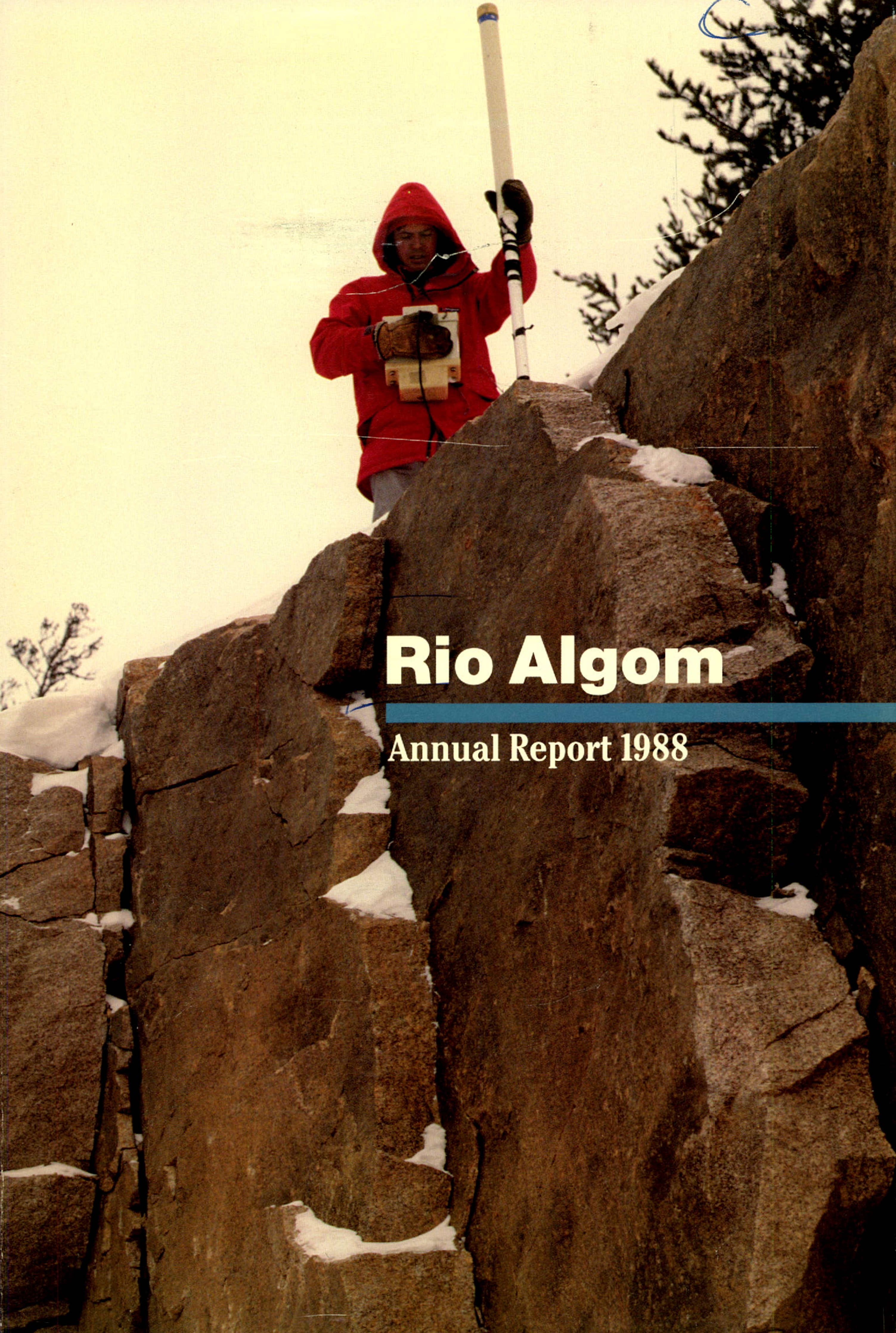


Rio Algom

Annual Report 1988

Cover: Rio Algom geologist Kevin Kivi exploring in Northern Ontario. On the facing page, he is inspecting core samples.

Annual Meeting of Shareholders

An Annual Meeting of Shareholders of Rio Algom Limited will be held on Wednesday, April 26, 1989 at 10.30 a.m. (Toronto time) in the Ontario Room, Royal York Hotel, 100 Front Street West, Toronto, Ontario, Canada

Rio Algom Limited

is a major Canadian resource and industrial organization which provides diverse products to the energy, industrial, construction and agricultural markets. Rio Algom's principal activities include the mining of uranium, potash, copper-molybdenum, coal and tin; minerals exploration; the manufacture of stainless and specialty steels and the marketing through metals service centres of stainless and specialty steels and other metal products.

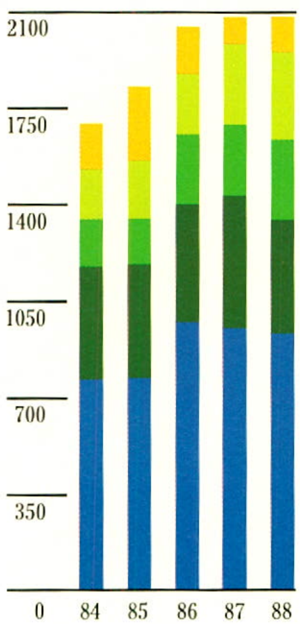
Contents

Highlights

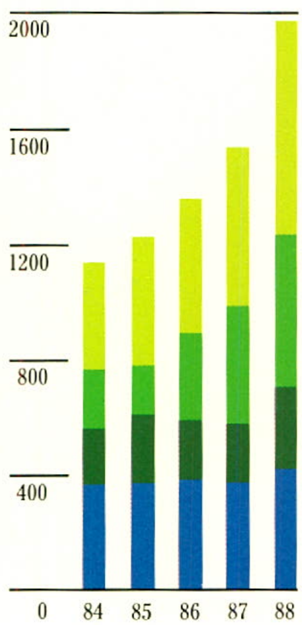
	(in thousands, except per share data)	1988	1987
Revenue	Underground mining	$ 421,080	$ 375,280
	Open pit mining	291,431	209,315
	Steel manufacture	523,462	404,353
	Metals distribution	743,099	543,608
	Consolidated revenue	$1,979,072	$1,532,556
Operating Profit	Underground mining	$ 33,834	$ 46,295
	Open pit mining	114,286	76,465
	Steel manufacture	63,821	16,635
	Metals distribution	62,918	25,972
	Consolidation adjustment	(5,230)	220
	Total operating profit	$ 269,629	$ 165,587
Net Earnings	Net earnings	$ 134,440	$ 93,075
	Earnings per common share — Before extraordinary item	$ 2.57	$ 2.12
	— Net earnings	$ 3.02	$ 2.12
Selected Financial Data	Dividends paid on common shares	$ 30,616	$ 27,716
	Per common share	$ 0.70	$ 0.65
	Working capital, year end	$ 625,836	$ 665,432
	Ratio of current assets to current liabilities	2.5 to 1	2.8 to 1
	Common shareholders' equity	$ 827,369	$ 713,612
	Return on average common shareholders' equity	17.1%	13.2%
	Total common shares outstanding at December 31	43,736	42,640
	Equity per common share	$ 18.92	$ 16.74

All dollar amounts set out in this Report refer to Canadian dollars unless otherwise stated. At March 2, 1989 Cdn$1.00 = U.S.$0.8379.

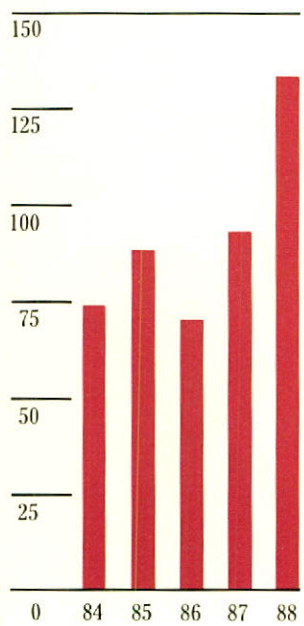
Total Assets
(millions of dollars)



Consolidated Revenue
(millions of dollars)



Net Earnings
(millions of dollars)



Directors' Report to Our Shareholders

Rio Algom achieved record net earnings and revenues in 1988, further strengthening its financial position. The North American economy was generally buoyant, and this impacted favourably on the Corporation's copper, steel manufacturing, metals distribution and potash operations.

Financial Position

Consolidated net earnings for 1988, including an extraordinary gain, were $134.4 million, ($3.02 per common share), a 44% increase over the $93.1 million ($2.12 per common share) achieved in 1987. The extraordinary benefit of $19.7 million ($0.45 per common share) resulted from the utilization of prior years' tax losses. Revenues increased to $1,979 million, up 29% from $1,533 million in the previous year.

Semi-annual dividends of $0.325 and $0.375 per share were paid in May and December, respectively, totalling $0.70 per share compared with $0.65 per share paid in 1987. This increase is in keeping with our policy of gradually raising dividends on a consistent and sustainable basis.

Working capital at the end of the year was $626 million, including cash and short term deposits of $187 million. Long-term debt was reduced by $27 million to $244 million. At the end of 1988, the debt to equity ratio, exclusive of limited recourse obligations, was 1:10, reflecting the Corporation's strong financial condition.

1988 Highlights

The results produced by our operating units are reviewed comprehensively in later sections of the Annual Report. The especially noteworthy circumstances that influenced particular business segments included:

- an extraordinarily strong copper market reflecting heavy demand as world supply was adversely affected by production difficulties and labour unrest in various parts of the world. As a result, the L.M.E. average price in 1988 was U.S.$1.18 per pound, compared to U.S.$0.81 per pound in 1987.
- the agreement to include Highmont as a partner with a 5% interest in Highland Valley Copper. This was done without detriment to Lornex's partnership interest, which was effectively maintained at 45%.
- a major increase in potash prices following the restoration of improved market conditions due, in part, to the resolution of U.S. anti-dumping actions initiated in 1987. Following a successful test program, work was begun on a project to re-open the Saskatoon potash mine, which was flooded in 1987, as a solution mine. Commercial production is expected to resume in 1989.
- a strong demand for our steel manufacturing products, notably stainless steel, in an environment of rapid cost increases for scrap, nickel and chrome. The strength of demand, however, was such that cost escalation could be passed on to customers. Similar circumstances were evident also in our metals distribution operations in North America and Australasia.
- the fall in the spot price of uranium from U.S.$16.55 to U.S.$11.75 over the year, which necessitated a writedown in the value of inventory held at the Lisbon mine in Utah; the mine was closed in September with the exhaustion of economic reserves. Uranium earnings also reflected continued provisions for long-term reclamation costs.

Lornex Mining Corporation Ltd. was wound up in December 1988, following the acceptance by the public minority shareholders of a cash offer or Rio Algom preferred shares. This resulted in the acquisition by Rio Algom Limited of a direct interest of 74.6% in the assets and liabilities previously held by Lornex (as compared with the former 69.1% shareholding interest). This structural adjustment recognized that, for some time, Lornex had been a holding company with no direct operating interests. The major advantages that will accrue to Rio Algom are direct access to cash flow and increased beneficial interests in Highland Valley Copper (from 31% to 34%) and Bullmoose Coal (from 27% to 29%).

Strategy

Considerable effort was devoted during the year to the development of an appropriate strategy that would provide a framework for future action. In both the 1987 Annual Report and at the Annual Meeting in April 1988, it was stated that mining activity would be the area of future emphasis without, at the same time, denying other investment opportunities capable of utilizing the skills inherent in the core business. This commitment has been recognized by a number of actions that occurred during the year or early in 1989:

- the re-acquisition of the East Kemptville tin mine in Nova Scotia and the application of significant capital to increase production and reduce operating costs.
- added investment at Highland Valley Copper relating to its expanded and more efficient milling capacity.
- the development of a solution mining facility at the Saskatoon potash mine, which has the potential for adding significantly to future growth and enhanced profitability.
- the expansion of staff and facilities for minerals exploration, including the acquisition in December 1988 of a significant minority interest in Pan Orvana Resources Inc. — a mineral exploration company involved in precious metal and polymetallic deposits in Canada and the United States.
- the acquisition in January 1989 of additional low-cost uranium properties in Wyoming and New Mexico with a view to long-term market opportunities.

The strategic review also considered the role of our steel manufacturing units, which have a history in the Corporation dating back to 1962. Accordingly, it was decided to consider the various alternatives that might be available and, among others, their disposition on acceptable terms is being explored. That process is continuing and the management and staff at these operations must be recognized for their understanding and support during this period of uncertainty.

Further, it has been decided that the characteristics of our metals distribution organization — liquidity, modest capital requirements and relatively stable profitability — are such that expansion, where suitable opportunities present themselves, is warranted.

The Directors also wish to acknowledge the support of The RTZ Corporation PLC, Rio Algom's majority shareholder. RTZ's acknowledged international stature in mining and related fields and their depth and quality of management are of considerable value to the Corporation.

Directors and Officers

Mr. William E. Bradford, President and Chief Executive Officer of North American Life Assurance Company, was elected as a Director of Rio Algom in April 1988. The Corporation will be well served by the extensive experience Mr. Bradford brings to the Board.

That same month, Rio Algom announced the appointment of Mr. John A. H. Bush as Vice-President, Secretary of the Corporation, replacing Mr. Archie C. Turner, who retired after more than 26 years of service.

On August 1, 1988, Mr. Ray W. Ballmer was appointed Vice-Chairman and Mr. Colin A. Macaulay as President and Chief Operating Officer. Mr. Ballmer was previously President and Chief Operating Officer and Mr. Macaulay, Managing Director, Chief Executive and Deputy Chairman of Rossing Uranium Limited in Namibia.

Outlook

From a broad economic perspective, 1989 is expected to experience some slowdown from the vigorous pace of 1988, which will probably be felt increasingly as the year proceeds. This could carry with it the prospect of lower base metal prices. However, offsetting these possible adverse features, is an expected recovery in uranium earnings, which this year will not be impacted by the unusual circumstances that were recognized in 1988.

Rio Algom continues to seek new investment opportunities, particularly in the mining field. Present values are relatively high, from a long-term economic viewpoint, and this makes the search demanding. Properties at the exploration, development or production stages in Canada and the United States, with base metals, uranium and gold the principal commodities, are all areas of interest.

Finally, on a national level, it was encouraging that the Free Trade Agreement with the United States was ratified late in 1988. While this is not expected to have either immediate or significant direct benefit to Rio Algom, it does, in the broader context of international economic development, bode well for Canada and Canadians.

Appreciation

The strong operating performance in 1988, supported by the corporate staff, produced record net earnings and a financially stronger company. The Directors, therefore, wish to thank all of the Rio Algom people who contributed to this accomplishment.

On behalf of the Board of Directors

Ross J. Turner
Chairman

R. W. Ballmer

Ray W. Ballmer
Vice-Chairman

Toronto, Canada
March 2, 1989

Ray Ballmer, Vice-Chairman, Colin Macaulay, President and Ross Turner, Chairman.

*Rio Algom corporate officers. Standing, left to right: John Hood, Douglas French and John Bush.
Seated, left to right: Alan Lowell, Stanley Kerr and Gordon Littlejohn.*

Mining

Rio Algom's mining interests include:

- uranium production at Elliot Lake, Ontario;
- potash production at Sussex, New Brunswick and Saskatoon, Saskatchewan;
- copper and molybdenum production at Logan Lake, British Columbia through Highland Valley Copper;
- coal production at Tumbler Ridge, British Columbia through the Bullmoose joint venture;
- tin production at East Kemptville, Nova Scotia;
- minerals exploration in Canada and the United States.

Uranium

The Quirke, Panel and Stanleigh mines and processing facilities at Elliot Lake, Ontario produce uranium concentrates for use by the nuclear electricity generating industry. In September, 1988, following the exhaustion of economic reserves, the Lisbon uranium mine at Moab, Utah was closed after 16 years of operation and the mill was placed on standby.

Comparative results of operations are:

	1988	1987
	(in thousands)	
Revenue	$283,004	$287,924
Operating profit	$ 19,800	$ 50,988

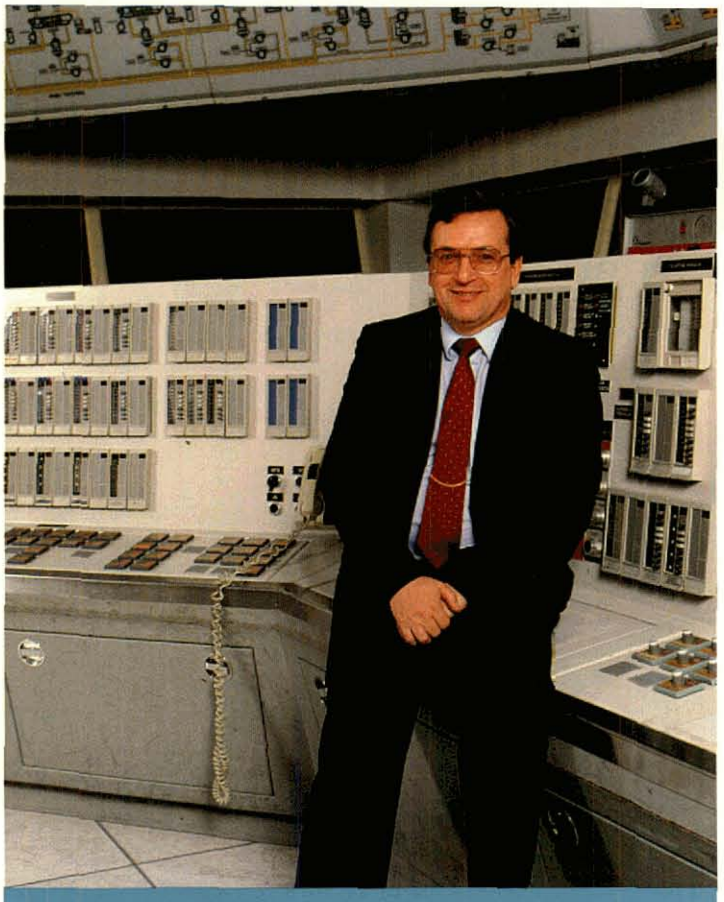
Revenue declined in 1988 due to lower production from the Quirke and Panel mines and a stronger Canadian dollar. The closure of the Lisbon mine, a softening in uranium spot market prices, which resulted in the revaluation of concentrate inventory at the Lisbon mine, and continued provisions for long-term reclamation costs led to reduced operating profits.

Production at the Quirke and Panel mines was lower than planned mainly as a result of lower recovered grades and a shortage of skilled people. Training programs for miners and mobile equipment mechanics were reinstituted during the year to alleviate the shortage. In 1988, the Quirke, Panel and Stanleigh facilities processed 3.5 million tons of ore to recover 6.1 million pounds of uranium in concentrates. Comparable figures for 1987 were 3.5 million tons of ore to recover 6.3 million pounds of uranium in concentrates. The recovery rate was 95% in both years.

During the year, 6.7 million pounds of uranium were delivered from Elliot Lake under long term contracts, compared to 6.2 million pounds in the previous year. At year end, 19.5 million pounds of uranium remained to be delivered from the Quirke and Panel operations from 1989 to 1996 and 66.7 million pounds of uranium remained to be delivered from the Stanleigh operation to Ontario Hydro from 1989 to the 2020's.

The utilization of bacterial leaching technology to recover uranium from lower grade uranium-bearing material in the underground workings at all three Elliot Lake mines was further expanded during 1988. Leaching programs are now in place using both spray leaching and flood leaching methods of extracting lower grade uranium. Uranium oxide production at Elliot Lake from the leaching and minewater recovery programs totalled 370,000 pounds, a 23% increase over that of 1987.

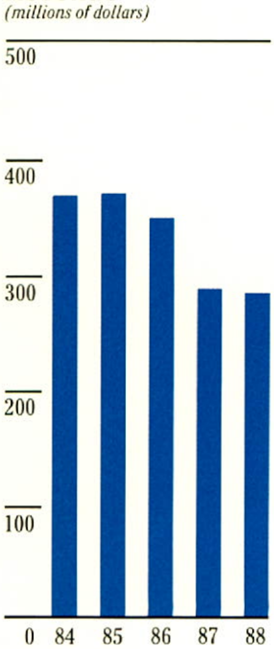
Ongoing cost reduction and productivity enhancement programs at Elliot Lake contributed to the reduction of certain operating costs during 1988 and these programs are expected to yield additional benefits in the future.



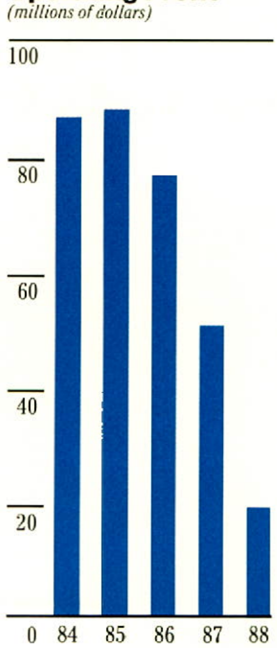
Donald Cumming, Vice-President, Elliot Lake, in the central control room at the Stanleigh uranium mill.

Rockbolting provides additional safety at Elliot Lake.

Revenue
(millions of dollars)



Operating Profit
(millions of dollars)



URANIUM
Quirke, Panel and Stanleigh mines,
Elliot Lake, Ontario

Potash

Potash Company of America, a division of Rio Algom, ("PCA") is a major Canadian producer of potash for use in fertilizers. It has mining and processing facilities at Sussex, New Brunswick and Saskatoon, Saskatchewan.

Comparative results of operations are:

	1988	1987
	(in thousands)	
Revenue	**$138,076**	**$ 87,356**
Operating profit (loss)*	**$ 15,494**	**$ (349)**

*Excludes shutdown expenses at the Saskatoon operation amounting to $1.5 million in 1988 and $4.3 million in 1987.

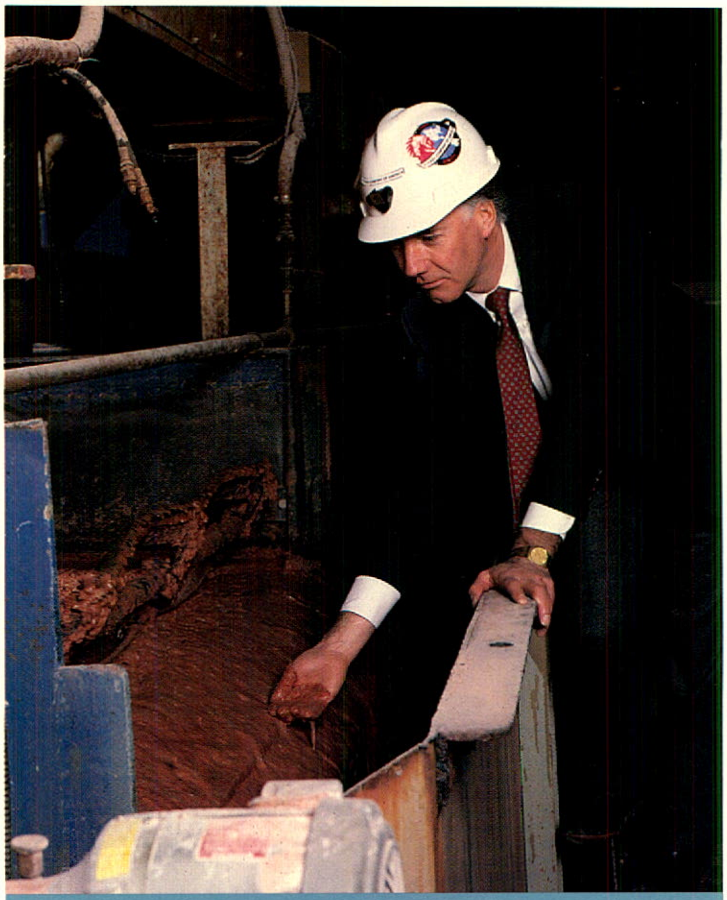
Revenue and operating profit improved significantly in 1988 due to higher selling prices. Revenue figures include sales of potash purchased from other producers. Revenue figures are not strictly comparable; in 1988 transportation costs were included in operating costs and not netted against revenue as they were in 1987. Approximately 98% of PCA potash is exported and was sold in 30 countries during 1988.

The market outlook for potash improved considerably in 1988. Demand continues to grow, particularly in developing countries. While prices have improved significantly from the prior depressed levels, world supply is adequate and competition is intense.

The Sussex facilities operated at 87% of capacity in 1988 to produce 608,000 tons of potash, compared to 611,000 tons in 1987. Additional progress was made during the year to attain technical operating efficiencies at the Sussex mill and further improvements are expected in 1989.

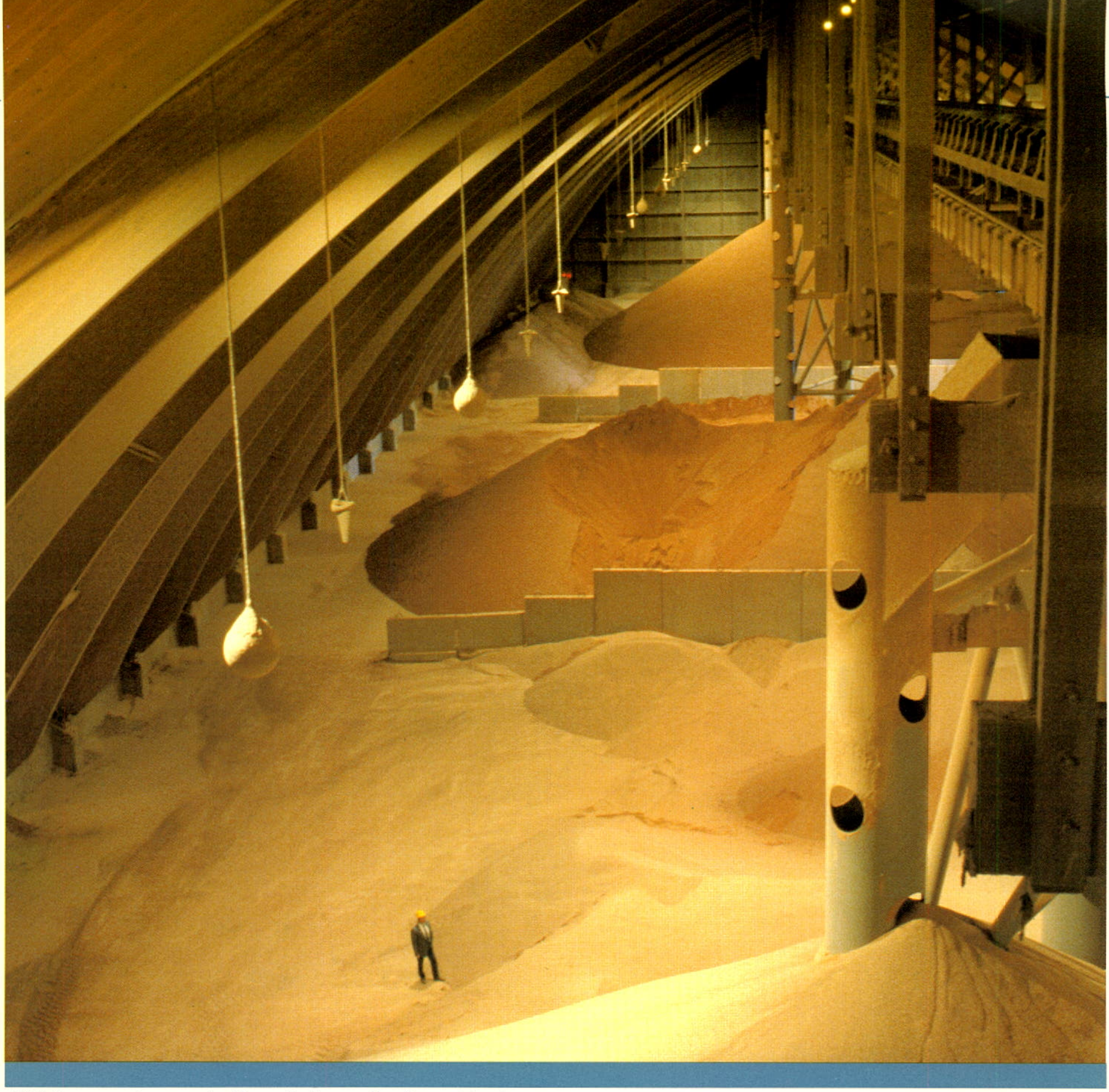
At the Saskatoon mine, which ceased production in 1987 because of mine flooding, work was initiated in August 1988 on a $23 million project to recommence commercial production by solution mining. The project involves drilling several injection and extraction wells into the flooded mine and the construction of large precipitation ponds from which potash will be recovered for processing. This method of mining potash has the potential advantage of lower unit operating costs relative to conventional underground mining. The successful operation during 1988 of a pilot plant demonstrated the technical feasibility of utilizing solution mining techniques at the Saskatoon mine. With the expected resumption of potash production in 1989, PCA has recalled 110 employees who were laid off when the mine flooded.

It is estimated that there is sufficient potash-bearing mineralization at Sussex to sustain production for at least 25 years at the design rate of production. Owing to the characteristics of the solution mining process to be used at Saskatoon it is not possible at this time to fix definitively the productive capacity of the Saskatoon facilities. It is believed, however, that when the solution mining operation is in full production, annual production should be substantially similar to that attained in prior years and that the potash-bearing mineralization at Saskatoon could sustain production for at least 40 years.

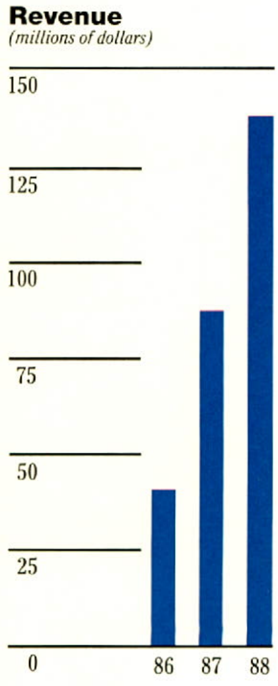


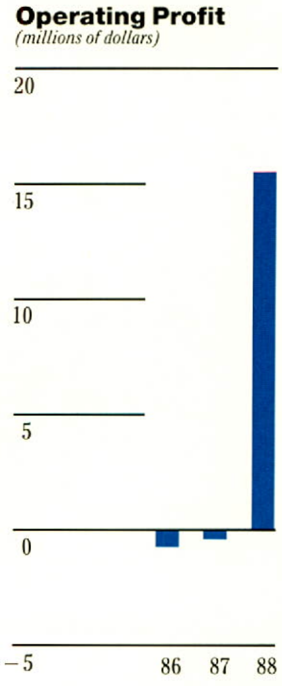
Robert Connochie, President, Potash Company of America, Inc., at the Sussex, New Brunswick mill.

Precipitation ponds under construction at PCA's Saskatoon operations will be used to recover potash extracted by solution mining.

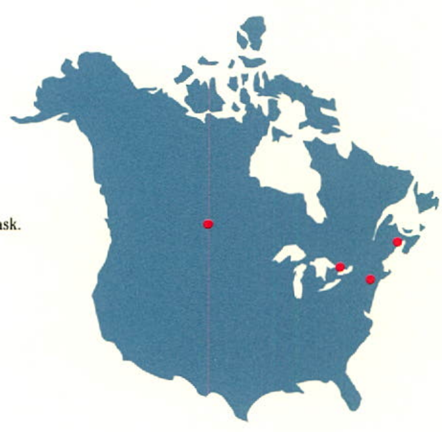


PCA's large potash storage facility at the Sussex, New Brunswick mine.





POTASH
Sussex mine, Sussex, N.B.
Saskatoon Mine, Saskatoon, Sask.
Sales Offices at Toronto, Ontario; Darien, Connecticut



Copper and Coal

Lornex Mining Corporation Ltd.

Lornex, 69.1% owned by Rio Algom prior to its reorganization and wind-up in December 1988, held a 45% beneficial interest in the copper-molybdenum operations of Highland Valley Copper and a 39% joint venture interest in the Bullmoose coal mine.

Comparative results of operations are:

	1988	1987
	(in thousands)	
Revenue	$267,176	$209,315
Operating profit	$119,430	$ 76,465

Lornex had net earnings of $76.5 million in 1988 and $44.0 million in 1987. The increase in net earnings over the previous year was due to substantially higher copper prices and increased copper production at Highland Valley Copper.

As a result of the Lornex reorganization and wind-up, Rio Algom now holds a direct 33.6% beneficial interest in Highland Valley Copper and a direct 29.1% joint venture interest in the Bullmoose coal mine.

Highland Valley Copper

The Highland Valley Copper partnership holds and operates large scale copper-molybdenum mining and milling facilities in the Highland Valley area of British Columbia.

For Highland Valley Copper, 1988 was a good year. The in-pit crushing and conveying system, which became operational at the end of 1987, performed successfully during 1988 to transport the higher grade ore from crushers in the Valley pit to the Lornex mill and, by means of a transfer conveyor, to haulage trucks providing crushed feed to the Bethlehem concentrator. As a result, the gains in production, efficiency and productivity that had been anticipated with the formation of the partnership in 1986, were realized.

During 1988, Highland Valley Copper milled an average of 120,516 tonnes of ore per operating day to produce a record 374 million pounds of copper and 4.3 million pounds of molybdenum in concentrates. Average mill head grade was 0.471% copper and 0.009% molybdenum.

Copper prices on the London Metal Exchange averaged U.S.$1.18 per pound during the year compared to U.S.$0.81 per pound in 1987. This reflected the tight copper supply situation which prevailed for most of 1988. The molybdenum market improved substantially during 1988 due primarily to strong demand from the steel industry. The Metals Week Dealer Oxide average price for 1988 was U.S.$3.44 per pound, 19% above the 1987 average price of U.S.$2.90 per pound.

In January 1988, Highland Valley Copper acquired the nearby Highmont mill and, following careful study, undertook a $70 million program to relocate the Highmont milling facilities some 10 kilometres to a site adjacent to the Lornex milling facility. This was a major undertaking. In addition to the mills themselves, the weight of the largest being approximately 800 tonnes, two sections of the mill building were moved in modules 30 metres wide, 45 metres in length, 25 metres high and weighing up to 1,500 tonnes. The program will increase the milling capacity of the Lornex complex to 131,000 tonnes per day. By the year end all mill components had been relocated and the program was within budget and on schedule for completion in the Spring of 1989.

Proven and probable ore reserves of Highland Valley Copper as of January 3, 1989 were estimated to be 768 million tonnes with an average grade of 0.399% copper and 0.0065% molybdenum.

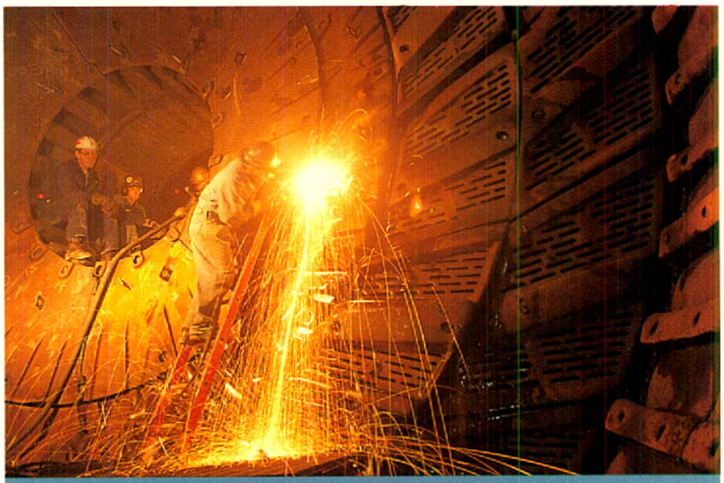
Bullmoose Coal

The Bullmoose open pit coal mine and processing facilities are located in northeastern British Columbia, approximately 30 kilometres northwest of Tumbler Ridge.

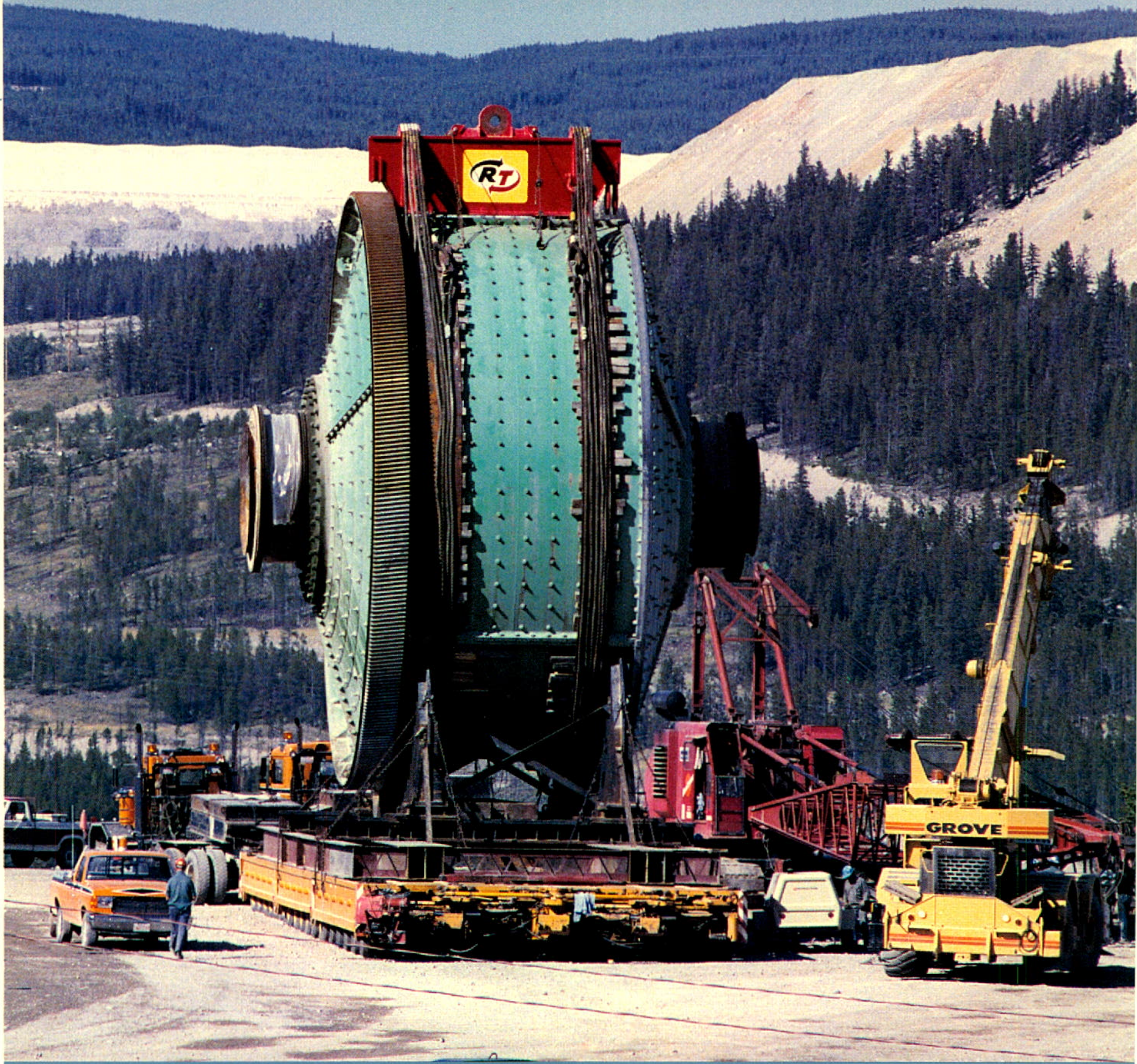
During the 12 months ended December 31, 1988, 2.2 million tonnes of raw coal were fed to the plant, resulting in metallurgical coal production of 1.7 million tonnes, the same amount as was recovered the previous year.

Since coal shipments started in January 1984, more than nine million tonnes of metallurgical coal have been sold to nine Japanese steel companies under long term contracts, which provide for shipments of 1.7 million tonnes per year (plus or minus 5% at the buyers' option). The mine has adequate reserves of metallurgical coal to satisfy these contracts.

Coal prices are determined in accordance with a formula in the sales contracts which provide for periodic review of the price at the request of either the buyer or the seller. The steel companies have asked for such a review, which is now underway.

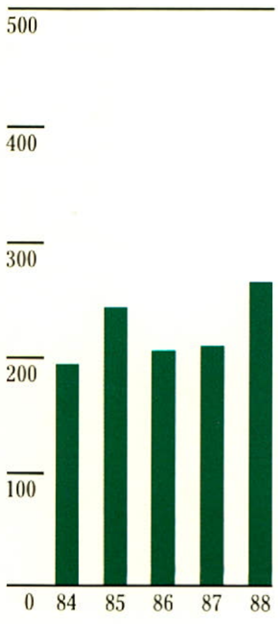


Workers at Highland Valley Copper prepare the interior of the large grinding mill shown on the opposite page.

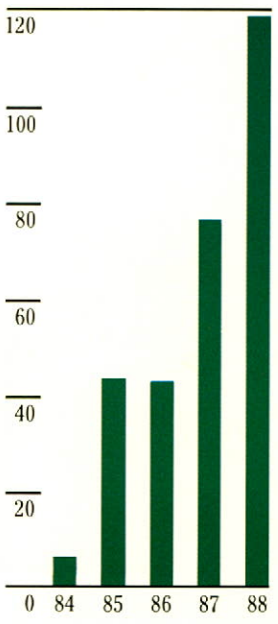


An 800 tonne grinding mill on its 10 kilometre journey, as part of the program to relocate the Highmont mill and expand Highland Valley Copper milling capacity.

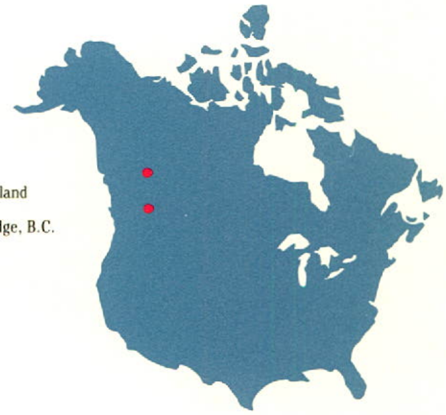
Revenue
(millions of dollars)



Operating Profit
(millions of dollars)



COPPER/COAL
Highland Valley Copper, Highland Valley area, B.C.
Bullmoose Mine, Tumbler Ridge, B.C.



Tin

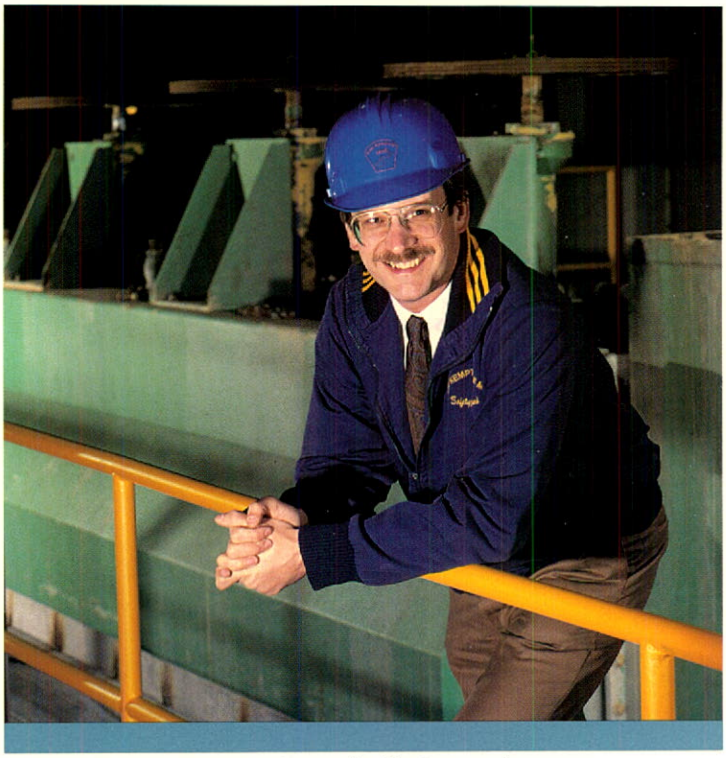
Rio Kemptville Tin Corporation, a wholly owned subsidiary of Rio Algom, owns and operates the East Kemptville open-pit tin mine and concentrating facilities near Yarmouth, Nova Scotia. These facilities were re-acquired effective March 1, 1988.

Operations for the 10 month period beginning March 1, 1988 resulted in revenue of $24.3 million and an operating loss of $5.1 million.

During the same period East Kemptville processed 2.7 million tonnes of ore to produce 5,700 tonnes of tin concentrate averaging 55.9% tin. Minor quantities of copper and zinc concentrates were also recovered.

Revenue and operating profit were affected by low tin recoveries and metal prices. Due to the nature of the ore and plant design, tin recovery was limited to 62.1% in 1988. However, construction has commenced on a $5.5 million tin flotation circuit which will be operational in the second quarter of 1989 and is expected to significantly improve tin recoveries. In addition, a program is underway to increase copper and zinc recoveries. All tin in concentrate produced is currently sold under two smelter contracts. During 1988, tin prices averaged U.S.$3.20 with a high of U.S.$3.43 and a low of U.S.$3.02.

Proven and probable ore reserves at December 31, 1988 were estimated to be 36.4 million tons with an average grade of 0.175% tin, 0.102% copper and 0.181% zinc.



Ken Collison, President, Rio Kemptville Tin Corporation, in the mill at East Kemptville, Nova Scotia.

Minerals Exploration

During 1988 Rio Algom renewed its central commitment to the mining industry. In keeping with this commitment a strategy of identifying and aggressively pursuing opportunities at all stages of exploration has been implemented.

Grass roots exploration is being undertaken and more advanced-stage exploration projects are being pursued through expanded and more accommodative dealings with the junior mining sector. Additional regional exploration offices at Saskatoon, Thunder Bay and Val d'Or were opened during the year. Together with the existing exploration offices at Toronto, Fredericton, Vancouver and Reno, Nevada, these offices and a larger geological staff will provide Rio Algom with greater exposure and allow heightened activity in exploration areas of high potential.

Exploration expenditures were increased significantly in 1988 to $7.4 million. Focusing initially on proven geological environments Rio Algom is concentrating its exploration activities on gold, base metal and uranium prospects. During 1988, important property positions were acquired in base metal producing belts in Newfoundland, New Brunswick and Ontario and gold areas in Ontario and Nevada. Fourteen exploration properties were held under active consideration at year end. Preliminary surveys and drilling on some properties have enhanced their potential and further exploration will be undertaken on these during 1989.

Construction in progress on a new $5.5 million tin flotation circuit at East Kemptville which is expected to significantly improve tin recoveries.

Kelly O'Connor, Vice-President, Exploration (left) maps out program with Bob Shewman of the Toronto exploration office.

TIN
East Kemptville mine,
Yarmouth, Nova Scotia
MINERALS EXPLORATION
Regional Offices at Toronto, Fredericton,
Thunder Bay, Saskatoon, Vancouver
and Reno, Nevada.

Steel Manufacture

Rio Algom's steel manufacturing operations consist of the production and sale of:

- **stainless steel sheet, strip and plate by the Atlas Stainless Steels division located at Tracy, Quebec;**
- **a wide variety of alloy and stainless steel bar and billet products by the Atlas Specialty Steels division located at Welland, Ontario; and**
- **specialty steel bar, rod, wire, pipe, tubing and extruded shapes by AL Tech Specialty Steel Corporation, which has facilities at Dunkirk and Watervliet, New York.**

Comparative results of operations are:

	1988	1987
	(in thousands)	
Revenue*	**$582,417**	**$449,091**
Operating profit	**$ 63,821**	**$ 16,635**

*Inclusive of intercompany sales.

Higher sales volumes and selling prices, particularly at Atlas Stainless Steels, led to improved revenue and operating profit from steel manufacturing in 1988. Each of the three operations implemented surcharges during the year to offset significant and rapid cost increases in raw materials, especially nickel, chrome and scrap.

Atlas Stainless Steels

In 1988, revenue and operating profit from production of stainless flat rolled products manufactured at the Tracy plant reached record levels. Demand was strong from major market segments including the pulp and paper, metallurgical, automotive, housing, food processing, transportation, commercial kitchen and architectural industries. Also, shipments to metals service centres for resale to a wide cross section of industry were at record levels reflecting the overall strength of the Canadian and global economies.

Although availability of critical raw materials was tight, adequate supplies were obtained at competitive costs to meet production schedules.

Product and process development programs executed in recent years resulted in additional capacity, new business, improved quality and productivity gains. Production constraints were alleviated and work scheduling improved during 1988 resulting in a 12% increase in plant capacity, which led to improved levels of production and employment.

Atlas Specialty Steels

Improved revenue and operating profit in 1988 were achieved through a better product mix, strong market demand for specialty steels and enhanced pricing posture for high value products. Atlas Specialty also benefitted from a favourable purchasing position at a time of rapidly rising costs for scrap and alloys.

Various programs undertaken during 1988 also contributed to increased profitability through changes and improvements in both facilities and operating procedures that provided better productivity, yield and quality of both process and product.

Demand for hollow drill steel for rock drill mining applications reached an all time high in 1988. This is an important product for Atlas Specialty and one which provides global marketing opportunities. Work has continued towards improving hollow drill production practices to enhance value and performance in the field.

Sales efforts during 1988 focused on broadening the market base both domestically and offshore. Emphasis has been placed on the training of marketing representatives, and specific product specialists who work closely with operations and marketing planners to meet customer needs.

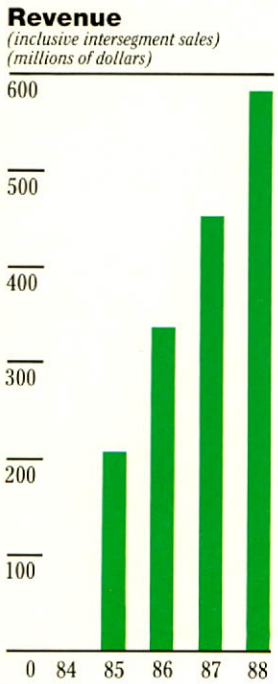
During the year, Atlas Specialty's capital expenditures were largely directed to the development of a state-of-the-art electric furnace which will provide a world competitive productivity standard for specialty steel. The new continuous caster has proven its capability and adaptability for processing a major portion of the grades of steel marketed by Atlas Specialty Steels. Casting of larger diameter and differing grade materials has been facilitated with the introduction of a bottom pour ingot process at the Welland plant. Significant improvement in yield and reduction in processing costs have resulted from this ingot process.

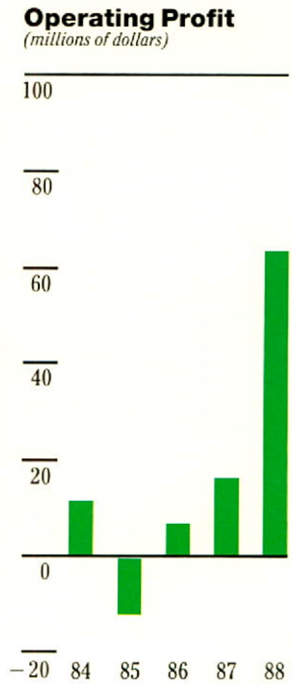
James Mintun, Jr., President, AL Tech Specialty Steel Corporation, William Pollock, Vice-President, Atlas Stainless Steels and Bruce Hamilton, Vice-President, Atlas Specialty Steels.

The new continuous caster at Atlas Specialty Steels, Welland processes a wide range of billet products.

AL Tech

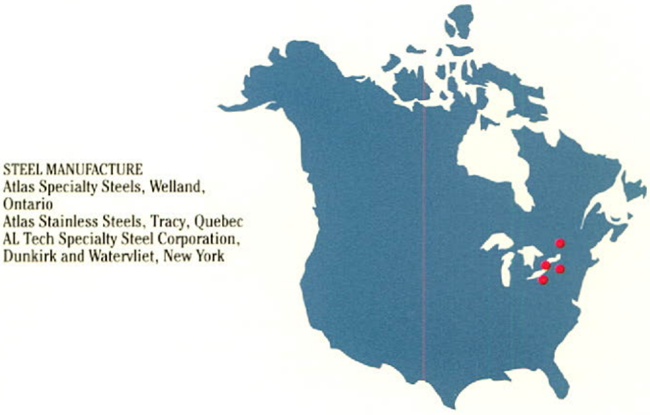
1988 revenue and operating profit rose significantly over 1987 mainly as a result of a substantial increase in sales volume. Demand was very strong for specialty steel long products in the United States due to the high level of capital spending by U.S. manufacturers. The lower value of the U.S. dollar resulted in increased exports of goods made from AL Tech products, increasing demand to record levels. The strong demand for stainless steel products led to dramatic increases in nickel, chrome and stainless scrap prices. AL Tech utilized base price increases and raw material surcharges to offset these cost increases.





The increase in sales volume allowed AL Tech's manufacturing plants to operate efficiently and profitably during 1988. In addition, significant benefits were achieved from product planning and quality improvement programs initiated previously.

Owing to the high level of activity at both AL Tech and Atlas Specialty Steels, both the Welland and Watervliet melt shops were required throughout the year. The extent to which further rationalization of melting activity in the two facilities can be reasonably advanced is under further review.



Metals Distribution

Rio Algom's metals distribution operations involve the warehousing, manufacturing, processing and distribution of a wide variety of metal products for industrial use from:

- **twelve Atlas Alloys metals service centres located across Canada;**
- **ten Vincent Metals metals service centres and warehouses located in the central and southeastern United States; and**
- **Atlas Steels Limited's twelve metals service centres and warehouses, a bright steel manufacturing plant and a wire drawing facility in Australia and four distribution warehouses in New Zealand.**

Comparative results of operations are:

	1988	1987
	(in thousands)	
Revenue	$743,099	$543,608
Operating profit	$ 62,918	$ 25,972

Significantly higher sales volumes and improved margins were achieved as a result of strong demand in Canada, the U.S. and Australia. This led to increased revenues and operating profits from metals distribution in 1988.

Canada

Strong demand for the products sold by Atlas Alloys came from virtually all segments of Canadian industry. Heavy investment by the pulp and paper industry and high demand in some segments of the transportation industry contributed significantly. All four of Atlas Alloys major product lines — aluminum, stainless steel, machinery steels and fluids-handling products — registered strong sales increases. On the supply side substantial increases in the prices of aluminum ingot, nickel and chrome were passed through the fabricating mills to the distributors and on to end users.

Atlas Alloys' Valve and Control Division and Fastener Division, both of which were created in 1987 as separate marketing units, had very successful results in 1988. During the year, an Aerospace and Defence group was organized, in recognition of the need for further specialized marketing. This group is already assisting Atlas Alloys to broaden the significant success experienced in the aerospace field in recent years.

In October 1988, ground was broken for a new warehouse and office building in Dartmouth, Nova Scotia. This facility will be the thirteenth Atlas Alloys metals service centre in Canada when opened in March 1989. Atlas Alloys continued its ongoing program of up-grading processing and materials-handling capabilities to better meet customer requirements. A larger capacity cut-to-length line was added in Vancouver; extra high level racking and a new technology plasma cutting unit were installed in Toronto.

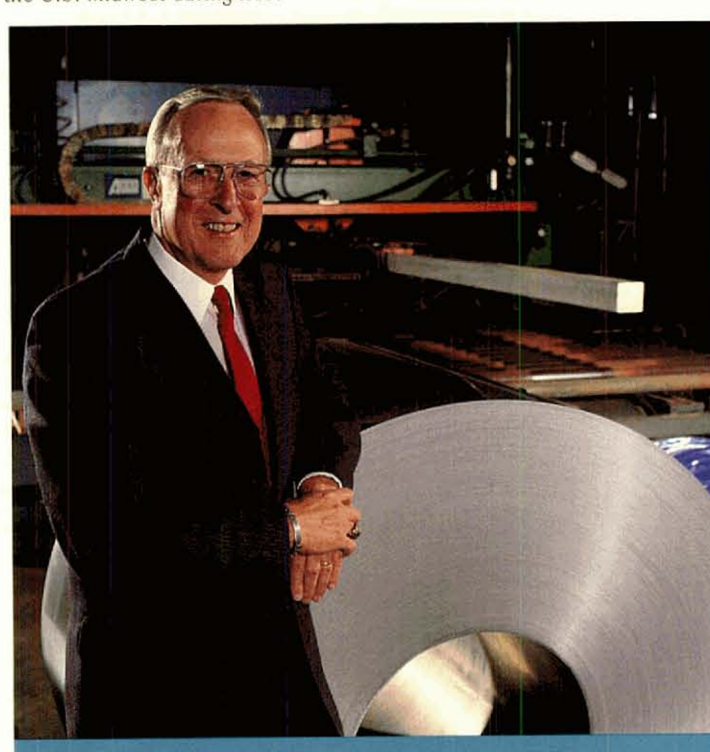
United States

Vincent Metals enjoyed another excellent year, with major customer groups operating at high levels of activity. All ten locations of Vincent Metals produced record sales and operating profits. With raw materials in short supply, mill lead times lengthened and it became necessary to institute surcharges in respect of stainless steel to compensate for nickel prices which almost quadrupled during the year.

Vincent Metals improved customer service and increased margins with the addition of new equipment in 1988. New cut-to-length processing lines were installed in both Little Rock and Indianapolis. These new lines, which are capable of producing precision-cut sheet metal for use by many industries, allow a higher level of productivity and more value added to the end product. Another cut-to-length line was purchased during the year for installation in 1989.

Sales programs were developed during 1988 that will lead to higher sales in copper, brass and fasteners during the coming years. A special program is being instituted to enhance the sale of beryllium copper products which are widely used in the electronics industry.

Vincent Metals is continuing to pursue strategic acquisitions throughout the United States and will open an eleventh location in the U.S. Midwest during 1989.



Norman Smith, Vice-President, Vincent Metals, at a processing and warehousing facility in Minneapolis.

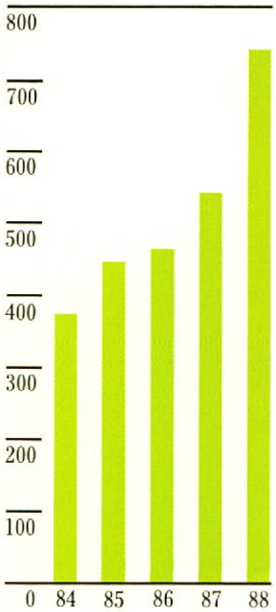
Kenneth Collyer, Vice-President, Atlas Alloys, with Bernard Macho, Managing Director, Atlas Steels Limited, in the warehouse distribution facility in Melbourne, Australia.

Australia

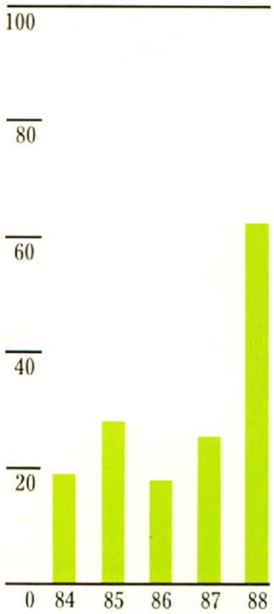
Atlas Steels Limited, 55.9% owned by Rio Algom, with three operating divisions in Australia and one in New Zealand, experienced an outstanding year. The excellent results are attributable to a very strong demand for metals in Australia, especially stainless steel distributed by the group, carbon bright steels manufactured by Martin Bright Steels and bar and wire products produced by Atlas Steels. Despite limited mill supplies of stainless steels, due to worldwide nickel shortages, Atlas Steels increased sales and improved profitability. The tight stainless supply situation resulted in rapid price escalation during the year.

Atlas Steels has initiated programs to integrate and rationalize its various steel businesses. Operational improvements and efficiencies are expected in 1989, mainly in customer service and inventory control.

Revenue
(millions of dollars)



Operating Profit
(millions of dollars)



Employees

Rio Algom's strength lies in the competence and dedication of its employees. In a year marked by strong demand for all products, our employees were more than equal to the challenge. At December 31, 1988, Rio Algom and its subsidiaries employed 7,926 people compared to 7,981 at the end of the previous year.

Safety

Safety in the workplace is a continuing priority at Rio Algom and, with one exception only, Rio Algom's operations achieved improved safety performance in 1988 over 1987. The Directors, management and employees are committed to maintaining the safest possible working conditions at all facilities. The management and employees of the Panel mine at Elliot Lake are to be commended for their dedication to achieving safe operations. During 1988, Panel was the only mine in North America to receive a Five Star Advanced rating under the International Safety Rating System. In spite of Rio Algom's dedication to safety, two fatalities occurred in 1988 at Rio Algom's Canadian operations. This loss of life is tragic and reinforces Rio Algom's determination to prevent accidents in the workplace.

Collective Agreements

Collective bargaining agreements are in effect until September 1, 1990 at the Elliot Lake uranium mines. A collective agreement covering all production and maintenance and office and technical employees is in effect at Highland Valley Copper until June 30, 1989. An agreement covering all production and maintenance and warehouse employees at the East Kemptville mine is in effect until January 6, 1991. The agreement at the PCA Saskatoon mine for hourly-rated employees was reopened in September 1988 and is in effect until May 31, 1989.

Agreements are in effect at Atlas Stainless Steels until November 30, 1990 for production and maintenance employees, until January 31, 1991 for office and technical employees and until February 28, 1991 for security guards. At Atlas Specialty Steels, agreements are in effect for production and maintenance employees until February 16, 1991 and for office and technical employees until April 30, 1991. The agreement covering production and maintenance employees at AL Tech is in effect until September 30, 1989. Vincent Metals has collective agreements at three of its operations which expire on December 14, 1989, December 31, 1989 and May 31, 1991.

The Williamson team from Quirke mine, Elliot Lake, demonstrating rescue techniques at a mine rescue competition.

Sign at the Panel mine underscores the emphasis on safe operations. The Five Star flag recognizes attainment of the highest safety rating.

Management's Report on the Consolidated Financial Statements

Management is responsible for preparation of its consolidated financial statements and the information contained throughout this Report. The accompanying consolidated financial statements have been prepared by management in accordance with accounting principles generally accepted in Canada and necessarily include some amounts that are based on informed judgments and best estimates of management. Financial and operating information appearing throughout this Report is consistent with that contained in the consolidated financial statements.

Coopers & Lybrand, our independent auditors, are engaged to express a professional opinion on the consolidated financial statements. Their examination is conducted in accordance with generally accepted auditing standards and includes tests and other procedures which allow the auditors to report on the fairness of the consolidated financial statements prepared by management.

The Board of Directors, through an audit committee composed of five non-management directors, oversees management's responsibilities for financial reporting. The independent auditors have full and free access to the audit committee. The audit committee reports to the Board of Directors, which has ultimate responsibility to the shareholders for the consolidated financial statements.

Auditors' Report to the Shareholders

We have examined the consolidated balance sheet of Rio Algom Limited as at December 31, 1988 and 1987, and the consolidated statements of earnings, retained earnings, contributed surplus and changes in financial position for each of the three years in the period ended December 31, 1988. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Corporation as at December 31, 1988 and 1987 and the results of its operations and changes in its financial position for each of the three years in the period ended December 31, 1988 in accordance with generally accepted accounting principles in Canada applied, except for the change in accounting policy with respect to pension costs and obligations as explained in note 2, on a consistent basis.

Coopers & Lybrand
Chartered Accountants

Toronto, Canada
March 1, 1989

Accounting Policies

The principal accounting policies followed by the Corporation and its subsidiaries are summarized hereunder to facilitate a comprehensive review of the consolidated financial statements contained in this report.

Basis of Consolidation

The consolidated financial statements include the accounts of all significant subsidiary corporations and the Corporation's proportionate interests in the accounts of an unincorporated joint venture (Bullmoose) and a partnership (Highland Valley Copper).

Valuation of Inventories and Concentrates Awaiting Shipment

Inventories of potash, steel, other metals, raw materials and supplies are valued at the lower of cost and market. Cost is determined generally at average or standard costs which approximate actual except for inventories of potash for which costs are determined on the first-in, first-out basis and inventories of two United States subsidiaries for which costs are determined on the last-in, first-out basis. Market for potash, steel and other metals is net realizable value and for raw materials and supplies is replacement cost. Intercompany profits have been excluded from these inventories.

Concentrates awaiting shipment and coal inventories are valued at estimated realizable prices.

Depreciation and Amortization

The Corporation charges depreciation and amortization on the following bases:

i) Mining fixed assets:
Fixed assets are depreciated on the basis of the shorter of physical life (straight-line method) or economic life as estimated for each mining unit (units of production method); economic life is adjusted from time to time as conditions warrant.

ii) Other fixed assets:
Fixed assets are depreciated on the straight-line method based on engineering estimates of the lives of the assets at the following rates:

Buildings	4% per annum
Plant and equipment	6⅔% per annum

Mining properties and preproduction expenditures are amortized on the same basis as mining fixed assets are depreciated.

Capitalization of Interest

The Corporation follows the policy of capitalizing net interest costs during construction or development only on those projects for which funds have been borrowed; this would normally apply only to such major new projects from the beginning of construction or development up to the commencement of commercial operations. In these cases interest earned on borrowed funds during the development and construction period is applied against the interest expense to reduce the amount of interest costs capitalized. Such net interest costs are capitalized because it is considered that they would not have been incurred if the project had not been undertaken and therefore are properly part of the capital cost of the total project.

Mineral Exploration and Development Costs

Exploration costs are written off as incurred. Expenditures on development projects are capitalized while the projects are considered to be of value to the Corporation.

Income and Mining Taxes

The Corporation provides for deferred income and mining taxes on all significant timing differences which represent the tax effects of revenue and expense items reported for tax purposes in periods different than for accounting purposes. Investment tax credits are recorded using the cost reduction approach when there is reasonable assurance that the credits will be realized; these credits are deferred and amortized to income on the same basis as the related assets.

Pension Costs

The Corporation's defined benefit pension plans cover substantially all employees. Pension costs and obligations are determined using the projected benefit method of actuarial valuation prorated on the projected length of employee service. Pension surpluses and deficiencies, experience gains or losses and the effects of changes in plan assumptions are amortized on a straight-line basis over the expected average remaining service life of the relevant employee group. The cumulative difference between amounts expensed or credited to income and funding contributions has been recorded on the balance sheet (note 9).

Earnings per Common Share

Earnings per common share are stated after provisions for dividends on preference shares and are based on the weighted average number of shares outstanding.

Consolidated Statement of Earnings

Years Ended December 31	1988	1987	1986
		(Thousands of dollars)	
Revenue:			
Revenue from mine production and sales of steel and other products	**$1,979,072**	$1,532,556	$1,357,915
Expenses:			
Cost of mine production and steel and other sales	**1,482,505**	1,166,989	1,033,960
Selling, general and administration	**170,198**	144,209	119,697
Interest (net) (note 15)	**1,829**	947	(9,602)
Depreciation and amortization (note 16)	**68,216**	64,768	68,880
Exploration	**7,366**	3,663	5,071
	1,730,114	1,380,576	1,218,006
Earnings before taxes and minority interests	**248,958**	151,980	139,909
Income and mining taxes (note 17)			
Current	**81,396**	49,721	27,913
Deferred	**23,767**	(4,296)	10,660
	105,163	45,425	38,573
Earnings before adjustment for minority interests in subsidiary corporations and extraordinary items	**143,795**	106,555	101,336
Minority interests in net earnings of subsidiary corporations	**29,022**	13,480	11,453
Earnings before extraordinary items	**114,773**	93,075	89,883
Extraordinary items:			
Benefit realized from utilization of prior years' tax losses	**19,667**	—	—
Write-off of East Kemptville tin project less income tax credit of $18.7 million	**—**	—	(19,701)
Net earnings for the year (note 14)	**$ 134,440**	$ 93,075	$ 70,182
Earnings per common share (note 1):			
Earnings before extraordinary items	**$ 2.57**	$ 2.12	$ 2.04
Net earnings for the year	**$ 3.02**	$ 2.12	$ 1.58

Consolidated Statement of Retained Earnings

Years Ended December 31	1988	1987	1986
		(Thousands of dollars)	
Balance, beginning of year	**$ 630,037**	$ 567,472	$ 528,001
Add net earnings for the year	**134,440**	93,075	70,182
	764,477	660,547	598,183
Deduct:			
Dividends on preference shares	**2,581**	2,794	2,995
Dividends on common shares	**30,616**	27,716	27,716
	33,197	30,510	30,711
Balance, end of year	**$ 731,280**	$ 630,037	$ 567,472

Consolidated Balance Sheet

December 31	1988	1987
Assets		
Current:		
Cash and short term deposits	$ 187,156	$ 218,085
Receivables and prepaid expenses	253,761	220,573
Inventories and concentrates awaiting shipment (note 4)	590,639	589,821
	1,031,556	1,028,479
Plant and equipment (note 5)	715,299	670,485
Construction in progress, at cost	25,389	44,934
Mining properties and preproduction expenditures (note 6)	295,527	312,901
Other assets, at cost	26,542	25,303
	$2,094,313	$2,082,102

	1988	1987
	(Thousands of dollars)	
Liabilities		
Current:		
Bank loans and overdrafts	**$ 17,515**	$ 14,350
Accounts payable and accrued liabilities	**284,766**	265,852
Income and mining taxes	**78,856**	50,178
Current portion of long term debt	**24,583**	32,667
	405,720	363,047
Long term debt (note 7):		
Recourse	**92,043**	104,015
Limited recourse	**151,890**	166,552
Advances from Ontario Hydro (note 8)	**307,523**	312,630
Deferred income and mining taxes	**204,588**	213,363
Minority shareholders' interests in subsidiary corporations	**34,617**	112,554
Other (note 9)	**17,421**	40,676
	1,213,802	1,312,837
Capital Stock and Retained Earnings		
First preference shares (note 10)	**5,850**	6,658
Second preference shares (note 10)	**29,235**	29,390
Common shares (note 10)	**68,875**	49,152
Contributed surplus	**55,639**	57,048
Cumulative translation adjustment (note 11)	**(10,368)**	(3,020)
Retained earnings	**731,280**	630,037
	$2,094,313	$2,082,102

Approved on behalf of the Board of Directors:

J. K. Reynolds

J. Keith Reynolds, Director

Ross J. Turner, Director

Consolidated Statement of Contributed Surplus

Years Ended December 31	1988	1987	1986
		(Thousands of dollars)	
Balance, beginning of year	$ 57,048	$ 58,536	$ 60,040
Deduct loss on purchase and cancellation of preference shares (net) (note 10(d))	1,409	1,488	1,504
Balance, end of year	$ 55,639	$ 57,048	$ 58,536

Consolidated Statement of Changes in Financial Position

Years Ended December 31	1988	1987	1986
		(Thousands of dollars)	
Operating Activities:			
Earnings before adjustment for minority interests in subsidiary corporations and extraordinary items	$ 143,795	$ 106,555	$ 101,336
Gain on disposal of investment	—	(7,786)	—
Depreciation and amortization	68,216	64,768	68,880
Deferred income and mining taxes	23,767	(4,296)	10,660
Decrease (increase) in non-cash working capital	31,659	(24,394)	(19,065)
	267,437	134,847	161,811
Financing Activities:			
Issue of Second Preference Shares Series C (note 10(f))	21,496	—	—
Increase in long term debt	—	—	63,616
Repayments of long term debt and other obligations	(42,925)	(68,069)	(26,590)
Repayments to Ontario Hydro (net)	(5,107)	(9,268)	(15,207)
Dividends on common shares	(30,616)	(27,716)	(27,716)
Dividends on preference shares	(2,581)	(2,794)	(2,995)
Dividends to minority shareholders	(6,054)	—	—
Purchase and cancellation of preference shares	(4,145)	(3,021)	(2,305)
	(69,932)	(110,868)	(11,197)
Investing Activities:			
Acquisitions of subsidiary corporations (note 3)	(74,693)	(16,674)	(13,687)
Cash and equivalents acquired (disposed of)	(43,921)	—	11,360
Disposal of equity in subsidiary corporation	—	18,319	—
	(118,614)	1,645	(2,327)
Expenditures (net) for plant and equipment, construction in progress, mining properties and preproduction and development	(112,985)	(70,446)	(108,108)
	(231,599)	(68,801)	(110,435)
Change in cash and equivalents during year (a)	(34,094)	(44,822)	40,179
Cash and equivalents, beginning of year	203,735	248,557	208,378
Cash and equivalents, end of year	$ 169,641	$ 203,735	$ 248,557

(a) Cash and equivalents comprise cash and short term deposits less current bank loans and overdrafts.

Notes to Consolidated Financial Statements

December 31, 1988, 1987 and 1986

1. Accounting Policies

The information on page 20 presents a summary of the principal accounting policies and is an integral part of these consolidated financial statements.

2. Change in Accounting Policy

Effective January 1, 1987 the Corporation adopted prospectively the recommendations of the Canadian Institute of Chartered Accountants with respect to the accounting for pension costs and obligations, (see Accounting Policies — Pension Costs). Previously pension expense consisted of the amortization of past service pension contributions plus the amount of any funding in respect of the current year's service. The change in accounting policy has had the effect of increasing consolidated net earnings for 1988 and 1987 by $10.2 million and $6.1 million respectively.

3. Reorganization and Acquisitions

(a) As a result of a reorganization of Lornex Mining Corporation Ltd. ("Lornex") completed on December 30, 1988, the Corporation and Teck Corporation ("Teck") acquired direct interests of 74.6% and 25.4% respectively in the assets and liabilities of Lornex in exchange for their common share interests in Lornex. As a part of such reorganization the Corporation increased its common share interest in Lornex by purchasing the minority-held shares for cash of $13.8 million and by the issue of Cumulative Preference Shares Series C (more fully described in note 10(f)) for $21.5 million which eliminated minority interests of $19.0 million. The excess purchase consideration of $16.3 million has been included in the carrying value of mining properties. The net assets received by Teck for its common shares in Lornex amounted to $83.7 million which has been applied against minority interests.

Effective March 1, 1988, the Corporation acquired ownership of the East Kemptville tin mine from the Banking Group to which it was conveyed in December 1986. The transaction involved the purchase by the Corporation of all the issued shares of Rio Kemptville Tin Corporation ("Rio Kemptville") for a total cash consideration of $39.4 million and the retention by the vendor of a royalty interest. The royalty interest provides for price participation when the price of tin exceeds a certain level — one which is somewhat higher than the prevailing price. The acquisition has been accounted for by the purchase method with the results of operations included from the date of acquisition. The cost of the purchase has been allocated to the acquired net assets based on their fair value at the date of acquisition.

The net assets acquired in each case were as follows:

	1988		
			(in thousands)
	Lornex	Rio Kemptville	Total
Net current assets	$ 7,977	$ 8,334	$ 16,311
Property, plant and equipment	36,945	37,626	74,571
	44,922	45,960	90,882
Liabilities assumed	9,586	6,603	16,189
Total acquisition cost	**$ 35,336**	**$ 39,357**	**$ 74,693**

(b) Effective October 30, 1987, Atlas Steels Limited ("Atlas Steels"), a newly incorporated Australian public company purchased the net assets of the manufacturing operation of Martin Bright Steels Limited and all the issued shares of Gilbert Lodge & Co. Limited and Clayton Bros. Pty. Ltd. The business and companies acquired are engaged in the manufacture and distribution of steel products, machine tools and industrial engineering products throughout Australia and New Zealand.

The Corporation acquired a 55.9% equity interest in Atlas Steels Limited which consisted of treasury shares received in consideration for the sale of its wholly-owned subsidiary, Atlas Steels

(Australia) Pty. Ltd., ("Atlas Australia") together with additional shares acquired for $1 million in the open market. As a result of the reduction in the equity of Atlas Australia the Corporation realized a gain of $7.8 million which was included in 1987 earnings.

The acquisition was accounted for by the purchase method with the results of operations of the acquired business and companies included from the date of acquisition. The excess of the acquisition cost over the aggregate book value of the acquired net assets amounting to $11.6 million was included as goodwill in Other Assets on the balance sheet and is being amortized on a straight-line basis over twenty years.

The net assets acquired were as follows:

	1987
	(in thousands)
Net current assets	$ 42,993
Property, plant and equipment	8,842
Goodwill	11,625
	63,460
Liabilities assumed	(18,837)
Net assets acquired	44,623
Additional bank debt and liabilities	(14,805)
Minority interests	(13,144)
Total acquisition cost	$ 16,674

(c) As a result of the amalgamation effective December 31, 1987 of the Corporation and Potash Company of America, Inc. ("PCA"), all of the outstanding $2.50 Voting Convertible Preferred Shares of PCA were exchanged for Redeemable Retractable Convertible Second Preference Shares Series B of the Corporation. The transaction is more fully described in note 10(e).

(d) Effective January 31, 1986 the Corporation purchased all of the outstanding common shares of Potash Company of America, Inc. ("PCA"), a major Canadian potash producer with mines in Saskatchewan and New Brunswick, for a total consideration of $13.2 million in cash; the common shares of PCA acquired represent approximately 87.8% of the PCA voting shares outstanding.

Effective July 1, 1986 the Corporation purchased all of the outstanding shares of AL Tech Specialty Steel Corporation ("AL Tech"), a leading specialty steel producer in the United States with manufacturing facilities in New York State, for a total consideration of $0.5 million in cash. These acquisitions were accounted for by the purchase method with the results of operations included from the date of acquisition. The costs of the purchases were allocated to the acquired net assets based on their fair value at the date of acquisition. The excess of the aggregate book value of the acquired net assets over the acquisition cost was $5.0 million for PCA and $34.2 million for AL Tech and these amounts were applied to reduce the values of the respective property, plant and equipment acquired.

The net assets acquired in each case were as follows:

	1986		
			(in thousands)
	PCA	AL Tech	Total
Net current assets	$ 42,495	$ 38,433	$ 80,928
Property, plant and equipment	157,438	3,612	161,050
	199,933	42,045	241,978
Liabilities assumed:			
Long term	(148,406)	(8,385)	(156,791)
Other	(7,327)	(33,173)	(40,500)
Minority interests	(31,000)	—	(31,000)
Total acquisition cost	$ 13,200	$ 487	$ 13,687

4. Inventories and Concentrates Awaiting Shipment

	1988	1987
	(in thousands)	
Mining operations		
Concentrates awaiting shipment and coal inventories	**$ 264,943**	$ 303,566
Potash	**12,597**	7,750
Mine supplies	**35,754**	36,988
	313,294	348,304
Steel and other metals operations (a)		
Steel, other metals, raw materials and supplies	**277,345**	241,517
	$ 590,639	$ 589,821

(a) Includes all United States steel inventories, valued on a LIFO basis at December 31, 1988, of $73.7 million (1987 — $88.6 million) which have a replacement cost of $126.7 million (1987 — $119.7 million).

5. Plant and Equipment

	1988	1987
	(in thousands)	
Buildings, at cost	**$ 426,476**	$ 411,157
Machinery and equipment, at cost	**847,253**	782,136
	1,273,729	1,193,293
Less accumulated depreciation	**562,202**	526,023
	711,527	667,270
Land, at cost	**3,772**	3,215
	$ 715,299	$ 670,485

Plant and equipment includes $37.6 million in respect of assets of mines presently idle which have been fully depreciated.

6. Mining Properties and Preproduction Expenditures

	1988	1987
	(in thousands)	
Mining properties, at cost	**$ 122,397**	$ 118,269
Less accumulated amortization	**19,164**	18,077
	103,233	100,192
Preproduction expenditures, at cost (a)	**343,230**	360,637
Less accumulated amortization	**150,936**	147,928
	192,294	212,709
	$ 295,527	$ 312,901

(a) The value of preproduction expenditures of PCA has been written down as described in note 10(e).

7. Long Term Debt

	1988	1987
		(in thousands)
Recourse debt:		
Bullmoose bank loans (a)	$ —	$ 2,214
Potash Company of America (PCA) bank loans (b)	**76,000**	80,000
Housing loans and mortgages (c)	**22,328**	28,212
AL Tech note payable	**6,594**	7,492
	104,922	117,918
Less portion included in current liabilities	**12,879**	13,903
	92,043	104,015
Limited recourse debt:		
Bullmoose bank loans (a)	**32,969**	49,400
PCA bank loans (b)	**106,018**	108,504
Housing loans and mortgages (c)	**24,607**	27,412
	163,594	185,316
Less portion included in current liabilities	**11,704**	18,764
	151,890	166,552
	$ 243,933	$ 270,567

(a) The Bullmoose bank recourse loan was repaid in full in February 1988. The limited recourse loans and acceptances outstanding at December 31, 1988 carried average interest rates of 12.7% and are repayable in semi-annual installments through to July, 1994.

A first charge has been placed on the Corporation's share of the assets of the Bullmoose mine as security for the limited recourse loan.

(b) As a result of the amalgamation of PCA and the Corporation, the recourse and limited recourse loans of PCA have been assumed by the Corporation on essentially the same terms and conditions as applied previously. These bank loans are repayable in semi-annual instalments through to December, 1999 and carried average interest rates of 11.3% on the recourse loans and 12.1% on the limited recourse loans at December 31, 1988. Under a demand debenture a first charge has been placed on PCA's assets as security for the recourse and limited recourse loans.

(c) The housing loans and mortgages carry interest rates varying from 9.75% to 12.00%.

(d) Long term debt repayment requirements, after allowing for prepayments, over the next five years amount to $24.6 million in 1989, $18.3 million in 1990, $24.0 million in 1991, $26.4 million in 1992 and $27.1 million in 1993.

8. Advances from Ontario Hydro

	1988	1987
		(in thousands)
Balance at December 31	**$ 307,523**	$ 312,630

Ontario Hydro has agreed to make interest-free advances of the funds required to bring the Stanleigh Project into production and the funds necessary for its working and sustaining capital requirements. The funds advanced are being repaid to Ontario Hydro over the delivery period in amounts approximately equal to the amortization allowance included in the base price, as defined in the agreement, of uranium delivered. A non-recourse first charge has been placed against the Stanleigh Project assets as security for the advances.

9. Other

	1988	1987
	(in thousands)	
Pension liability (net) (note 12)	**$ 18,768**	$ 42,211
Less portion included in current liabilities	**7,367**	8,000
	11,401	34,211
Potash Company of America		
Deferred income	**6,020**	6,465
	$ 17,421	$ 40,676

10. Capital Stock

Authorized:

408,503 First Preference Shares, issuable in series.
22,188,370 Second Preference Shares, issuable in series.
Unlimited Common Shares.

Issued:

Preference Shares

	First Preference Shares Series A (a)		Second Preference Shares Series A (a)		Second Preference Shares Series B (a)		Second Preference Shares Series C (a)	
	Number	Amount	Number	Amount	Number	Amount	Number	Amount
		(000's)		(000's)		(000's)		(000's)
Balance, December 31, 1985	70,550	$ 7,055	6,485,074	$ 9,727	—	$ —	—	$ —
Purchased and cancelled in 1986 (b) (c)	(1,384)	(138)	(442,225)	(663)	—	—	—	—
Balance, December 31, 1986	69,166	6,917	6,042,849	9,064	—	—	—	—
Issued in 1987 (e)	—	—	—	—	1,200,000	21,600	—	—
Purchased and cancelled in 1987 (b) (c) (e)	(2,585)	(259)	(441,668)	(662)	(34,000)	(612)	—	—
Balance, December 31, 1987	66,581	6,658	5,601,181	8,402	1,166,000	20,988	—	—
Issued in 1988 (f)	—	—	—	—	—	—	859,842	21,496
Purchased and cancelled in 1988 (b) (c)	(8,078)	(808)	(442,154)	(663)	(70,266)	(1,265)	—	—
Converted into Common Shares (e)	—	—	—	—	(1,095,734)	(19,723)	—	—
Balance, December 31, 1988	**58,503**	**$ 5,850**	**5,159,027**	**$ 7,739**	**—**	**$ —**	**859,842**	**$21,496**

(a) The issued preference shares are comprised as follows:

(i) $5.80 Cumulative Redeemable First Preference Shares Series A (redeemable at $101.00 per share);

(ii) 8.5% Cumulative Redeemable Second Preference Shares Series A (redeemable at $5.00 per share);

(iii) Redeemable Retractable Convertible Second Preference Shares Series B (redeemable at $18.00 per share or convertible into common shares on a one for one basis by February 12, 1988. All outstanding shares on February 15, 1988 were redeemed by the Corporation at $18.00 per share by the issue of an equal number of Common Shares); and

(iv) 8.5% Cumulative Redeemable Non-voting Second Preference Shares Series C (redeemable at $25.00 per share on January 31, 1994 or may be re-purchased by the Corporation on the open market for cancellation commencing January 1, 1992 at a price not exceeding $25.00).

(b) 8,078 First Preference Shares Series A were purchased and cancelled in 1988, 2,585 shares were purchased and cancelled in 1987, and 1,384 shares were purchased and cancelled in 1986 at costs of $669,000, $201,000 and $94,000 respectively. The Corporation's obligation for 1989 referred to in note 13 (c) (i) has been fulfilled.

(c) 442,154 Second Preference Shares Series A were purchased and cancelled in 1988, 441,668 shares were purchased and cancelled in 1987 and 442,225 shares were purchased and cancelled in 1986 at costs of $2,211,000, $2,208,000 and $2,211,000 respectively. The Corporation has set aside sufficient funds in a retirement fund account to be used to purchase or redeem Second Preference Shares Series A at \$5.00 per share by January 31, 1989, thereby fulfilling the Corporation's 1988 obligation referred to in note 13 (c) (ii).

(d) During 1984 the stated capital of the Second Preference Shares Series A was reduced by \$3.50 per share to \$1.50 per share for each share issued and outstanding on that date and the resultant reduction was credited to Contributed Surplus. Since the redemption price of the shares remained unchanged at \$5.00 there is a potential loss of \$3.50 per share; the losses of \$1,548,000 in 1988, \$1,545,000 in 1987 and \$1,548,000 in 1986 on the purchase and cancellation of Second Preference Shares Series A, reduced by profits of \$139,000 in 1988, \$57,000 in 1987 and \$44,000 in 1986 on the purchase and cancellation of First Preference Shares, have been charged to Contributed Surplus. The reduction in the stated capital does not change the total amount of \$25,795,000 which may be required to satisfy the mandatory retirement fund obligations in respect of the Second Preference Shares Series A outstanding as at December 31, 1988.

(e) On December 31, 1987, 1,200,000 Redeemable Retractable Convertible Second Preference Shares Series B were issued at \$18.00 per share in exchange for 1,200,000 \$2.50 Voting Convertible Preferred Shares of Potash Company of America, Inc. ("PCA"), a majority-owned subsidiary corporation. The excess of the carrying value of the PCA Preferred Shares over the Corporation's Redeemable Retractable Convertible Second Preference Shares, net of certain expenses, amounting to \$10.7 million has been applied to reduce the value of PCA's preproduction expenditures acquired. 34,000 Second Preference Shares Series B were redeemed on December 31, 1987 at a cost of \$612,000. During 1988, 104,266 shares were redeemed at \$18.00 per share and 1,095,734 shares were converted into Common Shares.

(f) On December 30, 1988, 859,842 8.5% Cumulative Redeemable Second Preference Shares Series C were issued at \$25.00 per share on a three for one basis to the remaining minority shareholders of Lornex, pursuant to the terms of the reorganization of Lornex as described in note 3 (a).

Common Shares

	Number	**Amount**
		(\$000's)
Balance, December 31, 1985; 1986; 1987	42,639,860	\$ 49,152
Issued in 1988 (note 10(e))	1,095,734	19,723
Balance, December 31, 1988	**43,735,594**	**\$ 68,875**

Restrictions exist on the payment of common share dividends in the provisions attaching to the Preference Shares.

Under the 1987 Share Option Plan, Rio Algom may grant up to one million Common Shares to its executives and senior managers. At December 31, 1988, outstanding options have been granted under this Plan and the 1987 Key Executive Option Plan, (now terminated except as to outstanding options), in respect of 311,750 Common Shares at prices of \$21.75 and \$19.75 per share with varying dates of expiry up to February 27, 1997.

11. Cumulative Translation Adjustment

	1988	1987
	(in thousands)	
Balance, beginning of year	**\$ (3,020)**	\$ 4,274
Less foreign currency translation losses	**(7,348)**	(7,294)
Balance, end of year	**\$ (10,368)**	\$ (3,020)

12. Pension Plans

Most employees are covered by either contributory or non-contributory defined benefit pension plans. The funds of each of the various pension plans are administered by a corporate trustee or an insurance company. Benefits under the plans are generally determined by years of service and employees' compensation, the latter being based on the three highest of the last ten years of employment or a flat dollar benefit.

An actuarial valuation is performed triannually with intervening annual reassessments for substantially all plans to determine the present value of the accrued pension benefits. Pension fund assets are carried at market values determined by using a three year average between book and market values.

The following data is based upon reports of independent actuarial consultants at December 31:

Actuarial present value of benefit obligations	Assets exceed accumulated benefits		Accumulated benefits exceed assets	
	1988	1987	**1988**	1987
			(in thousands)	
Vested	**$ 188,904**	$ 153,394	**$ 127,832**	$ 141,945
Non-vested	**17,036**	10,973	**3,378**	3,111
Accumulated benefit obligations	**$ 205,940**	$ 164,367	**$ 131,210**	$ 145,056
Projected benefit obligations	**$ 237,739**	$ 194,788	**$ 137,168**	$ 152,575
Less: Market value of pension fund assets	**(317,352)**	(303,300)	**(95,438)**	(113,553)
	$ (79,613)	$(108,512)	**$ 41,730**	$ 39,022
Unrecorded plan surplus	**$ (57,067)**	$(101,716)	**$ 416**	$ (9,985)
Pension liability (asset) recognized on the consolidated balance sheet (note 9)	**(22,546)**	(6,796)	**41,314**	49,007
	$ (79,613)	$(108,512)	**$ 41,730**	$ 39,022

Total pension expense (credit) amounted to $(1,608,000) in 1988, $(721,000) in 1987 and $11,178,000 in 1986. The components of pension expense are as follows:

	1988	1987
	(in thousands)	
Current service cost	**$ 10,399**	$ 9,287
Interest cost on projected benefit obligation	**29,663**	27,396
Return on plans' assets	**(33,076)**	(30,997)
Amortization of plans' surplus	**(8,594)**	(6,407)
Pension expense (credit)	**$ (1,608)**	$ (721)

The assumed rate of return used on plan assets was 8.6% in 1988 and 1987. Accumulated plan benefits at December 31, 1988 and December 31, 1987 were calculated based on an assumed interest rate of 8.6%. The assumed annual increase in compensation over employees' estimated remaining service lives (where this was a relevant factor) was approximately 7.0% at December 31, 1988 and December 31, 1987. The unrecorded plan surplus is amortized on a straight-line basis over periods varying from 5.5 years to 28 years, depending on the pension plan demographics.

13. Commitments and Contingencies

(a) Estimated total cost to complete capital projects, as at December 31, 1988 was approximately $44.9 million (committed $17.1 million).

(b) The Corporation is committed to total minimum rentals in the amount of $41.4 million under operating leases for land and buildings which expire from 1989 to 2003. Commitments are $7.2 million in 1989, $6.4 million in 1990, $5.8 million in 1991, $4.8 million in 1992 and $3.8 million in 1993.

(c) So long as Preference Shares are outstanding, the Corporation is obligated to set aside each year, on the dates indicated, the following amounts as a retirement fund to be used to purchase or redeem these shares:

(i) First Preference Shares Series A — $300,000 on April 1; and
(ii) Second Preference Shares Series A — $2,207,625 on February 28.

(d) The Corporation was contingently liable at December 31, 1988 for housing mortgage guarantees of $18.4 million.

(e) An action has been commenced against the Corporation by a former executive claiming damages in the aggregate of approximately $10 million for wrongful dismissal and for a declaration with respect to certain pension benefits. The Corporation is defending this action and based on the opinion of counsel believes it has a good defence and will be successful.

14. The Effect of Applying United States Generally Accepted Accounting Principles

Generally accepted accounting principles in the United States require the recording of the future tax benefits of investment tax credits under certain conditions as they arise and the recording of inventory at the lower of cost and market. The effect of applying U.S. generally accepted accounting principles on consolidated net earnings is as follows:

	1988	1987	1986
			(in thousands)
Net earnings for the year as reported	**$134,440**	$ 93,075	$ 70,182
Add (deduct):			
Investment tax credits	**(5)**	(3,000)	(5,800)
Restatement of inventory of concentrates awaiting shipment at lower of cost and market	**7,955**	7,827	891
Net earnings for the year (adjusted on a U.S. basis)	**$142,390**	$ 97,902	$ 65,273

The net earnings for 1988 include an extraordinary gain of $19.7 million and the net earnings for 1986 include an extraordinary loss of $19.7 million; such gains and losses would not be classified as extraordinary under the accounting principles generally accepted in the United States.

Also, the Statement of Financial Accounting Standard No. 96 — Accounting for Income Taxes — has not been adopted in the preparation of these financial statements. The impact of not adopting this accounting principle is not readily determinable.

15. Interest (net)

	1988	1987	1986
			(in thousands)
Interest on demand bank loans	**$ 4,698**	$ 4,274	$ 4,106
Interest on long term debt	**29,234**	32,988	51,033
Interest capitalized	**—**	—	(28,745)
Investment and other income	**(32,103)**	(36,315)	(35,996)
Net interest expense (income)	**$ 1,829**	$ 947	$ (9,602)

16. Depreciation and Amortization

	1988	1987	1986
			(in thousands)
Plant and equipment	**$ 55,611**	$ 50,717	$ 55,863
Mining properties and preproduction expenditures	**12,605**	14,051	13,017
	$ 68,216	$ 64,768	$ 68,880

17. Income Taxes

Earnings before taxes and minority interests consist of:

	1988	1987	1986
			(in thousands)
Canadian	**$218,941**	$131,879	$124,853
Foreign	**30,017**	20,101	15,056
	$248,958	$151,980	$139.909

The timing differences giving rise to deferred taxes principally relate to depreciation and preproduction expenses and it is not practical to determine these amounts separately.

A reconciliation of the weighted average Canadian income tax rates and the effective rate of income and mining taxes is as follows (different rates of income tax apply to income from mining, manufacturing and other sources):

	1988	1987	1986
Weighted average Canadian income tax rates	**46.7%**	51.3%	50.4%
Increase (decrease) resulting from:			
Resource & depletion allowances net of provincial mining taxes	**(3.9)**	(6.0)	(7.1)
Inventory allowances	**—**	—	(.3)
Investment tax credits	**—**	(3.6)	(9.4)
Exempt income (a)	**(4.5)**	(3.2)	(3.6)
Foreign taxes	**3.5**	(5.7)	(3.6)
Other	**.4**	(2.9)	1.2
Effective rate of income and mining taxes	**42.2%**	29.9%	27.6%

(a) Exempt income principally relates to non-taxable dividends and capital gains.

The Corporation has approximately $174 million of non-capital loss carry forwards available for deduction against future taxable income; if unused these will expire between 1991 and 1993. At December 31, 1988, no recognition has been given in these financial statements to the potential future tax benefit which may result from the application of these losses.

18. Business Segment Data

The operations of the Corporation and its subsidiaries may be grouped into segments. The primary operations of each segment are as follows:

Business Segment	Operations
Underground mining	Underground mining and milling of uranium and potash.
Open pit mining	Beneficial partnership interest in open pit mining and milling of copper-molybdenum ore and joint venture interest in open pit mining and treatment of metallurgical coal represent the majority of this business segment. Open pit mining and milling of tin.
Steel manufacture	Manufacture of stainless and specialty steels.
Metals distribution	Marketing through service centres of stainless and specialty steels and other metal products.

Revenue from mine production and sales of steel and other products, by segment, are as follows (all are to customers outside the Corporation except for steel manufacture inter-segment sales):

	Year Ended December 31		
	1988	1987	1986
			(in thousands)
Underground mining	**$ 421,080**	$ 375,280	$ 389,247
Open pit mining	**291,431**	209,315	205,144
Steel manufacture	**523,462**	404,353	298,128
Steel manufacture inter-segment (a)	**58,955**	44,738	41,250
Metals distribution	**743,099**	543,608	465,396
	2,038,027	1,577,294	1,399,165
Inter-segment sales elimination	**(58,955)**	(44,738)	(41,250)
Consolidated	**$1,979,072**	$1,532,556	$1,357,915

(a) Inter-segment sales are accounted for at prices comparable to open market prices for similar products.

The operating profit (loss) of each segment is as follows:

	Year Ended December 31		
	1988	1987	1986
			(in thousands)
Underground mining	**$ 33,834**	$ 46,295	$ 76,191
Open pit mining	**114,286**	76,465	43,130
Steel manufacture	**63,821**	16,635	7,183
Metals distribution	**62,918**	25,972	18,453
Consolidation adjustment	**(5,230)**	220	(135)
Operating profit	**269,629**	165,587	144,822
Deduct:			
Exploration	**7,366**	3,663	5,071
Corporate expenses	**11,476**	8,997	9,444
Interest (net)	**1,829**	947	(9,602)
	20,671	13,607	4,913
Earnings before taxes and minority interests	**$ 248,958**	$ 151,980	$ 139,909

Operating profit is revenue less applicable operating expenses. In computing operating profit none of the following items has been deducted: exploration, general corporate expenses, interest expense (net of investment and other income) and minority interests in net earnings of subsidiaries.

During the last three years the following products contributed to consolidated revenue in the percentages shown (1987 restated for consistency):

	Year Ended December 31		
	1988	1987	1986
Uranium	**14%**	19%	26%
Stainless steels	**29**	26	22
Copper	**10**	8	8
Other	**47**	47	44
	100%	100%	100%

Identifiable assets of each segment are as follows:

	Year Ended December 31		
	1988	1987	1986
			(in thousands)
Underground mining	**$ 938,591**	$ 955,503	$ 977,067
Open pit mining (a)	**413,781**	476,151	434,232
Steel manufacture	**293,306**	251,602	235,923
Metals distribution	**327,316**	301,733	224,401
Consolidation adjustment	**(7,700)**	(2,029)	(1,829)
Segment identifiable assets (b)	**1,965,294**	1,982,960	1,869,794
General corporate assets (b)	**129,019**	99,142	164,352
Total assets	**$2,094,313**	$2,082,102	$2,034,146

(a) The Corporation's proportionate share of the partnership and joint venture liabilities amounts to $28.2 million in 1988, $30.2 million in 1987 and $45.3 million in 1986.

(b) Segment identifiable assets are those assets that are used in the operations of each segment. General corporate assets are principally cash and short term deposits and construction in progress.

Depreciation, depletion and amortization expense of each segment is as follows:

	Year Ended December 31		
	1988	1987	1986
			(in thousands)
Underground mining	**$ 34,407**	$ 36,316	$ 39,530
Open pit mining	**22,475**	18,665	20,568
Steel manufacture	**7,761**	7,190	6,447
Metals distribution	**3,129**	2,140	1,991
Segment depreciation, depletion and amortization expense	**67,772**	64,311	68,536
General corporate depreciation	**444**	457	344
Total depreciation, depletion and amortization expense	**$ 68,216**	$ 64,768	$ 68,880

Net capital expenditures of each segment including capitalized interest are as follows:

	Year Ended December 31		
	1988	1987	1986
			(in thousands)
Underground mining (a)(b)	**$ 22,958**	$ 10,404	$ 60,907
Open pit mining	**64,046**	35,516	8,302
Steel manufacture (a)	**17,764**	19,035	4,637
Metals distribution (a)	**8,008**	5,116	1,987
Segment capital expenditures	**112,776**	70,071	75,833
General corporate capital expenditures (c)	**209**	375	32,275
Total capital expenditures (net)	**$ 112,985**	$ 70,446	$ 108,108

(a) Includes expenditures on construction in progress.

(b) Underground mining capital expenditures are net of sales of housing units at Elliot Lake.

(c) Corporate capital expenditures include construction costs for the East Kemptville tin project in 1986.

The Corporation's domestic operations make export sales to various parts of the world and foreign operations are conducted by subsidiaries in three countries. Details of foreign and domestic revenue are as follows:

	Year Ended December 31		
	1988	1987	1986
			(in thousands)
Domestic operations (Canada)			
Revenue — Canadian customers	**$ 557,315**	$ 441,060	$ 439,112
Export revenue — customers (a)	**653,315**	525,187	483,811
— inter-segment	**17,401**	83,105	55,085
— total	**670,716**	608,292	538,896
	1,228,031	1,049,352	978,008
Foreign operations — United States, Australia and New Zealand	**768,442**	566,309	434,992
	1,996,473	1,615,661	1,413,000
Inter-segment sales elimination	**(17,401)**	(83,105)	(55,085)
Consolidated revenue	**$1,979,072**	$1,532,556	$1,357,915

(a) Export revenues from sales to customers outside the Corporation are as follows:

	Year Ended December 31		
	1988	1987	1986
			(in thousands)
Japan	**$ 180,497**	$ 180,512	$ 171,995
United States	**155,557**	132,979	115,453
United Kingdom	**99,541**	85,478	89,470
Other countries	**217,720**	126,218	106,893
	$ 653,315	$ 525,187	$ 483,811

Operating profit by domestic and foreign operations is as follows:

	Year Ended December 31		
	1988	1987	1986
			(in thousands)
Domestic (Canada)	**$ 239,426**	$ 146,302	$ 126,066
Foreign	**30,203**	19,285	18,756
Operating profit of segments	**$ 269,629**	$ 165,587	$ 144,822

Identifiable assets of the Corporation's foreign operations totalled $361.4 million, $376.2 million and $306.4 million at December 31, 1988, 1987 and 1986 respectively.

19. Related Party Transactions

During the year ended December 31, 1988 the Corporation sold to an affiliated corporation, at competitive prices and terms, a quantity of uranium in concentrates for U.S.$7.0 million (1987 — U.S.$9.1 million; 1986 — U.S.$10.7 million) of which U.S.$1.3 million remained unpaid at December 31, 1988 (December 31, 1987 — U.S.$1.2 million; December 31, 1986 — U.S.$0.5 million).

20. Subsequent Event

Effective January 17, 1989, the Corporation concluded an agreement to acquire the uranium properties owned by Kerr-McGee in Wyoming and all the issued and outstanding shares of Quivira Mining Company ("Quivira"), formerly a wholly-owned subsidiary of Kerr-McGee, for a cash consideration of U.S.$28.5 million. In addition, the Corporation has guaranteed certain reclamation liabilities of Quivira up to a maximum of U.S.$25.8 million.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Financial Condition

Liquidity and Capital Resources

There was an overall increase in Rio Algom's financial strength during 1988.

Cash from operations of $267.4 million and $34.1 million of cash on hand at December 31, 1987 were used to fund: capital expenditures of $113.0 million; the reacquisition of the East Kemptville tin mine for $39.4 million; the cash distribution of $57.7 million as part of the reorganization of Lornex; dividends of $39.3 million; repayments of long-term debt and other obligations of $42.9 million; repayments to Ontario Hydro of $5.1 million and the purchase and cancellation of preference shares amounting to $4.1 million.

Working capital decreased during 1988 by $39.6 million to $625.8 million at December 31, 1988, principally as a result of the reorganization of Lornex. Cash and short-term deposits at December 31, 1988 amounted to $187.2 million, the current ratio was 2.5:1 and the debt-equity ratio, exclusive of limited recourse loans, advances from Ontario Hydro and current liabilities, increased to 1:10 from 1:7 at the end of 1987.

The Corporation's healthy liquid position, strong internal cash flow, existing credit facilities, and new financing capacity are expected to provide the funds needed to meet anticipated capital expenditures, dividends and working capital requirements for 1989, as well as the financial resources that may be required to pursue new ventures.

Results of Operations

Summary

The following table provides an analysis of the Corporation's consolidated revenue and operating profit by business segment and consolidated net earnings for each of the three years in the period ended December 31, 1988:

	1988	1987	1986
			(in millions)
Revenue:			
Underground mining	**$ 421.1**	$ 375.3	$ 389.2
Open pit mining	**291.4**	209.3	205.1
Steel manufacture	**582.4**	449.1	339.4
Metals distribution	**743.1**	543.6	465.4
Inter-segment elimination	**(58.9)**	(44.7)	(41.2)
	$1,979.1	$1,532.6	$1,357.9
Operating profit (loss):			
Underground mining	**$ 33.8**	$ 46.3	$ 76.2
Open pit mining	**114.3**	76.5	43.1
Steel manufacture	**63.8**	16.6	7.2
Metals distribution	**62.9**	26.0	18.4
Consolidation adjustment	**(5.2)**	.2	(.1)
	$ 269.6	$ 165.6	$ 144.8
Consolidated net earnings	**$ 134.4**(a)	$ 93.1	$ 89.9(b)

(a) includes $19.7 million benefit realized from utilization of prior years' tax losses.

(b) includes extraordinary write-off of $19.7 million for the East Kemptville tin project.

For further business segment information see note 18 to the consolidated financial statements. Reference is also made to note 14 to the consolidated financial statements for a description of the effect on consolidated net earnings of applying United States generally accepted accounting principles.

Revenue

Underground Mining

The $45.8 million increase in underground mining revenue, or 12% over 1987, is attributable to the potash operations and was due to significantly higher sales prices. 1988 uranium revenue was slightly lower than the previous year, the result of marginally lower production and a stronger Canadian dollar.

1987 revenue from underground mining operations decreased by $13.9 million or 4% from 1986 — the net result of lower uranium revenues more than offsetting increased potash revenues. The latter resulted from the Sussex potash mine being in commercial production for all of 1987, compared with only the last two months of 1986. Uranium revenues were adversely affected by lower production at both Elliot Lake and Lisbon. At Elliot Lake, the lower level reflected reduced production and deliveries to Ontario Hydro and the effects of a nineteen day strike.

Open Pit Mining

1988 net revenue from open pit mining was higher by $82.1 million or 39% compared with the previous year. The increase was primarily due to sharply higher copper prices and the inclusion of revenue from the East Kemptville tin mine from the date of its acquisition on March 1, 1988.

Net revenue from open pit mining operations during 1987 increased by $4.2 million or 2% from 1986. Production of copper concentrates during 1987 was lower than in 1986, but copper prices were significantly higher. The two years, however, are not strictly comparable due to a change in the nature of the operations; the 1987 financial results reflect Lornex's 45% interest in Highland Valley Copper, a partnership formed effective July 1, 1986, whereas the 1986 fiscal year included 100% of Lornex's own copper-molybdenum operation for the first six months, and its 45% interest in Highland Valley Copper for the last six months of the year. Coal revenues were somewhat lower in 1987 than in 1986.

Steel Manufacture

Revenue from steel manufacturing increased by $133.3 million or 30% over that recorded in 1987. This reflects higher sales volume and prices which occurred as a result of the strong demand experienced by the industry in the current year.

1987 revenue from steel manufacturing increased by $109.7 million or 32% over the 1986 level. AL Tech, acquired on July 1, 1986, contributed the majority of the increase through the inclusion of a full year's revenue in 1987 compared with only six months' revenue in the previous year. Atlas Stainless Steels also achieved a significant growth in revenues in 1987 over 1986, reflecting both increased volume and higher prices.

Metals Distribution

Revenue from the metals distribution businesses increased by $199.5 million or 37% over 1987. This is attributable to higher sales volume and prices and the inclusion of the 1987 Australian acquisitions for the first full year.

1987 revenue from metals distribution was $78.2 million or 17% higher than in 1986. This reflected both increased volume and prices in the four market areas — Canada, the United States, Australia and New Zealand. In addition, the Australian operations had substantially higher revenues in the last two months of the year, resulting from acquisitions which took place on October 30, 1987.

Operating Profit by Segment

Underground Mining

The 1988 operating profit from underground mining declined by $12.5 million or 27% from the 1987 level. An operating profit by the potash operations, due to higher sales prices, compared with a loss in 1987 was offset by lower uranium profits. The uranium operations were adversely affected by a substantial decline in the uranium spot market price necessitating an inventory valuation adjustment at the Lisbon mine (which closed in September due to the exhaustion of ore reserves), as well as the continued provisions for long-term reclamation costs.

1987 operating profit from underground mining declined by $29.9 million or 39% from 1986. The principal factors responsible were the decline in uranium revenue, referred to above, and certain non-recurring expenses at PCA's Saskatoon mine following the cessation of conventional underground mining because of flooding.

Open Pit Mining

The operating profit from open pit mining increased by $37.8 million or 49% over 1987. This reflects sharply higher copper prices at Highland Valley Copper, offset somewhat by an operating loss at the East Kemptville tin mine due to low world tin prices.

Operating profit from open pit mining in 1987 increased to $76.5 million from $43.1 million in 1986. While, as already noted, the results are not strictly comparable, higher copper prices and lower operating costs at Highland Valley Copper were the key elements that were responsible for the improved level of operating profit.

Steel Manufacture

The steel manufacturing operations recorded an operating profit during 1988 of $63.8 million, which is almost four times the earnings in the previous year. This is due to the increased sales volume and prices noted above.

Steel manufacturing had an operating profit of $16.6 million in 1987, compared with $7.2 million in 1986. The improvement reflects better trading margins for stainless steel produced by Atlas Stainless Steels and the continuing rationalization of operations at the AL Tech facilities. These favourable factors more than offset Atlas Specialty Steels' inability to offset significant increases in raw material costs by higher selling prices.

Metals Distribution

Operating profits from metals distribution during 1988 increased to $62.9 million, more than twice the 1987 level. This reflects improved gross profit margins at all operations and the inclusion of the 1987 Australian acquisitions for the first full year. Significant increases to inventory reserves were recorded during the year by Vincent Metals in the United States due to the LIFO method of accounting.

Metals distribution operating profit in 1987 at $26.0 million was 41% higher than the $18.4 million recorded in the previous year, reflecting the increased sales revenues referred to above, and effective control of operating costs. The largest proportion of this increase was earned by the Australian operation. The operating profit recorded in Canada by Atlas Alloys was also significantly higher. Vincent Metals in the United States returned lower operating profits compared with 1986, due solely to increased costs of materials for resale towards the end of the year being reflected in cost of sales for the entire year under LIFO accounting.

Consolidated Net Earnings

The 1988 operating profits of the business segments increased by $104.0 million or 63% over the previous year. Inclusive of the extraordinary gain, 1988 consolidated net earnings were $41.3 million or 44% higher than in 1987. Net interest costs increased by $0.9 million, minority interests were $15.5 million higher, corporate and exploration expenses increased by $6.2 million and income and mining taxes were higher by $59.7 million.

1987 segment consolidated operating profit of $165.6 million increased by $20.8 million or 14% from 1986. 1987 consolidated net earnings of $93.1 million were $3.2 million higher than the earnings before extraordinary items recorded in 1986, of $89.9 million. Corporate and exploration expenses were $1.9 million lower, net interest expense was $10.5 million higher, minority interests increased by $2.0 million and income and mining taxes were $6.9 million higher.

Impact of Inflation and Changing Prices

The major effect of inflation during the last three years on underground mining operations was on operating costs; during the period cost escalation has been less than average inflation rates. To a large extent the effects of inflation were ameliorated by the fact that a significant part of uranium production is for delivery under contracts which contain protective mechanisms designed to substantially offset such increases.

The effect of inflation on open pit mining revenues in the years 1986 to 1988 inclusive was minimal because realization prices are based on world market prices for copper and molybdenum. While these prices declined during 1986, they increased in both nominal and real terms during 1987 and 1988. Increases in operating and other costs have been lower than average inflation rates during 1986 and 1987 due to strict cost control measures and, to a lesser extent, to lower prices for materials and services as a result of competition among suppliers. The increase in operating costs during 1988 have generally been in line with the average inflation rate.

The steel manufacturing operations experienced substantial increases in costs of raw materials during the latter part of 1987 and during 1988. However, in the case of Atlas Stainless Steels in 1987, and for all three operations during 1988, it was possible to pass these increased costs on in the form of increased selling prices and raw material surcharges.

Through the early part of 1987 the metals distribution operations experienced relatively little change in metals prices. However, the supply situation gave rise to a significant escalation in the cost and selling prices of most metals during the second half of 1987 and throughout 1988.

Quarterly Financial Data

	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	Year
	(Unaudited, in millions except per share data)				
1988					
Revenue	$464.9	$511.0	$474.1	$529.1	$1,979.1
Gross profit	104.6	125.0	108.6	158.4	496.6
Net earnings	26.4	33.7	30.0	44.3	134.4
Earnings per common share					
— Before extraordinary item	0.60	0.68	0.52	0.77	2.57
— Net earnings	0.60	0.75	0.68	0.99	3.02
1987					
Revenue	$363.9	$395.1	$352.1	$421.5	$1,532.6
Gross profit	83.5	93.1	75.0	114.0	365.6
Net earnings	16.2	22.0	15.1	39.8	93.1
Earnings per common share	0.36	0.50	0.34	0.92	2.12

Exchange Rates

The following table shows the exchange rate of Canadian currency into United States currency at year end on December 31, the average rate and the range of high and low rates for the years ended on that date:

		Year		
	At Year End	Average	High	Low
1988	$0.8384	$0.8155	$0.8433	$0.7698
1987	$0.7691	$0.7542	$0.7712	$0.7254
1986	$0.7241	$0.7196	$0.7331	$0.6954
1985	$0.7150	$0.7308	$0.7575	$0.7130
1984	$0.7566	$0.7710	$0.8054	$0.7492

Ten Year Review

	1988(i)	1987(ii)
Earnings (millions of dollars)		
Revenue	**$1,979.1**	$1,532.6
Investment and other income	**32.1**	36.3
	2,011.2	1,568.9
Cost of mine production and steel sales	**1,482.5**	1,167.0
Selling, general and administration	**170.2**	144.2
Interest expense	**33.9**	37.2
Depreciation and amortization	**68.2**	64.8
Exploration	**7.4**	3.7
	1,762.2	1,416.9
Earnings before taxes and minority interests	**249.0**	152.0
Income and mining taxes	**105.2**	45.4
	143.8	106.6
Minority interests in net earnings (loss) of subsidiaries	**29.1**	13.5
Extraordinary item	**19.7**	—
Net earnings(vii)	**$ 134.4(iii)**	$ 93.1
Production Data (millions except potash, coal and steel)		
Uranium in concentrate (pounds)	**6.5**	7.0
Potash (thousands of tons)	**608**	671(ii)
Copper in concentrate (pounds)	**160.0**	155.4
Molybdenum in concentrate (pounds)	**1.83**	2.75
Coal (thousands of tonnes)	**647**	663
Tin in concentrate (pounds)	**6.84(viii)**	—
Steel (thousands of tons)	**246**	241
Financial Data (millions of dollars except per share data)		
Per common share		
Net earnings(vii)	**$ 3.02**	$ 2.12
Dividends	**0.70**	0.65
Equity	**18.92**	16.74
Working capital	**625.8**	665.4
Plant and equipment	**715.3**	670.5
Total assets	**2,094.3**	2,082.1
Return on average total assets	**6.31%**	4.39%
Redeemable preference shares	**35.1**	36.1
Long term debt	**243.9**	270.6
Advances from Ontario Hydro	**307.5**	312.6
Capital expenditures	**113.0**	70.4
Common shareholders' equity	**827.4**	713.6
Return on average common shareholders' equity	**17.1%**	13.2%
Other Data		
Common shares outstanding (millions)	**43.7**	42.6
Number of employees	**7,926**	7,981
Price range of common shares — high	**$ 25.00**	$ 25.50
— low	**$ 18.25**	$ 15.50

(i) Includes 10 months' operations at Rio Kemptville Tin Corporation, a wholly owned subsidiary.

(ii) Includes 2 months' operations of Atlas Steels Limited, a 55.9% owned Australian subsidiary, and production until February 4, 1987 at PCA's Saskatoon mine.

(iii) 1988 — $114.8 million ($2.57 per common share) before extraordinary item; 1986 — $89.9 million ($2.04 per common share) before extraordinary item.

(iv) Includes 11 months' operations of PCA (2 months only at Sussex) and 6 months' operations of AL Tech.

(v) Includes 9 months' operations of Vincent Metals, a United States service centre business.

(vi) The accounts of the United States subsidiaries are not included in the data for 1979 and earnings of those subsidiaries amounting to $3.5 million for that year have been included in the net earnings for 1980.

(vii) Net earnings (in millions of dollars) and net earnings per common share (in parenthesis) as reported adjusted to reflect the application of U.S. generally accepted accounting principles are: 1988 — $142.4 ($3.21); 1987 — $97.9 ($2.23); 1986 — $65.3 ($1.46); 1985 — $87.6 ($1.98); 1984 — $76.9 ($1.72); 1983 — $37.6 ($0.80); 1982 — $31.2 ($0.64); 1981 — $74.8 ($1.66); 1980 — $85.9 ($1.93) and 1979 — $82.7 ($1.84). See note 14 to consolidated financial statements.

1986[iv]	1985	1984[v]	1983	1982	1981	1980[vi]	1979[vi]
$1,357.9	$1,226.9	$1,141.8	$ 779.7	$ 760.2	$ 918.3	$ 847.5	$ 710.7
36.0	29.7	22.8	25.0	22.3	16.2	20.3	7.5
1,393.9	1,256.6	1,164.6	804.7	782.5	934.5	867.8	718.2
1,033.9	914.0	867.1	586.0	614.1	654.2	568.7	433.5
119.7	101.6	88.5	59.0	67.7	74.0	63.3	47.1
26.4	23.5	30.4	14.8	16.0	16.3	12.5	11.7
68.9	70.5	71.8	58.8	58.7	55.4	51.0	38.1
5.1	11.2	5.6	7.0	9.9	12.7	10.7	9.1
1,254.0	1,120.8	1,063.4	725.6	766.4	812.6	706.2	539.5
139.9	135.8	101.2	79.1	16.1	121.9	161.6	178.7
38.6	39.8	28.3	27.1	1.9	48.7	63.3	84.6
101.3	96.0	72.9	52.0	14.2	73.2	98.3	94.1
11.4	7.7	(1.0)	.9	(3.6)	7.4	20.8	18.4
(19.7)	—	—	—	—	—	—	—
$ 70.2[iii]	$ 88.3	$ 73.9	$ 51.1	$ 17.8	$ 65.8	$ 77.5	$ 75.7
8.2	8.1	8.2	6.8[viii]	7.1	7.8	7.9[viii]	5.5
861[iv]	—	—	—	—	—	—	—
172.1[viii]	210.6	186.2	181.7	194.6	164.7[viii]	126.3	134.2
6.2[viii]	7.6	7.5	7.5	6.3	4.8	4.8	4.4
693	858	692[viii]	—	—	—	—	—
—	—	—	—	—	—	—	—
217	179	188	144	133	212	180	193
$ 1.58[iii]	$ 2.00	$ 1.65	$ 1.11	$ 0.33	$ 1.45	$ 1.73	$ 1.67
0.65	0.60	0.55	0.50	0.50	0.50	0.50	0.50
15.43	14.59	13.09	11.90	11.29	11.46	10.50	9.27
710.1	591.1	526.1	424.5	323.8	315.9	285.2	221.3
676.3	650.8	689.7	677.9	450.8	459.3	343.8	347.5
2,034.1	1,833.7	1,697.5	1,587.5	1,355.7	1,240.8	1,061.3	898.8
3.47%	4.82%	4.28%	3.48%	1.37%	5.72%	7.91%	9.34%
16.0	16.8	18.7	45.3	45.5	47.8	48.7	53.0
349.0	283.4	240.3	225.7	149.6	98.8	105.5	93.1
321.9	337.1	353.4	351.5	259.5	162.2	82.7	28.6
108.1	110.1	42.5	165.7	195.6	176.3	182.2	121.0
658.3	622.2	558.1	507.6	481.7	488.8	448.0	395.6
10.50%	14.43%	13.22%	9.60%	2.89%	13.23%	17.53%	19.43%
42.6	42.6	42.6	42.6	42.6	42.6	42.6	42.6
8,068	7,347	7,408	6,847	6,431	7,811	7,378	6,878
$ 28.00	$ 25.50	$ 22.75	$ 20.66	$ 13.58	$ 13.96	$ 13.92	$ 13.33
$ 19.00	$ 19.375	$ 14.00	$ 12.50	$ 8.92	$ 10.25	$ 8.58	$ 8.58

(viii) (a) The Panel uranium mine commenced operations in November 1979.
(b) The expanded Lornex facilities commenced operations in August 1981.
(c) The Stanleigh uranium mine commenced operations in July 1983.
(d) The Bullmoose metallurgical coal mine, in which Rio Algom has a 29% joint venture interest, commenced operations in January 1984.
(e) Highland Valley Copper, a partnership of Rio Algom, Cominco Ltd. and Highmont Mining Company, in which Rio Algom has a 34% beneficial interest, commenced operations in July 1986.
(f) The East Kemptville tin mine was re-acquired March 1, 1988.

Market Price Range of Common Shares and Dividends Paid

The following tables show the high and low prices for Rio Algom common shares on:

The Toronto Stock Exchange

	1988	1987
First Quarter	C$23.375 - 18.25	C$25.50 - 20.50
Second Quarter	25.00 - 20.50	24.50 - 20.50
Third Quarter	24.25 - 20.50	24.00 - 20.75
Fourth Quarter	24.50 - 20.25	23.50 - 15.50

The American Stock Exchange

	1988	1987
First Quarter	US$18.125 - 14.00	US$19.25 - 15.125
Second Quarter	20.375 - 16.625	18.75 - 15.625
Third Quarter	20.00 - 17.125	18.25 - 15.875
Fourth Quarter	20.625 - 16.50	18.00 - 12.00

Dividends paid per common share during 1988 and 1987:

December 5, 1988	C$0.3750
May 31, 1988	C$0.3250
November 30, 1987	C$0.3250
June 1, 1987	C$0.3250

At December 31, 1988 there were 5,935 registered holders of record of the common shares of the Corporation. In recent years, Rio Algom has paid common share dividends on a semi-annual basis. The payment of such dividends in future years must necessarily be determined by the Board of Directors of the Corporation in the light of future earnings, financial requirements and other relevant factors. Restrictions on the payment of dividends are contained in the provisions of the Rio Algom First Preference Shares Series A and Rio Algom Second Preference Shares Series A and Series C. These documents have been filed at the offices of the Securities & Exchange Commission in Washington, D.C.

All non-residents receiving dividends from Rio Algom are subject at the source to 25% Canadian Non-Resident Withholding Tax unless the rate is reduced by tax treaty (e.g. U.S.A. rate is 15% unless recipient owns at least 10% of the voting stock of the company when the rate is 10%).

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Bernard J. Macho
Managing Director

Directors and Corporate Officers

Directors

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Vice-Chairman of the Corporation

J. Derek Birkin
Chief Executive and Deputy Chairman, The RTZ Corporation PLC, London, England

James T. Black
Honorary Chairman, The Molson Companies Limited, a brewing, retail distribution and chemical specialties company, Toronto

William E. Bradford
President and Chief Executive Officer, North American Life Assurance Company, Toronto

Arthur F. Earle
Management and Economic Consultant, Toronto

Sir Alistair Frame
Chairman, The RTZ Corporation PLC, London, England

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Chairman, Royal LePage Limited, a diversified real estate services company, Toronto

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Chairman of the Corporation and Chairman, Genstar Investment Corporation, San Francisco, California, U.S.A.

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Chairman

Ray W. Ballmer
Vice-Chairman

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President and Chief Operating Officer

Stanley B. Kerr
Senior Vice-President, Finance and Corporate Relations

John A. H. Bush
Vice-President, Secretary

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Vice-President, Treasurer

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Vice-President, General Counsel

Alan F. Lowell
Vice-President, Minerals Marketing

C. Kelly O'Connor
Vice-President, Exploration

Forbes L. West
Vice-President, Human Resources

Corporate Information

Auditors

Coopers & Lybrand
Chartered Accountants
Toronto, Ontario

Registrars and Transfer Agents

Common Shares

The Montreal Trust Company of Canada
Toronto, Montreal, Winnipeg, Regina, Calgary and Vancouver

Canadian Imperial Bank of Commerce
(New York), New York, NY

First Preference Shares Series A
Second Preference Shares Series A and Series C

The Montreal Trust Company of Canada
Toronto, Montreal, Halifax, Winnipeg and Vancouver

Shares Listed

Common Shares (symbol ROM)

Toronto Stock Exchange
Montreal Exchange
American Stock Exchange

First Preference Shares Series A (symbol ROM.PR.A)
Second Preference Shares Series A (symbol ROM.PR.B)

Toronto Stock Exchange
Montreal Exchange

Second Preference Shares Series C (symbol ROM.PR.C)

Toronto Stock Exchange

Form 10-K Annual Report

Rio Algom's Form 10-K annual report for 1988 to the United States Securities and Exchange Commission will be available to shareholders on request to the Secretary, Rio Algom Limited, Suite 2600, 120 Adelaide Street West, Toronto, Ontario M5H 1W5, Canada — Tel. (416) 367-4000 or FAX 416-365-6870.

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Printed in Canada