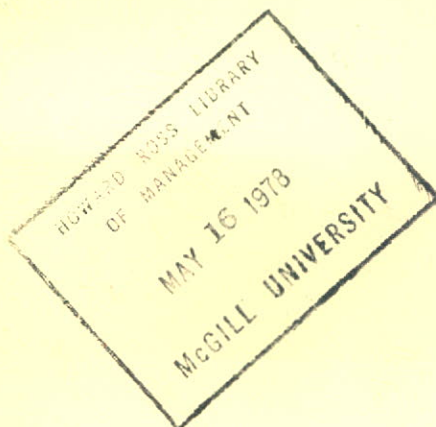


C

1977 ANNUAL REPORT

Wardair International



Wardair International Ltd.

Board of Directors

Maxwell W. Ward	Chairman and President Wardair International Ltd.
M.D. Ward	Secretary-Treasurer Wardair International Ltd.
T.L. Spalding	Executive Vice-President Wardair International Ltd.
W.T. Brown *	Chairman Odlum Brown and T.B. Read Ltd.
J.N. Hyland *	Consultant
G.D. Curley *	Vice President, Marketing Wardair International Ltd.

* members of audit committee

Officers and Senior Management

Maxwell W. Ward	Chairman and President
T.L. Spalding	Executive Vice-President
M.D. Ward	Secretary-Treasurer
G.D. Curley	Vice-President, Marketing
N.A. Patterson	Vice-President, Finance
F.S. Dornan	Staff Vice-President
G.N.R. Bell	Staff Vice-President
T.B. Dunnigan	Assistant Treasurer, Planning
N.J. Parsons	Assistant Treasurer, Operations
D.R. Rouse	Director, Customer Relations and Consumer Affairs
B.R. Corbett	Director, Organizational Development
I.C. Wilkie	Manager, Legal Services

Financial Highlights

	1977	1976
Revenues	\$110,665,000	\$89,685,000
Operating costs, before depreciation and amortization	97,087,000	78,610,000
Depreciation and amortization	5,820,000	5,279,000
Earnings from operations	7,758,000	5,796,000
Interest on long term debt	3,924,000	4,759,000
Net earnings for year	3,834,000	1,037,000
Operating margin	7.0%	6.5%
Return on total capital	13.6%	9.7%
Earnings per common share	\$1.08	\$.22
Dividends per common share	\$.06	\$.06

The Annual Meeting of Shareholders will be held at 11:00 a.m. (M.D.T.) on May 19, 1978 at the head office of Wardair International Ltd., 2201 Toronto Dominion Tower, Edmonton Centre, Edmonton, Alberta.

To Our Shareholders and Employees

The successful financial performance of your company in 1977 was achieved despite the continuing escalation of operating costs and adverse currency exchange conditions. Management believes these results can be attributed to an aggressive marketing policy which increased demand for 'Holidays by Wardair' products and the continued high productivity of the Wardair fleet. In summary:

- Consolidated earnings for 1977 were \$3,834,000 compared with \$1,037,000 in 1976.
- Earnings per common share in 1977 after providing for preferred share dividends were \$1.08 compared with 22¢ per share in 1976.
- Consolidated revenues for the year were \$110,665,000 compared to \$89,685,000 in 1976, an increase of 23.4%.
- Operating costs increased 22.7% from 1976 to \$102,907,000.

Increases in non-controllable costs such as fuel and airport user charges, together with labour costs, continue to plague our industry. The only remedy for combating these costs, without major increases in the prices of our products, is to improve the efficiency and productivity of operations. This is becoming increasingly difficult given the strict regulatory framework within which charter carriers are forced to operate in Canada.

The International Charter Market

Regulation will have a major impact on Wardair's future growth in the international charter market. Charter carriers cannot achieve optimum load factors when utilization of fleet capacity is hampered by government restrictions. For example, under regulations set forth by the Air Transport Committee of the Canadian Transport Commission (CTC), charter carriers cannot:

- carry Advance Booking Charter (ABC) and Inclusive Tour Charter (ITC) passengers on the same aircraft;
- mix Canadian originating and foreign returning passengers (and vice versa) on the same flight;
- transport passengers and freight on the same aircraft.

Internationally, some progress was made during 1977 in the move toward deregulation in the charter airline industry. The United States Civil Aeronautics Board, the Civil Aviation Authority in the U.K., and several European countries made major changes to charter regulations giving charter carriers the flexibility required to make air travel more readily available to the public.

Your company has made strong representations to the CTC, urging it to liberalize charter regulations in Canada. If the CTC acts on these requests it will enable us to compete on equal ground with scheduled carriers' part-charters and promotional fares which are not subject to the restrictions imposed upon charter carriers.

Quite simply, to sell its product effectively, your company needs the same flexibility and market accessibility enjoyed by its competitors.

The Domestic Charter Market

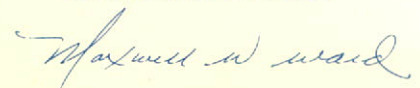
In 1977 the Canadian Transport Commission authorized domestic ABC air travel between Canadian cities. Wardair intends to participate in domestic ABC service in 1979 and is now taking steps to obtain the necessary licenses to operate Wardair's wide-bodied jet aircraft between major Canadian cities. Management believes that charter flights within Canada at a reasonable cost will appeal to Canadians and visitors to Canada alike, and help reduce the national travel deficit.

In Summary

It should be noted that 1978 marks Wardair's 25th year in business. Over these years we have built a solid reputation for quality air transportation dedicated to serving the needs of both the holiday traveller and the unique requirements of the north.

A large measure of our success is directly attributable to support from the loyal and hard-working employees of all Wardair companies. With the same support, we are confident that our short term problems will be solved and we will be able to take full advantage of our long term opportunities.

On behalf of the Board



Maxwell W. Ward,
Chairman and President

Review of Operations

WARDAIR INTERNATIONAL LTD.

In 1977 Wardair International established a corporate head office management team to provide overall policy, planning and direction to its subsidiaries in the areas of financial planning, employee relations, legal services and customer service and consumer affairs.

WARDAIR CANADA (1975) LTD.

Wardair Canada (1975) Ltd. is the airline subsidiary of Wardair International Ltd. which operates a fleet of jet aircraft serving the international holiday charter market, and a fleet of turbo prop aircraft chartered by both government and private industry in the Canadian north.

Northern Division

The northern fleet consists of six de Havilland Twin Otter aircraft and one Grumman Gulfstream 1. The Grumman Gulfstream was acquired in 1977 by purchasing G1 Leasing Ltd., which owned the aircraft and leased it to the Government of the Northwest Territories.

In January 1978 the Mitsubishi MU 2 was sold at a small loss.

In 1977 Wardair Canada announced plans to purchase two de Havilland Dash 7 STOL (short take-off and landing) aircraft for its Northern Division. Ideally suited to the rugged terrain and weather conditions of the north, the Dash 7s will have a convertible configuration to allow the transportation of passengers or cargo (or both).

The Dash 7s will join the northern fleet in 1978, and the company plans to offer 'Holidays by Wardair' ITC packages to the Northwest Territories and the

Yukon in 1979.

Although revenues from the northern operation did not meet forecasts, the division still made a profit contribution to your company in 1977.

International Division

Wardair's international fleet operates from the Canadian cities of Vancouver, Edmonton, Calgary, Winnipeg, Toronto and Montreal to a variety of holiday destinations. These include the United Kingdom, Europe, the continental U.S.A., the Caribbean, Mexico, Hawaii and South America.

In 1978, Ottawa will become the seventh Canadian city served by Wardair with the operation of ABC flights to Britain.

Wardair charts its aircraft to tour operators such as International Vacations Ltd. (Intervac), a subsidiary of Wardair International Ltd., and Skylark Holidays Ltd. Tour operators, in turn, market ABC flights and ITC packages directly to the public or through travel agents.

Wardair's 1976 annual report discussed the company's plans to acquire two additional Boeing 747 aircraft for delivery in April 1978 and March 1979 respectively, and two McDonnell Douglas DC-10-30 aircraft for delivery in May 1978.

Labour problems experienced by both suppliers have delayed aircraft production and as a result, deliveries have been rescheduled as follows:

1 Boeing 747-200B	June 1978
1 McDonnell Douglas DC-10-30	Nov. 1978
1 McDonnell Douglas DC-10-30	Dec. 1978
1 Boeing 747-200B	Mar. 1979

Arrangements have been made

to retain the existing two Boeing 707-320C aircraft until the new DC-10-30s are in operation at which time the 707s will be retired from service as originally planned.

While planned revenues for 1978 will decrease as a result of the delays, substantial costs relative to the new aircraft acquisition will not be incurred as early as expected.

When this expansion program is completed in March, 1979, Wardair's international fleet will consist of six wide-bodied aircraft: two Boeing 747-100s, two Boeing 747-200s and two McDonnell Douglas DC-10-30 aircraft.

International Fleet Utilization

Average aircraft utilization was 11.6 hours per day in 1977. This achievement is noteworthy because it placed Wardair among the leaders in aircraft utilization throughout the world. In addition, passenger load factors in 1977 far exceeded marketing objectives.

These two factors provided the high level of productivity necessary for a charter carrier to operate profitably on yields considerably lower than the average yields of scheduled carriers.

Edmonton Hangar

In May 1977 Wardair's maintenance department moved into a new hangar and maintenance headquarters at Edmonton International Airport. The hangar is leased from the Government of Alberta through Pacific Western Airlines.

The modern, 120,000 sq. ft. hangar is large enough to house a wide-bodied 747 aircraft and also contains 41,000 sq. ft. of shops and service areas, and 14,000 sq. ft. of offices and training rooms.

INTERNATIONAL VACATIONS LTD.

International Vacations Ltd. (Intervac), has become one of the largest wholesalers and tour operators in Canada. Intervac charters the majority of the aircraft capacity it requires from Wardair Canada and markets 'Holidays by Wardair' — the brand name for Wardair vacation products — directly to the public or through travel agents.

Approximately 90% of Intervac's sales are made through more than 3,000 retail travel agents across Canada. Sales offices serving travel agents are located in Vancouver, Calgary, Edmonton, Winnipeg and Toronto. In 1977, a sales office was opened in Montreal and ABC service from Montreal to Miami and Tampa was introduced in December.

Reservation offices are located in Vancouver, Edmonton and Toronto with toll free lines serving Canada and U.S. border cities. During the past year Intervac expanded its computer network to include Honolulu, Hawaii and London, England.

Sales of onward travel products — hotel accommodation, car rental and escorted coach tours — continued to gain acceptance in 1977 and this market will be further developed in 1978.

New Destinations

New destinations developed by Intervac in 1977 include ITC packages to Cartagena, Colombia; ABC flights to Los Angeles, California; and the introduction of a fly and cruise ITC program in the Caribbean.

The fly and cruise program was launched in the summer of 1977 when Intervac marketed a pilot cruise package to the Mediterranean in conjunction with Thomson Holidays of the U.K.

Because of the success of this experiment, Intervac chartered the M.V. Jupiter from Epirotiki Lines, of Athens, Greece.

Caribbean and Mediterranean cruise packages have been developed and are being sold under the brand name 'Holidays by Wardair'.

From December 1977 to April 1978, Intervac offered seven and fourteen-night cruises, flying passengers via Wardair 747 from Toronto to Barbados where the cruise began.

In its first season with this new product, Intervac captured a large segment of the growing Canadian cruise market.

The program will be continued throughout the summer of 1978 when the Jupiter sails the Mediterranean for 'Holidays by Wardair' on seven and fourteen-night cruise holidays.

Intervac has also arranged to wholesale the cruise portion of the holiday to tour operators in other countries.

In 1977 Intervac took over the marketing and operating of all ground handling and tour arrangements — escorted coach tours and transportation of passengers and baggage between airports and hotels — for Wardair ABC and ITC customers in Hawaii. In addition, three client service centres were opened on the island of Oahu to better serve the growing number of Wardair passengers visiting Hawaii each year.

Throughout the year, Intervac continued to expand its 'Holidays by Wardair' line and moved closer to the concept of vertically integrated Wardair/Intervac holiday packages.

WARDAIR (U.K.) LIMITED

This subsidiary is the British outlet for the sale of Wardair ABC flights from London, Manchester and Prestwick to Canadian destinations. In response to strong market demand in 1977, the number of seats offered from the U.K. to Canada has been substantially increased for 1978. Management expects continued growth in this market.

WARDAIR HAWAII LIMITED

In 1977 Wardair Hawaii Ltd. concluded preliminary negotiations for the purchase of 110 one-bedroom condominium apartments in the Waikiki Banyan project on Kuhio Avenue and Ohua Street, two short blocks from Waikiki Beach.

Initially, Wardair Hawaii plans to rent these units to Intervac and other tour operators for short-term holiday occupancy. Wardair Hawaii will continue to evaluate other Hawaiian hotel and condominium properties for acquisition by purchase or lease.

WARDAIR JAMAICA LIMITED

Wardair Jamaica Ltd. remained inoperative in 1977 and management has no plans to reactivate this subsidiary in the immediate future.

EMPLOYEES

Wardair has been fortunate over the years in its ability to attract the high-calibre people so important to

a service-oriented industry. It is the friendly, courteous and efficient employees in all areas of the company that have helped it gain a reputation for providing the travelling public with first-rate service.

In 1977, improvements were made to the Wardair Employee Retirement Plan, the cost of which is to be funded by the company. The major improvement to the plan was an increase in pension benefits for service to the end of 1976 by adjustment of earnings for pension purposes to the 1976 earnings level.

On July 29, 1977 Wardair Canada (1975) Ltd. reached agreement with the Canadian Airline Flight Attendants Association (CALFAA) covering wages and conditions of employment for the one-year period commencing April 1, 1977. This agreement has yet to be approved by the Federal Anti-Inflation Board.

Terms of a new agreement are being negotiated.

The collective agreement between Wardair Canada (1975) Ltd. and the International Association of Machinists and Aerospace Workers (IAM) covering certain maintenance employees expired on June 30, 1977 and the terms of a new agreement have not been concluded.

The Air Crew Association of Canada (ACAC) contract on behalf of flight officers and flight engineers on Wardair's International operations was renewed on July 1, 1977 for a one-year period. This agreement is also pending approval by the Anti-Inflation Board.

Non-union employee compensation plans and levels are under constant review by management. Compensation for several groups and classifications of employees are

currently under review by the Anti-Inflation Board.

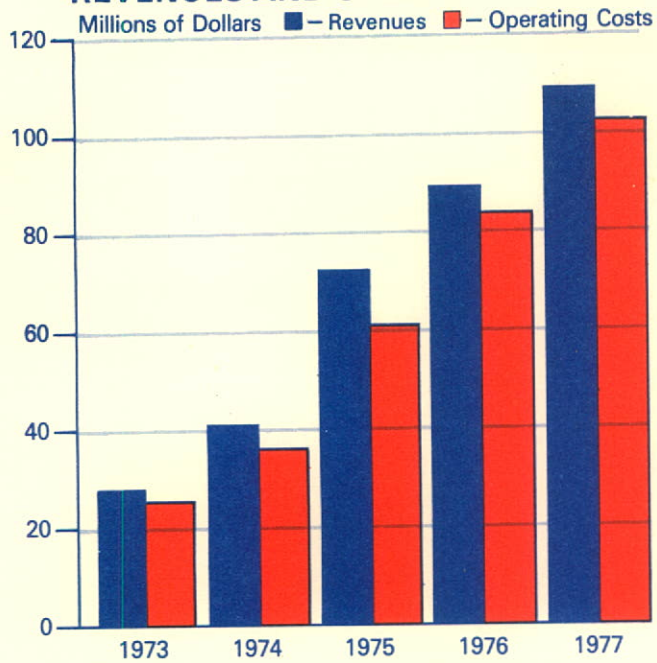
OUTLOOK FOR 1978

The winter holiday market to sunspot destinations has shown a sizeable improvement over the same period last year and a profitable first quarter is expected for 1978.

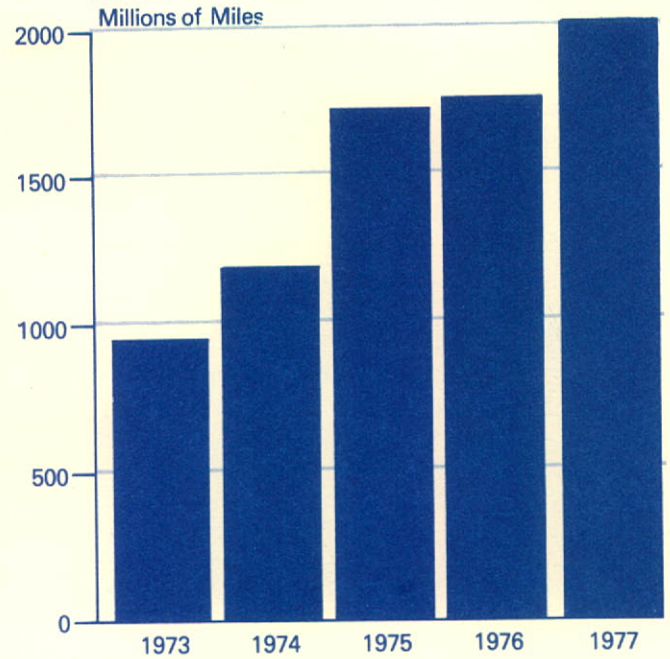
While the delay in delivery of one 747-200B and two DC-10-30 aircraft is disappointing, management believes that by retaining the two 707-320C aircraft until the delivery of the DC-10s, the company will not lose its strong position in the marketplace.

As noted earlier in this report, if remedial changes to Canadian charter regulations are made promptly, allowing charter carriers access to the market on a fair, competitive basis, your company should realize satisfactory results in 1978.

REVENUES AND OPERATING COSTS



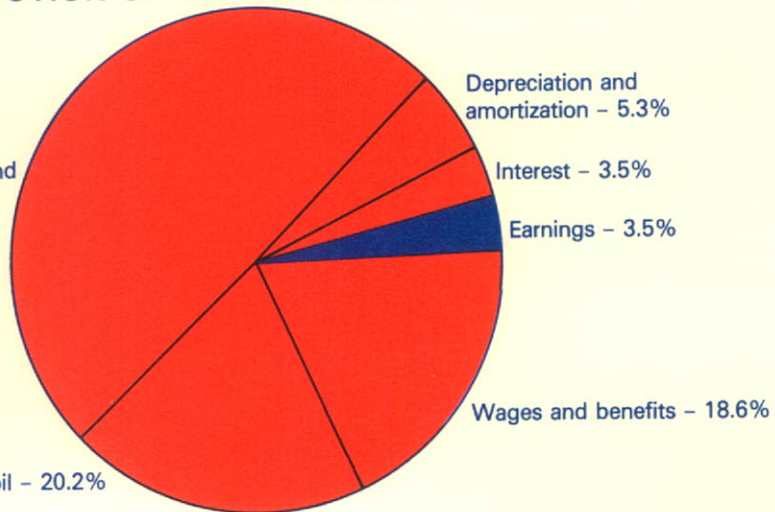
INTERNATIONAL PASSENGER MILES



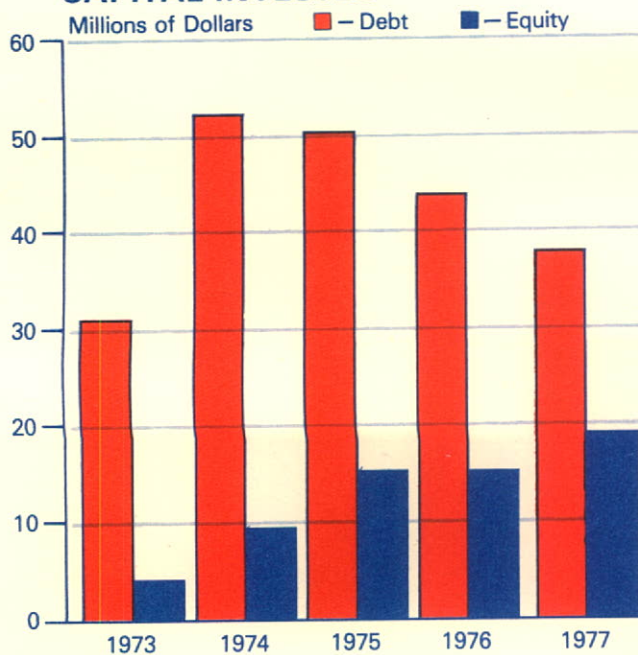
DISTRIBUTION OF THE 1977 REVENUE DOLLAR

Other supplies and services including land tour package expenses - 48.9%

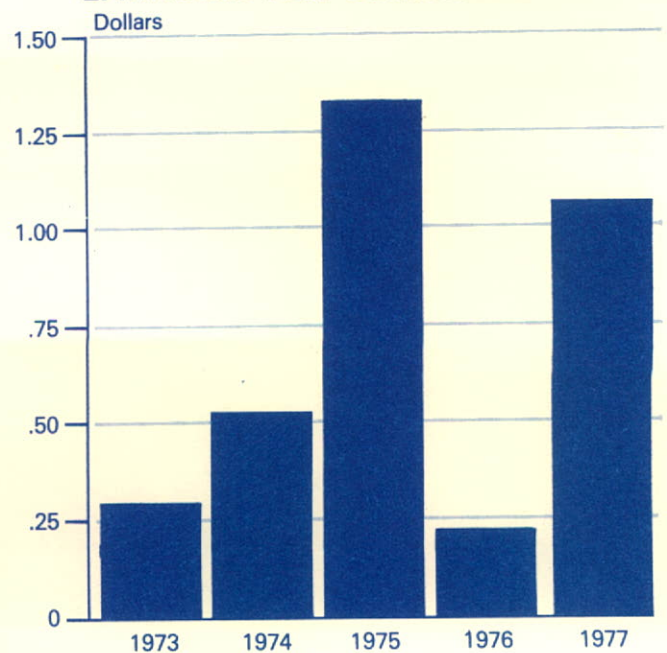
Fuel and oil - 20.2%



CAPITAL INVESTED



EARNINGS PER COMMON SHARE



WARDAIR INTERNATIONAL LTD.
And Subsidiary Companies

CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 1977
(In Thousands of Dollars)

STATEMENT OF EARNINGS

	1977	1976
REVENUES (note 2)	<u>\$110,665</u>	<u>\$89,685</u>
EXPENSES		
Operating	82,073	65,661
Marketing and administration	15,014	12,949
Depreciation	5,400	5,062
Amortization of deferred charges	<u>420</u>	<u>217</u>
	<u>102,907</u>	<u>83,889</u>
Earnings from operations	7,758	5,796
Interest on long term debt	<u>3,924</u>	<u>4,759</u>
NET EARNINGS (note 10)	<u>\$ 3,834</u>	<u>\$ 1,037</u>
EARNINGS PER COMMON SHARE (in dollars)		
Calculated after providing for annual dividends on preferred shares	<u>\$1.08</u>	<u>\$0.22</u>
Fully diluted earnings per common share, assuming conversion of all preferred shares is calculated at \$0.94 in 1977. Conversion had no dilutive effect in 1976.		

STATEMENT OF RETAINED EARNINGS

	1977	1976
BALANCE AT BEGINNING OF YEAR	\$11,543	\$11,027
NET EARNINGS	<u>3,834</u>	<u>1,037</u>
	<u>15,377</u>	<u>12,064</u>
DIVIDENDS DECLARED		
Preferred shares	288	324
Common shares	<u>197</u>	<u>197</u>
	<u>485</u>	<u>521</u>
BALANCE AT END OF YEAR	<u>\$14,892</u>	<u>\$11,543</u>

BALANCE SHEET

ASSETS

CURRENT ASSETS

Cash and short term investments (note 3)
Accounts receivable
Inventories
Deposits and prepaid expenses

FIXED ASSETS, at cost

Flight equipment
Land, buildings and ground facilities

Less accumulated depreciation

DEFERRED CHARGES (note 4)

LIABILITIES & SHAREHOLDERS' EQUITY

CURRENT LIABILITIES

Accounts payable and accrued liabilities
Dividends payable
Charter prepayments
Long term debt — current maturities

LONG TERM DEBT (note 5)


SHAREHOLDERS' EQUITY

Capital Stock
Authorized —
300,000 12% cumulative redeemable non-voting convertible preferred shares of \$10 each par value (note 6)
5,000,000 common shares of no par value
Issued —
240,000 preferred shares
3,287,570 common shares

Purchase fund for redemption of preferred shares (note 6)

Retained earnings (notes 5, 6 and 10)

Approved by the Board


Maxwell W. Ward Director


T.L. Spalding Director

STATEMENT OF CHANGES IN FINANCIAL POSITION

1977	1976		1977	1976
		SOURCE OF FUNDS		
\$17,750	\$14,736	Net earnings	\$3,834	\$1,037
2,441	2,264	Add charges not requiring cash expenditures		
3,471	2,376	Depreciation	5,400	5,062
2,503	2,975	Amortization of deferred charges	<u>420</u>	<u>217</u>
<u>26,165</u>	<u>22,351</u>		9,654	6,316
73,470	70,860	Sale of fixed assets	462	54
8,663	6,805	Deferred charges recovered	4	12
<u>82,133</u>	<u>77,665</u>	Issue of common shares	<u>—</u>	<u>45</u>
24,365	19,355		<u>10,120</u>	<u>6,427</u>
<u>57,768</u>	<u>58,310</u>			
1,571	1,301	APPLICATION OF FUNDS		
<u>\$85,504</u>	<u>\$81,962</u>	Additions to fixed assets	5,320	3,662
		Deferred charges incurred	693	—
		Reduction of long term debt	6,327	6,129
		Redemption of preferred shares	300	300
		Dividends	<u>485</u>	<u>521</u>
			13,125	10,612
\$11,675	\$ 8,267	DECREASE IN WORKING CAPITAL	3,005	4,185
288	243	DEFICIENCY IN WORKING CAPITAL AT		
16,639	13,416	BEGINNING OF YEAR	<u>5,632</u>	<u>1,447</u>
6,200	6,057	DEFICIENCY IN WORKING CAPITAL AT		
<u>34,802</u>	<u>27,983</u>	END OF YEAR	<u>\$8,637</u>	<u>\$5,632</u>
32,051	38,377			
2,400	2,700			
1,059	1,059			
300	300			
<u>14,892</u>	<u>11,543</u>			
18,651	15,602			
<u>\$85,504</u>	<u>\$81,962</u>			

Notes to Consolidated Financial Statements

Year Ended December 31, 1977

1. Summary of Significant Accounting Policies

Consolidation

The consolidated financial statements include the accounts of the company and its subsidiaries: Wardair Canada (1975) Ltd., International Vacations Ltd., Wardair (U.K.) Limited, Wardair Jamaica Limited and Wardair Hawaii Limited, all of which are wholly-owned.

Conversion of Foreign Currencies

Amounts in foreign currencies are converted to Canadian dollars on the following basis:

- i) current assets and current liabilities at exchange rates in effect at the balance sheet date;
- ii) fixed assets at exchange rates in effect at the dates of acquisition;
- iii) long term debt at exchange rates in effect at the dates incurred;
- iv) revenues and expenses at the average annual rate of exchange.

Gains and losses resulting from foreign exchange conversions and transactions are reflected in earnings for the year.

Inventories

Inventories are valued at the lower of cost and replacement cost.

Property and Equipment

Depreciation is computed by the straight line method:

- i) jet aircraft and related equipment — over 14 years to 15% residual value;
- ii) turbo aircraft and related equipment — over 12 years to 15% residual value;
- iii) other equipment and property — at various rates over the estimated useful life of the asset.

Engine and airframe overhaul costs are charged to earnings in the year incurred. Significant expenditures

for modifications are capitalized. Upon retirement or disposal of equipment, the related cost and accumulated depreciation are removed from the accounts and the gain or loss, if any, is reflected in earnings.

Deferred Charges

Deferred charges are amortized on the straight line method:

- i) training expenses over 10 years;
- ii) lease costs over the term of the leases;
- iii) inclusive tour development over four years to 1980;
- iv) debenture issue expense over the term of the debenture.

2. Change in Presentation

During the year under review, the company's earnings statement presentation has been revised to reflect in revenue all revenues net of commissions, including gross revenues from land package tours. Land package tour costs, which in prior years were netted against the relative revenues, are now reflected in operating expenses. The comparative figures for the prior year have been reclassified to conform to this presentation.

3. Cash and Short Term Investments

Short term investments include \$1,900,000 held in escrow as security for bonds required by certain regulatory bodies, and certain contracts entered into in the normal course of business.

4. Deferred Charges

	1977	1976
Training expenses	\$1,221,738	\$ 719,022
Lease costs	56,708	192,807
Inclusive tour development	262,061	353,154
Debenture issue expense	29,866	36,265
	<u>\$1,570,373</u>	<u>\$1,301,248</u>

5. Long Term Debt

Following is a summary of long term debt:

	1977	1976
a) 6.50% Debenture — Series A, due September, 1982, with annual purchase fund requirements which may be satisfied by cash payment, purchase of debentures in the open market at par or less, or by redemption at varying prices reducing from 103.25% to 100.65%	\$ 1,574,000	\$ 1,853,000
b) 10.00% Debenture, due February, 1979. Secured by a first fixed charge on specific aircraft	89,978	167,102
c) 9.00% Conditional Purchase Agreements, due April, 1983; \$11,651,396 is payable in U.S. funds. Secured by one Boeing 747 and auxiliary equipment together with a subordinated debenture on one Boeing 707	18,436,141	20,930,486
d) Secured Note Purchase Agreement, due November, 1983, with interest at 2.25% above prime lending rate. Secured by one Boeing 747	7,686,194	10,071,566
e) 8% Term Loan, payable in U.S. funds to Export-Import Bank of the United States. This loan is guaranteed by a commercial bank for a fee of 1% of a portion of the loan and 1.5% of the remainder	7,492,622	7,492,622
f) Bank term loans, at rates varying between bank prime rate plus 1.5% and 2%, final installment due November, 1983. Secured by a chattel mortgage on specific aircraft and engines, general assignment of accounts receivable and a land mortgage on the Yellowknife hangar	2,952,746	3,822,249

	1977	1976
g) Miscellaneous mortgages and equipment purchase agreements	18,790	96,942
	38,250,471	44,433,967
Less principal due within one year	6,199,647	6,056,702
	<u>\$32,050,824</u>	<u>\$38,377,265</u>

Certain debt agreements contain restrictions on the amount of additional debt, the creation of liens and guarantees, the payment of cash dividends and on loans to officers and employees. In addition, certain debt agreements include covenants by the company with respect to maintenance of working capital, capital expenditures and investments, some of which have not been met. In these cases of default, the lenders have been notified as required under reporting agreements, and these covenants will be renegotiated at the time of financing the fleet expansion as described in note 9.

Principal due on existing long term debt in each of the years 1979 to 1982 is \$6,445,542, \$6,674,519, \$7,004,030 and \$7,392,862 respectively, expressed in Canadian funds.

Long term debt repayable in U.S. dollars translated at current rates at December 31, 1977 would be \$21,000,000 which is \$1,865,000 more than the amount at which it is carried above.

6. Preferred Shares

Each preferred share is convertible, at the option of the holder, into $3\frac{1}{2}$ fully paid common shares and is redeemable at par value or under certain prescribed conditions at \$11 per share.

In accordance with these provisions, the company redeemed 30,000 preferred shares during the year under review and another 30,000 preferred shares subsequent to the year end.

Annually, prior to December 31, the company is required to appropriate \$300,000 of its retained earnings as a Purchase Fund for Redemption of Preferred Shares, which appropriation is returned to retained

earnings subsequent to the redemption of a related number of preferred shares. At December 31, 1977 the Purchase Fund totalled \$300,000.

In addition, on the redemption of each 30,000 preferred shares the company is required to designate \$300,000 of its retained earnings as a Capital Redemption Reserve Fund as defined in the Alberta Companies Act. At December 31, 1977 a total of \$600,000 of retained earnings is so designated and is not available for dividends.

7. Pension Plan

Effective January 1, 1977 certain improvements were made to the company's pension plan by an adjustment of earnings levels to improve benefits which, based on an actuarial report, resulted in an unfunded liability on that date of approximately \$720,000. Commencing with a payment of \$72,000 in 1977 this unfunded balance is being amortized equally over fifteen years.

8. Contingent Liabilities

On July 16, 1975, an action was commenced in The Supreme Court of Ontario by T.R.W. Canada Limited against International Vacations Ltd. and Wardair International Ltd. alleging repudiation and breach of certain obligations under rental agreements for computer equipment. The claim is in the amount of \$600,000. International Vacations Ltd. and Wardair International Ltd., on the advice of counsel, believe that this action will be successfully defended. International Vacations Ltd. and Wardair International Ltd. have denied liability and have asserted a counterclaim against the plaintiffs in the amount of \$200,000.

There are additional claims and actions pending against the company, some of which are adequately covered by insurance. The outcome of these matters should have no adverse effect on the company's financial position.

9. Commitments

Leases

The company has a Boeing 707 jet aircraft under lease until 1979 at an annual rental of \$1,358,000 (U.S.) with an option to purchase the aircraft at the expiration

of the lease for \$1,500,000 (U.S.).

The company is obligated under long term lease agreements, including \$1,358,000 (U.S.) referred to above, for aggregate basic annual rentals of approximately \$4,477,000, \$3,220,000, \$2,808,000, \$2,695,000 and \$2,507,000 in each of the years 1978 to 1982 respectively.

Fleet Expansion

The company has entered into contracts with the Boeing Company and the McDonnell Douglas Corporation for the purchase of two B747-200B aircraft and two DC-10-30 aircraft respectively, and with the General Electric Company for the purchase and lease of spare engines, and has also committed for the purchase of certain ground support and other equipment, all of which will be financed by a syndicate of Canadian banks.

The financing, in the total principal amounts of \$185,000,000 (U.S.) and \$7,450,000 (Cdn.), is subject to a tax ruling and documentation satisfactory to the Canadian banks, which is in the process of being finalized. Concurrent with the delivery of the new DC-10-30 aircraft, the company has contracted to dispose of the two B707-320C aircraft in its present fleet.

The deliveries of the first B747 and the two DC-10-30 aircraft will be delayed due to strikes experienced by both manufacturers. Delivery dates are now scheduled as follows: first B747 in June, 1978; first DC-10-30 in November, 1978; second DC-10-30 in December, 1978. Delivery of the second B747 remains as March, 1979.

In addition to the above expansion program for the international fleet, the company has signed letters of intent with de Havilland Aircraft of Canada Ltd. for the purchase of two de Havilland DHC-7 aircraft, including spare engines and parts for an approximate cost of \$10 million. Financing of this program is also in the process of being finalized.

Cruise Ship Rentals

The company has entered into agreements for the rental of cruise ships and is committed to rental payments in 1978 of \$4,200,000 (U.S.) and \$800,000 (Cdn.).

Condominium Purchase

The company has advanced a deposit of \$55,000 (U.S.) with an offer to purchase one hundred and ten condominium units in Hawaii. The total purchase price is estimated to be approximately \$6,300,000 (U.S.). Financing for this project is under negotiation.

Forward Exchange Contracts

The company has contracted to acquire \$7,800,000 (U.S.) between January and May, 1978 at a cost of \$8,330,000 (Cdn.). At December 31, 1977 the value of these contracts was \$8,540,000 (Cdn.).

10. Income Taxes

The company and its subsidiaries claim capital cost allowances and other deductions allowed for income tax purposes in excess of the related amounts reflected in the accounts and provide in their accounts only for the taxes payable for the year. This accounting treatment differs from the tax allocation basis which requires that the income tax provision be based on earnings reported in the accounts.

If the tax allocation basis had been followed in current and prior years, earnings would have been reduced by \$1,815,000 for 1977 and \$670,000 for 1976. Reported net earnings per common share would have been \$0.53 for 1977 and \$0.01 for 1976. The cumulative effect on retained earnings to December 31, 1977 would have been a reduction of \$7,747,000.

The Canadian Institute of Chartered Accountants recommends the tax allocation basis for all but certain regulated corporations. Management does not concur that this principle is appropriate for the company. The capital cost allowance on flight equipment is substantially in excess of the depreciation recorded in the accounts. Consequently, the deferred tax liability which results from the tax allocation basis is expected to be indefinitely postponed. Accordingly, there should be no necessity to provide an amount for which the payment date is indeterminable.

11. Federal Anti-Inflation Legislation

The company has complied with the requirements of the Anti-Inflation Act, which restrains increases in certain prices, profit margins, compensation and dividends.

12. Remuneration of Directors and Officers

Remuneration of the directors and officers of the company and its subsidiaries, including the five highest paid employees other than flight personnel, amounted to \$543,000.

Auditors' Report

To the Shareholders
Wardair International Ltd.

We have examined the consolidated balance sheet of Wardair International Ltd. and its subsidiaries as at December 31, 1977 and the consolidated statements of earnings and retained 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, except for the effect of not providing for deferred income taxes as explained in Note 10 to the financial statements, these financial statements present fairly the financial position of the companies as at December 31, 1977 and the results of their operations and the changes in their financial position for the year then ended, in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Edmonton, Alberta
March 10, 1978

Thorne Ridell & Co.
Chartered Accountants

Five Year Summary

Financial (dollar amounts in thousands)	1977	1976	1975	1974*	1973*
Revenues	\$110,665	\$89,685	\$70,923	\$41,207	\$28,912
Operating costs	<u>102,907</u>	<u>83,889</u>	<u>61,130</u>	<u>36,899</u>	<u>26,121</u>
Earnings from operations	7,758	5,796	9,793	4,308	2,791
Interest on long term debt	<u>3,924</u>	<u>4,759</u>	<u>5,133</u>	<u>2,638</u>	<u>1,877</u>
Net earnings	<u>3,834</u>	<u>1,037</u>	<u>4,660</u>	<u>1,670</u>	<u>914</u>
Dividends					
Preferred	288	324	379	—	—
Common	<u>197</u>	<u>197</u>	<u>—</u>	<u>—</u>	<u>—</u>
	485	521	379	—	—
Earnings retained in year	<u>\$ 3,349</u>	<u>\$ 516</u>	<u>\$ 4,281</u>	<u>\$ 1,670</u>	<u>\$ 914</u>
Long term debt	\$38,251	\$44,434	\$50,616	\$52,169	\$30,979
Shareholders' equity	<u>18,651</u>	<u>15,602</u>	<u>15,342</u>	<u>9,071</u>	<u>4,401</u>
Invested capital	<u>\$56,902</u>	<u>\$60,036</u>	<u>\$65,958</u>	<u>\$61,240</u>	<u>\$35,380</u>
Depreciation and amortization	\$5,820	\$5,279	\$4,998	\$4,941	\$2,777
Cash flow provided by operations	\$9,654	\$6,316	\$9,658	\$6,611	\$3,691
Additions to fixed assets	\$5,320	\$3,662	\$6,375	\$24,980	\$28,769
Reduction in long term debt	\$6,327	\$6,129	\$12,695	\$2,258	\$1,729
Operating margin	7.0%	6.5%	13.8%	10.5%	9.7%
Return on total capital	13.6%	9.7%	14.8%	7.0%	7.9%
Debt—equity ratio	2.1	2.8	3.3	5.8	7.0
Price—earnings ratio	3.0	10.4	1.6	2.7	5.5
Per common share data (in dollars)					
Earnings	\$1.08	\$.22	\$1.33	\$.52	\$.28
Dividends	.06	.06	—	—	—
Book value	4.94	3.92	3.72	1.87	1.36

Operating (International Service)

Passengers carried	637,674	547,149	527,070	350,457	273,659
Passenger miles (000's)	2,022,889	1,798,700	1,762,459	1,176,512	948,986
Aircraft miles (000's)	8,265	7,991	7,610	5,690	5,524
Aircraft hours	16,959	16,165	15,488	11,525	11,208

Personnel

Average number of employees	1,410	1,384	1,263	948	666
Employee wages and benefits (000's)	\$20,630	\$17,810	\$12,981	\$8,072	\$6,288

* Does not reflect prior years' adjustment for depreciation and change in overhaul provision policy made in 1976.

Distribution of Capital

	Shareholders		Shares Held		Percentage	
	1977	1976	1977	1976	1977	1976
CANADA	1,448	1,437	3,272,191	3,270,041	99.53	99.47
UNITED STATES	21	18	14,569	16,569	.44	.50
OTHER	<u>7</u>	<u>7</u>	<u>810</u>	<u>960</u>	<u>.03</u>	<u>.03</u>
	<u>1,476</u>	<u>1,462</u>	<u>3,287,570</u>	<u>3,287,570</u>	<u>100.00</u>	<u>100.00</u>

Wholly-Owned Subsidiaries Officers and Senior Management

Wardair Canada (1975) Ltd.

Maxwell W. Ward	Chairman and President
T.L. Spalding	Executive Vice-President
M.D. Ward	Secretary-Treasurer
G.D. Curley	Vice-President, Marketing
N.A. Patterson	Vice-President, Finance
A.B. Freeman	Vice-President, Flight Operations
C.D. McNiven	Vice-President, Maintenance and Engineering
W.C. Besant	Director, Passenger Services
A.W. Jackman	Director, Crew Scheduling
M.J. Kozak	Director, Catering Services
J.R. Loew	Director, Cabin Services
M.K. Borrowman	Controller
L.E. Sukut	Manager, Northern Operations

International Vacations Ltd.

Maxwell W. Ward	President
T.L. Spalding	Executive Vice-President
M.D. Ward	Secretary-Treasurer
G.D. Curley	Vice-President and General Manager
N.A. Patterson	Vice-President, Finance
B. Walker	Director, Marketing Operations
J.A. Craig	Controller

Wardair (U.K.) Limited

Maxwell W. Ward	Chairman
J.L. Standley	Managing Director
G.W. Hopkinson	Secretary

Wardair Hawaii Limited

Maxwell W. Ward	President
T.L. Spalding	Executive Vice-President
M.D. Ward	Secretary-Treasurer

Wardair Jamaica Limited

Maxwell W. Ward	President
G.D. Curley	Secretary-Treasurer

Corporate Information

Head Office:

2201 Toronto Dominion Tower
Edmonton Centre, Edmonton, Alberta

Shares Listed:

Toronto Stock Exchange
Vancouver Stock Exchange

Auditors:

Thorne Riddell & Co.
Edmonton, Alberta

Trustee:

Montreal Trust Company

Registrar and Transfer Agent:

Montreal Trust Company
Edmonton, Toronto and Vancouver

Principal Bankers:

Canadian Imperial Bank of Commerce
Royal Bank of Canada

