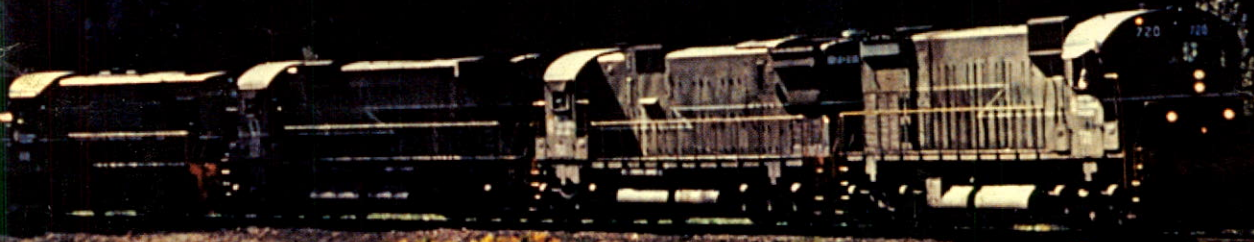




**BRITISH
COLUMBIA
RAILWAY**



ANNUAL REPORT 1978

Highlights

	1978	1977
Operating revenues	\$114,309,000	\$100,639,000
Operating expenses	108,021,000	109,091,000
Operating profit (loss)	6,288,000	(8,452,000)
Interest	54,338,000	47,983,000
Net loss	46,848,000	58,291,000
Carloadings	154,850	152,597
Tonnage	8,842,253	8,283,169
Number of employees	2,950	3,204

Officers

M. C. Norris
President and Chief Executive Officer

J. R. Clarke
Vice-President — Finance

N. A. McPherson
Vice-President — Operations and Maintenance

G. L. Ritchie
Vice-President — Administration and Corporate Development

A. C. Sturgeon
Vice-President — Marketing and Sales

*Corporate Secretary
and Administrative Assistant*
Mrs. Marian Robson

General Offices: 1095 West Pender Street,
Vancouver, B.C. V6E 2N6

Bond Registration Office: Parliament Buildings,
Victoria, B.C. V8V 1X4

COVER: Photo by Ken Talbot, Engineering Assistant, catches the early morning departure of a northbound British Columbia Railway freight train as it passes a sunlit meadow near Pemberton, B.C., some 95 miles (152 km) north of Vancouver.

Board of Directors

J. N. Fraine
Chairman of the Board

Stanley M. Horner
Chartered Accountant, retired

E. C. Hurd
*Chairman of the Board
Trans Mountain Pipe Line Co. Ltd.*

J. Norman Hyland
President, Granduc Mining Co. Ltd.

Glenn W. McPherson
*Chairman
Vancouver Port Authority*

Hon. D. M. Phillips
*Minister of Economic Development
Province of British Columbia*

Bruce Rome
Businessman

Robert E. Swanson
Consulting Engineer

Donald N. Watson
*Chairman
President
Chief Executive Officer
Canadian Cellulose Company Limited*

Report of the Board of Directors

Encouraging progress was made in a number of important areas during 1978. Particularly gratifying to the Board was the improvement in the Railway's operating performance. Following operating losses of \$21,056,000 in 1976 and \$8,452,000 in 1977 the Railway recorded an operating profit of \$6,288,000 in 1978.

In December, the Directors were pleased to announce the appointment of Mackenzie C. Norris as President and Chief Executive Officer of the Railway. Mr. Norris has had more than 26 years of experience in the railway industry. He joined the British Columbia Railway as Regional Manager in February, 1970. Two years later he was appointed General Manager and in March, 1973 became Vice-President Operations. He was appointed Vice-President in January, 1974, a position he held until his December, 1978 appointment.

On May 26th, 1978 the Provincial Government announced its decision to continue operation of the Fort Nelson Extension. The Government's financial commitment is twofold: to provide the capital funds necessary to upgrade the Extension to branch line standards and to provide annual subsidies to protect the Railway against operating losses on the Extension. A three-year upgrading program is scheduled to be completed in 1980. Two joint committees, representing the Railway and the Provincial Government, were formed in mid-year to consider the allocation of costs and methods of reimbursement to the Railway for the Fort Nelson Extension upgrading program.

The Report of the Royal Commission on B.C. Rail was filed with the Provincial Government on August 28th. The Report has been studied in detail by the Board of Directors and Management. Discussions will be held with the shareholder, the Provincial Government, to consider the several recommendations of the Royal Commission.

Some of the main issues receiving special consideration are financial restructuring of the Railway, the ongoing relationship between the independent Board and the Provincial Government and the method of payment for the maintenance of uneconomic lines and services.



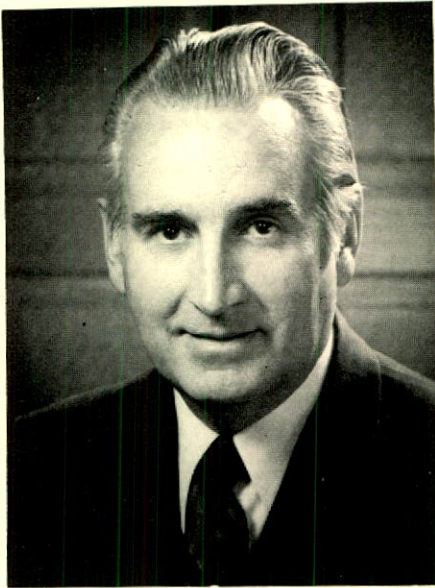
Jack Fraine

The Board is pleased with the general improvement in labour-management relations on the Railway. Despite a brief interruption in rail service, agreement was reached in the final quarter of the year, on terms for a one-year contract expiring July 31st, 1979. Ratification of the agreement marked the first contract to be negotiated by the newly formed Council of Trade Unions which represents all unions on the Railway.

The Railway's success in 1978 was achieved through the hard work of everyone involved throughout its operations. The Directors wish to express sincere appreciation to B.C. Rail customers for their continued support and to the officers and employees for their contribution to the Company's performance.

On Behalf of the Board

J. N. Fraine
Chairman



M.C. Norris

President's Report

A major financial milestone was reached in 1978 when, for the first time in many years, the year-end results showed an operating profit before interest charges.

The operating profit of \$6.3 million includes a \$5.8 million payment as a contribution to the operating expenses on the developmental Fort Nelson Line. The significant point, of which all employees can be proud, is that even without the \$5.8 million payment the Railway had an operating profit over the entire line which includes the two developmental lines — Fort Nelson and Dease Lake north of Fort St. James.

Offsetting the improved operating performance, interest costs on outstanding debt continued to climb rising from \$47,983,000 in 1977 to \$54,338,000 in 1978. Net loss for the year, after interest and other charges, was \$46,848,000, down from the \$58 million net loss reported in the previous year.

A record volume of carloadings, virtually uninterrupted service and rising revenues from car rentals were the major factors favourably affecting the revenue picture. A portion of the Railway's revenues is received in U.S. dollars and the premium on these funds also contributed to the improved performance. In addition, costs were held in line despite inflationary pressures, increasing by less than five per cent, from \$109.1 million in 1977 to \$113.9 million in 1978.

Another important event in 1978 was the filing of the final report of the Royal Commission on B.C. Rail. This inquiry, while demanding in time and effort, was a positive experience for the Railway and clarified many issues for the citizens of British Columbia with respect to this provincially-owned transportation system.

In May the Provincial Government announced its decision to continue operation of the Fort Nelson Extension. The Government will provide the capital necessary to upgrade the line, over a three-year period, to acceptable branch line standards.

Immediately following the announcement work began on the rehabilitation program. As described elsewhere in the Report, the first year of the program was completed on schedule and within budget.

During the year the Company introduced a new pension plan and new employee benefit plans. The pension plan introduces several improvements over the previous plan while the benefits package now ranks as one of the most progressive in British Columbia.

Last fall a Company-wide suggestion system was introduced. The response from employees has been most gratifying. From the date of implementation in mid-September to year-end more than 200 suggestions had been submitted, several cash awards had been paid and many of the award-winning suggestions had been implemented.

Labour-management relations continued to reflect steady improvement. In October a one-year contract was negotiated successfully for the first time with the Council of Trade Unions which represents all unions on the Railway.

There is still much room for improvement in the Railway's safety performance. Despite our efforts, the overall frequency of lost time accidents showed a slight increase over the previous year. With the introduction of a new approach to the safety program we have set as a goal for the year ahead a 25% reduction in overall injuries.

During 1978 the Management Committee undertook a series of meetings with our employees and customers and with business leaders, mayors and councils and news media at nearly all communities along the line to establish much needed lines of direct communication. The results were gratifying and it is expected that these visits will become an annual event.

Further progress was made on the Railway's L.I.C. (location, identification, control) program which employs advanced electronic techniques to monitor and control train movements. This system is being developed by the Railway in association with Glenayre Electronics of North Vancouver.

The next phase is to equip and operate an entire Railway subdivision as a demonstration to the North American railway industry of the system's capabilities. Funding for the project of \$1.6 million will be provided by the Federal Transportation Development Centre and \$800,000 is expected from the Provincial Government.

The capital expenditures in 1978 were \$18 million. This substantial reduction from the heavier expenditures of recent years reflects the benefit of major improvement programs to plant and equipment which in turn is reflected in more efficient operation and maintenance. In 1978 with the addition of 196 bulkhead flatcars, the Railway's car fleet, including shipper leases, totalled almost 10,000 cars.

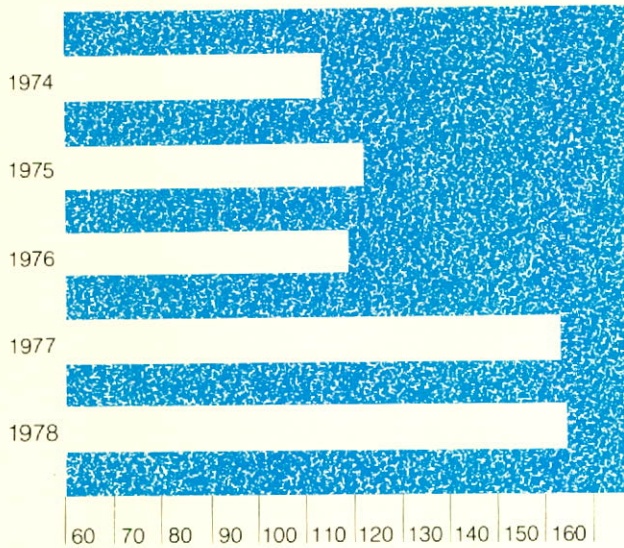
I am optimistic concerning the Railway's future as we work towards achieving its long-term objectives. Foremost among these are financial restructuring, broadening of the traffic base, continuation of the trend to harmonious labour-management relations and continued effort to improve the productivity and efficiency of the Railway's operating and management procedures.

Of particular satisfaction to management was the employees' performance in 1978. The importance of their efforts is recognized and appreciated and is vital to the continuing success of the Railway.

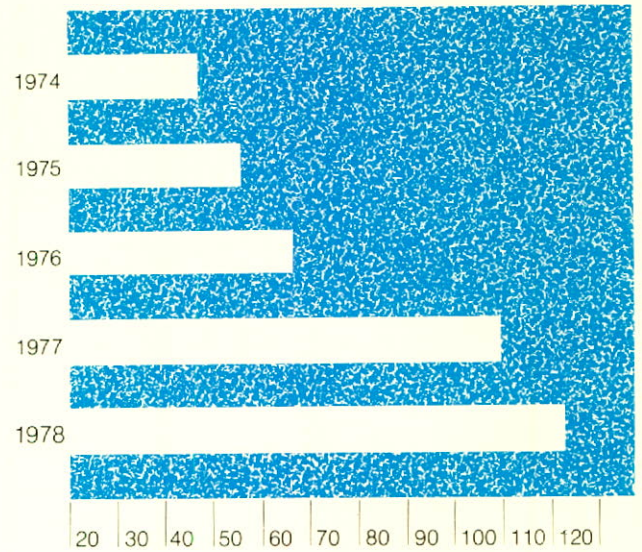
Throughout the year the Directors gave unstintingly of their time and experience in addressing many important issues which confronted the Railway. On behalf of the management and staff I express my appreciation for their support.

M. C. Norris
President and
Chief Executive Officer

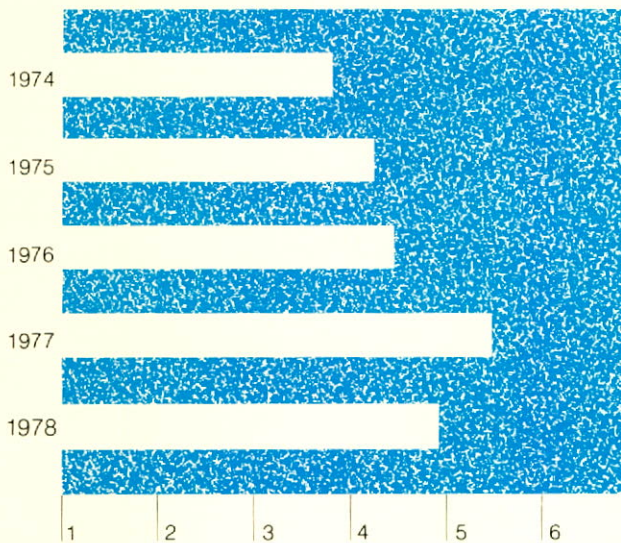
Carloadings (in thousands)



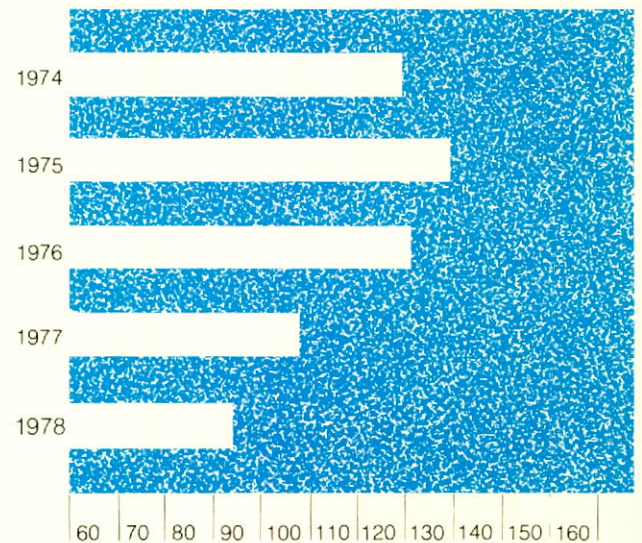
Gross Revenue (in millions of dollars)



Gross Ton Miles (in billions)



Operating Ratio



*one ton hauled one mile equals 1 gross ton mile
(including contents and car weight)*

THE YEAR IN REVIEW

TRAFFIC

For the second consecutive year carloadings moved in record volume. Loadings in 1978 totalled 154,850 compared with the previous high of 152,597 achieved in 1977.

Also at a record high was net tonnage hauled which totalled 8,842,253, up from 8,283,169 in the previous year.

A number of factors contributed to the year's record traffic performance. Foremost among these was a continuing strong demand for forest products, uninterrupted service, an adequate supply of railcars and motive power, closer liaison between the Railway and its customers and an improved physical plant.

Passenger traffic was slightly lower than in the previous year. The Railway's Budd car service carried 75,592 passengers compared with 78,770 in 1977.

Completing its fifth year in operation under contract with the Provincial Government, the Royal Hudson steam train excursion from North Vancouver to Squamish continued as a popular attraction. Sixty-eight thousand passengers were carried on 107 trips.

LOCOMOTIVE AND CAR FLEETS

Fifteen diesel-electric locomotives were rebuilt during the year at Squamish Shops and major repairs were completed on an additional 25 locomotives.

The Car Shop handled a record volume of work completing 712 major repairs and some 2,100 light repairs. Repainting of cars was done at the Paint Shop of Railwest Manufacturing which ceased operations in August, 1977.

Production has increased at intermediate repair points at North Vancouver and Prince George. Each terminal is handling, on average, 800 light car repairs monthly.

A new fuel dispensing system was installed at Prince George and a repair pit at Chetwynd.

At North Vancouver improvements were made to lighting, roadways and washroom accommodation in the Shop area.

The Railway owns 119 diesel locomotives and operates 9,931 freight and other cars. Its fleet of cars, trucks and road trailers totals 550 units.

ENGINEERING

Fort Nelson Extension

Upgrading on the Extension commenced in June and this first year of work on the three-year program was completed, on schedule and within budget.

Major work included replacing 50 miles (80 km) of 85-lb. rail with 100-lb. rail from Fort Nelson south, ballasting over a distance of 50 miles (80 km), rehabilitation of 85-lb. rail, installation of ties, bank widening, culvert extensions, line revisions, stabilization and reconstruction of existing grade.

Main Track Improvements

There were 77 miles (123 km) of new rail laid on the main track during the year.

Other improvements included the installation of 160,000 treated ties, 186.3 miles (297.6 km) of ballasting and 265 miles (424 km) of surfacing outside the ballast area.

Two timber trestles were replaced with prestressed concrete girders and four smaller bridges were upgraded. A major siding, more than one mile in length, was built at Birken, 17 miles (27 km) north of Pemberton.

Ten bridge decks were fireproofed, 565 miles (904 km) of ballast was sprayed for weed control, and the Sperry rail flaw detector car tested 254 miles (406.4 km) of main track.

New accommodation was provided for section forces at Soda Creek, D'Arcy and Garibaldi.

By year-end tenders had been received from nine bidders on a catering contract covering all of the Railway's on-line camps.

Elsewhere, in the area of engineering, the following projects were completed during the year: a waste treatment plant at Squamish, a Prince George industrial yard study and improvements and upgrading of buildings and facilities including the Transportation Building in North Vancouver, lighting at the Squamish Car Shop and water supply at Fort Nelson.

Consulting Services

The Railway's Engineering Services Department, under contract with the Federal and Provincial Governments, completed pre-engineering studies to provide access to the northeast coal fields via the Anzac-Tumbler Ridge route. The studies produced a cost estimate for construction of a 65 mile (105 km) branch line.

In addition, the department was asked to undertake a similar study to provide access to the coal fields via Chetwynd. Referred to as the Chetwynd South Route, the line would be approximately 55 miles (90 km) in length. The study was in progress at year-end and is expected to be completed by the end of March, 1979.

COMMUNICATIONS

In August the Railway's Communications Department received an order from the Westcoast Transmission Company to provide a number of microwave circuits for Westcoast's new gas processing plant at Hasler south of Chetwynd. Construction of these circuits enabled the Railway to upgrade its own system in the area.

As a result, three repeater stations were upgraded during the year — one at Nelson Creek in the Pine Pass area, one at Hasler Creek and one at Wabi Hill, three miles south-east of Chetwynd. The latter is the Railway's main repeater station in this area.

INDUSTRIAL DEVELOPMENT

Industrial development along the rail line in 1978 was marked by the construction of several new facilities and some major plant expansions.

Expansion of forest product manufacturing plants was completed at Williams Lake, Prince George, Taylor and Fort St. James. A sawmill at Fort Nelson, destroyed by fire in the fall of 1977, was reconstructed and resumed production early in 1978.

New plants went into production at Pemberton, Prince George, Fort St. John and Fort Nelson. Included among these were lumber manufacturing, sash and door production, warehousing and bulk petroleum facilities.

LABOUR RELATIONS

Labour-management relations on the Railway continued to improve in 1978.

Early in the year the Council of Trade Unions was formally certified as the sole bargaining agent for the Railway's 2,100 union employees, thus ending the fragmented bargaining procedures which had prevailed in the past.

Commodities Carried

Carloadings:	1974	1975	1976	1977	1978
Lumber — to Canadian, U.S. & off-shore markets (includes plywood & veneer).	41,141	50,390	49,341	65,654	64,586
Other Forest Products (includes logs and wood chips).	31,817	28,545	32,944	39,217	44,328
Manufacturers & miscellaneous (includes wood pulp and paper).	19,844	19,699	19,014	23,449	23,126
Piggyback	5,442	5,236	5,699	8,560	8,762
Merchandise L.C.L.	5,650	5,071	3,985	4,643	4,547
Products of mines	3,900	4,529	2,973	3,644	2,553
Grain	1,734	3,170	2,539	2,749	1,695
Total revenue cars loaded on line	109,528	116,640	116,495	147,916	149,597
Received from connections	4,685	3,804	2,985	4,681	5,253
	<u>114,213</u>	<u>120,444</u>	<u>119,480</u>	<u>152,597</u>	<u>154,850</u>

Rolling Stock Fleet

	1974	1975	1976	1977	1978
Motive power- diesel units	100	107	119	119	119
Freight cars	7,357	8,280	8,851	9,254	9,376
Passenger cars	6	5	5	6	6
Boarding and work cars	513	538	546	562	549



BRITISH COLUMBIA RAILWAY

A STORY OF PROGRESS

From its humble beginnings, with two locomotives, 52 cars and a staff of 128 people, most of them at work on construction, the British Columbia Railway has been transformed, during the course of a single lifetime, into one of the most modern railroads in North America. Today it has a staff of almost 3,000.

Since it was incorporated as the Pacific Great Eastern Railway on February 27, 1912 it has played, in a period spanning less than seven decades, an increasingly important role in the growth of the provincial economy and in moving British Columbia's resources to both domestic and world markets. The old PGE was laid to rest with the change of the Railway's name on April 1, 1972.

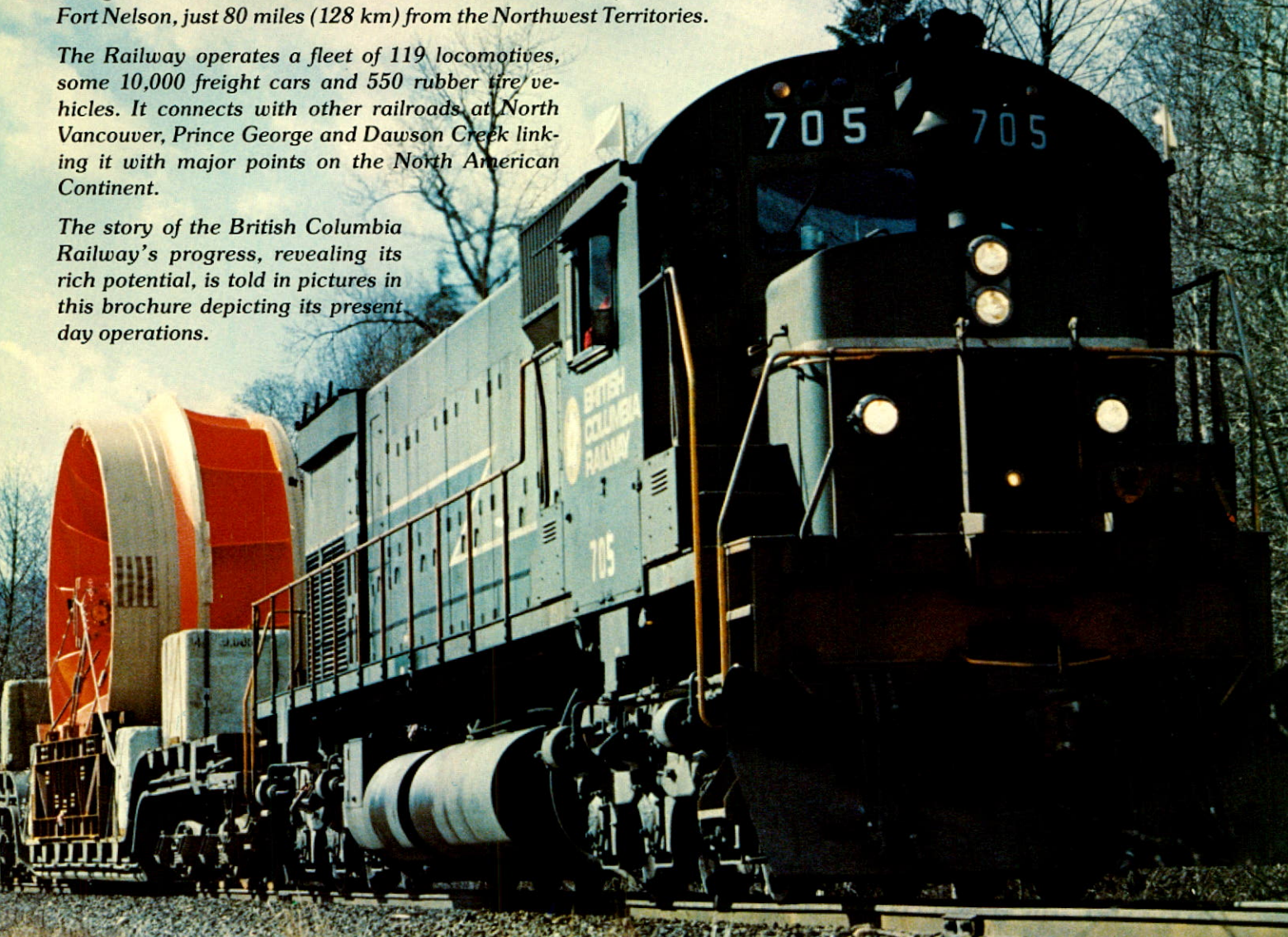
The Railway now generates revenues in excess of \$100,000,000 per year and handles more than 150,000 carloadings annually.

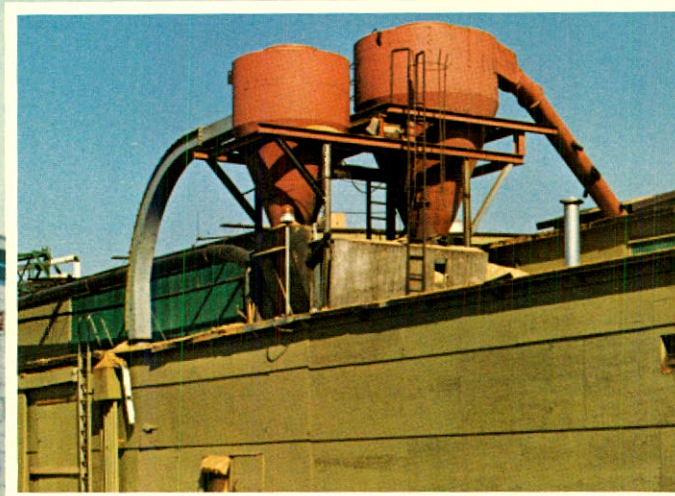
Industry continues to flourish throughout the areas which it serves. The Railway owns Industrial Parks at Williams Lake, Prince George, Fort St. James, Mackenzie, Dawson Creek, Fort St. John and Fort Nelson.

Employing microwave communications throughout its system, it operates 1,631 miles (2,610 km) of road including yard tracks and sidings. Its main track extends 1,261 miles (2,017 km) as far north as Fort Nelson, just 80 miles (128 km) from the Northwest Territories.

The Railway operates a fleet of 119 locomotives, some 10,000 freight cars and 550 rubber tire vehicles. It connects with other railroads at North Vancouver, Prince George and Dawson Creek linking it with major points on the North American Continent.

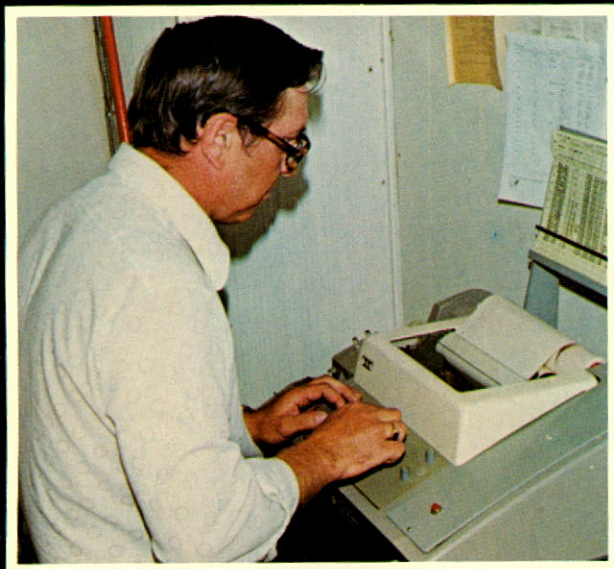
The story of the British Columbia Railway's progress, revealing its rich potential, is told in pictures in this brochure depicting its present day operations.





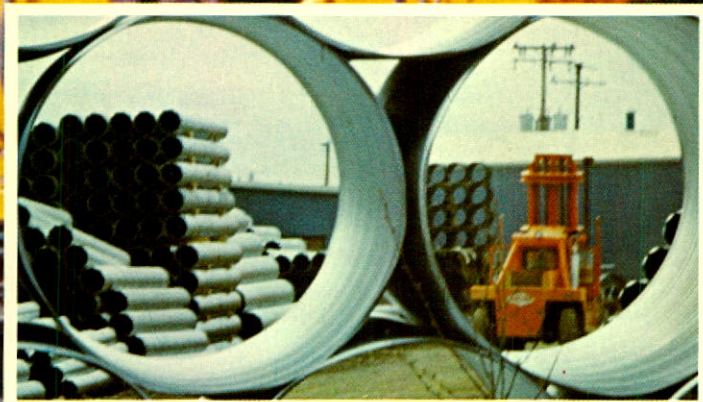
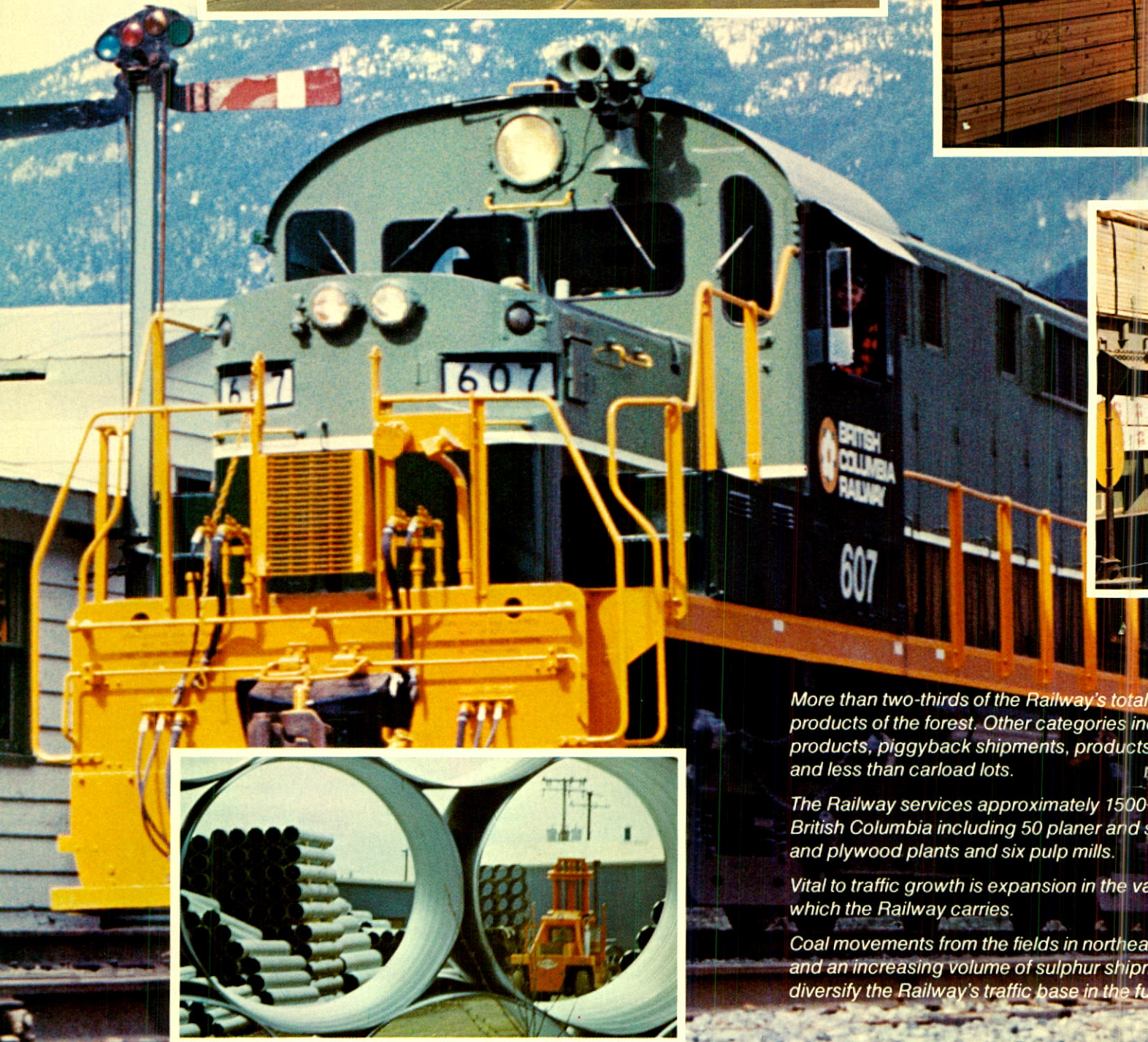
Myriads of plants are located along the Railway's route between North Vancouver and Fort Nelson.

Pulp mills, saw mills, chemical plants, oil refineries, light manufacturing and distribution facilities have sprung up along the right-of-way providing employment for British Columbians and generating revenues for further industrial expansion.



At the British Columbia Railway people are of prime importance. With a staff of almost 3000, the Railway has some 250 separate job classifications.

This is a pictorial salute to some of those who help to make the Railway run.



More than two-thirds of the Railway's total products of the forest. Other categories include piggyback shipments, products and less than carload lots.

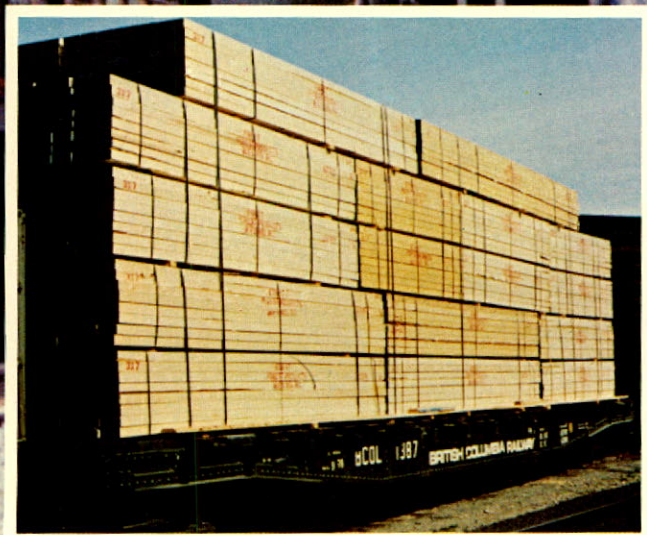
The Railway services approximately 1500 British Columbia including 50 planer and sawmills and plywood plants and six pulp mills.

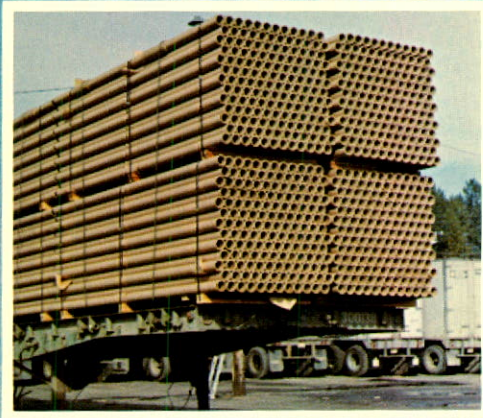
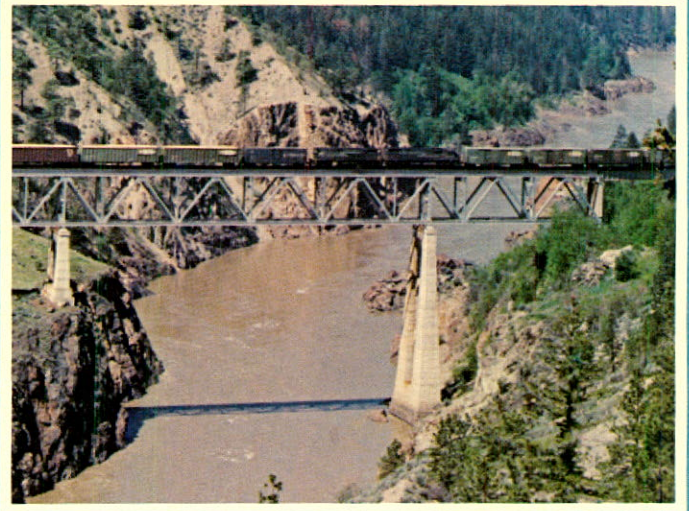
Vital to traffic growth is expansion in the volume of traffic which the Railway carries.

Coal movements from the fields in northeastern British Columbia and an increasing volume of sulphur shipments diversify the Railway's traffic base in the future.



Annual carloadings are
include manufactured
of the mines, grain
carload shippers in
law mills, six veneer
variety of commodities
Western British Columbia
ments are expected to
ture





The special shipment may be wide, long or unusually heavy.

Whether it's hauling a giant turbine runner over the Fraser River Bridge near Lillooet, moving pipe to northern British Columbia or whatever the variety of shipment, the Railway has the personnel and equipment to meet the challenge.

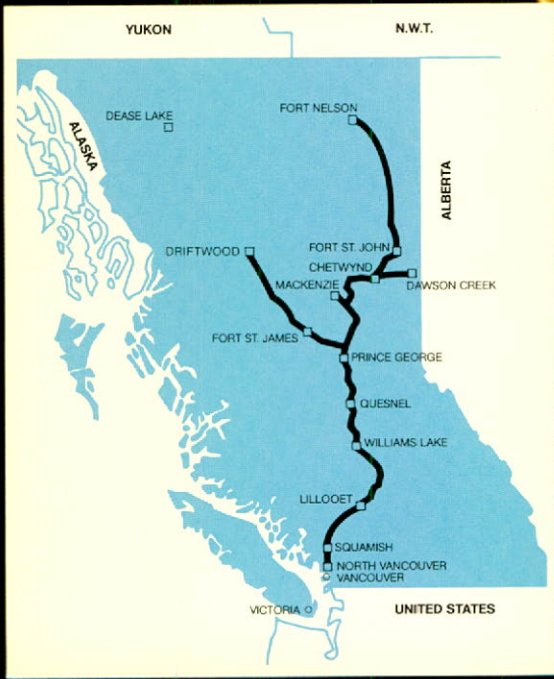


Some 20 per cent of the net rail freight tons loaded in British Columbia originate on the British Columbia Railway.

A portion of this traffic is local and is loaded and unloaded at points along the line. However, most of this traffic is interchanged to other railways including the Northern Alberta Railway at Dawson Creek and the C.N.R. at Prince George and North Vancouver. The C.N.R. interchange at North Vancouver provides a link with C.P. Rail, B.C. Hydro Railway and the Burlington Northern Railway. A rail barge service between North Vancouver and Seattle also connects the British Columbia Railway with the Milwaukee Road, Union Pacific and Burlington Northern.

A daily passenger service operates between North Vancouver and Lillooet. The stainless steel dayliners also run between North Vancouver and Prince George three times weekly returning south from Prince George on alternate days.





By adequately maintaining its rail line, its locomotive fleet and rolling stock, the Railway in recent years has improved its operating performance.

The main track has been regularly up-graded through major programs of rail re-laying, ballasting and bank widening. As well, new sidings and yards have been constructed.

Locomotives are overhauled or rebuilt and rolling stock is serviced and maintained at the Railway's major service centre located at Squamish, B.C.

Equipment repairs and replacement are undertaken at two medium repair centres. Service and inspection are performed at 10 terminals along the route.

Bargaining for the 1978-1979 contract commenced in late May and a negotiated agreement was reached in October. The agreement expires for all seven unions on July 31st, 1979.

The Strand Commission, appointed early in 1977, pursuant to the Railway and Ferries Bargaining Assistance Act, continued to play an active role in studying labour-management relations on the Railway on a continuing basis.

OUTLOOK

Traffic Prospects

Projections for 1979 show another record year for carloadings and freight revenues. Carloadings are expected to total 166,000.

Lumber demand in the U.S. is expected to closely parallel 1978 levels. Veneer and plywood should also remain at the 1978 level. Wood chip shipments should show an increase as a result of the export market which is developing.

Piggyback traffic will be higher than expected due to the gas and oil exploration in the northeastern part of the Province.

Two commodities which show promising potential for the Railway are sulphur and coal.

Currently the Railway handles 75,000 tons of sulphur per year. Westcoast Transmission is constructing a gas plant south of Chetwynd which will process sulphur from the Grizzly Valley sour gas and will produce annually 250,000 tons of pelletized sulphur by 1982.

Petrosul, currently the sales agent for Fort Nelson Sulphur, has also been awarded the contract to market sulphur from the Westcoast plant at Taylor commencing in 1981, and will also market the Pine River sulphur.

In total, when all three plants are in operation, approximately 450,000 tons of sulphur per year will be shipped to Vancouver for export.

B.C. Rail has been working with BP Canada Ltd. on a proposed movement of coal from Chetwynd to the coast.

Rates have been quoted to BP for movements from the mine site (37 miles south of Chetwynd) to tidewater based on a volume of 500,000 and 1,000,000 short tons annually.

The Foothills Pipe Line Project could result in approximately 13,000 carloads to B.C. Rail over a three-year period between 1982-1984.

The B.C. portion of the line is 440 miles (704 km) long and will be constructed of 56" pipe of lengths between 52-83 ft. Two plants will be producing pipe, Steel Company of Canada at Welland, Ontario and Inter-Provincial Pipe Company at Regina. There is a possibility of some pipe from Edmonton if plant expansion there goes forward.

The total volume of pipe to be moved is approximately 400,000 tons which represents 7,700 cars. An additional

5,000 carloads of other material to support the pipeline construction will be carried.

Industrial Development

A number of important industrial developments are planned for 1979, including a wood chip export terminal at North Vancouver, two lumber remanufacturing plants, one at Williams Lake and another at Barlow north of Quesnel, and a forest manufacturing complex, a bulk petroleum operation and a steel fabrication plant at Prince George. At Fort St. John new facilities are planned for handling cement, chemicals and fertilizer.

Labour Relations

On the labour scene the Strand Commission will be reviewing wage relationships among the various unions on the Railway.

Bargaining for a new contract with the Council of Trade Unions on the British Columbia Railway is expected to commence in the second quarter of 1979.

Physical Plant

The engineering program on the Fort Nelson Extension will proceed on schedule. Major work will include 105 miles (168 km) of ballasting and completion of the bank widening program and the 85-lb. rail rehabilitation program. Work will continue on grade stabilization and reconstruction and on culvert extension.

On the Railway's main track a ballast program for the Cariboo Division is scheduled in 1979. The ballast program on the main track from North Vancouver to Chetwynd will be completed in 1980. Upon completion of the program, this trackage will be up-graded to acceptable Railway standards.

To adequately maintain its power fleet, the Railway plans to rebuild 22 locomotives in 1979.

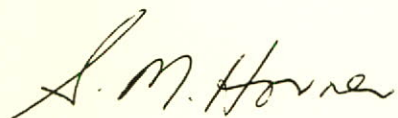
With rail freight cars being heavily utilized there will be an increase in the volume of car equipment repairs.

The rail car fleet will be further expanded early in 1979 through the leasing of 500 double door box cars. The cars were required to replace customer lease cars as contracts expired and to increase the Railway's car fleet in line with lumber requirement forecasts. A further 400 box cars will be phased out and replaced with plain box cars better suited for handling forest products.

Assets

	December 29 1978	December 30 1977
	<i>(Dollars in Thousands)</i>	
Current assets		
Cash and temporary investments	\$ 18,865	27,648
Accounts receivable	22,260	39,221
Materials and supplies — Note 1	24,659	27,574
Other	571	478
	<u>66,355</u>	<u>94,921</u>
 Property and equipment — Note 1		
Road	413,249	409,198
Equipment	174,307	173,792
Other properties	6,930	6,897
	<u>594,486</u>	<u>589,887</u>
Accumulated depreciation	104,555	93,101
	<u>489,931</u>	<u>496,786</u>
 Dease Lake Extension , construction costs — Note 2	<u>91,433</u>	<u>92,224</u>
 Deferred charges unamortized	<u>2,474</u>	<u>2,767</u>
	<u>\$650,193</u>	<u>686,698</u>

On behalf of the Board:



S. M. Horner, Director



J. N. Fraine, Director

Liabilities and Shareholder's Equity (Deficit)

	December 29 1978	December 30 1977
	<i>(Dollars in Thousands)</i>	
Current liabilities		
Accounts payable and accruals	\$ 30,927	20,687
Accrued interest	16,164	14,996
Notes payable	20,000	—
Deposits and other	1,111	1,324
Current obligations on long-term debt	8,483	14,871
	<u>76,685</u>	<u>51,878</u>
Long-term debt —Note 4	<u>627,227</u>	643,117
Deferred liabilities	<u>2,220</u>	794
Shareholder's equity (deficit)		
Share capital—Note 5	185,573	185,573
Contributed surplus—Government grants	61,250	61,250
	<u>246,823</u>	246,823
Deficit	<u>302,762</u>	255,914
	<u>(55,939)</u>	<u>(9,091)</u>
Commitments and contingent liabilities —Notes 6, 7 and 8		
	<u>\$650,193</u>	<u>686,698</u>

Auditors' Report

To the Lieutenant Governor in Council
Province of British Columbia

We have examined the balance sheet of British Columbia Railway Company as at December 29, 1978 and the statements of income and deficit and changes in financial position for the fiscal 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 financial statements present fairly the financial position of the Railway as at December 29, 1978 and the results of its operations and the changes in its financial position for the fiscal year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding fiscal year.

Peat, Marwick, Mitchell & Co.
Chartered Accountants

Vancouver, British Columbia, Canada
March 22, 1979

BRITISH COLUMBIA RAILWAY COMPANY

Income and Deficit

	<i>Fiscal Year Ended</i>	
	December 29 1978	December 30 1977
<i>(Dollars in Thousands)</i>		
Operating revenues	\$114,309	100,639
Operating expenses		
Transportation	44,640	41,872
Road maintenance	23,914	25,018
Equipment maintenance	22,317	19,337
Depreciation	13,585	12,783
Other	9,402	10,081
Government grants—Note 3	(5,837)	—
	108,021	109,091
Railway operating profit (loss)	6,288	(8,452)
Other expenses		
Interest on borrowed money—Note 4	54,338	47,983
Loss on discontinuance of Railwest manufacturing plant	—	2,890
	54,338	50,873
Less other income	1,202	1,034
	53,136	49,839
Net loss	46,848	58,291
Opening deficit	255,914	197,623
Closing deficit	\$302,762	255,914

BRITISH COLUMBIA RAILWAY COMPANY

Changes in Financial Position

	<i>Fiscal year ended</i>	
	December 29 1978	December 30 1977
<i>(Dollars in Thousands)</i>		
Funds provided		
Long-term debt	\$ —	72,000
Government construction grants		
— Fort Nelson Extension (Note 3)	9,827	—
— Dease Lake Extension	—	79,904
	<u>9,827</u>	<u>151,904</u>
Funds used		
Operations		
Net Loss	46,848	58,291
Deduct items not requiring funds	13,736	16,045
	<u>33,112</u>	42,246
Property and equipment	16,557	30,070
Dease Lake Extension, construction costs	(791)	9,175
Sinking funds and long-term debt	15,890	30,439
Deferred items	(1,568)	—
	<u>63,200</u>	<u>111,930</u>
Working capital (deficiency)		
Increase (decrease)	(53,373)	39,974
Opening balance	43,043	3,069
Closing balance	<u>\$ (10,330)</u>	<u>43,043</u>

Notes to Financial Statements

December 29, 1978

1. Significant accounting policies

The accounting regulations prescribed by the Canadian Transport Commission for Canadian railways have been adopted to the extent that this is possible without submitting specific accounting policies and depreciation rates to the Commission for approval.

Road property

New construction is recorded at cost net of grants received. Abandoned or relocated sections are removed at average unit costs. Elements of track structure installed during planned programs are recorded at cost and the material released is removed from the asset accounts at the average unit cost. Labour costs for programmed replacements are expensed as incurred.

All costs of constructing extension lines are capitalized to the date the line is certified operational by the British Columbia Ministry of Transportation, Communications and Highways. Capitalization of interest ceases and provision of depreciation commences on the date of certification.

Depreciation

Depreciation is provided for major categories of property and equipment on the straight-line basis at composite rates estimated to reduce the original cost to estimated salvage value over the average service lives of the classes. The group method is used for recording depreciation under which the original cost of assets retired less salvage value is charged against accumulated depreciation. No gain or loss on retirements, other than on accidental destruction of rolling stock and on disposal of land, is included in operations. The original cost of principal assets less estimated salvage value is depreciated over the following number of years:

	<u>Number of Years</u>
Grades, surfacing and tunnels	100
Rails	50
Ties and ballast	25
Bridges	65
Locomotives and power units	25
Freight cars	33

Repairs

Repairs and non-programmed replacements of track structure are charged against current operations. Betterments and major track relocations are capitalized.

Bond discount

Bond discount is deferred and amortized over the term of the issue to which it relates. Unamortized amounts related to debt retired are charged against operations in the year the debt is retired unless the debt is specifically refinanced in which case the remaining amount is amortized over the balance of the life of the original debt or the life of replacement debt if less.

Materials and supplies

Inventories of materials and supplies are valued at the lower of average cost or net realizable value.

Income taxes

The Railway is exempt from Canadian federal and provincial income taxes.

Transactions in foreign currency

Transactions originating in United States currency are generally recorded at the approximate exchange rates prevailing at the dates of the transactions. Current assets and current liabilities have been translated to equivalent Canadian amounts at the rate of exchange in effect on the balance sheet date.

Fiscal year-end

The Railway's fiscal year ends on the Friday closest to December 31. The 1978 fiscal year ended on December 29, 1978 and the 1977 fiscal year ended on December 30, 1977; both comprised 52 weeks.

2. Dease Lake Extension, construction costs

During 1977, construction of the Dease Lake Extension was suspended. Construction costs consist of all charges relating to the uncompleted extension of the Railway including capitalized interest to the date construction was suspended. In 1977, a grant of \$79,904,000 from the Government of the Province of British Columbia was applied to construction costs. Transfers and disposals of unapplied construction materials and equipment are credited to construction costs.

The British Columbia Ministry of Transportation, Communications and Highways has certified a portion of the extension operational and all costs relating to that portion are included in property and equipment.

At December 29, 1978, there were no commitments to continue construction of the extension. In the event any portion of the Dease Lake Extension is abandoned, the cost less any value recovered will be written off at that time.

3. Fort Nelson Extension

During 1978, the Government of the Province of British Columbia undertook to reimburse the Railway for the costs of the rehabilitation program which began in June, 1978 and the annual operating losses.

The Province has provided a total of \$11,664,000 to the Railway for the rehabilitation program of which \$9,827,000 has offset road property capital expenditures. The balance of \$1,837,000, together with a \$4,000,000 initial contribution to offset the 1978 Fort Nelson Extension operating loss, has been deducted from operating expenses. All amounts are subject to final determination.

4. Long-term debt

Long-term debt is not secured by assets of the Railway. Bonds issued by the Railway which are held in the sinking fund are not cancelled but for financial statement presenta-

tion have been deducted from the amounts shown as outstanding. As of December 29, 1978 the principal amount of such bonds held in the sinking fund aggregated \$32,766,000 (1977 — \$33,365,000).

Bonds totalling \$143,951,000 which are held by the Minister of Finance for Canada contain a provision whereby under certain circumstances they may be presented for redemption upon six months notice given to the Railway. A further \$48,387,000 of bonds are subject to redemption after 1979 at the option of either the holder or the Railway. The Railway also has the right under certain circumstances to redeem bonds aggregating \$435,693,000 at various dates, principally after 1990, in some cases at premiums up to 1%.

Interest and debt expense related to long-term debt has been reduced by sinking fund earnings on investments other than bonds issued by British Columbia Railway Company totalling \$4,772,000 (1977 — \$3,658,000) and interest on temporary investment of long-term debt proceeds of \$1,642,000 (1977 — \$4,380,000). In 1977, the debt expense was further reduced by interest charged to construction of \$3,594,000.

Long-term debt outstanding, less current maturities, is as follows:

	1978	1977
Sinking fund bonds		
1981-1985—3¼% to 5%	\$ 17,617,000	16,554,000
1986-1990—4¾% to 8¼%	50,000,000	49,569,000
1991-1995—4.5% to 8.92%	142,734,000	143,340,000
1996-2000—7.08% to 10.5%	336,834,000	336,834,000
2001-2005—9.05% to 10.4%	155,000,000	155,000,000
	702,185,000	701,297,000
Less sinking fund assets net of Railway's own bonds held	68,109,000	51,553,000
	634,076,000	649,744,000
Serial Bonds		
4¾% — due 1988	1,634,000	1,894,000
Notes payable to bank	—	6,350,000
	635,710,000	657,988,000
Deduct current obligations on long-term debt	8,483,000	14,871,000
	\$627,227,000	643,117,000

Long-term debt retirements and sinking fund provisions for the four fiscal years ending with 1983 are \$8,490,000, \$8,498,000, \$8,506,000 and \$8,305,000.

Included in the above long-term debt outstanding at December 29, 1978 are obligations recorded at a par value of \$14,757,000 payable in United States currency. The Canadian equivalent of these obligations at December 29, 1978 is approximately \$17,539,000.

The Government of the Province of British Columbia has unconditionally guaranteed the principal and interest of the long-term debt.

5. Share capital

Authorized share capital is 2,105,729 shares of \$100 each of which 1,855,729 shares are outstanding and held by the Government of the Province of British Columbia.

6. Commitments

The Railway has significant lease commitments for rolling stock and additional minor lease commitments for equipment and real estate which expire during varying periods to 1993. Annual payments under long-term lease contracts for the fiscal year ended December 29, 1978 were \$6,562,000 (1977 — \$6,242,000). The minimum average annual lease payments under existing leases at December 29, 1978 are as follows:

1979-1983	\$4,497,000
1984-1988	4,076,000
1989-1993	3,566,000

The Railway is negotiating lease commitments for rolling stock which when concluded will result in aggregate annual lease payments of \$8,500,000 in addition to those mentioned above.

7. Contingent liabilities

The Railway has been advised by certain Indian band representatives of their intention to claim for damages in connection with construction of a rail line over reserve lands. Any payments made in settlement of such claims should not be material and would be accounted for as part of the cost of the total road property.

Three contractors have commenced actions against the Railway to recover losses and other damages for specific claims in the aggregate amount of approximately \$21,000,000 together with other unspecified amounts. The Railway has not provided for these claims in its accounts as in the opinion of counsel these claims should not succeed.

8. Pension plan

The majority of employees participate in a contributory pension plan and are entitled to limited vested rights prior to retirement. Based on a report by independent actuaries, the unfunded accrued liabilities of the pension plan at January 1, 1979 approximated \$7,000,000. The unfunded liabilities will be amortized over a period of 24 years at an estimated annual cost of \$570,000.

Total pension expense for the year was \$4,800,000 (1977 — \$2,000,000) including past service costs of \$1,300,000. Current service contributions for 1979 are projected to be \$3,500,000.

9. Remuneration of directors and officers

Total remuneration paid to six officers amounted to \$234,000 (six in 1977 — \$244,000). Remuneration paid to eight directors who were not officers of the Railway amounted to \$44,000 (eight in 1977 — \$137,000); the remaining director served in each year without remuneration from the Railway.

