ANNUAL REPORT

1986

ALUMINUM COMPANY OF CANADA, LIMITED

ALCAN

GENERAL INFORMATION

10-K Report

A copy of the Company's current annual 10-K Report filed with the United States Securities and Exchange Commission will be available after April 1 upon written request to the Secretary of the Company.

Terms

Unless otherwise stated, all amounts are reported in United States dollars and all quantities are in metric tons, or 'tonnes'. A tonne is 1,000 kilograms, or 2,204.6 pounds.

'Parent company' means Alcan Aluminium Limited.

'Subsidiary' means a company in which Aluminum Company of Canada, Limited owns more than 50% of the voting stock.

'Related company' means a subsidiary of the parent company, or a company in which the parent company owns 50% or less of the voting stock and has significant influence over management, or a company in which Aluminum Company of Canada, Limited owns 50% or less of the voting stock and has significant influence over management.

Version Française

Pour obtenir la version française de ce rapport, veuillez écrire à : Aluminium du Canada, Limitée, 1188, rue Sherbrooke Ouest, Montréal, (Québec) H3A 3G2

PRESIDENT'S MESSAGE

Net income rose to $154 million from a loss of $119 million in 1985. The year-ago loss includes special charges and rationalization expenses of $168 million after tax. Net income for both years is before preferred dividends of $33 million. This improvement in earnings is largely due to three factors.

Average realizations on ingot products were 11% higher than the very low levels of 1985.

Shipments of fabricated products, which have higher average margins than do ingot products, rose 5% to 725,000 tonnes from 693,000 tonnes. The Company continued to strengthen its position in key markets and has benefitted from the integration of facilities acquired in 1985 from Atlantic Richfield Company (ARCO).

Most importantly, the Company also realized the benefits from the cost reduction programs initiated in early 1985. The total number of employees, adjusted for acquisitions and disposals, has been reduced by over 2,500, and the management structure has been simplified. The level of operating working capital and hence related financing charges have also been lowered. By these and other steps in 1985 and 1986, the Company has reduced annual pre-tax costs by over $150 million from what they would otherwise have been. In addition, the Company has begun to rationalize rolling operations in the U.S. and Canada and will continue this program in 1987.

Following a strike, unionized employees at the Sebree, Kentucky, smelter ratified a new three-year contract. However, the strike resulted in the closure of one of the plant's three 54,000 tonnes per year potlines. The timing of its reopening will depend upon market conditions. Prior to the strike, two of the lines had been operating.

The Company's strategy of cutting costs, rationalizing operations, and developing its position in selected markets for fabricated products has already improved its earnings potential. In 1987, the Company is continuing to pursue this strategy.

D Morton

David Morton
President and Chief Executive Officer

Montreal, Canada
February 4, 1987

MANAGEMENT'S DISCUSSION AND ANALYSIS

RESULTS OF OPERATIONS

Production of primary aluminum declined by 3% to 1,126,000 tonnes, largely due to the closure of one line at the Sebree smelter. Shipments of aluminum in all forms totalled 1,338,000 tonnes as against 1,439,000 tonnes in 1985, which included the sale of inventory acquired from ARCO. During the year inventories declined by 49,000 tonnes to 288,000 tonnes at year-end.

Average ingot realizations improved over 1985, while average realizations for fabricated products were lower. However, costs for both ingot and fabricated products were reduced and, as a result, margins on sales of fabricated and ingot products were higher than in 1985.

Interest charges for the year totalled $88 million compared to $95 million in 1985. Of these amounts, $5 million and $16 million respectively were capitalized.

LIQUIDITY AND CAPITAL RESOURCES

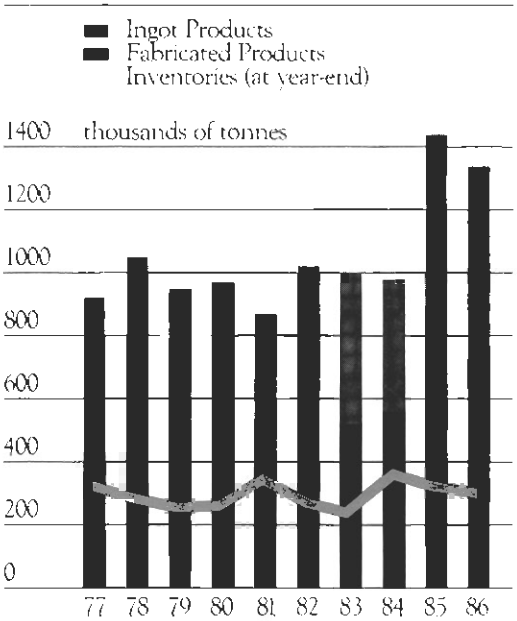
Cash generation from operations rose to $519 million from $381 million in 1985, largely as a result of improved earnings.

Dividends on preferred and common shares were $33 million and $38 million respectively, compared to $33 million and $5 million a year ago.

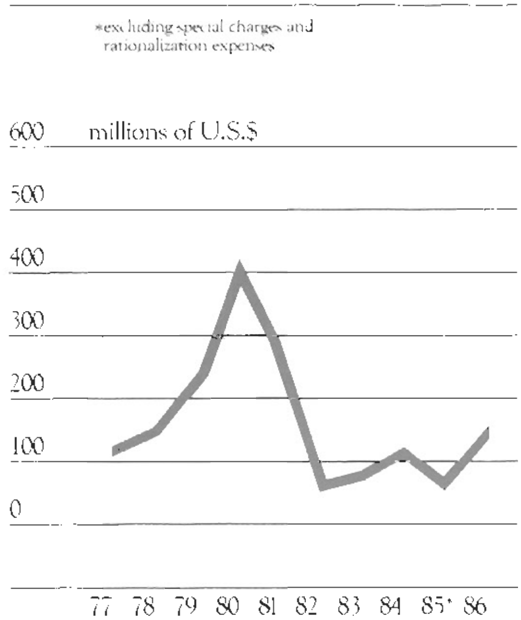
Capital expenditures and investments net of disposals were $145 million, compared to $155 million in 1985 excluding the acquisition of certain assets from ARCO and from the parent company.

The Company made considerable progress in strengthening its financial position. Total borrowings were reduced by $381 million. In addition, the Company extended the average term of debt, reduced interest costs, and lowered the amount of floating rate debt in proportion to total borrowings.

ALUMINUM SHIPMENTS AND INVENTORIES



NET INCOME



During the year, $100 million of 12-year debentures, and CAN$75 million of cumulative redeemable preference shares were issued. The Company also issued $69 million in common shares to the parent. In January 1987, the Company issued SFr 178 million of 16-year bonds, which were subsequently swapped into U.S. dollars.

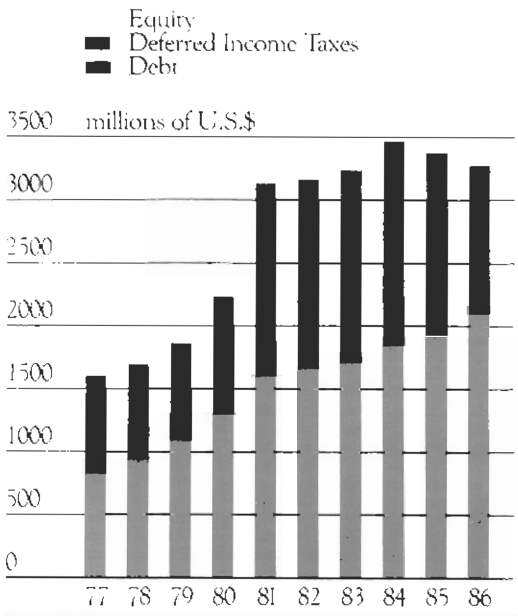
The Company redeemed CAN$49 million of 1994 and $47 million of 1995 sinking fund debentures, as well as $20 million of 1988 debentures. The Company also redeemed $33 million of preferred shares. In January 1987, CAN$24 million of 1991 sinking fund debentures were redeemed.

The Company had $421 million of preferred shares outstanding at the end of the year, of which $203 million were non-retractable.

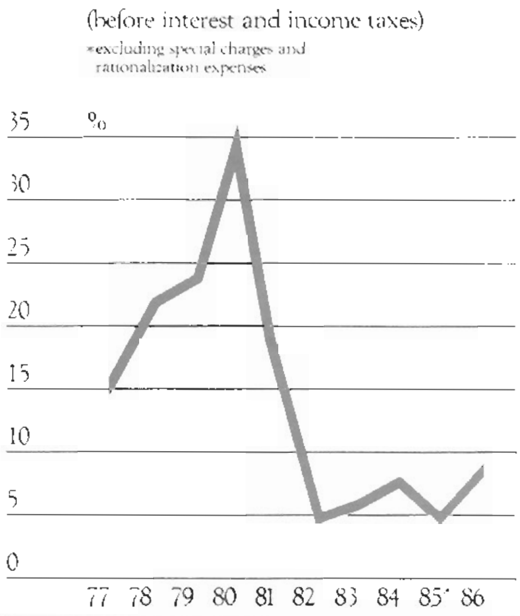
At year-end, the ratio of total debt (including short-term borrowings and a demand loan from the parent company) to equity (including preferred shares) was 24:76 compared with 35:65 at the end of 1985. Including deferred income taxes with equity, the ratio was 21:79 at the end of 1986, and 31:69 at the end of 1985.

During the year, the Company reduced term credit lines with banks by $350 million while arranging a $120 million note issuance facility. At year-end the Company's term credit lines with banks totalled $420 million and CAN$200 million, none of which were utilized. In addition, the Company's U.S. subsidiary reduced its revolving credit facilities by $100 million to $200 million, of which none were utilized at year-end.

CAPITAL EMPLOYED



RETURN ON CAPITAL EMPLOYED



QUARTERLY FINANCIAL DATA
(Unaudited)

(in millions of U.S. $)	**1986**			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Sales and operating revenues	**$ 794**	**$ 874**	**$ 821**	**$ 792**
Gross profit	**92**	**167**	**147**	**131**
Net income	**14**	**57**	**49**	**34**
	1985			
Sales and operating revenues	$ 782	$ 902	$ 847	$ 799
Gross profit	75	101	99	72
Net income (Loss)	5	(8)	19	(135)
	1984			
Sales and operating revenues	$ 703	$ 768	$ 707	$ 656
Gross profit	139	159	116	75
Net income	42	53	14	14

SALES BY MARKET

(in millions of U.S. $)	**1986**	1985	1984
Containers and packaging	**$ 802**	$ 678	$ 499
Transportation	**187**	191	183
Electrical	**327**	303	353
Building and construction	**477**	432	495
Other	**1,377**	1,593	1,216
	$3,170	$3,197	$2,746

CONSOLIDATED STATEMENT OF INCOME

Years ended December 31 *(in millions of U.S. $)*	**1986**	1985	1984
Revenues			
Sales *(note 4)*	**$3,170**	$3,197	$2,746
Operating revenues	**111**	133	88
Other income	**33**	49	30
	3,314	3,379	2,864
Costs and expenses			
Cost of sales and operating expenses *(note 4)*	**2,571**	2,815	2,186
Depreciation	**173**	168	159
Selling, administrative and general expenses	**171**	184	183
Research and development expenses	**56**	50	49
Interest *(note 15)*	**83**	79	79
Other expenses	**40**	31	27
	3,094	3,327	2,683
Income before special charges and rationalization expenses and income taxes	**220**	52	181
Special charges and rationalization expenses *(note 6)*	**—**	320	—
Income (Loss) before income taxes	**220**	(268)	181
Income taxes *(note 7)*	**66**	(149)	58
Net income (Loss) *(notes 2 and 3)*	**$ 154**	$ (119)	$ 123

Net income (Loss) per common share and average number of shares outstanding are not reported as all of the common shares are owned by Alcan Aluminium Limited.

CONSOLIDATED STATEMENT OF RETAINED EARNINGS

Years ended December 31 *(in millions of U.S. $)*	**1986**	1985	1984
Retained earnings – beginning of year	**$ 922**	$1,080	$1,029
Net income (Loss)	**154**	(119)	123
	1,076	961	1,152
Share issue expenses	**1**	1	1
Dividends			
Common	**38**	5	40
Preferred	**33**	33	31
	72	39	72
Retained earnings – end of year *(note 13)*	**$1,004**	$ 922	$1,080

CONSOLIDATED BALANCE SHEET

ASSETS

December 31 *(in millions of U.S. $)*	**1986**	1985	1984
Current assets			
Cash and time deposits	**$ 69**	$ 57	$ 190
Receivables	**474**	486	380
Inventories			
Aluminum	**407**	461	483
Raw materials	**187**	213	239
Other supplies	**172**	174	148
	1,309	1,391	1,440
Deferred charges and receivables	**95**	76	86
Investments	**70**	72	38
Property, plant and equipment			
Cost *(note 9)*	**4,717**	4,602	4,257
Accumulated depreciation	**2,115**	1,971	1,846
	2,602	2,631	2,411
Total assets	**$4,076**	$4,170	$3,975

CONSOLIDATED BALANCE SHEET

LIABILITIES AND SHAREHOLDERS' EQUITY

December 31 *(in millions of U.S. $)*	**1986**	1985	1984
Current liabilities			
Payables	**$ 403**	$ 361	$ 347
Demand loan from parent company *(note 4)*	**130**	141	423
Short-term borrowings (principally from banks)	**1**	60	91
Income and other taxes	**5**	16	18
Debt maturing within one year	**15**	14	15
	554	592	894
Debt not maturing within one year *(note 10)*	**528**	837	566
Deferred credits and other liabilities *(note 5)*	**180**	162	152
Provision for rationalization and related liabilities *(note 6)*	**226**	262	—
Deferred income taxes	**486**	389	542
Redeemable retractable preferred shares *(note 11)*	**218**	249	293
Redeemable non-retractable preferred shares *(note 12)*	**203**	149	112
Common shareholder's equity *(note 13)*			
Common shares	**677**	608	336
Retained earnings	**1,004**	922	1,080
	1,681	1,530	1,416
Commitments and contingencies *(note 14)*			
Total liabilities and shareholders' equity	**$4,076**	$4,170	$3,975

Approved by the Board: David Morton, Director
R.F. Shartatt, Director

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

Years ended December 31 *(in millions of U.S. $)*	1986	1985	1984
Operating activities			
Net income (Loss)	$ 154	$(119)	$ 123
Depreciation	173	168	159
Special charges and rationalization expenses	—	307*	—
Deferred income taxes	98	(151)	21
Operating working capital	125	194	(25)
Other – net	(31)	(18)	(3)
	519	381	275
Dividends	(71)	(38)	(71)
Cash from operating activities	448	343	204
Financing activities			
New debt	100	535	138
Debt repayments	(411)	(270)	(154)
Shorr-rerm borrowings – net	(70)	(313)	130
Preferred shares	54	37	112
Redemption of preferred shares	(33)	(34)	(34)
Common shares	69	272	—
Cash from financing activities	(291)	227	192
Total cash available before investment activities	157	570	396
Investment activities			
Property, plant and equipment	156	408	243
Investments	4	59	—
Operating working capital acquired	—	274*	—
Sales and disposals	(15)	(38)	(19)
Cash used for investment activities	145	703	224
Increase (Decrease) in cash and time deposits for the year	12	(133)	172
Cash and time deposits, beginning of year	57	190	18
Cash and time deposits, end of year	$ 69	$ 57	$ 190

Changes in operating working capital	1986	1985	1984
Receivables	$ (12)	$ 106	$ (61)
Inventories	(82)	(22)	116
Payables	(42)	(14)	(12)
Income and other taxes	11	2	(18)
Less: Operating working capital acquired	—	(274)*	—
Other	—	8	—
Increase (Decrease) for the year	$(125)	$(194)	$ 25

**Net of cash items*

NOTES TO FINANCIAL STATEMENTS
(in millions of U.S. $, except where indicated)

1. Summary of accounting policies

PRINCIPLES OF CONSOLIDATION

The consolidated financial statements, which are prepared in accordance with generally accepted accounting principles in Canada, include the accounts of all companies more than 50% owned. Joint ventures, irrespective of percentage of ownership, are included to the extent of the Company's participation. In addition, consolidated net income includes the Company's equity in the net income or loss of companies owned 50% or less where the Company has significant influence over management, and the investments in these companies are increased or decreased by the Company's share of their undistributed net income or loss since acquisition. Investments in companies in which the Company does not have significant influence over management are carried at cost less amounts written off.

Intercompany items and transactions, including profits in inventories, are eliminated.

TRANSLATION OF ACCOUNTS INTO UNITED STATES DOLLARS

The consolidated financial statements are expressed in U.S. dollars, the principal currency of international trade and of the Company's business, under translation procedures recommended by The Canadian Institute of Chartered Accountants (CICA).

Current assets (excluding inventories), current liabilities and long-term monetary assets and liabilities are translated at the rates of exchange at year-end. Other balance sheet items are translated at the rates prevailing at the respective transaction dates. Income statement items are translated at average rates prevailing during the year, except for the cost of inventories and for depreciation which are translated at rates prevailing when the related assets were acquired. Translation gains and losses are included in income except for unrealized gains and losses arising from the translation of long-term monetary assets and liabilities which are deferred and amortized over the remaining lives of the related items.

OTHER

Aluminum, raw materials, and other supplies are stated at cost (determined for the most part on the monthly average method) or net realizable value, whichever is the lower.

Depreciation is calculated on the straight-line method using rates based on the estimated useful lives of the respective assets.

2. Accounting changes

In 1986, the Company adopted the CICA's new recommendations on accounting for pension costs and obligations. The effect of this change, applied prospectively, was to increase net income for 1986 by $14. See also note 16.

Beginning in 1985, in accordance with the recommendations of the CICA, investment tax credits are accounted for using the cost reduction approach instead of the flow through approach used prior to 1985. Under the cost reduction approach investment tax credits are recognized over the same period as the related expenditures are charged to income principally through depreciation. Under the flow through approach, investment tax credits were generally recognized in income in the year that the related expenditures were made. Income for 1986 would have been increased by $2 and the loss for 1985 would have been reduced by $10 had the flow through approach been continued.

3. Currency translation

Currency translation gains included in income were $11 in 1986 ($15 in 1985 and $10 in 1984).

The currency translation recommendations of the CICA largely parallel those of the U.S. Financial Accounting Standards Board (FASB), with two principal exceptions. The first is the CICA recommendation to defer and amortize unrealized exchange gains and losses on long-term monetary items whereas the FASB recommends immediate absorption in income. The second exception is the CICA recommendation that deferred income taxes of companies using the temporal method be translated at historical exchange rates instead of current rates.

The following table compares results reported with those that would have been reported under the FASB method together with the cumulative effect on retained earnings:

	1986		1985		1984	
	As Reported	FASB Method	As Reported	FASB Method	As Reported	FASB Method
Consolidated net income (loss)						
First quarter*	**$ 14**	**$ 13**	$ 5	$ 16	$ 42	$ 53
Second quarter*	**57**	**56**	(8)	(14)	53	70
Third quarter*	**49**	**34**	19	14	14	14
Fourth quarter*	**34**	**31**	(135)	(126)	14	18
	154	**134**	(119)	(110)	123	155
Consolidated retained earnings – end of year	**$1,004**	**$1,099**	$ 922	$1,037	$1,080	$1,186

**Unaudited*

4. Related party transactions

Sales and cost of sales include transactions with related companies. Sales to related companies are disclosed under Information by geographic areas (note 17). Cost of sales includes purchases from related companies as follows:

	1986	1985	1984
Alumina	**$ 62**	$ 54	$103
Bauxite	**109**	106	94

The demand loan from the parent company bears interest at the Citibank N.A. prime rate less 0.5%, payable on the first day of the month following the end of each quarter. Interest charges for the last three years were waived by the parent company.

5. Deferred credits and other liabilities

Deferred credits include a prepayment by a related company under an alumina tolling arrangement of $56 in 1986 ($58 in 1985 and $61 in 1984), and unamortized net amounts of unrealized exchange gains of $13 in 1986 ($29 in 1985 and $39 in 1984).

6. Special charges and rationalization expenses

In 1985, the Company made provisions aggregating $320 to cover losses, asset write-downs and expenses related to several rationalization programs. Of this amount $94 has been utilized to the end of 1986 and the balance of $226 is expected to be utilized for rationalizations and write-downs of identified businesses.

7. Income taxes

	1986	1985	1984
Income (Loss) before income taxes			
Canada	**$ 222**	$(246)	$205
Other countries	**(2)**	(22)	(24)
	220	(268)	181
Current income taxes			
Canada	**(21)**	(9)	17
Other countries	**(11)**	11	20
	(32)	2	37
Deferred income taxes			
Canada	**89**	(146)	27
Other countries	**9**	(5)	(6)
	98	(151)	21
Total income tax provision	**$ 66**	$(149)	$ 58

The composite of the applicable statutory corporate income tax rates in Canada is 46.9% (44.9% in 1985 and 44.8% in 1984). Dividends paid by subsidiary companies are generally tax-exempt upon receipt in Canada. Taxes withheld at source are included in Current income taxes – Other countries. The following is a reconciliation of income taxes calculated at the above composite rates with the total income tax provision:

	1986	1985	1984
Income taxes at the composite rate	**$ 103**	$(120)	$ 81
Increase (Reduction) attributable to:			
Investment and other allowances	**(32)**	(27)	(40)
Prior years' tax adjustments	**2**	4	10
Other – net	**(7)**	(6)	7
Income tax provision	**$ 66**	$(149)	$ 58

The principal components giving rise to the deferred portion of income taxes are:

	1986	1985	1984
Depreciation	**$ 63**	$ (1)	$ (1)
Inventory valuation	**11**	(20)	(14)
Investment and foreign tax credits	**19**	7	51
Special charges and rationalization expenses	**—**	(152)	—
Other – net	**5**	15	(15)
	$ 98	$(151)	$ 21

8. Abatable preferred shares

Payment terms for assets acquired in January 1985 from Atlantic Richfield Company included contingent consideration in the form of abatable preferred shares with an initial total nominal value of $400. Of these, $40 have been fully abated and $360 continue to be outstanding. The outstanding shares will either qualify for dividend and redemption or be subject to abatement depending upon whether or not Alcan and three other designated aluminum producers realize certain specified prices for ingot products (ranging from $0.97 per pound to $1.99 per pound) in the years to 1994.

To the extent the shares are not abated, the qualifying amount will be reflected in the financial statements and a corresponding amount, together with a cumulative dividend of 9% per annum payable thereon, at the time the shares qualify, retroactive to the date of issue (January 18, 1985), will be added to the book value of the assets acquired and amortized against income over the remaining lives of the fixed assets acquired. Such qualifying shares are subject to retraction by the holder on January 18, 1997, but may be redeemed earlier at the option of the Company.

9. Property, plant and equipment

	1986	1985	1984
Land, and property rights	**$ 62**	$ 61	$ 60
Buildings, machinery and equipment	**4,504**	4,352	3,919
Construction work in progress	**151**	189	278
	$4,717	$4,602	$4,257

Capital expenditures are expected to total $220 in 1987.

10. Debt not maturing within one year

	1986	1985	1984
Bank loans under revolving credit agreement	**$ —**	$ 50	$ —
Bank loans under credit agreement	**—**	—	50
Notes payable (commercial paper)	**—**	116	66
Notes payable	**—**	120	—
9½% Sinking fund debentures	**—**	20	24
15¾% Eurodollar debentures, due 1992	**75**	75	75
14¼% Notes, due 1992	**100**	100	100
9½% Notes, due 1987/1994	**31**	34	38
9½% Sinking fund debentures	**—**	51	52
11¼% Debentures, due 1995	**100**	100	—
9⅞% Debentures, due 1998	**100**	—	—
9⅜% Sinking fund debentures, due 1991 (CAN$24)	**17**	19	29
9.956% Bank loan, due 1995	**25**	25	—
10¾% Sinking fund debentures	**—**	35	39
8¾% Loan, due 1987/1992 (£24)	**34**	40	37
Other debt, due 1987/2013	**61**	66	71
	543	851	581
Debt maturing within one year included in current liabilities	**(15)**	(14)	(15)
	$528	$837	$566

10. Debt not maturing within one year (cont'd)

The Company and its subsidiaries have a number of agreements for the purpose of assuring future credit availability, the most significant of which are:

A revolving credit agreement with a group of banks providing for loans up to $300 bearing interest at a rate equal to the base rate of Citibank, N.A. or rates related to the London interbank offered rate (LIBOR). Loans under this agreement are to be repaid in five annual instalments of 10%, 15%, 25%, 25% and 25%, beginning one year after May 1, 1989, the termination date of the credit agreement.

A revolving note issuance facility with a group of banks providing for the issue of five-year notes up to $120, bearing interest at a rate related to LIBOR.

Long-term credit agreements with banks amounting to CAN$200 available to back up notes payable (commercial paper) issued in Canada and the United States.

Long-term credit agreements amounting to $200 available to back up notes issued in the United States.

In January 1987, the Company issued SFr178 of 16-year bonds which have been swapped into $105 at an effective interest rate of 8.98%. The proceeds were used to repay debt.

Based on rates of exchange at year-end and after allowing for prepayments, sinking fund and other requirements over the next five years amount to $15 in 1987, $15 in 1988, $14 in 1989, $14 in 1990 and $14 in 1991.

11. Redeemable retractable preferred shares

AUTHORIZED

3,760,503 Cumulative Redeemable First Preferred Shares without nominal or par value, issuable in series. The first series consists of 1,760,503 CAN$2.00 Tax Deferred Cumulative Redeemable Retractable First Preferred Shares.

An unlimited number of Preference Shares without nominal or par value and issuable in series. Series A consists of 7,747,000 Cumulative Redeemable Retractable Preference Shares and series B consists of 1,842,700 Cumulative Redeemable Retractable Preference Shares.

OUTSTANDING	December 31		
	1986	1985	1984
First preferred – 1,760,503 shares (1985 – 1,760,503; 1984 – 1,762,203)	**$ 32**	$ 32	$ 33
Second preferred – redeemed during 1986	**—**	33	67
Preference, series A – 7,747,000 shares (1985 – 7,747,000; 1984 – 7,750,000)	**140**	138	147
Preference, series B – 1,842,700 shares (1985 – 1,842,700; 1984 – 1,850,000)	**46**	46	46
	$218	$249	$293

11. Redeemable retractable preferred shares (cont'd)

Outstanding shares are eligible for quarterly dividends as follows:

First preferred – CAN$2.00 per share per annum payable out of the Company's 1971 capital surplus.
Preference, series A – CAN$2.3125 per share per annum.
Preference, series B – U.S.$2.1875 per share per annum.

Retraction privileges which may be exercised at the option of holders of outstanding shares are as follows:

First preferred – At CAN$25.00 per share on June 1, 1988.
Preference, series A – At CAN$25.00 per share on December 31, 1989.
Preference, series B – At U.S.$25.00 per share on December 31, 1989.

The Company is obliged to make reasonable efforts to purchase in the open market for cancellation the following shares:

First preferred – 15,000 shares per quarter at a price not exceeding CAN$25.00 per share.
Preference, series A – 58,125 shares per quarter up to December 31, 1989 and thereafter 1% per quarter of the shares outstanding on January 1, 1990 at prices not exceeding CAN$25.00 per share.
Preference, series B – 13,875 shares per quarter up to December 31, 1989 and thereafter 1% per quarter of the shares outstanding on January 1, 1990 at prices not exceeding U.S.$25.00 per share.

The purchase obligations are cumulative only within each calendar year.

Outstanding shares may be called for redemption at the option of the Company as follows:

First preferred – On 30 days' notice at CAN$25.30 per share until November 30, 1987, after which the shares may be redeemed at CAN$25.00 per share.
Preference, series A – On 30 days' notice at CAN$26.25 per share during the twelve-month period commencing December 31, 1987 and reducing by CAN$0.25 per share in each of the succeeding twelve-month periods until December 31, 1992, after which the shares may be redeemed at CAN$25.00 per share.
Preference, series B – On 30 days' notice at U.S.$26.25 per share during the twelve-month period commencing December 31, 1987 and reducing by U.S.$0.25 per share in each of the succeeding twelve-month periods until December 31, 1992, after which the shares may be redeemed at U.S.$25.00 per share.

Any partial redemption must be made on a pro rata basis or by lot.

12. Redeemable non-retractable preferred shares

AUTHORIZED

An unlimited number of Preference Shares without nominal or par value and issuable in series. Series C consists of 5,700,000 Floating Rate Cumulative Redeemable Non-retractable Preference Shares of which 4,200,000 are 1984 series C Preference Shares and 1,500,000 are 1985 series C Preference Shares. Series D consists of 1,700,000 Floating Rate Cumulative Redeemable Non-retractable Preference Shares of which 1,300,000 are 1984 series D Preference Shares and 400,000 are 1985 series D Preference Shares. Series E consists of 3,000,000 Cumulative Redeemable Preference Shares.

12. Redeemable non-retractable preferred shares (cont'd)

OUTSTANDING	December 31		
	1986	1985	1984
Preference, series C – 5,700,000 shares (1985 – 5,700,000; 1984 – 4,200,000)	**$106**	$106	$ 79
Preference, series D – 1,700,000 shares (1985 – 1,700,000; 1984 – 1,300,000)	**43**	43	33
Preference, series E – 3,000,000 shares	**54**	—	—
	$203	$149	$112

Outstanding shares are eligible for quarterly dividends as follows:

Preference, series C – An amount determined by applying to CAN$25.00 per share one-quarter of the greater of (i) 72% of the average of the Canadian prime interest rates quoted by two major Canadian banks for stated periods, and (ii) the lesser of 7.5% and the average of the Canadian prime interest rates quoted by two major Canadian banks for stated periods.

Preference, series D – An amount determined by applying to U.S.$25.00 per share one-quarter of the greater of (i) 72% of the average of the U.S. prime interest rates quoted by two major Canadian banks for stated periods, and (ii) the lesser of 7.5% and the average of the U.S. prime interest rates quoted by two major Canadian banks for stated periods.

Preference, series E – An amount equal to CAN$0.54 in the case of dividends payable on or prior to October 31, 1991 and thereafter in an amount determined by applying to CAN$25.00 per share one-quarter of 75% of the average of the Canadian prime interest rates quoted by two major Canadian banks for stated periods.

Outstanding shares may be called for redemption at the option of the Company as follows:

Preference, series C – On 30 days' notice at CAN$26.50 per share during the twelve-month period commencing January 1, 1988 and reducing by CAN$0.30 per share in each of the succeeding twelve-month periods until December 31, 1992, after which the shares may be redeemed at CAN$25.00 per share.

Preference, series D – On 30 days' notice at U.S.$26.50 per share during the twelve-month period commencing January 1, 1988 and reducing by U.S.$0.30 per share in each of the succeeding twelve-month periods until December 31, 1992, after which the shares may be redeemed at U.S.$25.00 per share.

Preference, series E – On 30 days' notice at CAN$25.00 per share commencing November 1, 1991.

Any partial redemption must be made by lot.

The Company may at any time purchase for cancellation the whole or any part of the above shares at a price per share not exceeding CAN$26.50 for series C and U.S.$26.50 for series D if such purchase is made prior to January 1, 1988, and if such purchase is made thereafter, at a price per share not exceeding the then current redemption price and CAN$25.00 per share for series E, plus all accrued and unpaid dividends and costs of purchase.

13. Common shareholder's equity

COMMON SHARES

The authorized share capital is an unlimited number of common shares, without nominal or par value. The number of shares outstanding at December 31, 1986 was 14,549,452 (1985: 13,691,325; 1984: 11,480,712).

RETAINED EARNINGS

Consolidated retained earnings at December 31, 1986 include $481 which, pursuant to the provisions of certain debt and share issues of the Company, is not distributable as dividends either in cash or in kind to the common shareholder, Alcan Aluminium Limited.

14. Commitments and contingencies

To assure long-term supplies of bauxite, the Company participates in long-term cost sharing arrangements with related companies. The Company's fixed and determinable commitments, which comprise of "take-or-pay" obligations are estimated at $106 in 1987, $85 in 1988, $89 in 1989, $85 in 1990, $85 in 1991 and $493 thereafter. Total charges from these related companies were $101 in 1986 and $81 in 1985. Commitments with third parties for supplies of other inputs are estimated at $33 in 1987, $27 in 1988, $27 in 1989, $23 in 1990, $24 in 1991 and $213 thereafter. Total charges from these third parties were $24 in 1986 and in 1985.

Minimum rental obligations amount to $31 in 1987, $26 in 1988, $21 in 1989, $19 in 1990, $17 in 1991 and lesser annual amounts thereafter. Total rental expense amounted to $52 in 1986 ($57 in 1985 and $33 in 1984).

The Company, in the course of its normal operations, is subject to claims and lawsuits. The Company does not believe that these matters will materially impair its operations or have a material adverse effect on its financial position.

See also reference to abatable preferred shares in note 8, to capital expenditures in note 9, debt repayments in note 10 and redeemable retractable preferred shares in note 11.

15. Supplementary income statement information

	1986	1985	1984
Repairs and maintenance	**$283**	$274	$266
Taxes, other than payroll and income taxes	**85**	78	92
Interest on long-term debt	**84**	74	69
Capitalized interest	**(5)**	(16)	(10)

16. Pension plans

The Company and its subsidiaries have established pension plans in the principal countries where they operate, for the greater part contributory and generally open to all employees. Most plans provide pension benefits that are based on the employee's highest average eligible compensation during any consecutive thirty-six month period before retirement. Plan assets consist primarily of listed stocks and bonds.

The Company's funding policy is to contribute the amount required to provide for benefits attributed to service to date with projection of salaries to retirement and to amortize unfunded actuarial liabilities for the most part over periods of 15 years or less.

1986 Pension Cost

Service cost for the year	$	29
Interest cost on projected benefit obligations		84
Actual return on assets		(190)
Deferral of excess return on assets (above expected long-term rate of 7.7%) and amortization of other gains and losses		75
Net credit for year	$	(2)

The plans' funded status at December 31, 1986 was:		
Actuarial accumulated benefit obligation, including vested benefit obligations of $931	$	952
Plan assets at market value		1,461
Actuarial projected benefit obligation (based on average compensation growth of 5.5% and discount rate of 7.8%)		1,151
Plan assets in excess of projected benefit obligation		310
Unamortized actuarial gains (net)		(91)*
Unamortized prior service cost		12*
Unamortized portion of actuarial surplus at January 1, 1986		(263)*
Pension liability in balance sheet	$	32

**Being amortized over expected average remaining service of employees, generally 15 years.*

The pension cost for 1986 is based on the new Canadian and U.S. accounting standards. The accounting practice in previous years was generally to expense the contributions made in the year, which were based on actuarial valuations prepared for funding purposes. Under the previous accounting method, pension costs were $51 in 1985 and $26 in 1984.

Based on actuarial reports the present value of vested accumulated plan benefits was $931 in 1986 ($819 in 1985 and $725 in 1984) and the present value of accumulated non-vested benefits was $21 in 1986 ($14 in each of 1985 and 1984). The value of the net assets available for benefits was $1,111 in 1985 ($995 in 1984) at market prices prevailing at the time of actuarial valuation. The discount rate used to measure pension obligations and the expected long-term rate of return on assets were 6.9% in 1985 and 6.7% in 1984.

17. Information by geographic areas

	Canada	United States	Other	Eliminations	Consolidated
Year 1986					
Sales and operating revenues					
Third parties	$ 794	$1,998	$ 96	$ —	$2,888
Related companies	386	1	6	—	393
Subsidiaries	821	101	255	(1,177)	—
Total	2,001	2,100	357	(1,177)	3,281
Net income (Loss)	151	44	(30)	(11)	154
Total assets	2,265	1,116	970	(275)	4,076
Year 1985					
Sales and operating revenues					
Third parties	$ 895	$1,957	$ 84	$ —	$2,936
Related companies	366	1	27	—	394
Subsidiaries	471	82	198	(751)	—
Total	1,732	2,040	309	(751)	3,330
Net income (Loss)	11	23	(47)	(106)	(119)
Total assets	2,296	1,110	893	(129)	4,170
Year 1984					
Sales and operating revenues					
Third parties	$ 838	$1,576	$ 17	$ —	$2,431
Related companies	283	1	119	—	403
Subsidiaries	673	90	70	(833)	—
Total	1,794	1,667	206	(833)	2,834
Net income (Loss)	163	17	(51)	(6)	123
Total assets	2,511	999	620	(155)	3,975

Sales to subsidiary and related companies are made at a fair market price recognizing volume, continuity of supply and other factors. The loss incurred in "other" areas relates largely to alumina.

Net income (Loss) is total revenues less expenses directly related to the geographic area in accordance with generally accepted accounting principles.

AUDITORS' REPORT

To the Shareholders of
Aluminum Company of Canada, Limited

We have examined the consolidated balance sheet of Aluminum Company of Canada, Limited as at December 31, 1986, 1985 and 1984 and the consolidated statements of income, retained earnings and changes in financial position for each of the years in the three year period ended December 31, 1986. Our examinations were made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Company as at December 31, 1986, 1985 and 1984 and the results of its operations and the changes in its financial position for each of the years in the three year period ended December 31, 1986, in accordance with generally accepted accounting principles in Canada applied, except for the changes in accounting, with which we concur, as described in note 2, on a consistent basis.

PRICE WATERHOUSE
Chartered Accountants

Montreal, Canada
February 4, 1987

RESPONSIBILITY FOR FINANCIAL REPORTING

The Company's management is responsible for the integrity and fair presentation of the accompanying financial statements. These have been prepared in accordance with generally accepted accounting principles in Canada, conforming in all material respects with international standards. Financial and operating data elsewhere in the annual report are consistent with those contained in the accompanying financial statements.

The Company's policy is to maintain systems of internal accounting and administrative controls of high quality consistent with reasonable cost. Such systems are designed to provide reasonable assurance that the financial information is accurate and reliable and that company assets are adequately accounted for.

The annual financial statements are approved by the Board of Directors. In addition, the financial statements are examined by the shareholders' independent auditors, Price Waterhouse, whose report appears on this page.

INFLATION ACCOUNTING
(Unaudited)

This information is prepared in accordance with the recommendations of The Canadian Institute of Chartered Accountants.

The primary emphasis of the data is on current cost accounting. Historical reported information is adjusted for changes in prices of assets and expenses associated with the use of fixed assets and the sale of inventories. A "financing adjustment" is also made based on the supposition that the funds required to maintain a company's operating capability (replace the assets it consumes) will be provided by a combination of shareholder and borrowed funds.

Two items of general inflation are presented. The first, 'increase in current cost amounts of inventory and property, plant and equipment based on general inflation' provides a comparison with the specific price change for these assets. The second is the 'general purchasing power gain on net monetary liabilities'. This calculation recognizes that monetary assets lose purchasing power during periods of inflation while monetary liabilities gain.

The effect of high inflation in the past accounts for the significant difference between the current cost and the historical reported values of the Company's property, plant and equipment.

SCHEDULE OF CONSOLIDATED INCOME

(in millions of U.S. $)

	Historical as reported		Current cost basis in average 1986 $	
	1986	1985	**1986**	1985
Cost of sales and operating expenses	**$2,571**	$2,815	**$2,584**	$2,850
Depreciation expense	**173**	168	**258**	275
Income taxes	**66**	(149)	**66**	(152)
Net income (Loss), before financing adjustment	**154**	(119)	**56**	(197)
Financing adjustment*	**—**	—	**31**	3
Net income (Loss), after financing adjustment	**154**	(119)	**87**	(194)

SCHEDULE OF CONSOLIDATED ASSETS

(in millions of U.S. $)

	Historical as reported		Current cost basis in year-end 1986 $	
	1986	1985	**1986**	1985
Inventory	**$ 766**	$ 848	**$ 803**	$ 916
Property, plant and equipment – net	**2,602**	2,631	**4,483**	4,444
Net assets (common shareholder's equity)	**1,681**	1,530	**3,609**	3,414

SUPPLEMENTARY INFORMATION

(in millions of U.S. $)

	In average 1986 $	
	1986	1985
Increase in current cost amounts of inventory and property, plant and equipment based on:		
General inflation	**$ 60**	$ 210
Specific prices	**145**	12
Difference	**(85)**	198
General purchasing power gain on net monetary liabilities	**11**	49

** Based on specific price increases of inventory and property, plant and equipment. Based on current cost adjustments made to income during the year, the financing adjustment amounts to $21 ($17 in 1985).*

SELECTED FINANCIAL DATA

Operating data *(in thousands of tonnes, except as indicated)*	1977	1978	1979	1980	1981	1982	1983	1984	1985	**1986**
Aluminum shipments										
Ingot and ingot products	526	665	450	456	365	628	478	429	746	**613**
Fabricated products	397	484	500	517	506	398	523	560	693	**725**
Total	923	1,149	950	973	871	1,026	1,001	989	1,439	**1,338**
Primary aluminum production	826	898	709	918	962	917	945	1,075	1,159	**1,126**
Aluminum inventories (end of year)	348	270	240	244	369	259	227	383	337	**288**
Primary aluminum capacity (end of year)	894	894	904	961	1,018	1,075	1,075	1,075	1,238	**1,238**
Net realization on sales of ingot and ingot products (U.S. $ per tonne)	1,023	1,062	1,295	1,578	1,526	1,064	1,309	1,380	1,086	**1,210**
Consolidated income statement items *(in millions of U.S. $)*										
Total revenues										
Sales of aluminum ingot and ingot products	538	707	583	719	557	668	626	593	810	**743**
Sales of aluminum fabricated products	760	962	1,129	1,281	1,335	1,054	1, 334	1,600	1,821	**1,871**
Sales of all other products	428	476	599	761	690	482	495	553	566	**556**
Operating revenues	130	135	170	171	158	163	107	88	133	**111**
Other income	6	11	31	17	13	14	18	30	49	**33**
Costs and expenses										
Cost of sales and operating expenses	1,448	1,698	1,854	1,948	1,936	1,930	2,028	2,186	2,815	**2,571**
Depreciation	75	82	84	85	115	125	139	159	168	**173**
Interest	53	51	48	32	62	75	81	79	79	**83**
Other expenses	125	146	152	176	198	205	229	259	585	**267**
Income taxes	56	123	132	287	154	(2)	23	58	(149)	**66**
Net income (Loss)*										
As reported	105	191	242	421	288	48	80	123	(119)	**154**
FASB method	115	200	243	418	291	51	87	155	(110)	**134**
Consolidated balance sheet items *(in millions of U.S. $)*										
Working capital	526	575	565	561	820	670	475	546	799	**755**
Property, plant and equipment – net	913	986	1,146	1,503	2,087	2,290	2, 335	2,411	2,631	**2,602**
Long-term debt	471	393	357	380	844	814	594	566	837	**528**
Deferred income taxes	175	248	311	405	506	503	522	542	389	**486**
Redeemable preferred shares	172	171	155	140	289	340	337	405	398	**421**
Common shareholder's equity	646	770	922	1,165	1,313	1,328	1,365	1,416	1,530	**1,681**
Total assets	1,893	2,120	2,342	2,765	3,597	3,517	3,689	3,975	4,170	**4,076**
Other statistics										
Cash from operating activities, before dividends (in millions of U.S. $)	161	428	318	554	246	307	200	275	381	**519**
Property, plant and equipment expenditures (in millions of U.S. $)	131	156	257	450	710	331	196	243	408	**156**
Average number of employees (in thousands)	26	26	27	27	27	25	24	24	26	**25**

* *See note 3 to the financial statements which explains the reasons for the differences between the As reported and FASB methods.*

Bauxite reserves *(in millions of crude tonnes)*	1982	1983	1984	1985	**1986**
Subsidiaries					
Proved and probable bauxite reserves at beginning of year	108	106	101	101	**93**
Total weighted average aluminum content (%)**	26	26	26	26	**26**
Bauxite mined during the year	2.0	2.4	2.4	2.4	**2.8**
Related companies					
Company's share of proved and probable bauxite reserves at beginning of year	108	106	108	107	**111**

** *The amount of aluminum extractable is always less than the total aluminum content, varying according to the nature of the bauxite, the process technology employed to extract the intermediate product (alumina) and the alumina plant efficiency.*

DIRECTORS AND OFFICERS

DIRECTORS

David M. Culver, O.C. Montreal	Chairman and Chief Executive Officer Alcan Aluminium Limited
Pierre Laurin, O.C. Montreal	Senior Vice President and General Manager, Quebec of Merrill Lynch Canada Inc.
David Morton Montreal	President and Chief Executive Officer of the Company and President and Chief Operating Officer of Alcan Aluminium Limited
Hon. John L. Nichol, O.C. Vancouver	President of a private investment company
Jean-Marie Poitras Quebec	Chairman of La Laurentienne Mutuelle d'Assurance
William J. Rich Vancouver	Vice President
Richard F. Sharratt Montreal	Vice President and Chief Financial Officer

OFFICERS

David M. Culver	Chairman of the Board
David Morton	President and Chief Executive Officer
Stephen R. Brown	Vice President
J. Gerald H. Clark	Vice President
S. Bruce Heister	Vice President
Owen M. Ness	Vice President, Personnel
Prabir Kumar Pal	Vice President and Chief Legal Officer
William J. Rich	Vice President
E. Ian Rugeroni	Vice President
François Sénecal-Tremblay	Vice President
Richard F. Sharratt	Vice President and Chief Financial Officer
Jeffrey A. Skelton	Vice President, Government Relations
Timothy C. Tuff	Vice President
Maurice D. Taylor	Treasurer
Suresh Thadhani	Controller
Richard S. Porter	Secretary

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Aluminum Company
of Canada, Limited

ALCAN

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