u>	<u>371,150</u>
Deficiency before financing	<u>134,097</u>	<u>50,273</u>	<u>324,709</u>
FINANCING			
Long-term debt issued	326,126	95,545	248,181
Preference shares issued	—	75,000	77,000
Common shares issued	1,508	1,657	57
Notes, mortgages and other	8,674	15,095	13,723
Redemption of preference shares and purchase of minority interests	(4,487)	(4,249)	(3,923)
Repayment of long-term debt	(222,460)	(126,466)	(18,246)
Cash generated from financing activities	<u>109,361</u>	<u>56,582</u>	<u>316,792</u>
INCREASE (DECREASE) IN CASH DEFICIENCY	<u>24,736</u>	<u>(6,309)</u>	<u>7,917</u>
CASH DEFICIENCY – Beginning of the year	<u>62,084</u>	<u>68,393</u>	<u>60,476</u>
CASH DEFICIENCY – End of the year	<u>86,820</u>	<u>62,084</u>	<u>68,393</u>
REPRESENTED BY			
Bank advances	103,755	63,587	73,050
Less: cash and short-term deposits	16,935	1,503	4,657
	<u>86,820</u>	<u>62,084</u>	<u>68,393</u>

See accompanying notes

Consolidated Statement of Retained Earnings

For the years ended December 31, 1986, 1985 and 1984

<i>(In Thousands of Dollars)</i>	1986	1985	1984
BALANCE – Beginning of the year	56,774	34,615	45,534
Underwriting commission and issue expenses of Third preference shares, 1985 Series, net of income taxes of \$1,488	–	1,549	–
Net income (loss)	56,774 29,134	33,066 44,060	45,534 (2,331)
	85,908	77,126	43,203
Dividends –			
Preference shares	12,979	11,052	1,177
Common shares	11,236	9,300	7,411
	24,215	20,352	8,588
BALANCE – End of the year	61,693	56,774	34,615

See accompanying notes

Notes to Consolidated Financial Statements

For the years ended December 31, 1986, 1985 and 1984

1. SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

These financial statements have been prepared in accordance with generally accepted accounting principles in Canada which differ in certain respects with accounting principles in the United States. The differences between generally accepted accounting principles in Canada and the United States are described further in the Company's annual report on Form 10-K filed with the Securities and Exchange Commission.

Consolidation

The consolidated financial statements include the assets, liabilities and operating results of all subsidiary companies from the dates of acquisition, on the basis of purchase accounting. The excess of purchase price of subsidiary companies over the fair value of the assets acquired is treated as goodwill, and amortized on a straight line basis. All such amounts incurred to date have been fully amortized or otherwise written off.

Inventories

Natural gas in storage is carried at cost which includes transportation and storage costs. Propane and petroleum products are valued at the lower of cost (first-in, first-out) and replacement cost. Raw materials, work-in progress, merchandise, finished goods, and materials and supplies are valued at the lower of cost (first-in, first-out) and net realizable value.

Fixed Assets

Fixed assets are recorded at cost, which includes interest and overhead capitalized while construction and oil and gas exploration and development activities are in progress, less accumulated depletion and depreciation. The Company follows the full cost method of accounting for oil and gas properties. Government assistance for exploration and development activities is applied as a reduction of the related capital expenditures.

Depreciation is provided on a straight-line basis at the following rates based on the estimated useful lives of the applicable assets:

Buildings	2%–20%
Customer installations	2%–10%
Transportation equipment	5%–33%
Machinery, equipment and furniture	3%–33%

Depreciation of transmission lines and distribution systems, and other assets employed in utility operations is provided on the straight-line method at rates approved by regulatory authorities. The application of such rates is equivalent to composite rates of 3.15% to 3.33%.

Depletion of oil and gas properties and depreciation of production and related equipment is provided on a unit of production method based on proved reserves. Costs associated with unproved properties less provisions for impairment are excluded from the calculations.

Fixed assets leased under capital leases are capitalized and depreciated on the same basis and rates as above.

Substantially all of the Company's exploration and production activities related to oil and gas are conducted jointly with others, and accordingly, the accounts reflect only the Company's proportionate interest in such activities.

The Company has adopted the ceiling test provisions of the accounting guideline on full cost accounting in the oil and gas industry, released by the Canadian Institute of Chartered Accountants in September 1986. The remaining aspects of the guideline will be adopted prospectively, effective January 1, 1987. In accordance with the guideline, as it relates to the ceiling tests, the following determination has been made. In the case of Canadian oil and gas properties, the estimated future net revenues from proved properties, based on prices and costs prevailing at the year-end, and the cost of unproved properties less provisions for impairment, exceeds the net book value of oil and gas properties. The net book value of U.S. properties, after the write-down during the year, equals the estimated future net revenues from such properties. On a consolidated basis, the future net revenues from proved properties, and the cost of unproved properties, net of provisions for impairment, less estimated future financing and administrative expenses, and income taxes, exceeds the consolidated net book value of the related assets, less the accumulated provision for related deferred income taxes.

Investments in Related and Other Companies

Investments in related and other companies are recorded at cost less write-down for any impairment in value.

Deferred Costs

Amortization of deferred costs is provided on a straight-line basis over various periods, not exceeding twenty years.

Contributions and Grants in Aid of Construction

Contributions and grants in aid of construction are represented primarily by non-refundable contributions from large customers and grants from governmental bodies in support of specific transmission and distribution facilities in the Utilities Division. These amounts are amortized to income at the same rates as depreciation of the applicable fixed assets to which they relate.

Revenue Accounting

Gas sales revenue in the Utilities Division is recorded on the basis of meter readings plus an estimate of customer usage since the last meter reading to the end of the fiscal period.

Income Taxes

Subsidiaries in the Utilities Division provide only for income taxes allowed by regulatory authorities in the calculation of their rates of return for rate-making purposes, and generally include only income taxes currently payable. However, for all other operations, the Company provides for deferred income taxes on all timing differences between accounting income and taxable income, including those relating to exploration, development and acquisition of oil and gas properties.

2. ACQUISITION OF HEIL-QUAKER CORPORATION

Effective October 31, 1986, the Company acquired all of the issued and outstanding common shares of Heil-Quaker Corporation ("Heil-Quaker"), formerly Heil-Quaker Home Systems Inc. Heil-Quaker manufactures and distributes central heating and air-conditioning products for the residential and light commercial markets in the United States. The total consideration of \$215,666,000 (U.S. \$156,359,000) was paid in cash, financed by term and operating bank loans. The purchase price is comprised of \$68,489,000 (U.S. \$49,655,000) in respect of the common shares, and \$147,177,000 (U.S. \$106,704,000) as repayment of inter-company advance owed to the vendor by Heil-Quaker.

The acquisition has been accounted for by the purchase method of accounting as follows:

	(\$000)
Net assets acquired – at fair value	
Fixed assets	123,983
Working capital	91,683
Net purchase price	<u>215,666</u>

The consolidated balance sheet includes the accounts of Heil-Quaker as at December 31, 1986 and the consolidated statements of income and changes in financial position include the results of Heil-Quaker's operations for the period from November 1 to December 31, 1986.

The acquisition of Heil-Quaker affected net income for the year to common shareholders by less than 1 cent per share.

On a pro-forma basis, assuming the acquisition had taken place on January 1, 1986, certain key operating figures, on an annualized basis, would have been as follows:

	(\$000)
Consolidated Statement of Income	
Operating revenue	1,788,232
Operating profit	165,812
Income from operations before unusual and extraordinary items	39,066
Income before extraordinary items	29,722
Net income for the year	30,935
Net income per common share –	
From operations before unusual and extraordinary items	\$1.39
Before extraordinary items	\$0.89
After extraordinary items	\$0.96

3. FOREIGN CURRENCY TRANSLATION ADJUSTMENT

This adjustment which is included as a component of shareholders' equity represents the unrealized gain on translation of financial statements of self-sustaining foreign operations in the United States. Changes during the year are as follows:

	1986	1985
	(\$000)	(\$000)
Cumulative unrealized gain at January 1	6,304	4,759
Realized gain on sale of utility operations in Minnesota	(3,891)	–
Unrealized (loss) gain on translation of net assets	(721)	1,545
Cumulative unrealized gain at December 31	<u>1,692</u>	<u>6,304</u>

The rate of exchange, as at December 31, 1986 was Cdn \$1.3805 = U.S. \$1.00 (1985 – Cdn \$1.3975 = U.S. \$1.00), and the average exchange rate for the year was Cdn \$1.3892 = U.S. \$1.00 (1985 – Cdn \$1.3652 = U.S. \$1.00; 1984 – Cdn \$1.2948 = U.S. \$1.00).

4. SECURITY FOR BANK ADVANCES, TERM LOANS AND OTHER LONG-TERM INDEBTEDNESS

Inventories, accounts receivable, shares of certain subsidiary companies, property, equipment and interests in petroleum and natural gas properties, and the note receivable from Norcen Energy Resources Limited ("Norcen"), referred to in Note 6 (iii), are generally pledged as security for current bank advances, term bank loans and other long-term indebtedness.

The Company and its subsidiaries have operating lines of credit with Canadian and United States banks totalling \$320,881,000 (1985 – \$181,599,000) of which \$103,755,000 was utilized at December 31, 1986 (1985 – \$63,587,000). The weighted average interest rate on the outstanding bank advances at December 31, 1986 was 9.5% (1985 – 10.2%). Weighted average interest rates are calculated based on actual interest rates in effect and the bank advances outstanding as at December 31.

The maximum amount of bank advances outstanding at any month-end during the year ended December 31, 1986 was \$103,755,000 (1985 – \$86,461,000). The average bank advances outstanding, calculated by averaging month-end balances, during the year ended December 31, 1986 was \$71,042,000 (1985 – \$71,383,000). Virtually all of the Company's lines of credit are at bank prime rates with options to utilize various short-term money market instruments, primarily Bankers' Acceptances. Bank prime rates averaged 10.6% in 1986 (1985 – 10.6%; 1984 – 12.1%).

5. INVENTORIES

Inventories are classified as follows:

	1986	1985
	(\$000)	(\$000)
Natural gas in storage	11,937	13,144
Propane and petroleum products	10,832	14,018
Raw materials	34,798	18,149
Work-in-progress	9,367	4,784
Finished goods	73,119	26,114
Merchandise, materials and supplies	19,189	24,557
	<u>159,242</u>	<u>100,766</u>

6. INVESTMENTS IN RELATED AND OTHER COMPANIES

Investments in related and other companies are comprised of the following:

	1986	1985
	(\$000)	(\$000)
RELATED		
MICC Investments Limited ("MICC") (i) –		
Preference shares	10,000	10,000
OTHER		
Gaz Metropolitan, inc ("GMi") –		
Common shares (ii)	55,016	55,016
Preference shares	14,260	17,905
Debt	–	64,105
	<u>69,276</u>	<u>137,026</u>
Note receivable from Norcen (iii)	47,300	47,300
	<u>126,576</u>	<u>194,326</u>

(i) Dividends on the preference shares held in MICC have been suspended since 1984, and the annual redemption requirements of \$1,800,000 have not been met in 1984, 1985 and 1986. In 1984, the Company recorded a total provision of \$28,700,000 against the investment in preference shares and common share purchase warrants. Cumulative dividends in arrears are \$13,338,000. The

preference shares are subject to mandatory redemption requirements of \$1,800,000 on December 31 of each year to 1986 with the balance to be redeemed on December 31, 1987. The warrants, which entitle the Company to acquire 3,000,000 common shares at \$12.00 per share, expire in December 1987. MICC owns approximately 29% of the Company's common shares on a fully-diluted basis.

(ii) In a prior year, a subsidiary issued \$55,016,000 principal amount of exchangeable subordinated debentures redeemable in 1988, exchangeable at any time into 6,877,049 GMi common shares. The issue conferred upon the holders the right to vote the shares during the term of the issue and prior to exercising the exchange right. As a result, the subsidiary has no voting interest in GMi, and accordingly, the investment is accounted for by the cost method. In the event the holder does not exercise its exchange privilege, the subsidiary has the option to pay the redemption price in cash or tender the common shares of GMi subject to the exchange right.

(iii) The note receivable from Norcen is a subordinated demand note bearing interest at 7.6% and is subject to minimum annual principal repayments of \$1,672,000 in 1988 and \$4,148,000 thereafter to 1999. The Company and Norcen have entered into a set-off agreement whereby each party has the right to set-off its financial obligations to the other party under the redeemable preference shares referred to in Note 11(c), and the note, respectively, in the event that either party defaults in its obligations thereunder.

7. FIXED ASSETS

Property, plant and equipment are classified as follows:

	1986		1985	
	Cost	Accumulated Depreciation and Depletion	Net Book Value	Net Book Value
	(\$000)	(\$000)	(\$000)	(\$000)
Oil and gas properties	388,754	108,030	280,724	281,598
Production and other equipment	92,758	31,401	61,357	55,515
Transmission lines and distribution systems	743,381	118,365	625,016	614,850
Customer installations	132,472	62,242	70,230	57,987
Machinery, equipment and furniture	175,022	47,056	127,966	49,502
Transportation equipment	47,430	26,809	20,621	17,203
Buildings	109,586	16,025	93,561	30,538
Land	11,936	—	11,936	8,469
	1,701,339	409,928	1,291,411	1,115,662

Details of assets leased under capital leases and included in fixed assets are as follows:

	1986		1985	
	Cost	Accumulated Depreciation and Depletion	Net Book Value	Net Book Value
	(\$000)	(\$000)	(\$000)	(\$000)
Customer installations	11,823	2,261	9,562	6,651
Transportation equipment	24,322	10,438	13,884	11,741
Machinery and equipment	2,945	962	1,983	2,214
	39,090	13,661	25,429	20,606

8. LONG-TERM DEBT

The details of long-term debt are as follows:

	1986	1985
	(\$000)	(\$000)
Term bank loans, repayable during the period 1987 to 1998		
— at fixed interest rates with a weighted average interest rate of 12.5% (1985-12.6%)	55,528	55,000
— at variable interest rates (see below)	354,805	192,029
	410,333	247,029
Revolving bank credits, unsecured	—	116,953
Debentures at a weighted average fixed interest rate of 11.8% (1985-12.2%) repayable during the period 1987 to 2008	260,813	193,968
Promissory notes at a weighted average fixed interest rate of 13.5% (1985-13.3%) repayable during the period 1987 to 1996	124,951	126,555
First mortgage bonds at a weighted average fixed interest rate of 9.6% (1985-9.5%) repayable during the period 1989 to 1998	98,098	110,188
Capitalized lease obligations at a weighted average fixed interest rate of 11.7% (1985-12.5%) repayable during the period 1987 to 1998	26,494	20,946
Sundry notes and mortgages	1,755	1,703
	922,444	817,342
Current portion included in current liabilities	38,845	33,290
	883,599	784,052

Of the total amount outstanding at December 31, 1986, debt denominated in U.S. dollars amounted to U.S. \$214,849,000 (1985-U.S. \$88,119,000).

The weighted average interest rate on all fixed rate debt instruments is 11.9% at December 31, 1986 (1985-12.0%).

With respect to variable interest rate debt, the Company has options to fix interest rates for various periods of time through the use of short-term money market instruments, primarily Bankers' Acceptances. Accordingly, as at December 31, 1986, interest rates have been fixed for periods of 30 to 365 days at a weighted average rate of 9.0% on \$158,538,000 of the \$354,805,000 variable interest rate term bank loans.

Of the long-term debt, \$55,016,000 is offset as indicated in Note 6(ii).

Under the provisions of the various agreements and indentures, excluding capitalized lease obligations, the Company is required to make the following installments during the next five years.

Year	(\$000)
1987	33,595
1988 (includes \$55,016 referred to above)	220,418
1989	125,017
1990	73,457
1991	87,202

Minimum lease payments required under capital leases are as follows:

Year	(\$000)
1987	7,816
1988	5,770
1989	5,686
1990	6,089
1991	2,903
Subsequent years	9,023
Total minimum lease payments	37,287
Less - amount representing interest	10,793
Balance of capitalized lease obligations	26,494

9. ADVANCES UNDER NATURAL GAS SALES CONTRACTS

Amounts received in respect of certain natural gas sales contracts for which minimum deliverable quantities are in excess of actual deliveries are reflected as Advances Under Natural Gas Sales Contracts. These amounts are being repaid in accordance with the formula contained in the agreements under which they were advanced but which, in any event, are not expected to be less than 10% per annum of the amounts initially advanced. These advances are non-interest bearing.

10. MINORITY INTERESTS IN SUBSIDIARIES

The minority interests in subsidiaries are comprised of the following:

	1986	1985
	(\$000)	(\$000)
Preference shares in -		
ICG Utilities (Ontario) Limited, formerly Northern and Central Gas Corporation Limited	35,078	38,626
Canadian Hydrocarbons Limited	2,790	2,893
ICG Utility Investments Ltd.	1,425	1,510
	<u>39,293</u>	<u>43,029</u>
Equity interest in -		
KeepRite Inc.	2,374	2,257
Greater Winnipeg Gas Company	83	75
Vancouver Island Gas Company Limited	-	29
	<u>2,457</u>	<u>2,361</u>
	<u>41,750</u>	<u>45,390</u>

11. PREFERENCE SHARES

(a) Authorized

600,000 first preference shares issuable in series of which 110,000 have been designated as Series A shares carrying a cumulative annual dividend entitlement of \$56.00 per share and redeemable at \$700.00 per share; 265,000 have been designated as Series B shares carrying a cumulative annual dividend entitlement of \$1.65 per share and redeemable at \$21.00 per share; and 200,000 have been designated as Series C shares carrying a cumulative annual dividend entitlement of \$2.10 per share and redeemable at \$21.00 per share.

262,468 second preference shares issuable in series of which 125,000 have been designated as Series A shares carrying a cumulative annual dividend entitlement of \$1.30 per share and redeemable at a price not to exceed \$20.63 per share; and 100,000 have been designated as Series B shares carrying a cumulative annual dividend entitlement of \$1.50 per share and redeemable at \$20.75 per share.

10,000,000 third preference shares issuable in series of which 3,000,000 have been designated as convertible third preference shares, 1985 Series, carrying a cumulative annual dividend entitlement of \$2.125 per share. They are convertible into common shares of the Company at the option of the holder (i) prior to the close of business on May 2, 1988 at a conversion price of \$14.375 per common share and (ii) after May 2, 1988 and prior to the close of business on May 2, 1990 at a conversion price of \$15.25 per common share. These shares are redeemable on or after May 2, 1990 at \$26.00 per share declining by \$0.25 per share at the end of each 12 month period until May 2, 1994, thereafter at \$25.00 per share.

The redemption privileges on all preference shares are at the option of the Company only. The preference shares have voting privileges at all meetings of shareholders, except meetings at which only holders of another class or series of shares are entitled to vote.

(b) Issued and Fully Paid

	1986		1985	
	Number	Amount	Number	Amount
		(\$000)		(\$000)
REDEEMABLE First preference shares –				
Series A	110,000	77,000	110,000	77,000
Series B	34,633	692	64,550	1,291
Series C	82,075	1,642	82,075	1,642
Second preference shares –				
Series A	67,747	1,355	71,173	1,423
Series B	66,210	1,324	68,310	1,366
		<u>82,013</u>		<u>82,722</u>
CONVERTIBLE Third preference shares, 1985 Series	3,000,000	<u>75,000</u>	3,000,000	<u>75,000</u>

(c) Purchase Fund Requirements

First preference shares Series A

To offer to purchase an amount of \$8,000,000 in each of the years 1988 to 1990; \$10,000,000 in each of the years 1991 to 1993; \$12,000,000 in 1994; and the balance of \$11,000,000 in 1995. These shares were issued to Norcen in 1984 (see Note 6(iii)).

First preference shares Series B and C

To offer to purchase 13% of the original issue amount in 1986 and 5% for each year thereafter. In 1986, 29,917 Series B were purchased and cancelled (1985 – Series B: 34,450 and Series C: 25,925).

Second preference shares Series A and B

To purchase annually in the market, a minimum of 3% of the original issue amount outstanding at the end of the preceding year. In 1986, 3,426 Series A shares and 2,100 Series B shares were purchased and cancelled (1985 – 5,300 and 2,500).

Third preference shares, 1985 Series

Commencing July 1, 1990, the Company will make reasonable efforts to purchase for cancellation in the open market, 4% of the original issue amount outstanding at the end of the preceding year.

The minimum purchase requirements for all series in the next five years are as follows:	Year	(\$000)
	1987	545
	1988	8,543
	1989	8,438
	1990	9,834
	1991	13,299

12. COMMON SHARES**(a) Authorized and Outstanding**

The Company is authorized to issue 50,000,000 common shares. Changes in the issued and outstanding common shares for the years 1986, 1985 and 1984 are as follows:

	1986		1985		1984	
	Number	Amount	Number	Amount	Number	Amount
		(\$000)		(\$000)		(\$000)
Issued and fully paid –						
beginning of the year	23,618,563	178,779	23,481,097	177,122	23,474,697	177,065
Issued under the Dividend						
Reinvestment, Stock Dividend						
and Share Purchase Plans	45,214	644	68,166	1,008	–	–
Issued to employees under the						
Employee Stock Option Plan	88,600	864	69,300	649	6,400	57
Issued and fully paid –						
end of the year	23,752,377	<u>180,287</u>	23,618,563	<u>178,779</u>	23,481,097	<u>177,122</u>
Less – shares held by subsidiaries	4,953,735		4,953,735		4,953,735	
	<u>18,798,642</u>		<u>18,664,828</u>		<u>18,527,362</u>	

(b) Share Purchase Warrants

The Company has reserved 3,000,000 common shares for the exercise of share purchase warrants at \$12.00 per share. The warrants expire in December 1987, and are held by MICC.

(c) Employee Stock Option Plan

A total of 1,499,000 common shares have been reserved for issuance to officers and employees of the Company under the Employee Stock Option Plan.

The term of each option is five years and the options are exercisable on a cumulative basis at 20% per annum. The option exercise price is fixed by the Board of Directors at the time each option is authorized and cannot be less than 90% of the weighted average sales price per share on The Toronto Stock Exchange on the business day preceding the date of authorization.

Changes in the issued and outstanding share options from January 1, 1984 to December 31, 1986 are as follows:

	1986	1985	1984
Balance – beginning			
of the year	637,500	547,200	489,100
Issued	260,000	167,000	90,000
Exercised	(88,600)	(69,300)	(6,400)
Cancelled	(3,400)	(7,400)	(25,500)
Balance – end of			
the year	805,500	637,500	547,200

The option exercise prices and the number of options outstanding at December 31, 1986 at each price are as follows:

Price	Number
\$	
8.875	130,400
9.25	10,000
10.125	65,000
11.25	28,000
11.375	1,600
12.50	311,100
14.625	259,400
	805,500

(d) Dividend Reinvestment, Stock Dividend and Share Purchase Plans

A total of 1,000,000 common shares have been set aside for issuance under the Dividend Reinvestment and Share Purchase Plan and the Stock Dividend and Share Purchase Plan (500,000 for each plan) as approved by the Board of Directors on December 13, 1984. These plans took effect in the first quarter of 1985.

Generally, the plans allow shareholders to elect to reinvest cash dividends on common shares in additional common shares, to receive dividends on common shares in the form of stock dividends in lieu of cash dividends and to make optional cash payments of up to \$5,000 per quarter to purchase additional common shares of the Company. Common shares purchased through cash dividend reinvestment and stock dividends are issued at 95% of the Average Market Price. Shares purchased through the optional cash payments are issued at the Average Market Price. The Average Market Price is defined as the average of the closing prices for a board lot on The Toronto Stock Exchange for the five trading days immediately preceding the Investment Date.

13. INCOME TAXES

A reconciliation between the statutory and the effective rates of income taxes is provided as follows:

	1986	1985	1984
	(\$000)	(\$000)	(\$000)
Income before income taxes	69,027	88,276	57,494
Statutory tax rate	47.8%	46.9%	46.0%
Computed income taxes	32,995	41,401	26,447
Increase (decrease) in income taxes resulting from –			
Deductible energy taxes	(38)	(191)	(572)
Excess of non-deductible oil and gas expenditures over tax deductions	1,745	337	1,208
Inventory allowance	(160)	(1,145)	(936)
Non-deductible expenses and losses in excess of non-taxable gains	2,447	2,582	1,758
Regulated natural gas operations	(6,792)	(5,371)	(2,276)
Non-taxable dividend income	(2,926)	(3,470)	(914)
Other	1,980	1,885	421
Actual income taxes	29,251	36,028	25,136
Effective rate of income taxes	42.4%	40.8%	43.7%

The components of income before taxes and income tax expense are as follows:

	1986	1985	1984
	(\$000)	(\$000)	(\$000)
Income before income taxes			
Canada	62,072	78,295	49,745
United States	6,955	9,981	7,749
	69,027	88,276	57,494
Current income tax expense			
Canada	22,978	24,168	9,194
United States	7,473	2,890	1,980
	30,451	27,058	11,174
Deferred income tax expense (recovery)			
Canada	1,894	7,433	12,245
United States	(3,094)	1,537	1,717
	(1,200)	8,970	13,962
	29,251	36,028	25,136

Deferred income tax expense (recovery) results from timing differences in the recognition of revenues and expenses for income tax purposes and financial statement purposes. The source of these differences is as follows:

	1986	1985	1984
	(\$000)	(\$000)	(\$000)
Excess of tax depreciation over book depreciation	(4,459)	124	(1,254)
Drilling and exploration costs claimed net of book depletion	3,118	3,007	9,436
Excess of items capitalized for book purposes and expensed for tax purposes	1,192	5,176	6,294
Other	(1,051)	663	(514)
Deferred income tax expense (recovery)	(1,200)	8,970	13,962

If deferred income taxes had been recorded in respect of all timing differences between accounting income and taxable income in respect of subsidiaries in the Utilities Division, the provision for deferred income taxes would have increased and consolidated net income would have decreased by \$6,792,000 (1985 – \$5,371,000; 1984 – \$2,276,000). At December 31, 1986 the accumulated, unrecorded deferred income taxes on regulated income, that would be reflected as a liability, amounted to approximately \$90,800,000 (1985 – \$84,008,000).

Various consolidated subsidiaries of the Company have accumulated losses for income tax purposes totalling approximately \$4,146,000 which are available to reduce future taxable incomes. The potential future income tax

benefits arising from these losses have not been recognized in the financial statements. The expiry dates of these tax losses are as follows:

	(\$000)
1987	5
1990	1,018
1991	567
1992	1,367
1993	748
2001	441
	<u>4,146</u>

14. NET INCOME (LOSS) PER COMMON SHARE

The net income (loss) per common share is calculated on the weighted average number of shares outstanding during the respective years as follows:

	1986	1985	1984
	(\$000)	\$(000)	(\$000)
Income before unusual and extraordinary items	37,265	43,168	26,042
Less – dividends on preference shares	12,979	11,052	1,177
Income to common shareholders before unusual and extraordinary items	24,286	32,116	24,865
Write-down of oil and gas properties	(9,344)	–	–
Income to common shareholders before extraordinary items	14,942	32,116	24,865
Extraordinary items	1,213	892	(28,373)
Net income (loss) to common shareholders	16,155	33,008	(3,508)
Weighted average number of common shares outstanding during the year	23,672,856	23,539,114	23,479,696
Less – weighted average number of common shares held by subsidiaries	4,953,735	4,953,735	4,953,735
	<u>18,719,121</u>	<u>18,585,379</u>	<u>18,525,961</u>
Net income (loss) per common share			
From operations before unusual and extraordinary items	\$1.30	\$1.73	\$ 1.34
Before extraordinary items	\$0.80	\$1.73	\$ 1.34
After extraordinary items	\$0.86	\$1.77	\$(0.19)

The exercise of the share purchase warrants and stock options outstanding as at December 31, 1986, and conversion of the preference shares would have resulted in fully diluted net income per common share before unusual and extraordinary items of \$1.28, and would be anti-dilutive in respect of net income per common share after unusual and extraordinary items. Imputed earnings on cash received on the exercise of options and warrants is computed at 10%.

15. PENSION PLANS

The Company and its subsidiaries have various pension plans available to substantially all permanent full-time employees. The Company makes contributions to the plans based on salary levels. The total pension expense for 1986 was \$3,824,000 (1985 – \$2,608,000; 1984 – \$1,932,000), including contributions in respect of unfunded past service benefits. A summary of accumulated plan benefits and plan net assets at December 31, 1986 is as follows:

	Canada	United States
	(\$000)	(\$000)
Net assets available for benefits	64,410	23,038
Actuarial present value of accumulated plan benefits	57,274	20,383

The assumed rates of return used in determining the actuarial present value of accumulated plan benefits ranged from 6.5% to 8% for the Canadian plans, and from 7% to 8.5% for the U.S. plans.

16. LEASE COMMITMENTS

Lease rental expense during the current year amounted to \$9,343,000 (1985 – \$6,850,000; 1984 – \$7,425,000). The approximate aggregate minimum annual rentals under long-term leases, excluding capital leases, at December 31, 1986, are as follows:

Year	(\$000)
1987	11,445
1988	10,141
1989	8,589
1990	7,410
1991	6,713
Subsequent years	11,947

17. BUSINESS SEGMENTS

The following is an analysis of certain financial information by business lines and geographical areas for the three years ended December 31, 1986, 1985 and 1984 as it relates to operating revenue, operating profit and investment income, identifiable assets, capital expenditures and depreciation and depletion.

Intersegment sales are not material and are accounted for at prices comparable to those charged to unaffiliated customers. Operating profit is total revenue less operating expenses which includes an allocation of corporate expenses. Identifiable assets include only those assets directly identifiable with those operations. Corporate assets consist primarily of investments in related and other companies.

	Operating Revenue			Operating Profit		
	1986	1985	1984	1986	1985	1984
	(\$000)	(\$000)	(\$000)	(\$000)	(\$000)	(\$000)
Resources						
Canada	62,673	79,079	69,378	25,322	46,163	38,780
United States	3,430	7,474	8,123	1,379	3,265	6,163
	66,103	86,553	77,501	26,701	49,428	44,943
Utilities						
Canada	823,634	916,195	368,413	78,277	79,900	42,459
United States	37,979	62,478	69,450	4,966	6,926	3,937
	861,613	978,673	437,863	83,243	86,826	46,396
Liquid Gas						
Canada	280,632	320,670	284,659	22,175	23,529	15,034
Energy Products						
Canada	121,697	121,414	109,970	7,039	6,715	3,388
United States	97,771	34,016	30,552	3,574	1,927	2,216
	219,468	155,430	140,522	10,613	8,642	5,604
Corporate and other	701	50	276	(1,318)	(1,268)	(2,351)
	1,428,517	1,541,376	940,821	141,414	167,157	109,626

	Identifiable Assets			Capital Expenditures			Depreciation and Depletion Expenses		
	1986	1985	1984	1986	1985	1984	1986	1985	1984
	(\$000)	(\$000)	(\$000)	(\$000)	(\$000)	(\$000)	(\$000)	(\$000)	(\$000)
Resources									
Canada	360,665	341,926	302,291	33,113	49,246	36,571	16,880	13,903	11,388
United States	27,531	51,530	47,350	9	4,488	3,507	936	2,136	942
	<u>388,196</u>	<u>393,456</u>	<u>349,641</u>	<u>33,122</u>	<u>53,734</u>	<u>40,078</u>	<u>17,816</u>	<u>16,039</u>	<u>12,330</u>
Utilities									
Canada	874,652	870,299	778,346	70,707	113,092	54,974	20,313	18,624	6,016
United States	4,364	38,818	36,287	857	2,066	1,143	766	1,246	1,128
	<u>879,016</u>	<u>909,117</u>	<u>814,633</u>	<u>71,564</u>	<u>115,158</u>	<u>56,117</u>	<u>21,079</u>	<u>19,870</u>	<u>7,144</u>
Liquid Gas									
Canada	148,920	140,057	151,641	37,509	20,882	13,779	13,684	10,911	10,225
Energy Products									
Canada	89,508	78,271	76,217	3,206	804	1,364	1,135	1,270	1,293
United States	280,046	24,558	22,725	6,879	675	326	3,081	760	701
	<u>369,554</u>	<u>102,829</u>	<u>98,942</u>	<u>10,085</u>	<u>1,479</u>	<u>1,690</u>	<u>4,216</u>	<u>2,030</u>	<u>1,994</u>
Corporate	151,981	220,462	275,921	2,599	4,037	4,238	2,156	2,466	2,469
	<u>1,937,667</u>	<u>1,765,921</u>	<u>1,690,778</u>	<u>154,879</u>	<u>195,290</u>	<u>115,902</u>	<u>58,951</u>	<u>51,316</u>	<u>34,162</u>

18. SELECTED FINANCIAL DATA

Selected financial data for the five years ended December 31, 1982 to 1986 are as follows. Amounts are in thousands of dollars except per share amounts.

	1986	1985	1984	1983	1982
Operating revenues	1,428,517	1,541,376	940,821	657,150	620,712
Net income (loss)					
From operations before unusual and extraordinary items	37,265	43,168	26,042	16,514	9,239
Before extraordinary items	27,921	43,168	26,042	16,514	9,239
After extraordinary items	29,134	44,060	(2,331)	12,097	10,442
Basic net income (loss) per common share					
From operations before unusual and extraordinary items	\$1.30	\$1.73	\$ 1.34	\$0.92	\$0.61
Before extraordinary items	\$0.80	\$1.73	\$ 1.34	\$0.92	\$0.61
After extraordinary items	\$0.86	\$1.77	\$(0.19)	\$0.66	\$0.70
Dividends per common share	\$0.60	\$0.50	\$ 0.40	\$0.40	\$0.40
Total assets	1,937,667	1,765,921	1,690,778	814,491	765,755
Long-term obligations	965,612	866,774	932,205	296,606	253,869

Long-term obligations include long-term debt and redeemable preference shares.

Supplementary Information

The following information on Quarterly Financial Data and Oil and Gas Producing Activities is provided by management as supplementary information as required by the Securities and Exchange Commission, but does not form part of the basic financial statements.

QUARTERLY FINANCIAL DATA

Summarized quarterly financial data is as follows. Amounts are in thousands of dollars except per share amounts.

	3 Months Ended				Year Ended
	Mar. 31	June 30	Sept. 30	Dec. 31	Dec. 31
1986					
Operating revenue	488,918	278,285	219,749	441,565	1,428,517
Gross profit	153,309	80,754	62,734	146,567	443,364
Net income (loss) after dividends on preference shares					
From operations before unusual item	29,271	(5,243)	(16,647)	16,905	24,286
Before extraordinary items	29,271	(5,243)	(16,647)	7,561	14,942
After extraordinary items	29,271	(5,243)	(14,641)	6,768	16,155
Net income (loss) per common share					
From operations before unusual item	\$1.57	\$(0.28)	\$(0.89)	\$0.90	\$1.30
Before extraordinary items	\$1.57	\$(0.28)	\$(0.89)	\$0.40	\$0.80
After extraordinary items	\$1.57	\$(0.28)	\$(0.78)	\$0.36	\$0.86*
1985					
Operating revenue	507,210	312,943	250,437	470,786	1,541,376
Gross profit	152,822	88,662	65,377	139,419	446,280
Net income (loss) after dividends on preference shares					
Before extraordinary items	29,321	(354)	(14,324)	17,473	32,116
After extraordinary items	29,321	5,146	(14,284)	12,825	33,008
Net income (loss) per common share					
Before extraordinary items	\$1.58	\$(0.02)	\$(0.77)	\$0.94	\$1.73
After extraordinary items	\$1.58	\$0.28	\$(0.77)	\$0.69	\$1.77*

*Net income per share by quarter does not add to the total for the year due to changes in the number of common shares outstanding during the year.

OIL AND GAS PRODUCING ACTIVITIES

Additional information with respect to the oil and gas activities of the Company is presented below. This information will not agree in all cases with information included under Note 17 to the consolidated financial statements (Business Segments), as the Resources Division includes other activities and operations which are not defined as oil and gas producing activities for purposes of the following disclosures.

Information On Oil and Gas Reserves

(a) Capitalized Costs

Aggregate capitalized costs and related accumulated depreciation and depletion at December 31, 1986 and 1985 are as follows:

	Canada	U.S.	Total
	(\$000)	(\$000)	(\$000)
(i) Cost			
1986			
Oil and gas properties	347,194	40,097	387,291
Production and other equipment	69,441	3,008	72,449
	<u>416,635</u>	<u>43,105</u>	<u>459,740</u>
1985			
Oil and gas properties	319,081	39,348	358,429
Production and other equipment	64,957	3,351	68,308
	<u>384,038</u>	<u>42,699</u>	<u>426,737</u>

	Canada	U.S.	Total
	(\$000)	(\$000)	(\$000)
(ii) Accumulated depreciation and depletion – 1986			
Oil and gas properties	84,308	22,506	106,814
Production and other equipment	21,138	1,028	22,166
	<u>105,446</u>	<u>23,534</u>	<u>128,980</u>
1985			
Oil and gas properties	71,341	5,722	77,063
Production and other equipment	16,930	916	17,846
	<u>88,271</u>	<u>6,638</u>	<u>94,909</u>

(b) Expenditures

Costs incurred in oil and gas activities for the years ended December 31, 1986, 1985 and 1984 are as follows:

	1986			1985			1984		
	Canada	U.S.	Total	Canada	U.S.	Total	Canada	U.S.	Total
	(\$000)	(\$000)	(\$000)	(\$000)	(\$000)	(\$000)	(\$000)	(\$000)	(\$000)
Property acquisition	2,110	–	2,110	7,085	809	7,894	2,605	219	2,824
Exploration	19,552	–	19,552	16,847	3,094	19,941	20,251	1,696	21,947
Development	11,035	9	11,044	22,702	585	23,287	12,971	1,592	14,563
	<u>32,697</u>	<u>9</u>	<u>32,706</u>	<u>46,634</u>	<u>4,488</u>	<u>51,122</u>	<u>35,827</u>	<u>3,507</u>	<u>39,334</u>

Expenditures reported for 1986 are net of government assistance of \$6,975,000 (1985 – \$16,819,000; 1984 – \$21,535,000).

(c) Results of Operations

Results of operations from oil and gas producing activities for the years ended December 31, 1986, 1985 and 1984 are as follows:

	1986			1985			1984		
	Canada	U.S.	Total	Canada	U.S.	Total	Canada	U.S.	Total
	(\$000)	(\$000)	(\$000)	(\$000)	(\$000)	(\$000)	(\$000)	(\$000)	(\$000)
Revenues	52,695	3,430	56,125	63,493	5,654	69,147	52,199	6,069	58,268
Production expenses	11,257	476	11,733	10,008	822	10,830	8,657	738	9,395
Administrative expenses	3,366	344	3,710	3,897	362	4,259	2,834	315	3,149
Depletion and depreciation	16,151	712	16,863	14,506	746	15,252	10,634	713	11,347
Taxes –									
Current	–	304	304	–	(289)	(289)	(585)	626	41
Deferred	10,695	873	11,568	16,251	1,690	17,941	14,407	940	15,347
Energy	2,033	17	2,050	6,613	677	7,290	6,315	899	7,214
ARTC	(2,723)	–	(2,723)	(1,963)	–	(1,963)	(1,927)	–	(1,927)
	<u>40,779</u>	<u>2,726</u>	<u>43,505</u>	<u>49,312</u>	<u>4,008</u>	<u>53,320</u>	<u>40,335</u>	<u>4,231</u>	<u>44,566</u>
Income before the following	11,916	704	12,620	14,181	1,646	15,827	11,864	1,838	13,702
Write-down of oil and gas properties	–	(9,344)	(9,344)	–	–	–	–	–	–
Results of operations (excluding corporate overhead and interest costs)	<u>11,916</u>	<u>(8,640)</u>	<u>3,276</u>	<u>14,181</u>	<u>1,646</u>	<u>15,827</u>	<u>11,864</u>	<u>1,838</u>	<u>13,702</u>

(d) Proved Reserves

Net quantities of proved reserves of oil, gas and gas liquids at December 31, 1986, 1985 and 1984 are as follows:

	Oil and Gas Liquids			Gas		
	(Thousands of Barrels)			(Millions of Cubic Feet)		
	Canada	U.S.	Total	Canada	U.S.	Total
1984						
Proved developed and undeveloped reserves, January 1, 1984	9,515	723	10,238	243,562	2,411	245,973
Revisions to estimates	461	220	681	(6,168)	499	(5,669)
Extensions, discoveries and additions	1,233	82	1,315	34,798	—	34,798
Production	(762)	(113)	(875)	(9,359)	(497)	(9,856)
Proved developed and undeveloped reserves, December 31, 1984	10,447	912	11,359	262,833	2,413	265,246
1985						
Revisions to estimates	18	(92)	(74)	8,054	252	8,306
Extensions, discoveries and additions	2,341	80	2,421	27,582	22	27,604
Production	(849)	(126)	(975)	(12,379)	(246)	(12,625)
Proved developed and undeveloped reserves, December 31, 1985	11,957	774	12,731	286,090	2,441	288,531
1986						
Revisions to estimates	(286)	(44)	(330)	11,697	(2)	11,695
Extensions, discoveries and additions	3,454	—	3,454	22,450	653	23,103
Sale of reserves	(208)	—	(208)	(7,481)	—	(7,481)
Production	(1,028)	(94)	(1,122)	(13,182)	(323)	(13,505)
Proved developed and undeveloped reserves, December 31, 1986	<u>13,889</u>	<u>636</u>	<u>14,525</u>	<u>299,574</u>	<u>2,769</u>	<u>302,343</u>
Proved developed reserves only						
December 31, 1984	10,283	912	11,195	246,433	2,413	248,846
December 31, 1985	11,774	774	12,548	255,768	2,441	258,217
December 31, 1986	13,684	636	14,320	275,629	2,769	278,401

(e) Future Net Revenues From Proved Reserves

The following information has been computed in accordance with the procedures specified by the Financial Accounting Standards Board in the United States. These procedures are designed to provide consistency among companies required to disclose this information. The assumptions made will not result in an amount representing fair market value nor do they provide the best estimate of the present value of cash flows that will be realized for the following reasons:

- (i) The calculations are based on prices and costs in effect at the end of each year with no provision for increases or decreases except to the extent provided by contractual arrangements in effect at the year-end.
- (ii) Income taxes are computed at the statutory tax rate, not the rate actually incurred by the Company.
- (iii) Probable reserves which may ultimately become proved are excluded from the calculations.

Estimated future net revenues from proved reserves, as at December 31, 1986, 1985 and 1984 are as follows:

	(In Millions Of Dollars)								
	1986			1985			1984		
	Canada	U.S.	Total	Canada	U.S.	Total	Canada	U.S.	Total
Future revenues	919	23	942	1,162	36	1,198	1,101	44	1,145
Future production and development costs	(292)	(3)	(295)	(290)	(5)	(295)	(270)	(4)	(274)
Future income and other taxes	(170)	(9)	(179)	(282)	(15)	(297)	(424)	(20)	(444)
Future net revenues	457	11	468	590	16	606	407	20	427
10% annual discount for estimated timing of cash flows	(239)	(5)	(244)	(331)	(6)	(337)	(238)	(9)	(247)
Discounted future net revenues	218	6	224	259	10	269	169	11	180

Changes in value of discounted future net revenues from proved reserves during the years ended December 31, 1986, 1985 and 1984 are as follows:

	(In Millions Of Dollars)		
	1986	1985	1984
Sales, net of production expenses	(44)	(58)	(49)
Net changes in prices and production costs	(94)	(39)	22
Extensions and discoveries less related costs	51	63	55
Development costs incurred during the year	11	23	15
Revisions of previous estimates	(19)	(6)	(14)
Net change in income and other taxes	23	88	(14)
Accretion of discount	27	18	15
	(45)	89	30

Ten-Year Summary of Operations

OPERATIONS

(In Thousands of Dollars)

	1986	1985	1984
Operating revenues	1,428,517	1,541,376	940,821
Operating profit	141,414	167,157	109,626
Investment income	21,541	19,746	4,770
Financial expenses	93,928	98,627	56,902
Income before unusual and extraordinary items	37,265	43,168	26,042
Dividends –			
Preference shares	12,979	11,052	1,177
Common shares	11,236	9,300	7,411

PER COMMON SHARE

(In Dollars)

Net income before unusual and extraordinary items	\$ 1.30	\$ 1.73	\$ 1.34
Net income after extraordinary items	\$ 0.86	\$ 1.77	\$ (0.19)
Dividends paid	\$ 0.60	\$ 0.50	\$ 0.40
Book value	\$12.41	\$12.40	\$11.13

FINANCIAL POSITION

(In Thousands of Dollars, except where otherwise stated)

Total assets	1,937,667	1,765,921	1,690,778
Working capital	46,668	36,333	32,428
Fixed assets (cost)	1,701,339	1,472,156	1,325,299
Capital structure – %			
Long-term debt	69	67	75
Redeemable preference shares	7	7	7
Shareholders' equity	24	26	18
	100	100	100
Return on common shareholders equity – %	10.2	14.7	11.1

DIVISIONAL DATA

Resources –

Production			
Gas – millions of cubic feet	13,505	12,625	\$9,856
Oil and Gas Liquids – thousands of barrels	1,122	975	875
Net Proved Reserves			
Gas* – millions of cubic feet	302,343	288,531	265,247
Oil and Gas Liquids – thousands of barrels	14,525	12,731	11,359
Utilities			
Gas – millions of cubic feet	186,171	201,502	90,384
Liquid Gas			
Propane – thousands of litres	994,471	1,061,211	908,536
Energy Products			
Air Conditioners – units	72,714	102,078	86,570

*In addition, the Company has natural gas reserves in the Canadian Arctic Islands, estimated to total 525.8 billion

1983	1982	1981	1980	1979	1978	1977
657,150	620,712	571,256	417,775	454,383	229,090	81,995
65,457	67,711	73,098	57,193	39,317	19,018	10,634
4,348	—	—	—	2,187	2,471	2,852
35,611	44,910	42,365	22,535	19,285	11,386	7,439
16,514	9,239	10,459	18,106	11,939	7,188	5,310
772	891	983	1,592	1,619	1,335	1,100
6,956	5,393	5,377	3,823	2,372	1,570	1,160

\$ 0.92	\$ 0.61	\$0.70	\$1.40	\$1.36	\$1.19	\$0.98
\$ 0.66	\$ 0.70	\$0.74	\$1.42	\$1.43	\$1.21	\$0.94
\$ 0.40	\$ 0.40	\$0.40	\$0.32	\$0.31	\$0.28	\$0.27
\$11.46	\$11.11	\$9.94	\$9.60	\$6.97	\$5.96	\$4.06

814,491	765,755	648,960	502,219	364,623	327,868	126,029
12,553	(9,072)	(28,306)	(74,119)	(37,474)	(22,578)	(16,804)
688,127	608,458	533,523	430,898	289,244	267,508	66,606
56	55	59	41	56	62	61
2	2	3	5	11	12	16
42	43	38	54	33	26	23
100	100	100	100	100	100	100
8.1	6.1	7.2	17.1	21.1	19.5	26.4

9,405	10,490	10,393	9,789	7,494	7,477	8,511
749	673	585	629	240	257	284
245,985	264,492	260,652	261,478	106,399	116,967	96,637
10,239	9,811	10,686	9,861	2,061	N/A	N/A
42,767	42,737	38,858	44,091	47,118	45,321	26,560
832,117	879,940	779,132	832,023	799,423	746,931	—
111,551	82,453	135,768	—	—	—	—

cubic feet.

Directory

BOARD OF DIRECTORS

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Toronto, Ontario

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Toronto, Ontario

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Calgary, Alberta

Leonard Ellen
Montreal, Quebec

John F. Fraser
Winnipeg, Manitoba

Robert G. Graham
Toronto, Ontario

Wayne R. Harding
Treasure Island, Florida

J. Derek Riley
Winnipeg, Manitoba

Donald S. Rogers
Winnipeg, Manitoba

George C. Solomon
Regina, Saskatchewan

Alan Sweatman, Q.C.
Winnipeg, Manitoba

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President and Chief Executive Officer

P. Marriott
Senior Vice-President and Chief Financial Officer

C. R. Beenham
Senior Vice-President, Administration

N. J. Didur
Group Vice-President, Utilities

H. J. Forrest
Group Vice-President, Energy Products

R. C. Siegfried
Group Vice-President, Resources

H. J. Stollery
Group Vice-President, Liquid Gas

W. R. Harding
Vice-President, Corporate Development

J. E. Carstairs
Vice-President and Secretary

SENIOR MANAGEMENT

Corporate

K. J. Mondor
Treasurer

A. Singh
Corporate Controller

T. M. Carey
Assistant Secretary

Resources

P. Krenkel
Vice-President, Operations

C. J. Palmer
Vice-President, Land

W. J. Smart
Vice-President, Special Projects

B. K. Smith
Vice-President, Exploration

J. F. Whitworth
Vice-President, Controller

Utilities

H. E. Andrews
Vice-President, Finance and Regulatory Affairs

R. R. Burke
Vice-President, Controller

E. P. Rimmer
Vice-President, Gas Supply & Planning

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M. E. Burton
Vice-President, Marketing

R. P. Callow
Vice-President and General Manager

H. G. Cook
Vice-President, Management Information Systems

M. G. Meacher
Vice-President, Special Projects

M. A. Wolnik
Vice-President, Operations

MANITOBA REGION

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President, Greater Winnipeg Gas

G. Hoffman
Vice-President and General Manager

H. M. Kast
Vice-President, Controller

J. W. Kruk
Vice-President, Operations

B. McLean
Vice-President, Rate Administration

P. O. Petursson
Vice-President, Planning and Gas Supply

J. A. Prefontaine
Vice-President, Human Resources

G. A. Staples
Vice-President, Marketing and Sales

ALBERTA REGION

L. L. Hartford,
Vice-President and General Manager

B. C. REGION

J. B. deGrasse
Vice-President and General Manager

Liquid Gas

G. Boutin
Vice-President, Quebec Region

P. C. Monahan
Vice-President, Finance and Administration

M. D. Patterson
Vice-President, Ontario Region

J. L. Pinault
Vice-President, Alberta Region

D. L. Podgurny
Vice-President, Supply and Distribution

J. R. Schaffer
Vice-President, B.C. Region

G. O. Valois
Vice-President, Human Resources

I. G. Wright
Vice-President, Marketing

Energy Products

KEEPRITE INC.

B. A. Bennett
Vice-President, Manufacturing

D. DiMillo
Vice-President, U.S. Operations

R. P. Gannon
Vice-President, Canadian Operations and Treasurer

A. T. Lim
Vice-President, Research and Development

T. G. Phillips
Vice-President (Unifin International Division)

D. E. Tayler
Vice-President, International Operations

W. G. Woodcock
Vice-President and Secretary

HEIL-QUAKER CORPORATION

C. H. Findley
President

E. W. Beatty
Vice-President, Human Resources

D. W. Clark
Vice-President, Lewisburg Division

W. E. Dalton
Vice-President, Engineering

C. L. Shattuck
Vice-President, Marketing

R. G. Marquardt
Vice-President, Finance and Treasurer

THOMPSON PIPE & STEEL COMPANY

R. S. Mills
President

S. Dunbar
Vice-President, Engineering

Shareholder Information

ANNUAL MEETING

The Annual Meeting of the Shareholders of Inter-City Gas Corporation will be held on Thursday, May 14, 1987, at 11:00 a.m. in the Muriel Richardson Auditorium, Winnipeg Art Gallery, Winnipeg, Manitoba, Canada.

10-K REPORT

The SEC Annual Report on Form 10-K for the year ended December 31, 1986 will be provided by mail upon receipt of a written request. Requests should be directed to:

The Secretary
Inter-City Gas Corporation
Inter-City Gas Building
444 St. Mary Avenue
Winnipeg, Manitoba R3C 3T7

COMMON SHARES

The common shares of Inter-City Gas Corporation are listed on the Winnipeg, Toronto and American Stock Exchanges. The markets where most of the shares are traded are Toronto and New York.

TRANSFER AGENTS

Guaranty Trust Company of Canada, Winnipeg, Toronto, Calgary, Vancouver, Montreal, Regina and Halifax. Morgan Guaranty Trust Company, New York, N.Y.

SHAREHOLDER INVESTMENT PLANS

The Company offers common shareholders two convenient ways of acquiring additional Inter-City Gas Corporation common shares at regular intervals and without payment of brokerage commissions or service charges. These are known as Dividend Reinvestment and Share Purchase Plan and Stock Dividend and Share Purchase Plan. For information write – or call collect:

Guaranty Trust Company of Canada
88 University Avenue
Toronto, Ontario M5J 1T8

COMPANY OFFICES

HEAD OFFICE:
444 St. Mary Avenue, Winnipeg, Manitoba R3C 3T7

EXECUTIVE OFFICE:
20 Queen Street West, Toronto, Ontario M5H 3R3

QUARTERLY DIVIDENDS AND COMMON SHARE PRICES

1985	Dividends per share	Common Share Price (ASE – U.S.\$)		Common Share Price (TSE – CDN\$)	
		High	Low	High	Low
Quarter					
First	.10	9.75	7.375	13.375	9.50
Second	.10	11.75	8.75	15.875	12.00
Third	.15	13.00	10.75	17.50	15.00
Fourth	.15	12.875	11.125	17.75	15.25
Year	.50				
<hr/>					
1986	Dividends per share	Common Share Price (ASE – U.S.\$)		Common Share Price (TSE – CDN\$)	
		High	Low	High	Low
Quarter					
First	.15	12.00	10.25	16.75	14.125
Second	.15	11.88	10.88	16.625	14.75
Third	.15	11.88	10.00	16.50	14.00
Fourth	.15	11.00	10.25	15.25	14.125
Year	.60				



INTER-CITY GAS CORPORATION

Inter-City Gas Building, 444 St. Mary Avenue,
Winnipeg, Canada R3C 3T7