1987 ANNUAL REPORT

ATCO LTD.

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

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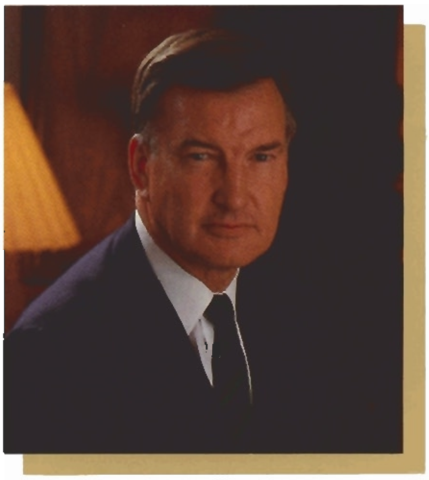
Corporate Profile and Financial Highlights

ATCO's growth since its inception in 1946 has been characterized by its ability to penetrate new markets and create an integrated operating base. Originally a pioneer in the production of transportable industrial accommodation, ATCO's divisions today include electric and natural gas utilities, oil and gas exploration and production, gas marketing and processing, contract drilling and well servicing, oilfield equipment sales and rentals, manufacturing and leasing operations for transportable shelter and real estate development and management. With its record of growth, combined with a corporate mandate to enhance earnings and revenue performance, ATCO is poised for an important phase in its development.

Years ended March 31

(Thousands except share data)	*1987*	*1986*	*Change*
		(Restated) (See Note 7)	
Revenues	**$1,443,706**	$1,527,229	− 5%
Earnings for the year	**$ 52,276**	$ 47,738	+ 10%
Earnings attributable to Class I and Class II shares	**$ 25,219**	$ 13,395	+ 88%
Earnings per Class I and Class II share	**$ .91**	$ .57	+ 60%
Dividends paid per Class I and Class II share	**$ .20**	$ .20	—
Cash position	**$ 71,970**	$ 73,433	− 2%
Additions to property, plant and equipment	**$ 275,299**	$ 260,061	+ 6%
Total assets	**$3,219,791**	$3,261,587	− 1%
Class I and Class II shareholders' equity	**$ 278,544**	$ 256,775	+ 8%
Class I and Class II shares outstanding	**27,759,550**	27,757,550	
Weighted average Class I and Class II shares outstanding	**27,757,717**	23,569,638	

Report to Shareholders



ATCO's performance for the fiscal year ended March 31, 1987 reflects the Company's continuing commitment to strengthen its financial base and improve shareholder values. Earnings before preferred share dividends increased 10 per cent to $52,276,000 on total revenue of $1,443,706,000, compared with the previous year's restated earnings before preferred share dividends of $47,738,000 on total revenue of $1,527,229,000. After payment of preferred share dividends of $27,057,000, earnings attributable to Class I and Class II shares rose to $25,219,000 or 91 cents per share compared with the restated 1986 figures of $13,395,000 or 57 cents. The weighted average number of shares outstanding for 1987 was 27,757,717 compared with 23,569,638 for 1986. ■ Fiscal 1986 results have been restated following the retroactive adoption of the guideline issued in calendar 1986 by the Canadian Institute of Chartered Accountants regarding petroleum and natural gas properties. As outlined in Note 7 to the financial statements, 1987 earnings were increased by approximately $771,000 and 1986 reported earnings reduced by $10,637,000 after income taxes and minority interests as a result of the guideline application. ■ Canadian Utilities Limited, ATCO's electric and natural gas utilities subsidiary, continued to perform satisfactorily last year. Despite record warm temperatures in the winter months, earnings increased because of higher electrical sales, continuing gains in productivity and rate increases. ■ Despite the slowdown in economic activity in Alberta last year, power consumption for ATCO's major electric subsidiary, Alberta Power, increased 14 per cent compared with a provincial average of 5 per cent. This resulted from increased use of electrical power for oilfield pumping and the start-up of a number of energy projects in northern Alberta. This trend is continuing in calendar 1987. ■ Earnings from natural gas operations declined in calendar 1986 because of a number of factors including warmer temperatures and reduced allowance for funds used during construction. These reductions were partially offset by the purchase of lower priced gas. ■ Frontec Logistics Corp., a joint venture of ATCO and Canadian Utilities, was established to spearhead the Company's efforts to become a major supplier of electrical service, related technical expertise and logistic support in Northern Canada. As part of these efforts, Alberta Power recently agreed to sell shares in its utility subsidiary, Northland Utilities (NWT) Limited, to a number of northern business groups. ■ ATCO pioneered modular transportable shelter and the concept of temporary accommodation is ideal for the XV Olympic Winter Games. To date, ATCO has been awarded several major contracts for the Games which will be held at Calgary, Alberta next February. Temporary housing for more than 3,000 athletes, media representatives and Olympic officials, a 50,000-square-foot television studio for ABC-TV and on-site television broadcast facilities will be provided by ATCO. An additional 300 buildings from the Company's rental fleet will be installed at major Olympic venues as support facilities. ■ ATCO is Canada's only national supplier of site office equipment and during the past year expanded its presence in the lease market through both the acquisition and manufacture of additional units. ■ The Company's Energy

Services Group, which includes contract drilling, well servicing and oilfield equipment operations, experienced a difficult year during fiscal 1987 with activity levels dropping to historic lows as a result of falling oil prices. The Group recorded a small cash flow loss last year, however, the current outlook is much more optimistic. Indications are that the combination of higher oil prices, significant equity financing within the industry and government incentives will lead to higher cash flow, increased activity and higher operating rates. ■ ATCO's interest in Northern Canada extends to the frontier regions where the Company and its subsidiaries hold an approximate eight per cent interest in the Amauligak discovery in the Beaufort Sea. Although initial production from Amauligak is expected to be brought to market by tankers, eventual development of the Beaufort will involve a series of pipelines and gathering systems which represent further opportunities for ATCOR Ltd., Canadian Utilities' non-utility subsidiary. ATCOR is also employing a very aggressive strategy to increase its conventional exploration and production activities in Alberta and is expanding its gas marketing activities to include Eastern Canada and the United States. ■ Perhaps the most important development of the past year was a series of steps taken to increase shareholders' values and ensure the Company's long term growth. Initially, two office towers and the Australian subsidiary were sold with the proceeds being used to reduce long term debt and increase liquidity. Other, smaller asset sales followed and studies are now underway to determine the most appropriate investment opportunity for the funds generated by these sales. At the same time, studies are being conducted to determine the most efficient and flexible organization to accommodate the planned investments. Success with this program will enhance ATCO's attractiveness as an investment vehicle for shareholders and facilitate any future financing required to support growth opportunities. ■ In addition to the measures outlined above, which strengthened the balance sheet significantly, the Company continues to reduce its exposure to floating interest rates. Including offsetting deposits, the exposure to floating interest rates has been reduced to approximately $137 million. ■ ATCO is committed to the communities it serves through the sponsorship of a variety of service programs. Of particular significance this year was the outstanding contribution made by Norman W. Robertson, President and Chief Operating Officer of ATCO Ltd., who served as Chairman of the most successful United Way Campaign in Calgary's history. ■ In the near term, the growing stability of commodity prices and, in particular, the world oil price has created a positive outlook for the economy of Alberta, ATCO's core marketplace. With its mix of products and services, ATCO is well positioned to benefit from a return to a more satisfactory level of economic development in Alberta. ■ ATCO's leadership in many of the industries it serves reflects the strength of its management and the dedication of its employees, shareholders and customers. On behalf of the Directors, we wish to acknowledge their contributions during the past year.

R. D. Southern
Deputy Chairman and
Chief Executive Officer

Utilities

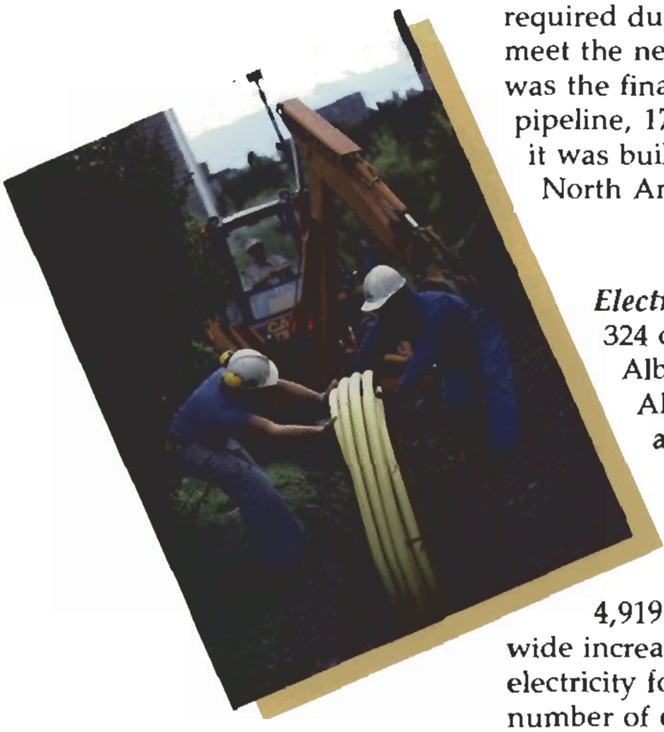
ATCO's controlling interest in Canadian Utilities Limited continues to provide stable dividend income and growth opportunities. An estimated eight out of ten Albertans rely on CU for natural gas service, electric power or both. ■ CU earnings increased from a restated $1.87 per share in 1985 to $2.16 per share in 1986. This improvement, which was achieved despite record warm temperatures, was the result of higher electrical sales, asset sales, rate increases and continuing gains in productivity. ■ Since the first productivity program was initiated five years ago, the number of employees has declined by 5 per cent while total customers served has increased by 11 per cent. Recent surveys indicate this improved staff-customer ratio has been achieved while maintaining the customer's high regard for the quality of service received. ■ Because Canadian Utilities' fiscal year corresponds with the calendar year, all references in the following narrative to this year and last year refer to calendar 1986 and 1985, respectively.

Natural Gas Operations ■ Canadian Utilities' major gas subsidiaries are Canadian Western Natural Gas, serving southern Alberta, and Northwestern Utilities in north-central Alberta. Despite the addition of 8,300 customers, bringing the total to 610,000, earnings from natural gas operations were down in 1986. While warmer than normal weather reduced natural gas sales, the lower earnings were also the result of a reduction in the allowance for funds used during construction, increased operation and maintenance expenses to serve new customers, and a higher effective tax rate. ■ Consolidated revenues of $737 million were 14 per cent lower than last year, partly because the Federal Government abolished taxes on natural gas consumption which previously had been collected for the Government by the gas utilities. ■ Total system throughput — the amount of gas provided to consumers and transported for other companies — decreased by 11 per cent to

The official turn-on of the first 375-megawatt unit of the Sheerness Generating Station in central Alberta was held on June 20, 1986.

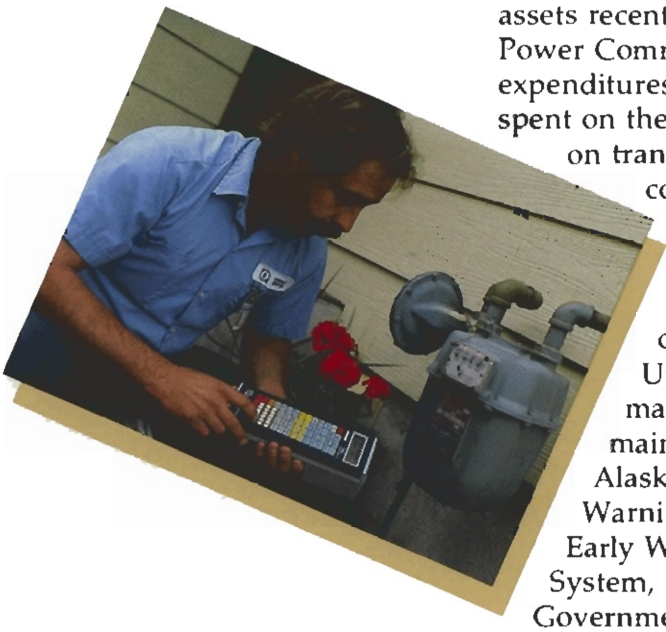
Capital expenditures of $68 million were required last year to expand services to existing natural gas customers and provide for growth.

419 petajoules. Warmer weather was responsible for a portion of this decrease while the volume of gas transported for others also declined. ■ In December 1986, the Alberta Public Utilities Board issued its decision on Canadian Western's 1985 general rate application. The Board approved final rates effective January 1, 1987 and affirmed the interim rates under which Canadian Western had operated during 1985 and 1986. ■ The Board issued a decision in February 1987 on Northwestern's general rate application for 1984 and 1985, awarding additional revenues of $2.9 million to be recorded during 1987. The Board also ordered that a schedule of revenue surplus or deficiency be filed for 1986 to determine Northwestern's rates for 1987. ■ Capital expenditures of $68 million were required during the past year to provide for growth and to meet the needs of existing customers. A major project was the final stage of replacing Canadian Western's first pipeline, 170 miles long, from Taber to Bow Island. When it was built in 1912, it was the longest 16-inch pipeline in North America.



Electrical Utilities ■ When you flick a switch in 324 communities in east-central and northern Alberta, Canadian Utilities' major electric utility, Alberta Power, is at your service. The Company also provides electricity to important resource regions of the province where growth in power consumption is strong. ■ Retail energy sales in Alberta Power's service area surged by 14 per cent during the year to a total of 4,919 million kilowatt hours, while demand province-wide increased by only 5 per cent. Greater use of electricity for oilfield pumping and the start-up of a number of energy projects in northern Alberta were largely responsible for this trend which is expected to continue as the development of oil sands and heavy oil reserves accelerates with the return to higher oil prices. ■ The Company also sold 1,166 million kilowatt hours of electricity to the City of Edmonton. Peak load grew to 895 megawatts from 844 megawatts the previous year. ■ During the year, 2,600 retail customers were added, bringing the total to almost 150,000 customers.

Computerized meter reading, introduced in Alberta last year by Canadian Utilities, is expected to improve service and reduce costs to customers.



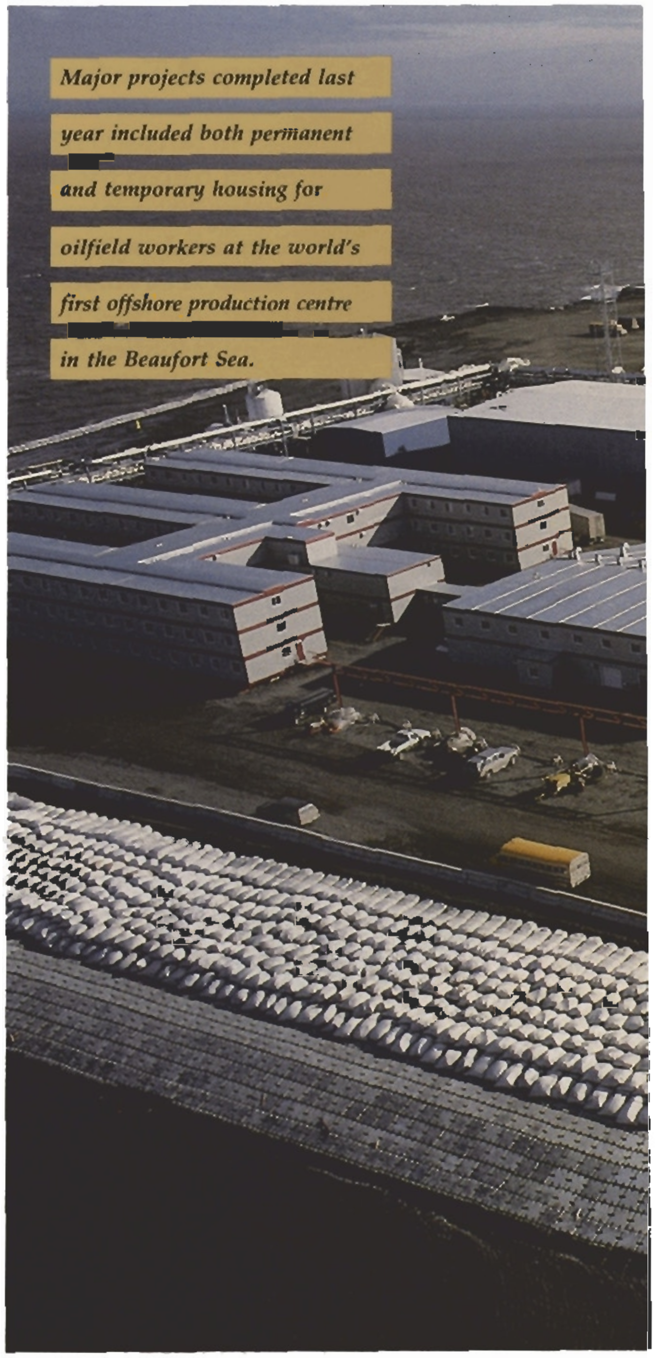
■ The first 375-megawatt unit of the Sheerness Generating Station in central Alberta commenced full operation January 1, 1986. Commissioning of this $1.1 billion project was the culmination of 1,900 man-years of work by 200 contractors, supervised by an Alberta Power management team. Commissioning of the second unit is scheduled for 1990. Alberta Power is managing partner of the Sheerness Station and an equal owner with TransAlta Utilities Corporation. ■ Another significant development was the selection by the Yukon Government of Alberta Power's Yukon subsidiary to provide management services for the electrical generation, transmission and distribution assets recently transferred from the Northern Canada Power Commission to the Yukon Government. ■ Capital expenditures of $156 million included a further $35 million spent on the Sheerness Generating Station and $80 million on transmission projects. Similar expenditures will continue in 1987 as Alberta Power responds to the growing needs of its customers.

Frontec Logistics Corp. ■ A joint venture company of ATCO Ltd. and Canadian Utilities Limited, Frontec is competing for major management, operation and maintenance contracts in Northern Canada and Alaska. The largest contract is for the North Warning System which will replace the Distant Early Warning (DEW) Line in 1992. The new System, funded by the United States and Canadian Governments, will consist of approximately 50 short- and long-range radar stations across Alaska, the Canadian Arctic and Labrador. The joint venture has spent more than $2 million in preparing their proposal which was submitted to the Canadian Government in mid-June.

CATS Defense Support Systems Inc. ■ Another joint ATCO/CU company, CATS, has completed development of a mobile target system for artillery training. This project is now in the marketing phase with the initial objective being sales to the Canadian, United States and British armed forces.

Manufacturing And Leasing

ATCO combined its engineering and manufacturing expertise last year to complete an innovative range of projects from a base operations centre installed on a man-made island in the Beaufort Sea to staff housing designed as alpine chalets for Alberta's Banff Springs Hotel. ■ The Company's leasing division continued its strong performance and the Canadian office rental fleet was expanded through additional investment as well as acquisitions.



Major projects completed last year included both permanent and temporary housing for oilfield workers at the world's first offshore production centre in the Beaufort Sea.

Canada ■ ATCO manufactures both temporary and permanent structures for a wide range of industrial and commercial applications. Fiscal 1987 contracts included: A 650-man temporary construction camp and a 150-man base operations facility for the world's first offshore production centre in the Beaufort Sea near Prudhoe Bay, Alaska. The 86,000-square-foot permanent base facility, one of ATCO's most advanced engineering and design projects, included 150 private bedrooms, racquetball courts, gymnasium, running track, recreation room, theatre, emergency medical facilities and operating room, firehall and commercial kitchen / Three Hercules-transportable camps were engineered, built and shipped to the Canadian Arctic to house United States Air Force personnel assigned to the North Warning System project / Contracts were completed for an engineering office, seven 42-man dormitory complexes and a school addition for Manitoba Hydro at its Limestone Hydro Project on the Nelson River south of Churchill, Manitoba / A 50-man base camp for Shell Oil and a 50-man camp for ATCO Drilling were installed at Inuvik, N.W.T. / Fifteen mobile homes were supplied as part of an on-going project for the Alberta Government native housing program. ■ In a joint venture involving ATCO's manufacturing and real estate development divisions, two innovative projects were undertaken in fiscal 1987: A total of 336 modular

Modules built at the Company's Calgary plant were later complexed as three-storey alpine chalets for staff housing at the Banff Springs Hotel (see photo page 18).

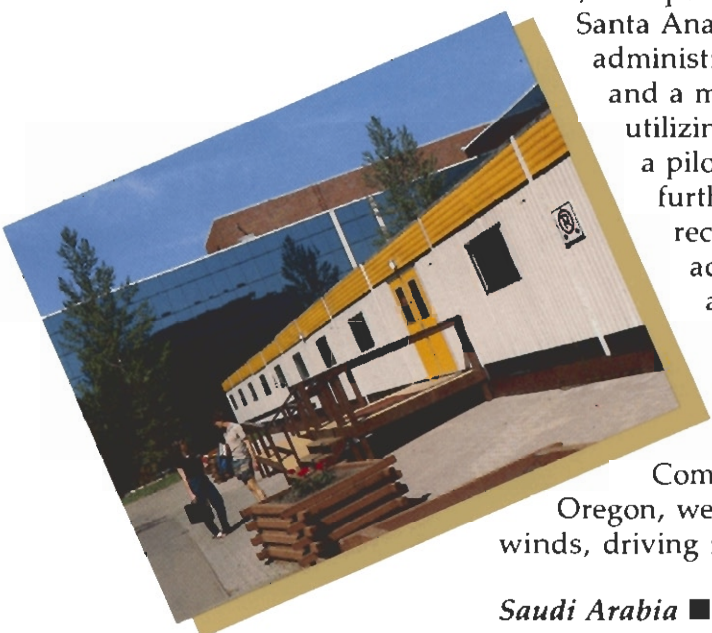
units were manufactured in Calgary for staff housing at the Banff Springs Hotel at Banff, Alberta. Site work and installation of the units as six individual three-storey chalets was completed by ATCO Development / Lincoln Park Village, ATCO's largest project for the 1988 Winter Olympics, will house 2,300 media representatives in 500 modular homes. The Village is scheduled for completion in October 1987. ■ Site-office rentals have produced consistently strong revenues and earnings during the past three years. In fiscal 1987, ATCO expanded its market penetration by acquiring lease fleets from competitors, through additional investment in new assets, and by modifying surplus industrial camp equipment. The Company also disposed of approximately $5 million worth of industrial fleet equipment. ■ Space rentals, supplied mainly to the construction industry, were particularly strong in Ontario and Quebec where housing starts jumped 26 per cent in the last year. To supplement its fleet in central Canada, the Company acquired 700 portable office units from two competitors and transferred equipment from the western provinces. ■ ATCO operates Canada's largest and only national rental fleet leasing more than 6,000 units from offices located coast to coast. Market exposure, coupled with the flexibility to transfer units anywhere in Canada as required, has resulted in contracts such as a recent order for 300 site-office units at the 1988 Winter Games. The units will be installed at all major venue sites for support facilities including emergency medical centres, briefing rooms for course officials, storage depots and security stations. ■ ATCO Metal, which fabricates commercial and industrial structures, was an important supplier of pre-engineered buildings to Alberta's energy industry this year. Contracts included facilities for Novacor Chemicals, Canterra Energy and Syncrude Canada. The Company experienced steady demand for its roll-formed products in the agricultural, industrial and commercial markets.

Australia ■ The Australian manufacturing and leasing division was sold in December 1986. This division was established 26 years ago and was a market leader in the supply of relocatable housing and related services. Factors in the decision to dispose of this unit were the weakening of the Australian dollar, concerns regarding

ATCO units leased by the University of Alberta at Edmonton were used for study, seminar, office and locker space while a renovation program was completed on campus.

the Australian economy and the desire to increase corporate liquidity. The sale also reflects ATCO's objective to focus on core businesses in North America.

United States ■ ATCO expanded its services as a major supplier to correctional institutions in the United States during fiscal 1987. Projects included a 45-bed maximum security facility in Douglas, Arizona; a 52-bed minimum security modular housing complex near Seattle, Washington; and a 100-bed minimum security facility at Canon City, Colorado. The Colorado project is the Company's eighth prison site completion in the State. ■ The division's most significant contract last year was a 36,000-square-foot modular federal courthouse at Santa Ana, California encompassing public administration offices, judges chambers, prison cells and a maximum security system. The concept of utilizing modular units for a public courthouse is a pilot project and, if successful, could lead to further orders. ■ During fiscal 1987, ATCO also received a $7.5 million contract to build an additional 100 two-storey family units to augment its original order for the supply of 405 homes to the United States Department of the Navy at its air base in the Aleutian Islands. The units, manufactured and shipped by barge from the Company's dockside facility at Portland, Oregon, were designed to withstand 200 kilometre/hour winds, driving rain and the salt air of the North Pacific.



Saudi Arabia ■ Similar to other energy dependent economies, Saudi Arabia was adversely affected by low domestic capital spending and the curtailment of major projects. The depressed economy led to highly competitive bidding for limited requirements and resulted in the elimination of several competitors. ■ ATCO not only maintained its presence in the Kingdom but identified a number of significant opportunities. Its pursuit of nearby markets also resulted in contracts to supply products to Iraq, Pakistan and Egypt. Economic conditions in Saudi Arabia are expected to improve in the coming year due to firmer oil prices. This outlook, coupled with the reduced level of competition, should result in increased demand for ATCO products and services.

Special Projects

Left: When completed this fall, ATCO's Lincoln Park Village in Calgary will encompass 500 custom-designed homes to house more than 2,300 people during the Winter Games.

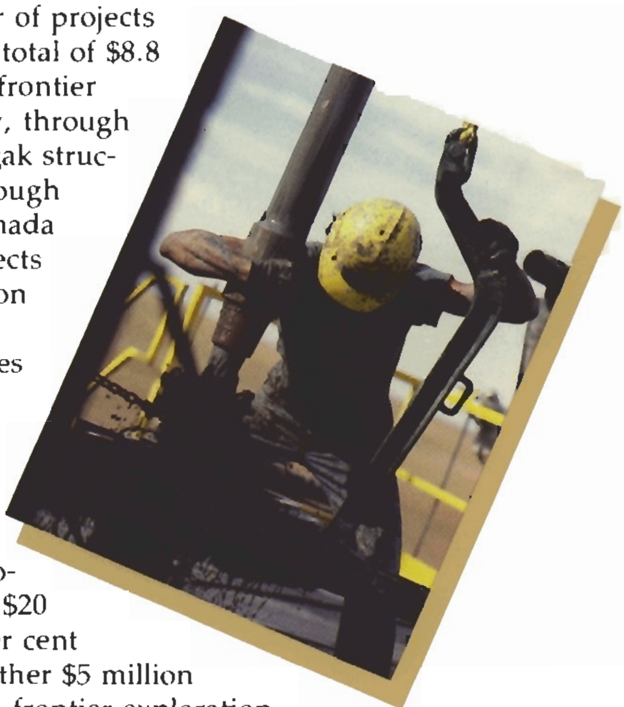
Below: Unit No. 1 at the Canmore Athletes' Village.

The 1988 Calgary Olympic Winter Games will allow ATCO to demonstrate to a worldwide audience innovative concepts for accommodation. ■ Relocatable shelter engineered and manufactured by ATCO is ideal for the Winter Olympics. It avoids surplus housing problems encountered following previous Games when large amounts of permanent facilities were erected by the host city to accommodate athletes, officials and spectators. ATCO will supply temporary housing for more than 3,000 people during the Winter Games as well as provide television broadcast facilities and a variety of venue offices for officials, team members and support staff. ■ Lincoln Park Village, in southwest Calgary, will house some 2,300 media personnel and Olympic officials in 500 custom-designed homes. Following the Games, the houses will be moved to various locations throughout Western Canada for use on Alberta and Federal Government housing projects. ■ At Canmore, ATCO is building an Athletes' Village to provide housing and support facilities for 600 competitors in the nordic and biathlon competitions. At the conclusion of the Games, the housing and dining modules will be removed and a permanent Olympic legacy will remain — a swimming pool, curling rink and golf clubhouse. ■ Another major facility, a broadcast centre for ABC Television, will be built at Calgary Stampede Park. ATCO will install some 50,000 square feet of offices and studios in an existing building for the two-week duration of the Games. In addition, rental units will be provided at 11 Olympic venues to house the equipment used on location by ABC. ■ ATCO's space rentals division, Canada's largest fleet of site-office rental equipment, will supply 300 office units as support facilities for officials, athletes and service staff at the various Games sites. ■ In its most spectacular project for the Games, an ATCO subsidiary will place an Olympic torch atop the downtown Calgary Tower. The flame will be the largest and most dramatic torch in the history of the Olympics. The subsidiary, Canadian Western Natural Gas, has been appointed the official supplier of natural gas to the Olympics and will also provide flame installations at all major venue sites.

Resources

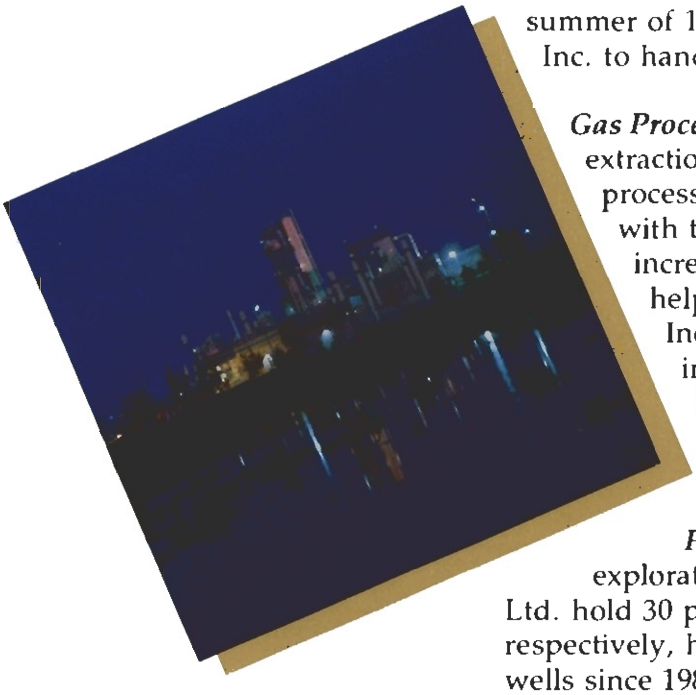
Left: ATCO and its subsidiaries hold an approximate eight per cent interest in the Amauligak discovery in the Beaufort Sea. Below: A rig hand "makes a connection" in southern Alberta.

Despite reduced oil revenue, ATCOR Ltd. remained profitable during calendar 1986. Canadian Utilities' integrated oil and gas subsidiary was better positioned than most junior exploration companies to withstand price fluctuations through its involvement in natural gas processing and gas marketing. Lower oil and gas prices offered ATCOR, Alberta's largest independent industrial gas broker, a number of benefits including reduced feedstock costs and increased demand for gas brokerage services. ■ Calendar 1986 marked the beginning of an important change in direction for ATCOR's exploration and production activities. Strategies included increasing reserves with an emphasis on natural gas and the generation of quality prospects with larger working interests. The Company also maintained its focus on frontier development. ■ ATCOR participated in 70 wells last year with a success ratio of 42 per cent for exploration wells and 76 per cent for development drilling. ■ Daily oil production averaged 201 cubic metres per day, down slightly from the previous year. Natural gas production averaged 167,000 cubic metres per day, a decrease of 20 per cent from the previous year. ■ Net capital expenditures on exploration and production activities in Western Canada were $13.7 million, down 13 per cent from the previous year. The reduction in capital expenditures was caused by the cancellation of a number of projects due to low oil prices. A total of $8.8 million was invested in frontier exploration both directly, through a farmin on the Amauligak structure, and indirectly, through AT&S's activities on Canada Frontier lands. ■ Prospects for oil and gas exploration should improve in the coming year with oil prices stabilizing in the U.S. $18 - $19 range. ATCOR's expenditures for Western Canada exploration and production activities are projected to be in excess of $20 million, up almost 50 per cent from last year, with another $5 million budgeted to be spent on frontier exploration.



ATCOR was well positioned last year to withstand oil price fluctuations through its involvement in natural gas processing and gas marketing.

Gas Marketing ■ During calendar 1986, ATCOR increased its share of the Alberta gas brokerage market while exporting to both Eastern Canada and the United States. ATCOR sold 103 petajoules of natural gas during the year, an increase of 18 per cent over 1985 while the total number of customer contracts increased to 30 from 23 in the prior year. Gas was purchased from 109 producing companies under approximately 175 separate contracts. ■ Deregulation of gas pricing in Canada and the United States, as well as efforts by government and regulatory agencies across North America to open access to gas markets and transportation, will provide ATCOR with further opportunities to expand into markets outside of Alberta. In anticipation of ATCOR's growing involvement in the United States, a company was incorporated in the summer of 1986 under the name CU Energy Marketing, Inc. to handle transactions in that market.



Gas Processing ■ An expansion to the Edmonton ethane extraction plant, completed in 1985, permitted the processing of additional volumes of gas associated with two large custom processing contracts. The increased volumes processed during the year helped offset the impact of lower LPG prices. Income earned on a cost of service basis also increased as a result of the upgrading of the House Mountain pipeline, which transports gas to the Swan Hills enhanced oil recovery project.

Frontier ■ AT&S Exploration Ltd., a joint exploration company in which ATCOR and ATCO Ltd. hold 30 per cent and 7.5 per cent interests, respectively, has participated in the drilling of 49 frontier wells since 1983, and has earned interests in over 3 million gross acres of petroleum and natural gas rights, mainly in the Beaufort-Mackenzie Delta region, but also offshore Nova Scotia. ■ AT&S holds 10.16 per cent of the Amauligak structure in the Beaufort Sea. An extensive seismic survey conducted in 1986 has improved definition of the structure area. The operator, Gulf Canada Corporation, is proceeding with plans to drill two

The Company's resource division introduced aggressive strategies to expand its conventional exploration and production activities in Alberta last year.

delineation wells during the 1987-88 season. These wells are intended to provide confirmation of 600-800 million gross barrels of oil reserves and offer the opportunity for extended seasonal production testing pending full scale development in the 1990's. ■ ATCOR and ATCO earned a 3.8 per cent direct working interest in the Amauligak structure by participating in the Gulf Amauligak I-65B well which was the last delineation well drilled in the structure. As a result, ATCOR and ATCO have a combined direct and indirect interest in Amauligak of 7.61 per cent.

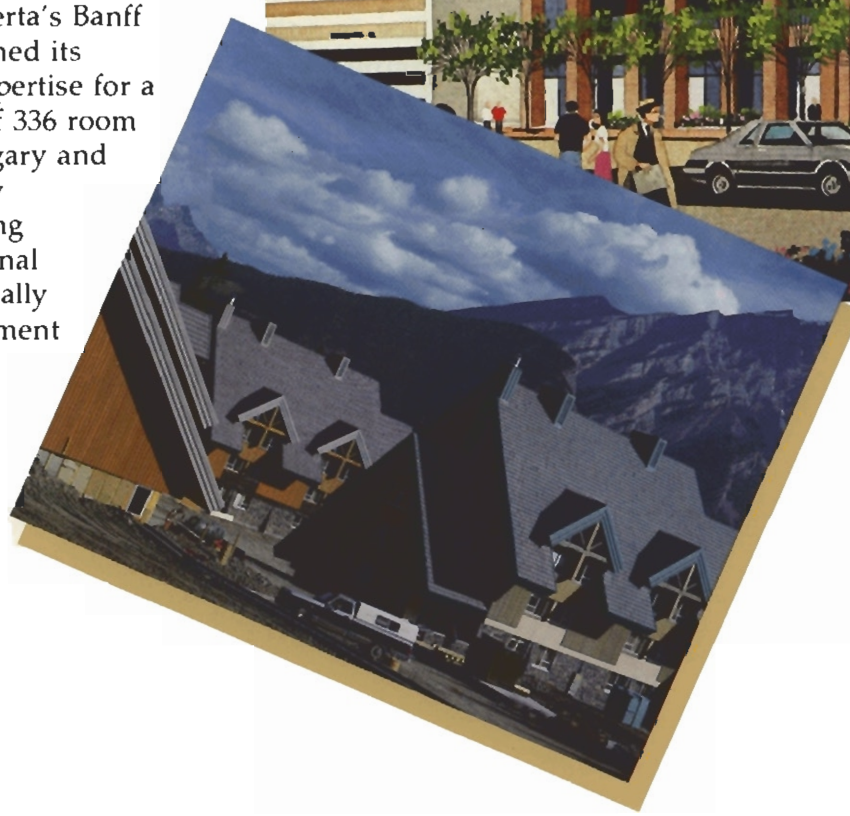
Energy Services ■ ATCO operates one of North America's largest contract drilling and well servicing operations. In Canada, 35 drilling and 20 well servicing rigs cover the full range of depth capacities while the U.S. fleet encompasses 20 deep drilling and 11 well servicing rigs. Three drilling and four well servicing rigs in Australia were sold last year reducing the total fleet count to 86 rigs. ATCO's energy services operations also include oilfield equipment sales and rentals conducted by a division headquartered in Edmonton. ■ The dramatic fall in world oil prices last year impacted sharply on rig utilization, both in drilling and well servicing, throughout North America. In Canada, however, government assistance produced a significant increase in the utilization rate by year end. ■ The Canadian Federal Government eliminated its Petroleum Gas Revenue Tax, providing an additional $800 million in estimated cash flow, while the Alberta Provincial Government announced reduced royalty rates and a new program for royalty holidays of up to five years to further aid the industry. ■ The commitment of OPEC members to maintain oil price stability coupled with the recent $350 million per year Canadian Exploration and Development Incentive program introduced April 1, 1987 by the Federal Government is expected to provide further cash flow to the Canadian industry. As Canada's largest contract drilling and well servicing company, ATCO is well positioned to participate in the recovery now forecast for the 1987-88 winter drilling season.

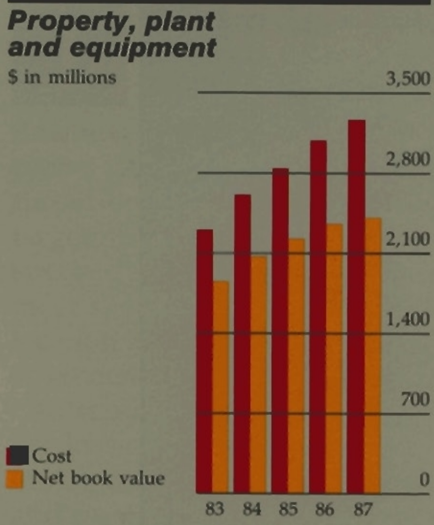
Real Estate

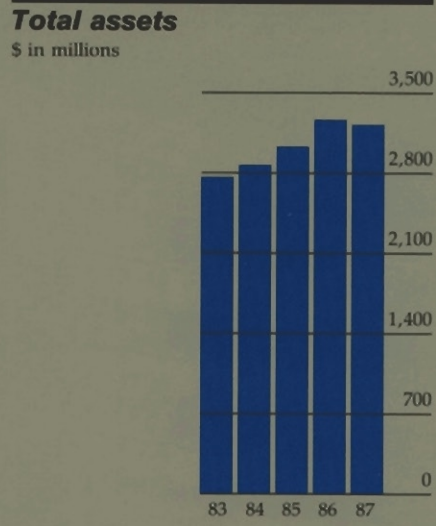
The Real Estate Group provides property development and management services as well as construction and interior finishing. ATCO has met the challenge of the cyclical Alberta real estate market by tailoring these services to meet its clients' needs and by targeting new areas for growth. ■ ATCO specializes in developing office properties that meet specific criteria in terms of pre-leasing, location and economic return. An example of this approach is the Company's Canadian Western Centre Phase II in Calgary which is 80 per cent pre-leased with construction scheduled to begin in August 1987. Construction, interior finishing and property management services will be supplied for the 145,000-square-foot nine-storey office complex. ■ Despite high vacancy rates in Calgary and Edmonton last year, ATCO achieved full occupancy at its three office towers and negotiated the sale of Canadian Western Centre Phase I and Canadian Utilities Centre. The third building, Place 800, was sold during the first quarter of the current fiscal year. The Company's property management group will continue to manage the buildings as part of its expanding portfolio of services for the owners of office buildings, shopping centres, apartments and condominiums. ■ ATCO also specializes in "build to suit" construction. At Alberta's Banff Springs Hotel, the Company combined its manufacturing and development expertise for a new staff housing project. A total of 336 room modules were manufactured in Calgary and completed on-site as six three-storey chalets. ATCO's concept of supplying factory-built units and completing final construction stages on-site substantially reduced building time, heavy equipment work and disruption to the hotel guests and staff.

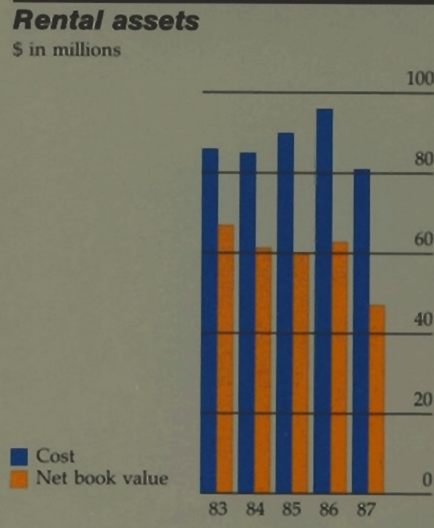
Construction of Canadian Western Centre Phase II in Calgary is scheduled to begin in August 1987.

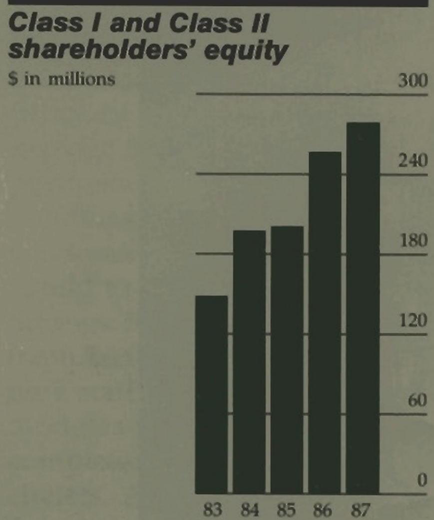
Below: Banff Springs Hotel staff housing, utilizing ATCO modules, is an example of the Company's innovative construction services.

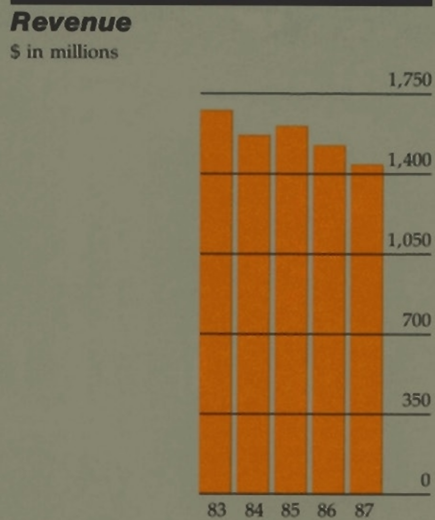


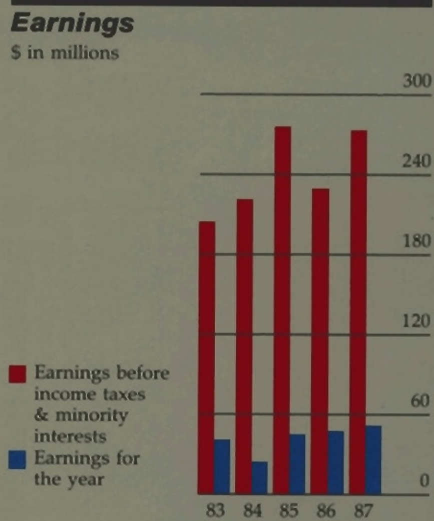

Property, plant and equipment
$ in millions
3,500
2,800
2,100
1,400
700
0
Cost
Net book value
83 84 85 86 87


Total assets
$ in millions
3,500
2,800
2,100
1,400
700
0
83 84 85 86 87


Rental assets
$ in millions
100
80
60
40
20
0
Cost
Net book value
83 84 85 86 87


Class I and Class II shareholders' equity
$ in millions
300
240
180
120
60
0
83 84 85 86 87


Revenue
$ in millions
1,750
1,400
1,050
700
350
0
83 84 85 86 87


Earnings
$ in millions
300
240
180
120
60
0
Earnings before income taxes & minority interests
Earnings for the year
83 84 85 86 87

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

Auditors' Report

Price Waterhouse

To the Shareholders of ATCO Ltd.

We have examined the consolidated balance sheet of ATCO Ltd. as at March 31, 1987 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, 1987 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 non-regulated petroleum and natural gas properties as explained in Note 7 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, 1987

Consolidated Statement of Earnings and Retained Earnings

Years ended March 31

(Thousands of Canadian dollars)	*Note Reference*	*1987*	*1986*
			(Restated) (Note 7)
Revenues		**$1,443,706**	**$1,527,229**
Costs and expenses			
Natural gas supply		382,167	456,192
Taxes — other than income		66,586	83,365
Operating and maintenance		458,014	469,868
Selling and administrative		128,872	118,351
Depreciation, depletion and amortization		123,013	106,567
Interest		106,506	96,895
		1,265,158	1,331,238
		178,548	195,991
Allowance for funds used during construction		34,094	44,517
Other income	2	23,993	18,105
Other items	3	37,350	(29,024)
		273,985	229,589
Income taxes			
Current		111,258	102,722
Deferred		1,508	(9,882)
	4	112,766	92,840
		161,219	136,749
Minority Interests	5	108,943	89,011
Earnings for the year		52,276	47,738
Dividends on redeemable preferred shares	6	27,057	34,343
Earnings attributable to Class I and Class II shares		25,219	13,395
Retained earnings at beginning of year			
As previously reported		160,622	143,317
Prior period adjustment	7	(10,637)	—
As adjusted		149,985	143,317
		175,204	156,712
Dividends on Class I and Class II shares		5,552	4,714
Share issue and redemption expenses, net of deferred income taxes		15	673
Exchange adjustments on preferred shares	6	1,137	1,340
Retained earnings at end of year		**$ 168,500**	**$ 149,985**
Earnings per Class I and Class II share			
Basic		**$.91**	**$.57**
Fully diluted		**$.84**	**$.53**
Dividends paid per Class I and Class II share		**$.20**	**$.20**

Consolidated Balance Sheet

March 31

ATCO Ltd.

(Thousands of Canadian dollars)	*Note Reference*	*1987*	*1986*
			(Restated) (Note 7)
Assets			
Current assets			
Cash and short term investments		$ 81,497	$ 132,524
Accounts receivable		135,543	182,131
Inventories		53,361	74,577
Prepaid expenses		7,717	5,977
		278,118	395,209
Investments	8	350,738	341,374
Property, plant and equipment	9	2,432,579	2,353,529
Goodwill		123,343	129,911
Deferred financing charges and other assets		35,013	41,564
		$3,219,791	$3,261,587
Liabilities and Shareholders' Equity			
Current liabilities			
Bank indebtedness	10	$ 9,527	$ 59,091
Accounts payable and accrued liabilities		243,790	282,309
Income taxes payable		2,529	11,545
Long term debt due within one year		65,428	39,320
		321,274	392,265
Long term debt	11	835,138	850,225
Contributions for extensions to utility plant		209,103	192,456
Deferred credits		42,765	41,879
Deferred income taxes		3,559	4,043
Minority interests	5	1,157,114	1,133,282
Redeemable preferred shares	6	372,294	390,662
Class I and Class II shareholders' equity			
Class I and Class II shares	12	109,980	109,959
Retained earnings		168,500	149,985
Foreign currency translation adjustments		64	(3,169)
		278,544	256,775
		$3,219,791	$3,261,587

Approved by the Board:

Robert Rice

Director

Director

Consolidated Statement of Changes in Cash Position

Years ended March 31

(Thousands of Canadian dollars)	*1987*	*1986*
		(Restated) (Note 7)
Operating activities		
Earnings for the year	$ 52,276	$ 47,738
Depreciation, depletion and amortization	123,013	139,930
Deferred income taxes	1,508	(9,882)
Minority shareholders' interests	108,943	89,011
Allowance for equity funds used during construction	(13,112)	(18,458)
Gains on disposals of property, plant and equipment	(22,505)	(2,306)
Gain on sale of TransAlta Utilities shares	(16,817)	(4,339)
Gain on sale of subsidiary	(6,634)	—
Other — net	2,712	3,882
	229,384	245,576
Decrease in non-cash working capital	16,382	10,969
	245,766	256,545
Dividends		
Redeemable preferred shares	(27,057)	(34,343)
Class I and Class II shares	(5,552)	(4,714)
Minority interests	(89,260)	(82,593)
	(121,869)	(121,650)
Financing activities		
Issue of long term debt	298,164	170,162
Reduction in long term debt	(278,974)	(71,835)
Issue of preferred shares by Canadian Utilities	80,000	185,000
Redemption of preferred shares by Canadian Utilities	(75,901)	(137,107)
Redemption and conversion of preferred shares by the Corporation	(17,060)	(66,952)
Issue of Class I and Class II shares by the Corporation	21	48,839
Contributions for extensions to utility plant	23,773	25,831
Costs of financing	(6,551)	(8,451)
	23,472	145,487
Investing activities		
Property, plant and equipment	(263,216)	(237,837)
Proceeds on sale of buildings — net	79,870	—
Proceeds on sale of subsidiary — net	29,316	—
Investments		
TransAlta Utilities Corporation		
Net carrying cost	(3,698)	(4,897)
Proceeds on disposition of shares	135,020	31,351
Other securities	(125,750)	(40,150)
Other	(82)	3,530
Deferred charges and credits — net	(292)	(19,294)
	(148,832)	(267,297)
Cash position		
Increase (decrease) in cash*	(1,463)	13,085
Cash at beginning of year	73,433	60,348
Cash at end of year	$ 71,970	$ 73,433

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

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 39 and 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 utility subsidiaries are regulated primarily by the Public Utilities Board of Alberta (the "Board") and the Energy Resources Conservation Board of Alberta, which administer acts and regulations covering such matters as rates, financing, accounting, construction, operation and service area. The Board may award interim rates, subject to final determination. Decisions made by these authorities or management which impact on utility accounting policies are reflected in the consolidated financial statements 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

The utility subsidiaries include in the cost of additions an allowance for funds used during construction, at a rate approved by the Board for debt and equity funds.

Certain additions are made with the assistance of cash contributions 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, and offset the depreciation charge of, 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 assets, the utility subsidiaries charge accumulated depreciation with the cost of the retired unit less net salvage. Gains and losses on extraordinary retirements are recognized in earnings as extraordinary items.

Included in the natural gas subsidiaries' Property, Plant and Equipment are gas wells that have been drilled, tested and capped and remain unconnected to the utility system. The 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 development of, petroleum and natural gas properties are capitalized in one cost centre per country. The net book value of petroleum and natural gas properties is limited to an amount equivalent to the estimated net amount to be received with respect to the production of proved reserves, based on current prices and costs, plus the net cost of unproved properties less future general and administrative expenses, financing costs and income taxes. All resource properties are depleted on a unit of production basis.

Deferred Credits

As Alberta gas producers, the natural gas utility subsidiaries receive a pro rata share of funds available under The Natural Gas Pricing Agreement Act. The amounts received, net of royalties and income taxes, are deferred and, subject to Board approval, 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. Significant additional revenues or refunds resulting from Board decisions are recorded in the period to which they relate. Other adjustments are recorded in the current period.

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 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)	*1987*	*1986*
Interest income	$16,813	$14,812
Dividends	4,402	1,507
Exchange gains (losses)		
Operating	(1,551)	2,200
Translation	261	(1,657)
Other	4,068	1,243
	$23,993	$18,105

3. Other Items

(Thousands of dollars)	*1987*	*1986*
Gain on sale of:		
Canadian Western Centre and Canadian Utilities Centre	$ 34,621	$ —
TransAlta Utilities Corporation shares	16,817	4,339
Shares in Australian subsidiary	6,634	—
	58,072	4,339
Write-down and provision for relocation of assets:		
Drilling rigs	(15,072)	—
Rental assets	(3,500)	—
Oil and gas properties	—	(33,363)
Other equipment	(200)	—
	(18,772)	(33,363)
Provisions for discontinuance of operations	(1,950)	—
	$ 37,350	$(29,024)

Although the utility subsidiaries are the principal tenants of Canadian Western Centre and Canadian Utilities Centre, the gain on the sale of the buildings has been included in 1987 earnings because the rentals are subject to the regulatory process.

4. Income Taxes

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

(Thousands of dollars)	1987	1986
Earnings before income taxes and minority interests	$273,985	$229,589
Income taxes at statutory rate of 48.62% (1986 - 48.35%)	$133,212	$111,006
Allowance for equity funds used during construction	(7,713)	(12,925)
Crown royalties and other non-deductible government payments	3,824	9,293
Earned depletion and resource allowance	(6,756)	(9,872)
Unrecorded benefits of loss carryforwards	8,047	1,979
Non-taxable portion of capital gains	(16,281)	(6,003)
Taxes related to amounts allocated to assets in excess of tax values on share acquisitions	1,042	3,886
Foreign tax rate differences	4,429	1,036
Provincial rebates	(3,025)	(2,672)
Non-taxable dividends	(2,167)	(516)
Re-assessments	269	(5,473)
Other	(2,115)	3,101
	$112,766	$ 92,840
Effective rate	41.2%	40.4%

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 $101,000 (1986 — $5,344,000) to an accumulated amount of $134,616,000.

Certain subsidiaries have operating loss carryforwards of approximately $37,000,000 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.

5. Minority Interests

(Thousands of dollars)	1987	1986
Equity of minority interests:		
In preferred shares of Canadian Utilities and subsidiaries (detailed below)	$ 802,702	$ 798,603
In Class A non-voting and Class B common shares of Canadian Utilities	353,958	334,101
Other	454	578
	$1,157,114	$1,133,282
In Canadian Utilities earnings for the year	$ 109,010	$ 88,953
Other	(67)	58
	$ 108,943	$ 89,011

Canadian Utilities and Subsidiaries

1987 *1986* (Thousands of dollars)	*1988 Redemption Premium*	*Issued Amount*	*Dividends*
Cumulative Redeemable Preferred Shares, 4% to 6%	1% - 4%	**$ 30,508** $ 30,508	**$ 1,424** $ 1,424
Floating Rate Cumulative Redeemable Preferred Shares	N/A	**20,000** 20,000	**1,282** 1,337
Cumulative Redeemable Second Preferred Shares			
Non-retractable, 7.3%	.8%	**22,814** 23,715	**1,702** 4,083
Retractable, 7.08% to 14.5%	(See below)	**729,380** 724,380	**66,736** 66,870
Less: Dividends capitalized (Note 8)			**16,844** 25,124
		$802,702 $798,603	**$54,300** $48,590

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 below.

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 G	$ 50,000	May 1, 1987	4%	May 1, 1987
Series H	$288,577	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
Series M	$ 80,000	June 1, 1991	4%	June 1, 1993

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)

1988	*1989*	*1990*	*1991*	*1992*
$342,477	$3,900	$5,900	$5,900	$116,703

6. *Redeemable Preferred Shares*

(Thousands of dollars)	Issued Amount 1987	Issued Amount 1986	Dividends 1987	Dividends 1986
Issued by:				
ATCO Ltd.	$ 55,000	$ 55,000	$ 4,980	$ 9,341
ATCO Holdings (N.A.) Ltd.	32,270	43,150	2,213	3,120
ATCO Utilities Holdings Ltd.	150,000	150,000	10,399	11,287
474243 Ontario Ltd.	135,024	142,512	9,465	10,595
Total issued (detailed below)	$372,294	$390,662	$27,057	$34,343

ATCO Ltd.

1987 1986 (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	9.9%	$ 349
	200,000	$ 5,000	11.1%	$ 376
Series 2	—	—	N/A	—
	—	—	N/A	4,317
Series 3	2,000,000	50,000	N/A	4,631
	2,000,000	50,000	N/A	4,648
		$55,000		$4,980
		$55,000		$9,341

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%.

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.

1987 1986 (Thousands of dollars)	Issued Shares	Issued Amount	Average Prime Rate	Dividends
First Preferred Shares				
Par value $100 each				
Authorized 800,000 shares				
Series A, issued in U.S. dollars	140,000	$18,270	8.4%	$1,213
	180,000	$25,150	10.2%	$1,774
Series B	140,000	14,000	9.9%	1,000
	180,000	18,000	10.8%	1,346
		$32,270		$2,213
		$43,150		$3,120

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 to purchase the preferred shares upon the occurrence of certain events. This sale agreement is secured by a floating charge debenture of U.S. $90,000,000 issued and pledged by ATCO Ltd. and 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.

1987 *1986* (Thousands of dollars)	*Issued* *Shares*	 *Amount*	*Average Prime Rate*	*Dividends*
Preferred Shares				
Authorized 150,000 shares	**150,000**	**$150,000**	**9.9%**	**$10,399**
	150,000	$150,000	10.7%	$11,287

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.

1987 *1986* (Thousands of dollars)	*Issued* *Shares*	 *Amount*	*Average Prime Rate*	*Dividends*
Preference Shares				
Par value $1,000 each				
Authorized 150,000 shares				
Classes A - G	**135,024**	**$135,024**	**9.9%**	**$ 9,465**
	142,512	$142,512	10.7%	$10,595

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 ($67,512,000)	50% of prime plus 2%
Classes E - F ($22,504,000)	50% of prime plus 1⅞%
Class G ($45,008,000)	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.

7. *Change in Accounting Policy*

The Corporation has adopted, on a retroactive basis, the method of accounting for its non-regulated petroleum and natural gas properties which conforms with the Guideline issued in calendar 1986 by the Canadian Institute of Chartered Accountants. The Guideline prescribes a ceiling test calculation based on current prices and costs for all proved reserves and the net cost of unproved properties and the maintenance of one cost centre per country.

Application of the Guideline resulted in a write-down of $33,363,000 ($10,637,000 after income taxes and minority interests), thereby increasing 1986 depletion by $33,363,000 and decreasing 1986 income taxes and minority interests by $12,916,000 and $9,810,000, respectively. The 1986 write-down was based on a May 1986 oil price of approximately $14.00 per barrel and a natural gas price of approximately $1.60 per mcf and the then current royalty rates and production costs. If March 31, 1986 prices for oil and natural gas had been used, no additional write-down would have been required. Under the Guideline, no further write-down is required in 1987.

As a result of the retroactive application of the Guideline, 1987 earnings were increased by approximately $1,904,000 ($771,000 after income taxes and minority interests).

8. *Investments*

(Thousands of dollars)	*1987*	*1986*
TransAlta Utilities Corporation	**$108,309**	$222,814
Hydro-Quebec bonds	**49,969**	49,960
Other securities (at cost which approximates market value)	**165,900**	40,150
Joint ventures and partnerships	**26,560**	28,450
Total (detailed below)	**$350,738**	$341,374

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 on or before November 1, 1987. Gains on disposition are recorded as warrants are exercised. During the year, 6,068,244 warrants were exercised (1986 — 1,409,016), leaving 5,489,857 outstanding at March 31, 1987.

The investment in TransAlta consisted of the following:

(Thousands of dollars)	*1987*		*1986*	
	Shares	*Amount*	*Shares*	*Amount*
Common shares	**5,489,903**	**$103,255**	11,558,147	$217,368
Net carrying costs		**5,054**		5,446
		$108,309		$222,814

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 $5,054,000 are dividends on the Series H preferred shares net of dividends received from TransAlta and any related interest income.

Hydro-Quebec Bonds

The proceeds on the issue of the Series 3 Junior Preferred Shares were invested in $50,000,000 principal value of 12⅜% Hydro-Quebec 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)	1987	1986
Real estate development	$25,363	$25,435
Energy services	1,197	3,015
	$26,560	$28,450

ATCO's share of the joint ventures' and partnership's earnings amounted to $565,000 (1986 — losses of $2,693,000) and is included in revenues.

9. *Property, Plant and Equipment*

(Thousands of dollars)	1987		1986	
	Cost	*Accumulated Depreciation & Depletion*	*Cost*	*Accumulated Depreciation & Depletion*
Electric utility plant and equipment	$1,683,786	$324,655	$1,521,843	$275,541
Natural gas utility plant and equipment	1,093,838	259,910	1,018,089	233,404
Drilling and well servicing rigs and related equipment	188,981	116,676	196,079	92,817
Gas and oil properties	124,887	61,809	101,005	57,273
Urban and industrial space rental assets	81,326	33,873	95,626	32,797
Other plant and equipment	91,737	35,053	150,437	37,718
	$3,264,555	$831,976	$3,083,079	$729,550
	$2,432,579		$2,353,529	

As explained in the Summary of Significant Accounting Policies, gas wells accounted for as plant held for future use in the amount of $24,683,000 are included in natural gas utility plant and equipment at March 31, 1987 (1986 — $24,932,000).

Deferred gas exploration costs of $27,801,000 (1986 — $24,836,000) are included in natural gas utility plant and equipment. During the year $2,879,000 (1986 — $1,944,000) of unsuccessful gas exploration costs, net of related income taxes, were charged against monies received under The Natural Gas Pricing Agreement Act.

10. *Bank Indebtedness*

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

(Thousands of dollars)	1987		1986	
	Available	*Drawn*	*Available*	*Drawn*
Operating lines of credit	$ 63,732	$ 9,527	$ 68,800	$21,364
Term credit agreement	50,000	—	50,000	37,727
	$113,732	$ 9,527	$118,800	$59,091

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.

11. Long Term Debt

(Thousands of dollars)	1987	1986
Canadian Utilities and Subsidiaries		
Sinking fund debentures, at 7¼% to 17½%, due at various dates to 2002	$679,799	$505,986
First mortgage sinking fund bonds, at 5⅝% to 9¾%, due at various dates to 1994	36,998	42,430
Capitalized lease obligation	19,363	20,257
Notes payable	—	82,296
Other	24,860	26,915
ATCO Ltd.		
Term loans, unsecured, at fixed rates of 10.13% to 10.33%, due at various dates to March 1993	90,000	85,000
ATCO Enterprises Ltd.		
First mortgages, on Canadian Utilities Centre and Canadian Western Centre (See Note 3)	—	65,603
Bank loan, at prime plus 2¾%, due December 31, 1992, non-recourse, secured by assignment of partnership interest in ALDC Partnership	8,800	8,800
Interim financing on Olympic Media Housing project, at prime, due December 31, 1988, secured by assignment of Olympic Media Housing contracts	3,400	4,549
Term loan at 11¾% from November 20, 1985 to March 31, 1987 and 10⅛% thereafter, due March 31, 1992, secured by a first charge on drilling and well servicing rigs of the corporation	22,500	22,500
Term loan, at 9.89% due December 30, 1990	14,000	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	846	8,809
	900,566	889,545
Less: Amounts due within one year	65,428	39,320
	$835,138	$850,225

The terms of the above debt include restrictions relating to new debt and guarantees. Covenants also require maintenance of specified working capital and shareholders' equity. 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 $157,696,000 is free of such restrictions.

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 lease payments in aggregate are $29,540,000 of which $2,421,000 is payable in each of the five succeeding years. The imputed interest included in these future minimum rentals at 7.62% implicit in the lease is $10,177,000.

Under a bank loan agreement, which provides a line of credit of up to $75,000,000 to September 14, 1988, 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, 1987, there were no loans outstanding (1986 — $82,296,000) under this agreement.

Interest expensed on long term debt during the year was $98,947,000 (1986 — $89,912,000).

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

(Thousands of dollars)

1988	1989	1990	1991	1992
$65,428	$50,674	$41,780	$79,063	$112,683

12. *Class I and Class II Shares*

(Thousands of dollars)	*Class I Non-Voting*		*Class II Voting*		*Total*	
	Shares	*Consid-eration*	*Shares*	*Consid-eration*	*Shares*	*Consid-eration*
Authorized	100,000,000		50,000,000		150,000,000	
Issued:						
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
Exercise of warrants	2,000	21	—	—	2,000	21
Conversions from Class II to Class I	144,747	74	(144,747)	(74)	—	—
March 31, 1987	23,538,420	$107,840	4,221,130	$2,140	27,759,550	$109,980

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.

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, 1987 at prices ranging from $8.125 to $8.75 per share.

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 were exercisable at any time prior to April 25, 1987. At March 31, 1987, 2,000 warrants had been exercised. From April 1 to April 24, 1987, warrants to purchase 1,762,950 Class I non-voting shares were exercised for $18,510,975.

13. *Segmented Information*

By Industry

(Thousands of dollars)

1987 1986	*Electric Utility Operations*	*Gas Utility Operations*	*Drilling and Well Servicing*	*Other Energy (1)*	*Manu-facturing & Leasing*	*Other (2)*	*Consolidated (3)*
Revenues:							
Trade	$ 371,008 $ 328,517	$713,310 $796,490	$ 33,892 $ 89,585	$118,843 $156,180	$169,470 $153,851	$ 37,183 $ 2,606	$1,443,706 $1,527,229
Inter-segment	75 102	10,815 18,088	1,731 2,033	47,963 23,006	13,944 1,483	22,489 23,316	— —
Total segment revenues	371,083 328,619	724,125 814,578	35,623 91,618	166,806 179,186	183,414 155,334	59,672 25,922	1,443,706 1,527,229
Expenses:							
Operating costs	160,270 146,098	567,371 659,777	37,760 79,216	145,820 153,265	164,606 134,094	56,577 23,464	1,035,639 1,127,776
Depreciation, depletion and amortizaton	50,416 34,874	29,996 28,187	15,295 14,279	6,489 8,946	11,771 11,865	5,259 6,229	123,013 106,567
Total segment expenses	210,686 180,972	597,367 687,964	53,055 93,495	152,309 162,211	176,377 145,959	61,836 29,693	1,158,652 1,234,343
Segment operating profit (loss)	$ 160,397 $ 147,647	$126,758 $126,614	$ (17,432) $ (1,877)	$ 14,497 $ 16,975	$ 7,037 $ 9,375	$ (2,164) $ (3,771)	$ 285,054 $ 292,886
Identifiable assets	$1,428,986 $1,318,586	$924,905 $896,513	$ 85,088 $136,339	$121,673 $111,939	$ 82,270 $148,256	$461,406 $533,078	$3,219,791 $3,261,587
Capital expenditures	$ 150,925 $ 133,343	$ 76,412 $ 71,731	$ 674 $ 6,186	$ 25,674 $ 24,258	$ 21,280 $ 22,996	$ 334 $ 1,547	$ 275,299 $ 260,061

(1) Exploration and production, petrochemicals and gas marketing.

(2) Holding companies and real estate development.

(3) Inter-segment transactions have been eliminated in the consolidated column.

	1987	*1986*
Segment operating profit	$ 285,054	$ 292,886
Interest	(106,506)	(96,895)
Allowance for funds used during construction	34,094	44,517
Other income	23,993	18,105
Other items	37,350	(29,024)
Income taxes	(112,766)	(92,840)
Minority interests	(108,943)	(89,011)
	(232,778)	(245,148)
Earnings for the year	$ 52,276	$ 47,738

14. *Rate Applications*

One of the natural gas subsidiaries had been operating on interim rates since October 1984. A final decision for 1984 and 1985 in the amount of $7,971,000 has been received and recorded in 1987. The Board also ordered that a schedule of revenue surplus or deficiency be filed for 1986 to determine appropriate additional revenues or refunds for that year. As a result of the filing, the subsidiary, in a late April decision of the Board, was awarded additional revenues for 1986 of $3,200,000. These will be recorded later in calendar 1987.

The other natural gas subsidiary has been operating under final rates approved in 1986.

The electric subsidiary has received a final decision on its 1986 rate application and the required refunds of $5,819,000 have been recorded in 1987.

15. *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 $4,578,000 for 1987 (1986 — $5,444,000). Future minimum lease payments are as follows:

(Thousands of dollars)

1988	*1989*	*1990*	*1991*	*1992*	*Total of All Subsequent Years*
$15,353	$14,716	$14,056	$13,161	$11,748	$126,397

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.

The electric subsidiary has a 50% joint ownership in the Sheerness Generating Station which is under construction. The project is forecast to cost the corporation approximately $568,000,000 of which $418,000,000 has been expended to date.

ATCO has pension plans covering substantially all of its employees. The most recent actuarial evaluations of the plans disclose that significant appreciation in the value of the plan assets since the last evaluations has resulted in these assets exceeding the revised actuarial liability. Pension costs for the year amounted to $13,545,000 (1986 — $12,617,000).

As part of the financing of the acquisition of shares of Canadian Utilities, ATCO 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 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. Effective April 30, 1987, one of the lenders demanded payment under the agreement. Such payment amounts to $7,868,000 and will be discharged by issue of 732,932 Class I shares of ATCO Ltd. The maximum liability to the other lender is $6,000,000 and, based on the March 31, 1987 market price of the Canadian Utilities shares, the estimated liability to such lender is $3,687,000. The amount payable arising as a result of this agreement is being deferred and charged to earnings from 1986 to 1993. The amount charged to 1987 earnings was $1,986,000 (1986 — $324,000).

ATCO has a long term compensation plan under which 538,200 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, 1987 market price of ATCO's shares, the liability would be approximately $3,500,000. The estimated amounts payable as a result of this plan are being accrued over the life of the individual agreements to termination at various dates to January 23, 1995. $3,200,000 has been accrued at March 31, 1987 and is included in deferred credits. The amount charged to earnings in 1987 was $1,382,000 (1986 — $708,000).

16. *Comparative Figures*

Certain of the comparative figures have been reclassified to conform with the financial statement presentation adopted for 1987.

Consolidated Summary of Operations

Years ended March 31

(Thousands of Canadian dollars)	*1987*	*1986*	*1985*	*1984*	*1983*
		(Restated) (See Note 7)			
Revenues	$1,443,706	$1,527,229	$1,610,827	$1,571,347	$1,677,922
Costs and expenses	1,265,158	1,331,238	1,410,467	1,425,520	1,536,900
	178,548	195,991	200,360	145,827	141,022
Allowance for funds used during construction and other income	58,087	62,622	75,353	76,304	63,996
Other items	37,350	(29,024)	—	—	—
	273,985	229,589	275,713	222,131	205,018
Income taxes	112,766	92,840	108,645	80,901	68,858
	161,219	136,749	167,068	141,230	136,160
Minority interests	108,943	89,011	122,331	116,327	95,519
Earnings for the year	52,276	47,738	44,737	24,903	40,641
Dividends on redeemable preferred shares	27,057	34,343	33,343	21,704	26,001
Earnings attributable to Class I and Class II shares	$ 25,219	$ 13,395	$ 11,394	$ 3,199	$ 14,640
Earnings per Class I and Class II share					
Basic	$ .91	$ .57	$ .51	$ .17	$ .90
Fully diluted	$ .84	$ .53	$ .50	$ .17	$ .89
Dividends per Class I and Class II share	$ .20	$ .20	$ .20	$ .20	$ .20
Equity per Class I and Class II share	$10.03	$9.25	$9.05	$8.96	$9.10
Class I and Class II shares outstanding	27,759,550	27,757,550	22,166,800	22,156,900	16,317,505
Market price of shares					
Class I High	10⅞	11⅞	9⅜	10¾	11½
Low	7½	8½	5¼	6½	5
Class II High	11	11¾	9¼	10⅝	11¼
Low	7½	8¼	5½	6⅜	5

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

Honourable
E. P. Lougheed,
P.C., C.C., Q.C.,
Partner, Bennett Jones
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Consultant
Greenwich, Conn. U.S.A.

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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

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

* Member — Executive Committee
** Member — Audit Committee

Officers

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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

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Company Limited
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Manufacturing & Leasing Group

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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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Real Estate & Other

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Dividend information and other inquiries concerning your shares should be directed to:
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National Trust Company
1008 The Home Oil Tower
324 - 8th Avenue S.W.
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The shares of ATCO Ltd. are listed under the ticker symbols:
ACO.X (Class I Non-Voting Shares)
ACO.Y (Class II Voting Shares)
on The Toronto Stock Exchange, The Montreal Exchange and Alberta Stock Exchange.

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

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

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Calgary, Alberta

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The annual shareholders' meeting will be held at 10 a.m. M.D.T. on Wednesday, August 12, 1987 in Macleod Hall A of the Calgary Convention Centre, Calgary, Alberta.

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ATCO

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