



The Arctic Group Inc.

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The Arctic Group Inc.

Building an
Internationally
Recognized Ice
Company

A N N U A L R E P O R T
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C O R P O R A T E
P R O F I L E

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The Arctic Group Inc. is one of the largest ice manufacturers in North America, distributing quality ice and water products from Québec to British Columbia in Canada, and south to Texas in the United States. The Company is committed to growth through acquisition and has launched an aggressive campaign to lead the consolidation of major market producers in the industry.

The Arctic Group was incorporated in 1996 as the platform for the initial public offering, and the vehicle to execute the consolidation strategy. In April 1997, it completed its IPO on the Alberta Stock Exchange, and over the first 12 months of operation, Arctic completed five acquisitions, increasing its sales threefold. The Company has subsequently concluded nine important transactions and has entered into agreements on five additional targets.

Arctic's programs will enable the Company to establish a brand name and image for quality ice and water products. The management of the Company has a proven record of delivering transactions and managing growth profitably.

Through the acquisition and integration of independent, locally owned ice companies, Arctic will use its expertise to enhance the profitability of these businesses through economies of scale and greater operational, marketing and financial support. As a public company, Arctic has the ability to attract investment capital for acquisitions, and is able to offer the vendors of target businesses an attractive financial model. Having recently expanded the capital base of the Company, Arctic is in a position to accelerate its corporate development activities.

Management is confident that its program to acquire and assimilate industry leaders will proceed with careful attention to operations and an appropriate capital structure. Over time, this strategy will provide significant benefits to the customers, the shareholders of Arctic and the industry as a whole.

M I S S I O N S T A T E M E N T

"To build an internationally recognized ice company by following a focused acquisition and consolidation strategy".



The Arctic Group Inc.

OFFICERS AND DIRECTORS

ROBERT J. NAGY,
*Chairman, President, Chief Executive
Officer, Director*

Mr. Nagy has been involved in the ice industry for more than twenty-five years. He has made a substantial contribution to the consolidation of the industry in western Canada over the past eleven years. Mr. Nagy has been an officer and director of the Company since its incorporation in March, 1996.

JAMES E. CLARK,
*Vice-President, Finance &
Acquisitions, Chief Financial Officer,
Director*

Mr. Clark received his chartered accountants designation in 1970. He has been involved in the ice industry for more than ten years and has been a major proponent of industry consolidation. Mr. Clark has been involved in a variety of real estate and related developments in Canada and the United States and has been an Officer and Director of the Company since August, 1996.

HUGH A. ADAMS,
Corporate Secretary

Mr. Adams is a partner of the law firm Tupper & Adams, Barristers and Solicitors, 1982 to present. Mr. Adams has been Corporate Secretary since August, 1996 and is the third

generation of his family to serve in the capacity of Secretary and Corporate Council for Arctic Ice and Alberta Ice.

PEGGY D. JOHNSON,
Director

Ms. Johnson is President of Arctic Glacier Canadian Water Company Inc., a water company founded by Ms. Johnson in 1993. She has been involved in the ice industry for the past ten years and is well known to the industry. Ms. Johnson has been a Director of the Company since August, 1996.

PETER S. HYNDMAN,
Director

Mr. Hyndman has been Vice-President, Law and Corporate Secretary of The Loewen Group since 1990, and a Director of that company since 1986. He is also a Director of Molnar Capital. Mr. Hyndman has been a Director of the Company since August, 1996.

KEITH F. BURROWS,
Director

Mr. Burrows, until recently served as President of Bristol Aerospace Limited. He has served as a member of the International Trade Advisory Committee (ITAC) reporting to the Minister of International Trade. Mr. Burrows has been a Director of the Company since August, 1996.

REGINALD K. GROOME, O.C.,
Director

Mr. Groome is retired Chairman and President of Hilton Canada Inc., and Vice-President, Development, North America, Hilton International Co., New York, NY. He currently serves as a director of Industrial Alliance Life Insurance Company, MPACT and Voyageur Insurance Co. Mr. Groome became a Director of the Company in August, 1996.

DONALD L. JOHNSON,
*Vice-President, Plainview Ice and
Cold Storage Inc., Director*

Mr. Johnson has been active in the ice industry for 30 years, serving as Chairman of the International Packaged Ice Association and as a member of numerous committees. A former USAF Instructor, he has been a Director of the Company since January, 1998.

RICHARD L. JOHNSON,
*President, Plainview Ice and Cold
Storage Inc., Director*

Mr. Johnson has led the development and expansion of Host Ice over the past three decades and is a Past Chairman of the Southwestern Ice Association. He has been a Director of the Company since January, 1998.

CORPORATE INFORMATION

ANNUAL MEETING

The Annual Meeting of Shareholders will be held on Thursday, October 29, 1998 at 2 p.m. (Central Standard Time) Lombard Hotel – West Ball Room
2 Lombard Place,
Winnipeg, Manitoba

HEAD OFFICE

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LEGAL COUNSEL

Canadian Counsel
Tupper & Adams
Winnipeg, Manitoba

Shea Nerland Calnan
Calgary, Alberta

United States Counsel
Jones, Day, Reavis & Pogue
Dallas, Texas

AUDITORS

KPMG
Winnipeg, Manitoba

BANKERS

RoyNat Inc.
Scotiabank

REGISTRAR AND TRANSFER AGENT

Montreal Trust Company of Canada
Winnipeg, Manitoba

STOCK EXCHANGE LISTING

The Alberta Stock Exchange
Stock Trading Symbol: "AGP"

INVESTOR INFORMATION

For the latest information on the Company, call The Arctic Group Investor Relations toll free at: 1-888-573-9237.

During the spring of 1998, Arctic marked its first anniversary as a public company. This was a year of growth, and included a series of developments that signal our evolution from a regional operation, to one with a North American focus.

Over the past year, a tremendous amount of energy has been directed at preparing the Company for rapid growth. This has included changes in the capital base and the completion of a number of strategic acquisitions, in both Canada and the United States.

The loss experienced during fiscal 1998 reflects more the timing of the acquisitions than any other fact. The Company was successful in establishing a base of operations in Texas, Oklahoma and Kansas over the winter, and the seasonal impact of this investment adversely affected the results of operations. Without question, Arctic's management has proven its ability to deliver above average results, and the outlook for all business units moving forward is very positive.

In a very short time, we have taken a number of initiatives to ensure the continued success of the Company. These include the positioning of the organization as the leading producer within Canada, the progress in building a base in the American market, and the creation of a management team to lead the aggressive expansion program.

Our retail and institutional shareholders continue to demonstrate solid support for the Company's business plan. In equal measure, our company has been able to grow through the substantial efforts of RoyNat Inc., Arctic's lead lender.



Robert J. Nagy
Chairman of the Board and Chief Executive Officer

Underlying our approach to this growth, is a plan to manage the expansion responsibly. This encompasses our activities in corporate development, the engineering behind the balance sheet, the capital structure, the integration of acquired businesses and the realization of synergies.

For the future, we plan to continue our aggressive expansion into the United States, and intend to leverage our distribution channel with leadership in products, pricing and efficiencies. Ultimately, we look towards building an exciting and rewarding enterprise with focus and drive. To that end, we would like to express our sincere appreciation to the shareholders, customers and employees for their continued support, effort and commitment to Arctic's success.

A handwritten signature in black ink, appearing to read 'R. Nagy', written over a horizontal line.

Robert J. Nagy, /s/
Chairman of the Board and Chief Executive Officer



The Arctic Group manufactures and packages ice at modern production facilities in each of its geographic trading areas. Utilizing over 1,800 tons of daily production capacity, it services over 25,000 accounts in markets with a total population in excess of 30 million.

Each of Arctic's subsidiaries maintains a modern fleet of refrigerated vehicles to distribute its product.

CURRENT OPERATIONS

Winnipeg, Manitoba

Arctic Ice was established in 1882. It services southern Manitoba and northwestern Ontario from a production facility located in Winnipeg. This location is also home to the Arctic Group head office.

Regina, Saskatchewan

Crystal Ice, incorporated in 1960, services the central Saskatchewan area from its Regina facility.

Calgary, Alberta

Alberta Ice services a trading area including central and southern Alberta from facilities situated in Calgary. Alberta Ice was established in 1911.

Vancouver, British Columbia

Pacific Ice has serviced the lower mainland area of B.C. since 1918. This growing market is serviced from a centrally located operation in Surrey.

Customers range from grocery and convenience stores, to restaurants, bars and hotels, food processors, bakeries and construction companies.

Arctic and its subsidiaries maintain a network of 18,000 ice merchandisers from which its retailers sell packaged ice.

West Texas

Founded in 1962, Host Ice services the west Texas market from a production facility located in Lubbock, Texas. The Company also operates distribution facilities in Amarillo, Odessa-Midland and San Angelo, Texas as well as Roswell, New Mexico. During the year Host acquired several smaller ice companies in Comanche, Texas (Lakeview Ice), Perry, Oklahoma (Shepards Ice) and Independence, Kansas (Arctic Ice and Water).

Wichita, Kansas

Party Pak services southern Kansas from its base in Wichita, Kansas.



Arctic's Montreal production and distribution facility.



SUBSEQUENT TO THE YEAR END, THE FOLLOWING BUSINESSES WERE ACQUIRED BY THE ARCTIC GROUP

Québec and Eastern Ontario

Thibault & Brunelle service southern Québec from their production facility in Montréal, with distribution centres strategically located within the trading zone. Through a related company, Capital City Ice, T&B has extended its reach to include the Ottawa Valley.

Southern Ontario

Great Lakes Ice, located in Chatham, has expanded into the Windsor, Chatham, Barrie and Sarnia markets. From facilities in Mississauga, Iceco services the Metropolitan Toronto market and Highland Ice fills the demand in the Kitchener-Waterloo region.

Northern Alberta

With a production facility located in Edmonton, The Ice Pedlar services the northern Alberta market.

Iowa

A significant investment for Arctic, with production plants in Dubuque, Ames and Mason City, Krieg Boys are the largest supplier to the Iowa marketplace.



Canadian Operations

British Columbia

Alberta

Saskatchewan

Manitoba

Ontario

Québec

United States Operations

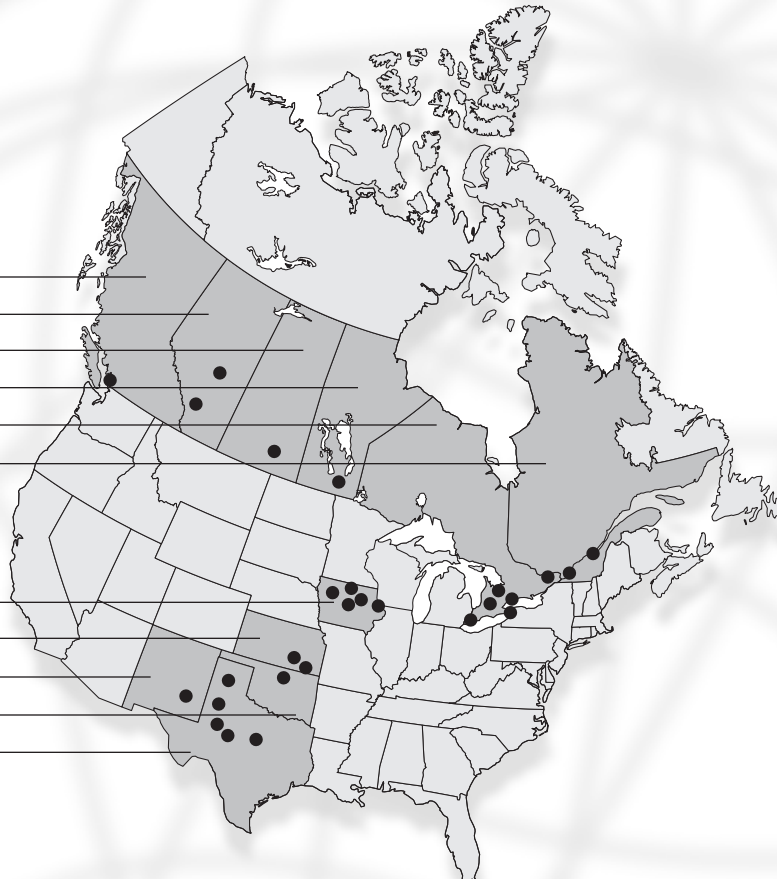
Iowa

Kansas

New Mexico

Oklahoma

Texas



RESULTS OF OPERATIONS

Sales for the fiscal year ended April 30th, 1998 were \$9,573,747, an increase of \$4,228,743 or 79% compared to the year ended April 30th, 1997. This is attributable to the expansion into the American market which added \$3,068,336, and the growth of Canadian business, which contributed an incremental \$1,160,407.

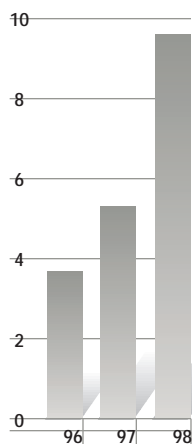
Cost of sales, selling, general and administrative expenses increased to \$9,151,233 compared with \$4,313,889 in the prior year. The increase relates to the expansion of the business into the United States, the relatively higher cost of operating that business over the winter, and the additional overhead required to support Arctic as a public company.

Interest expense increased by \$465,835 to \$609,573 in fiscal 1998 as the Company secured additional debt to fund its expansion program.

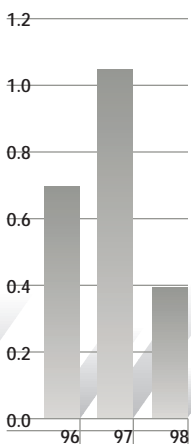
Amortization expense increased from \$457,244 in fiscal 1997 to \$1,266,755 in fiscal 1998. The increase is due to the American acquisitions and the corresponding increase in the asset base of the Company.

The Company is reporting a net loss for the current year of \$1,016,214 compared with net earnings of \$218,279 in the prior year. This is attributable to the timing of the United States acquisitions and the additional overhead required to move the business forward in the public company environment.

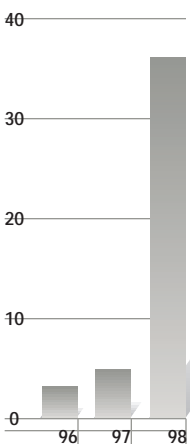
REVENUE
(in millions of dollars)



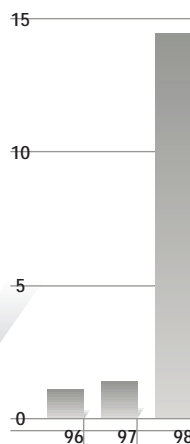
EBITDA
(in millions of dollars)



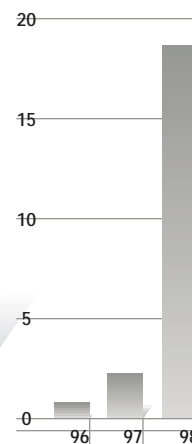
ASSETS
(in millions of dollars)



LONG-TERM DEBT
(in millions of dollars)



SHAREHOLDERS' EQUITY
(in millions of dollars)



LIQUIDITY AND CAPITAL RESOURCES

Historically, the Company has relied on cash flow from operating activities supplemented as necessary by bank borrowings to finance working capital, capital expenditures and investments. Working capital for the year ended April 30th, 1998 was \$4,163,541 an increase of \$3,607,529 over the balance of \$556,012 at April 30th, 1997.

During the year ended April 30th, 1998 the Company used \$23,273,450 in investing activities, consisting of \$1,988,960 in capital expenditures, and \$21,284,490 related primarily to the acquisitions in Texas. Long term debt increased by \$12,866,828 to \$14,523,924 reflecting the placement of a \$5,000,000 term loan, \$6,000,000 of convertible debentures

issued in November, and the assumption of existing debt in acquired companies. As at April 30th, 1998 the debt/equity ratio was .80 to 1.00 and subsequent to year end, the Company has arranged for additional term financing and operating lines of credit to support the business.

For the year ended April 30th, 1998 the Company generated a cash deficit of \$366,574 from operations as a result of the timing of acquisitions and increased administration costs. This anomaly arises from the seasonal nature of the business, and the Company believes it has sufficient resources from cash flows from operating activities and if necessary, from additional borrowings, to satisfy ongoing cash requirements for the next twelve months.



CONSOLIDATED
BALANCE SHEETS

As at April 30, 1998 and 1997

	1998	1997
ASSETS		
Current assets:		
Cash and term deposits	\$ 4,177,047	\$ 1,085,984
Accounts receivable	1,508,247	190,586
Inventories	923,246	172,700
Prepaid expenses and deferred charges	433,645	38,984
	7,042,185	1,488,254
Capital assets (note 5):		
Land, building and equipment	18,464,351	7,388,445
Accumulated amortization	5,066,481	4,059,131
	13,397,870	3,329,314
Other assets (note 6)	14,721,201	129,783
Deferred income taxes (note 17)	995,412	-
	\$ 36,156,668	\$ 4,947,351
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Bank indebtedness (note 7)	\$ 59,546	\$ 134,250
Accounts payable and accrued liabilities	2,360,968	448,390
Income taxes payable	-	50,545
Current obligations under capital leases	110,795	71,057
Principal due within one year on long-term debt	347,335	228,000
	2,878,644	932,242
Obligations under capital leases (note 8)	369,909	180,265
Long-term debt (note 9)	14,176,589	1,429,096
Deferred income taxes	-	37,508
Preferred shares of subsidiaries (note 10)	-	131,490
Shareholders' equity:		
Equity portion of convertible debentures (note 9)	5,708,405	-
Capital stock (note 11)	10,043,883	3,033,941
Special warrants (note 12)	4,788,348	-
Deficit	(1,910,345)	(797,191)
Cumulative translation adjustment	101,235	-
	18,731,526	2,236,750
Commitments (note 16)		
Subsequent events (note 19)		
	\$ 36,156,668	\$ 4,947,351

On behalf of the Board:



Robert Nagy, Director,/s/



Peggy Johnson, Director,/s/

See accompanying notes to consolidated financial statements.



CONSOLIDATED STATEMENTS
OF OPERATIONS

Years ended April 30

	1998	1997
Sales	\$ 9,573,747	\$ 5,345,004
Cost of sales, selling, general and administration expenses	9,151,233	4,313,889
Earnings before the undernoted	422,514	1,031,115
Amortization	1,266,755	457,244
Interest (note 14)	609,573	143,738
Earnings (loss) before income taxes	(1,453,814)	430,133
Income tax expense (recovery) (note 17):		
Current	-	27,100
Deferred	(437,600)	184,754
	(437,600)	211,854
Net earnings (loss)	\$ (1,016,214)	\$ 218,279
Earnings (loss) per share (note 13)	\$ (.068)	\$.022

CONSOLIDATED STATEMENTS
OF DEFICIT

Years ended April 30

	1998	1997
Deficit, beginning of year, as previously reported	\$ (710,844)	\$ (565,382)
Adoption of new accounting standard (note 3)	(86,347)	(30,813)
Deficit, as restated	(797,191)	(596,195)
Net earnings (loss)	(1,016,214)	218,279
	(1,813,405)	(377,916)
Interest on equity component of convertible debentures (net of applicable deferred income taxes of \$82,575)	(96,940)	-
Deficit on acquisition of Alberta Ice Co. Ltd.	-	(419,275)
Deficit, end of year	\$ (1,910,345)	\$ (797,191)

See accompanying notes to consolidated financial statements.



CONSOLIDATED STATEMENTS OF
CHANGES IN FINANCIAL POSITION

Years ended April 30

	1998	1997
Cash provided by (used in):		
Operations:		
Net earnings (loss)	\$ (1,016,214)	\$ 218,279
Interest on equity component of convertible debentures	(179,515)	-
Items not involving cash:		
Amortization of capital assets	1,019,663	427,287
Amortization of other assets	247,092	29,957
Deferred income taxes	(437,600)	184,754
Operating cash flow	(366,574)	860,277
Change in non-cash operating working capital	(414,179)	(70,148)
	(780,753)	790,129
Financing:		
Change in the following:		
Affiliated companies accounts	-	(153,359)
Dividends payable	-	(330,794)
Notes payable to shareholders	-	(361,832)
Obligations under capital leases	317,898	181,935
Principal payments under capital lease obligations	(88,516)	(87,957)
Proceeds from long-term debt	12,858,279	-
Principal payments on long-term debt	(3,062,661)	(268,000)
Equity portion of convertible debentures	5,708,405	-
Issuance of special warrants	4,608,113	-
Issuance of common shares	7,009,942	2,077,597
Redemption of preferred shares of subsidiaries	(131,490)	(532,950)
	27,219,970	524,640
Investments:		
Additions to capital assets	(1,988,960)	(483,549)
Proceeds from sale of capital assets	68,720	13,000
Additions to other assets	(1,058,322)	-
Acquisition of subsidiaries and operating assets, net of cash acquired of \$425,846 (1997 - \$46,905)	(20,311,624)	46,905
Cumulative translation adjustment	16,736	-
	(23,273,450)	(423,644)
Increase in cash	3,165,767	891,125
Cash, beginning of year	951,734	60,609
Cash, end of year	\$ 4,117,501	\$ 951,734
Operating cash flow per share (note 13)	\$ (.024)	\$.094
Cash consists of the following:		
Cash and term deposits	\$ 4,177,047	\$ 1,085,984
Bank indebtedness	(59,546)	(134,250)
Cash, end of year	\$ 4,117,501	\$ 951,734

See accompanying notes to consolidated financial statements.



Years ended April 30, 1998 and 1997

1. GENERAL:

The Arctic Group Inc. is a public company incorporated on March 1, 1996 under the laws of the Province of Alberta. The Company operates in the packaged ice industry and has been active in acquiring ice manufacturing and distribution companies since incorporation. The Company is one of the largest manufacturers and distributors of packaged ice in North America.

2. SIGNIFICANT ACCOUNTING POLICIES:

(a) **Principles of consolidation:** The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant inter-company accounts and transactions have been eliminated.

(b) **Inventory:** Inventory is valued at the lower of cost and net realizable value.

(c) **Capital assets:** Capital assets are stated at cost. Vehicles under capital leases are initially recorded at the present value of minimum lease payments at the inception of the lease. Amortization is provided on the following basis and at the following annual rates:

Building	4% straight-line
Plant equipment	5% straight-line
Merchandisers	20% straight-line
Vehicles and vehicles under capital leases	13% - 20% straight-line
Leasehold improvements	20% straight-line

(d) **Other assets:** Other assets are recorded at cost. Goodwill, which represents the excess of purchase price over the fair value of net assets acquired, is amortized on a straight-line basis to a maximum of 40 years. The Company evaluates its goodwill balance to determine whether any impairment has occurred. Where circumstances indicate a possible inability to recover the carrying amount of goodwill relating to a business acquisition, the Company evaluates, on an undiscounted basis, the cash flows of the underlying businesses which gave rise to the goodwill. Deferred financing costs are amortized on a straight-line basis over the term of the related debt.

(e) **Foreign exchange translation:** The financial statements of the U.S. subsidiary, considered self-sustaining, are translated in accordance with the current rate method. Assets and liabilities are translated at the exchange rate in effect at the balance sheet date and earnings statement items are translated at the average exchange rate for the period. Translation adjustments arising from exchange rate fluctuations are shown as "cumulative translation adjustments" under shareholders' equity until realized, at which time they are transferred to income.

Other monetary assets and liabilities denominated in U.S. dollars have been translated into Canadian dollars at the rate of exchange at year end. Gains and losses from translations are taken into income in the year they occur.

(f) **Income taxes:** The Company follows the asset and liability method for accounting for income taxes. Under this method, current income taxes are recognized for the estimated income taxes payable for the current year. Deferred income tax assets and liabilities are recognized for temporary differences between the tax and accounting bases of assets and liabilities as well as for the benefit of losses available to be carried forward to future years for tax purposes that are likely to be utilized. Deferred income tax assets and liabilities are measured using current statutory income tax rates.

(g) **Use of estimates:** The preparation of financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of certain assets and liabilities at the date of the financial statements and the reported amounts of certain revenue and expenses during the year. Actual results could differ from those estimates.

3. ADOPTION OF NEW ACCOUNTING STANDARD:

Effective with the fourth quarter of the 1998 fiscal year, the Company adopted the new accounting recommendations of the Canadian Institute of Chartered Accountants (CICA) for the accounting for income taxes. The new standard requires the use of the asset and liability method for accounting for income taxes as disclosed in note 2 (f). Previously, the Company followed the deferral method of accounting for income taxes which related the provision for income taxes to the accounting income for the period. This change has been applied retroactively and prior periods have been restated to reflect this change. As a result of this change, deficit at May 1, 1996 has been increased by \$30,813 and deferred income tax expense and liability have been increased by \$55,534 for the year ended April 30, 1997.



4. ACQUISITIONS:

Effective July 1, 1997 and December 8, 1997, the Company acquired all of the issued and outstanding common shares of Jacyn Enterprises Ltd., a Canadian company, and Plainview Ice & Cold Storage, Inc. ("Host Ice"), a U.S. company, respectively, both of which are ice manufacturing and distribution companies. Also in March, 1998, Host Ice acquired certain assets of three manufacturing and distribution companies operating in the United States. The transactions have been accounted for by the purchase method and the results of operations are included in the Company's accounts from the date of acquisition. Details of the acquisitions are as follows:

Net assets acquired, at fair values:		
Current assets		\$ 1,919,090
Capital assets		9,123,271
Deferred income taxes		335,290
Goodwill		13,737,611
		25,115,262
Current liabilities		1,410,106
Long-term debt		2,967,686
		4,377,792
		\$ 20,737,470
Consideration given:		
Cash		\$ 13,742,785
Due to vendors on acquisition of subsidiary		1,681,425
4,715,870 common shares		5,313,260
		\$ 20,737,470

5. CAPITAL ASSETS:

Capital assets at April 30, 1998 consist of the following:

	Cost	Accumulated amortization	Net
Land	\$ 346,251	\$ -	\$ 346,251
Building	3,036,694	994,448	2,042,246
Plant equipment	7,733,566	1,217,134	6,516,432
Merchandisers	4,116,194	1,694,053	2,422,141
Vehicles and vehicles under capital leases	3,039,510	970,662	2,068,848
Leasehold improvements	192,136	190,184	1,952
	\$ 18,464,351	\$ 5,066,481	\$ 13,397,870

Capital assets at April 30, 1997 consist of the following:

	Cost	Accumulated amortization	Net
Land	\$ 143,049	\$ -	\$ 143,049
Building	1,444,598	627,225	817,373
Plant equipment	2,884,388	1,173,847	1,710,541
Merchandisers	1,750,525	1,434,540	315,985
Vehicles and vehicles under capital leases	976,749	634,383	342,366
Leasehold improvements	189,136	189,136	-
	\$ 7,388,445	\$ 4,059,131	\$ 3,329,314

6. OTHER ASSETS:

Other assets consist of the following:

	1998	1997
Goodwill, net of accumulated amortization of \$260,521 (1997 - \$100,914)	\$ 13,886,256	\$ 99,528
Deferred financing costs, net of accumulated amortization of \$123,113 (1997 - \$35,628)	834,945	30,255
	\$ 14,721,201	\$ 129,783



7. **BANK INDEBTEDNESS:**

Bank indebtedness bears interest at prime plus 1.5% and is secured by a general security agreement of a subsidiary.

8. **OBLIGATIONS UNDER CAPITAL LEASES:**

The company leases vehicles under long-term capital leases. The following is a schedule of future minimum lease payments together with the balance of the obligations under capital leases:

	1998	1997
1998	\$ -	\$ 86,556
1999	138,622	86,556
2000	138,622	86,556
2001	95,662	43,596
2002	53,533	1,467
2003	52,066	-
2004 and beyond	133,079	-
Total minimum lease payments	611,584	304,731
Amount representing interest (at rates ranging from 7% to 9.5%)	(130,880)	(53,409)
Present value of minimum capital lease payments	480,704	251,322
Current obligations under capital leases	(110,795)	(71,057)
	\$ 369,909	\$ 180,265

9. **LONG-TERM DEBT:**

	1998	1997
RoyNat Inc. debenture, interest at a floating rate, rate at April 30, 1998 being 8.36%, interest only with a lump sum payment of \$5,000,000 on due date of December 15, 2000, administration fees of \$90,000 due quarterly to October 15, 1998, \$105,000 quarterly to October 15, 1999, and \$115,000 quarterly to October 15, 2000, secured by a debenture giving a fixed and specific charge on all capital assets of the Company and a first floating charge on all other assets of the Company	\$ 5,000,000	\$ -
Convertible debentures, interest at 8.5%	291,595	-
Subsidiaries:		
RoyNat Inc. debenture, interest at a floating rate, rate at April 30, 1998 being 8.36% (1997 - 6.72%), repayable by monthly principal payments of \$3,000 to June 1997 and monthly payments of \$3,500 thereafter to June 1999, with a lump sum payment of \$357,500 on due date of August 15, 1999, secured by a debenture giving a first, fixed and specific charge on all capital assets and a first floating charge on all assets of Alberta Ice Co. Ltd. and guarantees of two affiliated companies and a shareholder of the Company	406,500	447,000
RoyNat Inc. debenture, interest at a floating rate, rate at April 30, 1998 being 8.36% (1997 - 6.72%), interest only to September 15, 1996, repayable by monthly principal payments of \$3,000 plus interest to September 15, 1997 with monthly increments of \$500 every year thereafter, with a lump sum payment of \$410,000 in September 2001, secured by guarantee of a shareholder of the Company, first, fixed and specific charge on capital assets, a floating charge on all assets and assignment of fire insurance proceeds, all with regard to Arctic Ice Services Ltd.	586,000	626,000
RoyNat Inc. debenture, interest at a floating rate, rate at April 30, 1998 being 8.11% (1997 - 6.47%), payable in monthly principal instalments of \$8,500 plus interest and a final payment of \$8,350, due November 15, 2000, secured by a first charge on capital assets and a floating charge on all assets of Pacific Ice Company Inc. and Morrow Ice Ltd., assignment of life insurance of \$250,000 on a shareholder of the Company, guarantees of an affiliated company and a shareholder to a maximum of \$200,000	263,350	365,350



RoyNat Inc. debenture, interest at a floating rate, rate at April 30, 1998 being 8.86% (1997 – 7.22%), payable in monthly principal instalments of \$3,750 plus interest, due April 15, 2001, secured by a first charge on the capital assets and a floating charge on all assets of Pacific Ice Company Inc. and Morrow Ice Ltd., assignment of life insurance of \$250,000 on a shareholder of the Company and a guarantee of an affiliated company to a maximum of \$225,000	135,000	180,000
Norwest Bank term loan of \$2,262,690 U.S., interest at 8% per annum, interest only to May 31, 1998, repayable by monthly principal payments of \$16,667 U.S. plus interest beginning June 30, 1998 with a lump sum payment of \$1,162,664 U.S. on due date of December 16, 2003, secured by a commercial security agreement covering all personal and real property of Host Ice	3,237,909	–
Norwest Bank term loan of \$1,400,000 U.S., interest calculated as defined in credit facility agreement (8.75% at April 30, 1998), interest only to May 31, 1998, repayable by monthly principal payments of \$17,700 U.S. commencing June 30, 1998, due on February 28, 2003, secured by a commercial security agreement covering all personal and real property of Host Ice	2,003,400	–
Norwest Bank demand term loan of \$450,000 U.S. to a maximum of \$950,000 U.S., interest at 8.25% per annum, interest only, due August 31, 1999, secured by a commercial security agreement covering all personal and real property of Host Ice	643,950	–
Town & Country loan of \$257,030 U.S., interest at 8.5%, repayable by monthly principal and interest payments of \$7,181 U.S., due on August 31, 2001, secured by furniture, fixtures and equipment of Host Ice	367,810	–
Payable to vendors on acquisition of subsidiary, non-interest bearing, payable in monthly principal instalments of \$12,917 U.S. to December 1998, \$17,083 U.S. to December 1999, \$21,250 U.S. to December 2001 and \$25,467 U.S. to December 2003, due December 2003, unsecured	1,588,410	–
Loan payable, interest at 7%, \$1,101 paid monthly, interest only, due May 1998, secured by a second floating charge on all assets of Alberta Ice Co. Ltd.	–	38,746
	14,523,924	1,657,096
Principal included in current liabilities	347,335	228,000
	\$ 14,176,589	\$ 1,429,096

On November 27, 1997 the Company issued convertible debentures aggregating \$6,000,000, bearing interest at 8.5% per year payable quarterly and maturing on December 8, 2002. The convertible debentures are secured by a first floating charge on all of the property and assets of the Company, both present and future, and is subordinated to other long-term debt of the Company. The debentures are convertible at the option of the holder into common shares at any time prior to maturity at a rate of one common share for each \$1.50 of aggregate principal amount of debentures converted, subject to adjustment pursuant to a subdivision, redivision, reduction, combination or consolidation of the common shares. Subsequent to April 30, 1998, \$704,495 of debentures were converted into 469,663 common shares.

Commencing December 8, 1998, the Company can force the conversion of the debentures into common shares of the Company provided that the current market price of common shares of the Company is not less than \$3.00 and provided that the forced conversion date is not more than 60 days and not less than 30 days from the date on which notice of forced conversion is given.

As a result of the accounting recommendations of the Canadian Institute of Chartered Accountants for the presentation and disclosure of financial instruments, the convertible debentures are split between a debt component (\$291,595) and an equity component (\$5,708,405). Using an implicit rate of 13%, the present value of the interest payments on the convertible debentures until December 8, 1998 is presented as long-term debt while the remaining portion of the principal amount of the convertible debentures is included in shareholders' equity. The interest related to the long-term debt portion is charged to earnings and the increase in the equity component is charged to deficit, net of taxes.



9. LONG-TERM DEBT (continued)

Principal repayments, excluding long-term debt refinanced as described in note 19 (b), for the next five years are as follows:

1999	\$	347,335
2000		427,345
2001		5,478,290
2002		449,250
2003		545,595
	\$	7,247,815

10. PREFERRED SHARES OF SUBSIDIARIES:

The preferred shares in subsidiaries are as follows:

	1998	1997
Pacific Ice Company Inc.:		
Nil preferred shares, 10% non-cumulative, at redemption amount of \$10 per share (1997 – 2,089 preferred shares)	\$ -	\$ 20,890
Alberta Ice Co. Ltd.:		
Nil class A shares, \$.08 cumulative dividend non-voting unless dividends in arrears, at redemption amount of \$140 per share (1997 – 790 class A shares)	-	110,600
	\$ -	\$ 131,490

Dividends declared on preferred shares of subsidiaries for the year ended April 30, 1998 were \$4,374 (1997 – \$60,848) and have been recorded as an other expense in the statement of operations.

During fiscal 1998, Pacific Ice Company Inc. redeemed 2,089 (1997 – 28,295) preferred shares for cash consideration of \$20,890 (1997 – \$282,950) and Alberta Ice Co. Ltd. redeemed 790 preferred shares for cash consideration of \$110,600.

11. CAPITAL STOCK:

Authorized: The company has authorized share capital of an unlimited number of common voting shares and preferred shares. The preferred shares may be issued in one or more series, and the directors may fix prior to each series issued, the designation, rights, privileges, restrictions and conditions attaching to each series of preferred shares.

Issued: Common shares issued and outstanding are as follows:

	Number of shares	Amount
Balance at April 30, 1996	5,635,707	\$ 675,944
Acquisition of Alberta Ice Co. Ltd.	3,700,000	10,500
Conversion of debt for common shares as follows:		
Payable to Dry Ice & Gases (Western) Ltd.	225,000	225,000
Payable to shareholders	318,083	318,083
Conversion of preferred shares of subsidiaries for common shares	121,210	121,210
Initial prospectus offering dated February 21, 1997, net of share issue costs of \$586,704, less deferred income taxes of \$269,900	2,666,667	1,683,204
Balance at April 30, 1997	12,666,667	\$ 3,033,941
Acquisition of subsidiaries	4,600,000	5,030,000
Acquisition of operating assets	115,870	283,882
Exercise of common share purchase warrants	1,141,957	1,151,205
Exercise of Agent options	226,474	169,855
Exercise of warrants by RoyNat Inc.	250,000	375,000
Balance at April 30, 1998	19,000,968	\$ 10,043,883

The legal stated capital of the issued and outstanding common shares at April 30, 1998 is \$19,009,942 (1997 – \$12,000,000).

During fiscal 1997, the Company had granted options to directors and officers to acquire an aggregate of 512,500 common shares pursuant to the Company's stock option plan. These options are exercisable at a price of



\$0.75 per share and expire on March 25, 2002. There were no options exercised in fiscal 1998. Subsequent to April 30, 1998, 10,000 options were exercised resulting in the issuance of 10,000 common shares for proceeds of \$7,500.

During fiscal 1998, the Company has granted additional stock options to certain employees, officers and directors to acquire an aggregate of 200,000 and 987,500 common shares of the Company at \$1.90 and \$2.65 per share, respectively. These options expire on November 21, 2002 and February 27, 2003, respectively. The Company has also granted options to certain employees of its wholly-owned subsidiary, Host Ice, to acquire an aggregate of 160,000 common shares of the Company at \$2.30 per share. These options expire December 8, 2002. There were no options exercised in fiscal 1998.

On March 25, 1997, the Company had issued an aggregate of 2,666,667 common share purchase warrants in connection with its initial prospectus offering. These warrants entitle the holders to purchase an aggregate of 2,666,667 common shares and are exercisable at a price of \$1.00 per share until February 24, 1998 and \$1.25 per share thereafter until February 24, 1999 at which time they expire. No value has been ascribed to the warrants for financial statement purposes. As at April 30, 1998, 1,141,957 of the warrants have been exercised for proceeds of \$1,151,205. Subsequent to April 30, 1998, a further 67,566 of warrants have been exercised resulting in the issuance of 67,566 common shares for proceeds of \$84,458.

In March, 1997, the Company had granted options to its agents and their sub-agents under the Company's initial prospectus offering to purchase an aggregate of 400,000 common shares. These options are exercisable at a price of \$0.75 per share and expire on March 25, 1999. As at April 30, 1998, 226,474 of these options have been exercised.

The Company has granted 400,000 common share purchase warrants to the agent in connection with the Company's private placement of \$6,000,000 convertible debentures on November 27, 1997. These warrants entitle the agent to purchase 400,000 common shares at \$1.50 per share and expire on November 27, 1999. No warrants were exercised in fiscal 1998.

The Company has granted RoyNat Inc. a warrant to purchase 250,000 common shares in connection with the \$5,000,000 term loan financing the Company received during fiscal 1998 (note 9). The warrant is exercisable at a price of \$1.50 per share and expires on October 31, 1999. The warrant has been exercised as at April 30, 1998 resulting in the issuance of 250,000 common shares for proceeds of \$375,000. If the term loan is not prepaid in full before December 2, 1998, the Company shall issue to RoyNat a second warrant to purchase an additional 125,000 common shares at a price equal to the weighted average closing market price of common shares of the Company as determined over the five trading days immediately prior to December 2, 1998. The second warrant expires on October 31, 2000. If the term loan is not prepaid in full before December 2, 1999, the Company shall issue to RoyNat a third warrant to purchase an additional 125,000 common shares at a price equal to the weighted average closing market price of common shares of the Company as determined over the five trading days immediately prior to December 2, 1999. The third warrant expires on October 31, 2001.

12. SPECIAL WARRANTS:

On March 19, 1998, the Company issued through a private placement 2,500,000 special warrants pursuant to prospectus exemptions under applicable securities legislation at a price of \$2.00 per special warrant for an aggregate gross consideration of \$5,000,000 with issue costs incurred on the offering aggregating \$391,887 before related tax benefit of \$180,235. Each special warrant entitles the holder to acquire, without further consideration, but subject to adjustment, one common share of the Company. The special warrants are exchangeable for common shares on or before March 19, 1999 as set out in the Special Warrant Indenture dated March 19, 1998.

Should a receipt for the prospectus not be issued on or before October 15, 1998, then the special warrants exchange rate for common shares will be increased to 1.1 common shares from 1.0 common shares.

The Company has also granted 125,000 compensation warrants to the agents that allow the agents to acquire 125,000 common shares a price of \$2.00 per share at any time until March 20, 2000.

13. PER SHARE AMOUNTS:

Per share amounts are based on a weighted average number of common shares issued and outstanding during the year. The basic weighted average number of common shares outstanding for the years ended April 30, 1998 and April 30, 1997 was 14,975,697 and 10,096,941 respectively.

Fully diluted per share amounts have not been disclosed as the effect of the exercise of options or warrants and the conversion of convertible debentures or special warrants would be anti-dilutive.



14. INTEREST:

	1998	1997
Interest incurred on:		
Long-term debt including administration fees	\$ 569,649	\$ 128,387
Convertible debentures	202,603	-
Capital lease obligations	16,836	15,351
	789,088	143,738
Less: interest on convertible debentures classified as equity	179,515	-
	\$ 609,573	\$ 143,738

15. SEGMENTED INFORMATION:

The Company has determined that it operates in one business segment, the manufacturing and distribution of packaged ice and related products. The Company operates in Canada and the United States.

The following presents key information by geographic segment:

	Canada		United States		Total	
	1998	1997	1998	1997	1998	1997
Total sales	\$ 6,505,411	\$ 5,345,004	\$ 3,068,336	\$ -	\$ 9,573,747	\$ 5,345,004
Net earnings (loss)	(162,487)	218,279	(853,727)	-	(1,016,214)	218,279
Total assets	\$14,817,535	\$ 4,947,351	\$ 21,339,133	\$ -	\$ 36,156,668	\$ 4,947,351

16. COMMITMENTS:

The Company's subsidiaries rent premises and equipment under long-term operating leases. The following is a schedule by year of rental payments required under operating leases outstanding at April 30, 1998:

1999	\$ 135,449
2000	132,657
2001	74,942

17. INCOME TAXES:

The difference between the effective rate of income tax reflected in the consolidated financial statements and the basic income tax rates are as follows:

	1998	1997
Basic income tax rate	37.6%	45.2%
Rate reduction for manufacturing and processing	(0.6)	(3.1)
Effect of non-deductible expenses	(6.9)	7.2
Effective income tax rate	30.1%	49.3%

Significant components of deferred income tax assets and liabilities are as follows:

	1998	1997
Assets:		
Loss carry-forwards and other	\$ 2,016,505	\$ 305,544
Liabilities:		
Capital and other assets - values in excess of tax values	(1,021,093)	(343,052)
Deferred income tax assets (liabilities)	\$ 995,412	\$ (37,508)

18. RELATED PARTY TRANSACTIONS:

The Company had the following transactions with companies affiliated with shareholders of the Company:

	1998	1997
Sales	\$ 107,395	\$ 73,483
Purchases	493,689	417,581
Rent	18,000	12,000
Rental income	15,120	15,120



19. SUBSEQUENT EVENTS:

- (a) On May 21, 1998 and May 28, 1998, the Company issued through a private placement, 9,244,000 special warrants pursuant to prospectus exemptions under applicable securities legislation at a price of \$2.50 per special warrant for an aggregate gross consideration of \$23,110,000. Each special warrant entitles the holder to acquire, without further consideration but subject to adjustment, one unit of the Company. Each unit consists of one common share and one warrant to purchase common shares of the Company. Each warrant entitles the holder to acquire one common share of the Company for \$3.75 per common share, subject to adjustment in certain circumstances, until May 21, 2000. The special warrants are exchangeable for units on or before May 21, 1999 as set out in the Special Warrant Indenture dated May 21, 1998.

The proceeds of the special warrants have been used to fund the acquisition of ice manufacturing and distribution companies.

Agent's fees and other expenses of the offering are expected to approximate \$2,000,000. The Company has also granted 924,400 compensation warrants to the agents that allow the agents to acquire 924,400 common shares at a price of \$2.50 per share at any time until May 21, 2000.

Should a receipt for the Company's prospectus not be issued on or before November 17, 1998, then the special warrant exchange rate for units and the compensation warrants exchange rate for common shares will be increased to 1.05 from 1.0.

- (b) The Company has received \$19,857,000 of a total \$30,000,000 available in financing through a debenture from RoyNat Inc. The term loan is interest bearing at the RoyNat Inc. floating base rate plus 2.50% per annum and bears interest only until July 15, 2000, at which time it is repayable by monthly principal repayments of \$220,000 plus interest to June 15, 2002, \$250,000 plus interest to June 15, 2004, \$280,000 plus interest to June 15, 2007 and a lump sum payment of \$8,640,000 on the due date of July 15, 2007. The loan will be secured by a debenture giving a first, fixed and specific charge on all capital assets of the Company and its subsidiaries and a first floating charge on all other assets of the Company and its subsidiaries. There are certain financial and reporting covenants contained in the debenture that the Company must meet.

The Company has also granted 500,000 warrants to RoyNat to purchase common shares of the Company at \$3.75 per share with a forced exercise if the market value of the common shares of the Company closes at or above a 40% premium to the warrant price (\$5.25) for twenty consecutive trading days.

The proceeds from the term loan has been used to (i) replace the long-term debt as disclosed in note 9, excluding the loan from Town & Country, the convertible debentures, the \$5,000,000 RoyNat Inc. debenture and the payable to vendors on acquisition of subsidiary; and (ii) to finance the acquisition of packaged ice manufacturing and distribution companies.

- (c) Subsequent to year end, the Company has acquired all of the issued and outstanding shares of six ice manufacturing and distribution companies in Canada and the operating assets of two ice manufacturing and distribution companies in the United States. The transactions will be accounted for by the purchase method and the results of operations will be included in the Company's accounts from the date of acquisition. Details of the acquisitions in aggregate are approximately as follows:

Net assets acquired, at fair value:		<i>(unaudited)</i>
Current assets	\$	3,073,000
Capital and other assets		27,409,000
Deferred income taxes		1,128,000
Goodwill		16,805,000
		48,415,000
Current liabilities		4,755,000
Long-term debt		2,094,000
		6,849,000
	\$	41,566,000
Consideration given:		
Cash	\$	32,410,000
Due to vendors on acquisition of subsidiary		2,750,000
2,788,929 common shares		6,406,000
	\$	41,566,000



20. FINANCIAL INSTRUMENTS:**(a) Credit risk:**

The Company, in its normal course of business, evaluates the financial condition of its clients on a continuous basis and examines credit history for any new client. The Company establishes a provision for bad debts based on specific client's credit risk, historical trends and other information. The Company believes that its clients are not exposed to a credit risk level higher than normal.

(b) Fair value of financial instruments:

The carrying value of cash and term deposits, accounts receivable, bank indebtedness, accounts payable and accrued liabilities and income taxes payable approximates their fair value, since these items fall due in the short-term. The carrying value of obligations under capital leases and long-term debt approximates their fair value since they bear interest at rates comparable to the prevailing market rates.

21. YEAR 2000 ISSUE:

The year 2000 issue arises because many computerized systems use two digits rather than four to identify a year. Date-sensitive systems may recognize the year 2000 as 1900 or some other date, resulting in errors when information using year 2000 dates is processed. In addition, similar problems may arise in some systems which use certain dates in 1999 to represent something other than a date. The effects of the year 2000 issue may be experienced before, on, or after January 1, 2000, and, if not addressed, the impact on operations and financial reporting may range from minor errors to significant systems failure which could affect an entity's ability to conduct normal business operations. It is not possible to be certain that all aspects of the year 2000 issue affecting the entity, including those related to the efforts of investees, suppliers, or other third parties, will be fully resolved.

22. COMPARATIVE FIGURES:

Certain comparative figures have been restated to conform with the financial statement presentation adopted in the current year.

A U D I T O R S
R E P O R T

TO THE SHAREHOLDERS OF THE ARCTIC GROUP INC.

We have audited the consolidated balance sheets of The Arctic Group Inc. as at April 30, 1998 and 1997 and the consolidated statements of operations, deficit and changes in financial position for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at April 30, 1998 and 1997 and the results of its operations and the changes in its financial position for the years then ended in accordance with generally accepted accounting principles.

KPMG

Chartered Accountants, /s/

Winnipeg, Canada

June 19, 1998, except for notes 9, 11 and 19 which are as of July 23, 1998

