

KERR ADDISON



KERR ADDISON MINES LIMITED
1988 ANNUAL REPORT

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CORPORATE PROFILE

Kerr Addison is an experienced mine operator, developer and an aggressive explorer for minerals, participates in oil and gas exploration, development and operations, and holds extensive investments in the resource industries. The Company was incorporated over fifty years ago and has paid dividends for 49 consecutive years.

TABLE OF CONTENTS

Financial Summary and Highlights	1
President's Message to the Shareholders	2
Ownership Interests	7
Review of Operations	8
Ore Reserves	11
Consolidated Financial Statements	16

ANNUAL MEETING OF SHAREHOLDERS

The annual meeting of shareholders will be held in Commerce Hall of Commerce Court West, King and Bay Streets, Toronto, Ontario on Monday, May 15, 1989 at 11:30 a.m.

FINANCIAL SUMMARY

	<i>(millions of dollars)</i>				
	1988	1987	1986	1985	1984
Net sales	\$109.9	\$ 90.2	\$ 59.2	\$ 48.0	\$ 48.7
* Net income	10.5	24.0	5.1	2.5	16.3
Cash and short-term securities	128.2	203.1	74.3	36.7	3.4
* Total assets	683.3	695.7	518.1	388.7	425.1
Long-term debt	125.0	135.0	50.0	5.0	40.0
* Shareholders' equity	348.2	348.1	331.1	336.2	341.7

	<i>(dollars per share)</i>				
* Net income	\$ 0.60	\$ 1.38	\$ 0.30	\$ 0.14	\$ 0.95
Dividends declared	0.60	0.60	0.60	0.60	0.60

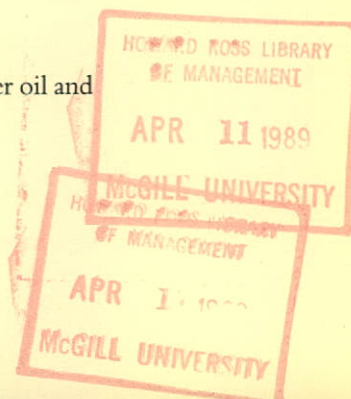
* 1984 figures restated for the change in the method of accounting for oil and gas expenditures.

IN THIS REPORT Dollars are Canadian unless otherwise noted.

As at December 31, 1988 U.S.\$ = Cdn. \$1.23 (1987: U.S.\$ = Cdn. \$1.30)

HIGHLIGHTS IN BRIEF

- ◆ The Winston Lake zinc mine commenced commercial production in April 1988.
- ◆ Development of the Ansil copper mine continued in preparation for its production start-up in the second quarter of 1989.
- ◆ A decision was made to put the Samatosum high-grade silver mine into production by the fourth quarter of 1989.
- ◆ A shaft deepening project was commenced at the Lac Shortt gold mine which will extend its life to at least 1992.
- ◆ A major modernization project was launched at the Canadian Electrolytic Zinc refinery in 1988 as it celebrated its 25th year of operation.
- ◆ Kerr Addison and its subsidiary, Minnova Inc., consolidated their mineral exploration properties into a 50/50 joint venture.
- ◆ In the oil and gas sector, Anderson Exploration Ltd. showed improved financial performance in its first year as a publicly-traded company on The Toronto Stock Exchange.
- ◆ Kerr Addison agreed to dispose of its 13% interest in the Canadian Hunter oil and gas joint venture to Noranda Inc. effective January 1, 1989.



Highlights

Major progress in Kerr Addison's affairs continued in 1988. The Company increased its production capacity in the mining sector, initiated capital programs which will make it a substantial and diversified metals producer, and rationalized its oil and gas interests. As to mining in particular, operations commenced at one new mine, decisions were made to bring two additional mines into production in 1989, and a major development program began at an existing mine. As well, the Canadian Electrolytic Zinc plant began extensive renovations to ensure that it remains one of the lowest cost refineries in the world. Anderson Exploration Ltd., in which Kerr Addison is the major shareholder, has been well received by investors since becoming a publicly-traded company in July. At year-end, Kerr Addison had agreed to dispose of its 13% interest in the Canadian Hunter joint venture for \$85 million, effective as of January 1, 1989.

Mining

In January, commissioning of the concentrator commenced at the new Winston Lake zinc mine. Commercial production began in April at this \$72 million facility and the mine produced at 80% of capacity over the balance of the year.

In February, the decision was made to place Lac Dufault's Ansil copper deposit into production. This followed the completion of the underground evaluation program initiated in 1984. The Company's cumulative investment in this mine will be \$60 million when commissioning of the rehabilitated Norbec concentrator commences in the first quarter of 1989.

A decision was made in October to place the Samatosum precious and base metals deposit into production. The Company is the operator and its 70% share of the capital cost is estimated at \$22 million. Production should commence by the fourth quarter of 1989 at a rate of 450 tonnes per day, with the initial three years of production coming from an open pit.

In July, the Board of Directors approved a \$20 million capital expenditure program to develop the Lac Shortt gold mine between the 500 and 800 meter levels. This project follows a number of years of extensive underground exploration at the mine and will extend Lac Shortt's life to at least 1992.

Canadian Electrolytic Zinc has launched a major modernization project which will employ the latest and best technology to automate the existing cell-houses. This program will enhance employee working conditions, improve productivity and keep C.E.Z. world competitive. Kerr Addison's 9.83% share of the capital costs will be \$12 million over two years.

During the year, the Opemiska Division was able to increase its ore reserve position as a result of its successful underground exploration program and higher copper prices. The underground exploration program at the Donalda gold property has also proceeded well and a preliminary evaluation of this deposit should be completed in the third quarter of 1989. In addition, two base metal properties in British Columbia, the Chu Chua and Lara deposits, were added to the Company's mineral inventory through exploration and acquisition.



The Winston Lake Division will continue to be a major contributor to the Company's profitability in the years to come.

Effective in October, Kerr Addison and its subsidiary, Minnova Inc., consolidated their mineral exploration properties into a joint venture in which each party has a 50% working interest, with Minnova as operator. Exploration areas around Minnova's existing operations and development projects are excluded from the joint venture. This agreement represents a logical rationalization of the two exploration groups, permits Minnova to intensify its commitment to exploration around its existing operations, and provides both companies with broader exposure to exploration in new areas. Total mineral exploration expenditures increased to \$23.3 million in 1988.

Oil and Gas

Anderson Exploration Ltd., which is 34.2% owned by Kerr Addison, commenced trading on The Toronto Stock Exchange in July. Anderson's financial performance was the best since its formation by amalgamation in 1982. Natural gas reserves continued to increase, with proven reserves reaching 543 billion cubic feet, representing a 22 year reserve life at current levels of production.

Kerr Addison's disposal of its interest in Canadian Hunter will ultimately bring Noranda's ownership of Canadian Hunter to 100% to support the larger regional exploration programs being pursued by Canadian Hunter. These programs require funding by a substantial entity and the risks involved were not considered to be in the best interests of this Company or consistent with its objectives in the oil and gas sector. Kerr Addison commenced participating in the joint venture in 1977, and the carrying value of its interest was \$50 million at December 31, 1988. Under the terms of this transaction, Kerr Addison will receive \$20 million in cash and \$65 million of preferred shares, redeemable over five years and paying a dividend of 70% of the prime rate.

Investments

Noranda Inc., in which the Company holds 7.4 million common shares, had another excellent year in 1988, reporting earnings of \$603 million, or \$3.14 per share, compared to \$2.14 per share in the previous year. Dividends received on Noranda's common shares increased by 55% over 1987 and Kerr Addison was able to recommence recording these dividends as income in 1988. The Company became a subsidiary of Noranda in late 1987 and must dispose of its share holdings in Noranda within the next four years to comply with securities regulations.

During 1988, the Company increased its holdings in Minnova Inc. and Anderson Exploration Ltd., and purchased a 45% equity interest in RFC Resource Finance Corporation. RFC has acquired an option to purchase 100% of the formerly-producing Pend Oreille zinc/lead mine, located in Washington State, U.S.A. Over the next year, it will be studying the feasibility of reopening the mine.

Financial Results

Net income for 1988 was \$10.5 million, or 60¢ per share, as sales, operating profits and dividend income all increased substantially over the previous year. In 1987, earnings of \$1.38 per share were almost entirely derived from gains on the sale of investments, reflecting strong equity markets during the first half of that year.

Metal sales increased in 1988 due to the commencement of production at the new Winston Lake zinc mine, higher base metal prices and excellent results from Canadian Electrolytic Zinc. The principal offsetting factor was the rising value of the Canadian dollar. In addition, gold prices declined and gold production was lower because of the

sale of the Kerr Addison mine in mid-1987. Significant increases in production of natural gas, oil and natural gas liquids, were balanced by lower prices for all products, resulting in similar results from the oil and gas sector for the two years.

Capital expenditures during the year amounted to \$56.6 million, including \$43.5 million on mining projects and \$13.1 million on oil and gas properties. Investment in subsidiary and associated companies totalled \$13.4 million. Long-term debt was reduced by \$10.0 million, to \$125.0 million at year-end. Cash and short-term investments declined by \$74.9 million during the year, to a balance of \$128.2 million.

Outlook

The prospects are very positive for all aspects of our business. In the mining sector, the large capital investment programs over the past number of years are beginning to reflect in our improved operating results. Demand for base metals has responded well to the past six years of growth in the major economies of the Western World, and prices have also reacted to capacity shortfalls. Firm zinc prices will be beneficial to the Winston Lake Division as production levels increase and it commences its first full year of

operations. Strong copper markets bode well for the Lac Dufault Division where the Ansil mine is expected to commence commercial production in the second quarter of 1989. Although precious metal prices have weakened recently, we consider gold and silver as core products in the long-term. The Samatsum Division is expected to become a large silver producer by the fourth quarter of the year. In summary, we anticipate a significant increase in metal production over the next two years, with a good balance between base and precious metal sales.

Our principal objectives for 1989 are to complete our major projects and to bring the Winston Lake mine up to full production rates. Planned capital expenditures of about \$40 million should be financed mainly by operating cash flow. The reorganization of our mineral exploration group allows us to focus on increasing reserves close to existing operations, and provides a wider exposure elsewhere.

Working from a strong reserve base, Anderson Exploration will continue to emphasize natural gas in Alberta, where exploration opportunities are enormous for a company of its size and expertise. Anderson's growth will come primarily from exploration, property acquisitions and development. The ratification of the Free Trade Agreement between Canada and the United States will allow increased penetration of Canadian natural gas into the U.S. market. The investment of the proceeds to be received from the disposal of our

interest in Canadian Hunter will exceed our projected return had we continued to participate in that joint venture.

Investment income increased in 1988 and we expect this trend to continue next year. The Company's underlying financial strength and ability to generate cash flow improved substantially during the past year. We manage our business for the long-term, closely coordinating our exploration, development, operating and acquisition activities. We will redeploy our financial capital as appropriate operating assets are found.

In closing, our belief is that people are the most important ingredient for our future success. Our people have made a tremendous effort during the past year and we believe that 1989 will be equally challenging. The Board of Directors wishes to thank all employees for their outstanding contribution.



Ian D. Bayer
President and Chief Executive Officer

Toronto, Canada
February 21, 1989



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EXPLO

Mining and Refining Interests

Minnova Inc. 50.2%

Operating Mines

Winston Lake Division 100%

Lac Shortt Division 94.2%

Opemiska Division 100%

Developing Mines

Ansil (Lac Dufault Division) 100%

Samatosum Division 70%

Canadian Electrolytic Zinc 9.8%

Oil and Gas Interests

Anderson Exploration Ltd. 34.2%

Canadian Hunter Joint Venture
(agreement for its disposition to
be effective January 1, 1989) 13%

Mining

Winston Lake Division

The Winston Lake underground mine and milling facility, located 27 kilometers north of Schreiber, Ontario, commenced commercial production on April 1, 1988. It was completed as planned at a capital cost of \$72 million and generated a cash operating profit of \$13.9 million over the remaining nine months of the year. During this start-up period the mine operated at 80% of its capacity and produced 65,000 tonnes of zinc concentrates. Near year-end, a rod mill was added to the grinding circuit in order to increase metal recoveries and enhance both the zinc and copper concentrate grades.

The need to maximize production, safely and efficiently, is the Division's chief priority for 1989. This goal will be achieved through an increased emphasis on training as well as a continuation of the recruitment of experienced miners. Ore production of 340,000 tonnes is planned for 1989 at this high-grade, zinc operation.



Miners coming off shift at the Winston Lake Division.



Production will commence in 1989 from the Ansil high-grade copper mine at a rate of 1,225 tonnes per day.

Lac Shortt Division

The Lac Shortt gold mine, located 100 kilometers west of Chapais, Quebec, contributed a \$7.3 million cash operating profit to the Company during 1988, compared to \$12.0 million in 1987. This reduction was primarily due to the combined effect of lower gold prices and a stronger Canadian dollar.

In July, the mine embarked on a \$20 million shaft deepening program in order to access ore reserves between the 500 meter and 800 meter levels. This development work is scheduled for completion in the first quarter of 1990, thereby extending the mine life to 1992. Production of 365,000 tonnes of ore will be maintained in 1989 with an output of 50,000 ounces of gold.

Opemiska Division

During the year, ore was provided to the mill at Chapais, Quebec, from all three of the mines in this Division. These operations generated a cash operating profit of \$3.4 million in 1988, compared to \$5.9 million in 1987. This reduction was primarily due to lower production levels.

The Cooke mine will cease production in mid-1989 and mining operations will then focus on the Springer and Perry mines. Exploration is continuing in the area.

Lac Dufault Division

Underground development work continued throughout the year at the Ansil mine, located 12 kilometers north of Rouyn-Noranda, Quebec, in preparation for the start of production in the second quarter of 1989. Full production is anticipated by mid-1989 at a rate of 450,000 tonnes per year of high-grade, copper ore.

During the year, \$24.8 million was spent on the project for a total net cost-to-date of \$55.5 million. Further capital expenditures of \$5 million will be required in 1989 to complete the project as scheduled.

The Norbec mill treated over 250,000 tonnes of ore, on a custom milling basis, from the Mobrun mine of Audrey Resources Inc. Milling ended in August, following which modifications were carried out in preparation for treatment of ore from the Ansil mine.

FINANCIAL REVIEW		Winston Lake		Lac Shortt		Opemiska	
		1988	1987	1988	1987	1988	1987
Average price received: copper (\$ per pound)		1.52	—	—	—	1.28	1.21
zinc (\$ per pound)		0.75	—	—	—	—	—
gold (\$ per ounce)		—	—	531	593	574	587
(\$000's)							
Net sales		28,532	—	27,622	31,968	23,221	24,680
Cost of production:	Mining	7,432	—	11,157	10,821	11,323	10,576
	Milling	3,638	—	3,604	3,464	1,612	1,463
	Plant	1,113	—	1,907	1,926	3,679	3,452
	General	2,417	—	3,208	3,011	3,194	3,255
		14,600	—	19,876	19,222	19,808	18,746
Operating profit		13,932	—	7,746	12,746	3,413	5,934
Minority interest		—	—	449	739	—	—
Underground exploration		—	—	1,505	2,138	3,186	2,536
Depreciation and depletion		5,291	—	6,200	6,632	180	322
Profit (loss) before tax		8,641	—	(408)	3,237	47	3,076

PRODUCTION REVIEW		Winston Lake		Lac Shortt		Opemiska	
		1988	1987	1988	1987	1988	1987
Tonnes milled (000's)		220	—	371	396	349	407
Grade:	zinc, %	16.62	—	—	—	—	—
	copper, %	0.85	—	—	—	1.42	1.39
	gold, grams per tonne	—	—	4.66	4.53	2.64	2.37
	silver, grams per tonne	—	—	—	—	11.76	10.29
Production:	zinc, pounds (000's)	73,755	—	—	—	—	—
	copper, pounds (000's)	3,051	—	—	—	10,545	11,980
	gold, ounces	2,428	—	52,029	53,889	26,551	27,299
	silver, ounces	68,275	—	1,668	1,366	111,379	110,502
Operating cost	\$ per tonne milled	66.27	—	53.52	48.57	46.70	37.88
	\$ per ounce gold	—	—	382	357	—	—
Number of employees, December 31		145	117	171	168	286	291
Lost time accident frequency per 200,000 hours worked		7.4	6.1	1.2	1.3	4.8	8.7

Samatosum Division

Construction proceeded at the Samatosum property, near Barriere, British Columbia, following approval of the Company's feasibility study in October 1988. The total cost of the project will be \$32 million, of which \$6.5 million was spent by year-end. The Company's joint venture share is 70%. Production is planned to commence in the fourth quarter of 1989.

The silver-rich, base-metal deposit will be mined by open pit methods for the first three years, following which an underground mine may be developed. The results of metallurgical investigations, pilot plant testing and marketing studies indicated that the highest revenues will be achieved by producing separate silver-copper, zinc and lead concentrates from the 450 tonnes per day flotation mill.



The initial three years of production at the Samatosum Division will be from an open pit mine.

Exploration

Prior to October 1988, Kerr Addison and its subsidiary, Minnova Inc., each carried out their own exploration programs. On October 1, the two companies consolidated their existing exploration projects into a 50/50 joint venture with all future projects to be carried out by Minnova on behalf of the joint venture. Designated areas around the existing mining Divisions along with the developing Donalda and Mount Sicker area projects are excluded from this agreement. The joint venture controls a land position in excess of 250,000 hectares and exploration is oriented towards the search for both precious and base metals.

Exploration programs are carried out from regional offices located in Chapais and Rouyn-Noranda, Quebec; Thunder Bay, Ontario; Vancouver, British Columbia; and Reno, Nevada. The geologists at these locations study both the geology of the mining Divisions as well as the joint venture properties in their regions.

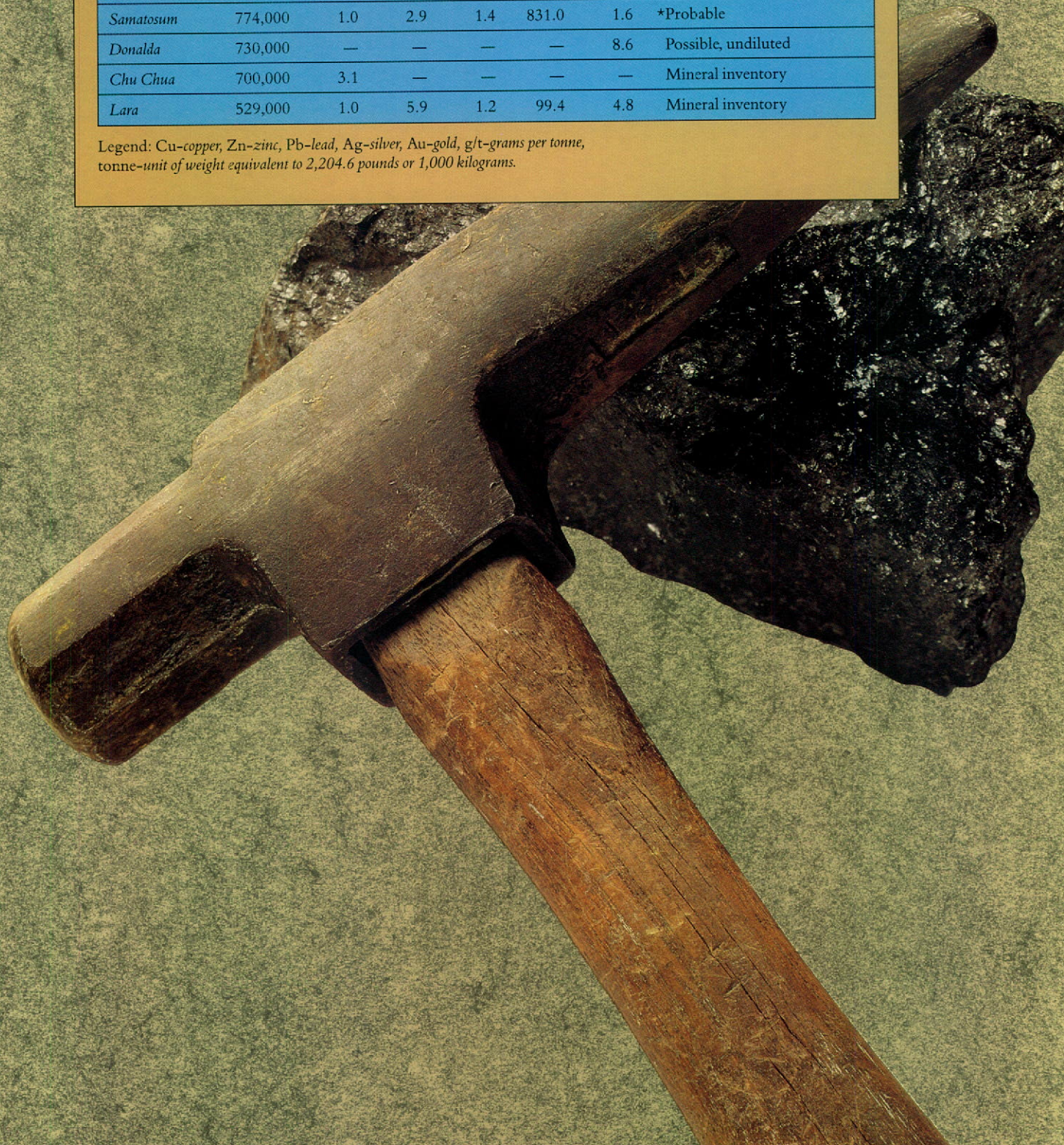
Donalda – Underground exploration progressed throughout the year at the Donalda project, located in the Rouyn-Noranda area, Quebec. The previous mine workings were dewatered and drifting was carried out along a new extension of the Donalda No. 1 gold-bearing, quartz vein. This preliminary evaluation will be completed by the third quarter of 1989.

Lara/Mount Sicker – To complement its extensive land holdings at Mount Sicker, on Vancouver Island, British Columbia, the Company acquired control of the adjacent Lara deposit through an equity interest in Laramide Resources Ltd. The reserves on the Lara base-metal, volcanogenic, massive-sulphide deposit, as estimated by Laramide Resources, were based on earlier diamond drilling and underground drifting in the deposit.

ORE RESERVES at December 31, 1988

Deposit	Tonnes	% Cu	% Zn	%Pb	Ag (g/t)	Au (g/t)	Remarks (*diluted)
Winston Lake	2,743,000	1.0	15.3	—	31.5	1.1	*Proven, probable & possible
Lac Shortt	1,484,000	—	—	—	—	4.6	*Proven, probable & possible
Opemiska	1,041,000	1.9	—	—	—	1.4	*Proven & probable
Ansil	1,587,000	7.2	0.9	—	26.5	1.6	*Probable
Samatosum	774,000	1.0	2.9	1.4	831.0	1.6	*Probable
Donalda	730,000	—	—	—	—	8.6	Possible, undiluted
Chu Chua	700,000	3.1	—	—	—	—	Mineral inventory
Lara	529,000	1.0	5.9	1.2	99.4	4.8	Mineral inventory

Legend: Cu-copper, Zn-zinc, Pb-lead, Ag-silver, Au-gold, g/t-grams per tonne, tonne-unit of weight equivalent to 2,204.6 pounds or 1,000 kilograms.



Chu Chua – About 40 kilometers north of the Samatsum property in British Columbia, drilling on the Chu Chua deposit has discovered an area having significantly higher copper grade than known previously. Additional drilling on this near-surface deposit is planned for 1989.

Exploration expenditures totalled \$23.3 million during the year. Of this amount \$4.7 million was expended on underground exploration at the mine sites with the balance of \$18.6 million spent on surface exploration.

Business Development

The acquisition of ore reserves is regarded by the Company as an integral part of its strategy towards increased production capacity. The primary focus for acquisitions is on properties containing reserves of precious or base metals which are at the developing or operating stage.



C.E.Z. celebrated its 25th year of operation in 1988.

Potential property or corporate acquisitions are evaluated by a small, but aggressive, in-house business development group. They, in turn, are supported with additional technical expertise from the mining professionals at the Company's operating divisions and regional exploration offices. Business opportunities are generated through active solicitation by this group as well as by way of submissions received from property owners.

Refining

Canadian Electrolytic Zinc

Zinc slab production from the Canadian Electrolytic Zinc refinery at Valleyfield, Quebec, was 218,000 tonnes in 1988, compared to 220,000 tonnes in 1987. As in the previous year, the plant operated at nearly full capacity.

Net income to Kerr Addison was \$6.6 million, compared to \$3.8 million in 1987, as a result of substantially higher zinc prices received over the course of the year.

A \$120 million modernization project has been initiated and will be utilizing the best available technology with the well-proven Vieille Montagne cell-house design. This project will improve both productivity and employee working conditions, ensuring that C.E.Z. remains one of the most cost-competitive zinc refineries in the world.

Construction commenced on a production facility for Battery Grade zinc powder. This will enable C.E.Z. to produce specialized zinc powder used in the manufacture of alkaline batteries. In addition, pilot study work is continuing to determine the feasibility of a silver recovery process at the plant.



Oil and Gas

Anderson Exploration Ltd.

Anderson Exploration, with its headquarters in Calgary, Alberta, became a publicly traded company on July 12, 1988, when its shares were listed on The Toronto Stock Exchange. Subsequently, Kerr increased its equity interest in Anderson to 34.2% by way of a \$5 million private placement.

This company's financial performance was the best since its formation in 1982 and earnings were the highest experienced to date. Higher production volumes more than offset the lower average prices received for both oil and gas.

Anderson's land inventory, most of which is in Alberta, increased to 759,000 net acres in 1988 from 609,000 net acres in 1987. Net expenditures on exploration, development and land acquisitions amounted to \$24.8 million. As a result, on a proven barrel equivalent basis, Anderson replaced 169% of its 1988 production.

Record production levels were achieved for all three of Anderson's products. Gas production, primarily from the Dunvegan field, increased by 11% over the previous year with 73% of this production being sold to the northern California market.



Anderson Exploration achieved record production levels in 1988.

The average 1988 gas sales price was \$1.92 per thousand cubic feet. Gas sales comprised 76% of Anderson's gross 1988 production revenue. Oil production increases were achieved from successful exploration and development drilling, as well as work-over projects at Progress, Saddle Hills, Manyberries and Hayter. The increase in natural gas liquids production was chiefly a result of 1988 being the first full year of operations for the Dunvegan deep-cut, liquids recovery facility.

Anderson operates 92% of its gas production, 99% of its natural gas liquids production and 47% of its oil production. This enables it to maintain a high degree of control over its production methods and costs. Anderson intends to continue growing primarily through exploration successes, property acquisition and development. These activities

will largely be funded through available cash flow. The emphasis on gas will continue, although exploration for oil will also comprise a significant part of its efforts.

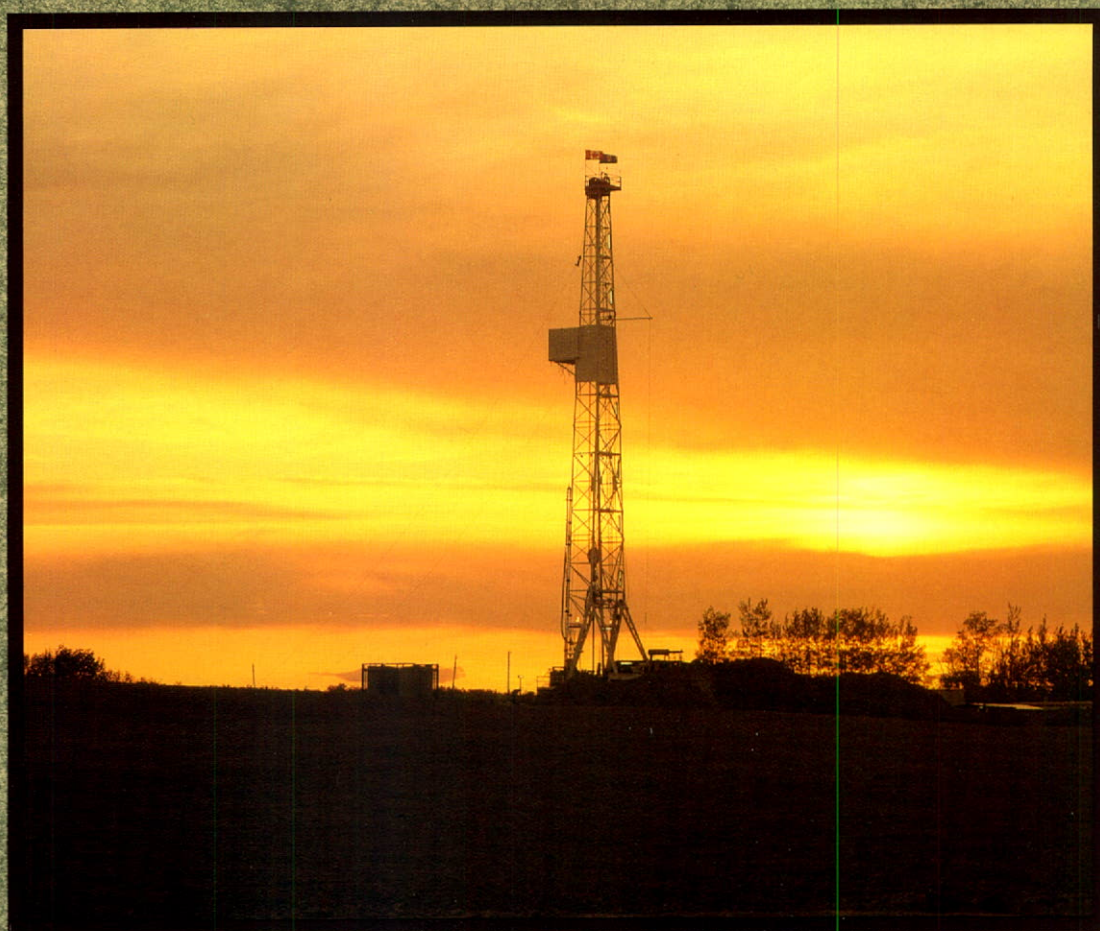
Canadian Hunter Joint Venture

Canadian Hunter carries out oil and gas exploration, development and production throughout Western Canada, with its principal assets being its natural gas and liquids reserves in the Elmworth and Wapiti contract areas of northwestern Alberta. Operating cash flow to Kerr Addison was \$9.0 million in 1988 and its share of capital expenditures was \$13.1 million.

Effective as of January 1, 1989, Kerr Addison entered into an agreement to dispose of its 13% interest in the Canadian Hunter Joint Venture to Noranda Inc. for a total consideration of \$85 million. Kerr's carrying value for this interest was \$50 million at the end of 1988.

Kerr Addison's share of proven reserves at December 31, 1988, before royalties was 84 billion cubic feet of natural gas and 5.7 million barrels of oil and natural gas liquids. Proven and probable reserves were 182 billion cubic feet of natural gas and 11.1 million barrels of oil and natural gas liquids.

Toronto, Canada
February 21, 1989



ANDERSON EXPLORATION LTD.

HIGHLIGHTS: (September 30th year-end)

Financial (\$000's)	1988	1987	Reserves:	1988	1987
Revenues (net of royalty)	\$ 48,800	\$ 45,400	<i>Natural gas</i> (billions of cubic feet)		
Net earnings	7,300	6,300	– Proven	543	512
Cash flow	28,000	23,800	– Proven plus probable	765	721
Net capital expenditures	24,800	14,100	<i>Oil and gas liquids</i>		
Long-term debt	85,000	86,400	(thousands of barrels)		
Shareholders' equity	119,700	110,900	– Proven	14,778	15,430
Production:			– Proven plus probable	20,997	21,465
<i>Natural gas</i>			Drilling Activity:		
(millions of cubic feet per day)	69.0	62.2	Wells drilled		
<i>Oil</i> (barrels per day)	1,464	1,034	– Gross	74	39
<i>Natural gas liquids</i> (barrels per day)	1,242	545	– Net	42	18

December 31, 1988

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in Canada. The principal accounting policies are summarized hereunder to facilitate review of the consolidated financial statements.

A. Basis of consolidation

The consolidated financial statements include, on a consolidated basis, the accounts of Kerr Addison Mines Limited ("Kerr Addison" or "the company"), its 50.2% owned subsidiary company, Minnova Inc. ("Minnova"), and its wholly-owned subsidiary companies, Keradamex, Inc. and Kerramerican, Inc.

The company has direct and undivided interests of 13.0% in all of the oil and gas properties, production and related activities of Canadian Hunter Exploration Limited ("Canadian Hunter") and 9.8% in all of the properties, production and related activities of Canadian Electrolytic Zinc ("CEZ"). Noranda Inc. is a major holder and operator of both of these ventures. The company's share of the ventures' assets, liabilities, revenues and expenses is reflected in the consolidated financial statements.

B. Investments in associated companies

The company's interest in the common shares of Noranda Inc. ("Noranda") is accounted for following the cost method.

The company's interest in the common shares of Anderson Exploration Ltd. ("Anderson") is accounted for following the equity method whereby the investment is initially recorded at cost and the carrying value is adjusted thereafter to reflect the company's share of post-acquisition profits or losses.

C. Revenue recognition

Metals contained in concentrates are sold under contracts. Gold bullion and refined metals are sold on a spot basis. Forward sales positions, related to mine production of both gold and copper, are taken from time to time. Estimated revenues, based upon anticipated metal prices or forward sales commitments, are recognized when the concentrates, bullion and refined metals are produced. The estimated revenues from metals in concentrates may be subject to adjustment on or before final settlement, usually four months after the date of shipment, to reflect changes in metal market prices and weights and assays. The inclusion in sales of the excess of realizable value over cost of metals on hand is not significant.

D. Valuation of concentrates, bullion and refined metals

Concentrates, bullion and refined metals awaiting settlement, in transit and on hand are valued at estimated realizable value except that, in 1988 a portion of the in-process inventories of CEZ (i.e., a base stock amount required to maintain the continuous smelting and refining process) is priced at cost. This change in valuation, which has not been applied retroactively, does not have a material effect on 1988 earnings or those of prior years.

E. Short-term securities

Short-term securities are recorded at the lower of cost or market determined on an individual basis.

F. Property, plant and equipment*Mining and smelting –*

Property, plant and equipment and related expenditures are recorded at cost less applicable investment tax credits and government assistance. Property, plant and equipment includes previously deferred exploration and development expenditures on properties which have been brought into production. Preproduction and development expenditures on projects under construction are capitalized until the commencement of commercial production.

Mineral exploration and development expenditures are charged against current earnings unless they relate to interests in properties where the reserves have the potential of being economically recoverable, in which case the expenditures are deferred. Upon disposal or abandonment of such interests, the net gain or loss is reflected in earnings. If the properties are brought into production, deferred exploration and development expenditures relating thereto are reclassified with property, plant and equipment.

Depreciation of mining assets is provided on the unit-of-production basis over the estimated economic life of the related mine. Depreciation of smelting assets is provided on the straight-line method over periods of 4 to 20 years.

Oil and gas –

The company's oil and gas investments consist of its participation in Canadian Hunter and its common share interest in Anderson.

The company follows the full cost method of accounting whereby all costs associated with the exploration for and development of oil and gas reserves, whether productive or unproductive, are capitalized in cost centres on a country-by-country basis and charged against earnings as set out below. Such costs include land acquisition, drilling, geological and geophysical interest and overhead expenses related to exploration and development activities.

Depletion is provided on costs accumulated in producing cost centres using the unit-of-production method based on estimated proven oil and gas reserves. The company periodically reviews the costs associated with unproven properties to determine whether they are likely to be recovered. When costs are not likely to be recovered, an impairment allowance is made.

The carrying value of the company's oil and gas investments in producing cost centres is limited to an ultimate recoverable amount which is the aggregate of future net revenues from proved reserves and the costs of unproved properties, net of impairment allowances, less future general and administrative costs, financing costs and income taxes. Future net revenues are estimated using year-end prices.

G. Income taxes

The company follows the deferral method of applying the tax allocation method of accounting for income taxes. Under this method, timing differences between the period when income or expenses are reported for tax purposes and the period when they are recorded in the accounts result in deferred income taxes.

H. Retirement plans

Pension expense or credit includes the amortization, on a straight-line basis, of the difference between the value of the pension fund assets and the actuarial present value of the accrued pension benefits over the expected average remaining service lives of the employee groups covered by the plans. Actuarial valuations are calculated using the "projected benefit" method based on management's best estimates of future interest rates and salary levels. The difference between pension expense or credit and the funding contributions is reflected as a deferred pension asset or liability.

I. Flow-through shares

The company issues common shares ("flow-through" shares) from time to time which entitle the subscriber to earn tax deductions in respect of qualifying exploration expenditures made by the company. The portion of the subscription price of such shares which is based on their market value is credited to share capital. The remainder of the subscription price (the "premium") attributable to the tax benefits transferred to subscribers is credited either to exploration expenditures or capitalized expenditures on properties under development.

CONSOLIDATED STATEMENT OF OPERATIONS

(in thousands of dollars)

For the year ended December 31, 1988 (with comparative figures for the year ended December 31, 1987)	1988	1987
Income from mining and smelting, and oil and gas activities:		
Net sales	\$109,883	\$90,206
Cost of production	67,047	58,715
	42,836	31,491
Gain on sale of investments and other assets (note 6)	1,946	26,403
Dividend and interest income (note 2a)	21,982	10,783
Share of profit of Anderson Exploration Ltd.	571	545
	67,335	69,222
Deduct:		
Mineral exploration expenses (net of premium on flow-through shares \$3,491 - 1988, \$6,655 - 1987)	19,858	13,787
Depreciation and amortization	20,620	13,281
Interest on debt (note 5)	16,711	9,287
Administrative and general expenses	2,449	2,370
Minority interest in earnings of Minnova Inc.	462	1,633
Income taxes (note 7)	(3,274)	6,108
	56,826	46,466
Income before extraordinary items	10,509	22,756
Extraordinary items (note 9)		1,211
Net income for the year	\$ 10,509	\$23,967
Earnings per share:		
Income before extraordinary items	\$ 0.60	\$ 1.31
Net income for the year	\$ 0.60	\$ 1.38

(See accompanying notes to consolidated financial statements)

CONSOLIDATED BALANCE SHEET

(in thousands of dollars)

December 31, 1988
(with comparative figures at December 31, 1987)

1988

1987

ASSETS

Current:

Cash and short-term securities, at lower of cost and market value (note 11)	\$128,175	\$203,101
Accounts and interest receivable	18,079	14,127
Concentrates, bullion and metals awaiting settlement, in transit and on hand	26,114	16,828
Supplies and materials, at cost	8,010	6,211
Total current assets	180,378	240,267
Investments and other assets (note 2)	223,565	213,239
Property, plant and equipment (note 3)	279,363	242,238
	<u>\$683,306</u>	<u>\$695,744</u>

LIABILITIES AND SHAREHOLDERS' EQUITY

Current:

Accounts payable and accrued charges	\$ 23,531	\$ 22,680
Income and production taxes payable	763	4,672
Total current liabilities	24,294	27,352
Long-term debt (note 5)	125,000	135,000
Deferred income taxes	41,249	44,082
Other deferred liabilities	5,730	6,534
	<u>196,273</u>	<u>212,968</u>

Minority interest in Minnova Inc.:

Convertible debentures (note 8)	65,000	65,000
Common shares	73,788	69,672
	<u>138,788</u>	<u>134,672</u>

Shareholders' equity:

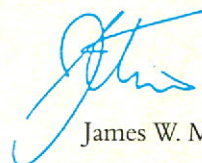
Share capital (note 4)	184,351	184,196
Retained earnings	163,894	163,908
	<u>348,245</u>	<u>348,104</u>
	<u>\$683,306</u>	<u>\$695,744</u>

(See accompanying notes to consolidated financial statements)

On behalf of the Board:



Ian D. Bayer, Director



James W. McCutcheon, Director

KERR ADDISON MINES LIMITED

CONSOLIDATED STATEMENT OF RETAINED EARNINGS

	<i>(in thousands of dollars)</i>	
For the year ended December 31, 1988 <i>(with comparative figures for the year ended December 31, 1987)</i>	1988	1987
Retained earnings, beginning of year	\$163,908	\$150,364
Net income for the year	10,509	23,967
	174,417	174,331
Dividends paid (\$0.60 per share in each year)	(10,523)	(10,423)
Retained earnings, end of year	\$163,894	\$163,908

(See accompanying notes to consolidated financial statements)

AUDITORS' REPORT

To the Shareholders of
Kerr Addison Mines Limited:

We have examined the consolidated balance sheet of Kerr Addison Mines Limited as at December 31, 1988 and the consolidated statements of operations, retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of

the company as at December 31, 1988 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.



Toronto, Canada
February 15, 1989

Chartered Accountants

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

	<i>(in thousands of dollars)</i>	
For the year ended December 31, 1988 <i>(with comparative figures for the year ended December 31, 1987)</i>	1988	1987
Cash provided by (used in) operating activities:		
Income before extraordinary items	\$ 10,509	\$ 22,756
Items not affecting cash –		
Depreciation and amortization	20,620	13,281
Gain on sale of investments and other assets	(1,946)	(26,403)
Other	(2,471)	3,202
	26,712	12,836
Net change in non-cash working capital balances (receivables and inventories, less payables)	(19,151)	(917)
Cash provided by operating activities	7,561	11,919
Cash provided by (used in) financing activities:		
Issue (repayment) of long-term debt by the company	(10,000)	85,000
Issue of convertible debentures by Minnova Inc.		63,043
Issue of common shares by the company	155	3,413
Issue of common shares by Minnova Inc.	8,769	4,670
Cash provided by (used in) financing activities	(1,076)	156,126
Cash used in (provided by) investing activities:		
Investment in common shares of Minnova Inc.	4,083	6,420
Investment in common shares of Anderson Exploration Ltd.	5,000	
Additions to property, plant and equipment	55,655	69,936
Purchase (sale) of investments and other assets (net)	4,755	(30,008)
Sale of Virginiatown mine		(14,016)
Dividends received on shares of Noranda Inc.		(4,233)
Cash used in investing activities	69,493	28,099
Dividends paid (including \$1,395 in 1988 and \$687 in 1987 to minority shareholders of Minnova Inc.)	11,918	11,110
Increase (decrease) in cash during the year	(74,926)	128,836
Cash and short-term securities, beginning of year	203,101	74,265
Cash and short-term securities, end of year	\$128,175	\$203,101
(See accompanying notes to consolidated financial statements)		

December 31, 1988

1. Accounting policies

The principal accounting policies followed by the company are detailed under the caption "Accounting Policies."

2. Investments and other assets

(in thousands)	1988	1987
Investments in associated companies:		
Noranda Inc.	\$119,449	\$119,449
Anderson Exploration Ltd.	80,390	74,819
Other investments, at cost	15,834	11,358
Other assets	7,892	7,613
	<u>\$223,565</u>	<u>\$213,239</u>

(a) Noranda Inc. -

At December 31, 1988 and 1987, the company owned 7,361,281, or 4.0% of the outstanding common shares of Noranda Inc. Noranda and its associated companies are engaged in businesses encompassing mining and metallurgy, manufacturing, forest products and oil and natural gas exploration and production. At December 31, 1988 the quoted market value of the shares was approximately \$177 million. Effective from January 1, 1988, the company has included in income all dividends received on the Noranda shares. In

1988, such dividends amounted to \$6,625,000. For the period June 30, 1984 to December 31, 1987, dividends on the Noranda shares were deducted from the cost of the company's investment because of losses incurred by Noranda. In 1987, the amount of the deduction was \$4,233,000.

(b) Anderson Exploration Ltd. -

At December 31, 1988, the company owned 6,202,281, or 34.2%, of the outstanding common shares of Anderson which is engaged in the exploration and production of oil and gas properties in Western Canada. On September 30, 1988, the company purchased 392,157 treasury shares of Anderson for \$5,000,000. Anderson became a public company during the year and, at December 31, 1988, the quoted market value of the company's investment was approximately \$71 million.

(c) Other investments -

Included in Other Investments at December 31, 1988 are investments, at a cost of \$12.2 million, in exploration companies whose underlying properties have not yet been determined to contain economical ore reserves. The recoverability of these investments is dependent upon the discovery of economically recoverable reserves and future profitable production therefrom or the sale of the investments.

3. Property, plant and equipment

(in thousands)	1988		1987	
	Cost	Accumulated depreciation and amortization	Net book value	Book value
Mining and smelting properties:				
In production	\$240,617	\$123,741	\$116,876	\$ 33,703
Under development	82,654		82,654	135,833
	373,271	123,741	199,530	169,536
Oil and gas properties	108,403	28,570	79,833	72,702
	<u>\$431,674</u>	<u>\$152,311</u>	<u>\$279,363</u>	<u>\$242,238</u>

4. Share capital

In 1988 and 1987, common and preferred shares without par value are authorized for issuance in an unlimited number. The changes in common shares for the years 1988 and 1987 are set out below:

	1988		1987	
	Shares	Amount (000's)	Shares	Amount (000's)
Issued, beginning of year	17,535,177	\$184,196	17,315,027	\$180,783
Issued as "flow-through" shares			110,011	1,667
Issued under employee share purchase and option plans	9,350	155	110,139	1,746
Issued, end of year	<u>17,544,527</u>	<u>\$184,351</u>	<u>17,535,177</u>	<u>\$184,196</u>

At December 31, 1988, options on 21,350 common shares were outstanding, exercisable at prices varying from \$15.11 to \$19.87 for periods up to 1998.

5. Long-term debt

The company has a line of credit with its bankers which expires January 1, 1990. Advances totalling \$70 million are funded by bankers' acceptances. The effective interest rate payable on the bankers' acceptances is 11.15% at December 31, 1988. A further \$55 million of floating rate long-term debt is provided by Noranda Inc. The debt matures on January 1, 1990, and the rate of interest is 10.68% at December 31, 1988. No assets have been pledged as collateral for the long-term debt. Interest on long-term debt, including the convertible debentures of Minnova, amounted to \$15,512,000 in 1988 (\$7,346,000 in 1987).

6. Gain on sale of investments and other assets

<i>(in thousands)</i>	1988	1987
Gain on issue of capital stock		
by subsidiary	\$ 995	\$ 272
Gain on sale of investments		24,078
Gain on sale of fixed and other assets	951	2,053
	<u>\$1,946</u>	<u>\$26,403</u>

7. Income taxes

The provisions for income taxes for the years 1988 and 1987 are analyzed in the following table to show the difference between the taxes that would be payable by applying statutory tax rates to pre-tax earnings, and the taxes actually provided in the accounts:

<i>(in thousands)</i>	1988	1987
Earnings before income taxes	\$ 7,235	\$28,864
Statutory tax rates	<u>47.0%</u>	<u>49.0%</u>
Tax at statutory rates	\$ 3,400	\$14,143
Adjusted for the effect of –		
Resource allowance	(3,550)	(2,784)
Depletion allowance	(895)	(1,571)
Flow-through exploration expenditures	2,891	2,507
Non-taxable income	(7,876)	(8,423)
Other (net)	2,756	2,236
Tax provided (recovered) in the accounts	<u>\$ (3,274)</u>	<u>\$ 6,108</u>

8. Convertible debentures of Minnova Inc.

The adjustable rate convertible subordinated debentures are unsecured obligations of Minnova Inc. ("Minnova"). The debentures were issued on September 30, 1987, mature on September 30, 2007, and pay interest at a rate per annum equal to the greater of (i) 5% and (ii) 1% plus the percentage that two times the dividends paid on the common shares of Minnova in the six months ended on the date six months prior to the interest payment date is of the conversion price. The debentures are convertible at the holder's option into common shares of Minnova on or before the earlier of September 29, 2007 and the last business day prior to redemption, at a conversion price of \$34.25 per common share. At any time after September 30, 1992, Minnova may adjust the conversion price to \$38.00, provided that Minnova also fixes the interest rate at 6% per annum. The debentures are redeemable at par plus accrued interest after September 30, 1992 and, at any time prior to that date, at 105% of par plus accrued interest if at least 85% of the original principal amount of the debentures have been converted. On September 30, 2007, Minnova has the option to retire any debentures then outstanding by issuing common shares at the average closing market price for the 30 trading days prior to maturity.

9. Extraordinary items

The extraordinary items totalling \$1,211,000 in 1987 consisted of the gain on sale of the Virginiatown gold mine and mill complex – \$15,311,000 (net of deferred taxes of \$7,400,000) together with the write-down of certain mining properties in the amount of \$14,100,000.

10. Segmented information

The company operates primarily in two industries – mining and smelting, and oil and gas, and in one geographic area – Canada. The mining and smelting industry is comprised principally of the mining operations of Minnova and the zinc

reduction activities of Canadian Electrolytic Zinc. The oil and gas industry comprises the company's interest in Canadian Hunter (note 15). Information regarding industry segments is set out in the table below:

(in thousands)	Mining and smelting (i)		Industry segments Oil & Gas		Consolidated	
	1988	1987	1988	1987	1988	1987
Net sales	\$ 95,671	\$ 79,373	\$14,212	\$10,833	\$109,883	\$ 90,206
Cost of production	61,865	55,004	5,182	3,711	67,047	58,715
	33,806	24,369	9,030	7,122	42,836	31,491
Mineral exploration expenses	(19,858)	(13,787)			(19,858)	(13,787)
Depreciation and amortization	(14,650)	(8,579)	(5,970)	(4,702)	(20,620)	(13,281)
Segment operating profit (loss)	\$ (702)	\$ 2,003	\$ 3,060	\$ 2,420	2,358	4,423
Income and expenses not allocated to industry segments (net)					8,151	18,333
Income before extraordinary items					10,509	22,756
Extraordinary items						1,211
Net income for the year					\$ 10,509	\$ 23,967
Identifiable assets	\$300,479	\$289,445	\$87,231	\$79,703	\$387,710	\$369,148
Investments and other assets					295,596	326,596
Total assets					\$683,306	\$695,744
Capital expenditures	\$ 43,443	\$ 62,619	\$13,118	\$ 9,580	\$ 56,561	\$ 72,199

(i) Canadian production includes exports of \$26,460 (\$19,313 in 1987) primarily to customers in the United States.

11. Related party transactions

The company is a subsidiary of Noranda Inc. Details of significant transactions with the Noranda Group for the years 1988 and 1987 are set out below:

(i) Canadian Electrolytic Zinc ("CEZ") –

The company's portion of zinc concentrate purchased on the company's behalf by CEZ from the Noranda Group amounted to approximately \$12,397,000 (1987 – \$11,275,000).

(ii) Marketing and administrative services –

The Noranda Group markets substantially all of the company's production and renders technical and administrative services to the company. During the year marketing fees were \$429,000 (1987 – \$315,000) and fees for technical and administrative services were \$175,900 (1987 – \$126,000).

Copper and zinc concentrates and gold bullion sales by the company to Noranda Inc. during 1988 amounted to approximately \$77,917,000 (1987 – \$65,527,000).

(iii) Short-term securities –

The company participates in a short-term investment pool with the Noranda Group. The pool is operated to provide participating companies with the opportunity to invest or borrow funds on a short-term demand basis within the Noranda Group. During 1988, the company earned interest on net deposits amounting to \$1,556,000 (1987 interest paid – \$1,656,000). At December 31, 1988, the company's deposit in the pool was \$30,670,000 (1987 – deposit of \$3,660,000).

The company has a \$100,000,000 (\$100,000,000 in 1987) investment in the common shares of an affiliated company. These shares, the cost of which approximates market, are included in short-term securities. Dividends received on these shares during the year amounted to \$7,535,000 (1987 \$4,639,000).

(iv) Effective October 1, 1988, the company and Minnova consolidated certain of their exploration properties into a 50-50 joint venture operated by Minnova. Following an initial payment by the company of \$625,000, all joint venture costs on these and subsequently acquired properties are shared equally. In the three months ended December 31, 1988, Minnova's share of costs was \$460,000 and the company's share was \$1,085,000.

12. Commitments and Contingencies

(a) Capital expenditure commitments –

Capital expenditure commitments for 1989 for properties under development are estimated to be \$36,000,000.

(b) Forward metal sales –

Gold –

At December 31, 1988, 50,000 troy ounces of gold are contracted for delivery in various quantities monthly from March 1989 through June 1990 at an average price of U.S. \$474.

Copper –

At December 31, 1988, 42 million pounds of copper are contracted for delivery in various quantities monthly from March 1989 through March 1990 at an average price of U.S. \$1.06.

13. Retirement plans

The company has retirement plans covering substantially all employees. Based on the most recent actuarial valuation of the plans at January 1, 1988 projected to December 31, 1988, the estimated actuarial present value of accrued pension benefits and the estimated value of the pension fund net assets available to provide for these benefits are as follows:

(in thousands)	1988	1987
Accrued pension benefits	\$17,433	\$15,833
Pension fund assets	\$29,488	\$28,713

14. Litigation

Minnova's 100% ownership of its Winston Lake mine is subject to a 10% net proceeds of production royalty under the terms of the original 1980 option agreement. In December of 1987, an action was instituted against Minnova alleging, among other things, that under the option agreement the previous owner is entitled to purchase a 20% participating ownership interest in the mine rather than the 10% net proceeds of production royalty.

Minnova's 94.2% ownership interest in its Lac Shortt gold mine is subject to a 7.5% net proceeds of production royalty under the terms of the original 1979 option agreement. In January 1988, an action was instituted against Minnova alleging, among other things, that the annual royalty calculations performed by Minnova pursuant to the 1979 agreement were not done in accordance with the agreement.

Minnova believes that its defences to these actions are meritorious and is vigorously defending each action.

15. Subsequent event

The company has agreed to dispose of its 13% interest in Canadian Hunter to Noranda Inc. for \$85 million effective January 1, 1989. The payment terms include \$20 million of cash and \$65 million of preferred shares redeemable over five years and paying a dividend of 70% of prime rate. The carrying value of its interest at December 31, 1988 is \$50 million.

16. Comparative figures

Certain of the 1987 comparative figures have been reclassified to conform to the presentation adopted in the current year.

DIRECTORS

*Ian D. Bayer

*President & Chief Executive Officer
Kerr Addison Mines Limited*

Jack L. Cockwell

*Executive Vice-President &
Chief Operating Officer
Brascan Limited*

P.S. Cross, P.Eng.

*Consultant
Kerr Addison Mines Limited*

J.A. Hall

Company Director - Mining Engineer

*K.C. Hendrick

*President
Noranda Minerals Inc.*

*David W. Kerr

*President
Noranda Inc.*

†*James W. McCutcheon, Q.C.

*Partner
Shibley, Righton & McCutcheon*

†*J.P.W. Ostiguy, O.C.

*Honorary Chairman
Richardson Greenshields
of Canada Limited*

†*Alfred Powis, O.C.

*Chairman & Chief Executive Officer
Noranda Inc.*

E. Courtney Pratt

*Senior Vice-President
Human Resources &
Strategic Planning
Noranda Inc.*

*Member of Executive Committee

†Member of Audit Committee

OFFICERS

K.C. Hendrick

Chairman of the Board

Ian D. Bayer

President & Chief Executive Officer

P. Bojtos

Vice-President - Corporate Development

A.H. Cross

Treasurer

J.B. Sage

Secretary

J.A. Snow

General Counsel

P.J. Smith

Comptroller

MINNOVA INC.

J.K. Carrington

Senior Vice-President

D.H. Watkins

Senior Vice-President

D. Tolgyesi

General Manager - Quebec

J. Desrosiers

*Mine Manager,
Lac Dufault Division*

T.A. Dickson

*Mine Manager,
Winston Lake Division*

M. Garon

*Mine Manager,
Opemiska Division*

S. Nantel

*Mine Manager,
Lac Shortt Division*

J. Purkis

*Project Manager,
Samatsum Division*

F. Balint

*Exploration Manager,
Central Canada*

A.J. Davidson

*Exploration Manager,
Western Canada & U.S.A.*

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