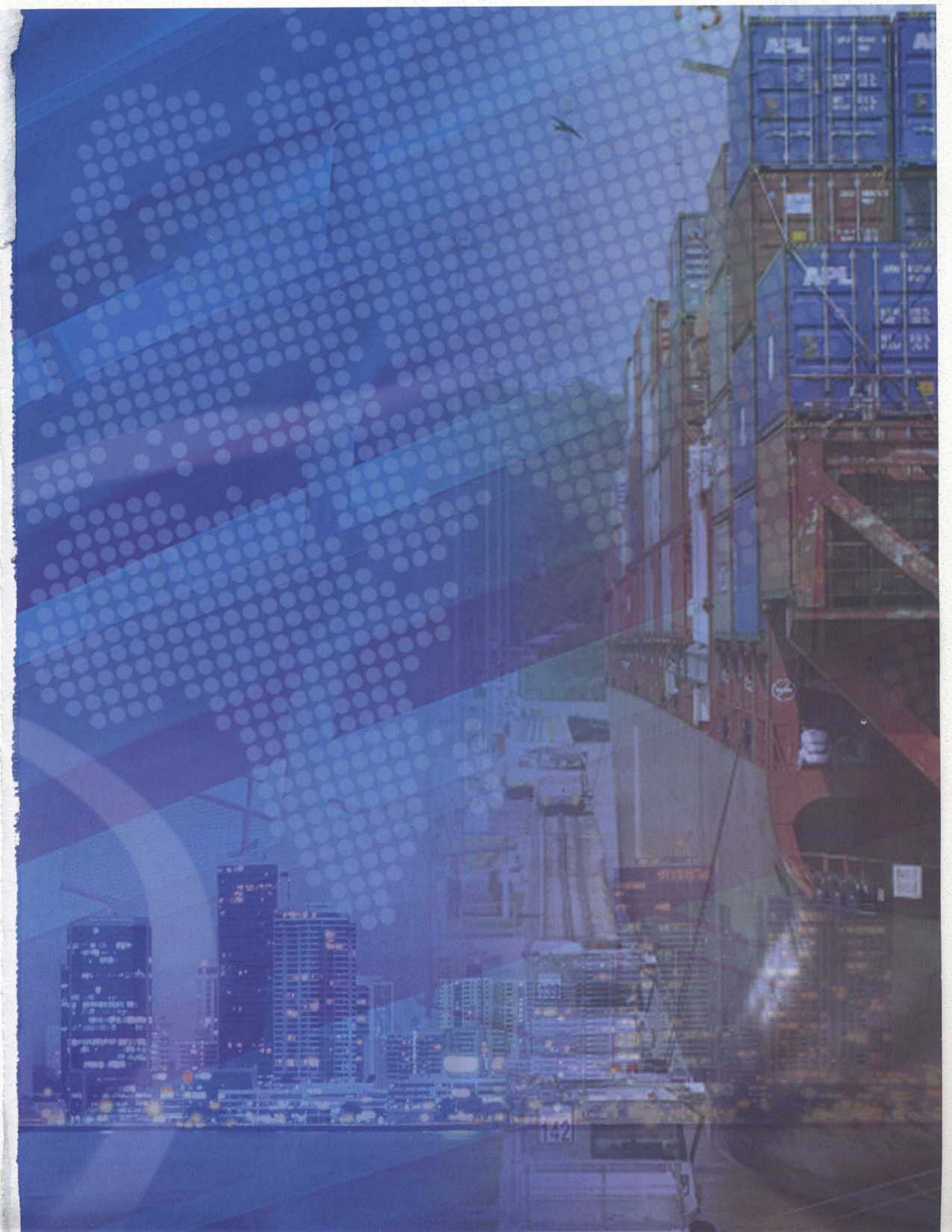




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board of directors



Ricaurte Vásquez Morales



Adolfo Ahumada



Eloy Alfaro



Norberto R. Delgado D.

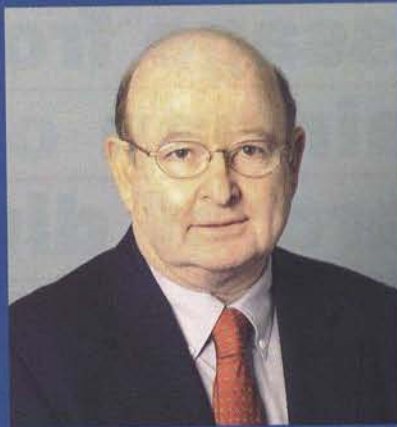


Antonio Domínguez Álvarez





Mario J. Galindo H.



Guillermo E. Quijano Jr.



Eduardo A. Quirós B.



Alfredo Ramírez



Abel Rodríguez Cañizales



Roberto Roy



First row, from left to right: Philip A. Embiricos (Embiricos Shipbrokers), Admiral William J. Flanagan (Skarven Enterprises), Joe Reeder (Greenberg Traurig), William A. O'Neil (Chairman) (Videotel), Albert J. Nahmad (Watsco Inc.), Captain Wei Jiafu (COSCO). Second row, from left to right: L. Francis Rooney III, Andrónico Luksic (Banco de Chile), Stephan Schmidheiny (Avina Foundation), Gerhard Kurz, Salvador Jurado (Building Components Group). Third row, from left to right: Dr. Aaron Gellman (Northwestern University), Flemming R. Jacobs. Absent: Dr. Ernst Frankel (MIT), Koji Miyahara (NYK Line), Mikio Sasaki (Mitsubishi Corp.), Tommy Thomsen (A. P. Moller), C. C. Tung (OOIL)

board of advisors

message from the chairman of the board of directors



The fiscal year ended on September 30, 2006 sets a landmark and a major milestone in the operation and management of the Panama Canal Waterway. Only seven years have lapsed since the Autoridad del Canal de Panamá took over the administration of the waterway, when it presented the organization and Panama as a whole with the decision to expand the Panama Canal by building a third sets of locks.

After six years of constant research, investigation and consultation, on April 24 of 2006 the Board of Directors of the Autoridad del Canal de Panamá, in a unanimous vote, proposed the President of the Republic and to all Panamanians the proposal for such expansion. This proposal was, in no minor way, the result of a commitment of the Administration and its Board of Directors, over the years, to assure a proposal that encompassed every relevant element for decision: from economics to operations, from environmental to social and national impact, from engineering to marketing. Years of efforts by ACP's, as well as international, professionals contributed to summarize, in one single document, the relevant elements of the capital expansion.

The effort was acknowledged and rewarded as 78.0 percent of the voters gave a clear mandate to proceed with the construction of the third set of locks, in a process that included a nationwide effort to share and learn from every interested individual, that was clearly reflected on the October 22 referendum. But the disclosure effort was not only limited to Panama. Given the international nature of our business, presentations were made to every stakeholder: customers, shippers, foreign governments and environmental groups were presented with the proposal and endorsed the proposal. Recognition has to be given to the Advisory Board and the Board of Directors of the Panama Canal for their timely advice.

Whilst a great deal of effort and energy was devoted to the presentation and approval of the proposal third set of locks, a commensurable effort has been devoted to current operations: 2006 has been a year of intense activity and new outcomes for the Panama Canal, which had a sustained growth in tonnage, transits and incomes. During this fiscal year the Canal accomplished 12,772 transits of oceangoing vessels with cargo capacity of 296.3 million PC/UMS tons, which represents 6.2 percent growth in comparison to the volume of previous year. The Canal had total revenues of B/. 1,494.8 million and contributed to the National Treasury a total of B/. 570.0 million. This contribution, the largest to date, included tonnage payments, payments for public services rendered to the Autoridad del Canal de Panamá, and the operation surplus that was due to Central Government.

Notwithstanding the sizeable contribution to the Panamanian government, the Canal continued its capital investment program. This program is aimed to marginally increase operational capacity while the third set of locks is under construction. As in the past, the administration is fully committed to continuously provide high quality service to our customers and to international commerce. In this context, total capital expenditures during fiscal year 2006 totaled B/. 162.3 million. This program included, among other projects, widening



and deepening the internal navigational channels, the additions of staging stations in order to improve vessel traffic scheduling, the acquisition of additional tugboats and the initial phase of improvements to the illumination system of the existing lock chambers.

Over the years, the Panama Canal has gained prominence as a key element in the international transportation system. By committing to high service quality and identifiable value added to its customers, the Autoridad del Canal de Panama has been in a position to realign its pricing structure to the value of the services rendered. This is a key element that supports the proposed Canal expansion program and it will be submitted to the market as early as the first semester of the following fiscal year.

As it has been a permanent of the Autoridad del Canal de Panama management and operation, the corporation remains committed to high values of social responsibility, to the protection of the environment, always critical to our operation and by serving international trade providing the maximum benefit to Panama and its citizenry. As we face new challenges into the future, we remain committed to the high standards and values that have led us to the accomplishments we enjoy today and are the foundation to our success in the future.

Ricaurte Vásquez Morales
President of the Board of Directors
Panama Canal Authority

administration



Alberto Alemán Zubieta
Administrator



Manuel E. Benitez
Deputy Administrator



Agustín A. Arias
Engineering and Projects Director



José Barrios Ng
Chief Financial Officer



Álvaro Cabal
General Counsel



Ana Maria P. de Chiquilani
Human Resources Director



Víctor Diamond
Inspector General



Juan Héctor Díaz
Safety and Environment Director



Francisco Loiza
Information and Technology Director



Stanley Muschett I.
Executive Administration Manager



Jorge L. Quijano
Maritime Operations Director



Rodolfo Sabonge
Corporate Planning and Marketing Director



Esteban G. Sáenz
Industrial Services Director

message from the administrator



We hereby submit the Annual Report for fiscal year 2006, a period marked by historical challenges for the citizens of the Republic of Panama in general, and in particular, for the Panama Canal Authority (ACP). This period ended with extraordinary performance records.

During fiscal year 2006, the Panama Canal moved 296.3 million Panama Canal tons (PC/UMS) of cargo, an increase of 6.2 percent from fiscal year 2005. Due to the growing demand generated by the strong boom in world trade, the Canal's PC/UMS daily cargo average increased to 859,000 tons in March 2006, breaking the record of 820,700 tons that had been established in April 2005. On March 13, 2006, we registered 1,070,023 PC/UMS tons, breaking the March 16, 2004 record of 1,006,807 PC/UMS tons that had transited the Canal. Also in fiscal year 2006, the record of 1,000,000 PC/UMS tons transited in a single day was surpassed five times. Likewise, we established a record for the highest daily and monthly Panamax ship transits - 24 and 539, respectively. The Canal also established a record in transiting ships more than 900 feet in length overall - we transited nine of these vessels in a single day.

The yearly number of maritime accident investigations is one of the most significant records for the ACP. It is noteworthy that, despite the growing volume of transits through the Panama Canal, only 10 accident investigations were conducted out of more than 14,000 transits. A similar record had been achieved in fiscal year 2004. This is of special importance because, in fiscal year 2006, the mix of vessels that transited the waterway had a higher percentage of Panamax ships, the largest vessels that are able to transit the Canal and require the most resources, skills and handling ability.

The financial aspect also reflected the efficient management of resources and expenses. The level of toll revenues represented an increase of 21.1 percent in comparison to the previous fiscal year with B/. 178.9 million in additional revenues. Total revenues increased 23.6 percent compared to fiscal year 2005, while expenses rose by 10.3 percent. This allowed the ACP to increase its contributions to the National Treasury (surplus payments) by more than 17.3 percent, thereby honoring its commitment to contribute to the sustainable development of the country.

As is evident, the figures for this period clearly show the commitment of our organization and its employees to offer to its customers a characteristically excellent service, which in turn results in greater benefits for the citizens of Panama.

In this regard, the major achievement of the ACP during this fiscal year was the submission of the Panama Canal Expansion proposal, on April 24, 2006, to the Republic of Panama.

This proposal was the culmination of many years of efforts during which exhaustive research and hundreds of studies were conducted, allowing us to prepare a strong proposal





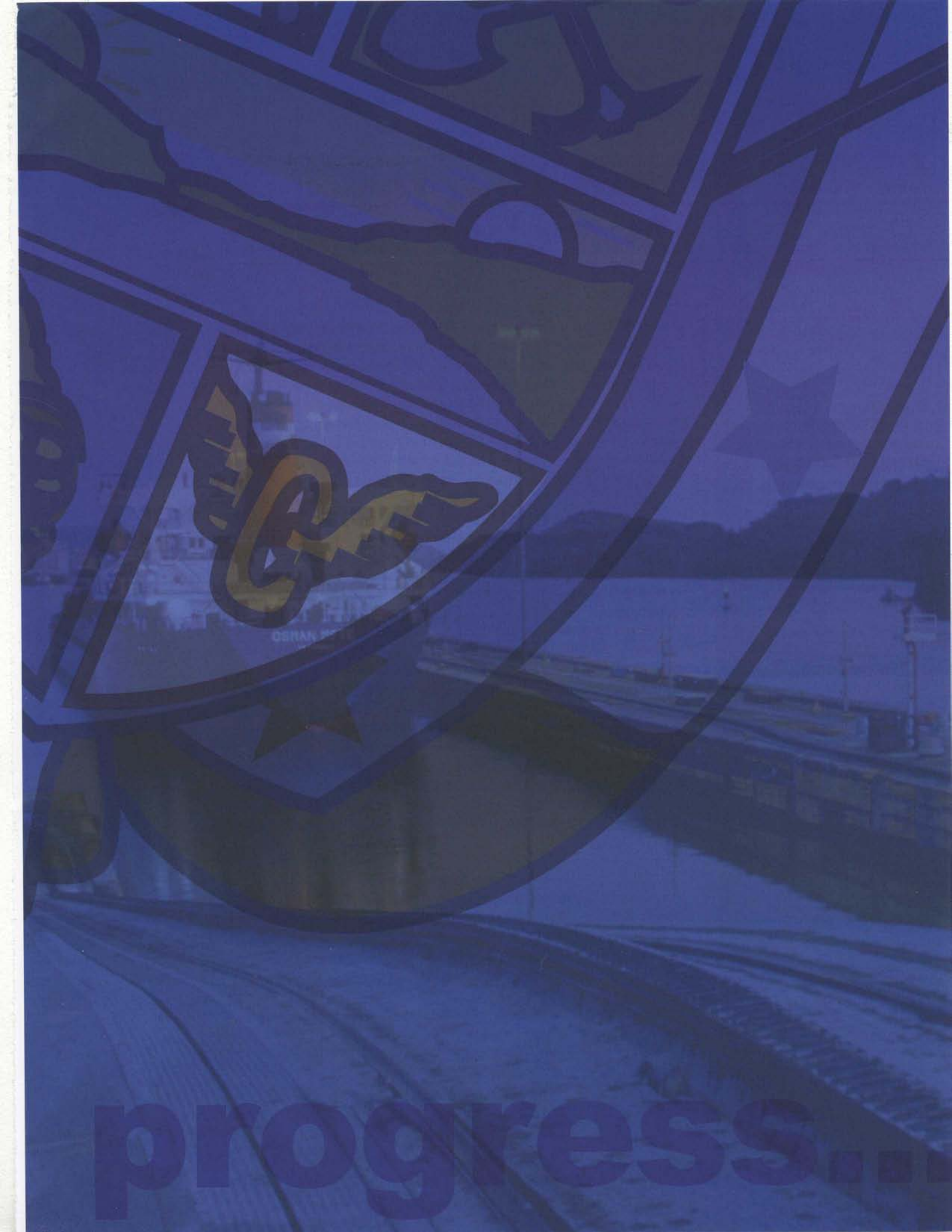
that provides a prudent and responsible outline for the interoceanic waterway's immediate future. The soundness of the proposal - submitted to resolve the pressing capacity problem of the Canal makes it an environmentally and socially responsible plan, as well as a financially viable one.

Upon submitting its proposal, the ACP immediately assumed the responsibility of informing all Panamanians about its content, scope, and effects by implementing an information campaign that covered the entire national territory of the Republic of Panama:

- * ACP employees were trained as spokespersons for the project and conducted an intensive information program in the various regions of the country;
- * Sixteen information centers or plazas were set up in the nine provinces and native territories;
- * An ACP Information Center was opened in the city of Panama; and information booths were installed at strategic mass traffic locations;
- * Two bus exhibitions toured the interior of the country;
- * The "ACP Responds" hotline was opened to receive inquiries from the general public; and, A media campaign was implemented to provide Panamanians with the necessary elements of judgment to form their own criteria and exercise their informed right to vote during the national referendum to be held on October 22, 2006.

The possible approval by the people of Panama in the October 22 referendum poses new challenges and responsibilities for the ACP. We are aware that in the new era that lies ahead, the ACP and its nearly nine thousand employees will act as the tools that Panama will utilize to undertake this project - one that will shape the collective destiny of the Republic of Panama. To that end, we shall devote all of our daily efforts and commitment to bring it to fruition and make our country proud.

Alberto Alemán Zubieta
Administrator



progress

growth... the ACP challenge



Through its first seven years of existence, the Panama Canal Authority has successfully completed an ambitious and challenging journey of institutional reaffirmation, of economic and financial strengthening and of market positioning aimed at establishing solid basis for the Canal growth during the XXI century. Prior to the transition to the Panamanian administration, the Canal had identified its opportunities of growth and had recognized the challenge represented by timely obtaining the capacity required by the upcoming demand. It was always clear that the Canal had to grow in order to strengthen its competitive position at a global level and, therefore, maintain the sustained and uninterrupted increasing contributions to the National Treasury.

It was determined that, in order to fulfill the current demand and still grow, it was necessary to invest on improvements to the existing plant, technology, new locks and trenches. Investments in the expansion of capacity would not only require the approval of Panamanians through a National Referendum, but also require the support and backing of its clients and users, of financial and credit institutions and of national and international groups concerned with environmental and social issues. To obtain the confidence and necessary support, ACP proposed and accomplished through these seven years of Panamanian administration, to make a more profitable, efficient, productive and safe Canal, demonstrating with transparency and capability, the capacity of Panama not only to properly administering its Canal, but also to develop it to its maximum potential.



Due to the timely investment in the modernization of the Canal and to the tenacious effort made by its more than 8,000 employees, more tonnage and bigger vessels transit the isthmus today than ever before. The Canal, due to its visionary modernization and investment initiative and more than 120 studies performed for "the Canal of the Future", holds an advantageous financial, economic and market position and will be prepared to assume and successfully perform the challenge represented by the construction of a third set of locks.

Demand opportunity

A relevant number of factors join to give Panama and its Canal a solid growth opportunity. After the Cold War, the world began a phase pronounced by opening markets, remote relocation of production centers and commerce intensification, and the globalization phenomena that force the increase of volume in maritime transportation that are, therefore, favorable to the use of the Canal.

Among the relevant trends for the Canal, is the consolidated export oriented economic development of Northeastern Asia and the inclusion of China in the World Trade Organization. The growth of Asian export has its counterpart in the economic and consumer boom of the United States, especially on the East Coast, which concentrates an important volume of population. As a result, a sustained growth of general transpacific



commerce is expected specifically of maritime transportation of manufactured products between Asia and the U. S. East Coast and raw material to Asia, providing a firm and sustainable growth opportunity for the route through the Panama Canal.

The route through Panama has been favored by the chronic congestion of the ports on the West Coast and by the lack of capacity of the North American intermodal railroad system. This has favored the relocation of the merchandise distribution centers to the United States East Coast, closer to their destiny and the increased of capacity of the ports of the region favoring even more the "all water" route through the Isthmus of Panama.

On that direction, it is expected that 20 years from now the demand on the Canal will double, almost reaching 600 million PC/UMS tons by fiscal year 2025.

Challenge to capacity

Capacity challenges for the Panama Canal have two main dimensions. On one hand, it requires increased capacity to transit more tonnage and more vessels. On the other hand, it requires capacity to transit bigger vessels. In terms of transiting tonnage, the Canal operates close to 90.0 percent of its maximum sustainable capacity and faces a real short term lack of capacity to transit the estimated tonnage volume.

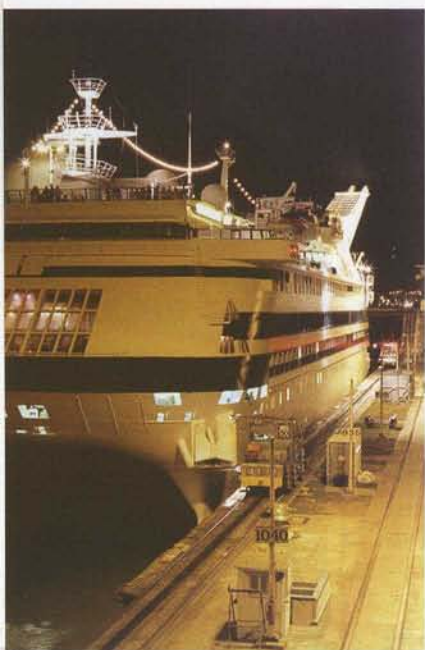
It is foreseen that at this growing pace on the demand, the Canal will reach its maximum capacity between 2009 and 2012 when approximately 13,500 vessels transit every year carrying 325 millions of PC/UMS tons.

The situation is even more compelling every time the Canal closes one set of locks for maintenance since capacity is then reduced in more than 30.0 percent. The Canal leaves inoperative one of its locks between four and five times a year, for a maximum of seven days each time. Each day that the Canal keeps locks closed, 10 to 12 vessels accumulate adding up in a line of 100 waiting vessels in a week which takes several more weeks to normalize.

The great amount of cargo produced by the intensification of trade; by the relocation of the production centers and the need to operate more efficient and reliable logistical chains have forced the use of bigger vessels. It is already common the use of postpanamax vessels with a capacity for 12,000 containers and that do not fit into the existing locks.

The container segment represents nearly 40.0 percent of the income and 35.0 percent of the tonnage volume of the Canal and constitutes the segment with fastest potential growth through the Canal in the future. The Canal must acquire locks with dimensions that enable it to maintain this market and take the maximum advantage of its growth. It is necessary to remember that the Canal bills for the cargo capacity of the vessels. Therefore, it is convenient to transit the bigger vessels interested in taking this route.





It is estimated that the container segment will represent nearly 60.0 percent of the cargo volume through the Canal by 2025. Within the next 10 years, more than half of the capacity of container cargo will be in vessels that do not fit into the existing Canal. Canal clients have stated they would deploy postpanamax vessels through the Panama Canal route as soon as the Canal is able to transit them, by the year 2025 the Canal would receive more than 3,000 annual transits of postpanamax container vessels with a capacity equivalent to transiting nearly 6,000 panamax vessels. The transit of postpanamax vessels will allow the Canal to maximize its income and reduce operational costs, transiting the largest estimated amounts of cargo more efficiently, with fewer transits and using smaller amounts of water.

The importance of widening capacity now

The existing Canal will reach its maximum sustainable capacity within 6 years. Nowadays, each time the Canal gives maintenance to the locks, the demand already exceeds capacity and an unacceptable waiting line of vessels is immediately formed.

The ACP is finishing the last capacity improvements to the existing Canal and once finished, the existing Canal will have reached its maximum capacity which will be irremediably limited by the mechanical and physical operation cycles of the locks. To provide the Canal with greater capacity, it is necessary to provide it with additional locks and trenches, within an estimated construction time of seven years.

To keep its market share and maintain its increasing contributions to the National Treasury, the project of the third set of locks must be built while the Canal still has capacity to stay attractive and reliable for its clients so that it does not interrupt service or leave unattended demand. The widening must be completed promptly and diligently so that the Canal does not lose clients or allows viability to new competitors.

We have the advantageous opportunity and favorable conditions to invest in the Canal. The tonnage transiting the Canal is increasing, its competitors are congested, clients support it, and the project for the third set of locks is solid, profitable and environmentally responsible. We face another unique window of opportunity that will not repeat and is valuable to strengthen the growth of the waterway and its contributions to Panama. Since it has been determined that the Canal will reach its maximum capacity by 2012, and that the operation of the third set of locks will take nearly seven years, the challenge to the capacity is imminent and its solution is urgent.

It is a job we must build while we continue to manage the existing Canal in a safe, profitable and reliable manner. The compelling situation of lack of capacity of the existing Canal shows that we must strive to the maximum, with creativity to extend the capacity



and the high level of service of the existing Canal until the third set of locks is ready. The objective is to achieve an uninterrupted growth of transits and contributions to the National Treasury while the widening is constructed. The transition to the widened Canal must be accomplished in the same imperceptible way as the transition to the Panamanian administration was done, with no market loss and no interruption of growth.

Feasibility of the project

The project of the third set of locks is a profitable investment for the Canal as well as for Panama. The Canal will receive a return rate of 12.0 percent on the investment and for the country it will represent an additional growth of its gross internal product between 1.0 percent and 2.0 percent during the next 20 years with a social profit of between 11.0 percent and 14.0 percent. The widening of the Canal will provide benefits to the Panamanian economy that will surpass the costs of the resources used in its construction and complementary activities.

It is estimated that the project will create approximately 7,000 direct and between 35,000 to 40,000 indirect job opportunities during the most intensive phase of construction. Once the third set of locks is inaugurated, the increase in transits and the economic and export activities related to the conglomerate of services will create between 150,000 and 250,000 additional job opportunities nationwide.

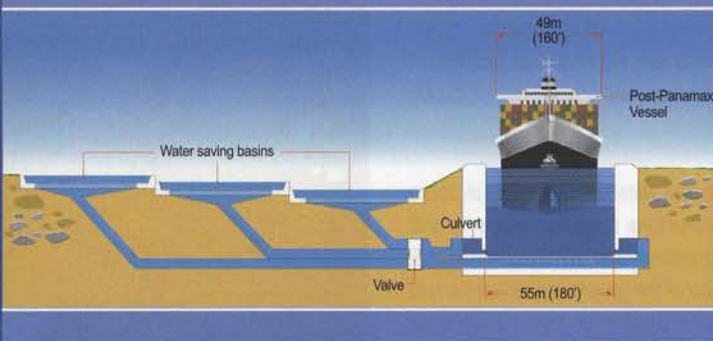
Due to its national relevance and international projection, the widening of the Canal, more than any other construction project will constitute a milestone towards prosperity and development. Its discussion and approval in a national referendum will break the inertia and will get wide economic segments in movement in lieu of the growth expectations and opportunities. The widening of the Canal as a catalyst for positive change, will give the country an optimistic perspective, internally and internationally. Its effects can already be perceived in increased investments, general optimism and anticipation of progress for the country.



Conceptual Isometric View of the New Locks Complex

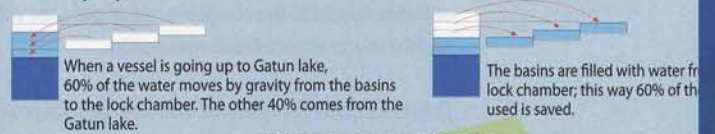


Cross Section of the New Locks Complex



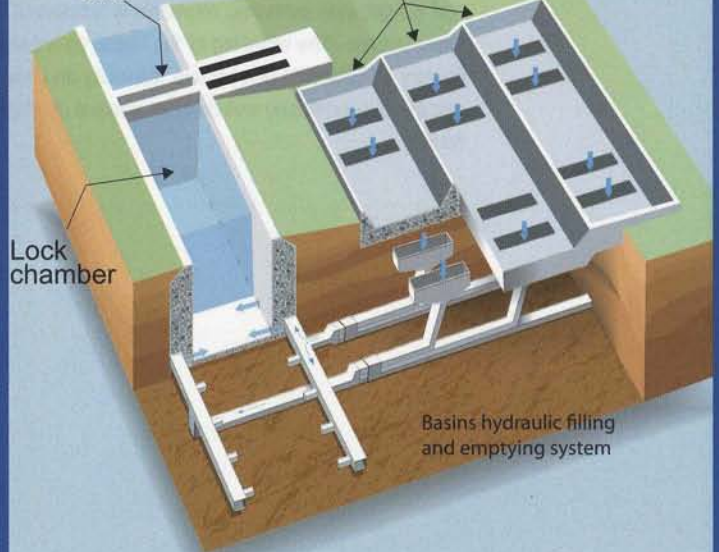
Isometric View of Water Saving Basins

Gravity System

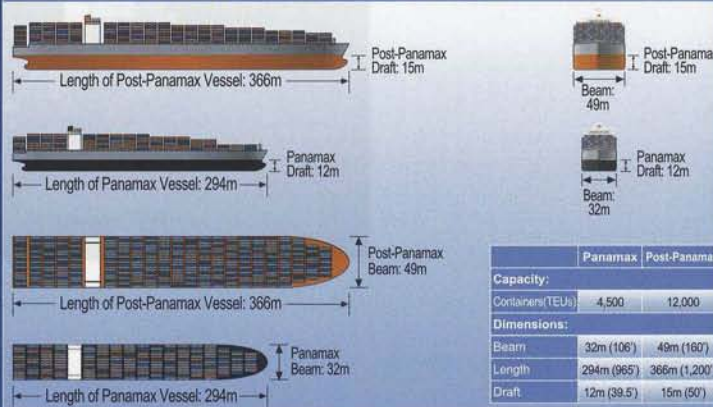


Water saving basins

Rolling gates



Comparison between Panamax and Post-Panamax Container Vessels



growth... the third set of locks



A well analyzed project

Since the 1930 decade, studies of the capacity expansion of the Canal had determined that the most effective and efficient option to endow the Canal with more capacity is by means of the construction of a third set of locks. In 1939 the North Americans began the construction of a third set of locks designed for navy vessels capacity, whose sizes (postpanamax) exceeded the Canal locks dimensions. After significantly advanced in the excavations for the new locks, the North Americans suspended the jobs indefinitely in 1942, as consequence of its entrance to the Second World War.

In the 1980-decade, the three party Alternatives of the Panama Canal study performed by Panama, Japan and the United States, retook the subject of the Canal expansion and as well as the North Americans in their studies of the 1930 decade, concluded that the construction of a third set of locks for vessels post-panamax was the most adequate alternative. Today, more than 120 studies, models and analysis performed by ACP within the years 2000 and 2006, as part of the Master Plan 2006-2025, confirmed that a third set of locks using the actual Canal route and with greater dimensions that the actual locks, would be the most adequate option to increase the Canal capacity and allowed that the route through Panama continue growing.

To prepare the project the ACP with the advice of prestigious international consultants and the participation of hundreds of Canal experts, analyzed multiple designs and options where the most approved relevant technology was taken in consideration. In the process of project design worked experienced Pilots, Locks Engineers and Canal Tug Captains, who analyzed and inspected the existing post-panamax locks operations around the world and afterwards they tried for several months multiple lockages maneuvers and techniques, where they confirmed the operation schemes feasibility and the configuration of a third set of locks.

The navigation channel design took in account the successful experienced of Canal navigation as well as the guides of the Permanent International Association of Navigation Congress (PIANC), by which the configuration of new waterways is functional, efficient and secure. These designs were tried using the advanced marine maneuvers simulator of the ACP.

The third set of locks project is based on complete engineering designs and on six years of rigorous investigations of the marine industry, marine transportation technology and on the current potential market of the Canal. The locks and the navigation channels dimensions to be constructed are configured for the objective market of the Canal and are capable to transit vessels nearby the 150 marine routes through Panama. The users, the





steamships as well as the experts of the naval industry and the Advisors Board of the ACP confirmed the dimensions of the new locks. The third set of locks project is correctly conceived to transit with absolute certainty and efficiency the vessels that will use the Canal route in the future.

New locks for an increasing market

The third set of locks project is a whole expansion program of the Canal capacity which three main components are: (1) the construction of two locks complexes - one in the Atlantic and the other in the Pacific - each one of three levels, including water basins; (2) waterways excavation access to the new locks and existing navigation channels expansion, and; (3) the deepening of navigation channels and maximum elevation level of the Gatun lake. The program of the Canal expansion capacity is a job that will be executed in a sinuous construction of 80 kilometers of length within seven or eight years. A work that must be understood as a sum of multiple components and phases; being the locks as the most visible and prominent element.

Currently, the Canal has two locks lane. The construction of two locks complexes; one in each extreme of the Canal will add a third lane. Each new complex of locks will be a whole set of three consecutive chambers or steps to move the vessels between the ocean level and Gatun lake. Each chamber will consist of three water basins, which added nine water basins for each locks complex and totaled 18 water basins. As in the current locks, the fill and empty of the nine locks, with its water basins, will be by gravity without using pumps.

Both locks complexes will be located inside the patrimonial area of the PCA, next to the current locks. The new locks and waterways will formed a whole system of transit and navigation with the existing locks and waterways.

A locks complex will be located at the extreme of the Atlantic Ocean of the Canal, and the East side of Gatun Locks. The other one will be located at the extreme of the Pacific Ocean of the Canal, at the Southwest of Miraflores Locks. The location of both locks complexes used a significant portion of the excavations of the third set of locks suspended by the North Americans in 1972.

The new locks chambers will be of 427 meters (1,400 feet) of length by 55 meters (180 feet) wide and will allow up to 15 meters (50 feet) of depth. To position the vessels, the new locks will use tugs instead of locomotives, which is also high technology used in locks of similar dimensions. The locks will use rolling gates instead of miter gates that are used by the current locks. The rolling gates are confirmed technology used in almost all the existing locks of similar dimensions.

Rolling gates, the best alternative

All types of feasible gates were studied for the new locks, and it was determined that the rolling type, fully used in locks of post-panamax dimensions are the best option. As in the current locks, the new ones will have two gates in each extreme of the chambers. The rolling gates will slide on the rails when open and saved on lateral recess; these recess when closed and dried will be used as watertight compartments to provide maintenance to the gate. The maintenance of these gates





will be faster, secure and efficient than the existing miter gates, due since the maintenance of each gate will be done in its own recess avoiding cost, time consuming and risk of having to dismount and transfer each gate to the dockyard for its maintenance and repair.

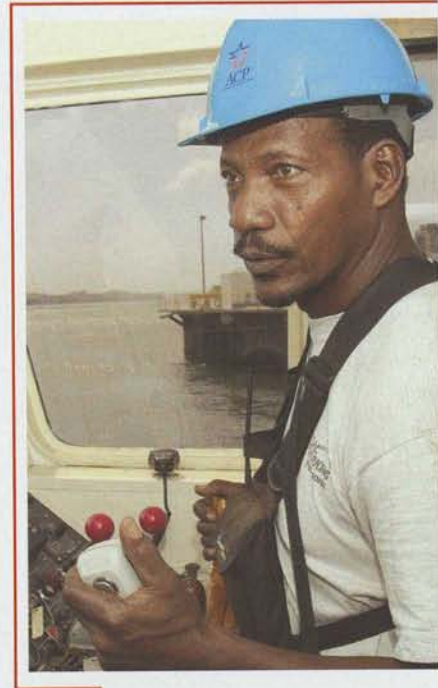
The rolling gates including its recess have an equivalent cost as the miter gates, since the miter gates, as the actual locks, due to the stoop against the chamber requires a longer locks chamber. Due to the lack of a recess, these have to be removed from the locks and taken to a shop for maintenance. These removing and reinstallation operations forced to suspend temporarily the locks functioning and reduce the Canal capacity.

In risk matter, having reduced maintenance time and avoiding gate transferred, the period the locks operate with one gate will be reduced and transit will be more trustful and predictable. The recommended rolling gates do not need interruption in locks functioning, therefore; the capacity and flexibility of locks operations increases, allowing a shorter maintenance time with lower cost and with less risk. The rolling gates are the most effective and secure option, key factors for the Canal operation whose market value trustful and security of the route.

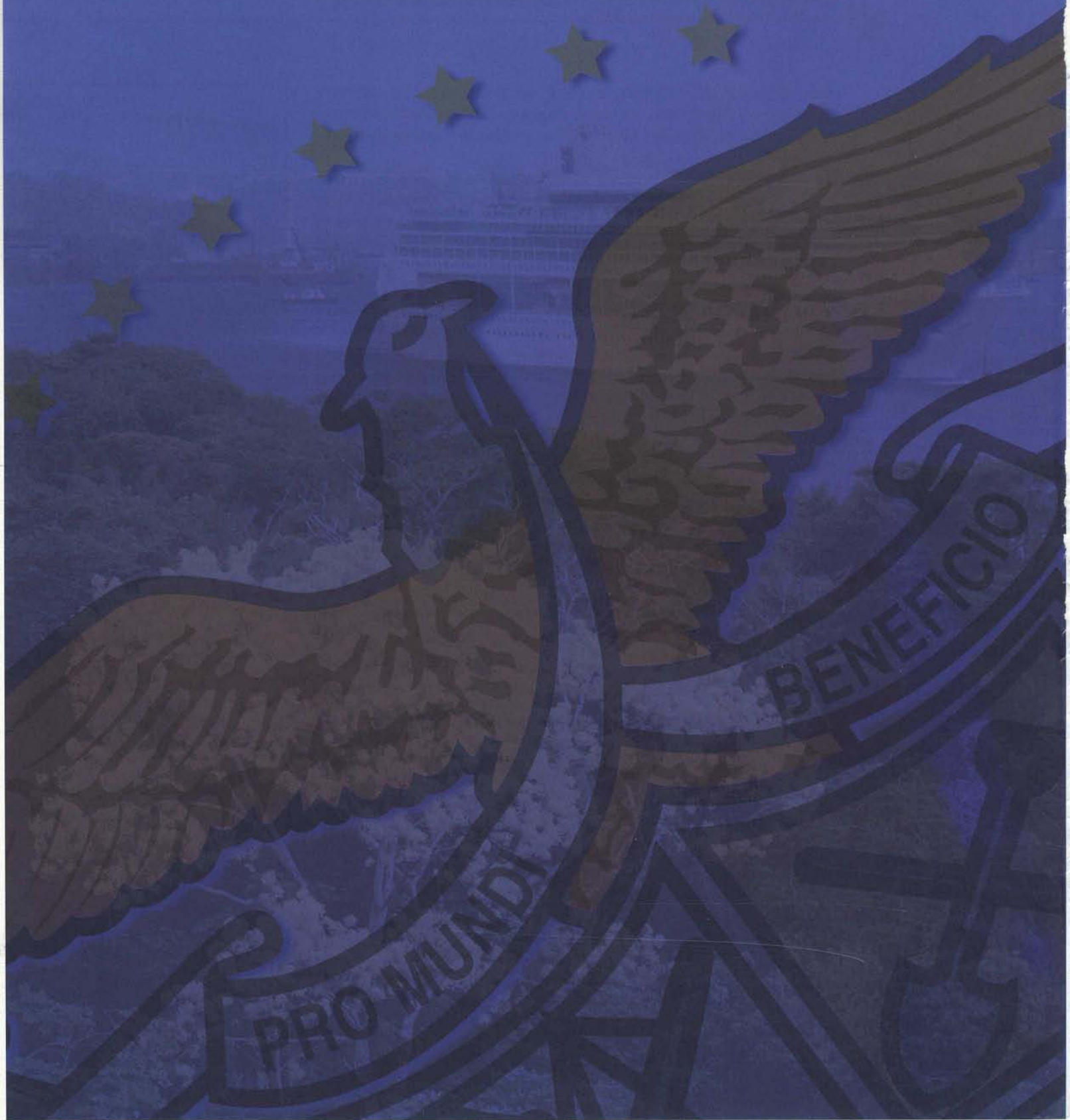
More loads with less water will transit

The third set of locks project as part of the environmental conservation strategy and supported development of the ACP has as part of its key objectives, to take advantage of the hydrological regulations of the watershed to improve efficiently the use of water. Two components of the project are: 1) deepening the navigation channels of Gatun lake, and 2) increasing the maximum level of the functioning of the lake to expand the capacity of water of the Canal, to improve all the pluvios of the watershed. A third component of this project are the water basins that will permit the reutilization of 60.0 percent of water of the new locks, even though the volume is double from the actual locks, using 7.0 percent less water.

Once the new locks are functioning the amount of water used to transit each PC/UMS tonnage will be reduced. Another reason of the convenience of a larger lock is that it will allow more hydrological resource efficiency, avoiding the construction of new dams for the expanded Canal.



flora and fauna...



growth...

environmental and social impact

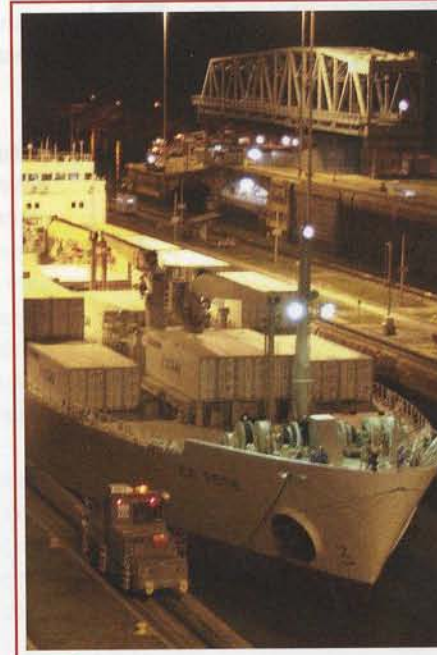
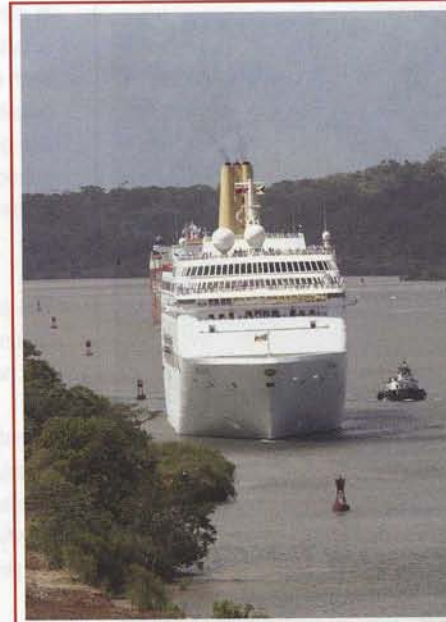


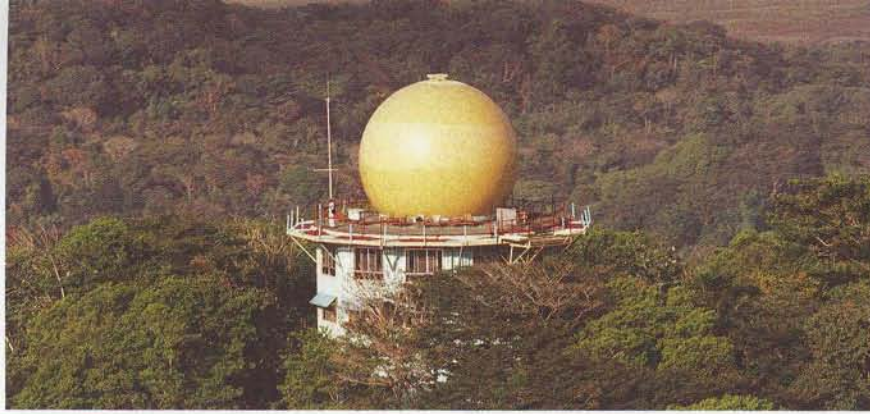
The Panama Canal Authority recognizes it is necessary to administer the water way with criteria that take into consideration the social and environmental expectations of all Panamanians, giving special importance to the communities bordering the waterway. On this sense, by principle and framed by the strategic mission of the ACP, the project of the third set of locks has been formulated to be socially and environmentally feasible regarding the most demanding standards.

To that effect, the ACP has formulated, at corporate level, an environmental and social strategy of sustained development with programs destined to the conservancy of the environment and the natural resources of the Canal watershed. The purpose of this strategy is to guarantee the long term availability, quality and sustainability of hydric resources for human consumption as well as for Canal operation. In consequence, the project of the third set of locks is framed in environmental principles accepted worldwide and incorporates adequate analysis, selection, consulting, alleviation and follow up processes.

As every engineering project of wide scope, the construction of the third set of locks implies effects on the environment and social surroundings. To formulate the proposal for the widening of the Canal, the ACP developed a multidisciplinary range of environmental, scientific, social and technical studies on recognition, diagnoses, prospection, pre feasibility and evaluation levels. The results of these researches were used to evaluate and compare the different options and components of the project, determine the possible impact and benefits of each one of them and conform an environmentally equilibrated, sustainable and responsible proposal. Through these studies, it was determined that all possible environmental impacts of the widening program can be mitigated by existing procedures and technologies, with no adverse impact on the communities bordering the Canal or on the environment in general. The project has been formulated following sustainable construction and clean operation concepts. In that sense, it has been designed so that the water flows by gravity and not by bombs, requiring very few components operated by electricity, will have long and spaced maintenance cycles and the maintenance of vital components will be provided on site with a minimum impact on the environment.

The project of the third set of locks will be carried out within the Canal operating areas. In the area of the project, there are no elements compromising its environmental viability, such as, communities, primary forests, national parks or forest reserves, relevant patrimonial or archeological sites, farming areas, tourist or port areas and it has been determined that the project, during its construction as well as in operation, will not cause any permanent or irreversible adverse impact on the quality of water or air.





In general, the project will be developed in areas that have previously been intervened by diverse activities. The most relevant environmental impacts will be the usual to any construction project, such as noise, emissions from the construction equipment, erosion and airborne dust. All these possible environmental impacts can be mitigated by the use of existing procedures and technology and good construction and environmental management practices. Therefore, no relevant adverse impacts are foreseen to the population and to the ecosystem or to communities or human settlements.

Water will be utilized to its maximum, in the most efficient way

The purpose of the proposed program of water provision is to use the maximum capacity of the Gatun and Alhajuela lakes and apply the most efficient technology in water usage to the locks, so that no new dams will be necessary.

In that sense, the proposed technology of basins for water reutilization is the most efficient system to reduce the volume of water that will be used in the new locks. Those basins are water storage structures, adjacent to the chambers of the locks and connected to them by culverts regulated by valves. These basins will allow reusing 60.0 percent of water and will allow the proposed locks use 7.0 percent less water per lockage than the existing locks.

Beside the use of basins, the expansion project will maximize the performance of the basin by deepening the navigation channels and increasing the maximum level of operation of Gatun lake. These two components of the program will allow the maximum amount possible of water from the basin to be utilized guaranteeing the water supply for future generations, as well as for the Canal operation.

Water quality in lakes

Water from Gatun and Alhajuela lakes is extracted for municipal consumption. The IDAAN takes water from the Alhajuela reservoir to operate its treatment plant in Chilibre. However, this lake will not be affected by the expansion project. Gatun lake, which provides water for the Miraflores, Mount Hope, Escobal, Sabanitas, Gatuncillo and Laguna Alta treatment plants will maintain its tropical fresh water characteristics with stable ecosystems, and its waters will remain within the standards of quality required for potabilization and human consumption. This premise was at the center of the selection of locks options considered for the Canal expansion. The ACP can support this statement on the simulations that indicate that the three step system acts as a barrier to the entrance of salt water into the lake.

Gatun lake was formed nearly a century ago with the construction of Gatun dam which flooded the lower reaches of the Chagres, Ciri Grande, Trinidad and Gatun rivers. It is an artificial lake that in its short period of existence has developed ecological systems and an aquatic biodiversity comparable to those of natural lakes. Gatun lake provides water for human consumption, for Canal operations and for hydropower generation. In addition, Gatun lake functions as a navigation route for the vessels that transit through the Panama Canal.

Effect of Raising the Maximum Operating Level of Gatun Lake and the Deepening of the Navigational Channels



The component to raise the maximum operating level of Gatun lake 45 centimeters increases the usable storage capacity of the reservoir and provides the Canal hydrological system with an average 165 million gallons of additional water per day. This additional water volume is sufficient to provide water for approximately 1,100 lockages or the equivalent of 75.0 percent of the actual annual water consumed by the communities that obtain their water from Alhajuela and Gatun lakes.

Raising the maximum operating level of Gatun lake affects primarily sites within the areas under ACP administration. But even though the maximum operating level of Gatun Lake are within ACP established limits, there are structures in nearby areas that would have to be modified, resettled or retrofitted; such is the case with some shops, docks and buildings, primarily in Gamboa.

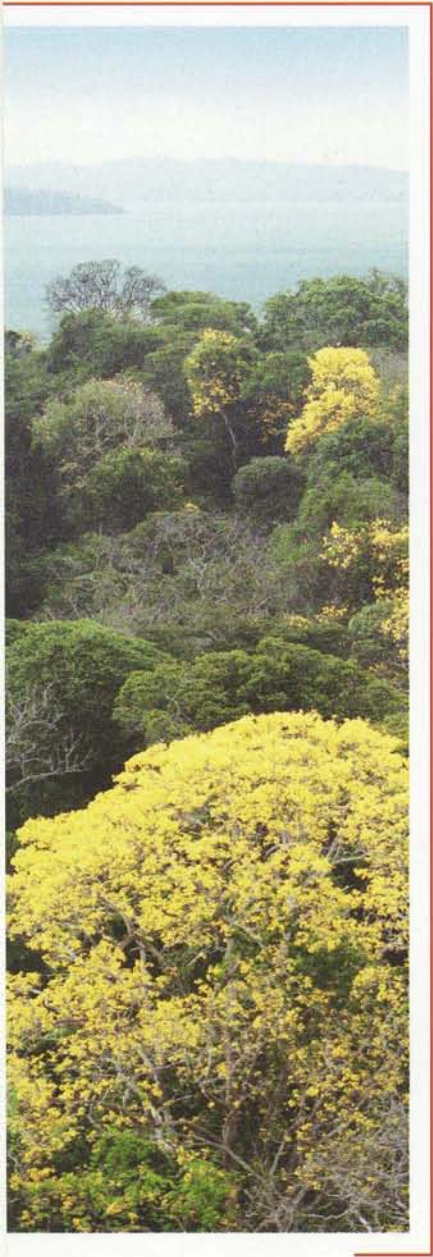
The operation of the third set of locks does not require any additional dams. Therefore, it will not be necessary to resettle any communities.

Vast archeological and paleontological prospections, of the sites where the new locks and trenches would be located, have been performed and it has been determined that there are no probabilities of any archeological, cultural or scientific discoveries in the area. On that sense, appropriate measures will be taken in coordination with the competent authorities, to protect and safeguard all cultural, patrimonial and historic resources that may be discovered, before, during and after the construction of the project.

Taking care of the flora and fauna

The areas where the new locks will be located, the navigation channels and the sites for dumping the excavated material have been intervened by human activities in many occasions since the construction of the Canal. These places have a vegetal cover mainly composed by grassland, stubbles and secondary woods in different stages of development. Besides, the areas identified as possible dumping sites are inhabited by very few species of flora and fauna of special interest. It has been determined that the species that may be affected are of wide distribution in nearby areas, as well as in the rest of the national territory. Since the beginning of the Panamanian administration of the Canal, the ACP is constantly monitoring the natural surroundings of the Canal and devotes resources, personnel and effort to its conservancy and protection.

The new alignments will not directly affect in any manner the protected areas located within the Canal watershed. The major impact on the terrestrial biotic aspects is the loss



of vegetative cover. This impact is considered important because it is associated with direct and indirect effects on the associated flora and fauna.

With respect to the flora, the major impacts relate to the loss of cover in the areas to be excavated for the new alignments, locks, water saving basins in addition to the areas to be used for disposal sites, shops, field offices, parking facilities, most of which are to be located at a 200 meters distance on both sides of the alignments.

ACP has estimated that the area to be affected by removal of vegetation for the new locks construction project is approximately 236 hectares of secondary forests, 82 hectares of shrubbery and 286 hectares of grasslands. ACP has also calculated that 260 hectares of fragmented secondary forests could be affected with the expansion and preparation of upland excavation material disposal sites.

To mitigate the one significant environmental impact of the expansion project, that is the loss of forest cover, ACP has included within the project costs, estimates for the ecological compensation fund. These funds can be used in the reforestation of an area approximately the same size as the affected, or in the protection of an existing forest with similar characteristics as the fragments of forests in the project area. As a comparison, mature forests in the Canal watershed cover over 159,000 hectares, which means that the loss of secondary tracks of forests as a result of the expansion project would affect less than 0.3 percent of the total forest area of the region.

Another impact is the effects on the fauna that inhabits the areas to be affected. As the vegetative cover is removed, its loss can alter the distribution and behavior of the animal species. Those that are less mobile might perish. Other species might be affected indirectly by the fragmentation of habitats, noise and vibration, and the disturbance of feeding or reproductive areas.

ACP is considering the rescue and relocation of wild fauna to be affected, an activity that has to take place before and during construction. The studies conducted by the Center for Biotic Studies of the University of Panamá, URS, and the Louis Berger Group indicate that all the species existing in the areas to be affected by the Canal expansion project are widely distributed throughout the country. The project will not endanger or cause the extinction of any of the species of fauna identified in the environmental studies.

The construction of the third set of locks will not affect primary woods, protected areas, national parks or forest reserves. Neither will destroy or endanger any species and, in any case, will take the necessary measures and actions to mitigate the possible impact of the construction on the fauna and flora. The ACP, in coordination with the National



Environment Authority, will rescue and relocate in adequate ecosystems the wild species before the construction work is started, will protect the flora and fauna during the construction and will provide follow up and sustainability to the species after the project is completed.

Excavation material

The excavation works for the construction of new locks and alignment channels in the Atlantic and Pacific generates considerable quantities of dry material. Similarly, the widening and deepening of the navigation channel and the deepening of the Culebra Cut will also result in the generation of large quantities of dredged material.

Dry material from the new locks excavation and channels will be disposed of in the sites previously evaluated for this purpose. It is important to note that most of the disposal sites selected have been historically Canal operating areas and therefore, their use for the construction of the project implies that natural areas are not affected.

ACP studied numerous possible sites for depositing the excavation material. Most of these sites have been used since the original construction of the Canal and are still being used as deposits for material produced by the many dredging, channel widening and stabilization of slopes works routinely performed by ACP. During the process of study of the project, ACP evaluated new sites for their potential to produce usable lands or to win some land to the sea by marine or terrestrial fillings.

It is intended to deposit the excavation material in the sites closer to the excavation and dredging works, because of the reduced transportation costs and the reduced environmental impact this represents. All the sites recommended for depositing the excavation material are located within the operation areas of the ACP and it has been determined that they will not be any severe environmental impact on those sites.

ACP develops and maintains updated environmental evaluations for each of the sites it uses to deposit excavation material, and permanently applies an environmental management and recovery plan. Once each construction phase is completed, these sites will be reforested and rehabilitated and the ACP will provide follow up to the environmental recovery and sustainability of these areas. Besides, before and during the construction, the ACP will continue evaluating opportunities for taking economic advantage of the excavated material.

work...



growth... for the future of panama and panamanians



The Panama Canal has a significant impact on Panama's national economy. The operation of the Canal results in direct payments to the Panama National Treasury, which amounted to B/.569.7 million in 2006. In addition, the Canal makes other contributions in the form of Social Security, income tax, and educational insurance payments made by Canal employees. Other such contributions to the country's economy are the wages paid to employees and the purchases the Canal makes from local suppliers. All these items represent approximately 7.0 percent of Panama's Gross Domestic Product in ordinary terms. Nonetheless, the impact of the Canal on the country's economy is considerably broader, as it involves a significant exportation of Panama's services as the generator of maritime and other related economic activities.

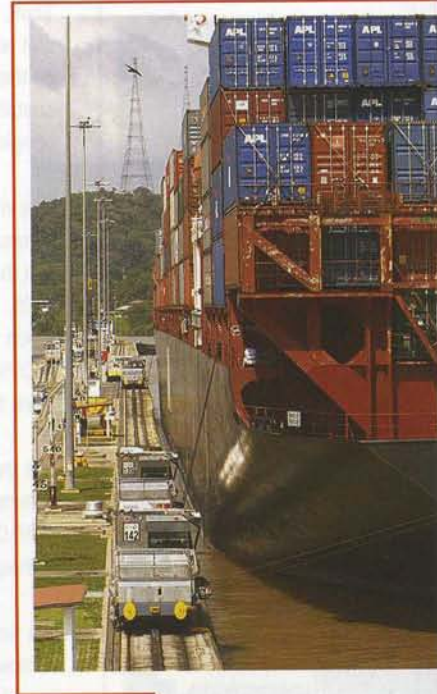
Canal operations are basically service exports. Revenues are mainly generated by Canal users and as such, they are part of Panama's total exports, which in turn create the basis for its growth with the jobs, investments, use of technologies, and training they generate. Each balboa generated by the Canal in exports has a multiplying effect in the country's economic activity, since its circulation within the country results in secondary demand for other goods and services.

These operations are the core of additional economic activities which arise as a result of Canal traffic (such as shipping agencies and ship bunkering) or are located in Panama due to the international competitiveness that Canal traffic adds to Panama's geographic location (such as its ports, the Colon Free Zone, and the Panama Railroad). These economic activities are classified in a group known as the Canal Economic System (CES).

There are other service export economic activities located in the Panama Canal traffic zone whose growth has been spurred by Panama's currency and fiscal system, as well as by special laws (such as the country's Merchant Vessel Registration system, its banking center, and its legal services), increasingly related to the CES. For example, the Colon Free Zone depends partly on bank credit, Canal traffic, and the ports in Panama. The Colon Free Zone and the Tocumen International Airport complement each other.

As all these economic activities intertwine, they are becoming an economic conglomerate that generates the exportation of multiple services that increase its productivity and competitiveness.

The resulting revenue generated in this manner circulates through Panama's domestic economy creating secondary demands for other goods and services, with a multiple impact in the economy and the attendant increase in production, tax revenue, and employment.





Thus, the impact of the expanded Canal on Panama's domestic economy should be seen as one that reflects its export-generating functions, as a great part of Panama's economic growth depends on the exportation of services by the CES and the Conglomerate. An expanded Canal will allow a sustained increase in Canal traffic (more cargo transits), and a higher increase in the CES, the conglomerate, and Panama's economy as a whole.

This means that the benefits of the Canal expansion will not only come from an increase in direct revenues, but from the level of economic activity throughout the entire conglomerate. It is estimated that the expansion of the Panama Canal will allow a threefold increase in CES exports by the year 2025. It may also generate a 40.0 percent increase in investments in the rest of the conglomerate, which by the year 2025 may reach B/. 1,100.0 million per year. The Gross Domestic Product (GDP) shall be approximately 2.5 times the 2005 GDP, equivalent to an average growth rate of more than 5.0 percent per year in the next 20 years.

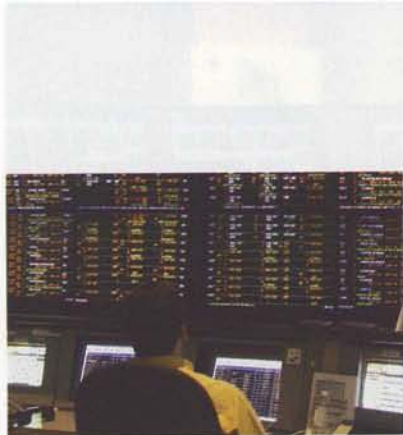
The impact of the Canal expansion in employment will come initially from the jobs directly and indirectly generated by the economic boom that will come during the years of project construction, estimated at 35,000 to 40,000 new positions. During the peak construction years, between 6,500 and 7,000 of these jobs will be directly related to the Panama Canal expansion program.

It is worth noting that since the project is designed for its development by both the ACP as well as contractors, it will create two job supply base flows. For the first one, ACP will perform dredging work for the expansion project, specifically to deepen and widen the navigation channel in the area of Gaillard Cut. For the second one, ACP will administer the contracts for the excavation, construction, and dredging of the Pacific and Atlantic entrances of the Canal. Thus, the expansion of the Canal will require various job skill categories.

For the portion of the project requiring the dredging of the navigation channels to be performed with ACP personnel, positions have already been identified, such as dredge operators, dredge engineers, dredge seamen, oilers, open-air blasting personnel, drill equipment operators, engineering technicians, launch operators, seamen, and drill barge chief engineers, among others. For the administration of the project, another series of positions have been identified, such as project managers, engineers, inspectors, programmers, budget analysts, and communicators. The Human Resources Department has been making preparations to face this demand for technical and professional jobs with a data base of in-house employee candidates and outside applicants that may enable it to handle the internal needs for most of the required positions.

On the other hand, contractors will be conducting excavation and dredging projects, the construction of the third set of locks, as well as in various other related contracts that will result during the various phases of the projects. Therefore, contracting companies will directly generate employment for masons, fitters, carpenters, blast handlers, heavy equipment operators, welders, foremen, project managers, inspectors, surveyors, engineers, engineering technicians, programmers, and administrative support and logistical personnel, among others.





In the same manner as the Canal expansion project's multiplying effect, it will also stimulate a series of activities for the supply of goods and services that will generate opportunities for micro, small, and medium-size businesses. This, in turn, will reduce informal employment and will remove many Panamanians from their subsistence work cycle with greater opportunities for first jobs for men and women, as well as for skilled and experienced technical, professional, and executive positions.

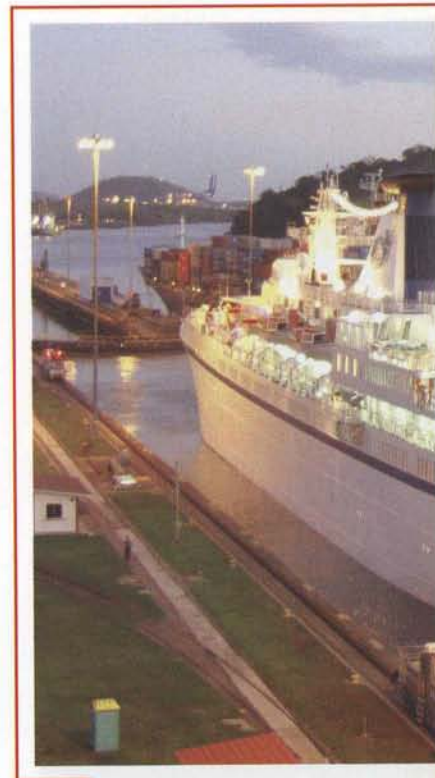
Training and development programs

To achieve the best utilization of the high rate of formal employment that will be generated by the Canal expansion and its multiplying effect on Panama's national economy, the need to provide training, development, and education programs to enable panamanian citizens to avail themselves of the employment opportunities that will open both at the ACP as well as in the country's economy has been identified as one of the utmost importance.

On February 15, 2006, the Government of Panama passed its Law Decree No. 8 to create the Instituto Nacional de Formación Profesional y Capacitación para el Desarrollo Humano - INADEH. This agency provides coverage to the entire country of Panama, and will integrate, coordinate, and conduct a National Development Program in response to the labor demands of both Government and private projects to be undertaken in coming years in Panama (such as the Canal expansion, port development, drydocks, refineries, real estate, and others), as well as for the attendant economic activities they will stimulate (tourism, lodging, seamen, cruise industry, supply of materials, among others).

On May 2, 2006, the ACP signed a cooperation agreement with INADEH for the purpose of providing support to the technical and skilled job training programs required for Panama Canal projects and its present and future operations. Important planning and management efforts such as an inventory of the infrastructure of all shops and technical laboratories at all INADEH training centers, and of the technical institutes of the Ministerio de Educación (MEDUCA) and of the Universidad Tecnológica de Panamá (UTP), as well as plans for their adaptation and refitting. INADEH has also approached and signed agreements with potential suppliers of such training; installed a technology data base to obtain, process, and follow up on training registries; polled the domestic markets to determine the interest of Panamanian citizens in the various development programs to be provided; determined the budget requirements to meet the needs for such resources; identified better practices to implement technical training programs on a national and international level; purchased and installed simulators for practical training; recruited, updated, and prepared an instructor pool, and developed new specialized training programs which will grant the appropriate certifications.

The major training and development areas of the national INADEH training program to meet the needs of the Panama Canal in the unskilled, skilled, certified specialist, heavy





equipment operator and foreman categories are:

- * Civil construction assistants, apprentices, masons, carpenters, refitters, and foremen.
- * Metal mechanic and industrial maintenance welder assistants, general welders, specialized welders, and industrial equipment mechanics
- * Heavy equipment operators, including truck, excavator, tractor, crane, and drill operators.
- * Electrical and electronic personnel, including electricians, electrician assistants, and electronic equipment mechanics.

The ACP is working jointly with the appropriate Panama Government agencies and private enterprises to obtain and recruit training, development, and education personnel through IFHARU, CAPAC, Ministry of Labor, Ministry of Education, SENACYT, University of Panama, Panama Technological University, Panama Maritime University, and representatives from international governments and businesses, to ensure the availability of Panamanian labor. The basis for the study and analysis of these efforts is a projection of human resource demands of the ACP as well as of the future contractors who will be involved in the Canal expansion project, the professional skills that will be needed most, and the type of practical or field experience required by the technical jobs.

To meet the internal needs of the Panama Canal Authority

Canal operations will continue to respond to the growing traffic tonnage and ACP will take any action required to optimize its installations, which are projected to reach their maximum capacity in the next few years. Furthermore, during the performance of the Canal expansion project, ACP will have the responsibility of administering the various related programs and projects, as well as the dredging of the navigation channel activities. Consequently, in addition to the natural mobility and rotation, and the Panamanian labor market competitiveness for high skilled personnel that will be generated, ACP will continue to implement a series of development programs in the following fields:

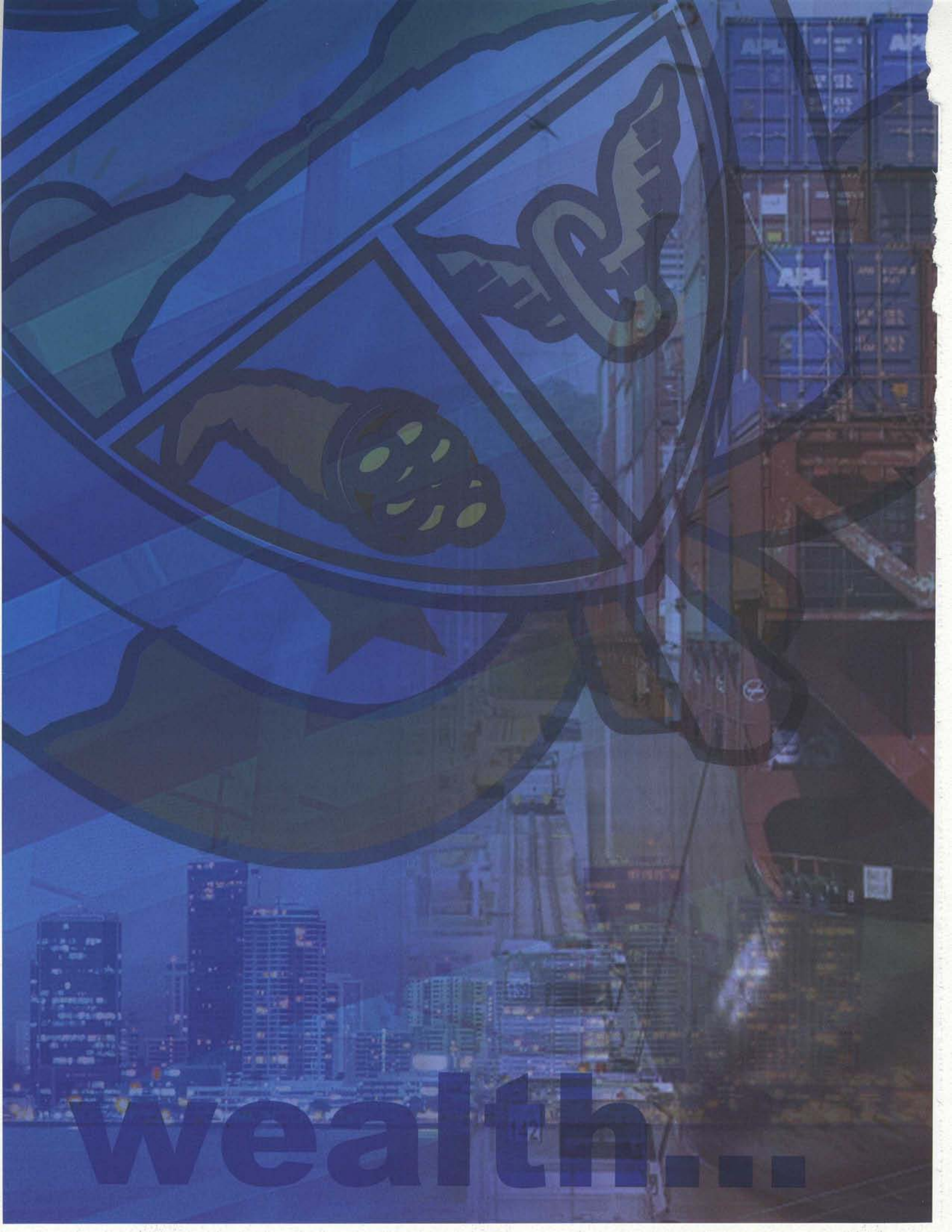
- * In accordance with future traffic and tonnage projections for the maritime area, it will develop new groups of pilots, tugboat captains, dredge officers, seamen, motor launch operators, and traffic controllers. All this activity is supported by a marine simulator system that will also be used to validate the navigation channels and operating specifications of the new locks.
- * In the technical-industrial area, it will design development programs for pipefitters, shipfitters, metal forgers, electronics mechanics, high-precision instrument mechanics, blasters, crane operators, dredge operators, and locomotive operators, in accordance with the projections for the operation areas, difficult recruitment positions, demographics, and the potential retirement of skilled workers with considerable experience in Canal operations.



- * In the professional and administrative area, ACP will develop the skills required by project managers, the engineering staff in several disciplines who will provide support to the various project activities, project inspectors, contracting officers, and attorneys who will handle the legal, contractual, and claim matters.

The most important impact is the medium and long-term employment aspect that will come with an increased growth in the economic activities of the conglomerate's services resulting from a higher cargo and vessel traffic through the Panama route. It is estimated that by 2025, the expanded Canal will generate between 150,000 and 250,000 additional jobs in Panama.

Moreover, the additional revenues to be received by the Government of Panama from an expanded Canal are estimated at approximately B/. 1,749.0 million by the year 2025, starting in 2015 and continuing to grow gradually. Such additional resources will enable the public sector to expand its investments on the human and social development for the country's population.



wealth...

operating results



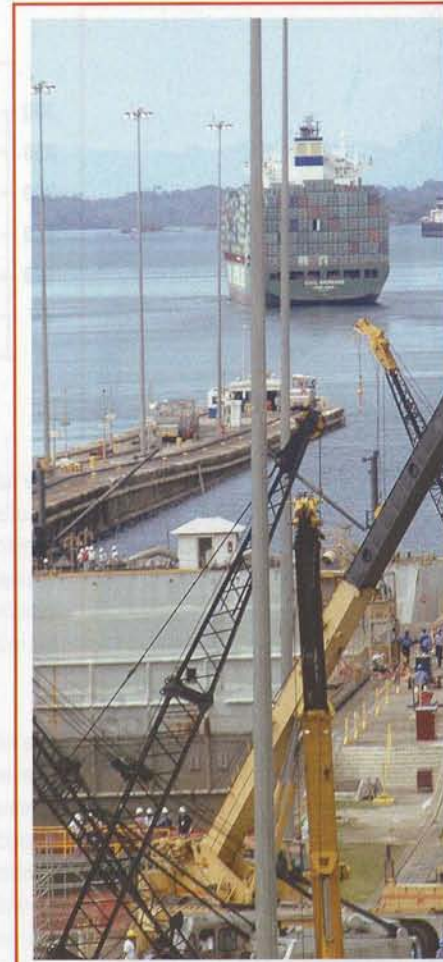
Traffic

During fiscal year 2006, the Panama Canal reaped the benefits of a strong world economy. The United States, the Canal's most important user in terms of cargo flows, exhibited an estimated economic growth of 3.4 percent, the highest in the last five years. Such growth was essentially due to lower taxes fueling a rise in the internal demand, lower interest rates stimulating consumption and strong exports arising from a weak United States dollar.

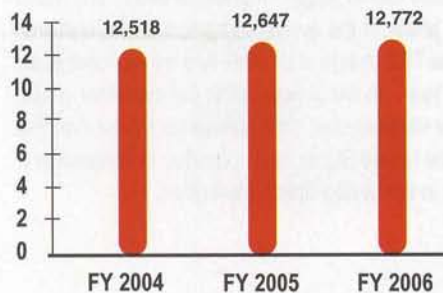
China, the second most important Canal user, maintained its strong economic growth in the order of 10.0 percent as a result of more flexible economic policies and the opening of its economy to international markets. Exports and foreign investment remain the main drivers of China's economic growth. Japan, the third most important Canal user, continued its economic recovery, registering a 2.8 percent Gross Domestic Product (GDP) growth, the highest after the 1990's crisis; the main driver of this recovery is exports, principally to China and the United States.

In fiscal year 2006, the Panama Canal recorded a total of 14,194 transits, a 1.3 percent increase from 14,011 transits in the previous year. PC/UMS tonnage for fiscal year 2006 was 296.3 million, a 6.2 percent rise from fiscal year 2005. The size of vessels transiting the waterway increased 4.8 percent, which translated into higher tolls revenues. Transits of oceangoing vessels during fiscal year 2006 amounted to 12,772, with a daily average of 35 transits. Transits of Panamax vessels, those of 100 feet or more in beam, increased 7.9 percent due mostly to a greater number of full containerships, dry bulkers, and vehicle carrier transits.

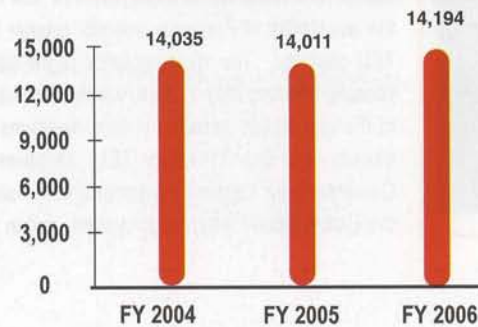
A total of 11.4 million TEU, subject to tolls, were transported via the Panama Canal in fiscal year 2006. Tolls revenues totaled B/. 1,026.4 million out of which, B/. 513.3 million corresponded to PC/UMS tolls, and B/. 513.1 million arose from TEU tolls. Fiscal year 2006 total toll revenues were 21.1 percent and B/. 178.9 million higher than the previous year.



Oceangoing transits

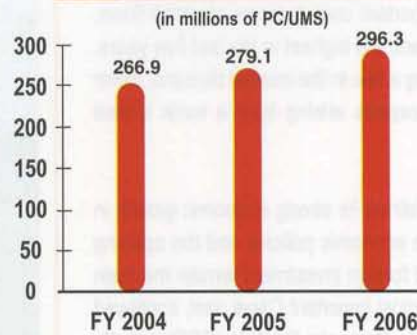


Panama Canal transits

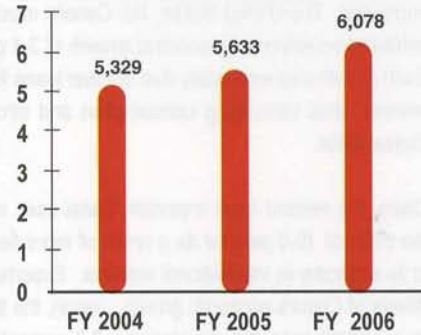




Vessel tonnage



Panamax vessel transits



The full container segment's strong performance was the prime reason for the positive operating results of the Panama Canal. The sustained dynamism of this segment, along with the implementation of the second phase of the approved increase in tolls charged to full container vessels on TEU basis, were the foremost drivers of the increase in toll revenues. Dry bulkers, vehicle carriers, roll on - roll off, and general cargo vessels also made significant contributions to toll revenues.

Market segments

The full container vessels segment once again registered the most significant traffic indicators. This segment registered 3,290 transits, 113.2 million PC/UMS tons and B/. 502.6 million in toll revenues, for increases of 14.3, 15.8 and 50.3 percent, in transits, PC/UMS tons and toll revenues, respectively. The main thrust of such increases was the introduction of new services via the Panama Canal, particularly in the Asia-United States east coast route, which increased the market share in this route relative to the intermodal system and other route alternatives. Eight new services were introduced and three services were eliminated, due to a consolidation of routes arising from important mergers in the maritime shipping industry.

In addition, there was an increase in the average size of full container vessels utilizing the Panama Canal, as a result of the deployment of new Pospanamax vessels in other routes, which increased the availability of Panamax vessels greater than 900 feet in length, 100 feet in beam, and 4,000 TEU capacity. The implementation of the second phase of the new tolls structure for full container vessels, effective May 1, 2006, which established the TEU charge at B/. 49.0, was a major contributor to the significant increase in toll revenues this year. In fiscal year 2006, full container vessel transits recorded 11.1 million TEU. Shippers have made evident their preference for the Panama Canal route for cargoes transported from Asia to the United States east coast due to congestion in the United States intermodal system, and in ports in the United States west coast.



The dry bulk segment enjoyed favorable results for the third consecutive year, recording an increase in transits of 4.6 percent. The segment's PC/UMS tons totaled 58.9 million, 7.0 percent above the previous year's figures, as a result of the increase in the average vessel size, and therefore, toll revenues also rose 7.0 percent to B/. 170.6 million. Grain shipments increased as a result of greater United States' exports to Asia. Early in the year, China stopped its corn exports to the Asian region, thereby prompting Taiwan and South Korea to turn to the United States to secure the availability of this commodity, which is used in animal feedstock processing.

On another front, the high prices of traditional petroleum products have encouraged the switch to cheaper alternatives that are shipped in dry bulk vessels, such as coal and petroleum coke. Petroleum coke shipments rose, particularly in the China - United States east coast route. The flows of metal and related manufactures increased as a result of a trend to import cheaper products, especially from China. Following hurricane Katrina's devastation, the rebuilding of New Orleans has also contributed to the higher demand of iron and steel manufactures, wood and other products that were transported in dry bulk vessels via the Panama Canal.

The liquid bulk segment registered 1,684 transits, 33.0 million PC/UMS tons and B/. 91.0 million in tolls revenues in fiscal year 2006, equivalent to decreases in the order of 4.4, 4.3 and 4.5 percent, respectively. These results reflect the severe impact of hurricanes Katrina and Rita, especially in the processing of crude oil in the Gulf of Mexico, and in the production capacity of refineries and petrochemical plants. Therefore, United States exports via the Panama Canal were negatively affected during the first four months of fiscal year 2006. Likewise, ports in the Gulf of Mexico were unable to take product deliveries as a result of hurricane damage, thereby affecting petroleum products imports.

Nonetheless, the liquid bulk segment staged a noteworthy recovery during the second half of fiscal year 2006. The United States pressing need to import petroleum related products mitigated somewhat the hurricanes negative impact. In the end, however, even the surge in petroleum related products imports by the United States in the months after the hurricanes, and the increased flows from the Caribbean to the west coast of Central and South America, were not enough to offset the negative impact in the first half of fiscal year 2006; consequently, in fiscal year 2006 liquid bulk flows through the Panama Canal performed below fiscal year 2005 levels.

The vehicle carrier segment recorded 766 transits, 37.2 million PC/UMS tons and B/. 99.8 million in tolls revenues in fiscal year 2006, reflecting increases of 1.6, 3.8 and 3.3 percent, correspondingly. The flows which contributed to these increases were exports from Asia to the Antilles and the United States east coast and exports from Europe to the United States west coast.





The passenger vessel segment registered 220 transits, 8.9 million PC/UMS tons and B/. 25.7 million in tolls revenues in fiscal year 2006, revealing decreases of 5.2, 10.5 and 10.6 percent, respectively. A weak United States dollar relative to the euro induced the main cruise lines to deploy their vessels to European destinations in lieu of Panama and the Caribbean.

The refrigerated cargo segment closed fiscal year 2006 with 2,097 transits, 17.0 million PC/UMS tons and B/. 52.5 million in tolls revenues, reflecting declines of 9.0, 8.7 and 1.4 percent, respectively. Billed on-deck containers reached the 119,962 TEU mark. The decrease in refrigerated cargo vessels traffic through the Panama Canal is the result of a decline in exports of bananas from Ecuador to Europe and the United States east coast, fruits from Chile to Europe, and meat from Australia and New Zealand to the United States east coast.

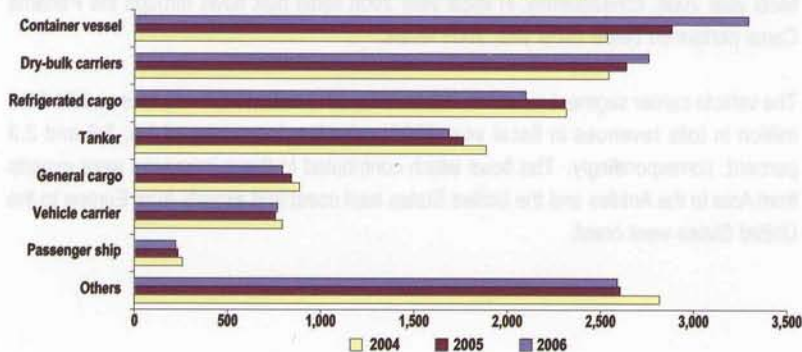
The impact of import duties imposed by the European Union to banana exporting countries has been more severe than anticipated. Banana exports from Ecuador to European countries such as Belgium, Italy and Croatia, have decreased relative to fiscal year 2005 prior to the implementation of import duties. Other factors also affected banana exports, including weather conditions and the entrance of new banana producers with lower prices than Ecuador, such as Costa Rica, Guatemala, and Colombia.

Operating results

Revenues

At the end of fiscal year 2006, total revenues amount B/. 1,494.8 millions, representing an increase of 23.6 percent compared with fiscal year 2005. Toll revenues account for 69.0 percent, reaching a total of B/. 1,026.4 millions (2005: B/. 847.5 millions), 21.1 percent more than the previous fiscal year. During the last three years, toll revenues show an annual average growth of 16.4 percent. The 18.3 percent increase in revenues from transit related services this year reflects the higher level of intensity being experimented by the core business. These services total this year B/. 318.5 millions (2005: B/. 269.2 millions), representing a 21.0 percent of the total revenues.

Transits by vessel type





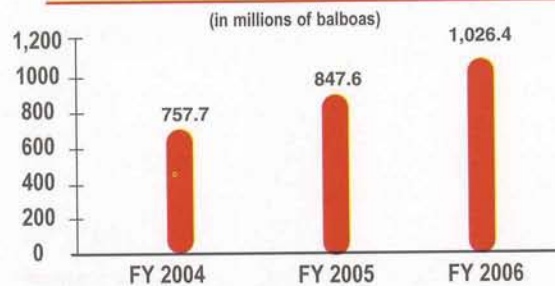
It is important to point out the rapid growth of other Canal revenues, reaching 10.0 percent of total revenues, with B/. 149.9 millions this fiscal year (62.4 percent more than the B/. 92.3 millions collected last year), as the result of the continued growth in energy sales and interest income.

Expenses

Total operating expenses represent approximately 33.0 percent of total revenues, totaling B/. 488.4 millions during fiscal year 2006, only a 10.0 percent increase compared with 2005. Almost 53.0 percent of this variation obeys principally to an increase in fuel expenses, while another 37.0 percent corresponds to additional salaries, wages and employ benefits caused to the increased volume of operations.

Annual payments to the National Treasury in fiscal year 2006 for net tonnage and public service fees arose to B/. 254.4 millions (2005: B/. 220.0 millions), a 15.6 percent increase. This payment represents 17.0 percent of the total revenues or 25.2 percent of the earnings before taxes and depreciation, showing an average growth rate of 12.0 percent annually.

Tolls revenues



Net income

Fiscal year 2006 resulted in a net income of B/. 675.9 millions, 39.7 percent more than fiscal year 2005. About 50.0 percent (B/. 360.6 millions) was retained in part to finance the capital investment program and equity reserves. The rest (B/. 315.3 millions) became dividend paid to the National Treasury. Dividends show a 31.0 percent annual growth rate during the last three years of operations.



Total contribution to the National Treasury amount B/. 569.7 millions (2005: B/. 488.8 millions), a 16.6 percent increase (B/. 81 millions). Between fiscal year 2000 and 2006, this total contribution show an annual growth rate of 22.7 percent.

Financial indicators

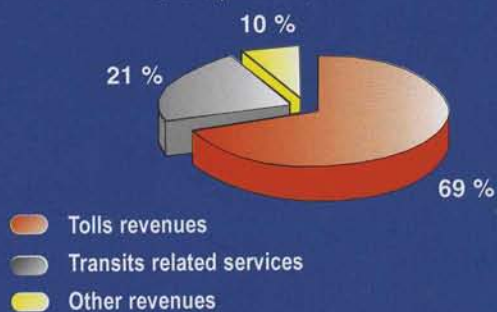
ACP performed exceptionally well in fiscal year 2006. All profitability indicators grew as a result of the continued growth of its transit operation business, expense control and efficiency policies, the ability to set market price, and an increased productivity and use of the installed capacity during fiscal year 2006: net income to sales margin (ROS) grew from 40.0 percent to 45.0 percent; return on total assets (ROA) grew from 15.0 percent to 19.0 percent; and the return on operating capital employed (ROCE) grew from 23.0 percent to 28.0 percent. It should be noted that these indicators show annual growth rates between 12.0 percent and 19.0 percent for the past three years, confirming ACP's ability to generate sustainable surplus income.



Net income to sales margin (ROS) grew from 40.0 percent to 45.0 percent; return on total assets (ROA) grew from 15.0 percent to 19.0 percent; and the return on operating capital employed (ROCE) grew from 23.0 percent to 28.0 percent. It should be noted that these indicators show annual growth rates between 12.0 percent and 19.0 percent for the past three years, confirming ACP's ability to generate sustainable surplus income.

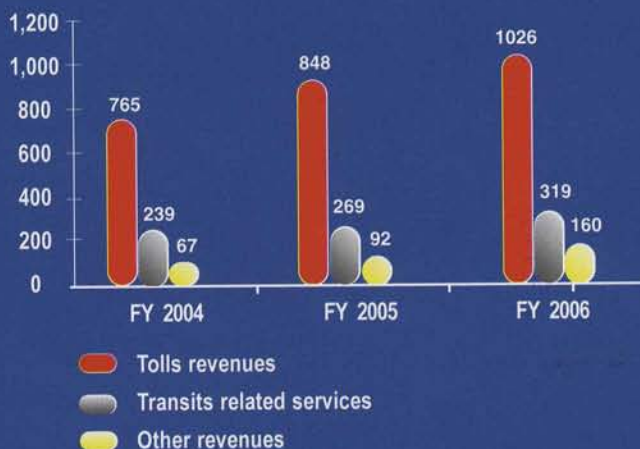
Revenues

as of september 30, 2006



Revenues

as of september 30, 2006



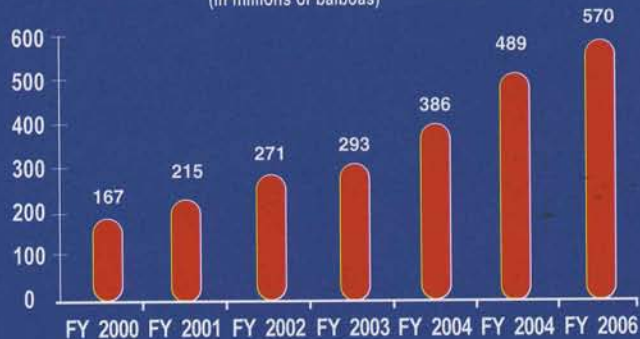
ACP total contribution

(in millions of balboas)



Payments to the National Treasury

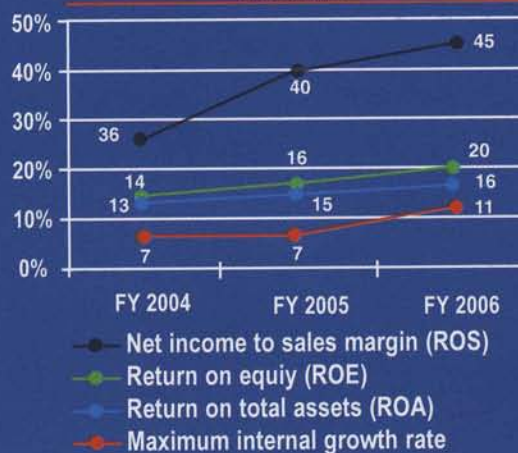
(in millions of balboas)



Operating performance



Returns



(in millions of balboas)	FY 2003	FY 2004	FY 2005	FY 2006	Variation FY 2005 vs FY 2006	Avg. Annual Growth Rate FY 2004 - FY 2006
Total expenses	421.1	419.9	443.8	488.4	44.7	10.1%
Net income	258.0	380.3	483.9	675.9	192.0	39.7%
Net tonnage and public service fees	186.8	202.5	220.0	254.4	34.4	15.6%
Dividends	106.8	183.7	268.9	315.3	46.5	17.3%
Total contribution to the National Treasury	293.0	386.2	488.8	569.7	80.9	16.6%



(Translation of financial statements originally issued in Spanish)

Panama Canal Authority

Index to Financial Statements

September 30, 2006

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Report of Independent Auditors

Translation of a report originally issued in Spanish
(See explanation in the notes to the financial statements)

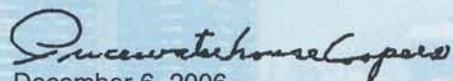
To the Board of Directors of the
Panama Canal Authority

We have audited the accompanying balance sheet of the Panama Canal Authority as of September 30, 2006, and the related statements of income, changes in equity, and cash flows for the year then ended. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Panama Canal Authority as of September 30, 2006, the result of its operations, and its cash flows for the year then ended, in conformity with International Financial Reporting Standards.

PricewaterhouseCoopers (signed)



December 6, 2006

Panama, Republic of Panama

(Translation of financial statements originally issued in Spanish)

Panama Canal Authority

Balance Sheet

September 30, 2006

(In thousands of balboas)

	2006	2005
Assets		
Properties, plant, and equipment, net of accumulated depreciation (Notes 2 and 14)	B/. 2,181,293	B/. 2,095,404
Account receivable (Note 3)	20,140	20,140
Current assets		
Cash and cash equivalents (Note 4)	821,170	664,428
Investments (Note 5)	490,399	305,654
Accounts receivable (Note 6)	31,946	26,030
Inventories:		
Materials and supplies, net of allowance for obsolescence and slow turnover of B/.6,510 (2005 - B/.5,236)	25,678	26,534
Fuel	3,437	4,538
Other current assets	25,135	12,397
Total current assets	<u>1,397,765</u>	<u>1,039,581</u>
Total assets	<u>B/. 3,599,198</u>	<u>B/. 3,155,125</u>
Equity and Liabilities		
Equity		
Equity (Note 14)	B/. 1,904,540	B/. 1,904,547
Retained earnings:		
Appropriated retained earnings (Note 7)	1,154,918	794,325
Unappropriated retained earnings (Note 8)	<u>315,332</u>	<u>268,850</u>
Total equity	<u>3,374,790</u>	<u>2,967,722</u>
Severance pay (Note 9)	10,000	10,000
Current liabilities		
Accounts payable (Note 10)	98,943	62,464
Provision for marine accident claims (Note 11)	27,715	27,524
Accrued salaries and leave	83,540	84,495
Other liabilities	<u>4,210</u>	<u>2,920</u>
Total current liabilities	<u>214,408</u>	<u>177,403</u>
Total equity and liabilities	<u>B/. 3,599,198</u>	<u>B/. 3,155,125</u>

The accompanying notes are an integral part of these financial statements.

(Translation of financial statements originally issued in Spanish)

Panama Canal Authority

Statement of Income

For the Year Ended September 30, 2006

(In thousands of balboas)

	2006	2005
Revenues		
Toll revenues	B/.1,026,427	B/. 847,539
Vessel-transit-related services	318,476	269,235
	<u>1,344,903</u>	<u>1,116,774</u>
Other revenues:		
Electric power sales	74,008	45,430
Potable water sales	19,018	17,499
Interest income	50,085	23,243
Miscellaneous	6,811	6,169
	<u>149,922</u>	<u>92,341</u>
Total other revenues		
Total revenues	<u>1,494,825</u>	<u>1,209,115</u>
Expenses		
Fee per net ton (Note 10)	252,796	190,960
Salaries and wages	332,190	317,221
Employee benefits	41,795	40,362
Materials and supplies	36,124	33,610
Fuel	63,175	39,467
Transportation, meals, and lodging abroad	711	750
Allowances and local transportation	769	624
Services rendered by third parties	37,049	33,620
Panamanian Treasury (Tesoro Nacional) - public service fees	1,577	29,000
Insurance	9,892	13,700
Marine accidents, net (Note 11)	3,004	4,123
Obsolete and slow turnover inventory	2,958	899
Other expenses	8,608	8,206
	<u>790,648</u>	<u>712,542</u>
Less capitalized labor and materials (Note 12)	47,835	48,806
	<u>742,813</u>	<u>663,736</u>
Income before depreciation	752,012	545,379
Depreciation (Note 2)	76,087	61,445
Net income (Note 13)	<u>B/. 675,925</u>	<u>B/. 483,934</u>

The accompanying notes are an integral part of these financial statements.

(Translation of financial statements originally issued in Spanish)

Panama Canal Authority

**Statement of Changes in Equity
For the Year Ended September 30, 2006**

(In thousands of balboas)

	Equity		Retained Earnings		Total Equity			
			Appropriated	Unappropriated				
Balance as of September 30, 2004	B/.	1,904,568	B/.	579,241	B/.	183,708	B/.	2,667,517
Transfer to Panamanian Treasury (Note 8)	-	-	-	-	(183,708)	(183,708)		
Net income	-	-	-	-	483,934	483,934		
Contributions to the investment program (Note 7)	-	-	147,784	-	(147,784)	-		
Corporate reserve for contingencies and working capital (Note 7)	-	-	37,700	-	(37,700)	-		
Other equity reserves (Note 7)	-	-	29,600	-	(29,600)	-		
Properties transferred to the Government of Panama (Notes 2 and 14)		(21)	-	-	-	-		(21)
Balance as of September 30, 2005		1,904,547		794,325		268,850		2,967,722
Transfer to Panamanian Treasury (Note 8)	-	-	-	-	(268,850)	(268,850)		
Net income	-	-	-	-	675,925	675,925		
Contributions to the investment program (Note 7)	-	-	76,974	-	(76,974)	-		
Corporate reserve for contingencies and working capital (Note 7)	-	-	23,466	-	(23,466)	-		
Reserve for Enterprise capitalization	-	-	182,003	-	(182,003)	-		
Reserve for Canal expansion (Note 7)	-	-	120,000	-	(120,000)	-		
Other equity reserves (Note 7)	-	-	(41,850)	-	41,850	-		
Properties transferred to the Government of Panama (Notes 2 and 14)		(7)	-	-	-	-		(7)
Balance as of September 30, 2006	B/.	1,904,540	B/.	1,154,918	B/.	315,332	B/.	3,374,790

The accompanying notes are an integral part of these financial statements.

(Translation of financial statements originally issued in Spanish)

Panama Canal Authority

Statement of Cash Flows

For the Year Ended September 30, 2006

(In thousands of balboas)

	2006	2005
Cash flows from operating activities		
Net income	B/. 675,925	B/. 483,934
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	76,087	61,445
Loss on retirement or disposal of properties, plant, and equipment	316	478
Obsolete and slow turnover inventory	2,958	899
Provision for marine accident claims	3,004	4,123
Changes in operating assets and liabilities:		
Accounts receivable	(5,916)	(8,841)
Inventories	(1,001)	(5,700)
Other current assets	(12,738)	(6,962)
Current liabilities	34,001	2,776
	<u>772,636</u>	<u>532,152</u>
Net cash provided by operating activities		
Cash flows from investing activities		
Acquisition and installation of properties, plant, and equipment, net	(162,299)	(149,797)
Net increase in investments	(184,745)	(166,394)
Net increase in time deposits with original maturities over 90 days	(282,196)	(172,629)
	<u>(629,240)</u>	<u>(488,820)</u>
Net cash used in investing activities		
Cash flows from financing activities		
Transfer to Panamanian Treasury	(268,850)	(183,708)
	<u>(268,850)</u>	<u>(183,708)</u>
Net decrease in cash and cash equivalents	(125,454)	(140,376)
Cash and cash equivalents at beginning of the year	229,193	369,569
	<u>229,193</u>	<u>369,569</u>
Cash and cash equivalents at end of the year (Note 4)	B/. 103,739	B/. 229,193
	<u>B/. 103,739</u>	<u>B/. 229,193</u>
Investing activity that did not represent cash outlay		
Properties transferred to the Government of Panama (Notes 2 and 14)	B/. (7)	B/. (21)
	<u>B/. (7)</u>	<u>B/. (21)</u>

The accompanying notes are an integral part of these financial statements.

(Translation of financial statements originally issued in Spanish)

Panama Canal Authority

Notes to Financial Statements

September 30, 2006

(In thousands of balboas)

Explanation Added for Translation into English

The accompanying financial statements have been translated from Spanish into English for international use. These financial statements are presented in accordance with International Financial Reporting Standards issued by the International Accounting Standards Board. Certain accounting practices applied by the Panama Canal Authority that conform with International Financial Reporting Standards may not conform with accounting principles generally accepted in the country of use.

1. General Information

The Panama Canal Authority (PCA) is an autonomous agency of the Government of Panama, established in conformity with Article 310 of the Political Constitution of the Republic of Panama. The PCA is responsible for the administration, operation, conservation, maintenance, modernization, and other related activities of the Panama Canal (the Canal), that are necessary to ensure the safe, uninterrupted, efficient and profitable operation of the Canal in accordance with the constitutional and legal regulations in effect. The PCA has its own patrimony and the right to manage it. The PCA was organized on June 11, 1997 under Law No.19 (Organic Law).

The PCA, in coordination with government entities designated by law, is also responsible for the management, maintenance, use and conservation of the water resources of the Canal watershed, including lakes and their tributary streams.

With the expiration of the 1977 Torrijos-Carter Treaty at noon on December 31, 1999, the Panama Canal reverted to the Republic of Panama free of debts and liens, becoming an inalienable patrimony of the Republic of Panama, open to the peaceful and uninterrupted passage of vessels of all nations and whose use will be subject to the requirements and conditions established by the Political Constitution of Panama, the Organic Law of PCA, and its management.

As of September 30, 2006, the PCA had a total of 9,210 employees, of which 7,875 were permanent and 1,335 were temporary. As of September 30, 2005, the total was 9,223 employees, of which 7,974 were permanent and 1,249 were temporary.

Summary of Significant Accounting Policies

A summary of the principal accounting policies adopted in preparing the financial statements of PCA are as follows:

Basis of Preparation

The accompanying financial statements have been prepared under the historical cost convention, in conformity with International Financial Reporting Standards issued by the International Accounting Standards Board that were in effect at the date of the financial statements. PCA's management authorized and approved the issuance of these financial statements on December 6, 2006.

Preparing the financial statements, in conformity with the International Reporting Standards, requires management to make estimates and assumptions that affect reported amounts of assets and liabilities, and the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Future actual results could differ from those estimates. The most significant estimates for these financial statements are the provisions for marine accident claims and for inventory of supplies and materials, and the depreciation of properties, plant, and equipment.

Interpretations and amendments to the published Standards effective in 2005

The following amendment and interpretation to the Standards are mandatory for PCA's accounting periods beginning on or after January 1, 2005:

- IAS 39 (Modified), Transition and initial recognition of financial assets and liabilities (effective since January 1, 2005).

PCA's management evaluated the relevance of these amendments and interpretations in relation with PCA operations and concluded their compliance.

Standards, interpretations and amendments to the published Standards not yet in effect

Certain new Standards, amendments and interpretations to the existing Standards which have been published and which are mandatory for PCA accounting periods beginning on or after January 1, 2007, or subsequent periods, but that PCA has not adopted in advance, are the following:

- IFRS 7, Financial Instruments: Disclosures and complementary amendment to IAS 1, Presentation of Financial Statements - Capital disclosures (effective for periods beginning on or after January 1, 2007). IFRS 7 introduces new disclosures to improve the qualitative and quantitative information about the exposure to risks derived from financial instruments. It replaces IAS 30 and the disclosure requirements of IAS 32, Financial Instruments: Disclosures and Presentation.

PCA will start applying these Standards, interpretations and amendments on fiscal year 2007 and does not expect that they will have any impact on PCA's financial statements.

Panama Canal Authority

Notes to Financial Statements

September 30, 2006

(In thousands of balboas)

Monetary Unit

The PCA maintains its accounting records in balboas (B/.), the monetary unit of the Republic of Panama, which is at par with the US dollar.

Properties, Plant, and Equipment

Items of properties, plant, and equipment with a value of five thousand balboas or more are recorded at cost. The cost of items that are not capitalized or under five thousand balboas is expensed as incurred.

Depreciation is calculated using the straight-line method over the following estimated useful lives of the depreciable assets:

Buildings	25 - 75 years
Structures	5 - 100 years
Equipment	3 - 75 years

The useful life of assets is reviewed periodically to ensure that the depreciation period is consistent with the economic benefit expectations of the components of properties, plant, and equipment.

The gain or loss resulting from the retirement or disposal of an asset is the difference between the net proceeds and the net book value of the asset. The gain or loss is reflected in the statement of income when incurred, except for buildings and properties that were received from the Government of Panama, which are charged against equity when they are demolished or returned back to the Government of Panama.

Maintenance and repairs are expensed as incurred, while major improvements are capitalized. Dredging costs incurred for recurrent maintenance of the waterway, as a result of landslides and erosion, are expensed. Dredging costs for substantial improvements to the waterway are capitalized and depreciated over their estimated useful lives.

Construction in progress represents plant and properties under construction and includes construction and other direct costs. Such items are not subject to depreciation until the assets are completed and placed in operation.

Notes to Financial Statements

September 30, 2006

(In thousands of balboas)

Impairment of Assets

Assets that are subject to amortization are reviewed annually to identify any impairment losses, whenever events or changes in circumstances indicate that the carrying amounts may not be recoverable. An impairment loss is recognized when the asset's carrying amount exceeds its recoverable amount, which is the higher of an asset's net selling price and its value in use.

Cash and Cash Equivalents

For purposes of the statement of cash flows, PCA's cash and cash equivalents consist of cash on hand, deposits in current and saving accounts, and time deposits with original maturity dates of less than 90 days.

Investments

Purchases of investments are recognized on the settlement date, the date on which PCA pays and receives the asset.

Investments are acquired with the intention to be held to maturity and are recorded at amortized cost. Amortized cost is the initial cost of the investment, adjusted by the cumulative amortization of any discount or premium on acquisition. The amortization of the discount or premium is recorded as an increase or decrease of interest income in the statement of income.

Inventories

The inventories of materials, operating supplies, and fuel are valued at average cost, which does not exceed net realizable value, after the allowance for supplies and materials inventory.

Allowance for Supplies and Materials

The supplies and materials inventory is annually evaluated to determine if stock levels are adequate or are in excess and should be reduced due to obsolescence, impairment, diminishment of quality, slow turnover or are not useful for the operation and functioning of the Canal.

If any inventory item of supplies and materials complies with the previously mentioned characteristics, the allowance is adjusted to its reasonable value to recognize the probable loss.

Accounts Payable

The accounts payable are recognized at their cost, being all goods or services rendered at their reasonable value to be paid in the future.

(Translation of financial statements originally issued in Spanish)

Panama Canal Authority

Notes to Financial Statements

September 30, 2006

(In thousands of balboas)

Revenue Recognition

Revenues are recognized as a result of the economic benefits which flow to the PCA and those revenues could be easily measured. The following specific criteria have to be complied before revenues are recognized:

Toll Revenue

The toll revenue is recognized once vessels complete their transits through the Canal.

Services Rendered

Revenues from other services are recognized when services are rendered.

Interest

Interest income on bank deposits and investments are recognized as accrued.

Severance Pay

Severance labor payments are charged to expense as incurred, except for the portion corresponding to the years of employment with the Panama Canal Commission, as explained in Note 9.

Retirement Benefits

Retirement benefits for PCA employees are provided for through a statutory contribution plan with the Panamanian Social Security (Caja de Seguro Social), which assumes responsibility for the retirement benefits. Contributions are made in accordance with parameters established by the Social Security organic law.

Financial Instruments

Financial assets and liabilities presented on the balance sheet correspond to cash, accounts receivable, investments, and accounts payable. Financial instruments are classified as assets and liabilities according to the substance of the contractual agreement from which they originated. The interests, gains or losses generated by a financial instrument, classified as asset or liability are recorded as expenses or revenues or against the respective provision, if applicable.

Panama Canal Authority**Notes to Financial Statements****September 30, 2006**

(In thousands of balboas)

2. Properties, Plant, and Equipment

Properties, plant, and equipment are as follows:

	September 30, 2005 Beginning Balance	Additions	Retirements	Transfers and Reclassifications	September 30, 2006 Ending Balance
Assets					
Land	B/. 1,022,222	B/. -	B/. -	B/. -	B/. 1,022,222
Buildings	82,924	3,340	-	66	86,330
Structures	496,767	32,326	(8)	17,694	546,779
Equipment	663,350	103,764	(2,403)	(16,661)	748,050
Constructions in progress	146,707	162,299	-	(139,430)	169,576
	<u>2,411,970</u>	<u>301,729</u>	<u>(2,411)</u>	<u>(138,331)</u>	<u>2,572,957</u>
Accumulated Depreciation					
Buildings	20,129	3,180	-	67	23,376
Structures	86,933	19,305	-	3,986	110,224
Equipment	209,504	53,602	(2,088)	(2,954)	258,064
	<u>316,566</u>	<u>76,087</u>	<u>(2,088)</u>	<u>1,099</u>	<u>391,664</u>
Net value	<u>B/. 2,095,404</u>	<u>B/. 225,642</u>	<u>B/. (323)</u>	<u>B/. (139,430)</u>	<u>B/. 2,181,293</u>
	September 30, 2004 Beginning Balance	Additions	Retirements	Transfers and Reclassifications	September 30, 2005 Ending Balance
Assets					
Land	B/. 1,022,222	B/. -	B/. -	B/. -	B/. 1,022,222
Buildings	80,175	2,941	(192)	-	82,924
Structures	445,703	51,055	-	9	496,767
Equipment	588,819	77,986	(3,446)	(9)	663,350
Constructions in progress	128,892	149,797	-	(131,982)	146,707
	<u>2,265,811</u>	<u>281,779</u>	<u>(3,638)</u>	<u>(131,982)</u>	<u>2,411,970</u>
Accumulated Depreciation					
Buildings	16,871	3,407	(149)	-	20,129
Structures	68,755	18,177	-	1	86,933
Equipment	172,634	39,861	(2,990)	(1)	209,504
	<u>258,260</u>	<u>61,445</u>	<u>(3,139)</u>	<u>-</u>	<u>316,566</u>
Net value	<u>B/. 2,007,551</u>	<u>B/. 220,334</u>	<u>B/. (499)</u>	<u>B/. (131,982)</u>	<u>B/. 2,095,404</u>

Panama Canal Authority

Notes to Financial Statements

September 30, 2006

(In thousands of balboas)

PCA recorded losses in retirement or disposal of fixed assets for B/.316 (2005 - B/.478). During 2006, the main assets retired included lighting system, winch, computer system, various projectors, forklift trucks, uninterruptible power system, and gasoline tank. During 2005, the main assets retired included a mobile crane, portable transformers, a satellite communication system, vehicles, a portable air compressor, and forklift trucks.

During fiscal years ended September 30, 2006, and 2005, there were no retirements due to demolished buildings.

PCA transferred equipment to the Government of Panama for a net value of B/.7 (2005 - B/.21). These assets were transferred to the Government of Panama as they were not useful for the operation of the Canal. (See Note 14)

3. Account Receivable

The account receivable from the Office of Transition Administration (OTA) represents the portion of the Canal's investment program that was not transferred by the Panama Canal Commission (the Commission) to PCA on December 31, 1999. Since May 2004, these funds, which have no due date, were transferred to the Treasury of the United States of America and do not generate interest. The OTA was terminated on October 1, 2004, and its responsibility to pay these funds to the PCA was transferred to the General Services Administration (GSA), a U.S. government agency.

4. Cash and Cash Equivalents

Cash and cash equivalents are composed as follows:

	2006	2005
Cash on hand	B/. 34	B/. 25
Deposits in current accounts	7,957	8,832
Deposits in saving accounts	59,842	59,895
Time deposits with original maturities under 90 days	35,906	160,441
Total cash and cash equivalents	103,739	229,193
Time deposits with original maturities over 90 days not exceeding 360 days	717,431	435,235
	B/. 821,170	B/. 664,428

Notes to Financial Statements

September 30, 2006

(In thousands of balboas)

Article 44 of the Organic Law states that PCA's funds may be placed in short-term investment grade instruments and may not be used to buy other types of financial investment instruments issued by Panamanian or foreign public or private entities, or to grant loans to such entities or to the Panamanian Government. All investments in time deposits are placed in investment grade banks.

5. Investments

Investments were acquired with the intention to be held to maturity, and are mainly composed of bonds. All the investments are short-term and have been placed in investment grade instruments.

Changes in investments held to maturity are stated as follows:

	2006		2005
Balance at beginning of the year	B/. 305,654	B/. 139,260	
Additions	638,506	553,292	
Redemptions	(453,761)	(386,898)	
Balance at the end of the year	<u>B/. 490,399</u>	<u>B/. 305,654</u>	

	2006		2005
Fair value	B/. 490,295	B/. 305,060	
Unrealized loss	104	594	
Amortized cost	<u>B/. 490,399</u>	<u>B/. 305,654</u>	

Panama Canal Authority

Notes to Financial Statements

September 30, 2006

(In thousands of balboas)

6. Accounts Receivable

The accounts receivable are detailed as follows:

	2006	2005
Transit-related services	B/. 8,229	B/. 4,043
Electric power sales	15,985	14,706
Other services	1,730	764
Government entities	<u>6,002</u>	<u>6,517</u>
	<u>B/. 31,946</u>	<u>B/. 26,030</u>

Accounts receivable from government entities include B/.4,781 (2005 - B/.4,499) due from the National Institute of Pipelines and Sewerage (Instituto de Acueductos y Alcantarillados Nacionales [IDAAN]) for water treatment services provided.

7. Appropriated Retained Earnings

Changes in appropriated retained earnings are detailed as follows:

	Beginning Balance	Net Appropriations	Ending Balance
2006			
Investment program	B/. 591,325	B/. 76,974	B/. 668,299
Reserve for catastrophic risks	36,000	-	36,000
Reserve for the social and environmental program of the Canal watershed	10,000	-	10,000
Corporate reserve for contingencies and working capital	99,400	23,466	122,866
Reserve for Enterprise capitalization	-	182,003	182,003
Reserve for Canal expansion	-	120,000	120,000
Other equity reserves	<u>57,600</u>	<u>(41,850)</u>	<u>15,750</u>
	<u>B/. 794,325</u>	<u>B/. 360,593</u>	<u>B/. 1,154,918</u>
2005			
Investment program	B/. 443,541	B/. 147,784	B/. 591,325
Reserve for catastrophic risks	36,000	-	36,000
Reserve for the social and environmental program of the Canal watershed	10,000	-	10,000
Corporate reserve for contingencies and working capital	61,700	37,700	99,400
Other equity reserves	<u>28,000</u>	<u>29,600</u>	<u>57,600</u>
	<u>B/. 579,241</u>	<u>B/. 215,084</u>	<u>B/. 794,325</u>

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Article 41 of the Organic Law allows PCA to set aside funds from net income of the year to cover the costs of the investment program and the modernization and expansion of the Canal, as well as for other equity reserves that may be needed.

The funds for the investment program are determined based on investments expected to be realized during the year.

The equity reserves established up to date are as follows:

Reserve for Catastrophic Risks

The Board of Directors approved a reserve for catastrophic risks to cover the deductibles on the catastrophic insurance policy for a maximum total of B/.36,000. In fiscal years 2006 and 2005, PCA did not make appropriations to this reserve.

Reserve for the Social and Environmental Program of the Canal Watershed

The Board of Directors approved the establishment of a reserve to finance the social and environmental program of the Canal watershed. The purpose of this program is to preserve the natural resources and to promote the development and integral management of the watershed. In fiscal years 2006 and 2005, PCA did not make appropriations to this reserve.

Corporate Reserve for Contingencies and Working Capital

The Board of Directors approved a reserve for contingencies and working capital. The amount of this reserve will be defined based on the average of 30 days of Canal revenues or billing, and will be funded in stages, periodically, as agreed by the Board of Directors. In fiscal year 2006, the Board of Directors approved the increase of this reserve by B/.23,466 (2005 - B/.37,700) for a total of B/.122,866 (2005 - B/.99,400).

Reserve for Enterprise Capitalization

The Board of Directors approved a reserve for the Enterprise capitalization. The purpose of this reserve is to ensure and facilitate the long term financial projection of the Enterprise. This reserve will be funded in stages, according to the periodicity agreed by the Board of Directors. During fiscal year 2006, the Board of Directors approved to reserve B/.182,003

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Reserve for Canal Expansion

The Board of Directors approved an equity reserve for the construction program of the third set of locks in the Panama Canal. These funds will be segregated based on expected outlays during the program execution. In fiscal year 2006, the Board of Directors approved to reserve B/.120,000. (See Note 17b)

Other Equity Reserves

In addition, the Board of Directors approved the establishment of other equity reserves to contemplate programs to support the operation and administration of the Canal. During fiscal year 2005, the Board of Directors approved the increase of these reserves by B/.29,600 for a total of B/.57,600. During fiscal year 2006, the Board of Directors approved the use and partial reversal of these reserves by B/.41,850, for a total of B/.15,750, at the end of period.

8. Unappropriated Retained Earnings

Article 41 of the Organic Law also establishes that after covering the costs for the investment program and the reserves detailed in Note 7, any surplus shall be remitted to the Panamanian Treasury in the following fiscal period.

9. Severance Pay

In May 1999, the Panama Canal Commission's Board of Directors approved the transfer of B/.10,000 to PCA for severance payments to involuntarily terminated employees. This amount takes into account the employees' years of service with the Commission.

PCA's Personnel Administration Regulation establishes that severance will be paid only to employees who are terminated due to a reduction in force according to the dispositions described in section two of this regulation. All employees with at least 12 continuous months of permanent services will be entitled to severance pay. For severance payment purposes, the years of service that shall be credited are as follows:

1. For employees hired as permanent by the Commission prior to December 18, 1997, the years of service with both, PCA and the Commission, even though the severance pay will be calculated separately.
2. For permanent employees hired after December 18, 1997, only the years of service with PCA starting on December 31, 1999.

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Employees that are receiving a retirement pension from the United States of America Federal Government or from the Panamanian Social Security or, according to a resolution by the Panamanian Social Security, any person who will receive a pension within thirty days following severance, are not entitled to severance pay.

All severance payments for the time worked in PCA will be recorded in the statement of income as they are incurred.

10. Accounts Payable

The accounts payable are as follows:

	2006	2005
Panamanian Treasury	B/. 20,713	B/. 17,546
Suppliers and others	<u>78,230</u>	<u>44,918</u>
	<u>B/. 98,943</u>	<u>B/. 62,464</u>

Article 39 of the Organic Law establishes that PCA shall pay annually to the Panamanian Treasury a fee per net ton, or its equivalent, collected from vessels paying tolls for the use of the Canal. This fee shall be set by PCA. The total of such fees amounted to B/.252,796 (2005 - B/.190,960).

The balance payable to the Panamanian Treasury represents the fee per net ton payment that is outstanding at September 30, 2006.

11. Provision for Marine Accident Claims

The provision for marine accident claims for B/.27,715 (2005 - B/.27,524), represents the estimated value of filed or anticipated claims for accidents occurred in Canal waters for which PCA expects to be liable.

PCA carries out investigations to determine the cause of each marine accident. When the cause of the accident is determined, PCA records, if applicable, a provision based on an estimate of the vessel's permanent and temporary repair costs. The amount of the provision is reviewed at the date of the balance sheet, and if necessary, it is adjusted to reflect the best estimate at that moment.

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Changes in the provision for marine accident claims are detailed, as follows:

	2006	2005
Balance at the beginning of the year	B/. 27,524	B/. 24,887
Plus: Current year adjustments and new claims	3,389	4,809
Minus: Prescribed claims	<u>385</u>	<u>686</u>
	<u>3,004</u>	<u>4,123</u>
	30,528	29,010
Minus: Payments	<u>2,813</u>	<u>1,486</u>
Balance at the end of the year	<u>B/. 27,715</u>	<u>B/. 27,524</u>

Provisions are included in the marine accident claims expense in the statement of income.

12. Capitalized Labor and Materials

To execute its investment program, PCA contracts the services of suppliers and also utilizes its own resources and equipment.

The direct costs such as labor, supplies and materials, equipment (fuel, maintenance and depreciation), and other expenses related to these investments are originally recorded as operating expenses when incurred. These costs are credited in the statement of income under the specific line item and charged to the investment program.

Among the most significant investment projects carried out during the year ended September 30, 2006 are the following: deepening of Gatun Lake and Culebra (Gaillard) Cut, rehabilitation of the tow tracks, deepening of the entrances of the Canal, acquisition and installation of hydraulic operators, straightening of the Culebra (Gaillard) Cut, improvements to all locks' lighting system, acquisition of towing locomotives, and new ships' landing station in the Culebra (Gaillard) Cut. During the year ended September 30, 2005, the following projects were accomplished: deepening of Gatun Lake and Culebra (Gaillard) Cut, rehabilitation of the tow tracks, straightening of the Culebra (Gaillard) Cut, acquisition and assembly of drilling and blasting barge, deepening of the entrances of the Canal, acquisition and installation of hydraulic operators, improvements to all locks' lighting system, replacement of the locks' approach wall fenders from wood to rubber.

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13. Income Taxes

The PCA is not subject to income taxes, as states in Article 43 of the Organic Law which exempts it from the payment of all national or municipal taxes, except for the employer's contribution of social security, educational insurance, workmen's compensation, fees for public services, and the fees per net ton.

14. Equity

Article 310 of the Political Constitution of the Republic of Panama states that PCA has its own patrimony and the right to manage it.

Upon the transfer of the Canal to the Republic of Panama at noon on December 31, 1999, PCA became the administrator of all personal and real estate property identified in the Organic Law of PCA as the patrimony necessary to operate and maintain the Canal.

This patrimony is divided into two groups: the inalienable patrimony, comprised of land, lakes, rivers, dams, locks and anchorages, as established in Article 2 of the Organic Law, and the economic patrimony, comprised of installations, buildings, structures and equipment that support the operation of the Canal, as established in Article 33 of the same Law.

In compliance with these requirements, the Government of Panama transferred the related land and buildings to PCA. In order to record the assets transferred by the Government of Panama as part of PCA's patrimony, a conservative method was used to reflect an estimated market value for each asset subsequently registered in the Public Registry.

Preliminary appraisal reports of land and buildings were provided by the Department of Patrimonial Goods of the Office of the Comptroller General of the Republic of Panama and the Department of Public Registry of the Ministry of Economy and Finance in January and August 2002, respectively. In the opinion of PCA's Administration, the adjustments to determine those values will not have an adverse effect on the financial position.

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PCA transferred to the Government of Panama equipment with a value of B/.7 (2005 - B/.21) because they were not useful for the operation of the Canal.

15. Remunerations and Benefits to Key Managers

PCA paid remunerations and benefits to key managers for a total of B/.1,748 (2005 - B/.1,782).

16. Contingent Liabilities, Commitments and Contract

Contingent liabilities

PCA has received claims and is a defendant in various legal proceedings mainly related to marine accidents. The PCA's contingent liabilities amounted approximately to B/.2,797 (2005 - B/.2,595) corresponding to marine accident claims. It is management's opinion that the outcome of these matters is not likely to have a material adverse effect on the PCA's financial position.

Commitments

Commitments under uncompleted construction contracts and undelivered purchase orders amounted approximately to B/.146,000 (2005 - B/.177,000).

Contract

On September 16, 2006, the PCA and the National Institute of Pipelines and Sewerage (Instituto de Acueductos y Alcantarillados Nacionales [IDAAN]) subscribed Contract No.139-2006 for the purchase and sale of blocks of potable water for the area of La Chorrera, for a 30-year period, renewable on mutual agreement. PCA agrees to build a water treatment plant, to be known as Mendoza, on the shores of Gatun Lake, District of La Chorrera, which shall include all works, machinery, accessories, and equipments necessary for the production and sale of blocks of potable water to IDAAN at an approximate cost of B/.26,150. IDAAN agrees to install potable water delivery pipelines and to build all necessary infrastructure to meet minimum water supply requirements.

17. Subsequent Events

a. Referendum on the Proposal for the Expansion of the Panama Canal through the Construction of the Third Set of Locks

On April 24, 2006, PCA Board of Directors approved Agreement No. 112 by which the PCA submitted for consideration of the Executive Branch the proposal to expand the Canal's capacity, in the existing route, through the construction of the third set of locks. This proposal for the expansion of the Canal was formally presented to the President of the Republic of Panama, who in turn submitted it for debate to the Cabinet Council. On June 26, 2006, the Cabinet Council approved for consideration of the National Assembly, Bill No.224, the proposal for the construction of the third set of locks in the Panama Canal and other dispositions. Law No.28 created on July 17, 2006, and promulgated on July 18, 2006, approved the proposal and authorized the Electoral Tribunal to regulate and conduct a national referendum. As stated in Article No.325 of the Constitution of the Republic of Panama, the referendum shall not be held before three months following the approval of the Executive Branch; therefore, the date established for the referendum was October 22, 2006. According to Law No.28, this is the Sunday following expiration of the three-month period. The final result of the national referendum was the citizens' approval of the proposal of the Canal Expansion Program.

b. Canal Expansion Program through the Construction of a Third Set of Locks

On November 24, 2006, the Board of Directors approved an equity reserve for B/.120,000 for the construction program of the third set of locks in the Panama Canal.

The third set of locks program is a plan to expand the Canal's capacity composed of three integrated components: 1) the construction of two lock facilities - one on the Atlantic side and another on the Pacific side, each with water reutilization basins; 2) the excavation of new access channels to the new locks and the widening of existing navigational channels; and, 3) the deepening of existing navigation channels and the elevation of Gatun Lake's maximum operating level.

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The objectives of the Canal expansion are to: 1) achieve long-term sustainability and growth through the payments it makes to the National Treasury; 2) maintain the Canal's competitiveness as well as the value added by Panama's maritime route to the national economy; 3) increase the Canal's capacity to capture the growing tonnage demand with the appropriate levels of services for each market segment; and, 4) make the Canal more productive, safe, and efficient.

The program will have an approximate estimated cost of B/.5,250 million, which includes provisions for contingencies and inflation during the construction period. This estimate assumes 2% average annual inflation.

The execution of the program of the third set of locks will begin in 2007 and will take up to 8 years, between 2007 and 2014. The third set of locks could begin operations in 2015. During the construction period, the Canal tonnage payments and contributions for operational surplus to the National Treasury will be maintained and increased. These payments will not be less than that paid in 2005 or than that made in 2006.

Program investments for the construction of the third set of locks will be recovered through tolls collected by the Canal.

The financing of the third set of locks will be the result of combining a reasonable tolls increase, implemented immediately after the expansion program is approved through referendum, with interim external financing sources in order to meet requirements during the peak period of the Canal expansion.

Therefore, the third set of locks program will be financed through a mix of PCA capital contributions and interim external financing. The amount to come from external financing will depend on (1) investment amounts required by the project; (2) the need to build as fast as it is technically and economically viable; (3) Canal revenues resulting from Canal traffic volumes and the price policy implemented by PCA.

The source for the repayment of this interim financing will be the Canal tolls and no State guarantees will be utilized to back up the third set of locks program. The external financing contracts undersigned by PCA will be solely guaranteed by the cash flows that the program will generate.

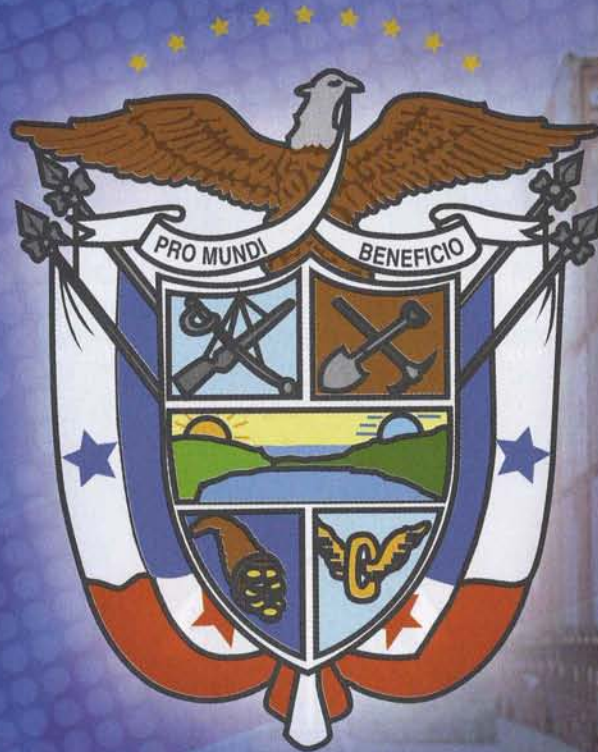
For more information on the Panama Canal, visit the Balboa Administration Building Information Office or call (507) 272-7602 or (507) 272-7677.
The Miraflores Locks Visitors Center is open daily from 9 a.m. to 5 p.m.
Internet users can visit the ACP website at www.pancanal.com or send an e-mail to info@pancanal.com

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*National Coat of Arms of the Republic of Panama
Designed by Nicanor Villalaz - 1904*



The Coat of Arms of the Republic of Panama is of pointed form and it is divided in three sections:

- The head is divided in two quarters: in the one of the right hand, in the silver field, a sword and a gun are hung meant as abandonment for always to the civil wars; in the one of the left-hand side, and on field of gules, a crossed shovel and a grub hoe are shown shining, to symbolize the work*
- The center shows the Isthmus with its seas and sky, in which the moon begins to rise above the waves and the sun begins to hide behind the mountain, marking thereby the solemn hour of the declaration of our independence.*
- The bottom section is divided in two quarters: the one of the right-hand side, in blue field, shows a cornucopia, emblem of the wealth; and the one of the left-hand side, in field of silver, the winged wheel, symbol of the progress.*

Behind the shield and covering it with his opened wings, is the eagle, emblem of the sovereignty, the head turned towards the left, and takes in the tip a silver tape, which hangs from right to left. On the tape the following motto is printed "Pro Mundi Beneficio". On the eagle, in arc form, nine gold stars go in representation of the provinces in which the Republic is divided. On each side of the coat there are two gathered national flags.

"The Panama Canal: national identity symbol"