Canada Southern Petroleum Ltd.
1984 Annual Report

Directors

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Sharon, Connecticut

John W. Bush
Consultant
Naples, Florida

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Petroleum Consultant
Somis, California

Benjamin W. Heath
President
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Newport Beach, California

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Vice President

Evelyn D. Scott
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First Interstate Bank
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Auditors

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One Corporate Center
20 Church Street
Hartford, Connecticut 06103

On the cover:
"August Ice"
photographed off Rea Point, Melville Island.

At the right:
The tanker Irving Arctic, approaching the Panarctic base camp at Rea Point with fuel for the company's drilling rigs, is typical of the ice-strengthened vessels that would be used to ship oil from the Bent Horn field.

Photos courtesy of Panarctic Oils Ltd
Calgary, Alberta

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Canada Southern Petroleum Ltd.

A Special Supplement to the 1984 Annual Report

Shareholders:

Know Your Company

Fellow Shareholders:

As noted in this year's Annual Report, your company posted record earnings of \$1.34 million (or 15¢ a share) in fiscal 1984, tripling the earnings in the prior-year period. We again are free of all debt, have working capital in excess of \$1 million, and have a \$2 million line of credit if needed.

More importantly, our most promising properties remain covered by carried interest agreements that enable us to participate in oil and gas ventures in which our share of exploration, development, and operating costs is advanced by others, and is repaid out of production revenue on an interest-free basis.

We believe that these factors, in conjunction with our very substantial reserves (see opposite page), should entitle our company to be regarded as one of the more substantial independent oil and gas companies in Canada. With that in mind, we have prepared this review of Canada Southern's producing and prospective properties to insure that our shareholders will, indeed, know their company.

Please note that, in addition to the oil and gas reserves shown on the opposite page, your company has a 5 percent carried interest in the Bent Horn oilfield, which is discussed on page 10. However, it is not now possible to accurately determine the recoverable reserves from that field; hence Canada Southern's share of those reserves has not yet been estimated.

Respectfully submitted

C.J. Horne

Charles J. Horne
President

Calgary, Alberta
October 15, 1984

Canada Southern Petroleum Ltd.

1984 Estimated Oil & Gas Reserves

	OIL & NATURAL GAS LIQUIDS (million bbls.)	GAS (billion cu. ft.)
Northwestern Canada		
Alberta and British Columbia	.34	26
Kotaneelee		117
Arctic Islands		
Hecla		668
Whitefish	1.60	108
Kristoffer		3
TOTAL:	1.94	922

Note: the reserves shown herein are classified as proved or probable by independent consultants.

Petroleum Acreage Summary
(As of June 30, 1984)

	GROSS ACRES	NET ACRES
Northwestern Canada		
Alberta:		
Working Interests	640	40
British Columbia:		
Carried Interests	139,847	15,507
Working Interests	65,079	13,831
Overriding Royalty Interests	5,533	389
	210,459	29,727
Yukon and Northwest Territories:		
Carried Interests	118,016	33,045
Working Interests	924,958	122,349
	1,042,974	155,394
Arctic Islands		
Panarctic Agreements:		
Carried Interests	3,101,793	702,459
Working Interests	1,628,812	78,951
	4,730,605	781,410
TOTAL CANADA	5,984,678	966,571
AUSTRALIA	3,051,943	1,974
GRAND TOTAL:	9,036,621	968,545

Oil & Gas Properties, 1984

Northwestern Canada (1.3 MILLION GROSS ACRES)

Canada Southern's acreage in northwestern Canada is located in the Yukon and Northwest Territories (the Liard Basin) and in northeastern British Columbia, with an interest in one small oil and gas field in the Province of Alberta.

The Liard Basin-Kotaneelee

In terms of its potential revenue, by far the most significant of the Liard Basin properties is the Kotaneelee gas field—not yet fully developed or delineated—which was discovered by Canada Southern in 1964. Canada Southern has a 30 percent carried interest in Kotaneelee, for which the operator is Columbia Gas Development of Canada Ltd. ("Columbia Canada").

Kotaneelee now has four wells that are capable of production; and, according to the operator's independent consultants, has proved and probable reserves of 390 billion cubic feet. A gas gathering system and dehydration plant are in place; and the field is connected to a major pipeline system with links to Vancouver, B.C. and the northwestern United States. However, there has been no Canadian market for the gas since the field's discovery; and, in recent years, two U.S. pipeline companies that signed contracts to purchase Kotaneelee gas have not obtained U.S. import approval.

In 1984, however, the U.S. Department of Energy issued flexible and pragmatic new guidelines to facilitate the import approval procedure; and the Canadian Government made substantial changes to its gas pricing policies. Moreover, the newly elected Canadian Government apparently has an entirely new policy—characterized by flexibility—with respect to gas exports. In brief, the situation, although quite fluid, seems most favorable to the movement of substantially increased quantities of Canadian gas into the U.S., including Kotaneelee production.

Canada Southern, as a carried interest holder, will not receive its share of the Kotaneelee production revenues until past development and operating costs (approximately $47 million) have been recovered by Columbia Canada and the other working interest partners. Given the maximum projected volume of gas to be sold—approximately 18 billion cubic feet per year—and the anticipated wellhead price of about $3.00

Note: All monetary values in this review are expressed in Canadian dollars.

per thousand cubic feet, such expenses should be recovered within 24 months after production commences. Subsequent to that "payout period," Canada Southern should receive a 30 percent share of the field's net revenues after operating costs.

The Liard Basin-Other Areas

The company has a 15.57 percent pooled working interest in 675,061 gross acres in the Celibeta-Bovie area as well as a 45 percent carried interest in 1,591 gross acres surrounding the Celibeta discovery well. It also has a 6.9 percent pooled working interest in 249,897 gross acres and a 22.5 percent carried interest in 16,628 gross acres in the Island River area; and retains a 22.5 percent carried interest in 84,540 gross acres in the Trout Lake area.

British Columbia

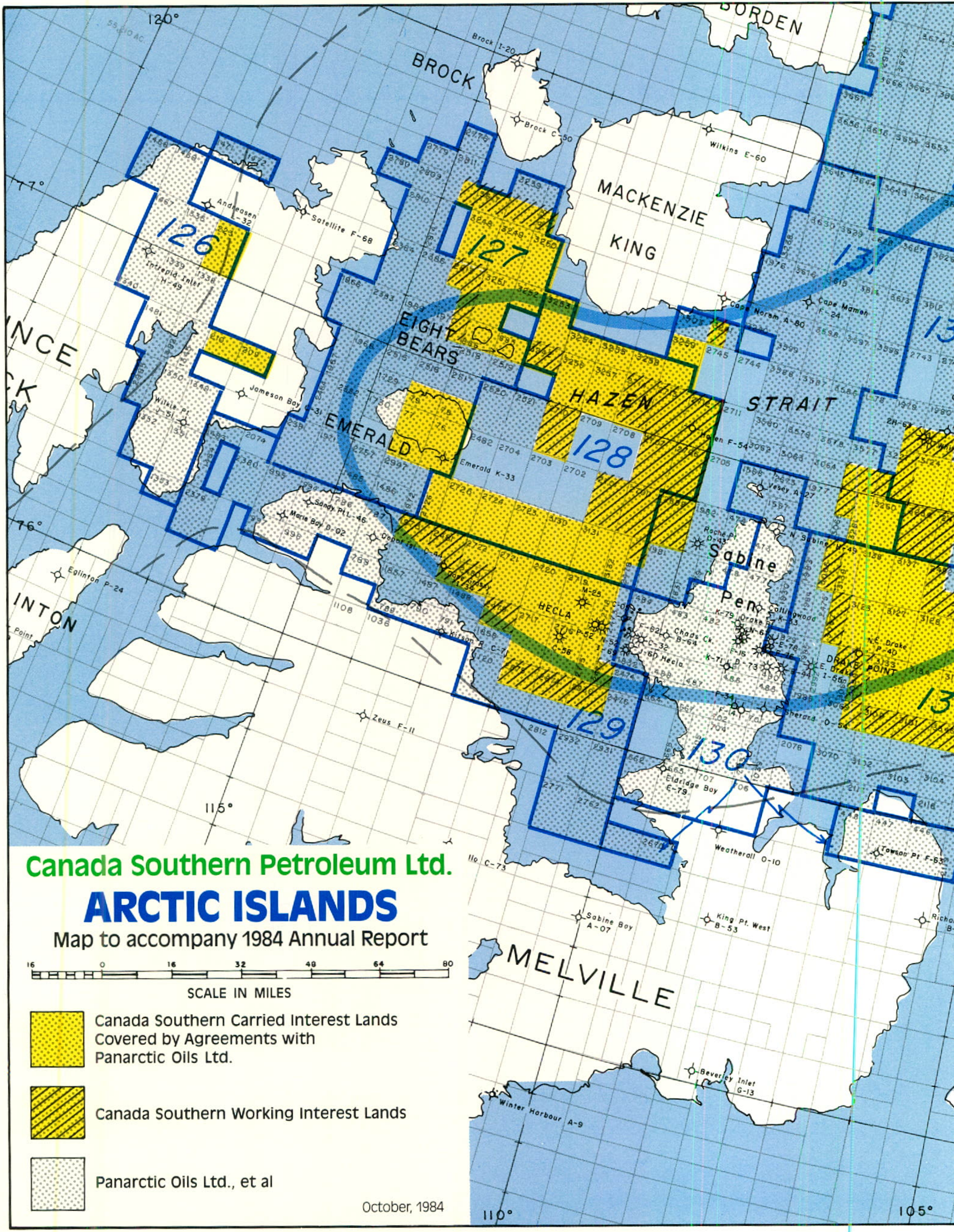
Excepting the 320-acre Clive field in Alberta, Canada Southern's producing properties are located in an area of northeast British Columbia where there are numerous oil and gas fields that were developed in the '50s and '60s.

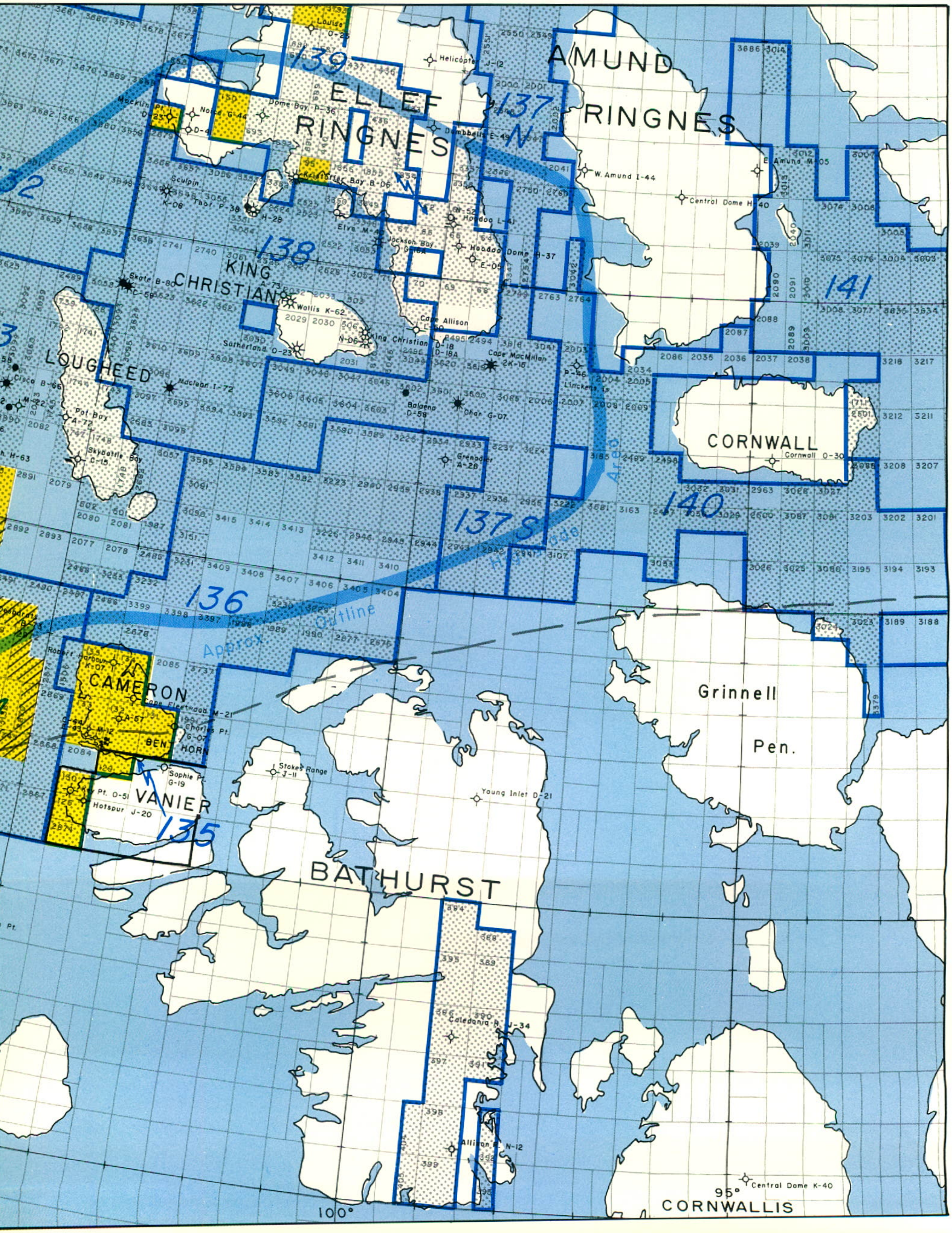
Canada Southern has varying interests in 210,459 gross acres in this area, most of which remains undeveloped. However, there are 43 productive oil wells and 51 productive gas wells on 43,255 acres that are considered developed, located, for the most part, within an 80-mile radius of Fort St. John. These producing properties—which are the Boundary Lake, Buick Creek, Flatrock, Inga, Peejay, Siphon, Stoddart, and Town fields—generated net income of $1.34 million for Canada Southern in fiscal 1984.

The High Arctic (4.7 MILLION GROSS ACRES)

Background

Canada Southern's Arctic Island properties are located, for the most part, to the north of Melville Island in the western Sverdrup Basin. (See map, centerfold). Approximately 3 million acres, including the most promising properties, are covered by carried interest agreements. The operator, Panarctic Oils Ltd., is a unique industry/government consortium that is more than 50-percent-owned by the Canadian Government through Petro-Canada Inc., the national oil company, with the remaining shares held by 37, largely Canadian, corporate or


Canada Southern Petroleum Ltd.
ARCTIC ISLANDS
Map to accompany 1984 Annual Report
SCALE IN MILES
16 0 16 32 48 64 80
Canada Southern Carried Interest Lands Covered by Agreements with Panarctic Oils Ltd.
Canada Southern Working Interest Lands
Panarctic Oils Ltd., et al
October, 1984
BORDEN
BROCK
MACKENZIE KING
EIGHT BEARS
EMERALD
HAZEN STRAIT
HECLA
Sabine Pen
MELVILLE
DRAKE POINT
126
127
128
129
130
Brock I-20
Brock C-50
Wilkins E-60
Andreasen L-32
Satellite F-68
Intrepid Inlet H-49
Jameson Bay C-31
Wilkie Pt. J-51
Emerald K-33
Hazen F-54
Cape Norem A-80
Cape Mamen F-24
Vesey A-27
Sandy Pt. L-46
Marie Bay D-02
Eglinton P-24
Zeus F-11
Eldridge Bay E-79
Weatherall O-10
Sabine Bay A-07
King Pt. West B-53
Beverley Inlet G-13
Winter Harbour A-9
Towson Pt. F-63
Sherard O-54
120°
115°
110°
105°
77°
76°


AMUND
RINGNES
ELLEF
RINGNES
KING
CHRISTIAN
LOUGHEED
CORNWALL
CAMERON
VANIER
BATHURST
Grinnell
Pen.
CORNWALLIS
139
137 N
138
141
140
137 S
136
135
Approx. Outline Hot Area
Helicopter J-12
Dome Bay P-36
Dumbells E-49
W. Amund I-44
Central Dome H-40
E. Amund M-05
Kristoffer Bay B-06
Sculpin K-08
Thor P-38
Elve M-40
Jackson Bay G-16A
Hoodoo L-41
Hoodoo Dome H-37
Skate B-80
Wallis K-62
King Christian D-18
Cape Allison L-60
Sutherland O-23
Cape Macmillan 2K-15
Cisco B-66
Maclean I-72
Pat Bay A-72
Skybattle Bay C-15
Balaena D-58
Char G-07
Grenadier A-26
Linckens Is.
Cornwall O-30
Cape Fleetwood M-21
Charles Pt.
Sophia Pt. G-19
Hotspur J-20
Stokes Range J-11
Young Inlet D-21
Caledonia R. J-34
Allison R. N-12
Central Dome K-40
100°
95°

individual shareholders. At the end of 1983, reserve estimates by Panarctic and its consultants indicated recoverable natural gas reserves in the Arctic Islands of 17.4 trillion cubic feet, plus recoverable oil reserves in the order of 500 million barrels. Since its founding, in 1966, Panarctic's exploration expenditures have exceeded $350 million, or approximately one-third of the $1 billion expended by all parties involved in Arctic Islands exploration.

Company-Interest Discoveries

The large Hecla gas field, discovered in 1972, is located on the western tangent of Melville Island's Sabine Peninsula, and extends about 15 miles offshore in a west-northwesterly direction. To date, four onshore and five offshore wells have been drilled, establishing recoverable gas reserves of 3.7 trillion cubic feet, according to Panarctic. The field also is believed to contain a substantial amount of heavy (19° API gravity) oil-in-place in two lower horizons; however, further development and production history are required before the recoverability of this oil can be calculated. As Canada Southern has a 30 percent carried interest in most of the offshore portion of the field, its share of the Hecla gas reserves is 668 billion cubic feet.

Approximately 40 miles northeast of the Sabine Peninsula is the Whitefish structure, where gas first was discovered in 1979. Three wells have been drilled at Whitefish, establishing recoverable gas reserves of 2.4 trillion cubic feet and 36 million barrels of natural gas liquids, according to Panarctic. Canada Southern has combined working and carried interests of approximately 5.7 percent in the Whitefish structure, and its share of the reserves is calculated at 108 billion cubic feet of gas and 1.6 million barrels of natural gas liquids.

Cameron Island, about 50 miles east of the Sabine Peninsula, is the site of the Bent Horn oilfield, which was discovered in 1976. This field now has three wells capable of production, one of which was tested at an average rate of 3,500 barrels per day over an extended period. However, due to the fractured and cavernous nature of the reservoir, production history is necessary before reserve estimates can be made. Canada Southern has a 5 percent carried interest in Bent Horn, which Panarctic hopes to bring into limited production in the near future. (Discussion follows on page 10.)

Arctic Exploration Areas

Under the terms of the Canada Oil and Gas Act (COGA), which became effective over two years ago, all companies holding interests in federal acreage were required to renegotiate their agreements with the Canadian Oil and Gas Lands Administration (COGLA).

The new exploration agreements (EA's)—which have a maximum duration of five years—require the surrender of 50 percent of the acreage held at the end of the five-year period, and are renegotiable for an additional five-year term. They also require the drilling of at least one well under each agreement, and retain a 25 percent net carried interest in all federal lands for the Government.* However, significant discovery areas, such as Hecla, are not subject to surrender or drilling requirements.

In light of the fact that there were more than 70 Arctic-interest holders with widely scattered interests—many involving farmouts and sub-farmouts—it would have been exceedingly difficult, if not impossible, for these companies to negotiate individual agreements with COGLA. Therefore, that responsibility was assumed by Panarctic Oils Ltd. (itself a quasi-governmental organization), which now is the only company active in Arctic Islands exploration. Twenty EA's covering more than 35 million acres were negotiated by Panarctic, which also negotiated corresponding operating agreements with the interest-holders.

Thirteen of the new EA's are located (in whole or in part) within what Panarctic terms the "high-grade area" of the western Sverdrup Basin; and nearly all of Canada Southern's Arctic acreage—*predominately in the carried interest position*—falls within eight EA's in the high-grade area. The carried interest lands are subject to prior agreements with Panarctic, under which the properties are divided into seven blocks that are *separate economic entities,* as if they had been negotiated with seven different companies. To illustrate: revenue ultimately generated by the Hecla field would pay off the Hecla block, and Bent Horn revenue would pay off the Bent Horn block, but expenses incurred on a nonproductive block could not be charged against Hecla or Bent Horn revenues.

*It should be noted that this 25 percent "back-in"—which is regarded as confiscatory by many Canadian and U.S. observers—and the other less-than-desirable provisions of COGA were enacted by the *previous* Administration, and hence may be subject to change.

Oil & Gas Marketing

The year 1984 might be termed a watershed in the history of Panarctic Oils Ltd., for, after 16 years of enormously successful exploration, the company now is placing primary emphasis on pursuing marketing outlets for its Arctic oil and gas reserves.

Charles R. Hetherington, Panarctic's President and Chief Executive Officer, has stressed that it is absolutely essential to get Arctic oil and gas into production so as to provide badly needed revenues for his company and its partners, which have invested about $1 billion in Arctic exploration. Some industry observers, however, have expressed the view that most of the parties involved simply are not interested in further exploration unless they are given some assurance that the reserves established will be allowed to go to market. Others cite the contradictory objectives of various Government Departments, noting that COGLA appears to give full support to Arctic exploration and development while other agencies—with their own constituencies and interests—are insisting on sociological, economic, and environmental impact studies that could drag on for years. In short, there has been no clear-cut, coherent policy *vis a vis* petroleum exploration and development in Canada's Northern Frontier. However—in light of the enormous plurality received by the new Government in the September elections—it appears that federal policies will become more beneficial to the Canadian energy industry, as was promised by the new Prime Minister during his campaign.

At present, Panarctic and other companies have advanced three proposals aimed at bringing Arctic oil and gas to market. The one deemed most likely to proceed in the near future is Panarctic's *Bent Horn Project,* which contemplates crude oil production from the Bent Horn field on Cameron Island, in which Canada Southern has a 5 percent carried interest. Initially, this project would involve limited production of 100,000 barrels of oil (to test the feasibility of the project), which would be shipped to market by ice-strengthened tanker during the summer of 1985. Ultimately, continuous production, at a much larger rate, and year-round ice-breaking tanker traffic are envisioned from Bent Horn. Panarctic has solicited federal approval to proceed with the trial run, which will cost about $6 million.

The Arctic Pilot Project, conceived in 1976 by Petro-Canada, envisions a 100-mile gas pipeline from a gathering station on the Sabine Peninsula to a barge-mounted liquefaction facility on the southern tangent of Melville Island, where the gas would be converted to LNG.

The gas then would be transported to market in ice-breaking tankers specifically designed for year-round service in the Arctic.

To date, Petro-Canada and its partners have expended more than $40 million on the project, which has an estimated capital cost of $2.3 billion. Unfortunately, the North American "gas glut" and falling world oil prices have substantially altered the economics of the project, which has been suspended pending increased demand for natural gas.

Another gas marketing proposal, sponsored by Trans-Canada PipeLines Ltd., is the *Polar Gas Project,* which would involve the transmission of gas from the MacKenzie Delta, Beaufort Sea, and Arctic Islands fields to southern markets *via* a 30-inch pipeline that would have a capacity of 800 million cubic feet per day. Applications for authority to proceed with this project have been filed with Canada's National Energy Board; and, according to Charles Hetherington, the project could be completed by the time the U.S. market is ready to accept the contemplated volume of gas.

Printed in U.S.A.

Corporate Profile, 1984

Canada Southern Petroleum Ltd. was incorporated under the Canada Corporations Act in 1954 as the successor to Canada Southern Oils, Ltd., which was founded in 1951. It has been a Nova Scotia Corporation since June 4, 1980. The company has no debt, has working capital in excess of $1 million, and had gross revenues of $2.98 million in fiscal 1984.

The company has been engaged in petroleum exploration ventures for many years, and has acquired substantial interests in largely undeveloped properties in northwestern Canada as well as the Arctic Islands Sverdrup Basin, totaling 6 million gross acres. These properties include:

- Several mature oil and gas fields in British Columbia, which generated net income of $1.34 million for the company in fiscal 1984. Canada Southern's share of the proved reserves in these fields is 344,767 barrels of oil and 26 billion cubic feet of gas.
- The huge Kotaneelee gas field in the southeastern Yukon Territory, which—although not yet fully delineated or developed—has proved and probable reserves of 390 billion cubic feet. By virtue of its 30 percent carried interest in the field, Canada Southern's share of these reserves is 117 billion cubic feet.
- Offshore portions of the Hecla gas field in the Sverdrup Basin, which is estimated by independent consultants to contain proved and probable reserves of 3.58 trillion cubic feet. Canada Southern's share of the Hecla reserves is 668 billion cubic feet.
- The Whitefish gas discovery, also in the Sverdrup Basin, which has proved and probable reserves estimated at 2.4 trillion cubic feet. Canada Southern's share of these reserves is calculated at 108 billion cubic feet, plus 1.6 million barrels of natural gas liquids.

Canada Southern's share of estimated reserves is 922 billion cubic feet of natural gas and 1.94 million barrels of oil and natural gas liquids.

Nearly all of the company's acreage is covered by *carried interest* agreements with other companies, which places Canada Southern in an enviable (if not unique) position among exploration-oriented oil and gas companies in Canada. These agreements enable the company to participate in oil and gas revenues from a given well or field after the recovery of exploration, drilling, completion, and operating costs by the party bearing those costs. Moreover, most of the company's Arctic Islands acreage is divided into seven geographic areas, or "blocks," that are structured as *separate economic entities*; and hence the expenses incurred in the exploration of an area that proves to be of no commercial value cannot be charged against the revenues derived from a successful area. In effect, Canada Southern's share of the exploration and development costs on a given block is advanced by the working interest partners, and is repaid only out of production revenue from that block on an interest-free basis.

The company also is a minor participant in the Amadeus Joint Venture, a consortium that is exploring a large tract in central Australia's Amadeus Basin. Upon completion of the consortium's extensive exploration and drilling program next year, Canada Southern will have a .04 percent working interest in the exploration area, which then will encompass approximately 6.1 million acres. To date, the Amadeus Joint Venture has discovered natural gas at two locations, and now is drilling another large gas prospect.

Canada Southern has approximately 9 million shares of capital stock outstanding, held by about 11,000 shareholders of record. The company's stock is listed on the Toronto Stock Exchange in Canada and on the Boston and Pacific Stock Exchanges in the United States, with the ticker symbol CSW in both countries.

To Our Shareholders:

It is a great pleasure to advise you that your company's gross revenues and net income for fiscal 1984 exceeded all previous records, and that our short-term bank loan has been repaid, leaving the company free of any debt.

For the 12-month period ended June 30, gross revenues were \$2.98 million, a very substantial increase over last year's \$1.85 million. More importantly, our net income tripled, to \$1.34 million, or 15¢ a share. These very positive results can be attributed, for the most part, to a 77 percent increase in the income derived from our producing properties in northwestern Canada, in spite of substantially increased petroleum revenue taxes and lease operating costs.

As of this writing, we are not yet in a position to offer a definitive prognosis for production at Kotaneelee. However, the U.S. and Canadian authorities apparently have resolved their impasse over gas pricing; and, as a result, Canadian gas is now competitive in U.S. markets. Moreover, the newly elected Canadian Government seems firmly committed to increasing gas exports to the U.S., which is a most welcome change from the inflexible, "take it or leave it" attitude of the previous Administration. For these reasons, your company and its partners are reasonably optimistic that the long-deferred commencement of production at Kotaneelee is near at hand.

Over the past few years, it has become evident that some investors—particularly in the U.S.—are not fully cognizant of the significance of our carried interest positions, which enable the company to participate in oil and gas ventures without having to advance any development capital. We therefore have prepared a special supplement to this report, entitled "Shareholders: Know Your Company" to provide you with a comprehensive and meaningful review of the Company's property interests; and I commend it to your careful study.

In conclusion, I would like to take this opportunity to express our great appreciation to Thomas W. Donlon, a Director of Canada Southern since 1976, who has decided not to seek re-election to the Board this year. Mr. Donlon, who has been actively involved in the oil business for over 40 years, has been an exceptionally able director whose wise and pragmatic counsel has been of inestimable benefit to our company over the past eight years. To succeed Mr. Donlon, the Board of Directors has nominated David Goodwill, whose 38-year career in the oil business has included executive positions with Standard Oil of California and the Champlin Petroleum Company.

Respectfully submitted,

C. J. Horne

Charles J. Horne,
President

Calgary, Alberta
October 15, 1984

Consolidated Balance Sheet

(Expressed in Canadian dollars)

Assets	June 30, 1984	1983
Current assets:		
Cash	$ 35,911	$ 146,759
Term deposits	750,000	—
Accounts receivable and other	432,539	303,722
Government Petroleum Incentive Grants receivable	—	5,750
Total current assets	1,218,450	456,231
Oil and gas properties (Note 1 and 2):		
Costs being depleted	7,049,463	6,968,655
Less accumulated depletion	(2,309,158)	(2,200,827)
	4,740,305	4,767,828
Costs not being depleted	4,885,071	4,738,422
	9,625,376	9,506,250
Other	253,224	265,547
	$11,097,050	$10,228,028

Liabilities and Shareholders' Equity	1984	1983
Current liabilities:		
Bank loan	$ —	$ 400,000
Accounts payable and accrued liabilities	103,766	179,095
Total current liabilities	103,766	579,095
Shareholders' equity:		
Capital stock, par value $1 per share (Note 5):		
Authorized 15,000,000 shares		
Outstanding 8,992,465 shares	8,992,465	8,992,465
Capital in excess of par value	14,982,543	14,982,543
	23,975,008	23,975,008
Accumulated deficit	(12,981,724)	(14,326,075)
Total shareholders' equity	10,993,284	9,648,933
	$11,097,050	$10,228,028

See accompanying notes.

Consolidated Statement of Operations and Accumulated Deficit

(Expressed in Canadian dollars)

	Year ended June 30,		
	1984	1983	1982
Income:			
Oil and gas sales	**$ 1,838,795**	$ 174,695	$ 293,045
Proceeds under carried interest agreements (Note 2)	**1,129,785**	1,498,678	920,452
Interest	**14,518**	22,714	92,816
Other (Note 4)	**—**	150,205	—
	2,983,098	1,846,292	1,306,313
Costs and expenses:			
General and administrative (Note 6)	**864,610**	929,583	1,309,427
Depletion and depreciation (Note 2)	**109,276**	118,081	233,858
Petroleum and gas revenue tax	**207,273**	219,648	135,064
Lease operating costs	**417,664**	60,031	71,393
Rent	**39,924**	63,537	71,677
Income (loss) before income taxes and extraordinary item	**1,344,351**	455,412	(515,106)
Income taxes (Note 7)	**804,000**	338,000	—
Income (loss) before extraordinary item	**540,351**	117,412	(515,106)
Extraordinary item—			
Tax benefit realized from carryforward of exploration, development and lease acquisition costs not claimed in prior years (Note 7)	**804,000**	338,000	—
Net income (loss)	**1,344,351**	455,412	(515,106)
Accumulated deficit—beginning of year	**(14,326,075)**	(14,781,487)	(14,266,381)
Accumulated deficit—end of year	**$(12,981,724)**	$(14,326,075)	$(14,781,487)
Average number of shares outstanding	**8,992,465**	8,992,465	8,992,465
Per share based on average number of shares outstanding during the period:			
Income (loss) before extraordinary item	**$.06**	$.01	$(.06)
Extraordinary item	**.09**	.04	—
Net income (loss)	**$.15**	$.05	$(.06)

See accompanying notes.

Consolidated Statement of Changes in Financial Position

(Expressed in Canadian dollars)

	Year ended June 30, 1984	1983	1982
Source of working capital:			
Income (loss) before extraordinary item	**$ 540,351**	$ 117,412	$ (515,106)
Charges to income not involving outlay of working capital:			
Depreciation and depletion	**109,276**	118,081	233,858
Other	**11,378**	11,379	11,378
Working capital (used in) provided by operations	**661,005**	246,872	(269,870)
Extraordinary item—Tax benefit realized from carryforward of exploration, development and lease acquisition costs not claimed in prior years (Note 7)	**804,000**	338,000	—
	1,465,005	584,872	(269,870)
Disposition of working capital:			
Additions to oil and gas properties	**232,283**	364,402	1,590,016
Less Government Petroleum Incentive Grants (Note 1)	**(4,826)**	(22,306)	(107,789)
Other	**—**	—	385
	227,457	342,096	1,482,612
Increase (decrease) in working capital	**$1,237,548**	$ 242,776	$(1,752,482)
Increase (decrease) in working capital by component:			
Cash	**$ (110,848)**	$ (70,842)	$ 141,392
Term deposits	**750,000**	(240,000)	(1,110,000)
Accounts receivable and other	**128,817**	80,461	(21,454)
Government Petroleum Incentive Grants receivable	**(5,750)**	(102,039)	107,789
Bank loan	**400,000**	449,000	(849,000)
Accounts payable and accrued liabilities	**75,329**	126,196	(21,209)
Increase (decrease) in working capital	**$1,237,548**	$ 242,776	$(1,752,482)

Consolidated Statement of Changes in Capital Stock and Capital in Excess of Par Value

(Expressed in Canadian dollars)

Three years ended June 30, 1984

	Number of shares	**Capital stock, $1 par value**	**Capital in excess of par value**	**Total**
Balances at June 30, 1981, 1982, 1983 and 1984	8,992,465	$8,992,465	$14,982,543	$23,975,008

See accompanying notes.

Notes to Consolidated Statements— June 30, 1984
(Expressed in Canadian dollars)

1. Summary of significant accounting policies

The accompanying consolidated financial statements include the accounts of Canada Southern Petroleum Ltd. (Canada Southern) and its wholly-owned subsidiaries, Canpet Inc. and C.S. Petroleum Limited, hereafter referred to collectively as the Company. The financial statements are in conformity with both Canadian and United States generally accepted accounting principles.

The Company, which is engaged primarily in one industry, exploration for and development of oil and gas properties, principally in Canada, follows the full cost method of accounting for oil and gas properties, whereby all costs associated with the exploration for and the development of oil and gas reserves are capitalized. Proceeds received from disposal of properties are credited against accumulated costs. Depletion of net costs accumulated in the Canada cost center (excluding the Arctic Islands) is provided on the composite unit-of-production method which is based on estimated recoverable proved reserves. Expenditures incurred in the Arctic Islands have been excluded from the capitalized costs in the Canada cost center to be depleted pending the commencement of pay-outs, if any, of the Company's interests in this major development project (see Note 2).

Depreciation has been computed for equipment, other than well equipment, by the straight-line method based on estimated useful lives of four to ten years. Depreciation of well equipment and depletion of intangible drilling costs pertaining to producing wells are computed by the unit-of-production method.

Interest costs incurred which are applicable to oil and gas properties not being depleted currently and on which exploration or development activities are in progress are capitalized. Interest costs for the years ended June 30, 1984 and 1983 amounted to $25,588, and $135,697, respectively, all of which were capitalized.

Amounts received or receivable from the Canadian Government as Petroleum Incentive Grants are applied as a reduction in the carrying value of the related oil and gas properties.

Transactions for settlement in U.S. dollars have been converted at average monthly exchange rates. Assets and liabilities in U.S. dollars have been translated at the year-end exchange rate. During the three years ended June 30, 1984, exchange gains and losses have not been significant.

2. Properties

The Company's property interests are located in British Columbia, the Yukon and Northwest Territories, the Arctic Islands and Alberta in Canada, and in Australia.

At June 30, 1984, a substantial portion of the acreage located in British Columbia and the Yukon and Northwest Territories was covered by carried interest agreements. These carried interest agreements provide that revenues are not payable to the Company until expenditures by the operators have been recouped from production. Also, the Company may at any time elect to convert from a carried interest to a working interest by paying its share of the expenditures not recouped by revenues from production. At June 30, 1984, 1983, and 1982, for the carried interest areas that have not reached payout status, the Company would have been required to pay $17,343,951, $17,334,068 and $16,711,196, respectively, to convert all of the carried interests to working interests. Two blocks, in which the Company's interest is 27.75%, have reached payout status. The Company's share of profits from these blocks was $1,295,527 and $830,519 for the years ended June 30, 1983 and 1982, respectively, which amounts have been credited to income. On November 1, 1983, these blocks were converted to working interests. During the period July 1, 1983 to October 31, 1983, the Company's share of profits from these blocks was $404,887.

The Company has a 30% carried interest in the Kotaneelee field in the Yukon Territory where four gas wells have been completed. Approval has been granted by the Canadian National Energy Board to export gas from the Kotaneelee field at the rate of 10 million cubic feet per day increasing to 51.2 million cubic feet per day when necessary authorizations and facilities are in place. Within the last six months, government agencies in the United States and Canada have issued new policy guidelines which should have a favorable impact on marketing of Kotaneelee gas.

Oil and gas properties in the Arctic Islands and Australia and mineral properties, aggregating $5,117,441 and $4,970,792 at June 30, 1984 and 1983, respectively, are substantially unexplored or undeveloped.

Most of the Company's interests in the Arctic Islands are subject to carried interest agreements with Panarctic Oils Ltd under which the Company's participation percentages range from 5% to 30%.

The Company has an interest in 3,051,943 gross (1,974 net) acres in the Amadeus Basin in the Northern Territory in Australia. It is a minor participant in a five year exploration program begun in 1980. To date, eight wells have been drilled of which three have been completed as shut-in gas wells.

See also Supplementary Oil and Gas Information (Unaudited).

Costs of oil and gas properties excluded from the depletion computation are shown in the table on the following page.

2. Properties (Cont.)

	Balance June 30, 1984	Net unimpaired costs by year incurred — Year ended June 30, 1984	1983	1982	Cumulative to June 30, 1981
Arctic Islands					
Acquisition costs	$ 970,721	$ —	$ —	$ 959,412	$ 11,309
Exploration costs	3,565,862	119,783	165,206	431,382	2,849,491
Capitalized interest	210,285	25,588	135,697	49,000	—
	4,746,868	145,371	300,903	1,439,794	2,860,800
Australia (all exploration costs)	138,203	1,278	4,502	8,919	123,504
	$4,885,071	$146,649	$305,405	$1,448,713	$2,984,304

3. Line of credit

The Company has a line of credit for a production loan with a Canadian chartered bank which provides for a revolving loan of $2 million. The interest rate on borrowings is at ¾% above the bank's prime lending rate.

4. Litigation

On November 2, 1981 the Securities and Exchange Commission (SEC) filed a civil action in the United States District Court for the District of Columbia against the Company, Benjamin W. Heath and John W. Buckley, directors of the Company, C. Dean Reasoner, special counsel to the Company and certain other public companies. All the parties named in the action have consented to the entry of final judgments of permanent injunctions against violations of securities laws and other equitable relief.

The SEC's complaint alleged that The Catawba Corporation (Catawba), a privately held corporation, provided management services to the corporate defendants from early in the 1950's until May, 1978 during which time Mr. Buckley, Mr. Reasoner and Mr. Heath were the principal operating directors of Catawba and beneficial owners of minority interests in Catawba. The complaint alleged that certain filings made by the corporate defendants under the Securities Exchange Act of 1934 and the Securities Act of 1933 were materially inadequate and incomplete concerning transactions which accrued to the benefit of Catawba and its shareholders.

All the claims between the Company and other interested parties were settled during 1983 and resulted in the receipt of net settlement proceeds of $106,000 (U.S.) by the Company. Such amount was included in other income in fiscal 1983.

Under the settlement, the Company may be the recipient of additional funds which certain of the defendants have placed in escrow. It is not expected that any payments will be material to the financial condition of the Company.

5. Capital and stock options

Stock options outstanding at June 30, 1984 are summarized in the table on the opposite page.

The options granted May 12, 1980 were granted under an incentive option plan covering 300,000 shares adopted by the Board of Directors on December 13, 1978. All options were exercisable on the date of grant. During fiscal 1982 and 1984, options on 10,000 and 7,500 shares, respectively, expired as a result of termination of employment.

On January 21, 1982, certain directors of the Company were granted options on 30,000 shares at $5.78 per share for services on various committees. These options are subject to the same terms as options otherwise granted pursuant to the incentive option plan.

There were no other changes in stock options during the three years ended June 30, 1984.

Upon exercise of options, the excess of the proceeds over the par value of the shares issued is credited to capital in excess of par value. No charges are made against income in accounting for options.

The letters patent, as supplemented, of the Company provide that no person (as defined) shall vote more than 1,000 shares.

5. Capital and Stock Options (Cont.)

Optionee	Date of grant	Expiration date	Number of shares	Option price Per share	Option price Aggregate	Market price at date of grant Per share	Market price at date of grant Aggregate
Officer and consultants	5/12/80	5/11/85	50,000	$14.40	$ 720,000	$14.40	$ 720,000
Directors	6/9/81	6/8/86	20,000	12.50	250,000	12.50	250,000
Directors	1/21/82	1/20/87	30,000	5.78	173,400	5.25	157,500
			100,000		$1,143,400		$1,127,500

6. Compensation

The Company has a contributory pension plan for all employees which is administered by an insurance company. Benefits payable on retirement to employees are guaranteed by annuities purchased from the insurance company. The Company's policy is to fund pension cost currently. Contributions by the Company to the pension plan were $30,364, $30,785 and $29,870, for the years ended June 30, 1984, 1983 and 1982, respectively.

Mr. K.E. Noble, former secretary-treasurer, was granted early retirement effective July 1, 1983 under an agreement whereby he will be paid at an annual rate of $37,259 until his normal retirement date, October 1, 1984.

Compensation of directors in all forms, for the years ended June 30, 1984, 1983 and 1982 amounted to $118,508, $118,226 and $118,818, respectively. Of these amounts, for the same periods, $44,613, $44,336 and $44,933 were directors' fees.

7. Income taxes and extraordinary item

For the year ended June 30, 1984 and 1983, respectively, the Company realized tax benefits of $804,000 and $338,000 for Canadian income tax purposes from carryforward of exploration, development and lease acquisition costs not claimed in prior years.

The following reconciles the statutory Canadian income tax rate to recorded income tax expense:

	1984 Amount	1984 Pretax earnings	1983 Amount	1983 Pretax earnings
Expected tax expense	$ 637,895	47.45%	$222,241	48.80%
Tax effect of permanent differences between financial statements and tax return income:				
Deemed income	87,536	6.51	12,051	2.65
PGRT and resource royalty taxes	98,352	7.32	107,188	23.53
Crown royalties	140,729	10.47	1,901	.42
Resource allowance	(162,041)	(12.05)	—	
Other	1,529	.11	(5,381)	(1.18)
	$ 804,000	59.81%	$338,000	74.22%

At June 30, 1984, the following amounts remained to be carried forward indefinitely to reduce future taxable income:

Drilling, exploration and lease acquisition costs	$12,392,412
Undepreciated capital costs	483,050
Capital losses (can only be used against future year's capital gains)	154,500
Noncapital losses	46,844

The tax benefits attributable to the above accumulated expenditures will not be reflected in the financial statements until such benefits are realized.

Report of Independent Public Accountants

The Shareholders
Canada Southern Petroleum Ltd.

We have examined the accompanying consolidated balance sheet of Canada Southern Petroleum Ltd. at June 30, 1984 and 1983 and the related consolidated statements of operations and accumulated deficit, changes in financial position and in capital stock and capital in excess of par value for each of the three years in the period ended June 30, 1984. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the consolidated financial statements mentioned above present fairly the consolidated financial position of Canada Southern Petroleum Ltd. at June 30, 1984 and 1983, the consolidated results of operations, the consolidated changes in financial position and the consolidated changes in capital stock and capital in excess of par value for each of the three years in the period ended June 30, 1984 in conformity with generally accepted Canadian accounting principles applied on a consistent basis during the period.

ARTHUR YOUNG, CLARKSON, GORDON & CO.

Hartford, Connecticut
September 12, 1984

Management's Discussion and Analysis of Financial Condition and Results of Operations

Liquidity and Capital Resources

At June 30, 1984, the Company had working capital in the amount of $1,114,684. This contrasted with negative working capital of $122,864 at June 30, 1983. Expected revenues should be more than sufficient to meet the Company's working capital requirements for the next year.

Most of the Company's property interests are covered by carried interest agreements, which provide that expenditures are made by the operator and are recouped solely out of revenues from production. Certain of the properties in which the Company has carried interests have reached pay-out status. Proceeds from these carried interests plus revenues from oil and gas sales are the major sources of working capital for the Company.

The Company has a $2,000,000 line of credit with a Canadian bank. Operating revenues and this line of credit are the Company's principal sources of liquidity.

During fiscal 1985, the Company does not expect to make any significant expenditures on any of its properties, nor does it expect any revenues from the Kotaneelee Field.

Inflation is not expected to have a significant effect on operating results for fiscal 1985.

Results of Operations

1984 vs. 1983

Total revenues were significantly higher in fiscal 1984 than in fiscal 1983 due to improved prices and the conversions from carried interests to working interests. As the result of conversion of certain carried interests to working interests, the proceeds from carried interests decreased and oil and gas sales increased. That conversion also accounted for the increase in lease operating costs.

General and administrative expenses and rent expense for fiscal 1984 were lower because of continued efforts to reduce expenses.

1983 vs. 1982

Proceeds under carried interest agreements increased in 1983 because of reduced capital expenditures on the properties subject to these agreements. Capital expenditures are deducted from proceeds as incurred.

Revenues from oil and gas sales were lower in fiscal 1983 because of depressed demand in Canadian markets. Interest income was also lower because funds previously invested were used for acquisitions in fiscal 1983.

The decrease in general and administrative expenses was principally due to reduced legal charges and shareholder expenses.

The petroleum and gas revenue tax increase in fiscal 1983 resulted from the increase in proceeds under carried interest agreements.

Market Information

The Company's capital stock, par value $1.00 per share, is listed for trading on the Pacific Stock Exchange, Boston Stock Exchange, and The Toronto Stock Exchange. The stock is traded under the symbol "CSW" in both the United States and Canada.

The quarterly high and low closing prices (in Canadian dollars) on The Toronto Stock Exchange, the principal market in Canada, during the periods indicated were as follows:

1982			3rd quarter	4th quarter
High . . .			5.00	6.50
Low . . .			3.75	3.90

1983	1st quarter	2nd quarter	3rd quarter	4th quarter
High . . .	6.00	5.62	5.50	4.80
Low . . .	3.40	3.45	4.60	3.40

1984	1st quarter	2nd quarter	3rd quarter
High . . .	4.50	4.65	5.00
Low . . .	3.30	3.50	3.75

The quarterly high and low closing prices (in United States dollars) on the Pacific Stock Exchange, the principal market in the United States, during the last two years were as follows:

1982			3rd quarter	4th quarter
High . . .			4⅛	5½
Low . . .			3	3

1983	1st quarter	2nd quarter	3rd quarter	4th quarter
High . . .	4¾	4¾	4 3/16	4⅛
Low . . .	2⅝	2¾	3⅝	2 11/16

1984	1st quarter	2nd quarter	3rd quarter
High . . .	3⅝	3⅝	3⅞
Low . . .	2 11/16	2 11/16	2 13/16

Supplementary Oil and Gas Information (Unaudited)

The following information consists of estimates only which are subject to rapid and unanticipated change. Therefore, these estimates may not accurately reflect future net income to the Company.

The Company has no proved oil and gas reserves in Australia that require disclosure under SEC regulations and no revenues from oil and gas production in that country. All amounts below except for costs, acreage, wells drilled and present activities relate to Canada. Oil and gas reserve data and the information relating to cash flows was provided by D & S Petroleum Consultants (1974) Ltd.

(1.) Estimated net quantities of proved oil and gas reserves:

	Oil (bbls)	Gas (bcf)
Proved reserves:		
June 30, 1981	580,049	61.444
Revisions of previous estimates	75,585	3.607
Extensions, discoveries and other additions	3,564	1.357
Production	(62,353)	(1.373)
June 30, 1982	596,845	65.035
Revisions of previous estimates	29,184	2.343
Production	(63,425)	(1.375)
June 30, 1983	562,604	66.003
Revisions of previous estimates	(164,874)	.309
Production	(52,963)	(1.366)
June 30, 1984	344,767	64.946

Proved developed reserves:	Oil (bbls)	Gas (bcf)
June 30, 1980	679,740	54.070
June 30, 1981	580,049	61.444
June 30, 1982	596,845	65.035
June 30, 1983	562,604	66.003
June 30, 1984	344,767	64.946

The 1984 revision of previous estimates for oil reserves relates principally to unitized fields in British Columbia. These are mature waterflood projects experiencing steep production declines.

(2.) Costs of oil and gas activities

(Excluding costs relating to carried interests.)

	1984	1983	1982
Property acquisition—unproved	**$ —**	$ —	$959,412
Exploration	**201,459**	339,778	520,191
Development	**25,998**	2,318	2,624

(3.) Results of oil and gas operations:

	1984	1983	1982
Income:			
Proceeds under carried interest agreements	**$1,129,785**	$1,498,678	$920,452
Oil and gas sales	**1,838,795**	174,695	293,045
	2,968,580	1,673,373	1,213,497

(3.) Results of oil and gas operations: (cont.)

	1984	1983	1982
Income:			
Proceeds under carried interest agreements ..	**$1,129,785**	$1,498,678	$920,452
Oil and gas sales.	**1,838,795**	174,695	293,045
	2,968,580	1,673,373	1,213,497
Costs and expenses:			
Production costs			
—lifting costs	**417,664**	60,031	71,393
—wellhead taxes	**207,273**	219,648	135,064
Depletion and depreciation ..	**109,276**	118,081	233,858
Income tax expense*	**—**	—	—
	734,213	397,760	440,315
Results of oil and gas operations from producing activities	**$2,234,367**	$1,275,613	$ 773,182

*For the purposes of preparing this table only, the Company considered that during the years ended June 30, 1984, 1983 and 1982, the Company realized tax benefits of $1,158,559, $729,687 and $443,224, respectively, from carryforward of exploration, development and lease acquisition costs not claimed in prior years.

(4.) Standardized measure of discounted future net cash flows relating to proved oil and gas reserve quantities during the three years ended June 30, 1984

	(In thousands of dollars)		
	1984	1983	1982
Future cash inflows.	**$202,325**	$220,159	$261,590
Future development and production costs	**(39,570)**	(43,567)	(46,727)
	162,755	176,592	214,863
Future income tax expense*	**(76,493)**	(72,907)	(79,645)
Future net cash flows	**86,262**	103,685	135,218
10% annual discount	**(47,503)**	(60,271)	(68,523)
Standardized measure of discounted future net cash flows ..	**$ 38,759**	$ 43,414	$ 66,695

Current prices used in the foregoing estimates were based upon selling prices at the wellhead in June 1984. Current costs were based upon estimates made by consulting engineers in June 1984. Cash flows are predicated upon timely approval by U.S. authorities of import of gas from the Kotaneelee field. The amounts of estimated future net revenues by years is significantly different from previous projections because of a decline in the price expected to be realized from Kotaneelee gas. The above amounts were calculated based upon a start-up date of November 1, 1985 for sales of Kotaneelee gas, but the Company has no assurance that that target date will be met.

*Reflects reduction of $12,392,412, $14,145,418 and $14,575,156 for the years ended June 30, 1984, 1983 and 1982, respectively, from carryforward of exploration, development and lease acquisition costs.

(5.) Changes in the standardized measure during the year:

	(In thousands of dollars)		
	1984	1983	1982
Changes due to:			
Prices, production costs, development costs*	**$ (2,012)**	$ (28,110)	$ (10,240)
Sales net of production costs	**(2,343)**	(1,394)	(1,007)
Extensions, discoveries and improved recovery less related costs....	**—**	—	4,872
Development costs incurred during the year	**26**	2	3
Revisions of previous quantity estimates	**(1,000)**	5,335	9,054
Accretion of discount**	**2,640**	(7,723)	1,075
Net change in income taxes ...	**(1,966)**	8,609	(1,607)
Net change	**$ (4,655)**	$ (23,281)	$ 2,150

*The export price at the U.S.-Canadian border was $4.94 (U.S.) per thousand cubic feet (mcf) in 1982. In 1983, the export price was reduced to $4.40 (U.S.) per mcf for the first 50 percent of full contract volumes and volumes of gas in excess of that level were priced at $3.40 (U.S.) per mcf. For purposes of making these calculations for the years 1983 and 1984, the 1983 prices were used. As a result of changes in Government export policies, current prices are lower than those used in the above table.

**This negative accretion is due principally to the change in the assumed start-up date for Kotaneelee production: April 1, 1983 was used in fiscal 1982, November 1, 1985 was used in fiscal 1983 and fiscal 1984.

Canada Southern Petroleum Ltd.

Selected Financial Data

	Year ended June 30,				
	1984	1983	1982	1981	1980
Operating revenues	**$ 2,968,580**	$ 1,673,373	$ 1,213,497	$ 1,381,523	$ 1,855,737
Total revenues	**$ 2,983,098**	$ 1,846,292	$ 1,306,313	$ 1,541,866	$ 1,984,950
Net income (loss)	**$ 1,344,351***	$ 455,412*	$ (515,106)	$ (250,125)	$ 534,911*
Net income (loss) per share	**$ .15***	$ .05*	$ (.06)	$ (.03)	$ .06*
Working capital (deficit)	**$ 1,114,684**	$ (122,864)	$ (365,641)	$ 1,386,841	$ 1,286,593
Total assets	**$ 11,097,050**	$ 10,228,028	$ 10,347,813	$ 9,992,710	$ 9,903,787
Stockholders' Equity:					
Capital stock	**$ 8,992,465**	$ 8,992,465	$ 8,992,465	$ 8,992,465	$ 8,937,965
Capital in excess of par value	**14,982,543**	14,982,543	14,982,543	14,982,543	14,764,543
Accumulated deficit	**(12,981,724)**	(14,326,075)	(14,781,487)	(14,266,381)	(14,016,256)
	$ 10,993,284	$ 9,648,933	$ 9,193,521	$ 9,708,627	$ 9,686,252
Average number of outstanding shares	**8,992,465**	8,992,465	8,992,465	8,971,234	8,904,427

*Includes $804,000 ($.09 per share), $338,000 ($.04 per share) and $205,000 ($.02 per share) for the years 1984, 1983 and 1980 respectively, for tax benefits realized as the result of carryforwards of exploration, development, and lease acquisition costs.

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