ABITIBI-PRICE

# 1986 ANNUAL REPORT

# Abitibi-Price Inc.

Annual Report for the year ended December 31, 1986

Abitibi-Price is a Canadian forest products company with manufacturing operations in Canada and the United States. The world's leading producer of newsprint and uncoated groundwood papers, the Company has an annual capacity of 2.3 million tonnes of these grades and manages over 36,000 square miles of forest land.

Major subsidiaries are involved in the distribution of printing papers, industrial paper and plastic products, and information processing products. Other divisions and subsidiaries make coated papers, converted paper products and specialty building products.

At the end of 1986, the Company employed over 16,000 people in 34 plants and more than 80 sales and distribution locations.

Abitibi-Price's ongoing objective is to be the best in the businesses in which it operates. This report features some of the skilled people and advanced technologies that are making this goal a reality.

Abitibi-Price's common shares are currently listed on the Toronto, Montreal and Vancouver stock exchanges, and traded under the ticker symbol A.

On peut obtenir ce rapport annuel en français sur demande.

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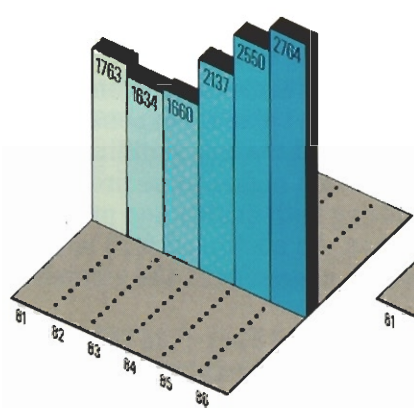
# Financial Highlights

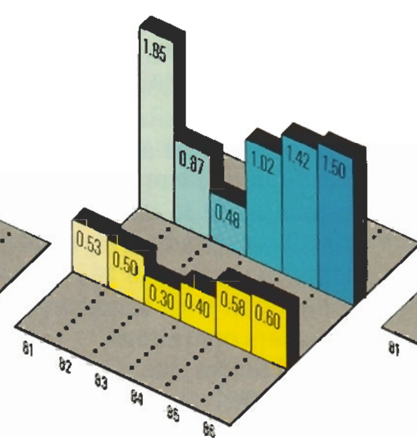
| (millions of dollars) | 1986 | 1985 |
|---|---|---|
| Net sales | **$2,764** | $2,550 |
| Earnings before extraordinary items | **110** | 100 |
| Net earnings | **107** | 100 |
| Capital expenditures | **263** | 202 |
| Working capital | **459** | 373 |
| Common shareholders' equity | **1,047** | 858 |
| Per common share | | |
| Earnings before extraordinary items | **$ 1.50** | $ 1.42 |
| Net earnings | **1.46** | 1.42 |
| Dividends declared* | **.60** | .73 |
| Dividends paid* | **.60** | .58 |
| Common shareholders' equity | **15.13** | 13.37 |
| Return on average common shareholders' equity | **10.7%** | 10.9% |
| Long-term debt/debt plus shareholders' equity | **26.8%** | 31.7% |

*Four quarterly dividends were paid in each of 1985 and 1986, but because of a change in dividend declaration dates, five dividends were declared in 1985.

NET SALES
(millions of dollars)

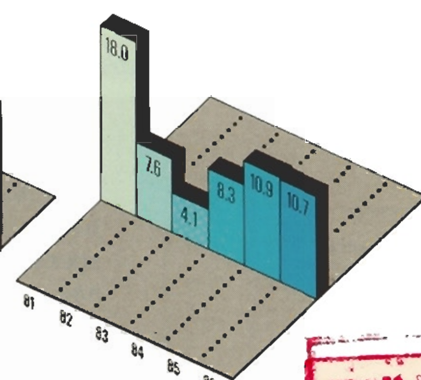



EARNINGS AND DIVIDENDS PER COMMON SHARE
(dollars)




■ Earnings before extraordinary items
■ Dividends paid

RETURN ON AVERAGE COMMON SHAREHOLDERS' EQUITY
(percent)



# Report of the Directors

The strengthening of newsprint markets that occurred towards the end of 1986 marked a turnaround for the Company's major product and, together with developments in other divisions, set the stage for improved performance in 1987.

Sales in 1986 increased to $2.8 billion from $2.5 billion in 1985, while earnings before extraordinary items rose to $110 million, or $1.50 per common share, from $100 million or $1.42 per share last year.

Net earnings were $107 million, or $1.46 per share, after a net extraordinary charge resulting from the sale of a kraft pulp operation and the writedown of a sawmill which was permanently closed.

Results for 1986, as compared with those of 1985, reflect the impact of non-operating items, including a higher effective income tax rate, which adversely affected 1986 net earnings by $15 million. This was offset by the adoption during the year of The Canadian Institute of Chartered Accountants' new accounting standard for pension costs, which benefited net earnings by $17 million. These items are explained in more detail in the financial review.

Dividends of 60 cents per common share were paid in 1986, compared with 58 cents in 1985.

Abitibi-Price's financial position was strengthened in the second quarter of 1986 with the issue of five million common shares and two and one-half million common share purchase warrants. The net proceeds of $134 million were used to reduce short-term debt and augment working capital. At year-end, long-term debt represented 27 percent of debt plus equity.

**Markets and Operations** Markets for most of the Company's products were highly competitive in 1986. The effect of the resulting pressure on prices was largely offset by cost reductions including lower energy prices, upgraded product mix and productivity improvements arising from capital investments made in previous years. Additional benefits were realized from increases in market share and the higher average value of U.S. and other foreign currencies against the Canadian dollar. Total operating profit was $246 million in 1986 compared with $204 million in 1985.

For the newsprint division, the improvement in the supply/demand balance was accompanied in the fourth quarter by an increase in the U.S. list price of $35 per tonne. Newsprint price increases have also been implemented or announced for Canadian and international markets. The groundwood papers and coated papers divisions both benefited from a richer mix of higher value papers produced during the year.

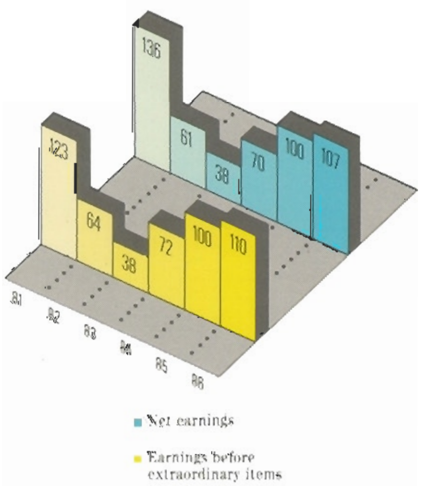
Some anticipated benefits were delayed, however. It has taken longer than originally projected to integrate with existing operations the recently acquired industrial papers distribution and envelope converting businesses.

**Capital Expenditures and Acquisitions** Capital expenditures in 1986 were $263 million and were largely directed towards fulfilling the Company's strategic commitment to modernization and higher value products.

Modernization expenditures, involving both quality and productivity improvements, amounted to $65 million. An additional $122 million was spent in connection with major product upgrading in the groundwood papers and coated papers operations.

In the United States, the Company acquired Flair-Fold Inc., a manufacturer of bi-fold doors, shelving and shutters. These products complement those

EARNINGS
(millions of dollars)



made by the Company's building products division for the U.S. remodeling and repair market and will be marketed through the same dealer network.

**Director Changes** The Board welcomed two new members in 1986. Robert J. Butler is Chairman of Urban Transportation Development Corporation Ltd. and Lionel G. Dodd is Senior Vice-President and Chief Financial Officer of Gulf Canada Corporation. Thomas J. Bell, a former President, Chief Executive Officer and Chairman of the Company, and Edmund C. Bovey completed their terms as directors and did not stand for re-election. Both gentlemen have contributed significantly to the success of the Company.

**Outlook for 1987** The Company expects stronger earnings improvement in 1987 than in 1986. However, since exchange rates directly affect the profitability of export sales, any significant sustained increase in the value of the Canadian dollar would temper expectations.

For newsprint, markets are expected to continue to strengthen. Most other product groups will experience continuing strong competition and the principal opportunities for improvement will come from within. In the groundwood papers division, benefits should be realized from the improved mix of higher value products resulting from recent capital investments. In the Diversified Group, streamlined operations and new products will provide opportunities for improved earnings in a continuing competitive environment.

In 1987, the Company will be negotiating renewal of labour agreements with unions representing approximately 8,600 employees in various operations. While this year's bargaining is expected to address some difficult issues, it is anticipated that the parties will successfully negotiate an agreement that will be in the best interests of both unionized employees and shareholders.

The Company's principal shareholder, Gulf Canada Corporation, has announced that during 1987 it intends to complete a reorganization which will include the distribution of its 83 percent holding in Abitibi-Price to Gulf Canada's shareholders on a pro rata basis, thereby raising Abitibi-Price's "public float" from 10 percent to 27 percent and transferring the controlling interest from Gulf Canada to Olympia & York Enterprises Limited.

While the operations of Abitibi-Price will not be affected by the reorganization, the Company will benefit from the greater access to capital markets that will result from wider public ownership of its shares, including a larger shareholder base in the United States. As soon as practicable, Abitibi-Price plans to register with the U.S. Securities and Exchange Commission and to seek a listing on the New York Stock Exchange.

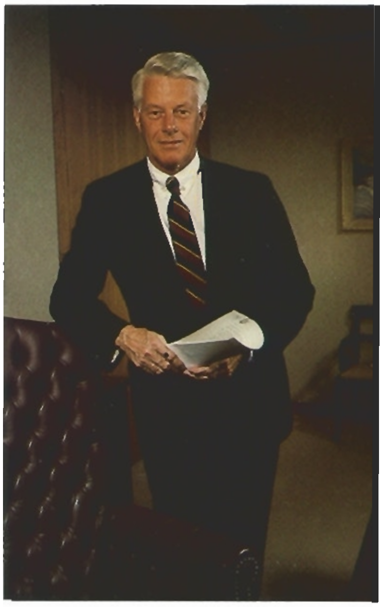
The future, as ever, contains opportunities and challenges. Abitibi-Price enters 1987 with optimism and confidence reinforced by the support of dedicated and highly capable employees. The directors wish to acknowledge this important contribution and express their appreciation.

On behalf of the Board of Directors,

B. K. Koken

Bernd K. Koken
President and Chief Executive Officer

Toronto, February 16, 1987



**Bernd K. Koken**
President and
Chief Executive Officer

**K. Linn Macdonald**
Group Vice-President
*Responsible for newsprint and groundwood papers manufacturing, lumber and pulp divisions, woodlands, capital projects and research.*

# Core Paper Group

The Core Paper Group's principal products, newsprint and uncoated groundwood papers, are made at 10 mills in Canada and one in the United States. Currently, 18 machines produce newsprint and 10 produce groundwood papers. The combined annual capacity of 2.3 million tonnes makes the Company the world's largest supplier of these products. The group is also responsible for the management of over 36,000 square miles of forest land.

## MARKETS AND OPERATIONS

***Newsprint*** World newsprint markets improved throughout 1986 with supply and demand coming roughly into balance in the second half of the year. Demand grew in all major industrialized countries, including the critical United States market where consumption increased 3.1 percent over 1985 levels. Prices, which had been under pressure for some time, showed substantial improvement in virtually all markets late in the year. In the United States, the list price of standard newsprint rose $35 per tonne, an increase of 6.5 percent.

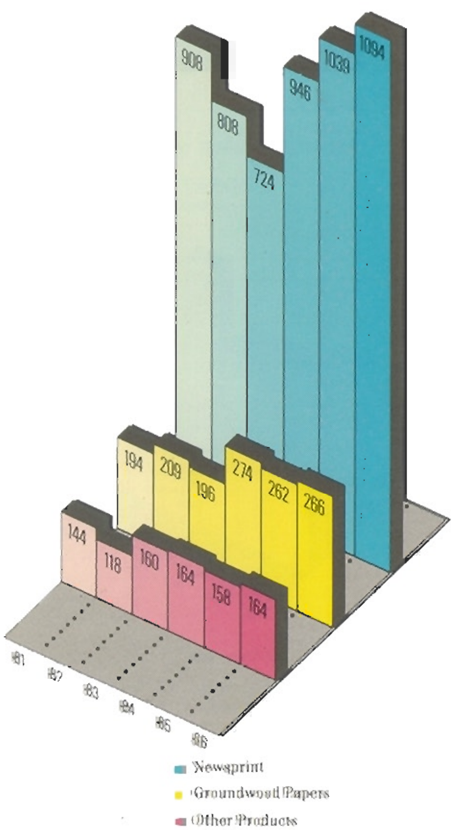
Company mills operated at 92 percent of capacity, producing 1.8 million tonnes, augmented by a further 48,800 tonnes available through a marketing arrangement. With the exception of a fire at the Chandler, Quebec mill that caused three weeks of production downtime, operations were normal. Newsprint contributed a considerably larger portion of Company earnings than in 1985, aided by favourable exchange rates in many export markets, improving prices late in 1986, and cost improvements, including pension cost adjustments.

***Groundwood Papers*** "Groundwood papers" covers a wide range of paper grades, each of which responds to different market conditions. The key grades of uncoated groundwood papers manufactured by Abitibi-Price are directory, supercalendered and high brightness machine finished printing papers. In 1986, market penetration for each of these grades was increased.

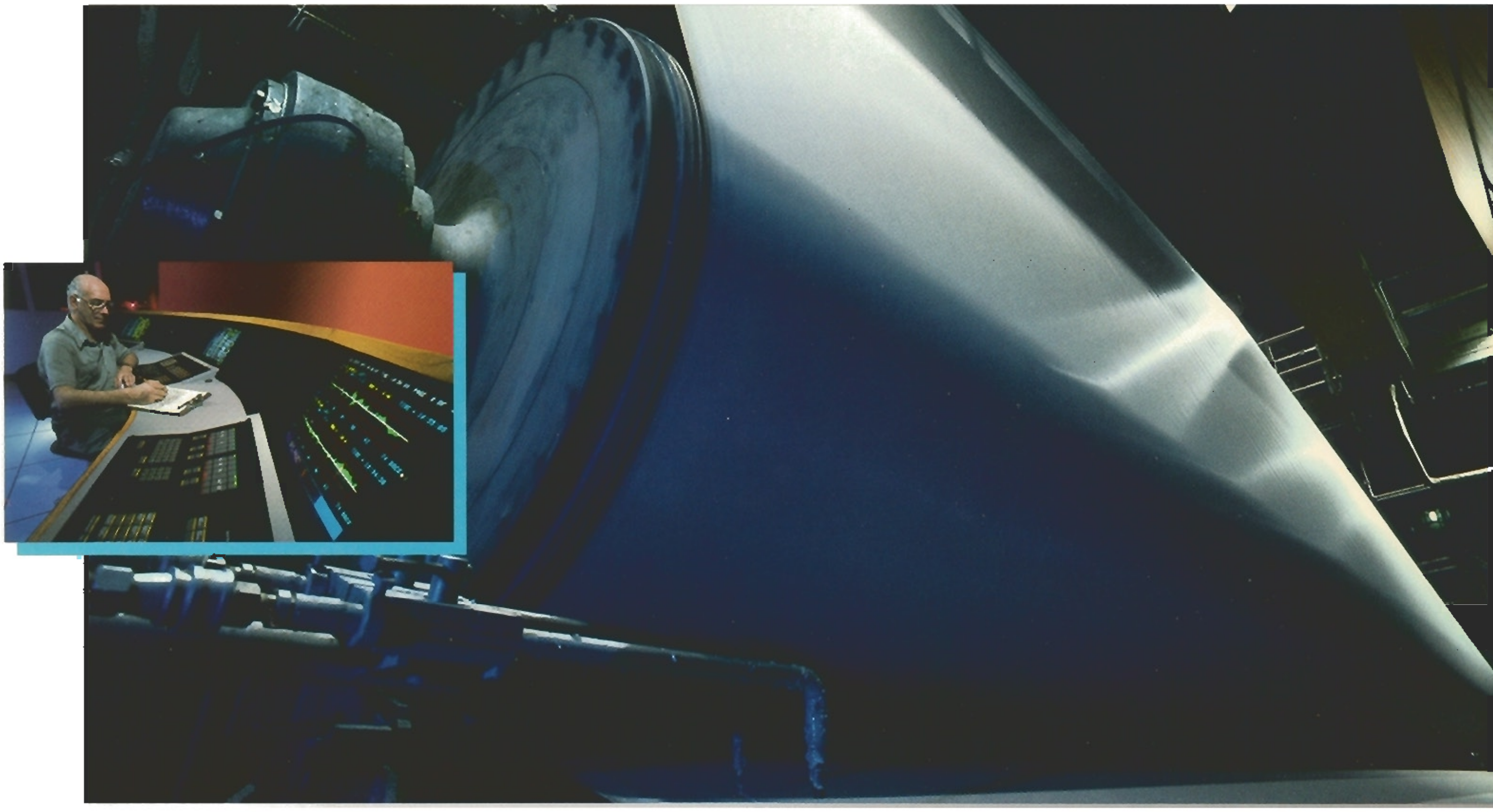
Demand was strong in most end-use markets, particularly directory printing, and the Company benefited from its increased capacity for higher quality papers. In 1986, the Company made its entry into supercalendered papers with an unfilled sheet and, in 1987, will follow up with the highest quality clay-filled supercalendered papers.

Although demand for supercalendered papers continues to grow, considerable new capacity has produced a world oversupply which will last for some time. Prices have been further eroded by a market surplus of the next higher quality grade, No. 5 lightweight coated paper.

CORE PAPER GROUP
NET SALES
(millions of dollars)



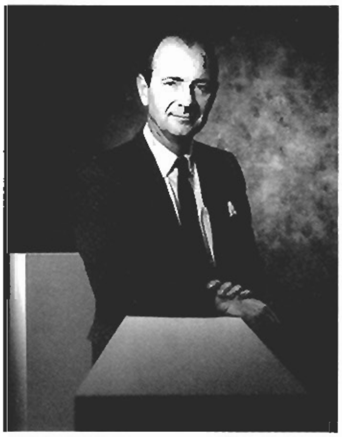
Computerized control systems, modern production equipment, and skilled employees like beater engineer Jean Carrière, ensure our continuing ability to compete in world markets.



On the No. 8 newsprint machine at Iroquois Falls, the twin-wire former produces a high quality printing surface on both sides of the paper. When committed projects are completed, 95 percent of the Company's newsprint will be produced using twin-wire technology.

The groundwood papers mills operated at available capacity of 350,000 tonnes and remained sold out during 1986. Available capacity was somewhat diminished by periods of downtime required by the significant capital improvement program taking place in our operations. Nevertheless, earnings improved over those of 1985.

*Other Products* During 1986, the Company reduced its involvement in the lumber market to one sawmill at L'Ascension, Quebec, and sales agreements with unrelated companies covering three sawmills and a waferboard mill. We permanently closed an inactive sawmill at Falardeau, Quebec, and sold our kraft pulp mill in Smooth Rock Falls, Ontario, to Waferboard Corporation, for whom we will act as sales agent and market the mill's output. In the 11 months before the sale, the mill operated at capacity and produced 87,000 tonnes. As part of the sale we relinquished a stud lumber mill which had produced 18 million board feet in the 11-month period. Total lumber production in 1986 was 83 million board feet.



**John G. Davis**
Group Vice-President
*Responsible for worldwide sales and marketing of newsprint and groundwood papers.*

Control of manufacturing costs continued to play an important role in protecting and enhancing Company earnings. Excellent results were achieved in 1986 as mill operations, aided by lower energy prices, realized the benefits of earlier expenditures on equipment modernization and the installation of computerized process controls. Overall manufacturing costs again declined from the previous year's level. We expect that future cost increases can be held below the inflation level through a combination of capital investments, economies of scale, and process and productivity improvements.

## CAPITAL IMPROVEMENTS

Ongoing capital investments continue to permit advances in cost effectiveness, quality and competitiveness in world markets. These investments provide modern, highly automated equipment capable of producing an optimum range of papers, with greater productivity.

In 1986, capital expenditures of $94 million for newsprint operations and $122 million for groundwood papers operations included several major projects, some spanning periods of more than one year.

At Grand Falls, Newfoundland, the rebuilding of the No. 3 newsprint machine was completed and new formers were installed on the other two machines. By the end of 1987, about $70 million will have been spent to modernize this mill and raise its quality to world standards. In one of the newsprint mills at Thunder Bay, Ontario, a $55 million quality improvement project was launched. The rebuilding of the woodroom, cleaning system and headboxes, and the installation of twin-wire formers on two paper machines will be completed in 1987.

The logistics of managing the world's largest supply of newsprint are complex. Under the direction of Bob Graham, the challenge is met using a masterpiece of linear program-

ming known as the "newsprint allocation model". The program integrates sales, production and transportation data, matching machines and mills with customer orders and locations, to achieve efficient use of manufacturing resources and cost-effective delivery.

The Company participates in cooperative research programs with government and industry to investigate new methods of forest management. Greg Wiggins, a research forester with ABL Forest Science Inc., conducts studies in the Iroquois Falls forest using instruments that combine sophisticated microprocessor electronics with rugged field portability. The steady state porometer shown here measures the efficiency with which a seedling uses available water. This research is designed to develop seedling preconditioning treatments that will improve the survival and growth potential of Company forest plantations.

Early in 1987, the modernization of the No. 7 machine at the Jonquière mill in Quebec will be completed, allowing production of high quality clay-filled supercalendered paper. This is part of a $135 million, multiphased project which began in 1985 and will result in two of the mill's machines producing supercalendered paper—45 percent of the plant's capacity—by the end of 1987.

At the nearby Alma mill, the conversion of the No. 9 machine from newsprint to directory papers was completed at a cost of $37 million. Output has exceeded our expectations for quality and volume.

Twin-wire technology is the most modern method of paper formation, and the conversion of newsprint machines from single-wire to twin-wire configuration is a central component of our ongoing capital improvement plan. In 1986, twin-wire formers were installed on two machines at Grand Falls and on the No. 9 machine at Alma. Twin-wire upgrades are planned for mills at Jonquière, Chandler and Thunder Bay. By the end of 1987, we expect 90 percent of our newsprint and groundwood papers tonnage will be from twin-wire machines.

**J. Ian McGibbon**
Group Vice President
*Responsible for corporate development, industrial relations, personnel and information systems.*

## MARKETING INITIATIVES

The direct beneficiaries of capital investments in quality are our customers. In turn, satisfied, long-term customers are of value to both shareholders and employees.

As well as providing customers with quality products, the Company invests in programs to supply recognizable value over and above the product. Those marketing initiatives that differentiate Abitibi-Price from other suppliers combine to form a supply and service program called VIP—Value Improved Product.

The VIP program means providing the finest customer service in the industry and putting well-trained professionals in contact with our customers. It means capitalizing on our advantages of size, using our wide range of paper grades and network of mills to offer customers broader choice and security of supply. It means the overall commitment to fulfil obligations to customers in any kind of market. Finally, it means searching for opportunities to help customers become more profitable through special services such as our PDM (pressroom data management) and ABITROL (inventory control system).

The VIP marketing concept is flexible enough to meet new needs, but its consistent and continuing objective is to provide our customers with more value than they can receive from any other supplier.

## FOREST MANAGEMENT

Abitibi-Price manages 36,400 square miles (9.4 million hectares) of timberland in Canada and the United States. Various arrangements, from long-term agreements to shorter term silviculture cost-sharing arrangements, allow the Company to conduct forest renewal activities on the public lands which constitute 95 percent of the total area.

Proper and productive resource management is a key factor in supplying Company mills today and regenerating for tomorrow's needs. The forest management practices of Abitibi-Price are aimed at maximizing current cost effectiveness, increasing future competitiveness, and ensuring the protection and perpetuation of the forest resource for the benefit of both the Company and the public.

During 1986, approximately 47 percent of our wood fibre needs was supplied through Company forest operations, the balance being purchased as wood chips or pulpwood logs. Capital expenditures on woodlands operations, including mechanized harvesting equipment, roads and other facilities, amounted to $12.1 million compared with $10.9 million in 1985.

An additional $8.8 million was spent on other forest management activities such as forest protection and regeneration, including the planting of almost 14 million seedlings. Planting by itself, however, is not regarded as a sufficient indicator of reforestation activity since in many areas natural regeneration is more appropriate. On these lands the Company carried out various silvicultural activities, including scarification (surface loosening), seeding, pre-commercial thinning and tending.

Research is an integral part of forest management operations. The Company's professional foresters and technicians participate in programs to improve wood quality, shorten crop rotations and increase yield. One important target for the industry at this time is the establishment of tree-breeding orchards to produce genetically superior trees which will grow faster and yield more wood per acre than at present. The Company contributes expertise at senior levels and participates in cooperative research management endeavours across Canada.

## OUTLOOK

Although growth in newsprint consumption will be modest in Canada and the United States and only slightly stronger in our other export regions in 1987, the market will be healthy since no significant new supply will be introduced. As demands on our newsprint system increase to fill existing capacity, our challenge will be to maintain high standards of reliability, quality and customer service, while controlling costs and sustaining our capital improvement program.

The groundwood grades will experience a mixed environment in 1987. We expect strong demand for papers to supply printers of directories, business forms, advertising inserts and flyers. However, ongoing overcapacity of lightweight coated papers will maintain pressure on the uncoated supercalendered grades. With the introduction of an improved unfilled supercalendered grade and a new high quality clay-filled supercalendered paper, we expect to compete well in these grades and to again sell out the production of our groundwood mills in 1987.

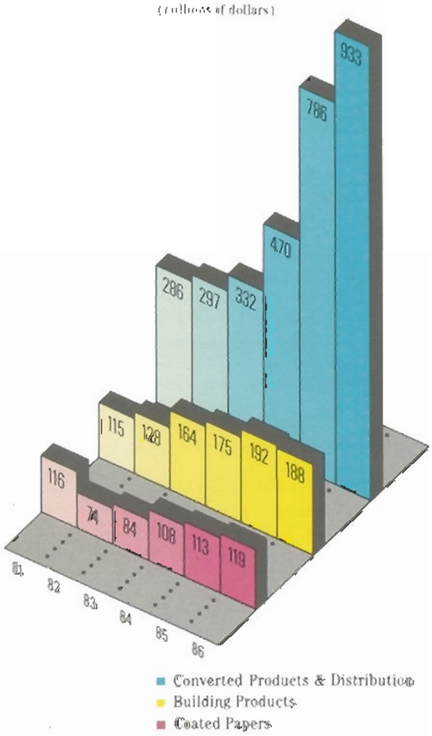
Ronald Y. Oberlander
Group Vice-President
*Responsible for the Diversified Group.*

# Diversified Group

The Diversified Group's four principal segments—Distribution, Converting, Coated Papers and U.S. Building Products—encompass a number of autonomously managed divisions and subsidiaries located in Canada and the United States. Many individual operations set new sales and earnings records in 1986 although overall earnings were down from 1985 and some setbacks were experienced. The merger of recently acquired distribution and converting operations, while representing a major accomplishment, took longer than planned and therefore did not yield the expected synergistic benefits in 1986. A new siding product was stalled on its introduction and will require further development.

On balance, however, progress far outweighed problems, with each segment strengthening its operations and performance potential. By year-end, the distribution and converting segments had implemented most of their consolidation plans; Provincial Papers successfully made the transition to 100 percent coated papers production; and the building products division completed an attractive acquisition.

DIVERSIFIED GROUP
NET SALES
(millions of dollars)




## DISTRIBUTION

Barbecon Inc. and Inter City Papers Limited, through various divisions and subsidiaries, distribute printing papers, industrial products and information processing products. Distribution resnlts were modestly improved over 1985 as merger costs and lower contributions from U.S. printing papers distribution operations reduced gains from other areas.

***Printing Papers*** The Barber-Ellis paper merchant and retail operation improved its earnings in the face of intensified competition. To capitalize on growth opportunities, this division is expanding its line of papers for computer printers and copiers and is also extending the range and volume of its non-paper printing industry supplies such as inks and plates for graphic printing needs.

Reorganization of Florida-based Jaffe Stationers significantly improved operations and justified expansion of this retail office products division. Jaffe plans to launch three new stores in Florida during 1987.

The Printing Papers division of Inter City Papers, including its Lauzier Little operation, continued to post sales and earnings records in 1986. A highlight for the division was the establishment of a second distribution centre in the Metropolitan Toronto area. This new centre, operating as Whyte Hooke Papers, serves the rapidly expanding eastern Toronto market and has been profitable since its launch in June 1986.


Thousands of orders flow daily through the computer networks of Inter City and Barbecon, either with the help of sales and service staff or by direct telecommunications links with customers. Carolyn Langille, Andy Colwell and Wayne Smith emphasize service at Inter City's Mississauga distribution centre.

A marketing priority for Inter City in 1987 will be the introduction of a new line of business communication papers for specialty applications, including facsimile transmission, laser printing and engineering design.

Overall results from Chicago-based Whitaker Carpenter were below expectations. Although sales for this merchant operation increased 20 per cent over the previous year, earnings were adversely affected by high operating costs associated with equipment upgrades, the expansion of a warehouse in Chicago and the opening of a new warehouse in Detroit. With modern equipment and computer systems now installed, progressive earnings improvement is expected in 1987.

***Industrial Products*** In 1986, the Price Daxion division both improved earnings and addressed the significant task of combining the operations of the former Price Wilson industrial distribution network with the CIP Daxion operation acquired in 1985. The consolidation of 30 operations into 18 and the streamlining of procedures will benefit future earnings and allow the division to compete effectively. The rapid growth of this market is tied to the success of fast food chains and the increasing use of protective packaging for consumer products.

***Information Processing Products*** The swift and steady sales growth of information processing supplies within Inter City's Printing Papers division justified the creation during 1986 of an operation dedicated to the marketing of information processing products. This new division encompasses all marketing operations for information processing products, including the existing successful Azerty division in the U.S.

## CONVERTING

Various divisions or subsidiaries of Abitibi-Price Inc., Inter City Papers Limited and Barbecon Inc. carry on converting businesses within the Diversified Group.

Hilroy, well-known as a supplier of school and office stationery, extended its presence in the home stationery market in 1986 with the successful integration of Barbecon's consumer stationery division.

Hilroy experienced intense competition, particularly in the school products sector, from domestic and foreign suppliers. Through competitive pricing and new product introduction, Hilroy maintained its market share, although the pressure on margins was reflected in lower earnings. Improving prices in 1987, an upgraded product line and higher productivity should allow Hilroy to recover earnings growth momentum.

The Price Wilson converting operation at Lachute, Quebec, which manufactures folding cartons, paper bags and industrial towels, achieved record earnings, largely as a result of productivity gains and reduced operating costs. Customer service for carton deliveries was improved by the installation in August of a new, efficient, board sheeter.

The merging of envelope operations of Barbecon and Canada Envelope into Innova Envelope involved a major reorganization in 1986 in which the number of operating facilities was reduced from 13 to 9. Most of the efforts and costs—greater than initially expected—have now been expended and only a few aspects of the reorganization remain to be finalized in order to achieve our original objectives.

Innova's results were affected by the merger activities as well as by difficult markets in which margins were eroded by softening prices and escalating operating costs. In 1987, this division will concentrate on completing the merger and identifying customer and market opportunities, particularly in the growth market for non-post office envelope products.

**COATED PAPERS**

While demand for coated papers was strong in 1986, large capacity increases in North America during the year produced a highly competitive market for Provincial Papers. Nonetheless, earnings equalled those of 1985 as Provincial's strategy of increased automation and higher value products proved to be a key factor in offsetting the effect of declining selling prices and rapidly escalating kraft pulp costs.

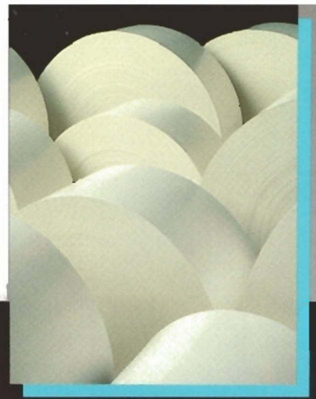
Technological improvements at the Thunder Bay, Ontario mill, including new coating equipment and computer controls, allowed production of a higher value product mix while decreasing controllable costs. Close to $9 million was spent on capital improvements in 1986, primarily to upgrade one supercalender machine and to install a new coater on the No. 5 paper machine. Both are scheduled for startup in 1987.

With extra coating capacity, Provincial has been able to increase the proportion of higher value coated paper output. The production of lower-priced, lightweight coated grades, used for popular magazines, has been reduced, whereas that of premium grades such as those used for this annual report, for art books and for other quality applications, has increased. Provincial was successful in quickly developing markets for its upgraded product mix.

Although demand for coated papers is expected to grow, additional capacity increases and rising pulp prices will exert continuing pressure on margins. The principal opportunity to enhance earnings will arise from the increased production and sale of higher value grades resulting from the completion of capital improvements in the first quarter of 1987.

**U.S. BUILDING PRODUCTS**

***Siding*** With stable selling prices and controlled operating costs, the siding division produced record earnings in 1986. However, while demand was strong through the first half of the year, it weakened considerably in the second half. Housing starts remained at a relatively high level, but the location of new starts shifted from the southern U.S., where hardboard siding is widely used, to the midwestern and northeastern regions.



Cross-machine control systems increase our ability to produce consistently high quality printing papers. Sensors continuously scan the paper web, measuring moisture, basis weight, and caliper, and relaying data to other points in the production process to permit instant, automatic adjustments.

Successful product introductions are the norm for the building products division. Thus it was a significant disappointment that Thermolock, a new design in self-insulating hardboard siding introduced in the first half of 1986, fell far short of expectations. The division experienced difficulty in consistently manufacturing to its rigid field specifications and withdrew the product to make the necessary design and production changes. Inventories in the distribution channel were removed and a related writedown was taken.

***Hardboard Products*** Markets for the hardboard division were mixed, with disappointing results overall. The strongest product line was the moisture-resistant tileboard marketed as AQUATILE™ and GLAZTILE™. The division also produces decorative wallpaper-type panelling which is gaining popularity with consumers. Woodgrain panelling, on the other hand, is performing poorly as consumer tastes change and is adversely affecting the division's results.

***Mouldings*** As the Company increased its market share of plastic moulding products, the division achieved record earnings in 1986. Since traditional moulding designs have been tied to the now declining market for woodgrain panelling, the division has been expanding into other moulding products. The Oak Trim line has been a very successful complement to paint and wallpaper as has the recently introduced Canterbury line.

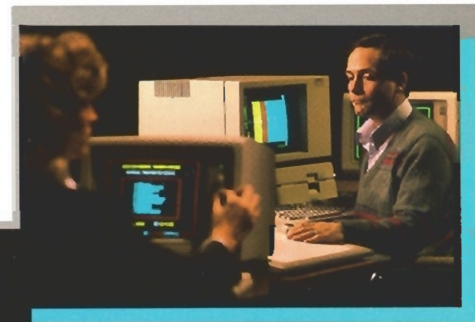
The Company intends to continue enriching its mix of moulding products and to use its patented AZTRA™ process to expand into other low cost applications requiring the appearance and performance characteristics of wood.

Towards the end of 1986, the Company acquired Flair-Fold Inc., a manufacturer of bi-fold doors, shelving and shutters, with plants in Kansas and North Carolina. Flair-Fold provides attractive potential for synergies as its products complement our existing home centre building products line and will be marketed through the Company's established dealer network.

## OUTLOOK

Distribution results are expected to improve in 1987, with good performance in most segments and growth in the new information processing products division. Industrial products distribution and converted products should produce improved results as the benefits of rationalized operations flow through to earnings. Coated papers will experience a difficult environment, with increasing costs for kraft pulp and continuing pricing pressure in the coated groundwood grades. For the building products division, changing consumer tastes will continue to adversely affect demand levels for woodgrain panelling, but markets for other building products are expected to remain relatively unchanged.

Investment in technology has turned the plant at Middlebury, Indiana, into a state-of-the-art facility for production of extruded plastic mouldings.



CAD/CAM systems design and produce the original tooling. Accuracy is verified by Steve Bates using the comparator shown here. At the terminal, draftsman Ken Blinco discusses a design with Lori Warner.

# Locations, Products and Markets

| Group | Division or Segment | Plants | Sales Companies and Offices |
|---|---|---|---|
| **CORE PAPER GROUP** | **Newsprint** | Pine Falls, Man.; Thunder Bay (2 mills) and Iroquois Falls, Ont.; Alma and Chandler, Que.; Grand Falls and Stephenville, Nfld.; Augusta, GA | *Abitibi-Price Inc.*<br>Toronto, Ont.; Montreal, Que.<br>*Abitibi-Price Sales Corporation*<br>New York, NY; Des Plaines, IL; Atlanta, GA; Detroit, MI; Dallas, TX<br>*Abitibi-Price Sales Company Limited*<br>London, England |
| | **Groundwood Papers** | Beaupré, Jonquière and Alma, Que. | |
| | **Other Products** | L'Ascension, Que. | *Abitibi-Price Lumber Sales*<br>Toronto, Ont.<br>*Abitibi-Price Inc. (pulp sales)*<br>Toronto, Ont.; Montreal, Que. |
| **DIVERSIFIED GROUP** | **Coated Papers** | Thunder Bay and Georgetown, Ont. | *Provincial Papers*<br>Thunder Bay and Toronto, Ont.; Montreal, Que. |
| | **Distribution**<br>Printing Papers | | *Inter City Papers Limited*<br>Ottawa, Toronto and London, Ont.; Halifax, N.S.; Winnipeg, Man.; Vancouver, B.C.<br>*Lauzier Little Inc.*<br>Montreal and Quebec, Que.<br>*Whyte Hooke Papers*<br>Toronto, Ont.<br>*Whitaker Carpenter Paper Company*<br>Chicago, IL; Detroit, MI; Nashville, TN; Appleton and Milwaukee, WI<br>*Barber-Ellis*<br>Moncton, N.B.; Dartmouth, N.S.; St. John's, Nfld.; Montreal and Quebec, Que.; Toronto, London, Hamilton, Windsor and Kitchener, Ont.; Winnipeg, Man.; Regina and Saskatoon, Sask.; Calgary and Edmonton, Alta.; Vancouver, B.C.<br>*Jaffe Stationers, Inc.*<br>North Miami and Fort Lauderdale, FL |
| | Industrial Products | | *Price Daxion*<br>St. John's, Nfld.; Moncton, N.B.; Halifax, N.S.; Quebec and Montreal, Que.; Toronto, London, Ottawa and Thunder Bay, Ont.; Winnipeg, Man.; Regina and Saskatoon, Sask.; Calgary, Edmonton and Lethbridge, Alta.; Vancouver, Victoria and Vernon, B.C. |
| | Information Processing Products | | *Azerty*<br>Buffalo, NY; Richmond, VA; Shreveport, LA; South Bend, IN; Toronto, Ont.; Montreal, Que.<br>*Compu-Redi*<br>Toronto and Ottawa, Ont.; Montreal, Que. |
| | **Converted Products**<br>Envelopes | Dartmouth, N.S.; Montreal, Que.; Toronto (2) and Brantford, Ont.; Winnipeg, Man.; Calgary and Edmonton, Alta.; Vancouver, B.C. | *Innova Envelope*<br>Dartmouth, N.S.; Montreal, Que.; Ottawa and Toronto, Ont.; Winnipeg, Man.; Calgary and Edmonton, Alta.; Vancouver, B.C. |
| | School, Office, Home Products | Toronto, Ont.; Vancouver, B.C.; Joliette, Que. | *Hilroy*<br>Toronto, Ont.; Montreal, Que.; Vancouver, B.C. |
| | Industrial Paper Products | Lachute, Que. | *Price Wilson, Inc.*<br>Montreal, Que. |
| | **U.S. Building Products**<br>Hardboard Panel Products | Alpena, MI; Toledo, OH | *Abitibi-Price Corporation*<br>Troy, MI |
| | Hardboard Siding Products | Roaring River, NC; Alpena, MI | |
| | Plastic Products | Middlebury, IN | |
| | Bi-Fold Doors, Shutters and Shelving | Hiawatha, KS; Lumberton, NC | |

*an Inter City Papers operation*
*a Barbecon operation*

| Products and Services | Markets or End Uses | Abitibi-Price Market Position |
|---|---|---|
| Produces standard grade newsprint from 75-95% mechanical pulp reinforced with chemical pulp, weighing between 40 and 52 grams per square metre of surface and measuring 58 on the brightness scale. | Used primarily for daily newspapers; also for various commercial printing purposes, including free-standing inserts distributed through newspapers and direct mail. | The world's largest newsprint producer, with about 13% of North American capacity and 6% of world capacity; most production is shipped to the U.S. and Canada, with the balance going to over 30 other countries. |
| Produces uncoated groundwood papers in basis weights from 29.3 to 97.6 grams per square metre. Principal grades are directory, supercalendered and machine finished high brightness. | Used for business forms, weekend newspaper supplements, magazines, advertising inserts and flyers, telephone and other directories, catalogues and paperback books. | A leading world producer of uncoated groundwood papers; most production is sold to commercial printers in Canada and the U.S. |
| Produces random length softwood lumber; sells the output of three sawmills, a waferboard plant and a pulp mill owned by others. | Lumber sold to wholesale distributors, retail chains, buying groups and mass merchandisers. Pulp sold to producers of paper, packaging and tissue products. | A minor factor in these markets. |
| Manufactures a broad range of coated printing papers in woodfree and groundwood grades. | Sold to publication printers, commercial printers, paper merchants and converters. | Canada's largest producer of premium coated papers. |
| Paper merchant operations distribute a wide selection of domestic and imported printing papers, business papers, graphic arts supplies and office stationery products. | Thousands of deliveries made daily to a wide variety of markets, including commercial printers, in-house printing operations, quick copy businesses and office users. | Canada's largest paper merchant companies, with the number one market position in most of the individual Canadian markets they serve. |
| Sells a full range of office products as well as office furniture and equipment. | Serves small businesses and retail customers. | |
| Distributes a wide array of products including bags, folding cartons, plastic containers and other disposable items; foil, closures, labels; cleaning and institutional paper supplies; plastic packaging products and equipment. | Users include restaurants, fast food chains, airlines, food and drug manufacturers, hospitals and other institutions. | |
| Distributes information processing products including diskettes, printer accessories, file and storage accessories, computer care products, and some peripherals. | Supplies primarily the business market for computer and data processing products. | |
| Manufactures all types of envelopes, including courier envelopes, computer diskette pouches, photo bags and cash dispersal envelopes for automated teller machines. | Supplies primarily the office market. | Largest envelope manufacturer in Canada with the number one market position in the markets it serves. |
| Manufactures and distributes a variety of paper and paper-related products for school, home and office. | Supplies wholesalers, office products dealers, school boards, chain and department stores. | Holds the number one position in most areas of the market for its products. |
| Manufactures and distributes a wide range of products including plain and printed paper bags, folding cartons and impact-cushioned bags. | Supplies the foodservice industry, supermarkets, retail stores, the fish processing industry and agricultural end users. | Market position varies depending on product line. |
| Manufactures 1/4" and 1/8" hardboard panels with various surface treatments, including woodgrain designs and decorative plastic finishes; also makes industrial hardboard. | All products serve new construction and repair and renovation markets, primarily for residential, commercial and light industrial applications. Sales are made to wholesalers and mass merchandisers. | The number one producer of 1/8" decorative hardboard panelling and the second largest producer of 1/4" prefinished hardboard panelling in the U.S. |
| Manufactures primed and prefinished lap and panel siding. | | Second largest producer of hardboard siding in the U.S., serving markets east of the Rockies. |
| Manufactures prefinished extruded plastic mouldings and industrial products. | | Number one supplier of these products to dealers and retailers in the U.S. |
| Manufactures interior wood bi-fold doors, shutters, shelving and allied millwork. | | One of two national suppliers to the home centre industry. |

## Financial Review

Sales for the year 1986 were $2.8 billion, up from $2.5 billion in 1985. Earnings before extraordinary items increased to $110 million or $1.50 per common share from $100 million or $1.42 per share the preceding year. Net earnings for 1986 were $107 million or $1.46 per share after a net extraordinary loss of $3 million resulting from the sale of a kraft pulp operation at Smooth Rock Falls, Ont. and the writedown of a sawmill at Falardeau, Que. which has been permanently closed. There were no extraordinary items in 1985.

In the third quarter of 1986, the company adopted, with effect from the beginning of the year, the new requirement of The Canadian Institute of Chartered Accountants with respect to accounting for pension costs. As a result of this change in accounting policy, which is referred to in Note 2 and described in more detail in Note 1 (e) to the accompanying financial statements, net earnings for the year have been increased by $17 million or $0.25 per common share.

Operating profit for the year 1986 was $246 million, compared with $204 million in 1985. Apart from the effect of the change in the method of accounting for pension costs, the principal reasons for the improvement were cost reductions resulting from manufacturing technology improvements and lower energy prices, a higher value product mix, and the higher average value of the U.S. dollar and other foreign currencies against the Canadian dollar.

Interest expense charged against earnings declined to $37 million in 1986 from $47 million the preceding year as the result of an increase in the amount of interest capitalized on major capital additions and a reduction in outstanding debt.

Other income and expense for the year decreased to $4 million from $20 million in 1985. In 1986 there were smaller gains from disposals of fixed assets and investments. In addition, 1986 absorbed a foreign currency exchange loss of $4 million, compared to a gain of $8 million in 1985. These gains and losses result from changes in exchange rates between the time when sales and other transactions made in foreign currencies occur and the time when foreign currencies are converted to Canadian funds or when foreign currency working capital items are translated to their Canadian funds equivalent.

Income taxes as a percentage of before-tax earnings increased to 43% in 1986 from 39% in 1985. In 1986 there was a reduction in capital gains which are taxed at a lower rate than regular income. Also, the 5% federal surtax which came into effect during 1985 applied to the full year 1986 and the inventory allowance was eliminated at the end of February.

Four quarterly common share dividends totalling $0.60 were paid in 1986, compared with four dividends totalling $0.58 in 1985. Because of a change in the timing of dividend declaration dates, however, five quarterly dividends were declared in 1985, with the fifth being the first dividend paid in 1986.

Capital expenditures of $263 million in 1986 increased 30% from the

$202 million spent in 1985 and were largely directed towards productivity and quality improvements and the development of higher value products.

On April 2, the company issued 5 million common shares and 2.5 million common share purchase warrants in units, with each unit priced at $27.50 and comprising one share and one-half of a purchase warrant. The proceeds of $134 million, after underwriters' fees and expenses net of income taxes, were used to reduce short-term indebtedness and augment working capital.

Cash generated by operations declined to $151 million in 1986 from $262 million in 1985 principally as the result of an increase in non-cash operating working capital. This was largely due to higher trade receivables resulting from increased business activity towards the end of the year and a reduction in accounts and taxes payable.

The Company's net cash position, consisting of cash and short-term investments less bank loans, decreased by $3 million during the year. The working capital ratio improved to 2.4:1 from 2:1 the preceding year. Also, partly because of the new common share issue during the year, long-term debt expressed as a percentage of debt plus shareholders' equity decreased to 27% from 32% at the end of 1985.

**J. Kenneth Stevens**
Senior Vice-President, Finance
*Responsible for all finance functions and investor relations.*

## Net Sales by Market

| (millions of dollars) | 1986 | 1985 |
|---|---|---|
| U.S.A. | $1,451.4 | $1,390.9 |
| Canada | 1,094.3 | 967.9 |
| Other | 217.8 | 191.0 |
| | $2,763.5 | $2,549.8 |

## Net Sales by Quarter

| (millions of dollars) | 1986 | 1985 |
|---|---|---|
| 1st Quarter | $ 647.4 | $ 581.4 |
| 2nd Quarter | 701.7 | 662.4 |
| 3rd Quarter | 716.5 | 633.5 |
| 4th Quarter | 697.9 | 672.5 |
| | $2,763.5 | $2,549.8 |

## Earnings before Extraordinary Items by Quarter

| | 1986 | | 1985 | |
|---|---|---|---|---|
| | $ millions | Per share | $ millions | Per share |
| 1st Quarter | $ 21.7* | $ .30* | $ 23.7 | $ .34 |
| 2nd Quarter | 28.5* | .39* | 21.3 | .29 |
| 3rd Quarter | 31.1 | .42 | 25.4 | .36 |
| 4th Quarter | 28.8 | .39 | 29.8 | .43 |
| | $110.1 | $1.50 | $100.2 | $1.42 |

*Earnings for the first two quarters of 1986 have been restated to reflect the adoption in the third quarter, with effect from the beginning of the year, of the new standard of The Canadian Institute of Chartered Accountants with respect to accounting for pension costs, as referred to in Note 2 to the financial statements.

# Consolidated Earnings

| Year ended December 31<br>(millions of dollars) | 1986 | 1985 |
|---|---|---|
| Net sales | $2,763.5 | $2,549.8 |
| Cost of sales | 2,226.0 | 2,075.3 |
| Selling and administrative expenses | 203.1 | 188.4 |
| Depreciation and depletion | 88.7 | 82.1 |
| | 2,517.8 | 2,345.8 |
| Operating profit | 245.7 | 204.0 |
| Interest expense—long-term (note 9) | (35.1) | (43.6) |
| —short-term | (2.0) | (3.0) |
| Other income and expense (note 4) | 4.0 | 20.0 |
| | 212.6 | 177.4 |
| Income taxes (note 5) | 91.9 | 69.4 |
| | 120.7 | 108.0 |
| Minority interest | 10.6 | 7.8 |
| Earnings before extraordinary items | 110.1 | 100.2 |
| Extraordinary items (note 6) | (2.8) | — |
| Net earnings | $ 107.3 | $ 100.2 |
| Per Common Share (note 10): | | |
| Earnings before extraordinary items | $ 1.50 | $ 1.42 |
| Net earnings | 1.46 | 1.42 |

# Consolidated Retained Earnings

| Year ended December 31<br>(millions of dollars) | 1986 | 1985 |
|---|---|---|
| Retained earnings at beginning of year | $ 715.2 | $ 671.3 |
| Net earnings | 107.3 | 100.2 |
| | 822.5 | 771.5 |
| Expenses of common share issue, net of income taxes of $2.9 million | (3.4) | — |
| Dividends declared— | | |
| Preferred shares | (8.7) | (9.3) |
| Common shares | (41.5) | (47.0) |
| Retained earnings at end of year | $ 768.9 | $ 715.2 |

# Changes in Consolidated Cash Position

| Year ended December 31 (millions of dollars) | 1986 | 1985 |
|---|---|---|
| **Operating Activities** | | |
| Earnings before extraordinary items | $ 110.1 | $ 100.2 |
| Depreciation and depletion | 88.7 | 82.1 |
| Deferred pension cost | (16.6) | — |
| Deferred income taxes | 37.4 | 24.8 |
| Minority interest | 10.6 | 7.8 |
| Other | (1.7) | 4.6 |
| | 228.5 | 219.5 |
| Change in operating working capital (note 7) | (77.7) | 42.9 |
| | 150.8 | 262.4 |
| **Financing Activities** | | |
| Issue of common shares, after expenses net of income taxes | 134.1 | 0.8 |
| Net decrease in long-term debt | (17.2) | (1.7) |
| Repayment of note payable | (14.4) | — |
| Retirement of preferred shares | (1.3) | (22.4) |
| Other | 0.1 | 0.4 |
| | 101.3 | (22.9) |
| **Investment Activities** | | |
| Additions to fixed assets | (263.0) | (202.4) |
| Government capital grants and investment tax credits | 32.8 | 28.6 |
| Disposals of fixed assets | 4.7 | 5.6 |
| Decrease (increase) in long-term receivables | 8.1 | (8.9) |
| Sale of kraft pulp operation, less note receivable of $15.0 million | 30.1 | — |
| Contribution to newsprint joint venture | — | (12.2) |
| Acquisition of subsidiary companies | (9.4) | (29.7) |
| Other | (1.9) | 3.5 |
| | (198.6) | (215.5) |
| **Dividends Paid** | | |
| Preferred shareholders | (8.7) | (9.4) |
| Common shareholders | (40.8) | (37.3) |
| Minority shareholder of a subsidiary company | (6.6) | — |
| | (56.1) | (46.7) |
| **Cash—Decrease** | (2.6) | (22.7) |
| **—Beginning of year** | 14.4 | 37.1 |
| **—End of year** | $ 11.8 | $ 14.4 |

Cash comprises cash and short-term investments, less bank loans.

# Consolidated Balance Sheet

| December 31<br>(millions of dollars) | 1986 | 1985 |
|---|---|---|
| **Assets** | | |
| **Current assets** | | |
| Cash and short-term investments | $ 17.1 | $ 31.3 |
| Accounts receivable | 398.5 | 354.3 |
| Inventories (note 8) | 357.5 | 353.4 |
| Prepaid expenses | 14.3 | 9.2 |
| | 787.4 | 748.2 |
| **Fixed assets** | | |
| Property, plant and equipment | 1,879.9 | 1,742.6 |
| Logging equipment and development | 88.5 | 88.7 |
| Timber limits and water power rights | 26.6 | 30.2 |
| | 1,995.0 | 1,861.5 |
| Less—accumulated depreciation and depletion | 762.4 | 729.5 |
| | 1,232.6 | 1,132.0 |
| **Other assets** | | |
| Equity interests in joint ventures— | | |
| Newsprint (note 3) | 53.1 | 51.3 |
| Mining | 6.8 | 6.5 |
| Deferred pension cost | 19.1 | — |
| Long-term receivables and other assets | 54.1 | 47.3 |
| Goodwill | 23.5 | 23.9 |
| Unrealized loss on translation of long-term debt payable in U.S. funds (note 1(b)) | 61.3 | 67.1 |
| | 217.9 | 196.1 |
| | $2,237.9 | $2,076.3 |

The financial statements have been approved by the Board:

Director

Director

| | 1986 | 1985 |
|---|---|---|
| **Liabilities** | | |
| **Current liabilities** | | |
| Bank loans | $ 5.3 | $ 16.9 |
| Accounts payable and accrued liabilities | 288.6 | 309.2 |
| Income and other taxes payable | 5.0 | 20.0 |
| Dividends payable | 11.6 | 10.9 |
| Long-term debt due within one year (note 9) | 17.9 | 3.8 |
| Note payable | — | 14.4 |
| | 328.4 | 375.2 |
| **Deferred income taxes** | 273.5 | 236.9 |
| **Long-term debt** (note 9) | 428.9 | 455.7 |
| **Minority interest** | 36.9 | 26.3 |
| **Shareholders' Equity** | | |
| **Stated capital** (note 10) | | |
| Preferred Shares— | | |
| Series A—135,200 shares (1985—137,100 shares) | 6.8 | 6.8 |
| Series C—1,500,000 shares | 75.0 | 75.0 |
| Series F—3,565,844 shares (1985—3,680,393 shares) | 41.0 | 42.3 |
| Common Shares—69,211,114 shares (1985—64,200,874 shares) | 259.8 | 122.2 |
| **Retained earnings** | 768.9 | 715.2 |
| **Deferred foreign currency translation gain** (note 1(b)) | 18.7 | 20.7 |
| | 1,170.2 | 982.2 |
| | $2,237.9 | $2,076.3 |

# Segmented Information

(millions of dollars)

| Business Segments | Printing Papers | | Converted Products and Distribution | |
|---|---|---|---|---|
| | 1986 | 1985 | 1986 | 1985 |
| Net Sales | | | | |
| Newsprint | $1,094.9 | $1,040.8 | $ | $ |
| Groundwood papers | 265.9 | 262.2 | | |
| Coated papers | 147.6 | 137.1 | | |
| Converted products and distribution | | | 938.4 | 792.1 |
| Building products | | | | |
| Lumber | | | | |
| Other | 48.7 | 55.1 | | |
| Total | $1,557.1 | $1,495.2 | $ 938.4 | $ 792.1 |
| Operating profit before depreciation and depletion | $ 271.7 | $ 222.4 | $ 39.3 | $ 38.7 |
| Depreciation and depletion | (70.9) | (65.3) | (6.7) | (5.4) |
| Operating profit | $ 200.8 | $ 157.1 | $ 32.6 | $ 33.3 |
| Total assets—identifiable | $1,553.9 | $1,402.5 | $ 291.7 | $ 272.2 |
| —general | | | | |
| —total | | | | |
| Additions to fixed assets | | | | |
| —identifiable | $ 240.7 | $ 178.0 | $ 9.3 | $ 6.2 |
| —general | | | | |
| —total | | | | |

| Geographic Segments | Canada | |
|---|---|---|
| | 1986 | 1985 |
| Net sales | $2,153.1 | $1,986.4 |
| Operating profit | $ 234.2 | $ 189.1 |
| Total assets—identifiable | $1,763.8 | $1,626.8 |
| —general | | |
| —total | | |

Notes: (1) Geographic segments reflect the location of the Company's production facilities.

(2) Canadian operations include sales to the U.S. market of $847.7 million (1985—$830.7 million) and other export sales of $217.2 million (1985—$189.9 million).

| Building Products and Lumber | | Inter-Segment Sales | | Consolidated | |
|---|---|---|---|---|---|
| 1986 | 1985 | 1986 | 1985 | 1986 | 1985 |
| $ | $ | $ (1.2) | $ (1.5) | $1,093.7 | $1,039.3 |
| | | (0.2) | | 265.7 | 262.2 |
| | | (28.5) | (24.2) | 119.1 | 112.9 |
| | | (5.3) | (6.4) | 933.1 | 785.7 |
| 188.0 | 192.6 | | | 188.0 | 192.6 |
| 117.3 | 108.3 | | | 117.3 | 108.3 |
| | | (2.1) | (6.3) | 46.6 | 48.8 |
| $ 305.3 | $ 300.9 | $ (37.3) | $ (38.4) | $2,763.5 | $2,549.8 |
| $ 23.4 | $ 25.0 | | | $ 334.4 | $ 286.1 |
| (11.1) | (11.4) | | | (88.7) | (82.1) |
| $ 12.3 | $ 13.6 | | | $ 245.7 | $ 204.0 |
| $ 217.1 | $ 222.7 | | | $2,062.7 | $1,897.4 |
| | | | | 175.2 | 178.9 |
| | | | | $2,237.9 | $2,076.3 |
| $ 11.9 | $ 17.0 | | | $ 261.9 | $ 201.2 |
| | | | | 1.1 | 1.2 |
| | | | | $ 263.0 | $ 202.4 |

| U.S.A. | | Consolidated | |
|---|---|---|---|
| 1986 | 1985 | 1986 | 1985 |
| $ 610.4 | $ 563.4 | $2,763.5 | $2,549.8 |
| $ 11.5 | $ 14.9 | $ 245.7 | $ 204.0 |
| $ 298.9 | $ 270.6 | $2,062.7 | $1,897.4 |
| | | 175.2 | 178.9 |
| | | $2,237.9 | $2,076.3 |

(3) Operating profits of the various business segments for the year 1986 have been increased as follows as a result of the change in accounting policy for pension costs referred to in note 2 to the financial statements: Printing Papers—$26.2 million, Converted Products and Distribution—$1.6 million and Building Products and Lumber—$0.7 million.

## 1. Summary of significant accounting policies

### (a) Principles of consolidation
The financial statements consolidate the accounts of Abitibi-Price Inc. and all companies in which it holds more than a 50% interest. Investments in joint ventures are included in the financial statements in accordance with the equity method of accounting.

Goodwill, which represents the excess of the cost of shares of acquired companies over the values attributed to underlying net assets, is amortized over periods not exceeding 40 years.

### (b) Translation of foreign currencies
The assets and liabilities of self-sustaining foreign subsidiaries and affiliates are translated to Canadian funds at year-end exchange rates and the resulting unrealized exchange gains or losses are deferred in shareholders' equity. The earnings statements of such operations are translated at exchange rates prevailing during the year.

Monetary assets and liabilities of domestic companies and integrated foreign subsidiaries which are denominated in foreign funds are translated to Canadian funds at year-end exchange rates, non-monetary assets are translated at historical rates, and transactions included in earnings are translated at rates prevailing during the year with the exception of depreciation which is translated at historical rates. Exchange gains or losses are included in earnings with the exception of unrealized gains or losses arising on the translation of long-term debt payable in U.S. funds which are deferred and are hedged by an income stream denominated in U.S. funds.

### (c) Inventories
Inventories of finished products, work in process and materials and operating supplies are valued at the lower of average cost and net realizable value. Inventories of pulpwood and sawlogs are valued at average cost.

### (d) Fixed assets and depreciation
Fixed assets are recorded at cost, which includes capitalized interest and preproduction and start-up costs. Investment tax credits and grants received under government programs relating to capital expenditures are credited to fixed assets.

Depreciation is provided at rates considered adequate to amortize the cost over the productive lives of the assets. The principal asset category is primary production equipment which is depreciated over 20 years on a straight-line basis.

### (e) Pension costs
The Company's pension plans, covering most employees, are principally contributory plans that provide benefits based on length of service and final average earnings. The Company has an obligation to ensure that there are sufficient funds in the plans to pay the benefits earned.

Earnings are charged with the cost of benefits earned by employees as services are rendered. The cost reflects management's best estimates of the pension plans' expected investment yields, wage and salary escalation, mortality of members, terminations and the ages at which members will retire. Adjustments arising from pension plan amendments, experience gains and losses and changes in assumptions are amortized to earnings over the estimated average remaining service lives of the members.

The difference between amounts included in earnings and Company contributions to the pension plans appears on the balance sheet as deferred pension cost.

### (f) Income taxes
Earnings are charged with income taxes relating to reported profits. Differences between such taxes and taxes currently payable, which result from timing differences between the recognition of income and expenses for accounting and for tax purposes, are reflected as deferred income taxes in the financial statements.

## 2. Change in accounting for pension costs

Earnings for 1986 reflect the adoption, on a prospective basis, of the new standard of The Canadian Institute of Chartered Accountants with respect to accounting for pension costs and obligations, as described in note 1(e). Previously, current service pension costs were charged to earnings and funded as they accrued and past service costs were charged to earnings and funded over periods not longer than those permitted by the various regulatory bodies.

As a result of this change, net earnings for 1986 have been increased by approximately $17 million or $0.25 per common share.

## 3. Newsprint joint venture

The Company's 50% share of the earnings (loss) and net assets of the joint venture newsprint operation at Augusta, Georgia, is as follows:

| | 1986 | 1985 |
|---|---|---|
| | ($ millions) | |
| Revenue | **$105.1** | $ 95.5 |
| Expenses | **102.4** | 98.6 |
| Earnings (loss) | **$ 2.7** | $ (3.1) |
| Assets | **$215.1** | $219.7 |
| Liabilities | **162.0** | 168.4 |
| Net assets | **$ 53.1** | $ 51.3 |

The Company's share of the joint venture's earnings (loss) is included in cost of sales.

Liabilities, which are without recourse to the Company or its co-venturer, include $150.9 million (1985—$157.8 million) of long-term borrowings.

Under a marketing agreement, the joint venture's newsprint production is sold through a wholly-owned sales subsidiary of Abitibi-Price Inc.

## 4. Foreign exchange

Other income and expense includes a foreign exchange loss of $4.5 million in 1986 (1985—$7.5 million gain).

## 5. Income taxes

| The Company's effective income tax rate is as follows: | 1986 | 1985 |
|---|---|---|
| | ($ millions) | |
| Earnings before income taxes, minority interest and extraordinary items | **$212.6** | $177.4 |
| Income taxes | **91.9** | 69.4 |
| Effective income tax rate | **43.2%** | 39.1% |
| Made up of: | | |
| Combined basic Canadian federal/provincial income tax rates | **47.3%** | 46.0% |
| Increase (decrease) resulting from— | | |
| Manufacturing and processing allowances | **(4.2)** | (4.0) |
| Inventory allowances | **(0.3)** | (1.6) |
| Capital gains and other reduced rate transactions | **(1.6)** | (2.6) |
| Other | **2.0** | 1.3 |
| Effective income tax rate | **43.2%** | 39.1% |

## 6. Extraordinary items

| | 1986 | 1985 |
|---|---|---|
| | ($ millions) | |
| Net gain on sale of kraft pulp operation at Smooth Rock Falls, Ont., after income taxes of $2.3 million | $ 0.8 | $ — |
| Net loss on closure of sawmill at Falardeau, Que., after income tax credit of $2.1 million | (3.6) | — |
| | $ (2.8) | $ — |

## 7. Change in operating working capital

| Cash provided by (used for) changes in operating working capital components: | 1986 | 1985 |
|---|---|---|
| | ($ millions) | |
| (Increase) decrease in current assets: | | |
| Accounts receivable | $(44.2) | $(62.0) |
| Inventories | (4.1) | (26.6) |
| Prepaid expenses | (5.1) | (2.5) |
| Increase (decrease) in current liabilities: | | |
| Accounts payable and accrued liabilities, excluding dividend payable to a minority shareholder of a subsidiary company | (14.0) | 68.2 |
| Income and other taxes payable | (15.0) | 7.0 |
| | (82.4) | (15.9) |
| Operating working capital included in sale of kraft pulp operation | (9.3) | — |
| Operating working capital acquired with purchase of subsidiary companies | 14.0 | 58.8 |
| Change in operating working capital | $(77.7) | $ 42.9 |

## 8. Inventories

| | 1986 | 1985 |
|---|---|---|
| | ($ millions) | |
| Finished products and work in process | $179.6 | $164.1 |
| Pulpwood, sawlogs and expenditures on current logging operations | 110.5 | 126.4 |
| Materials and operating supplies | 67.4 | 62.9 |
| | $357.5 | $353.4 |

## 9. Long-term debt

| | 1986 | 1985 |
|---|---|---|
| | ($ millions) | |
| Abitibi-Price Inc.: | | |
| Sinking Fund Debentures (secured)– | | |
| 7¼% Series B, maturing 1987 | **$ 4.5** | $ 5.3 |
| 9¾% Series D, maturing 1990 | **6.8** | 7.5 |
| 11% Series F, maturing 1995 | **10.0** | 10.9 |
| 11⅜% Series G, maturing 1995 (U.S. $32 million) | **44.2** | 55.9 |
| 10.15% Series H, maturing 2000 (U.S. $126.3 million) | **174.4** | 188.8 |
| 15¾% Debentures Series I, maturing 1991 (secured) (U.S. $50 million) | **69.0** | 69.9 |
| Abitibi-Price Refinance Inc.: | | |
| Floating Rate Cumulative/Term Loan, maturing 1993 (U.S. $67.5 million) (a) | **93.1** | 67.2 |
| The Price Company Limited: | | |
| 6¾% Sinking Fund Debentures Series B, maturing 1987 | **7.9** | 8.6 |
| Gaspesia Pulp and Paper Company Ltd.: | | |
| Floating Rate Revolving Loan, maturing 1993 (b) | **—** | 15.3 |
| Abitibi-Price Corporation: | | |
| 7⅜% Instalment Notes, maturing 1988 (U.S. $4 million) (c) | **5.5** | 7.0 |
| Barbecon Inc.: | | |
| Bank Loans, maturing 1987 and 1991 (d) | **11.5** | 11.5 |
| Other indebtedness | **19.9** | 11.6 |
| | **446.8** | 459.5 |
| Less: Amount due within one year, less amounts to be refinanced | **17.9** | 3.8 |
| | **$428.9** | $455.7 |

(a) Abitibi-Price Refinance Inc. may borrow from certain banks up to U.S. $103 million, or its Canadian funds equivalent, to December 31, 1987 to refinance long-term debt repayment obligations of Abitibi-Price Inc. The balance of the loan at that date is to be repaid by December 31, 1993. Interest is at rates approximating U.S. base rate, U.S. dollar bankers' acceptances or LIBOR for U.S. funds borrowings and at rates approximating Euro-Canadian rate or Canadian bank prime for Canadian funds borrowings. The loan is secured by an Abitibi-Price Inc. Series K Debenture (secured).

(b) Gaspesia Pulp and Paper Company Ltd. may borrow from a bank on a revolving basis up to U.S. $25 million to September 19, 1993, with the balance of the loan becoming due on that date. Interest is at rates approximating U.S. prime, U.S. dollar bankers' acceptances or LIBOR.

(c) Abitibi-Price Corporation's 7⅜% Instalment Notes are secured by Abitibi-Price Inc. 7⅜% Series C Debentures (secured).

(d) Of Barbecon Inc.'s bank loans, $7 million bears interest at 13¾% and matures in 1987. The balance, consisting of a floating rate term loan, bears interest at rates approximating bank prime.

Sinking fund and other long-term debt repayment obligations for the years 1988 to 1991 are estimated to be $28.6 million, $24.7 million, $26.7 million and $90.2 million, respectively.

All outstanding debentures are currently redeemable at the option of the Company, with the exception of the 15¾% Debentures Series I which will become redeemable after December 15, 1988.

At December 31, 1986, the Company had $178 million in unused bank lines of credit. Any borrowings under these lines of credit would bear interest at the prevailing market rates.

During the year ended December 31, 1986, interest of $12.5 million has been capitalized on major capital additions (1985-$5.9 million).

## 10. Stated capital

The Company is governed by the Canada Business Corporations Act and is authorized to issue an unlimited number of preferred shares, common shares and Class A shares.

| Common Shares and Class A Shares— | 1986 Number of common shares | 1986 $ millions | 1985 Number of common shares | 1985 $ millions |
|---|---|---|---|---|
| Outstanding at beginning of year | **64,200,874** | **$122.2** | 63,930,387 | $121.3 |
| Issued under— | | | | |
| Public offering | **5,000,000** | **137.5** | — | — |
| Terms of the Key Employees' Stock Option Plan | **10,240** | **0.1** | 262,332 | 0.8 |
| Stock dividend elections by common shareholders | — | — | 8,155 | 0.1 |
| Outstanding at end of year | **69,211,114** | **$259.8** | 64,200,874 | $122.2 |

On April 2, 1986, the Company issued 5 million common shares and 2½ million common share purchase warrants in units consisting of one share and one-half of a warrant at a price of $27.50 per unit. Each whole warrant entitles the holder to purchase, on or prior to June 15, 1990, one common share for $30. Although no warrants were exercised during the year, had the warrants been exercised it would not have had a dilutive effect on earnings or book value per common share.

No Class A Shares are outstanding.

**7½% Cumulative Redeemable Preferred Shares Series A—**
The Series A shares, which were issued at $50 per share, are redeemable at $51 per share. During 1986, 1,900 shares with a book value of $0.1 million were purchased at a cost of $0.1 million and cancelled (1985—7,200 shares with a book value of $0.4 million at a cost of $0.3 million).

**Floating Rate Preferred Shares Series C—**
The Series C shares, which were issued at $50 per share, are redeemable by the Company at $50 per share and are retractable at the option of the shareholders at $50 per share on January 1, 1990. Dividends are payable at a floating rate of one-half the average prime rate of the five largest Canadian chartered banks plus 1%, with a maximum dividend rate of 9% per annum.

**$0.94 Cumulative Redeemable Retractable Preferred Shares Series F—**
The Series F shares, which were issued at $11.50 per share, are redeemable by the Company in whole or in part at $12.00 per share to December 31, 1987 and thereafter at prices declining to $11.50 per share on January 1, 1990. The shares are retractable at $11.50 per share at the option of the holder on January 1 in each year. In 1986, 114,549 shares were retracted at $11.50 per share.

## 11. Lease commitments

The Company and its subsidiaries have entered into operating leases to charter ships and to lease equipment and property for various periods up to the year 2004 at rentals aggregating approximately $129.6 million. Minimum payments under these leases are as follows:

| | ($ millions) |
|---|---|
| 1987 | $ 24.0 |
| 1988 | 23.4 |
| 1989 | 14.8 |
| 1990 | 10.5 |
| 1991 | 9.4 |
| Remaining years | 47.5 |
| | $129.6 |

## 12. Pension plans

Accumulated pension plan benefits and assets were as follows at December 31, 1986:

| | ($ millions) |
|---|---|
| Actuarial present value of accumulated plan benefits based on projected service and compensation levels | |
| Vested | $521.6 |
| Non-vested | 33.4 |
| | $555.0 |
| Market value of assets available for benefits | $731.9 |

# Auditors' Report

## To the Shareholders of Abitibi-Price Inc.:

We have examined the consolidated balance sheet of Abitibi-Price Inc. as at December 31, 1986 and the consolidated statements of earnings, retained earnings and changes in cash position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procednres as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of Abitibi-Price Inc. as at December 31, 1986 and the results of its operations and changes in its cash position for the year then ended in accordance with generally accepted accounting principles applied, except for the change, with which we concur, in the method of accounting for pension costs as referred to in Note 2 to the consolidated financial statements, on a basis consistent with that of the preceding year.

Price Waterhouse

Chartered Accountants
Toronto, February 13, 1987

# Directors

Marcel Bélanger, O.C. (2)
President
Gagnon et Bélanger Inc.
Quebec, Quebec

Howard W. Blauvelt (3, 4)
Director
Charlottesville, Virginia

Robert J. Butler (5)
Business Consultant and Chairman
Urban Transportation Development
Corporation Ltd.
Toronto, Ontario

Marshall A. Cohen, Q.C. (1, 3, 4)
President
Olympia & York Enterprises Limited
Toronto, Ontario

Lionel G. Dodd (2)
Senior Vice-President and Chief Financial Officer
Gulf Canada Corporation
Toronto, Ontario

Robert C. Gimlin (1, 4, 5)
Chairman
Abitibi-Price Inc.
Toronto, Ontario

Bernd K. Koken (1, 3, 4)
President and Chief Executive Officer
Abitibi-Price Inc.
Toronto, Ontario

S. Keith McWalter (1, 4)
President and Chief Executive Officer
Gulf Canada Resources, a division of
Gulf Canada Corporation
Calgary, Alberta

C. Edward Medland (2, 3)
Chairman and Chief Executive Officer
Wood Gundy Inc.
Toronto, Ontario

Gilbert I. Newman (1, 2, 4, 5)
Executive Vice-President
Olympia & York Developments Limited
Toronto, Ontario

Albert Reichmann (1, 3, 4)
President
Olympia & York Developments Limited
Toronto, Ontario

Paul Reichmann (1, 4)
Senior Executive Vice-President and Secretary
Olympia & York Developments Limited
Toronto, Ontario

Ralph Reichmann
Executive Vice-President and Treasurer
Olympia & York Developments Limited
Toronto, Ontario

Francis J. Ryan, Q.C. (2)
Partner
Stirling, Ryan
St. John's, Newfoundland

Kenneth R. Thomson
Chairman, President and Chief Executive Officer
Thomson Newspapers Limited
Toronto, Ontario

John A. Tory, Q.C. (1, 3)
President
The Thomson Corporation Limited
Toronto, Ontario

Paul-Gaston Tremblay, C.M. (2, 5)
President
Primo-Gestion Inc.
Chicoutimi, Quebec

David A. Ward, Q.C.
Partner
Davies, Ward & Beck
Toronto, Ontario

Honorary Director
General Lauris Norstad
D.S.M., Silver Star, C.B.E.

(1) Executive Committee
(2) Audit Committee
(3) Human Resources and Compensation Committee
(4) Planning Committee
(5) Pension Fund Committee

# Officers

**Chairman**
Robert C. Gimlin

**President and Chief Executive Officer**
Bernd K. Koken

**Group Vice-Presidents**
John G. Davis
K. Linn Macdonald
J. Ian McGibbon
Ronald Y. Oberlander

**Senior Vice-Presidents**
T. Newman McLenaghen
Capital Projects

J. Kenneth Stevens
Finance

**Vice-Presidents**
J. Fitzgerald Allison
Industrial Relations

T. Maitland Devine
Operations (Region III)

William W. Hall
Corporate Marketing and Development

William J. Johnston
Operations (Region II)

J. Gordon Maw
Treasurer

M. Thomas Neill
Research and Development

James B. Papoe
Operations (Region I)

Sharon A. Paul
Corporate and Public Affairs

Michael D. Thompson
General Counsel and Secretary

H. Colin Warner
Controller

J.A. Warner Woodley

**Other Officers**
Douglas J. Butler
Assistant Secretary

Bernard Conway
Assistant Treasurer

Robert A. Cook
Assistant Treasurer

Jean E. Gebbie
Assistant Secretary

Donald J. McMullan
Assistant Treasurer

**Principal Divisions and Subsidiaries**

*CORE PAPER GROUP (Sales Divisions)*
*Abitibi-Price Sales Corporation*
George R. Arellano
President
Commercial Division

G. Bart DeLashmet
Executive Vice-President
North American Publisher Division

Edmund W.E. Hughes
Vice-President & General Sales Manager
North American Publisher Division (Area 1)

David L. Loretto
Executive Vice-President
International Division

C. Donald Martin
Vice-President & General Sales Manager
North American Publisher Division (Area 2)

*DIVERSIFIED GROUP*
Jeffrey Chipman
President and Chief Executive Officer
Inter City Papers Limited

J. Raymond Langevin
Vice-President
Diversified Group

Bruce J. McGroarty
President
Abitibi-Price Corporation

James G. Westaway
President
Barbecon Inc.

# Six-year Financial Review

| | 1986 | 1985 | 1984 | 1983 | 1982 | 1981 |
|---|---|---|---|---|---|---|
| **Sales and earnings** ($ millions) | | | | | | |
| Net sales | $2,763.5 | $2,549.8 | $2,137.2 | $1,660.2 | $1,634.3 | $1,763.4 |
| Cost of sales | 2,226.0 | 2,075.3 | 1,794.0 | 1,439.7 | 1,352.4 | 1,356.3 |
| Selling and administrative expenses | 203.1 | 188.4 | 132.9 | 114.8 | 121.8 | 117.8 |
| Depreciation and depletion | 88.7 | 82.1 | 76.8 | 68.6 | 70.1 | 61.7 |
| Interest expense—long-term | 35.1 | 43.6 | 40.4 | 18.9 | 25.2 | 28.2 |
| —short-term | 2.0 | 3.0 | 1.2 | 0.8 | 1.4 | — |
| Other income and expense | 4.0 | 20.0 | 19.0 | 25.0 | 29.0 | 19.0 |
| Income taxes | 91.9 | 69.1 | 30.2 | 0.7 | 22.4 | 87.2 |
| Minority interest | 10.6 | 7.8 | 8.4 | 3.7 | 6.1 | 7.8 |
| Earnings before extraordinary items | 110.1 | 100.2 | 72.3 | 38.0 | 63.9 | 123.4 |
| Extraordinary items | (2.8) | — | (2.2) | — | (2.6) | 12.3 |
| Net earnings | 107.3 | 100.2 | 70.1 | 38.0 | 61.3 | 135.7 |
| **Dividends declared** ($ millions) | | | | | | |
| Preferred shares | $ 8.7 | $ 9.3 | $ 8.0 | $ 7.4 | $ 10.8 | $ 10.0 |
| Common shares (2) | 41.5 | 47.0 | 25.0 | 12.1 | 31.1 | 33.1 |
| **Capital expenditures** ($ millions) | $ 263.0 | $ 202.4 | $ 126.3 | $ 165.3 | $ 187.9 | $ 207.0 |
| **Financial position** ($ millions) | | | | | | |
| Working capital | $ 459.0 | $ 373.0 | $ 409.5 | $ 384.2 | $ 437.3 | $ 461.1 |
| Fixed assets, net | 1,232.6 | 1,132.0 | 1,010.3 | 993.6 | 917.9 | 837.1 |
| Long-term debt | 428.9 | 455.7 | 419.9 | 395.1 | 385.8 | 388.9 |
| Deferred income taxes | 273.5 | 236.9 | 209.3 | 191.8 | 187.6 | 174.7 |
| Minority interest | 36.9 | 26.3 | 25.1 | 19.5 | 19.5 | 16.6 |
| Preferred shares | 122.8 | 124.1 | 104.2 | 113.8 | 122.7 | 130.8 |
| Common shareholders' equity | 1,047.4 | 858.1 | 805.7 | 747.7 | 721.1 | 701.5 |
| **Per common share** (1) | | | | | | |
| Earnings before extraordinary items | $ 1.50 | $ 1.42 | $ 1.02 | $ .48 | $ .87 | $ 1.85 |
| Net earnings | 1.46 | 1.42 | .99 | .48 | .82 | 2.05 |
| Dividends declared (2) | .60 | .73 | .40 | .20 | .50 | .53 |
| Dividends paid (2) | .60 | .58 | .40 | .30 | .50 | .53 |
| Common shareholders' equity | 15.13 | 13.37 | 12.60 | 12.02 | 11.60 | 11.29 |
| Return on average common shareholders' equity | 10.7% | 10.9% | 8.3% | 4.1% | 7.6% | 18.0% |
| Long-term debt/debt plus shareholders' equity | 26.8% | 31.7% | 31.6% | 31.4% | 31.4% | 31.8% |
| Number of employees (year end) | 16,200 | 15,500 | 14,800 | 15,100 | 14,600 | 17,800 |

Notes: (1) Figures for the years 1981 to 1984 have been restated to reflect the 3-for-1 split of common shares which became effective May 1, 1985.
(2) Four quarterly dividends were paid in each of the years 1981 to 1986, but because of changes in dividend declaration dates, three dividends were declared in 1983 and five in 1985.

# Primary Production

| (figures in thousands) | Newsprint* (tonnes) | Groundwood Papers (tonnes) | Kraft Products (tonnes) | Lumber (mfbm) | Coated Papers (tonnes) | Hardboard (msf-equivalent) |
|---|---|---|---|---|---|---|
| Production | | | | | | |
| 1981 | 1,788 | 308 | 188 | 291 | 154 | 878 |
| 1982 | 1,512 | 321 | 173 | 140 | 101 | 942 |
| 1983 | 1,461 | 321 | 173 | 181 | 114 | 1,113 |
| 1984 | 1,721 | 374 | 115 | 181 | 121 | 1,111 |
| 1985 | 1,699 | 349 | 105 | 103 | 126 | 1,155 |
| **1986** | **1,798** | **350** | **87** | **83** | **132** | **1,058** |
| Capacity—1987 | 1,921 | 374 | — | 107 | 136 | 1,267 |

*Newsprint figures include the total production of the 50%-owned joint venture at Augusta, Georgia, but exclude tonnage made available under an exclusive marketing agreement during the years following the sale of the Company's 50% interest in a newsprint machine at DeRidder, Louisiana, at the end of 1980.

### Annual general meeting

The annual meeting of shareholders of Abitibi-Price Inc. will be held at the Metro Toronto Convention Centre, Lower Level, Reception Hall, 255 Front Street West, Toronto, Canada, on Monday, April 27, 1987 at 11:00 a.m.

### Common share information

Common shares of the Company are listed on the Montreal, Toronto and Vancouver stock exchanges and traded under the ticker symbol A.

Valuation Day (December 22, 1971) share prices:

| | |
|---|---|
| Common | $ 7.25 |
| 7½% Cumulative redeemable preferred, Series A | $49.50 |

The Valuation Day common share price does not reflect the 3-for-1 split which was effective May 1, 1985.

### Transfer agents and registrars

Montreal Trust Company
Toronto, Montreal, Vancouver, Calgary, Regina, Winnipeg and Halifax, Canada

National Bank of Detroit
Detroit, U.S.A.

### Auditors

Price Waterhouse
Toronto, Canada

### Head office

Abitibi-Price Inc.
Toronto-Dominion Centre
Toronto, Canada M5K 1B3
Telephone (416) 369-6700

As of May 15, 1987, the Company's head office will be located at:

2 First Canadian Place
Toronto, Canada M5X 1A9

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