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ATCO 86

Corporate Profile

ATCO Ltd. has built a worldwide reputation for excellence, progressiveness and performance. Through internal growth and acquisition, ATCO has established a diversified asset base balancing steady income with growth opportunities.

The majority of Albertans are served by ATCO subsidiaries that distribute natural gas or generate and distribute electrical power.

A pioneer in providing modular transportable shelter, ATCO is the world leader in this industry. Factories are located in Canada, the U.S., Australia and Saudi Arabia.

ATCO designs, builds and manages commercial buildings. The company also develops and builds housing projects of a specialized nature.

Among the largest drilling contractors in North America and Australia, ATCO also is involved in well servicing, supplying oilfield equipment, processing and marketing of natural gas and exploration for hydrocarbons.

With the financial stability that comes from this diversified range of activities, and a staff of 6,000 employees noted for their dedication and expertise, ATCO is positioned for the future.

From the left: N.W. Robertson, President and Chief Operating Officer, ATCO Ltd.; J.D. Wood, President and Chief Operating Officer, Canadian Utilities Limited; and C.S. Richardson, Senior Vice President, Finance, ATCO Ltd.

Financial Highlights

Years ended March 31

(Thousands except share data)	1986	1985	Change
Revenues	$1,527,229	$1,610,827	− 5%
Earnings for the year	$ 58,375	$ 44,737	+ 30%
Earnings attributable to Class I and Class II shares	$ 24,032	$ 11,394	+ 111%
Earnings per Class I and Class II share	$ 1.02	$ .51	+ 100%
Dividends paid per Class I and Class II share	$ .20	$ .20	–
Working capital	$ 2,944	$ 17,184	− 83%
Additions to property, plant and equipment	$ 260,061	$ 239,623	+ 9%
Total assets	$3,298,377	$3,032,501	+ 9%
Class I and Class II shareholders' equity	$ 267,412	$ 200,660	+ 33%
Class I and Class II shares outstanding	27,757,550	22,166,800	
Weighted average Class I and Class II shares outstanding	23,569,638	22,164,344	

Report to Shareholders

Backed by a broad based improvement in the performance of the Company's subsidiaries throughout the year, per share earnings for the ATCO Group of Companies for the year ended March 31, 1986 were double those of the previous year.

Earnings before preferred share dividends increased to $58,375,000 on total revenue of $1,527,229,000 compared with the previous year's earnings before preferred share dividends of $44,737,000 on total revenue of $1,610,827,000. After payment of preferred share dividends of $34,343,000, net earnings attributable to Class I and Class II shares were $24,032,000 or $1.02 per share compared with $11,394,000 or 51¢ per share in 1985. The weighted average number of shares outstanding for 1986 was 23,569,638 compared with 22,164,344 last year.

In reviewing the comparative results, it should be noted that the accounting for investment tax credits was changed from the flow-through method to the cost reduction method. This change has been applied retroactively and the effect on earnings is outlined in Note 6 to the financial statements.

ATCO's utility subsidiaries continued their significant contribution to the Company's success with increased earnings of approximately 10% in calendar 1985. These earnings were the result of higher electric utility sales, gains on the Company's investment in TransAlta Utilities Corporation and gas utility rate increases.

Both the gas and electric utilities experienced growth in customers served and sales volume. In order to provide continued reliable service to existing customers and [illegible] new customers, Canadian Utilities is planning to spend some $300 million in capital expenditures in calendar 1986 mainly for electric and natural gas transmission and distribution facilities. On January 1, 1986, Sheerness Unit 1, a thermal generating station located near Hanna in southeastern Alberta began commercial service. Alberta Power is the managing partner in the project which is jointly owned by TransAlta Utilities.

[illegible] manufacturing [illegible] leasing operations are beginning to realize the benefits [illegible] the industry rationalization strategy adopted two years ago. The philosophy of emphasizing leasing has contributed to the improvement in the Company's financial results and further steps have been taken in this regard through the purchase of additional lease fleet asset[illegible] petitors in both [illegible] Australia. With an investment in rental assets of over $95 million, ATCO has established market leadership in Canada and Australia. The intent is to protect that position and build on the foundation that now exists while improving the Company's position in [illegible] United States rental market

ATCO's Australian manufacturing operations experienced a most successful year with the highlight being the receipt of a $20 million contract for the supply of housing and related services on the Burrup Peninsula in Western Australia. The backlog of orders at year end, coupled with developing new opportunities, indicates that the coming year will be the most profitable the Company has enjoyed since establishing in Australia in 1962.

An interesting development in the past year has been the utilization of ATCO's manufacturing capability in conjunction with the Development division. Because of this combined effort three major projects are now in-house with construction scheduled to start shortly. These projects include the 1988 Winter Olympic Games Media Village, housing and administrative facilities for athletes and officials for the Olympic Nordic Events in Canmore, Alberta and the 336-room Banff Springs Hotel staff quarters. In each case the combined expertise of the personnel in the Manufacturing and Development Divisions was an important factor in obtaining the contract. With a number of similar projects in the design and proposal stage the outlook for this segment of the business is most encouraging.

[illegible] CO Ltd. and [illegible] utility subs[illegible] [illegible] Exploration Ltd. which in turn has a 10.1625% interest in the Gulf Resources Canada Amauligak discovery in the Beaufort Sea. In addition ATCO and ATCOR own directly a 5.8% interest in Amauligak. The significance of this holding is underlined by the Gulf Resources Canada estimate of 700-1,000 million barrels of oil reserves in the structure. Indications are that Amauligak will, because of its size and location, be the lead project in the future delivery of gas and oil from the Beaufort. An extended testing program is planned for I-65B, the most recent Amauligak well. This program, to be run in the summer of 1986, will confirm flow potential and assist in obtaining information related to the design of production facilities.

Although ATCO Ltd. did not do any financing during fiscal 1986, the terms of all floating rate debt were rewritten to include an option to fix rates at the Company's discretion. This option reduces the exposure to higher costs from increasing interest rates.

On December 18, 1985, the Company issued a Redemp[illegible] [illegible] the holders of [illegible] [illegible]rtible Junior Preferred Shares. As a r[illegible] 1,950,554 Preferred Shar[illegible] were converted to Class I N[illegible] Voting Shares. Based on a conversion rate of 2.86 a total of 5,578,550 Class I Non-Voting shares were issued. At year end the total of Class I Non-Voting and Class II Voting shares outstanding was [illegible]

[illegible] payment of dividends o[illegible] share per quarter on C[illegible] [illegible] Class II shares during fiscal 1986.

On July 31, 1985, Dr. C. Norman Simpson, a Director since July, 1968, passed away. His many and varied contributions to the Board are greatly missed by his associates.

On November 26, 1985, the Honourable E.P. Lougheed, P.C., Q.C., the former Premier of the Province of Alberta, was appointed to the Board. Mr. Lougheed brings a unique blend of expertise and understanding of the Canadian scene to the Board's deliberations and his colleagues look forward to working with him on the development of corporate policy.

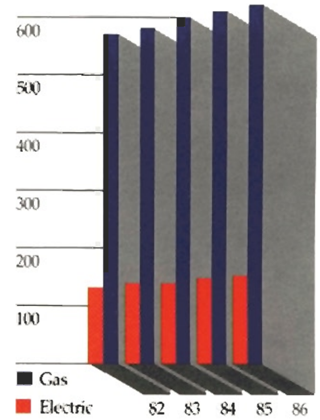
In assessing the future the outlook is mixed and uncertain. Lower oil and gas prices coupled with high real rates of interest make it difficult to ascertain the direction of [illegible]omic trends. It is at times [illegible] as these that ATCO's strategy of a diversity of geographic locations and both products and services proves invaluable. With a mix of utility operations, manufacturing, [illegible] estate and gas marketing, [illegible] processing to offset gas [illegible] oil operations and energy [illegible]ces, ATCO is well positioned to not only maintain but increase earnings. This diversity combined with a management style which emphasizes the achievement of objectives and the surfacing of problems at a regularly scheduled monthly meeting of senior operating and staff executives has created an organization with the tools and determination to succeed.

We wish to thank our dedicated staff, our customers and suppliers for their continuing support and significant contributions to the Company's success. In addition, we wish to express our appreciation to the Board of Directors for their thoughtful guidance and wise counsel especially during these volatile and difficult economic times. Finally, a special thank you to our Shareholders without whose support none of our accomplishments would be possible.

R.D. Southern
Deputy Chairman and
Chief Executive Officer

Utilities

Gas and electric customers at year-end
(thousands)



ATCO owns 51 percent of Canadian Utilities Limited, a holding company with subsidiaries engaged in the operation of electric and natural gas utilities. The subsidiaries service much of Alberta and parts of British Columbia, Saskatchewan, the Yukon and the Northwest Territories.

During calendar 1985, Canadian Utilities spent $211.0 million on capital expenditures for facility construction and replacement programs in order to ensure continued safe, reliable service to customers. A significant part of the program was also geared to meeting the needs of future customer growth.

Calendar 1986 capital expenditures for new electric and natural gas transmission and distribution facilities and for replacement of existing facilities have been forecast to exceed $279 million. At that level, the Canadian Utilities capital program will be one of the largest in the Province of Alberta.

Electric Power Operations

Canadian Utilities' major electric utility, Alberta Power, generates, transmits and distributes electrical energy to 323 communities, including several cities in east-central and northern Alberta. Alberta Power's three subsidiaries, The Yukon Electrical Company, Yukon Hydro Company and Northland Utilities (NWT), serve communities in the Yukon, British Columbia and the Northwest Territories.

During calendar 1985, electric sales to retail customers increased by 11.6 percent to 4,331 million kilowatt hours. A total of 3,723 retail customers were added during the year bringing the number served to 147,124. Heavy oil recovery projects in the Cold Lake and Lloydminster areas contributed to the increased demand for electricity in Alberta Power's service territory. Peak load rose to 844 megawatts in calendar 1985 from 741 megawatts in calendar 1984.

On January 1, 1986, the first unit of the Sheerness Generating Station began commercial service. Sheerness is a joint project of Alberta Power and TransAlta Utilities Corporation, with Alberta Power providing construction and operations management.

Alberta Power continued its emphasis on productivity improvement programs and action was taken in several areas to further reduce costs and improve efficiency. Evidence of the success of these programs is the fact that, of the 94 thermal generation plants in Canada, the four operated by Alberta Power rank in the top ten in utilization and reliability.

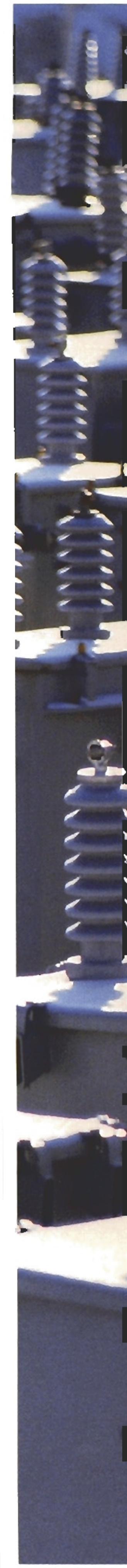
Alberta Power spent $142.0 million in calendar 1985 on additions to property, plant and equipment and the Company expects to significantly increase expenditures on transmission projects in calendar 1986 in response to growing demand in its service area. Alberta Power is also negotiating to participate in the ownership and operation of the Northern Canada Power Commission's assets when they are transferred from the federal level to the governments of the Yukon and the Northwest Territories.

In a non-utility venture, Alberta Power is a major proponent to the federal government to operate and maintain the North Warning System, which will consist of 36 short-range radar sites and 11 long-range sites, extending from the Yukon to Labrador.

Natural Gas Operations

Canadian Utilities' natural gas operations encompass two major utilities: Canadian Western Natural Gas, serving southern Alberta; and Northwestern Utilities in north-central Alberta. Northland Utilities (B.C.), a subsidiary of Northwestern, serves the Dawson Creek area and the community of Tumbler Ridge in northeastern British Columbia.

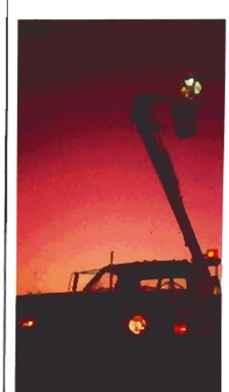
By the end of calendar 1985, these utilities were serving over 600,000 customers. Canadian Western and Northwestern also transport gas through their pipeline systems for others, including exporting companies and industrial customers.



A customer service representative, far left, assists an Alberta Power customer. The utility added more than 3,700 accounts during the year, for a total of 147,000.

Transformers are checked by a technician, left. The company provides service to 323 communities.

Below, a crew repairs a street light in the city of Drumheller.



Far right, state-of-the-art technology has improved productivity at Canadian Western.

Far right below, Canadian Western's retail outlets sell a full range of gas appliances.

Lab technologists, right, analyse the composition and monitor the odorant in natural gas.

Below, Denny Harrigan, tests gas meters to ensure accuracy.

Sales volume declined 10.0 petajoules during the year due largely to the closing of two oil refineries and reduced sales to a fertilizer plant and sugar refinery. The decline was offset, however, by an increase in transportation volumes of 14.3 petajoules. Total system throughput in calendar 1985 was 474.8 petajoules.

With capital expenditures of $69.0 million for the year, natural gas operations undertook a substantial program of new construction and replacement of older facilities. Canadian Western, replacing a line built in 1912, completed 54 kilometres of 323.9 mm transmission line between Lethbridge and Taber at a total cost of $7.8 million.

Two salt caverns for natural gas storage were constructed by Northwestern near Fort Saskatchewan. Four caverns are now in use with a fifth under construction. The caverns facilitate the economical handling of peaking requirements. New compressor stations at Corbett Creek and Judy Creek northwest of Edmonton will increase pipeline capacity allowing Northwestern to fulfill new transportation agreements.

Cost control measures instituted two years ago, continued in effect over the past year with very positive results. It is interesting to note that although Canadian Western and Northwestern have added more than 21,000 customers since 1983, the number of employees has declined.

A marketing program emphasizing the benefits of natural gas as a safe, clean, efficient source of energy has met with success.

Manufacturing and Leasing

The Manufacturing and Leasing Group completed a most successful year with all operations showing an operating profit. Rationalization of competitors continued, leading to an increase in lease fleet investment and market share.

Canada

As a result of obtaining a wide variety of contracts calling for a number of different products, ATCO's Canadian manufacturing capabilities were put to the test on several occasions during fiscal 1986. Contracts received during the year ranged from highly custom projects to basic construction camp facilities and modular housing. These contracts included:

650-man construction camp and a 150-man base operations centre for Sohio Oil - North Slope, Alaska,

100 modular homes for Alberta's Native Housing Program;

32 modular staff units for the Bechtel-Kumagi Limestone Hydro Project in Manitoba; and

60 kiosks and ticket booths for Expo 86 - Vancouver.

In line with ATCO's commitment to service the increasing demand for urban space rental space throughout Canada, the Company sold its specialized drilling camp equipment and acquired the site office rental fleet of a United States-based competitor servicing Ontario as a primary market. Revenues from this acquisition will enhance the Company's performance during fiscal 1987 because these assets are neither seasonal nor dependent on activity levels in a single industry. To improve rental fleet utilization rates, site office units were transferred to the eastern Canadian market where demand is strong.

The Company supplied a 588-man camp to Syncrude in Fort McMurray on a long term rental basis and in addition, installed a 500-man camp at Suncor's Burnt Lake Heavy Oil Project and two 250-man camps at Esso's Cold Lake Heavy Oil Project.

ATCO now has in excess of 6,500 rental units in Canada and serves the market from 18 offices and 12 distributors strategically located from Nanaimo, British Columbia, to St. John's, Newfoundland. Approximately 4,500 units are located in western Canada with the balance in eastern Canada.

ATCO supplied and installed a 150-man camp and 60-man permanent accommodations, far left, for an offshore oil project on Lowendall Island, 100 km northwest of Australia.

Ocean-going barges, left, transport 500 two-storey housing units to the Aleutians, for U.S. Navy personnel.

Below, a crane swings a housing unit into place on the Burrup Peninsula LNG plant construction project in Australia.

Housing for the America's Cup challengers, below, was provided by ATCO at Fremantle, Australia.

ATCO portable site offices were utilized during construction of Calgary's civic administration building.

Far right, Gordon Vepraca, manager of the Calgary metal fabricating plant, inspects high-tensile cladding.

ATCO Metal experienced a record year in pre-engineered building sales. The versatile and practical nature of this product was the key to selling twelve buildings for the Esso Cold Lake Project and a large building for the Western Cooperative Fertilizers Limited plant in Brandon, Manitoba.

Fold-A-Way sales included ten buildings to the Exxon Gas Plant in Wyoming. Roll-formed product and metal siding sales to the agricultural market remained steady.

Australia

The buoyant Australian economy presented ATCO with many opportunities to supply products and services during the past year.

Investment in lease fleet - industrial and site office units - increased by 75 percent. The addition of 2,000 units was accomplished by acquiring the lease assets of competitors in Darwin, Townsville and Brisbane and by capitalization of units manufactured in ATCO's three facilities. The market for used units was very strong and the revenue and contribution from this segment contributed to an excellent financial performance.

The Australian subsidiary was awarded the largest contract in its twenty-five year history. Valued at $20 million, the turnkey contract calls for the supply and installation of workforce housing and related facilities on the Burrup Peninsula in Australia. Scheduled for late calendar 1986 completion, the project will contribute significantly to fiscal 1987.

ATCO was awarded a contract to house America's Cup sailing contenders in Fremantle, Western Australia. Several visiting crews will be housed in comfortable ATCO supplied accommodation near the docks.

South Australian-based ATCO Homes experienced strong sales until mid-year when high interest rates and reduced mortgage funding tempered the demand for new homes. ATCO recently formed a joint venture with a Melbourne-based company to produce modular homes for the Victorian market. The large population in the Victorian marketplace combined with the quality and sophistication of the range of homes being offered, augurs well for the success of this venture.

United States

Now headquartered in Denver, Colorado, United States operations will concentrate on the domestic market rather than the international export market.

Although demand for resource and energy-based sectors softened, the Company was awarded contracts by the United States Forestry Services and Sohio Alaska Petroleum Company for installations on the North Slope. Facilities were also supplied to various correctional institutes in the United States. Operating from a facility in Portland, Oregon, ATCO is currently engaged in building 405 houses for the United States Department of the Navy for its air base in the Aleutian Islands. Valued at $30 million, the technically sophisticated project is proceeding on schedule and will be completed in the final quarter of the current fiscal year.

Rental fleet utilization remained high during the past year. The Company was successful in leasing 60 site offices to General Motors for its Saturn Plant in Springhill, Tennessee and several large office complexes to Chevron in California.

Saudi Arabia

The continuing decline in the demand and price of OPEC oil resulted in delays and the deferral of projects in the Middle East. Operations were reduced to essential staffing and inventory levels as a lower cost profile and selective market approach was adopted. Despite fewer contracts and a highly competitive market, ATCO Saudi Arabia remained profitable.

Real Estate

The Real Estate Group provides services ranging from land development and general construction to interior contracting and property management. In two decades ATCO has built an outstanding reputation for product innovation and design excellence. As an interiors contractor, the Company has earned acclaim for its expertise in production technology and craftsmanship.

Adult Communities

ATCO's commitment to innovation in serving the needs of the real estate market has led to the planned construction of two mature adult communities in the Calgary area. They will offer, in conjunction with a health care facility, a mixture of privately owned and rented accommodation designed for the lifestyle of people over 55 years of age. The unique concept offers a feeling of security while promoting independence and progressive living. Construction of the 67,000 square foot care centers in Cochrane and Airdrie is to begin the summer of 1986.

Property Development

Renewed confidence in the economy of western Canada combined with lower interest rates brought about an improvement in real estate activity during fiscal 1986. The net absorption of office space in downtown Calgary of 1.3 million square feet together with a significant reduction in sub-lease space resulted in an improved balance in supply and demand.

As a result of this increased activity, ATCO experienced higher occupancy rates and firmer rental rates. However, the oversupply of office space is still a problem and ATCO will maintain its conservative development policy, requiring pre-lease commitments prior to commencement of construction on any major project.

During fiscal 1986, Amoco Canada became a major tenant in the Milner Building, an ATCO facility in Edmonton.

Calgary Winter Games

ATCO Development was awarded a contract during fiscal 1986 for the design and construction of media housing for the 1988 Winter Olympics to be held in Calgary. The complex, to house 3,000 media personnel, will be situated on city-owned land. The modular housing units have been pre-sold to various entities and will be relocated and installed throughout western Canada after the Games.

The Company was also successful with its proposal to provide temporary accommodation for 600 athletes in the town of Canmore along with the construction of a permanent recreation complex. "Athletes Village II", housing personnel associated with the Nordic events, will be installed in conjunction with a permanent facility containing an aquatic centre, curling rink and golf clubhouse. The permanent recreation facility will be used by Olympic personnel on an interim basis following the September 1987 completion, and after the Games will be owned and operated by the Town. The temporary Athletes Village will be removed after the Games, leaving the town with fully-serviced land for future residential development.

[illegible] office interiors (at left above) [illegible] from ATCO [illegible].

ATCO [illegible] level the gro[illegible] adult [illegible] mark[illegible] below [illegible] and [illegible]

[illegible] Canadian Utilities Com[illegible] ATCO [illegible] office [illegible]

Belo[w] [illegible] O[illegible] openings [illegible] ATCO Development's president, with his marketing vice-president, Ted Stack.

Resources

ATCOR Resources Limited, a subsidiary of Canadian Utilities Limited, explores for and produces crude oil and natural gas to large volume industrial users and has a significant investment in a gas processing plant.

In calendar 1985, ATCOR benefited from the improved operating conditions resulting from the Western Accord. The Company participated in a total of 113 gross (41 net) wells. 50 were completed as oil wells, 16 as gas wells, and 47 were dry and abandoned. The success rate was 70 percent for development wells and 20 percent for exploration wells.

During calendar 1985 ATCOR assumed an average working interest of 36 percent. The Company's exploration effort is being expanded and larger working interests will be pursued, particularly in natural gas prospects. Gross land holdings of 283 thousand hectares (96 thousand net) are located primarily in Alberta. In addition, ATCOR holds petroleum rights on an additional 340 thousand hectares (170 thousand net).

Capital expenditures dedicated exclusively to exploration and production activities during the calendar year were $15.7 million.

An additional $3.6 million was invested in AL&S Exploration Ltd. through the purchase of preferred shares.

Daily oil production rose to 301 cubic metres per day, a 16 percent increase over calendar 1984. In addition, daily natural gas production increased to 262 thousand cubic metres, 110 percent higher than the previous year. Gross revenues from production totalled $33.1 million, a 22 percent increase over the previous year.

Total crude oil reserves are estimated at 1337 thousand cubic metres; while natural gas reserves total 1657 cubic metres.

Gas Marketing

As the largest broker in Alberta, ATCOR markets natural gas to large industrial customers for use as fuel and feedstock, and to resource companies for enhanced oil recovery projects. ATCOR purchases additional gas volumes from various producers for resale.

During calendar 1985, ATCOR sold 87 petajoules of natural gas, an increase of 14 percent over calendar 1984. The number of contracts for natural gas sales increased from 16 in calendar 1984 to 23 in calendar 1985.

Far left, ATCOR geologists Brian Parson, right, and Ken Statham plan work on a prospect in west-central Alberta.

ATCOR Resources owns 50 percent of a natural gas processing plant, left, in Edmonton.

AT&S Exploration has increased its interest in the Amauligak structure of the Beaufort Sea, below.

Exacting maintenance and safety procedures are followed by ATCO's rig hands, below.

Far right, ATCO strategically deploys drilling rigs in Canada, the United States and Australia, according to market conditions.

Right, skilled staff service oilfield rental equipment before it is delivered to a customer.

As natural gas prices are deregulated on November 1, 1986, the price paid by the consumer will likely be lower because of competition for sales among producers. ATCOR anticipates the impact on the company will be minimal because of its strong position in the industry and its ability to increase market share. Over the long term, de-regulation will open up new markets, and ATCOR is pursuing these opportunities.

Natural Gas Processing

ATCOR owns 50 percent of an ethane extraction plant in Edmonton which has the capacity to process 8.9 million cubic metres of natural gas per day. During calendar 1985, ATCOR processed an average of 6.0 million cubic metres per day, producing 616 cubic metres of ethane and 235 cubic metres of LPGs per day. An additional $2.1 million in revenue was generated from gas processed on a fee basis.

Frontier Exploration

AT&S, owned 30 percent by ATCOR, 7½ percent by ATCO Ltd., 25 percent by Texaco Canada Resources Ltd. and 37½ percent by Sun Life Assurance Company of Canada, is engaged in frontier exploratory drilling.

AT&S has earned interests in lands located in the Northwest Territories, offshore Nova Scotia, and in the Beaufort and Mackenzie Delta areas. Over the past three years, AT&S has participated in the drilling of 46 wells offshore Newfoundland and Nova Scotia, in the Mackenzie Delta, the Northwest Territories and in the Beaufort Sea. Significant oil and gas reserves have been discovered on a number of prospects, the majority of which are located in the Beaufort Sea – Mackenzie Delta area.

The three-well delineation program initiated on the Amauligak structure to determine the reserve potential of the 1984 discovery has yielded exceptional results. The wells drilled to date indicate a reserve potential of between 110 and 130 million cubic metres of proven recoverable oil. Regarded as a world class discovery, Amauligak is the first frontier structure that could be a stand-alone production project. AT&S has increased its interest in this prospect to 10.16 percent. ATCOR and ATCO are also making a direct investment in the prospect by farming in on the last delineation well to earn 3.8 percent interest in the lands covering the structure and the previously drilled wells.

Contract Drilling

Canadian exploration activity increased significantly over fiscal 1985 due to the stimulative effects of the Western Accord and over 11,000 wells were drilled in the western sedimentary basin.

In Canada, ATCO's rig utilization increased to 54 percent compared to 50 percent in the previous year. Due to the high levels of activity and the re-deployment of rigs into the healthy Canadian market, earnings of Drilling-Canada were up $3.0 million over fiscal 1985. Similarly, cash flow increased by $6.0 million during fiscal 1986.

ATCO Drilling returned three rigs to Canada from the United States. At year end, 34 rigs were located in Canada, 24 in the United States and four in Australia.

In the United States, drilling activity declined marginally from 1985 due to the continuing oversupply of crude oil worldwide. ATCO's rig utilization of 29 percent was higher than the industry average. Little change is forecast for fiscal 1987.

In Australia, ATCO-APM Drilling Pty. Ltd. experienced a moderate decline in activity from a rig utilization rate of 45.8 percent in 1985 to 43.5 percent in 1986. Although activity levels will remain uncertain due to depressed crude oil prices, the Australian government's pursuit of oil self sufficiency is expected to help balance the negative outlook for contract drilling.

Well Servicing

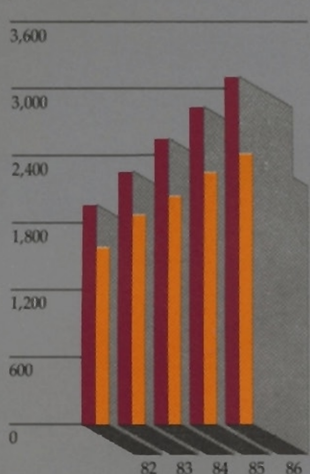
As a result of strong Canadian demand for well service equipment, ATCO moved five rigs from the United States to Canada. At fiscal year end, 20 service rigs were in Canada, 11 in the United States, and three in Australia.

Oilfield Equipment

Increased oilfield activity resulted in higher levels of business for the Canadian-based sales and rental operation. Improved asset utilization rates, dependable service and low overhead combined to generate better earnings.

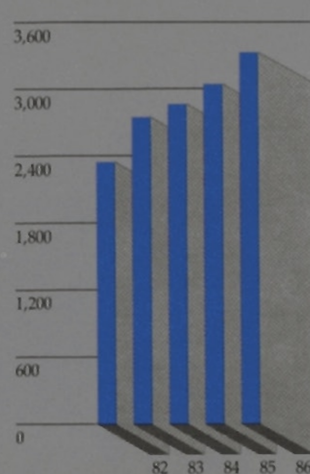
Financial Review

Property, plant and equipment
$ in millions

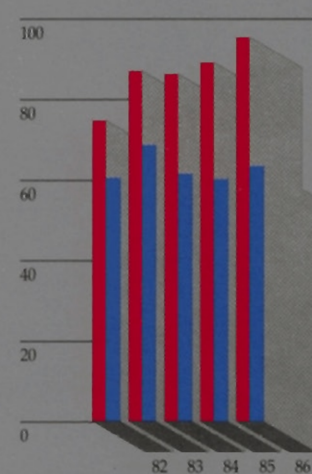


Cost   Net book value

Total assets
$ in millions

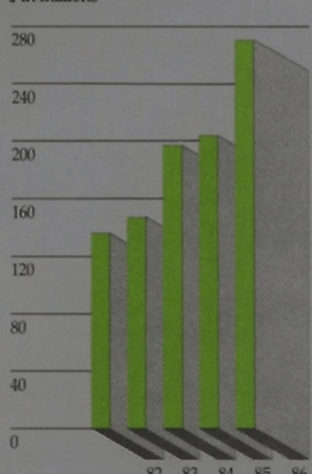


Rental assets
$ in millions

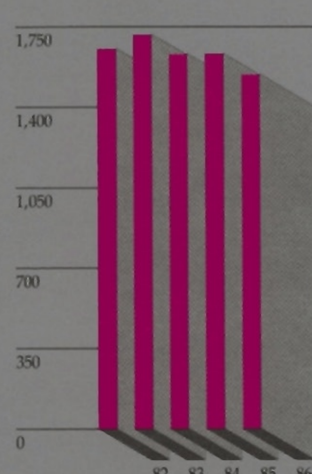


Cost   Net book value

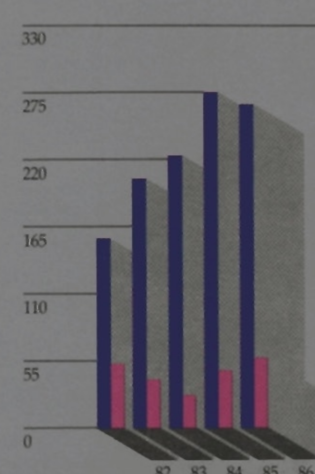
Class I and Class II shareholders' equity
$ in millions



Revenue
$ in millions



Earnings
$ in millions



Earnings before income taxes & minority interests   Earnings for the year

Management's Responsibility for Financial Reporting

Management is responsible for the preparation of the consolidated financial statements and other financial information relating to the Corporation contained in this annual report. The consolidated financial statements have been prepared in conformity with Canadian generally accepted accounting principles and necessarily include some amounts that are based on informed judgements and best estimates of management.

Price Waterhouse, our independent auditors, are engaged to express a professional opinion on the consolidated financial statements. Their examination is conducted in accordance with generally accepted auditing standards and includes tests and other procedures which allow the auditors to report on the fairness of the consolidated financial statements prepared by management.

The Board of Directors, through an audit committee comprised of three non-management directors and one management director, oversees management's responsibilities for financial reporting. The Audit Committee meets regularly with management, the internal auditors and the independent auditors to discuss auditing and financial matters and to gain assurance that management is carrying out its responsibilities. The internal auditors and the independent auditors have full access to the Audit Committee.

C.S. Richardson
Senior Vice President, Finance

A.J. Pullman
Vice President, Controller

Consolidated Statement of Earnings and Retained Earnings

ATCO Ltd.

Years ended March 31

(Thousands of Canadian dollars)	Note Reference	1986	1985
			(restated) (Note 6)
Revenues		$1,527,229	$1,610,827
Costs and expenses			
Natural gas supply		456,192	525,447
Taxes – other than income		83,365	113,136
Operating and maintenance		469,868	455,502
Selling and administrative		118,351	113,415
Depreciation, depletion and amortization		106,567	105,286
Interest		96,895	97,681
		1,331,238	1,410,467
		195,991	200,360
Allowance for funds used during construction		44,517	41,517
Other income	2	22,444	33,836
		262,952	275,713
Income taxes			
Current		102,722	110,133
Deferred		3,034	(1,488)
	3	105,756	108,645
		157,196	167,068
Minority Interests	4	98,821	122,331
Earnings for the year		58,375	44,737
Dividends on redeemable preferred shares	5	34,343	33,343
Earnings attributable to Class I and Class II shares		24,032	11,394
Retained earnings at beginning of year			
As previously reported		146,805	140,935
Prior period adjustment	6	(3,488)	(3,540)
As adjusted		143,317	137,395
		167,349	148,789
Dividends on Class I and Class II shares		4,714	4,433
Share issue expenses, net of deferred income taxes		673	–
Exchange adjustments on preferred shares	5	1,340	1,039
Retained earnings at end of year		$ 160,622	$ 143,317
Earnings per Class I and Class II share			
Basic		$1.02	$ .51
Fully diluted		$ .91	$ .50
Dividends paid per Class I and Class II share		$ .20	$ .20

Consolidated Balance Sheet

ATCO Ltd.

March 31

(Thousands of Canadian dollars)	Note Reference	1986	1985
			(restated) (Note 6)
Assets			
Current assets			
Cash and short term investments		$ 132,524	$ 62,893
Accounts receivable		182,131	191,505
Inventories		74,577	42,704
Prepaid expenses		5,977	7,444
		395,209	304,546
Investments in other companies	7	344,801	333,854
Property, plant and equipment	8	2,386,892	2,227,586
Goodwill		129,911	133,275
Deferred financing charges and other assets		41,564	33,240
		$3,298,377	$3,032,501
Liabilities and Shareholders' Equity			
Current Liabilities			
Bank indebtedness	9	$ 59,091	$ 2,545
Accounts payable and accrued liabilities		282,309	236,282
Income taxes payable		11,545	25,571
Long term debt due within one year		39,320	22,964
		392,265	287,362
Long term debt	10	853,652	771,515
Contributions for extensions to utility plant		192,456	173,329
Deferred credits		41,879	49,103
Deferred income taxes		16,959	14,487
Minority interests	4	1,143,092	1,078,971
Redeemable preferred shares	5	390,662	457,074
Class I and Class II shareholders' equity			
Class I and Class II shares	11	109,959	61,120
Retained earnings		160,622	143,317
Foreign currency translation adjustments		(3,169)	(3,777)
		267,412	200,660
		$3,298,377	$3,032,501

Approved by the Board:

N.W. Robertson

Director

Director

Consolidated Statement of Changes in Cash Position

Years ended March 31

ATCO Ltd.

(Thousands of Canadian dollars)	1986	1985
		(restated) (Note 6)
Operating activities		
Earnings for the year	$ 58,375	$ 44,737
Charges (credits) not affecting cash		
Depreciation, depletion and amortization	106,567	105,286
Deferred income taxes	3,034	(1,488)
Minority shareholders' interests	98,821	122,331
Allowance for equity funds used during construction	(18,458)	(16,549)
Other items – net	1,576	2,041
	249,915	256,358
(Increase) decrease in non-cash working capital	10,969	(4,951)
	260,884	251,407
Dividends		
Redeemable preferred shares	(34,343)	(33,343)
Class I and Class II shares	(4,714)	(4,433)
Minority interests	(82,593)	(97,186)
	(121,650)	(134,962)
Financing activities		
Issue of long term debt	170,162	190,082
Reduction in long term debt	(71,835)	(273,812)
Issue of preferred shares by Canadian Utilities	185,000	–
Redemption of preferred shares by Canadian Utilities	(137,107)	–
Issue of preferred shares by the Corporation	–	200,000
Redemption and conversion of preferred shares by the Corporation	(66,952)	(9,194)
Issue of Class I and Class II shares by the Corporation	48,839	57
Contributions for extensions to utility plant	25,831	20,353
Costs of financing	(8,451)	(5,706)
	145,487	121,780
Investing activities		
Property, plant and equipment	(237,837)	(226,748)
Other companies	(14,505)	(53,335)
Deferred charges and credits – net	(19,294)	6,467
	(271,636)	(273,616)
Cash position		
Increase (decrease) in cash*	13,085	(35,391)
Cash at beginning of year	60,348	95,739
Cash at end of year	$ 73,433	$ 60,348

* For the purpose of this statement, cash is defined as cash and short term investments less bank indebtedness.

Notes to Consolidated Financial Statements

March 31, 1986

1. Summary of Significant Accounting Policies

Consolidation

The consolidated financial statements include the accounts of ATCO Ltd. and all of its subsidiaries (collectively referred to herein as "ATCO") which are wholly owned except for Canadian Utilities Limited ("Canadian Utilities"), which is 50.1% owned, and ATCO Saudi Arabia Ltd., which is 75% owned. ATCO Ltd. and its wholly owned subsidiaries are collectively referred to herein as "the Corporation". The operating subsidiaries and divisions are shown on pages 38 to 40.

Investments in joint ventures and partnerships are recorded on the equity basis.

Goodwill is recorded at cost and amortized on a straight line basis generally over 40 years.

Regulation

The accounting records and policies of the utility subsidiaries reflect decisions made by regulatory bodies, principally the Public Utilities Board of Alberta, as part of the rate making process. Decisions made by these regulatory bodies which impact on operating results or accounting policies are reflected in the accounts after the date of decision.

Foreign Currency Translation

The financial statements of the foreign subsidiaries and foreign currency transactions are translated as follows:

Integrated foreign subsidiaries and Canadian companies with balances and transactions denominated in foreign currency:

Monetary assets and liabilities – at year end exchange rates
Other assets and liabilities, depreciation and amortization – at historical exchange rates
Revenues and expenses, except depreciation and amortization – at exchange rates prevailing during the year

Translation adjustments are recognized in the current year's earnings, except for those arising from translation of monetary assets and liabilities that have an ascertainable life extending more than twelve months beyond the balance sheet date. These adjustments are deferred and amortized over the remaining life of the asset or liability.

Self-sustaining foreign subsidiaries:

Assets and liabilities – at year end exchange rates
Revenues and expenses – at exchange rates prevailing during the year

Translation adjustments are deferred and included in a separate component of Class I and Class II shareholders' equity.

Property, Plant and Equipment

Additions to electric and natural gas utility plant and equipment include an allowance for funds used during construction at a rate approved by the Public Utilities Board for debt and equity funds. Certain of these additions are made with the assistance of cash contributions from customers and governments where the estimated revenue is less than the cost of providing service or where special equipment is needed to supply the customers' specific requirements. These contributions are amortized on the same basis as the assets to which they relate. All other plant and equipment additions are recorded at cost.

Depreciation Methods and Rates Per Annum

	Straight Line	Declining Balance
Electric and natural gas utility plant and equipment	1.5% to 6.4%	
Industrial rental units	10%	
Drilling rigs	6% to 10%	
Replacement drill pipe	25%	
Well servicing rigs	10%	
Other buildings, furniture, fixtures and equipment	2.5%	5% to 30%

On retirement of depreciable natural gas and electric utility plant and equipment, the accumulated depreciation is charged with the cost of the retired unit less net salvage value.

Included in the natural gas utility subsidiaries' property, plant and equipment are gas wells that have been drilled, tested and capped and remain unconnected to the utility system. The Public Utilities Board has directed that the costs of such wells, including an allowance for funds, be accounted for as plant held for future use. If, after a period of five years, these wells have not been added to the utility system, the costs are written off against funds received under The Natural Gas Pricing Agreement Act. If at a future date a gas well is placed in service or is required to be used, the amount written off will be reinstated in property, plant and equipment.

In accounting for non-regulated gas and oil exploration and development activities, the full cost method is followed whereby all costs relating to the exploration for and the development of gas and oil reserves are capitalized. These costs are depleted by the unit of production method based on estimated proven gas and oil reserves.

Deferred Credits

As Alberta gas producers, the natural gas utility subsidiaries receive a pro rata share of monies available under The Natural Gas Pricing Agreement Act. The amounts received, net of royalties and income taxes, are deferred and, subject to the approval of the Public Utilities Board, are reduced by the costs of unsuccessful natural gas exploration.

Revenue Recognition

Utility customers are billed on a cycle billing basis and revenues are recognized when billed with the exception that final Public Utilities Board decisions relating to:

(a) prior years' revenues are recorded in the current year at the date of decision; and
(b) current year revenues collectible or refundable in a subsequent year are recorded in the current year.

Revenues resulting from the supply of contracted products and services are recorded by the percentage of completion method, except for footage drilling contracts which are recorded when contract depths are attained. Any anticipated loss is provided for in its entirety when the estimated loss is identified.

Inventories

Inventories are carried at the lower of cost or estimated net realizable value.

Income Taxes

The utility subsidiaries provide for current income taxes by claiming as deductions for tax purposes only amounts recorded in the accounts. This method is referred to as the "Normalization – All Taxes Paid" method of income tax accounting as approved by the Public Utilities Board.

Deferred Financing Charges

Expenses of issue of long term debt are amortized over the term of the debt and expenses of issue of preferred shares are amortized over the lesser of the expected life of the issue or 30 years.

Other deferred charges are subject to amortization over various periods not exceeding 40 years.

2. Other Income

(Thousands of dollars)	1986	1985
Interest income	**$14,812**	$13,988
Dividends	**1,507**	14,803
Gain on disposition of investments	**4,339**	9
Gain on purchase of long term debt	**322**	2,085
Exchange gains (losses)		
Operating	**2,200**	1,424
Translation	**(1,657)**	(610)
Other	**921**	2,137
	$22,444	$33,836

3. Income Taxes

The income tax provision differs from that computed using the statutory tax rate for the following reasons:

(Thousands of dollars)	1986	1985
Earnings before income taxes and minority interests	**$262,952**	$275,713
Income taxes at statutory rate of 48.35% (1985–47%)	**$127,137**	$129,585
Allowance for equity funds used during construction	**(12,925)**	(12,532)
Crown royalties and other non-deductible government payments	**9,293**	10,935
Earned depletion and resource allowance	**(9,872)**	(12,836)
Unrecorded benefits of loss carryforwards	**1,979**	5,108
Taxes related to amounts allocated to assets in excess of tax values on share acquisitions	**671**	1,506
Foreign tax rate differences	**1,036**	(3,932)
Provincial rebates	**(2,672)**	(2,193)
Non-taxable dividends	**(516)**	(6,838)
Re-assessments	**(5,473)**	–
Other	**(2,902)**	(158)
	$105,756	$108,645
Effective rate	**40.2%**	39.4%

Prior to adoption of the "Normalization – All Taxes Paid" method of income tax accounting, the utility subsidiaries followed the "Flow-Through" method whereby deductions claimed in calculating taxable income exceeded the expenses recorded in the accounts, thereby reducing income taxes otherwise payable. Since the income tax component of rates recovers only income taxes currently payable, the deferred tax provision for these reductions was not recorded by the utility subsidiaries. Unrecorded deferred taxes of the utility subsidiaries increased during the year by $5,344,000 (1985 – decrease of $1,960,000) to an accumulated amount of $134,515,000.

Certain subsidiaries have operating loss carryforwards of approximately $20,000,000 for which the tax benefits have not been recognized in the accounts. The operating loss carryforwards are available to reduce future years' taxable income and begin to expire in 1991.

4. Minority Interests

(Thousands of dollars)	1986	1985
Equity of minority interests:		
In preferred shares of Canadian Utilities and subsidiaries (detailed below)	$ 798,603	$ 750,710
In Class A non-voting and Class B common shares of Canadian Utilities	343,911	327,285
In common shares of ATCO Saudi Arabia Ltd.	578	976
	$1,143,092	$1,078,971
In Canadian Utilities earnings for the year	$ 98,763	$ 121,872
In ATCO Saudi Arabia Ltd. earnings for the year	58	459
	$ 98,821	$ 122,331

Canadian Utilities and Subsidiaries

1986 1985 (Thousands of dollars)	1986 Redemption Premium	Issued Amount	Dividends
Cumulative Redeemable Preferred Shares, 4% to 6%	2% -4%	$ 30,508 $ 30,508	$ 1,424 $ 1,424
Floating Rate Cumulative Redeemable Preferred Shares	N/A	20,000 20,000	1,337 1,458
Cumulative Redeemable Second Preferred Shares			
Non-retractable, 7.3% to 9.24%	1.6%	23,715 59,527	4,083 5,066
Retractable, 7.7% to 14.5%	(See below)	724,380 640,675	66,870 64,958
Less: Dividends capitalized (Note 7)			25,124 6,404
		$798,603 $750,710	$48,590 $66,502

Redemption and retraction privileges

The preferred shares of Canadian Utilities are redeemable subject to premiums listed above plus accrued dividends. The Cumulative Redeemable Preferred Shares and the non-retractable Cumulative Redeemable Second Preferred Shares are redeemable at the option of the corporation at any time. The retractable Cumulative Redeemable Second Preferred Shares will be subject to redemption at the option of the corporation commencing at the redemption dates and with initial premiums stated on the next page.

The retractable Cumulative Redeemable Second Preferred Shares are retractable on the retraction dates specified below at the option of the holder at the stated value plus accrued dividends.

(Thousands of dollars)	Stated Value	Redemption Date	Redemption Premium	Retraction Date
Series F	$ 74,952	October 1, 1986	4%	October 1, 1989
Series G	$ 50,000	May 1, 1987	4%	May 1, 1987
Series H	$288,625	November 1, 1987	Nil	November 1, 1987
Series I	$ 98,803	November 1, 1988	4%	November 1, 1991
Series J	$ 27,000	January 31, 1992	Nil	January 31, 1992
Series K	$125,000	October 15, 1993	Nil	October 15, 1993
Series L	$ 60,000	June 1, 1994	6%	June 1, 1994

The Series H Cumulative Redeemable Second Preferred Shares can be redeemed at the option of the holder prior to November 1, 1987 if presented with a warrant to purchase a Class A common share of TransAlta Utilities Corporation.

Redemption

The maximum redemptions of preferred shares of Canadian Utilities and subsidiaries required for each of the next five fiscal years are:

(Thousands of dollars)

1987	1988	1989	1990	1991
$8,400	$344,025	$6,900	$71,852	$5,900

5. Redeemable Preferred Shares

(Thousands of dollars)	Issued Amount 1986	Issued Amount 1985	Dividends 1986	Dividends 1985
Issued by:				
ATCO Ltd.	$ 55,000	$105,000	$ 9,341	$ 7,702
ATCO Holdings (N.A.) Ltd.	43,150	52,074	3,120	4,212
ATCO Utilities Holdings Ltd.	150,000	150,000	11,287	9,477
474243 Ontario Ltd.	142,512	150,000	10,595	11,952
Total issued (detailed below)	$390,662	$457,074	$34,343	$33,343

ATCO Ltd.

1986
1985

(Thousands of dollars)	Issued Shares	Issued Amount	Average Prime Rate	Dividends
Junior Preferred Shares				
Authorized 8,000,000 shares				
Series 1	**200,000**	**$ 5,000**	**11.1%**	**$ 376**
	200,000	$ 5,000	12.4%	$ 410
Series 2	**–**	**–**	**N/A**	**4,317**
	2,000,000	50,000	N/A	5,750
Series 3	**2,000,000**	**50,000**	**N/A**	**4,648**
	2,000,000	50,000	N/A	1,542
		$ 55,000		**$9,341**
		$105,000		$7,702

The Series 1 Junior Preferred Shares are to be redeemed June 16, 1991 (or earlier under certain circumstances). Dividends are payable quarterly, calculated daily at one-half the prime rate plus 2%.

On December 18, 1985, the corporation gave notice to all holders of the Series 2 Junior Preferred Shares of the corporation's intent to redeem such shares on January 17, 1986. Subsequent to such notice, 1,950,554 Series 2 shares were converted at the rate of 2.86 Class I non-voting shares for each convertible preferred share. 33,995 Series 2 shares were redeemed and 15,451 Series 2 shares are still outstanding with the rights of the holders being limited to receipt of the redemption price thereof. The redemption amount on these outstanding shares is $386,000 and is included in current liabilities. Dividends were paid up to redemption or conversion at a fixed rate of $.71875 per share per quarter.

The Series 3 Junior Preferred Shares are redeemable, at the corporation's option, from December 31, 1989 to December 14, 1990 at $26.00 per share and at $25.00 thereafter. Dividends are payable quarterly at a fixed rate of $.58125 per share.

ATCO Holdings (N.A.) Ltd.

1986 1985 (Thousands of dollars)	Issued Shares	 Amount	Average Prime Rate	Dividends
First Preferred Shares				
Authorized 400,000 shares				
Series A, issued in U.S. dollars	**180,000**	**$25,150**	**10.2%**	**$1,774**
	220,000	$30,074	12.4%	$2,408
Series B	**180,000**	**18,000**	**10.8%**	**1,346**
	220,000	22,000	12.2%	1,804
		$43,150		**$3,120**
		$52,074		$4,212

The Series A and B First Preferred Shares, which may be redeemed earlier subject to certain restrictions and penalties, are to be redeemed, at par, in equal semi-annual installments of U.S. $2,000,000 and Canadian $2,000,000 to April 1, 1990.

The Series A First Preferred Shares are translated at the year end exchange rate. Exchange adjustments arising on translation are deferred and amortized to retained earnings over the remaining life of the preferred shares.

Dividends are payable monthly, calculated daily at 52% of prime plus 1½%.

The subsidiary has indemnified holders of the preferred shares to the extent of any reduction in the holders' net after tax return from the preferred shares, caused by changes in law.

The preferred shares are the subject of a sale agreement wherein ATCO Ltd. agrees upon certain events occurring to purchase the preferred shares. This sale agreement is secured by a floating charge debenture of U.S. $90,000,000 issued and pledged by ATCO Ltd. and by hypothecation of the ATCO Drilling Holdings Ltd. shares. The sale agreement is also secured by guarantees and pledge of a U.S. $90,000,000 floating charge debenture of certain subsidiaries.

Terms relating to the preferred shares include restrictions on capital expenditures, new debt, intercompany loans and guarantees and performance bonds. Covenants also require maintenance of specified working capital and debt to equity ratios.

Failure to pay dividends, redeem shares or comply with covenants constitutes default and may result in the holders of the preferred shares demanding payment under the terms of the sale agreement.

ATCO Utilities Holdings Ltd.

1986 1985 (Thousands of dollars)	Issued Shares	 Amount	Average Prime Rate	Dividends
Preferred Shares				
Authorized 150,000 shares	**150,000**	**$150,000**	**10.7%**	**$11,287**
	150,000	$150,000	12.2%	$9,477

The preferred shares may be redeemed, at the corporation's option, at a price of $1,040 per share from July 7, 1987 through July 6, 1988 or at a price of $1,020 per share from July 7, 1988 through July 6, 1989. The preferred shares outstanding at July 7, 1989 must be redeemed at a price of $1,000 per share.

Dividends are payable quarterly at a rate of one quarter of 70% of the average prime rate for the quarter.

474243 Ontario Ltd.

1986 1985 (Thousands of dollars)	Issued Shares	 Amount	Average Prime Rate	Dividends
Preference Shares				
Par value $1,000 each				
Authorized 150,000 shares				
Classes A - G	**142,512**	**$142,512**	**10.7%**	**$10,595**
	150,000	$150,000	12.2%	$11,952

The issued preference shares are to be redeemed, at par, at 1.25% per quarter to February 1, 1992, with the balance to be redeemed, at par, on May 1, 1992. The preference shares may be redeemed earlier subject to certain restrictions and penalties.

Dividends are payable quarterly at the following rates, calculated daily:

Classes A-D ($71,256,000)	50% of prime plus 2%
Classes E-F ($23,752,000)	50% of prime plus 1⅞%
Class G ($47,504,000)	52% of prime plus 1½%

The subsidiary has indemnified holders of the preference shares to the extent of any reduction in the holders' net after tax return from the preference shares, caused by changes in law.

6. Change in Accounting Policy

Effective April 1, 1985, ATCO changed its method of accounting for investment tax credits from the flow-through method to the cost reduction method to conform to the recommendations of The Canadian Institute of Chartered Accountants. Investment tax credits, previously credited to earnings in the year in which they were earned, are now recorded as reductions in the cost of the related fixed assets in the year in which the credits are claimed for tax purposes. This change has been applied retroactively and has decreased amounts reported in 1985 for net property, plant and equipment by $3,878,000, deferred income taxes by $390,000 and retained earnings by $3,488,000. The change increased earnings in the current year and 1985 by $357,000 and $52,000, respectively, and decreased earnings of prior years by a total of $3,540,000.

7. Investments in Other Companies

(Thousands of dollars)	1986	1985
TransAlta Utilities Corporation	$222,814	$244,964
Hydro-Québec bonds	49,960	49,950
Floating rate preferred shares	40,150	–
Joint ventures and partnerships	31,877	38,940
Total (detailed below)	$344,801	$333,854

TransAlta Utilities Corporation

On December 1, 1982, each Canadian Utilities Series H preferred shareholder was issued a warrant, for each share held, entitling the bearer to purchase one Class A common share of TransAlta owned by Canadian Utilities at a price of $22.25 per share ($27.38 market value at March 31, 1986) on or before November 1, 1987. Gains on disposition are recorded as warrants are exercised. During the year, 1,409,016 warrants were exercised (1985 - 2,600), leaving 11,558,101 outstanding at March 31, 1986.

The investment in TransAlta consisted of the following:

(Thousands of dollars)	1986		1985	
	Shares	Amount	Shares	Amount
Common shares	11,558,147	$217,368	12,967,163	$243,889
First Preferred Shares	–	–	352	26
Net carrying costs		5,446		1,049
		$222,814		$244,964

Since January 1, 1985 the net carrying cost of the TransAlta investment has been deferred and added to the cost of the investment. Included in the deferred amount of $5,446,000 are dividends on the Series H preferred shares net of dividends received from TransAlta and any related interest income.

Hydro-Québec Bonds

The proceeds on the issue of the Series 3 Junior Preferred Shares were invested in $50,000,000 principal value of 12 ⅜% Hydro-Québec bonds maturing January 3, 1991. These securities have been hypothecated and use of the principal and interest is restricted.

Joint Ventures and Partnerships

(Thousands of dollars)	1986	1985
Real estate development	$28,862	$36,095
Energy services	3,015	2,845
	$31,877	$38,940

ATCO's share of the joint ventures' and partnership's losses amounted to $2,693,000 (1985 – $818,000) and is included in revenues.

8. Property, Plant and Equipment

(Thousands of dollars)	1986		1985	
	Cost	Accumulated Depreciation & Depletion	Cost	Accumulated Depreciation & Depletion
Electric utility plant and equipment	$1,379,284	$275,541	$1,043,197	$242,678
Natural gas utility plant and equipment	984,851	233,404	918,625	207,646
Utility plant construction work in progress	158,748	–	355,348	–
Drilling and well servicing rigs and related equipment	196,079	92,817	190,953	79,473
Rental assets	95,626	32,797	89,761	29,687
Other plant and equipment	47,159	18,849	41,929	17,214
Gas and oil properties	101,005	23,910	80,939	18,141
Deferred gas exploration	24,836	–	20,470	–
Land, buildings and improvements	95,491	18,869	97,631	16,428
	$3,083,079	$696,187	$2,838,853	$611,267
	$2,386,892		$2,227,586	

As explained in the Summary of Significant Accounting Policies, gas wells accounted for as plant held for future use in the amount of $24,932,000 are included in natural gas utility plant and equipment at March 31, 1986 (1985 – $31,959,000).

During the year $1,944,000 (1985 – Nil) of unsuccessful gas exploration costs, net of related income taxes, were charged against monies received under The Natural Gas Pricing Agreement Act.

9. Bank Indebtedness

The Corporation maintains lines of credit, a term credit agreement and standby lines of credit, at varying interest rates, as follows:

(Thousands of dollars)	1986		1985	
	Available	Drawn	Available	Drawn
Operating lines of credit	$ 68,800	$21,364	$ 46,810	$2,545
Term credit agreement	50,000	37,727	50,000	–
Standby lines of credit	25,000	–	35,000	–
	$143,800	$59,091	$131,810	$2,545

The operating lines of credit are generally secured by accounts receivable, inventories and uncompleted contracts.

The term credit agreement, which expires in April 1993, is secured by Class A non-voting and Class B common shares of Canadian Utilities owned by the Corporation, and by covenants which require maintenance of voting control of Canadian Utilities and the continued ownership, either directly or indirectly, by ATCO Utilities Holdings Ltd. of the Canadian Utilities shares currently owned by the Corporation.

10. Long Term Debt

(Thousands of dollars)	1986	1985
Canadian Utilities and Subsidiaries		
Sinking fund debentures, at 7¼% to 17½%, due at various dates to 2002	$505,986	$520,914
First mortgage sinking fund bonds, at 5½% to 9¾%, due at various dates to 1994	42,430	43,227
Capitalized lease obligation	20,257	21,086
Notes payable	82,296	–
Other	26,915	15,345
ATCO Ltd.		
Term loans, unsecured, at prime minus ⅜% to prime with fixed rate options, due at various dates to March 1993.	85,000	68,864
ATCO Development Ltd.		
First mortgages, at 12¼% to 12⅜% to July 1989, at prime minus ¼% to prime plus ½% thereafter, due July 1991.	65,603	65,857
Bank loan, at prime plus 2¾%, due December 31, 1992, non-recourse, secured by assignment of partnership interest in ALDC Partnership.	12,227	12,227
Interim and long term financing on projects, at prime minus ⅛%, due at various dates to December 31, 1987, secured by charges on specific joint venture projects.	4,549	9,854
ATCO Drilling Ltd.		
Term loan, at 12½% from April 1, 1985 to November 19, 1985, 11¾% from November 20, 1985 to March 31, 1987 and 13% thereafter, due March 31, 1989, secured by a first charge on drilling and well servicing rigs of the corporation and its subsidiaries	22,500	30,000
Term loan, at various fixed and floating rate options (12% at March 31, 1986), due December 30, 1990	16,400	–
Other		
Mortgage and other loans, at 9% to prime plus 1%, due at various dates to 2001, secured mainly by charges on specific operating assets	8,809	7,105
	892,972	794,479
Less: Amounts due within one year	39,320	22,964
	$853,652	$771,515

The terms of the above debt include restrictions relating to new debt and guarantees. Canadian Utilities has restrictions on the payment of dividends on Class A and Class B shares, however, Canadian Utilities' consolidated retained earnings in the amount of $211,203,000 is free of such restrictions. Covenants also require maintenance of specified working capital and shareholders' equity.

The terms of a $100,000,000 13.10% Canadian Utilities sinking fund debenture, 1984 series, due June 1, 1994, grant the holder of the debentures the option of requiring the corporation to redeem all or any of the holder's debentures on June 1, 1989 at a price equal to the principal amount plus accrued and unpaid interest to June 1, 1989.

Canadian Utilities leases, with an option to purchase, a dragline costing $24,818,000 which is included in electric utility plant and equipment. The future minimum payments are $2,421,000 per year for the next five years and $19,856,000 thereafter to June 30, 1996. The imputed interest included in these future minimum rentals at 7.62% implicit in the lease is $11,704,000.

Under a bank loan agreement, which provides a line of credit of up to $50,000,000 to March 14, 1987, Canadian Utilities issues commercial paper and assumes bank loans. Under the agreement Canadian Utilities maintains an unused bank line of credit of not less than 50% of the commercial paper outstanding. At March 31, 1986, Canadian Utilities had issued $82,296,000 of commercial paper under this facility (1985 – Nil).

The minimum annual repayments of long term debt over each of the next five fiscal years are as follows:

(Thousands of dollars)

1987	1988	1989	1990	1991
$39,320	$87,370	$61,389	$58,345	$73,071

Interest expensed on long term debt during the year was $89,912 (1985 – $94,998).

11. Class I and Class II Shares

(Thousands of dollars)	Class I Non-Voting		Class II Voting		Total	
	Shares	Consider-ation	Shares	Consider-ation	Shares	Consider-ation
Authorized	100,000,000		50,000,000		150,000,000	
Issued:						
March 31, 1984	17,381,431	$ 58,679	4,775,469	$2,384	22,156,900	$ 61,063
Employee share option plans	6,600	38	3,300	19	9,900	57
Conversions from Class II to Class I	202,241	101	(202,241)	(101)	–	–
March 31, 1985	17,590,272	58,818	4,576,528	2,302	22,166,800	61,120
Employee share option plans	8,800	54	3,400	21	12,200	75
Conversions:						
Class II to Class I	214,051	109	(214,051)	(109)	–	–
Preferred to Class I	5,578,550	48,764	–	–	5,578,550	48,764
March 31, 1986	23,391,673	$107,745	4,365,877	$2,214	27,757,550	$109,959

Each Class II voting share may be converted to one Class I non-voting share at the shareholder's option. The two classes of shares rank equally in all other respects.

Warrants

In conjunction with the October 6, 1983 issue of Class I non-voting shares, the Corporation issued 3,000,000 warrants to purchase one Class I non-voting share each at a price of $10.50 per share. The warrants are exercisable at any time prior to April 25, 1987. At March 31, 1986 no warrants had been exercised.

Share Options

ATCO has share option plans under which options to purchase 994,740 Class I non-voting and 217,260 Class II voting shares may be granted to selected directors, officers and key employees. The options are exercisable cumulatively over periods up to ten years from the date of grant.

Options to purchase 897,820 Class I non-voting and 216,660 Class II voting shares have been granted under the plan, of which 450,000 and nil, respectively, were outstanding at March 31, 1986 at prices ranging from $8.125 to $8.75 per share.

12. Segmented Information

(Thousands of dollars)

By Industry 1986 1985	Electric Utility Operations	Gas Utility Operations	Drilling and Well Servicing	Other Energy[1]	Manu-facturing & Leasing	Real Estate & Property Develop-ment	Other[2]	Consoli-dated[3]
Revenues:								
Trade	$ 328,517	$796,490	$ 89,585	$156,180	$153,851	$ 1,289	$ 1,317	$1,527,229
	$ 344,519	$879,373	$ 77,805	$161,920	$139,657	$ 6,435	$ 1,118	$1,610,827
Inter-segment	102	46,204	2,033	23,006	1,483	14,253	9,063	–
	146	20,055	1,909	8,612	886	14,239	9,187	–
Total segment revenues	328,619	842,694	91,618	179,186	155,334	15,542	10,380	1,527,229
	344,665	899,428	79,714	170,532	140,543	20,674	10,305	1,610,827
Expenses:								
Operating costs	146,098	687,893	79,216	153,265	134,094	11,031	12,433	1,127,776
	146,158	752,516	71,350	143,900	120,509	16,386	11,566	1,207,501
Depreciation, depletion and amortization	34,874	28,187	14,279	8,946	11,865	2,078	4,151	106,567
	36,624	26,279	14,130	6,902	10,693	1,227	5,932	105,286
Total segment expenses	180,972	716,080	93,495	162,211	145,959	13,109	16,584	1,234,343
	182,782	778,795	85,480	150,802	131,202	17,613	17,498	1,312,786
Segment operating profit (loss)	$ 147,647	$126,614	$ (1,877)	$ 16,975	$ 9,375	$ 2,433	$ (6,204)	$ 292,886
	$ 161,883	$120,633	$ (5,766)	$ 19,730	$ 9,341	$ 3,061	$ (7,193)	$ 298,041
Identifiable assets	$1,318,586	$896,513	$136,339	$145,302	$148,256	$85,761	$450,744	$3,298,377
	$1,191,909	$871,970	$138,611	$114,376	$121,454	$95,757	$381,639	$3,032,501
Capital Expenditures	$ 133,343	$ 71,731	$ 6,186	$ 24,258	$ 22,996	$ 542	$ 1,005	$ 260,061
	$ 129,992	$ 56,437	$ 4,008	$ 32,224	$ 16,195	$ 17	$ 750	$ 239,623

[1] Exploration and production, petrochemicals and gas marketing.
[2] Holding companies.
[3] Inter-segment transactions have been eliminated in the consolidated column.

	1986	1985
Segment operating profit	$ 292,886	$ 298,041
Interest	(96,895)	(97,681)
Allowance for funds used during construction	44,517	41,517
Other income	22,444	33,836
Income Taxes	(105,756)	(108,645)
Minority interests	(98,821)	(122,331)
	(234,511)	(253,304)
Earnings for the year	$ 58,375	$ 44,737

13. Rate Applications

One of the natural gas subsidiaries received a final rate decision for calendar 1985 on December 20, 1985 and revenues of $1,304,000 have been accrued at March 31, 1986. The other natural gas subsidiary has been operating on interim rates since October 1984. Final decisions for calendar years 1984 and 1985 are expected during calendar 1986.

In a final decision released in December 1985, the Board set the revenue requirements of the electric subsidiary for calendar years 1984 and 1985. The decision, requiring a revenue refund of approximately $13,255,000 for 1984 ($2,852,000 after income taxes, other related expenses and minority interests), has been recorded in the current year.

14. Commitments and Contingencies

ATCO has contractual obligations in respect of long term operating leases for manufacturing facilities, office premises and equipment. The rentals amounted to $5,444,000 for 1986 (1985 – $6,282,000). Future minimum lease payments are as follows:

(Thousands of dollars)

1987	1988	1989	1990	1991	Total of All Subsequent Years
$4,912	$4,043	$3,339	$2,530	$1,733	$1,559

United States treasury officials are investigating the basis followed by ATCO in determining certain United States customs and duty payments since 1969. These investigations are still in progress. In the opinion of counsel, claims will probably be asserted. Management is of the opinion that no material amount above those amounts already provided in the accounts will ultimately be payable.

Alberta Power Limited has a 50% joint ownership in the Sheerness Generating Station which is under construction. The project is forecast to cost the corporation approximately $587,000,000 of which $384,000,000 has been expended to date.

ATCO has pension plans covering substantially all of its employees. The aggregate unfunded past service liability, all of which is attributable to Canadian Utilities, amounted to approximately $28,098,000 at March 31, 1986 (1985 – $30,832,000). Of this amount $1,703,000 is a result of plan experience and is being amortized and funded over 3 years. The balance of $26,395,000 arose from changes in assumptions and is being amortized and funded over periods ranging from 3 to 13 years.

As part of the financing of the acquisition of shares of Canadian Utilities, ATCO has agreed to pay the lenders 7% of the increase in value of the Canadian Utilities shares from acquisition to date of demand, to a maximum amount of $21,000,000. The amount is payable on demand if ATCO sells or transfers any of the shares of Canadian Utilities, or at any time from December 31, 1985 to December 15, 1992. Payment may be made in cash or, at ATCO's option, by the issue of an appropriate number of Class I shares of ATCO Ltd. based on their then quoted market price. Based on the March 31, 1986 market price of the Canadian Utilities shares, the liability to the lenders would be approximately $8,600,000. The estimated amount payable arising as a result of this agreement will be deferred and charged to earnings from 1986 to 1993. The amount charged to 1986 earnings was $324,000.

ATCO has a long term compensation plan under which 624,630 share equivalents have been granted to selected officers, directors and key employees. The equivalents generally are deemed to be received (at prices ranging from $4.05 to $8.22 per share) when a stock option is exercised and are redeemable five years later. Future payments under the plan are based on the increase in the price of ATCO's Class I and Class II shares plus deemed dividends. Based on the March 31, 1986 market price of ATCO's shares the liability would be approximately $2,900,000. The estimated amounts payable as a result of this plan are being accrued over the life of the plan to termination on March 31, 1988. $2,400,000 has been accrued at March 31, 1986 and is included in deferred credits. The amount charged to earnings in 1986 was $708,000 (1985 – $1,209,000).

15. Comparative Figures

Certain of the comparative figures have been reclassified to conform with the financial statement presentation adopted for 1986.

Auditors' Report

Price Waterhouse

To the Shareholders of ATCO Ltd.

We have examined the consolidated balance sheet of ATCO Ltd. as at March 31, 1986 and the consolidated statements of earnings and retained earnings and changes in cash 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 March 31, 1986 and the results of its operations and the changes in its cash position for the year then ended in accordance with generally accepted accounting principles. After giving retroactive effect to the change in method of accounting for investment tax credits as explained in Note 6 to the financial statements, these principles have been applied on a basis consistent with that of the preceding year.

Price Waterhouse

Chartered Accountants

Calgary, Alberta
May 20, 1986

Consolidated Summary of Operations

ATCO Ltd.

Years ended March 31

(Thousands of Canadian dollars)	1986	1985	1984	1983	1982
Revenues	$1,527,229	$1,610,827	$1,571,347	$1,677,922	$1,638,973
Costs and expenses	1,331,238	1,410,467	1,425,520	1,536,900	1,533,539
	195,991	200,360	145,827	141,022	105,434
Allowance for funds used during construction and other income	66,961	75,353	76,304	63,996	49,838
	262,952	275,713	222,131	205,018	155,272
Income taxes	105,756	108,645	80,901	68,858	46,023
	157,196	167,068	141,230	136,160	109,249
Minority interests	98,821	122,331	116,327	95,519	57,291
Earnings for the year	58,375	44,737	24,903	40,641	51,958
Dividends on redeemable preferred shares	34,343	33,343	21,704	26,001	28,547
Earnings attributable to Class I and Class II shares	$ 24,032	$ 11,394	$ 3,199	$ 14,640	$ 23,411
Earnings per Class I and Class II share					
Basic	$1.02	$ .51	$ .17	$ .90	$1.44
Fully diluted	$ .91	$ .50	$ .17	$ .89	$1.42
Dividends per Class I and Class II share	$ .20	$ .20	$ .20	$ .20	$ .20
Equity per Class I and Class II share	$9.63	$9.05	$8.96	$9.10	$8.44
Class I and Class II shares outstanding	27,757,550	22,166,800	22,156,900	16,317,505	16,234,600

		1986	1985	1984	1983	1982
Market price of shares						
Class I	High	11⅞	9⅜	10¾	11½	11¼
	Low	8½	5¼	6½	5	6½
Class II	High	11¾	9¼	10⅝	11¼	11⅛
	Low	8¼	5½	6⅜	5	6½

Directors, Officers and Operating Units

Directors

W.L. Britton, Q.C.
Partner, Bennett Jones
Calgary

B.P. Drummond ★
Vice Chairman, Richardson Greenshields of Canada Limited
Montreal

B.K. French★
President,
Karusel Management Ltd.
Calgary

G.P. Kiefer ★☆
Senior Vice President,
Special Projects, ATCO Ltd.

E.W. King
Corporate Director
Edmonton

Honorable E.P. Lougheed,
P.C., Q.C.,
Partner, Bennett Jones
Calgary

K.B. Purdie ☆
President,
Manufacturing & Leasing,
ATCO Ltd.

R. Rice ★
Consultant
Greenwich, Conn. U.S.A.

C.S. Richardson ☆
Senior Vice President,
Finance, ATCO Ltd.

N.W. Robertson ☆
President and Chief
Operating Officer, ATCO Ltd.

R.D. Southern
Deputy Chairman and
Chief Executive Officer
ATCO Ltd.

S.D. Southern
Chairman of the Board
ATCO Ltd.

O. Steiner ☆
President
ATCO Development Ltd.

J.D. Wood
President and Chief
Operating Officer
Canadian Utilities Limited

Officers

S.D. Southern
Chairman of the Board

R.D. Southern
Deputy Chairman and
Chief Executive Officer

N.W. Robertson
President and
Chief Operating Officer

C.S. Richardson
Senior Vice President,
Finance

G.P. Kiefer
Senior Vice President,
Special Projects

A.J. Pullman
Vice President,
Controller

D.P. Wood
Vice President,
Corporate Services and
Corporate Secretary

M. Durdle
Assistant Secretary

★ Member – Audit Committee
☆ Member – Executive Committee

Utilities Group

Alberta Power Limited
Generation and Distribution of Electricity
Head Office:
10035 - 105 Street
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Tel:(403)420-7310
Telex:037-2848
TWX:610-831-1143

Canadian Utilities Limited
Electric and Natural Gas Utilities and Energy-related Activities
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Canadian Western Natural Gas Company Limited
Production and Distribution of Natural Gas
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909 - 11th Avenue S.W.
Calgary, Alberta T2R 1L8
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Northland Utilities (B.C.) Limited
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Northland Utilities (NWT)
Generation and Distribution of Electricity
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Northwestern Utilities Limited
Production and Distribution of Natural Gas
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The Yukon Electrical Company Limited
Generation and Distribution of Electricity
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Telex: 04-98229

Resources Group

ATCO Drilling Inc.
U.S. Contract Drilling
Head Office:
12200 E. Iliff Avenue
Building C, Suite 204
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ATCO Drilling Ltd.
Contract Drilling, Well Servicing and Oilfield Equipment Rentals and Sales
Head Office:
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Calgary, Alberta T2P 3G3
Tel: (403) 292-7979
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ATCO Marine Exploration Ltd.
Exploration and Development of Frontier Lands
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800, 800 - 6th Avenue S.W.
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Tel: (403) 292-8000
Telex: 03-821313

ATCO Oilfield Equipment
Oilfield Equipment Rentals and Sales
Head Office:
9755 - 51 Avenue
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ATCO Well Servicing
Well Completion and Workovers
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7774 - 47 Avenue Close
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Red Deer, Alberta T4N 5H3
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ATCO Well Servicing Inc.
Well Completion and Workovers
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Corpus Christi, Texas 78469
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Rapicom: (512) 289-6452

ATCO-APM Drilling Pty. Ltd.
Joint Venture with Australian Paper Manufacturers Ltd. in Contract Drilling and Well Servicing
Head Office:
4 Formation Street
Wacol, Queensland 4076
Australia
Tel: (07) 271-2288
Telex: 42006

ATCO/Equtak Drilling Ltd.
Joint Venture with the Inuvialuit Development Corporation in Contract Drilling
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ATCOR Resources Limited
Energy Development
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Telecopier: 261-7665

AT&S Exploration Ltd.
Joint Venture with Sun Life Assurance Company of Canada and Texaco Canada Resources Ltd. in Exploration of Canada Frontier Lands
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Manufacturing Group

ATCO Industries (Aust) Pty. Ltd.
Manufacturing and Distribution of Shelter Products, Australia
Head Office:
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Elizabeth West 5112
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Telex: 71-82308

ATCO Industries (N.A.) Ltd.
Manufacturing and Distribution of Shelter Products, North America
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ATCO Eastern
Rental and Sales of Industrial, Commercial and Community Structures
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Telex: 05-566175

ATCO Homes (Australia)
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ATCO Metal
Manufacture and Sale of Roll-Form Cladding and Decking, Pre-Engineered Metal Buildings for Farm, Commercial and Industrial Applications
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ATCO Pacific
Rental of Office Industrial Units
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ATCO Saudi Arabia Ltd.
Manufacture and Sale of Industrial, Commercial and Community Structures; and Construction Services
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Kingdom of Saudi Arabia
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ATCO Structures
Manufacture, Rental and Sales of Industrial, Commercial and Community Services
Construction Services
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ATCO Structures, Inc.
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Real Estate Group

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Other

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Corporate Travel
Tel: (403) 250-9984

InterATCO B.V.
InterATCO Drilling B.V.
Financial Holding Companies
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3271 BL Mijnsheerenland
The Netherlands
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Telex: 27464

Shareholders' Information

Shareholder and security analyst inquiries should be directed to:
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ATCO Ltd.
1600, 909 - 11th Avenue S.W.
Calgary, Alberta T2R 1N6
Telephone: (403) 292-7554

Dividend information and other inquiries concerning your shares should be directed to:
STOCK TRANSFER DEPARTMENT
National Trust Company
1008 The Home Oil Tower
324 - 8th Avenue S.W.
Calgary, Alberta T2P 2Z2

The shares of ATCO Ltd. are listed under the ticker symbols:
ACO.X (Class I Non-Voting Shares)
ACO.Y (Class II Voting Shares)
ACO.WT (Warrants to purchase Class I Non-Voting Shares) on
The Toronto Stock Exchange and the Montreal Exchange

ATCO's fiscal year ends on March 31. Dividends are mailed approximately the end of June, September, December and March

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ATCO Ltd. is incorporated under the laws of the Province of Alberta

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CORPORATE OFFICE
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AUDITORS
Price Waterhouse
Calgary, Alberta

COUNSEL
Bennett Jones
Calgary, Alberta

The annual shareholders' meeting will be held at 10 a.m. M.D.T. on Wednesday, August 13, 1986 in the Calgary Convention Centre, Calgary, Alberta

ATCO