The White Pass and Yukon Corporation Limited
1985 Annual Report

Directors' Report to Shareholders

DIRECTORS

*John F. Fraser,
Winnipeg, Manitoba
Thomas H. King,
Winnipeg, Manitoba
Augustus S. Leach, Jr.,
Winnipeg, Manitoba
*Arthur V. Mauro,
Winnipeg, Manitoba
John S. Pelton,
Winnipeg, Manitoba
*J. Derek Riley,
Winnipeg, Manitoba
Stewart A. Searle,
Winnipeg, Manitoba

OFFICERS

J. F. Fraser,
Chairman of the Board
T. H. King,
President and Chief Executive Officer
M. P. Taylor,
Executive Vice-President and Chief Operating Officer
T. J. Martin,
Vice-President, Administration
H. W. Wray
Vice-President, Financial Planning
A. M. Stewart,
Secretary

HEAD OFFICE

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Whitehorse, Yukon
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REGISTRAR AND TRANSFER AGENT

The Royal Trust Company
Vancouver, Calgary,
Toronto, Montreal

*Member of Audit Committee

1985 SUMMARY

Net earnings before extraordinary items for the year ended December 31, 1985 were $4,262,000 or $2.06 per common share, compared to earnings of $3,020,000 or $1.40 per common share in 1984. Revenue in 1985 totalled $171,841,000 compared to $137,004,000 in 1984.

In 1984 there was an extraordinary charge to income in the fourth quarter of $15.2 million or $8.05 per share, reflecting the write-down of selected railway and related assets of the Company. As a result of this extraordinary charge in 1984 the net earnings for the year were reduced to a loss of $6.65 per share. There were no extraordinary items in 1985.

OPERATIONS

Earnings before income taxes were up 51% in 1985 on the strength of a 25% increase in sales volume to $171.8 million.

The major contributor to this sales growth was the September acquisition of Direct Transportation System, a $100 million-a-year Toronto-based trucking company. Operating profit improvement came mainly at Motorways Direct and in White Pass' Northern operations.

The merger of Motorways and Direct Transportation marked an important milestone by balancing the division's national presence and reducing fixed costs as a percent of sales through terminal rationalization. The result is one of Canada's five largest less-than-truckload carriers, with the profitability and financial strength to prosper in the coming changes from deregulation. Prospects for 1986 are for enhanced returns.

Northern operations' sales, including White Pass Systems, grew by 33% and operating profits by over 80%, reflecting higher sales and better margins in petroleum distribution due to enhanced cost control and increased profits from Skagway, Alaska port management. Results for 1986 should improve as a result of increased activity connected with the opening of the Cyprus Anvil mine. White Pass has entered into an agreement to provide Curragh Resources, the mine's new owner, with terminalling facilities in Skagway, Alaska for transshipment of lead/zinc concentrate. Shipments from the mine are expected to begin in the third quarter of 1986.

White Pass Systems, the drill-rig and specialty hauling division, enjoyed sales of $12 million, up $8 million from 1984, primarily as a result of the acquisition of Ron Jackson Transport. However, profitability was reduced significantly on a bad debt created by the bankruptcy of Exco, a major independent drilling company. Recent declines in oil prices will reduce this operation's available markets in the second half of 1986, and management is planning for redeployment of assets at that time.

On behalf of the Board of Directors,

John F. Fraser
Chairman of the Board

Thomas H. King
President and Chief Executive Officer

March 31, 1986

Consolidated Statement of Earnings

for the year ended December 31, 1985

	$000 1985	$000 1984
Revenue		
Northern operations	$ 42,242	$ 31,586
Freight hauling services	129,599	105,418
	171,841	137,004
Expenses		
Cost of sales and operating expenses	155,933	125,726
Depreciation	4,222	4,048
Interest on long term debt	4,860	4,621
Other interest expense	562	623
Interest earned	(765)	(225)
Management fees	432	–
Gain on sale of fixed assets	(1,043)	(2,855)
	164,201	131,938
Earnings before income taxes and extraordinary item	7,640	5,066
Provision for (recovery of) income taxes		
Current	97	(167)
Deferred	3,281	2,213
	3,378	2,046
Net earnings before extraordinary item	4,262	3,020
Extraordinary item (Note 4)	–	15,219
Net earnings (loss) for the year	$ 4,262	$ (12,199)
Net earnings (loss) per common share		
Before extraordinary item	$ 2.06	$ 1.40
Extraordinary item	–	(8.05)
Including extraordinary item	$ 2.06	$ (6.65)

See accompanying notes to consolidated financial statements.

Consolidated Balance Sheet
as at December 31, 1985

ASSETS	1985 ($000)	1984 ($000)
Current		
Cash	$ 145	$ 211
Accounts receivable	39,712	23,957
Income taxes recoverable	1,609	1,575
Inventories (Note 5)	7,945	7,936
Prepaid expenses	2,122	942
Advances to parent company	7,403	—
Total current assets	58,936	34,621
Fixed (Note 6)		
Property and equipment	140,817	116,653
Less accumulated depreciation	57,666	56,907
	83,151	59,746
Other		
Mortgages and agreements receivable	369	106
Deferred charges	640	523
Intangible assets	3,816	1,542
	4,825	2,171
	$146,912	$ 96,538

Approved by the Board

Director

Director

See accompanying notes to consolidated financial statements.

	$000	
LIABILITIES	1985	1984
Current		
Bank indebtedness	$ 238	$ 3,746
Accounts payable and accrued liabilities	37,723	19,034
Due to parent company	—	1,966
Current portion of long term debt	4,854	1,521
Total current liabilities	42,815	26,267
Long term debt (Note 7)	72,094	40,474
Deferred income taxes	4,661	6,346
Total liabilities	119,570	73,087
Contingencies and commitments (Note 12)		
SHAREHOLDERS' EQUITY		
Capital stock		
Authorized		
500,000 cumulative, redeemable, preferred shares, with a par value of $25 each, issuable in series and redeemable at $25.25 each		
12,000,000 common shares, without par value		
Issued and fully paid		
220,000 6¾% preferred shares, Series A	5,500	5,500
1,891,516 common shares	4,783	4,783
Retained earnings	17,059	13,168
	27,342	23,451
	$146,912	$ 96,538

Consolidated Statement of Changes in Financial Position

for the year ended December 31, 1985

	$000	
	1985	1984
Operating activities		
Net earnings (loss) for the year	$ 4,262	$ (12,199)
Depreciation	4,222	4,048
Amortization of deferred charges	62	13
Deferred income taxes	3,181	2,213
Gain on sale of fixed assets	(1,336)	(2,855)
Extraordinary item	–	9,980
Working capital from operations	10,391	1,200
Accounts receivable	(2,787)	(876)
Accounts payable and accruals	(5,050)	636
Advances to parent company	(6,869)	1,966
Reclassifications of current and non-current items	300	1,254
Other	1,540	2,533
Net cash from (used in) operations	(2,475)	6,713
Financing activities		
Increase in deferred charges	(179)	–
Increase in long term receivable	(263)	–
Decrease in long term debt	(12,029)	(6,160)
Increase in long term debt	431	3,704
Acquisition of subsidiary companies		
Long term debt assumed	21,458	–
Long term debt retired	(17,112)	–
Long term debt due to parent company	39,402	–
Advances from parent and affiliated companies	–	2,269
Dividends	(371)	(371)
Total financing activities	31,337	(558)
(Carried-forward)	$ 28,862	$ 6,155

	1985	1984
	$000	
Investing activities		
Investment in subsidiary	(4)	–
Acquisition of subsidiary		
Working capital, excluding cash	8,888	–
Fixed assets	(26,628)	–
Other non-current assets acquired	(7,130)	–
Purchase of fixed assets	(5,201)	(7,350)
Proceeds of sale of fixed assets	4,807	4,031
Other assets	(152)	57
Total investing activities	(25,420)	(3,262)
Increase in cash	3,442	2,893
Cash funds, beginning of year	(3,535)	(6,428)
Cash funds, end of year	$ (93)	$ (3,535)
Cash funds		
Cash	$ 145	$ 211
Bank indebtedness	(238)	(3,746)
Cash funds	$ (93)	$ (3,535)

See accompanying notes to consolidated financial statements.

Consolidated Statement of Retained Earnings
for the year ended December 31, 1985

	$000	
	1985	1984
Balance at beginning of year	$ 13,168	$ 25,738
Net earnings (loss) for the year	4,262	(12,199)
	17,430	13,539
Dividends		
Preferred shares	371	371
Balance at end of year	$ 17,059	$ 13,168

See accompanying notes to consolidated financial statements.

AUDITORS' REPORT

The Shareholders,
The White Pass and Yukon Corporation Limited.

We have examined the consolidated balance sheet of The White Pass and Yukon Corporation Limited as at December 31, 1985 and the consolidated statements of retained earnings, earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Company as at December 31, 1985 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied, except for the change in the method of accounting for investment tax credits as described in Note 2, on a basis consistent with that of the preceding year.

Vancouver, B.C.
February 17, 1986

Touche Ross & Co

Chartered Accountants

Notes to Consolidated Financial Statements
December 31, 1985

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a. Principles of consolidation

The consolidated financial statements include the accounts of the Company and the wholly-owned subsidiaries as follows:

- British Columbia-Yukon Railway Company
- The British Yukon Railway Company
- Nissan Diesel (Canada) Ltd.
- White Pass Systems Ltd.
- White Pass Transportation Limited, and its subsidiary companies:
  - T & H Cariboo Transport (1958) Ltd.
  - Canadian Motorways Ltd. and its subsidiary companies:
    - Motorways (1980) Limited
    - Cougar Freight Systems Limited
    - La Compagnie Motorways (Quebec) Limitée
    - Demanagement Hill Securite Inc.
    - Motorways Inc.
    - Direct Transportation System Limited
    - Transport Direct System Limitée
    - D.T.S.L. Equity Investments Ltd.
    - D.T.S.L. Holdings Ltd.
    - Direct Winter Transport Ltd.
    - 477599 Ontario Limited
- Yukon Pipelines Limited
- Triad Transport Ltd.
- White Pass Transportation, Inc. and its subsidiary companies:
  - Haines Terminal & Highway Company
  - Pacific and Arctic Pipelines Incorporated
  - Pacific and Arctic Railway and Navigation Company
  - Skagway Terminal Company

All material inter-company balances, transactions and profits have been eliminated.

b. Inventories

Inventories of bulk petroleum products and other products held for resale are valued at the lower of cost applied on a "first-in, first-out" basis and market determined at net realizable value; inventories of other products and materials and supplies are valued at the lower of average cost and net realizable value or replacement cost.

c. Fixed assets and depreciation

Fixed assets are recorded at cost. All equipment leases of a capital nature entered into subsequent to 1977 have been recorded as fixed asset acquisitions and long-term debt obligations. Depreciation is determined at rates which amortize the cost of the assets over their estimated useful lives on the straight-line, declining balance or volume of use method, whichever is appropriate in the circumstances under which the assets are employed. No depreciation is recorded on idle assets or equipment held for sale. Gains and losses on disposal of equipment and real property are included in earnings.

d. Deferred charges

Deferred charges include (i) a foreign exchange loss on long term debt which is repayable in United States dollars (ii) finance charges incurred in securing long term debt, both of which are being amortized over the remaining terms of the respective debts.

e. Intangible assets

Intangible assets represent licenses, operating rights and franchises which are not being amortized.

f. Income taxes

The Company follows the tax allocation method of accounting for income taxes whereby earnings are charged with income taxes relating to reported earnings.

Differences between such taxes and taxes currently payable are reflected in deferred income taxes and arise because of differences between the time certain items of revenue and expense are reported in the accounts and the time they are reported for income tax purposes.

Potential tax reductions that may result from the application of losses against future taxable income are not recognized unless recovery out of future taxable income is virtually certain.

g. Net earnings (loss) per common share

Net earnings (loss) per common shares has been computed by dividing the net earnings (loss) for the year less the preferred share dividends paid during the year by the number of common shares outstanding during the year.

h. International accounting standards

The accompanying financial statements are prepared in accordance with accounting principles generally accepted in Canada and conform in all material respects with international accounting standards.

2. CHANGE IN ACCOUNTING POLICY

In accordance with the recommendation of the Canadian Institute of Chartered Accountants, the Company changed the method of accounting for investment tax credits from the flow through method to the cost reduction method. The Company has applied this accounting change on a prospective basis and accordingly, in 1985, tax credits amounting to $625,000, have been applied against the related qualifying capital expenditures. During 1984, investment tax credits amounting to $506,000 were accounted for as a reduction of the current tax provision.

3. ACQUISITION OF SUBSIDIARY COMPANY

Effective September 27, 1985 the Company acquired a 100% interest in the Direct Transportation System group of companies, a truck transport organization carrying on freight hauling business. The results from operation of these companies are included in the accounts from the date of acquisition.

This acquisition, which was accounted for by the purchase method, is summarized as follows:

Net assets acquired at fair market values at acquisition date	
Current assets	$ 15,074,502
Current liabilities	(27,521,667)
	(12,447,165)
Fixed assets	26,627,555
Other non-current assets	7,277,840
Long term debt assumed	(21,458,230)
	$ –

Under the terms of the acquisition agreement, the Company advanced approximately $23,200,000 at the time of closing to enable Direct to repay certain secured indebtedness and to purchase additional debt of Direct from its creditors. The vendors may receive additional consideration if the profitability of the Company for the 1986 fiscal year exceeds certain target levels.

4. *SUSPENSION OF RAILWAY OPERATIONS*

In October 1982, the Company suspended its railway operations pending a recommencement of mining operations in the Yukon. In December 1984, the Canadian government decided that it should support year round commercial operation of a road running parallel to the railway. Accordingly, the directors of the Company concluded that permanent impairment had resulted in the Company's investment in the railway and its related assets. These impaired assets were written down to net realizable value in 1984.

5. *INVENTORIES*

	$000 1985	$000 1984
Petroleum products held for sale	$ 5,195	$ 6,151
Tires, batteries and accessories held for sale	542	434
Spare parts and supplies	2,208	1,351
	$ 7,945	$ 7,936

6. *FIXED ASSETS*

	$000 1985 Cost	$000 1985 Accumulated depreciation	$000 1985 Net	$000 1984 Net
Northern Operations				
Storage facilities	$ 4,151	$ 1,089	$ 3,062	$ 3,335
Pipeline	1,174	882	292	345
Skagway Terminal	6,629	4,468	2,161	2,193
Rail	798	357	441	483
Ship and containers	954	927	27	27
Automotive equipment	10,826	6,619	4,207	4,241
Land and buildings	4,663	1,994	2,669	2,740
Machinery and equipment	2,418	1,260	1,158	920
	31,613	17,596	14,017	14,284
Freight hauling services				
Automotive equipment	53,982	33,267	20,715	8,434
Land and buildings	25,635	2,802	22,833	15,882
Machinery and equipment	9,492	4,001	5,491	4,734
	89,109	40,070	49,039	29,050
Assets held for sale	20,095	–	20,095	16,412
	$140,817	$57,666	$83,151	$59,746

Included in the amounts reported above are assets under capital leases of $4,360,000 (1984 – $3,281,000) and related accumulated depreciation thereon of $1,243,000 (1984 – $1,659,000).

7. *LONG TERM DEBT*

	$000 1985	$000 1984
Due to parent company, payable on demand.		
The parent company does not intend to call these loans during 1986.		
Secured by the company's investment in Canadian Motorways Ltd.		
Interest at ½% above prime rate per annum	$21,061	$ 1,164
Non-interest bearing	20,840	–
Unsecured		
Interest at 12% per annum	18,861	–
	60,762	1,164
Alaska Industrial Development Authority Port Facility, 13¾% bond, 1985 to 1998	4,905	5,080
Government of Canada non-interest bearing loan, secured by certain rail assets	4,500	4,750
Mortgages, 10⅝%, 11¼%, 1987 to 1990	2,746	3,397
Capitalized lease obligations, 8.2%-18.0%	2,749	1,784
Promissory note, 15%, secured, 1986 to 1987	1,280	1,280
Other	6	30
Due to an affiliated company	–	17,695
Bank loan, ¼% above prime rate	–	6,400
Bank loan, ½% above U.S. prime rate	–	415
	76,948	41,995
Less current portion	4,854	1,521
	$72,094	$40,474

The aggregate amount of maturities over the next five years, excluding demand loans with parent company, is approximately as follows: 1986 – $2,534,000; 1987 – $2,682,000; 1988 – $1,620,000; 1989 – $799,000; 1990 – $766,000.

8. *INCOME TAXES*

a. The Company's effective income tax rate is derived as follows:

	1985	1984
Average combined tax rate	53.1%	51.5%
Inventory tax allowances	(1.4)	(2.4)
Reduced rate on capital gains	(4.4)	(3.6)
(Recorded) unrecorded tax benefits related to losses of subsidiary companies	(2.0)	8.2
Investment tax credits	(0.3)	(11.7)
Foreign exchange	(0.6)	(1.1)
Other	(0.2)	(0.1)
Average effective tax rate	44.2%	40.4%

b. Certain subsidiaries of the Company have tax loss carry forwards of approximately $3,468,000 and investment tax credit carry forwards of approximately $1,817,000 available to reduce future taxable income and taxes payable. The potential benefit of these carry forwards will be recorded as the benefits are received. In addition, certain subsidiaries have losses of $7,789,000 for tax purposes available to be applied against future taxable income. The benefit of these tax losses has been reflected as a reduction of deferred income taxes payable.

9. *REMUNERATION OF DIRECTORS AND OFFICERS*

	Number 1985	Number 1984	Amount 1985	Amount 1984
As directors	7	7	$ 6,000	$ 6,000
As officers	7	5	$434,500	$354,100

10. *SEGMENTED INFORMATION*

	$000			
	1985		1984	
	Revenue	Segment Margin	Revenue	Segment Margin
Northern operations	$ 42,512	$ 4,219	$ 32,040	$ 2,536
Freight hauling services	129,952	8,078	105,418	7,549
	172,464	12,297	137,458	10,085
Inter-segment transactions	623	–	(454)	–
	$171,841	12,297	$137,004	10,085
Interest expense		5,422		5,244
Interest income		(765)		(225)
		4,657		5,019
Earnings from operations		7,640		5,066
Provisions for income taxes		3,378		2,046
Net earnings before extraordinary item		4,262		3,020
Extraordinary item		–		15,219
Net earnings (loss)		$ 4,262		$(12,199)
Capital expenditures				
Northern operations		$ 1,315		$ 3,346
Freight hauling services		3,886		4,047
Acquisition of subsidiary		26,628		–
		$31,829		$ 7,393
Depreciation				
Northern operations		$ 1,140		$ 951
Freight hauling services		3,082		3,097
		$ 4,222		$ 4,048

11. *RELATED PARTY TRANSACTIONS*

a. The Company recorded the following intercompany transactions during the year:

	$000 1985	$000 1984
i) Parent company		
Interest expense	$2,724	$1,075
Management fee	$ 432	$ 20
Interest income	$ 671	$ 225
Reimbursement for direct costs paid on behalf of the Company	$ 347	$ 538
ii) Affiliated company		
Interest expense	$ 417	$1,106

12. *CONTINGENCIES AND COMMITMENTS*

a. A subsidiary of the Company has guaranteed certain bank indebtedness of Federal Industries Ltd. to a maximum of $10,000,000. Effective January 16, 1986, this guarantee was released, as on that date the bank indebtedness of Federal Industries Ltd. became unsecured.

b. The Company has commitments under operating leases to make the following minimum lease payments:

	$000
1986	$1,985
1987	1,514
1988	789
1989	459
1990	342
	$5,089

c. The Company has committed to the purchase of automotive equipment in the amount of $13,885,000, which will be received in 1986.

d. A subsidiary of the Company and other members of The Western Tariff Bureau, an association of trucking companies, were charged in 1981 under the provisions of the Companies Investigation Act (Canada). The charges allege that the members of the bureau have breached the prohibition against price fixing in the Act since 1962 by publishing freight tariffs. The preliminary hearing on the charges has not yet been held. At the present time, the Company is not able to estimate the probability of loss, if any, arising from this action.

13. *RESTATE OF PRIOR YEAR'S BALANCES*

Certain of the 1984 comparative balances have been restated to conform with the presentation adopted in 1985.