

EAST
SULLIVAN
MINES
LIMITED

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EAST SULLIVAN MINES LIMITED

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To the shareholders of EAST SULLIVAN MINES LIMITED

Your directors are pleased to submit the consolidated financial statements of your company for the fiscal year ended August 31, 1978.

The net losses of the company's divisions and subsidiaries amounted to \$108,646 compared to \$6,763,624 the previous year (\$0.04 per share effectively in circulation versus \$2.47 reported last year).

However, when reading the financial statements, you will notice that the working capital of your company is now standing at \$9,346,755 compared to \$8,994,692 last year. The increase is resulting from the sale of equipment, machinery and buildings during the course of the last fiscal term.

Brunswick Tin Mines

We are pleased to report the signature of an agreement, on November 30, 1977, between your subsidiary, Brunswick Tin Mines, and Billiton Exploration Canada Limited, the Canadian operating company of the Billiton Group, part of the Royal Dutch-Shell Group of companies. This agreement permits Billiton to complete a feasibility study which, if successful, could lead to a Joint Venture with Brunswick Tin Mines.

Ore reserves, which were reported as blocked out, have been reassessed and confirmed. Furthermore, Billiton has mined a large bulk sample of approximately 10,000 tons of ore which were trucked to the Nigadoo concentrator. Metallurgical test runs have been completed, using the

modified Nigadoo Mill, and this verified the flotation process developed by Brunswick Tin Mines. The recoveries of tungsten and molybdenum are encouraging, based on technical work completed thus far, but further testwork is in progress to confirm the results.

Currently a program concerned with detailed evaluation of mining, metallurgical, waste disposal and project design and engineering is underway. With the tabulation of the various information during the course of this program, a final feasibility study will be completed at the latest, on December 31 of this year.

Then Billiton shall have the privilege to exercise its option within a maximum of 90 days from that date and, in which case, it will assume the responsibility for arranging the financing to attain commercial production. At first the cashflow generated from the operations will serve to reimburse the financing. From thereon Billiton and Brunswick Tin Mines will, each, receive 50% of the profits.

Until such time as Billiton is completely reimbursed, Brunswick Tin Mines will receive, under certain conditions, from the operating profits, a royalty of two dollars (\$2.00) per ton treated up to a maximum of \$1,000,000 per year.

Quebec Lithium

During the course of the year, your officers have continued the market study of lithium carbonate in various parts of the world. Moreover we have

visited a number of consumers using lithium carbonate. The market study is not completed yet and we are expecting a final report within a few months. It is only then that we will be in a position to reassess the feasibility of the resumption of the lithium operation and take a decision as to the future of this important deposit.

Miscellaneous

The Board of directors of Nigadoo River Mines Limited deemed it advisable to proceed to the reorganization and the change of name of the company. This Company is now known under the name of Sullico Resources Ltd. Also Sullivan Mining Group Ltd. subscribed to new shares of the reorganized company.

Two subsidiaries, Federal Metals Corporation and Peninsula Metals Corporation were amalgamated during the year as their respective mining concessions and claims were adjoining. These properties, now owned by FEDPEN LTÉE, have an

interesting potential and might be the object of further research and exploration together with other associates during the course of the coming year.

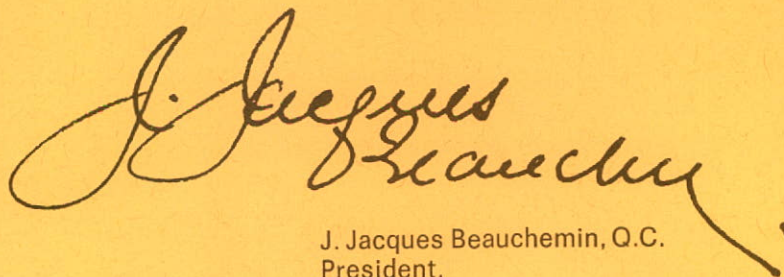
Finally, we wish to mention to you that your company disposed of three minor companies, under the advice of its engineers and geologists. These are: Brompton Mines Ltd, Eastern Explorers Corporation and Millstream Mines Ltd.

Conclusion

Keeping in mind the great potential of Brunswick Tin Mines Limited, the value of the lithium division, as well as the working capital of your Company, your Board of Directors is still more optimistic for the future.

In closing, on behalf of the Board of Directors, I wish to thank the personnel of your company for their loyalty and sustained efforts during the year.

On behalf of the Board of Directors,

A handwritten signature in dark ink, reading "J. Jacques Beauchemin". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

J. Jacques Beauchemin, Q.C.
President.

Montreal, September 25, 1978.

Officers

Marc H. Dhavernas, *Honorary Chairman of the Board*
J. Jacques Beauchemin, Q.C., *President and Chairman of the Board*
Lucien C. Béliveau, Eng., *Executive Vice-President*
Réal J. Lafleur, *Secretary-Treasurer*
Roger Plasse, Eng., *General Manager*
Thérèse Ouellette, *Assistant Secretary*
R. E. Boylan, Geologist, *Manager of Nigadoo Mine*

Directors

Claude Beauchemin, Attorney
Gendron Beauchemin, Eng.*
J. Jacques Beauchemin, Q.C.*
Lucien C. Béliveau, Eng.*
Albert Doyon, Economist
Major Jacques Gauvreau
Brigadier General J. Guy Gauvreau, D.S.O., E.D., C.D.*
Réal J. Lafleur
André Latreille, Eng.
Léo Scharry, Eng.

*Executive Committee

Registrar and Transfer Agent

Guaranty Trust Company of Canada, Montreal - Toronto

Shares Listed

Montreal Stock Exchange / Toronto Stock Exchange

Auditors

Maheu, Noiseux & Associés, Montreal

Head Office

Suite 2500 - B.C.N. Building, 500 Place d'Armes, Montreal, Quebec, H2Y 2W6

EAST SULLIVAN MINES LIMITED

(No Personal Liability)
(Incorporated under the Laws of Quebec)
and its subsidiaries

CONSOLIDATED BALANCE SHEET

August 31, 1978

STATEMENT 1

ASSETS

	1978	1977
CURRENT		
Cash and term deposits	\$ 7,790,396	\$ 6,530,345
Accounts receivable	84,565	135,241
Marketable securities (note 2)	758,168	696,418
Recoverable income taxes	—	111,406
Inventories (note 3)	718,905	1,774,477
Prepaid expenses	178,620	188,269
	<u>9,530,654</u>	<u>9,436,156</u>
 INVESTMENTS (note 4)	 77,835	 85,548
 FIXED ASSETS (note 5)		
Land, buildings and equipment	952,684	1,121,775
Buildings and equipment at estimated realizable value	1,282,131	1,786,127
	<u>2,234,815</u>	<u>2,907,902</u>
 DEFERRED EXPENDITURES (notes 6 and 12)	 9,017,239	 8,936,978
	<u>\$20,860,543</u>	<u>\$21,366,584</u>

LIABILITIES

CURRENT		
Accounts payable and accrued expenses	\$ 182,072	\$ 399,097
Salaries payable	1,827	14,081
Mining taxes	—	28,286
	<u>183,899</u>	<u>441,464</u>
 MINORITY INTEREST	 13,382,636	 13,525,467

SHAREHOLDERS' EQUITY

Capital stock (note 7)		
Authorized — 9,350,000 shares without par value		
Issued — 4,675,000 shares	4,250,000	4,250,000
Contributed surplus	700,503	700,503
Retained earnings	3,863,243	3,968,888
	<u>8,813,746</u>	<u>8,919,391</u>
Shares of East Sullivan Mines Limited held by subsidiaries	(1,519,738)	(1,519,738)
	<u>7,294,008</u>	<u>7,399,653</u>
	<u>\$20,860,543</u>	<u>\$21,366,584</u>

On behalf of the Board of Directors

J. JACQUES BEAUCHEMIN, Director

LUCIEN C. BÉLIVEAU, Director

The annexed notes are an integral part of these financial statements.

CONSOLIDATED STATEMENT OF EARNINGS

Year ended August 31, 1978

STATEMENT 2

	1978	1977
VALUE OF PRODUCTION	\$ —	\$13,417,723
Cost of realization and freight	—	6,729,663
	—	6,688,060
COST OF OPERATIONS		
Mining and milling	—	6,267,309
Administrative and general expenses	523,761	573,737
Depreciation of fixed assets and amortization of pre-milling and deferred development expenses	57,919	3,015,199
	581,680	9,856,245
OPERATING LOSS	581,680	3,168,185
Additional depreciation of fixed assets and amortization of deferred expenditures	—	1,863,590
Reduction in value of mining and milling supplies	—	316,402
Exploration and development expenses, and mining claims and concessions ..	—	2,772,037
	—	4,952,029
	581,680	8,120,214
OTHER EXPENSES		
Outside exploration	37,529	463,263
Net expenses of closed and non operating mines	539,362	865,639
	576,891	1,328,902
	1,158,571	9,449,116
OTHER INCOME		
Net revenue — ore from exploration	237,201	—
Interest and dividends	617,082	298,545
Gain on sales of fixed assets	25,414	189,458
Gain on sales of investments	9,988	—
Other revenue	11,714	—
	901,399	488,003
LOSS BEFORE MINING TAXES, EXTRAORDINARY ITEMS AND MINORITY INTEREST	257,172	8,961,113
MINING TAXES	—	28,286
LOSS BEFORE EXTRAORDINARY ITEMS AND MINORITY INTEREST	257,172	8,989,399
EXTRAORDINARY ITEMS	—	8,062,747
LOSS BEFORE MINORITY INTEREST	257,172	17,052,146
MINORITY INTEREST	148,526	10,288,522
NET LOSS FOR THE YEAR	\$ 108,646	\$ 6,763,624
NET LOSS PER SHARE	\$ 0.04	\$ 2.47

CONSOLIDATED STATEMENT OF RETAINED EARNINGS

Year ended August 31, 1978

STATEMENT 3

	1978	1977
RETAINED EARNINGS AT BEGINNING OF YEAR	\$ 3,968,888	\$10,835,937
Prior years' income tax adjustments	10,330	—
	<u>3,979,218</u>	<u>10,835,937</u>
Net loss for the year	108,646	6,763,624
Transfer of minority interest of subsidiaries	7,329	(19,572)
Excess of book value of shares acquired by a subsidiary over the cost	—	122,997
	<u>115,975</u>	<u>6,867,049</u>
RETAINED EARNINGS AT END OF YEAR	<u>\$ 3,863,243</u>	<u>\$ 3,968,888</u>

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

Year ended August 31, 1978

STATEMENT 4

SOURCE OF FUNDS	1978	1977
Other items affecting working capital		
Reimbursements of advances	\$ 4,595	\$ 35,000
Proceeds from sales of fixed assets	645,668	993,241
Instalments on mortgages receivable	3,117	2,902
Sales of shares and rights	8,358	—
Prior years' income tax adjustments	10,330	—
	<u>672,068</u>	<u>1,031,143</u>
USE OF FUNDS		
Funds applied to operations		
Net loss for the year	108,646	6,763,624
Minority interest	148,526	10,288,522
	<u>257,172</u>	<u>17,052,146</u>
Items not requiring an outlay of funds		
Depreciation of fixed assets and amortization of deferred expenditures ..	(57,919)	(3,015,199)
Additional depreciation of fixed assets and amortization of deferred expenditures	—	(4,635,627)
Gain on sales of fixed assets	25,414	189,458
Extraordinary items	—	(8,062,747)
Profit on sales of investments	9,988	—
	<u>234,655</u>	<u>1,528,031</u>
Other items applied against working capital		
Purchases of fixed assets	—	21,824
Acquisition of shares in parent company	—	52,682
Pre-milling and deferred mine development expenditures	85,350	264,379
	<u>320,005</u>	<u>1,866,916</u>
INCREASE (DECREASE) IN WORKING CAPITAL	352,063	(835,773)
WORKING CAPITAL AT BEGINNING OF YEAR	8,994,692	9,830,465
WORKING CAPITAL AT END OF YEAR	<u>\$ 9,346,755</u>	<u>\$ 8,994,692</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

August 31, 1978

1 — Accounting Policies

The subsidiaries terminated mining operations during 1977 and are now in the process of disposing of their assets.

A. Basis of consolidation

The accompanying financial statements include, on a consolidated basis, the accounts of East Sullivan Mines Limited (No Personal Liability) (the Company) and all of its subsidiaries including those that are at the exploration stage.

Certain subsidiary companies own shares in the Company. The carrying value of such shares has been deducted from the Company's shareholders equity. Similarly the Company's loss per share has been calculated on the number of its shares outstanding after reduction for such intercompany holdings.

B. Valuation of inventories

Mining and milling supplies are valued at possible amount of realization.

C. Valuation of investments

Investments are carried at cost.

D. Valuation of fixed assets

- (i) Land is valued at cost.
- (ii) Buildings, machinery and equipment of closed and non operating mines are valued at the amount that the Company anticipates to recover.
- (iii) Proceeds arising from sales of fixed assets of closed mines were used to reduce realizable value and it is the intention of these companies to continue to reduce the anticipated realization value by the proceeds of future sales of fixed assets. The final balance will be applied to operations.
- (iv) Fixed assets of Québec Lithium, a non operating division of the Company is carried at undepreciated capital cost amounting to \$771,684 which is the value that management estimates to be recoverable.

E. Deferred expenditures

- (i) Pre-production and deferred mine development expenditures amount to \$8,862,231 for the mine at the exploration stage (Brunswick Tin Mines Limited) and will only be recovered if the ore body is brought to the commercial production stage and providing that proceeds less costs to produce and sell are sufficient to amortize the precited amount of expenses.
- (ii) The value at which the mining properties, the mining rights and concessions are recorded in the books does not purport to represent their present or future value.

F. Depreciation and amortization

- (i) Depreciation of buildings, machinery and equipment used for exploration is calculated at a rate of 10% and rolling stock at 15% per annum on the straight-line method.
- (ii) Depreciation is not calculated on fixed assets of closed and non operating mines.
- (iii) Depreciation is not calculated on buildings, machinery and equipment of the subsidiary at the exploration stage. The cost of these fixed assets amounts to \$539,253 (1977 - \$573,516).

2 — Marketable Securities — at cost

	1978	1977
Bonds		
market value 1978 - \$134,069;		
1977 - \$138,468	\$ 132,952	\$ 142,952
Shares		
market value 1978 - \$675,977;		
1977 - \$522,838	625,216	553,466
	<u>\$ 758,168</u>	<u>\$ 696,418</u>

3 — Inventories	1978	1977
These consist of:		
Mining and milling supplies		
Valued at possible amount of realization	\$ 631,312	\$ 853,382
Concentrates at smelters	87,593	921,095
	<u>\$ 718,905</u>	<u>\$ 1,774,477</u>

4 — Investments — at cost

Shares		
(market value 1978 - \$9,666; 1977 - \$6,743)	\$ 24,176	\$ 24,176
Advances to a company	20,405	25,000
Mortgages receivable from employees and a director	33,254	36,372
	<u>\$ 77,835</u>	<u>\$ 85,548</u>

5 — Fixed Assets

	Cost	Accumulated Depreciation	Net value	
			1978	1977
Land	\$ 111,175	\$ —	\$ 111,175	\$ 111,175
Buildings, machinery and equipment	1,196,328	354,819	841,509	1,010,600
	<u>\$ 1,307,503</u>	<u>\$ 354,819</u>	<u>\$ 952,684</u>	<u>\$ 1,121,775</u>
Buildings and equipment at estimated realizable value			<u>\$ 1,282,131</u>	<u>\$ 1,786,127</u>

6 — Deferred Expenditures — at cost

Mine at the exploration stage	\$ 8,862,231	\$ 8,781,976
Mining properties, claims and concessions	155,008	155,002
	<u>\$ 9,017,239</u>	<u>\$ 8,936,978</u>

7 — Shareholders' Equity

The issued capital stock of the Company is summarized below:

	1978 (number of shares)	1977 (number of shares)
Class A	4,554,222	4,543,236
Class B	120,778	131,764
	<u>4,675,000</u>	<u>4,675,000</u>
Less: The Company's interest in its shares held by subsidiaries	1,940,471	1,940,471
	<u>2,734,529</u>	<u>2,734,529</u>

Class A and class B shares are voting, convertible into one another on a share for share basis and rank equally with respect to dividends and in all other respects. The only distinction between the two classes is that the directors may specify that cash dividends on class B shares be paid first out of 1971 tax-paid undistributed surplus on hand (as those expressions are defined in the Income Tax Act of Canada), with the result that Class B dividends so paid will be less than the Class A dividends by the amount of tax paid thereon.

8 — Income Taxes

- (i) The Company and its subsidiaries are not taxable because they have claimed for tax purposes, capital cost allowance in excess of the income otherwise taxable for the year.
- (ii) Furthermore, the Company and its subsidiaries had as at August 31, 1978 further amounts available to reduce possible future taxable income:

	1978	1977
Undepreciated capital cost	\$ 7,143,050	\$ 7,949,862
Outside exploration expenditures	4,519,731	4,412,067
Preproduction expenditures	4,722,917	4,877,703
Losses for income tax purposes	1,617,336	1,567,843

- (iii) The subsidiaries at the exploration stage have as a Group, an amount of \$9,647,484 (1977 - \$9,124,272) available to reduce their possible future taxable incomes or the Company's which might be earned from mining operations or from investments.

9 — Pending Legal Procedures

Legal proceedings have been instituted against the Company whereby the plaintiffs are claiming $\frac{4}{5}$ of the 340,000 escrowed shares of Sullipek Mines Inc. to be issued and allotted to Sullivan Mining Group Ltd. and alternatively failing delivery of the claimed shares, the plaintiffs have claimed the sum of \$1,000,000 of damages against Sullivan Mining Group Ltd. This litigation has arisen from an option granted by the Company to Terra Nova Explorations Ltd. on certain claims situated in the Gaspé area of the Province of Québec. These proceedings have been contested and in the opinion of the Company's counsel they are ill-founded in facts and in law.

10 — Contractual Obligations

Contractual obligations including the office lease expiring in 1979 total \$68,807 as at August 31, 1978 (1977 - \$98,146).

11 — Remuneration of Directors and Officers

The aggregate remuneration received by directors and officers of the company amounts to \$254,390 for the year (\$365,977 for 1977). The directors received no remuneration for their services as directors during the year.

12 — Evaluation and Feasibility — Brunswick Tin Mines Limited

The Company has signed on November 30, 1977, an agreement with Billiton Exploration Canada Limited to enter into a joint venture to evaluate and if feasible, develop and exploit, the mining property of the company in New Brunswick.

During the year, Billiton, at its sole risk and expense, carried out a feasibility study to evaluate the commercial potential of the property. The company provided facilities and personnel to assist them in this study. Billiton requested and obtained from the company an extension for the feasibility study which should be completed by December 31, 1978.

Within 90 days after completion of the feasibility study, Billiton will advise the company if it decides to put the property into commercial production. It will then acquire a 50% interest by arranging for the remaining finance necessary to achieve commercial production, the company thereby retaining a 50% interest.

The Company shall, under certain conditions, be entitled to receive a royalty of \$2 Canadian per ton of ore treated, up to a maximum of one million dollars per year, while the required financing is being fully retired. Thereafter, the cash flow shall be shared equally between Billiton and Brunswick Tin Mines Limited, in which Sullivan Mining Group has an interest of 89%.

AUDITORS' REPORT

To the shareholders of
East Sullivan Mines Limited
(No Personal Liability)

We have examined the consolidated balance sheet of East Sullivan Mines Limited (No Personal Liability) and its subsidiaries as at August 31, 1978 and the consolidated statements of earnings, retained earnings and changes in financial position for the year then ended and we have obtained all the information and explanations we have required. 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, subject to the recovery of deferred expenditures and the realization of the assets as referred to in note 1 and according to the best of our information and explanations given to us and as shown by the books of the company, these consolidated financial statements present fairly the financial position of the company as at August 31, 1978 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.

MAHEU, NOISEUX & ASSOCIÉS
Chartered Accountants

October 10, 1978

