

# ABC INCORPORATED

## FINANCIAL STATEMENTS AND SUPPLEMENTARY INFORMATION

Years Ended December 31, 2005 and 2004

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## **(ACCOUNTANTS' LETTERHEAD)**

**To the Board of Directors  
ABC, Incorporated  
Irvine, California**

We have reviewed the accompanying balance sheets of ABC, Incorporated as of December 31, 2005 and 2004, and the related statements of income, changes in stockholders' equity, and cash flows for the years then ended, in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management of ABC, Incorporated.

A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an audit in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles.

Our review was made for the purpose of expressing limited assurance that there are no material modifications that should be made to the financial statements in order for them to be in conformity with generally accepted accounting principles. The information included in the accompanying schedules of selling and administrative expenses is presented only for supplementary analysis purposes. Such information has been subjected to the inquiry and analytical procedures applied in the review of the basic financial statements, and we are not aware of any material modifications that should be made to it.

Signature

March 15, 2006

## Chairman's Introduction

This has been a year of great activity and success for ABC. A year in which we have restructured our business, continued to build our product lines and achieved strong growth.

I am proud and fortunate, not only to serve on your board, but also to represent ABC Inc. internationally and I feel that the future lies in expansion into other markets and countries. It will prove, I know, to be an exciting time during this expansion and I am very pleased for the opportunity to lead this company into new fields.

One factor has remained constant throughout this year and past years – the irrepressible commitment and drive of our people. This is in no small measure due to their loyalty to our products, which help us to attract highly talented people to work with us. Our people are an essential part of our products and the success of our business. It is a real privilege to work with them.

## Business performance

We are committed to delivering sustained growth and have once again done so in the financial year 2005. As you will read elsewhere in this report, ABC is now structured as two regional business units: Illinois and California.

We have made good progress in many of our markets in each of these regions and continue to address challenges where we face them. And as our new structure establishes itself, I fully anticipate a series of benefits to feed through, including reduced costs and the widespread sharing of best practice.

# Directors' Report

The directors have pleasure in presenting to shareholders their annual financial statements for the year ended December 31, 2005.

The financial statements, directors' report and report of the auditor on the financial statements are available to shareholders free of charge.

## Business activities and development

### Operating Review

The company continues to expand into the muscle-car market utilizing the present manufacturing facilities. This make more effective use of our capacity.

### Market Review

The company continues to expand into the muscle-car market and is optimistic regarding the launch of the new S331 truck. This is a new venture to supply a demand and to which the company is responding. Advance orders are encouraging and the company can look forward to an exciting addition to its present product line.

### Financial review

It has been a tight financial year, funds being provided by borrowings and earnings as detailed in the statement of cash flows included in these financial statements and used to finance our growth into the retail sector and the launch of our new model line.

## Dividends

ABC Inc. paid no dividends during the year and none are recommended.

## Directors

The directors, their responsibilities and memberships of the principal committees are set out in the Board of Director section.

### Executive Directors

Chief Executive Officer	John Smith
Chief Financial Officer	Joseph Doheney, C.P.A.
Chief Operating Officer	James Dean

## **Non-executive Directors**

Jane Doheney

Janis Smythe

James Brown

## **Changes in Directorship during the year are:**

Retired

Thomas Cook

## **Annual General Meeting**

The AGM will be held at 110 Lake Forest Drive, Irvine, California 92608 at 2.30pm on Tuesday, 18 June, 2006.

## **Summary Corporate Governance Report**

The company is not required to comply with the Sarbanes Oxley Act of 2002 since it is not a Publically Traded Company.

However, the directors have reviewed the effectiveness of the group's system of internal control for the relevant period and much work is in hand in this area. It is our intention to continue to work with our internal control advisers to maintain a high standard in internal control.

**ABC, INCORPORATED**  
**BALANCE SHEETS**  
December 31, 2005 and 2004

Note	2005 \$	2004 \$
<b>ASSETS</b>		
<b>Current Assets</b>		
Cash	22,400	38,700
Marketable securities	271,500	226,500
Trade accounts receivable, less allowance of \$2,000 in 2005 and \$2,500 in 2004	30,400	30,900
Inventory	2,316,200	1,427,150
Prepaid expenses	57,500	64,400
	<b>2,698,000</b>	<b>1,826,650</b>
<b>Long-term Assets</b>		
Long-term Note Receivable	550,000	-
Equipment and Leasehold Improvements	119,200	139,700
Land held for Investment	321,400	23,500
	<b>3,688,600</b>	<b>1,988,850</b>
<b>LIABILITIES and STOCKHOLDERS EQUITY</b>		
<b>Current Liabilities</b>		
Demand notes	65,000	93,000
Trade accounts payable		164,000
Loan payable to officer		-
Current portion of long-term debt	285,200	475,000
Compensation	231,800	225,100
Contributions to retirement plan	140,900	136,600
Income taxes currently payable	65,700	-
	<b>888,600</b>	<b>1,094,000</b>
<b>Long-term Liabilities</b>		
Long-term debt less current portion	721,400	-
Deferred taxes	15,000	9,200
<b>Shareholder's Equity</b>		
Common stock, \$100 par value 250 shares authorized, 175 shares issued	17,500	17,500
Retained earnings	2,062,800	1,686,500
Accumulated other comprehensive income	(2,100)	-
	<b>2,093,200</b>	<b>1,701,900</b>
	<b>3,688,600</b>	<b>1,988,850</b>

*See accompanying notes and accountants' report.*

**ABC, INCORPORATED**  
**STATEMENTS OF INCOME**  
Years Ended December 31, 2005 and 2004

	Note	2005 \$	2004 \$
<b>Revenues</b>			
Sales		8,924,000	7,593,200
Other		8,300	12,700
		<b>8,932,300</b>	<b>7,605,900</b>
<b>Cost of Merchandise Sold</b>		5,505,000	4,528,900
		<b>3,427,300</b>	<b>3,077,000</b>
<b>Expenses</b>			
Compensation		1,271,600	1,271,400
Retirement plan		162,000	175,000
Selling and administrative		1,374,500	1,119,900
Interest		285,200	39,800
		<b>2,856,700</b>	<b>2,552,100</b>
<b>Other Income and Expenses</b>			
Gain (loss) of sale of marketable securities		5,000	(2,500)
		<b>575,600</b>	<b>522,400</b>
<b>Income before Income Taxes</b>		199,300	171,900
<b>Income Taxes</b>			
		<b>376,300</b>	<b>350,500</b>

*See accompanying notes and accountants' report.*

**ABC, INCORPORATED**  
**STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY**  
**Years Ended December 31, 2005 and 2004**

	Common Stock \$	Retained Earnings \$	Accumulated Other Comprehensive Income \$	Total \$
<b>Balance December 31, 2003</b>	<b>17,500</b>	<b>1,436,000</b>	<b>9,000</b>	<b>1,462,500</b>
Comprehensive Income				
Net Income for the year		350,500		350,500
Other comprehensive income, net of tax:				
Unrealized holding losses arising During the period (net of \$8,400 income tax benefit)			(12,600)	(12,600)
Less: reclassification adjustment (net of \$1,000 income tax)			1,500	1,500
			(11,100)	(11,100)
Total Comprehensive Income				339,400
Dividend Declared		(100,000)		(100,000)
<b>Balance December 31, 2004</b>	<b>17,500</b>	<b>1,686,500</b>	<b>(2,100)</b>	<b>1,701,900</b>
Comprehensive Income				
Net Income for the year		376,300		376,300
Other comprehensive income, net of tax:				
Unrealized holding gains arising During the period (net of \$12,000 income tax benefit)			18,000	18,000
Less: reclassification adjustment (net of \$2,000 income tax)			(3,000)	(3,000)
			15,000	15,000
Total Comprehensive Income				
<b>Balance December 31, 2005</b>	<b>17,500</b>	<b>2,062,800</b>	<b>12,900</b>	<b>2,093,200</b>

*See accompanying notes and accountants' report.*

**ABC, INCORPORATED**  
**STATEMENTS OF CASH FLOWS**  
**Years Ended December 31, 2005 and 2004**

	<b>2005</b>	<b>2004</b>
	<b>\$</b>	<b>\$</b>
<b>Operations</b>		
Net income	376,300	350,500
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation	43,100	47,000
Deferred income taxes	(4,200)	3,500
Cash value of life insurance	(6,100)	(4,500)
Gain(loss) on sale of securities	(5,000)	2,500
(Increase) decrease in:		
Trade accounts receivable	500	12,700
Inventory	(34,800)	(532,800)
Prepaid expenses	6,900	(21,900)
Increase (decrease) in:		
Trade accounts payable	(190,100)	270,400
Compensation	6,700	9,300
Contributions to retirement plan	4,300	(28,400)
Income taxes payable	65,700	(82,500)
	<b>263,300</b>	<b>400</b>
<b>Investments</b>		
Purchase of available-for-sale securities	(60,000)	(20,000)
Proceeds from sale of available-for-sale securities	45,000	17,500
Long-term note receivable	(550,000)	-
Acquisition of equipment	(22,600)	(68,000)
	<b>(587,600)</b>	<b>(70,500)</b>
<b>Financial Activities</b>		
New borrowings		
Long-term	500,000	-
Short-term	-	35,000
Debt reduction		
Short-term	(192,000)	(59,700)
Dividends paid	-	(100,000)
	<b>308,000</b>	<b>(124,700)</b>
<b>Net decrease in cash</b>	<b>(16,300)</b>	<b>(194,800)</b>
<b>Cash at beginning of year</b>	<b>38,700</b>	<b>233,500</b>
<b>Cash at end of year</b>	<b>22,400</b>	<b>38,700</b>

*See accompanying notes and accountants' report.*

# **ABC, INCORPORATED**

## **NOTES TO FINANCIAL STATEMENTS**

### **NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

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#### **Nature of Operations**

The Company operates retail home improvement stores under the trade name of Homeowner's Helper primarily within the Dallas-Fort Worth metropolitan area. The Company provides credit in the normal course of business to its customers and performs ongoing credit evaluations of those customers. It maintains allowances for doubtful accounts based on factors surrounding the credit risk of specific customers, historical trends, and other information. Credit losses, when realized, have been within the range of the Company's expectations and, historically, have not been significant.

#### **Use of Estimates**

Management uses estimates and assumptions in preparing financial statements. Those estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported revenues and expenses. Actual results could differ from these estimates.

#### **Investments**

The Company classifies its marketable debt and equity securities as available for sale. Securities classified as available for sale are carried in the financial statements at fair value. Realized gains and losses, determined using the first-in, first-out (FIFO) method, are included in earnings; unrealized holding gains and losses are reported in other comprehensive income.

#### **Trade Accounts Receivable**

Trade accounts receivable is recorded net of an allowance for expected losses. The allowance is estimated from historical performance and projections of trends.

#### **Inventory**

The Company's inventory is valued at the lower of cost (first in, first out) or market using the retail method.

#### **Depreciation**

The Company's equipment and leasehold improvements are depreciated using primarily the straight-line method.

#### **Amortization**

The discount under the noninterest bearing note will be amortized over the 13-year term of the note using the interest method.

#### **Advertising**

The Company expenses advertising costs as they are incurred. Advertising expenses for the years ended December 31, 2005 and 2004 were \$220,700 and \$200,700, respectively.

### Deferred Income Taxes

For income tax reporting, the Company uses accounting methods that recognize depreciation sooner than for financial statement reporting. As a result, the basis of property and equipment for financial reporting exceeds its tax basis by the cumulative amount that accelerated depreciation exceeds straight-line depreciation. Deferred income taxes have been recorded for the excess, which will be taxable in future periods through reduced depreciation deductions for tax purposes. Also, for income tax reporting, unrealized holding gains and losses on available-for-sale marketable securities are not included in taxable income. As a result, the basis of marketable securities for financial reporting differs from the tax basis by the cumulative amount of unrealized holding gains and losses. Deferred income taxes have been recorded for the difference, which will be taxable or deductible in future periods when the securities are sold.

### NOTE 2: RELATED PARTY TRANSACTIONS

Effective November 30, 2005, all of the Company's common stock was acquired by XYZ, Inc. Part of the consideration for the selling price was a note, which is collateralized by the Company's common stock.

The Company has an employment agreement with the principal seller providing for compensation of \$150,000 in 2007, \$100,000 in 2008, and \$50,000 in 2009. If the seller continues active employment after 2010, compensation will be negotiated. The Company's obligation under the employment agreement accrues only as the service is rendered.

The principal seller has agreed not to compete with the Company through December, 2015. In consideration for the noncompetition agreement, the Company has agreed to pay varying quarterly installments beginning in January, 2006, and ending in December, 2015. In the event of the seller's death, payments under the noncompetition agreement will cease. The Company also acquired land from the seller as a potential site for constructing a warehouse. Consideration provided consisted of a noninterest bearing note (Note F).

There were no other significant transactions between the Company and its parent or related companies during 2005 or 2004.

### NOTE 3: MARKETABLE DEBT AND EQUITY SECURITIES

Cost and fair value of marketable debt and equity securities at December 31, 2005 and 2004, are as follows:

	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Losses	Fair Value
<b>Balance December 31, 2005</b>	\$	\$	\$	\$
Available for sale Equity securities	200,000	30,000	13,500	<b>216,000</b>

U.S. Treasury notes	50,000	5,000	-	55,000
	<b>250,000</b>	<b>35,000</b>	<b>13,500</b>	<b>271,500</b>
<b>Balance December 31, 2004</b>				
Available for sale				
Equity securities	180,000	500	5,000	175,500
U.S. Treasury notes	50,000	1,000	-	51,000
	<b>230,000</b>	<b>1,500</b>	<b>5,000</b>	<b>226,500</b>

U.S. Treasury notes mature in 2015. The change in net unrealized holding gains and losses on securities available for sale in the amount of \$25,000 and (\$18,500) has been charged to other comprehensive income for the years ended December 31, 2005 and 2004, respectively.

#### **NOTE 4: LONG-TERM NOTE RECEIVABLE**

The note is receivable in annual principal installments of \$78,600 beginning in 2007, with monthly interest payments at prime plus 1.5% due from inception. The note is secured by trade accounts receivable and inventory and is guaranteed by the stockholders of the debtor. Based on interest rates at December 31, 2005, for similar loans by independent established lending institutions, the fair value of the note approximates the amount recorded in the financial statements at that date.

#### **NOTE 5: EQUIPMENT AND LEASEHOLD IMPROVEMENTS**

Equipment and leasehold improvements consist of the following:

	<b>2005</b>	<b>2004</b>
	<b>\$</b>	<b>\$</b>
Furniture and fixtures	301,200	291,300
Delivery vehicles	46,900	34,200
Leasehold improvements	23,700	23,700
Accumulated depreciation	(252,600)	(209,500)
	<b>119,200</b>	<b>139,700</b>

## **NOTE 6: DEBT**

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The Company's long-term debt consists of the following:

	<b>2005</b>
	<b>\$</b>
Note payable in varying quarterly installments plus interest at prime plus 1/4%	500,000
Note secured by land held for investment, net of unamortized discount of \$678,600	321,400
	<b>821,400</b>

The \$500,000 note is secured by the Company's trade accounts receivable, inventory, and equipment, and contains restrictive covenants covering the Company's financial position and compensating balance requirements.

The Company has an additional \$500,000 working capital line of credit. The \$65,000 demand note at December 31, 2005, was borrowed under that line and is collateralized by the same assets pledged as security on the long-term note.

The \$1,000,000 note for the land acquired from the former principal stockholder (Note B) is noninterest bearing. However, to reflect the time value of money, the liability recorded in the financial statements reflects future payments discounted at an imputed interest rate of 10%, which was the Company's long-term borrowing rate in November, 2005.

The following is a summary of principal maturities of long-term debt during the next five years:

	<b>\$</b>
2006	100,000
2007	100,000
2008	105,200
2009	123,000
2010	126,900

## **NOTE 7: DESCRIPTION OF LEASING ARRANGEMENTS**

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The Company leases its stores and warehouse under noncancelable operating leases. While all of the agreements provide for minimum lease payments, some provide for additional rentals contingent upon prescribed sales volumes. Most of the leases contain renewal options.

The following is a schedule of future minimum lease payments required under the leases:

	\$
2006	533,500
2007	519,200
2008	523,300
2009	480,500
2010	444,000
Later years	2,466,600
	<b>4,967,100</b>

Minimum lease payments in this schedule exclude contingent rentals and rentals under renewal options, which, as of December 31, 2005, are not reasonably assured of being exercised.

Rent expense consists of the following components:

	2005 \$	2004 \$
Minimum lease payments	522,100	487,100
Contingent rentals	38,100	18,800
	<b>560,200</b>	<b>505,900</b>

#### **NOTE 8: RETIREMENT PLAN**

The Company has a discretionary profit-sharing plan covering substantially all of its employees. Profit-sharing expense is funded through annual contributions to the plan.

#### **NOTE 9: INCOME TAXES**

The provision (benefit) for income taxes consists of the following components:

	2005 \$	2004 \$
Current	203,500	168,400
Deferred	(4,200)	3,500
	<b>199,300</b>	<b>171,900</b>

The income tax provision differs from the expense that would result from applying federal statutory rates to income before income taxes because certain expenses are not deductible for tax purposes.

**NOTE 10: NON-CASH INVESTING AND FINANCING TRANSACTIONS**

Non-cash investing and financing transactions consisting of the cost of acquiring land held for investment and the related obligation (Note F) have been included in assets and liabilities, respectively, in the accompanying financial statements at a discounted value of \$321,400.

**SUPPLEMENTARY INFORMATION**  
**ABC, INCORPORATED**  
**SCHEDULES OF SELLING AND ADMINISTRATIVE EXPENSES**  
**Years Ended December 31, 2005 and 2004**

	<b>2005</b>	<b>2004</b>
	<b>\$</b>	<b>\$</b>
Advertising	220,700	200,700
Charge plans	50,100	37,900
Charitable contributions	1,600	5,700
Commissions	5,700	-
Delivery	12,200	10,500
Depreciation	43,100	47,000
Directors' fees	6,000	5,500
Dues and subscriptions	5,500	5,000
Employment fees	25,500	-
Insurance		
Employees	36,500	14,500
Other	27,200	26,500
Miscellaneous	7,500	4,600
Professional fees	57,500	24,200
Rent	560,200	505,900
Repairs and maintenance	8,000	6,100
Security	4,700	3,600
Supplies	31,500	28,800
Taxes		
Payroll	80,000	69,100
Other	34,400	26,800
Telephone	11,600	11,400
Utilities	90,700	86,100
	<b>1,374,500</b>	<b>1,119,900</b>

*See accompanying accountants' report.*