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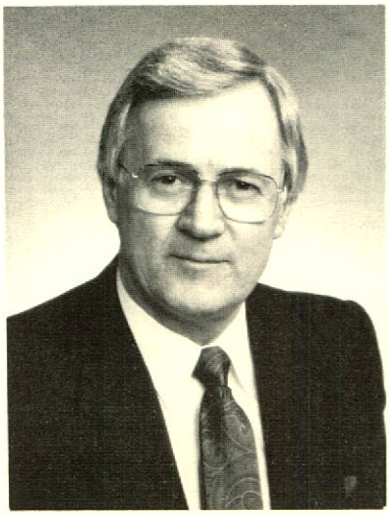
Avco
Financial
Services
Canada
Limited

1988
Annual
Report

THE PRESIDENT'S MESSAGE



Don A. Morrison
President

We are pleased to report that net earnings for Avco Financial Services Canada Limited were $24.7 million. This represents an increase of 37.3% over 1987 and the fourth consecutive year of net earnings improvement.

The increase in net earnings was due primarily to a gain from foreign exchange resulting from the prepayment of long-term debt in 1988 compared to foreign exchange losses in 1987. Also contributing to the increase in earnings was an increase in the level of receivables outstanding in 1988 offset, in part, by a loss on the prepayment of long-term debt in 1987.

Receivable growth was particularly strong as our receivable base grew almost $124 million or 16% for the year. We point with pride to the success we have had in our premier product line, the consumer loan. Since June 1983, we have posted 67 consecutive months of growth in this portfolio, truly a remarkable achievement.

Our Quality culture has flourished in the 1980's and our superior performance is the result of the work of a family of dedicated, motivated and creative people. They believe in our core values and are committed to providing our customers with the highest possible level of quality and service.

The introduction, in 1988, of our new logo was a strong statement that we care about people and reflects our commitment to serve the interests of both customers and employees. In 1989, we will raise the level of customer service and product quality to a new plateau by introducing a state-of-the-art in-branch computer system. This investment in technology is driven by our desire to be the very best.

I would personally like to thank our customers for their patronage and our employees for their hard work.

Don Morrison

CONSOLIDATED HIGHLIGHTS
For the Five Years Ended

		December 31			November 30
Thousands of dollars	1988	1987	1986	1985	1984
NET EARNINGS (a)	$ 24,655	$ 17,955	$ 17,390	$ 13,481	$ 9,270
RECEIVABLES OUTSTANDING					
Consumer loans	$432,107	$374,493	$327,928	$281,979	$230,676
Real estate	283,404	257,209	245,464	249,806	341,860
Sales finance	184,787	144,977	130,150	88,077	63,260
Other receivables	4,672	4,516	4,814	4,426	10,301
Total	$904,970	$781,195	$708,356	$624,288	$646,097
VOLUME OF BUSINESS					
Consumer loans	$284,613	$257,740	$224,116	$187,714	$156,397
Real estate	114,474	101,847	93,981	80,212	107,915
Sales finance	316,487	273,582	250,416	184,852	138,098
Other receivables	1,832	945	1,882	1,212	10,110
Total	$717,406	$634,114	$570,395	$453,990	$412,520
NUMBER OF BRANCH OFFICES	254	242	231	226	235
OTHER SIGNIFICANT DATA					
Shareholders' equity	$131,048	$116,666	$107,308	$145,251	$173,684
Total lines of credit	$166,300	$195,000	$146,098	$135,000	$105,000
Commercial paper coverage	105%	106%	101%	107%	154%
Average cost of borrowed funds	11.11%	10.49%	10.96%	11.43%	11.54%
Allowance for losses as a percentage of net receivables outstanding	3.50%	3.70%	3.97%	4.31%	4.38%
Net credit losses as a percentage of average net receivables outstanding	1.08%	1.16%	0.89%	1.26%	0.87%
Other operating expenses as a percentage of revenues	34.23%	34.26%	35.04%	36.62%	37.76%

(a) After giving retroactive effect to the change in the method of recognizing interest, discount and service charges as explained in Note 2 to the financial statements, net earnings have increased (decreased) by: 1987 - $491,000; 1986 - $439,000; 1985 - ($143,000) and 1984 - $269,000.

AUDITORS' REPORT

The Shareholders,
Avco Financial Services Canada Limited

We have examined the consolidated statement of financial position of Avco Financial Services Canada Limited as at December 31, 1988 and the consolidated statements of earnings, 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, these consolidated financial statements present fairly the financial position of the Company as at December 31, 1988 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, after giving retroactive effect to the change in the method of accounting for interest, discount and service charges as explained in Note 2 to the consolidated financial statements, on a basis consistent with that of the preceding year.

Arthur Young, Clarkson, Gordon & Co.

Chartered Accountants

London, Canada
February 10, 1989

CONSOLIDATED EARNINGS

Thousands of dollars, year ended December 31,	1988	1987
REVENUES		
Interest, discount and service charges (note 2)	$185,189	$164,292
Insurance premiums	5,644	4,846
Investment income	4,462	3,820
Other revenues	2,086	2,106
Total revenues	197,381	175,064
EXPENSES		
Interest and debt expense		
Interest on long-term note debt	61,012	49,213
Amortization of long-term note debt financing costs	1,574	1,133
Interest on short-term note debt	10,854	12,771
Total interest and debt expense	73,440	63,117
Provision for losses on collection of receivables, less recoveries	11,476	9,023
Insurance losses and adjustment expenses	3,342	3,043
Other operating expenses	67,567	59,971
Loss (gain) on foreign exchange	(6,427)	2,390
Loss on prepayment of long-term note debt		1,633
Total expenses	149,398	139,177
Earnings before income taxes	47,983	35,887
Income taxes	23,328	17,932
NET EARNINGS	$ 24,655	$ 17,955

See accompanying notes.

CONSOLIDATED RETAINED EARNINGS

Thousands of dollars, year ended December 31,	1988	1987
Balance at beginning of year, as previously reported		$ 78,946
Adjustment for accrued interest (note 2)		4,800
Balance at beginning of year, as adjusted	$ 93,667	83,746
Net earnings	24,655	17,955
Cash dividend paid on common shares	(10,273)	(8,018)
Cash dividends paid on preference shares		(16)
Balance at end of year	$108,049	$ 93,667

See accompanying notes.

CONSOLIDATED FINANCIAL POSITION

Thousands of dollars, December 31,	1988	1987
ASSETS		
Cash	$ 867	$ 3,074
Receivables (note 3)	904,970	781,195
Allowance for losses	(31,674)	(28,904)
	873,296	752,291
Investments (note 4)	47,216	41,543
Accrued interest, prepaid expenses and other receivables (note 2)	20,817	19,928
Deferred income taxes	1,144	3,130
Income taxes recoverable		3,832
Property and equipment, at cost (less accumulated depreciation and amortization: $1,622 in 1988 and $994 in 1987)	6,327	3,303
Other assets, net of amortization	7,499	5,569
TOTAL ASSETS	$957,166	$832,670
LIABILITIES AND SHAREHOLDERS' EQUITY		
Short-term note debt - unsecured - commercial paper	$158,070	$184,191
Accounts payable and accrued liabilities	35,124	29,793
Income taxes payable	3,783	
Deferred insurance commissions	1,259	1,493
Insurance provisions and claims		
Unearned premiums	20,944	17,551
Provision for outstanding claims	11,270	9,923
Unrealized gain on foreign exchange (less accumulated amortization: $6,780 in 1987)		1,103
Long-term note debt - unsecured (note 7)	595,668	471,950
Total liabilities	826,118	716,004
SHAREHOLDERS' EQUITY		
Common share capital (note 5)	16,788	16,788
Additional paid-in capital	6,211	6,211
Retained earnings	108,049	93,667
Total shareholders' equity	131,048	116,666
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$957,166	$832,670

See accompanying notes.

On behalf of the Board

W.A. Barrett
Director

D.A. Morrison
Director

CHANGES IN CONSOLIDATED FINANCIAL POSITION

Thousands of dollars, year ended December 31,	1988	1987
OPERATING ACTIVITIES		
Net earnings	$ 24,655	$ 17,955
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Provision for losses on receivables	15,706	12,757
Increase in accrued interest payable	5,797	4,011
Depreciation and amortization of property and equipment and other assets	2,234	2,052
Decrease in deferred income taxes	1,986	3,953
Increase in provision for outstanding claims	1,347	5,514
Increase in accrued interest receivable	(1,994)	(1,002)
Loss (gain) on foreign exchange	(6,427)	2,390
	43,304	47,630
Changes in non-cash operating accounts		
Increase (decrease) in income taxes payable	7,615	(7,780)
Increase in unearned insurance premiums	3,393	11,384
Decrease in deferred insurance commissions	(234)	(623)
Decrease in accounts payable and accrued liabilities	(466)	(2,757)
Decrease (increase) in other assets	(2,432)	736
	51,180	48,590
FINANCING ACTIVITIES		
Proceeds from issuance of long-term note debt	241,400	151,000
Decrease (increase) in unrealized loss on foreign exchange	(417)	8,243
Cash dividend on common shares	(10,273)	(8,018)
Increase (decrease) in short-term note debt	(26,121)	39,587
Repayment of long-term note debt	(111,941)	(143,218)
Cash dividends on preference shares		(16)
Redemption of preference shares		(563)
	92,648	47,015
INVESTING ACTIVITIES		
Additional funds advanced on receivables	(717,406)	(634,114)
Principal collections on receivables	586,510	551,702
Purchases of property and equipment (net)	(3,651)	(1,373)
Increase in investments	(5,673)	(11,898)
Bulk purchases of receivables	(5,815)	(2,434)
	(146,035)	(98,117)
Net decrease in cash	(2,207)	(2,512)
Cash at beginning of year	3,074	5,586
Cash at end of year	$ 867	$ 3,074

See accompanying notes.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 1988

NOTE 1: SUMMARY OF 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.

(b) Receivables

Interest ceases to be accrued when an account is contractually past due 90 days. Thereafter, interest income is recognized on a cash basis only.

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 no payment has been received for eight 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.

(c) Deferred insurance commissions

The entire amount of insurance commissions received is deferred and credited to earnings over the life of the related insurance contracts on a basis consistent with the premium recognition method.

(d) Deferred income taxes

Income taxes are provided on the basis of accounting income which differs from taxable income on which income taxes are currently payable as a result of timing differences principally relating to: the allowance for losses, deferred development costs and unrealized foreign exchange gains or losses.

(e) Foreign exchange

Assets and liabilities denominated in foreign currency have been translated at the closing rates on the balance sheet date. 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 except for the amounts relating to long-term note debt in which case it is the Company's practice to defer the translation gain or loss and to provide for the amortization of such deferred amount annually on a straight-line basis over the remaining term of related long-term note debt outstanding. At December 31, 1988 there was no U.S. dollar long-term note debt outstanding.

(f) 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: business machines – 5 years; computer hardware and software – 5 years; furniture and fixtures – 8 years; leasehold improvements – 8 years and signs – 15 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 reporting period.

(g) Other assets

Other assets consist of (1) intangibles recognized in the acquisition of subsidiaries (all prior to 1974) which are being amortized on a straight-line basis over 25 years, (2) debt financing costs which are amortized on a straight-line basis over the terms of the respective debt issues, and (3) deferred development costs relating to the external costs of designing and developing a branch office computer system which will be amortized on a straight-line basis over 5 years, commencing in 1989 when the system becomes fully operational.

(h) Deferred loan fees and origination costs

Loan fees and origination costs are amortized into earnings over the respective terms of the applicable lending periods. At December 31, 1988 and 1987 the Company had no deferred loan fees or origination costs.

(i) Insurance subsidiary

The following are the significant accounting policies followed by the Company's insurance subsidiary for purposes of these consolidated financial statements:

(i) Unearned premiums

Unearned premiums represent the portion of premiums written which is determined to be unearned on the balance sheet date. These unearned premiums are taken into earnings over the life of the policies in the following manner: (1) for accident and sickness insurance in relationship to anticipated claims and (2) for property and casualty insurance on a straight-line basis.

(ii) Provisions for outstanding claims

Provisions are made for losses and adjustment expenses, as claims are reported, based on estimates of the probable ultimate liability, and are adjusted for subsequent developments. Provisions are also made for estimated losses incurred but not reported. The provisions are net of estimated reinsurance recoverable.

NOTE 2: CHANGE IN ACCOUNTING POLICY

The Company has retroactively changed its accounting policy with regards to interest, discount and service charges from a collection basis to an accrual basis. The effect of this change as at December 31, 1986 is to record accrued interest of $9,917,000 and to increase retained earnings by $4,800,000.

The effect of this change for 1988 and 1987, is to record accrued interest of $12,913,000 and $10,919,000 and to increase net earnings by $1,027,000 and $491,000, respectively.

NOTE 3: RECEIVABLES

Thousands of dollars, December 31,	**1988**	1987
Consumer loans	**$432,107**	$374,493
Real estate	**283,404**	257,209
Sales finance	**184,787**	144,977
Other	**4,672**	4,516
	$904,970	$781,195

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 96 percent of the dollar amount of consumer loan accounts are written with terms of 48 months or less.

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 5 years.

Sales finance includes retail instalment contracts with average written terms of 10 months and Revolving Charge accounts.

NOTE 4: INVESTMENTS AT COST

Thousands of dollars, December 31,	**1988**	1987
Short-term notes	**$ 12,550**	$ 10,400
Bonds (market value: $21,695 in 1988 and $17,590 in 1987)	**22,150**	17,528
Stocks (market value: $12,820 in 1988 and $13,417 in 1987)	**12,468**	13,529
Mortgages	**48**	86
	$ 47,216	$ 41,543

NOTE 5: SHARE CAPITAL

Thousands of dollars, December 31,	**1988**	1987
Common shares		
Authorized - 2,000,000 shares		
Issued -		
December 31, 1988 and 1987		
- 1,670,382 3/4 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.

NOTE 6: LEASE AND FIXED ASSET COMMITMENTS

The Company's executive office is occupied under a long-term lease expiring in 1999 at an annual rental of approximately $613,000. The branch office locations are occupied under leases having terms generally not in excess of five years at annual rentals of approximately $2,916,000. Vehicles are leased over terms generally not in excess of three years at annual rentals of approximately $1,240,000.

The total net rental obligations at December 31, 1988 under all leases are as follows: 1989 - $4,769,000; 1990 - $3,496,000; 1991 - $2,536,000; 1992 - $1,770,000; 1993 and thereafter - $4,623,000. Rent expense charged to earnings for the years ended December 31, 1988 and 1987 amounted to $5,555,000 and $4,771,000, respectively.

The Company has planned commitments for the purchase of $5,278,000 of computer hardware in 1989, relating to the development of a branch office computer system.

NOTE 7: GUARANTEED LONG-TERM NOTE DEBT

Thousands of dollars, December 31,	1988	1987
Due in Canadian Funds		
9½ notes payable maturing March 1993 (a)	$ 793	$ 908
10% notes payable maturing February 1993	1,000	
10% notes payable maturing March 1993	3,600	
10⅛% notes payable maturing February 1993	5,000	
10⅛% notes payable maturing March 1993	10,000	
10$^2/_{10}$% notes payable maturing March 1993	3,000	
10¼% notes payable maturing July 1992	75,000	75,000
10.46% notes payable maturing June 1991	10,000	
10½% notes payable maturing July 1991	3,000	
10.56% notes payable maturing November 1991	5,000	
10.65% notes payable maturing November 1991	5,000	
10¾% notes payable maturing April 1991	60,000	60,000
10$^8/_{10}$% notes payable maturing September 1993	5,000	
10.85% notes payable maturing November 1991	4,000	
10⅞% notes payable maturing January 1989	3,000	3,000
10.90% notes payable maturing November 1991	6,500	
11% notes payable maturing January 1993	100,000	
11% notes payable maturing August 1993	75,000	
11.05% notes payable maturing September 1993	1,800	
11.05% notes payable maturing October 1993	1,500	
11.08% notes payable maturing October 1993	1,000	
11$^1/_{10}$% notes payable maturing December 1990	1,000	1,000
11.38% notes payable maturing September 1993	1,000	
11⅝% notes payable maturing October 1992	75,000	75,000
11¾% notes payable		500
12% notes payable maturing January 1989	5,000	5,000
12% notes payable maturing May 1990	50,000	50,000
12¼% notes payable maturing February 1989	7,500	7,500
12$^3/_{10}$% notes payable maturing January 1989	2,000	2,000
12¾% note payable maturing April 1990	1,000	1,000
12¾% notes payable maturing May 1990	15,975	15,975
13% notes payable		50,000
13% notes payable		2,090
13% notes payable maturing February 1989	8,000	8,000
13% notes payable maturing November 1989	50,000	50,000
Total due in Canadian funds	595,668	406,973
Due in U.S. funds		
Floating rate notes payable (U.S. $50,000) (b)		64,977
Total long-term note debt	$595,668	$471,950

(a) Subject to sinking fund provision.

(b) Prepayment in July 1988 resulted in an unusual gain from foreign exchange of $5,741,000.

The maturities and sinking fund obligations on long-term note debt for the five years subsequent to December 31, 1988 and thereafter are as follows: 1989 – $75,550,000; 1990 – $68,025,000; 1991 – $94,550,000; 1992 – $150,050,000; 1993 and thereafter – $207,493,000.

The Company has entered into several interest rate agreements which come into effect in 1989 and 1990 and expire through 1993. These agreements have the effect of fixing the rate on $65,000,000 of variable rate short-term note debt, thereby allowing the Company to issue short-term note debt without being exposed to the effects of varying interest rates. The interest rate exchange agreements have a weighted average interest rate of 10.49%.

NOTE 8: OPERATIONS BY INDUSTRY SEGMENT

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

Thousands of dollars, December 31,	**1988**	1987
Revenues		
Financial Services	**$187,631**	$166,901
Insurance Services	**9,750**	8,163
Total	**$197,381**	$175,064
Operating profit		
Financial Services	**$ 37,597**	$ 36,689
Insurance Services	**3,959**	3,221
Total	**$ 41,556**	$ 39,910
Identifiable assets		
Financial Services	**$912,749**	$793,809
Insurance Services	**47,829**	41,720
Intercompany eliminations	**(3,412)**	(2,859)
Total	**$957,166**	$832,670

Operating profit by industry segment represents total revenues less operating expenses before loss (gain) on foreign exchange (1988 – ($6,427,000) and 1987 – $2,390,000) and loss on prepayment of long-term note debt (1987 – $1,633,000) in Financial Services, and income taxes.

Insurance Services include investments of $46,171,000 and $40,518,000 at December 31, 1988 and 1987, respectively. These investments are subject to government regulation which controls the type of investments permitted, and are not interchangeable with other assets of the Company.

Rules prescribed by the Office of the Superintendent of Financial Institutions with respect to capital requirements for the Company's insurance subsidiary and certain provisions of the Canadian and British Insurance Companies Act (Canada) have the effect of restricting the amount of dividends which the subsidiary is permitted to pay in any year. Retained earnings at December 31, 1988 and 1987 includes the unremitted accumulated net earnings of the insurance subsidiary of $5,050,000 and $3,925,000, respectively.

NOTE 9: SUPPLEMENTAL INFORMATION

Amounts paid for administrative services (to the parent company) deducted in arriving at net earnings for the years ended December 31, 1988 and 1987 amounted to $1,195,000 and $638,000, respectively. Amounts received for administrative services (from certain affiliates) included in arriving at net earnings for the years ended December 31, 1988 and 1987 amounted to $157,000 and $488,000, respectively.

NOTE 10: COMPARATIVE AMOUNTS

Certain amounts for 1987 have been restated to conform with the financial statement presentation adopted for 1988.

SENIOR OFFICERS AND DIRECTORS

AVCO FINANCIAL SERVICES CANADA LIMITED

+ W.A. Barrett: Director (Executive Vice President and President International Finance Operations, Avco Financial Services, Inc.)

D.A. Morrison: President and Director

+ J.F. Robinson, F.C.A.: Director (President, XYLAN Inc.)

+ Colonel L.F. Stevens, F.C.A.: Director (Financial Consultant)

L.R. Guest: First Vice President, Secretary and Director

A.J. Smith-Windsor: First Vice President, General Manager of London and Midland General Insurance Company and Director

W.A. Carswell: Vice President

R.J. Columbus: Vice President

J.G. Comrie: Vice President and Treasurer

W.H.S. Cox: Vice President

J.A. Harcourt: Vice President

K.G. Lawrence: Vice President (Insurance)

A.W. Miles: Vice President (Insurance)

J.N. Moore: Vice President

W.B. O'Dell: Vice President

D.J. Sadler: Vice President

H.A. Vanden Heuvel: Vice President and Controller

R.W.K. Webb: Vice President

+ Member of the Audit Committee

BANKS EXTENDING LINES OF CREDIT

Bank of Montreal - Toronto, Ontario
The Bank of Nova Scotia - Toronto, Ontario
Canadian Imperial Bank of Commerce - London, Ontario
The Royal Bank of Canada - Toronto, Ontario
Toronto-Dominion Bank - London, Ontario
National Westminster Bank of Canada - Toronto, Ontario
Banque Nationale de Paris (Canada) - Toronto, Ontario
The Chase Manhattan Bank of Canada - Toronto, Ontario
Citibank Canada - Toronto, Ontario
Dresdner Bank - Los Angeles, California
Swiss Bank Corp. - Los Angeles, California
First National Bank of Chicago - Chicago, Illinois

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 unconditionally 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, Saskatoon, Calgary, Edmonton and Vancouver. For rates and information please contact the Company's Treasury Department office. Toronto area: 1-800-265-7953; Toronto direct line: 364-4773; and London (collect): 519-672-4220.

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