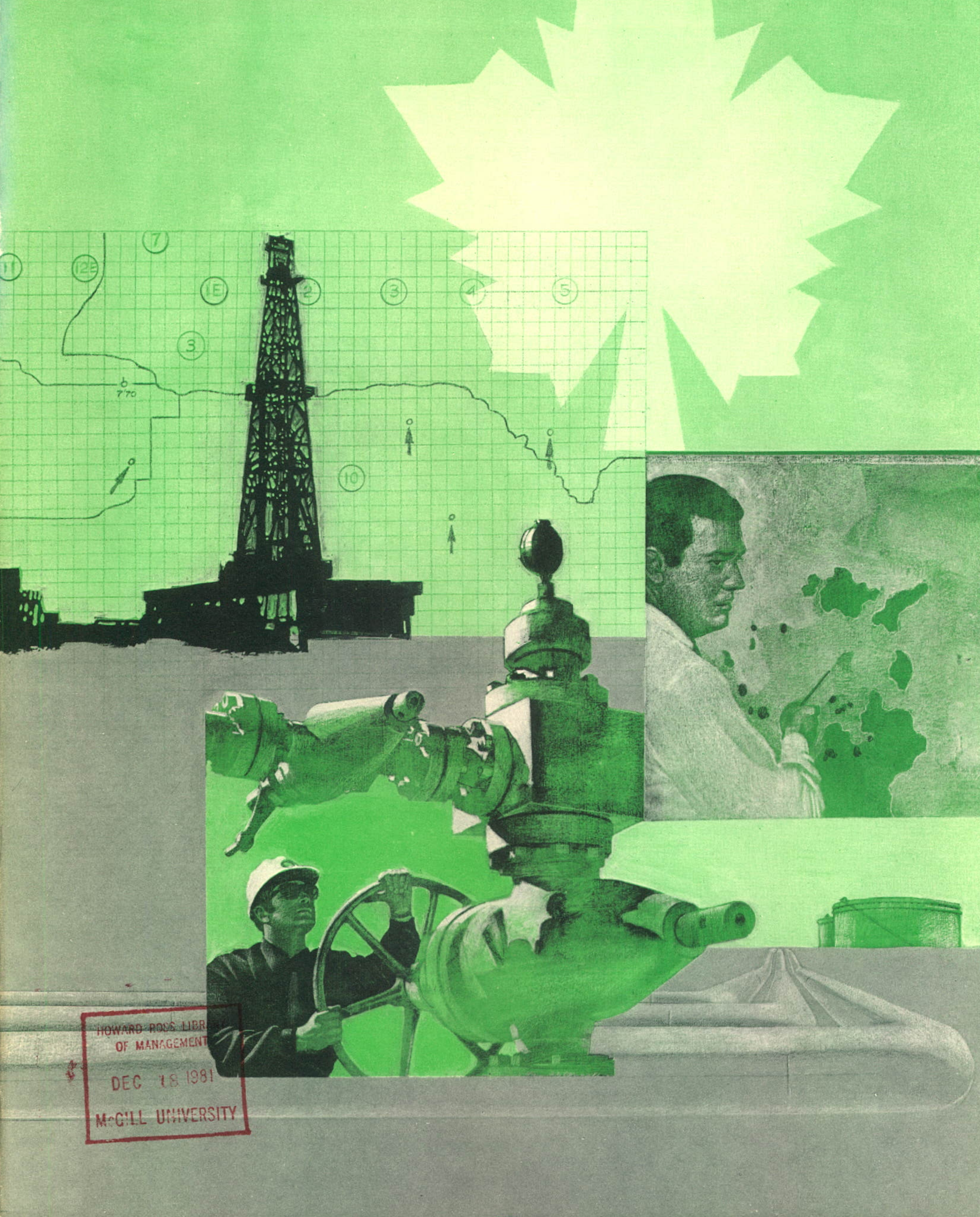
CANADA SOUTHERN PETROLEUM LTD.
1981 ANNUAL REPORT



Corporate Profile

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

The Company's primary business is petroleum exploration and development, principally in Canada. At present, its interests include largely undeveloped properties in Canada's Northwest Territories and Arctic Islands as well as several properties in Alberta, British Columbia, and the Yukon Territory that either are producing or are capable of production. Substantially all of these Canadian properties (4.4 million gross acres) are covered by "carried interest" agreements that require the assignee (operator) to advance all the funds necessary to develop and operate an oil or gas property. Subsequently, the operator is entitled to recoup his expenses from production revenues. After all monies advanced have been recovered, the position of the assignor (Canada Southern) becomes equivalent to that of a working interest holder, sharing the profits with the assignee on a *pro rata* basis.

The Company's more promising properties include a 30 percent carried interest in offshore portions of the Arctic Islands' Hecla gas field, where Canada Southern's share of the reserves has been estimated at 668 billion cubic feet by independent consultants. Approximately 40 miles northeast of Hecla is the Panarctic Whitefish gas discovery, in which Canada Southern has acquired half of Panarctic's working interest in the main portion of the field, which, at present, is thought to contain marketable gas reserves of approximately 2.4 trillion cubic feet. The Company also holds a 30 percent carried interest in the Kotaneelee gas field in the southeastern Yukon Territory. It is hoped that this field will go into production early in 1982, with an initial production rate of about 36 million cubic feet per day.

Canada Southern has approximately 9.0 million shares of capital stock outstanding, held by more than 12,000 shareholders of record. The stock is traded on the Toronto and Montreal stock exchanges in Canada and on the Boston and Pacific exchanges in the United States under the symbol CSW.

The Company's annual report to the U.S. Securities and Exchange Commission for 1981 on Form 10-K is available to shareholders upon written request to Mr. Donald Gallagher, First Jersey National Bank, P.O. Box 960, Jersey City, N.J. 07303, U.S.A.

DIRECTORS

John W. Buckley
President,
Pantepec International, Inc.
Hartford, Connecticut

John W. Bush
Vice President,
Coastal Petroleum Company
Tallahassee, Florida

Thomas W. Donlon
Vice President—
Foreign Production (Ret.)
American Overseas Petroleum Ltd.
Somis, California

Benjamin W. Heath
President,
Magellan Petroleum Corporation
Hartford, Connecticut
Chairman,
Magellan Petroleum Australia Limited
Brisbane, Australia
President,
Coastal Caribbean Oils & Minerals, Ltd.
Hamilton, Bermuda

M.A. Reasoner
Technical Advisor,
Canada Southern Petroleum Ltd.
Calgary, Alberta

OFFICERS

Charles J. Horne
President

John A. Scott
Vice President

Kenneth E. Noble
Secretary-Treasurer

Executive Offices

505 Eighth Avenue South West
Calgary, Alberta T2P 1G2

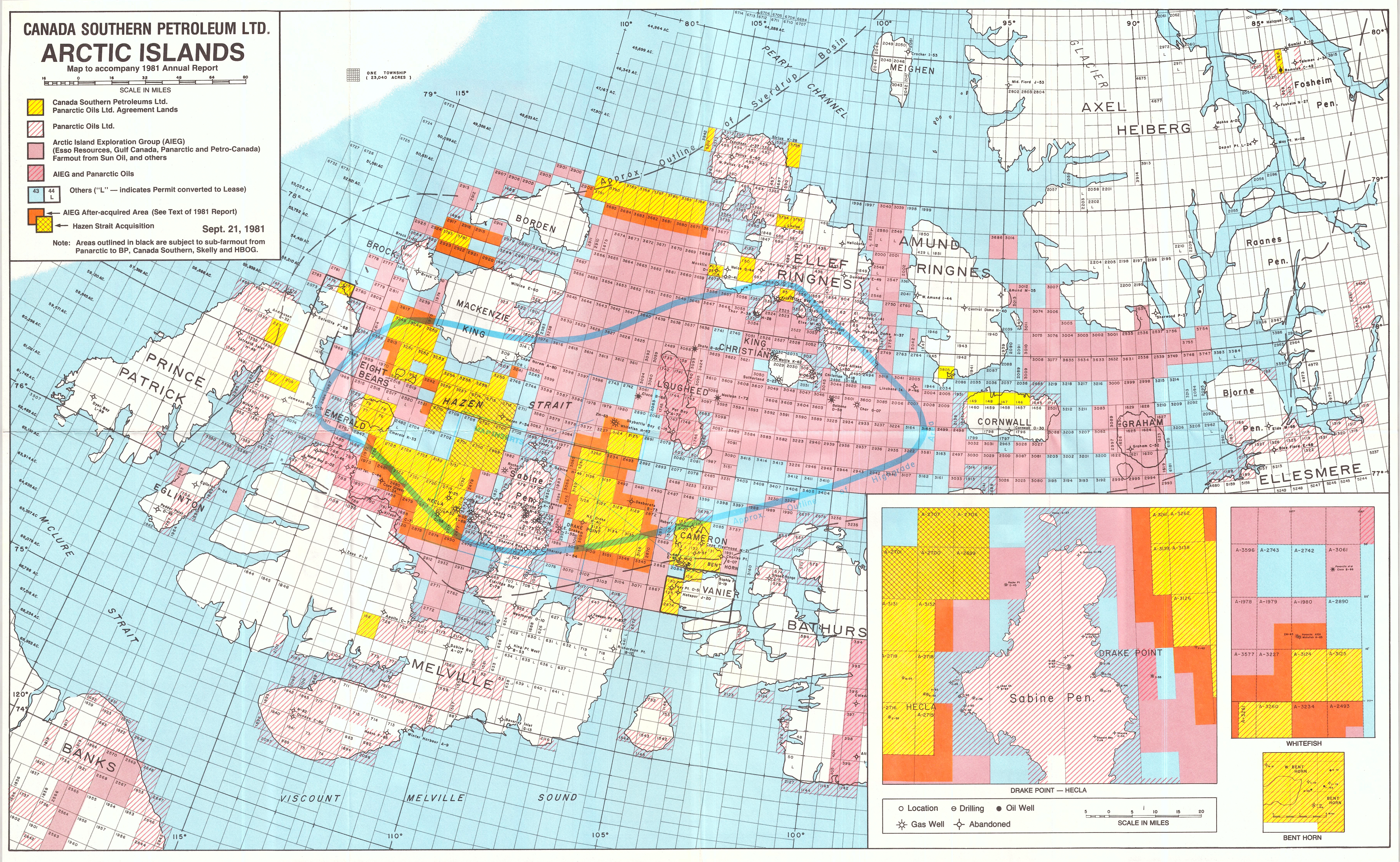
Canadian Transfer Agent

The Montreal Trust Company
15 King Street West
Toronto, Ontario M5H 1B4

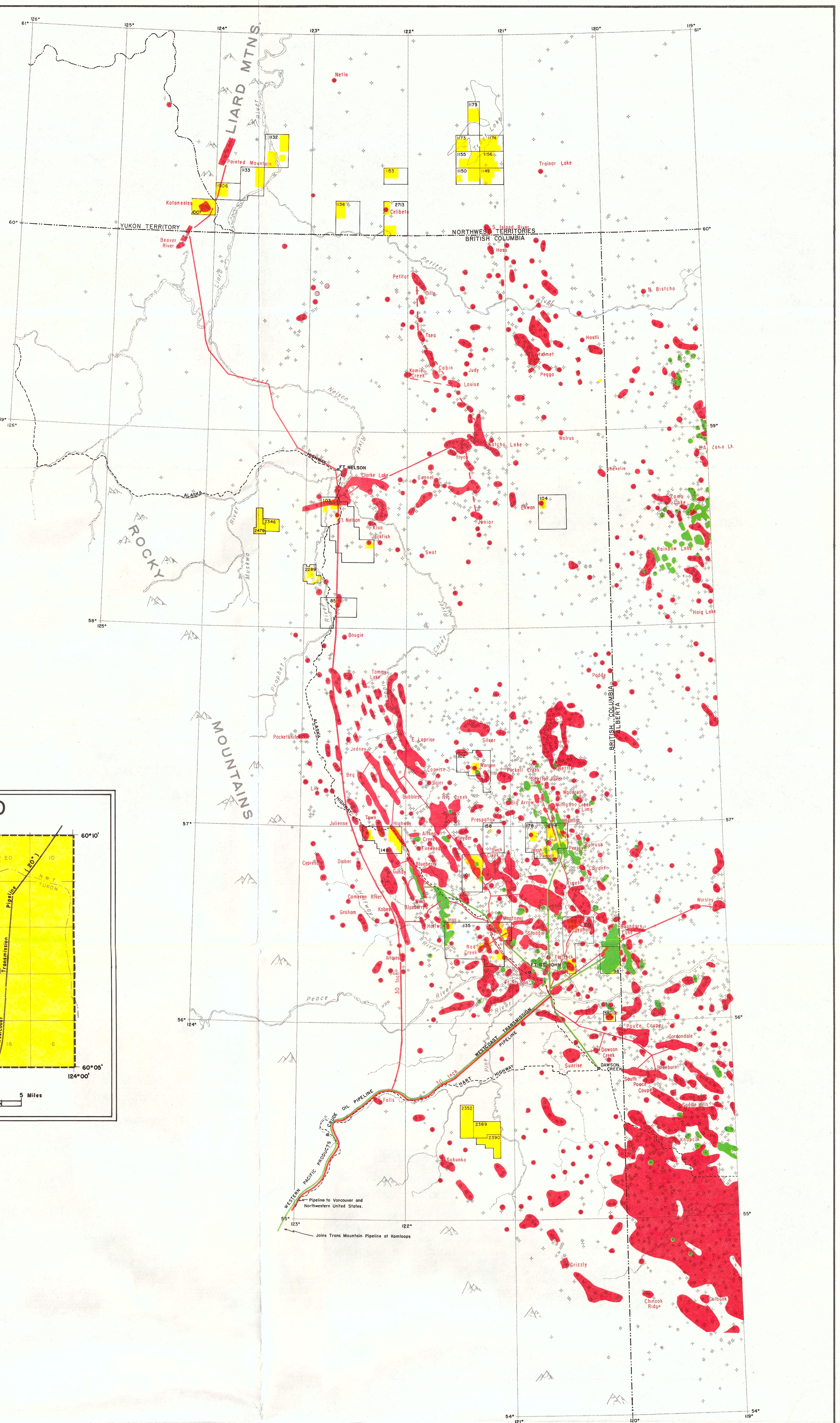
U.S. Transfer Agents

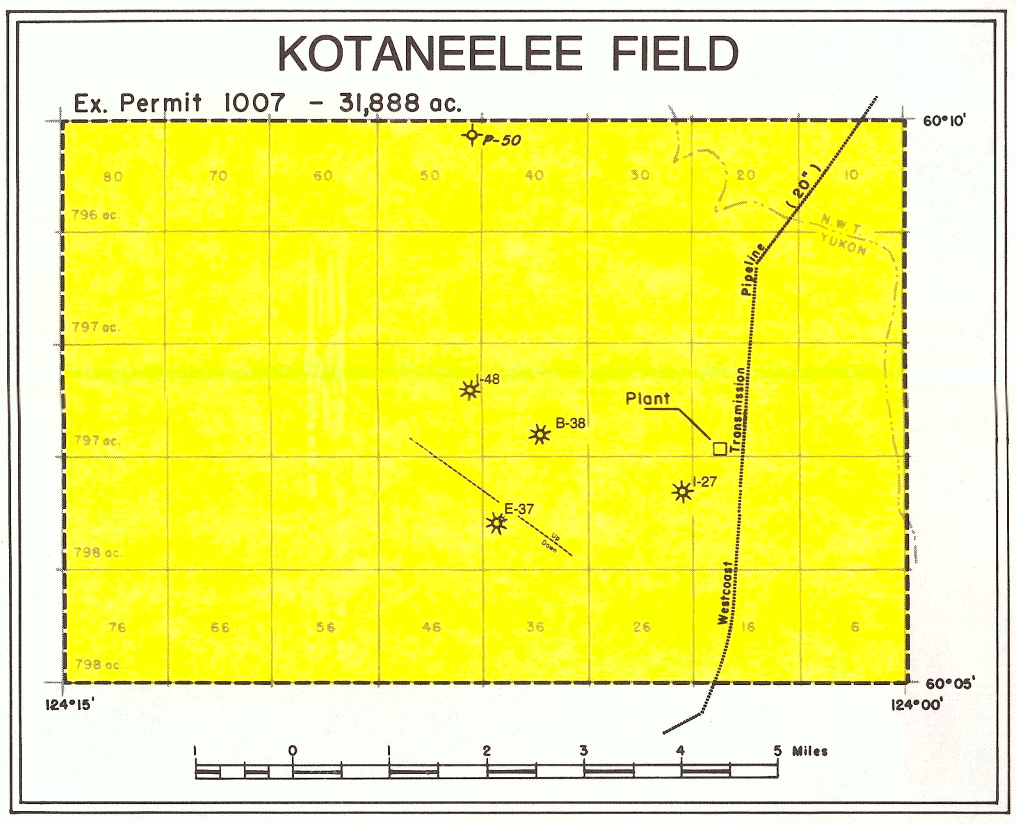
First Jersey National Bank
P.O. Box 960
Jersey City, NJ 07303

First Interstate Bank
P.O. Box 3667, Terminal Annex
Los Angeles, CA 90051

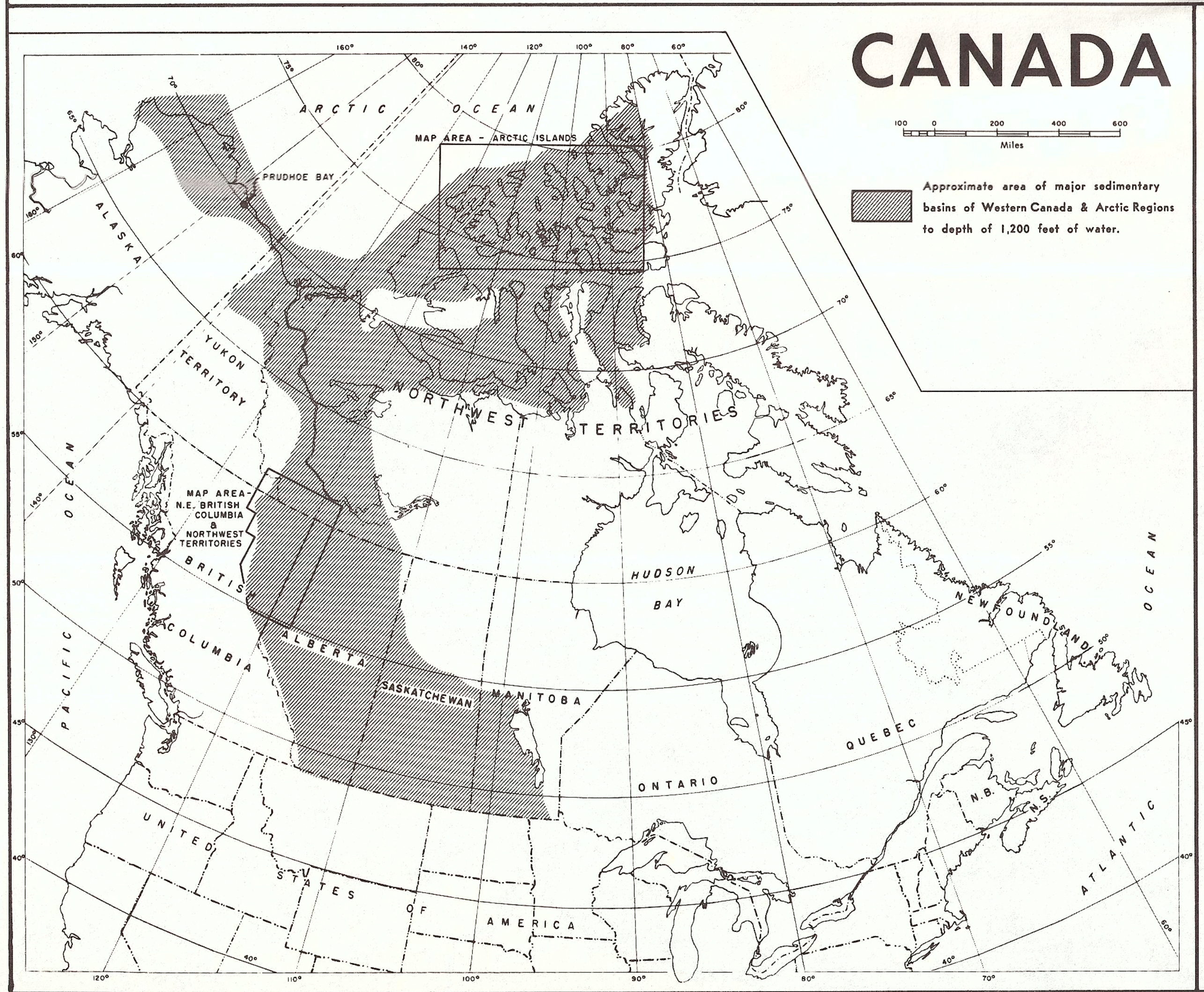


CANADA SOUTHERN PETROLEUM LTD.
ARCTIC ISLANDS
Map to accompany 1981 Annual Report
SCALE IN MILES
Canada Southern Petroleums Ltd. Panarctic Oils Ltd. Agreement Lands
Panarctic Oils Ltd.
Arctic Island Exploration Group (AIEG) (Esso Resources, Gulf Canada, Panarctic and Petro-Canada) Farmout from Sun Oil, and others
AIEG and Panarctic Oils
Others ("L" — indicates Permit converted to Lease)
AIEG After-acquired Area (See Text of 1981 Report)
Hazen Strait Acquisition
Sept. 21, 1981
Note: Areas outlined in black are subject to sub-farmout from Panarctic to BP, Canada Southern, Skelly and HBOG.
ONE TOWNSHIP (23,040 ACRES)
PRINCE PATRICK
EGLINTON
BROCK
BORDEN
MACKENZIE KING
EIGHT BEARS
EMERALD
HAZEN STRAIT
MELVILLE
Sabine Pen.
HECLA
DRAKE POINT
LOUGHEED
KING CHRISTIAN
ELLEF RINGNES
AMUND RINGNES
MEIGHEN
AXEL HEIBERG
Fosheim Pen.
Raanes Pen.
Bjorne Pen.
GRAHAM
CORNWALL
ELLESMERE
CAMERON
BENT HORN
VANIER
BATHURST
BANKS
M'CLURE STRAIT
VISCOUNT MELVILLE SOUND
PEARY CHANNEL
GLACIER
Approx. Outline of Sverdrup Basin
Approx. Outline of High Grade Area
DRAKE POINT — HECLA
WHITEFISH
BENT HORN
Location
Drilling
Oil Well
Gas Well
Abandoned
SCALE IN MILES





CANADA



HOLDINGS OF

CANADA SOUTHERN PETROLEUM LTD.

IN

NORTHWEST TERRITORIES & N.E. BRITISH COLUMBIA

10 0 10 20 30 40 50 60 70 80 Miles

- Oil Well
- Gas Well
- Suspended
- Abandoned
- Drilling and/or Testing
- Location
- Oil Field
- Gas Field
- Oil Pipeline
- Gas Pipeline
- Gas Pipeline—Proposed/Under Construction
- Canada Southern Pete. Interest Lands

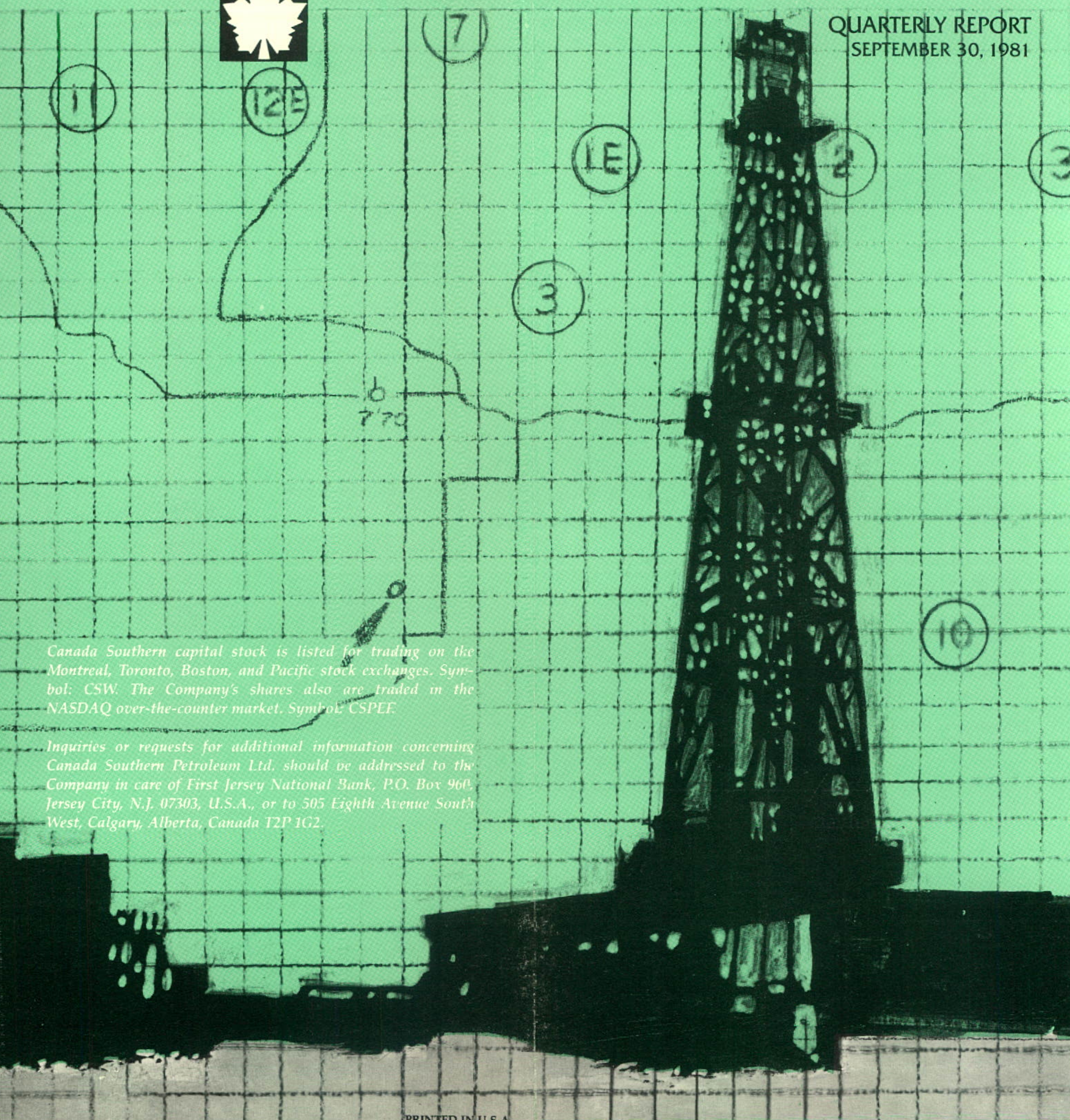
Sept. 21, 1981

lawson graphics western limited
PRINTED IN CANADA

CANADA SOUTHERN
PETROLEUM LTD.

CANADA SOUTHERN PETROLEUM LTD.

QUARTERLY REPORT
SEPTEMBER 30, 1981



Canada Southern capital stock is listed for trading on the Montreal, Toronto, Boston, and Pacific stock exchanges. Symbol: CSW. The Company's shares also are traded in the NASDAQ over-the-counter market. Symbol: CSPEF.

Inquiries or requests for additional information concerning Canada Southern Petroleum Ltd. should be addressed to the Company in care of First Jersey National Bank, P.O. Box 960, Jersey City, N.J. 07303, U.S.A., or to 505 Eighth Avenue South West, Calgary, Alberta, Canada T2P 1G2.

PRINTED IN U.S.A.

Canada Southern Petroleum Ltd.

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION (unaudited)

	Three months ended September 30,	
	1981	1980
Source of working capital:		
Net income (loss)	**$ 42,053**	$ (1,278)
Charges to income not involving outlay of working capital:		
Depreciation, depletion and amortization	**51,102**	50,322
Working capital provided by operations	**93,155**	49,044
Exercise of stock options	**—**	197,500
	93,155	246,544
Disposition of working capital:		
Additions to oil, gas and mineral properties	**48,268**	66,279
Deferred charge	**(2,846)**	(2,845)
	45,422	63,434
Increase in working capital	**$ 47,733**	$ 183,110
Increase (decrease) in working capital by component:		
Cash	**$ 183,268)**	$ (40,720)
Term deposits	**(150,000)**	210,000
Accounts receivable and other current assets	**24,205**	16,131
Accounts payable and accrued liabilities	**(9,740)**	(2,301)
Increase in working capital	**$ 47,733**	$ 183,110

Canada Southern Petroleum Ltd.

CONSOLIDATED STATEMENT OF INCOME (LOSS) (unaudited)

	Three months ended September 30,	
	1981	1980
Revenues:		
Proceeds under carried interest agreements	**$ 269,097**	$ 260,883
Interest income	**63,354**	29,656
Oil and gas sales	**63,195**	34,176
	395,646	324,715
Costs and expenses	**353,593**	325,993
Income (loss) before taxes on income and extraordinary item	**42,053**	(1,278)
Provision for taxes on income	**16,000**	—
Income (loss) before extraordinary item	**26,053**	(1,278)
Tax benefit realized from carry-forward of exploration, development, and lease acquisition costs not claimed in prior years	**16,000**	—
Net income (loss)	**$ 42,053**	$ (1,278)
Average number of shares outstanding	**8,992,465**	8,949,715
Net income (loss) per share	**$.01**	$ —

Note: Financial data expressed in Canadian dollars.

Management's Analysis

Liquidity and Capital Reserves

Working capital amounted to $1,482,962 at September 30, 1981 and is expected to increase by a modest amount from ordinary operations. Most of the working capital has been allocated for use in connection with the exercise of after-acquired rights during fiscal 1982. The Company is presently exploring the availability of loan funds with certain Canadian banks, which loans may be secured by the Company's properties and are to be utilized to replenish working capital as required.

Results of Operations

Revenues from gas sales and royalty income benefited from higher gas prices but this revenue increase was offset by higher production taxes. Interest income was higher because of high interest rates and an increase in funds invested.

Legal expenses were higher because of the investigation conducted by the Securities and Exchange Commission.

JOHN W. BUSH

Mr. Charles J. Horne, President
Canada Southern Petroleum Ltd.
505 Eighth Avenue, S.W.
Calgary, Alberta T2P 1G2
CANADA

Dear Chuck:

In recent weeks and months in the business sections of many periodicals and newspapers, a well-defined theme toward the acquisitions of companies with large reserves of petroleum or minerals has been noted. The general trend is that oil, gas, coal, and other minerals "in the ground" can be worth far more than the price the Canadian and American stock markets are setting on the producer's shares of stocks. Also, the many negative factors of the "NEP" have seriously depressed the market prices of energy company stocks.

In view of such factors, I believe our Directors should recognize that Canada Southern Petroleum may obviously be a potential target company for corporate raiders. I further believe that our shareholders should know that we recognize this vulnerability and should be made well aware of takeover devices most often used by corporate raiders, in particular the <u>proxy battle</u> and the <u>tender offer.</u>

The least expensive course of action for the corporate raider, but possibly the most costly to the shareholder, is the proxy contest, since here the raider generally seeks to get something for little or nothing. Such raiders have little to lose; and if successful, can gain control of a company and its valuable assets at relatively small expense.

A typical proxy battle begins with a request by the raider for the company's shareholder list. With this list the raider then contacts the company's shareholders to declare shortcomings of present management and proclaim virtues of a proposed new slate of directors, invariably depicting them as the "white knights." To win votes, expansive promises may be made regarding plans for the company.

Were Canada Southern the target, a shareholder may be assured that a raider's proxy material would either omit or gloss over a number of salient facts. A raider, for example, would not remind shareholders that the company's present and former directors—one of whom ranks among Canada's most esteemed geologists—started from scratch and put together, with a very limited budget, a property package unique in the history of the Canadian petroleum industry; that they managed to obtain financing during trying periods that witnessed the disapearance of many independents from the Canadian exploration scene; that they persuaded more affluent partners to launch exploration programs that were beyond the financial capabilities of all but major companies; and, that they were successful in building huge petroleum reserves that should reap excellent rewards in the years ahead.

And if the raiders should succeed (as almost one out of four takeover attempts do), they would probably seek to recover their proxy battle costs from the raided company.

The tender offer is a rather different ballgame. It can represent a friendly, well-intended approach by a bona fide suitor. However, a suitor may also attempt to acquire a company's assets for considerably less than their true value. Therefore, if our shareholders are confronted with such an offer, they should give it a long, hard scrutiny and analysis. Our Board of Directors should then prepare and furnish to each shareholder it could reach figures on the Company's reserves and information on financial value estimates to help them make such as analysis. Based on this data, they could determine whether they felt the offer was fair and in their own best interests.

Should Canada Southern be confronted with a tender offer, shareholders should bear in mind that if the first offer does not reflect the real value of the Company's properties, it would not be at all unusual for the organization making the offer to raise its bid. Moreover, other groups often jump in with competitive bids. A tender offer, then, is no time to act in haste. An offer that might seem attractive as compared to current market price could well be far below the per share value of the Company's oil and gas properties.

The recent Conoco takeover is a startling example. With the market price at around $50 a share, competitive takeover bidders ran the offers up to well over $100 in just a relatively few weeks.

Sincerely,

John W. Bush

John W. Bush, Director
Canada Southern Petroleum Ltd.

Naples, Florida
September 4, 1981

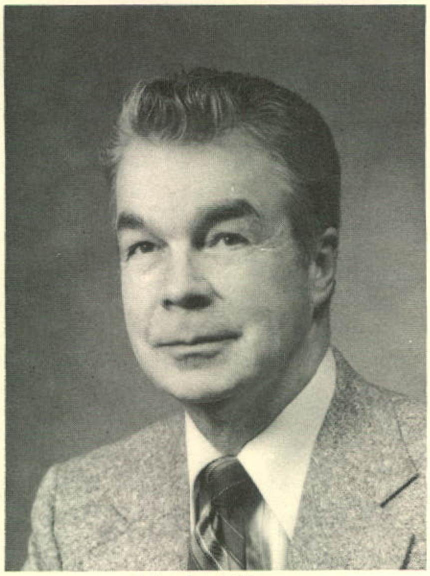
PRESIDENT'S REPORT

In light of the many uncertainties created by the Canadian National Energy Program ("NEP") that was announced last year, the period covered by this report is perhaps best-described as having been an unsettled one for the Canadian petroleum industry, and Canada Southern was not immune to that malaise. However, I feel it important to preface these remarks with the observation that, NEP notwithstanding, Canada Southern's prospects for the future are *excellent*.

While I regret to report that the production date has not yet been announced for the Kotaneelee gas field, it is hoped that this long-deferred project will be brought on stream early in 1982. Given the planned average delivery of 36 million cubic feet per day, the operator (Columbia Canada) should recoup its development expenses in about 18 months. At that point, Canada Southern would begin receiving 30 percent of the net profits from the field, or about $10 million (Can.) per year based on current gas prices and current ownership interests. I also am pleased to report that Canadian Energy Minister Marc Lalonde has suggested that the Kotaneelee field be exempted from the proposed 25 percent no-cost "acquisition" by Petro-Canada that is a key provision of the NEP. Enactment of the Minister's suggestion is considered a certainty; and that, obviously, will be of great benefit to your Company.

There can be no doubt that the NEP will have a *substantial* impact on petroleum exploration and development in Canada's frontier areas. Naturally, the full impact of the program cannot be analyzed until it has been enacted by the Federal Government and has been in effect for some time. However, there are certain features of the NEP which, *if implemented*, would obviously be less than desirable for Canada Southern in some respects. Most significant is the proposed 25 percent back-in by Petro-Canada (or another Government-owned oil company) on Federal properties *where oil and gas already have been discovered*. Panarctic Oils Ltd., the operator for almost all of Canada Southern's Arctic Island property interests, is vigorously opposing this measure, as is most of the Canadian petroleum industry; and it is, of course, possible that the proposal could be amended or modified. But *if enacted in its present form*, this measure would reduce Canada Southern's Arctic Island interests by 25 percent. (For example: our 30 percent interest in the Hecla gas field would be reduced to 22.5 percent.) The NEP also proposes a new progressive incremental royalty—based on the profitability of each producing field—in addition to the underlying 10 percent royalty to the Government. Moreover, there will be a new tax on *net petroleum revenues*, with an initial rate of 8 percent. In short: we are faced with the prospect of a tax package that probably would reduce our carried interest income.

There is another aspect to the NEP which, in my opinion, should be of interest to all shareholders; and I therefore commend to your special attention the enclosed letter addressed to me by Mr. John W. Bush, a Director of Canada Southern since 1977 and the only Board Member standing for reelection at the forthcoming Annual Meeting. I feel Mr. Bush's comments are particularly timely in light of the fact that the NEP already has precipitated several mergers and takeovers, and there is little room for doubt that others will follow.



Charles J. Horne

As regards the direct ownership proposal that was announced last year, management has applied for a ruling from Revenue Canada on the tax consequences of such a plan. Until that ruling is received, the Board cannot determine whether the proposal would be in the best interest of the shareholders.

In conclusion, I would like to reaffirm that your management will continue to take advantage of every opportunity within its capabilities to upgrade Canada Southern's holdings.

Respectfully submitted,

Charles J. Horne

Charles J. Horne
President

Calgary, Alberta
October 9, 1981

ARCTIC ISLAND PROPERTIES

During fiscal 1981, the great potential of Canada Southern's Arctic Island properties (3.6 million gross acres) in the Sverdrup Basin was again enhanced by the remarkably successful exploration efforts of Panarctic Oils Ltd., which, under carried interest agreements, acts as operator for almost all of your Company's property interests in the region.

This rather unique organization, an industry-government consortium, is owned almost 50 percent by the Canadian government (through Petro-Canada) and 50 percent by 29 other, largely Canadian, companies. To date, Panarctic is the only company physically operating in the Arctic, and has discovered natural gas reserves estimated to be in excess of 16 trillion cubic feet. In addition, substantial oil reserves are indicated as a result of discoveries made in 1980 and 1981.

Ice Platform Drilling

Winter lasts about 10 months in the Arctic; and in consequence the sea is frozen over except for a short period in August and September. Between December and June, the islands anchor the sea ice, and hence there is very little horizontal ice movement. This phenomenon has enabled the development of Panarctic's ice platform drilling technique, which involves deep-water (up to 1,500 feet) drilling with rigs positioned on ocean ice that has been thickened by flooding and freezing.

Whitefish

In 1980, three offshore wells were drilled from such ice platforms—two of them to the south of Ellef Ringnes Island; the other near Lougheed Island—and all three resulted in the discovery of hydrocarbons. Perhaps of greatest significance to Canada Southern shareholders was the second Whitefish well, AIEG Whitefish 2H-63, a multi-zone gas well drilled to a depth of 9,820 feet approximately 24 miles west of Lougheed Island. The main gas zone, comprised of the porous and permeable sandstones of the King Christian Formation, was production tested at flow rates up to 44 million cubic feet per day, with a calculated absolute open flow potential for this zone estimated at 145 million cubic feet per day.

The bulk of the Whitefish structure is located on two federal exploratory permits (see map, Permits 1979 and 1980) on which Canada Southern has exercised "after acquired" rights of 3.3 percent. A portion of the structure also falls on Permit 3227, on which Canada Southern has exercised "after acquired" rights of 6.33 percent. Moreover, the structure extends into the northern portion of Permit 3124, in which the Company has a 30 percent carried interest. This gives Canada Southern an estimated participation of 5.7 percent in the entire Whitefish structure.

Cisco, MacLean, and Skate

During the 1981 drilling season, Panarctic drilled three wells from ice platforms off Lougheed Island. Again, all three of these exploratory wells resulted in new and highly significant oil and gas discoveries.

Cisco B-66 was drilled on Permit 3061, about 15 miles north of the Whitefish structure. It was a dual zone oil and gas well; and drill stem tests indicated a major oil discovery in the (Upper Jurassic) Awingak Sandstone Formation. Over the interval 5,350 to 5,376 feet, this well flowed light gravity oil to the surface at the rate of 1,456 barrels per day as well as yielding a natural gas flow of 1.08 million cubic feet per day. In addition, sandstones of the underlying King Christian Formation also yielded both oil and gas.

MacLean I-72, on Permit 3096, also was a dual zone oil and gas discovery. Drill stem tests over the interval 4,827 to 4,840 feet flowed natural gas from the King Christian Formation at rates up to 6.2 million cubic feet daily through a restricted choke. Four separate tests of the underlying Skybattle Formation (from 5,755 to 5,873 feet) also encountered natural gas and light gravity oil. This well is thought to be particularly significant in that it was the first to produce substantial quantities of hydrocarbons from the Skybattle Formation.

Skate B-80, drilled northeast of Lougheed Island on Permit 3093, flowed natural gas from the King Christian Formation at rates up to 5.7 million cubic feet per day through a restricted choke over the interval 2,865 to 2,973 feet, and also recovered light gravity oil at the rate of 950 barrels per day during further tests within the same interval. A second tested formation, the underlying Schei Point Sandstone, flowed natural gas through a restricted choke at the rate of 7.3 million cubic feet per day.

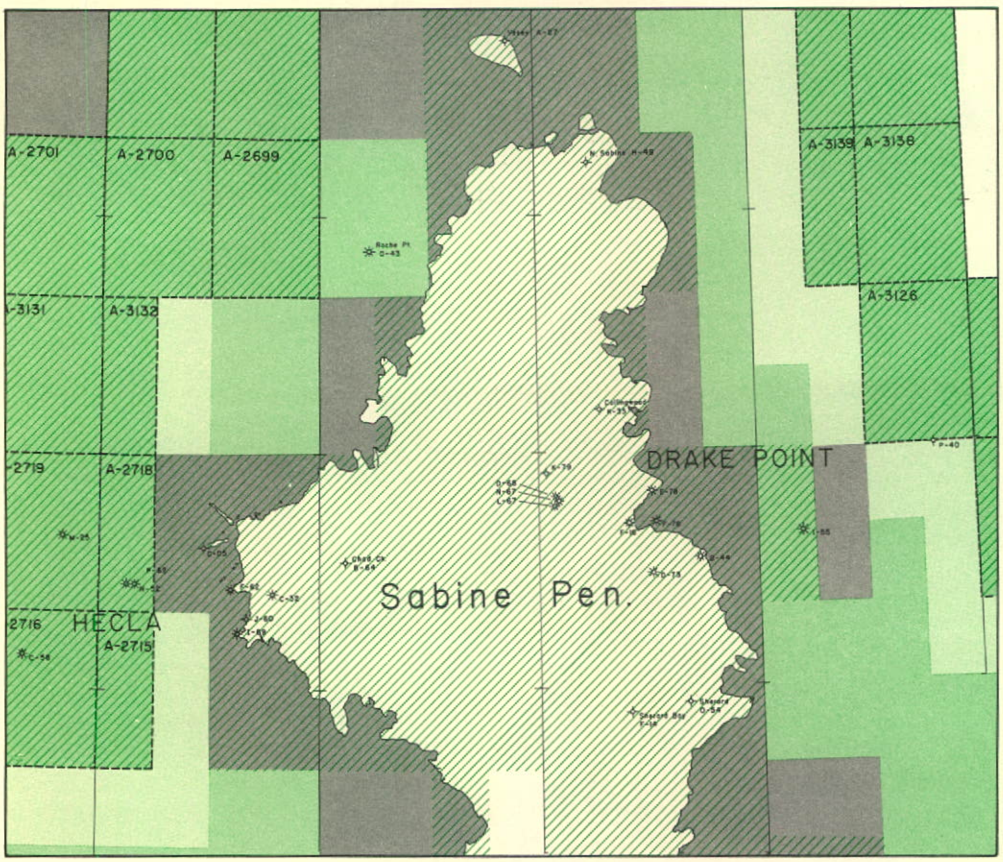
Although the Cisco, MacLean, and Skate discoveries were not located on Canada Southern permits, they nonetheless are of major significance to Canada Southern shareholders. According to Panarctic, these discoveries (together with those made in 1980) have strikingly demonstrated that most of the folded, closed structures in the Western Sverdrup Basin—the "high-grade area"—can be expected to contain hydrocarbons. Five additional offshore wells are scheduled to be drilled by Panarctic this winter; and one of these will be located on the flank of the Whitefish structure, which could contain substantial quantities of oil downflank from the discovery well. Overall, the phenomenal success of the Arctic Islands drilling program in 1980 and 1981 has clearly established the Western Sverdrup Basin as an exploration "hot spot," within which Canada Southern's holdings cover approximately 2.8 million acres.

High-Grading

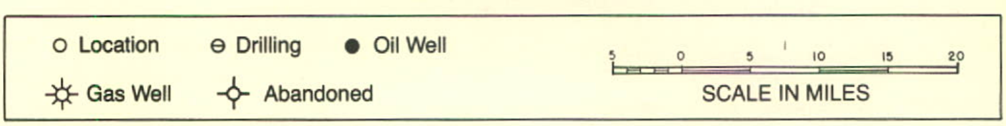
During the past year, Panarctic continued to high-grade its permits by surrendering lands that are now considered non-prospective. (This is due to the rapidly escalating work obligations applied to mature holdings in the Arctic Islands.) As a result of that policy, Canada Southern joined Panarctic in the surrender of 1.1 million gross acres of its Arctic Island properties *outside of the high-grade area* during fiscal 1981.

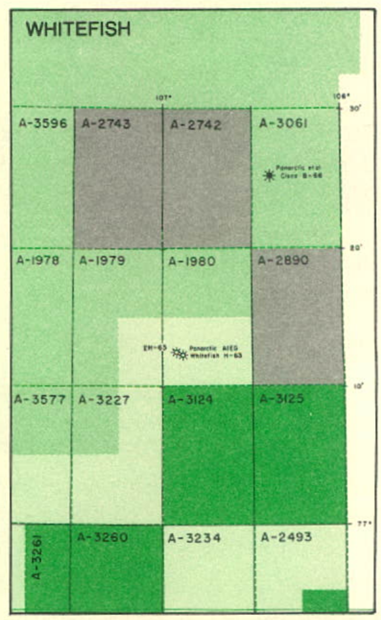
Hazen Strait Acquisition

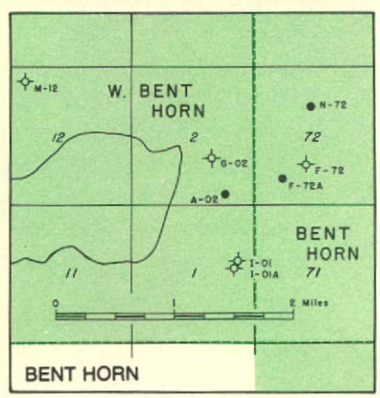
In keeping with this high-grading philosophy, Panarctic also exchanged a portion of its working interest in 478,017 gross acres in the Hecla Block (see map, Sabine Pen. insert) for a like interest in permits held by Phillips Petroleum Canada in the vicinity of Hazen Strait. This acquisition fell, in part, on a Canada Southern after-acquired area amounting to 173,903 gross acres. Pursuant to negotiations with Panarctic, Canada Southern elected to obtain a 3 percent *working interest* in the Hazen Strait Block (523,074 gross acres) in exchange for 3 percent of its 30 percent carried interest in the Hecla Exchange Block plus $166,000 (Can.), which represents Canada Southern's *pro rata* share of a previously drilled dry hole on the property and seismic work conducted during the spring of 1981. The decision to acquire the Hazen Strait property was based, among

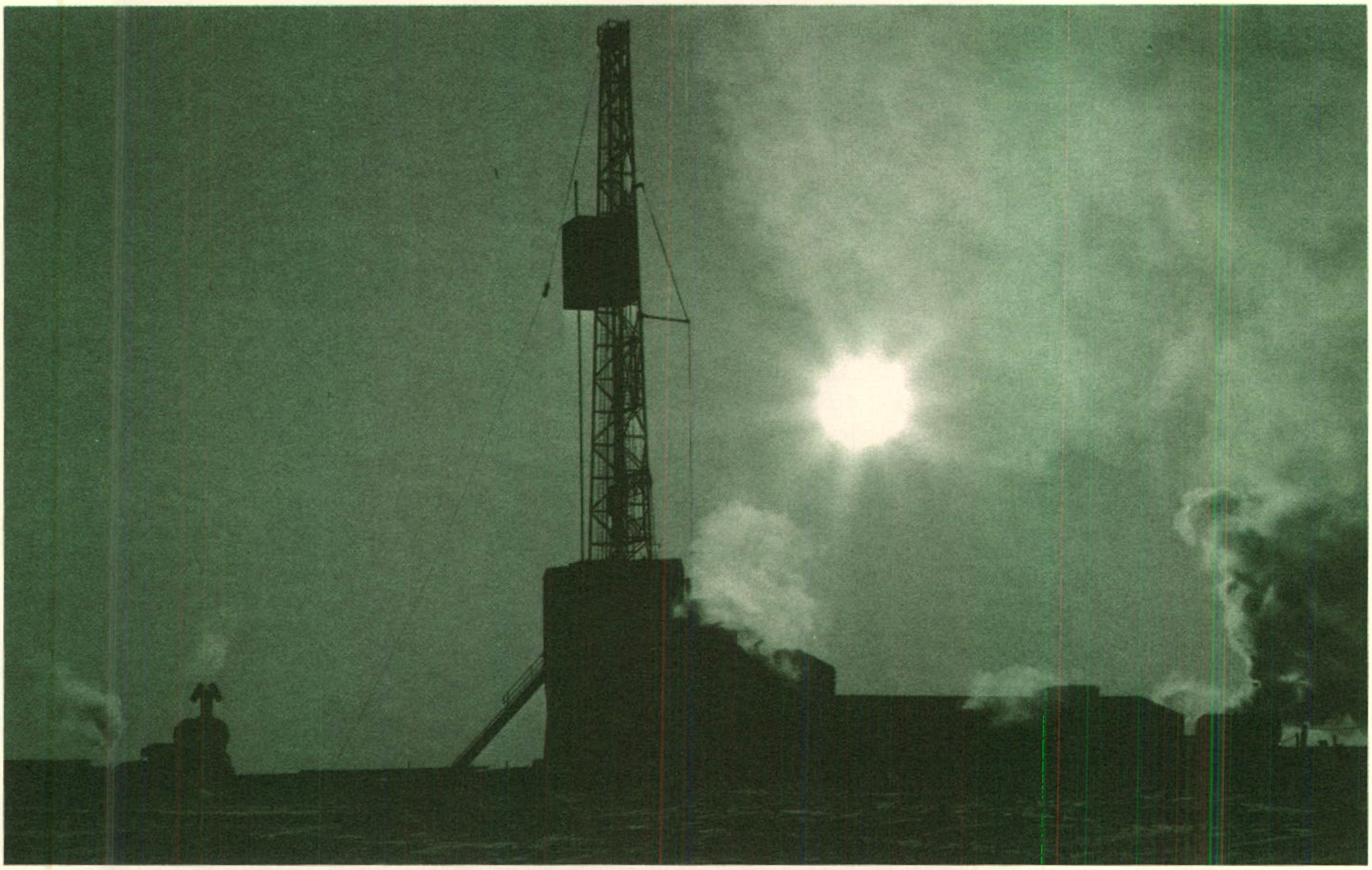


DRAKE POINT — HECLA









The Cisco B-66 well, approximately 15 miles north of Whitefish. Photo courtesy of Panarctic Oils Ltd., Calgary, Alberta.

other factors, on the belief that the property is more attractive from the geologic standpoint, that it expands the Company's coverage, and that it will be drilled sooner than the Hecla exchange area.

AIEG Whitefish Acquisition

Another Canada Southern acquisition that was negotiated during fiscal 1981 resulted from Panarctic's participation in the Arctic Islands Exploration Group (AIEG), a consortium that farmed into 32 million acres in 1976. This affiliation enabled Panarctic to acquire interests ranging from 5.28 to 13.2 percent in this property, which, for the most part, is located in the high-grade area of the western Sverdrup Basin. Some of this acquisition fell on the Canada Southern "after-acquired" area (portions of Permits 1979, 1980, and 3227) on which the Whitefish structure is located; and thus Canada Southern exercised its right to acquire half of Panarctic's interest in the area (1.61 million gross acres) on October 7th, 1981. The Company now has a 3.3 percent *working interest* in its portions of Permits 1979 and 1980 and a 6.334 percent *working interest* in 3227. The cost to Canada Southern was $854,716 (Can.) plus an estimated $410,000 (Can.), which represents the Company's share of the well that will be drilled this winter. At present, the Whitefish field is reported by Panarctic to contain marketable gas reserves of approximately 2.4 trillion cubic feet.

West Bent Horn

On May 29, 1981, Panarctic's West Bent Horn G-02 onshore well was spudded on the southwest quadrant of Cameron Island (Permit A-133), in which Canada Southern has a 5 percent carried interest. This 10,500-foot Devonian test well was abandoned as a dry hole on September 4, 1981, although three earlier wells yielded significant flows of light gravity oil. At present, it is not known if Panarctic contemplates additional drilling on Cameron Island.

ALBERTA, BRITISH COLUMBIA, AND THE YUKON

Canada Southern property interests in Alberta, British Columbia, and the Yukon & Northwest Territories (the Liard Basin) encompass some 579,816 gross acres, substantially all of which are covered by carried interest agreements that range from 1.67 to 50 percent. Most of this acreage is undeveloped; however, 35,565 acres are considered developed, with 39 productive oil wells and 60 productive gas wells. These producing properties generated revenues of $1.38 million for Canada Southern during fiscal 1981.

The Kotaneelee Field

With respect to projected cash flow in the near-term, Canada Southern's most promising property is the huge Kotaneelee gas field in the extreme southeast corner of the Yukon Territory.

This field, discovered by Canada Southern in 1964, has not been fully developed or delineated. However, it falls within the boundaries of a former exploration permit (No. 1007) that has been fully converted to production leases covering 31,888 acres, in which Canada Southern holds a 30 percent carried interest. The operator, Columbia Gas Development of Canada Ltd. ("Columbia Canada") has constructed a dehydration plant to remove water vapors from the gas, and the facility is connected to a pipeline that is linked to Vancouver and the northwestern U.S. Moreover, the Canadian National Energy Board has approved the export of 84.5 billion cubic feet ot Kotaneelee gas to the United States over an 8-year period. Unfortunately, U.S. Government approval to import the gas has not yet been forthcoming.

Many shareholders undoubtedly will recall that when the 1980 Annual Report was published, it was anticipated that U.S. import authorization would be granted by the end of 1980 or early in 1981. However, it is now apparent that the U.S. Department of Energy will not approve the import of Kotaneelee gas—as well as a number of other Canadian import applications—until the matter of "take or pay" clauses has been resolved.

It should be noted that "take or pay" clauses—which, in recent years, have been incorporated in most Canadian natural gas contracts—obligate the American customer to purchase a stipulated quantity of gas over a given period, and also obligate him to pay for a certain percentage ("load factor") of the gas if not taken. For example: a contract calling for 10 billion cubic feet a year with a 90 percent load factor would require the customer to pay for 9 billion cubic feet even though he only took 7 billion cubic feet.

These clauses have become increasingly objectionable to U.S. authorities, who take the position that the cost of gas not taken is an indefensible burden on the U.S. consumer. As a result, the U.S.-Canadian dispute over "take or pay" clauses to some extent has become a political issue. Moreover, the relatively high price of Canadian gas and the so-called "gas glut" in the United States have not contributed to an expeditious resolution of this issue.

At present, Columbia Canada and its U.S. affiliate are negotiating an amended gas sales contract with a revised "take or pay" clause which, it is hoped, will be acceptable to the U.S. authorities. Total export volume will remain 84.5 billion cubic feet over an 8-year period. However, major amendments are a reduced load factor (80 percent) and a 3-year make-up period for gas that has been paid-for but not taken. While these revisions will require correlative amendments to the export license granted by the Canadian National Energy Board, it appears that the Board will be willing to approve these amendments. Thus it is hoped that Kotaneelee production will commence early in 1982, at an initial price of $4.94 (U.S.) per thousand cubic feet at the border.

AUSTRALIA

Canada Southern holds a small (.0647 percent) working interest in a petroleum permit (OP 175) that covers approximately 6 million acres in the Amadeus Basin of central Australia, within which oil and gas discoveries have been made at two locations to date.

In 1980, this interest in OP 175 enabled the Company to join a Canadian/Australian consortium that is exploring OP 175 and an adjacent permit, OP 178, in the Amadeus Basin. Upon completion of this 5-year, $60 million (Can.) program, Canada Southern will have a .0323 percent interest in the 12.2-million-acre exploration area.

The consortium's first well, Wallaby No. 1, was drilled to a depth of 8,000 feet during the summer of 1981; and while no commercial discoveries were made, several gas shows recorded in two objective formations confirmed the presence of hydrocarbons in the area. The second well, Dingo No. 1, was started on September 24. Two additional wells are to be drilled during the program year ending March 1982, with a minimum of 10 wells scheduled for drilling during the 5-year program.

	Gross Acreage in which Interest Is Held	Net Acreage		
		Held Under Lease	Held Under Permit	Total
CANADA				
Alberta				
Overriding Royalty Interest	320	20		20
British Columbia				
Pacific Agreement:				
Working Interest	29,909	5,683		5,683
Carried Interest	58,255	12,380		12,380
Phillips Agreement-Carried Interest	190,637	20,493	4,235	24,728
Other:				
Overriding Royalty Interest	6,841	423		423
Working Interest	16,064	2,840		2,840
Carried Interest	28,072	777		777
Total British Columbia	329,778	42,596	4,235	46,831
Yukon & Northwest Territories [The Liard Basin]				
Columbia Gas Agreement-Carried Interest	73,038	21,911		21,911
Atkinson Agreement-Carried Interest	101,166	22,763		22,763
Dome-Pan Am Agreement-Carried Interest	62,794	28,258		28,258
Other—Working Interest	12,720	11,448		11,448
Total Liard Basin	249,718	84,380		84,380
Arctic Islands				
Panarctic Agreements	3,602,673	2,905	852,794	855,699
Other	109,328		5,466	5,466
Overriding Royalty Interest	26,967		388	388
B.P. Sub-Farmout	58,659		6,328	6,328
Total Arctic Islands	3,797,627	2,905	864,976	867,881
TOTAL CANADA	4,377,443	129,901	869,211	999,112
AUSTRALIA				
Amadeus Basin	5,947,697		3,848	3,848
GRAND TOTAL	10,325,140	129,901	873,059	1,002,960

Arctic Island Properties Covered by Panarctic Agreements — June 30, 1981

Properties	Gross Acres	Interest retained by Canada Southern: Carried Interest	Net Acres
TriCeeTee Agreement			
Prince Patrick, Emerald, Melville, Vanier, Cameron, Ellef Ringnes, and Cornwall Islands	832,003	5.0% [1]	41,600
Canada Southern-Clark-Skelly Agreement			
Eight Bears Islands	57,210	6.0%	3,433
Canada Southern			
Ellesmere Island	22,482	15.0%	3,372
Sverdrup Basin Offshore Properties	2,690,978	30.0% [2]	807,294
Total	3,602,673		855,699

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

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

British Columbia and The Yukon & Northwest Territories Status of Carried Interest Agreements — June 30, 1981

	1980		1981		Cumulative to June 30, 1981			Company Interest	
	Gross Expenditures	Production Proceeds	Gross Expenditures	Production Proceeds	Gross Expenditures	Production Proceeds	Net Expenditures	%	Cost to Convert to a Working Interest
Pacific Agreement (B.C.)									
Ex-Permits 100-104	$ 1,506,425	$4,420,522	$ 2,987,424	$2,540,156	$24,006,726	$30,252,356	$ (6,245,630)	21.25	(1)
Ex-Permit 135	499,595	1,364,970	1,077,595	449,712	9,400,478	12,613,380	(3,212,902)	1.67	(2)
Phillips Agreement (B.C.)									
Ex-Permit 149	108,670	(2,193)	368,519	(10,740)	6,344,947	218,205	6,126,742	50.00	$ 3,063,371
Ex-Permit 178	149,736	1,429,607	95,435	1,836,052	3,742,732	11,637,181	(7,894,449)	27.75	(3)
Ex-Permit 224	283,836	2,506,866	235,877	2,303,427	8,336,957	25,617,510	(17,280,553)	27.75	(4)
Dome-Pan American Agreement (The Liard Basin)									
Ex. Ps. 1007,1132,1133	12,633,894	2,010,417	6,581,065		47,185,851	2,010,417	45,175,434	30.00	13,552,630
Ex. Ps. 1136,2713,1153	27,930		27,930		686,332		686,332	45.00	308,849
Ex. Ps. 1149,1156	13,451		13,453		1,195,239		1,195,239	45.00	537,858

(1) Ex-Permits 100-104 net proceeds from production became payable to the Company in March, 1978, and by June 30, 1981 the Company's share amounted to $1,327,196, including $619,246 in fiscal 1980 and nil in fiscal 1981.

(2) Ex-Permit 135 net proceeds from production became payable to the Company in January, 1977, and by June 30, 1981 the Company's share amounted to $53,549, including $14,423 in fiscal 1980 and nil in fiscal 1981.

(3) Ex-Permit 178 net proceeds from production became payable to the Company in July, 1970, and by June 30, 1981 the Company's share amounted to $2,165,538, including $348,672 in fiscal 1980 and $473, 364 in fiscal 1981.

(4) Ex-Permit 224 net proceeds from production became payable to the Company in December, 1968, and by June 30, 1981 the Company's share amounted to $4,754,987, including $609,580 in fiscal 1980 and $563,554 in fiscal 1981.

CONSOLIDATED BALANCE SHEET

(Expressed in Canadian dollars)
June 30, 1981 and 1980

Assets	1981	1980
Current assets:		
Cash	$ 76,209	$ 122,099
Term deposits	1,350,000	1,120,000
Accounts receivable and other current assets	244,715	262,029
Total current assets	1,670,924	1,504,128
Oil and gas properties, at cost, using the full cost method (Notes 1 and 2):		
Costs being amortized	5,466,986	5,368,373
Less accumulated amortization and depletion	1,859,118	1,633,004
	3,607,868	3,735,369
Costs not being amortized	4,415,768	4,349,539
	8,023,636	8,084,908
Mineral properties, at cost (Notes 1 and 2)	232,370	232,370
Equipment, at cost less accumulated depreciation of $56,584 and $51,360 at June 30, 1981 and 1980, respectively	14,545	19,769
Deferred charge	51,235	62,612
	$ 9,992,710	$ 9,903,787

Liabilities and Capital	1981	1980
Current liabilities:		
Accounts payable and accrued liabilities:		
Accrued legal	$ 166,397	$ 64,628
Other	117,686	152,907
Total current liabilities	284,083	217,535
Capital (Note 4):		
Capital stock, par value $1 per share: Authorized 15,000,000 shares; Outstanding 8,992,465 and 8,937,965 shares, respectively	8,992,465	8,937,965
Capital in excess of par value	14,982,543	14,764,543
	23,975,008	23,702,508
Accumulated deficit	(14,266,381)	(14,016,256)
Total capital	9,708,627	9,686,252
	$ 9,992,710	$ 9,903,787

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 *(Note 1)*

Canada Southern Petroleum Ltd.
(A Nova Scotia corporation)

(Expressed in Canadian dollars)

	Year ended June 30, 1981	1980	1979
Income:			
Proceeds under carried interest agreements (Note 2)	$ 1,137,513	$ 1,593,050	$ 1,468,691
Interest	158,095	96,565	56,303
Oil and gas sales	244,010	262,687	223,903
Gains on sales of equipment and properties	2,248	—	—
	1,541,866	1,952,302	1,748,897
Costs and expenses:			
General and administrative (Notes 3 and 5)	1,424,038	1,090,169	858,197
Depletion, depreciation and amortization	231,338	259,643	230,471
Lease operating costs	69,071	42,221	36,478
Write-off of investments	—	(32,648)	(15,994)
Rent	67,544	58,006	41,569
Abandonments (Note 2)	—	—	203,702
	1,791,991	1,417,391	1,354,423
Income (loss) before taxes on income and extraordinary item	(250,125)	534,911	394,474
Provision for taxes on income (Note 6)	—	205,000	209,000
Income (loss) before extraordinary item	(250,125)	329,911	185,474
Tax benefit realized from carryforward of exploration, development and lease acquisition costs not claimed in prior years (Note 6)	—	205,000	209,000
Net income (loss)	(250,125)	534,911	394,474
Accumulated deficit—beginning of year	(14,016,256)	(14,551,167)	(14,945,641)
Accumulated deficit—end of year	$ (14,266,381)	$ (14,016,256)	$ (14,551,167)
Average number of shares outstanding	8,971,234	8,904,427	8,873,619
Per share based on average number of shares outstanding during the period:			
Income (loss) before extraordinary item	$(.03)	$.04	$.02
Extraordinary item	—	.02	.02
Net income (loss)	$(.03)	$.06	$.04

See accompanying notes.

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

(Expressed in Canadian dollars)

	Year ended June 30, 1981	1980	1979
Sources of working capital:			
Net income (loss)	$ (250,125)	$ 534,911	$ 394,474
Charges (credits) to income not involving outlay of working capital:			
Depreciation, depletion and amortization	231,338	259,643	230,471
Abandonments	—	—	200,211
Working capital (used in) provided by operations	(18,787)	794,554	825,156
Exercise of stock options	272,500	256,749	137,600
	253,713	1,051,303	962,756
Disposition of working capital:			
Additions to oil, gas and mineral properties	164,842	607,236	627,573
Decrease in bank loan (noncurrent)	—	—	248,000
Deferred charge	(11,377)	(24,690)	87,302
Other	—	3,276	8,769
	153,465	585,822	971,644
Increase (decrease) in working capital	$ 100,248	$ 465,481	$ (8,888)
Increase (decrease) in working capital by component:			
Cash	$ (45,890)	$ 22,390	$ 15,587
Term deposits	230,000	385,025	410,000
Accounts receivable and other current assets	(17,314)	(70,025)	(403,297)
Bank loan payable	—	—	144,000
Accounts payable and accrued liabilities	(66,548)	128,091	(175,178)
Increase (decrease) in working capital	$ 100,248	$ 465,481	$ (8,888)

CONSOLIDATED STATEMENT OF CAPITAL STOCK AND CAPITAL IN EXCESS OF PAR VALUE

(Expressed in Canadian dollars)
Three years ended June 30, 1981

	Number of shares	Capital stock, $1 par value	Capital in excess of par value	Total
Balance at June 30, 1978	8,851,465	$8,851,465	$14,456,694	$23,308,159
Exercise of stock options	32,000	32,000	105,600	137,600
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	8,992,465	$8,992,465	$14,982,543	$23,975,008

See accompanying notes.

(Expressed in Canadian dollars)
June 30, 1981

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 subsidiary, Canpet, Inc., hereafter referred to collectively as the Company.

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 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 amortized pending the commencement of payouts, if any, of the Company's carried interests in those major development projects (see Note 2).

Acquisition costs, exploration and development expenditures and other costs related to mineral properties are capitalized until such time as it is determined whether commercially exploitable reserves exist. Costs associated with properties which are determined to be unsuccessful or are abandoned are charged to income. Costs associated with commercially exploitable prospects will be amortized, depleted, and depreciated on the unit-of-production method.

Depreciation has been provided 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 amortization of intangible drilling costs pertaining to producing wells are computed by the unit-of-production method.

Transactions for settlement in U.S. dollars have been converted at average monthly exchange rates. Current assets and current liabilities in U.S. dollars have been translated at the year-end exchange rate. During the three years ended June 30, 1981, exchange gains and losses have not been significant.

For Canadian income tax purposes, the Company may claim as a tax deduction, exploration, development and lease acquisition costs in the year incurred, and capital cost allowances (depreciation) in amounts which may exceed those provided in the accounts (see Note 6).

2. Properties and related exploratory and other expenses

Oil and gas properties by cost center are as follows:

	1981	1980
Canada:		
Costs being amortized	$5,466,986	$5,368,373
Less accumulated amortization	1,859,118	1,633,004
	3,607,868	3,735,369
Costs not being amortized:		
Arctic Islands	2,860,800	2,794,571
Kotaneelee Area	1,431,464	1,431,464
Total	7,900,132	7,961,404
Australia:		
Costs not being amortized	123,504	123,504
	$8,023,636	$8,084,908

Current valuations of proved reserves exceed related book value plus expected development costs.

Amounts represented by oil and gas properties and mineral properties, aggregating $3,216,674 and $3,150,445 at June 30, 1981 and 1980, respectively, are substantially unexplored or undeveloped.

Costs incurred in oil and gas producing activities (all in Canada) in which the Company has working interests were as set forth in the table below.

These costs exclude costs relating to carried interests.

Amortization and depletion expense per equivalent physical unit of production for fiscal 1981 was $.77, and for fiscal 1980 was $.72.

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.

At June 30, 1981, 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

Year ended June 30,	*Property acquisition costs*	*Exploration costs*	*Development costs*	*Production costs*	*Aggregate depreciation depletion, amortization and valuation provisions*
1979	—	$714,485	$ 20,163	$36,478	$222,668
1980	—	$271,348	$335,888	$42,221	$254,330
1981	—	$140,306	$ 24,536	$69,071	$226,114

(Expressed in Canadian dollars)
June 30, 1981

Company until expenditures by the operators have been recouped from production. Also, the Company may at any time elect to convert its position from a carried interest to a working interest by paying its share of the expenditures not recouped by profits from production. At June 30, 1981 and 1980, the accumulated expenditures by the operators attributable to all of the Company's carried interests in these areas exceeded the amounts recouped from production by approximately $18,550,000 and $15,300,000, respectively. 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 $1,129,724, $958,252 and $1,036,908 for the three years ended June 30, 1981, which amounts have been credited to income. In the same periods, the Company received income of $338,967, $634,809 and $100,605, respectively, from other carried interests which have also reached payout status.

The Company has a 30% carried interest in the Kotaneelee Field in the Yukon Territory. Four wells have been completed. The original discovery well was drilled in 1964 and required a significant amount of rework, which was completed in 1979. Approval has been granted by the Canadian National Energy Board to export a maximum of 84.5 billion cubic feet (bcf) from the Kotaneelee Field over a period of eight years. During the first five years, the maximum amount will be 13 bcf per year or 39.2 million cubic feet per day. Authorization by United States authorities for importation of this gas has not yet been received, principally because of objections to the percentage stipulated under the so-called "take or pay" provisions of the gas sales contract. In addition, the combination of proposed tax increases in the Canadian Budget and the depressed export market to the United States may adversely affect the amount and timing of the Company's projected income from the field. (See Note 7.)

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 5% to 30%. As a result of negotiations with Panarctic initiated in 1981, during fiscal 1982 the Company anticipates expenditures of approximately $1.5 million in connection with property acquisitions in this region.

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. An application has been made to Revenue Canada to determine whether the plan will provide the desired tax benefits to the shareholders.

The Company has an interest in 5,947,697 gross (3,848 net) acres in the Amadeus Basin in the Northern Territory in Australia.

3. The Catawba Corporation (Catawba) and related matters

During the years prior to fiscal 1979, Catawba performed financial, technical and other services for the Company. By virtue of Catawba's contracts with Canada Southern and the services Catawba performed pursuant thereto, and the fact that certain officers and directors of Canada Southern were also officers, directors or shareholders of Catawba, Catawba may have been deemed a "parent" of and to "control" Canada Southern, as such terms are defined in the Securities Act of 1933, as amended. By agreement between Canada Southern and Catawba dated May 10, 1978, the parties agreed to terminate as of May 31, 1978 their contract dated as of August 1, 1973. Certain of the directors, officers and employees of Catawba who were also directors or officers of Canada Southern have severed their relationships with Catawba. In view of the termination of the Catawba contract and the severing of these relationships, the Company believes that the statement that Catawba may be "deemed to be a 'parent' of and to 'control' Canada Southern" is no longer applicable.

The Company has been advised by the Staff of the Securities and Exchange Commission (the "Commission") that, based upon the results of the private investigation of the Company and certain others commenced in 1978 by the Staff of the Commission, the Commission has authorized the filing of an action for a civil injunction against the Company, Catawba, Catawba's former clients, and certain former directors and officers of Catawba, including Mr. Benjamin W. Heath and John W. Buckley, directors of the Company. The Company has entered into discussions with the Staff of the Commission with a view towards settling the action. In this connection, the Board of Directors of the Company authorized the Company to make an offer of settlement to the Commission. The Company believes that an agreement in principle on the terms of a settlement has been reached subject to approval by the Company's Board of Directors and the Commission.

The Commission intends to seek injunctive relief against all of the parties to be named in the Commission's proposed action, including the Company, under various sections of the Federal securities laws. In addition, the Commission intends to seek repayment by Catawba and the individuals to be named as defendants of certain amounts received from the Catawba clients, including the Company. The Company

3. The Catawba Corporation (Catawba) and related matters (continued)

may be a beneficiary of a portion of these payments, if any.

The agreement in principle includes the signing of a consent decree and an undertaking to appoint a special committee of outside directors to conduct a review of the transactions referred to in the Commission's proposed action and to take such action as the special committee may deem appropriate on behalf of the Company in light of such committee's findings. The Company will also undertake to appoint a second committee of outside directors to review and determine the fairness of future transactions between the Company and the individuals and corporations proposed to be named in the Commission's action and any other persons associated with the Company's management. The Company believes that the proposed settlement will not have a material adverse effect on the Company's business or financial position, although there is no assurance that the proposed settlement will become effective.

4. Capital and stock options

Stock options outstanding at June 30, 1981 are summarized in the table below.

The options granted May 11, 1979, May 12, 1980 and March 27, 1981 were granted under an incentive option plan on 300,000 shares adopted by the Board of Directors on December 13, 1978. All options were exercisable on the date of grant. There were 146,000 and 156,000 shares reserved for future option grants at June 30, 1981 and 1980, respectively. 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 $256,250, 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.

On June 9, 1981, certain directors of the Company were granted options on 20,000 shares at $12.50 per share. These options were 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 two years ended June 30, 1981.

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. 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 $33,957, $33,867 and $25,595 for the three years ended June 30, 1981. During 1981, the Company entered into an agreement with four 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 three years ended June 30, 1981 amounted to $84,519, $100,849 and $110,905, respectively. Of these amounts, $23,531, $33,446 and $37,718 were for directors' fees.

6. Income taxes and extraordinary item

The amount of income tax expense for fiscal 1979 is higher than the amount computed by multiplying pretax income by the statutory Canadian rate of 46% due to nondeductible mineral costs which were charged to abandonments for financial reporting purposes. This was partially offset by statutory deductions for depletion and resource allowances. For fiscal 1980, the amount of income tax expense is lower than the amount computed due to similar deductions for depletion and resource allowances.

For the two years ended June 30, 1980, the Company realized tax benefits of $209,000 and $205,000, respectively, for Canadian income tax purposes

				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
Officer	3/27/81	3/26/86	10,000	10.87	108,700	10.87	108,700
Directors	6/09/81	6/08/86	20,000	12.50	250,000	12.50	250,000
			87,500		$1,116,200		$1,116,200

(Expressed in Canadian dollars)
June 30, 1981

from carryforward of exploration, development and lease acquisition costs not claimed in prior years. At June 30, 1981, the following amounts remained to be carried forward indefinitely to reduce future taxable income:

Drilling, exploration and lease acquisition costs	$13,226,272
Undepreciated capital costs	481,215
Capital losses (can only be used against future years capital gains)	150,000

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

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

The following information has been supplied in compliance with regulations prescribed by the Securities and Exchange Commission (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.

Proved undeveloped reserves have been excluded from the amount of proved reserves for 1981 in item (b) below. Reserve estimates for prior years have not been restated. Items (d) and (e) have been restated for fiscal 1980 to reflect refinements in computing amount of other costs net of income and development costs which are reported in these summaries.

(a.) Revenues from producing oil and gas:

Year ended June 30,	
1979	$1,692,594
1980	1,855,736
1981	1,381,523

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

	Oil (bbls.)	*Gas (bcf)*
Proved reserves:		
July 1, 1978	471,001	52.822
Revisions of previous estimates	295,205	(2.170)
Extensions, discoveries and other additions	—	—
Production	(81,481)	(1.980)
June 30, 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)
Extensions, discoveries and other additions	—	—
Production	(68,681)	(1.540)
June 30, 1981	580,049	61.444
Proved developed reserves:		
July 1, 1978	471,001	37.622
June 30, 1979	684,725	33.595
June 30, 1980	679,740	54.070
June 30, 1981	580,049	61.444

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

(i.) Estimated future net revenues:

	For the fiscal year ended 6/30/82	*For the fiscal year ended 6/30/83*	*For the fiscal year ended 6/30/84*	*For the remaining fiscal years for which reserves are projected*
Proved reserves	$4,490,000	$11,633,000	$16,882,000	$176,096,000
Proved developed reserves	4,490,000	11,633,000	16,882,000	176,096,000

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

	Proved reserves	*Proved developed reserves*
June 30, 1979	$ 31,908,000	$ 24,599,000
June 30, 1980	$ 86,252,000	$ 82,419,000
June 30, 1981	$104,209,000	$104,209,000

Current prices used in the foregoing estimations were based upon selling prices at the wellhead in June, 1981. Current costs were based upon estimates made by consulting engineers in June, 1981. 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 in (c.) (i.) above by years is significantly different from previous projections because of unanticipated delays in receiving approval by United States authorities. The above amounts were calculated based upon a start-up date of November 1, 1981, but the Company has no assurance that the target date will be met.

During 1980 the present value of estimated future net revenues from proven 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 proposed 8 percent Canadian Petroleum and Gas Revenue Tax.

7. Oil and gas revenue and reserve information (unaudited) (continued)

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

	1980	1981
	(Thousands of dollars)	
Additions and revisions to estimated proved reserves:		
Additions to estimated proved reserves	$23,169	$ —
Revisions to estimates of reserves proved in prior years:		
Changes in prices	34,753	19,359
Other	—	(114)
Subtotal	57,922	19,245
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
	3,390	1,471
Net additions	54,532	17,774
Provision for income taxes*	26,000	8,500
Results of oil and gas producing activities on the basis of RRA	$28,532	$ 9,274

*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 change in present value of estimated future net revenues:

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

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, 1981 and 1980 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, 1981. 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 financial statements mentioned above present fairly the consolidated financial position of Canada Southern Petroleum Ltd. at June 30, 1981 and 1980, the consolidated results of operations, changes in financial position and changes in capital stock and capital in excess of par value for each of the three years in the period ended June 30, 1981, in conformity with generally accepted accounting principles applied on a consistent basis during the period.

ARTHUR YOUNG, CLARKSON, GORDON & CO.

Hartford, Connecticut
September 18, 1981

Liquidity and Capital Resources

As of June 30, 1981, Canada Southern had working capital in the amount of $1,386,841.

Nearly all of the Company's property interests are covered by carried interest agreements, which stipulate that expenditures are made by the operator of a property and are recouped solely from production revenues. Hence the only significant demands upon Canada Southern's capital resources relate to property acquisitions upon the exercise of "after-acquired" rights, such as the Whitefish acquisition discussed on page 4. Approximately $1.5 million has been allocated for use in connection with the exercise of after-acquired rights during fiscal 1982, to be funded out of existing working funds or, if necessary, through bank financing. The Company is presently exploring the availability of loan funds with certain Canadian banks, which loans may be secured by the Company's properties.

Some of the properties in which Canada Southern has carried interests have reached pay-out status. This is the source of a major portion of the Company's working capital. Other sources of working capital are oil and gas sales and interest income. The latter will be reduced as funds are expended for property acquisitions.

1981 vs. 1980

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

General and administrative expenses were higher as a result of the increased legal costs attributable to the SEC investigation of the Company as well as higher accounting fees, salaries, shareholder-related expenses, travel costs, and business taxes, resulting, in part, from inflation.

1980 vs. 1979

Proceeds from carried interest agreements and oil & gas sales were higher in 1980 as a result of improved prices. Interest income increased due to the increased availability of investment funds.

General and administrative expenses increased in 1980, principally because of higher shareholder-related expenses. In both fiscal 1980 and the prior year, the Company made partial recoveries relating to an investment in a project that previously had been written off.

The Company paid no income taxes in 1980 as a consequence of the loss-carry forward of exploration, development, and lease acquisition costs not claimed in prior years.

1979 vs. 1978

The Company recorded its second consecutive profitable year in 1979, although revenues were down slightly as a consequence of weak demand for oil and gas and refinery shutdowns early in the year. Interest income rose as a result of higher interest rates and an increase in the amount invested in time deposits.

Increases in salaries and employee benefits as well as higher legal and shareholder-related expenses resulted in higher general and administrative expenses in 1979. Lease operating costs increased due to inflationary pressures. Also, depletion, depreciation, and amortization allowances were higher in 1979 because higher-cost properties were added to the amortization base.

The Company made a partial recovery relating to an investment in a project that previously had been written off. Abandonments included a mineral project in Saskatchewan.

MARKET PRICE AND VOLUME INFORMATION

Canada Southern's 8,992,465 shares of outstanding capital stock are listed on the Toronto and Montreal stock exchanges 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 **Pacific Stock Exchange** for calendar year 1980 was 16,756,100 shares as compared to 5,706,800 shares during 1979. The quarterly price range *(expressed in U.S. dollars)* for these shares in 1980 and 1981 was as follows:

	1980		*1981*	
	High	*Low*	*High*	*Low*
1st Quarter	26 5/8	9	10 3/4	7 1/2
2nd Quarter	16 1/4	11	12 7/8	8
3rd Quarter.....	19 1/8	12 7/8	10	4 1/4
4th Quarter.....	16 7/8	8 3/4	—	—

On the **Toronto Stock Exchange,** the total sales volume in 1980 amounted to 3,794,361 shares as compared to 7,676,377 shares in the prior year. The quarterly price range *(in Canadian dollars)* for these shares in 1980 and 1981 was as follows:

	1980		*1981*	
	High	*Low*	*High*	*Low*
1st Quarter	22	15 1/8	12 3/4	9 1/8
2nd Quarter	20	16 3/8	15 3/8	9 1/2
3rd Quarter.....	22	15 7/8	12 1/4	5 1/4
4th Quarter.....	20	10 3/4	—	—

SELECTED FINANCIAL DATA

	Fiscal Year ended June 30, 1981	1980	1979	1978	1977
Revenues	$ 1,541,866	$ 1,952,302	$ 1,748,897	$ 1,874,842	$ 391,297
Net income (loss)	$ (250,125)	$ 534,911	$ 394,474	$ 820,982	$ (847,432)
Income (loss) per share	$ (.03)	$ .06*	$ .04*	$ .09*	$ (.10)
Working capital	$ 1,386,841	$ 1,286,593	$ 821,112	$ 830,000	$ 136,949
Total assets	$ 9,992,710	$ 9,903,787	$ 9,240,218	$ 8,924,967	$ 8,069,396
Average number of outstanding shares	8,971,234	8,904,427	8,873,619	8,851,465	8,810,273
Stockholders' equity:					
Capital stock	$ 8,992,465	$ 8,937,965	$ 8,883,465	$ 8,851,465	$ 8,764,965
Capital in excess of par value	14,982,543	14,764,543	14,562,294	14,456,694	14,365,740
Accumulated deficit	(14,266,381)	(14,016,256)	(14,551,167)	(14,945,641)	(15,766,623)
	$ 9,708,627	$ 9,686,252	$ 8,894,592	$ 8,362,518	$ 7,364,518

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

CANADA SOUTHERN
PETROLEUM LTD.

Printed in U.S.A.