PACIFIC WESTERN AIRLINES
ANNUAL REPORT 1978

Getting
People Together . . .

PACIFIC WESTERN TRANSAIR

Board of Directors

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President, McDaniel Consultants (1965) Ltd., Calgary, Alberta

A. H. MITCHELL, *Vice Chairman*
President, Mitchell & Associates Ltd., Edmonton, Alberta

W. J. BORRIE
Honorary Chairman, Pemberton Securities Ltd., Vancouver, B.C.

C. W. BRAZIER, Q.C.
Associate Counsel, Davis & Co., Vancouver, B.C.

A. F. CAMPNEY
Partner, Campney & Murphy, Vancouver, B.C.

R. T. EYTON
President & Chief Executive Officer,
Pacific Western Airlines Ltd., Calgary, Alberta

S. KANEE, O.C., Chairman of the Board
Soo Line Mills (1969) Ltd.,
Winnipeg, Manitoba

E. W. KING
President, Canadian Utilities Limited, Edmonton, Alberta

R. B. LOVE, Q.C.
Partner, Macleod Dixon, Calgary, Alberta

D. H. SEARLE, Q.C.
Senior Partner, Searle, Richard & Kingsmill, Yellowknife, N.W.T.

R. D. SOUTHERN
President & Chief Executive Officer, Atco Industries Ltd., Calgary, Alberta

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R. T. EYTON, *President & Chief Executive Officer*
H. D. COPE, *Executive Vice President & Chief Operating Officer*
D. F. GRANGER, *Senior Vice President (Finance & Secretary)*
R. L. LAKE, *Senior Vice President (Regional Services)*
J. M. ROBINS, *Senior Vice President (Planning & Regulatory Affairs)*
A. C. CAMPBELL, *Vice President (Central Region)*
G. J. COOKE, *Vice President (Western Region)*
A. W. CORBETT, *Vice President (Administration)*
W. DOBIN, *Vice President (Technical Services)*
K. FRANSBERGEN, *Vice President (Flight Operations)*
K. E. GRAY, *Vice President (Charter Services)*
D. R. JACOX, *Vice President (Public & Industry Affairs)*
A. J. MOUL, *Vice President*
E. PEZZOT, *Vice President (Transair Division)*
J. V. R. WARK, *Controller*
R. W. BENALLICK, *Treasurer*
M. SIGLER, *Corporate Counsel & Assistant Secretary*

Registered Office

Vancouver International Airport Central
Vancouver, B.C.

Head Office and Executive Offices

Suite 700
700 - 2nd Street S.W.
Calgary, Alberta

Registrar and Transfer Agent

Montreal Trust Company
Vancouver, B.C.; Edmonton, Alberta

Bankers

Canadian Imperial Bank of Commerce
The Mercantile Bank of Canada

Shareholders' Auditors

Peat, Marwick, Mitchell & Co.
Vancouver, B.C.

Subsidiary Companies (Wholly-owned or controlled)

Transair Limited
Midwest Airlines Ltd.
Pacific Western (Alberta) Ltd.
Pacific Western Airlines (Alberta) Ltd.
Aero Engineering Limited
B.C. Airlines Limited
Arctic Wings Limited
Aircraft Services (Western) Limited

1978 in Brief

	1978	1977
FINANCIAL (in thousands of dollars)		
Operating revenue	**$178,431**	$131,220
Operating expense	**156,771**	113,376
Operating income	**12,157**	9,368
Net earnings for the year	**8,447**	3,246
Funds provided by operations	**15,003**	11,291
Average number of common shares issued	**2,567,718**	2,549,296
Earnings per common share	**$3.24**	$1.23
OPERATIONS		
Passengers carried		
Mainline	**2,775,352**	2,308,287
International charter	**102,514**	107,689
Domestic charter	**231,696**	123,896
Passenger miles flown		
Mainline	**728,352,166**	543,317,913
International charter	**366,583,018**	381,308,025
Domestic charter	**279,348,671**	152,129,798
Cargo ton miles flown		
Mainline	**14,858,873**	14,412,778
Domestic charter (excluding Hercules)	**6,613,717**	5,527,825
Hercules	**15,868,384**	20,050,015
Aircraft miles flown		
Mainline	**13,604,184**	10,006,629
International charter (excluding Hercules)	**2,757,993**	2,895,428
Domestic charter (excluding Hercules)	**3,764,159**	2,187,552
Hercules	**1,573,354**	1,913,236


R. R. McDANIEL


A. H. MITCHELL


W. J. BORRIE


C. W. BRAZIER, Q.C.


A. F. CAMPNEY


R. T. EYTON


S. KANEE, O.C.


E. W. KING


R. B. LOVE, Q.C.


D. H. SEARLE, Q.C.


R. D. SOUTHERN

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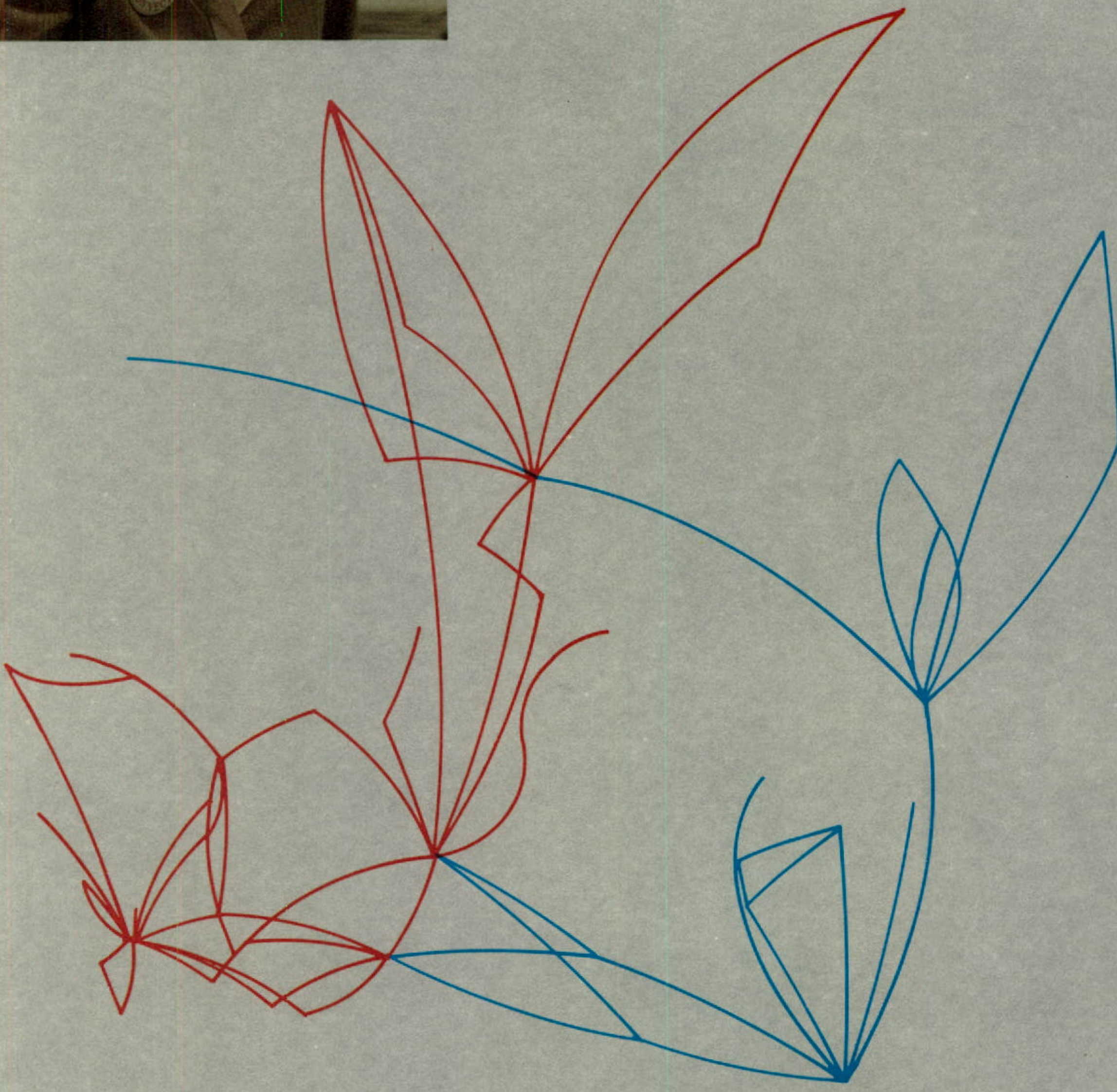
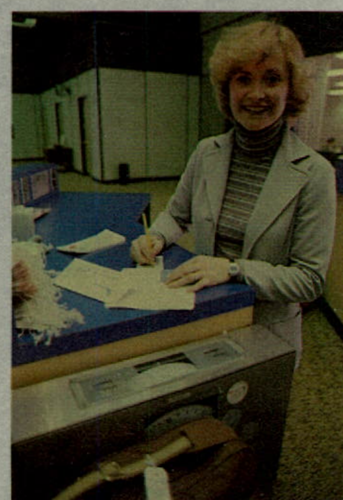
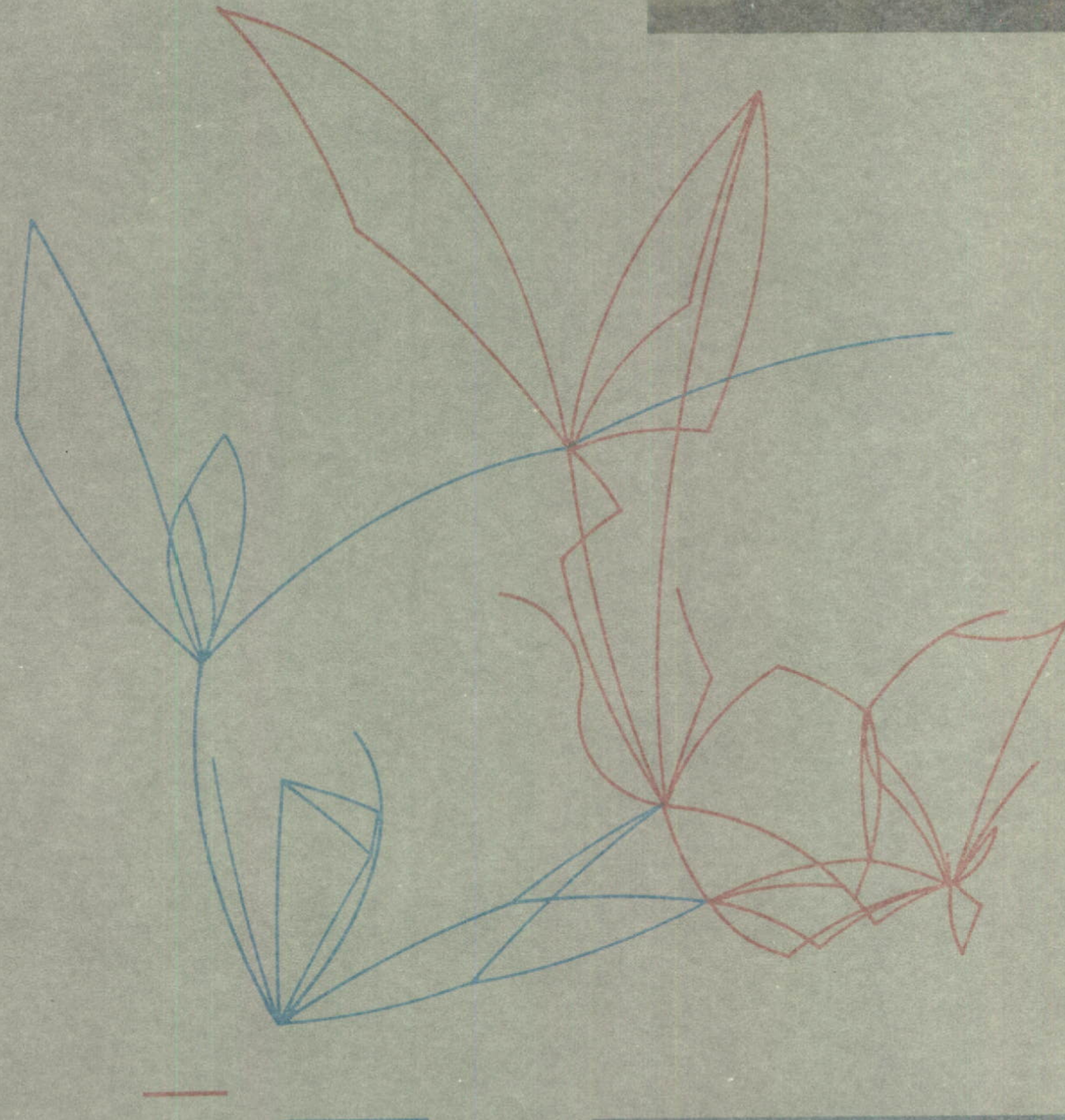






PACIFIC WESTERN AIRLINES
TRANSAIR

Report of the President and Chief Executive Officer

On behalf of the Board of Directors I am pleased to submit the Annual Report for the twelve month period ending December 31, 1978.

Financial

In 1978, the company produced record net consolidated earnings of $8.4 million compared with restated net earnings of $3.2 million in 1977.

The earnings for 1978 include gains on disposition of assets of $2.9 million compared to $.4 million in 1977. As well, the accounts of Transair Limited, a new subsidiary of Pacific Western Airlines Ltd. were consolidated with those of the parent company for the period May 1, 1978 to December 31, 1978. The effect of this consolidation was to add $.8 million to net earnings for the year.

Net earnings per common share amounted to $3.24 per share compared to $1.23 in 1977.

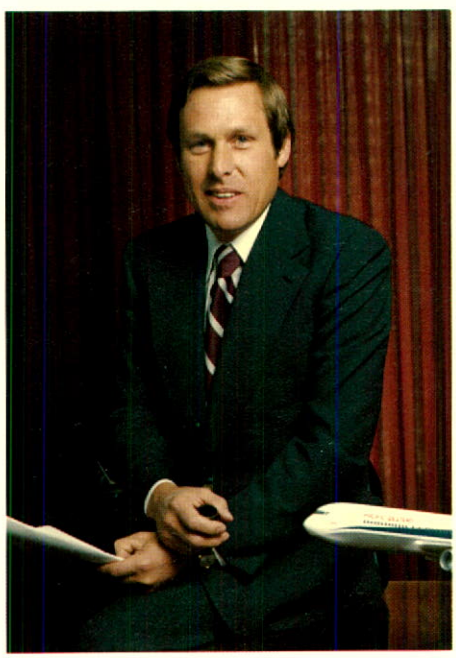
The Company's operating revenue climbed to a record $178.4 million compared to $131.2 million in 1977, representing a 36% increase over the prior year.

Operating expenses climbed to $156.8 million in 1978 compared to $113.4 million in 1977.

During the year the Company completed a significant refinancing by the issuance of preferred shares through a new subsidiary company — Pacific Western (Alberta) Ltd. The proceeds of this transaction permitted the Company to retire and restructure a large portion of its debt and to provide funds for planned aircraft purchases over the next five years.

The new subsidiary, Pacific Western (Alberta) Ltd., now holds a major portion of Pacific Western Airlines Ltd. fixed assets which are being leased back to the airline.

An existing issue of Series A redeemable preferred shares which were exchangeable for four common shares at the option of the holder at any time prior to December 2, 1978, were exchanged for common shares prior to the deadline.



Transair Acquisition

The acquisition of Transair Limited by Pacific Western Airlines Ltd. was approved by the Canadian Transport Commission in April, 1978. Subsequent to this approval, additional shares were solicited and the Company now holds approximately 96.5% of the common shares of Transair.

Transair relinquished its scheduled routes east of Winnipeg, Manitoba, on February 3, 1979, and replaced these with new services between Winnipeg, Regina, Saskatoon, Calgary, and Edmonton. This has resulted in the linking of the route structures of the two companies at Calgary and Edmonton, as well as at Yellowknife, N.W.T. Although Pacific Western is required to operate Transair as a separate legal entity, many temporary operating efficiencies were implemented, following the acquisition approval, to the benefit of both companies.

It is contemplated that an application to merge Pacific Western and Transair will be made in 1979 in order to achieve full economies of scale and the total benefits of an integrated route network.

Mainline Revenue

Mainline revenues for 1978 were $125.1 million, an actual increase of $36.3 million or 40.9%, surpassing, by some margin, the 1977 figure of $88.8 million. The increase is attributable to the higher than anticipated traffic levels in the Company's area of operation and to the addition of Transair revenues for the last eight months of the year of $23.6 million.

Passenger Charter Revenues

These revenues of $30.9 million contributed 17.3% to the total operating revenues in 1978 compared to 17% and $22.3 million in 1977.

The future of the Company's overseas passenger charter operation was reviewed during the year. A decision was made to withdraw from this activity in view of large continuing operating losses and because of the generally unsettled climate in this market. Although contributing a revenue of $15.1 million in 1978, an operating loss of approximately $1.4 million was incurred in the year. This followed sizeable losses in each of the preceding five years. This program was operated with two Boeing 707 aircraft, one of which was sold in the early Fall of 1978 while the other has been sold for delivery following the conclusion of the Company's Winter charter program at the end of April, 1979.

This decision has and will result in the dislocation of a number of Company employees. Steps have been taken by the Company to minimize the effects of job dislocation following final shutdown.

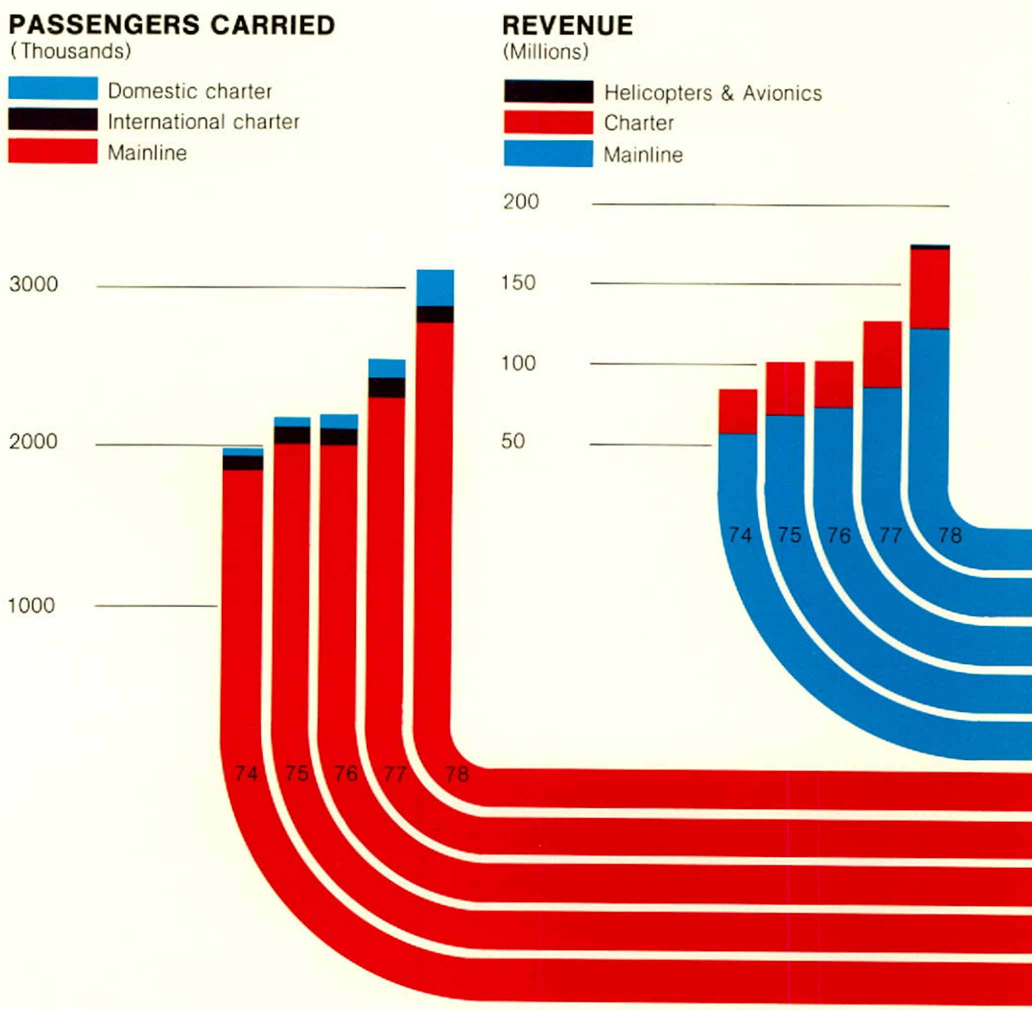
The Company implemented plans during the year to increase its presence in the transborder passenger charter market to sunspots in the southern U.S.A., Mexico and the

Caribbean. In 1978 this operation produced revenues of $13.8 million compared to $6.0 million in 1977. Pacific Western has been in this market in a significant way for several years, using its Boeing 737 aircraft, and plans to build on this foundation in its future plans. The effect of this stepped-up activity should be to mitigate some of the employee dislocation that will occur with the Company's exit from the overseas passenger charter market.

Hercules Cargo Operation

This operation produced a total of $16.1 million in 1978 compared to $16.5 million in 1977. Hercules aircraft to supplement the Company's fleet of three were leased for several short periods during the year to meet peak demands.

A new Hercules Dash 30 model was acquired in December 1978 to replace one of the older models. The new aircraft enabled the Company to successfully tender on the transporting of Canadian military aircraft from points in Europe to Edmonton, Alberta, for overhaul. The



contract will be spread over a three year period and although it represents only partial utilization of the new aircraft it will generate a significant amount of revenue for the overall Hercules program.

Operating Expenses

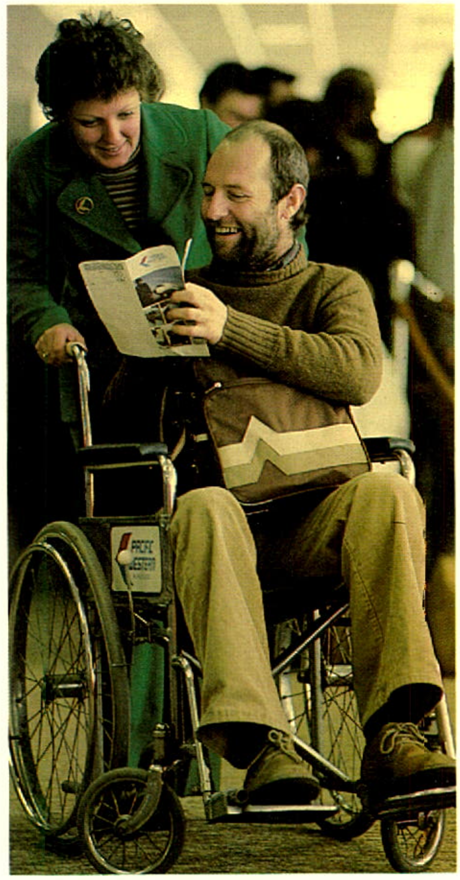
Fuel and oil, along with wages and benefits, represented 63.8% of the Company's operating expenses in 1978 compared to 66.2% in 1977.

In 1978 fuel and oil amounted to $37.3 million and 23.8% of operating costs compared to $26.7 million in 1977 and 23.5% of costs. Fuel costs increased 14.7% per gallon in 1978 compared to 1977. This area of cost continues to concern the Company, particularly in view of strong indications that the upward price spiral is far from over. With every 1¢ per gallon increase in the average cost representing a $525,000 addition to the Company's fuel bill, continuing upward pressure in our operating costs is a certainty.

Wages and benefits represented 40.0% of operating costs in 1978 compared to 42.7% in 1977.

Fleet Planning

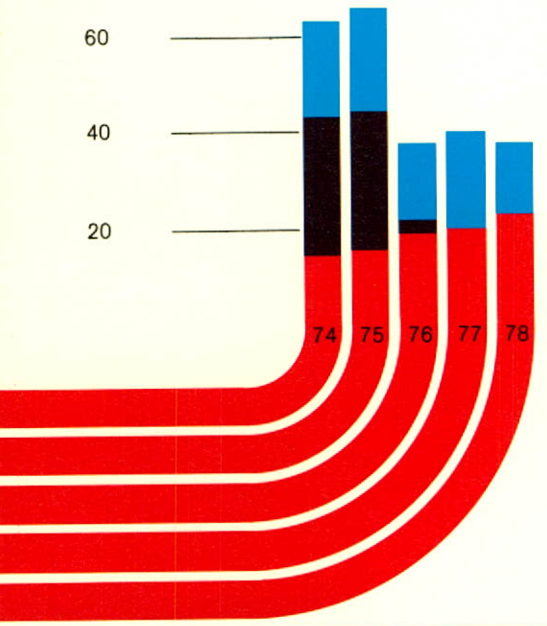
Several steps were taken during the year to standardize the fleets of both Pacific Western and Transair. Three Convair 640 aircraft were retired from active service by Pacific Western in the first half of 1978 and were sold. The Hercules fleet has been upgraded by the addition of a new stretched Dash 30 model and one of the Hercules Dash 20 models has been retired from the fleet and is



CARGO TON MILES

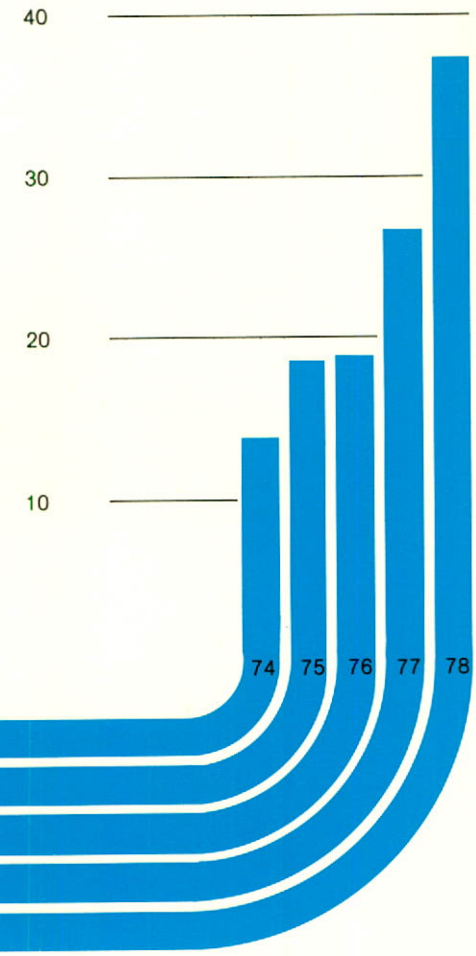
(Millions)

Hercules
International charter (Excluding Hercules)
Mainline



FUEL AND OIL COSTS

(Millions of dollars)



Aircraft Fleet

At December 31st, Pacific Western and Transair had 26 fixed wing aircraft and 11 helicopters in their fleets, including:

	Pacific Western	Transair	Total
Boeing 737-200	13	3	16
Boeing 727-100C	1	—	1
Boeing 707-320C	1	—	1
Lockheed Hercules Dash 20 *	3	—	3
Lockheed Hercules Dash 30	1	—	1
YS-11	—	2	2
F-28	—	2	2
	19	7	26

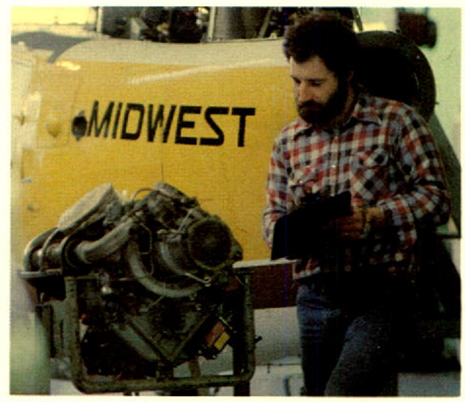
* One Hercules retired from service and being offered for sale.

Helicopters:

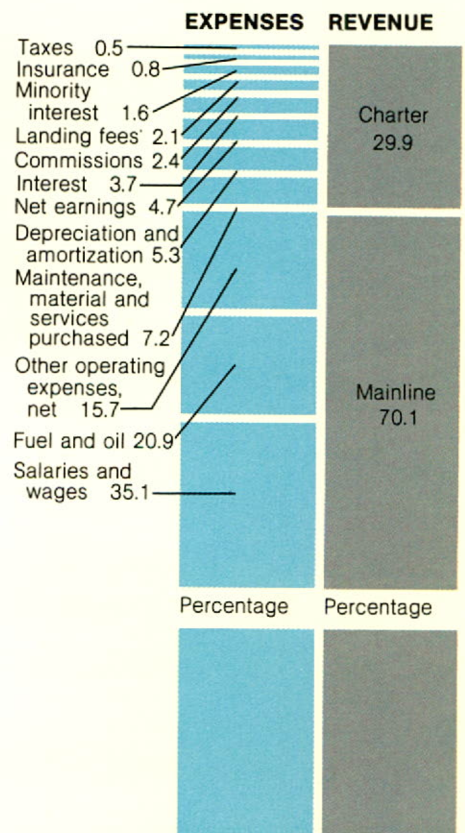
	Pacific Western	Transair	Total
Bell 204	—	1	1
Bell 206B	—	10	10
TOTAL	19	18	37

being held for sale. The Boeing 707-320C will be withdrawn from service at the end of April and has been sold for delivery at that time. The two F-28 aircraft of Transair's will be phased from service in the first half of 1979 and have been sold for delivery in February and June of 1979.

Pacific Western holds firm orders for three additional Boeing 737's and options for an additional two. It is planned that two of these aircraft will be taken in 1979, two more in 1980, and one in 1981, which would bring the combined Boeing 737 fleet of Pacific Western and Transair to twenty-one.



DOLLAR DISTRIBUTION 1978



Following a market analysis of expected passenger traffic in the 1980's, orders were placed in February, 1979, for four new generation Boeing 767 jet aircraft for delivery in 1983 and 1984. Options on two additional Boeing 767's were taken at the same time. This represents the most significant expansion program ever embarked on by the Company. The total Canadian dollar value for the six aircraft, along with support equipment and facilities, will exceed $200 million.

Aircraft Loss

The loss of forty-three lives in an accident involving one of our Boeing 737 aircraft at Cranbrook, B.C., on February 11, 1978, was reported to you last year. The final report on this accident is expected to be available to us shortly.

Management Changes

A reorganization of senior management responsibilities took place in mid-1978 in order to prepare the Company for the addition of the Transair operation and the growth expected over the next few years in the Pacific Western system.

We were fortunate to have Mr. Harold Cope, previously President of Transair Limited, join Pacific Western as Executive Vice President & Chief Operating Officer in June of 1978.

The reorganization has strengthened the Company and prepared it well for future growth opportunities.

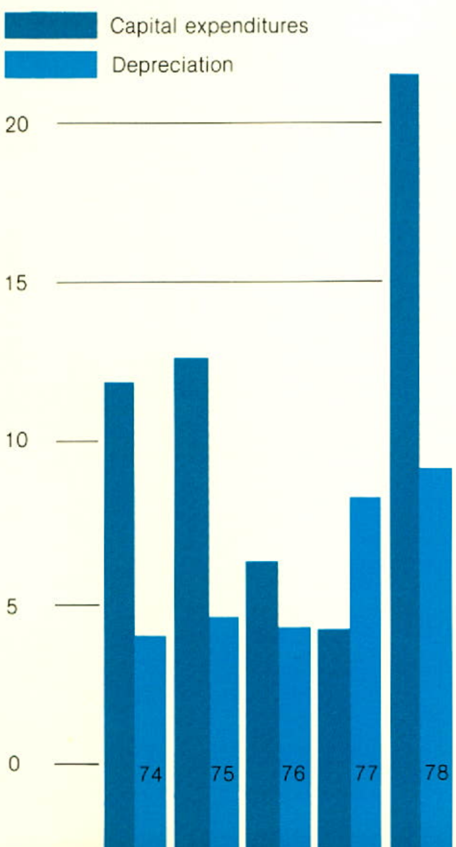
Human Resources

The Company began in 1978 to focus major attention on its human resources programs. Numerous new career enrichment and planning programs are now being made available to our employees at all levels. It is planned to continue to strengthen activities in this area in preparation for our future growth.

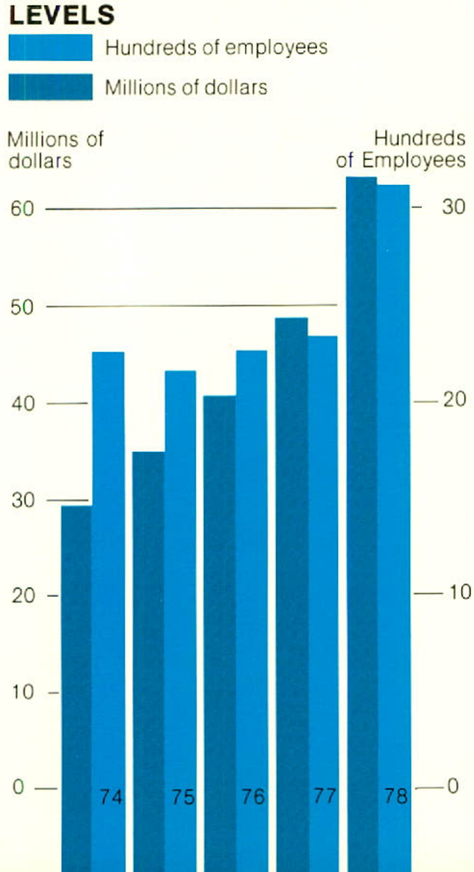
Staff levels in Pacific Western increased during the year from 2,426 at the end of 1977 to 2,471. In Transair staff levels were 730 compared to 747 at the previous year-end.

Employee productivity once again improved as reflected by revenue generated per employee of $61,086 in 1978 compared to $54,515 in 1977.

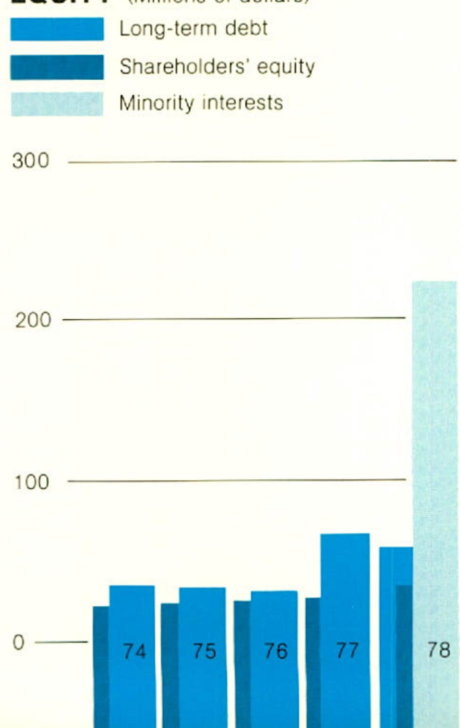
CAPITAL EXPENDITURES AND DEPRECIATION
(Millions of dollars)



SALARIES, WAGES & EMPLOYEE BENEFITS vs. AVERAGE STAFF LEVELS



LONG-TERM DEBT, MINORITY INTERESTS vs. SHAREHOLDERS' EQUITY (Millions of dollars)



Future Outlook

We are cautiously optimistic with regard to 1979. Service levels were adjusted in early 1979 to reflect traffic demand throughout our scheduled route system and with the planned

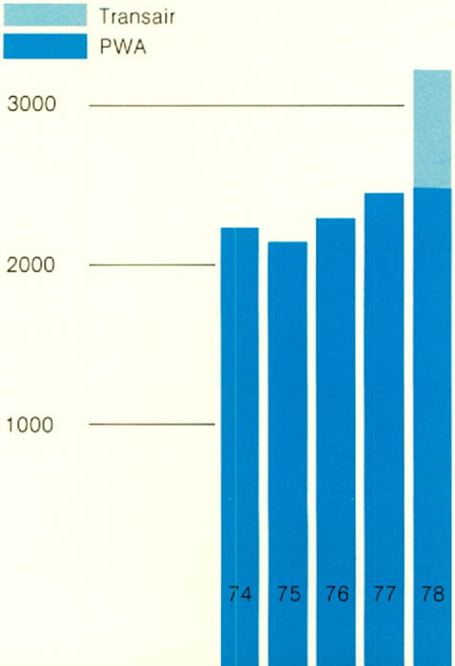
introduction of two additional Boeing 737's into mainline service this year, the Company should be in a position to handle traffic levels in excess of what has been planned for the year.

New incentive fares were introduced throughout our system in early February, 1979. These fares, which discount regular rates by up to 35%, will result in a substantial dollar saving for those who are able to arrange their travel within the limitations of the fare plan. It is hoped that many new and first-time travellers will also take advantage of this offer.

The Company has applications before the Canadian Transport Commission for non-stop services between both Calgary and Vancouver and Edmonton and Vancouver. As well, an application was filed in 1978 for service between Calgary, Lethbridge, the B.C. Interior and Vancouver. We expect to hear from the Canadian Transport Commission on how they propose to handle these applications, before long.

An application to provide jet service to Cold Lake, Alberta, from Edmonton is being prepared and will be submitted in 1979.

STAFF EMPLOYED
(at December 31)



General

Mr. J. C. S. Miles, Senior Vice President of Operations, retired during the year. We wish to acknowledge his contribution to the success and growth of the Company during his 24 years with the organization. Mr. Miles was

responsible for the introduction of a number of positive programs in the Company and most recently for the computerization of the airline's dispatch system and for the acquisition of our advanced Boeing 737 flight simulator.

Effective January 1, 1979, a profit sharing plan has been introduced for all employees. Profit sharing begins to occur once a certain level of net earnings has been reached and participation increases further once budgeted earnings for the year have been exceeded. We anticipate that this plan will be a meaningful way of sharing the Company's financial success with employees and will encourage a unified effort in maintaining profitability.

A special word of thanks to all employees for the professional and dedicated way in which they carried out their duties throughout the year notwithstanding a number of adverse situations which faced the airline in 1978. This positive effort permitted the airline to achieve its most successful financial results to date.

Respectfully submitted on behalf of the Board of Directors,

Rhys T. Eyton,
President & Chief Executive Officer.

February 21, 1979.

Pacific Western Airlines Ltd.

Consolidated Balance Sheet

December 31, 1978
(With comparative figures for 1977)

ASSETS

	1978	1977 (Restated)
Current assets:		
Cash and short-term deposits	**$ 35,217,370**	4,878,860
Accounts receivable	**18,619,331**	11,695,542
Inventory of parts, materials and supplies at the lower of cost or net realizable value	**5,770,250**	3,805,796
Prepaid expenses and other current assets	**1,157,258**	938,346
Total current assets	**60,764,209**	21,318,544
Investments (Note 4)	**151,978,910**	—
Mortgages and loans receivable, net of current portion	**1,574,116**	677,552
Property and equipment, at cost:		
Flight equipment	**155,051,181**	119,405,137
Land, building and ground facilities	**20,913,836**	19,151,658
	175,965,017	138,556,795
Less accumulated depreciation	**35,640,915**	38,348,223
	140,324,102	100,208,572
Deposits on new flight equipment	**4,926,476**	1,141,209
Property and equipment, net	**145,250,578**	101,349,781
Deferred charges, at cost less amortization	**673,595**	308,175
Goodwill, at cost less amortization	**1,718,800**	1,767,908
	$361,960,208	125,421,960

LIABILITIES AND SHAREHOLDERS' EQUITY

	1978	1977 (Restated)
Current liabilities:		
Accounts payable and accrued expenses	**$ 29,681,678**	19,015,538
Current portion of long-term debt	**9,232,966**	8,626,755
Unearned transportation revenue	**3,551,522**	2,879,353
Dividends payable	**3,081,511**	—
Deposits on sale of flight equipment (Notes 6 and 11)	**1,186,900**	—
Total current liabilities	**46,734,577**	30,521,646
Long-term debt (Notes 5 and 6)	**58,951,722**	67,086,601
Minority interests (Note 7)	**220,308,715**	—
Shareholders' equity:		
Capital stock (Note 8)	**8,589,861**	8,589,861
Retained earnings per accompanying statement	**27,375,333**	19,223,852
Total shareholders' equity	**35,965,194**	27,813,713
Commitments (Note 11).		
	$361,960,208	125,421,960

On behalf of the Board:

R. R. McDANIEL, Chairman of the Board

C. W. BRAZIER, Q.C., Director

See accompanying notes to consolidated financial statements.

Pacific Western Airlines Ltd.

Consolidated Statement of Earnings

Year ended December 31, 1978
(With comparative figures for 1977)

	1978	1977 (Restated)
Operating revenues:		
Mainline:		
Passenger	**$110,136,390**	77,720,633
Cargo	**12,351,302**	9,139,774
Mail	**2,572,646**	1,953,183
Total mainline	**125,060,338**	88,813,590
Charter	**49,222,088**	41,041,399
Helicopter and avionics	**1,325,275**	—
Outside sales and other income	**2,823,494**	1,365,390
	178,431,195	131,220,379
Operating expenses:		
Flying operations	**64,615,470**	49,234,018
Maintenance	**27,419,177**	19,493,661
Commercial services	**48,989,312**	34,612,778
Helicopter and avionics	**1,081,007**	—
General and administrative	**14,665,801**	10,035,432
Total operating expenses	**156,770,767**	113,375,889
Operating income before depreciation and amortization	**21,660,428**	17,844,490
Depreciation	**9,292,411**	8,335,582
Amortization of goodwill and deferred charges	**210,845**	141,346
	9,503,256	8,476,928
Operating income	**12,157,172**	9,367,562
Gain on disposal of property and equipment	**2,962,674**	377,665
Interest expense, net (Note 5)	**(2,924,827)**	(6,499,398)
Earnings before income taxes	**12,195,019**	3,245,829
Income taxes	**1,320,435**	—
Earnings before minority interest	**10,874,584**	3,245,829
Minority interest	**2,892,659**	—
Earnings before extraordinary item	**7,981,925**	3,245,829
Reduction of income taxes (Note 1(f))	**464,587**	—
Net earnings	**$ 8,446,512**	3,245,829
Earnings per common share (Note 9):		
Earnings before extraordinary item	**$3.06**	$1.23
Net earnings	**$3.24**	$1.23

See accompanying notes to consolidated financial statements.

Pacific Western Airlines Ltd.

Consolidated Statement of Retained Earnings

December 31, 1978
(With comparative figures for 1977)

	1978	1977 (Restated)
Balance at beginning of year as restated (Note 2)	$19,223,852	16,099,606
Net earnings	8,446,512	3,245,829
	27,670,364	19,345,435
Cost of issuing shares in subsidiary, net of income taxes	173,448	—
Dividends	121,583	121,583
	295,031	121,583
Balance at end of year	$27,375,333	19,223,852

Consolidated Statement of Changes in Financial Position

Year ended December 31, 1978
(With comparative figures for 1977)

	1978	1977 (Restated)
Funds provided by:		
Operations:		
Earnings before extraordinary item	$ 7,981,925	3,245,829
Add charges not requiring working capital	7,020,782	8,045,642
Funds provided by operations	15,002,707	11,291,471
Long-term debt	3,200,000	3,826,806
Disposal of equipment	8,431,077	523,078
Issue of preferred shares by a subsidiary	220,000,000	—
Total funds provided	246,633,784	15,641,355
Funds applied to:		
Property and equipment	21,525,889	4,281,404
Long-term debt	27,939,796	12,268,265
Dividends	121,583	121,583
Purchase of Transair Limited shares	5,489,717	—
Working capital deficiency of Transair Limited at date of acquisition	11,985,936	—
Deposits on flight equipment	3,785,267	1,141,209
Cost of issuance of preferred shares of subsidiary	173,448	—
Investments	151,978,910	—
Other, net	400,504	90,861
Total funds applied	223,401,050	17,903,322
Increase (decrease) in working capital	$ 23,232,734	(2,261,967)

See accompanying notes to consolidated financial statements.

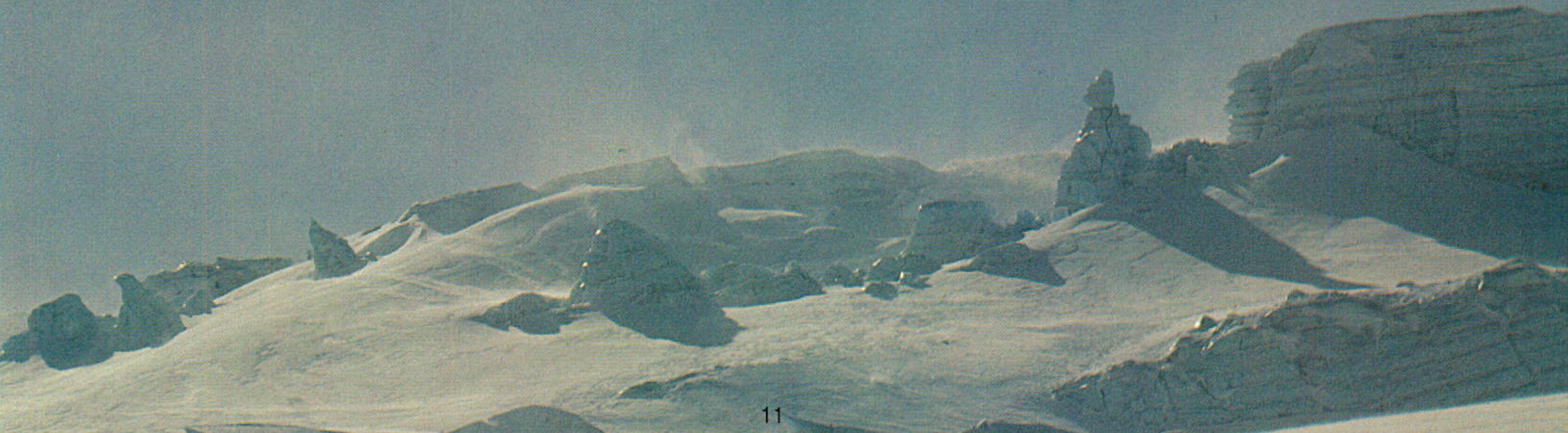
Auditors' Report to the Shareholders

We have examined the consolidated balance sheet of Pacific Western Airlines Ltd. as at December 31, 1978 and the consolidated statements of earnings, retained earnings and changes in financial position for the year then ended. Our examination of the financial statements of Pacific Western Airlines Ltd. and those companies of which we are the auditors and which are consolidated in these financial statements was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances. We have relied on the report of the auditors who examined the financial statements of the other subsidiary.

In our opinion, these consolidated financial statements present fairly the financial position of the company as at December 31, 1978 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 after giving retroactive effect to the change in accounting for leased flight equipment referred to in Note 2 of the notes to the consolidated financial statements.

PEAT, MARWICK, MITCHELL & CO.
Chartered Accountants

Vancouver, British Columbia, Canada
February 16, 1979



Pacific Western Airlines Ltd.

Notes to Consolidated Financial Statements

December 31, 1978

1. Accounting policies:

(a) Basis of consolidation:
The consolidated financial statements include the accounts of the company and the following subsidiaries:

Wholly-owned:
Aero Engineering Limited (inactive)
B.C. Air Lines Limited (inactive)
Pacific Western Airlines (Alberta) Ltd. (inactive)

Partially-owned:
Pacific Western (Alberta) Ltd.
Transair Limited (96.52% owned)

Wholly-owned subsidiaries of Transair Limited:
Midwest Airlines Ltd.
Arctic Wings Limited (inactive)
Aircraft Services (Western) Limited (inactive)

All significant inter-company loans and transactions have been eliminated on consolidation.

(b) Conversion of foreign currencies:
Current assets and current liabilities in foreign currencies have been translated into Canadian dollars at the rate of exchange in effect at the balance sheet date. Long-term debt payable in foreign currencies is carried at rates prevailing at dates of issue or forward exchange contract rates. Gains and losses resulting from foreign exchange conversions are reflected in the earnings for the year.

(c) Property and equipment:
Costs of repairs, renewals and replacements, including major flight equipment overhauls, are charged to earnings except for those expenditures which improve or extend the useful life of assets or which relate to pre-acquisition hours. Upon retirement or disposal of equipment, the cost and related depreciation are removed from the accounts and gain or loss, if any, is reflected in the earnings for the year.

Depreciation is provided at the following straight-line rates, except for aircraft rotable spare parts where depreciation is based on the diminishing balance at a rate of 12½% per annum to a 15% residual:

	Useful Life	Residual Value
Flight equipment:		
Jet aircraft	14 - 18 years	15%
Turbo Prop aircraft	5 - 15 years	15%
Helicopters	15 years	15%
Buildings	10 - 20 years	—
Ground equipment	5 - 10 years	—

Flight equipment includes the capitalized value of leased aircraft (see also Note 2) which have a net book value at December 31, 1978, of $40,539,808 (1977 - $43,794,368).

(d) Deferred charges:
Costs incurred in corporate re-organizations have been deferred. These costs are being amortized over five years from the date incurred.

(e) Goodwill:
While management is of the opinion that none of the recorded goodwill, which arose in prior years on acquisition of subsidiaries and routes, has diminished in value, in accordance with the recommendation of the Canadian Institute of Chartered Accountants, goodwill is being amortized over a period of forty years commencing January 1, 1974.

(f) Income taxes:
The company and its wholly-owned subsidiaries are exempt from taxation under Section 149(1)(d) of the Income Tax Act.

Certain subsidiaries, however, are not tax exempt and accordingly these companies follow income tax allocation principles of recording income taxes based on their accounting income.

Deferred income tax recoveries of $464,587 shown as an extraordinary item in the statement of earnings have resulted from utilizing losses and capital cost allowances carried forward from prior years, the benefits of which had not previously been recorded.

At December 31, 1978, the capital cost of allowances available to a taxable subsidiary as deductions against taxable income in future years exceeds its book value of depreciable assets by $6,212,000. Deferred income taxes have not been recorded with respect to this amount.

(g) Approval of consolidated financial statements:
These consolidated financial statements have been prepared taking into consideration events occurring between December 31, 1978, and February 16, 1979, the date of their approval by the Audit Committee.

2. Retroactive change in accounting policy:
In order to comply with the recommendations issued in 1978 by the Canadian Institute of Chartered Accountants, the policy relating to capital leases of flight equipment described in Note 1 was adopted effective January 1, 1978, on a retroactive basis. Prior to 1978, the Company did not reflect on its balance sheet the cost and related obligation for capital leases of flight equipment and all rental payments were charged directly to earnings. A summary of the restatement of previously reported figures follows:

Effect of	Retained Earnings December 31, 1977	Net Earnings 1977	Retained Earnings December 31, 1976
Reversal of previous rental expense	$39,907,618	8,380,759	31,526,859
Expenses now recorded:			
Depreciation	17,326,584	3,742,677	13,583,907
Interest	24,151,940	4,338,115	19,813,825
Net restatement	(1,570,906)	299,967	(1,870,873)
Previously reported	20,794,758	2,945,862	17,970,479
As restated	$19,223,852	3,245,829	16,099,606

The effect of this accounting change for the year ended December 31, 1978, has been to increase net earnings for the year by $352,397 ($.14 per share).

3. Acquisition of Transair Limited:

Effective April 30, 1978, the company acquired 72.88% of the outstanding common shares of Transair Limited and since that date the Company has acquired an additional 23.64% of the outstanding common shares of that company. The acquisition of Transair Limited has been accounted for by the purchase method whereby assets acquired and liabilities assumed are recorded at their cost to the purchaser. Although the consolidated statement of earnings includes $776,405 being the company's portion of the net earnings for the period from May 1, 1978 to December 31, 1978, the net earnings of Transair Limited for the year ended December 31, 1978 amounted to $279,677.

3. Acquisition of Transair Limited, continued:

A summary of the acquisition is as follows:

	$000
Tangible assets of Transair Limited at book value	32,496
Liabilities assumed	31,984
	512
Adjustment to fair values of tangible assets and liabilities	5,189
	5,701
Minority interest	211
Consideration for net tangible assets	5,490

Net assets acquired are represented by:

Property and equipment	33,351
Other assets	962
Working capital deficiency	(11,986)
Long-term liabilities	(16,604)
Deferred income taxes	(22)
Minority interest	(211)
	5,490

4. Investments:

These investments are short-term deposits. It is intended that these funds will be used to purchase additional flight equipment and accordingly have not been included in current assets.

5. Long-term debt:

	1978	1977
Canadian bank term loans at various rates ranging from prime to prime plus 1% payable by instalments in 1979, secured by chattel mortgages on various aircraft and spare parts and by a general assignment of accounts receivable	**$ 810,400**	11,788,948
6% term loans from Export-Import Bank of United States payable in U.S. funds by semi-annual instalments to June 1985, guaranteed by certain Canadian banks who hold chattel mortgages on various aircraft. (U.S. $17,899,647; 1977 -$15,514,764)	**18,423,602**	15,486,472
Lease-purchase obligations on various flight equipment payable by monthly and quarterly instalments at various dates up to 1991	**40,854,223**	46,090,686
Other agreements and notes payable, bearing interest up to prime plus 1% and payable at various dates to 1981, including U.S. $5,863,854 (1977 - NIL)	**8,096,463**	2,347,250
	68,184,688	75,713,356
Less current portion	**9,232,966**	8,626,755
	$58,951,722	67,086,601

The effect of translating the non-current portion of U.S. debt at the current rate of exchange would be to increase the liability by $3,100,000 (1977 -$1,513,000).

Interest on long-term debt for the year ended December 31, 1978, amounted to $6,584,000 (1977 - $6,782,000).

6. Debt maturity:

Maturities of long-term debt for the next five years are as follows:

	1978	1977
1978 — B737	$ —	2,866,000
— Other	—	8,627,000
1979 — F-28	4,646,000	—
— Other	9,233,000	7,505,000
1980	10,530,000	9,014,000
1981	9,449,000	7,166,000
1982	8,089,000	7,404,000
1983	7,640,000	—
	$49,587,000	42,582,000

7. Minority interests:

Minority interests include $220,000,000 of preferred shares issued by a subsidiary company which have preferred rights on liquidation and carry a cumulative dividend variable with current bank lending rates, payable semi-annually commencing December 31, 1978. These shares have an annual mandatory sinking fund redemption of $16,500,000 from June 30, 1982, to June 30, 1989, inclusive and the remaining $88,000,000 are to be redeemed on June 30, 1990.

The shareholder is entitled to require redemption or the purchase by the company in certain circumstances of default or winding up of the company.

These shares are redeemable at the option of the subsidiary company on June 30, 1981, at a premium of 3%, such premium reducing annually by 1% until 1983.

8. Capital stock:

	1978	1977
$2.20 redeemable preferred shares Series A without nominal or par value. Authorized 120,000 shares outstanding NIL (1977 - 55,265 shares)	$ —	1,630,318
Common shares without nominal or par value. Authorized 5,000,000 shares; issued 2,770,356 (1977 - 2,549,296) shares	8,589,861	6,959,543
	$8,589,861	8,589,861

On December 1, 1978, each of the oustanding $2.20 redeemable preferred shares Series A were exchanged for 4 common shares of the company.

9. Earnings per common share:

The per share figures have been computed by dividing the earnings figures after payment of preferred share dividends by the average number of common shares outstanding during each year.

If the $2.20 redeemable preferred shares Series A had been exchanged at the beginning of 1978, the earnings per share figures for 1978 would have been $2.88 and $3.05, respectively (1977 fully diluted earnings per share $1.17).

10. Remuneration of directors and senior officers:

Aggregate remuneration of directors, senior officers and certain operating personnel of the company, as defined by the B.C. Companies Act, amounts to $1,056,164 for the year.

11. Commitments:

(a) The company has the following commitments relating to aircraft purchases:

Aircraft Type	Estimated Cost in U.S. Dollars	Delivery Date
B737	$ 8,700,000	February, 1979
B737	9,200,000	November, 1979
B737	9,600,000	April, 1980
B767	35,150,000	March, 1983
B767	35,400,000	April, 1983
B767	40,150,000	November, 1983
B767	40,850,000	April, 1984

In addition the company has options to purchase the following aircraft:

B737	$ 9,900,000	August, 1980
B737	10,300,000	January, 1981
B767	39,700,000	March, 1985
B767	41,200,000	November, 1985

(b) With respect to the employee pension plans, the company and a subsidiary have an estimated unfunded commitment at December 31, 1978, of $1,959,000.

Special payments are being made to fund this commitment at an annual rate of approximately $360,000 which will be charged to earnings as it is paid.

(c) The company has executed an agreement to sell one Boeing 707-320C aircraft for delivery in May, 1979. The net gain on the sale of the aircraft is estimated to be $3,000,000.

(d) A subsidiary company, Transair Limited, has executed an agreement to sell its two F-28 aircraft and related parts inventory for delivery in February and June 1979. Subsequent to the year-end, Transair has repaid the full amount of long-term debt related to these aircraft (see Note 6). There will be no material gain on the sale of these aircraft.

12. Anti-inflation legislation:

The company believes it has complied wth controls on prices, profits, compensation and dividends under the Canadian Government Anti-Inflation Programme which terminated in 1978.

AIRCRAFT FLEET

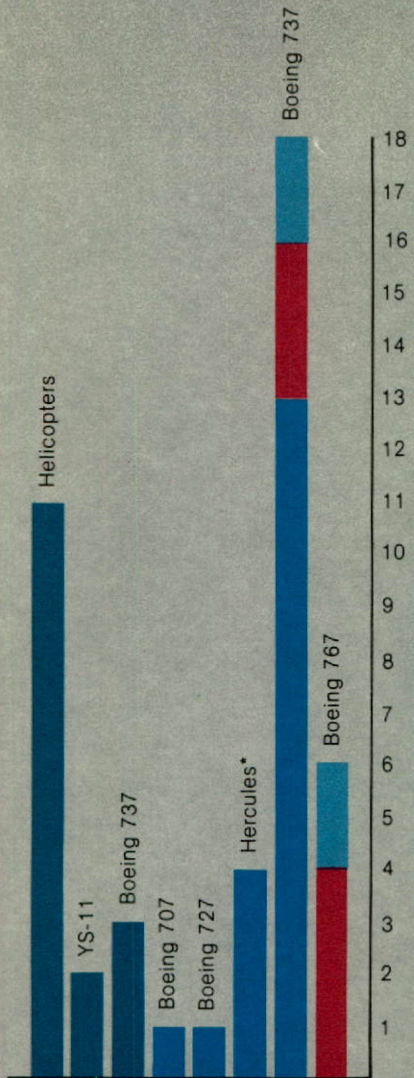
Pacific Western

Commitments

Transair

Options

*Includes 1 Hercules Dash 30



Pacific Western Airlines Ltd. and Subsidiary Companies

10-year Summary

(all figures in thousands)

	1978	1977	1976	1975	1974	1973	1972	1971	1970	1969
Financial Statistics		(Restated)								
Mainline Revenue	**125,060**	88,814	76,289	70,135	59,249	47,144	36,256	30,185	23,496	17,978
Contract and Charter Revenue										
Hercules — Cargo	**16,133**	17,692	11,222	15,640	13,144	8,928	7,974	7,742	7,019	5,597
International — Charter	**15,141**	14,277	8,844	12,029	9,442	8,310	5,487	4,741	7,962	5,463
Multi-engine aircraft (excluding International and Hercules)	**17,949**	9,072	6,208	3,768	3,174	4,186	3,512	2,686	2,065	2,337
Helicopter	**1,325**	—	—	—	—	—	—	—	—	—
Other Income	**2,823**	1,365	—	—	—	—	—	—	—	—
Total Revenue	**178,431**	131,220	102,563	101,572	85,009	68,568	53,229	45,354	40,542	31,375
Funds provided by operations	**15,003**	11,291	4,076	6,189	5,519	8,278	6,788	5,460	3,453	2,446
Depreciation and amortization	**9,503**	8,477	4,337	4,593	5,304	3,692	3,163	2,630	2,899	1,976
Equipment purchased	**21,526**	4,281	6,361	12,725	11,839	14,368	11,605	2,784	2,762	13,580
Income taxes										
Current	**723**	—	—	—	—	—	—	—	—	—
Deferred, net	**132**	—	—	—	622	2,368	1,956	1,415	(132)	240
Gain (loss) on disposal of equipment (after provision for future years income taxes) (Note 1)	**2,963**	378	2,178	(20)	40	36	64	(31)	(77)	439
Earnings (loss) from discontinued operation	**—**	—	—	(25)	22	(326)	24	(58)	(38)	(46)
Minority interest	**2,893**	—	—	—	—	—	—	—	—	—
Net earnings (loss)	**8,447**	3,246	2,292	1,360	1,301	1,992	2,120	1,438	(232)	584
Reduction of long-term debt	**27,940**	12,268	9,295	13,925	10,422	6,834	5,748	6,690	2,736	3,752
Dividends										
Preferred shares	**122**	122	122	122	184	250	263	57	64	64
Common shares	**—**	—	—	—	349	696	572	232	—	—
Operating Statistics										
Mainline										
Passengers carried	**2,775**	2,308	2,038	2,047	1,858	1,625	1,195	1,037	789	627
Cargo carried (lbs)	**59,703**	49,532	49,258	48,890	38,174	35,395	31,375	21,595	18,732	15,987
Passenger miles flown	**728,352**	543,318	486,320	480,651	447,076	400,417	305,086	256,452	209,007	168,068
Ton miles flown	**86,094**	68,745	63,100	62,897	58,072	49,887	40,288	31,971	26,455	21,834
Aircraft miles flown	**13,604**	10,007	9,482	10,210	10,101	9,272	7,858	6,922	6,065	5,501
Contract and charter										
Hercules aircraft miles flown	**1,573**	1,913	1,708	2,207	2,269	2,042	2,521	2,050	1,992	1,228
International charter miles flown	**2,758**	2,895	2,028	2,484	2,251	2,514	1,814	1,530	2,603	1,750
Other aircraft miles flown	**3,764**	2,188	1,531	974	957	1,098	998	940	851	908

Note 1: Gain (loss) on disposal of fixed assets before provision for future years income taxes was included in "Other Income" in the 1971 to 1974 Statement of Earnings. However, to be consistent with our ten year summary the gain or loss on disposal has been reclassified for 1971 to 1974 inclusive.

Note 2: The results for 1977 have been restated to reflect changes in accounting policy explained in Note 2 of the financial statements. However, the years 1969 - 1976 have not been restated to remain consistent with previous reports.

ALCRAFT CALGARY
LITHOGRAPHED IN CANADA

PACIFIC WESTERN AIRLINES