FEDERAL INDUSTRIES LTD. 1983 ANNUAL REPORT

The cover of this year's Report shows, for the first time, the new Federal Industries symbol — a stylized depiction of our corporate initials.

Annual Meeting
The Annual Meeting of the Shareholders will be held at the Westin Hotel, Two Lombard Place, Winnipeg, Manitoba, on May 9, 1984 at 11:00 a.m.

FEDERAL INDUSTRIES

Federal Industries Ltd. is a diversified company headquartered in Winnipeg, Canada. Through its three operating Groups, Federal is involved in transportation, aerospace and industrial distribution in North America and internationally.

Incorporating recent acquisitions, the Company has assets exceeding $375 million and will have pro-forma annual consolidated sales of approximately $500 million. More than 93% of the Common and Preferred Shares are owned by residents of Canada. Shares are traded on the Toronto and Winnipeg Stock Exchanges.

Contents

	December 1983 12 Months ($000,000)	December 1982 12 Months ($000,000)
Sales	**$203.8**	$179.2
Earnings before interest, taxes and extraordinary items	**20.2**	19.3
Interest Charges	**8.8**	7.9
Net Income	**5.9**	6.0
Working Capital	**126.5**	50.5
Earnings per Common Share	**$ 1.02**	$ 1.25
Equity per Common Share	**$ 16.02**	$ 16.46

THE REPORT TO SHAREHOLDERS

1983 was a transitional year for Federal Industries. Earnings per share were down from 1982, but the stage was set for your Company's next growth phase.

More than five years of planning culminated in two acquisitions that will more than double the size of your Company in 1984. Two equity financings totalling $55 million maintained the integrity of our balance sheet and, despite the lingering effects of the recent recession, progress was made toward resolving some longstanding problems impeding growth and profitability.

Earnings per share for the year declined to $1.02 from $1.25 in 1982 on sales of $204 million – a less than satisfactory performance, particularly in the first half when recessionary effects continued to hamper most operations. Financial results in the second half improved and the trend is expected to continue in 1984.

Key developments:

- *Despite the continued closure of the Cyprus Anvil mine and the resulting suspension of The White Pass and Yukon's marine, rail and bulk trucking activities, earnings from the Petroleum and Land Divisions enabled the company to produce a small operating profit from its traditional northern operations. The Canadian Transport Commission issued a preliminary report on Yukon transportation with favourable implications for the railway.*
- *The combination of a depressed general aviation market plus higher than expected costs of consolidating and reorganizing Standard Aero International, our worldwide aviation parts distribution business, resulted in substantial losses.*
- *An important new western hemisphere market has been opened for Standard Aero Limited to service the popular Allison 250 gas turbine engine. The successful penetration of the U.S. market and increased volumes from the Canadian military in 1983 offset the decline in commercial helicopter flying hours in Canada.*
- *Thunder Bay Terminals reached agreement with CP Rail on a new dry bulk system to handle increasing volumes of potash. Construction was well underway by year-end.*
- *As part of the strategy to reduce White Pass' dependency on the economy of Yukon, we concluded the purchase of Canadian Motorways Ltd., one of Canada's largest trucking companies. Motorways' operations contributed positively to Federal's 1983 earnings.*
- *An Industrial Distribution Group was created through the purchase of Russelsteel Inc., a major distributor of steel and valves in Canada and the United States. The acquisition will reduce significantly your Company's dependency on the natural resource sector and is expected to contribute positively to 1984 earnings.*

The balance of this Report provides further insight into both 1983 results and the future outlook for Federal, and answers typical shareholder questions submitted as a result of the 1982 Report.

Inside the back cover, you will find a brief questionnaire. We hope you will use it to comment on your Company's progress.

On behalf of the Board of Directors,

JFraser

John F. Fraser
President and Chief Executive Officer

Stewart A. Searle

Stewart A. Searle
Chairman of the Board

Your Company has embarked upon a new phase of growth and profitability, the result of several years' planning and preparation. Our two major acquisitions during 1983, which will push 1984 sales to the half-billion dollar mark, are clear evidence of this growth, but they're only part of the story. A lot of ground work has been laid to insure continuing growth and profitability of existing subsidiaries while these major acquisitions are integrated into our existing operations.

First, let's look at 1983's financial results. Our net earnings for 1983 were $5,924,000, very close to 1982's profit of $6,029,000. Due to an increased number of shares outstanding, the earnings per share declined 18% to $1.02, compared to $1.25 the previous year. That deterioration is relatively small but an assessment of your Company's recent performance is important in understanding clearly our current position.

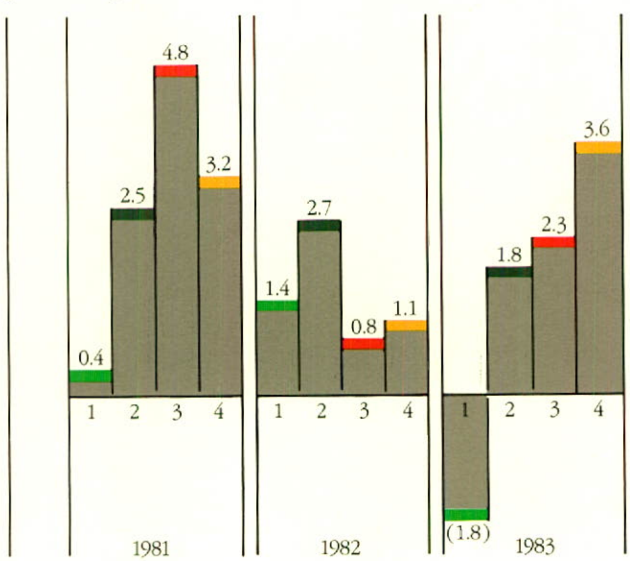
As the chart below shows, the impact of the "Great Recession" hit our earnings in the last half of 1982, bottoming out in the first quarter of 1983. By mid-year, actions taken to counteract adverse external developments started to show results, and our earnings in the last half of 1983 were significantly ahead of the previous year, a trend we are confident will continue through 1984.

Thomas Watson, Sr., the founder of IBM, said that boom times are a time for caution, and recessions a time for boldness. Most business failures spring from decisions made in good times that come home to roost when the economy is weak. We agree, and we took this past recession as an opportunity to implement a major strategic expansion.

John F. Fraser
President and Chief Executive Officer

1982 and 1983 were difficult years operationally for Federal Industries, as they were for most companies. Like others, we worked hard to minimize the recession's impact, trim our operations to suit economic realities, and enhance the fundamental strengths of your Company. Unlike many other companies which are just now starting to rebuild from the recession, we had the management depth, detailed strategic plans and financial strength to take advantage of opportunities presented by these turbulent times. A brief review of the major strategic moves we made in 1983 will illustrate their impact on your Company's future growth and earnings:

QUARTERLY NET PROFIT
($ MILLION)



Aerospace Group

Comprised of Standard Aero Limited of Winnipeg and Standard Aero International of Minneapolis, the Aerospace Group showed sharply reduced profits, primarily due to problems in distribution activities. In late 1982, your management decided to combine the two newly-acquired U.S. distribution companies with parallel Canadian operations to produce an integrated worldwide aviation parts distribution company. Costs of consolidating and reorganizing ran higher than expected, and, together with a declining general aviation market, added up to substantial losses in the Distribution Division. However, with start-up costs behind us and a strengthening market place evident, we anticipate that 1984 results from aviation distribution will improve markedly.

Profit performance from Standard Aero's overhaul operations was ahead of forecast, due in large part to the success of our U.S. marketing efforts, begun in late 1982. In 1983, close to one-half of our commercial overhauls came from the U.S. Further, the Allison Gas Turbine Division of General Motors, manufacturer of the 250 gas turbine engine, our largest volume producer, removed regional restrictions on its franchisees, giving Standard Aero free access to the Western Hemisphere. This important development will enhance significantly growth opportunities in years ahead.

Transport Group

Consisting of The White Pass and Yukon Corporation Limited, Canadian Motorways Ltd. and Thunder Bay Terminals Ltd., the Transport Group showed overall improvement in operations from 1982 as a result of actions taken during the year.

For several years the Group has had a well-defined strategy to diversify away from its dependency on the economy of Yukon and the mining sector. That strategy led to the acquisition at mid-year of Canadian Motorways, a $100 million general freight trucking company with operations throughout Canada and into the United States. All of the Group's general freight trucking activities are now conducted through Motorways.

The White Pass and Yukon Railway was a major victim of the recent recession. Efforts begun in the late 70's toward bringing the Railway to profitability showed every sign of culminating in success in 1982; but declining metal prices and other economic problems led to closure of the Cyprus Anvil lead-zinc mine, the rail's major customer, and consequently forced temporary suspension of the railway's operations. This crisis in Northern transportation led to an inquiry by the Canadian Transport Commission. The Commission's preliminary recommendations are positive, concluding that the Railway is viable, can be economically competitive, and is the best alternative for the transportation of mineral concentrates to tidewater. Although no immediate action has yet been initiated by the Government, and Anvil continues to press for an all-truck route to the coast, we remain cautiously optimistic that a positive and long-term solution to this chronic problem is in sight.

However, because of the uncertainty of the current situation, the Transport Group has reorganized its operations in Yukon to assure at least a break even position without the volumes historically provided by the Anvil mine. The Petroleum and Land Divisions remained profitable,and the assets of the rail, marine and bulk trucking divisions are standing ready to resume operations. Additional strategies for further diversification have been developed and should contribute to profits in 1984.

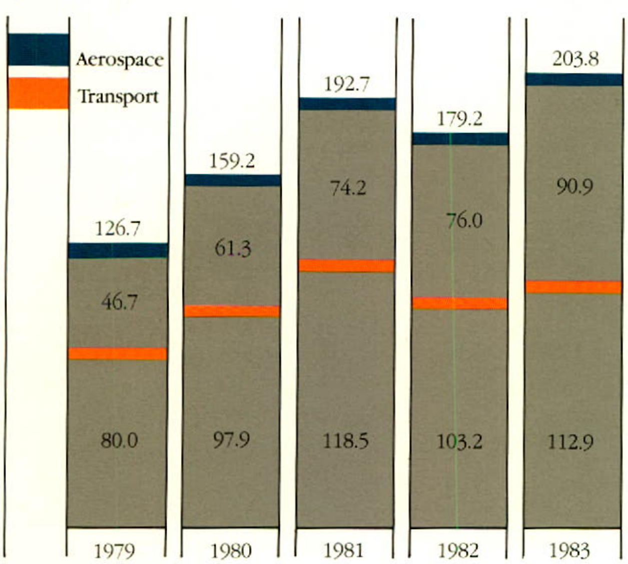
Canadian Motorways Ltd., your Company's first major acquisition in several years, has a long history of reasonable profits and a reputation for good service in the Western Canadian market. This addition to our Transport Group further commits Federal Industries to one of Canada's basic industries. Motorways had a positive impact on our 1983 earnings and will provide a new source of sales and earnings in 1984 and beyond.

Thunder Bay Terminals Ltd. had another near-record year for both sales and earnings despite an early freeze-up of the Great Lakes that reduced scheduled potash shipments at the year-end. For some time, potash shippers, led by the Canadian Pacific Railway, have been seeking a dedicated dry bulk terminal at the Port of Thunder Bay. In 1983, negotiations were concluded and ground was broken for such a facility to be built on Thunder Bay Terminal's site. This new $5.7 million project is being financed by CP Rail and will utilize TBTL's existing ship loading equipment, improving what is already the Port's most efficient handling system for most dry bulk products. We are confident this addition and other marketing initiatives will lead to improved earnings at Thunder Bay.

Industrial Distribution Group

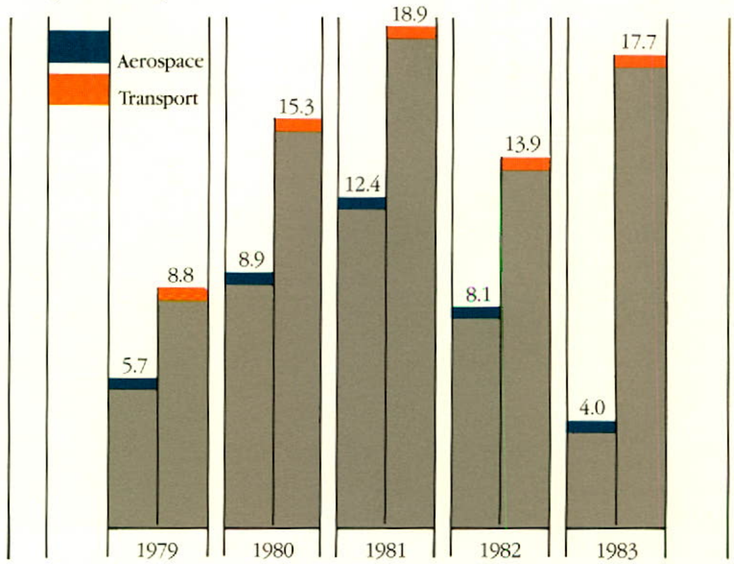
The major event of 1983 was the creation of The Industrial Distribution Group through the purchase of Russelsteel Inc., a major distributor

SALES
($ MILLION)



**Former Terminals Division combined into Transport Group.

DIVISIONAL EARNINGS
($ MILLION)



†Before taxes, extraordinary items, interest and intercompany charges

of steel and valves in Canada and the United States.

Russelsteel serves markets that are well established, has a strong management team, and a verifiable track record. It offers your Company an excellent opportunity to expand in industrial distribution, a sector identified by our Corporate Long-Range Plan as compatible with, and complementary to, our existing businesses. Despite the cyclicality of the steel market and the extraordinary effect of the recent recession on steel producers, Russelsteel has maintained operating profits every year. Unlike steel manufacturing, steel service centers are not fixed capital intensive, and good management can expand or shrink the operation to suit the needs and opportunities of the market. Circumstances made it possible to buy these operations at a favourable price, making our new subsidiary a strong and leading player in a major industry. We anticipate that the acquisition will add substantially to our earnings in 1984.

As will be further detailed in the following Finance Section, the acquisitions of Canadian Motorways and Russelsteel were funded by a combination of new equity and debt. A private placement issue of Federal Common Shares in June of 1983 raised $15 million and a very successful Convertible Preferred Issue in November raised $40 million. After providing prudent equity bases for Motorways and Russelsteel, approximately $15 million in equity funds remain to finance future growth.

Management excellence: a concrete goal

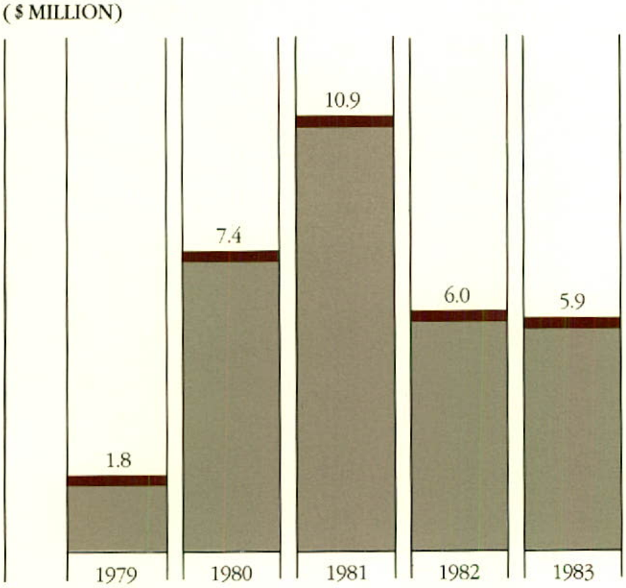
Management — and how it can alter the strategic direction and the financial performance of a corporation — is the central theme running through my commentary on 1983. In fact, management excellence is more than an abstract goal at Federal Industries. We strive for excellence and require a solid performance base with sensible and well-defined strategies in place as a foundation for moving to the next growth phase. Despite the impact of the recession, by 1983 that kind of base was in position, and during the year we took a bold step, capitalizing on opportunities presented by these turbulent times. The opportunities were there because of the recent recession. We found them because a great deal of work and planning went into the search.

Now as we look forward to a promising 1984 and years beyond, I'd like to convey the thanks of the Board, the Chairman and myself to the members of our Executive Committee, the Presidents of our subsidiaries and all the men and women who contribute to make Federal Industries a strong, respected and well-managed company. I would like to welcome to Federal the management and employees of the new companies that joined us in 1983.

Finally, I want to welcome over 2,500 new Federal shareholders who invested in our Company during the year. They have my assurance that we will work tirelessly to earn the confidence they have placed in us.

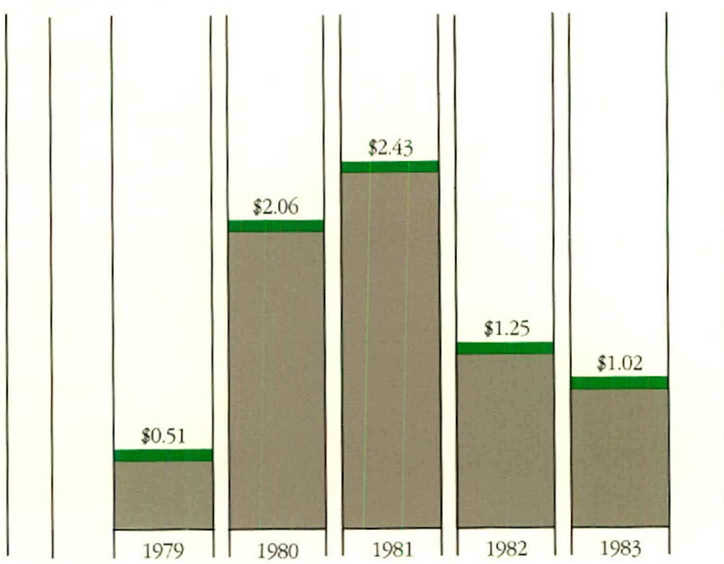
During 1983, Federal Industries attained a new plateau of size and profit potential. With three basic industries — aerospace, transport and industrial distribution — we are coming into a rising economy with a solid foundation. While the outlook is exceptionally bright, nothing worthwhile comes easily. We have our work cut out for us and we look forward to the challenge with enthusiasm.

NET PROFIT*
($ MILLION)



*Before extraordinary items, where applicable

EARNINGS PER COMMON SHARE*



*Before extraordinary items, where applicable

Earnings

In 1983, earnings declined to $1.02 per share or $5,924,000 from $1.25 per share or $6,029,000 the previous year. The differential in dollar and per share earnings is the result of an increase in average shares outstanding, primarily a consequence of Federal's June private placement of 1,170,000 Common Shares.

The past year's profitability was affected by losses sustained in the Company's aviation parts distribution business, offset by income from newly-acquired Canadian Motorways and increased earnings in aviation engine remanufacturing.

Operations of all Divisions are described more fully in the review beginning on page 14.

Interest Costs

Net interest expense relating to operations increased to $8,760,000 from $7,917,000 in 1982. After excluding the cost of debt related to Thunder Bay Terminals Ltd. (covered by an all events contract with Ontario Hydro and discussed under "Balance Sheet"), interest expense increased to $3,140,000 from $1,916,000. Almost all of this increase is due to the addition of Canadian Motorways' debt as of June 30, 1983.

John S. Pelton
Vice-President, Finance

During the year, $984,000 in interest was earned on short-term deposits compared with $492,000 in 1982. This increase represents primarily income on the $15,000,000 private placement of Common Shares completed in June.

In 1984, the Company expects to be able to fund both capital requirements and dividend payments from internally generated funds. In addition, approximately $15,000,000 of the $40,000,000 Preferred Share issue in December 1983 is available currently for short-term investment and is being deployed primarily into marketable preferred shares with retraction features. As a result, the Company expects that income from invested funds will increase substantially in 1984.

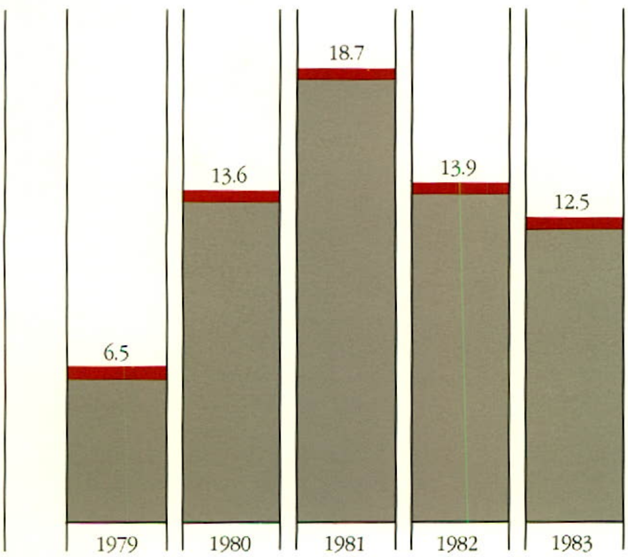
Most of the Company's debt obligations are at fixed rates, which, together with balanced cash flow of operations, leave Federal Industries relatively immune to the effect of interest rate fluctuations.

Income Taxes

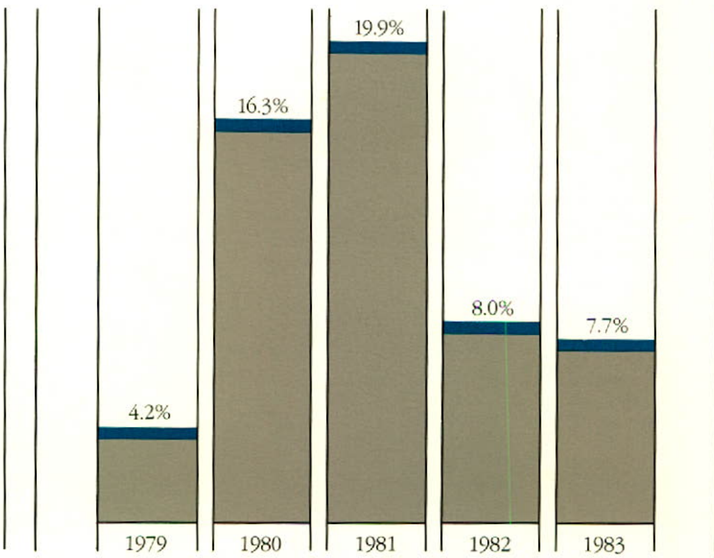
Because Federal Industries is comprised of subsidiaries in several tax jurisdictions, the consolidated rate of tax may vary from period to period. This is particularly true in Canada when one or more companies incur losses while others remain profitable, or when tax incentive programs affect the amount of tax paid. In 1983, the consolidated income tax rate was 45.1% compared to 43.9% in 1982. Note 11 to the Financial Statements sets out in tabular form the principal factors affecting the respective rates of tax.

For its United States businesses, your Company files consolidated tax

CASH FLOW
($ MILLION)



RETURN ON SHAREHOLDERS EQUITY‡



‡Based on opening common equity

returns, grouped for transportation services under White Pass Transportation Inc. and for distribution activities under Standard Aero International Inc. Accordingly, immediately subsequent to the acquisition of the Russelsteel operations, the U.S. steel division, comprised of Russelsteel (USA) Inc.,was transferred to the Standard Aero tax consolidation group. The inclusion of this highly profitable division of Russelsteel, together with improving prospects for aviation parts distribution in the United States, allowed the provision of current taxes recoverable against losses sustained in the aviation business during 1983.

Foreign Currency Translation
Standard Aero International Inc. and newly-acquired Russelsteel (USA) Inc. operate distribution businesses in the United States. For foreign currency translation purposes, both operations are considered self-sustaining. Accordingly, income and expenses are translated on the basis of average exchange rates during the year and the year-end assets and liabilities are translated at year-end exchange rates. Exchange gains and losses for self-sustaining operations are customarily shown as a segregated section of shareholders' equity. In 1983 and 1982, the adjustments were not material and have been included in accounts payable.

Acquisitions
Effective June 30, 1983, your Company acquired Canadian Motorways Ltd. from British Electric Traction Co. PLC of the United Kingdom. The purchase price for British Electric's 99% interest was $15,976,000. Some minority shareholders did not respond during the solicitation process, and it is the Company's intention to proceed to acquire these shares in 1984.

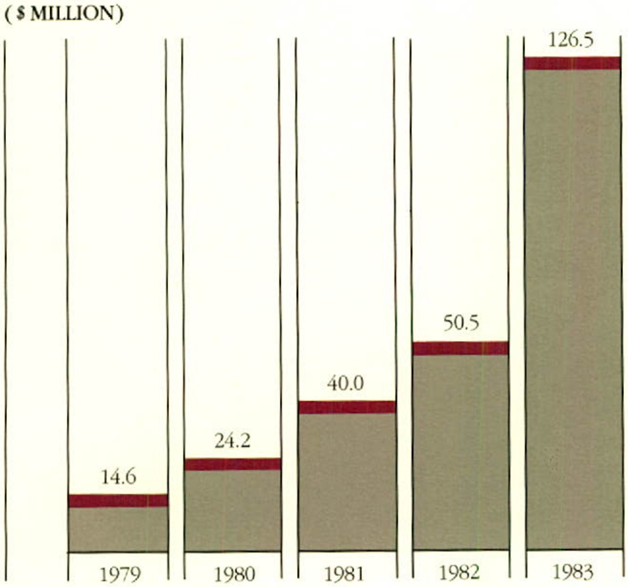
After adjustment of Motorways' asset carrying costs to fair market value, the purchase price represented an effective discount of approximately $6,800,000. Part of this amount has been allocated to write off goodwill and to provide for the closure and reorganization of certain operations. The remainder has been credited to automotive equipment.

On December 31, 1983, Federal Industries acquired, through newly-incorporated subsidiaries, substantially all of the steel and industrial valve distribution assets of York Russel Inc. The purchase price paid for the assets was $113,238,000, subject to adjustment by audit, and was satisfied by assumption of accounts payable, existing mortgages and capital leases, by the issuance of a five-year secured note of $55,000,000, and by the payment of $25,000,000 in cash. The cash portion was provided by Federal Industries out of its December issue of Class II Series B Preferred Shares.

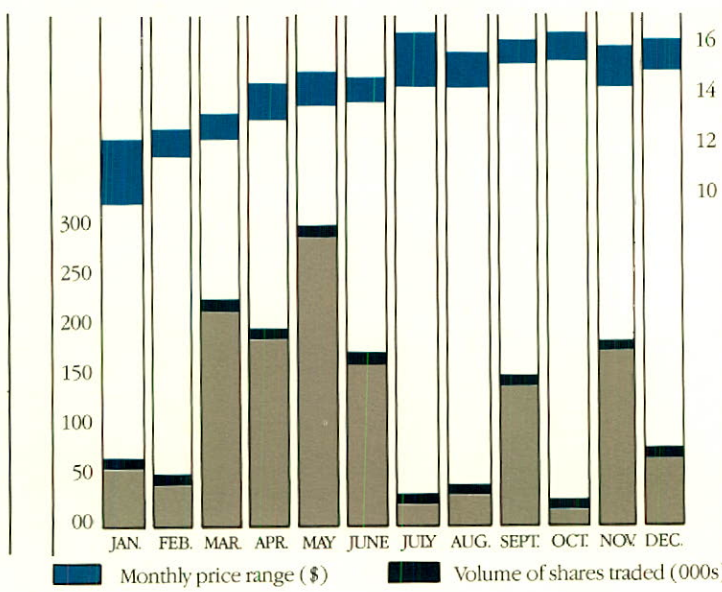
After restating net book values of the acquired Russelsteel assets to reflect fair market value, the effective purchase discount amounted to approximately $18,600,000. This amount was allocated to a combination of fixed assets and accrued liabilities.

Divestitures
In the course of its operations in previous years, Federal Industries disposed of a number of businesses. The historical effects of all divestitures have been shown retroactively in the Consolidated Historical Summary.

WORKING CAPITAL
($ MILLION)



1983 TRADING VOLUMES AND
PRICE RANGES, COMMON STOCK



Balance Sheet

During the year, working capital more than doubled to $126,474,000 from $50,542,000, the seventh successive annual increase in this important indicator. The inclusion of Russelsteel's balance sheet as of December 31 is the most significant contributor to this increase. Also impacting favourably are the proceeds from the sale of Common Shares in June and Class II Series B Preferred Shares in December.

A summary of the working capital components, in millions of dollars, is set out below:

	1983	1982
Cash inflow from profits and non-cash expenses	12.5	13.9
Cash inflow from other sources		
Issuance of shares	55.2	2.9
Issuance or assumption of debt	85.9	9.3
Other	3.3	2.0
	156.9	28.1
Cash outflow from operations		
Purchase of fixed assets	8.5	3.2
Investments in newly-acquired business	55.1	4.0
Retirement of debt	11.5	5.7
Dividends paid	3.4	2.8
Other	2.5	1.9
	81.0	17.6
Net cash provided for addition to working capital	75.9	10.5

Long-term debt doubled to $146,311,000 from $71,895,000, mainly because of the inclusion of the Russelsteel purchase debt, a five-year $55,000,000 note taken back by the vendor, carrying a fixed interest rate of 12.36% and having no principal payments during the initial term. The remaining increment reflects bank term debt of Canadian Motorways Ltd., aggregating $14,154,000 at year end. The 1983 long-term debt position includes $52,754,000 of funded obligations of Thunder Bay Terminals. As more fully explained in the Notes to the Financial Statements, a long-term contract between the Terminal and Ontario Hydro provides for the payment of debt service in all events and, under the terms of the mortgage bonds, security is limited to the assets of the Terminal. Accordingly, it is reasonable to exclude this "Project Financing" debt in calculating the Company's long-term debt-to-equity ratio. On this basis, the year-end ratio was 0.62 to one, compared to 0.16 to one at December 31, 1982. Total debt to equity was 0.59 to one at the end of 1983, compared with 0.24 to one in 1982.

In order to aid the reader in understanding the effects on the Balance Sheet of our two recent acquisitions, we set out below a table showing the composition of consolidated totals as at year-end.

Note 2 to the Financial Statements sets out the make-up of the purchase prices at date of acquisition.

Banking

Federal Industries has established relationships with three major Canadian Banks: Bank of Montreal, Canadian Imperial Bank of Commerce, and Toronto-Dominion Bank. Under various loan arrangements, your Company has operating and term lines of credit totalling $97,000,000, of which $27,000,000 was drawn down at December 31, 1983.

Capital Expenditures and Depreciation

In 1983, capital expenditures totalled $8,538,000, compared with $3,183,000 in 1982. As in the previous year, most outlays were incurred for the purchase of highway equipment, including some rolling stock bought by

Consolidated Balance Sheet as at December 31, 1983

Assets ($000's)	Federal Industries*	Motorways	Russelsteel	Adjusting Entries	Consolidated
CURRENT					
Cash and short-term deposits	18,543	8	—		18,551
Accounts receivable	24,556	17,799	31,635		73,990
Inventories	49,539	693	55,027		105,259
Other Assets	7,998	575	479		9,052
Total current assets	100,636	19,075	87,141		206,852
INVESTMENT IN SUBSIDIARIES	42,923			(42,923)	
FIXED, at cost less accumulated depreciation	101,582	31,863	20,825		154,270
OTHER ASSETS	9,037	1,538	5,272		15,847
	254,178	52,476	113,238	(42,923)	376,969
Liabilities					
CURRENT					
Bank indebtedness	4,274	6,070	—		10,344
Accounts payable and accrued liabilities	18,784	13,070	30,518		62,372
Other liabilities	6,325	609	728		7,662
Total current liabilities	29,383	19,749	31,246		80,378
LONG-TERM DEBT	75,165	14,154	56,992		146,311
DEFERRED INCOME TAXES	6,917	650	—		7,567
MINORITY INTEREST	5,500	—	—		5,500
Total Liabilities	116,965	34,553	88,238		239,756
Inter-company account		509		(509)	
Shareholders' Equity					
SHARE CAPITAL	87,662	16,140	25,000	(41,140)	87,662
RETAINED EARNINGS	49,551	1,274	—	(1,274)	49,551
	254,178	52,476	113,238	(42,923)	376,969

**Federal Industries Ltd. and its consolidated subsidiaries, excluding Motorways and Russelsteel.*

Canadian Motorways Ltd. In addition, the Aerospace Group spent approximately $2,000,000 on upgrading of productive facilities and systems-related equipment.

1984 capital expenditures will increase substantially, again primarily representing replacement of highway equipment.

Depreciation charges declined marginally from 1982, reflecting incremental charges from six months' ownership of Canadian Motorways, together with reductions at The White Pass and Yukon Corporation, where much of the depreciable assets were idle due to lack of volume.

Share Capital
The Shareholders have authorized four classes of Share Capital: Class I and Class II Preferred Shares and Class A and Class B Common Shares. The Class II Preferred Shares are intended to have special features, such as participatory or convertibility rights, whereas Class I Preferred Shares are directed toward the more conservative, yield-oriented investor. Both classes of Preferred Shares can be issued in series. The Common Shares are divided into Class A and Class B, and are interconvertible at the option of the Shareholder. Each class carries one vote per share and is identical in every respect except that Class A Common Shares customarily pay cash dividends and Class B Common Shares normally pay dividends in the form of additional Class B Common Shares.

In May 1982, 28,760 Class II Convertible Preferred Shares, Series A, valued at $2,876,000 were issued on the acquisition of a U.S.-based aviation distribution company. Bearing a coupon rate of 9%, these shares are convertible within ten years at $15.60 per Federal Common Share.

On May 25, 1983, your Board of Directors approved the private placement with twelve institutions and pension funds of 1,170,000 Class A Common Shares at a subscription price of $13.00 per share. The proceeds of approximately $15,000,000 were used to fund the purchase of substantially all the shares of Canadian Motorways Ltd.

On December 15, 1983, 1,600,000 $2.0625 Cumulative Redeemable Convertible Class II Preferred Shares, Series B, were issued pursuant to a public offering across Canada. The dividend rate is equivalent to 8.25% on an issue price of $25.00 per share, and each share is convertible into 1.37 Class A Common Shares ($18.25 per share) at any time on or before the earlier of December 15, 1990 and the date fixed by the Company for redemption. The Company may call the Series B Preferred Shares for redemption after December 15, 1986, subject to certain conditions having been satisfied. Further details are contained in Note 9 to the Consolidated Financial Statements.

The primary purpose of the Preferred Share public offering was to provide the required equity base to support our purchase of Russelsteel assets. Secondly, your Company felt there was a market for a retail-oriented security, and we were pleased that more than 2,300 individuals purchased approximately 1,300,000 of the 1,600,000 shares offered. Finally, the issue enabled Federal Industries to raise its profile in the investment community, and to reach a wider geographic area of potential investors.

During the year 4,598 Class B Common Shares were issued as stock dividends, and 98,484 Class B Shares were outstanding at the year end. At December 31, 1983, a total of 5,887,211 Class A and B Shares were outstanding, and the weighted average for the year was 5,390,600 compared to 4,699,512 in 1982.

Market performance of Federal Industries' stock was most encouraging, with new highs being set for the Common Shares shortly after the completion of the Series B Preferred Share issue and consummation of the Russelsteel purchase. We are pleased to report that the Series B Preferred Shares, listed on the Toronto and Winnipeg Stock Exchanges in January 1984, traded almost immediately at a premium to the issue price, and volume has been substantial.

Current Cost Accounting
The Canadian Institute for Chartered Accounting has prepared guidelines for disclosing the presumed effects of inflation on the financial assets and operations of the Company. This current cost accounting information is set out on page 34, under the title "Accounting for the Effects of Inflation".

Summary
1983 was momentous year for your Company. Shareholders' equity rose by 70% to $137,213,000, total assets almost doubled to $376,969,000, and working capital increased two and one-half times to $126.5 million, virtually equivalent to the equity balance. At the same time, total debt to equity, excluding the project financing debt at Thunder Bay, increased to only 0.59 to one from 1982's 0.24 to one.

With funds in excess of $18,000,000 invested in short-term securities at year end, and with substantial unused lines of credit, your Company is in a position to expand into an improving economy, and to take advantage of acquisition opportunities as they arise. Our policy of fiscal prudence has shown once again its value, and we foresee continuing improvement through 1984.

At Federal Industries, we think of ourselves as students of business management, but not in the academic sense. We study on the playing field of business and like most scholars, find our subject endlessly fascinating, rich in challenge and far from being mastered.

This section of our "annual report card" is a summary of what we've learned in recent years about managing diversity, and how we've applied this knowledge to your company's latest acquisitions. A more general discussion of the subject of managing diversity can be found at the back of the Report.

In 1980, as Federal's balance sheet gained strength, management turned its attention toward the future. Although our subsidiaries operating at that time had substantial growth potential, the basic thrust of Federal's growth needed clarification. Should we continue diversifying, or concentrate on our existing businesses?

To answer that question, we looked at the fundamentals (a lesson we've learned well). We found that businesses work best when operating management is well experienced in their particular industry, and decided that Federal's subsidiary management teams were better qualified by this measure than our Head Office team. We looked at the long range prospects for each of our companies and found that each had good potential, but each faced uncertainties that could be crippling under certain circumstances. We looked at the Canadian and world economies and found the outlook turbulent. Though all of Federal's subsidiaries were in transportation-related industries, consolidating them under a single operating management team appeared to offer little benefit, and would create several significant problems.

As a result, our direction seemed clear: to leave subsidiary management operating their companies and

R.J. Vahsholtz
Vice-President, Planning

to provide them the means to do the job.

Defining objectives and strategy

While we continued our aggressive efforts to find ways to improve the management of existing subsidiaries, Federal's Head Office launched a major planning effort to find a long range objective and an overall strategy for the parent company.

From our own experience, and from the experience of others drawn from textbooks, magazine articles and biographies of great businessmen, we'd learned the importance of sound structure and proper financing. We'd learned the importance of the bottom line, strategic planning and balance sheet management. And we'd learned the importance of teamwork: now more than ever, business management is the art of finding and maintaining the *balance* of a greater number of critically important factors than any one person can fully understand.

Confident of our ability to manage the fundamentals of business, we also viewed our experience in managing diversity as one of our key strengths. We concluded that diversity *can* be managed, given experienced and capable management, and we found many companies doing so successfully, including ourselves. We concluded that the benefits of managing diversity are real, though not quite as perceived by the early conglomerators, and that diversified management offers great advantages in turbulent times. Mastering the skills required to manage diversity seemed to offer great potential to Federal Industries, more so than concentrating on a particular industry and learning to master its intricacies. The decision to remain diversified — and refine and polish our acquisition strategy — was made and confirmed.

By 1983, our acquisition criteria were well developed and well understood. Scores of candidates that could fit well with existing operations had been evaluated, many rejected and several identified as targets, awaiting only opportune conditions for a mutually profitable transaction. Our balance sheet was strong, our Federal management team well developed, and all subsidiaries under good management control.

The acquisition criteria we developed over a five-year period appear simple (see the answer to shareholder question on page 49) — yet like most simple things, they are more complex than they look and require full understanding. The two acquisitions our company made in 1983 — Canadian Motorways and Russelsteel — fully met these criteria.

Calculated risks taken

Driving our acquisition strategy was our commitment to fiscal prudence — our responsibility for managing the investment entrusted to us by Federal's shareholders. Business is a game played with real dollars — and the outcome is of more than academic interest to investors. Management's challenge is to take carefully calculated risks in search of substantial gains while avoiding any action that might jeopardize the equity base.

As in any bold business venture, there are many risks in acquisitions. Our criteria for fiscal prudence seek to minimize these risks by avoiding excess leverage, by concentrating on stable industries, by avoiding long-term capital commitments and by seeking proven operating strength. Another danger often overlooked is compatibility of cultures: the ability of an acquired company and its parent to agree to a set of common objectives and move toward them with unified purpose. Our criteria are designed to filter out companies embodying these high risk components and, in doing so, eliminate some otherwise very attractive opportunities.

Canadian Motorways Ltd. and Russelsteel Inc. are both solid, stable companies serving basic industries with long-standing markets. Both have dominant positions in those markets and are managed by experienced teams having a long track record with their respective companies. Neither is long-term capital intensive and both have the flexibility to adapt to changing times. In both cases, their operating management favoured acquisition by Federal and see significant strategic opportunities that previously were not available to them. Both have profitable histories, both were bought for less than book value and both now have improved balance sheets.

The acquisition of Canadian Motorways and Russelsteel Inc. has also reduced Federal's dependence on natural resource industries and enhanced the Company's ability to capitalize on strategic opportunities during periods of economic upheaval. Though their management cultures are quite different, both cultures are well developed, proven workable, and compatible with Federal's. We're comfortable with them and believe they're comfortable with us. Both Canadian Motorways and Russelsteel differ somewhat from other Federal companies and offer unique strategic opportunities. However, they share many operating commonalities with our existing subsidiaries and can be looked upon as "focused diversification".

Now more than ever, business management is the art of finding and maintaining the* balance *of a greater number of critically important factors than any one person can fully understand.

Despite our optimism and the *esprit de corps* currently being demonstrated, experience tells us there may be surprises or a nasty shock or two. Our acquisition criteria can only reduce risk; not eliminate it. We would have preferred more time between the two acquisitions, but circumstances provided only six months. In fact, during most of 1983, both acquisitions were under way simultaneously, along with investigations of other potential candidates. When the Canadian Motorways negotiations were complete, we continued with Russelsteel and others, keeping our options open until we were reasonably certain that Motorways was working as anticipated. As the Russelsteel acquisition neared completion, we withdrew from active pursuit of other targets. Now that these two companies have joined the Federal group, our prime task is absorbing and integrating them, and that task is proceeding smoothly. We are confident the acquisitions will prove valuable additions to your Company, and that both companies will contribute to both short-term and long-term Federal earnings.

Other acquisitions on horizon

Though the pace has slowed, we have not stopped looking toward further acquisitions. In fact, there are investigations under way on strategic acquisitions destined to become part of existing subsidiaries, and preliminary work is being done on the next major target. We're prepared to seek opportunities in industries not currently on the glamour hit parade and, in fact, we see considerable evidence that the best prospects often lie in areas overlooked by most acquisitors. Acquisition criteria are now being revised with an objective of further refining Federal's group of companies along a path of planned and balanced growth. In short, 1983's acquisitions are incremental steps toward our prime objective of building a Great Canadian Company.

Our strategy for managing diversity in pursuit of greatness is one of incremental progress. By the end of 1982 in Federal's long range plan, we had accomplished the basics. We had built a small but strong and well-managed foundation of diversified but related companies. In 1983 we made a big step, increasing the size and scope of the company, but staying comfortably close to industries, management styles, and environments where we have demonstrated expertise. By buying profitable companies at less than book value while keeping leverage low, risk has been minimized. The next step is to demonstrate that these major acquisitions can be smoothly integrated into the Federal system and perform as planned.

For the next few years, our challenge is to perfect our skills at managing diversity which will be facilitated by remaining concentrated on relatively stable industries and companies. As our ability to manage these relatively straightforward operations becomes perfected, we can perhaps broaden our acquisitions to include companies in high growth or technology intensive industries.

As students of management, we have learned from our own experience, and the experience of others, and have put these lessons to use. We think of ourselves as "mature students" continuing to learn as we work, seeking our marks on Federal's bottom line.

Over the past two years the face of Federal Industries has changed dramatically, primarily as a result of acquisitions. The business activities comprising Federal have increased, and the structure into which they were organized has evolved, based on a commonality of interests.

As a result, in the 1983 Annual Report, the previous three Divisions, Transportation, Aerospace and Terminals, have been combined into two Groups: Aerospace and Transport, the latter now including Terminal operations. In addition, the year-end acquisition of Russelsteel formed the basis of a third Group, Industrial Distribution. Each of these Groups and the companies which constitute them have capable management teams, with proven experience in their particular industry. Federal's Corporate office works with the Group executives to develop long-term strategies for future growth, thus providing the detached but committed overview that complements management's operating knowhow.

The three Groups and their constituents are as follows:

Aerospace Group:
Standard Aero Limited
Standard Aero International Inc.
PF Industries, Inc.

Transport Group:
The White Pass and Yukon Corporation Limited
Canadian Motorways Ltd.
Thunder Bay Terminals Ltd.

Industrial Distribution Group:
Russelsteel Inc.
Russelsteel (U.S.A.) Inc.

Key Appointments

Underscoring our commitment to management strength as a key ingredient in your Company's success, a number of key senior management appointments were made during 1983 and early 1984 — two of which established new positions with overall Group responsibility.

William E. Watchorn
Vice-President

In the Aerospace Group, Edward G. Kelley, a seasoned executive with extensive experience in the aviation industry in both the U.S. and Canada, joined Federal as Chief Executive Officer of the Aerospace Group. A former Colonel, Chief of Flight Test in the U.S. Air Force, Ed was Chief Operating Officer of Pacific Southwest Airmotive, a major American aviation overhaul subsidiary of Pacific Southwest Airlines — and, most recently, President of Rolls-Royce (Canada) Ltd. in Montreal.

In the Industrial Distribution Group, Wayne P. E. Mang, is President and Chief Executive Officer of Russelsteel Inc. and has overall responsibility for the various units in that Group. Wayne is a Chartered Accountant who has served Russelsteel and predecessor companies for more than 20 years in a variety of capacities, most recently as President and Chief Operating Officer.

At Standard Aero International, Inc., Mr. W. L. Carolla became Chairman of the Board, moving up from President. Gino L. Cantele was appointed President and General Manager. Gino's 28-year career in the aviation industry has involved senior management positions in several aviation parts supply companies, and ownership of both a Cessna multi-engine dealership and an aircraft electronics supply company. A business administration graduate, Gino is also an airline transport rated pilot.

Within the Transport Group, two key appointments were made.

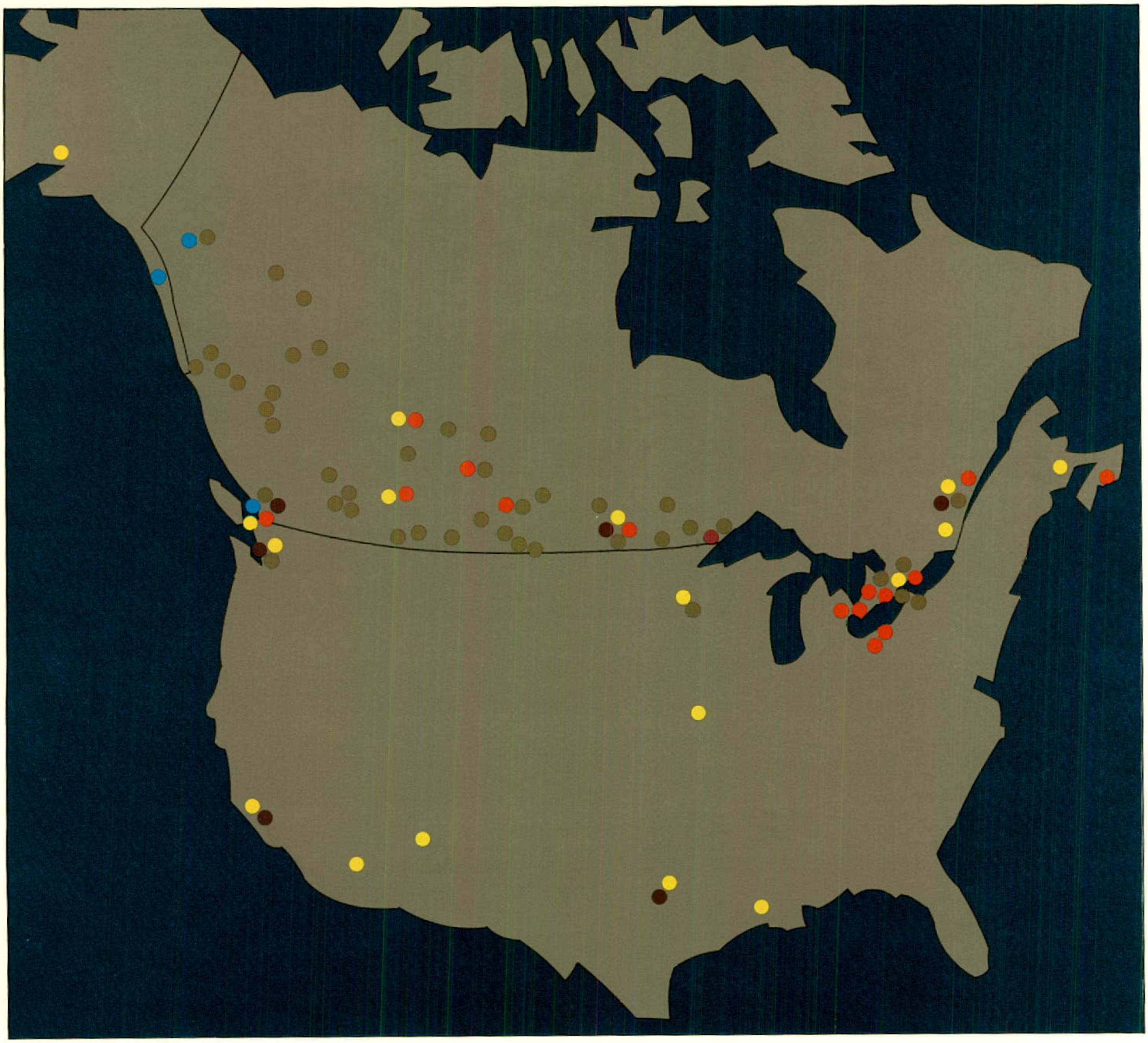
At Thunder Bay Terminals Ltd., N. H. (Jack) Carr was made President and General Manager. Jack's experience with terminal operations stems from his 15-year career with Iron Ore Company of Canada in which he held management positions in Sept Iles and Labrador City. A member of the Canadian Institute of Mining and Metallurgy and the American Institute of Mining and Engineering, he joined Thunder Bay Terminals in August of 1979 and was appointed Vice-President and General Manager in 1981.

At Canadian Motorways Ltd., Federal's newly-acquired trucking company, Paul J. Maley is President. Paul joined Motorways in 1955 and held a number of increasingly important management positions prior to his appointment as the company's senior executive in 1979.

Summary

We believe the new Group structure better links those companies with common interests, provides for both operating economies and co-operation, encourages improved penetration of specific markets and offers greater flexibility in adapting to future growth.

The following pages provide considerable detail on Federal's Group operations. Photographic coverage is dedicated to businesses acquired during the year.



- The White Pass and Yukon Corporation
- Canadian Motorways Ltd.
- Thunder Bay Terminals Ltd.
- Standard Aero Limited
- Standard Aero International
- Russelsteel Inc.

Not shown is the international network of branches, agencies and service centres operated by Standard Aero Limited and Standard Aero International.

AEROSPACE GROUP

Standard Aero Limited

Standard Aero Limited, based in Winnipeg, is primarily engaged in the repair and remanufacture of engines and related accessories for helicopters and fixed wing aircraft.

Despite the continued slowdown in development and exploration within the Canadian natural resource sector, the profitability of Standard Aero Limited increased in 1983, reflecting both higher gross margins and better volumes.

These positive results are due primarily to the company's concerted effort to increase penetration of the U.S. market. While helicopter hours in Canada declined about 20% during 1983, after a decrease of 25% in 1982, commercial sales to the U.S. increased by 72% over the previous year. This increased export orientation, coupled with a 19% increase in sales to the Canadian Armed Forces, more than offset the decrease of 26% in Canadian commercial activity and resulted in an overall increase of 6% in sales compared to 1982.

Reflecting the company's aggressive pursuit of military and foreign markets are the 1983 appointments of a Manager of Government Sales and a Military Supply Specialist, and an expanded, reorganized Marketing Department. SAL now has employees in Los Angeles, Dallas and Shreveport, Louisiana, and has established five new Service Centres: Trans Quebec and LaVerendrye in Quebec, SECA (Societé D'Exploitation Et De Constructions Aeronautiques) in France, OGMA (Officinas Gerais De Material Aeronautics) in Portugal and SAEOL (Singapore Aero Engine Overhaul Limited) in Singapore. Agents have also been appointed in South America and South East Asia. In order to provide more extensive coverage and service to the expanding set of worldwide customers, the Marketing Department was reorganized as of January 1, 1984 on a program basis, with managers responsible for each of the various engine types overhauled at Standard Aero.

Edward G. Kelley
Chief Executive Officer
Aerospace Group

Although Canadian turbine engine overhaul activity was down substantially in 1983, piston engine overhaul increased by 44% over 1982, largely due to a new marketing strategy designed to increase market share while retaining current margins. The company's commitment to the overhaul of piston engines was strengthened during the year with the purchase of the formerly leased, 2,740 sq. meter (29,500 sq. ft.) building which houses this activity.

Significant productivity improvements were achieved in 1983. A parts kitting concept was introduced to speed field repairs and turnaround times. Shop floor and inventory control procedures at Standard Aero will also be streamlined for greater cost and service efficiency with the phase-in over the next two years of a new IBM System 38 computer.

Five Year Review ($ millions)

12 Months	Sales: Overhaul	Sales: Distribution	Sales: Total	Earnings from Operations*
1983	44.2	46.7	90.9	4.0
1982	38.1	37.9	76.0	8.1
1981	46.0	28.2	74.2	12.4
1980	37.8	23.5	61.3	8.9
1979	32.3	14.4	46.7	5.7

*Before taxes, extraordinary items, interest and inter-company charges.

Although no new engine lines were taken on during the year, engineering evaluation studies on several new engine lines were undertaken and are continuing. The company is also refining, following evaluation of industry proposals, specifications for new engine test cells. Standard Aero's present test facilities are designed for piston and turboshaft (propeller) engines. If turbo thrust ("jet") engine overhaul is undertaken, a new test cell would be required, at a cost of several million dollars.

Engineering services were expanded to include publishing of technical publications for our customers, and a government research and development grant was obtained to examine ways of reworking parts now purchased new from original suppliers. We expect these activities will signal new opportunities for our extensive overhaul facilities.

Again this year, Standard Aero Limited complied with the government's 6&5 guidelines by restricting salary adjustments at all levels to 5%.

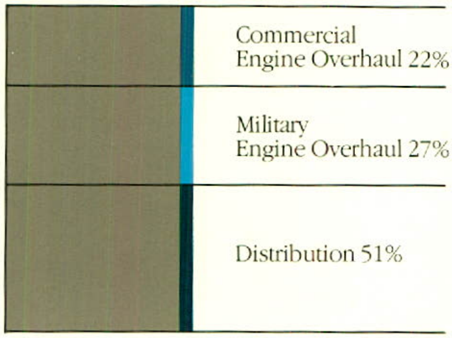
PF Industries, Inc., located in Seattle, Washington and purchased by the company in 1982, manufactures maintenance and ground support equipment for the current generation of large commercial aircraft.

Sales of PF Industries, Inc. in 1983 totalled $2.9 million, virtually unchanged from 1982. The fortunes of PF Industries are tied to the demands of the world's airlines for the new generation airliners, particularly those built by the Boeing Commercial Airplane Company. With the commercial airline industry experiencing economic difficulty, production of new commercial aircraft has been curtailed, and the expected sales growth for PF's products has not materialized. Nevertheless, PF's market share has increased significantly and it is in an ideal position to capitalize with proprietary products when the demand for new generation airliners improves.

Standard Aero International Inc.
The financial performance of the distribution operations was a significant disappointment. Although reported sales in 1983 were up 23.2%, this increase was well below forecast and reflects the full-year impact of the SPAD and IMI acquisitions in mid-1982 rather than real sales gains. Gross margins showed some erosion due to increased competition and expenses exceeded expectations, primarily due to start-up costs of relocating the head office to Minneapolis, integrating the various distribution companies into a single operating unit and the cost of acquiring and modifying new operating systems. While many of the expenses incurred in 1983 were of a one time nature, some will continue as the company further develops and pursues operating efficiencies.

The strengthening U.S. economy during 1983 had little favourable impact on the aviation distribution business, which tends to trail a general economic upturn. U.S. distribution sales doubled during the year, reflecting the 1982 acquisitions noted above, but sales were down somewhat on a relative basis. Several new general aviation distributorship agreements were executed, enhancing the company's product lines. The Atlanta and Long Beach hose facilities were closed following consolidation of the airline hose manufacturing business in Kansas City.

Aerospace Group sales distribution for the twelve months to December 31, 1983.



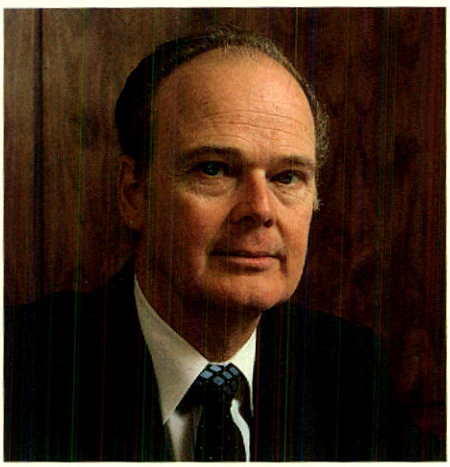
Canadian distribution operations did not escape the slowdown in the Canadian resource industry, although the effect was not as severe as on overhaul operations due to the wider marketplace of distribution activities. Adverse economic conditions, combined with strong competitive pressures and a decline in the aircraft population, resulted in a year-to-year sales decrease of approximately 12%.

While overall sales outside North America increased 46% over 1982, the depressed European economy resulted in a 14% decrease in sales for the London operation. Most military operators of the engines sold in Europe curtailed flying activities during the year — reducing the demand for spare parts and engine overhaul — and increased competition from U.S. based distributors affected both sales and margins. However, prospects for 1984 are much more encouraging as two new overhaul facilities sponsored by Standard Aero begin operation in Portugal and in France, with parts to be supplied from our London branch. Far East operations showed much improved performance during 1983 with a fourfold increase over 1982. Sales of new engines and related products contributed significantly to these results.

During 1983 the company undertook an exhaustive evaluation of its operational financial systems. A two-year program to upgrade significantly all operating and control systems was developed and implementation commenced. An integral part of this plan will see the establishment of a Minneapolis based central warehouse in early 1984 coupled with sophisticated purchasing and inventory control systems. These changes will further improve the division's ability to efficiently serve its customers. The corporate office was relocated to Minneapolis at the beginning of 1983, replacing functions previously carried out in two separate locations, Bellevue, Washington and San Jose, California. The costs of these decisions, which will be of great long-term benefit, were all written off in the year, contributing significantly to the loss incurred.

For 1984, the company is planning to open two new branches in Miami and Minneapolis. Improved customer service and more aggressive marketing should enable the company to continue to increase market share in its operating areas. Costs are now under tight control, and there are signs that the aviation industry is beginning to see increasing activity. If this trend continues, the company is well positioned to benefit.

Gino L. Cantele
President and General Manager
Standard Aero International Inc.



Gordon B. Sampson
President and General Manager
Standard Aero Limited

TRANSPORT GROUP

The White Pass and Yukon Corporation Limited

The White Pass and Yukon Corporation Limited provides a full range of transportation and petroleum distribution services to northern British Columbia and Yukon Territory.

In 1983 White Pass revenues totalled $40.8 million, a decline of approximately 50% from revenues of $80.8 million in 1982. This dramatic decline resulted primarily from the closure of the Cyprus Anvil lead-zinc mine in Yukon and the subsequent "mothballing" of White Pass' marine, rail and bulk haul truck operations. The primary management task during 1983 was to take the actions necessary to offset this disastrous drop in revenues and to put the company in, at worst, a breakeven position under current circumstances. While this program had a serious and adverse impact on results for the first six months of the year, this objective was achieved in 1983.

Five Year Review ($ millions)

12 Months	Sales: Petroleum	General Freight	Bulk* Haulage	Terminals	Other	Total	Earnings† from Operations
1983	29.1	59.2	1.0	20.9	2.7	112.9	17.7
1982	41.3	6.5	30.5	22.2	2.7	103.2	13.9
1981	55.0	7.7	34.0	18.7	3.1	118.5	18.9
1980	39.9	7.7	30.5	17.1	2.7	97.9	15.3
1979	28.0	5.4	30.2	14.8	1.6	80.0	8.8

***Includes rail, marine and truck equipment and facilities.**
†Before taxes, extraordinary items, interest and inter-company charges.

Bulk Haulage, Marine and Rail Divisions

The operations of all three of these divisions were suspended in the first quarter of 1983 due to the announcement that the Cyprus Anvil mine would not ship concentrates in 1983. Except for key management positions, all staff in these three divisions was laid off in the first quarter of 1983. Equipment and facilities required to operate these three divisions are being maintained in readiness at a minimum cost until such time as the Cyprus Anvil mine might commence milling operations and product shipment.

The company continues to explore a number of options to utilize the two owned ships in the marine division on a variety of special projects.

During the year White Pass was successful in having the Full Crew Law repealed in Alaska. The Full Crew Law had constrained operations by requiring overmanning in its rail division in the U.S. The company can now work with the unions to develop more appropriate staffing levels. When the railway reopens, it is of paramount importance that management recover its rights to conduct its operations in the most efficient manner and that the high cost of labour be moderated to make the rail more competitive with other forms of transportation in Yukon. During 1983 and continuing in 1984, management has and will continue to negotiate with the various unions to achieve these vital objectives.

As a result of the disastrous economic impact of mine closures, in June, 1983, the Yukon Territorial Government asked the Canadian Transport Commission to carry out a special inquiry into Yukon transportation. White Pass' position paper to the CTC stated that the preferred option for transporting minerals from Yukon mines was the railway, and a transportation subsidy should be provided to the mine if railway costs were shown to be higher than trucking. The CTC's preliminary report, issued on December 15, 1983, clearly supported the railway by indicating that, if direct and indirect costs are taken into account, the railway is the most economic means of moving mineral concentrates to tidewater. The inquiry, and the ensuing process of industry/government communication, bode well for a solution to this longstanding problem.

Petroleum Division

The petroleum division continues to be profitable although volume declined by 39% to 15.2 million gallons, reflecting the severe economic decline in Yukon and increased competition as a result of the continuing glut of petroleum products in western Canada.

Improvements were made in the pipeline system between Skagway, Alaska and Whitehorse, Yukon to allow for the movement of gasoline products through the line. Previously, gasoline products were transported by rail tank car. In addition, advanced filtration systems were installed and a laboratory placed in Whitehorse to ensure the noncontamination of products.

A long-term contract was signed with Imperial Oil Limited to transport petroleum products via marine-

Thomas H. King
President and Chief Executive Officer
White Pass and Yukon Corporation Limited

pipeline and provide bulk storage in Yukon.

Looking ahead to 1984, The White Pass and Yukon Corporation has restructured its non-trucking operations to maintain, at a minimum, a break-even position assuming no change in present conditions. Should the CTCs final report be consistent with the preliminary report and government adopt the recommendations contained therein, or should the Cyprus Anvil mine reopen and White Pass recover its tonnage, northern operations of White Pass would again provide a positive profit contribution to Federal.

Land Division

A $1 million sale of land to the Government of Yukon was consummated in the fourth quarter of 1983. The proceeds from this sale were used to repay the loan of equal amount from the Government of Yukon received in 1981 as part of the purchase price of four new locomotives which, to this date, remain undelivered.

Canadian Motorways Ltd.

General Freight

Newly-acquired Canadian Motorways Ltd., headquartered in Winnipeg, is one of Canada's ten largest general freight truck transportation companies with sales in excess of $100 million.

Paul J. Maley
President
Canadian Motorways Ltd.

White Pass' general freight trucking has been combined with that of Canadian Motorways, one of Canada's largest carriers with sales in excess of $100 million.

Canadian Motorways Ltd. has over 1,700 employees, owns 2,600 pieces of transportation equipment, and conducts operations from 46 terminals and 11 agencies in Canada, and 3 terminals in the U.S. Acquired through White Pass in July 1983, the general freight operations of the two companies were integrated in November 1983.

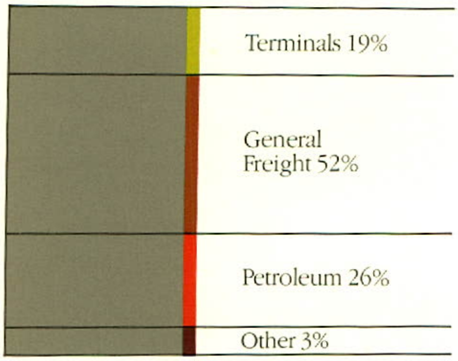
Motorways' operations are divided into four regions: the Western Region consisting of British Columbia and Yukon, the Alberta Region, the Central Region consisting of Saskatchewan, Manitoba and northwestern Ontario to Thunder Bay, and the Eastern Region extending from Thunder Bay to Montreal. As part of its "LTL" (less than truckload) operations, Motorways provides an express service operating from Montreal and Toronto to Winnipeg, Regina, Saskatoon, Calgary, Edmonton and Vancouver under the trade name "MOTOSPAN".

The full load contract hauling operations of Motorways are carried on through its Cougar Freight Systems division which utilizes independent contractors to provide motive power. Under the trade name "HIGH-TECH", Motorways operates a specialized service for transporting fragile equipment including computers and related equipment, banking equipment, and fragile office equipment such as photocopiers.

The recessionary trend that adversely impacted Motorways' freight volumes in 1981 and 1982 continued into the first half of 1983. The company enjoyed a mild upturn in business activity during the third quarter which dropped off in the fourth quarter, partially due to seasonal factors. Overall, Motorways experienced a 3% decline in volume over 1982, although the industry in total had tonnage declines averaging 12%.

For the six months ended December 31 — the period of ownership by The White Pass and Yukon Corporation Limited — Motorways reported revenues of $51.1 million, an increase of 4% over the comparable period in 1982. During this period Motorways provided a profit contribution to the Transport Group. On a full year basis, 1983 revenues of $102.5 million were approximately equal to 1982. These results reflect a volume decline which was effectively offset by freight rate increases.

Transport Group sales distribution for the twelve months to December 31, 1983.



The sale of Motorways' household moving operations was completed in 1983. While revenue for this portion of operations amounted to approximately $18 million on an annual basis, it had only returned acceptable profits in two of the last nine years. The purchasers of this operation assumed all union contracts and offered employment to most salaried personnel. As a result of the closing of the household division, Motorways has a number of redundant assets which it plans to divest. The funds so generated will be redeployed in its primary general freight activities. Divestiture of this operation will enable the company to devote all of its time and resources to its primary activity, general freight operations.

During 1984 the company will pursue improved productivity in its existing operations and expand volume in those regions where it can do so profitably, with particular emphasis on eastern Canada. The company will focus on increasing tariffs where possible and work to reduce labour costs so as to improve its competitive position relative to

In addition to its regular general freight operations, Canadian Motorways offers a less-than-truckload express service, from Montreal and Toronto to Winnipeg, Regina, Saskatoon, Calgary, Edmonton and Vancouver, under the name MOTOSPAN.

other carriers, many of which are non-union. Strategies are being developed to increase the company's international traffic through its three U.S. portals — Seattle, Minneapolis/St. Paul and Buffalo.

Thunder Bay Terminals Ltd.
Bulk Terminal

Thunder Bay Terminals Ltd. operates a bulk handling facility at the Port of Thunder Bay, Ontario. Volumes of both coal and potash declined slightly in 1983 in comparison to the volumes handled in 1982.

Potash volumes were down to 887,195 metric tonnes from 1,027,992 metric tonnes in 1982 as a result of large feed grain surpluses in the U.S. and the U.S. Department of Agriculture's Payment In Kind program which took much land out of production. However, shipments of potash picked up substantially in the last quarter of 1983. Total 1983 potash volumes would have been almost equal to last year had it not been for the cancellation of several cargoes in late December due to unusually severe weather conditions. Coal throughput declined to 2,874,618 metric tonnes in 1983 from 3,029,398 metric tonnes in 1982. This shortfall resulted from a negotiated reduction in Ontario Hydro's contractual deliveries from western Canadian coal mines due to Ontario's reduced requirements for fossil fuels.

Motorways' full-load contract hauling operations are carried out through its Cougar Freight Systems Division, which utilizes independent contractors to supply motive power.


N. H. (Jack) Carr
President and General Manager
Thunder Bay Terminals Ltd.

The late season surge in the movement of potash will likely carry over into the spring of 1984. This improvement was brought about by year-end reductions in surpluses of feed grains and a poor 1983 harvest caused by drought conditions. Fertilizer sales for 1984 are expected to be very strong.

During the year, the company successfully concluded negotiations with CP Rail for a long-term potash handling agreement providing for a new $5.75 million dry bulk handling system to be constructed adjacent to the company's coal handling facility. Although initially intended for the handling of potash, the new system will be compatible with a wide variety of free-flowing, bulk commodities, including agricultural products, and will provide many new opportunities for the terminal. At year end, construction was well under way and it is expected that the system will be completed for the opening of navigation in 1984.

During 1983, Mr. N.H. Carr was appointed President and General Manager after the resignation of Mr. A.S. Leach, Jr. Mr. Carr was Vice-President and General Manager at the time of his appointment. In addition, Mr. K.W. Traynor, formerly Director of Finance and Treasurer, was appointed to the new position of Director of Marketing, and Mr. J.W. Kepes was promoted to Director of Finance and Treasurer from Controller.

Profitability of the terminal in 1983 suffered slightly from lower volumes, but increased coal demand — the result of difficulties with Ontario nuclear power stations — coupled with greater potash tonnage should increase net returns in 1984.

THE INDUSTRIAL DISTRIBUTION GROUP

On December 31, 1983 Federal Industries purchased substantially all the assets of the Canadian Metals Group, the Lytle Specialties division, and the U.S. division of the Metals Group from York Russel Inc. The assets, primarily inventory, receivables, plant and equipment, real estate and leases, are now owned and operated by a new subsidiary of Federal Industries, Russelsteel Inc.

Russelsteel Inc. is the largest steel service centre operation in Canada, with expertise and operations in each of the major market segments and branches located across the country. The company is one of the largest customers of each of the major Canadian steel mills, has gross assets of approximately $100 million and employs more than 750 people.

Russelsteel's operations are carried out from 17 locations, 14 in Canada and 3 in the U.S. Operations are organized along product lines into three major segments: general line; flat-rolled; and specialty. Each branch is responsible for organizing and controlling day-to-day operations and ongoing development in its geographic and product areas. Overall control and financial planning are provided by corporate management located in the Toronto head office. A central computer system linking each Canadian location provides information concerning inventory, sales and customer credit.

The general line product segment consists of 11 service centres focusing primarily on the distribution of general line carbon and stainless steel products with a broad range of sizes, shapes and specifications. Substantial inventory is maintained at each service centre and sales are primarily from this stock. While some orders involve a limited amount of processing — such as sawing, shearing or flame cutting — prior to shipment, the chief function of these

Wayne P. E. Mang
President and Chief Executive Officer
Russelsteel Inc.

service centres is the holding of inventory and subsequent distribution of steel products to a broad range of customers.

The flat-rolled product segment consists of Russelsteel (Hamilton), Vincent Steel (Toronto) and B&T Steel (Hamilton). Both Russelsteel and Vincent Steel are primarily engaged in the warehousing, processing and distribution of sheet, strip and coil steel. Processing principally involves the slitting and cutting to length of strip and coil products. Customers are, for the most part, manufacturers of consumer and consumer-durable products such as appliances and automobiles. These two companies also distribute conventional coil steel grades and sizes with capabilities and efficiencies competitive with other processing oriented distributors. B&T Steel, a relatively new operating unit which commenced operations in 1981, utilizes heavier equipment designed for processing thicker coil steel grades and wider, heavier, flat-bar products.

The specialty product segment forms the U.S. operating division and

The core of Russelsteel's operations is a network of 11 general line service centres which stock a broad range of shapes and sizes of carbon and stainless steel products. Russelsteel also provides flat roll steel and specialty metals and, through its Lytle Specialties Division, is Canada's largest distributor of industrial valves, piping components and related products.

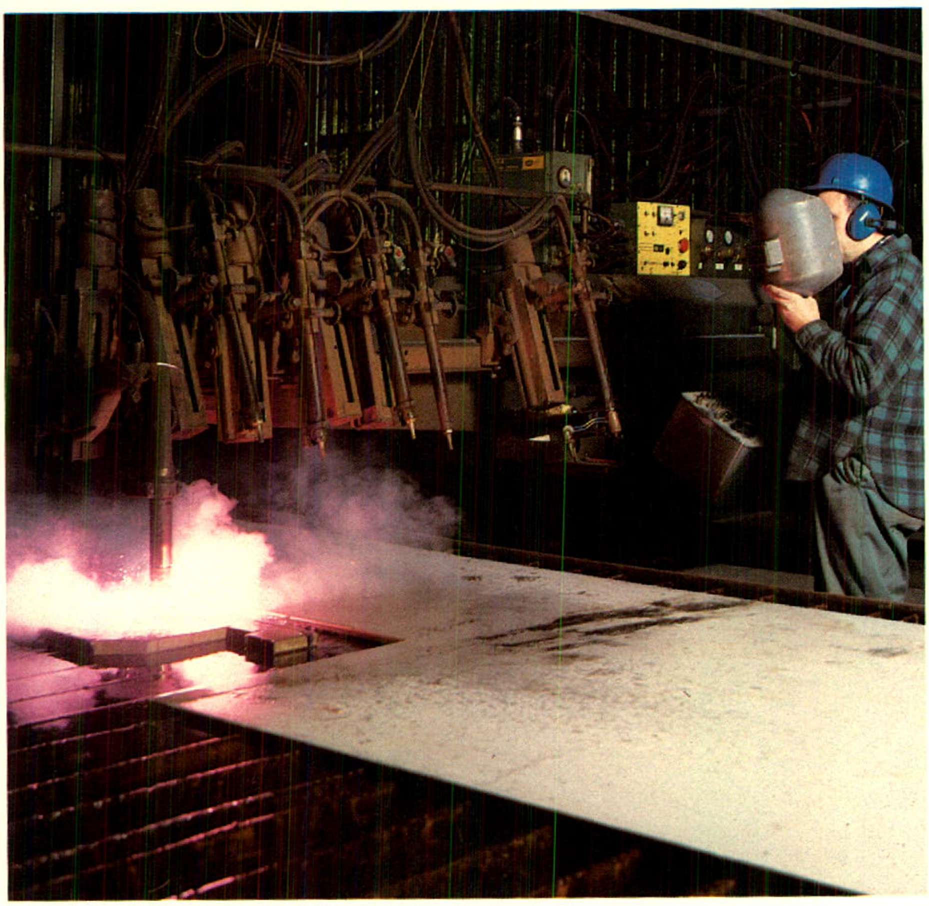
distributes alloy steel plates and bars to industry, mines and utilities for machine repair and maintenance applications. Products are shipped throughout North America from two locations in Cleveland and one in Detroit, and marketed by a network of sales agents and representatives in major centres across the U.S. and Canada.

The Lytle Specialties division is the largest distributor of industrial valves, piping components and related products in Canada. Lytle currently has branch operations in Calgary, Edmonton, Winnipeg, Toronto, Sarnia, Stoney Creek, Montreal and Dartmouth. This branch network enables Lytle to provide fast service and close contact with its customers in all major manufacturing areas of Canada. Lytle maintains inventories at all branch locations as determined by local market needs. Branches are supplied with certain items from the central warehouse in Montreal, but the bulk of inventory is shipped directly from the manufacturer.

Lytle's customers are mainly oil refineries, petrochemical and other processing plants, pipeline companies, paper mills, steel mills, utilities and general construction contractors.

Overall, it's expected that the Industrial Distribution Group will both contribute to Federal's 1984 earnings and further reduce dependency on the natural resource sector. While Lytle Specialties, which primarily services the capital expenditure segment of the market, should not show a substantial increase over 1983, Russelsteel operations in Canada and the United States should benefit significantly from the consumer-driven economic recovery currently under way.

Russelsteel's B&T Steel unit in Hamilton, Ontario processes heavier and wider coil and flat-bar steel for appliance, automobile and other manufacturers.



Flame cutting is one of the customer services offered by Russelsteel. Most orders, however, are shipped directly – without processing – from large inventories.

FINANCIAL INFORMATION

CONSOLIDATED BALANCE SHEET

Assets For the year ended December 31, 1983	$000	
	1983	1982
Current		
Cash and short-term deposits	**$ 18,551**	$ 4,342
Accounts receivable	**73,990**	25,340
Income taxes recoverable	**2,770**	1,149
Inventories (Note 3)	**105,259**	49,586
Prepaid expenses	**2,052**	667
Claims recoverable	**380**	304
Current portion of long-term receivable (Note 5)	**3,850**	3,850
Total current assets	**206,852**	85,238
Fixed (Note 4)		
Property, plant and equipment, at cost	**254,547**	161,164
Accumulated depreciation	**100,277**	54,780
	154,270	106,384
Other		
Long-term receivable (Note 5)	**2,702**	1,925
Other investments, at cost	**3,027**	2,366
Deferred charges	**5,162**	145
Goodwill, less amounts amortized	**2,043**	2,072
Other intangible assets, less amounts amortized	**2,913**	1,439
	15,847	7,947
	$376,969	$199,569

Liabilities For the year ended December 31, 1983	$000	
	1983	1982
Current		
Bank indebtedness, secured (Note 7)	**$ 10,344**	$ 9,683
Accounts payable and accrued liabilities	**62,372**	18,562
Dividends	**801**	652
Current portion of long-term debt	**6,861**	5,799
Total current liabilities	**80,378**	34,696
Long-term (Note 6)	**146,311**	71,895
Deferred income taxes	**7,567**	7,342
Minority interest (Note 8)	**5,500**	5,500
Total liabilities	**239,756**	119,433
Contingencies and Commitments (Note 14)		
Shareholders' Equity		
Share capital (Note 9)	**87,662**	32,433
Retained earnings	**49,551**	47,703
	137,213	80,136
	$376,969	$199,569

On behalf of the Board

Stewart A. Searle

Director

Director

See accompanying notes to financial statements.

CONSOLIDATED STATEMENT OF EARNINGS

For the year ended December 31, 1983	$000	
	1983	1982
Revenue (Note 12)	**$203,798**	$179,193
Cost of sales and operating expenses (Note 13)	**176,333**	152,638
Depreciation	**7,092**	7,159
Amortization of goodwill and intangible assets	**142**	74
Interest on long-term debt	**8,427**	6,760
Other interest expense	**1,317**	1,649
Interest earned	**(984)**	(492)
	192,327	167,788
Earnings before income taxes	**11,471**	11,405
Provision for income taxes (Note 11)		
Current	**2,335**	1,782
Deferred	**2,841**	3,222
	5,176	5,004
Net earnings	**6,295**	6,401
Earnings allocated to minority shareholders	**371**	372
Net earnings for the year	**$ 5,924**	$ 6,029
Earnings per Common Share (Note 10)	**$ 1.02**	$ 1.25

See accompanying notes to financial statements.

CONSOLIDATED STATEMENT OF RETAINED EARNINGS

For the year ended December 31, 1983	$000	
	1983	1982
Balance, beginning of year	**$47,703**	$44,849
Net earnings for the year	**5,924**	6,029
Share issue expenses, net of tax	**(1,025)**	—
Loss on redemption of shares	—	(671)
	52,602	50,207
Dividends		
Class II Preferred Shares, Series A	**259**	159
Class A Common Shares	**2,744**	2,238
Class B Common Shares	**48**	107
	3,051	2,504
Balance, end of year	**$49,551**	**$47,703**

See accompanying notes to financial statements.

Auditors' Report

Touche Ross & Co.
Suite 2000, 360 Main Street
Winnipeg, Manitoba R3C 3Z3
(204) 942-0051

To the Shareholders,
Federal Industries Ltd.

We have examined the consolidated balance sheet of Federal Industries Ltd. at December 31, 1983 and the consolidated statements of retained earnings, earnings and changes in financial position 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.

In our opinion, these consolidated financial statements present fairly the financial position of the Company at December 31, 1983 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.

Touche Ross & Co.

Chartered Accountants

Winnipeg, Manitoba
March 16, 1984.

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

For the year ended December 31, 1983	$000	
	1983	1982
Source of funds		
Operations		
Net earnings for the year	**$ 5,924**	$ 6,029
Add Depreciation	**7,092**	7,159
Amortization of goodwill and intangible assets	**142**	74
Amortization of deferred charges	**13**	87
Deferred income taxes	**2,841**	3,222
Accrued revenue in respect of deferred income taxes (Note 5)	**(2,379)**	(2,380)
Gain on sale of fixed assets	**(1,504)**	(685)
Earnings allocated to minority shareholders	**371**	372
Funds provided by operations	**12,500**	13,878
Proceeds on sale of fixed assets	**3,337**	901
Additional long-term debt financing	**24,859**	9,130
Issue of shares (Note 9)	**55,170**	2,876
Long-term debt assumed on acquisition of subsidiary companies	**61,034**	186
Other	**43**	1,097
	$156,943	$ 28,068
Application of funds		
Acquisition of subsidiary companies		
Fixed assets acquired	**$ 48,275**	$ 602
Other non-current assets acquired	**6,787**	109
Excess of cost of subsidiary companies over the book amount of net assets acquired	**—**	3,293
Purchase of fixed assets	**8,538**	3,183
Increase in long-term receivable net of deferred income tax component of $2,379 (Note 5)	**777**	98
Decrease in long-term debt	**11,477**	5,734
Dividends	**3,003**	2,397
Dividends paid by subsidiary company to minority shareholders	**371**	372
Redemption of shares	**—**	1,330
Other	**1,783**	456
	81,011	17,574
Increase in working capital, including $47,246 (1982-$3,490) increase due to acquisition of subsidiary companies	**75,932**	10,494
	$156,943	$ 28,068
Working capital, end of year	**$126,474**	$ 50,542

See accompanying notes to financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended December 31, 1983

1. Summary of significant accounting policies

a. *Principles of consolidation*

The consolidated financial statements include the accounts of the Company and all subsidiaries. The names of the principal subsidiaries, which are essentially all wholly owned, are as follows:

Canadian Motorways Ltd.
Russelsteel Inc.
Russelsteel (U.S.A.) Inc.
Standard Aero Limited
Standard Aero International Inc.
The White Pass and Yukon Corporation Limited
Thunder Bay Terminals Ltd.

All material inter-company balances, transactions and profits have been eliminated.

b. *Foreign currency translation*

The accounts of certain subsidiaries of The White Pass and Yukon Corporation Limited are maintained in United States dollars. These accounts represent integrated foreign operations and have been translated into Canadian dollars as follows: current assets, current liabilities and long term debt at exchange rates prevailing at the end of the year; fixed assets and depreciation substantially on the basis of rates prevailing at date of acquisition; income and expenses (other than depreciation) on the basis of average exchange rates during the year. Exchange gains or losses from such translation practices have been included in consolidated earnings.

The accounts of Russelsteel (U.S.A.) Inc., and certain subsidiaries of Standard Aero Limited are maintained in United States dollars. These accounts represent self-sustaining foreign operations and have been translated into Canadian dollars as follows: assets and liabilities at exchange rates prevailing at the end of the year; income and expenses on the basis of average exchange rates during the year. The adjustment arising from the translation of these accounts has been deferred and, as not material, included in accounts payable and accrued liabilities.

c. *Valuation of inventories*

Inventories have been valued at the lower of cost and net realizable value.

d. *Capitalization of leases*

All material leases of a capital nature have been recorded as fixed assets and long term debt obligations.

e. *Revenue recognition — bulk handling terminal contract*

A portion of the revenues accruing under the bulk handling terminal contract between Thunder Bay Terminals Ltd. and Ontario Hydro is being recognized on a basis that reflects an approximate constant return over each of the fifteen years of the initial term of the contract. (See Note 5).

f. *Depreciation*

Depreciation on property, plant and equipment is provided at rates which are estimated to amortize the original cost of such assets over their useful lives.

g. *Goodwill and intangible assets*

Goodwill on the balance sheet represents the excess cost of subsidiary companies over the book amount of net assets acquired, less amounts amortized. The Company's policy is to amortize goodwill over a forty year period. Intangible assets include: (i) organizational costs of subsidiary companies, amounts paid for distribution agreements and research materials, which are being amortized over a ten year period, and (ii) $1,538,000 of licenses, operating rights and franchises which are not being amortized.

h. *Income taxes*

The Company follows the tax allocation method of accounting for income taxes whereby earnings are charged with income taxes relating to reported earnings.

Differences between such taxes and taxes currently payable are reflected in deferred income taxes and arise because of differences between the time certain items of revenue and expense are reported in the accounts and the time they are reported for income tax purposes.

Potential tax reductions that may result from the application of losses against future taxable income are not recognized until recovery out of future taxable income is virtually certain.

i. *Basic earnings per share*

Earnings per common share are calculated using the weighted daily average number of common shares outstanding. The calculation of fully diluted earnings per share is described in Note 10.

j. *International accounting standards*

The accompanying financial statements are prepared in accordance with accounting principles generally accepted in Canada and conform in all material respects with international accounting standards.

2. Acquisition of subsidiary companies

During the year the Company made the following acquisitions:

a. Effective June 30, 1983, The White Pass and Yukon Corporation Limited acquired Canadian Motorways Ltd. which carries on a truck transportation business in Canada. Operations of this company are included in the accounts from the date of acquisition. The assets and liabilities of this company have been included in the consolidated balance sheet at December 31, 1983.

b. On December 31, 1983, the Company acquired steel and valve distribution businesses which are being carried on in Canada and the United States by Russelsteel Inc. and Russelsteel (U.S.A.) Inc. No operations of these companies have been included in the statements of earnings and changes in financial position for the year. The assets and liabilities of these companies have been included in the consolidated balance sheet at December 31, 1983. These acquisitions, which were accounted for by the purchase method, are summarized as follows:

	$000		
	Transport Group	Industrial Distribution Group	Total
Net assets acquired, at fair market values at acquisition dates			
Current assets	$ 19,461	$ 87,141	$106,602
Current liabilities	(28,110)	(31,246)	(59,356)
Working capital	(8,649)	55,895	47,246
Fixed assets	27,450	20,825	48,275
Other non-current assets	1,515	5,272	6,787
	20,316	81,992	102,308
Long term debt assumed	(4,042)	(1,992)	(6,034)
Other non-current liabilities	(134)	—	(134)
	$ 16,140	$ 80,000	$ 96,140
Consideration			
Cash	$ 16,140	$ 25,000	$ 41,140
Note payable, 12.36%, due 1988	—	55,000	55,000
	$ 16,140	$ 80,000	$ 96,140

3. Inventories	$000	
	1983	1982
Aerospace Group		
Aircraft engines	$ 6,405	$ 5,470
Work in process	3,207	3,149
Parts	28,104	27,699
	37,716	36,318
Transport Group		
Petroleum division products held for resale	7,650	8,825
Spare parts and supplies	3,437	3,054
Terminal division spare parts and supplies	1,429	1,389
	12,516	13,268
Industrial Distribution Group		
Metals division	49,498	—
Valve division	5,529	—
	55,027	—
	$105,259	$ 49,586

4. Fixed assets

	$000			
	1983			1982
	Cost	Accumulated Depreciation	Net	Net
Aerospace Group				
Land and buildings	$ 5,663	$ 1,964	$ 3,699	$ 2,358
Machinery and equipment	6,680	4,470	2,210	2,313
	12,343	6,434	5,909	4,671
Transport Group				
Petroleum distribution				
Storage facilities	4,138	512	3,626	3,637
Trucks	467	408	59	91
Land and buildings	1,820	841	979	909
Machinery and equipment	915	577	338	397
Transportation				
Rail and pipeline	36,699	10,401	26,298	26,355
Ship and containers	6,315	5,815	500	639
Trucks and containers	55,833	44,422	11,411	3,561
Skagway terminal	6,690	4,451	2,239	2,239
Land and buildings	23,967	4,050	19,917	2,131
Machinery and equipment	7,508	3,642	3,866	482
Equipment held for resale	6,540	4,175	2,365	2,207
Terminals				
Handling facilities	70,006	14,288	55,718	58,843
	220,898	93,582	127,316	101,491
Industrial Distribution Group				
Land and buildings	13,529	—	13,529	—
Machinery and equipment	7,296	—	7,296	—
	20,825	—	20,825	—
Other corporate assets	481	261	220	222
	$254,547	$100,277	$154,270	$106,384

Included in the amounts reported above are assets under capital leases of $4,833,000 (1982 — $3,194,000) and related accumulated depreciation thereon of $2,089,000 (1982 — $1,912,000).

5. Terminal handling facility — Thunder Bay, Ontario

a. *Coal handling facility*
Thunder Bay Terminals Ltd. has entered into a long term contract with Ontario Hydro for the construction and operation of a bulk terminal handling facility at Thunder Bay, Ontario. The total cost of the terminal is $69,851,000 of which $53,953,000 relates to facilities which became operational on March 1, 1979 and $15,898,000 relates to terminal facilities which became operational in 1981.

The cost of the terminal has been financed by the issue of $71,496,000 aggregate principal amount, 9⅝% First Mortgage Sinking Fund Bonds, Series A. As at December 31, 1983, the Series A bonds issued and outstanding aggregated $56,604,000. The terms and conditions of the Series A bond issue are provided for in a Deed of Trust and Mortgage dated as of October 12, 1977 between the company and the trustee for the bondholders.

Under the terms of the agreements with Ontario Hydro, Thunder Bay Terminals Ltd. will receive, over the initial fifteen year term of the contract, contractual amounts of revenue including specific revenue components to cover all payments required for the redemption of all of the Series A bonds and for income taxes. These revenue components become recoverable as and when the bond and income tax payments become due and payable. The use of the cash received in respect of these specific revenue components is restricted to the redemption of the Series A bonds and the payment of income taxes.

The amounts receivable over the fifteen years of the initial term of the contract to cover the redemption of the Series A bonds represent the revenues required to pay for the capital cost of the terminal facility. The net contribution to earnings from these revenues (total amounts receivable less depreciation on the terminal) is recorded in the accounts so as to reflect an approximate constant annual return over each of the fifteen years.

At December 31, 1983, the accrued revenues receivable from Ontario Hydro for the redemption of Series A bonds amount to $6,552,000 of which $2,702,000 is long term and $3,850,000 is current. The long term accrued revenues receivable for the payment of income taxes amount to $10,837,000 (1982 — $8,458,000), all of which relate to deferred income taxes. Because the $10,837,000 to be received is restricted to the payment of income taxes, the liability for the deferred income taxes has been netted against the long term receivable.

b. *Potash handling facility*
On September 16, 1983, Thunder Bay Terminals Ltd. entered into agreements with Canadian Pacific Limited for (i) the management and supervision of the construction of a dry bulk handling facility; and (ii) an exclusive license to operate the facility.

The initial term of the potash handling agreement commences upon completion of construction of the dry bulk handling facility and is scheduled to terminate on February 28, 1994.

6. Long term debt

	$000 1983	1982
Aerospace Group		
Bank loan, secured, ½% above United States prime rate	$ —	$ 1,842
Bank loan, secured, 2¼% above United States prime rate, due 1987	—	160
Bank loan, secured, 13.05% — 13.43%, due 1990	6,222	—
Note payable, 15%, due 1984	—	1,071
Other	49	9
	6,271	3,082
Transport Group		
Thunder Bay Terminal First mortgage bond, 9⅝% (Note 5)	52,754	56,604
First ship mortgage note, 8½%, due 1984	—	325
Capitalized lease obligations, 8.2% — 14.4%	1,785	1,039
Government of Canada non-interest bearing loan, secured by certain rail assets	4,750	5,000
Government of Yukon Territory non-interest bearing loan, secured by certain rail assets	—	1,000
Alaska Industrial Development Authority Port Facility 13¾% bond, 1985 to 1998	4,368	4,672
Mortgages, 10⅝% — 12½%, 1985 to 1988	3,409	—
Bank loan, secured, ½% above United States prime rate	403	—
Bank loan, secured, ¼% above prime, due 1985	9,000	—
Other	6	18
	76,475	68,658
Industrial Distribution Group		
Industrial Development Bond, 7½%	1,245	—
Note payable, 12.36%, due 1988	55,000	—
Mortgages, 7¾% — 8%	623	—
Capitalized lease obligations	124	—
	56,992	—
Corporate debt		
Bank loan, secured, 13.05% — 13.43%, due 1990	6,222	—
Note payable	220	—
Capitalized lease obligations, 14¼% — 16½%	131	155
	6,573	155
	$146,311	$ 71,895

The aggregate amount of maturities over the next five years is approximately as follows: 1984 — $6,818,000; 1985 — $17,326,000; 1986 — $5,371,000; 1987 — $5,205,000; 1988 — $67,199,000.

7. Bank indebtedness

Bank indebtedness is secured by a pledge of shares in subsidiaries, assignment of book debts and inventories, specific pledges of certain inventories and fixed and floating charges on certain fixed assets.

8. Minority interest

Minority interest is $5,500,000 of 6¾% preferred shares of The White Pass and Yukon Corporation Limited (1982 — $5,500,000).

9. Share capital

a. At December 31, 1983, the authorized share capital of the Company consists of:

i. an unlimited number of Class A convertible common shares without nominal or par value;

ii. an unlimited number of Class B convertible common shares without nominal or par value;

iii. an unlimited number of Class I preferred shares without nominal or par value, issuable in series; and

iv. an unlimited number of Class II preferred shares without nominal or par value, issuable in series; to date the directors have authorized:

28,760 Class II cumulative, convertible, preferred shares, designated Series A, with annual cash dividends of $9.00 per share payable in quarterly instalments. These shares are convertible on or before May 20, 1992 on the basis of approximately 6.41 Class A common shares for each Series A preferred share.

1,600,000 Class II cumulative, redeemable, convertible preferred shares, designated Series B, with annual cash dividends of $2.0625 per share payable in quarterly instalments. This series of Class II preferred shares is redeemable subject to certain conditions being met at prices ranging from $26.25 per share in 1986 to $25.00 per share in 1993 and thereafter. These shares are convertible on or before the earlier of December 15, 1990 and the date fixed for redemption on the basis of approximately 1.37 Class A common shares for each Series B preferred share.

Both Class A shares and the Class B shares are inter-convertible at any time at the option of the holder on a share for share basis. The basic difference between the two classes of shares is that dividends on Class A shares are payable in the form of cash dividends, while dividends on Class B shares are presently in the form of stock dividends, payable in Class B shares.

The directors have the authority to issue the Class I and Class II preferred shares in series and fix the designation, rights, privileges and conditions to be attached to each series, except the Class I shares shall be entitled to preference over the Class II shares with respect to the payment of dividends and the distribution of assets in the event of liquidation, dissolution or winding-up of the Company.

During the year the directors authorized the creation of 1,600,000 Class II preferred shares, Series B.

b. During 1983 the following shares were issued:

i. 1,600,000 Class II preferred shares, Series B for an aggregate consideration of $40,000,000.

ii. 1,170,000 Class A shares for an aggregate consideration of $14,942,000, net of share issue expenses of $268,000.

iii. 18,000 Class A shares under the share option plan for an aggregate consideration of $229,000.

iv. 4,598 Class B shares as stock dividends of $58,000. An additional 781 Class B shares were issued as stock dividends of $12,000 on January 1, 1984.

c. The number of shares issued and outstanding at December 31 was as follows:

	1983	1982
Class II preferred, Series A	**28,760**	28,760
Class II preferred, Series B	**1,600,000**	–
	1,628,760	28,760
Class A common	**5,788,727**	4,530,419
Class B common	**98,484**	164,194
	5,887,211	4,694,613

d. The dollar values of the shares issued and outstanding at December 31 were as follows:

$000	1983	1982
Class II preferred		
Series A	**$ 2,876**	$ 2,876
Series B	**40,000**	–
Common shares	**44,786**	29,557
	$87,662	$32,433

e. In December 1981,the directors approved a share option plan, the purpose of which is to provide employees of the Company the opportunity to participate in the growth and development of the Company. At December 31, 1983, 282,000 authorized and unissued Class A convertible shares of the Company have been reserved and set aside for purposes of the plan. Options have been granted to officers of the Company and an officer of a subsidiary company for an aggregate of 180,000 shares at a price of $12.6875 per share. These options, which expire in 1991, are exercisable on a cumulative basis to the extent of 36,000 shares per year in each of the years 1981 to 1985, except that under certain specified conditions they become exercisable immediately.

During 1983, additional options were issued as follows: 20,000 shares at a price of $11.5118 and 10,000 shares at a price of $12.50. These options, which expire in 1993, are exercisable on a cumulative basis to the extent of 6,000 shares per year in each of the years 1983 to 1987.

10. Earnings per common share

a. Basic earnings per common share are calculated using the weighted daily average number of common shares outstanding.

b. Fully diluted earnings per common share are as follows:

	1983	1982
Fully diluted earnings per common share	**$1.02**	$1.25

Fully diluted earnings per share are calculated under the assumption that all convertible, preferred shares were converted at the beginning of the year or the date of issue and that stock options outstanding during the year had been exercised at the beginning of the year, or when granted. Imputed earnings on the proceeds from the exercise of the options of $282,000 were calculated using a 10% after tax rate of return.

11. Income taxes

a. The Company's effective income tax rates are derived as follows:

	1983	1982
Average combined tax rate	**51.1%**	48.1%
Inventory tax allowances	**(5.6)**	(5.5)
Reduced rate on capital gains	**(5.3)**	–
Unrecorded tax benefits related to losses of subsidiary companies	**3.3**	4.6
Manufacturing and processing tax credits	**(1.3)**	(2.3)
Investment tax credits	**(0.3)**	(1.6)
Other	**3.2**	0.6
Average effective tax rate	**45.1%**	43.9%

b. Certain subsidiaries of the Company have tax loss carry forwards of approximately $4,000,000 and investment tax credit carry forwards of approximately $1,750,000 available to reduce future taxable income and taxes payable. The potential benefits of these carry forwards will be recorded as the benefits are received.

12. Segmented information

	1983		1982	
$000	Sales & Services	Segment Margin*	Sales & Services	Segment Margin*
Groups				
Aerospace	$ 97,935	$ 358	$ 75,995	$ 5,346
Transport				
Petroleum distribution	31,830	1,320	46,224	2,154
Transportation	65,511	1,630	43,971	(2,008)
Terminal	20,937	6,402	22,180	6,900
	216,213	9,710	188,370	12,392
Inter-segment eliminations	(12,415)	(97)	(9,177)	(339)
	$203,798	9,613	$179,193	12,053
Corporate interest expense		(466)		(41)
Inter-segment interest		2,839		1,622
Interest earned		959		492
Other corporate expenses		(1,474)		(2,721)
Earnings from operations		11,471		11,405
Provision for income taxes		(5,176)		(5,004)
Allocated to minority shareholders		(371)		(372)
Net earnings		$ 5,924		$ 6,029

*After deduction of interest: Aerospace $3,673,000 (1982 — $2,779,000); Petroleum distribution $448,000 (1982 — $418,000); Transportation $2,376,000 (1982 — $792,000); Terminal $5,620,000 (1982 — $6,001,000).

Other segmented information

	1983			1982		
$000	Capital Expenditures	Deprec. and Amort.	Identifiable Assets	Capital Expenditures	Deprec. and Amort.	Identifiable Assets
Groups						
Aerospace	$ 2,175	$ 851	$ 66,950	$ 1,613	$ 524	$ 64,108
Transport						
Petroleum distribution	320	474	15,502	86	400	16,094
Transportation	33,278	2,426	94,975	1,469	2,918	46,061
Terminal	168	3,292	66,949	542	3,272	68,601
Industrial Distribution	20,825	—	112,793	—	—	—
Other corporate assets	47	49	19,800	75	45	4,705
Total	$ 56,813	$ 7,092	$376,969	$ 3,785	$ 7,159	$199,569

a. The Company has segmented its operations on the basis of the major industries in which it operates as described below:

i. The Aerospace Group's operations consist of the remanufacturing and rebuilding of aircraft engines and distribution of aviation parts and accessories.

ii. The Transport Group's operations consist of the marketing of petroleum and related consumer products; the provision of ocean, rail and truck transportation services; and the operation of major bulk handling terminal facilities.

iii. The Industrial Distribution Group's operations consist of the distribution of general line, flat-rolled and specialty steel products, as well as industrial valves, piping components and related products.

Inter-segment sales are accounted for at prices comparable to open market prices for similar products and services.

b. The Aerospace Group had domestic sales to foreign customers, principally in Europe, of $7,354,000 (1982 — $8,606,000).

13. Directors' remuneration

The aggregate remuneration of directors and senior officers of the Company is as follows:

	1983				1982			
	As Directors		**As Officers**		As Directors		As Officers	
	No.	**Amount**	**No.**	**Amount**	No.	Amount	No.	Amount
Federal Industries Ltd.	**9**	**$63,250**	**8**	**$704,184**	9	$31,500	6	$575,513
The White Pass and Yukon Corporation Limited	**6**	**$ 6,000**	—	—	6	$ 6,400	—	—

3 officers are also directors of the Company (1982 — 4 officers).

14. Contingencies and commitments

a. The White Pass and Yukon Corporation Limited's largest customer indefinitely shut down its mining operations on June 4, 1982 and accordingly that subsidiary has suspended a major portion of its transportation operation pending a recommencement of mining operations sufficient to generate an appropriate level of shipping tonnage.

At December 31, 1983, the assets necessary for the operation of the White Pass and Yukon Railway were carried on the balance sheet of the Company at $25.9 million. If the Railway were not to recommence operations or if freight volumes available to the Railway do not improve substantially from current levels or if government decides to open the road from Skagway to Whitehorse for year-round commercial traffic, then the economic viability of the Railway and the value of the Railway assets on the books of the Company will have to be reassessed. Any such reassessment would have no cash flow impact on the Company. The Company anticipates that mining shipments in Yukon will recommence in the future and that sufficient rail freight volumes will become available to warrant the reopening of the Railway.

b. The Company has an investment of $1,650,000 in the preferred shares of a company that is highly leveraged, with substantially all of its debt repayable on demand. Although its lenders have not indicated their intent to demand repayment, should such an event occur it is unlikely that it would be able to meet such repayment demand. In these circumstances, liquidation could result and the Company could suffer a loss on its investment.

c. The Company and its subsidiary companies have operating lease commitments with varying terms requiring annual rental payments of approximately $686,000.

15. Other

a. At December 31, 1983, housing loans to directors and officers amounted to $256,000 (1982 — $168,000).

b. Certain of the prior years' figures have been restated to reflect the current year's presentation.

ACCOUNTING FOR THE EFFECTS OF INFLATION

The audited financial statements in this Annual Report are based on historical cost accounting, which matches actual costs incurred with actual revenues received. To highlight the effect of inflation on financial assets of the business, the Canadian Institute of Chartered Accountants has recommended that corporations provide supplemental information to show the effect of inflation on the balance sheet and results of operations for the year. The primary focus is upon specific changes in prices of assets and in expenses associated with the use of fixed assets or the sale of inventories. It is a method of measuring their current values in terms of what the assets would cost to purchase or produce at the balance sheet date or at the date of use of fixed assets or sale of goods purchased or produced.

Current cost accounting amounts for the Company's assets were determined for the most part by using appropriate specific indices or reliable market prices. For property, plant and equipment this method assumes the assets would be replaced with like technology, although this would not always be the case. The current cost of sales was determined by adjusting the historical costs by the estimated specific price changes which occurred between the time of purchase or production and the time of sale.

This method of reporting requires the use of numerous assumptions and estimates, and accordingly, the resulting information, presented below, is not a precise indication of the effects of inflation on the results of your Company. In addition, the provision for income taxes, according to the CICA recommendations, remains unchanged, since adjustments to income under the current cost computations are not deductible for tax purposes. This results in a tax rate which is considerably higher than normal, and in the case of your Company, taxes are actually in excess of total income. Accordingly, management feels that the pretax comparison of operating results on an historic and current cost basis is more meaningful than the net of tax amounts.

The after-tax current cost loss of $3.18 million for 1983, as shown in the schedule below, is based on an operating capability concept of capital. This concept measures income and loss generated by an enterprise from all sources of capital, whether provided by lenders or shareholders. To measure income attributable to shareholders on a current cost basis, the CICA recommends the calculation of a "financing adjustment". It is based on the supposition that the funds required to maintain a company's operating capability (replace the assets it consumes) will be provided by a combination of shareholder and borrowed funds. The financing adjustment aims to provide a measure of the increases in current costs that would be financed by debt. Recognizing this adjustment mitigated the inflation-adjusted loss by $1.2 million, and generates a pre-tax profit of $2.6 million compared to an historic cost profit of $11.5 million.

Two items of general inflation information are presented. The first, "Excess of increase in current cost over the effect of general inflation" provides a comparison of the specific price change adjustments and changes that would have resulted from general inflation level application. This differential was $5.1 million for 1983. The second is "General purchasing power gain on net monetary liabilities". Federal has greater monetary liabilities than monetary assets and the general purchasing power gain thereon helps preserve the general purchasing power of the shareholder's equity. On the CICA basis of calculation, which excludes deferred income taxes as a monetary item, your Company would have reported a net gain in purchasing power of slightly less than $500,000.

As a final item of disclosure, we present a comparative schedule of consolidated assets on the bases of current and historical costs. This table shows there is an apparent increase in common shareholder's equity from historical to current cost accounting of $12.1 million.

In arriving at the foregoing estimates, judgment has been exercised with respect to the treatment of certain asset groups. For example, it is assumed that the White Pass railway would not be replaced, and accordingly the current cost estimates are based on net realizable values. In the case of Thunder Bay Terminals, no adjustment has been made for the incremental cost of replacing assets, since funding is covered on a "current cost" basis with Ontario Hydro, the company's principal customer. In addition, Federal's newest investments in Canadian Motorways Ltd. and Russelsteel have not been adjusted from historic bases since they were fair valued at time of purchase.

Despite the obvious weaknesses inherent in estimating and the apparent anomalies, such as tax rates, your Company supports the disclosure of inflation accounting information to enable readers of the financial statements to obtain a more informed assessment of the Company's results.

Consolidated Statement of Earnings on a Current Cost Basis

Under an Operating Capability Concept of Capital
For the year ended December 31, 1983

	$000	
	Current Cost	Historical Cost
Sales and services	$203,798	$203,798
Cost of sales and operating expenses	184,378	176,333
Depreciation	9,126	7,092
Amortization of goodwill and intangible assets	142	142
Interest on long term debt	8,427	8,427
Other interest expense	1,317	1,317
Interest earned	(984)	(984)
	202,406	192,327
Earnings before income taxes	1,392	11,471
Provision for income taxes		
Current	2,335	2,335
Deferred	2,841	2,841
	5,176	5,176
Net earnings (loss)	(3,784)	6,295
Earnings allocated to minority shareholders	371	371
Net earnings (loss) for the year	(4,155)	5,924
Financing adjustment	1,234	—
Dividends on preferred shares	(259)	(259)
Net earnings (loss) attributable to common shareholders (current cost basis under an operating capability concept of capital)	$ (3,180)	$ 5,665

Reporting the Effects of Changing Prices

Supplementary Information for the year ended December 31, 1983

	$000
	1983
Increase in current cost amounts of inventory and property, plant and equipment	$6,169
Effect of general inflation	1,073
Excess of increase in current cost over the effect of general inflation	$5,096
General purchasing power gain on net monetary liabilities	$ 472

Based on the current cost adjustments made to income during the year, the financing adjustment amounts to $2,016

Schedule of Consolidated Assets on a Current Cost Basis

	$000	
	1983	
	Current Cost	Historical
Inventory	$108,000	$105,259
Property, plant and equipment — net	163,634	154,270
Net assets (common shareholders equity)	106,442	94,337

SEGMENTED INFORMATION

($000)	Transport Group			
	Petroleum Distribution		Freight Hauling Services	
	1983	1982	**1983**	1982
Sales	**$ 31,830**	$ 46,224	**$ 65,511**	$ 43,971
Inter-segment sales	**2,686**	4,941	**2,674**	4,236
	29,144	41,283	**62,837**	39,735
Segment operating profit before interest	**1,671**	2,233	**4,006**	(1,216)
Interest earned				
Interest expense				
Inter-segment interest				
General corporate expenses				
Earnings from operations before income taxes				
Income taxes				
Net earnings before minority interests and extraordinary items				
Identifiable assets	**15,502**	16,094	**94,975**	46,061
Corporate assets				
Metals				
Capital expenditures	**320**	86	**33,278**	1,469
Depreciation and amortization	**474**	400	**2,426**	2,918

			Aerospace Group		Consolidated	
	Terminal					
	1983	1982	**1983**	1982	**1983**	1982
	$ 20,937	$ 22,180	**$ 97,935**	$ 75,995	**$216,213**	$188,370
	—	—	**7,055**	—	**12,415**	9,177
	20,937	22,180	**90,880**	75,995	**203,798**	179,193
	12,022	12,901	**4,031**	8,125	**21,730**	22,043
					959	492
					(12,583)	(10,031)
					2,839	1,622
					(1,474)	(2,721)
					11,471	11,405
					5,176	5,004
					$ 6,295	$ 6,401
	66,949	68,601	**66,950**	64,108	**244,376**	194,864
					19,800	4,705
					112,793	—
					376,969	199,569
	168	542	**2,175**	1,613		
	3,292	3,272	**851**	524		

SUMMARIZED QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

For the year ended December 31, 1983

	Three months ended				Year ended
1983	**March 31**	**June 30**	**Sept. 30**	**Dec. 31**	**Dec. 31**
Sales ($000)	**$ 34,307**	**$ 41,357**	**$ 42,356**	**$ 85,778**	**$203,798**
Gross earnings from operations ($000)	**2,530**	**6,406**	**6,248**	**12,281**	**27,465**
Gross margin percentage	**7.4%**	**15.5%**	**14.8%**	**14.3%**	**13.5%**
Net earnings ($000)	**(1,817)**	**1,770**	**2,308**	**3,663**	**5,924**
Earnings per Common Share	**$ (.39)**	**$ .35**	**$ .44**	**$ .62**	**$ 1.02**
Market price of Common Shares					
High	**13.50**	**15.00**	**16.50**	**16.50**	**16.50**
Low	**10.37**	**13.12**	**14.50**	**14.50**	**10.37**
Number of shares traded	**361,100**	**672,400**	**232,100**	**74,500**	**1,340,100**

	Three months ended				Year ended
1982	March 31	June 30	Sept. 30	Dec. 31	Dec. 31
Sales ($000)	$ 47,822	$ 47,462	$ 45,293	$ 38,616	$179,193
Gross earnings from operations ($000)	6,659	8,390	5,808	5,698	26,555
Gross margin percentage	13.9%	17.7%	12.8%	14.8%	14.8%
Net earnings ($000)	1,434	2,658	817	1,120	6,029
Earnings per Common Share	$ .30	$ .57	$ .15	$ .23	$ 1.25
Market price of Common Shares					
High	13.75	14.00	11.50	11.75	14.00
Low	11.00	10.25	8.50	8.25	8.25
Number of Shares traded	106,800	207,000	361,000	326,700	1,001,500

CONSOLIDATED HISTORICAL SUMMARY

	12 Mos. 31 Dec. 83	12 Mos. 31 Dec. 82	12 Mos. 31 Dec. 81	12 Mos. 31 Dec. 80	12 Mos. 31 Dec. 79
Income Information ($000)					
Sales & Services	**203,798**	179,193	192,690	159,226	126,716
Gross Earnings from Operations	**27,465**	26,555	35,980	29,291	18,192
Net Earnings Before Extraordinary Items	**5,924**	6,029	10,914	7,407	1,789
Extraordinary Items	**—**	—	24	(290)	—
Net Earnings After Extraordinary Items	**5,924**	6,029	10,938	7,117	1,789
Depreciation	**7,092**	7,159	6,649	5,615	5,227
Interest on Long-Term Debt	**8,427**	6,760	6,503	8,319	7,969
Income Taxes	**5,176**	5,004	10,462	7,158	1,756
Earnings (Loss) per Common Share ($)	**1.02**	1.25	2.44	1.98	.51
Earnings (Loss) per Share Excluding Extraordinary Items ($)	**1.02**	1.25	2.43	2.06	.51
Balance Sheet Information ($000)					
Current Assets	**206,852**	85,238	91,084	69,032	56,490
Current Liabilities	**80,378**	34,696	51,036	44,805	41,880
Working Capital	**126,474**	50,542	40,048	24,227	14,610
Fixed Assets — Net	**154,270**	106,384	109,974	102,250	119,092
Other Assets	**15,847**	7,947	5,246	7,965	16,135
Total Assets	**376,969**	199,569	206,304	179,247	191,717
Long-Term Debt	**146,311**	71,895	68,313	68,853	95,043
Deferred Income Taxes	**7,567**	7,342	6,500	5,079	5,525
Minority Interest	**5,500**	5,500	5,500	5,500	5,500
Shareholders' Equity	**137,213**	80,136	74,955	55,010	43,769
Other Information					
Gross Margin Ratio %	**13.5**	14.8	18.7	18.4	14.4
Net Earnings as % of Sales	**2.9**	3.4	5.7	4.5	1.4
No. Common Shares Outstanding (A & B)	**5,887,211**	4,694,613	4,789,774	3,944,006	3,528,900
Dividend per Share					
Class A ($) Note 1	**.50**	.45	.275	.20	.20
Class B ($) Note 2	**.50**	.45	.275	.20	—
Price Range of Stock ($)					
High	**16.50**	14.00	15.87	15.25	8.00
Low	**10.37**	8.25	10.00	6.37	5.50
Shareholders' Equity per Common Share ($)	**16.02**	16.46	15.65	13.95	12.40

NOTES:

(1) Payable in cash dividends.

(2) Payable by way of stock dividend in Class B Shares. These Class B Shares were created in May, 1980.

DIVERSIFICATION: THE ISSUES, THE STRATEGY.

Investors are confronted today by an apparent increase in diversification by large public companies, accompanied by a discordant chorus of management experts pointing to the hazards of diversifying and the problems encountered by conglomerates and others who seek the promises of diversity. Here's an examination of the subject, intended to shed some light on this complex and timely issue.

"Conglomerates are the normal and natural business form for efficiently channelling investment into the most productive use. If nature takes its course, then conglomerates will become the dominant form of business organization . . ." *Bruce Henderson, Founder and Chairman of the Board, The Boston Consulting Group.*

". . . corporate diversification resembles Russian roulette." *Ralph Biggadike, Professor of Business Administration, University of Virginia, in the* Harvard Business Review.

Most business people are familiar with both of these viewpoints — and have an opinion that shades toward one or the other.

In fact, the question of whether or not to diversify has come very much to the fore in recent months with the popularity of *In Search of Excellence,* a best-seller which strongly advocates that companies stay close to their core businesses.

Its authors, Peters and Waterman, are but two of the voices that speak for the merits of a single-industry bias — rather than a conglomerate corporate structure.

Other experts have identified diversification as the answer to a myriad of modern-day business problems.

At Federal Industries, we believe that both answers are right — and both answers are wrong — the truth being in a correct balance of both. That is, we feel the virtues of "excellence" are attainable within a highly diversified or "conglomerate" structure and that — if properly managed — diversification is a worthy business strategy to pursue in turbulent times.

But, back to the beginning. What are today's critics of diversification saying? Interestingly, even the harshest critics are not painting a completely negative picture.

Take renowned management consultant and author Peter Drucker, for example. Drucker is a highly vocal opponent of "razzle dazzle" conglomeration and in his writings warns repeatedly of the perils likely to befall a business venturing into unknown territory either by acquisition or internal expansion.

At the same time, as Drucker makes clear in *Managing in Turbulent Times,* we are now in a decade of great economic upheaval which will require light-footed entrepreneurial management, if we are to prosper. In a 1982 interview he said, "Where you have structural changes, you must expect the industry to change and then you need merger and acquisition."

Boiled down to its basics, what Drucker and most others who condemn conglomerates oppose is, in fact, the opportunistic pyramiding of companies that was developed to a high point in the 1960s and continues to be practiced from time to time. This is what Drucker terms "diversification for the sake of diversification", as opposed to diversification in response to industry change or economic upheaval.

Even Peters and Waterman do not oppose diversification or acquisition *per se,* but simply advocate that those doing so diversify around their central skill or into interrelated fields. As they say, ". . . it would appear that some diversification is a basis for stability through adaptation, but that willy-nilly diversification doesn't pay — by any measure". In support of this statement they quote a wellknown Harvard Business School study which concludes companies diversify from their core business only at considerable peril.

And this *is* a very real and present danger. The annals of business are filled with horror stories of acquisitions, mergers and new divisions that have failed dramatically — as harness makers try to cope with internal combustion, railroads try to keep rubber tires on ill-defined roads and adding machine manufacturers clamber onto the computer bandwagon.

But business failures of companies of all orientations and sizes are a continuing fact of our economic system. And with so many companies seeking to diversify there must be significant benefits to counterbalance the risks — and management approaches to minimize them.

BUSINESS CYCLES: A BIG FACTOR

One of the prime motivations for diversification has been the disruption and shortening of industrial life cycles. Where business was once thought of as an ongoing process, it's now seen in many quarters as a barely controllable cyclical phenomenon — one in which management skills appropriate for one part of the cycle are ill-suited to others. Finding ways to manage these life cycles has become a critical concern . . . one that has been advanced by the accelerating pace of technology.

The answer for many excellent North American companies seeking to break out of downward cycles has been innovation combined with diversification. Not by careening through the fence in search of greener grass, but by managing the existing pastures, many excellent — and even some not-so-excellent — companies have managed to find a way to live with business cycles.

As Peters and Waterman point out, although it's more difficult to do, a gradual process of continuing renewal by ". . . internally generated diversification, one manageable step at a time" can keep a well-managed business functioning and healthy.

It only makes sense. But that answer need not and should not be applied across the board to all businesses, nor of necessity to business in general. No single formula for success in business has yet been found. And the life blood of economics in a free enterprise society is new business ventures.

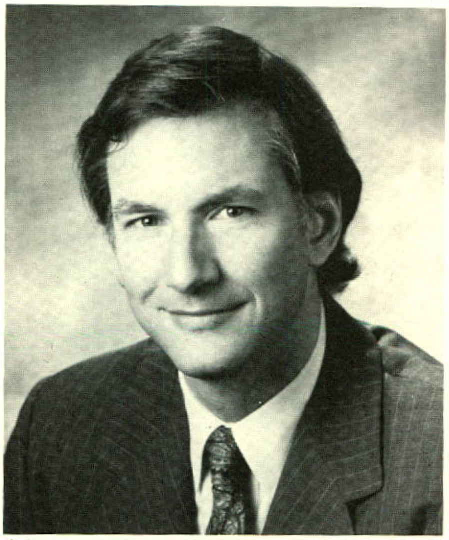
Over 2,000 new companies start every day in North America and the small number that survive and prosper provide most of the growth and vitality of our economy. A few of these new companies are "hived off" from billion dollar giants; however, the vast majority are started and built by entrepreneurs, people of vision in pursuit of goals fundamental to our economic system.

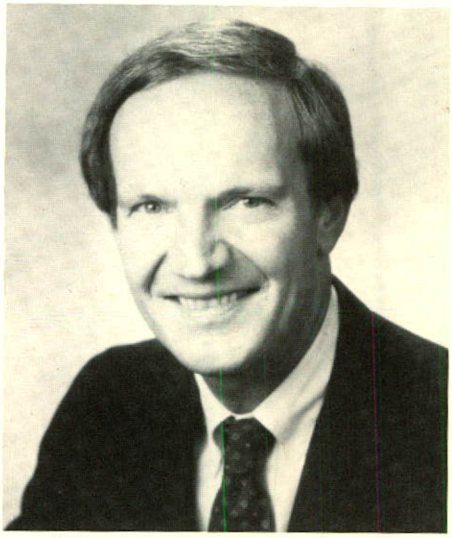
Many of these entrepreneurs lack education, experience and business judgement. They're almost always short of cash. And the companies they build lack certain elements that business schools deem indispensable. Despite these handicaps, many forge ahead to become major corporations, violating tenets of "good management" all the way to the bank.

Mature companies that were started and built by entrepreneurs are particularly susceptible to the life cycle syndrome. Their status often parallels that of the founder, with his vision and commitment to see a dream through to reality and sustain the company. It's companies like this that are often the targets of acquisitor corporations seeking to diversify — along with companies that have weak management and survive due to strong markets . . . companies that gambled on excess leverage and lost . . . and orphans created by ill-conceived diversification efforts.

What becomes of these imperfect but functional and profitable companies? Left to their own devices, they tend to survive and prosper (given a run of good years and a bit of luck). Some transcend their heritage and become tough, aggressive and well managed companies that go on to greatness. Given a few poor years and a bad break or two, many collapse, victims of their stronger competition.

Still others work *better* once they're acquired, given the support that can come from a diversified parent.





Thomas Peters (left) and Robert Waterman: "Our principal finding is clear and simple. Organizations that do branch out (whether by acquisition or internal diversification) but stick very close to their knitting outperform the others."

DIVERSIFICATION: BACKGROUND AND BENEFITS

There is no single strategy for business survival and success. Times, and strategies, change.

At the turn of the century, for example, monopoly-builders sought to dominate — and dictate — in a single, well-defined industrial sphere. But anti-trust legislation gradually outlawed large-scale monopolies. And as industries matured, so did the realization that growth prospects are not infinite ... and that concentrated industries can be vulnerable to a host of frequently unpredictable and uncontrollable risks. These combined forces gave birth to a new — and essentially opposite — business strategy: conglomeration.

A conglomerate is an assembly, under one management, of a number of subsidiary companies or divisions which are engaged in a variety of more or less "unrelated" industries.

Occasionally, these subsidiaries are "grassroots" developments — businesses built through internal growth. More frequently, they're existing businesses obtained by the parent company through acquisition.

A defense against business risks...

C. Northcote Parkinson once warned that "Chill winds have a habit of blowing on one-product companies, no matter how industrious their workers or how energetic their managers." These "chill winds" are common business risks. They include:

- Business cycles. Although a general recession affects profits almost universally, industry sectors react at different times — and with different volatility — to changes in economic and operating environments
- Rapid changes in consumption patterns or technology
- The failure (or fickleness) of a major supplier or customer
- Prolonged labour unrest.

In theory, a diversified company is better able to withstand these risks than is a single product or industry company. Diversification, in this sense, is a form of business insurance.

... an agressive business strategy

For three decades following World War II, North America was a "growth" continent. In many sectors the opposite is now true, due in part to the quadrupling of oil prices in 1974 and the consequent flood of products from foreign countries seeking increased exports to pay for their rising energy costs. These factors have contributed to the adoption of a strategy of diversification on the part of many companies concerned that their base industry does not offer any real potential for long-term growth. They acquire businesses in industries that are expected, over time, to outpace the expansion of the economy.

"In today's low-growth yet volatile environment," according to Malcolm Salter and Wolf Weinhold in *Harvard Business Review*, "most companies with high-growth goals or an imbalanced portfolio of businesses find diversification necessary."

Other benefits of diversification

- Financial synergy. According to a study reported in the *Academy of Management Review*, banks and other institutions are frequently willing "to lend more and at better rates to a combined firm than ... to two firms operating separately".
- Operating synergy. Two operating units can sometimes be run more efficiently and/or more effectively than one. Based on the theory that "two can live more cheaply than one", potential operating savings exist in research and development, marketing, distribution, legal and accounting services and compensation and benefits administration.

Characteristics of successful diversifiers

Salter and Weinhold also feel that diversification is most likely to be successful if the parent company possesses three special qualities:

- The capacity to analyze the strategies and financial requirements of a wide range of businesses. Insufficient, or incompetent, analysis of acquisition candidates is a frequent cause of failed diversification attempts.
- The capacity to tolerate — and even encourage — a lack of uniformity in the organization's structure. Most successful diversifiers make it a practice of acquiring companies with excellent operating management in place. Retaining these key people requires flexible attitudes to the organizational structure — and corporate culture — of the acquired company.
- A capacity to transfer surplus financial resources and general management skills among subsidiaries.

Worldwide, perhaps the most successful conglomerators are the Japanese. While many factors contribute to their success, perhaps the most critical is the Japanese method of management. As Peter Drucker points out, the job of top management in Japan is not to "operate", but to "relate": top management "takes care of the outside relationships — with government, with the bank and with the industry group, and so on. Younger people, the senior department heads who are the 'company directors', run the business. Top management makes sure that the people who are in these jobs are qualified ... and of course it gets involved in the major decisions. But it does not 'manage' the business itself."

Drucker concludes that it is "top management that faces the challenges of setting directions for the enterprise ... top management that will have to restructure itself to meet the challenges of the 'sea-change', the changes in population structure and dynamics ... top management that above all will have to concern itself with the turbulences in the environment, the emergence of the world economy."

It's a parallel that has not been lost on successful North American diversified companies where "core management" takes on a similar "relating" and macro-economic planning role on behalf of subsidiary management.

DIVERSIFICATION ... AND FREE ENTERPRISE

Though often viewed as a negative force, the mergers, acquisitions and takeovers inherent in diversification can and often do provide a means of fine-tuning the free enterprise system. Ideally, the acquiring company sees the flaws in a fundamentally sound company — the relatively minor factors that prevent it from realizing its potential. Sometimes the original owners and managers of the target company also realized those flaws, but due to circumstances, were in no position to fix them or were so immersed in the trees that they lost sight of the forest. Upon acquisition (at least in theory), the new owners take whatever actions circumstances dictate and the acquired company goes forward invigorated, to new heights of success and prosperity.

Certainly, that's the way it's supposed to work, and a vast amount of study has gone into identifying the strategies that contribute to successful, and unsuccessful, acquisitions. In the 1960s — and to a lesser extent, in the 1970s — many conglomerators shifted their emphasis away from management, and deal-making became an end in itself. Negotiating multi-million dollar acquisitions can be an ego-stroking occupation. And the technique of using deals to create the illusion of earnings was well-developed. Many of the high-rolling conglomerates of twenty years ago built giant corporations on these illusory skills combined with the investment community's initial enthusiasm for the potential implied by diversification.

When those jerry-built edifices collapsed, the market's image of diversity as a management breakthrough collapsed as well. Overlooked was the brilliant performance of conglomerates like Teledyne which demonstrated over many years that diversity can be managed ... that the promise of the conglomerates had substance ... and that the whole *can* be greater than the sum of its parts.

In essence, the unsuccessful conglomerators were seeking salvation in diversity. Peters and Waterman describe it this way:

> "The company decides it is in a sluggish business. It determines to move afield. It doesn't know what it is buying. It buys companies at or past their peak. Moreover, it doesn't understand them (e.g., vanity acquisitions). Finally, and most devastating of all, the effort and attention going into the management of the new acquisitions sapped the vitality of the already shaky core business. New products (line extensions or reformulations of the old products) are given short shrift or subjected to 'short cuts' ... and the downhill spiral is underway."

Small wonder that most acquisitions proved unsatisfactory. Nor is it surprising that investors came to react to diversity with caution. Yet, despite such handicaps, diversified management companies over the years have performed on a par with other kinds of companies.

THE IMPORTANCE OF MANAGEMENT

The answer to those questioning the value of diversity is, like most fundamental business questions, very simple: reaping the rewards of diversity requires good management. Defining "good management", however, is not a simple task. Peters and Waterman and many others have concluded that good management requires a thorough understanding of the business being practiced, a commitment to that business, and a simple belief that it's worth doing well. Combine these traits with a basic knowledge of business methods and well-structured business operations, and excellent performance should result.

Unfortunately, however, many companies that diversify assume that a good manager can manage anything. They discover too late that knowledge developed in the brewery business is not necessarily applicable to potato chips. On the contrary, excellent diversified management companies such as Teledyne and Imasco have learned to avoid messing with the beer and potato chip aspect of their businesses. They leave such activities to well-motivated operating management with competence in those fields. The parent company concentrates on seeing that the fundamentals are in place, understood and operational in each subsidiary.

Excellent, well-diversified companies are as mesmerized by the intricacies of management structures as the brewer is fascinated by his beer. They cultivate sound balance sheets the way the potato chip executives savour crispness. They rejoice at good strategies emanating from operating management, and reward them. In short, they *manage management.*

The skills required for managing managers are similar to the skills involved in other areas of management practice — requiring a combination of training and experience. Just as the experience required for excellence in beer brewing is different from the skills that get potato chips delivered on schedule 99.5% of the time, managing managers requires experience in the field of managing diversity.

The conglomerators of the 1960s, in most cases, lacked that experience. But from the generally frustrating and unrewarding diversification experiences of past decades

Peter Drucker: "... a time of turbulence is also one of great opportunity for those who can understand, accept, and exploit the new realities. It is above all a time of opportunity for leadership."

emerged a body of knowledge containing important clues to successful diversification, along with a core group of executives having the know-how needed to make diversity work.

Like so many innovations, the initial promise of diversified management failed to live up to expectations; however, there is good evidence to suggest that the numerous success stories can and will be repeated and improved upon in the years ahead.

Philip L. Wilson, in Morin and Chippindale's *Acquisitions and Mergers in Canada,* reinforces this opinion when he states that "the literature suggests ... that a significant proportion of all mergers and acquisitions is regarded as unsuccessful by the acquiring party ... A number of causes that contribute to failure and dissatisfaction can be identified and can be eliminated by prudent managers". These are the managers who approach new acquisitions with the skill and knowledge of past experience in managing acquisitions, as opposed to the zest for adventure of a kid with a new toy.

But why go to all the trouble? Is successful diversification really worth the effort and risk? Why not follow Peters and Waterman's advice and "stick to the knitting"?

Many businesses will wisely choose to concentrate their strengths and resources against the onslaught of turbulent times. Many will survive and prosper, and some will fail. For their part, diversified companies can hedge their bet by advancing an army of autonomous diversified subsidiaries into the fray, but that's not the only, or even the main virtue of diversity. Listen to Peter Drucker's comments from the introduction of his 1980 landmark book, *Managing in Turbulent Times:*

"But a time of turbulence is also one of great opportunity for those who can *understand, accept, and exploit the new realities.* It is above all a time of opportunity for leadership. One constant theme of this book is therefore the need for the decisionmaker in the individual enterprise to face up to reality and to resist the temptation of what 'everybody knows', the temptation of the *certainties of yesterday,* which are about to become the *deleterious superstitions of tomorrow".* (emphasis added)

Innovation, Drucker clearly says, is vital to survival and prosperity in turbulent times, and he's talking about far more than potato chips (or microchips). He's talking about changes in:

"... population structure and in population dynamics ... the emergence of the world economy, the emergence of the employee society, and the need for the enterprises ... to take the lead in respect to political process, political concepts, and social policies."

The giant corporations Peters and Waterman studied have a particularly challenging problem ahead of them. As they state:

"The most discouraging fact of big corporate life is the loss of what got them big in the first place: innovation. If big companies don't stop innovating entirely, the rate

SUCCESS OR FAILURE IN DIVERSIFICATION: LESSONS FROM THE PAST

The management of diversified companies has ranged from good to disastrous over the past two decades. And, as this new business form has developed, the relatively high percentage of poorly-managed conglomerates has given diversification a bad image in some quarters. Many of the problems can be traced back to one or more of these management mistakes:

- The notion that "a good manager can manage anything".
- The tendency of "dealmakers" to build business empires relying on financial synergy and financial controls — without finding a way to maintain management control over the resulting conglomerate.
- Excessive leverage, justified in part by the assumption of countercyclicality. Where those assumptions have proven incorrect, the results have been disastrous.
- Culture shock — inability to cope with conflicts in management style between parent and subsidiary or merged companies.
- Attempts to blend businesses lacking true common purpose — simply in the interest of reducing overhead.
- Inappropriate expertise — the assumption that the parent company's skills were equally applicable to the acquired company.
- Weak management, unable to succeed in their established business, looking for greener grass.
- The bandwagon effect, where the acquiring company believed their acquisitions would be favourably perceived by the market.
- The ethic of "growth for growth's sake" ... pursuing acquisition and diversification as a shortcut to success.

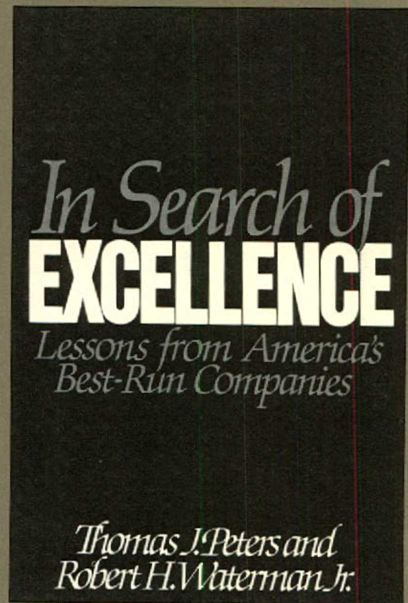
almost certainly goes way down. According to *Inc.,* a National Science Foundation study finds that 'small firms produced about four times as many innovations per research and development dollar as medium-sized firms and about twenty-four times as many as large firms.'"

Finding ways that good management of large companies can restore a semblance of the innovative vitality they had when small is a central theme of *In Search of Excellence,* and many of these techniques were found. Undoubtedly many more exist than those turned up in that limited study, and well managed diversity may be a technique having great potential for the coming decades.

In a diversified management company, technological innovation can (and should) continue to be done primarily by those smaller subsidiary firms having the need, the knowledge and the short lines of communication that make research most productive. Management innovation, overview to anticipate changes, and clout to deal with political and societal changes can be provided by the parent company, drawing on the resources of its subsidiaries and providing them a high profile when and if it's needed.

Overall, the diversified company can offer an orientation toward long term profits (rather than just next quarter's results) coupled with a smoothing of the economic cycles. It was this latter benefit that was extolled by yesterday's North American conglomerates as a means of balancing the ups and downs of the overall business cycle due to the varying industrial sub-cycles. And, even though in difficult times cycles often fail to repeat themselves predictably, it *is* reasonable to expect some "smoothing" of earnings due to counter-cyclicality from a diversified portfolio of operations.

"STICK TO THE KNITTING"... AMPLIFYING A BUSINESS BEST-SELLER.



"Most acquisitions go awry". That's the conclusion of Thomas J. Peters and Robert H. Waterman, Jr. in their current best-seller, *In Search of Excellence.*

It's a conclusion drawn from the authors' study of 62 large North American companies — few with annual sales of less than $1 billion and histories shorter than 20 years — all of which are judged to be excellent by an informed group of businessmen, consultants, business reporters and business academics.

Several companies in Peters' and Waterman's study have never diversified beyond a single industry, and don't intend to. "This company has never left its base. We seek to be anything but a conglomerate", says Edward G. Harness, past chief executive officer of Proctor and Gamble, for example.

However, most of the companies profiled have had experience in making acquisitions, and many of those experiences were bad. In Chapter Ten, Peters and Waterman conclude: "Our principal finding is clear and simple. Organizations that do branch out (whether by acquisition or internal diversification) but stick very close to their knitting outperform the others".

The companies selected as being "excellent" were not intended to — and did not — cover the entire spectrum of North American business. In fact, by its very nature, the selection process turned up a large number of "high tech companies" and billion dollar organizations with an identifiable industry bias.

Even so, *in general,* Federal Industries supports the conclusions drawn about "sticking to knitting". It's in the specifics of its application that we disagree. It's our belief that further research would confirm the risks of managing diversity to companies *inexperienced in doing so* and that companies that *make it their business to manage diversity* can achieve the virtues of "excellence" within a conglomerate type of business structure.

Certainly, there's considerable evidence that many acquisitions find problems. Peter Drucker, for example, estimates that "the proportion of acquisitions that turn out to be expensive mistakes or at least disappointments is substantial. I would put it close to 50 per cent...". Yet, he also points out that "the failure of grass-roots developments is higher — perhaps two-thirds...". But neither Drucker nor Peters and Waterman conclude that diversification should be avoided; only that caution is advisable and skill is required.

In our view, whether the company is diversified or part of a single industry, "sticking to knitting" is only common sense. It's just that in well structured diversified companies, the "knitting" isn't the management of a particular business, it's the managing of diversity.

**See Epilogue, page 48, for a final word from Robert Waterman, Jr.*

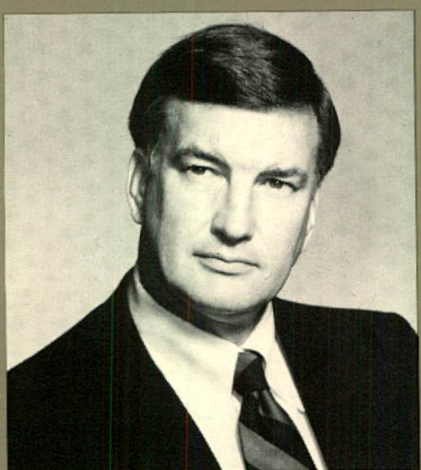
In addition, another kind of counter-cyclicality is provided from a diversified group of companies in various stages of their life cycles. This "portfolio management strategy", managed by a parent company committed to long-term growth and possessed of vision, can enable smaller, more vigorous and innovative members of the group to undertake risks and plan long term strategies their bankers would not support and their shareholders could not afford, if they were freestanding companies.

In summary, there's little to argue about in either of the quotations that open this article. Peters and Waterman make a strong case for companies holding a sharp focus on what they do well, innovating incrementally by whatever means are appropriate to their strategic capabilities and situation, including carefully planned and executed mergers and acquisitions. To do otherwise can indeed be compared to playing "Russian roulette" with the company treasury.

Like any other specialized business, conglomerates require specific knowledge and experience on the part of management if they are to realize their potential. The opportunities Bruce Henderson and others identify are genuine, as borne out by many success stories. Unfortunately, the notion of diversity has broad appeal to many who are unqualified and unprepared for the realities of this form of business, and their failures have tainted the whole concept.

There's a long litany of distressing obstacles to successful management of diversity (see box) which helps explain many of the examples of failure and poor performance, and it should help discourage some companies from entering this form of business. Still, an equally formidable list can be constructed for any other form of business that a company might contemplate embarking upon. Companies engaged in managing diversity (a rapidly increasing tribe) have learned how to handle those obstacles, and as in any business, some do it poorly and some do it well.

Inevitably, there is no such thing as a free lunch, and those who see diversification as an answer to their problems would be well advised to "stick to their knitting". Those whose business is managing diversity would be well advised to exercise prudence and responsibility in developing this exciting form of business toward its potential as "the normal and natural business form for efficiently channeling investment into the most



Ronald D. Southern, President and Chief Executive Officer, ATCO Ltd., quoted from The Financial Post, March 3, 1984.
"I think we'd be in very difficult circumstances without ... diversification ... The historic Atco businesses of servicing energy and resources have had a severe cyclical downturn. If we had just the historic Atco, I'm sure we'd still be in business — but it would be even tougher than it is now."

Paul Paré, Chairman and Chief Executive Officer, Imasco Limited, quoted from the Imasco 1983 Annual Report.
"Only a short time ago it was popular to believe that small was beautiful, that size was synonymous with sin. Holding company, conglomerate, multi-national — all these were choice expressions in the vocabulary of opprobrium favoured by the advocates of zero growth.

A dynamic organization cannot stand still. Not to grow is to stagnate; and to stagnate is to die."

C.D. Reekie, President and Chief Executive Officer, CAE Industries Ltd., quoted from remarks to The Policy Analysis Committee, C.D. Howe Institute, November 21, 1980.
"Diversification is a form of insurance not available to the one-product, one-plant, or one-industry company. This is particularly important in Canada with its small domestic markets, and its vulnerability to the economy of its giant next-door neighbour."

productive use". As Bruce Henderson goes on to say:

"If a conglomerate is to realize its potential, it must have an investment and strategy development skill which goes well beyond the characteristic pattern of the independent business. Certainly, some corporations are going to do this. Those that do are quite likely to be the pre-eminent and dominant firms of the future."

MANAGING DIVERSITY: FEDERAL INDUSTRIES' VIEWPOINT

Like many diversified companies, Federal Industries has gone through an "identity crisis" recently. Five years ago we asked ourselves: What do we stand for? Who are we? What do we do? Where are we going? We took those questions seriously ... and saw there were no easy answers.

Three years ago we got the questions clearly in focus and set a two-year deadline for finding our answers. One year ago, we reached our consensus, and wrote it down in our Corporate Long Range Plan. Following that, we embarked on an exercise where Federal and all its subsidiaries set out to identify the fundamentals of each of our businesses. That process culminated in defining the essence of Federal Industries.

That is, our business is *managing managers*. Federal Industries' role is to select, structure and staff operating businesses so they can stand up to the best a competitive market throws at them, and make better than average profits in the process. Each of our companies is among the best in its field and each "sticks to its knitting".

At Federal, we have no particular industry bias, nor have we had one since the Company left the grain business over a decade ago. At that time conglomerates were fashionable and, like many other companies, Federal moved out of its historic business and cast its lot with diversity. Management of that time learned some of the lessons so well summarized by *In Search of Excellence* – along with many other companies mesmerized by the prospect of countercyclicality, synergistic benefits and growth by acquisition. Some companies crashed on the rocks of reality, but Federal survived. We know the lessons Peters and Waterman put forth, and we know them well, because we learned them in an excellent management university, the School of Hard Knocks.

During the past five years we asked ourselves dozens of times, should we abandon our new found heritage and pursue a course in accordance with the current conventional wisdom that favours single industry orientation? Or should we stick to *our* knitting and find a way to manage diversity? There was never any question in our minds that choosing an industry focus would be the choice favoured by most of the business press and many knowledgeable analysts, consultants and shareholders.

Following our usual approach to difficult problems, we took a look at the fundamentals of the situation. This was long before *In Search of Excellence* was published, but these opening lines from that book summarize our approach nicely:

"Let us suppose that we were asked for one all-purpose bit of advice for management, one truth that we were able to distill from the excellent companies research. We might be tempted to reply, 'Figure out your value system. Decide what your company stands for. What does your enterprise do that gives everyone the most pride? Put yourself out ten or twenty years in the future: what would you look back on with greatest satisfaction?'"

It turned out that our business was *managing diversity*, and that despite our problems in doing so, we were making good progress toward learning how it's done. We believed successful diversified management was possible, and we could master the techniques if doing so was truly worthwhile. Further research has convinced us it is not only worthwhile, but perhaps is leading to a breakthrough in management theory and concept.

We found that while the majority viewpoint on conglomerates was negative, there was evidence of a growing trend toward diversity, often masked as "vertical integration", "expansion of the base business" or "related diversification", which seemed to be working. From observing these diversifications, from the previous exprience of members of our management team, and from Federal's own experience, we assembled and perfected our own methods of managing diversity. Though development of those methods continues, and we keep a close eye on what others are doing in this area, we've developed a system that works well and minimizes the problems of diversification management. Key components of our system include:

• We promote or hire presidents of subsidiaries primarily based on their proven competence in that subsidiary's field of operations.

• Each subsidiary company is autonomous, and prepares and executes its own plans and budgets, while we at Federal work with the subsidiaries until we understand and agree with their strategies. They keep us posted about changes in strategy in addition to supplying information needed for normal financial controls.

• Though all subsidiaries agree upon and accept Federal's basic principles of management, each is encouraged to continue and develop its own company's management culture.

• Each subsidiary is encouraged to teach us at Federal the fundamentals of their business. Federal's Executive Committee monitors the progress of each subsidiary in a role similar to active outside directors, sitting on each company's "Board".

• Federal's Executive Committee is made up of professionals in the field of managing diversity, with no industry bias. Our expertise is managing management.

• Each subsidiary is structured primarily to serve its market, and its performance is evaluated in that context. Synergy is sought but not forced.

• While Federal companies cover a wide range of industries, a planned degree of continuity is maintained, and each acquisition must meet the criteria that were established to guide the search.

• Aggressive growth is a target, but the prime requirement is successful integration, operation, and management of the companies already in the group.

• Internal growth of each subsidiary is encouraged, and each is free to make acquisitions within acceptable industry boundaries.

• Funding of growth by any means is limited to opportunities that are "on strategy", with priority given to potential for return on investment.

• Leverage is set primarily according to standards based on fiscal prudence, with secondary consideration given to maximizing short-term return on investment.

• We are, quite simply, committed to a course of excellence in diversified management.

In short, we believe the benefits of diversity are and always have been real and attainable to those prepared to view managing diversity as a business . . . that the techniques of managing such a business are becoming established and agreed upon, paving the way towards realization of the great conglomerate companies originally envisioned in the sixties . . . that these companies are the logical successors to the single industry giants of the past, because the diversified form can combine the flexibility of small companies with the resources of large companies . . . and that Federal Industries is well on its way to becoming such a company.

EPILOGUE: A COMMENT FROM ROBERT WATERMAN, JR.

As part of our research, we contacted Robert Waterman, one of the authors of *In Search of Excellence*, and asked him to comment on a draft of this article. Just prior to the Annual Report going to press, we received written comments from Mr. Waterman which provide a fitting final word on diversification and "excellence":

"In retrospect, our 'stick to the knitting' title for our chapter on diversification suggests a narrower interpretation than we had in mind. What we were arguing against were the extremes: the large, randomly diverse conglomerate; and on the other side of the spectrum, a company so narrow and vertically integrated that it cannot move into new areas as the environment changes.

The critical question for the diverse company is how those at the corporate center add value. If the rationale for the big U.S. conglomerates is capital allocation, we don't buy it; that is what the stock market is for and seems to do more efficiently. (However, in countries with less developed markets or in situations where companies being acquired are smaller — and therefore, less well understood by the securities markets — freeing up capital and reallocating it may be a valid role for the corporate center.)

Other valid roles might include:

- *Developing broad gauge managers (e.g., General Electric)*
- *Fostering an entrepreneurial culture (e.g., 3M)*
- *Building a company-wide distinctive competence in marketing (e.g., Ore-Ida, the Heinz subsidiary)*
- *Using small, bite-size acquisitions as a way of experimenting your way into businesses that you don't know well (as I believe General Mills has successfully done).*

So, we are not against diversification per se. But so much of it has been done in the name of "synergy" that never materializes, or under the banner of a corporate theme that makes no economic sense, that we retain a healthy degree of skepticism. The key question: How does the corporate center of a diversified company create wealth for its shareholders? The record for the big U.S. conglomerates is not that good."

We at Federal appreciate Bob Waterman's comments, and agree strongly that increasing value *is* the issue. He has noted several valid ways in which this can and is being done. We have found — and are using — some of these and several more. ■

Many shareholders returned the "feedback" cards in last year's Annual Report. Here are answers to a number of the questions most commonly posed.

1982 was not a strong year for the Company. Over the next few years will we see a resumption of the growth we enjoyed from 1979 through to 1981?

The period from 1979 through 1981 climaxed Canada's most dramatic growth cycle since World War II, particularly in the natural resource sector. Since Federal's businesses were closely related to this sector, sales and profitability rose to new highs. While we don't see the current economic cycle supporting such widespread, sustained growth, we do anticipate significant overall growth in both revenues and earnings over the next few years. The 1983 reorganization and restructuring of the Company's operations should generate some internal growth; however, most near-term increases will result from strategic acquisitions.

What are you doing to encourage more trading in Federal Shares?

In December 1983, your Company concluded a public offering of Convertible Preferred Shares, targeted toward the individual investor. This offering was successful in achieving cross-Canada distribution, and of the 2,554 new shareholders, 2,341 were individuals with an average share purchase numbering slightly more than 400. Since listing in early 1984, trading has been vigorous. It's also likely that increased activity in Preferred Shares will have a positive impact on trading of Federal Common Shares.

Will the Cyprus Anvil mine ever reopen? If so, when? What impact will this have on White Pass' earnings in the short and long term?

Our economic analysis and discussions with Government and industry officials indicate that the Cyprus Anvil mine should reopen in the near future. The earliest opening would be late 1984, with full production resuming in 1985. During the year and a half since the mine ceased shipping concentrates, White Pass has restructured its operations and entered into negotiations with its various unions to reduce the overall cost structure for transportation of bulk products into and out of Yukon. Accordingly, we expect to be able to offer the mine owners an attractive transportation package, which, together with spin-off sales in petroleum products, should add up to $50,000,000 in sales to the Transport Group and substantial incremental earnings. In 1981, the last full year prior to the mine shutdown, White Pass' northern operations earned in excess of $3,000,000 after tax.

When you consider acquisitions, what are your prime criteria?

While our specific criteria are under constant review, *in general* Federal seeks acquisitions that:

a) Are in management-intensive (in terms of management excellence) industries, serving other businesses in established markets
b) Meet our definition of fiscal prudence
c) Meet our long-term earnings criteria
d) Are of a size compatible with existing subsidiaries
e) Have the potential to reward any "turnaround" effort required
f) Have a manageable or compatible culture
g) Can dominate a defined market.

In 1983, we applied the additional criterion that acquisitions be less capital intensive than existing subsidiaries.

Are there any plans to split the Common Stock?

While the Company has no current plans for a stock split, we realize its attraction for the small investor. Hypothetically, a split could be considered at such time as Common Shares trade above $20.

Are you optimistic or pessimistic about Canada's economy in the years to come?

Although we anticipate regional volatility and substantial uncertainty, Canada's medium term should produce a modest recovery. Federal's businesses are now structured to be profitable in this environment, with substantial financial and operational capacity to take advantage of economic upturns where and when they occur. We are more bullish about the prospects for the United States economy, and expect substantial expansion of our business interests there throughout the 1980's.

Since the beginning of the year, Federal Industries has purchased companies involved in trucking and steel distribution. Do you consider these to be "growth industries"? Would you consider acquiring "high tech" companies?

Both transportation and steel are relatively mature industries, and we do not forsee dramatic growth in these areas in the current North American economy. However, our research indicates that steel distribution centres are acquiring an increasing proportion of total steel shipments and, in that sense, are a growing industry. Transportation will offer significant opportunities as established patterns change, as with the Crow Rate settlement.

In both transport and steel distribution, growth will be largely through expanding on new opportunities in the existing markets and through acquisition.

Federal's present plans do not include a significant participation in high technology industries. The Company intends to "stick to its knitting", with orientation toward stable, mature companies in the industrial sector where we deal primarily with other businesses — and where we see ample opportunities for growth and profitability.

How will your acquisition policy affect the Company's debt/equity ratio?

We no not expect our debt/equity ratio to change appreciably. Our leverage policy is closely tied to our perception of the general economic climate. It is our belief that debt is best used in times of economic expansion, and that a conservative balance sheet with relatively high equity is appropriate for today's weaker, more volatile economic cycles. In fact, many of our acquisition prospects are excellent companies that are for sale because of insufficient equity.

With the benefit of an additional six months of evidence, at what state of the business cycle is the Canadian economy now?

We believe that the Canadian economy is entering its second year of a weak recovery, with 1982 being the end of the previous cycle. Present growth is primarily consumer-driven, and this may be relatively short-lived. Prospects for growth through 1986 are clouded with uncertainty, and it is possible that there will be another decline in late 1986 or '87.

Are further major acquisitions planned at this time?

Yes. As a consequence of recent equity offerings and the restructuring and reorganization of your Company to lower volumes, substantial cash and lines of credit are available for future growth. Acquisitions in the short term likely will fit in with the existing Transport, Industrial Distribution or Aerospace Groups. However, Federal is committed to establishing another major acquisition, possibly in a new industrial group, within the next two years.

FEDERAL INDUSTRIES LTD.
2400 — One Lombard Place
Winnipeg, Canada R3B 0X3

Board of Directors

J. F. Fraser
President and Chief Executive Officer
Federal Industries Ltd.

*R. G. Graham
President
Inter-City Gas Corporation

A. S. Leach, Jr.
Corporate Director

*J. B. MacAulay
Partner, Fraser & Beatty
Barristers and Solicitors

*A. V. Mauro
President
The Investors Group

J. S. Pelton
Vice-President, Finance
Federal Industries Ltd.

*J. D. Riley
Corporate Director

C. L. Searle
Professor of Electrical Engineering
Massachusetts Institute of Technology

S. A. Searle
Chairman of the Board
Federal Industries Ltd.

* *Member of Audit Committee*

Officers

S. A. Searle
Chairman of the Board

J. F. Fraser
President and Chief Executive Officer

J. S. Pelton
Vice-President, Finance

R. J. Vahsholtz
Vice-President, Planning

W. E. Watchorn
Vice-President and Assistant Secretary

M. H. Freedman
Secretary

SUBSIDIARIES

Baldwin Steel
Ohio Division
7255 Division Street
Bedford, Ohio 44146
(216) 439-1480

S. G. Moss
President

Michigan Division
4111 12th Street
Ecorse, Michigan 48229
(313) 928-7171

J. N. Spero
President

Canadian Motorways Ltd.
60 Eagle Drive, P.O. Box 738
Winnipeg, Manitoba R3C 2L8
(204) 633-5560

J. F. Fraser
Chairman of the Board

P. J. Maley
President

D. L. White
Vice-President, Operations

R. C. Hamaberg
Vice-President, Finance and Secretary

J. A. Hopkins
Director of Marketing

J. H. Attenborrow
Director of Maintenance

W. H. White
General Manager, Western Region

B. Sagert
General Manager, Alberta Region

W. Neufeld
General Manager, Central Region

J. Giles
General Manager, Eastern Region

International Alloy Steel
30403 Bruce Industrial Parkway
Solon, Ohio 44139
(216) 248-9500

J. T. Shannon, Jr.
President

Lytle Specialties
75 Ingram Drive
Toronto, Ontario M6M 2M2
(416) 245-3333

N. B. Katzman
President

D. Fine
Vice-President, Marketing

Russelsteel Inc.
P.O. Box 5009, 535 Bowes Road
Downsview, Ontario M3M 3B5
(416) 669-6454

W. P. E. Mang
President and Chief Executive Officer

D. K. Hurst
Executive Vice-President

A. M. Shkut
Executive Vice-President

M. J. Greene
Vice-President, Finance and Secretary

J. M. White
Vice-President, Marketing

J. S. P. Eckersley
Vice-President, Operations

H. M. Ho
Vice-President, Human Resources

Standard Aero Inc.
One Corporate Center, 7301 Ohms Lane
Minneapolis, Minnesota 55435
(612) 835-9250

J. F. Fraser
Chairman of the Board

E. G. Kelley
President and Chief Executive Officer

Standard Aero International Inc.
One Corporate Center, 7301 Ohms Lane
Minneapolis, Minnesota 55435
(612) 835-9250

W. L. Carolla
Chairman of the Board

G. L. Cantele
President and General Manager

R. A. Carter
Vice-President, Material

E. W. Davies
Vice-President, Finance/Administration
and Secretary

Standard Aero Limited
33 Allen Dyne Road
Winnipeg International Airport
Winnipeg, Manitoba R2R 0S8
(204) 775-9711

E. G. Kelley
Chairman of the Board

G. B. Sampson
President and General Manager

J. A. Burgess
Vice-President, Engineering

D. A. Pilley
Vice-President, Administration and Secretary

D. M. Finley
Vice-President, Operations

H. T. Goldie
Director, Marketing

Thunder Bay Terminals Ltd.
P.O. Box 1800, Station "F"
Thunder Bay, Ontario P7C 5J7
(807) 623-6921

J. F. Fraser
Chairman of the Board

N. H. Carr
President and General Manager

K. W. Traynor
Director of Marketing and Secretary

J. W. Kepes
Director of Finance

D. E. Kelso
Operations Superintendent

D. S. Bhattal
Maintenance Superintendent

Vincent Steel
156 Disco Road
Rexdale, Ontario M9W 1M4
(416) 675-1800

C. A. Roberts
President

R. H. Cork
Vice-President, Finance

R. A. Moodie
Vice-President, Sales

The White Pass and Yukon Corporation Limited
P.O. Box 4070
Whitehorse, Yukon Y1A 3T1
(403) 668-7611

J. F. Fraser
Chairman of the Board

T. H. King
President and Chief Executive Officer

G. W. Goertz
Vice-President, Finance and Secretary

W. V. McIsaac
Vice-President, Truck Transportation

F. H. Hoskin
Manager, Industrial Relations and Personnel

E. R. Bouchard
Manager, Petroleum Division

K. M. Steele
Lands Manager

Transfer agent and registrar

The Royal Trust Company
Calgary, Montreal, Toronto, Vancouver
and Winnipeg

SHAREHOLDER QUESTIONNAIRE

At Federal Industries, we frequently hear from shareholders who wish to voice an opinion on specific issues. The questionnaire below is designed to give an understanding of the opinions of a larger number of shareholders — and those who are considering investing in the Company.

Please answer candidly each question that applies. Thank-you.

1. Are you currently a Federal Industries shareholder?

☐ yes

☐ no

(If "no" please go directly to question 5)

2. Please indicate whether your shareholdings are

☐ individual

☐ institutional

3. Do you hold

☐ Common Shares

☐ Preferred Shares

☐ both

4. Please indicate which option summarizes your current feelings toward Federal shares you hold:

Common Shares

☐ planning to purchase more

☐ planning to sell shares

☐ planning to hold what I now have

☐ planning to switch to Preferred Shares

Preferred Shares

☐ planning to purchase more

☐ planning to sell shares

☐ planning to hold what I now have

☐ planning to switch to Common Shares

5. Please indicate if you have traded in Federal shares

☐ within the last five years

☐ within the last year

☐ within the last six months

6. As a present or prospective shareholder what is (or would be) your prime reason for holding or buying Federal Industries' shares:

☐ capital appreciation

☐ dividend income

☐ both capital appreciation and dividend income

☐ other (please state)__________

____

____

7. Given the company's dedication to maintaining a strong balance sheet, do you consider the current dividend yield to be adequate?

☐ yes

☐ no

If "no" what yield would you consider appropriate?

____

____

____

8. How did you first become aware of Federal Industries?

☐ through a stock broker

☐ through a Federal Industries employee

☐ through a Federal Industries shareholder

☐ by reading a previous annual report

☐ through a newspaper or magazine article

☐ this is my first exposure to Federal Industries

☐ other__________________

____

____

____

____

9. If your shares are held in a "street name" (you have not taken delivery of the share certificates) would you like your name added to a mailing list to receive information directly at your home or business address?

☐ yes

☐ no

If "yes", please provide name and address:

____

____

____

10. Please indicate which sections of the Annual Report you read — and which <u>one</u> was most valuable:

I read	Most Valuable
☐ Report to Shareholders	☐
☐ President's Report	☐
☐ Financial Report	☐
☐ Planning Report	☐
☐ Group Report	☐
☐ Financial Statements	☐
☐ Essay on Diversification	☐

Please use this space to ask questions or to offer any comments you may have about the Annual Report or the Company's performance.

____

____

____

____

____

____

____

____

A return envelope was enclosed with the Report at the time of mailing. If it is not available, please return the completed questionnaire to:

J.F. Fraser
President & Chief Executive Officer
Federal Industries Ltd.
Suite #2400
One Lombard Place
Winnipeg, Manitoba R3B 0X3

Printed in Canada.

FEDERAL INDUSTRIES

Federal Industries Ltd., Suite 2400, One Lombard Place, Winnipeg, Canada R3B 0X3