Canada Southern Petroleum Ltd.

Annual Report 1982

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Canada Southern Petroleum Ltd. was incorporated under the Canada Companies Act in 1954 as a successor to Canada Southern Oils, Ltd., and has been a Nova Scotia corporation since June 4, 1980.

The Company's only business is petroleum exploration and development, principally in Canada, where its interests include largely undeveloped properties in the Northwest Territories and Arctic Islands. In addition, several Company properties in Alberta, British Columbia, and the Yukon Territory are either producing or are capable of production. Nearly all of these Canadian properties, over 4.0 million gross acres, are covered by *carried interest* agreements that require the working interest partners to advance all the funds necessary to develop and operate an oil or gas property. Subsequently, the working interest partners are entitled to recoup their expenses from production revenues. After all monies advanced have been recovered, the position of the assignor (i.e., Canada Southern) becomes equivalent to that of a working interest partner, sharing the profits with the assignee(s) on a *pro rata* basis.

Canada Southern's more promising properties include a 30 percent carried interest in offshore portions of the Arctic Island Hecla gas field, in which the Company's share of the reserves has been estimated by independent consultants as 567 billion cubic feet proven, plus 101 billion cubic feet probable, for a total of 668 billion cubic feet of proven and probable gas reserves. Approximately 40 miles northeast of Hecla is the Panarctic Whitefish gas discovery which, at present, is thought to contain over 2 trillion cubic feet of marketable gas. The Whitefish structure extends into four federal exploratory permits in which Canada Southern has varying interests, and the Company's estimated participation in the structure as a whole is 5.7 percent.

Canada Southern also holds a 30 percent carried interest in the Kotaneelee gas field, located in the southeastern Yukon Territory, which currently has four wells capable of production. A gas gathering system and dehydration plant are in place, and the field is connected to a major pipeline system. The export of Kotaneelee gas remains subject to U.S. regulatory approval, and it is not now determinable when that approval may be forthcoming.

Approximately 9 million shares of Canada Southern capital stock are outstanding (15 million are authorized) and held by more than 12,000 shareholders of record. The stock is traded on the Toronto Stock Exchange in Canada and on the Boston and Pacific Exchanges in the United States, and has the ticker symbol CSW in both countries.

A color map of Canada Southern's holdings in the Arctic Islands, and northwestern Canada is available in limited quantity and may be obtained by writing to: Canada Southern Petroleum Ltd., 505 Eighth Avenue South West, Calgary, Alberta, T2P 1G2.

The Company's report to the U.S. Securities and Exchange Commission for fiscal 1982, on Form 10-K, is available to shareholders upon written request to Canada Southern Petroleum Ltd., c/o First Jersey National Bank, P.O. Box 960, Jersey City, NJ 07303, U.S.A.

October 15, 1982

Northwestern Canada

Canada Southern's income-producing properties are located in Alberta, British Columbia, and the Yukon Territory. Substantially all of these properties are covered by carried interest agreements that range from 1.67 to 50 percent. Although most of this acreage is undeveloped, there are 43 productive oil wells and 64 productive gas wells on 46,385 gross acres that are considered developed. These producing properties generated revenues of $1.2 million for Canada Southern during fiscal 1982.

The Kotaneelee Field

The huge Kotaneelee gas field, located in the extreme southeast corner of the Yukon Territory, was discovered by Canada Southern in 1964. Although the field has not yet been fully delineated or developed, it falls within the boundaries of a former exploration permit (No. 1007) that has been fully converted to production leases covering 31,888 gross acres. Canada Southern has a 30 percent carried interest in this field.

At present, Kotaneelee has four wells that are capable of production and, according to the field's operator, Columbia Gas Development of Canada Ltd., proved reserves established to date are on the order of 250 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 U.S. Prior to 1982, however, the field was shut in because (a) there was no Canadian market for the gas, and (b) U.S. Government approval to import the gas could not be obtained.

On March 15, 1982, a new export sale of natural gas from western Canada to Texas Gas Transmission Corp. of Owensboro, Kentucky, was announced jointly by Columbia Canada, Westcoast Transmission Company Ltd. and their agent, Pan-Alberta Gas Ltd. This transaction involves a contract quantity of 101.2 million cubic feet of gas per day—*or approximately 36.5 billion cubic feet per year*—over a 15-year period, with approximately one-half of the gas involved to be supplied by the Kotaneelee field. Subsequently, the Canadian National Energy Board granted the requisite approval for the initial phase of the program and, in July, Texas Gas applied to the U.S. Federal Energy Regulatory Commission (FERC) for authorization to import the gas.

When the sale was first announced, the sellers (Columbia Canada et al.) anticipated a start-up date of November 1, 1982. At present, the FERC regulatory process has commenced, but it is not now determinable when FERC approval may be forthcoming.

At such time as production does commence, the revenues from the field initially would go toward reimbursement of the operator's development costs. Given the projected volume of Kotaneelee gas to be sold—i.e., about 18.5 billion cubic feet per year—it is expected that Columbia Canada would recover its development expenses in less than 24 months after production commences. Thereafter, Canada Southern would receive a 30 percent share of Kotaneelee's revenues after operating costs. Under current pricing, the gas would have an initial wellhead price of about $3.50 per thousand cubic feet.

Arctic Island Properties

Canada Southern's Arctic Island property interests encompass approximately 4.6 million gross acres in the western Sverdrup Basin, most of which are covered by carried interest agreements that range from 5 to 30 percent. The Company's working interest partner under these agreements is Panarctic Oils Ltd., a unique industry-government consortium that is slightly more than 50 percent-owned by the Canadian Government through Petro-Canada, the Canadian national oil company. The remaining shares are owned by 29 other, largely Canadian, companies. Since its founding in 1966, Panarctic has discovered in the Arctic Islands, recoverable gas reserves in excess of 18 trillion cubic feet as well as oil reserves believed to amount to over one billion barrels of recoverable oil.

Panarctic continues to be the only company that is physically operating in the Arctic Islands. Four offshore wells were drilled from ice platforms during the 1982 drilling season:

Whitefish A-26, a delineation well spudded January 15, was drilled to investigate the possibility of an oil zone on the northeast flank of the huge Whitefish structure. Two earlier discovery wells—drilled during the winter drilling season in 1979 and 1980—encountered natural gas in at least four separate zones; and the A-26 well was positioned approximately 4¾ miles from these wells. Contrary to expectations, A-26 encountered water in all horizons, some of which are believed to be below the closing contours ("spill point") of the structure. According to Panarctic, this well demonstrated that, although the Whitefish structure will contain over 2 trillion cubic feet of marketable gas, it will not contain any significant quantities of oil on its flanks. Canada Southern technical advisors point out, however, that the information gained from this well does not preclude the possibility of an oil leg being present in two horizons. Canada Southern has combined working and carried interests of approximately 5.7 percent in the Whitefish structure.

Cape Mamen F-24, a wildcat, also was spudded on January 15 on Permit A-3636, approximately 20 miles east-northeast of the Cape Norem A-80 dry hole on Mackenzie King Island. This well was drilled to a depth of 9,597 feet and abandoned as a dry hole.

Sculpin K-08, on Permit A-3647, was spudded on January 27 at a location about 11 miles south of the Noice Peninsula of Ellef Ringnes Island. This offshore wildcat was drilled in 1,817 feet of water (a record water depth for Arctic drilling), and resulted in a gas discovery in the porous, permeable sandstones of the King Christian Formation. During a bottom hole drillstem test of the interval 4,915-4,979 feet, this well flowed natural gas at rates up to 7.5 million cubic feet per day. Total depth was 6,070 feet.

Cisco C-42, a well spudded on March 2, was a 5-mile stepout to the Cisco B-66 oil and gas discovery well drilled in 1981. This delineation well flowed 39° API crude oil to the surface at rates up to 944 barrels per day along with 330,000 cubic feet of natural gas per day during a test of the interval 5,446-5,469 feet. A second test, of the interval 5,453-5,476 feet, flowed oil at rates up to 900 barrels per day and gas up to 350,000 cubic feet per day. According to Panarctic, this well confirmed that Cisco is a major oil field by world standards; however, further drilling will be required to determine the size of the field.

Marketing Arctic Gas: The Arctic Pilot Project

The Arctic Pilot Project was conceived in 1976 by Petro-Canada, the Canadian national oil company, as a way to stimulate frontier exploration and increase Canadian energy reserves by proving the feasibility of transporting liquified natural gas (LNG) from the Arctic Islands by icebreaking tankers. Other companies participating in the joint venture are Dome Petroleum Ltd., Melville Shipping Ltd., and Nova, An Alberta Corporation.

The project envisions a 100-mile buried pipeline from the Drake Point gas field—located on the Sabine Peninsula of Melville Island—south to a barge-mounted liquefaction facility at Bridport Inlet, where the gas would be converted to LNG. Subsequently, the LNG would then be shipped in ice-breaking tankers specifically designed for arduous, year-round Arctic service. More than 1,200 feet long and 138 feet wide, the design considerations for these gargantuan vessels indicate a propulsion system capable of producing 175,000 shaft horsepower.

By the end of 1981, the four consortium members had spent more than $40 million on the project, which now has an estimated capital cost of $2.3 billion. As originally conceived, the project called for a regasification plant in Quebec or Nova Scotia on the assumption that the gas would be destined for the North American market. However, by the time the Canadian National Energy Board (NEB) commenced its hearings on the project in February 1982, the economics of the project had changed considerably as a consequence of a gas glut in Canada and falling world oil prices. These and other factors made it apparent that the project is not needed for (Canadian) domestic supply, and, in any case, would result in gas too costly for the North American market. Therefore, western Europe has emerged as the potential best market for Arctic gas, and it is apparent that to supply the volume required by this market, the gas reserves of both the Drake Point field and the Hecla field would be required. Canada Southern, through its carried interest would be entitled to approximately 18% of the Hecla field reserves. Discussions were held with the state-owned French utility Gaz de France, Ruhrgas AG of West Germany, and others even as the NEB hearings continued into the summer months.

Although the NEB hearings were adjourned on August 31 pending a definitive export proposal from the project's sponsors, the companies remain optimistic that a preliminary agreement with the Europeans will reached. According to the chairman of the Arctic Pilot Project, the European utilities apparently are ready to offer attractive financing for the venture. For its part, the Canadian group is seeking a 20-year take-or-pay agreement for the gas, which it proposes to deliver at the rate of 260 million cubic feet per day.

Working Interest Acquisitions

During fiscal 1982, Canada Southern acquired *working interests* in two Arctic Island tracts as a result of previously negotiated agreements with Panarctic Oils Ltd. Although covered briefly in last year's Annual Report, these acquisitions—which were made at a cost of $1.0 million—have had a significant impact upon the Company's financial position, and hence are included in this review.

The *Hazen Strait* acquisition, which was consummated on July 10, 1981, involved the Company's exchange of 3 percent of its 30 percent carried interest in a portion (478,017 gross acres) of the Hecla Block for a 3 percent working interest in 523,074 gross acres in the Hazen Strait block. The Company also reimbursed Panarctic approximately $166,000, which was Canada Southern's *pro rata* share of a previously drilled dry hole and seismic work on the property. Canada Southern continues to hold a 30 percent carried interest in 273,053 gross acres in the Hecla block, a tract that includes the Hecla gas field.

The *AIEG Whitefish Acquisition* was a consequence of Panarctic's participation in the *Arctic Islands Exploration Group* (AIEG), which enabled Panarctic to earn varying interests in 19,665,092 gross acres located primarily in the high-grade area of the western Sverdrup Basin. A 1972 agreement between Panarctic and Canada Southern, as later amended, provided that Canada Southern had the right to acquire an undivided 50 percent of the interest earned by Panarctic in certain of these properties, most notably the Whitefish gas field. In October 1981, Canada Southern exercised its right to acquire interests averaging 4.8 percent in 1,490,528 gross acres (71,544 net) at a cost of $793,412. The Company thus has *working* interests, as well as carried interests, in the Whitefish field, and is therefore obligated to pay its *pro rata* share of the drilling costs and any other work on the properties to maintain its working interests. At present, management is no aware of any plans for work programs that would require such expenditures by the Company. It should be noted, however, that Canada Southern's *pro rata* share of the cost of the Whitefish A-26 delineation well, drilled last winter (see page 2), was approximately $431,484.

Australia

Canada Southern's only non-Canadian property interest is a minor (.0647 percent) working interest in an Australian petroleum exploration permit (OP 175) that now encompasses approximately 3.1 million acres in the northern Amadeus Basin, where several oil and gas discoveries have been made. To date, four wells have been drilled under a five year exploration program, of which two have been completed as gas wells.

A fifth wildcat, Undandita No. 1, was spudded on October 10, 1982 and at least five additional wells are to be drilled prior to completion of the program.

Other Developments

During fiscal 1981, the Company's Board of Directors announced that it had initiated a study to determine the feasibility of a plan whereby Canada Southern shareholders would receive direct ownership participation in certain of the Company's oil and gas producing properties. At the time, it was believed that such direct ownership might confer distinct advantages upon the Company's shareholders from both economic and tax standpoints. However, as the consequence of an adverse tax ruling by Revenue Canada, the Company has now determined that direct ownership participation by the Company's shareholders would *not* be in their best interest.

Under the Canada Oil and Gas Act, proclaimed into force on March 5, 1982, all companies holding interests in Canada Lands, which include the Yukon and Northwest Territories and all offshore areas under the jurisdiction of the Federal Government, will generally be required to renegotiate their present agreements with the Government. The new agreements will have a maximum duration of five years and companies will generally be required to drill at least one well under each agreement and to return 50 percent of the lands held under each agreement to the Federal Government. The Federal Government has a right to a net carried interest of 25 percent in all Canada Lands. Prior to the production of any well, a production license must be obtained and will be granted only if the production has Canadian ownership level of at least 50 percent.

Petroleum Acreage Summary

June 30, 1982

	Gross Acreage in which Interest is Held	Net Acreage Held Under Lease	Net Acreage Held Under Permit	Net Acreage Total
Canada				
British Columbia				
Carried Interests	191,854	28,886		28,886
Working Interests	41,149	7,158		7,158
Overriding Royalty Interests	5,536	389		389
Total British Columbia	238,539	36,433		36,433
Alberta				
Working Interests	320	20		20
Yukon & Northwest Territories				
Carried Interests	236,998	72,932		72,932
Working Interests	12,720	11,448		11,448
Total	249,718	84,380		84,380
Arctic Islands (see table below.)				
Panarctic Agreements				
Carried Interests	3,602,673	2,905	838,453	841,358
Working Interests	2,013,602		87,236	87,236
Other	167,987		11,794	11,794
Overriding Royalty Interest	26,967		388	388
Total Arctic Islands	5,811,229	2,905	937,871	940,776
Total Canada	6,299,806	123,738	937,871	1,061,609
Australia	3,051,364	—	1,974	1,974
TOTAL	9,351,170	123,738	939,845	1,063,583

Arctic Island Properties Covered By Panarctic Agreements

June 30, 1982

Properties	Gross Acres	Interests retained by Canada Southern % Interest	Interests retained by Canada Southern Net Acres
Prince Patrick, Melville, Emerald, Vanier, Cameron, Ellef Ringnes, Amund Ringnes, Cornwall	832,003	5 (1)	41,600
Eight Bears	57,210	6	3,433
Ellesmere	22,482	15	3,372
Offshore, Sverdrup Basin	478,017	27	129,065
	2,212,961	30 (2)	663,888
Total—Carried Interests	3,602,673		841,358
Offshore, Sverdrup Basin: Working Interests			
After Acquired	1,490,528	4.8	71,544
Hazen Strait	523,074	3.0	15.692
Total—Working Interests	2,013,602		87,236

(1) Does not include the Company's additional interest to be acquired under a sub-farmout agreement covering permits on Vanier Island.

(2) Area divided into six blocks, each converted to 30.0% carried interest, which may be reconverted to 30.0% working interest at the Company's option.

Consolidated Balance Sheet

(Expressed in Canadian dollars)
June 30, 1982

Assets

	1982	1981
Current Assets:		
Cash	$ 217,601	$ 76,209
Term deposits	240,000	1,350,000
Accounts receivable and other	223,261	244,715
Government Petroleum Incentive Grants (Note 1)	107,789	—
Total current assets	788,651	1,670,924
Oil And Gas Properties Using The Full Cost Method (Notes 1 and 2):		
Costs being depleted	5,500,500	5,466,986
Less accumulated depletion	2,087,814	1,859,118
	3,412,686	3,607,868
Costs not being depleted	5,864,481	4,415,768
	9,277,167	8,023,636
Other	281,995	298,150
	$10,347,813	$ 9,992,710

Liabilities and Capital

	1982	1981
Current Liabilities:		
Bank loan (Note 3)	$ 849,000	$ —
Accounts payable and accrued liabilities:		
Accrued legal	187,365	166,397
Other	117,927	117,686
Total current liabilities	1,154,292	284,083
Capital (Note 5):		
Capital stock, par value $1 per share:		
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	(14,781,487)	(14,266,381)
Total capital	9,193,521	9,708,627
	$10,347,813	$ 9,992,710

On behalf of the Board: /s/ John W. Buckley, Director /s/ Benjamin W. Heath, Director

See accompanying notes.

Consolidated Statement of Income (Loss) and Accumulated Deficit

(Expressed in Canadian dollars)

	Year ended June 30, 1982	1981	1980
Income:			
Proceeds under carried interest agreements (Note 2)	$ 920,452	$ 1,137,513	$ 1,593,050
Interest	92,816	158,095	96,565
Oil and gas sales	293,045	244,010	262,687
Other	—	2,248	32,648
	1,306,313	1,541,866	1,984,950
Costs and Expenses:			
General and administrative (Notes 4 and 6)	1,309,427	1,369,558	1,090,169
Depletion and depreciation	233,858	231,338	259,643
Petroleum and gas revenue tax	135,064	54,480	—
Lease operating costs	71,393	69,071	42,221
Rent	71,677	67,544	58,006
	1,821,419	1,791,991	1,450,039
Income (loss) before income taxes and extraordinary item	(515,106)	(250,125)	534,911
Income taxes (Note 7)	—	—	205,000
Income (loss) before extraordinary item	(515,106)	(250,125)	329,911
Extraordinary item—Tax benefit realized from carryforward of exploration, development and lease acquisition costs not claimed in prior years (Note 7)	—	—	205,000
Net income (loss)	(515,106)	(250,125)	534,911
Accumulated deficit—beginning of year	(14,266,381)	(14,016,256)	(14,551,167)
Accumulated deficit—end of year	$(14,781,487)	$(14,266,381)	$(14,016,256)
Average number of shares outstanding	8,992,465	8,971,234	8,904,427
Per share based on average number of shares outstanding during the period:			
Income (loss) before extraordinary item	$(.06)	$(.03)	$.04
Extraordinary item	—	—	.02
Net income (loss)	$(.06)	$(.03)	$.06

See accompanying notes.

Consolidated Statement of Changes in Financial Position

(Expressed in Canadian dollars)

	Year ended June 30, 1982	1981	1980
Source of Working Capital:			
Net income (loss)	$ (515,106)	$(250,125)	$534,911
Charges to income not involving outlay of working capital:			
Depreciation and depletion	233,858	231,338	259,643
Other	11,378	11,377	24,690
Working capital (used in) provided by operations	(269,870)	(7,410)	819,244
Exercise of stock options	—	272,500	256,749
	(269,870)	265,090	1,075,993
Disposition of Working Capital:			
Additions to oil and gas properties	1,590,016	164,842	607,236
Less Government Petroleum Incentive Grants (Note 1)	(107,789)	—	—
Other	385	—	3,276
	1,482,612	164,842	610,512
Increase (decrease) in working capital	$(1,752,482)	$ 100,248	$ 465,481
Increase (Decrease) in Working Capital by Component:			
Cash	$ 141,392	$ (45,890)	$ 22,390
Term deposits	(1,110,000)	230,000	385,025
Accounts receivable and other	(21,454)	(17,314)	(70,025)
Government Petroleum Incentive Grants	107,789	—	—
Bank loan payable	(849,000)	—	—
Accounts payable and accrued liabilities	(21,209)	(66,548)	128,091
Increase (decrease) in working capital	$(1,752,482)	$ 100,248	$ 465,481

See accompanying notes.

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

(Expressed in Canadian dollars)
Three years ended June 30, 1982

	Number of shares	Capital stock, $1 par value	Capital in excess of par value	Total
Balance at June 30, 1979	8,883,465	$8,883,465	$14,562,294	$23,445,759
Exercise of stock options	54,500	54,500	202,249	256,749
Balance at June 30, 1980	8,937,965	8,937,965	14,764,543	23,702,508
Exercise of stock options	54,500	54,500	218,000	272,500
Balance at June 30, 1981 and 1982	8,992,465	$8,992,465	$14,982,543	$23,975,008

See accompanying notes.

Notes to Consolidated Financial Statements

(Expressed in Canadian dollars)
June 30, 1982

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 and Kotaneelee Area) is provided on the composite unit-of-production method which is based on estimated recoverable proven reserves. Expenditures incurred in the Arctic Islands and Kotaneelee Area have been excluded from the capitalized costs in the Canada cost center to be depleted pending the commencement of payouts, if any, of the Company's interests in those major development projects (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 have been capitalized. Interest costs for the year ended June 30, 1982 amounted to $49,000, all of which were capitalized.

Amounts 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, 1982, exchange gains and losses have not been significant.

2. Properties and related exploratory and other expenses

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

Oil and gas properties by cost center are as follows:

	1982	1981
Canada:		
Costs being depleted	$5,500,500	$5,466,986
Less accumulated depletion	2,087,814	1,859,118
	3,412,686	3,607,868
Costs not being depleted:		
Arctic Islands	4,300,594	2,860,800
Kotaneelee Area	1,431,464	1,431,464
	9,144,744	7,900,132
Australia:		
Costs not being depleted	132,423	123,504
	$9,277,167	$8,023,636

Based upon current valuations by consultants, D & S Petroleum Consultants (1974) Ltd., proved reserves exceed related book values plus expected development costs (see Note 8).

At June 30, 1982, substantially all of the acreage located in British Columbia and the Yukon and Northwest Territories was covered by carried (net profits) interest agreements. These carried interest agreements provide that profits 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 profits from production. At June 30, 1982, 1981 and 1980, for the carried interest areas that have not reached payout status, the Company would have been required to pay $16,711,196, $17,462,708 and $15,280,138, 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 $830,519, $1,036,908 and $958,252 for the years ended June 30, 1982, 1981 and 1980, respectively, which amounts have been credited to income.

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. Authorization by United States authorities for importation of this gas has not yet been received. In addition, the depressed market in the United States may adversely affect the amount and timing of the Company's projected income from the field. (See Note 8.)

Notes to Consolidated Financial Statements (continued)

(Expressed in Canadian dollars)
June 30, 1982

Costs incurred in oil and gas producing activities, excluding costs relating to carried interests, were as set forth below:

Year ended June 30,	Property acquisition costs	Exploration costs	Development costs	Production costs	Aggregate depreciation and depletion
1980	—	$271,348	$335,888	$42,221	$254,330
1981	—	140,306	24,536	69,071	226,114
1982	$959,412	520,191	2,624	71,393	228,696

Depletion expense per barrel equivalent for fiscal 1982 was $.86, for fiscal 1981 was $.77 and for fiscal 1980 was $.72.

During fiscal 1982, because proceeds from carried interests and revenues from oil and gas sales were inadequate to meet the Company's requirements, a line of bank credit was arranged (see Note 3 below). The Company anticipates that this line of credit will be adequate to meet any working capital deficiency in fiscal 1983. If delays are experienced in marketing Kotaneelee gas beyond the November 1982 anticipated start-up date, it is probable that debt or equity financing will be sought later in the current fiscal year.

Amounts represented by oil and gas properties in the Arctic Islands and Australia and mineral properties, aggregating $4,665,387 and $3,216,674 at June 30, 1982 and 1981, 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. The Company's carried interests range from 3% to 30%.

The Company has an interest in 5,947,697 gross (3,848 net) acres in the Amadeus Basin in the Northern Territory in Australia. It is a participant in a five year exploration program begun in 1980. To date, four wells have been drilled of which two have been completed as gas wells.

In August 1980, the Board of Directors announced that consideration was being given to the feasibility of a plan whereby the Company's shareholders would become the beneficiaries of direct ownership participations in certain of the Company's oil and gas producing properties. As a consequence of an adverse ruling by Revenue Canada, the Company has determined that such transfer of property ownership to the shareholders would not be in their economic interests.

3. Bank loan

The Company has a line of credit for a production loan with a Canadian chartered bank which provides for a primary loan of $2 million ($800,000 utilized at June 30, 1982) with an additional $2 million ($49,000 utilized at June 30, 1982) to cover accumulated interest charges.

Amounts due under the terms of this production loan are payable on demand and substantially all of the assets of the Company have been pledged as collateral for the loan.

The interest rate on borrowings is at ¾% above the Bank's prime lending rate. In addition, a commitment fee of ½ of 1% is payable monthly on the second $2 million of the line of credit.

4. Litigation

On November 2, 1981 the Securities and Exchange Commission (SEC) filed a civil action (No. 81-2640) 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 four other companies with which Mr. Heath, Mr. Reasoner and Mr. Buckley have been affiliated (The Catawba Corporation, Coastal Caribbean Oils and Minerals, Ltd., Magellan Petroleum Corporation, and Pantepec International Inc.). On the same date, all the parties named in the action, without admitting or denying the SEC's allegations, entered into consent agreements for the purpose of settling the litigation which resulted from an investigation ordered by the SEC in April, 1978.

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. With respect to the Company, the Commission's complaint included allegations that inaccurate and misleading disclosures were made in filings with the Commission concerning the fees paid to Catawba, royalty payments to Catawba shareholders and various transactions relating to Borealis Exploration Limited, a Canadian mining company in which the Company and Catawba had financial interests.

Pursuant to the settlement agreements, the defendants consented to an injunction against violations of the federal securities laws and certain other equitable relief. Pursuant to its consent, the company has established a Special Committee of the Board of Directors to conduct an investigation of the matters alleged in the complaint and to take such action as it deems appropriate following its investigation. The Company has also established a Transaction Review Committee of the Board of Directors which will review future transactions between the Company and any entity in which any officer or director has a direct or indirect material interest.

Under the settlement, the Company may be the recipient of certain 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.

(Expressed in Canadian dollars)
June 30, 1982

5. Capital and stock options

Stock options outstanding at June 30, 1982 are summarized as follows:

				Option Price		Market price at date of grant	
Optionee	Date of grant	Expiration date	Number of shares	Per share	Aggregate	Per share	Aggregate
Officer	5/11/79	5/10/84	7,500	$ 5.00	$ 37,500	$ 5.00	$ 37,500
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
			107,500		$1,180,900		$1,165,000

The options granted May 11, 1979 and 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. There were 156,000 shares reserved for future option grants at June 30, 1982. During fiscal 1980, officers and employees exercised options on 22,500 shares at $4.30 and 32,000 shares at $5.00, an aggregate of $256,749, compared with market prices ranging from $20.78 to $22.00, an aggregate of $1,178,476. During fiscal 1981, officers and employees exercised options on 54,500 shares at $5.00 per share, an aggregate of $272,500, compared with market prices ranging from $13.25 to $18.00, an aggregate of $895,688. During fiscal 1982, an option on 10,000 shares expired as a result of termination of employment.

On June 9, 1981, certain directors of the Company were granted options on 20,000 shares at $12.50 per share for services on various committees. On January 21, 1982, these directors were granted options on an additional 30,000 shares at $5.78 per share. These options are subject to the same terms as options otherwise granted pursuant to the incentive option plan described above.

There were no other changes in stock options during the three years ended June 30, 1982.

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.

6. Compensation

The Company has a contributory pension plan which is in effect for all employees and is administered by an insurance company. Benefits payable on retirement to employees are guaranteed by annuities purchased by the insurance company. The Company's policy is to fund pension cost accrued, except that total prior service cost for the plan was prepaid in 1979. Contributions by the Company to the pension plan on behalf of all employees were $29,870, $25,595, and $33,867 for the years ended June 30, 1982, 1981 and 1980, respectively. During 1981, the Company entered into an agreement with five employees which guarantees certain minimum pension contributions by the Company in the event an individual's employment terminates prior to age 60.

Compensation of directors, for the years ended June 30, 1982, 1981 and 1980, respectively, amounted to $118,818, $110,905, and $100,849. Of these amounts, for the same periods, $44,933, $37,718, and $33,446 were for directors' fees.

7. Income taxes and extraordinary item

For fiscal 1980, the amount of income tax expense is lower than the amount computed by multiplying pretax income by the statutory Canadian rate of 46% due to statutory deductions for depletion and resource allowances. For the year ended June 30, 1980, the Company realized a tax benefit of $205,000 for Canadian income tax purposes from carryforward of exploration, development and lease acquisition costs not claimed in prior years.

At June 30, 1982,the following amounts remained to be carried forward indefinitely to reduce future taxable income:

Drilling, exploration and lease acquisition costs	$14,575,156
Undepreciated capital costs	473,955
Capital losses (can only be used against future years capital gains)	150,000

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

8. Oil and gas revenue and reserve information (unaudited)

The following information has been supplied in compliance with regulations prescribed by the SEC. However, current reserve, production and cost estimates 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 for reserve recognition accounting (RRA) and no revenues from oil and gas production in that country. All amounts below relate to Canada.

(a.) Revenues from producing oil and gas:

Year ended June 30,	
1980	$1,855,737
1981	1,381,523
1982	1,213,497

(Expressed in Canadian dollars)
June 30, 1982

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

	Oil (bbls)	Gas (bcf)
Proved reserves:		
July 1, 1979	684,725	48.672
Revisions of previous estimates	11,314	(0.008)
Extensions, discoveries and other additions	92,008	17.819
Production	(65,657)	(2.355)
June 30, 1980	722,390	64.128
Revisions of previous estimates	(73,660)	(1.144)
Production	(68,681)	(1.540)
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
Proved developed reserves:		
June 30, 1979	684,725	33.595
June 30, 1980	679,740	54.070
June 30, 1981	580,049	61.444
June 30, 1982	596,845	65.035

(c.) Future net revenues from estimated production of proved oil and gas reserves:

(i.) Estimated future net revenues:

	For the fiscal year ended 6/30/83	For the fiscal year ended 6/30/84	For the fiscal year ended 6/30/85	For the remaining fiscal years for which reserves are projected
Proved reserves	$3,441,000	$5,539,000	$13,106,000	$192,777,000
Proved developed reserves	$3,441,000	$5,539,000	$13,106,000	$192,777,000

(ii.) Present value (discounted at 10%) of estimated future net revenues.

	Proved reserves	Proved developed reserves
June 30, 1980	$ 86,252,000	$ 82,419,000
June 30, 1981	$104,209,000	$104,209,000
June 30, 1982	$103,582,000	$103,582,000

Current prices used in the foregoing estimations were based upon selling prices at the wellhead in June, 1982. Current costs were based upon estimates made by consulting engineers in June, 1982. Values 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 unanticipated delays in receiving approval by United States authorities for the importation of Kotaneelee gas. The above amounts were calculated based upon a start-up date of April 1, 1983 for sales of Kotaneelee gas, but the Company has no assurance that that target date will be met.

During 1980 the present value of estimated future net revenues from proved reserves increased by $54,344,000. This increase was mainly the result of an increase in proved gas reserves totaling 17.819 bcf and an increase in the export price of gas from $2.80 to $4.47 per mcf. The present value of estimated future net revenues from proved reserves increased by $17,957,000 in 1981 primarily as a result of the increase in the export price of gas from $4.47 to $4.94 per mcf which was partially offset by the Canadian Petroleum and Gas Revenue Tax.

(d.) Summary of oil and gas producing activities:

	1980	1981	1982
	(Thousands of dollars)		
Additions and revisions to present value of estimated future net revenues:			
Additions	$23,169	$ —	$ 474
Revisions for reserves proved in prior years:			
Changes in prices	34,753	19,359	3,800
Other	—	(114)	(3,762)
	57,922	19,245	512
Less:			
Present value of estimated future development and production costs attributable to additions to estimated proved reserves	2,100	—	—
Other costs net of income	1,290	1,471	1,766
	3,390	1,471	1,766
Net additions (reductions)	54,532	17,774	(1,254)
Provision for income taxes*	26,000	8,500	(600)
Results of oil and gas producing activities on the basis of RRA	$28,532	$ 9,274	$ (654)

*This provision for income taxes is only for purposes of RRA. The statutory income tax rate was applied to net additions. All tax carryforward benefits and statutory depletion for development costs were assumed to be applicable to the estimated value of proved reserves at the beginning of the year.

(e.) Summary of changes in present value of estimated future net revenues:

	1980	1981	1982
	(Thousands of dollars)		
Present value at beginning of year	$31,908	$ 86,252	$104,209
Increases during year:			
Additions and revisions	57,922	19,245	512
Less related estimated future development and production costs attributable to additions	(2,100)	—	—
	55,822	19,245	512
Development costs incurred	336	25	3
	88,066	105,522	104,724
Decreases during year:			
Sales of oil and gas, net of production costs	(1,814)	(1,313)	(1,142)
Present value at end of year	$86,252	$104,209	$103,582

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, 1982 and 1981 and the related consolidated statements of income (loss) and accumulated deficit, changes in financial position and capital stock and capital in excess of par value for each of the three years in the period ended June 30, 1982. 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, 1982 and 1981, 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, 1982, in conformity with generally accepted accounting principles applied on a consistent basis during the period.

ARTHUR YOUNG, CLARKSON, GORDON & CO.

Hartford, Connecticut
September 16, 1982

Management's Discussion and Analysis

Liquidity and Capital Resources.

At June 30, 1982, the Company had negative working capital in the amount of $365,641. This contrasted with working capital of $1,386,841 at June 30, 1981. During fiscal 1982, $1,482,227 was expended for oil and gas property acquisitions principally in the Arctic Islands. No comparable acquisitions are anticipated in fiscal 1983.

Substantially all 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.

During fiscal 1982, because the aforementioned sources were inadequate to meet the Company's requirements, a line of bank credit with a Canadian bank was arranged providing for the borrowing of $2,000,000 of principal and an additional $2,000,000 of interest, if necessary. At June 30, 1982, the Company had borrowed $800,000 of principal and $49,000 of interest. The Company anticipates that this line of credit will be adequate to meet any working capital deficiency in fiscal 1983. If significant delays are experienced in marketing Kotaneelee gas, it is probable that debt or equity financing will be sought later in fiscal 1983.

Results of Operations.

1982 vs. 1981

Proceeds from carried interests decreased in 1982 as a consequence of reduced gas sales and new capital expenditures, which are immediately deducted from proceeds. Interest income was lower in fiscal 1982 because funds previously invested were utilized for property acquisitions. Oil and gas sales revenues improved because of higher prices.

Costs and expenses were at virtually the same level in 1982 as 1981 except for petroleum and gas revenue taxes which increased by 150 percent in 1982 to $135,064.

1981 vs. 1980

Despite price increases, proceeds under carried interest agreements and from oil and gas sales were lower because of weak demand for natural gas in 1981. Interest income increased because of higher interest rates and the increased availability of funds for investment.

General and administrative expenses were higher, due to increased legal costs resulting from the private investigation of the Company by the Securities and Exchange Commission and also because of higher accounting fees, salaries, stockholders' expenses, administrative expenses, travel expenses and business taxes, resulting in part from inflation.

Market Price and Volume Information

Canada Southern's 8,992,465 shares of outstanding stock are listed on the Toronto Stock Exchange in Canada and on the Boston and Pacific stock exchanges in the United States. The stock is traded under the symbol "CSW" in both countries.

The total sales volume on the Toronto Stock Exchange for calendar year 1981 was 1,712,300 shares, as compared to 3,794,361 shares during 1980. The quarterly price range (in Canadian dollars) for these shares in 1981 and 1982 was as follows:

	1981			
	1st quarter	2nd quarter	3rd quarter	4th quarter
High	12.75	15.37	12.25	8.50
Low	9.12	9.50	5.25	5.50
	1982			
	1st quarter	2nd quarter	3rd quarter	*4th quarter
High	6.37	6.75	5.00	5.00
Low	3.30	4.55	3.75	3.90

The total sales volume on the Pacific Stock Exchange for the calendar year 1981 was 4,527,093 shares as compared to 16,756,100 shares during 1980. The quarterly price range (expressed in U.S. dollars) for these shares in 1981 and 1982 was as follows:

	1981			
	1st quarter	2nd quarter	3rd quarter	4th quarter
High	10¾	15⅜	12¼	8½
Low	7½	9½	5¼	5½
	1982			
	1st quarter	2nd quarter	3rd quarter	*4th quarter
High	5½	5½	4¼	4⅛
Low	3½	2 13/16	2⅝	3⅛

*Through October 15

Selected Financial Data

	Year ended June 30,				
	1978	1979	1980	1981	1982
Revenues	$ 1,874,842	$ 1,748,897	$ 1,984,950	$ 1,541,866	$ 1,306,313
Net income (loss)	$ 820,982	$ 394,474	$ 534,911	$ (250,125)	$ (515,106)
Net income (loss) per share	$ .09*	$ .04*	$ .06*	$ (.03)	$ (.06)
Working capital	$ 830,000	$ 821,112	$ 1,286,593	$ 1,386,841	$ (365,641)
Total assets	$ 8,924,967	$ 9,240,218	$ 9,903,787	$ 9,992,710	$ 10,347,813
Average number of outstanding shares	8,851,967	8,873,619	8,904,427	8,971,234	8,992,465
Stockholders' Equity:					
Capital stock	$ 8,851,465	$ 8,883,465	$ 8,937,965	$ 8,992,465	$ 8,992,465
Capital in excess of par value	14,456,694	14,562,294	14,764,543	14,982,543	14,982,543
Accumulated deficit	(14,945,641)	(14,551,167)	(14,016,256)	(14,266,381)	(14,781,487)
	$ 8,362,518	$ 8,894,592	$ 9,686,252	$ 9,708,627	$ 9,193,521

*Includes $.03, $.02, $.02 for the years 1978, 1979, and 1980, respectively, for an extraordinary item of tax benefits realized.

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