

cc Mr A C Long

Imasco Dividends

For some time the size of the Imasco dividends in relation to Imasco's resources and profits has been under discussion. The problem stems I think from Imasco planning dividend increases at a minimum level consistent with Canadian stock market expectations, whereas B.A.T Industries would like a higher cash return from its investment in Imasco. In setting its own guidelines for shareholder return Imasco concentrates primarily on capital return bought about by a higher share price and against this the cash return to shareholders via dividends is small.

The Group financial objectives paper prepared in 1986 included dividend guidelines for Imasco which assumed the same payout as in the Imasco five year plan submitted in late 1985. Since then - and before the current guidelines were formulated - Imasco experienced the cigarette price war, the downturn of Peoples Drug and the Genstar acquisition. It was, however, decided to keep to the Imasco plan dividend distribution for B.A.T Industries purposes on the grounds that during the short term profit set-back Imasco would have to distribute a higher percentage of profit to protect its share price and in the longer term Genstar would increase rather than reduce dividend paying potential.

In December 1986 we received the Imasco five year plan, the figures of which are being incorporated in the B.A.T Industries budget and forecast. As has happened in the past it shows a reduction in dividend payments as compared with the previous plan. The differences in dividends per share and BAT's total receipts from its investment of 48.06 million common shares are:-

	Imasco 1985 Plan		Imasco 1986 Plan	
	Dividend Per Share	BAT Dividend	Dividend Per Share	BAT Dividend
Years to March	C\$	C\$ millions	C\$	C\$ millions
1987	0.86	41	0.84	40
1988	1.03	50	0.96	46
1989	1.23	59	1.08	52

This will mean that the total dividend for 1987 will be $21 \times 3 + 24 = 87!$

I understand that Mr Crawford intends to put to his Board a proposal to increase the quarterly dividend from C\$0.21 to C\$0.24 a share. ~~Once having established a rate per quarter Imasco rarely changes it so a March-1987 payment implied C\$0.96 for the year which is in line with the current plan. The question is whether this 14% increase is high enough.~~

For the year to March '88 it is likely that the first 3 quarters will provide a dividend of 24 per quarter making 72 cents. It would then be necessary for Imasco to pay 31 cents if the overall 103 included in the Imasco 1985 plan. A 29% increase from 24 cents is perhaps unlikely but not impossible

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Compared with other diversified tobacco Groups Imasco has traditionally had a low payout, which is presumably acceptable to the stock exchange because of Imasco's sustained growth. The following table compares the Imasco payout with other companies:-

Imasco (year to 31.3.86)	31X
B.A.T Industries (year to 31.12.85)	26X
RJR (year to 31.12.85)	39X
US Tobacco (year to 31.12.85)	51X
Philip Morris (year to 31.12.85)	38X
BATUS (year to 31.12.85)	49X*
AMATIL (year to 31.10.86)	36X

* (before deducting restructuring provision from profit)

As far as the future is concerned Imasco is ~~likely to increase~~ ^{has} its payout for the depressed year to March 1987. Dividends as a percentage after tax earnings are forecast to progress as follows:-

Fiscal 1987	48.0% (The actual payout will be higher - say 50%)
Fiscal 1988	41.1%
Fiscal 1989	37.4%

Presumably Imasco will regard a lower ^{percentage} payout for 1988 onwards as acceptable to the stock exchange because of the resumed growth in earnings. If BAT wants to increase the payout there would appear to be at least two ways that this can be approached.

One could insist on a higher payout than the proposed one of C\$0.24 per quarter in order to protect the Imasco share price. Objections that this is inappropriate because of the high debt/equity position could be countered by pointing to Philip Morris and RJR whose recent acquisitions have led to enormous borrowings in relation to equity. // Enclosed is a draft letter on the subject prepared last year but never sent. It contains some arguments for higher dividends.

Alternatively one could agree with the C\$0.24 dividend and perhaps obtain an agreement that the payout rate will not be reduced in future.

It is, however, appropriate to mention that because of Genstar Imasco is much more heavily geared than usual, although this does not appear to have ^{been} deferred the company from seeking further acquisitions. The salient points of Imasco's borrowing position are summarised in the appendix which is taken from the current plan. On the assumptions of C\$800 million goodwill for Genstar, the Imasco net debt/equity on a UK accounting basis is estimated at 240% for March 1987, 145% for March 1988 and 130% for March 1989. These figures exclude off balance sheet borrowings.

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