You matter most at Avco

1997 Annual Report

Avco Financial Services Canada Limited

Avco Financial Services
Subsidiary of Textron Inc.

You matter most at Avco

President's Message

On behalf of Avco Financial Services Canada Limited, I am pleased to report net earnings of $31.9 million for 1997.

Volume of new business for the year rose to a record $1.3 billion compared with $0.9 billion in 1996, bringing our total receivables outstanding to $1.7 billion. This exceptional growth is due in large part to the success of our automated credit approval system for retail sales financing, which serves more than 2,500 retailers from coast to coast.

These financial achievements are driven by our employees' passionate commitment to meeting the needs of their customers. In fact, leading consumer surveyor, Forum Canada Research Inc., ranks us among the top companies in Canada for providing customer satisfaction. Inspired by this success and recognizing the need for continuous improvement, we undertook a number of important initiatives in 1997 to further enhance our service to customers.

For instance, working with a panel of consumer rights experts, we started developing our own code of consumer rights and responsibilities – a first for our industry in Canada. This code will be put into action in 1998 to clearly outline the mutual responsibilities we, at Avco, and our customers have when we do business together.

We also conducted a series of focus groups across Canada to ask our customers how they would define the "ideal" consumer finance company. The outcome was a new positioning statement for our company – one that conveys the warm, friendly, helpful attitude our customers can expect from us. ***"You matter most at Avco"*** articulates the underlying philosophy of how we'll conduct our business with customers and retail partners alike in 1998 and beyond.

It is through initiatives like these that our vision is continually pursued: ***to become the standard of excellence by which other companies in our industry are measured.*** In fact, it is through the ongoing involvement of all our key stakeholders – customers, retailers, suppliers, government, industry groups, employees and shareholders – that we are able to ensure we have the knowledge and guidance required to meet and exceed our business objectives.

Murray Wallace

D. Murray Wallace
President
Avco Financial Services Canada Limited

You
matter most
at Avco

"The creation of a local sales finance company by two London businessmen in 1954 was, in retrospect, not only a bold but an inspired decision. The enterprise that Reginald A. Palmer, an appliance store proprietor, and Ninian T. Sanderson, a commercial market gardener, originated with a few thousand dollars is today one of the outstanding success stories in Canadian business history..."
(From *An Illustrated History of London* by Frederick H. Armstrong)

Avco Financial Services, 44 years later, is one of Canada's leading finance companies. Through our nationwide network of 215 branches, we provide small-balance consumer loans, mortgages, access to specialized insurance products and a roadside assistance program to our customers. We also provide sales financing for the customers of hundreds of national, regional and local retailers from coast to coast.

Collectively and as individuals, the 1,400 men and women of Avco Canada strive to deliver satisfaction for our customers, retail partners and shareholders, while serving the needs of the community. In 1997, we made some tangible improvements in each of these areas – achievements that moved us closer to our vision of becoming the standard of excellence by which other companies in our industry are measured.

You matter most at Avco

"Many thanks for your smiling, helpful and friendly treatment of our problems," writes a satisfied customer served in 1997 by our branch team in Listowel, Ontario. "I know that business is business, but humanity and compassion will carry you a long way in this world."

We adhere to a simple philosophy at Avco Canada. Our customers come first. And our customers are telling us we do a good job. In fact, in 1997, Forum Canada Research Inc. ranked us among Canada's top companies for customer satisfaction. We're proud of this achievement, and we work harder every day to exceed the expectations of our customers with every service we provide.

Total commitment to outstanding customer service

"It's refreshing to be partnered with a company that puts people first," writes one of our valued 2,500-plus retail partners. "My customers and I appreciate it."

Not only does Avco Canada provide outstanding service to thousands of individual Canadians every year, we also help hundreds of merchants grow their businesses. In 1997, thanks to the innovation of our retail credit services division and the success of our automated credit approval system (ARCS), we doubled the number of retail partners we serve. With ARCS fully implemented across Canada as of March 1997, dollar volumes generated within our sales portfolio increased 39 per cent over the past year.

A company with heart

In 1997, Avco Canada continued its long-standing commitment to supporting registered charities and local community groups across the country. And for every community in which we do business, there's a new story to tell about a company that does what it can to help…

For instance, sick children in Alberta, Ontario and Quebec benefited from Avco contributions made to local Children's Miracle Network Telethons. When floods struck in southern Manitoba, Avco was there with money for relief efforts and entertainment to bring cheer to 100 children evacuated from their homes and placed in shelters. At home office, 96 per cent of our employees donated to the United Way. In Amherst, Nova Scotia, local branch staff helped organize the Wishmaker Parade for their fifth consecutive year in Cumberland County, an event which raised $10,000 for the Children's Wish Foundation of Canada. And the stories go on.

Last year also saw the creation of the *Avco Canada Employee Needs Fund*. Supported entirely by the voluntary contributions of employees, the fund provides financial assistance to employees facing unanticipated expenses arising from an emergency or tragic turn of events. One more example of Avco employees' caring spirit.

Part of the Avco family

Avco Canada is part of Avco Financial Services, Inc., a multinational finance company with operations in Australia, France, Hong Kong, India, Ireland, New Zealand, Spain, Sweden, the United Kingdom and the United States. Avco Financial Services, Inc., in turn, is a subsidiary of Textron Inc. – a $10.5-billion global, multi-industry company with market-leading operations in Aircraft, Automotive, Industrial and Finance.

Consolidated Highlights

For the Five Years Ended December 31

Thousands of dollars,	1997	1996	1995	1994	1993
Net Earnings	$31,860	$35,059	$30,439	$28,731	$22,983
Receivables Outstanding					
Consumer loans	$738,932	$620,055	$570,612	$519,443	$477,944
Real estate loans	336,482	339,730	387,272	405,059	377,957
Sales finance loans	503,958	382,078	362,096	349,644	301,468
Commercial loans	126,095	57,678			
TOTAL	$1,705,467	$1,399,541	$1,319,980	$1,274,146	$1,157,369
Volume of Business					
Consumer loans	$514,452	$398,719	$337,454	$305,193	$267,110
Real estate loans	88,450	67,519	78,288	121,157	110,883
Sales finance loans	572,315	412,049	396,491	389,860	356,382
Commercial loans	172,277	32,251			
TOTAL	$1,347,494	$910,538	$812,233	$816,210	$734,375
Number of Branch Offices	215	214	214	215	217
Other Significant Data					
Shareholders' equity	$201,396	$173,705	$201,646	$183,359	$166,128
Total lines of credit	$807,176	$577,401	$400,000	$426,177	$335,000
Commercial paper coverage	104%	103%	117%	103%	102%
Average cost of borrowed funds	5.88%	7.11%	8.46%	8.01%	8.94%
Allowance for losses as a percentage of receivables outstanding	2.64%	2.46%	2.54%	2.53%	2.53%
Net credit losses as a percentage of average receivables outstanding	2.64%	2.50%	1.69%	1.47%	2.06%
Other operating expenses as a percentage of revenues	40.79%	38.24%	36.25%	37.26%	38.12%

Management's Discussion and Analysis
of Financial Condition and Results of Operations

Results of Operations:

Earnings before income taxes for the year ended December 31, 1997, were $57.9 million, compared to $62.6 million in 1996. On a segmented basis, financial services increased by 5% to $50.8 million, while insurance services decreased by 50% to $7.1 million.

Financial Services:

Financial services earnings before taxes increased by $2.5 million. The most significant factor affecting this was a $34.1 million increase in interest margin. This increase was partially offset by a higher provision for credit losses and increased operating expenses.

The Company increased receivables outstanding by $305.9 million during the year. In late 1996, the Company commenced commercial financing activities with the acquisition of Insurex Canada Inc. and increased the extent of these activities in April 1997, with the contribution of shares of Textron Financial Corporation (Canada) from the Company's parent.

Interest margins (interest, discount and service charges less total interest and debt expense) increased by $34.1 million in 1997. Interest revenues increased by $37 million due to a $191.9 million (15%) increase in average receivables outstanding, including an increase of $63.5 million in average commercial receivables. Despite a $229.5 million (21.4%) increase in the average debt outstanding, lower interest rates enabled the Company to limit the increase in interest and debt expense to only $0.6 million (0.7%). The average cost of borrowed funds decreased to 5.88% in 1997 from 7.11% in 1996 due to decreases in both short- and long-term borrowing rates. During the last quarter of 1997 the Bank of Canada rate increased by 125 basis points. This increase resulted in a slight increase in short-term borrowing costs in the latter part of 1997 which management believes will continue into 1998.

The general trend of higher consumer debt loads and rising personal bankruptcy rates was reflected in increased charge-off during the year. Net credit losses, as a percentage of average receivables outstanding, increased to 2.64% in 1997 from 2.50% in 1996.

Other operating expenses increased by 14% to $129.2 million in 1997. The increase is primarily a reflection of a 34% increase in volumes in the Company's traditional consumer finance businesses combined with the introduction of commercial financing activities in late 1996. The nature of the Company's commercial operations results in a higher ratio of operating expenses to revenues in these businesses.

Insurance Services:

London and Midland General Insurance Company, a wholly owned subsidiary of the Company, underwrites Accidental Death and Dismemberment insurance for customers of other financial institutions.

Effective June 1, 1996, London and Midland ceased underwriting the Creditor Accident & Sickness, Involuntary Unemployment and Personal Property Insurance for Avco customers. These product lines are now underwritten by the Canadian branches of Balboa Insurance Company and Balboa Life Insurance Company, both of which are related companies. Effective January 1, 1997, London and Midland sold the remaining assets of $25.4 million and liabilities of $29.3 million relating to the above product lines to the same companies.

The effect of the transactions was to reduce underwriting income and investment income. Underwriting income from these insurance products in 1996 was approximately $5.2 million. Investment income attributable to these product lines in 1996 was estimated to be in the range of 40% to 50% of total investment income.

Liquidity and Capital Resources:

The Company depends on a broad base of financial support for its liquidity and capital requirements. Cash is provided from both operations and several different sources of borrowings, including unsecured borrowings under bank lines of credit, the issuance of commercial paper, and sales of medium- and long-term debt instruments. Commercial paper is issued in both the United States and Canada. During the year, all medium- and long-term borrowings were in the Canadian market.

One of the operating risks affecting the Company is credit risk. The Company controls this risk through geographical diversification across all ten provinces and the Yukon territory. With respect to the consumer loan and sales finance portfolios, diversification is also enhanced by relatively small account balances spread among many customers. At December 31, 1997, 19.7% of the Company's finance receivables were residential real estate loans, secured primarily by first and second mortgages on single family homes, with an average outstanding principal balance of approximately $31,450 per loan. Such loans are limited to a maximum of 85% of the appraised value of the property at the time of loan origination less any existing encumbrances. Most loans, however, are made at significantly lower loan-to-value ratios. Management believes that substantially all residential real estate loans remain fully secured.

Underwriting controls in the consumer loan approval process are a primary factor in managing credit risk. A Corporate Credit Committee is responsible for establishing and monitoring underwriting standards on a Canada-wide basis. This committee is supported by a national product management department and credit managers in each of the four regional operating areas. Underwriting controls are integrated into the branch operating system, including credit bureau access, automated analysis of loan quality and periodic supervisory review. Underwriting skills are fully incorporated into the Company's employee training programs and compliance audits are conducted by the Company's management audit department. During 1996 and 1997, the Company introduced a new credit approval system to its retail business partners. This new system automates the credit approval process to increase the speed, efficiency and consistency of the lending process.

Interest rate risk is carefully managed by adjusting the mix between fixed-rate debt and variable-rate debt according to current and anticipated market conditions. The larger the proportion of fixed-rate debt, the more protected the Company is from the risk of future interest rate increases; however, the potential benefits of a declining interest rate market are reduced. By utilizing medium- and long-term fixed-rate financing, as well as interest rate exchange agreements, the Company had a ratio of fixed-rate debt to total debt of 55.3%, on average, throughout the year. The Company's only use of derivative products is to manage its exposure to interest rate movements or fluctuations in foreign exchange rates.

The strong growth during the year, combined with dividend payments, increased the Company's debt-to-equity ratio to 7.4/1 from 6.9/1 at December 31, 1996. This level of capitalization remains in the range of industry norms.

The Company continued to refinance maturing long-term debt at more attractive rates. During the year, $155.2 million in long-term debt matured at an average rate of 8.26%. These amounts were initially refinanced in the short-term market to take advantage of lower rates. During the year, as required by receivable growth, $218.5 million were issued under the Company's Medium Term Note Program. Of the new notes, $75 million are variable-rate and $143.5 million are made variable due to interest rate swap agreements. The Company believes average long-term debt costs should decrease in 1998 as $392 million of maturing debt at average rates of 7.03% is refinanced at lower rates. Subsequent to year end, the Company issued $150 million of long-term debt maturing in 2003 at 5.75%.

During 1997, the Company increased receivables outstanding by $305.9 million, or 21.9%. Continued emphasis on creating additional branch sales capacity and improving the effectiveness of branch solicitation practices helped to increase the consumer loans portfolio by $119 million ($49 million in 1996). Although real estate loans decreased slightly by $3.2 million, this represents a significant improvement from the $48 million decrease experienced in 1996 and reflects an increased emphasis on this portfolio during the year. Sales finance receivables increased $122 million ($20 million in 1996) as the Company continued to build on the success of its new sales finance processes during a period of strong consumer confidence. Commercial receivables increased by $68.4 million ($57.7 million in 1996) during the year. The Company will continue to focus efforts on increasing receivables in the higher yielding consumer loans portfolio. Sales finance growth is expected to be maintained at levels sufficient to support the consumer loans growth and is affected by consumer purchasing patterns and retailer initiatives in the home furnishings and electronics marketplace.

For liquidity purposes, the Company maintains unused bank lines of credit to back up its commercial paper borrowing. The Company has a line of credit syndication of $550 million with seven financial institutions, including all of the Canadian "Schedule A" banks. The syndication expires in 2001. In September 1997, the Company increased the value of its lines of credit by adding $200 million of 364-day facilities from four of the Canadian "Schedule A" banks. As required, our parent company, Avco Financial Services, Inc., allocates to the Company additional bank lines to provide coverage. The commercial paper coverage ratio at December 31, 1997, was 104%.

The amount of net assets of the Company available for cash dividends and other payments to its shareholders is restricted by insurance statutory requirements. The Company declared dividends of $13.7 million in 1997.

The Company has an $800 million Shelf Registration on file, expiring in 1998, of which $400 million has been allocated to a Medium Term Note Program. During 1997, the rating on the Company's long-term debt was maintained at "A (High)", by CBRS and DBRS, due to the positive earnings trend, good asset quality, conservative leverage and interest coverage ratios of Avco Financial Services, Inc. All debt of the Company is guaranteed by Avco Financial Services, Inc.

In early 1997, the Company completed an assessment of its computer programs to identify the impact of the Year 2000 Issue on its operations. Some of these programs are critical to operations and could fail to properly process data unless they are modified. The Year 2000 Issue results from many computer programs using only two digits to identify the year in the date field. As a result of this assessment, the Company instituted a plan of corrective action. This project, which began in mid-1997, will be carried out both by existing personnel and outside contractors. The Company anticipates that all of the necessary internal program modifications will be completed by the end of 1998. During the latter part of 1998 and the first half of 1999, the Company will test its ability to communicate electronically with other entities, such as suppliers, independent data processing agencies and customers. The cost of these efforts are recognized in income as incurred. The costs related to this project did not have a material impact on the Company's results of operations in 1997, and they are not anticipated to have a material impact in 1998 or 1999. The Company does not expect the Year 2000 Issue to materially affect its financial results, products, services or competitive conditions in the year 2000 or thereafter.

Auditors' Report

To The Shareholders of Avco Financial Services Canada Limited

We have audited the consolidated statements of financial position of Avco Financial Services Canada Limited as at December 31, 1997 and 1996 and the consolidated statements of earnings and retained earnings and changes in consolidated financial position for the years then ended. 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 consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 1997 and 1996 and the results of its operations and the changes in its financial position for the years then ended in accordance with generally accepted accounting principles.

Ernst & Young

Chartered Accountants
London, Canada
January 23, 1998

Consolidated Earnings and Retained Earnings

Thousands of dollars, year ended December 31,	1997	1996
Revenues		
Interest, discount and service charges	$290,989	$256,339
Insurance premiums	13,953	28,880
Investment income	4,815	6,550
Other revenues	7,075	4,599
TOTAL REVENUES	316,832	296,368
Expenses		
Interest and debt expense:		
Interest on long-term debt	47,797	52,737
Amortization of long-term debt financing costs	1,272	1,359
Interest on short-term debt	27,193	21,583
TOTAL INTEREST AND DEBT EXPENSE	76,262	75,679
Provision for losses on collection of receivables	49,597	33,023
Insurance losses and adjustment expenses	3,851	11,765
Other operating expenses	129,225	113,345
TOTAL EXPENSES	258,935	233,812
Earnings before income taxes	57,897	62,556
Income taxes	26,037	27,497
Net Earnings	31,860	35,059
Retained earnings, beginning of year	150,708	178,649
Dividends declared	(13,725)	(63,000)
Retained Earnings, End of Year	$168,843	$150,708

See accompanying notes.

Consolidated Financial Position

Thousands of dollars, December 31,	1997	1996
Assets		
Receivables (note 2)	$1,705,467	$1,399,541
Allowance for losses	(45,069)	(34,401)
	1,660,398	1,365,140
Investments (note 9)	31,385	65,584
Prepaid expenses and other receivables	39,803	20,537
Deferred income taxes	2,263	3,051
Property and equipment (note 3)	17,854	16,903
Cash	13,193	1,002
Other assets, net of amortization	11,154	6,526
TOTAL ASSETS	$1,776,050	$1,478,743
Liabilities		
Short-term debt - unsecured - commercial paper (note 4)	$776,517	$559,534
Long-term debt - unsecured (note 5)	710,500	647,250
	1,487,017	1,206,784
Accounts payable and accrued liabilities	59,383	55,977
Dividends payable	13,725	
Deferred insurance commissions	2,732	1,764
Income taxes payable	2,622	2,779
Deferred income taxes payable	2,190	47
Insurance provisions and claims:		
Unearned premiums	2,233	18,987
Provision for outstanding claims	4,752	18,700
TOTAL LIABILITIES	$1,574,654	$1,305,038
Shareholders' Equity (note 6)		
Common share capital	$16,788	$16,788
Additional paid-in capital (note 10)	15,765	6,209
Retained earnings	168,843	150,708
TOTAL SHAREHOLDERS' EQUITY	201,396	173,705
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$1,776,050	$1,478,743

See accompanying notes.

On behalf of the Board

D.M.Wallace, President and Director

J.C. Maynard, Senior Vice President and Director

Changes in Consolidated Financial Position

Thousands of dollars, year ended December 31,	1997	1996
Operating Activities		
Net earnings	$31,860	$35,059
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Provision for losses on receivables	49,597	33,023
Depreciation and amortization of property and equipment and other assets	6,250	5,283
Decrease in deferred income taxes	1,339	1,492
Increase in deferred insurance commissions	968	762
Decrease in unearned insurance premiums	(266)	(14,389)
Decrease in provision for outstanding claims	(586)	(2,034)
Decrease in income taxes payable	(1,836)	(502)
Other (net)	(7,178)	7,554
Decrease in accounts payable and accrued liabilities	(13,961)	(916)
	66,187	65,332
Investing Activities		
Funds advanced on receivables	(1,347,494)	(910,538)
Principal collections on receivables	1,001,111	832,348
Purchases of property and equipment (net)	(4,132)	(6,856)
Decrease in investments (net)	9,892	5,269
Investment in Insurex		(7,999)
Disposal of insurance assets and liabilities (net)	(2,173)	
Related party sale of insurance assets and liabilities	2,173	
Net non-cash asset contribution by parent company	(989)	
	(341,612)	(87,776)
Financing Activities		
Increase in short-term debt (net)	216,983	200,030
Proceeds from issuance of long-term debt	218,450	50,000
Repayment of long-term debt	(155,200)	(163,185)
Dividends declared and paid		(63,000)
Decrease in dividends payable		(2,150)
Contribution by parent company	7,383	
	287,616	21,695
Net increase (decrease) in cash	12,191	(749)
Cash at beginning of year	1,002	1,751
Cash at end of year	$13,193	$1,002

See accompanying notes.

Notes to Consolidated Financial Statements

December 31, 1997 and 1996

Note 1: Summary of Significant Accounting Policies

The following represent the significant accounting policies used in the preparation of the consolidated financial statements.

(a) Basis of presentation

The consolidated financial statements include the accounts of the Company and all of its subsidiaries. All significant inter-company transactions are eliminated.

(b) Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in those statements and accompanying notes. Actual results may differ from such estimates.

(c) Receivables

Interest income is recognized in revenues so as to produce a constant rate of return over the terms of the receivables. Accrual of interest income is suspended for accounts once they have been identified as impaired. Accounts are considered to be impaired once they are more than 90 days contractually past due. Impaired loans are adjusted to an estimate of net realizable value by way of a general provision.

It is generally the Company's policy to write off accounts monthly when they are deemed uncollectible, but in any event, except for real estate secured loans, all accounts for which an amount aggregating a full contractual payment has not been received for six consecutive months are written off. The Company charges against current earnings as a provision for losses on receivables such amounts as management believes to be adequate to reduce the recorded investment in loans receivable to their estimated realizable value. The determination of the allowance for losses is based upon loss experience and payment history on a product by product basis. As these estimates are influenced by factors outside the Company's control, such as economic conditions in the regions where the Company operates, there is uncertainty inherent in these estimates, making it reasonably possible that they could change.

Foreclosed real estate loans are transferred out of finance receivables into other assets at the lower of fair value (less estimated costs to sell) or the outstanding loan balance. The carrying value of real estate owned is periodically re-evaluated and, where appropriate, adjustments are made to reflect subsequent decreases in fair value.

(d) Income taxes

The Company's provision for income taxes is based primarily on reported earnings before income taxes and includes an appropriate provision for deferred income taxes resulting from timing differences. Timing differences result from items whose treatment for financial reporting and income tax reporting differs and consist principally of depreciation, amortization and the allowance for losses.

(e) Property and equipment

Property and equipment are stated at cost. The Company calculates depreciation and amortization on a straight-line basis at the following rates, which are estimated to fully depreciate the cost over the estimated useful lives of the following principal assets: computer hardware and software – three or five years; furniture and fixtures - eight years; leasehold improvements - eight years; and equipment - five years.

Cost and accumulated depreciation or amortization are removed from the accounts at the time of disposal. Any resulting gain or loss is included in net earnings of the current period.

(f) Other assets

Other assets consist of (1) intangibles recognized on the acquisition of subsidiaries which are being amortized on a straight-line basis over 15 or 25 years, and (2) debt financing costs which are amortized on a straight-line basis over the terms of the respective debt issues.

(g) Deferred insurance commissions

The entire amount of insurance commissions received from carriers is deferred and credited to earnings over the life of the related insurance contracts on a basis consistent with the premium recognition method as described in (i) below.

(h) Foreign currency translation

Assets and liabilities denominated in foreign currency have been translated at the closing year-end rates. Income and expense accounts have been translated at the average rates prevailing during the respective years. The resulting gain or loss from translation has been reflected in earnings.

(i) Insurance operations

The following are the significant accounting policies followed by the Company's insurance subsidiary for purposes of these consolidated financial statements. These accounting policies conform, in all material respects, to generally accepted accounting principles and the accounting requirements of the Office of the Superintendent of Financial Institutions Canada.

(i) Premium recognition and unearned premiums

Unearned insurance premiums represent the portion of premiums written which is determined to be unearned on the year-end dates. These unearned premiums are taken into earnings over the life of the policies on a straight-line basis.

(ii) Deferred policy acquisition expenses and prepaid campaign expenses

Certain costs of acquiring new business (principally commissions, campaign expenses and premium taxes) are deferred and charged to expense in substantially the same manner as the premiums are taken into earnings.

(iii) Provisions for unpaid claims and adjustment expenses

The provision for unpaid claims represents the amounts needed to provide for the estimated ultimate expected cost of settling claims related to insured amounts, both reported and unreported, that have occurred on or before the balance sheet date. In addition, provisions are made for adjustment expenses and changes in reported claims incurred but not reported based on past experience and business in force. The estimates are regularly reviewed and updated, in light of emerging claim experience and changing circumstances, and any resulting adjustments are included in current income.

The risk that the amount of the provision will be insufficient to discharge the Company's liabilities is mitigated by including a provision for adverse deviations in the calculation. In all recent years, the provision for adverse deviations has been more than sufficient to absorb adverse deviations of current emerging experience from historical patterns. Those adverse deviations occur from time to time, as do favourable deviations. Claim liabilities are carried on an undiscounted basis. The carrying value of the provision for unpaid claims and adjustment expenses approximates fair value.

(iv) Reinsurers' share of provisions for unpaid claims and adjustment expenses and unearned premiums

Expected reinsurance recoveries on unpaid claims and adjustment expenses and unearned premiums, net of any required provision for doubtful amounts, are recognized as assets at the same time and using principles consistent with the Company's method of establishing the related liability.

(v) Reinsurance

The Company reflects reinsurance balances on the balance sheet on a gross basis to indicate the extent of credit risk related to reinsurance and its obligations to policyholders and on a net basis in the statement of income to indicate the results of its retention of premiums written.

(vi) Investments

Investments are carried at cost except where it is estimated that there has been a decline that is other than temporary in the underlying market value, in which case the carrying value is written down.

Note 2: Finance Receivables and Allowance for Losses

Contractual maturities of finance receivables outstanding at December 31, 1997, and total finance receivables outstanding at that date and at December 31, 1996, were as follows:

	Contractual Maturities			Less Finance	Receivables Outstanding	
Thousands of dollars,	1998	1999	2000 to 2012	Charges	1997	1996
Consumer loans	$364,905	$335,828	$384,304	$346,105	$738,932	$620,055
Real estate loans	176,811	131,304	101,069	72,702	336,482	339,730
Sales finance loans	422,146	103,892	63,114	85,194	503,958	382,078
Commercial loans	83,888	13,518	45,038	16,349	126,095	57,678
	$1,047,750	$584,542	$593,525	$520,350	$1,705,467	$1,399,541

Gross impaired loans totalled $29,653,000 at December 31, 1997 ($24,843,000 at December 31, 1996). This excludes foreclosed real estate assets held for sale with a gross carrying value of $6.6 million (1996 - $7.7 million) and a related allowance of $331,000 (1996 - $384,000).

The terms of the Company's receivables generally require repayment in equal monthly instalments. The maximum term over which consumer loan accounts are written is 60 months. However, approximately 99% of the dollar amount of consumer loan accounts are written with terms of 48 months or less. Consumer loans are unsecured or secured by personal property and are in relatively small amounts.

Real estate loans are written for amortization periods of up to 25 years; however, substantially all of these loans have a term of, or are callable by the Company after, not more than five years. Real estate loans are secured by real property and are limited to a maximum of 85% of the property's unencumbered appraised market value at the date of the loans.

Sales finance loans include retail instalment contracts, with average written terms of five months, and revolving charge accounts. Retail instalment contracts are secured by personal property.

Commercial loans include finance leases which have initial terms up to nine years, secured by the underlying collateral, and instalment loans with initial terms up to one year, secured by an assignment of the insurance policy.

Substantially all of the Company's loans carry fixed interest rates to maturity. The effective interest rate on all finance receivables was 20.21% in 1997 and 20.36% in 1996. The effective interest rate does not vary substantially between the maturities.

Accounts are often repaid or refinanced prior to contractual maturity. Accordingly, the foregoing tabulation should not be regarded as a forecast of future cash collections.

Changes in allowance for losses were as follows:

Thousands of dollars, year ended December 31,	1997	1996
Allowance for losses at beginning of the year	$34,401	$33,474
Add - charged to income		
Real estate	$2,866	$3,578
All other	46,731	29,445
Total	$49,597	$33,023
Deduct - balances charged off		
Gross charge offs:		
Real estate	$3,424	$4,790
All other	43,628	34,325
Total	$47,052	$39,115
Recoveries:		
Real estate	$509	$499
All other	7,614	6,520
Total	$8,123	$7,019
Net charge offs	$38,929	$32,096
Allowance for losses at end of the year		
Real estate	$5,732	$5,781
All other	39,337	28,620
Total	$45,069	$34,401

Note 3: Property and Equipment

Thousands of dollars, December 31,	1997			1996		
	Cost	Accumulated Depreciation	Net Book Value	Cost	Accumulated Depreciation	Net Book Value
Computer hardware and software	$24,995	$14,729	$10,266	$22,594	$12,938	$9,656
Furniture and fixtures	12,863	8,344	4,519	12,233	7,635	4,598
Leasehold improvements	5,036	2,841	2,195	5,242	3,034	2,208
Equipment	2,168	1,294	874	1,459	1,018	441
	$45,062	$27,208	$17,854	$41,528	$24,625	$16,903

Note 4: Debt and Credit Facilities

Commercial paper is issued with maturities up to one year with interest at prevailing market rates. The weighted average interest rates on commercial paper outstanding at December 31, 1997 and 1996, without giving effect to the costs of maintaining the lines of credit, were 3.48% and 4.66%, respectively. The weighted average interest rate is determined primarily by reference to daily outstanding principal amounts.

The commercial paper program is supported by a revolving line of credit which is guaranteed by Avco Financial Services, Inc. At December 31, 1997 and 1996, lines of credit with various banks amounted to $807.2 million and $577.4 million, respectively, of which the unused portion of these lines amounted to $30.7 million and $17.9 million, respectively.

The Company has entered into interest rate exchange agreements expiring October 13, 1999, December 1, 1999, and March 1, 2000. Respectively, these agreements have the effect of fixing the rate on $100,000,000 of variable-rate short-term debt at approximately 7.11%; making variable the rate on $25,000,000 of medium-term notes with a fixed-rate of 5.088%; and making variable the rate on $118,450,000 of medium-term notes with a fixed-rate of 5.11%.

Note 5: Long-term Debt

Thousands of dollars, December 31	1997	1996
Variable-rate notes due June 1998	50,000	
Variable-rate notes due September 1998	25,000	
4.900% notes due December 1999	50,000	50,000
5.088% notes due December 1999	25,000	
5.110% notes due March 2000	118,450	
6.900% notes		6,000
6.900% notes due November 1998	10,000	10,000
6.950% notes due November 1998	40,000	40,000
6.950% notes due November 1998	20,000	20,000
6.950% notes due November 1998	25,000	25,000
7.000% notes		19,000
7.030% notes		200
7.120% notes due September 1998	21,050	21,050
7.150% notes due October 1998	6,000	6,000
7.600% notes due September 1998	70,000	70,000
8.500% notes		100,000
8.500% notes due March 1998	125,000	125,000
8.550% notes		30,000
8.750% notes due March 2000	125,000	125,000
TOTAL LONG-TERM DEBT	$710,500	$647,250

The $50,000,000 variable-rate notes are priced at 90-day Banker's Acceptance rates, plus 25 basis points and are reset quarterly. The Banker's Acceptance rate at the last reset date was 3.894%.

The $25,000,000 variable-rate notes are priced at 30-day Banker's Acceptance rates, plus 10 basis points and are reset monthly. The Banker's Acceptance rate at the last reset date was 4.523%.

Long-term debt is Senior Debt and is guaranteed by the Company's parent, Avco Financial Services, Inc.

The maturities on long-term debt for the three years subsequent to December 31, 1997, are as follows: 1998 - $392,050,000; 1999 - $75,000,000; and 2000 - $243,450,000.

Note 6: Shareholders' Equity

Thousands of dollars, December 31,	1997	1996
COMMON SHARE CAPITAL		
Authorized - 2,000,000 shares		
Issued - December 31, 1997 and 1996		
- 1,670,376 1/4 shares	$16,788	$16,788

Avco Financial Services, Inc., a United States company, owns in excess of 99.9% of the issued common shares. The ultimate parent company is Textron Inc., a United States company.

Rules prescribed by the Office of the Superintendent of Financial Institutions Canada with respect to capital requirements for the Company's insurance subsidiary and certain provisions of the Insurance Companies Act (Canada) have the effect of restricting the amount of dividends which the subsidiary is permitted to pay in any year. Restricted assets at December 31, 1997 and 1996 were $27,144,000 and $70,655,000, respectively.

Note 7: Operating Lease Commitments

At December 31, 1997, minimum annual rentals relating to leases on executive and branch offices and vehicles are as follows: 1998 - $5,306,000; 1999 - $3,548,000; 2000 - $2,074,000; 2001 - $1,319,000; 2002 - $683,000; and thereafter - $563,000. Rent expense charged to earnings for the years ended December 31, 1997 and 1996 for these leases amounted to $8,834,000 and $8,178,000, respectively.

Note 8: Operations by Industry Segment

The following is a summary of revenues, operating profit and identifiable assets by industry segment.

Thousands of dollars, year ended December 31,	1997	1996
Revenues		
Financial Services	$298,153	$261,026
Insurance Services	18,679	35,342
TOTAL	$316,832	$296,368
Operating Profit		
Financial Services	$50,781	$48,234
Insurance Services	7,116	14,322
TOTAL	$57,897	$62,556
Identifiable Assets		
Financial Services	$1,739,549	$1,404,852
Insurance Services	36,501	73,891
TOTAL	$1,776,050	$1,478,743

Operating profit by industry segment represents earnings before income taxes.

Note 9: Cost and Fair Value of Financial Instruments

The estimated fair values of investments were based on quoted market values.

The estimated fair values of fixed-rate consumer loans, real estate loans and commercial loans were estimated based on discounted cash flow analysis using interest rates currently being offered for similar loans to borrowers of similar credit quality. The estimated fair value of all sales finance receivables and variable-rate commercial loans approximated the net carrying value of such receivables.

The estimated fair value of fixed-rate debt was determined by independent investment bankers. The fair values of variable-rate debt approximated their carrying values. The estimated fair values of interest-rate exchange agreements were determined by independent investment bankers.

The fair values of the Company's financial instruments approximate their carrying values except as follows:

Thousands of dollars, December 31,	1997		1996	
	Cost	Estimated Fair Value	Cost	Estimated Fair Value
Assets				
Finance receivables (net)	$1,660,398	$1,652,624	$1,365,140	$1,361,453
Investments:				
Short-term notes	$893	$893	$13,095	$13,095
Bonds	24,510	25,904	41,642	44,772
Stocks	5,982	7,207	10,847	12,325
Total Investments	$31,385	$34,004	$65,584	$70,192
Liabilities				
Debt:				
Variable-rate debt	$776,517	$776,517	$559,534	$559,534
Interest-rate exchange agreements		4,903		6,680
Fixed-rate debt	710,500	720,999	647,250	678,736
Total Debt	$1,487,017	$1,502,419	$1,206,784	$1,244,950

The insurance subsidiary has investments of $30,031,000 and $64,258,000 at December 31, 1997 and 1996, respectively. These investments are subject to government regulation and are not interchangeable with other assets of the Company.

Maturity profile of bonds held at December 31, 1997:

Thousands of dollars,	Within 1 year	1 to 5 Years	5 to 10 Years	Over 10 Years	Book Value
	$5,783	$12,408	$5,480	$839	$24,510
Per cent of total	23.6%	50.6%	22.4%	3.4%	100.0%
Effective interest rate	8.54%	7.95%	8.01%	8.38%	8.12%

Note 10: Related Party Transactions

All related party transactions are carried out with the parent company or wholly owned subsidiaries of the parent. Except as noted, inter-company balances are non-interest bearing and are payable on demand. Transactions with related entities in the normal course of operation are recorded at the agreed upon exchange amount. Amounts paid for administrative services to the parent company for the years ended December 31, 1997 and 1996, amounted to $5,907,000 and $5,195,000, respectively. At December 31, 1997 and 1996, amounts owing to the parent company are $243,000 and $410,000.

For the years ended December 31, 1997 and 1996, the Company received $866,000 and $449,000, respectively, from Balboa Insurance Company - Canadian Branch in respect of fees for collection of premiums and claims paid. For the years ended December 31, 1997 and 1996, the Company received $11,771,000 and $3,683,000, respectively, from Balboa Life Insurance Company - Canadian Branch, in respect of fees for collection of premiums and claims paid. At December 31, 1997 and 1996, the amounts owing to the Canadian Branches of these companies were $3,051,000 and $3,412,000, respectively. Amounts paid for administrative services to the Balboa companies for the years ended December 31, 1997 and 1996, amounted to $137,000 and $1,016,000, respectively.

Transactions with related entities not in the normal course of operation are recorded at the carrying values of transferred items. On January 1, 1997, the Company sold assets of $25,456,000 and liabilities of $29,336,000 relating to its accident and sickness insurance and its casualty insurance. The difference between the price received by the Company and the carrying values of the assets and liabilities is $2,173,000 after tax of $1,707,000. This amount is reported as additional paid-in capital in the equity section of the balance sheet.

The assets and liabilities relating to accident and sickness insurance were transferred to Balboa Life Insurance Company – Canadian Branch, and the assets and liabilities relating to casualty insurance were transferred to Balboa Insurance Company – Canadian Branch.

The effect of the transactions was to reduce underwriting income and investment income. Underwriting income from these insurance products in 1996 was approximately $5.2 million. Investment income attributable to these product lines in 1996 was estimated to be in the range of 40% to 50% of total investment income.

Effective April 1, 1997, the parent company contributed to the Company 100% of the shares of Textron Financial Corporation (Canada). Total assets contributed amounted to $48,694,000 and liabilities were assumed in the amount of $41,311,000.

Note 11: Insurex Acquisition

Effective September 1, 1996, the Company acquired 100% of the shares of Insurex Canada Inc. for cash of $8 million.

Total assets acquired amounted to $38 million and liabilities were assumed in the amount of $30 million.

Note 12: Comparative Amounts

Certain comparative amounts have been reclassified to conform to the current year's presentation.

Banks Extending Lines of Credit

Bank of Montreal - Toronto, Ontario
The Bank of Nova Scotia - Toronto, Ontario
Canadian Imperial Bank of Commerce - Toronto, Ontario
Royal Bank of Canada - Toronto, Ontario
The Toronto-Dominion Bank - Toronto, Ontario
Bank of America Canada - Toronto, Ontario
Deutsche Bank - Toronto, Ontario
National City Bank - Columbus, Ohio

Commercial Paper

Avco Financial Services Canada Limited is a direct issuer of commercial paper. Short-term notes may be purchased on any business day and are available to investors on either a discount or interest bearing basis in minimum denominations of $100,000 for terms of 1 to 365 days. All commercial paper is senior debt of the Company and is guaranteed by Avco Financial Services, Inc. Same day delivery can be made to investors through an issuing agent bank in Montreal, New York, Toronto, London, Winnipeg, Regina, Saskatoon, Calgary, Edmonton and Vancouver. For rates and information please contact Avco Financial Services, Inc., Costa Mesa, California at 1-800-334-2826.

Avco Financial Services Canada Limited

Credit Agency Ratings:	Commercial Paper	Long-term Debt
Dominion Bond Rating Service	R-1	A(High)
Canadian Bond Rating Service	A-1	A(High)

Avco Financial Services, Inc.

Credit Agency Ratings:	Commercial Paper	Long-term Debt
Standard & Poor's	A-1	A
Moody's	P-1	A-2
Fitch	F-1	A+

Senior Officers and Directors

G. BURNETT*
Director

A.J. KNIGHT
Vice President and Director

J.C. MAYNARD
Senior Vice President and Director

J.F. ROBINSON, F.C.A.*
Director (President, XYLAN Inc.)

E.R. SCHUTT, JR.
Director, and President International Finance Operations, Avco Financial Services, Inc.

D.M. WALLACE*
President and Director

*Member of the Audit Committee

R. BUKOW
Vice President and Treasurer

W.H.S. COX
Vice President

G. DAICOFF
Vice President

S. D'ITRI
Vice President

S.G. FURLONGER
Vice President and Controller

L.A. INNANEN
Vice President

J.P. LOW
Vice President

V.J. MCALEA MAJOR
Vice President, General Counsel and Secretary

A.W. MILES
Vice President and General Manager (Insurance)

M.F. PIERCE
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