

1986 ANNUAL REPORT

COBI FOODS INC.



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LETTER TO SHAREHOLDERS

Since its formation just over two years ago with the consolidation of Stokely Van Camp of Canada Inc., and the Atlantic regional entities of M.W. Graves Ltd., Avon Foods Ltd., and Campbell & Burns Ltd., COBI has aggressively expanded its interests in food and beverage manufacturing and marketing in Canada, and internationally.

With the acquisition in late 1985 of Hardee Farms International Ltd., including the Honeydew and Freeze-Dry organizations, COBI FOODS INC. became a publicly traded company on the Toronto Stock Exchange.

In May of 1986, after six months of active negotiations started by the Hardee organization, COBI signed a Licensing Agreement with Nestle Enterprises Ltd., and acquired the right to produce, distribute and market nationally Libby brand seasonal products in Canada.

In the past year COBI built the infrastructure to manage this major new \$120 million Canadian food company. In fiscal 1986 heavy investments were made in research & development, quality improvement, management information systems, distribution, and marketing. New personnel were recruited and major training initiatives were undertaken. Strategic planning and capital projects — including a state of the art TETRA aseptic facility — expanded corn production, plant rationalizations in Eastern Canada, and a fully equipped R & D laboratory all were part of an active year, as was a renovation of our new Port Williams Head Office building.

Coupled with these investments were the extraordinary expenses of merging Hardee with COBI and gearing up to bring the \$20 million Libby business on stream. These extraordinary expenditures had a serious negative impact on COBI's year-end results. Profitability was further eroded by a weather related crop failure in Nova Scotia in 1985 and an inventory write-down, weak markets and low prices for COBI products both in Canada and on the international markets.

Many of the corporate building blocks, organizational changes and growth of the corporate computer and distribution systems, are now behind us. We are aggressively pursuing profitable new opportunities such as the planned launch of a new line of Graves concentrated juices and beverages packaged in 250 mL aseptic packages. These new products will be test-marketed in Atlantic Canada later this year.

Prices and demand for our products on the export market, based on early bookings, are substantially stronger than in fiscal 1986, and we anticipate a record sales year internationally. The domestic sales environment continues to be sluggish with substantial inventory carry-overs from the 1985 pack-season, particularly with frozen and canned peas.

We are grateful for the unstinting efforts of all our employees, both long service COBI and those who recently joined with the Hardee/Baxter amalgamation. Without their continuing commitment and dedication, COBI could not have accomplished as much as it did.

Management is dedicated to the challenge of making COBI a profitable, quality driven, growing corporation in the Canadian and international markets.

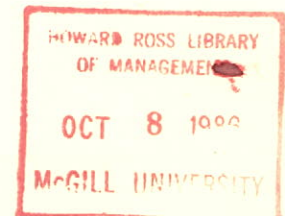


Norman L. Williams
President & Chief Executive Officer



Arnold G. Park
Executive Vice-President & Chief Operating Officer

June 11, 1986



CONSOLIDATED BALANCE SHEET

As at April 30, 1986

	1986 (\$000)	1985 (\$000)
Assets		
Current Assets		
Accounts receivable	\$10,631	\$ 7,807
Inventories	40,008	27,076
Prepaid expenses	1,446	623
	<u>52,085</u>	<u>35,506</u>
Fixed Assets (Note 5)	26,873	17,043
Other Assets	1,404	—
	<u>\$80,362</u>	<u>\$52,549</u>
Liabilities		
Current Liabilities		
Bank loans	\$31,672	\$21,706
Accounts payable and accrued liabilities	16,028	11,604
Income taxes	—	258
Current portion of long-term debt (Note 6)	600	91
	<u>48,300</u>	<u>33,659</u>
Long-Term Debt (Note 6)	21,778	9,793
Deferred Income Taxes	—	1,906
	<u>70,078</u>	<u>45,358</u>
Shareholders' Equity		
Capital Stock (Notes 4 and 7)	17,260	2,266
Retained Earnings (Deficit)	(6,976)	4,925
	<u>10,284</u>	<u>7,191</u>
	<u>\$80,362</u>	<u>\$52,549</u>

Signed on Behalf of the Board

N. L. Williams

Director

Harold Park

Director

AUDITORS' REPORT TO THE SHAREHOLDERS

We have examined the consolidated balance sheet of COBI FOODS INC. (formerly Hardee Farms International Ltd.) as at April 30, 1986 and the consolidated statements of earnings (loss), retained earnings (deficit) and changes in financial position for the year then ended. 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 company as at April 30, 1986 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

June 11, 1986
Halifax, Nova Scotia

Coopers & Lybrand
Chartered Accountants

CONSOLIDATED STATEMENT OF EARNINGS (LOSS)

For the Year Ended April 30, 1986

	<u>1986</u> <u>(\$ 000)</u>	<u>1985</u> <u>(\$ 000)</u>
Sales	\$75,384	\$67,065
Cost of Sales	<u>66,128</u>	<u>53,855</u>
Gross Profit	<u>9,256</u>	<u>13,210</u>
Expenses		
Selling and advertising	8,607	6,284
General and administrative	3,671	2,529
Interest —		
Short-term debt	3,786	2,640
Long-term debt	<u>795</u>	<u>828</u>
	<u>16,859</u>	<u>12,281</u>
	<u>(7,603)</u>	<u>929</u>
Provision for Income Taxes		
Current	(152)	99
Deferred	<u>—</u>	<u>17</u>
	<u>(152)</u>	<u>116</u>
Earnings (Loss) Before Extraordinary Item	(7,451)	813
Extraordinary Item		
Provision for cost of plant closures and reorganization	<u>(1,800)</u>	<u>—</u>
Net Earnings (Loss) for the Year	<u>(\$ 9,251)</u>	<u>\$ 813</u>
Earnings Per Share (Note 8)		
Calculated on the weighted average number of shares outstanding during the year —		
Earnings (loss) before extraordinary item	<u>(62c)</u>	
Net earnings (loss) for the year	<u>(77c)</u>	
Calculated on the number of shares outstanding at the year end —		
Earnings (loss) before extraordinary item	<u>(50c)</u>	
Net earnings (loss) for the year	<u>(62c)</u>	

CONSOLIDATED STATEMENT OF RETAINED EARNINGS (DEFICIT)

For the Year ended April 30, 1986

	<u>1986</u> <u>(\$ 000)</u>	<u>1985</u> <u>(\$ 000)</u>
Retained Earnings — Beginning of Year	\$4,925	\$4,115
Premiums Paid on Redemption of Preference Shares (Note 7)	(2,650)	—
Net Earnings (Loss) for the Year	(9,251)	813
Dividend on Preference Shares	<u>—</u>	<u>(3)</u>
Retained Earnings (Deficit) — End of Year	<u>(\$6,976)</u>	<u>\$4,925</u>

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

For the Year Ended April 30, 1986

	<u>1986</u> <u>(\$000)</u>	<u>1985</u> <u>(\$000)</u>
Operating Activities		
Earnings (loss) before extraordinary item	(\$ 7,451)	\$ 813
Charges (credits) to earnings not involving cash —		
Depreciation and amortization	1,858	1,533
Other	(95)	(41)
	<u>(5,688)</u>	<u>2,305</u>
Net change in non-cash working capital balances related to operations	(2,092)	(202)
Cost of plant closures and reorganization less assets written down	(1,070)	—
Dividends paid during the year	<u>—</u>	<u>(9,525)</u>
	<u>(8,850)</u>	<u>(7,422)</u>
Investing Activities		
Proceeds on disposal of fixed assets	123	61
Purchase of fixed assets	<u>(5,632)</u>	<u>(7,422)</u>
	<u>(5,509)</u>	<u>(7,361)</u>
Financing Activities		
Long-term borrowings	10,436	164
Repayment of long-term debt	(6,411)	(90)
Issue of capital stock	8,650	—
Redemption of preference shares	<u>(3,300)</u>	<u>—</u>
	<u>9,375</u>	<u>74</u>
Other Activities		
Current bank indebtedness assumed on the business combination (Note 4)	<u>(4,982)</u>	<u>—</u>
Increase in Bank Indebtedness During the Year	<u>(9,966)</u>	<u>(14,709)</u>
Bank Indebtedness — Beginning of Year	<u>(21,706)</u>	<u>(6,997)</u>
Bank Indebtedness — End of Year	<u>(\$31,672)</u>	<u>(\$21,706)</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the Year Ended April 30, 1986

1. Contents of Financial Statements

Pursuant to the business combination referred to in Note 4, these financial statements include the results of operations of COBI FOODS INC. and all of its subsidiaries for the year ended April 30, 1986 together with the results of operations of Hardee Farms International Ltd. and its subsidiaries since November 30, 1985, the effective date of its deemed acquisition. The comparative figures are the accounts of COBI FOODS INC. and its subsidiaries for the year ended April 30, 1985.

2. Change of Name and Year End

Effective on the opening of business on May 1, 1986, Hardee Farms International Ltd. was amalgamated with its two active wholly-owned subsidiaries, The Baxter Canning Company Limited and COBI FOODS INC., under Section 178 of The Canada Business Corporation Act. Under the terms of the amalgamation agreement, the shares of the subsidiaries owned by Hardee Farms International Ltd. were cancelled and the amalgamated company continued with identical attributes of the company, including its name. Immediately prior to the amalgamation, the company changed its name from Hardee Farms International Ltd. to COBI FOODS INC.

Pursuant to the amalgamation, the fiscal year-end of the company has been changed from March 31 to April 30 commencing in 1986.

3. Summary of Accounting Policies

Acquisition of subsidiaries. All acquisitions of subsidiaries, including the deemed acquisition referred to in Note 4, have been accounted for by the purchase method.

Inventories. Inventories are valued at the lower of cost and net realizable value, with cost generally determined on a first-in, first-out basis.

Prepaid expenses. Prepaid expenses include advances to growers and cost of growing crops which are deferred until the crops are harvested.

Depreciation. Depreciation of buildings, improvements, machinery and equipment is calculated principally using the straight-line basis over their estimated useful lives. The estimated useful lives for buildings and improvements range from 20 to 50 years and for machinery and equipment range from 4 to 10 years.

Income taxes. The company uses the deferral method of income tax allocation. Income taxes are provided at current rates for all items included in the statement of earnings regardless of the period when such items are reported for income tax purposes. No adjustment is made to deferred income taxes for subsequent changes in income tax rates.

4. Business Combination

On December 12, 1985, Hardee Farms International Ltd. (Hardee) issued 10,000,000 common shares and a conditional option to acquire 666,000 common shares in consideration of the transfer of all of the outstanding shares of COBI FOODS INC. (COBI) to Hardee. As a result of the transaction, the former shareholder of COBI holds a majority of the outstanding common shares of Hardee and, accordingly, the transaction has been treated, for accounting purposes, as an acquisition by COBI of control of the net assets and business of Hardee.

The consolidated net assets of Hardee deemed to have been acquired by COBI are summarized as follows:

		(\$000)
Current assets		\$17,451
Current liabilities —		
Bank indebtedness	\$4,982	
Other	<u>8,946</u>	13,928
		3,523
Fixed assets, at net book value		7,089
Other assets, at cost		1,451
Deferred income tax debit arising on the transaction		<u>1,997</u>
		14,060
Long-term debt		7,566
Ascribed value of net assets		6,494
Recorded value of COBI's issued common shares immediately prior to the transaction		<u>10,766</u>
Ascribed value of Hardee's common shares		<u>\$17,260</u>

The opening balance shown for retained earnings is the balance of COBI's retained earnings at April 30, 1985, COBI's previous year-end.

5. Fixed Assets

	1986		1985	
	Cost (\$000)	Accumulated depreciation (\$000)	Net (\$000)	Net (\$000)
Land	\$ 1,774	\$ —	\$ 1,774	\$ 865
Buildings and improvements	13,828	4,363	9,465	5,573
Machinery and equipment	31,460	16,013	15,447	10,408
Land, building and equipment under capital lease	643	456	187	197
	<u>\$47,705</u>	<u>\$20,832</u>	<u>\$26,873</u>	<u>\$17,043</u>

6. Long-Term Debt

	1986 (\$000)	1985 (\$000)
Bank loan, bearing interest at bank prime, on which no principal payments are required prior to May 1, 1987	\$10,000	\$ —
Income debentures, bearing interest at 1% and 1½% above one-half bank prime, due May 31, 1986 and for which arrangements have been made to obtain a term loan	5,927	—
Mortgages, debentures and secured loans, bearing interest rates ranging from 5⅞% to 16¾%, due at various dates through 1994	2,618	343
Amounts payable to affiliated companies including debentures, bearing interest at 10%, non-interest bearing advances, and advances, bearing interest at bank prime, all with no fixed terms of repayment	2,404	8,404
Other	1,429	1,137
	<u>22,378</u>	<u>9,884</u>
Less: Current portion	600	91
	<u>\$21,778</u>	<u>\$9,793</u>

Certain assets of the company, with a carrying value of approximately \$25,000,000, have been pledged as security, either directly or through debentures, for the long-term debt.

The aggregate amount of payments required in each of the next five years to meet retirement provisions are as follows:

Year ending April 30	(\$000)				
	1987	1988	1989	1990	1991
	<u>\$600</u>	<u>\$17,138</u>	<u>\$644</u>	<u>\$589</u>	<u>\$516</u>

7. Capital Stock

- a) During the year, the capital of the company was increased by the creation of an unlimited number of non-voting equity shares, without nominal or par value and ranking equally with the company's common shares, and an unlimited number of preferred shares which shall be issuable in series by the directors, each such series carrying such rights and conditions as the directors may determine. The common shares of the company are also authorized in unlimited number.

b) During the year, the company issued 86,500 common shares for cash considerations aggregating \$8,650,000 and redeemed 10,000 Class A preference and 500 Class B preference shares for \$2,750,000 and \$50,000, respectively. The premium on the redemption of the Class A shares has been charged to retained earnings. The Class B shares were redeemed at their issue price.

c) Issued and fully paid capital stock consists of:

	1986		1985	
	Shares	(\$000)	Shares	(\$000)
Class A preference	—	\$ —	10,000	\$ 100
Class B preference	—	—	500	50
Common shares	15,001,201	17,260	21,160	2,116
	<u>15,001,201</u>	<u>\$ 17,260</u>	<u>31,660</u>	<u>\$ 2,266</u>

d) At April 30, 1986, options to acquire 999,000 common shares of the company at \$1.50 per share were outstanding. These options were exercised in May 1986.

8. Earnings Per Share

a) Generally accepted accounting principles require that earnings per share be calculated based on the weighted average number of shares outstanding during the year. The weighted average number of shares has been calculated on the basis that 10,000,000 common shares were outstanding throughout the year and 5,001,201 shares were outstanding from the effective date of the deemed acquisition referred to in Note 4.

In addition to the earnings per share calculated on the basis of the weighted average number of shares, the company has provided a calculation of earnings per share based upon the number of shares outstanding as at the year-end date, 15,001,201.

b) Comparative figures for earnings per share have not been calculated because of the business combination referred to in Note 4.

9. Related Party Transactions

During the year, the company was charged approximately \$3,600,000 by related companies for the purchase of supplies, services and interest.

10. Segmented Information

As a food processor engaged in the canning, freezing and freeze-drying of vegetables, other food products and beverages, the company operates in only one line of business. Export sales during the period amounted to approximately 12% of sales.

11. Future Incomes Taxes

The company and its subsidiaries have accumulated losses for tax purposes of approximately \$7,290,000 which may be carried forward and used to reduce taxable income in future years and for which no future tax benefit has been recognized in the accounts. These losses may be claimed no later than:

Year ending April 30	(\$000)		
	1991	1992	1993
	<u>\$160</u>	<u>\$1,720</u>	<u>\$5,410</u>

The companies also have capital cost allowance of approximately \$2,300,000 available which has not been deducted in determining income for tax purposes to April 30, 1986. This capital cost allowance may be claimed to create additional losses for tax purposes which would be used to reduce income that would otherwise be subject to tax.

DIRECTORS

Bernadin J. Comeau
Saulnierville, N.S.
Chairman of the Board
Comeau Seafoods Ltd.

* **Cecil H. Franklin**
Toronto, Ontario
Chairman of the Board
Algonquin Mercantile

Robert M. Franklin
Toronto, Ontario
Executive Vice-President
Algonquin Mercantile

†* **David J. Hennigar**
Halifax, N.S.
Atlantic Regional Director
Burns Fry Limited

* **John M. Lindley**
Campbellville, Ontario
Corporate Director

†* **J. Thomas MacQuarrie, Q.C.**
Halifax, N.S.
Senior Partner
Stewart, MacKeen & Covert

Arnold G. Park
Port Williams, N.S.
Executive Vice-President &
Chief Operating Officer
Cobi Foods Inc.

† **Angela Peters**
Halifax, N.S.
Corporate Director

* **Norman L. Williams**
Port Williams, N.S.
President & Chief Executive Officer
Cobi Foods Inc.

* Member of Executive Committee
† Member of Audit Committee

OFFICERS

Cecil H. Franklin
Chairman of the Board

Norman L. Williams
President & Chief Executive Officer

Arnold G. Park
Executive Vice-President & Chief Operating Officer

Robert J. Hickey
Vice-President Financial & Administrative Services,
and Secretary

GENERAL INFORMATION

Banks

The Canadian Imperial Bank of Commerce
The Royal Bank of Canada
The Bank of Nova Scotia

Transfer Agent

Guaranty Trust Company of Canada
Toronto, Ontario

Stock Listing

Toronto Stock Exchange

Head Office

P.O. Box 1000
Collins Road
Port Williams, N.S.
B0P 1T0

Auditors

Coopers & Lybrand



Cobi Foods Inc. Aliments Cobi Inc.
P.O. Box 1000, Port Williams
Nova Scotia, Canada, B0P 1T0
(902) 542-5722 Telex 019-32127