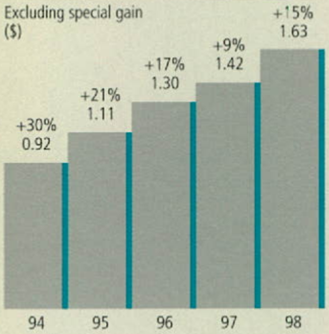
Imasco

1998 Annual Report

Imasco

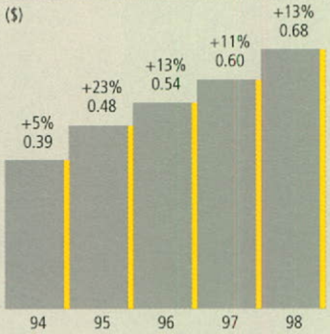
Imasco's mission is to build value for shareholders. We are a leading consumer products and services growth company with operations in Canada and the United States.

Net earnings from continuing operations per common share



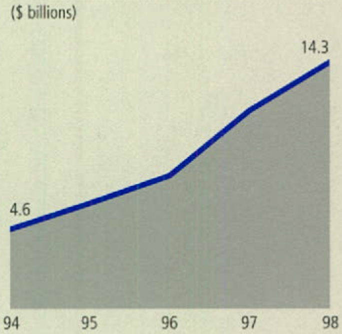
Excluding the gain on the sale of First Federal, net earnings from continuing operations per common share increased 15% in 1998, and over the past five years have increased at an annual compound growth rate of 18.1%.

Dividends per common share



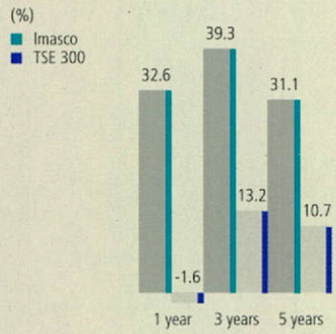
Over the past five years the dividend has increased at an annual compound growth rate of 12.9%. The indicated annual dividend for 1999 is $0.80 per share, an increase of 18%.

Stock market value



At year-end the market value of Imasco's common equity was $14.3 billion, more than triple what it was in 1994, even though the number of shares outstanding declined from 467 million to 437 million over the same period.

Total return to shareholders



With dividends reinvested, the total return on Imasco's common shares in 1998 was 32.6% compared with a negative return of 1.6% for the TSE 300. The compound annual total returns for the three- and five-year periods ended December 31, 1998, were 39.3% and 31.1% versus 13.2% and 10.7% for the TSE 300.

Contents

For Imasco's news releases, analyst meeting presentations, and a great deal more.
http://www.imasco.com

Financial Highlights
($ millions, except as noted)

	1997-98 % change	1998	1997	1996
Operating results				
Revenues, net of tobacco taxes and duties	3	**8,584**	8,332	7,202
Net earnings from continuing operations, excluding special gain[1]	12	**741**	659	612
Net earnings	(4)	**759**	790	601
Cash from continuing operating activities	8	**1,027**	954	608
Return on common equity		**20.5%**	22.0%	18.2%
Earnings from operations[2]				
Imperial Tobacco	5	**815**	775	705
CT Financial Services[3]	(4)	**452**	472	473
Shoppers Drug Mart/ Pharmaprix	25	**199**	159	131
Genstar Development Company	26	**54**	43	29
	5	**1,520**	1,449	1,338

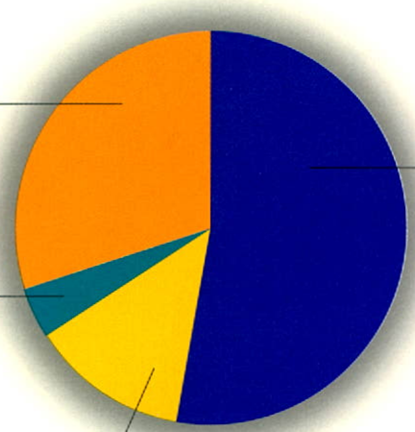
Certain comparative amounts have been restated to conform with the presentation adopted in 1998.

[1] Excludes the gain on the sale of First Federal Savings and Loan Association of Rochester in March 1997 (refer to Note 9 on page 58).

[2] Represents earnings before goodwill amortization, other costs and administration, gain on business disposal, interest expense, provision for income taxes, and discontinued operations.

[3] Earnings from operations of CT Financial Services are not comparable due to acquisitions, dispositions, and non-recurring provisions and expenses.

Contributions to 1998 Earnings from Operations



CT Financial Services – 30%
A strong competitor in Canadian personal financial services, with 429 branches complemented by *EasyLine* telephone and *EasyWeb* Internet access.

Imperial Tobacco – 53%
Canada's largest tobacco enterprise, with a 64.3% market share and the country's two top cigarette brands, *du Maurier* and *Player's*.

GENSTAR

Genstar Development Company – 4%
Developer of master-planned residential communities in Canadian and U.S. metropolitan centres.

Shoppers Drug Mart/Pharmaprix – 13%
Canada's leading drugstore group, with 824 stores focused on meeting health-care needs with personalized, convenient pharmacy services.

Multi-business corporations that function well have a vital strength embedded in their structure: while each operating company single-mindedly focuses on fulfilling its vision and mission, the corporate centre concentrates entirely on increasing value for shareholders. At Imasco the board of directors and managers at the corporate centre work closely with the leaders of each company to add value by promoting excellence in strategic direction, financial discipline, and leadership.

Imasco's board is a dynamic mix of eight outside directors and four inside directors. The outside directors gain insight into front-line business issues through the inside directors: Imasco's two most senior officers, Brian Levitt and Ray Guyatt, and the leaders of Imperial Tobacco and Shoppers Drug Mart, Don Brown and David Bloom. CT Financial's Chief Executive Officer, Ed Clark, regularly attends meetings. What better way

"Ultimately, successful business performance hinges on the quality of senior leadership and the empowerment of employees."

to assess the caliber of Imasco's top leadership and to be kept abreast of the opportunities and challenges facing each business than through face-to-face interactions with the principal players?

In areas of intersecting responsibility between Imasco's management and board, distinct value is created. For instance, in early December Imasco holds its annual planning meeting attended by the board and senior management teams from all the businesses. The company leaders report on results and highlights from the year, and expectations are rigorous.

The thrust of the meeting then shifts to presenting strategic and financial plans that each business has developed reflecting short- and long-term priorities for building competitiveness. The process is a disciplined one in which projected net income is measured against the cost of capital employed. Once the plans are approved, actual results are reviewed quarterly.

Ultimately, successful business performance hinges on the quality of senior leadership and the empowerment of employees. Here the board makes a significant imprint. Its human resources committee, comprised of six unrelated directors, meets four times a year to review and approve compensation policies, making sure incentives line up with business objectives, and to oversee leadership development and succession planning.

What talent, capabilities, and attributes are distilled into that ineffable quality called leadership? While leaders represent many individual styles, I have observed several qualities that seem requisite.

Successful leaders always have a vision about where they want to go and a consuming passion about leading their organizations to success. At Imasco it must be part of the drinking water! A shining example is Ed Clark's tenacity in focusing Canada Trust on leading the market in personal financial services.

Another essential skill that leaders must have is the ability to see the big picture. Most people get caught up in the daily issues and problems, yet no matter how compelling these issues are, leaders somehow transcend them to achieve perspective on the industry as a whole and on the relative place of the company. Imperial Tobacco's Don Brown is remarkable in this regard. Beset on one side by government regulations and on the other by a diminishing market, he steers the company to ever-greater earnings heights year after year.

Effective leaders are continuous learners who are open to change, even when things are going well. Sometimes the most powerful barrier to change is a track record of success. Without an impending threat or crisis, it can be hard to create the momentum you need to make major changes. Instilling a culture that embraces change is the mark of great leadership, and Shoppers Drug Mart and Genstar are both admirable examples. Led by David Bloom and Frank Thomas, these companies have completely rethought their approaches to business to build competitiveness and enhance returns.

Finally, all great leaders have a strong sense of integrity that permeates the culture of the organizations they lead. I am proud to say that Brian Levitt and Imasco's operating leaders all demonstrate such integrity, in addition to the other key leadership qualities I have cited. This fact, along with Imasco's financial strength and outstanding people, bodes well for the company's tomorrows.

At this year's annual meeting, Nan-b de Gaspé Beaubien will not stand for re-election. Nan-b has been a valued contributor to our board's deliberations since 1987. We thank her sincerely and wish her well in her future endeavours. The nominating & corporate governance committee has proposed two new directors, Judy Erola, former president of the Pharmaceutical Manufacturers' Association of Canada, and L.R. (Red) Wilson, chairman of BCE Inc. Judy and Red bring extensive experience and new perspectives to Imasco. We look forward to working with them.

Purdy Crawford

Purdy Crawford
Chairman
January 28, 1999

I am pleased to report on another successful year for Imasco. In addition to assessing our 1998 performance against objectives, I will also discuss specific issues that are top-of-mind for investors and highlight some initiatives that will enhance the performance of our companies in the years ahead.

It was a turbulent year in equity markets and, happily, Imasco shareholders fared much better than most. With dividends reinvested, the total return on our stock amounted to 32.6% in 1998 compared with a negative return of 1.6% for the TSE 300. We believe our success in the stock market is largely tied to communicating clearly with investors and delivering on what we promised. Imasco's proposition for investors is one of steady earnings and dividend growth through good times and bad.

Our businesses all enjoy leadership positions, but each is operating in a mature industry where competitive battles are hard won. On behalf of shareholders, I want to acknowledge our employees' outstanding efforts in winning those battles in 1998 and thank them sincerely for their contribution.

"Imasco's proposition for investors is one of steady earnings and dividend growth through good times and bad."

Business Highlights

Imasco's operating companies consistently achieve challenging goals, year in and year out, and 1998 was no exception.

Don Brown and his team at Imperial Tobacco continue to extend their impressive lead over the competition in the Canadian tobacco industry. The company's share of the cigarette market grew to 68.4% in 1998, an increase of 0.4 of a share point. Unit volumes were up 1.5% while volumes for the industry as a whole increased 0.6%. Imperial is now into the final phase of its efficient manufacturing program. By the time the project is completed in 1999, the company will have invested more than $230 million in updating virtually every aspect of its manufacturing capabilities to the latest standards. The resulting enhanced competitiveness will yield benefits for many years to come.

CT Financial had another strong year under the leadership of Ed Clark and his management team. Earnings from ongoing operations were up 15%. The turbulent financial markets of 1998 tested Canada Trust's strategy of focusing tightly on personal financial services while carefully managing interest rate and other financial risks. The aim is to operate the business in a way that produces steady earnings growth and stable returns on equity in the 15% range. Clearly, the strategy is working.

Earnings from operations at Shoppers Drug Mart/Pharmaprix have nearly doubled in the last three years. David Bloom and his management colleagues have masterminded a total makeover of the company's infrastructure and successfully assimilated the Big V chain, the largest acquisition in the company's history. The "new" Shoppers Drug Mart with its greatly enhanced information technology capabilities is rich in information about customer buying patterns. The process of mining that information to grow profitability began in 1998, and there is more to come in the years ahead.

Genstar Development Company also had a record year. A significant contribution had been anticipated from 4S Kelwood, Genstar's flagship development in San Diego, but delays in planning approvals pushed that project's opening into the first quarter of 1999. A booming Calgary market handily filled the earnings gap. The 1998 experience demonstrates the merit of Genstar's diversification strategy. Through diversified markets and financial discipline, Frank Thomas and his team have transformed Genstar into a real estate company with unique performance characteristics.

We sold substantially all of Fast Food Merchandisers (FFM) in 1998 and expect to sell the remaining cleaning supplies business in 1999. It had become clear that FFM would not generate acceptable returns in the foreseeable future and that its sale would free up capital for more productive purposes.

Tobacco Regulation

In last year's annual report, I talked about the major public policy challenges facing the Canadian tobacco industry and the need to restore a measure of balance in the debate. Imperial Tobacco has no objection to legitimate government policies aimed at reducing smoking. We readily accept the fact that the Canadian tobacco market will decline over time. That decline is a fundamental assumption in Imperial Tobacco's business plan, and we are managing the business accordingly.

We are in complete agreement with policy makers on the issue of youth smoking. Critics of the tobacco industry accuse it of marketing to youth because, in their view, the industry needs underage customers. This is simply not true: Imperial Tobacco does not market its products to youth. Smoking is a long-established social phenomenon. If underage smoking were eliminated tomorrow, there would still be a tobacco industry, and we are prepared to manage in that context.

For many years the Canadian tobacco industry has been sponsoring and funding programs aimed at eliminating youth access to tobacco products in retail stores. The most recent initiative, under way since 1996, is Operation ID, which educates tobacco retailers about the law and supports their efforts to make sure all young buyers are asked for proof of age.

Where the industry has clearly come up short in the past is in setting the record straight in an environment characterized by misinformation. Some initial steps were taken to rectify this in 1998, and much more will be done.

For example, a key industry-sponsored initiative is an advertising campaign in British Columbia designed to state facts. The industry chose to begin in B.C. because that province has imported a particularly strident set of anti-tobacco policies from the United States, even though Canadian circumstances are very different. An underlying message to politicians is that Canadian tobacco policy should be based upon Canadian realities. The industry has followed up with an offer to government officials to work cooperatively on tobacco regulation.

For its part, Imperial Tobacco has also become more vocal in stating its position on the contentious issues surrounding smoking. Activities in 1998 included media

Performance against Objectives

In pursuing Imasco's mission to build value for shareholders, we are guided by a set of seven long-term financial objectives.

Objective **1**

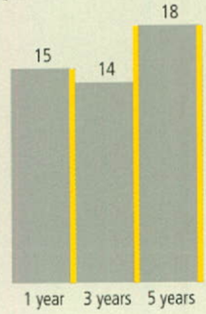
Grow earnings per share 15% per year.

Excluding the impacts of discontinued operations and the 1997 gain on the sale of First Federal, earnings per share were up 15% in 1998. This reflects solid performances by all the Imasco businesses. Compound earnings growth for the three- and five-year periods ended 1998 was 13.7% and 18.1%, respectively.

Our earnings growth target might be considered ambitious given Imasco's mix of businesses. However, we believe that the target can be attained over time through a combination of superior operations and the effective deployment of surplus cash – for example by making acquisitions or repurchasing shares.

Growth in earnings per common share from continuing operations

Excluding special gain
(%)



Objective **2**

Generate return on equity greater than 15%.

Return on average common shareholders' equity (ROE) reached 20.5% in 1998. ROE has averaged 20.2% over the past three years and 16.7% over the past five years. For 1999 the ROE objective has been increased to 20%.

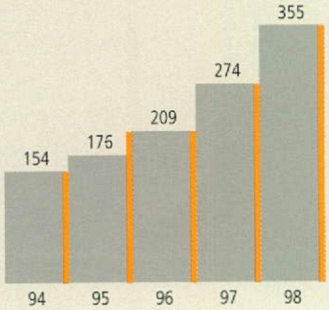
Objective **3**

Steadily increase economic profit over time.

Imasco's economic profit for the year was $355 million compared with $274 million in 1997. This measure calculates the returns from business activities after deducting the estimated cost of capital employed. Imasco's economic profit has increased in each of the last five years.

Economic profit

($ millions)



interviews, public speaking engagements, and a booklet prepared for wide distribution titled *Where We Stand*. All shareholders received a copy of the booklet with this annual report, and I encourage you to read it. The investment Imperial is making in tobacco policy formulation is no less important to its future than those the company has been making in plant and equipment.

Financial Services Developments

Early in 1998, the merger proposal announced by Royal Bank and Bank of Montreal dramatically accelerated the pace of change in the Canadian financial services industry. While that proposal and the one subsequently announced between CIBC and TD Bank were rejected by the federal government in mid-December, the debate sparked by the proposals will have a lasting impact on the development of the industry.

The government now intends to complete the process it initiated in 1996 to update the regulatory framework for financial services in Canada. Objectives for the new regulations are to ensure that Canadian consumers enjoy the full benefits of competition while giving Canadian-based companies the flexibility they need to compete globally. The government also wants to ensure that the industry remains sound, with strong participation from Canadian-owned institutions. While this is a tall order, we share the government's objectives and will participate in the process. We see financial services as a key component of Imasco's future and will continue to look for ways to expand our presence in the sector. Consequently, CT Financial has moved some of the investments it has been considering to the front burner. We are confident that 1999 will see developments in this area.

Objective **4**
Increase dividends in line with earnings growth.

The indicated annual dividend rate for 1999 is $0.80 per share, an increase of 18%. Since 1994 the dividend rate has increased at an annual compound rate of 15.5%.

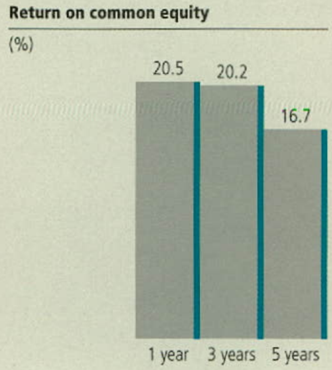
Objective **5**
Maintain balance sheet strength.

At year-end Imasco's total debt to capital ratio was 27.7%. The objective is 35%, with allowance for temporary variations resulting from acquisitions and dispositions. Our conservative approach to the balance sheet gives Imasco access to financing at attractive rates as well as flexibility to support the growth of our businesses, through acquisitions or otherwise, when opportunities arise.

Objective **6**
Optimize cash generation.

Cash from continuing operating activities exceeded $1.0 billion, a new record for Imasco. Superior cash generation contributes to shareholder value in several ways. It allows us to maintain balance sheet strength, reinvest in our businesses for sustainable growth, and boost shareholder returns with dividends and share repurchases. Capital expenditures amounted to $267 million in 1998, and a record $882 million was returned to common shareholders through dividends and share repurchases.

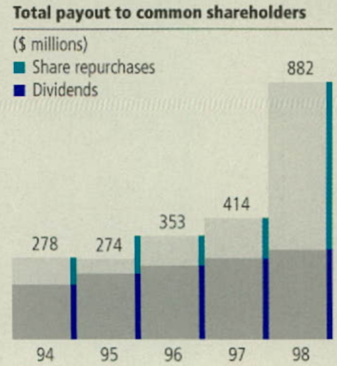
Return on common equity



Objective **7**
Provide superior returns to shareholders.

This is the most pertinent objective, as it reflects what is actually delivered as a result of our efforts to build value for shareholders. The compounded annual total returns on Imasco common shares for the three- and five-year periods ended December 31, 1998, were 39.3% and 31.1% versus 13.2% and 10.7% for the TSE 300. At year-end the market value of Imasco's common equity was $14.3 billion, more than triple what it was at the end of 1994.

Total payout to common shareholders



Building for the Future

Regulatory developments such as those that are occurring in tobacco and financial services (and I could add pharmacy) present a good example of environmental changes that our companies must consider when formulating their business plans. There are of course many others, including new competitors, emerging technologies, shifts in customer preferences, and demographic trends. While these factors cannot be controlled, businesses must adapt to them if they are to be successful. Weather provides an apt analogy: You can't change the weather, but you can certainly dress for it.

Our businesses strive to manage the things they can control to achieve excellence in operations and the best possible short-term results. They also continuously adapt so as to respond to environmental changes and strengthen their long-term competitiveness.

An impressive array of projects is under way across the Imasco companies to enhance competitiveness. Some involve new markets, such as CT Financial's direct marketing of insurance or Genstar's 4S Kelwood project in San Diego. Others are aimed at improved margins, such as Imperial Tobacco's manufacturing investments and Shoppers' retail positioning work. These projects and others, which are more fully described in the operations review that follows, demonstrate clearly that Imasco companies are determined to avoid the complacency that often accompanies success. The management approach that spawned these initiatives is creating a strong foundation for Imasco's future growth.

Outlook

We are confident about Imasco's prospects in 1999. All our businesses are expected to increase their earnings contribution, and all have exciting plans afoot to secure their future competitiveness. This optimism is reflected in the board's decision to increase the quarterly dividend by 18% to $0.20 and allocate up to $400 million for the repurchase of common shares in 1999.

The promise of the coming year is built upon our successes in 1998. On behalf of shareholders, I want to sincerely thank our operating company leaders, the corporate centre staff, and Imasco's board of directors for their invaluable contributions. They are a formidable team with remarkable dedication and talents.

B M Ltt

Brian M. Levitt
President and Chief Executive Officer
January 28, 1999

Operations Review

Imperial Tobacco

Canada's Premiere Tobacco Company

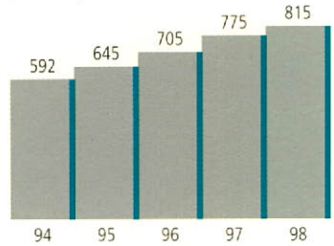
Imperial Tobacco is the largest tobacco enterprise in Canada. Operations, which are carried on through a number of affiliated companies, range from leaf tobacco buying to the manufacture and sale of a full range of tobacco products. Imperial products now account for 64.3% of the Canadian tobacco market, with *du Maurier* and *Player's* the number one and two cigarette brands in the country.

1998 Highlights

- **Imperial's cigarette market share grew by 0.4 of a share point to 68.4%.**
- **Shipments of cigarettes and cigarette equivalents increased 1.5% over 1997.**
- **Contribution to operating earnings was $815 million, up 5% due to higher volumes and margins.**
- **The company completed the consolidation of all primary processing activities in Aylmer, Ontario, and began phasing in high-speed cigarette manufacturing equipment at the Guelph plant.**

Operating earnings

($ millions)



Business Environment

The Canadian tobacco industry is mature, and sales have been in gradual decline for many years. This long-term trend is expected to continue, yet the Canadian industry remains substantial and profitable. Three major manufacturers compete intensely for a share of the shrinking market. Other, smaller participants are making inroads and, including imports, currently account for approximately 2% of the market.

While the economics of tobacco sales are attractive, the public policy environment is decidedly hostile, and this presents a considerable challenge for Imperial Tobacco and its competitors. For example, legislation that effectively bans tobacco advertising in Canada limits the industry's ability to communicate with consumers. And, largely due to public sentiment against smoking, the industry receives scant recognition for the considerable tax revenues it generates for public coffers. Imperial Tobacco's operations generated an estimated $3.5 billion for all levels of government in 1998, more than seven times the after-tax tobacco earnings that accrued to Imasco shareholders.

Tobacco product liability litigation is on the rise in Canada, and Imperial Tobacco is defending its interests vigorously. At the same time, Imperial remains focused on growing market share profitably so as to enhance earnings and cash flow in a declining-demand environment.

Building for the Future

Imperial Tobacco's current initiatives are centred on strengthening its trademarks, increasing efficiency, and becoming more proactive in the public discourse about tobacco policy.

- An ongoing priority is to further strengthen trademarks to maintain market share growth. In 1998 Imperial began developing forms of communication that conform with new government restrictions. While the restrictions are comprehensive and confining, a number of innovative approaches have been identified and will be progressively introduced in 1999.
- By the middle of 1999 the company will have completed its efficient manufacturing program, which entails investments of more than $230 million in a major makeover of production capabilities.
- The one-sided public "debate" around smoking remains a challenge. Imperial wants to balance the public dialogue about tobacco and participate in the development of reasonable tobacco policies. One clear opportunity is to emphasize important common ground the company shares with governments, namely the conviction that tobacco product use is an adult choice.
- Realizing that employees, suppliers, customers, and the public at large need and deserve the facts, Imperial recently produced *Where We Stand,* a booklet detailing the company's position on contentious issues surrounding tobacco use, including smoking and health. *Where We Stand* has been widely distributed and can be obtained through Imperial's Corporate Affairs Department.

R. Donald Brown
Chairman, President and
Chief Executive Officer

Outlook

Though smoking in Canada is in slow decline, nearly seven million Canadian adults choose to smoke. Accordingly, demand for tobacco products will remain substantial for many years to come. Imperial's success can and will be sustained through a steady focus on increasing the value of our trademarks by creating quality products that best satisfy consumer preferences – products manufactured more efficiently and at lower cost than our competitors.

Imperial's success is in large measure a credit to its employees past and present. We acknowledge and thank them sincerely for their contributions. A spirit of confidence prevails across our company stemming from the continued popularity of Imperial brands with smokers. We are enthused about the initiatives the company is implementing to strengthen its position and united in our belief that Imperial Tobacco will continue to grow earnings and market share.

Canada Trust

Comfortable Personal Financial Services

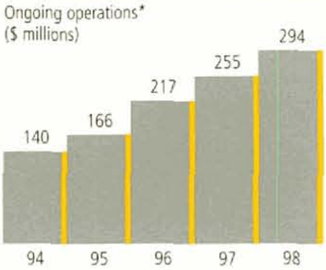
Canada Trust, the principal operating subsidiary of CT Financial Services Inc., provides a comprehensive array of personal financial services to Canadians, including chequing and savings, lending, insurance, and a complete range of wealth management services. The company has built a reputation for personalized attention and quick, creative responses to customers' needs. Access is made easy through 429 branches and 847 automated banking machines in Canada, and 24-hour *EasyLine* telephone and *EasyWeb* Internet services.

1998 Highlights

- **Net common share earnings from ongoing operations were $294 million, up 15% from 1997.**
- **Revenues from ongoing operations grew 11%.**
- **Return on common shareholders' equity was 16.1%, excluding the impact of more than $900 million of excess capital held for redeployment.**
- **Exceptional asset quality helped maintain credit ratings that are among the highest of Canadian financial institutions.**

Common share earnings

Ongoing operations*
($ millions)



Ongoing operations: excludes the gain on the 1997 sales of First Federal and the trust and custody business as well as the earnings from these businesses and certain one-time expenses.

Business Environment

After several years of exceptional growth, a series of shocks to the global economy produced volatile capital markets in 1998. *Heading into 1999, market prospects* remain uncertain. With growth ebbing among the country's major trading partners, Canadian economic activity is also expected to decelerate in 1999. In addition, Canadians are heavily invested in equity markets through mutual funds and RRSPs and, while rising equity prices create a sense of wealth that boosts consumer confidence, falling markets can have the opposite effect. Never before has the real economy been so tied to financial market developments.

A likely result of slower growth is increased competition and further consolidation in the financial services industry. Canada Trust competes with the large Canadian banks and with *monoline companies: the brokerage, insurance, mutual fund, and other specialty* companies that operate in tightly targeted product and customer segments. Four of the major banks announced merger plans in early 1998, only to have the proposals turned down by the federal finance minister in December. The banks are now anxious to restore momentum in personal financial services and are expected to be aggressive in both marketing and pricing.

To compete head-on with the banks and with the monoline specialists, CT Financial's strategy is to focus exclusively on personal financial services delivered within a friendly, "comfortable" environment and made easier through cutting-edge technology.

Building for the Future

In keeping with its focus on personal financial services, CT Financial is concentrating its building efforts on four key areas: day-to-day personal financial services, lending, wealth management, and insurance.

- Seven new branches were added in 1998, and plans call for 12 more in 1999. The company also enhanced *EasyWeb* Internet and *EasyLine* telephone services. *EasyLine* now has one million customers, and *EasyWeb* customers grew by 125,000. Together, the two groups generated more than 66 million transactions.
- Value-added service package options were introduced to reward best customers, and the company's easy-access credit and other personal financial services were extended to the small business banking market.
- A redesigned state-of-the-art credit approval system was put in place, enabling Canada Trust to offer a broader range of options to customers, each priced according to inherent risk. Under the new system, consumer and collateral lending grew strongly in the second half, and the company enters 1999 with strong momentum.
- The Wealth Management Team was re-organized and strengthened to integrate the delivery of investment products and estate, trust, and investment management services. The company also began testing a mobile financial-planning sales force that offers clients personalized service in their homes or places of work.
- The company continued building on the success of industry-leading Meloche Monnex Inc., acquired in 1997, by launching CT Direct Insurance, a sister company that creates insurance solutions to meet the needs of target customers.

Outlook

As we enter more challenging markets, CT Financial's low-risk profile will serve us well. Our balance sheet is well hedged and positioned to offset the movement of interest rates, a strategy that should continue to yield stable, predictable earnings over time. The redeployment of the capital we gained from the 1997 sale of our U.S. operations and pension and custody business remains a focus. While the bank merger debate deflected our energies for much of 1998, we did not cease our search for appropriately priced acquisitions that fit with the company's strategy. We are confident that 1999 will see developments in this area.

W. Edmund Clark
President and
Chief Executive Officer

Success in financial services is increasingly dependent upon building relationships with customers and the adept use of information technology. Winners will be those companies with the best knowledge of their customers that deliver the best response to their needs. Besides developing an exceptional understanding of customers and of the economics of our business, Canada Trust will cement its success by providing a superior customer experience at every point of contact. Our employees are central to our reputation for service excellence, and we are tremendously grateful to them. Their dedicated efforts keep Canada Trust building value for customers and shareholders alike.

Shoppers Drug Mart/ Pharmaprix

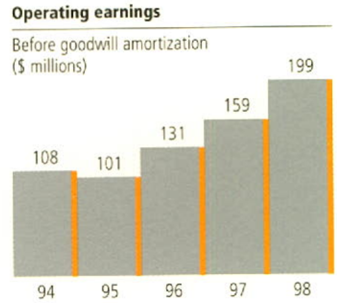
Canada's Drugstore

With 824 stores from coast to coast, Shoppers Drug Mart/Pharmaprix is the largest drugstore group in Canada. The company meets health-care needs with sound professional advice and personalized, convenient services. Stores are owned by pharmacist "associates" and operated under license agreements. The system combines entrepreneurial drive and close community ties with the benefits of national scale.

1998 Highlights

- System sales grew 3.9% on a comparable store basis. Prescription sales grew 10%.
- Focused marketing and in-store activities contributed to a more profitable sales mix and a 25% increase in operating earnings contribution.
- All former Big V stores (acquired in 1996) were fully converted to Shoppers Drug Mart systems and licensed to associates.
- The company acquired the 17-store Doncaster Home Health Care business and merged it with the Shoppers Home Health Care Division.

Operating earnings



Business Environment

A growing, ageing population creates a favourable backdrop for the Canadian drugstore industry. The same demographics are also increasing the national health-care bill. A resulting trend has been downward pressure on prescription margins brought on by public and private efforts to reduce costs. Heightened industry competition is also squeezing industry profits. Competition for Shoppers Drug Mart/Pharmaprix comes from a variety of sources, notably regional chains and also mass merchandisers and food/drug combo stores that offer discounted pharmacy services.

The company's strategy positions Shoppers Drug Mart/Pharmaprix as the best choice for professional health care. Its expertise lies in counseling customers on prescriptions and over-the-counter medications, and the high quality of that professional service has become a source of competitive advantage. Effective pharmacy care complements the work of hospitals and physicians.

Building for the Future

Shoppers Drug Mart is focused on expanding and strengthening its value-added health-care services and improving the shopping experience for customers.

- In collaboration with the Province of New Brunswick and the Canadian Association of Chain Drug Stores, Shoppers Drug Mart and all other Fredericton-area pharmacies are undertaking Canada's first pilot study to quantify the benefits of pharmacist interventions, including counseling, monitoring patient compliance, and providing information to prescribing physicians.
- The company is expanding its programs to help patients manage their health care. Over the past two years Shoppers Drug Mart/Pharmaprix has screened 20,000 customers for cardiac risk factors, recommending 9,000 for follow-up care by physicians. Another 15,000 patients with diabetes or asthma have received assistance from *HealthWatch* pharmacists during Clinic Days.
- To enhance service in over-the-counter medications, associates are augmenting the number of hours that additional pharmacists are on the floor, counseling customers. Their advice will be extended to the growing area of nutraceuticals – vitamins, minerals, herbal remedies, and other dietary supplements consistent with good health.
- Recently completed sales analyses and retail positioning studies are helping the company focus on those customers who most value Shoppers Drug Mart services and develop ways of serving them better. Targeting these important customers has implications for nearly every aspect of the business, from advertising and merchandising techniques to store layout.
- Store design will continue to be refined in 1999 to improve the shopping experience for customers. Over the next few years the new dispensary prototype, Pharmacy 2000, will be rolled out to all stores. Its open format facilitates patient-pharmacist dialogue. Further store acquisitions and openings are anticipated, including 33 new stores in 1999.

David R. Bloom
Chairman and
Chief Executive Officer

David Bloom was named Chain Drug Review's 1998 Retailer of the Year – the first Canadian to receive this prestigious U.S. award.

Outlook

Over the last five years, working closely with our associates, we have transformed Shoppers Drug Mart/Pharmaprix into an information-based retailer. The transition to centralized purchasing, distribution, and accounting was critical to our future, but not without risks. The success of these sweeping endeavours underlines what an asset we have in our people – surely the strongest complement in the drugstore industry.

A hallmark of Shoppers Drug Mart/Pharmaprix is embracing change. Our associates welcome every opportunity to build their businesses, and we are all tremendously energized by the potential for growth embedded in our retail positioning work. The process of harvesting that potential began in 1998, it will continue for years to come, and it is creating a firm new platform for steady and profitable growth.

Genstar

Bringing Land to Life

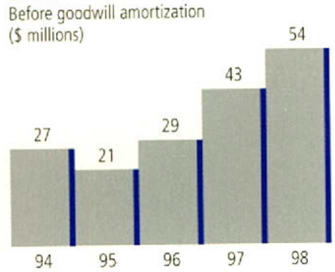
Genstar develops master-planned residential communities in Canada and the United States. The company adds value to projects by transforming raw land into marketable communities with attractive amenities, working closely with homebuilders and other partners.

1998 Highlights

- **Sales reached $200 million for the first time in Genstar's history, up 12% over 1997.**
- **Contribution to operating earnings grew 26% to $54 million, with the company's U.S. operations contributing most of the increase.**
- **Canadian earnings were strongest in the booming Calgary market.**
- **Land-use approvals were obtained for Genstar's most important U.S. project, 4S Kelwood in San Diego, and sales will begin in 1999.**

Operating earnings

Before goodwill amortization
($ millions)



Business Environment

Key variables affecting the residential real estate market are economic activity, consumer confidence, mortgage rates, and building-lot inventories. Fundamentals are now favourable in most of North America, but particularly in the United States, where many metropolitan areas are enjoying brisk development. In Canada, similar market conditions prevail, and the company's traditional markets are performing well; however, high land prices make new projects with sound economics hard to come by. Consequently, Genstar has set its investment sights primarily on the United States, where opportunities are numerous.

Building for the Future

Genstar continues to strengthen its U.S. presence and to focus on enhancing financial returns.

- U.S. markets represent solid growth opportunities for Genstar, and 58% of the company's assets, measured by net book value, are now in the United States. Further U.S. expansion is expected in 1999.
- A priority for Genstar has been to shorten investment cycles. Formerly, the company purchased long-term land on the fringe of major markets and developed it only as the city expanded outward. Genstar now looks for opportunities – often joint ventures with landowners and builders – to achieve its target investment cycle of five or fewer years, with less capital invested up front.
- In Canada, Genstar is selling surplus long-term land where development horizons are too distant to fit the company's new financial model. These sales make cash available for more productive investments.
- An overall objective is to significantly improve return on capital by maintaining a balanced portfolio of long- and short-term projects.

Outlook

Through the efforts of talented and committed employees, Genstar has evolved from being land bank driven to knowledge driven. Success is based on understanding financial opportunities, market opportunities, and buyers' objectives, and by selling Genstar's considerable development strengths. This approach has created strong and valuable business relationships with builders across North America. Given our strict financial framework and geographically diversified portfolio of projects, we expect dependable and growing earnings in the years ahead.

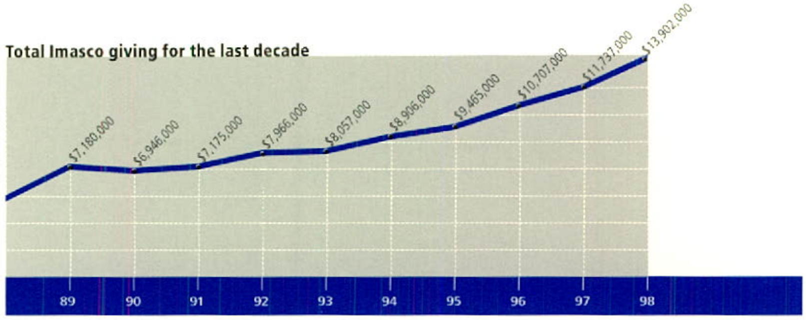
Frank L. Thomas
President and
Chief Executive Officer

In 1998, Imasco and its companies contributed $13.9 million to more than 1,600 national and community organizations across Canada, as follows: corporate and local donations by Imasco, Imperial Tobacco, Shoppers Drug Mart/Pharmaprix, and Genstar, $8.3 million; Canada Trust, $3.7 million; and du Maurier Arts, $1.9 million. A publication detailing the Imasco corporate donations is mailed to shareholders every spring and can also be obtained from the Secretary of Imasco.

Imagine
A Caring Company

Imasco has met or exceeded the Canadian Centre for Philanthropy's suggested *Imagine* giving level of 1% of corporate pre-tax profits since the program's inception in 1989.

Total Imasco giving for the last decade



Imasco Corporate Donations

Throughout the world, people are living longer, and by 2030 one person in three will be age 60 or older in Canada and other developed countries. To recognize "humanity's demographic coming of age" the United Nations has designated the period October 1, 1998, through December 31, 1999, the International Year of Older Persons.

Imasco corporate donations have long supported a wide spectrum of initiatives designed for Canada's over-60 population. We highlight here a sampling of programs receiving funds in 1998. Each contributes to the well-being of clients in their elder years.

Encouraging lifelong learning and contributions

The wide range of lectures and courses presented by the Minerva Senior Studies Institute at Edmonton's Grant MacEwan Community College enables "50 Up" students to explore their intellectual interests, plan for retirement, and learn new skills for second careers.

Caring for those who have lost autonomy

Across Canada, Imasco supports scores of outstanding care facilities for elders who can no longer care for themselves. In Scarborough, Ontario, the Yee Hong Centre for Geriatric Care provides for the comfort of elderly Chinese immigrants through ethnic foods, spoken Chinese, and care inspired by Chinese cultural values.

Canada Trust

Canada Trust generously supports the United Way and, through its "Reach Out" program, encourages employees to volunteer and contribute to their favourite charities. The company's other contributions focus on education and the environment. Of the $3.7 million in sponsorships and donations given by Canada Trust in 1998, 20 Canada Trust Scholarships for Outstanding Community Leadership, valued at $50,000 each, were awarded to high school and CEGEP graduates; also in 1998, Canada Trust customers helped the Friends of the Environment Foundation raise more than $3.4 million to support 1,333 environmental projects in communities across Canada.

The Friends of the Environment Foundation has contributed more than $14 million since 1990 in support of some 7,700 environmental projects Canada-wide. An impressive1998 project in Fergus, Ontario, is the new terrace garden for residents at the Wellington Home for the Aged. The Foundation contributed $3,000 for trees, shrubs, and flowers and for developing walkways for wheelchair access.

du Maurier Arts

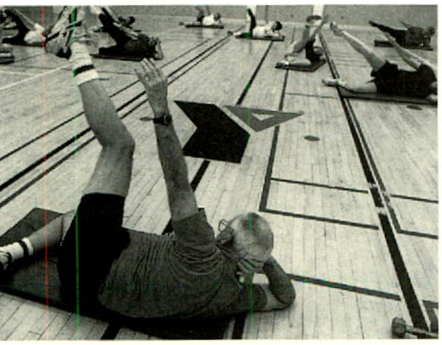
du Maurier Arts reached a most notable milestone in 1998, when its total contribution to Canadian arts programs and capital support for venues since its inception in 1971 surpassed $50 million. In that span, some 400 arts organizations have received du Maurier Arts funding, enabling thousands of artists in all parts of the country to display their remarkable talents in a diversity of disciplines.

As in previous years, du Maurier Arts helped to stimulate innovative projects in virtually every form of artistic expression: music, dance, theatre, visual arts, literature, opera, and regional festivals. In the process, it contributed to the emergence of new artists, the growth of the audience base, and the enrichment of the entire arts community.

Promoting independent living

Transportation to community services is a key factor enabling many elderly and disabled persons to live at home. Brantford, Ontario's Operation Lift provides rides by appointment to its 2,200 clients to destinations such as the doctor's office, food shopping, and the mall, 7 days a week, 24 hours a day, for a total of 56,000 trips a year.

Isolation and lack of mobility put many low-income or disabled seniors at risk for nutritional deficiencies. Montréal's Santropol roulant supports "ageing in place" by providing homebound elderly clients nutritious, cooked meals plus daily contact with youthful volunteers.



Exercise programs for the elderly – like "Prime Tyme" in Toronto's Metro-Central YMCA – promote optimum fitness and a sense of well-being. Research shows that no matter one's age, strength-training exercise combats the ill-effects of ageing.

Board of Directors

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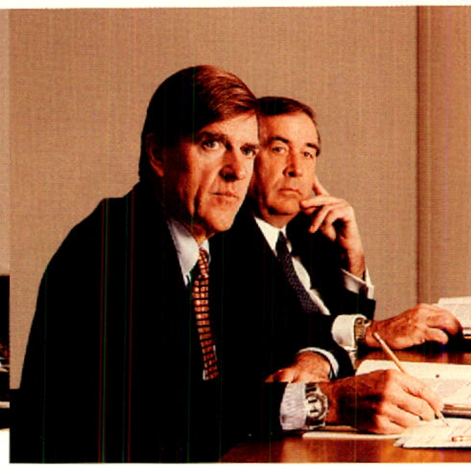

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5 6

1 **J. Robert S. Prichard,** O.C.
Toronto, Ontario. Director since 1993. Chair of Human Resources Committee and member of the Executive and Audit Committees. President, University of Toronto. Professor, Faculty of Law, University of Toronto. Director, Four Seasons Hotels Inc., Moore Corporation Limited, ONEX Corporation, Tesma International, Association of American Universities, Association of Universities and Colleges of Canada, International Association of Universities, Japan Society, Toronto Economic Advisory Committee. Governor, University of Toronto. Trustee, Royal Ontario Museum, Toronto Hospital.

2 **John L. Bragg,** O.C.
Collingwood, Nova Scotia. Director since 1997. Member of the Executive, Human Resources, and Nominating & Corporate Governance Committees. President, Oxford Frozen Foods Ltd. Director, Canada Bread Company Limited, Shaw Communications Inc., Stora Forest Industries Limited, Sobey's Inc. Board of Regents, Mount Allison University.

3 **Bernard A. Roy,** Q.C.
Nun's Island, Verdun, Québec. Director since 1989. Member of the Executive, Human Resources, and Nominating & Corporate Governance Committees. Senior Partner, Ogilvy Renault. Director, Intrawest Corporation, Métro-Richelieu Inc., Noranda Inc. (Honorary member), Fonds Ville-Marie, Foundation of the Board of Trade of Metropolitan Montréal, Institut de Design Montréal, Montreal Symphony Orchestra. Governor, National Theatre School of Canada (Chairman), The Portage Program for Drug Dependencies Inc., Royal Victoria Hospital Corporation, Université de Montréal.

4 **James R. Bullock**
Burlington, Ontario. Director since 1997. Member of the Executive and Audit Committees. President and Chief Executive Officer, Laidlaw Inc. Chairman, Safety-Kleen Corp. Director, Ontario Hydro, The Conference Board of Canada. Governor, McMaster University.

5 **Ronald D. Southern,** C.M., CBE
Calgary, Alberta. Director since 1993. Member of the Executive and Nominating & Corporate Governance Committees. Chairman and Chief Executive Officer, ATCO Ltd. and Canadian Utilities Limited. Director, Akita Drilling Ltd., Canadian Airlines Corp., Canadian Pacific Limited, Chrysler Canada Ltd., Fletcher Challenge Canada Limited, Lafarge Corporation, Royal & Sun Alliance Insurance Company of Canada, Southam Inc. Strategic Advisory Board, Xerox Canada Inc.

6 **Nan-Bowles de Gaspé Beaubien**
Westmount, Québec. Director since 1987. Chair of Nominating & Corporate Governance Committee and member of the Executive and Human Resources Committees. President, Institute for Family Enterprise. Director, Four Seasons Hotels Inc., Telemedia Communications Inc. Governor, Junior Chamber of Commerce of Montreal.

7 8 9 10 11 12

7 **Charles H. Hantho,** C.M.
Islington, Ontario. Director since 1993. Chair of Audit Committee and member of the Executive and Human Resources Committees. Chairman, Dofasco Inc. Director, AGRA Inc., Camco Inc., Inco Limited, Telemedia Communications Inc., TransAlta Corporation. Chairman, Board of Governors, York University.

8 **David R. Bloom**
Thornhill, Ontario. Director since 1983. Chairman and Chief Executive Officer, Shoppers Drug Mart Limited. Director, Canadian Association of Chain Drug Stores, Hospital for Sick Children, National Association of Chain Drug Stores, Retail Council of Canada. Advisory Council, Faculty of Administrative Studies, York University.

9 **Purdy Crawford,** O.C.
Toronto, Ontario. Director since 1973. Chair of Executive Committee and member of the Audit, Human Resources, and Nominating & Corporate Governance Committees. Chairman of Imasco Limited, CT Financial Services Inc. Director, Aeroquip-Vickers, Inc., Camco Inc., Canadian National Railway Company, Inco Limited, Maple Leaf Foods Inc., Nova Scotia Power Inc., Petro-Canada, Venator Group, Inc. Chancellor, Mount Allison University. Governor Emeritus, McGill University. Advisory Board, Oxford Frozen Foods Ltd., Sullivan & Associates. Honorary Counsel, Osler, Hoskin & Harcourt.

10 **Brian M. Levitt**
Montréal, Québec. Director since 1989. Member of the Executive Committee. President and Chief Executive Officer, Imasco Limited. Director, CT Financial Services Inc., BCE Inc., Domtar Inc., Moore Corporation Limited, C.D. Howe Institute, Fraser Institute, Montcrest School, Montreal Museum of Fine Arts, Wharton School.

11 **R. Donald Brown**
Westmount, Québec. Director since 1993. Chairman, President and Chief Executive Officer, Imperial Tobacco Limited. Chairman, Canadian Tobacco Manufacturers' Council. Director, British American Racing, Canadian Golf Foundation.

12 **Raymond E. Guyatt**
Westmount, Québec. Director since 1990. Executive Vice-President and Chief Financial Officer, Imasco Limited. Director, CT Financial Services Inc.

Corporate Governance

Snapshots from Imasco's annual planning meeting in December 1998. The yearly event brings together directors, Imasco officers, and senior management teams from all the businesses.

Purdy Crawford and Brian Levitt in conversation with David Bloom of Shoppers Drug Mart.

Jodi White of Imasco with John Bragg and Chuck Hantho.

Paul Derksen of CT Financial with Nan-b de Gaspé Beaubien.

Imperial Tobacco's Don Brown confers with Pierre Duhamel of Imasco and Jim Bullock.

Imasco's mission is to build value for shareholders. Our corporate governance system exists to support the accomplishment of this mission – not as an end in itself. Although process and structure are helpful, ultimately it is the quality of the people involved on the board, on the management team, and throughout the organization, and the quality of their work, that will have the greatest impact on our performance.

Imasco recognizes the importance of keeping shareholders and other stakeholders informed of our approach to governance and has been providing such information since 1990. Our corporate governance practices are described in the 1999 management proxy circular, a copy of which may be obtained from the Secretary of Imasco. Disclosure is made with reference to guidelines (which are not mandatory) set forth in Canadian stock exchange rules. The board of directors believes that Imasco's approach to corporate governance conforms to these guidelines in all material respects.

Financial Review

Management's Discussion and Analysis (MD&A) provides an analysis of Imasco Limited's 1998 consolidated results of operations, financial condition, and cash flows, and it should be read in conjunction with the audited consolidated financial statements of the Corporation contained on page 49 to page 73 of this annual report. This MD&A focuses on the operating companies (Imperial Tobacco, Shoppers Drug Mart/Pharmaprix, and Genstar Development Company) and on CT Financial Services Inc. (CT Financial). CT Financial publishes a more detailed discussion and analysis of its results of operations and financial condition in its annual report. A copy may be obtained from the Secretary of Imasco Limited.

Building Value for Shareholders

Imasco's mission is to build value for shareholders. This goal is achieved by continuously enhancing the long-term competitiveness of its operating companies and CT Financial while insisting on operational and financial excellence that produces superior short-term results. Imasco believes that the resulting consistent growth in earnings and cash flows will enable it to provide superior returns to shareholders in the form of dividends and share-price appreciation.

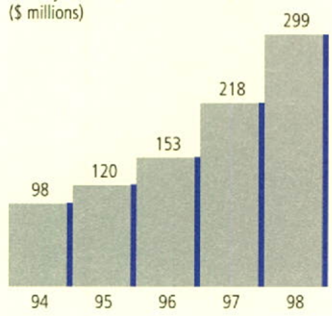
In keeping with its mission, the financial framework of Imasco has evolved to one that focuses on maximizing shareholder value over the long term. Value-based principles drive Imasco's capital allocation, asset management, strategy evaluation, planning, and performance measurement processes. This approach is in line with the view that financial discipline, relevant performance measurement, controls, and accountability are essential to creating shareholder value. To build value over the long term, Imasco strives to earn a return on operating capital that exceeds its estimated after-tax cost of capital. For the period 1994 to 1996 Imasco used an estimated overall cost of capital of 11.5% after tax. As a result of lower long-term interest rates, the estimated after-tax cost of capital was reduced to 10.5% effective January 1, 1997, and to 10% effective January 1, 1999.

Economic profit and economic value added (EVA) are measures that allow operating companies to evaluate their contributions to Imasco's overall mission and share-price performance. These concepts provide management with an effective framework for evaluating performance from a value-generating perspective by focusing on asset productivity. Economic profit is defined as net operating profit after tax and after deducting a notional amount for the cost of average operating capital employed. The calculation excludes certain non-recurring items to better reflect sustainable operating performance and potential. EVA is the growth in economic profit year over year.

Imasco achieved economic profit of $355 million in 1998 and $274 million in 1997, while EVA was $81 million in 1998 and $65 million in 1997.

Cumulative economic value added

January 1, 1994, to December 31, 1998
($ millions)



Overview

Earnings summary	1998	1997	% Change
($ millions, except per share amounts)			
Net earnings from continuing operations	**741**	905	(18)
Discontinued operations	**18**	(115)	n.m.
Net earnings	**759**	790	(4)
Earnings per common share[1]			
Continuing operations	**$1.63**	$1.95	(16)
Discontinued operations	**$0.04**	($0.25)	n.m.
Net earnings	**$1.67**	$1.70	(2)
Excluding gain on sale of First Federal			
Net earnings from continuing operations	**741**	659	12
Net earnings from continuing operations per common share[1]	**$1.63**	$1.42	15

n.m.: not meaningful

[1] Reflects the subdivision of common shares on a two-for-one basis on May 15, 1998.

Continuing operations

Imasco's net earnings from continuing operations amounted to $741 million ($1.63 per share) in 1998 compared with $905 million ($1.95 per share) in 1997. Included in Imasco's 1997 net earnings from continuing operations is a net gain of $246 million ($0.53 per share) resulting from the sale of First Federal Savings and Loan Association of Rochester (First Federal) by CT Financial on March 1, 1997. Excluding this 1997 special gain, Imasco's net earnings from continuing operations grew 12% from $659 million ($1.42 per share) to $741 million ($1.63 per share) in 1998. This improvement reflects increased operating earnings at Imperial Tobacco, Shoppers Drug Mart/Pharmaprix (Shoppers Drug Mart), and Genstar Development Company (Genstar), as well as reduced interest expense.

Per share amounts are calculated by dividing net earnings attributed to common shares (which are determined after deducting dividends on preference shares) by the weighted-average number of common shares outstanding during the year. The weighted-average number of common shares outstanding in 1998 was 448,224,073 compared with 458,997,664 (post-split) in 1997. Changes in common shares outstanding are itemized in Note 7 to the consolidated financial statements on page 57.

Discontinued operations

In April 1998 Imasco announced its decision to sell the remaining business in the Foodservice segment, being the four business units of Fast Food Merchandisers, Inc. (FFM). On September 30, 1998, the Corporation completed the sale of the foodservice distribution operations. In October 1998 the Corporation sold the pork processing business and, in a separate transaction, the poultry processing operation. The sale of these three business units provided Imasco with net proceeds of $178 million (US $116 million). The sale of the cleaning supplies business is expected to be completed in 1999. The resulting gain on the sale of the three business units and FFM's 1998 net earnings from operations together amounted to $18 million and are included in discontinued operations. The 1997 loss from discontinued operations of $115 million includes special charges totalling $124 million (US $90 million) to provide for certain liabilities and costs associated with the sale of Hardee's Food Systems, Inc. (Hardee's) (sold effective July 15, 1997) and to write off deferred income tax assets. In addition, 1997 discontinued operations include net earnings from operations of $9 million.

Including discontinued operations, Imasco's 1998 net earnings amounted to $759 million ($1.67 per share) compared with $790 million last year ($1.70 per share). The return on average common shareholders' equity was 20.5% in 1998 compared with 22.0% in 1997.

Consolidated Results of Operations

The following comments summarize the consolidated results of Imasco's operating companies and CT Financial, which are discussed in greater detail in subsequent sections.

Operating results	Revenues		Operating earnings	
($ millions)	1998	1997	1998	1997
Imperial Tobacco	**1,754**[1]	1,642[1]	**815**	775
CT Financial	**3,844**	3,831	**452**	472
Shoppers Drug Mart/Pharmaprix	**2,786**	2,681	**199**	159
Genstar Development Company	**200**	178	**54**	43
	8,584	8,332	**1,520**	1,449
Goodwill amortization			**71**	73
Other costs and administration			**61**	55
Operating earnings before special gain			**1,388**	1,321
Gain on sale of First Federal			**–**	288
Operating earnings			**1,388**	1,609

[1] Net of tobacco taxes and duties

Revenues

Imasco's consolidated revenues, net of tobacco taxes and duties, grew by $252 million (3%) in 1998. This improvement was attributable to:

- higher revenues at Shoppers Drug Mart (4%) resulting from strong growth in fee-related income;
- an increase of 7% in Imperial Tobacco revenues due to price increases and slightly higher volumes; and
- strong revenue growth at Genstar (12%), particularly in its U.S. operations.

Total revenues of CT Financial, which are reported on a gross investment income basis in Imasco's consolidated results, were essentially unchanged in 1998 when compared with last year, despite the impact of the March 1, 1997, sale of First Federal. Fees and other income rose by 2% primarily due to increased fee-based products and net gains on the sale of mortgage-backed securities.

Operating earnings

Imasco's operating earnings before the special gain increased by $67 million (5%) in 1998 due to:

- higher revenues and improved margins at Imperial Tobacco;
- stronger gross margins at Shoppers Drug Mart resulting from a shift in the sales mix, and from 53 weeks of operations in 1998 versus 52 weeks in 1997; and
- improvements at Genstar reflecting a strong housing market in Alberta and substantial growth in U.S. operations;

partially offset by

- a decline of 4% at CT Financial resulting from the 1997 sale of First Federal. (Net earnings from CT Financial's ongoing operations increased 15.3% in 1998 when compared with 1997. Ongoing operations exclude the gains on the sale of First Federal and the custody business sold in 1997 as well as the earnings from these businesses and certain special charges in 1997.)

Interest expense

In 1998 Imasco's interest expense decreased 18% to $101 million from $123 million in 1997, reflecting:

- lower average debt levels largely attributable to strong operating cash flows as well as the repayment of debt with the proceeds from the 1997 sale of Hardee's and from the 1998 sale of FFM; and
- the refinancing of $150 million 10½% debentures that matured in April 1998 with lower-cost debt.

The average total debt outstanding during 1998 amounted to $1.5 billion, $300 million lower than during 1997. The average interest rate on total debt was 7.3% compared with 7.0% in 1997, while the average interest rate on variable-rate debt was 5.5% compared with 4.7% last year. The proportion of fixed-rate debt declined from 73% of total debt at December 31, 1997, to 69% at December 31, 1998, as a result of financing and hedging activities undertaken during 1998. Changes in the composition of total debt in 1998 are discussed under Capital resources on page 43 of this MD&A. Interest coverage (the ratio of earnings before interest and taxes to interest expense) was 13.7 in 1998 compared with 13.1 in 1997.

Income taxes

Imasco's overall effective income tax rate on earnings from continuing operations was 35.3% in 1998 compared with 32.7% in 1997. Comparability of the effective income tax rate is affected by the 1997 sale of First Federal, which resulted in a taxable capital gain that enabled Imasco to record the benefit of previously unrecognized capital loss carryforwards. This reduced Imasco's 1997 tax expense by $36 million. As outlined in the following table, excluding the impact of the sale of First Federal, the 1997 effective income tax rate would have been 37.4%.

Effective income tax rate	Pre-tax earnings from continuing operations	Income taxes	Effective income tax rate
($ millions, except as noted)			
1998			
As reported	**1,287**	**455**	**35.3%**
1997			
As reported	1,486	486	32.7%
Sale of First Federal	(288)	(37)	
Excluding the above	1,198	449	37.4%

Note 11 to the consolidated financial statements on page 58 outlines the principal factors that caused the effective income tax rate to vary between 1997 and 1998 and provides details of loss carryforwards.

Outlook

In 1999 earnings improvement is expected from each of Imasco's businesses, leading to overall growth in operating earnings and in net earnings from continuing operations.

Imperial Tobacco

Revenues

Imperial Tobacco's revenues, net of tobacco taxes and duties, grew by $112 million (7%) in 1998 to $1.8 billion due to:

- a cigarette price increase to wholesalers of 4.4% in April 1998;
- an increase of 1.5% in total shipments of cigarettes and approximate equivalents; and
- cigarette price increases to wholesalers in April 1997 and October 1997 of 4.3% and 2.9%, respectively, the latter to recover the cost of the federal surtax;

partially offset by

- lower export sales of leaf tobacco in 1998.

Imperial Tobacco shipments	**1998**	1997	1996
(Billions of cigarettes and approximate equivalents)			
Domestic			
Cigarettes	**31.5**	31.2	31.6
Roll-your-own	**1.6**	1.6	1.6
Tobacco sticks	**0.5**	0.1	–
Export and duty-free			
Cigarettes	**0.6**	0.8	0.7
Roll-your-own	**–**	–	0.1
Total	**34.2**	33.7	34.0
Market share (%) [1]	**64.3**	63.6	62.3

[1] Based upon Statistics Canada figures and Imperial Tobacco estimates.

The Canadian industry's total shipments of cigarettes, roll-your-own products, and tobacco sticks are estimated to have increased 0.6% in 1998 to 53.2 billion cigarettes and equivalents.

Industry shipments	**1998**	1997	1996
(Billions of cigarettes and approximate equivalents)			
Domestic			
Cigarettes	**45.5**	45.5	47.1
Roll-your-own	**4.1**	4.2	4.2
Tobacco sticks	**2.0**	1.5	1.4
Export and duty-free			
Cigarettes	**1.4**	1.5	1.4
Roll-your-own	**0.2**	0.2	0.4
Total [1]	**53.2**	52.9	54.5

[1] Based upon Statistics Canada figures and Imperial Tobacco estimates.

The preceding table does not provide an accurate measure of smoking prevalence or consumption levels. Shipments represent sales to wholesalers and can vary according to production and inventory levels and other distribution-channel dynamics. Making minor adjustments for these inventory and shipment fluctuations, the industry volume and consumer demand indicators have been relatively flat to declining over the last several years.

Market share

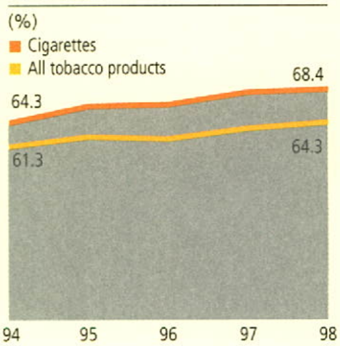
In 1998 Imperial Tobacco's share of the manufactured cigarette market grew by 0.4 of a share point to 68.4%. The gain in this segment, in which profit margins are largest, is due to:

- the strength of the company's three major Canadian trademarks: *du Maurier, Player's,* and *Matinée;*
- product quality;
- market and consumer research; and
- the effectiveness of the company's domestic sales force.

In the roll-your-own segment, Imperial Tobacco's market share increased 1.3 share points to 37.8% in 1998. This was achieved through the successful launch of additional products in the growing bonus fine-cut category.

The tobacco sticks segment continued to grow in 1998 and represented 3.7% of the total Canadian market at December 31, 1998, compared with 2.8% a year earlier. Imperial Tobacco re-entered the tobacco sticks segment in Québec in late 1997 and increased its market share to 24.2% in 1998. Imperial Tobacco had been absent from this segment since 1991 due to apparent patent restrictions. Launches in other provinces will also be considered in 1999. The viability of this segment is contingent upon differential tax treatments that permit this product to be sold at a retail price substantially lower than that of manufactured cigarettes.

Market share



Operating earnings

Imperial Tobacco's operating earnings rose 5% in 1998 to $815 million, reflecting:

- higher revenues as discussed above;
- the impact of cost controls and productivity improvements; and
- increased margins in the cigarette segment;

partially offset by

- regulatory compliance costs of $10 million in 1998 with respect to the Tobacco Sales Act of British Columbia (see discussion below under Business environment).

Operating earnings represented 46.4% of revenues in 1998 compared with 47.2% last year.

Business environment

Taxation and other governmental regulation of tobacco products continue to be major issues that may adversely affect the operating results of Canadian tobacco manufacturers.

In addition, litigation against the tobacco manufacturers has increased. Information on tobacco litigation involving Imperial Tobacco and Imasco is contained in the discussion below and in Note 20 to the consolidated financial statements on page 61.

Federal legislation

On April 25, 1997, the federal government enacted the Tobacco Act to replace the Tobacco Products Control Act and the Tobacco Sales to Young Persons Act. The Tobacco Act purports to give the federal government the authority to regulate the manufacture, sale, labeling, advertising, and promotion of tobacco products in Canada. Provisions of this legislation include the establishment of powers to regulate the composition of tobacco products; further restrictions on access to tobacco products by young persons; health messages on packages of tobacco products, attributable to an authority prescribed by regulations, and detailed information concerning tobacco products and their emissions; prohibition of advertising of tobacco products except for product information and brand-preference advertising in (1) publications with primarily adult readership, (2) materials mailed to adults, and (3) places where young persons are not permitted by law, but an outright prohibition of any product advertising that evokes an image or emotion about a lifestyle, or any advertising that could on reasonable grounds be construed to be appealing to people younger than 18; prohibition of the distribution and promotion of tobacco products if any of their brand elements appear on a non-tobacco product associated with youth or evocative of a lifestyle; severe restrictions on sponsorship promotions containing tobacco brand elements that limit the tobacco brand elements to the bottom 10% of promotional materials and permit promotional materials to appear only in publications with primarily adult readership, in materials mailed to adults, and on signs at the site of the event and in places where young persons are not permitted by law; and the requirement that manufacturers report on tobacco products and related brand elements.

On December 10, 1998, Parliament adopted an Act to amend the Tobacco Act which extends until October 1, 2000, the right to continue to use promotional material in the sponsorship of an event or activity, where the tobacco-related brand element was displayed in an event or activity that took place between January 25, 1996, and April 25, 1997. After October 1, 2000, and until October 1, 2003, further restrictions will apply, limiting most sponsorship activities to on-site promotions.

The Tobacco Act also provides for a stern enforcement scheme including searches and seizures without warrant, heavy monetary fines and jail sentences, and wide discretion on the part of the authorities regarding the venue for enforcement proceedings.

The federal government is currently preparing regulations pursuant to the Tobacco Act. On January 18, 1999, the federal health minister released for comment proposed tobacco product labeling regulations that would introduce new, prominent messages on health and smoke emissions and health risks, as well as proposed further regulatory restrictions with respect to tobacco promotion. He also announced his intention to submit regulations to Parliament in spring 1999, to take effect by mid-1999, that would expand the reporting requirements of tobacco manufacturers.

Imperial Tobacco views the provisions of the Tobacco Act as a *de facto* ban on product advertising and as legislation that removes the commercial value of tobacco sponsorship and, unless amendments are made to the legislation, will cease substantially all sponsorship activities after October 1, 2000.

On May 14, 1997, Imperial Tobacco and other members of the Canadian tobacco industry brought proceedings in the Québec Superior Court challenging the validity of several sections of the Tobacco Act.

Provincial and municipal legislation

On November 12, 1998, the government of the province of British Columbia (B.C.) brought into force the Tobacco Damages and Health Care Costs Recovery Act (the Recovery Act) and instituted a legal action to recover the costs of amounts it has allegedly spent for the treatment of what is defined in the Recovery Act as "tobacco related disease" against Imperial Tobacco Limited, Imasco Limited, other Canadian and international tobacco companies, and tobacco industry and research groups. On the same day the three major Canadian tobacco manufacturers, in separate actions, brought a constitutional challenge of the Recovery Act.

On June 22, 1998, the minister of health of B.C. announced amendments to the Tobacco Sales Act requiring the tobacco manufacturers to disclose additives and ingredients in cigarette and tobacco smoke. Imperial Tobacco has complied with the disclosure requirements of the Tobacco Sales Act with respect to the disclosure of additives in certain cigarette products by September 15, 1998, and the disclosure by October 31, 1998, of constituents of mainstream and sidestream tobacco smoke in certain cigarette products. Imperial Tobacco expects to be in a position to comply with all of the disclosure requirements of the B.C. government except for certain specific tests which may not be able to be completed, due to insufficient testing capacity in Canada, for the June 30, 1999 report. In 1998 Imperial Tobacco provided for costs of $10 million to cover expenditures required to comply with the reporting provisions of the Tobacco Sales Act.

In addition, the legislative assembly of B.C. adopted the Tobacco Fee Act, which awaits proclamation and which would levy a licence fee in exchange for the right to do business and sell tobacco products in B.C. The statute contains provisions that would purport to prevent this fee from being passed on to customers. Imperial Tobacco has announced its intention to bring a constitutional challenge of this Act if and when it is proclaimed into force.

Other provincial and municipal governments have also imposed various restrictive measures. They include the prohibition of the sale of tobacco products in Ontario and New Brunswick drugstores. In Québec, a judgment in favour of the *Ordre des Pharmaciens du Québec* upheld its decision to prohibit the sale of tobacco products in drugstores effective September 1, 1998. Provincial governments, including Nova Scotia, B.C., and Québec, have proposed or implemented additional legislative initiatives concerning the sale, distribution, packaging, and consumption of tobacco products and concerning limitations on advertising and sponsorship activities. Various municipalities throughout Canada have proposed or adopted further restrictive measures covering the consumption of tobacco products. Anti-tobacco lobby groups continue to pressure governments at all levels to adopt ever more stringent measures against smoking.

Federal surtax

In 1998 Imperial Tobacco's provision for tobacco surtaxes amounted to $59 million compared with $56 million in 1997. The surtax, which is levied on the profits of tobacco manufacturers, was originally introduced by the federal and Québec governments in 1994 in conjunction with rollbacks of tobacco taxes and was scheduled to expire February 8, 1997. While the federal government extended the surtax for an additional three-year period, the Québec government did not. Cigarette sales prices to wholesalers were increased in 1996 and 1997 and currently generate sufficient after-tax earnings to substantially offset the surtax. Imperial Tobacco regards the surtax as a product tax rather than an income tax.

Taxation of tobacco products

In taxing tobacco products, the federal and provincial governments generate significant revenues and address their stated objective of reducing tobacco product consumption as well as discouraging youth from starting to smoke.

On February 13, 1998, the federal government announced a federal excise tax increase of $0.60 per carton of 200 cigarettes intended for retail sale in Ontario, Québec, Nova Scotia, and Prince Edward Island, and of $0.40 per carton of 200 cigarettes intended for retail sale in New Brunswick. On the same date, the governments of these provinces announced identical increases in their respective tobacco taxes. Previously, in March 1997, the Québec government increased its provincial tax on cigarettes by $0.28 per carton.

Increases in fine cut tax have also been announced in 1998 for the province of Ontario: $0.60 (for 200 grams), Prince Edward Island (P.E.I.): $0.32, and Québec: $0.30. The federal government has matched only the Québec increase, for a total increase in that province of $0.60. Finally, tobacco sticks had an across-the-country federal increase of $0.80 per 200 sticks except for the following provinces: Ontario and Québec: $1.52 and P.E.I.: $0.94. Combined with the provincial increase of $0.60 in Ontario, $1.11 in Québec, and $0.40 in New Brunswick, the total increases in taxes were $2.12 in Ontario, $2.63 in Québec, and $1.20 in New Brunswick. British Columbia also increased its tax rate on sticks from $0.11 per gram to $0.11 per unit effective March 31, 1998, in line with the manufactured cigarette rate.

The different levels of taxation of cigarettes imposed by the federal and provincial governments have an impact on the illegal trade of cigarettes. An incentive for inter-provincial smuggling is provided by federal and provincial taxes that range from less than $17 per carton of 200 cigarettes in Ontario to more than $39 per carton in Newfoundland.

U.S. developments

In November 1998 the four major U.S. tobacco companies agreed to pay US $206 billion to settle claims with 46 U.S. states, the District of Columbia, and five U.S. territories, relating to the recovery of smoking-related health costs. The settlement also includes a number of new restrictions on tobacco marketing. It does not provide immunity from individual or class action claims. While not a party to any of the litigation affected by the agreement, in order to ensure continued access to the U.S. market, Imperial Tobacco's U.S. affiliate, ITL (USA) Limited, intends to sign the agreement as will most other manufacturers who distribute in the U.S. and were not party to the original agreement. By doing so, however, ITL (USA) Limited will not be required to make any payments unless and until its market share in the U.S. exceeds 125% of its 1997 levels. This action will give ITL (USA) Limited and its affiliated companies immunity from State Medicaid lawsuits and require it to comply with the marketing restrictions contained in the agreement. In total, Imperial Tobacco sales in the U.S. duty-paid market are not significant and account for less than 0.2% of the company's net revenues. Imperial Tobacco believes that the U.S. settlement will not have a significant impact on the company.

Outlook

The major challenge for Imperial Tobacco continues to be to increase its sales volume despite the long-term, slow decline in total consumption of tobacco products in Canada. This trend may vary from year to year, but over the long term Imperial Tobacco expects this decline to continue due to an aging population, consumer health concerns, and the diminishing social acceptance of smoking.

With this environment as a backdrop, Imperial Tobacco is increasing its focus on improving productivity. Major investments have been made to upgrade the company's information technology systems, streamline manufacturing processes, and modernize machinery. The installation of high-speed cigarette-making equipment, which began in 1997, is expected to be completed in

1999. The company has begun to realize benefits from its productivity initiatives, with additional improvement expected in future years upon completion of the various projects.

The company continues to explore international markets as an avenue for growth. However, since Imperial Tobacco does not own the rights to its major Canadian trademarks outside Canada, new brands must be developed. This expansion in international markets forms part of the company's longer-term strategy, but is unlikely to result in a significant contribution to profits in the short term. In September 1997 test marketing of an all-natural tobacco, American-type cigarette under the *Mercer* trademark began in Portland, Oregon. Results to date have been modest and below expectations. During 1999 Imperial Tobacco will continue to monitor progress on this project.

Imperial Tobacco has consistently demonstrated its ability to overcome difficult competitive and regulatory circumstances. The company foresees continuing growth in revenues and operating earnings in 1999, assuming no significant impact from additional anti-tobacco initiatives by government. The growth is expected to be derived from market share gains, productivity enhancements, and price increases.

CT Financial Services

CT Financial's principal business is the provision of personal financial services in Canada offering core banking services, lending, wealth management, and insurance to its customers across Canada. It also has certain international financial services operations.

CT Financial's two principal subsidiaries, Canada Trustco Mortgage Company and The Canada Trust Company (collectively referred to as Canada Trustco in this MD&A), are fully integrated for operating purposes and carry on business under the name Canada Trust. Each of these subsidiaries is registered under, and carries on business subject to, the provisions of the federal Trust and Loan Companies Act (the Act) and provincial legislation. Canada Trust is the largest trust and loan company in Canada based on total assets and the only trust and loan company operating across Canada that is not owned by a bank.

In order to compare year-over-year performance of CT Financial, the following comments frequently refer to results from ongoing operations. Ongoing operations exclude the effect of gains realized on the sale of CT Financial's U.S. operations and the pension and institutional trust and custody business sold during 1997 as well as earnings from these businesses and certain one-time expenses incurred in 1997. Removing the effect of these transactions from the 1997 comparative figures allows CT Financial to focus attention on trends and performance issues arising from its ongoing activities.

Results of operations

Net earnings

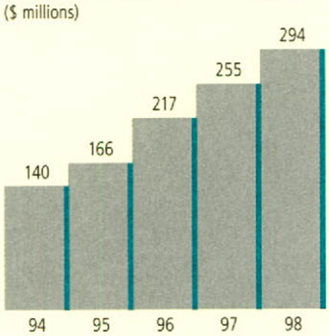
CT Financial's net earnings attributed to common shareholders amounted to $294 million in 1998 as detailed below:

CT Financial – Condensed consolidated statements of earnings	**1998**	1997	1996
($ millions)			
Revenues	**3,844**	3,831	4,407
Interest expense	**1,829**	1,832	2,488
Provision for credit losses	**135**	162	172
Operating expenses	**1,428**	1,365	1,274
Pre-tax earnings, before gain on business disposal and goodwill amortization	**452**	472	473
Gain on sale of First Federal	**–**	288	–
Goodwill amortization	**(5)**	(7)	(7)
Pre-tax earnings	**447**	753	466
Provision for income taxes	**127**	223	135
Preference share dividends of subsidiaries and non-controlling interest	**10**	12	13
Net earnings	**310**	518	318
Preference share dividends of CT Financial	**16**	16	15
Net earnings attributed to common shareholders	**294**	502	303

In keeping with CT Financial's objective to grow net earnings from ongoing operations by 15%, net earnings available to common shareholders for 1998 amounted to $294 million, an increase of $39 million or 15.3% over earnings from ongoing operations of $255 million in 1997. The earnings growth came from increased fee-based products and an expanding consumer and collateral loans portfolio. Fees of $742 million, including those charged to customers for products, mutual funds, brokerage, agencies, trust and estates and insurance services, rose $93 million over ongoing fees from 1997, an increase of 14%. The consumer and collateral loans portfolio increased 11% over December 31, 1997, resulting in a 35% increase in interest income to $944 million. Lending volumes grew more slowly than in the previous year but increased significantly in the last quarter of 1998 after new marketing programs and lending initiatives were put in place supported by cross country training for CT Financial's retail distribution staff. CT Financial also implemented new credit card decision score cards. These new programs and initiatives have been designed and implemented to ensure that asset quality is maintained as volumes rise. Mutual fund assets under administration increased from $7.3 billion to $8.8 billion in 1998. The growth in assets under administration reflects the continuing desire of customers to achieve a higher return and a mix of assets consistent with their investment objectives. This shift from traditional deposit products to equities is known as disintermediation. Disintermediation affected the balance between deposits and loans on CT Financial's balance sheet and provided the opportunity to group together mortgages and sell them as mortgage-backed securities. The sale of mortgages in 1998 is the primary reason mortgage income decreased by 26% to $1.1 billion. Amortized gains on the sale of mortgages amounting to $82 million are recorded in other income of CT Financial.

CT Financial – net earnings from ongoing operations attributed to common shareholders

($ millions)



Return on common shareholders' equity

Excluding the impact of excess capital, CT Financial's return on average common shareholders' equity was 16.1%, exceeding the company's 1998 objective of 15%. CT Financial's reported return on common shareholders' equity was 11.5% in 1998 compared with a return from ongoing operations of 12.0% in 1997. The excess capital generated by the sale of First Federal continued to put downward pressure on CT Financial's return on equity.

Market share

In 1998 CT Financial aimed to increase market share in personal financial services over 1997 primarily in mutual funds, demand deposits, and lending. CT Financial managed to increase market share in both mutual funds and demand deposits; however, the targeted increase in lending and overall personal banking market share fell short. This shortfall in CT Financial's objective was due to slower growth in lending volumes causing the company's market share in mortgages to decline. CT Financial was unwilling to lower product margins to the unacceptable levels earned in this market during certain periods in 1998. Market share in personal loans increased significantly during the year but not enough to offset the decrease in mortgages.

In 1997 the company acquired Meloche Monnex Inc., a leading affinity-based insurance company, in order to provide direct marketing property and casualty insurance in Canada. The insurance business has seen revenue growth of 36% with insurance fees contributing $132 million to total revenue of CT Financial.

As part of its exclusive focus on personal financial services, CT Financial also acquired The Affinity Group Inc., a leading distributor of third-party mutual funds to members of Canadian professional and alumni associations. During the year CT Financial also established CTUSA, F.S.B., a U.S. federal savings bank in Naples, Florida. The company also invested additional resources in the retail business by establishing a mobile financial planning and sales force that offers customers third-party mutual funds in addition to proprietary Canada Trust funds. The mobile sales force is currently in the pilot test phase.

Revenues

Revenues of CT Financial, as reported by Imasco, are summarized in the table below:

Revenues	**1998**	1997	1996
($ millions)			
Gross investment income	**2,953**	2,961	3,781
Fees	**742**	685	593
Other income	**149**	185	33
	3,844	3,831	4,407

Net investment income

Net investment income (revenue earned on investments less interest expense paid on deposits and borrowings) from ongoing operations increased by 4% to $1.1 billion in 1998. The increase in net investment income was primarily attributable to higher consumer lending volumes, a significant portion of which are unsecured. Interest earned on consumer and collateral loans increased 35% over 1997 levels. Unsecured loans have a higher risk of default than secured loans and therefore pay a higher yield to the lender. Mortgage income decreased 26% primarily as a result of disintermediation as mortgages were securitized and sold for funding purposes. Funds received on the sale of mortgages were redistributed to the consumer lending products. Funds were also partly reinvested in the securities portfolio, accounting for an increase in short-term notes and securities income of 17% over 1997.

During 1998 net interest margin increased from 2.49% in 1997 to 2.71% due to an improved mix in CT Financial's business and the company's focus on profitable market share.

Net interest margin [1]	Average balance	Income/ expense	Average rate
($ millions, except as noted)			
1998			
Assets	**46,298**	**3,084**	**6.66%**
Liabilities and equity	**46,298**	**1,829**	**3.95%**
Net interest income and margin		**1,255**	**2.71%**
1997			
Assets	48,061	3,030	6.30%
Liabilities and equity	48,061	1,832	3.81%
Net interest income and margin		1,198	2.49%

[1] Calculated on a taxable equivalent basis.

The change in net interest income caused by variations in volume and rate is detailed as follows:

Change in net interest income [1]	Volume	Rate	Net
($ millions)			
1998			
Investments	**(112)**	**166**	**54**
Deposits and borrowings	**(67)**	**64**	**(3)**
	(45)	**102**	**57**
1997			
Investments	(348)	(469)	(817)
Deposits and borrowings	(226)	(430)	(656)
	(122)	(39)	(161)

[1] Calculated on a taxable equivalent basis.

Fees

Revenue from fees increased 14% to $742 million, up from 1997 ongoing fees of $649 million. Revenue mix continues to move towards fee-based products and services such as wealth management and insurance.

Fee revenue	**1998**	1997	1996
($ millions)			
Service and product	**332**	315	301
Wealth management	**247**	204	182
Insurance	**132**	97	30
Other	**31**	69	80
	742	685	593

Service and product

Service and product fees are earned on transactions such as the purchase and sale of foreign currencies, use of deposit, credit card and loan accounts, and automated banking machines (ABMs). Increases in these fees reflect increased volumes of transactions and usage of these services. Product fees include fees earned on the credit card portfolio, which increased by 15% during 1998 to $1.6 billion, generating fees of $70 million compared with $65 million in 1997. As well, demand fees increased 14% as the demand portfolio increased to $17.0 billion from $16.1 billion in 1997 as the products were redesigned.

Wealth management

Personal trust fees are earned by providing investment management and planning services to individuals and trustees. Advisory services such as income tax planning and administration of wills, estates and SelfDirected RSPs also generate fee income. Personal trust fees rose 13% from $80 million in 1997 to $90 million in 1998. Personal trust assets under administration increased to $11.4 billion from $10.8 billion in 1997.

Mutual fund fees are based on a percentage of fund assets under administration. Fees earned from mutual funds in 1998 increased 27% from 1997 as the book value of mutual funds under administration rose from $7.3 billion at December 31, 1997, to $8.8 billion at year-end 1998. Customers continue to invest for the long term in CT Financial's mutual fund products despite the volatility experienced in the capital markets during 1998.

Fees generated by brokerage services increased by 13% to $17 million for 1998. This increase reflected greater transaction volumes.

Insurance

Wholly owned insurance subsidiaries CT Financial Assurance Company and CT Insurance Company Limited generated $50 million in insurance fees for 1998, up from $41 million in the previous year. Insurance fees in 1998, derived from the Meloche Monnex Inc. property and casualty business, were $82 million compared with $56 million in 1997. CT Financial believes that this is a significant growth area for the company and will continue to focus efforts on increasing market share and profitability in the insurance business.

Other fees

Other fees decreased from $69 million in 1997 to $31 million in 1998 due in part to the inclusion of $29 million of fees earned on the pension and institutional trust and custody business sold in 1997.

Assets under administration (measured at book value)	**1998**	1997	1996
($ millions)			
Corporate	**47,739**	46,703	55,208
Personal trust	**11,385**	10,812	9,713
Mutual funds	**8,780**	7,271	5,566
Pension trust	**5,368**	4,657	167,380
Securitized assets	**5,768**	5,139	8,780
	79,040	74,582	246,647
CT Financial excluding First Federal	**79,040**	74,582	228,456
First Federal	**–**	–	18,191
	79,040	74,582	246,647

Other income

Other income includes net gains on the sale of securities and investment properties and net gains on the sale of mortgage-backed securities. Within this category, CT Financial realized other income gains of $10 million on the sale of non-core businesses, CB Commercial, and corporate relocation activities. These investments were disposed of during the year in keeping with CT Financial's strategy to focus its business on personal financial services.

Operating expenses

Operating expenses increased by 5% or $63 million over 1997. During 1997 there was $70 million in non-recurring items including accelerated depreciation of computer technology due to significant advancements within the industry. Excluding the non-recurring expenses in 1997, operating expenses increased by 10% or $133 million over 1997's operations.

The reason for the increase ties back to CT Financial's strategy to concentrate its business on personal financial services. Spending in 1998 therefore focused on customer service enhancements within the distribution system; improved lending capabilities; wealth management initiatives; continual growth in the insurance business; and systems modifications to deal with Year 2000 compliance. Salaries and employee benefits grew 15% in 1998 over 1997 as part of the investment in infrastructure and improved client service. Computer, furniture, and equipment expense increased 12%, excluding 1997 one-time items of $53 million, from $164 million to $183 million in 1998.

Income taxes

Overall, the taxation of financial institutions is among the highest in Canada compared with other industries. The statutory income tax rate of 44.6% is unchanged from 1997. Income taxes were lower in 1998, largely as a result of the gains in 1997 on the sale of First Federal and the pension and institutional trust and custody business. CT Financial's effective income tax rate was 28.4% for the year compared with 29.7% in 1997.

Investments

Cash, short-term notes, and securities

Cash, short-term notes, and short-term government bonds are utilized to meet liquidity requirements. Liquidity remained high during the year as proceeds from the sale of First Federal and funds generated by sales of mortgage-backed securities were invested in short-term investments. During 1998 the mix of securities continued to change in order to improve yields. At the end of 1998 short-term notes had decreased over the prior year by $871 million and domestic government bonds decreased by $377 million. Increases in investments at the end of the year were in the corporate and foreign government bond portfolios and in mortgage-backed securities.

Corporate and foreign government bonds represented 27% of securities compared with 19% at December 31, 1997. Investments in mortgage-backed securities increased from $675 million to $2.0 billion at December 31, 1998. For more details see Note 23 to the consolidated financial statements on page 65.

Loans

In addition to the information provided below, further details on loans are contained in Note 24 to the consolidated financial statements on page 66.

Mortgages

Throughout the year CT Financial strived to ensure that asset quality remained high. In 1998 the company experienced a temporary decline in lending volumes after the implementation of a new lending infrastructure.

Residential mortgages represented 92% of total mortgages at year-end 1998 and 32% of total investments compared with 36% at year-end 1997. Residential mortgages decreased by a net amount of $1.5 billion during 1998. This decrease included $3.7 billion that resulted from the securitization of mortgages. Additional discussion of the asset securitization program of CT Financial is contained in the Risk management section of this MD&A on page 36.

Mortgage balances in arrears more than 90 days decreased to 0.30% of the portfolio at the end of 1998, down from 0.35% at December 31, 1997. Actual losses on residential mortgages as a percentage of the portfolio on average for the last five years was 0.05%, significantly lower than average losses on all other loan portfolios.

Commercial mortgages declined by $107 million during 1998. This decline reflects CT Financial's decision and strategy to focus on personal financial services and the retail business.

Consumer and collateral loans

Consumer and collateral loans grew by $1.3 billion in 1998. The largest growth was in PowerLine receivables, the line of credit business, of which 85% was secured by residential real estate or marketable securities. This portfolio increased by 12% from $8.6 billion at December 31, 1997, to $9.6 billion at December 31, 1998. Unsecured PowerLine receivables in arrears more than 90 days declined to 0.44% compared with 0.52% at year-end 1997.

Corporate and commercial loans

Corporate and commercial loans, excluding loans to financial institutions, continued to fall from $192 million in 1997 to $86 million at the end of 1998 representing a 55% decrease in the portfolio. Again, in keeping with its strategy, the company's lending focus continues to shift toward more profitable consumer and collateral lending services.

Loans to financial institutions increased $278 million to $349 million over 1997.

Credit card loans
MasterCard loans grew 15% in 1998 compared with 14% in 1997. Arrears more than 90 days decreased during 1998 from 1.27% to 0.84% of the portfolio.

Real estate investment properties
Truscan Property Corporation is the real estate investment sector of CT Financial. Revenue increased from $121 million in 1997 to $135 million in 1998 based on improvements in vacancy rates, coupled with strengthening lease rates for the office markets in core areas of major Canadian cities. CT Financial expects that improved vacancy and leasing rates will continue for commercial real estate markets in 1999.

The net book value of real estate investment properties increased by a net amount of $73 million in 1998 to $789 million at year-end. This investment represented 1.7% of corporate assets, up from 1.5% in the prior year. The company's goal is to grow its portfolio at the rate of 5% per year, primarily in British Columbia, Alberta, and Ontario.

Impaired investments

Regulatory requirements as prescribed by the Office of the Superintendent of Financial Institutions (OSFI) require that the carrying values of impaired investments be reduced to their estimated realizable values. Investments are considered to be impaired when there is material uncertainty associated with the repayment of all principal and interest payments. The estimated realizable values are determined by discounting the expected future cash flows of these impaired investments by a predetermined required rate of return. The application of a consistent valuation methodology has facilitated greater comparability of impaired investment levels within the financial services industry.

During the year ended December 31, 1998, gross impaired investments declined 18% to $127 million. This continues the downward trend that began four years ago with gross impaired investments declining from $468 million in 1995. CT Financial attributes these declines to the resolution of loans in its discontinued portfolio and a general improvement in the economy. In conjunction with the overall reduction in impaired investment levels during 1998, a significant shift in the composition of impaired investments occurred, reflecting the increased focus on consumer loan products by the company. Consumer and collateral impaired loans accounted for 28% of the total impaired investments, an increase from 13% at December 31, 1997. Corporate and commercial loans and commercial mortgages classified as impaired declined from 49% to 33% of total impaired investments during the year.

In 1998 reserve coverage of the impaired investments portfolio decreased from 179% to 176% as the requirements for specific reserves decreased and the general allowance was adjusted to consumer loss rates. On this basis, net impaired investments changed from negative $121 million to negative $97 million. This was the result of a $51 million reduction in allowances for credit losses to $224 million, in addition to the above-noted reduction in the gross level of impaired investments.

Allowance for credit losses

The allowance for credit losses is comprised of two components, the general allowance for credit losses (GACL) and the specific allowance. The GACL is a balance sheet reserve that is not allocated to any individual loan account. In contrast, the specific allowance includes reserves set aside to cover potential losses related to particular loans or pools of loans. Thus, the GACL is set aside on the basis of historical loss trends of performing loan portfolios while the specific allowance reduces the value of impaired loans and investments. As of December 31, 1998, the GACL totalled $204 million and the specific allowance totalled $20 million.

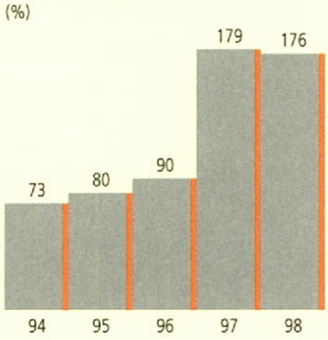
The level of allowance for credit losses is affected by the amount of the credit loss provision charged during the period and the credit losses incurred net of recoveries.

Provision for credit losses	**1998**	1997	1996
($ millions)			
Loans			
Mortgages – residential	**9**	(4)	17
– commercial	**(8)**	(18)	(31)
Consumer and collateral	**116**	141	60
Corporate and commercial	**(9)**	(27)	(5)
Credit cards	**75**	77	50
Other	**–**	–	(4)
Securities	**(6)**	(2)	(5)
Real estate investment properties	**(42)**	(5)	90
	135	162	172

The provision for credit losses declined from $162 million in 1997 to $135 million in 1998. This overall reduction was primarily driven by declines in the provision for consumer and collateral loan losses, down from $141 million in 1997 to $116 million in 1998. Credit losses for the year were $186 million, down from $196 million the prior year. The most significant reduction in credit losses also occurred in the consumer and collateral loan category with net losses declining from $107 million to $97 million. These factors combined to reduce the level of allowance for credit losses to $224 million. The allowance for credit losses has declined annually from its level of $375 million at December 31, 1995, consistent with declining impaired investments and investment levels. Because of this reduction, CT Financial's impaired investment coverage ratio of 176% (allowance for credit losses as a percentage of gross impaired investments) remains significantly above the Schedule I bank average of 112%. Details of the allowance are included in Note 27 to the consolidated financial statements on page 67 and in the table below.

Allowance for credit loss statistics	**1998**	1997	1996
($ millions, except as noted)			
Allowance for credit losses	**224**	275	368
As a % of credit losses	**120%**	140%	145%
As a % of total investments	**0.48%**	0.61%	0.68%

Allowance for credit losses as a percentage of impaired investments
(%)



Deposits and borrowings

While the majority of deposits continue to come from retail customers, increasing disintermediation has resulted in continued dependence on wholesale deposits. Deposits held at year-end were $40.8 billion compared with $40.4 billion at December 31, 1997. Although deposits remained relatively flat, retail deposits decreased by $191 million from 1997 year-end portfolio balances, reflecting further disintermediation as customers continue to look to wealth management products for long-term financial return.

While demand deposits increased 5% over 1997, term deposits decreased 2% due to falling interest rates and volatile capital markets in the latter half of the year. The wholesale deposit base was increased by $608 million primarily through the issue of Canada Trustco wholesale investment certificates in the Canadian capital markets. These were placed with retail and institutional investors for terms ranging from one to 10 years.

Risk management

Overview

Risk management is of paramount importance to CT Financial. The company believes that risk can and should be integrated into all of its business decisions rather than managed as a separate element. Also, CT Financial believes that by adopting a balanced and "risk for reward" approach it will continue to create stable and predictable earnings which in turn will ultimately enhance long term shareholder value.

In order to fully integrate its risk management process, CT Financial developed an effective organizational structure capable of monitoring, measuring, and acting upon the current and progressive risks faced by the company.

A significant role of CT Financial's Risk Management Group is to continually identify risk exposures within the organization and ensure processes are in place to manage these exposures within acceptable parameters.

Process

The desire to fully understand risk adjusted profitability and improve upon risk management techniques has driven CT Financial to direct significant attention to the measurement of loss and volatility across key financial and product structure risks. In response to these needs, CT Financial installed automated systems capable of collecting and integrating all transaction data across key asset and liability classes. The company uses this data to drive proprietary programs capable of quantifying risk at the portfolio level. This ability to routinely analyze large volumes of customer-specific data helps manage transaction adjudication activities, and determine expected loss adjusted profitability, product pricing, risk limits, and optimal economic capital allocations.

CT Financial continues to use a Risk Adjusted Performance Management framework (RAPM) to measure loss and volatility across various risk categories. The profitability of each business within the company is risk adjusted through the application of RAPM. The RAPM framework adjusts product margins by the amount of a risk premium or "expected loss" statistically determined based on long-term loss experience across critical financial or operational type risks. The amount of economic capital required to fund the "unexpected loss" related to each business is then calculated using a combination of approaches that quantify and reconcile historic, current, and anticipated risk levels to the requisite confidence level. By deducting the cost of capital from the risk premium adjusted profitability, CT Financial's management can assess the resulting shareholder value added (SVA) of each business on a comparable basis. During the year the company made significant progress enhancing the measurement of operating, consumer credit, and insurance risks used to determine SVA for wealth management, unsecured lending, and property and casualty businesses.

Business risk

CT Financial operates within a very competitive and dynamic industry. Given the constantly changing mix of competitors, products, and technologies, the business risk that it faces is significant. In this environment it is critical that CT Financial's business units recognize the opportunities for improved delivery of customer products and services and move proactively to implement the actions necessary for success. In late 1997 CT Financial established a dedicated Project Management Office with the objective to improve its ability to plan, implement, and manage complex projects initiated across various business lines.

Credit risk

The primary goal of CT Financial's credit risk management process is to maintain a diversified, high-quality portfolio of loans that optimizes the risk-adjusted return on allocated capital and reserves. Credit risk, measured on the basis of a quantitative approach, is managed by ensuring that potential credit loss is priced properly and that loss allowances and capital are maintained at a level sufficient to protect against unexpected changes in loss patterns. Credit risk is measured and managed using methods that are conceptually similar to those used for measuring and managing market risk.

CT Financial recognizes that its role as a financial institution is to create loans and investments that inherently reflect various levels of credit risk. Within this context, its strategic focus is to produce and maintain a diversified portfolio of loans for individuals and small business owners. This focus permits a greater degree of diversification within product portfolios, is consistent with overall corporate strategies centered on retail rather than commercial customers, and in general leads to less volatility in loan loss experience.

As a financial intermediary, CT Financial must also maintain a portfolio of liquid investments and hedging instruments (primarily derivatives). CT Financial's policy is to maintain a portfolio of high-quality issues to minimize its credit exposure to large counterparties. Accordingly, credit exposure to large counterparties is centrally managed and, with few exceptions, the investment and hedging portfolio is comprised of issuers rated AA or better.

The credit risk of the portfolio is measured on a quantitative basis using several risk indicators. Given that consumer loan portfolios are made up of a large number of relatively small and similar credits, they are well suited to statistical analysis. The primary measure of credit risk then, is the statistical correlation between loan risk attributes, underwriting criteria and borrower characteristics, and loss rates. This relationship yields a statistical estimate of expected credit loss and the variance of the expected credit loss with respect to the risk attributes of each product portfolio. This method of estimating loss not only provides a measure of portfolio risk, it also provides a quantitative basis for pricing credit risk, allocating economic capital, and establishing adequate allowance levels.

On the basis of the underwriting policies and portfolio targets established at the corporate level, credit transactions are managed and approved at the product level through automated loan scorecards and manual adjudication. Automated underwriting by loan scoring models is typically applied to large volume, routine personal loan applications within specified maximum dollar amounts. Manual underwriting is required on all transactions exceeding the dollar limit or on more complex mortgage or small business loan applications.

Loan approval authority is centrally managed by the Credit Risk Department, which is independent of the lending business unit.

CT Financial's overall credit risk profile improved in 1998 reflecting reduced losses on personal loans and better risk attributes on new loan production. In addition, new loan risk scorecards were implemented, providing a better means to evaluate loans and measure the relative risk of unsecured loan portfolios. Net write-offs declined during the year as the improved mix of personal loans and a reduction in exposure to large commercial borrowers combined to drive average loss rates down. For the year, net losses on the personal loan portfolio – the largest segment – were $157 million, down from $169 million in 1997. The reduction in loss rates helped to maintain the company's allowance level as one of the highest in the industry on a relative basis. As of December 31, 1998, the ratio of General Allowance for Credit Losses to Canada Trustco's risk-weighted assets totalled 0.91%. Because of this level of reserves, OSFI has permitted CT Financial to include the General Allowance for Credit Losses as part of tier 2 capital, up to 0.75% of risk-weighted assets in accordance with guidelines established at the end of 1997. CT Financial believes that its improved risk profile, augmented by an industry-leading level of reserve coverage, provides a solid foundation for continued stability in the credit performance of the company.

The positioning of the company and the investments it makes to improve lending activities are necessary ingredients to compete in the current marketplace. The competition for loans will continue to increase in 1999 as new channels for delivery make entry into the market less costly. In addition, the forecasted slowdown in economic activity for 1999 may reduce market growth and affect asset quality. However, in this environment CT Financial expects to maintain stable growth in loan profitability through its strong balance sheet, operating efficiency, and innovative lending programs.

Given this outlook, CT Financial expects to maintain the allowance for credit loss coverage near current levels on a relative basis. After several consecutive years of reducing its impaired investment portfolio, CT Financial expects little change in 1999. This trend reflects the virtual elimination of large corporate and commercial real estate loans in the portfolio and the normal seasoning of the consumer loan portfolio. The company will continue to maintain a high-quality liquidity and investment portfolio and utilize only the highest-rated counterparties for derivative transactions, minimizing its exposure to institutional risks.

Market risk

CT Financial's primary objective in market risk management is to enable the company to create long-term profitability from being an effective and efficient financial intermediary. This is done by providing the expertise and infrastructure to design, deliver, and price products that create value for customers and allow customers to intermediate freely across all products regardless of term preference. It also means that the company must only engage in productive risk-taking activities, that is, accepting only those risks where the price received is greater than the expected cost.

Market risks such as interest rate risk and foreign exchange risk are not viewed as productive risks. There is no value gained from absorbing these risks. CT Financial's strategy is to eliminate these risks as they arise through hedging, using the most efficient risk transference instruments available. The company does not view the active taking of market risk as an objective that aligns with its mission to be the best personal financial services company. Paradoxically, because it is naturally exposed to market risks from normal course intermediary banking activities – primarily deposit taking and lending – CT Financial must possess leading expertise and technology to quantify and manage these exposures.

The company's Treasury Group manages the risks that arise from retail banking activities at the operational level. These risks are managed in concert with the liquidity portfolio and are managed separately from positions representing investments of the company's capital.

CT Financial's corporate policy prohibits engaging in any proprietary trading or market-making activities except limited trading by the brokerage subsidiary, CT Securities Inc. In keeping with its services to retail and institutional clients, CT Securities Inc. incurs limited open positions in fixed-income and equity securities. Its market exposures are managed independently within very narrow market risk limits that are set based on value-at-risk methodologies.

Interest rate risk

The objective of interest rate risk management is to reduce the impact of changing interest rates on the company's earnings and net worth. Interest rate risk arises when asset and liability principal and interest cash flows have mismatched repricing dates (differing interest payment or maturity dates). Repricing of an interest-sensitive asset or liability occurs when the rate changes or a cash flow occurs as a result of final maturity, normal amortization or customers exercising prepayment, conversion or redemption options. The amount at risk is a function of the magnitude and direction of interest rate changes and the size and maturity structure of the mismatched position and is measured in terms of the impact on net interest income. Net interest income results from the spread between the yield and the cost of currently booked assets and liabilities. In practice, CT Financial measures, manages, and hedges net interest income based on the margin created between the yield or cost of each asset and liability compared with a fully hedged transfer pricing cost of funds.

Mismatches that occur in the current accounting or planning period affect the earnings level of net investment income. Mismatches that occur beyond the current reporting period affect the earnings level of future net investment income and are best measured by the impact on the present value of equity. The present value of equity discounts all asset and liability cash flows at the transfer price cost of funds and, as such, embeds the present value of all future net investment income. Effective duration measures the change in present value of an asset or liability for a given change in interest rates and provides a single index to measure and manage overall exposure.

CT Financial's Treasury Group contains interest rate risk within the narrow risk limits established by its operating policies. These limits are defined by the amount of net investment income earnings at risk over a defined period of time and the sensitivity of the present value of equity at risk. At December 31, 1998, the company's static gap and present value of equity exposure were negligible.

The company's Treasury Group matches asset and liability repricing cash flows and also controls sensitivities associated with the present value of equity by matching asset and liability durations. CT Financial identifies, monitors, and analyzes interest rate sensitivity through analysis of float rate and short-term asset and liability repricing exposures, comprehensive cash flow gap matching, duration analysis, and monitoring exposures across the yield curve. CT Financial uses derivative financial instruments, wholesale investments, and other capital market alternatives and, as a last resort, retail product pricing strategies to manage its exposures to risk.

To the extent that any exposure existed at year-end, downward rate shocks represented more risk than upward rate shocks. The impact on the present value of equity, including assets funded by capital, as measured by an instantaneous downward rate shock of 1% would be a reduction of $16 million. This measure embeds the revaluation of all interest and principal cash flows, both contractual and contingent to final maturity, and represents near-immunity to rate shocks.

Additional disclosure of interest rate risk management is set out in Note 35 to the consolidated financial statements on page 70.

Foreign exchange risk
CT Financial's primary sources of foreign exchange risk arise from financial intermediary activities, transaction activities, and funding and investment activities. Exposures taken are minimal relative to the assets of the company and are controlled under strict guidelines.

Derivative financial instruments
CT Financial's objective to fully hedge all market risk has led to extensive use of derivative instruments.

Derivative financial instruments help manage overall interest rate, foreign exchange, and price risks. They are integral to managing the risk associated with products issued with embedded options and interest rate commitment options. Certain derivative hedges are customized to reduce risk on a product specific basis.

Derivatives used are predominantly interest rate swap contracts, interest rate options, forward rate agreements, interest rate futures, foreign exchange contracts and, on a limited basis, equity swap contracts. CT Financial's investment policy prohibits any derivative market-making or trading activities. The use of derivatives is limited to risk management activities, except for CT Securities, which sells exchange-traded derivatives to fill customer orders. Equity swaps are used to convert price risk inherent in financial intermediary products such as equity-linked guaranteed investment certificates (GICs) to interest rate risk and to modify the market risk characteristics of certain investments.

Additional information concerning CT Financial's derivative financial instruments can be found in Note 35 to the consolidated financial statements on page 70.

Liquidity risk
The objective of liquidity risk management is to ensure that funds are available or will be available to honour all cash flow obligations as they fall due. In 1998 CT Financial enhanced its liquidity management program by further developing the Prudent Person Management Approach. This approach accommodates the company's unique business strategies focused on personal financial services and provides a very flexible framework that allows it to manage liquidity requirements in a constantly changing environment. CT Financial operates within a conservative framework and ensures that operational cash flows are pre-funded for a specific time frame and sufficient liquidity exists to cover any cash flow commitments that may arise in the event of a company-specific, economic, or industry disruption. The liquidity management process allows for the modeling of various disruptive scenarios to ensure that current liquidity risks are managed prudently. Liquidity requirements are met through cash inflows and the holding of readily marketable assets. These are supplemented with an active wholesale funding program.

To a greater degree than its principal competitors, CT Financial continues to fund its operations predominately through a highly diversified retail deposit base. This gives the company the opportunity to tailor its capital market-based funding activities in order to maximize the diversification of funding sources as well as obtain funds in the most cost effective and capital-efficient manner.

An active wholesale debt and securitization funding program provides further diversification of funding sources. Securitization involves the sale of pools of homogenous, credit-enhanced, cash-generating assets into the capital markets. High quality retail assets with broad credit diversification such as pools of residential mortgages, credit cards, and lines of credit are the best suited to a securitization program. As a company focused on personal financial services, more of CT Financial's assets are readily securitizable than the assets of most of its principal competitors. As a result, asset securitization is regarded as a strategic funding alternative and a competitive advantage.

CT Financial accesses the wholesale debt markets for both short-term and long-term funds. These provide a diversified complement to retail and securitized flows and help ensure that the company maintains an active following with institutional investors. CT Financial is unique in its funding in that it places minimal reliance on short-term wholesale funding, which is only used for cash management purposes. As such, a disruption in the short-term wholesale markets will not materially affect the company's ability to meet obligations. The Canadian and international medium- and long-term debt capital markets are accessible to the company because of its strong reputation and high credit rating. Medium- and long-term wholesale funds are raised through investment dealers by issuing a combination of traditional investment certificates and structured investment products.

The liquidity management program involves actively measuring, controlling, monitoring, and reporting liquidity funding requirements and capital market developments. Funding requirement forecasts are based on expected product volumes and the cash flows from assets, liabilities, and off-balance sheet instruments. In the event of a liquidity disruption, CT Financial's contingency plans ensure all obligations are met as they fall due.

European economic and monetary union (EMU)
On January 1, 1999, Stage 3 of EMU began with the introduction of a new European currency, the euro. In 2002 the euro will replace 11 European currencies including the German deutsche mark, the French franc, and the Dutch guilder. Until 2002 the euro will co-exist, in paperless form, with the 11 European currencies. Exchange rates between the euro and the 11 currencies were irrevocably fixed on December 31, 1998, and now each of the 11 currencies is effectively a sub-unit of the euro.

As expected, the introduction of the euro has had a significant impact on wholesale banking and capital market activities in Europe. In 1998 CT Financial established a project team to determine the impact of the introduction of the euro on its operations. Although system modifications and process changes were necessary in some business units, the introduction of the euro did not have a significant impact on the company's operations due to its focus on personal financial services in Canada.

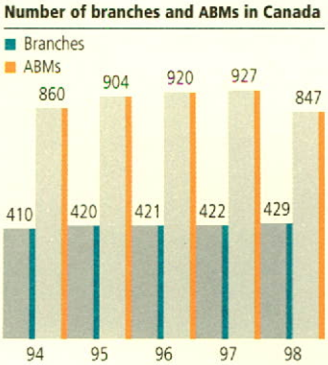
Pricing leverage risk
Pricing leverage risk addresses risks created by the overlap of market and operational risk in the pricing and delivery of products and related business unit cost structure. CT Financial pays particular attention to the mitigation of anti-selection risks that occur primarily as a result of (i) the failure to price adequately for customer risk or the existence of option features in products; or (ii) unanticipated customer shifts between individual product portfolios with different term and margin characteristics during a period of fluctuating interest rates. The Risk Management Group works closely with business units in the design and pricing of products to ensure that the full cost of risk is reflected in target gross margins.

Operational risk
At CT Financial, operational risk is an inherent by-product of the internal working environment and the forces exerted by external, and generally uncontrollable, events. Risks that fall under this category include:
- processing, transactional, and settlement activities of various kinds;
- control losses related to the failure of employees to adhere to internal guidelines; and
- technological risks related to implementation error, system input/output error, or systems failure.

Criminal, physical property, customer relationship, and third-party liability risks cover a much broader spectrum of business event risks faced by the company.

The company's retail focus provides a natural "hedge" against potential exposure to large-scale execution risks given that transaction balances generally are relatively small and well diversified. At CT Financial, operational risks are mitigated through a comprehensive system of key controls and processes established to ensure appropriate segregation of duties, clearly defined accountabilities and authorities, data and report integrity, systems and premises security, management exposure recognition, and comprehensive insurance programs. As a result of a concentrated focus in 1998 to reduce losses, CT Financial was successful in reducing losses associated with deposit activities by 38%.

Number of branches and ABMs in Canada



Year 2000
One of the most significant operational exposures facing CT Financial is the risk of prolonged computer-based systems failure or interruption due to the Year 2000 problem. This issue is significant to all industries but especially to financial institutions where all operating aspects are highly dependent upon accurate dates. Accordingly, CT Financial has invested significant time and technical and financial resources to ensure its systems become fully compliant before the year 2000.

CT Financial first began addressing the Year 2000 issue in the mid-1980s when revised date standards were established for all new applications built in-house. In March 1995 a preliminary study was carried out to determine the overall exposure to Year 2000 risks. In mid-1996 the Year 2000 project was launched, with an in-depth study by external Year 2000 consultants. A project timeline was developed requiring company systems and facilities to be "Year 2000 ready" by the end of 1998. "Year 2000 ready" to CT Financial implies:
- all essential computer systems will be updated and fully tested to make them ready;
- centralized and distributed computer platforms will be updated and fully tested to make them ready;
- electronic links with external business associates and service providers will be updated and internally tested to make them ready; and
- tests of selected critical business functions will have been started on the Year 2000 "time machine" (a dedicated Year 2000 computer platform that is configured to run in the year 2000 and beyond).

In April 1998 CT Financial compared its Year 2000 project to the best practices published by OSFI, the Government of Canada's Year 2000 Task Force, The Canadian Institute of Chartered Accountants, and specialized firms recognized as being highly experienced in the field. The results of this comparison were very favourable suggesting that CT Financial's remediation strategy and testing processes rank highly among Canadian companies.

A Year 2000 steering committee was established at CT Financial as a sub-committee of the company's Executive Management Group to complete the supervision of all Year 2000 issues. Twice during 1998 the committee presented a Year 2000 project update to CT Financial's board of directors. The Project Management Office also monitors the progress in relation to best practices.

During the last quarter of 1998 CT Financial's Business Risk Management Committee, made up of executive representatives from each business unit, identified the highest risk threats that require mitigation plans, including third-party risks, and began the plan development. The company's business units will continue to develop contingency plans through to the end of the first quarter of 1999.

CT Financial's Year 2000 project has six stages: planning, inventory, impact analysis, change/conversion, testing, and certification. The high-risk computer platforms and enterprise systems are at the end of the change and testing phases. These components are on track for Year 2000 readiness with the exception of a small number of components controlled by external vendors. Testing is also under way with external interface associates. The lower risk departmental systems and facilities equipment are well into the change and test stages. All outstanding Year 2000 work on these components is expected to be completed prior to June 30, 1999.

Total cost of the Year 2000 compliance project over the three-year period from 1997 to 1999 at CT Financial is currently estimated to be $35 million for expenses and $21 million for new capital acquisitions. To date, CT Financial has incurred $21 million of expenses and $14 million of capital. Additional testing will continue throughout 1999 to ensure the company is "Year 2000 ready".

Capital

Capital provides a foundation for CT Financial's future growth, protection against losses and serves as a basis for accepting deposits and continuing expansion of credit services. CT Financial's objective is to maintain adequate capital while earning a satisfactory return. Capital adequacy maintains investors' and depositors' confidence in the stability of the company and is determined by management prudence and business conditions. Capital is generated internally from net earnings, after dividends are paid. Capital is raised externally from the sale of securities to investors.

Capital released by the 1997 sale of First Federal and not currently redeployed, continues to negatively impact CT Financial's return on common shareholders' equity. Capital ratios will continue to be unusually high, reducing returns, until the company can economically redeploy the proceeds on the sale. Excluding the effect of the gain on the sale of First Federal and the excess capital, CT Financial's return on common shareholders' equity in 1998 would be 16.1% compared with 15.7% in 1997.

Using excess capital, CT Financial redeemed $150 million outstanding series 1 capital debentures, maturing March 12, 2003, from Canada Trustco. As well, in June 1998 CT Financial redeemed all of the $21 million outstanding cumulative first preference shares, series 6, held by Imasco Limited. The shares were issued in connection with the purchase of Meloche Monnex in 1997. Neither CT Financial nor Canada Trustco issued additional capital during the year.

Capital adequacy standards

The regulated companies are subject to federal capital guidelines, similar to those applied to Canadian chartered banks, and Québec regulations that prescribe minimum capital requirements. There are two federal measures of capital adequacy. The first is the risk-weighted capital ratio based on standards developed by the Bank for International Settlements as a common international measure of capital adequacy. This standard defines acceptable types and levels of core and secondary capital and weights assets by credit risk. Canadian trust and loan companies must meet a minimum risk-weighted capital ratio of 8%. CT Financial's risk-weighted capital ratio of 14.64% is not required by regulation but is calculated in accordance with regulatory definitions. The components of Canada Trustco's total risk-weighted assets and its risk-weighted capital ratios measured at year-end are set out below.

For the first time in 1998, risk-weighted capital requirements were extended to certain market risks associated with trading portfolios. The regulated companies do not engage in any trading activities and do not incur any capital requirements related to market risks. A second capital adequacy standard is the multiple of total adjusted assets to qualifying capital. This figure is limited to a maximum of 20 times, unless OSFI approves a higher level. Canada Trustco is permitted to maintain a multiple not in excess of 22 times, provided that its total risk-weighted capital ratio is at least 9.5%. Canada Trustco's total assets to capital multiple was 19 times at year-end 1998.

CT Financial capital ratios	**1998**	1997	1996
($ millions, except as noted)			
Risk-weighted assets	**23,390**	22,614	26,881
Qualifying capital	**3,424**	3,362	2,941
Risk-weighted capital ratio	**14.64%**	14.87%	10.94%
Common shareholders' equity to risk-weighted assets	**11.30%**	10.92%	7.78%
Total shareholders' equity to total assets	**5.98%**	5.79%	4.17%

Canada Trustco risk-weighted capital ratios	**1998**	1997	1996
($ millions, except as noted)			
Risk-weighted assets			
On balance sheet	**22,308**	21,782	21,539
Off balance sheet	**81**	93	89
	22,389	21,875	21,628
Qualifying capital			
Tier 1	**1,834**	1,736	1,654
Tier 2	**517**	637	547
Other deductions	**(3)**	(8)	–
	2,348	2,365	2,201
Capital ratios			
Tier 1	**8.19%**	7.93%	7.65%
Tier 2	**2.30%**	2.88%	2.52%
	10.49%	10.81%	10.17%

Dividend policy

The provisions attached to the first preference shares of CT Financial provide that no dividends may be paid on the common shares unless all dividends payable on the first preference shares are declared and paid or set aside for payment.

Statutory capital requirements may affect the ability of regulated subsidiaries to pay dividends to CT Financial after preference share dividend requirements are met. There are no anticipated or known restrictions to CT Financial's ability to declare or pay dividends in the future. The common share dividend policy of CT Financial is to pay approximately 40% of the prior year's net earnings available to common shareholders on a fully diluted per share basis, except when the directors of CT Financial in their discretion feel that circumstances warrant a different ratio.

CT Financial increased its quarterly common share dividend from $0.23 at the end of 1997 to $0.25 per common share, commencing first quarter 1998, based on strong internal capital generation. This trend is continuing as CT Financial is increasing its 1999 first quarter dividend to $0.28 per common share.

Regulatory environment

Legislation

The regulated companies are primarily governed by the federal Trust and Loan Companies Act (the Act), which provides the necessary powers to carry on business on virtually the same basis as the chartered banks. The Act applies corporate governance, capital, liquidity, and investment standards to the operations of the regulated companies and restricts transactions between the regulated companies and related parties such as officers, directors, shareholders, and affiliates. In addition, Canada Deposit Insurance Corporation requires adherence to its eight Standards of Sound Business and Financial Practices. This program requires that for each standard, a well-defined program of policies and procedures be put in place, and that a sound and prudent program be followed on a consistent basis.

Statutes in other provinces have varying degrees of application to the operations of the regulated companies, primarily in the area of market conduct. Certain subsidiaries of CT Financial are registered with provincial securities commissions, insurance regulators, stock exchanges, and self-regulatory bodies, where appropriate, or by local regulatory authorities, in the case of U.S. and overseas operations.

In September 1998 the minister of finance released the report of the Task Force on the Future of the Financial Services Sector, the MacKay Report. It contained a variety of recommendations designed to enhance competition and consumer choice in the financial services industry including changes in ownership rules, structure, business powers, market conduct rules, and the regulatory framework. The report also contained proposals for enhanced business powers for deposit-taking institutions (insurance retailing and auto leasing), which were balanced by increased responsibilities for consumer protection and corporate responsibility.

During the fall the Senate Banking Committee and the House Finance Committee held hearings to study the findings of the Task Force and issued their own reports. The Finance Committee acknowledged that the Task Force recommendations on expanded insurance powers for deposit-takers would enhance competition but recommended that the current restrictions not be reconsidered until a new consumer protection regime is established. The Senate Banking Committee recommended that deposit-takers only be permitted to sell life annuities to their RRSP customers for now. The Department of Finance is expected to issue a policy paper to introduce legislation sometime in 1999.

Québec Bill 188, which governs market intermediaries, was passed in June 1998. Once it is proclaimed, probably in mid-1999, the legislation will permit deposit-takers to sell insurance in their branches in Québec. Use of customer information to market other products will require express consent. CT Financial will not be able to take advantage of the distribution channel until federal legislation changes.

Ontario released a discussion paper in June 1998 on the regulation of the distribution of insurance and other financial products and services. The paper proposes a model that would apply identical rules to insurance sales regardless of the distribution channel used and would regulate the insurance transaction rather than the intermediary.

CT Financial is increasingly concerned by the complexity of the regulatory regime governing market conduct and distribution of financial services. Differences in rules between provinces, or between provincial/federal rules, increase the compliance burden and create barriers to efficient distribution of products and services such as deposits, retirement products, insurance, trust services, investment counseling, and securities brokerage services. The MacKay Report considered the failings of the current system for market conduct regulation and recommended the development of harmonized national proficiency standards. In addition CT Financial would consider common distribution rules, and a single window registration approach, to be crucial elements in an efficient regulatory regime.

Outlook

CT Financial's long-term mission is to be the best personal financial services company in the markets it serves. The company's strategy is to maximize shareholder value as a retail financial services company, differentiated by a superior customer experience and managed with the discipline of monoline economics.

CT Financial has aggressively invested for future growth because it wants to enhance its competitive position within the industry. CT Financial's goal is to maintain a two-track approach of simultaneously delivering short-term earnings and building long-term value. The company's aim is to ensure its business will be worth more in three to five years while at the same time producing acceptable short-term earnings growth.

CT Financial continues to generate solid earnings despite volatile markets that have impacted the financial services sector. In this environment CT Financial will continue with its long-standing strategy to maintain a well-hedged balance sheet to offset the movement of markets and thereby achieve stable and predictable earnings over time.

Shoppers Drug Mart/ Pharmaprix

System sales

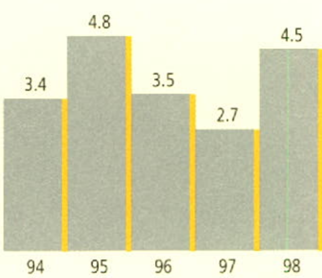
System sales at Shoppers Drug Mart rose 4% in 1998 to $4.2 billion. This increase is attributable to:

- stronger sales of higher-margin products;
- the acquisition of the 17-store Doncaster Home Health Care chain from MDS Inc. in May 1998; and
- 53 weeks of activity in 1998 versus 52 weeks in 1997.

System sales	1998	1997	1996
($ billions, except where noted)			
System sales	**4.2**	4.0	3.9
Comparable system store sales increase			
All product categories	**3.9%**	2.4%	2.9%
Excluding tobacco	**4.5%**	2.7%	3.5%

Comparable store sales increase

Excluding tobacco
(%)



The number of retail locations in the Shoppers Drug Mart system increased from 815 at the beginning of the year to 824 at December 31, 1998. During the year 39 new stores (15 in 1997) were opened or acquired, including the May 1998 acquisition of the 17 Home Health Care stores, and 30 stores (19 in 1997) were closed or consolidated into existing stores.

On a comparable store basis, which excludes the impact of stores opened, acquired, closed, or divested during the year, sales grew 3.9%, and 4.5% excluding tobacco products, despite a decrease in customer counts of 2.6%. The average sales volume per store was $5.1 million in 1998 compared with $4.9 million in 1997, and the average sales per square foot was $856 compared with $842 last year.

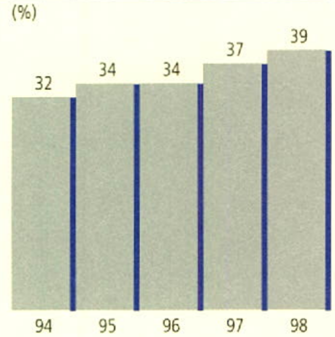
A key objective for Shoppers Drug Mart in 1998 was to improve the sales mix by emphasizing higher-margin product categories. The number of items in the weekly advertising flyer was reduced by about 25%. The coverage of lower-margin products including beverage, paper, and food items was reduced substantially, while the focus on over-the-counter (OTC) medications, cosmetics, and health and beauty aids was increased. This change in the weekly advertising flyer strategy positively affected the sales mix and reduced customer counts in 1998. Sales in the beverage, paper, and food categories were down when compared with 1997, whereas sales were strong in higher-margin product categories such as OTC medications, prescriptions, health and beauty aids, and cosmetics.

The professional segment of the business (prescriptions and OTC medications) forms the backbone of Shoppers Drug Mart store operations, accounting for approximately half of total store sales. On a comparable store basis, prescription sales increased 10% in 1998 and accounted for 39% of total store sales compared with 37% in 1997. The increase in prescription sales is due to:

- higher average selling prices driven by higher drug costs; and
- growth of 4.4% in the number of prescriptions filled.

Prescription sales as a percentage of total sales

(%)



Revenues

Revenues of Shoppers Drug Mart amounted to $2.8 billion in 1998 compared with $2.7 billion in 1997. The comparability of revenues by category over the past three years continues to be affected by fundamental changes in operations. Under its Vision 97 program, Shoppers Drug Mart commenced distribution operations in 1996, and revenues grew to include distribution centre sales to associates. (The three-year Vision 97 program was launched in 1994 in order to reduce product costs, better manage inventories, provide space for new products, and improve labour productivity.)

Revenues	1998	1997	1996
($ millions)			
Distribution centre sales and other	**2,161**	1,855	420
Fee income	**343**	273	216
Company store sales	**282**	553	504
	2,786	2,681	1,140

The 1998 increase in revenues derived from distribution centre sales mainly results from the continued integration of the Big V stores, acquired in 1996, into the Shoppers Drug Mart system. By the end of 1998, all remaining Big V locations had been converted from company-operated to associate-operated stores, and all had implemented new information systems for merchandise management, pharmacy, and point-of-sale. The revenue improvement in 1997 reflected the first full year of operation for all three of the distribution centres in Mississauga, Calgary, and Moncton.

Fee income is the principal contributor to Shoppers Drug Mart's operating earnings. It increased 26% in 1998 as a result of the conversion of Big V locations to associate-operated stores and the improved profitability of associate-operated stores. Strong growth in gross profit dollars at store level resulting from the change in the flyer strategy and the continued maturing of the Vision 97 program contributed to this improvement.

Company store sales decreased in 1998 as a result of the conversion of Big V locations discussed above. This decrease was partially offset by the acquisition and opening of corporate-owned Home Health Care stores.

Operating earnings

Shoppers Drug Mart's operating earnings before goodwill amortization increased 25% in 1998 to $199 million. The increase reflects:

- stronger gross margins resulting from a change in sales mix to higher-margin cosmetics, OTC medications, and health and beauty aids;
- operating efficiencies and improved inventory turns; and
- 53 weeks of activity in 1998 versus 52 weeks in 1997;

partially offset by

- a slight decline in prescription margins due to pressure from governments and other third-party payers, and higher drug costs.

Business environment

The evolution of the pharmacy business is critical to the success of Shoppers Drug Mart. Over the past few years third-party prescription payers have focused on ways to control the costs of their drug programs. Third-party payers are comprised of governments, employers, insurance companies, claims processors, and benefit consultants. Cost-cutting measures implemented include reduced drug coverage, cost sharing with participants, and reduced compensation to pharmacies. Shoppers Drug Mart is expanding its professional pharmacy services in managed care and assisting payers in managing their health-care costs. Shoppers Drug Mart's approach is to demonstrate to payers that pharmacy services, properly managed, lead to better patient outcomes and lower overall health-care costs. A number of organizations have implemented wellness programs, recognizing that appropriate use of drugs and better employee health can provide savings in the areas of long- and short-term disability, absenteeism, and productivity. Technological and other improvements now allow governments to consider new approaches and measures that could eventually lead to a change in the role of pharmacies within a more integrated health-care system. Initiatives or actions of various governments in the future could impact the operations of the company either positively or negatively.

Competition from both within and outside the traditional drugstore industry continues to be strong. Pharmacies with discounted dispensing fees are proliferating within food/drug combination stores and mass merchandise stores. Grocery chains are also adding pharmacies in their smaller-sized stores in many communities. Besides pharmacy, these competitors are increasingly emphasizing the traditional drugstore categories of health and beauty aids, OTC medications, and cosmetics. They price these products aggressively and often use them as loss leaders. The consolidation now taking place in the grocery business in Canada will impact the competitive landscape in the near future. As a result, the company expects the number of food/drug combination stores to increase.

Shoppers Drug Mart has developed competitive responses to protect and build the pharmacy segment of the business. Its general retail response to the competition is to focus its product mix and selection to better serve its customers, and to emphasize the company's excellent service and the convenience of its locations and shopping hours. Investment in store renovations continues to improve client-oriented features such as waiting areas, semi-private counseling areas, and private consultation rooms. A key objective for each Shoppers Drug Mart store is to improve the delivery of value-added pharmacy services beyond those generally available in the market place. Standards for professional services higher than those imposed by the regulatory authorities have been established and the necessary resources allocated to ensure the goal of providing superior service with each pharmacy transaction is met. Emphasis is being placed on "best practices" to follow in Shoppers Drug Mart pharmacies. This is essential to freeing up pharmacist time to devote to client care and to enhance the efficiencies needed to provide superior customer satisfaction.

Governmental regulations and judicial decisions have also affected the sale of tobacco products in Shoppers Drug Mart stores. In Québec, a judgment in favour of the *Ordre des Pharmaciens* *du Québec* upheld its decision to prohibit the sale of tobacco products in drugstores effective September 1, 1998. Legislation passed by the government of New Brunswick prohibited the sale of tobacco products in drugstores in that province effective July 1, 1997. Similar legislation was introduced by the Ontario government effective January 1, 1995. Although there is no pending legislation, other provinces may implement similar restrictions. Tobacco products traditionally helped build sales volumes and customer traffic, but tobacco sales now represent less than 4% of total system sales.

Outlook

Shoppers Drug Mart places great emphasis on reinforcing its image as a leading health-care provider. The company has made substantial investments in building its *HealthWatch* trademark and disease-state management programs in the stores. Shoppers Drug Mart is committed to providing access to more information through its *HealthWatch* system. The company is active in programs related to certain illnesses to help patients with specific medical conditions to better manage their health. Specific programs have been launched for diabetes, asthma, and cardiovascular disease. Shoppers Drug Mart believes that these and other initiatives enable pharmacy teams to provide the best service and have the potential to convert users of other pharmacies to the ongoing use of Shoppers Drug Mart services.

As a complement to its Vision 97 program, the company began a retail positioning project in 1997 that focuses on the customer's shopping experience at Shoppers Drug Mart. Efforts in 1997 were directed at improving the company's understanding of its customers and of the economics of both its business and its competitors. During 1998 core teams designed and tested hypotheses in areas that included store location and concepts, in-store experience, professional service, customer acquisition and retention, product, and price. In 1999 the roll-out of the first phases of Shoppers Drug Mart's new retail positioning will begin. It will focus on improving the overall in-store experience for customers including:

- superior customer service;
- efficient and fast checkout service; and
- uncluttered stores.

Also during 1999, further refinements to the company's retail positioning will be designed and tested for implementation during that year and into 2000.

Shoppers Drug Mart's operating earnings are expected to increase in 1999.

Genstar Development Company

Revenues

Genstar achieved exceptional results in 1998. Revenues increased 12% to $200 million due mainly to favourable housing markets, particularly in Alberta, and the commencement of new projects in the U.S.

Geographic data	Canada	United States	Total
($ millions, except as noted)			
1998			
Revenues	**133**	**67**	**200**
Operating earnings	**33**	**21**	**54**
Land inventory – acres [1]	**11,843**	**7,323**	**19,166**
1997			
Revenues	134	44	178
Operating earnings	37	6	43
Land inventory – acres [1]	13,672	6,143	19,815

[1] Includes land held through joint ventures but excludes options.

1998 revenues represented the sale of 3,187 residential building lots and 1,659 acres of serviced or raw land compared with 2,671 lots and 1,926 acres in 1997. The largest regional contributors to revenues in 1998 were Calgary and Edmonton. Revenue performance in the Calgary region was exceptionally strong due to an active economy. Despite a slowdown in the energy sector, local industrial diversification is contributing to a healthy economic cycle in Calgary. U.S. operations contributed 34% of total revenues in 1998 compared with a contribution of 25% last year. Revenues in the U.S. grew 52% over 1997 and have been stronger in all centres where Genstar operates.

Land acquisitions have been concentrated in the U.S., and these projects are an increasingly important source of revenue for Genstar.

Operating earnings

Operating earnings before goodwill amortization rose 26% in 1998 to $54 million. This increase mainly resulted from growth in revenues and was partially offset by higher selling expenses, and general and administration expenses related to the expansion of U.S. operations. Gross margins can vary significantly from year to year depending on the mix of sales and the level of development activity. The gross margin on U.S. sales was higher in 1998 than in 1997 due to improved performance from partnerships that in prior years were in the start-up phase.

Business environment

The residential land development industry is subject to cyclical fluctuations caused by a variety of factors such as housing affordability, mortgage rates, consumer confidence, and optimism in the economy. Consumer confidence in both Canada and the U.S. was tempered by the volatility in the stock markets during the year and uncertainty in the world economy. However, mortgage rates remain attractive, and certain regions in Canada and all regions where Genstar is present in the U.S. are experiencing strong job growth. These factors positively influence the desire and ability of consumers to purchase homes. Land suitable for near-term development is in short supply as are building lots in most markets. At this time, all these factors result in a strong housing market in most areas where Genstar operates.

Genstar has built a geographically diverse land inventory and offers a mix of products sought by consumers. The company constantly evaluates its geographic balance and market concentrations. Its disciplined approach towards land acquisition, its conservative capitalization policies, and its ability to respond to market desires while minimizing servicing costs reduce Genstar's exposure to a cyclical downturn.

Outlook

In November 1998, 4S Kelwood, a partnership in which Genstar is the manager, received the necessary approvals to proceed with a 5,000-home project in San Diego County. Construction and lot sales will commence in 1999.

In 1998 Genstar acquired approximately 1,937 acres of land in California, Florida, Minnesota, and Texas, and none in Canada. Continued success in future years will be fuelled by ongoing land acquisitions. Genstar has established strict criteria for acquisitions that focus on return on capital invested. While the company believes in pursuing a mix of short- and long-term projects that produce steady earnings growth, the emphasis will be on shorter-term opportunities with a particular focus on the U.S. market. Genstar will seek new opportunities to enhance its performance through increased marketing awareness combined with the analysis of trends projected through demographic and sociographic research.

Genstar will continue to pursue arrangements that allow it to participate in the profits earned by homebuilders and commercial developers. These arrangements have been very successful in a number of locations and are being expanded wherever market conditions permit.

The outlook for 1999 is for continued growth in the company's revenues and operating earnings. Growth is expected to be derived mostly from U.S. operations, while less buoyant sales in the Alberta markets are expected.

Consolidated Financial Condition

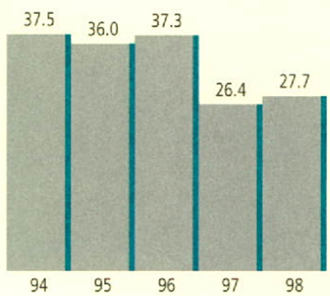
Capital resources

Shareholders' equity decreased by $127 million in 1998 to $3.7 billion. The overall decrease in shareholders' equity is comprised of decreases of $93 million in retained earnings and $28 million in issued share capital, and an increase of $6 million in the unrealized foreign exchange loss. Net earnings for the year exceeded dividend payments by $445 million. However, Imasco's common share repurchase program reduced shareholders' equity by $577 million in 1998: $39 million as a reduction of capital stock, representing the stated value of the 20,523,373 common shares purchased, and $538 million as a charge to retained earnings, being the amount by which the purchase price exceeded the stated value. Also in 1998, 1,123,240 common shares were issued pursuant to the exercise of stock options for $11 million. The increase in the unrealized foreign exchange loss is primarily attributable to the weakening of the Canadian dollar as compared with the U.S. dollar.

Imasco's ratio of total debt to capital increased to 27.7% at December 31, 1998, from 26.4% at December 31, 1997, below Imasco's long-term objective of 35%. This long-term objective allows for temporary variations that may result from business acquisitions and dispositions.

Total debt to capital

(%)



Total debt at December 31, 1998, amounted to $1.4 billion, essentially unchanged from a year earlier. Total debt increased only $43 million in 1998, as significant cash requirements for share repurchases and other corporate needs were largely offset by strong cash flows from Imasco's operations and proceeds on the sale of FFM business units. At December 31, 1998, 31% of total debt was variable rate in nature and, after giving effect to foreign exchange forward contracts, 16% of total debt was denominated in U.S. dollars. This compares with 27% and 26%, respectively, at December 31, 1997.

Total debt	**1998**	1997	1996
($ millions, except as noted)			
Short-term borrowings	**73**	102	125
Long-term debt	**1,357**	1,285	1,966
	1,430	1,387	2,091
Fixed-rate debt [1]	**69%**	73%	47%
Variable-rate debt [1]	**31%**	27%	53%
Canadian dollar debt [2]	**84%**	74%	61%
U.S. dollar debt [2]	**16%**	26%	39%

[1] After giving effect to interest rate swaps.
[2] After giving effect to foreign exchange forward contracts.

During 1998 Imasco issued $150 million of medium-term notes with an interest rate of 5.68%. Long-term debt maturities repaid consisted of $150 million 10½% debentures due in April 1998 and $77 million medium-term notes. During 1998, US $75 million of fixed interest rate swaps expired and were not replaced. Also in 1998, $150 million of fixed interest rate swaps expiring in 2001 were entered into. At December 31, 1998, US $25 million of variable-rate debt and $150 million of variable-rate debt had effectively been converted to fixed-rate debt by means of interest rate swap contracts. Imasco also entered into foreign exchange forward contracts to purchase US $47 million in 1999 at predetermined exchange rates to hedge a portion of its U.S. dollar commercial paper debt. Debt maturities in 1999 consist of $62 million medium-term notes.

Imasco maintains committed long-term credit facilities that make significant financial resources available and provide the Corporation with the flexibility to meet its borrowing requirements. At December 31, 1998, the Corporation had two committed long-term credit facilities, which consisted of a five-year revolving $1.5 billion (US $1.0 billion) facility expiring in 2003, and a $230 million (US $150 million) facility expiring in 2001. At December 31, 1998, unused long-term credit facilities of $1.5 billion (US $1.0 billion) remained available to back up commercial paper programs and to enable additional direct borrowings. These unused credit facilities, together with Imasco's significant cash-generating abilities, ensure that short-term operating requirements, including debt maturities in 1999, will be met.

The financial strength of Imasco is reflected in its credit ratings. During 1998 Imasco's long-term debt was rated A (high) by CBRS and A by both DBRS and Standard & Poor's.

Common share split

On April 30, 1998, shareholders approved a two-for-one stock split of Imasco's common shares. The split took effect on May 15, 1998, for shareholders of record at the close of business on that date.

Share repurchase program

In January 1998 Imasco's board of directors authorized a normal course issuer bid, which expired on January 29, 1999, for the purchase of up to 22,800,000 common shares (post-split), representing approximately 5% of the then outstanding shares. Imasco allocated up to $625 million for the purchases under this 1998 bid. During 1998 Imasco acquired 20,430,373 common shares at a cost of $575 million under its 1998 issuer bid program, in addition to 93,000 shares (post-split) for a consideration of $2 million under its 1997 issuer bid, which expired on February 3, 1998.

Total purchases on a calendar-year basis are presented below:

Common share repurchases (post-split)	**1998**	1997	1996
Number of shares repurchased	**20,523,373**	6,850,108	7,145,700
Total purchase price ($ millions)	**577**	138	102
Average purchase price per share	**$28.13**	$20.10	$14.32
Market value per share at year-end	**$32.70**	$25.25	$16.80

On January 28, 1999, the Imasco board authorized a normal course issuer bid to purchase up to 11,000,000 common shares (representing approximately 2.5% of the then outstanding common shares) during the period commencing on February 1, 1999, and ending on January 28, 2000. Up to $400 million has been allocated to this program. Common shares may be purchased when they represent an attractive investment opportunity for Imasco. The Corporation may also purchase common shares under the bid to cover the exercise of options under its stock option plan (thereby reducing the dilution that would otherwise result) or to make shares available for other purposes. Shares must be purchased at the market price at the time of acquisition, plus brokerage fees. Imasco's major shareholder, British American Tobacco p.l.c. (BAT), has indicated that, as a result of changes to the U.K. corporate tax system and in particular the rules regarding the utilization of credits for Advance Corporation Tax, it has elected not to participate in the bid commencing on February 1, 1999. At December 31, 1998, BAT owned approximately 42% of Imasco's common shares.

Derivative financial instruments and risk management

Imasco recognizes that certain risks are incidental to normal business operations. However, Imasco's general philosophy is to avoid unnecessary risk and to limit to the extent practicable risks associated with business activities. The Corporation does not take risks unrelated to normal business activities nor does it engage in activities that expose it to risk from speculative transactions.

Imasco has operations in the U.S., and exchange rate fluctuations can impact on net earnings and net asset values. This exposure is minimized by Imasco's practice of maintaining borrowings in U.S. dollars, which are prudently managed by taking into account the differing costs of borrowing in the two currencies. The average exchange rate during 1998 was approximately US $1 = Cdn $1.484 compared with approximately US $1 = Cdn $1.385 during 1997.

The Corporation is also exposed to fluctuations in interest rates. Imasco has implemented a policy to maintain the percentage of fixed- and variable-rate debt within certain parameters to minimize the impact of interest rate fluctuations.

As discussed in greater detail in Note 35 to the consolidated financial statements on page 70, CT Financial actively uses derivative financial instruments as risk-management tools to protect against interest rate and foreign exchange risk and to hedge risks associated with certain innovative products. Imasco employs derivative financial instruments to a limited extent to manage its exposure to interest rate fluctuations (principally interest rate swaps and, occasionally, forward rate agreements). In addition, from time to time the company enters into forward currency contracts as part of its management of foreign exchange risks. The Corporation does not trade in such contracts. Information with respect to Imasco's derivative financial instruments is disclosed in Note 22 to the consolidated financial statements on page 63.

Consolidated Cash Flows

The audited statements of changes in financial position presented on page 51 are prepared in accordance with generally accepted accounting principles and consolidate the activities of CT Financial on a line-by-line basis. However, the actual cash contribution from CT Financial is the amount of dividends received by Imasco, which was $117 million in 1998 and $108 million in 1997. Unaudited summaries of cash flows, which exclude the line-by-line activities of CT Financial and recognize the dividend received as a single amount, are presented below. Management considers this presentation to be more meaningful.

Non-consolidated summaries of cash flows (unaudited)	1998	1997	1996
($ millions)			
Net earnings from continuing operations	**741**	905	612
Deduct: CT Financial net earnings attributed to common shares	**(294)**	(502)	(303)
Add: CT Financial dividend	**117**	108	104
Amortization	**183**	183	154
Other non-cash items	**(28)**	(24)	4
Earnings from continuing operations adjusted for non-cash items and CT Financial dividend	**719**	670	571
Changes in non-cash current assets and liabilities	**66**	94	(216)
Increase in other liabilities	**14**	17	34
Additions to capital assets	**(149)**	(134)	(142)
Proceeds from disposal of capital assets	**11**	14	10
Changes in investments, notes receivable, and other	**(45)**	(25)	(37)
Dividends	**(314)**	(285)	(260)
Net cash from (required for) continuing operations	**302**	351	(40)
Proceeds from business disposals	**178**	547	68
Decrease (increase) in investment in CT Financial	**21**	(57)	–
Business acquisition	**–**	–	(243)
Repurchase of common shares, net	**(566)**	(108)	(57)
Discontinued operations	**18**	6	22
Net financing (required) available	**(47)**	739	(250)
Repayment (issue) of long-term debt, net	**(59)**	674	(123)
Increase (decrease) in net cash balances	**12**	65	(127)
Net financing	**(47)**	739	(250)

On this basis, Imasco generated significant available cash in 1998, with net cash from continuing operations before investing and share repurchase activities amounting to $302 million. This compares with net cash of $351 million in 1997. The decrease in cash available when compared with 1997 is due primarily to higher capital expenditures and higher dividends.

With respect to investing activities, net proceeds of $178 million from the sale of FFM's business units in 1998 compare with proceeds of $547 million from the sale of Hardee's and its Roy Rogers restaurants in 1997. Also in 1998 CT Financial redeemed preference shares held by Imasco for $21 million. From an overall non-consolidated perspective, Imasco required net additional financing of $47 million in 1998 comprised of $59 million of additional long-term debt partially offset by an increase in cash resources of $12 million. In 1997 Imasco generated $739 million in cash for use in financing activities.

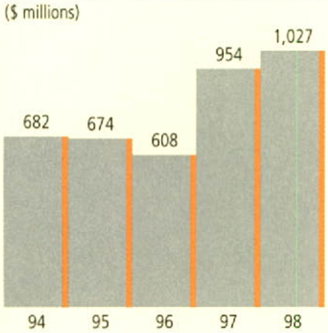
Consolidated cash from continuing operating activities

As reported on the consolidated statements of changes in financial position on page 51, cash from continuing operating activities amounted to $1.0 billion compared with $954 million in 1997 and continued to be sufficient to fund dividend payments and additions to capital assets. Earnings from continuing operations adjusted for non-cash items contributed $1.1 billion of cash in 1998 compared with $1.0 billion in 1997. The two most significant recurring non-cash items are amortization, which is detailed in Note 2 to the consolidated financial statements on page 54, and the provision for credit losses. Amortization charges decreased by $64 million in 1998. The decrease is primarily attributable to reduced amortization recorded by CT Financial (approximately $62 million) due to the 1997 sale of First Federal and accelerated amortization of technology investments recorded in 1997. The provision for credit losses declined by $27 million in 1998 and is discussed on page 32 of this MD&A.

As detailed in Note 15 to the consolidated financial statements on page 59, working capital generated $66 million of cash in 1998 compared with $94 million in 1997. The reduction in cash generated by working capital when compared with 1997 was principally due to increased inventory levels at Imperial Tobacco and Genstar and to lower income taxes payable caused by variations in the timing of tax payments.

Cash from continuing operating activities

($ millions)



Dividend payments

Dividend payments amounted to $314 million in 1998 compared with $285 million in 1997 and are detailed by class of shares in Note 14 to the consolidated financial statements on page 59. The rise in common share dividends reflects the 13% increase in the annual dividend rate (post-split) to $0.68 in 1998 from $0.60 in 1997. Excluding the impact of the 1997 gain on the sale of First Federal, the dividend per common share represented 41.7% of net earnings from continuing operations per common share in 1998 compared with 42.3% last year. The impact of the dividend rate increase was partially offset by a reduction in the number of common shares outstanding as a result of purchases under Imasco's normal course issuer bid. On January 28, 1999, the board of directors approved an 18% increase in the indicated annual dividend rate for 1999 to $0.80 per common share. Based upon this new dividend rate and the number of shares outstanding at December 31, 1998, dividend payments on common shares will increase by approximately $45 million in 1999. The number of common shares will vary, however, depending upon the level of Imasco's share purchase activity and the exercise of stock options.

Additions to capital assets

Gross additions to capital assets are listed by reportable segment in Note 2 to the consolidated financial statements on page 54. Additions to capital assets amounted to $267 million in 1998 compared with $207 million in 1997. The increase results from higher spending by CT Financial mainly relating to information technology. CT Financial's capital spending is expected to rise again in 1999. While Imperial Tobacco continues to invest in its production processes and facilities, the company's capital spending in 1998 was slightly lower than in 1997. In 1999 additions to capital assets at Imperial Tobacco are expected to approximate the 1998 level as the installation of the higher-speed equipment is nearly completed. Shoppers Drug Mart's capital expenditures increased in 1998 and related primarily to information systems, store remodeling and renovations, and the conversion of the remaining Big V locations to the Shoppers Drug Mart format. In 1999 capital spending is expected to increase moderately at Shoppers Drug Mart, as the company will continue to upgrade existing stores through renovations and remodeling. On a consolidated basis, Imasco's 1999 additions to capital assets are expected to approximate $300 million and will be funded internally.

Liquidity in 1999

Imasco expects to have sufficient resources available, either through internally generated cash flows or through unused credit facilities and debt-issuance capabilities, to fund all its cash requirements for 1999.

Year 2000 Compliance

The Year 2000 issue is a major challenge to all businesses. The problem arises because many software programs, computer equipment, and other equipment and systems with embedded technology use two-digit fields rather than four to identify a year and may, for example, recognize a date using "00" as the year 1900 rather than the year 2000.

Imasco, its operating companies, and CT Financial have been aware of the Year 2000 problem for some time and recognized the need for corrective action. The goal of Imasco's Year 2000 initiatives is an orderly transition to the year 2000, and these initiatives have the full support of Imasco's board of directors and senior management. Every quarter, a report is provided to Imasco's Audit Committee of the board and to senior management. The Chairman of the Audit Committee also provides a status report to the full board on a quarterly basis.

The Chief Financial Officer of Imasco oversees the Year 2000 project for the corporate centre, and the Chief Executive Officers of the operating companies are responsible for the execution of the Year 2000 projects in their respective companies. The board of directors of CT Financial has ultimate responsibility for its Year 2000 project. Refer to page 37 of this MD&A for details.

System dependency and the potential scope of the Year 2000 problem vary from operating company to operating company. Each has initiated its own project, constituted a Year 2000 steering committee, and engaged outside consultants to assist where necessary. The projects share a similar process that involves the following elements: inventory taking and impact assessment, remediation or replacement of non-compliant components, third-party assessments, testing, and contingency planning.

Imperial Tobacco had already taken a significant step towards dealing with Year 2000 issues in January 1996 through its implementation of major new business systems warranted to be Year 2000 compliant. Following the inventory taking and impact assessment, a Year 2000 plan was established to deal with the remediation or replacement of non-compliant components and comprehensive testing. The plan is scheduled for completion by March 31, 1999. In addition, key suppliers and customers have been contacted to ensure that Year 2000 technical issues are mutually addressed. The certification phase for key third parties is currently in process and is scheduled for completion by March 31, 1999. Also in 1999, steps will be taken to enhance business recovery plans to provide contingency coverage for business-critical issues.

In 1995, Shoppers Drug Mart implemented a number of key business systems that are warranted to be Year 2000 compliant as part of its Vision 97 program. The company has assessed the Year 2000 readiness of key internal systems and related hardware, validated them, and established a plan to implement changes, where required, by June 30, 1999. Shoppers Drug Mart has communicated with all merchandise vendors regarding standards required as part of its Year 2000 compliance program. Testing programs have been developed and are being implemented for internal systems and with the company's "priority" suppliers, as appropriate. Procedures have been put in place to deal with third-party pharmacy adjudicators and a program of testing is targeted for completion by June 1, 1999. During 1999 Shoppers Drug Mart will be re-assessing Year 2000 compliance in all areas, and contingency plans are being developed to deal with any material risks that are identified.

Genstar began replacing hardware, software, and application systems that are not Year 2000 compliant starting in the fourth quarter of 1998. System installation and testing are scheduled for completion by March 31, 1999. An inventory of key suppliers and facilities systems will be finalized during the first quarter of 1999. In addition, contingency plans will be developed during 1999 to deal with any material Year 2000 risks that have been identified.

Costs associated with Year 2000 projects at the corporate centre and the operating companies, both incurred to date and expected to be incurred, are being charged against operating earnings. These costs are not expected to be material.

Also refer to Note 21 to the consolidated financial statements on page 62.

Management Report

Management's Responsibility for Consolidated Financial Statements

The accompanying consolidated financial statements of Imasco Limited and its subsidiaries, and all information in the annual report, are the responsibility of management and are reviewed and approved by the board of directors. The financial statements necessarily include some amounts that are based on management's best estimates, which have been made using careful judgment.

The financial statements have been prepared by management in accordance with accounting principles generally accepted in Canada. Financial and operating data elsewhere in the annual report are consistent with the information contained in the financial statements.

In fulfilling its responsibilities, management of Imasco and its subsidiaries has developed and continues to maintain systems of internal controls, including policies, procedures, and segregation of duties and responsibilities.

Although no cost-effective system of internal controls will prevent or detect all errors and irregularities, these systems are designed to provide reasonable assurance that resources are safeguarded from material loss or inappropriate use, that transactions are authorized, recorded, and reported properly, and that the financial records are reliable for preparing the financial statements. The internal control systems are augmented by a program of internal audits, training of qualified personnel, a Code of Business Conduct and Conflicts of Interest Policy, and appropriate reviews by management.

The board of directors carries out its responsibility for oversight and approval of the financial statements and other financial information in this annual report principally through its Audit Committee. The Audit Committee, which is composed solely of non-executive directors, meets periodically with management and the internal and external auditors to discuss the results of audit examinations relating to the adequacy of internal controls and to review the financial statements and financial reporting matters.

The financial statements have been audited by Deloitte & Touche LLP, Chartered Accountants, who have full access to the Audit Committee with and without the presence of management. Their report follows.

B M Levitt

Brian M. Levitt
President and Chief Executive Officer

Raymond E. Guyatt, CA
Executive Vice-President and
Chief Financial Officer

Pierre Duhamel

Pierre Duhamel, CA
Vice-President and Controller

January 27, 1999

Auditors' Report

To the Shareholders of Imasco Limited

We have audited the consolidated balance sheets of Imasco Limited as at December 31, 1998, 1997, and 1996, and the consolidated statements of earnings, retained earnings, and changes in financial position for the years then ended. These consolidated financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Corporation as at December 31, 1998, 1997, and 1996, and the results of its operations and the changes in its financial position for the years then ended in accordance with generally accepted accounting principles.

Deloitte & Touche LLP

Chartered Accountants
Montréal, Canada

January 27, 1999

Consolidated Statements of Earnings and Retained Earnings

For the years ended December 31
In millions of dollars, except earnings per common share

	Notes	1998	1997	1996
Consolidated Statements of Earnings				
Revenues		**10,031**	9,695	8,502
Tobacco taxes and duties		**1,447**	1,363	1,300
Revenues, net of tobacco taxes and duties		**8,584**	8,332	7,202
Operating costs		**5,235**	5,051	3,376
Financial services interest expense	8	**1,829**	1,832	2,488
Goodwill amortization		**71**	73	73
Other costs and administration		**61**	55	51
Operating earnings before special gain		**1,388**	1,321	1,214
Gain on business disposal	9	**–**	288	–
Operating earnings		**1,388**	1,609	1,214
Interest expense	10	**101**	123	155
Earnings before income taxes and non-controlling interest		**1,287**	1,486	1,059
Provision for income taxes	11	**455**	486	359
Provision for tobacco surtaxes		**59**	56	53
Dividends on preference shares of subsidiary companies				
and non-controlling interest	12	**32**	39	35
Net earnings from continuing operations		**741**	905	612
Discontinued operations	13	**18**	(115)	(11)
Net earnings		**759**	790	601
Net earnings attributed to				
Preference shares	14	**9**	9	9
Common shares		**750**	781	592
		759	790	601
Earnings per common share[1]				
Continuing operations		**$1.63**	$1.95	$1.30
Net earnings		**$1.67**	$1.70	$1.28

[1] Reflects the subdivision of common shares on a two-for-one basis on May 15, 1998.

	Notes	1998	1997	1996
Consolidated Statements of Retained Earnings				
Beginning of year, as previously reported		**2,882**	2,502	2,290
Adjustment for change in accounting policy	1	**–**	–	(40)
Beginning of year, as restated		**2,882**	2,502	2,250
Net earnings		**759**	790	601
Dividends	14	**(314)**	(285)	(260)
Cost of common shares repurchased in excess of stated value		**(538)**	(125)	(89)
End of year		**2,789**	2,882	2,502

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

Consolidated Balance Sheets

December 31
In millions of dollars

	Notes	1998	1997	1996
Assets				
Current assets				
Cash and short-term investments		**40**	57	15
Accounts receivable and other		**374**	518	531
Inventories		**1,040**	1,075	1,158
		1,454	1,650	1,704
Non-current assets				
Investments, notes receivable, and other	3	**369**	308	324
Capital assets	4	**608**	657	1,255
Goodwill		**208**	222	264
		1,185	1,187	1,843
Financial Services				
Investments				
Short-term notes		**2,922**	3,829	2,260
Securities	23	**10,336**	8,407	7,032
Loans	24	**32,304**	32,186	44,067
Real estate investment properties	25	**789**	716	739
Capital assets and other	28	**1,293**	1,474	1,059
Goodwill		**1,239**	1,284	1,290
		48,883	47,896	56,447
Total assets		**51,522**	50,733	59,994
Liabilities and shareholders' equity				
Current liabilities				
Short-term borrowings	5	**73**	102	125
Accounts payable and other		**771**	797	889
Income, excise, and other taxes		**228**	238	159
		1,072	1,137	1,173
Long-term debt	6	**1,357**	1,285	1,966
Other liabilities		**208**	186	182
Financial Services				
Deposits	29	**40,811**	40,394	45,952
Borrowings	30	**2,668**	2,153	6,121
Other liabilities	31	**1,255**	1,303	630
Preference shares of subsidiary companies	32	**363**	363	409
Non-controlling interest	33	**49**	46	47
		45,146	44,259	53,159
Shareholders' equity				
Capital stock	7	**958**	986	969
Unrealized (loss) gain on foreign currency translation		**(8)**	(2)	43
Retained earnings		**2,789**	2,882	2,502
		3,739	3,866	3,514
Total liabilities and shareholders' equity		**51,522**	50,733	59,994

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

Approved by the board,

B M Levitt

Brian M. Levitt
Director

C H Hantho

Charles H. Hantho
Director

Consolidated Statements of Changes in Financial Position

For the years ended December 31
In millions of dollars

	Notes	1998	1997	1996
Operating activities				
Net earnings from continuing operations		**741**	905	612
Items not affecting cash				
Amortization	2	**272**	336	271
Provision for credit losses		**135**	162	172
Gain on business disposal	9	**–**	(288)	–
Other items		**(15)**	(76)	(12)
Net earnings from continuing operations adjusted for non-cash items		**1,133**	1,039	1,043
Changes in non-cash current assets and liabilities	15	**66**	94	(216)
Increase in other liabilities		**14**	17	34
Investment losses and write-offs, net of recoveries		**(186)**	(196)	(253)
Cash from continuing operating activities		**1,027**	954	608
Investing activities				
Additions to capital assets		**(149)**	(134)	(142)
Proceeds from disposal of capital assets		**11**	14	10
Proceeds from business disposals	13	**178**	547	68
Business acquisition	16	**–**	–	(243)
Changes in investments, notes receivable, and other		**(45)**	(25)	(37)
Financial Services				
Changes in investments				
Short-term notes		**907**	(1,638)	1,040
Securities and other investments		**(2,004)**	(2,403)	433
Loans		**(2,328)**	(1,600)	(4,393)
Proceeds from sales of mortgages		**2,244**	5,458	–
Proceeds from business disposal	9	**–**	923	–
Business acquisition	16	**–**	(142)	–
Net additions to capital assets		**(112)**	(65)	(94)
Changes in other assets and liabilities		**154**	(76)	(148)
Cash (used for) from continuing investing activities		**(1,144)**	859	(3,506)
Financing activities				
Issue of long-term debt		**536**	188	592
Repayment of long-term debt		**(477)**	(862)	(469)
Repurchase of common shares, net		**(566)**	(108)	(57)
Dividends	14	**(314)**	(285)	(260)
Financial Services				
Increase in deposits		**417**	304	1,394
Increase (decrease) in borrowings		**515**	(939)	1,549
Redemption of non-controlling interest preference shares		**–**	(46)	(1)
Other changes in non-controlling interest and other capital transactions		**–**	(6)	1
Cash from (used for) continuing financing activities		**111**	(1,754)	2,749
Cash and cash equivalents				
Increase (decrease) from continuing operations		**(6)**	59	(149)
Cash from discontinued operations		**18**	6	22
Increase (decrease) for the year		**12**	65	(127)
Beginning of year		**(45)**	(110)	17
End of year		**(33)**	(45)	(110)
Cash and short-term investments		**40**	57	15
Short-term borrowings		**(73)**	(102)	(125)
		(33)	(45)	(110)

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

1. Significant accounting policies

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in Canada, and all amounts are in Canadian dollars unless otherwise stated.

Basis of presentation

The consolidated financial statements include the accounts of the Corporation and its subsidiaries. Investments in joint ventures are accounted for using the proportionate consolidation method. The common shares of all subsidiaries of the Corporation are 100% directly or indirectly owned, except for CT Financial Services Inc. (CT Financial), of which the Corporation owns approximately 98% of the common shares, and for certain subsidiaries in the Land Development segment.

Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Although these estimates are based on management's knowledge of current events and on actions that the Corporation may undertake in the future, actual results may differ from the estimates.

Change in accounting policy

Effective January 1, 1996, a new accounting policy was adopted, as required by the Office of the Superintendent of Financial Institutions Canada (OSFI) and The Canadian Institute of Chartered Accountants (CICA), for the valuation of impaired investments, formerly known as non-performing investments. This accounting policy prescribes that an impaired investment be reduced to its estimated realizable amount. The estimated realizable amount is defined as the present value of expected cash flows from the investment, discounted at the interest rate inherent in the investment or, in the absence of such information, the fair value of the security underlying the investment or an observable market price for the investment. Upon the policy's adoption on January 1, 1996, the allowance for credit losses was increased by $73 million, and consolidated retained earnings were reduced by $40 million, net of income taxes of $32 million and non-controlling interest of $1 million.

Service fee income

Service fees in the Drugstore segment are recognized as income as a variable percentage of sales of associate drugstores.

Sale of development land

Revenue is recognized in the period in which the transaction occurs, provided the collectibility of sales proceeds is reasonably assured and all material conditions are met, including a cash down payment of not less than 15% in Canada and 20% in the United States.

Cash and short-term investments

Cash and short-term investments include investments that are readily marketable with maturities not exceeding 90 days.

Securitization of accounts receivable

Where groups of accounts receivable are sold to special-purpose entities under terms that transfer the significant risks and rewards of ownership to third parties, the transaction is recognized as a sale and the accounts receivable are removed from the consolidated balance sheets.

Inventories

Raw materials and supplies are valued at the lower of average cost and replacement cost. Finished goods and development land are valued at the lower of cost and net realizable value. Cost is determined substantially as follows: Tobacco – average cost; Drugstore – first-in, first-out; Land Development – specific item basis (cost of development land includes the original cost of properties and the cost of services such as roads and sewerage and water systems; carrying costs such as interest and property taxes are not capitalized).

Investments, notes receivable, and other

Securities are stated at cost and are written down to reflect impairments in value that are other than temporary. Notes receivable are stated at their estimated net realizable value. Deferred charges are stated at cost, less accumulated amortization calculated on a straight-line basis.

Capital assets

Capital assets are accounted for at cost. Amortization is calculated on a straight-line basis over the estimated useful lives of the assets. The estimated useful lives of the principal classes of assets range from 20 to 40 years for buildings and from 1 to 14 years for equipment. The cost of leasehold improvements is amortized on a straight-line basis over the lesser of the estimated useful lives of the assets and the term of the lease. Favourable leases (the fair market value allocated to leases acquired in a business acquisition with terms favourable to prevailing market conditions) are amortized on a straight-line basis over the term of the lease.

Goodwill

Goodwill and related costs arising from acquisitions are capitalized and amortized on a straight-line basis over their estimated lives, not exceeding 40 years. Goodwill is written down to estimated fair value to reflect permanent impairments in value, which are evaluated based upon undiscounted expected future cash flows of the respective subsidiary.

Derivative financial instruments

Outside of its financial services operations, the Corporation has limited involvement with derivative financial instruments and does not use them for trading purposes. The Corporation enters into fixed interest rate swaps to manage exposure to changes in interest rates. The interest rate differentials to be paid or received under these swaps are recognized over the life of the contracts

1. Significant accounting policies (continued)

as an adjustment to interest expense. In addition, the Corporation from time to time enters into foreign exchange transactions to buy or sell foreign currencies in order to manage exposure to fluctuations in these currencies. The transactions are recorded at the rate specified under the contracts on the date of execution.

Translation of foreign currencies

Foreign currency assets and liabilities are translated into Canadian dollars at the year-end rate of exchange, and revenues and expenses are translated at the rate in effect at the time of the transaction. Gains and losses on foreign currency transactions are included in earnings.

Assets and liabilities of self-sustaining foreign operations are translated into Canadian dollars at the year-end rate of exchange, while revenues and expenses are translated at average rates of exchange for the year. Gains and losses resulting from the translation of the financial statements of these operations, net of hedging activities and related income taxes, are deferred and included as a separate component of shareholders' equity.

For balance sheet purposes, amounts in U.S. dollars have been translated into Canadian dollars at the rate of exchange in effect at year-end as follows: December 31, 1998 – US $1 = Cdn $1.531; December 31, 1997 – US $1 = Cdn $1.429; December 31, 1996 – US $1 = Cdn $1.370.

Comparative amounts

Certain comparative amounts have been reclassified to conform with the presentation adopted in 1998.

Financial Services

Fees

Fees are recorded as income over the term of the loan or when the service is provided.

Investments

Investments, which are reduced by an allowance for credit losses where applicable, and investment income are stated as follows:

a) Securities

Bonds, debentures, and mortgage-backed securities are stated at amortized cost plus accrued interest. Stocks other than loan substitutes are stated at cost plus dividends receivable. Any impairment in underlying value that is other than temporary is recorded as a charge to earnings in the year in which it occurs. Loan substitutes are securities that have been structured as after-tax instruments, rather than as conventional loans, to provide the issuer with a borrowing rate advantage. Loan substitutes are accorded the accounting treatment applicable to loans and are stated at cost plus dividends receivable less an allowance for credit losses.

b) Loans

Mortgages are stated at cost, including capitalized and accrued interest, less repayments and unamortized mortgage discounts. Interest income is accrued on a daily basis, and mortgage discounts are amortized over the term of the mortgage. Consumer and collateral loans, corporate and commercial loans, and credit card loans are stated at cost, including accrued interest less repayments.

Any real estate acquired in settlement of loans is classified as impaired and recorded at the lower of the amount expected to be recovered and the outstanding balance of the loan at the time the customer transfers the real estate to the company.

Receivables under equipment leases are stated at gross rentals receivable net of unearned income. Unearned income is reflected in earnings over the term of the lease. Gains resulting from the residual values of leased equipment are reflected in earnings only when realized. Earned income is accrued on a daily basis. Securities purchased under resale agreements are stated at cost plus accrued interest.

c) Real estate investment properties

Real estate investment properties are stated at the lower of cost less accumulated amortization and estimated net recoverable amount. Cost includes the original cost of properties and carrying costs incurred during development. Estimated net recoverable amount is the projected undiscounted net cash flow after interest and income taxes, including residual value. Administrative expenses are not capitalized. Buildings are amortized on a 5% sinking-fund basis over periods of 30 and 50 years.

d) Impaired investments

Impaired investments consist of securities on which interest or preferred dividend payments have been suspended, loans in arrears, credit card loans on which interest accrual has been stopped, and restructured and reduced-rate loans. In addition, management of CT Financial may at any time classify an investment as impaired if there is evidence of deterioration in the borrower's financial condition.

Interest income recognition ceases once the investment is classified as impaired, and any changes in the value of the investments are recorded in the allowance for credit losses.

1. Significant accounting policies (continued)

Restructured loans are reduced to the value of the net cash flows receivable under the modified terms, discounted at the effective interest rate inherent in the loan at the time it was recognized as being impaired. Interest income on such loans, where reasonably assured, is recorded at the same effective interest rate.

e) Allowance for credit losses
The allowance for credit losses is calculated as the amount required to reduce an impaired investment to the present value of its expected cash flows, discounted at the interest rate inherent in the investment or, in the absence of such information, the fair value of the security underlying the investment or an observable market price for the investment, present valued from the date of anticipated disposition.

A specific allowance is established on an investment-by-investment basis, where practicable. In addition, a general allowance is established to provide for losses that cannot be determined on an investment-by-investment basis. Management of CT Financial considers current economic conditions, concentrations of investments, deterioration of general credit conditions, and other relevant matters in establishing the general allowance.

Each investment category has been reduced by the applicable portion of the allowance for credit losses. Any allowance for credit losses of derivative financial instruments is recorded in other liabilities. Write-offs are generally recorded after all reasonable restructuring or collection activities have taken place and the possibility of further recovery is considered remote.

Capitalized mortgage servicing rights
Capitalized mortgage servicing rights are included in establishing the gain or loss on the sale of mortgages at the date of sale. The estimated present value of the interest to be retained on mortgages sold, net of normal servicing fees, is recognized as earnings.

Securitization
Where groups of loans are sold to special-purpose entities under terms that transfer the significant risks and rewards of ownership to third parties, the transaction is recognized as a sale and the related loan assets are removed from the consolidated balance sheets. Gains on these sales are recorded as earnings only when funds have been received and there is no recourse to the funds. Fees earned for servicing the portfolio of loans are recorded as earnings as services are provided.

Securities sold under repurchase agreements
Interest incurred on repurchase agreements is charged to financial services interest expense.

Securities sold but not yet purchased
Securities sold but not yet purchased are marked to market with the resultant gains and losses amortized to earnings over the estimated life of the hedged asset or liability.

Hedge accounting
Where off-balance sheet financial instruments and on-balance sheet assets and liabilities are designated for accounting purposes as hedges of specific assets or liabilities or groups of assets or liabilities, or as modifying the market risk characteristics of assets or liabilities, gains and losses arising from these instruments are deferred and recorded in other assets and are amortized to earnings in the same period as the interest income or expense on the related hedged or modified item is recognized.

Derivative financial instruments
Derivative financial instruments such as interest rate swaps, interest rate options, forward rate agreements, foreign exchange contracts, and futures contracts are used to manage overall interest rate and foreign exchange risk. This is accomplished by creating positions that modify the interest rate or foreign exchange characteristics of financial instruments included in the consolidated balance sheets.

Accounting for derivative financial instruments is the same as the accounting for the related financial instruments included in the consolidated balance sheets. Premiums paid on options, and gains and losses realized on the early termination of derivative financial instruments, are deferred and recorded in other assets to be amortized to earnings over the estimated life of the hedged asset or liability.

2. Segmented financial information

Effective January 1, 1998, the Corporation adopted, on a retroactive basis, the new CICA recommendations with respect to the disclosure of segmented financial information. These changes, which are reflected below, had no effect on the consolidated balance sheets, and the consolidated statements of earnings, retained earnings, and changes in financial position of the Corporation.

The Corporation's reportable segments are strategic business units that operate in different industries and are managed separately. The accounting policies of the reportable segments are the same as those described in the summary of significant accounting policies. The reportable segments are as follows:

Tobacco – Imperial Tobacco manufactures cigarettes, cigars, tobacco sticks, and fine-cut tobacco; imports pipe tobaccos; and processes leaf tobacco.

Financial Services – CT Financial provides a variety of personal banking and wealth management services. Prior to March 1, 1997, this segment included First Federal Savings and Loan Association of Rochester (First Federal), a subsidiary that provided financial intermediary and wealth management services in the Northeast United States.

Drugstore – Shoppers Drug Mart licenses and operates retail outlets that specialize in prescription and over-the-counter drugs, health and beauty aids, and a broad mix of consumer products; distributes a wide range of products to these retail outlets; and operates home health care specialty stores.

Land Development – Genstar Development Company conducts land development activities in Canada and the United States through subsidiaries and joint ventures.

During 1998 the Corporation exited from the Foodservice segment (refer to Note 13).

All tabular figures are in millions of dollars, except as noted

2. Segmented financial information (continued)

Information about segment earnings from operations:

	1998	1997	1996
Revenues, net of tobacco taxes and duties			
Tobacco	**3,201**	3,005	2,827
Tobacco taxes and duties	**(1,447)**	(1,363)	(1,300)
Tobacco, net	**1,754**	1,642	1,527
Financial Services	**3,844**	3,831	4,407
Drugstore	**2,786**	2,681	1,140
Land Development	**200**	178	128
	8,584	8,332	7,202
Operating earnings			
Tobacco	**815**	775	705
Financial Services [1]	**452**	472	473
Drugstore	**199**	159	131
Land Development [2]	**54**	43	29
Total segment earnings from operations	**1,520**	1,449	1,338
Goodwill amortization	**(71)**	(73)	(73)
Other costs and administration	**(61)**	(55)	(51)
Gain on business disposal (Note 9)	**–**	288	–
Operating earnings	**1,388**	1,609	1,214
Interest expense	**101**	123	155
Earnings before income taxes, non-controlling interest, and discontinued operations	**1,287**	1,486	1,059

[1] Includes provision for credit losses, which amounted to $135 million for the year ended December 31, 1998 (1997 – $162 million; 1996 – $172 million).
[2] Includes $5 million (1997 and 1996 – $4 million) representing the Corporation's proportionate share of interests in joint ventures.

	1998	1997	1996
Amortization expense			
Capital assets amortization			
Tobacco	**34**	26	22
Financial Services [1]	**84**	146	106
Drugstore	**75**	65	57
	193	237	185
Other amortization [2]			
Financial Services	**–**	–	4
Drugstore	**2**	18	2
Land Development	**2**	2	2
	4	20	8
Total segment amortization	**197**	257	193
Goodwill amortization			
Financial Services	**53**	55	55
Drugstore	**17**	17	17
Land Development	**1**	1	1
	71	73	73
Other amortization [2]	**4**	6	5
	272	336	271

[1] Includes amortization expense on real estate investment properties.
[2] Includes amortization expense on deferred charges, fair value allocations, and other.

The Corporation also evaluates the performance of its Financial Services segment based on net earnings attributed to common shares, excluding special gain (refer to Note 9), as follows:

	1998	1997	1996
CT Financial			
Pre-tax earnings, excluding special gain and goodwill amortization	**452**	472	473
Goodwill amortization	**(5)**	(7)	(7)
Pre-tax earnings excluding special gain	**447**	465	466
Provision for income taxes	**127**	150	135
Preference share dividends of subsidiaries and non-controlling interest	**10**	12	13
Net earnings excluding special gain	**310**	303	318
Preference share dividends of CT Financial	**16**	16	15
Net earnings attributed to common shares, excluding special gain	**294**	287	303

Information about segment assets:

	1998	1997	1996
Total assets			
Tobacco	**873**	818	779
Drugstore	**753**	876	874
Land Development [1]	**497**	409	454
	2,123	2,103	2,107
Financial Services	**47,644**	46,612	55,157
Total segment assets	**49,767**	48,715	57,264
Other assets	**304**	266	236
Discontinued operations (Note 13)	**4**	246	940
Goodwill	**208**	222	264
Goodwill – Financial Services	**1,239**	1,284	1,290
	51,522	50,733	59,994
Additions to capital assets			
Tobacco	**74**	83	66
Drugstore	**72**	51	76
Land Development	**3**	–	–
	149	134	142
Financial Services	**118**	73	120
	267	207	262

[1] Includes inventories of $55 million (1997 – $43 million; 1996 – $34 million) representing the Corporation's proportionate share of interests in joint ventures.

All tabular figures are in millions of dollars, except as noted

2. Segmented financial information (continued)

Geographic information:

Foreign operations include U.S. Land Development, First Federal up to the date of sale on March 1, 1997, and certain other activities of the Financial Services segment.

	1998	1997	1996
Revenues, net of tobacco taxes and duties			
Canada	**8,315**	8,121	6,389
Foreign	**269**	211	813
	8,584	8,332	7,202
Capital assets and goodwill			
Canada	**2,443**	2,435	2,491
Foreign	**5**	85	816
	2,448	2,520	3,307

3. Investments, notes receivable, and other

	1998	1997	1996
Securities – fixed income [1,2]	**120**	106	97
Securities – equity [1]	**64**	52	46
Notes receivable [3]	**91**	75	80
Deferred charges [4]	**12**	12	33
Deferred income taxes	**25**	14	19
Other	**57**	49	49
	369	308	324

[1] The total amount of securities in U.S. dollars at December 31, 1998, was $177 million (US $115 million); at December 31, 1997, $147 million (US $103 million); and at December 31, 1996, $132 million (US $96 million). The Corporation endeavors to limit investment risk by establishing thresholds to restrict investments in securities by type, maturity, and credit rating. The fair values of securities are presented in Note 22.

[2] Maturities of fixed-income securities are as follows: $19 million maturing within one year, $68 million maturing within one to five years, and $33 million maturing after five years.

[3] Includes demand notes receivable from drugstore associates of $75 million (1997 – $59 million; 1996 – $51 million). The amounts are repayable as agreed, but not later than on termination of the service agreement.

[4] Amortization of deferred charges amounted to $3 million during 1998 (1997 – $20 million; 1996 – $3 million).

4. Capital assets

	1998	1997	1996
Land	**28**	29	192
Buildings	**186**	272	591
Equipment	**818**	860	1,193
Leasehold improvements	**158**	149	463
Favourable leases and other	**43**	54	77
	1,233	1,364	2,516
Accumulated amortization	**(625)**	(707)	(1,261)
	608	657	1,255

Accumulated amortization is summarized below:

	1998	1997	1996
Buildings	**85**	123	214
Equipment	**421**	479	731
Leasehold improvements	**87**	79	281
Favourable leases and other	**32**	26	35
	625	707	1,261

Amortization expense is summarized below:

	1998	1997	1996
Buildings	**7**	6	4
Equipment	**73**	65	59
Leasehold improvements	**13**	11	12
Favourable leases and other	**17**	10	6
	110	92	81

The net book value of capital assets, other than land, not being amortized amounted to $37 million at December 31, 1998 (1997 – $48 million; 1996 – $40 million). These principally represent capital assets under construction or development.

5. Short-term borrowings

	1998	1997	1996
Commercial paper [1]	**329**	191	457
Term loans [1]	**229**	286	747
Bank overdraft and other borrowings [1]	**73**	35	97
Amount reclassified as long-term debt (Note 6)	**(558)**	(410)	(1,176)
	73	102	125

[1] All or partly payable in U.S. dollars. The aggregate principal amount of short-term borrowings payable in U.S. dollars at December 31, 1998, was $300 million (US $196 million); at December 31, 1997, $353 million (US $247 million); and at December 31, 1996, $805 million (US $588 million). At December 31, 1998, the exposure to exchange rate fluctuations on US $47 million of commercial paper principal and interest was hedged by foreign exchange forward contracts. Refer to Note 22 for details.

The weighted-average interest rate for short-term borrowings at December 31 is summarized below:

	1998	1997	1996
Commercial paper	**5.3%**	4.4%	3.3%
Term loans	**5.8%**	6.1%	5.9%

The Corporation has entered into fixed interest rate swaps to manage exposure to changes in interest rates. At December 31, 1998, interest payments on $150 million variable-rate short-term borrowings and on US $25 million variable-rate short-term borrowings have effectively been converted through swaps to fixed interest rates. Information related to these swaps is presented in Note 22.

The Corporation maintains credit facilities with a number of lending institutions to enable direct borrowings of term loans, to support commercial paper borrowings, and to make available cash resources for acquisitions and other corporate purposes. The Corporation had two committed long-term credit facilities at December 31, 1998, which consisted of a five-year revolving $1.5 billion (US $1.0 billion) facility expiring in 2003 and a $230 million (US $150 million) facility expiring in 2001. These facilities enable the Corporation to refinance short-term borrowings on a long-term basis. Therefore, short-term borrowings intended to be refinanced were reclassified as long-term debt.

All tabular figures are in millions of dollars, except as noted

6. Long-term debt

	1998	1997	1996
Short-term borrowings reclassified (Note 5)	**558**	410	1,176
Debentures			
10¼% due December 2001	**150**	150	150
9.85% due April 2002	**150**	150	150
8.375% due June 2003	**150**	150	150
10½% due April 1998	**–**	150	150
	450	600	600
Notes payable and other			
5.7% to 7.4% medium-term notes due to 2005[1]	**345**	272	175
Other obligations	**4**	3	15
	349	275	190
	1,357	1,285	1,966

[1] Medium-term notes carried a weighted-average interest rate of 6.2% at December 31, 1998 (1997 – 6.8%; 1996 – 7.4%).

Long-term debt maturities over the next five years, excluding short-term borrowings reclassified as long-term debt, are as follows:

	Weighted-average interest rate	Amount
1999	7.4%	62
2000	7.1%	12
2001	10.0%	162
2002	8.2%	261
2003	8.4%	150

Maturities in 1999 are expected to be refinanced through existing committed long-term credit facilities and have therefore been classified as long-term debt.

7. Capital stock

All references to number of common shares, stock options, and per share amounts have been restated to reflect the subdivision of common shares on a two-for-one basis on May 15, 1998.

Authorized:
An unlimited number of First and Second Preference Shares, issuable in series; 482,000,000 common shares.

Issued and outstanding:

	1998	1997	1996
270 6.90% Perpetual First Preference Shares Series D	**135**	135	135
436,990,813 common shares	**823**	851	834
	958	986	969

The dividend rate on the Perpetual First Preference Shares Series D is set at 6.90% until June 30, 1999, and thereafter can be reset through negotiation or auction procedures. The shares are redeemable at the Corporation's option at $500,000 per share plus accrued and unpaid dividends.

Changes in issued and outstanding common shares were as follows:

	Shares	Amount
December 31, 1995	464,578,532	802
Issued at $7.00 to $9.91 on the exercise of stock options	1,169,680	11
Issued at $13.07 on the acquisition of Big V (Note 16)	2,626,706	34
Shares repurchased	(7,145,700)	(13)
December 31, 1996	461,229,218	834
Issued at $6.88 to $11.94 on the exercise of stock options	923,340	9
Issued at $18.76 on the acquisition of Meloche Monnex Inc. (Note 16)	1,088,496	21
Shares repurchased	(6,850,108)	(13)
December 31, 1997	456,390,946	851
Issued at $7.00 to $15.53 on the exercise of stock options	1,123,240	11
Shares repurchased	(20,523,373)	(39)
December 31, 1998	436,990,813	823

The weighted-average number of outstanding common shares used in the determination of earnings per common share for 1998 was 448,224,073 (1997 – 458,997,664; 1996 – 464,101,640).

Common shares repurchased represent the number and total stated value of shares repurchased under normal course issuer bids authorized by the Corporation's board of directors. In January 1998 the board authorized a normal course issuer bid to purchase up to 22,800,000 common shares at the prevailing market price from February 4, 1998, to January 29, 1999. Up to $625 million was allocated to this program. At December 31, 1998, 20,430,373 common shares had been repurchased under this issuer bid in addition to 93,000 shares under the 1997 issuer bid. Repurchased shares are restored to the status of authorized but unissued shares.

Under the Corporation's Stock Option Plan, options to purchase common shares of the Corporation may be granted to certain employees. Each option enables the holder to purchase one common share at an option price equal to the closing price per common share on The Toronto Stock Exchange on the last trading day prior to the date of the grant. The options expire not later than ten years after the date of the grant and are generally

All tabular figures are in millions of dollars, except as noted

7. Capital stock (continued)

first exercisable two years following the date of the grant. During the periods reported, the exercise of stock options would have diluted earnings per common share by $0.01 or less.

Details of the stock options outstanding are as follows:

	1998	1997	1996
Outstanding, beginning of year	**7,890,540**	7,925,540	7,792,340
Granted	**1,215,800**	1,251,000	1,518,000
Exercised	**(1,123,240)**	(923,340)	(1,169,680)
Cancelled	**(45,400)**	(362,660)	(215,120)
Outstanding, end of year	**7,937,700**	7,890,540	7,925,540
Weighted-average exercise price of stock options outstanding, end of year	**$14.18**	$11.61	$10.42

8. Financial services interest expense

	1998	1997	1996
Demand deposits	**310**	269	593
Term deposits	**1,356**	1,433	1,629
Notes, mortgages, and convertible debentures	**23**	21	36
Subordinated debentures	**37**	47	47
Other borrowings	**45**	51	197
Net expense (income) on hedging instruments	**58**	11	(14)
	1,829	1,832	2,488

9. Business disposal

Sale of First Federal – Financial Services

On March 1, 1997, CT Financial sold its investment in First Federal for a cash consideration of $923 million (US $675 million).

Details of the sale are as follows:

	1997
Proceeds from disposal	923
Net assets disposed	553
Gain on sale before expenses	370
Sale expenses	(82)
Gain on sale before the undernoted	288
Provision for income taxes	(73)
Gain on sale reported by CT Financial	215
Tax benefit of loss carryforwards [1]	36
Non-controlling interest	(5)
Net gain on sale	246

[1] Results from the realization of previously unrecorded capital loss carryforwards.

The results of First Federal have been included in the Corporation's consolidated financial statements to the date of sale on March 1, 1997. The net gain on the sale of First Federal amounted to $0.53 (post-split) per common share.

10. Interest expense

	1998	1997	1996
Interest on long-term debt	**105**	123	152
Other interest, net	**(4)**	–	3
	101	123	155

11. Income taxes

The effective income tax rate on earnings from continuing operations varies from year to year due to factors such as changes in statutory income tax rates, the imposition of temporary surtaxes, variations in special tax incentives made available under tax legislation and differences in the extent to which they may be claimed, differences in the geographic and industrial mix of earnings, and special gains.

The principal factors causing the difference between the effective income tax rate and the combined federal and provincial tax rate in Canada were as follows:

	1998	1997	1996
Combined federal and provincial income tax rate	**42.1%**	42.2%	42.1%
Tax-exempt investment income	**(2.2)**	(2.1)	(2.3)
Non-deductible goodwill amortization	**2.3**	2.6	2.9
Foreign income taxed at lower rates	**(3.9)**	(1.9)	(3.0)
Manufacturing and processing allowances	**(3.6)**	(3.6)	(3.4)
Other items	**0.6**	0.2	1.9
Effective income tax rate, excluding the undernoted	**35.3%**	37.4%	38.2%
First Federal gain on sale	**–**	(4.7)	–
First Federal tax recovery [1]	**–**	–	(4.3)
Effective income tax rate	**35.3%**	32.7%	33.9%

[1] Represents a $45 million reduction of accumulated provisions for income taxes reported by First Federal following the favourable settlement of an outstanding tax matter.

The components of the provision for income taxes were as follows:

	1998	1997	1996
Current	**463**	529	413
Deferred	**(8)**	(43)	(54)
	455	486	359

For income tax purposes, the Corporation has U.S. operating loss carryforwards that arose in the Foodservice segment of approximately US $180 million at December 31, 1998. The operating losses expire in 2011 and 2012. The potential benefit of utilizing these loss carryforwards has not been recognized in these consolidated financial statements.

All tabular figures are in millions of dollars, except as noted

12. Dividends on preference shares of subsidiary companies and non-controlling interest

	1998	1997	1996
Dividends on preference shares of			
CT Financial and its subsidiaries	**26**	28	28
Non-controlling interest in			
CT Financial's net earnings	**6**	11	7
	32	39	35

13. Discontinued operations

On April 17, 1998, the Corporation announced its decision to sell Fast Food Merchandisers, Inc. (FFM) and its four business units. On September 30, 1998, the Corporation completed the sale of FFM and its foodservice distribution operations. Also, in October 1998 the Corporation completed the sale of the pork processing assets and, in a separate transaction, the poultry processing operation. The net cash proceeds from these three transactions amounted to $178 million (US $116 million). The sale of the cleaning supplies business is expected to be completed in 1999.

In 1997 the Corporation sold Hardee's Food Systems, Inc. (Hardee's) and its Roy Rogers restaurants for total cash proceeds of $547 million (US $399 million). In 1996 cash proceeds from the sale of Roy Rogers and certain Hardee's restaurants amounted to $68 million (US $49 million).

With the decision to sell FFM and the sale of Hardee's, the Corporation is exiting completely from its Foodservice segment. Consequently, the results of FFM and Hardee's up to the dates of sale are reported separately as discontinued operations. The net earnings for 1998 reported below are those prior to April 17, 1998.

The carrying value of the net assets of the cleaning supplies business included in the consolidated balance sheet as at December 31, 1998, amounted to $4 million.

Results of discontinued operations are summarized below:

	1998	1997	1996
Revenues	**1,181**	1,676	2,241
Operating earnings (loss)			
before special items	–	9	(11)
Special items [1]	–	(59)	–
Operating earnings (loss)	–	(50)	(11)
Provision for income taxes [1]	–	(65)	–
Net earnings (loss)	–	(115)	(11)
Net gain on sale [2, 3]	**18**	–	–
Discontinued operations	**18**	(115)	(11)

[1] Represents special charges to provide for certain liabilities and costs associated with the sale of Hardee's and to write off deferred income tax assets. Both charges were recorded in 1997 and reduced 1997 earnings per common share by $0.27 (post-split).

[2] Includes net earnings from operations from April 17, 1998, to the disposal dates of $12 million (US $8 million) and the gain on sale of $6 million (US $4 million).

[3] Current year losses are used to offset $7 million of taxes that would otherwise be payable on the net gain on sale of FFM.

14. Dividends

	1998	1997	1996
6.90% Perpetual First			
Preference Shares Series D	**9**	9	9
Common shares	**305**	276	251
	314	285	260

The attributes of the Perpetual First Preference Shares Series D provide that no dividends may be declared, paid, or set apart for payment on the common shares unless all dividends payable on such preference shares have been declared and paid or set apart for payment.

The board of directors of the Corporation has no fixed policy with respect to the payment of dividends on the Corporation's common shares. However, the Corporation has declared and paid dividends on its common shares every year since its inception.

15. Changes in non-cash current assets and liabilities

Changes in non-cash current assets and liabilities relating to operations were as follows:

	1998	1997	1996
Decrease (increase) in			
current assets			
Accounts receivable			
and other	**79**	(26)	(173)
Inventories	**(15)**	80	(232)
Increase (decrease) in current			
liabilities			
Accounts payable and other	**13**	(16)	172
Income, excise, and			
other taxes	**(11)**	56	17
	66	94	(216)

16. Business acquisitions

Acquisition of Meloche Monnex Inc. – Financial Services

Effective January 1, 1997, the Corporation, through its subsidiary CT Financial, acquired a 100% ownership interest in Meloche Monnex Inc. This company provides home, automobile, and travel insurance to members of professional and alumni associations across Canada. The purchase consideration of $142 million consisted of $105 million in cash, 544,248 Imasco Limited common shares (1,088,496 on a post-split basis) with a market value of $21 million at the date of acquisition, and $16 million of future cash consideration.

Details of the acquisition are as follows:

	1997
Fair value of assets acquired	311
Less liabilities assumed	(265)
Fair value of net assets acquired	46
Goodwill	96
Total purchase consideration	142

All tabular figures are in millions of dollars, except as noted

16. Business acquisitions (continued)

Acquisition of Big V Pharmacies Co. Limited

On February 23, 1996, Imasco completed the acquisition of Big V Pharmacies Co. Limited (Big V), a chain consisting of 135 drugstores primarily in Southwestern Ontario. The total consideration amounted to $243 million, consisting of $151 million in cash, $58 million in medium-term notes, and 1,313,353 Imasco Limited common shares (2,626,706 on a post-split basis) with a market value of $34 million at the date of the acquisition.

Details of the acquisition are as follows:

	1996
Fair value of net assets acquired	49
Goodwill	194
Total purchase consideration	243

17. Retirement benefits

Pension benefits are available to substantially all full-time employees under the Corporation's registered defined benefit plans. The Corporation also makes supplementary retirement benefits available to certain employees under unregistered plans. Employees of CT Financial are covered by a separate pension plan, as described in Note 34.

The registered defined benefit pension plans are funded through contributions based on actuarial cost methods as permitted by pension regulatory bodies. Earnings are charged with the cost of benefits earned by employees as services are rendered. Benefits under these plans are based on the employee's years of service and final average pay. The projected benefit obligations were determined using assumed discount rates ranging from 7% to 8% (1997 and 1996 – 7¾% to 8%) and assumed increases in compensation rates ranging from 4¾% to 5% (1997 and 1996 – 4¾% to 5%). The assumed long-term rates of return on assets ranged from 7¾% to 8% (1997 and 1996 – 7¾% to 8%). Significant judgment is exercised in the determination of these assumptions, and actual results may vary from those estimated.

The projected benefit obligation of approximately $266 million relating to Canadian retirees has been substantially immunized against the impact of future changes in interest rates. Both the assumed discount rate used to project this obligation and the assumed rate of return on the related assets were 6.05%.

The status of the Corporation's defined benefit pension plans was as follows:

	1998	1997	1996
Plan assets at market related value [1]	**843**	765	706
Projected benefit obligations	**(817)**	(752)	(701)
Plan assets in excess of projected benefit obligations	**26**	13	5
Projected benefit obligations for supplementary retirement benefits [2]	**(91)**	(89)	(86)
Unamortized transition assets	**(10)**	(14)	(17)
Unamortized plan amendments	**26**	31	30
Unamortized net (gain) loss	**(23)**	2	26
Recognized net pension liability	**(72)**	(57)	(42)
Pension expense [3]	**27**	29	30
Pension contribution	**12**	13	17

[1] The market value of plan assets amounted to approximately $936 million at December 31, 1998 (1997 – $871 million; 1996 – $775 million).

[2] Represents unfunded obligations which under the Canadian plan are secured by an irrevocable letter of credit in the amount of $91 million (1997 – $75 million; 1996 – $63 million).

[3] Includes the cost of both registered and supplementary benefits.

The components of the Corporation's pension expense are as follows:

	1998	1997	1996
Service cost – benefits earned	**14**	15	14
Interest cost on projected benefit obligations	**63**	60	58
Expected return on plan assets	**(58)**	(54)	(51)
Net amortization	**8**	8	9
Pension expense	**27**	29	30

The Corporation provides limited health benefits for eligible employees upon retirement which are substantially expensed as incurred. During 1998 these costs were approximately $4 million (1997 and 1996 – $3 million).

All tabular figures are in millions of dollars, except as noted

18. Operating lease commitments

The Corporation has commitments with respect to real estate operating leases that are for terms of 1 to 27 years. The minimum annual commitments under such leases and the amounts assumed by drugstore associates and other third parties are detailed in the accompanying table:

	Rental commitment	Assumed by third parties	Net rental commitment
1999	175	121	54
2000	162	112	50
2001	142	96	46
2002	122	82	40
2003	100	67	33
Thereafter	302	166	136
	1,003	644	359

The minimum annual rental commitments listed above do not reflect escalation and percentage-of-sales clauses contained in some leases. Net rentals under leases, including escalation and percentage-of-sales payments, amounted to $66 million for the year ended December 31, 1998 (1997 – $93 million; 1996 – $123 million). The Corporation also has operating lease commitments for equipment for terms of 1 to 15 years, with a minimum annual rental cost of approximately $32 million.

19. Related party transactions

British American Tobacco p.l.c., through the ownership of 42.1% of Imasco Limited's common shares, is defined as a related party. Transactions with British American Tobacco p.l.c. and its subsidiaries were as follows:

	1998	1997	1996
Fees [1]	**3**	3	3
Export sales of leaf tobacco	**31**	41	35
Royalty payments	**–**	1	1

[1] Represents payment of fees by the Corporation for research and development, marketing, and manufacturing services.

During 1998, under the Corporation's normal course issuer bid, Imasco acquired 8,629,173 common shares (post-split) (1997 and 1996 – nil) from British American Tobacco p.l.c. at market price plus brokerage fees amounting to $243 million.

20. Contingencies

On March 3, 1995, Imperial Tobacco Limited was served with a statement of claim on behalf of several individual plaintiffs. In this suit filed in the Ontario Court of Justice against Imperial Tobacco and the two other major Canadian tobacco companies, the plaintiffs allege, among other things, that they are addicted to tobacco, that the defendants conspired to withhold information on addiction and manipulated levels of nicotine in tobacco to make it addictive, and that they are entitled to damages for losses said to be consequential to the alleged addiction. The plaintiffs are seeking awards of $1 million each, as well as punitive damages. They have also served a motion to have the suit certified as a class action. The scope of the purported class remains unclear but if plaintiffs succeed in having the suit certified, it could involve a large but indeterminate number of people. It is not known when the motion will be heard, but it could be in 1999. On June 16, 1997, the plaintiffs brought a motion to join British American Tobacco p.l.c., the Corporation's largest shareholder, as a defendant in the case. The motion was adjourned by consent until plaintiffs' motion for certification is heard.

On May 3, 1996, a writ was served in the Supreme Court of British Columbia against an affiliate of Imperial Tobacco Limited by one plaintiff. Allegations include, among other things, failure to warn against risks of smoking both generally and specifically with respect to Buerger's Disease, addiction, deceit, misrepresentation, and breach of warranty. No statement of claim has yet been served. Although no specific monetary claim has been made, the Corporation believes that the claim will not have a significant impact on the Corporation.

On May 1, 1997, in the Ontario Court (General Division), Imperial Tobacco Limited and one other major Canadian tobacco company were named defendants in an action brought on behalf of Mirjana Spasic, alleging that she contracted lung cancer as a result of the actions of the defendants. The suit alleges negligence, negligent misrepresentation, conspiracy, product liability, and breach of warranty. The plaintiff is seeking an award of $1 million as well as punitive damages. Due to the deteriorating health of the plaintiff (who is now deceased), the case received expedited treatment, and discovery and testimony of the plaintiff were taken in late 1997. On September 16, 1997, the plaintiff, in a companion case, brought suit against British American Tobacco p.l.c., alleging substantially the same claims as in the earlier case against Imperial Tobacco. The suits are now being pursued by the plaintiff's estate.

On June 12, 1997, a suit was brought against Imperial Tobacco Limited by a single plaintiff, Joseph Battaglia, before the North York Ontario Small Claims Court, seeking recovery of damages of $6,000 based on allegations of conspiracy, nicotine manipulation, and addiction. The case is expected to go to trial in 1999.

As previously reported, Imperial Tobacco Limited was named a defendant in two small claims actions filed in Rimouski, Québec, to recover a total of $653.91 for the costs of nicotine patches. Subsequently, one of the plaintiffs withdrew her case, and in 1998 a final decision was rendered in favour of Imperial Tobacco in the second case.

On September 11, 1998, a proceeding was initiated through the filing of a motion in the Superior Court of Québec against Imperial Tobacco Limited, Rothmans, Benson & Hedges Inc., and RJR-Macdonald Inc., seeking authorization to institute a class action on behalf of "all persons residing in Québec who are or who have been addicted to the nicotine contained in the cigarettes manufactured by the respondents, as well as the legal heirs of persons included in the group but deceased". The proceeding seeks to recover $5,000 for each member of the class, along with other damages to be determined. The claims are based on allegations of wrongdoing similar to those found in the first three cases reported above. No date for the hearing of the

20. Contingencies (continued)

motion for authorization has been set. The scope of the purported class remains unclear but if plaintiffs succeed in having the motion granted, it could involve a large but indeterminate number of people.

In July 1997 the Province of British Columbia enacted legislation which empowers the Province, among other things, to initiate litigation to recover the medical costs it allegedly incurred as a consequence of the consumption of tobacco products. The legislation also extends the time within which individuals can sue tobacco companies and grants the Province certain rights with respect to private suits against tobacco manufacturers. On November 12, 1998, in the Supreme Court of British Columbia, the Province of British Columbia initiated its lawsuit against Imperial Tobacco Limited, Imasco Limited, and other Canadian and international tobacco companies. The suit contains allegations of wrongdoing similar to those found in the first three cases reported above. No specific amount of damages is claimed. On the same day, in the same court, separate lawsuits were filed by the three major Canadian tobacco manufacturers seeking to have the legislation underlying the lawsuit struck down on the grounds that it is unconstitutional.

On November 18, 1998, a proceeding was initiated through the filing of a motion in the Superior Court of Québec against Imperial Tobacco Limited, RJR-Macdonald Inc., and Rothmans, Benson & Hedges Inc., seeking authorization to institute a class action on behalf of "all persons who are suffering or have suffered from cancer of the lung, larynx, or throat, or are suffering from emphysema, after having inhaled cigarette smoke over an extended period of time, and heirs and/or successors of deceased persons, who would otherwise have formed part of the group". The proceedings ask for unspecified compensatory and punitive damages. The claims are based on allegations of wrongdoing similar to those found in the first three cases reported above. No date for the hearing of the motion for authorization has been set. The scope of the purported class remains unclear but if the motion is granted, it could involve a large but indeterminate number of people.

The purported class actions and the action by the Province of British Columbia involve several complicated and novel questions of law and fact that may take years to resolve. Accordingly, the Corporation is unable to meaningfully estimate the amount or range of loss that might possibly result from an unfavourable outcome in any of these matters.

On April 4, 1997, Meditrust Healthcare, Inc. brought suit in the Ontario Court (General Division) against fifteen defendants, including two of the Corporation's subsidiaries (Shoppers Drug Mart Limited and one of its subsidiaries) and three of their employees, one of whom is also a director of the Corporation. The suit claimed general damages of $100 million, alleging conspiracy, unfair competition, injurious falsehood, unlawful interference with economic relations, infliction of economic harm, intimidation, and misleading advertising. Additional claims, including $10 million for aggravated damages and $10 million for punitive damages, were also made. Subsequent to a successful motion brought by the defendants to strike the statement of claim, the plaintiff filed an amended statement of claim containing the same basic allegations but now seeking damages of some $700 million. In another motion, the three employees of the subsidiary of the Corporation who were named defendants were struck as defendants from the case. The plaintiff has appealed that decision.

All the foregoing actions will be vigorously defended and, although some of these cases are at very early stages and the course and outcome of litigation are difficult to predict, the Corporation believes that a number of valid defenses are available.

Certain subsidiaries acquired as part of the acquisition of Genstar Corporation in 1986 are subject to numerous claims and suits, most of which are asbestos related. Certain of these claims and suits allege significant damage. Substantially all of the expenses incurred in connection with the defense of asbestos-related claims and suits have been covered by insurance proceeds. Furthermore, in order to supplement the substantial established coverage already in place, these subsidiaries have instituted lawsuits seeking to establish additional insurance coverage from certain carriers who have denied such coverage. In the opinion of management, all such claims and suits against these subsidiaries are adequately covered by insurance or are provided for in the financial statements. If not so covered or provided for, the results are not expected to materially affect the Corporation's financial position.

As previously reported, on March 19, 1997, prior to the sale of Hardee's, Flagstar Corporation (now called Advantica Restaurant Group, Inc.), Hardee's largest franchisee, commenced an arbitration proceeding seeking significant damages. In 1998 this matter was settled at no cost and without further liability to the Corporation or its subsidiaries.

In addition, the Corporation and its subsidiaries are parties to claims and suits brought against them in the ordinary course of business that are not expected to have a significant impact on the Corporation, either individually or in the aggregate.

21. Year 2000

The Year 2000 issue arises because many computerized systems use two digits rather than four to identify a year. Date-sensitive systems may recognize the year 2000 as 1900 or some other date, resulting in errors when information using year 2000 dates is processed. In addition, similar problems may arise in some systems which use certain dates in 1999 to represent something other than a date. The effects of the Year 2000 issue may be experienced before, on, or after January 1, 2000, and if not addressed, the impact on operations and financial reporting may range from minor errors to significant systems failure which could affect an entity's ability to conduct normal business operations.

The Corporation is addressing the Year 2000 issue; however, it is not possible to be certain that all aspects of the Year 2000 issue affecting the Corporation and its business segments, including those related to the efforts of customers, suppliers, or other third parties, will be fully resolved.

All tabular figures are in millions of dollars, except as noted

22. Financial instruments

The following information on financial instruments excludes the Financial Services segment, which is presented separately in Note 35.

Derivative financial instruments

The Corporation uses derivative financial instruments to a limited extent to manage well-defined interest rate or foreign currency risks. The Corporation does not trade in derivatives for speculative purposes.

From time to time the Corporation enters into foreign exchange forward contracts as part of its management of foreign exchange risks.

During 1998 the Corporation entered into forward contracts to purchase US $47 million in 1999 at predetermined exchange rates to hedge the principal and interest related to its U.S. dollar commercial paper debt. The following table summarizes the contracts outstanding at December 31, 1998:

US dollars	Buy	47
Canadian equivalent	Sell	73
	Average exchange rate	1.546

During 1997 the Corporation entered into forward contracts to buy specific amounts of British pounds and German marks at predetermined dates and exchange rates to hedge anticipated purchases of equipment in the Tobacco segment. The following table summarizes the contracts outstanding at December 31, 1998, all of which mature in 1999:

British pounds	Buy	3
Canadian equivalent	Sell	6
	Average exchange rate	2.199
German marks	Buy	8
Canadian equivalent	Sell	6
	Average exchange rate	0.783

Interest rate swaps and occasionally forward rate agreements are employed to manage the fixed/variable debt mix in a cost-efficient manner. The following table summarizes the Corporation's interest rate hedge agreements outstanding at December 31:

	1998	1997	1996
Swaps – Payable fixed –			
notional amount (millions of US $)[1]	**25**	100	150
Weighted-average			
receive rate	**5.2%**	5.8%	5.5%
Weighted-average			
pay rate	**6.2%**	5.8%	6.1%
notional amount (millions of $)[1]	**150**	–	–
Weighted-average			
receive rate	**5.1%**	–	–
Weighted-average			
pay rate	**5.6%**	–	–

[1] The US $25 million swaps mature in 2000, and the $150 million swaps mature in 2001.

The following table summarizes debt-related strategies to manage exposure to interest rate fluctuations as at December 31, 1998:

	Before hedging strategies	After hedging strategies
Fixed-interest rate	795	984
Variable-interest rate	635	446
Total debt[1]	1,430	1,430

[1] Total debt consists of short-term borrowings and long-term debt.

The Corporation minimizes its credit exposure to counterparties by entering into contracts only with highly rated financial institutions and by distributing the transactions among the selected institutions. All of the Corporation's contracts outstanding at December 31, 1998, were with financial institutions rated AA or better, and as a result management believes that the risk of incurring credit losses is remote. Such losses, if any, would not be material.

Sale of accounts receivable

A wholly owned subsidiary of the Corporation has entered into an agreement giving it an ongoing right to sell qualifying accounts receivable in the Tobacco segment to a maximum amount of $100 million. As at December 31, 1998, the subsidiary had sold, with a maximum credit recourse of 10%, accounts receivable for cash proceeds of $75 million (1997 and 1996 – $75 million).

On December 23, 1997, an indirect wholly owned subsidiary of the Corporation entered into an agreement giving it an ongoing right to sell qualifying accounts receivable in the Land Development segment to a maximum amount of $70 million. As at December 31, 1998, the subsidiary had sold, with a maximum credit recourse of 7%, accounts receivable for cash proceeds of $30 million (1997 – $45 million).

The agreements call for purchase discounts based on Canadian commercial paper rates as well as program fees to be paid on an ongoing basis.

Guarantees and letters of credit

A wholly owned subsidiary of the Corporation has provided guarantees to various banks with respect to certain borrowings by drugstore associates. These guarantees are secured by general security agreements with associates. The total amount of the guarantees at December 31, 1998, was $232 million (1997 – $197 million; 1996 – $195 million).

All tabular figures are in millions of dollars, except as noted

22. Financial instruments (continued)

Indirect wholly owned subsidiaries of the Corporation that operate in the Land Development segment have letters of credit outstanding that guarantee completion of work under land servicing agreements and commitments under land purchase agreements. The total amount of these letters of credit at December 31, 1998, was $102 million (1997 – $70 million; 1996 – $59 million).

Certain of the Corporation's obligations for unfunded supplementary retirement benefits are secured by an irrevocable letter of credit in the amount of $91 million (1997 – $75 million; 1996 – $63 million) (refer to Note 17). The Corporation has a letter of credit in the amount of $26 million (1997 – $26 million; 1996 – $25 million) at December 31, 1998, that secures its obligations under an executive retiring allowance plan. In addition, at December 31, 1998, the Corporation has other letters of credit outstanding in the amount of US $10 million and $3 million.

Special tax bonds

Community facilities districts have been formed by certain U.S. public authorities and have sold tax bonds with an aggregate outstanding balance of US $33 million (1997 – US $27 million) to fund certain infrastructure costs of two real estate projects in the Land Development segment. Under the terms of the bond indenture, special taxes will be levied against the land in order to repay the bonds. The underlying land is used as collateral for the bonds, and the obligations for these special assessments are transferred to buyers as the land is sold. No provision for these taxes has been included in these consolidated financial statements. These taxes will be recorded as an expense in the period incurred.

Concentrations of credit risk

The Corporation does not have significant exposure to any individual customer or counterparty.

Fair value of financial instruments

The carrying values of the Corporation's financial instruments as at December 31, other than those of the Financial Services segment (refer to Note 35), approximate fair value with the following exceptions:

	1998		1997		1996	
	Carrying value	**Fair value**	Carrying value	Fair value	Carrying value	Fair value
Securities – fixed income	**120**	**122**	106	107	97	97
Securities – equity	**64**	**99**	52	79	46	58
Long-term debt	**1,357**	**1,424**	1,285	1,357	1,966	2,058
Derivatives						
Foreign exchange forwards	**–**	**1**	–	2	–	–
Interest rate swaps	**–**	**(3)**	–	–	–	–

Estimates of fair value are dependent upon subjective assumptions and involve significant uncertainties. Accordingly, the fair value estimates presented do not necessarily represent the amounts that could be realized in a current market exchange. The use of different market assumptions and/or estimation methods may have a material effect on the estimated fair value amounts. Potential income taxes and other expenses that would be incurred on the actual disposition of these financial instruments are not reflected in the fair values disclosed.

The following methods and assumptions were used to estimate the fair values of financial instruments:

The carrying values of certain financial instruments approximate their fair value, as they are short term in nature. These financial instruments include cash and short-term investments, accounts and current notes receivable, short-term borrowings, and accounts payable and other.

Estimated fair values of securities are based on quoted market prices at the reporting dates for those or similar investments.

The carrying values of notes receivable reflect fair value, as the notes carry interest rates that approximate those used in current transactions.

The estimated fair values for long-term debt are determined by discounting the future contractual cash flows under current financing arrangements at discount rates that represent borrowing rates available to the Corporation at the valuation dates for loans with similar terms and maturities.

The fair values of derivatives reflect the estimated amounts the Corporation would receive or pay to terminate the contracts at the reporting dates.

All tabular figures are in millions of dollars, except as noted

23. Securities – Financial Services

Remaining term to contractual maturity

	Less than 1 year	1 to 5 years	6 to 10 years	Over 10 years	No fixed maturity	1998 Total	1997 Total	1996 Total
Bonds and debentures								
Canada	2,007	2,047	169	299	–	4,522	4,680	4,059
Provincial	–	1	1	–	–	2	193	182
Corporate	349	454	–	32	–	835	416	61
Foreign governments	739	1,112	–	–	–	1,851	1,158	751
Accrued income	127	–	–	–	–	127	119	65
	3,222	3,614	170	331	–	7,337	6,566	5,118
Stocks								
Preference	22	197	57	–	139	415	396	355
Loan substitutes	–	–	–	–	121	121	247	273
Common	–	–	–	–	471	471	515	339
Accrued income	7	–	–	–	–	7	8	6
	29	197	57	–	731	1,014	1,166	973
Mortgage-backed securities								
Government insured	10	1,965	–	–	–	1,975	674	765
Other insured	–	–	7	–	–	7	–	170
Accrued income	3	–	–	–	–	3	1	6
	13	1,965	7	–	–	1,985	675	941
	3,264	5,776	234	331	731	10,336	8,407	7,032

Unrealized gains and losses

	1998 Carrying value	1998 Gross unrealized gains	1998 Gross unrealized losses	1998 Fair value	1997 Carrying value	1997 Gross unrealized gains	1997 Gross unrealized losses	1997 Fair value
Bonds and debentures								
Canada	4,522	173	1	4,694	4,680	39	7	4,712
Provincial	2	–	–	2	193	3	–	196
Corporate	835	8	–	843	416	3	1	418
Foreign governments	1,851	17	–	1,868	1,158	3	–	1,161
Accrued income	127	–	–	127	119	–	–	119
	7,337	198	1	7,534	6,566	48	8	6,606
Stocks								
Preference [1]	415	18	5	428	396	30	2	424
Loan substitutes	121	–	–	121	247	–	–	247
Common [1]	471	110	2	579	515	155	1	669
Accrued income	7	–	–	7	8	–	–	8
	1,014	128	7	1,135	1,166	185	3	1,348
Mortgage-backed securities								
Government insured	1,975	1	–	1,976	674	1	–	675
Other insured	7	–	–	7	–	–	–	–
Accrued income	3	–	–	3	1	–	–	1
	1,985	1	–	1,986	675	1	–	676
	10,336	327	8	10,655	8,407	234	11	8,630

[1] The 1998 net unrealized gains on common and preferred stocks of $121 million decreased to $21 million after taking into account the net effect of the derivative financial instruments associated with these securities.

The fair values of securities are based upon the quoted market prices, which may not necessarily be realized on sale. Where a quoted price is not readily available, other valuation techniques have been used to estimate the fair value. The fair values of loan substitutes approximate carrying value.

All tabular figures are in millions of dollars, except as noted

23. Securities – Financial Services (continued)

Sales of mortgages

The principal value of mortgages pooled as mortgage-backed securities during the year was $2.3 billion (1997 – $4.2 billion; 1996 – nil) of which $1.5 billion (1997 – $1.1 billion; 1996 – nil) was retained.

	1998	1997	1996
Outstanding principal of mortgage-backed securities sold	**3,461**	3,023	268
Present value of interest rate spread	**83**	89	3
Average rate of mortgage-backed securities	**6.79%**	7.21%	9.16%
Average coupon rates paid to investors	**5.44%**	5.81%	7.71%
Maturity dates of securities	**1999 to 2003**	1998 to 2002	1997 to 2001

The principal value of mortgages securitized during the year was $1.4 billion (1997 – $2.4 billion; 1996 – nil).

	1998	1997	1996
Outstanding principal of securitized mortgages sold	**2,300**	2,112	–
Recourse for credit losses	**25**	34	–

24. Loans – Financial Services

Remaining term of contractual repayments					**1998**	1997	1996
	Less than 1 year	**1 to 5 years**	**6 to 10 years**	**Over 10 years**	**Total**	Total	Total
Mortgages	**5,545**	**10,229**	**286**	**1**	**16,061**	17,633	31,210
Consumer and collateral	**11,102**	**2,134**	**6**	**–**	**13,242**	11,983	10,280
Corporate and commercial	**251**	**104**	**43**	**37**	**435**	263	367
Credit cards	**1,571**	**–**	**–**	**–**	**1,571**	1,363	1,196
Receivables under equipment leases	**153**	**80**	**64**	**46**	**343**	352	382
Securities purchased under resale agreements	**652**	**–**	**–**	**–**	**652**	592	632
	19,274	**12,547**	**399**	**84**	**32,304**	32,186	44,067

25. Real estate investment properties – Financial Services

	1998	1997	1996
Land	**185**	177	187
Buildings and leasing costs	**729**	649	662
	914	826	849
Accumulated amortization	**(125)**	(110)	(110)
	789	716	739

Amortization of real estate investment properties amounted to $7 million in 1998 (1997 and 1996 – $7 million).

26. Impaired investments – Financial Services

	1998	1997	1996
Loans			
Mortgages – residential	**32**	37	131
– commercial	**41**	65	118
Consumer and collateral	**35**	20	18
Corporate and commercial	**1**	10	127
Credit cards	**18**	21	15
Receivables under equipment leases	**–**	1	1
Impaired investments	**127**	154	410
Allowance for credit losses (Note 27)	**(224)**	(275)	(368)
Net impaired investments	**(97)**	(121)	42

All tabular figures are in millions of dollars, except as noted

27. Allowance for credit losses – Financial Services

	1998	1997	1996
Beginning of year	275	368	375
Adoption of impaired investments accounting standard (Note 1)	–	–	73
Beginning of year, as restated	275	368	448
Provision charged to earnings	135	162	172
Adjustment regarding sale of First Federal	–	(59)	–
Foreign exchange adjustment	–	–	1
Investment losses and write-offs, net of recoveries	(186)	(196)	(253)
End of year	224	275	368

The apportionment of the allowance for credit losses is summarized below:

	1998	1997	1996
Loans			
Mortgages – residential	10	11	63
– commercial	24	52	102
Consumer and collateral	89	69	38
Corporate and commercial	31	82	115
Credit cards	63	48	33
Receivables under equipment leases	5	5	5
Securities	2	8	12
	224	275	368
Specific allowance	20	48	147
General allowance	204	227	221
	224	275	368

28. Capital assets and other – Financial Services

	1998	1997	1996
Land	83	83	89
Buildings	165	156	217
Equipment	618	550	598
Leasehold improvements	202	179	192
	1,068	968	1,096
Accumulated amortization	(675)	(611)	(598)
Capital assets	393	357	498
Amounts receivable from brokers, dealers, and brokerage clients	131	295	153
Reinsurance recoverable for unpaid claims	131	121	–
Capitalized and purchased mortgage servicing rights	128	175	105
Other financial assets	12	18	–
	402	609	258
Accounts receivable	391	291	113
Hedge accounting deferrals			
Sales of mortgages	(85)	(147)	–
Other, including terminated derivatives	(64)	170	(34)
Premiums on purchased options	63	93	88
Current income taxes	67	–	–
Deferred income taxes	13	30	–
Other	113	71	136
Other assets	900	1,117	561
	1,293	1,474	1,059

Accumulated amortization is summarized below:

	1998	1997	1996
Buildings	70	63	84
Equipment	470	425	397
Leasehold improvements	135	123	117
	675	611	598

Amortization expense is summarized below:

	1998	1997	1996
Buildings	8	13	11
Equipment	55	106	73
Leasehold improvements	14	20	15
	77	139	99

29. Deposits – Financial Services

Remaining term to contractual maturity							1998	1997	1996
		On demand	Less than 1 year	1 to 5 years	6 to 10 years	Over 10 years	Total	Total	Total
Demand	– Fixed-rate	4,164	–	–	–	–	4,164	4,918	8,172
	– Variable-rate	12,840	–	–	–	–	12,840	11,227	13,693
Term	– Fixed-rate	–	11,554	10,897	371	138	22,960	24,059	23,977
	– Variable-rate	–	847	–	–	–	847	190	110
		17,004	12,401	10,897	371	138	40,811	40,394	45,952

All tabular figures are in millions of dollars, except as noted

29. Deposits – Financial Services (continued)

Canada Trustco Mortgage Company (Canada Trustco), a wholly owned subsidiary of CT Financial, has issued $500 million 99-year term deposit receipts maturing September 20, 2089, with interest payable at 12.75% per annum. Subsequent to issue, interest coupons payable in years 11 through 99 were purchased and cancelled. The present value of these coupons of $399 million (1997 – $352 million; 1996 – $311 million) is offset against the deposit receipts of $518 million (including accrued interest) included in term deposits as of December 31, 1998, 1997, and 1996; however, there is no legal right of offset in the event of default.

30. Borrowings – Financial Services[1]

	1998	1997	1996
Notes, mortgages, convertible debentures, and other borrowings			
11.2% notes due to 2009[2]	**28**	28	28
8% to 12.75% mortgages repayable to 2012	**107**	109	116
Variable rate $200 million money market convertible redeemable debentures due 2010	**201**	201	200
Prime rate $21 million series A convertible redeemable debentures	**–**	–	22
11.86% limited recourse loan due 2003	**33**	34	34
Advances from Federal Home Loan Bank	**–**	–	2,441
Other advances[3]	**61**	69	244
	430	441	3,085
Subordinated debentures			
8.125% $150 million series 1 capital debentures due 2003	**–**	154	154
10.05% $150 million series 2 capital debentures due 2014	**156**	156	156
9.15% $200 million series 3 capital debentures due 2025	**202**	202	202
	358	512	512
Securities sold under repurchase agreements	**1,418**	967	2,069
Securities sold but not yet purchased	**462**	233	455
	2,668	2,153	6,121

[1] Amounts reported include accrued interest.
[2] Secured by assets with a carrying value of $28 million.
[3] Principally represents advances from borrowers for taxes.

Mortgages are primarily first and second real estate mortgages secured by assets with a carrying value of $97 million at December 31, 1998 (1997 – $109 million; 1996 – $119 million).

Money market debentures are convertible in whole, into preference shares of CT Financial, at the issuer's option and at the holder's option at any time after May 17, 2009.

Subordinated debentures represent direct unsecured obligations of Canada Trustco. They are subordinated in right of payment to the prior payment in full of the deposit liabilities and all other liabilities of that company.

On March 12, 1998, Canada Trustco redeemed, with the consent of the Superintendent of Financial Institutions, all of its issued and outstanding 8.125% series 1 capital debentures due March 12, 2003. Holders of the series 1 capital debentures were paid 100% of the principal amount of their debentures plus all accrued and unpaid interest to March 12, 1998.

Series 2 capital debentures are redeemable by Canada Trustco on or after August 4, 1999. The debentures are also exchangeable by the holder on August 4, 1999, or on any interest payment date thereafter, after notice from Canada Trustco, for an equal aggregate principal amount of (i) investment certificates or (ii) a new issue of subordinated indebtedness of Canada Trustco. Both privileges require the consent of the Superintendent of Financial Institutions.

Series 3 capital debentures are redeemable by Canada Trustco on or after May 25, 2000. The debentures are also exchangeable by the holder on May 25, 2000, or on any interest payment date thereafter, after notice from Canada Trustco, for an equal aggregate principal amount of (i) investment certificates or (ii) a new issue of subordinated indebtedness of Canada Trustco. Both privileges require the consent of the Superintendent of Financial Institutions.

Required contractual repayments[1]

	1998	1997	1996
Less than 1 year (includes accrued interest)	**92**	98	1,933
1 to 2 years	**2**	2	657
2 to 3 years	**10**	3	16
3 to 4 years	**9**	11	73
4 to 5 years	**29**	10	38
5 to 10 years	**10**	36	66
Over 10 years	**278**	281	302
	430	441	3,085

[1] Comprises notes, mortgages, convertible debentures, and other borrowings.

31. Other liabilities – Financial Services

	1998	1997	1996
Amounts payable to brokers, dealers, and brokerage clients	**353**	450	291
Accounts payable and accrued liabilities	**554**	425	260
Insurance reserves	**295**	268	16
Current income taxes	**–**	108	48
Deferred income taxes	**–**	–	9
Other	**53**	52	6
	1,255	1,303	630

All tabular figures are in millions of dollars, except as noted

32. Preference shares of subsidiary companies – Financial Services

Issued and outstanding preference shares of subsidiary companies, all owned by third parties, were as follows:

	1998	1997	1996
CT Financial			
6,000,000 Non-cumulative redeemable perpetual first preference shares – series 4	**150**	150	150
2,000,000 Non-cumulative redeemable perpetual first preference shares – series 5 – US $50 million	**63**	63	63
Canada Trustco [1]			
6,000,000 Preference shares (1997 – 6,000,000; 1996 – 7,986,036)	**150**	150	196
	363	363	409

[1] Includes $150 million non-cumulative redeemable third preference shares – series 1. In June 1997 the voting rights attached to Canada Trustco's widely held and publicly traded non-cumulative redeemable third preference shares – series 1 became effective, each share having a single vote equivalent to that of a common share. CT Financial continues to hold 100% of the common shares of Canada Trustco. In May 1997 the number of Canada Trustco common shares outstanding was consolidated, such that the holders of the third preference shares represent 35% of the voting rights of Canada Trustco. This then satisfied the federal legislation requiring the Corporation to reduce its voting interests to 65% effective June 1, 1997.

The dividend rate on the first preference shares – series 4 is 7.35%. The shares are redeemable on or after February 1, 2003, at $25.00 per share plus declared and unpaid dividends to the redemption date and are convertible on or after August 1, 2003, at the option of the holder, into that number of common shares of CT Financial determined by dividing $25.00, plus declared and unpaid dividends to the conversion date, by the greater of $2.00 and 95% of the weighted-average trading price of the common shares of CT Financial for a specified period immediately prior to the date of conversion. CT Financial has the right to redeem or find a substitute purchaser for the tendered shares.

The dividend rate on the first preference shares – series 5 is 6.40%. The shares are redeemable on or after February 1, 2003, at US $25.00 per share plus declared and unpaid dividends to the redemption date and are convertible on or after August 1, 2003, at the option of the holder, into that number of common shares of CT Financial determined by dividing US $25.00, plus declared and unpaid dividends to the conversion date, by the greater of US $2.00 and the U.S. dollar equivalent of 95% of the weighted-average trading price of the common shares of CT Financial for a specified period immediately prior to the date of conversion. CT Financial has the right to redeem or find a substitute purchaser for the tendered shares.

33. Non-controlling interest – Financial Services

	1998	1997	1996
CT Financial	**49**	46	41
CT Securities	**–**	–	2
First Federal	**–**	–	4
	49	46	47

34. Retirement benefits – Financial Services

Pension benefits are available to all employees of CT Financial under the company's contributory pension plan. The plan consists of a defined benefit section and a money purchase section. Employees joining the plan after May 31, 1987, must join the money purchase fund. Earnings are charged with the cost of benefits earned by employees as services are rendered for both sections of the plan.

The defined benefit plan has been valued based upon the following assumptions: 7% average annual investment return (1997 and 1996 – 8½%) and 3½% average annual increase in compensation rates (1997 and 1996 – 5½%).

The status of CT Financial's pension plan was as follows:

	1998	1997	1996
Defined benefit			
Plan assets at market value	**285**	273	249
Projected benefit obligations	**269**	250	225
Plan assets in excess of projected benefit obligations	**16**	23	24
Unamortized transition assets	**–**	(6)	(12)
Unamortized net gains	**(17)**	(21)	(17)
Recognized net pension liability	**(1)**	(4)	(5)
Money purchase			
Plan assets at market value	**204**	186	165
Pension expense	**10**	10	8
Pension contribution	**12**	11	10

CT Financial provides certain health benefits for eligible employees upon retirement. The cost of these benefits is expensed as incurred. During 1998 these costs were $1 million (1997 – nil; 1996 – $1 million).

All tabular figures are in millions of dollars, except as noted

35. Financial instruments – Financial Services

Derivative financial instruments

Derivative financial instruments are used to manage interest rate and foreign exchange risks and include interest rate swap contracts, interest rate options, forward rate agreements, foreign exchange contracts, and futures contracts. Derivative financial instruments are not offered to customers, nor are they used to generate gains from anticipated market movements. The notional amount of a derivative financial instrument represents the agreed amount upon which calculations of interest payments to be exchanged are based. It does not represent a direct credit exposure or market risk, nor does it represent the extent to which one position offsets another.

Notional amounts by remaining term to contractual maturity

	Within 1 month	1 to 3 months	3 to 12 months	1 to 5 years	Over 5 years	1998 Total	1997 Total
Over-the-counter							
Interest rate contracts							
Forward rate agreements	–	150	1,240	–	–	1,390	7,125
Interest rate swaps	652	1,038	6,463	15,658	822	24,633	22,552
Purchased interest rate options	15	–	1,947	4,750	240	6,952	7,196
Foreign exchange forwards and cross currency swaps	323	148	786	1,256	–	2,513	2,087
Equity swaps	–	30	15	714	–	759	627
	990	1,366	10,451	22,378	1,062	36,247	39,587

The main risks associated with derivative financial instruments are credit risk and market risk. Credit risk includes the possibility that a counterparty will default on its contractual obligations under the terms of a derivative contract. The credit exposure amount is the potential decrease in earnings should a counterparty default. Credit exposure is measured by the cost of replacing contracts at current market rates. It is controlled by limiting available counterparties to those of high quality and by setting and observing concentration limits. Exposure under derivative contracts is included when calculating the permitted and outstanding exposure for all credit risks to any counterparty.

Management of CT Financial monitors market risk regularly by use of modelling and simulation techniques to ensure that limits established by policy and capital requirements are not exceeded.

The replacement cost of a derivative financial instrument represents the cost of replacing at current market rates all contracts with a positive market value. The amounts do not take into consideration master netting agreements or any collateral that might be obtained.

The risk-weighted amount of a derivative financial instrument is prescribed by OSFI regulation. It is the sum of the positive market value and the notional amount of the derivative, weighted by factors prescribed by OSFI reflecting the risks involved in the contract.

Credit exposure

	1998			1997		
	Notional amount	Replacement cost	Risk-weighted amount	Notional amount	Replacement cost	Risk-weighted amount
Over-the-counter						
Interest rate contracts						
Forward rate agreements	1,390	–	–	7,125	4	1
Interest rate swaps	24,633	96	38	22,552	129	42
Purchased interest rate options	6,952	28	12	7,196	37	13
Foreign exchange forwards and cross currency swaps	2,513	32	21	2,087	47	25
Equity swaps	759	5	10	627	7	12
	36,247	161	81	39,587	224	93

All tabular figures are in millions of dollars, except as noted

35. Financial instruments – Financial Services (continued)

Credit risk management

Policy and management judgment require diversification of lending practices by industry and geographic location in addition to diversification of borrowers and counterparties. Management of CT Financial considers the following concentrations to be within acceptable limits.

a) Corporate assets

At December 31, 1998, 94% of corporate assets reported by CT Financial were located in Canada and 6% were located outside Canada compared with 96% and 4%, respectively, at December 31, 1997. Loans in Canada represented 99% of total loans (68% were concentrated in Ontario). At December 31, 1997, 100% of loans were in Canada (69% in Ontario).

b) Credit exposure of derivative financial instruments

Of the $161 million credit exposure of derivative financial instruments outstanding at December 31, 1998, approximately 88% was related to Canada and 12% to outside Canada (1997 – Canada – 91%; outside Canada – 9%). Banks accounted for 97% of the counterparties for these derivatives (1997 – 97%).

c) Pledged assets

Securities with a carrying value of $135 million have been pledged as collateral for various types of funding arrangements. In addition, assets with a carrying value of $13 million have been deposited as collateral in order to participate in clearing and payment systems and depositories.

d) Credit commitments

These amounts represent the maximum obligation to extend credit to customers and are set out in the following table. All of the $13 billion obligation at December 31, 1998, was within Canada as it was at December 31, 1997.

	1998	1997	1996
Standby and documentary letters of credit	**27**	26	14
Securities lending	**50**	14	8,044
Commitments to extend credit			
Original term to maturity one year or less	**12,389**	10,338	9,224
Original term to maturity more than one year	**564**	448	823
	13,030	10,826	18,105

Interest rate sensitivity

Interest rate risk arises when principal and interest cash flows, both on- and off-balance sheet, including final maturities, have mismatched repricing dates. Interest rate risk or sensitivity is the potential impact of changes in interest rates on earnings and on the present value of equity. The present value of equity is the difference between the present value of all asset cash flows and the present value of all liability cash flows, including the expected impact of interest rate options due to rate commitments or embedded product options.

An interest rate gap is a common measure of interest rate sensitivity. A positive gap occurs when more assets than liabilities reprice within a particular time period. A negative gap occurs when there is an excess of liabilities over assets repricing. The former provides a positive earnings impact in the event of an increase in interest rates during the time period. Conversely, negative gaps are positively positioned for decreases in interest rates during the particular time period. The determination of the interest rate sensitivity or gap position is based upon the earlier of the repricing or maturity date of assets, liabilities, and derivatives and entails numerous assumptions.

The gap position presented is measured at the close of business on December 31. That position is subject to significant change in subsequent periods based on changes in customer preferences and in the application of asset/liability management policies.

Variable-rate assets and liabilities are immediately sensitive to a change in interest rates, while other assets are sensitive to changing interest rates periodically, either as they mature or as contractual repricing events occur. Non-interest rate sensitive assets and liabilities are not directly affected by changes in interest rates. Yields are based upon the contractual interest rate in effect for the assets or liabilities at year-end.

All tabular figures are in millions of dollars, except as noted

35. Financial instruments – Financial Services (continued)

Interest rate risk gap

1998

	Variable rate	Within 1 month	1 to 3 months	3 to 12 months	1 to 5 years	Over 5 years	Non-interest rate sensitive	Total
Short-term notes	300	1,846	518	90	–	–	168	2,922
Yield	5.00%	6.24%	5.01%	5.01%	–	–	–	–
Securities	3,850	207	142	922	4,639	386	190	10,336
Yield	5.08%	5.46%	6.23%	6.47%	7.29%	6.58%	–	–
Loans	12,298	773	1,767	4,403	12,407	623	33	32,304
Yield	9.05%	7.12%	7.19%	7.17%	7.07%	9.11%	–	–
Real estate investment properties	–	–	–	–	–	–	789	789
Capital assets and other	–	–	–	–	–	–	1,293	1,293
Goodwill	–	–	–	–	–	–	1,239	1,239
Total assets	16,448	2,826	2,427	5,415	17,046	1,009	3,712	48,883
Deposits	7,716	3,093	3,676	9,738	11,703	520	4,365	40,811
Yield	1.58%	4.38%	4.74%	5.19%	5.84%	8.85%	–	–
Notes, mortgages, convertible debentures, and other borrowings	200	108	–	–	–	28	94	430
Yield	5.13%	8.73%	–	–	–	10.90%	–	–
Subordinated debentures	–	–	–	–	–	350	8	358
Yield	–	–	–	–	–	9.54%	–	–
Securities sold under repurchase agreements	–	1,418	–	–	–	–	–	1,418
Yield	–	5.17%	–	–	–	–	–	–
Securities sold but not yet purchased	462	–	–	–	–	–	–	462
Yield	5.08%	–	–	–	–	–	–	–
Other liabilities	–	–	–	–	–	–	1,255	1,255
Preference shares of subsidiary companies and non-controlling interest	–	–	–	–	–	–	412	412
Total liabilities	8,378	4,619	3,676	9,738	11,703	898	6,134	45,146
On-balance sheet gap	8,070	(1,793)	(1,249)	(4,323)	5,343	111		
Total pay-side swaps	(16,589)	(80)	(667)	(3,432)	(9,852)	(410)		
Yield	5.01%	5.06%	3.94%	2.87%	5.64%	5.99%		
Total receive-side swaps	16,299	148	1,361	4,427	8,455	340		
Yield	4.57%	12.76%	2.22%	5.02%	5.38%	6.25%		
Off-balance sheet gap	(290)	68	694	995	(1,397)	(70)		
Total interest rate sensitivity gap – 1998	7,780	(1,725)	(555)	(3,328)	3,946	41		
Total interest rate sensitivity gap – 1997	3,714	4,956	(1,076)	(4,791)	2,701	354		

The above table details the earlier of maturity or repricing date of interest sensitive instruments. Certain demand deposits are shown as non-interest rate sensitive, although the profile assumed for actual management may be different. Loans are shown to their contractual maturity even though principal (and interest) payments often occur throughout the lifetime of the loan.

All tabular figures are in millions of dollars, except as noted

35. Financial instruments – Financial Services (continued)

Fair value of on-balance sheet financial instruments

The carrying values of all on-balance sheet financial instruments as at December 31 approximate fair value, with the following exceptions:

	1998		1997	
	Carrying value	**Fair value**	Carrying value	Fair value
Assets				
Short-term notes	**2,922**	**2,930**	3,829	3,829
Securities	**10,336**	**10,655**	8,407	8,630
Loans	**32,304**	**32,959**	32,186	32,647
Liabilities				
Deposits				
Demand	**17,004**	**17,004**	16,145	16,168
Term	**23,807**	**24,387**	24,249	24,570
Notes, mortgages, convertible debentures, and other borrowings	**430**	**466**	441	479
Subordinated debentures	**358**	**520**	512	653

Fair value of derivative financial instruments

	1998			1997		
	Gross assets	**Gross liabilities**	**Net**	Gross assets	Gross liabilities	Net
Over-the-counter						
Interest rate contracts						
Forward rate agreements	**–**	**–**	**–**	4	1	3
Interest rate swaps	**96**	**216**	**(120)**	129	256	(127)
Purchased interest rate options	**28**	**–**	**28**	37	–	37
Foreign exchange forwards and cross currency swaps	**32**	**234**	**(202)**	47	8	39
Equity swaps	**5**	**22**	**(17)**	7	48	(41)
	161	**472**	**(311)**	224	313	(89)

Estimates of fair value are dependent upon subjective assumptions and involve significant uncertainties. Fair values disclosed represent estimates of value made at a point in time and may not be relevant in predicting CT Financial's future earnings or cash flows. Potential income taxes and other expenses that would be incurred on the actual disposition of these financial instruments are not reflected in the fair values disclosed.

The following methods and assumptions were used to estimate the fair values of financial instruments:

The carrying values of certain financial instruments approximate their fair value, as they are short term in nature. These financial instruments include securities purchased and sold under resale and repurchase agreements, and certain other assets and liabilities that are considered financial instruments.

The fair values of short-term notes are estimated by discounting future cash flows using market interest rates for similar instruments.

Estimated fair values of securities are based on quoted market prices or dealer quotes, when available, or on quoted market prices of similar securities.

For certain variable-rate loans that reprice frequently, estimated fair values are assumed to be equal to their carrying values. Fair values of other loans are estimated through a discounted cash flow calculation that uses market interest rates currently charged for similar new loans at December 31 to expected maturity amounts, adjusted for prepayments where appropriate.

The fair values of mortgage servicing rights are estimated by discounting the net servicing income to be received over the estimated servicing terms using current market rates.

The fair values of deposits without specified maturities are the amounts payable on demand at December 31. The fair values of other deposits and other borrowings are determined by discounting the contractual cash flows using market interest rates currently offered for liabilities with similar terms and credit risks.

The fair values of subordinated debentures are determined by reference to current market prices for the same or similar debt.

The fair values of derivative financial instruments are the net present values of expected future cash flows. The fair values of derivative financial instruments also represent the cost of replacing the contracts on the date that fair values are determined.

Quarterly Consolidated Financial Information (unaudited)

In millions of dollars, except as noted

	March		June		September		December	
	1998	1997	**1998**	1997	**1998**	1997	**1998**	1997
Revenues	**2,258**	2,244	**2,544**	2,430	**2,536**	2,506	**2,693**	2,515
Revenues, net of tobacco taxes and duties	**1,959**	1,955	**2,172**	2,077	**2,151**	2,149	**2,302**	2,151
Operating earnings								
Imperial Tobacco	**161**	153	**205**	193	**218**	206	**231**	223
CT Financial Services	**116**	132	**124**	136	**115**	92	**97**	112
Shoppers Drug Mart/Pharmaprix	**37**	30	**43**	36	**49**	40	**70**	53
Genstar Development Company	**9**	7	**13**	8	**17**	21	**15**	7
	323	322	**385**	373	**399**	359	**413**	395
Goodwill amortization	**17**	18	**18**	20	**18**	17	**18**	18
Other costs and administration	**14**	13	**15**	15	**14**	11	**18**	16
Operating earnings before special gain	**292**	291	**352**	338	**367**	331	**377**	361
Gain on business disposal	**–**	293	**–**	–	**–**	–	**–**	(5)
	292	584	**352**	338	**367**	331	**377**	356
Interest expense	**26**	34	**24**	36	**25**	28	**26**	25
Provision for income taxes	**98**	143	**113**	119	**124**	103	**120**	121
Provision for tobacco surtaxes	**12**	11	**15**	15	**15**	14	**17**	16
Dividends on preference shares of subsidiary companies and non-controlling interest	**8**	13	**8**	8	**8**	9	**8**	9
Net earnings from continuing operations	**148**	383	**192**	160	**195**	177	**206**	185
Discontinued operations	**–**	(11)	**–**	(106)	**10**	4	**8**	(2)
Net earnings	**148**	372	**192**	54	**205**	181	**214**	183
Per common share[1]								
Continuing operations	**\$0.32**	\$0.82	**\$0.42**	\$0.35	**\$0.43**	\$0.38	**\$0.46**	\$0.40
Net earnings	**\$0.32**	\$0.80	**\$0.42**	\$0.11	**\$0.45**	\$0.39	**\$0.48**	\$0.40
Dividends	**\$0.17**	\$0.15	**\$0.17**	\$0.15	**\$0.17**	\$0.15	**\$0.17**	\$0.15

Certain comparative amounts have been reclassified to conform with the presentation adopted in 1998.

[1] Restated to reflect the subdivision of common shares on a two-for-one basis on May 15, 1998.

Supplementary Information
Selected Six-Year Financial Data

For the years ended December 31
In millions of dollars, except as noted

	1998	1997	1996	1995	1994	1993
Operations						
Revenues	**10,031**	9,695	8,502	7,373	6,631	6,893
Revenues, net of tobacco taxes and duties	**8,584**	8,332	7,202	6,128	5,380	5,184
Amortization expense	**272**	336	271	231	221	202
Earnings from operations[3]	**1,520**	1,449	1,338	1,197	1,061	832
Interest expense	**101**	123	155	160	165	169
Provision for income taxes	**455**	486	359	313	258	170
Provision for tobacco surtaxes	**59**	56	53	47	39	–
Net earnings from continuing operations	**741**	905[1]	612	526	447	358
Discontinued operations	**18**	(115)	(11)	(305)[2]	59	51
Net earnings	**759**	790[1]	601	221	506	409
Earnings per common share						
Continuing operations	**$1.63**	$1.95[1]	$1.30	$1.11	$0.92	$0.71
Net earnings	**$1.67**	$1.70[1]	$1.28	$0.45	$1.04	$0.82
Dividend record						
On preference shares[4]	**9**	9	9	9	11	20
On common shares	**305**	276	251	224	185	177
Per common share	**$0.68**	$0.60	$0.54	$0.48	$0.39	$0.37
Cash from continuing operating activities	**1,027**	954	608	674	682	605
Additions to capital assets	**267**	207	262	306	184	209
Financial position						
Total assets – Financial Services (excluding goodwill)	**47,644**	46,612	55,157	52,112	48,963	46,402
Total assets	**51,522**	50,733	59,994	56,305	53,411	50,739
Long-term debt	**1,357**	1,285	1,966	1,781	1,927	1,992
Total debt	**1,430**	1,387	2,091	1,835	1,998	2,084
Shareholders' equity						
Preference Shares	**135**	135	135	135	135	156
Common shareholders[5]	**3,604**	3,731	3,379	3,129	3,202	2,944
Total equity	**3,739**	3,866	3,514	3,264	3,337	3,100
Per common share[6]	**$8.25**	$8.17	$7.33	$6.74	$6.86	$6.18
Financial ratios						
Return on average common shareholders' equity[7]	**20.5%**	22.0%	18.2%	6.7%	16.1%	13.8%
Return on average common shareholders' equity from continuing operations, excluding special gain[8]	**20.0%**	18.6%	18.5%	15.6%	14.0%	12.0%
Interest coverage ratio	**13.7x**	13.1x	7.8x	6.8x	5.7x	4.3x
Total debt to capital ratio[9]	**27.7%**	26.4%	37.3%	36.0%	37.5%	40.2%
Common dividend payout ratio[10]	**40.7%**	35.3%	42.4%	105.5%	37.3%	45.4%
Share price – high	**$33.10**	$27.13	$17.38	$13.63	$11.06	$10.41
– low	**$22.00**	$16.15	$12.19	$9.66	$8.00	$8.56
– close	**$32.70**	$25.25	$16.80	$13.25	$9.94	$10.03
Weighted-average number of shares outstanding (in millions)	**448.2**	459.0	464.1	467.1	473.7	476.6

Certain comparative amounts have been reclassified to conform with the presentation adopted in 1998.

All references to per common share amounts, share price, and number of common shares have been restated to reflect the subdivision of common shares on a two-for-one basis on May 15, 1998.

1 Amounts reported for 1997 reflect the gain on the sale of First Federal (refer to Note 9). Excluding this gain, results would have been as follows: Net earnings from continuing operations – $659 million; Net earnings per common share from continuing operations – $1.42; Net earnings – $544 million; Net earnings per common share – $1.17.

2 The amount reported for 1995 reflects a special charge of $325 million mainly related to the sale of Roy Rogers restaurants.

3 Represents earnings before goodwill amortization, other costs and administration, gain on business disposal, interest expense, provision for income taxes, and discontinued operations.

4 During the last five fiscal years, the Corporation has paid dividends on its outstanding preference shares on an annualized basis per share as follows: (1) 6% Cumulative Preference Shares – $0.29 to November 1994, when they were repurchased; and (2) Series D Preference Shares, from date of issue to June 30, 1994, – $39,500 and from July 1, 1994, after the redemption of 30 shares – $34,500.

5 Common shareholders' equity includes unrealized gain or loss on foreign currency translation.

6 Common shareholders' equity divided by the number of common shares outstanding at year-end.

7 Net earnings less dividends on preference shares as a percentage of average common shareholders' equity.

8 The special gain consists of the 1997 gain on the sale of First Federal.

9 Total debt as a percentage of total debt and total equity.

10 Dividend per common share as a percentage of net earnings per common share.

Operating Company Statistics – Six-Year Review

For the years ended December 31
In millions of dollars, except as noted

	1998	1997	1996	1995	1994	1993
Imperial Tobacco						
Revenues	**3,201**	3,005	2,827	2,652	2,586	2,860
Revenues, net of tobacco taxes and duties	**1,754**	1,642	1,527	1,407	1,335	1,151
Earnings from operations[1]	**815**	775	705	645	592	462
Inventories	**458**	430	457	440	450	353
Capital assets	**316**	275	220	178	151	147
Additions to capital assets	**74**	83	66	49	31	28
CT Financial Services[2, 3]						
Investment income	**2,953**	2,961	3,781	3,927	3,321	3,322
Provision for credit losses	**135**	162	172	127	140	205
Net investment income after provision for credit losses	**989**	967	1,121	1,049	977	846
Fees	**742**	685	593	497	439	357
Earnings from operations[4]	**452**	472	473	430	334	232
Net earnings	**310**	518	318	267	222	166
Net earnings attributed to common shareholders	**294**	502	303	241	196	145
Per common share						
Net earnings	**$2.46**	$4.20	$2.53	$2.02	$1.64	$1.22
Dividends paid[5]	**$1.00**	$0.92	$0.89	$2.30	$0.80	$0.80
Shareholders' equity – fully diluted	**$22.13**	$20.68	$17.50	$16.17	$16.59	$15.57
Assets under administration (at book value)	**79,040**	74,582	246,647	196,907	182,344	160,332
Corporate assets	**47,739**	46,703	55,208	52,117	48,965	46,402
Loans	**32,304**	32,186	44,067	39,672	37,087	34,534
Deposits	**40,811**	40,394	45,952	44,558	42,254	40,418
Shareholders' equity	**2,855**	2,703	2,303	2,144	2,343	2,220
Return on average common shareholders' equity – fully diluted	**11.5%**	21.4%	15.2%	11.8%	10.2%	7.9%
Return on average corporate assets	**0.67%**	1.08%	0.60%	0.53%	0.47%	0.36%
Credit loss experience as a percentage of investments	**0.401%**	0.434%	0.468%	0.238%	0.257%	0.434%
Allowance for credit losses as a percentage of impaired investments	**176%**	179%	90%	80%	73%	55%
Shareholders' equity and non-controlling interest as a percentage of total assets	**6.3%**	6.1%	4.5%	4.5%	5.2%	5.2%
Risk-weighted capital ratios						
Tier 1 capital	**12.44%**	12.12%	8.92%	8.94%	8.88%	8.59%
Tier 2 capital	**2.20%**	2.75%	2.02%	2.14%	2.30%	1.79%
Total capital	**14.64%**	14.87%	10.94%	11.08%	11.18%	10.38%
Financial services branches – Canada	**429**	422	421	420	410	389
– United States	**1**	–	79	79	81	82
Automated banking machines – Canada	**847**	927	920	904	860	643
– United States	**–**	–	90	87	64	63

Certain comparative amounts have been reclassified to conform with the presentation adopted in 1998.

[1] Earnings from operations are equivalent to operating earnings before goodwill amortization.
[2] Statistics presented have been extracted from CT Financial's annual reports.
[3] The 1998, 1997, and 1996 results are not comparable due to acquisitions, dispositions, and non-recurring provisions and expenses. Further details are provided in Management's Discussion and Analysis beginning on page 22.
[4] Represents CT Financial's pre-tax earnings before goodwill amortization and gain on sale of First Federal (refer to Note 9).
[5] The 1995 amount includes a special dividend of $1.50 per share.

Supplementary Information
Operating Company Statistics – Six-Year Review

For the years ended December 31
In millions of dollars, except as noted

	1998	1997	1996	1995	1994	1993
Shoppers Drug Mart/Pharmaprix						
System sales (unaudited)	**4,193**	4,025	3,905	3,299	3,230	3,181
Revenues						
Distribution centre sales and other	**2,161**	1,855	420	–	–	–
Fee income	**343**	273	216	192	193	181
Company store sales	**282**	553	504	–	–	–
	2,786	2,681	1,140	192	193	181
Earnings from operations[1]	**199**	159	131	101	108	105
Inventories	**156**	236	287	22	–	–
Capital assets	**280**	289	310	255	176	158
Additions to capital assets	**72**	51	76	124	54	50
Number of stores						
Shoppers Drug Mart	**718**	736	741	640	617	625
Home Health Care	**37**	9	9	9	5	–
Pharmaprix	**69**	70	69	68	67	65
Total number of stores	**824**	815	819	717	689	690
Genstar Development Company						
Revenues	**200**	178	128	69	85	101
Earnings from operations[1]	**54**	43	29	21	27	33
Land inventory	**425**	350	349	301	294	256
Land inventory (acres)[2]	**19,166**	19,815	21,932	20,806	21,622	21,160

[1] Earnings from operations are equivalent to operating earnings before goodwill amortization.

[2] Includes land held through joint ventures, but excludes options.

Company Information and Officers

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Chief Executive Officer

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Executive Vice-President and
Chief Financial Officer

Roy R. Schwartz
Senior Vice-President

Pierre Duhamel
Vice-President and
Controller

Jocelyn Dumas
Vice-President,
Business Development

Ron Farrell
Vice-President,
Administration

Denis Faucher
Vice-President,
Human Resources

Peter McBride
Vice-President, Communications
and Investor Relations

Katrin Nakashima
Vice-President,
Secretary and Senior Counsel

Sunil Panray
Vice-President and Treasurer

Jodi White
Vice-President,
Corporate Affairs

Pierre Leclerc
Assistant Secretary

Harry Steinbrenner
Assistant Treasurer

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Lloyd J. Schnell
President

Imasco Finance LLC

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U.S.A.

Lloyd J. Schnell
President

Imperial Tobacco

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Chief Executive Officer

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Vice-President,
General Counsel and
Secretary

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Vice-President,
Marketing

Marius Dagneau
Vice-President,
Human Resources

Patrick J. Dunn
Vice-President,
Quality Management

Pierre W. Fortier
Vice-President,
Corporate Affairs

Luc Jobin
Vice-President and
Chief Financial Officer

Yvon Lessard
Vice-President,
Operations

Christian Trépanier
Controller

CT Financial Services Inc.

161 Bay Street
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Executive Vice-President and
Chief Financial Officer

Bernard T. Dorval
Executive Vice-President,
Lending and Insurance

Nick L. Mancini
Executive Vice-President,
Retail Distribution

Thomas J. Mullin
Executive Vice-President,
Business Development and
Corporate Strategy

Christopher J. Stringer
Executive Vice-President,
Corporate Services

Fredric J. Tomczyk
Executive Vice-President,
Core Banking and Wealth
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Diane E. Walker
Executive Vice-President,
Corporate Resources

Michael D. Woeller
Executive Vice-President,
Direct Banking and Information
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David R. Bloom
Chairman and
Chief Executive Officer

Herbert R. Binder
President and
Chief Operating Officer

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Retail Development

Andrew Faas
Senior Executive Vice-President,
Human Resources
and Administration

Albert A. Krakauer
Senior Executive Vice-President,
Pharmacy

Brian P. Relph
Senior Executive Vice-President,
Corporate Integration

Kenneth A. Sloan
Senior Executive Vice-President,
Finance and Planning,
and Chief Financial Officer

Stanley A. Thomas
Senior Executive Vice-President,
Marketing

Fred K. Van Laare
Senior Executive Vice-President,
Operations

Elie Ajram
Executive Vice-President,
Merchandising and Logistics

Bruce A. Burgetz
Executive Vice-President,
Information Technology

Woody Borenstein
Senior Vice-President,
Merchandising

Robin Boys
Senior Vice-President,
Retail Planning

Chris Dawson
Senior Vice-President,
Business Strategy

Bryna Goldberg
Senior Vice-President,
Legal Affairs, General Counsel
and Secretary

Raymond A. Hallett
Senior Vice-President,
Human Resources

Arthur Konviser
Senior Vice-President,
Public Affairs

Ian Maxwell
Senior Vice-President,
Home Health Care

Gordon Stromberg
Senior Vice-President,
Advertising

Aubrey Browne
National Vice-President,
Pharmacy Services

Virginia Cirocco
Vice-President,
Pharmacy Marketing

Terry L. Creighton
Vice-President,
Corporate Relations

Sander Biderman
Executive Vice-President,
Ontario West

Russell Cohen
Executive Vice-President,
Ontario Central

Paul Kuras
Executive Vice-President,
London Region

Terry Landry
Executive Vice-President,
Pharmaprix

Gary MacPhee
Executive Vice-President,
Atlantic Region

Terry Morrison
Executive Vice-President,
British Columbia

Cliff Proceviat
Executive Vice-President,
Prairies

Isadore Snyder
Executive Vice-President,
Ontario East

Roman P. Niemy
President,
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Genstar Development Company

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San Diego, CA 92121, U.S.A.

Frank L. Thomas
President and
Chief Executive Officer

Brian K. Laidlaw
Executive Vice-President

Gina R. Papandrea
Senior Vice-President,
Finance

Investor Information

Incorporation

Imasco Limited was incorporated under federal charter on April 3, 1912, and continued under the Canada Business Corporations Act on August 6, 1976.

Annual meeting

The annual meeting of shareholders will be held at 2:30 p.m. on Thursday, April 29, 1999, at Le Windsor, 1170 Peel Street, Montréal, Québec.

Investor relations

Peter McBride, Vice-President,
Communications and Investor Relations
(514) 982 6407

Shareholder enquiries

Imasco Limited
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Si vous désirez recevoir le rapport annuel en français, veuillez communiquer avec

Le Secrétaire
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600, boulevard de Maisonneuve Ouest
20^{e} étage
Montréal, QC H3A 3K7
(514) 982 9111

Stock exchange listings and ticker symbol

IMS: Montréal, Toronto, Vancouver

Reporting calendar

The year-end is December 31. The annual report is mailed in March, and interim results are mailed approximately 30 days after the end of each quarter.

Dividend dates

Quarterly: at the end of March, June, September, and December.

Transfer agent and registrar

CIBC Mellon Trust Company
Client Services
2001 University Street
16th Floor
Montréal, QC H3A 2A6
1 (800) 387 0825 (toll free throughout North America)
or (416) 643 5500

CIBC Mellon is responsible for the maintenance of shareholder records and the issue, transfer, and cancellation of stock certificates. Transfers can be effected at their offices in Halifax, Montréal, Toronto, Winnipeg, Calgary, and Vancouver. CIBC Mellon also distributes dividends and shareholder communications and administers the dividend reinvestment and share purchase plan. Enquiries with respect to these matters and corrections to shareholder information should be addressed to CIBC Mellon Client Services.

Dividend reinvestment and share purchase plan

Imasco maintains a dividend reinvestment and share purchase plan for the benefit of common shareholders. Under the plan, eligible shareholders can elect to invest their dividends in additional common shares. They can also increase their holdings by making optional cash payments, subject to certain quarterly limits. In both cases, the brokerage fees are paid by Imasco.

Direct dividend deposit service

For convenience and security, Imasco offers a direct dividend deposit service to its Canadian shareholders. The dividend payments are transferred electronically to the shareholder's account with a financial institution on the date they become due. Shareholders wishing to take advantage of this service should direct their request to CIBC Mellon Client Services.

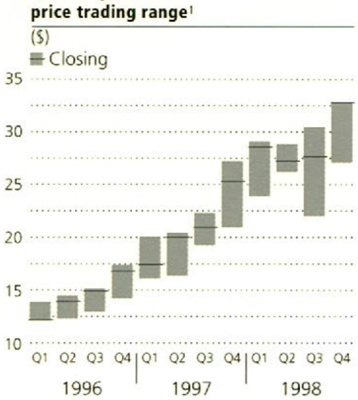
Payments of dividends to U.S. residents

Shareholders with addresses of record in the United States receive dividends in U.S. funds. The dividend amount is converted at the Bank of Canada noon rate of exchange on the record date. Canadian withholding tax is deducted.

Auditors

Deloitte & Touche LLP
Chartered Accountants
1 Place Ville Marie, Suite 3000
Montréal, QC H3B 4T9

Quarterly share price trading range[1]



Quarterly share price data[1]

1998	Q1	Q2	Q3	Q4
Share price				
High	**$28.98**	**$28.75**	**$30.35**	**$33.10**
Low	**$23.88**	**$26.15**	**$22.00**	**$27.05**
Close	**$28.50**	**$27.15**	**$28.35**	**$32.70**
Average daily volume	**898,656**	**761,682**	**669,732**	**782,278**

1997	Q1	Q2	Q3	Q4
Share price				
High	$20.00	$20.38	$22.25	$27.13
Low	$16.15	$16.38	$19.25	$20.93
Close	$17.43	$20.00	$20.93	$25.25
Average daily volume	792,176	854,272	534,908	707,988

1996	Q1	Q2	Q3	Q4
Share price				
High	$13.88	$14.50	$15.13	$17.38
Low	$12.19	$12.38	$13.00	$14.25
Close	$12.25	$13.95	$14.95	$16.80
Average daily volume	689,136	624,232	786,422	874,220

[1] Restated to reflect the subdivision of common shares on a two-for-one basis on May 15, 1998.

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