

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2006

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission file number 0-9827

PHI, INC.

(Exact name of registrant as specified in its charter)

**2001 SE Evangeline Thruway
Lafayette, Louisiana 70508
(337) 235-2452**

(Address, including zip code and telephone number of principal executive office)

Securities registered pursuant to Section 12(b) of the Act: NONE

Securities registered pursuant to Section 12(g) of the Act:

Title of Each Class
Voting Common Stock
Non-Voting Common Stock

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes: No:

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes: No:

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes: No:

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer See definition of "accelerated filer" and "large accelerated filer" in Rule 12b-2 of the Exchange Act (Check One). Large accelerated filer

Accelerated filer: Non-accelerated filer:

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes: No:

The aggregate market value of the voting and non-voting common stock held by non-affiliates of the registrant as of June 30, 2006 was \$501,416,427 based upon the last sales price of the Common Stock on June 30, 2006, as reported on the Nasdaq National Market System.

The number of shares outstanding of each of the registrant's classes of common stock, as of February 28, 2007 was:
Voting Common Stock..... 2,852,616 shares. Non-Voting Common Stock.....12,423,992 shares.

Documents Incorporated by Reference

Portions of the registrant's definitive Information Statement for the 2007 Annual Meeting of Shareholders are incorporated by reference into Part III of this Form 10-K.

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PHI, INC.

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PART I

Forward-Looking Statements

All statements other than statements of historical fact contained in this Form 10-K and other periodic reports filed by PHI, Inc. (the “Company” or “PHI”) under the Securities Exchange Act of 1934 and other written or oral statements made by it or on its behalf, are forward-looking statements. When used herein, the words “anticipates”, “expects”, “believes”, “goals”, “intends”, “plans”, “projects” and similar words and expressions are intended to identify forward-looking statements. Forward-looking statements are based on a number of assumptions about future events and are subject to significant risks, uncertainties, and other factors that may cause the Company’s actual results to differ materially from the expectations, beliefs, and estimates expressed or implied in such forward-looking statements. Although the Company believes that the assumptions underlying the forward-looking statements are reasonable, no assurance can be given that such assumptions will prove correct or even approximately correct. Factors that could cause the Company’s results to differ materially from the expectations expressed in such forward-looking statements include but are not limited to the following: unexpected variances in flight hours, the effect on demand for our services caused by volatility of oil and gas prices and the level of exploration and production activity in the Gulf of Mexico, the effect on our operating costs of volatile fuel prices, the availability of capital required to acquire aircraft, environmental risks, hurricanes and other adverse weather conditions, the activities of our competitors, changes in government regulation, unionization, operating hazards, risks related to operating in foreign countries, the ability to obtain adequate insurance, at an acceptable cost and the ability of the Company to develop and implement successful business strategies. For a more detailed description of risks, see the “Risk Factors” section in Item 1A below. All forward-looking statements in this document are expressly qualified in their entirety by the cautionary statements in this paragraph and the Risk Factors section below. PHI undertakes no obligation to update publicly any forward-looking statements, whether as a result of new information, future events, or otherwise.

ITEM 1. BUSINESS

General

Since our inception in 1949, our primary business has been the safe and reliable transportation of personnel and, to a lesser extent, parts and equipment, to, from, and among offshore platforms for customers engaged in the oil and gas exploration, development, and production industry, principally in the Gulf of Mexico. We are a leading provider of helicopter transportation services in the Gulf of Mexico. We also provide helicopter services to the oil and gas industry internationally, and to non-oil and gas customers such as health care providers and U.S. governmental agencies such as the National Science Foundation. We also provide helicopter maintenance and repair services to certain customers. At December 31, 2006, we owned or operated approximately 236 aircraft domestically and internationally.

Availability of SEC filings and other information

Our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to any of these reports are available free of charge through our web site: www.phihelico.com. These reports are available as soon as reasonably practicable after we file them with the Securities and Exchange Commission (“SEC”). You may also read and copy any of the materials that we file with the SEC at the SEC’s Public Reference Room at 100 F. Street, N.E., Washington, DC 20549. You may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC also maintains a web site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC. The SEC’s website address is www.sec.gov.

Description of Operations

We operate in four business segments: Domestic Oil and Gas, Air Medical, International, and Technical Services. For financial information regarding our operating segments and the geographic areas in which they operate, see Note 9 of the Notes to Consolidated Financial Statements included elsewhere in this Form 10-K.

Domestic Oil and Gas. Our Domestic Oil and Gas segment operates approximately 152 owned, leased, and customer-owned aircraft from several bases or heliports in the Gulf of Mexico region. Those operations serve facilities located in the Gulf of Mexico. Operating revenues from the Domestic Oil and Gas segment accounted for 60%, 60%, and 62% of consolidated operating revenues during the years ended December 31, 2006, December 31, 2005, and December 31, 2004, respectively.

Oil and gas exploration and production companies and other offshore oil service companies use our services primarily for routine transportation of personnel and equipment, to transport personnel during medical and safety emergencies, and to evacuate personnel during the threat of hurricanes and other adverse weather conditions. Most of our customers have entered into contracts for transportation services for a term of one year or longer, although some hire us on an “ad hoc” or “spot” basis.

Most of our Domestic Oil and Gas aircraft are available for hire by any customer, but some are dedicated to individual customers. Our helicopters have flight ranges of up to 495 miles with a 30-minute fuel reserve and thus are capable of servicing many of the deepwater oil and gas operations that are from 50 to 200 miles offshore. (See Item 2. – Properties, for specific information by aircraft model.)

Air Medical. We provide air medical transportation services for hospitals and emergency service agencies where we operate as an independent provider of medical services in 12 states using approximately 68 aircraft at 55 separate locations, which includes locations prior to the expansion. The aircraft dedicated to this segment are specially outfitted to accommodate emergency patients and emergency medical equipment. Our helicopters transport patients between hospitals, as well as to hospitals from accident sites or rural locations where ground transportation would be prohibitively slow. We are paid by either commercial insurance companies, federal or state agencies such as Medicare and Medicaid, or the patient. The Air Medical segment’s operating revenues accounted for 32%, 31%, and 27% of consolidated operating revenues for the years ended December 31, 2006, December 31, 2005, and December 31, 2004, respectively.

International. Our International segment uses approximately 16 aircraft to provide helicopter services in Angola, Antarctica, and the Democratic Republic of Congo. Aircraft operating internationally are typically dedicated to one customer, most of which are oil and gas customers. Operating revenues from our International segment accounted for 6% of consolidated operating revenues for the year ended December 31, 2006, and 8% for each of the years ended December 31, 2005 and 2004.

Technical Services. We perform maintenance and repair services at our Lafayette facility pursuant to an FAA repair station license, primarily for our existing customers that own their aircraft. The license includes authority to repair airframes, powerplants, accessories, radios, and instruments and to perform specialized services.

Operating revenues from the Technical Services segment accounted for 2%, 1%, and 3% of consolidated operating revenues for the years ended December 31, 2006, December 31, 2005, and December 31, 2004, respectively.

Seasonal Aspects

Seasonality affects our operations, in three principal ways: weather conditions are generally poorer in December, January, and February; tropical storms and hurricanes are prevalent in the Gulf of Mexico in late summer and early fall; and reduced daylight hours restrict our operations in winter, which result in reduced flight hours. When a tropical storm or hurricane is about to enter or begins developing in the Gulf of Mexico, flight activity may temporarily increase because of evacuations of offshore workers, but during the storms, we are unable to operate in the area of the storm and can incur significant expense in moving our aircraft to safer locations. For a more detailed discussion of these events, see the “Adverse Weather Conditions” paragraph in the “Risk Factors” section of Item 1A. Our operating results vary from quarter to quarter, depending on seasonal factors and other factors outside of our control. As a result, full year results are not likely to be a direct multiple of any particular quarter or combination of quarters.

Inventories

We carry a significant inventory of aircraft parts to support the maintenance and repair of our helicopters. Many of these inventory items are parts that have been removed from aircraft, refurbished according to manufacturers and FAA specifications, and returned to inventory. The cost to refurbish these parts is expensed as incurred. We use systematic procedures to estimate the value of these used parts, which includes consideration of their condition and

continuing utility. The carrying values of inventory reported in our financial statements are affected by these estimates and may change from time to time if our estimated values change.

Customers

Our principal customers are major integrated energy companies and independent exploration and production companies. We also serve oil and gas service companies, hospitals and medical programs under the independent provider model, government agencies, and other aircraft owners and operators. Our largest customer is in our Domestic Oil and Gas segment and accounted for 17%, 14%, and 13% of operating revenues for the years ended December 31, 2006, 2005, and 2004, respectively. We have entered into contracts with most of our customers for terms of at least one year, although most contracts include provisions permitting earlier termination.

Competition

Our business is highly competitive in each of our markets, and many of our contracts are awarded after competitive bidding. Factors that impact competition include safety, reliability, price, availability of appropriate aircraft and quality of service. Some of our competitors recently have undertaken expansion and/or upgrades of their fleets.

We are a leading operator of helicopters in the Gulf of Mexico. There are two major and several small competitors operating in the Gulf of Mexico market. Although most oil companies traditionally contract for most specialty services associated with offshore operations, including helicopter services, certain of our customers and potential customers in the oil industry operate their own helicopter fleets, or have the capability to do so if they so elect.

In the air medical market, we compete against national and regional firms, and there is usually more than one competitor in each local market. In addition, we compete against hospitals that operate their own helicopters and, in some cases, against ground ambulances as well.

Our international operations primarily serve customers in the oil and gas industry, although we do service some U.S. governmental agencies, such as the National Science Foundation. Most of our international contracts are subject to competitive bidding, and certain of our principal competitors domestically also compete internationally. In addition, there is one additional major competitor internationally that does not compete domestically. Typically, in each international area there are firms that compete only in that region.

Employees

As of December 31, 2006, we employed approximately 2,126 full-time employees and 41 part-time employees, including approximately 525 pilots and 1,373 aircraft maintenance and support personnel. At December 31, 2005, we employed 2,110 full-time employees and 65 part-time employees.

As previously reported, the pilots represented by the OPEIU (the Office and Professional Employees International Union) commenced a general strike on September 20, 2006, affecting both the Domestic Oil and Gas and Air Medical segments. Approximately 236 pilots initially participated in this strike, out of a total pilot work force of 597 as of the date the strike commenced. On November 10, the OPEIU made a purported "unconditional" offer for the strikers to return to work and an end to strike activities. To date, 196 of the 236 strikers (83%) have been rehired or have taken themselves out of consideration for reemployment. On January 11, 2007, the Federal Court for the Western District of Louisiana agreed to our return-to-work criteria and process for the remaining striking pilots, and we are committed to processing those pilots back to work by April 29, 2007. Pilots are currently working under the terms and conditions of employment set forth in the final implementation proposals made by the Company at the end of collective bargaining negotiations on August 28, 2006.

Other issues surrounding PHI's allegations that the OPEIU engaged in bad faith bargaining, as well as the OPEIU's counterclaims and claims arising out of the OPEIU's offer to return to work, remain outstanding and are expected to be addressed by the same Federal Court. A trial on these matters is currently set to start on November 7, 2007. It is not possible to assess the outcome of the remaining claims and counterclaims.

In addition to processing the remaining striking pilots back to work, we are also hiring additional pilots. This process was interrupted November 10, 2006, when the union announced that the striking pilots would return to work unconditionally. In early January 2007, we again commenced hiring additional pilots based on the requirements due to new aircraft deliveries. As of February 28, 2007, the pilot work force was 648.

Environmental Matters

We are subject to federal, state and local environmental laws and regulations that impose limitations on the discharge of pollutants into the environment and establish standards for the treatment, storage, recycling, and disposal of toxic and hazardous wastes. Operating and maintaining helicopters requires that we use, store, and dispose of materials that are subject to federal and state environmental regulation. We periodically conduct environmental site surveys at our facilities, and determine whether there is a need for environmental remediation based on these surveys.

ITEM 1.A. Risk Factors

All phases of our operations are subject to significant uncertainties, risks, and other influences. Important factors that could cause our actual results to differ materially from anticipated results or other expectations include the following:

RISKS INHERENT IN OUR BUSINESS

Our operations are affected by adverse weather conditions and seasonal factors.

We are subject to three types of weather-related or seasonal factors:

- the tropical storm and hurricane season in the Gulf of Mexico;
- poor weather conditions that often prevail during winter and can develop in any season; and
- reduced daylight hours during the winter months.

Poor visibility, high winds and heavy precipitation can affect the operation of helicopters and significantly reduce our flight hours. A significant portion of our operating revenue is dependent on actual flight hours and a substantial portion of our direct costs is fixed. Thus, prolonged periods of adverse weather can materially and adversely affect our operating revenues and net earnings.

In the Gulf of Mexico, the months of December, January and February have more days of adverse weather conditions than the other months of the year. Also, June through November is tropical storm and hurricane season in the Gulf of Mexico, with August and September typically being the most active months. During tropical storms, we are unable to operate in the area of the storm and can incur significant expense in moving our aircraft to safer locations. In addition, as most of our facilities are located along the Gulf of Mexico coast, tropical storms and hurricanes may cause substantial damage to our property, including helicopters that we are unable to relocate.

Because the fall and winter months have fewer hours of daylight, our flight hours are generally lower at those times, which typically results in a reduction in operating revenues during those months. Currently, only 44 of the 152 helicopters used in our oil and gas operations are equipped to fly under instrument flight rules, or IFR, which enables these aircraft, when manned by IFR-rated pilots and co-pilots, to operate when poor visibility or darkness prevents flight by aircraft that can fly only under visual flight rules, or VFR. Not all of our pilots are IFR rated.

We may not be able to obtain acceptable customer contracts covering some of our new helicopters, and there will be a delay between the time that a helicopter is delivered to us and the time that it can begin generating revenues.

We are substantially expanding our fleet of helicopters. Many of our new oil and gas helicopters may not be covered by customer contracts when they are placed into service, and we cannot assure you as to when we will be able to utilize these new helicopters or on what terms. In addition, with respect to those helicopters that will be covered by customer contracts when they are placed into service, our contract terms generally are too short to recover our cost of purchasing the helicopter at current rates. Thus, we are subject to the risk that we will be unable to recoup our investment in the helicopters.

Once a new helicopter is delivered to us, we generally spend between two and five months installing mission-specific and/or customer-specific equipment before we place it into service. As a result, there can be a significant delay between the delivery date for a new helicopter and the time that it is able to generate revenues for us.

There is also a possibility that our customers may request new helicopters in lieu of our existing helicopters, which could adversely affect the utilization of our existing fleet.

Our contracts generally can be terminated or downsized by our customers without penalty.

Most of our fixed-term contracts contain provisions permitting early termination by the customer, sometimes with as little as 30 days' notice for any reason and generally without penalty. In addition, many of our contracts permit our customers to decrease the number of aircraft under contract with a corresponding decrease in the fixed monthly payments without penalty. As a result, you should not place undue reliance on our customer contracts or the terms of those contracts.

Increased governmental regulations could increase our costs or reduce our ability to operate successfully.

Our operations are regulated by a number of federal and state agencies. All of our flight operations are regulated by the Federal Aviation Administration, or FAA. Aircraft accidents are subject to the jurisdiction of the National Transportation Safety Board. Standards relating to the workplace health and safety are monitored by the federal Occupational Safety and Health Administration, or OSHA. We are also subject to various federal and state environmental statutes.

The FAA has jurisdiction over many aspects of our business, including personnel, aircraft and ground facilities. We are required to have an Air Taxi Certificate, granted by the FAA, to transport personnel and property in our helicopters. This certificate contains operating specifications that allow us to conduct our present operations, but it is potentially subject to amendment, suspension or revocation in accordance with procedures set forth in the Federal Aviation Act. The FAA is responsible for ensuring that we comply with all FAA regulations relating to the operation of our aviation business, and conducts regular inspections regarding the safety, training and general regulatory compliance of our U.S. aviation operations. Additionally, the FAA requires us to file reports confirming our continued compliance.

FAA regulations require that at least 75% of our voting securities be owned or controlled by citizens of the U.S. or one of its possessions, and that our president and at least two-thirds of our directors be U.S. citizens. Our Chief Executive Officer and all of our directors are U.S. citizens, and our organizational documents provide for the automatic reduction in voting power of each share of voting common stock owned or controlled by a non-U.S. citizen if necessary to comply with these regulations.

We are subject to significant regulatory oversight by OSHA and similar state agencies. We are also subject to the Communications Act of 1934 because of our ownership and operation of a radio communications flight-following network throughout the Gulf of Mexico.

Numerous other federal statutes and rules regulate our offshore operations and those of our customers, pursuant to which the federal government has the ability to suspend, curtail or modify certain or all offshore operations. A suspension or substantial curtailment of offshore oil and gas operations for any prolonged period would have an immediate and material adverse effect on us. A substantial modification of current offshore operations could adversely affect the economics of such operations and result in reduced demand for our services.

The helicopter services business is highly competitive.

All segments of our business are highly competitive. Many of our contracts are awarded after competitive bidding, and the competition for those contracts generally is intense. The principal aspects of competition are safety, price, reliability, availability and service.

We have two major competitors and several small competitors operating in the Gulf of Mexico, and most of our customers and potential customers could operate their own helicopter fleets if they chose to do so. At least one of our primary competitors is in the process of significantly expanding its fleet.

Our Air Medical segment competes for business primarily under the independent provider model and, to a lesser extent, under the hospital-based model. Under the independent provider model, we have no contracts and no fixed revenue stream, but must compete for transport referrals on a daily basis with other independent operators in the area. Under the hospital-based model, we contract directly with the hospital to provide their transportation services, with the contracts typically awarded on a competitive bid basis. Under both models, we compete against national

and regional companies, and there is usually more than one competitor in each local market. In addition, we compete against hospitals that operate their own helicopters and, in some cases, against ground ambulances as well.

The failure to maintain our safety record would seriously harm our ability to attract new customers and maintain our existing customers.

A favorable safety record is one of the primary factors a customer reviews in selecting an aviation provider. If we fail to maintain our safety and reliability record, our ability to attract new customers and maintain our current customers will be materially adversely affected.

Helicopter operations involve risks that may not be covered by our insurance or may increase the cost of our insurance.

The operation of helicopters inherently involves a high degree of risk. Hazards such as aircraft accidents, collisions, fire and adverse weather are hazards that must be managed by providers of helicopter services and may result in loss of life, serious injury to employees and third parties, and losses of equipment and revenues.

We maintain hull and liability insurance on our aircraft, which insures us against physical loss of, or damage to, our aircraft and against certain legal liabilities to others. In addition, we carry war risk, expropriation, confiscation and nationalization insurance for our aircraft involved in international operations. In some instances, we are covered by indemnity agreements from our customers in lieu of, or in addition to, our insurance. Our aircraft are not insured for loss of use.

While we believe that our insurance and indemnification arrangements provide reasonable protection for most foreseeable losses, they do not cover all potential losses and are subject to deductibles, retentions, coverage limits and coverage exceptions such that severe casualty losses, or the expropriation or confiscation of significant assets could materially and adversely affect our financial condition or results of operations. The occurrence of an event that is not fully covered by insurance could have a material adverse impact on our financial condition and results of operations.

Our air medical operations, which we are expanding, expose us to numerous special risks, including collection risks, high start-up costs and potential medical malpractice claims.

We recently have expanded our air medical business. These operations are highly competitive and expose us to a number of risks that we do not encounter in our oil and gas operations. For instance, the fees for our air medical services generally are paid by individual patients, insurance companies, or government agencies such as Medicare and Medicaid. As a result, our profitability in this business depends not only on our ability to generate an acceptable volume of patient transports, but also on our ability to collect our transport fees. We are not permitted to refuse service to patients based on their inability to pay.

As a result of our recent expansion, even if we are able to generate an acceptable volume of patient transports, we cannot assure you that our new markets will be profitable for us. We generally incurred significant startup costs and lower utilization rates when we entered new air medical markets, which impacted our profitability. Finally, we employ paramedics, nurses and other medical professionals for these operations, which can give rise to medical malpractice claims against us, which, if not fully covered by our medical malpractice insurance, could materially adversely affect our financial condition and results of operations.

Our international operations are subject to political, economic and regulatory uncertainty.

Our international operations, which represented approximately 6% of our total operating revenues for the year ended December 31, 2006, are subject to a number of risks inherent in operating in lesser developed countries, including:

- political, social and economic instability;
- terrorism, kidnapping and extortion;
- potential seizure or nationalization of assets;
- import-export quotas; and
- currency fluctuations or devaluation.

Additionally, our competitiveness in international markets may be adversely affected by government regulation, including regulations requiring:

- the awarding of contracts to local contractors;
- the employment of local citizens; and
- the establishment of foreign subsidiaries with significant ownership positions reserved by the foreign government for local ownership.

Our failure to attract and retain qualified personnel could adversely affect us.

Our ability to attract and retain qualified pilots, mechanics, nurses, paramedics and other highly trained personnel will be an important factor in determining our future success. Many of our customers require pilots of aircraft that service them to have inordinately high levels of flight experience. The market for these experienced and highly trained personnel is extremely competitive. Accordingly, we cannot assure you that we will be successful in our efforts to attract and retain such persons. Some of our pilots and mechanics, and those of our competitors, are members of the U.S. military reserves and could be called to active duty. If significant numbers of such persons are called to active duty, it would reduce the supply of such workers, possibly curtailing our operations and likely increasing our labor costs.

RISKS SPECIFIC TO OUR COMPANY

We are highly dependent on the offshore oil and gas industry.

Approximately 60% of our 2006 operating revenue was attributable to helicopter support for domestic offshore oil and gas exploration and production companies. Our business is highly dependent on the level of activity by the oil and gas companies, particularly in the Gulf of Mexico. The level of activity by our customers operating in the Gulf of Mexico depends on factors that we cannot control, such as:

- the supply of, and demand for, oil and natural gas and market expectations regarding supply and demand;
- weather-related or other natural causes;
- actions of OPEC, and Middle Eastern and other oil producing countries, to control prices or change production levels;
- general economic conditions in the United States and worldwide;
- war, civil unrest or terrorist activities;
- governmental regulation; and
- the price and availability of alternative fuels.

Any substantial or extended decline in the prices of oil and natural gas could depress the level of helicopter activity in support of exploration and production activity, and thus have a material adverse effect on our business, results of operations and financial condition.

Additionally, the Gulf of Mexico is generally considered to be a mature area for oil and gas exploration, which may result in a continuing decrease in activity over time. This could materially adversely affect our business, results of operations and financial condition. In addition, the concentrated nature of our operations subjects us to the risk that a regional event could cause a significant interruption in our operations or otherwise have a material affect on our profitability.

Moreover, companies in the oil and gas exploration and production industry continually seek to implement cost-savings measures. As part of these measures, oil and gas companies have attempted to improve operating efficiencies with respect to helicopter support services. For example, certain oil and gas companies have pooled helicopter services among operators, reduced staffing levels by using technology to permit unmanned production installations and decreased the frequency of transportation of employees offshore by increasing the lengths of shifts offshore. The continued implementation of such measures could reduce demand for helicopter services and have a material adverse effect on our business, results of operations and our financial condition.

Our pilot workforce represented by Office and Professional Employees International Union conducted a general strike beginning on September 20, 2006.

On September 20, 2006, approximately 236 pilots commenced a strike. On November 10, the OPEIU made a purported “unconditional” offer for the strikers to return to work and an end to strike activities. To date, 196 of the 236 strikers have been rehired or have taken themselves out of consideration for reemployment. On January 11, 2007, the Federal Court for the Western District of Louisiana agreed to PHI’s return to work criteria and process for the remaining strikers, and the processing of those pilots should be completed by the end of April. Pilots are currently working under the terms and conditions of employment set forth in the final implementation proposals made by the Company at the end of collective bargaining negotiations on August 28, 2006.

Other issues surrounding PHI’s allegations that the OPEIU engaged in bad faith bargaining, as well as the OPEIU’s counterclaims and claims arising out of the OPEIU’s purported “unconditional” offer to return to work remain outstanding and are expected to be addressed by the same Federal Court. A trial on these matters is currently set to start November 7, 2007. It is not possible to predict the outcome of the remaining claims and counterclaims

We depend on a small number of large oil and gas industry customers for a significant portion of our revenues, and our credit exposure within this industry is significant.

We derive a significant amount of our revenue from a small number of major and independent oil and gas companies. For the year ended December 31, 2006, 17% of our revenues were attributable to our largest customer. The loss of one of our significant customers, if not offset by revenues from new or other existing customers, would have a material adverse effect on our business and operations. In addition, this concentration of customers may impact our overall credit risk in that these entities may be similarly affected by changes in economic and other conditions.

Our Chairman of the Board and Chief Executive Officer is also our principal stockholder and has voting control of the Company.

Al A. Gonsoulin, our Chairman of the Board and Chief Executive Officer, beneficially owns stock representing approximately 52% of our total voting power. As a result, he exercises control over the election of all of our directors and the outcome of most matters requiring a stockholder vote. This ownership also may delay or prevent a change in our management or a change in control of us, even if such changes would benefit our other stockholders and were supported by a majority of our stockholders.

Our substantial indebtedness could adversely affect our financial condition and impair our ability to operate our business.

We are a highly leveraged company and, as a result, have significant debt service obligations. As of December 31, 2006, our total indebtedness was \$205.5 million, including \$200 million of our 7.125% Senior Notes due 2013. On April 12, 2006, we completed the sale of 4,287,920 non-voting common shares, and then on May 1, 2006 we completed the sale of the over-allotment of shares of 578,680 non-voting common shares. These transactions resulted in an increase in shareholder equity of \$160.7 million, net of expenses. We also issued \$200 million of 7.125% Senior Notes due April 15, 2013. Proceeds of the Notes were used to retire our existing \$200 million 9 3/8% Senior Notes due May 1, 2009. These transactions are discussed in more detail under “Management’s Discussion And Analysis of Financial Condition and Results of Operations – Overview” on page 14. As a result of these transactions, our debt to equity ratio at December 31, 2006 was 0.51 to 1.00, as compared to 0.85 to 1.00 at December 31, 2005.

At December 31, 2006, we had \$5.5 million in borrowings and \$5.1 million in letters of credit outstanding under our revolving line of credit. As of December 31, 2006, availability for borrowings under our revolving credit facility was \$24.3 million.

Our substantial indebtedness could have significant negative consequences to us that you should consider. For example, it could:

- require us to dedicate a substantial portion of our cash flow from operations to pay principal of, and interest on, our indebtedness, thereby reducing the availability of our cash flow to fund working capital, capital expenditures or other general corporate purposes, or to carry out other aspects of our business plan;

- increase our vulnerability to general adverse economic and industry conditions and limit our ability to withstand competitive pressures;
- limit our flexibility in planning for, or reacting to, changes in our business and future business opportunities;
- place us at a competitive disadvantage compared to our competitors that have less debt; and limit our ability to obtain additional financing to fund future working capital, capital expenditures and other aspects of our business plan.
- limit our ability to obtain additional financing for working capital, capital expenditures and other aspects of our business plan.

Our ability to meet our debt obligations and other expenses will depend on our future performance, which will be affected by financial, business, economic, regulatory and other factors, many of which we are unable to control. When our 7.125% Senior Notes come due in 2013, we will likely need to enter into new financing arrangements at that time to repay those notes. We may be unable to obtain that financing on favorable terms, which could adversely affect our business, financial condition and results of operations. For more information on our indebtedness, please see the financial statements included elsewhere herein.

The DOJ investigation could result in criminal proceedings and the imposition of fines and penalties.

On June 15, 2005, we received a subpoena from the United States Department of Justice relating to a grand jury investigation of potential antitrust violations among providers of helicopter transportation services in the Gulf of Mexico. We are cooperating fully with the investigation and believe we have provided all documents and other information required by the subpoena. We will respond to any DOJ request for further information, and will continue to cooperate with the investigation.

We cannot predict the ultimate outcome of the DOJ investigation. The outcome of the DOJ investigation and any related legal proceedings could include civil injunctive or criminal proceedings, the imposition of fines and other penalties, remedies and/or sanctions, referral to other governmental agencies and/or the payment of damages in civil litigation, any of which could have a material adverse effect on our business, financial condition and results of operations. Additionally, the cost of defending such an action or actions against us could be significant.

Our stock has a low trading volume.

Our common stock is listed for trading on The NASDAQ National Market System under the symbol “PHIHK” for our non-voting common stock and “PHII” for our voting common stock. Both classes of common stock have low trading volume. As a result, a stockholder may not be able to sell shares of our common stock at the time, in the amounts, or at the price desired.

We do not pay dividends.

We have not paid any dividends on our common stock since 1999 and do not anticipate that we will pay dividends on our common stock in the foreseeable future. In addition, our ability to pay dividends is restricted by the indenture governing our 7.125% Senior Notes due 2013 and our bank credit facility.

Provisions in our articles of incorporation and by-laws and Louisiana law make it more difficult to effect a change in control of us, which could discourage a takeover of our company and adversely affect the price of our common stock.

Although an attempted takeover of our company is unlikely by virtue of the ownership by our chief executive officer of more than 50% of the total voting power of our capital stock, there are also provisions in our articles of incorporation and by-laws that may make it more difficult for a third party to acquire control of us, even if a change in control would result in the purchase of your shares at a premium to the market price or would otherwise be beneficial to you. For example, our articles of incorporation authorize our board of directors to issue preferred stock without stockholder approval. If our board of directors elects to issue preferred stock, it could be more difficult for, or discourage, a third party to acquire us.

In addition, provisions of our by-laws, such as giving the board the exclusive right to fill all board vacancies, could make it more difficult for a third party to acquire control of us. In addition to the provisions contained in our articles of incorporation and by-laws, the Louisiana Business Corporation Law (“LBCL”), includes certain provisions applicable to Louisiana corporations, such as us, which may be deemed to have an anti-takeover effect. Such provisions give stockholders the right to receive the fair value of their shares of stock following a control transaction from a controlling person or group and set forth requirements relating to certain business combinations. Our descriptions of these provisions are only abbreviated summaries of detailed and complex statutes. For a complete understanding of the statutes, you should read them in their entirety.

The LBCL’s control share acquisition statute provides that any person who acquires “control shares” will be able to vote such shares only if the right to vote is approved by the affirmative vote of at least a majority of both (i) all the votes entitled to be cast by stockholders and (ii) all the votes entitled to be cast by stockholders excluding “interested shares.” The control share acquisition statute permits the articles of incorporation or bylaws of a company to exclude from the statute’s application acquisitions occurring after the adoption of the exclusion. Our by-laws do contain such an exclusion; however, our board of directors or stockholders, by an amendment to our by-laws, could reverse this exclusion.

Future sales of our shares could depress the market price of our non-voting common stock.

The market price of our non-voting common stock could decline as a result of issuances and sales by us of additional shares of non-voting or voting common stock pursuant to our existing shelf registration statement or otherwise. The market price of our non-voting common stock could also decline as the result of the perception that these sales could occur. These sales, or the possibility that these sales may occur, also might make it more difficult for us to sell equity securities in the future at a time and at a price that we deem appropriate.

ITEM 1.B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

Aircraft

Information regarding our owned and leased aircraft fleet as of December 31, 2006 is set forth in the following table:

<u>Manufacturer</u>	<u>Type</u>	<u>Number in Fleet</u>	<u>Engine</u>	<u>Passengers</u>	<u>Cruise Speed (mph)</u>	<u>Appr. Range (miles)⁽²⁾</u>
Light Aircraft						
Bell	206 / 407	93	Turbine	4 – 6	130 – 150	300 – 420
Eurocopter	BK-117 / BO-105	15	Twin Turbine	4 – 6	135	255 – 270
Eurocopter	EC-135 ⁽¹⁾	20	Twin Turbine	7	143	382
Aerospatiale	AS350 B2 / B3	24	Turbine	5	140	337 – 385
Medium Aircraft						
Bell	212 ⁽¹⁾ / 222 ⁽¹⁾ 230 ⁽¹⁾ / 412 ⁽¹⁾	25	Twin Turbine	8 – 13	115 – 160	300 – 370
Sikorsky	S-76 ⁽¹⁾ A, A++, C+	28	Twin Turbine	12	150	400
Transport Aircraft						
Bell	214ST ⁽¹⁾	4	Twin Turbine	18	155	429
Sikorsky	S-92A ⁽¹⁾	8	Twin Turbine	19	160	495
	Total Helicopters	<u>217</u>				
Fixed Wing						
Rockwell ⁽³⁾	Aero Commander	2	Turboprop	6	300-340	1,200-1,600
Lear Jet ⁽³⁾	31A ⁽¹⁾	1	Turbojet	8	527	1,437
Cessna ⁽⁴⁾	Conquest 441 ⁽¹⁾	3	Turboprop	6	330	1,200
Beech ⁽⁴⁾	King Air ⁽¹⁾	1	Turboprop	8	300	1,380
	Total Fixed Wing	<u>7</u>				
	Total Aircraft	<u><u>224</u></u>				

- (1) Equipped to fly under instrument flight rules (“IFR”). All other types listed can only fly under visual flight rules (“VFR”). See Item 1A. “Business – Risk Factors, Risks Inherent In Our Business – Our operations are affected by adverse weather conditions and seasonal factors.”
- (2) Based on maintaining a 30-minute fuel reserve.
- (3) Aircraft used for corporate purposes.
- (4) Aircraft used in the Air Medical segment.

Of the 224 aircraft listed, we own 206 and lease 18. Additionally, we operate 12 aircraft owned by customers that are not reflected in the above table. In total, we own or operate 236 aircraft.

We sell aircraft whenever they (i) become obsolete or (ii) do not fit into future fleet plans.

Facilities

Our principal facilities are located on property leased from the Lafayette Airport Commission at Lafayette Regional Airport in Lafayette, Louisiana. The lease covers approximately 28 acres and two buildings, with an aggregate of approximately 256,000 square feet, housing our main operational, executive, and administrative offices and the main repair and maintenance facility. The lease for this facility commenced in 2001, expires in 2021 and contains three five-year renewal options following the expiration date.

We own our Boothville, Louisiana operating facility. The property has a 23,000 square foot building, a 7,000 square foot hangar, and landing pads for 35 helicopters. This facility was extensively damaged by Hurricane Katrina, but was repaired and returned to service in 2006.

We also lease property for an Executive and Marketing office in Houston, Texas and 12 additional bases to service the oil and gas industry throughout the Gulf of Mexico. Those bases that represent a significant investment in leasehold improvements and are particularly important to our operations are:

<u>Facility</u>	<u>Lease Expiration</u>	<u>Area</u>	<u>Facilities</u>	<u>Comments</u>
Morgan City (Louisiana)	June 30, 2008	53 acres	Operational and maintenance facilities, landing pads for 46 helicopters	Options to extend to June 30, 2018
Intracoastal City (Louisiana)	December 31, 2008	18 acres	Operational and maintenance facilities, landing pads for 45 helicopters	Options to extend to December 31, 2010
Houma-Terrebonne Airport (Louisiana)	August 31, 2008	14 acres	Operational and maintenance facilities, landing pads for 30 helicopters	Three renewal options to extend for one year each
Galveston (Texas)	May 31, 2021	4 acres	Operational and maintenance facilities, landing pads for 30 helicopters	Lease period to May 31, 2021 with certain cancellation provisions
Fourchon (Louisiana)	February 28, 2008	8 acres	Operational and maintenance facilities, landing pads for 10 helicopters	Facility under three separate leases, of which two contain options to extend thru 2026 and 2028.

Our other operations-related facilities in the United States are located at New Orleans and Lake Charles, Louisiana; at Port O'Connor and Sabine Pass, Texas; and at Theodore, Alabama.

We also operate from offshore platforms that are provided without charge by the owners of the platforms, although in certain instances we are required to indemnify the owners against loss in connection with our use of their facilities.

We also lease office and hangar space for our Air Medical operations in Phoenix, Arizona. The two buildings are held under separate leases and collectively provide 5,000 square feet of hangar space and 26,000 square feet of office space. The leases expire in 2009, subject to options to extend for up to ten additional years. Other Air Medical bases are located in California, Indiana, Kentucky, Maryland, New Jersey, New Mexico, Texas and Virginia. Other bases for our International and other Air Medical operations are generally furnished by customers.

ITEM 3. LEGAL PROCEEDINGS

We have been named as a defendant in various legal actions that have arisen in the ordinary course of our business and have not been finally adjudicated. In the opinion of management, the amount of the ultimate liability with respect to these actions will not have a material adverse effect on our consolidated financial condition, results of operations or liquidity.

As previously reported, on June 15, 2005, we received a subpoena from the United States Department of Justice relating to a grand jury investigation of potential antitrust violations among providers of helicopter transportation services in the Gulf of Mexico. We are cooperating fully with the investigation and believe we have provided all documents and other information required by the subpoena. We have not received any further communications from the Department of Justice since shortly after providing the requested information. At this stage, it is not possible to predict the outcome of this investigation, although based on the information available to us to date, management does not expect the outcome of the investigation to have a material adverse effect on our financial condition, results of operations, or liquidity.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED SHAREHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our voting and non-voting common stock trades on The Nasdaq National Market System, under the symbols PHII and PHIIK, respectively. The following table sets forth the range of high and low sales prices per share, as reported by Nasdaq, for our voting and non-voting common stock for the fiscal quarters indicated.

Period	Voting		Non-Voting	
	High	Low	High	Low
January 1, 2006 to March 31, 2006	\$ 41.00	\$ 29.00	\$ 39.48	\$ 30.00
April 1, 2006 to June 30, 2006	38.00	29.99	38.54	29.00
July 1, 2006 to September 30, 2006	34.24	29.01	34.39	26.69
October 1, 2006 to December 31, 2006	34.10	27.29	33.06	27.56
January 1, 2005 to March 31, 2005	\$ 30.25	\$ 23.42	\$ 30.11	\$ 20.75
April 1, 2005 to June 30, 2005	30.95	24.10	30.50	23.12
July 1, 2005 to September 30, 2005	35.48	23.90	32.48	23.02
October 1, 2005 to December 31, 2005	34.59	27.25	32.40	26.35

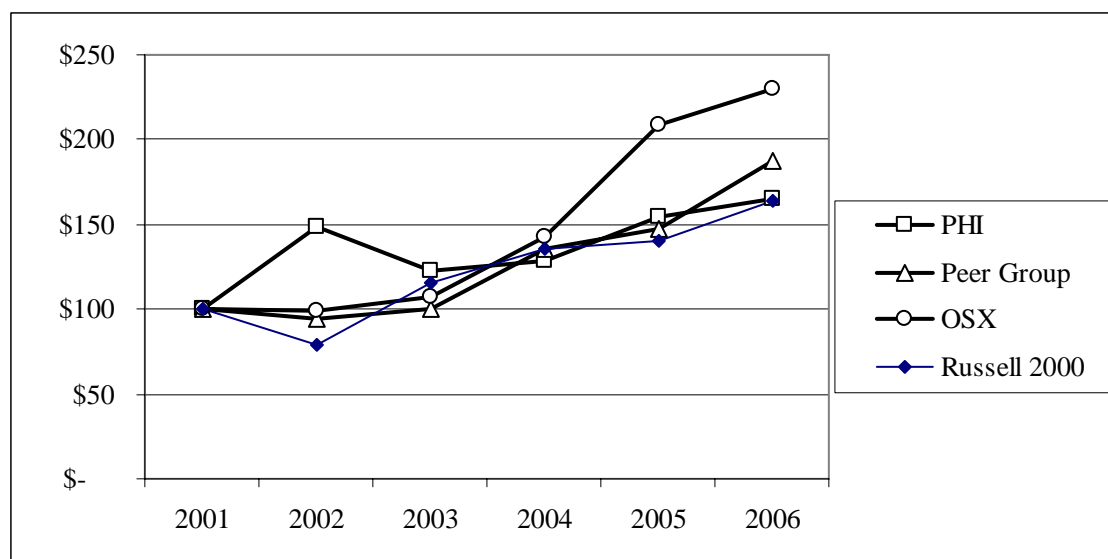
We have not paid dividends on either class of our common stock since 1999 and do not expect to pay dividends in the foreseeable future.

In addition, the indenture governing our 7.125% Series B Senior Notes due 2013 and our revolving credit facility with a commercial bank restrict the payment of dividends. See Item 8. "Financial Statements and Supplementary Data – Notes to the Consolidated Financial Statements, Note 3.

Stock Performance Graph

The information included under the caption "Stock Performance Graph" in this Item 5 of this Annual Report on Form 10-K is not deemed to be "soliciting material" or to be "filed" with the SEC or subject to Regulation 14A or 14C under the Securities Exchange Act of 1934 or to the liabilities of Section 18 of the Securities Act of 1934, and will not be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, except to the extent we specially incorporate it by reference into such a filing.

The following performance graph compares PHI's cumulative total stockholder return on its Voting Stock for the last five years with the cumulative total return on the Russell 2000 Index and the Oil Service Index, assuming the investment of \$100 on January 1, 2001, at closing prices on December 31, 2000, and reinvestment of dividends. The Russell 2000 Index consists of a broad range of publicly-traded companies with small market capitalizations of \$0.5 billion to \$1.07 billion, and is published daily in the Wall Street Journal. The peer group companies are Bristow Group, Inc.; Tidewater, Inc.; Gulfmark Offshore, Inc.; CHC Helicopter Corp.; Seacor Holdings, Inc.; and Air Methods Corp.



<u>Index</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>
PHI	100.00	148.20	122.50	128.90	155.00	165.00
Peer Group	100.00	94.64	100.71	135.61	147.59	187.73
OSX	100.00	99.50	107.82	142.23	209.02	229.40
Russell 2000	100.00	79.30	115.60	135.25	139.75	163.50

As of February 28, 2007, there were approximately 932 holders of record of our voting common stock and 62 holders of record of our non-voting common stock.

Information regarding our stock based compensation plan is included in Item 8, Notes to Consolidated Financial Statements Note (5) EMPLOYEE BENEFIT PLANS – Stock Based Compensation.

On April 12, 2006, we issued \$200.0 million of 7.125% Senior Notes that mature in 2013. These Notes were offered and sold in a private placement under Rule 144A and Regulation S under the Securities Act of 1933. Net proceeds of \$196.0 million were used to repurchase \$184.8 million of our outstanding 9 3/8% Senior Notes due 2009 pursuant to a tender offer that also closed on April 12, 2006. Our total cost to repurchase those notes was \$201.6 million, including the tender offer premium and accrued interest. We called for redemption on May 1, 2006, the remaining \$15.2 million of 9 3/8% notes outstanding, at a redemption price of 104.688% of their face amount plus accrued and unpaid interest. Interest on the 7.125% notes is payable semi-annually on April 15 and October 15, and those notes mature April 15, 2013. The estimated annual interest cost of the new notes is \$14.3 million, excluding amortization of issuance costs, which represents a reduction in annual interest cost on the notes of \$4.5 million. As a result of the early redemption of the 9 3/8% notes, a pretax charge of \$12.8 million (\$7.7 million, net of tax) was recorded as a charge for debt restructuring in the quarter ended June 30, 2006, which consisted of \$9.8 million for the early call premium, \$2.6 million of unamortized issuance costs, and \$0.4 million in related expenses for the tender of outstanding notes.

The new notes contain restrictive covenants, including limitations on indebtedness, liens, dividends, repurchases of capital stock and other payments affecting restricted subsidiaries, issuance and sales of restricted subsidiary stock, dispositions of proceeds of asset sales, and mergers and consolidations or sales of assets. We were in compliance with the covenants applicable to these notes as of December 31, 2006.

ITEM 6. SELECTED FINANCIAL DATA

The selected financial data presented below for each of the past five fiscal periods should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and the Consolidated Financial Statements and Notes to Consolidated Financial Statements included elsewhere in this Annual Report.

	Year Ended December 31,				
	2006	2005	2004 (Thousands)	2003	2002
Income Statement Data					
Operating revenues	\$413,118	\$363,610	\$291,308	\$269,392	\$283,751
Net earnings (loss)	(667)	14,154	3,972	1,139	9,231
Net earnings (loss) per share					
Basic	(0.05)	1.76	0.74	0.21	1.73
Diluted	(0.05)	1.76	0.72	0.21	1.70
Weighted average shares outstanding					
Basic	13,911	8,040	5,383	5,383	5,334
Diluted	13,911	8,063	5,486	5,486	5,438
Cash dividends declared per share	--	--	--	--	--
Cash Flow Data					
Net cash provided by operating activities	\$ 30,324	\$ 28,020	\$ 10,905	\$ 29,415	\$ 39,529
Net cash used in investing activities ⁽¹⁾	(178,928)	(137,464)	(18,594)	(30,943)	(169,760)
Net cash provided by financing activities	146,388	108,947	8,275	2,026	127,245
Balance Sheet Data ⁽²⁾					
Current assets	\$307,689	\$224,265	\$128,405	\$110,135	\$103,851
Working capital	254,099	162,527	88,716	70,300	72,751
Property, plant and equipment, net	369,465	311,678	253,241	258,526	252,577
Total assets	700,970	549,209	394,173	377,454	366,707
Total debt	205,500	204,300	210,275	202,000	200,000
Shareholders' equity	400,125	239,051	109,975	105,993	104,854

(1) See "Restatement" in Note 1 to the Consolidated Financial Statements.

(2) As of the end of the period.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") should be read in conjunction with our Consolidated Financial Statements and the related Notes included elsewhere in this report.

Overview

As previously reported, the pilots represented by the OPEIU (the Office and Professional Employees International Union), commenced a general strike on September 20, 2006, affecting both the Domestic Oil and Gas and Air Medical segments. Approximately 236 pilots initially participated in this strike, out of a total pilot work force of 597.

Shortly after the strike began and until November 10, 2006, the Company began aggressively hiring new pilots, while also processing an increasing number of pilots who voluntarily elected to return to work from the strike. On November 10, 2006, the OPEIU notified the Company that it was ending the strike, purportedly offering an "unconditional" return to work of the remaining striking pilots. Thereafter, questions arose over whether the OPEIU's offer was indeed unconditional. As a result, the parties were unable to agree on a return to work process, and the OPEIU subsequently filed suit seeking injunctive relief in the United States District Court for the Western District of Louisiana.

On January 11, 2007, Federal Court conducted a hearing relating to our handling of the return to work of the approximately sixty remaining strikers. At the Judge's request, an agreement was reached on a return to work process for those strikers. The agreement provides for a phased-in process (which returns striking pilots by groups, and then by aircraft type as determined by PHI, and then by seniority) that is consistent with the methodology PHI has used with the greater number of former strikers who had already individually offered to return to work. PHI's court-approved methodology focuses on pilot qualifications and currency, safety, customer requirements, training status and certain other criteria. The return-to-work process commenced January 29, 2007 and is expected to conclude by April 29, 2007, although processing of a few pilots who require flight simulator training at third party training facilities may extend the process. To date, 196 of 236 pilots (83%) have been rehired or have taken themselves out of consideration for employment. We continue to operate without a collective bargaining agreement and under a pilot compensation program and other terms and conditions of employment based on the final proposals that were made by the Company at the end of collective bargaining negotiations on August 28, 2006.

Other issues surrounding PHI's allegations that the OPEIU engaged in bad faith bargaining, as well as the OPEIU's counterclaims and claims arising from the OPEIU's offer to return to work remain outstanding and are expected to be addressed by the same Federal Court. A trial on these matters is currently set to start November 7, 2007. It is not possible to predict the outcome of the remaining claims and counterclaims.

In addition to processing the remaining striking pilots back to work, we continue to hire additional pilots. That process was interrupted November 10, 2006, when the union announced that the striking pilots would return to work unconditionally, but in early January 2007, we again commenced hiring pilots based on increasing needs due to new aircraft deliveries. As of February 28, 2007, the pilot work force was 648, compared to a total pilot work force on the date the strike commenced of 597.

Total flight hours were 150,980 for 2006 compared to 154,643 for 2005. The decrease in flight hours was due to the pilots' strike. The number of aircraft in service at December 31, 2006, was 236 compared to 235 at December 31, 2005. Twenty-two new aircraft were delivered in 2006, twenty for service in the Domestic Oil and Gas segment and two for service in Air Medical segment. Twenty-one light aircraft were sold, eighteen from the Domestic Oil and Gas segment and three from the Air Medical segment. These were older aircraft and had little flight time in 2006. In addition, five aircraft were converted from Domestic Oil and Gas use to Air Medical use.

Operating revenues for 2006 were \$413.1 million compared to \$363.6 million for 2005, an increase of \$49.5 million. Domestic Oil and Gas operating revenues increased \$28.4 million due primarily to customer requirements for additional aircraft and contractual rate increases. Operating revenues in the Air Medical segment increased \$21.3 million, or 19%, due to the additional Air Medical operations established during 2005 that were in operation for a full year in 2006. Although Domestic Oil and Gas and Air Medical segments reflected increased revenues compared to 2005, both segments were adversely affected by the pilots' strike. International segment revenues

decreased \$2.6 million due to the scheduled release of one aircraft from contract by the customer and a decrease in flight hour activity. Technical Services operating revenues increased \$2.4 million due to recategorization of certain contractual work for third parties to Technical Services previously recorded in Domestic Oil and Gas.

In the fourth quarter 2006, operating revenues were \$95.3 million compared to operating revenues in the same quarter 2005 of \$102.6 million. The net loss in the fourth quarter 2006 was \$5.3 million or \$0.34 per share diluted share compared to net earnings of \$6.4 million or \$0.62 per diluted share in the fourth quarter 2005. There were 4.9 million additional shares outstanding at December 31, 2006 than were outstanding at December 31, 2005. The loss in the fourth quarter was a result of the pilots' strike.

Although substantial progress has been made in rebuilding the pilot workforce, we expect to report a loss from operations in the first quarter 2007. Although it is not possible to reliably estimate the amount of loss, we expect it to be substantially less than the loss in the fourth quarter 2006. The total pilot work force has continued to increase subsequent to December 31, 2006.

On April 12, 2006, we completed the sale of 4,287,920 non-voting common shares at \$35.00 per share and on May 1, 2006, we completed the sale of another 578,680 shares subject to the underwriters' over-allotment option, also at \$35.00 per share. Proceeds from the sales were \$160.7 million, net of underwriting fees and expenses, and were used to fund the acquisition of aircraft delivered in 2006 and may be used to fund the acquisition of aircraft being delivered in 2007 and 2008. We also issued \$200 million of 7.125% Senior Notes due April 15, 2013 pursuant to Rule 144A and Regulation S of the Securities Act of 1933. Proceeds were \$196.0 million net of underwriting fees and expenses, and were used to retire \$184.8 million of our existing 9 3/8% Senior Notes pursuant to a tender offer, at a total cost of \$201.6 million including an early call premium and accrued interest. We subsequently redeemed the remaining \$15.2 million of Senior Notes outstanding on May 1, 2006, at a redemption price of 104.688% of the face amount plus accrued interest. As a result of the early redemption of the 9 3/8% Senior Notes, we recorded a pretax charge of \$12.8 million (\$7.7 million, net of tax), which consisted of a \$9.8 million early call premium, \$2.6 million of unamortized issuance costs, and \$0.4 million in related expenses for the tender of outstanding notes. On December 8, 2006, we filed a registration statement for an offer to exchange these Notes for debt securities with identical terms.

In 2006, we took delivery of three transport category aircraft, eight medium aircraft and nine light aircraft for service in the Domestic Oil and Gas segment. We also took delivery of two light aircraft for service in the Air Medical segment.

At December 31, 2006, we had an order for two additional transport category aircraft, at an approximate cost of \$37.2 million. We intend to execute an operating lease for these two aircraft.

In addition, at December 31, 2006, we had orders for 34 other aircraft for service in the Domestic Oil and Gas and Air Medical segments, with a total cost of \$144.6 million and scheduled delivery dates throughout 2007 and 2008. Of this total, five aircraft totaling \$16.7 million have been delivered in 2007.

As previously reported, on June 15, 2005, we received a subpoena from the United States Department of Justice relating to a grand jury investigation of potential antitrust violations among providers of helicopter transportation services in the Gulf of Mexico. We are cooperating fully with the investigation and believe we have provided all documents and other information required by the subpoena. We have not received any further communications from the Department of Justice since shortly after providing the requested information. At this stage, it is not possible to predict the outcome of this investigation, although based on the information available to us to date, management does not expect the outcome of the investigation to have a material adverse effect on our financial condition, results of operations, or liquidity.

Results of Operations

The following table presents segment operating revenues, expense and operating profit before tax, along with certain non-financial operational statistics, for the years ended December 31, 2006, 2005 and 2004:

	Year Ended December 31,		
	2006	2005	2004
	(Thousands of dollars)		
Segment operating revenues			
Domestic Oil and Gas	\$ 248,035	\$ 219,644	\$ 180,102
Air Medical	133,397	112,123	77,476
International	25,588	28,192	24,342
Technical Services	6,098	3,651	9,388
Total operating revenues	<u>413,118</u>	<u>363,610</u>	<u>291,308</u>
Segment direct expense			
Domestic Oil and Gas	213,279	173,177	151,107
Air Medical	130,412	104,465	67,664
International	18,456	19,099	18,668
Technical Services	4,125	2,522	7,935
Total direct expense	<u>366,272</u>	<u>299,263</u>	<u>245,374</u>
Segment selling, general and administrative expense			
Domestic Oil and Gas	1,010	1,003	1,499
Air Medical	7,384	6,503	6,525
International	96	214	49
Technical Services	82	7	12
Total selling, general and administrative expense	<u>8,572</u>	<u>7,727</u>	<u>8,085</u>
Total direct and selling, general and administrative expense	<u>374,844</u>	<u>306,990</u>	<u>253,459</u>
Net segment profit (loss)			
Domestic Oil and Gas	33,746	45,464	27,496
Air Medical	(4,399)	1,155	3,287
International	7,036	8,879	5,625
Technical Services	1,891	1,122	1,441
Total	<u>38,274</u>	<u>56,620</u>	<u>37,849</u>
Other, net ⁽¹⁾	9,946	3,230	2,961
Unallocated selling, general and administrative costs	(19,267)	(17,169)	(12,949)
Interest expense	(17,243)	(20,448)	(20,109)
Loss on debt restructuring	(12,790)	--	--
Earnings (loss) before income taxes	<u>\$ (1,080)</u>	<u>\$ 22,233</u>	<u>\$ 7,752</u>
Flight hours			
Domestic Oil and Gas	107,735	111,236	100,814
Air Medical	29,980	26,619	19,595
International	13,265	16,788	15,871
Total	<u>150,980</u>	<u>154,643</u>	<u>136,280</u>
Air Medical Transports	<u>20,808</u>	<u>17,200</u>	<u>11,390</u>
Aircraft operated at period end			
Domestic Oil and Gas	152	155	151
Air Medical	68	64	51
International	16	16	19
Total ⁽²⁾	<u>236</u>	<u>235</u>	<u>221</u>

(1) Including gains on disposition of property and equipment, and other income.

(2) Includes 12, 12, and 14 aircraft as of December 31, 2006, 2005 and 2004, respectively that are customer owned or leased by customers but operated by us.

Year Ended December 31, 2006 compared with Year Ended December 31, 2005

Combined Operations

Revenues – Operating revenues for 2006 were \$413.1 million compared to \$363.6 million for 2005, an increase of \$49.5 million, or 14%. Operating revenues increased in the Domestic Oil and Gas segment \$28.4 million due to an increase in contracted aircraft and an increase due to contractual rate increases. Although revenues increased in the Domestic Oil and Gas segment, flight hours were negatively impacted in the fourth quarter by the pilots' strike, resulting in an estimated revenue decrease of \$4.7 million. Operating revenues in the Air Medical segment also increased \$21.3 million in 2006, due to the additional operating locations established in 2005 that were in service for all of 2006, although patient transport volume and operating revenues were also negatively impacted in the fourth quarter by the pilots' strike. We estimate a decrease in operating revenues in the Air Medical segment of \$4.2 million as a result of the strike. Operating revenues in the International segment decreased \$2.6 million due to the scheduled release of one aircraft from contract and decreased flight hours. Revenues in the Technical Services segment increased \$2.4 million due to recategorization of certain contractual work for third parties to Technical Services that was previously recorded in the Domestic Oil and Gas segment. These items are discussed in the Segment Discussion below.

Other Income and Losses - Gain on equipment dispositions was \$1.9 million for 2006 compared to \$1.2 million for 2005. Gain or loss on equipment dispositions is related to dispositions of aircraft. Other income increased approximately \$6.0 million in 2006 due to interest income on unspent proceeds from securities offerings.

Direct Expenses – Direct expense was \$366.3 million for 2006 compared to \$299.3 million for 2005, an increase of \$67.0 million, or 22%. Included in direct expense are costs incurred as a result of the strike which includes overtime pay and a work completion bonus for working pilots (\$5.7 million), other pilot associated costs (\$1.9 million), and security costs (\$0.6 million).

Direct expense in the Domestic Oil and Gas segment increased by \$40.1 million due to increased employee costs (\$7.2 million) including the strike related amount mentioned above, aircraft parts and repair costs (\$3.9 million), aircraft warranty costs (\$5.4 million), aircraft rent (\$6.7 million), insurance expense (\$3.0 million), aircraft fuel (\$1.7 million), outside services (\$5.1 million), also including (\$1.9 million) pilot associated costs mentioned above, and training costs (\$3.3 million). The remaining increase (\$3.8 million) was due to travel expenses, security services, temporary labor and property taxes. The effect of the strike on this segment, as well as a further discussion of the above items, is described in the Segment Discussion.

Air Medical segment direct expense increased (\$25.9 million) due to new locations opened in 2005 being in service for a full twelve months in 2006 as well as an increase related to the pilots' strike, which is discussed in the Segment Discussion below.

There was also an increase in the Technical Services segment (\$1.6 million), and a decrease in the International segment due to the release of one aircraft from contract as mentioned above (\$0.6 million). These items are also discussed in the Segment Discussion below.

Selling, General, and Administrative Expenses – Selling, general and administrative expense was \$27.8 million for 2006 compared to \$24.9 million for 2005, an increase of \$2.9 million, or 12%. This increase resulted from legal costs and other expenses (\$1.5 million) related to the pilots' strike and other union issues, increased employee costs (\$0.5 million), and increased insurance expense (\$0.9 million).

Income Taxes - Income tax benefit for 2006 was \$0.4 million, compared to income tax expense of \$8.1 million for 2005. The effective tax-rate was 38% for 2006 compared to 36% for 2005. The 2005 rate benefited from a Hurricane Katrina tax credit of \$0.8 million in 2005.

Earnings - Our net loss for 2006 was \$0.7 million, compared to net earnings of \$14.2 million for 2005. Losses before tax for 2006 were \$1.1 million compared to earnings before tax of \$22.2 million in 2005. Losses per diluted share were \$0.05 for 2006 as compared to earnings per diluted share of \$1.76 for 2005. The loss for 2006 included \$12.8 million related to the early call premium and associated costs for redemption of our 9 3/8% Senior Notes, and also the impact of the pilots' strike.

Segment Discussion

Domestic Oil and Gas - Domestic Oil and Gas segment revenues for 2006 were \$248.0 million compared to \$219.6 million for 2005, an increase of \$28.4 million or 13%. The increase was due to increased use of medium and transport aircraft and an increase in contracted aircraft prior to the pilots' strike and contractual rate increases. Flight hours were 107,735 for 2006 compared to 111,236 for 2005, a decrease of 3,501 hours, which was also attributable to the strike, resulting in an estimated revenue decrease of \$4.7 million. The number of aircraft in the segment at December 31, 2006 was 152 compared to 155 aircraft at December 31, 2005. In 2006, we sold 18 light aircraft, which had little flight time in 2006, and had 20 new aircraft delivered. We also converted five aircraft from the Domestic Oil and Gas segment for Air Medical use. We have deliveries scheduled throughout 2007 and 2008 for two additional transport category aircraft and 30 additional medium and light aircraft for service in the Domestic Oil and Gas segment to meet contracted and anticipated customer requirements. Of this amount, four aircraft totaling \$12.8 million have been delivered in 2007.

Direct expenses in the Domestic Oil and Gas segment were \$213.3 million for the year ended December 31, 2006, compared to \$173.2 million for the prior year, an increase of \$40.1 million, or 23%. Included in this increase were increases in employee costs (\$7.2 million). Of this amount, \$2.5 million was related to increased pilot compensation expense, related to overtime and a work completion bonus, due to the pilots' strike. There was also an increase in outside services (\$5.1 million). Of this amount, \$1.9 million was other pilot associated costs related to the strike. Other increases include aircraft parts usage (\$2.1 million), aircraft rent (\$6.7 million) due to additional aircraft on lease, aircraft warranty costs (\$5.4 million) due to additional aircraft covered under the manufacturers' warranty programs, fuel (\$1.7 million) due to increased prices and increased use of medium and transport aircraft, component repair costs (\$1.9 million), and insurance expense (\$3.0 million) due to a contractual premium refund in 2005 due to favorable loss experience. There were also increases in training costs (\$3.3 million), travel expenses (\$1.7 million), security services (\$0.6 million), which were also partially strike related costs, and other items (\$1.4 million).

The Domestic Oil and Gas segment's operating income was \$33.7 million for 2006 compared to \$45.5 million for 2005. The decrease was due to decreased flight hours and revenues, and increased employee and other strike related costs in the fourth quarter due to the pilots' strike.

Air Medical - Air Medical segment revenues were \$133.4 million for 2006 compared to \$112.1 million for 2005. The increase was due to the additional operations established in 2005 that were in service for all of 2006. Operating revenues in 2006 from the locations opened in 2005 were \$37.2 million. Flight hours were 29,980 for 2006 compared to 26,619 for 2005. Patient transports were 20,808 for 2006, compared to 17,200 for 2005. Patient transport volume was negatively impacted by the pilots' strike in the fourth quarter 2006. We estimate a decrease of approximately 700 transports related to the strike in the fourth quarter resulting in an estimated revenue decrease of \$4.2 million. The number of aircraft in the segment was 68 at December 31, 2006, compared to 64 at December 31, 2005. At December 31, 2006, we had four aircraft deliveries scheduled throughout 2007 and 2008. Subsequent to December 31, 2006, one of these aircraft totaling \$3.9 million was delivered for service in the Air Medical segment.

Direct expenses in the Air Medical segment increased to \$130.4 million for 2006 compared to \$104.5 million for 2005. During fiscal year 2005, we opened 15 locations, and the increase in direct expense in 2006 reflects a full year of operations at those locations. The \$25.9 million increase includes increases in employee costs (\$13.8 million) primarily due to new locations opened in the prior year being in service for a full twelve months, but also pilot compensation expenses related to the strike (\$3.2 million). There were also increases in fuel costs (\$2.3 million), aircraft rent (\$0.3 million) and aircraft warranty costs (\$1.7 million) as additional aircraft were added to the manufacturers' warranty programs, insurance expense (\$1.2 million), depreciation expense (\$2.5 million), and other operating costs (\$0.9 million).

Selling, general and administrative expense was \$7.4 million for the year ended December 31, 2006, compared to \$6.5 million for the year ended December 31, 2005.

The Air Medical segment operating loss was \$4.4 million for 2006 compared to operating income of \$1.2 million for 2005. Although the Air Medical segment revenues increased in 2006, the decrease in transports in the fourth quarter related to the strike resulted in an estimated revenue decrease of \$4.2 million. Expenses related to the strike also increased an estimated \$3.2 million.

International - International segment revenues were \$25.6 million for 2006, compared to \$28.2 million for 2005, a decrease of \$2.6 million, or 9%. The decrease was due to the scheduled release of one aircraft from contract by the customer in the second quarter. Flight hours decreased in 2006 to 13,265 as compared to 16,788 for 2005.

Direct expenses were \$18.5 million for the year ended December 31, 2006, compared to \$19.1 million for the year ended December 31, 2005, a decrease of \$0.6 million. The decrease was due to decreased flight hours in 2006.

Selling, general and administrative expense was \$0.1 million for 2006 compared to \$0.2 million for 2005.

International segment operating income for 2006 was \$7.0 million compared to \$8.9 million for 2005. The decrease was due to the scheduled release of one aircraft from contract by the customer in the second quarter and a decrease in flight hour activity.

Technical Services - Technical Services segment revenues for 2006 were \$6.1 million compared to \$3.7 million for 2005. The increase in Technical Services revenues was due to recategorization of certain contractual work for third parties that was previously recorded in the Domestic Oil and Gas segment.

Direct expenses were \$4.1 million for 2006 compared to \$2.5 million for 2005, which was also due to the recategorization of contract revenue and expense.

The Technical Services segment had operating income of \$1.9 million for December 31, 2006, compared to \$1.1 million for December 31, 2005. The increase was due to recategorization of the contractual work.

Year Ended December 31, 2005 compared with Year Ended December 31, 2004

Combined Operations

Revenues – Operating revenues for 2005 were \$363.6 million compared to \$291.3 million for 2004, an increase of \$72.3 million, or 25%. Operating revenues increased in the Domestic Oil and Gas segment \$39.5 million due to increased flight hours and an increase in contracted aircraft. Operating revenues in the Air Medical segment also increased \$34.6 million, due to the additional operating locations. Operating revenues in the International segment increased \$3.9 million due primarily to increased flight hours. Revenues in the Technical Services segment decreased \$5.7 million due to completion of a contract in 2004. These items are discussed in the Segment Discussion below.

Other Income and Losses - Gain on equipment dispositions was \$1.2 million for 2005 compared to \$2.6 million for 2004. Gain or loss on equipment dispositions is related to dispositions of aircraft. Other income increased approximately \$1.7 million in 2005 due to interest earnings on unspent proceeds from the stock offering.

Direct Expenses – Direct expense was \$299.3 million for 2005 compared to \$245.4 million for 2004, an increase of \$53.9 million, or 22%. The increase was due to increased Air Medical operations (\$36.8 million), an increase in the Domestic Oil and Gas segment (\$22.1 million) due to increased flight hour activity and increased aircraft, and an increase in the International segment (\$0.4 million). There was a decrease in the Technical Services segment due to completion of a contract in 2004 as mentioned above (\$5.4 million). These items are also discussed in the Segment Discussion below.

Selling, General, and Administrative Expenses – Selling, general and administrative expense was \$24.9 million for 2005 compared to \$21.0 million for 2004, an increase of \$3.9 million, or 19%. This increase is a result of legal costs incurred (\$1.0 million) in responding to the Department of Justice antitrust investigation subpoena, increased depreciation expense (\$1.3 million), increased employee costs (\$0.4 million), a non-recurring reduction in the environmental provision in the prior year (\$0.3 million), and other items (\$0.9 million).

Income Taxes - Income tax expense for 2005 was \$8.1 million, compared to \$3.8 million for 2004. The effective tax-rate was 36% for 2005 compared to 49% for 2004. The provision for 2005 includes a tax credit of \$0.8 million related to the Katrina Emergency Tax Relief Act of 2005. This amount was recorded as a tax carryforward credit and will be available as a credit once the net operating loss amount is utilized. Included in the 2004 provision was \$0.7 million related to foreign taxes paid for which we cannot take a credit for U.S. tax purposes due to the availability of net operating losses for tax purposes. Such operating loss carryforwards arose from accelerated tax depreciation expense deductions as a result of the aircraft purchased since 2002. We anticipate the foreign taxes paid in 2005 will be utilized as a tax credit in future years based on recent changes in the tax laws.

Earnings - Our net earnings for 2005 were \$14.2 million, compared to \$4.0 million for 2004. Earnings before tax for 2005 were \$22.2 million compared to \$7.8 million in 2004. Earnings per diluted share were \$1.76 for 2005 as compared to \$0.72 per diluted share for 2004.

Segment Discussion

Domestic Oil and Gas - Domestic Oil and Gas segment revenues for 2005 were \$219.6 million compared to \$180.1 million for 2004, an increase of \$39.5 million or 22%. The increase was due to an increase in flight hours in the Gulf of Mexico and an increase in contracted aircraft. Flight hours were 111,236 for 2005 compared to 100,814 for 2004, an increase of 10,422 hours, as a result of our customers' increased production and exploration activities in the Gulf of Mexico. The number of aircraft in the segment at December 31, 2005 was 155 compared to 151 aircraft at December 31, 2004. In 2005, we sold 11 light aircraft, which had little flight time, and added 15 total aircraft.

Direct expenses in the Domestic Oil and Gas segment were \$173.2 million for the year ended December 31, 2005, compared to \$151.1 million for the year ended December 31, 2004, an increase of \$22.1 million, or 14.6%. The increase was due to increases in employee costs (\$1.2 million), aircraft parts usage due to increased flight hour activity (\$3.1 million), aircraft rent (\$3.7 million) due to additional aircraft on lease, aircraft warranty costs (\$5.0 million) due to additional aircraft covered under the manufacturers' warranty programs but also due to a warranty termination credit in the prior year (\$2.2 million), fuel (\$6.7 million) due to increased prices and flight activity, component repair costs (\$0.8 million), outside services (\$1.1 million) primarily related to outside pilot training costs, and other items (\$0.5 million). Fuel cost above a certain rate per gallon in customers' contracts is invoiced to the customer and is included in revenue. These increases were due to increased aircraft and increased flight hours.

The Domestic Oil and Gas segment's operating income was \$45.5 million for 2005 compared to \$27.5 million for 2004. The increase was due to increased flight hours and also due to additional contracted aircraft as mentioned above.

Air Medical - Air Medical segment revenues were \$112.1 million for 2005 compared to \$77.5 million for 2004. The increase was due to the additional operations established in 2004 and 2005. Flight hours were 26,619 for 2005 compared to 19,595 for 2004. The number of aircraft in the segment was 64 at December 31, 2005, compared to 51 at December 31, 2004. One additional aircraft was received in early 2006. Patient transports were 17,200 for 2005, compared to 11,390 for 2004. Fifteen new locations were opened in 2005, seven of which were opened in the fourth quarter 2005. Operating revenues in 2005 from the new locations opened in 2005 were \$20.4 million.

Direct expenses in the Air Medical segment increased to \$104.5 million for 2005 compared to \$67.7 million for 2004, due to growth in the segment mentioned above. At December 31, 2004, we had 22 operating locations that were opened in 2004, and the increase in direct expense in 2005 reflects a full year of operations at those locations, as well as the direct expense of the 15 locations opened during 2005. The \$36.8 million increase was due to increases in employee costs (\$21.1 million) due to additional employees at the new operations, operating costs (\$9.2 million) related to the additional bases, which includes rent, utilities, services purchased, and supplies. Aircraft parts usage increased due to additional aircraft and additional flight hours (\$1.3 million); fuel costs increased (\$2.3 million); aircraft rent increased due to additional aircraft on lease (\$1.1 million); and aircraft warranty costs increased (\$1.8 million) as additional aircraft were added to the manufacturers' warranty programs.

Selling, general and administrative expense was \$6.5 million for the years ended December 31, 2005 and 2004 in the Air Medical segment.

The Air Medical segment operating income was \$1.2 million for 2005 compared to \$3.3 million for 2004. The decrease in operating income was due to increased direct expense related to the expansion of operations, and also due to the impact of weather in the first quarter and fourth quarter as compared to 2004. There was a loss of \$2.5 million related to the additional operations that commenced in 2005. New locations typically take several months to build sufficient volume to absorb facility operating costs and achieve profitable aircraft utilization levels.

International - International segment revenues were \$28.2 million for 2005, compared to \$24.3 million for 2004, an increase of \$3.9 million, or 15.8%. The increase was due to increased flight hours and rates in 2005. Flight hours increased in 2005 to 16,788 as compared to 15,871 for 2004. The additional flight hours were achieved in spite of a reduction in the number of aircraft in the segment from 19 at December 31, 2004, to 16 at December 31, 2005, as three aircraft in that segment were sold during 2005.

Direct expenses were \$19.1 million for the year ended December 31, 2005, compared to \$18.7 million for the year ended December 31, 2004, an increase of \$0.4 million. The increase was due to increased flight hours in 2005.

Selling, general and administrative expense was \$0.2 million for 2005 compared to less than \$0.1 million for 2004.

International segment operating income for 2005 was \$8.9 million compared to \$5.6 million for 2004. The improvement was due to the increase in operating revenue due to increased flight hours and to increased rates.

Technical Services - Technical Services segment revenues for 2005 were \$3.7 million compared to \$9.4 million for 2004. The decrease in Technical Services revenues was due to completion of its principal contract in the third quarter of 2004.

Direct expenses were \$2.5 million for 2005 compared to \$7.9 million for 2004.

The Technical Services segment had operating income of \$1.1 million for December 31, 2005, compared to \$1.4 million for December 31, 2004. The decrease was due to completion of the contract mentioned above.

Liquidity and Capital Resources

General

Our ongoing liquidity requirements arise primarily from the funding of working capital needs, such as the acquisition or leasing of aircraft, the maintenance and refurbishment of aircraft, improvement of facilities, and acquisition of equipment and inventory. Our principal sources of liquidity historically have been net cash provided by our operations and borrowings under our revolving credit facility, as augmented in recent years by the issuance of our Senior Notes in 2002, which were refinanced in 2006, and the sale of non-voting common stock in 2005 and 2006.

As we grow our operations, we continually monitor the capital resources available to meet our future financial obligations, planned capital expenditures and liquidity. We also review acquisition opportunities on an ongoing basis. If we were to make a significant acquisition for cash, we would need to obtain additional equity or debt financing.

Cash Flow

Our cash position at December 31, 2006 was \$0.8 million, compared to \$3.0 million at December 31, 2005. Short-term investments were \$153.4 million at December 31, 2006, compared to \$66.5 million at December 31, 2005. Working capital was \$254.1 million at December 31, 2006, as compared to \$162.5 million at December 31, 2005, an increase of \$91.6 million. The increase in working capital was primarily a result of an increase in short-term investments of \$86.9 million and an increase in inventory of \$7.5 million. The increase in short-term investments was due primarily to completion of the equity offering in April 2006, with remaining short-term investments from the offering being \$91.9 million at December 31, 2006.

Net cash provided by operating activities was \$30.3 million for 2006 compared to \$28.0 million for 2005, an increase of \$2.3 million. The increase was due primarily to changes in operating assets and liabilities of \$10.6 million, a decrease in net earnings of \$14.8 million, including the loss of \$12.8 million recorded in the second quarter as a result of refinancing our 9 3/8% Senior Notes, an increase in depreciation and amortization expense of \$3.2 million, a decrease in the deferred tax provision of \$8.0 million, and other items, net, \$1.3 million. The decrease in deferred tax is due to the tax benefit associated with the loss before tax of \$1.1 million in the current year compared to a tax expense associated with earnings before tax of \$22.2 million in the prior year. Capital expenditures were \$123.3 million for 2006 compared to \$96.2 million for 2005. Capital expenditures for 2006 were \$94.7 million for aircraft purchases, \$18.3 million for refurbishments and equipment installations for new aircraft, \$3.8 million for facility improvements and \$6.5 million for operating equipment, engine spares, and medical equipment. Capital expenditures for 2005 were \$73.0 million for aircraft purchases, \$11.3 million for refurbishments and equipment installations for new aircraft, \$4.2 million for facility improvements and \$7.7 million for operating equipment, engine spares, and medical equipments. Gross proceeds from aircraft sales were \$36.8 million for 2006 compared to \$10.8 million for 2005.

Financing Activities

On April 12, 2006, we completed the sale of 4,287,920 non-voting common shares at \$35.00 per share and on May 1, 2006, we completed the sale of another 578,680 shares pursuant to the underwriters' over-allotment option, also at \$35.00 per share. Proceeds from the offering were \$160.7 million, net of expenses, and were used to fund the acquisition of aircraft delivered in 2006 and may be used to fund the acquisition of aircraft delivered in 2007. Also on April 12, 2006, we issued \$200 million of 7.125% Senior Notes due 2013. Net proceeds of \$196.0 million were used to repurchase \$184.8 million of our existing 9 3/8% Senior Notes, which were tendered by April 12, 2006, at a total cost of \$201.6 million including an early call premium and accrued interest. We redeemed the remaining \$15.2 million of 9 3/8% Senior Notes on May 1, 2006, at a redemption price of 104.688% of the face amount plus accrued interest. As a result of the refinancing of the 9 3/8% Senior Notes, we recorded a pretax charge of \$12.8 million (\$7.7 million, net of tax) in the quarter ended June 30, 2006, which consisted of a \$9.8 million early call premium, \$2.6 million of unamortized issuance costs, and \$0.4 million in related expenses of the tender for the outstanding notes.

The 7.125% Senior Notes mature April 15, 2013, and interest is payable semi-annually on April 15 and October 15. The notes contain restrictive covenants, including limitations on indebtedness, liens, dividends, repurchases of capital stock and other payments affecting restricted subsidiaries, issuance and sales of restricted subsidiary stock, dispositions of proceeds of asset sales, and mergers, consolidations and sales of assets. Estimated annual interest cost of the 7.125% Senior Notes is \$14.3 million, excluding amortization of issuance costs.

Credit Facility

We have a \$35 million revolving credit facility with a commercial bank that expires on September 1, 2008. At December 31, 2006, there were \$5.5 million in borrowings and \$5.1 million in letters of credit outstanding under the facility. The facility includes covenants related to working capital, funded debt to net worth, and consolidated net worth. As of December 31, 2006, we were in compliance with these covenants.

Contractual Obligations

The table below sets out our contractual obligations related to operating lease obligations, purchase commitments, credit facility, and the 7.125% Senior Notes due 2013. The operating leases are not recorded as liabilities on the balance sheet, but payments are treated as an expense as incurred. Each contractual obligation included in the table contains various terms, conditions, and covenants which, if violated, accelerate the payment of that obligation. We currently lease eighteen aircraft included in the lease obligations below.

	Payment Due by Year						
	Total	2007	2008	2009	2010	2011	Beyond 2011
	(Thousands of dollars)						
Aircraft Purchase commitments ⁽¹⁾	\$ 144,593	\$ 127,364	\$ 17,229	\$ --	\$ --	\$ --	\$ --
Aircraft Purchase commitments ⁽²⁾	37,181	37,181	--	--	--	--	--
Aircraft lease obligations	157,090	15,663	15,663	15,663	16,265	17,533	76,303
Other lease obligations	21,199	3,237	2,652	1,945	1,664	1,348	10,353
Long term debt	205,500	--	5,500	--	--	--	200,000
	<u>\$ 565,563</u>	<u>\$ 183,445</u>	<u>\$ 41,044</u>	<u>\$ 17,608</u>	<u>\$ 17,929</u>	<u>\$ 18,881</u>	<u>\$ 286,656</u>

(1) These commitments are for aircraft that we intend to finance with remaining cash from the equity offering completed April 2006, and with cash from operations.

(2) These commitments are for aircraft that we intend to finance with an operating lease.

Estimated interest costs on the debt obligations set forth above, without considering any additional debt that may be obtained relative to purchase commitments for aircraft, are \$14.9 million for 2007 and each successive year through 2011, including amortization of debt issuance costs.

In 2006, we took delivery of three transport category aircraft, eight medium aircraft and nine light aircraft for service in the Domestic Oil and Gas segment. We also took delivery of two light aircraft for service in the Air Medical segment.

At December 31, 2006, we had an order for two additional transport category aircraft, which we intend to finance with an operating lease. The approximate cost for these two aircraft is \$37.2 million

At December 31, 2006, we also had orders for 34 additional aircraft with a total cost of \$144.6 million and scheduled delivery dates throughout 2007 and 2008. Of this total, five aircraft totaling \$16.7 million were delivered subsequent to December 31, 2006, as mentioned above.

We believe that cash flow from operations will be sufficient to fund operating requirements and required interest payments on the 7.125% Senior Notes for the next twelve months. We have capital requirements for aircraft on order totaling \$144.6 million over 2007 and 2008, which we intend to fund from existing cash, short-term investments, and operating leases, as required.

Critical Accounting Policies and Estimates

Management's discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to allowances for doubtful accounts, inventory valuation, long-lived assets and self-insurance liabilities. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates, and the differences may be material. We believe the following critical accounting policies affect our more significant judgments and estimates used in preparation of our consolidated financial statements.

The allowance for doubtful accounts receivable is estimated based on an evaluation of individual customer financial strength, current market conditions, and other information. If our evaluation of our significant customers' and debtors' creditworthiness should change or prove incorrect, then we may have to recognize additional allowances in the period in which we identify the risk of loss. In the Air Medical segment, the Company monitors its collection experience by payor category within the Air Medical segment and updates its estimated collections to be realized based on its most recent collection experience.

We maintain a significant parts inventory to service our own aircraft and the aircraft and components of customers. Portions of that inventory are used parts that are often exchanged with parts removed from aircraft or components and reworked to a useable condition. We use systematic procedures to estimate the valuation of the used parts, which includes consideration of their condition and continuing utility. If our valuation of these parts should be significantly different from amounts ultimately realizable or if we discontinue using or servicing certain aircraft models, then we may have to record a write-down of our inventory. We also record provisions against inventory for obsolescent and slow-moving parts, relying principally on specific identification of such inventory. If we fail to identify such parts, additional provisions may be necessary.

Our principal long-lived assets are aircraft. We review our long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. We measure recoverability of assets to be held and used by comparing the carrying amount of an asset to the future undiscounted net cash flows that we expect the asset to generate. When an asset is determined to be impaired, we recognize the impairment amount, which is the amount by which the carrying value of the asset exceeds its estimated fair value. Similarly, we report assets that we expect to sell at the lower of the carrying amount or fair value less costs to sell. Future adverse market conditions or poor operating results could result in an inability to recover the current carrying

value of certain long-lived assets, thereby possibly requiring an impairment charge in the future.

We must make estimates for certain of our liabilities and expenses, losses, and gains related to self-insured programs, insurance deductibles, and good-experience premium returns. Our group medical insurance program is largely self-insured, and we use estimates to record our periodic expenses related to that program. We also carry deductibles on our workers' compensation program and aircraft hull and liability insurance, and poor experience or higher accidents rates could result in additional recorded losses.

New Accounting Pronouncements

For a discussion of new accounting pronouncements applicable to the Company, see Note 1 to the Consolidated Financial Statements.

Environmental Matters

We have an aggregate estimated liability of \$0.2 million as of December 31, 2006 and 2005 for environmental remediation costs that are probable and estimable. We have conducted environmental surveys of our former Lafayette Facility, which we vacated in 2001, and have determined that limited soil and groundwater contamination exists at the facility. We have installed groundwater monitoring wells at the facility and periodically monitor and report on the contamination. In May 2003, we submitted a Louisiana Risk Evaluation/Corrective Action Plan ("RECAP") Standard Site Assessment Report to the Louisiana Department of Environmental Quality ("LDEQ") fully delineating the extent and type of contamination. In April, 2006 the Site Assessment was updated to include recent analytical data. LDEQ is reviewing the assessment report. Once LDEQ completes its review and reports on whether all contamination has been fully defined, a risk evaluation in accordance with RECAP will be submitted and evaluated by LDEQ. At that point, LDEQ will establish what cleanup standards must be met at the site. When the process is complete, we will be in a position to develop an appropriate remediation plan and determine the resulting cost of remediation. We have not recorded any estimated liability for remediation and contamination and, based upon the May 2003 Site Assessment Report, the April 2006 update and ongoing monitoring, we believe the ultimate remediation costs for the former Lafayette facility will not be material to our consolidated financial position, results of operations, or liquidity.

During 2004, LDEQ advised us that groundwater contaminants impacting monitor wells at the PHI Lafayette Heliport were originating from an off-site location and that we would no longer be required to perform further monitoring at the site. Subsequently, based upon site investigation work performed by the Lafayette Airport Commission, the source of the contamination was identified as residing at another location, for which PHI is not responsible. The Lafayette Airport Commission has begun remediation of the PHI Lafayette Heliport.

ITEM 7.A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Prior to the issuance of our 9 3/8% Senior Notes on April 23, 2002, we were exposed to market risks associated with interest rates, and made limited use of derivative financial instruments to manage that risk. When used, all derivatives for risk management were closely monitored by our senior management. We do not hold derivatives for trading purposes and we do not use derivatives with leveraged or complex features. Derivative instruments were transacted either with creditworthy major financial institutions or over national exchanges. Interest on the 7.125% Senior Notes is payable semi-annually on April 15 and October 15.

The market value of the Senior Notes will vary as changes occur in market interest rates, the remaining maturity of the Senior Notes, and our credit-worthiness. At December 31, 2006, the market value of the Notes was \$194.0 million. A hypothetical 100 basis-point increase in the Senior Notes imputed rate at December 31, 2006 would have resulted in a market value decline of approximately \$9.3 million.

The Company has not engaged in activities involving financial derivatives during the years 2006, 2005, and 2004.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of
PHI, Inc.
Lafayette, Louisiana

We have audited the accompanying consolidated balance sheets of PHI, Inc. and subsidiaries (the “Company”) as of December 31, 2006 and 2005, and the related consolidated statements of operations, shareholders’ equity, and cash flows for each of the three years in the period ended December 31, 2006. Our audits also included the financial statement schedule, listed in the Index at Item 15. These financial statements and financial statement schedule are the responsibility of the Company’s management. Our responsibility is to express an opinion on the financial statements and financial statement schedule based on our audits.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). 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 audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of PHI, Inc. and subsidiaries as of December 31, 2006 and 2005, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2006, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company’s internal control over financial reporting as of December 31, 2006, based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 16, 2007 expressed an unqualified opinion on management’s assessment of the effectiveness of the Company’s internal control over financial reporting and an unqualified opinion on the effectiveness of the Company’s internal control over financial reporting.

DELOITTE & TOUCHE LLP

New Orleans, Louisiana
March 16, 2007

PHI, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Thousands of dollars)

	December 31, 2006	December 31, 2005
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 820	\$ 3,036
Short-term investments	153,414	66,525
Accounts receivable – net of allowance:		
Trade	87,366	89,351
Other	1,928	6,766
Inventories of spare parts and supplies	55,596	48,123
Other current assets	7,930	10,042
Refundable income taxes	635	422
Total current assets	307,689	224,265
Other	23,816	13,266
Property and equipment, net	369,465	311,678
Total Assets	\$ 700,970	\$ 549,209
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	\$ 35,815	\$ 40,506
Accrued liabilities	8,511	10,807
Accrued interest	3,045	3,175
Accrued vacation payable	2,583	3,811
Accrued salaries and wages	3,636	2,439
Notes payable	-	1,000
Total current liabilities	53,590	61,738
Long-term debt	205,500	203,300
Deferred income taxes	32,828	38,906
Other long-term liabilities	8,927	6,214
Commitments and contingencies (Note 8)		
Shareholders' Equity:		
Voting common stock – par value of \$0.10; authorized shares of 12,500,000	285	285
Non-voting common stock – par value of \$0.10; authorized shares of 12,500,000	1,242	742
Additional paid-in capital	290,695	129,531
Accumulated other comprehensive income	77	--
Retained earnings	107,826	108,493
Total shareholders' equity	400,125	239,051
Total Liabilities and Shareholders' Equity	\$ 700,970	\$ 549,209

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

PHI, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(Thousands of dollars and shares, except per share data)

	<u>Year Ended December 31, 2006</u>	<u>Year Ended December 31, 2005</u>	<u>Year Ended December 31, 2004</u>
Operating revenues	\$ 413,118	\$ 363,610	\$ 291,308
Gain on disposition of property and equipment, net	1,910	1,173	2,569
Other	8,036	2,057	392
	<u>423,064</u>	<u>366,840</u>	<u>294,269</u>
Expenses:			
Direct expenses	366,272	299,263	245,374
Selling, general and administrative expenses	27,839	24,896	21,034
Interest expense	17,243	20,448	20,109
Loss on debt restructuring	12,790	--	--
	<u>424,144</u>	<u>344,607</u>	<u>286,517</u>
Earnings (loss) before income taxes	(1,080)	22,233	7,752
Income taxes	(413)	8,079	3,780
Net earnings (loss)	<u>\$ (667)</u>	<u>\$ 14,154</u>	<u>\$ 3,972</u>
Earnings (loss) per share			
Basic	\$ (0.05)	\$ 1.76	\$ 0.74
Diluted	\$ (0.05)	\$ 1.76	\$ 0.72
Weighted average shares outstanding:			
Basic	13,911	8,040	5,383
Diluted	13,911	8,063	5,486

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

PHI, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(Thousands of dollars and shares)

	Voting Common Stock		Non-Voting Common Stock		Additional Paid-in Capital	Accumulated Other Com- prehensive Income	Retained Earnings
	Shares	Amount	Shares	Amount			
Balance at Dec. 31, 2003	2,852	\$ 285	2,531	\$ 253	\$ 15,088	\$ --	\$ 90,367
Stock options exercised	--	--	--	--	10	--	--
Net earnings	--	--	--	--	--	--	3,972
Balance at Dec. 31, 2004	2,852	285	2,531	253	15,098	--	94,339
Stock issuance, net	--	--	4,887	489	113,352	--	--
Stock options exercised	--	--	--	--	1,081	--	--
Net earnings	--	--	--	--	--	--	14,154
Balance at Dec. 31, 2005	2,852	285	7,418	742	129,531	--	108,493
Stock issuance, net	--	--	4,867	487	160,235	--	--
Other	--	--	139	13	929	--	--
SFAS No. 158 incremental effect	--	--	--	--	--	77	--
Net loss	--	--	--	--	--	--	(667)
Balance at Dec. 31, 2006	<u>2,852</u>	<u>\$ 285</u>	<u>12,424</u>	<u>\$ 1,242</u>	<u>\$ 290,695</u>	<u>\$ 77</u>	<u>\$107,826</u>

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

PHI, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Thousands of dollars)

	<u>Year Ended December 31, 2006</u>	<u>Year Ended December 31, 2005</u>	<u>Year Ended December 31, 2004</u>
Cash flows from operating activities:			
Net earnings (loss)	\$ (667)	\$ 14,154	\$ 3,972
Adjustments to reconcile net earnings (loss) to net cash provided by operating activities:			
Depreciation	30,297	27,133	27,843
Deferred income taxes	(1,631)	6,415	3,845
Gain on asset dispositions	(1,910)	(1,173)	(2,569)
Loss on debt restructuring	12,790	--	--
Other	806	1,411	1,332
Changes in operating assets and liabilities:			
Accounts receivable - trade	1,985	(31,109)	(16,499)
Inventories	(7,473)	(8,898)	1,180
Refundable income taxes	(213)	--	(876)
Other assets	177	(2,313)	(7,241)
Accounts payable, accrued liabilities and vacation payable	(6,679)	23,049	(146)
Other long-term liabilities	2,842	(649)	64
Net cash provided by operating activities	<u>30,324</u>	<u>28,020</u>	<u>10,905</u>
Cash flows from investing activities:			
Purchase of property and equipment	(123,253)	(96,165)	(33,921)
Acquisition of additional operating locations	--	--	(1,518)
Proceeds from asset dispositions	36,809	10,751	14,395
Purchase of short-term investments	(186,339)	(97,950)	(16,975)
Proceeds from sale of short-term investments	99,450	45,900	19,425
Other	(5,595)	--	--
Net cash used in investing activities	<u>(178,928)</u>	<u>(137,464)</u>	<u>(18,594)</u>
Cash flows from financing activities:			
Proceeds of debt issuance – Senior Notes	200,000	--	--
Premium and costs to retire debt early	(10,208)	--	--
Repayment of Senior Notes	(200,000)	--	--
Debt issuance costs	(4,857)	--	--
Payments on long-term debt	(1,000)	(1,000)	--
Proceeds from line of credit	181,900	114,875	37,008
Payments on line of credit	(179,700)	(119,850)	(28,733)
Proceeds from stock issuance	161,155	115,162	--
Less related fees and expenses	(433)	(1,265)	--
Proceeds from exercise of stock options	--	1,025	--
Other	(469)	--	--
Net cash provided by financing activities	<u>146,388</u>	<u>108,947</u>	<u>8,275</u>
(Decrease) Increase in cash and cash equivalents	(2,216)	(497)	586
Cash and cash equivalents, beginning of year	3,036	3,533	2,947
Cash and cash equivalents, end of year	<u>\$ 820</u>	<u>\$ 3,036</u>	<u>\$ 3,533</u>

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

PHI, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations, Basis of Consolidation, and Other General Principles

Since its inception, PHI, Inc.'s primary business has been to transport personnel and, to a lesser extent, parts and equipment, to, from and among offshore facilities for customers engaged in the oil and gas exploration, development, and production industry. The Company also provides air medical transportation services for hospitals, medical programs, and aircraft maintenance services to third parties.

The consolidated financial statements include the accounts of PHI, Inc. and its subsidiaries ("PHI" or the "Company") after the elimination of all intercompany accounts and transactions.

A principal stockholder has substantial control. Al A. Gonsoulin, Chairman of the Board and Chief Executive Officer, beneficially owns stock representing approximately 52% of the total voting power. As a result, he exercises control over the election of PHI's directors and the outcome of matters requiring a stockholder vote.

Revenue Recognition

The Company recognizes revenue related to aviation transportation services after the services are performed or the contractual obligations are met. Aircraft maintenance services revenues are recognized at the time the repair or services work is completed. Revenues related to emergency flights generated by the Company's Air Medical segment are recorded net of contractual allowances under agreements with third party payors when the services are provided.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements, as well as reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash Equivalents

The Company considers cash equivalents to include demand deposits and investments with original maturity dates of three months or less.

Short-term Investments

Short-term investments consist primarily of auction rate securities, which represent funds available for current operations. In accordance with SFAS No. 115 "Accounting for Certain Investments in Debt and Equity Securities," these short-term investments are classified as available for sale. The Company's auction rate securities generally have long-term stated maturities, but have characteristics of short-term investments due to a rate-setting mechanism and the ability to liquidate them through a Dutch auction process that occurs on pre-determined intervals of less than 90 days. The Company has not recorded any unrealized gains or losses associated with short-term investments as the carrying value approximates fair value at December 31, 2006 and 2005.

Inventories of Spare Parts and Supplies

The Company's inventories are stated at the lower of average cost or market and consist primarily of spare parts. Portions of the Company's inventories are used parts that are often exchanged with parts removed from aircraft, reworked to a useable condition according to manufacturers' and FAA specifications, and returned to inventory. The Company uses systematic procedures to estimate the valuation of the used parts, which includes consideration of their condition and continuing utility. Reusable aircraft parts are included

in inventory at the average cost of comparable parts. The rework costs are expensed as incurred. The Company also records an allowance for obsolescent and slow-moving parts, relying principally on specific identification of such inventory. Valuation reserves related to obsolescence and slow-moving inventory were \$7.3 million and \$6.3 million at December 31, 2006 and 2005, respectively.

Property and Equipment

The Company records its property and equipment at cost less accumulated depreciation. For financial reporting purposes, the Company uses the straight-line method to compute depreciation based upon estimated useful lives of five to fifteen years for flight equipment and three to ten years for other equipment. The salvage value used in calculating depreciation of aircraft ranges from 30% to 40%. The Company uses accelerated depreciation methods for tax purposes. The cost of scheduled inspections and modifications for flight equipment are charged to maintenance expense as incurred. Modifications that enhance the operating performance or extend the useful lives of the aircraft are capitalized and depreciated over the remaining life of the asset. Upon selling or otherwise disposing of property and equipment, the Company removes the cost and accumulated depreciation from the accounts and reflects any resulting gain or loss in earnings at the time of sale or other disposition.

Effective January 1, 2005 and prospectively, the Company reassessed the salvage values applicable to major modifications to aircraft based on updated estimates derived from recent aircraft sales. The adjustment for the year 2005 resulted in a decrease in depreciation expense (\$1.6 million). In addition, the Company incurred approximately \$1.1 million of expense in 2005 for repairs to an aircraft that incurred substantial damage due to a weather related incident.

The Company reviews its long-lived assets and certain identifiable intangibles for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The Company measures recoverability of assets to be held and used by comparing the carrying amount of an asset to future undiscounted net cash flows that it expects the asset to generate. When an asset is determined to be impaired, the Company recognizes that impairment amount, which is measured by the amount that the carrying value of the asset exceeds its fair value. Similarly, the Company reports assets that it expects to sell at the lower of the carrying amount or fair value less costs to sell.

Self-Insurance

The Company maintains a self-insurance program for a portion of its health care costs. Self-insurance costs are accrued based upon the aggregate of the liability for reported claims and the estimated liability for claims incurred but not reported. As of December 31, 2006 and 2005, the Company had \$1.3 million and \$1.1 million, respectively, of accrued liabilities related to health care claims.

During 2005, the Company established an offshore insurance captive to realize savings in reinsurance costs on its insurance premiums. Amounts paid to the captive in 2006 and 2005 totaled \$3.2 million and \$1.9 million, respectively. The financial position and operations of the insurance captive were not significant in 2006 nor 2005. The captive is fully consolidated in the accompanying financial statements.

Concentration of Credit Risk

Financial instruments that potentially expose the Company to concentrations of credit risk consist primarily of short-term investments and trade accounts receivable. Short-term investments include auction rate securities and money market securities. The Company does not believe significant credit risk exists with respect to these securities at December 31, 2006.

PHI conducts a majority of its business with major and independent oil and gas exploration and production companies with operations in the Gulf of Mexico. The Company also provides services to major medical centers and US governmental agencies. The Company continually evaluates the financial strength of its customers but generally does not require collateral to support the customer receivables. The Company establishes an allowance for doubtful accounts based upon factors surrounding the credit risk of specific customers, current market conditions, and other information. Collection efforts are typically exhausted at approximately nine months, at which time unpaid amounts are charged off as uncollectible. The allowance for doubtful accounts was \$0.1 million and \$0.2 million at December 31, 2006 and December 31, 2005,

respectively. The Company's largest domestic oil and gas customer accounted for 17%, 14%, and 13%, of consolidated operating revenues for years ended December 31, 2006, 2005, and 2004, respectively. The Company also carried accounts receivable from this same customer totaling 14% of net trade receivable on December 31, 2006 and 2005, respectively.

Trade receivables representing amounts due pursuant to air medical services are carried net of an allowance for estimated contractual adjustments on unsettled invoices. The Company monitors its collection experience by payor category within the Air Medical segment and updates its estimated collections to be realized based on its most recent collection experience.

Stock Compensation

In December 2004, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 123 (R), "Share Based Payment." SFAS No. 123 (R) supersedes Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees," and amends SFAS No. 95, "Statement of Cash Flows". Generally, the approach in SFAS No. 123 (R) is similar to the approach described in SFAS No. 123. However, SFAS No. 123 (R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Pro forma disclosure is no longer an alternative. As permitted by SFAS No. 123, prior to January 1, 2006, we accounted for share-based payments to employees using the intrinsic value method of and, as such, generally recognized no compensation expense for employee stock options. In September 2001, the Company underwent a change of control and as a result, all awards issued prior to the change of control became fully vested. The Company has not issued any shares, options or rights under its stock plan since 2001. As a result, no pro forma information for 2005 and 2004 is necessary under SFAS 123. We have adopted SFAS No. 123(R) effective January 1, 2006 using the modified-prospective method. Under the modified-prospective method, the prior periods' financial statements are not restated. As no employee stock options were granted in the current period, the adoption of SFAS No. 123 (R) had no impact on our results of operations for the year ended December 31, 2006. The impact on future periods will be dependent on levels of share based payments granted in the future.

Stock-based employee compensation expense relates to restricted stock grants and stock options that were settled for cash. The employee compensation expense for stock grants and options settled for cash was \$0 for 2006, \$122,498 for 2005, and \$45,000 for 2004. There have been no stock awards granted since 2001.

Income Taxes

The Company provides for income taxes using the asset and liability method under which deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. The deferred tax assets and liabilities measurement uses enacted tax rates that are expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The Company recognizes the effect of any tax rate changes in income of the period that included the enactment date.

Earnings per Share

The Company computes basic earnings per share by dividing income available to common stockholders by the weighted average number of common shares outstanding during the period. The diluted earnings per share computation uses the weighted average number of shares outstanding adjusted for incremental shares attributed to dilutive outstanding options to purchase common stock.

Deferred Financing Costs

Costs of obtaining long term debt financing are deferred and amortized ratably over the term of the related debt agreement.

Derivative Financial Instruments

The Company has not engaged in activities involving financial derivatives during the years 2004, 2005, and 2006.

New Accounting Pronouncements

In July 2006, the FASB issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109" (FIN 48), which clarifies the accounting and disclosure for uncertain tax positions, as defined. FIN 48 seeks to reduce the diversity in practice associated with certain aspects of the recognition and measurement related to accounting for income taxes. This interpretation is effective for fiscal years beginning after December 15, 2006. The Company estimates the cumulative effect of adopting FIN 48 to be immaterial to the consolidated financial statements.

In September 2006, FASB issued SFAS No. 157, "Fair Value Measurements" which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. This Statement is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. Earlier application is encouraged provided that the reporting entity has not yet issued financial statements for that fiscal year including financial statements for an interim period within that fiscal year. The Company is assessing SFAS No. 157 and has not determined yet the impact that the adoption of SFAS No. 157 will have on its results of operations, financial position, or liquidity.

In September 2006, the FASB issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans – An Amendment of FASB Statements No. 87, 88, 106 and 132(R)" (SFAS No. 158). SFAS No. 158 requires the Company, as the sponsor of a plan, to (a) recognize on its Balance Sheets as an asset a plan's over-funded status or as a liability such plan's under-funded status, (b) measure a plan's assets and obligations as of the end of the Company's fiscal year and (c) recognize changes in the funded status of its plans in the year in which changes occur through adjustments to other comprehensive income. The Company adopted SFAS No. 158 as of December 31, 2006. The following table summarizes the effect of the adjustments to record the adoption of SFAS No. 158 (in thousands):

	<u>Before Adoption of SFAS No. 158</u>	<u>Change due to SFAS No. 158</u>	<u>After Adoption of SFAS No. 158</u>
Other Long-Term Liabilities:			
Benefit obligations	\$ 1,192	\$ (129)	\$ 1,063
Deferred income taxes	--	52	52
Shareholders' Equity:			
Accumulated other comprehensive income	--	77	77

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities, including an amendment of FASB Statements No. 115" ("SFAS No. 159"). SFAS No. 159 permits the Company to choose, at specified election dates, to measure eligible items at fair value (the "fair value option"). The Company would report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting period. This accounting standard is effective as of the beginning of the first fiscal year that begins after November 15, 2007. The Company is assessing SFAS No. 159 and has not determined yet the impact that the adoption of SFAS No. 159 will have on its results of operations, financial position, or liquidity.

Comprehensive Income

Comprehensive Income includes net earnings and other comprehensive income items such as revenues, expenses, gains or losses that under generally accepted accounting principles are included in comprehensive income, but excluded from net income. Since 2002, the Company has no such items required to be excluded from net earnings. Accordingly, there is no difference between net earnings and comprehensive income for the years ended December 31, 2006, 2005, or 2004.

Goodwill

Goodwill represents costs in excess of the fair value acquired in connection with purchase business combinations. Goodwill arose in connection with the acquisition of a company related to the planned expansion of the Air Medical segment. In accordance with the provisions of SFAS No. 142, Goodwill and Other Intangibles, the Company tests its goodwill for impairment annually on January 1st or if impairment indicators are present. The impairment evaluation for goodwill is performed by using a two-step process. In the first step, the fair value of each reporting unit is compared with the carrying amount of the reporting unit, including goodwill. The estimated fair value of the reporting unit is generally determined on the basis of discounted future cash flows. If the estimated fair value of the reporting unit is less than the carrying amount of the reporting unit, then a second step must be completed in order to determine the amount of the goodwill impairment that should be recorded. In the second step, the implied fair value of the reporting unit's goodwill is determined by allocating the reporting unit's fair value to all of its assets and liabilities other than goodwill (including any unrecognized intangible assets) in a manner similar to a purchase price allocation. The resulting implied fair value of the goodwill that results from the application of this second step is then compared to the carrying amount of the goodwill and an impairment charge is recorded for the difference. The Company performed the test at January 1st and determined that no impairment charge for goodwill was required.

Restatement

The Company has determined that its auction rate securities were not properly classified in its 2005 balance sheet. As a result the accompanying 2005 balance sheet has been restated to classify \$66.5 million from cash and cash equivalents to short-term investments-available for sale. The Company has also made corresponding adjustments to its consolidated statements of cash flows for 2005 and 2004 to reflect the gross purchases and sales of these securities as investing activities rather than as a component of cash and cash equivalents. The condensed financial information in Note 13 also reflects these adjustments. The Company had historically classified these securities as cash equivalents based on management's likely ability to liquidate its holdings during the predetermined interest rate reset auctions, however, the definition of a cash equivalent in Statement of Financial Accounting Standards ("SFAS") No. 95, "Statement of Cash Flows", requires the classification of these securities as short-term investments. There was no impact on previously reported net earnings, cash flows from operating activities or shareholders' equity as a result of this restatement.

(2) **PROPERTY AND EQUIPMENT**

The following table summarizes the Company's property and equipment at December 31, 2006 and December 31, 2005.

	<u>December 31,</u> <u>2006</u>	<u>December 31,</u> <u>2005</u>
	(Thousands of dollars)	
Flight equipment	\$ 480,934	\$ 416,076
Other	74,638	67,645
	<u>555,572</u>	<u>483,721</u>
Less accumulated depreciation	(186,107)	(172,043)
Property and equipment, net	<u>\$ 369,465</u>	<u>\$ 311,678</u>

Property and equipment at December 31, 2005 included aircraft with a net book value of \$1.1 million that was held for sale.

(3) **LONG-TERM DEBT**

On April 12, 2006, the Company issued \$200.0 million of 7.125% Senior Notes that mature in 2013. These Notes were offered and sold in a private placement under Rule 144A and Regulation S under the Securities Act of 1933. Net proceeds of \$196.0 million were used to repurchase \$184.8 million of our outstanding 9 3/8% Senior Notes due 2009 pursuant to a tender offer that also closed on April 12, 2006. The total cost to

repurchase those notes was \$201.6 million, including the tender offer premium and accrued interest. The Company called for redemption on May 1, 2006, the remaining \$15.2 million of 9 3/8% notes outstanding, at a redemption price of 104.688% of their face amount plus accrued and unpaid interest. Interest on the 7.125% notes is payable semi-annually on April 15 and October 15, and those notes mature April 15, 2013. The estimated annual interest cost of the new notes is \$14.3 million, excluding amortization of issuance costs, which represents a reduction in annual interest cost on the notes of \$4.5 million. As a result of the early redemption of the 9 3/8% notes, a pretax charge of \$12.8 million (\$7.7 million, net of tax) was recorded as a charge for debt restructuring in the quarter ended June 30, 2006, which consisted of \$9.8 million for the early call premium, \$2.6 million of unamortized issuance costs, and \$0.4 million in related expenses for the tender of outstanding notes.

The new notes contain restrictive covenants, including limitations on indebtedness, liens, dividends, repurchases of capital stock and other payments affecting restricted subsidiaries, issuance and sales of restricted subsidiary stock, dispositions of proceeds of asset sales, and mergers and consolidations or sales of assets. The Senior Notes are fully and unconditionally guaranteed on a joint and several senior basis by all of the Company's Guarantor Subsidiaries. See Note 13 of the Notes to Consolidated Financial Statements. We were in compliance with the covenants applicable to these notes as of December 31, 2006.

The Company has a \$35 million revolving credit facility with a commercial bank, which is scheduled to expire on September 1, 2008. At December 31, 2006, the Company had \$5.5 million in borrowings under the revolving credit facility, and the Company had \$3.3 million under the credit facility at December 31, 2005. The Company had five letters of credit for \$5.1 million outstanding at December 31, 2006, and four letters of credit for \$4.2 million outstanding at December 31, 2005. The credit agreement permits both prime rate based borrowings and "LIBOR" rate borrowings plus a spread. The spread for LIBOR borrowings is from 1.25% to 3.0%. The Company will pay an annual 0.25% commitment fee on the unused portion of the revolving credit facility. The credit agreement includes covenants related to working capital, funded debt to net worth, and consolidated net worth. As of December 31, 2006 and 2005, the Company was in compliance with these covenants. The credit agreement is collateralized by accounts receivable and inventory. Also included in notes payable at December 31, 2005 was \$1.0 million, representing finance agreements on purchase commitments for transport category aircraft as further described at Note 8.

Cash paid for interest was \$16.5 million, \$19.5 million, and \$19.1 million, for the years ended December 31, 2006, 2005, and 2004, respectively.

(4) INCOME TAXES

Income tax expense (benefit) is composed of the following:

	Year Ended December 31, 2006	Year Ended December 31, 2005	Year Ended December 31, 2004
	(Thousands of dollars)		
Current			
Federal	\$ -	\$ 343	\$ -
State	-	(50)	(1,142)
Foreign	1,175	1,371	1,077
Deferred - principally Federal	(1,588)	6,415	3,845
Total	<u>\$ (413)</u>	<u>\$ 8,079</u>	<u>\$ 3,780</u>

Income tax expense (benefit) as a percentage of pre-tax earnings varies from the effective Federal statutory rate of 34% as a result of the following:

	Year Ended December 31, 2006		Year Ended December 31, 2005		Year Ended December 31, 2004	
	Amount	%	Amount	%	Amount	%
Income taxes at statutory rate	\$ (367)	(34)	\$ 7,559	34	\$ 2,636	34
Increase (decrease) in taxes resulting from:						
Effect of foreign tax expense, net of U.S. benefits	--	--	--	--	679	9
Hurricane relief credit	--	--	(537)	(2)	--	--
Effect of state income taxes	(35)	(3)	762	3	298	4
Other items – net	(11)	(1)	295	1	167	2
Total	\$ (413)	(38)	\$ 8,079	36	\$ 3,780	49

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 2006 and 2005 are presented below (in thousands):

	December 31, 2006	December 31, 2005
Deferred tax assets:		
Deferred compensation	\$ 1,644	\$ 1,652
Foreign tax credits	5,792	4,617
Vacation accrual	962	1,419
Inventory valuation	3,355	3,549
Workman's compensation reserve	323	190
Allowance for uncollectible accounts	19	2,297
Alternative minimum tax credit	343	343
Hurricane relief credit	814	814
Other	720	1,321
Net operating loss	34,192	23,282
Total deferred tax assets	48,164	39,484
Valuation allowance – tax credit carryforwards	(2,142)	(2,142)
Total deferred tax assets, net	46,022	37,342
Deferred tax liabilities:		
Tax depreciation in excess of book depreciation	(74,326)	(68,167)
Total deferred tax liabilities	(74,326)	(68,167)
Net deferred tax liabilities	\$ (28,304)	\$ (30,825)

A valuation allowance was recorded against certain foreign tax credits paid in 2004 and prior as management believes it is more likely than not that the deferred tax asset related to certain foreign tax credit carryforwards will not be realized during their carryforward period. The estimated future U.S. taxable income, after utilization of the available net operating loss carryforwards, will limit the ability of the Company to utilize the foreign tax credit carryforwards during their carryforward period. Due to recent changes in the tax laws extending the credit carryforward period, management believes that a valuation allowance is not necessary for foreign tax credits generated in 2006 and 2005. A tax credit of \$0.8 million was realized in 2005 as a result of Hurricanes Katrina and Rita Legislation. At December 31, 2006 and 2005, other current assets include \$4.5 million and \$8.1 million, respectively, of deferred tax assets.

The Company has net operating loss carryforwards (“NOLs”), of approximately \$90.0 million that, if not used will expire beginning in 2022 through 2026. Additionally, for state income tax purposes, the Company has NOLs of approximately \$72.0 million available to reduce future state taxable income. These NOLs expire in varying amounts beginning in 2012 through 2026, the majority of which expires in 2017 and through 2020. Most of these NOLs arose from accelerated tax depreciation deductions related to substantial aircraft additions since 2002.

Income taxes paid were approximately \$0.1 million, \$0.1 million, and \$0.7 million, for the years ended December 31, 2006, 2005, and 2004, respectively. The Company received net income tax refunds of approximately \$0.3 million, \$0.8 million and \$0.5 million during the years ended December 31, 2006, 2005 and 2004, respectively.

(5) EMPLOYEE BENEFIT PLANS

Savings and Retirement Plans

The Company maintains an Employee Savings Plan under Section 401(k) of the Internal Revenue Code. The Company matches 2% for every 1% of an employee's salary deferral contribution, not to exceed 3% of the employee's compensation. The Company contributions were \$6.2 million for the year ended December 31, 2006, \$5.4 million for the year ended December 31, 2005 and \$4.8 million for the year ended December 31, 2004.

The Company maintains a Supplemental Executive Retirement Plan ("SERP"). During January 2006, active employees were given a substitute benefit in the Officer Deferred Compensation Plan based on a calculated present value participant's interest in the SERP except for the four remaining retired participants. As a result, approximately \$2.0 million of the SERP liability was transferred to the Deferred Compensation Liability in 2006.

As of December 31, 2006, the Company adopted SFAS No. 158 for its SERP plan. For additional information relating to this accounting pronouncement and its impacts, see Note 1.

The Company recorded the following plan costs for the years ended December 31, 2006, 2005, and 2004.

	Years Ended December 31,		
	2006	2005	2004
	(Thousands of dollars)		
Service cost	\$ --	\$ 259	\$ 302
Interest cost	64	124	111
Recognized actuarial (gain) loss	62	53	(30)
Net periodic plan cost	<u>126</u>	<u>436</u>	<u>383</u>

The benefit obligation, funded status, and assumptions of the plan on December 31, 2006 and 2005 were as follows:

	December 31,	
	2006	2005
	(Thousands of dollars)	
Change in benefit obligation:		
Benefit obligation at the beginning of the year	\$ 3,413	\$ 3,148
Service cost	--	259
Interest cost	64	124
Actuarial loss	(18)	13
Benefits paid	(384)	(131)
Transferred to deferred compensation	(2,012)	--
Benefit obligation at the end of the year	<u>1,063</u>	<u>3,413</u>

	December 31,	
	2006	2005
	(Thousands of dollars)	
Reconciliation of funded status		
Unfunded status	(1,063)	(3,413)
Unrecognized actuarial gains	--	(123)
Total liability included in other long term liabilities on the consolidated balance sheet	<u>\$ (1,063)</u>	<u>\$ (3,536)</u>
Weighted average assumptions		
Discount rate	5.8%	4.0%
Employee turnover/early retirement rate	--	--

Amounts recognized in accumulated other comprehensive income consists of approximately \$129,000 pre-tax in unrecognized actuarial gain in 2006.

The SERP plan is an unfunded arrangement. However, the Company has purchased life insurance contracts on the lives of the participants in anticipation of using the life insurance's cash values and death benefits to help fulfill the obligations of the plan. The Company, as owner of such policies, may sell or redeem the contracts at any time without any obligation to the plan participants. The Company recorded expenses of approximately less than \$0.1 million for 2006 and \$0.5 million for each of the years 2005 and 2004 related to the life insurance contracts. Cash values of the life insurance contracts, recorded in other assets, are \$0.4 million at December 31, 2006 and \$0.9 million at December 31, 2005.

The Company maintains an Officer Deferred Compensation Plan that permits key officers to defer a portion of their compensation. The plan is nonqualified and funded. The Company has established a separate account for each participant, which is invested and reinvested from time to time in investments that the participant selects from a list of eligible investment choices. Earnings and losses on the book reserve accounts accrue to the plan participants. Liabilities for the plan are included in other long-term liabilities, and the corresponding investment accounts are included in other assets. Aggregate amounts deferred under the plans were \$3.4 million and \$0.9 million, respectively, for the years December 31, 2006 and 2005.

Stock Based Compensation

Under the PHI 1995 Incentive Plan (the "1995 Plan"), the Company is authorized to issue up to 175,000 shares of voting common stock and 575,000 shares of non-voting common stock. The Compensation Committee of the Board of Directors is authorized under the 1995 Plan to grant stock options, restricted stock, stock appreciation rights, performance shares, stock awards, and cash awards. The exercise prices of the stock option grants are equal to the fair market value of the underlying stock at the date of grant. The 1995 Plan also allows awards under the plan to fully vest upon a change in control of the Company. In September of 2001, the Company underwent a change of control as defined in the 1995 plan and as a result, all awards issued prior to the change of control became fully vested.

During the year ended December 31, 2001, the Company granted 20,000 non-voting restricted shares and 150,000 non-voting stock options under the 1995 Plan. The non-voting restricted shares had a fair value of \$11.06 on the date of issue and became unrestricted during 2001. The non-voting stock options are 100% vested and expire on September 1, 2010. Such options were exercised in 2005. The Company has not issued any shares, options or rights under the 1995 Plan since 2001.

At December 31, 2006, there were 116,520 voting shares and 183,802 non-voting shares available for issuance under the 1995 Plan. The Company recorded compensation expense related to the 1995 Plan of \$0 million for December 31, 2006, \$0.2 million for December 31, 2005 and \$0.1 million for the year ended December 31, 2004. There was no unearned stock compensation expense at December 31, 2006 and 2005.

The following table summarizes employee and director stock option activities for the years ended December 31, 2006, 2005, and 2004. All of the options were issued with an exercise price equal to or greater than the market price of the stock at the time of issue.

	1995 Plan Options <u>Non- Voting</u>	<u>Weighted Average Exercise Price</u>
Balance outstanding at December 31, 2003	217,703	11.63
Options settled for cash	<u>(10,750)</u>	12.75
Balance outstanding at December 31, 2004	206,953	11.57
Options exercised	(150,000)	11.06
Options settled for cash	<u>(10,203)</u>	8.50
Balance outstanding at December 31, 2005	46,750	13.87
Options exercised	(8,500)	12.75
Options cancelled	<u>(500)</u>	12.75
Balance outstanding at December 31, 2006	<u>37,750</u>	14.14
Shares exercisable at December 31, 2006	<u>37,750</u>	14.14
December 31, 2005	<u>46,750</u>	13.87
December 31, 2004	<u>206,953</u>	11.57

The following table summarizes information about stock options outstanding as of December 31, 2006. All of the outstanding stock options are exercisable.

Options Outstanding and Exercisable		
Number Outstanding	Remaining Contractual Life (Years)	Exercise Price
22,750	2.5	\$ 12.75
15,000	1.8	16.25
<u>37,750</u>	2.4 ⁽¹⁾	14.14

(1) Weighted Average

Incentive Compensation

During 2002, the Company implemented an incentive plan for non-executive and non-represented employees. The plan allows the Company to pay up to 7% of earnings before tax, net of incentive compensation. During 2004, the Company implemented an Executive/Senior Management plan for certain corporate and business unit management employees. The Company did not record incentive compensation expense for the year ended December 31, 2006 and 2004, as certain requirements under the incentive plans established were not met. For 2005, the Company recorded \$2.3 million of incentive compensation expense related to the above plans.

(6) **OTHER ASSETS**

The following table summarizes the Company's other assets at December 31, 2006 and 2005.

	December 31, 2006	December 31, 2005
	(Thousands of dollars)	
Goodwill acquired	\$ 2,747	\$ 2,747
Security deposits on aircraft	10,170	4,576
Deferred financing cost	5,231	3,520
Investments	3,298	910
Other	2,370	1,513
Total	<u>\$ 23,816</u>	<u>\$ 13,266</u>

During 2006 and 2005, the Company placed security deposits on aircraft to be leased or purchased. Upon delivery of the aircraft, the deposits will be applied to the lease or purchase.

(7) **FINANCIAL INSTRUMENTS**

Fair Value – The following table presents the carrying amounts and estimated fair values of financial instruments held by the Company at December 31, 2006 and December 2005. The table excludes cash and cash equivalents, short-term investments, accounts receivable, accounts payable and accrued liabilities and term notes payable, all of which had fair values approximating carrying amounts.

	December 31, 2006		December 31, 2005	
	Carrying Amounts	Estimated Fair Value	Carrying Amounts	Estimated Fair Value
Long-term debt	\$200,000	\$194,000	\$200,000	\$210,500

At December 31, 2006 and 2005, the fair value of long-term debt is based on quoted market indications.

(8) **COMMITMENTS AND CONTINGENCIES**

Operating Leases – The Company leases certain aircraft, facilities, and equipment used in its operations. The related lease agreements, which include both non-cancelable and month-to-month terms, generally provide for fixed monthly rentals and, for certain real estate leases, renewal options. The Company generally pays all insurance, taxes, and maintenance expenses associated with these aircraft and some of these leases contain renewal and purchase options. Rental expense incurred under these leases consisted of the following:

	Year Ended December 31, 2006	Year Ended December 31, 2005	Year Ended December 31, 2004
	(Thousands of dollars)		
Aircraft	\$ 15,663	\$ 5,817	\$ 748
Other	5,174	5,167	3,906
Total	<u>\$ 20,837</u>	<u>\$ 10,984</u>	<u>\$ 4,654</u>

The Company began leasing a principal operating facility at Lafayette, Louisiana for twenty years, effective September 2001. The lease expires in 2021 and has three five-year renewal options.

The following table presents the remaining aggregate lease commitments under operating lease having initial non-cancelable terms in excess of one year. The table includes renewal periods on the principal operating facility lease.

	Aircraft	Other	Total
	(Thousands of dollars)		
2007	\$ 15,663	\$ 3,237	\$ 18,900
2008	15,663	2,652	18,315
2009	15,663	1,945	17,608
2010	16,265	1,664	17,929
2011	17,533	1,348	18,881
Thereafter	76,303	10,353	86,656
	<u>\$ 157,090</u>	<u>\$ 21,199</u>	<u>\$ 178,289</u>

The Company expects to finance the acquisition of new aircraft, discussed below, with existing cash and cash equivalents, short-term investments, operating leases, the issuance of debt or equity securities or some combination thereof.

In 2006, the Company took delivery of three transport category aircraft, eight medium aircraft and nine light aircraft for service in the Domestic Oil and Gas segment. The Company also took delivery of two light aircraft for service in the Air Medical segment. Subsequent to December 31, 2006, the Company took delivery of four light aircraft for service in Domestic Oil and Gas and one light aircraft for service in the Air Medical segment.

At December 31, 2006, the Company had an order for two additional transport category aircraft, which it intend to finance with an operating lease. The approximate cost for these two aircraft is \$37.2 million

At December 31, 2006, the Company also had orders for 34 additional aircraft with a total cost of \$144.6 million and scheduled delivery dates throughout 2007 and 2008. Of this total, five aircraft totaling \$16.7 million was delivered subsequent to December 31, 2006, as mentioned above.

Environmental Matters – The Company has an aggregate estimated liability of \$0.2 million as of December 31, 2006 and 2005 for environmental remediation costs that are probable and estimable. The Company has conducted environmental surveys of our former Lafayette Facility, which it vacated in 2001, and has determined that limited soil and groundwater contamination exists at the facility. The Company has installed groundwater monitoring wells at the facility and periodically monitor and report on the contamination. In May 2003, the Company submitted a Louisiana Risk Evaluation/Corrective Action Plan (“RECAP”) Standard Site Assessment Report to the Louisiana Department of Environmental Quality (“LDEQ”) fully delineating the extent and type of contamination. In April, 2006, the Site Assessment was updated to include recent analytical data. LDEQ is reviewing the assessment report. Once LDEQ completes its review and reports on whether all contamination has been fully defined, a risk evaluation in accordance with RECAP will be submitted and evaluated by LDEQ. At that point, LDEQ will establish what cleanup standards must be met at the site. When the process is complete, the Company will be in a position to develop an appropriate remediation plan and determine the resulting cost of remediation. The Company has not recorded any estimated liability for remediation and contamination and, based upon the May 2003 Site Assessment Report, the April 2006 update and ongoing monitoring, it believes the ultimate remediation costs for the former Lafayette facility will not be material to our consolidated financial position, results of operations, or liquidity.

During 2004, LDEQ advised PHI that groundwater contaminants impacting monitor wells at the PHI Lafayette Heliport were originating from an off-site location and that the Company would no longer be required to perform further monitoring at the site. Subsequently, based upon site investigation work performed by the Lafayette Airport Commission, the source of the contamination was identified as residing at another location, for which PHI is not responsible. The Lafayette Airport Commission has begun remediation of the PHI Lafayette Heliport.

Legal Matters – The Company is named as a defendant in various legal actions that have arisen in the ordinary course of business and have not been finally adjudicated. In the opinion of management, the amount of the ultimate liability with respect to these actions will not have a material adverse effect on the Company’s consolidated financial position, results of operations or liquidity.

As previously reported, on June 15, 2005, the Company received a subpoena from the United States Department of Justice relating to a grand jury investigation of potential antitrust violations among providers of helicopter transportation services in the Gulf of Mexico. The Company is cooperating fully with the investigation and believe it has provided all documents and other information required by the subpoena. The Company has not received any further communications from the Department of Justice since shortly providing the requested information. At this stage, it is not possible to assess the outcome of this investigation, although based on the information available to us to date, management does not expect the outcome of the investigation to have a material adverse effect on our financial condition, results of operations, or liquidity.

Purchase Commitments – At December 31, 2006, there were no purchase commitments other than those described above, with respect to aircraft which the Company expects to fund with existing cash and cash equivalents, short-term investments, execute operating leases, or some combination thereof.

Employee Matters - On September 20, 2006, the pilots represented by the OPEIU (the Office and Professional Employees International Union) commenced a general strike affecting both the Domestic Oil and Gas and Air Medical segments. On November 10, the OPEIU made a purported “unconditional” offer for the strikers to return to work and an end to strike activities. On January 11, 2007, the Federal Court for the Western District of Louisiana agreed to the Company’s return-to-work criteria and process for the remaining striking pilots, and the Company is committed to processing those pilots back to work by April 29, 2007. Pilots are currently working under the terms and conditions of employment set forth in the final implementation proposals made by the Company at the end of collective bargaining negotiations on August 28, 2006.

Other issues surrounding PHI’s allegations that the OPEIU engaged in bad faith bargaining, as well as the OPEIU’s counterclaims and claims arising out of the OPEIU’s purported “unconditional” offer to return to work, remain outstanding and are expected to be addressed by the same Federal Court. A trial on these matters is currently set to start on November 7, 2007. It is not possible to assess the outcome of the remaining claims and counterclaims.

(9) BUSINESS SEGMENTS AND GEOGRAPHIC AREAS

PHI is primarily a provider of helicopter services, including helicopter maintenance and repair services. The Company has used a combination of factors to identify its reportable segments as required by Statement of Financial Accounting Standards No. 131, “Disclosures about Segments of an Enterprise and Related Information” (“SFAS 131”). The overriding determination of the Company’s segments is based on how the chief operating decision-maker of the Company evaluates the Company’s results of operations. The underlying factors include customer bases, types of service, operational management, physical locations, and underlying economic characteristics of the types of work the Company performs. The Company identifies four segments that meet the requirements of SFAS 131 for disclosure. The reportable segments are Domestic Oil and Gas, Air Medical, International, and Technical Services.

The Domestic Oil and Gas segment provides helicopter services to oil and gas customers operating in the Gulf of Mexico. The International segment provides helicopters in various foreign countries to oil and gas customers. The Air Medical segment provides helicopter services to hospitals and medical programs in several U.S. states, and also to individuals under which the Company is paid by either a commercial insurance company, federal or state agency, or the patient. The Company’s Air Evac subsidiary is included in the Air Medical segment. The Technical Services segment provides helicopter repair and overhaul services for existing flight operations customers.

The Company’s largest customer, who is a customer in the Domestic Oil and Gas segment, accounted for 17% (\$72.2 million), 14% (\$50.5 million), and 13% (\$37.8 million) of operating revenues for the years ended December 31, 2006, 2005, and 2004, respectively.

The following table shows information about the profit or loss and assets of each of the Company's reportable segments for the years ended December 31, 2006, 2005, and 2004. The information contains certain allocations, including allocations of depreciation, rents, insurance, and overhead expenses that the Company deems reasonable and appropriate for the evaluation of results of operations. The Company does not allocate gains on dispositions of property and equipment, other income, interest expense, and corporate selling, general, and administrative costs to the segments. Where applicable, the tables present the unallocated amounts to reconcile the totals to the Company's consolidated financial statements. Segment assets are determined by where they are situated at period-end. Corporate assets are principally cash and cash equivalents, short-term investments, other assets, and certain property, plant, and equipment.

	Year Ended		
	December 31,		
	2006	2005	2004
	(Thousands of dollars)		
Segment operating revenues			
Domestic Oil and Gas	\$ 248,035	\$ 219,644	\$ 180,102
Air Medical	133,397	112,123	77,476
International	25,588	28,192	24,342
Technical Services	6,098	3,651	9,388
Total operating revenues	<u>413,118</u>	<u>363,610</u>	<u>291,308</u>
Segment direct expense			
Domestic Oil and Gas	213,279	173,177	151,107
Air Medical	130,412	104,465	67,664
International	18,456	19,099	18,668
Technical Services	4,125	2,522	7,935
Total direct expense	<u>366,272</u>	<u>299,263</u>	<u>245,374</u>
Segment selling, general and administrative expense			
Domestic Oil and Gas	1,010	1,003	1,499
Air Medical	7,384	6,503	6,525
International	96	214	49
Technical Services	82	7	12
Total selling, general and administrative expense	<u>8,572</u>	<u>7,727</u>	<u>8,085</u>
Total direct and selling, general and administrative expense	<u>374,844</u>	<u>306,990</u>	<u>253,459</u>
Net segment profit (loss)			
Domestic Oil and Gas	33,746	45,464	27,496
Air Medical	(4,399)	1,155	3,287
International	7,036	8,879	5,625
Technical Services	1,891	1,122	1,441
Total	<u>38,274</u>	<u>56,620</u>	<u>37,849</u>
Other, net ⁽¹⁾	9,946	3,230	2,961
Unallocated selling, general and administrative costs	(19,267)	(17,169)	(12,949)
Interest expense	(17,243)	(20,448)	(20,109)
Loss on debt restructuring	(12,790)	--	--
Earnings (loss) before income taxes	<u>\$ (1,080)</u>	<u>\$ 22,233</u>	<u>\$ 7,752</u>

(1) Including gains on disposition of property and equipment and other income.

	2006	Year Ended December 31, 2005	2004
	(Thousands of dollars)		
Expenditures for long lived			
Assets			
Domestic Oil and Gas	\$ 107,896	\$ 55,876	\$ 7,614
Air Medical	14,446	39,361	18,071
International	136	284	198
Corporate	775	644	8,038
Total	\$ 123,253	\$ 96,165	\$ 33,921

	2006	Year Ended December 31, 2005	2004
	(Thousands of dollars)		
Depreciation and			
Amortization			
Domestic Oil and Gas	\$ 15,939	\$ 15,829	\$ 18,342
Air Medical	8,634	6,023	4,992
International	1,443	1,236	1,587
Technical Services	--	--	42
Corporate	4,281	4,045	2,880
Total	\$ 30,297	\$ 27,133	\$ 27,843

Assets			
Domestic Oil and Gas	\$ 289,349	\$ 247,657	\$ 227,929
Air Medical	166,367	137,911	89,722
International	15,170	13,560	12,289
Corporate	230,084	150,081	64,233
Total	\$ 700,970	\$ 549,209	\$ 394,173

The following table presents the Company's revenues from external customers attributed to operations in the United States and foreign areas and long-lived assets in the United States and foreign areas.

	Year Ended December 31, 2006	Year Ended December 31, 2005	Year Ended December 31, 2004
	(Thousands of dollars)		
Operating revenues:			
United States	\$ 387,530	\$ 335,418	\$ 266,966
International	25,588	28,192	24,342
Total	\$ 413,118	\$ 363,610	\$ 291,308
Long-Lived Assets:			
United States	\$ 362,527	\$ 303,924	\$ 246,819
International	6,938	7,754	6,422
Total	\$ 369,465	\$ 311,678	\$ 253,241

(10) EFFECTS OF HURRICANES

At December 31, 2005, the Company recognized a loss from Hurricane Katrina on August 29, 2005 and Hurricane Rita on September 24, 2005 of approximately \$5.6 million consisting of write-off of inventory and other tangible assets of \$2.5 million, incremental repair costs and costs to relocate operations from damaged or destroyed bases of \$3.1 million. These losses were offset by insurance recoveries of \$5.6

million at December 31, 2005, of which \$2.7 million was reflected as receivable from the insurance carriers in accounts receivable, other at December 31, 2005. In 2006, the Company incurred additional repair costs and costs related to relocation of operations from damaged or destroyed bases, of \$3.0 million. This loss was offset by insurance recoveries of \$3.0 million in 2006. The Company received proceeds from insurance carriers totaling \$8.6 million, of which \$2.9 million and \$5.7 million was received in 2005 and 2006, respectively.

(11) QUARTERLY FINANCIAL DATA (UNAUDITED)

The summarized quarterly results of operations for the years ended December 31, 2006 and December 31, 2005 (in thousands of dollars, except per share data) are as follows:

	Quarter Ended			
	March 31, 2006	June 30, 2006	September 30, 2006	December 31, 2006
	(Thousands of dollars, except per share data)			
Operating revenues	\$ 101,372	\$ 107,157	\$ 109,315	\$ 95,274
Gross profit	14,317	17,946	16,091	(1,508)
Net earnings (loss)	2,225	(2,755)	5,122	(5,259)
Net earnings (loss) per share				
Basic	0.21	(0.19)	0.34	(0.34)
Diluted	0.21	(0.19)	0.33	(0.34)

	Quarter Ended			
	March 31, 2005	June 30, 2005	September 30, 2005	December 31, 2005
	(Thousands of dollars, except per share data)			
Operating revenues	\$ 74,239	\$ 86,783	\$ 100,018	\$ 102,570
Gross profit	10,203	13,887	19,834	20,422
Net earnings	359	1,961	5,460	6,374
Net earnings per share				
Basic	0.07	0.32	0.53	0.62
Diluted	0.07	0.31	0.53	0.62

(12) SHAREHOLDERS' EQUITY

On April 12, 2006, the Company completed the sale of 4,287,920 non-voting common shares at \$35.00 per share and on May 1, 2006, the Company completed the sale of the over-allotment of 578,680 shares also at \$35.00 per share. Proceeds from the offering were \$160.7 million, net of expenses.

The Company had an average of 13.9 million common shares outstanding for the period ended December 31, 2006, compared to an average of 8.0 million shares for the period ended December 31, 2005. The increase was the result of the equity offerings in April 2006 and June 2005.

(13) CONDENSED FINANCIAL INFORMATION – GUARANTOR ENTITIES

On April 12, 2006, the Company issued \$200 million of 7.125% Senior Notes due 2013 and retired \$184.8 million of 9 3/8% Series B Senior Notes due 2009. On May 1, 2006, the Company redeemed the remaining \$15.2 million 9 3/8% Series B Senior Notes.

The 7.125% Senior Notes are fully and unconditionally guaranteed on a joint and several, senior basis by all of the Company's Guarantor Subsidiaries.

The following condensed financial information sets forth, on a consolidating basis, the balance sheet,

statement of operations, and statement of cash flows information for PHI, Inc. (“Parent Company Only”) and the Guarantor Subsidiaries. The principal eliminating entries eliminate investments in subsidiaries, intercompany balances, and intercompany revenues and expenses.

PHI, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATING BALANCE SHEETS
(Thousands of dollars)

	December 31, 2006			
	Parent Company Only	Guarantor Subsidiaries ⁽¹⁾	Eliminations	Consolidated
ASSETS				
Current Assets:				
Cash and cash equivalents	\$ 385	\$ 435	\$ --	\$ 820
Short-term investments	153,414	--	--	153,414
Accounts receivable – net of allowance	75,642	13,652	--	89,294
Inventories of spare parts and supplies	55,596	--	--	55,596
Other current assets	7,922	8	--	7,930
Refundable income taxes	44	591	--	635
Total current assets	293,003	14,686	--	307,689
Investment in subsidiaries	46,226	--	(46,226)	--
Intercompany receivable	--	44,085	(44,085)	--
Other assets	23,759	57	--	23,816
Property and equipment, net	361,570	7,895	--	369,465
Total assets	\$ 724,558	\$ 66,723	\$ (90,311)	\$ 700,970
LIABILITIES AND SHAREHOLDERS’ EQUITY				
Current liabilities:				
Accounts payable and accrued liabilities	\$ 46,653	\$ 4,354	\$ --	\$ 51,007
Intercompany payable	44,085	--	(44,085)	--
Accrued vacation payable	2,295	288	--	2,583
Total current liabilities	93,033	4,642	(44,085)	53,590
Long-term debt	205,500	--	--	205,500
Deferred income taxes and other long-term liabilities	25,900	15,855	--	41,755
Shareholders’ Equity				
Paid-in capital	292,222	4,402	(4,402)	292,222
Accumulated other comprehensive income	77	--	--	77
Retained earnings	107,826	41,824	(41,824)	107,826
Total shareholders’ equity	400,125	46,226	(46,226)	400,125
Total liabilities and shareholders’ equity	\$ 724,558	\$ 66,723	\$ (90,311)	\$ 700,970

1) Foreign subsidiaries represent minor subsidiaries and are included in the guarantors’ subsidiaries amounts.

PHI, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATING BALANCE SHEETS
(Thousands of dollars)

December 31, 2005

	Parent Company Only	Guarantor Subsidiaries ⁽¹⁾	Eliminations	Consolidated
ASSETS				
Current Assets:				
Cash and cash equivalents	\$ 2,577	\$ 459	\$ --	\$ 3,036
Short-term investments	66,525	--	--	66,525
Accounts receivable – net of allowance	81,881	14,236	--	96,117
Inventories of spare parts and supplies	48,123	--	--	48,123
Other current assets	9,978	64	--	10,042
Refundable income taxes	(61)	483	--	422
Total current assets	<u>209,023</u>	<u>15,242</u>	<u>--</u>	<u>224,265</u>
Investment in subsidiaries	38,700	--	(38,700)	--
Intercompany receivable	--	39,867	(39,867)	--
Other assets	13,253	13	--	13,266
Property and equipment, net	303,421	8,257	--	311,678
Total assets	<u>\$ 564,397</u>	<u>\$ 63,379</u>	<u>\$ (78,567)</u>	<u>\$ 549,209</u>
LIABILITIES AND SHAREHOLDERS' EQUITY				
Current liabilities:				
Accounts payable and accrued liabilities	\$ 46,322	\$ 10,605	\$ --	\$ 56,927
Intercompany payable	39,867	--	(39,867)	--
Accrued vacation payable	3,522	289	--	3,811
Notes payable	1,000	--	--	1,000
Total current liabilities	<u>90,711</u>	<u>10,894</u>	<u>(39,867)</u>	<u>61,738</u>
Long-term debt	203,300	--	--	203,300
Deferred income taxes and other long-term liabilities	31,335	13,785	--	45,120
Shareholders' Equity				
Paid-in capital	130,558	4,402	(4,402)	130,558
Retained earnings	108,493	34,298	(34,298)	108,493
Total shareholders' equity	<u>239,051</u>	<u>38,700</u>	<u>(38,700)</u>	<u>239,051</u>
Total liabilities and shareholders' equity	<u>\$ 564,397</u>	<u>\$ 63,379</u>	<u>\$ (78,567)</u>	<u>\$ 549,209</u>

PHI, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATING STATEMENTS OF OPERATIONS
(Thousands of dollars)

For the year ended December 31, 2006

	Parent Company Only	Guarantor Subsidiaries ⁽¹⁾	Eliminations	Consolidated
Operating revenues	\$ 357,355	\$ 55,763	\$ --	\$ 413,118
Management fees	2,231	--	(2,231)	--
Gain on dispositions of property and equipment, net	1,910	--	--	1,910
Other	8,016	20	--	8,036
	<u>369,512</u>	<u>55,783</u>	<u>(2,231)</u>	<u>423,064</u>
Expenses:				
Direct expenses	325,115	41,157	--	366,272
Management fees	--	2,231	(2,231)	--
Selling, general, and administrative	25,106	2,733	--	27,839
Equity in net income of consolidated subsidiaries	(7,592)	--	7,592	--
Interest expense	17,243	--	--	17,243
Loss on debt restructuring	12,790	--	--	12,790
	<u>372,662</u>	<u>46,121</u>	<u>5,361</u>	<u>424,144</u>
Earnings (loss) before income taxes	(3,150)	9,662	(7,592)	(1,080)
Income taxes	(2,483)	2,070	--	(413)
Net earnings (loss)	<u>\$ (667)</u>	<u>\$ 7,592</u>	<u>\$ (7,592)</u>	<u>\$ (667)</u>

For the year ended December 31, 2005

	Parent Company Only	Guarantor Subsidiaries ⁽¹⁾	Eliminations	Consolidated
Operating revenues	\$ 310,868	\$ 52,742	\$ --	\$ 363,610
Management fees	1,485	--	(1,485)	--
Gain on dispositions of property and equipment, net	1,173	--	--	1,173
Other	1,988	69	--	2,057
	<u>315,514</u>	<u>52,811</u>	<u>(1,485)</u>	<u>366,840</u>
Expenses:				
Direct expenses	263,861	35,402	--	299,263
Management fees	--	1,485	(1,485)	--
Selling, general, and administrative	22,110	2,786	--	24,896
Equity in net income of consolidated subsidiaries	(8,921)	--	8,921	--
Interest expense	20,448	--	--	20,448
	<u>297,498</u>	<u>39,673</u>	<u>7,436</u>	<u>344,607</u>
Earnings before income taxes	18,016	13,138	(8,921)	22,233
Income taxes	3,862	4,217	--	8,079
Net earnings	<u>\$ 14,154</u>	<u>\$ 8,921</u>	<u>\$ (8,921)</u>	<u>\$ 14,154</u>

1) Foreign subsidiaries represent minor subsidiaries and are included in the guarantors' subsidiaries amounts.

PHI, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATING STATEMENTS OF OPERATIONS
(Thousands of dollars)

For the year ended December 31, 2004

	Parent Company Only	Guarantor Subsidiaries ⁽¹⁾	Eliminations	Consolidated
Operating revenues	\$ 244,230	\$ 47,078	\$ --	\$ 291,308
Management fees	4,943	--	(4,943)	--
Gain on dispositions of property and equipment, net	2,575	(6)	--	2,569
Other	373	19	--	392
	<u>252,121</u>	<u>47,091</u>	<u>(4,943)</u>	<u>294,269</u>
Expenses:				
Direct expenses	217,072	28,302	--	245,374
Management fees	--	4,943	(4,943)	--
Selling, general, and administrative	17,354	3,680	--	21,034
Equity in net income of consolidated subsidiaries	(7,398)	--	7,398	--
Interest expense	20,109	--	--	20,109
	<u>247,137</u>	<u>36,925</u>	<u>2,455</u>	<u>286,517</u>
Earnings before income taxes	4,984	10,166	(7,398)	7,752
Income taxes	1,012	2,768	--	3,780
Net earnings	<u>\$ 3,972</u>	<u>\$ 7,398</u>	<u>\$ (7,398)</u>	<u>\$ 3,972</u>

PHI, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATING STATEMENTS OF CASH FLOWS
(Thousands of dollars)

For the year ended December 31, 2006

	Parent Company Only	Guarantor Subsidiaries ⁽¹⁾	Eliminations	Consolidated
Net cash provided by operating activities	\$ 30,142	\$ 182	\$ --	\$ 30,324
Cash flows from investing activities:				
Purchase of property and equipment	(123,047)	(206)	--	(123,253)
Proceeds from asset dispositions	36,809	--	--	36,809
Purchase (sale) of short-term investments	(86,889)	--	--	(86,889)
Other	(5,595)	--	--	(5,595)
Net cash used in investing activities	<u>(178,722)</u>	<u>(206)</u>	<u>--</u>	<u>(178,928)</u>
Cash flows from financing activities:				
Proceeds of debt issuance – Senior Notes	200,000	--	--	200,000
Premium and costs to retire debt early	(10,208)	--	--	(10,208)
Repayment of Senior Notes	(200,000)	--	--	(200,000)
Debt issuance costs	(4,857)	--	--	(4,857)
Payments on long-term debt	(1,000)	--	--	(1,000)
Proceeds (payments) line of credit, net	2,200	--	--	2,200
Proceeds from stock issuance, net	160,722	--	--	160,722
Other	(469)	--	--	(469)
Net cash provided by financing activities	<u>146,388</u>	<u>--</u>	<u>--</u>	<u>146,388</u>
Increase in cash and cash equivalents	(2,192)	(24)	--	(2,216)
Cash and cash equivalents, beginning of period	2,577	459	--	3,036
Cash and cash equivalents, end of period	<u>\$ 385</u>	<u>\$ 435</u>	<u>\$ --</u>	<u>\$ 820</u>

1) Foreign subsidiaries represent minor subsidiaries and are included in the guarantors' subsidiaries amounts.

PHI, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATING STATEMENTS OF CASH FLOWS
(Thousands of dollars)

For the year ended December 31, 2005

	Parent Company Only	Guarantor Subsidiaries ⁽¹⁾	Eliminations	Consolidated
Net cash provided by operating activities	\$ 27,864	\$ 156	\$ --	\$ 28,020
Cash flows from investing activities:				
Purchase of property and equipment	(96,161)	(4)		(96,165)
Proceeds from asset dispositions	10,751	--	--	10,751
Purchase (sale) of short-term investments	(52,050)	--	--	(52,050)
Net cash used in investing activities	<u>(137,460)</u>	<u>(4)</u>	<u>--</u>	<u>(137,464)</u>
Cash flows from financing activities:				
Proceeds from (payment of) long-term debt, net	(5,975)	--	--	(5,975)
Proceeds from exercise of stock options	1,025	--	--	1,025
Proceeds from stock issuance, net	113,897	--	--	113,897
Net cash provided by financing activities	<u>108,947</u>	<u>--</u>	<u>--</u>	<u>108,947</u>
Increase in cash and cash equivalents	(649)	152	--	(497)
Cash and cash equivalents, beginning of period	3,226	307	--	3,533
Cash and cash equivalents, end of period	<u>\$ 2,577</u>	<u>\$ 459</u>	<u>\$ --</u>	<u>\$ 3,036</u>

For the year ended December 31, 2004

	Parent Company Only	Guarantor Subsidiaries ⁽¹⁾	Eliminations	Consolidated
Net cash provided by operating activities	\$ 10,644	\$ 261	\$ --	\$ 10,905
Cash flows from investing activities:				
Acquisition of additional operating locations	(1,518)	--	--	(1,518)
Purchase of property and equipment	(33,916)	(5)		(33,921)
Proceeds from asset dispositions	14,395	--	--	14,395
Purchase (sale) of short-term investments	2,450	--	--	2,450
Net cash used in investing activities	<u>(18,589)</u>	<u>(5)</u>	<u>--</u>	<u>(18,594)</u>
Cash flows from financing activities:				
Proceeds from long-term debt, net	8,275	--	--	8,275
Net cash provided by financing activities	<u>8,275</u>	<u>--</u>	<u>--</u>	<u>8,275</u>
Increase (decrease) in cash and cash equivalents	330	256	--	586
Cash and cash equivalents, beginning of period	2,896	51	--	2,947
Cash and cash equivalents, end of period	<u>\$ 3,226</u>	<u>\$ 307</u>	<u>\$ --</u>	<u>\$ 3,533</u>

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURES

None.

ITEM 9.A. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

Our Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) or 15d-15(e) under the Securities Exchange Act of 1934 (the "Exchange Act")) as of the end of the period covered by this report (the "Evaluation Date"). Based on such evaluation, such officers have concluded that, as of the Evaluation Date, our disclosure controls and procedures are effective in ensuring that the information required to be included in reports we file or submit to the SEC under the Exchange Act is recorded, processed, and summarized to timely alert them to material information relating to us, including our consolidated subsidiaries.

During the last quarter, there have not been any changes in our internal controls that materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Management's Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Our internal control system was designed to provide reasonable assurance to our management and board of directors regarding the reliability of financial reporting and preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

Our management assessed the effectiveness of our internal control over financial reporting as of December 31, 2006. In making this assessment, we used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control-Integrated Framework*. Based on this assessment our management believes that, as of December 31, 2006, our internal control over financial reporting is effective under those criteria.

Deloitte & Touche LLP, our independent registered public accounting firm, has issued an attestation report on our management's assessment of the Company's internal control over financial reporting as of December 31, 2006. This report appears below.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of
PHI, Inc.
Lafayette, Louisiana

We have audited management's assessment, included in the accompanying Management's Report on Internal Control over Financial Reporting (Item 9A), that PHI, Inc. and subsidiaries (the "Company") maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that the Company maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements and financial statement schedule as of and for the year ended December 31, 2006 of the Company and our report dated March 16, 2007, expressed an unqualified opinion on those financial statements and financial statement schedule.

DELOITTE & TOUCHE LLP

New Orleans, Louisiana
March 16, 2007

ITEM 9.B. OTHER INFORMATION

Not Applicable.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

Information concerning directors and executive officers required by this item will be included in our definitive information statement in connection with our 2007 Annual Meeting of Shareholders and is incorporated herein by reference.

ITEM 11. EXECUTIVE COMPENSATION

Information required by this item will be included in our definitive information statement in connection with our 2007 Annual Meeting of Shareholders and is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

Information required by this item will be included in our definitive information statement in connection with our 2007 Annual Meeting of Shareholders and is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS, RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

Information required by this item will be included in our definitive information statement in connection with our 2007 Annual Meeting of Shareholders and is incorporated herein by reference.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

Information required by this item will be included in our definitive information statement in connection with our 2007 Annual Meeting of Shareholders and is incorporated herein by reference.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

	<u>Page</u>
1. <u>Financial Statements</u>	
Included in Part II of this report:	
Report of Independent Registered Public Accounting Firm	27
Consolidated Balance Sheets – December 31, 2006 and December 31, 2005.	28
Consolidated Statements of Operations for the years ended December 31, 2006, December 31, 2005, and December 31, 2004.	29
Consolidated Statements of Shareholders' Equity for the years ended December 31, 2006, December 31, 2005, and December 31, 2004.	30
Consolidated Statements of Cash Flows for the years ended December 31, 2006, December 31 2005, and December 31, 2004.	31
Notes to Consolidated Financial Statements.	32
2. <u>Financial Statement Schedules</u>	
Schedule II – Valuation and Qualifying accounts for the years ended December 31, 2006, December 31, 2005 and December 31, 2004.	59
3. <u>Exhibits</u>	
3 Articles of Incorporation and By-laws	
3.1 (i) Amended and Restated Articles of Incorporation of the Company (incorporated by reference to Exhibit No. 3.1(i) to PHI's Report on Form 10-Q for the quarterly period ended June 30, 2006).	
(ii) Articles of Amendment to Articles of Incorporation of the Company (incorporated by reference to Exhibit 3.1 to PHI's Report on Form 8-K filed January 3, 2006).	
(iii) Amended and Restated By-laws of the Company (As amended through May 1, 2002).	
4 Instruments defining the rights of security holders, including indentures.	
4.1 Loan Agreement dated as of April 23, 2002 by and among PHI, Inc., Acadian Composites, LLC, Air Evac Services, Inc., Evangeline Airmotive Inc., and International Helicopter Transport, Inc. and Whitney National Bank (incorporated by reference to Exhibit 10.3 to PHI's Report on Form 10-Q for the quarterly period ended June 30, 2002).	
4.2 1 st Amendment to Loan Agreement dated as of April 23, 2002 by and among PHI, Inc. Acadian Composites, LLC, Air Evac Services, Inc., Evangeline Airmotive Inc., and International Helicopter Transport, Inc. and Whitney National Bank (incorporated by reference to Exhibit 10.4 to PHI's Report on Form 10-Q for the quarterly period ended June 30, 2004).	
4.3 Form of Senior Debt Indenture (incorporated by reference to Exhibit 4.5 to PHI's Registration Statement on Form S-3, filed on March 23, 2005, File No. 333-123528)	
4.4 Form of Subordinated Debt Indenture (incorporated by reference to Exhibit 4.6 to PHI's Registration Statement on Form S-3, filed on March 23, 2005, File No. 333-123528)	
4.5 First Supplemental Indenture dated April 12, 2006, among PHI, Inc., the Subsidiary Guarantors named therein and The Bank of New York, as Trustee (incorporated by reference to Exhibit 10.1 to PHI's Report on Form 8-K filed on April 13, 2006).	

- 4.6 Indenture dated April 12, 2006 among PHI, Inc., the Subsidiary Guarantors named therein and The Bank of New York, as Trustee (incorporated by reference to Exhibit 10.2 to PHI's Report on Form 8-K filed on April 13, 2006).
- 4.7 Third Amendment to Loan Agreement dated April 12, 2006 by and among PHI, Inc., Air Evac Services, Inc., PHI Tech Services, Inc. (formerly Evangeline Airmotive, Inc.), and International Helicopter Transport, Inc. and Whitney National Bank (incorporated by reference to Exhibit 10.4 to PHI's Report on Form 8-K filed on April 13, 2006).
- 10 Material Contracts
 - 10.2 The Amended and Restated PHI, Inc. 401 (k) Retirement Plan effective January 1, 2006.
 - 10.3 Amended and Restated PHI, Inc. 1995 Incentive Compensation Plan adopted by PHI's Board effective July 11, 1995 and approved by the shareholders of PHI on September 22, 1995.
 - 10.4 Form of Non-Qualified Stock Option Agreement under the PHI, Inc. 1995 Incentive Compensation Plan between PHI and certain of its key employees.
 - 10.5 Officer Deferred Compensation Plan II adopted by PHI's Board effective January 1, 2005.
 - 10.6 Articles of Agreement Between PHI, Inc. & Office & Professional Employees International Union and its Local 108 dated June 13, 2001.
- 21 Subsidiaries of the Registrant
 - 23.1 Consent of Deloitte & Touche LLP
 - 31.1 Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 by Al A. Gonsoulin, Chief Executive Officer.
 - 31.2 Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 by Michael J. McCann, Chief Financial Officer.
 - 32.1 Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 by Al A. Gonsoulin, Chief Executive Officer.
 - 32.2 Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 by Michael J. McCann, Chief Financial Officer.

PHI, INC. AND SUBSIDIARIES
Schedule II – Valuation and Qualifying Accounts
(Thousands of dollars)

Description	Balance at Beginning of Year	<u>Additions</u> Charged to Costs and Expenses	Deductions	Balance at End of Year
Year ended December 31, 2006:				
Allowance for doubtful accounts	\$ 163	\$ --	\$ 113	\$ 50
Allowance for obsolescent inventory	6,268	1,502	514	7,256
Year ended December 31, 2005:				
Allowance for doubtful accounts	\$ 163	\$ --	\$ --	\$ 163
Allowance for obsolescent inventory	6,988	(70)	650	6,268
Year ended December 31, 2004:				
Allowance for doubtful accounts	\$ 120	\$ 43	\$ --	\$ 163
Allowance for obsolescent inventory	5,536	2,400	948	6,988

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

PHI, INC.

By: /s/ Michael J. McCann
Michael J. McCann
Chief Financial Officer
(Principal Financial and
Accounting Officer)

Pursuant to requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u>/s/ Al A. Gonsoulin</u> Al A. Gonsoulin	Chairman of the Board Chief Executive Officer and Director (Principal Executive Officer)	March 16, 2007
<u>/s/ Lance F. Bospflug</u> Lance F. Bospflug	Director	March 16, 2007
<u>/s/ Arthur J. Breault, Jr.</u> Arthur J. Breault, Jr.	Director	March 16, 2007
<u>/s/ Thomas H. Murphy</u> Thomas H. Murphy	Director	March 16, 2007
<u>/s/ Richard H. Matzke</u> Richard H. Matzke	Director	March 16, 2007
<u>/s/ C. Russell Luigs</u> C. Russell Luigs	Director	March 16, 2007
<u>/s/ Michael J. McCann</u> Michael J. McCann	Chief Financial Officer (Principal Financial and Accounting Officer)	March 16, 2007