Federal Industries Ltd.
Fiftieth Annual Report
December 31
1978

Financial Highlights

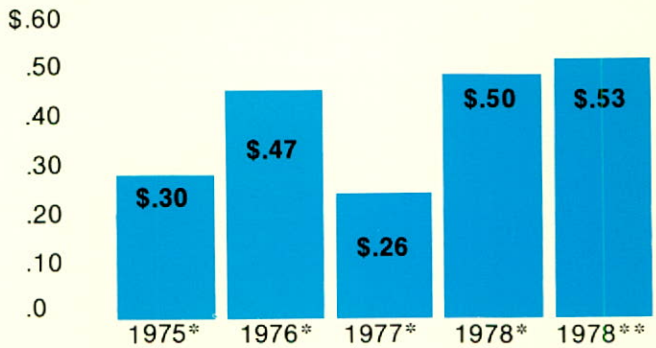
	December 1978 9 Months ($ Million)	March 1978 12 Months ($ Million)
Sales	**94.1**	107.0
Earnings from Continuing Operations*	**8.1**	6.3
Net Income before Extraordinary Items	**1.6**	–
Net Income (loss) after Extraordinary Items	**2.7**	(2.5)
Working Capital	**10.7**	4.8
Earnings per Share before Extraordinary Items	**$ .46**	($.01)
Earnings per Share after Extraordinary Items	**$ .77**	($.73)
Equity per Class A and Class B Share	**$12.17**	$11.48

Before taxes, extraordinary items and interest.

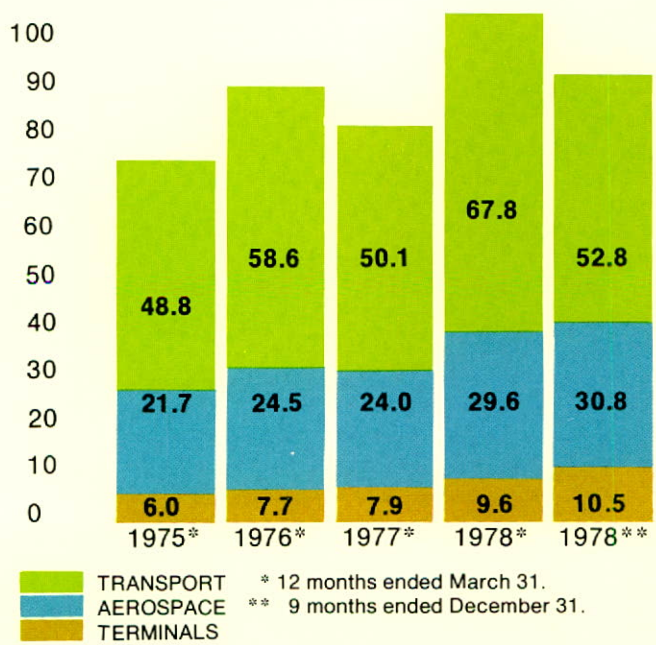
Federal Industries Ltd.

Federal Industries is a Canadian-controlled, diversified public transportation company. Through its thirteen wholly-owned subsidiaries, it is engaged in the provision of truck, ocean and rail services to Western Canada, and in the servicing of other transportation systems through bulk product transshipment terminals and through aerospace product manufacturing and distribution. Operations are grouped into three divisions: Aerospace, Terminals and Transport. Annual sales in excess of $120 million and assets of $176 million rank it among the 125 largest corporations doing business in Canada. The shares are traded on the Toronto and Winnipeg Stock Exchanges.

Earnings per Share from Continuing Operations Before Extraordinary Items



Sales from Continuing Operations ($ Million).



John F. Fraser,
President

Stewart A. Searle,
Chairman of the Board

Report to Shareholders

1978 Results

The 1978 results of operations were significantly improved over the previous year. A fiscal year change to December from March produced a 9-month period of operations in which net earnings, excluding extraordinary items, were $1,591,259 or 46¢ per share, compared to a loss of $17,216 or 1¢ per share for the year ended 31 March 1978. After including extraordinary items, net income for the 9 months was $2,660,805 or 77¢ per share, compared to a loss of $2,515,543 or 73¢ per share in the previous year.

Sales from continuing operations for the 9 months were $94,082,604 compared to $107,038,821 in the 12-month period. This represents a 23% increase over the corresponding 9-month period in 1977.

Operations

Federal Industries Ltd. is divided into three operating divisions: Aerospace, represented by Standard Aero Limited of Winnipeg; Terminals, comprised of Neptune Bulk Terminals Ltd. of Vancouver and Thunder Bay Terminals Ltd. of Thunder Bay; and Transport, provided by The White Pass and Yukon Corporation Limited of Whitehorse, Yukon Territory.

Aerospace Division

The Aerospace Division achieved record sales and earnings in the fiscal period, with increases of more than 50% in both categories over the corresponding period in 1977. Demand for the Divisions' products and services remained strong during the year and is expected to continue so throughout 1979. Standard Aero's European operation is a success, contributing important foreign currencies to the Federal group of companies and pointing the way to a major expansion area for the Division.

The market outlook for the Canadian aerospace industry is bright. Major aircraft purchases by the armed forces, increased natural resource activity, anticipated pipeline construction and the beneficial impact of "offset" volume from foreign aerospace companies selling aircraft and parts to Canada bodes well for the future of the Division. Your Company is committed to take full advantage of the present favourable market situation both through internal growth and by future acquisition of related companies.

Terminals Division

The Terminals Division enjoyed record levels of sales with all commodity products performing strongly throughout the period. Dollar volume increased by 58% over the comparable 9 months, due in part to the commencement of operations at Thunder Bay Terminals.

Operations of Neptune Bulk Terminals were hampered by the necessity of handling coal tonnage on a temporary system. As reported last year, a serious industrial accident shut down a major piece of coal handling equipment. It is a tribute to Neptune's staff that virtually no interruptions in service to our customers occurred. However, the costs of maintaining the temporary system were significant, a situation which has depressed recent earnings of the Division. Repairs to the equipment are almost complete, and regular operations are expected to resume by mid-April.

Our new coal handling facility at Thunder Bay began receiving coal in July 1978 and was officially opened on September 14th. Although the favourable impact on 1978 earnings was not significant, this major addition to Federal's portfolio will produce substantial and stable profits in 1979 and beyond. Thunder Bay management has brought this $55 million project to completion on time and on budget. Expansion of the new terminal is already underway, with construction of a $15 million facility for the delivery of approximately one million tons of coal annually to an adjacent Ontario Hydro generating station.

Transport Division

The Transport Division presented the Company with its major challenges during the period, and the most dramatic changes occurred in this area. Appraisal of the economic situation faced by the Division was completed in late summer of 1978, leading to sweeping changes in management, the closure of the Vancouver offices, the move of headquarters to Whitehorse and to closure or cessation of activities in several areas of the Division. Permanent savings in overhead of approximately $2 million annually will be achieved and all senior operating managers are now located at Whitehorse, the centre of the Division's business region.

Further, a re-assessment of pricing and rate policies led to significant increases in general freight tariffs and petroleum products prices, the effect of which will be first felt during the second quarter of 1979. Active discussions with contractual customers respecting rate adjustments are being held.

As mentioned in last year's Report, the loss of Cassiar Asbestos volume was a serious blow to the earnings potential of the Division, and the effect of this lost tonnage was felt for the first time in the last quarter of 1978. Earnings in 1979 and later will continue to reflect these reduced volumes, but the Divisional management is confident that a realignment of activity and equipment, reduced costs and added revenue from freight rate increases will in part compensate for this loss. Management is endeavouring to regain at least a portion of the Cassiar traffic.

One aspect of the Division's operation has received a great deal of publicity; the White Pass railway between Whitehorse and Skagway and the Company's attempt to acquire government participation in supporting this important element of the Yukon's transportation infrastructure. We are disappointed at the absence of a positive response from the Federal government to a situation which could cause a serious bottleneck in the economic development of the Yukon.

While operating losses in the Division will continue during the initial phase of the turn-around, we are determined to meet this challenge by providing new and experienced management, closing unprofitable operations, revising pricing policies, improving service and aggressive marketing.

Discontinued Operations

During the period, decisions were made to sell or discontinue three money-losing operations: Citation Cabinets, Pioneer Alaska Express Inc., an Alaska-based trucking company, and Pacific and Arctic Motors, a heavy equipment dealership in Whitehorse.

Agreements for the sale of Citation were concluded in July 1978, and the Citation operations were combined with the purchaser's business to form a new company, Citation Industries Ltd. The management team at Citation Industries Ltd. has long experience in cabinet manufacturing. Part of the consideration on sale included access at the Company's option to a substantial equity position in the new company. To date, the results of operations are encouraging.

Pioneer Alaska Express and Pacific and Arctic Motors, subsidiaries of White Pass, have been closed and the operating assets sold because it was felt that the attainment of acceptable profit levels was unlikely and that the assets could better be employed elsewhere.

The results of the discontinued operations are shown separately on the financial statements to allow an assessment of ongoing business.

Change of Year End

In order to conform the fiscal periods within the Federal group of companies, the year end has been changed from March 31st to December 31st. This action will aid the Company in all forms of fiscal planning and will improve the comparability of results in the future.

Future Direction

In the President's address to the shareholders at the last Annual Meeting, the Company's management committed "to encourage, support and expand our winners; to improve our average performers; and to fix or dispose of our losers quickly". As is readily apparent from this Report and from the financial statements, we are deeply involved in fulfilling this commitment.

Federal Industries is a diversified transportation enterprise, involved directly or indirectly in every mode of transport; truck, rail, ocean, terminals, aerospace and pipeline. This identity is reinforced by our conviction and belief that the underlying assets and operations of the Company are sound and that they can be organized or supplemented to enable the Company to assume a position of leadership in profitability, efficiency and innovation in the Canadian transportation industry.

We see our share of the traditional transportation market, particularly trucking, improving both by internal growth and by acquisition. New markets and product lines are being aggressively sought for the Aerospace Division, a strategy especially aided by the maturity, stability and outstanding earnings record of Standard Aero Limited. Our particular expertise in bulk terminalling will be exploited wherever the asset risk is warranted.

We intend to continue to review critically all of the properties and holdings of the Company: those which do not satisfy criteria of profit and return on net assets employed will require approval for continuance.

On behalf of the Board of Directors.

S A Searle

Stewart A. Searle,
Chairman

J. Fraser

John F. Fraser,
President

April 4, 1979.

John S. Pelton,
Treasurer and Chief Financial Officer

Financial Review

Earnings

Earnings for the 9 months before extraordinary items improved to $1,591,259 or 46¢ per share from a loss of $17,216 or 1¢ per share in the previous 12 months. This improvement resulted primarily from the cessation of operations and sale of three unprofitable subsidiaries, as more fully discussed under Divestitures. To illustrate the profitability of ongoing businesses of your Company, the Statement of Earnings and Financial Highlights section set out separately the before and after tax earnings of continuing operations. It should be noted that even these latter amounts include unusual and non-recurring expenses experienced in reorganizing the Transport Division of over $1 million. The reorganization has reduced administration and operating costs on a permanent basis.

Extraordinary items of $1,069,546 or 31¢ per share resulted from utilization of income tax loss carry-overs of $1,510,546 and a provision for losses on discontinuance of operation of a subsidiary. In the previous year, almost all of the $2,498,327 or 72¢ per share extraordinary loss resulted from a write-off of goodwill on Citation Cabinets.

During the period, 50,000 Class A shares were issued under a stock purchase plan, and all per share amounts reflect this issuance. Subsequent to 31 December 1978, an additional 40,000 Class A shares were issued.

Earnings by major Divisions of your Company are described in the Review of Operations following the consolidated financial statements.

Divestitures

As commented in the Report to Shareholders, three companies of the group were sold or closed. In July 1978, Citation Cabinets was sold to a private cabinet-manufacturing concern in British Columbia for a sale price equivalent to the book value of its net operating assets. Accordingly, neither a gain nor loss resulted on the transaction. In December 1978, The White Pass and Yukon Corporation ceased operating its trucking subsidiary in Alaska and, conditional upon regulatory approval, sold the trucking authorities owned by that company. Subsequent to the period-end, the operations of another White Pass company engaged in sales and service of trucks and heavy equipment were closed, and the assets liquidated.

The effect of these divested subsidiaries on the earnings of the Company has been segregated in the Statement of Income under the caption "Loss from Discontinued Operations" and in Extraordinary Items. The dispositions have improved the immediate liquidity of Federal Industries by well in excess of $1 million, freeing such funds for repayment of debt or for reinvestment in profit-making opportunities. The management is committed to a policy of continuous review of all its investments, and those not measuring up to appropriate, predetermined criteria will be redeployed or divested.

Interest Costs

With the exception of Thunder Bay Terminals' bonds, most of your Company's debt bears interest related to the prime bank rate, and thus interest costs reflected in earnings have risen over the last year. As noted in the Balance Sheet section , interest on Thunder Bay obligations is covered by an all-events contractual relationship, and should be excluded in assessing interest coverage and other liquidity tests. Interest expense, excluding the Terminal, amounted to $2.3 million in the 9 months, compared to $2.4 million for the previous year. The Company expects to benefit from the anticipated decline in prime bank rates over the remainder of 1979.

Foreign Exchange Fluctuations

Foreign exchange fluctuations have caused significant operating losses in The White Pass and Yukon Corporation. Most of the costs of running that company's railway between Skagway, Alaska and Whitehorse, Yukon are incurred in U.S. dollars, while the revenues derived from the service have been payable historically in Canadian currency. The imbalance totals approximately $6 million annually and has depressed that company's profits by nearly $1 million in the current period. To compensate, freight rates are being raised on non-contractual commodities, and discussions are under way with the railway's major customers to receive payment for services rendered in the United States in U.S. currency. In addition, most analysts expect the Canadian dollar to recover some ground in 1979.

Income Taxes

Because Federal Industries is comprised of a group of companies, each with its particular tax characteristics, the consolidated rate of tax may differ greatly from period to period. This is particularly true when one or more companies incur losses while others remain profitable, as was the case in the years ended March 1978 and 1975, when the total tax rates were 82% and 860% respectively.

The rate of tax in the 9 month period on continuing operations reflects a fairly normal relationship at 44.3%, with a comparable rate of 44.7% for the previous year (Note 8 to the financial statements). However, because White Pass is itself a holding company, and because some of its subsidiaries are forecast to incur losses, it is probable that the consolidated tax rate will increase during 1979. The Company is embarked on a plan of corporate rationalization to mitigate this problem, but until Revenue Canada allows the filing of consolidated tax returns, it will not be possible to eliminate the variations.

Balance Sheet

Working capital increased by nearly $6 million during the period, primarily as a result of a major reorganization of the Company's debt structure. As part of a new agreement with the Bank of Montreal, a portion of the existing bank current debt was converted into term loans, with periods of repayment up to 12 years, and the amortization periods of existing term loans were extended. When this reorganization is completed in mid-1979, a minimum additional $4 million will be contributed to working capital, enabling the Company to finance its medium-term operational plans without difficulty.

Long term debt increased by more than $23 million to $82.5 million, representing an apparent substantial increase both in dollars and in the debt-to-equity ratio. However, most of the funded obligations of the Company and its increase comprise bonds and other debt issued by Thunder Bay Terminals Ltd. ($61.7 million at 31 December and $41.5 million at 31 March), the security for which is limited to the Terminal assets and proceeds of a long term contract with Ontario Hydro. This contract provides for the payment of both principal and interest in all events; therefore, the debt, sometimes called project financing, should not be considered in assessing the propriety of the Company's long term debt-to-equity relationship. If the Terminal debt is excluded, this key ratio is approximately .39 to 1 at year-end, compared to .35 to 1 at 31 March 1978, where equity includes minority interest and deferred taxes.

Although the capitalization of lease obligations is not mandatory until 1979, the Company has shown all material finance leases as long term debt in the 1978 financial statements.

Capital Expenditures and Depreciation

Capital expenditures, other than at Thunder Bay Terminals, arose primarily in White Pass, where substantial monies were committed to a new system for hauling southbound mineral concentrate. Of these expenditures, almost one-half, or $2.2 million, represent capitalized lease obligations.

Depreciation increased on an annualized basis, due to the addition of fixed assets; no depreciation was provided on assets under construction at Thunder Bay Terminals.

Summary

The financial strength of the Company improved significantly in the last 9 months both in the balance sheet and in earnings results. The maintenance of liquidity and avoidance of excessive leverage are of vital importance in assuring the financial stability of the organization, and management will continue its practice of giving preference to investments which employ lesser amounts of assets and produce more sales per dollar invested than the present mix. This, combined with the solid earnings base represented by the Aerospace and Terminals Divisions, should assure the Company's shareholders of long-term growth in share values and dividends.

John S. Pelton
Treasurer and Chief Financial Officer

Federal Industries Ltd. and its Subsidiary Companies

Consolidated Statement of Earnings

For the nine months ended December 31, 1978

	December 31, 1978 (9 months)	March 31, 1978 (12 months) (Restated) (Note 14)
Sales and services (Note 12)	**$94,082,604**	$107,038,821
Cost of sales and operating expenses (Note 13)	**82,076,628**	96,301,317
Depreciation and amortization (Note 1 [g])	**3,825,739**	4,331,425
Amortization of goodwill	**54,000**	144,000
Interest on long term debt (Note 1 [e])	**3,162,200**	1,473,547
Other interest expense	**1,165,248**	941,111
	90,283,815	103,191,400
Earnings from continuing operations	**3,798,789**	3,847,421
Loss from discontinued operations, after depreciation of $127,244 (March 31, 1978—$287,275) (Note 14)	**(443,391)**	(1,882,000)
Earnings before income taxes and extraordinary items	**3,355,398**	1,965,421
Provision for income taxes (Note 8)		
Current	**1,182,871**	1,059,834
Deferred	**302,868**	551,603
	1,485,739	1,611,437
Earnings before extraordinary items	**1,869,659**	353,984
Extraordinary items (Note 15)	**1,069,546**	(2,498,327)
Net earnings (loss)	**2,939,205**	(2,144,343)
Earnings allocated to minority shareholders	**278,400**	371,200
Net earnings (loss) for the period	**$2,660,805**	$(2,515,543)
Net earnings (loss) per common share (Note 1 [j])		
Before extraordinary items	**$.46**	($.01)
Extraordinary items	**.31**	(.72)
Including extraordinary items	**$.77**	($.73)

See accompanying notes to financial statements.

Federal Industries Ltd. and its Subsidiary Companies

Consolidated Statement of Retained Earnings

For the nine months ended December 31, 1978

	December 31, 1978 (9 months)	March 31, 1978 (12 months) (Restated) (Note 11)
Balance, beginning of period		
As previously reported	**$25,446,881**	$28,812,039
Adjustment of prior years' earnings (Note 11)	**223,186**	577,186
As restated	**25,670,067**	29,389,225
Net earnings (loss) for the period	**2,660,805**	(2,515,543)
	28,330,872	26,873,682
Dividends—Class A shares	**404,094**	1,009,327
Dividends—Class B shares	**116,741**	194,288
	520,835	1,203,615
Balance, end of period	**$27,810,037**	$25,670,067

See accompanying notes to financial statements.

Auditors' Report

Touche Ross & Co.
213 Notre Dame Avenue
Winnipeg, Manitoba R3B 1N3
(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, 1978 and the statements of retained earnings, earnings and changes in financial position for the nine months 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, 1978 and the results of their operations and the changes in their financial position for the nine months then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Touche Ross & Co.

Chartered Accountants

Winnipeg, Manitoba,
April 4, 1979

Federal Industries Ltd. and its Subsidiary Companies

Consolidated Balance Sheet

As at December 31, 1978

Assets	**December 31, 1978**	March 31, 1978 (Restated) (Note 11)
Current		
Cash	**$ 96,247**	$ 271,794
Short term investments, at cost	**1,674,099**	2,250,000
Accounts receivable	**17,646,766**	18,501,531
Income taxes recoverable	**783,905**	87,828
Inventories (Note 2)	**26,372,161**	27,590,430
Prepaid expenses	**798,193**	743,049
Insurance claims recoverable (Note 3)	**2,673,124**	—
Total current assets	**50,044,495**	49,444,632
Fixed (Note 4)		
Property, plant and equipment, at cost	**98,388,649**	99,959,788
Accumulated depreciation	**40,297,826**	38,872,656
	58,090,823	61,087,132
Terminal facility under construction (Note 5)	**54,482,604**	37,310,976
	112,573,427	98,398,108
Other		
Unexpended construction funds (Note 5)	**6,978,901**	4,376,327
Other investments, at cost (Note 6)	**3,734,396**	513,784
Deferred charges	**363,702**	420,654
Goodwill, at cost less amounts amortized	**2,270,259**	2,324,259
	13,347,258	7,635,024
	$175,965,180	$155,477,764

See accompanying notes to financial statements.

On behalf of the Board:

Stewart A. Searle, *Director*
John F. Fraser, *Director*

Liabilities	December 31, 1978	March 31, 1978 (Restated) (Note 11)
Current		
Bank indebtedness, secured	**$ 16,937,859**	$ 22,757,326
Accounts payable and accrued liabilities	**18,998,480**	17,946,591
Dividends	**—**	171,945
Current portion of long term debt	**3,450,100**	3,742,000
Total current liabilities	**39,386,439**	44,617,862
Long term (Note 7)	**82,541,803**	59,395,552
Deferred income taxes	**6,090,851**	5,926,983
Minority interest (Note 9)	**5,500,000**	5,500,000
Total liabilities	**133,519,093**	115,440,397

Shareholders' Equity

Capital stock		
Common shares (Note 10)	**14,636,050**	14,367,300
Retained earnings	**27,810,037**	25,670,067
Total shareholders' equity	**42,446,087**	40,037,367
	$175,965,180	$155,477,764

Federal Industries Ltd. and its Subsidiary Companies

Consolidated Statement of Changes in Financial Position

For the nine months ended December 31, 1978

	December 31, 1978 (9 months)	March 31, 1978 (12 months) (Restated) (Notes 11 & 14)
Source of funds		
Operations		
Net earnings (loss) for the period	**$ 2,660,805**	($ 2,515,543)
Add Depreciation and amortization	**3,825,739**	4,331,425
Amortization of goodwill	**54,000**	144,000
Deferred income taxes	**302,868**	551,603
Extraordinary items	**(1,069,546)**	2,498,327
Earnings allocated to minority shareholders	**278,400**	371,200
Loss (gain) on sale of fixed assets	**152,331**	(34,684)
Loss from discontinued operations	**443,391**	1,882,000
Funds provided by continuing operations	**6,647,988**	7,228,328
Issue of first mortgage bonds, 9⅝% (Note 5)	**20,000,000**	37,000,000
Additional long term debt financing	**5,769,916**	4,474,902
Reduction in income taxes (Note 15)	**1,510,546**	—
Disposal of assets of subsidiary company, net of liabilities assumed of $904,900	**2,462,500**	—
Proceeds on sale of fixed assets	**368,988**	393,260
Issue of shares (Note 10)	**268,750**	—
Adjustment of prior years' earnings, excluding deferred taxes of $182,600 (Note 11)	**—**	405,786
Prior years' pension costs recovered (Note 11)	**—**	98,000
	$37,028,688	$49,600,276
Application of funds		
Loss from discontinued operations, before depreciation	**$ 316,147**	$ 1,594,725
Provision for loss on discontinued operations (Note 15)	**580,000**	—
Purchase of fixed assets	**4,793,641**	5,709,921
Terminal facility under construction	**17,171,628**	37,310,976
Decrease in long term debt	**1,718,765**	4,112,872
Dividends	**520,835**	1,203,615
Dividends paid by subsidiary company to minority shareholders	**278,400**	371,200
Other investments (Note 6)	**3,215,412**	144,258
Unexpended construction funds	**2,602,574**	4,376,327
	31,197,402	54,823,894
Increase (decrease) in working capital	**5,831,286**	(5,223,618)
	$37,028,688	$49,600,276
Working capital, end of period	**$10,658,056**	$ 4,826,770

See accompanying notes to financial statements.

Notes to Consolidated Financial Statements

For the nine months ended December 31, 1978

1. Summary of significant accounting policies

(a) The Company changed its fiscal year end to December 31.

(b) **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:

Neptune Bulk Terminals Ltd.

Standard Aero Limited (Note 14)

The White Pass and Yukon Corporation Limited

Thunder Bay Terminals Ltd.

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

(c) **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 and current liabilities at exchange rates prevailing at the end of the year; fixed assets, depreciation and long term debt 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 transferred to consolidated income or expense.

(d) **Valuation of inventories**

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

(e) **Capitalization of terminal facility under construction**

All expenditures, including financing costs, incurred by Thunder Bay Terminals Ltd. prior to the commencement of its partial operations on August 1, 1978 have been capitalized and included as terminal facility under construction on the balance sheet.

(f) **Capitalization of leases**

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

(g) **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. Depreciation is not provided on the terminal facility under construction prior to completion date of the project.

(h) **Goodwill**

The goodwill on the balance sheet represents the excess of cost of shares of a subsidiary company over the book amount of net assets acquired, less amounts amortized. The Company's policy is to amortize goodwill over a forty year period.

(i) **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 such future taxable income is earned.

(j) **Earnings per share**

Earnings per common share are calculated using the weighted daily average number of common shares outstanding.

2. Inventories

	December 31, 1978	March 31, 1978 (Restated) (Note 11)
Aircraft engines, parts and work-in-progress	**$15,477,384**	$14,417,107
Petroleum products held for resale	**5,560,400**	5,960,400
Other goods held for resale	**1,765,000**	4,112,446
Spare parts and supplies	**3,569,377**	3,100,477
	$26,372,161	$27,590,430

3. Insurance claims recoverable

On May 2, 1978 an industrial accident occurred which shut down one of the main operating assets of the coal handling system of Neptune Bulk Terminals Ltd., but the company has continued operations with a temporary system. The company carries insurance coverage in respect of business interruption, property damage and public liability. At the date of issuing these statements, it is not possible to determine with certainty whether there will be any costs, claims, or losses that will not be fully covered by insurance. However, management believes that the Company has valid claims for all amounts included in the financial statements as insurance claims recoverable at December 31, 1978.

4. Fixed assets

	December 31, 1978			March 31, 1978
	Cost	**Accumulated Depreciation**	**Net**	Net
Rail and pipeline	**$ 32,013,000**	**$ 8,218,000**	**$ 23,795,000**	$23,458,000
Ships and containers	**14,001,000**	**9,498,000**	**4,503,000**	3,769,000
Trucks	**9,541,000**	**5,955,000**	**3,586,000**	3,186,000
Skagway terminal	**6,973,000**	**3,092,000**	**3,881,000**	4,074,000
Neptune terminal	**21,858,349**	**5,982,016**	**15,876,333**	16,358,457
Land and buildings	**3,223,490**	**1,187,609**	**2,035,881**	4,514,200
Other machinery and equipment	**9,455,865**	**5,399,386**	**4,056,479**	4,983,861
Furniture and fixtures	**1,322,945**	**965,815**	**357,130**	743,614
	98,388,649	**40,297,826**	**58,090,823**	61,087,132
Thunder Bay terminal — under construction	**54,482,604**	**—**	**54,482,604**	37,310,976
	$152,871,253	**$40,297,826**	**$112,573,427**	$98,398,108

5. Terminal facility under construction

(a) Thunder Bay Terminals Ltd. entered into a long term contract with Ontario Hydro dated as of September 30, 1977 for the construction and operation of a bulk handling terminal at Thunder Bay, Ontario. The total cost of the terminal is estimated not to exceed $71,500,000 of which $54,482,604 has been incurred to December 31, 1978. The cost of the terminal is being financed by the issue of up to $71,500,000, aggregate principal amount, 9⅝% First Mortgage Sinking Fund Bonds, Series A. As at December 31, 1978, the Series A Bonds issued and outstanding aggregated $57,000,000. 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.

(b) On August 1, 1978, Thunder Bay Terminals Ltd., commenced partial operation under the terms of the agreement with Ontario Hydro. Completion of the project occurred on March 1, 1979 at which time the Terminal became fully operational.

(c) As at December 31, 1978 unexpended construction funds of $6,978,901 were being held for the purpose of paying construction costs payable.

6. Other investments

	December 31, 1978	March 31, 1978
Mortgages and agreements for sale	**$ 2,634,145**	$ 513,784
Loans to an officer and director		
Stock purchase plan	**268,750**	—
Housing	**146,500**	—
Other securities	**685,001**	—
	$ 3,734,396	$ 513,784

7. Long term debt

	December 31, 1978	March 31, 1978
Term bank loans, secured, 1¼% — 1¾% above prime rate	**$10,969,500**	$ 7,259,500
Income debenture, secured, 1¼% above one-half of prime rate	**2,250,000**	3,250,000
Purchase agreement, secured, non-interest bearing, due 1987	**2,775,185**	3,027,437
Construction costs payable (Note 5)	**4,708,918**	4,474,902
First mortgage bonds, 9⅝% (Note 5)	**57,000,000**	37,000,000
First mortgage bonds, 8½% due 1989	**1,338,000**	1,504,000
First ship mortgage note, 6⅛% due 1981	**120,000**	240,000
First ship mortgage note, 8½% due 1985	**1,500,000**	1,700,000
Mortgages payable, 11¼%	**9,300**	939,713
Capitalized equipment leases, 9%—13½%	**1,870,900**	—
	$82,541,803	$59,395,552

The aggregate amount of maturities over the next five years are approximately as follows: 1979—$3,450,100; 1980—$4,600,000; 1981—$7,000,000; 1982—$7,300,000; 1983—$6,000,000.

8. Income taxes

The Company's provision for income taxes has been affected by losses incurred in the year and in prior years. Taxes as a percentage of earnings from continuing operations may be illustrated as follows:

	December 31, 1978 (9 months)	March 31, 1978 (12 months) (Restated) (Note 14)
Earnings from continuing operations before income taxes and extraordinary items	**$3,798,789**	$3,847,421
Provision for income taxes on earnings from continuing operations	**1,682,265**	1,720,437
Percentage	**44.3%**	44.7%

The provision for income taxes for the current year has been reduced by $196,526 (March 31, 1978—$109,000) for the reduction in income taxes relating to the loss from discontinued operations.

The Company's liability for income taxes has been further reduced by $1,510,546 from the utilization of loss carry forwards by subsidiary companies. This reduction has been shown as an extraordinary item on the statement of earnings.

9. Minority interest

Minority interest is $5,500,000 of 6¾% preferred shares of The White Pass and Yukon Corporation Limited (March 31, 1978—$5,500,000).

10. Capital stock

(a) The authorized share capital of the Company consists of:

(i) 6,000,000 Class A convertible shares without nominal or par value.

(ii) 6,000,000 Class B convertible shares without nominal or par value.

The maximum consideration for the issue of these shares is not to exceed $20,000,000.

The two classes of shares are interconvertible at any time and are similar in all respects, including dividend rights, except that dividends on Class B shares were declared out of tax paid undistributed surplus on hand or out of 1971 capital surplus on hand as defined in the Income Tax Act of Canada.

Where a dividend was paid on Class B shares out of tax paid undistributed surplus, that dividend was reduced by the 15% tax paid on 1971 undistributed income on hand to create tax paid undistributed surplus. Where a dividend was paid out of 1971 capital surplus on hand, that dividend was not reduced. Recent changes in the Income Tax Act preclude the payment of tax deferred dividends on Class B shares after December 31, 1978.

(b) During the period 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.

(c) During the period, 50,000 shares were issued to an officer and director of the Company under the provisions of the stock purchase plan for an aggregate consideration of $268,750. Subsequent to the year end, 40,000 shares were issued to two officers of the Company for an aggregate consideration of $240,000.

(d) At December 31, 1978 there were 3,488,900 (March 31, 1978—3,438,900) shares issued and outstanding comprised of 2,189,080 (March 31, 1978—2,883,355) Class A shares and 1,299,820 (March 31, 1978—555,545) Class B shares.

11. Prior years' adjustments

	December 31, 1978 (9 months)	March 31, 1978 (12 months)
Adjustment of prior years' earnings relating to an accounting policy change of Standard Aero Limited in respect of its inventory, net of related deferred income taxes of $182,600	**$223,186**	$223,186
Adjustment of prior years' earnings relating to successful income tax appeals of The White Pass and Yukon Corporation Limited in respect of its 1970 to 1974 fiscal years	**—**	354,000
	$223,186	$577,186

12. Sales and services by subsidiary company

	December 31, 1978 (9 months)	March 31, 1978 (12 months) (Restated) (Note 14)
Neptune Bulk Terminals Ltd.	**$ 7,493,960**	$ 9,606,982
Standard Aero Limited	**30,788,612**	29,618,939
The White Pass and Yukon Corporation Limited		
Transportation revenue	**28,213,805**	39,216,500
Petroleum sales and related revenue	**24,628,400**	28,596,400
Thunder Bay Terminals Ltd.	**2,957,827**	—
	$94,082,604	$107,038,821

13. Directors' remuneration

The aggregate remuneration of directors and senior officers of the Company was as follows:

	December 31, 1978 (9 months)				March 31, 1978 (12 months)			
	As Directors		As Officers		As Directors		As Officers	
	No.	Amount	No.	Amount	No.	Amount	No.	Amount
Federal Industries Ltd.	**13**	**$24,150**	**6**	**$238,564**	13	$34,200	5	$215,020
The White Pass and Yukon Corporation Limited	**7**	**9,400**	**1**	**53,669**	7	10,000	2	71,837
Thunder Bay Terminals Ltd.	**3**	**600**			3	400		

4 Officers are also Directors of the Company (March 31, 1978—4 officers).

14. Discontinued operations

(a) Effective July 28, 1978 a subsidiary company disposed of the assets and undertakings of the Citation Cabinet Division for a sale price equivalent to the book value of the Division's net operating assets. Accordingly, no gain or loss resulted from this transaction. The consideration received consists of convertible preferred shares and an income debenture of the successor company of the purchaser, secured by fixed and floating charges on its assets. These shares and the income debenture are included in other investments on the balance sheet.

(b) Effective November 18, 1978 Pioneer Alaska Express, Inc. discontinued operations and, subject to regulatory approval sold its operating authority.

(c) In March 1979 management discontinued the operations of Pacific & Arctic Motors Ltd. A provision of $441,000, net of deferred income taxes of $139,000, for anticipated costs and losses of this discontinuance has been included in extraordinary items in the statement of earnings.

(d) For comparative purposes, the figures for both December 31, 1978 and March 31, 1978 relating to discontinued operations have been eliminated from sales and services, costs of sales, etc., and the results of these operations have been shown as a separate item of earnings under the caption "loss from discontinued operations".

15. Extraordinary items

	December 31, 1978 (9 months)	March 31, 1978 (12 months)
Reduction of income taxes arising from the utilization of loss carry forwards by subsidiary companies	**$1,510,546**	$ —
Provision for costs and losses related to the discontinuance of a subsidiary company, net of related deferred income taxes of $139,000	**(441,000)**	—
Prior years' pension costs recoverable, net of income taxes of $102,000	**—**	98,000
Write off of goodwill of Citation Cabinets Ltd.	**—**	(2,596,327)
	$1,069,546	($2,498,327)

16. Contractual obligations

(a) The Company and its subsidiary companies have operating lease commitments with varying terms requiring annual rental payments of approximately $815,000.

(b) Commitments for capital expenditures and other capital items at December 31, 1978 were approximately $14,000,000, of which $13,500,000 is related to the terminal facility under construction.

17. Contingent liabilities

At December 31, 1978, the Company is contingently liable as guarantor of bank loans of a non-affiliated company to a maximum of $1,500,000.

Consolidated Historical Summary

	9 Mos. 31 Dec. 78	12 Mos. 31 Mar. 78	12 Mos. 31 Mar. 77	12 Mos. 31 Mar. 76	12 Mos. 31 Mar. 75
Income Information ($000)					
Sales & Services	**94,083***	123,775	103,139	106,729	88,068
Gross Earnings from Operations	**12,006***	9,606	9,946	13,390	7,787
Net Earnings Before Extraordinary Items	**1,591**	(17)	591	2,161	(874)
Extraordinary Items	**1,070**	(2,498)	891	514	1,130
Net Earnings After Extraordinary Items	**2,661**	(2,515)	1,482	2,675	256
Depreciation	**3,826***	4,619	4,699	4,361	4,294
Interest on Long Term Debt	**3,162**	1,568	2,084	1,575	1,732
Income Taxes	**1,486**	1,611	573	2,999	844
Earnings (Loss) per Common Share	**.77**	(.73)	.43	.78	.07
Earnings (Loss) per Share Excluding Extraordinary Items	**.46**	(.01)	.17	.63	(.25)
Balance Sheet Information ($000)					
Current Assets	**50,044**	49,039	52,508	41,306	34,869
Current Liabilities	**39,386**	44,618	42,457	29,381	21,468
Working Capital	**10,658**	4,421	10,051	11,925	13,401
Fixed Assets—Net	**112,574**	98,398	60,369	61,506	61,873
Other Assets	**13,347**	7,635	5,840	6,028	9,902
Total Assets	**175,965**	155,072	118,717	108,840	106,644
Long Term Debt	**82,542**	59,396	22,034	24,174	19,284
Deferred Income Taxes	**6,091**	5,744	5,193	5,255	5,241
Minority Interest	**5,500**	5,500	5,500	6,794	18,588
Shareholders' Equity	**42,446**	39,814	45,533	43,236	42,063
Other Information					
Gross Margin Ratio %	**12.8***	7.8	9.6	12.5	8.8
Net Earnings as % of Sales	**2.8***	(20.3)	1.4	2.5	.3
No. Shares Outstanding (A & B)	**3,488,900**	3,438,900	3,438,900	3,438,900	3,438,900
Dividend per Share					
Class A ($)	**.20**	.35	.40	.40	.40
Class B ($)	**.20**	.35	.34	.34	.17
Price Range of Stock ($)					
High	**6.62**	8.00	6.00	6.25	7.00
Low	**4.90**	4.90	4.80	3.70	3.65
Shareholders' Equity per Share ($)	**12.17**	11.58	13.24	12.57	12.23

*Adjusted to exclude non-continuing operations

Harold W. Grant, President,
Standard Aero Limited

Aerospace Division

Five Year Review	Sales (Millions)	Earnings from Operations* (Millions)
1978 Dec. (9 Months)	30.8	4.9
1978 Mar. (12 Months)	29.6	3.8
1977	24.0	2.7
1976	24.5	2.9
1975	21.7	2.5

**Before taxes, interest and inter-company transactions.*

Business Description
Standard Aero Limited, located in Winnipeg, Manitoba, is the largest independent aircraft engine remanufacturing and parts distribution operation in Canada, and one of the largest in North America. The company is highly experienced in the remanufacture of piston and turbine engines used in a variety of aircraft.

Eighty per cent of all non-military helicopters flying in Canada are serviced by this Federal subsidiary. Canadian Government and international contracts also represent a large portion of the company's market.

Standard Aero's specialists are constantly upgrading their knowledge to keep abreast of new developments in the aerospace industry, and the company's sophisticated production equipment serves to help complete the complex task of engine overhaul. In addition, Standard Aero operates seven branch sales offices across Canada to distribute a wide range of general aviation components and recently opened a branch office near London, England to serve the United Kingdom and Western Europe. The company acts as distributor in Canada for the well-known Allison and Lycoming engines.

Operations Review
The Aerospace Division completed the best period of its history, with both sales and earnings more than 50% higher than the comparable 9 months in 1977. Despite the significant increase in volume, inventories and receivables growth was contained, and working capital improved by almost $3 million. Additional cash of almost $1.4 million was provided by the use of loss carryovers from Citation Cabinets, which was amalgamated with Standard Aero in April 1978. As noted earlier, the Cabinets division was sold in July, with Standard Aero acquiring access to a common equity position in the purchaser.

Capital expenditures were limited during the period to slightly more than $200,000, compared to $870,000 last year, when a substantial addition was made to the Winnipeg production facilities. The company does not foresee the requirement for material capital expenses in 1979, although growth of the European operation and scarcity of lease premises may result in the erection of owned plant and offices by early 1980.

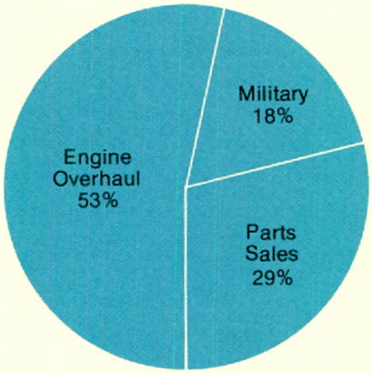
The company maintains significant inventories as a characteristic of the industry, and comparisons with similar operations in North America are quite favourable. Of the $15.5 million on hand at 31 December, about $3.6 million represented work in progress, $9.1 million parts on hand in Winnipeg and $2.8 million comprised branch inventories. In addition, the company holds approximately $5.1 million of inventory owned by the Department of National Defense and used in military overhaul programs.

Although the Division purchases much of its parts inventory from the United States, it is able to adjust sale prices for variations in the exchange rates, and thus has not suffered from the decline of the Canadian dollar. Furthermore, there are increasing sales outside of Canada, especially in Europe, where non-U.K. business is written in U.S. currency.

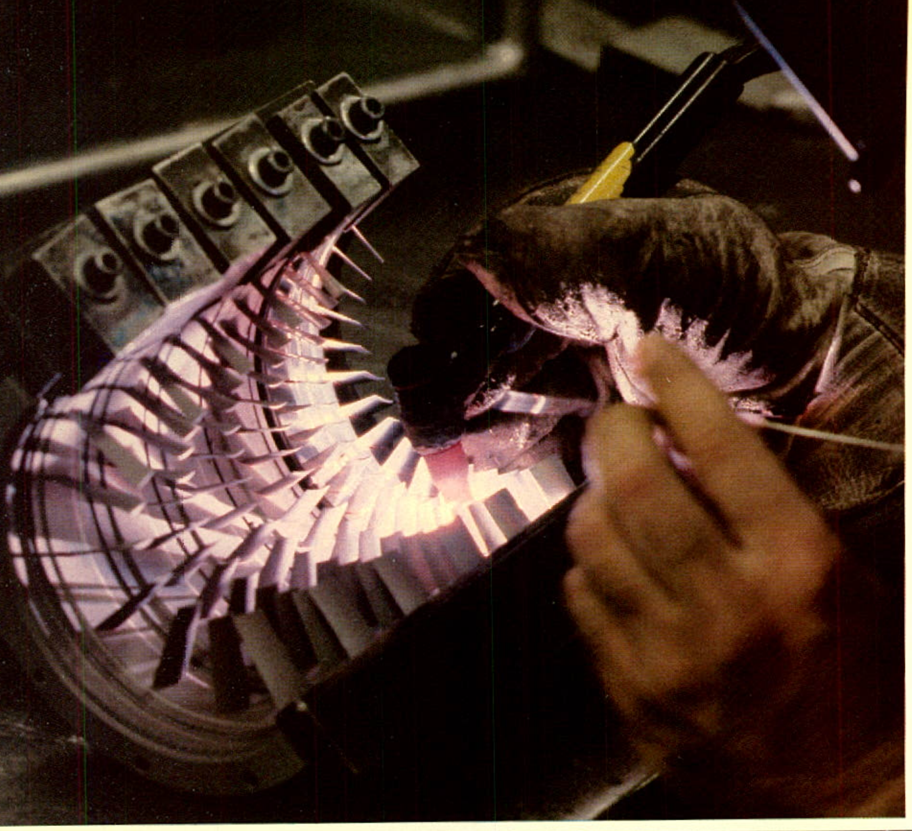
Outlook for 1979
Sales and earnings should maintain the high levels of the 1978 period, with demand for all of the Division's product lines remaining strong. Management of balance sheet items, particularly inventories, will add substantial liquidity to the operation, providing a widening base for expansion.

The military business is expected to produce significantly more volume as the offset programs associated with government aircraft purchases get under way, and export markets will provide the Federal group with important profits and foreign currency.

The Division is well placed to take full advantage of opportunities for internal growth and acquisition of related companies.

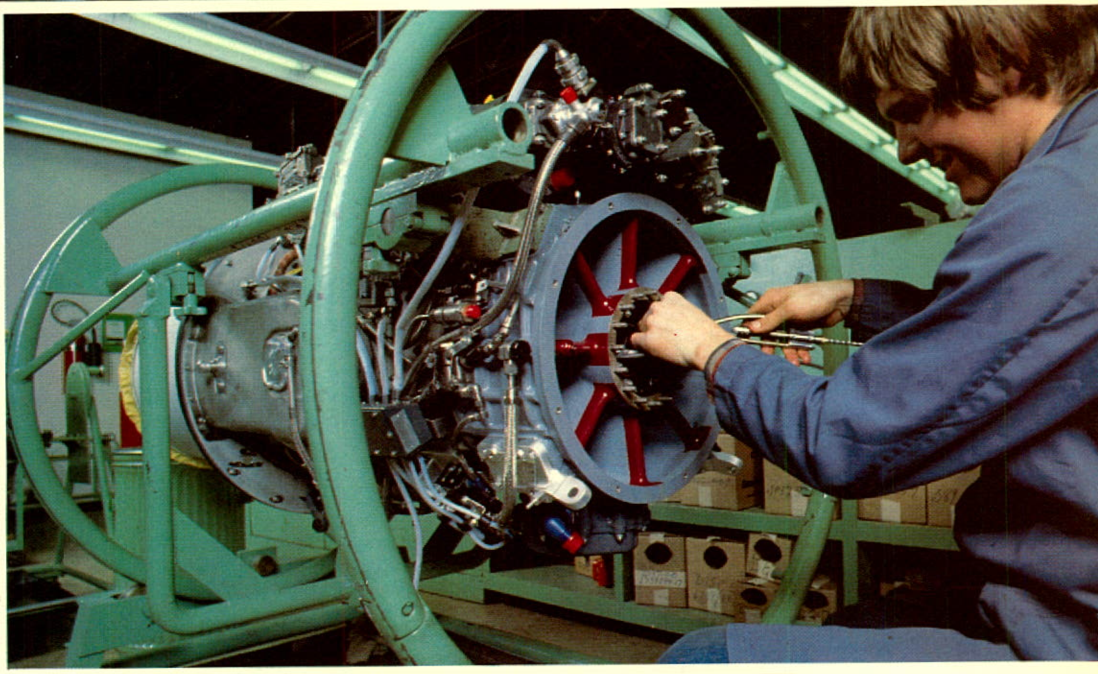


Sales Distribution for Nine Months to December 31, 1978



1.

1. *Weld repair of a compressor case for an Allison 250 engine used in Bell and Hughes helicopters.*
2. *Building up an Allison T-56 engine which powers the Lockheed C-130 Hercules transport aircraft.*
3. *Assembly of a turbine engine fuel control.*
4. *Pratt & Whitney piston engine parts prepared for inspection prior to assembly.*



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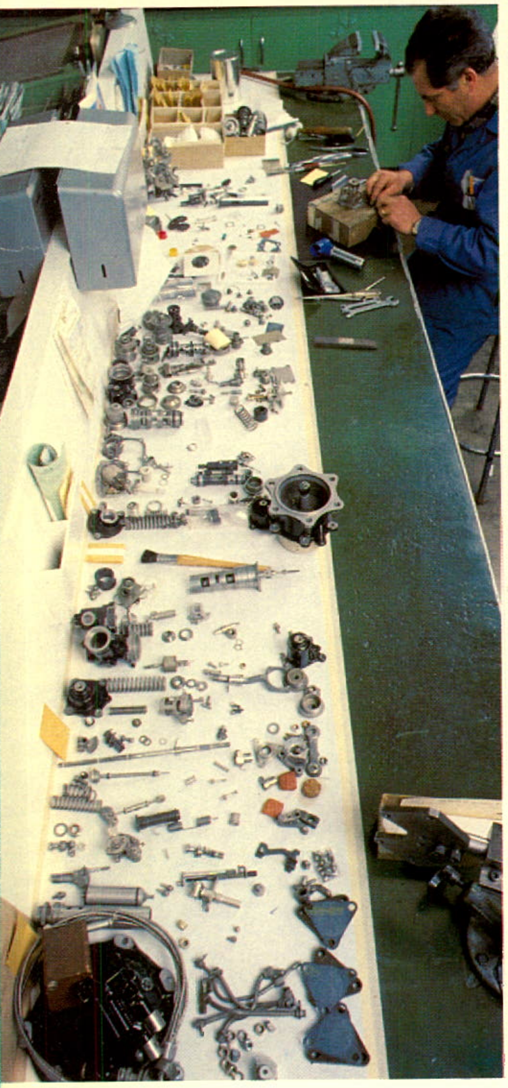

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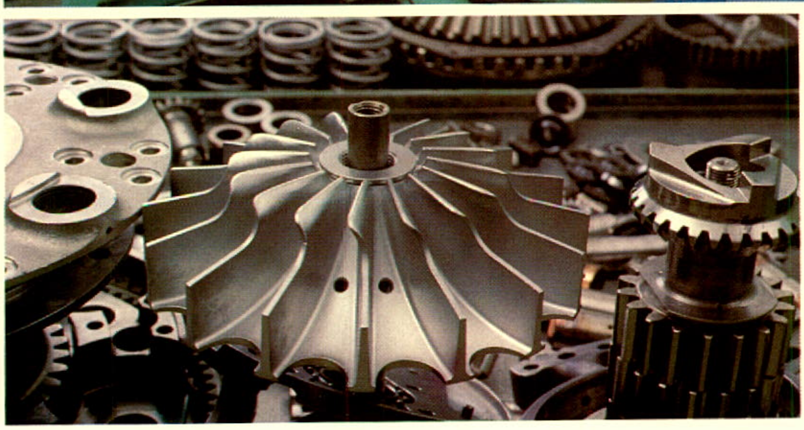


4.

Augustus S. Leach Jr., President, Neptune Bulk Terminals Ltd. and Thunder Bay Terminals Ltd.

Terminals Division

Five Year Review

	Sales (Millions)	Earnings From Operations* (Millions)	Assets (Millions)
1978 Dec. (9 Months)	10.5	3.2	86.6
1978 Mar. (12 Months)	9.6	1.8	60.6
1977	7.9	1.3	30.4
1976	7.7	1.8	23.9
1975	6.3	1.5	24.5

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

Business Description

The Terminals Division is comprised of two bulk transshipment facilities: Neptune Bulk Terminals Ltd. of Vancouver, British Columbia and Thunder Bay Terminals Ltd. of Thunder Bay, Ontario.

Neptune, one of the major bulk-handling facilities on the west coast, is located on the north shore of Vancouver's Burrard Inlet. Coal, potash, fertilizer, and agricultural pellets, all export commodities, are transported to Neptune by rail where they are loaded onto bulk-carrier ships for delivery to world markets. Products imported into Canada by vessel include phosphate rock and salt. These are stored at Neptune and loaded onto trucks or rail cars for delivery. Copper concentrates coming from the Yukon are shipped via The White Pass and Yukon Corporation to Neptune in containers. The product is removed from the containers and then shipped via rail cars to an eastern Canadian smelter. In addition to the above facilities, Neptune has available a rapeseed oil tank farm to service the growing demand for this product.

Neptune is a leader in the bulk-handling industry with a current annual volume exceeding 6 million tons, and with excellent potential for expansion.

Thunder Bay Terminals, the newest Federal company, was completed officially on 1 March 1979. Initially, the terminal will handle coal from western Canadian mines for use in thermal generating stations operated by Ontario Hydro. The coal is shipped by unit train directly to the site on McKellar Island where it is stored and then loaded onto ships for onward delivery.

The terminal has now the capacity to handle over 3 million tons of coal per annum with potential for rapid expansion to facilitate other coal users. In addition, the terminal facilities are designed to permit the handling of other bulk commodities.

Under an agreement with Ontario Hydro, work has begun to expand the terminal to handle lignite coal for transfer to the generating station on adjacent Mission Island. This 1 million ton per annum, $15-million project is due for completion in 1980.

Operations Review

The Division enjoyed record sales in the 9 month period, due to strong throughput of coal and potash at Neptune and to the opening of limited operations at Thunder Bay. Interruption of coal deliveries from Australia and the United States to Japan provided Canadian mines with an unusually high sales volume, a volume handled well by Neptune despite the use of a temporary coal-handling system. In May 1978, an industrial accident immobilized the stacker-reclaimer, a major piece of coal-handling equipment, requiring alternative methods of receiving and loading coal at a significant cost penalty. By December 31, costs of approximately $2.1 million had been incurred in excess of normal operating levels to allow continuation of coal handling. These extra costs are likely to increase to $2.5 million by the time normal operations resume in April 1979. In addition, costs of approximately $550,000 were incurred by December 31 in connection with repairs to the equipment, which repair cost will rise to $1.8 million by completion. The company expects to recover these expenses in 1979 from the proceeds of insurance, and as such, they are deferred on the balance sheet as a current asset.

Feasibility studies for the development of a new bulk coal terminal near Prince Rupert are continuing. The Federal government has announced that commercial access will be provided to the site and necessary improvements to the infrastructure made; Alberta has proposed major financial assistance for the establishment of a grain terminal. We believe that development of coal-handling facilities will proceed and Neptune will be active in soliciting a substantial involvement. The company is also engaged in discussions respecting the construction and operation of a terminal in New Brunswick to handle potash from new mines currently being developed.

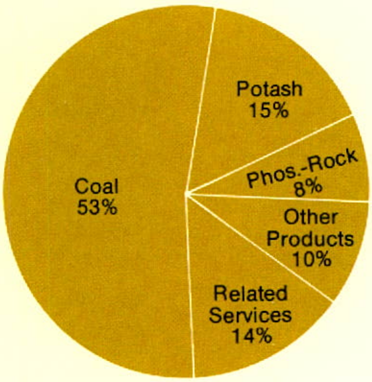
Thunder Bay Terminals conducted limited operations during the period, primarily to run-in the equipment and to obtain engineering certification of completion. No significant difficulties have been encountered in the start-up period, a tribute to the staff, project management and project engineering.

Outlook for 1979

The prospects for sales and earnings in the Division are generally bright. Thunder Bay Terminals is now fully under way, with coal shipments forecast to be unaffected by recent reports of cutbacks in power generation by Ontario Hydro. Throughput on bituminous coal should reach 2 million tons in 1979, rising to 2.7 million tons in 1980, and supplemented by 1 million tons per annum of lignite beginning in mid-1980. At Neptune Bulk Terminals, demand for most major commodities handled is expected to remain strong, although total coal throughput may decline because of labour difficulties at mine sites.

Operating the temporary coal system at Neptune will occasion excess costs and will exert a downward pressure on earnings during the first half of the year.

However, normal profit levels will return towards the end of 1979, and we look forward to a strong finish in both volume and profits.



Sales Distribution for Nine Months to December 31, 1978

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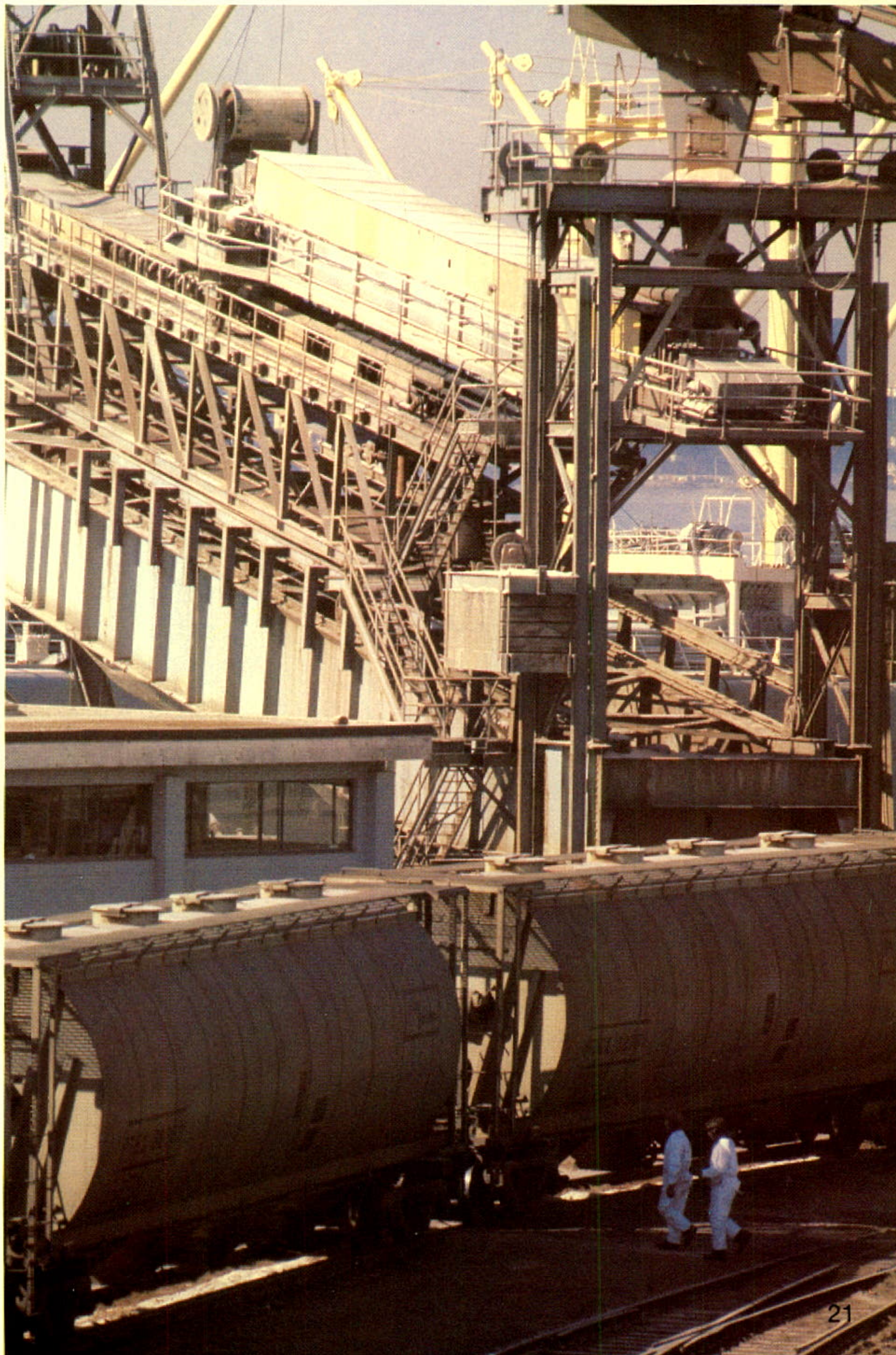


3.

1. Aerial view of the Thunder Bay bulk commodity terminal on Lake Superior.

2. Neptune Bulk Terminals shiploader with bulk commodity rail cars in the foreground.

3. Thunder Bay Terminals stacker assembly depositing coal.

Thomas H. King, Executive Vice-President and General Manager, The White Pass and Yukon Corporation Limited

Transport Division

Five Year Review		**Sales (Millions)**		**Earnings from Operations* (Millions)**
	Freight	**Petroleum**	**Total**	
1978 Dec. (9 Months)	28.2	24.6	52.8	.4
1978 Mar. (12 Months)	41.7	28.6	70.3	1.8
1977	31.4	23.6	55.0	1.9
1976	38.6	20.9	59.5	4.2
1975	30.1	18.6	48.7	1.0

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

Business Description:
The Transport Division is by far the largest in the Company, representing over 50% of consolidated sales. The Division, operating through subsidiaries of The White Pass and Yukon Corporation Limited, is a major supplier of transportation services and petroleum products in the Yukon Territory, Alaska, Alberta and British Columbia.

A portion of the operation, known as the White Pass "Route", is a fully-integrated ocean, rail and highway transportation system linking Vancouver, B.C. and Whitehorse in the Yukon. The Route operates a tug and barge ocean section, utilizing one of the largest tugs on the west coast and two 6,000-ton converted ship-barges. Containerized freight is off-loaded in Skagway, Alaska for onward delivery to Whitehorse via the 110-mile White Pass railway, which also carries in excess of 70,000 passengers annually past some of the most magnificent, historical scenery in North America. From Whitehorse, goods are delivered to all parts of the Yukon, Northwest Territories and northern British Columbia via the company's extensive truck fleet. This general freight service is complemented by the Division's Edmonton-based Loiselle Transport Ltd., which serves Alberta and British Columbia, and interlines with the White Pass trucking operations at Whitehorse.

A significant portion of the transport revenues is earned in contractual haulage of bulk commodities, primarily lead, zinc and copper. Over 500,000 tons annually are trucked from mine sites to the railhead and by The White Pass and Yukon Railway to the Company's terminal facilities at Skagway. When combined with general freight and petroleum business, the Division operates 105 truck power units and 438 units of railway rolling stock.

As is apparent from the Five-Year Review, a significant part of the Transport Division's activities are related to petroleum sales and services. The company transports petroleum products on its vessels to Skagway, where they are stored for further transmission either by pipeline or rail car to the 8 million gallon tank farm at Whitehorse. Distribution is accomplished by a fleet of truck tankers, serving retail and wholesale customers, including 6 owned and 30 independent service stations. The Petroleum Department also operates a growing tires, batteries and accessories business with its products being distributed by the company's chain of service stations and to commercial accounts throughout the Yukon. The company enjoys a majority participation in the Yukon market place for petroleum and related products.

Operations Review
1978 was a period of transition and adjustment for the Division, with significant changes to management and operations. An assessment of the prospects of the Division led to the conclusion that a major restructuring was necessary to meet a changing and challenging economic environment.

The loss of a major customer, Cassiar Asbestos, caused an imbalance in freight flows by virtually eliminating the southbound ocean tonnage and reducing rail revenues. The realignment of rates, prices and assets required to compensate is substantial and will take some months to accomplish.

Rising labour and material costs of operating the Division's ships as manned vessels resulted in a decision to convert the vessels to barge configuration and to contract for tug towing services. The conversion was completed in early 1979, with indicated annual operational savings in excess of $1 million.

In August, major changes were made to the senior operating management of the Division, and headquarters transferred to Whitehorse. The Vancouver administrative offices were reduced to a nominal status, and reductions in overhead aggregating an annualized $2 million were achieved. Decisions were made to close two unprofitable subsidiaries of White Pass, and the relating assets are being liquidated. Critical evaluations of all services provided by the Division are proceeding, with the result that certain unprofitable freight services have been discontinued and all rates adjusted to reflect actual operating costs.

Attainment of the beneficial financial results represented by these actions has not been without short term costs. Non-recurring charges in excess of $1 million were recorded against the Division's 9-month earnings, and more such expenses are anticipated in 1979 as the operations are brought into balance.

Major capital expenditures of over $4 million were undertaken during the period, primarily to provide a more efficient form of haulage for mineral concentrate of our largest customer, Cyprus Anvil. Of the total amount, $2.2 million represented capitalized lease obligations relating to truck power units and containers. Depreciation rose 26% to $2.9 million, reflecting the additions to fixed assets. Further, the Division invested or committed approximately $1.5 million to secure the services of a tug to tow its converted ship-barges. Working capital of the Division decreased by approx-

1. Loading lead-zinc concentrate from the Cyprus Anvil Mine for the 234 mile trip southwest to Whitehorse and the Whitepass rail terminal.

imately $1.8 million in the period due to operating losses, capital expenditures in excess of depreciation provided, and the inclusion in the financial statements for the first time of capitalized lease obligations. Further, current bank debt was increased by approximately $1 million on the purchase by the company of debt obligations of the tug owner. This amount is offset by a mortgage receivable and will be converted into long term debt during 1979. The company has negotiated recently an agreement with its bankers to convert $3 million U.S. from current to 12-year debt, thereby freeing substantial working capital for operational purposes.

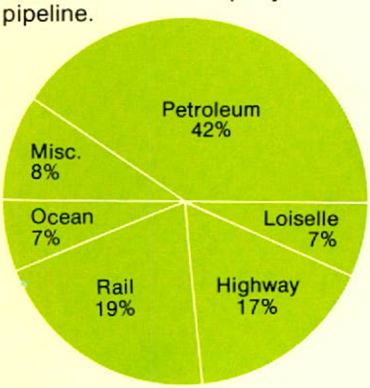
Outlook for 1979

The short and medium term difficulties facing the Division are extensive and a return to acceptable levels of profitability will require time and effort. Although attainment of net profitability by the Division in 1979 is unlikely, the trend of results of operations by year-end should be strongly positive.

The current turn around strategy is based on four major thrusts. First, the Division will continue the program of reducing costs and increasing productivity; second, implement further new pricing policies which will realign freight rates and product prices more closely to current costs; third, introduce an aggressive plan to improve service and strengthen operational management and, last, develop new policies to foster more acceptable labour/management relations.

Whether the White Pass and Yukon Railway can become commercially viable in the long run is the major issue facing this Division. In the short term, cost cuts already implemented, combined with rate increases, will reduce the size of current losses. We believe the long term solution will require either financial assistance from the Federal Government or an orderly wind down with existing traffic being transferred to the recently constructed highway running parallel to the railway. The Divison's commitment to and expertise in truck transportation assure that such a transition would be practical, providing for improved service, lower freight rates in the future and an acceptable level of earnings.

The present, but temporary, pause in the economic development of the Yukon is providing the new management team the much-needed time to implement the corrective measures and bolster operational management. This important rebuilding program will enable the Division to take maximum advantage of substantial increases in freight volumes and product sales that will accompany the construction of the gas pipeline.



Sales Distribution for Nine Months to December 31, 1978

2. A White Pass and Yukon diesel electric locomotive — one of 19 used for freight haulage on the company's railway.

3. A White Pass container carrier loading material bound from Vancouver to Skagway, Alaska.

Directory of Subsidiaries

AEROSPACE DIVISION

STANDARD AERO LIMITED
Winnipeg, Manitoba

H. W. Grant
President

J. A. Burgess
Vice-President, Engineering & Service

R. A. Carter
Vice-President, Sales

M. G. Moncrieff
Vice-President, Operations

S. R. Ewart
Vice-President & Treasurer

TERMINALS DIVISION

NEPTUNE BULK TERMINALS LTD.
North Vancouver, B.C.

A. S. Leach, Jr.
President

H. M. McLennan
Director, Operations

G. A. Klinkow
Director, Customer Services

L. A. W. Seney
Comptroller

THUNDER BAY TERMINALS LTD.
Thunder Bay, Ontario

A. S. Leach, Jr.
President

C. A. Lawrence
Vice-President & General Manager

D. E. Kelso
Operations Superintendent

D. R. Thomas
Maintenance Superintendent

K. W. Traynor
Controller

TRANSPORT DIVISION

THE WHITE PASS AND YUKON CORPORATION LIMITED
Winnipeg, Manitoba

J. F. Fraser
President & Chief Executive Officer

J. S. Pelton
Vice-President, Finance

Vancouver, B.C.

R. A. Hubber-Richard
Chairman of the Board

D. H. Sladden
Senior Manager—Vancouver

North Vancouver, B.C.

S. Kollbaer
Manger, Ocean Division

Whitehorse, Yukon

T. H. King
Executive Vice-President and General Manager

A. Ali
Vice-President, Administration

P. R. Mulligan
Manager, Highway Division

W. A. Dickson
Manager, Freight Terminal

F. A. Taylor
Manager, Regional Marketing

J. L. Stricharuk
Manager, Petroleum Sales & Service

R. D. F. Morris
Manager, Petroleum Administration

Edmonton, Alberta

M. L. Huntley
General Manager, Loiselle Transport

Skagway, Alaska

W. A. Hisman
Manager, Rail Transportation

Seattle, Washington

C. P. Reynolds
Manager, Passenger Sales

Company Addresses

BRITISH COLUMBIA

Vancouver—
Neptune Bulk Terminals Ltd.
P.O. Box 86367
North Vancouver, B.C.
V7L 4X6
(604) 985-7461

Standard Aero Limited
4540 Cowley Crescent
Vancouver International Airport, South
Vancouver, B.C.
V7B 1B8
(604) 273-8621

The White Pass & Yukon Corporation Limited
P.O. Box 10140 Pacific Centre
Vancouver, B.C.
V7Y 1E6
(604) 683-7221

The White Pass & Yukon Corporation Limited
Ocean Division
P.O. Box 86190
North Vancouver, B.C.
V7L 4J9
(604) 984-9561

Dawson Creek
Loiselle Transport Limited
P.O. Box 358
Dawson Creek, B.C.
V1G 4H1
(604) 782-8101

Fort St. John
Loiselle Transport Limited
10703 - 100 Avenue
Fort St. John, B.C.
V1J 1Z4
(604) 785-6764

Hudson Hope
Loiselle Transport Limited
P.O. Box 450
Hudson Hope, B.C.
V9C 1V0
(604) 783-5225

Fort Nelson
Loiselle Transport Limited
P.O. Box 236
Fort Nelson, B.C.
V0C 1R0
(604) 774-2161

Prince George
Loiselle Transport Limited
P.O. Box 250
Prince George, B.C.
V2L 4S1
(604) 564-0858

ALBERTA

Edmonton
Loiselle Transport Limited
16045 - 114 Avenue
Edmonton, Alberta
T5M 2Z3
(403) 452-5920

Standard Aero Limited
48 Airport Road, Industrial Airport
Edmonton, Alberta
T5G 0W7
(403) 453-3502

Calgary
Standard Aero Limited
Bay No. 1, Bldg. W154
Calgary International Airport
Calgary, Alberta
T2E 5T3
(403) 276-4471

Grande Prairie
Loiselle Transport Limited
8919 - 111 Street
Grande Prairie, Alberta
T8V 4M5
(403) 532-0895

MANITOBA

Winnipeg
Federal Industries Ltd.
2400 - One Lombard Place
Winnipeg, Manitoba
R3B 0X3
(204) 942-8161

Standard Aero Limited
No. 6 Hangar
Winnipeg International Airport
Winnipeg, Manitoba
R2R 0S8
(204) 775-9711

ONTARIO

Thunder Bay
Thunder Bay Terminals Ltd.
P.O. BOX 1800, Station "F",
Thunder Bay, Ontario
P7C 5J7
(807) 623-6921

Toronto
Standard Aero Limited
7171 Torbram Road
Mississauga, Ontario
L4T 3B6
(416) 676-2578

Ottawa
Standard Aero Limited
P.O. Box 821, R.R. #5
Ottawa International Airport
Ottawa, Ontario
K1G 3N3
(613) 737-3985

QUEBEC

Montreal
Standard Aero Limited
2433 - 46th Avenue
Lachine, Quebec
H4Y 1A5
(514) 636-9215

NEW BRUNSWICK

Fredericton
Standard Aero Limited
P.O. Box 74
Postal Station "A"
Fredericton, New Brunswick
E3B 4Y2
(506) 455-1551

YUKON

Whitehorse
The White Pass & Yukon Corporation Limited
P.O. Box 4070
Whitehorse, Yukon
Y1A 3T1
(403) 667-7611

Watson Lake
Loiselle Transport Limited
P.O. Box 387
Watson Lake, Yukon
Y0A 1C0
(403) 536-7385

UNITED STATES

ALASKA

Skagway
The White Pass & Yukon Corporation Limited
Rail Division
P.O. Box 435
Skagway, Alaska 99840
(907) 983-2214

WASHINGTON

Seattle
The White Pass & Yukon Corporation Limited
Rail Passenger Division
P.O. Box 2147 Vance Building
Seattle, Washington 98111
(206) 623-2510

EUROPE

England
Standard Aero Limited
Building #281
No. 2 Maintenance Area
Heathrow-London Airport
Hounslow, Middlesex, England
TW6 3AE

Board of Directors

J. F. FRASER
President
Federal Industries Ltd.

*R. G. GRAHAM
President
Inter-City Gas Limited

R. N. HAMBRO
Director
Hambros Bank Limited

R. A. HUBBER-RICHARD
Chairman of the Board
The White Pass and Yukon Corporation Limited

A. S. LEACH
Honorary Chairman of the Board
Federal Industries Ltd.

A. S. LEACH, JR.
Vice-President
Federal Industries Ltd.

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

*A. V. MAURO
Executive Vice-President
The Investors Group

*J. D. Riley
Company Director

J. D. SCOTT
President
Yukon River Industries Ltd.

C. L. SEARLE
Professor of Electrical Engineering & Psychology
Queen's University
Kingston, Ontario

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

*Member of Audit Committee

Officers

A. S. LEACH
Honorary Chairman of the Board

S. A. SEARLE
Chairman of the Board

J. F. FRASER
President

A. S. LEACH, JR.
Vice-President

J. S. PELTON
Treasurer and Chief Financial Officer

W. D. DAVIE
Secretary

The Company And its Subsidiaries

FEDERAL INDUSTRIES LTD.
Ste. 2400 - One Lombard Place
Winnipeg, Manitoba R3B 0X3

Neptune Bulk Terminals Ltd.

Standard Aero Limited

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

Federal Industries Ltd.
Suite 2400, One Lombard Place
Winnipeg, Manitoba
R3B 0X3