

# ANNUAL REPORT



PREMIUM INCOME CORPORATION

## Mulvihill Capital Management Inc.

# MESSAGE TO UNITHOLDERS

**P**remium Income Corporation was launched in October 1996 to provide investors with a superior yield alternative. This product enjoyed an enthusiastic response from investors and the Company has performed extremely well.

A summary of the Company's investments as well as its financial statements are included in this annual report.

The financial services sector of the Canadian equity market moved higher throughout 1997 and dividend

increases by the major banks helped propel share values upwards in a volatile but strongly upward moving market. These favourable price movements and increased price volatility both had positive effects on the performance of Premium Income Corporation.

We would like to take this opportunity to thank investors for their overwhelming support in 1996 and 1997 and we look forward to a mutually beneficial relationship in 1998.

John P. Mulvihill  
*President & CEO*  
Mulvihill Capital Management

Donald Biggs  
*Vice President*  
Mulvihill Capital Management





# PREMIUM INCOME CORPORATION

## INVESTMENT OBJECTIVES

The Company's investment objectives are (i) to provide holders of Preferred Shares with cumulative preferential quarterly cash dividends in the amount of \$0.215625 per share to yield 5.75% per annum; (ii) to provide holders of Class A Shares with quarterly cash dividends equal to the amount, if any, by which the net realized capital gains, dividends and option premiums earned on the Portfolio in any year, net of expenses and loss-carry-forwards, exceed the amount of the dividends paid on the Preferred Shares; and (iii) to return the original issue price to holders of both Preferred Shares and Class A Shares at the time of redemption of such shares on November 1, 2003.

## INVESTMENT STRATEGY

The Company intends to achieve its investment objectives by investing the net assets in a portfolio consisting of common shares of: Bank of Montreal, The Bank of Nova Scotia, Canadian Imperial Bank of Commerce, Royal Bank of Canada, and The Toronto-Dominion Bank (the "Banks"). To generate additional returns above the dividend income generated by the Portfolio, the Company will write covered call options in respect of all or part of the common shares in the Portfolio.

## HOLDINGS

BANK OF MONTREAL

THE BANK OF NOVA SCOTIA

CANADIAN IMPERIAL  
BANK OF COMMERCE

ROYAL BANK OF CANADA

THE TORONTO-DOMINION BANK

## DISTRIBUTION HISTORY

<u>Date</u>	<u>Class A Regular</u>	<u>Class A Special</u>	<u>Total Class A</u>	<u>Regular Preferred</u>
Jan 1997	\$0.20		\$0.20	\$0.220400
April 1997	\$0.20	\$0.10	\$0.30	\$0.215625
July 1997	\$0.20	\$0.10	\$0.30	\$0.215625
Oct 1997	\$0.20	\$1.701447	\$1.901447	\$0.226194
<b>Total</b>			<b>\$2.701447</b>	<b>\$0.877844</b>

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**Premium Income Corporation**

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Toronto, Ontario  
M5H 3T9

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(800) 725-7172  
fax: (416) 681-3901  
premium@mulvihill.com

Visit our website at [www.mulvihill.com](http://www.mulvihill.com) for additional information on all Premium Income Funds.

**Officers**

John P. Mulvihill  
President and Secretary

David N. Middleton  
Chief Financial Officer

**Directors**

John P. Mulvihill\*  
Chairman and President  
Mulvihill Capital Management Inc.

David N. Middleton  
Vice President, Finance  
Mulvihill Capital Management Inc.

Robert W. Korthals\*  
Corporate Director

R. John Lawrence  
Chairman  
Lawrence & Company

C. Edward Medland\*  
President  
Beauwood Investments Inc.

\* Audit Committee

**Auditors**

Deloitte & Touche  
BCE Place  
181 Bay Street, Suite 1400  
Toronto, Ontario  
M5J 2V1

**Shares Listed**

Toronto Stock Exchange and  
Montreal Exchange  
trading under PIC.PR.A & PIC.A

**Transfer Agent**

Montreal Trust  
151 Front Street, 8th Floor  
Toronto, Ontario  
M5J 2N1

**Trustee**

Royal Trust  
Royal Trust Tower  
77 King Street West, 11th Floor,  
Toronto, Ontario  
M5W 1P9



# AUDITORS' REPORT

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To the Shareholders of the  
Premium Income Corporation

We have audited the statements of financial position of Premium Income Corporation as at October 31, 1997 and 1996, the statement of investments at market value as at October 31, 1997 and the statements of operations and retained earnings (deficit), changes in net assets and changes in investments for the periods ended October 31, 1997 and 1996. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these 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 financial statements present fairly, in all material respects, the financial position of the Company as at October 31, 1997 and 1996, the investments at market value at October 31, 1997 and the results of its operations and the changes in its net assets and investments for the periods ended October 31, 1997 and 1996 in accordance with generally accepted accounting principles.

*Deloitte + Touche*

Chartered Accountants

Toronto, Ontario  
November 28, 1997

## 6. Income Taxes (cont'd)

No amounts are payable in respect of income taxes for 1997 or 1996. The Company has loss carryforwards of approximately \$200,000 which expire in 2003.

## 7. Distributions

Distributions per share paid to shareholders during the year were allocated as follows:

	1997	
	Preferred Shares	Class A Shares
Capital gains dividends	\$ 0.143922	\$ 2.701447
Taxable dividends	0.733922	-
	<u>\$ 0.877844</u>	<u>\$ 2.701447</u>

## 8. Financial instruments

The fair value of cash and short-term deposits, interest, dividends and other receivables, accounts payable and accrued liabilities, and due to brokers - investments purchased are equivalent to their carrying value given the short-term maturity of those instruments.

There were no options outstanding as at October 31, 1997 or 1996.

## 9. Statement of portfolio transactions

The Company will provide, without charge, a Statement of Portfolio Transactions (unaudited) upon written request by any shareholder to the Company at 121 King Street West, Suite 2600, Toronto, Ontario, M5H 3T9.





# PREMIUM INCOME CORPORATION

## STATEMENTS OF OPERATIONS AND RETAINED EARNINGS (DEFICIT)

Periods ended October 31, 1997 and 1996

	<u>1997</u>	<u>1996</u> (Note 1)
<b>Revenue</b>		
Interest	\$ 1,024,220	\$ 18,053
Dividends	3,030,640	-
	<u>4,054,860</u>	<u>18,053</u>
Net realized gains on investments and options	12,612,969	-
	<u>16,667,829</u>	<u>18,053</u>
<b>Expenses (Note 5)</b>		
Management fees	938,011	4,715
Administrative and other expenses	83,650	8,740
Government taxes	67,673	87,000
	<u>1,089,334</u>	<u>100,455</u>
<b>Net income (Loss)</b>	<u>\$ 15,578,495</u>	<u>\$ (82,402)</u>
<b>Net income (Loss) per share (Note 4)</b>		
Preferred share	\$ 0.873	\$ 0.005
Class A share	3.022	(0.025)
Total per unit	<u>\$ 3.895</u>	<u>\$ (0.020)</u>
<b>Retained earnings (Deficit)</b>		
Balance, beginning of period	\$ (82,402)	\$ -
Net income (loss)	15,578,495	(82,402)
Less distributions (Note 7)		
Preferred shares	(3,511,376)	-
Class A shares	(10,805,788)	-
Balance, end of period	<u>\$ 1,178,929</u>	<u>\$ (82,402)</u>

*(see accompanying notes to financial statements)*

### 3. Share Capital

The Company is authorized to issue an unlimited number of Preferred and Class A Shares and 1,000 Class B Shares.

#### *Issued and outstanding:*

	1997	1996
4,000,000 Preferred Shares	\$ 60,000,000	\$ 60,000,000
4,000,000 Class A Shares	40,000,000	40,000,000
1,000 Class B Shares	1,000	1,000
	<u>100,001,000</u>	<u>100,001,000</u>
Share issue expenses	(4,330,000)	(4,330,000)
	<u>\$ 95,671,000</u>	<u>\$ 95,671,000</u>

Preferred Shares are entitled to a cumulative preferential quarterly dividend of \$0.215625 per share payable on the last day of January, April, July and October in each year commencing on January 31, 1997. To the extent that a quarterly dividend is a capital gains dividend funded by net realized capital gains or option premiums, holders of Preferred Shares will receive an additional capital gains dividend of \$0.068 for each \$1.00 of Preferred Share dividend so funded.

All Preferred Shares and Class A Shares outstanding on November 1, 2003 will be redeemed by the Company on that date.

Preferred Shares and Class A Shares may be surrendered at any time for retraction at specified retraction amounts. Holders of Preferred Shares and Class A Shares may

concurrently retract one Preferred Share and one Class A Share on an October 31 valuation date at their net asset values. Shares retracted at any other valuation date or not retracted concurrently at an October 31 valuation date will be retracted at a discount to net asset value. Under the terms of a Recirculation Agreement, the Company may, but is not obligated to, require the Recirculation Agent to use its best efforts to find purchasers for any Preferred Shares or Class A Shares tendered for retraction. The Preferred Shares rank in priority of the Class A Shares and the Class A Shares rank in priority to the Class B Shares with respect to the payment of dividends and repayment of capital on the dissolution, liquidation or winding up of the Company.

The holders of Class B Shares are not entitled to receive dividends. The Class B Shares are retractable at a price of \$1.00 per share.

Class B Shares are entitled to one vote per share. Preferred Shares and Class A Shares are entitled to vote on certain shareholder matters.

On August 27, 1996, the Company issued 1,000 Class B Shares to Mulvihill Capital Management Inc., the Company's investment manager, for cash consideration of \$1,000.

On October 30, 1996, the Company issued 4,000,000 Units, each unit consisting of one Preferred Share and one Class A Share. In total, the Company issued





# PREMIUM INCOME CORPORATION

## STATEMENTS OF CHANGES IN INVESTMENTS

Periods ended October 31, 1997 and 1996

	<u>1997</u>	<u>1996</u> (Note 1)
Investments at market value, beginning of period	\$ -	\$ -
Unrealized appreciation in the market value of investments, beginning of period	-	-
Investments at cost, beginning of period	-	-
Cost of investments purchased during the period	<u>413,797,067</u>	<u>-</u>
Cost of investments sold during the period		
Proceeds from sales	338,231,480	-
Net realized gains on sales	<u>12,612,969</u>	<u>-</u>
	<u>325,618,511</u>	<u>-</u>
Investments at cost, end of period	88,178,556	-
Unrealized appreciation in the market value of investments, end of period	<u>10,530,194</u>	<u>-</u>
Investments at market value, end of period	<u>\$ 98,708,750</u>	<u>\$ -</u>

*(see accompanying notes to financial statements)*

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## STATEMENT OF INVESTMENTS AT MARKET VALUE

October 31, 1997

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### Common stocks

<u>Number of shares</u>		<u>Average Cost</u>	<u>Market Value</u>	<u>% of Portfolio</u>
377,500	Bank of Montreal	\$ 21,520,496	\$ 23,027,500	23.4
100,000	The Bank of Nova Scotia	6,157,334	6,215,000	6.3
500,000	Canadian Imperial Bank of Commerce	18,558,491	20,550,000	20.8
375,000	Royal Bank of Canada	25,647,486	28,256,250	28.6
400,000	The Toronto-Dominion Bank	<u>16,294,749</u>	<u>20,660,000</u>	<u>20.9</u>
<b>Total Common Stocks</b>		<u>\$ 88,178,556</u>	<u>\$ 98,708,750</u>	<u>100.0</u>





# PREMIUM INCOME CORPORATION

October 31, 1997 and 1996

## NOTES TO THE FINANCIAL STATEMENTS

### 1. Corporate Information

The Company is a mutual fund corporation incorporated under the laws of the Province of Ontario on August 27, 1996. The Company was inactive prior to the initial public offering of Preferred Shares and Class A Shares on October 30, 1996. All shares outstanding on November 1, 2003 will be redeemed by the Company on that date.

The Company invests in a portfolio consisting principally of common shares of Bank of Montreal, The Bank of Nova Scotia, Canadian Imperial Bank of Commerce, Royal Bank of Canada and The Toronto-Dominion Bank.

To generate additional returns above the dividend income earned on the portfolio, the Company will from time to time write covered call options in respect of all or part of the common shares in the portfolio. Additionally, the Company may use put options to preserve the value of the portfolio where appropriate. From time to time, the portfolio may include debt securities having a remaining term to maturity of less than one year issued or guaranteed by the government of Canada or a province or short-term commercial paper issued by one or more of the Banks.

### 2. Summary of Significant Accounting Policies

#### *Investment valuation policies*

Investments are recorded in the financial statements at their market value at the end of

the period, determined as follows:

Shares or other securities for which market quotations are readily available are valued at the closing sale price or, if there is no sale price, the average of the closing bid and ask prices. Shares or other securities for which market quotations are not readily available are valued at fair market value as determined by management.

Options are valued at market values as reported on recognized exchanges.

Treasury bills are valued at quoted market values.

#### *Policies for the recognition of investment appreciation, depreciation and income*

Realized gains and losses on investment sales, which are included in income, and unrealized appreciation or depreciation in investment values, which are included in a separate component of shareholders' equity, are calculated on the average cost basis.

Option fees paid or received are deferred and are recognized in the statement of net income when options are exercised, expire or are closed out.

Deferred gains and losses on options are recognized in investments and as a component of net unrealized appreciation (depreciation) in the value of investments in shareholders' equity.

Dividend income is recognized on the ex-dividend date.

## STATEMENTS OF CHANGES IN NET ASSETS

Periods ended October 31, 1997 and 1996

	<u>1997</u>	<u>1996</u> (Note 1)
Net income (Loss) for the period	\$ 15,578,495	\$ (82,402)
Less Distributions (Note 7)		
Preferred shares	(3,511,376)	-
Class A shares	(10,805,788)	-
Change in net unrealized appreciation in market value of investments	10,530,194	-
Issue of common and preferred shares, net of issue costs (Note 3)	-	95,671,000
<b>Changes in net assets during the period</b>	<b>11,791,525</b>	<b>95,588,598</b>
<b>Net assets, beginning of period</b>	<b>95,588,598</b>	<b>-</b>
<b>Net assets, end of period</b>	<b>\$ 107,380,123</b>	<b>\$ 95,588,598</b>

*(see accompanying notes to financial statements)*





# PREMIUM INCOME CORPORATION

October 31, 1997 and 1996

## NOTES TO THE FINANCIAL STATEMENTS (cont'd)

### 3. Share Capital (cont'd)

4,000,000 Preferred Shares at \$15.00 per share for gross proceeds of \$60,000,000 and 4,000,000 Class A Shares at \$10.00 per share for gross proceeds of \$40,000,000. Issue costs of \$4,330,000 were incurred in connection with this offering.

### 4. Net Income (Loss) per Class A share

The income per Class A Share is based on the weighted average number of shares outstanding during the period. In 1996, the loss per share is based on the weighted average number of shares outstanding during the period for which the Company was operational and net income available to Class A shareholders after provision for accrued but unpaid cumulative dividends of \$18,904.

### 5. Expenses

The Company is responsible for all ongoing trustee, manager, legal, accounting and audit fees as well as all other expenses incurred by the trustee and manager in the ordinary course of business relating to the Company's operations.

Fees are paid to Mulvihill Capital Management Inc. under the terms of an investment management agreement and to Mulvihill Fund Services Inc. under the terms of a management agreement. The fees are comprised of monthly fees calculated at 1/12 of 0.80% and 1/12 of 0.10%, respectively, of the net asset value.

The management expense ratio for the Company is as follows:

	<u>1997</u>
Total expenses	\$ 1,089,334
Expenses as a percent of average net assets	<u>1.04%</u>

Average net assets are calculated to be the average of the net assets of the Company at each month end.

### 6. Income Taxes

The Company is a "mutual fund corporation" as defined in the Income Tax Act (Canada) (the "Act") and is subject to tax in respect of its net realized capital gains. This tax is refundable in certain circumstances. Also, the Company is generally subject to a tax of 33 1/3% under Part IV of the Act on taxable dividends received in the year. This tax is fully refundable upon payment of sufficient dividends.

The Company is also a "financial intermediary corporation" as defined in the Act and, as such, is not subject to tax under Part IV.1 of the Act on dividends received nor is it generally liable to tax under Part VI.1 on dividends paid on taxable preferred shares.

Given the investment and dividend policies of the Company and taking into account expenses, the Company does not expect to bear any appreciable non-refundable income tax.

## STATEMENT OF FINANCIAL POSITION

October 31, 1997 and 1996

<b>Assets</b>	<b>1997</b>	<b>1996</b>
Investments at market value (average cost - \$88,178,556; 1996 - \$Nil)	\$ 98,708,750	\$ -
Cash and short-term investments	13,018,077	96,209,434
Interest, dividends and other receivables	146,250	9,619
<b>Total Assets</b>	<b>\$ 111,873,077</b>	<b>\$ 96,219,053</b>
<b>Liabilities</b>		
Accounts payable and accrued liabilities	\$ 115,604	\$ 630,455
Due to brokers - investments purchased	4,377,350	-
	<b>4,492,954</b>	<b>630,455</b>
<b>Net assets</b>		
Share capital (Note 3)	95,671,000	95,671,000
Retained earnings (deficit)	1,178,929	(82,402)
Unrealized appreciation in the market value of investments	10,530,194	-
	<b>107,380,123</b>	<b>95,588,598</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$ 111,873,077</b>	<b>\$ 96,219,053</b>
 Net asset value per Unit	 <b>\$ 26.84</b>	 <b>\$ 23.90</b>

On behalf of the board,

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**John P. Mulvihill, Director**

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**Robert W. Korthals, Director**

*(see accompanying notes to financial statements)*



# MULVIHILL CAPITAL MANAGEMENT INC.

Mulvihill Capital Management Inc. is a leading Canadian investment counsellor responsible for the care of institutional and personal assets. The company manages corporate, pension, insurance, endowment, trust and mutual funds under a wide variety of investment mandates. Founded in 1985 as CT Investment Counsel Inc., the investment arm of Canada Trust, the company emerged in 1995 as an independent company operated by a cohesive team of senior managers and owners who have been together for more than a decade. The company's scale and independent structure allow it to provide clients with a uniquely customized approach to asset management.

Premium Income Corporation is managed by Mulvihill Capital's structured finance group. This area of the company concentrates exclusively on creating and managing products tailored to meet very specific investment objectives. Assets are generally managed to meet specific absolute return levels rather than taking on the additional risk of targeting relative returns. This methodology allows the company to make investment decisions that meet the client's needs rather than to make investments to rival the competition.

Mulvihill's personal asset management division, Mulvihill Wealth Management, offers a comprehensive specialized approach tailored to client's personal strategies. This not only relieves the client's burden of day-to-day investment decisions but also

provides financial peace of mind for today and tomorrow. The company's personalized service and customized reporting assure that its powerful team of professionals is always working toward your current objectives and that you are fully aware of the progress you are making.

Mulvihill's reputation has been built on its ability to provide customized portfolios that meet the stated needs of its clients. The Premium Income investments are prime examples of that customized approach to asset management.

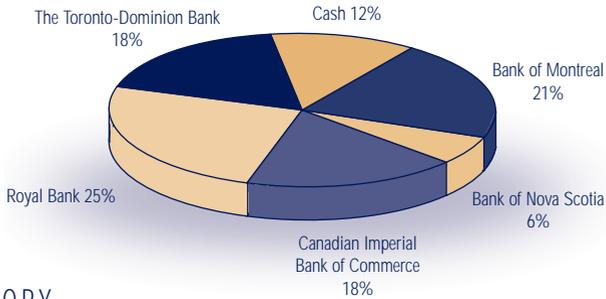
Other Premium Income products within the Mulvihill Group include First Premium Income Trust, First Premium US Income Trust and First Premium Oil & Gas Income Trust.

These Funds are Unit Trusts and are traded on the Toronto Stock Exchange and the Montreal Exchange over the past year as follows:

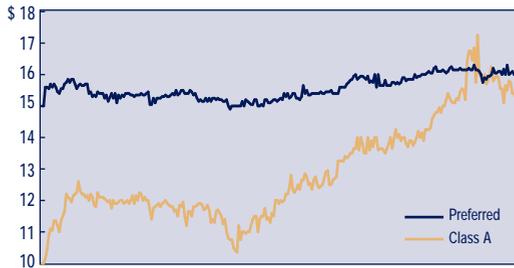
	High	Low
First Premium Income Trust FPI.UN	\$30.75	\$26.50
First Premium US Income Trust FPU.UN	\$26.00	\$20.00
First Premium Oil & Gas Income Trust FPG.UN	\$13.00	\$8.50

## ASSET MIX

October 31, 1997



## TRADING HISTORY



## COMMENTARY

As of October 31, 1997, the net assets of the Company were \$107,380,123, an 11% increase from inception on October 30, 1996. Dividends to Preferred Shareholders amounted to \$3,511,376 (\$0.877844 per Preferred Share) representing a 5.9% annual yield on the initial price of \$15.00. Dividends to Common Shareholders amounted to \$10,805,788 (\$2.701447 per Class A Share) representing a 27.0% annual yield on the initial price of \$10.00.

The trading prices of the Shares rose from the initial issue prices of \$15 and \$10 in October 1996 for the Preferred and Class A Shares respectively to \$15.75 and \$15.75 respectively.

The financial services sector of the Canadian equity market showed the greatest appreciation of any market area during the fiscal year of the Company. Dividend increases by the major banks helped propel share values upwards in a volatile but strongly upward moving market.

Because of the strength of the equity market in general and bank stocks in particular, we were cautious in our writing of covered call options. Even so, approximately 20% of the income of the Company was attributable to premiums from the successful application of this activity.

Although the Bank stocks have already experienced a substantial market rise, the continuation of strong earnings growth, further dividend increases and stock splits provide a strong underpinning for current values.

The Company's focus on this sector resulted in substantial gains for Class A Shareholders as evidenced by the Special Dividends during this fiscal year. The Company's conservative strategy of enhancing income by way of covered call writing also reduces the downside risk in the event of a market correction. We believe the Company is well positioned to provide investors with target distributions in 1998 while continuing to grow the assets of the Company.





## MULVIHILL

Mulvihill Capital Management Inc.  
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