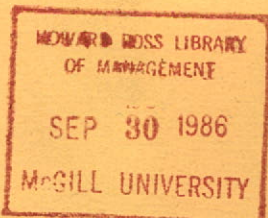
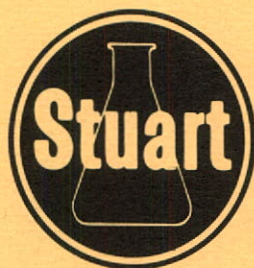


D. A. STUART OIL CO., LIMITED



ANNUAL REPORT 1986





D. A. STUART OIL CO., LIMITED

DIRECTORS and OFFICERS

Directors

CHRISTOPHER T. LOUGHRIN
WILLIAM H. MANN
NORMAN J. MUNN, Q.C.
Dr. STEPHEN P. OGRYZLO
CHARLES E. SANTANGELO
Dr. ROLF STÜSSER
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

An Annual and Special Meeting of Shareholders will be held in the Library of the Royal York Hotel, Toronto, Canada, on Thursday, October 9, 1986 at 11 A.M. Toronto Time.

D. A. STUART OIL CO., LIMITED

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, 1986 were U.S. \$45,364,676 versus U.S. \$49,164,207 for the prior year. Income before an extraordinary item for the year was U.S. \$1,772,610 (\$3.89 per share) compared to U.S. \$2,082,943 (\$4.57 per share) for the previous year. During the year, an income tax reduction was realized on the carry-forward of prior years' losses. After this extraordinary item, Net Income for the year was U.S. \$1,875,610 (\$4.11 per share) versus the previous year's U.S. \$2,082,943 (\$4.57 per share). Royalties and Other Income were U.S. \$310,019 compared to U.S. \$184,978 last year.

The decline in sales and earnings can be attributed principally to lower sales by the U.S. operations. In addition, earnings were further negatively affected by a major U.S. customer filing for protection under bankruptcy laws. All other operations showed increased sales and profits over the previous year. European operations also benefited from a strengthening of their currencies against the U.S. dollar.

Despite reduced earnings during the year, your company repaid \$1,500,000 of long-term debt associated with The Ironsides Company acquisition.

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

You will note from the attached Notice of Annual and Special Meeting of Shareholders that the Company intends to seek approval to change its name to D. A. Stuart Ltd. and to increase the size of its Board of Directors from seven to nine members.

Enclosed with the Annual Report is a brochure which provides some information on the nature of the Company's operations.

On behalf of the Board

H. WERHAHN
Chairman

C. E. SANTANGELO
President

Toronto, Canada
August 22, 1986

D. A. STUART OIL CO., LIMITED*(Incorporated under the laws of Ontario)***Consolidated***(Expressed in United***ASSETS**

	May 31	
	1986	1985
Current Assets		
Cash and deposit receipts	\$ 1,186,312	\$ 150,304
Accounts receivable	5,498,619	7,068,703
Inventories	6,510,584	7,024,101
Advances and prepaid expenses	177,218	282,925
Income taxes recoverable	13,114	64,775
	<u>13,385,847</u>	<u>14,590,808</u>
Property, Plant and Equipment (Note 3)		
Land, buildings and equipment	11,112,125	10,442,542
Less: accumulated depreciation	5,725,000	5,018,380
	<u>5,387,125</u>	<u>5,424,162</u>
Excess of Cost of Acquired Assets Over Values Assigned, less amortization	3,628,015	3,737,017
Other Assets	320,634	280,514
	<u>\$22,721,621</u>	<u>\$24,032,501</u>

Approved by the Board:

HERIBERT WERHAHN, Director

CHARLES E. SANTANGELO, Director

AUDITORS'

To the Shareholders of
D. A. Stuart Oil Co., Limited

We have examined the consolidated balance sheet, expressed in United States currency, of D. A. Stuart Oil Co., Limited as at May 31, 1986 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 14, 1986



Balance Sheet

(States currency)

LIABILITIES AND SHAREHOLDERS' EQUITY

	1986	May 31 1985
Current Liabilities		
Bank indebtedness	\$ —	\$ 332,770
Accounts payable and accrued liabilities	3,007,385	4,503,130
Income taxes payable	551,963	580,291
Dividend payable	33,074	33,238
Current portion of long-term debt	31,936	24,578
	<u>3,624,358</u>	<u>5,474,007</u>
 Long-Term Debt (Note 3)	 5,600,000	 7,130,220
 Deferred Income Taxes	 666,481	 582,394
 Minority Interest	 22,500	 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)	13,064,522	11,322,503
Equity adjustment arising from foreign currency translation	(692,728)	(935,611)
	<u>12,808,282</u>	<u>10,823,380</u>
	<u>\$22,721,621</u>	<u>\$24,032,501</u>

REPORT

In our opinion, these consolidated financial statements present fairly the financial position of the Company as at May 31, 1986 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 OIL CO., LIMITED

Consolidated Statement of Income

(Expressed in United States currency)

	Year Ended May 31	
	1986	1985
Net sales	\$45,364,676	\$49,164,207
Royalties and other income	310,019	184,978
	<u>45,674,695</u>	<u>49,349,185</u>
Costs and expenses:		
Cost of products sold	32,666,691	35,623,660
Selling and administrative expenses	9,371,532	8,978,130
Interest expense, including interest on long-term debt of \$742,598 (1985 — \$1,038,023)	761,731	1,071,612
(Gain) loss on foreign exchange	(157,750)	53,499
	<u>42,642,204</u>	<u>45,726,901</u>
Income Before Income Taxes and Extraordinary Item	3,032,491	3,622,284
Income taxes:		
Current	1,179,627	1,374,725
Deferred	80,254	164,616
	<u>1,259,881</u>	<u>1,539,341</u>
Income Before Extraordinary Item	1,772,610	2,082,943
Extraordinary item:		
Income tax reduction realized on the carry-forward of prior years' losses	103,000	—
Net Income for the year	<u>\$ 1,875,610</u>	<u>\$ 2,082,943</u>
Per Common Share:		
Earnings before extraordinary item	<u>\$3.89</u>	<u>\$4.57</u>
Net Earnings	<u>\$4.11</u>	<u>\$4.57</u>

Consolidated Statement of Retained Earnings

(Expressed in United States currency)

	Year Ended May 31	
	1986	1985
Retained earnings, beginning of year	\$11,322,503	\$ 9,378,060
Net income for the year	1,875,610	2,082,943
	<u>13,198,113</u>	<u>11,461,003</u>
Dividends on minority interest	(1,350)	(1,350)
Dividends on common shares (Note 2)	(132,241)	(137,150)
Retained earnings, end of year	<u>\$13,064,522</u>	<u>\$11,322,503</u>



Consolidated Statement of Changes in Financial Position

(Expressed in United States currency)

	Year Ended May 31	
	1986	1985
Source of Funds		
Operations —		
Income before extraordinary item	\$ 1,772,610	\$ 2,082,943
Charges to income not affecting working capital —		
Depreciation	586,282	536,309
Amortization of excess of cost of acquired assets over values assigned	109,002	106,715
Deferred income taxes	84,087	179,662
Loss on disposals of property, plant and equipment	622	—
	<u>2,552,603</u>	<u>2,905,629</u>
Extraordinary item	103,000	—
	<u>2,655,603</u>	<u>2,905,629</u>
Application of Funds		
Dividends	133,591	138,500
Purchases of property, plant and equipment	448,237	441,746
Decrease in long-term debt	1,540,331	1,424,578
Increase in other assets	40,120	62,573
Effect of exchange rate changes	(151,364)	113,602
	<u>2,010,915</u>	<u>2,180,999</u>
Increase in Working Capital	644,688	724,630
Working capital, beginning of year	9,116,801	8,392,171
Working Capital, end of year	<u>\$ 9,761,489</u>	<u>\$ 9,116,801</u>

D. A. STUART OIL CO., LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in United States currency)

May 31, 1986

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 Oil Co., Limited 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.

Investment tax credits — Effective for the year ended May 31, 1986, the Company changed its method of accounting for investment tax credits by adopting the new accounting standard issued by the Canadian Institute of Chartered Accountants. As a result of this change, investment tax credits arising from the purchase of fixed assets are deferred and recognized in income as related assets are depreciated. Previously, such credits were recognized in income when they were claimed for tax purposes. This change has been applied prospectively and does not have a material effect on earnings.

Tax credits relating to current expenses are recognized in income in the year incurred.

Insurance — Effective with the year ended May 31, 1986, \$1,000,000 of retained earnings 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 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 (1986 — \$0.40 Canadian per share; 1985 — \$0.40 Canadian per share).

NOTE 3 — LONG-TERM DEBT:

	1986	1985
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 (\$8,066 U.S.)	\$ 31,936	\$ 54,798
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, 1986 was 8.859%	2,000,000	4,000,000
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, 1986 was 8.859%	600,000	100,000
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	3,000,000	3,000,000
	5,631,936	7,154,798
Less: Current portion	31,936	24,578
Long-term portion	<u>\$ 5,600,000</u>	<u>\$ 7,130,220</u>



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,

- (a) the retirement of subordinated debt is not to exceed 35% of the consolidated net income of the Company in any year; and
- (b) 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:

	1986	1985
Net sales:		
Canada	\$ 5,395,576	\$ 4,985,351
United States	33,011,060	39,479,692
Europe	7,246,806	5,337,941
	<u>45,653,442</u>	<u>49,802,984</u>
Inter-area eliminations	(288,766)	(638,777)
Net Sales	\$45,364,676	\$49,164,207
Contributions to income:		
Canada	\$ 390,978	\$ 194,841
United States	1,614,668	3,231,621
Europe	1,006,577	86,691
	<u>3,012,223</u>	<u>3,513,153</u>
Unallocated general and administrative expenses	(112,146)	(11,473)
Corporate interest and royalty income	137,595	63,340
Unrealized inter-area exchange gains (losses)	(5,181)	57,264
Income Before Income Taxes and Extraordinary Item	\$ 3,032,491	\$ 3,622,284
Identifiable assets:		
Canada	\$ 5,048,056	\$ 4,912,341
United States	16,977,050	19,392,453
Europe	3,558,235	2,771,717
	<u>25,583,341</u>	<u>27,076,511</u>
Inter-area eliminations	(3,172,735)	(3,137,393)
Corporate assets	311,015	93,383
Assets	\$22,721,621	\$24,032,501

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 PLAN:

Based upon the most recent actuarial valuation as at May 1, 1985, the net assets of the pension plan exceeded the computed present value of accumulated plan benefits by approximately \$1,760,000. For the year ended May 31, 1986 no pension expense has been charged to the accounts with regard to the Company's United States pension plan due to the plan surplus.

D. A. STUART OIL CO., LIMITED

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	
	1986	1985
Income tax computed at statutory income tax rate	52.8	51.0
Differing asset bases for book and tax purposes in foreign jurisdiction	(2.2)	(2.7)
Investment and other tax credits	(0.8)	(1.8)
Income taxed at different rates in foreign jurisdictions	(5.7)	(1.7)
Other	(2.6)	(2.3)
Effective tax rate	<u>41.5</u>	<u>42.5</u>

NOTE 8 — RETAINED EARNINGS:

At May 31, 1986, \$1,000,000 of retained earnings has been appropriated as a reserve for self-insurance.

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.

FIVE YEAR COMPARATIVE REVIEW OF OPERATIONS

	Net sales	Income before income taxes	Income taxes	Net income	Dividends declared	Income retained
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
1982	39,677,400	714,999	297,182	417,817	155,689	262,128

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

