MAGNETICS INTERNATIONAL LTD.

ANNUAL REPORT 1977

Magnetics International Ltd. (Incorporated under the Quebec Companies Act)
and subsidiary companies

DIRECTORS AND OFFICERS

G. M. Curtis	President and Director
N. E. Goodman	Secretary and Director
J. H. Morgan	Director
B. Leebosh	Director
W. J. D. Stone	Director
C. Gillissie	Assistant Secretary

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Montreal and Toronto

AUDITORS

Touche Ross & Co.

SHARES LISTED

The Montreal Stock Exchange
The Toronto Stock Exchange

Magnetics International Ltd. (Incorporated under the Quebec Companies Act)
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To the Shareholders

The attached financial statements reflect the company's profitable operating results for the year under review. Several transactions which occured during 1977 are worth noting. By far the most exciting and challenging of these was the decision to purchase an equity interest in a solar energy company. Significant in other respects were the repayment of all the company's long term debt and the purchase, through a wholly owned subsidiary of 700,000 shares of the company at $0.50 per share. This subsidiary now holds 1,050,000 shares of the Company.

During February 1978, the company finalized it's purchase of an equity interest in Thermo Solar Inc. The terms of the agreement call for the company to issue 40,000 shares in exchange for 50% of the equity, and to guarantee a working capital advance of not more than $150,000. In addition, the company has the option to purchase within three years an additional 10% interest in exchange for 140,000 shares of the company.

Thermo Solar Inc., a private Canadian company headed by its President Mr. Jacques Sicotte, is exclusively involved in solar energy equipment, systems and design. In addition to its own solar product line, Thermo Solar Inc. has obtained an exclusive license for Canada to manufacture the Sunworks line of solar products. Sunworks, one of the leading names in the solar energy industry in the U.S.A. is a division of Enthone Inc., a leading supplier in the plating and metal finishing industry. Enthone Inc., is in turn a subsidiary of Asarco Inc., one of the world's largest smelters and refiners of non-ferrous metals. Together, they combine their historical leadership in developing quality products for the solar energy industry.

The growth of the solar energy industry in the U.S.A. during the last four years has been dynamic. Management is confident that Thermo Solar Inc., backed by the expertise of Sunworks, will be a leader in the quickly growing Canadian solar energy industry. The pace of growth of the industry is such that at time of writing, one cannot hazard a guess at what the current year's sales might be.

The relocation in Switzerland of the company's laboratory and testing facility for the Jones Separator has proven to be successful. The move has indeed contributed to a closer working relationship with our licensed manufacturer, Klockner-Humboldt-Deutz of West Germany and the inventor, Professor Jones of England. The testing facility, which has a healthy backlog of test work on hand, has this past year obtained very favourable results with the Jones Machine in the areas of beneficiating aluminium and uranium. These new areas, when added to the others that the Jones Machine is successful in, should produce significant income for the company during the next several years.

The year 1978 should be a very exciting and profitable one for the company.

On Behalf of the Board

G. Curtis

G.M. Curtis
President

Magnetics International Ltd. (Incorporated under the Quebec Companies Act)
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Consolidated Balance Sheet

	December 31 1977	1976
Assets		
Current assets		
Cash	$ 34,574	$ 87,353
Short term deposits	514,041	411,000
Accounts receivable	53,464	71,158
Inventories — work in process	—	10,090
	602,079	579,601
Investment in shares of mining companies	—	3,174
Receivables not currently due	25,000	120,000
Fixed assets (Note 2)	61,198	229,845
Patent rights (Note 3)	225,800	257,400
	$ 914,077	$1,190,020
Liabilities		
Current liabilities		
Bank loans	$ —	$ 45,000
Accounts payable and accrued liabilities	113,173	105,971
Income taxes payable	20,000	—
Indebtedness payable within one year (Note 4)	—	30,000
Deferred revenue	—	215,294
	133,173	396,265
Indebtedness not maturing within one year (Note 4)	—	165,000
Shareholders' Equity		
Capital stock (Note 5 and 6)		
Authorized		
5,000,000 common shares without par value		
Issued and fully paid		
3,216,055 (1976 — 3,266,055)	960,191	1,147,691
Deficit	(179,287)	(518,936)
	780,904	628,755
	$ 914,077	$1,190,020

Signed on behalf of the Board

G. M. Curtis, Director
N. E. Goodman, Director

Magnetics International Ltd. (Incorporated under the Quebec Companies Act)
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Consolidated Statement of Income

	Year ended December 31	
	1977	1976
Sales and other operating revenues	**$769,343**	$1,664,042
Cost of sales including royalties	**145,903**	269,259
Depreciation and amortization	**45,444**	40,267
Selling and administrative expenses	**279,803**	309,193
Loss (profit) on foreign exchange	**6,514**	(4,215)
Interest	**715**	13,800
	478,379	628,304
Income before income taxes and extraordinary items	**290,964**	1,035,738
Provision for income taxes	**73,351**	535,217
Income before extraordinary items	**217,613**	500,521
Extraordinary items		
Non-recurring gains, net (Note 7)	**68,685**	—
Reduction of income taxes from application of prior years' losses	**53,351**	535,217
Recovery of advances to non-consolidated subsidiary companies	**—**	18,157
Gain on sale of subsidiary companies	**—**	107,045
Net income for the year	**$339,649**	$1,160,940
Per share (Note 5)		
Income before extraordinary items	**$ 0.07**	$ 0.15
Net income for the year	**0.11**	0.34

Consolidated Statement of Deficit

	Year ended December 31	
	1977	1976
Deficit, beginning of year	**$518,936**	$1,679,876
Net income for the year	**339,649**	1,160,940
Deficit, end of year	**$179,287**	$ 518,936

Magnetics International Ltd. (Incorporated under the Quebec Companies Act)
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Consolidated Statement of Changes in Financial Position

	Year ended December 31 1977	1976
Source of funds		
Income before extraordinary items	**$217,613**	$ 500,521
Charges to income not affecting working capital		
Depreciation and amortization	**45,444**	40,267
Loss on disposal of fixed assets	**8,760**	—
	271,817	540,788
Decrease in receivable not currently due	**10,000**	—
Disposal of fixed assets	**184,590**	—
Extraordinary items		
Reduction of income taxes	**53,351**	535,217
Recovery of advances to non-consolidated subsidiary	**—**	18,157
Gain on sale of specific development project	**80,547**	—
Gain on settlement of long-term debt	**15,138**	—
Share options exercised	**162,500**	3,125
Proceeds from sale of subsidiary companies	**—**	120,000
Disposal of investments in mining companies	**3,174**	—
	781,117	1,217,287
Application of funds		
Investment in fixed assets	**38,547**	219,001
Acquisition of shares in Magnetics International Ltd.	**350,000**	—
Increase in receivable not currently due	**25,000**	—
Decrease in amount due to non-consolidated subsidiary companies	**—**	4,882
Working capital of subsidiary companies sold	**—**	1,252
Decrease in indebtedness not maturing within one year	**82,000**	190,000
Investment in and advances to a consolidated subsidiary	**—**	183,075
Proceeds on disposal of subsidiary companies converted to receivables not currently due	**—**	120,000
	495,547	718,210
Increase in working capital	**285,570**	499,077
Working capital (deficiency), beginning of year	**183,336**	(315,741)
Working capital, end of year	**$468,906**	$ 183,336

Auditors' Report

To the Shareholders,
Magnetics International Ltd.,

We have examined the consolidated balance sheet of Magnetics International Ltd. as at December 31, 1977 and the consolidated statements of income, deficit 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. We have obtained all the information and explanations we have required.

In our opinion, subject to the settlement of the contingent liabilities described in Note 10, and according to the best of our information and the explanations given to us and as shown by the books of the company, these consolidated financial statements present fairly the financial position of Magnetics International Ltd. as at December 31, 1977 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.

Montreal, Quebec,
March 10, 1978.

Touche Ross & Co.
Chartered Accountants

Notes to Consolidated Financial Statements December 31, 1977

1. Significant Accounting Policies

a) Principles of consolidation
The consolidated financial statements include the accounts of Magnetics International Ltd. and all of its subsidiary companies with the exception of Con Quest Exploration Ltd. The latter, a 54% owned subsidiary, has not been active for several years. It is therefore not appropriate to include its accounts in the consolidated financial statements. The company's investment in and advances to this subsidiary have been written down to a nominal value in prior years.

b) Foreign exchange
Accounts other than Canadian dollar accounts included in the consolidated balance sheet have been translated into Canadian dollars at rates of exchange current at year-end except that investments, fixed assets, patent rights, and accumulated depreciation and amortization are at rates prevailing at dates of acquisition. Accounts included in the consolidated statement of income except depreciation and amortization are translated at average rates of exchange prevailing during the year.

c) Income recognition
The income under the licensing agreement for the sale of Jones Separators is recognized when received; all other income is recognized on the accrual basis.

d) Fixed assets
Fixed assets are valued at cost, and depreciation is provided on a straight line basis over the estimated useful lives of the assets.

e) Patent rights
Patent rights are recorded at cost and are being amortized over their remaining useful lives.

2. Fixed assets

	1977	1976
Fixed assets, at cost		
Land	**$ 21,001**	$ 36,001
Buildings	**—**	181,800
Machinery, equipment and fixtures	**54,041**	21,159
	75,042	238,960
Less: accumulated depreciation	**13,844**	9,115
	$ 61,198	$229,845

3. Patent rights

	1977	1976
Patent rights, at cost	**$490,000**	$490,000
Less: accumulated amortization	**264,200**	232,600
	$225,800	$257,400

4. Indebtedness not maturing within one year

	1977	1976
Magnetics International Ltd. Owing to director on purchase of patents, payable in annual installments of $15,000 until 1988	**$ —**	$180,000
Magint N.V. 6½% promissory note payable U.S. $15,000 on January 1, 1977. Endorsed by Magnetics International Ltd.	**—**	15,000
	—	195,000
Less: indebtedness payable within one year	**—**	30,000
	$ —	$165,000

5. Capital stock options

During 1976 the company established a stock option plan for senior employees and allocated 180,000 shares for this purpose. To date 130,000 shares (1976 — 30,000 shares) have been set aside to cover options granted to a senior employee and an officer. These options are exercisable at various dates to 1980 at $0.52 per share for 30,000 shares and $0.375 per share for 100,000 shares. None of these options were exercised during the year.

During the year the Bra-Curt Syndicate exercised its option to purchase 650,000 shares in the capital stock of the company at $0.25 per share.

6. Capital stock

During 1976, the company acquired all the shares of a private company whose only asset was 350,000 shares of Magnetics International Ltd. In August 1977, this subsidiary company acquired a further 700,000 shares of Magnetics International Ltd. from a third party at $0.50 per share. At December 31, 1977, the subsidiary held 1,050,000 shares of Magnetics International Ltd.

7. Non-recurring gains, net

	1977	1976
Gain on settlement of long-term debt	$ 98,138	$ —
Gain on sale of specific development project	80,547	—
Loss on disposal of long-term notes receivable	(110,000)	—
	$ 68,685	$ —

The company settled the long-term liabilities outstanding at December 31, 1976 amounting to $195,000 for $96,862 giving rise to a gain of $98,138.

The company sold its rights to a specific development project for $80,547. The rights were carried at nil value in the accounts.

The company received a payment of $10,000 as final settlement of the long-term notes receivable of $120,000.

8. Earnings per share

Earnings per share have been calculated on the average number of shares outstanding during the year, excluding the 1,050,000 shares held by a subsidiary company.

9. Remuneration of directors

No remuneration was paid to directors in that capacity during 1977 (nil in 1976). Senior officers, who were also directors, received no remuneration in that capacity during 1977 (nil in 1976).

Consulting, management and office administration services were provided to the company during the year for a total cost of $75,000 (1976 — $76,000). Three directors of the company two of whom are officers, are shareholders in the firms which provided these services.

10. Contingent liabilities

The company has outstanding guarantees to third parties in the amount of $34,000. Management is of the opinion that any demands under these guarantees will not be significant.

During the year, the company received a tax assessment relating to 1976 totalling $54,000. The company has filed a notice of objection. Both management and the company's attorneys are confident that the assessment will be reversed and therefore no provision has been made for this amount.

An amount of approximately $55,000 is claimed by an individual relative to an acquisition made by the company in 1973. However, certain warranties relative to this acquisition were issued to the company by the above individual at that time. Management is of the opinion that the claims under these warranties exceed the amount due and therefore no provision has been made for this amount.

11. Subsequent event

During February 1978 the company purchased a 50% equity interest in Thermo Solar Inc., a private Canadian Company specializing in solar energy equipment and systems. The terms of the purchase agreement call for the company to issue 40,000 shares of Magnetics International Ltd. and to guarantee a working capital advance of $150,000. The company has the option to purchase within three years and additional 10% interest in exchange for 140,000 shares of the company.