Sales: $192.7 versus $159.2 – 21% gain
Net profit: $10.9 versus $7.4 – 47% increase
Working capital: $40.0 versus $24.2 – up 65%
After tax return on equity: 20%
Earnings per share: $2.43 versus $2.06 – up 18%
(845,000 shares issued in 1981)

Federal Industries Ltd.

Federal Industries is a Canadian-controlled, diversified transportation company, with Head Office located in Winnipeg, Canada. Through wholly owned subsidiaries, it provides truck, ocean and rail services to Western Canada, services other transportation systems through a bulk transshipment terminal, and remanufactures and distributes aerospace products.

Current operations are grouped into three divisions: Aerospace, Terminals and Transport. The Company has annual sales in excess of $192 million and assets of $206 million. Ninety two percent of the 4,789,774 shares are owned by residents of Canada and are traded on the Toronto and Winnipeg Stock Exchanges.

Contents

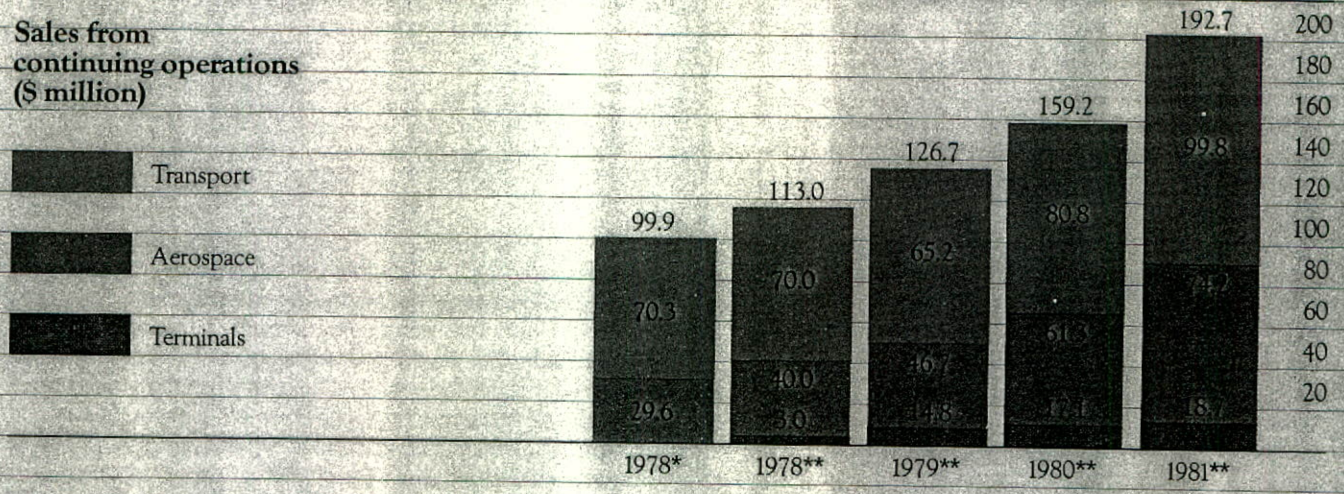
Annual Meeting

The Annual Meeting of the Shareholders will be held at the Westin Hotel, Two Lombard Place, Winnipeg, Manitoba, on May 7, 1982 at 4:30 p.m.

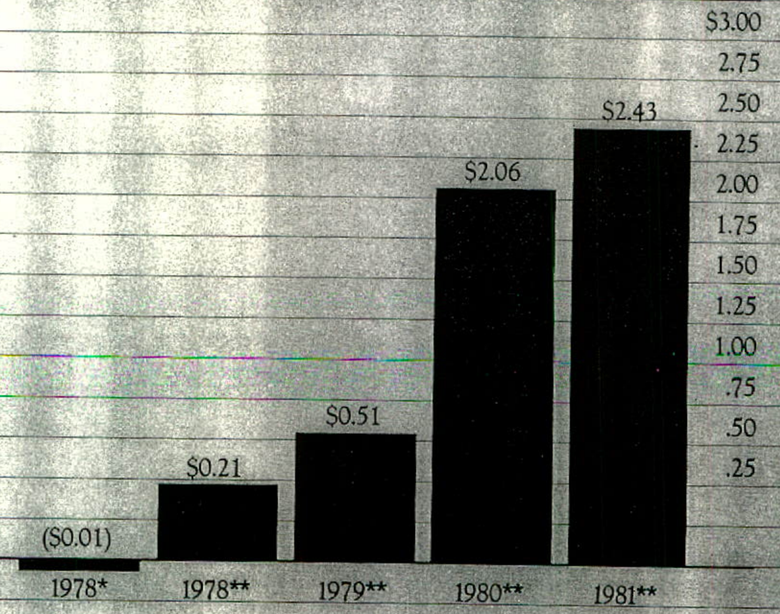
Financial highlights

	December 1981 12 Months ($ Million)	December 1980 12 Months ($ Million)
Sales	**192.7**	159.2
Earnings before interest, taxes and extraordinary items	**29.3**	23.7
Interest Charges	**7.6**	8.7
Net Income before Extraordinary Items	**10.9**	7.4
Net Income after Extraordinary Items	**10.9**	7.1
Working Capital	**40.0**	24.2
Earnings per Share before Extraordinary Items	**$ 2.43**	$ 2.06
Earnings per Share after Extraordinary Items	**$ 2.44**	$ 1.98
Equity per Class A and Class B share	**$15.65**	$13.95

Sales from continuing operations ($ million)



Earnings per share before extraordinary items



*12 months ended March 31
**12 months ended December 31

Report to Shareholders

1981 was the second successive record year for your Company with all Divisions reporting strong gains in sales and profits.

Net earnings for the year ended December 31, 1981 increased by 47% to $10,914,000 from $7,407,000 in 1980. Earnings per share increased by 18% to $2.43 from $2.06 in the previous year, reflecting the 845,768 additional common shares issued during 1981. A net extraordinary gain of $24,000 or 1 cent per share increased earnings for 1981 to $10,938,000 or $2.44 a share. In 1980 a net extraordinary loss of $290,000 or 8 cents per share reduced earnings to $7,117,000 or $1.98 per share.

Consolidated sales rose 21% to $192,690,000, reflecting new highs in all Divisions of your Company. Working capital improved by 65% to $40,048,000, mainly as a result of a 37% increase to $18,709,000 in cash flow from operations and the $9,600,000 raised in May from the fully-subscribed rights issue. Possibly of greatest importance to shareholders is the achievement of a 20% after-tax return on common equity, up from 16.9% in 1980.

Aerospace Division

Operating earnings of Standard Aero Limited increased by 26% to $12.4 million, on a 21% increase in sales to $74.2 million.

Although all Standard Aero divisions reported sales increases, the greater proportion flowed from the distribution of aviation parts and accessories, and from military overhaul work. A concentrated sales effort, primarily in export markets, increased distribution receipts by over 20%. Military overhaul sales increased by 47%, reflecting continuing growth in our activity with the armed forces. Commercial overhaul sales were up 12%, with this relative sluggishness reflecting the general slowdown in helicopter activity in Canada and the worldwide shortage of parts for aircraft engines overhauled by the company.

The Federal Government's long-awaited energy settlement with the Province of Alberta has not produced the anticipated return to activity in the oil and gas exploration field. As a result, Standard Aero's business from this sector has remained at a reduced level, and although the effect to date on earnings has not been material, the matter is of future concern.

By and large, the company is not seriously affected by short-term economic trends because of its diverse customer base, and because these customers are engaged primarily in activities that are not related directly to the consuming public. Accordingly, Standard Aero is able to plot a future course that is less significantly affected by cyclical fluctuations, resulting in consistent and positive growth.

Terminals Division

Sales and earnings at Thunder Bay Terminals Ltd. rose modestly, primarily because Ontario Hydro, the company's predominant customer, has not increased its use of Western Canadian thermal coal owing to a current excess load capacity. The company completed its expansion to provide a supplementary handling system to transfer lignite to the adjacent Mission Island electrical generating station, and product movement began in mid-1981. However, this new tonnage was offset by shortfalls in expected tonnage of other Ontario Hydro coal, with rate increases improving the net financial contribution.

Of particular importance was the movement of substantial quantities of non-coal commodities. Over 650,000 tonnes of potash and 17,000 tonnes of corn were transshipped during the year, and management is aggressively pursuing the permanent handling of these tonnages. A major marketing effort is continuing to identify and acquire further product diversification for this Division.

Transport Division

The White Pass and Yukon Corporation Limited operational earnings increased by more than 50% on sales gains of 24% during the year. This substantial and encouraging profit growth, primarily the result of improved earnings in the petroleum and marine divisions, was achieved despite the adverse impact of several events, including a four-week rail strike, spring road bans in Yukon for the first time and recurring production difficulties of the company's major customer, Cyprus Anvil Mining Corporation. While these improvements are gratifying and are expected to continue, the rail division on a fully-allocated cost basis, experienced further substantial losses.

Three factors are critical if rail operations are to be made profitable: increased traffic, reduced costs and achieving and maintaining compensatory tariffs. The key factor for long-term profitability is greater volume. Volume increases may come from the development of new mines, expanded production at Cyprus Anvil, or through the proposed Alaska Gas Pipeline. This latter project would provide the opportunity for significant profits not only in the railway, but also in petroleum distribution and general freight haulage.

During the year, White Pass expanded its general freight trucking operations to Vancouver, B.C., offering for the first time an expedited freight service between Vancouver and Yukon. This important strategic move, together with initiatives of a similar nature in 1982, will allow White Pass to compete effectively for traffic growth in developing areas of western and northern Canada.

Final agreement was reached during the year with the Federal and Yukon Governments for the provision of $6 million in interest-free loans to be used to purchase locomotives and other rail equipment. Delivery of most equipment is expected in 1982, and resulting efficiencies will reduce operating costs. This important agreement is also an indication of the commitment of both levels of government to maintaining a successful rail infrastructure as a key part of the transportation system of the North.

The outlook for 1982 is bright. An expected return to more normal tonnages at Cyprus Anvil will improve materially both the volume and the balance of products carried by the company. Although the most dramatic effect of this development will be in the railway, all divisions will

derive significant efficiencies. Passenger business should increase substantially, reflecting both the rectification of the mechanical problems that affected cruise ships in 1981 and a substantially increased marketing effort to stimulate passenger movement both south from and north to Whitehorse. The combination of these and other factors should produce significant increased earnings and enhance the future prospects for the company.

Corporate Developments

The Company offered shareholders of record on April 10, 1981 the right to subscribe for one common share for each five shares held, at a price of $12.50 per share. The rights offering closed on May 13th, and subscriptions were received for virtually all the 789,387 shares offered. The net proceeds of approximately $9.6 million were used in part to retire current secured bank indebtedness, with the remainder augmenting working capital of the Company.

At a Special Meeting in November, shareholders approved an increase in the authorized capital of the corporation by creating two classes of preferred shares, each issuable in series. The purpose is to permit increased financing flexibility and to accommodate future developments such as internal expansion and acquisition. Two classes of preferred shares were created in order to provide for the issuance of both ordinary preferred shares and preferred shares that have a participatory or convertibility feature. Although there are no specific plans for the issuance of these shares, their existence will be a material addition to your Company's ability to expand successfully for the benefit of all shareholders.

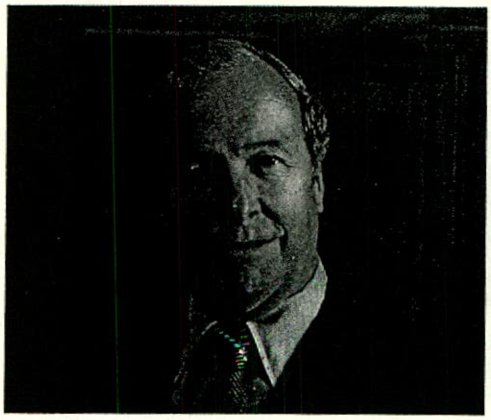
The Board of Directors has approved an increase in the quarterly dividend payable April 1, 1982, to shareholders of record on March 12, 1982 from 7½ cents to 12½ cents per Class A and Class B common share. Dividends on Class B common shares are paid customarily in the form of additional Class B shares. This dividend increase reflects the increased level of earnings of your Company, and continuing expected profit and liquidity growth will be reflected in future dividend payouts.

During the year, Mr. R. A. Hubber-Richard, a Director of your Company since 1972, tendered his resignation as a result of accepting the position as Chairman of the Pilotage Commission of the Port of Vancouver, British Columbia. Mr. Hubber-Richard has had a long association with Federal Industries as President of Neptune Bulk Terminals Ltd. and subsequently The White Pass and Yukon Corporation Limited. The Directors gratefully acknowledge the contribution he has made to the growth and success of the Company.

In December 1981, the Directors approved the creation of a share option plan for Federal Industries, in order to provide employees with the opportunity to participate in the growth and development of the Company. This plan is intended to replace the previously approved stock purchase plan, which was adversely affected by changes to tax law announced in the November Federal Budget. The share option plan will be presented for ratification at the Annual Meeting in May.

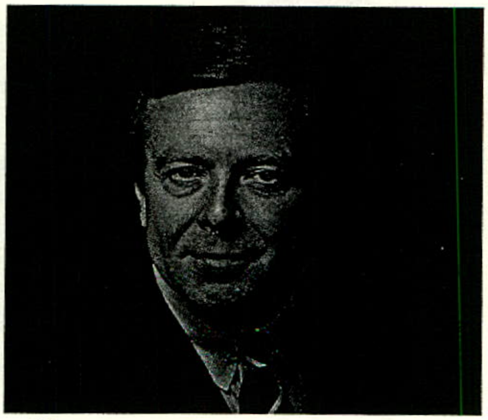
In perspective, 1981 began to demonstrate the potential of your Company for aggressive, profitable growth, even in an unsettled economic environment. Future strategic direction has been focussed to take advantage of the Company's operating and financial strength through evolutionary expansion of existing Divisions and by acquisition of companies in complementary industries. Significant scope exists for managed growth on both pathways without incurring excessive liquidity risks. Management expects 1982 to be another year of above-average increases in sales and earnings.

On behalf of the Board of Directors.



Stewart A. Searle

Stewart A. Searle, Chairman



J. Fraser

John F. Fraser, President and Chief Executive Officer
March 15, 1982

Financial Review

Earnings
Earnings for 1981 rose to $10,914,000 or $2.43 per share from $7,407,000 or $2.06 per share in the previous year. A net extraordinary gain of $24,000 or 1 cent per share increased earnings for the year to $10,938,000 or $2.44 per share. This gain arose from a combination of tax loss carryforwards and an allowance against a claim currently under litigation. In 1980, a net extraordinary loss of $290,000 or 8 cents per share reduced earnings for the year to $7,117,000 or $1.98 per share. This extraordinary loss was comprised also of tax loss carryforwards and an allowance against a claim under litigation, together with a loss on the sale of a subsidiary completed during the year.

This improvement in earnings resulted primarily from substantial gains at The White Pass and Yukon Corporation Limited, where operating profit increased by more than 50%, and at Standard Aero Limited, where operational earnings rose by approximately 26%.

Operations of major Divisions are described more particularly in the review following this report.

Divestitures
In the course of its operations in previous periods, your Company has disposed of a number of businesses. The effects of all divestitures historically have been segregated in the financial statements, and this segregation is shown retroactively in the Consolidated Historical Summary.

Interest Costs
Total interest expense relating to operations declined to $7,584,000 from $8,740,000 in 1980. After excluding the costs of debts related to Thunder Bay Terminals Ltd., which costs are covered by an all-events contract with Ontario Hydro as discussed in the Notes to Financial Statements, interest expense declined more than 25% to $1,416,000. This reflects the Company's improved liquidity, as a result of strong cash flow from operations and the proceeds from sale of capital stock in the spring rights issue.

The Statement of Earnings shows an income item, reported as "Interest Earned", of $578,000 in 1981 and $1,291,000 in 1980. The current period amount arises from the use of term deposits with Canadian chartered banks, the investment vehicle chosen for short-term excesses in Canadian dollars. In 1980, interest earned arose from the payment of interest on the deferred sale price of Neptune Bulk Terminals Ltd. Most of the Company's borrowings from time to time are now represented by United States currency, a situation more fully explained under "Foreign Exchange Fluctuations" below.

For 1982, the Company expects to be able to fund its expansion and capital requirements for existing subsidiaries, together with dividend payments, from internally generated funds, continuing to leave the Company relatively insensitive to interest rate fluctuations.

Foreign Exchange Fluctuations
Foreign exchange fluctuations historically have caused significant operating losses at The White Pass and Yukon Corporation. Most of the costs of running that company's railway between Skagway, Alaska and Whitehorse, Yukon have been incurred in U.S. dollars, while revenues derived from the service have been payable in Canadian dollars. The resulting imbalance depressed profits by $550,000 in 1981 and by $1,400,000 in 1980.

The relative improvement in the net costs is the consequence of renegotiation of White Pass' major rail contract, providing for the payment of U.S. rail services in U.S. currency. Further, the company anticipates a substantial increase in rail passenger traffic in 1982, the majority of which revenue is in U.S. dollars.

Income Taxes
Because Federal Industries is comprised of subsidiaries in several tax jurisdictions, the consolidated rate of tax may vary from period to period. This is particularly true when one or more companies incur losses while others remain profitable, or where tax incentive programs affect the amount of tax paid. In 1981, the consolidated income tax rate increased to 48.1% from 47.9% in 1980. Certain White Pass railway subsidiaries remained unprofitable in 1981, and accounting practice of not recognizing in the current year potential recovery of taxes from losses carried forward resulted in a tax rate at White Pass of 56.4% thus increasing Federal's overall tax rate.

The Company has organized its affairs in the United States to allow for the filing of joint tax returns, a practice that is not yet permitted in Canada. Until this is allowed, and with the continued use of available tax incentives, some volatility in the consolidated rate of tax will persist.

Balance Sheet
Working capital improved by nearly $16,000,000 to $40,048,000, the fifth successive annual increment in this important indicator.

Of particular significance in the increase was cash flow from continuing operations, which rose 37% to $18,709,000, and the successful rights offering, which netted approximately $9,600,000. Long-term debt decreased marginally to $68,313,000 from $68,853,000, reflecting retirement payments of $6,066,000 less additional borrowings of $5,500,000 under an agreement between a White Pass subsidiary and the Federal and Yukon Governments. This latter loan, which does not bear interest, is for a period of 24 years and will provide funds for the purchase of railway rolling stock and other rail assets. The Yukon Government has agreed to provide an additional $500,000 on the same terms in 1982.

Of the $68,313,000 long-term debt, $60,454,000 represents funded obligations of Thunder Bay Terminals. As more fully set out in Note 4 to the financial statements, a long-term contract between the Terminal and Ontario Hydro provides in all events for the payment of debt service, and under the terms of the mortgage bonds, security is limited to assets of the Terminal. Accordingly, it is appropriate to exclude this "project financing" debt in assessing

the Company's long-term debt-to-equity ratio, and on this basis the year-end ratio was 0.09 to 1 compared with 0.05 to 1 at December 31, 1980. Total debt-to-equity was 0.20 to 1 at the end of 1981 compared with 0.27 to 1 in 1980.

As part of new loan arrangements reached with the Bank of Montreal after the year-end, the Company has established an operating line of credit of $50,000,000, secured primarily by charges against current assets. The medium-term operating and capital requirements of the existing Divisions can be met from internally-generated cash flow as supplemented from time to time by these operating lines of credit. The terms of an acquisition line of $15,000,000 have been negotiated, which, together with the proceeds from the rights issue and the sale in 1980 of Neptune Bulk Terminals, provide a substantial base for funding future acquisitions.

Capital Expenditures and Depreciation

Capital expenditures totalled $14,515,000 in 1981 compared with $5,829,000 in 1980. After excluding additions to Thunder Bay Terminals, which are covered under a separate all-events contract with Ontario Hydro, capital expenditures in 1981 were $13,202,000, compared with $2,580,000 in 1980. The major proportion of these expenditures in both years occurred at The White Pass and Yukon Corporation. In 1981, White Pass spent $5,500,000 from the proceeds of the non-interest bearing government loans on railway rolling stock, replaced a substantial part of its trucking fleet and incurred the majority of expenditures in relocating a petroleum tank farm in Skagway, Alaska. In 1980, most of the capital outlay was related to replacing highway equipment.

Depreciation increased to $6,649,000 from $5,615,000 in 1980. After excluding Thunder Bay Terminals' depreciation, the comparable amounts are $3,686,000 in 1981 and $3,021,000 in 1980.

Share Capital

At a Special Meeting held on November 2, 1981, shareholders approved an increase in the authorized capital of the Company by creating two classes of shares, each consisting of an unlimited number of preferred shares without nominal or par value, to be designated Class I Preferred Shares and Class II Preferred Shares. Class I Preferred Shares will be entitled to a preference over Class II Preferred Shares with respect to the payment of dividends and the distribution of assets in the event of the liquidation, dissolution or winding up of the Company. It is envisaged that the Class II Preferred Shares might have a participatory or convertible feature, whereas the Class I Preferred Shares would be what is commonly referred to as "ordinary preferreds".

The reasons for creation of these preferred shares are to increase the Company's flexibility for financing and to accomodate future developments such as internal expansion and acquisition. In the increasingly unsettled marketplace, your Company may find it necessary to consider a somewhat hybrid equity instrument in raising funds for expansion. The Company is averse to the excessive use of leverage, either in existing operations or for purposes of acquiring or expanding operations, and the existence of preferred shares will facilitate the maintenance of a prudent equity base.

In May and June, 1981, the Company issued an additional 788,844 Class A Common Shares pursuant to a rights offering. With the issuance of these shares, and the issuance of Class B Common Shares as stock dividends during the year, a total of 4,789,774 shares were outstanding at December 31, 1981, comprised of 4,463,656 Class A Shares and 326,118 Class B Shares.

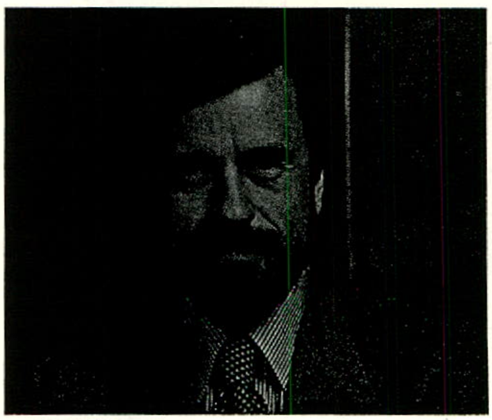
The weighted average number of Class A and B Shares outstanding for 1981 was 4,475,749, compared to the weighted average of 3,600,023 shares in 1980. This accounts for the differential between the dollar earnings increase and the earnings per share.

Market performance of Federal Industries' shares was encouraging. Prices varied from a low of $10.00 to a high of $15.87.

Three major investment dealers following the Company have recommended Federal Industries to their clients, and the strong, consistent earnings growth should assure a significant increase in the capital value of the Company's equities in the future.

Summary

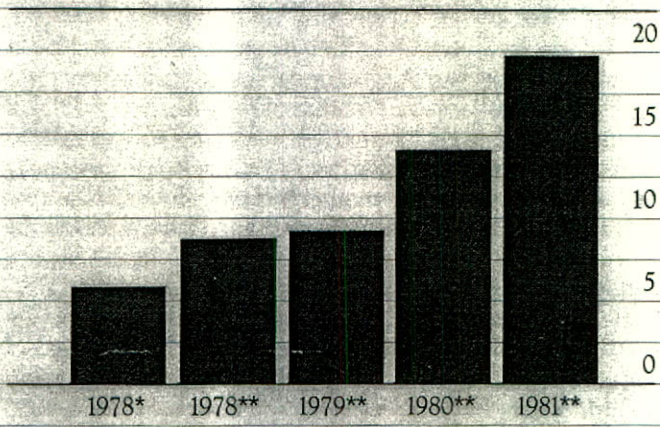
Events and actions of 1981 underscore the success of management's overall financial policy: to maintain liquidity and avoid excessive leverage. The collapse of long-term debt markets and continuing record-high interest rates confirm the importance of this posture. Internally-generated funds can provide the majority of medium-term capital and dividend requirements, and the equity base established through 1981 furnishes the foundation for aggressive growth by acquisition without the need to encumber the earnings of existing subsidiaries.



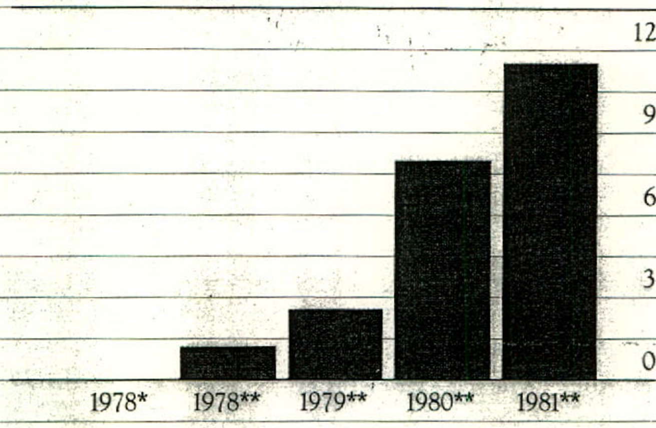
John S. Pelton
Vice-President Finance

Financial Charts

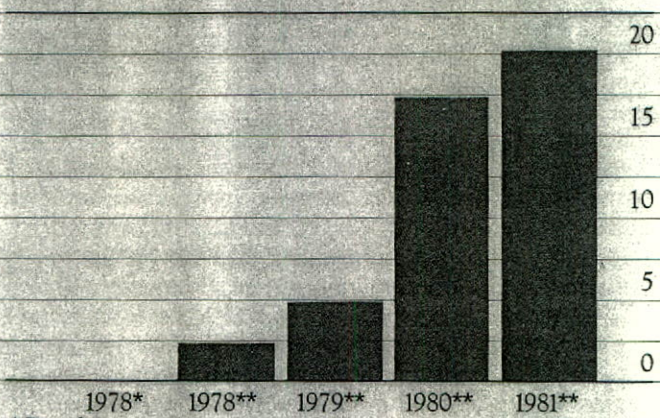
Cash flow from continuing operations ($ million)



Net profit before extraordinary items ($ million)

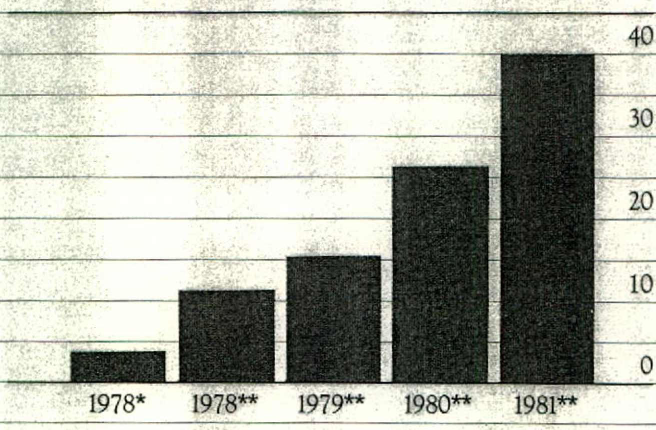


Return on shareholders' equity (%) ‡

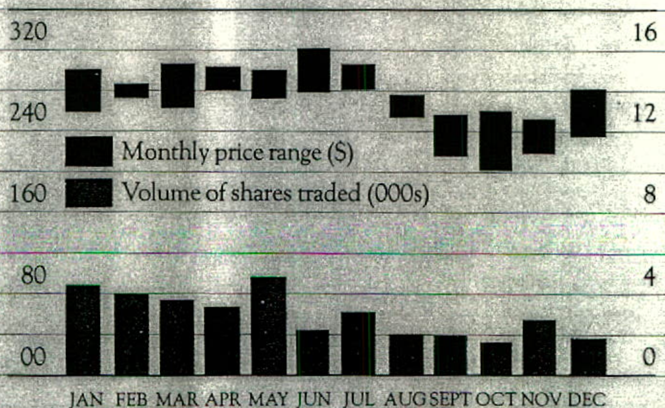


‡ Based on opening common equity

Working capital ($ million)

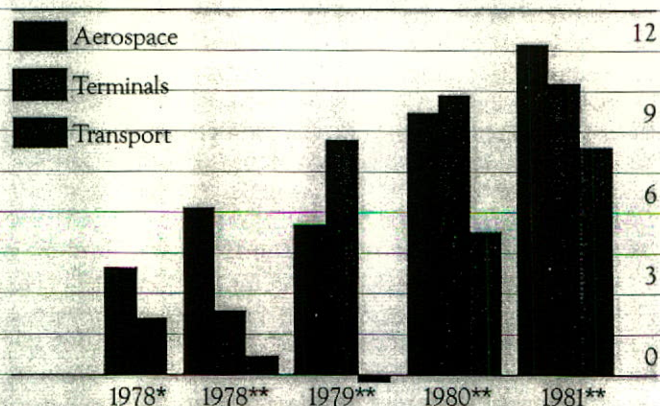


1981 Trading volumes and price ranges, common stock



*12 months ended March 31
**12 months ended December 31

Divisional earnings from continuing operations† ($ million)



†Before taxes, extraordinary items, interest and intercompany charges

Consolidated Financial Statements

Consolidated statement of earnings

for the year ended December 31, 1981

	$000	
	1981	1980
Sales and services (Note 11)	**$192,690**	$159,226
Cost of sales and operating expenses (Note 12)	**156,710**	129,935
Depreciation and amortization	**6,649**	5,615
Interest on long term debt	**6,503**	8,319
Other interest expense	**1,659**	1,712
Interest earned	**(578)**	(1,291)
	170,943	144,290
Earnings before income taxes and extraordinary items	**21,747**	14,936
Provision for income taxes		
Current	**7,207**	4,857
Deferred	**3,255**	2,301
	10,462	7,158
Earnings before extraordinary items	**11,285**	7,778
Extraordinary items (Note 13)	**24**	(290)
Net earnings	**11,309**	7,488
Earnings allocated to minority shareholders	**371**	371
Net earnings for the year	**$ 10,938**	$ 7,117
Earnings per common share (Note 10)		
Before extraordinary items	**$2.43**	$2.06
Extraordinary items	**.01**	(.08)
Including extraordinary items	**$2.44**	$1.98

See accompanying notes to financial statements.

Consolidated statement of retained earnings

for the year ended December 31, 1981

	$000	
	1981	1980
Balance, beginning of year	**$35,281**	$28,893
Net earnings for the year	**10,938**	7,117
	46,219	36,010
Dividends (Note 9)		
Class A shares	**1,267**	673
Class B shares	**103**	56
	1,370	729
Balance, end of year	**$44,849**	$35,281

See accompanying notes to financial statements.

Auditors' Report

Touche Ross & Co.
Suite 2000, 360 Main Street
Winnipeg, Manitoba R3C 3Z3
(204) 942-0051

To the Shareholders,
Federal Industries Ltd.

We have examined the consolidated balance sheet of Federal Industries Ltd. and its subsidiary companies as at December 31, 1981 and the consolidated statements of retained earnings, 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 companies as at December 31, 1981 and the results of their operations and the changes in their 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.

Touche Ross & Co.

Winnipeg, Manitoba,
March 15, 1982.

Chartered Accountants

Consolidated Balance Sheet

as at December 31, 1981

	$000	
Assets	**1981**	1980
Current		
Cash and short term deposits	**$ 7,521**	$ 691
Accounts receivable	**31,167**	26,039
Income taxes recoverable	**–**	676
Inventories (Note 2)	**47,081**	35,467
Prepaid expenses	**1,220**	1,118
Claims recoverable	**245**	869
Current portion long term receivable (Note 4)	**3,850**	3,850
Current portion of mortgage	**–**	322
Total current assets	**91,084**	69,032
Fixed (Note 3)		
Property, plant and equipment, at cost	**159,344**	131,259
Accumulated depreciation	**49,370**	43,086
	109,974	88,173
Terminal facility under construction	**–**	14,077
	109,974	102,250
Other		
Unexpended construction funds	**–**	2,737
Long term receivable (Note 4)	**1,827**	1,487
Other investments, at cost (Note 5)	**3,354**	3,602
Deferred charges	**65**	139
	5,246	7,965
	$206,304	$179,247

On behalf of the Board

Stewart A. Searle

Director

Director

See accompanying notes to financial statements

	$000	
Liabilities	**1981**	1980
Current		
Bank indebtedness, secured (Note 6)	**$ 16,637**	$ 14,059
Accounts payable and accrued liabilities	**24,324**	24,446
Dividends	**359**	197
Income taxes payable	**5,114**	1,388
Current portion of long term debt	**4,602**	4,715
Total current liabilities	**51,036**	44,805
Long term (Note 7)	**68,313**	68,853
Deferred income taxes	**6,500**	5,079
Minority interest (Note 8)	**5,500**	5,500
Total liabilities	**131,349**	124,237
Shareholders' Equity		
Share capital		
Common shares (Note 9)	**30,106**	19,729
Retained earnings	**44,849**	35,281
Total shareholders' equity	**74,955**	55,010
	$206,304	$179,247

Consolidated statement of changes in financial position

for the year ended December 31, 1981

	$000	
	1981	1980
Source of funds		
Operations		
Net earnings for the year	**$10,938**	$ 7,117
Add Depreciation	**6,649**	5,615
Amortization of deferred charges	**74**	–
Deferred income taxes	**3,255**	2,301
Accrued revenue in respect of deferred income taxes (Note 4)	**(2,310)**	(2,068)
Gain on sale of fixed assets	**(244)**	(27)
Extraordinary items	**(24)**	290
Earnings allocated to minority shareholders	**371**	371
Funds provided by operations	**18,709**	13,599
Disposal of assets of a subsidiary company, net	**–**	17,165
Proceeds on sale of fixed assets	**386**	402
Additional long term debt financing	**5,526**	–
Issue of shares (Note 9)	**10,282**	4,797
Reclassification from current to deferred income taxes	**476**	–
Reduction in income taxes (Note 13)	**324**	1,214
Unexpended construction funds	**2,737**	4,859
Other investments	**248**	801
Deferred charges	**–**	376
	$38,688	$43,213
Application of funds		
Purchase of fixed assets	**$14,515**	$ 3,512
Terminal facilities under construction	**–**	2,317
Increase in long term receivable, net of deferred income tax component of $2,310 (Note 4)	**340**	64
Decrease in long term debt	**6,066**	26,190
Dividends	**1,267**	673
Dividends paid by subsidiary company to minority shareholders	**371**	371
Allowance for claims recoverable, net of income taxes of $261	**300**	469
Other	**8**	–
	22,867	33,596
Increase in working capital	**15,821**	9,617
	$38,688	43,213
Working capital, end of year	**$40,048**	$24,227

See accompanying notes to financial statements.

Notes to consolidated financial statements

for the year ended December 31, 1981

1. Summary of significant accounting policies

(a) Principles of consolidation

The consolidated financial statements include the accounts of the Company and all subsidiaries. The names of the subsidiaries, which are all wholly owned, are as follows:

Standard Aero Limited
The White Pass and Yukon Corporation Limited
Thunder Bay Terminals Ltd.

All material inter-company balances, transactions and profits have been eliminated.

(b) Foreign currency translation

The accounts of certain subsidiaries are maintained in United States dollars. These accounts have been translated into Canadian dollars as follows: current assets, current liabilities and long term debt at exchange rates prevailing at the end of the year; fixed assets and depreciation substantially on the basis of rates prevailing at date of acquisition; income and expenses (other than depreciation) on the basis of average exchange rates during the year. Exchange gains or losses from such translation practices have been included in consolidated earnings.

(c) Valuation of inventories

Inventories have been valued at the lower of cost and net realizable value.

(d) Capitalization of leases

All material leases of a capital nature have been recorded as fixed assets and long term debt obligations.

(e) Revenue recognition–bulk handling terminal contract

A portion of the revenues accruing under the bulk handling terminal contract between Thunder Bay Terminals Ltd. and Ontario Hydro is being recognized on a basis that reflects an approximate constant return over each of the fifteen years of the initial term of the contract. (See Note 4).

(f) Depreciation

Depreciation on property, plant and equipment is provided at rates which are estimated to amortize the original cost of such assets over their useful lives.

(g) Income Taxes

The Company follows the tax allocation method of accounting for income taxes whereby earnings are charged with income taxes relating to reported earnings.

Differences between such taxes and taxes currently payable are reflected in deferred income taxes and arise because of differences between the time certain items of revenue and expense are reported in the accounts and the time they are reported for income tax purposes.

Potential tax reductions that may result from the application of losses against future taxable income are not recognized until recovery out of future taxable income is virtually certain.

(h) Basic earnings per share

Earnings per common share are calculated using the weighted daily average number of common shares outstanding. The calculation of fully diluted earnings per share is described in Note 10.

(i) International accounting standards

The accompanying financial statements are prepared in accordance with accounting principles generally accepted in Canada and conform in all material respects with international accounting standards.

2. Inventories

	$000	
	1981	1980
Aerospace Division		
Aircraft engines and parts	**$26,627**	$20,398
Work in process	**4,625**	5,391
	31,252	25,789
Terminal Division		
Spare parts and supplies	**1,336**	1,194
Transport Division		
Petroleum division products held for resale	**10,957**	5,627
Spare parts and supplies	**3,536**	2,857
	14,493	8,484
	$47,081	$35,467

3. Fixed assets

	$000			
	1981			1980
	Cost	Accumulated Depreciation	Net	Net
Aerospace Division				
Land and buildings	$ 3,455	$ 1,490	$ 1,965	$ 1,764
Machinery and equipment	5,180	3,562	1,618	921
	8,635	5,052	3,583	2,685
Terminal Division				
Terminal handling facilities	69,322	7,749	61,573	49,151
Transport Division				
Petroleum				
Trucks	315	226	89	147
Land and buildings	1,911	714	1,197	1,269
Machinery and equipment	1,013	519	494	152
Transportation				
Rail and pipeline	32,502	10,125	22,377	22,512
Ships and containers	13,016	10,213	2,803	3,006
Trucks	12,036	8,095	3,941	3,968
Skagway terminal	6,797	4,139	2,658	3,052
Land and buildings	3,170	1,172	1,998	1,620
Machinery and equipment	1,589	1,179	410	402
Storage facilities	3,978	15	3,963	–
Equipment under construction	4,694	–	4,694	–
	81,021	36,397	44,624	36,128
Other corporate assets	366	172	194	209
Terminal handling facilities under construction– Thunder Bay	–	–	–	14,077
	$159,344	$ 49,370	$109,974	$102,250

Included in the amounts reported above are assets under capital leases of $3,065,000 (1980–$3,689,000) and related accumulated depreciation thereon of $1,450,000 (1980–$1,323,000).

4. Terminal handling facility–Thunder Bay, Ontario

(a) Thunder Bay Terminals Ltd. has entered into a long term contract with Ontario Hydro for the construction and operation of a bulk terminal handling facility at Thunder Bay, Ontario. The total cost of the terminal is $69,322,000 of which $53,953,000 relates to facilities which became operational on March 1, 1979 and $15,369,000 relates to terminal facilities which became operational in 1981.

(b) The cost of the terminal has been financed by the issue of $71,496,000 aggregate principal amount, 9⅝% First Mortgage Sinking Fund Bonds, Series A. As at December 31, 1981, the Series A bonds issued and outstanding aggregated $64,304,000. The terms and conditions of the Series A bond issue are provided for in a Deed of Trust and Mortgage dated as of October 12, 1977 between the company and the trustee for the bondholders.

(c) Under the terms of the agreements with Ontario Hydro, Thunder Bay Terminals Ltd. will receive, over the initial fifteen year term of the contract, contractual amounts of revenue including specific revenue components to cover all payments required for the redemption of all of the Series A bonds and for income taxes. These revenue components become recoverable as and when the bond and income tax payments become due and payable. The use of the cash received in respect of these specific revenue components is restricted to the redemption of the Series A bonds and the payment of income taxes.

(d) The amounts receivable over the fifteen years of the initial term of the contract to cover the redemption of the Series A bonds represent the revenues required to pay for the capital cost of the terminal facility. The net contribution to earnings from these revenues (total amounts receivable less depreciation on the terminal) is recorded in the accounts so as to reflect an approximate constant annual return over each of the fifteen years.

(e) At December 31, 1981, the accrued revenues receivable from Ontario Hydro for the redemption of Series A bonds amount to $5,677,000 of which $1,827,000 is long term and $3,850,000 is current. The long term accrued revenues receivable for the payment of income taxes amount to $6,078,000 (1980–$3,768,000), all of which relate to deferred income taxes. Because the $6,078,000 to be received is restricted to the payment of income taxes, the liability for the deferred income taxes has been netted against the long term receivable.

5. Other investments

	$000	
	1981	1980
Mortgages and agreements for sale	**$ 401**	$1,493
Loans to officers and directors		
Stock purchase plan	**873**	619
Housing	**176**	135
Securities	**1,650**	1,328
Other	**254**	27
	$3,354	$3,602

6. Bank indebtedness

Bank indebtedness is secured by a pledge of shares in subsidiaries, assignment of book debts and inventories and specific pledges of certain inventories.

7. Long term debt

	$000	
	1981	1980
Terminal Division		
First mortgage bonds, 9⅝% (Note 4)	**$60,454**	$65,721
Transport Division		
First ship mortgage note, 8½% due 1984	**650**	975
Capitalized equipment leases, 9%–16%	**1,508**	1,964
Government of Canada non-interest bearing loan, secured by certain rail assets	**5,000**	–
Government of Yukon Territory non-interest bearing loan, secured by certain rail assets	**500**	–
Other–non-interest bearing	**24**	–
	7,682	2,939
Corporate debt		
Capitalized lease obligations, 16¼%	**177**	193
	$68,313	$68,853

The aggregate amount of maturities over the next five years are approximately as follows: 1982–$4,600,000; 1983–$4,675,000; 1984–$5,085,000; 1985–$4,390,000; 1986–$4,225,000.

8. Minority interest

Minority interest is $5,500,000 of 6¾% preferred shares of The White Pass and Yukon Corporation Limited (1980–$5,500,000).

9. Share capital

(a) At December 31, 1981 the authorized share capital of the Company consists of:

(i) an unlimited number of Class A convertible shares without nominal or par value;

(ii) an unlimited number of Class B convertible shares without nominal or par value;

(iii) an unlimited number of Class I preferred shares without nominal or par value, issuable in series; and

(iv) an unlimited number of Class II preferred shares without nominal or par value, issuable in series.

Both the Class A shares and the Class B shares are inter-convertible at any time at the option of the holder on a share for share basis. The basic difference between the two classes of shares is that dividends on Class A shares are payable in the form of cash dividends, while dividends on Class B shares are presently payable in the form of stock dividends, payable in Class B shares.

The directors have the authority to issue the Class I and Class II preferred shares in series and fix the designation, rights, privileges and conditions to be attached to each series, except the Class I shares shall be entitled to preference over the Class II shares with respect to the payment of dividends and the distribution of assets in the event of liquidation, dissolution or winding-up of the Company.

(b) During 1981 the following shares were issued:

(i) 788,844 Class A shares under a rights offering to holders of outstanding Class A and Class B shares for an aggregate consideration of $9,597,000.

(ii) 50,000 Class A shares to two officers of the Company and an officer of a subsidiary company under the provisions of the stock purchase plan for an aggregate consideration of $685,000 (1980–20,000 Class A shares to an officer for $133,000).

(iii) 6,924 Class B shares as stock dividends of $95,000. An additional 2,134 Class B shares were issued as stock dividends of $24,000 on January 1, 1982.

(c) The number of shares issued and outstanding at December 31 were as follows:

	1981	1980
Class A	**4,463,656**	3,614,795
Class B	**326,118**	329,211
	4,789,774	3,944,006

(d) In 1978 the shareholders confirmed a by-law authorizing a stock purchase plan, the purpose of which is to provide loans to employees of the Company for the purchase of Class A shares of the Company. The price at which such shares may be purchased is the market value thereof and employee loans may be provided by the Company in such amounts and on such terms and conditions as the directors of the Company may determine. The by-law expressly provides the aggregate number of shares reserved for issuance under any such plan shall not exceed five percent (5%) of the aggregate number of common shares of the Company of all classes then issued and outstanding.

(e) Subsequent to the year end the Company repurchased 104,800 shares, originally issued under the provisions of the stock purchase plan, from officers of the Company and an officer of a subsidiary company at their market value of $12.6875 per share for an aggregate consideration of $1,330,000 and all employee loans made under the stock purchase plan with respect to those shares were repaid.

(f) In December 1981 the directors approved a share option plan, the purpose of which is to provide employees of the Company the opportunity to participate in the growth and development of the Company. At December 31, 300,000 authorized and unissued Class A convertible shares of the Company have been reserved and set aside for purposes of the plan. Options have been granted to officers of the Company and an officer of a subsidiary company for an aggregate of 210,000 shares at a price of $12.6875 per share. These options, which expire on December 14, 1991, are exercisable on a cumulative basis to the extent of 42,000 shares per year in each of the years 1981 to 1985, except that under certain specified conditions they become exercisable immediately.

10. Earnings per common share

(a) Basic earnings per common share are calculated using the weighted daily average number of common shares outstanding.

(b) Fully diluted earnings per common share for 1981 are as follows:

Before extraordinary items	$2.38
Extraordinary items	.01
Including extraordinary items	$2.39

Fully diluted earnings per share are calculated under the assumption that all stock options outstanding had been exercised at the beginning of the year. Imputed earnings on the proceeds from the exercise of these options are calculated using a 10% after-tax rate of return.

11. Segmented information

	$000			
	1981		1980	
	Sales & Services	**Segment Margin***	Sales & Services	Segment Margin*
Divisions				
Aerospace	**$ 74,232**	**$ 9,726**	$ 61,283	$ 6,931
Terminal	**18,676**	**4,620**	17,091	4,136
Transport				
Petroleum	**58,712**	**8,572**	42,573	5,535
Transportation	**49,831**	**(1,179)**	43,726	(1,020)
	201,451	**21,739**	164,673	15,582
Inter-segment eliminations	**8,761**	**373**	5,447	336
	$192,690	**21,366**	$159,226	15,246
Corporate interest expense		**(231)**		(870)
Inter-segment interest		**2,029**		763
Interest earned		**578**		1,291
Other corporate expenses		**(1,995)**		(1,494)
Earnings from operations		**21,747**		14,936
Provision for income taxes		**(10,462)**		(7,158)
Extraordinary items		**24**		(290)
Allocated to minority shareholders		**(371)**		(371)
Net earnings		**$ 10,938**		$ 7,117

*After deduction of interest: Aerospace $2,672,000 (1980–$2,738,000); Terminal $6,168,000 (1980–$6,174,000); Petroleum $129,000 (1980–$710,000); Transportation $991,000 (1980–$101,000).

Other segmented information

	$000					
	1981			1980		
	Capital Expenditures	Deprec. and Amort.	Identifiable Assets	Capital Expenditures	Deprec. and Amort.	Identifiable Assets
Divisions						
Aerospace	**$ 1,443**	**$ 545**	**$ 54,544**	$ 575	$ 338	$ 43,871
Terminal	**1,313**	**2,963**	**71,462**	3,251	2,594	75,670
Transport						
Petroleum	**258**	**195**	**20,104**	189	160	12,820
Transportation	**11,478**	**2,908**	**51,791**	1,793	2,488	45,414
Other corporate assets	**23**	**38**	**8,403**	21	35	1,472
	$ 14,515	**$ 6,649**	**$206,304**	$ 5,829	$ 5,615	$179,247

(a) The Company has segmented its operations on the basis of the major industries in which it operates as described below:

(i) The Aerospace Division's operations consist of the remanufacturing and rebuilding of aircraft engines and sales of related parts and accessories.

(ii) The Terminal Division operates a major coal handling terminal facility.

(iii) The Transport Division's operations consist of the marketing of petroleum and related consumer products, and the provision of ocean, rail and truck transportation services.

Inter-segment sales are accounted for at prices comparable to open market prices for similar products and services.

(b) The Aerospace Division had sales to foreign customers, principally in Europe, of $13,759,000 (1980–$11,087,000).

12. Directors' remuneration

The aggregate remuneration of directors and senior officers of the company is as follows:

	1981				1980			
	As Directors		As Officers		As Directors		As Officers	
	No.	Amount	No.	Amount	No.	Amount	No.	Amount
Federal Industries Ltd.	10	$33,300	7	$504,503	13	$30,500	7	$407,400
The White Pass & Yukon Corporation Limited	7	6,800	1	25,000	8	6,600	1	25,000

5 Officers are also Directors of the Company (1980–5 Officers).

13. Extraordinary items

	$000	
	1981	1980
Allowance in respect of claims recoverable, net of income taxes of $261,000 (1980–$400,000)	$ (300)	$ (469)
Reduction of income taxes arising from the utilization of loss carry forwards by a subsidiary company	324	414
Loss on disposition of assets and business of Neptune Bulk Terminals Ltd.		
Gain on sale of assets and business, net of income taxes of $483,000	–	1,163
Reduction of income taxes arising from the utilization of loss carry forwards	–	800
Write off of goodwill	–	(2,198)
	$ 24	$ (290)

14. Sale of assets–1980

The assets and business of Neptune Bulk Terminals Ltd. were sold in 1980. The sale was effective January 1, 1980 but because of certain conditions precedent the transaction was not completed until October 23, 1980. Under the sales agreement, Neptune received interest of $1,808,000 on the net sales price. This $1,808,000, less interest paid by Neptune to third parties of $517,000, gives the $1,291,000 which has been shown as a separate item of earnings in 1980 under the heading "interest earned". The disposition of the assets and business of Neptune resulted in a net extraordinary loss of $235,000 in 1980.

15. Other

(a) The Company and its subsidiary companies have operating lease commitments with varying terms requiring annual rental payments of approximately $500,000.

(b) Certain of the 1980 figures have been restated to reflect the current year's presentation.

Consolidated Historical Summary

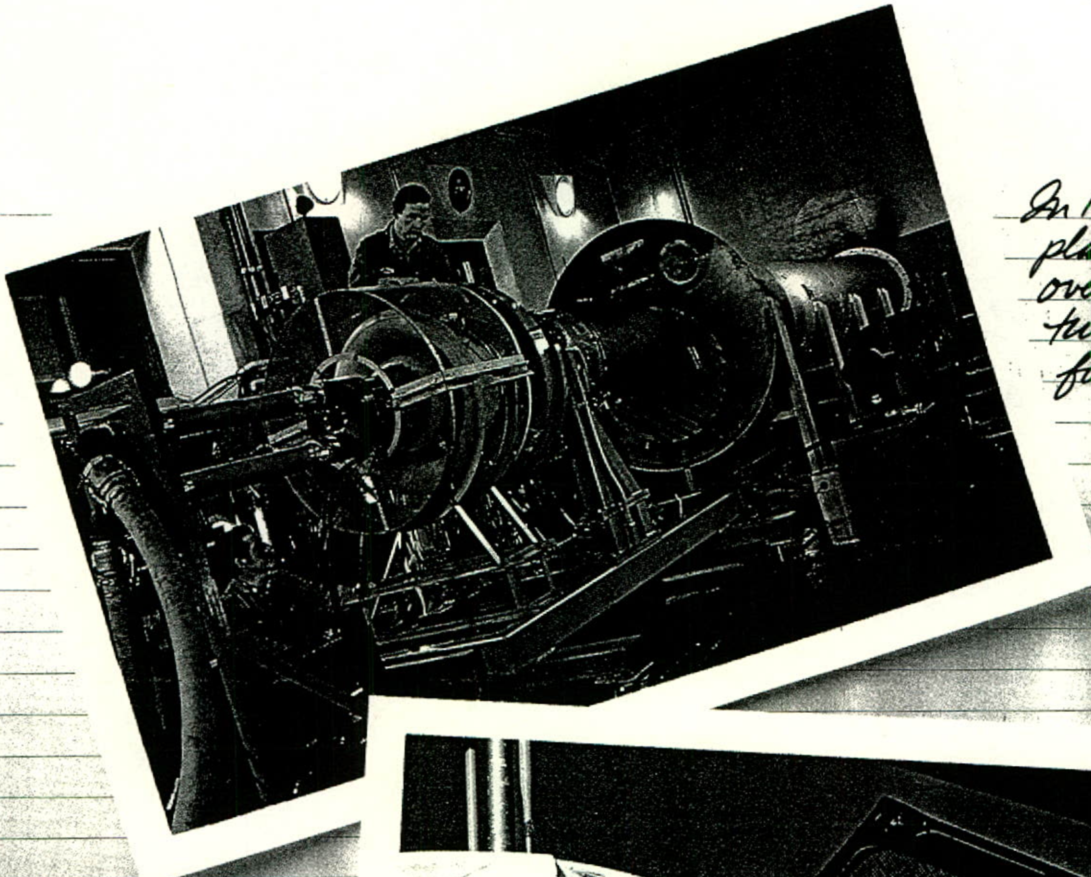
	12 Mos. 31 Dec. 81	12 Mos. 31 Dec. 80	12 Mos. 31 Dec. 79	12 Mos.* 31 Dec. 78	12 Mos. 31 Mar. 78
Income Information ($000)					
Sales & Services	**192,690**	159,226	126,716	112,987	99,830
Gross Earnings from Operations	**35,980**	29,291	18,192	11,293	7,779
Net Earnings Before Extraordinary Items	**10,914**	7,407	1,789	714	(17)
Extraordinary Items	**24**	(290)	–	(1,527)	(2,498)
Net Earnings After Extraordinary Items	**10,938**	7,117	1,789	(813)	(2,515)
Depreciation	**6,649**	5,615	5,227	3,974	3,431
Interest on Long Term Debt	**6,503**	8,319	7,969	3,120	1,074
Income Taxes	**10,462**	7,158	1,756	1,475	1,611
Earnings (Loss) per Common Share ($)	**2.44**	1.98	.51	(.23)	(.73)
Earnings (Loss) per Share Excluding Extraordinary Items ($)	**2.43**	2.06	.51	.21	(.01)
Balance Sheet Information ($000)					
Current Assets	**91,084**	69,032	56,490	50,044	49,039
Current Liabilities	**51,036**	44,805	41,880	39,386	44,618
Working Capital	**40,048**	24,227	14,610	10,658	4,421
Fixed Assets–Net	**109,974**	102,250	119,092	112,574	98,398
Other Assets	**5,246**	7,965	16,135	13,347	7,635
Total Assets	**206,304**	179,247	191,717	175,965	155,072
Long Term Debt	**68,313**	68,853	95,043	82,542	59,396
Deferred Income Taxes	**6,500**	5,079	5,525	6,091	5,744
Minority Interest	**5,500**	5,500	5,500	5,500	5,500
Shareholders' Equity	**74,955**	55,010	43,769	42,446	39,814
Other Information					
Gross Margin Ratio %	**18.7%**	18.4	14.4	10.0	7.8
Net Earnings as % of Sales	**5.7%**	4.5	1.4	(.7)	(2.5)
No. Shares Outstanding (A & B)	**4,789,774**	3,944,006	3,528,900	3,488,900	3,438,900
Dividend per Share					
Class A ($) Note 1	**.275**	.20	.20	.20	.35
Class B ($) Note 2	**.275**	.20			
Price Range of Stock ($)					
High	**15.87**	15.25	8.00	7.12	8.00
Low	**10.00**	6.37	5.50	4.90	4.90
Shareholders' Equity per Share ($)	**15.65**	13.95	12.40	12.17	11.58

*Unaudited

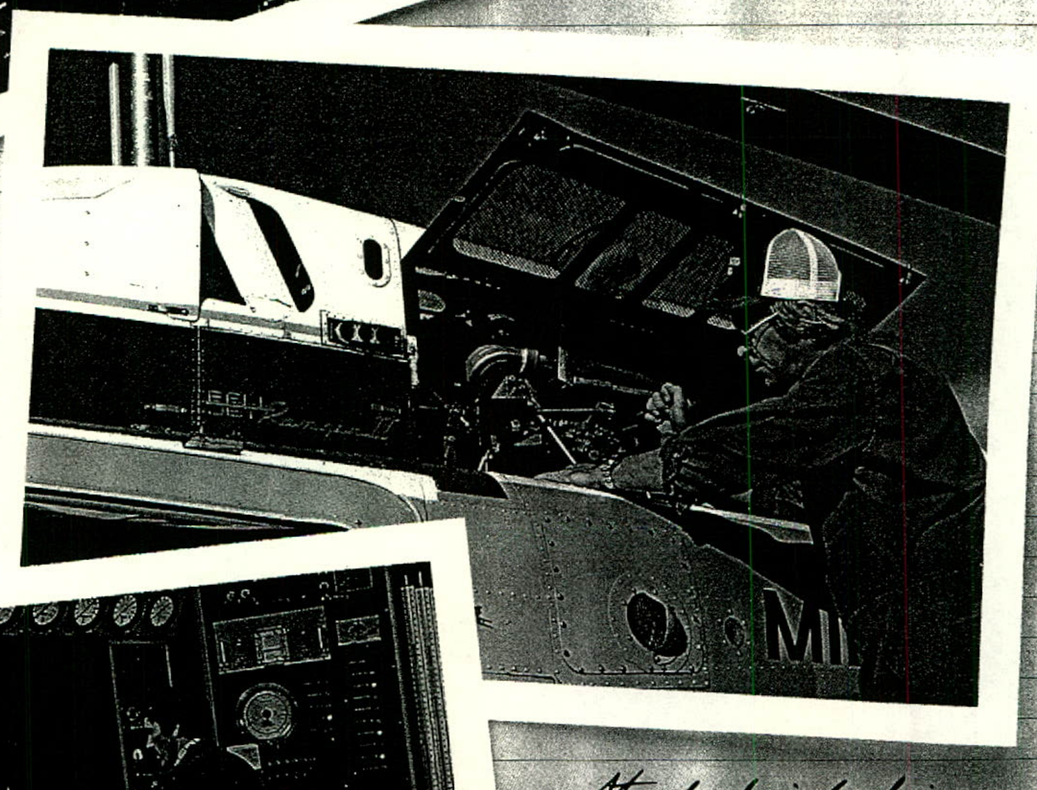
NOTES:

(1) Payable in cash dividends.

(2) Payable by way of stock dividend in Class B shares. These Class B shares were created in May, 1980.



In 1981, the Winnipeg plant began overhauling the T-53 turbine engine for helicopters.



Two separate divisions — Overhaul and Distribution — have been created within Standard Aero, each with distinct development objectives.

Standard is looking to expand its operations into the United States.

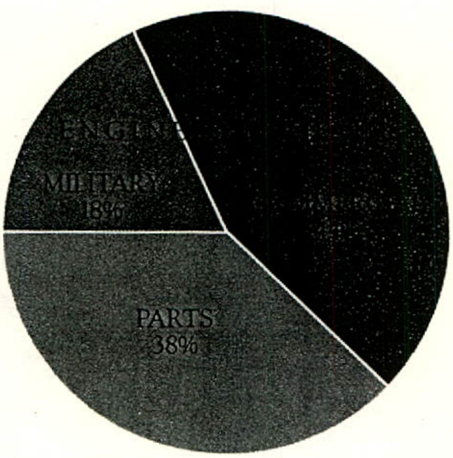
Aerospace Division

Five Year Review

12 months	Sales (Millions)	Earnings from Operations* (Millions)
1981 December	74.2	12.4
1980 December	61.3	9.6
1979 December	46.7	5.7
1978 December	40.0	6.1
1978 March	29.6	3.8

*Before taxes, extraordinary items, interest and inter-company charges.

Standard Aero Limited is Canada's largest independent overhauler of aircraft and helicopter engines and distributor of aircraft parts and accessories, with a growing trade around the world. Standard operates a major aviation engine overhaul plant in Winnipeg. Parts distribution branches are located across Canada and in London, England.



Sales distribution for the twelve months to December 31, 1981

In a year when revenue and profits at Standard Aero increased strongly, distribution sales accounted for 38 per cent of total sales, compared with 36 per cent in 1980. Military sales increased to 18 per cent of the total from 15 per cent, while the contribution from commercial overhaul sales declined to 44 per cent from 49 per cent the previous year.

These figures show a continuation of the trend at Standard over the past five years, in which aviation product distribution has emerged as a major growth area. As a result, two separate divisions–Overhaul and Distribution–have been created, each with its own operating head and distinct objectives. The company believes both have an exciting and profitable future.

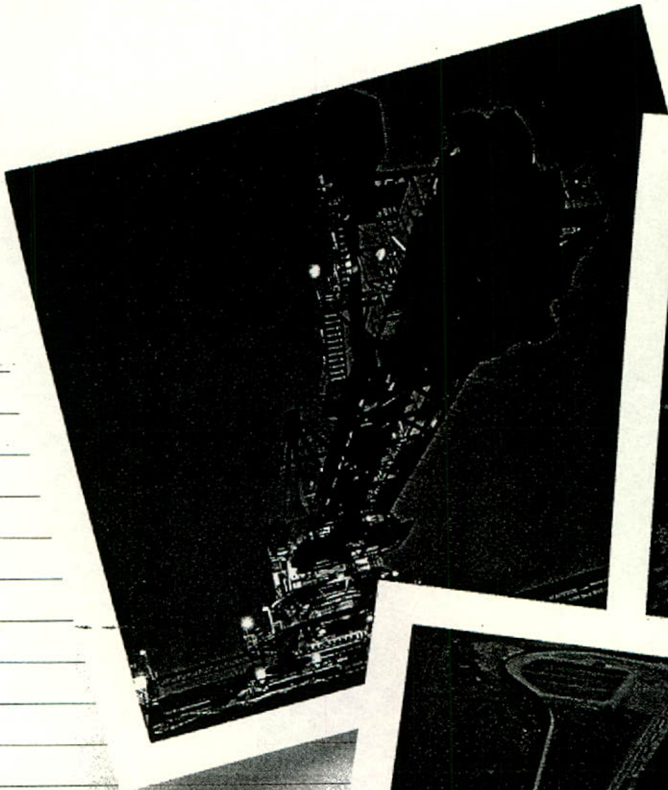
Operating margins at Standard improved for the third consecutive year, reflecting success at cost control and changes in product mix. Further steps were taken to strengthen and expand overall management at administrative and operational levels in order to prepare for future growth and expansion. The company is optimistic about 1982 and profitability gains are expected to run considerably ahead of relative sales growth, with improvement coming from all areas of the company's operations.

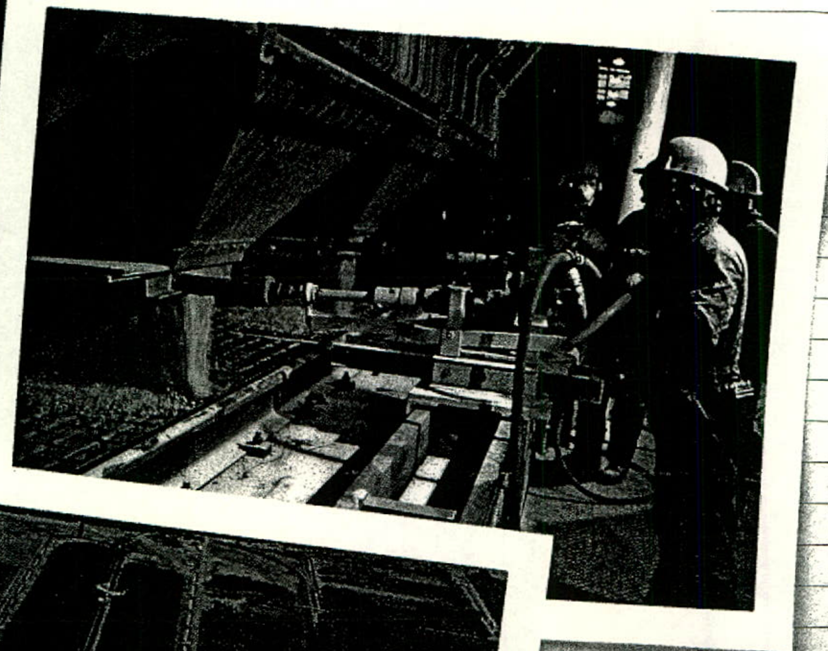
For the longer term, Standard expects to establish or acquire a significant operating base and distribution network in the United States as a first step toward further international geographical diversification.

In addition, the company has begun overhauling a new family of turbine engines used in helicopters and is actively seeking expansion of Standard Aero's role in the overhaul of industrial turbine engines which are seeing increasing use in gas transmission systems in Western Canada and for power generation in remote communities and on drilling platforms.

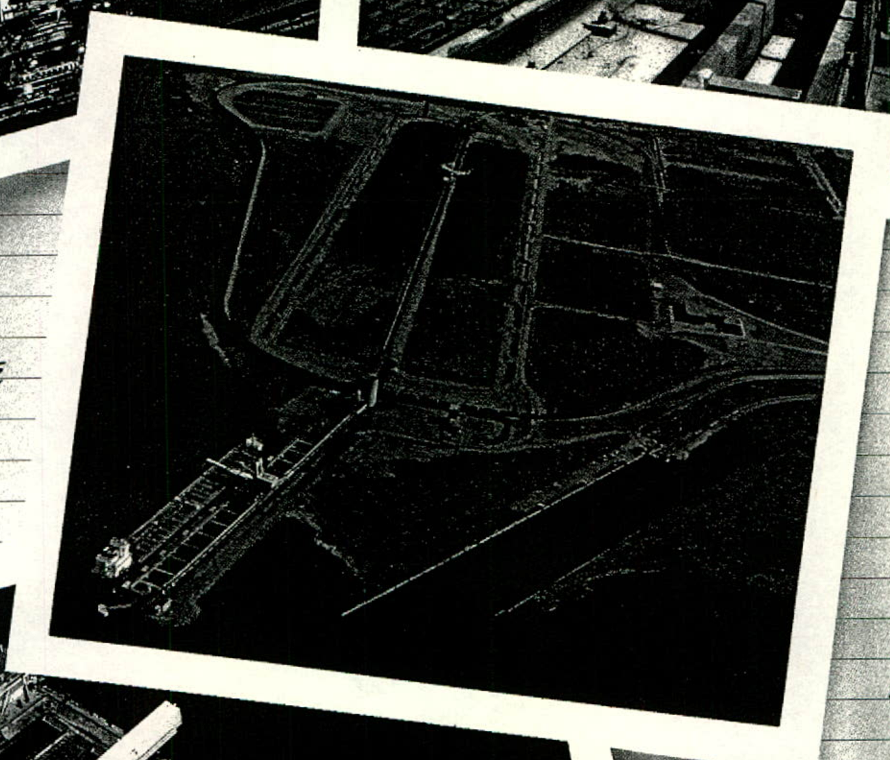
J.O. Baatz
President and Chief
Executive Officer

Initial corn shipments, while not large, are a reflection of continuing product diversification.

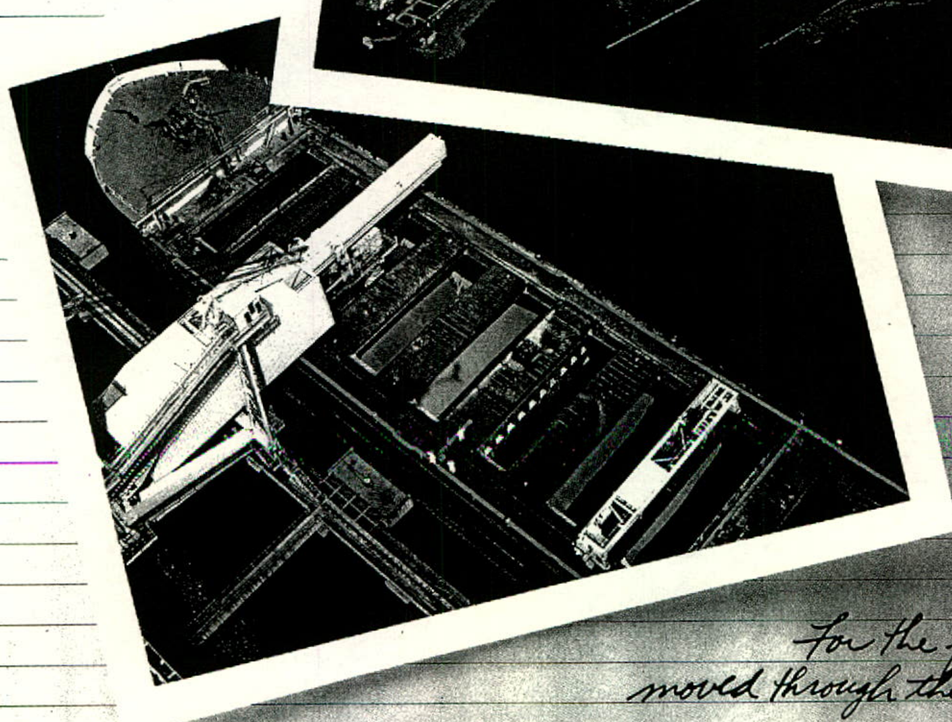




With a supplementary handling system completed, lignite is now handled for a nearby generating station.



Substantial room is available for future growth and expansion at Thunder Bay Terminals' modern facility.



For the first time potash moved through the terminal in 1981.

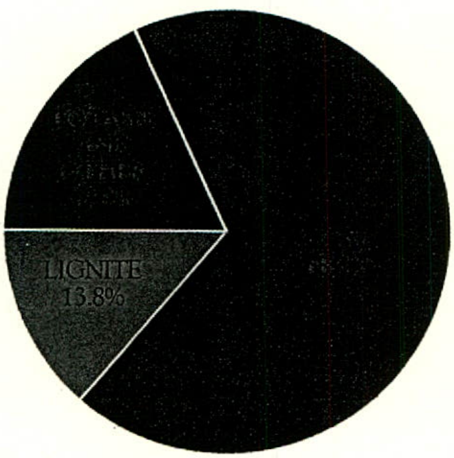
Terminals Division

Four Year Review

12 months	Sales (Millions)	Earnings from Operations* (Millions)
1981 December	18.7	10.8
1980 December	17.1	10.3
1979 December	14.8	8.9
1978 December	3.0	1.9

*Before taxes, extraordinary items, interest and inter-company charges.

Thunder Bay Terminals Ltd. is a major transshipment point between trains and Great Lakes vessels moving Western Canadian products to Eastern markets. Initially handling only thermal coal, the terminal is currently diversifying into other bulk commodities.



Sales distribution for the twelve months to December 31, 1981

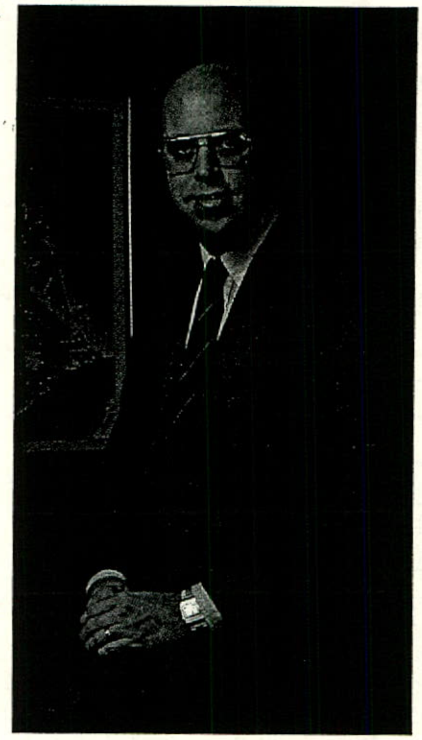
While thermal coal tonnage handled at Thunder Bay Terminals was up only five per cent over 1980 to 2,540,000 tonnes, there was a diversification of product into potash and corn, with a total of 678,000 tonnes handled. In addition, approximately 51,000 tonnes of metallurgical coal moved across the terminal in 1981.

Following completion of the supplementary handling system to serve the adjacent Mission Island Electrical Generating Station, 527,000 tonnes of lignite was handled, beginning a long-term arrangement for this type of coal for Ontario Hydro.

A total of 661,000 tonnes of potash were moved through Thunder Bay Terminals beginning in the second quarter of the year. The success of the Terminals Division in handling this new commodity profitably, at competitive rates, together with additional tonnages available in the Port of Thunder Bay, indicates that a separate, dry bulk handling system to handle additional potash as well as corn and grain-related products may be feasible.

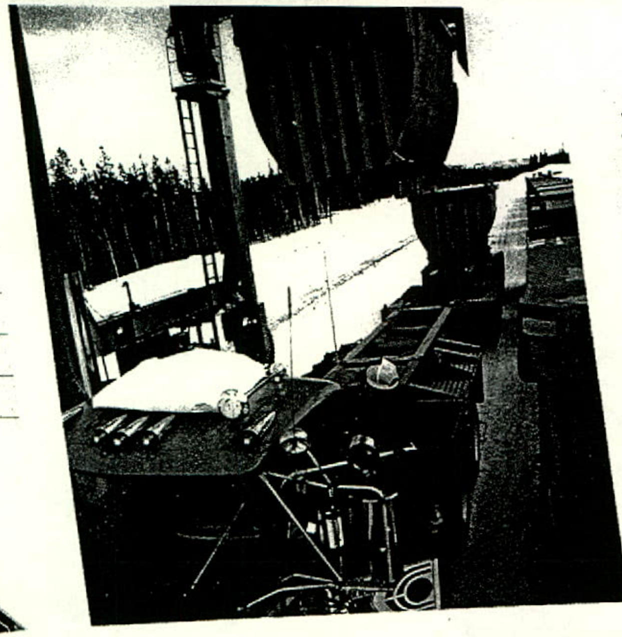
As one example of this potential, two shipments totalling more than 17,000 tonnes of Manitoba corn moved through the Terminal on its way to overseas markets. This was the first corn to move eastward from Manitoba and represents a possible continuing market for the company's services.

Thunder Bay management is aggressively pursuing future potash volumes and other commodities on a long-term contract basis. These initiatives, together with an expected increase in Ontario Hydro coal handling, should ensure that profits will continue to increase at a higher rate in 1982 and subsequent years.

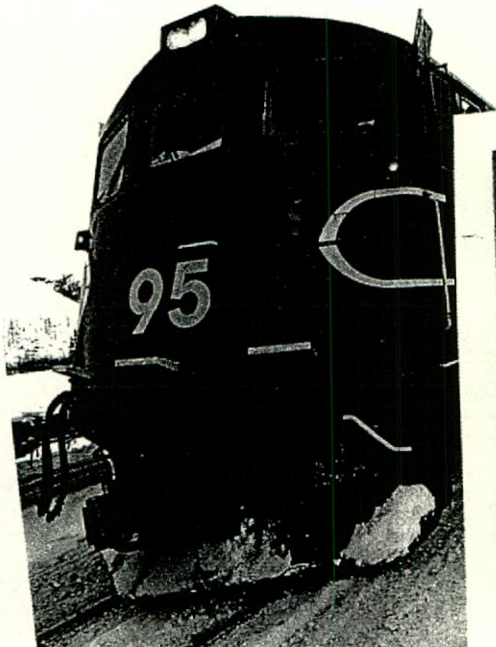


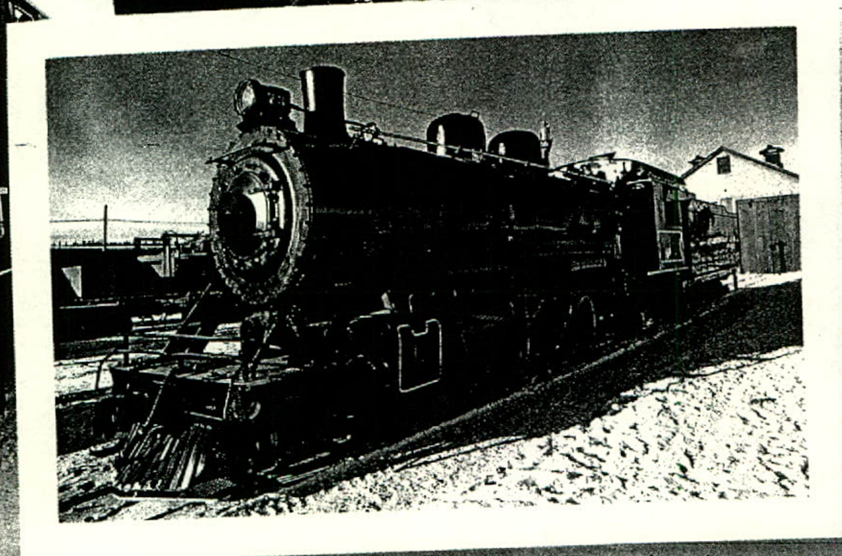
A. S. Leach, Jr.
President

The multi-modal White Pass transportation system moves bulk and general cargoes via truck, ship and rail throughout Western and Northern Canada

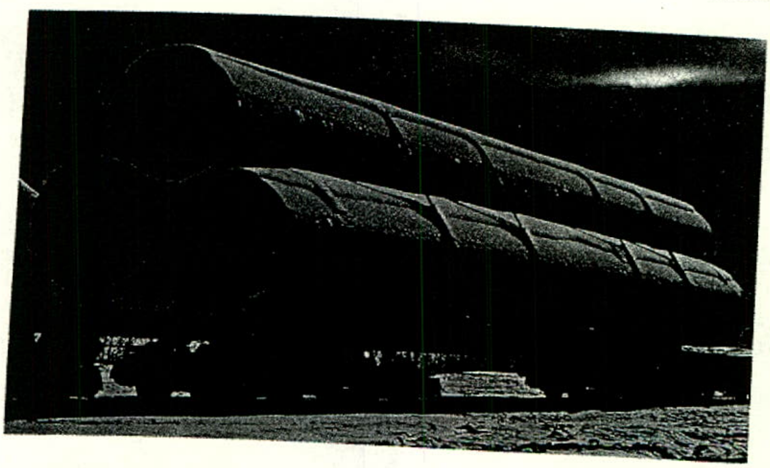


Historic engine #73 has been re-built as part of a summer tourism promotion designed to bolster rail passenger traffic.

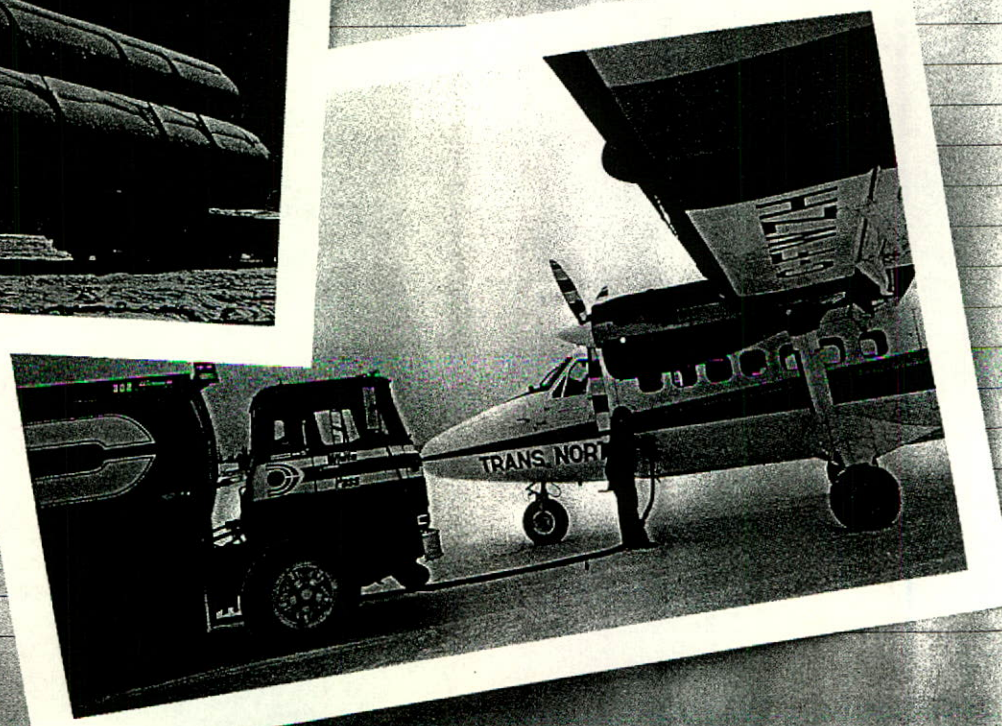




A special flatcar has been developed to carry large diameter pipe on existing roadbeds.



The White Pass petroleum products distribution network includes aviation fuels at Whitehorse airport.



Transport Division

Five Year Review

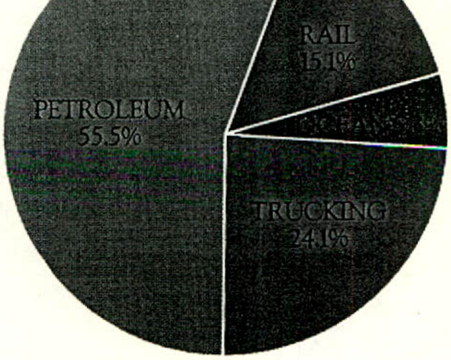
12 months	Sales (Millions) Freight	Petroleum	Total	Earnings from Operations* (Millions)
1981 December	45.5	54.3	99.8	8.1
1980 December	41.6	39.9	81.5	5.0
1979 December	37.2	28.0	65.2	(0.6)
1978 December	40.6	29.4	70.0	0.4
1978 March	41.7	28.5	70.2	1.8

*Before taxes, extraordinary items, interest and inter-company charges.

The White Pass and Yukon Corporation Limited is Yukon's largest petroleum and automotive parts distributor and provides a wide range of truck, rail, ocean and pipeline transportation services for bulk commodities and general freight in Alberta, British Columbia, Yukon and Northwest Territories.

On a divisional basis, the most significant improvement over 1980 was achieved in petroleum distribution. During the year, agreement was reached with the company's supplier, Chevron Canada, to purchase petroleum at the refinery in Burnaby, British Columbia rather than at Whitehorse. This new arrangement will give more effective control of inventories, timing of purchases and method of delivery. Also, White Pass was successful in signing a five-year agreement with the Northern Canada Power Commission to provide diesel fuel for electrical generation.

In late 1981, a major relocation of petroleum tank storage was completed in Skagway. Although constructed primarily for safety reasons, the new facility will provide a more effective and efficient transshipment operation.



Sales distribution for the twelve months to December 31, 1981

Trucking operations continued to expand during the year. The company received operating authorities between Vancouver and Whitehorse and began service from a new terminal in Burnaby, British Columbia, offering–for time-sensitive freight–a new alternative to the company's marine service. Additional operating authorities were received from the Alberta Government to truck on a new route between Edmonton and Prince George, B.C. An application for the B.C. portion of the route has been heard by the B.C. Motor Transport Board. In addition, approval is being sought to provide service to other areas including Tuktoyaktuk and McKinley Bay, N.W.T.

These initiatives are part of the company's overall strategy to extend its trucking services on a north/south axis and, over time, to become a prominent mover of general freight and other commodities in British Columbia, Alberta, Yukon, Northwest Territories and into the United States.

Events in 1981 surrounding the construction of the Northern natural gas pipeline have been encouraging and suggest that this major undertaking could begin relatively soon. White Pass and Yukon is in an ideal position to provide a substantial proportion of the haulage and servicing connected with construction and in 1981 successfully designed a special railway flatcar to carry large diameter pipe on existing roadbed. This, together with the company's proven competence in Northern trucking services, should ensure its prominent position among firms chosen to handle transport of up to 400,000 tonnes of pipe, to provide general freight services and to supply petroleum products during the construction period.

Management expects 1982 to be another year of continuing improvement. A return to more normal tonnage output from the company's largest customer, Cyprus Anvil Mining Corporation, together with anticipated increases in rail passenger traffic and efficiency gains, should produce significantly increased earnings for White Pass and enhance the future prospects of the company.

T. H. King
President and Chief
Executive Officer

Assessing Performance

There are many factors in a complete assessment of how well a company is doing. Performance must be evaluated in absolute terms, in comparison with other companies in the same industry, and in the light of market and economic conditions.

But in any analysis numbers are fundamental and the best source of these numbers is a company's financial statements and accompanying notes. They contain a wealth of information which can lead to a better understanding of your Company and its progress.

That's why we've dedicated the next few pages to a brief examination of information available to the shareholder in two of the basic financial statements — and from calculation of a few simple financial ratios.

Condensed Statement of Earnings

		$000
1	SALES AND SERVICES	192,690
2	(less) Operating costs	156,710
3	(less) Provision for depreciation and amortization	6,649
4	(less) Interest paid and received*	7,584
5	(less) Income taxes	10,462
6	NET EARNINGS BEFORE EXTRAORDINARY ITEMS	11,285
	(plus) extraordinary items	24
6a	NET EARNINGS	11,309
7	(less) Earnings allocated to minority shareholders	371
6b	NET EARNINGS ATTRIBUTABLE TO FEDERAL SHAREHOLDERS	10,938

*Interest paid is made up of $6,503 paid on long-term debt and $1,659 of other interest expense less $578 of interest earned.

Like people, companies vary in character. They can be aggressive or conservative, young at heart or mature, tight-fisted or openhanded, prosperous or struggling.

An experienced financial analyst can deduce many of these traits and more–as well as anticipate changes in corporate character and strategy–by using numbers to calculate a series of comparative financial ratios and percentages.

Investors without formal financial training can go a surprisingly long way down the same road, simply by understanding the logical format of the financial statements and by developing a basic feel for the changing figures.

That's because, even in cold print, the financial statements say a great deal about management decisions.

How much money should be set aside to replace plant and equipment at a time of high inflation–without decimating profits?

What is the true cost of the company's products and services, bearing in mind the continually rising price of labour and raw materials?

What value should be put on the inventory of unsold goods during a period of economic slowdown?

Corporate management, deploying hundreds of millions of dollars in assets, makes these kinds of decisions thousands of times each year. Ultimately, they're reflected in the financial statements–which provide a mirror of the company's strategies, successes and failures.

With that in mind, what can we tell about Federal Industries in 1981 from the income statement and balance sheet?

We'll start with the income statement because of the popular belief that the most important number is "the bottom line." In reality, it can mean relatively little if some of the other numbers cast doubt on the company's financial strength or provisions for the future. But it does show the profit that, in the best judgement of management, was earned during the financial year.

The bottom line (described in the abbreviated income statement opposite as net earnings attributable to Federal shareholders Line 6(b) is calculated by determining the dollar value of sales and services (Line 1) and deducting:

- All operating costs (Line 2)
- Depreciation and amortization–the provision for the continuing replacement of worn-out or obsolescent plant and equipment (Line 3)
- Interest paid and received (Line 4)
- Corporate income taxes (Line 5)
- The share of profits of a subsidiary attributable to the other shareholders of that company (Line 7).

For 1981, Federal Industries' net earnings attributable to shareholders were $10,938,000–or $10,914,000 before $24,000 in extraordinary items.

For some analysts, a more significant yardstick than profits is what is known as cash flow. Without a steadily increasing flow of internally generated cash to meet future needs, a corporation can wither and die, however impressive its bottom line may be.

Cash flow is not complex. It's the sum of the bottom line and those deductions from net income which are retained in the business and not paid out in cash. In short, the total portion of the profits available for reinvestment.

Federal's cash flow (Line 6(b) plus seven other items listed at the top of the Statement of Changes in Financial Position on page 12) was $18,709,000.

Ratios from the income statement can also be used to measure management efficiency.

One gauge is the gross profit margin, or the number of cents of profit remaining from each sales dollar after paying out operating costs and providing for depreciation and amortization. To calculate it, simply take the amount left from sales and services (Line 1) after deducting operating costs and depreciation (Lines 2 and 3) and express this as a percentage of sales and services.

$$\frac{(\text{Line 1 minus Lines 2 and 3} \times 100)}{\text{Line 1}} = 15.2\%$$

This particular yardstick is frequently applied to retailers and distributors. More often employed for companies such as Federal is net profit margin, which offers a more general measurement of management effectiveness.

Simply stated, this is net earnings before extraordinary items expressed as a percentage of sales and services.

$$\frac{(\text{Line 6} \times 100)}{\text{Line 1}} = 5.9\%$$

This represents an improvement of more than 20% over the net profit margin for 1980. In fact, Federal's profit margins have been improving steadily for the past five years.

One other useful measure of financial security is to calculate how well interest charges are covered. If, for instance, coverage is slender, a relatively small drop in profits can wipe out the bottom line.

Interest coverage is normally determined by dividing the profits available to pay interest charges (sales and services–Line 1, minus operating costs–Line 2, and depreciation–Line 3) by total interest charges (Line 4). In 1981, Federal's 1981 coverage was 3.9 times. Or, put another way, 25.9% of operating profit was absorbed by borrowing costs.

One further income statement ratio that says something about the credibility of a company in the eyes of investors is the payout rate–the percentage of the bottom line paid out in dividends. In Federal's case, $1.4 million was paid out in 1981 dividends. Divided by Line 6(b) and multiplied by 100 the resulting ratio is 12.5%. In March 1982, the annualized dividend rate was increased by 66⅔%, which rate, if applied to 1981, would have produced a payout rate of 20.9%. A steady payout ratio implies that investors can relate their dividend expectations to estimates of earnings growth in the years to come.

Condensed Balance Sheet

	Assets	$000
8	Current assets	91,084
9	Fixed assets (property, plants and equipment)	109,974
10	Other assets	5,246
	Total assets	206,304

	Liabilities	$000
11	Current	51,036
12	Long-term debt	68,313
13	Deferred income taxes	6,500
14	Minority interest	5,500
	Total Liabilities	131,349
	Shareholders' Equity	
15	Share capital	30,106
16	Retained earnings	44,849
	Total shareholders' equity	74,955
	Total liabilities and equity	206,304

The Balance Sheet

In turbulent economic times, this statement, which shows how well a company is managing its assets, takes on extra importance.

In essence, the balance sheet is a statement of what a company owns in short-term holdings (Line 8), plant and equipment (Line 9) and in less readily definable assets (Line 10)–balanced against what it owes in the short-term (Line 11), its long-term debt (Line 12), its provision for future taxes (Line 13), the share of subsidiary companies attributable to outside, or "minority" shareholders (Line 14) and last, but most important, the remaining share of the assets that the shareholders can call their own (Lines 15 and 16).

This shareholders' equity is divided into the funds originally subscribed (Line 15) and the sum total of profits plowed back into the business since Day One (Line 16).

The beauty of any balance sheet is that it is very easy to determine how large a stake in the company is held by a company's short-term creditors, its long-term creditors and its shareholders.

This breakdown can then be used to gauge leverage, or the effect of borrowing other people's money to increase the return on the company's own funds.

Leverage is a great way of boosting profits when interest rates are relatively low. But if interest rates soar, as they did last year, leverage can start working the wrong way with rising interest costs consuming profits.

The income statement provides one indication of leverage, but only in terms of past operations and past levels of interest rates. As a result, most analysts prefer to look at the balance sheet to determine precisely how reliant a company is on borrowed capital.

There are several ways of doing this. One, the debt/equity ratio involves dividing total long-term outstanding debt (Line 12) by the total of shareholders' equity (Lines 15 and 16) plus minority interest (Line 14) and deferred taxes (Line 13). In theory, the result of 0.78:1 for Federal at December 31, 1981, shows somewhat better than the "norm" of one dollar or more of long term debt for every dollar of equity.

In practice, more than 85% of Federal's long-term debt is involved in Thunder Bay Terminals Ltd. This portion is an integral part of the contract with the Terminal's major user, Ontario Hydro, which also provides for the method of repayment. In other words, there is not the same reliance on the borrowing as if Federal had raised this long-term debt for general corporate purposes. Setting aside Thunder Bay's debt, as many analysts do, provides a debt/equity ratio of 0.09 to 1–or one dollar of debt for every $11 of equity.

In the end, the key is that repayment of principal is well within the corporation's ability. Your management is satisfied that this test is readily met.

As any shareholder who owns a house will appreciate, there is little point in achieving the right capital ratios if you haven't got the cash in hand to pay your bills. Lack of liquidity, as this painful circumstance is known, can put you in a position of having to sell valuable assets at fire sale prices.

Corporate liquidity is measured by two common ratios. The working capital ratio is calculated by dividing current assets (Line 8) by current liabilities (Line 11). It is a simple measure of how much the value of short-term assets exceeds what a corporation owes within the next 12 months. Federal's ratio at yearend was 1.78:1. For 1971-1980, the average working capital ratio for 160 Canadian investor-owned companies as measured by The Financial Post Investment Databank was 2.0:1.

A more stringent test is to determine how much of what is owed within the next 12 months is covered by cash and by items with a ready cash value. This is the quick asset ratio, calculated by first subtracting inventories (valued at $47.1 million in the formal accounts) before doing the division sum. In the company's case, the resulting ratio was 0.86:1. By comparison, the 10-year average for the 160 companies was a less favourable 0.39:1.

A final concept that should be examined is that of invested capital. This is the sum of all long-term capital invested in the business, and is used in determining some of the combined balance sheet and income statement ratios that follow. Federal's invested capital at yearend was $155,268,000, representing the total of shareholders' equity, (Lines 15 and 16), long-term debt (Line 12), deferred taxes (Line 13), and minority interest (Line 14). This total was up from $134,442,000 at the beginning of the year ("opening" invested capital).

Combined ratios

By combining income statement and balance sheet numbers into a broad spectrum of ratios, analysts measure the effective use of a company's assets.

For instance, a 25% increase in profits every year for five years may sound exceptional when stated in isolation. But it will not cut much ice with prospective investors if the return on the assets at management's disposal averages 1% over the same period.

One way to measure how well all a company's assets are being managed is to look at net return on invested capital. Start with net earnings before extraordinary items (Line 6), add half the interest on long-term debt (Line 4 divided by two, to allow for the effects of income tax) and divide by average invested capital (invested capital at yearend plus opening invested capital, divided by two). Multiplied by 100, this gives Federal a net return on invested capital of 10% for 1981. (The 10-year average for the 160 Canadian companies measured was 11%).

From the ordinary shareholders' point of view the best measure is perhaps net return on common equity, calculated by dividing the bottom line (Line 6(b)) by opening common equity (the sum of Lines 15 and 16 on January 1, or $55,010,000) and multiplying by 100. Federal's return on common equity in 1981 was 20.0%.

Another method to calculate the latter ratio uses average common equity as the divisor. On this basis, Federal's return on common equity would be 16.8% in 1981, compared with 15.6% for the 10-year average of other companies.

Market ratios

Yet another group of ratios is used to measure the stock market ratings of different companies. That's because share price alone does not say a great deal unless there is a common means of relating it to earnings, dividends and shareholders' equity.

This is done by calculating the fraction of each of these that would accrue to the holder of a single share. Divide the bottom line (Line 6(b)) by the average number of shares outstanding (4,475,749) and you have earnings per share ($2.44). The dividend per share of 27.5 cents is recorded in the Historical Summary on page 19.

Common equity per share, better known as book value, is calculated by dividing common equity by the number of shares outstanding. At December 31, it was $15.65.

These per-share numbers can be used to determine how investors at large currently perceive the value of a particular stock. (This perception can, of course, be wrong. And proving the pundits incorrect by buying a stock before the market as a whole awakes to its real value is part of the joy of investing).

Divide the share price by earnings per share and you get a measure called the price-earnings multiple. This tells how many years' earnings at the current rate investors are prepared to pay for an individual stock. If the multiple is high, investors are–rightly or wrongly–looking for sharply increased earnings and are thus prepared to pay a high price in relation to current earnings. If the multiple is low, there's relatively less optimism about (or understanding of) the company's future prospects.

At yearend, the multiple on Federal's common stock was 5.35 times, which was close to the average multiple for the Toronto Stock Exchange's Transportation Index of 5.67 times, but below the average of 8.57 for the TSE's composite, 300-stock index and for the diversified holding companies represented in that index.

Another measure is to calculate the dividend as a percentage of the share price. The resulting dividend yield can then be compared with returns on alternative investments of all kinds. However, dividend yield does not take into account the proportion of the bottom line reinvested in the business. At yearend, the yield on Federal common stock was 2.1%, which was low by any comparative Toronto Stock Exchange yardstick. What this means is that a relatively larger proportion of earnings had been reinvested in the business, making the common stock more attractive to investors seeking future growth than to those needing current dividend income.

One ratio used somewhat less frequently relates book value to share price. It is not an absolute comparison because market values are established by investors' estimates of the future pattern of earnings. In other words, investors are normally much more concerned with the return on book value (or common equity) achieved by management than book value itself.

A market price well below book value can be one measure of an undervalued stock, particularly if the return on common equity has been rising. On the other hand, a market price significantly above book value can be a warning sign that investors have unrealistic expectations of future performance.

For the record, the book value of Federal's stock at yearend was at a 20% premium to market price.

Some Conclusions–and Caveats.

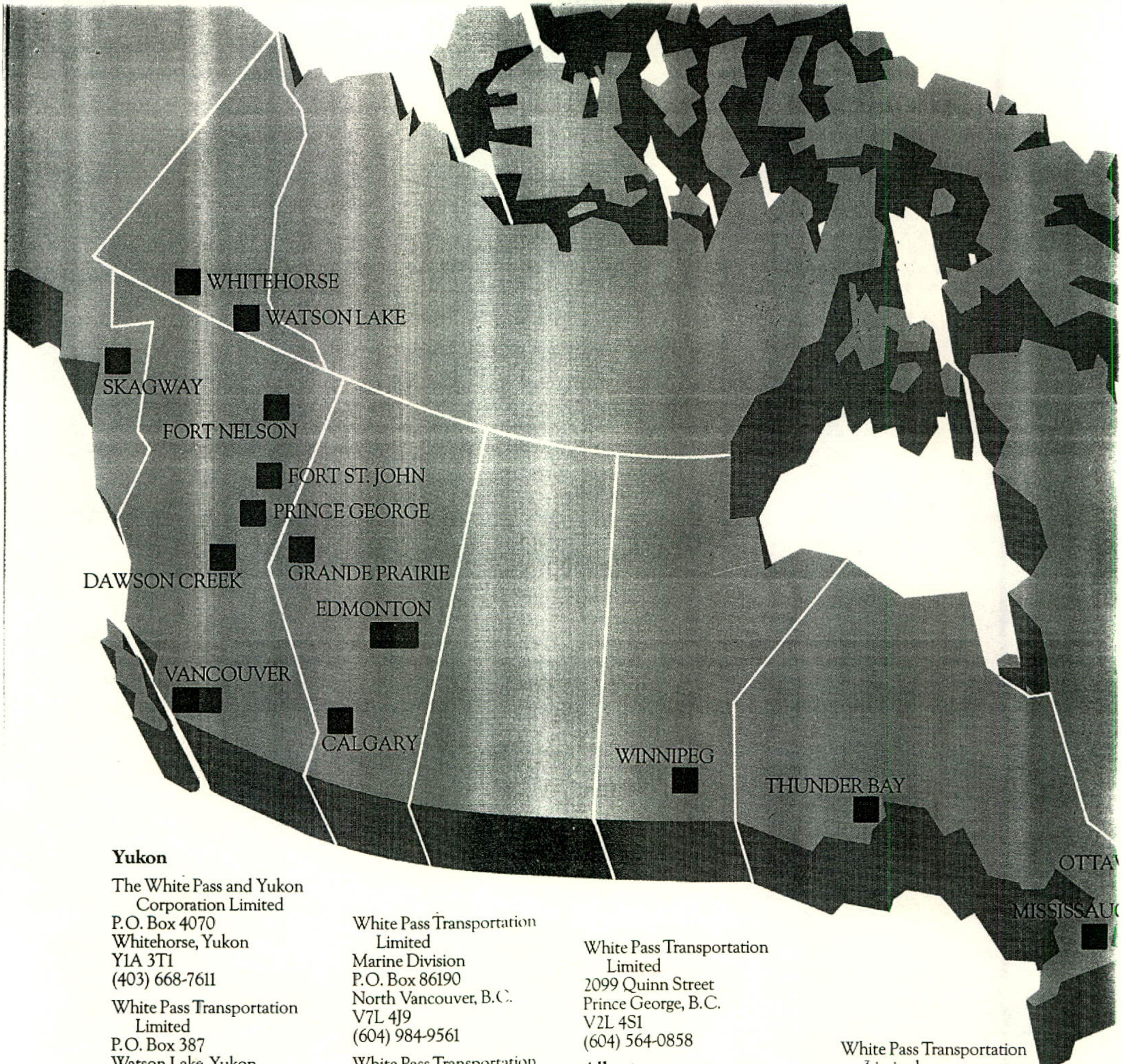
An analysis of the income statement and balance sheet points to a currently satisfactory financial position.

Earnings have grown consistently for the past several years and the return on your investment in the company is now up to our targeted level. The balance sheet has also improved significantly.

In general, the analysis points to a solid financial base for future expansion.

As Federal Industries grows, and in response to varying economic conditions, its results must–and will–change. As with any company, a continuing assessment of Federal Industries' progress will demand a regular re-evaluation of the numbers in the light of corporate strategies and prevailing economic trends.

We invite you to continue to assess the company's results–and to measure comparative management performance–as one means of justifying your continuing involvement as a shareholder.



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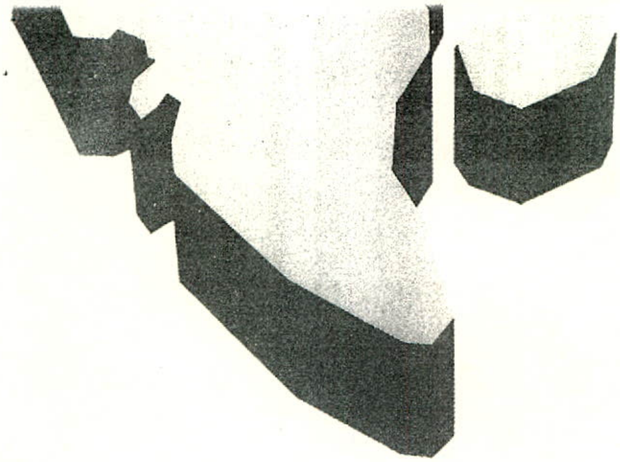

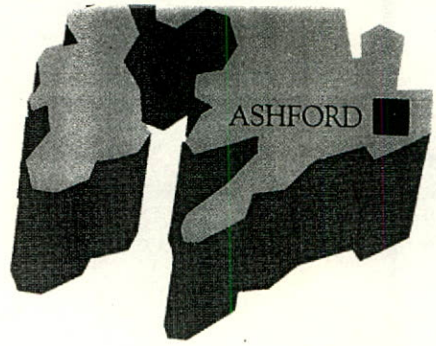

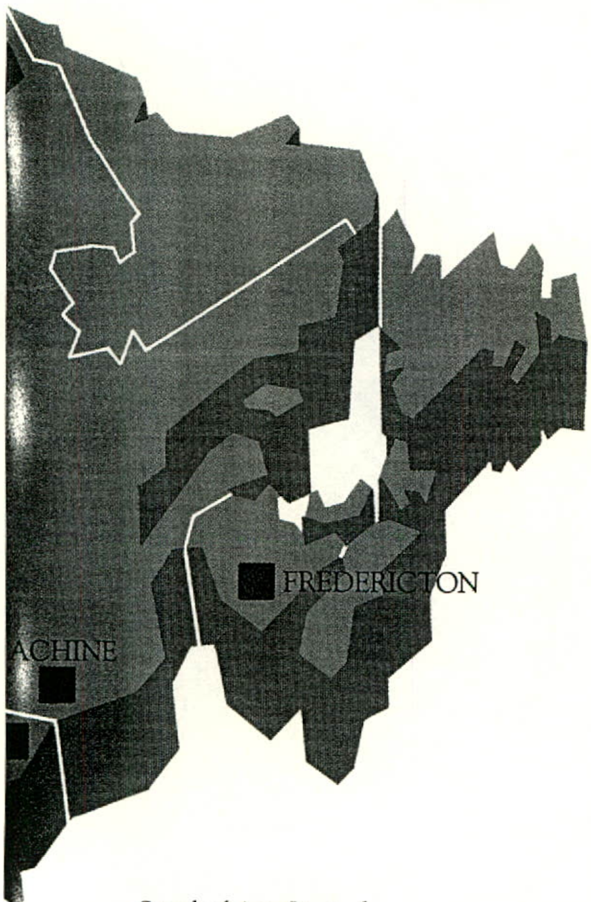

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Directory of subsidiaries

TRANSPORT DIVISION

The White Pass and Yukon Corporation Limited

Whitehorse, Yukon

J. F. Fraser
Chairman of the Board

T. H. King
President and Chief Executive Officer

G. W. Goertz
Chief Financial Officer and Treasurer

F. A. Taylor
Manager, Marketing

F. H. Hoskin
Manager, Industrial Relations and Personnel

J. W. Campbell
Manager, Petroleum Division

W. V. McIsaac
Manager, Yukon Operations

K. M. Steele
Lands Manager

Edmonton, Alberta

W. T. Cowger
Manager, General Freight Division

Skagway, Alaska

M. P. Taylor
Manager, Rail and Alaska Operations

Seattle, Washington

W. E. Feero
Manager, Passenger Services and Planning

Vancouver, B.C.

D. H. Sladden
Senior Manager–Vancouver

North Vancouver, B.C.

S. Kollbaer
Manager, Marine Division

AEROSPACE DIVISION

Standard Aero Limited
Winnipeg, Manitoba

H. W. Grant
Chairman of the Board

J. O. Baatz
President and Chief Executive Officer

J. A. Burgess
Vice-President, Engineering

R. A. Carter
Vice-President, Distribution Division

D. A. Pilley
Vice-President, Administration

TERMINALS DIVISION

Thunder Bay Terminals Ltd.
Thunder Bay, Ontario

J. F. Fraser
Chairman of the Board

A. S. Leach, Jr.
President

N. H. Carr
Vice-President and General Manager

D. E. Kelso
Operations Superintendent

D. S. Bhattal
Maintenance Superintendent

K. W. Traynor
Director of Finance

J. W. Kepes
Controller

Board of Directors

J. F. Fraser
President and Chief Executive Officer
Federal Industries Ltd.

***R. G. Graham**
President
Inter-City Gas Corporation

A. S. Leach, Jr.
Vice-President
Federal Industries Ltd.

***J. B. MacAulay**
Partner, Fraser & Beatty
Barristers and Solicitors

***A. V. Mauro**
President
The Investors Group

J. S. Pelton
Vice-President, Finance
Federal Industries Ltd.

***J. D. Riley**
Company Director

C. L. Searle
Professor of Electrical Engineering
Massachusetts Institute of Technology

S. A. Searle
Chairman of the Board
Federal Industries Ltd.

**Member of Audit Committee*

Officers

S. A. Searle
Chairman of the Board

J. F. Fraser
President and Chief Executive Officer

A. S. Leach, Jr.
Vice-President

J. S. Pelton
Vice-President, Finance

R. J. Vahsholtz
Vice-President, Planning

W. D. Davie
Secretary

The Company and its Subsidiaries

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Thunder Bay Terminals Ltd.

The White Pass and Yukon Corporation Limited

Transfer agent and registrar
The Royal Trust Company
Calgary, Montreal, Toronto, Vancouver and Winnipeg

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