

IMAX[®]

IMAX CORPORATION 1998 ANNUAL REPORT





EXTREME
Spring 1999



IMAX: BIGGER THAN YOUR IMAGINATION

The IMAX Experience® inspires constant,
ever-renewed brand loyalty.

EXTREME IS A PRODUCTION OF BEYAK LONG DEJONG FRANKEN PRODUCTIONS

Message to Shareholders

In 1998, Imax Corporation took major strides in its growth as a family entertainment company. Five years ago, we created a three-step plan to transform Imax from a niche provider of theatre hardware to a major branded family entertainment company.

First, we needed to expand the international IMAX theatre network. In 1998, we had a record year for IMAX theatre signings and openings. Second, we needed to release even better films to the IMAX theatre network. In 1998, MacGillivray Freeman Films' *Everest* and *T-REX: Back to the Cretaceous*, two of the most successful and innovative large-format films, were released to IMAX theatres. Third, we had to harness and leverage the IMAX brand. In 1998, IMAX brand recognition in the United States increased from 60% to 75%.

During the next 12 months, we expect to continue to have tremendous opportunities to develop and build IMAX as a major worldwide family entertainment brand.

Our collaboration with The Walt Disney Company in their exclusive release of *Fantasia 2000: The IMAX Experience* to the IMAX theatre network on January 1, 2000 is just one example. A more in-depth description of 1998's accomplishments is detailed below.

Theatre network

1998 was a record year for IMAX theatre signings and openings. We signed contracts for 43 new third-party theatre locations valued at \$129.2 million, including our first theatres in China, India, Israel, Poland and the Czech Republic.

Among our more notable signings in 1998 was an agreement with Famous Players for 10 IMAX 3D theatres to be built in new and existing Famous Players theatres across Canada over the next five years. The two IMAX theatres they have opened to date have helped their multiplexes be among the 10 highest-grossing in North America.

Imax Highlights

Everest



MacGillivray Freeman Films' *Everest* became the first large-format film to crack *Variety's* top 10 highest-grossing films – and did it while playing on only 46 screens. In its first year, *Everest* became the fastest-grossing film in the IMAX theatre network's history, grossing more than \$75 million worldwide in its first 12 months of release.

SIEGFRIED & ROY: THE MAGIC BOX

Summer 1999

LARGER-THAN- LIFE FORMAT FUELS GARGANTUAN GROWTH

USA TODAY, October 1998

SPACE STATION 3D

Spring 2001

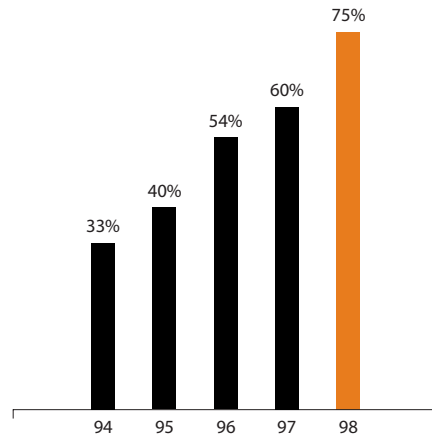
感動、壮麗



[breathtaking, spectacular]

THE DAILY YOMIURI, October 1998

IMAX brand awareness. Awareness of the IMAX brand continues to grow in many markets, and has more than doubled in the U.S. in the past four years. The exposure surrounding the box office hit *Everest* and the ever-growing network of IMAX theatres drove a 25% increase in 1998 awareness.



One of the multiplexes, The Colossus in Vaughan, Ontario, has been the highest-grossing multiplex in North America since it opened. By July 1999, seven of the 10 new Famous Players IMAX theatres will be in operation. In 1998, we also signed an agreement for our first five theatres in Eastern Europe and a deal for our first three theatres in Turkey.

Our institutional theatres, a dynamic component of this Company and where The IMAX Experience got its start, continue to flourish. In Seattle, Washington, The IMAX Experience has proved so popular that after the Pacific Science Center opened its new Boeing IMAX 3D

Theatre this spring, it decided to keep the original IMAX theatre operating as well. Similarly, the Smithsonian Institution in Washington, D.C. is opening a second IMAX theatre in May 1999. This new IMAX 3D theatre at the National Museum of Natural History will complement the highly successful IMAX theatre at the National Air and Space Museum.

At year end there were 183 IMAX theatres in operation in 25 countries. Over the next few years more than 75 theatres, with a backlog value of more than \$175 million, will open in 15 new countries (with a total population of more than two billion).

Imax in the news



In 1998, well over 4,000 stories about The IMAX Experience appeared in newspapers, magazines and on television worldwide, including such places as the cover of *Time* magazine, *USA Today*, *Money*, *Business Week* and even on the hit TV show *South Park*.

Film

IMAX theatres attracted more filmgoers in 1998 than ever before. They came to watch some of the best films ever shown. Within a year of opening in March 1998, *Everest* had grossed more than \$75 million, making it a huge success by any measure. For the week ending May 28, 1998, *Everest* became the first large-format film to be among the top 10 highest-grossing films in North America – while playing on just 46 screens!

Meanwhile, *T-REX: Back to the Cretaceous*, an IMAX 3D film which opened broadly last Christmas, has been grossing approximately \$750,000 a week in fewer than 40 theatres. Leases for an additional 30 theatres have already been signed.

The releases of *Everest* and *T-REX* have taken large-format films to new levels. Both *Everest* and *T-REX* have clearly demonstrated the broad-based appeal and impact of The IMAX Experience and the potential for a widely-released Hollywood-produced IMAX film.

Brand

Everest drew more first-time IMAX viewers than ever before and one result was a further increase in IMAX brand recognition. In 1998, 75% of adults in the United States recognized the IMAX brand, compared to 60% the year before and just 29% five years ago. In Canada, recognition levels are more than 90%.

In 1999, we expect another significant increase in IMAX brand recognition, driven by the exclusive four-month release of Disney's newest animated classic, *Fantasia 2000: The IMAX Experience*, to IMAX theatres worldwide. *Fantasia 2000* will be the first theatrical feature film to be reformatted into the 15/70 format and released to IMAX theatres around the world in its full 90-minute length. As a result of the film's release, Imax and IMAX theatres will be more broadly publicized and promoted than ever before. This marks a major step in our strategy of bringing more mainstream commercial films to IMAX theatres.

Disney's *Fantasia 2000* to premiere exclusively in IMAX theatres



One of Imax's goals has long been to team up with a Hollywood studio to allow IMAX theatres to be an ancillary window for Hollywood properties. Whether a film is launched in IMAX theatres before or after its conventional theatrical release, we believe that The IMAX Experience will complement the film's 35mm release.

ISLAND OF THE SHARKS

Spring 1999

IMAX À LA CONQUÊTE DE L'EUROPE

[Imax conquering Europe]

ECRAN TOTAL, March 1998

GALAPAGOS

Fall 1999

IMAX IST DAS NEUE MAXIMUM

[IMAX is the new gold standard]

MITTELDEUTSCHE ZEITUNG, January 1999

1998 financial results

For the year ended December 31, 1998, revenues increased 20% to \$190.4 million as a result of a 45% increase in systems revenues associated with a record 41 theatre deliveries. Prior to the impact of certain primarily non-cash charges in the fourth quarter, Imax's net earnings were \$0.93 per share, exceeding analyst expectations.

The charges in the fourth quarter reflected the Company's strategic move away from the IMAX *Ridefilm* motion simulation business; costs related to Imax's decision to take advantage of favorable financial markets with a senior debt offering; and a revaluation of the Company's film assets, providing for unrecoverable costs on certain films in its library.

Looking ahead to 1999

Imax is moving to a new and more exciting stage in its evolution. In 1999, our network of theatres will continue to expand, and we expect the total number of IMAX theatres to be well over 200 – almost half of them 3D theatres – by the time Disney's *Fantasia 2000* opens on January 1, 2000.

In 1999, Imax is stepping up investment in a number of key areas, in part to enable our brand to leverage off all the promotion and publicity that will surround the release

of *Fantasia 2000: The IMAX Experience*.

We will also be providing more and better services to support our theatres through an expanded affiliate relations department.

We will continue to make progress in our R&D program, looking for better ways to translate computer generated animation into 3D. A number of projects are under development using our innovative SANDEE™ technology, which allows animators to draw and color 3D images freehand in space as easily as if they were putting pencil to paper. In February 1999, the Company made a strategic investment in Mainframe Entertainment Inc., one of the world's leading producers of 3D computer generated animation. This partnership with Mainframe will allow us to create, produce and distribute our own 3D animation content cost-effectively, and to cross-platform that content into other markets.

In 1999, we are looking forward to another excellent season of films, including *Extreme*, a production of Beyak Long deJong Franken, a film about athletes pushing their limits in such extreme sports as rock and ice climbing, big-wave surfing and snowboarding; *Island of the Sharks*, which takes viewers inside the amazing underwater world of some of the ocean's most feared predators; *Siegfried & Roy*, the amazing story behind the world's

T-REX wows audiences



Already leased by more than 65 theatres internationally, *T-REX* was the second-highest-grossing film on *Variety's* Limited-Release Chart for the first quarter of 1999. The film has grossed more than \$1 million on each of the Sydney, Australia and the Sony New York IMAX screens. It was the first IMAX 3D film to rank among *Variety's* top 20 highest-grossing films of the weekend.

EVEREST
Spring 1998

EL IMAX ESCALA EL EVEREST

A MACGILLIVRAY FREEMAN FILM

[IMAX scales Everest]

EL PERIÓDICO, March 1998

greatest illusionists; and *Galapagos: The Enchanted Voyage*, which traces the footsteps of Charles Darwin, exploring the unique biological diversity of the Galapagos archipelago. With more than 20 films in development, including those based on stories by Stephen King, R.L. Stine and Gahan Wilson, as well as the core documentaries that originally made Imax famous, the future film slate looks better than ever. We also look forward to the release of two independent films to IMAX theatres in 1999 – one film featuring Michael Jordan's march to his final NBA championship season with the Chicago Bulls, the other being Sony Pictures Classics' production of *Journey of Man*, featuring Cirque de Soleil. And as you would expect, Imax continues to be committed to producing a strong educational component to accompany most of the Imax-distributed films.

In 1999, our focus will be on developing the brand and setting the stage for our growth in 2000 and beyond. Every theatre we open and every new film success we enjoy draws us closer to our goal of becoming one of the world's foremost mainstream family entertainment companies.

We have never been more excited about Imax's long-term future than we are today, and we thank you for your continued support.

March, 1999

Bradley J. Wechsler

Bradley J. Wechsler

CHAIRMAN AND CO-CHIEF
EXECUTIVE OFFICER

Richard L. Gelfond

Richard L. Gelfond

VICE CHAIRMAN AND
CO-CHIEF EXECUTIVE OFFICER



Bradley J. Wechsler

CHAIRMAN AND CO-CHIEF EXECUTIVE OFFICER

Bradley J. Wechsler has been Chairman of the Company since March 1994, and Co-Chief Executive Officer since May 1996. From March 1, 1994 to September 12, 1994, Mr. Wechsler also served as Interim Chief Executive Officer. Prior to 1994, Mr. Wechsler held various finance and operations positions in the entertainment industry. Mr. Wechsler also serves on the boards of NYU Hospital, the Kernochan Center for Law, Media and the Arts, and the American Museum of the Moving Image.



Richard L. Gelfond

VICE CHAIRMAN AND CO-CHIEF
EXECUTIVE OFFICER

Richard L. Gelfond has been Vice Chairman of the Company since March 1994, and Co-Chief Executive Officer since May 1996. In 1991, Mr. Gelfond founded Cheviot Capital Advisors Inc., a financial advisory and merchant banking firm that specializes in acquisitions and venture capital investments. In addition, Mr. Gelfond serves on the boards of several private and philanthropic entities.

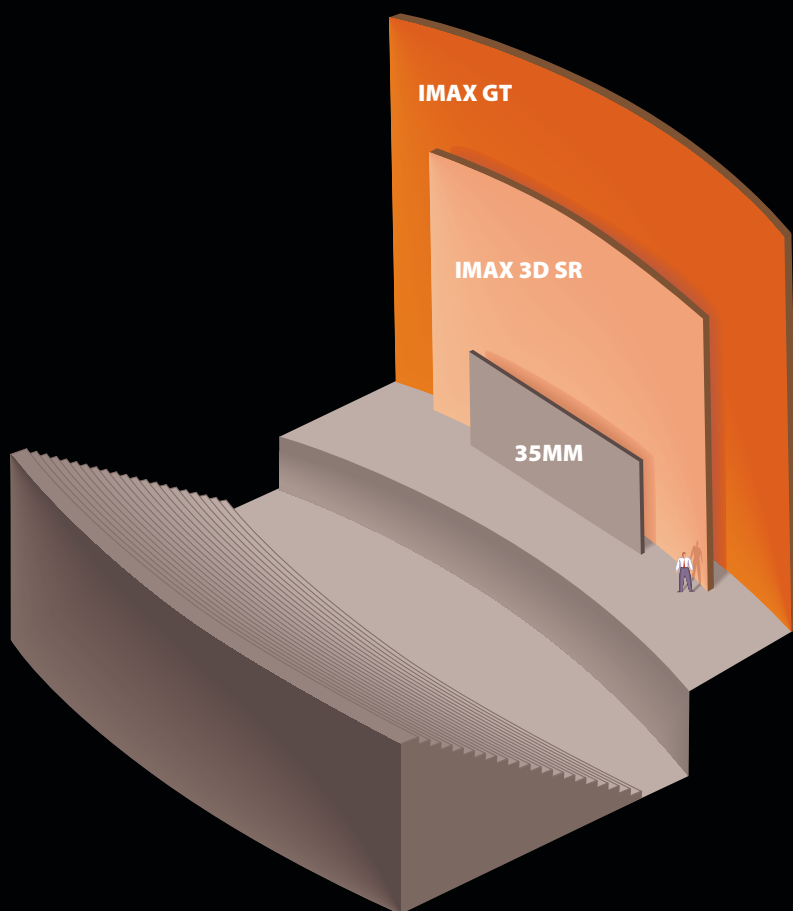
COMING TO A CITY NEAR YOU

By January 1, 2000, there will be well over 200 IMAX theatres in 30 countries.

It took 22 years to open the first hundred IMAX theatres, five years to open the second hundred and should take less than three years to open the third hundred.

The IMAX Experience is engrossing, immersive and unforgettable. Our research shows that IMAX theatre-goers describe their visit as one that "takes them to another place." This is one of the key elements that bring audiences back again and again.

The IMAX 3D Experience is even more immersive. The feeling of involvement is so real it's not uncommon during a film to see audiences instinctively reach out to touch the action. It has been called "the next best thing to being there."



There will be nearly 100 IMAX 3D theatres open by the end of 2000, up from 11 in 1994. The IMAX 3D SR system has helped accelerate that growth by allowing IMAX theatres to be located in smaller cities that could not previously support one.

Commercial exhibitors around the world, including Famous Players, Cinemark USA, Edwards Theatres Circuit, Regal Cinemas, Gaumont Cinémas, Bofiscope/UFA and UCI will be adding IMAX 3D theatres to their multiplexes, most likely in a city near you.

Boeing IMAX Theatre

Open since 1979, Seattle's Pacific Science Center received a great facelift in 1998 with the premiere of the Boeing IMAX Theatre. The Center now operates two IMAX theatres, one 2D and one 3D.



Muvico IMAX Theater

Launched in July 1998, the Muvico Pointe 21 IMAX Theater in Orlando, Florida is the first IMAX theatre for this southeastern U.S. theatre chain. Their second IMAX theatre is scheduled to open in Memphis, Tennessee later this year.



IMAX Theatre at Arizona Mills

A joint venture with Ogden Corporation, the theatre is located in a regional mall in the greater Phoenix market. The theatre has performed strongly since opening and is a draw for the mall, with people coming specifically for The IMAX Experience.



Berlin IMAX Theatre

The Discovery IMAX Berlin Theatre Potsdamer Platz, which opened to the public in October, has averaged attendance of more than 3,500 people daily since opening. It was one of the most successful IMAX theatre openings in the 30-year history of the large-format film medium.



Colossus IMAX Theatre

In February 1998, Famous Players announced an agreement to open 10 IMAX 3D theatres in Canada during the next five years. By July 1999, seven of these will be open. Both The Colossus near Toronto and Silver City in Richmond, B.C., have ranked among the top 10 highest-grossing multiplexes in North America since opening.



NEW FILM RELEASES

More than 15 films will be released to IMAX theatres in the coming year.

Cyberworld

AN IMAX 3D EXPERIENCE

In *Cyberworld*, an unprecedented IMAX 3D computer-generated animation film festival, you'll meet some of the world's most beloved animated characters from around the world, shown in 3D for the first time. Produced by Imax Ltd.

Island of the Sharks

An unforgettable adventure that immerses you in an amazing underwater world populated by stingrays, moray eels, giant sea turtles and the ocean's most feared and misunderstood predators, sharks. Produced by NOVA/WGBH Boston and Howard Hall Productions with the New England Aquarium.

Siegfried & Roy: The Magic Box

AN IMAX 3D EXPERIENCE

Siegfried & Roy: The Magic Box follows the intriguing story of the world's greatest illusionists and their white tigers and lions, who have performed to 20 years of sold-out appearances in Las Vegas. An L-Squared Entertainment Production in association with Lexington Road Productions.





Extreme

Extreme takes you to witness world-renowned athletes rock and ice climbing in Utah, first-descent skiing and snowboarding in Alaska, big-wave surfing in Hawaii and windsurfing from a whole new perspective. A production of Beyak Long deJong Franken.



Galapagos

AN IMAX 3D EXPERIENCE

The Galapagos archipelago is so unique that more than half the plants, at least a third of the fish and almost all the reptiles are found nowhere else on Earth. A Smithsonian Institution and Imax Ltd. presentation of a Mandalay Media Arts Production in association with the National Science Foundation.



T-REX: Back to the Cretaceous

AN IMAX 3D EXPERIENCE

T-REX: Back to the Cretaceous, brings audiences face-to-face with eight-story-high digital dinosaurs in 3D. *T-REX* is a unique blend of entertainment and education that leaves audiences breathless. Produced by Imax Corporation.

Imax 1998 Financial

PERFORMANCE





Management's report to shareholders

Management is responsible for the preparation, integrity, presentation and consistency of financial information contained in this Annual Report. The financial statements and accompanying notes, prepared in accordance with United States generally accepted accounting principles, are considered by management to present fairly the Company's consolidated financial position, its results of operations and changes to its financial position. Management maintains the necessary system of internal controls to provide assurance that transactions are authorized, assets are safeguarded and records are properly maintained.

The Audit Committee meets regularly with the Company's management as well as its external auditors to review matters relating to the quality of financial reporting and internal accounting control and the nature, extent and results of the audit effort. In addition, this Committee is responsible for reviewing consolidated financial statements and reporting thereon to the Board of Directors.

Independent auditors appointed by the shareholders of the Company examine the consolidated financial statements in accordance with generally accepted auditing standards. Their report on the audited consolidated financial position and results of operations of the Company appears on page 30. The external auditors have free and independent access to the Audit Committee and meet with the Committee and with management to consider matters relating to financial presentation, internal controls and audit procedure.

Bradley J. Wechsler

Bradley J. Wechsler
*Chairman and
Co-Chief Executive Officer*

Richard L. Gelfond

Richard L. Gelfond
*Vice Chairman and
Co-Chief Executive Officer*

John M. Davison

John M. Davison
*Chief Operating Officer and
Chief Financial Officer*

Five year review

(in thousands of U.S. dollars except per share and systems data)

	1998	1997	1996	1995	1994 pro forma ¹
Operating statement data:					
Revenue					
Systems	\$ 140,874	\$ 97,539	\$ 85,972	\$ 51,968	\$ 37,507
Films	30,824	39,683	28,367	28,835	30,885
Other	18,657	21,259	15,499	7,694	6,617
Total revenue	190,355	158,481	129,838	88,497	75,009
Costs and expenses ²	111,784	73,806	58,257	44,348	56,118
Gross margin	78,571	84,675	71,581	44,149	18,891
Loss from equity-accounted investees ³	(6,763)	(22)	—	—	—
Selling, general and administrative expenses ⁴	38,777	32,115	29,495	25,925	21,972
Research and development ⁵	2,745	2,129	2,493	2,808	4,563
Amortization of intangibles ⁶	5,948	2,701	2,708	2,541	2,603
Earnings (loss) from operations	24,338	47,708	36,885	12,875	(10,247)
Interest income	5,320	5,604	5,797	3,377	1,794
Interest expense	(14,646)	(13,402)	(11,765)	(7,337)	(7,400)
Foreign exchange gain (loss)	588	(623)	(337)	193	(538)
Earnings (loss) before taxes and minority interest	15,600	39,287	30,580	9,108	(16,391)
(Provision for) recovery of taxes	(9,810)	(17,265)	(13,579)	(5,458)	4,833
Earnings (loss) before minority interest	5,790	22,022	17,001	3,650	(11,558)
Minority interest	(1,895)	(1,357)	(1,593)	—	—
Earnings (loss) before extraordinary item	\$ 3,895	\$ 20,665	\$ 15,408	\$ 3,650	\$ (11,558)
Extraordinary loss on early retirement of debt, net of income tax benefit of \$1,588	(2,095)	—	—	—	—
Net earnings	\$ 1,800	\$ 20,665	\$ 15,408	\$ 3,650	\$ (11,558)
Earnings (loss) per share⁷ before extraordinary item					
Basic	\$ 0.10	\$ 0.71	\$ 0.54	\$ 0.12	\$ (0.42)
Diluted	\$ 0.09	\$ 0.68	\$ 0.50	\$ 0.11	\$ (0.42)
Net earnings (loss)					
Basic	\$ 0.03	\$ 0.71	\$ 0.54	\$ 0.12	\$ (0.42)
Diluted	\$ 0.03	\$ 0.68	\$ 0.50	\$ 0.11	\$ (0.42)
Systems and other data:					
Total systems signed ⁸	43	48	26	24	19
Value of systems signed (in millions)	\$ 129.2	\$ 128.4	\$ 89.6	\$ 64.6	\$ 46.0
New systems delivered	41	24	26	11	13
Total systems in operation	183	159	149	130	120
Total systems in sales backlog ⁹	76	77	45	44	36
Revenue in sales backlog ¹⁰	\$ 175,756	\$ 175,394	\$ 131,835	\$ 107,238	\$ 80,767

¹ The Unaudited Pro Forma Consolidated Statement of Operations for the year ended December 31, 1994 gives effect to the issuance and sale of senior notes, the application of the net proceeds therefrom, the acquisition of Predecessor Imax and TCI, the equity conversions and the issuance of common shares (collectively "the Transactions") as if the transactions had occurred on January 1, 1994.

² The costs and expenses for the years ended December 31, 1994, 1995, 1996, 1997 and 1998 include \$9.3 million, \$2.5 million, \$1.9 million, \$1.4 million and \$0.5 million, respectively, of charges for the amortization of purchase accounting adjustments. The year ended December 31, 1998 includes a \$7.9 million charge related to rationalization of the Company's motion simulation division and \$19.1 million related to the write-down of the value of some of the films in the Company's library.

³ Loss from equity-accounted investees in 1998 includes the Company's 50% share of the loss of Forum Ride Associates and a provision against the remaining carrying value of the Company's equity investment in Forum Ride Associates totaling \$6.1 million and a \$0.5 million provision against an equity investment in a motion simulation ride.

⁴ The selling, general and administrative expenses for the year ended December 31, 1994 include \$1.1 million of non-recurring charges as a result of the Transactions. For the year ended December 31, 1998 selling, general and administrative expenses include a \$1.9 million charge related to the rationalization of Ridefilm.

⁵ Research and development expenses for the year ended December 31, 1994 include a non-recurring charge of \$2.4 million to reflect the write-off of purchased in-process research and development in connection with the acquisition of Ridefilm.

⁶ Amortization of intangibles includes a \$3.3 million charge related to the write-off of goodwill associated with the Ridefilm business.

⁷ Earnings (loss) per share in the current and prior periods give retroactive effect to (a) the 2-for-1 stock split which became effective by May 27, 1997 and (b) the adoption of FASB Statement of Standards No. 128 which became effective by December 31, 1997.

⁸ Represents the number of theatre systems which were the subject of sale or lease agreements entered into by the Company in the years indicated. The 1996, 1997 and 1998 signings exclude three, 12 and one theatres in which the Company has an equity interest, respectively.

⁹ 1996, 1997 and 1998 systems in backlog include two, 13 and 13 theatres in which the Company has an equity interest.

¹⁰ Represents the minimum revenue on signed system sale and lease agreements that will be recognized as revenue as the associated theatre systems are delivered. Does not include revenues from wholly-owned, partnership or joint-venture theatres.

Management's discussion and analysis of financial condition and results of operations

1998 highlights

-] The Company signed contracts for 43 third-party theatre locations valued at a record \$129.2 million.
-] The Company signed an agreement with Famous Players to build 10 new IMAX 3D theatres across Canada over the next five years. The first two theatres to open under this agreement have consistently ranked among the top 10 highest-grossing multiplexes in North America.
-] The Company signed contracts for its first theatres in Eastern Europe. The contracts, a five-theatre deal with I.T. International of Israel and a three-theatre deal with Transtürk Holdings A.S. of Turkey, will bring IMAX theatres to four new European countries – Poland, Turkey, Hungary and the Czech Republic.
-] The Company opened theatres in Ireland, Norway and Thailand in 1998, bringing the year-end total of IMAX theatre locations to 183 in 25 countries worldwide, with theatres in backlog located in an additional 15 countries. By the end of 2000, the Company will have theatres in more than 30 countries.
-] Six new films were released in 1998, including *T-REX: Back to the Cretaceous*, which recently made motion picture history by becoming the first IMAX 3D film to rank among the top 20 highest-grossing films of the weekend. MacGillivray Freeman Films' *Everest*, which became the first large-format film to break into *Variety's* top 10 highest-grossing films in North America, has grossed more than \$75 million to date.
-] The Company raised \$200 million in a Senior Debt offering in December 1998, giving the Company the capital it needs for its future growth plans.
-] Sales backlog at December 31, 1998 was \$175.8 million, representing the value of contracts for 76 theatre systems.
-] Revenues rose 20% to \$190.4 million, driven by a 44% increase in systems revenues as a result of a record 41 theatre system deliveries.

Business of the Company

Imax Corporation and its subsidiaries (the “Company”) designs and manufactures projection and sound systems for giant-screen (“15/70-format”) theatres based on proprietary and patented technology and is the largest producer and distributor of films for giant-screen theatres. The Company generally does not own IMAX® theatres but leases its projection and sound systems and licenses the use of its trademarks. The IMAX brand name enjoys widespread recognition with more than 500 million viewers throughout the world having experienced the Company’s high-quality giant-screen theatre attractions since 1970, including more than 65 million viewers in 1998.

The IMAX theatre network is the most extensive giant-screen theatre network in the world with 183 theatres operating in 25 countries as of December 31, 1998, which will grow to more than 250 theatres by the year 2000. The Company has experienced substantial growth as a result of the increased demand for both IMAX theatres in commercial locations and IMAX 3D theatre systems in North America and around the world.

IMAX theatre systems combine advanced high-resolution projection systems, sound systems and screens as large as eight stories high (approximately 80 feet) that extend to the edge of a viewer’s peripheral vision to create highly realistic audiovisual experiences. As a result, audiences feel as if they are a part of the on-screen action in a way that is more intense and exciting than in traditional theatres. In addition, the Company’s IMAX 3D theatre systems combine the same projection and sound systems and up to eight-story screens with 3D images that further increase the audience’s feeling of immersion in the film. IMAX theatre systems are often a featured attraction at high-profile and prestigious locations such as the Smithsonian Institution in Washington, D.C., the Kennedy Space Center in Florida, Lincoln Square in New York, Potsdamer Platz in Berlin (Germany), the Museum of Science and Industry in Chicago, the theatre adjacent to Grand Canyon National Park, and the Luxor Hotel and Casino in Las Vegas.

The Company derives revenue principally from long-term theatre system lease agreements, maintenance agreements, film production agreements and from the distribution of films. Other revenues include the operation of theatres in which the Company has an equity interest, the sale of motion simulation systems, and camera rentals.

Theatre systems

The Company generally provides its theatre systems on a long-term lease basis to customers, with initial lease terms of typically 10 to 20 years. Lease agreements typically provide for three major sources of revenue: (i) upfront fees, (ii) ongoing royalty payments, and (iii) maintenance fees. The amount of upfront fees vary depending on the type of system and location, and generally are paid to the Company in instalments commencing upon the signing of the agreement and continuing through the delivery of the theatre system. Ongoing royalty payments are paid monthly over the term of the contract, commencing after delivery. These payments are generally equal to the greater of a fixed minimum amount per annum and a percentage of box office receipts. An annual maintenance fee is generally payable commencing in the second year of theatre operations. Both minimum royalty payments and maintenance fees are typically indexed to the local consumer price index.

SALES AND SALES-TYPE LEASES

Revenues from the Company’s theatre system sale agreements and from theatre system lease agreements which transfer substantially all of the benefits and risks of ownership (“sales-type leases”) are recognized on the completed contract method (that is, upon delivery of the system). Revenues recognized at the time of the theatre system delivery consist of upfront fees and the present value of minimum royalties on sales-type leases over the initial term of the lease. For leases with initial terms greater than 10 years, the Company’s practice is to reserve the revenue related to the present value of minimum royalties beyond the initial 10 years. The timing of theatre system delivery is largely dependent on the timing of the construction of the customer’s theatre, which is used to fix the delivery date in the contract. The delivery of the theatre system stated in the contract may be before the actual opening of the theatre, and as of December 31, 1998 the Company had delivered 32 theatre systems to theatres that had not yet begun operations. Revenues recognized at the time of the theatre system delivery generally are derived from contracts signed 12 to 24 months prior to the date of recognition. Such revenue is shown as sales backlog until it is recognized upon delivery. Therefore, revenue for theatre systems is generally predictable on a long-term basis given the relationship to projected theatre system deliveries. However, systems revenue in any given quarter may vary significantly depending on the nature and timing of the delivery of systems.

Cash receipts under upfront fees are generally received in advance of deliveries over an average of 12 to 24 months from initial contract signing to final delivery, and are recorded as deferred revenue. The associated costs of manufacturing the theatre system are recorded as inventory and systems under construction. Upon delivery, deferred revenue and inventory costs are recognized in income.

Cash receipts under royalty payments are received after delivery. Typically, ongoing royalties are received over the 10- to 20-year life of the system agreements and under any renewal periods. The Company recognizes the present value of the minimum royalties on sales-type leases upon delivery of the theatre system up to 10 years. The discounted minimum royalties are recorded on the Company's balance sheet as an increase in net investment in leases. For financial reporting purposes, the actual cash received for minimum royalties in each year is divided into two components, representing both a repayment of the net investment in leases (which has no income effect but reduces net investment in leases) and finance income on the net investment in leases balance (which is recorded as royalty revenue as earned). In the event of default of payment of minimum contracted royalties, the Company may repossess the system and refurbish it for resale. Royalties in excess of minimums are recorded as revenue when due under the terms of the lease agreement.

SALES BACKLOG

Sales backlog represents the minimum revenues on signed system sale and lease agreements that will be recognized as revenue as the associated theatre systems are delivered. The minimum revenue comprises the upfront fees plus the present value of the minimum royalties due under sales-type lease agreements for the first 10 years of the initial lease term. The value of sales backlog does not include revenues from theatres in which the Company has an equity interest, letters of intent, IMAX *Ridefilm* system contracts, or long-term conditional theatre commitments.

Film production

Revenue from films produced for third parties is recognized when the film is completed and delivered to the sponsor. The associated production costs are deferred and charged against the associated revenue when the revenue is recognized. The completion of films for third parties depends upon the contracted delivery dates with film sponsors. Thus, both film revenues and film income in any given period will vary significantly depending upon the timing of the completion of films. When the Company invests in films, costs incurred are deferred and shown on the balance sheet as film assets. Cash received from sales of the film in advance of delivery is shown as deferred revenue until the film is complete and delivered to the exhibitor. The film assets are amortized against revenues using the individual-film-forecast method in accordance with *Financial Accounting Standards Board Statement No. 53* ("FAS 53").

Film distribution

Revenues from the distribution of films are recognized when films are exhibited by theatres. The costs of films are charged as expenses using the individual-film-forecast method in accordance with FAS 53. The individual-film-forecast method amortizes film costs (reflected on the balance sheet as film assets) in the same ratio that current gross revenues bear to anticipated total gross revenues. The costs of distribution of films are charged against the specific license to which they relate. Estimates of anticipated total gross revenues are reviewed quarterly by the Company and revised where necessary to reflect more current information.

International operations

A significant portion of the Company's sales are made to customers located outside of the United States and Canada. During 1996, 1997 and 1998 approximately 39.5%, 47.6% and 46.7%, respectively, of the Company's revenues were derived from sales outside the United States and Canada. The Company expects that international operations will continue to account for a substantial portion of its revenues in the future. In order to minimize exposure to exchange rate risk, the Company prices theatre systems (the largest component of revenues) in U.S. dollars except in Canada and Japan where they are priced in Canadian dollars and Japanese yen, respectively. Annual minimum royalty payments and maintenance fees follow a similar currency policy.

Accounting policies

The Company reports its results under both United States generally accepted accounting principles ("U.S. GAAP") and Canadian generally accepted accounting principles. The financial statements and results referred to herein are reported under U.S. GAAP.

Results of operations

Year ended December 31, 1998 versus year ended December 31, 1997

In 1998, the Company had revenues of \$190.4 million and net earnings (after a \$2.1 million extraordinary loss on the early extinguishment of debt) of \$1.8 million (\$0.03 per share on a diluted basis) compared to revenues of \$158.5 million and net earnings of \$20.7 million (\$0.68 per share on a diluted basis) in 1997. The increase in revenues of 20% is due to higher systems revenue, which more than offset declines in film and other revenues. Results in 1998 were adversely affected by four significant items: a) the rationalization of the Company's motion simulation and attractions business resulted in a charge of \$0.46 per share; b) the write-down of assets in the Company's film library resulted in a charge of \$0.35 per share; c) the extraordinary loss on the early extinguishment of debt contributed a charge of \$0.07 per share; and d) the redemption premium of the Company's Class C preferred shares contributed a charge of \$0.02 per share.

Rationalization of motion simulation and attractions business

Included in earnings for the year ended December 31, 1998 is a pre-tax charge of \$13,569,000 related to the Company's investment in the motion simulation and attractions business. The motion simulation industry in general has not generated significant returns for any of its key participants. The high cost of producing motion simulation films and high manufacturing and installation costs at recently delivered locations have resulted in continued inadequate returns for this operation. Sales, which hit a low of only two signings in 1998, continued to lag. The lack of growth in the network of bases, which was required to support the original investment plus ongoing investment in film, will prevent the recovery of future film investment. Recent sales cancellations have also contributed to the Company's decision to rationalize the Ridefilm activity to reduce future potential losses.

The Company does not intend to manufacture or sell the Ridefilm motion bases product (with the exception of delivering in 1999 the three motion bases currently in backlog), and does not intend to produce new motion simulation films. Existing motion base owners will be informed of the Company's decision to no longer market the motion base product in the future. Administration and sales personnel associated with the Ridefilm operation have been either terminated or reassigned to other areas of the Company. The Company will continue to license the existing Ridefilm library to its existing motion base customers and make efforts to convert non-Ridefilm motion simulation films to be compatible with the Ridefilm projection system.

Also included in earnings for the year ended December 31, 1998 is a loss of \$1,937,000 representing the Company's 50% share of the loss of Forum Ride Associates, a 50% joint venture with Starwood Hotels & Resorts Inc., operating an IMAX 3D *Simulator Ride* at the Forum Shops at Caesars Palace in Las Vegas, Nevada. The ride opened in January 1998 and attendance levels in its first year of operations were approximately 50% below budget. The Company believes that it will have limited ability to improve attendance at this attraction since much of it is dependent upon the flow of local traffic to its retail location, which has also proven to be well below original forecasts. The Company has been unsuccessful in obtaining changes required to stimulate local traffic in the retail area where the attraction is located. Despite the critical acclaim the movie ride has received, the Company does not anticipate that it will be able to attain the future attendance levels necessary to generate earnings sufficient to justify the remaining carrying value of its investment. The Company took a charge of \$4,208,000 to write off its remaining investment in the joint venture after considering current-period operating losses combined with a projection that demonstrated continuing losses.

Theatre network and sales backlog

The Company signed agreements for 43 theatre systems in 1998, excluding one theatre in which it has an equity interest, which represents future minimum revenues of \$129.2 million. In 1997, the Company signed agreements for 48 theatre systems excluding 12 theatres in which it had an equity interest, for future minimum revenues of \$128.4 million. The majority of signings for 1998 were for IMAX 3D systems (91%) and commercial operators (88%). In 1998, signings for theatres to be located outside of Canada and the U.S. increased to 66% from 22% in 1997. As of December 31, 1998, there were IMAX theatres operating in 25 countries, up from 22 countries at December 31, 1997, with theatres to be located in a further 15 countries once the theatres in backlog open. As a result of the strong theatre signings and record deliveries, the Company's sales backlog increased slightly to \$175.8 million at December 31, 1998 from \$175.4 million at December 31, 1997.

The IMAX theatre network increased to 183 theatres in operation at December 31, 1998 from 159 theatres at the beginning of the year. The following is a geographic, market and product breakdown of the IMAX theatres in operation, and theatres in backlog at December 31, 1998:

	Existing theatres		Backlog ¹	
	Theatres	Percentage	Theatres	Percentage
Geographic:				
United States	87	48%	41	56%
Europe	32	17	13	18
Japan	19	10	1	1
Canada	18	10	7	9
Asia (excluding Japan)	12	7	4	5
Mexico	8	4	—	—
Australia	6	3	2	3
South Africa	1	1	—	—
Middle East	—	—	5	7
South America	—	—	1	1
Total	183	100%	74	100%
Market:				
Science and natural history	94	51%	6	8%
Commercial	57	31	68	92
Theme parks	21	12	—	—
Destination sites	5	3	—	—
Zoos and aquaria	6	3	—	—
Total	183	100%	74	100%
Product:				
2D	130	71%	7	9%
3D	53	29	67	91
Total	183	100%	74	100%

¹ Exclusive of one upgrade from IMAX to IMAX 3D and one replacement of a 2D system.

Film library

There were six new films released in the 15/70 format in 1998, bringing the total number of available films to 139 at the end of the year. The Company has the distribution rights to 49 of these films. In 1998, the Company released one new film: *T-REX: Back to the Cretaceous*, which features giant 3D digital dinosaurs.

The Company currently has three films in production which are scheduled for release in 1999 through 2001, and 12 films in development and preproduction. As of December 31, 1998 there were more than 25 films in the 15/70 format in production, including the three being produced by the Company.

Revenues

The Company's revenues in 1998 were \$190.4 million, compared to \$158.5 million in 1997, an increase of 20%. The following table sets forth the breakdown of revenue by category in thousands of dollars:

	1998	1997	1996
Systems revenue:			
Sales and leases	\$ 121,042	\$ 78,672	\$ 70,671
Royalties ¹	10,154	10,285	7,949
Maintenance	9,678	8,582	7,352
	140,874	97,539	85,972
Film revenue:			
Production	352	6,459	8,298
Distribution	15,052	21,953	13,422
Post-production	15,420	11,271	6,647
	30,824	39,683	28,367
Other revenue	18,657	21,259	15,499
	\$ 190,355	\$ 158,481	\$ 129,838

¹ Includes finance income.

SYSTEMS REVENUES

Systems revenues increased from \$97.5 million in 1997 to \$140.9 million in 1998, an increase of 44%. Revenue from sales and leases increased from \$78.7 million to \$121.0 million, an increase of 54%. The Company recognized revenues on the delivery of 41 theatre systems under sales and sales-type leases in 1998, as compared to 24 theatre systems in 1997. Royalty revenue, excluding arrears billings, and maintenance revenue increased 7% and 13%, respectively, over the prior year, principally due to the increased number of theatre systems in the network.

FILM REVENUES

Film revenues declined from \$39.7 million in 1997 to \$30.8 million in 1998. In 1997, the Company produced one film for a third party whereas in 1998 the Company did not produce any third-party films. Film distribution revenues declined from \$22.0 million in 1997 to \$15.1 million in 1998 due to the timing of film releases including the strong performance in 1997 of three films released in the latter half of 1996 and the fact that the Company's major 1998 release, *T-REX: Back to the Cretaceous*, was not released until the fourth quarter. Film post-production activities increased from \$11.3 million in 1997 to \$15.4 million in 1998, an increase of 37%. The growth in revenues was due to an increase in the number of prints released, post-production activities and extensions of products and services.

OTHER REVENUES

Other revenues declined 12% from \$21.2 million in 1997 to \$18.7 million in 1998 due to lower revenue from the delivery of IMAX *Ridefilm* systems, which declined to six units versus 15 units in 1997. Partially offsetting the lower revenues were increases in camera and Company-owned theatre operations revenues.

Gross margin

Gross margin in 1998 was \$78.6 million versus \$84.7 million in 1997. The number of systems delivered in 1998 increased to 41 from 24 in 1997. The resulting increase in the gross margin was more than offset by the write-down in 1998 of the Company's motion simulation assets of \$7.9 million and a write-down of its film assets of \$19.1 million. Gross margin as a percentage of total revenues decreased from 53.4% in 1997 to 41.3% in 1998. An increase resulting from the higher proportion of systems revenue (which generally has higher margins than film and other revenues) was more than offset by the charges noted above, which reduced the gross margin by 4.1% and 10.0%, respectively.

Other

Loss from equity-accounted investees in 1998 includes \$6.1 million of the Company's share of the loss of Forum Ride Associates (a 50% joint venture with Starwood Resorts Worldwide Inc., operating an IMAX 3D *Simulator Ride*) and a write-off of the Company's remaining investment in the joint venture.

Selling, general and administrative expenses were \$38.8 million in 1998 versus \$32.1 million in 1997. The increase in selling, general and administrative costs in 1998 over 1997 resulted primarily from increases in performance-based compensation expenses, marketing, branding and affiliate relations initiatives and staffing additions to the Company's film department, particularly marketing, partially offset by declines in litigation expense. Also included in 1998 is \$1.9 million in costs related to the rationalization of the Company's motion simulation and attractions unit.

Research and development expenses were \$2.7 million in 1998 versus \$2.1 million in 1997. In 1997, the Company's technical staff were engaged in the design and production of the new IMAX 3D SR system and not in typical research and development activities.

Amortization of intangibles in 1998 includes a non-recurring charge of \$3.3 million to write off the remaining goodwill associated with the Company's motion simulation business.

Interest expense increased in 1998 as a result of the \$200 million Senior Notes due 2005, which were issued on December 4, 1998.

The Company experienced a foreign exchange gain of \$0.6 million in 1998 compared to a loss of \$0.6 million in 1997. The foreign exchange gain in 1998 resulted primarily from fluctuations in exchange rates on Japanese yen-denominated net investment in leases, while the loss in 1997 resulted primarily from fluctuations in exchange rates on Canadian dollar, Japanese yen and French franc-denominated cash balances and net investment in leases.

The effective tax rate on earnings before tax differs from the statutory tax rate and will vary from year to year, primarily as a result of the amortization of goodwill, which is not deductible for tax purposes, manufacturing and processing profits deduction, and provision of income taxes at different rates in foreign and other provincial jurisdictions. The effective tax rate in 1998 was much higher than in recent years, due to the large amount of non-deductible goodwill and the deferred tax charge associated with the rationalization of *Ridefilm*, as well as being affected by the \$6.1 million loss associated with Forum Ride Associates, which is provided for at a lower tax rate than the Company's statutory tax rate.

Minority interest expense of \$1.9 million and \$1.4 million in 1998 and 1997, respectively, represents a 49% minority interest in the earnings of the Company's subsidiary, Sonics Associates Inc.

Year ended December 31, 1997 versus year ended December 31, 1996

Revenues

The Company's revenues in 1997 were \$158.5 million compared to \$129.8 million in 1996, an increase of 22%.

Systems revenues increased from \$86.0 million in 1996 to \$97.5 million in 1997, an increase of 13%. Revenues from sales and leases increased from \$70.7 million to \$78.7 million, an increase of 11%. The Company recognized revenues on the delivery of 24 theatre systems under sales and sales-type leases in 1997, as compared to 26 theatre systems in 1996. Royalty revenues, excluding arrears billings, and maintenance revenues increased 19% and 17%, respectively, over the prior year principally due to the increased number of theatre systems in the network.

Film revenues increased from \$28.4 million in 1996 to \$39.7 million in 1997. Film distribution revenues increased from \$13.4 million in 1996 to \$22.0 million in 1997, an increase of 64%. Film distribution revenues increased in 1997 over 1996 due to strong results of films released in the latter half of 1996 and in 1997, and also to the growth in the IMAX theatre network. Film post-production activities generated revenues of \$11.3 million in 1997 versus \$6.6 million in 1996, an increase of 70%. The growth in revenues was due to an increase in the number of post-production projects, an increase in the number of prints released and extensions of related products and services.

Other revenues of \$21.2 million in 1997 represented an increase of 37% over 1996. The growth in other revenues was primarily due to the delivery of 15 IMAX *Ridefilm* systems in 1997 versus seven in 1996. Theatre operations revenue also increased 17% in 1997 over 1996 due to the opening of a new theatre in which the Company had an equity interest at the end of 1996.

Gross margin

Gross margin in 1997 was \$84.7 million versus \$71.6 million in 1996. Gross margin improved in 1997 over 1996 principally due to the higher average value of systems deliveries, increased royalty revenue and an increase in film revenues in 1997. The average value of systems deliveries increased in 1997 due to a higher number of IMAX 3D and international theatre systems delivered compared to 1996. In 1997, gross margin as a percentage of sales was 53.4% versus 55.1% in 1996. The decline in gross margin as a percentage of total revenues in 1997 from 1996 was due to the higher proportion of film and other revenues, which are generally lower-margin revenue sources than systems sources.

Other

Selling, general and administrative expenses were \$32.1 million in 1997 versus \$29.5 million in 1996. The increase in selling, general and administrative costs in 1997 over 1996 resulted primarily from an increase in performance-based compensation expenses, marketing, branding and affiliate relations initiatives and litigation costs, offset by declines in costs associated with the Company's *Ridefilm* division.

Research and development expenses were \$2.1 million in 1997 versus \$2.5 million in 1996. The Company's technical staff were engaged earlier in 1997 in the design and production of the new IMAX 3D SR system and not in the typical research and development activities. Research and development activities returned to historical levels in the latter half of 1997.

Interest expense included a full year's debt service in 1997 related to the 5¾% Convertible Subordinated Notes which were issued in April 1996, resulting in a \$1.6 million increase in interest expense in 1997 compared to the prior year.

The Company experienced a foreign exchange loss of \$0.6 million in 1997 compared to a loss of \$0.3 million in 1996. The foreign exchange losses in 1997 and 1996 resulted primarily from fluctuations in exchange rates on Canadian dollar, Japanese yen and French franc-denominated cash balances and net investment in leases.

Impact of the year 2000

The Year 2000 issue involves computer programs and embedded chips that use two-digit date fields failing or creating errors as a result of the change in the century. The Company has assessed and continues to assess the impact of the Year 2000 issue on its operations, including information technology systems, non-information technology systems and the readiness of facility and utility suppliers. The Company's information technology systems include the cost accounting and financial systems. The Company completed an upgrade of these systems in the first quarter of 1999 to versions that are Year 2000 ready.

The Company's non-information technology systems include the projection and sound systems. The Company completed the evaluation of its projection system in the first quarter of 1999 and concluded that the performance of the projection system would not be negatively impacted by the change in the century. Sonics has been evaluating each of the subsystems of the sound system used in connection with the projection system. Sonics has concluded that the current standard sound systems hardware would not be negatively impacted by the change in the century. The software incorporates proprietary software elements in addition to "off-the-shelf" utility software. Sonics has evaluated the proprietary software elements and has concluded that they too would not be negatively impacted by the change in the century. Sonics has verified that the manufacturer of each purchased software element has tested and certified their product as Year 2000 ready. Sonics must still complete the testing of a few automation subsystems. These automation subsystems, however, are not part of every sound system. Sonics' service department will conduct a Year 2000 readiness test on each of the automation subsystems in use at IMAX theatres during routine service visits. Sonics expects to complete such testing at minimal cost by the end of the second quarter of 1999. If there is a failure in a subsystem of a sound system to be Year 2000 ready, this failure would impact the ability of a theatre to present pre-show material but would not affect the theatre's ability to present a 15/70-format film.

The Company is evaluating the facilities and utility systems to determine their Year 2000 readiness. The Company plans to complete this evaluation by the second quarter of 1999.

The impact of the Year 2000 issue on the Company will also be affected by the Year 2000 readiness of its customers, suppliers of raw materials, components and software, and providers of facilities, equipment and services. The Company has identified critical suppliers and service providers, and sent them questionnaires to determine their Year 2000 readiness. The responses to the questionnaires are currently being reviewed by the Company. By the end of the second quarter of 1999, the Company will decide the alternatives or contingency plans required to address the potential failure of a third party to be Year 2000 ready.

While the Company's Year 2000 efforts are expected to reduce the Company's level of uncertainty about the Year 2000 issue, failure by a third party to be Year 2000 ready may have a material adverse effect on the Company's business, results of operations and financial condition, and there is no assurance that a material adverse effect may be avoided.

Liquidity and capital resources

At December 31, 1998, the Company's principal source of liquidity included cash and cash equivalents of \$143.6 million, marketable securities of \$59.4 million, trade accounts receivable of \$45.2 million, net investment in leases due within one year of \$9.3 million and the amounts receivable under contracts in backlog which are not yet reflected on the balance sheet.

In addition, the Company is party to an agreement with the Toronto-Dominion Bank with respect to a working capital facility. The Bank has made available to the Company a revolving loan in an aggregate amount of up to Canadian \$10 million or its U.S. dollar equivalent. Loans made under the working capital facility bear interest at the prime rate of interest per annum for Canadian dollar-denominated loans and, for U.S. dollar-denominated loans, at the U.S. base rate of interest established by the Bank. These loans are repayable upon demand. At December 31, 1998, \$3.1 million was available for use under this facility.

In December, 1998, the Company issued \$200 million of Senior Notes due December 1, 2005, part of the proceeds of which were used to redeem the \$65 million of 10% Senior Notes due 2001. The Senior Notes due 2005 bear interest at 7.875% per annum and are subject to redemption by the Company, in whole or in part, at any time on or after December 1, 2002 at redemption prices expressed as percentages of the principal amount for each 12-month period commencing December 1 of the years indicated; 2002 – 103.938%, 2003 – 101.969%, 2004 and thereafter – 100.000% together with interest accrued thereon to the redemption date. Until December 1, 2001, up to 35% of the aggregate principal amount of the Notes may be redeemed by the Company using the net proceeds of a public offering of common shares of the Company or certain other equity placements, at a redemption price of 107.875%, together with accrued interest thereon. The Company may also redeem the Notes, in

whole or in part, at any time prior to December 1, 2002 at a redemption price equal to 100% of the principal amount plus a “make-whole premium” calculated in reference to the redemption price on the first date that the Notes may be redeemed by the Company plus accrued interest to, but excluding, the redemption date. If certain changes result in the imposition of withholding taxes under Canadian law, the Senior Notes are subject to redemption at the option of the Company, in whole but not in part, at a redemption price of 100% of the principal amount thereof plus accrued interest to the date of redemption. In the event of a change in control, holders of the Notes may require the Company to repurchase all or part of the Notes at a price equal to 101% of the principal amount thereof plus accrued interest to the date of repurchase.

In April 1996, the Company completed a private placement of a \$100 million offering of 5¾% Convertible Subordinated Notes (the “Subordinated Notes”) due 2003. These Subordinated Notes are convertible into common shares of the Company at the option of the holder at a conversion price of \$21.406 per share (equivalent to a conversion rate of 46.7154 shares per \$1,000 principal amount of Subordinated Notes) at any time prior to maturity. The Subordinated Notes are redeemable at the option of the Company on or after April 1, 1999 at redemption prices expressed as percentages of the principal amount (1999 – 103.286%; 2000 – 102.464%; 2001 – 101.643%; 2002 – 100.821%) plus accrued interest. The Subordinated Notes may only be redeemed by the Company between April 1, 1999 and April 1, 2001 if the last reported market price of the Company’s common shares is equal to or greater than \$30 per share for any 20 of the 30 consecutive trading days prior to the notice of redemption. The Subordinated Notes may be redeemed at any time on or after April 1, 2001 without limitation.

The Company partially funds its operations through cash flow from operations. Under the terms of the Company’s typical theatre system lease agreement, the Company receives substantial cash payments before it completes the performance of its obligations. Similarly, the Company typically receives cash payments for film productions in advance of related cash expenditures. These cash flows have generally been adequate to finance the ongoing operations of the Company.

Cash provided by operating activities amounted to \$23.9 million for the year ended December 31, 1998 after the payment of \$14.6 million of interest, \$4.1 million of income taxes and working capital requirements. Working capital requirements included an increase of \$12.8 million in accounts receivable, primarily related to an increase in upfront fees billed in connection with increased signings and the growth in the number of systems in backlog, and an increase of \$30.4 million in net investment in leases due to the theatre systems delivered under sales-type leases in 1998. Cash used in investing activities in 1998 amounted to \$72.1 million. Of this amount, \$21.2 million was invested in film assets, principally *T-REX: Back to the Cretaceous* and *Galapagos*, \$14.0 million was invested in capital assets, principally space cameras and 3D cameras and owned and operated theatres, \$4.0 million was invested in other assets, principally joint-venture and owned and operated theatres, and \$32.9 million was invested in marketable securities. Cash provided by financing activities include proceeds of \$200 million from the issuance of Senior Notes, part of the proceeds of which were used to repay the \$65 million of 10% Senior Notes, the \$2.8 million redemption premium thereon, debt financing costs of \$4.9 million and the redemption of Class C preferred shares amounting to \$2.2 million. Cash provided by financing activities also included \$2.6 million from the issuance of common shares pursuant to the Company’s stock option plan.

Cash provided by operating activities amounted to \$11.6 million for the year ended December 31, 1997 after the payment of \$11.4 million of interest, \$5.1 million of income taxes and working capital requirements. Working capital requirements included an increase of \$15.1 million in accounts receivable, primarily related to an increase in upfront fees billed in connection with increased signings and the growth in the number of systems in backlog, and an increase of \$18.7 million in net investment in leases due to the theatre systems delivered under sales-type leases in 1997. Cash used in investing activities in 1997 amounted to \$53.5 million. Of this amount, \$28.1 million was invested in film assets, principally *The IMAX Nutcracker*, *T-REX: Back to the Cretaceous*, *The Hidden Dimension* and the IMAX *Ridefilm* film library, \$12.7 million was invested in capital assets, \$8.3 million was invested in marketable securities and \$4.5 million was invested in other assets, principally investments in a joint-venture theatre, IMAX Attractions and IMAX *Ridefilm* operations. Cash provided by financing activities included proceeds of \$5.8 million from the issuance of common shares pursuant to the Company’s stock option plan and repayment of the Company’s long-term debt totaling \$2.3 million.

The Company believes that cash flow from operations together with existing cash balances and the working capital facility will be sufficient to meet cash requirements of its existing level of operations for the foreseeable future.

Auditors' report to shareholders

We have audited the consolidated balance sheets of Imax Corporation as at December 31, 1998 and 1997 and the consolidated statements of operations, shareholders' equity and cash flow for each year in the three-year period ended December 31, 1998. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with Canadian 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 misstatements. 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 December 31, 1998 and 1997 and the results of its operations and cash flows for each year in the three-year period ended December 31, 1998 in accordance with United States generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants

Toronto, Ontario

February 9, 1999

Consolidated balance sheets in accordance with United States generally accepted accounting principles

(in thousands of U.S. dollars)

	As at December 31,	
	1998	1997
Assets		
Current assets:		
Cash and cash equivalents	\$ 143,566	\$ 64,069
Short-term marketable securities	39,305	10,184
Accounts receivable (note 3)	45,217	32,401
Current portion of net investment in leases (note 4)	9,303	6,007
Inventories and systems under construction (notes 3 and 5)	18,747	21,922
Prepaid expenses	3,766	2,474
Total current assets	259,904	137,057
Long-term marketable securities	20,070	16,277
Net investment in leases (note 4)	79,124	51,825
Film assets (notes 3 and 6)	34,885	42,036
Capital assets (note 7)	46,563	41,360
Goodwill (notes 3 and 8)	38,129	43,915
Other assets (note 9)	11,416	11,889
Total assets	\$ 490,091	\$ 344,359
Liabilities		
Current liabilities:		
Accounts payable	\$ 9,882	\$ 7,129
Accrued liabilities	30,153	24,220
Current portion of deferred revenue	22,062	29,067
Income taxes payable	435	318
Total current liabilities	62,532	60,734
Deferred revenue	15,005	13,618
Senior notes due 2005 (note 10)	200,000	—
Senior notes due 2001 (note 11)	—	65,000
Convertible subordinated notes (note 12)	100,000	100,000
Deferred income taxes (note 16)	23,263	19,596
Total liabilities	400,800	258,948
Minority interest	4,845	2,950
Redeemable preferred shares (note 13)	—	1,344
Commitments and contingencies (notes 14, 19 and 20)		
Shareholders' equity		
Capital stock (note 13)	55,236	52,604
Retained earnings	29,436	28,642
Other comprehensive income	(226)	(129)
Total shareholders' equity	84,446	81,117
Total liabilities and shareholders' equity	\$ 490,091	\$ 344,359

(the accompanying notes are an integral part of these consolidated financial statements)

Approved on behalf of the Board

Bradley J. Wechsler
Director

Richard L. Gelfond
Director

Consolidated statements of operations in accordance with United States generally accepted accounting principles

(in thousands of U.S. dollars except per share amounts)

	Years ended December 31,		
	1998	1997	1996
Revenue			
Systems	\$ 140,874	\$ 97,539	\$ 85,972
Films	30,824	39,683	28,367
Other	18,657	21,259	15,499
	190,355	158,481	129,838
Costs and expenses (notes 3 and 6)	111,784	73,806	58,257
Gross margin	78,571	84,675	71,581
Loss from equity-accounted investees (notes 3 and 9)	(6,763)	(22)	—
Selling, general and administrative expenses (note 3)	38,777	32,115	29,495
Research and development	2,745	2,129	2,493
Amortization of intangibles (note 3)	5,948	2,701	2,708
Earnings from operations	24,338	47,708	36,885
Interest income	5,320	5,604	5,797
Interest expense	(14,646)	(13,402)	(11,765)
Foreign exchange gain (loss)	588	(623)	(337)
Earnings before income taxes and minority interest	15,600	39,287	30,580
Provision for income taxes (notes 3 and 16)	(9,810)	(17,265)	(13,579)
Earnings before minority interest	5,790	22,022	17,001
Minority interest	(1,895)	(1,357)	(1,593)
Earnings before extraordinary item	\$ 3,895	\$ 20,665	\$ 15,408
Extraordinary loss on early retirement of debt, net of income tax benefit of \$1,588 (note 11)	(2,095)	—	—
Net earnings	\$ 1,800	\$ 20,665	\$ 15,408
Earnings per share (note 13)			
Earnings before extraordinary item:			
Basic	\$ 0.10	\$ 0.71	\$ 0.54
Diluted	\$ 0.09	\$ 0.68	\$ 0.50
Net earnings:			
Basic	\$ 0.03	\$ 0.71	\$ 0.54
Diluted	\$ 0.03	\$ 0.68	\$ 0.50

(the accompanying notes are an integral part of these consolidated financial statements)

Consolidated statements of cash flow in accordance with United States generally accepted accounting principles

(in thousands of U.S. dollars)

	Years ended December 31,		
	1998	1997	1996
Cash provided by (used in):			
Operating Activities			
Net earnings	\$ 1,800	\$ 20,665	\$ 15,408
Items not involving cash:			
Depreciation and amortization (note 17)	22,677	15,075	12,685
Loss from equity-accounted investees	6,763	22	—
Deferred income taxes	3,975	14,015	8,961
Unrecoverable film costs (note 6)	22,738	—	—
Extraordinary loss on early extinguishment of debt	3,683	—	—
Minority interest	1,895	1,357	1,593
Amortization of discount on senior notes	—	311	1,863
Other	(259)	237	145
Changes in deferred revenue on film production	8,046	(5,840)	3,331
Changes in other operating assets and liabilities (note 17)	(47,371)	(34,254)	(17,211)
Net cash provided by operating activities	23,947	11,588	26,775
Investing Activities			
Increase in marketable securities	(32,920)	(8,250)	(18,164)
Increase in film assets	(21,192)	(28,056)	(14,822)
Purchase of capital assets	(14,021)	(12,654)	(11,905)
Increase in other assets	(3,982)	(4,502)	(3,638)
Net cash used in investing activities	(72,115)	(53,462)	(48,529)
Financing Activities			
Repurchase of 10% senior notes due 2001	(67,789)	—	(4,919)
Issue of 7.875% senior notes due 2005	200,000	—	—
Issue of convertible subordinated notes	—	—	100,000
Deferred charges on debt financing	(4,852)	—	(3,301)
Class C preferred shares dividends paid	(386)	—	—
Redemption of Class C preferred shares	(2,178)	—	—
Common shares issued	2,632	5,758	2,038
Repayment of long-term debt	—	(2,326)	(729)
Common shares and warrants repurchased	—	—	(19,508)
Net cash provided by financing activities	127,427	3,432	73,581
Effect of exchange rate changes on cash	238	(78)	15
Increase (decrease) in cash and cash equivalents during the year	79,497	(38,520)	51,842
Cash and cash equivalents, beginning of year	64,069	102,589	50,747
Cash and cash equivalents, end of year	\$ 143,566	\$ 64,069	\$ 102,589

(the accompanying notes are an integral part of these consolidated financial statements)

Consolidated statements of shareholders' equity in accordance with United States generally accepted accounting principles

(in thousands of U.S. dollars)

	Number of common shares issued and outstanding	Capital stock	Retained earnings (deficit)	Other compre- hensive income	Total shareholders' equity
Balance at December 31, 1995	28,153,258	\$ 64,046	\$ (6,792)	\$ 232	\$ 57,486
Issuance of common stock	391,960	2,038	—	—	2,038
Common shares and warrants repurchased	(660,000)	(19,508)	—	—	(19,508)
Accrual of stock compensation benefit	—	234	—	—	234
Accrual of preferred dividends	—	—	(169)	—	(169)
Accretion of discount on preferred shares	—	—	(140)	—	(140)
Net earnings	—	—	15,408	—	15,408
Foreign currency translation adjustments	—	—	—	(508)	(508)
Balance at December 31, 1996	27,885,218	46,810	8,307	(276)	54,841
Issuance of common stock	1,230,200	5,758	—	—	5,758
Accrual of stock compensation benefit	—	36	—	—	36
Accrual of preferred dividends	—	—	(170)	—	(170)
Accretion of discount on preferred shares	—	—	(160)	—	(160)
Net earnings	—	—	20,665	—	20,665
Foreign currency translation adjustments	—	—	—	147	147
Balance at December 31, 1997	29,115,418	52,604	28,642	(129)	81,117
Issuance of common stock	362,966	2,632	—	—	2,632
Accrual of preferred dividends	—	—	(171)	—	(171)
Accretion of discount on preferred shares	—	—	(183)	—	(183)
Premium paid on early redemption of Class C preferred shares	—	—	(652)	—	(652)
Net earnings	—	—	1,800	—	1,800
Foreign currency translation adjustments	—	—	—	(97)	(97)
Balance at December 31, 1998	29,478,384	\$ 55,236	\$ 29,436	\$ (226)	\$ 84,446

(the accompanying notes are an integral part of these consolidated financial statements)

Notes to consolidated financial statements in accordance with United States generally accepted accounting principles for the years ended December 31, 1998, 1997 and 1996

(tabular amounts in thousands of U.S. dollars unless otherwise stated)

1. Description of the business

Imax Corporation provides a wide range of products and services to the network of IMAX® theatres. The principal activities of the Company are:

- the design, manufacture and marketing of proprietary projection and sound systems for IMAX theatres;
- the development, production, post-production and distribution of films shown in the IMAX theatre network; and
- the provision of other services to the IMAX theatre network, including designing and manufacturing IMAX camera equipment for rental to filmmakers and providing ongoing maintenance services for the IMAX projection and sound systems.

2. Summary of significant accounting policies

The preparation of the financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. The most significant estimates are related to the recoverability of film assets, capital assets, goodwill and the measurement of contingencies. Actual results could be materially different from these estimates. Significant accounting policies are summarized as follows:

[a] Basis of consolidation

The consolidated financial statements include the accounts of the Company and its subsidiaries.

[b] Investments

Investments in marketable securities categorized as available-for-sale securities are carried at fair value, with unrealized gains or losses included in a separate component of shareholders' equity. Investments in marketable securities categorized as held-to-maturity securities are carried at amortized cost.

Investments in joint ventures are accounted for by the equity method of accounting, under which consolidated net earnings include the Company's share of earnings or losses of the investees. The carrying values of the investments are adjusted for the Company's share of undistributed income or losses since acquisition, and dividends received are recorded as a reduction in the investments. Write-downs are only made for declines in value which are other than temporary.

[c] Inventories

Inventories are carried at the lower of cost, determined on a first-in, first-out basis, or net realizable value. Finished goods and work-in-process include the cost of raw materials, direct labour and manufacturing overhead costs.

[d] Film assets

Film assets represent costs incurred in producing and distributing films net of accumulated amortization. Film costs are charged as expenses using the individual-film forecast method as prescribed by *Statement of Financial Accounting Standards No. 53*, whereby film costs are amortized in the same ratio that current gross revenues bear to anticipated total gross revenues. Estimates of anticipated total gross revenues are reviewed quarterly by management and revised where necessary to reflect more current information.

The recoverability of film costs is dependent upon commercial acceptance of the films. Any capitalized costs of a film that are determined to be unrecoverable are charged to operations in the period that determination is made.

[e] Capital assets

Capital assets are stated at cost and are depreciated on a straight-line basis over their estimated useful lives as follows:

Projection equipment	10 to 15 years
Motion simulation equipment	5 years
Camera equipment	5 to 10 years
Buildings	20 to 25 years
Office and production equipment	3 to 5 years
Leasehold improvements	Over the term of the underlying leases

[f] Goodwill

Goodwill represents the excess purchase price of acquired businesses over the fair value of net assets acquired. Goodwill is amortized on a straight-line basis over its estimated life ranging from 10 to 25 years. The carrying value of goodwill is periodically reviewed by the Company and impairments are recognized in earnings when the undiscounted expected future operating cash flows derived from the acquired businesses are less than the carrying value.

[g] Deferred revenue

Deferred revenue comprises receipts under systems sales and lease contracts, film production contracts and film exhibition contracts not yet recognized as revenue. The current portion of deferred revenue represents the estimated amount to be recognized in earnings during the following 12-month period.

[h] Income taxes

Income taxes are accounted for under the asset and liability method whereby deferred tax assets and liabilities are recognized for the expected future tax consequences of events that have been recognized in the financial statements or tax returns. Deferred tax assets and liabilities are measured using tax rates expected to apply to taxable income in the years in which temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in earnings in the period in which the change occurs.

[i] Revenue and cost recognition**SALES AND SALES-TYPE LEASES**

Revenues from theatre system sales and leases which transfer substantially all of the benefits and risks of ownership to the customer ("sales-type leases") are recognized on the completed contract method (that is, upon delivery of the system). Revenues include initial advance payments and contracted minimum rental payments discounted to their present value.

Cash receipts under initial advance payments are generally received in advance of deliveries and are recorded as deferred revenue. The associated costs are recorded as inventories and systems under construction. Upon delivery of the theatre system, deferred revenue and deferred costs, net of residual value at the end of the lease term, are recognized in earnings.

The Company recognizes the present value of the minimum rentals on sales-type leases upon delivery of the theatre system. Cash receipts under minimum rental payments are received after delivery. Typically, ongoing rentals are received over the life of the system agreement and under any renewal periods. In the event of default of payment of minimum contracted rentals, the Company may repossess the system and refurbish it for resale. Royalties in excess of minimum rentals are recorded as revenue when due under the terms of the lease agreement.

OPERATING LEASES

Revenues from leases which do not transfer substantially all of the benefits and risks of ownership to the customer are treated as operating leases where revenues and direct expenses are recognized over the term of the lease and costs of leased assets are amortized over their estimated useful lives.

FILM PRODUCTION REVENUES

Revenues from films produced for third parties are recognized when the film is completed and delivered to the sponsor. The associated production costs are deferred and subsequently charged to earnings when the film is delivered and the revenue is recognized.

[j] Research and development

Research and development expenditures are expensed as incurred.

[k] Foreign currency translation

Effective April 1, 1996, the U.S. dollar was adopted as the Company's functional currency as a result of the continued growth of the Company's business outside of Canada and the additional U.S. dollar-denominated financing raised by the Company in April 1996. Monetary assets and liabilities of the Company's operations which are denominated in currencies other than the U.S. dollar are translated into U.S. dollars at the exchange rates prevailing at year end. Non-monetary items are translated at historical exchange rates. Revenue and expense transactions are translated at exchange rates prevalent at the transaction date. All exchange gains and losses are included in the determination of net earnings in the period in which they arise.

[l] Stock-based compensation

Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation, became effective for the Company for the year ended December 31, 1996. This statement allows enterprises to continue to measure compensation cost for employee stock option plans using the methodology currently prescribed by *APB Opinion No. 25, Accounting for Stock Issued to Employees*. The Company elected to remain with the accounting prescribed in Opinion No. 25 and has made pro forma disclosures of net earnings and earnings per share in note 13 as if the methodology prescribed by Statement No. 123 had been adopted.

3. Rationalization of motion simulation and attractions business

Included in earnings for the year ended December 31, 1998 is a pre-tax charge of \$13,569,000 related to the Company's investment in its motion simulation and attractions business. The Company's decision to rationalize its activities in this business was based upon declining sales of its motion simulation products and continued operating losses within the business unit. The Company does not intend to manufacture or sell additional Ridefilm motion base products (with the exception of delivering in 1999 the three motion bases currently in backlog) and does not intend to produce new motion simulation films.

As a result, management determined that there has been a permanent impairment of the Ridefilm assets amounting to \$13,293,000 based on the estimated present value of future cash flows of the operations. As a result of the revaluation and write-down of Ridefilm assets, the Consolidated Statements of Operations for the Company reflect the following costs and expenses for the year ended December 31, 1998: a) amortization of intangibles includes \$3,266,000 related to the write-off of the remaining unamortized goodwill; b) costs and expenses include \$1,427,000 related to the write-down of three participating joint-venture operations, \$3,665,000 related to a write-down of film assets, \$768,000 related to write-down of inventory (leaving the historical cost of assets contracted to be delivered in 1999), and \$1,067,000 related to the write-off of obsolete fixed assets; c) selling, general and administrative expenses include \$1,682,000 related to a provision for doubtful accounts as the future collectibility of amounts is expected to be impaired by the decision to rationalize the business; d) loss from equity-accounted investees includes \$543,000 representing the write-down of the assets to fair market value of the Company's 50% equity share of a joint venture; and e) income tax expense includes a write-down of deferred state tax assets amounting to \$875,000 relating to losses considered unlikely to be utilized. In addition to the impairment of assets, costs and expenses includes a provision for costs totaling \$950,000 that will provide no future economic benefit, and included in selling, general and administrative expense for the year ended December 31, 1998 is a provision for severance of \$201,000 for seven management, sales and administrative staff.

4. Net investment in leases and lease payments receivable

The Company enters into sales-type leases that have initial advance payments and annual rental payments with contracted minimums which are generally indexed with inflation. The Company's net investment in sales-type leases comprises:

	1998	1997
Total minimum lease payments receivable	\$ 159,422	\$ 109,036
Residual value of equipment	5,004	3,157
Unearned finance income	(62,792)	(51,014)
Present value of minimum lease payments receivable	101,634	61,179
Valuation allowance	(13,207)	(3,347)
	88,427	57,832
Less current portion	9,303	6,007
	\$ 79,124	\$ 51,825

Income recognized on systems from annual rental payments comprised the following:

	1998	1997	1996
Minimum rental payments on operating leases	\$ 910	\$ 1,073	\$ 1,178
Contingent rentals ¹	4,100	4,971	3,892
Finance income	5,144	4,241	2,878
Total	\$ 10,154	\$ 10,285	\$ 7,948

¹ 1997 contingent rentals include \$832,000 of arrears billings.

The estimated amount of minimum rental payments receivable from all signed leases, excluding those in sales backlog at December 31, 1998, for each of the next five years is as follows:

1999	\$ 11,565
2000	\$ 12,573
2001	\$ 12,697
2002	\$ 12,715
2003	\$ 12,589

5. Inventories and systems under construction

	1998	1997
Raw materials	\$ 7,555	\$ 6,943
Work-in-process	10,686	14,508
Finished goods	506	471
	\$ 18,747	\$ 21,922

6. Film assets

	1998	1997
Completed films, net of amortization	\$ 25,687	\$ 30,396
Films in production	9,198	11,313
Acquired film rights, net of amortization	–	327
	\$ 34,885	\$ 42,036

Included in costs and expenses for the year ended December 31, 1998 is a charge of \$22.7 million to reflect a write-down for unrecoverable film costs. The write-down of film assets is attributed principally to the write-down of the Ridefilm film library of \$3,665,000 and the 15/70-format films *Mission To Mir*, *The Hidden Dimension* and *The IMAX Nutcracker*.

7. Capital assets

	1998		
	Cost	Accumulated depreciation	Net book value
Equipment held for lease:			
Projection equipment	\$ 11,131	\$ 6,324	\$ 4,807
Motion simulation equipment	3,403	3,263	140
Camera equipment	12,373	2,870	9,503
	26,907	12,457	14,450
Assets under construction	6,605	–	6,605
Other capital assets:			
Land	2,431	–	2,431
Buildings	17,227	2,368	14,859
Office and production equipment	18,389	10,255	8,134
Leasehold improvements	376	292	84
	38,423	12,915	25,508
	\$ 71,935	\$ 25,372	\$ 46,563

	1997		
	Cost	Accumulated depreciation	Net book value
Equipment held for lease:			
Projection equipment	\$ 9,964	\$ 4,052	\$ 5,912
Motion simulation equipment	3,403	1,090	2,313
Camera equipment	9,466	2,440	7,026
	22,833	7,582	15,251
Assets under construction	3,634	–	3,634
Other capital assets:			
Land	2,431	–	2,431
Buildings	14,557	1,793	12,764
Office and production equipment	14,297	7,150	7,147
Leasehold improvements	398	265	133
	31,683	9,208	22,475
	\$ 58,150	\$ 16,790	\$ 41,360

8. Goodwill

The accumulated amortization of goodwill, excluding goodwill relating to Ridefilm, was \$9,176,000 and \$7,285,000 at December 31, 1998 and 1997, respectively. The accumulated amortization of goodwill relating to Ridefilm was \$6,321,000 in 1998 and \$2,423,000 in 1997. Unamortized goodwill related to Ridefilm was fully written off in 1998 (see note 3).

9. Other assets

	1998	1997
Investments in joint ventures accounted for under the equity method	\$ 2,454	\$ 6,915
Deferred charges on debt financing	6,794	3,771
Other assets	2,168	1,203
	\$ 11,416	\$ 11,889

Included in loss from equity-accounted investees for the year ended December 31, 1998 is a loss of \$1,937,000 representing the Company's share of the loss of Forum Ride Associates, a 50% joint venture with Starwood Hotels & Resorts Worldwide, Inc., operating an IMAX 3D *Simulator Ride* at the Forum Shops at Caesars Palace in Las Vegas, Nevada. The Company also took a charge of \$4,208,000 to write off its remaining investment in the joint venture after considering current-period operating losses combined with a projection that demonstrated continuing losses exist.

Investments in joint ventures accounted for under the equity method as at December 31, 1998 also reflect the charge to write down a Ridefilm joint venture (see note 3).

10. Senior Notes due 2005

In December 1998, the Company issued \$200 million of Senior Notes due December 1, 2005, bearing interest at 7.875% per annum with interest payable in arrears on June 1 and December 1 of each year, commencing June 1, 1999. The 7.875% Senior Notes are the senior unsecured obligation of the Company, ranking *pari passu* in right of payment to all existing and future senior unsecured and unsubordinated indebtedness of the Company and senior in right of payment to any subordinated indebtedness of the Company.

The 7.875% Senior Notes Indenture contains covenants that, among other things, limit the ability of the Company and its subsidiaries to incur additional indebtedness, pay dividends or make other distributions, make certain investments, create certain liens, engage in certain transactions with affiliates, engage in sale and leaseback transactions, engage in mergers, consolidations or the transfer of all or substantially all of the assets of the Company.

The 7.875% Senior Notes are subject to redemption by the Company, in whole or in part, at any time on or after December 1, 2002, at redemption prices expressed as percentages of the principal amount for each 12-month period commencing December 1 of the years indicated: 2002 – 103.938%; 2003 – 101.969%; 2004 and thereafter – 100.000% together with interest accrued thereon to the redemption date. Until December 1, 2001, up to 35% of the aggregate principal amount of the Notes may be redeemed by the Company using the net proceeds of a public offering of common shares of the Company or certain other equity placements, at a redemption price of 107.875%, together with accrued interest thereon. The Company may also redeem the notes, in whole or in part, at any time prior to December 1, 2002, at a redemption price equal to 100% of the principal amount plus a “make-whole premium” calculated in reference to the redemption price on the first date that the notes may be redeemed by the Company plus accrued interest to, but excluding, the redemption date. If certain changes result in the imposition of withholding taxes under Canadian law, the 7.875% Senior Notes are subject to redemption at the option of the Company, in whole but not in part, at a redemption price of 100% of the principal amount thereof plus accrued interest to the date of redemption. In the event of a change in control, holders of the notes may require the Company to repurchase all or part of the notes at a price equal to 101% of the principal amount thereof plus accrued interest to the date of repurchase.

Interest expense on the 7.875% Senior Notes amounted to \$1,181,000 in 1998.

11. Senior Notes due 2001

In December 1998, the Company provided all holders of the 10% Senior Notes due 2001 with a notice of redemption at a price in accordance with the terms of the 10% Senior Notes of 104.29% of the principal amount. As of December 31, 1998, all of the 10% Senior Notes due 2001 had been redeemed for a total of \$67,789,000. The excess of the redemption price over the principal amount of the 10% Senior Notes of \$2,789,000 and the write-off of the remaining unamortized deferred financing costs of \$894,000 resulted in an extraordinary pre-tax loss of \$3,683,000 in the year ended December 31, 1998.

Interest expense on the 10% Senior Notes amounted to \$6,681,000 in 1998 (1997 – \$6,175,000; 1996 – \$6,621,000).

12. Convertible Subordinated Notes

In April 1996, the Company issued \$100 million of Convertible Subordinated Notes due April 1, 2003 bearing interest at 5.75% payable in arrears on April 1 and October 1. The Notes, subordinate to present and future senior indebtedness of the Company, are convertible into common shares of the Company at the option of the holder at a conversion price of \$21.406 per share (equivalent to a conversion rate of 46.7154 shares per \$1,000 principal amount of Notes) at any time prior to maturity.

Interest expense related to the Convertible Subordinated Notes was \$5,750,000 during the year ended December 31, 1998 (1997 – \$5,750,000; 1996 – \$4,159,000).

The Notes are redeemable at the option of the Company on or after April 1, 1999 at redemption prices expressed as percentages of the principal amount (1999 – 103.286%; 2000 – 102.464%; 2001 – 101.643%; 2002 – 100.821%) plus accrued interest. The Notes may only be redeemed by the Company between April 1, 1999 and April 1, 2001 if the last reported market price of the Company's common shares is equal to or greater than \$30 per share for any 20 of the 30 consecutive trading days prior to the notice of redemption. The Notes may be redeemed at any time on or after April 1, 2001 without limitation.

13. Capital stock and redeemable preferred shares

[a] Authorized

The authorized capital of the Company consists of an unlimited number of common shares and an unlimited number of Class C preferred shares issuable in two series.

The following is a summary of the rights, privileges, restrictions and conditions of each of the classes of shares.

COMMON SHARES

The holders of common shares are entitled to receive dividends if, as and when declared by the directors of the Company, subject to the rights of the holders of any other class of shares of the Company entitled to receive dividends in priority to the common shares.

The holders of the common shares are entitled to one vote for each common share held at all meetings of the shareholders.

REDEEMABLE CLASS C PREFERRED SHARES, SERIES 1

The holders of Class C shares are entitled to a cumulative dividend at the rate of 7% per annum on the Class C issue price of Canadian \$100 per share. These dividends shall accrue from the issue date but shall not be declared or paid prior to the third anniversary date of the issue date. Dividends on the Class C shares are to be paid in priority to dividends payable to the holders of the common shares.

If on any anniversary date of the issue date after the third such anniversary date the Class C cumulative dividends to be paid on such date are not paid, and such dividends were required to have been paid pursuant to certain conditions, then the rate at which Class C cumulative dividends shall accrue thereafter will increase by 1% per annum to a maximum dividend rate of 10% per annum until all Class C cumulative dividends have been paid as required, at which time the dividend rate will revert to 7% per annum.

The Class C shares are redeemable at the option of the Company at any time in whole, or from time to time in part, in each case for an amount equal to the Class C issue price plus all accrued and unpaid dividends to, but not including, the date of such redemption. The Class C shares are to be redeemed in whole on September 1, 2002. Notice of redemption for all outstanding Class C shares was delivered on December 29, 1998 and all outstanding shares were redeemed on January 21, 1999 (see note 13e).

Except as otherwise required by law, the holders of Class C shares Series 1 are not entitled to vote at any meeting of the shareholders.

REDEEMABLE CLASS C PREFERRED SHARES, SERIES 2

The Class C Series 1 preferred shares may be converted at any time in whole upon a resolution of the directors of the Company into the same number of Class C Series 2 preferred shares. The Series 2 shares shall be identical to the Series 1 shares except that the holders of Series 2 shares will be entitled to such number of votes as the directors determine subject to a maximum of six percent of the votes attaching to all voting shares of the Company outstanding immediately following the conversion.

[b] Changes during the period

Pursuant to shareholders' approval at the Annual and Special Meeting held on May 6, 1997, the Company's shares were split on a 2-for-1 basis in May 1997. Common share, stock option and earnings per share data for the comparative periods give retroactive effect to the stock split as if it had taken place at the beginning of the period.

In 1998, the Company issued 361,300 common shares pursuant to the exercise of stock options for cash proceeds of \$2,605,000 and 1,666 shares were issued under the terms of an employment contract with an ascribed value of \$27,000.

In 1997, the Company issued 778,200 common shares pursuant to the exercise of stock options for cash proceeds of \$5,616,000 and 5,000 shares were issued under the terms of an employment contract with an ascribed value of \$37,000.

In 1996, the Company issued 386,960 common shares pursuant to the exercise of stock options for cash proceeds of \$2,001,000 and 5,000 shares were issued under the terms of an employment contract with an ascribed value of \$37,000. The Company repurchased 660,000 common shares and all of the outstanding warrants of the Company from certain officers and directors of the Company for \$19,508,000 in cash.

[c] Shares held for other than retirement

As at December 31, 1998 and 1997, 213,000 (1996 – 660,000) issued common shares are held by a subsidiary of the Company for other than retirement. During 1997, 447,000 common shares held by a subsidiary of the Company were sold to a former employee of the Company in connection with the exercise of a stock option grant for cash proceeds of \$105,000.

[d] Stock options and warrants

The Company has reserved a total of 4,618,788 common shares for future issuance as follows:

(i) 381,744 common shares have been reserved for issuance pursuant to stock options granted in connection with the employment of Douglas Trumbull, former Vice Chairman of the Company, at an exercise price equivalent to Canadian \$0.32 per share and expire on September 1, 2002. These options are fully vested.

(ii) 26,208 common shares have been reserved for issuance pursuant to stock options granted at an exercise price equivalent to Canadian \$1.59 per share which vest over a five-year period and expire on April 8, 2004. At December 31, 1998, options in respect of 4,000 common shares were vested and exercisable.

(iii) 4,210,836 common shares have been reserved for issuance under the Employee Stock Option Plan, of which options in respect of 3,327,300 common shares are outstanding at December 31, 1998. The options granted under the Employee Stock Option Plan generally vest over a five-year period and expire 10 years from the date granted. As at December 31, 1998, options in respect of 1,140,766 common shares were vested and exercisable.

	Number of shares			Average exercise price per share		
	1998	1997	1996	1998	1997	1996
Options outstanding, beginning of year	2,005,600	2,126,800	2,009,800	\$ 14.55	\$ 8.99	\$ 6.86
Granted	1,815,500	711,000	481,000	22.58	23.10	15.47
Exercised	(335,900)	(749,200)	(350,800)	7.14	7.45	6.49
Canceled or expired	(157,900)	(83,000)	(13,200)	19.56	9.36	6.77
Options outstanding, end of year	3,327,300	2,005,600	2,126,800	\$ 19.38	\$ 14.55	\$ 8.99

The weighted average fair value of common share options granted in 1998 is \$11,707,000 (1997 – \$5,604,000; 1996 – \$2,622,000). The fair value of common share options granted is estimated at the grant date using the Black-Scholes option-pricing model with the following assumptions: dividend yield of 0%, a risk-free interest rate of 5% (1997 and 1996 – 6%), expected life of the options ranging from two to five years and expected volatility of 40%.

The following table summarizes certain information in respect of options outstanding under the Employee Stock Option Plan as at December 31, 1998:

	Number of shares outstanding	Number of shares vested	Average exercise price per share	Average remaining term
Range of exercise prices per share:				
\$5.00–\$9.99	494,300	253,900	\$ 6.83	6 years
\$10.00–\$14.99	104,000	42,000	11.21	7 years
\$15.00–\$19.99	526,400	302,000	16.35	7 years
\$20.00–\$24.99	1,695,500	414,366	22.20	9 years
\$25.00–\$28.99	507,100	128,500	27.02	8¾ years
Total	3,327,300	1,140,766	\$ 19.38	8 years

[e] Redeemable preferred shares

In December 1998, all holders of the outstanding redeemable Class C preferred shares were notified by the Company that the shares were being redeemed. As at December 31, 1998, accrued liabilities include the amount owing on the redemption of the preferred shares of Canadian \$3,300,000. Cumulative dividends payable amounted to \$423,000 as at December 31, 1998. In January 1999, all of the outstanding redeemable Class C preferred shares were redeemed and cumulative dividends owing were paid.

As at December 31, 1997, there were 33,333 Class C Series 1 redeemable preferred shares issued and outstanding. Cumulative dividends payable on the Class C Series 1 redeemable preferred shares amounted to \$653,000 at December 31, 1997.

[f] Earnings per share

	1998	1997	1996
<i>Net earnings available to common shareholders:</i>			
Earnings before extraordinary loss	\$ 3,895	\$ 20,665	\$ 15,408
Less: accrual of preferred dividends	(171)	(170)	(169)
accretion of discount of preferred shares	(183)	(160)	(140)
premium paid on early redemption of preferred shares	(652)	—	—
	\$ 2,889	\$ 20,335	\$ 15,099
Extraordinary loss on the early redemption of debt, net of income tax benefit of \$1,588	(2,095)	—	—
	\$ 794	\$ 20,335	\$ 15,099
<i>Weighted average number of common shares:</i>			
Issued and outstanding at beginning of year	29,115,418	27,885,218	28,153,258
Weighted average shares:			
Issued in the year	165,175	659,065	172,546
Repurchased in the year	—	—	(476,686)
Weighted average used in computing basic earnings per share	29,280,593	28,544,283	27,849,118
Assumed exercise of stock options, net of shares assumed acquired under the Treasury Stock Method	1,192,975	1,575,410	2,075,780
Weighted average used in computing diluted earnings per share	30,473,568	30,119,693	29,924,898

Common shares potentially issuable pursuant to the Convertible Subordinated Notes would have an antidilutive effect on earnings per share and have not been included in the above computations.

If the methodology prescribed by *Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation*, had been adopted by the Company, pro forma results would have been as follows:

	1998	1997	1996
Net earnings (loss)	\$ (2,828)	\$ 19,499	\$ 15,059
Earnings (loss) per share:			
Basic	\$ (0.13)	\$ 0.67	\$ 0.53
Diluted	\$ (0.13)	\$ 0.64	\$ 0.49

14. Commitments

[a] Total minimum annual rental payments under operating leases for premises are as follows:

1999	\$ 2,074
2000	\$ 2,174
2001	\$ 2,338
2002	\$ 2,461
2003	\$ 2,518

Rent expense was \$1,478,000 for the year ended December 31, 1998 (1997 – \$1,033,000; 1996 – \$1,161,000).

[b] The Company has unused lines of credit amounting to Canadian \$4.7 million, or the equivalent in U.S. dollars. No commitment fees are payable on these lines of credit.

The Company has guaranteed up to \$5.75 million of a term loan undertaken by the Forum Ride Associates joint venture to which it is a party in connection with the development and construction the IMAX *Race For Atlantis* attraction in Las Vegas. The term loan, which matures in January 2009, bears interest at LIBOR plus 3% and is collateralized by the assets of the joint venture.

15. Government assistance

A portion of the Company's research activities which relate to 3D motion pictures is eligible for government grants. Government grants have been credited against research and development expense in the amount of \$67,000 during the year ended December 31, 1998 (1997 – \$100,000; 1996 – \$324,000).

16. Income taxes

[a] Earnings before income taxes and minority interest by tax jurisdiction comprise the following:

	1998	1997	1996
Canada	\$ 16,481	\$ 31,872	\$ 32,461
United States	(5,439)	6,512	3,308
Japan	1,475	1,424	(5,351)
Other	3,083	(521)	162
Total	\$ 15,600	\$ 39,287	\$ 30,580

[b] The provision for income taxes comprises the following:

	1998	1997	1996
Current	\$ (4,247)	\$ (3,250)	\$ (4,618)
Deferred	(5,563)	(14,015)	(8,961)
Total	\$ (9,810)	\$ (17,265)	\$ (13,579)

[c] The provision for income taxes before extraordinary item differs from the amount that would have resulted by applying the combined Canadian federal and Ontario provincial statutory income tax rates (44.62%) to earnings as described below:

	1998	1997	1996
Income tax expense at combined statutory rates	\$ (6,961)	\$ (17,530)	\$ (13,644)
(Increase) decrease resulting from:			
Non-deductible expenses, including amortization of goodwill	(2,727)	(985)	(1,519)
Manufacturing and processing profits deduction	159	684	977
Large corporations tax	(235)	(335)	(275)
Income tax at different rates in foreign and other provincial jurisdictions	(266)	292	701
Investment tax credits and other	220	609	181
Provision for income taxes as reported	\$ (9,810)	\$ (17,265)	\$ (13,579)

[d] The deferred income tax liability consists of:

	1998	1997
Net operating loss carry forwards	\$ 2,346	\$ 2,349
Investment tax credit carry forwards	5,492	5,015
Asset write-downs	1,688	800
Income recognition on systems deliveries	(74,994)	(52,374)
Excess book over tax depreciation and amortization	43,405	26,740
Other	1,611	(145)
	(20,452)	(17,615)
Valuation allowance	(2,811)	(1,981)
	\$ (23,263)	\$ (19,596)

17. Consolidated statements of cash flow

	1998	1997	1996
[a] Changes in other operating assets and liabilities were as follows:			
Decrease (increase) in:			
Accounts receivable	\$ (12,816)	\$ (15,081)	\$ (7,940)
Net investment in leases	(30,447)	(18,674)	(15,499)
Inventories and systems under construction	2,476	(1,365)	(3,761)
Prepaid expenses	(1,635)	(604)	420
Increase (decrease) in:			
Accounts payable	2,969	2,428	1,446
Accrued liabilities	5,933	7,543	5,633
Income taxes payable	(187)	(2,423)	1,964
Other deferred revenue	(13,664)	(6,078)	526
	\$ (47,371)	\$ (34,254)	\$ (17,211)
[b] Cash payments made during the year on account of:			
Income taxes	\$ 4,106	\$ 5,145	\$ 2,395
Interest	\$ 14,597	\$ 11,402	\$ 7,872
[c] Depreciation and amortization comprise the following:			
Acquired systems contracts in process	\$ –	\$ 1,027	\$ 1,337
Film assets	5,740	4,905	2,850
Capital assets	8,459	5,560	5,020
Intangibles	5,948	2,701	2,708
Deferred financing costs	935	882	770
Other	1,595	–	–
	\$ 22,677	\$ 15,075	\$ 12,685

18. Segmented information

The Company has two reportable segments: systems and films. The systems segment designs, manufactures and sells or leases and maintains projection systems. The film segment performs production, post-production and distribution of films. The accounting policies of the segments are the same as those described in note 2. Segment performance is evaluated based on gross margin less selling, general and administrative expenses, research and development expenses and goodwill amortization. Inter-segment transactions are not significant.

[a] Business segments

	1998	1997	1996
Revenue			
Systems	\$ 140,874	\$ 97,539	\$ 85,972
Films	30,824	39,683	28,367
Other	18,657	21,259	15,499
Total consolidated revenues	\$ 190,355	\$ 158,481	\$ 129,838
Earnings (loss) from operations			
Systems	\$ 78,145	\$ 52,594	\$ 45,224
Films	(16,458)	11,452	7,965
Other	(18,053)	1,000	(1,101)
Corporate overhead	(19,296)	(17,338)	(15,203)
Consolidated earnings from operations	\$ 24,338	\$ 47,708	\$ 36,885
Depreciation and amortization			
Systems	\$ 7,572	\$ 6,741	\$ 6,781
Films	5,908	5,100	2,954
Other and corporate	9,197	3,234	2,950
	\$ 22,677	\$ 15,075	\$ 12,685
Purchase of capital assets			
Systems	\$ 4,547	\$ 6,103	\$ 3,406
Films	194	206	76
Other	9,280	6,345	8,423
	\$ 14,021	\$ 12,654	\$ 11,905
Assets			
Systems	\$ 204,349	\$ 167,926	\$ 146,835
Films	49,048	52,199	23,729
Other	26,092	28,116	11,422
Corporate	210,602	96,118	126,758
	\$ 490,091	\$ 344,359	\$ 308,744

In 1998, the loss in the film segment includes a write-down of \$19,073,000 for unrecoverable film costs. The other segment includes a charge of \$13,569,000 relating to rationalization of the motion simulation and attractions business (note 3) and a loss of \$6,145,000 from the Company's 50% share of Forum Ride Associates' loss for the year and the write-off of the remaining carrying value of this equity-accounted investee (note 9).

[b] Geographic segments

Systems revenue and film distribution and post-production revenues by geographic area are based on the location of the theatre, while the location of the customer determines the geographic allocation of film production revenues:

	1998	1997	1996
Revenues			
Canada	\$ 22,037	\$ 12,890	\$ 27,740
United States	79,494	70,070	50,852
Europe	45,680	38,238	25,567
Japan	12,454	11,986	17,350
Rest of world	30,690	25,297	8,329
	\$ 190,355	\$ 158,481	\$ 129,838
Long-lived assets			
Canada	\$ 134,740	\$ 131,600	\$ 108,808
United States	49,888	43,109	30,061
Europe	30,012	17,910	11,100
Japan	4,820	6,787	7,429
Rest of world	10,727	7,896	3,143
	\$ 230,187	\$ 207,302	\$ 160,541

19. Financial instruments

From time to time the Company engages in hedging activities to reduce the impact of fluctuations in foreign currencies on its profitability and cash flow. The credit risk exposure associated with these activities would be limited to all unrealized gains on contracts based on current market prices. The Company believes that this credit risk has been minimized by dealing with highly rated institutions.

To fund Canadian dollar costs in 1999 and 2000, the Company had entered into forward exchange contracts as at December 31, 1998 to hedge the conversion of \$39 million of its cash flow into Canadian dollars at an average exchange rate of Canadian \$1.45 per U.S. dollar. In addition, the Company had entered into forward exchange contracts as at December 31, 1998 to hedge the conversion of 182.6 million yen of its cash flow in 1999 into U.S. dollars at an average exchange rate of 122 yen per U.S. dollar. The Company recognizes exchange gains or losses on the forward exchange contracts when the contracts mature.

The Company has also entered into foreign currency swap transactions to hedge minimum lease payments receivable under sales-type lease contracts denominated in Japanese yen and French francs. These swap transactions fix the foreign exchange rates on conversion of 139 million yen at 98 yen per U.S. dollar through September 2004 and on 15.5 million francs at 5.1 francs per U.S. dollar through September 2005. The Company recognizes an exchange gain or loss when the swaps mature.

The estimated fair values of the Company's financial instruments at December 31, 1998 are summarized as follows:

	Carrying amount	Estimated fair value
Cash and cash equivalents	\$ 143,566	\$ 143,566
Marketable securities	59,375	59,375
Senior notes	200,000	200,000
Convertible subordinated notes	100,000	145,000
Foreign currency contracts	473	(1,901)

The carrying amount of cash and cash equivalents approximates fair value due to the short maturity of these instruments. Marketable securities, which principally represent investments in corporate bonds maturing through 2000, have been categorized as available-for-sale securities and are carried at estimated fair value. The fair values of the Company's Senior Notes and Convertible Subordinated Notes are estimated based on quoted market prices for the Company's debt. The fair value of foreign currency contracts held for hedging purposes represents the estimated amount the Company would pay to terminate the agreements, taking into consideration current exchange rates and the credit worthiness of the counterparties.

20. Contingencies

[a] In April 1994, Compagnie France Film Inc. filed a claim against the Company in the Superior Court in the District of Montreal, in the Province of Quebec, alleging breach of contract and bad faith in respect of an agreement which the plaintiff claims it entered into with the Company for the establishment of an IMAX theatre in Quebec City, Quebec, Canada. Until December 1993, Predecessor Imax was in negotiations with the plaintiff and another unrelated party for the establishment of an IMAX theatre in Quebec City. In December 1993, Predecessor Imax executed a system lease agreement with the other party. During the negotiations, both parties were aware of the other party's interest in also establishing an IMAX theatre in Quebec City. The plaintiffs claimed damages of Canadian \$4.6 million, representing the amount of profit they claim they were denied due to their inability to proceed with an IMAX theatre in Quebec City, together with expenses incurred in respect of this project and pre-judgment interest.

Compagnie France Film had also incorporated a shell company, 3101-8450 Quebec Inc. ("3101"). 3101 was to, among other things, enter into a lease for the proposed IMAX theatre site. In November 1993, while negotiations between Compagnie France Film and the Company were still ongoing, 3101 entered into a lease for the site. 3101 defaulted on the lease and the landlord sued 3101 in an unrelated action to which the Company was not a party. In February 1996, 3101 was found liable to pay the landlord damages in the amount of Canadian \$2.5 million. Subsequent to that judgment 3101 intervened in the lawsuit between Compagnie France Film and the Company in order to claim from the Company damages in the amount of Canadian \$2.5 million.

The Company disputed these claims and the suit went to trial in January 1998. In a decision rendered in April 1998, the Court dismissed the plaintiffs' claims with costs. In May 1998, Compagnie France Film Inc. and 3101 both filed appeals of the April 1998 decision to the Court of Appeal. The Company believes that it will be successful in responding to these appeals and the ultimate loss, if any, will not have a material impact on the financial position or results of operations of the Company, although no assurance can be given with respect to the ultimate outcome of this litigation.

[b] On February 26, 1996, Iwerks Entertainment Inc. filed a complaint against the Company alleging violations under the Sherman Act, the Clayton Act, tortious interference with contracts and prospective economic advantage, and unfair competition. The plaintiff was seeking unquantified damages, injunctive relief and restitution. All claims against the Company were dismissed in a summary judgment in April 1998. In May 1998, Iwerks Entertainment Inc. filed an appeal of this decision. The amount of the loss, if any, cannot be determined at this time.

[c] In addition to the litigation described above, the Company is currently involved in other litigation which, in the opinion of the Company's management, will not materially affect the Company's financial position or future operating results, although no assurance can be given with respect to the ultimate outcome for any such litigation.

21. Impact of recently issued accounting standards

Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities will become effective in the first quarter of the Company's 2000 fiscal year. The Company is evaluating the impact that the requirements of this Statement will have on the accounting for its hedging activities.

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Trading Symbol:
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TSE: **IMX**

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Annual Meeting Date
June 7, 1999

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