Canada Southern Petroleum Ltd.

Annual Report 1978

Canada Southern Petroleum Ltd.

Directors and Executive Officers

John W. Buckley, *Chairman of the Board, President and Director*
President and a Director of United Canso Oil & Gas Ltd. and Pantepec International, Inc.; and a Director of Coastal Caribbean Oils & Minerals, Ltd., and Pancoastal, Inc.

M. A. Reasoner, *Technical Advisor to the Chairman of the Board and Director*
Associated with Canada Southern Petroleum Ltd. since its formation, he served as Vice President and General Manager until 1971.

John W. Bush, *Director*
Vice President of Coastal Petroleum Company, and served as Chairman of the Interstate Commerce Commission and special advisor to the United States Senate Commerce Committee.

Thomas W. Donlon, *Director*
Director of Pantepec International, Inc. and Pancoastal, Inc., and until his retirement in 1967 was Vice President in charge of foreign production for American Overseas Petroleum, Ltd.

Benjamin W. Heath, *Director*
President and a Director of Coastal Caribbean Oils & Minerals, Ltd. and Magellan Petroleum Corporation; Chairman and a Director of Magellan Petroleum Australia Limited, and a Director of United Canso Oil & Gas Ltd.

Charles J. Horne, *Vice President*
Associated with Canada Southern Petroleum Ltd. since 1950, was elected Vice President in July 1976.

Arthur B. O'Donnell, *Vice President*
President and a Director of Pancoastal, Inc. and a Vice President of Coastal Caribbean Oils & Minerals, Ltd., Magellan Petroleum Corporation, Pantepec International, Inc., and United Canso Oil & Gas Ltd.

K. E. Noble, *Treasurer*
Associated with Canada Southern Petroleum Ltd. since 1955, was elected Treasurer in September 1975.

Paul A. Giesinger, *Secretary*
Associated with Canada Southern Petroleum Ltd. since 1954, was elected Secretary in February 1977.

Auditors
Arthur Young, Clarkson, Gordon & Co.

Transfer Agents
First Jersey National Bank
2 Montgomery Street
Jersey City, N.J. 07303, U.S.A.

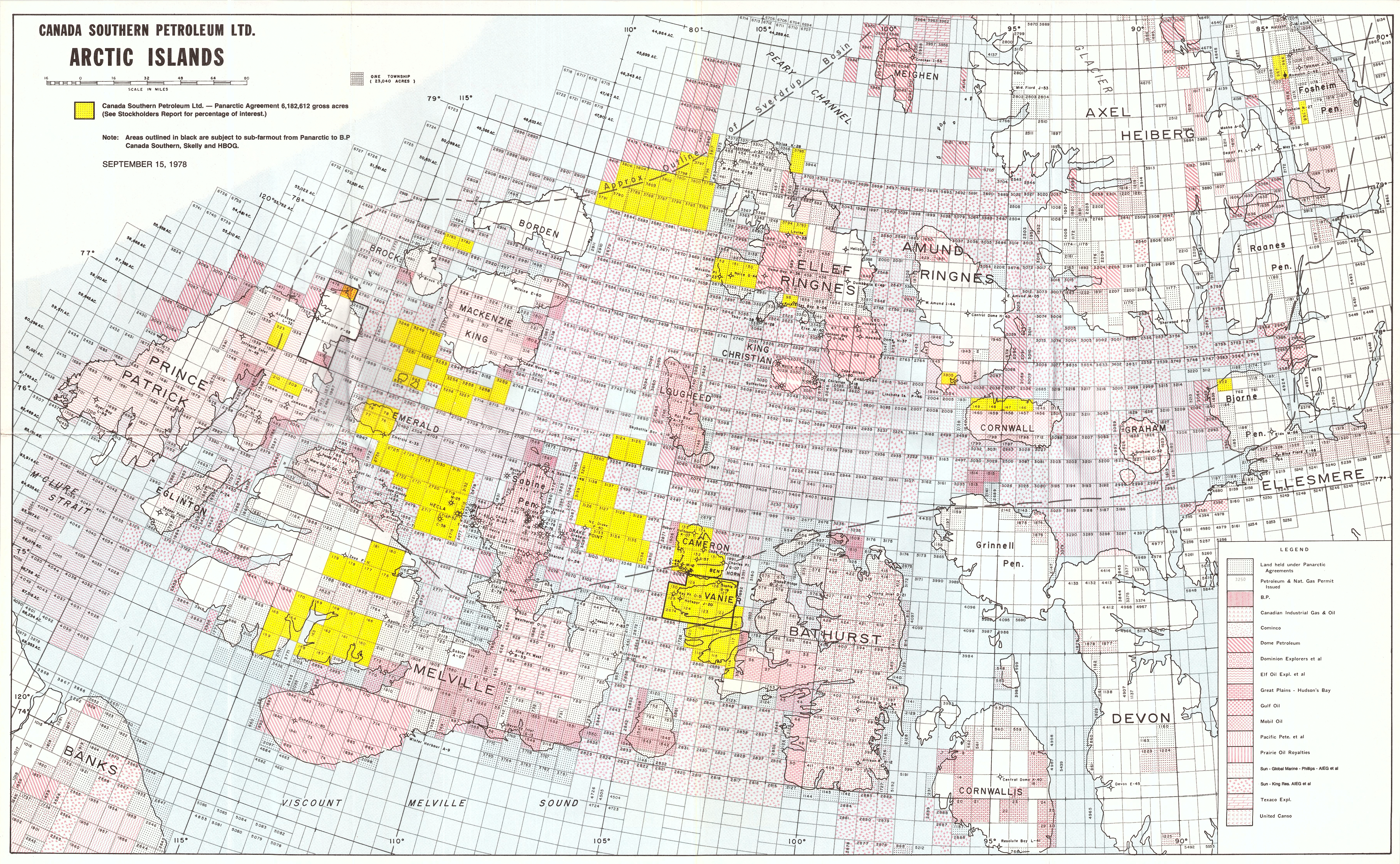
Montreal Trust Company
15 King Street West
Toronto, Ontario, Canada M5H 1B4

United California Bank
Box 3667 Terminal Annex
Los Angeles, Calif. 90051, U.S.A.

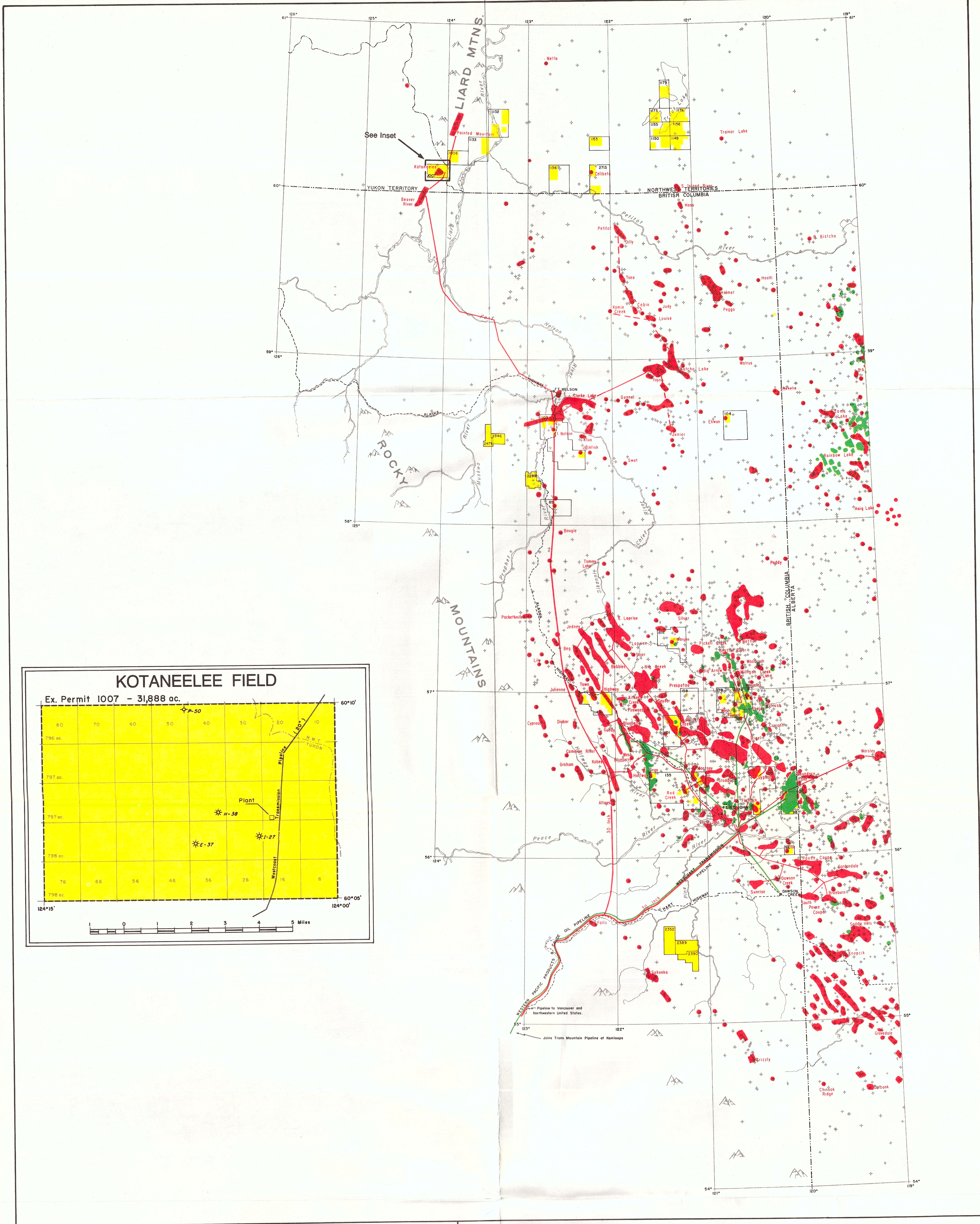
Canada Southern's capital stock is listed for trading on the Montreal, Toronto, Boston and Pacific stock exchanges. Symbol: CSW. The Company's shares also are traded in the NASDAQ over-the-counter market. Symbol: CSPEF.

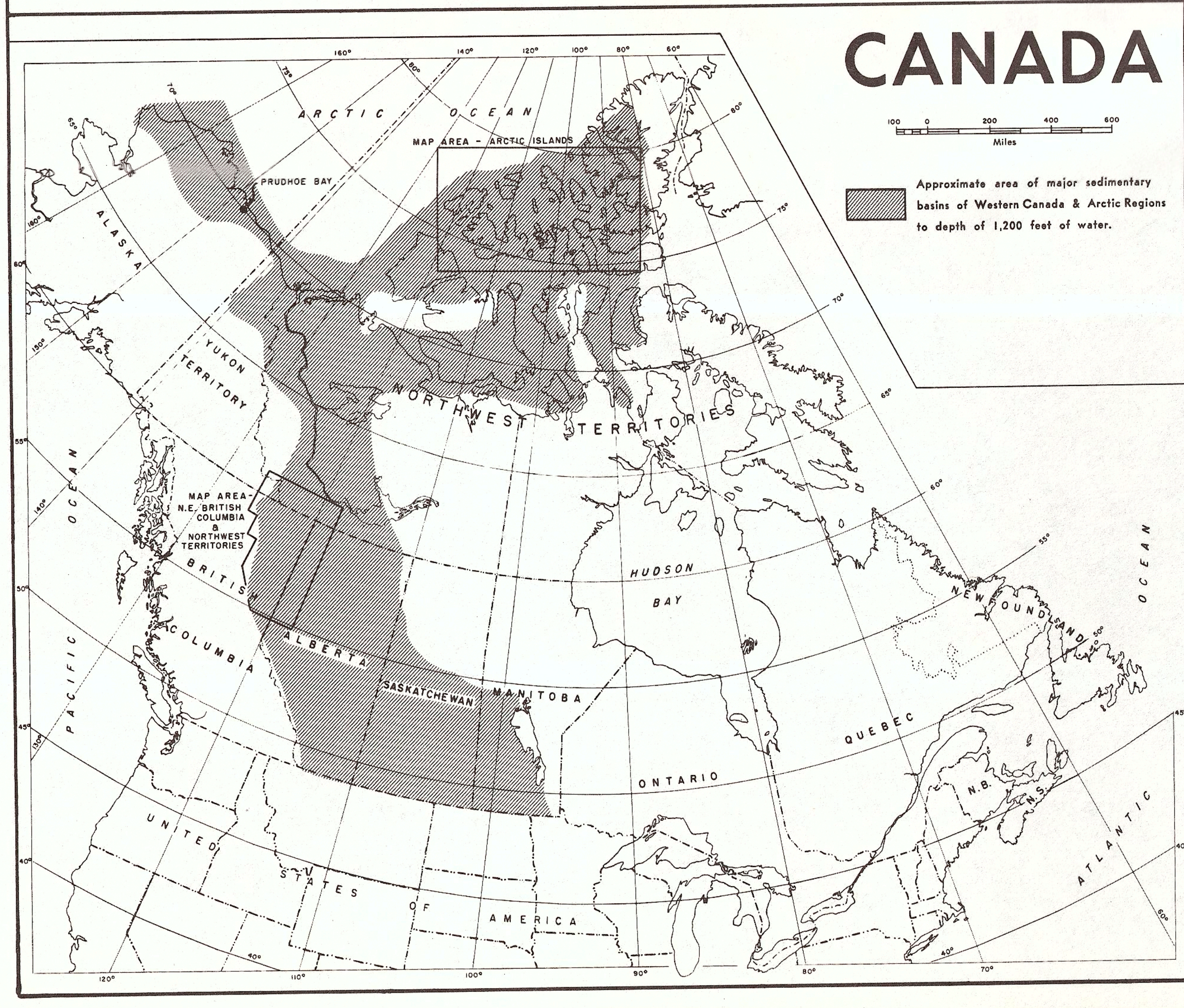
Inquiries or requests for additional information concerning Canada Southern Petroleum Ltd. should be addressed to the Company in care of First Jersey National Bank, P.O. Box 960, Jersey City, N.J. 07303, U.S.A., or to 505 Eighth Avenue South West, Calgary, Alberta, Canada T2P 1G2.

About the Cover—Aerial view of the Kotaneelee YT E-37 location, a development well in the Kotaneelee gas field in Canada's Yukon Territory. This is the third successful gas well to have been drilled on the 31,888-acre Kotaneelee block in which Canada Southern has a 30 percent carried interest.
Photo courtesy Columbia Gas Development of Canada Ltd.



CANADA SOUTHERN PETROLEUM LTD.
ARCTIC ISLANDS
SCALE IN MILES
ONE TOWNSHIP (23,040 ACRES)
Canada Southern Petroleum Ltd. — Panarctic Agreement 6,182,612 gross acres
(See Stockholders Report for percentage of interest.)
Note: Areas outlined in black are subject to sub-farmout from Panarctic to B.P. Canada Southern, Skelly and HBOG.
SEPTEMBER 15, 1978
PRINCE PATRICK
EGLINTON
M'CLURE STRAIT
BANKS
MELVILLE
EMERALD
MACKENZIE KING
BROCK
BORDEN
HECLA
Sabine Pen.
DRAKE POINT
CAMERON
BENT HORN
VANIER
BATHURST
LOUGHEED
KING CHRISTIAN
ELLEF RINGNES
AMUND RINGNES
MEIGHEN
PEARY CHANNEL
SVERDRUP CHANNEL
Approx. Outline of Sverdrup Basin
AXEL HEIBERG
Fosheim Pen.
Raanes Pen.
Bjorne Pen.
GRAHAM
CORNWALL
ELLESMERE
Grinnell Pen.
DEVON
CORNWALLIS
VISCOUNT MELVILLE SOUND
LEGEND
Land held under Panarctic Agreements
Petroleum & Nat. Gas Permit Issued
B.P.
Canadian Industrial Gas & Oil
Cominco
Dome Petroleum
Dominion Explorers et al
Elf Oil Expl. et al
Great Plains - Hudson's Bay
Gulf Oil
Mobil Oil
Pacific Pete. et al
Prairie Oil Royalties
Sun - Global Marine - Phillips - AIEG et al
Sun - King Res. AIEG et al
Texaco Expl.
United Canso





HOLDINGS OF
CANADA SOUTHERN PETROLEUM LTD.

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

SEPTEMBER 15, 1978

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Chairman's letter

To the Shareholders:

In addressing the Company's Annual Meeting in Calgary last February, I expressed my concept of Canada Southern as that of a Four-Phase company. The First Phase, survival and land acquisition, I said lay behind us. The Second Phase was described as one in which the generation of field income would be sufficient not only to meet all expenses but to achieve profitability. That is our present position. I categorized Phase Three as one in which substantial field revenue would begin to be credited to our account as soon as production begins in the southern Yukon, which now seems virtually certain to occur during fiscal 1979. Finally, I envisaged Phase Four as one in which our holdings in the Canadian Arctic area would begin to yield very significant income. It is my expectation that we will achieve this fourth growth phase as soon as our Hecla field gas reserves go to market, in all likelihood sometime in the early to mid-1980's.

The Company's prospects for continued strong growth were greatly enhanced with the completion in December 1977 of a major gas well on our former Permit 1007 in the southern Yukon and located one and one-quarter miles northwest of Canada Southern's 1964 suspended gas discovery which presently is being reworked in preparation for sales to the pipeline. The Kotaneelee YT H-38 success, drilled by Columbia Gas Development of Canada Ltd., as operator for the Canada Southern group, flowed gas in initial tests at a rate of 20 million cubic feet per day through a restricted choke from approximately the top one-fifth of the 1,156 feet of indicated productive zone that was penetrated. Canada Southern holds a 30 percent, carried interest in both the Kotaneelee gas field and the surrounding 31,888-acre permit.

The Kotaneelee YT E-37 follow-up step-out well, recently drilled to a depth of 13,750 feet at a location one and one-quarter miles south-southwest of the H-38 well, encountered surprising and significant new developments. First, the well fell low on structure and from preliminary testing at the bottom, penetrated over 900 feet of gross pay zone without encountering water. This establishes that the Kotaneelee field will be productive some 600 feet deeper than some technical factors had indicated. Second, and of equal or even greater importance, was the finding that a near-reef-type porosity exists over most of the pay zone, revealing higher porosity than was encountered in other area wells. Both of these factors will result in increased reserves. Only future drilling will develop the information needed to estimate reserves with reasonable accuracy.

At the time of this writing preparations are under way to complete the well in the top 400 feet of the more prolific section.

The substantial increase in recoverable reserves indicated by the YT E-37 success will be reflected in increased gas sales under the marketing contract currently being negotiated by the Kotaneelee field partners with Westcoast Transmission Company Limited, in that sales are tied to reserves as these are established. Westcoast's 20-inch pipeline extension to the southern Yukon, with excess capacity of over 75 million cubic feet per day, crosses the tract on which the Kotaneelee field is located. Production into this line is expected to commence in November 1978 at an initial rate of 35 million cubic feet per day. An estimated wellhead price of $1.90 per thousand cubic feet is indicated, with provisions for increases tied to proven reserves as these are established. As a 30-percent, carried-interest partner, Canada Southern is not required to expend any funds to pay costs related to exploration and field development but will begin to participate in field income once such costs, borne by the working-interest partners, have been recovered out of production revenues.

Again, referring to my comments at the last Annual Meeting of Shareholders, you will note I looked upon Phase Four of the Company's projected growth pattern as one in which the Arctic Islands' properties would begin to yield very significant income. The eventual realization of this latter goal received major impetus during the past year with a successful demonstration by the Panarctic Oils Ltd. consortium

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DEC 11 1978
McGILL UNIVERSITY

that offshore wells in the ice-covered Arctic Ocean indeed can be completed and produced. The Drake F-76 offshore well, drilled in the spring of 1978, was completed, connected to shore by a flow line, and successfully tested to prove the technology for completing and producing offshore gas wells below the ocean ice.

The marketing of such gas was the subject of applications filed this past year by Polar Gas Limited, sponsor of the project to deliver Arctic Islands' gas by large-diameter pipeline to southern markets. Additional hearings on the applications are expected later this year; meantime, Petro-Canada, the Canadian national oil company, and associates, Alberta Gas Trunkline Co., Ltd. and Melville Shipping Ltd., are participants in a project which aims to establish early in the 1980's the world's most northerly plant to liquefy Arctic Islands' gas and ship it south by ice-breaking tankers.

The opportunities, therefore, for Canada Southern's continued strong growth, we believe, are indeed promising. The Company, through its judicious land acquisitions, extending over the past two decades and more, finds itself today in a particularly favored position. The realization of increased earnings from our British Columbia oil and gas properties, the near-term outlook for earnings growth based on anticipated production of gas from the Kotaneelee field in the southern Yukon, and the potential for future development and marketability of our Arctic Islands' gas reserves, all reinforce the Company's prospects for sound progress in the years ahead.

It is gratifying to report that fiscal 1978 marked the year in which your Company moved into a position of profitability, an achievement of which we are justly proud. Revenues for the fiscal year ended June 30, 1978, at $1,874,842, were up 379 percent from the $391,297 received in the previous year. Net income for fiscal 1978 amounted to $938,417, equal to 11¢ per share, compared with a loss the prior year of $748,442, or 8¢ per share.

The increased revenues realized in fiscal 1978 reflected, in part, net proceeds from carried-interest agreements on British Columbia properties, unencumbered by the previous year's charges for expenditures related to improved productivity on the lands. In addition, the Company's accounts during the year began to reflect the attainment of payout status of still other acreage blocks in British Columbia. Finally, oil and gas sales and royalty income in fiscal 1978 benefited from both increased production and higher prices.

We wish here to express our sincere thanks to Columbia Gas Development of Canada Ltd. and Panarctic Oils Ltd. for their cooperation in the preparation of this year's report. To our shareholders, employees, and the many others whose interest and support have contributed to Canada Southern's past progress, as well as to all who share our commitment to the Company's future growth, we extend our grateful appreciation.

On behalf of the Board of Directors,

John W. Buckley

John W. Buckley
Chairman

Calgary, Alberta
October 31, 1978

Photo, courtesy of Panarctic Oils Ltd.

Review of Operations

PETROLEUM

Arctic Islands

The attractive exploration area of the Sverdrup Basin in the Arctic Islands comprises some 15 percent land and 85 percent ocean which is covered with ice most or all of the year. As a result, early exploration work was limited to land areas until technology was sufficiently developed to permit both drilling and seismic operations to be carried out under the adverse conditions which prevail in the offshore areas. At an early stage it became evident that onshore discoveries would extend to offshore areas. Panarctic Oils Ltd., a consortium composed of federally financed Petro-Canada (Canada's national oil company) and some 30 individuals and oil and gas and mining companies, initiated studies and programs for the development of offshore drilling techniques. These studies led to the introduction of winter drilling from artificially thickened sea-ice platforms. Such exploratory wells, most of which contained prolific amounts of hydrocarbons, were later abandoned as expendable since completion methods under ocean ice had not yet been perfected.

To date, 11 wells have been drilled from ocean-ice platforms, eight of which encountered gas, with only three having been abandoned as dry holes. Of the eight wells which encountered gas, four were drilled on Canada Southern's 751,070-acre carried-interest block (CSP, 30%), on which most of the prolific Hecla gas field is located. The first well to be drilled under such conditions was one of the four that established an eight-mile westward extension of the Hecla field into the offshore areas. Hecla and its "sister" Melville Island Drake Point field are now considered to be the two largest gas fields in all of Canada.

Drake F-76 Subsea Completion

During the past winter drilling season (1977-78), Panarctic, by far the largest operator and landholder in the Arctic Islands, drilled three wells from ice platforms. One of these, Cape Grassy I-34, drilled only three and one-half miles southwest of Canada Southern's Hecla block, was abandoned with no reported hydrocarbons. Another, the Roche Pt. O-43 well, located some 15 miles east-northeast of the Hecla block, resulted in a gas discovery which is known as the Roche Point field. The third offshore test, Drake Point F-76, was a development well in the Drake Point field. This well, located 4,000 feet from shore in some 200 feet of water off the east coast of the Sabine Peninsula, was selected to test Panarctic's newly designed underwater completion and control equipment. The wellhead is placed on the ocean floor beneath the Arctic ice and is controlled by means of a conduit containing flow lines and control mechanisms, which extends along the ocean floor to a shore station. Tests using this new equipment flowed gas at the rate of 76 million cubic feet per day. Since most of the gas reserves thus far established have been found in offshore areas—a pattern which is expected to continue—the door appears to have been opened for the development of Arctic Islands' fields as soon as marketing arrangements are completed.

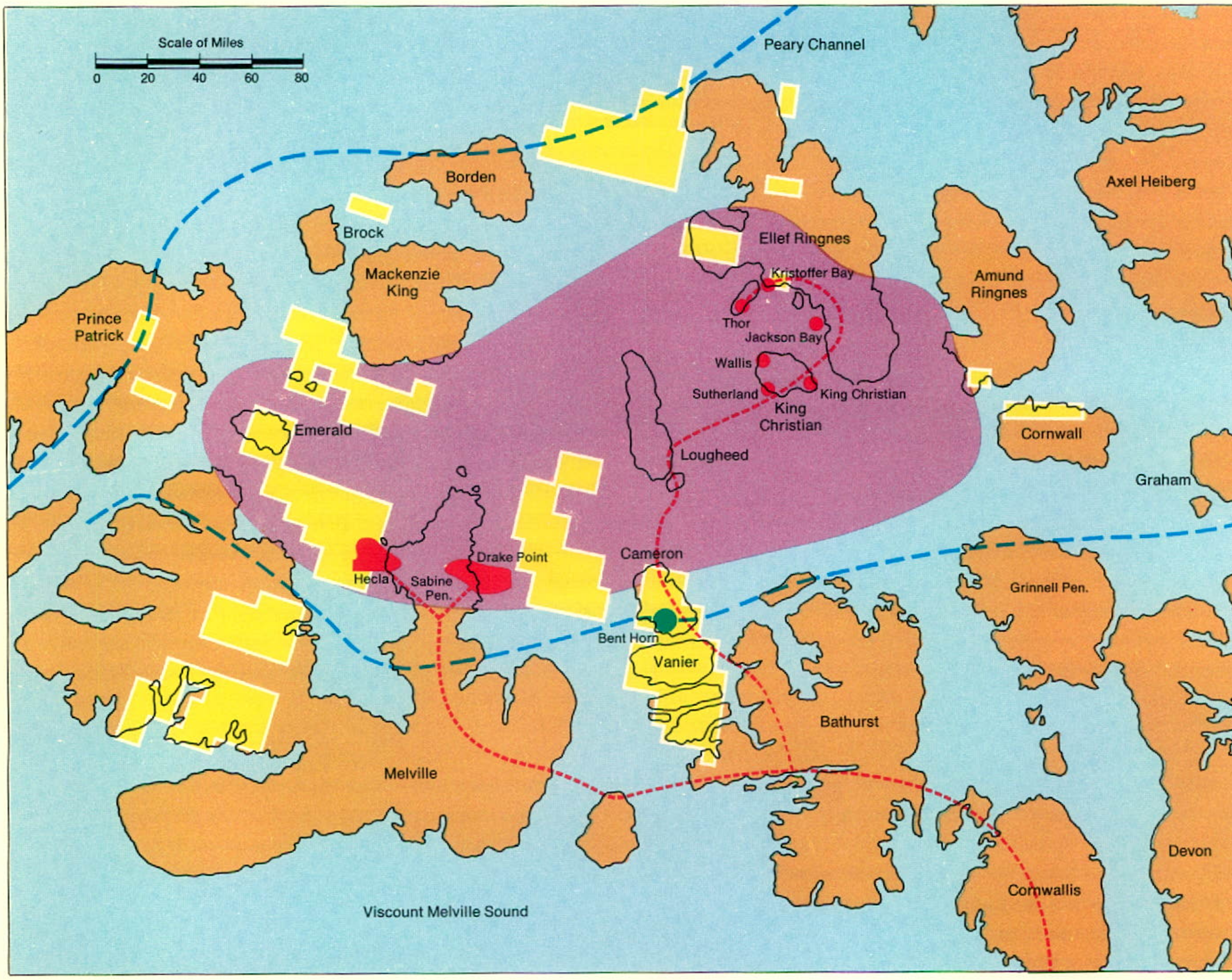
Subsequent to the drilling of the first well (Winter Harbour A-9) in the Arctic Islands in 1962, exploration has been carried out from Banks to Ellesmere islands, with significant results occurring in the western portion of the Sverdrup Basin as outlined in the map, page 5. Extensive offshore seismic operations, conducted mainly in this area during the past few years, have resulted in the mapping of numerous large structures; this, in turn, has resulted in the area being earmarked for intensive future exploration by Panarctic and its partners, including Petro-Canada, Imperial Oil, and Gulf Oil. This partnership is now referred to as the Arctic Islands Exploration Group (A.I.E.G.). The efforts of this group are expected to result in the expenditure of $120 million to $150 million on exploration during the next two years, principally in the western offshore portion of the Sverdrup Basin.

Bent Horn

There has been no drilling since 1975 in the Bent Horn oil field where Canada Southern has a 5 percent carried interest. However, during the past drilling season the Bent Horn A-57 exploration well was drilled without success six miles north of the field proper on a separate geological feature. It is anticipated that the next Bent Horn test will be drilled in the spring some four miles to the west of the field on Cape Kennedy. Since production from this field is a high-gravity crude oil requiring little or no treatment, it is anticipated that it will find its initial market as fuel for tankers in the proposed shipping of LNG from the Arctic Islands.

Hecla Field

As stated in the Company's 1977 Annual Report, Panarctic, the operator, has reported that the Hecla gas field, where Canada Southern holds a 30 percent carried interest, is now delineated, awaiting markets, and ready for development drilling.



Intensified exploration in the western offshore portion of the Sverdrup Basin, now considered the most prospective Arctic Islands' area for oil and gas, will mark future search efforts by Panarctic Oils Ltd. Canada Southern's large property interests in the High Arctic, shown above and in the separate map enclosed with this report, include 6,061,303 gross acres assigned under contract to Panarctic.

September 30, 1978

CSP Interest Lands
Area of Intensified Exploration
Gas Field
Oil Field
Outline of Sverdrup Basin
Polar Gas Proposal

Winter Work Programs

Panarctic has not announced its 1978-79 work programs; however, it is reasonable to expect that during the coming drilling season two wells will be drilled on Canada Southern's 5-percent, carried-interest lands and two wells will be drilled offsetting Canada Southern's 30-percent, carried-interest lands, all in the western portion of the Sverdrup Basin.

Marketing Plans for Arctic Islands' Gas

The Polar Gas pipeline group recently filed with the National Energy Board of Canada the gas reserve phase of its submission to build a natural gas pipeline from Melville Island southward, connecting with TransCanada Pipelines near Longlac, Ontario. TransCanada, through existing facilities, is able to serve markets in Eastern Canada and portions of the United States.

In addition, studies are continuing by Petro-Canada on the feasibility of interim marketing by liquefying gas (LNG) and shipping it year round to Eastern Canada and the United States by using tankers strengthened structurally to withstand the extreme ice conditions. At least one operator, based on recent studies, has expressed the belief that liquefied gas initially can be delivered to markets at less cost than by pipeline; further, this operator feels that such a system will precede the construction of a pipeline, possibly by several years.

The National Energy Board of Canada, on October 11, 1978, commenced hearings in Calgary, Alberta, that will continue during the fall in Victoria, British Columbia, finally ending in Ottawa, on the export of gas to United States markets. At the same time, the Board will examine Canadian supply and demand requirements to the year 2000. In view of the generally accepted belief that Canada is assured of a continuing surplus of natural gas, based upon high levels of exploration activity in Western Canada and the Frontier potentials, it is reasonable to expect that the National Energy Board will find an exportable surplus. Other factors involved include the industry's need for income to maintain the exploration and development momentum necessary to establish still more reserves, and Canada's need for export to ease the current balance of payments deficit. When these hearings are completed, it is hoped that a better projection can be made with regard to Arctic Islands' markets.

Arctic Islands' Gas Reserves

Panarctic's consultants have reported the proven and probable reserves of the Hecla and Drake Point fields at 8,827 billion cubic feet. These are the first fields expected to go to market. These same consultants report Canada Southern's share of these reserves in the Hecla field, also in the proven and probable category, at 668.2 billion cubic feet, representing 7.6 percent of the initial market based on present threshold reserves. On the same basis, gas reserves for the seven fields thus far discovered in the entire Arctic Islands' area through 1977 are given as 11,955 billion cubic feet in the proven and probable category, which means that 5.6 percent of the Arctic Islands' reserves established to that date are allotted to Canada Southern's interest. More than $600 million has been expended by Panarctic and others in some 10 years in establishing these reserves, representing a finding cost of approximately 5 cents per thousand cubic feet of gas.

The Polar Gas submission report also predicts that the ultimate potential of gas reserves in the Arctic Islands will be 100 trillion cubic feet, some 23 trillion cubic feet of which should be established by 1983. It states that exploration in the Arctic Islands has taken place in three stages: first, the initial exploration effort in the islands; second, delineation of early discoveries; and third, a relatively unrestricted wildcat exploration program in a "high-grade" area in the western portion of the Sverdrup Basin as outlined in the map on page 5. This high-grade area comprises some 17,600,000 acres, of which Canada Southern's interest amounts to 2,244,000 gross acres and 606,100 net acres.

COMPANY-INTEREST PROPERTIES INCLUDED IN PANARCTIC AGREEMENTS

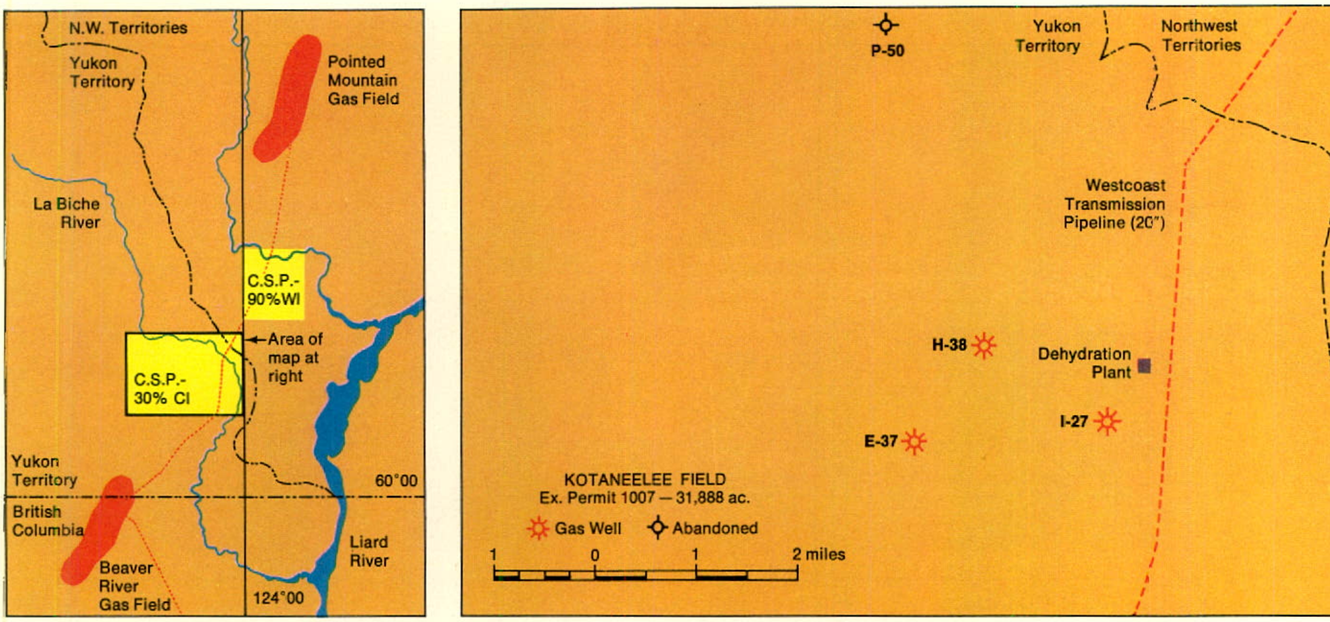
as of September 30, 1978

		Interest retained by Company	
Properties	**Gross Acres**	**Carried Interest**	**Net Acres**
TriCeeTee Agreement			
Prince Patrick, Melville, Emerald, Vanier, Cameron, Ellef Ringnes, Cornwall	2,750,641	5.0%(1)	137,532
Canada Southern-Clark-Skelly Agreement			
Eight Bears	57,210	6.0%	3,433
Canada Southern			
Ellesmere	95,330	15.0%	14,300
Offshore, Sverdrup Basin	3,158,122	30.0%(2)	947,437
	6,061,303		1,102,702

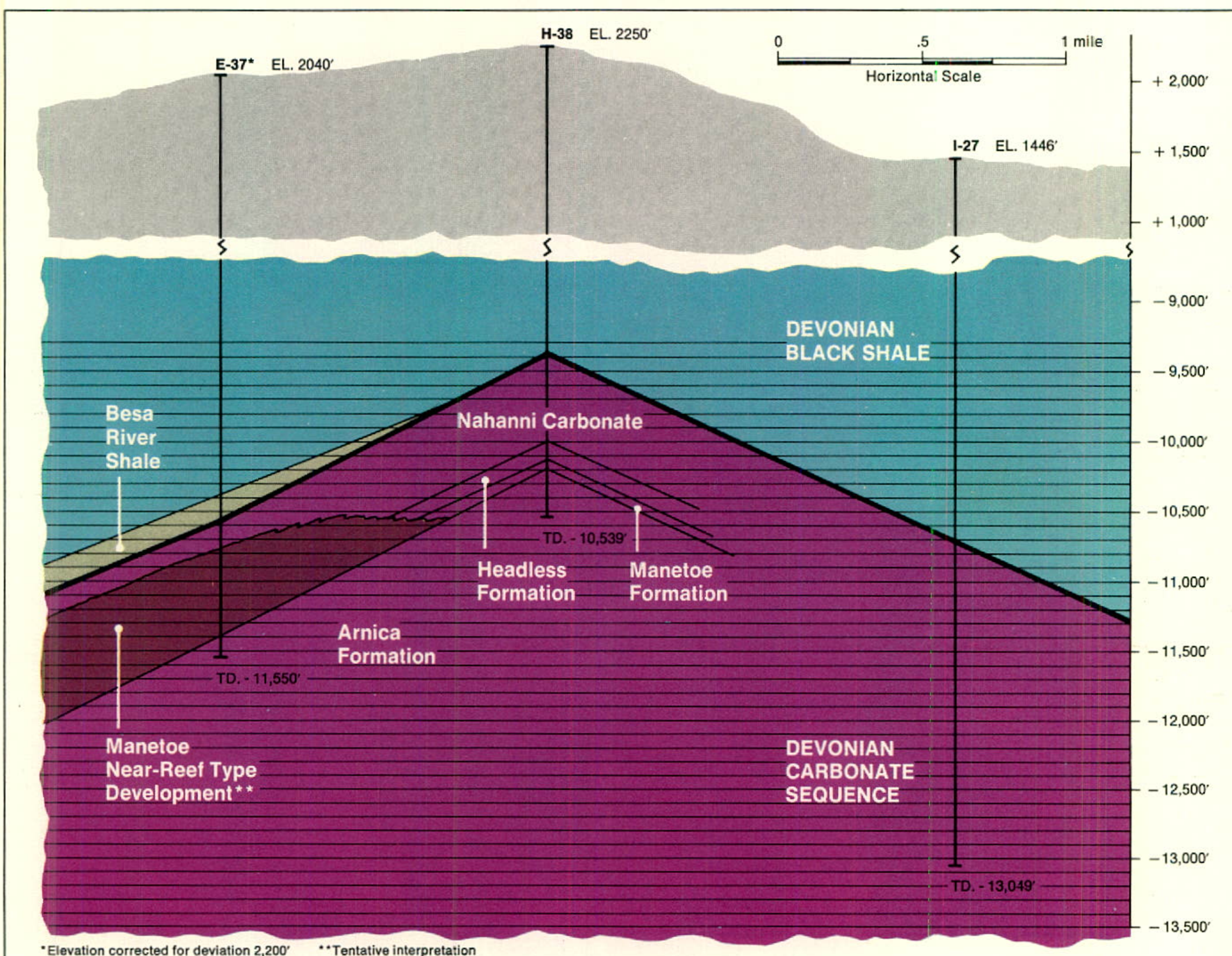
(1)Does not include the Company's additional interest to be acquired under the sub-farmout agreement covering permits on Vanier Island.

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

Aerial view (above) of the YT E-37 delineation well in the Kotaneelee gas field which reportedly penetrated over 900 feet of gross pay zone without encountering water. Supplies for the next Kotaneelee test, destined for Mount Martin (middle elevation, above) are being stockpiled at the Kotaneelee airport (below), center for crew changes and day-to-provisioning.



Kotaneelee gas field in Canada's Yukon Territory is crossed by the same Westcoast Transmission 20-inch pipeline serving the nearby Beaver River and Pointed Mountain fields. Main producing horizon for all three fields is the Devonian Carbonate sequence. Chart (below) shows relationship of the three gas wells drilled to date on the Kotaneelee structure.



Yukon Territory

As reported in previous annual reports, in 1964 Canada Southern and its partners drilled the North Beaver River YT I-27 well in the southeast corner of the Yukon Territory to a depth of 14,495 feet (see map, page 8). After experiencing considerable mechanical problems, this well was suspended as a gas discovery, in what has recently become known as the Kotaneelee field. In 1977, Columbia Gas Development of Canada Ltd., as operator, along with others entered into partnership with the Canada Southern group for the development of this field. Under this new agreement, the Company retained a 30-percent, carried (net profits) interest in the 31,888-acre tract, an area believed to contain the limits of the field. Canada Southern also retains all the privileges of a working-interest partner with respect to information, sales of products, etc.

As indicated on the map, the Kotaneelee field is located between the Beaver River and Pointed Mountain gas fields, the main producing horizon for all three being the Devonian Carbonate (dolomitized limestone), with a thickness of more than 3,000 feet. This carbonate zone is divided into four subgeological members: the Nahanni, the Headless, the Manetoe, and the Arnica, reading from top to bottom. Although porosity in these formations is generally low, varying from place to place, the entire sequence is believed to be one reservoir with a common water level.

The Beaver River and Pointed Mountain geological structures are believed to have been formed by thrust faulting at the same geological age, resulting in rather narrow northeast-southwest trending fields. On the other hand, it is now believed that the Kotaneelee field is the result of a much older and broader anticlinal-type structure. Although thrust faulting occurring in the younger formations has made seismic interpretations difficult, it may or may not affect the Devonian Carbonate at Kotaneelee. With all the complications of a large, faulted, anticlinal-type structure, including both blanket-type carbonate porosity and now near-reef-type porosity, it is anticipated that a number of wells will be required fully to evaluate the field's potential.

The YT E-37 delineation well was located on the south flank of the Kotaneelee structure approximately one and one-quarter miles south-southwest of the H-38 well. One of the objectives was to establish the gas-water content, a factor used in calculating reserves. The well fell some 600 feet lower on structure than prognosis and after reaching a depth of 13,750 feet (11,550 subsea), drilling was halted for safety reasons at a depth expected to be well below the water level. Preliminary testing in the bottom 110 feet, the least porous of the carbonate sections penetrated, not only failed to produce water but tested a small flow of gas. This adds some 600 feet more of productive section to the field than had been expected.

The bottom section will be plugged and the well completed for production in 400 feet of the more prolific section near the top of the pay zone. Drilling supplies are stockpiled on the lease for the next location which will probably fall on Mount Martin to the northwest of the H-38 well.

Since formation water was not indicated in the bottom of the E-37 well during preliminary testing, it is felt that the following calculations will prove to be reasonably correct.

The Canada Southern I-27 well encountered the carbonate productive formation at a subsea depth of 10,714 feet, but did not establish a water level contact, except within broad limits. The H-38 well encountered the carbonate at the subsea depth of 9,383 feet; subsequently penetrating that section an additional 1,156 feet, the top 259 feet of which was tested at a sustained flow rate of 20 million cubic feet of gas per day. The E-37 well encountered the carbonate at a subsea depth of 10,574 feet and penetrated 976 feet of carbonate, also without encountering the water contact level. This indicates that the I-27 well has in excess of 836 feet of gross pay and suggests that had the E-37 and H-38 wells been drilled deeper, they would have in excess of 976 feet and 2,167 feet, respectively, of gross pay.

The top 180 feet of the E-37 well has porosity equal to or better than the upper section that was tested in the H-38 well, the next 420 feet encountered porosity calculated up to 6 percent without taking into consideration the vugular portions (small cavities), the next 200 feet is similar to the top 180 feet, and the bottom 176 feet has low porosity for a gross productive section indicated at 976 feet.

The more porous portion of the section has been interpreted to be a Manetoe near-reef-type development on an Arnica formation platform which grows up through the Headless formation and all but the top 200 feet of the Nahanni formation (see chart, page 8). At this stage of work on the property it is possible only to speculate as to the area covered by the newly discovered near-reef development, with additional wells being required to determine the actual extent. Because this situation has not occurred in the general area drilled to date, it is considered an extremely important new development and one which eventually should be reflected in higher estimated reserves.

The drilling of some of the upper formations at Kotaneelee is extremely difficult resulting in wells

Bridge constructed over the La Biche River assures year round supplies for the Kotaneelee field on all-weather highway leading from Liard River staging area.

Canada Southern Petroleum Ltd.

STATUS OF CARRIED INTEREST

Pacific Agreement

Ex-Permits 100-104 ....

Phillips Agreement

Ex. P. 149 ....

Ex. P. 178 ....

Ex. P. 224 ....

Dome Pan-American Agreement

Ex. Ps. 1007, 1132, 1133 ....

Ex. Ps. 1136, 2713, 1153 ....

Ex. Ps. 1149, 1156 ....

* Ex-Permits 100-104 net proceeds 1978, the Company's share amo

** Ex-Permit 178 net proceeds fron the Company's share amounted

*** Ex-Permit 224 net proceeds fron 1978, the Company's share amo

costing $6 million to $7 million each, with a required drilling time of approximately seven months. A recently completed seismic program, conducted at a cost of $1.3 million, employed sophisticated methods including innovative recording from aircraft in mountain terrain almost inaccessible for surface vehicles. The interpretations of this work will help locate to better advantage future drilling locations of expensive wells.

Marketing

Because all gas produced in this area carries a fresh water vapor which must be removed to prevent condensation in the form of ice while being transported by pipeline during extreme low temperatures, a central dehydration plant for the removal of such moisture is under construction and slated for completion by November 15, 1978. Gas is scheduled to begin going to market immediately thereafter into Westcoast Transmission Company's 20-inch pipeline that crosses the Kotaneelee lease near the gas processing plant. This pipeline has capacity in excess of approximately 75 million cubic feet per day. Twelve miles south at the Beaver River field where the pipeline size increases to 24 inches there is an additional excess capacity of over 200 million cubic feet per day.

Although the last draft of the gas purchase contract has not been signed, buyer and sellers are negotiating for an initial take of 35 million cubic feet per day with provisions for escalating in proportion to additional reserves established. In general, sales

AGREEMENTS AS AT JUNE 30, 1978

1977		1978		Cumulative to June 30, 1978			Company Interest	
Gross Expenditures	Production Proceeds	Gross Expenditures	Production Proceeds	Gross Expenditures	Production Proceeds	Net Expenditures	%	Cost to Convert to a Working Interest
170,824	1,902,438	364,084	4,263,260	18,491,356	20,777,559	(2,286,203)	21.25	*
41,864	(1,424)	207,224	(36,528)	5,813,916	233,790	5,580,126	50.00	2,790,063
716,280	677,440	284,974	1,419,507	3,442,007	6,632,055	(3,190,048)	27.75	**
1,253,829	2,028,459	638,484	3,203,266	7,676,535	18,184,731	(10,508,196)	27.75	***
3,416,498		10,230,208		14,020,694		14,020,694	30.0	4,206,208
27,930		27,930		602,542		602,542	45.0	271,144
13,452		13,451		1,154,883		1,154,883	45.0	519,697

from production became payable to the Company in March 1978, and by June 30,
nted to $485,818.

production became payable to the Company in July 1970, and by June 30, 1978
to $887,462, including $1,188 in fiscal 1977 and $326,620 in fiscal 1978.

production became payable to the Company in December 1968, and by June 30,
nted to $2,908,179, including $258,411 in fiscal 1977 and $738,277 in fiscal 1978.

are tied to depleting the reserves over a 15-year to 20-year period with a provision for redetermination of reserves which increases sales as reserves are increased. For example, a reserve of 500 billion cubic feet could be produced over a 15-year to 20-year period at between 91 million and 68 million cubic feet per day, respectively. The industry average is 18 and one-half years, which would amount to a production rate of 74 million cubic feet per day, given the same reserve of 500 billion cubic feet. If the buyer fails to take gas on this basis, then excess reserves established can be released for the negotiation of sales to others. The aforementioned National Energy Board hearings on the export of Canadian gas may well improve the market opportunities for Kotaneelee gas.

British Columbia

The increase in prices for both oil and gas, granted by the British Columbia Government, has significantly boosted Canada Southern's income. As predicted in the 1977 Annual Report, the major British Columbia carried-interest accounts paid out in March 1978, meaning that the Company is now sharing in net profits from such accounts. Work continues by the operator, principally Pacific Petroleums, on this older production, one of the incentives being price increases for hydrocarbons. Although the amount of capital expenditures by the operator cannot accurately be predicted, it is reasonable to expect that beginning in 1979 the annual income from the British Columbia properties should fall within the $1.5 million to $2 million range.

Canada Southern Petroleum Ltd.
(A Canadian corporation)

CONSOLIDATED BALANCE SHEET

(Expressed in Canadian dollars)
June 30, 1978 and 1977

	1978	1977
ASSETS		
Current assets:		
Cash	$ 84,122	$ 22,739
Bank deposit receipts	324,975	294,975
Accounts receivable and accrued interest	728,300	127,051
Refundable deposits and prepaid expenses	7,051	5,497
Total current assets	1,144,448	450,262
Investments and advances (Note 2)	2	1
Oil and gas properties, at cost less accumulated depletion of $1,156,007 and $992,790 at June 30, 1978 and 1977, respectively (Notes 1 and 3)	7,658,767	7,570,052
Mineral properties, at cost (Notes 1 and 3)	427,062	427,062
Equipment, at cost less accumulated depreciation of $38,244 and $35,504 at June 30,1978 and 1977, respectively	20,840	8,190
	$ 9,251,119	$ 8,455,567
LIABILITIES AND CAPITAL		
Current liabilities:		
Bank loan payable	$ 144,000	$ 108,000
Accounts payable and accrued liabilities:		
The Catawba Corporation (Note 4)	37,498	54,487
Other	132,951	150,827
Total current liabilities	314,449	313,314
Bank loan payable, less current portion included above (Note 7)	248,000	392,000
Capital (see accompanying statements and Note 5):		
Capital stock, par value $1 per share:		
Authorized 15,000,000 shares		
Outstanding 8,851,465 shares	8,851,465	8,851,465
Capital in excess of par value	14,456,694	14,456,694
	23,308,159	23,308,159
Accumulated deficit	(14,619,489)	(15,557,906)
	8,688,670	7,750,253
	$ 9,251,119	$ 8,455,567

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

See accompanying notes.

CONSOLIDATED STATEMENT OF INCOME (LOSS) (Note 1)

(Expressed in Canadian dollars)

	Year ended June 30,				
	1974	1975	1976	1977	1978
Income:					
Proceeds under carried interest agreements (Note 3)	$ 386,473	$ 271,743	$ 241,430	$ 233,582	$1,549,293
Interest	158,861	73,666	28,430	13,999	16,145
Oil and gas sales	78,536	85,121	75,785	144,693	309,404
Rent	35,400	37,350	18,012	—	—
Other	200	(1,363)	9,745	413	—
Gains and losses on sales of equipment and properties	—	—	335,583	(1,390)	—
	659,470	466,517	708,985	391,297	1,874,842
Costs and expenses:					
General and administrative (Notes 4 and 6)	660,021	595,457	786,646	670,076	748,465
Abandonments (Note 3)	467,996	30,156	223,891	55	—
Depletion, depreciation and amortization	141,187	141,545	107,105	130,937	166,548
Lease operating costs	24,934	18,892	22,220	28,447	19,258
Write-offs:					
Borealis Exploration Limited (Note 2)	—	—	—	308,999	—
Foraco projects	—	—	142,769	520	2,078
Canada Southern Petroleum (N.Z.) Limited	76,867	188	576	520	76
PXP Steam Power Units Ltd.	53,731	189	50	—	—
Canpet (Ireland)	—	—	552	185	—
	1,424,736	786,427	1,283,809	1,139,739	936,425
Income (loss) before taxes on income and extraordinary item	(765,266)	(319,910)	(574,824)	(748,442)	938,417
Provision for taxes on income (Note 8)	—	—	—	—	291,000
Income (loss) before extraordinary item	(765,266)	(319,910)	(574,824)	(748,442)	647,417
Tax benefit realized from carryforward of exploration, development and lease acquisition costs not claimed in prior years	—	—	—	—	291,000
Net income (loss)	$ (765,266)	$ (319,910)	$ (574,824)	$ (748,442)	$ 938,417
Average number of shares outstanding	8,764,812	8,764,965	8,764,965	8,810,273	8,851,465
Per share based on average number of shares outstanding during the period:					
Income (loss) before extraordinary item	$(.09)	$(.04)	$(.07)	$(.08)	$.08
Extraordinary item	—	—	—	—	.03
Net income (loss)	$(.09)	$(.04)	$(.07)	$(.08)	$.11

See accompanying notes.

Canada Southern Petroleum Ltd.
(A Canadian corporation)

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

(Expressed in Canadian dollars)

	Year ended June 30,				
	1974	1975	1976	1977	1978
Disposition of working capital:					
Net (income) loss	$ 765,266	$ 319,910	$ 574,824	$ 748,442	$ (938,417)
(Charges) credits to revenues not involving outlay of working capital in current periods:					
Depreciation, depletion and amortization	(141,187)	(141,545)	(107,105)	(130,937)	(166,548)
Write-off of investments	(130,598)	(377)	(142,769)	(308,999)	—
Abandonments	(467,996)	(30,156)	(223,891)	—	—
Gains and losses on sales of equipment and properties	—	—	335,583	(1,390)	—
Working capital used in (provided by) operations	25,485	147,832	436,642	307,116	(1,104,965)
Additions to oil, gas and mineral properties	1,216,030	662,640	300,666	303,556	366,932
Increase in investments	98,522	5,579	10,204	16,625	—
Expenses of capital stock offerings	13,340	26,416	103,616	—	—
Decrease in bank loan (noncurrent)	—	—	—	—	144,000
Additions to equipment	—	65	12,491	329	15,981
Other	3,964	—	(4,400)	—	1
	1,357,341	842,532	859,219	627,626	(578,051)
Source of working capital:					
Net proceeds from sales of capital stock	—	—	—	177,454	—
Exercise of stock purchase warrants	2,168	—	—	—	—
Proceeds from sales of equipment or properties	—	10,000	588,765	281	115,000
Bank loan	—	—	—	392,000	—
	2,168	10,000	588,765	569,735	115,000
Increase (decrease) in working capital	$(1,355,173)	$(832,532)	$(270,454)	$ (57,891)	$ 693,051
Increase (decrease) in working capital by component:					
Cash	$ (643)	$ 12,607	$ (8,168)	$ (28,396)	$ 61,383
Bank deposit receipts	(1,375,000)	(755,000)	(310,025)	100,000	30,000
Accounts receivable and accrued interest	43,879	(43,941)	10,959	40,213	601,249
Refundable deposits and prepaid expenses	(574)	187	(754)	2,616	1,554
Current portion of debt	7,441	—	—	(99,688)	(36,000)
Accounts payable and accrued liabilities	(30,276)	(46,385)	37,534	(72,636)	34,865
Increase (decrease) in working capital	$(1,355,173)	$(832,532)	$(270,454)	$ (57,891)	$ 693,051

See accompanying notes.

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

(Expressed in Canadian dollars)
Years ended June 30, 1977 and 1978

	Number of shares	Capital stock, $1 par value	Capital in excess of par value	Total
Balance at June 30, 1976	8,764,965	$8,764,965	$14,365,740	$23,130,705
Net proceeds from sales of capital stock	86,500	86,500	90,954	177,454
Balance at June 30, 1977 and 1978	8,851,465	$8,851,465	$14,456,694	$23,308,159

CONSOLIDATED STATEMENT OF ACCUMULATED DEFICIT

(Expressed in Canadian dollars)
Years ended June 30, 1977 and 1978

	1977	1978
Balance at beginning of year	$(14,809,464)	$(15,557,906)
Net income (loss)	(748,442)	938,417
Balance at end of year	$(15,557,906)	$(14,619,489)

See accompanying notes.

NOTES TO FINANCIAL STATEMENTS

June 30, 1978

1. Summary of significant accounting policies and current developments

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 in only one industry, exploration and development, 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 on net costs accumulated in the Canada cost center is provided on the composite unit-of-production method based on estimated recoverable proven reserves. Expenditures incurred in the Arctic Islands and in foreign areas are being deferred pending the results of exploration in progress in those areas. These costs will be depleted by cost center on the basis of reserves discovered in each area or written off to income if exploration activities in that area prove unsuccessful.

Properties abandoned prior to July 1, 1974 were not capitalized as the resulting total cost of the properties would have exceeded their estimated value at that date.

The Company accounts for the costs of its mineral properties in the following manner. Acquisition costs, exploration and development expenditures and related administrative overhead 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 abandoned are charged to income. Costs associated with commercially exploitable prospects will be amortized or depreciated on a unit-of-production basis.

Depreciation has been provided for building and equipment by the straight-line method based on estimated useful lives. 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 rates. During the five years ended June 30, 1978, 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.

The Securities and Exchange Commission issued an order dated April 11, 1978 directing that an examination and private investigation by the staff of the Commission be made of the Company, The Catawba Corporation ("Catawba") (see Note 4) and Catawba's other client companies. The Commission has expressed interest in investigating, among other things, the Australian hydrocarbon reserves of the various companies, the relationship between those companies and Catawba and the fees and royalties paid by them to Catawba, and the proposed acquisition of Pantepec International, Inc., by United Canso Oil & Gas Ltd., to determine whether possible violations of the Securities Exchange Act of 1934 and/or the Investment Company Act of 1940 may have occurred. The Company is cooperating fully with the Commission in providing whatever information may be required and believes it has committed no violations.

2. Investments and advances

The Company owns 3.81% of the outstanding common shares and $225,000 face amount of 8% unsecured debentures of Borealis Exploration Limited (Borealis), a company engaged in mineral exploration in northern Canada. None of the interest on the debentures has been paid by Borealis or accrued by the Company. The Company's Board of Directors has agreed in principle, subject to approval of Borealis shareholders, to accept Borealis shares in exchange for the debentures and related unpaid interest. In view of the uncertainty as to ultimate realization of the investment in Borealis, the Company wrote down its investment to nominal value at June 30, 1977.

3. Properties and related exploratory and other expenses

Oil, gas and mineral properties by cost center are as follows:

	1978	1977
Oil and gas properties:		
Canada (excluding the Arctic Islands)	$4,641,398	$4,627,620
Arctic Islands	2,889,341	2,815,069
Foreign areas	128,028	127,363
	7,658,767	7,570,052
Mineral properties	427,062	427,062
	$8,085,829	$7,997,114

Current valuations of proved reserves and other discoveries exceed the book value of $8,085,829 and $7,997,114 at June 30, 1978 and 1977, respectively.

Realization of the amounts represented by oil and gas properties in the Arctic and foreign areas cost centers and mineral properties, aggregating $3,444,431 and $3,369,494 at June 30, 1978 and 1977, respectively, is dependent upon future developments, since most of the properties represented by these assets are substantially unexplored or undeveloped.

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, 1978, 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 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, 1978 and 1977, 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 $53,738 and $2,456,948, 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 $386,473, $271,743, $241,430, $222,065 and $1,043,967 for the five years ended June 30, 1978, which amounts have been credited to income. In fiscal 1978 and 1977, the Company received income of $505,327 and $11,517, respectively, from other carried interests. Of the 1978 amount, approximately $355,000 related to recoveries of tax credits (in the fourth quarter) arising from exploration expenditures; approximately $254,000 of this amount relates to prior years and is nonrecurring.

The Company's share of the cost of a standing well, Canada Southern North Beaver River YT I-27, completed as a discovery on a permit in the Yukon during the year ended June 30, 1965, amounted to $1,119,443 at June 30, 1978. The Company has a 30% carried interest in this well. It is anticipated that a significant amount of rework will be necessary to bring this well to production. A well is presently drilling on this permit as a follow up to a successful step-out well drilled in 1977. The operator has reported significant production test flows from the Columbia et al Kotaneelee YT H-38 1977 step-out well. Further drilling and production are anticipated in fiscal 1979.

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%.

4. The Catawba Corporation

The amounts included in general and administrative expense for financial, technical and other services under contract represent charges from The Catawba Corporation (Catawba). Canada Southern's contracts with Catawba provided for payments based on services rendered and the granting of a 1/64th overriding royalty on all properties acquired by Canada Southern during the term of the contracts. For the five years ended June 30, 1978, the Company was charged $264,954, $227,004, $362,320, $309,171, and $300,069 for services rendered by Catawba. 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. Catawba provided similar services to Borealis Exploration Limited. 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 and Borealis 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 referred to above that Catawba may be "deemed to be a 'parent' of and to 'control' Canada Southern" is no longer applicable.

5. Stock options and reservations

Stock options outstanding at June 30, 1978 are summarized in box on following page.

These options were granted under an incentive option plan on 300,000 shares of Canada Southern's capital stock adopted by the Board of Directors on September 21, 1973 and were exercisable on the date of grant. There were 150,500 shares and 205,000 shares reserved for future option grants at June 30, 1978 and 1977, respectively. There were no other changes in stock options during the two years ended June 30, 1978 except that in fiscal 1977, options on 25,000 shares were forfeited upon termination of employment. In August 1978, as a result of the termination of the Catawba contract (see Note 4), options on 150,000 shares granted to Catawba expired.

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. (See chart below.)

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. Contributions by the Company to the pension plan on behalf of all employees were $14,653, $13,015, $11,759, $29,075 and $33,274 for the five years ended June 30, 1978. The Company has made certain plan revisions increasing benefits payable, effective October 1, 1976. These revisions resulted in a liability of $131,138 for past service costs which is being amortized over a 10-year period.

Compensation of directors, officers and senior employees allocated to or paid directly by Canada Southern, including contributions to a pension plan on their behalf, amounted to $159,672 and $184,168 for the years ended June 30, 1977 and 1978, respectively. Of these amounts, $48,974 and $54,455 were on behalf of directors and $110,698 and $129,713 were on behalf of officers. At June 30, 1978, there were five directors and five officers, of which one was also a director.

7. Bank loan

The Company at June 30, 1978 had a bank loan of $392,000 with interest at 1% over the bank's minimum lending rate (interest at June 30, 1978: 10¼%), repayable in installments of $12,000 per month plus interest. The loan is secured by the assignment of certain accounts receivable and the Company's interest in reserves in producing properties.

8. Income taxes and extraordinary item

In the year ended June 30, 1978, the Company realized a benefit of $291,000 for Canadian income tax purposes from carryforward of exploration, development and lease acquisition costs not claimed in prior years. For the five years ended June 30, 1978, the Company had no Canadian income tax liability and at June 30, 1978, the following accumulated expenditures remained to be carried forward indefinitely to reduce future taxable income:

Drilling, exploration and lease acquisition costs	$13,500,000
Undepreciated capital costs	380,000

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

9. Proposed change in accounting

The Securities and Exchange Commission (SEC) has recommended development of an accounting method that recognizes valuations of proved oil and gas reserves in the balance sheets and income statements of oil and gas producers. Until the new method, Reserve Recognition Accounting (RRA), is developed, the Commission will allow either successful efforts accounting or a form of full cost

Stock options outstanding at June 30, 1978 are summarized as follows:

Optionee	Date of grant	Expiration date	Number of shares	Option price: Per share	Option price: Aggregate	Market price at date of grant: Per share	Market price at date of grant: Aggregate
Catawba	Nov. 20, 1973	Nov. 20, 1978	150,000	$5.20	$780,000	$5.20	$780,000
Officers	Nov. 20, 1973	Nov. 20, 1978	10,000	5.20	52,000	5.20	52,000
Employees	Nov. 20, 1973	Nov. 20, 1978	17,000	5.20	88,400	5.20	88,400
Officers and director	Oct. 7, 1977	Oct. 6, 1982	52,000	4.30	223,600	4.30	223,600
Employees	Oct. 7, 1977	Oct. 6, 1982	2,500	4.30	10,750	4.30	10,750
			231,500				

accounting as prescribed by the SEC. According to the SEC, "The feasibility of RRA, however, is not assured because of the inherent imprecision of reserve valuations, and, therefore, the ultimate method of reporting is not yet determinable."

The Financial Accounting Standards Board issued Statement of Financial Accounting Standards (SFAS) No. 19, "Financial Accounting and Reporting by Oil and Gas Producing Companies." The statement would require the use of the successful efforts method of accounting for oil and gas properties instead of the full cost method presently used by the Company. If the Company were to report on the basis of SFAS No. 19 as presently issued, it is estimated that capitalized costs of oil and gas properties of approximately $6,300,000 would be written off to accumulated deficit. The effect on income (loss) would be as follows:

	Increase in net loss or decrease in income	
Year	**Total**	**Per share of capital stock**
1974	$635,000	$.07
1975	550,000	.06
1976	80,000	—
1977	425,000	.05
1978	510,000	.06

In October 1978, in response to the SEC recommendations with respect to oil and gas accounting and financial reporting, the FASB eliminated the effective date of SFAS No. 19. This had the effect of indefinitely postponing any requirement to conform to the standard.

Report of Independent Public Accountants

The Shareholders

CANADA SOUTHERN PETROLEUM LTD.

We have examined the accompanying consolidated balance sheets of Canada Southern Petroleum Ltd. at June 30, 1978 and 1977 and the related consolidated statements of income (loss) and consolidated changes in financial position for each of the five years in the period ended June 30, 1978 and of capital stock and capital in excess of par value and accumulated deficit for the two years ended June 30, 1978. 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 report dated September 22, 1977, our opinion on the 1977 financial statements was qualified as being subject to the effects of such adjustments, if any, as might have been required had the realization of oil, gas and mineral properties been known. As explained in Note 3 the realization of oil, gas and mineral properties which aggregated $7,997,114 at June 30, 1977 is no longer dependent on future developments. Accordingly, our present opinion on the 1977 financial statements, as presented herein, does not include the qualification.

In our opinion, the financial statements mentioned above present fairly the consolidated financial position of Canada Southern Petroleum Ltd. at June 30, 1978 and 1977, the consolidated results of operations and the consolidated changes in financial position for each of the five years in the period ended June 30, 1978 and the consolidated changes in capital stock and capital in excess of par value and the consolidated changes in accumulated deficit for the years ended June 30, 1978 and 1977, in conformity with generally accepted accounting principles applied on a consistent basis during the period.

ARTHUR YOUNG, CLARKSON,
GORDON & CO.

Hartford, Connecticut
September 18, 1978, except as to Note 9,
as to which the date is October 20, 1978.

MANAGEMENT'S DISCUSSION AND ANALYSIS

1978 vs 1977

The Company recorded its first profitable year in fiscal 1978 as a result of a very significant increase in proceeds under carried-interest agreements. A portion of the increase, estimated at $254,000, related to recoveries of tax credits arising from exploration expenditures in prior years and is nonrecurring. However, the balance of the increase reflects improvements as carried interests benefit from capital expenditures in other years and as prices improve. Oil and gas sales also benefited from higher unit sales and improved prices in 1978.

General and administrative expenses were higher in 1978, primarily because of increased salaries and legal expenses. Depletion, depreciation and amortization charges increased in 1978 with increased production.

1977 vs 1976

The decline in proceeds under carried-interest agreements, which began in 1975 due to the effect of royalty increases by the government of the Province of British Columbia, continued through fiscal 1977. Interest income was lower in 1977 due to the liquidation of marketable securities to provide working capital. Revenues from oil and gas sales improved in 1977 due to sharp price increases. Rental income ceased in fiscal 1976 with the sale of an office building. The gain from this sale is the principal component of the $335,583 gain on sales of equipment and properties in that year.

General and administrative expenses were lower in 1977, primarily due to lower salary expense. In fiscal 1976, the Company wrote off costs of $308,999 relating to its investment in Borealis Exploration Limited (see Note 2 to the financial statements).

SUPPLEMENTARY AND MARKET INFORMATION

Canada Southern Petroleum Ltd., now approaching its first quarter-century as an investor-owned, Dominion-chartered company, finds itself at the threshold of a significant new chapter in its corporate existence. Heretofore, the Company has been engaged principally in acquisitions of interests in large tracts of potential oil and gas lands in Western Canada, the Yukon and Northwest Territories, and the Canadian Arctic Islands, as well as in the Northern Territory of Australia.

More recently, certain of these tracts, following successful exploration and active development, have begun to provide the Company with increased revenues under carried-interest agreements. Additionally, development of the southern Yukon's Kotaneelee gas field, in which Canada Southern has a 30 percent carried interest, has heightened the Company's growth prospects. Moreover, the Company's down-the-road potential is enhanced by its 30 percent carried interest in offshore portions of the Arctic Islands' Hecla gas field, where indicated reserves approach six trillion cubic feet.

The Company's shares of capital stock are listed and traded under the symbol "CSW" on the Toronto and Montreal stock exchanges in Canada and on the Pacific and Boston stock exchanges in the United States. The Company's shares are also traded under the symbol "CSPEF" in the NASDAQ over-the-counter market.

The total sales volume on the Pacific Stock Exchange for the years 1976 and 1977 amounted to 660,311 shares and 919,808 shares, respectively, and a quarterly price range for such shares during 1977 and 1978 follows (prices expressed in U.S. dollars):

1977	1st quarter	2nd quarter	3rd quarter	4th quarter
High	3½	2¾	4	5⅜
Low	2⅝	2⅛	2⅛	3 9/16

1978	1st quarter	2nd quarter	3rd quarter	*4th quarter
High	5 7/16	5	6½	5¾
Low	3 11/16	3¾	4 5/16	4

* through October 31

The total sales volume on The Toronto Stock Exchange for the years 1976 and 1977 amounted to 4,801,884 shares and 7,383,200 shares, respectively, and a quarterly price range for such shares during 1977 and 1978 follows (prices expressed in Canadian dollars):

1977	1st quarter	2nd quarter	3rd quarter	4th quarter
High	3.60	2.99	4.20	6.75
Low	2.70	2.21	2.65	3.85

1978	1st quarter	2nd quarter	3rd quarter	*4th quarter
High	5.87	5.62	7.12	6.75
Low	4.20	4.35	4.85	4.80

* through October 31

Canada Southern Petroleum Ltd.
(A Canadian corporation)

ACREAGE SUMMARY—SEPTEMBER 30, 1978

PETROLEUM CANADA	Gross Acreage in Which Interest is Held	Net Acreage Held Under Lease	Net Acreage Held Under Permit	Net Acreage Total
British Columbia				
Pacific Agreement				
Working Interest	32,584	6,133		6,133
Carried Interest	61,971	13,170		13,170
Phillips Agreement—Carried Interest	190,637	20,493	4,235	24,728
Other				
Overriding Royalty Interest	7,918	585		585
Working Interest	18,649	1,998	1,810	3,808
Carried Interest	36,443	1,271		1,271
Total British Columbia	348,202	43,650	6,045	49,695
Alberta — Working Interest	640	160		160
Overriding Royalty Interest	320	80		80
Total Alberta	960	240		240
Yukon & Northwest Territories				
Liard Basin				
Atkinson Agreement—Carried Interest	101,166	22,763		22,763
Dome-Pan Am Agreement—Carried Interest	62,794	28,258		28,258
Columbia Gas Agreement—Carried Interest	73,038	21,911		21,911
Other—Working Interest	12,720	11,448		11,448
Total Liard Basin	249,718	84,380		84,380
Arctic Islands				
Panarctic Agreements (see table, page 6)				
TriCeeTee	2,750,641	1,325	136,207	137,532
Other	3,310,662		965,170	965,170
Total Panarctic Agreements	6,061,303	1,325	1,101,377	1,102,702
Overriding Royalty Interest	26,967		388	388
B.P. Sub-Farmout	58,659		19,843	19,843
Total Arctic Islands	6,146,929	1,325	1,121,608	1,122,933
Total Canada	6,745,809	129,595	1,127,653	1,257,248
AUSTRALIA	76,800		3,840	3,840
Total Petroleum	6,822,609	129,595	1,131,493	1,261,088
MINERALS				
Northwest Territories	*16,809		2,453	2,453
GRAND TOTAL	6,839,418	129,595	1,133,946	1,263,541

(*) Includes interests held through the Company's 3.81% stock interest in Borealis Exploration Limited and the Company's 15.5% interest in the Melville Peninsula iron ore prospect.

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