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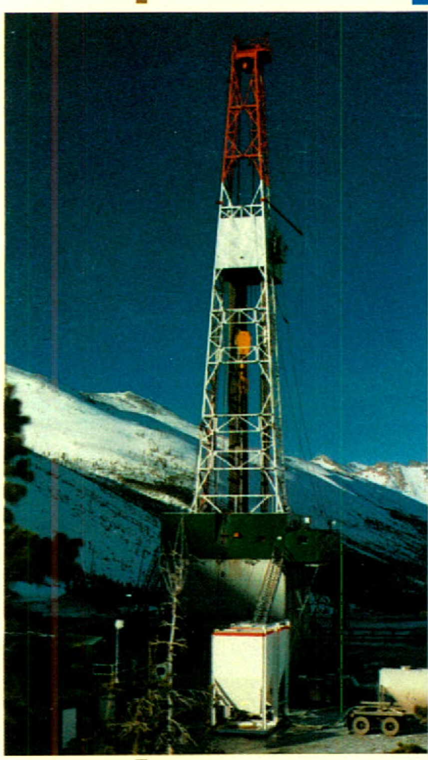
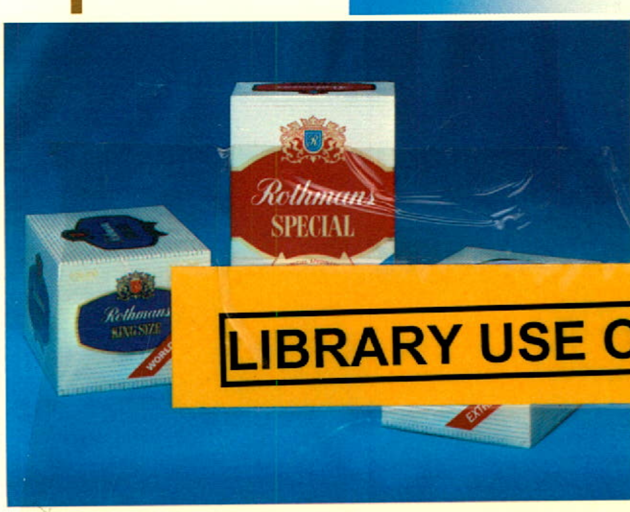
Rothmans of Pall Mall Canada Limited

ANNUAL REPORT 1981





Rothmans of Pall Mall Canada Limited

ANNUAL REPORT 1981

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The Annual Meeting of shareholders will be held at the Four Seasons Hotel, 21 Avenue Road, Toronto, Ontario, at 11:00 o'clock, on Wednesday, July 22, 1981.

Ce rapport peut être obtenu en français sur demande.

Rothmans of Pall Mall Canada Limited

CONSOLIDATED HIGHLIGHTS

	1981	1980
Year Ended March 31 ($000)		
SALES	**$998,839**	$897,798
EARNINGS:		
BEFORE EXTRAORDINARY ITEM	**30,273**	27,056
FOR THE YEAR	**35,536**	27,056
DIVIDENDS PAID:		
PREFERRED SHARES	**1,894**	2,683
COMMON SHARES	**7,439**	6,067
WORKING CAPITAL FROM OPERATIONS	**60,304**	54,253
CAPITAL EXPENDITURES	**35,109**	31,681
At March 31 ($000)		
WORKING CAPITAL	**133,519**	123,571
TOTAL ASSETS	**503,854**	462,669
TOTAL INTEREST-BEARING DEBT	**79,069**	88,265
SHAREHOLDERS' EQUITY	**175,846**	149,765
Per Common Share		
EARNINGS (Note):		
BEFORE EXTRAORDINARY ITEM	**5.15**	4.77
FOR THE YEAR	**6.11**	4.77
DIVIDENDS PAID	**1.35**	1.20
SHAREHOLDERS' EQUITY (Note)	**26.82**	22.04

Note: 1981 figures and the 1980 shareholders' equity figure based on the 5,510,684 shares which are presently outstanding; other 1980 figures based on the weighted average number of shares outstanding during that year (5,116,810) after giving effect to the conversion of Second Preferred shares into Common shares (the conversion privilege expired October 31, 1979).

Corporate Profile

Rothmans of Pall Mall Canada Limited was incorporated on May 8, 1956 and was continued under the Canada Business Corporations Act on July 24, 1979. Manufacturing operations commenced in October 1957. In 1968 and 1969, the Company acquired 50.1% of Carling O'Keefe Limited. Through Rothmans of Canada Limited, the Company is a majority-owned subsidiary of Rothmans International Limited of London, England, a holding company which also has interests in tobacco companies in Australia, Belgium, Cyprus, England, Fiji, Germany, Northern Ireland, Republic of Ireland, Jamaica, Malaysia, the Netherlands, New Zealand and Switzerland.

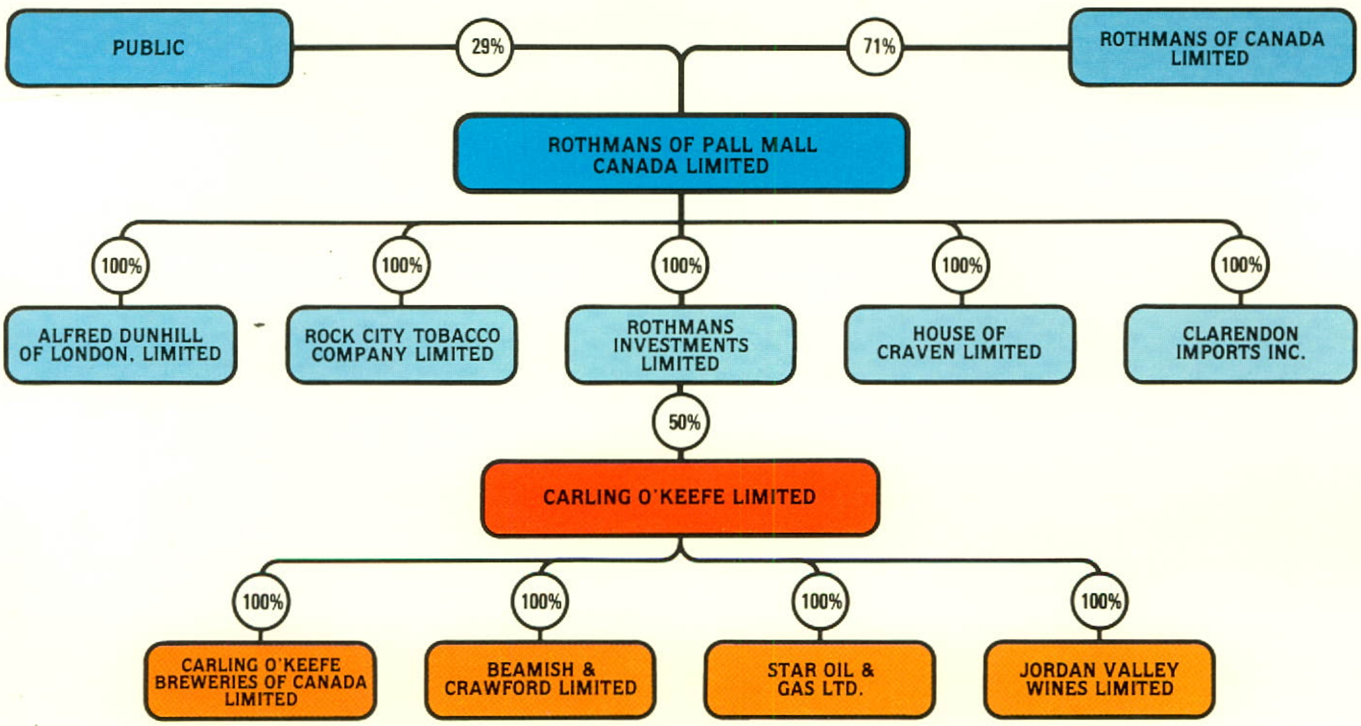
The Company is Canada's second largest manufacturer and distributor of cigarettes and tobacco products. Carling O'Keefe Limited, through subsidiary companies, is engaged in the production and sale of beer and wine and is also involved in oil and gas operations.

The major cigarette trade marks sold by the Company are Rothmans, Craven "A", Number 7, Sportsman, Dunhill and Peter Stuyvesant. Regular length, king size, international length and 100 mm cigarettes are produced. In addition, the Company sells fine cut and imported pipe tobaccos, cigars and a number of other related products. Manufacturing operations are carried out at two plants (Toronto and Quebec City) and the Company has seventeen sales offices across Canada.

Carling O'Keefe operations are carried out through four principal subsidiary companies. In Canada, Carling O'Keefe Breweries of Canada Limited operates seven breweries, producing such well-known brands as O'Keefe Ale, Old Vienna, Carlsberg, Carling Black Label, O'Keefe Extra Old Stock, Colt 45 and Trilight. In addition, the Canadian brewing company owns Le Club de Hockey Les Nordiques and The Argonaut Football Club. Jordan Valley Wines Limited produces wine at four Canadian wineries and sells under the trading styles of Jordan and Ste-Michelle. Star Oil & Gas Ltd. is engaged in the exploration for and the development and production of oil and gas in both Canada and the United States. In the Republic of Ireland, Beamish & Crawford Limited owns and operates a brewery in Cork, with the principal brands being Carling Black Label, Carlsberg and Bass.

The Company, including its subsidiaries, is among the 200 largest corporations in Canada, employing more than 5,300 people.

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



(PERCENTAGES HAVE BEEN ROUNDED)

PERFORMANCE

Consolidated earnings from operations, amounting to $30,273,000 or $5.15 per Common share, were the highest in the Company's history, and increased by 11.9 percent for the year ended March 31, 1981, compared to $27,056,000 or $4.77 per share in 1980. Earnings from tobacco operations of $21,391,000 were 10.2 percent higher and were the second highest in Rothmans history. Rothmans share of earnings from Carling O'Keefe Limited increased to $8,882,000 from $7,649,000 in 1980.

Final consolidated earnings after an extraordinary item were $35,536,000 or $6.11 per Common share. There were no extraordinary items in 1980.

The quarterly Common share dividend was increased, effective with the September payment, from 30 cents to 35 cents per share. Carling O'Keefe increased its quarterly common dividend from 2.5 cents to 5 cents per share effective with the July 1980 payment.

ROTHMANS TOBACCO OPERATIONS

Cigarette sales continue to move to the "light/mild" category which now accounts for 57 percent of the total market. Your Company is well represented in this segment of the market.

In October 1980, Rothmans Extra Light was introduced in the Ontario market and, in January, both king size and regular length versions were launched across the country. There are now three versions of the Rothmans family in addition to the premium priced Rothmans International.

Overall sales of the Rothmans trade mark have stabilized in the past year and the newer versions are designed to provide milder alternatives to Rothmans customers. The distribution of Rothmans International has been extended and the brand continues to show increases in both the domestic and duty-free markets.

The Craven family offers customers a broad choice of milder products in three lengths, and continues to increase sales. The newer versions of Craven Ultra Light and Craven Special Mild 100's have broadened their base in the growing "mild" segment of the market. The Craven Collection of antique and classic cars continues to be the major promotional activity supporting these products. During the year the Craven vehicles were seen by approximately four million people in over 40 major shopping malls across the country.

The third major trade mark, Number 7, also increased its sales in the "light" versions and is publicized with the "Number 7 Lights Up The Fifties" promotion. The cars of the 1950's continue to attract large crowds wherever they are displayed.

The Dunhill brand has enjoyed increased sales in both the International and king size versions. Dunhill Superior Mild, a lighter version of Dunhill International, is now available in the Dunhill shop in Toronto. The shop has attracted a steady clientele for its line of men's luxury goods, cigars, tobacco and smokers' accessories.

While overall unit sales have not increased during the year, the sales trends of the newer versions of the Company's trade marks are very encouraging.

During the past year, work stoppages occurred at the Company's warehouse in Vancouver as well as at its two plant locations in Toronto and Quebec City. The Company continued to operate in each location with staff personnel and, through their efforts, the effects on the Company's sales were minimal. All three strikes have now been settled, and each of the contracts covers a two-year period.

The 1980 tobacco crop in Ontario amounted to 214 million pounds and sold for an average price of $1.36, compared to last year's $1.33. The subsidy paid by domestic manufacturers to encourage export sales was continued at an increased level and resulted in approximately 70 million pounds being purchased for export. For 1981, a crop of 220 million pounds is planned with an average guaranteed minimum price of $1.42. The domestic companies have agreed again to an export subsidy.

ROTHMANS INTERNATIONAL

While the events of April and May do not fall within the period under review, it is appropriate to comment on the change in ownership of Rothmans Tobacco (Holdings) Ltd., the company which controls 44 percent of Rothmans International equity. As many shareholders may be aware, the Rembrandt Group Ltd., formerly the beneficial owner of all of the shares in Rothmans Tobacco (Holdings) Ltd., and the U.S. tobacco group, Philip Morris Inc., reached an agreement which, when fully implemented will mean that the two companies will own an equal number of shares in Rothmans Tobacco (Holdings) Ltd. In addition, Rembrandt Group and Philip Morris now hold between them the Convertible Junior Bonds and 37 percent of the Convertible Senior Bonds.

Both companies have given formal assurances to the Panel on Take-Overs and Mergers of the London Stock Exchange that they will not extend their holdings to change the 50/50 position, nor will they convert into ordinary shares the convertible bonds without the consent of the Panel.

The Board of Rothmans International has been assured that the operations and management of Rothmans International and its associated companies will continue as before, with Philip Morris participating only as an investor.

CARLING O'KEEFE OPERATIONS

The 1981 fiscal year was a successful one for Carling O'Keefe. Sales revenue and earnings increased over the previous year, despite reduced sales volume in the Canadian brewing subsidiary due to industry labour disputes in British Columbia and Alberta.

Carling O'Keefe Breweries of Canada Limited had a satisfactory year, reporting increased share of market, sales revenue and earnings. The low rate of industry growth, which is projected to continue for the foreseeable future, has resulted in intense competition within the industry. The company believes that it has significantly improved its competitive position by the acquisition of major sports advertising and promotional vehicles. During the past year, there was a continuation in the trend of launching a number of new brands in the Canadian brewing industry. Labour contracts signed during the 1981 fiscal year should provide the industry and the company with a period without labour disruptions. Because productive capacities of several breweries have been reached, the company is facing large outlays of capital funds in order to provide needed future capacity.

Jordan Valley Wines Limited had improved results for the year, with increased sales volume, sales revenue and earnings. The rate of return on this investment, however, was still not satisfactory. The volume of Canadian-produced wines continues to grow, and Jordan made progress during the year by introducing new products and reducing costs.

Beamish & Crawford Limited, the Irish brewing subsidiary, had another satisfactory year. Improvements in share of market, sales revenue and earnings were achieved despite intense competition and the economic situation in Ireland.

Unfortunately, plans for Star Oil & Gas were disrupted by the National Energy Program in October 1980. The indicated future pricing of the products has severely curtailed the anticipated earnings and cash flow. While at the present time it is the intention to remain in the oil and gas industry in Canada, activities will be restricted. Increased emphasis will be placed on attempting to build business in the United States.

INFLATION AND FINANCIAL REPORTING

As a result of high levels of inflation, questions have been raised regarding the relevance of historical cost accounting and studies have been undertaken to find an appropriate method of reflecting the effects of inflation on financial reporting. Two methods are most commonly suggested, although they are not intended as alternatives: "current cost" accounting and "constant dollar" accounting. Until the Canadian Institute of Chartered Accountants decides on the best method, management feels it would be inappropriate for the Company to present supplementary information.

DIRECTORS AND MANAGEMENT

During the year, Mr. John C. Lockwood retired as Chairman of Carling O'Keefe Limited and as a director of Rothmans. Mr. Lockwood made a major contribution to Carling O'Keefe during a particularly difficult period in the company's history. Mr. Ronald D. Southern and Mr. Neil M. Shaw also retired as directors because of the increasing business pressures in their own groups of companies. All of these gentlemen made great contributions to your Company and, on behalf of the shareholders, your Board expressed its appreciation to them.

The Honorable Alastair Gillespie, P.C., was appointed Chairman of Carling O'Keefe Limited in September, 1980 and joined your Board in January, 1981.

During the year, Mr. Ronald F. Findlay, C.A., was appointed Vice President Corporate Services and Mr. James K. Strickland was appointed General Counsel and Secretary. Subsequent to the year end, Mr. Edward A. Crighton, C.A., formerly Director of Human Resources, was appointed Comptroller, Mr. Warren A. Brackmann was promoted to Vice President Engineering and Technology and Mr. Joseph J. Heffernan, formerly Director of Distribution and Purchasing, was appointed Vice President Manufacturing Operations.

Our fellow directors join us in thanking all employees of the Company and its subsidiaries for their contribution to the 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 21, 1981

Policies and Plans

INTRODUCTION

This section of our Annual Report has been established to inform shareholders of the current status of important financial policies and objectives established by the Board of Directors. These policies and objectives relate to capital expenditures, target capital structure, dividend policy and diversification and acquisition policy.

Our plans are periodically reviewed in the context of changing capital market and business conditions and we will keep shareholders aware of any major policy revisions as they occur.

CAPITAL EXPENDITURES

Capital expenditures in the company's tobacco operations for the 1981 fiscal year totalled $8.6 million and covered a broad range of additions and improvements to facilities. These outlays were $1.4 million below our anticipated expenditures of $10 million for 1981, primarily due to delays in delivery and installation of equipment. The majority of these commitments have been carried forward into our projections for 1982.

During fiscal 1982 approved captial expenditures total approximately $12 million for new capital projects and additions to our present facilities. Of this amount $3.7 million is budgeted to upgrade our leaf processing facilities. The remainder of our capital expenditures anticipated for fiscal 1982 pertain to further replacement of and improvements to our existing facilities.

CAPITAL STRUCTURE

In establishing financing guidelines, management believes that shareholders benefit from prudent use of debt because of the tax benefits that leverage provides and the lower after-tax cost of debt relative to common equity. At the same time, we recognize the importance of maintaining an adequate degree of financing flexibility and a sound financial base to support the Company's current operations and anticipated expansion.

We have established as our target for tobacco operations a ratio of debt-to-total capital of 45-50 percent at fiscal year-end. Our analysis has excluded the investment in Carling O'Keefe and considered 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 1981 the debt-to-total capital ratio was reduced from 40 percent at the end of fiscal 1980 to 32 percent at March 31, 1981. This low level of debt reflects the reduced level of financing requirements due to lower levels of finished goods inventories as a result of work stoppages and slowdowns at our two plants. The overall level, although lower than our target, is consistent with our stated plan to reduce our use of debt from past levels, which are shown below. We believe that this capital structure has worked to our advantage with the currently high interest rates and provides a more flexible and prudent financial position to support our operations.

DIVIDEND POLICY

Effective September 1980, the quarterly Common share dividend was increased from 30 cents to 35 cents. This payout has been established in the context of the anticipated profitability and internal financing requirements of our tobacco operations. We plan to continually review our dividend policy and you will be informed should that policy be revised.

DIVERSIFICATION AND ACQUISITION POLICY

Rothmans has taken no further steps with respect to acquisitions or additional diversification within the past year. It is our feeling that the internal opportunities which are available to us, with their relatively high rates of return, should be fully developed in conjunction with any potential external opportunities.

DEBT-TO-TOTAL CAPITAL
(Dollars in Millions)

	As At Fiscal Year-End				
	1981	1980	1979	1978	1977
Total Interest-Bearing Debt	**51.2**	60.9	60.0	78.4	76.0
Total Capital*	**158.4**	153.6	142.2	151.4	135.7
Debt-to-Total Capital Ratio	**32%**	40%	42%	52%	56%

*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).

Review of Tobacco Operations

ANALYSIS OF PERFORMANCE

($000)	Year ended March 31 1981	1980	1979	1978	1977
*Net Operating Profits After Tax**					
Earnings From Operations	**$ 21,391**	$ 19,407	$ 17,605	$ 19,612	$ 18,022
Deferred Income Taxes	**618**	(775)	(228)	66	1,427
After Tax Interest Expense	**2,805**	2,683	2,772	3,027	3,581
(A)	**$ 24,814**	$ 21,315	$ 20,149	$ 22,705	$ 23,030
Average Total Capital Employed					
Interest-Bearing Debt	**$ 48,078**	$ 47,686	$ 54,993	$ 65,905	$ 69,680
Deferred Income Taxes	**5,812**	6,216	6,486	6,563	5,910
Shareholders' Equity**	**95,925**	82,690	72,433	60,897	47,999
(B)	**$149,815**	$136,592	$133,912	$133,365	$123,589
Return On Average Total Capital Employed (A÷B)	**16.6%**	15.6%	15.0%	17.0%	18.6%

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

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

The above table provides a five-year comparative summary of the Company's performance in tobacco operations, as measured by return on average total capital employed. Operating profits in 1981 were better than the previous year in both absolute and relative terms.

Statements of earnings, financial position and changes in financial position are on pages 10 and 11 of this report. The following commentary provides a review of the more significant factors which affected the 1981 fiscal year results.

Earnings for the year of $21.4 million were the second highest in the Company's history, and represented a gain of $2 million or approximately 10 percent over last year. This improved performance was achieved despite relatively flat sales volumes for the major product categories and the adverse effect of strikes at the Toronto plant and the Vancouver warehouse. Earnings before income taxes were up by 12.5 percent.

Total sales revenue was $461.5 million, an increase of $41.8 million or almost 10 percent over the 1980 fiscal year. Virtually all of the gain was attributable to cigarettes, but slightly higher revenue was also recorded in sales of fine cut and imported pipe tobacco.

Revenue from the sale of cigarettes totalled $446.9 million and represented approximately 97 percent of the Company's total sales. The 1981 amount was up by $41.1 million or 10.1 percent over last year, reflecting selling price adjustments. During the year, cigarette selling prices were increased twice—in June as a result of higher federal taxes and in November to cover higher operating costs.

The Company's unit cigarette sales totalled 16,533 million in 1981, virtually the same as the 16,541 million sold in the previous year. Total industry cigarette sales were up by 4.6 percent, to 67,183 million from 64,249 million in 1980.

Sales revenue from fine cut tobacco was $8.2 million, or a gain of $760,000 over last year. Volume of 677,000 kilograms was marginally lower than in 1980.

Although unit sales of imported pipe tobacco were unchanged from the previous year at 135,000 kilograms, sales revenue of $2.7 million was up by 10 percent because of higher selling prices.

Revenue from the sales of domestic and imported cigars totalled $2.4 million (1980—$2.5 million). Sales of all other products (primarily cigarette tubes, cigarette rolling devices, pipes and lighters) amounted to $1.3 million compared to $1.5 million last year.

The Company's selling prices include excise duty, excise tax and sales tax imposed by the Government of Canada. In 1981, these three taxes amounted to $231.4 million, an increase of $18.4 million or 8.6 percent over last year. Since sales volumes were relatively unchanged, the higher taxes primarily reflect increases in excise duty and sales tax. The rate of excise duty was raised by 2.8 cents per pack of 25 cigarettes in the budget of April 1980. The sales tax rate was not changed during the year, but the tax on a package of cigarettes increased slightly as a result of the aforementioned duty change and also because of the manufacturers' price increase in November 1980. Subsequent to the year-end, all three federal taxes increased by a total of just over one cent per pack as a result of the most recent federal budget. At the present time, these taxes amount to 37.3 cents per pack of 25 king size cigarettes.

The retail selling price of tobacco products includes not only the above-noted federal taxes, but also tobacco taxes levied by the provinces and territories. In addition, two provinces also impose sales tax on the sale of tobacco products. Since last year's annual report, there have been eleven provincial tobacco tax adjustments, of which four were in Quebec. Details of changes in provincial taxes and the status of current taxes, both provincial and combined federal/provincial, are outlined in the table at the bottom of this page.

Total costs for the Company, excluding taxes on sales and income, amounted to $194.2 million in 1981, an increase of $19.4 million or 11.1 percent. The only expense category which declined from the previous year was interest on long term debt, reflecting purchases of Debentures for sinking fund purposes.

Raw materials and manufacturing costs charged against earnings totalled $131.2 million, compared to $119.8 million in 1980. This represents an increase of 9.5 percent in the overall cost of leaf tobacco, packaging materials, manufacturing overheads, direct labour and imported products.

The charge against fiscal 1981 earnings for leaf tobacco amounted to $54.8 million or $1.49 per pound, versus $51.1 million and $1.38 per pound last year. This increase reflects the higher cost of leaf purchased during the 1980 fiscal year, as noted in last year's annual report. Leaf purchased during the most recent year is included in year-end inventories and will not impact on earnings until the 1982 fiscal year. For future reference,

Per pack of 25 King Size Cigarettes	Provincial Tobacco Tax: 1980 Annual Report	Increases	Current	Current Federal and Provincial Tax
British Columbia	24.0¢	10.0¢	34.0¢	71.3¢
Alberta	8.0	—	8.0	45.3
Saskatchewan	30.0	3.0	33.0	70.3
Manitoba	30.0	5.0	35.0	72.3
Ontario	30.0	6.5	36.5	73.8
Quebec	30.0	9.4	39.4	76.7
New Brunswick	25.0	9.0	34.0	71.3
Nova Scotia	25.0	—	25.0	62.3
Prince Edward Island*	25.0	—	25.0	62.3
Newfoundland**	50.0	12.5	62.5	99.8
Yukon Territory	15.0	25.0	40.0	77.3
Northwest Territories	30.0	—	30.0	67.3

* excluding provincial sales tax of 10% (9% in 1980)

** excluding provincial sales tax of 11%

these purchases were made at prices which in general were not much different from the prior year and thus the increase in leaf costs next year will be fairly moderate. Further information on leaf tobacco is outlined in the Directors' Report on page 4.

Packaging material costs included in cost of sales totalled $37.8 million in 1981, an increase of 14 percent over last year's $33.2 million. Significantly higher suppliers' prices were the major cause of the increase.

Costs incurred during 1981 for manufacturing overheads and direct labour were distorted by a strike at the Toronto plant beginning in early February. Cigarette production was lower than normal in the last few weeks before the work stoppage and management personnel achieved only partial production during the last two months of the fiscal year. Costs related to the strike have been included in administrative and general costs.

A few days prior to the end of the fiscal year, a work stoppage began at the Quebec City plant. This had relatively little impact on Company costs for the 1981 year.

Marketing and distribution costs amounted to $43.8 million in 1981, an increase of $4.5 million or 11.6 percent. Included in this category are advertising and promotion expenses, costs of the sales organization and marketing administration, and freight and warehousing expenses. Most of the higher cost was accounted for by salaries and fringe benefits, media expenditures, promotions and vehicle operating costs.

Administrative and general expenses totalled $14.2 million, up by $3.2 million or 29.5 percent. This significant increase primarily reflects higher salary and benefit costs, expenses related to the relocation of the Company's head office in Metropolitan Toronto and the aforementioned costs due to work stoppages. In addition, last year's costs were reduced by certain non-recurring credits.

As noted earlier, interest on long term debt was slightly lower than in 1980. Conversely, other interest was up by approximately $400,000 or 17.5 percent as a result of high short term interest rates and slightly higher average borrowing levels.

Income tax expense amounted to $14.5 million in 1981, compared to $12.5 million last year. As a percentage of pre-tax earnings, the provision for the current year was 40.4 percent (1980—39.2 percent). As in prior years, income taxes were accounted for on the tax allocation basis for all timing differences between accounting and taxable income, with the major difference arising between capital cost allowance claimable for income tax purposes and depreciation recorded in the accounts.

During the year ended March 31, 1981, the Company's working capital increased by $9.6 million, ending the year at $93.7 million.

The combination of earnings and non-cash items such as depreciation expense and deferred income taxes resulted in working capital from operations increasing by $26.4 million during the 1981 fiscal year. Other items which increased working capital were proceeds of $670,000 from the disposal of fixed assets and common share dividends received from Carling O'Keefe Limited in the amount of almost $2.2 million.

The most significant items reducing working capital during the year were capital expenditures of $8.6 million, dividends of $9.3 million and a reduction of $1.4 million in long term debt.

The largest part of the 1981 additions to property, plant and equipment was related to production facilities at the Toronto and Quebec City plants. Other significant amounts were spent on the new head office premises and on furniture and equipment for non-production premises across Canada.

Total dividends paid during the most recent year were approximately $600,000 more than in 1980. Dividends on Common shares were up by almost $1.4 million, reflecting both an increase in the rate and a larger number of shares outstanding for the full year. The quarterly payout was increased to 35 cents per share from 30 cents, effective with the September 1980 dividend. Dividends on Preferred shares were about $800,000 lower in 1981, primarily as a result of the conversion of Second Preferred shares into Common shares midway through the previous year.

Excluding the Company's investment in Carling O'Keefe Limited, total assets employed in tobacco operations amounted to $186.7 million at the end of 1981, an increase of $4.6 million over last year. Inventories, primarily consisting of leaf tobacco and finished goods, accounted for $127.1 million or 68 percent of the year-end total.

ROTHMANS OF PALL MALL CANADA LIMITED

EARNINGS FROM TOBACCO OPERATIONS

(in thousands of dollars)

	Year ended March 31	
	1981	1980
Sales	$461,491	$419,739
Excise and sales taxes	231,436	213,016
Net sales	230,055	206,723
Costs:		
Raw materials and manufacturing	131,190	119,840
Marketing and distribution	43,811	39,264
Administrative and general	14,242	10,994
Interest on long term debt	2,235	2,423
Other interest	2,686	2,285
	194,164	174,806
	35,891	31,917
Income taxes:		
Current	13,882	13,285
Deferred	618	(775)
	14,500	12,510
Earnings for the year	$ 21,391	$ 19,407

CHANGES IN FINANCIAL POSITION OF TOBACCO OPERATIONS

(in thousands of dollars)

	Year ended March 31	
	1981	1980
Working capital was increased by:		
Earnings from tobacco operations	$ 21,391	$ 19,407
Depreciation	4,698	4,653
Deferred income taxes	555	(775)
Other items not requiring working capital	(290)	(93)
Working capital from operations	26,354	23,192
Disposal of property, plant and equipment	670	177
Dividends from Carling O'Keefe Limited	2,181	1,091
	29,205	24,460
Working capital was decreased by:		
Additions to property, plant and equipment	8,622	6,290
Reduction of long term debt	1,424	1,475
Purchase of First Preferred shares	172	607
Dividends	9,333	8,750
Other	54	27
	19,605	17,149
Increase in working capital	9,600	7,311
Working capital at beginning of year	84,136	76,825
Working capital at end of year	$ 93,736	$ 84,136

ROTHMANS OF PALL MALL CANADA LIMITED

FINANCIAL POSITION OF TOBACCO OPERATIONS

(in thousands of dollars)

	March 31	
	1981	1980
ASSETS		
Current assets:		
Accounts receivable	$ 24,852	$ 18,958
Inventories	127,071	131,942
Prepaid expenses	1,380	1,250
Total current assets	153,303	152,150
Investment in Carling O'Keefe Limited, on the equity basis	74,532	62,518
Property, plant and equipment	74,491	69,330
Less: Accumulated depreciation	41,710	39,988
	32,781	29,342
Other assets	597	614
	$261,213	$244,624
LIABILITIES		
Current liabilities:		
Bank and other short term indebtedness	$ 30,025	$ 38,469
Accounts payable and accrued liabilities	13,809	15,848
Income taxes	1,299	2,230
Excise, sales and other taxes	14,434	11,467
Total current liabilities	59,567	68,014
Long term debt	19,850	21,450
Total liabilities	79,417	89,464
DEFERRED INCOME TAXES	5,950	5,395
SHAREHOLDERS' EQUITY		
Capital stock:		
Preferred shares	27,992	28,241
Common shares	27,349	27,349
	55,341	55,590
Retained earnings	120,505	94,175
Total shareholders' equity	175,846	149,765
	$261,213	$244,624

Review of Brewing, Wine and Oil and Gas Operations

ANALYSIS OF PERFORMANCE

($000)		1981	1980	1979	1978	1977
		Year ended March 31				
*Net Operating Profits After Tax**						
Earnings From Operations		**$ 19,785**	$ 17,338	$ 13,612	$ 11,809	$ 4,833
Deferred Income Taxes		**4,965**	2,824	3,225	2,578	2,169
After Tax Interest Expense		**1,487**	1,406	1,042	1,433	1,509
	(A)	**$ 26,237**	$ 21,568	$ 17,879	$ 15,820	$ 8,511
Average Total Capital Employed						
Interest-Bearing Debt		**$ 27,611**	$ 26,434	$ 26,952	$ 43,000	$ 55,747
Other Long Term Liabilities		**1,441**	348	—	—	—
Minority Interest		**933**	1,845	1,777	1,690	1,681
Deferred Income Taxes		**30,177**	26,732	23,708	19,781	16,383
Shareholders' Equity**		**179,372**	161,051	149,299	123,963	102,906
	(B)	**$239,534**	$216,410	$201,736	$188,434	$176,717
Return On Average Total Capital Employed	(A÷B)	**11.0%**	10.0%	8.9%	8.4%	4.8%

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

** Average shareholders' equity is computed from total shareholders' equity minus the investment in United States operations on the equity basis (in 1977 only).

The above table provides a five-year comparative summary of consolidated performance for Carling O'Keefe Limited and its subsidiary companies, as measured by return on capital employed. The 1981 fiscal year saw a continuation of the trend of improvement in operating profits, both on an absolute and relative basis.

Statements of earnings, financial position and changes in financial position can be found on pages 14 and 15 of this report. A copy of the 1981 annual report for Carling O'Keefe is enclosed to provide more detailed information. The following commentary by segment provides a review of the more significant factors which influenced 1981 fiscal year results.

CONSOLIDATED RESULTS

Earnings from operations for the year were $19.8 million and represented a gain of almost $2.5 million or 14 percent over 1980. The major contributing factors were improved earnings from Canadian brewing and oil and gas operations. Earnings before income taxes were up by 12 percent.

An extraordinary gain of $10.5 million on the sale of trade marks in southern Africa increased final earnings in 1981 to $30.3 million. There were no extraordinary items last year.

Total sales revenue amounted to $537.3 million, an increase of $59.3 million or 12.4 percent. All four operating divisions of the company contributed to the gain.

Consolidated working capital of Carling O'Keefe was $39.8 million at March 31, 1981, marginally higher than at the end of last year. Working capital from operations was almost $34 million and other significant items increasing working capital were $3.1 million from the current portion of a long term receivable, $2.6 million from the sale of the trade marks and $2.2 million from disposal of property, plant and equipment and other assets. Working capital was decreased by fixed asset additions of $26.5 million, dividends of $6.4 million, reduction of $3.5 million in long term debt, additions to other assets of $3.2 million and $3 million for the purchase of the remaining minority interest in Jordan Valley Wines Limited.

Total assets of the company and its subsidiaries amounted to $317.5 million at March 31, 1981, an increase of $36.7 million over last year.

CANADIAN BREWING

Earnings of Carling O'Keefe Breweries of Canada Limited before interest expense and income taxes were $23.1 million compared to $20.8 million in 1980. This improvement of $2.3 million or almost 11 percent was achieved despite the adverse impact of labour disputes in two western provinces during the year.

The company recorded total sales of 4,756,000 hectolitres, a decline of 184,000 hectolitres or 3.7 percent from 1980. Market share comparisons with last year on a national basis are subject to some distortion because of the impact of the work stoppages. However, the company's share of the total Canadian market has shown a modest increase over last year due primarily to gains in British Columbia, Quebec and Manitoba, partially offset by further share erosion in Ontario. Industry labour problems caused work stoppages for two months in British Columbia and for seven months in Alberta. During the year, the company introduced Carlsberg Light in Ontario and Quebec and Carlsberg Gold in Ontario.

Because of selling price increases, sales revenue was up by $42.4 million or 10.8 percent to $435.7 million.

Capital expenditures during 1981 amounted to $14.7 million, compared to $9.9 million last year, and included expansion of production capacities of the St. John's and Montreal breweries. Depreciation expense was slightly higher in the latest year at $6.6 million (1980—$6.2 million).

Identifiable assets attributable to Canadian brewing operations were $165.8 million at March 31, 1981, an increase of $24 million over the previous year-end.

IRISH BREWING

Earnings of Beamish & Crawford Limited before interest and income taxes amounted to $1.3 million in 1981, a decrease of $0.4 million or almost 25 percent over last year. However, as was the case in 1980, operating earnings before the foreign exchange adjustment on translation of the Irish company's financial statements to Canadian dollars recorded an increase over the previous year ($2.5 million versus $2.1 million in 1980).

Sales volume was marginally lower in 1981 at 235,000 hectolitres. The decrease was somewhat less than the overall Irish industry decline of 2.1 percent. Two selling price increases during the year and the passing on to the consumer of substantial excise duty increases meant that sales revenue was higher in 1981 (up by 15.8 percent).

Capital expenditures of about $900,000 were significantly lower than last year and related primarily to energy conservation projects. Depreciation expense of $473,000 was virtually the same as in 1980.

Total assets employed in the Irish brewing operations increased to $21.9 million from $20.1 million at the end of last year.

WINE

Earnings of Jordan Valley Wines Limited before interest and income taxes increased slightly in 1981, amounting to $1.6 million compared to $1.5 million last year.

Sales volume was 22,277,000 litres compared to 20,942,000 litres in 1980. This increase of 6.4 percent compares to total industry growth of approximately 5 percent. The growth in industry volume was helped by the work stoppages in the brewing industry in Western Canada, but was adversely affected by changes in the rate and method of application of excise taxes. The company's volume was also adversely impacted by a labour dispute which closed the British Columbia winery for five weeks. Following a trend seen last year, the share of the total market held by Canadian produced products increased in 1981 to approximately 48%.

Sales revenue was ahead of last year by almost 23 percent, reflecting the higher volumes, increased excise taxes, the continuing trend to higher-priced products and selling price increases necessary to cover increased costs.

Capital expenditures for the year were just over $2 million and depreciation expense was more than $1.1 million. As a result of a major study on production facilities, the wineries at Moose Jaw, Saskatchewan and Selkirk, Manitoba were closed during the year.

Identifiable assets attributable to wine operations amounted to $52.8 million at March 31, 1981, up slightly from a year ago.

OIL AND GAS

Earnings of Star Oil & Gas Ltd. before interest and income taxes were $6.1 million in 1981, an increase of 28.7 percent over last year's $4.7 million.

Natural gas sales volume was 1.4 percent lower than 1980, while oil and other sales were unchanged. Sales revenue of $12.1 million represented an increase of almost 26 percent.

Because of the National Energy Program announced by the Government of Canada in its October 1980 budget, high provincial crown royalty rates, and the lack of market for new natural gas, many oil and natural gas projects in Canada are now uneconomical. Total capital expenditures for Star were $8.8 million in 1981, a reduction of 26 percent from last year. Depreciation and depletion expense was up slightly to $2.4 million.

Total assets employed in the oil and gas business amounted to almost $59 million at year-end, compared to $52 million at March 31, 1980.

INTERNATIONAL DIVISION

Royalty income from the sale of Carling Black Label in overseas markets, where it is produced under license, declined to $1.7 million from $3.7 million in the previous year. The decrease reflected the sale of the Carling trade marks for southern Africa, details of which are set out in note 5 to the consolidated financial statements. Royalty income from sales in Europe increased by 17.7 percent, as a result of higher royalty rates and improved foreign exchange factors. Sales volume in this market decreased modestly from the prior year, in line with the general volume decline of the brewing industry in these countries because of poor economic conditions.

CARLING O'KEEFE LIMITED

AND SUBSIDIARY COMPANIES

EARNINGS FROM OPERATIONS

(in thousands of dollars)

	Year ended March 31 1981	Year ended March 31 1980
Income:		
Sales	**$537,348**	$478,059
Excise and sales taxes	**177,814**	152,827
Net sales	**359,534**	325,232
Investment and other income	**7,566**	6,579
	367,100	331,811
Costs:		
Raw materials and manufacturing	**176,049**	160,551
Marketing and distribution	**130,058**	116,314
Administrative and general	**25,016**	23,047
Interest on long term debt	**1,694**	1,827
Other interest	**1,404**	812
	334,221	302,551
	32,879	29,260
Income taxes:		
Current	**8,016**	9,057
Deferred	**4,965**	2,824
	12,981	11,881
	19,898	17,379
Minority interest	**113**	41
Earnings for the year before extraordinary item	**$ 19,785**	$ 17,338

CHANGES IN FINANCIAL POSITION

(in thousands of dollars)

	Year ended March 31 1981	Year ended March 31 1980
Working capital was increased by:		
Earnings before extraordinary item	**$ 19,785**	$ 17,338
Depreciation and depletion	**10,605**	9,741
Deferred income taxes	**4,965**	2,824
Other items not requiring working capital	**(1,405)**	1,158
Working capital from operations	**33,950**	31,061
Sale of trade marks, less long term receivable of $6,987 and deferred income taxes	**2,613**	—
Disposal of property, plant and equipment and other assets	**2,219**	1,029
Current portion of mortgage and long term receivable	**3,085**	6,885
Other	**1,213**	—
	43,080	38,975
Working capital was decreased by:		
Additions to property, plant and equipment	**26,487**	25,391
Purchase of shares in subsidiary company	**2,993**	—
Cost of National Hockey League franchise	**—**	6,937
Additions to other assets	**3,178**	937
Reduction of long term debt	**3,510**	2,325
Dividends	**6,414**	4,253
Other	**150**	164
	42,732	40,007
Increase (decrease) in working capital	**348**	(1,032)
Working capital at beginning of year	**39,435**	40,467
Working capital at end of year	**$ 39,783**	$ 39,435

CARLING O'KEEFE LIMITED

AND SUBSIDIARY COMPANIES

FINANCIAL POSITION

(in thousands of dollars)

	March 31	
	1981	1980
ASSETS		
Current assets:		
Cash and short term deposits	$ 7,637	$ 8,855
Accounts receivable	36,863	29,740
Receivable from sale of trade marks	4,291	—
Mortgage receivable	—	6,885
Inventories	63,672	54,857
Prepaid expenses	5,036	3,521
Total current assets	117,499	103,858
Property, plant and equipment	270,743	250,614
Less: Accumulated depreciation and depletion	108,869	102,767
	161,874	147,847
Other assets	38,125	29,128
	$317,498	$280,833
LIABILITIES		
Current liabilities:		
Bank and other short term indebtedness	$ 11,387	$ 7,128
Accounts payable and accrued liabilities	51,349	43,891
Income taxes	3,155	3,186
Other taxes	10,222	9,156
Dividends payable	1,603	1,062
Total current liabilities	77,716	64,423
Long term liabilities	16,341	18,890
Total liabilities	94,057	83,313
DEFERRED INCOME TAXES	32,209	28,144
MINORITY INTEREST IN SUBSIDIARY COMPANY	—	1,865
SHAREHOLDERS' EQUITY		
Capital stock:		
Preference shares	42,526	42,776
Common shares	78,357	78,357
	120,883	121,133
Retained earnings	70,349	46,378
Total shareholders' equity	191,232	167,511
	$317,498	$280,833

ROTHMANS OF PALL MALL CANADA LIMITED
AND SUBSIDIARY COMPANIES
(Incorporated under the laws of Canada)

Consolidated Statement of Earnings

(in thousands of dollars)

	Year ended March 31	
	1981	1980
Income:		
Sales	$998,839	$897,798
Excise and sales taxes	409,250	365,843
	589,589	531,955
Investment and other income	7,566	6,579
	597,155	538,534
Costs:		
Raw materials and manufacturing	307,239	280,391
Marketing and distribution	173,869	155,578
Administrative and general	39,258	34,041
Interest on long term debt	3,929	4,250
Other interest	4,090	3,097
	528,385	477,357
	68,770	61,177
Income taxes:		
Current	21,898	22,342
Deferred	5,583	2,049
	27,481	24,391
	41,289	36,786
Minority interest (Note 4)	11,016	9,730
EARNINGS BEFORE EXTRAORDINARY ITEM	30,273	27,056
Gain of $10,500 on sale of trade marks, less minority interest of $5,237 (Note 5)	5,263	—
EARNINGS FOR THE YEAR	$ 35,536	$ 27,056
Earnings per Common share (Note 6):		
Before extraordinary item	$5.15	$4.77
For the year	$6.11	$4.77

ROTHMANS OF PALL MALL CANADA LIMITED
AND SUBSIDIARY COMPANIES

Consolidated Statement of Retained Earnings

(in thousands of dollars)

	Year ended March 31	
	1981	1980
Balance at beginning of year	**$ 94,175**	$ 75,709
Earnings for the year	**35,536**	27,056
Excess of carrying value over cost of First Preferred shares purchased for cancellation (Note 12)	**77**	117
Excess of par value over cost of preference shares purchased for cancellation by Carling O'Keefe Limited, less minority interest	**50**	43
	129,838	102,925
Dividends paid:		
Preferred shares—		
First Preferred shares, Series A ($6.85 per share)	**990**	1,025
Second Preferred shares ($1.325 per share)	**904**	1,658
	1,894	2,683
Common shares (1981—$1.35 per share; 1980—$1.20)	**7,439**	6,067
	9,333	8,750
Balance at end of year	**$120,505**	$ 94,175

ROTHMANS OF PALL MALL CANADA LIMITED
AND SUBSIDIARY COMPANIES

Consolidated Statement of Changes in Financial Position
(in thousands of dollars)

	Year ended March 31	
	1981	1980
Working capital was increased by:		
Earnings before extraordinary item	$ 30,273	$ 27,056
Depreciation and depletion	15,303	14,394
Minority interest in earnings before extraordinary item	11,016	9,730
Deferred income taxes	5,520	2,049
Other items not requiring working capital	(1,808)	1,024
Working capital from operations	60,304	54,253
Sale of trade marks, less long term receivable of $6,987 and deferred income taxes (Note 5)	2,613	—
Disposal of property, plant and equipment and other assets	2,889	1,206
Current portion of mortgage and long term receivable	3,085	6,885
Other	1,213	—
	70,104	62,344
Working capital was decreased by:		
Additions to property, plant and equipment	35,109	31,681
Purchase of shares in subsidiary company (Note 3)	2,993	—
Cost of National Hockey League franchise (Note 14)	—	6,937
Additions to other assets	3,232	964
Reduction of long term debt	4,934	3,800
Dividends—		
By the Company	9,333	8,750
By Carling O'Keefe Limited to minority shareholders	4,233	3,162
Other	322	771
	60,156	56,065
Increase in working capital	9,948	6,279
Working capital at beginning of year	123,571	117,292
Working capital at end of year	$133,519	$123,571

ROTHMANS OF PALL MALL CANADA LIMITED

AND SUBSIDIARY COMPANIES

Consolidated Balance Sheet

(in thousands of dollars)

	March 31 1981	March 31 1980
ASSETS		
Current assets:		
Cash and short term deposits	$ 7,637	$ 8,855
Accounts receivable	61,390	48,428
Receivable from sale of trade marks (Note 5)	4,291	—
Mortgage receivable	—	6,885
Inventories (Note 7)	190,743	186,799
Prepaid expenses	6,416	4,771
Total current assets	270,477	255,738
Property, plant and equipment (Note 8)	345,234	319,944
Less: Accumulated depreciation and depletion	150,579	142,755
	194,655	177,189
Other assets (Note 9)	38,722	29,742
	$503,854	$462,669
LIABILITIES		
Current liabilities:		
Bank and other short term indebtedness (Note 10)	$ 41,412	$ 45,597
Accounts payable and accrued liabilities	65,378	59,742
Income taxes	4,454	5,416
Excise, sales and other taxes	24,656	20,623
Dividends payable to minority interest	1,058	789
Total current liabilities	136,958	132,167
Long term liabilities (Note 11)	36,191	40,340
Total liabilities	173,149	172,507
DEFERRED INCOME TAXES	38,159	33,539
MINORITY INTEREST IN SUBSIDIARY COMPANIES (Note 4)	116,700	106,858
SHAREHOLDERS' EQUITY		
Capital stock (Note 12):		
Preferred shares	27,992	28,241
Common shares	27,349	27,349
	55,341	55,590
Retained earnings	120,505	94,175
Total shareholders' equity	175,846	149,765
	$503,854	$462,669

APPROVED BY THE BOARD:
J.H. DEVLIN, *Director*
R.H. HAWKES, *Director*

ROTHMANS OF PALL MALL CANADA LIMITED
AND SUBSIDIARY COMPANIES

Segmented Information on Operations

(in thousands of dollars)

	Year ended March 31 1981	Year ended March 31 1980
SALES		
Tobacco	$461,491	$419,739
Beer—Canada	435,721	393,281
—Ireland	45,468	39,265
Wine	44,021	35,873
Oil and gas	12,138	9,640
	$998,839	$897,798
OPERATING PROFITS		
Tobacco	$ 40,812	$ 36,625
Beer—Canada	23,078	20,834
—Ireland	1,253	1,660
Wine	1,625	1,475
Oil and gas	6,074	4,720
	72,842	65,314
Corporate income, net	3,947	3,210
Interest expense	(8,019)	(7,347)
Earnings before extraordinary item, income taxes and minority interest	$ 68,770	$ 61,177
CAPITAL EXPENDITURES		
Tobacco	$ 8,622	$ 6,290
Beer—Canada	14,714	9,857
—Ireland	923	1,611
Wine	2,050	1,970
Oil and gas	8,800	11,953
	$ 35,109	$ 31,681
DEPRECIATION AND DEPLETION		
Tobacco	$ 4,698	$ 4,653
Beer—Canada	6,621	6,190
—Ireland	473	471
Wine	1,144	1,040
Oil and gas	2,367	2,040
	$ 15,303	$ 14,394

	March 31 1981	March 31 1980
IDENTIFIABLE ASSETS		
Tobacco	$186,454	$182,106
Beer—Canada	165,752	141,801
—Ireland	21,875	20,052
Wine	52,801	52,681
Oil and gas	58,967	51,993
	485,849	448,633
Corporate	18,005	14,036
	$503,854	$462,669

Corporate income, net represents corporate revenue less corporate costs of Carling O'Keefe Limited. Corporate assets consist primarily of cash, short term deposits, receivable from sale of trade marks and mortgage receivable of Carling O'Keefe.

Notes to Consolidated Financial Statements

MARCH 31, 1981 AND 1980

1. Summary of significant accounting policies:

The financial statements are prepared on the historical cost basis in accordance with accounting principles generally accepted in Canada and conform in all material respects with International Accounting Standards.

PRINCIPLES OF CONSOLIDATION:

The consolidated financial statements include the accounts of the Company and all of its subsidiaries. The principal subsidiary companies are listed on page 3 of the annual report. Purchase accounting has been followed for all acquisitions and the results of operations of subsidiaries are included from effective dates of acquisition.

For certain subsidiaries of Carling O'Keefe Limited 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. Intangible assets acquired subsequently and sports franchises are amortized over periods not exceeding forty years.

FOREIGN EXCHANGE:

Foreign currency accounts are translated into 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 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:

Property, plant and equipment are recorded at cost. Depreciation is provided 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 assets 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 proved oil and gas reserves.

OTHER ASSETS:

Other assets are recorded at cost or amortized cost. Deferred charges are primarily payments under employment and promotional rights contracts which are amortized over the life of the respective contracts.

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 over periods up to fifteen years.

MARKETING COSTS:

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

INVESTMENT TAX CREDITS:

Net investment tax credits relating to capital expenditures are accounted for as a reduction of income tax expense in the year earned.

2. Segmented information:

In these financial statements, all references to "Rothmans" relate to the tobacco operations of the Company and its tobacco subsidiaries. All references to "Carling O'Keefe" 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.

3. Purchase of shares in subsidiary company:

Under the terms of the 1972 acquisition agreement, effective March 31, 1981 Carling O'Keefe acquired for $2,993,000 cash the shares owned by the minority shareholders of Jordan Valley Wines Limited. The transaction increased the cost of shares of subsidiaries in excess of underlying net tangible asset values at acquisition by $1,015,000.

4. Minority interest in subsidiary companies:

The interest of minority shareholders in consolidated earnings, before the extraordinary item in 1981, was as follows:

	1981	1980
CARLING O'KEEFE LIMITED:		
Preference shares	$ 2,062,000	$ 2,077,000
Common shares	8,841,000	7,612,000
	10,903,000	9,689,000
JORDAN VALLEY WINES LIMITED:		
Common shares	113,000	41,000
	$ 11,016,000	$ 9,730,000

The minority shareholders' interest in the capital stock and retained earnings of subsidiary companies at March 31 is as follows:

	1981	1980
CARLING O'KEEFE LIMITED:		
Preference shares	$ 42,526,000	$ 42,776,000
Common shares	74,174,000	62,217,000
	116,700,000	104,993,000
JORDAN VALLEY WINES LIMITED (Note 3):		
Common shares	—	1,865,000
	$116,700,000	$106,858,000

5. Gain on sale of trade marks:

On July 16, 1980, Carling O'Keefe finalized the sale of the Carling Black Label and Red Cap trade marks for southern Africa effective March 31, 1980. The total consideration of Rand 14,500,000 is receivable over a four year period subject to reduction should certain objectives not be achieved. In determining the gain, the estimated receivable was reduced to its present value using an imputed interest rate of 20%. The resulting discount of $5,711,000 will be included in investment and other income over the four year period. The consideration has been treated as an eligible capital receipt for taxation purposes.

Analysis of gain on sale of trade marks:

Estimated receivable—		
Current, less unamortized discount of $827,000		$ 6,313,000
Long term, less unamortized discount of $4,884,000		6,987,000
		13,300,000
Provision for income taxes—		
Current	$3,700,000	
Deferred	(900,000)	2,800,000
Gain on sale of trade marks		$10,500,000

Amount still outstanding from sale of trade marks:

As at March 31, 1981, the estimated receivable outstanding was:

	Current	Long term
Receivable	$5,001,000	$7,391,000
Unamortized discount	710,000	2,489,000
Net receivable	$4,291,000	$4,902,000

6. Earnings per Common share:

The 1981 earnings per Common share figures are based on the 5,510,684 shares which were outstanding during the year. The 1980 earnings per share figures are based on the weighted average number of shares outstanding during the year (5,116,810) after giving effect to the conversion of 1,155,845 Second Preferred shares into 924,676 Common shares. Consolidated earnings were reduced by dividends on Preferred shares for purposes of this calculation.

If all of the above Second Preferred shares had been converted as at April 1, 1979, earnings per Common share for the year ended March 31, 1980 would have been $4.56.

7. Inventories:

	1981	1980
ROTHMANS—		
Leaf tobacco (including purchase advances of $49,879,000 in 1981)	$ 86,491,000	$ 81,817,000
Finished goods	27,109,000	38,527,000
Packaging material and other	13,471,000	11,598,000
	127,071,000	131,942,000
CARLING O'KEEFE—		
Beverage products, finished and in process	37,668,000	34,959,000
Materials and supplies	13,033,000	11,463,000
Containers	12,971,000	8,435,000
	63,672,000	54,857,000
	$190,743,000	$186,799,000

8. Property, plant and equipment:

	1981		1980	
	Cost	Accumulated depreciation and depletion	Cost	Accumulated depreciation and depletion
ROTHMANS—				
Land	$ 2,727,000	$ —	$ 2,639,000	$ —
Buildings	9,781,000	3,154,000	9,768,000	3,070,000
Machinery, furniture and fixtures	48,162,000	29,089,000	42,556,000	27,238,000
Motor vehicles	5,760,000	3,935,000	6,193,000	3,832,000
Leasehold improvements	8,061,000	5,532,000	8,174,000	5,848,000
	74,491,000	41,710,000	69,330,000	39,988,000
CARLING O'KEEFE—				
Land	6,785,000	—	6,338,000	—
Buildings	70,754,000	25,510,000	69,128,000	24,534,000
Machinery and equipment	110,016,000	63,311,000	102,621,000	61,382,000
Motor vehicles	14,356,000	7,399,000	13,197,000	6,806,000
Oil and gas assets	66,414,000	11,576,000	57,674,000	9,248,000
Leasehold improvements	2,418,000	1,073,000	1,656,000	797,000
	270,743,000	108,869,000	250,614,000	102,767,000
	$345,234,000	$150,579,000	$319,944,000	$142,755,000

9. Other assets:

	1981	1980
Unamortized cost of shares of subsidiaries in excess of underlying net tangible asset values at acquisition (Note 3)	$ 12,785,000	$ 11,805,000
Sports franchises, less amortization	12,356,000	12,680,000
Mortgages and long term receivables	6,517,000	203,000
Unamortized deferred charges, trade marks, patents and other investments	7,064,000	5,054,000
	$ 38,722,000	$ 29,742,000

Amortization of other assets amounted to $427,000 for the year ended March 31, 1981 (1980—$426,000).

10. Bank and other short term indebtedness:

Bank and other short term indebtedness consists of bank indebtedness (1981-$33,112,000; 1980-$17,597,000), bankers' acceptances (1981-$8,000,000; 1980-$23,000,000)and notes payable(1981-$300,000; 1980-$5,000,000).

	1981	1980
Rothmans	$ 30,025,000	$ 38,469,000
Carling O'Keefe	11,387,000	7,128,000
	$ 41,412,000	$ 45,597,000

11. Long term liabilities:

	1981	1980
Sinking Fund Debentures—		
Rothmans—		
Series A 8% due January 3, 1988	$ 6,056,000	$ 6,984,000
Series B 11% due February 15, 1995	15,088,000	15,489,000
	21,144,000	22,473,000
Carling O'Keefe—		
Series B 4 1/4% due January 15, 1981	—	800,000
Series C 5% due January 15, 1983	1,200,000	1,800,000
Series D 5 1/2% due April 1, 1986	3,467,000	3,819,000
Series E 5 1/2% due April 1, 1989	6,046,000	7,376,000
	10,713,000	13,795,000
Term bank loan—		
Carling O'Keefe, due March 31, 1985	5,800,000	6,400,000
Obligations under capital leases—Carling O'Keefe	592,000	—
Unfunded pensions—Carling O'Keefe (Note 13)	882,000	695,000
Deferred revenue under gas contracts—Carling O'Keefe	715,000	—
	39,846,000	43,363,000
Less—Amount included in current liabilities	3,655,000	3,023,000
	$ 36,191,000	$ 40,340,000

The remaining principal requirements for long term liabilities are as follows for the years ending March 31:

	1982	1983	1984	1985	1986
Rothmans	$1,294,000	$1,600,000	$1,600,000	$1,600,000	$1,600,000
Carling O'Keefe	2,361,000	2,957,000	3,927,000	2,943,000	1,917,000
	$3,655,000	$4,557,000	$5,527,000	$4,543,000	$3,517,000

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.

The term bank loan bears interest at 1/2% over the bank's prime rate and is repayable in varying instalments up to March 31, 1985.

Containers and equipment leased under capital leases by Carling O'Keefe are included in their respective categories and will be amortized accordingly.

12. Capital stock:

AUTHORIZED:

469,889 First Preferred shares issuable in series

2,817,062 Second Preferred shares

An unlimited number of Common shares

ISSUED:	1981	1980
143,446 6.85% Cumulative Redeemable First Preferred shares, Series A (1980—145,939)	$ 14,345,000	$ 14,594,000
682,367 6 5/8% Cumulative Redeemable Second Preferred shares	13,647,000	13,647,000
	27,992,000	28,241,000
5,510,684 Common shares	27,349,000	27,349,000
	$ 55,341,000	$ 55,590,000

PURCHASES AND CONVERSIONS:

During the year ended March 31, 1981, 2,493 First Preferred shares with a total carrying value of $249,000 were purchased for cancellation at a cost of $172,000.

During the year ended March 31, 1980, 7,242 First Preferred shares were purchased for cancellation and 1,155,845 Second Preferred shares were converted into 924,676 Common shares.

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 $103 per share if redeemed before January 27, 1984, at $102 per share if redeemed before January 27, 1989, and at $101 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, 1981, 1,554 shares of the 1981 requirement had been acquired.

The Second Preferred shares were not redeemable before November 1, 1979, but are redeemable on or after that date at the option of the Company at $20 per share. These shares were convertible on the basis of 1 Common share for 1 1/4 Preferred shares converted on or before October 31, 1979.

OWNERSHIP:

Rothmans of Canada Limited, a wholly-owned subsidiary of Rothmans International Limited, is the owner of record of 71.2% of the Company's issued Common shares and 17.4% (1980—17.1%) of the issued Series A First Preferred shares. It is the intention of Rothmans International Limited to reduce its equity interest to 50% at some future date, as conditions warrant.

13. Pensions:

The Company and its subsidiaries maintain a number of pension plans covering substantially all employees and generally it is the Company's policy to fund pensions with independent trustees in accordance with legal requirements. Certain supplementary pensions are unfunded and charged to operations when paid. The charge against earnings was $7,811,000 for the year ended March 31, 1981 (1980—$7,724,000), including $6,343,000 (1980—$6,488,000) for employees of Carling O'Keefe.

Based on actuarial valuations, unfunded prior service costs for Carling O'Keefe are estimated at $14,600,000 of which $882,000 is vested and has been accrued. The unrecorded unfunded amounts are being charged to operations over periods up to fifteen years, as described in Note 1.

14. Commitments and contingent liabilities:

There are commitments under operating lease obligations relating to sports facilities, warehouses, retail stores and offices. The following table summarizes the minimum rental payments due after March 31, 1981:

	Rothmans	Carling O'Keefe	Total
Year ending March 31—			
1982	$ 1,622,000	$ 2,869,000	$ 4,491,000
1983	1,527,000	2,449,000	3,976,000
1984	1,484,000	2,093,000	3,577,000
1985	1,477,000	1,590,000	3,067,000
1986	1,394,000	1,454,000	2,848,000
Total for all years subsequent to March 31, 1986	5,801,000	8,232,000	14,033,000
	$13,305,000	$18,687,000	$31,992,000

Approved capital expenditures for the year ending March 31, 1982 total $48,000,000, of which $36,000,000 relates to Carling O'Keefe.

Under an agreement with The United Breweries Limited of Copenhagen, Denmark, Carling O'Keefe and its affiliates have the exclusive right to manufacture and sell brewery products under the Carlsberg and Tuborg trade marks 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.

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 1981 Ontario crop at a guaranteed minimum average price.

On June 22, 1979, Le Club de Hockey Les Nordiques, Inc. (Club), a wholly-owned subsidiary of Carling O'Keefe, was granted a National Hockey League (NHL) franchise for Quebec City at a cost of $6,937,000. The Club and the other teams which were granted franchises at that time were required to indemnify the NHL and its member teams from all claims arising from the 1979 expansion and granted a security interest in their respective assets in favour of the NHL and its member teams to secure this commitment.

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 effect on the Company's financial position.

Price Waterhouse & Co.
CHARTERED ACCOUNTANTS

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

May 21, 1981

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, 1981 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, 1981 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

dunhill

A prestigious Dunhill shop has been opened in downtown Toronto, at Simpson's on the corner of Bay and Richmond streets, to make a wide range of Dunhill luxury merchandise available to Canadian shoppers. The handsome new cigar humidor in the shop offers the finest selection of Cuban cigars in North America.

THE ROTHMANS ART PROGRAM

The Rothmans Art Program continues to receive wide recognition from all parts of the country. Currently, an exhibition, titled "Manzù 100 Works 1938 to 1980", a retrospective exhibition of one of the most eminent sculptors of our time, is touring the country until 1982. In the Province of Quebec, the Rothmans collection of contemporary French and Quebec tapestries continues to draw enthusiastic response during the current exhibition tour. Acquisitions continue to be made each year for the Rothmans Permanent Collection of Canadian Art to enrich the Company's collection of contemporary paintings, prints, drawings, and sculptures.

ROTHMANS EQUESTRIAN PROGRAM

Over the past eleven years, the Company's support of this activity has given young riders the opportunity of developing their skills to international levels. During 1981 Rothmans will sponsor major equestrian events in 23 horse shows from coast to coast in Canada.

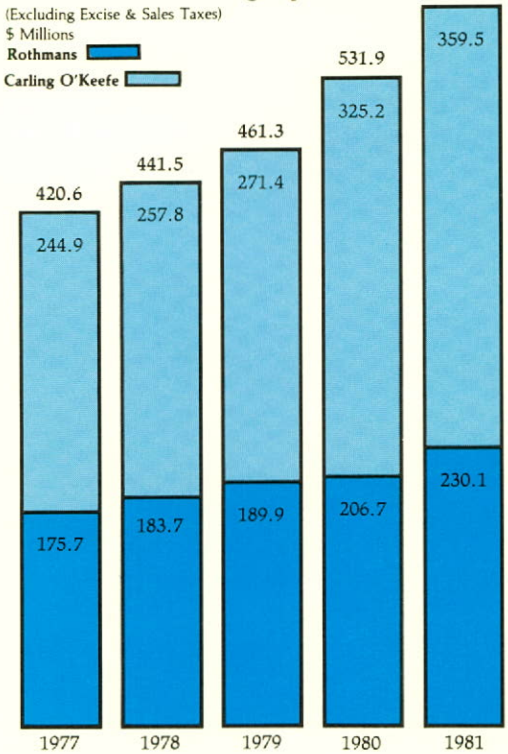
LOCAL COMMUNITY INVOLVEMENT

Rothmans Special Events caravans continue to assist, free of charge, many local organizations in their activities across Canada. The caravans are fully equipped to function as control centres for outdoor events and offer complete sound, lighting and communications systems.

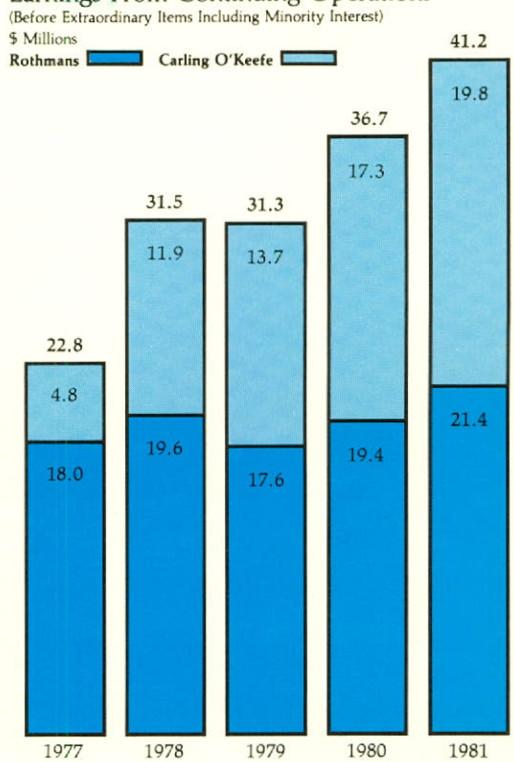
Five-Year Financial Review

	Year Ended March 31				
	1981	1980	1979	1978	1977
Results For The Year ($000)					
Sales from continuing operations—					
Rothmans	**$461,491**	$419,739	$400,042	$398,751	$394,484
Carling O'Keefe	**537,348**	478,059	401,273	381,147	359,189
	998,839	897,798	801,315	779,898	753,673
Excise and sales taxes	**409,250**	365,843	340,046	338,348	333,063
	589,589	531,955	461,269	441,550	420,610
Earnings—					
Earnings from continuing operations—					
Rothmans	**21,391**	19,407	17,605	19,612	18,022
Carling O'Keefe, less minority interest	**8,882**	7,649	5,775	4,863	1,361
	30,273	27,056	23,380	24,475	19,383
Loss from operations of former United States subsidiary of Carling O'Keefe, less minority interest	**—**	—	—	(5,091)	(51)
Earnings before extraordinary items	**30,273**	27,056	23,380	19,384	19,332
Extraordinary items from Carling O'Keefe, less minority interest	**5,263**	—	161	(5,118)	336
Earnings for the year	**35,536**	27,056	23,541	14,266	19,668
Depreciation and depletion—continuing operations	**15,303**	14,394	13,403	12,367	11,397
Interest expense—continuing operations	**8,019**	7,347	6,868	8,131	9,272
Dividends paid—					
Preferred	**1,894**	2,683	3,505	3,547	3,581
Common	**7,439**	6,067	4,583	3,028	2,370
Financial Position ($000)					
Working capital	**$133,519**	$123,571	$117,292	$118,467	$ 64,980
Property, plant and equipment—net	**194,655**	177,189	160,583	145,510	136,909
Total assets	**503,854**	462,669	418,512	415,854	432,494
Total interest-bearing debt	**79,069**	88,265	85,515	106,762	133,666
Shareholders' equity	**175,846**	149,765	132,023	117,054	109,167
Per Common Share					
Earnings—					
From continuing operations	**$ 5.15**	$ 4.77	$ 4.33	$ 4.58	$ 3.47
Before extraordinary items	**5.15**	4.77	4.33	3.47	3.46
For the year	**6.11**	4.77	4.37	2.35	3.53
Dividends paid	**1.35**	1.20	1.00	0.663	0.52
Shareholders' equity	**26.82**	22.04	17.40	14.00	12.24
Other Information					
Return on average total capital employed (%)—					
Rothmans	**16.6**	15.6	15.0	17.0	18.6
Carling O'Keefe	**11.0**	10.0	8.9	8.4	4.8
Working capital from continuing operations ($000)	**60,304**	54,253	48,905	47,042	37,610
Capital expenditures ($000)	**35,109**	31,681	31,324	26,056	22,199
Working capital ratio	**1.97**	1.93	2.06	1.94	1.44

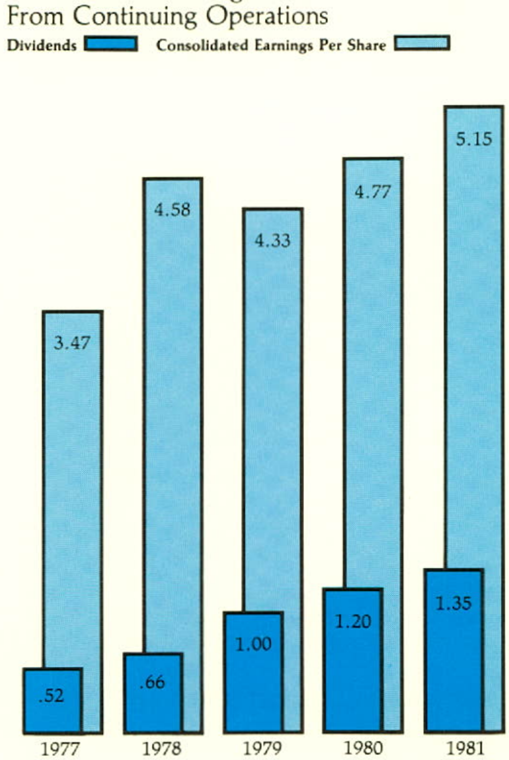
Sales From Continuing Operations



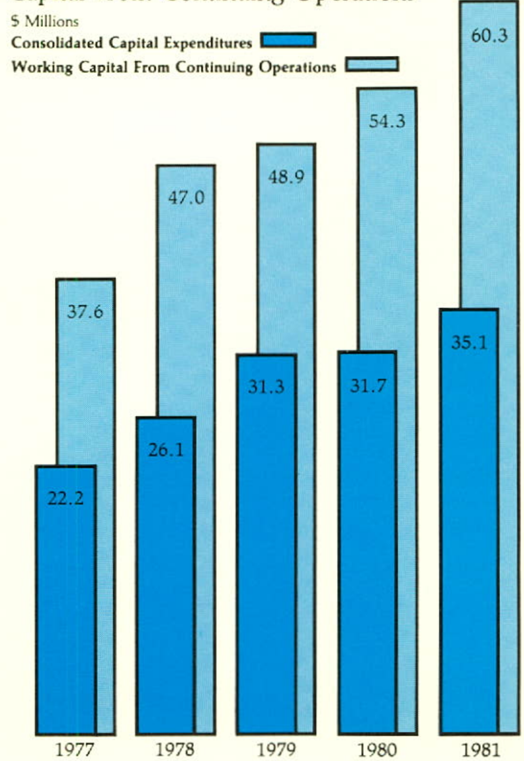
Earnings From Continuing Operations



Common Dividends Paid and Consolidated Earnings Per Common Share From Continuing Operations



Consolidated Capital Expenditures and Working Capital From Continuing Operations



Quarterly Financial Data

($000)

	Year Ended March 31					
	Rothmans		Carling O'Keefe		Total	
	1981	1980	1981	1980	1981	1980
Consolidated Sales:						
Quarter ended—						
June 30	**$110,409**	$104,480	**$145,669**	$122,124	**$256,078**	$226,604
September 30	**116,487**	106,050	**140,308**	132,273	**256,795**	238,323
December 31	**125,236**	123,895	**140,343**	124,490	**265,579**	248,385
March 31	**109,359**	85,314	**111,028**	99,172	**220,387**	184,486
	$461,491	$419,739	**$537,348**	$478,059	**$998,839**	$897,798
Consolidated Earnings Before Extraordinary Item:						
Amount						
Quarter ended—						
June 30	**$ 5,540**	$ 4,886	**$ 2,821***	$ 1,999*	**$ 8,361**	$ 6,885
September 30	**5,119**	4,666	**2,338***	3,057*	**7,457**	7,723
December 31	**6,575**	6,376	**2,863***	2,389*	**9,438**	8,765
March 31	**4,157**	3,479	**860***	204*	**5,017**	3,683
	$ 21,391	$ 19,407	**$ 8,882***	$ 7,649*	**$ 30,273**	$ 27,056

	1981	1980
Per Common Share		
Quarter ended—		
June 30	**$1.43**	$1.31
September 30	**1.26**	1.45
December 31	**1.63**	1.50
March 31	**0.83**	0.51
	$5.15	$4.77

*After deducting minority interest.

Directors

RENÉ AMYOT, Q.C.†*	*Senior Partner* *Amyot, Lesage, Bernard, Drolet & Associés* *Quebec, Quebec*
FRIEDRICH CORDEWENER	*Director & Member of Management* *Martin Brinkmann AG* *Bremen, Federal Republic of Germany*
JOHN H. DEVLIN*	*Chairman of the Board* *Rothmans of Pall Mall Canada Limited* *Don Mills, Ontario*
THE HON. ALASTAIR GILLESPIE, P.C.†	*Chairman of the Board* *Carling O'Keefe Limited* *Toronto, Ontario*
ROBERT H. HAWKES, Q.C.✦	*President and Chief Executive Officer* *Rothmans of Pall Mall Canada Limited* *Don Mills, Ontario*
GEORGE B. McKEEN †✦	*President* *McKeen & Wilson Ltd.* *Vancouver, British Columbia*
SIR DAVID NICOLSON	*Chairman* *Rothmans International Limited* *London, England*
ALEXANDER ORLOW	*Chief Executive* *Rothmans International Limited* *London, England*

Officers

JOHN H. DEVLIN*
Chairman of the Board

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

ROBERT W. ALLAN, C.A.
Vice President

WARREN A. BRACKMANN
Vice President Engineering and Technology

JOHN E. BROEN
Vice President Marketing Operations

CAMILLE A. DENIS
Vice President Corporate Affairs

RONALD F. FINDLAY, C.A.✦
Vice President Corporate Services

JOSEPH J. HEFFERNAN
Vice President Manufacturing Operations

GERALD G. NORMAN
Vice President Production

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

GORDON R. WHITE
Vice President Sales

EDWARD A. CRIGHTON, C.A.✦
Comptroller

JAMES K. STRICKLAND
General Counsel and Secretary

DOROTHY I.L. WILLIAMS
Assistant Secretary

† Member of the Audit Committee
* Member of the Compensation Committee
✦ Member of the Pension Investment Committee

Head Office	• 1500 DON MILLS ROAD, DON MILLS, ONTARIO, M3B 3L1
Auditors	• PRICE WATERHOUSE & CO.
Bankers	• BANK OF MONTREAL
Registrar and Transfer Agent	• THE ROYAL TRUST COMPANY
Solicitors	• SMITH, LYONS, TORRANCE, STEVENSON & MAYER

MARKET PRICES

Rothmans 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.

	1981				1980			
	4th Qtr.	3rd Qtr.	2nd Qtr.	1st Qtr.	4th Qtr.	3rd Qtr.	2nd Qtr.	1st Qtr.
First Preferred—								
High	$68	$69⅞	$75	$75	$80	$86½	$89	$89½
Low	63	61	68½	65	71	81	86¼	86
Second Preferred—								
High	13	12½	14¼	14¾	14¾	15¾	17	18½
Low	11½	11⅜	12¼	11⅝	11¾	13⅝	14¾	16
Common—								
High	26⅞	28	28¾	24	24½	21	21½	22⅞
Low	23½	26	23¾	19	21¾	18	19	19¼

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 Preferred Shares, Series A	$82½
Second Preferred Shares	$19⅞
Common Shares	$16⅝

Rothmans of Pall Mall Canada Limited