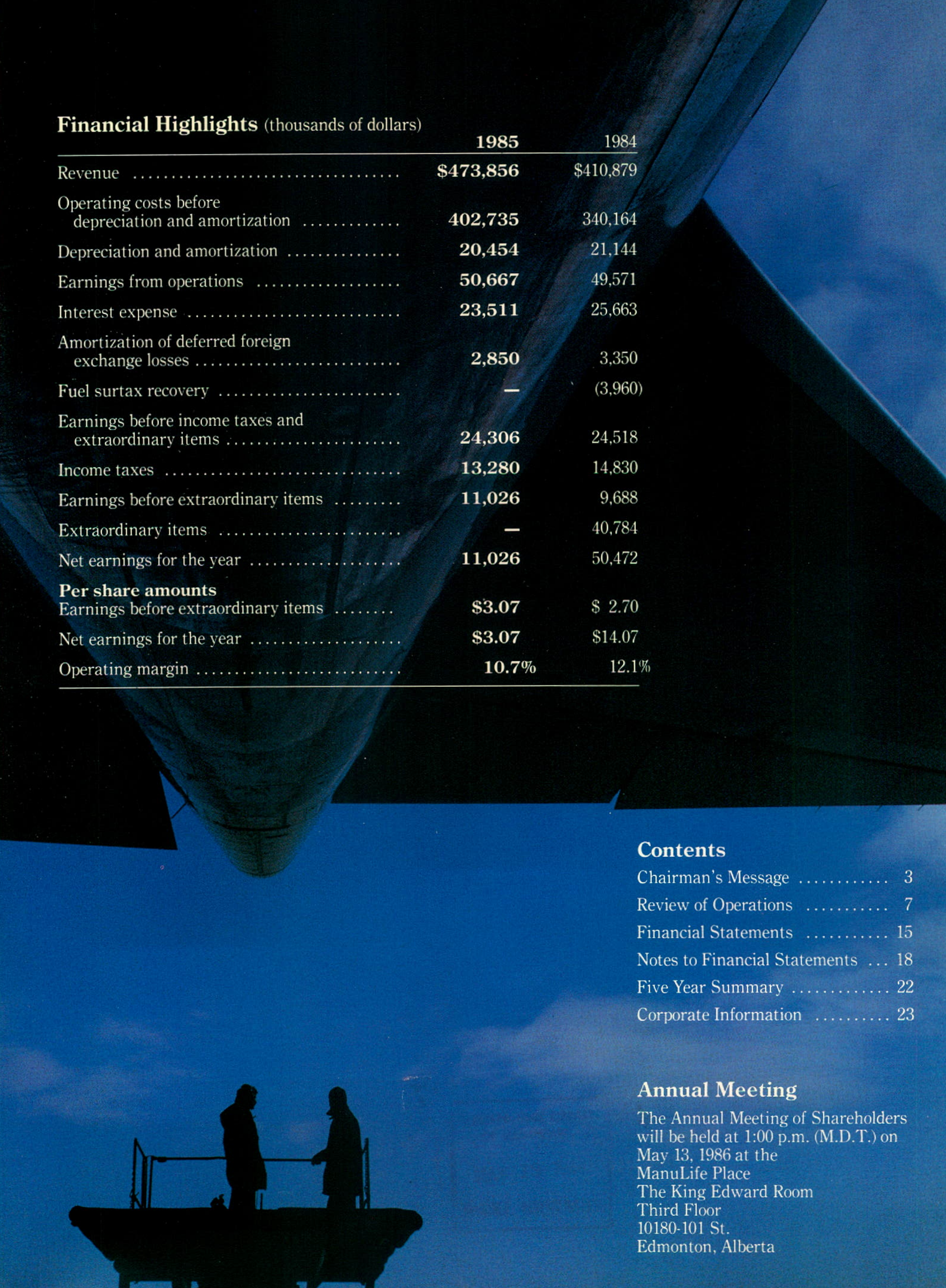
Wardair International Ltd.

Annual Report 1985



Financial Highlights (thousands of dollars)

	1985	1984
Revenue	$473,856	$410,879
Operating costs before depreciation and amortization	402,735	340,164
Depreciation and amortization	20,454	21,144
Earnings from operations	50,667	49,571
Interest expense	23,511	25,663
Amortization of deferred foreign exchange losses	2,850	3,350
Fuel surtax recovery	—	(3,960)
Earnings before income taxes and extraordinary items	24,306	24,518
Income taxes	13,280	14,830
Earnings before extraordinary items	11,026	9,688
Extraordinary items	—	40,784
Net earnings for the year	11,026	50,472
Per share amounts		
Earnings before extraordinary items	$3.07	$ 2.70
Net earnings for the year	$3.07	$14.07
Operating margin	10.7%	12.1%

Contents

Annual Meeting

The Annual Meeting of Shareholders will be held at 1:00 p.m. (M.D.T.) on May 13, 1986 at the
ManuLife Place
The King Edward Room
Third Floor
10180-101 St.
Edmonton, Alberta

Involvement by senior management ensures that standards of excellence are maintained.

To Our Shareholders and Employees

Chairman's Message

Nineteen eighty-five was a year of progress and change for our Company. Earnings from operations showed modest growth, our long-term debt was restructured and, after twenty-four years of operating charter flights between Canada and England, we began scheduled air service to that country.

Wardair's new scheduled authority to the U.K. will let us serve those passengers prepared to pay higher fares for the benefit of unrestricted travel while continuing to serve the advance booking passengers. We are extremely pleased to have been awarded this broadened operating authority as it will be essential to the expansion and improved profitability of our North Atlantic routes. We will continue to use our charter license to meet the seasonal demand for Wardair's low cost flights to the U.K. provincial cities as well as to various centres in Europe.

The first six months of 1985 produced above-average performance for our Company. During the second half of the year, however, the additional charter aircraft placed into service by our competitors resulted in vigorous competition for market share. Even so, Wardair carried more passengers than any other year in its history. Revenues increased nearly $63 million, but operating profit remained approximately the same as in 1984. Although average fare levels increased approximately 5 percent, load factors dropped by a similar amount, thereby offsetting potential gains.

Maxwell W. Ward, Chairman and Chief Executive Officer (left), with George D. Curley, President and Chief Operating Officer, in the Corporation's hangar at Lester B. Pearson International Airport.

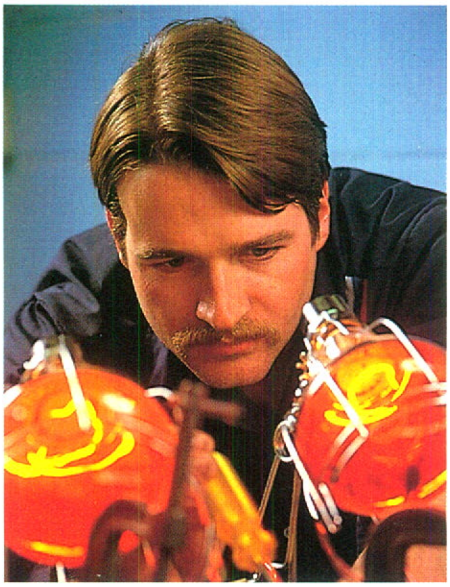
Nearly one-third of the revenue increase can be attributed to the development of our tour operation "Wardair Holidays". Although this aspect of our business carries low margins, orderly sales growth of holiday-related travel services is important to our expansion plans as it ensures our long-term security in the marketplace.

Our present reservation and ticketing system is well suited to the needs of the charter passenger; however, it does not provide all of the functions the scheduled passenger has come to expect. Accordingly, we are presently installing the Sperry Univac Standard Airline System (USAS) package software at our computer centre in Toronto. These computer programs are considered to be "state of the art" in reservations, ticketing and related passenger handling systems by a number of the world's major airlines. Sperry is committed to a policy of ensuring this system keeps its position of leadership within the industry by adding new software as needs are identified by their airline customers.

We will bring USAS*RES on line in the Spring of 1986, in time to market our new domestic scheduled operations. In addition to giving a better level of service to both the travel agent and the passenger, we expect our new computer system to lower the cost of accepting bookings through increased efficiency.

Before we can take full advantage of the opportunities

Safe, modern facilities provide an optimum working environment for skilled employees.



To Our Shareholders and Employees

available through our planned scheduled services. Wardair must acquire additional aircraft better suited to Domestic and North American routes. We have discussed our fleet requirements with the major aircraft manufacturers, however, there is considerable doubt whether the expected level of airfares in a deregulated Canadian marketplace can carry the capital cost of new, high technology aircraft. The financial advantages obtained by the purchase of new equipment is insufficient to warrant the required expenditure. Therefore, we have directed our attention towards the availability of good used aircraft.

Wardair's depreciation policy for its fleet of Boeing 747 and Douglas DC10 aircraft was based on a projected life of sixteen years. This policy was reviewed in 1985. We considered current industry practice and our intention and ability to operate our fleet for a longer period. Accordingly, the Company has caused its 1985 financial statements to reflect an extension of the remaining period for depreciation to a revised estimated economic life of nineteen years.

The evolution of our industry from a regulated to a market-driven business is causing great insecurity amongst the airlines and the investment community. Regulation has left the major Canadian carriers in an unequal market position with each having their own strengths and weaknesses. Wardair's advantages are a combination of low operating costs and a reputation for quality service. We intend to maintain these strengths in the years ahead.

During the year, Mr. Thomas L. Spalding retired from active service after fifteen years of outstanding contribution in his capacities as Executive Vice President, and Senior Vice President and Chief Financial Officer. Mr. Spalding will continue to give valuable advice to the Company in his role as consultant and member of the Board of Directors. Captain A.B. Freeman, Vice President, Flight Operations, also retired in 1985. During his twenty years with the Company, Captain Freeman provided the excellent flight standards and leadership which successfully carried Wardair into the jet age.

On behalf of the shareholders, I would like to acknowledge my sincere appreciation for the dedication and commitment of the management and employees who carry out the work of the Company. These are the individuals who, through their effort, abilities and personal sacrifice provide the spirit of caring that is truly Wardair.

For the Board of Directors,

Maxwell W Ward

Maxwell W. Ward

Chairman and
Chief Executive Officer.

Personalized, responsive service is evidence of a very important value —customer choice.

Review of Operations

Sales and Marketing

General

During 1985, Wardair carried a record 1,567,000 passengers which represented an increase of almost 5 percent over the previous year. Revenue passenger miles totalled 4,215 million showing a similar increase, however, an improvement in airfare yields produced passenger revenues of $374,982,000 which was approximately 10 percent above the 1984 level.

Our positioning as Canada's Holiday Airline was further expanded through the successful promotion of packaged vacations and land arrangements sold in conjunction with individual travel. This important sector of our business grew by 43 percent over last year, contributing $62,534,000 to our gross revenues.

A new element of Wardair service to the travelling public was introduced on December 9, 1985, with the beginning of our scheduled flights between Canada and the United Kingdom. This new service did not significantly impact our financial results during the year but we are confident it will become a major factor in the years ahead.

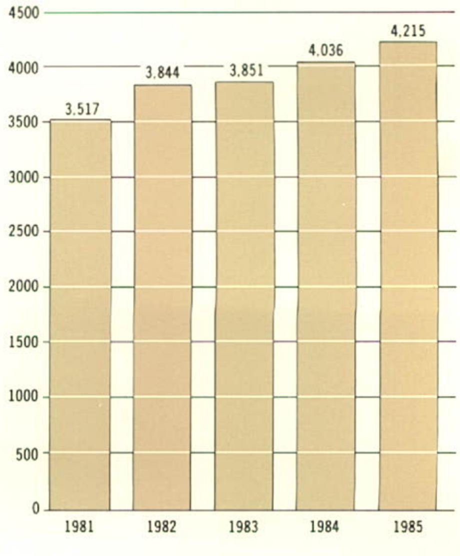
United Kingdom and Europe

Wardair continued to occupy a dominant position as the major charter carrier between Canada and the United Kingdom during 1985. While our trips from Western Canada concentrated on Prestwick, Manchester and London, the Eastern Canadian operations added Birmingham, Cardiff and Newcastle to the above-noted destinations, thereby maintaining our presence in the provinces and ensuring our continued high profile in the United Kingdom travel market.

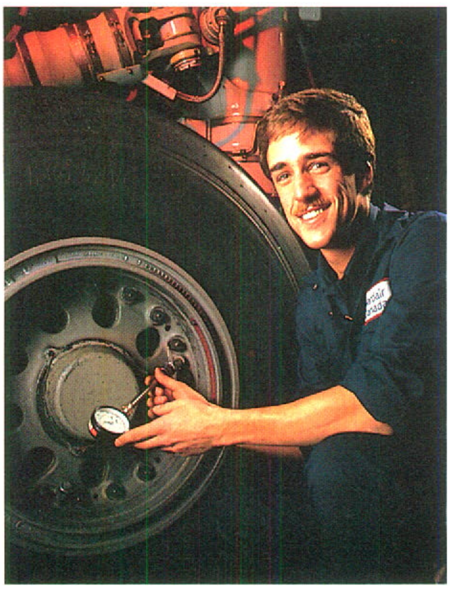
Our charter flights to Amsterdam, Frankfurt and Paris were successfully marketed on both sides of the Atlantic, although the relative weakness of the United Kingdom and European currencies again resulted in a heavy contribution of traffic from Canada. By year end it was evident there would be a strengthening of both the pound and deutschmark and it seems likely this imbalance will be corrected, if not reversed, in 1986.

Together with a consortium of prominent Canadian-based tour operators, Wardair flew a profitable program to Malaga, on Spain's Costa del Sol, using B747 equipment. We were pleased to return to this popular destination and would like to include Spain as a permanent summer route. We were also pleased with the enthusiastic reception given to our Rome and Lamezia flights by the Canadian/Italian communities. This was the second year of our participation in this program and we were encouraged by the positive reaction amongst the participants.

Revenue Passenger Miles
(Millions of Miles)



Wardair has one of the best on-time departure records in the industry.



Review of Operations

Hawaii

A very successful first quarter ensured 1985 was the Company's best year in a long history of flying to Hawaii. We carried over 276,000 passengers during the year, representing an increase of 8.8 percent over 1984. Despite a weakening demand in the fourth quarter, revenues improved over the previous year, keeping Hawaii our number two destination. According to the Hawaiian Visitors Bureau, our market share was 57 percent of all Canadian traffic.

The competitive situation became a concern in the fourth quarter as total capacity offered by all airlines operating from Canada increased substantially over the same period in 1984. This excess capacity brought significant pressure on pricing; however, Wardair managed to protect its yield through the availability and wide selection of well priced land products.

The Caribbean and Mexico

The Mexican market was very strong during the first quarter of 1985, in terms of passenger numbers. However, the fourth quarter demand was adversely affected by the September earthquake. We are confident Mexico will recover from this unfortunate incident to regain its preferred position with Canadian vacationers.

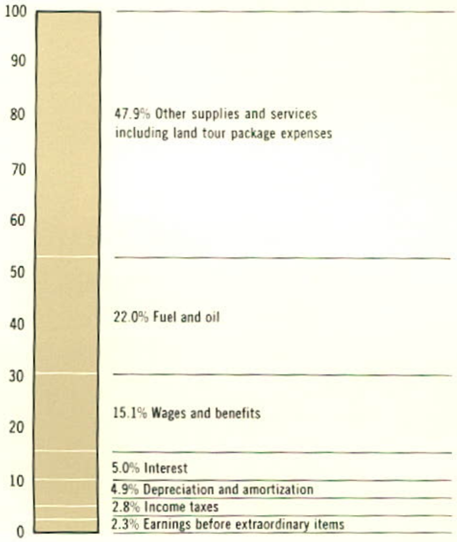
Travel to the Caribbean was stable throughout the year. The commencement of our scheduled flights to San Juan occurred on November 5, 1985 and will be continued twice weekly until the spring of 1986. We expect to operate year round to Puerto Rico once appropriate medium-range aircraft for our domestic service has been selected.

In an ongoing effort to explore new markets, the Company offered programs to Nassau and Grand Cayman under the "Wardair Holidays" banner. This required the contracting of seats on other carriers; however, the expansion of our market share to these destinations should allow the utilization of Wardair equipment in the years ahead.

Florida

Traffic to Florida demonstrated robust growth during most of the year. Our research suggested this sunspot had the greatest potential for improvement in 1985. An aggressive, multi-media campaign co-ordinated with the Florida Tourist Board was designed to stimulate demand in the fourth quarter. The campaign surpassed its objectives to the extent our passenger traffic showed an increase of 21.5 percent over 1984. For the first time, a wide range of accommodation was offered throughout Florida to meet the needs of the individual traveller. The results of this season bode well for the future.

Distribution of 1985 Revenue
(Earnings before extraordinary items)



Every air cargo shipment receives efficient, reliable service at competitive rates.

Review of Operations

Canada Domestic Operations

Wardair enjoyed a modest 10 percent increase in traffic on its Domestic routes to a total of 272,700 passengers. Although some price stimulation was required during the off-peak season, satisfactory yields were maintained. Expansion of this business is limited by our ability to allocate aircraft resources to this market without detracting from our traditional flight patterns. Revenues from the domestic zone now account for one-eighth of our total passenger revenues.

Cargo

Our 1985 cargo operation produced a healthy increase in volume for the third consecutive year. All market areas contributed to this growth pattern but the most significant expansion occurred on our North Atlantic routes which saw our income nearly double over 1984 level as a result of further relaxation of government restrictions.

We believe this increase can be attributed to a greater awareness of Wardair's involvement in the air-cargo markets and of our utilization of interline opportunities.

With the introduction of scheduled service to the United Kingdom and a successful application for scheduled authority within Canada, another substantial increase in cargo revenue is anticipated.

Duty-Free

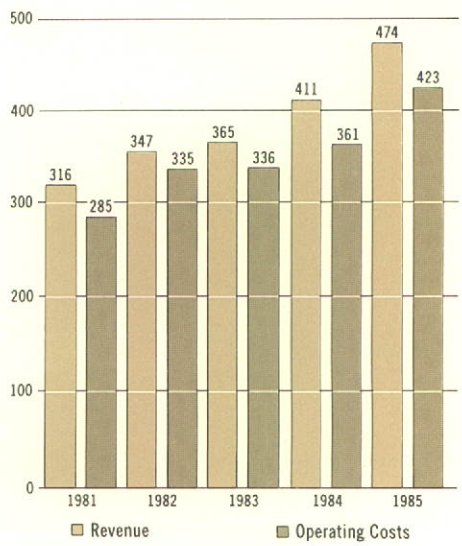
1985 marked the completion of the first calendar year of our in-flight, duty-free retail operations. The program has proven to be a popular service with the majority of our passengers and is providing a significant contribution to operations.

In November, 1985, Wardair expanded its service by initiating a unique ReSerVed Products program (RSVP) on all international routings. This program allows consumers to preselect their choice of merchandise from a wide range of duty-free products for purchase on board the aircraft. The preselection is arranged by telephoning our reservations office prior to travel. Response from passengers and the travel trade has been positive.

Contract Services

Wardair continued to expand its outside contract activities in 1985. Passenger handling functions were performed in Canada and the United States for several international carriers. The Company also provided hangarage and maintenance services for various international and domestic operators at its office/hangar facilities at Toronto's Lester B. Pearson International Airport. These contracts included storage of aircraft, line and repair maintenance functions and installation of hush kits on DC8 aircraft.

Revenue and Operating Costs
(Millions of Dollars)



The Company strives for the best and freshest food for Wardair Class in-flight meals.

Review of Operations

Redrock Reinsurance Limited (Bermuda)

Redrock Reinsurance Limited, a wholly-owned subsidiary of Wardair Canada Inc., had another profitable year in 1985. Managed by Insurance Managers Ltd., of Hamilton, Bermuda, Redrock reinsures certain lines of travel related insurance issued by primary underwriters, such as passenger cancellation, baggage liability, medical and accident coverages.

Employee Relations

The ever-changing nature of the airline industry has continued to generate many competitive issues which prove to be a challenge to both the Company and its employees. To be successful in the service industry, we must maintain a balance between the expectations of our employees, our customers and our shareholders.

By continuing to focus on productivity, efficiency and service, the Company will be well positioned to address the opportunities presented by deregulation and deal with the critical challenges of providing an appropriate level of employee compensation, achieving safe, comfortable working conditions and optimizing job security.

One of our major objectives is to provide the means by which our employees can have a greater awareness of the economic performance of their Company. We believe this awareness will generate the employee support necessary to successfully deal with the competitive environment in which we now find ourselves.

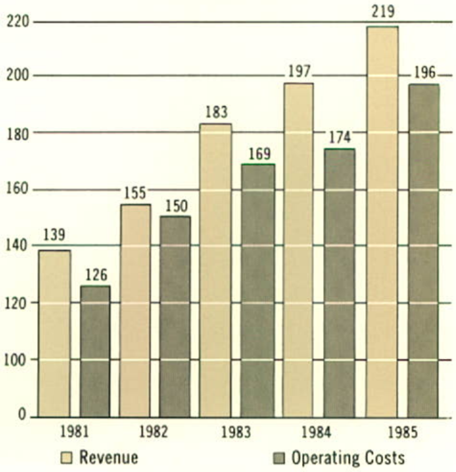
Collective bargaining in 1985 generated contracts expiring in 1987 with the Canadian Air Line Flight Attendants' Association, the International Association of Machinists and Aerospace Workers and the reservation and sales agents, who are represented by the Canadian Association of Passenger Agents and the Brotherhood of Railway and Airline Clerks.

A review of the compensation levels for non-unionized staff is scheduled for July 1, 1986 and negotiations for new collective agreements covering airport passenger services staff and flight crew members will commence this summer and fall respectively.

For the Board of Directors,

George D. Curley,
President and
Chief Operating Officer

Revenue/Employee Versus Operating Cost/Employee
(Thousands of Dollars)



The Corporation's "wings of excellence" symbolize commitment to safety, reliability and quality.

Consolidated Statement of Earnings

Year ended December 31, 1985

(thousands of dollars)	**1985**	1984
Revenue	**$473,856**	$410,879
Expenses		
Operating	**300,706**	254,646
Marketing and administration	**102,029**	85,518
Depreciation	**17,893**	20,512
Amortization of deferred charges	**2,561**	632
	423,189	361,308
Earnings from operations	**50,667**	49,571
Interest expense (note 5)	**23,511**	25,663
Amortization of deferred foreign exchange losses	**2,850**	3,350
Fuel surtax recovery	**—**	(3,960)
	26,361	25,053
Earnings before income taxes and extraordinary items	**24,306**	24,518
Income taxes (note 6)		
Current	**—**	3,537
Deferred	**13,280**	11,293
	13,280	14,830
Earnings before extraordinary items	**11,026**	9,688
Extraordinary items (note 7)	**—**	40,784
Net earnings for the year	**$ 11,026**	$ 50,472
Earnings per share		
Earnings before extraordinary items	**$3.07**	$ 2.70
Net earnings for the year	**$3.07**	$14.07

Consolidated Statement of Retained Earnings

Year ended December 31, 1985

(thousands of dollars)	**1985**	1984
Retained earnings (deficit) at beginning of year	**$ 17,849**	$ (32,623)
Net earnings for the year	**11,026**	50,472
Retained earnings at end of year	**$ 28,875**	$ 17,849

Consolidated Balance Sheet

as at December 31, 1985

(thousands of dollars)	**1985**	1984
Assets		
Current assets		
Cash and short term investments (note 2)	**$ 50,840**	$ 65,767
Accounts receivable	**7,438**	4,617
Inventories	**16,533**	15,750
Prepaid expenses	**3,783**	2,815
	78,594	88,949
Property and equipment (note 3)	**246,704**	251,431
Deferred charges (note 4)	**14,743**	4,300
	$340,041	$344,680
Liabilities		
Current liabilities		
Bank indebtedness (note 5)	**$ 8,359**	$ 7,412
Accounts payable and accrued liabilities	**38,128**	41,313
Passenger prepayments	**47,638**	46,292
Principal due within one year on long term debt	**28,891**	47,968
	123,016	142,985
Long term debt (note 5)	**161,298**	170,273
Deferred income taxes	**24,893**	11,614
	309,207	324,872
Shareholders' Equity		
Share capital		
Authorized		
80,000,000 Common shares without nominal or par value		
Issued		
3,587,570 Common shares	**1,959**	1,959
Retained earnings	**28,875**	17,849
	30,834	19,808
	$340,041	$344,680

Approved by the Board

Director

Director

Consolidated Statement of Changes in Financial Position

Year ended December 31, 1985

(thousands of dollars)	**1985**	1984
Funds provided by (used for)		
Operating activities		
Earnings before extraordinary items	**$ 11,026**	$ 9,688
Items not involving funds		
Depreciation	**17,893**	20,512
Amortization	**5,411**	3,982
Deferred income taxes	**13,280**	11,293
Cash flow from operations	**47,610**	45,475
Change in working capital	**(7,857)**	3,640
	39,753	49,115
Financing activities		
Long term borrowing	**162,813**	—
Repayment of long term debt	**(202,854)**	(19,291)
Payments arising on asset re-organization	**—**	(8,039)
	(40,041)	(27,330)
Investing activities		
Property and equipment	**(13,335)**	(5,582)
Reservations system development	**(2,455)**	—
Other	**(1,142)**	53
	(16,932)	(5,529)
Increase (decrease) in funds	**(17,220)**	16,256
Funds (deficiency) at beginning of year	**12,063**	(4,193)
Funds (deficiency) at end of year	**$ (5,157)**	$12,063
Funds are comprised of:		
Cash and short term investments	**$ 50,840**	$65,767
Bank indebtedness	**(8,359)**	(7,412)
Passenger prepayments	**(47,638)**	(46,292)
	$ (5,157)	$12,063

KMG Thorne Riddell

Auditors' Report

To the Shareholders of
Wardair International Ltd.

We have examined the consolidated balance sheet of Wardair International Ltd. as at December 31, 1985 and the consolidated statements of earnings, retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Company as at December 31, 1985 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Thorne Riddell

Toronto, Canada
February 28, 1986

Chartered Accountants

Year ended December 31, 1985

1. Summary of significant accounting policies

(a) Consolidation
The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, other than Wardair Equipment Ltd. from July 1, 1984.

(b) Foreign exchange
The operations of foreign subsidiaries are considered to be integrated with those of the Company. Accordingly, all foreign currency amounts are translated into Canadian dollars on the following basis:

> Fixed assets, related depreciation, and other non-monetary items, at the rates of exchange in effect at the dates of acquisition;
>
> Other assets and liabilities, at the rate in effect at the balance sheet date or the hedged rate; and
>
> Revenues and expenses, other than charges for depreciation and amortization of non-monetary assets, at average rates of exchange or hedged rates in effect during the period.

Foreign exchange gains and losses are reflected in earnings in the year in which they arise except those relating to monetary items with an initial fixed life exceeding one year which are amortized over the remaining life of the item.

(c) Inventories
Inventories are valued at the lower of cost and replacement cost less a provision for obsolescence.

(d) Property and equipment and overhaul costs
Property and equipment is stated at cost. Significant expenditures for modifications are capitalized. Upon retirement or disposal of equipment, the related cost and accumulated depreciation are removed from the accounts and the gain or loss is reflected in earnings.

Depreciation is computed by the straight-line method as follows:

> Jet aircraft and related equipment — effective January 1, 1985, the estimated useful life was revised from sixteen to nineteen years with a 15% residual. The undepreciated balance at that date is depreciated over the remaining useful life.
>
> Other property and equipment — at various rates over the estimated useful life of the asset.

Major airframe overhaul costs are capitalized in the year incurred and amortized over the period to the next scheduled overhaul. Aircraft engine overhaul costs are expensed in the year incurred.

(e) Deferred charges
Deferred charges, other than deferred foreign exchange gains and losses, are amortized on the straight-line method over various periods up to ten years.

(f) Airfare revenues and direct costs
The Company recognizes airfare revenues and related direct costs at the departure date of each flight.

(g) Income taxes
Provision is not made for income taxes which would be payable on the transfer to Canada of earnings considered to be permanently invested in foreign subsidiaries.

Investment tax credits are accounted for by the cost reduction method whereby the tax credits reduce the cost of assets acquired. Prior to 1985, the Company followed the flow-through method of accounting for these credits whereby they were included in earnings when received. The effect of this change in accounting policy in 1985 is not material.

(h) Pensions
Adjustments arising from actuarial revaluations are recognized in earnings while the costs of pension plan amendments are deferred and amortized over the lives of the work force. Actuarial pension liabilities, determined as at December 31, 1984, are fully funded.

2. Cash and short term investments

Short term investments includes $38,522,000 set aside as segregated securities to meet passenger prepayment obligations.

Year ended December 31, 1985

3. Property and equipment	1985	1984
	(thousands of dollars)	
Flight equipment	**$342,245**	$332,839
Land, buildings and ground equipment	**56,951**	54,135
	399,196	386,974
Less accumulated depreciation	**152,492**	135,543
	$246,704	$251,431

4. Deferred charges	1985	1984
	(thousands of dollars)	
Foreign exchange losses on long term monetary items	**$ 8,454**	$ 788
Reservations system development	**2,989**	2,986
Pension plan amendment	**1,383**	—
Other	**1,917**	526
	$ 14,743	$ 4,300

5. Long term debt and bank indebtedness	1985	1984
	(thousands of dollars)	
Syndicated term loan, due 1992 (1984, secured debentures)	**$140,966**	$164,291
Hangar loan, due 1995	**25,000**	19,350
Conditional sales contract, due 1988	**16,219**	20,440
Other long term debt	**8,004**	14,160
	190,189	218,241
Less principal due within one year	**28,891**	47,968
	$161,298	$170,273

(a) Syndicated term loan
The syndicated term loan is secured by a $200,000,000 bond providing a first fixed charge on all assets of the Company subject to the priority on the assets pledged to secure the conditional sales contract and the hangar loan.

The loan agreement provides the Company with an ongoing option to borrow funds in Canadian dollars, United States dollars and to a limited extent in pounds sterling. As at December 31, 1985, the term loan includes $128,406,000 payable in United States dollars.

The interest rate, which at December 31, 1985 averaged 9.9%, varies according to the currency in which the loan is denominated and the Company's debt to equity ratio. The Company may fix the interest rate on a limited portion of the loan.

(b) Hangar loan
This loan is secured by a mortgage on the office and hangar facilities and leasehold interest in land and a fixed charge upon two aircraft engines.

The loan bears interest at prime until 1987 which at December 31, 1985 was 10% and thereafter bears interest at prime plus 1/2%. The Company has the option of fixing the interest rate on the loan for periods up to five years based on commercial mortgage rates.

(c) Conditional sales contract
The 8.25% conditional sales contract is payable in United States dollars. It is secured by one McDonnell Douglas DC-10 series 30 aircraft together with installed engines and auxiliary equipment.

(d) Other long term debt
These notes and term loans due 1986 to 2005, are secured by various charges on the assets of the Company with interest at varying fixed and floating rates which at December 31, 1985 have a weighted average of 10.3%.

Year ended December 31, 1985

5. Long term debt and bank indebtedness (cont'd)

(e) Additional information

The bank indebtedness is secured by a $10,000,000 bond providing for identical security to the syndicated term loan.

The various debt agreements contain restrictions and covenants, the most significant of which are:

(i) limitations on additional indebtedness;

(ii) requirement that the appraised value of pledged aircraft and engines be 135% of the outstanding debt;

(iii) requirement to maintain shareholders' equity of at least $20,000,000; and

(iv) restriction on payment of annual dividends to 25% of net earnings of the preceding year.

Principal due on long term debt in the years 1986 to 1990 is approximately $28,891,000; $28,896,000; $28,902,000; $24,690,000 and $24,697,000 respectively.

Interest expense on long term debt amounts to $23,096,000 (1984, $25,128,000).

6. Income taxes

Total income tax expense varies from the amounts that would be computed by applying the Canadian federal and provincial tax rates to income before income taxes for the following reasons:

	1985	1984
	(thousands of dollars)	
Canadian federal and provincial tax rates	**48.8%**	48.2%
Tax based upon earnings before income taxes	**$11,865**	$11,818
Increase (decrease) results from:		
Non-deductible interest	**—**	3,147
Non-deductible foreign exchange losses	**778**	1,575
Non-deductible expenses	**793**	—
Investment tax credits	**—**	(1,108)
Other	**(156)**	(602)
	$13,280	$14,830

7. Extraordinary items

An internal re-organization involved the transfer of assets between wholly-owned subsidiaries, the conversion of income debentures to conventional debt and the withdrawal of corporate support to the transferor upon cessation of its business. The adjustments to earnings to effect the foregoing, including the deconsolidation of the transferor at July 1, 1984, are as follows:

	1984
	(thousands of dollars)
Reduction of deferred income taxes less current taxes payable of $7,239,000	$54,627
Foreign exchange losses, financing and re-organization costs, less deferred tax reductions of $400,000	(13,843)
	$40,784

Notes to Consolidated Financial Statements

Year ended December 31, 1985

8. Commitments

The Company has obligations under long term operating leases for computer equipment, offices and airport facilities. The aggregate minimum rentals under these leases in each of the years 1986 to 1990 are $5,374,000, $4,830,000, $4,285,000, $4,069,000 and $3,932,000 respectively and an aggregate of $8,853,000 thereafter to the year 2000.

The Company has entered into forward contracts to buy United States dollars and sell pounds sterling for United States dollars in order to hedge certain of the Company's sterling denominated revenues and United States dollar liabilities.

9. Segmented information

The Company considers its international travel and airline operations to be the dominant segment of its business.

Revenue from sales originating in foreign countries approximated $52,400,000 in 1985 (1984, $53,600,000).

Management Report

Management is responsible for the preparation and presentation of the accompanying consolidated financial statements and other information in the Annual Report. The preparation of the financial statements requires the use of estimates based on careful judgements and the selection of appropriate generally accepted accounting principles. Financial information presented elsewhere in this Annual Report is consistent with that in the financial statements.

To assure the integrity and objectivity of the financial statements, management has established systems of internal control which provide reliable accounting records and properly safeguard Company assets. The financial statements have been audited by our independent auditors, Thorne Riddell, whose report outlines the scope of their examination and their opinion on the financial statements.

The Board of Directors appoints an audit committee from among its members to oversee the responsibility of management for financial reporting and to meet with management and the external auditors in order to gain assurance that management is carrying out its responsibilities. This committee reviews the financial statements and report of the external auditors and reports its findings to the Board of Directors for its consideration when approving the financial statements for issuance to shareholders.

T.S. Currie,
Vice President, Finance

G.D. Curley,
President and Chief Operating Officer

Five Year Summary

(thousands of dollars)	1985	1984	1983	1982	1981
Financial					
Revenue	**$473,856**	$410,879	$364,543	$346,531	$315,656
Operating costs	**423,189**	361,308	336,075	334,560	284,876
Earnings from operations	**50,667**	49,571	28,468	11,971	30,780
Interest expense	**23,511**	25,663	20,705	25,604	24,264
Amortization of foreign exchange losses	**2,850**	3,350	3,293	4,308	1,716
Fuel surtax (recovery)	**—**	(3,960)	1,056	(4,530)	7,434
(Gain) loss on sale of aircraft and related equipment	**—**	—	—	—	(1,219)
Earnings (loss) before the undernoted	**24,306**	24,518	3,414	(13,411)	(1,415)
Provision for income taxes					
Current	**—**	3,537	—	—	—
Deferred	**13,280**	11,293	9,162	1,970	9,640
	13,280	14,830	9,162	1,970	9,640
Earnings (loss) before extraordinary items	**11,026**	9,688	(5,748)	(15,381)	(11,055)
Extraordinary gain (loss)	**—**	40,784	—	(597)	—
Net earnings (loss)	**$ 11,026**	$ 50,472	$ (5,748)	$(15,978)	$(11,055)
Dividends					
Preference shares of subsidiary company	**—**	—	—	—	—
12% preferred	**—**	—	—	—	$ 180
Common	**—**	—	—	—	394
Total dividends	**—**	—	—	—	$ 574
Long term debt	**$190,189**	$218,241	$225,823	$239,212	$262,209
Deferred income taxes	**24,893**	11,614	62,586	53,424	52,050
Shareholders' equity (deficiency)	**30,834**	19,808	(30,664)	(24,916)	(8,638)
Capital employed	**$245,916**	$249,663	$257,745	$267,720	$305,621
Depreciation and amortization	**$ 23,304**	$ 24,494	$ 27,561	$ 25,655	$ 21,562
Cash flow from operations	**$ 47,610**	$ 45,475	$ 30,975	$ 12,509	$ 18,928
Additions to property and equipment	**$ 13,335**	$ 5,582	$ 3,301	$ 11,188	$ 84,170
Decrease (increase) in long term debt	**$ 40,041**	$ 19,291	$ 15,842	$ 18,787	$ (50,624)
Operating margin	**10.7%**	12.1%	7.8%	3.5%	9.7%
Per share data (in dollars)					
Earnings (loss) before extraordinary items	**$ 3.07**	$ 2.70	$ (1.72)	$ (4.68)	$ (3.36)
Net earnings (loss)	**$ 3.07**	$ 14.07	$ (1.72)	$ (4.86)	$ (3.36)
Dividends	**—**	—	—	—	$ 0.12
Operating					
Passengers carried	**1,566,625**	1,499,057	1,482,200	1,383,900	1,251,800
Revenue passenger miles (000's)	**4,215,420**	4,035,952	3,851,200	3,843,500	3,517,200
Aircraft miles (000's)	**14,314**	12,823	12,365	13,682	12,317
Aircraft hours	**30,048**	26,949	26,198	29,183	26,224
Personnel					
Average number of employees	**2,159**	2,081	1,992	2,234	2,264
Employee wages and benefits (000's)	**$ 71,754**	$ 63,551	$ 60,206	$ 60,620	$ 55,524
Share Information (excludes preferred shares)					
Common shares issued	**3,587,570**	3,587,570	3,587,570	3,287,570	3,287,570
Shares held by Canadian residents	**97.77%**	99.43%	99.55%	99.53%	99.48%
Total number of shareholders	**1,639**	1,662	1,538	1,552	1,524

Board of Directors

Maxwell W. Ward
Chairman and Chief Executive Officer, Wardair International Ltd.

G.D. Curley*
President and Chief Operating Officer, Wardair International Ltd.

T.L. Spalding*
Consultant, Spalding Associates

M.D. Ward
Vice President, Wardair International Ltd.

K.M. Ward
Vice President, Customer Services, Wardair International Ltd.

J.N. Hyland*
Corporate Director

L.R. Duncan*
Partner, Duncan Collins

M.J. Brown
President, Ventures West Management Inc.

*member of audit committee

Officers and Senior Management

Maxwell W. Ward, *Chairman and Chief Executive Officer*
G.D. Curley, *President and Chief Operating Officer*
B. Walker, *Senior Vice President, Sales and Marketing*
M.D. Ward, *Vice President*
T.S. Currie, *Vice President, Finance*
K.M. Ward, *Vice President, Customer Services*
I.C. Wilkie, *Vice President, Corporate and Legal Affairs, and Secretary-Treasurer*
A.K. Willard, *Vice President, Human Resources*
D.W. Rouse, *Executive Assistant to the Chairman*
B.R. Corbett, *Director, Industrial Relations*
R.N. Driscoll, *Director, Tax Planning*
E.R. Lysyk, *Director, Corporate Security and Safety*
L.B. Menzies, *Director, Strategic Planning*
J.E. Murray, *Director, Internal Audit*
J.W. Ormiston, *Director, Financial Planning*
J.L. Shaffer, *Director, Customer Relations and Consumer Affairs*
W.C. Thompson, *Director, Financial Operations*
G.L. Tibbles, *Director, Corporate Administration and Insurance*

Corporate Information

Head Office: *325 ManuLife Place, 10180-101 Street, Edmonton, Alberta, T5J 3S4*

Principal Operating Offices: *Lester B. Pearson International Airport, 3111 Convair Drive, Mississauga, Ontario, L5P 1C2*

Shares Listed: *The Toronto Stock Exchange*

Auditors: *Thorne Riddell*
Toronto, Ontario

Registrar and Transfer Agent: *Montreal Trust Company*
Edmonton, Toronto, Vancouver, Calgary and Montreal

Principal Banker: *Toronto-Dominion Bank*

Officers and Senior Management

Wardair Canada Inc.

Maxwell W. Ward
Chief Executive Officer

G.D. Curley
President and Chief Operating Officer

B. Walker
Senior Vice President, Sales and Marketing

M.D. Ward
Vice President

T.S. Currie
Vice President, Finance

C.D. McNiven
Vice President, Maintenance & Engineering

D.V. Nicholson
Vice President, Flight Operations

W. R. O'Hara
Vice President, Cargo Sales

K.M. Ward
Vice President, Customer Services

I.C. Wilkie
Vice President, Corporate & Legal Affairs, and Secretary-Treasurer

P.W. Bolton
Director, Cabin Services

J.V. Gordon
Director, Passenger Services

A.H. Graham
Director, Operations Control

A.W. Jackman
Director, Crew Scheduling

M.J. Kozak
Director, Catering Services

J.H. Mills
Director, Quality Control

T.F. Nord
Director, Engineering and Maintenance Production

J.F. Woodhall
Director, Maintenance and Contract Sales

†Wholly-owned subsidiary of Wardair Canada Inc.

International Vacations Ltd.

Maxwell W. Ward
Chief Executive Officer

G.D. Curley
President and Chief Operating Officer

B. Walker
Senior Vice President, Sales and Marketing

M.D. Ward
Vice President

T.S. Currie
Vice President, Finance

K.M. Ward
Vice President, Customer Services

I.C. Wilkie
Vice President, Corporate & Legal Affairs and Secretary-Treasurer

M.J. Braley
Director, Marketing Communications

P.W. Jenkins
Director, Marketing

S.A. Taggart
Director, Product Development

Wardair (U.K.) Limited

Maxwell W. Ward
Chairman

A.I. Mayer
Managing Director

S.G. Hoad
Joint Secretary

T.S. Currie
Joint Secretary

Wardair Hawaii, Limited

Maxwell W. Ward
President

G.D. Curley
Vice President

I.C. Wilkie
Secretary-Treasurer

P.B. Gard
General Manager

Wardair Holidays (Deutschland) GmbH

K. Uhlmann
Managing Director

Wardair (france) S.A.R.L.

K. Uhlmann
Managing Director

Redrock Reinsurance Limited † (Bermuda)

R.D. Spurling
Director and President

S.W. Kempe
Director

G.D. Curley
Director

F.C. White
Director

Wardair Leasing Inc.

Maxwell W. Ward
President

R.N. Driscoll
Vice President and General Manager

WARDAIR W

* North Magnetic Pole
Resolute
Pond Inlet
Inuvik
Fairbanks
Dawson
Coppermine
Gjoa Haven
Anchorage
Mackenzie
Whitehorse
Yellowknife
Baker Lake
Juneau
Frob
Churchill
Fort Nelson
Fort Chimo
Prince George
Edmonton
Churchill
Nelson
Saskatoon
Vancouver
Calgary
Regina
Victoria
Seattle
Winnipeg
Moosonee
Goose Bay
Thunder Bay
Sept Iles
Portland
Columbia
Québec City
Ottawa
Montréal
Charlottetown
Missouri
Minneapolis
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Saint John
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Mexico City
Acapulco
Montego Bay
San Juan
Barbados
San Salvador
Managua
Panama
Caracas
Port-of-Spain
San Jose
Pacific Ocean
Orinoco
Georgeto
Bogota

ORLDWIDE


Murmansk
Archangel
ay
Godthåb
Angmagssalik
Reykjavik
Nanortalik
Helsinki
Stockholm
Oslo
Leningrad
Moscow
Prestwick
Newcastle
Belfast
Leeds-Bradford
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Warsaw
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Cardiff
London (Gatwick)
Rhine
Kiev
Frankfurt
Gander
St. John's
Paris
Vienna
Dnepr
Danube
Odessa
Monte Carlo
Belgrade
Rome
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Madrid
Ankara
Lisbon
Athens
Tangier
Algiers
Tripoli
Casablanca
Jerusalem
Alexandria
Cairo
Atlantic Ocean
Nile
Nowakchott
Timbuktu
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