ROTHMANS OF PALL MALL CANADA LIMITED

Annual Report
1979

ROTHMANS OF PALL MALL CANADA LIMITED

Annual Report 1979

CONTENTS

The Annual Meeting of shareholders will be held at the Four Seasons Hotel, 21 Avenue Road, Toronto, Ontario at 3:00 o'clock on Thursday, July 5, 1979.

Ce rapport peut être obtenu en français sur demande.

ROTHMANS OF PALL MALL CANADA LIMITED

CONSOLIDATED HIGHLIGHTS

(in thousands of dollars)

	1979	1978
Year Ended March 31		
SALES	**$801,315**	$779,898
EARNINGS:		
FROM CONTINUING OPERATIONS	**23,380**	24,475
BEFORE EXTRAORDINARY ITEMS	**23,380**	19,384
AFTER EXTRAORDINARY ITEMS	**23,541**	14,266
DIVIDENDS PAID:		
PREFERRED SHARES	**3,505**	3,547
COMMON SHARES	**4,583**	3,028
WORKING CAPITAL FROM CONTINUING OPERATIONS	**48,905**	47,042
CAPITAL EXPENDITURES	**31,324**	26,056
EARNINGS PER COMMON SHARE:		
FROM CONTINUING OPERATIONS	**4.33**	4.58
BEFORE EXTRAORDINARY ITEMS	**4.33**	3.47
AFTER EXTRAORDINARY ITEMS	**4.37**	2.35
	5399538	
At March 31	.85	5343886 .56
WORKING CAPITAL	**117,292**	118,467
TOTAL ASSETS	**418,512**	415,854
LONG TERM DEBT	**43,672**	49,242
SHAREHOLDERS' EQUITY:		
AMOUNT	**132,023**	117,054
PER COMMON SHARE	**17.40**	14.00

7,587,529 9,361,000

Corporate Profile

The Company is a member of the world-wide Rothmans Group which operates 87 plants in 27 countries and whose products are sold in more than 180 countries. Rothmans of Pall Mall Canada Limited and its subsidiary companies are engaged in the production and sale of tobacco, beer and wine products and are involved in oil and gas operations.

Rothmans is Canada's second largest manufacturer and distributor of cigarettes and tobacco products. The Company's present cigarette brands are set out below:

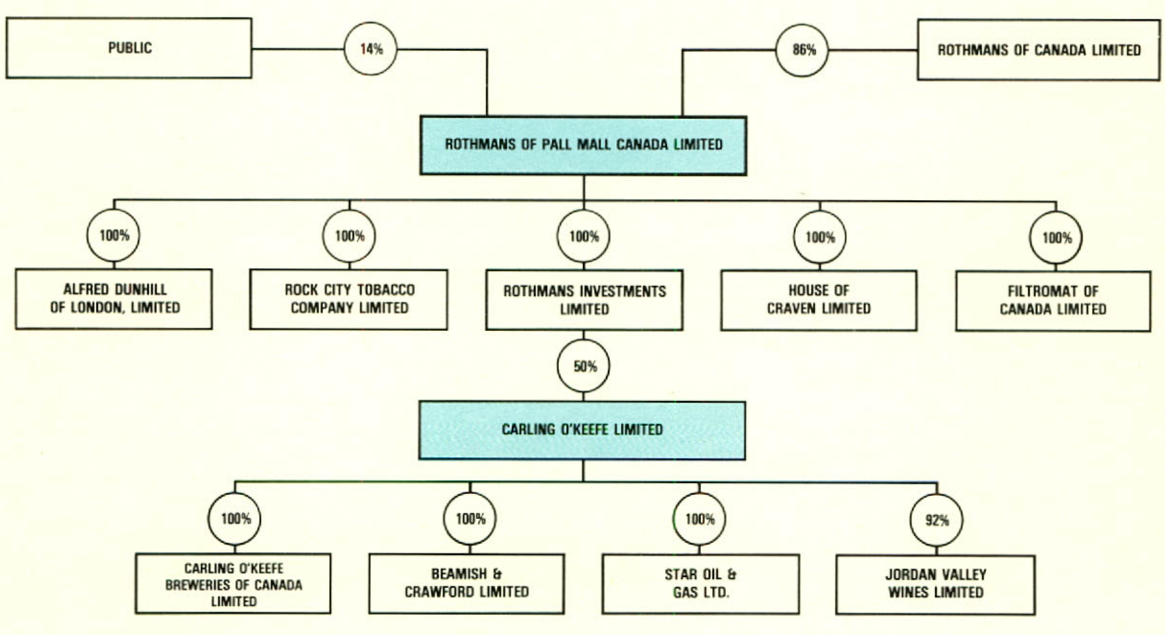
REGULAR LENGTH	*KING SIZE*		*LUXURY LENGTH*
Craven "A"	Rothmans	Craven "A" Ultra Light	Peter Stuyvesant 100's
Craven "A" Special Mild	Rothmans Special Mild	Craven Menthol	Peter Stuyvesant 100's Menthol
Rothmans Special Mild	Number 7	Sportsman	Dunhill Luxury Length
Number 7 Lights	Number 7 Lights	Perilly's Private Blend	
Sportsman	Craven King Size	Peter Stuyvesant	
Black Cat	Craven "A" Special Mild	Dunhill	
	Craven Menthol Special Mild	Dumont Select Mild	

In addition, Rothmans sells fine cut tobacco, cigarette rolling devices and tubes for home use, imported pipe tobaccos, cigars and smokers' accessories. Tobacco manufacturing operations are carried out in plants located in Toronto and Quebec City and the Company has seventeen sales offices across Canada.

Carling O'Keefe Limited, a majority-owned subsidiary, operates eight breweries in Canada and one in the Republic of Ireland, producing such well known brands as Carling Black Label, Old Vienna, O'Keefe Ale, Carlsberg, Colt 45, Magnum Ale and Trilight. Jordan Valley Wines Limited produces wine at six Canadian wineries and Star Oil & Gas Ltd. is engaged in oil and gas operations in Canada and the United States.

The consolidated corporation is among the 100 largest companies in Canada and employs more than 5,300 people, paying annual salaries in excess of $100 million.

The following chart outlines the corporate relationship between your Company, its shareholders and its main subsidiaries.



(Percentages have been rounded.)

Directors' Report

PERFORMANCE

Consolidated earnings from operations showed a decline of 4.5 percent in the year ended March 31, 1979 and amounted to $23,380,000 or $4.33 per Common share, compared to $24,475,000 or $4.58 per Common share in 1978. Earnings from tobacco operations of $17,605,000 were 10.2 percent lower than last year. Our share of earnings from Carling O'Keefe Limited increased to $5,775,000 from $4,863,000 in 1978.

In 1979, final consolidated earnings after an extraordinary item were $23,541,000 or $4.37 per Common share. In 1978, after giving effect to the losses incurred in United States brewing operations and extraordinary items, final consolidated earnings amounted to $14,266,000 or $2.35 per Common share.

The annual Common share dividend of $1.00 per share was maintained for the year. Effective with the June 17, 1979 payment, an increase in the quarterly dividend from 25¢ to 30¢ per Common share was approved by your Board of Directors. Carling O'Keefe Limited reinstituted a Common share dividend on January 1, 1979, at the rate of 10¢ per share per annum. This is equivalent to 24¢ per annum for each presently outstanding Rothmans Common share.

TOBACCO

Sales revenue from tobacco operations increased to $400,042,000 from $398,751,000 in 1978, in spite of a slight overall decline in company cigarette sales volume. Accurate year to year comparisons of total industry sales are difficult to assess because of the influences of price increases, tax increases, and competition between companies in the area of trade promotions. However, following last year's slight decline, total shipments in the 1979 fiscal year represented a modest increase for the industry.

The trend to "milder" cigarettes continues. Consumer preference for this type of product has increased industry sales of these brands to 47 percent of the total market. Forty-nine percent of your Company's sales are in this increasingly important market segment and it is anticipated that with continued growth, "light/mild" brands will account for over one-half of the total market during the 1980 fiscal year.

The growth of the "light/mild" product category has placed pressure on sales of traditional full-flavour brands. Marketing efforts during recent periods have placed increased emphasis on the development and introduction of "light/mild" products for each of the Company's brand families.

Within the Rothmans brand family, Rothmans Special Mild in both King Size and Regular Length grew to a level representing over 2 percent of the total market, largely offsetting sales declines in Rothmans King Size Filter.

Although sales for the entire Craven Family declined slightly during the year, sales of Craven Menthol and the new Craven Menthol Special Mild introduced in January, 1978 were particularly encouraging. Craven Menthol products now represent 38 percent of the total menthol market and are the only growth trade marks within this important market segment.

Recently, Craven "A" Ultra Light, a King Size 1 mg "tar" product was launched in Montreal and Vancouver, to take advantage of the rapid growth within the ultra-low "tar" segment. Initial sales results for this new brand are extremely encouraging.

The "light" member of the Number 7 family, Number 7 Lights, in both Regular and King Size was successfully introduced into all Ontario and Western Canadian markets during the course of the year. Recently, a totally new advertising approach for the brand has been introduced featuring a "Sevens are Mild" theme. Sales growth of this important brand extension will serve to complement the sales of Number 7.

Export sales and Duty Free sales continued strong during the year, thus maintaining the Company's leading position within the industry in these important markets.

It is expected that in 1980 market pressures will continue to affect sales of full-flavour brands including our own. We are confident, however, that the successful introduction of "light/mild" versions of each of our major brand families will, by and large, offset these anticipated sales declines and position the Company to take full advantage of the continuing trend to "milder" brands.

Last year, we advised you that capital expenditures during the year were expected to amount to $7.5 million. Of this amount, $4.8 million was spent and commitments will be made for the balance. Following an extensive technical study, plans have been approved for a major upgrading of our leaf processing department in the Quebec City factory. The ability to carry out these plans was made possible by the expansion of the Quebec City plant approved last year, construction of which is now underway. The benefits will include the ability to apply the most recent technology available to the processing of tobacco before its introduction to the cigarette-making machines. It is anticipated that the improved product quality and reduction of waste will yield benefits to your Company that will substantially exceed our minimum investment criteria.

In Toronto, the Company has completed labour negotiations on a contract that was not subject to Anti-Inflation Board controls. The two-year collective agreement was settled amicably and will expire on December 20, 1980. In Quebec, the labour contract is currently under negotiation and it is anticipated that it will be settled on a similar basis as that of Toronto in the near future.

Leaf tobacco represents the largest component of manufacturing costs at 43 percent of the total. The 1978 crop of Ontario flue-cured tobacco was sold at auction which was completed in April, 1979. A total of 230 million pounds were sold, up from 205 million pounds in 1977. The overall average price paid for the 1978 crop was $1.18, compared to $1.09 the previous year. As a result of increased overseas interest, the reduced value of the Canadian dollar and the export subsidy paid to overseas buyers by the domestic companies, 103 million pounds of tobacco from Ontario were purchased for export. For 1979, negotiations have been completed with the Ontario Flue-Cured Tobacco Growers Marketing Board. A crop of 230 million pounds will be grown, with the average guaranteed minimum price of $1.16 per pound, an increase from the $1.065 guaranteed in 1978. The domestic companies have agreed to subsidize up to 100 million pounds of tobacco for export by making available $3,500,000, equivalent to 3.5¢ per pound exported.

Anti-Inflation Board pricing and profit constraints, which continued to apply to your Company for the first three quarters of the fiscal year, terminated on December 31, 1978.

In the section of this Report dealing with Policies and Plans, shareholders will note that the target set last year for the Company's debt-to-total capital ratio was achieved. In view of our major capital expenditure program and the substantial returns expected from these expenditures, no additional steps were taken with respect to acquisitions or further diversification in the past year. Given the relatively high rates of return available within the tobacco business, it was felt that the Company should concentrate in this area until all such opportunities have been developed.

BREWING

Carling O'Keefe Limited made gains during the year and reported higher consolidated sales revenue and earnings than for the previous year. Work stoppages in Canadian brewing operations in the Provinces of Manitoba, Alberta and British Columbia during the key summer months of 1978 reduced sales volume below the company's expectations.

Carling O'Keefe has introduced Magnum Ale in the important Ontario market, where the company's market share was relatively unchanged. Market share increases were achieved in Quebec, Manitoba, Saskatchewan and Newfoundland but were offset by declines in Alberta and British Columbia.

The Canadian wine market continues to grow, particularly in the table wine category. Despite this overall growth, Jordan Valley Wines Limited's sales and earnings declined slightly. This is attributed to a reduction in volume in Ontario where imported table wines continued to take a larger share of the market, a seven-week strike at the Manitoba Liquor Commission and the difficulties encountered in Quebec where only domestic wines bottled in that province are accepted for distribution in grocery stores.

Star Oil & Gas Ltd. reported a slight decline in sales and earnings. Sales volume of natural gas was reduced as a result of the present excess in the available supply for domestic and export requirements. Earnings were affected by the increased level of exploration and development expenditures, which increased depletion costs. However, proven reserves of both natural gas and oil increased, adding to the worth of the company.

In Ireland, Beamish & Crawford Limited reported increased earnings resulting from improved margins.

More complete details are included in the Carling O'Keefe Limited report which is enclosed.

ROTHMANS INTERNATIONAL LIMITED

During the year, Rothmans International Limited of London, England acquired, through Martin Brinkmann AG, Germany, a wholly-owned subsidiary, the majority interest in your Company. As a result, a much closer working relationship has been developed with other members of the Rothmans family in Europe and in the Asia/Pacific region. This has been of particular importance to the Canadian company in developing marketing plans for its international brands. It has also provided, through membership in the functional committees of Rothmans International Limited, an opportunity for members of your senior management to meet on a regular basis with their counterparts from other countries to discuss problems of a common nature relating to their particular areas of expertise.

It is the intention of Rothmans International Limited to reduce its equity interest in your Company to 50 percent at some future date, as conditions warrant.

Mr. John H. Devlin, Chairman of your Company, has joined the Board of Directors of Rothmans International and Mr. Robert H. Hawkes, President and Chief Executive Officer of your Company, has joined its Executive Committee.

CONVERSION OF SECOND PREFERRED SHARES

We wish to remind shareholders that the Second Preferred shares of the Company are convertible on the basis of 1 Common share for 1¼ Preferred shares on or before October 31, 1979. Thereafter, the Second Preferred shares will not be convertible into Common shares of the Company.

DIRECTORS AND MANAGEMENT

During the year, the Honourable John E. Shaffner retired from the Board of Directors when he was appointed Lieutenant-Governor of the Province of Nova Scotia. Mr. Shaffner had been a director of your Company since 1961, and a member of the Audit Committee since it was established. On behalf of all shareholders, directors and officers, we wish him every success in his new responsibilities and thank him for his dedicated service to the Company.

Mr. A. Orlow, Chief Executive of Rothmans International Limited, was elected to the Board of Directors at the Annual Meeting of Shareholders in 1978. Mr. F. Cordewener, Finance Director of Martin Brinkmann AG, joined the Board of Directors during the year.

Mr. Daniel Di Ianni, Vice President Manufacturing, retired this year after nineteen years with the Company and its associates. Mr. Di Ianni has been a vital part of the Rothmans family since the beginning of our operations in Canada. His contribution to our success over the past two decades has been invaluable. We all extend to Mr. Di Ianni and his family our thanks and best wishes for many years of health and happiness. Mr. G.G. Norman, Vice President Production, has assumed Mr. Di Ianni's duties. Mr. J.E. Broen joined the Company during the year and has been appointed Vice President Marketing Operations.

Our fellow directors join us in thanking all employees of the Company and its subsidiaries for their contribution to the continuing success of the business during the year. To our shareholders, we express thanks for your continuing interest and support.

John H. Devlin

J.H. Devlin
Chairman of the Board

R.H. Hawkes

R.H. Hawkes
President and Chief Executive Officer

May 25, 1979

Policies and Plans

INTRODUCTION

Last year we introduced in this section of our Annual Report a discussion of important financial policy and planning objectives established by the Board of Directors. These plans relate to capital expenditures, target capital structure, dividend policy and diversification and acquisition policies.

It is our intention to keep shareholders informed of our policies and plans in these areas. Accordingly, we present in this section the current status of these plans and our progress in moving toward our objectives. Our plans are periodically reviewed to reflect changes in our financial position and changes in business and capital market conditions.

CAPITAL EXPENDITURES

Capital expenditures for the 1979 fiscal year totalled approximately \$4.8 million and covered a broad range of additions and improvements to facilities. Actual outlays were \$2.7 million below our budgeted expenditures of \$7.5 million for 1979 due to postponement of certain capital projects. These commitments have been carried over into our projections for 1980.

During fiscal 1980 we expect to spend approximately \$9.5 million on new capital projects and additions to our existing facilities. Of this amount, approximately \$2.1 million relates to the reorganization of our warehousing facilities in Quebec City. This project will allow us to improve our handling of finished goods, reduce material handling costs and decrease our transportation costs. In addition, approximately \$1.2 million is budgeted for the upgrade of our leaf processing facilities in the Quebec City plant. We expect to commit approximately \$9 million to this project over the next four years. The remainder of our capital expenditures anticipated for 1980 pertain to vehicle replacements, and replacement of and improvements to our existing facilities.

CAPITAL STRUCTURE

Our objective in establishing financing guidelines for Rothmans is to balance the relatively low after-tax cost of debt with the need to maintain financing flexibility and a sound financial base to support existing operations and anticipated expansion. Last year, after a thorough review of capital market conditions and consideration of important aspects of our operations, we established as our target for tobacco operations a ratio of debt-to-total capital of 45-50 percent at fiscal year-end. This target excludes the investment in Carling O'Keefe and considers only the tobacco operations capital structure because of Carling O'Keefe's independent financing. Because of relatively large short term borrowings at fiscal year-end to support seasonal inventory buildups, our actual average use of debt throughout the year is lower than at year-end.

During fiscal 1979 we reduced our debt-to-total capital ratio from 52 percent at the end of fiscal 1978 to 42 percent at March 31, 1979. This level is roughly in line with our target and is consistent with our stated plan to reduce our use of debt from past levels, which are shown on the following page. We believe that this capital structure provides a more flexible and prudent financial position to support our operations.

We were able to substantially moderate our use of debt during the year as a result of lower receivables and improved management of inventories. Our level of short term debt in 1979 was reduced by approximately \$16.8 million from the level at the end of fiscal 1978. The total amount of debt employed in tobacco operations was \$60.0 million at March 31, 1979, compared with \$78.4 million a year earlier.

DEBT-TO-TOTAL CAPITAL
(Dollars in Millions)

	As At Fiscal Year-End				
	1979	1978	1977	1976	1975
Total Interest-Bearing Debt	**60.0**	78.4	76.0	76.6	71.6
Total Capital*	**142.2**	151.4	135.7	123.2	105.9
Debt-to-Total Capital Ratio	**42%**	52%	56%	62%	68%

*Capital includes all interest-bearing debt, deferred taxes, preferred shares and common shareholders' equity (excluding the investment in Carling O'Keefe Limited on the equity basis).

DIVIDEND POLICY

Effective with the March 1978 payment, our annual Common dividend rate became $1.00 per share. This payout, approximately double the previous level, was established last year in view of anticipated cash flow and internal financing requirements of our tobacco operations alone, and gave no consideration to the improvement in the earnings of Carling O'Keefe.

Effective June 1979, the Common share dividend was increased to an annual indicated rate of $1.20 per share. This increase was made in view of further improvements in the earnings of Carling O'Keefe and a lower than anticipated debt-to-total capital ratio.

Our dividend policy is carefully and continually reviewed in the context of investment opportunities and financial objectives, and any revision in policy necessitated by changes in circumstances will be communicated to our shareholders.

DIVERSIFICATION AND ACQUISITION POLICY

As stated in the Directors' Report, we have not taken any additional steps with respect to acquisitions or further diversification within the past year. We feel that the available internal opportunities, with their relatively high rates of return, should be developed before your Company expands its range of activities.

Review of Tobacco Operations

This section of the Annual Report is presented to aid shareholders in their evaluation of our performance over the past year. In last year's Annual Report we introduced the concept of return on total capital invested in the Company as a measure of our performance. We define the return on capital as net operating profits after tax, divided by average total capital employed.

To fully incorporate the effect of seasonal financing requirements on capital employed, we have computed average capital on the basis of monthly averages for debt, deferred taxes and shareholders' equity.

ANALYSIS OF PERFORMANCE
TOBACCO OPERATIONS
($000)

	Fiscal Year				
	1979	**1978**	**1977**	**1976**	**1975**
Average Total Capital Employed					
Average Interest-Bearing Debt - - - - -	**$ 54,993**	$ 65,905	$ 69,680	$ 67,441	$ 65,846
Average Deferred Taxes - - - - - - -	**6,486**	6,563	5,910	4,275	3,174
Average Shareholders' Equity* - - - - -	**72,433**	60,897	47,999	35,248	25,311
	$133,912	$133,365	$123,589	$106,964	$ 94,331
*Net Operating Profits After Tax***					
Earnings Before Extraordinary Items - - -	**$ 17,605**	$ 19,612	$ 18,022	$ 21,729	$ 17,328
Deferred Taxes - - - - - - - - - -	**(228)**	66	1,427	1,566	1,203
After Tax Interest Expense - - - - - -	**2,772**	3,027	3,581	3,370	3,434
	$ 20,149	$ 22,705	$ 23,030	$ 26,665	$ 21,965
Return on Average Total Capital Employed - -	**15.0%**	17.0%	18.6%	24.9%	23.3%

* Average shareholders' equity for tobacco is computed from total shareholders' equity minus the investment in Carling O'Keefe Limited on the equity basis.

** Net operating profits after tax represent the Company's profits before interest expense but after taxes other than deferred taxes.

The following table and explanatory notes provide a more detailed view of factors which influenced tobacco operations and profitability in the past year.

YEAR ENDED MARCH 31 (in thousands of dollars)	1979	1978	INCREASE (DECREASE)
SALES:			
Cigarettes	$386,438	$386,204	0.1%
Fine cut tobacco	6,787	6,884	(1.4)
Imported pipe tobacco	2,510	2,199	14.1
Cigars	2,231	1,818	22.7
Other products	2,076	1,646	26.1
	400,042	398,751	0.3
EARNINGS:			
Before income taxes	28,544	32,131	(11.2)
After income taxes	17,605	19,612	(10.2)

SALES:

Cigarette sales revenue remained virtually the same as last year, with gains arising from selling price increases offset by lower unit sales. The selling price adjustment in the third quarter of last year had a full year's impact in 1979 and there was a further, relatively minor, improvement from a price increase in February 1979. The Company's unit sales were 16,424 million compared to 16,877 million in 1978, a decrease of 2.7 percent.

Total industry unit cigarette sales, as reported by Statistics Canada, were 63,592 million, an increase of 2.8 percent over last year's 61,844 million.

Sales revenue from fine cut tobacco was down marginally from last year, with lower sales partially offset by a selling price increase in the latter part of the year. Unit sales amounted to 1,496,000 pounds, a decline of 2.9 percent from last year's 1,541,000 pounds.

Although unit sales of imported pipe tobacco were virtually the same as last year (322,000 pounds compared to 328,000 pounds), sales revenue for this product line increased by 14.1 percent because of selling price increases instituted in March 1978.

The substantial gain in revenue from cigar sales was primarily attributable to increased volume. Unit sales were almost 4.3 million in 1979 compared to just over 3.5 million last year.

Other products includes cigarette tubes, cigarette rolling devices, pipes, lighters and smokers' accessories. In total, revenue from these lines was up by $430,000 (26.1 percent) over last year.

EARNINGS:

The following table outlines the appropriation of a tobacco sales dollar:

	Year ended March 31	
	1979	1978
Excise and sales taxes	**52.6¢**	53.9¢
Costs:		
Raw materials and manufacturing	**27.5**	26.2
Marketing and distribution	**8.9**	8.0
Administrative and general	**2.7**	2.5
Interest	**1.2**	1.3
	40.3	38.0
Income taxes	**2.7**	3.2
Earnings	**4.4**	4.9
Sales revenue	**100.0¢**	100.0¢

Comments on excise and sales taxes can be found in the section "Federal and Provincial Taxes" on page 11.

Raw materials and manufacturing expenses consist primarily of leaf tobacco, packaging materials, direct labour and manufacturing overheads. The total charged against earnings in 1979 was $110,011,000, an increase of 5.6 percent over last year despite lower unit cigarette sales.

Leaf tobacco continues to represent the most significant element of raw materials and manufacturing expenses. Leaf tobacco charged against earnings in 1979 amounted to $47.4 million ($1.30 per pound), compared to $45.7 million ($1.20 per pound) last year. The significant unit increase reflects the higher cost of Ontario flue-cured tobacco purchased last year. Leaf purchased during 1979 is included in inventory at year-end. Further information on leaf tobacco can be found in the Directors' Report.

Packaging materials consist of all raw materials other than leaf tobacco and represent the second largest component of production cost. In total, the charge against earnings amounted to slightly more than $29 million (1978—$27.3 million).

Labour and overhead expenses together totalled approximately $30 million. Lower production volume in 1979 meant that the unit cost for manufacturing overheads increased more than the absolute dollar amount.

Marketing and distribution expenses include selling, advertising, freight and warehousing costs. The total charge against earnings in 1979 was $35,602,000, an increase of approximately 11 percent over last year.

Selling expenses were higher than in 1978 because of both additional sales staff and increased costs for salaries, fringe benefits and vehicles. Advertising and promotion expenditures increased as a result of higher costs and the funds related to the introduction and/or extension of new brands.

Freight expenses were only slightly higher than last year, as lower sales volume partially offset increased rates. Warehousing costs also showed only a modest gain over 1978.

Administrative and general expenses totalled $10,859,000 in 1979, an increase of about 9 percent over last year. Higher salary and fringe benefit costs were the major cause.

Interest and expense on both short and long term debt amounted to $4,864,000, a reduction of more than

$500,000 or 9.5 percent. The major reason for the lower cost was a substantial reduction in short term borrowings. A partial offsetting factor was higher interest rates. There were six increases in the prime bank rate during the 1979 fiscal year (from 8 3/4% at April 1, 1978 to 12% in January 1979).

As a result of a reduction in pre-tax earnings and a slightly lower effective tax rate, income tax expense in 1979 amounted to $10,939,000, a decrease of 12.6 percent. The provision of 38.3 percent compares to a 1978 rate of 39 percent, primarily reflecting an increase in the amount of the 3% inventory allowance.

Earnings for the year were $17,605,000, down by approximately $2 million or 10 percent. The major adverse factors were lower unit cigarette sales and increased costs of production and marketing.

FEDERAL AND PROVINCIAL TAXES:

The Company's selling price includes three federal taxes—excise tax, excise duty and sales tax. In total, these taxes amounted to $210,162,000 in 1979, a decrease of 2.3 percent from last year as a result of lower unit cigarette sales.

There were no changes in rates of federal tax during the year, but the manufacturers' selling price increase in February 1979 marginally increased the unit cost of sales tax. Together, the three taxes amount to $2.60 per carton of 200 king size cigarettes.

The retail selling price of cigarettes also includes taxes imposed by the various provinces and territories. All twelve areas levy a tobacco tax and, in addition, the price in Newfoundland includes provincial sales tax. During the year ended March 31, 1979, there were six provincial tobacco tax increases, including two in New Brunswick totalling $1.20 per carton. The other four adjustments were 96 cents in British Columbia, 24 cents in Saskatchewan, 40 cents in Manitoba and 56 cents in Quebec. Subsequent to year-end, there have been increases of 80 cents per carton in Nova Scotia and 20 cents in Ontario. At the present time, provincial tobacco taxes are as follows (per carton):

British Columbia	$1.92	New Brunswick	$2.00
Alberta	0.64	Nova Scotia	2.00
Saskatchewan	2.16	Prince Edward Island	1.60
Manitoba	2.00	Newfoundland*	2.70
Ontario	2.40	Yukon Territory	1.20
Quebec	2.16	Northwest Territories	2.00

*excluding provincial sales tax of 11%

Together, federal and provincial taxes represent between 46 and 66 percent of the retail selling price of cigarettes.

FINANCIAL POSITION:

During the year ended March 31, 1979 there was an increase in working capital from tobacco operations of $7,797,000, bringing the total at year-end to $76,825,000. Major contributing factors were earnings of $17,605,000 and depreciation expense of $4,494,000; capital expenditures of $4,791,000 and dividends of $8,088,000 were partial offsetting factors.

Major capital expenditures in 1979 were related to production facilities and replacement of vehicles.

In total, dividends paid were $1,513,000 higher than in 1978. The increase was attributable to distributions made to Common shareholders, reflecting a full year's impact of the $1.00 per share annual rate instituted with the March 1978 dividend.

There was a significant reduction during the year in the Company's short and long term debt—a total of $18,434,000. The major contributing factors were the aforementioned increase of $7,797,000 in working capital and decreases of $6,933,000 in inventories and $4,908,000 in accounts receivable.

EARNINGS FROM TOBACCO OPERATIONS

(in thousands of dollars)

	Year ended March 31	
	1979	1978
Sales	$400,042	$398,751
Excise and sales taxes	210,162	215,034
Net sales	189,880	183,717
Costs:		
Raw materials and manufacturing	110,011	104,223
Marketing and distribution	35,602	32,037
Administrative and general	10,859	9,950
Interest and expense on long term debt	2,631	2,783
Other interest	2,233	2,593
	161,336	151,586
Earnings before income taxes	28,544	32,131
Income taxes:		
Current	11,167	12,453
Deferred	(228)	66
	10,939	12,519
Earnings for the year	$ 17,605	$ 19,612

CHANGES IN FINANCIAL POSITION OF TOBACCO OPERATIONS

(in thousands of dollars)

	Year ended March 31	
	1979	1978
Working capital was increased by:		
Earnings from tobacco operations	$ 17,605	$ 19,612
Depreciation	4,494	3,932
Other items not requiring working capital	(313)	26
Working capital from operations	21,786	23,570
Proceeds on disposal of property, plant and equipment	433	688
Dividends from Carling O'Keefe Limited	545	—
Issue of Common shares	—	566
	22,764	24,824
Working capital was decreased by:		
Additions to property, plant and equipment	4,791	3,282
Reduction of long term debt	1,559	1,533
Purchase of First Preferred shares	526	420
Dividends:		
Preferred shares	3,505	3,547
Common shares	4,583	3,028
Other	3	41
	14,967	11,851
Increase in working capital	7,797	12,973
Working capital at beginning of year	69,028	56,055
Working capital at end of year	$ 76,825	$ 69,028

FINANCIAL POSITION OF TOBACCO OPERATIONS

(in thousands of dollars)

	March 31 1979	March 31 1978
ASSETS		
Current assets:		
Accounts receivable	$ 18,658	$ 23,566
Inventories	117,747	124,680
Prepaid expenses	1,154	1,095
Total current assets	137,559	149,341
Investment in Carling O'Keefe Limited, at equity	55,917	50,485
Property, plant and equipment, at cost	63,705	60,975
Less: Accumulated depreciation	35,858	33,100
	27,847	27,875
Other assets	654	714
	$221,977	$228,415
LIABILITIES		
Current liabilities:		
Bank and other short term indebtedness	$ 35,413	$ 52,239
Accounts payable and accrued liabilities	14,706	15,321
Income taxes	560	259
Excise, sales and other taxes	10,055	12,494
Total current liabilities	60,734	80,313
Long term debt	23,050	24,650
Total liabilities	83,784	104,963
DEFERRED INCOME TAXES	6,170	6,398
SHAREHOLDERS' EQUITY		
Capital stock:		
Preferred shares	52,082	52,747
Common shares	4,232	4,159
	56,314	56,906
Retained earnings	75,709	60,148
Total shareholders' equity	132,023	117,054
	$221,977	$228,415

Review of Brewing Operations

A copy of the 1979 Annual Report for Carling O'Keefe Limited is enclosed to provide detailed information on that company's consolidated operations. The following tables and commentary comprise a highlight review.

ANALYSIS OF PERFORMANCE
BREWING CONTINUING OPERATIONS
($000)

	Fiscal Year				
	1979	1978	1977	1976	1975
Average Total Capital Employed					
Average Interest-Bearing Debt	**$ 26,952**	$ 43,000	$ 55,747	$ 49,569	$ 47,841
Average Minority Interest	**1,777**	1,690	1,681	2,554	3,354
Average Deferred Taxes	**23,708**	19,781	16,383	14,869	13,686
Average Shareholders' Equity*	**149,299**	123,963	102,906	107,583	113,984
	$201,736	$188,434	$176,717	$174,575	$178,865
*Net Operating Profits After Tax***					
Earnings Before Extraordinary Items	**$ 13,612**	$ 11,809	$ 4,833	$ 10,334	$ 7,796
Deferred Taxes	**3,225**	2,578	2,169	858	1,509
After Tax Interest Expense	**1,042**	1,433	1,509	1,497	1,703
	$ 17,879	$ 15,820	$ 8,511	$ 12,689	$ 11,008
Return on Average Total Capital Employed	**8.9%**	8.4%	4.8%	7.3%	6.2%

* Average shareholders' equity for brewing continuing operations is computed from total shareholders' equity minus the investment in United States operations on the equity basis.

** Net operating profits represent the company's profits before interest expense but after taxes other than deferred taxes.

YEAR ENDED MARCH 31 (in thousands of dollars)	1979	1978	INCREASE (DECREASE)
SALES:			
Beer—			
Canada	$329,074	$317,322	3.7%
Ireland	31,519	25,123	25.5
	360,593	342,445	5.3
Wine	33,525	31,904	5.1
Oil and gas	7,155	6,798	5.3
	401,273	381,147	5.3
EARNINGS FROM CONTINUING OPERATIONS			
Before income taxes:			
Beer—			
Canada	12,952	12,627	2.6
Ireland	2,534	1,584	60.0
	15,486	14,211	9.0
Wine	2,166	2,383	(9.1)
Oil and gas	3,816	4,179	(8.7)
	21,468	20,773	3.3
Corporate income—net	3,221	1,761	82.9
Interest expense	(2,004)	(2,755)	(27.3)
	22,685	19,779	14.7
After income taxes	13,612	11,809	15.3

CANADIAN BREWING:

Sales volume for the year was 4,534,000 hectolitres, a decline of 4.4 percent from 1978, reflecting mainly the impact of work stoppages from labour disputes in three western provinces during the summer period. There was also a slight erosion in the company's overall share of market. Total Canadian brewing industry sales volume declined by 2.6 percent.

Despite the lower volume, sales revenue was up by 3.7 percent because of selling price increases. Earnings were also slightly ahead of last year. Lower malt costs and the full year effect of the consolidation of Ontario production contributed to the earnings improvement. Substantially higher marketing expenditures and increased wage rates had an offsetting effect.

As part of its continuing involvement in sports, the company acquired the 60 percent interest in The Toronto Argonaut Football Club which it did not previously own and made application, shortly after year-end, to obtain a National Hockey League franchise to be located in Quebec City.

IRISH BREWING:

Despite slightly lower sales volume, the Irish brewing subsidiary recorded significantly higher sales revenue and earnings. There were two selling price increases during the year and distribution costs were lower because of a rationalization program. In addition, the lower Canadian dollar improved operating results when earnings were translated into Canadian funds.

Sales volume totalled 235,000 hectolitres, a decline of 4.5 percent from 1978. Industry sales increased by more than 5 percent during the same period.

WINE:

Sales volume from Canadian wine operations was lower than last year. However, a combination of selling price increases and product mix resulted in a 5.1 percent gain in sales revenue.

Sales volume totalled 21,581,000 litres, a decline of 2.5 percent from 1978. Gains in Western Canada during the summer months because of labour disruptions in the brewing industry were offset by a seven-week strike at the Manitoba Liquor Commission and a decline in Ontario volume. Total Canadian wine industry sales volume was up by approximately 8 percent, with imported foreign products continuing to increase their market share.

Carling O'Keefe's share of earnings before interest and income taxes was down by $217,000 or 9.1 percent.

OIL AND GAS:

Volume was down slightly more than 4 percent in both gas and oil sales. Selling price increases, however, boosted total sales revenue by 5.3 percent over last year. As a result of lower volume and a significant increase in depletion costs from the expanded capital expenditure program, earnings were down by $363,000.

INTERNATIONAL DIVISION:

Royalty income from the sale of Carling Black Label under license agreements in overseas markets showed a substantial increase in 1979, rising by 78 percent to $3,157,000. The increase reflected higher volume (up approximately 16 percent), increased royalty rates, a retroactive rate adjustment relating to the previous year and a favourable foreign exchange factor when translated to Canadian funds.

EXTRAORDINARY ITEMS:

In 1979, the only extraordinary item was a gain of $351,000 on the sale of the Victoria winery. During the year, Jordan Valley Wines completed construction of a new winery in Surrey, British Columbia.

Last year, there were three extraordinary items which resulted in a net loss to Carling O'Keefe of $10,211,000. The most significant amount was a loss of $12,093,000 on the sale of the investment in the United States brewing subsidiary.

ROTHMANS OF PALL MALL CANADA LIMITED
AND SUBSIDIARY COMPANIES

Consolidated Statement of Earnings

(in thousands of dollars)

	Year ended March 31 1979	1978
Income:		
Sales	$801,315	$779,898
Excise and sales taxes	340,046	338,348
	461,269	441,550
Investment and other income	6,241	4,470
	467,510	446,020
Costs:		
Raw materials and manufacturing	245,472	240,667
Marketing and distribution	135,135	117,784
Administrative and general	29,500	28,123
Interest and expense on long term debt	4,418	4,348
Other interest	2,450	3,783
Foreign exchange	(758)	(678)
	416,217	394,027
	51,293	51,993
Income taxes:		
Current	17,015	17,845
Deferred	2,997	2,644
	20,012	20,489
	31,281	31,504
Minority interest (Note 5)	7,901	7,029
EARNINGS FROM CONTINUING OPERATIONS	23,380	24,475
Loss of $10,157 from operations of former United States brewing subsidiary, less minority interest of $5,066	—	(5,091)
EARNINGS BEFORE EXTRAORDINARY ITEMS	23,380	19,384
Extraordinary items (Note 4)	161	(5,118)
EARNINGS FOR THE YEAR	$ 23,541	$ 14,266
Earnings per Common share (Note 6):		
From continuing operations	$4.33	$4.58
Before extraordinary items	$4.33	$3.47
After extraordinary items	$4.37	$2.35

ROTHMANS OF PALL MALL CANADA LIMITED
AND SUBSIDIARY COMPANIES

Consolidated Statement of Retained Earnings

(in thousands of dollars)

	Year ended March 31	
	1979	1978
Balance at beginning of year	**$60,148**	$52,326
Earnings for the year	**23,541**	14,266
Excess of par value over cost of First Preferred shares purchased for cancellation (Note 10)	**66**	80
Excess of par value over cost of preference shares purchased for cancellation by Carling O'Keefe Limited, less minority interest	**42**	51
	83,797	66,723
Dividends paid:		
Preferred shares—		
First Preferred shares, Series A ($6.85 per share)	**1,065**	1,106
Second Preferred shares ($1.325 per share)	**2,440**	2,441
	3,505	3,547
Common shares (1979—$1.00 per share; 1978—66.3¢)	**4,583**	3,028
	8,088	6,575
Balance at end of year	**$75,709**	$60,148

ROTHMANS OF PALL MALL CANADA LIMITED
AND SUBSIDIARY COMPANIES

Consolidated Statement of Changes in Financial Position

(in thousands of dollars)

	Year ended March 31	
	1979	1978
Working capital was increased by:		
Earnings from continuing operations before extraordinary items	$ 23,380	$ 24,475
Depreciation	13,403	12,367
Minority interest in earnings from continuing operations	7,901	7,029
Other items not requiring working capital	4,221	3,171
Working capital from continuing operations	48,905	47,042
Proceeds on sale of—		
Winery assets	1,183	—
United States brewing subsidiary	—	29,765
Canadian brewery assets and sundry property, less mortgage of $6,885	—	10,377
Working capital from extraordinary items (Note 4)	1,183	40,142
Proceeds on disposal of property, plant and equipment and other assets	1,667	2,648
Issue of term bank loan (Note 9)	—	7,000
Issue of Common shares (Note 10)	—	566
	51,755	97,398
Working capital was decreased by:		
Additions to property, plant and equipment	31,324	26,056
Purchase of assets of The Toronto Argonaut Football Club for $3,500 cash plus working capital deficiency of $768 (Note 3)	4,268	—
Additions to other assets	704	681
Increase in advances to former United States brewing subsidiary	—	1,105
Reduction of long term debt	5,210	6,772
Purchase of First Preferred shares	526	420
Dividends—		
Preferred shares	3,505	3,547
Common shares	4,583	3,028
By subsidiary company to minority shareholders	2,634	2,107
Other	176	195
	52,930	43,911
Increase (decrease) in working capital	(1,175)	53,487
Working capital at beginning of year	118,467	64,980
Working capital at end of year	$117,292	$118,467

ROTHMANS OF PALL MALL CANADA LIMITED
AND SUBSIDIARY COMPANIES

Consolidated Balance Sheet

(in thousands of dollars)

	March 31 1979	March 31 1978
ASSETS		
Current assets:		
Cash and short term investments, at cost which approximates market	$ 8,927	$ 16,993
Accounts receivable	46,781	50,554
Recoverable income taxes	—	664
Inventories	167,806	171,650
Prepaid expenses	4,608	4,417
Total current assets	228,122	244,278
Property, plant and equipment, at cost	293,292	268,737
Less: Accumulated depreciation	132,709	123,227
	160,583	145,510
Other assets (Note 7)	29,807	26,066
	$418,512	$415,854
LIABILITIES		
Current liabilities:		
Bank and other short term indebtedness (Note 8)	$ 38,421	$ 54,508
Accounts payable and accrued liabilities	49,496	46,566
Income taxes	4,472	4,623
Excise, sales and other taxes	17,649	19,589
Dividends payable to minority interest	792	525
Total current liabilities	110,830	125,811
Long term debt (Note 9)	43,672	49,242
Total liabilities	154,502	175,053
DEFERRED INCOME TAXES	31,490	28,493
MINORITY INTEREST IN SUBSIDIARY COMPANIES (Note 5)	100,497	95,254
SHAREHOLDERS' EQUITY		
Capital stock (Note 10):		
Preferred shares	52,082	52,747
Common shares	4,232	4,159
	56,314	56,906
Retained earnings (Note 11)	75,709	60,148
Total shareholders' equity	132,023	117,054
	$418,512	$415,854

APPROVED BY THE BOARD:

J.H. DEVLIN, *Director*

R.H. HAWKES, *Director*

ROTHMANS OF PALL MALL CANADA LIMITED

AND SUBSIDIARY COMPANIES

Line of Business Data

CONSOLIDATED OPERATING RESULTS—CONTINUING OPERATIONS

(in thousands of dollars)

	Year ended March 31					
	Tobacco		Brewing		Total	
	1979	1978	1979	1978	1979	1978
INCOME:						
Sales	$400,042	$398,751	$401,273	$381,147	$801,315	$779,898
Excise and sales taxes	210,162	215,034	129,884	123,314	340,046	338,348
	189,880	183,717	271,389	257,833	461,269	441,550
Investment and other income	—	—	6,241	4,470	6,241	4,470
	189,880	183,717	277,630	262,303	467,510	446,020
COSTS:						
Raw materials and manufacturing	110,011	104,223	135,461	136,444	245,472	240,667
Marketing and distribution	35,602	32,037	99,533	85,747	135,135	117,784
Administrative and general	10,859	9,950	18,641	18,173	29,500	28,123
Interest and expense on long term debt	2,631	2,783	1,787	1,565	4,418	4,348
Other interest	2,233	2,593	217	1,190	2,450	3,783
Foreign exchange	—	—	(758)	(678)	(758)	(678)
	161,336	151,586	254,881	242,441	416,217	394,027
	28,544	32,131	22,749	19,862	51,293	51,993
INCOME TAXES:						
Current	11,167	12,453	5,848	5,392	17,015	17,845
Deferred	(228)	66	3,225	2,578	2,997	2,644
	10,939	12,519	9,073	7,970	20,012	20,489
	17,605	19,612	13,676	11,892	31,281	31,504
MINORITY INTEREST	—	—	7,901	7,029	7,901	7,029
EARNINGS FROM CONTINUING OPERATIONS BEFORE EXTRAORDINARY ITEMS	$ 17,605	$ 19,612	$ 5,775	$ 4,863	$ 23,380	$ 24,475

CONSOLIDATED FINANCIAL POSITION

(in thousands of dollars)

	March 31 1979	March 31 1978
INVENTORIES:		
Tobacco—		
Leaf tobacco (including purchase advances of $40,523 in 1979; $37,959 in 1978)	$ 76,129	$ 76,810
Finished stock	34,297	39,029
Packaging material and other	7,321	8,841
	117,747	124,680
Brewing—		
Beverage products, finished and in process	32,293	29,257
Materials and supplies	10,130	9,429
Containers	7,636	8,284
	50,059	46,970
	$167,806	$171,650

ROTHMANS OF PALL MALL CANADA LIMITED

AND SUBSIDIARY COMPANIES

Line of Business Data

CONSOLIDATED FINANCIAL POSITION

(in thousands of dollars)

	March 31 1979		March 31 1978	
PROPERTY, PLANT AND EQUIPMENT:	Cost	Accumulated depreciation	Cost	Accumulated depreciation
Tobacco—				
Land	$ 2,559	$ —	$ 2,544	$ —
Buildings	7,110	2,878	6,568	2,697
Machinery, furniture and fixtures	40,114	24,847	39,685	22,979
Motor vehicles	5,896	2,932	4,861	2,963
Leasehold improvements	8,026	5,201	7,317	4,461
	63,705	35,858	60,975	33,100
Brewing—				
Land	6,135	—	6,096	—
Buildings	66,724	23,020	64,550	21,678
Machinery and equipment	101,758	60,775	95,690	57,391
Motor vehicles	12,141	6,257	11,496	5,666
Oil and gas properties	41,479	6,098	28,721	4,781
Leasehold improvements	1,350	701	1,209	611
	229,587	96,851	207,762	90,127
	$293,292	$132,709	$268,737	$123,227

	March 31 1979	March 31 1978
BANK AND OTHER SHORT TERM INDEBTEDNESS:		
Bank indebtedness—		
Tobacco	$16,413	$39,411
Brewing	3,008	2,269
	19,421	41,680
Bankers' acceptances—Tobacco	14,000	—
Notes payable—Tobacco	5,000	12,828
	$38,421	$54,508

	1979	1978
LONG TERM DEBT:		
Sinking Fund Debentures—		
Rothmans of Pall Mall Canada Limited—		
Series A 8% due January 3, 1988	$ 7,757	$ 8,565
Series B 11% due February 15, 1995	16,800	17,600
	24,557	26,165
Carling O'Keefe Limited—		
Series A 4 3/4% due January 15, 1979	—	600
Series B 4 1/4% due January 15, 1981	1,600	2,071
Series C 5% due January 15, 1983	2,315	2,826
Series D 5 1/2% due April 1, 1986	4,164	5,533
Series E 5 1/2% due April 1, 1989	7,458	8,059
	15,537	19,089
Term bank loan—		
Carling O'Keefe Limited due March 31, 1985	7,000	7,000
	47,094	52,254
Less: Amount included in current liabilities	3,422	3,012
	$43,672	$49,242

ROTHMANS OF PALL MALL CANADA LIMITED
AND SUBSIDIARY COMPANIES

Notes to Consolidated Financial Statements

MARCH 31, 1979 AND 1978

1. Summary of significant accounting policies:

PRINCIPLES OF CONSOLIDATION:

The consolidated financial statements include the accounts of the Company and all of its subsidiaries. Purchase accounting has been followed for all acquisitions and the results of operations of subsidiaries are included from effective dates of acquisition.

For certain brewing subsidiaries acquired prior to April 1, 1974, the excess of the cost of shares over the recorded value of underlying net tangible assets at dates of acquisition is carried at cost and is not amortized. In accordance with current accounting practice, intangible assets acquired subsequently are amortized over periods not exceeding forty years.

FOREIGN EXCHANGE:

Foreign currency accounts are translated to Canadian dollars as follows: current accounts at exchange rates in effect at March 31; other balance sheet accounts and depreciation expense at historical rates of exchange; income and other costs at average rates of exchange during the year. The resulting exchange gains or losses are included in the consolidated statement of earnings.

INVENTORIES:

Except for containers, inventories are stated at the lower of average cost and net realizable value. Containers are recorded at amortized cost which is lower than new replacement cost.

PROPERTY, PLANT AND EQUIPMENT:

Depreciation is recorded on the straight-line basis over the estimated service lives of the assets, which are as follows for the principal asset categories:

Buildings—15 to 40 years

Machinery, furniture and fixtures—5 to 15 years

Motor vehicles—3 to 10 years

Leasehold improvements—term of lease, not to exceed 10 years

Oil and gas properties are accounted for on the full cost method, whereby all costs of exploration and development are capitalized and amortized against income using the unit of production method based on proven oil and gas reserves.

OTHER ASSETS:

Other assets are recorded at cost or amortized cost.

PENSIONS:

Current service costs are charged to operations as they accrue. Prior service costs arising from amendments to the plans and actuarial gains or losses are charged to operations as they are funded in accordance with legal requirements over periods ranging from five to fifteen years.

RESEARCH AND DEVELOPMENT:

Research and development expenditures are charged to operations as incurred.

MARKETING:

Marketing costs, including those related to the introduction of new brands, are charged against earnings during the year in which they are incurred.

INCOME TAXES:

Income taxes are accounted for on the tax allocation basis for all timing differences between accounting and taxable income. These timing differences arise principally between accounting and tax depreciation.

2. Line of business reporting:

In these statements, all references to "brewing" relate to all activities of the Company's majority-owned (50.1%) subsidiary, Carling O'Keefe Limited, which include the production and sale of beer and wine and also the oil and gas operations. Details by line of business of consolidated operating results from continuing operations and certain consolidated assets and liabilities are shown on pages 20 and 21.

3. Acquisition:

Under an agreement dated December 15, 1978, Carling O'Keefe acquired for $3,500,000 cash the 60% interest in The Toronto Argonaut Football Club which it did not previously own. The values underlying this transaction were as follows:

Investment at March 31, 1978		$1,886,000
Cash payment	$3,500,000	
Working capital deficiency at acquisition	768,000	4,268,000
		6,154,000
Less: Tangible assets acquired		87,000
Cost of sports franchise		$6,067,000

4. Extraordinary items:

	1979	1978
Gain on sale of winery assets	$ 351,000	$ —
Loss on sale of investment in United States brewing subsidiary sold on December 30, 1977 to R & R Holdings Limited, Soc. An., a member of the Rothmans World Group for $30,000,000 cash	—	(12,093,000)
Gain on sale of Canadian brewery assets and sundry property, less income taxes of $2,253,000	—	3,722,000
Unamortized excess cost of shares of Le Club de Hockey Les Nordiques, Inc. written off	—	(1,840,000)
	351,000	(10,211,000)
Minority interest	190,000	(5,093,000)
	$ 161,000	$ (5,118,000)

5. **Minority interest in subsidiary companies:**

The interest of minority shareholders in consolidated earnings from continuing operations was as follows:

	1979	1978
CARLING O'KEEFE LIMITED:		
Preference shares	$ 2,091,000	$ 2,107,000
Common shares	5,746,000	4,839,000
	7,837,000	6,946,000
JORDAN VALLEY WINES LIMITED:		
Common shares	64,000	83,000
	$ 7,901,000	$ 7,029,000

The minority shareholders' interest in the capital stock and retained earnings of subsidiary companies is as follows:

	1979	1978
CARLING O'KEEFE LIMITED:		
Preference shares	$ 43,026,000	$ 43,283,000
Common shares	55,647,000	50,240,000
	98,673,000	93,523,000
JORDAN VALLEY WINES LIMITED:		
Common shares	1,824,000	1,731,000
	$100,497,000	$ 95,254,000

6. **Earnings per Common share:**

The 1979 earnings per Common share figures are based on the weighted average number of shares outstanding during the year (4,583,440) after giving effect to the conversion of 3,650 Second Preferred shares into 2,920 Common shares. The 1978 earnings per share figures are based on the weighted average number of shares outstanding during the year (4,564,869). Dividends earned on Preferred shares were deducted from consolidated earnings for purposes of this calculation.

Assuming conversion of outstanding Second Preferred shares as at April 1, 1978, earnings per Common share on a fully diluted basis for the year ended March 31, 1979 would have been $3.68 before the extraordinary item and $3.71 after the extraordinary item.

7. **Other assets:**

	1979	1978
Unamortized cost of shares of Carling O'Keefe subsidiaries in excess of underlying net tangible asset values at acquisition (Note 14)	$ 12,058,000	$ 11,493,000
Sports franchise (Note 3)	6,067,000	1,886,000
Mortgages and long term receivables	7,079,000	7,178,000
Unamortized deferred charges, trademarks, patents and other investments	4,603,000	5,509,000
	$ 29,807,000	$ 26,066,000

Amortization of other assets amounted to $99,000 for the year ended March 31, 1979 (1978—$143,000).

On February 21, 1978, Carling O'Keefe sold its property located at Yonge and Front Streets, Toronto for $8,100,000. The consideration included a first mortgage of $6,885,000 due in 1981.

8. Bank and other short term indebtedness:

Bank indebtedness and bankers' acceptances of $30,413,000 (1978—$39,411,000) arising from tobacco operations are secured by the related accounts receivable and inventories.

9. Long term debt:

Long term debt consists of Sinking Fund Debentures of the Company ($23,050,000) and Carling O'Keefe Limited ($13,622,000) and a term bank loan of Carling O'Keefe Limited ($7,000,000). The remaining principal requirements for the years ending March 31, 1980 through 1984 are as follows:

	1980	1981	1982	1983	1984
Rothmans of Pall Mall Canada Limited - -	$1,507,000	$1,600,000	$1,600,000	$1,600,000	$1,600,000
Carling O'Keefe Limited - - - - - - - -	1,915,000	2,164,000	3,258,000	3,800,000	3,800,000
	$3,422,000	$3,764,000	$4,858,000	$5,400,000	$5,400,000

The Rothmans debentures and the Carling O'Keefe Series C, D and E debentures are payable in Canadian funds. The Carling O'Keefe Series B debentures are payable in either Canadian or U.S. funds at par, at the option of the holder. The Rothmans debentures are secured by a floating charge on the Company's assets in the Provinces of Ontario and Quebec.

An affiliated company owns $3,319,000 principal amount of the Company's outstanding Series A debentures.

In June 1977, Carling O'Keefe arranged a term bank loan of $7,000,000, bearing interest until March 31, 1979 at 1 1/4% over the bank's prime rate and thereafter at 1% over prime. The loan is repayable in varying instalments up to March 31, 1985.

10. Capital stock:

AUTHORIZED:

469,889 First Preferred shares of the par value of $100 each, issuable in series
2,817,062 Second Preferred shares of the par value of $20 each
7,950,000 Common shares without nominal or par value

ISSUED:	1979	1978
153,181 6.85% Cumulative Redeemable First Preferred shares, Series A (1978—159,098) - - - - - - - - - - -	$15,318,000	$15,910,000
1,838,212 6 5/8% Convertible Cumulative Redeemable Second Preferred shares (1978—1,841,862) - - - - - - - - - - - - -	36,764,000	36,837,000
	52,082,000	52,747,000
4,586,008 Common shares (1978—4,583,088) - - - - - - - - - - - - -	4,232,000	4,159,000
	$56,314,000	$56,906,000

PURCHASES, CONVERSIONS AND ISSUES:

During the year ended March 31, 1979, 5,917 First Preferred shares with a total par value of $592,000 were purchased for cancellation at a cost of $526,000 and 3,650 Second Preferred shares were converted into 2,920 Common shares.

During the year ended March 31, 1978, 5,002 First Preferred shares were purchased for cancellation, 200 Second Preferred shares were converted into 160 Common shares and 25,000 Common shares were issued through exercise of warrants.

REDEMPTION AND CONVERSION PRIVILEGES:

The Series A First Preferred shares were not redeemable before January 27, 1979, but are redeemable on or after that date at the option of the Company at a premium of $3 per share if redeemed before January 27, 1984, of $2 per share if redeemed before January 27, 1989, and of $1 per share if redeemed on or after January 27, 1989. The Company is required to purchase 5,000 of these shares in each calendar year. At March 31, 1979, 1,819 shares of the 1979 requirement had been acquired.

The Second Preferred shares are not redeemable before Novemeber 1, 1979, but are redeemable on or after that date at the option of the Company at par. These shares are convertible on the basis of 1 Common share for 1 1/4 Preferred shares converted on or before October 31, 1979. Thereafter, the Second Preferred shares will not be convertible into Common shares of the Company.

Of the authorized and unissued Common shares, 1,470,570 shares are reserved for the conversion of Second Preferred shares.

OWNERSHIP:

Rothmans of Canada Limited, a wholly-owned subsidiary of Rothmans International Limited, is the owner of record of 85.6% of the Company's issued Common shares and 16.3% of the issued Series A First Preferred shares.

11. Retained earnings:

Under Section 62 of the Canada Corporations Act, $1,671,000 of retained earnings at March 31, 1979 is designated as capital surplus on the purchase for cancellation of 16,708 First Preferred shares.

Under the most restrictive provisions of the covenants relating to the Debentures and the Preferred shares, the Company cannot declare dividends on Common shares unless, after providing for them, consolidated retained earnings will be not less than $6,000,000 and all dividends on the Preferred shares have been declared and either paid or provided for.

12. Remuneration of directors and officers:

The remuneration of thirteen directors and fifteen officers (three of whom were also directors), who held their positions with the Company during the year ended March 31, 1979, was $86,000 and $1,023,000 respectively (1978—thirteen directors: $89,000 and fifteen officers: $858,000). Of the total remuneration, $51,000 (1978—$51,000) was paid by Carling O'Keefe Limited.

13. Pensions:

The Company and its subsidiaries maintain a number of pension plans covering substantially all employees and it is the Company's policy to fund pensions with independent trustees. The charge against earnings from continuing operations was $6,210,000 for the year ended March 31, 1979 (1978—$5,434,000), including $4,755,000 (1978—$4,035,000) for employees in brewing operations.

Based on actuarial valuations, unfunded prior service costs for brewing operations are estimated at $7,300,000. These amounts are being funded over periods ranging from five to fifteen years, as described in Note 1.

14. Commitments and contingent liabilities:

Under a long term agreement with The United Breweries Limited of Copenhagen, Denmark, Carling O'Keefe and its affiliates have access to the brewing research and technical knowledge of United Breweries, together with the exclusive right to manufacture and sell brewery products under the Carlsberg and Tuborg trademarks in Canada and the Republic of Ireland. Royalties are payable based on total sales of all brewery products at rates varying with the volumes and selling prices of the products. The agreement is cancellable on twenty years' notice or earlier if certain specified conditions are not fulfilled.

On April 28, 1978, in consideration of a payment of $600,000 to the minority shareholders of Jordan Valley Wines Limited, the commitment of Carling O'Keefe to acquire the minority interest (8.1%) was extended to the 1982 fiscal year. The purchase price will be at least equal to $2,993,000. Mr. N. Torno, a director of Carling O'Keefe, and a member of his family hold the minority shares.

Capital expenditures for the year ending March 31, 1980 are estimated at $35,000,000, of which $25,500,000 relates to brewing operations.

To ensure an adequate supply of Ontario flue-cured tobacco, the Company, together with the other major Canadian cigarette manufacturers, has agreed to purchase a specified quantity of the 1979 Ontario crop at a guaranteed minimum average price.

On March 29, 1979, the National Hockey League resolved to accept applications for franchises from four teams in the World Hockey Association. On April 18, 1979, Le Club de Hockey Les Nordiques, Inc., a majority-owned subsidiary of Carling O'Keefe, applied for a National Hockey League franchise to be located in Quebec City. If the application is accepted, it is estimated that the cost of the franchise will approximate $7,000,000.

There are a number of outstanding claims and legal actions involving the Company and its subsidiaries. In the opinion of management, the outcome of these matters should have no material adverse effect on the Company's financial position.

15. Anti-inflation legislation:

The Company and its Canadian subsidiaries were subject to, and believe that they complied with, controls on prices, profits, dividends and compensation instituted by the Government of Canada in the Anti-Inflation Act, effective October 14, 1975. These controls have now expired.

Price Waterhouse & Co.
CHARTERED ACCOUNTANTS

Box 51 Toronto-Dominion Centre
Toronto, Ont. M5K 1G1
(416) 863-1133 Telex 065-24111

May 25, 1979

AUDITORS' REPORT

TO THE SHAREHOLDERS OF
ROTHMANS OF PALL MALL CANADA LIMITED:

We have examined the consolidated statements of earnings, retained earnings and changes in financial position of Rothmans of Pall Mall Canada Limited for the year ended March 31, 1979 and the consolidated balance sheet as at that date. 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 results of operations and the changes in financial position of the Company for the year ended March 31, 1979 and its financial position as at that date in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Price Waterhouse & Co.

Chartered Accountants

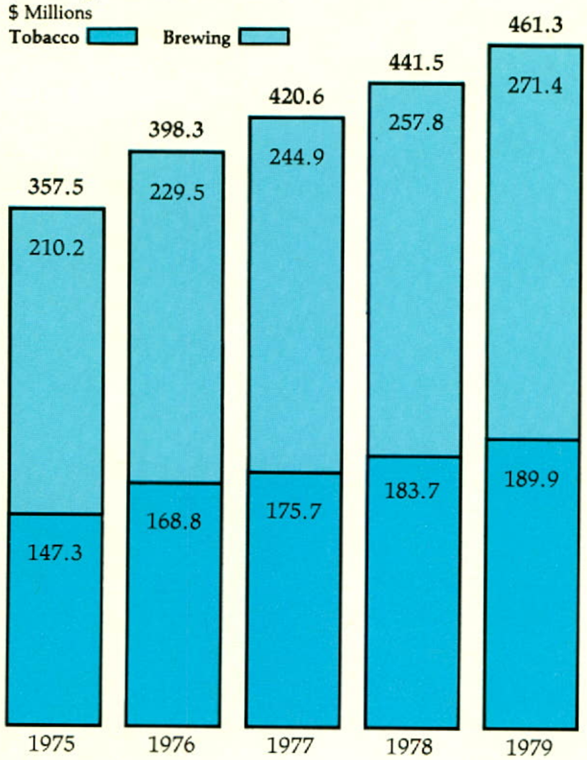
Five-Year Financial Review

	Year Ended March 31 1979	1978	1977	1976	June 30 1975
Results for the Year (in thousands of dollars):					
Sales from continuing operations—					
Tobacco	**$400,042**	$398,751	$394,484	$385,406	$344,134
Brewing	**401,273**	381,147	359,189	343,511	322,533
	801,315	779,898	753,673	728,917	666,667
Excise and sales taxes	**340,046**	338,348	333,063	330,639	309,183
	461,269	441,550	420,610	398,278	357,484
Earnings—					
Earnings before income taxes—					
Tobacco	**28,544**	32,131	31,644	37,578	30,648
Brewing	**22,749**	19,862	7,998	14,967	10,430
	51,293	51,993	39,642	52,545	41,078
Income taxes	**(20,012)**	(20,489)	(16,816)	(20,315)	(15,786)
Minority interest	**(7,901)**	(7,029)	(3,443)	(6,390)	(5,130)
Earnings from continuing operations	**23,380**	24,475	19,383	25,840	20,162
Loss from operations of former United States brewing subsidiary, less minority interest	**—**	(5,091)	(51)	(4,756)	(4,361)
Earnings before extraordinary items	**23,380**	19,384	19,332	21,084	15,801
Extraordinary items, less minority interest	**161**	(5,118)	336	(73,255)	(71,570)
Earnings (loss)	**23,541**	14,266	19,668	(52,171)	(55,769)
Depreciation—continuing operations	**13,403**	12,367	11,397	11,283	10,865
Interest expense—continuing operations	**6,816**	8,066	9,170	8,835	9,434
Dividends paid—					
Preferred	**3,505**	3,547	3,581	3,604	4,592
Common	**4,583**	3,028	2,370	2,279	1,910
Financial Position (in thousands of dollars):					
Working capital	**$117,292**	$118,467	$ 64,980	$ 64,291	$ 71,100
Property, plant and equipment—net	**160,583**	145,510	136,909	127,078	124,672
Investment in United States brewing subsidiary, at equity	**—**	—	50,910	49,782	46,053
Other assets	**29,807**	26,066	30,512	29,214	29,252
Total assets	**418,512**	415,854	432,494	398,982	389,032
Bank and other short term indebtedness	**38,421**	54,508	80,946	71,748	56,162
Long term debt	**43,672**	49,242	49,650	55,050	59,639
Deferred income taxes	**31,490**	28,493	23,799	20,203	18,307
Minority interest in subsidiaries	**100,497**	95,254	100,695	99,317	104,904
Shareholders' equity	**132,023**	117,054	109,167	95,795	88,227
Per Common Share:					
Earnings (loss)—from continuing operations	**$ 4.33**	$ 4.58	$ 3.47	$ 4.88	$ 4.01
—before extraordinary items	**4.33**	3.47	3.46	3.84	2.90
—after extraordinary items	**4.37**	2.35	3.53	(12.24)	(15.36)
Dividends paid	**1.00**	0.663	0.52	0.50	0.50
Shareholders' equity	**17.40**	14.00	12.24	9.18	7.52
Ratios and Statistics:					
Return on average total capital employed (%)—					
Tobacco	**15.0**	17.0	18.6	24.9	23.3
Brewing	**8.9**	8.4	4.8	7.3	6.2
Capital expenditures ($000)	**31,324**	26,056	22,199	17,709	15,764
Working capital from continuing operations ($000)	**48,905**	47,042	37,610	45,532	38,297
Debt to total capital ratio (%)—					
Tobacco	**42**	52	56	62	68
Brewing	**12**	14	25	24	20
Working capital ratio	**2.06**	1.94	1.44	1.50	1.60
Number of common shares outstanding (thousands)	**4,586**	4,583	4,558	4,558	4,558

Note: The fiscal year-end of the Company and its subsidiaries was changed from June 30 to March 31, effective in 1976. Comparative amounts for 1976 are for the twelve months ended March 31.

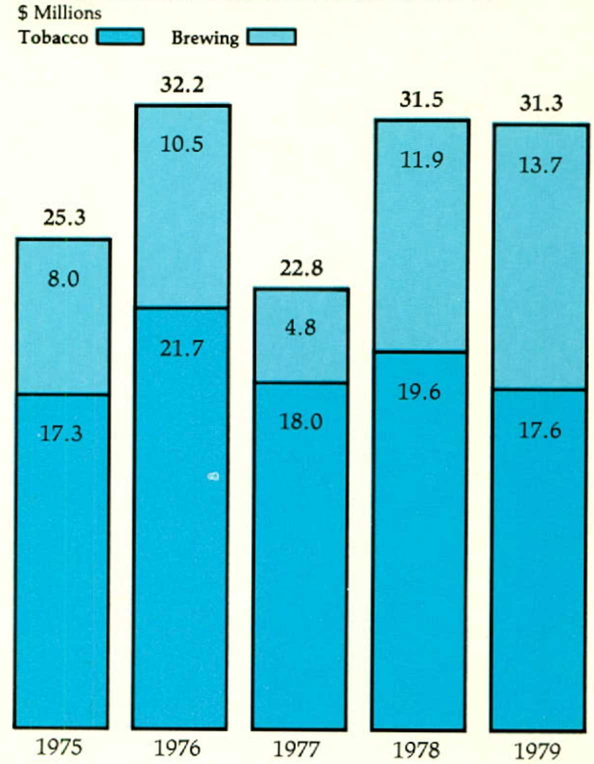
Sales From Continuing Operations

(Excluding Excise & Sales Taxes)
$ Millions

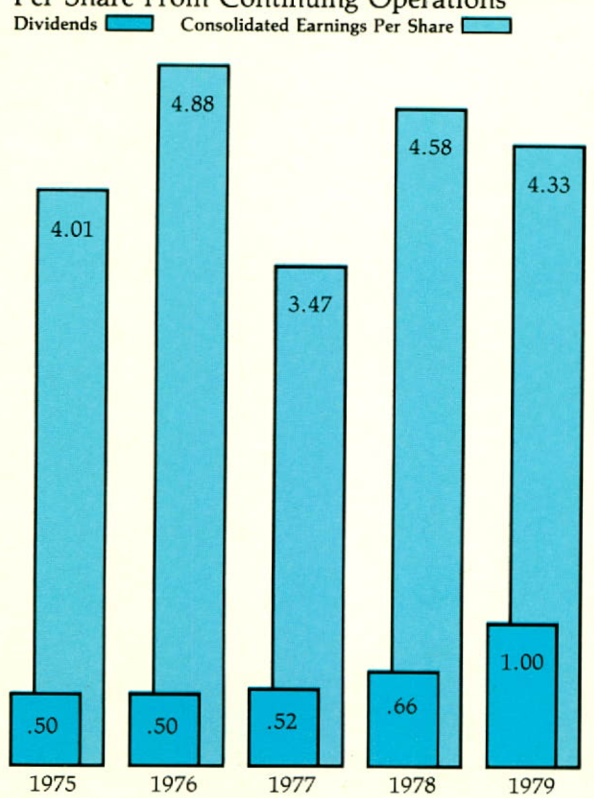


Earnings From Continuing Operations

(Before Extraordinary Items, Including Minority Interest)
$ Millions

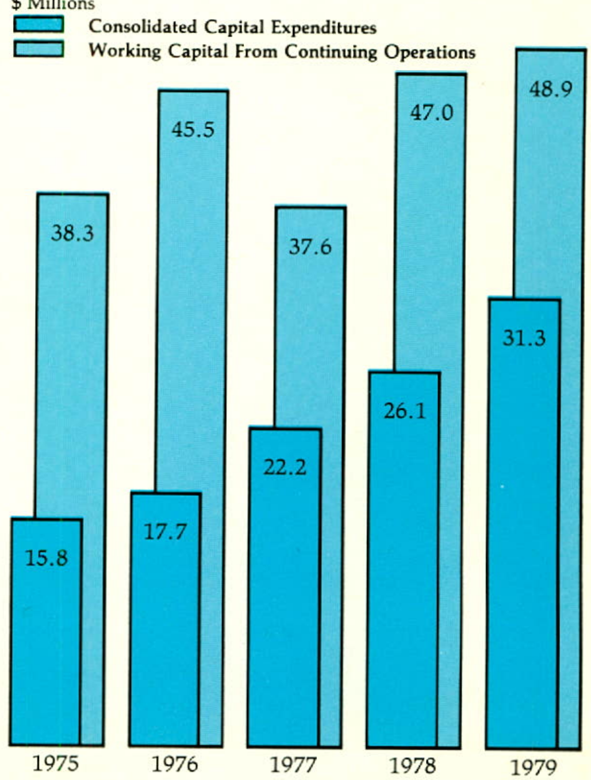


Dividends Paid and Consolidated Earnings Per Share From Continuing Operations



Consolidated Capital Expenditures and Working Capital From Continuing Operations

$ Millions



Quarterly Financial Data—Continuing Operations
(in thousands of dollars)

CONSOLIDATED SALES

	Year ended March 31	
	1979	1978
Quarter ended—		
June 30	$209,672	$199,703
September 30	208,320	207,911
December 31	217,733	209,127
March 31	165,590	163,157
	$801,315	$779,898

CONSOLIDATED EARNINGS BEFORE EXTRAORDINARY ITEMS

AMOUNT:		
Quarter ended—		
June 30	$ 6,527	$ 5,655
September 30	6,843	6,709
December 31	7,397	8,227
March 31	2,613	3,884
	$ 23,380	$ 24,475
PER COMMON SHARE:		
Quarter ended—		
June 30	$ 1.23	$ 1.05
September 30	1.30	1.28
December 31	1.42	1.60
March 31	0.38	0.65
	$ 4.33	$ 4.58

Officers

JOHN H. DEVLIN
Chairman of the Board

ROBERT H. HAWKES, Q.C.
President and Chief Executive Officer

ROY H. NEWTON
Senior Vice President Marketing

C. PAUL YOUNG
Senior Vice President Corporate Services

ROBERT W. ALLAN, C.A.
Vice President Materials Management

GERALD G. NORMAN
Vice President Production

JOHN E. BROEN
Vice President Marketing Operations

CAMILLE A. DENIS
Vice President Corporate Affairs

HUGH R. SAMPSON, C.A.
Vice President and Treasurer

GORDON R. WHITE
Vice President Sales

DOROTHY I.L. WILLIAMS
Assistant Secretary

Directors

JOEL W. ALDRED, D.F.C.

FRIEDRICH CORDEWENER

GEORGE E. CREBER, Q.C.

JOHN H. DEVLIN

ROBERT H. HAWKES, Q.C.

JOHN C. LOCKWOOD

GEORGE B. McKEEN

SIR DAVID NICOLSON

ALEXANDER ORLOW

RONALD D. SOUTHERN

AUDIT COMMITTEE

JOEL W. ALDRED, D.F.C.　GEORGE E. CREBER, Q.C.　GEORGE B. McKEEN

COMPENSATION COMMITTEE

JOEL W. ALDRED, D.F.C.　GEORGE E. CREBER, Q.C.　RONALD D. SOUTHERN

PENSION INVESTMENT COMMITTEE

EDWARD A. CRIGHTON, C.A.

HUGH R. SAMPSON, C.A.

GEORGE B. McKEEN

C. PAUL YOUNG

Head Office	75 DUFFLAW ROAD, TORONTO, ONTARIO, M6A 2W4
Auditors	PRICE WATERHOUSE & CO.
Bankers	BANK OF MONTREAL
Registrar and Transfer Agent	THE ROYAL TRUST COMPANY
Solicitors	SMITH, LYONS, TORRANCE, STEVENSON & MAYER

MARKET PRICES

The Company's Preferred and Common shares are listed on the Toronto, Montreal and Vancouver Stock Exchanges. The following table sets forth, for the fiscal periods indicated, the high and low sales prices of the Preferred and Common shares.

		1979				1978			
		4th Qtr.	3rd Qtr.	2nd Qtr.	1st Qtr.	4th Qtr.	3rd Qtr.	2nd Qtr.	1st Qtr.
First Preferred	—High	$87	$89	$90	$86⅛	$84	$86	$86	$82⅜
	—Low	84½	84	87½	84	81½	82¼	81½	75
Second Preferred	—High	18½	19⅝	20	19⅜	17⅜	17⅜	16⅝	16⅜
	—Low	17	17½	17⅞	16¾	15¾	16	16	14¼
Common	—High	23⅛	23¼	23½	22⅞	20	19	14½	14½
	—Low	21	19	22¼	19½	17	12½	13	11⅞

VALUATION DAY PRICES

For Canadian capital gains tax purposes, the valuation day values of Rothmans of Pall Mall Canada Limited securities were as follows:

8% Debentures due January 3, 1988	$93
First Peferred Shares, Series A	$82½
Second Preferred Shares	$19⅞
Common Shares	$16⅝