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SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934

For the Fiscal Year Ended December 31, 1985 **Commission File Number 1-7651**

Kaiser Steel Corporation

(Exact name of registrant as specified in its charter)

Delaware
(State of incorporation)

94-0594733
(I.R.S. Employer Identification No.)

9400 Cherry Avenue, P. O. Box 5050
Fontana, California 92335
(Address of principal executive offices and zip code)

(714) 350-5199
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title:	Exchange on which registered:
Series A Preferred Stock, $1 par value	Pacific Stock Exchange
Series B Preferred Stock, $1 par value	Pacific Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:
None

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

State the aggregate market value of the voting stock held by non-affiliates of the registrant:

Title	Aggregate Market Value as of March 21, 1986	Shares Excluded Because Held by Persons Who May Be Deemed Affiliates
Common Stock, 10 cents par value	No established market value	All shares held by persons who may be deemed affiliates
Series A Preferred Stock, $1 par value	$44,835,000	5,693
Series B Preferred Stock, $1 par value	$71,923,000	5,693

Indicate the number of shares outstanding of each of the registrant's classes of stock as of the latest practicable date:

Class	Outstanding at March 25, 1986
Common Stock, 10 cents par val	
Series A Preferred Stock, $1 pai	
Series B Preferred Stock, $1 pai	

File in:
❑ Confidential
❑ Shelf
❑ Expandable
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In C/ 007 , 007 , Incoming
For additional information

Documents Incorpor:

Document*

Proxy Statement for 1986 Annual Meeting of Sto(to

* Only selected portions of the document specified, a... e.

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

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Series B Preferred Stock, $1 par value	$71,923,000	5,693

Indicate the number of shares outstanding of each of the registrant's classes of stock as of the latest practicable date:

Class	Outstanding at March 25, 1986
Common Stock, 10 cents par value	10,000,000
Series A Preferred Stock, $1 par value	7,478,256
Series B Preferred Stock, $1 par value	7,478,256

Documents Incorporated By Reference

Document*	Incorporated Into
Proxy Statement for 1986 Annual Meeting of Stockholders	Part III

* Only selected portions of the document specified, as indicated herein, are incorporated by reference.

TABLE OF CONTENTS

Item		Page
PART I		
Item 1.	Business	1
Item 2.	Properties	10
Item 3.	Legal Proceedings	13
Item 4.	Submission of Matters to a Vote of Security Holders	14
PART II		
Item 5.	Market for Registrant's Common Equity and Related Stockholder Matters	15
	Series B Preferred Stock Purchase Fund Report	16
Item 6.	Selected Financial Data	18
Item 7.	Management's Discussion and Analysis of Financial Condition and Results of Operations	18
Item 8.	Financial Statements and Supplementary Data	25
Item 9.	Disagreements on Accounting and Financial Disclosure	48
PART III		
Item 10.	Directors and Executive Officers of the Registrant	49
Item 11.	Executive Compensation	49
Item 12.	Security Ownership of Certain Beneficial Owners and Management	49
Item 13.	Certain Relationships and Related Transactions	50
PART IV		
Item 14.	Exhibits, Financial Statement Schedules, and Reports on Form 8-K	51
Signatures		60

PART I

Item 1. BUSINESS

General

The operations of Kaiser Steel Corporation (the "Company") are organized into two principal operating groups: Coal and Fabricated Products. The Coal Group mines metallurgical and steam coal in Utah and New Mexico at mines of the Company's wholly-owned subsidiary, Kaiser Coal Corporation, and markets the coal throughout the western United States and overseas. Other Coal Group operations include the Company's Colorado coal properties and other Company mineral properties and development projects. The Fabricated Products Group engages in heavy steel fabrication and erection activities, the operation of an ocean-going launch barge, the manufacture of large diameter pipe and the operation of a bulk loading terminal. The Company is also actively involved in developing its real property in Fontana, California. The coal mines, fabricating plants and other facilities and properties of the Company and its subsidiaries are all located in the western United States.

Markets and Operations of Industry Segments

The markets and operations of the Company's two principal operating groups, Coal and Fabricated Products, are described below.

Coal Group

Coal Group General Information

In April 1985, the Company transferred all of its Utah and New Mexico coal properties to a new wholly-owned subsidiary, Kaiser Coal Corporation. The facilities and equipment of the operating mines in Utah and New Mexico were in turn transferred to two subsidiaries of Kaiser Coal Corporation, Kaiser Coal Corporation of Sunnyside and Kaiser Coal Corporation of York Canyon, respectively. In 1985, the Company also obtained certain coal properties located in Colorado, as discussed below.

In December 1985, Kaiser Coal Corporation acquired the Somerset coal mine complex near Paonia, Colorado and a coal preparation plant near Wellington, Utah from United States Steel Corporation and U. S. Steel Mining Co., Inc. At the same time, Kaiser Coal Corporation entered into a contract to supply the requirements of high volatile metallurgical coal to United States Steel Corporation's Geneva Steel Mill in Provo, Utah. The Company expects to supply 750,000 to 800,000 tons of coal per year through 1989 under this contract. The Somerset coal mine complex contains 60 million tons of recoverable high Btu, low ash, low sulfur coal. The mine, which was idled prior to the acquisition, also includes a unit train loadout facility and mining equipment, some of which has been relocated to Kaiser Coal Corporation's operating mines in Utah and New Mexico. The coal preparation plant near Wellington, Utah has a capacity of 2 million tons of clean coal per year. The Wellington coal preparation plant is approximately 20 miles from the Company's Sunnyside Coal Mine and is linked by railroad.

The Company and its subsidiaries now control coal acreage in Utah, New Mexico, and Colorado and operate mines that produce both steam and metallurgical coal in Utah and New Mexico. The in-place raw coal reserves, based on properties that have been explored, total more than 2.1 billion tons. From these reserves, potential mining areas are estimated to contain 1.3 billion tons of recoverable coal (the in-place tonnage that can be recovered using existing mining techniques without regard to economic considerations, discounted to reflect mining losses and any washing losses). Of this amount, approximately 160 million tons (12 percent) are currently "assigned" (reserves which can be mined on the basis of current mining practices using existing or planned mine shafts and plant facilities) and the remaining 1,140 million tons (88 percent) are currently "unassigned" (reserves which would require additional mine development before operations could begin with respect thereto). The Company believes that all of these reserves have potential for sale to the steam coal market and that a substantial portion of the reserves can be upgraded, by washing, for sale in the metallurgical coal market. Kaiser Coal Corporation and its subsidiaries also have approximately 200,000 acres of land in New Mexico that have not been explored.

In February 1986, Cottonwood Canyon Land Company, a wholly-owned subsidiary of the Company, acquired approximately 31,000 acres of undeveloped property in Colorado (the "Cottonwood Property"). For additional information regarding the purchase of the Cottonwood Property and certain liens and options with respect thereto, see Note E to the Consolidated Financial Statements.

In April 1985, the Company acquired certain Colorado coal properties and coal supply contracts pursuant to an exchange agreement between the Company and a joint venture (the "Perma/Frates Joint Venture") between a group led by Perma Resources Corporation (an affiliate of Perma Pacific, Inc. which owns all the Common Stock of the Company) (the "Perma Group") and a group led by J. A. Frates of Tulsa, Oklahoma (the "Frates Group"). The acquired Colorado coal properties have proven reserves and probable reserves of over 255 million tons of recoverable coal and two permitted but currently idle mining operations. The property was acquired through the exchange of surplus real estate and a structural fabricating plant located at Fontana, California, with an aggregate assigned fair value of $45 million, a $5 million note receivable from the sale of Kaiser Pipe and Casing, Inc. and $5 million in cash. In connection with the exchange, the Company also repaid approximately $12 million and assumed approximately $11 million of debt associated with the Colorado coal properties. The exchange was approved in accordance with the procedures for approval of transactions with holders of the Company's Common Stock set forth in the Company's Certificate of Incorporation.

Prior to the Perma Group's and the Frates Group's acquisition of the Company's Common Stock in connection with a merger in 1984, the Perma Group and Southwestern Public Service Company, an interstate public utility ("SPS"), entered into agreements (the "SPS Agreement"). The SPS Agreement provided that SPS would enter into a long-term coal supply contract with either the Company or the Perma/Frates Joint Venture and would assist in the furtherance of the Company's coal operations. The agreements also provided for SPS to receive a one percent overriding royalty interest in coal and other minerals mined from the property containing Kaiser Coal Corporation's New Mexico coal reserves and the Company's Colorado coal reserves, an option to acquire a 10 percent interest in the New Mexico and Colorado coal properties for $10 million, and, under certain circumstances, an option to acquire an additional interest of up to 10 percent in the same properties for a price based on the value of the properties but no more than $25 million. The SPS Agreement and the proposed coal supply contract were assigned to the Company in the April 1985 exchange with the Perma/Frates Joint Venture described above. The proposed coal supply contract was for the supply of coal to SPS' planned electric power generating facility to be constructed in Texas. In 1985, SPS was denied approval by the Texas Public Utility Commission of a Notice of Intent (a necessary step to obtaining a Certificate of Convenience and Necessity to proceed with construction of the plant) due to a perceived availability of purchased and cogenerated power. SPS then entered into negotiations with the Company to obtain lower coal prices under the proposed coal supply contract to assist SPS in reapplying for the Notice of Intent. Recently, however, SPS notified the Company that although it worked vigorously to enable a reversal of the denial of the Notice of Intent, it had determined that it would be unable to proceed with construction of the facility within the time frame contemplated by the agreements. Due to the denial of SPS' Notice of Intent for the facility, the Company is presently discussing with SPS changes in the agreements, including possible amendments with respect to SPS' interests in the New Mexico and Colorado coal properties and/or the possible substitution of new fuel supply agreements for other facilities. The parties have also extended certain performance dates under the agreements, including the extension of the last date for the exercise of the first purchase option to the end of August 1986.

Coal Group Operations

Kaiser Coal Corporation and its subsidiaries operate two coal mines in northeastern New Mexico's Raton Basin. The underground mine uses the longwall mining technique, while the surface mine utilizes a dragline and truck and shovel stripping operations. The Company's York Canyon deep mine was idled in March 1986 and has been replaced by a new underground mine in the York Canyon area referred to as the Cimarron deep mine. The Company anticipates that the first longwall in the Cimarron mine will be operational in April 1986. Kaiser Coal Corporation's Utah mining operations are located near Sunnyside, which is approximately 150 miles southeast of Salt Lake City. The Sunnyside Mine uses the underground longwall mining technique. In addition, Kaiser Coal Corporation and its subsidiaries control nearby coal leases known as the North Leases, the South Leases and the B Canyon Leases.

The coal mines in Utah and New Mexico are currently capable of producing up to 5.0 million tons of coal annually, depending upon the mix of steam and metallurgical coal.

The Company first acquired coal reserves at Raton and Sunnyside in 1955 and 1942, respectively, to supply the Fontana steelworks with metallurgical grade coking coal. In 1982 coal shipments to the Fontana steel mill ceased with the shutdown of the Company's coke ovens. Since April 1, 1984, Perma Mining Corporation, a member of the Perma Group, has managed the coal and mineral reserves and marketed the coal production of the Company. Sales to outside customers of $97.2 million in 1985 were a record high exceeding the previous record set in 1984 by $24.8 million. Production company-wide also reached record levels. The Raton mines produced nearly 2 million tons of coal in 1985 compared with 1.6 million tons of coal in 1984, while the Sunnyside Mine, which is the oldest continuously operated underground coal mine west of the Mississippi River, produced nearly 1.5 million tons of coal in 1985 compared with 0.7 million tons of coal in 1984. It is anticipated that production and sales in 1986 will exceed 1985 levels. For additional information regarding the Perma Group's management of the Company's coal operations, see Note E to the Consolidated Financial Statements.

In April 1985, the Company established a management and planning group under the name Kaiser Power to develop electrical and thermal cogeneration projects at the Company's coal mines and elsewhere. Plans are underway to develop cogeneration facilities at Kaiser Coal Corporation's Sunnyside Mine and York Canyon Mine.

In 1985, the Company and Perma Resources Corporation joined with SPS to study the feasibility of transporting coal in a pipeline slurry of coal and liquified carbon dioxide. A research project slurry line has been constructed and is in the startup and testing phase at SPS' coal-fueled plant near Amarillo, Texas. The Company spent $2.2 million on this project in 1985.

Results of the Coal Group for the years ended December 31, 1985, 1984 and 1983 are as follows:

Results of Coal Group

	1985	1984	1983
	(millions of dollars)		
Net sales	$ 97.2	$ 72.4	$ 43.4
Operating earnings (loss):			
Kaiser Coal Corporation and its subsidiaries	$ 10.3	$ 5.0	$ (7.5)
Other operations	(7.3)		
	$ 3.0	$ 5.0	$ (7.5)
Shipments (000s net tons)	3,294	2,163	1,074
Production (000s net tons)	3,599	2,358	939

The results of Kaiser Coal Corporation and its subsidiaries reflect the operations of the Group's operating mines in Utah and New Mexico. Other Coal Group operations include the Company's Colorado coal properties and other mineral properties and development projects including Kaiser Power and the research and development project described above. For additional financial information about results of the Coal Group, see Note P to the Consolidated Financial Statements.

Coal Group Market

Both the world-wide and the domestic coal markets remained depressed in 1985. However, despite the adverse market conditions and lower prices, the Company was able to increase coal sales for 1985. Coal sales for 1985 were $97.2 million on shipments of 3.3 million tons compared to coal sales in 1984 of $72.4 million on shipments of 2.2 million tons.

The Company sells coal primarily in the southwestern United States. Most of the Company's sales in 1985 were to the utility and cement industries, but the Company also sold significant amounts of coal to the steel, copper and chemical industries. During both 1984 and 1985 the Company was the largest supplier of coal to the western cement industry. In 1985 the Company supplied coal to nineteen cement plants located throughout the West and the Southwest. Approximately 44 percent of Kaiser Coal Corporation's sales in 1985 were to its three largest customers. The Company anticipates that the drop in oil prices during early 1986, if sustained, will have an adverse impact on coal prices, particularly on sales to the cement industry.

The Company believes that the quality of its reserves and reduced costs of production combined with transportation advantages stemming from the location of its mines and their proximity to rail transportation places the Company in an advantageous position with respect to its competition.

For further information regarding the properties, facilities and operations of the Coal Group, see "Item 2. Properties."

Fabricated Products Group

Fabricated Products Group General Information

The Fabricated Products Group engages in heavy steel fabrication and erection activities, the manufacture of large diameter pipe, the operation of a bulk loading facility, the operation of an ocean-going launch barge for transporting and launching deepwater offshore oil platform jackets, and the design and manufacture of pipe making equipment. Heavy steel fabrication operations are conducted at the Company's fabricating facilities at Napa, California and Fontana, California. The Company has marine assembly yards at Vallejo, California and at Los Angeles harbor for the construction of offshore oil and gas drilling platforms, decks and modules for California and Alaska. Large diameter pipe is produced at the Company's pipe mill in Napa, California. The Company's versatile bulk loading and unloading facility is operated through its subsidiary, Kaiser International Corporation, at the Port of Los Angeles.

During the fourth quarter of 1985, the Company restructured the Fabricated Products Group into five business units in an on-going effort to reduce administrative and overhead costs and improve operations. The restructuring and accompanying force reductions were based on recommendations from outside management consultants. In March 1986, the Company announced that it will temporarily suspend operations at its Napa fabricating plant upon completion of those projects presently under contract. The Napa Pipe Mill will continue to operate. The Company is continuing to study further steps to improve operating results.

Fabricated Products Group Operations

The Company's fabricating plant in Napa, California operated at less than one-half its capacity in 1985, compared to approximately one-third its capacity in 1984 and one-half its capacity in 1983. The Fontana structural and plate fabricating plants operated at only a small fraction of their capacity throughout the year. The Vallejo Marine Assembly Yard operated at approximately one-quarter its capacity in 1985, compared to over three quarters its capacity in 1984 and 1983. The large diameter pipe mill in Napa, California operated at approximately one-quarter its capacity in 1985 compared to less than one-tenth of its capacity in 1984 and in 1983.

Kaiser International Corporation, a subsidiary of the Company, operates a versatile bulk loading and unloading facility in the Port of Los Angeles under an agreement that runs through 1993. During 1985, Kaiser International Corporation generated pretax earnings of $2.2 million on revenues of $10.2 million. The facility handled 1.9 million tons of exported and imported bulk products in 1985 including most of the coal exported from the West Coast. Products loaded and unloaded include metallurgical coal, steam coal, petroleum coke, coke breeze, steel scrap, pig iron, cement clinker, copper concentrates and copper slag. Annual capacity at the facility is in excess of 3 million tons. Total volume for 1986 is expected to be comparable to total volume for 1985.

Results of the Fabricated Products Group for the years ended December 31, 1985, 1984 and 1983 are as follows:

Results of Fabricated Products Group

	1985	1984	1983
	(millions of dollars)		
Net sales	$123.3	$ 78.9	$94.0
Operating loss	$(11.3)	$(12.0)	$(6.6)

Major Products—Fabricated Products Group
(Percent of Net Sales)

	1985	1984	1983
Large diameter pipe	44%	25%	19%
Energy-related fabrications and launch barge	28	27	61
Fabricated water pipe	6	15	4
Pipe mill equipment and other heavy fabrications	14	21	16
Kaiser International Corporation	8	12	
Total	100%	100%	100%

For additional financial information about results of the Fabricated Products Group, see Note P to the Consolidated Financial Statements.

Fabricated Products Group Markets

As one of the principal steel fabricators on the West Coast, the Company sells most of its fabricated products and field construction and installation services to customers in the western United States.

Adverse market conditions combined with intensified foreign competition in the market for offshore oil platforms and related work constrained prices and operating results during 1985 and are expected to continue throughout 1986. The Company has taken action on a number of fronts against the strong competition from foreign sources on fabricated components for offshore platforms. The actions include the filing jointly with the International Brotherhood of Boilermakers of Antidumping Petitions against Korea and Japan and Countervailing Duties Petitions against Korea and lending support to legislative activity requiring domestic content to be used in offshore platforms in U.S. waters. Additionally, efforts to increase competitiveness have been made with the labor force as discussed below under "Collective Bargaining Agreements" and in the restructuring of the Fabricated Products Group as discussed above. The Company is unable to predict the outcome or impact of such petitions and legislative activity. Management believes that the market for energy related products of the Fabricated Products Group and the market for the sale of unused energy-related assets of the Group will continue to be weak in the near future. The Company has temporarily suspended operations at certain of its facilities and is continuing to study further steps to improve operating results.

The Company's large diameter pipe mill at Napa, California which services customers nationwide is one of only four operating mills in the country capable of producing large diameter submerged arc-welded pipe. Shipments of pipe during 1985 of over 89,000 tons increased significantly over shipments of only 28,000 tons in 1984. In 1985, the Company completed orders from All American Pipeline Company for a portion of the California section of the project and from Northern Engineering for a CO_2 pipeline project in Texas for an aggregate total of 44,100 tons. To date the Company has no such large orders and consequently expects total pipe sales for 1986 to be less than in 1985.

The Company has a long-term lease for a 700-foot ocean-going launch barge capable of loading out, transporting and launching deepwater offshore oil platform jackets. It is the largest of only five in the world capable of handling large, deep-water jackets. The launch barge was utilized during the second quarter of 1985 to tow the jacket for the Texaco offshore drilling platform Harvest. The launch barge is presently being outfitted for another tow in 1986. The Company is actively marketing the services of the launch barge internationally.

During 1985, a joint venture between the Company and Gulf Marine Fabricators, Inc., a subsidiary of Peter Kiewit Sons, Inc., was awarded the contract to fabricate, transport and install the jacket section of Shell Offshore, Inc.'s platform Bullwinkle which when installed in the Gulf of Mexico will be the largest off-shore platform in the world. The jacket will be fabricated and assembled at a leased yard near Corpus Christi, Texas. In addition, in 1985 the Company was awarded the fabrication and assembly of the topside facilities (decks) for Chevron's Hidalgo platform to be installed offshore near Southern California. The Hidalgo decks are scheduled to be delivered by the middle of 1986. The Endicott Project for the fabrication of steel skid bases for SOHIO to support buildings on the Alaskan North Slope permafrost commenced in 1985 with assembly at the Company's Vallejo Yard and a customer furnished yard in New Iberia, Louisiana to be completed during the first quarter of 1986.

The markets for heavy fabrication, fabricated water pipe, and pipe mill equipment remained depressed in 1985. Despite the depressed market, projects completed during 1985 include a large pipe order for the East Bay Municipal Utilities District, the Boulder Highway Interchange in Las Vegas, Nevada, and various government and defense-related work.

For further information regarding the properties, facilities and operations of the Fabricated Products Group, see "Item 2. Properties."

Real Estate

The Company is engaged in efforts to develop or sell its 940 acres of real property in the Fontana area and certain other property which the Company has under option. The Company is undertaking to develop such property as an industrial park, sell it, or enter into another arrangement, such as a joint venture, for the development of the property. The Company and URS Corporation have reached an agreement in principle to form a venture to develop certain property and water rights and related assets of the Company at Fontana and Eagle Mountain, California, and utilize them as the basis for new businesses in land development, water, cogeneration and waste management. The Company's interest in the venture is to be determined by independent appraisals, currently in process, and structured based on advice of independent investment bankers.

In the third quarter of 1985, the Company sold the land and buildings of a former subsidiary in Vernon, California, for $4.8 million in cash and sold certain land in Montebello, California for $1.5 million in cash..In January 1985, the Company sold undeveloped land south of Fontana for $4 million.

The Company is in the process of selling and simultaneously leasing back its corporate office complex located on 42 acres in the Fontana area to an affiliate of Altair Investment Company. Under the terms of the proposed agreement, the sales price is to be $4.5 million, payable in cash at closing, and the lease is to be for a period of 10 years with an option to renew for a second 10 year period. The initial lease rental is to be $45,000 per month. The Company is to receive an option to repurchase the property either 15 or 18 months from closing. The Company and Altair Investment Company are currently finalizing the terms of the agreement.

In addition to the property the Company owns directly, the Company also has a 46 percent interest in companies that own 3,618 acres of land in the Fontana area.

In September 1985, the Company acquired an option from Perma Pacific Properties (an affiliate of Perma Pacific, Inc. which owns all the Common Stock of the Company) to purchase approximately 240 acres of real property in the Fontana area, including the Fontana Structural Fabricating

Plant (the "West End Option Property"). The property was transferred to the Perma/Frates Joint Venture in April 1985 in connection with the exchange with the Perma/Frates Joint Venture, described above. Upon the Perma Group's purchase of the Frates Group's interest in the Perma/Frates Joint Venture, the West End Option Property was transferred to Perma Pacific Properties, which in turn leased the West End Option Property back to the Company. The acquisition of the property pursuant to the option will provide improved access to the Company's other property in the Fontana area and enhance the development of the Company's property as an industrial park. The property to be acquired has an aggregate value of approximately $21 million and would be purchased through the exchange of certain of the Company's other property in the Fontana area and the payment of cash or assumption of debt. In January 1986, the option was extended to December 31, 1986. For further information regarding the option, see Note E to the Consolidated Financial Statements.

Discontinued Operations

The Company discontinued its steelmaking and steel finishing operations at Fontana, California in late 1983. During the third quarter of 1984, the Company sold substantially all of its steel finishing facilities and certain of the Company's land at Fontana, California to California Steel Industries, Inc. The proceeds from the sale consisted of $25 million in cash and an $85 million interest bearing note which was paid in August 1985 at a discount of $5 million. Under the terms of the sale, a suit filed against the Company by Companhia Vale do Rio Doce ("CVRD") of Brazil alleging breach of a long-term contract to purchase iron-ore pellets was dismissed.

During the third quarter of 1985, the Company sold all the assets of its wholly-owned subsidiary, Kaiser Steel Tubing, Inc., for $6.5 million in cash, two promissory notes payable in the aggregate principal amount of $7.5 million, and convertible preferred stock of the company purchasing the real property and equipment. Also in the third quarter of 1985, the Company sold the land and building of a former subsidiary in Vernon, California for $4.8 million in cash.

The Company intends to actively market the remaining assets of its discontinued steel mill, including inventories, machinery and equipment and surplus real estate.

Environmental Considerations

In preparation for the discontinuance of steelmaking at the Fontana steelworks in 1983, the Company undertook an evaluation of the effects of the discontinuance on future environmental compliance. Under certain conditions, federal and state programs relating to water quality and waste disposal could impose continuing obligations on the Company for the costs of remedial actions. In the following discussion, facts are presented which could ultimately result in the Company's exposure to significant liabilities for such remedial actions.

Water Quality. There are four operable water wells located on the Company's property in Fontana. Periodic tests of water quality in these wells have over time shown varying concentrations of total dissolved solids. In 1983, the Company began a well testing and groundwater evaluation program to determine the nature and extent of total dissolved solids in the groundwater. Initial testing on the Company's wells indicated elevated salinity in some of the wells. In June 1983, the Company entered into an agreement with an engineering consulting firm to do additional well testing and to undertake a computer modeling study of the groundwater underlying the Fontana facility. The report from the engineering consulting firm received in December 1983 confirmed high salinity in certain areas below the plant site. The report also concluded that it is likely that the Company's steelmaking operations over the years contributed to the observed levels of salinity.

The report proposed that additional work be undertaken which would include the following: (1) refine the computer modeling study, (2) conduct soil and groundwater sampling and testing, and (3) evaluate the findings of the study and, if warranted, propose alternative remedial actions. This work was completed in March 1986. It indicates the presence in one well of an organic compound in concentrations slightly above the state action level but not in concentrations exceeding established drinking water standards or other federal limits. A report recommending the methodology for further studies has been submitted to the staff of the California Regional Water Quality Control Board—Santa Ana Region. The Company also advised members of the Chino Basin Watermaster Appropriator's Pool Committee, a committee comprised of representatives of local cities and water companies, of the potential groundwater problem.

The Company cannot now estimate with any degree of certainty the magnitude of the potential liability, if any, on account of the groundwater situation.

Waste Handling and Disposal. Since the inception of operations in 1942, a number of facilities have existed at the Fontana steelworks which, over the past 40 years, could have contained substances currently defined as hazardous by federal and California regulations. Steelmaking, coke production and ancillary by-products generation inherently involve the presence of certain compounds and elemental materials which may fall within the definition of "hazardous." However, until more is known about releases at the Fontana steelworks, no firm conclusions can be drawn. An engineering consultant has been retained to recommend a program of assessment of various sites on the former steel mill property in order to determine whether remedial actions may be required. The consultant's recommendation on a program of assessment has been submitted to regulatory authorities for evaluation and comment.

If subsequent studies reveal releases of hazardous substances from the steelworks in violation of state or federal standards, and agencies take enforcement action, the Company could be held liable for remedial costs. Due to the large number of uncertainties, the Company is not now in a position to accurately estimate its exposure to liability, if any.

Order Backlog

The consolidated order backlog at December 31, 1985 was $584.8 million, of which the coal backlog represented $544.1 million. Approximately $453.0 million of the backlog represents coal orders which are not expected to be filled within one year. The consolidated order backlog at December 31, 1984 was $554.4 million.

Employees

As of December 31, 1985, the Company had a total of 1,564 active employees. This compares with a total of 1,998 active employees at year-end 1984 and 2,962 active employees at year-end 1983. As of December 31, 1985, the Company also had a total of 392 employees on layoff status, 30 percent of whom were on permanent layoff status from the Fontana steelworks. Approximately 130 employees will be affected by the temporary suspension of operations of the Napa fabricating plant announced in March 1986.

Collective Bargaining Agreements

Approximately 75 percent of the Company's employees are represented by labor unions and are covered by various collective bargaining agreements. Significant collective bargaining developments during 1985 included the following:

(1) In May 1984, the Company initiated discussions with the United Steelworkers of America concerning the health benefits insurance program for Fontana steel mill retirees. On September 14, 1984, after extensive negotiations, the parties signed a Memorandum of Understanding which provides for the following: 1) the opportunity for lifetime health benefit coverage, on a modified basis, for those retirees who elect to participate (the "Program of Continuing Coverage") and 2) an earnings sharing program which, depending on the Company's future profitability, will be used to fund a trust to provide future health benefit coverage. Effective January 1, 1985, the Company discontinued paying for retirees' benefits at the level provided under the prior program and the Program of Continuing Coverage commenced for those retirees who elected to participate. As an alternative to participation in the Program of Continuing Coverage, the Company made a lump-sum buyout offer to those retirees who

preferred to receive a cash settlement rather than future health benefit coverage. The lump-sum payout payment of approximately $18 million was made on April 3, 1985. Pursuant to the Memorandum of Understanding, in December 1985 the Company contributed its Cushenbury Limestone Mine, valued at approximately $15.2 million, to a trust, the proceeds of which are distributed to a qualified trust for the benefit of the retired steelworkers.

(2) In July 1985, the Company implemented a Gainsharing Plan covering approximately [illegible] employees at its Vallejo, California marine assembly yard. Under the terms of the plan, the seven unions which represent employees at the Vallejo marine assembly yard agreed to wage reductions of approximately $3.00 per hour in return for the opportunity to share in cost savings accomplished through improved productivity and conservation of tools and materials. The first payments to employees under the Plan, which amounted to approximately 46 cents per hour paid, were made on December 29, 1985.

(3) In March 1985, the Company consolidated its Fontana Structural Fabricating Plant and its Fontana Plate Fabricating Plant. Prior to the consolidation, employees at the Structural Fabricating Plant were represented by the United Steelworkers of America and employees at the Plate Fabricating Plant were represented by the International Brotherhood of Boilermakers. After the consolidation, the National Labor Relations Board ruled that a single bargaining unit, including all hourly employees of the consolidated facility, was appropriate. An election to determine which union will represent the employees in the consolidated facility will probably be held during the first half of 1986. As of December 31, 1985 there were 86 active hourly employees in the consolidated facility.

(4) The collective bargaining agreement between the Company and the eight unions representing the hourly employees at the Company's Napa pipe mill and fabricating plant expired in July 1985. A new agreement, which provides for wage and benefit reductions and work practice efficiencies, all of which will reduce the Company's labor costs at the Napa facilities by approximately $4.50 per hour, was reached between the Company and the eight unions. The new agreement will remain in effect until October 31, 1988 with no general wage increases to take effect during that period.

Executive Offices

The principal executive office of the Company is at Fontana, California, where its address is 9400 Cherry Avenue, P. O. Box 5050, Fontana, California 92335, and its telephone number is (714) 350-5199.

Perma Pacific, Inc. Acquisition of the Common Stock

On April 2, 1985, Perma Pacific, Inc., a Delaware corporation ("Perma Pacific"), acquired all the outstanding Common Stock of the Company. Perma Pacific is controlled by Monty H. Rial, Eustace H. Winn, Jr. and Charles S. McNeil. Perma Pacific acquired the Common Stock pursuant to a Restated Joint Venture and Option Agreement, dated August 15, 1984, as amended, between the Perma Group and the Frates Group. The Frates Group had acquired all the Common Stock of the Company on February 29, 1984 pursuant to the merger on that date of Kaiser Acquisition Corporation ("KAC") into the Company (the "Merger"). Under the terms of the Restated Joint Venture and Option Agreement, all the Common Stock of the Company was deemed equitably owned since the Merger by the Perma/Frates Joint Venture. The Perma Group acquired an option under the Restated Joint Venture and Option Agreement to acquire all the Frates Group's interest in the Perma/Frates Joint Venture. The Perma Group exercised the option on December 28, 1984, and the acquisition was consummated on April 2, 1985. Immediately following the acquisition, the three members of the Board of Directors elected as representatives of the Frates Group resigned.

Item 2. PROPERTIES

Following is a description of the principal facilities of the Company. For additional information, see "Item 1. Business."

Coal Group

New Mexico .... Kaiser Coal Corporation and its subsidiaries mine high-volatile, high-Btu coal, with an average sulfur content of approximately 0.5 percent, through both surface and underground methods near Raton, New Mexico. The Company's underground mine at York Canyon was idled in March 1986 and has been replaced by the Cimarron deep mine, also at York Canyon. The Company currently expects that the first longwall in the Cimarron deep mine will be operational in April 1986. The Company anticipates that the mines will be capable of producing over 3.0 million tons of coal annually. A coal preparation plant at the mines has a 1.5 million ton capacity. The operating mines, including the Cimarron deep mine, have proven reserves and probable reserves of approximately 66 million tons of recoverable coal located on almost 15,000 acres owned or leased by Kaiser Coal Corporation and its subsidiaries. The long-term lease of 4,125 acres, including approximately 2,400 acres comprised of coal-bearing lands, is from private interests and continues as long as exploration or operations are conducted on any part of the leased property.

In addition to the reserves of the operating mines, Kaiser Coal Corporation and its subsidiaries also control proven reserves and probable reserves aggregating approximately 648 million tons of recoverable coal on more than 600,000 acres comprised of fee land, coal rights and leased land.

Total proven reserves and probable reserves in the Raton area are approximately 714 million tons of recoverable coal.

Agreements with SPS and Associated Southern Investment Company provide for options to acquire or exchange property for interests in coal properties located in New Mexico and Colorado. For additional information, see "Item 1. Business, Coal Group General Information" and Note E to the Consolidated Financial Statements.

Utah .... Kaiser Coal Corporation and its subsidiaries mine high-volatile, high-Btu, low-ash coal, with an average sulfur content of less than 0.7 percent, through underground methods at Sunnyside, Utah. The mine is presently capable of mining 2.0 million tons of coal annually. A coal preparation plant with a 2.0 million ton annual capacity is located at the mine. A coal wash plant near Wellington, Utah with an annual capacity of 2.0 million tons was acquired in 1985. The operating mine has proven reserves and probable reserves of approximately 32 million tons of recoverable coal located on 13,000 acres owned or held under county, state or federal leases. The federal leases are subject to the Federal Coal Leasing Act Amendments of 1976, which impose certain requirements regarding development and operation of the properties as a condition to continuation of such leases and obtaining new leases in the future.

In addition to the reserves of the operating mines, Kaiser Coal Corporation and its subsidiaries control proven reserves and probable reserves in Carbon and Emery counties of approximately 233 million tons of recoverable coal on over 20,000 acres of land held under federal or state leases and about 9,000 acres of coal rights.

Total proven reserves and probable reserves in Utah are approximately 265 million tons of recoverable coal.

Colorado

The Company's Colorado coal properties are all in southern Colorado and include the Chimney Rock Coal Mine in Archuleta County, Colorado. The mine, which was capable of producing approximately 0.4 million tons annually, was idled in July 1985. The mine has proven reserves and probable reserves of approximately 2.1 million tons of recoverable coal.

In December 1985, Kaiser Coal Corporation acquired the Somerset coal mine complex near Paonia, Colorado having proven reserves and probable reserves of 60 million tons of recoverable coal. This coal mine complex was idled prior to the acquisition.

In addition to the reserves of the Chimney Rock coal mine and the Somerset mine, the Company controls proven reserves and probable reserves of approximately 255 million tons of recoverable coal on 60,000 acres either owned or leased by the Company. Two of these reserves are currently permitted for immediate mining operations when marketing conditions dictate.

In February 1986, Cottonwood Canyon Land Company, a wholly-owned subsidiary of the Company, acquired approximately 31,000 acres of undeveloped property in Colorado. For additional information regarding the purchase of the Cottonwood Property and certain liens and options with respect thereto, see Note E to the Consolidated Financial Statements.

Total proven reserves and probable reserves in Colorado are approximately 317 million tons of recoverable coal.

Agreements with SPS and Associated Southern Investment Company provide for options to acquire or exchange property for interests in coal properties located in Colorado and New Mexico. For more information, see "Item 1. Business, Coal Group General Information" and Note E to the Consolidated Financial Statements.

Fabricated Products Group

Napa Fabricating Plant

The plant, located on a 160 acre site on the navigable Napa River with access to the San Francisco Bay, has approximately 480,000 square feet of buildings, overhead crane systems, four permanent drydocks and 620 lineal feet of seawall. In March 1986, the Company announced that the Napa Fabricating Plant would be idled upon the completion of the work then in process.

Napa Pipe Mill .... The pipe mill located at Napa is one of only four operating mills in the country capable of producing large diameter submerged arc-welded pipe. The pipe mill also has double-ending and coating capabilities. It can produce 25 miles of large-diameter pipe per week, or more than 350,000 to 400,000 tons of pipe per year, depending upon product mix.

Fontana Fabricating Plants .. The Fontana Plate Fabricating Plant is on a 67 acre site in the Fontana area and is equipped to manufacture heavy plate fabrications including pressure vessels, penstock, manifolds and large diameter water pipe.

The Fontana Structural Fabricating Plant is on a 98 acre site and has been used for the fabrication of girders, beams and special fabrications for marine and general uses. In April 1985, the Company transferred the Fabricating Shop to the Perma/Frates Joint Venture. Upon the Perma Group's purchase of the Frates Group's interest in the Perma/Frates Joint Venture, the Fontana Structural Fabricating Plant was transferred to Perma Pacific Properties which, in turn leased the Fontana Structural Fabricating Plant back to the Company. In September 1985 the Company entered into an option to acquire the Fontana Structural Fabricating Plant. This option expires on December 31, 1986. For more information regarding the option, see "Item 1. Business, Real Estate." The Fontana Structural Fabricating Plant was vacated in April 1985 when the Fontana fabricating operations were consolidated into the Fontana Plate Shop.

Vallejo Marine Assembly Yard .... This assembly yard has a 500 foot long deep draft seawall on its 40 acre site in Vallejo, California and deepwater access inland or to sea. The yard is used for assembly and shipment of large marine structures.

Terminal Island Marine Assembly Yard .... This 48 acre parcel in the Los Angeles Harbor, which the Company leased in 1983, is designed to be used for assembly of offshore oil and gas exploration and production platforms. Approximately five acres of the site were sublet during 1985.

Los Angeles Harbor Bulk Loading Terminal .... The Company has a lease through 1993 for the operation of a bulk loading terminal at Los Angeles Harbor for the importing and exporting of coal, petroleum coke, steel scrap and other bulk products. The bulk loading facility is operated by a wholly-owned subsidiary, Kaiser International Corporation.

Launch Barge .... The Company has a long-term lease for a 700-foot ocean-going launch barge capable of loading out, transporting and launching deepwater offshore oil platform jackets. It is the largest of only five in the world capable of handling large, deep-water jackets.

Corporate Assets

Corporate Office Buildings	The Company's administrative offices are on approximately 42 acres of land near Fontana, California. The administrative offices are housed in five office buildings with 101,000 square feet of floor space, but only a portion of such property is now in use. In addition, there are 6 support buildings with 50,000 square feet of floor space. The Company is currently finalizing the terms of a sale-leaseback of the Corporate Office Buildings. For additional information, see "Item 1. Business, Real Estate."

Discontinued Operations

Eagle Mountain Iron Ore Mine	The Eagle Mountain iron ore mine, located 150 miles east of Fontana, was shut down in 1981. The Company has patented and unpatented mining claims on approximately 9,000 acres. Facilities and equipment include ore crushing and separating systems, a pelletizing plant, and heavy mobile equipment, most of which is held for sale.
Fontana Real Estate and Facilities	In addition to the Corporate Office Building complex described above, the Company owns approximately 900 acres of real estate near Fontana, California as well as certain facilities including raw materials blending and storage facilities, foundry, storage facilities, water treatment facilities, and a blast furnace. In addition, the Company has an option to acquire an additional 240 acres. See "Item 1. Business, Real Estate." The Company and URS Corporation have reached an agreement in principle to form a venture to develop the Fontana real estate and facilities, the Eagle Mountain Iron Ore Mine and certain other properties upon which the Company has an option. For additional information, see "Item 1. Business, Real Estate."

For information regarding certain encumbrances upon the Company's properties under its loan and credit agreements, see "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations."

Item 3. LEGAL PROCEEDINGS

In May 1983, Union Carbide Corporation filed a suit against the Company in the United States District Court for the Central District of California alleging breach of a contract for the supply of oxygen, nitrogen and hydrogen to the Fontana steelworks. The amount currently at issue is approximately $16 million. In December 1985, the parties tentatively settled this action. Under the terms of the proposed settlement, the Company would pay Union Carbide Corporation a total of $12 million payable in forty quarterly installments plus interest.

The Company is named, along with many other defendants, in approximately 208 asbestos cases. These cases generally allege either exposure to asbestos during employment with a shipyard which was an alleged corporate predecessor to the Company, exposure elsewhere to asbestos materials incorporated in ships produced at the shipyard, or that the Company or its alleged predecessor was a manufacturer of asbestos or asbestos containing materials. Recovery is sought for unspecified general and punitive damages. Most of the complaints are so vague that the allegations against the Company cannot be ascertained. The amount of the Company's exposure is uncertain at this time. No trial is expected in the near future.

[illegible] is named in approximately 59 black lung cases arising out of its coal operations at [illegible] Corporation's mines at Sunnyside, Utah and York Canyon, New Mexico. These cases are [illegible] various levels of review within the Department of Labor, including the Benefits Review [illegible]

[illegible] and November 1983, and February 1984, suits were filed against the Company, its [illegible] directors, the Perma Group, the Frates Group, a shareholder group led by Irwin L. [illegible] "Jacobs Group"), and several others in connection with an option agreement (the [illegible] Option Agreement") entered into by the Company with the Jacobs Group. The Jacobs [illegible] Agreement provided, among other things, that the Company would purchase from the [illegible] Group, for a purchase price of approximately $14.5 million, an option to purchase, and under [illegible] circumstances direct the voting of, approximately 1,181,100 shares of the Company's former [illegible] Common Stock held by the Jacobs Group. Separate complaints were filed in the [illegible] Superior Court for Los Angeles County as purported class actions on behalf of all [illegible] other than the Jacobs Group by Edith Citron, Fanny Minsky, Herbert R. Behrens, [illegible] Lasker, Robert N. Kaplan, P.C. and William Steiner. Plaintiffs seek injunctive relief and [illegible] damages (including exemplary damages of $100 million) and allege, among other things, [illegible] intentional and negligent breach of fiduciary duties by the Company's directors in connection [illegible] the reincorporation in Delaware, the Merger, the Jacobs Option Agreement, the Company's [illegible] arrangements with First Boston Corporation and certain other matters; (b) abuse of control and [illegible] to abuse control by the defendant directors and members of the Jacobs Group; (c) [illegible] and negligent breach of fiduciary duties by members of the Perma Group and the Frates [illegible] conspiracy to breach fiduciary duties by all defendants (e) various federal securities law [illegible] by the Company and the directors in connection with disclosures in the Company's [illegible] 9, 1983 Prospectus and Proxy Statement; and (f) interference with prospective economic advantage by all defendants.

[illegible] May 13, 1985, Kaiser Coal Corporation filed a Petition seeking modification of a Mine Safety and Health Administration ("MSHA") Mandatory Safety Standard as applied to Kaiser Coal Corporation's Cimarron underground mine located in Colfax County, New Mexico. The modification would permit Kaiser Coal Corporation to continue the use of two-entry longwall systems in the mine. On July 2, 1985, Kaiser Coal Corporation also requested that interim relief from the application of the subject safety standard be granted while MSHA considered the above-referenced Petition. Following a MSHA mine investigation and notwithstanding the objections of the United Mine Workers of America ("UMWA"), on September 27, 1985, Kaiser Coal Corporation was granted the interim relief requested. UMWA thereafter demanded a review of MSHA's decision, and on February 21, 1986, the decision granting such interim relief was upheld. Meanwhile, on January 30, 1986, MSHA rendered its decision granting Kaiser Coal Corporation's Petition and ordering the requested modification to the subject safety standard as applied to specified sections of Kaiser Coal Corporation's Cimarron mine. In March 1986, UMWA appealed the MSHA decision.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted during the fourth quarter of the 1985 fiscal year to a vote of security holders.

PART II

Item 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

On April 2, 1985, Perma Pacific, an affiliate of the Perma Group, acquired all of the Company's presently outstanding Common Stock. No public trading market exists for the Common Stock. As of March 25, 1986, Perma Pacific was the sole holder of record of the Company's Common Stock. No Common Stock dividends were paid or declared in 1985 or 1984.

The Company is permitted under the Certificate of Incorporation to pay semiannual dividends on the Common Stock of up to $2,500,000 plus an additional amount up to the lesser of $2,500,000 or the excess of stockholders' equity at the end of the last fiscal quarter over a threshold of $[illegible]95,000. For the purposes of this provision, stockholders' equity includes amounts in the accounts of both the Series A Preferred Stock and the Series B Preferred Stock. Dividends on the Common Stock can be paid under the Certificate of Incorporation, however, only if all dividends on the Series A and Series B Preferred Stock for past quarters have been paid in full, dividends on the Series A and Series B Preferred Stock for the current quarter have been paid or funds are available for that purpose, and all required redemption or retirement payments on the Series A and Series B Preferred Stock have been made.

The Loan Agreement, dated as of April 1, 1985, between the Company and The Philadelphia Saving Fund Society and certain other financial institutions (the "PSFS Loan Agreement"), as amended in February 1986, prohibits the Company from paying dividends on the Common Stock. The PSFS Loan Agreement further prohibits the Company from declaring or paying any dividend on or redeeming the Series A Preferred Stock or Series B Preferred Stock if there exists an event of default under the PSFS Loan Agreement, except that if there exists an event of default the Company may nevertheless redeem Series B Preferred Stock to the extent funds for such redemption were previously placed in escrow in accordance with the provisions of the Company's Certificate of Incorporation.

Holders of the Series A Preferred Stock are entitled to receive cumulative cash dividends of $1.04 per share per annum and holders of the Series B Preferred Stock are entitled to receive cumulative cash dividends of $2.25 per share per annum. Dividends on the Series A Preferred Stock and Series B Preferred Stock are payable quarterly on the fifteenth day of February, May, August and November of each year.

Delaware law does not permit dividends to be paid except out of surplus (defined as the excess, at any given time, of a corporation's assets over its liabilities and stated capital) or, if there is no surplus, out of net profits for the fiscal year in which the dividends are declared or the preceding fiscal year.

The Chase Credit Agreement prohibits Kaiser Coal Corporation and its subsidiaries from paying dividends, or making advances, loans or other distributions to Kaiser Steel Corporation or any other person, except out of excess cash flow (as defined therein) for the preceding fiscal quarter less certain reductions in the commitment under the Chase Credit Agreement.

The Company's Series A Preferred Stock and Series B Preferred Stock are listed on the Pacific Stock Exchange. As of March 21, 1986, there were approximately 5,953 holders of record of the Series A Preferred Stock and approximately 5,549 holders of record of the Series B Preferred Stock. Additional information regarding the Company's stock and related stockholder matters required for Item 5 is included in Item 6 and in the section of Item 8 captioned "Quarterly Financial Data."

The Company has a purchase fund for the redemption of its Series B Preferred Stock. Certain information regarding the purchase fund for the Series B Preferred Stock is set forth below.

SERIES B PREFERRED STOCK PURCHASE FUND REPORT

The Company is required to apply to a purchase fund (the "Purchase Fund") for the redemption of the Series B Preferred Stock an amount generally equal to 25 percent of the amount of cash and certain other proceeds ("Qualifying Funds") in excess of $60 million (the "Deductible Amount") received on dispositions of specified coal properties or steel manufacturing properties ("Purchase Fund Assets"); provided, however, that if the total amount of Qualifying Funds received from both the coal properties and the steel manufacturing properties combined exceed $100 million, then the Company is required to apply 25 percent of such excess over $100 million. The portion of the cash proceeds allocated to the Purchase Fund (the "Purchase Fund Amounts") must be deposited into escrow within one year of receipt and any amounts deposited must be used for the purchase or redemption of the Series B Preferred Stock beginning in 1989. The Company can make open market purchases of the Series B Preferred Stock at such time to satisfy the redemption requirements. The Company's ability to deposit the funds into escrow is dependent upon obtaining new financing or selling additional assets. For additional information, see "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations."

Following is the annual report regarding the Purchase Fund required under the Company's Certificate of Incorporation.

KAISER STEEL CORPORATION

Purchase Fund for the Redemption of Series B Preferred Stock
Summary of Purchase Fund Assets
Years Ended December 31, 1985 and 1984
(Unaudited)
(Dollars in Millions)

Classification	Balance at December 31, 1984	Sales	Cash Collections	Balance at December 31, 1985
Coal Properties:				
Coal reserves	$214.0	$ —	$ —	$214.0
Land	35.4			35.4
Buildings and improvements	7.2			7.2
Machinery and equipment	70.1	(1.1)		69.0
Construction in progress		.7	.7	
	326.7	(.4)	.7	325.6
Steel Properties:				
Accounts receivable	2.3	9.3	9.4	2.2
Inventories	28.2	(21.8)		6.4
Notes receivable, including interest	78.1	6.5	84.6	
Land	44.1	(4.2)		39.9
Buildings and improvements	7.1	(2.8)		4.3
Machinery and equipment	18.6	(2.8)		15.8
	178.4	(15.8)	94.0	68.6
Total purchase fund assets	$505.1	$(16.2)	$94.7	$394.2

KAISER STEEL CORPORATION
Purchase Fund for the Redemption of Series B Preferred Stock
Summary of Qualifying Funds Received and Purchase Fund Amounts
Year Ended December 31, 1985
(Unaudited)

(Dollars in Millions)

	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sep.	Oct.	Nov.	Dec.	Total
Coal Properties:													
Qualifying Funds received:													
By Month:													
Receivables and cash proceeds	$—	$—	$—	$—	$ .7	$—	$—	$ —	$ —	$ —	$ —	$ —	$ .7
Cumulative: Receivables and cash proceeds	$ .3	$ .3	$ .3	$ .3	$ 1.0	$ 1.0	$ 1.0	$ 1.0	$ 1.0	$ 1.0	$ 1.0	$ 1.0	$ 1.0
Steel Properties:													
Qualifying Funds received:													
By Month:													
Receivables and cash proceeds	$ 0.7	$ 0.9	$ 0.8	$ 2.2	$ 0.6	$ 0.7	$ 0.6	$ 0.3	$ 0.2	$ 0.6	$ 1.0	$ 0.8	$ 9.4
Collections of principal and interest on notes receivable				1.8		0.4	11.9	70.5					84.6
Total	$ 0.7	$ 0.9	$ 0.8	$ 4.0	$ 0.6	$ 1.1	$12.5	$ 70.8	$ 0.2	$ 0.6	$ 1.0	$ 0.8	$ 94.0
Cumulative:													
Receivables and cash proceeds	$47.3	$48.2	$49.0	$51.2	$51.8	$52.5	$53.1	$ 53.4	$ 53.6	$ 54.2	$ 55.2	$ 56.0	$ 56.0
Collections of principal and interest on notes receivable	3.6	3.6	3.6	5.4	5.4	5.8	17.7	88.2	88.2	88.2	88.2	88.2	88.2
Total	$50.9	$51.8	$52.6	$56.6	$57.2	$58.3	$70.8	$141.6	$141.8	$142.4	$143.4	$144.2	$144.2
Purchase fund amount	$—	$—	$—	$—	$—	$—	$ 2.7	$ 20.4	$ 20.5	$ 20.6	$ 20.9	$ 21.0	$ 21.0
Purchase fund amounts deposited in escrow	$—	$—	$—	$—	$—	$—	$—	$ —	$ —	$ —	$ —	$ —	$ —
Purchase fund amounts applied for purchase or redemption	$—	$—	$—	$—	$—	$—	$—	$ —	$ —	$ —	$ —	$ —	$ —

Item 6. SELECTED FINANCIAL DATA

See "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" for a Condensed Statement of Operations for the years ending December 31, 1985, 1984 and 1983.

	1985	1984	1983
		(thousands of dollars)	
Dividends—Common Stock	$ —	$ —	$ —
—Series A Preferred Stock	$ 7,777	$ 5,511	$ —
—Series B Preferred Stock	$ 16,826	$ 11,913	$ —
Net sales	$220,445	$151,281	$ 137,356
Loss from continuing operations	$(24,123)	$(22,749)	$ (8,429)
Cash dividends per common stock	$ —	$ —	$ —
At year-end:			
Property, plant and equipment and coal reserves—net	$504,682	$485,738	$ 497,954
Total assets	$710,559	$794,738	$1,057,401
Long-term debt	$ 99,082	$ 75,070	$ 102,972
Series A preferred stock—redeemable	$ 58,751	$ 54,083	$ 50,478
Series B preferred stock—redeemable	$ —	$ 18,794	$ —
Series B preferred stock	$ 6,239	$ 6,372	$ 7,478
Common Stock	$ 1,000	$ 1,000	$ 1,000
Capital surplus	$ 69,914	$ 72,051	$ 89,739
Retained earnings (deficit)	$(19,405)	$ 26,657	$ —
Identifiable assets:			
Coal Group	$441,227	$346,531	$ 344,745
Fabricated Products Group	$ 92,805	$ 85,778	$ 92,152
Active employees at year-end	1,564	1,998	2,962

Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This discussion should be read in conjunction with the Consolidated Financial Statements and Notes to the Consolidated Financial Statements.

Financial Condition

Liquidity and Capital Resources

As of December 31, 1985, the Company had cash and short-term investments of $9.4 million, of which $4.3 million was available for use in the business and $5.1 million was restricted. See Note F to the Consolidated Financial Statements. Cash decreased by $18.9 million during 1985. The decrease reflects the $24.1 million loss from continuing operations, payments of $61.2 million connected with the discontinuance of steelmaking (including pension funding of $14.3 million), repayments of $142.3 million of long-term debt, capitalized mine development costs of $12.8 million, and preferred stock dividend payments of $24.6 million. Partially offsetting this decrease were $110 million received under the PSFS Loan Agreement (discussed below) and the Chase Credit Agreement (discussed below), $81 million from the payment of a note receivable, $20 million from the sale-leaseback of an ocean-going launch barge described below, cash proceeds of $17 million generated by the sale of assets and surplus real estate of discontinued operations, liquidation of $29.9 million of working capital of discontinued operations and $4.7 million from settlement of tax related issues.

As of March 21, 1986, the Company had cash and short-term investments of approximately $11.7 million, of which $3.9 million was available for use in the business and $7.8 million was restricted under agreements requiring the funds to be held as security for the performance of obligations under letter of credit agreements. The change from December 31, 1985 reflects $10.9 million in additional funds received in February 1986 under a new borrowing under the PSFS Loan Agreement, a $6.1 million preferred stock dividend payment in February 1986, $5 million from the settlement of a lawsuit, and cash generated by and used in continuing operations.

Capital expenditures were $30.8 million in 1985 compared to $13.6 million in 1984. During 1986, the Company anticipates capital requirements of approximately $22.5 million, deposits into escrow for the purchase or redemption of Series B Preferred Stock of $21 million, cash payments related to discontinued operations of $41.4 million (including pension funding requirements of $17 million and expenditures for health benefit coverage of retired steelworkers of $7 million), principal repayments under the PSFS Loan Agreement of $15 million, principal payments under the Chase Credit Agreement of $6 million, principal payments under the Company's other loan agreements of $7.5 million, and preferred stock dividend payments of $24.6 million. The Company would also make an additional expenditure of $12 million if the Company exercises its rights under an option agreement to acquire certain property in the Fontana area. See "Item 1. Business, Real Estate." The exercise of such option would be dependent upon the Company's plans to develop its property as an industrial park.

In order to meet the foregoing cash requirements, it will be necessary for the Company to arrange new long-term financing, utilize new lease financing and continue its program of asset sales. With respect to the Company's asset sales program, the Company has identified certain surplus assets in the Fontana area that it intends to sell or exchange within the next twelve months. Included in those assets are the corporate office building complex and certain real property. As discussed in more detail elsewhere in "Item 1. Business, Real Estate," the Company is also pursuing the sale or development as an industrial park of its real estate in the Fontana area. In addition, the Company is evaluating alternatives relating to the disposition of assets that are surplus to its other operations or that are not a necessary part of the Company's long range plans. For a further discussion of the asset sales program, see the discussion below under "Asset Sales Program." In keeping with its basic plan, the Company has been meeting a significant portion of its cash needs through the liquidation of assets that are surplus to its long range plans. Most of the Company's assets, however, are related to the energy industry which is currently depressed. Management believes that it may be imprudent and not in the best interests of the Company and its stockholders to sell sufficient assets during the current year to meet the Company's cash requirements. The Company is discussing with independent investment bankers the prudence and feasibility of a number of possible solutions to the cash needs of the Company, one of which is whether it would be prudent to seek relief from the cash requirements of the Series A and Series B Preferred Stock through a restructuring of these securities.

The Chase Credit Agreement prohibits Kaiser Coal Corporation and its subsidiaries from making dividends, advances, loans or other distributions to Kaiser Steel Corporation or any other person, except out of excess cash flow (as defined therein) for the preceding fiscal quarter less certain reductions in the commitment under the Chase Credit Agreement.

Reduction of Overhead Expense

During 1985, a major focus of management has been the reduction of overhead expenses, including corporate expenses. This effort has occupied a major portion of management time and has been supported by outside consultants. Corporate expenses during 1985 were inflated by non-recurring expenses. Management is continuing to place primary emphasis on elimination of unprofitable operations and unnecessary overhead expenses and is optimistic that future expenses can be reduced.

Financing Activity

The Company is currently engaged in seeking new long-term financing based on its real estate and other assets. The Company believes its efforts to create the new venture discussed above under "Item 1. Business, Real Estate" enhances its ability to borrow additional funds against the real estate assets. The Company recently completed a borrowing of $10.9 million under an amendment of the Loan Agreement, dated as of April 1, 1985, between the Company and The Philadelphia Saving Fund Society and certain other financial institutions (the "PSFS Loan Agreement") increasing the total amount outstanding to $15 million. The Company had originally borrowed $50 million under the PSFS Loan Agreement in April 1985, but repaid $45.9 million largely from asset sales. The additional funds received in February 1986 were used to make a $6.1 million preferred stock dividend payment and for working capital needs. The Company is required to repay the amount outstanding under the PSFS Loan Agreement in two installments; the first installment of $10.9 million is due on April 18, 1986 and the second installment of approximately $4.1 million is due on June 30, 1986. The loans under the PSFS Loan Agreement are secured by substantially all the assets of the Company other than the assets securing the Chase Credit Agreement and certain Colorado coal properties and by a second security interest in the stock of Kaiser Coal Corporation. The PSFS Loan Agreement, as amended in February 1986, imposes restrictions on further indebtedness of the Company, investments in other persons, guaranties, capital expenditures, sales of assets, lease obligations, dividends, stock redemptions, and certain other matters. In addition, the Company must meet certain financial tests including a tangible net worth test. The PSFS Loan Agreement, as amended, further provides that 50 percent, and under certain circumstances 100 percent, of the proceeds of certain dispositions of assets, other than dispositions in the ordinary course of business, must be used to prepay the loan.

In January 1986, Kaiser Coal Corporation obtained a working capital line of $6 million from The Chase Manhattan Bank (National Association) ("Chase") pursuant to a letter agreement, dated as of January 15, 1986. The agreement provides for working capital loans on a revolving credit basis in an aggregate amount not to exceed at any time the lesser of $6 million or 75 percent of certain of Kaiser Coal Corporation's accounts receivable acceptable to Chase. The loans are payable on demand, but no later than January 30, 1987, and bear interest at 1.5 percent above Chase's prime commercial lending rate. All accrued interest is payable on the last day of each of March, June, September and December. The loans are secured by the accounts receivable of Kaiser Coal Corporation.

In January 1986, the Company borrowed $2.2 million from Northern Cimarron Resources Company (a subsidiary of Southern California Edison Company) in connection with the purchase of approximately 31,000 acres of properties in Colorado (the "Cottonwood Property"). The loan from Northern Cimarron Resources Company bears interest at 3 percent above the prime commercial lending rate of Bank of America, N.T. & S.A., and all principal and interest is due and payable on February 18, 1987. For additional information regarding such loan and the Cottonwood Property, see "Item 1. Business, Coal Group" and Note E to the Consolidated Financial Statements.

In June 1985, the Company sold its ocean-going launch barge for $20.0 million under a sale-leaseback arrangement. A $0.1 million loss on the sale was recognized in the second quarter of 1985. The net book value of assets capitalized under the 15-year term lease for the barge was $18.6 million. Commitments under a standby letter of credit on the barge financing are $4.5 million. In connection with the sale-leaseback, the Company granted a second security interest in certain of the Company's Fontana, Napa and Vallejo real property and equipment and certain water company stock.

During 1985, Kaiser Coal Corporation entered into separate operating lease agreements with Chase and Mellon Bank, N. A. for equipment to be used in mining operations. Minimum payments under these lease agreements, which expire at various times in 1986 through 1991, are $18.4 million.

In April 1985, the Company transferred its Utah and New Mexico coal properties to its wholly-owned subsidiary, Kaiser Coal Corporation. In connection with the transfer, Kaiser Coal Corporation entered into a credit agreement, dated as of March 28, 1985, with Chase (the "Chase Credit Agreement") for a loan of $60 million secured by the stock and assets of Kaiser Coal Corporation and its subsidiaries. In April 1985, Kaiser Coal Corporation borrowed $60 million under the Chase Credit Agreement and then paid that amount to Kaiser Steel Corporation in a dividend. The loan to Kaiser Coal Corporation under the Chase Credit Agreement is payable over a ten year period in quarterly installments generally equal to between $.75 million and $1.5 million per quarter, depending on the amount of coal sales, cash flow, and other factors. The Chase Credit Agreement contains various financial and other covenants, including covenants restricting additional indebtedness, the acquisition or disposition of assets, investments in other persons, capital expenditures, and dividends, advances, loans and other distributions to its parent, Kaiser Steel Corporation. In addition Kaiser Coal Corporation must meet certain financial tests concerning working capital. As of December 31, 1985, the outstanding principal amount under the Chase Credit Agreement was $57 million. This amount was reduced to $55.5 million as of March 1986.

The $60 million received under the Chase Credit Agreement in April 1985 and the $50 million received under the PSFS Loan Agreement in April 1985 were used to repay the Company's then outstanding indebtedness of $66.1 million under an Acquisition Credit Agreement, dated as of January 27, 1984, with Citibank, N.A. (the "Citibank Credit Agreement"), to pay approximately $18 million for a lump-sum buyout offer made to those retirees who elected to accept a cash settlement rather than future health benefit coverage, to finance the construction of an ocean-going launch barge, to provide funds required pursuant to a property exchange agreement with the Perma/Frates Joint Venture, and to provide funds for working capital. The repayment of the Company's indebtedness under the Citibank Credit Agreement released $25 million which had been held as cash collateral under the Citibank Credit Agreement. See Note B to the Consolidated Financial Statements.

Program of Asset Sales

The Company has undertaken an intensive asset sales program to dispose of surplus assets, to sell facilities that are not a necessary part of the Company's long-range plans, and to generate additional cash and working capital. The following discusses both the Company's plans for the asset sales program and the principal accomplishments under the program in 1985.

In connection with the Company's asset sales program, the Company has designated certain properties for sale within the next twelve months. Included among these properties are the corporate office building complex and certain other surplus facilities and real property. As a result of the designation of these properties as for sale, and based upon book values and independent appraisals, the Company has reclassified approximately $10 million of long-term assets as current assets held for sale. The reclassification increased the loss on discontinuance by $0.9 million.

The Company is engaged in efforts to either develop the 1,180 acres of real property it owns or has under option in the Fontana area as an industrial park, sell it, or enter into another arrangement, such as a joint venture, for the development of the property. The Company and URS Corporation have reached an agreement in principle to form a venture for the development of this property as an industrial park. See "Item 1. Business, Real Estate."

The Company is currently finalizing the terms of a sale-leaseback of the corporate office building complex. For additional information, see "Item 1. Business, Real Estate."

In August 1985, California Steel Industries, Inc. ("CSI") paid the Company $70.5 million and discharged the outstanding indebtedness on the note payable by CSI to the Company in connection with the August 1984 sale to CSI of the Fontana steelworks. The payment by CSI reflected a discount of $5 million from the aggregate unpaid principal balance of the CSI obligations. CSI had previously paid $10 million to the Company in July 1985 as a partial prepayment of principal on the CSI note. Of the proceeds from the August payment by CSI, $35 million was applied to the Company's obligations under the PSFS Loan Agreement. In addition, $3.4 million of the proceeds from the payment by CSI was applied to the payment in full of the outstanding principal and interest under a $5 million short-term loan from the consortium of financial institutions that had entered into the PSFS Loan Agreement.

During the third quarter of 1985, the Company sold all the assets of its wholly-owned subsidiary, Kaiser Steel Tubing, Inc., for $6.5 million in cash, two promissory notes payable in the aggregate principal amount of $7.5 million, and convertible preferred stock of the company purchasing the real property and equipment. Also in the third quarter of 1985, the Company sold the land and buildings of a former subsidiary in Vernon, California for $4.8 million in cash and sold certain land in Montebello, California for $1.5 million in cash.

In June 1985, the Company sold its ocean-going launch barge for $20 million under a sale-leaseback arrangement. A $0.1 million loss on the sale was recognized in the second quarter of 1985. The net book value of assets capitalized under the 15-year term lease for the barge was $18.6 million.

In January 1985, the Company sold certain undeveloped land south of Fontana for $4 million.

Results of Operations

The schedule below shows sales and pretax earnings (loss) by business segment for continuing operations for the past three years.

	Year ended December 31 1985	1984	1983
	(thousands of dollars)		
Net sales:			
Coal Group:			
Kaiser Coal Corporation and its subsidiaries	$ 94,736	$ 72,373	$ 43,351
Other operations	2,428		
	97,164	72,373	43,351
Fabricated Products Group	123,697	78,908	94,005
Intersegment eliminations	(416)		
	$ 220,445	$ 151,281	$ 137,356
Operating profit (loss):			
Coal Group:			
Kaiser Coal Corporation and its subsidiaries	$ 10,275	$ 5,013	$ (7,502)
Other operations	(7,296)		
	2,979	5,013	(7,502)
Fabricated Products Group	(11,327)	(12,022)	(6,646)
Corporate	(17,334)	(14,343)	(11,954)
	(25,682)	(21,352)	(26,102)
Interest expense	(11,929)	(12,759)	(4,696)
Interest income	13,488	11,362	22,369
Loss from continuing operations	(24,123)	(22,749)	(8,429)
Discontinued operations:			
Loss from operations	(1,223)	(2,276)	(23,973)
Earnings (loss) on discontinuance, (net of applicable income tax (provision) benefits of ($40,623) in 1984 and $33,000 in 1983)	4,814	72,713	(395,784)
	3,591	70,437	(419,757)
Earnings (loss) before extraordinary item and cumulative effect on prior years of accounting changes	(20,532)	47,688	(428,186)
Extraordinary item			5,416
Cumulative effect on prior years of accounting changes	3,741		
Net earnings (loss)	$ (16,791)	$ 47,688	$(422,770)

Coal Group

Coal sales increased from $72.4 million in 1984 to $97.2 million in 1985 due to intensified marketing efforts. Although gross margin increased from $12.3 million in 1984 to $19.3 million in 1985, the effect during 1985 of the accounting changes for certain inventory and development costs described below and the extension of the useful lives of certain coal mine equipment was to increase the gross margin of Kaiser Coal Corporation by $16.4 million. Gross margin was constrained by market pressures on coal pricing.

Kaiser Coal Corporation and its subsidiaries reported an operating profit of $10.3 million for 1985. Kaiser Coal Corporation's selling and administrative expenses increased from $7.2 million in 1984 to $9 million in 1985 largely due to increased costs under its management and brokerage [illegible]contracts pursuant to which Kaiser Coal Corporation pays a fee based on a percentage of sales and [illegible] to increased costs of lease financings.

Other operations of the Coal Group were primarily development activities and the management [illegible] operation of Colorado coal properties other than the recently acquired Paonia, Colorado coal [illegible] The Company and Perma Resources Corporation, an affiliate of the Perma Group, have joined [illegible] Southwestern Public Service Company ("SPS") to study the feasibility of transporting coal in a pipeline slurry of coal and liquified carbon dioxide. A research project slurry line has been constructed at SPS' coal-fueled plant near Amarillo, Texas and is currently in the start up and testing phase. The Company spent $2.2 million on these research and development activities in 1985. The Coal Group is also developing plans to construct cogeneration power plants near Kaiser Coal Corporation's coal mines in Utah and New Mexico. During 1985, the Company's Colorado coal operations lost $4.3 million including a $1.6 million provision for costs associated with the idling of [illegible] Chimney Rock Coal Mine. In total, coal operations other than those of Kaiser Coal Corporation generated operating losses of $7.3 million for 1985.

The Coal Group as a whole reported an operating profit of $3 million in 1985 compared to an operating profit of $5 million in 1984.

In addition, Kaiser Coal Corporation reported a $3.7 million gain from the cumulative effect on [illegible] years of the changes in accounting for certain inventory and development costs in 1985. See [illegible] to the Consolidated Financial Statements.

Fabricated Products Group

Fabricated Products Group sales increased from $78.9 million in 1984 to $123.3 million in 1985. The increase was primarily due to higher levels of shipments of large diameter pipe, the tow during [illegible] quarter of 1985 of the jacket for the Texaco offshore drilling platform Harvest and the [illegible] completion closeout of a portion of the SOHIO Endicott Project in December 1985. Gross [illegible] for the Fabricated Products Group increased from a gross loss of $3.1 million in 1984 to [illegible] in 1985.

Despite the increased sales activity, the Fabricated Products Group reported an operating loss of [illegible] million in 1985 compared to an operating loss of $12 million in 1984. Certain significant unusual [illegible] in 1985 included an increase in selling and administrative expenses relating to the unusually [illegible] of bid activity, a write off of $0.5 million of site preparation costs at the Company's [illegible] yard, a $0.6 million provision for bad debts and a $0.5 million provision for costs associated with the restructuring of the Fabricated Products Group. These unusual expenses offset the improve[illegible] gross margin and the $3.5 million gain on the sale of the Company's marine assembly yard [illegible] in Oakland, California. Insurance expense, depreciation expense and interest expense also [illegible] primarily due to the sale-leaseback of the ocean-going launch barge.

During the fourth quarter of 1985, the Company restructured the Fabricated Products Group [illegible] business units in an ongoing effort to reduce administrative and overhead costs and improve [illegible]. The restructuring and accompanying force reductions were based on recommendations [illegible] outside management consultants. In March 1986, the Company announced that it will temporarily suspend operations at its Napa fabricating plant upon completion of those projects presently [illegible] contract. The Napa Pipe Mill will continue to operate. The Company is continuing to study steps to improve operating results.

In 1985, sales of the Company's bulk loading operation were $10.2 million and operating profits [illegible] million. These amounts include a $0.6 million gain from a contract termination settlement [illegible] California Steel Industries, Inc. These results compare to sales of $9.2 million and operating [illegible] of [illegible] million in 1984. The results for the bulk loading operation are included in the totals for [illegible] Fabricated Products Group.

Corporate expenses during 1985 were $23.2 million compared to $13.2 million in 1984. Increased corporate expenses during 1985 resulted primarily from nonrecurring expenses related to major transactions completed during the year, including $5.8 million of refinancing expenses and a $1.6 million provision for costs associated with the reorganization of the corporate staff. The Company reorganized the corporate staff in the third quarter of 1985 based on recommendations from outside consulting firms which had conducted an extensive review of the corporate structure, systems, procedures and staffing requirements. Over 70 positions were consolidated or eliminated.

The increase in interest income from $11.4 million during 1984 to $13.5 million in 1985 was due primarily to interest on the note receivable from the sale of the Fontana steelworks and interest on refundable income taxes. The Company expects that interest income will be significantly lower in future periods.

Discontinued Operations

A summary of discontinued operations for 1985, 1984 and 1983 is as follows:

	1985	1984	1983
	(millions of dollars)		
Loss from operations	$(1.2)	$ (2.3)	$ (24.0)
Gain (loss) on discontinuance:			
Write-down of plant and equipment to fair value	$ (.9)	$ —	$ (18.6)
Employee-related costs	5.5	(4.8)	(384.3)
Estimated operating losses during phase-out period			(6.1)
Negotiated reductions of employee-related liabilities		94.5	
Settlements of employee-related legal matters		6.0	
Dismissal of supply contract lawsuit	2.1	8.0	
Gains on sales, net	(.9)	5.7	
Other	(1.0)	3.9	(19.8)
	4.8	113.3	(428.8)
Income tax (provision) credit	—	(40.6)	33.0
Net earnings (loss) on discontinuance	$ 4.8	$ 72.7	$(395.8)

The $4.8 million gain on discontinuance during 1985 reflects the sale of certain steel mill equipment and iron ore mining equipment, assets of Kaiser Steel Tubing, Inc. and certain land and buildings and the settlement of a labor grievance and two supply contracts. In December 1985, the Company contributed its Cushenbury Limestone Mine, valued at approximately $15.2 million, to a trust, the proceeds of which are contributed to a qualified trust for the benefit of retired workers.

Results from discontinued operations in 1984 reflect the following: 1) the net reduction in employee-related liabilities of approximately $94.5 million resulting from the Program of Continuing Coverage, the lump-sum cash buyout and negotiation of an agreement settling substantially all employee-related disputes, including all grievances at the Fontana steelworks. See "Item 1. Business, Collective Bargaining Agreements;" 2) sale of substantially all of the Company's steel manufacturing facilities and certain land in Fontana and the reversal of an $8 million provision due to dismissal of the CVRD lawsuit; and 3) settlement of certain employee-related legal matters which resulted in a decrease of $6 million in reserves established for discontinued operations.

In connection with the sale or discontinuance of certain of the Company's subsidiaries described above, the Company provided $6.1 million in 1984 for employee-related matters and other costs related to the discontinuances.

Extraordinary Item

The extraordinary item in 1983 represents the gain on purchase of the Company's first mortgage bonds at a discount in June and July of 1983.

Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

INDEPENDENT ACCOUNTANTS' REPORT

To the Board of Directors and Stockholders
Kaiser Steel Corporation
Fontana, California

We have examined the consolidated balance sheets of Kaiser Steel Corporation and Subsidiaries as of December 31, 1985 and 1984, and the related statements of operations, redeemable preferred stock and stockholders' equity and changes in financial position for each of the three years in the period ended December 31, 1985. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

During 1983, the Company discontinued its steelmaking and finishing operations and entered into an Agreement of Merger which materially changed the presentation of the balance sheet as of December 31, 1983, and materially affected the statement of operations in 1984 and 1985.

The financial statements referred to above have been prepared using generally accepted accounting principles applicable to a going concern which contemplate the realization of assets and liquidation of liabilities in the normal course of business. However, continuation of the Company as a going concern is dependent upon its obtaining additional funding in 1986 and achieving profitable operations in the future. At December 31, 1985, the Company has substantial future cash requirements in excess of its currently available sources of funds. Should losses continue and the Company be unable to meet its obligations, the order of maturity of the liabilities and the carrying values of assets would be significantly affected.

In our opinion, subject to the possible effects of such adjustments, if any, as might have been required had the outcome of the uncertainties related to the Company's continuance as a going concern been known, the consolidated financial statements referred to above present fairly the financial position of Kaiser Steel Corporation and Subsidiaries as of December 31, 1985 and 1984, and the changes in their financial position for each of the three years in the period ended December 31, 1985, in conformity with generally accepted accounting principles applied on a consistent basis and the results of their operations for the years ended December 31, 1985 and 1984, in conformity with generally accepted accounting principles applied on a consistent basis, except for the changes, with which we concur, as described in Note D to the financial statements. The results of operations for the year ended December 31, 1983, are in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

We have also read the pro forma adjustments to the Statement of Operations-Pro Forma for the year ended December 31, 1983, and, in our opinion, these adjustments have been properly prepared and applied.

TOUCHE ROSS & CO.
Certified Public Accountants

Los Angeles, California
[illegible] 1986

CONSOLIDATED STATEMENTS OF OPERATIONS

	Year Ended December 31, 1985	Year Ended December 31, 1984	Year Ended December 31, 1983: Pro Forma	Year Ended December 31, 1983: Pro Forma Adjustments (Add) Deduct (Note B)	Year Ended December 31, 1983: Historical
	(thousands of dollars)				
Net sales	$220,445	$151,281	$137,356	$ —	$ 137,356
Cost of products sold (Note E)	201,177	142,236	142,879	3,750(2)(5)	139,129
	19,268	9,045	(5,523)	(3,750)	(1,773)
Costs and expenses:					
Selling and administrative expenses (Note E)	50,382	31,014	27,856	2,696(2)	25,160
Interest expense (Note J)	16,503	13,017	5,890	745(4)	5,145
Interest and other income	(23,494)	(12,237)	(1,280)	22,369(6)	(23,649)
	43,391	31,794	32,466	25,810	6,656
Loss from continuing operations	(24,123)	(22,749)	(37,989)	(29,560)	(8,429)
Discontinued operations (Notes C and L):					
Earnings (loss) from operations (Note G)	(1,223)	(2,276)	1,747	25,720(3)	(23,973)
Earnings (loss) on discontinuance, (net of applicable income tax (provision) benefits of ($40,623) in 1984 and $33,000 in 1983)	4,814	72,713		395,784(3)	(395,784)
	3,591	70,437	1,747	421,504	(419,757)
Earnings (loss) before extraordinary item and cumulative effect of accounting changes	(20,532)	47,688	(36,242)	391,944	(428,186)
Extraordinary item				(5,416)(1)	5,416
Cumulative effect on prior years of accounting changes (Note D)	3,741				
Net earnings (loss)	$(16,791)	$ 47,688	$(36,242)	$ 386,528	$(422,770)

See notes to consolidated financial statements and accompanying Accountants' Report.

CONSOLIDATED BALANCE SHEETS

	December 31 1985	December 31 1984
	(thousands of dollars)	
Current Assets:		
Cash and short-term investments (Note F)	$ 4,348	$ 3,310
Notes and accounts receivable (less allowance of $506 (1985) and $917 (1984))	29,380	28,777
Inventories (Note G)	19,137	14,063
Other current assets	14,786	11,776
Assets held for sale	9,768	
Current assets—discontinued operations (Note C)	4,000	33,858
Total current assets	81,419	91,784
Restricted cash (Note F)	5,106	25,000
Property, plant and equipment and coal reserves—net (Notes H, I and J)	504,682	485,738
Notes receivable, less current portion	4,600	74,594
Other assets (Note H)	60,216	42,828
Long-term assets—discontinued operations (Note C)	21,519	40,909
Excess of purchase price over fair value of net assets acquired, net of accumulated amortization of $3334 (1985) and $2,466 (1984) (Notes B, C and L)	33,017	33,885
	$710,559	$794,738
Current Liabilities:		
Current portion of long-term debt (Notes H and J)	$ 18,415	$ 4,356
Accounts payable	20,674	10,233
Payroll and related charges	13,592	18,632
Income taxes (Note L)		4,727
Other current liabilities	5,608	4,207
Series B preferred stock—redeemable (Notes J and K)	21,064	
Current liabilities—discontinued operations (Note C)	41,401	75,801
Total current liabilities	120,754	117,956
Long-term debt (Notes H and J)	99,082	75,070
Income taxes (Note L)	25,304	20,616
Other liabilities	62,250	56,271
Long-term liabilities—discontinued operations (Note C)	286,670	345,868
Commitments and contingencies (Notes H and N)		
Series A preferred stock—redeemable (Notes J and K)	58,751	54,083
Series B preferred stock—redeemable (Notes J and K)		18,794
Series B preferred stock (Notes J and K)	6,239	6,372
Common stock	1,000	1,000
Capital surplus	69,914	72,051
Retained earnings (deficit), subsequent to December 31, 1983	(19,405)	26,657
	$710,559	$794,738

See notes to consolidated financial statements and accompanying Accountants' Report.

CONSOLIDATED STATEMENTS OF REDEEMABLE PREFERRED STOCK AND STOCKHOLDERS' EQUITY

	Series A Redeemable Preferred Stock	Series B Redeemable Preferred Stock	Series B Preferred Stock	$1.46 Preferred Stock	Common Stock	Capital Surplus	Retained Earnings (Deficit)
			(thousands of dollars)				
Balance at December 31, 1982	$ —	$ —	$ —	$ 9,337	$4,845	$ 84,451	$ 166,486
Net loss							(422,770)
Cash dividends on Preferred Stock—$1.46 per share							(514)
Purchase and retirement of Preferred Stock				(1,000)		17	
To record purchase accounting adjustments:							
Purchase and retirement of Preferred Stock				(8,337)		71	
Payment of $22 per share of Common Stock					(4,845)		(156,591)
Payment for option on 1,181,100 shares of Common Stock, 66⅔ cents par value						(14,532)	
Gain on defeasance of Pollution Control Revenue Bonds						7,464	
Issuance of 10,000,000 shares of Common Stock, 10 cents par value					1,000		
Allocation of purchase price:							
Net tangible assets						384,949	
Excess of purchase price over fair value of net assets acquired						98,664	
Less: Par value of Series B Preferred Stock			7,478			(7,478)	
Assigned value of Series A Preferred Stock	50,478					(50,478)	
Capitalization of deficit						(413,389)	413,389
Balance at December 31, 1983	50,478		7,478		1,000	89,739	
Net earnings							47,688
Cash dividends on Preferred Stock—Series A and Series B							(17,426)
Series B Preferred Stock transfer to redeemable		18,794	(1,106)			(17,688)	
Accretion of mandatory redemption value—Series A	3,605						(3,605)
Balance at December 31, 1984	54,083	18,794	6,372		1,000	72,051	26,657
Net loss							(16,791)
Cash dividends on Preferred Stock—Series A and Series B							(24,603)
Series B Preferred Stock transfer to redeemable		2,270	(133)			(2,137)	
Transfer of Series B Preferred Stock—redeemable to current liabilities (Note K)		(21,064)					
Accretion of mandatory redemption value—Series A	4,668						(4,668)
Balance at December 31, 1985	$58,751	$ —	$ 6,239	$ —	$1,000	$ 69,914	$ (19,405)

See notes to consolidated financial statements and accompanying Accountants' Report.

CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION

	Year ended December 31		
	1985	1984	1983 (Restated, Note B)
	(thousands of dollars)		
Amounts related to continuing operations:			
Loss from continuing operations	$ (24,123)	$ (22,749)	$ (8,429)
Depreciation, amortization and depletion	14,180	16,086	9,324
Other	(3,293)		
Funds (used in) provided by continuing operations	(13,236)	(6,663)	895
Cumulative effect on prior years of accounting changes	3,741		
Extraordinary item			5,416
Additional long-term debt	180,317	3,479	
Payments and current maturities of long-term debts	(142,246)	(38,197)	(1,286)
Decrease (increase) in notes receivable	81,344	(74,594)	
Dividends on Series A and Series B Preferred Stock	(24,603)	(17,426)	
Transfer of Series B Preferred Stock—redeemable to current liabilities:			
Increase in current liabilities	21,064		
Decrease in redeemable preferred stock	(21,064)		
Disposal of (additions to) property, plant and equipment, net	(29,983)	(9,402)	(4,651)
Redemption of $1.46 Preferred Stock			(983)
Dividend on $1.46 Preferred Stock			(514)
Investment in related company (Note C)	(2,700)	(6,500)	
Exchange of assets (Note E):			
Coal properties and other assets received	65,766		
Long-term debt and other liabilities assumed	(22,856)		
Property, plant and equipment exchanged	(32,910)		
Note receivable exchanged	(5,000)		
Cash payment	(5,000)		
Other	(12,817)	(4,076)	2,754
Decreases in:			
Refundable income taxes		33,000	64,800
Billings in excess of costs and estimated earnings on uncompleted contracts		(3,596)	(7,550)
Income taxes	(39)	(4,473)	(35,242)
Increase in assets held for sale	(9,768)		
Increase in other current assets	(3,010)	(4,400)	(5,019)
Decrease (increase) in notes and accounts receivable	(6,547)	(13,853)	9,783
Decrease (increase) in inventories	(5,074)	5,102	19,817
Increase (decrease) in payroll and related changes	(2,409)	(8,896)	6,365
Increase (decrease) in other current liabilities	1,401	(19,981)	2,399
Increase (decrease) in accounts payable	10,441	7,557	(4,925)
Total funds (used in) provided by continuing operations	24,812	(162,919)	52,059
Amounts related to discontinued operations:			
Earnings (loss) from discontinued operations	3,591	70,437	(419,757)
Provisions (reversal of provisions) for losses, net	(6,437)	(105,695)	395,784
Provision for taxes		40,623	
Income resulting from LIFO layer liquidations			(112,238)
Depreciation and amortization		1,894	25,946
Funds provided by (used in) discontinued operations	(2,846)	7,259	(110,265)
Retirement of First Mortgage Bonds			(185,203)
Payments related to shutdown of steelmaking	(61,200)	(77,778)	(24,141)
Disposals of (additions to) property, plant and equipment, net	17,853	110,042	(3,112)
Contribution of Cushenbury Limestone Properties (Note C)	(15,200)		
Increase (decrease) in income taxes		(2,349)	22,965
Other	(9,821)	124	5,230
Decrease in current assets—discontinued operations	29,858	120,803	212,932
Decrease in current liabilities—discontinued operations	(2,312)	(13,487)	(102,751)
Total funds (used in) provided by discontinued operations	(43,668)	144,614	(184,345)
Funds used in Merger (Note B)			(115,183)
Net decrease in cash and short-term investments	(18,856)	(18,305)	(247,469)
Cash and short-term investments at beginning of period (including restricted cash of $25,000 at December 31, 1984 and 1983)	28,310	46,615	294,084
Cash and short-term investments at end of period (including restricted cash of $5,106 at December 31, 1985 and $25,000 at December 31, 1984 and 1983)	$ 9,454	$ 28,310	$ 46,615

See notes to consolidated financial statements and accompanying Accountants' Report.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE A—Summary of Significant Accounting Policies

Principles of Consolidation. The consolidated financial statements include the accounts of Kaiser Steel Corporation and its wholly-owned subsidiaries. Intercompany transactions and accounts have been eliminated.

Inventories. Inventories are stated at the lower of cost or market. The last-in, first-out (LIFO) method of accounting is used for finished and semi-finished products and raw materials. Cost of other inventories is determined by the average cost method. Depreciation, property taxes and insurance expenses are not included in the determination of inventory costs.

Contract Revenues. Revenues from long-term fabrication and construction contracts are recognized on the percentage-of-completion method, generally measured on the basis of direct labor hours.

Contract costs include all direct material and labor costs and those indirect costs related to contract performance, such as indirect labor and supplies. Selling and administrative costs and depreciation are charged to expense as incurred. Provisions for estimated losses on uncompleted contracts are made in the period in which such losses are determined. Profit is recognized when its realization is reasonably assured and the amount can be reliably estimated.

Property, Plant and Equipment. Property, plant and equipment are recorded at cost. Depreciation is calculated on the straight-line method, based primarily on estimated remaining useful economic lives of functionally related properties or the lease term, whichever is shorter, except for certain long-lived assets at the Company's coal mines and large diameter pipe mill which are depreciated on a units of production method.

Excess of Purchase Price Over Fair Value of Net Assets Acquired. The excess of purchase price over fair value of net assets acquired is being amortized over a period of forty years.

Pension and Profit Sharing Plans. The Company has pension plans that cover substantially all employees. Contributions to defined benefit pension plans are actuarially determined to include amounts necessary to provide for current employee service and the funding of prior service liabilities over periods up to 40 years. The Company maintains a salaried employees' Savings and Profit Sharing Plan. Contributions to the plan are based, in part, on earnings. The Company records its contributions to these plans as expenses. As part of discontinued operations in 1984 and 1983, the Company recorded as a liability the unfunded portion of the costs associated with the pension plans covering the employees of the discontinued operations.

Income Taxes. Utilization of financial statement net operating loss carryforwards first reduce the Excess of Purchase Price over Fair Value of Net Assets Acquired and then are credited to Capital Surplus in accordance with the accounting rules applicable to Quasi-Reorganizations.

Research and development. Expenditures for research and development are expensed when incurred. Expenses related to research and development activities during 1985 were $2.2 million.

NOTE B—Merger and Pro Forma Statement of Operations

On February 29, 1984, Kaiser Acquisition Corporation, which was owned by an investment group led by J. A. Frates (the "Frates Group") was merged into the Company (the "Merger"). The Merger was reflected on the books of the Company as if it had occurred on December 31, 1983 and was accounted for using the purchase accounting method whereby the assets and liabilities were recorded at their fair values.

The Pro Forma Statement of Operations appearing in the Consolidated Statements of Operations gives effect to the discontinuance of steelmaking and finishing operations in 1983, and the Merger as if they had occurred on January 1, 1983 based on the assumptions set forth in the following notes. This statement does not purport to be indicative of the results that would actually have been attained if the Merger and discontinuance had occurred on January 1, 1983, or which may be attained in the future.

NOTES TO PRO FORMA STATEMENT OF OPERATIONS

(1) To record the reversal of the extraordinary item related to retirement of debt.

(2) To record additional depreciation, amortization, and depletion based on changes in recorded values of the Company's property, plant and equipment and coal reserves, as well as the excess of purchase price over fair value of net assets acquired.

(3) To eliminate discontinued operations related to steelmaking and finishing operations.

(4) To reflect an increase in interest expense as a result of borrowing $100,000,000 at the lender's alternate base rate plus 1.25% and a reduction in interest expense due to the defeasance of the Company's Pollution Control Revenue Bonds and retirement of the Company's First Mortgage Bonds.

(5) To adjust cost of products sold to reflect medical expense liabilities recorded as part of the Merger entries.

(6) To reflect a decrease in earnings from investments as a result of disbursement of cash to retire the Company's First Mortgage Bonds and certain merger related disbursements, net of the $100,000,000 borrowing referred to above.

NOTE C—Discontinued Operations

Loss from discontinued operations for the years ended December 31, 1985 and 1984 consist of the following: 1) operations of Myers Drum Company which was sold in December 1984; 2) operations of Kaiser Pipe and Casing, Inc., which was sold in August 1984; and 3) operations of Kaiser Steel Tubing, Inc., which was discontinued in 1984 and sold in July 1985.

Earnings (loss) on discontinuance for the years ended December 31, 1985 and 1984, include certain reductions of previously established reserves (discussed below), provision for estimated losses on disposal of plant and equipment, and for other costs to be incurred as a result of the discontinuance of operations.

During 1984, the Company negotiated agreements with the United Steelworkers of America and retired steelworkers on several employee-related matters. As a result of these agreements, the Company realized a net reduction in employee-related liabilities of approximately $94.5 million. The reserve for employee-related matters was further reduced by $21.7 million as a result of improved actuarial data relating to the steelworker population. This latter adjustment was recorded as a reduction in the amount of Excess of Purchase Price Over Fair Value of Net Assets Acquired arising from the Merger. The Company also settled certain legal matters which resulted in a decrease of $6 million in reserves established for discontinued operations.

The proceeds from the sale of the steel manufacturing facilities and certain land in August 1984 consisted of $25 million in cash and an $85 million note which was paid in 1985 at a discount of $5 million. Under the terms of the sale, a suit filed by one of the purchasers alleging breach of a long-term supply contract was dismissed. As the result of this dismissal, a previously established reserve of $8 million was reversed.

During the third quarter of 1985, the Company sold all of the assets of its wholly-owned subsidiary, Kaiser Steel Tubing, Inc., for $6.5 million in cash, two promissory notes payable in the aggregate principal amount of $7.5 million, and convertible preferred stock of the corporation purchasing the real property and equipment.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The proceeds from the sales of Myers Drum Company and Kaiser Pipe and Casing, Inc. consisted of $14.8 million in cash and a $5.0 million note collateralized by the assets sold. Concurrent with the sale of Myers Drum Company, $6.5 million of the cash received from that sale was used to purchase preferred stock of the acquiring corporation.

In December 1985, the Company tentatively settled a suit filed by Union Carbide Corporation against the Company alleging breach of a contract for the supply of oxygen to the Fontana steelworks. Under the terms of the proposed settlement, the Company would pay Union Carbide Corporation a total of $12 million in forty quarterly installments, plus interest.

In December 1985, the Company contributed its Cushenbury Limestone Mine, valued at approximately $15.2 million, to a trust, the proceeds of which are contributed to a qualified trust for the benefit of retired steelworkers. The property was contributed pursuant to 1984 agreements with the United Steelworkers of America and retired steelworkers.

A summary of discontinued operations for 1985, 1984 and 1983 is as follows:

	1985	1984	1983
	(millions of dollars)		
Loss from operations	$ (1.2)	$ (2.3)	$ (24.0)
Earnings (loss) on discontinuance:			
Write-down of plant and equipment to fair value	$ (.9)	$ —	$ (18.6)
Employee-related costs	5.5	(4.8)	(384.3)
Estimated operating losses during phase-out period			(6.1)
Negotiated reductions of employee-related liabilities		94.5	
Settlements of employee-related legal matters		6.0	
Dismissal or settlement of supply contract lawsuits	2.1	8.0	
Gain (loss) on sales, net	(.9)	5.7	
Other	(1.0)	3.9	(19.8)
	4.8	113.3	(428.8)
Income tax (provision) credit	—	(40.6)	33.0
Net earnings (loss) on discontinuance	$ 4.8	$ 72.7	$(395.8)

The reserve for discontinued operations at December 31, 1985 and 1984 is summarized as follows:

	December 31, 1985	December 31, 1984
	(millions of dollars)	
Employee-related costs	$291.4	$359.1
Other	35.0	50.7
	326.4	409.8
Less: Amounts included in current liabilities—discontinued operations	40.7	70.4
Amounts included in long-term liabilities-discontinued operations	$285.7	$339.4

NOTE D—Changes in Accounting Principles

During 1985, the Company changed its method of accounting for certain coal mine inventories and development costs to more properly associate costs with revenues. Prior to 1985, the Company directly expensed all costs associated with the generation of pit inventories at its York Canyon surface mine and all costs associated with the development of submain entries and longwall panels at its underground mines as such costs were incurred. Pit inventories are now recognized as the coal is uncovered and the costs of generating pit inventories are allocated to the coal expected to be removed based upon engineering data. The costs incurred during the development of submain entries and longwall panels to expose unmined reserves are now capitalized as preproduction costs and amortized as coal is produced on a units-of-production method based upon coal expected to be recovered as determined by engineering data.

The cumulative effect on prior years due to the accounting changes reduced the net loss by $3.7 million. As a further result of the accounting changes, the loss before the cumulative effect on prior years of the accounting changes was reduced by $12.8 million during 1985.

Commencing during the second quarter of 1985, the Company extended the estimated useful lives of certain coal mine equipment based upon historical data and engineering studies. The effect of this change was to decrease the net loss by $3.6 million in 1985.

NOTE E—Related Party Transactions

Acquisition of Common Stock

In 1984, Perma Resources Corporation and certain affiliates (the "Perma Group") and an investment group led by J. A. Frates (the "Frates Group") acquired all the outstanding Common Stock of the Company in connection with the merger of Kaiser Acquisition Corporation into the Company (the "Merger"). Pursuant to an exchange agreement between the Perma Group and the Frates Group, all the Common Stock was deemed equitably owned since the Merger by a joint venture between the Perma Group and the Frates Group (the "Perma/Frates Joint Venture"). In April 1985, the Perma Group acquired the Frates Group's interest in the Perma/Frates Joint Venture and thereby acquired all the outstanding Common Stock of the Company.

April 1985 Exchange of Assets

In April 1985, the Company acquired certain Colorado coal properties and coal supply contracts pursuant to an exchange agreement between the Company and the Perma/Frates Joint Venture. The Colorado coal properties have proven reserves and probable reserves of over 255 million tons of recoverable coal and two permitted but currently idle mining operations. The property transferred to the Company included the SPS Agreement, discussed below, and the Chimney Rock coal mine. The property was acquired by the Company through the exchange of real estate located near Fontana, California, with an aggregate assigned fair value of $45 million, a $5 million note receivable from the sale of Kaiser Pipe and Casing, Inc. and $5 million in cash. In connection with the exchange, the Company also repaid approximately $12 million and assumed approximately $11 million of debt associated with the Colorado coal properties. Upon the exchange of assets, the Perma Group acquired the Frates Group's interest in the Perma/Frates Joint Venture and thereby acquired certain of the property of the Perma/Frates Joint Venture which it transferred to Perma Pacific Properties, an affiliate of the Perma Group. Certain property, including the Fontana Structural Fabricating Plant, was in turn leased back to the Company. During 1985, the Company paid Perma Pacific Properties $479,000 under this lease.

West End Option

In September 1985, after receipt of independent land use plans and the initiation of discussions for the potential development of the Company's Fontana property as an industrial park, the

Company acquired an option from Perma Pacific Properties to purchase approximately 240 acres of real property in the Fontana area, including the Fontana Structural Fabricating Plant (the "West End Option Property"). The West End Option Property was acquired by Perma Pacific Properties from the Perma/Frates Joint Venture in the April 1985 exchange of assets. The acquisition of the property pursuant to the Option will provide improved access to the Company's other property in the Fontana area and enhance the development of the Company's property as an industrial park. The West End Option Property has a value of approximately $21 million and would be acquired through the exchange of certain of the Company's other property in the Fontana area and the payment of cash or assumption of debt. The purchase price of the property under the option is the same as the value assigned to the property in the April 1985 exchange of assets, plus the value of any improvements. The option, which was originally to expire on January 2, 1986, was purchased for $2.6 million. On January 2, 1986, the option was extended to March 31, 1986 for a price of $800,000. The price of the original option and the extension to March 31, 1986 will be applied to the purchase price for the property in the event that the Company exercises the option. On January 17, 1986 the Company entered into an Extension of Option Agreement (the "Extension of Option Agreement") pursuant to which the option was extended from March 31, 1986 to December 31, 1986. Under the terms of the Extension of Option Agreement, the Company agreed to (1) reimburse Perma Pacific Properties for all its costs of carrying the property during the term of the option, including all real property taxes, interest on a $12 million loan on the property, and payments of approximately $86,000 per month to Associated Southern Investment Company ("ASIC") under the Put Option Agreement, described below, (2) perform all the obligations of Perma Pacific Properties under the Put Option Agreement in the event the Company acquires the property, (3) for a period of 20 years, supply utility and other services to any occupant of the property on the same basis the Company is now agreeing with a third party to provide such services, (4) grant to Perma Pacific Properties certain easements with respect to rail and road access, and (5) enter into amendments of its lease with Perma Pacific Properties for the Fontana Structural Fabricating Shop, as described below. ASIC is a subsidiary of Southern California Edison Company, of which Howard P. Allen, a Director of the Company, is Chairman of the Board and Chief Executive Officer and William R. Gould, a Director of the Company, is a director and the former Chairman of the Board and Chief Executive Officer.

Put Option and Exchange Agreements

In January 1986, Perma Pacific Properties and ASIC entered into a Put Option Agreement Re Real Property (the "Put Option Agreement") with respect to the West End Option Property. Under the Put Option Agreement, ASIC granted to Perma Pacific Properties an option to sell such property to ASIC for approximately $12 million at any time up to January 20, 1987. In consideration for such put option, Perma Pacific Properties agreed (1) to pay ASIC approximately $86,000 per month that the option is outstanding, but in no event less than a total of $259,000, and (2) if the put option is exercised, the Company would transfer to ASIC 20 percent of the emission reduction credits arising from the discontinuance of the Company's Fontana steelworks, transfer a right of first refusal option to purchase certain property in the Fontana area and, if the lease between Perma Pacific Properties and the Company has been terminated at the time the put option is exercised, enter into new leases on the same terms as the terminated lease. Simultaneously with the execution of the Put Option Agreement, the Company executed a Cooperation By Kaiser Steel Corporation agreement pursuant to which the Company (1) agreed to perform the obligations under the Put Option Agreement insofar as they pertain to the Company, (2) agreed to perform all the obligations of Perma Pacific Properties under the Put Option Agreement in the event the Company acquires the property, (3) guaranteed the payments by Perma Pacific Properties of $86,000 per month to ASIC, and (4) agreed to supply, for a period of 20 years, utility and other services on the same basis the Company is now agreeing with a third party to provide such services. The Company and Kaiser Coal Corporation also entered into an agreement with ASIC which provides that if the put option is exercised, ASIC may exchange the West

End Option Property for a percentage interest in the Company's Colorado coal properties (except for the Somerset Mine) and Kaiser Coal Corporation's New Mexico coal properties equal to $15 million divided by the appraised fair market value of such property.

Property Lease Amendment

In January 1986, in connection with the Extension of Option Agreement and the Put Option Agreement, the Company entered into an Additional Property Lease Amendment with Perma Pacific Properties under which the Company agreed, for the express benefit of ASIC and the principal lender on the property, that (1) the lease of the Fontana Structural Fabricating Shop would not be amended without the consent of ASIC and without the consent of such lender and (2) if the Put Option is exercised, the owner may reduce the remaining term of the lease to expire on such date as it gives by notice to the Company, but not prior to one year from the date of such notice.

Cottonwood Property Loan

In February 1986, the Company borrowed $2.2 million from Northern Cimarron Resources Company (a subsidiary of Southern California Edison Company) to fund a portion of the $7.5 million purchase price paid for approximately 31,000 acres of property in Colorado (the "Cottonwood Property"). The loan from Northern Cimarron Resources Company bears interest at 3 percent above the prime commercial lending rate of Bank of America, N.T. & S.A. and principal and interest is due and payable on February 18, 1987. The loan is secured by a second lien on the Cottonwood Property and a first lien on the stock of the Company's subsidiary which purchased the property, Cottonwood Canyon Land Company. In connection with the loan from Northern Cimarron Resources Company and the put option under the Put Option Agreement, Northern Cimarron Resources Company acquired a one third undivided interest in the Cottonwood Property from the Cottonwood Canyon Land Company.

Management, Brokerage and Consulting Agreements

In 1984, the Company entered into a Management Agreement with Perma Mining Corporation, a member of the Perma Group ("Perma Mining"), for managing, marketing and engineering services with respect to the Company's coal properties in Utah and New Mexico and the management of the Company's mineral properties at Cushenbury and Eagle Mountain, California. Under this agreement, Perma Mining is paid a management fee equal to 5 percent of the gross sales of all coal and other minerals sold or shipped from the properties covered by the agreement. The Agreement may continue for as long as coal and other minerals are sold or shipped from the properties but may be terminated on April 1, 1989 under certain circumstances. In connection with Kaiser Coal Corporation obtaining the loan under the Chase Credit Agreement and as required by Chase, the Company transferred its York Canyon and Sunnyside coal properties to Kaiser Coal Corporation. Consequently, the Management Agreement was amended as of April 1985 to exclude from the agreement the York Canyon and Sunnyside coal properties and to include the management of the properties under new agreements, a Coal Brokerage Agreement and Coal Management Agreements, described below. The agreement was also amended to add the Colorado coal properties acquired by the Company in April 1985, to add all other coal properties acquired by the Company since August 15, 1984, and to provide for a minimum monthly payment of $10,000. The Chimney Rock mine was idled in June 1985 and none of the other additional properties have been operational since April 1985.

Concurrently with such amendments and in connection with obtaining the loan under the Chase Credit Agreement, Kaiser Coal Corporation entered into a Coal Brokerage Agreement with Perma Mining for the marketing of coal from all of Kaiser Coal Corporation's mineral properties in Utah and New Mexico, including the Sunnyside and York Canyon properties transferred to Kaiser Coal Corporation in April 1985. Under this agreement, Perma Mining is paid a brokerage fee equal to 3 percent of the gross sales price for all coal and other minerals sold or shipped from such property. The agreement is for a term of 15 years. Also effective as of April 1985, the principal operating subsidiaries of Kaiser Coal Corporation, Kaiser Coal Corporation of Sunnyside and Kaiser Coal Corporation of York Canyon, entered into Coal Management Agreements with Perma Mining. Under these agreements, Perma Mining is paid a fee of 2 percent of the gross sales of all coal sold from these properties. These agreements are also for a term of 15 years. Thus under these Coal Brokerage Agreement and Coal Management Agreements Perma Mining still receives a total fee of 5 percent of gross sales as it did under the prior management agreement before it was amended to remove the York Canyon and Sunnyside coal properties. Basically, the Management Agreement entered into in 1984, as amended, provides a fee to Perma Mining for properties that were non-operational as of April 1985 (except for the Chimney Rock coal mine which was idled in June 1985) and the Coal Brokerage and Coal Management Agreements provide a fee to Perma Mining for properties that are operational as of April 1985.

Perma Mining received fees under the foregoing management and brokerage agreements of $4,632,000 in 1985 and $2,700,000 in 1984. Under the terms and provisions of these management agreements, Perma Mining provides requisite management functions of marketing, operating, engineering, permitting, drafting, finance, legal, human resources, public relations, governmental relations, and overall business development. Perma Mining maintains a full time staff of geologists, mining engineers, lawyers, marketing professionals, certified public accountants and cartographers to provide these services.

In 1985, the Company entered into a Management Agreement, effective September 1, 1985, with Perma Resources Corporation, a member of the Perma Group, for the management of all of the Company's and its subsidiaries' oil and gas properties. As compensation, the Company agreed to pay Perma Resources Corporation a fee equal to 5 percent of the gross revenue received for the sale of all oil, gas and other petroleum products from such properties (but not more than $6 million nor less than $1.2 million per year, adjusted for inflation). This agreement is for a term of 20 years. There has been no production of oil and gas in 1985; however, Perma Resources Corporation received fees of $388,000 to cover expenses under this agreement.

In 1984, the Company entered into certain agreements for consulting, legal and office support services with organizations controlled by members of the Perma Group and members of the Frates Group. The agreements with organizations controlled by the Frates Group were terminated in April 1985. During 1985 and 1984, $320,000 and $293,000 was paid to organizations controlled by the Perma Group and $249,000 and $1,090,000 was paid to organizations controlled by the Frates Group for these services.

SPS Agreement

Prior to the Perma Group's and the Frates Group's acquisition of the Company's Common Stock in connection with a merger in 1984, the Perma Group and Southwestern Public Service Company, an interstate public utility ("SPS"), entered into agreements (the "SPS Agreement"). The SPS Agreement provided that SPS would enter into a long-term coal supply contract with either the Company or the Perma/Frates Joint Venture and would assist in the furtherance of the Company's coal operations. The agreements also provided for SPS to receive a one percent overriding royalty interest in coal and other minerals mined from the property containing Kaiser Coal Corporation's New Mexico coal reserves and the Company's Colorado coal reserves, an option to acquire a 10 percent interest in the New Mexico and Colorado coal properties for $10 million, and, under certain circumstances, an option to acquire an additional interest of up to 10 percent in the same properties for a price based on the value of the properties but no more than $25 million. The SPS Agreement and the proposed coal supply contract were assigned to the Company in the April 1985 exchange with the Perma/Frates Joint Venture described above. The proposed coal supply contract was for the supply of coal to SPS' planned electric power generating facility to be constructed in Texas. In 1985, SPS was denied approval by the Texas Public Utility Commission of a Notice of Intent (a necessary step to obtaining a Certificate of Convenience and

Necessity to proceed with construction of the plant) due to a perceived availability of purchased and cogenerated power. SPS then entered into negotiations with the Company to obtain lower coal prices under the proposed coal supply contract to assist SPS in reapplying for the Notice of Intent. Recently, however, SPS notified the Company that although it worked vigorously to enable a reversal of the denial of the Notice of Intent, it had determined that it would be unable to proceed with construction of the facility within the time frame contemplated by the agreements. Due to the denial of SPS' Notice of Intent for the facility, the Company is presently discussing with SPS changes in the agreements, including possible amendments with respect to SPS' interests in the New Mexico and Colorado coal properties and/or the possible substitution of new fuel supply agreements for other facilities. The parties have also extended certain performance dates under the agreements, including the extension of the last date for the exercise of the first purchase option to the end of August 1986.

SPS Research and Development Agreement

In 1985, the Company and Perma Resources Corporation entered into a Research and Development Agreement with SPS to study the feasibility of transporting coal in a pipeline slurry of coal and liquified carbon dioxide. The Research and Development Agreement, as amended, provides in general that the Company and Perma Resources Corporation, on the one hand, and SPS on the other, will each share 50 percent of the costs and profits and all parties will share equally in the right to use the technology. In 1985, the Company spent $2.2 million on this project on behalf of itself and Perma Resources Corporation. A research project slurry pipeline has now been constructed and is in the startup and testing phase at SPS' coal-fueled plant near Amarillo, Texas.

Transaction Incentive Program

In March 1984, the Company established a Transaction Incentive Program pursuant to which incentive compensation is paid to certain employees and to certain common stockholders who are involved in management of the Company. In general, total awards under the Transaction Incentive Program are equal to 3 percent of the total consideration involved in the sale of certain of the Company's properties, certain development and joint venture activities, and certain financings and refinancings initiated on or before March 31, 1986. Awards to stockholders or former stockholders who are participants are fully vested upon consummation of the transaction. Awards to employees who are not stockholders vest 25 percent upon consummation and 25 percent upon each anniversary of the transaction for the following 3 years. Employees and stockholders who participate in the Transaction Incentive Program are not eligible for any other form of bonus from the Company. Payments are made when cash proceeds are received. If the Company receives non-cash consideration, the Executive Committee of the Board of Directors must determine the cash equivalent of the consideration before the incentives may be paid. During 1985, the Company paid $8.1 million under the Transaction Incentive Program compared with $1.8 million during 1984. At December 31, 1985, amounts accrued and vested totaled $271,000, and unvested but accrued amounts which will be paid in future years totaled $1.8 million. The Transaction Incentive Program includes all transactions designated by the Company as eligible transactions and initiated on or before March 31, 1986.

Aircraft Purchase and Use Agreements

During 1984 and 1985, the Company and Southern California Edison jointly purchased three corporate aircraft and from time to time jointly leased other aircraft. The parties also entered into agreements for the sharing of the expenses of operating and maintaining these aircraft. The Company and Southern California Edison also jointly leased hangar space for the planes at Ontario International Airport and have entered into a time sharing agreement which allows the Company to use certain of Southern California Edison's aircraft.

NOTE F—Cash and Short-Term Investments

Cash and short-term investments as of December 31, 1985 and 1984 consists of the following:

	December 31	
	1985	1984
	(thousands of dollars)	
Demand deposits	$(2,260)	$ (943)
Certificates of deposit	11,511	553
U. S. government obligations	203	5,462
Bankers acceptances		23,238
Restricted cash	(5,106)	(25,000)
	$ 4,348	$ 3,310

The above investments are recorded at cost, which approximates market.

Restricted cash of $5.1 million at December 31, 1985 represents funds held as security for the performance of obligations under long-term letter of credit agreements. An additional $1.3 million of the funds held as security for the performance of obligations under letter of credit agreements at December 31, 1985 will become available for use in the business during 1986 and are included in the total for Cash and Short-Term Investments. Restricted cash of $25 million at December 31, 1984 represented cash collateral under the Citibank Credit Agreement.

NOTE G—Inventories

Inventories of continuing operations consist of the following:

	December 31	
	1985	1984
	(thousands of dollars)	
Finished products	$ 1,078	$ 1,813
Semi-finished products	5,786	4,069
Raw materials	8,138	5,562
Operating supplies (less valuation allowance of $1,590 and $1,666)	4,135	2,619
	$19,137	$14,063

At December 31, 1985, inventories, other than operating supplies, are valued by the LIFO method. During 1985, prices decreased in relation to those at December 31, 1984 while inventory quantities increased. The effect was to decrease the 1985 loss from continuing operations by $982,000.

At December 31, 1984, inventories, other than operating supplies, are valued by the LIFO method. During 1984, prices decreased in relation to those at December 31, 1983 as did inventory quantities. The effect was to decrease the 1984 loss from continuing operations by $207,000.

During 1983, certain inventory quantities were reduced, which resulted in a liquidation of applicable LIFO quantities carried at lower costs prevailing in prior years. The effect was to decrease the 1983 loss from discontinued operations by $112,238,000.

NOTE H—Leases

Leased capital assets included in property, plant and equipment are as follows:

	December 31 1985	December 31 1984
	(thousands of dollars)	
Buildings and improvements	$10,750	$10,750
Machinery and equipment	19,838	1,286
	30,588	12,036
Less accumulated amortization	2,614	884
	$27,974	$11,152

The principal leased assets are office space in the Kaiser Center in Oakland, California and an ocean-going launch barge. The office space is sublet to others. Sublease income was $3,387,000, $3,484,000 and $3,626,000 in 1985, 1984 and 1983, respectively. Other capital leases relate to mobile equipment used in mining and manufacturing operations.

In connection with the sale-leaseback of the ocean-going launch barge, the Company granted a second security interest in certain of the Company's Fontana, Napa and Vallejo real property and equipment and certain water company stock.

Future minimum lease payments for capitalized leases and rental payments for operating leases as of December 31, 1985 are as follows:

	Capital Leases	Operating Leases
	(thousands of dollars)	
1986	$ 4,465	$ 5,836
1987	4,422	7,091
1988	4,421	7,456
1989	4,236	7,192
1990	3,761	5,827
Later years	36,568	13,402
Total minimum lease payments	$57,873	$46,804
Less amount representing interest	28,003	
Present value of net minimum lease payments	$29,870	

Rents charged to continuing operations were $10,025,000, $12,256,000 and $5,415,000 in 1985, 1984 and 1983, respectively. Variable rentals did not represent a significant portion of rent expense in these periods.

There are no significant renewal or purchase options, escalation clauses, related guarantees or obligations assumed in connection with these leases. There are no restrictions on paying dividends, incurring additional debt or negotiating additional leases under the terms of the present lease agreements.

Kaiser Coal Corporation also leases certain coal properties which require advance minimum royalty payments of $1,410,000 each year through 2004. The advance minimum royalty payments are to be credited against production royalties of 4 percent of gross coal sales from the properties, once production begins. Until production begins, these advance minimum royalty payments are recorded as other assets.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE I—Property, Plant and Equipment and Coal Reserves

Property, plant and equipment and coal reserves consist of the following:

	December 31 1985	1984
	(thousands of dollars)	
Coal Reserves	$278,454	$214,027
Land	75,092	126,825
Buildings and improvements	38,779	32,704
Machinery and equipment	136,828	117,155
Construction in progress	1,488	8,377
	530,641	499,088
Less accumulated depreciation, amortization and depletion	(25,959)	(13,350)
Net property, plant and equipment and coal reserves	$504,682	$485,738

NOTE J—Long-Term Debt

Long-term debt consists of the following:

	December 31 1985	1984
	(thousands of dollars)	
Loan payable to bank	$ 57,000	$62,950
Capitalized lease obligations 6% - 14%	29,870	12,174
Other	30,627	4,302
	117,497	79,426
Less current portion	18,415	4,356
	$ 99,082	$75,070

In connection with the Merger, the Company obtained a term loan of $100 million from Citibank, N.A. pursuant to an Acquisition Credit Agreement, dated January 27, 1984 (the "Citibank Credit Agreement"). The Citibank Credit Agreement provided that the Company must maintain at least $25 million in cash or short-term investments. The $25 million is shown in the financial statements as of December 31, 1984 as Restricted Cash.

In April 1985, the Citibank Credit Agreement, was repaid from the proceeds of the following refinancings:

A) Ten-Year Term Loan — Kaiser Coal Corporation, a wholly-owned subsidiary of the Company, obtained a $60 million ten-year loan from The Chase Manhattan Bank (National Association) ("Chase") pursuant to a Credit Agreement, dated as of March 28, 1985 (the "Chase Credit Agreement"). The amount outstanding under this loan at December 31, 1985 was $57.0 million. The loan is payable over ten years in quarterly installments of $1.5 million; however, under certain conditions, based on coal shipments and defined cash flows, the quarterly payment may be reduced to $750,000. The difference between the actual payment and $1.5 million must be made up in subsequent quarters. The loan bears interest at 1.5 percent above the bank's prime commercial lending rate. The loan is collateralized by the common stock of Kaiser Coal Corporation and its operating subsidiaries, substantially all of Kaiser Coal Corporation's and its operating subsidiaries' property, plant and equipment and coal reserves and assignment of all coal sales contracts.

The loan agreement contains various financial and other covenants relating to Kaiser Coal Corporation, including covenants pertaining to working capital, capital expenditures and dividends and other distributions to its parent Kaiser Steel Corporation.

B) Five-Year Term Loan—The Company obtained a $50 million loan from a consortium of financial institutions led by The Philadelphia Saving Fund Society ("PSFS") pursuant to a Loan Agreement, dated as of April 1, 1985 (the "PSFS Loan Agreement"). The amount outstanding under this loan at December 31, 1985 was $4.1 million.

In February 1986, the Company borrowed an additional $10.9 million under the PSFS Loan Agreement, increasing the total amount outstanding to $15 million. The additional funds received in February 1986 were used to make a $6.1 million preferred stock dividend payment and for working capital needs. The Company is required to repay the amount outstanding under the PSFS Loan Agreement in two installments; the first installment of $10.9 million is due on April 18, 1986 and the second installment of approximately $4.1 million is due on June 30, 1986. The loan bears interest at 3 percent above the prime commercial lending rate of Chase. The loans under the PSFS Loan Agreement are secured by substantially all the assets of the Company other than the assets securing the Chase Credit Agreement, and certain Colorado coal properties and by a second security interest in the stock of Kaiser Coal Corporation. The PSFS Loan Agreement, as amended in February 1986, imposes restrictions on further indebtedness of the Company, investments in other persons, guaranties, capital expenditures, sales of assets, lease obligations, dividends, stock redemptions, and certain other matters. In addition, the Company must meet certain financial tests including a tangible net worth test. The PSFS Loan Agreement, as amended, further provides that 50 percent, and under certain circumstances 100 percent, of the proceeds of certain dispositions of assets, other than dispositions in the ordinary course of business, must be used to prepay the loans.

NOTE K—Preferred Stocks

The acquisition of the Company pursuant to the Merger involved the exchange of $22.00 in cash plus one share of Series A Preferred Stock and one share of Series B Preferred Stock of the Company for each share of Common Stock outstanding.

The Company has 7,478,256 authorized, issued and outstanding shares of both Series A and Series B Preferred Stock. Holders of the Series A and Series B Preferred Stock are entitled to receive cumulative cash dividends of $1.04 per share and $2.25 per share, respectively.

Beginning in 1990, the outstanding Series A Preferred Stock will be subject to annual mandatory redemption at $13.00 per share, plus any accrued and unpaid dividends, in an amount each year equal to 20 percent of the original issue of Series A Preferred Stock. The Company can make open market purchases of the Series A Preferred Stock to satisfy the redemption requirements beginning in 1990. The difference between the estimated fair value of the Series A Preferred Stock at the date of issue and the mandatory redemption value is being recorded through periodic accretions, using the interest method with the related charge to retained earnings.

Series B Preferred Stock is redeemable at $17.00 per share, plus any accrued and unpaid dividends. The Company is required to apply to a purchase fund for the redemption of the Series B Preferred Stock 25 percent of the cash proceeds in excess of $60 million received on dispositions of specified coal properties or steel manufacturing properties, individually, provided that if the cash proceeds from both sources combined exceed $100 million, then the Company is required to apply 25 percent of such excess over $100 million. The portion of the cash proceeds allocated to the purchase fund must be deposited into escrow within one year of receipt and any amounts deposited must be used for purchase or redemption beginning in 1989. Beginning in 1989, the Company can make open market purchases of the Series B Preferred Stock to satisfy the redemption requirements. As of December 31, 1985, $144.2 million of defined cash proceeds have been received, and proceeds of $21 million have been credited to the purchase fund. Deposits into the escrow fund of $21 million are required during the period from July 1986 through December 1986. As a result of these funding requirements, the $21 million of Series B Preferred Stock — Redeemable has been classified on the balance sheet as a current liability. Once the required deposits have been made, the $21 million will be reclassified on the balance sheet as a Redeemable Preferred Stock and the deposit will be shown as long-term restricted cash.

NOTE L—Income Taxes

The $40,623,000 tax provision in 1984 relates to the utilization of financial statement net operating losses that arose primarily from the provision of net reserves for discontinued operations in 1983 which could not be tax benefited under generally accepted accounting principles. The net reserves impacted the deficit in retained earnings which was capitalized as of December 31, 1983 and was also reflected in the purchase accounting for the Merger. The 1984 utilization of these financial statement net operating losses reduced the carrying value of the Excess of Purchase Price over Fair Value of Net Assets Acquired.

Income tax benefits for the year ended December 31, 1983 were $33,000,000 and resulted from the Company's decision to carry back its tax losses to prior years for refunds of taxes paid in those years. The 1983 tax loss consisted primarily of the write-off of a substantial portion of the remaining tax basis of the Fontana steel mill. The income tax benefits are presented in the Consolidated Statements of Operations as a deduction from loss on discontinuance.

The 1983 provision for loss on discontinuance includes estimated costs which will not be deducted in the Company's income tax returns until the specific costs are incurred. Some of these costs, such as those for pensions and medical benefits, will cover an extended period of time.

The Company has available approximately $30 million of investment tax credit carryforwards and $80 million of net operating losses which may be used to reduce future federal tax payments. These carryforwards expire in various years from 1993 through 2000.

The Internal Revenue Service has completed its field examination of the Company's consolidated federal income tax returns for all years through 1979 and is in the process of examining returns for 1980 and 1981. Various state income tax authorities have proposed certain adjustments, which are being contested by the Company. The recorded liabilities for income taxes are considered by management to be adequate to cover any deficiencies which may reasonably be expected to be sustained for all open years through 1984.

NOTE M—Pension Expenses and Liabilities

Pension expenses for continuing operations, including prior service costs, under the Company's pension plans amounted to $10,115,000, $9,459,000 and $6,079,000 for the years ended December 31, 1985, 1984 and 1983, respectively. Pension expenses included in earnings (loss) on discontinued operations amounted to $67,000, $555,000 and $629,000 for the years ended December 31, 1985, 1984 and 1983, respectively (Note C).

The Company also accrued $399,000 in 1985, $434,000 in 1984 and $646,000 in 1983 for contributions to the Savings and Profit Sharing Plan.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

A comparison of the actuarial present value of accumulated plan benefits and net assets available for benefits related to continuing and discontinued operations is as follows:

	As of January 1 1985	As of January 1 1984
	(thousands of dollars)	
Actuarial present value of accumulated plan benefits:		
Continuing operations—		
Vested	$ 25,923	$ 31,178
Nonvested	2,439	3,550
Discontinued operations—		
Vested	240,452	248,479
Nonvested	10	1,339
	$268,824	$284,546
Net assets available for benefits—		
Continuing operations	$ 7,561	$ 22,223
Discontinued operations	90,787	106,798
	$ 98,348	$129,021

In the table above, the assumed rate of return used in determining the actuarial present value of accumulated plan benefits was 9.5 percent for 1985 and 1984.

As part of discontinued operations in 1984 and 1983, the Company recorded as a liability the unfunded portion of the costs associated with the pension plans covering the employees of the discontinued operations.

In addition to providing pension benefits, the Company provides certain health care and life insurance benefits for retired employees. Substantially all of the Company's employees may become eligible for those benefits if they attain retirement eligibility while working for the Company. A $47 million provision for liabilities relating to retiree health care and life insurance benefits for continuing operations was recorded as part of the purchase accounting for the Merger. For 1985, those costs relating to continuing operations totaled $1,991,000 compared to $1,586,000 for 1984. The liability for retiree health care and life insurance benefits related to discontinued operations was included in the provision for discontinued operations (Note C).

NOTE N—Commitments and Contingencies

The Company has been named as a defendant in litigation arising from its normal operations and the discontinuance of its steelmaking and finishing operations. On the basis of presently available information, and the advice of counsel, management is of the opinion that any resulting liability and costs will not have a material effect on the Company's consolidated financial position.

During 1985, the Company received a settlement of $8.5 million, including interest of $3.85 million, arising from a lawsuit related to tax returns filed in the late 1960's and 1970's.

NOTE O—Subsequent Events

Idling of Facilities:

In March 1986, the Company decided to idle its steel fabrication facility located in Napa, California upon completion of the projects presently under contract. The Company anticipates incurring costs of approximately $2.4 million associated with the idling. This amount will be charged to operations in the first quarter of 1986.

Additional Financing:

On January 31, 1986, Kaiser Coal Corporation entered into a one year $6,000,000 working capital loan with Chase. The loan is collateralized by the accounts receivable arising from sales of coal. Draws, repayments and redraws must be made in multiples of $120,000 and interest accrues on the loan at prime plus 1.5 percent on any outstanding balance.

NOTE P—Industry Segment Information

The Company's continuing domestic operations include the production and sale of coal and fabricated steel products from western United States mines and plants and the operation of a bulk loading facility. The Coal Group produces steam and metallurgical grades of coal from mines in Utah, New Mexico and Colorado for sale to worldwide markets. The Fabricated Products Group includes steel fabricating as well as manufacturing of large diameter pipe and operation of a facility for the loading and unloading of bulk products.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Certain information concerning the Company's business segments is contained in the following tables:

	Year Ended December 31 1985	1984	1983
	(thousands of dollars)		
Net sales:			
Coal Group	$ 97,164	$ 72,373	$ 43,351
Fabricated Products Group	123,281	78,908	94,005
	$220,445	$151,281	$ 137,356
Operating profit (loss):			
Coal Group	$ 2,979	$ 5,013	$ (7,502)
Fabricated Products Group	(11,327)	(12,022)	(6,646)
Corporate	(17,334)	(14,343)	(11,954)
	(25,682)	(21,352)	(26,102)
Interest expense	(11,929)	(12,759)	(4,696)
Interest income	13,488	11,362	22,369
Loss from continuing operations	$(24,123)	$(22,749)	$ (8,429)
Capital expenditures:			
Coal Group	$ 13,702	$ 1,337	$ 2,134
Fabricated Products Group	14,851	9,608	2,161
Corporate	2,271	2,635	123
	$ 30,824	$ 13,580	$ 4,418
Depreciation, amortization and depletion expense:			
Coal Group	$ 7,528	$ 8,322	$ 5,637
Fabricated Products Group	4,338	3,854	2,575
Corporate	2,314	3,910	1,112
Total continuing operations	$ 14,180	$ 16,086	$ 9,324
Identifiable assets at end of period:			
Coal Group	$441,227	$346,531	$ 344,745
Fabricated Products Group	92,805	85,778	92,152
	534,032	432,309	436,897
Discontinued operations	25,519	74,767	304,644
Other corporate assets	151,008	287,662	315,860
Total identifiable assets at end of period	$710,559	$794,738	$1,057,401

Net sales for the Fabricated Products Group in 1983 included $48.2 million from an oil company. No other single customer accounted for more than 10 percent of consolidated net sales in 1985, 1984 or 1983.

Assets of discontinued operations are all the remaining assets from the Steel Manufacturing Group, Myers Drum Company, and Kaiser Steel Tubing, Inc. (Note C).

Other corporate assets are Cash and Short-term Investments, surplus property, and Excess of Purchase Price Over Fair Value of Net Assets Acquired and other assets related to administrative functions.

QUARTERLY FINANCIAL DATA (Unaudited)

Summarized quarterly financial data for 1985 and 1984 follows:

	Three Months Ended				
	March 31	June 30	Sept 30	Dec. 31	Year
	(thousands of dollars except per-share data)				
1985					
Net sales and operating profit	$ 36,530	$ 54,546	$ 54,929	$ 74,440	$ 220,445
Gross margin	$ 3,359	$ 8,984	$ 6,499	$ 426	$ 19,268
Earnings (loss) from continuing operations	$ (6,155)	$ 1,658	$ (8,743)	$ (10,883)	$ (24,123)
Earnings (loss) from discontinued operations	601	(484)	(3,858)	7,332	3,591
Cumulative effect on prior years of accounting changes	3,741				3,741
Net earnings (loss)	$ (1,813)	$ 1,174	$ (12,601)	$ (3,551)	$ (16,791)
Market price of Series A Preferred Stock (high/low)	7¾-6¼	8½-7½	8¾-7⅝	8½-7⅝	8¾-6¼
Market price of Series B Preferred Stock (high/low)	13⅛-11⅛	14½-13¼	15½-14¼	15⅛-12¾	15½-11⅛
1984					
Net sales and operating profit	$ 27,177	$ 41,928	$ 40,306	$ 41,870	$ 151,281
Gross margin	$ 3,020	$ 349	$ 2,526	$ 3,150	$ 9,045
Earnings (loss) from continuing operations	$ 553	$ (11,027)	$ (7,261)	$ (5,014)	$ (22,749)
Earnings (loss) from discontinued operations	(202)	13,482	8,608	48,549	70,437
Net earnings	$ 351	$ 2,455	$ 1,347	$ 43,535	$ 47,688
Market price of Series A Preferred Stock (high/low)	7⅞-6⅝	7½-6	7⅞-6⅜	7-5¾	7⅞-5¾
Market price of Series B Preferred Stock (high/low)	13⅝-12⅝	13⅝-11¾	13-12	12⅝-11⅛	13⅝-11⅛

SUPPLEMENTARY INFORMATION ON THE EFFECTS OF CHANGING PRICES
(Unaudited)

Inflation adjusted information is presented in the accompanying tables to portray the impact of inflation on financial results. The data presented in the historical cost statements are adjusted using the current cost method. The values are based on price changes which are specific to the industry and reflect the estimated current cost of the Company's existing assets. Although the information presented in the tables may be helpful in illustrating the magnitude of inflation's impact on financial results, care must be exercised when analyzing the data, and when comparing the results to that of other companies as many estimates and assumptions are required to prepare this information.

	Year Ended December 31, 1985	
	As Reported in Financial Statements (Historical Cost)	Adjusted for Changes in Specific Prices (Current Costs)
	(thousands of dollars except per share data)	
Net Sales	$220,445	$220,445
Operating costs and expenses:		
Cost of products sold, excluding depreciation, amortization and depletion	189,311	191,129
Selling and administrative expenses	48,068	48,068
Depreciation, amortization and depletion	14,180	15,979
Interest expense	16,503	16,503
Interest and other income	(23,494)	(23,494)
Loss from continuing operations	$(24,123)	$(27,740)
Gain from decline in purchasing power of net amounts owed		$ 4,700
Increase in current cost of inventory and property, plant and equipment held during the year (based on specific price changes)*		$ 23,844
Less effect of increase in general price level (based on Consumer Price Index)		19,486
Increase in current costs, net of inflation		$ 4,358

* At December 31, 1985 current cost of inventory was $18,784 and current cost of property, plant and equipment, net of accumulated depreciation, amortization and depletion, was $520,691.

The above statement of operations illustrates the impact of inflation under current cost accounting methods which measures the effects of specific price changes. Property, plant and equipment was valued using Marshall and Swift Valuation Services indexes. Mineral resources were valued at the estimated current cost to replace the mineral reserves.

The Company's inventories are principally accounted for by the LIFO method, which generally recognizes current costs in the cost of products sold.

The "Gain from decline in purchasing power of net amounts owed" reflects the fact that the Company's excess of monetary liabilities (e.g., accounts payable and long-term debt) over monetary assets (e.g., cash and receivables) can be repaid with cheaper dollars due to the reduced purchasing power of the dollar. This is a theoretical gain which does not result in increased cash.

Two-Year Summary of Selected Supplementary Financial Data Adjusted for Effects of Changing Prices

(All amounts, except those designated as historical cost, are measured on a current cost basis in average 1985 dollars.)

	1985	1984
	(thousands of dollars except per share data)	
Revenues	$220,445	$156,679
Loss from continuing operations	$(27,740)	$(25,698)
Cash dividends per common share:		
At historical cost	$ —	$ —
In average 1985 dollars	$ —	$ —
Unrealized purchasing power gain	$ 4,700	$ 3,379
Net assets	$138,624	$204,834
Increase (decrease) in current cost, net of inflation	$ 4,358	$ (4,802)
Average Consumer Price Index (1967 = 100)	322.2	311.1

Information on the effects of changing prices for the year ending December 31, 1983 has not been presented because the Company does not believe that it would be informative when related to the balance sheet, as of December 31, 1983, which reflects the fair valuing of assets and liabilities in connection with the Merger and the fact that present operations of the Company are significantly different as a result of the discontinuance of steelmaking and finishing operations and the effects of the purchase accounting described in Note B.

Mineral Resources

The table below presents information regarding the Company's coal reserves. All of the coal reserves can be sold as steam coal and essentially all the reserves can be upgraded by washing for sale in the metallurgical coal market. The Company's coal reserves were increased by 257.1 million tons in April 1985 through an exchange of properties between the Perma Group and the Company (Note E). In December 1985, the Company acquired a coal mine complex with proven reserves and probable reserves of 60 million tons.

	Year Ended December 31	
	1985	1984
	(tons in millions)(1)	
Proven and probable coal reserves at end of year (2)	1298.5	985.0
Coal produced	3.6	2.4
Average market price per ton of coal (3)	$ 29.73	$33.45

1. All information is presented in recoverable net tons.
2. Proven reserves and probable reserves are estimates of recoverable reserves that are indicated to exist on the basis of geological and engineering data.
3. The average market price of coal is based on a weighted average of coal shipped to outside customers and is F.O.B. mine.

The Company is no longer mining iron ore, but has reserves of approximately 55 million tons, for which no market presently exists.

Item 9. DISAGREEMENTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

PART III

Item 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

The following table shows the directors and executive officers of the Company and their principal occupations as of March 27, 1986:

	Directors
Monty H. Rial	Chairman of the Board, President and Chief Executive Officer of the Company
Howard P. Allen	Chairman of the Board and Chief Executive Officer, Southern California Edison Company (a public utility)
Richard N. Gary	Attorney and partner of Thelen, Marrin, Johnson and Bridges (a law firm)
Stephen A. Girard	Retired Chairman of the Company
William R. Gould	Retired Chairman Emeritus, Southern California Edison Company (a public utility)
Lloyd G. Hansen	Vice Chairman of the Company
Charles S. McNeil	Vice Chairman and President, Coal Group of the Company
Dr. Eustace H. Winn, Jr	Business Developer, Investor and Practicing General Surgeon
	Executive Officers
Monty H. Rial	Chairman of the Board, President and Chief Executive Officer of the Company
Charles S. McNeil	Vice Chairman and President, Coal Group of the Company
Kevin J. Reidy	President, Fabricated Products Group of the Company
Lloyd G. Hansen	Vice Chairman of the Company
Claude A. Bradford	Vice President and Treasurer of the Company
Kenneth L. Gibson	Senior Vice President of the Company
Arthur W. Mullin	Vice President, Finance and Chief Financial Officer of the Company
M. Edward Stewart	Senior Vice President of the Company
Miles G. Yeagley	Senior Vice President of the Company

Additional information regarding directors and executive officers of the Company required for Item 10 is incorporated by reference to the section of the Company's Proxy Statement for its 1986 Annual Meeting of Stockholders entitled "Election of Directors," "Common Stock Directors" and "Executive Officers." Except for such sections and any other sections of such Proxy Statement specifically incorporated by reference elsewhere herein, no part of such Proxy Statement is to be deemed filed as part of this Annual Report on Form 10-K.

Item 11. EXECUTIVE COMPENSATION

Information regarding executive compensation required for Item 11 is incorporated by reference to the section of the Company's Proxy Statement for its 1986 Annual Meeting of Stockholders entitled "Compensation of Directors and Executive Officers." Except for such section and any other section of such Proxy Statement specifically incorporated by reference elsewhere herein, no part of such Proxy Statement is to be deemed filed as part of this Annual Report on Form 10-K.

Item 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

Information regarding security ownership of certain beneficial owners and management required for Item 12 is incorporated by reference to the section of the Company's Proxy Statement for its 1986 Annual Meeting of Stockholders entitled "Security Ownership of Certain Beneficial Owners and Management." Except for such section and any other section of such Proxy Statement specifically incorporated by reference elsewhere herein, no part of such Proxy Statement is to be deemed filed as part of this Annual Report on Form 10-K.

Item 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Information regarding certain relationships and related party transactions required for Item 13 is incorporated by reference to the section of the Company's Proxy Statement for its 1986 Annual Meeting of Stockholders entitled "Certain Relationships and Related Transactions." Except for such section and any other section of such Proxy Statement specifically incorporated by reference elsewhere herein, no part of such Proxy Statement is to be deemed filed as part of this Annual Report on Form 10-K.

PART IV

Item 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

(a) List of Documents Filed as Part of This Report:

	Page of This Report
(1) Financial Statements	
Consolidated Financial Statements:	
Independent Accountants' Report	25
Consolidated Statements of Operations—Years Ended December 31, 1985, 1984 and 1983	26
Consolidated Balance Sheets—December 31, 1985, and 1984	27
Consolidated Statements of Redeemable Preferred Stock and Stockholders' Equity—Years Ending December 31, 1985, 1984 and 1983	28
Consolidated Statements of Changes in Financial Position—Years Ended December 31, 1985, 1984 and 1983	29
Notes to Consolidated Financial Statements	30
(2) Financial Statement Schedules	
Independent Accountants' Report	55
Schedule V —Property, plant and equipment and coal reserves—Years ended December 31, 1985, 1984 and 1983	56
Schedule VI —Accumulated depreciation, depletion, and amortization of property, plant and equipment and coal reserves—Years ended December 31, 1985, 1984 and 1983	57
Schedule VIII—Valuation and qualifying accounts—Years ended December 31, 1985, 1984 and 1983	58
Schedule X —Supplementary income statement information—Years ended December 31, 1985 and 1984	59

Schedules I, II, III, IV, VII, IX, XI, XII, XIII and XIV have been omitted because they are not required or not applicable or the required information is presented in the financial statements.

Separate financial statements of Kaiser Steel Corporation without its consolidated subsidiaries have not been filed since Kaiser Steel Corporation is primarily an operating company and all consolidated subsidiaries of Kaiser Steel Corporation are majority owned and, considered in the aggregate, in 1985 did not have long-term debt outstanding in an amount which is material in relationship to total consolidated assets.

(3) Exhibits

Exhibit Number	Exhibit
(3)(a)	Certificate of Incorporation of Kaiser Steel Corporation (composite copy)*
(3)(b)	Restated Bylaws of Kaiser Steel Corporation*****
(10)(a)	Kaiser Steel Corporation 1983 Incentive Performance Plan*
(10)(b)	Kaiser Steel Corporation Bonus Plan**
(10)(c)	Stock Appreciation Plan for Officers and Employees of Kaiser Steel Corporation****
(10)(d)	Liability Insurance Policy****
(10)(e)	Form of amendment to agreement with stock option holders under 1982 Stock Incentive Plan and Stock Appreciation Plan****
(10)(f)	Form of Acquisition Credit Agreement, dated as of January 27, 1984, between Kaiser Steel Corporation and Citibank, N. A.****
(10)(g)	Agreement, dated as of November 12, 1983, by and among Equivest Associates et.al., ("Acquisition Group") and Chimney Rock Coal, et al. ("Perma Group")****
(10)(h)	Agreement, dated as of November 12, 1983, by and among Southwestern Public Service Company, Perma Resources Corporation, and Colorado Coal Resources Company****
(10)(i)	Consent Agreement, dated as of November 12, 1983, by and among Southwestern Public Utilities Corporation, Perma Resources Corporation, Colorado Coal Resources Company, and Frates Group****
(10)(j)	Option Agreement, dated February 28, 1984, by and among the Frates Group and the Perma Group*
(10)(k)	Agreement, dated February 28, 1984, by and among the Frates Group and the Perma Group*
(10)(l)	Agreement, dated February 29, 1984, by and among the Frates Group and the Perma Group*
(10)(m)	Transaction Incentive Program*****
(10)(n)	Letter agreement for consulting services terminating Employment Agreement with Stephen A. Girard, dated May 31, 1984*****
(10)(o)	Letter agreement for consulting services terminating Employment Agreement with Richard N. Gary, dated March 30, 1984*****
(10)(p)	Four letter amendments to Employment Agreement with Charles H. Black, dated August 13, 1984, December 28, 1984, January 28, 1985 and March 15, 1985*****
(10)(q)	Restated Joint Venture and Option Agreement and letter agreement, dated August 15, 1984, by and among the Frates Group and the Perma Group*****
(10)(r)	Amendment to Joint Venture and Option Agreement, dated December 28, 1984, by and among the Frates Group and the Perma Group*****
(10)(s)	Management Agreement, dated August 15, 1984, between Kaiser Steel Corporation and Perma Mining Corporation*****
(10)(t)	Exchange Agreement, dated April 1, 1985, by and between Kaiser Steel Corporation and a joint venture comprised of the Frates Group and the Perma Group*****
(10)(u)	Agreement of Purchase and Sale, dated as of July 13, 1984, among Kaiser Steel Corporation, California Steel Industries, Inc., Kawasaki Steel Corporation, Rio Doce Ltd. and Michael Wilkinson*****
(10)(v)	Credit Agreement, dated as of March 28, 1985, between Kaiser Coal Corporation and The Chase Manhattan Bank (National Association)*****
(10)(w)	Loan Agreement, dated as of April 1, 1985, among Kaiser Steel Corporation, The Philadelphia Saving Fund Society, California Federal Savings and Loan Association, Far West Federal Bank and Union Bank****

(10)(x)	Acquisition Agreement, dated as of December 1, 1984, among Kaiser Steel Corporation and John Cutt, Thomas Holmes, Roger Stavig and Bruce Wood*****
(10)(y)	Amendment Agreement, dated February 10, 1986, to Loan Agreement dated as of April 1, 1985 among Kaiser Steel Corporation, The Philadelphia Saving Fund Society, California Federal Savings and Loan Association, Far West Federal Bank and Union Bank
(10)(z)	Junior Pledge Agreement, dated as of February 10, 1986, between Kaiser Steel Corporation and The Philadelphia Saving Fund Society as agent for itself and California Federal Savings and Loan Association, Far West Federal Bank, and Union Bank
(10)(aa)	Extension of Option Agreement, dated as of January 17, 1986, by and between Perma Pacific Properties and Kaiser Steel Corporation
(10)(bb)	Put Option Agreement Re Real Property, dated January 17, 1986, by and between Associated Southern Investment Company and Perma Pacific Properties
(10)(cc)	Letter agreement between The Chase Manhattan Bank (National Association) and Kaiser Coal Corporation, dated January 15, 1986
(10)(dd)	Structural Shop Lease, dated as of April 3, 1985, by and between Perma Pacific Properties and Kaiser Steel Corporation
(10)(ee)	Additional Property Lease, dated as of April 3, 1985, by and between Perma Pacific Properties and Kaiser Steel Corporation
(10)(ff)	Structural Steel Shop Lease Amendment, dated as of January 17, 1986, by and between Perma Pacific Properties and Kaiser Steel Corporation
(10)(gg)	Additional Property Lease Amendment, dated as of January 17, 1986, by and between Perma Pacific Properties and Kaiser Steel Corporation
(10)(hh)	Amended Research and Development Agreement, dated October 1, 1985, by and among Southwestern Public Service Company, Perma Resources Corporation and Kaiser Steel Corporation
(10)(ii)	Management Agreement, dated December 15, 1985, by and between Kaiser Steel Corporation and Perma Resources Corporation
(10)(jj)	Coal Brokerage Agreement, dated as of March 28, 1985, by and between Kaiser Coal Corporation and Perma Mining Corporation
(10)(kk)	Management Services Agreement, dated March 28, 1985, by and between Kaiser Coal Corporation of Sunnyside and Perma Mining Corporation
(10)(ll)	Management Services Agreement, dated March 28, 1985, by and between Kaiser Coal Corporation of York Canyon and Perma Mining Corporation
(10)(mm)	Amendment to Management Agreement, dated February 13, 1986, by and between Kaiser Steel Corporation and Perma Mining Corporation
(10)(nn)	Extension Agreement, dated February 20, 1986, by and among Southwestern Public Service Company, Perma Resources Corporation, Colorado Coal Resources Company and Kaiser Steel Corporation
(10)(oo)	Letter agreement regarding performance of consulting services by Winria Asset Management Group for Kaiser Steel Corporation, dated July 18, 1984
(10)(pp)	Conveyance of Non-Participating Royalty, dated as of July 11, 1983, by and between Colorado Coal Resources Company and Dr. Eustace H. Winn, Jr.
(10)(qq)	Aircraft Acquisition and Use Agreement, dated as of September 10, 1984, by and between Kaiser Steel Corporation and Southern California Edison and Amendments No. 1, No. 2 and No. 3
(10)(rr)	Aircraft Time Sharing Agreement dated as of February 1, 1985, by and between Southern California Edison and Kaiser Steel Corporation
(10)(ss)	Vessel Purchase Agreement, dated as of June 10, 1985, between Andrea Corporation, GATX Leasing Corporation and Kaiser Steel Corporation
(10)(tt)	Bareboat Charter, dated as of June 10, 1985, between Andrea Corporation and GATX Leasing Corporation

(10)(uu) Bareboat Subcharter, dated as of June 10, 1985, between GATX Leasing Corporation and Kaiser Steel Corporation

(18) Letter regarding change in accounting principles******

(22) List of Subsidiaries

* The following exhibits are incorporated by reference to the respective exhibits listed below from the Company's Annual Report on Form 10-K for the year ended December 31, 1983: (3)(a) to (3)(a); (10)(a) to (10)(a); (10)(j) to (10)(ee); (10)(k) to (10)(ff); and (10)(l) to (10)(gg).

** The following exhibits are incorporated by reference to the respective exhibits listed below from the Company's Annual Report on Form 10-K for the year ended December 31, 1980: (10)(b) to (10)(i).

*** The following exhibits are incorporated by reference to the respective exhibits listed below from the Company's Annual Report on Form 10-K for the year ended December 31, 1982: (10)(c) to (10)(iv).

**** The following exhibits are incorporated by reference to the respective exhibits described below from the Registration Statement on Form S-14 filed by Kaiser Steel Corporation (formerly known as Kaiser Steel (Delaware), Inc.) and Kaiser Steel Corporation, a Nevada corporation, with respect to the registration of the Series A Preferred Stock, $1 par value, and Series B Preferred Stock, $1 par value, of Kaiser Steel Corporation (Registration No. 2-86783): (10)(d) to (10)(l); (10)(e) to (10)(p); (10)(f) to (10)(q); (10)(g) to (10)(u); (10)(h) to (10)(v); and (10)(i) to (10)(w).

***** The following exhibits are incorporated by reference to the respective exhibits listed below from the Company's Annual Report on Form 10-K for the year ended December 31, 1984: 3(b) to 3(b); 10(m) to 10(q); 10(n) to 10(r); 10(o) to 10(s); 10(p) to 10(t); 10(q) to 10(u); 10(r) to 10(v); 10(s) to 10(w); 10(t) to 10(x); 10(u) to 10(y); 10(v) to 10(z); 10(w) to 10(aa); 10(x) to 10(bb).

****** The following exhibit is incorporated by reference to the respective exhibit listed below from the Company's Quarterly Report on Form 10-Q for the quarter ending March 31, 1985: (18) to (18).

The Company will furnish to stockholders a copy of any exhibit listed above, but not contained herein, upon written request to the Treasurer, Kaiser Steel Corporation, P. O. Box 5050, Fontana, California 92335, and payment to the Company of 25¢ per page.

(b) Reports on Form 8-K

No reports on Form 8-K were filed by the Company during the fourth quarter of 1985.

INDEPENDENT ACCOUNTANTS' REPORT
To the Board of Directors and Stockholders
Kaiser Steel Corporation
Fontana, California

In connection with our examination of the consolidated financial statements of Kaiser Steel Corporation and subsidiaries as of December 31, 1985, 1984 and 1983 and for the years then ended, we also examined the supporting schedules listed in the accompanying index. In our opinion, subject to the possible effects of such adjustments, if any, as might have been required had the outcome of the uncertainties related to the Company's continuance as a going concern been known, the schedules present fairly, when read in conjunction with the related consolidated financial statements, the financial data required to be set forth therein.

TOUCHE ROSS & CO.

Certified Public Accountants

Los Angeles, California
March 27, 1986

KAISER STEEL CORPORATION AND SUBSIDIARIES
PROPERTY, PLANT AND EQUIPMENT AND COAL RESERVES
Years Ended December 31, 1985, 1984 and 1983
(Thousands of Dollars)

Classification	Balance at Beginning of Period	Additions (Transfers) at Cost	Retirements	Other Changes Add (Deduct) (A)	(B)	(C)	Balance at End of Period
Year Ended December 31, 1985							
Continuing operations:							
Coal reserves	$214,027	$ 1,045	$ —	$ 63,382	$ —	$ —	$278,454
Land	126,825	500	8,196	(44,037)			75,092
Buildings and improvements	32,704	11,834	4,801	(958)			38,779
Machinery and equipment	117,155	24,710	5,020	(100)		83	136,828
Construction in progress	8,377	(7,265)		376			1,488
	499,088	30,824	18,017	18,663		83	530,641
Discontinued operations:							
Land	6,255		6,255				
Buildings and improvements	10,057	51	4,063	(368)			5,677
Machinery and equipment	24,596		6,835	(1,910)		(83)	15,768
Construction in progress	668		668				
	41,576	51	17,821	(2,278)		(83)	21,445
	$540,664	$30,875	$ 35,838	$ 16,385	$ —	$ —	$552,086
Year Ended December 31, 1984							
Continuing operations:							
Coal reserves	$214,027	$ —	$ —	$ —	$ —	$ —	$214,027
Land	135,804	1,160	10,140				126,824
Buildings and improvements	36,229	393	667			(3,251)	32,704
Machinery and equipment	110,441	5,102	1,971			3,583	117,155
Construction in progress	1,453	6,925					8,378
	497,954	13,580	12,778			332	499,088
Discontinued operations:							
Land	6,255						6,255
Buildings and improvements	25,753	108	15,724			(80)	10,057
Machinery and equipment	111,843	509	87,687			(69)	24,596
Construction in progress	293	668				(293)	668
	144,144	1,285	103,411			(442)	41,576
	$642,098	$14,865	$116,189	$ —	$ —	$ (110)	$540,664
Year Ended December 31, 1983 (Restated)							
Continuing operations:							
Coal reserves	$ —	$ —	$ —	$ —	$ 214,027	$ —	$214,027
Land	12,666	1,603			122,649	(1,114)	135,804
Buildings and improvements	56,619	4,619	344		(21,773)	(2,892)	36,229
Machinery and equipment	148,159	7,652	11,004		(22,225)	(12,141)	110,441
Construction in progress	10,968	(9,456)				(59)	1,453
	228,412	4,418	11,348		292,678	(16,206)	497,954
Discontinued operations:							
Land	4,811				2,425	(981)	6,255
Buildings and improvements	130,470	839	24		(89,940)	(15,592)	25,753
Machinery and equipment	371,366	4,611	159		(306,635)	42,660	111,843
Construction in progress	12,279	(2,105)				(9,881)	293
	518,926	3,345	183		(394,150)	16,206	144,144
	$747,338	$ 7,763	$ 11,531	$ —	$(101,472)	$ —	$642,098

(A) Effects of an exchange of assets between the Perma/Frates Joint Venture and the Company (See Note E to the Consolidated Financial Statements) and the contribution of the Cushenbury Limestone Properties with a book value of $15.2 million to a trust for the benefit of retired steelworkers (See Note C to the Consolidated Financial Statements).

(B) Write-up (write-down) of coal reserves, land, and machinery and equipment of continuing operations and reclassification of accumulated depreciation to offset cost and reflect fair value of property, plant and equipment based on independent appraisals. (See Note B to Consolidated Financial Statements).

(C) Reclassification of property, plant and equipment from continuing operations to discontinued operations.

Schedule VI

KAISER STEEL CORPORATION AND SUBSIDIARIES
ACCUMULATED DEPRECIATION, DEPLETION AND AMORTIZATION OF PROPERTY, PLANT AND EQUIPMENT AND COAL RESERVES
Years Ended December 31, 1985, 1984 and 1983
(Thousands of Dollars)

Classification	Balance at Beginning of Period	Additions Charged to Costs and Expenses	Retirements	Other (A)	Other (B)	Balance at End of Period
Year Ended December 31, 1985						
Continuing operations:						
Coal reserves	$ 876	$ 1,595	$ —	$ —	$ —	$ 2,471
Land						
Buildings and improvements	2,279	2,032	410	(96)		3,805
Machinery and equipment	10,195	9,791	121	(182)		19,683
	13,350	13,418	531	(278)		25,959
Discontinued operations:						
Land						
Buildings and improvements						
Machinery and equipment		21				21
		21				21
	$ 13,350	$13,439	$ 531	$ (278)	$ —	$25,980
Year Ended December 31, 1984						
Continuing operations:						
Coal reserves	$ —	$ 876	$ —	$ —	$ —	$ 876
Land						
Buildings and improvements		2,318	39			2,279
Machinery and equipment		10,426	231			10,195
		13,620	270			13,350
Discontinued operations:						
Land						
Buildings and improvements						
Machinery and equipment						
	$ —	$13,620	$ 270	$ —	$ —	$13,350
Year Ended December 31, 1983 (Restated)						
Continuing operations:						
Coal reserves	$ —	$ —	$ —	$ —	$ —	$ —
Land	1,479	31			(1,510)	
Buildings and improvements	24,030	1,222	243		(25,009)	
Machinery and equipment	72,243	10,823	8,365		(74,701)	
	97,752	12,076	8,608		(101,220)	
Discontinued operations:						
Land	2,699	17			(2,716)	
Buildings and improvements	83,694	5,784		462	(89,940)	
Machinery and equipment	271,146	17,393		18,096	(306,635)	
	357,539	23,194		18,558	(399,291)	
	$455,291	$35,270	$8,608	$18,558	$(500,511)	$ —

(A) For 1985, effects of an exchange of assets between the Perma/Frates Joint Venture and the Company (See Note E to the Consolidated Financial Statements) and the contribution of the Cushenbury Limestone Properties with a book value of $15.2 million to a trust for the benefit of retired steelworkers (See Note C to the Consolidated Financial Statements). For 1983, write-down of buildings and improvements and machinery and equipment of discontinued operations to fair value based on independent appraisals (See Note B to the Consolidated Financial Statements).

(B) Reclassification of accumulated depreciation to offset cost and reflect fair value of property, plant and equipment based on independent appraisals. (See Note B to Consolidated Financial Statements).

Schedule VIII

KAISER STEEL CORPORATION AND SUBSIDIARIES

VALUATION AND QUALIFYING ACCOUNTS
Years Ended December 31, 1985, 1984 and 1983

(Thousands of Dollars)

Description	Balance at Beginning of Period	Additions: Charged to Costs and Expenses	Additions: Charged to Other Accounts	Deductions(A)	Balance at End of Period
Year Ended December 31, 1985	$ 917	$ 88	$ —	$ 499	$ 506
Year Ended December 31, 1984	$9,107	$ 60	$ —	$ 8,250	$ 917
Year Ended December 31, 1983	$5,391	$2,388	$ —	$(1,328)	$9,107

(A) Represents uncollectible accounts charged off during the year, less recoveries on accounts previously charged off.

Schedule X

KAISER STEEL CORPORATION AND SUBSIDIARIES
SUPPLEMENTARY INCOME STATEMENT INFORMATION
Years Ended December 31, 1985, 1984 and 1983
(Thousands of Dollars)

	1985	1984	1983
Continuing Operations:			
Taxes, other than payroll and income taxes	$ 2,776	$1,225	$1,453
Maintenance and repairs	$11,813	$8,729	$9,005
Royalties	$ 7,605	$4,463	$2,016

Categories not disclosed are less than 1% of sales.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: March 30, 1986

KAISER STEEL CORPORATION

By: /s/ MONTY H. RIAL
Name: Monty H. Rial
Title: Chairman

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

Signature	Title	Date
1. Principal Executive Officer		
/s/ MONTY H. RIAL **Monty H. Rial**	Chairman and Director	March 30, 1986
2. Principal Financial and Accounting Officer		
/s/ ARTHUR W. MULLIN **Arthur W. Mullin**	Vice President, Finance and Chief Financial Officer	March 30, 1986
3. Directors		
/s/ DR. EUSTACE H. WINN, JR. **Dr. Eustace H. Winn, Jr.**	Director	March 30, 1986
/s/ CHARLES S. McNEIL **Charles S. McNeil**	Director	March 30, 1986
/s/ WILLIAM R. GOULD **William R. Gould**	Director	March 30, 1986
/s/ LLOYD G. HANSEN **Lloyd G. Hansen**	Director	March 30, 1986
/s/ HOWARD P. ALLEN **Howard P. Allen**	Director	March 30, 1986
/s/ STEPHEN A. GIRARD **Stephen A. Girard**	Director	March 30, 1986
/s/ RICHARD N. GARY **Richard N. Gary**	Director	March 30, 1986

Kaiser Steel Settles Fight Over Control Of Board by Naming Hendry Chairman

By MICHAEL TOTTY
Staff Reporter of THE WALL STREET JOURNAL

COLORADO SPRINGS, Colo.—Kaiser Steel Corp. said it settled a dispute over control of its board by agreeing to name dissident Minneapolis shareholder Bruce Hendry chairman and chief executive officer.

The settlement, which took effect immediately, headed off a hearing yesterday in Delaware Chancery Court to decide the outcome of a shareholders' vote at the company's Nov. 25 annual meeting. Mr. Hendry's slate of candidates for the board won the election, according to a court-appointed inspector. The outcome was disputed by Kaiser management, whose slate of candidates for the board lost the vote. Mr. Hendry had intended to ask the court to uphold the vote.

Under the terms of the settlement, Mr. Hendry's slate of candidates won't have a majority of the reconstituted nine-member board of the coal and steel producer.

Instead, three members of Mr. Hendry's slate and three company candidates will represent Kaiser's preferred shareholders. In addition, three directors, including outgoing chairman Monty H. Rial, will remain on the board representing the company's common stockholders. Mr. Rial and other Kaiser officers control all of Kaiser's common stock. As reported earlier, Mr. Rial agreed to step down as chairman and chief executive officer.

Mr. Hendry couldn't be reached for comment.

Mr. Rial said the settlement should allow the company and its shareholders to proceed with restructuring the company's finances. Battered by falling coal prices, the company posted a loss of $22.8 million on sales of $101.4 million for the first half of 1986.

"We've got to get back to solving the company's problems and return it to viability," said Mr. Rial. "I'd like to see all the energy that went into both slates go into restoring the company."

Kaiser's preferred stock, which was issued in Mr. Rial's buyout of Kaiser in 1984, gave holders the right to elect a majority of the board if the company failed to pay two quarterly dividends and make payments toward retiring the preferred stock. The company defaulted on the payments in July.

In addition to Mr. Hendry, who is also president and chief executive of Erie Lackawanna Inc., the new board members from Mr. Hendry's slate are William Dimeling, Philadelphia, a director of Erie Lackawanna; and Lawrence Perlman, Minneapolis, president of Control Data Corp.'s data-storage products group.

The preferred director's from the Kaiser slate are Stonie Barker Jr., Lexington, Ky., former chairman and chief executive of Occidental Petroleum Corp.'s Island Creek Coal Co. unit; John C. Davis, Colorado Springs, a director of two Prudential-Bache Securities Inc. mutual funds; and James L. Marvin, Franktown Colo., a mining consultant and a former senior vice president of Atlantic Richfield Co.

The common stock directors are Mr. Rial, who is majority shareholder in Perma Resources, which owns all of Kaiser's common stock; Stephen A. Girard, Oakville, Calif., former chairman and chief executive of Kaiser; and Eustace A. Winn, Greenville Miss., a large stockholder in Perma.

Diamond Crystal Salt Co. Stake Increased to 27.64%

ST. CLAIR, Mich.—A Hong Kong investment firm increased its stake in Diamond Crystal Salt Co. to 27.64% and said it received government clearance to acquire as much as 50%.

A spokesman for Industrial Equity (Pacific) Ltd. said the firm had "no intentions at this point in time" to buy more stock, but sought permission to increase its holding to 50% in case it later decided to do so.

Frank Hayes, Diamond Crystal's vice president for finance, said the Moore family—which founded the company in 1886—and related interests held more than 50% of Diamond Crystal, and "I don't see any way (Industrial Equity) can take control." Before its latest purchase, Industrial Equity's stake in Diamond Salt was about 18%.

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SELF BONDING QUALIFICATION SHEET

Applicant Required to Meet One of the Following Criteria:

<u>UMC 800.23(b)(3)</u>

1. Current rating for most recent bond issuance ("A" or higher) (Moody's Investor Service or Standard and Poor's Corporation) ______________________

or

2.

   A. Tangible Net Worth = (at least $10 million) (Net worth minus intangibles [Goodwill and rights to patents or royalties]) ______________________

   B. Total Liabilities/Net Worth = Obligations to transfer to other assets or provide services to other entities/Total assets minus total liabilities and is equivalent to owner's equity (2.5 times or less). ______________________

   C. Current Assets/Current Liabilities = Cash or other assets or resources which are reasonably expected to be converted to cash or sold or consumed within one year/Obligations which are reasonably expected to be paid or liquidated within one year (1.2 times or greater). ______________________

   Reference: ______________________

or

3.

   A. Fixed assets in the United States (at least $20 million) = ______________________

B. Total Liabilities/Net Worth =
(2.5 times or less) ____________________

Current Assets/Current Liabilities (1.2 times or greater) = ____________________

Reference: ____________________

UMC 800.23(b)(1)

Suitable agent (resident within the state of Utah)

____
____
____

UMC 800.23(b)(2)

Been in continuous operation of not less than five (5) years (immediately preceding the time of application) (submitted five annual reports--Yes ___ No ___)

UMC 800.23(b)(4)

(i) Financial statements prepared by an independent certified public accountant in conformity with generally accepted accounting principles. Yes ___ No ___

(ii) Unaudited financial statements for completed quarters in the current fiscal year. Yes ___ No ___

(iii) Additional unaudited information as requested by the Division.

4. The Division shall not accept an individual cash account in an amount in excess of $100,000 or the maximum insurable amount as determined by the Federal Deposit Insurance Corporation or the Federal Savings and Loan Insurance Corporation.

E.

1. The estimated bond value of all collateral posted as assurance under this section shall be subject to a margin which is the ratio of bond value to market values, as determined by the Division. The margin shall reflect legal and liquidation fees, as well as value depreciation, marketability and fluctuations which might affect the net cash available to the Division to complete reclamation.

2. The bond value of collateral may be evaluated at any time, but it shall be evaluated as part of the permit renewal and, if necessary, the performance bond amount increased or decreased. In no case shall the bond value of collateral exceed the market value.

F. Persons with an interest in collateral posted as a bond, and who desire notification of actions pursuant to the bond, shall request the notification in writing from the Division at the time collateral is offered.

800.23 Self-Bonding

A. Definitions. For the purposes of this section only:

Current Assets means cash or other assets or resources which are reasonably expected to be converted to cash or sold or consumed within one year or within the normal operating cycle of the business.

Current Liabilities means obligations which are reasonably expected to be paid or liquidated within one year or within the normal operating cycle of the business.

Fixed Assets means plants and equipment, but does not include land or coal in place.

Liabilities means obligations to transfer assets or provide services to other entities in the future as a result of past transactions.

Net Worth means total assets minus total liabilities and is equivalent to owners' equity.

Parent Corporation means corporation which owns or controls the applicant.

Tangible Net Worth means net worth minus intangibles such as goodwill and rights to patents or royalties.

B. The Division may accept a self bond from an applicant for a permit if all of the following conditions are met by the applicant or its parent corporation guarantor:

1. The applicant designates a suitable agent, resident within the state of Utah, to receive service of process.

2. The applicant has been in continuous operation as a business entity for a period of not less than five years. Continuous operation shall mean that business was conducted over a period of five years immediately preceding the time of application.

(i) The Division may allow a joint venture or syndicate with less than five years of continuous operation to qualify under this requirement if each member of the joint venture or syndicate has been in continuous operation for at least five years immediately preceding the time of application.

(ii) When calculating the period of continuous operation, the Division may exclude past periods of interruption to the operation of the business entity that were beyond the applicant's control and that do not affect the applicant's likelihood of remaining in business during the proposed surface coal mining and reclamation operations.

3. The applicant submits financial information in sufficient detail to show that the applicant meets one of the following criteria:

(i) the applicant has a current rating for its most recent bond issuance of "A" or higher as issued by either Moody's Investor Service or Standard and Poor's Corporation;

(ii) the applicant has a tangible net worth of at least $10 million, a ratio of total liabilities to net worth of 2.5 times or less and a ratio of current assets to current liabilities to 1.2 times or greater; or

(iii) the applicant's fixed assets in the United States total at least $20 million and the applicant has a ratio of total liabilities to net worth of 2.5 times or less and a ratio of current assets to current liabilities of 1.2 times or greater.

4. The applicant submits:

(i) financial statements for the most recently completed fiscal year accompanied by a report prepared by an independent certified public accountant in conformity with generally accepted accounting principles and containing the accountant's audit opinion or review opinion of the financial statements with no adverse opinion;

(ii) unaudited financial statements for completed quarters in the current fiscal year; and

(iii) additional unaudited information as requested by the Division.

C. The Division may accept a written guarantee for an applicant's self bond from a parent corporation guarantor, if the guarantor meets the conditions of paragraphs (b)(1) through (b)(4) of this section as if it were the applicant. Such a written guarantee shall be referred to as a "corporate guarantee." The terms of the corporate guarantee shall provide for the following:

1. If the applicant fails to complete the reclamation plan, the guarantor shall do so or the guarantor shall be liable under the indemnity agreement to provide funds to the Division sufficient to complete the reclamation plan, but not to exceed the bond amount.

2. The corporate guarantee shall remain in force unless the guarantor sends notice of cancellation by certified mail to the applicant and to the Division at least 90 days in advance of the cancellation date, and the Division accepts the cancellation.

3. The cancellation may be accepted by the Division if the applicant obtains suitable replacement bond before the cancellation date or if the lands for which the self bond, or portion thereof, was accepted have not been disturbed.

D. For the Division to accept an applicant's self bond, the total amount of the outstanding and proposed self bonds of the applicant for surface coal mining and reclamation operations shall not exceed 25 percent of the applicant's tangible net worth in the United States. For the Division to accept a corporate guarantee, the total amount of the parent corporation guarantor's present and proposed self bonds and guaranteed self bonds for surface coal mining and reclamation operations shall not exceed 25 percent of the guarantor's tangible net worth in the United States.

E. If the Division accepts an applicant's self bond, an indemnity agreement shall be submitted subject to the following requirements:

1. The indemnity agreement shall be executed by all persons and parties who are to be bound by it, including the parent corporation guarantor, and shall bind each jointly and severally.

2. Corporations applying for a self bond or parent corporations guaranteeing a subsidiary's self bond shall submit an indemnity agreement signed by two corporate officers who are authorized to bind the corporation. A copy of such authorization shall be provided to the Division.

3. If the applicant is a partnership, joint venture or syndicate, the agreement shall bind each partner or party who has a beneficial interest, directly or indirectly, in the applicant.

4. The applicant or parent corporation guarantor shall be required to complete the approved reclamation plan for the lands in default or to pay to the Division an amount necessary to complete the approved reclamation plan, not to exceed the bond amount.

5. The indemnity agreement when under forfeiture shall operate as a judgment against those parties liable under the indemnity agreement.

F. The Division may require self-bonded applicants and parent guarantors to submit an update of the information required under paragraphs (b)(3) and (b)(4) of this section within 90 days after the close of each fiscal year following the issuance of the self bond or corporate guarantee.

G. If at any time during the period when a self bond is posted, the financial conditions of the applicant or the parent corporation guarantor change so that the criteria of paragraphs (b)(3) and (d) of this section are not satisfied, the permittee shall notify the Division immediately and shall within 90 days post an alternate form of bond in the same amount as the self bond. Should the permittee fail to post an adequate substitute bond, the provisions of Section 800.16(e) shall apply.

800.30 Replacement of Bonds

A. The Division may allow a permittee to replace existing bonds with other bonds that provide equivalent coverage.

B. The Division shall not release existing performance bonds until the permittee has submitted, and the Division has approved, acceptable replacement performance bonds. Replacement of a performance bond pursuant to this section shall not constitute a release of bond under Section 800.40.

800.40 Requirement to Release Performance Bonds

A. Bond release application.

1. Applications for bond release may be filed at any time after appropriate reclamation evaluations have been submitted to the Division. At the first appropriate season after this filing has been made (mid-June to mid-September) a Division biologist will inspect the reclaimed area prior to actual bond release.

2. Within 30 days after an application for bond release has been filed with the Division, the operator shall submit a copy of an advertisement placed at least once a week for four successive weeks in a newspaper of general circulation in the locality of the surface coal mining operation. The advertisement shall be considered part of any bond release application and shall contain the permit number and approval date, notification of the precise location of the land affected, the number of acres, the type and amount of the bond filed and the portion sought to be released, the type and appropriate dates of reclamation work performed, a description of the results achieved as they relate to the operator's approved reclamation plan and the name and address of the Division to which written comments, objections, or requests for public hearings and informal conferences on the specific bond release may be submitted pursuant to Sections 800.40(f) and (h). In addition, as