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D. A. STUART LTD.

formerly D. A. Stuart Oil Co., Limited



ANNUAL REPORT

1987

HOWARD ROSS LIBRARY OF MANAGEMENT

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Montreal, Quebec, Canada

1987 165

OCT 26 1987



D. A. STUART LTD.

DIRECTORS and OFFICERS

Directors

DOUGLAS F. HASLAM
FREDERICK W. HOHAGE
CHRISTOPHER T. LOUGHRIN
WILLIAM H. MANN
NORMAN J. MUNN, Q.C.
Dr. STEPHEN P. OGRYZLO
CHARLES E. SANTANGELO
Dr. HEYO SCHMIEDEKNECHT
HERIBERT WERHAHN

Officers of the Company

Chairman of the Board

HERIBERT WERHAHN

President

CHARLES E. SANTANGELO

Secretary and Vice President, Finance

DOUGLAS F. HASLAM

Transfer Agents and Registrars

NATIONAL TRUST COMPANY
4 King Street West
Toronto, Ontario M5H 3W7

General Office

7575 Plaza Court
Willowbrook, Illinois 60521

Head Office

43 Upton Road
Scarborough, Ontario, Canada M1L 2C1

The Annual Meeting of Shareholders will be held in the Library of the Royal York Hotel, Toronto, Canada, on Thursday, October 8, 1987 at 11 A.M. Toronto Time.

D. A. STUART LTD.

Serving the metal working industry for over 100 years



Report of the Directors

To the Shareholders:

Consolidated net sales for the year ended May 31, 1987 were U.S. \$42,796,666 versus U.S. \$45,364,676 for the prior year. Net income for the year was U.S. \$3,583,007 (\$7.85 per share) compared to U.S. \$1,875,610 (\$4.11 per share) for the previous year. The current year results include a gain on termination of a pension plan in the United States amounting to U.S. \$1,350,000 net of applicable income taxes. Also included is a foreign exchange gain of U.S. \$453,523 versus a gain of U.S. \$157,750 for the prior year.

A new pension plan similar in all aspects to the old plan has been established for the U.S. operation.

The decline in sales is attributable principally to lower sales by the U.S. operations. These lower sales are due, in a large part, to the strike experienced by a major customer and the decision by a large steel customer to manufacture their own products. Large export sales by both the U.S. and West German operations were responsible for the excellent results achieved during the fourth quarter. All other operations performed well.

On April 7, 1987 your company purchased the business of Torco USA Lubricants Corporation located in Los Angeles, California in order to strengthen its market position on the West Coast and to enhance its capability to export products to the Pacific Rim.

Torco USA Lubricants Corporation had sales of approximately U.S. \$4,000,000 in its last fiscal year in metal working lubricants, gear oils and specialty motor oils.

Due to certain changes in legislation and reporting requirements the Directors have decided to change the year end of the Company from May 31 to December 31 effective with the seven month period ending December 31, 1987.

Dr. Stephen P. Ogryzlo who has been a director of the Company since October 1970 will not be standing for re-election as a director. The Board of Directors wishes to acknowledge the many valuable contributions and wise counsel of Dr. Ogryzlo while a member of the Board.

The Management and Directors wish to express their appreciation to all employees for their achievements this year.

On behalf of the Board

HERIBERT WERHAHN
Chairman

C. E. SANTANGELO
President

Toronto, Canada
September 1, 1987

D. A. STUART LTD.*(Incorporated under the laws of Ontario)**(formerly D. A. Stuart Oil Co., Limited)***Consolidated***(Expressed in United States Dollars)***ASSETS**

	1987	May 31 1986
Current Assets		
Cash and short-term deposits	\$ 1,993,331	\$ 1,186,312
Accounts receivable	11,115,111	5,498,619
Inventories	6,758,307	6,510,584
Advances and prepaid expenses	186,451	177,218
	<u>20,053,200</u>	<u>13,372,733</u>
Property, Plant and Equipment		
Land, buildings and equipment	14,108,610	11,112,125
Less: accumulated depreciation	6,608,231	5,725,000
	<u>7,500,379</u>	<u>5,387,125</u>
Excess of Cost of Acquired Assets Over Values Assigned, less amortization	3,669,501	3,628,015
Other Assets	322,503	320,634
	<u>\$31,545,583</u>	<u>\$22,708,507</u>

Approved by the Board:

HERIBERT WERHAHN, Director

CHARLES E. SANTANGELO, Director

AUDITORS'To the Shareholders of
D. A. Stuart Ltd.

We have examined the consolidated balance sheet, expressed in United States currency, of D. A. Stuart Ltd. (formerly D. A. Stuart Oil Co., Limited) as at May 31, 1987 and the consolidated statements of income, retained earnings and changes in financial position, all expressed in United States currency, for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

July 17, 1987



Balance Sheet

(States currency)

LIABILITIES

	May 31	
	1987	1986
Current Liabilities		
Bank indebtedness	\$ 500,000	\$ —
Accounts payable and accrued liabilities	4,549,796	3,007,385
Income taxes payable (Note 7)	2,337,194	538,849
Current portion of long-term debt	2,610,283	31,936
Dividend payable	34,087	33,074
	<u>10,031,360</u>	<u>3,611,244</u>
Long-Term Debt (Note 3)	4,500,000	5,600,000
Deferred Income Taxes	688,580	666,481
Minority Interest	22,600	22,500

SHAREHOLDERS' EQUITY

Share capital:		
Authorized — 2,000,000 common shares no par value		
Issued — 456,256 common shares	424,608	424,608
Contributed surplus	11,880	11,880
Retained earnings (Note 8)	16,512,293	13,064,522
Equity adjustment arising from foreign currency translation	(645,738)	(692,728)
	<u>16,303,043</u>	<u>12,808,282</u>
	<u>\$31,545,583</u>	<u>\$22,708,507</u>

REPORT

In our opinion, these consolidated financial statements present fairly the financial position of the Company as at May 31, 1987 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Price Waterhouse
Chartered Accountants

D. A. STUART LTD.

Consolidated Statement of Income

(Expressed in United States currency)

	Year Ended May 31	
	1987	1986
Net sales	\$42,796,666	\$45,364,676
Royalties and other income	273,258	310,019
	<u>43,069,924</u>	<u>45,674,695</u>
Costs and expenses		
Cost of products sold	29,576,682	32,666,691
Selling and administrative expenses	9,933,403	9,371,532
Interest expense, including interest on long-term debt of \$511,286 (1986 — \$742,598)	529,854	761,731
Gain on foreign exchange	(453,523)	(157,750)
	<u>39,586,416</u>	<u>42,642,204</u>
Income before the undernoted items	3,483,508	3,032,491
Gain on termination of pension plan (Note 6)	2,700,000	—
Income before income taxes and extraordinary item	<u>6,183,508</u>	<u>3,032,491</u>
Income taxes:		
Current	1,192,748	1,179,627
Deferred	1,407,753	80,254
	<u>2,600,501</u>	<u>1,259,881</u>
Income Before Extraordinary Item	<u>3,583,007</u>	<u>1,772,610</u>
Extraordinary item:		
Income tax reduction realized on the carry-forward of prior years' losses	—	103,000
Net Income for the year	<u>\$ 3,583,007</u>	<u>\$ 1,875,610</u>
Per Common Share:		
Earnings before extraordinary item	<u>\$7.85</u>	<u>\$3.89</u>
Net Earnings	<u>\$7.85</u>	<u>\$4.11</u>

Consolidated Statement of Retained Earnings

(Expressed in United States currency)

	Year Ended May 31	
	1987	1986
Retained earnings, beginning of year	\$13,064,522	\$11,322,503
Net income for the year	3,583,007	1,875,610
	<u>16,647,529</u>	<u>13,198,113</u>
Dividends on minority interest	(1,353)	(1,350)
Dividends on common shares (Note 2)	(133,883)	(132,241)
Retained earnings, end of year	<u>\$16,512,293</u>	<u>\$13,064,522</u>



Consolidated Statement of Changes in Financial Position

(Expressed in United States currency)

	Year Ended May 31	
	1987	1986
Cash provided by operating activities		
Income before extraordinary item	\$ 3,583,007	\$ 1,772,610
Adjusted for non-cash items —		
Depreciation	722,034	586,282
Amortization of excess of cost of acquired assets over values assigned	108,514	109,002
Deferred income tax	22,009	84,087
Decrease in non-cash working capital	46,668	827,090
	<u>4,482,232</u>	<u>3,379,071</u>
Cash provided by (used in) investing activities		
Acquisition of business (Note 10)	(2,172,656)	—
Additions to property, plant and equipment	(666,393)	(448,237)
Other	(101,028)	111,866
	<u>(2,940,077)</u>	<u>(336,371)</u>
Cash provided by (used in) financing activities		
Proceeds on issue of long-term debt	2,000,000	—
Reduction in long-term debt	(3,100,000)	(1,540,331)
Dividends	(135,236)	(133,591)
Other	100	—
	<u>(1,235,136)</u>	<u>(1,673,922)</u>
Increase in cash and short-term deposits during the year	307,019	1,368,778
Cash and short-term deposits net of bank indebtedness, beginning of year	1,186,312	(182,466)
Cash and short-term deposits net of bank indebtedness, end of year	<u>\$ 1,493,331</u>	<u>\$ 1,186,312</u>

D. A. STUART LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in United States currency)

May 31, 1987

NOTE 1 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

General — The consolidated financial statements are presented in accordance with Canadian generally accepted accounting principles, which conform in all material respects with international accounting standards.

Principles of Consolidation — The accompanying consolidated financial statements include the accounts of D. A. Stuart Ltd. and its subsidiary companies, the common shares of which are all wholly owned.

Foreign Currency Translation — The Company operates principally in the United States and the accompanying financial statements are expressed in United States currency. Accounts maintained in other than United States currency have been translated on the following basis:

Revenues and expenses are translated at rates of exchange prevailing during the year. Assets and liabilities are translated at the exchange rate in effect at the balance sheet date. Unrealized gains and losses arising on translation of assets and liabilities are deferred except for gains and losses on intercompany trading balances which are included in income.

Realized gains or losses on translation of foreign currency accounts are recognized in income for the year in which they arise.

Inventories — Raw materials are valued at the lower of cost (first-in, first-out method) and replacement cost. Finished goods are valued at the lower of cost (first-in, first-out method) and net realizable value.

Property, Plant and Equipment — Property, plant and equipment are recorded at cost. Depreciation is recorded principally on the straight-line method at rates varying between 2½% and 25% which are based upon the estimated useful lives of the assets.

Excess of Cost of Assets Acquired Over Values Assigned — The excess is being amortized over 40 years on the straight-line method.

NOTE 2 — DIVIDENDS:

Dividends on common shares, as shown in the consolidated statement of retained earnings, represent the United States currency equivalent of dividends which were declared in Canadian funds (1987 and 1986 — \$0.40 Canadian per share).

NOTE 3 — LONG-TERM DEBT:

	1987	1986
Term loan (unsecured) dated June 30, 1983. The loan is repayable in principal amounts of \$500,000 on each of June 30, 1988, 1989, 1990, and 1991. The applicable interest rate on May 31, 1987 was 8.7868%	\$ 2,000,000	\$ 2,000,000
Revolving loan (unsecured), dated June 30, 1983. The loan is repayable at any time but not later than June 30, 1988. The interest rate on May 31, 1987 was 8.7868%	2,600,000	600,000
Interim financing note, payable to a related party. The note is subordinated to the loans dated June 30, 1983. If not retired earlier, it is repayable June 30, 1992. Interest is payable at the same rate as the loans dated June 30, 1983	2,500,000	3,000,000
8¾% mortgage bond secured by land and buildings of D. A. Stuart Oil GmbH. Repayment is made in quarterly instalments of 18,750 Deutsch Marks (\$10,283 U.S.)	10,283	31,936
	7,110,283	5,631,936
Less: Current portion	2,610,283	31,936
Long-term portion	\$ 4,500,000	\$ 5,600,000

The interest rate on the loans dated June 30, 1983 is 2% over the commercial paper rate of the lender. These loans have restrictive covenants as follows:

Except with the consent of the lender,

- the retirement of subordinated debt is not to exceed 35% of the consolidated net income of the Company in any year; and
- restricted payments (defined as cash dividends declared or paid by the Company subsequent to May 31, 1983, redemptions or purchase by the Company of any of its shares, and payments to retire subordinated debt) are not to exceed \$150,000 plus 35% of consolidated net income less the excess of any restricted payments over amounts received after May 31, 1983 through the issuance of additional shares by the Company.



NOTE 4 — SEGMENTED INFORMATION:

The Company's consolidated net sales, contribution to income and identifiable assets by principal geographic location of operations were as follows:

	1987	1986
Net sales:		
Canada	\$ 5,250,939	\$ 5,395,576
United States	30,660,761	33,011,060
Europe	7,240,775	7,246,806
	43,152,475	45,653,442
Inter-area eliminations	(355,809)	(288,766)
Net Sales	\$42,796,666	\$45,364,676
Export Sales (included above)	\$ 6,614,318	\$ 7,503,121
Contributions to income:		
Canada	\$ 460,523	\$ 390,978
United States	1,746,177	1,614,668
Europe	1,021,701	1,006,577
	3,228,401	3,012,223
Unallocated general and administrative expenses	(45,318)	(112,146)
Corporate interest and royalty income	107,390	137,595
Unrealized inter-area exchange gains (losses)	193,035	(5,181)
Income Before Gain on Termination of Pension Plan, Income Taxes and Extraordinary Item	\$ 3,483,508	\$ 3,032,491
Identifiable assets:		
Canada	\$ 5,619,821	\$ 5,048,056
United States	23,895,197	16,963,936
Europe	4,548,896	3,558,235
	34,063,914	25,570,227
Inter-area eliminations	(3,133,201)	(3,172,735)
Corporate assets	614,870	311,015
Assets	\$31,545,583	\$22,708,507

NOTE 5 — RELATED PARTY TRANSACTIONS:

The Company had no significant related party transactions during the year except as disclosed in Note 3.

NOTE 6 — PENSION PLANS:

The Company has a defined benefit pension plan in the United States and defined contribution plans in certain other countries. Effective May 31, 1987, the United States plan was terminated and the Company has made an application for a pension reversion of approximately \$2,700,000. Such amount has been included in income for the year ended May 31, 1987. No pension expense was recorded for 1987 or 1986 in respect of the United States plan in view of the surplus existing at that time.

NOTE 7 — INCOME TAXES:

The differences between the effective tax rate of the amounts recorded and the amounts computed by applying the statutory Canadian income tax rate to income before income taxes are explained as follows:

	% of pre-tax income	
	1987	1986
Income tax computed at statutory income tax rate	53.0	52.8
Differing asset bases for book and tax purposes in foreign jurisdiction	(4.6)	(2.2)
Investment and other tax credits	(0.8)	(0.8)
Income taxed at different rates in foreign jurisdictions	(3.8)	(5.7)
Other	(1.7)	(2.6)
Effective tax rate	42.1	41.5

D. A. STUART LTD.

NOTE 8 — RETAINED EARNINGS:

Retained earnings in the amount of \$1,000,000 has been appropriated as a reserve for self-insurance of undetermined risks for which the Company is unable to obtain insurance at reasonable rates.

NOTE 9 — CONTINGENCY:

A complaint has been filed against the Company and others by the Department of Environmental Management of the State of Indiana alleging contamination of certain formerly owned property. The Company's management is of the opinion that the Company is free of liability in this matter and, accordingly, no provision for loss is necessary in the financial statements.

NOTE 10 — ACQUISITION:

On April 7, 1987, the Company acquired the business and assets of Torco USA Lubricants Corporation located in Los Angeles, California for cash consideration of \$2,172,656. The assets acquired consisted principally of inventory and property, plant and equipment.

NOTE 11 — CHANGE IN NAME:

During the year, the name of the Company was changed from D.A. Stuart Oil Co., Limited to D. A. Stuart Ltd.

FIVE YEAR COMPARATIVE REVIEW OF OPERATIONS

	<u>Net sales</u>	<u>Income before income taxes</u>	<u>Income taxes</u>	<u>Net income</u>	<u>Dividends declared</u>	<u>Income retained</u>
1987	\$42,796,666	\$6,183,508	\$2,600,501	\$3,583,007	\$135,236	\$3,447,771
1986	45,364,676	3,032,491	1,259,881	1,875,610 (1)	133,591	1,742,019
1985	49,164,207	3,622,284	1,539,341	2,082,943	138,500	1,944,443
1984	43,791,955	2,398,089	791,784	1,606,305	111,142	1,495,163
1983	36,588,136	686,490	(145,224)	831,714	74,701	757,013

(1) After extraordinary gain of \$103,000.

