



Rothmans Inc.
Annual Report 1987

Corporate Profile

Rothmans Inc. is a holding company that produces and sells tobacco products through its 60 percent-owned subsidiary Rothmans, Benson & Hedges Inc.

Rothmans, Benson & Hedges was formed by the amalgamation in December 1986 of the Company's wholly-owned subsidiary Rothmans of Pall Mall Limited and Benson & Hedges (Canada) Inc., owned by Philip Morris Inc. The amalgamated company at year end was Canada's second largest manufacturer and distributor of cigarettes, with approximately 32 percent of the market. It also sells fine cut and pipe tobacco, represents more than half of the Canadian cigarette export market, and retails and wholesales Dunhill premium products, luxury leisure wear and accessories.

The Company's common shares are 71.2 percent-owned by Rothmans International p.l.c. of the United Kingdom. The common and preferred shares trade on the Toronto, Montreal and Vancouver stock exchanges under the ticker symbol ROC.

Business Highlights

December 1986

- Rothmans of Pall Mall Limited amalgamated with Benson & Hedges (Canada) Inc. to form Rothmans, Benson & Hedges Inc., of which Rothmans Inc. owns 60 percent.

February 1987

- Rothmans Inc. contracted to sell its 50.1 percent interest in Carling O'Keefe Limited at \$18 a share. Proceeds were received in April 1987 for a total of \$181 million, (net of capital gains taxes and disposal costs).

March 1987

- Rothmans Inc. redeemed all of the \$12 million Series A and Series B Debentures outstanding.

May 1987

- A special dividend of \$40 per common share was declared by Rothmans Inc. payable July 31, 1987 to shareholders of record July 13, 1987.

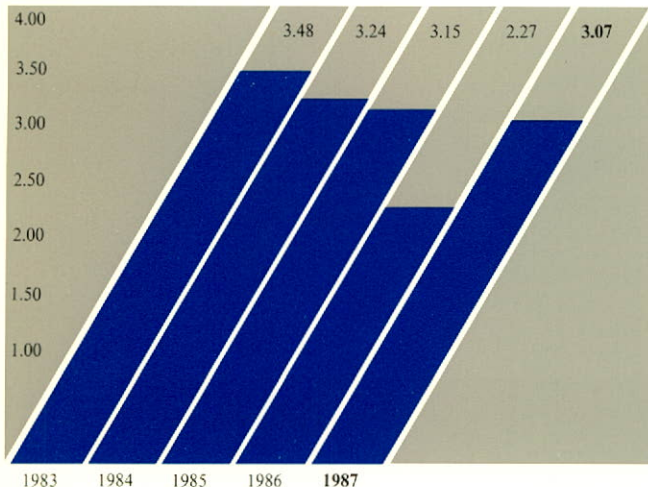
Financial Highlights

Year ended March 31	1987	1986 (Note)	Percentage Change
in thousands			
Income Statement			
From continuing operations:			
Sales net of excise and sales taxes	\$284,490	\$259,611	+ 9.6
Earnings before extraordinary items	18,582	14,236	+ 30.5
From Carling O'Keefe Limited	80,888	(10,864)	—
Earnings (loss) for the year	99,470	(1,126)	—
Financial Position			
Total assets	\$579,792	\$350,760	+ 65.3
Shareholders' equity	350,929	263,061	+ 33.4
Per Common Share (\$)			
Earnings (loss):			
From continuing operations, before extraordinary items	\$ 3.07	\$ 2.27	+ 35.2
For the year	17.74	(0.52)	—
Dividends paid	1.60	1.60	—
Shareholders' equity	59.14	43.15	+ 37.1
Ratios			
Return before extraordinary items on average total capital employed	12.9%	8.9%	
Return before extraordinary items on shareholders' equity	6.9%	5.3%	
Working capital ratio	3.4	2.8	
Long-term debt to shareholders' equity	—	7.93	

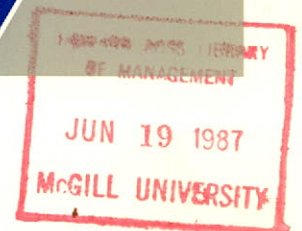
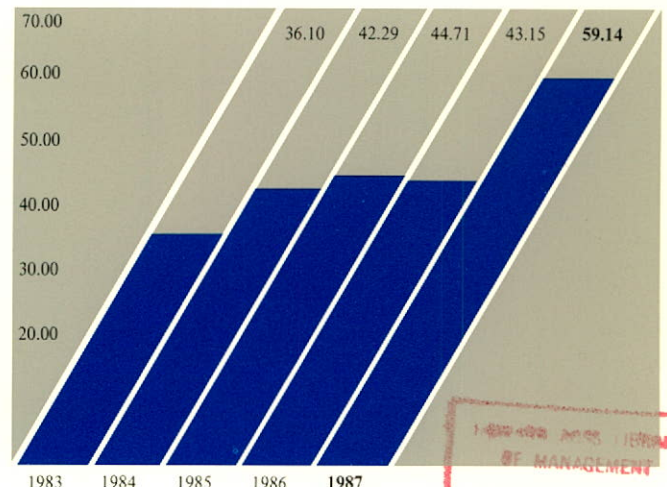
NOTE: The 1986 amounts have been restated to account for the Company's investment in Carling O'Keefe on the equity basis. Previously the accounts of Carling O'Keefe were fully consolidated.

The 1987 amounts reflect the acquisition of Benson & Hedges (Canada) Inc. effective December 19, 1986.

Earnings per common share from continuing operations (\$)



Shareholders' equity per share (\$)



Report to Shareholders



Hon. W.M. Kelly
Chairman of the Board

P.J. Fennell
President and
Chief Executive Officer

Rothmans Inc. is a holding company that strives to maximize the return on total capital employed in order to steadily increase shareholder value. It has set a target of 15 percent for its annual return on average total capital employed.

Following the divestment of Carling O'Keefe Limited, Rothmans has one operating subsidiary—60 percent-owned Rothmans, Benson & Hedges Inc. Despite pressures on the industry, Rothmans is strongly committed to the tobacco business where it has a longstanding reputation for quality.

Rothmans strategy in all its endeavours is to take a leadership position. Rothmans, Benson & Hedges is taking such a position in marketing, production efficiency and flexibility.



To the Shareholders

The year ended March 31, 1987 was the first full year of a new direction for your Company.

Not only did earnings begin a spirited turnaround last year, but we took advantage of two exceptional opportunities that became available to us. These were the amalgamation of our tobacco subsidiary and the sale of our investment in Carling O'Keefe.

Our strategy since the autumn of 1985 has been to take an aggressive leadership position within the tobacco industry in order to maximize investment returns. We strongly maintain our commitment to tobacco—our core business. This commitment and strategy lay behind the amalgamation effective December 19, of wholly-owned Rothmans of Pall Mall Limited with Benson & Hedges (Canada) Inc. to form Rothmans, Benson & Hedges Inc. of which we own 60 percent.

With the amalgamation, Rothmans, Benson & Hedges has about 32 percent of the Canadian cigarette market versus 21 percent for Rothmans of Pall Mall a year earlier, and is experiencing a solid earnings turnaround.


The other major opportunity was the offer in February 1987 by Elders IXL Limited of Australia for all of the shares

of Carling O'Keefe at \$18 per share. Following approval by Investment Canada, Elders completed the acquisition on April 27, netting Rothmans \$181 million after capital gains taxes and other costs. Though we were not seeking a buyer for our 50.1 percent interest, we readily accepted the offer for a number of reasons: it was a firm cash offer, the price was substantially above the market price, the offer was extended to all shareholders and was in the best interests of Carling O'Keefe.

Another notable achievement last year was the elimination of all long-term debt following redemption of the Series A and Series B debentures in March 1987.

Financial Results

Fiscal 1987 marked the beginning of a turnaround in earnings for Rothmans Inc. Earnings from continuing operations increased by 30.5 percent to \$18.6 million or \$3.07 per common share compared with \$14.2 million before an extraordinary loss of \$4.5 million relating to rationalization costs in fiscal 1986. Continuing operations exclude contributions from the Company's 50.1 percent interest in Carling O'Keefe, which was divested under a contract dated February 23, 1987, completed on April 27, 1987. Carling O'Keefe contrib-



uted earnings of \$4.5 million and a net capital gain at divestment of \$76.4 million. Net earnings for Rothmans were \$99.5 million or \$17.74 per share in fiscal 1987, compared with a loss of \$1.1 million or \$0.52 per share the previous year.

Earnings from continuing operations included Rothmans of Pall Mall in the first three quarters and Rothmans, Benson & Hedges in the fourth quarter. The increase primarily reflected the end of the "30 cigarettes for the price of 25" consumer offer, as well as manufacturers' price increases and production efficiencies.

Sales net of excise and sales taxes rose 9.6 percent to \$284.5 million. Excise and sales taxes increased 14.2 percent to \$442.3 million, resulting in gross sales of \$726.8 million compared with \$646.9 million in fiscal 1986. While federal tobacco tax increases were more moderate by comparison with the significant increases in recent years, accelerated increases in Alberta and Manitoba represented a disturbing trend, and tax increases overall again were the main contributor to declining industry volumes.

In the fourth quarter, after-tax earnings from continuing operations less minority interests increased 329 percent to

\$4.5 million or \$0.75 per share while net sales increased 64.4 percent to \$91.1 million, reflecting the amalgamation.

Financial Condition and Dividend

The formation of Rothmans, Benson & Hedges and the sale of Carling O'Keefe resulted in a considerably improved balance sheet, and a 33.4 percent increase in shareholders' equity to \$350.9 million. As a result of the amalgamation, a loan of \$78 million is repayable to Rothmans Inc. from Rothmans, Benson & Hedges Inc., which will be a self-financing company.

Following the formation of Rothmans, Benson & Hedges and the sale of the investment in Carling O'Keefe, the Company has substantial surplus cash funds. The Board of Directors considers that it is in the best interest of all holders of common shares that these surplus funds be distributed as a special dividend of \$40 per common share, to be paid on July 31, 1987 to holders of record at close of business on July 13, 1987.

The special dividend is in addition to the usual quarterly dividend of 40 cents per common share payable on June 17, 1987 to holders of record at the close of busi-

ness on June 3, 1987. The dividend paid on common shares was \$1.60 per share in fiscal 1987, the fourteenth consecutive year of cash dividends.

Acknowledgements

Rothmans has completed two challenging years of corporate restructuring, plant consolidation and modernization, and reductions in the work force as well as the recent integration of two tobacco companies. We are convinced that the long-term success of these many initiatives is dependent on our employees. Therefore, we have placed a high priority on supporting and assisting employees in the transitional period, and on creating a new and positive work culture that draws on the strengths of the two predecessor companies. We welcome the highly skilled management team and employees who have joined Rothmans, Benson & Hedges from the two amalgamating companies and express our gratitude and congratulations to all employees for their loyalty, co-operation and achievements during the past year.

This past year marked the end of a 20-year close corporate association with Carling O'Keefe. We have shared many rewarding and eventful years with our friends at Carling O'Keefe and wish them much success as a new member of the international brewing operations of Elders IXL.

Outlook

Despite pressures on the industry, we remain fully committed to tobacco which will present a challenging market over the next few years. We are confident our management and employees have the skills and commitment to operate the Company's tobacco business to best advantage and to optimize profit performance.



P.J. Fennell
President and
Chief Executive Officer



Hon. W.M. Kelly
Chairman of the Board

May 20, 1987

Operations Review

Rothmans, Benson & Hedges Inc.

Business Highlights

December 1986

- consolidated cigarette-making operations in the Quebec City plant.
- Rothmans of Pall Mall Limited amalgamated with Benson & Hedges (Canada) Inc. to form Rothmans, Benson & Hedges Inc.

March 1987

- consolidated Benson & Hedges' cigarette making operations in its Montreal plant.
- completed integration of the sales and marketing teams of the amalgamating companies.

New Products

- Craven "A" Lights cigarettes
- Benson & Hedges King Size cigarettes



Rothmans



Warning: Health and Welfare Canada advises that danger to health increases with amount smoked—avoid inhaling.

BENSON & HEDGES KING SIZE



WARNING: Health and Welfare Canada advises that danger to health increases with amount smoked — avoid inhaling.

Rothmans, Benson & Hedges Inc.

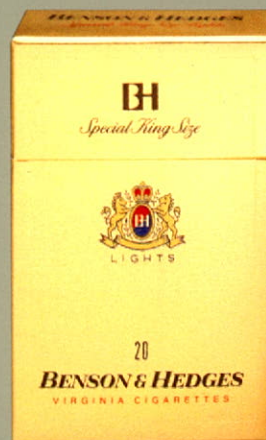
Formed in December 1986, Rothmans, Benson & Hedges Inc. is a different company from its two predecessors. The amalgamation strategy has been to capitalize on the strengths of each in order to develop an operational approach and a work culture that will maximize profitability and market share in the tobacco industry.

Rothmans, Benson & Hedges has cost-efficient cigarette-making operations and packaging capabilities. It also has advanced technology for processing high-quality tobacco. As industry volumes decline, Rothmans, Benson & Hedges is well-positioned to continue improving cost efficiency while maintaining the highest standards of quality in the industry.

Advantages of Amalgamation

The amalgamation results in increased economies of scale for production, distribution, administration, and in procurement cost efficiencies. The new company has approximately 32 percent of the Canadian cigarette market, based on retail sales figures, compared with 21 percent for Rothmans of Pall Mall.

Rothmans, Benson & Hedges can be more responsive to competition than were the two predecessor companies, since these companies complement one another in their mix of both product lines and geographic market strengths. The result is strong representation in all product and geographic segments of the market.



NEW



25



Light

FILTER TIPPED CIGARETTES

LIGHT



Warning: Health and Welfare Canada advises that danger to health increases with amount smoked - avoid inhaling.

Financial Results

Sales net of excise and sales taxes increased by 9.6 percent to \$284.5 million.

While the rise in federal government excise and sales taxes was less severe than in recent years, some provinces levied large increases, as is discussed below, and overall tax increases adversely affected sales. In addition, there were further restrictions on smoking in the workplace and other public areas, adversely affecting cigarette sales.

Two smaller segments of the tobacco market continued to experience gains. The roll-your-own tobacco market grew four percent this past year, to reach approximately ten percent of the factory-made market.

Earnings from all tobacco products rose by 30.5 percent to \$18.6 million, with gains concentrated in the second half of the year. This increase reflected primarily the end of value pricing of NUMBER 7 and Sportsman cigarettes in October 1986. Earnings also benefitted from a manufacturer's price increase of 2.2 percent in July 1986, and an additional 1.5 percent increase in October 1986. These price increases were translated into higher earnings by the significant cost containment achieved throughout the company.



Cigarettes

Rothmans, Benson & Hedges' market share slipped marginally from the fiscal 1986 year end when the "30 cigarettes for the price of 25" consumer offer was in full swing and market share was at a recent high. The consumer offer ended having successfully halted an earlier trend of steady market share attrition.

Responding to consumer demands, the tobacco subsidiary introduced new products, notably Craven "A" Lights, which received good response.

Production

Production was further rationalized during the past year, with considerable improvement in unit costs. Production initiatives are expected to result in additional efficiencies in fiscal 1988.

The Quebec City plant successfully absorbed volume demands previously met by the Toronto plant, where production was discontinued, as planned, in December 1986. To accomplish this increased production, the packing department was expanded by 25,000 square feet and new packing and cigarette-making equipment was installed. The capital expenditures of approximately \$11 million in fiscal 1987 essentially completed the company's major capital programmes.

The amalgamation with Benson & Hedges brought additional potential for savings in production costs. Its cigarette-making operation in Brampton, Ontario was transferred to its Montreal plant in March 1987. The Montreal plant now has productivity levels comparable to those in the Quebec City plant.



The NUMBER 7 Week of champions is a \$1 million week of harness racing for Ontario-sired standardbred horses, held annually at Greenwood Race Track in Toronto.



Dunhill

The Dunhill line of premium products, luxury leisure wear and accessories showed excellent growth during the year as emphasis was placed on increasing distribution beyond our company-operated retail outlets located in Montreal, Toronto and Vancouver. Sales by the Dunhill division benefitted particularly from strong demand in Vancouver during Expo '86, and from a growing demand for luxury accessories generally.



Cigarette excise and sales taxes

Per carton of 200 King Size cigarettes	Provincial tobacco tax			Current federal and provincial tax
	1986 Annual Report	Increases %	May 1987	
British Columbia	\$6.88	12.8	\$7.76	\$15.17
Alberta	2.96	170.3	8.00	15.41
Saskatchewan	8.16	—	8.16	15.57
Manitoba*	8.20	12.2	9.20	16.61
Ontario*	5.40	4.8	5.66	13.07
Quebec	9.04	—	9.04	16.45
New Brunswick	8.00	3.0	8.24	15.65
Nova Scotia	7.00	28.6	9.00	16.41
Prince Edward Island	3.00	133.3	7.00	14.41
Newfoundland**	9.56	—	9.56	16.97
Yukon Territory	6.40	—	6.40	13.81
Northwest Territories	6.60	6.1	7.00	14.41

Provincial retail sales taxes are imposed in three provinces on the total selling price including all tobacco taxes.

* excluding provincial sales tax of 7%

** excluding provincial sales tax of 12%

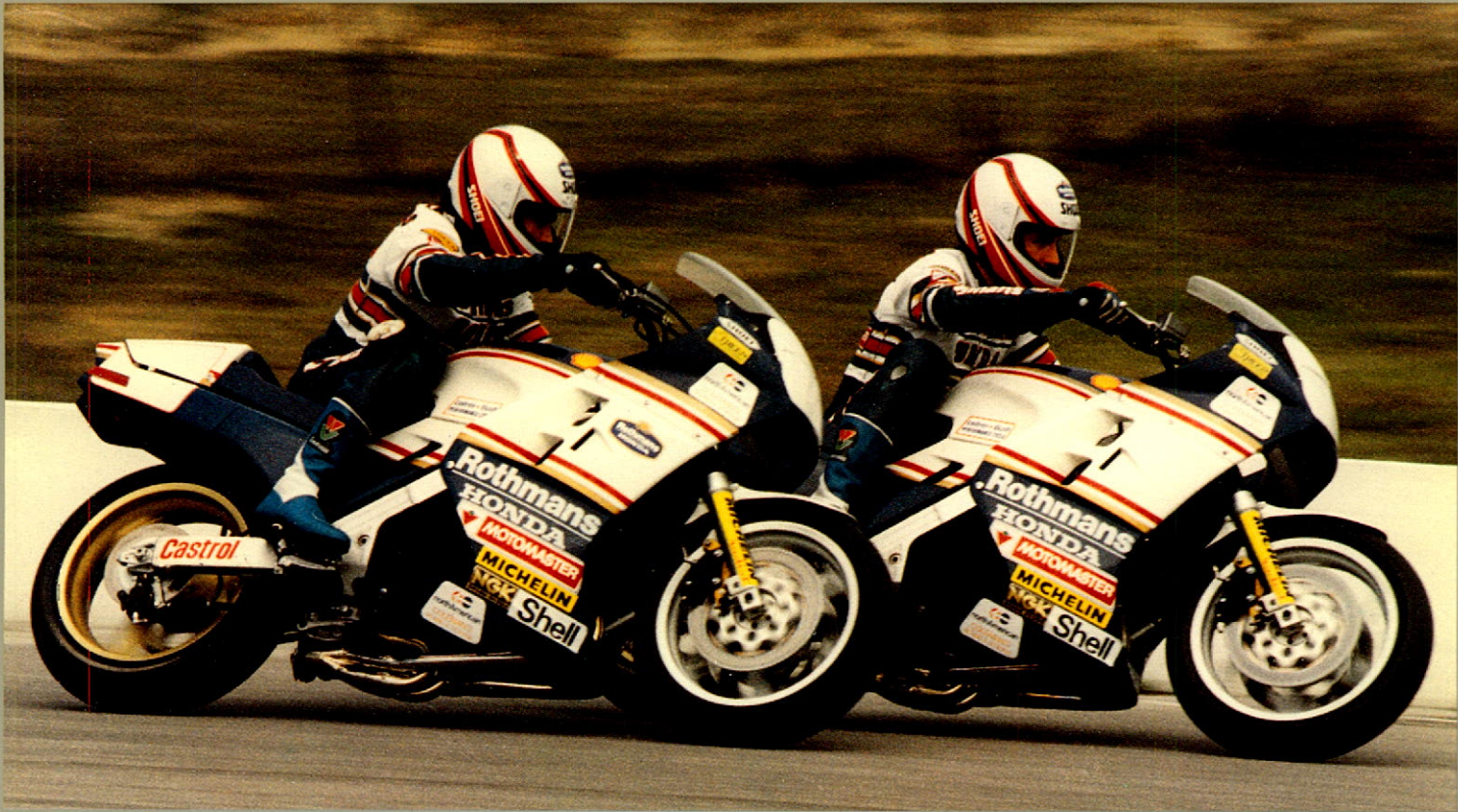
Tobacco Leaf Accord

Declining tobacco sales resulted in an accord being reached among Ontario tobacco growers, the Ontario and Federal governments and tobacco manufacturers. By this accord, dated March 1987, the governments agreed to assist farmers who must turn to other crops and to provide certain payments to those growers who sell their tobacco quota. For cigarette manufacturers, the accord is positive as it establishes a price formula for three years, based on the consumer price index; it requires no minimum purchases for domestic use; and it requires no subsidies for leaf exports. Satisfactory price and volume arrangements have been concluded with the other tobacco-growing provinces.

Taxes

While Federal government tobacco tax increases were more moderate compared with the excessive increases in recent years, some provinces—most notably Alberta and Manitoba—levied substantial price increases. As can be seen in the accompanying table, Alberta's 170 percent increase represented a catch-up, while Manitoba's 48 percent increase (including the extension of the retail sales tax to tobacco products) made its tax levy second only to Newfoundland's. Rising taxes are the main contributor to volume declines. They are levied arbitrarily, and unevenly from region to region, making corporate planning particularly difficult.





Rothmans Honda Superbikes compete in the R.A.C.E. National Championship Series.

Marketing

Based on the initial draft of the federal Tobacco Products Control Act, permissible marketing vehicles will become increasingly limited. The Act proposes the banning of: newspaper advertising effective January 1, 1988; all other provisions except billboards, magazine advertising and sponsorship as of July 1, 1988; and billboards, magazine advertising and sponsorships using tobacco product trademarks or brand names, effective January 1, 1989.

Rothmans, Benson & Hedges' strategy has been and will continue to be to develop the most disciplined and professional sales force in the tobacco industry. Beginning in January 1987, the newly-formed company invested significant sums on training. Integration of the two sales forces was completed April 1.



Comparative breakdown of retail sales dollar

	1982	Current
Federal tobacco taxes	27¢	32¢
Provincial tobacco taxes	26	32
Wholesalers & retailers	19	16
Manufacturers, processors and growers	28	20
Total	100¢	100¢



The Rothmans International is Canada's richest thoroughbred horse race, with a purse of \$750,000. It attracts top turf horses from around the world to Toronto's Woodbine Race Track.

Cigarettes (in order of sales volume):

Craven "A", Rothmans, Benson & Hedges, Number 7, Belvedere, Mark Ten, Viscount, Accord, Belmont, Dunhill, Sportsman and Peter Stuyvesant.

Fine Cut Tobaccos:

Mark Ten, Craven "A", Rothmans, Sportsman, Number 7 and Belvedere.

Pipe Tobaccos:

Captain Black, Erinmore, Gulden Dansk.

Cigars:

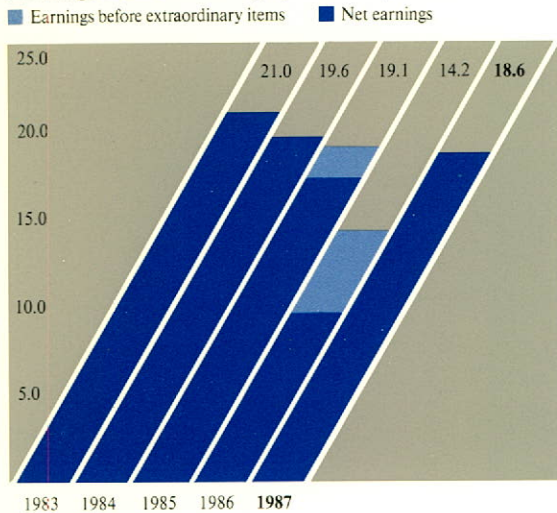
Montecristo (Cuban), Schimmelpenninck (Dutch), Antonio Y Cleopatra and Hamlet.



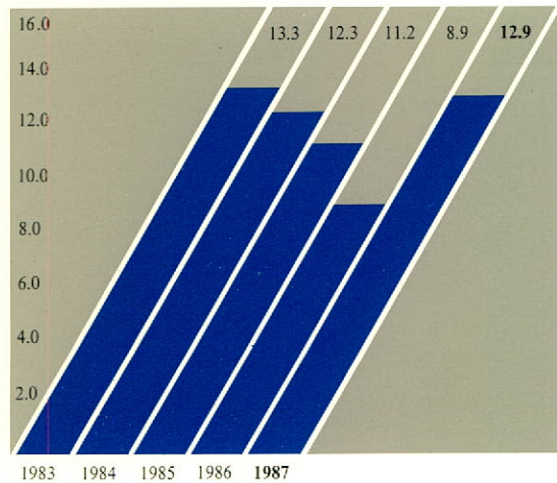
Rothmans Formula 2000 Scholarship Program will play a vital part in the development of Canadian racing drivers.

Rothmans Inc. Financial Review

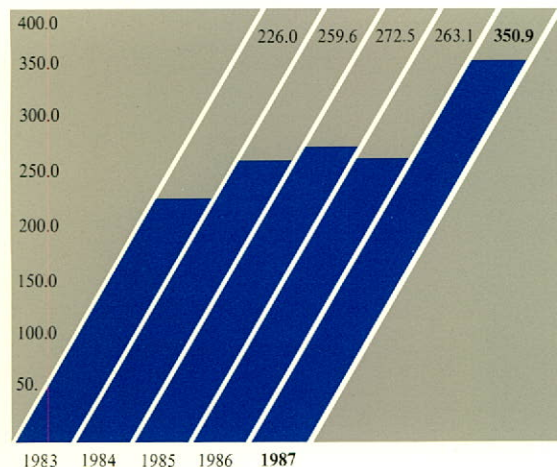
Earnings from continuing operations (\$ millions)



Return on average total capital employed (%)



Shareholders' equity (\$ millions)



Earnings

Earnings from continuing operations increased 30.5 percent to \$18.6 million or \$3.07 per share from \$14.2 million or \$2.27 per share in fiscal 1986 (before the extraordinary expense of \$4.5 million related to production rationalization). Earnings include the Company's 60 percent interest in Rothmans, Benson & Hedges in the final quarter.

Earnings benefitted most from the end of the "30 for 25" value pricing promotion, effective October 1986. Operating costs were successfully controlled, increasing by a modest 3.5 percent to \$243.0 million. Price increases in July and October also contributed to the earnings gain.

Return on average total capital employed

The return on average total capital employed based on earnings from continuing operations was 12.9 percent in fiscal 1987, compared with 8.9 percent before extraordinary items in fiscal 1986.

Average total capital employed represents the quarterly average of all interest-bearing debt, deferred taxes, minority interest related to Rothmans, Benson & Hedges, and shareholders' equity. Average total capital employed in continuing operations increased to \$235 million in fiscal 1987 from \$196 million last year.

Shareholders' equity

Total shareholders' equity increased 33.4 percent to \$351 million at year end. Common shareholders' equity per share increased to \$59.14 from \$43.15 at March 31, 1986.

The sale of the Company's 50.1 percent interest in Carling O'Keefe resulted in net proceeds of \$181 million after capital gains taxes and divestment costs with a gain of \$76.4 million being recognized in earnings.

The surplus funds generated from the amalgamation of Rothmans, Benson & Hedges and the divestment are to be distributed by way of a special dividend of \$40 per common share (\$220 million) to be paid on July 31, 1987 to holders of record at close of business on July 13, 1987.

Consolidated Statement of Earnings and Retained Earnings

Year ended March 31	1987	1986 (Restated-Note 2)
		in thousands
Earnings		
Sales	\$726,824	\$646,880
Excise and sales taxes	442,334	387,269
Sales net of excise and sales taxes	284,490	259,611
Costs:		
Operating costs	242,996	234,789
Interest on long-term debt	1,542	1,410
Other interest (net)	(845)	129
	243,693	236,328
Earnings from continuing operations before income taxes, minority interest and extraordinary items	40,797	23,283
Income taxes (Note 10)	19,273	9,047
Earnings from continuing operations before minority interest and extraordinary items	21,524	14,236
Minority interest (Note 1)	2,942	—
Earnings from continuing operations before extraordinary items	18,582	14,236
Extraordinary items, less income taxes (Note 13)	—	4,498
Earnings for the year from continuing operations Carling O'Keefe Limited (Note 2)	18,582	9,738
Share of earnings (loss) for the year	4,477	(10,864)
Gain on sale of investment	76,411	—
Earnings (loss) for the year	\$ 99,470	\$ (1,126)
Earnings (loss) per common share:		
From continuing operations before extraordinary items	\$ 3.07	\$2.27
For the year	\$17.74	\$(0.52)
Retained Earnings		
Balance at beginning of year	\$209,528	\$221,018
Earnings (loss) for the year	99,470	(1,126)
Excess of carrying value over cost of First Preferred shares purchased for cancellation (Note 8)	41	133
Excess of carrying value over cost of preference shares purchased for cancellation by Carling O'Keefe, less minority interest (Note 2)	—	50
	309,039	220,075
Dividends paid:		
Preferred shares—		
First Preferred shares, Series A (\$6.85 per share)	787	826
Second Preferred shares (\$1.325 per share)	904	904
	1,691	1,730
Common shares (\$1.60 per share)	8,817	8,817
	10,508	10,547
Balance at end of year	\$298,531	\$209,528

The accompanying notes are an integral part of the financial statements.

Consolidated Balance Sheet

March 31	1987	1986 (Restated-Note 2)
		in thousands
Assets		
Current assets:		
Cash and short-term investments	\$12,743	\$ 17,000
Accounts receivable	61,668	33,782
Due on sale of Carling O'Keefe Limited (Note 2)	196,335	—
Income taxes recoverable	12,921	—
Inventories (Note 3)	207,287	145,307
Prepaid expenses	2,641	1,312
Total current assets	493,595	197,401
Investment in Carling O'Keefe, at equity (Note 2)	—	106,265
Property, plant and equipment (Note 4)	137,073	105,700
Less: Accumulated depreciation	58,875	59,181
	78,198	46,519
Other assets (Note 5)	7,999	575
	\$579,792	\$350,760
Liabilities		
Current liabilities:		
Bank and other short-term indebtedness (Note 6)	\$ 24,115	\$ 24,925
Accounts payable and accrued liabilities	32,429	26,532
Excise, sales and other taxes	71,217	20,053
Income taxes	15,620	225
Total current liabilities	143,381	71,735
Long-term liabilities (Note 7)	—	11,199
Total liabilities	143,381	82,934
Deferred income taxes	16,855	4,765
Minority interest in subsidiary company (Note 1)	68,627	—
Shareholders' equity		
Capital stock (Note 8)	52,398	52,620
Retained earnings (Note 14)	298,531	209,528
Unrealized foreign currency translation adjustments	—	913
Total shareholders' equity	350,929	263,061
	\$579,792	\$350,760

The accompanying notes are an integral part of the financial statements.

Approved by the Board:



Director



Director

Consolidated Statement of Changes in Financial Position

Year ended March 31	1987	1986 (Restated-Note 2)
		in thousands
Cash provided by (used for):		
Operations-		
Earnings from continuing operations before extraordinary items	\$ 18,582	\$ 14,236
Adjusted for non-cash items-		
Depreciation	5,736	5,434
Minority interest	2,942	—
Deferred income taxes	8,578	2,325
Other items	—	379
Cash from continuing operations	35,838	22,374
Extraordinary items	—	7,968
Decrease in non-cash operating working capital	29,951	36,939
	65,789	67,281
Investing activities-		
Short-term indebtedness of Benson & Hedges (Canada) at acquisition (Note 1)	(47,154)	—
Disposal of assets	5,241	273
Additions to property, plant and equipment	(10,678)	(13,965)
Other items	7	(49)
	(52,584)	(13,741)
Financing activities-		
Decrease in long-term liabilities	(11,199)	(2,251)
Carling O'Keefe Limited-dividends	5,236	5,236
Dividends-preferred and common	(10,508)	(10,547)
Other items	(181)	(752)
	(16,652)	(8,314)
Decrease (increase) in net short-term indebtedness	(3,447)	45,226
Net short-term indebtedness at beginning of year	(7,925)	(53,151)
Net short-term indebtedness at end of year	\$ (11,372)	\$ (7,925)
Comprised of:		
Cash and short-term investments	\$ 12,743	\$ 17,000
Bank and other short-term indebtedness	(24,115)	(24,925)
	\$ (11,372)	\$ (7,925)

The accompanying notes are an integral part of the financial statements.

Management Report

The consolidated financial statements of Rothmans Inc. and its subsidiary companies have been prepared by management and are in accordance with accounting principles generally accepted in Canada, which conform in all material respects with international accounting standards adopted by the International Accounting Standards Committee relating to the presentation of historical cost financial information. The significant accounting policies are outlined on page 18. All other financial and operating information in the annual report is consistent with that contained in the financial statements.

Management is responsible for maintaining a system of internal accounting controls which provides reasonable assurance that assets are safeguarded and that reliable financial information is produced. Management believes that existing internal controls are appropriate in terms of cost and risk to meet these objectives. Internal auditors employed by the Company and its subsidiaries monitor accounting records and related systems.

Price Waterhouse have been appointed by the shareholders as independent auditors to examine and report on the Company's consolidated financial statements and their report appears to the right. As part of their examination, Price Waterhouse reviewed internal control systems to the extent deemed necessary to support their opinion on such financial statements.

The Company's Board of Directors has overall responsibility for and has approved the financial statements and all other information in the annual report. The Board has appointed an Audit Committee consisting of three outside directors to review the audited financial statements prior to their submission to the full Board. The Committee also meets periodically throughout the year with Company officials, internal auditors and Price Waterhouse.



President and Chief
Executive Officer

May 20, 1987

Auditors' Report

To The Shareholders of Rothmans Inc.:

We have examined the consolidated statements of earnings, retained earnings and changes in financial position of Rothmans Inc. for the year ended March 31, 1987 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, 1987 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.



Chartered Accountants

May 20, 1987

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 adopted by the International Accounting Standards Committee relating to the presentation of historical cost financial information.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and all of its subsidiaries except for Carling O'Keefe Limited and its subsidiaries which have been accounted for on the equity basis (Note 2). Purchase accounting has been followed for all acquisitions and the results of operations of subsidiaries are included from effective dates of acquisition.

Inventories

Inventories are stated at the lower of average cost and net realizable value.

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	— 30 to 40 years
Machinery and equipment	— 5 to 15 years
Motor vehicles	— 3 to 5 years
Leasehold improvements	— term of lease, not to exceed 10 years

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 generally over periods which approximate estimated service lives.

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.

Earnings Per Common Share

Earnings per common share are calculated after deducting dividends on Preferred shares and are based on the weighted average number of shares outstanding during the year.

Notes to Consolidated Financial Statements

March 31, 1987 and 1986

(Tabular amounts are in thousands of dollars)

1. Rothmans, Benson & Hedges Inc.

On December 19, 1986 Rothmans of Pall Mall Limited, a wholly-owned subsidiary of the Company, and Benson & Hedges (Canada) Inc. combined to form a new company, Rothmans, Benson & Hedges Inc., owned 60% by the Company and 40% by Philip Morris Inc., the former parent of Benson & Hedges (Canada). These ownership interests represent the respective net assets contributed by the two companies. This business combination has been accounted for as a purchase and the results of operations of Benson & Hedges (Canada) have been included in these financial statements from December 20, 1986. The transaction is summarized as follows:

Fair value of assets acquired	\$168,844
Fair value of liabilities assumed	107,056
	<u>\$ 61,788</u>
Goodwill	3,897
Total consideration	<u>\$ 65,685</u>
Comprised of:	
400,000 shares of Rothmans, Benson & Hedges Inc.	<u>\$ 65,685</u>

2. Carling O'Keefe Limited

On February 23, 1987, the Company committed to sell its 50.1% equity interest (10,907,487 common shares) in Carling O'Keefe to Elders IXL Limited for \$196,335,000 cash. The proceeds were received on April 27, 1987. An extraordinary gain of \$76,411,000 has been recorded in these financial statements as follows:

Investment at equity:

Balance March 31, 1986	\$106,265
Change in equity for the year	(1,671)
Balance March 31, 1987	104,594
Net proceeds less capital gains taxes of \$15,300	181,005
Gain on sale	<u>\$ 76,411</u>

The 1986 comparative amounts in these financial statements have been restated to account for the investment in Carling O'Keefe on the equity basis in order to provide comparative financial statements which relate to continuing operations.

Operating highlights of Carling O'Keefe for the years ended March 31 are as follows:

	1987	1986 (Restated)
Sales net of excise and sales taxes	\$551,245	\$525,102
Earnings before extraordinary items	12,844	1,054
Earnings (loss) for the year	10,819	(19,680)

3. Inventories

	1987	1986
Leaf tobacco	\$127,147	\$ 73,414
Finished goods	62,554	59,948
Packaging materials and other	17,586	11,945
	<u>\$207,287</u>	<u>\$145,307</u>

4. Property, plant and equipment

	1987		1986	
	Cost	Accumulated Depreciation	Cost	Accumulated Depreciation
Land	\$ 2,157	\$ —	\$ 1,591	\$ —
Buildings	20,330	4,127	10,616	3,721
Machinery and equipment	102,893	44,054	80,765	44,410
Motor vehicles	2,484	2,373	2,723	2,425
Leasehold improvements	9,209	8,321	10,005	8,625
	\$137,073	\$58,875	\$105,700	\$59,181

5. Other assets

	1987	1986
Goodwill (Note 1)	\$3,897	\$ —
Notes receivable—9%, repayable in equal annual instalments of \$1,536,000 until 1989, non-current portion	3,072	—
Unamortized deferred charges, trademarks and patents	1,030	575
	\$7,999	\$ 575

Amortization of other assets amounted to \$44,000 (1986—\$47,000). Goodwill will be amortized over five years.

6. Bank and other short-term indebtedness

	1987	1986
Bank indebtedness	\$ 8,428	\$24,925
Notes payable	15,687	—
	\$24,115	\$24,925

7. Long-term liabilities

	1987	1986
Sinking fund debentures-		
Series A 8% due January 3, 1988	\$—	\$ 1,032
Series B 11% due February 15, 1995	—	10,167
	\$—	\$11,199

The Company called its outstanding debentures for redemption on March 17, 1987 and deposited the required funds with the Trustee on that date. The security given in connection with these debentures was discharged on their redemption.

8. Capital stock

Authorized:

469,889 First Preferred shares issuable in series
2,817,062 Second Preferred shares
An unlimited number of Common shares

Issued:

	1987	1986
114,022 6.85% Cumulative Redeemable First Preferred shares, Series A (1986—116,242)	\$11,402	\$11,624
682,367 6 5/8% Cumulative Redeemable Second Preferred shares	13,647	13,647
	25,049	25,271
5,510,684 Common shares	27,349	27,349
	\$52,398	\$52,620

Purchases:

During the year ended March 31, 1987, 2,220 First Preferred shares with a total carrying value of \$222,000 were purchased for cancellation at a cost of \$181,000 (1986—7,511 shares).

Redemption privileges:

The Series A First Preferred shares are redeemable at the option of the Company 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, 1987, 978 shares of the 1987 requirement had been acquired.

The Second Preferred shares are redeemable at the option of the Company at \$20 per share.

Ownership:

Rothmans of Canada Limited, a wholly-owned subsidiary of Rothmans International p.l.c., is the owner of 71.2% of the Company's issued Common shares and 21.9% (1986—21.5%) of the issued Series A First Preferred shares.

9. Pensions

The Company and its subsidiaries maintain defined benefit pension plans for employees and generally fund pensions with independent trustees in accordance with legal requirements.

10. Income taxes

The consolidated provision for income taxes, which includes deferred taxes of \$8,578,000 (1986-\$2,325,000) has been determined as follows:

	1987	1986
Income taxes at basic rate of 50%	\$20,399	\$11,642
Incentives	(1,745)	(2,765)
Other, net	619	170
	\$19,273	\$ 9,047
Effective income tax rate	47.2%	38.9%

Incentives include manufacturing and processing credits and, in 1986, inventory allowances.

Deferred income taxes primarily reflect timing differences between accounting and tax depreciation.

11. Commitments and contingent liabilities

In the normal course of business, the Company and its subsidiaries have commitments which include capital expenditures and the purchase of agricultural products.

Commitments under operating lease obligations relate to warehouses, retail stores and offices. The following table summarizes the minimum rental payments due after March 31, 1987:

Year ending March 31-	
1988	\$2,787
1989	2,680
1990	2,606
1991	1,432
1992	1,055
Years subsequent to March 31, 1992	5,879
	\$16,439

12. Related party transactions

The Corporation and its tobacco subsidiary, Rothmans, Benson & Hedges Inc., purchased goods for resale and related services from subsidiaries of Rothmans International p.l.c. in the ordinary course of business in the amount of \$4,304,000 in the year ended March 31, 1987 (of which \$547,000 was payable at that date). In addition, Rothmans, Benson & Hedges Inc. purchased international advertising services from, and had access to, research and technical knowledge of, a subsidiary of Rothmans International p.l.c. The charges for these advertising services and access to the international research and technology was \$2,656,000 in the year ended March 31, 1987 (of which \$315,000 was payable at that date) and are based on a recharge of the actual costs incurred.

13. Extraordinary items from continuing operations

	1987	1986
Rationalization costs less income taxes of \$10,070	\$—	\$(10,784)
Gain on sale of non-strategic assets less income taxes of \$2,778	—	6,286
	\$—	\$ (4,498)

Rationalization costs in 1986 included costs and provisions arising from the staff reduction programme and the write-down of certain assets relating to the discontinuance of cigarette production at the Company's Toronto plant.

14. Subsequent event

On May 20, 1987, the Board of Directors declared a special dividend of \$40 per common share (\$220,427,000) to be paid on July 31, 1987 to common shareholders of record on July 13, 1987.

Six-Year Financial Review

Year ended March 31	1987	1986	1985	1984	1983	1982
						in thousands
Operations						
Sales	\$726,824	\$646,880	\$558,343	\$542,240	\$512,213	\$485,406
Excise and sales taxes	442,334	387,269	288,497	276,606	255,350	241,210
Sales net of excise and sales taxes	\$284,490	\$259,611	\$269,846	\$265,634	\$256,863	\$244,196
Earnings—						
From continuing operations before minority interest and extraordinary items	\$ 21,524	\$ 14,236	\$ 19,139	\$ 19,647	\$ 21,026	\$ 22,221
Minority interest in continuing operations	2,942	—	—	—	—	—
Extraordinary items, less income taxes	—	(4,498)	(1,705)	—	—	—
From continuing operations	18,582	\$ 9,738	\$ 17,434	\$ 19,647	\$ 21,026	\$ 22,221
From Carling O'Keefe	80,888	(10,864)	6,858	26,212	18,060	10,389
Earnings (loss) for the year	\$99,470	\$ (1,126)	\$ 24,292	\$ 45,859	\$ 39,086	\$ 32,610
Capital expenditures	\$ 10,678	\$ 13,965	\$ 10,569	\$ 8,303	\$ 7,916	\$ 5,492
Depreciation	5,736	5,434	4,306	3,107	4,396	4,658
Interest expense (net)	697	1,539	2,104	2,572	5,276	5,218
Dividends paid—						
Preferred	1,691	1,730	1,760	1,798	1,835	1,861
Common	8,817	8,817	8,817	8,817	8,817	8,541
Financial Position at Year End						
Working capital	\$350,214	\$125,666	\$128,320	\$123,279	\$115,680	\$106,988
Property, plant and equipment, net	78,198	46,519	47,032	41,405	36,765	33,315
Investment in Carling O'Keefe						
Limited, at equity	—	106,265	119,524	118,178	97,280	81,986
Total assets	579,792	350,760	384,980	345,696	324,400	306,300
Total long-term debt	—	11,199	14,288	15,978	17,664	18,887
Shareholders' equity	350,929	263,061	272,511	259,629	226,017	197,744
Per Common Share						
Earnings (loss)—						
From continuing operations less minority interest and before extraordinary items	\$ 3.07	\$ 2.27	\$ 3.15	\$ 3.24	\$ 3.48	\$ 3.69
For the year	17.74	(0.52)	4.09	8.00	6.76	5.58
Dividends paid	1.60	1.60	1.60	1.60	1.60	1.55
Shareholders' equity	59.14	43.15	44.71	42.29	36.10	30.91
Ratios						
Return before extraordinary items on average total capital employed (restated) (%)	12.9	8.9	11.2	12.3	13.3	15.8
Return before extraordinary items on shareholders' equity (restated) (%)	6.9	5.3	7.2	8.1	9.9	11.9
Working capital ratio (restated)	3.4	2.8	2.4	3.0	2.6	2.3
Long-term debt to shareholders' equity (restated)	—	7:93	9:91	10:90	12:88	14:86

NOTE: The 1982 to 1986 amounts have been restated to account for the Company's investment in Carling O'Keefe on the equity basis. Previously the accounts of Carling O'Keefe were fully consolidated.

Quarterly Data

Quarter ended	June 30	Sept. 30	Dec. 31	Mar. 31	Total Before Extraordinary Items	Total for the Year
(in thousands—restated)						
Sales—Continuing operations						
(net of excise and sales taxes)						
1986/1987	\$61,716	\$61,554	\$70,129	\$91,091	—	\$284,490
1985/1986	64,590	67,574	72,031	55,416	—	259,611
1984/1985	70,958	70,472	74,026	54,390	—	269,846
Earnings—Continuing operations						
1986/1987	\$ 1,884	\$ 2,894	\$ 9,260	\$4,544*	\$18,582	\$18,582*
1985/1986	3,288	4,452	5,113	1,383	14,236	9,738
1984/1985	4,600	5,271	6,502	2,766	19,139	17,434
Per Common Share						
1986/1987	\$0.27	\$0.45	\$1.60	\$0.75*	\$3.07	\$17.74
1985/1986	0.52	0.73	0.85	0.17	2.27	(0.52)
1984/1985	0.75	0.88	1.10	0.42	3.15	4.09

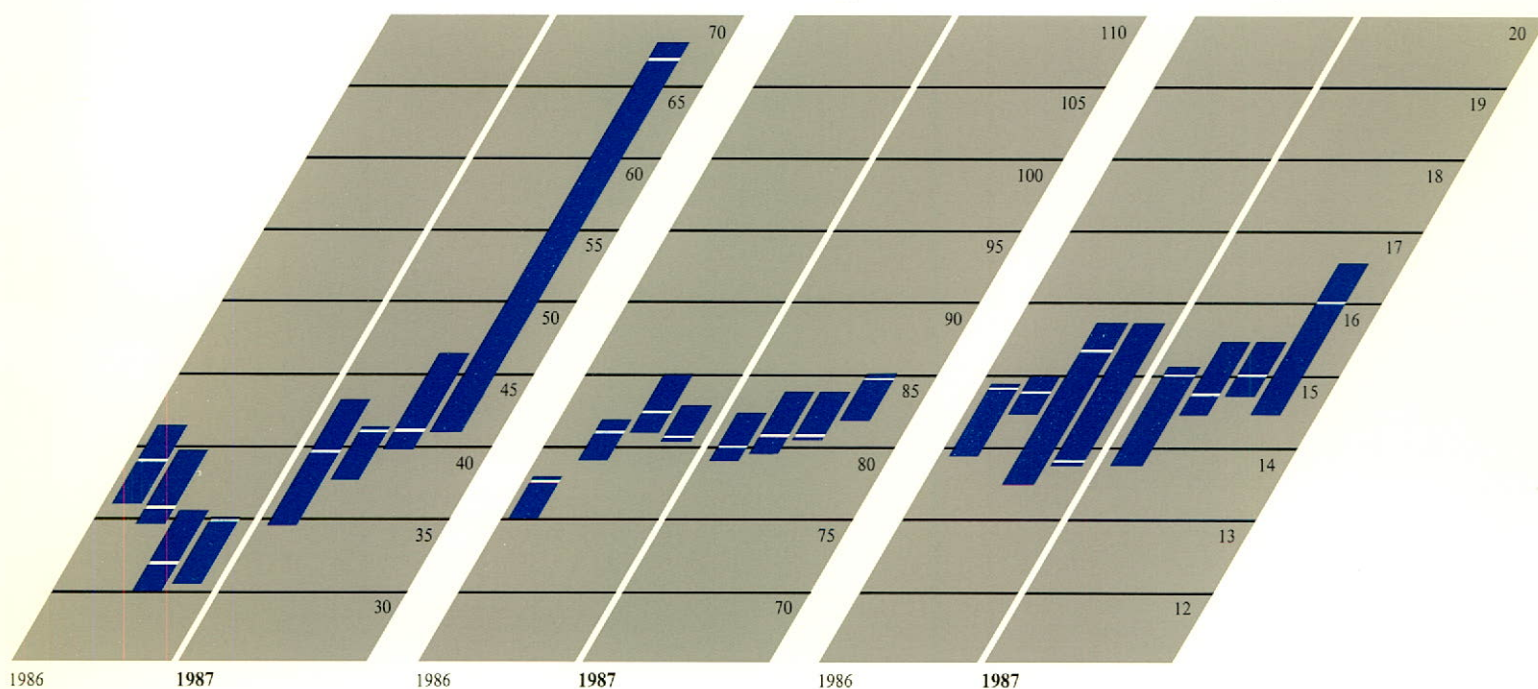
* after deducting minority interest.

Share market prices (\$)—quarterly range and closing

Common—

First preferred—

Second preferred—



Directors and Officers

Rothmans Inc.

Directors

The Honourable William M. Kelly
Chairman
Rothmans Inc.
North York, Ontario

Patrick J. Fennell
President and Chief Executive Officer
Rothmans Inc.
North York, Ontario

• **René Amyot, Q.C.**
Counsel to Jolin, Fournier & Associates
Barristers and Solicitors
Sainte-Foy, Quebec

• **Douglas G. Bassett**
President and Chief Executive Officer
Baton Broadcasting Incorporated
Toronto, Ontario

• **Vernon A. Brink**
Chief Executive Officer
Rothmans International p.l.c.
London, England

Mona L. Campbell
President
Dover Industries Limited
Toronto, Ontario

• **Sir Robert Crichton-Brown**
Chairman
Rothmans International p.l.c.
London, England

Pierre Des Marais II,
President
Pierre Des Marais Inc.
Montreal, Quebec

• **John J. Wettlaufer,**
M.B.A., LL.D.
Professor Emeritus
School of Business Administration
The University of Western Ontario
London, Ontario

Officers

The Honourable William M. Kelly
Chairman of the Board

Patrick J. Fennell
President and Chief Executive Officer

Brian Capper
Secretary

Edward A. Crighton, C.A.
Director of Finance

Brenda J. Moher
Assistant Secretary

- Audit Committee
- * Pension & Compensation Committee

Rothmans, Benson & Hedges Inc.

Officers

Patrick J. Fennell
President and Chief Executive Officer

Ralph Guile
Senior Vice President, Sales

John E. Broen
Vice President, Marketing

Dennis Robertson
Vice President, Finance and Administration

Joseph J. Heffernan
Vice President, Operations

Cynthia von Maerestetten
Vice President, Corporate Affairs

Jean-Pierre Suys
Vice President, Human Resources and Industrial Relations

Pierre Brochu, C.A.
Director of Finance

Brian Capper
Secretary

Brenda J. Moher
Assistant Secretary

Corporate Data

Head Office:

Rothmans Inc.

1500 Don Mills Road
North York, Ontario M3B 3L1
(416) 449-5525

Transfer Agent and Registrar:

The Royal Trust Company
Vancouver, Edmonton, Regina,
Winnipeg, Toronto, Montreal, St. John,
Halifax, Charlottetown, St. John's

Solicitors:

Smith, Lyons, Torrance,
Stevenson & Mayer

For Shareholder Information, contact:

Brian Capper
Secretary

Annual Meeting:

The Annual Meeting of Shareholders
will be held in Ballroom 'A' at l'Hôtel,
225 Front Street West, Toronto, Ontario
on July 15, 1987 at 11:00 a.m.

Rapport Annuel:

Si vous désirez recevoir ce rapport en
français, veuillez vous adresser au
Secrétaire général,
Rothmans Inc.
1500 Don Mills Road
North York, Ontario M3B 3L1.

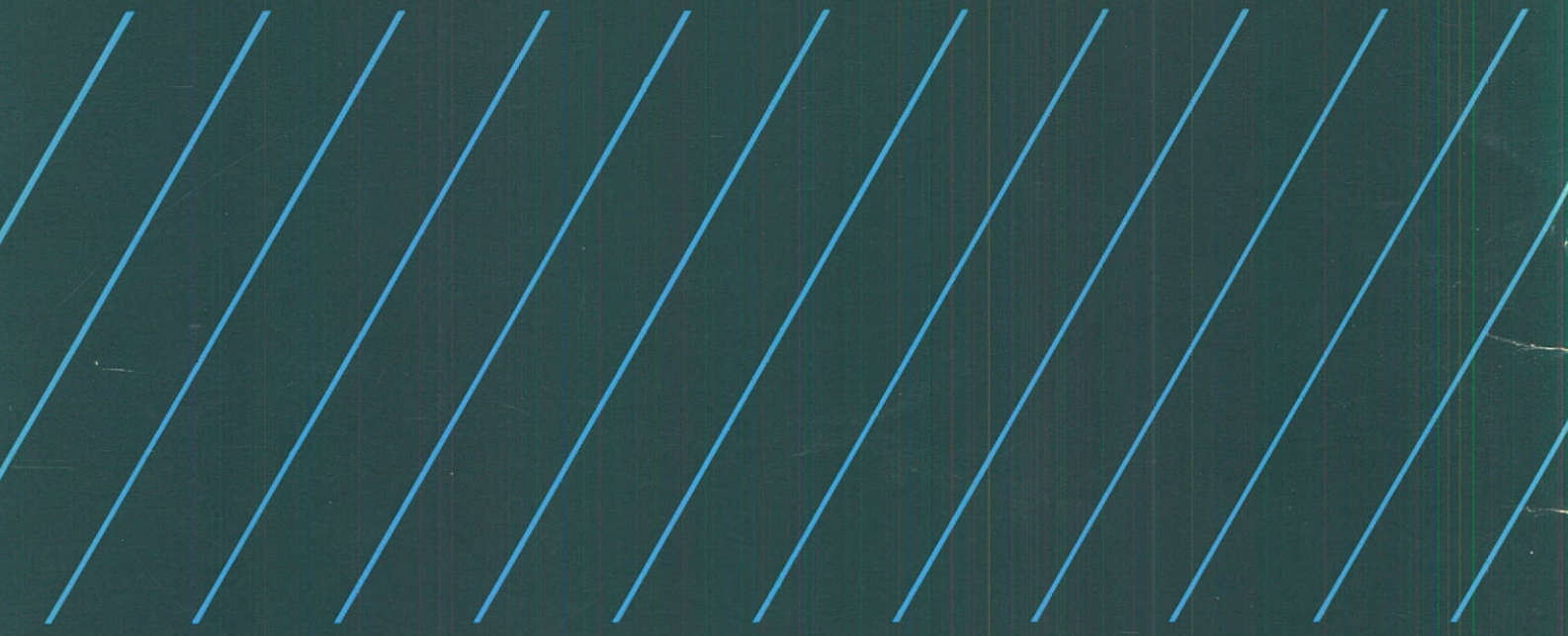
Rothmans, Benson & Hedges Inc.

Plant Locations:

Brampton, Ontario
Montreal, Quebec
Quebec City, Quebec

Sales Offices:

- Vancouver, British Columbia
- Calgary, Alberta
- Edmonton, Alberta
- Saskatoon, Saskatchewan
- Winnipeg, Manitoba
- Toronto, Ontario
- Burlington, Ontario
- Ottawa, Ontario
- Montreal, Quebec
- Sainte-Foy, Quebec
- Halifax, Nova Scotia
- St. John's, Newfoundland



Rothmans Inc.
1500 Don Mills Road
North York, Ontario
M3B 3L1