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Imasco/Trust Company Bill

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Inasco Limited1. Introduction

Lazard Brothers & Co., Limited has been asked by B.A.T Industries p.l.c. ('B.A.T') to look at the implications of the proposed new Canadian Trust Company Bill on the value of B.A.T's holding of 48 million ordinary ~~common~~ shares in Inasco Ltd, a major listed Canadian consumer products and financial services corporation.

2. Inasco

Inasco is a substantial Canadian company listed on the Toronto, Montreal and Vancouver stock exchanges with a market capitalisation of C\$3.3 billion. Its business interests are in the tobacco, drugstore and financial services sectors in Canada and the restaurant and drugstore sectors in the U.S.

(i) Canadian activities

Imperial Tobacco, Inasco's tobacco subsidiary, is the largest Canadian tobacco company with some 50 per cent. of the market. Brokers are forecasting sales revenues of some C\$1.8 billion and trading profit of C\$286 million for the year to March 1988.

Inasco's Canadian retail drugstore interests trade under the names of Shoppers Drug Mart and Super X Drugs and consist of some 625 retail outlets in aggregate; revenue is expected to be C\$160 million and trading profit C\$57 million in the year to March 1988.

Inasco also owns a chain of some 500 retail convenience tobacco stores trading throughout Canada under the name UCS Group with expected sales of C\$200 million and trading profit of C\$7 million in the year to March 1988.

Inasco acquired Canada Trustco for a net cost of C\$1.8 billion in 1986. Canada Trustco is a major financial services operation engaged in the provision of retail services, real estate sales brokerage and management, mortgage lending, pension and asset management, lending and

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trust activities with total assets in excess of C\$24 billion and a further C\$28 billion under management. In the year to March 1988 Canada Trustco is expected to contribute some C\$140 million to trading profits.

(ii) U.S. activities

Imasco's U.S. operations are grouped in Imasco USA and comprise Hardees, a chain of 3,000 fast food restaurants and Peoples Drug Stores with some 1,000 retail branches. Hardees is estimated to be the third largest in its sector in the U.S. and in the year to March 1988 is expected to show sales of C\$1.9 billion and trading profit of C\$164 million. Peoples Drug Stores is forecast to contribute sales of some C\$1.8 billion and to show a trading loss of C\$21 million in the year to March 1988, and a return to profitability in 1989.

(iii) Group results

Imasco's total revenues and pre-tax profits are expected to be C\$6 billion and C\$363 million respectively for the year to March 1988. At 31st March 1987, Imasco shareholders' equity amounted to C\$2.1 billion.

(iv) Capitalisation

Imasco has some 119 million shares of common stock outstanding of which B.A.T owns 48 million. The current share price is C\$28. Imasco is therefore capitalised at C\$3.3 billion and B.A.T's interest is valued at \$1.3 billion.

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### 3. Implications of the proposed legislation

We understand that following the passing of the proposed new legislation:

- i) As long as Imasco continues to own Canada Trustco, no single entity will be able to acquire more than 10 per cent. of Imasco; although
- ii) B.A.T would be able to continue to hold its 40 per cent. holding.

Accordingly, if B.A.T wished to sell its 40 per cent. holding at some stage in the future it could only do so either to four or more individual shareholders each owning up to 10 per cent. or to the public by means of a public offer.

### 4. Control

A holding in excess of 50 per cent. of the share capital of a company confers on the owner de jure control. Where the remaining shareholdings are wide spread however, a single shareholding in excess of 30 per cent. is generally considered to confer upon the holder de facto control and a 33 per cent. holding is presumed to be a controlling interest under the Investment Canada Act. Such a holder has an ability, whether or not he exercises that ability, to influence the decisions of the directors and, accordingly, the future direction of the company. Should there be a disagreement between the shareholder and directors, the shareholder is well placed to succeed in having the directors removed from office at a general meeting of shareholders. In any event, the shareholder is well placed to increase his stake to one of de jure control.

Accordingly, in the principal world stock markets the holder of a stake in excess of 30 per cent. in a quoted company is generally able to obtain a "control premium" for that holding over and above the market value of the shares. The extent of this premium varies, but as can be seen in Appendix 2, the premium will generally be in a band of 30 per cent. to 50 per cent.

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Although B.A.T has no management or board representation with Imasco its influence is that of a major and friendly shareholder. ~~It is not insignificant that Imasco's move into financial services has been similar to that of B.A.T.~~

We would expect that any single purchaser of B.A.T's stake in Imasco, especially since the remainder of Imasco's equity is widely spread amongst shareholders, would be prepared to pay a control premium in the region of 30 per cent. to 50 per cent.

5. Options open to B.A.T

If B.A.T wished to dispose of its holding in Imasco, the natural purchaser would be a single entity which either wished to use its 40 per cent holding as a controlling block, or who wished to increase its holding to one of absolute control. If the legislation is passed, this will no longer be an option, leaving the possibility of two principal routes under which the sale may be effected:

- (i) A private placing of shares to institutional investors; or
- (ii) A public offering of shares.

We consider that, given the sheer size of Imasco, neither of these operations would be easy to achieve and that, in order to have a reasonable chance of success, the sale price would have to be at a discount to the market price of Imasco ruling at the time. We would estimate such a discount to be of the order of 5 to 15 per cent, depending on the market conditions at the time.

It is noteworthy that a placing or public offering of C\$1.3 billion of equity would be significantly larger than any previous equity offering in the Canadian market. Information on recent Canadian equity financings is contained in Appendix 1.

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6. Impact on the value of B.A.T.'s holding

We have mentioned in Paragraph 4 above that we would expect that a single purchaser of B.A.T.'s stake in Inasco would be prepared to pay a control premium in the region of 30 per cent. to 50 per cent. which represents a price of C\$1.7 billion to C\$2.0 billion as against the current market value of B.A.T.'s holding of C\$1.3 billion. We have also mentioned in Paragraph 5 that the options for sale available to B.A.T. in the event that the Trust Company Bill is passed could result in B.A.T. receiving a discount for its shares of the order of 5 to 15 per cent. We would therefore estimate that the economic cost to B.A.T. of the effects of the Trust Company Bill should be in the region of C\$500 million to C\$800 million.

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Appendix 2

[To be completed]

Recent Canadian Acquisitions

Bidder	Target	Value (\$m)	Amount acquired (%)	Premium over market	
				30 days (%)	1 day (%)
British Telecom	Nitel	322	51	7	7
Campeau	Allied Stores	3500	100	34	21
Canadian Pacific Enterprises	Canadian Pacific Limited	1400	100		
Fletcher Challenge	BCFP	507	48		13
Gulf Canada	Hiram Walker	2500	81	35	36
Inasco	Genstar	2400	100	50	6
JWB Realty	Cadillac Fairview	2600	100		
Trans Canada Pipeline	ENCOR	1200	100	10	41
USSC Holdings	Husky Oil	1100	57	28	23

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The following are Canadian equity financings, over \$200 million,  
for 1986 and 1987:

	<u>\$ million</u>
BCE Development	300
Falconbridge Limited	212
First Australian Prime Investment Co.	413
Great West Lifeco	206
Imasco Limited	345
	200
Mitel Corporation	322
"B" Corp.	330
Hudson's Bay Company	200
British Petroleum Co.	784 - Canadian tranche
Gulf Canada Resources Inc.	450
Elders IXL Canada Inc.	400
* Noranda Forcst Inc.	351
Canadian Imperial Bank of Commerce	302
	214
Bank of Montreal	300
Campeau Corporation	264
GMAC	253
TBM NT Corporation	248
Onex Corporation	246
Lawson Mardon Group Limited	221
Canadian Oil Debco. Inc.	200
Laidlaw Transportation Limited	200
Wardair Finance Inc.	200

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