In connection with short-term borrowings and lines of credit, the Company has agreed to maintain compensating balances of average deposits at one of its banks at 2.5% of the amount of such borrowings and lines of credit. There are no restrictions on the withdrawal or use of these funds. Compensating balance requirements were $0.3 million at December 31, 1986, and the Company was in compliance with these arrangements during the year. Certain other of these commitments require fees of .4% and [illegible] the unused portion of the line and have various renewal dates through June 30, 1987.

## (4) Income taxes

The primary component of the deferred income tax provision for 1986 was the difference between book and tax methods of accounting for inventories.

A reconciliation between the statutory Federal income tax amount and the effective amounts at which taxes were actually provided is as follows (in thousands):

| | 1986 | 1985 | 1984 |
|---|---|---|---|
| Federal income tax at statutory rates | $ 15 | $3,101 | $5,795 |
| State income taxes, net of Federal income tax benefit | 1 | 327 | 1,220 |
| Investment credits | (54) | (360) | (300) |
| Tax exempt interest | (52) | (36) | (34) |
| | $ (90) | $3,032 | $6,681 |

During 1986, the Company was adversely affected by the Tax Reform Act of 1986 by $.2 million, or $.06 per share, due to the loss of investment tax credits which otherwise would have been available.

In 1984, prior to filing its 1983 Federal income tax return, the Company established an employee stock ownership plan (PAYSOP). The Company's 1985, 1984 and 1983 contributions to the plan, made in 1986, 1985, and 1984 respectively, were in the form of common stock with an aggregate market value exactly equal to the tax credit allowed. The tax credit was recorded as a reduction of Federal taxes currently payable and an increase in stockholder's equity in each respective year.

## (5) Long-term debt

Long-term debt consisted of the following at December 31, 1986, 1985, and 1984 (in thousands):

| | 1986 | 1985 | 1984 |
|---|---|---|---|
| Industrial development revenue bonds at interest rates of 4¼% (fixed ) to 70% of prime, due in varying installments through 2006(a) | $19,496 | $17,145 | $16,854 |
| 11½% insurance company term loan due in equal installments beginning in 1991, through 1995(b) | 7,500 | 7,500 | — |
| 10½% notes payable to insurance companies due in progressive semiannual installments through 1990(b) | 4,880 | 6,100 | 7,320 |
| 12% notes payable for acquisition of Geo. F. Blake, Inc. due in equal installments through 1992 | $ 1,606 | $ 1,799 | $ 2,120 |
| Other | 202 | 604 | 2,399 |
| Total | 33,684 | 33,148 | 28,693 |
| Less—current portion | (2,920) | (2,900) | (4,260) |
| Total long-term portion | $30,764 | $30,248 | $24,433 |

(a) The Company has loan and lease agreements with certain municipalities whereby industrial revenue bonds were issued to finance the purchase of land and construction of plant and equipment at new and existing service centers. Under the terms of the agreements, the loan and lease payments made by the Company are equivalent to the municipalities' debt service requirements on the bonds.

(b) Among others, the more restrictive provisions of the loan agreements require the Company to limit cash dividends and purchases of the Company's stock to $6 million, plus 70% of net income since September 30, 1985 (earnings reinvested in the business available for cash dividends or stock retirements under this provision were $2.3 million at December 31, 1986) and limit borrowings. The borrowing limitations are based on various formulas. At December 31, 1986, total debt was limited to $52.2 million and, debt as defined, was $47.7 million.

The note agreement also provides limitations on sales of subsidiaries, sale or lease of assets of the Company, acquisitions, leases over three years duration, and transactions with affiliates.

(c) Aggregate annual principal payments on the non-current portion of long-term debt (including obligations under capital leases) are due as follows (in thousands):

1988 $2,920 1989 $3,357 1990 $3,391 1991 $3,700

Total net book value of assets collateralized under financing arrangements approximated $5.2 million at December 31. 1986.

## (6) Lease agreements

(a) Description of leasing arrangements—The Company has capital and operating leases covering certain warehouse facilities, equipment, automobiles, and trucks, with lapse of time as the basis for all rental payments plus a mileage factor included in the truck rentals.

(b) Capital leases—Capitalized leased property by major class is summarized as follows (in thousands):

| | Asset Balances at December 31 | | |
|---|---|---|---|
| Class of Property | 1986 | 1985 | 1984 |
| Buildings | $1,178 | $1,178 | $1,178 |
| Machinery and equipment | 920 | 1,129 | 1,208 |
| | 2,098 | 2,307 | 2,386 |
| Less—accumulated depreciation | (863) | (997) | (966) |
| | $1,235 | $1,310 | $1,420 |