INTER-CITY PRODUCTS CORPORATION

ANNUAL REPORT 1996

MANAGEMENT KNOWS WHERE GROWTH OPPORTUNITIES ARE IN NORTH AMERICA AND OVERSEAS, AND HOW TO CONVERT THEM INTO REAL VALUE FOR OUR SHAREHOLDERS.

Corporate Profile

We offer residential and light commercial building owners a customized choice of energy-efficient indoor environmental comfort systems.

Our high quality air conditioning and heating systems carry the well-established Arcoaire, Comfortmaker, Heil, Tempstar, Airquest, KeepRite and Lincoln brand names. These home comfort products range from high-efficiency premium models to entry-level low-cost products and are marketed to dealers, contractors and builders through independent distributors.

As one of North America's leaders in the heating, ventilation and air conditioning industry, we have the capacity to design and produce more than one million units annually from our manufacturing and distribution complex in Lewisburg, Tennessee, and our oil furnace plant in Laval, Quebec.

With our registered shareholders' office in Toronto and corporate head office in Lewisburg, Inter-City Products' shares trade on both the Toronto and American stock exchanges under the IPR symbol.

The Annual General Meeting of Shareholders will be held at 10:00 a.m. (local time) on Friday, June 6, 1997 at the Metro Toronto Convention Centre, 101 Press Room, 255 Front Street West, Toronto, Ontario, Canada.

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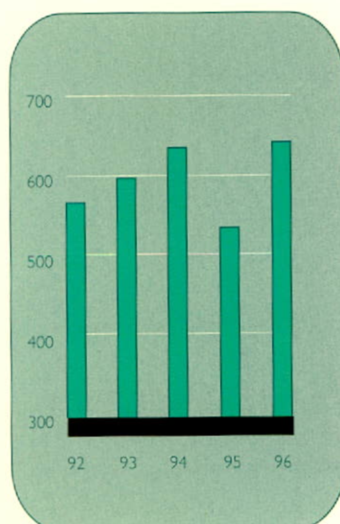
Inter-City Products Corporation has two independent operating subsidiaries, Inter-City Products Corporation (USA) and Inter-City Products Corporation (Canada). As a convenience to the reader, these separate legal entities are generally referred to in this annual report as if they were a single company.

Financial Highlights

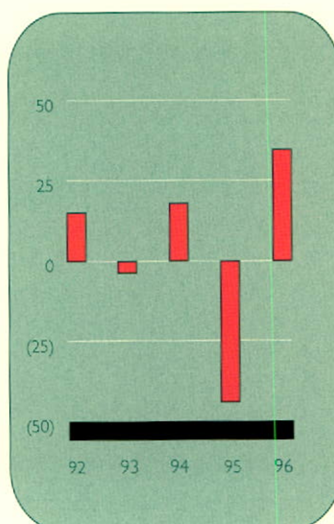
- Reported income from continuing operations of $11.6 million in 1996 (loss from continuing operations of $81.2 million in 1995). 1995 loss included $34 million in asset writedowns, restructuring costs, and non-recurring expenses.
- Reduced structural costs by $15 million ($25 million in 1995).
- Introduced 20-ton commercial packaged product and residential air handler series.
- Improved plant productivity by 16%, factory output by 26%.
- Recruited 21 U.S. distributors (24 in 1995), terminated 16 non-performers (six in 1995).
- Increased presence in Latin American markets.
- Transferred corporate management functions from Toronto to Tennessee.
- Hired new senior executives in finance, manufacturing, and marketing.
- Reorganized company around five business units to provide better focus for growth and profitability.
- Developed strategic plan to grow to a $1 billion business by 2000.

(Millions of U.S. Dollars Except Per Share Amounts)	1996	1995
OPERATING REVENUE	$ 641.9	$ 532.8
GROSS MARGIN	124.1	65.4
% OF OPERATING REVENUE	19.3%	12.3%
OPERATING PROFIT (LOSS)	33.4	(43.3)
INCOME (LOSS) FROM CONTINUING OPERATIONS	11.6	(81.2)
NET INCOME (LOSS)	8.5	(93.2)
NET INCOME (LOSS) PER SHARE		
FROM CONTINUING OPERATIONS	$ 0.30	$ (2.09)
AFTER DISCONTINUED OPERATIONS	$ 0.22	$ (2.40)
WORKING CAPITAL	103.8	60.5
TOTAL ASSETS	345.0	345.8

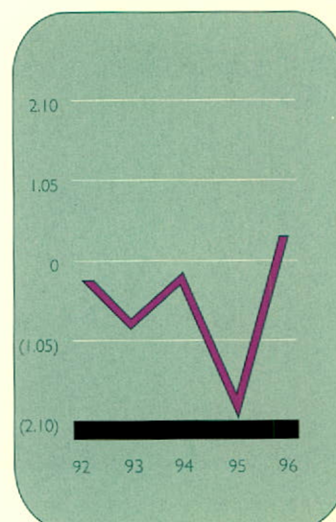
Five Year Operating Revenue
(U.S. $ Millions)



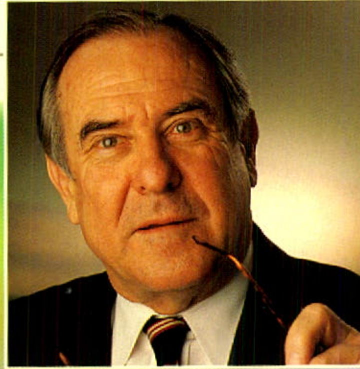
Operating Profit (Loss)
(U.S. $ Millions)



Earnings (Loss) Per Share
From Continuing Operations
(U.S. $)



We see the achievement of net income in 1996 as the beginning of a trend that should accumulate value for shareholders over the YEARS AHEAD.



Top photo:

Marvin G. Marshall, Chairman of the Board.

Pictured above: Mr. Marshall meets with John F. Fraser and The Hon. William G. Davis, two directors who serve on the Board.

Inter-City Products made major changes in its corporate governance during 1996, including a reconstitution of the board to better represent the interests of shareholders. At the same time, president and chief executive officer Mike Clevy strengthened the management team and established a style of leadership that has resulted in productive relations with the directors.

New directors were nominated with expertise pertinent to the Company's operations and future opportunities as well as to increase the number of independent directors. For an interim period, the board was expanded from 11 to 13 members. It is proposed to reduce the board size in 1997.

The expertise on the board has, we believe, helped management to expedite the transition from a turnaround phase built on cost reductions to the current period of profitability based on managed growth. All directors have deepened their understanding of the business through board meetings held during 1996 at the manufacturing plant in Lewisburg, Tennessee, as well as meetings convened to coincide with distributor events in Canada and the United States.

Among the major corporate governance initiatives undertaken by the board with management during 1996 were:

- the creation of the strategic planning committee and the adoption of a long-term strategic plan;
- the introduction of a new management compensation policy that, through annual bonuses and stock options, links the financial interests of senior managers with those of the shareholders by basing a large part of total compensation on the achievement of profit targets approved by the board;
- improved communications, including full disclosure of material events, with shareholders and other stakeholders.

Subsequent to year end, the board appointed new external auditors, Arthur Andersen & Co., subject to shareholder approval. This firm has also been asked to develop and implement new internal audit procedures, including criteria for internal audit accountability to the board.

This improved corporate governance and revitalized management team have done much to earn the renewed support of shareholders. As a result of better business practices, the directors can carry out their fiduciary duties without the anxiety of unexpected – and unacceptable – surprises.

We have full confidence in Mike Clevy and his management group and see the achievement of net income in 1996 as the beginning of a trend that should accumulate value for shareholders over the years ahead.

MARVIN G. MARSHALL
CHAIRMAN OF THE BOARD

Members of the Compensation and Pension Committee have more strongly linked management compensation with performance goals. Pictured above with members of the Committee are: (third from left) David Cain, Senior Vice President, General Counsel and Secretary; and (fourth from left) Bob Henningsen, Senior Vice President, Human Resources and Administration.

Strong corporate governance practices are essential to the Company's success and its ability to create shareholder value. As a public company whose shares trade on the Toronto Stock Exchange, we comply with the corporate governance guidelines issued by the exchange in 1995. Furthermore, as a company which operates in the United States, whose shares trade on the American Stock Exchange, and which has substantial American share ownership, our corporate governance practices are also influenced by guidelines issued in 1996 by the National Association of Corporate Directors.

Board mandate In December 1995, the board separated the functions of chairman and chief executive officer. This separation articulates the board's view that the chairman should represent the interests of shareholders and the CEO should represent the views of management, which is accountable to the board. The directors provide oversight and a policy framework that ensure management acts in the best interests of the shareholders.

In 1996, governance practices and expectations of management were improved through several initiatives that included:

- a strengthening of the board and its committees through the addition of independent directors;
- a new long-term strategic planning process, resulting in a four-year strategic plan;
- initial work on the appointment of new internal auditors;
- the linking of management compensation to measurable operational and profit performance targets;
- the partial payment of director's fees in shares of the Company; and
- a new communications policy to provide shareholders and other stakeholders with comprehensive and timely information.

Board membership The board currently has 13 members, of whom one is a related director (the Company's chief executive officer) and 12 are directors unrelated to either the management or the business of the Company. The Company does not have a controlling shareholder, although one director represents 19.9

percent and one director represents 13.8 percent of the Company's outstanding shares.

In 1996, shareholders approved a substantial change in the the composition of the board to include American residents with specific knowledge of the U.S. heating, ventilation and air conditioning industry and the markets in which we compete. Inter-City Products derives approximately 88 percent of its revenue from U.S. sales. Virtually all of the Company's manufacturing capacity is located in Lewisburg, Tennessee. The corporate head office and corporate management functions were relocated to Lewisburg in 1996. The former head office in Toronto remains the registered office of the Company as well as the principal office of the Chairman.

For an interim period, board membership was expanded from 11 to 13 directors to accommodate the new voices at the table while ensuring continuity in governance at a time of fundamental change in the Company's operations and direction. Now that the Company has developed and is implementing a long-term strategic plan, and has achieved profitability, it is proposed to further adjust the composition and reduce the size of the board in 1997.

The current board was elected in June 1996.

Board committees The board has five standing committees, each of which is comprised of a majority of independent directors.

The **audit committee** reviews the annual and quarterly financial statements, accounting practices and business and financial controls. It recommends the appointment of the external auditor to the board for approval by the shareholders at the annual meeting. The audit committee is also involved in developing revised internal audit procedures and guidelines, with the internal auditor empowered to meet with the audit committee in the absence of management.

The audit committee met five times in 1996.

The **compensation and pension committee** is responsible for the Company's overall compensation policy and specific incentive programs for managers.

In 1996, a new management compensation program was introduced to tie management's financial interests to those of the shareholders. Salaries are competitive at approximately 80 percent of the mid-range for senior managers in manufacturing companies. An annual bonus is granted provided that: 1) the Company's business targets as set by the board are met; and 2) an individual manager's objectives, as approved by the CEO, are achieved. A total of 36 key managers have been granted stock options.

This committee also initiated the policy approved by shareholders in 1996 of paying up to 20 percent of annual directors' fees in shares rather than cash to further align the interests of board members with the interests of shareholders.

The compensation and pension committee met four times in 1996.

The **nominating and corporate governance committee** recommends individuals for election as directors and oversees corporate governance practices.

Among the issues this committee will address in 1997 are the process for ensuring orderly senior management succession, an appropriate process issued by the board for the directors to evaluate their own performance, and the need for senior management to be aware of the Company's Canadian obligations as a Canadian corporation in view of its increasingly American orientation.

This committee met three times in 1996.

The **strategic planning committee** receives, reviews and approves the strategic plan recommended by the chief executive officer. This committee is comprised of five individuals including the CEO, with extensive industry experience. This committee worked closely with management in discussing and developing the four-year strategic plan approved in 1996. The plan will be reviewed by management, the committee and the full board at least annually and revised if considered appropriate.

The strategic planning committee met four times in 1996.

The **finance committee,** inaugurated in 1996, assists management in developing the Company's capitalization strategy to finance the long-term strategic plan.

The finance committee met four times in 1996.

Our Company is in a new era of confident growth and PROFITABILITY.

Clockwise from top: 1) President and CEO, W. Michael Clevy.

2) Mr. Clevy has strengthened his management team with the appointment of Steve Clanton as Senior Vice President, CFO and Treasurer.

3) Mr. Clevy meets with other members of his staff including: Karla Smith, Vice President, Corporate Communications; Frank Harrell, Senior Vice President, USA Sales; and Jim Kirwan, Senior Vice President, Operations.

I am pleased to report that we accomplished every major goal we set for ourselves in 1996. We continued to make good progress on the restructuring of our manufacturing operations in our relentless search for efficiencies and permanent cost savings. Overhead expenses were reduced for the second consecutive year. We strengthened the management team. We expanded our market share in North America. We increased our presence in Latin American markets and, most important of all, we made a net profit.

As a result, our Company is in a new era of confident growth and profitability.

A cost-competitive company Inter-City Products is a substantially different company today than it was just three years ago. In 1994, we began to wrestle with rationalizing our operations to become a lower cost manufacturer. This effort gained momentum in 1995 when we consolidated operations and offices at our large manufacturing and distribution complex in Lewisburg, Tennessee, sold redundant assets, concentrated on improving relations with suppliers and distributors, and introduced new mainline and entry-level products.

In 1996, we built further on this hard work, benefited from the renewed confidence of distributors and suppliers, and set new performance targets, the most important of which was to attain profitability while we carved out a clearer vision of where we wanted to be over the longer term.

1996 profitability The 1996 financial results ended a five-year cycle of consecutive losses. Operating revenue rose by 20 percent to $642 million, and gross margin improved by a stunning 90 percent to $124 million, or 19.3 percent of revenue. Net income of $8.5 million contrasted with a 1995 net loss of $93 million that included $50 million of write-offs, restructuring costs and other non-recurring expenses. The 1996 net income would have been higher but for a $3.1 million loss from discontinued operations by a wholly owned steel pipe subsidiary that was sold in May 1996.

Underlying this financial progress is an important factor – our break-even point has been dramatically lowered. I noted in last year's annual report that our efforts to improve cost competitiveness would reduce structural costs by $40 million – $25 million in 1995 and a further $15 million in 1996.

The lowering of these structural costs means that more of future revenue gains will flow to the bottom line and we will be better able to withstand the impact of economic recessions.

We accomplished every major goal we set for ourselves in 1996.

Stronger distribution network Inter-City Products is differentiated from competitors by the size and quality of its distribution network, which consists of some 400 independent distributor companies. Two years ago we set out to strengthen distribution. Since the start of 1995, we have recruited 45 distributors, of whom 36 were won from competitors. We also terminated 22 wholesalers, most of whom contributed little to our revenue.

We moved strategically to protect market share in 1996 by acquiring two distributors owned by an investment company that decided to exit the business. With 31 outlets, these distributors represented four percent of our annual sales. Our objective was to reposition these distributors for eventual sale. The distributor serving Florida and Georgia was sold at the start of 1997 to Watsco, Inc., one of the industry's fastest growing wholesale firms, along with four of the six U.S. factory branches we have maintained for several years. We believe Watsco will grow sales through these distribution outlets at a rate that will improve the profitability of both companies.

International expansion We further enlarged our marketing scope in 1996 through arrangements with distributors in many Latin American countries. These markets allow us to leverage our existing investments for little incremental cost. Our entry into otherwise unfamiliar territory was facilitated by staff expertise in the Latin American heating and cooling industry. This should be a fast growing source of future revenue.

Revitalized corporate structure While pleased with recent progress, we have much work to do if we are to fulfill our goal of being a $1 billion business by 2000. With that in mind, we have taken steps to revitalize the corporate organization.

First, we closed the Toronto head office and consolidated all corporate functions at Lewisburg. A review of the management team led to three key hirings – a senior executive for manufacturing, a chief financial officer, and a senior marketing executive. We also recognized that our experienced managers could be better utilized. Instead of hiring a chief operating officer, as we considered doing, we asked senior managers to take on new responsibilities as business unit leaders. We asked other managers to assume corporate responsibilities.

At the start of 1997, we formed five business units to drive future sales growth and profits. Two units (Canada and international) are geographic, while three (residential, light commercial and aftermarket parts) are product based. Each business unit brings together expertise in areas such as engineering, manufacturing and marketing to focus on winning orders from customers by offering products that deliver value at competitive prices. These business units will better utilize the greatly improved manufacturing capacity we have created through the implementation of lean production and also leverage our investments in engineering, marketing, sales, finance and human resources.

Outlook For 1997, our goal is to grow the top line and improve our gross margin as a percentage of revenue as we achieve further cost reductions and manufacturing efficiencies. Our operating profit and net income should both experience strong growth in 1997.

Looking out to the year 2000, we plan to be a $1 billion annual revenue company with strong operating profits. We will see growth in our five business segments with special emphasis on improvement in commercial and international sales.

The proposed name, ''International Comfort Products Corporation'', signals a change from the past emphasis on North American markets only. We will, of course, continue to serve our North American customer base, but we will also look to offshore opportunities as we plan for new products and services to add to our offering.

The HVAC industry is growing at a significantly greater pace outside North America, and we need to take advantage of the opportunity to expand our presence in markets where it makes sense. We have started slowly, being cautious with our investments, but we fully intend for the international business to be a major contributor to growth and profits as we move forward.

The important factor is this: management knows where growth opportunities are in North America and overseas, and how to convert them into real value for our shareholders.

W. MICHAEL CLEVY
PRESIDENT AND CHIEF EXECUTIVE OFFICER

We carved out a clearer vision of where we wanted to be over the LONGER TERM.

Left: Senior Vice President Jim Wiese is General Manager of our largest business unit, the Residential Products Group.

Right: Along with Alex Lim, Vice President, Engineering, Wiese checks out the new computerized run testing equipment recently installed in the Lewisburg plant.

We design, manufacture and market heating and cooling systems for residential and light commercial use. Our residential products create a clean, controlled climate in single-family homes and multi-family apartment buildings. Our light commercial products are appropriate for schools, restaurants, strip retail plazas, and small office buildings.

All products are marketed through independent wholesalers in the United States, Canada, Latin America and parts of Europe. The distribution channels for air conditioning systems and gas furnaces are Heil, Tempstar, Arcoaire, Comfortmaker and Airquest brands in the United States. These brands, along with Lincoln and KeepRite, are marketed in Canada, while overseas our products primarily carry the Comfortmaker and Tempstar brands.

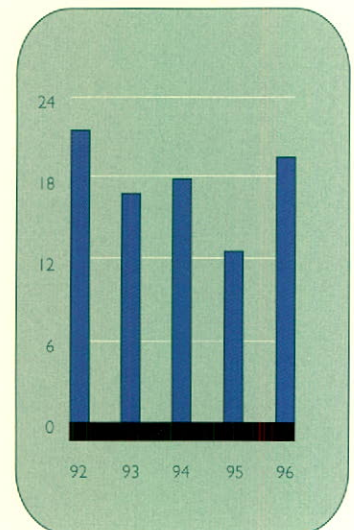
Our five heating and air conditioning systems are:

- Packaged systems that combine heating and cooling in a single unit for residential or light commercial use;
- Split systems that link an outdoor air conditioner with an indoor evaporator coil and air handling system;
- Split systems that link an outdoor heat pump with an indoor evaporator coil and air handling system;
- Gas furnaces; and
- Oil furnaces.

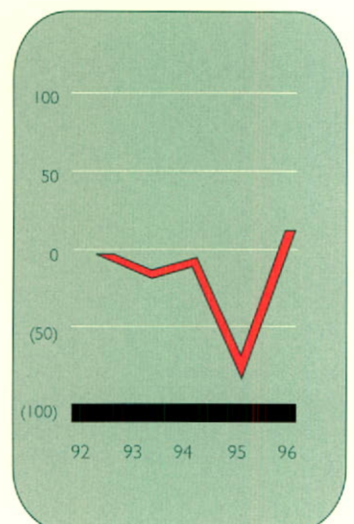
A two-tiered product strategy We offer two tiers of products – mainline, including our long established premium models, and standard performance products targeted at the low-cost entry-level sector. Our two-tier strategy has successfully shored up declining market share in mainline sales and achieved volume gains in the entry-level segment. Today, approximately 25 percent of our products are entry-level products, reflecting the demand profile of the marketplace.

Product development involves customers and suppliers We involve our distributors and suppliers in product design. Distributors primarily participate through advisory groups and design focus groups with their dealers, providing input vital to making our systems easier to install and service and, therefore, more cost effective. Key suppliers are consulted

Gross Margin
(% of Operating Revenue)



Income (Loss) From Continuing Operations
(U.S. $ Millions)



We will see growth in our five business segments with special emphasis on improvement in COMMERCIAL SALES.

Top photo: Dave Schumacher, Vice President and General Manager, leads the Commercial Products Group, an area in which some of our Company's greatest growth potential lies.

Pictured above: Schumacher and his team inspect the ease of installation of our large rooftop units.

during the design phase and test prototypes to determine the reliability and life cycle of their components. We deal with approximately 300 suppliers, of whom 75 firms represent 90 percent of our purchasing expenditures.

Considerable testing is undertaken during the development, manufacturing and pre-marketing phases to ensure design, performance, and reliability objectives are met. Over the past two years, the time from initial design to market availability has been shortened from 24 months to 12 months.

Two new product series were launched in late 1996. One is a 20-ton light commercial packaged product, our largest capacity unit that is suitable for roof-top installation at shopping malls, office buildings and other low-rise commercial buildings. The other is an air handler and coil line for our residential split systems. It uses 65 percent fewer parts, is easier to install, and provides the dealer with increased flexibility and ease of servicing.

These products followed the introduction in 1995 of a 78 percent AFUE (annual fuel utilization efficiency) entry-level gas furnace for the building industry, an upgraded 10 SEER (seasonal energy efficiency rating) entry-level air conditioning system, and a low-cost residential packaged heating and cooling system.

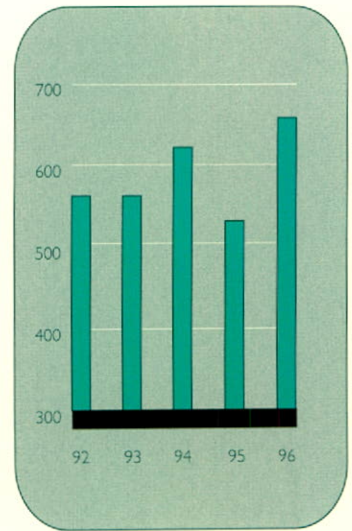
Manufacturing efficiency gains continue All systems except oil furnaces are produced at our one million square foot manufacturing complex in Lewisburg, Tennessee. Oil furnaces are manufactured at our 81,000 square foot plant in Laval, Quebec.

Inter-City Products has significantly improved its position as a cost-competitive manufacturer. Following the major restructuring initiated in late 1994 and implemented throughout 1995, our target for 1996 was to improve plant productivity by a further 10 percent and factory output by 20 percent.

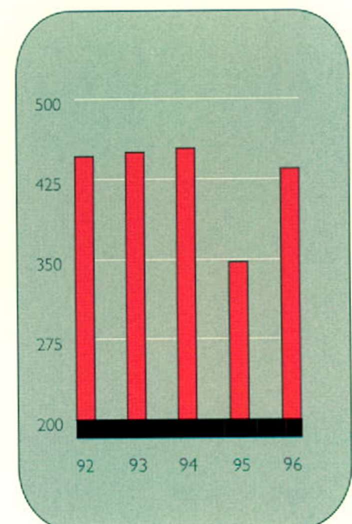
We improved them by 16 percent and 26 percent, respectively. Work in process turns more than doubled from 18 in 1995 to 46 in 1996.

A critical measure of our manufacturing competence is the time it takes to turn around a customer order. In 1994 the lead time was 90 days. By 1996 we had cut it to 30 days. For 1997 our target is 15 days. By 2000 we plan to cut lead time to a mere five days. All of this means that we are operating

Sales Volumes - Air Conditioners
(Thousands of Units)



Sales Volumes - Furnaces
(Thousands of Units)



We fully intend **for the international business to be a major contributor to growth and profits as we move FORWARD.**

Right: The International Sales group is led by Senior Vice President and General Manager, Augusto Millan.

Left: Millan and his group have expanded our Company's presence in Latin America and parts of Europe.

closer to market demand. We now operate on shorter production cycles and have as many as 12 assembly lines operating simultaneously.

Cost and efficiency gains are being won through lean production that focuses on asset and labor management. We have introduced computerized run testing; improved scheduling of production; adopted "point of use" manufacturing with materials delivered directly to the assembly line to eliminate handling and storage costs; and standardized many parts, with stock keeping units decreased by 45 percent during the past two years without abandoning any markets. We closely monitor inventory levels and expedite delivery from our new distribution center opened next to the Lewisburg plant in December 1995.

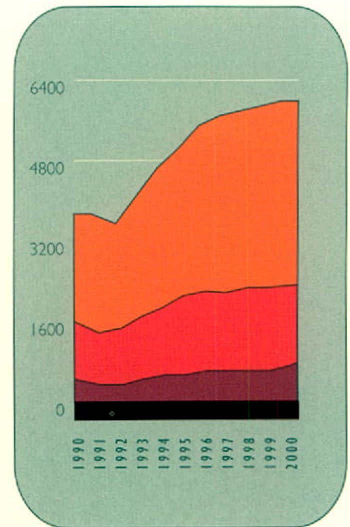
The aggressive attack on manufacturing waste is matched by intense attention to product quality. Our distributors and dealers conduct a monthly in-plant audit of products. The two-day audit involves the inspection and testing of up to 100 units. This program has been valuable in identifying design, operating and aesthetic improvements. By the end of 1996, we had adopted the ISO 9000 standards which set quality guidelines for manufacturers and requires an independent party to audit and document the compliance with guidelines twice a year. We anticipate certification in 1997.

In addition to further efficiencies and cost savings, one of our goals for 1997 is to stabilize the Lewisburg factory workforce at approximately 1,650 hourly employees to replace past swings in hirings and layoffs. Reliable, consistent employment will give employees greater security in planning their personal affairs and should result in further improvements in plant productivity and product quality.

Manufacturing efficiencies have also been introduced at the oil furnace plant in Laval, Quebec, which produces approximately 20,000 units annually, of which 60 percent are sold in Canada and the remainder in the United States. We are currently the number three producer of oil furnaces in North America and hope to achieve the number one ranking by 2000.

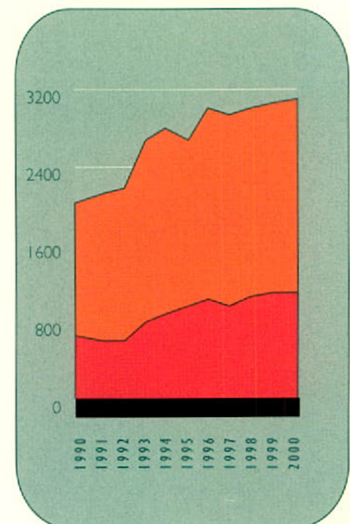
A strong and growing distribution network We maintain the largest distribution system in the North American heating, ventilation and air conditioning industry. Our entire network consists of approximately 400 independent distributor companies in Canada, the U.S. and international markets.

Industry Outlook for Integrated Heating & Cooling Systems
(Thousands of Units)



Replacement and Modernization
New Residential Construction
Commercial Properties

Industry Outlook for Gas Furnaces
(Thousands of Units)



Replacement and Modernization
New Residential Construction

Independent distributors are the lifeblood of our BUSINESS.

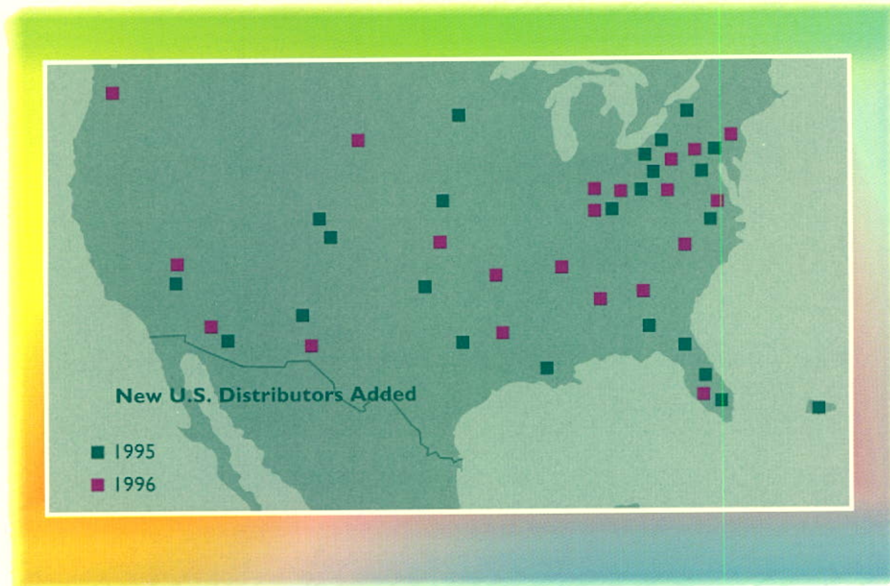
Right: Senior Vice President and General Manager, Canadian Operations, Dave Tayler.

Left: The Canadian group has a strong history and market share of national industry sales.

Independent distributors are very much the lifeblood of our business. To ensure we respond to their expectations, we conduct an annual survey to quantify distributor satisfaction with our performance on a variety of subjects. The first survey in 1995 set an unacceptably low customer satisfaction score of 6.2 on a scale of 1–10, with 10 representing complete satisfaction. We worked for a 10 percent improvement in 1996, and did a little better than expected with a score of 7.0. Our target is to earn a score of 9.0 by 2000.

Over the past two years, we revitalized U.S. distribution by recruiting new wholesalers. In 1995, 24 distributors were added, of whom 23 were won from competitors, and six distributors were discontinued. In 1996, we added a further 21 distributors, of whom 13 were won from competitors, and ended

New U.S. Distributors Added



The business unit approach should result in faster decision making, further waste reduction, improved time-based competitiveness, INCREASED SALES...

Augusto Millan, Senior Vice President and General Manager of

our Aftermarket Sales group,

checks inventory levels

with his team in the service parts warehouse.

relationships with 16 others. The net effect is that our products are now available in many new markets.

Distributors sell our products to installers in the replacement and renovation businesses as well as to contractors in the new housing and light commercial construction sectors. Approximately 70 percent of residential products are used to replace existing systems, with the balance installed in new construction projects. Approximately 20 national homebuilders, including three added in 1996, have selected our products for their new housing developments. In several cases, their loyalty to our brands dates back more than 10 years.

An emerging trend in our industry is dealer buying groups. In September 1996, we signed an agreement with a large national dealer organization that selected Inter-City Products as one of its two suppliers.

As part of our commitment to quality customer service at the homeowner level, we train up to 5,000 distributor, contractor and dealer personnel annually in the field, and approximately 500 a year at our national training center in LaVergne, Tennessee. We also train distributors' technical service advisors so they can deal with the service requirements of dealers. In 1996, approximately 400 technical specialists employed by distributors were trained at our LaVergne center.

An area of new growth is international sales. Overseas markets, especially emerging economies, will experience much higher growth rates than North America. In 1996, we decided to focus on Latin America because of its geographic proximity to North America and because we have staff familiar with these markets. In 1997, we plan to further expand our distribution network in Latin America and the Caribbean and we are opening warehouses in Miami, Florida, and Monterrey, Mexico to service these markets.

New business units will drive future profits Five business units were recently formed to better utilize our resources, improve market penetration, and deliver the value our customers expect in product quality, service and pricing. Three U.S. business units – residential products, light commercial products, and aftermarket sales – are organized along product lines. Two business units – Canada and international – reflect geographic

opportunities. The Canadian business unit has existed historically as a distinctive operating company, reflecting the Canadian origin of Inter-City Products and its strong market share of national industry sales. The other business units are based in Tennessee.

Each business unit contains a dedicated team of specialists in areas such as marketing, engineering and manufacturing under a general manager. In the case of Canada, the business unit also has its own sales force, finance staff and distribution center, and is responsible for our oil furnace manufacturing plant in Laval, Quebec.

Supporting the business units are corporate expertise in marketing, engineering, manufacturing, sales, corporate finance, human resources, and communications, that respond in part to the priorities identified by the general managers. For example, each business unit has its own plant manager responsible for that group's production, scheduling and material flow. Manufacturing's functional responsibility is for continuous improvement of overall product quality, productivity and in-plant safety.

The new organization separates light commercial and related residential packaged units from core residential products. Currently, only a small percentage of our distributors carry light commercial products. Our goal is to grow this business segment by reliably supplying products with capacities of up to 20 tons to current and new distributors.

The parts business has shifted from a primary emphasis on serving warranty claims to being a one-stop shopping counter that carries every item – from compressors, motors and fans to valves, fasteners and screws – that a distributor or dealer might need to service heating and cooling systems. We are encouraging distributors to adopt on-line computer ordering that ensures parts shipment within 24 hours. Currently, we carry approximately 27,000 stock keeping units and plan to reduce them to 15,000 units through standardization programs.

The business unit approach should result in faster decision making, further waste reduction, improved time-based competitiveness, increased sales, and profit accountability among general managers.

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In 1996, Inter-City Products Corporation returned to profitability after five consecutive years of losses and reported income from continuing operations of $11.6 million, or 30 cents per ordinary share, and net income after discontinued operations of $8.5 million, or 22 cents per share. The Company reaffirmed its position as one of North America's leading producers of heating and cooling products and systems by selling 427,000 furnaces (a 22 percent increase over 1995) and 653,000 air conditioning units (a 23 percent improvement). Unit volumes grew at a faster pace than the industry and represent gains in market share.

The return to profitability was accomplished through:

- reduced manufacturing costs;
- a stronger distribution network with 21 new distributors added and 16 under-performers terminated in 1996;
- the replenishment of low inventory levels in the distribution system;
- gains in market share; and
- a product mix shift from exclusively higher-value products to 75 percent premium products and 25 percent lower-priced entry-level products in step with changing market demands.

Strategic Opportunities

The Company markets its products through independent wholesalers, although it has maintained six factory branches in the U.S. and three outlets in Canada where distributors were unavailable.

In July 1996, the Company acquired Coastline Distribution, Inc. of Sanford, Florida and General Heating and Cooling Company of Kansas City, Missouri when the owner, an investment company, decided to exit the business. The acquisition was a strategic move to protect Inter-City Products' long-term growth prospects in the southeast and midwest states. The Company stated at the time that it would own the distributors until owners committed to the business could be found.

Accordingly, the results of the two distributors were consolidated with the Company's in 1996 and represented 4.5 percent of consolidated operating revenue. The impact of the acquisitions on the results of operations and financial position are described in note 2 to the consolidated financial statements.

In January 1997, the Company sold Coastline Distribution, which has 21 branches throughout Florida, Georgia and Alabama, to Watsco, Inc., a leading distributor in the climate control industry. In addition, Watsco also acquired four of the Company's U.S. factory branches.

FINANCIAL RESULTS

Net income in 1996 was based on a substantial increase in operating revenue, a much improved gross margin, and reductions in selling, general and administrative expenses and financial expenses.

Operating Revenue

Operating revenue rose by $109.1 million, or 20.5 percent, in 1996 and exceeded the previous record set in 1994. Excluding the $29.1 million contribution of the two distributor organizations acquired in 1996, operating revenue was $612.8 million, a 15 percent improvement over 1995.

Approximately 88 percent of the 1996 revenue was generated in the United States and 12 percent in Canada and overseas.

(Millions of U.S. Dollars)	**1996**	1995	1994
Operating revenue	**$ 641.9**	$ 532.8	$ 635.2
Gross margin	**124.1**	65.4	112.9
% of operating revenue	**19.3%**	12.3%	17.8%

Among other factors, the revenue improvement was primarily due to:

- distributors replenished inventories after severely reducing them in 1995 in a one-time response to a reduction in the Company's credit terms from 90 days to 53 days. This inventory correction recouped an estimated $20 million in revenue lost in 1995.
- uncertainties about the Company's future ownership were resolved in January 1996. Renewed distributor and dealer confidence produced an estimated recovery of $20 million in revenue lost in 1995.
- the acquisition of two major distributors (discussed earlier) added $29 million in revenue.
- robust industry growth, gains in market share, new distributors and no work stoppage in 1996 contributed to the remaining $40 million in higher operating revenue.

The 1996 performance more than offset the $102.4 million revenue decline reported in 1995. In 1995, distributors reduced orders in response to the new credit terms and doubts about the Company's future. In addition, the relationship with a large distributor was terminated and substantial improvement in product ordering lead times allowed distributors to operate with much less inventory. Also, the Company lost sales in 1995 as the result of a 16-day plant strike and the sale of the packaged terminal air conditioning product line.

Gross Margin

Gross margin increased by $58.7 million, or 90 percent in 1996, more than reversing the decline experienced in 1995. The recovery was the result of higher production volumes and sales as well as cost saving measures and manufacturing efficiencies at the plant in Lewisburg, Tennessee. Our goal is to continually improve gross margin by emphasizing cost reductions and manufacturing efficiencies.

The 1995 decline in gross margin was primarily caused by lower fixed burden absorption in the Lewisburg plant following a 25 percent reduction in production output. Production declined due to lower sales and the effort to reduce finished goods inventory by year end. The 1995 gross margin was further reduced by a higher than normal provision for obsolete inventory and higher material costs.

Selling, General and Administrative Expenses

Total selling, general and administrative ("SG&A") expenses include provision for bad debts and warranty expense. Total SG&A expenses declined by $2.5 million to $90.7 million in 1996 and more steeply as a percentage of operating revenue compared to 1995.

(Millions of U.S. Dollars)	**1996**	1995	1994
SG&A	**$ 71.2**	$ 69.6	$ 70.1
% of operating revenue	**11.1%**	13.1%	11.0%
Provision for bad debts	**2.8**	9.7	3.7
Warranty expense	**16.7**	13.9	13.5
% of operating revenue	**2.6%**	2.6%	2.1%
Total SG&A	**$ 90.7**	$ 93.2	$ 87.3
% of operating revenue	**14.1%**	17.5%	13.7%

SG&A expenses (excluding provision for bad debts and warranty expense) increased by $1.6 million in 1996 and reflected higher marketing, advertising and sales expenditures associated with strong business expansion as well as additional expense for managing the two distributor organizations acquired in 1996.

In 1995, SG&A expenditures were reduced by $5.3 million as sales declined, offset by a $1.3 million loss on the impairment of intangible assets and $3.5 million for the cost of consolidating administrative staff in Lewisburg, a loss on the sale of the distribution center in Nashville, the sale of corporate assets, an accrual for unused warehouse and office space in Canada, and costs associated with the termination of the search for a buyer of the Company.

The provision for bad debts returned to more traditional levels in 1996. In 1995, the bad debt provision increased by $6.0 million as a result of the deterioration in financial condition of certain large past due accounts.

In 1996, warranty expense as a percentage of operating revenue remained the same as compared to 1995. The reserve level for warranty claims was raised in 1995 as a result of two developments. One was the introduction of a standard five-year limited warranty on replacement and service parts, replacing the previous one-year warranty. The second was continuing provisions for the packaged terminal air conditioning product line, which was sold at the end of 1994.

Operating Profit (Loss)

The Company reported its best operating profit since 1989 at $33.4 million – a significant improvement from the $43.3 million operating loss recorded in 1995. No significant charges were incurred in 1996. EBITDA (earnings before interest, taxes, depreciation and amortization) was $49.1 million, compared with a negative $24.5 million in 1995.

(Millions of U.S. Dollars)	**1996**	1995	1994
Operating Profit (Loss)	**$ 33.4**	$ (43.3)	$ 17.6
including:			
asset writedowns	**—**	10.1	—
restructuring and other charges	**—**	5.4	8.0

An important charge to earnings in 1995 was $10.1 million in asset writedowns. The Company wrote off redundant machinery and equipment and closed the paint shop at the Lewisburg plant as it modernized production facilities. Idle assets at the former Brantford plant in Ontario were also written off.

Restructuring costs totaled $5.4 million in 1995 for staff severance in the U.S. and Canadian operations as well as corporate staff severance following the transfer of corporate functions from Toronto to Lewisburg.

In 1994, restructuring and other charges totaled $8.0 million and consisted of: (i) $2.3 million in severance costs, partially offset by a reversal of $1.5 million relating to the 1993 restructuring accrual for the Brantford plant closure; (ii) a $4 million provision for environmental costs relating to a sudden and accidental spill in 1980 at the Lewisburg plant by the previous property owner; and (iii) $3.2 million in consulting fees for the study of the Company's cost competitiveness and strategic priorities.

Financial Expenses

Financial expenses declined by $3.3 million, or 13 percent, in 1996, primarily as the result of lower interest expense.

(Millions of U.S. Dollars)	**1996**	1995	1994
Interest expense	**$ 19.4**	$ 21.7	$ 20.2
Amortization of debt issuance costs	**1.8**	1.3	1.7
Write-off of debt issuance costs	**0.6**	2.1	1.2
Financial expenses	**$ 21.8**	$ 25.1	$ 23.1

Interest expense declined by $2.3 million because of lower average borrowing levels in 1996, reversing the $1.5 million increase in 1995. The average borrowing level, net of cash, in 1996 declined to $196 million from $239 million in 1995 and $234 million in 1994.

	1996	1995	1994
Average borrowing costs			
U.S.	**9.8%**	9.2%	8.8%
Canada	**7.7%**	9.1%	7.0%

The improvement in borrowing costs was partially offset by the write-off of debt issuance costs associated with the replacement of a revolving credit facility in January 1996.

In 1995, the Company wrote off debt issuance costs of $2.1 million relating to the amendment and restatement of the revolving credit facility and the termination of the 1994 accounts receivable purchase agreement.

Income Taxes

The Company is currently not recording income taxes as a result of accumulated tax losses from prior years. In 1995, the total tax provision of $12.8 million included a write-off of $11.4 million of accumulated deferred income tax debits recorded as of December 31, 1994. This write-off was required since there was no longer reasonable assurance as of December 31, 1995 that the timing differences supporting these deferred tax debits would reverse.

Discontinued Operations

Loss from discontinued operations consists of the following:

(Millions of U.S. Dollars)	**1996**	1995	1994
Discontinued Operations			
Steel Pipe operations	**$ (3.1)**	$ (14.3)	$ (1.9)
Settlement of former resources claim	—	2.9	—
Utilization of prior years' tax losses	—	1.3	2.0
Write-off of deferred tax debit			
– Flying J environmental provision	—	(1.9)	—
Refrigeration operation	—	—	(3.0)
Loss from Discontinued Operations	**$ (3.1)**	$ (12.0)	$ (2.9)

The Company sold Thompson Pipe & Steel Company, a steel pipe manufacturing company based in Denver, in May 1996. It incurred a $3.1 million loss from Thompson in 1996, compared with an $8.3 million loss in 1995. The Company also wrote down Thompson's assets by $6.0 million to the estimated net realizable value in 1995.

The Company received $2.9 million in 1995 as its share of a favorable judgment involving a former Canadian oil and gas subsidiary, which was sold in 1989.

The results of discontinued operations were partly offset in 1994 and 1995 by the utilization of tax losses for prior years. These tax losses arose primarily from the costs of selling the gas utility and propane operations of the Company in 1990.

The commercial refrigeration division in Canada was sold in 1994, for gross proceeds of $6.7 million. Of the $3.0 million loss recorded in 1994, $1.4 million related to sale costs.

Net Income (Loss)

Net income totaled $8.5 million, or 22 cents per share, in 1996, compared with the loss of $93.2 million, or $2.40 per share, in 1995.

(Millions of U.S. Dollars Except Per Share Amounts)	**1996**	1995	1994
Income (loss) from continuing operations	**$ 11.6**	$ (81.2)	$ (4.6)
Net income (loss)	**8.5**	(93.2)	(7.5)
Net income (loss) per ordinary share			
From continuing operations	**$0.30**	($2.09)	($0.20)
After discontinued operations	**$0.22**	($2.40)	($0.29)

The 1996 return to profitability reflected the strong growth in sales revenue, the continued lowering of structural costs through the implementation of lean production at the manufacturing plant and lower financial expenses.

The 1995 loss included $50 million primarily for restructuring costs, asset writedowns, a loss from a discontinued non-core subsidiary, loss on the impairment of intangible assets, write-off of debt issuance costs and the write-off of accumulated deferred tax debits. These expenses resulted in a loss of $1.29 per share in 1995.

The exchange in 1994 of each Class C preference share for 5.5 ordinary shares increased the ordinary shares outstanding by 13.4 million, impacting the per share loss. On an adjusted basic earnings per share, the loss was 12 cents from continuing operations and 19 cents after discontinued operations.

LIQUIDITY AND FINANCIAL RESOURCES

The Company has sufficient credit facilities and liquidity from cash flow from operations. A $25 million term bank loan was recently renewed for a further five years. The Company's $140 million senior notes are not due until March 2000. A new three-year Cdn. $30 million revolving credit facility was arranged in December 1996.

Cash Flow

Cash flow from continuing operations was $14.1 million, compared with $70.5 million in 1995 and negative cash flow of $16.7 million in 1994.

The 1996 cash flow from continuing operations was negatively affected by the $14.1 million build up of inventory at year end, excluding $18.1 million of inventory at the two distributor organizations acquired in the year. The 1995 cash flow was unusually high due to the Company's aggressive reduction of inventories and trade receivables as a result of new working capital management practices.

Working Capital and Short-Term Borrowings

Working capital was $103.8 million in 1996, compared with $60.5 million in 1995. Inventories were tightly managed during the year, although as noted they rose in the second half as a result of consolidating the inventories of the two distributor organizations acquired in mid-1996. After adjusting for $12.8 million in receivables for the two distributor organizations, the Company's accounts receivables continued to decline for a second consecutive year.

(Millions of U.S. Dollars)	1996	1995	1994
Inventories	$ **117.7**	$ 85.5	$ 145.4
Accounts receivables	**78.0**	77.9	125.5
Working capital	**103.8**	60.5	153.0
Short-term borrowings	**39.0**	17.7	77.8

In 1995, the Company reduced working capital by $92.5 million and short-term borrowings by $60.1 million. The savings in working capital resulted from a 41 percent reduction in inventories and a 38 percent reduction in receivables. The principal driver behind the receivable reductions was the change in credit terms from 90 days to 53 days, which brought them closer to the industry average. A concerted effort was made to reduce inventory in the second half of 1995, and the Company ended the year with $55.0 million of finished goods on hand. The total inventory of finished goods, raw materials, and work in process and service parts declined by $59.9 million to $85.5 million in 1995.

Credit Facilities

The Company has negotiated credit facilities separately for the Canadian operations and the U.S. operations.

The Canadian operating company has a Cdn. $30 million revolving credit facility, which is sufficient to meet its needs. This three-year facility was arranged with a new lender in 1996.

The U.S. operating company has a five-year $70 million receivables purchase facility with a U.S. lender. This facility was arranged in July 1996 to replace the $75 million 364-day revolving credit facility scheduled to expire in January 1997. The U.S. operating company has adequate credit availability and expects to have more than sufficient cash flow from operations to meet its obligations in 1997.

Long-Term Debt

The U.S. operating company has $140 million of seven-year senior notes maturing in March 2000. The notes are collateralized by the real and personal property of the U.S. company other than accounts receivable and inventories.

A $25 million five-year unsecured term loan arranged for the Company's U.S. holding company was replaced in December 1996 with a similar amount under similar terms.

Capital Expenditures

The Company spent approximately $12 million on primarily capital improvements at the plant in 1996. This compared with $24.5 million in 1995, of which $12.5 million related to the construction of a new distribution center at the Lewisburg plant.

RISKS AND RISK MANAGEMENT

The Company essentially faces the following:

Weather risk: An early and hot summer, or an early and cold winter, can create a surge in sales. Mild seasons, by contrast, undermine customer demand. To reduce the costs of exposure to short-term weather risk, the Company has reduced the time it takes from receiving a customer's order and delivering the product to 30 days or less. Improved management practices generally enable the Company to adjust better to the seasonal nature of the business.

Supplier risk: A key supplier could be adversely affected by a labor dispute, an environmental devastation, a financial crisis, or transportation disruption. Supplier risk is managed by maintaining close relations with 75 companies that provide 90 percent of the material used in manufacturing. Several suppliers consign inventory and the Company only pays for components when they are used. Information management systems are integrated with key suppliers so that they can scan for product use at the end of the production line, provide an invoice, and replenish inventory.

Distributor risk: The Company maintains the largest distribution system in the North American industry. The network consists of approximately 400 independent distributors in Canada, the U.S. and international markets. Distributor risk is managed by terminating underperforming distributors and replacing them with more aggressive wholesalers. In 1996, 21 distributors were added and 16 were terminated in the United States. To ensure a productive business partnership, distributors are involved in product design and monthly in-plant product audits. The Company also helps distributors recruit installers by training 5,000 distributor, contractor and dealer personnel annually, including 500 a year at the training center in LaVergne, Tennessee.

Market risk: The heating, ventilating and air conditioning business for residential and light commercial users in North America is approximately a $6 billion a year industry at the manufacturing level and $25 billion at the final customer level. The industry has changed little in recent years with no new competitors emerging. The Company faces five major competitors. The largest has more than 20 percent of market share and the remainder have approximately the same share in the 11 to 12 percent range. The Company has improved its competitive position through a much lower cost structure and a change in its product mix.

Technology risk: Technological risk is low as technical improvements in heating and cooling systems tend to be evolutionary over a number of years.

Economic risk: The Company faces the normal economic risks of any consumer-oriented company – such as changes in interest rates, employment levels, consumer spending, and general consumer and business confidence in the economy. Under adverse economic conditions, homeowners and commercial property owners are more likely to repair rather than replace deteriorated and older heating or cooling systems. The poor condition of many systems that have already been repaired, and the introduction of lower-cost entry-level systems, tend to offset this risk.

Financial risk: The Company's return to profitability, a much lower break-even point, and adequacy of capital resources have mitigated the financial risk that undermined its viability in recent years. The Company's capitalization is over leveraged compared with other companies in and related to the industry. Management is addressing its longer-term capital requirements, including its long-term debt which is not due until March 2000.

Forward-looking information: Certain statements contained in this document constitute forward-looking statements that are not historical. Forward-looking statements involve risks and uncertainties, including, but not limited to, the risk factors as previously described. Actual results could differ materially from those projected in the forward-looking statements as a result of these risks, and should not be relied upon as a prediction of actual future results. The Company undertakes no obligation to update any forward-looking statement to reflect events or circumstances after the date on which such statement is made, or to reflect the occurrence of unanticipated events.

FUTURE EXPECTATIONS

In 1996, management developed a long-term strategic plan in consultation with the board of directors. The plan set out ambitious targets for growth, though management is optimistic of attaining them.

The overriding goal is to ensure continued profitability as the Company works toward the target of generating $1 billion in annual sales by 2000. Five business units were established in 1997 to drive profit performance. One business unit is focused on U.S. residential products and another on U.S. light commercial products, a market segment the Company has not aggressively pursued in the past. A third business unit is committed to growing the sale of service parts for the repair and replacement markets. The remaining two business units are responsible for the Canadian and international markets.

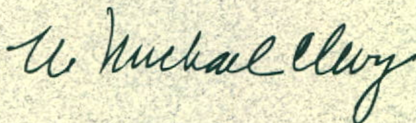
The Company will continue to aggressively seek out cost savings in its production facilities and strengthen the distribution network in markets where sales are below the target of 15 percent market share in North America. International sales should contribute growing revenues as a distribution network is expanded in Latin America.

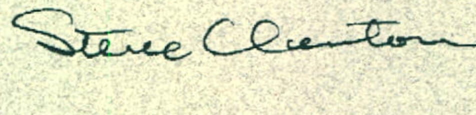
The accompanying consolidated financial statements of the Company were prepared by management in accordance with accounting principles generally accepted in Canada. The significant accounting policies, which management believes are appropriate for the Company, are described in note 1 to the consolidated financial statements. The financial information contained elsewhere in this document is consistent with that in the consolidated financial statements.

Management is responsible for the integrity and objectivity of the financial statements. Estimates are necessary in the preparation of these statements and, based on careful judgments, have been properly reflected in the financial statements. Management has established systems of internal control which are designed to provide reasonable assurance that assets are safeguarded from loss or unauthorized use and to produce reliable accounting records for the preparation of financial information.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal control. The Board exercises its responsibilities through the Audit Committee of the Board, which is comprised of independent directors. The Audit Committee meets regularly with management and the external auditors to discuss the Company's financial reporting practices and procedures, its systems of internal accounting controls, the planned scope of examinations by the external auditors and their findings and recommendations. It also reviews the Company's consolidated financial statements.

The Company's external auditors, Coopers & Lybrand, Chartered Accountants, conduct an independent examination on behalf of the shareholders, in accordance with generally accepted auditing standards and express their opinion on the consolidated financial statements. Their report outlines the scope of their examination and their opinion on the consolidated financial statements of the Company. The external auditors have free access to the Audit Committee of the Board.





W. Michael Clevy
President and
Chief Executive Officer

Stephen L. Clanton
Senior Vice President,
Chief Financial Officer
and Treasurer

February 11, 1997

To The Shareholders
Inter-City Products Corporation

We have audited the consolidated balance sheets of Inter-City Products Corporation as at December 31, 1996 and 1995 and the consolidated statements of income and deficit and changes in financial position for the years ended December 31, 1996, 1995 and 1994. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of Inter-City Products Corporation as at December 31, 1996 and 1995 and the results of its operations and the changes in its financial position for the years ended December 31, 1996, 1995 and 1994 in accordance with generally accepted accounting principles.

Coopers & Lybrand
Chartered Accountants
Toronto, Ontario

February 11, 1997

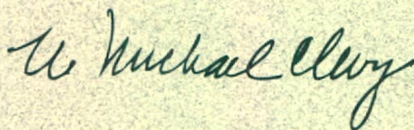
For The Years Ended December 31, 1996, 1995 and 1994 (In Millions of U.S. Dollars)	**1996**	1995	1994
Operating Revenue	**$ 641.9**	$ 532.8	$ 635.2
Cost of Sales	**517.8**	467.4	522.3
Gross Margin	**124.1**	65.4	112.9
Selling, General and Administrative Expenses	**90.7**	93.2	87.3
Asset Writedowns and Restructuring Costs (note 17)	**—**	15.5	8.0
Operating Profit (Loss)	**33.4**	(43.3)	17.6
Financial Expenses			
Interest expense	**19.4**	21.7	20.2
Amortization of debt issuance costs	**1.8**	1.3	1.7
Write-off of debt issuance costs	**.6**	2.1	1.2
	21.8	25.1	23.1
Income (Loss) Before Income Taxes	**11.6**	(68.4)	(5.5)
Income Taxes (note 12)	**—**	(12.8)	.9
Income (Loss) From Continuing Operations	**11.6**	(81.2)	(4.6)
Loss From Discontinued Operations (note 3)	**(3.1)**	(12.0)	(2.9)
Net Income (Loss)	**8.5**	(93.2)	(7.5)
Deficit – Beginning of the Year	**(146.9)**	(53.7)	(46.2)
Deficit – End of the Year	**$ (138.4)**	$ (146.9)	$ (53.7)

Net Income (Loss) Per Ordinary Share (note 13)

see accompanying notes

As at December 31, 1996 and 1995 (In Millions of U.S. Dollars)	**1996**	1995
ASSETS		
Current Assets		
Cash and short-term deposits	**$ 17.6**	$ 13.0
Restricted cash	**2.4**	6.7
Accounts receivable – trade (less allowance for doubtful accounts; 1996 – $7.7; 1995 – $7.6)	**78.0**	77.9
Inventories (note 4)	**117.7**	85.5
Prepaid expenses and other	**3.6**	5.9
Discontinued steel pipe operation	**—**	19.0
	219.3	208.0
Fixed Assets (note 5)		
Property, plant and equipment – at cost	**213.2**	186.2
Accumulated depreciation	**113.0**	93.5
	100.2	92.7
Fixed and Other Assets – Discontinued Steel Pipe Operation	**—**	8.6
Fixed Assets To Be Sold Or Leased, Net (note 5)	**—**	10.1
Intangible Assets (note 6)	**12.1**	10.4
Other Assets (note 7)	**13.4**	16.0
	$ 345.0	$ 345.8

see accompanying notes



W. Michael Clevy
Director

David A. Rattee
Director

	1996	1995
LIABILITIES		
Current Liabilities		
Short-term borrowings (note 8)	**$ 39.0**	$ 17.7
Accounts payable	**39.6**	43.1
Accrued liabilities	**28.2**	34.7
Product warranty	**8.7**	8.8
Current portion of long-term debt (note 9)	**—**	25.0
Discontinued steel pipe operation	**—**	18.2
	115.5	147.5
Long-Term Debt (note 9)	**165.0**	140.0
Product Warranty	**17.9**	15.7
Environmental Liabilities	**13.6**	14.6
Other Long-Term Liabilities	**4.2**	3.6
Long-Term Liabilities – Discontinued Steel Pipe Operation	**—**	5.9
	316.2	327.3
Commitments and Contingencies (note 16)		
SHAREHOLDERS' EQUITY		
Ordinary Shares (note 10)	**169.2**	166.5
Deficit	**(138.4)**	(146.9)
Foreign Currency Translation Adjustment (note 11)	**(2.0)**	(1.1)
	28.8	18.5
	$ 345.0	$ 345.8

Consolidated Statements of Changes in Financial Position

For The Years Ended December 31, 1996, 1995 and 1994 (In Millions of U.S. Dollars)	1996	1995	1994
CASH PROVIDED BY (USED FOR):			
Operations			
Income (loss) from continuing operations	**$ 11.6**	$ (81.2)	$ (4.6)
Items not involving current cash flows (note 18a)	**20.9**	54.4	22.4
Changes in working capital (note 18b)	**(18.4)**	97.3	(34.5)
	14.1	70.5	(16.7)
Discontinued Steel Pipe Operation	**.5**	(.2)	2.3
	14.6	70.3	(14.4)
Investment			
Property, plant and equipment	**(11.8)**	(24.5)	(11.1)
Proceeds on sale of fixed assets	**1.6**	11.8	2.4
Acquisition of Coastline and General (note 2)	**(15.3)**	—	—
Discontinued Steel Pipe Operation	**6.5**	(.9)	(1.4)
Other discontinued operations	**—**	2.8	2.1
	(19.0)	(10.8)	(8.0)
Financing			
Ordinary shares issued	**.5**	.6	46.0
Exchange of preference shares to ordinary shares	**—**	—	(46.0)
Repayment of long-term debt and other	**2.2**	—	(22.9)
Refinancing costs	**(4.5)**	(.9)	(2.5)
Discontinued Steel Pipe Operation	**(2.1)**	(1.4)	2.1
	(3.9)	(1.7)	(23.3)
Increase (Decrease) in Net Borrowings	**8.3**	(57.8)	45.7
Net Borrowings – Beginning of the Year	**13.1**	70.9	25.2
Net Borrowings – End of the Year	**$ 21.4**	$ 13.1	$ 70.9
Represented by			
Short-term borrowings	**$ 39.0**	$ 17.7	$ 77.8
Less: Cash and short-term deposits	**17.6**	13.0	12.8
	21.4	4.7	65.0
Discontinued Steel Pipe Operation	**—**	8.4	5.9
	$ 21.4	$ 13.1	$ 70.9

see accompanying notes

1. SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation These financial statements have been prepared in accordance with generally accepted accounting principles ("GAAP") in Canada which differ in certain respects with accounting principles in the United States. The differences between GAAP in Canada and the United States as they affect the Company are described in a note to the consolidated financial statements of the Company included in Report on Form 20-F, filed with the Securities and Exchange Commission.

The Company is a holding company which has two heating and cooling operating subsidiaries: Inter-City Products Corporation (USA) ("ICP (USA)"), and Inter-City Products Corporation (Canada) ("ICP (Canada)").

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 Steel Pipe Operation, which was sold in May 1996 and treated as a discontinued operation, is described in Note 3.

Nature of Operations The Company manufactures and markets central air conditioning and heating products for residential and light commercial use primarily in the United States and Canada. At the end of 1996, the Company's entire network consisted of approximately 400 independent distributors. The Company's network also included nine company-owned centers, of which four of these centers were subsequently sold in January 1997, as described in Note 2.

Foreign Currency Translation The assets and liabilities of the Company's Canadian operations are translated into United States dollars at the rate of exchange in effect at the balance sheet date. Revenues and expenses are translated at the average exchange rates prevailing during the year. The unrealized translation gains and losses are accumulated in a separate component of shareholders' equity.

Revenue and Expense Recognition Product sales are recognized at the time of shipment. Selling, general and administrative costs are charged to expense as incurred. Service contract revenue is deferred and amortized into income over the life of the contract on a straight-line basis. Severance and employee benefits costs relating to downsizings in 1995 and 1994 were reflected as restructuring costs.

Inventories Raw materials and supplies, work in process and finished goods, are valued at the lower of cost (first-in, first-out) or net realizable value.

Fixed Assets Fixed assets are recorded at cost less accumulated depreciation. Depreciation is provided on a straight-line basis at the following rates based on the estimated useful lives of the applicable assets:

Buildings	2.5% – 10%
Machinery, equipment and furniture	5% – 20%
Tooling and drawings	17% – 33%
Land improvements	5% – 10%

Intangible and Other Assets Intangible and other assets include amounts paid for patents, trade names, customer lists, goodwill and debt issuance costs. Amortization of intangible assets is provided on a straight-line basis over various periods, not exceeding twenty years. The realizability of goodwill and other intangibles is evaluated periodically as events and circumstances indicate a possible inability to recover their carrying amount. Such evaluation is based on undiscounted cash flow projections. The analyses necessarily involve significant management judgment regarding such projections and the actual results could differ materially from these projections. Amortization of debt issuance costs is provided on a straight-line basis over the term of the related debt.

Income Taxes The Company follows the deferral method of tax allocation in accounting for income taxes. Under this method, timing differences between accounting and taxable income result in the recording of deferred income taxes.

Product Warranties A liability for estimated warranty expense is established by a charge against operations at the time products are sold. The subsequent costs incurred for warranty claims serve to reduce the product warranty liability. The actual warranty costs the Company will ultimately pay could differ materially from this estimate. The Company offers and sells extended warranty contracts for its products through certain distributors. The revenue for such contracts is deferred and recognized over the life of the contract on a straight-line basis.

Postretirement Benefits Other Than Pensions The Company provides certain retirement benefits for its retired employees. Retirement benefits include health care benefits and life insurance. The Company accounts for these benefit payments on a cash basis.

Financial Instruments Periodically, the Company enters into interest rate swap agreements and forward rate agreements to hedge its interest exposure. The fair values of swap and forward rate agreements are based on current interest rates and any payments and receipts relating to these agreements are recognized in interest expense over the period of the respective agreement. All interest rate swaps are only subject to market risks as interest rates fluctuate. The Company is exposed to credit risk in the event of nonperformance by counterparties and does not anticipate default by any of the counterparties.

Management Estimates The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Such estimates include, but are not limited to, allowance for doubtful accounts, product warranty, product liability, environmental liability, sales returns and allowances, inventory obsolescence, pension obligation assumptions, and self-insured medical claims.

Reclassifications Certain comparative figures have been reclassified to conform with current financial statement presentations.

2. ACQUISITION OF COASTLINE AND GENERAL

On July 25, 1996, ICP USA acquired all of the outstanding shares of Coastline Distribution, Inc. ("Coastline") and General Heating and Cooling Company ("General"), both heating and cooling products distributors. These acquisitions were accounted for by the purchase method of accounting and accordingly, the results of operations of Coastline and General have been included in the consolidated statement of income since the date of acquisition. The purchase price has been allocated on the basis of the fair market value estimates of the net assets acquired as follows:

Net assets acquired	
Accounts receivables	$ 12.8
Inventories	18.1
Fixed assets	1.4
Intangible and other assets	4.2
Current liabilities	(20.0)
Long-term debt assumed	(16.5)
Net purchase price	$ —

In 1996, Coastline and General generated operating revenue of $29.1 and a net loss of $.5 since the date of acquisition

On January 27, 1997, ICP USA sold Coastline and four company-owned factory branches for net book value of approximately $23.0 cash which was used to repay short-term borrowings.

3. DISCONTINUED OPERATIONS

Discontinued Operations consist of the following:

	1996	1995	1994
Steel Pipe Operations	$ (3.1)	$ (14.3)	$ (1.9)
Settlement of Former Resources Claim	—	2.9	—
Utilization of Prior Years' Tax Losses	—	1.3	2.0
Write-off of Deferred Tax Debit – Flying J Environmental Provision	—	(1.9)	—
Refrigeration Operation	—	—	(3.0)
	$ (3.1)	$ (12.0)	$ (2.9)

(i) Steel Pipe Operations

On May 30, 1996, the Company sold Thompson Pipe and Steel Company ("TP&S"), its wholly owned steel pipe manufacturing subsidiary, for total consideration of approximately $6.5, including the assumption of bank indebtedness of approximately $6.1.

Operating results of the Steel Pipe Operation for the five months ended May 30, 1996 and each of the years ended December 31, 1995 and 1994 are as follows:

	1996	1995	1994
Operating revenue	$ 10.9	$ 37.9	$ 41.0
Loss before income taxes	(3.1)	$ (8.0)	$ (2.7)
(Provision for) recovery of income taxes	—	(.3)	.8
Loss from Steel Pipe Operation	(3.1)	(8.3)	(1.9)
Writedown to estimated net realizable value	—	(5.4)	—
Estimated disposal costs	—	(.6)	—
	$ (3.1)	$(14.3)	$(1.9)

(ii) Settlement of Former Resources Claim

In December 1995, the Company received a final cash settlement resulting from a favorable judgment relating to the Company's former Resources Operations, which were sold in 1989. The $2.9 settlement was recorded as income from discontinued operations.

(iii) Utilization of Prior Years' Tax Losses

The Company utilized prior years' tax losses which resulted from the costs incurred on the sale of the Company's Utilities and Propane Operations in 1990 to reduce current taxes otherwise payable from continuing operations. As the costs incurred on the sale of the Utilities and Propane Operations were classified in Discontinued Operations, the benefit of utilizing these losses was also classified as Discontinued Operations.

(iv) Write-off of Deferred Tax Debit – Flying J Environmental Provision

In 1995, the deferred tax provision of $1.9 represented the write-off of a deferred tax debit established in prior years. This write-off was required since there was no longer reasonable assurance as of December 31, 1995 that the timing differences supporting this deferred tax debit would reverse.

(v) Refrigeration Operation

On October 7, 1994, ICP (Canada) sold its commercial refrigeration division for total consideration of approximately $6.7. In 1994, the Company recorded a loss from the Refrigeration Operation of $3.0 in Discontinued Operations, of which $1.4 related to the costs of disposal. Operating revenue of the Refrigeration Operation for the year ended December 31, 1994 was $13.8.

4. INVENTORIES

Inventories are classified as follows:

	1996	1995
Finished goods	$ 86.3	$ 55.0
Raw materials and work in process	15.7	13.6
Service parts	15.7	16.9
	$ 117.7	$ 85.5

5. FIXED ASSETS

Fixed assets are classified as follows:

	1996			1995		
	Cost	Accumulated Depreciation	Net Book Value	Cost	Accumulated Depreciation	Net Book Value
Machinery, equipment and furniture	$ 101.7	$ 58.4	$ 43.3	$ 93.3	$ 50.9	$ 42.4
Buildings and improvements	51.2	16.6	34.6	38.4	10.3	28.1
Tooling and drawings	49.0	34.3	14.7	44.9	29.7	15.2
Land and land improvements	11.3	3.7	7.6	9.6	2.6	7.0
	$ 213.2	$ 113.0	$ 100.2	$ 186.2	$ 93.5	$ 92.7

Depreciation expense for the year amounted to $14.1 (1995 – $14.8; 1994 – $15.0).

In September 1996, the Company sold its Red Bud, Illinois warehouse for net book value of approximately $1.6.

In 1996, a portion of the Company's administrative office building in LaVergne, Tennessee was leased to a third party. The Company maintains certain functions at the facility. Management's estimates of its utilization and the lease proceeds are expected to recover the cost of the building. The carrying amount of the facility of $7.9 has been included in Fixed Assets for financial statement presentation purposes. At December 31, 1995, the carrying amount of this property of $8.5 was included in Fixed Assets To Be Sold or Leased, Net.

6. INTANGIBLE ASSETS

Intangible assets, net of accumulated amortization, are classified as follows:

	1996	1995
Patents	$ 2.8	$ 3.2
Tradenames	1.7	1.9
Goodwill	4.7	4.5
Customer lists	2.8	—
Other intangible assets	.1	.8
	$ 12.1	$ 10.4

Amortization of intangible assets during the year was $1.6 (1995 – $4.0; 1994 – $2.6). The accumulated amortization of intangible assets at December 31, 1996 was $13.5 (1995 – $12.0).

In 1995, the Company reengineered various business processes which led to a change in the extent to which certain intangibles were used in the Company's operations. Impairments were recognized when the undiscounted expected future operating cash flows derived from such intangible assets were less than their carrying values. The 1995 operating loss includes a $1.3 million loss on the impairment of such intangible assets. Once the impairment was identified, it was measured based on discounted cash flows, or in the case of certain patents and technology, on the discontinued use of such identifiable intangibles.

7. OTHER ASSETS

Other assets are classified as follows:

	1996	1995
Debt issuance costs, less accumulated amortization	$ 5.7	$ 3.7
Due from insurers on environmental claim (note 16(b))	5.6	5.8
Notes and accounts receivable, net of allowance for doubtful accounts	—	6.1
Other	2.1	.4
	$ 13.4	$ 16.0

8. SHORT-TERM BORROWINGS

Short-term borrowings at December 31 were:

	1996	1995
ICP (USA) –		
Receivables Purchase Agreement	$ 27.0	$ 6.0
ICP (USA) –		
Revolving Credit Facility	—	1.4
ICP (Canada)	12.0	10.3
	$ 39.0	$ 17.7

(a) ICP (USA)

Receivables Purchase Agreement

On July 25, 1996, ICP (USA) entered into an agreement to sell on a revolving basis, up to a $70.0 undivided participation ownership interest in a designated pool of its accounts receivable. This transfer of receivables does not constitute a sale for accounting purposes on the basis that all the significant risks and rewards of ownership of the receivables are not transferred to the purchaser. Accordingly, the pool of receivables of $27.0 is included in accounts receivable at December 31, 1996 (1995 – $6.0).

The receivables purchase agreement requires ICP (USA) to pay fees plus certain administrative costs. At December 31, 1996, the combined cost of the receivable facility was 7.66% (1995-11.0%). The initial transaction fees of $1.4 are being amortized over five years and are included in Other Assets as at December 31, 1996.

ICP (USA) terminated a 1994 receivables purchase agreement on January 18, 1996 in conjunction with the modified revolving credit facility.

Revolving Credit Facility

Borrowings outstanding under a Revolving Credit Facility amounted to $1.4 at December 31, 1995. On January 18, 1996, the 1994 receivables purchase agreement was terminated and the Revolving Credit Facility was amended and restated to provide for borrowings of up to $75.0 for a term of 364 days. In connection with the significant change in and amendment to the Revolving Credit Facility and 1994 receivables purchase agreement, ICP (USA) recorded a write-off of debt issuance costs of $2.1 in the 1995 consolidated statement of loss. This facility was replaced on July 25, 1996 with the $70.0 receivables purchase agreement.

(b) ICP (Canada)

ICP (Canada) has a Cdn. $30.0 million revolving credit facility, of which $12.0 (Cdn. $16.5 million) was utilized at December 31, 1996. This three year facility was established on December 19, 1996. ICP (Canada)'s revolving credit facility accrues interest at prime plus 1.0% per annum or at Bankers' Acceptance rates plus a stamping fee of 2.0% as selected by the company. All of ICP (Canada)'s assets are pledged as collateral under its facility which contains covenants, the most restrictive of which require it to maintain a certain minimum interest coverage and net worth and precludes the payment of dividends.

(c) The maximum amount of short-term borrowings outstanding, including the borrowings received under the receivables purchase agreement at any month-end during the year ended December 31, 1996 was $64.4 (1995 – $89.1). The average short-term borrowings outstanding, including the borrowings received under the receivables purchase agreement, calculated by averaging month-end balances, during the year ended December 31, 1996 was $46.0 (1995 – $66.0).

The weighted average interest rate on the outstanding short-term borrowings at December 31, 1996 was 5.3% (1995 – 7.6%). Weighted average interest rates are calculated based on actual interest rates in effect and the short-term borrowings outstanding as at December 31.

9. LONG-TERM DEBT

(a) The details of long-term debt are as follows:

	1996	1995
9.75% Senior Notes due March 1, 2000	**$140.0**	$140.0
Term bank loan, repayable during the period 2000 to 2001	**25.0**	25.0
	165.0	165.0
Current portion of term bank loan included in current liabilities	**—**	25.0
	$165.0	$140.0

(b) ICP (USA)

On March 11, 1993, ICP (USA) issued $140.0 of 9.75% senior secured notes ("Senior Notes") which are repayable on March 1, 2000. The Senior Notes require mandatory prepayments if ICP (USA) has certain cash proceeds from asset sales as defined in the Senior Note agreement. Interest on the Senior Notes is payable semi-annually in March and September. The Senior Notes were trading 102/103 (bid/offer) at December 31, 1996.

The Senior Notes are collateralized by substantially all the real and personal property of ICP (USA), other than accounts receivable and inventories. The Senior Notes indenture contains covenants which limit certain transactions including the payment of dividends.

In March 1993, ICP (USA) entered into interest rate swap agreements. These agreements effectively converted $80.0 of its 9.75% fixed rate Senior Notes into variable rate obligations expiring on March 1, 2000. In December 1995, ICP (USA) exercised an option to unwind $60.0 of its variable rate obligations back to the original fixed rate obligation of 9.75%. On July 25, 1996, ICP (USA) terminated the remaining $20.0 interest rate swaps back to the original fixed rate obligation of 9.75%. As of December 31, 1996, the entire $140.0 Senior Notes are fixed at a rate of 9.75% through the maturity date of March 1, 2000.

In connection with the termination of the $20.0 variable rate obligations to fixed rate obligations in 1996, ICP (USA) incurred costs of $1.9 which are deferred and amortized over the remaining term of the Senior Notes.

(c) CHL Holdings Inc.

On December 19, 1996, CHL Holdings Inc., a wholly owned United States subsidiary of the Company, arranged an unsecured term bank loan in the amount of $25.0 due in full by October 15, 2001. The Company is required to repay $15.0 in 2000 and $10.0 in 2001. The term bank loan accrues interest at LIBOR plus 0.25% and has been guaranteed by an arm's length third party. The guarantor holds a $15.0 subordinated security interest in ICP Canada's receivables and inventories, and the shares of ICP Canada have been pledged in support of the guarantee. The pledge agreement contains certain covenants, the most restrictive of which requires ICP Canada to maintain a minimum level of receivables and inventories in excess of its borrowings.

(d) Under the provisions of the various loan agreements and indentures, the Company is required to make installments of $155.0 and $10.0 in 2000 and 2001, respectively.

10. SHARE CAPITAL

(a) Ordinary Shares

(i) Authorized and Outstanding

The Company is authorized to issue an unlimited number of ordinary shares. Changes in the issued and outstanding ordinary shares for the years 1996, 1995 and 1994 are as follows:

	1996		1995		1994	
	Number	Amount	Number	Amount	Number	Amount
Issued and outstanding Beginning of the year	39,042,574	$ 166.5	38,649,949	$165.9	24,930,803	$119.9
Issued under the Share Ownership Savings Plan	201,763	.5	392,625	.6	319,724	.9
Issued under the Directors Share Compensation Arrangement	15,985	—	—	—	—	—
Receipt of Funds from Trustee for 1990 Plan of Arrangement	—	2.2	—	—	—	—
Dissenting shareholders to the amendment of the Company's articles	—	—	—	—	(300)	—
Issued in exchange for Class C preference shares	—	—	—	—	13,399,722	45.1
Issued and outstanding End of the year	39,260,322	$ 169.2	39,042,574	$166.5	38,649,949	$165.9

The amount of $45.1 recorded on the issue of ordinary shares exchanged for the Class C preference shares in 1994 is net of $.9 of costs incurred to effect the exchange.

(ii) Employee Stock Option Plan

A maximum of 2,500,000 ordinary shares have been reserved for issuance to officers and employees of the Company under the Employee Stock Option Plan. The term of all options cannot exceed ten years from the date the option is granted and are vested at an annual rate of 20% per year on a cumulative basis, except in certain circumstances where the exercise of such options would be accelerated, and for stock options received in exchange for Long-Term Incentive Plan Units as described in Note 10(a)(iv).

The option exercise price is fixed by the Board of Directors at the time each option is authorized and cannot be less than the weighted average sales price per share on the Toronto Stock Exchange ("TSE") on the business day preceding the date of authorization.

Changes in the outstanding share options from January 1, 1994 to December 31, 1996 are as follows:

	1996	1995	1994
Balance – Beginning of the year	776,000	1,281,400	490,000
Granted	1,000,000	—	385,000
Long-Term Incentive Plan units converted	—	10,000	526,400
Cancelled	(56,000)	(515,400)	(120,000)
Balance – End of the year	1,720,000	776,000	1,281,400

The details of the options outstanding at December 31, 1996 at each price are as follows:

Exercise Price (Cdn.$)	Expiry Date	Number of Shares
$4.15	November 5, 1997	350,000
$3.10	January 26, 2000	25,000
$3.10	February 29, 2000	25,000
$3.10	May 30, 2000	25,000
$3.50	August 24, 2001	65,000
$3.10	December 19, 2001	230,000
$2.80	April 16, 2003	850,000
$3.90	July 11, 2003	115,000
$4.20	July 31, 2003	10,000
$4.10	August 23, 2003	15,000
$3.83	November 29, 2003	10,000
		1,720,000

(iii) Share Ownership Savings Plan

Effective July 1, 1992, certain employees of the Company were eligible to participate in the Company's Share Ownership Savings Plan (the "Savings Plan"). Generally, the Savings Plan is available to all non-union employees following the completion of one year of continuous service with the Company. The Savings Plan allows eligible employees to contribute from one to six percent of their salary to the Savings Plan. The Company is required to match 25% of the employees' contributions and may make additional annual contributions of up to 75% of the employees' contribution at its discretion. In 1996, the Company's expense with respect to the Savings Plan was $.1 (1995 – $.1).

Effective January 1, 1994, ICP (USA)'s Savings Plan was amended to provide additional investment options, allowing participants to purchase bond, money market, or index funds in addition to ordinary shares of the Company.

(iv) Long-Term Incentive Plan

Effective November 5, 1990, the Company adopted a long-term incentive plan (the "Plan"). Under the Plan, certain key officers and employees of the Company may be granted long-term incentive compensation units ("LTIP Units") the value of which shall be determined by reference to the appreciation in the market value of the ordinary shares over stated periods of time. Based on the discretion of the Board of Directors of the Company, the appreciation in the market value of the ordinary shares will be distributed to the holder thereof by payment of cash, issuance of ordinary shares or a combination thereof.

The initial value of the units at the date of granting is established as the weighted average price of board lot sales of ordinary shares on the TSE during the five consecutive trading days immediately preceding the date of granting of such units. The value of the ordinary shares on the valuation date is established as the simple average of the closing sale price for the ordinary shares on the TSE on each trading day for the six month period ending on the valuation date.

The valuation date of the units is determined by the Board of Directors and shall be no sooner than the year in which the fifth anniversary of the date of grant occurs and in no event shall a valuation date be later than the date which is ten years after the date of grant.

On August 10, 1993, the Plan was amended to permit Canadian holders of LTIP Units to exchange all or any part of their LTIP Units for options to purchase ordinary shares granted under the Employee Stock Option Plan, on the basis of one ordinary share for each LTIP Unit exchanged. The stock options received in exchange for LTIP Units were exercisable at any time during the six month period used to establish the value of the ordinary shares on the valuation date of the respective LTIP Units.

As at December 31, 1996, the following units were outstanding under the Plan:

Date of Grant	Initial Value Per Unit (Cdn. $)	Number of Units	Valuation Date
February 1, 1993	$7.125	34,000	February 1, 1998

(b) Preference Shares

(i) The Company is authorized to issue an unlimited number of Class A preference shares issuable in series and rank senior to the Class B preference shares and ordinary shares as to dividends and participation in certain distributions of assets on liquidation. Any series of the shares may be made convertible into ordinary shares and have no voting rights as a class.

The Company is also authorized to issue an unlimited number of Class B preference shares issuable in series and rank senior to ordinary shares and junior to the Class A preference shares as to dividends and participation in certain distributions of assets on liquidation. Any series of the shares may be made convertible into ordinary shares and have no voting rights as a class.

(ii) On July 18, 1994, the Company's shareholders approved an amendment to the Company's articles to exchange each Class C preference share for 5.5 ordinary shares. The amendment which was effective July 19, 1994 also removed the Class C preference shares as part of the authorized share capital of the Company. In accordance with the terms of the amendment, Class C preference shareholders were not entitled to any undeclared preferred dividends. Class C preference shareholders holding 3,567 shares dissented to the amendment of the Company's articles and were paid fair value for their shares in accordance with the Canada Business Corporations Act.

11. FOREIGN CURRENCY TRANSLATION ADJUSTMENT

The Company adopted the United States dollar as its reporting currency, effective January 1, 1994. Accordingly, the foreign currency translation adjustment which is included as a component of shareholders' equity, represents the unrealized gain or loss on translation of financial statements of self-sustaining operations in Canada from 1994 to 1996. Prior to 1994, this adjustment represented the unrealized gain or loss on translation of financial statements of self-sustaining operations in the United States. Changes during the respective years are as follows:

	1996	1995	1994
Cumulative unrealized loss at January 1	$ (1.1)	$(1.9)	$ (.3)
Unrealized gain (loss) on translation of net assets	(.9)	.8	(1.6)
Cumulative unrealized loss at December 31	$ (2.0)	$(1.1)	$(1.9)

The rate of exchange as at December 31, 1996 was U.S. $1.00 = Cdn. $1.3706 (1995 -U.S. $1.00 = Cdn. $1.3652), and the average rate for the year was U.S. $1.00 = Cdn. $1.3636 (1995 – U.S. $1.00 = Cdn. $1.3727; 1994 – U.S. $1.00 = Cdn. $1.3659).

12. INCOME TAXES

The components of income (loss) before income taxes and the income tax provision (recovery) are as follows:

	1996	1995	1994
Income (loss) before income taxes			
Canada	$ 2.0	$ (1.3)	$ 7.9
United States	9.6	(67.1)	(13.4)
	$ 11.6	$(68.4)	$ (5.5)
Current income tax provision (recovery)			
Canada	—	$ 1.8	$ 2.8
United States	—	(.4)	(1.7)
	—	1.4	1.1
Deferred income tax provision (recovery)			
Canada	—	3.9	.5
United States	—	7.5	(2.5)
	—	11.4	(2.0)
Total income tax provision (recovery)	$ —	$ 12.8	$ (.9)

In 1995, the deferred income tax provision of $11.4 represented the write-off of accumulated deferred income tax debits recorded as of December 31, 1994. This write-off was required since there was no longer reasonable assurance as of December 31, 1995 that the timing differences supporting these deferred tax debits would reverse.

A reconciliation between the combined statutory and the effective rate of income tax is provided below:

	1996	1995	1994
Income (loss) before income taxes	$ 11.6	$(68.4)	$(5.5)
Combined statutory tax rate	38.8%	38.8%	38.8%
Computed income tax provision (recovery)	4.5	(26.5)	(2.1)
Increase (decrease) resulting from:			
Non-deductible depreciation	.3	.8	1.1
Unrecognized (recognized) benefit of losses and expenses	(1.6)	25.7	—
Prior years' deferred taxes written-off	—	11.4	—
Utilization of loss carryforwards	(3.4)	—	(.7)
Other	.2	1.4	.8
Actual income tax provision (recovery)	$ —	$ 12.8	$ (.9)
Effective rate of income tax recovery	not meaningful	not meaningful	16.4%

At December 31, 1996, the Corporation and its subsidiaries had the following approximate amounts available to reduce future years' earnings for income tax purposes, the effect of which has not been recognized in the financial statements.

Losses for tax purposes expiring in	Canada	United States	Total
1997	$ 1.2	$ —	$ 1.2
1998	3.9	—	3.9
1999	6.5	—	6.5
2000	.5	—	.5
2001	7.9	—	7.9
2002	5.5	—	5.5
2003	2.9	—	2.9
2008	—	2.9	2.9
2009	—	5.4	5.4
2010	—	28.3	28.3
Total losses	28.4	36.6	65.0
Other deductions and basis differences not yet taken as a deduction for income tax purposes	10.5	42.9	53.4
	$ 38.9	$ 79.5	$ 118.4

13. NET INCOME (LOSS) PER ORDINARY SHARE

The basic and adjusted basic net income (loss) per ordinary share are calculated on the weighted average number of shares outstanding during the respective years as follows:

	Basic			Adjusted Basic
	1996	1995	1994	1994
Income (loss) from continuing operations	$ 11.6	$(81.2)	$(4.6)	$(4.6)
Add – preference share dividend entitlements	—	—	(1.8)	—
Income (loss) to ordinary shareholders before discontinued operations	11.6	(81.2)	(6.4)	(4.6)
Loss from discontinued operations	(3.1)	(12.0)	(2.9)	(2.9)
Net income (loss) to ordinary shareholders	$ 8.5	$(93.2)	$(9.3)	$(7.5)

In accordance with GAAP, the undeclared cumulative dividend entitlements of the Class C preference shares for the first and second quarters of 1994 have been deducted in calculating the basic earnings per share to ordinary shareholders.

	Basic			Adjusted Basic
	1996	1995	1994	1994
Weighted average number of ordinary shares outstanding during the year (in millions)	**39.161**	38.828	31.832	38.477
Income (loss) per ordinary share				
From continuing operations	**$ 0.30**	$(2.09)	$(0.20)	$(0.12)
After discontinued operations	**$ 0.22**	$(2.40)	$(0.29)	$(0.19)

The calculation of net income per ordinary share on a fully diluted basis assumes the exercise of outstanding stock options if such action would result in dilution of earnings per share. In 1996, fully diluted net income per ordinary share from continuing operations and after discontinued operations were $0.29 and $0.21, respectively.

14. PENSION PLANS

The Company and its subsidiaries have various defined benefit pension plans available to substantially all permanent full-time employees. The total pension expense for 1996 amounted to $2.8 (1995 – $3.5; 1994 – $3.3). The pension expense for 1996 consisted of the following:

	1996	1995	1994
Current service costs	**$ 2.3**	$ 2.3	$ 2.8
Interest costs on projected benefit obligation	**4.1**	4.5	4.5
Return on assets held in the plans	**(4.5)**	(6.2)	.2
Net amortization and deferral	**.9**	2.9	(4.2)
	$ 2.8	$ 3.5	$ 3.3

The actuarial present value of accrued pension benefits represents the discounted value of benefits expected to be paid to plan members, based on projected salaries prorated on service. No escalation of salaries is used to determine the actuarial present value of accrued pension benefits where the pension benefit is fixed and subject to renegotiation.

Certain key assumptions used in determining both the pension expense for 1996, and the actuarial present value of accrued pension benefits as at December 31, 1996, are as follows:

	Canadian Plans	U.S. Plans
Discount rate	8.0%	7.75%
Rate of increase of compensation levels	6.0%	4.5%
Expected long-term rates of return on plan assets	8.0%	9.0%

The status of pension plans at December 31, 1996, is as follows:

	Canadian Plans	U.S. Plans
Actuarial present value of		
Vested benefit obligations	$ 15.1	$ 32.0
Nonvested benefit obligations	—	3.9
Accumulated benefit obligations	15.1	35.9
Additional amounts related to projected salary and wage increases	.6	6.5
Total projected benefit obligations	15.7	42.4
Plan assets at market value	17.5	33.3
Plan assets in excess of (less than) projected benefit obligations	1.8	(9.1)
Unrecognized net (gain) loss	(.9)	6.8
Unrecognized prior service cost	.3	1.6
Unrecognized net (asset) obligation	(.7)	1.2
Prepaid pension cost	$ .5	$ .5

15. BUSINESS SEGMENTS

The following is an analysis of certain financial information by business lines and geographical areas for the three years ended December 31, 1996, 1995 and 1994 as it relates to operating revenue, operating profit (loss), identifiable assets, capital expenditures and depreciation and amortization of intangibles. 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.

	Operating Revenue			Operating Profit (Loss)		
	1996	1995	1994	**1996**	1995	1994
Heating and cooling						
Canada	**$ 76.8**	$ 79.0	$ 80.9	**$ 3.3**	$ (1.0)	$ 4.6
United States	**564.7**	453.6	554.1	**30.2**	(38.3)	13.3
	641.5	532.6	635.0	**33.5**	(39.3)	17.9
Corporate	**.4**	.2	.2	**(.1)**	(4.0)	(.3)
	$ 641.9	$ 532.8	$ 635.2	**$ 33.4**	$(43.3)	$ 17.6

	Identifiable Assets			Capital Expenditures			Amortization of Intangibles and Depreciation		
	1996	1995	1994	**1996**	1995	1994	**1996**	1995	1994
Heating and cooling									
Canada	**$ 46.5**	$ 42.2	$ 58.3	**$ .4**	$ .6	$ .8	**$ .6**	$ .6	$ .4
United States	**280.4**	251.0	370.2	**11.4**	23.9	10.3	**15.1**	17.7	16.3
	326.9	293.2	428.5	**11.8**	24.5	11.1	**15.7**	18.3	16.7
Corporate	**18.1**	25.0	22.6	**—**	—	—	**—**	.5	.9
	345.0	318.2	451.1	**$ 11.8**	$ 24.5	$ 11.1	**$ 15.7**	$ 18.8	$ 17.6
Discontinued steel pipe operation	**—**	27.6	35.0						
	$ 345.0	$ 345.8	$ 486.1						

16. COMMITMENTS AND CONTINGENCIES

a) ICP (USA) has been involved in paying the costs of assessing the extent of, and remediating, environmental contamination at its Lewisburg manufacturing facility caused by a sudden and accidental spill in 1980. ICP (USA) has paid for certain investigative activities and remediation at the manufacturing facility as well as off-site drum storage locations. The discounted costs of the cleanup were recorded as a charge of $4.0 in 1994, net of probable recoveries of $3.0. At December 31, 1996, the costs of the remainder of the environmental cleanup, which management believes are reasonably determinable over a ten year period, were discounted at 6.25%. At December 31, 1996, ICP (USA) has a provision of $3.5 for the cost of this cleanup, of which $2.7 is included in Environmental Liabilities and $.8 in Accrued liabilities.

The undiscounted cash flows are estimated to be as follows:

Year	
1997	$ 1.0
1998	.8
1999	.3
2000	.3
2001	.3
Thereafter	1.4
	$ 4.1

In connection with the environmental remediation at the off-site drum storage locations, ICP (USA) has entered into a cost-sharing agreement with the previous owner. This agreement calls for each entity to bear fifty percent of the investigation, cleanup, monitoring, removal and treatment of the existing drum storage sites. Additionally, in the event that other

drum storage sites are discovered, ICP (USA) and the previous owner shall bear the additional costs at a ratio of sixty percent to forty percent, respectively. The estimated costs to clean up the existing drum storage sites are included in the amounts detailed above.

(b) In 1991, the Company and Flying J, Inc. ("Flying J") entered into a cost sharing agreement whereby the Company will participate with Flying J in the financing of future cleanup activities for environmental contamination at various refinery sites sold by the Company to Flying J in 1980. This settlement does not affect claims by Flying J or the Company against third parties who may be responsible for contribution to refinery cleanup costs. In 1991, the Company also reached a settlement with several of its insurance carriers whereby the insurers will reimburse the Company for a portion of the expenses the Company will incur in the cleanup activities at the refineries. Ongoing cleanup activities at four refinery sites are at different regulatory stages.

Although the scope of the projects is becoming better understood and defined with the various regulatory agencies, the ultimate scope of the projects remains uncertain and it is not possible to definitively estimate the ultimate costs of remediation of such environmental contamination. At December 31, 1996, the Company has a provision of $11.8 for its estimated share of future cleanup costs, of which $10.9 is included in Environmental Liabilities and $.9 in Accrued liabilities.

The undiscounted cash flows are expected to be as follows:

Year	
1997	$ .9
1998	.6
1999	.8
2000	1.1
2001	.8
Thereafter	7.6
	$ 11.8

Based on current information prepared by independent environmental consultants, the Company's share of the cost of environmental cleanup, discounted at 6.25% is currently estimated to be approximately $7.2 over the next 22 years. At December 31, 1996, the expected insurance recoveries of $5.4 and $1.5 are included in Other Assets and Accounts receivable, respectively. The expected insurance recoveries discounted at 6.25% are currently estimated to be approximately $3.6 over the next 22 years.

(c) In February 1995, an action was commenced against ICP (Canada) in the Ontario Court (General Division) by GEC Alsthom Limited and GEC Alsthom Australia Limited (collectively "GEC"), claiming damages for breach of contract or negligence in the amount of Cdn. $7.0 million, plus interest and costs, arising out of alleged defective cooling banks which were designed, manufactured and delivered by Unifin International, a former division of ICP (Canada), to GEC between 1981 and 1984.

The Company has filed a statement of Defense with the Ontario Court (General Division). The Company contends that the said cooling banks were sold to GEC for a completely different application in connection with transformers to be supplied by GEC and involving much lower cooling oil flow rates.

Accordingly, the Company denies GEC's allegations and intends to vigorously defend its position against this claim. The Company has notified its primary and umbrella liability insurance carriers for their possible involvement with this claim. The Company believes that it has insurance coverage for this claim.

(d) The Company leases certain facilities and equipment under noncancelable operating leases. Lease rental expense during the current year amounted to $5.9 (1995 – $6.8; 1994 – $7.9). The approximate aggregate minimum annual rentals under long-term leases in future years, excluding capital leases, at December 31, 1996, are as follows:

Year	
1997	$ 4.3
1998	2.4
1999	1.8
2000	1.3
2001	.8
Thereafter	1.0
	$ 11.6

17. ASSET WRITEDOWNS AND RESTRUCTURING COSTS

Through the continuation of the business process reengineering efforts which began in 1993, ICP (USA) identified in 1995 certain fixed assets which were no longer considered to be economically viable to the production process. These assets included a coil delivery system with a carrying value of $3.4 million, an automated paint system with a carrying value of $4.1 million, and other idle assets with a carrying value of $1.2 million. ICP (USA) recognized an impairment loss on these assets of $8.7 million which was included in asset writedowns and restructuring costs in 1995.

In 1995, ICP (Canada) wrote down the carrying value of idle assets, comprised of machinery and equipment by $1.4 to orderly liquidation value. This writedown was also included in asset writedowns and restructuring costs for 1995.

During 1995, the restructuring and reengineering programs resulted in $2.2 of severance and benefits expense at ICP (USA). In addition, reductions in salaried personnel at ICP (Canada) resulted in severance costs of $1.1. Finally, the Company's decision in December 1995 to move its Canadian corporate head office to Lewisburg, Tennessee resulted in severance and other retirement benefits of $2.8. The restructuring costs totaling $6.1 were partially offset by a reduction of prior years' restructuring accruals of $.7, resulting in a 1995 restructuring charge of $5.4 which was included in asset writedowns and restructuring costs.

In 1994, restructuring costs of $.8 consisted of severance costs of $2.3 relating to reductions in salaried personnel in ICP (USA), partially offset by a reduction of $1.5 in the 1993 restructuring accrual for the closure of the Brantford manufacturing facility which was converted to use as a distribution and warehouse center in 1994. In 1994, the Company also expensed $3.2 for fees associated with a reengineering study completed by an independent consulting firm.

A rollforward of the restructuring costs accrual is as follows:

	1996	1995	1994
Balance – Beginning of the year	$ 6.1	$ 3.6	$ 14.5
Restructuring costs provision	—	6.1	2.3
Reversals of prior years' accruals	—	(.7)	(1.5)
Payments	(3.7)	(2.9)	(11.7)
Balance – End of the year	$ 2.4	$ 6.1	$ 3.6

18. DETAILS OF CASH PROVIDED BY (USED FOR) OPERATIONS

	1996	1995	1994
(a) Items not involving current cash flows			
Depreciation and amortization	$ 17.5	$ 20.1	$ 19.3
Deferred income taxes	—	11.4	(2.0)
Asset writedowns	—	10.1	—
Provision for bad debts	2.8	9.7	3.7
Write-off of debt issuance costs	.6	2.1	1.2
Other	—	1.0	.2
	$ 20.9	$ 54.4	$ 22.4
(b) Changes in working capital			
Accounts receivable	$ 5.7	$ 33.8	$ 7.7
Inventories	(14.1)	59.9	(28.3)
Accounts payable, accrued liabilities and product warranty	(15.3)	8.3	(13.9)
Other	5.3	(4.7)	—
	$(18.4)	$ 97.3	$(34.5)

19. SELECTED FINANCIAL DATA

Selected financial data for the five years ended December 31, 1996 to 1992 are as follows. Amounts are in millions of U.S. dollars except per share amounts.

	1996	1995	1994	1993	1992
Operating revenue	**$ 641.9**	$ 532.8	$ 635.2	$ 598.0	$ 566.7
Net income (loss)					
From continuing operations	**11.6**	(81.2)	(4.6)	(17.8)	(2.1)
After discontinued operations	**8.5**	(93.2)	(7.5)	(21.0)	(3.2)
Basic net income (loss) per ordinary share					
From continuing operations	**$ 0.30**	$ (2.09)	$ (0.20)	$ (0.87)	$ (0.26)
After discontinued operations	**$ 0.22**	$ (2.40)	$ (0.29)	$ (1.00)	$ (0.31)
Total assets	**345.0**	345.8	486.1	490.2	401.8
Long-term obligations	**165.0**	140.0	165.0	224.9	140.9

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

The following information on Quarterly Financial Data 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 millions of U.S. dollars except per share amounts.

	3 Months Ended				Year Ended
	Mar 31	Jun 30	Sep 30	Dec 31	Dec 31
1996					
Operating revenue	**128.6**	**198.7**	**178.7**	**135.9**	**641.9**
Gross margin	**23.5**	**35.1**	**38.0**	**27.5**	**124.1**
Net income (loss)					
From continuing operations	**(1.1)**	**7.0**	**6.7**	**(1.0)**	**11.6**
After discontinued operations	**(4.2)**	**7.0**	**6.7**	**(1.0)**	**8.5**
Net income (loss) per ordinary share					
From continuing operations	**$(0.03)**	**$ 0.18**	**$ 0.17**	**$(0.02)**	**$ 0.30**
After discontinued operations	**$(0.11)**	**$ 0.18**	**$ 0.17**	**$(0.02)**	**$ 0.22**
1995					
Operating revenue	129.3	143.4	152.1	108.0	532.8
Gross margin	18.8	22.2	21.2	3.2	65.4
Net loss					
From continuing operations	(5.1)	(5.5)	(6.3)	(64.3)	(81.2)
After discontinued operations	(5.5)	(9.5)	(5.9)	(72.3)	(93.2)
Net loss per ordinary share					
From continuing operations	$(0.13)	$(0.14)	$(0.16)	$(1.65)	$(2.09)*
After discontinued operations	$(0.14)	$(0.24)	$(0.15)	$(1.86)	$(2.40)*

* *Net income (loss) per ordinary share does not add to the total for the year due to changes in the number of ordinary shares outstanding during the year.*

Ordinary share trading prices during the period of January 1, 1995 to December 31, 1996 are as follows:

	(ASE – U.S. $)		TSE (CDN. $)	
	High	**Low**	**High**	**Low**
1996				
First Quarter	**1.75**	**1.00**	**2.25**	**1.20**
Second Quarter	**3.19**	**1.56**	**4.25**	**2.05**
Third Quarter	**3.25**	**2.75**	**4.30**	**3.70**
Fourth Quarter	**3.50**	**2.56**	**4.60**	**3.40**

	(ASE – U.S. $)		TSE (CDN. $)	
	High	Low	High	Low
1995				
First Quarter	2.38	1.38	3.45	2.00
Second Quarter	2.75	1.38	3.60	1.80
Third Quarter	2.75	1.81	3.65	2.50
Fourth Quarter	2.00	0.81	2.55	1.05

For the Years Ended December 31	1996	1995	1994	1993	1992	1991	1990
OPERATIONS *(In Millions of U.S. Dollars)*							
Operating revenue	**641.9**	532.8	635.2	598.0	566.7	467.9	473.8
Gross margin	**124.1**	65.4	112.9	99.6	121.3	102.3	108.6
Operating profit (loss)	**33.4**	(43.3)	17.6	(4.0)	14.6	16.7	27.3
Financial expenses	**21.8**	25.1	23.1	18.1	16.8	26.6	21.9
Income (loss) from continuing operations	**11.6**	(81.2)	(4.6)	(17.8)	(2.1)	(5.0)	1.7
Net income (loss)	**8.5**	(93.2)	(7.5)	(21.0)	(3.2)	(6.9)	153.3
PER ORDINARY SHARE *(In U.S. Dollars)*							
Income (loss) from continuing operations	**$ 0.30**	$ (2.09)	$ (0.20)	$ (0.87)	$ (0.26)	$ (0.70)	$ (0.29)
Net income (loss) after discontinued operations	**$ 0.22**	$ (2.40)	$ (0.29)	$ (1.00)	$ (0.31)	$ (0.86)	$ 21.83
FINANCIAL POSITION *(In Millions of U.S. Dollars)*							
Total assets	**345.0**	345.8	486.1	490.2	401.8	420.5	327.1
Working capital	**103.8**	60.5	153.0	167.5	102.9	73.8	45.2
Fixed assets (cost)	**213.2**	186.2	197.9	213.3	201.9	179.1	155.6
Debt*	**204.0**	182.7	242.8	216.0	128.8	197.0	150.1
OPERATIONAL DATA *(In Thousands of Units)*							
Air conditioners	**653**	532	621	564	563	511	602
Furnaces	**427**	349	450	446	444	363	283

**Includes short-term borrowings and long-term debt.*

Corporate Information

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- ▲ *Member of the Compensation and Pension Committee*
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Corporate

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H. DAVID TAYLER
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20-F REPORT
The U.S. Securities and Exchange Commission Report on Form 20-F for the year ended December 31, 1996 will be provided by mail upon receipt of a written request. Requests should be directed to:

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STOCK SYMBOL AND CUSIP NUMBER
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IPR Toronto Stock Exchange
IPR American Stock Exchange
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