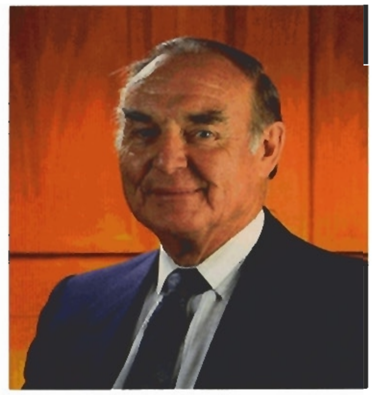
A T C O

ATCO LTD. 1988 ANNUAL REPORT

The Annual Meeting of Shareholders will be held at 10:00 a.m. M.D.T. on Wednesday, August 17, 1988 in Macleod Hall A of the Calgary Convention Centre, Calgary, Alberta.

Table of Contents

◀ From left to right, presidents and chief executive officers of ATCO's three operating groups: J. D. Wood, Canadian Utilities Limited; N. W. Robertson, ATCO Enterprises Ltd.; and W. A. Elser, ATCOR Ltd.

Corporate Profile

ATCO Ltd. is one of Canada's largest corporations with more than 5,500 employees and assets over $3 billion. During fiscal 1988, the Company announced the restructuring of its business interests into three operating groups and the appointment of chief executive officers for each segment:

Canadian Utilities Limited

One of Canada's largest investor-owned utilities, this segment is involved in the generation and distribution of electrical power, and the production and distribution of natural gas.

ATCO Enterprises Ltd.

Operations in Canada and the United States include contract drilling and well servicing equipment and services, oilfield equipment sales, manufacturing and leasing of transportable shelter, and real estate development.

ATCOR Ltd.

A major broker of natural gas in western Canada, ATCOR is also involved in frontier as well as conventional oil and gas exploration and production, gas marketing and processing.

Financial Highlights

(Thousands except share data)

(Year ended March 31)	**1988**	1987
Revenues	**$1,327,613**	$1,443,706
Earnings (loss) for the year	**$ (8,864)**	$ 52,276
Earnings (loss) attributable to Class I and Class II shares		
Before unusual items	**$ 19,877**	$ 7,990
After unusual items	**$ (34,475)**	$ 25,219
Earnings (loss) per Class I and Class II share		
Before unusual items	**$ .66**	$ .29
After unusual items	**$ (1.14)**	$ .91
Dividends paid per Class I and Class II share	**$ .20**	$ .20
Cash position	**$ 37,760**	$ 54,844
Additions to property, plant and equipment	**$ 210,598**	$ 275,299
Total assets	**$3,025,406**	$3,219,791
Class I and Class II shareholders' equity	**$ 263,652**	$ 278,480
Class I and Class II shares outstanding	**30,258,532**	27,759,550
Weighted average Class I and Class II shares outstanding	**30,196,421**	27,757,717

ATCO Ltd. earnings for the year ended March 31, 1988, before preferred share dividends and unusual items, were $45,488,000 ($35,047,000 in 1987) on revenue of $1,327,613,000 ($1,443,706,000 in 1987). After payment of preferred share dividends of $25,611,000 ($27,057,000 in 1987), earnings per Class I and Class II share for the year ended March 31, 1988 were 66¢ (29¢ in 1987). After recording a loss of $54,352,000 for Unusual Items (net of income taxes and minority interests), the loss per Class I and Class II share for the year ended March 31, 1988 was $1.14 as compared to earnings of 91¢ in the prior year. Prior years' earnings per share include a gain from Unusual Items of $17,229,000, after income taxes and minority interests.

The weighted average number of shares outstanding for 1988 was 30,196,421 compared with 27,757,717 for 1987.

As can be seen from the current year's results, significantly higher operational earnings were achieved despite a number of negative factors including very warm weather which reduced gas company earnings and an Alberta Public Utilities Board rate case decision requiring Alberta Power Limited to refund certain revenues collected through interim rates in 1986.

As was previously announced, the Board of Directors accepted a management recommendation to partially write down the value of certain assets (mainly drilling rigs) at year end. This write-down of $60,106,000 has been treated as an Unusual Item and was partially offset by gains on the sale of an office building and TransAlta Utilities shares. Details of the Unusual Items for both 1988 and 1987 are included in Note 3 to the Financial Statements.

I mentioned in last year's report that studies were underway to determine the most efficient and flexible organization to foster growth and increase shareholders' values. As a result of these studies, we have instituted a plan which will see operations conducted in three distinct units as outlined in the Corporate Profile. The plan further emphasizes operational decentralization to provide opportunity for increased initiatives within these units.

The Chief Executive Officers, along with their management and boards of directors, have the responsibility of choosing the growth options for their units within very broad corporate guidelines. Each of the units is well financed, has a strong balance sheet and is more than capable of following a well conceived plan for growth and prosperity. You might ask "that's all very well but what about a large acquisition in a new line of business"? The Board has examined the advisability of developing another unit to complement our current endeavors. This examination has convinced us that we still have considerable scope in the areas in which we now operate without assuming the risk of managing totally new businesses. Because of this, I foresee well planned investments in and extensions of our present activities rather than major moves to new endeavors.

Let's examine very briefly the current status of the three units, beginning with gas and oil.

Our success in exploration and development has been excellent and is highlighted by our participation in the Amauligak discovery in the Beaufort Sea. Our gas marketing efforts have expanded to include eastern Canada and the United States and while it takes considerable time to obtain regulatory approval for the movement of gas, we are confident of success in these new markets over the longer term.

The performance of the Energy Services, Manufacturing and Leasing and Real Estate divisions has continued to improve in line with the western Canadian economy. In addition, the Leasing division has increased its penetration of the eastern Canadian "urban space" market. The immediate goal of these divisions is to solidify their position as industry leaders and bring to their operations the innovative management techniques associated with such leadership.

The performance of Canadian Utilities over the past decade speaks for itself and we are now planning to extend its activities into non-utility business endeavors while maintaining the high standard of customer service for which the utilities are well known. The North Warning System logistics contract awarded to Frontec Logistics Corp. last December is a perfect example of the type of non-utility activity in which we are interested.

Both ATCOR and ATCO Enterprises are private companies. Our goal is to have them become public companies at the appropriate time taking into account financial markets as well as their performance and potential. Achievement of this goal will serve a twofold purpose in that investors will have the opportunity to hold an interest in these operations directly while, from the Company's point of view, access to public markets will provide the funding required for future growth.

To summarize, each unit is managed by an experienced independent management team which is accountable for the results of that unit. Each team is supported by a strong Board of Directors. The parent company exercises leadership in overall strategy, resource allocation and financing. It is also responsible to the shareholders for the overall performance of ATCO Ltd. This clear division of accountability and responsibility gives shareholders the benefit of the specialized knowledge and experience of each unit's management team combined with the broader perspective of the parent company.

I would be remiss if I did not reiterate ATCO's support of the Federal Government's Free Trade initiative. The overall Canadian economy will benefit from the opening up to Canadian suppliers of the world's largest consumer market. More specifically, ATCO will be afforded opportunities to capitalize on its entrepreneurial skills and demonstrated ability to be successful outside of home markets. Canada is the envy of the rest of the world for being able to negotiate such an agreement with the United States and I urge you to support its implementation.

The Board of Directors has approved a change in the year end of ATCO Ltd. and its 100% owned subsidiaries to December 31. This change results in a common year end throughout the ATCO Group which will reduce costs and simplify financial reporting both internally and externally. Because of this change we will report to you on a "onetime" nine month year end at the end of the 1988 calendar year.

ATCO's significant participation in the XV Olympic Winter Games is reviewed in this report; however, an interesting facet not covered is the Company's success in hosting over 1,700 visitors during the Games. Each guest was provided with a personalized itinerary to maximize his or her enjoyment of the many and varied athletic, cultural and social events staged during the Games. We are all very proud of the job done by our employees in designing and executing the hosting program.

On behalf of the Directors, I would like to thank our employees, customers and suppliers for their continued support and contribution to our success during the past year. We look forward to a continuation of these fine relationships in the future.

R. D. Southern
Deputy Chairman,
President and Chief Executive Officer

THE CALGARY TOWER FLAME, TALLEST IN THE WORLD

The XV Olympic Winter Games in Calgary allowed ATCO Ltd., an Official Sponsor, and its subsidiary Canadian Western Natural Gas Company Limited, an Official Supplier, to showcase their capabilities to an international audience.

Canadian Western installed the largest and most dramatic flame in the history of the Olympics on top of the 626-foot-high Calgary Tower. Flames were also provided at all venue sites including the Official Olympic Flame lit at McMahon Stadium during the Opening Ceremonies.

The ATCO Group of Companies was awarded more than $46 million in contracts to supply facilities and special services for the Winter Games. Major contracts included:

ACCOMMODATION FOR THE INTERNATIONAL MEDIA

To protect Calgary real estate values from a post Olympic housing surplus, ATCO manufactured and installed 500 relocatable homes to house 2,300 visiting media representatives at Lincoln Park Media Village. All 500 units were pre-sold to government agencies and, following their use during the Olympics, the homes are now being dismantled and transferred to sites throughout western Canada.

Canmore Athletes Village

At Canmore, Alberta, 50 miles west of Calgary, units from ATCO's industrial lease fleet provided chalet-style housing for 600 athletes while a major industrial kitchen was temporarily attached to the adjacent recreation centre. The new 38,000-square-foot centre, constructed by ATCO, features a swimming pool, curling rink and golf clubhouse.

Multi-Use Site Office Contract

From ticket booths to food kiosks to emergency first aid stations, 300 site offices from ATCO's Canadian space rentals fleet were used at all major venue sites to perform more than 50 different functions throughout the Winter Games.

ABC Broadcast Centre

ATCO converted Calgary's Roundup Centre into a 64,000-square-foot broadcast centre for ABC-TV. The modular nature of the project enabled ATCO to fulfill a key element of the contract — removal of the entire broadcast centre in six days to make way for another event.

VIP Hosting Facilities

Two VIP hospitality suites were donated by ATCO for use during the Winter Games. The facilities, manufactured and finished to the highest standards, were used to entertain royalty, heads of state and visiting dignitaries during the Games.

▲
Canadian Western Natural Gas, a major gas utility in southern Alberta, contributed the Official Olympic Flame to the 1988 Winter Games.

ATCO's controlling interest in Canadian Utilities Limited ("CU") provides a solid earnings base for the Company. Record warm temperatures in 1987, however, combined with lack of momentum in the Alberta economy and reduced volumes of natural gas marketed to major users, resulted in lower earnings compared with the previous year.

Canadian Utilities' earnings declined from $2.16 a share in 1986 to $1.78 a share in 1987. (Because CU's financial year corresponds with the calendar year, references in the following narrative to this year and last year refer to calendar 1987 and 1986, respectively.)

NATURAL GAS OPERATIONS

Natural gas service is provided by two Canadian Utilities subsidiaries: Canadian Western Natural Gas Company Limited serving southern Alberta, and Northwestern Utilities Limited serving northern Alberta.

The number of customers served increased during 1987 to 620,860, however natural gas throughput declined by 2 percent for the reasons outlined on the following page.

Natural gas revenues of $607.5 million were $129.5 million lower than last year. Another winter of record warm temperatures — 20 percent above normal — reduced residential and commercial sales by $46.1 million, while industrial sales declined by $33 million, and lower natural gas costs, which were passed on to customers, decreased revenue by $39.1 million.

These decreases were partially offset by additional revenues for Northwestern Utilities of $7.2 million resulting from a favorable Alberta Public Utilities Board ruling on rates charged during the two previous years.

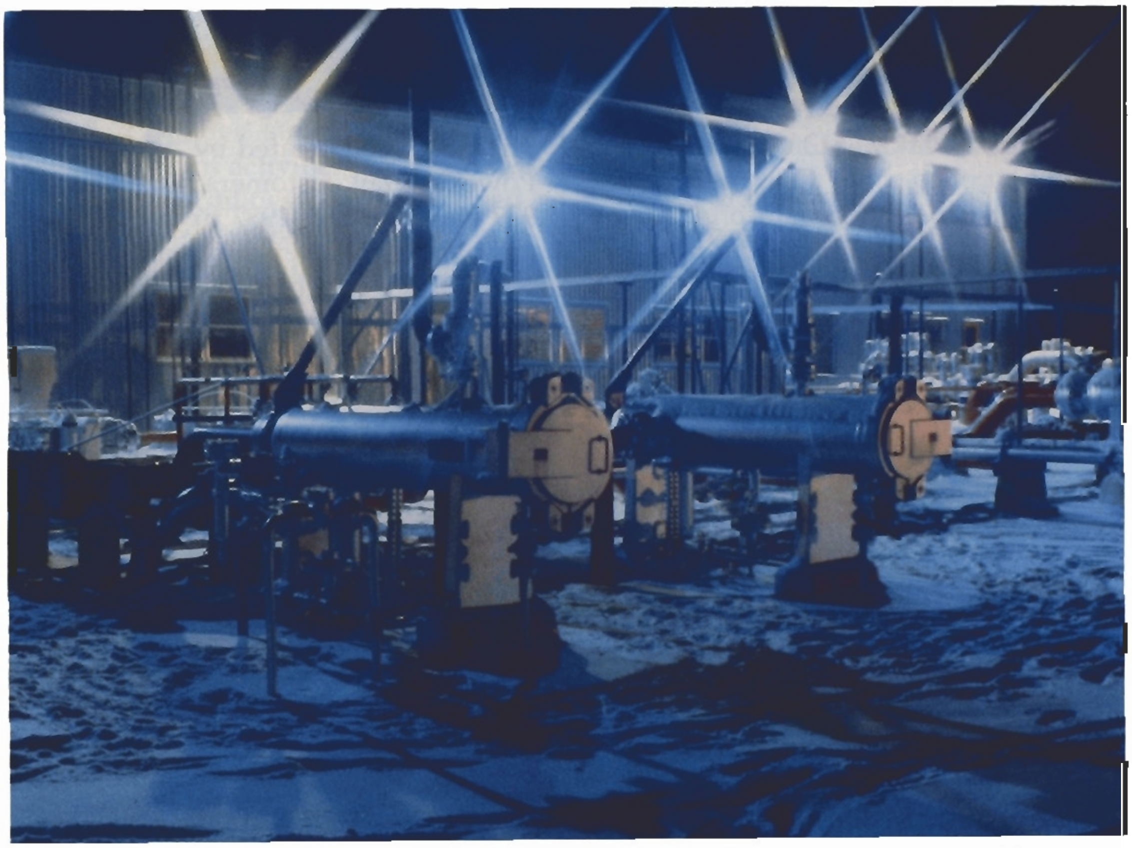
Total operating expenses declined by $119.9 million because of lower natural gas costs, reduced income tax and a continuing efficiency program.

Capital expenditures of $79.3 million provided for customer growth and improved facilities bringing net property, plant and equipment to $846.4 million. The largest project was the 1987 portion of a 10-year program to replace bare steel mains originally installed in Edmonton during the 1920's and 1930's.

With deregulation of field prices, the prices paid to producers for natural gas were established by the market rather than being set by the government. In this new environment, the gas utilities renegotiated long-term supply contracts at reduced prices and obtained new supplies at a similar cost, with the saving being passed on to consumers.

To commemorate Canadian Western's 75th anniversary, a spectacular flame was installed atop the Calgary Tower for the 1988 Olympic Winter Games. The company also installed flames at various games venues and at McMahon Stadium, site of the Opening and Closing Ceremonies.

During the year, two-year agreements were reached with employees' associations providing for a 3 percent increase in base pay in each of 1987 and 1988. Despite this increase, total operation and maintenance expenses were 2 percent less than the previous year.



◄ **Canadian Western's natural gas storage facility at Carbon, Alberta.**

In 1987, Alberte Power constructed almost 600 kilometres of new electrical transmission line.

Electric Power Operations

Electrical power is provided to 326 central and northern Alberta communities by Canadian Utilities' subsidiary, Alberta Power Limited. Other subsidiaries provide electricity to 26 communities in the Yukon, Northwest Territories and British Columbia.

Although energy sales increased by 8.9 percent during 1987, earnings declined by 7.8 percent. The higher sales came from the industrial sector, but only partially offset an adverse ruling by the Alberta Public Utilities Board on interim rates charged earlier, resulting in a refund of $17.3 million to customers.

The peak load created by Alberta Power's retail customers increased to 979 megawatts in 1987 from 895 megawatts the previous year. A milestone was achieved in 1987 with retail electrical sales exceeding 5 billion kilowatt hours versus 1 billion kilowatt hours in 1970.

Revenues rose by $33.4 million to $408.6 million, while operating expenses were up by $19.8 million. The number of customers increased by 2,566, including several oil and gas producers, bringing the total served to 150,505.

Late in the year, regulatory approval was received for the completion in 1990 of the second unit at the Sheerness Generating Station. Generating capacity of the $1.1 billion thermal plant will be doubled by the new unit to 760 megawatts. The Sheerness facility, located in central Alberta, is jointly owned by Alberta Power and TransAlta Utilities Corporation, with Alberta Power serving as the managing partner.

Capital spending was $136 million for the year, including $74.6 million on transmission and $23.1 million on generation. The majority of funds spent on transmission was in northeastern Alberta, where power demand related to the oil and gas industry continues to grow. A 207 km steel tower line was completed from the Fort Saskatchewan area to the Bonnyville area, and a 326 km line also was completed from northeast of Vilna to the Fort McMurray district. Another important transmission project was a 124 km steel tower line from the Swan Hills area to the Valleyview district.

Approval has been granted by the Energy Resources Conservation Board for Alberta Power to build a $36.4 million electrical interconnection with Saskatchewan Power. The 170 km line will complete a cross-Canada link between provincial power systems.

Non-Utility Operations

Canadian Utilities' subsidiaries are also involved in activities not regulated by the Public Utilities Board. Included are gas and oil exploration and production carried out by ATCOR

Ltd. and AT&S Exploration Ltd. Activities of these companies are reviewed in the Resources section of this report while other non-utility operations are outlined below.

Logistics

A particularly significant event was the selection of Frontec Logistics Corp., jointly owned by CU and ATCO, as contractor for a $114.2 million Federal Department of Defence contract to operate and maintain the new North Warning System in northern Canada.

Receipt of this contract is particularly important in that it could lead to substantial growth in providing logistics support services in remote areas. The five-year contract includes operating and maintaining 11 manned long-range radar sites in northern Canada. Additional options include the operation and maintenance of two long-range radar sites in Alaska, and 30 short-range radar sites in Canada and Alaska.

◄ **Growth in energy sales last year came largely from resource-related projects in northern Alberta.**

◄ **Frontec, an ATCO/CU company, was awarded a major government contract to operate and maintain Canada's new North Warning System.**

In its newest application for modular shelter, ATCO created two VIP hospitality suites for the Olympics. The facilities, manufactured, installed and furnished on site in less than four months, were used to entertain royalty and government dignitaries.

ATCO's manufacturing and leasing group completed a highly successful year in fiscal 1988. Major projects completed for the Olympic Winter Games showcased the group's capabilities to an international audience while demand for ATCO's industrial workforce housing and site office fleet improved with the strengthening of the economy.

INDUSTRIAL MANUFACTURING AND LEASING

Canada

ATCO's Canadian manufacturing operations produce a wide variety of modular accommodation for lease or for sale ranging from residential homes to industrial workforce housing. The division continued to develop new applications for modular housing as demonstrated by its projects for the 1988 Winter Games (profiled on pages four and five).

Non-Olympic related projects in fiscal 1988 included a $2.6 million order to supply 30 homes to China Aerotechnology Import and Export Corporation (CATIC) in Shanghai, Peoples' Republic of China. The homes were manufactured in Calgary, containerized and shipped to Shanghai for erection under ATCO's supervision. The contract is considered a significant breakthrough in this market and further opportunities are being pursued.

Demand for ATCO's industrial workforce housing showed steady improvement last year. Increased activity in gold mining, strong demand worldwide for forestry products and growth in the oil and gas sector contributed to a much improved utilization rate. The industrial fleet entered the new fiscal year with a strong backlog of work and utilization is projected to reach 65 percent, the highest level since 1980.

United States

During fiscal 1988, ATCO completed construction of a 36,000-square-foot Federal District courthouse at Santa Ana, California. This modular facility, designed for permanent use, includes three courtrooms, judges chambers, administrative offices and a maximum security lock-up. The facility was well-received by federal and state officials and prompted a directive instructing government representatives to consider modular construction for future courthouse requirements.

In an increasingly popular application for modular units, ATCO was awarded a contract to build a 12,000-square-foot learning centre. The combined administrative and classroom facility for Rio Salado Community College in Arizona was installed and operational within 90 days.

Prison overcrowding created further demand for correctional facilities and ATCO supplied an additional 100-man minimum security prison in Colorado last year. An upswing in mining activity in Nevada resulted in contracts for the supply and installation of a 150-man and a 250-man camp facility.

Saudi Arabia

Major projects awarded last year included a contract to manufacture, deliver and install a 250-man camp in the northern Sahara and a community housing project for the city of Rabigh in Saudi Arabia. The Rabigh facility included family housing, offices, kitchen, dining and recreation facilities in addition to life support systems such as electrical power generation, potable water distribution and sewage disposal. ATCO was required to build, transport and install the facility and life support systems in a period of 10 weeks.

▲

A contract to supply housing to China last year was considered a significant break-through for ATCO's export operations.

◀

Industrial workforce housing, installed as alpine chalets, formed part of the Canmore Athletes Village.

▲
The new Federal District courthouse at Santa Ana, California was constructed by ATCO using modular units. Services also included design and interior finishing.

▼
Site offices provided emergency facilities and temporary office space following tornado damage in Edmonton, Alberta.

ATCO Space Rentals

ATCO, the only national space rental company in Canada, completed its most profitable year to date and strengthened its position in all major Canadian centres.

The division stocks, for lease or for sale, construction site offices, classrooms, lunchrooms, washcar and first aid units. Business is conducted in all major market segments with the most active being site office rentals to contractors in the industrial, commercial and residential construction industries.

The versatility of the product was demonstrated by ATCO Space Rentals' contract to supply 300 site offices and team rooms for the XV Olympic Winter Games. The buildings were used at every major venue and served more than 50 functions including dining halls, emergency medical stations, ticket booths, fast-food outlets, security offices as well as briefing

rooms for officials. These units were relocated across Canada following the Winter Games.

Ontario continued as ATCO's strongest market last year while demand improved in the West. The division achieved a 77 percent utilization rate of its expanded fleet of 4,100 units. ATCO's national exposure and its ability to position equipment quickly to meet market demands was an important factor in achieving the high utilization rate and an excellent return on these assets. This strong performance is expected to continue throughout the coming year.

ATCO Metal

ATCO Metal manufactures pre-engineered and Fold-A-Way metal buildings as well as roll-formed products for agricultural, industrial and commercial markets in Canada. Following a slow start, a flurry of activity later in the year produced significantly higher revenues and a strong backlog of work to begin the current year.

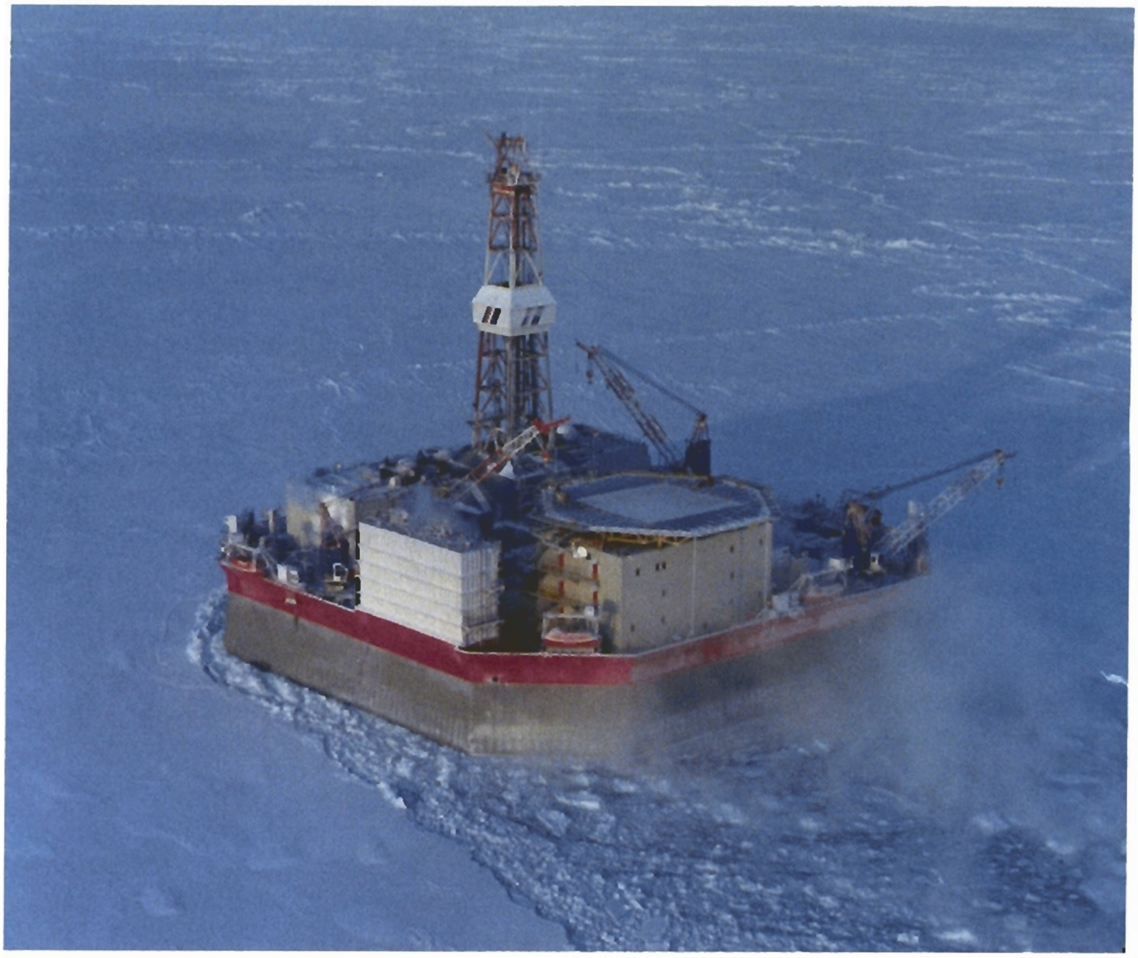
ATCO Metal designed and constructed a 38,000-square-foot recreation centre at Canmore, Alberta to accommodate a swimming pool, curling rink and golf clubhouse. Other projects included a 40,000-square-foot manufacturing plant for Alberta Truss Ltd. and a process building for Skyline Exploration's Johnny Mountain Gold Mine in northwestern British Columbia.

The division entered the new fiscal year with a number of contracts in hand including nine buildings for Esso Resources' bitumen recovery project at Cold Lake, a 110,000-square-foot mill facility for Canadian Forest Products, and a 40,000-square-foot planer mill for Dunkley Lumber.

◀ **Canada's largest supplier of site office equipment, ATCO achieved a 77 percent utilization rate last year for its fleet of versatile space rental units.**

◀ **ATCO Metal manufactures pre-engineered metal buildings and roll-formed products.**

▶ **The Amauligak discovery in the Beaufort Sea is the most significant frontier prospect in which ATCO/ ATCOR participate.**



ATCO participates in oil and gas exploration and production primarily through two companies. In western Canada, activities are conducted by Canadian Utilities' wholly owned subsidiary ATCOR Ltd. In Canadian frontier areas, exploration is carried out by AT&S Exploration Ltd., in which ATCO/ATCOR hold a 37.5 percent interest. ATCO ATCOR also hold a 3.80 percent direct participation in the Amauligak structure of the Beaufort Sea.

Cash flow from crude oil production improved considerably during the past year. ATCOR's average wellhead selling price for crude oil increased by 36 percent, to $21 CDN a barrel, while operating costs and provincial royalties were reduced. As a result, the company realized a $12 per barrel netback for crude oil, up some 90 percent from the previous year.

Wellhead natural gas prices fell 27 percent, however, to a level of $1.50 per thousand cubic feet last year as a result of gradual gas deregulation in Canada. The resulting wellhead netback was $0.75 per thousand cubic feet.

The overall outlook for exploration and development in western Canada is improving with relatively stable oil prices and indications that the United States natural gas market is approaching equilibrium.

In this environment, ATCOR has accelerated its investment program in oil and gas prospects. Total expenditures on provincial lands were $21.1 million resulting in a net finding and on-stream cost of $4.35 per barrel of oil equivalent. Petroleum and natural gas rights held by ATCOR increased by 18 percent during the year to 308,507 net acres.

The company participated in 95 wells, compared with 70 the previous year, with an overall success rate of 72 percent. Proven reserves of crude oil and natural gas liquids increased by 42 percent to 3,619,000 barrels while natural gas reserves rose by 40 percent to 62 billion cubic feet. Daily average crude oil production was up by 38 percent to 1,743 barrels and natural gas production increased 33 percent to 7.9 million cubic feet.

Exploration highlights included the development of a wet gas discovery in the Crystal area southwest of Edmonton containing 13.7 billion cubic feet of gas reserves. Total time from discovery through plant construction to going on-stream was only 10 months.

Gas Marketing

Gas volumes marketed to major industrial users declined by 11 percent due to the loss of spot sales because of increasing direct sales by producers as prices declined. ATCOR sold gas through 33 customer contracts in eastern Canada, the United States and the traditional Alberta markets. New markets are being pursued in anticipation of improved pipeline access.

Gas Processing

ATCOR is a 50 percent owner of an ethane extraction plant in Edmonton. Gas processed at the plant increased by 17 percent to 279 million cubic feet per day during 1987 and ATCOR's share of the liquid petroleum gases extracted increased by 7 percent to 1,726 barrels a day.

Frontier Exploration

Most significant of the frontier prospects in which ATCO/ATCOR participate is the Amauligak discovery in the Beaufort Sea. ATCO/ATCOR hold a 3.81 percent interest in Amauligak through AT&S and an additional 3.80

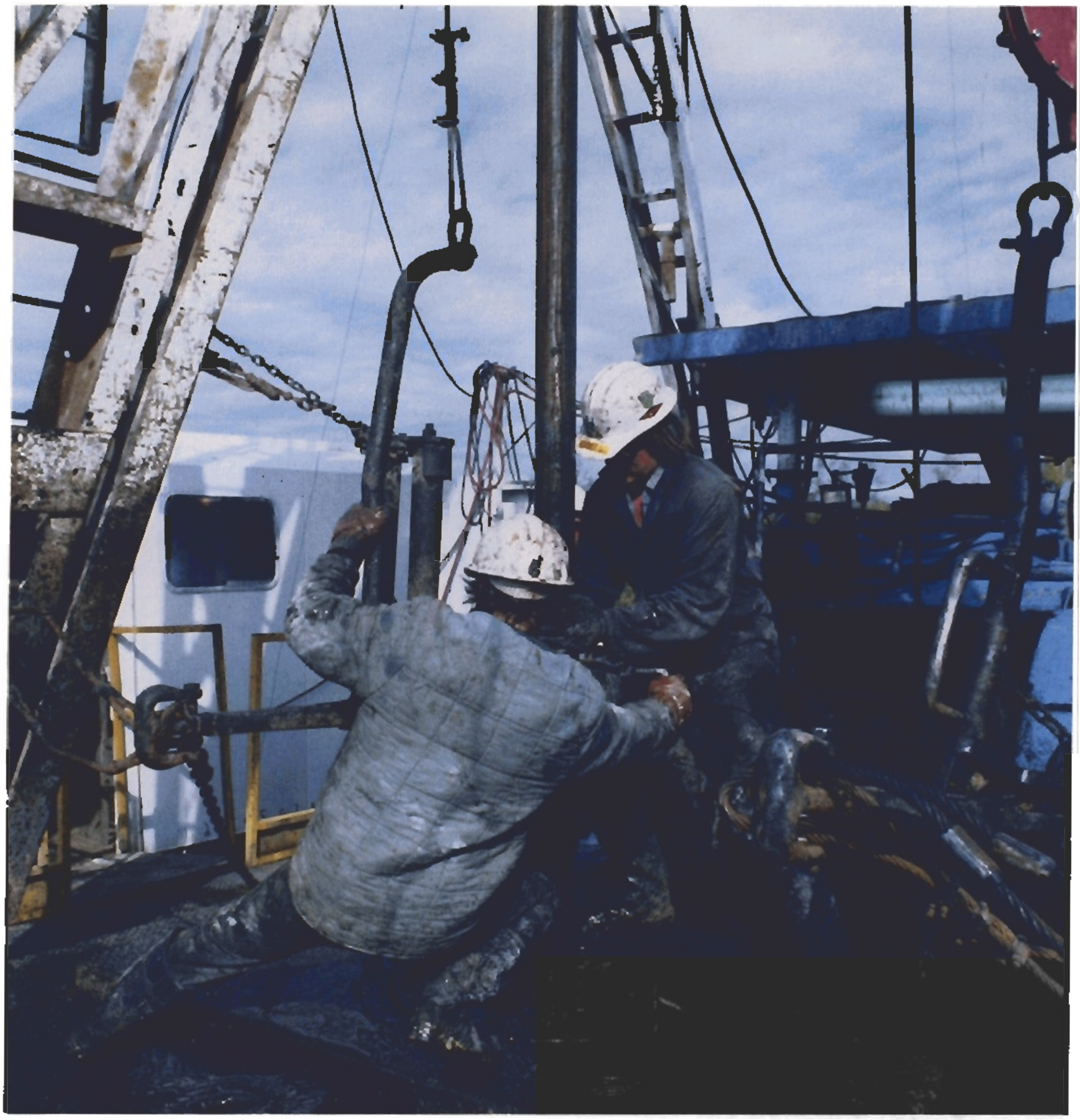
◄ An exploration highlight last year was the development of a wet gas discovery in the Crystal area near Edmonton.

percent direct interest. Three wells were drilled in 1987 as part of the continuing delineation of this field which contains an estimated 550 million barrels of recoverable oil reserves and 1.5 trillion cubic feet of natural gas.

ATCOR's strategy for the next few years is to increase investments in exploration and production with a greater amount of capital spending in western Canada directed toward the development of gas reserves rather than crude oil. The company is steadily increasing its net working interest ownership in new prospects developed in western Canada.

▼ ATCOR is Alberta's largest direct marketer of industrial gas in Canada.

▶
ATCO's North American fleet totals 78 drilling and well servicing rigs.



ATCO operates 78 drilling and well servicing rigs in North America with a full range of depth capacities. Thirty-three drilling and 20 well servicing rigs serve the Canadian industry while ATCO operates 14 drilling and 11 servicing rigs in the United States. The energy services group also operates an oilfield equipment sales and rental business in Alberta.

During the past year, oil price stability resulted in increased rig activity in both Canada and the United States. In Canada, this price stability and supportive federal and provincial government programs combined to help double the industry's average rig utilization to 37 percent. With this increased utilization came higher prices and improved margins.

Despite the general improvement in business conditions, the recent performance and outlook for certain of ATCO's drilling rigs indicates that their future operating cash flows will not be sufficient to recover their net book cost. Accordingly, these rigs and related equipment were written down by $41,933,000 in March 1988 to reflect their lower economic value.

In keeping with the policy of maximizing asset utilization as well as consolidating overhead costs, ATCO relocated four deep-drilling rigs from Texas, two of them to Canada and two to the Rocky Mountain region of the United States. The majority of ATCO's United States rigs are now located near the overthrust region of Utah, Wyoming and Idaho where the potential for new gas finds remains strong.

ATCO Oilfield Equipment doubled its earnings from the previous year and recorded a satisfactory cash flow. A supply store was opened in Taber, Alberta and other outlets are located in High Level and Grande Prairie, both in Alberta, in addition to the sales office in Calgary. An aggressive sales program has been launched with the goal of obtaining a greater share of the expanding Alberta market.

The performance of ATCO's energy service companies improved as the past year progressed. In light of the forecast of further gains in Canadian rig utilization as a result of oil price stability and gas export prospects, this favorable trend should continue.

◀ **Oil price stability resulted in improved rig utilization rates in Canada and the United States last year.**

◀ **Earnings for the oilfield equipment division doubled last year. A new supply store and yard were opened in Taber, Alberta.**

▶ Completion of Canadian Western Centre Phase II is scheduled for October 1988.

ATCO Development, the Company's real estate division, designs, constructs and manages commercial real estate properties.

Construction of Canadian Western Centre Phase II, a 130,000-square-foot office building in Calgary, is well underway with completion scheduled for October 1, 1988. In addition to the building's construction, ATCO is providing interior finishing and property management services. Major tenants will include the Province of Alberta Treasury Branches, occupying five of the building's nine floors, and ATCO Enterprises Ltd.

In fiscal 1988, ATCO Development completed the Bethany Care Centres in Airdrie and Cochrane, Alberta. The centres, which are owned and operated by the Lutheran Welfare Society, provide housing and health services for the elderly.

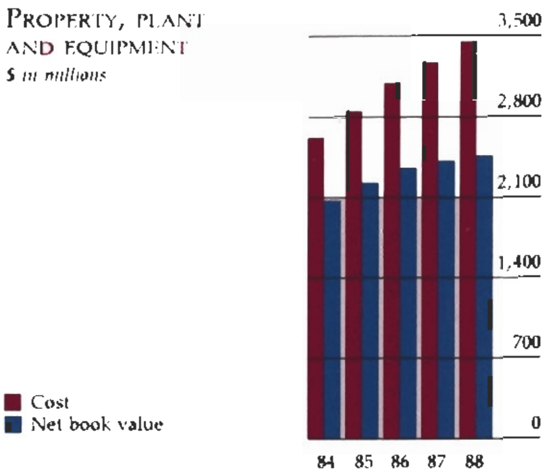
The Company has successfully diversified into property management and most recently was awarded a contract to manage the Abbotsford Mall, a 130,000-square-foot shopping centre in Edmonton.

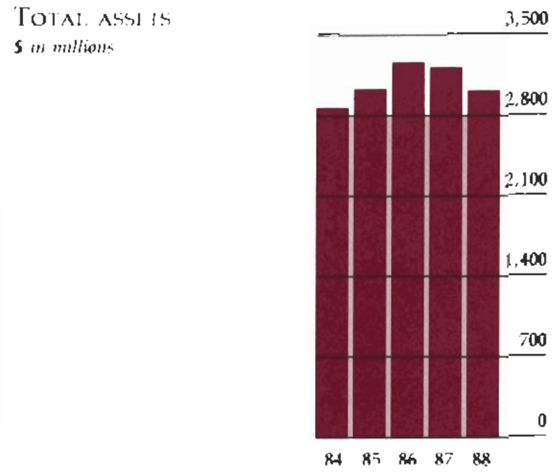
During the past year, two major projects were undertaken for the XV Olympic Winter Games. At Lincoln Park Media Village, ATCO Development installed and serviced 500 modular homes and later relocated the units throughout western Canada. A new recreation centre at Canmore, Alberta, which formed part of the Canmore Athletes Village, was also completed by ATCO Development.

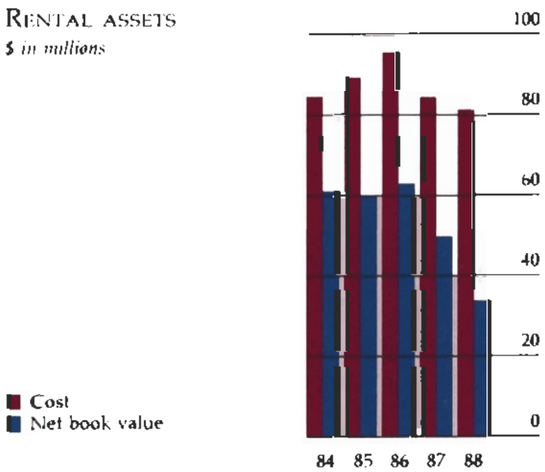
▼ Recreation facilities at Canmore, Alberta, including a swimming pool, golf clubhouse and curling rink, were completed by ATCO Development.

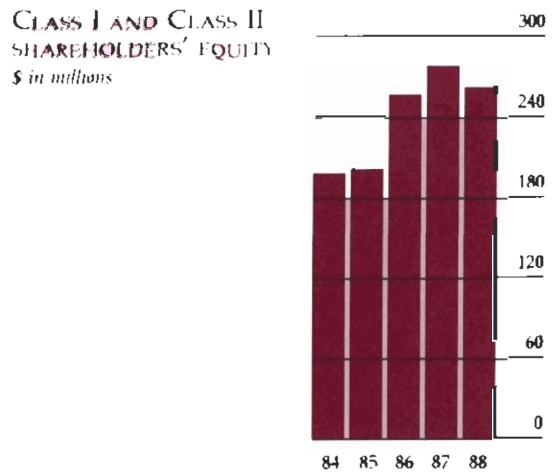
Financial Report

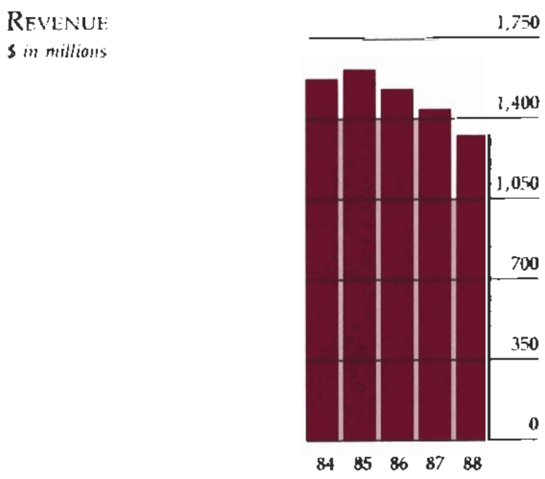
Financial Review

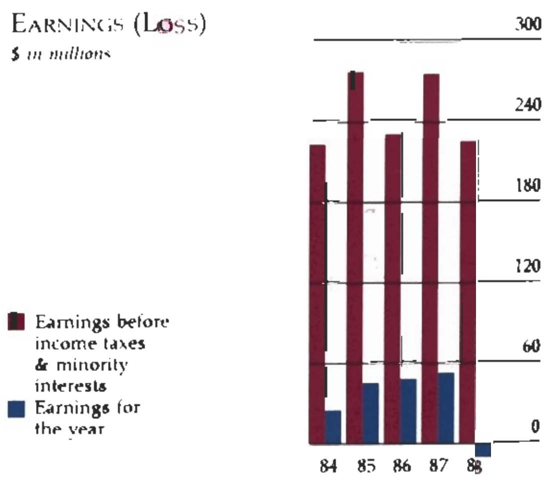












Management's Responsibility for Financial Reporting

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 and Chief Financial Officer	A. J. Pullman Vice President, Planning and Budgeting

June 1, 1988

Auditors' Report

Price Waterhouse

To the Shareholders of ATCO Ltd.

We have examined the consolidated balance sheet of ATCO Ltd. as at March 31, 1988 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, 1988 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. Except for the change in the method of accounting for pension costs as explained in Note 12 to the consolidated financial statements, these principles have been applied on a basis consistent with that of the preceding year.

Price Waterhouse

Chartered Accountants
Calgary, Alberta

June 1, 1988

Consolidated Statement of Earnings & Retained Earnings

ATCO Ltd.

(Thousands of Canadian dollars)

(Year ended March 31)

	Note Reference	1988	1987
Revenues		**$1,327,613**	$1,443,706
Costs and expenses			
Natural gas supply		**287,642**	382,167
Taxes — other than income		**61,601**	66,586
Operating and maintenance		**389,153**	458,014
Selling and administrative		**129,094**	128,872
Depreciation, depletion and amortization		**130,745**	123,013
Interest		**110,667**	106,506
		1,108,902	1,265,158
		218,711	178,548
Allowance for funds used during construction		**21,810**	34,094
Other income	2	**29,758**	23,643
Unusual items	3	**(46,585)**	37,700
		223,694	273,985
Income taxes			
Current		**125,725**	111,258
Deferred		**2,292**	1,508
	4	**128,017**	112,766
		95,677	161,219
Minority Interests	5	**104,541**	108,943
Earnings (loss) for the year		**(8,864)**	52,276
Dividends on redeemable preferred shares	6	**25,611**	27,057
Earnings (loss) attributable to Class I and Class II shares		**(34,475)**	25,219
Retained earnings at beginning of year		**168,500**	149,985
		134,025	175,204
Dividends on Class I and Class II shares		**6,052**	5,552
Share issue and redemption expenses		**396**	15
Exchange adjustments on preferred shares	6	**309**	1,137
Retained earnings at end of year		**$ 127,268**	$ 168,500
Earnings (loss) per Class I and Class II share			
Before unusual items			
Basic		**$.66**	$.29
Fully diluted		**$.65**	$.28
After unusual items			
Basic		**$(1.14)**	$.91
Fully diluted		**$(1.14)**	$.84
Dividends paid per Class I and Class II share		**$ .20**	$.20

Consolidated Balance Sheet

ATCO Ltd.

(Thousands of Canadian dollars)

(March 31)	Note Reference	1988	1987
ASSETS			
Current assets			
Cash and short term investments		$ 64,292	$ 64,371
Accounts receivable		169,580	135,543
Inventories		47,786	50,861
Prepaid expenses		7,342	7,717
		289,000	258,492
Investments	7	97,001	367,864
Property, plant and equipment	8	2,462,671	2,435,079
Goodwill		135,086	123,343
Deferred financing charges and other assets		41,648	35,013
		$3,025,406	$3,219,791
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current liabilities			
Bank indebtedness		$ 26,532	$ 9,527
Accounts payable and accrued liabilities		193,900	243,790
Income taxes payable		11,386	2,529
Long term debt due within one year		36,953	65,428
		268,771	321,274
Long term debt	9	969,072	835,138
Contributions for extensions to utility plant		222,965	209,103
Deferred credits		32,942	42,829
Deferred income taxes		5,916	3,559
Minority interests	5	907,212	1,157,114
Redeemable preferred shares	6	354,876	372,294
Class I and Class II shareholders' equity			
Class I and Class II shares	10	136,384	109,980
Retained earnings		127,268	168,500
		263,652	278,480
		$3,025,406	$3,219,791

Approved by the Board:

Robert Rice

Director

Director

Consolidated Statement of Changes in Cash Position

ATCO Ltd.

(Thousands of Canadian dollars)

(Year ended March 31)

	1988	1987
Operating activities		
Earnings (loss) for the year	**$ (8,864)**	$ 52,276
Depreciation, depletion and amortization	**130,745**	123,013
Deferred income taxes	**2,292**	1,508
Minority shareholders' interests	**104,541**	108,943
Unusual items	**46,585**	(37,700)
Other — net	**(15,388)**	(18,656)
	259,911	229,384
Decrease (increase) in non-cash working capital	**(73,220)**	16,382
Cash from operations	**186,691**	245,766
Dividends		
Paid to shareholders of the Corporation	**(31,663)**	(32,609)
Paid to preferred shareholders of subsidiaries	**(52,991)**	(54,300)
Paid to common shareholders of subsidiaries	**(34,130)**	(34,960)
	(118,784)	(121,869)
Financing activities		
Issue of long term debt	**209,557**	298,164
Reduction in long term debt	**(104,098)**	(278,974)
Issue of preferred shares by Canadian Utilities	**100,000**	80,000
Redemption of preferred shares by Canadian Utilities	**(342,299)**	(75,901)
Redemption of preferred shares by the Corporation	**(16,718)**	(17,060)
Issue of Class I shares by the Corporation	**26,404**	21
Other — net	**(5,436)**	16,848
	(132,590)	23,098
Investing activities		
Property, plant and equipment	**(191,094)**	(263,216)
Acquisition of shares of Canadian Utilities Limited	**(42,113)**	—
Investments	**280,806**	5,572
Proceeds on sale of buildings and subsidiary — net	**—**	109,186
	47,599	(148,458)
Cash position*		
Decrease	**(17,084)**	(1,463)
Beginning of year	**54,844**	56,307
End of year	**$ 37,760**	$ 54,844

* Cash position 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"). The principal operating subsidiaries are ATCO Enterprises Ltd. (100% owned) and its subsidiaries and Canadian Utilities Limited (53.8% owned) and its subsidiaries ("Canadian Utilities"), which include the utility subsidiaries and ATCOR Ltd. ATCO Ltd. and its wholly owned subsidiaries are collectively referred to herein as "the Corporation".

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 affect utility accounting policies are reflected in the consolidated financial statements prospectively from the date of decision.

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 customer's 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 7.2%	
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 utility assets, the accumulated depreciation is charged with the cost of the retired unit less net salvage.

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, net of related deferred income taxes, 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 estimated future general and administrative expenses, financing costs and income taxes. All resource properties are depleted on a unit of production basis.

Revenue Recognition

Utility revenues are recognized on the accrual basis with the exception of the electric subsidiary where revenues are recognized when billed. The natural gas subsidiaries include in revenues an estimate for natural gas sold but unbilled at the end of each accounting period. Prior to November, 1987 the natural gas subsidiaries recognized revenues when billed. This accounting policy change had no significant effect on earnings.

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.

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.

Pensions

ATCO has defined benefit plans covering substantially all its employees. Employees participate through contributions to the plans which provide for pensions based on length of service and final average earnings. The cost of pension benefits is determined using the accrued benefit actuarial cost method and reflects management's best estimates of investment returns, wage and salary increases, mortality rates, terminations and age at retirement. Adjustments resulting from plan enhancements, experience gains and losses and changes in assumptions are amortized over the estimated average remaining service life of employees. Assets in the plans are valued at market.

2. Other Income

(Thousands of dollars)	1988	1987
Interest	**$23,044**	$16,813
Dividends	**3,224**	4,402
Exchange losses	**(1,184)**	(1,290)
Other	**4,674**	3,718
	$29,758	$23,643

3. Unusual Items

(Thousands of dollars)	1988	1987
Gain on sale of:		
Real estate development properties	**$ 3,806**	$ 34,621
TransAlta Utilities Corporation shares and related securities	**9,715**	17,167
Australian subsidiary	**—**	6,634
	13,521	58,422
Write-down and provision for relocation of assets:		
Drilling rigs	**(41,933)**	(15,072)
Rental assets	**(11,906)**	(3,500)
Real estate development properties	**(5,000)**	—
Other property and equipment	**(1,267)**	(200)
	(60,106)	(18,772)
Provisions for discontinuance of operations	**—**	(1,950)
	$(46,585)	$ 37,700

In the last quarter of fiscal 1988, the Corporation wrote down the carrying value of certain assets in the energy services, manufacturing and leasing and real estate operations by $60,106,000 to reflect the estimated economic value of those assets.

4. Income Taxes

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

(Thousands of dollars)	1988	1987
Earnings before income taxes and minority interests	**$223,694**	$273,985
Income taxes at statutory rate of 51.31% (1987 — 48.62%)	**$114,777**	$133,212
Allowance for equity funds used during construction	**(7,804)**	(7,713)
Asset writedowns not tax effected	**30,836**	7,530
Crown royalties and other non-deductible government payments	**4,127**	3,824
Earned depletion and resource allowance	**(8,665)**	(6,756)
Non-taxable portion of capital gains	**(1,012)**	(16,281)
Foreign tax rate differences	**2,030**	4,429
Provincial rebates	**(3,269)**	(3,025)
Non-taxable dividends	**(1,656)**	(2,167)
Other	**(1,347)**	(287)
	$128,017	$112,766
Effective rate	**57.2%**	41.2%

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 utility 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 $394,000 (1987 — $101,000) to an accumulated amount of $135,010,000.

Certain subsidiaries have operating loss carryforwards of approximately $21,000,000 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.

In addition, certain subsidiaries have asset values for tax purposes in excess of the corresponding values for book purposes for which the tax benefits have not been recognized in the accounts. This excess amounts to approximately $76,000,000 and is available to reduce future years' taxable income.

5. Minority Interests

(Thousands of dollars)	**1988**	1987
Equity of minority interests:		
In preferred shares of Canadian Utilities and subsidiaries (detailed below)	**$560,403**	$ 802,702
In Class A non-voting and Class B common shares of Canadian Utilities	**345,418**	353,958
Other	**1,391**	454
	$907,212	$1,157,114
In Canadian Utilities —		
Preferred share dividends	**52,972**	54,300
Earnings attributable to Class A non-voting and Class B common shares	**51,522**	54,710
Other	**47**	(67)
	$104,541	$ 108,943

Preferred shares of Canadian Utilities and subsidiaries

(Thousands of dollars)	**1989 Redemption Premium**	**Issued Amount 1988**	Issued Amount 1987
Cumulative Redeemable Preferred Shares, 4% to 6%	**1% - 4%**	**$ 30,508**	$ 30,508
Floating Rate Cumulative Redeemable Preferred Shares	**N/A**	**20,000**	20,000
Cumulative Redeemable Second Preferred Shares Non-retractable, 7.3%	**N/A**	**22,085**	22,814
Retractable, 7.08% to 14.5%	**(See below)**	**487,810**	729,380
		$560,403	$802,702

Redemption and retraction privileges

The preferred shares of Canadian Utilities are redeemable subject to the 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 I	$ 98,802	November 1, 1988	4%	November 1, 1991
Series J	$ 27,000	January 31, 1992	Nil	January 31, 1992
Series K	$122,008	October 15, 1993	Nil	October 15, 1993
Series L	$ 60,000	June 1, 1991	6%	June 1, 1994
Series M	$ 80,000	June 1, 1991	4%	June 1, 1993
Series N	$100,000	June 1, 1995	Nil	June 1, 1995

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)	1989	1990	1991	1992	1993
	$6,400	$8,400	$8,400	$122,202	$5,400

6. Redeemable Preferred Shares

(Thousands of dollars)	Issued Amount 1988	Issued Amount 1987	Dividends 1988	Dividends 1987
Issued by:				
ATCO Ltd.	**$ 55,000**	$ 55,000	**$ 5,005**	$ 4,980
ATCO Holdings (N.A.) Ltd.	**22,340**	32,270	**1,610**	2,213
ATCO Utilities Holdings Ltd.	**150,000**	150,000	**10,182**	10,399
474243 Ontario Ltd.	**127,536**	135,024	**8,814**	9,465
Total issued (detailed below)	**$354,876**	$372,294	**$25,611**	$27,057

ATCO Ltd.

1988 1987 *(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**	**9.7%**	**$ 343**
	200,000	$ 5,000	9.9%	$ 349
Series 3	**2,000,000**	**50,000**	**N/A**	**4,662**
	2,000,000	50,000	N/A	4,631
		$55,000		**$5,005**
		$55,000		$4,980

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.

1988 1987 *(Thousands of dollars)*	Issued **Shares**	 **Amount**	**Average Prime Rate**	**Dividends**
First Preferred Shares				
Par value $100 each				
Authorized 800,000 shares				
Series A, issued in U.S. dollars	**100,000**	**$12,340**	**9.0%**	**$ 891**
	140,000	$18,270	8.4%	$1,213
Series B	**100,000**	**10,000**	**9.7%**	**719**
	140,000	14,000	9.9%	1,000
		$22,340		**$1,610**
		$32,270		$2,213

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 ATCO Enterprises Ltd.

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.

1988 1987 *(Thousands of dollars)*	Issued **Shares**	 **Amount**	**Average Prime Rate**	**Dividends**
Preferred Shares				
Authorized 150,000 shares	**150,000**	**$150,000**	**9.7%**	**$10,182**
	150,000	$150,000	9.9%	$10,399

The preferred shares may be redeemed, at the corporation's option, at a price of $1,040 per share 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 17.5% of the average prime rate for the quarter.

474243 Ontario Ltd.

1988 1987 *(Thousands of dollars)*	Issued **Shares**	 **Amount**	**Average Prime Rate**	**Dividends**
Preference Shares				
Par value $1,000 each				
Authorized 150,000 shares				
Classes A - G	**127,536**	**$127,536**	**9.7%**	**$8,814**
	135,024	$135,024	9.9%	$9,465

The issued preference shares are to be redeemed, at par, at $1,875,000 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 ($63,780,000)	50% of prime plus 2%
Classes E - F ($21,256,000)	50% of prime plus 1⅞%
Class G ($42,500,000)	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. INVESTMENTS

(Thousands of dollars)	**1988**	1987
TransAlta Utilities Corporation	**$ —**	$108,309
Hydro-Quebec bonds	**49,977**	49,969
Other securities, at cost (approximate current market value $17,563,000)	**20,244**	183,026
Joint ventures and partnership (on the equity basis)	**26,780**	26,560
Total (detailed below)	**$97,001**	$367,864

TransAlta Utilities Corporation

On August 3, 1982, ATCO Ltd., Canadian Utilities and TransAlta Utilities Corporation entered into an agreement providing for the divestiture of the interlocking equity ownership positions held by Canadian Utilities and TransAlta Utilities Corporation. On December 1, 1982, warrants were issued to the holders of the Series H preferred shares entitling the bearer, for each warrant held, to purchase one Class A common share of TransAlta Utilities Corporation owned by Canadian Utilities at a price of $22.25 per share on or before November 1, 1987.

During the year 5,380,134 (1987 — 6,068,244) warrants were exercised for a gain of $12,172,000 (1987 — $16,817,000). Proceeds from the exercise of warrants were invested in securities. The proceeds from sale of these securities were used to redeem, on November 2, 1987, the Series H preferred shares not tendered with warrants. ATCO recorded losses on these securities of $2,457,000.

Hydro-Quebec Bonds

The proceeds on the issue of the Series 3 Junior Preferred Shares were invested in $50,000,000 principal amount 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 Partnership

(Thousands of dollars)	**1988**	1987
Real estate development	**$24,398**	$25,363
Energy services	**2,382**	1,197
	$26,780	$26,560

ATCO's share of the joint ventures' and partnership's earnings amounted to $172,000 (1987 — $565,000) and is included in revenues.

8. PROPERTY, PLANT AND EQUIPMENT

	1988		1987	
(Thousands of dollars)	**Cost**	**Accumulated Depreciation & Depletion**	**Cost**	**Accumulated Depreciation & Depletion**
Electric utility plant and equipment	**$1,797,152**	**$375,431**	$1,683,786	$324,655
Natural gas utility plant and equipment	**1,136,524**	**289,870**	1,093,838	259,910
Drilling and well servicing rigs and related equipment	**188,515**	**169,414**	188,981	116,676
Gas and oil properties	**157,553**	**72,595**	124,887	61,809
Urban and industrial space rental assets	**84,251**	**49,763**	83,826	33,873
Other plant and equipment	**93,076**	**37,327**	91,737	35,053
	$3,457,071	**$994,400**	$3,267,055	$831,976
	$2,462,671		$2,435,079	

Deferred gas exploration costs of $13,750,000 (1987 — $27,801,000) are included in natural gas utility plant and equipment. During the year $20,383,000 (1987 — $2,879,000) of unsuccessful gas exploration costs, net of related income taxes, were charged against funds received under The Natural Gas Pricing Agreement Act.

9. Long Term Debt

(Thousands of dollars)	1988	1987
Canadian Utilities and Subsidiaries		
Sinking fund debentures, at fixed rates of 7¼% to 17½%, due at various dates to 2007	$ 747,674	$679,799
First mortgage sinking fund bonds, at fixed rates of 5⅝% to 9¾%, due at various dates to 1994	32,318	36,998
Capitalized lease obligation	18,399	19,363
Notes payable	10,000	—
Other	25,370	24,860
ATCO Ltd.		
Term loans, unsecured, at fixed rates of 10.13% to 10.18%, due at various dates to August, 1991	30,000	30,000
Term loans, unsecured, at prime, due at various dates to March, 1993	60,000	60,000
ATCO Enterprises Ltd.		
Term loan, at 11.49%, due July 3, 1990, secured by 2,000,000 Class B shares of Canadian Utilities	36,000	—
Bank loan, due December 31, 1992, non-recourse, secured by assignment of interest in ALDC Partnership	8,800	8,800
Interim financing of Canadian Western Centre, Phase II, at prime, due December 31, 1989, secured by the building under construction	3,091	—
Term loan, at 10⅛%, 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 prime, due December 30, 1990, secured by certain gas and oil properties	10,400	14,000
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	1,473	4,246
	1,006,025	900,566
Less: Amounts due within one year	36,953	65,428
	$ 969,072	$835,138

The Corporation has fixed the interest rate on certain of its floating rate instruments (both redeemable preferred shares and long term debt) by entering into interest rate swap agreements as follows:

Maturing in Fiscal Year	Principal Amount	Interest Rate
1991	$19,000,000	9.50% - 9.69%
1992	$85,000,000	9.77% - 10.51%
1993	$70,000,000	11.45% - 12.00%

The Corporation maintains a standby line of credit for $50,000,000 under a term credit agreement at negotiated interest rates. 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 that corporation. At March 31, 1988, no amount was outstanding under this agreement (1987 — Nil).

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 is subject to restrictions on the payment of dividends on Class A and Class B shares in excess of $145,119,000.

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 $27,119,000 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 $8,720,000.

Under a bank loan agreement, which provides a line of credit of up to $75,000,000 to September 15, 1989, 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, 1988, Canadian Utilities had issued $10,000,000 (1987 — Nil) of commercial paper under this agreement.

Interest expensed on long term debt was $101,825,000 (1987 — $98,947,000). In addition to the allowance for funds used during construction, interest of $1,076,000 (1987 — $49,000) was capitalized during the year.

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

(Thousands of dollars)	1989	1990	1991	1992	1993
	$36,953	$52,063	$113,744	$112,200	$38,953

10. Class I and Class II Shares

(Thousands of dollars)	Class I Non-Voting Shares	Class I Non-Voting Consideration	Class II Voting Shares	Class II Voting Consideration	Total Shares	Total Consideration
Authorized	**100,000,000**		**50,000,000**		**150,000,000**	
Issued:						
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:						
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
Exercise of warrants	1,762,950	18,511	—	—	1,762,950	18,511
CU financing agreement	732,932	7,868	—	—	732,932	7,868
Employee share option plans	3,100	25	—	—	3,100	25
Conversions from Class II to Class I	12,980	6	(12,980)	(6)	—	—
March 31, 1988	26,050,382	$134,250	4,208,150	$2,134	30,258,532	$136,384

Each Class II voting share may be converted to one Class I non-voting share at the shareholder's option. In the event an offer to purchase Class II voting shares is made to all holders of Class II voting shares, and is accepted and taken up by the holders of a majority of such shares pursuant to such offer, then provided an offer is not made to the holders of Class I non-voting shares on the same terms and conditions, the Class I non-voting shares shall be entitled to the same voting rights as the Class II voting shares. The two classes of shares rank equally in all other respects.

Share Options

The Corporation has a share option plan under which options to purchase 994,740 Class I non-voting and 217,260 Class II voting shares may be granted to certain 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 446,900 and nil, respectively, were outstanding at March 31, 1988 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 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.

CU Financing Agreement

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. Effective April 30, 1987, one of the lenders requested payment under the agreement. Such payment amounted to $7,868,000 and was discharged by the issue of 732,932 Class I shares of ATCO Ltd. The second lender requested payment effective February 25, 1988 when the liability was calculated at $3,384,000. This liability was discharged by a cash payment.

11. Segmented Information

By Industry

1988 1987 *(Thousands of dollars)*	Electric Utility Operations	Gas Utility Operations	Gas and Oil (1)	Energy Services	Manu-facturing & Leasing	Other (2)	Consol-idated (3)
Revenues:							
Trade	**$ 431,428**	**$613,403**	**$120,521**	**$ 59,048**	**$ 73,666**	**$ 29,547**	**$1,327,613**
	$ 371,008	$713,310	$118,843	$ 33,892	$169,470	$ 37,183	$1,443,706
Inter-segment	**210**	**14,969**	**17,787**	**1,947**	**9,856**	**19,525**	**—**
	75	10,815	47,963	1,731	13,944	22,489	—
Total segment revenues	**431,638**	**628,372**	**138,308**	**60,995**	**83,522**	**49,072**	**1,327,613**
	371,083	724,125	166,806	35,623	183,414	59,672	1,443,706
Expenses:							
Operating costs	**174,008**	**465,664**	**120,165**	**57,637**	**69,843**	**44,307**	**867,490**
	160,270	567,371	145,820	37,760	164,606	56,577	1,035,639
Depreciation, depletion and amortization	**53,865**	**35,703**	**4,632**	**14,278**	**9,228**	**8,975**	**130,745**
	50,416	29,996	6,489	15,295	11,771	5,259	123,013
Total segment expenses	**227,873**	**501,367**	**124,797**	**71,915**	**79,071**	**53,282**	**998,235**
	210,686	597,367	152,309	53,055	176,377	61,836	1,158,652
Segment operating profit (loss)	**$ 203,765**	**$127,005**	**$ 13,511**	**$(10,920)**	**$ 4,451**	**$ (4,210)**	**$ 329,378**
	$ 160,397	$126,758	$ 14,497	$(17,432)	$ 7,037	$ (2,164)	$ 285,054
Identifiable assets	**$1,500,815**	**$957,845**	**$147,272**	**$ 37,608**	**$ 63,944**	**$192,153**	**$3,025,406**
	$1,428,986	$924,905	$121,673	$ 85,088	$ 82,270	$461,406	$3,219,791
Capital expenditures	**$ 113,235**	**$ 50,605**	**$ 28,672**	**$ 3,084**	**$ 9,233**	**$ 5,769**	**$ 210,598**
	$ 150,925	$ 76,412	$ 25,674	$ 674	$ 21,280	$ 334	$ 275,299

(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.

(Thousands of dollars)	**1988**	1987
Segment operating profit	**$ 329,378**	$ 285,054
Interest	**(110,667)**	(106,506)
Allowance for funds used during construction	**21,810**	34,094
Other income	**29,758**	23,643
Unusual items	**(46,585)**	37,700
Income taxes	**(128,017)**	(112,766)
Minority interests	**(104,541)**	(108,943)
	(338,242)	$(232,778)
Earnings (loss) for the year	**$ (8,864)**	$ 52,276

12. Pensions

Effective April 1, 1987, ATCO adopted, on a prospective basis, the accounting recommendations for pension costs and obligations issued by the Canadian Institute of Chartered Accountants. The recommendations were implemented using an actuarial valuation of the pension plans as at December 31, 1986 which incorporated enhancements to the plans including changes required by new pension benefits legislation. Implementation of these recommendations had no significant effect on earnings for the year ended March 31, 1988.

The present value of the accrued pension benefits and the net assets available to provide for these benefits are as follows:

(Thousands of dollars)	1988	1987
Market value of assets	**$392,456**	$393,297
Accrued pension benefits	**336,826**	309,427
Surplus	**$ 55,630**	$ 83,870

The pension costs for the year amounted to $3,019,000 of which $743,000 was capitalized. The plan surplus is being amortized on a straight-line basis over 18.6 years. The difference of $1,125,000 between the amount expensed and the funding contribution is included in other deferred credits.

13. 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 $16,317,000 for 1988 (1987 — $4,578,000). Future minimum lease payments are as follows:

(Thousands of dollars)	1989	1990	1991	1992	1993	Total of all Subsequent Years
	$15,583	$14,809	$13,716	$12,268	$12,079	$119,746

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 $565,000,000 of which $432,000,000 has been expended to date.

The lender is questioning the non-recourse feature of the $8,800,000 loan secured by an assignment of the Corporation's interest in the ALDC Partnership. Management is discussing this matter with the lender. Counsel has advised that it is unlikely that any liability will ultimately attach to the Corporation.

ATCO has a long term compensation plan under which 327,395 share equivalents have been granted to certain 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, 1988 market price of ATCO's shares, the liability would be approximately $1,800,000. 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. $1,700,000 has been accrued at March 31, 1988 and is included in deferred credits. Approximately $1,200,000 was paid on agreements expiring in April, 1988. The amount charged to earnings in 1988 was $512,000 (1987 — $1,382,000).

14. COMPARATIVE FIGURES

Certain of the comparative figures have been reclassified to conform with the financial statement presentation adopted for 1988.

Consolidated Summary of Operations

ATCO Ltd.

(Thousands of Canadian dollars)

(Year ended March 31)	1988	1987	1986	1985	1984
Revenues	**$1,327,613**	$1,443,706	$1,527,229	$1,610,827	$1,571,347
Costs and expenses	**1,108,902**	1,265,158	1,331,238	1,410,467	1,425,520
	218,711	178,548	195,991	200,360	145,827
Allowance for funds used during construction and other income	**51,568**	57,737	64,022	75,353	76,304
Unusual items	**(46,585)**	37,700	(30,424)	—	—
	223,694	273,985	229,589	275,713	222,131
Income taxes	**128,017**	112,766	92,840	108,645	80,901
	95,677	161,219	136,749	167,068	141,230
Minority interests	**104,541**	108,943	89,011	122,331	116,327
Earnings (loss) for the year	**(8,864)**	52,276	47,738	44,737	24,903
Dividends on redeemable preferred shares	**25,611**	27,057	34,343	33,343	21,704
Earnings (loss) attributable to Class I and Class II shares	**$ (34,475)**	$ 25,219	$ 13,395	$ 11,394	$ 3,199
Earnings (loss) per Class I and Class II share					
Before unusual items					
Basic	**$ .66**	$ .29	$ .97	$ .51	$ .17
Fully diluted	**$ .65**	$ .28	$ .87	$ .50	$ .17
After unusual items					
Basic	**$(1.14)**	$ .91	$ .57	$ .51	$ .17
Fully diluted	**$(1.14)**	$ .84	$ .53	$ .50	$ .17
Dividends per Class I and Class II share	**$ .20**	$ .20	$ .20	$ .20	$ .20
Equity per Class I and Class II share	**$ 8.71**	$10.03	$9.25	$9.05	$8.96
Class I and Class II shares outstanding	**30,258,532**	27,759,550	27,757,550	22,166,800	22,156,900
Market price of shares					
Class I High	**14¾**	10¾	11⅞	9⅜	10¾
Low	**8**	7½	8½	5¼	6½
Class II High	**14½**	11	11¾	9¼	10⅝
Low	**8¼**	7½	8¼	5½	6⅜

Directors and Officers

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**
Vice President,
Special Projects,
ATCO Enterprises Ltd.

E. W. King
Corporate Director,
Edmonton

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

K. B. Purdie
Group President
Manufacturing & Leasing,
ATCO Enterprises Ltd.

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

C. S. Richardson*
Senior Vice President,
Finance and Chief Financial
Officer, ATCO Ltd.

N. W. Robertson*
President and
Chief Executive Officer,
ATCO Enterprises Ltd.

J. A. Scrymgeour
Corporate Director,
Hamilton, Bermuda

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

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

O. Steiner
Group President,
Development,
ATCO Enterprises Ltd.

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

*Member — Executive Committee
** Member — Audit Committee

Officers

S. D. Southern
Chairman of the Board

R. D. Southern
Deputy Chairman,
President and
Chief Executive Officer

C. S. Richardson
Senior Vice President,
Finance and Chief
Financial Officer

A. J. Pullman
Vice President,
Planning and Budgeting

D. P. Wood
Vice President,
Corporate Secretary

Principal Operations

Canadian Utilities Limited

Head Office:
10035 - 105 Street
Edmonton, Alberta T5J 2V6
Tel: (403) 420-7310

Operating Companies:

Alberta Power Limited
Canadian Western Natural Gas Company Limited
Northland Utilities (B.C.) Limited
Northland Utilities (NWT) Limited
Northwestern Utilities Limited
The Yukon Electrical Company Limited

ATCO Enterprises Ltd.

Head Office:
1500 Canadian Western Centre
909 - 11th Avenue S.W.
Calgary, Alberta T2R 1N6
Tel: (403) 292-7500

Operating Companies:

ATCO Industrial Manufacturing & Leasing
ATCO Space Rentals
ATCO Metal
ATCO Structures, Inc.
ATCO Saudi Arabia Ltd.
ATCO Drilling
ATCO Oilfield Equipment
ATCO Well Servicing
ATCO/Equtak Drilling Ltd.
ATCO Development
Southco Travel

ATCOR Ltd.

Head Office:
400, 800 - 6th Avenue S.W.
Calgary, Alberta T2P 3G3
Tel: (403) 292-8000

Operating Companies:

ATCOR Ltd.
AT&S Exploration Ltd. (37.5% owned)

ATCO/CU Corporate Joint Ventures

Frontec Logistics Corp.
CATS Defense Support Systems Inc.

Shareholders' Information

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Tel: (403) 292-7554

Dividend information and other inquiries concerning shares should be directed to:

National Trust Company
Stock Transfer Department
1008 The Home Oil Tower
324 - 8th Avenue S.W.
Calgary, Alberta T2P 3B2

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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