

**SAPUTO GROUP INC.**

---

**ANNUAL INFORMATION FORM**

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## ITEM 1 - THE COMPANY

### 1.1 Incorporation

The business of the Company commenced in 1954. Saputo Group Inc. was constituted by a Certificate of Amalgamation issued pursuant to the provisions of the *Canada Business Corporations Act* on July 1, 1992, which was amended on August 25, 1997 in order to change the provisions attached to its authorized share capital. Saputo Group Inc. is the successor corporation to Placements Saputo Inc., Fonds Saputo Inc., Placements Sapco Inc. and Fonds Sapco Inc. The head office and principal place of business of the Company is located at 6869 Metropolitan Boulevard East, Saint-Léonard, Québec, Canada, H1P 1X8.

Further to the Company's decision to proceed with its initial public offering (the "Initial Public Offering") in August 1997, all dairy food operations controlled by Mr. Emanuele (Lino) Saputo which were not already held by the Company were regrouped within Saputo. Such operations included Saputo Holdings, Inc. (previously bearing the name "Jolina Holdings, Inc.") and Crémierie des Trois-Rivières, Limitée.

In this Annual Information Form, unless the context otherwise requires or indicates, the terms "Saputo" and the "Company" mean Saputo Group Inc. itself or together with its subsidiaries, or any one or more of them, and the term "Stella" means Stella Holdings, Inc., itself or together with its subsidiaries, or any one or more of them.

In this Annual Information Form, all references to "\$" or "CDN\$" are to Canadian dollars and all references to "US\$" are to American dollars.

## 1.2 Corporate Structure

The following organizational chart illustrates the corporate structure of Saputo and its significant subsidiaries, and their respective jurisdictions of incorporation.

- (1) Production and distribution of dairy and other food products in the Province of Quebec.
- (2) Company resulting from the amalgamation, on March 31, 1998, of Saputo Cheese Limited and Froma-Dar Inc.
- (3) Production and distribution of dairy and other food products in Canadian provinces other than Quebec.
- (4) Fluid milk and ice cream production and distribution in the Province of Quebec.
- (5) Production and sale of Saputo dairy products in the United States outside the Stella operations.
- (6) On May 25, 1998, the Company changed its corporate name from "Jolina Holdings, Inc." to "Saputo Holdings, Inc."
- (7) Company resulting from the amalgamation, on March 31, 1998, of Stella Foods Importing Inc. and Fromages Caron Inc.
- (8) On May 25, 1998, the Company changed its corporate name from "Jolina Foods USA, Inc." to "Saputo Foods USA, Inc."
- (9) Production of Stella dairy products in Wisconsin, California, Indiana and South Dakota.
- (10) Production of Stella dairy products in Vermont.
- (11) Company acquired by a wholly-owned subsidiary of Saputo Holdings, Inc. on May 1, 1998 pursuant to a stock purchase agreement entered into on March 27, 1998. Prior to this acquisition, the company was named Avonmore Cheese Inc. and was an indirect wholly-owned subsidiary of Avonmore Waterford Group plc.
- (12) Company acquired by a wholly-owned subsidiary of Saputo Holdings, Inc. on May 1, 1998 pursuant to a stock purchase agreement entered into on March 27, 1998. Prior to this acquisition, the company was named Waterford Food Products, Inc. and was an indirect wholly-owned subsidiary of Avonmore Waterford Group plc.

## ITEM 2 - GENERAL DEVELOPMENT OF THE BUSINESS

### 2.1 Overview

Saputo produces and markets mozzarella, other specialty cheeses and by-products such as butter, lactose and whey protein. In Canada, Saputo also distributes fine imported cheeses and a large assortment of other non-dairy products that complement its cheese distribution. Mozzarella represents approximately 63.9 % of the Company's total cheese production and 58 % of its total sales. Of the Company's total sales, approximately 31 % are made in Canada, 65 % are made in the United States and 4 % are made internationally.

The Company operates seven manufacturing facilities in Canada and twenty in the United States. On May 30, 1998, the Company had 2,911 full-time employees and 242 part-time employees.

Saputo has established itself as Canada's leading producer of mozzarella, with a share of approximately 36 % of the Canadian mozzarella production and, with the acquisition of Stella in December 1997, now ranks as one of the leading natural cheese producers in the United States. In Canada, Saputo services mainly through its own distribution network three distinct market segments: food service (principally pizzerias), retail and industrial/ingredient. In the United States, Saputo markets its products to such segments through direct sales and independent non-exclusive distributors. Internationally, products are sold through direct sales, local distributors and sales agents.

### 2.2 History

Mr. Emanuele (Lino) Saputo, the Chairman of the Board and Chief Executive Officer of Saputo, started the Company with his parents in 1954, producing quality cheeses for the Italian community of Montréal.

In the late 1950's, the Company's first major production facility was constructed in the Montréal St-Michel district. In the 1960's, Saputo grew significantly as demand for its products increased both in Montréal and in new markets, such as other regions of Québec, Ontario and the Maritimes.

In the 1970's, Saputo acquired several production operations and developed its national distribution network, positioning itself, in Canada, as the leading producer of mozzarella, principally to the food service market segment. In 1981, the Company built a cheese plant in Mont-Laurier, Quebec and acquired a cheese plant in Cookstown, Ontario. In 1984, Saputo acquired a plant in St-Hyacinthe, Quebec which processes liquid whey, a by-product of its cheese production operations, into value-added products such as lactose and whey protein.

Since 1984, Saputo has continued its growth in Canada by acquiring small to medium-sized cheese manufacturers, food distributors and manufacturers of other dairy products located in various parts of Canada. In 1988, the Company entered the United States market by acquiring a cheese manufacturing plant located in Richmond, Vermont and the Jefferson cheese plant now located in Hancock, Maryland.

In 1996, Saputo acquired Fromages Caron Inc., a distributor of fine imported cheeses, which was later amalgamated with Stella Foods Importing Inc. On July 31, 1997, Saputo acquired Cr merie des Trois-Rivi res, Limit e which had sales of \$15 million during the fiscal year ended March 31, 1998. With this acquisition, the Company entered the fluid milk and ice cream markets, two segments of the dairy industry it had not previously explored.

On October 15, 1997, the Company completed its Initial Public Offering of 9,470,500 Common Shares at \$17.00 per share. In December of the same year, Saputo issued 9,000,000 special warrants at \$25.00 per warrant in order to finance, in part, the Stella Acquisition (as defined below). Following these two transactions, the Saputo family held, directly and indirectly, approximately 74% of all of the outstanding Common Shares of Saputo, with the balance being held by the public.

On December 5, 1997, Saputo acquired Stella from Specialty Foods Corporation for a total consideration of approximately US \$408 million (CDN \$580 million) paid in cash (the "Stella Acquisition"). Stella developed its cheese business through eight acquisitions between 1988 and 1993. The acquired companies had strong positions in specific geographical and product segments. The combination of these companies established Stella as one of the leading natural cheese producers in the United States. During its fiscal year ended December 31, 1996, Stella had revenues of approximately \$1 billion. With this acquisition, the Company tripled its size.

On March 27, 1998, the Company entered into agreements with Avonmore Waterford Group plc pursuant to which Saputo acquired, on May 1, 1998, all of the outstanding shares of Avonmore Cheese Inc. ("Avonmore") and Waterford Food Products, Inc. ("Waterford") both located in the United States, mainly in Wisconsin (the "AWG Acquisition"). Avonmore (whose name was changed to Saputo Cheese USA I, Inc.) produces and markets Italian specialty cheeses such as mozzarella, ricotta and provolone under the brand names of *Falbo* and *Lugano* as well as value-added products such as whey protein concentrates, ingredient blends and cream. Waterford (whose name was changed to Saputo Cheese USA II, Inc.) is an important producer of sweetened condensed milk and Swiss cheese in the United States. Combined, Avonmore and Waterford had revenues of approximately CDN \$261 million and an EBITDA of CDN \$12 million for their fiscal year ended December 31, 1997. Collectively, they employed over 375 people and produced approximately 33 million kilograms of cheese annually. Of the six plants acquired, two are whey processing facilities. The acquisition price of approximately CDN \$51.5 million (US \$36 million) was financed through the Company's bank credit facilities.

## **ITEM 3 - INDUSTRY OVERVIEW**

### **3.1 The Canadian Dairy Industry**

#### *Regulatory Environment*

The regulation of the content, composition, labelling, packaging, marketing and distribution of all food products in Canada is a shared responsibility between the federal and the provincial governments. The dairy industry is further governed by a series of federal and provincial regulations specific to the production, processing and distribution of milk and milk-related products. All applicable statutes, whether provincial or federal, permit plant inspections, product testing and other regulatory scrutiny.

In Canada, all milk processing plants are subjected to regular inspection by federal authorities and are required to be registered under the *Canada Agricultural Products Act*. Provincial legislation also demands that milk processing plants be licensed, compelling them to comply with all provincial inspections and regulations.

### *Milk Supply*

The Canadian dairy industry operates within a highly regulated environment. The Canadian Dairy Commission (“CDC”), a crown corporation, has been mandated by the federal government to implement Canada’s national dairy policy which is predicated on shared jurisdictional powers between the federal and provincial governments. Fluid milk is regulated provincially, while industrial milk is regulated federally. “Fluid milk” refers to table milk or cream intended for consumption in fluid forms, whereas “industrial milk” is used for the manufacturing of all other dairy products, such as cheese, butter, ice cream and yogurt. According to CDC information, the fluid milk sector represents approximately 38.2 % of raw milk delivered in Canada while the industrial milk sector represents approximately 61.8 %.

The principal means used by the CDC to implement the national dairy policy is the monitoring of a dairy supply management system. The key goal of supply management is to ensure stable revenues for dairy farmers while maintaining the production of sufficient volumes of industrial milk to satisfy the domestic Canadian consumer demand for dairy products as well as certain planned exports. This is essentially achieved by setting the support price that the dairy processors can receive for butter and skimmed milk powder and by controlling the supply of industrial milk.

Dairy farmers also receive a direct federal subsidy which is set to be phased out over the course of the five years commencing in February 1998. It is expected that the subsidy loss will be recovered through higher industrial milk prices.

Every dairy year, the CDC calculates the national industrial milk production quantum based on anticipated domestic demand and certain planned exports. This quantum is then allocated according to the terms of the National Milk Marketing Plan, a federal/provincial agreement. This agreement stipulates, among other things, that Quebec’s and Ontario’s shares of the national industrial milk production quantum (the “Market Sharing Quota”) are approximately 47.8% and 30.6% respectively.

Once the industrial milk quantum is determined and allocated among the provinces, provincial marketing boards govern the production, pricing and marketing of milk within their own borders. Each provincial marketing board allocates the milk to dairy processors. Industrial milk is allocated according to a cascading system that classifies industrial milk into various classes of products to be manufactured. Priority of supply is given to the higher milk class, which also commands a higher milk price.



Although there may be some provincial variations, quantities of milk in each class other than fluid milk are generally restricted in their growth. As a result, operating in a supply managed system means that a dairy processor can only achieve significant growth through acquisitions. Any attempt to grow internally is stymied by the plant quota which limits a dairy processor to a specific guaranteed volume. Conversely, since the Market Sharing Quota is based on historical and anticipated demand for dairy products, the risk of a processor losing an important part of its market share is very low.

*International Trade (Canada)*

*Imports.* The Department of Foreign Affairs and International Trade administers Canada’s cheese import quotas. These quotas are divided into European Union and non-European Union sources. This results from Canada’s obligation to the European Union to import 66.0% of the approximately 20.4 million kilograms of cheese that Canada is committed to import annually under the World Trade Organization (“WTO”) Agreement on Agriculture. Imports within this minimum access commitment are subject to low rates of duty while imports over this amount are subject to significantly higher tariffs. Over-access tariffs for cheese currently stand at 260% of invoiced value.

*Exports.* All dairy export activities must be submitted for consideration by the CDC. The issuance of a permit to the exporter under the agreement amongst provinces for international cheese exports is particularly important since it entitles the cheese processor to a price discount given by the local milk boards on the milk purchases required for the manufacturing of the products to be exported. This allows Canadian processors to be competitive in world markets as Canadian milk prices are higher than the average world industrial milk price. Since Canada’s dairy policy’s objective is to balance the supply and demand of milk, export activities are limited.

Notwithstanding the foregoing and in view of the increasing importance of the dairy world market, various provincial dairy boards have established or are attempting to establish an optional export program whereby both the farmer, through his board, and the processor commit themselves to a specific volume that would not be calculated as part of Canada’s domestic requirement. The Company intends to take advantage of the optional export program should it deem the potential return to be adequate.

*Canadian Market*

The dairy processing industry makes a major contribution to the Canadian economy with shipments valued at over \$7.5 billion in 1996. Second only to meat processing, the dairy processing sector accounted for over 13.7% of the estimated value of all food and beverage processing sales in 1996. Significant rationalization is occurring in the processing sector as plants strive to achieve the greater efficiencies and economies of scale required to remain competitive in increasingly global markets.

The following table indicates the production volumes of selected dairy products manufactured in Canada in 1997.

**Canadian Production Volumes of Selected Dairy Products in 1997 <sup>(1)</sup>**  
(in thousands)

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Cheddar .....	127,528 kg	Yogurt.....	99,646 kg
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Specialty cheeses <sup>(2)</sup> .....	198,794 kg	Milk powder .....	66,164 kg
Cottage cheese.....	21,250 kg	Concentrated milk .....	104,502 kg
Butter.....	89,701 kg	Fluid milk <sup>(3)</sup> .....	2,647,261 litres
Ice cream and other ice cream products ...	547,039 litres	Cream <sup>(3)</sup> .....	157,180 litres

(1) Source: 1997 Dairy Market Review of Agriculture and Agri-Food Canada.

(2) Includes mozzarella.

(3) Source: 1996 Dairy Market Review of Agriculture and Agri-Food Canada.

Production of mozzarella accounts for an important portion of the Canadian production volumes of specialty cheeses as demonstrated by the table below.

**Canadian Production Volumes of Specialty Cheeses and Mozzarella <sup>(1)</sup>**

	<b>1997</b>	<b>1996</b>	<b>1995</b>	<b>1994</b>	<b>1993</b>
	(In thousands of kilograms)				
Specialty cheeses.....	198,794	173,109	172,135	162,527	159,768
Mozzarella.....	104,643	101,148	103,950	102,691	99,186

(1) Source: 1997 Dairy Market Review of Agriculture and Agri-Food Canada.

### **3.2 The United States Dairy Industry**

#### *Regulatory Environment*

In the United States, the production of all food products is subject to extensive federal, state and local government regulations regarding the advertising, quality, packaging, labelling and safety.

All food plants are subject to regulation and inspection by agencies such as the Food and Drug Administration (“FDA”) and the United States Department of Agriculture (“USDA”). Individual states may also enforce more stringent regulations regarding the manufacturing of food products. State and local government agencies work with the federal government to ensure the safety of food produced within their jurisdictions. Violations of federal, state and local regulations may result in seizure and condemnation of products, cease and desist orders, injunctions and monetary penalties. State and local government agencies also enforce environmental compliance.

*Milk Supply*

In the United States, there are two grades of milk: Grade A and Grade B. Grade A milk is produced under specific sanitary requirements and dairy producers must hold a Grade A shipping permit. Grade A milk accounts for 97 % of the United States milk supply. Grade B milk represents 3 % of the United States milk production, and it is used exclusively to manufacture butter, cheese and skim milk powder. Almost 50 % of the United States Grade B milk production is located in Minnesota and Wisconsin.

The following table presents the utilization of the United States milk production in 1997:

**Utilization of United States Milk Production in 1997 <sup>(1)</sup>**

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Utilized as fluid milk and cream .....	36.1 %
Manufactured into cheese.....	35.2 %
Manufactured into creamery butter .....	13.3 %
Manufactured into frozen dairy products .....	10.1 %
Manufactured into evaporated and condensed milk .....	0.8 %
Used on farms where produced .....	0.9 %
Other uses.....	3.6 %

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(1) Source: USDA, Milk Production, Disposition and Income 1997, published May 1998.

In most cases, milk prices are set monthly based on the average milk price paid for Grade B milk in Minnesota-Wisconsin, updated by a product price formula known as the Basic Formula Price which takes into account weekly cheese price surveys conducted by the National Agriculture Statistics Service.

Wholesale pricing for the bulk of the United States cheese production is established by Cheese trades on the Chicago Mercantile Exchange. Cheese trades once a week on Thursdays. The last trade

on this day establishes the market price for the following week. If no trades occur, the market price is set based on the bid and offer prices. Processors usually charge a premium over the established market price.

A dairy processing plant is not limited in terms of the quantity of milk it can receive and is free to negotiate its milk supply with whomever it chooses. Independent processors usually negotiate with local cooperatives or may procure milk directly from individual farms for the necessary milk quantities and are charged a price which reflects the current month's milk price plus a negotiated handling charge.

United States dairy programs influence the production and marketing of milk and milk products through the operation of the Commodity Credit Corporation ("CCC"), a federal agency. CCC buys butter, non-fat dry milk and cheese at market support prices. Such products are sold or used either domestically or internationally in specific government programs. The CCC does not however directly support dairy farmers, nor does it establish a target return for farmers.

#### *International Trade (United States)*

*Imports.* Another key component of the United States dairy program is import restrictions. Most United States cheese import quotas are country and product specific. Under the terms of the WTO Agreement on Agriculture, the United States agreed to import, at a lower tariff rate, approximately 130 138 metric tons of cheese in 1998. Tariffs for cheese in excess of the quota are prohibitive.

Entry for dairy products made with sheep, goat and buffalo milk do not require a license nor are they subject to a United States duty. The same is true for a few other products including Brie cheese.

*Exports.* The United States is not a significant exporter of dairy products. In 1997 and 1996, the United States export activity accounted for US \$904.5 million and US \$709.8 million, respectively. In 1995, United States export activity accounted for US \$778.1 million representing 3.5 % of world-wide dairy products trade estimated at US \$22.2 billion (CDN\$29.1 billion).

Most export activity is conducted through the Dairy Export Incentive Program which allocates subsidized export volumes to specific countries thereby enabling exporters to bid for export assistance for dairy products destined to these countries.

#### *United States Market*

According to the USDA, there were 412 cheese manufacturing plants in the United States in 1997 producing 3.3 billion kilograms of cheese. In 1996, the aggregate wholesale value of cheese and cheese products in the United States exceeded US \$19.1 billion.

Of the 3.3 billion kilograms of cheese produced in 1997, cheddar accounted for 36 % of this total or 1.2 billion kilograms and Italian cheeses, as a whole, contributed 39 % or 1.3 billion kilograms. Mozzarella alone accounted for slightly more than 1.0 billion kilograms of total cheese production, representing 78 % of Italian cheeses and 31 % of all cheeses produced in 1997.

The following table indicates the production volumes of Italian cheeses and Mozzarella in the United States from 1993 to 1997.

**United States Production Volumes of Italian Cheeses and Mozzarella <sup>(1)</sup>**

	<b>1997</b>	<b>1996</b>	<b>1995</b>	<b>1994</b>	<b>1993</b>
	(In thousands of kilograms)				
Italian cheeses .....	1,306,543	1,275,695	1,213,095	1,191,010	1,131,507
Mozzarella.....	1,017,874	1,020,690	963,788	937,999	883,609

(1) Source: USDA, Dairy Products Annual Report, April 1998.

### **3.3 Future Trends**

The rationalization trend which began several years ago in both the American and Canadian dairy industries is, in the Company's opinion, set to continue. This evolving competitive environment will necessarily force regional processors to either adapt, sell or merge with other industry participants. Well-capitalized industry consolidators should take advantage of this rationalization trend to make strategic acquisitions.

Canada's supply management system of its dairy industry may also come under pressure from internal and external sources. Internally, provincial governments risk being questioned for maintaining a system which artificially limits the economic activity of the dairy processing sector in their jurisdictions. In the opinion of the Company, provincial governments have already shown some openness towards a less rigid control of this sector of economic activity. Internationally, some of Canada's trade partners, particularly the United States, have expressed their opposition to Canada's system and are expected to continue to apply pressure, and this despite Canada's recent North American Free Trade Agreement panel victory. The United States and New Zealand are challenging the legality of Canada's dairy supply management system under the terms of the 1994 GATT Agreement. The WTO panel that will hear this challenge has been selected and the preliminary decision to be rendered is expected at the end of summer 1998. Should this challenge be successful, Canada's dairy markets could be opened to direct American and international competition. Management is of the opinion that, should this occur, the Company is well placed to take advantage of this deregulation especially with its recent acquisitions in the United States which position it as a leader in the North American dairy industry.

In 1999, a new round of tariff reduction negotiations is set to begin under the auspices of the WTO. It is anticipated that over quota tariffs for agricultural products will be subject to reductions.

As long as Canada's supply management system remains in place, no significant growth can be achieved by Canadian dairy processors other than through acquisitions. The recent consolidation that

took place in the Canadian dairy industry has, however, greatly reduced the number of companies that can be acquired.

In the United States, plant quotas are non-existent. Accordingly, dairy processing companies are not limited to their existing milk reception volumes, but rather their expansion is a function of the market place's acceptance of their products.

## ITEM 4 - DESCRIPTION OF THE BUSINESS

### 4.1 Products

In Canada, Saputo produces and markets nationally a wide variety of quality cheeses. It also produces a number of products derived from its cheese production including butter, lactose and whey protein. The Company's distribution network also distributes fine imported cheeses and a large assortment of third party manufactured non-dairy products that complement its cheese distribution to the food service industry, especially pizzerias. On a smaller scale, the Company recently started to bottle fluid milk and produce ice cream.

In the United States, Saputo produces a broad line of mozzarella-type and specialty cheese products. Due to the recent completion of the AWG Acquisition, Saputo also produces sweetened condensed milk as well as whey protein concentrates and ingredient blends which are derived from its cheese production. The Company does not import any cheese in the United States, except for some limited quantities originating from its Canadian operations.

The following table shows Saputo's segmentation of sales by product category for the last two fiscal years and for the three months ended March 31, 1998:

	Three months ended March 31, 1998 <sup>(1)</sup>		Year ended March 31, 1998 <sup>(2) (3)</sup>		Year ended March 31, 1997 <sup>(3)</sup>	
	Sales (\$,000)	% of total sales	Sales (\$,000)	% of total sales	Sales (\$,000)	% of total sales
Mozzarella.....	220,556	58.0	465,878	57.0	262,517	58.3
Other manufactured cheeses and fluid milk and ice cream ....	129,541	34.0	227,751	27.9	78,132	17.3
Butter.....	5,332	1.4	21,843	2.7	21,655	4.8
By-products .....	5,035	1.3	22,229	2.7	21,206	4.7

Imported cheeses .....	5,156	1.4	21,135	2.6	14,043	3.1
Non-dairy products.....	14,835	3.9	58,419	7.1	52,959	11.8
Total .....	<u>380,455</u>	<u>100.0</u>	<u>817,255</u>	<u>100.0</u>	<u>450,512</u>	<u>100.0</u>

- (1) The presentation of the information on a quarterly basis better reflects the impact of the Stella Acquisition on the Company's operations and results.
- (2) Includes the results of Stella from December 6, 1997 to March 31, 1998.
- (3) The periods prior to December 6, 1997 include the results of the Company before the Stella Acquisition.

### *Mozzarella*

Saputo's major product is mozzarella which represents approximately 63.9 % of the total volume of cheese manufactured by the Company and 58 % of all sales. Used mainly as an ingredient in the preparation of various foods, especially pizza, mozzarella has always been at the centre of the Company's operations. Saputo has grown to become Canada's leading producer of mozzarella with a production share of approximately 36 %. In the United States, Saputo produces approximately 11 % of the approximately one billion kilograms of mozzarella production.

### *Other Manufactured Cheeses*

*Specialty Cheeses.* In Canada, Saputo produces an Italian specialty cheese line that includes ricotta, provolone, friulano, tuma, cacino, trecce, caciocavallo, bocconcini and a variety of parmesan cheese blends. Saputo's products are sold mainly under the *Saputo* and *Stella* brand names, and under private labels. Further to the completion in March 1997 of the Montréal specialty plant located in St-Léonard, Québec, Saputo intends to further expand its share of this market segment with the introduction of new high margin specialty cheeses, some of which are presently imported from Europe and sold at premium prices.

In the United States, the Company produces parmesan, romano, string cheese, blue and gorgonzola, feta, ricotta, Swiss-style cheese as well as Italian table cheeses such as asiago, fontina, Italian sharp, provolone and *Fontinella*. Saputo's specialty cheese products are sold under a variety of brand names such as *Stella*, *Frigo*, *Cheese Heads*, *Fontinella*, *Tolibia*, *Olympus*, *Dragone*, *Gardenia*, *Lorraine*, *Falbo* and *Lugano*, and under private labels.

*Cheddar and Other Firm Cheeses.* In Canada, Saputo also manufactures a more traditional North American product line which includes cheddar, brick, colby, farmer, munster, edam, monterey jack and other cheese varieties belonging to the firm cheese family.

*Process Cheese.* Saputo's Canadian operations also produce process cheese, a product that is widely consumed in Canada. Saputo sells this product both to institutional and food service clients which buy in bulk sizes and to retailers which buy packages consisting of individually wrapped slices.

*Imitation Cheese.* In the United States, the Company produces imitation mozzarella-style cheese which is used in various food service applications and as an ingredient by manufacturers of prepared foods. Saputo's imitation cheeses are sold under the *Uni-Chef* brand primarily to the industrial/ingredient segment.

#### *Other Dairy Products*

*Butter.* In Canada, Saputo produces butter from fat skimmed off the milk used in its cheese manufacturing process.

The butter manufactured by Saputo is distributed to restaurants and retail stores under the Saputo brand name and is packaged pursuant to private label arrangements with certain key customers. Saputo also sells small quantities of its butter production to the Canadian Dairy Commission which, in turn, sells it on the international market. When advantageous, the Company also sells its excess fat to other manufacturers who use it in the production of butter or ice cream.

*Fluid Milk and Ice Cream.* The acquisition of *Cr merie des Trois-Rivi res, Limit e* in 1997 marks Saputo's entry into the fluid milk and ice cream markets. It is Saputo's intention to broaden its understanding of the fluid milk and ice cream production processes and market segments and to apply, where possible, its low-cost manufacturing expertise to such processes. This should increase the profitability of this business and allow Saputo to slowly grow its share of the Quebec fluid milk and ice cream markets.

*Sweetened Condensed Milk.* As a result of the AWG Acquisition completed in May 1998, the Company produces sweetened condensed milk in the United States.

#### *By-Products: Lactose, Whey Protein, Whey Powder and Dairy Blends*

Liquid whey is a by-product of Saputo's cheese production which represents approximately 90% of total milk composition, leaving the remaining ten percent as the basis for cheese production.

Utilizing liquid whey from its operations and from third party facilities, Saputo's St-Hyacinthe facility extracts solids from liquid whey and processes these solids into lactose, whey protein and whey powder. Lactose, which is commonly found in infant formulas and dry soup mixes, is sold primarily on the international market. Saputo produces more than 10,000 tons of lactose per year and is the only producer of lactose in Canada.

Whey protein is used in the formulations of ice cream, caramel and yogurt and may also be used as animal feed. It is sold both domestically and internationally. In its St-Hyacinthe facility, Saputo also produces numerous blends of dairy product powders which clients use as substitutes for higher priced ingredients in their specific product formulations.

Whey powder results from the drying of liquid whey and is used in various product formulations, including bread. The resulting by-product of lactose and whey protein production, known as "mother liquor", is also sold by Saputo as animal feed.



All of Saputo's Canadian plants (with the exception of the Souris, Manitoba plant), as well as the Richmond and Hancock United States plants, send liquid whey by truck to the St-Hyacinthe facility for processing. Because of the distance between the Souris plant and the St-Hyacinthe plant, the liquid whey emanating from the Souris plant is dried on site. The process in place is different than the one in St-Hyacinthe and the resulting product, commonly referred to as popcorn whey, has less value and is sold as animal feed.

Prior to the AWG Acquisition, the Company did not have any whey processing facilities in the United States and disposed of the whey generated by its American plants (other than Richmond and Hancock) through plant-specific contracts with third parties. Of the six plants acquired through the AWG Acquisition, two are whey processing facilities. The Company is presently evaluating the feasibility of transferring a portion of the liquid whey produced by its United States plants to the two newly acquired whey processing facilities.

#### *Imported Cheeses*

As a holder of a cheese import allocation in Canada, Saputo is active in this market segment. The Company does not have sufficient quotas to satisfy demand for imported cheeses. Accordingly, it enters into agreements with existing Canadian quota holders.

In the United States, Saputo does not hold any import quotas. It does, however, import some very limited quantities of cheese originating from its Canadian operations through arrangements made with authorized American licence holders.

#### *Non-Dairy Products*

In Canada, Saputo's sales force distributes a wide variety of other products sourced from domestic and international suppliers. This line of products includes pasta, vegetable oils, margarine, spices, flour, various meats, tomato sauce, pizza boxes, olives, pineapples and shortening.

The nation-wide distribution of these complementary products is exclusively used to enhance the sale of Saputo's cheeses by offering clients, especially pizzerias, the advantage of dealing with one supplier offering a full range of products. Most of these products are sold under the *Saputo* label.

## 4.2 Production

### *Individually Quick Frozen*

Saputo is the only company in Canada equipped to apply the Individually Quick Frozen (“IQF”) process to some of its cheese production, particularly mozzarella. This process requires that the mozzarella be diced into small cubes weighing approximately one gram before going through a tunnel that freezes each individual cube of cheese. The shelf life of the resulting product is at least one year if kept under consistent freezing conditions. This process enables the Company to dice its cheese at the moment of optimum aging thereby ensuring quality and proper performance, both of which are important attributes for the pizza trade.

Although the Company’s IQF capability is currently limited to its Canadian operations, Saputo has nonetheless a non-IQF freezing process which it applies to a portion of its mozzarella stick production in the United States.

### *Quality Control*

Fundamental to Saputo’s growth and success has been its insistence on maintaining high standards of product quality. This has been achieved mainly through the training of all manufacturing employees and the control, on an ongoing basis, of every variable of the production process.

### *Milk Sourcing*

Due to the regulated nature of the Canadian dairy industry, Saputo sources its milk in Canada from the Fédération des producteurs de lait du Québec, the Dairy Farmers of Ontario and the Manitoba Milk Producers.

In the United States, Saputo sources its milk from independent milk farms and cooperatives. The Company is one of the largest participants in the Wisconsin patron milk program. Saputo obtains approximately 60% of its milk in Wisconsin from its patron base.

### *Facilities*

The Company operates a total of twenty seven manufacturing facilities, seven of which are located in Canada and twenty of which are located in the United States. Except for the facility located on Rolling Meadows Drive in Fond du Lac, Wisconsin, all of the Company's facilities are owned. The following table sets forth, for each facility, its location, surface, weekly processing capacity and the products manufactured at such facility.

Canadian facilities location	Square metres	Weekly capacity <sup>(1)</sup>	Products
Saint-Léonard, Québec Main plant	5,450	5,700,000 litres	Italian Mozzarella, cheddar, farmer, edam, monterey jack, brick, American mozzarella, provolone, parmesan blends, butter
Specialty plant	3,890	1,600,000 litres	Ricotta, bocconcini, cacino, friulano, string cheese, trecce, feta, provolone, Italian mozzarella, pastorella, caciocavallo, tuma, cheddar curds
Cutting operation	2,597	N/A	Process cheese, IQF process, cheese shredding, cheese dicing, retail cuts, food service cuts
St-Hyacinthe, Québec	5,860	9,675,000 litres of liquid whey <sup>(2)</sup>	Whey protein, lactose, dairy blends, whey powder
Mont-Laurier, Québec	1,995	2,100,000 litres	Italian mozzarella
St-Boniface de Shawinigan, Québec	1,163	1,275,000 litres	Cheddar
Trois-Rivières, Québec <sup>(3)</sup>	3,070	1,100,000 litres	Fluid milk, ice cream
Cookstown, Ontario	3,723	2,100,000 litres	Italian mozzarella
Souris, Manitoba	1,575	1,200,000 litres	Aged cheddar, monterey jack, American mozzarella, colby, brick, munster, popcorn whey

United States facilities location	Square metres	Weekly capacity <sup>(1)</sup>	Products
Lena, Wisconsin	16,720	6,700,000 litres	Mozzarella, string cheese, shredded, ricotta
Almena, Wisconsin	11,800	5,300,000 litres	Mozzarella, provolone, parmesan, romano, ricotta, asiago, <i>Fontinella</i>
Fond du Lac, Wisconsin (East Scott Street)	16,165	2,700,000 litres	Mozzarella, stick, blue
Branch, Wisconsin	2,975	2,550,000 litres	Mozzarella, provolone
Reedsburg, Wisconsin	2,415	2,150,000 litres	Mozzarella, provolone
Denmark, Wisconsin	1,895	2,350,000 litres	<i>Lorraine</i> , mozzarella curd
Thorp, Wisconsin	12,960	1,575,000 litres	Blue, gorgonzola
Fond du Lac, Wisconsin <sup>(4)</sup> (Tompkins Street)	12,000	4,317,181 litres <sup>(5)</sup>  3,083,700 litres <sup>(5)</sup>	Whole milk powder, spray dried ingredients, sweetened condensed milk, canned egg nog  Spray dried ingredients and whey protein concentrate
Fond du Lac, Wisconsin <sup>(4)</sup> (Rolling Meadows Drive)	2,765	630,000 lbs <sup>(6)</sup>	Canned milk powders
New London, Wisconsin <sup>(4)</sup>	10,770	1,775,000 litres	Swiss cheese
Monroe, Wisconsin <sup>(4)</sup> (11th Street)	1,800	8,017,621 litres <sup>(5)</sup>	Whey protein concentrate, buttermilk product, concentrated permeate
Monroe, Wisconsin <sup>(4)</sup> (18th Street)	3,200	1,700,000 litres	Mozzarella, provolone
Tulare, California	8,080	5,400,000 litres	Mozzarella, provolone, shredded
South Gate, California	5,915	4,250,000 litres	Mozzarella, string cheese, ricotta
Richmond, Vermont	1,420	1,600,000 litres	Italian mozzarella
Hinesburg, Vermont	9,869	1,300,000 litres	Feta
Hancock, Maryland	4,640	2,400,000 litres	Italian mozzarella, provolone,

			shredded cheese, diced cheese
Peru, Indiana	1,610	--	Imitation cheese
Big Stone, South Dakota (aging/finishing)	8,695	--	Parmesan, romano, asiago, packaging, <i>Fontinella</i>
Kent, Illinois <sup>(4)</sup>	4,235	1,700,000 litres	Mozzarella, provolone, hand dipped ricotta, whipped ricotta

- (1) Weekly plant capacity refers to the hourly pasteurization rate of the plant for a 20-hour operation (4 hours for washing), 6 days a week. Total capacity is then reduced by 15% to compensate for unforeseen events.
- (2) Weekly capacity refers to the liquid whey processing capacity based on a 24-hour operation, 7 days a week with 8 hours a week for maintenance and washing.
- (3) This building is encumbered by a hypothec granted to a Canadian chartered bank pursuant to a deed of hypothec dated March 3, 1991.
- (4) The facilities were acquired on May 1, 1998 pursuant to the AWG Acquisition. See "General Development of the Business-History".
- (5) Weekly capacity was determined based on a 20-hour operation (4 hours for washing), 7 days a week.
- (6) Weekly capacity was determined based on a 24 hour operation, 7 days a week and current product mix.

### *Capital Expenditures*

Management believes that the Company has adequate manufacturing capacity to meet current and near term demand for its products. It is Saputo's intention to continue to expand and modernize its plants, with investments being focused on equipment and processes designed to increase output per litre of milk. More specifically, during the last five fiscal years, Saputo (excluding Stella) has incurred \$50.4 million in capital expenditures. In addition, over the last three years, over \$90 million in capital expenditures was invested in the Stella operations by their previous owner, including \$33 million to rebuild the Lena plant following the January 1996 fire. In fiscal 1998, the Company spent \$12.7 million on its Canadian operations and \$9.6 million on its United States operations. In fiscal 1999, Saputo intends to incur capital expenditures of approximately \$6.7 million on its Canadian operations and \$11.2 million on its United States operations to enhance the efficiency of its plants.

### *Environment*

The Company's operations are subject to various federal, provincial, state and local government laws and regulations relating to the protection of the environment. Compliance with these laws and regulations requires the Company to incur expenses and to monitor its operations on an ongoing basis. The Company believes that its operations are in compliance in all material respects with currently applicable environmental laws and regulations except for the issues discussed below.

The Saputo St-Boniface plant has failed to comply with a depollution program agreed upon with the Quebec Ministry of Environment and Wildlife in connection with wastewater discharges. The Company is presently discussing with the authorities means of attaining compliance and intends to present its action plan shortly together with a request to obtain a certificate of authorization for its operations.

On July 9, 1997 and June 16, 1998, the Richmond plant received a notice of infraction from the

Department of Environmental Conservation of the State of Vermont concerning the violation of flow, biochemical oxygen demand ("BOD<sub>5</sub>") and pH standards provided in its wastewater pre-treatment permit. The Company is presently discussing with the authorities means of attaining compliance.

The Company may be required to provide the US Federal, State and Local authorities with certain environmental information relating to recently acquired facilities in the United States. The Company is currently evaluating whether or not these facilities are subject to reporting requirements and intends to file with the authorities before the end of fiscal 1999 the reports for the current year and most of the required reports for the past years, with the remaining reports being filed in fiscal 2000.

Three out of the nine groundwater quality monitoring wells at the Almena facility have shown levels of nitrate and/or chloride exceeding the permitted concentration. In 1994, the Wisconsin Department of Natural Resources (the "WDNR") notified the Almena facility that it was violating certain provisions of its permit relating to groundwater quality. Following such notice, the facility found ways to substantially reduce its chloride discharge into the lagoon. Four groundwater quality monitoring wells at the Lena facility have shown levels of chloride exceeding the permitted concentration. In July and December 1997, February, March and June 1998, the WDNR notified the Lena facility that it was violating certain provisions of its permit relating to groundwater and wastewater quality. The facility responded to the notices in implementing various actions to substantially reduce its chloride discharge into the lagoon and minimize BOD<sub>5</sub> and suspended solids loading. On June 12, 1998, the facility submitted a timetable to implement actions to further reduce its chloride emissions. The Company is closely monitoring the situation at both sites in order to determine the source of the problem and take action if necessary to reduce concentrations to an acceptable level.

Additionally, the permitted level of chloride and phosphorous discharge are currently being exceeded at the Branch facility and the permitted level of phosphorous discharge is being exceeded at the Lena facility. The Company is negotiating with authorities new limits for its permit at both facilities.

The South Gate facility received a deficient self monitoring report notice on April 8, 1998 from the County Sanitation District for non-compliance with the wastewater discharge permit for soluble sulfide. An additional analysis result sent to the County Sanitation District has shown that the level of soluble sulfide is in compliance with the permit. The Company is currently investigating the source of potential soluble sulfide generation.

One of the six groundwater quality monitoring wells located at the Kent facility shows levels of chloride in excess of the level permitted in the State of Illinois. The Company has identified the source of the problem and is presently taking action to reduce the concentration to an acceptable level.

The Tulare facility has been exceeding electrical conductivity, BOD<sub>5</sub> and sodium and chloride limits of its wastewater discharge permit issued by the City of Tulare and, as of January 1, 1998, is considered to be in violation with municipal wastewater discharge by-law. The Company is currently evaluating the various alternatives to ensure compliance with its discharge permit and with municipal by-law.

The Thorp facility received a notice on June 12, 1998 from the City of Thorp for non-compliance with

the BOD<sub>5</sub> discharge limitations to the municipal wastewater treatment plant as set in the discharge permit. The Company is currently implementing certain measures in order to minimize BOD<sub>5</sub> loading and is closely monitoring the situation to evaluate if further corrective actions are required.

The Monroe Whey plant has violated the provisions of its wastewater discharge permits issued by the City of Monroe. The plant has an agreement with a third party pursuant to which the wastewater is being pre-treated by this third party prior to its discharge into the city wastewater treatment plant. This pretreatment plant has experienced equipment failures which have resulted in wastewater discharges exceeding the permitted limits. The City has sent the Monroe Whey plant a number of notices regarding several violations that occurred in 1997 and has indicated that further violations may result in additional actions by the City. The Company acquired this facility on May 1, 1998 and is currently evaluating the various alternatives to ensure compliance with its discharge permit.

During fiscal 1999, the Company will implement a replacement and removal program of underground storage tanks at a number of its facilities in Canada and in the United States at a cost estimated at \$800,000, including cost of remediation of soil contamination.

During fiscal 1998, capital expenditures of approximately \$1.7 million were spent at the Company's facilities to comply with existing environmental laws and regulations. Management estimates that capital expenditures required for environmental compliance with laws and regulations currently in effect will aggregate approximately \$2.6 million during fiscal 1999, primarily to update or remove underground storage tanks and to improve wastewater systems at a number of its facilities in Canada and the United States.

Management believes that compliance with currently applicable environmental protection requirements will not have a material effect on the Company's earnings or competitive position during fiscal 1999. Any new environmental laws or regulations or more vigorous regulatory enforcement policies could have a material adverse effect on the financial position of the Company and could require significant additional expenditures to achieve or maintain compliance.

#### **4.3 Markets**

Saputo is one of Canada's largest cheese manufacturers and has established itself as Canada's leading producer of mozzarella with a production of 38.2 million kilograms in a total market of approximately 105 million kilograms of mozzarella. In the United States market, which accounts for approximately one billion kilograms of mozzarella, Saputo produces on an annual basis approximately 112 million kilograms of mozzarella. Saputo's reputation for product quality and service has grown with the increasing popularity of Italian foods.

##### *Geographic Segmentation*

The following table presents the geographic segmentation of the Company's sales during the last two fiscal years and during the three months ended March 31, 1998:

	Three months ended March 31, 1998 <sup>(1)</sup>		Year ended March 31, 1998 <sup>(2)(3)</sup>		Year ended March 31, 1997 <sup>(3)</sup>	
	Sales (\$,000)	% of total sales	Sales (\$,000)	% of total sales	Sales (\$,000)	% of total sales
Canada.....	117,317	30.8	401,436	49.1	341,930	75.9
United States.....	248,297	65.3	362,348	44.3	66,678	14.8
International.....	14,841	3.9	53,471	6.6	41,904	9.3
Total .....	<u>380,455</u>	<u>100.0</u>	<u>817,255</u>	<u>100.0</u>	<u>450,512</u>	<u>100.0</u>

- (1) The presentation of the information on a quarterly basis better reflects the impact of the Stella Acquisition on the Company's operations and results.
- (2) Includes the results of Stella from December 6, 1997 to March 31, 1998.
- (3) The periods prior to December 6, 1997 include the results of the Company before the Stella Acquisition.

*Canada.* Saputo is Canada's leading producer of Mozzarella with a production share of approximately 36 %. The Company is also a full-line product distributor selling to the food service industry, especially pizzerias, not only the products it manufactures but also a variety of fine imported cheeses as well as numerous other food and non-food products sourced from third-party manufacturers that are complementary to its cheese distribution business.

*United States.* The Company competes in all segments of the United States natural cheese industry, selling branded and private label products to retail, industrial/ingredient and food service customers. With the completion of the AWG Acquisition, the Company became an important producer of sweetened condensed milk in the United States.

*International.* As a direct result of the liberalization of trade barriers in agricultural products following the GATT agreement of 1994, the Company has intensified its presence in foreign markets. Today, Saputo's products can be found in Europe, South America, Africa and Asia. The Company's product quality further enhances its international sales potential. It is the Company's intention to pursue its efforts in world markets.

### *Clientele*

The company services four distinct market segments: food service, retail, industrial/ingredient and international. The following table illustrates the segmentation of sales by market segment for each of the last two fiscal years and the three months ended March 31, 1998:

Three months ended March 31, 1998 <sup>(1)</sup>	Year ended March 31, 1998 <sup>(2)(3)</sup>	Year ended March 31, 1997 <sup>(3)</sup>
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	Sales (\$,000)	% of total sales	Sales (\$,000)	% of total sales	Sales (\$,000)	% of total sales
Food Service.....	164,319	43.2	391,317	47.9	271,731	60.3
Retail .....	108,876	28.6	217,688	26.6	99,110	22.0
Industrial/Ingredient .....	92,419	24.3	154,779	18.9	37,767	8.4
International . . . . .	14,841	3.9	53,471	6.6	41,904	9.3
Total .....	<u>380,455</u>	<u>100.0</u>	<u>817,255</u>	<u>100.0</u>	<u>450,512</u>	<u>100.0</u>

- (1) The presentation of the information on a quarterly basis better reflects the impact of the Stella Acquisition on the Company's operations and results.
- (2) Includes the results of Stella from December 6, 1997 to March 31, 1998.
- (3) The periods prior to December 6, 1997 include the results of the Company before the Stella Acquisition.

*Food service.* In Canada, food service customers principally include pizzerias (corporate, franchisees and individually-owned) as well as restaurants and hotels. Saputo provides its food service customers with branded and private label cheeses as well as with non-dairy products manufactured by third parties. The direct customer service provided by the Company's trained sales force is the most important component of its food service segment marketing strategy. By selling directly to food service customers, the Company has forged valuable personal relationships based on the quality and effective distribution of its products. In the United States, Saputo provides branded and private label cheeses to its food service customers which include full range national distributors, corporate restaurant chains as well as independent distributors. Although Saputo's principal sales in the food service segment are comprised of mozzarella and provolone, Saputo is expanding its sales of specialty cheeses in this segment.

No food service customer represented more than five percent of total sales in fiscal years 1998 and 1997.

*Retail.* Saputo sells both branded and private label cheese to its retail customers which include supermarket chains, stores, warehouse clubs and specialty cheese boutiques. In fiscal 1998, approximately 78 % of Saputo's retail sales were in branded products with the remainder being private label. Saputo's retail grocery products are sold in the dairy case and deli cheese table sections of stores. In Canada, Saputo is also providing its retail customers with imported cheeses. The acquisition of Fromages Caron Inc. in 1996 (which company was later amalgamated with Stella Foods Importing Inc.) has enhanced the Company's presence in this market segment.

No retail customer represented more than five percent of total sales in fiscal years 1998 and 1997.

*Industrial/Ingredient.* Industrial/ingredient clients include processors who use the Company's products as an ingredient in the preparation of other food items. The Company supplies cheese to a majority of Canadian frozen pizza manufacturers as well as to processors of frozen entrées and supplies many important food manufacturers in the United States. Saputo is expanding its position in the industrial sector by building

strategic alliances with key customers. To support this effort, Saputo's technical experts work with customers to develop new products customized to their needs.

No industrial/ingredient customer represented more than five percent of total sales in fiscal years 1998 and 1997.

*International.* The Company is present in the international market through the sale of cheese, lactose and whey protein to a vast array of clients operating in the food service, retail and industrial/ingredient segments of their respective markets.

#### 4.4 Distribution

In Canada, Saputo has developed its own nation-wide distribution network. Since its inception, the Company has invested substantial time and capital in its distribution infrastructure and today it services directly more than 7,500 clients per week across Canada. Saputo believes that its distribution network is the cornerstone of its market penetration as its weekly personalized service constitutes a major obstacle to serious competitor activity. The Company intends to continue to expand its direct distribution capabilities in Canada so as to further increase efficiency and sales.

Canadian sales and distribution activities are conducted by a dedicated staff operating in 13 distribution centres across Canada, strategically located in the following urban centres:

St. John's (Nfld.)	Ottawa (Ont.)
Halifax (NS)	Toronto (Ont.)
Moncton (NB)	Regina (Sask.)
Québec City (Que.)	Saskatoon (Sask.)
Montréal-Saint-Léonard (Que.)	Calgary (Alta.)
Montréal-Saint-Laurent (Que.)	Edmonton (Alta.)
Vancouver (BC)	

The Company also has a sales office in Sydney, Nova Scotia, and a local distributor in Winnipeg, Mondo Foods Company Limited, with whom it has had a long-term business relationship. The Company works with a few regional independent distributors servicing more remote areas of the country.

In the United States, sales are made through direct shipments to certain large food service, retail and industrial/ingredient customers as well as to national and regional third party distributors.

#### 4.5 Competition

##### *Food Service*

*Canada.* In the food service segment in Canada, each of the Company's sales branches competes with a variety of regional cheese manufacturers and distributors. However, no other major Canadian cheese manufacturer has the Company's direct national market penetration and thus, in its overall business, the Company has developed a market position which is, in management's opinion, somewhat unique in the dairy industry.

The Company is Canada's leading producer of mozzarella with a production share of approximately 36%. Other significant mozzarella manufacturers in Canada with meaningful regional sales include Agropur Coopérative Agro-Alimentaire ("Agropur"), Parmalat Canada Inc. ("Parmalat"), Kraft General Foods Canada Inc. (through the production volumes of Agropur) ("Kraft"), Groupe Lactel, Limited Partnership ("Lactel"), and Agrifoods International Cooperative Ltd. ("Dairyworld").

*United States.* In the food service segment in the United States, the Company competes by region with a variety of regional cheese producers. The Company's strength in this segment is specialty cheeses for which it enjoys important market shares in blue cheese, parmesan/romano wheels and Italian table cheeses. Saputo's main competitors in this segment include Beatrice Cheese, Inc. ("Beatrice"), Raskas Foods, Inc., Aurrichio Cheese, Inc. ("Aurrichio"), The Antigo Cheese Company and S&R Cheese Corporation.

The Company produces close to 11% of the approximately one billion kilograms of mozzarella cheese production in the United States. The Company's mozzarella is almost exclusively sold to the food service and industrial/ingredient market segments. Saputo's principal mozzarella competitors in the food service segment are LePrino Foods Company ("Leprino"), Beatrice, Besnier USA, Inc. ("Sorrento"), Dairy Farmers of America ("DFA") and Land O'Lakes, Inc.

#### *Retail*

*Canada.* In the Canadian retail cheese market segment, Saputo competes with a number of established cheese manufacturers who own well-recognized brand name products. Nonetheless, in Quebec, Saputo believes it has built a reputation for its own brands which are also gaining market recognition in other provinces. Saputo is also a producer of cheese and butter for private labels.

With regards to Italian specialty cheeses produced by the Company and distributed to the retail market, Saputo has a strong position in Canada and its main competitors are National Cheese Co. Ltd., Salerno Dairy Products Ltd. and Silani Sweet Cheese Ltd. National Cheese Co. Ltd. also competes with the Company in the imported cheese category as does Parmalat and numerous smaller importers and distributors, but the most significant participant in this market segment is Agropur.

In Canada, the Company is not an important participant in the cheddar and firm cheese category. Dominant positions in this segment belong to Kraft (through Agropur's production volume), Dairyworld and Parmalat. Kraft (through its own production process), Dairyworld and Parmalat dominate the process cheese market at the retail level.

*United States.* In the United States retail cheese market segment, Saputo competes with a number of established national cheese manufacturers who own well-recognized brand name products. However, the Company believes that its *Stella* brand specialty cheeses combined with an organized network of brokers and distributors provide a strong presence in the deli section. Also, Stella's *Cheese Heads* brand is a leading national brand of string cheese. Saputo's main competitors in the retail segment are Aurichio, Sorrento and Kraft Foods, Inc. ("Kraft USA").

#### *Industrial/Ingredient*

*Canada.* In Canada, the Company is a dominant supplier of mozzarella to this market segment. Competitors include Parmalat, Kraft, Lactel and Dairyworld.

*United States.* In the United States, the Company is a leading supplier of blue cheese to the dressing industry and is an important supplier of mozzarella and ricotta to industrial customers. The Company's main competitors include Sorrento, J.R. Simplot Company, Kraft USA, DFA, Beatrice and Leprino.

#### *Other Products*

With respect to butter, fluid milk and ice cream in Canada, Saputo is not a significant participant in these markets where it competes with large corporations and cooperatives which dominate the Canadian market.

With respect to the other by-products, whey protein is the object of competition in Canada from Agropur and Parmalat. The other by-products are either made according to customers' specifications, as is the case with dairy blends, or exported as the Company does with its lactose.

In terms of the distribution of other non-dairy products in Canada, the Company competes with a large number of regional distributors, only one of which has national distribution capability. Accordingly, each sales branch faces a different competitive environment depending on the presence, activity level, and product range of local distributors.

#### *General*

Although competition varies from one market segment to another, the Company believes that its manufacturing techniques, quality control and dedicated customer service differentiate Saputo from its competitors.

## **4.6 Employee Relations**

As at May 30, 1998, the Company had 842 full-time employees and 150 part-time employees in Canada and 2,069 full-time and 92 part-time employees in the United States.

All of the Company's Canadian plants and distribution centres are non-unionized, except for the Trois-Rivières facility for which the collective agreement with Fédération des Travailleurs du Québec expires on December 18, 1999 and covered 41 full-time and 54 part-time employees as at May 30, 1998. In the United States, a portion of the production employees is unionized as shown in the table below:

Facility	Number of employees covered as at May 30, 1998	Name of union	Expiry date of agreement
Branch	48	International Brotherhood of Teamsters Local Union No. 75	May 31, 1999
Fond du Lac (East Scott Street)	159	International Brotherhood of Teamsters Local Union No. 200	November 1, 1998
Thorp	91	International Brotherhood of Teamsters Local Union No. 662	May 30, 2000
Reedsburg	46	International Brotherhood of Teamsters Local Union No. 695	June 30, 2001
Lena	291	Lena Independent Union	December 31, 1999
Peru	30	United Paper Workers	May 23, 2001
Monroe Cheese Plant (18th Street)	39	International Brotherhood of Teamsters Local Union No. 579	May 30, 2001
Fond du Lac (Tompkins Street) and New London	143	International Brotherhood of Teamsters Local Union No. 200 and 563	January 15, 2000
Fond du Lac (Rolling Meadows Drive)	12	International Brotherhood of Teamsters Local Union No. 200	April 30, 2000

The Company presently does not foresee any difficulty or labour unrest in connection with the renewal of the Fond du Lac agreement expiring in fiscal 1999. The Company has good employee relations both in Canada and in the United States. The loyalty and dedication of its employees are key elements in the Company's performance. In management's opinion, this is the direct result of the family culture that has permeated the entire Company.

#### 4.7 The Montreal Impact F.C.

Saputo owns and operates a professional soccer club, the Montreal Impact F.C., L.P. The team plays in the A-League division of the United System of Independent Soccer Leagues (U.S.I.S.L.).

Founded in 1993 as a community initiative, the Company has invested, since then, \$4.8 million to

support the club.

## ITEM 5 - SELECTED CONSOLIDATED FINANCIAL INFORMATION

### 5.1 Selected Consolidated Financial Information for the Last Five Fiscal Years.

	Years ended March 31				
	1998 <sup>(1)</sup>	1997 <sup>(2)</sup>	1996 <sup>(2)</sup>	1995 <sup>(2)</sup>	1994 <sup>(2)</sup>
	(audited)				
	(In thousands of dollars, except per share amounts)				
<b>Statement of earnings data</b>					
Revenue.....	817,255	450,512	409,025	402,021	362,416
Cost of sales, selling and administrative expenses.....	<u>721,828</u>	<u>378,845</u>	<u>344,141</u>	<u>338,656</u>	<u>311,399</u>
EBITDA <sup>(3)</sup> .....	95,427	71,667	64,884	63,365	51,017
<i>EBITDA margin</i> .....	11.7 %	15.9%	15.9%	15.8%	14.1%
Depreciation and amortization.....	15,703	7,796	7,074	7,803	6,866
Interest on long-term debt.....	8,435	—	—	—	—
Interest.....	491	231	708	1,211	1,496
Income taxes.....	<u>25,053</u>	<u>22,642</u>	<u>19,829</u>	<u>19,217</u>	<u>15,201</u>
Net earnings.....	<u>45,745</u>	<u>40,998</u>	<u>37,273</u>	<u>35,134</u>	<u>27,454</u>
<i>Net margin</i> .....	5.6%	9.1%	9.1%	8.7%	7.6%
Earnings per share <sup>(4)</sup> .....	1.23	1.37			
Fully diluted earnings per share.....	.93				
<b>Balance sheet data</b>					
Total assets.....	896,662	175,767			
Long-term debt (excluding current portion).....	330,271	—			
Dividends per share <sup>(5)</sup> .....	0.05				
Shareholders' equity.....	369,893	114,190			

**Statement of changes in financial position data**

Cash generated by operations <sup>(6)</sup> .....	63,972	49,114
Net additions to fixed assets .....	22,107	4,242

- (1) Includes the results of Stella from December 6, 1997 to March 31, 1998.  
(2) Certain amounts for periods prior to the Company's Initial Public Offering are omitted as such information would be based upon assumptions that would make it irrelevant.  
(3) Earnings before interest, income taxes, depreciation and amortization.  
(4) Earnings per share have been calculated using the weighted average number of Common Shares outstanding during the year.  
(5) This amount represents the quarterly dividend declared and paid on March 6, 1998 for the period from October 15, 1997 to December 31, 1997 in accordance with the Company's dividend policy. See "Dividend Policy". The amounts of dividends per share for the four-year period ended March 31, 1997 have been omitted as they are not indicative of future dividends as a result of the amount of dividends paid and the number of shares then outstanding.  
(6) Before changes in non-cash operating working capital items.

**5.2 Selected Consolidated Quarterly Financial Information**

	Three-month periods ended							
	Fiscal 1998 <sup>(1)</sup>				Fiscal 1997			
	March 31	December 31	September 30	June 30	March 31	December 31	September 30	June 30
	(unaudited) (in thousands of dollars)							
Revenue .....	380,455	196,042	123,181	117,577	107,626	121,956	113,903	107,027
Cost of sales, selling and administrative expenses.....	<u>347,669</u>	<u>171,521</u>	<u>103,751</u>	<u>98,887</u>	<u>90,816</u>	<u>103,126</u>	<u>95,373</u>	<u>89,530</u>
EBITDA <sup>(2)</sup> .....	32,786	24,521	19,430	18,690	16,810	18,830	18,530	17,497
<i>EBITDA margin.....</i>	8.6 %	12.5 %	15.8 %	15.9 %	15.6 %	15.4 %	16.3 %	16.3 %
Depreciation and amortization	7,369	4,287	2,051	1,996	1,913	2,014	1,921	1,948
Interest on long-term debt	6,539	1,896	--	--	--	--	--	--
Interest .....	271	198	68	(46)	177	(54)	156	(48)
Income taxes .....	<u>5,946</u>	<u>6,695</u>	<u>6,353</u>	<u>6,059</u>	<u>4,829</u>	<u>6,123</u>	<u>6,169</u>	<u>5,521</u>
Net earnings <sup>(3)</sup> .....	<u>12,661</u>	<u>11,445</u>	<u>10,958</u>	<u>10,681</u>	<u>9,891</u>	<u>10,747</u>	<u>10,284</u>	<u>10,076</u>
<i>Net margin.....</i>	3.3 %	5.8 %	8.9 %	9.1 %	9.2 %	8.8 %	9.0 %	9.4 %

- (1) Includes the results of Stella from December 6, 1997 to March 31, 1998.
- (2) Earnings before interest, income taxes, depreciation and amortization.
- (3) Earnings on a per share and fully diluted per share basis have been omitted from the table as these amounts are not considered representative of actual results.

## **ITEM 6 - DIVIDEND POLICY**

Saputo has a policy of declaring quarterly cash dividends on the Common Shares in an amount of \$0.06 per share representing a yearly dividend of \$0.24 per share. The balance of its earnings will be reinvested to finance the growth of the Company's business. The Company's dividend policy will be reviewed from time to time by the Board of Directors and will depend on Saputo's financial condition, results of operations, capital requirements and such other factors as the Board of Directors, in its sole discretion, deems relevant.

## **ITEM 7 - MANAGEMENT'S DISCUSSION AND ANALYSIS**

A discussion and analysis by management of the financial condition and results of operations of the Company for the fiscal year ended March 31, 1998 is presented under the section "Management's Discussion and Analysis" on pages 17 to 19 of the 1998 Annual Report of Saputo, which section is incorporated herein by reference. To complete management's discussion and analysis, reference is made to the Consolidated Financial Statements of Saputo for the fiscal year ended March 31, 1998, and the Notes thereto appearing on pages 20 to 30 of the 1998 Annual Report of Saputo, which Consolidated Financial Statements and Notes are also incorporated herein by reference.

## **ITEM 8 - MARKET FOR SECURITIES**

The Common Shares of Saputo are listed on The Montréal Exchange and The Toronto Stock Exchange under the stock market symbol "SAP".



## ITEM 9 - DIRECTORS AND OFFICERS

### 9.1 Directors

The following table sets forth, for each director, his name and municipality of residence, the year in which he first became a director, the principal occupation of each director and the number of Common Shares beneficially owned, directly or indirectly, or over which control or direction was exercised as at June 15, 1998. Directors are elected until the next annual meeting of shareholders or, in the case of a vacancy or resignation, until a successor is elected or appointed.

Name and municipality of residence	Director since	Principal occupation	Common Shares beneficially owned or over which control or direction was exercised
EMANUELE (LINO) SAPUTO Montréal, Québec	1992	Chairman of the Board and Chief Executive Officer of the Company <sup>(1)</sup>	33,811,137 <sup>(1)</sup>

CAMILLO LISIO <sup>(3)</sup> Westmount, Québec	1997	President and Chief Operating Officer of the Company <sup>(1)</sup>	15,390
ANDRÉ BÉRARD <sup>(3)(4)</sup> Verdun, Québec	1997	Chairman of the Board and Chief Executive Officer of a Canadian Chartered Bank	1,500
CARLO BIZZOTTO <sup>(4)(5)</sup> Montréal, Québec	1997	President of Développements du D'Arcy McGee Ltée (a real estate development company)	34,000
PIERRE BOURGIE <sup>(3)(4)</sup> Outremont, Québec	1997	President and Chief Executive Officer of Société Financière Bourgie Inc. (a holding company)	230,000
CATERINA MONTICCIOLO, CA <sup>(5)</sup> Laval, Québec	1997	Controller of Placements Vigica Inc. (a holding company)	17,500
LOUIS A. TANGUAY <sup>(4)(5)</sup> Anjou, Québec	1997	President and Chief Operating Officer of Bell Canada International	2,000

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- (1) Before April 1, 1998, Messrs. Saputo and Lisio were respectively President and Chief Executive Officer, and Executive Vice-President of the Company.
- (2) The shares are held by Jolina Capital Inc. and Gestion Jolina Inc., both of which are holding companies controlled by Emanuele (Lino) Saputo, and by other holding companies owned and controlled by his brothers and sisters and their families, which have granted to Gestion Jolina Inc. a power of attorney to vote all of the Common Shares held by them at the time of the Company's Initial Public Offering.
- (3) Members of the Corporate Governance and Human Resources Committee.
- (4) Messrs. Bérard, Bizzotto, Bourgie and Tanguay were appointed to the Board of Directors of the Company on October 15, 1997, following the Company's Initial Public Offering.
- (5) Members of the Audit Committee.

During the last five years, all of the above directors have been engaged in their present principal occupations or in other executive capacities with the companies indicated opposite their name or with related or affiliated companies, except for: Caterina Monticciolo who, from January 1995 to October 1996 was a financial analyst with the Company and prior thereto was an accountant with Samson Belair Deloitte & Touche (an accounting firm); Pierre Bourgie who, prior to January 1997, was President and Chief Executive Officer of Urgel Bourgie Inc. (funeral services); and Carlo Bizzotto who was President of Petra Limited (a real estate company) until January 1998.

Information as to shares beneficially owned by each director, or over which each exercised control or direction, as at June 15, 1998, has been furnished by the directors individually as such information is not within the knowledge of the Company.

## 9.2 Executive Officers

The following table sets forth the name, municipality of residence and position with the Company of each person who is an executive officer of the Company as of the date hereof:

<b>Name and municipality of residence</b>	<b>Position</b>
Emanuele (Lino) Saputo Montréal, Québec	Chairman of the Board and Chief Executive Officer
Camillo Lisio Westmount, Québec	President and Chief Operating Officer
Dino Dello Sbarba Rosemère, Québec	Executive Vice-President, Sales, Marketing and Logistics
Lino A. Saputo, Jr. Westmount, Québec	Executive Vice-President, Operations
Pierre Leroux Boucherville, Québec	Executive Vice-President, Human Resources and Quality Assurance
Louis-Philippe Carrière, CA Lorraine, Québec	Executive Vice-President, Finance and Administration and Secretary

During the last five years, all of the above executive officers have held the principal occupation indicated above or other executive capacities with the Company.

As at June 15, 1998, the directors and executive officers of Saputo, as a group, beneficially owned, directly or indirectly, or exercised control or direction over, an aggregate of 34,127,157 Common Shares, representing approximately 70.3 % of the outstanding Common Shares of the Company. Additional information concerning the share holdings of directors is contained in the section entitled "Election of Directors" appearing on page 4 of the Company's Information Circular for Solicitation of Proxies dated June 17, 1998, which information is incorporated herein by reference.

#### **ITEM 10 - ADDITIONAL INFORMATION**

Additional information, including directors' and officers' remuneration and indebtedness, principal holders of Saputo's securities, options to purchase securities and interests of insiders in material transactions, where applicable, is contained in Saputo's Information Circular for Solicitation of Proxies dated June 17, 1998.

Additional financial information is included in the Consolidated Financial Statements of Saputo and Notes thereto for the fiscal year ended March 31, 1998. Copies of these documents may be obtained upon request from the Secretary of Saputo, at its head office, 6869 Metropolitan Blvd. East, Saint-Léonard, Québec, H1P 1X8, Telephone: (514) 328-6662.

In addition, when the securities of Saputo are in the course of a distribution pursuant to a short form prospectus or when a preliminary short form prospectus has been filed, the following documents may be obtained free of charge from the Secretary of the Company:

- (i) one copy of the Annual Information Form, together with one copy of any documents or portion thereof incorporated by reference therein;
- (ii) one copy of the comparative financial statements of Saputo for its most recently completed fiscal year together with the report of the auditors thereon and one copy of any interim financial statements of Saputo subsequent to the financial statements for its most recently completed fiscal year;
- (iii) one copy of Saputo's Information Circular for Solicitation of Proxies for its most recent annual meeting of shareholders which involved the election of directors; and
- (iv) one copy of any other documents that are incorporated by reference in the preliminary short form prospectus or the short form prospectus.

At any other time, one copy of the documents referred to in subparagraphs (i) (ii) and (iii) above will be provided free of charge upon request to the Secretary.