MURPHY OIL COMPANY LTD.

ANNUAL REPORT 1985

CORPORATE PROFILE

Murphy Oil Company Ltd. is a federally chartered Canadian corporation with headquarters in Calgary, Alberta and listed on both the Toronto and Montreal Stock Exchanges. The Company is engaged in the exploration for, and development and production of, conventional and heavy crude oil and natural gas with major concentration in the western Canada sedimentary basin. In association with these activities, Murphy is also involved in the transportation and marketing of crude oil through pipeline and trucking facilities.

Murphy Oil Company Ltd. is affiliated with Murphy Oil Corporation of El Dorado, Arkansas, which owns 77.3 percent of the outstanding shares of the Company.

COVER PHOTOS

Left to right.

Aerial view of storage tanks, Lindbergh

Servicing heavy oil pumpjack pad, Lindbergh

Installing steam generator, Lindbergh

North Saskatchewan River, Lindbergh area

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ANNUAL MEETING

The Annual Meeting of the Shareholders of the Company will be held in the Glencoe Room of the Calgary Convention Centre in Calgary, Alberta, Wednesday, the 30th day of April 1986, at 2:00 p.m. (M.D.T.)

HIGHLIGHTS

FINANCIAL

(thousands of dollars except per share amounts)	**1985**	1984
Revenues	**$130,866**	119,997
Net Income	**21,088**	20,020
Per Share	**1.68**	1.59
Cash Flow	**62,760**	51,960
Per Share	**5.00**	4.13
Capital Expenditures	**77,981**	71,926
Working Capital*	**11,362**	12,547
Total Assets*	**362,851**	301,921
Shareholders' Equity*	**162,060**	145,354

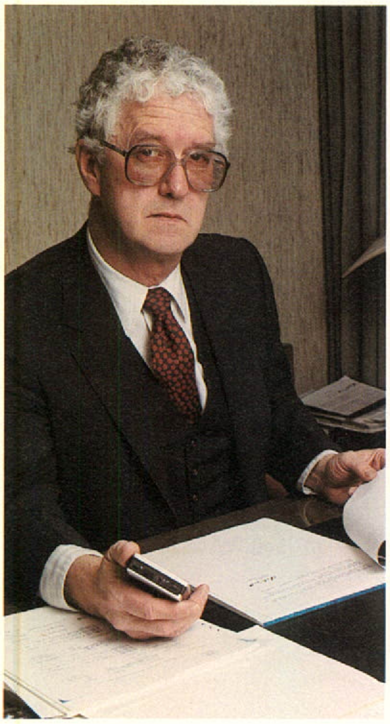
*Year-end

Drilling operation, Lindbergh

OPERATING

	1985	1984
Gross crude oil and natural gas liquids production		
– cubic metres per day	**1,635**	1,525
– barrels per day	**10,290**	9,595
Net crude oil and natural gas liquids production		
– cubic metres per day	**1,270**	1,149
– barrels per day	**7,995**	7,233
Gross natural gas production		
– thousands of cubic metres per day	**723**	700
– Mcf per day	**25,657**	24,861
Net natural gas production		
– thousands of cubic metres per day	**585**	558
– Mcf per day	**20,758**	19,807

LETTER TO THE SHAREHOLDERS



This is a very difficult time to inform, advise and report to the shareholders. The message is a very mixed one. On the one hand, 1985 performance of the Company more than met the objectives of our budget and plan. The industry made major gains in negotiating with governments. Fiscal and regulatory policy was much improved over recent years. On the other hand, the collapse of oil prices through January and early February of 1986 has cast a good deal of uncertainty on the outlook for the new year. The gains from changes to the royalty and tax system have been lost to lower prices. This means daily monitoring of the industry environment and modifications to the budgeted plan for 1986. The situation is fluid enough that the outlook will very likely have changed by the time this report reaches the shareholders. Presently, oil and gas prices continue to soften.

For positive reasons 1985 operating results were very good. Oil production was up by almost 11 percent and natural gas production by five percent from the year before. Along with slightly higher oil prices, but offset partially by lower gas prices, revenues increased by more than nine percent. Cash flow was up by greater than 20 percent and net income by more than five percent. A mandated change to accounting treatment of investment tax credits along with higher exploration expenses charged against income, held down profits by almost $3 million relative to the year before.

Capital spending throughout 1985 reached yet another record totalling $78 million, eight percent more than the prior year. Murphy participated in 312 wells, 165 on a net basis, and 81 percent were cased for oil and gas production or further evaluation. Fifty-six percent of a 43 net well exploratory program was successful and more than 85 percent of development wells were successfully completed. In 1984 the Company drilled 245 gross wells, 108 on a net basis, and cased 84 percent.

Almost $20 million of the 1985 capital budget was applied to development of the Lindbergh Enhanced Oil Recovery Project, supplementing $10 million for lease acquisition and capital spending on Lindbergh the year before. Negotiations with governments to put in place appropriate agreements required almost eight months. Although putting the project several months behind the scheduled plan, the outcome of these negotiations was a beneficial package of tax and royalty incentives. By year-end all wells were drilled at Lindbergh and construction of flowlines and other facilities was progressing satisfactorily, aiming for new production to reach the cleaning plant by April of 1986.

The Lindbergh project and other proposed developments enhancing oil recovery from Company leases will have a significant impact and play a material role in the future of Murphy. Heavy oil in-place under Murphy leases is measured in billions of barrels that can be converted to reserves only through advanced technology. Lindbergh is likely to be particularly significant in that the project is 100 percent owned by the Company, allowing a great deal of operating flexibility. Pilot results of the 1984 expansion lead us, with due cause, to project performance more favorable than early engineering estimates to the extent that early 1987 may very well see 50 percent added to the production base of the Company.

The 54-well Lindbergh development, coupled with success of other drilling, has resulted in a measurable increase of oil reserves of 19 percent, reversing a downtrend of recent years and in the face of overall declines in western Canada. Although the 1985 drilling program replaced natural gas production for the year, adjustments to certain properties in a downward direction left year-end reserves marginally lower than the year before. Farmins and successful bidding at lease sales resulted in a 12 percent increase in undeveloped acreage held by Murphy, up for the first time in four years, with attention focused around the fringes of the Peace River Arch, the Rainbow area and the core of the Alberta basin, along with a renewed effort in the heavy oil area and a residual of activity in southeast Saskatchewan. An exploratory program, which in dollar value exceeded the prior year, turned up most promising prospects offering development potential at Loon and Seal near Peace River, at Onoway and South Pembina, Keg River at Rainbow in northwest Alberta and thick channels of heavy oil at Plover Lake in Saskatchewan. Other reserves were added at a scattering of exploration tests and major infill drilling programs at Butte, Glen Ewen and Viewfield in south Saskatchewan, Provost and Tangleflags in the heavy oil area, and Atlee/Buffalo in Alberta. At year-end the Company had available a long list of investment options to choose from.

Governments, looking to the energy sector to create jobs, set the stage for more aggressive investment by removing many of the prior regulatory constraints. A February Atlantic Accord was followed in March by a Western Accord, which in the course of dismantling the disruptive National Energy Program will phase out controversial taxes. The Province of Alberta followed through with a plan to reduce royalties and a simplified incentive system. Other favorable incentives were introduced in Saskatchewan and British Columbia. Although the transition was not entirely smooth, oil prices were deregulated in June. Other visible signs that governments were looking to the petroleum industry to contribute materially to the economy by the creation of jobs, took the form of a change in the Foreign Investment Review Agency to a more favorable mandate under Investment Canada, a new frontier energy policy and a gas pricing and marketing scheme that is intended to provide freer access to markets. A favorable government-industry relationship, that has developed over several years, will now be put to the test of dealing with the challenges of an uncertain and unpredictable marketplace.

By mid-February oil prices had fallen to less than two-thirds of year-end values. Markets softened as buyers looked for further bargains. This scenario, if projected for any length of time, will result in a downturn of net income and cash flow available for reinvestment by the industry, perhaps seriously if prolonged. Murphy had anticipated some weakening of prices in constructing a 1986 plan. The positive impact of production from Lindbergh was expected to compensate for a minor deterioration of prices which in fact has been much more serious than expected. We have already modified this strategy in a downward direction.

Adding our voice to that of many experts willing to predict an unpredictable future, it seems unlikely that oil and natural gas prices can remain at this low level for any length of time. The recovery of prices, however, is likely to be at a slower pace than the majority are counting on. Prior changes to royalty and tax systems will cushion the downward pressure on cash flow to a certain extent. Nevertheless, it appears most likely that the 1986 investment plan of Murphy will by necessity have to be cut back. The objective remains to employ fully the cash flow available from operations.

An evaluation of the short-term future and the various scenarios by Company engineers and economists lead us to conclude that, even in the worst of cases projected, our performance should be relatively good by industry standards. A downturn may very well provide even higher quality opportunities for investment. Our projections also show feasibility to carry on investment at Lindbergh although if prices fall much further expansion may be slowed down.

The transition to free market pricing has not been without problems. Our Supply and Transportation Department has played a significant role in providing an understanding and stability to our marketing efforts. Transportation services continue to grow and contribute to operating and financial results.

After ten years of significant contribution to the direction of this Company, R.J. Sweeney, President and Chief Executive Officer of Murphy Oil Corporation, resigned from the Board of Directors. Mr. Sweeney was subsequently replaced by J.W. McNutt, Executive Vice President of Murphy Oil Corporation.

In retrospect, 1985 was a year of accomplishment for Murphy and further focus on direction for the future. The staff has responded well to the challenges of difficult projects and a changing business climate. There is every sign that 1986 will be even more difficult and we have put the challenges to our staff to focus even further on optimization. The Company has many good investment opportunities available and must rank and choose the best to employ capital that will generate maximum cash flow as oil and natural gas shift in value. The tone of the following text describes the status of our operations at year-end 1985. The few weeks that have followed have added caution to an otherwise optimistic outlook, however, Murphy is well poised to deal with any new realities.

R.G. Farquharson, P.Eng.
President and Chief Executive Officer

February 24, 1986
Calgary, Alberta

EXPLORATION/ PRODUCTION SUMMARY

As projected in the 1984 Annual Report, the high levels of exploratory and development activity continued in 1985 without losing momentum and resulted in the addition of significant equivalent reserves for the Company.

Drilling for oil and gas increased significantly in 1985, such that the combined exploration/development program was the most active in the history of the Company. Average percentage participation per well also increased from 44 percent in 1984 to 53 percent reflecting a policy of carrying a significant interest in projects and wells.

Lindbergh site in early stages of construction

The Company drilled, or had a working interest in, 312 wells, 165 on a net basis, compared to 245 gross (108 net) wells in 1984, a 27 percent increase. Of the overall program 81 (43 net) wells were classified as exploratory, a 103 percent increase over the 1984 total, while development drilling reached 231 gross (122 net) wells, up 13 percent from the previous year total of 205. The 43 net exploratory wells drilled resulted in 16 oil and eight gas discoveries. This exceeded the 1984 totals when 19 net exploratory wells were drilled resulting in 11 completed wells.

Land acquisition at crown sales was up marginally from 1984 with 60 229 gross hectares (30 909 net) being purchased, while farmins added to the inventory of undeveloped acreage. The geophysical database was enhanced by the acquisition of more than 5576 kilometres of new data.

According to Company engineers the oil reserves at year-end were up 19 percent. Lindbergh contributed roughly 50 percent of the increase with the remainder coming from other development and new discoveries. Proven gas reserves were down marginally to 5300 million cubic metres.

Highlights for 1985 included:

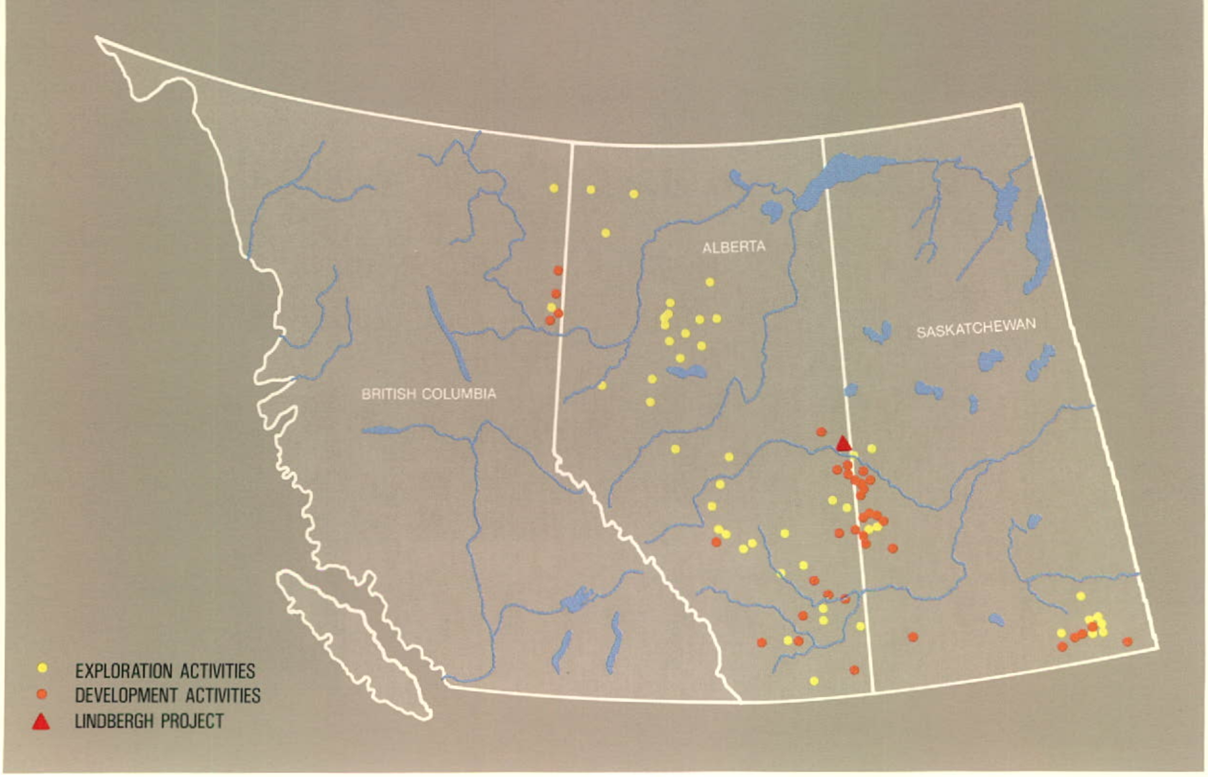
- Development of the Lindbergh heavy oil pilot to a viable commercial thermal project.
- Discovery of significant heavy oil reserves in the Plover Lake/Luseland area of Saskatchewan.
- Acquisition of more than 16 000 hectares of land in the Fort Pitt area of Saskatchewan.
- Record drilling activity with encouraging promise to provide opportunities for development.

Exploration and development drilling and individual projects are discussed in detail under separate headings.

WORKING INTEREST DRILLING RECORD

	1985 Gross	1985 Net	1984 Gross	1984 Net
EXPLORATION				
Conventional Oil Wells Completed	17	10.0	14	6.3
Heavy Oil Wells Completed	12	6.4	4	2.8
Gas Wells Completed	16	7.5	4	1.7
Dry Holes	36	19.0	18	8.1
	81	42.9	40	18.9
DEVELOPMENT				
Conventional Oil Wells Completed	71	15.5	92	12.7
Heavy Oil Wells Completed	121	87.9	80	60.0
Gas Wells Completed	9	1.1	1	1.0
Service Wells	6	.6	10	3.3
Dry Holes	24	16.7	22	12.2
	231	121.8	205	89.2
TOTAL	312	164.7	245	108.1

AREAS OF ACTIVITY IN WESTERN CANADA



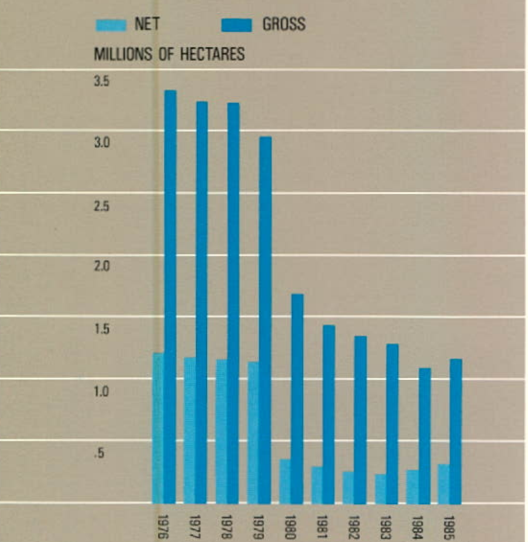
LAND

In 1985, Murphy maintained a policy of acquiring lands in areas deemed to have a high hydrocarbon potential as a result of in-house geological and seismic investigation. In 1985, 60 229 gross (30 909 net) hectares of new lands were purchased for $8,300,000. This expenditure was down from the 1984 figure of $11,600,000 when 59 297 gross hectares (28 919 net) were purchased including a consolidation of interests at Lindbergh. Land was acquired in Alberta, British Columbia and Saskatchewan at an average cost of $269 a hectare. Other lands were added by farmin.

Negotiations were completed with the Department of Indian Affairs to acquire a 100 percent interest in the petroleum and natural gas rights in a 16 304 hectare permit located on the Seekaskootch and Makaoo Indian Reservations in the Fort Pitt area of Saskatchewan.

The commitment to drill 17 wells in the Onoway area of Alberta, in order to earn a 45 percent interest in 110 sections, is nearing completion with only three wells left to drill. Murphy has added 28 331 gross (12 749 net) hectares to its land inventory pursuant to this exploratory venture.

UNDEVELOPED PROPERTY



LAND HOLDINGS SUMMARY

(As of December 31)

UNDEVELOPED PROPERTY	HECTARES 1985 Gross	1985 Net	1984 Gross	1984 Net
British Columbia	71,310	30,255	72,307	30,393
Alberta	491,804	172,557	456,313	162,246
Saskatchewan	122,333	72,093	92,272	48,285
Manitoba	4,056	2,342	4,696	3,486
Ontario	1,374	1,314	1,344	1,284
Davis Strait	474,797	23,740	474,797	23,740
TOTAL UNDEVELOPED	1,165,674	302,301	1,101,729	269,434
DEVELOPED PROPERTY				
British Columbia	8,891	3,536	8,755	3,452
Alberta	155,997	56,760	156,555	56,278
Saskatchewan	28,817	15,813	27,363	14,873
Manitoba	1,799	1,398	1,896	1,479
Ontario	1,983	1,787	2,014	1,821
TOTAL DEVELOPED	197,487	79,294	196,583	77,903
GRAND TOTAL	1,363,161	381,595	1,298,312	347,337

EXPLORATION

Murphy continued an aggressive exploration program throughout 1985 that saw exploration drilling activity substantially increased over 1984 levels. Western Canada continued to be the main exploration target where Murphy believes there still remains excellent opportunities for discovering economic oil and natural gas reserves, with Alberta the prime target.

Areas of special interest in the search for conventional oil include Seal, Gilwood, Senex, Peerless, Rainbow, Grande Prairie, Onoway and Buck Lake in Alberta, and Neptune, Forget, Freda Lake, Stoughton/Kendall and Gooseberry Lake in Saskatchewan. Heavy oil exploration was concentrated at Plover Lake, Luseland and Fort Pitt areas in Saskatchewan, and Wainwright in Alberta.

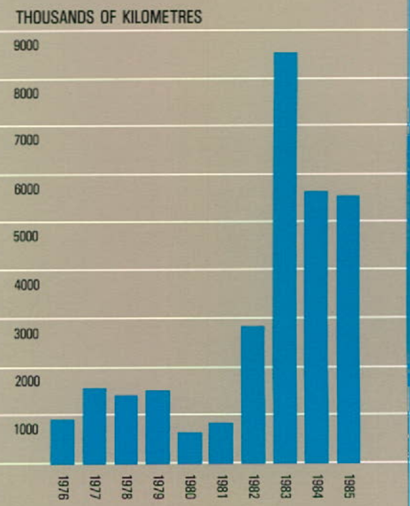
ALBERTA

CONVENTIONAL EXPLORATION

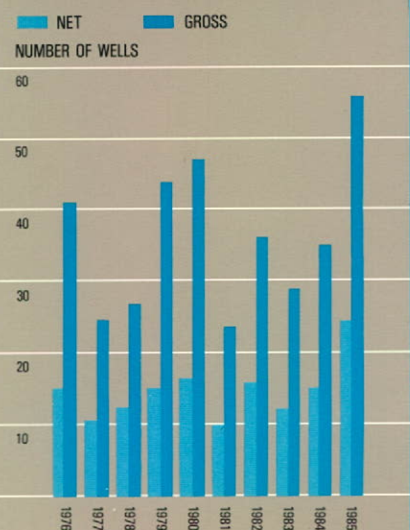
- During 1985 Murphy participated in 11 wells in southern Alberta. This drilling resulted in an extension to the oil pool previously discovered in the Skiff area. Additional oil reserves were found at Enchant, Drumheller West and Hespero. Gas discoveries were made in the Princess and Sheerness areas.
- A potentially significant oil discovery was made near Buck Lake at year-end. The Company has a 40 percent interest in 576 hectares of petroleum and natural gas leases in the vicinity of the discovery.
- The Company acquired a 100 percent interest in 1536 hectares in the Hilda area and has a comprehensive seismic program planned for 1986, as well as in the Davey Lake and Halkirk areas. A land acquisition program in the Three Hills Creek area resulted in a varied working interest in 2048 hectares of petroleum and natural gas leases through crown sales and farmins.
- At Onoway* in central Alberta, the Company mounted an aggressive drilling program on a 110 section farmin block acquired in late 1984. A 17 well program was committed by Murphy to earn a 45 percent interest in the acreage and by year-end 14 of the wells had been drilled. In spite of the exploratory nature of the drilling, Mannville gas has been discovered in three areas and Wabamun oil in two areas. Wells in two additional areas have been suspended and may be evaluated further in 1986. Seven of the completed tests have been cased for oil or gas reserves and additional drilling and production testing will be necessary to evaluate the potential of these discoveries.
- In the Slave/Seal* areas of northern Alberta, Murphy participated in six wells which resulted in four oil wells and one suspended awaiting further evaluation. An additional 896 hectares were acquired and will be evaluated in 1986. The Company holds a 50 percent working interest in two of the oil wells and a small working interest in the other two.
- In the Gilwood/Little Horse Lake* area of northern Alberta, increased industry drilling has resulted in new oil discoveries. Murphy participated in a farmin well at Little Horse which earned 2048 hectares and encouraged a successful bid on adjacent crown lands. An additional 5056 hectares of prospective acreage were acquired and seismic will be used in the 1986 season to delineate additional drilling locations. Murphy has a varied working interest ranging from 22 to 100 percent on these lands.
- In the Grande Prairie area of

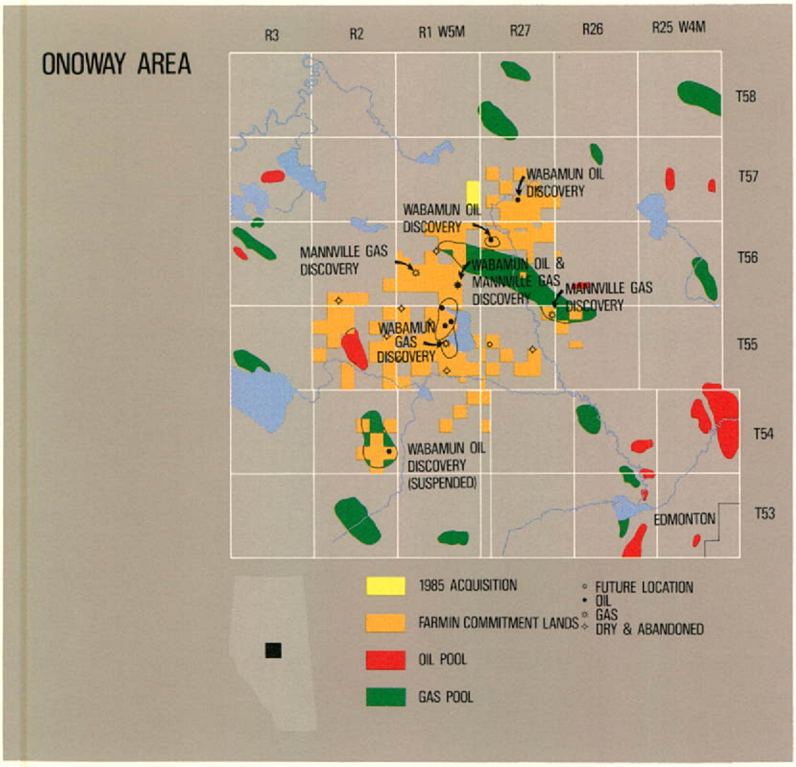
* Indicates map in this section.

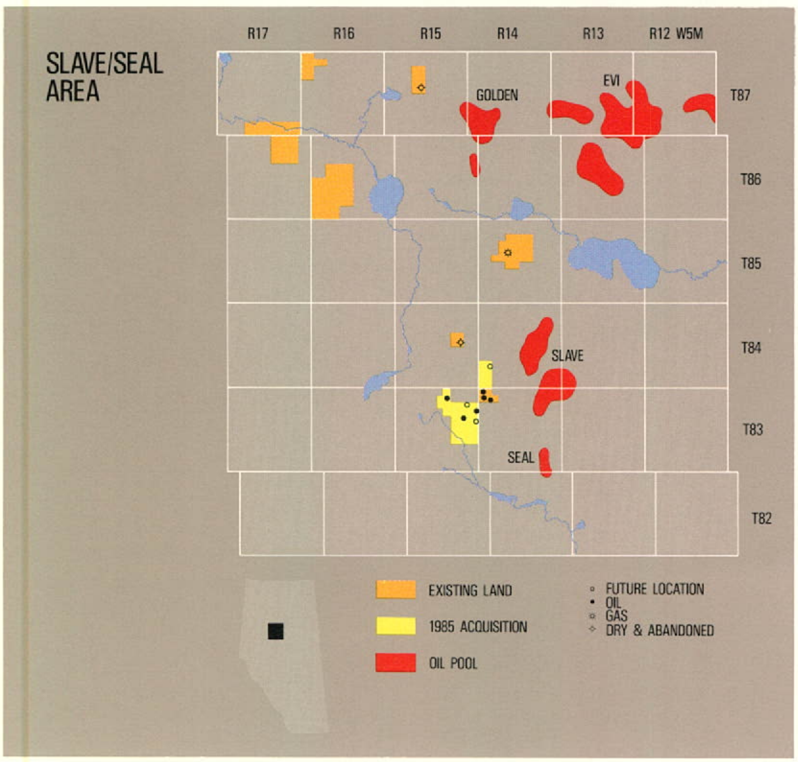
GEOPHYSICAL ACQUISITION WESTERN CANADA



CONVENTIONAL EXPLORATION DRILLING







northern Alberta, Murphy acquired an additional 768 net hectares to complement its 38 percent interest in over 5600 hectares of crown leases. The Company held a 50 percent interest in one well which failed to extend the reservoir of initial gas discovery made in 1984. However, the prospect remains potentially significant.

- In the Senex/Peerless Lake* region where Murphy previously held a varied working interest in 11 264 hectares of land, 9984 additional gross hectares (3043 net) of land were acquired. Recent industry discoveries have increased optimism for hydrocarbon accumulations on these lands and a seismic and drilling program is planned for 1986.
- In northwest Alberta an oil well at Rainbow is being completed and additional drilling is planned to evaluate other land holdings in the area. Murphy's interest in the oil well is 25 percent and the Company holds a one-third interest in the new drilling planned for early 1986.

HEAVY OIL

- In the Wainwright area of east-central Alberta, Murphy is continuing exploration for heavy oil in the Devonian carbonates and Cretaceous Mannville sands. In 1985 Murphy purchased a 50 percent interest in 1150 hectares at crown land sales. The Company also acquired an interest in an additional 1280 hectares having drilled three earning wells. One of the wells was completed for Cretaceous oil and one is awaiting completion as a Devonian oil well. More seismic and drilling are planned for 1986.

SASKATCHEWAN

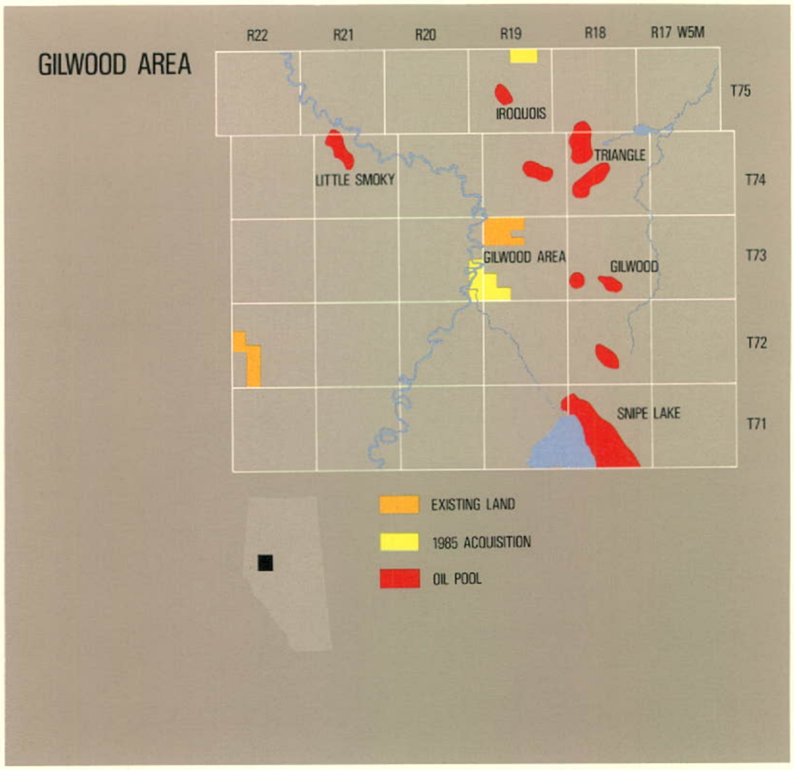
Despite a less favorable fiscal regime, Murphy continued to explore its Saskatchewan holdings offering significant reserve potential. Heavy oil lands were added to Plover Lake, Luseland and Fort Pitt. In total 27 223 gross hectares (21 440 net) were acquired in these heavy oil areas and 12 563 hectares (6508 net) in conventional oil areas.

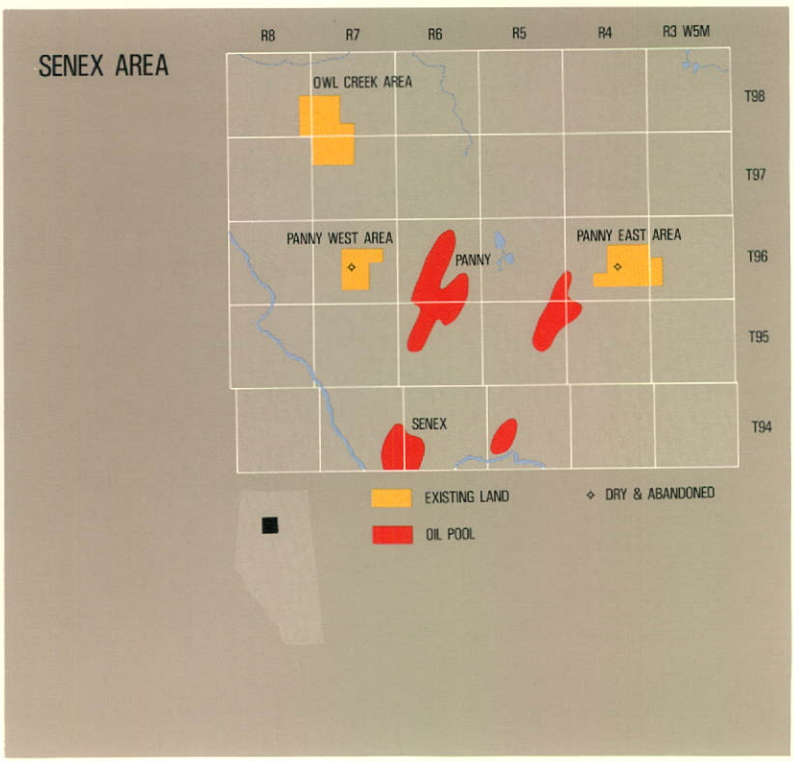
CONVENTIONAL EXPLORATION

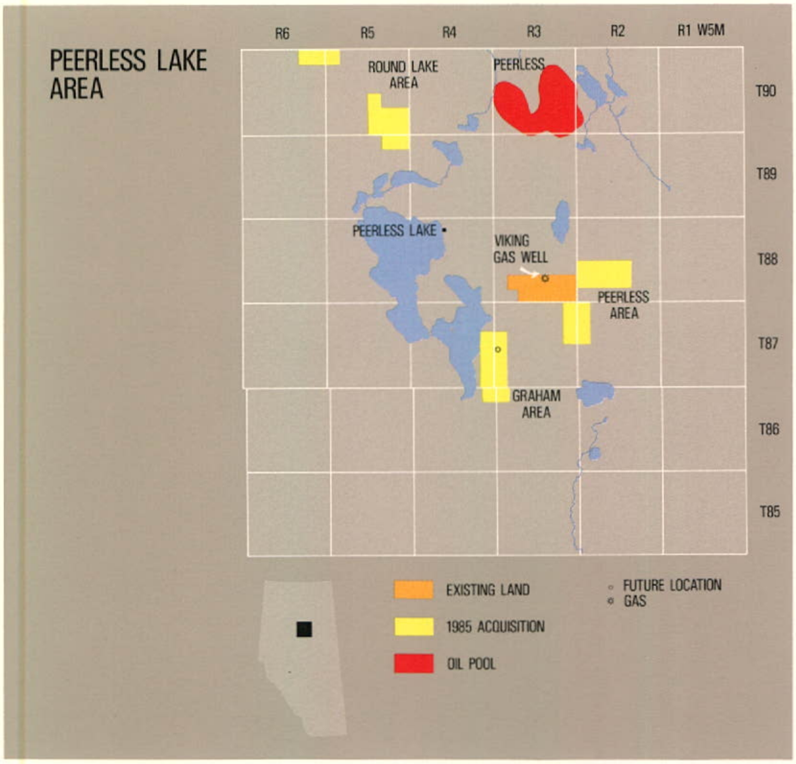
Although concentrating more of its exploration endeavors towards heavy oil, Murphy continued to maintain a positive stance with regard to exploration for conventional oil in the southeast section of the province. Additional lands were acquired in the Neptune, Freda Lake, Stoughton/Kendall, Forget and Gooseberry Lake areas. Drilling activity in these areas was minimal in 1985 but an ongoing seismic and drilling program may progress in 1986 with the Mississippian and deeper horizons targeted as the primary objectives. Drilling activity here will be most dependent upon oil pricing and royalty levels.

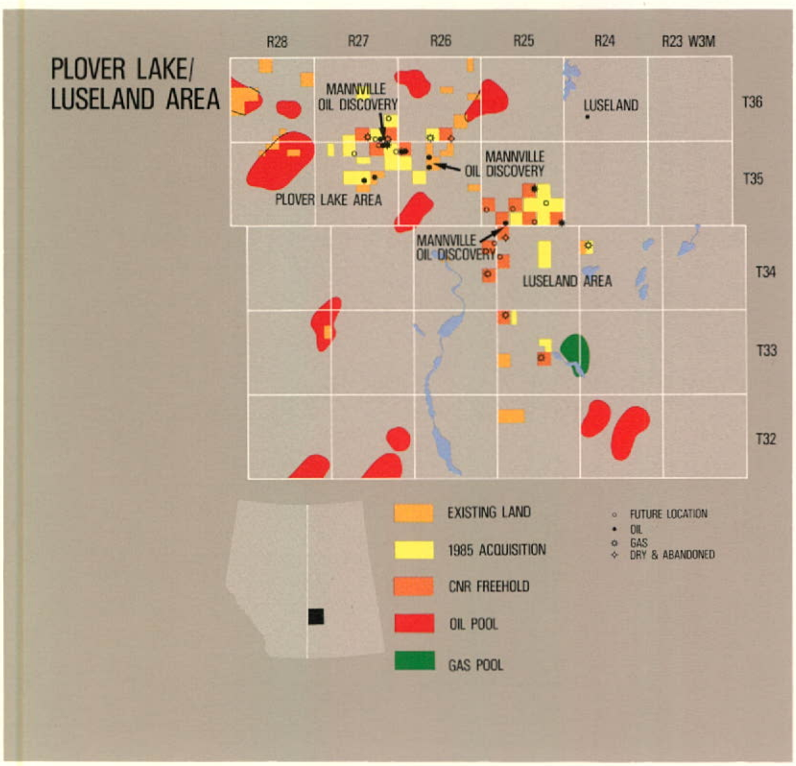
HEAVY OIL

- In the Plover Lake* area of west-central Saskatchewan, exploration along a prominent sand channel has proven successful. The Company participated in 13 wells, casing nine for oil production and three for gas. The drilling program resulted in a significant addition to recoverable reserves and more potential for enhanced oil in the future. Murphy and partners purchased 5376 gross hectares (2214 net) and have plans for continued exploration. Development drilling will follow a three-dimensional seismic program over selected lands. Murphy holds an average working interest of 42 percent along this sand trend.
- In the Luseland* area of west-central Saskatchewan, Murphy and partners









are actively exploring for Mannville and Mississippian heavy oil. During 1985 a total of eight wells were drilled resulting in three oil and gas wells and four gas wells. Drilling has been primarily on farmin lands from which the group will earn an interest in a further 1250 gross (416 net) hectares. Additionally 2176 gross (1237 net) hectares have been purchased at crown sales. Drilling in several prospective areas has been scheduled for 1986.

- At Fort Pitt* in west-central Saskatchewan, Murphy has acquired the petroleum and natural gas rights for a 3361 hectare block with heavy oil and gas potential in the Cretaceous Mannville. A seismic program was conducted during 1985 and has generated several drillable locations scheduled for evaluation in 1986.
- An exploration agreement has been negotiated by Murphy on two adjacent Indian Reservations also in the Fort Pitt area involving an additional 16 304 hectares of land with similar Mannville potential. The initial exploration phase involving reconnaissance seismic is scheduled for these lands in 1986.

BRITISH COLUMBIA

Recognizing the changed attitude of the British Columbia Government to exploration for oil and gas, Murphy acquired a 50 percent interest in 1562 gross hectares of petroleum and natural gas rights in the Rigel area and will be conducting a seismic program to evaluate this acreage.

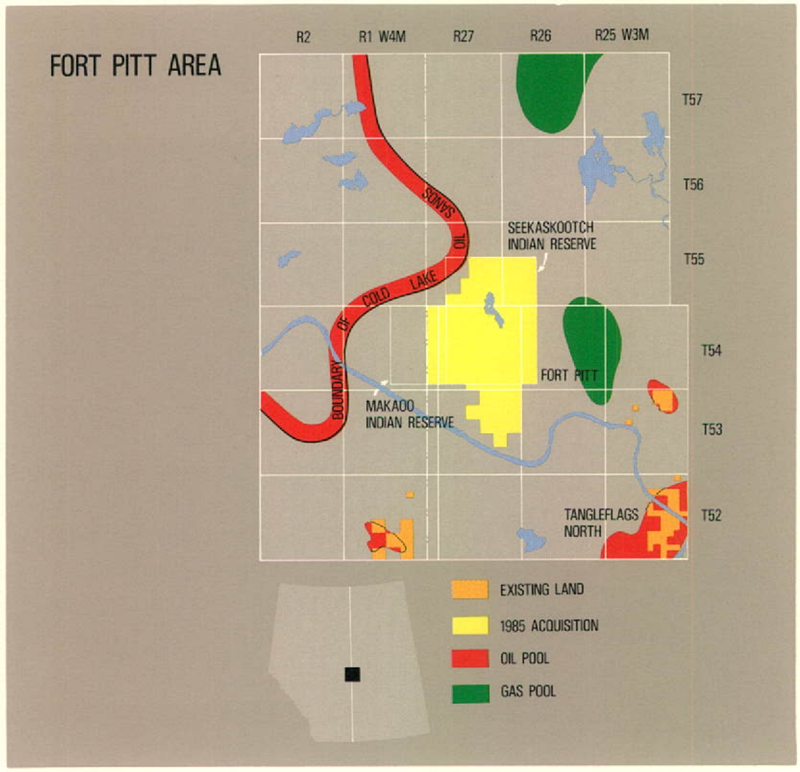
SUMMARY AND OUTLOOK

In total, exploratory drilling for conventional oil and gas reached 56 gross wells (30 net), an increase of 21 wells, or 60 percent, over 1984. The average working interest in these wells was 54 percent. This reflects the Company philosophy of maintaining a significant working interest in potentially attractive areas. In addition three exploratory wells were drilled on Company lands by competitors at no cost to the Company.

Emphasis on exploration for heavy oil was increased in 1985 with the drilling of 25 exploratory wells, 22 in Saskatchewan and three in Alberta.

Throughout 1985 Murphy maintained an active geophysical program to evaluate current land holdings. A total of 5576 kilometres of new geophysical data was acquired.

Looking to the future, Murphy Oil Company Ltd. plans to continue exploring aggressively in western Canada, building and expanding, blending its exploration endeavors in the search for both conventional and heavy oil and natural gas. It is the intent of the Company to maintain a diversified exploratory effort. The portfolio of prospects is reviewed regularly to assign budget based on up-to-date economic direction to conventional oil, heavy oil or natural gas. Natural gas is now receiving a heavier weighting in anticipation of an increase in demand over the next several years as a response to the deregulated market.

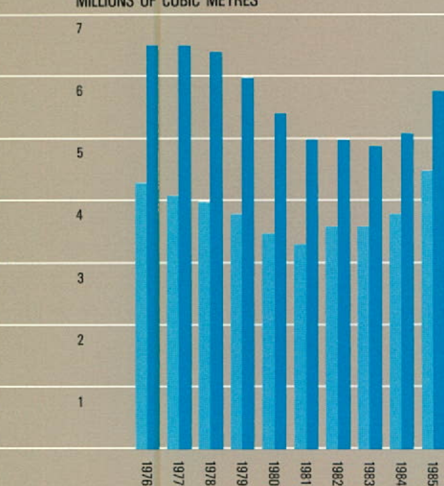


PRODUCTION

PROVEN OIL & NGL RESERVES

NET GROSS

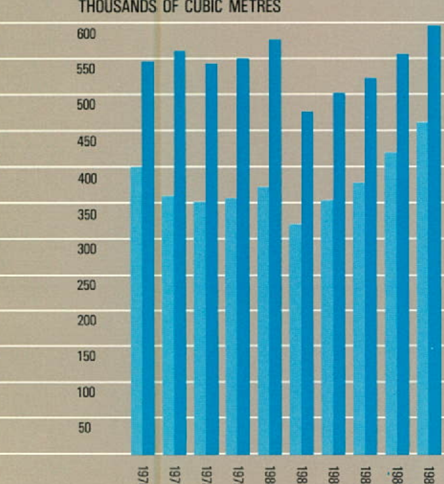
MILLIONS OF CUBIC METRES



OIL AND NGL PRODUCTION

NET GROSS

THOUSANDS OF CUBIC METRES



Oil and natural gas liquids production increased over the prior year, primarily as a result of general development, infill drilling and the 1984 Lindbergh pilot expansion, which has performed much better than predicted. Average daily oil production before deducting royalty was 1635 cubic metres, an increase of seven percent over 1984, while corresponding net production volumes of 1271 cubic metres per day exceeded the previous year by 11 percent. Natural gas production before royalty averaged 723 000 cubic metres per day, up three percent from the 700 000 cubic metres in 1984. On a net after royalty basis, average daily gas production was 585 000 cubic metres, up five percent.

DEVELOPMENT DRILLING

Throughout 1985 the Company participated in a total of 231 gross (122 net) development wells. Ninety percent of these were cased for oil, gas or other service. As in recent years, emphasis was on heavy oil where 142 gross wells (103 net) were drilled. This represents 62 percent of the development drilling activity of the Company in 1985. The heavy oil drilling was widely scattered throughout the greater Lloydminster area with concentrations at Lindbergh, Provost and Hayter in Alberta, and Tangleflags in Saskatchewan.

Government action saw the elimination of the Petroleum and Gas Revenue Tax on production from newly drilled wells and the termination of the Petroleum Incentive Program as of March 31, 1986, coupled with the introduction of periods of royalty-free production in Alberta, British Columbia and Saskatchewan. This has resulted in escalated joint venture infill drilling at Glen Ewen, Butte, Midale, Weyburn, Dodsland and Viewfield in Saskatchewan, and Atlee and Manyberries in Alberta.

In addition to the infill programs, development drilling extended the productive area of the recently discovered oil pools at Neptune and Bromhead in Saskatchewan, and Willesden Green in Alberta.

An inventory of development drilling is available for future investment at Plover Lake, Luseland, Silverdale, Neilberg, Forestbank and Evesham in Saskatchewan, at Grand Forks, Countess, Princess, Leslieville and Ferrybank in Alberta, along with Prespatou in British Columbia. With this inventory of viable development prospects, a high level of drilling activity could be carried out in 1986. To a large extent the level of this activity will be dependent upon the significance and duration of falling crude oil prices.

RESERVES

As estimated by Company engineers, oil and natural gas liquids reserves were 4 500 000 cubic metres at year-end, an increase of 741 000 cubic metres, or 19 percent, over 1984 figures.

A major contribution to the oil and NGL reserves was made by the development of the Lindbergh Thermal Project where predictable volumes of in-place oil can now be designated as recoverable based on a long history of successful pilot operations. Only reserves assignable to drilled locations have been added; however, significant additional reserves are anticipated as the development of Lindbergh proceeds through the various development phases planned. Along with Lindbergh drilling, other successful development during the year more than replaced production.

Net natural gas reserves of 5300 million cubic metres were down 302 million cubic metres, or five percent, from 1984 year-end. Natural gas drilling replaced production; however, a re-evaluation of several properties in inventory resulted in downgrading some prior year figures. At the current rate of production, natural gas reserves have a producing life of approximately 27 years.

CONVENTIONAL OIL OPERATIONS

The many pools in which the Company holds a working interest are continually reviewed for further development potential or unknown prospects. This monitoring process resulted in new oil wells at Sylvan Lake and Countess. Wells at North Boundary and Prespatou in British Columbia, and Cessford, Grand Forks and Willesden Green in Alberta, and Neptune along with Bromhead in Saskatchewan were drilled or reworked.

An enhanced oil recovery pilot project has been initiated in the Saskatchewan Midale oil pool where carbon dioxide is being used as an enhancing agent. In Alberta, hydrocarbon miscible floods at South Swan Hills, Swan Hills/Judy Creek and Rainbow are expected to add new reserves for the Company.

NATURAL GAS OPERATIONS

With less regulation of natural gas pricing, the Company has concentrated efforts on maintaining full deliverability to existing sales contracts and locating new markets for shut-in, noncontracted gas reserves. Shut-in wells were activated at Elm and Airport in British Columbia and at Claresholm in Alberta.

Protracted negotiations with industrial users have been initiated in an attempt to increase the Company's share of the natural gas market:

- At Yoyo, British Columbia, a market has been developed with an industrial user for surplus gas and delivery began in October, 1985.
- At Barrhead, Alberta, ongoing negotiations may lead to delivery of natural gas to the TransCanada PipeLines system by mid-1986.
- At Retlaw, Alberta, a contract has been negotiated with an industrial user and negotiations are continuing with partners to tie-in high productivity wells for delivery in 1986.

These projects demonstrate a Company policy of satisfying existing markets and at the same time exploiting the short-term spot markets while maintaining reserves for what is expected to be a significant upturn in several years as export demand improves.

HEAVY OIL OPERATIONS

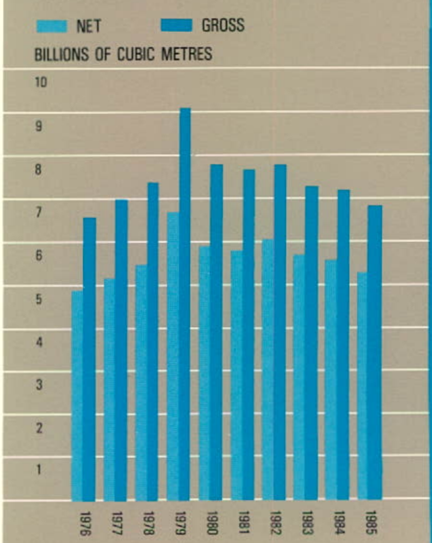
An internal reorganization dividing the heavy oil area into exploration and exploitation divisions has improved effectiveness to compete for land where industry activity is high.

The 1985 heavy oil development drilling program resulted in 142 gross (103 net) wells. The majority of these were drilled at enhanced recovery projects with 46 completed in the first phase of the Lindbergh Steam Project, two steam potential wells in Senlac, one at Morgan and one at Tangleflags. Other development activity was scattered throughout the general Lloydminster area with notable concentrations in the Hayter and Morgan areas in Alberta, and Tangleflags in Saskatchewan.

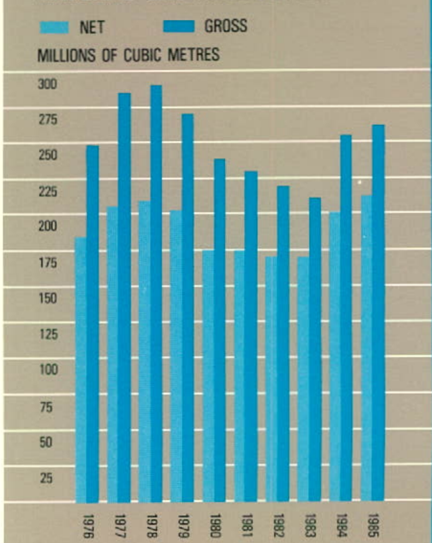
The focus remained on enhanced recovery potential with three new thermal projects initiated:

- At Bodo in southeastern Alberta, a nine-well steam stimulation project was developed in conjunction with the Alberta Oil Sands Technical Research Authority (AOSTRA). The pilot is expected to evaluate the relative

PROVEN NATURAL GAS RESERVES



NATURAL GAS PRODUCTION



potential of steam to that of the long standing fireflood at Bodo.

- At Morgan in eastern Alberta and Tangleflags in Saskatchewan, one-well pilot steam projects are in operation. Development drilling has confirmed the presence of large volumes of heavy oil in place in these pools of which less than one percent is likely recoverable by primary means. Early results show steam injection offers significant promise to improve recoveries.

Other projects are planned for 1986 at Senlac in Saskatchewan, Atlee in southeast Alberta and Morgan near Lloydminster.

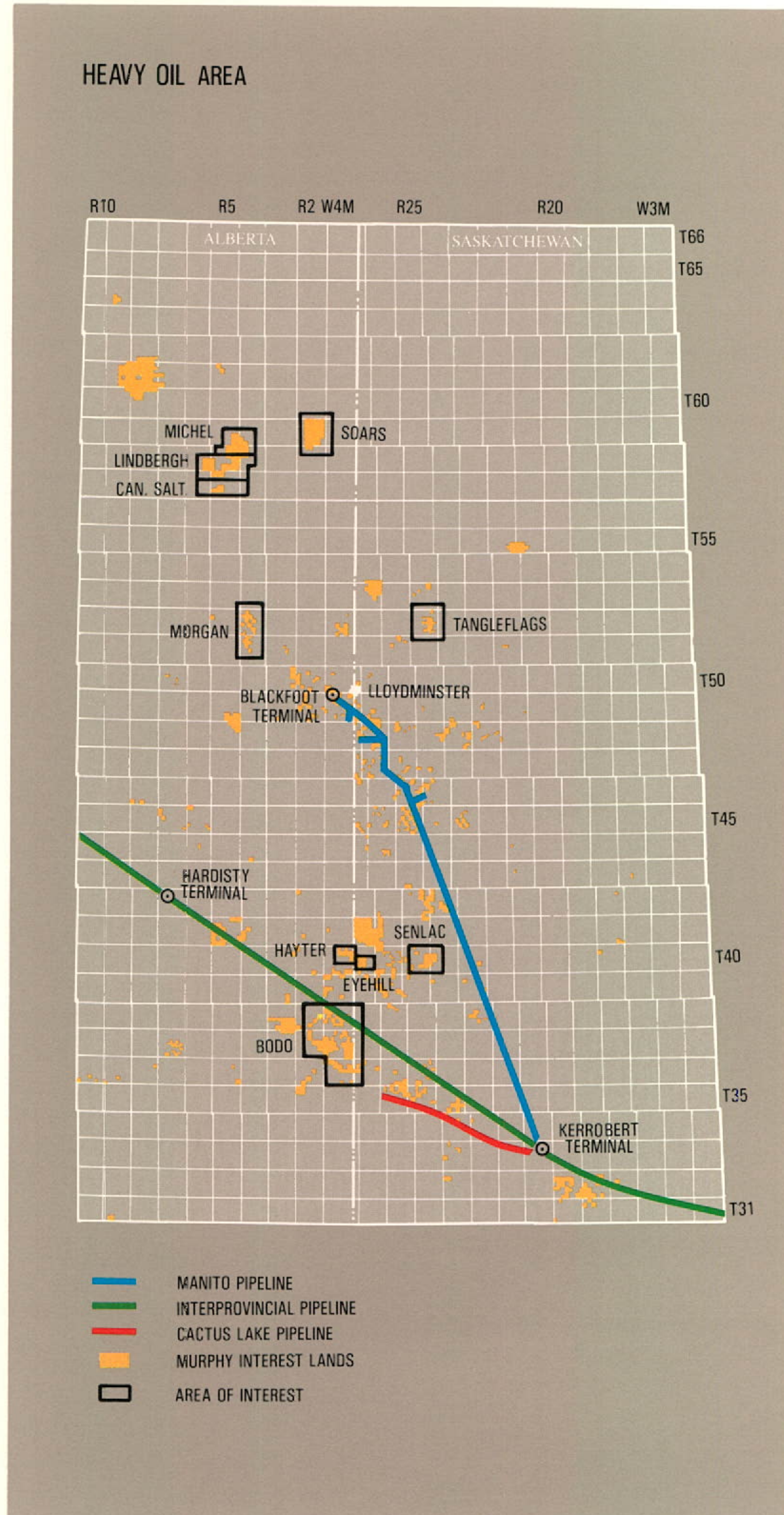
The operational pilots of the Company are meeting with mixed success:

- The Eyehill fireflood continues to perform well and an 18-well infill drilling program is scheduled for 1986 if oil prices permit.
- The Bodo fireflood, which was expanded to 31 wells in 1984, has been plagued by sanding and pump problems resulting in decreased production and has less promise from a commercial point of view.
- The Lindbergh Steam Project is being developed to a viable commercial stage.

OUTLOOK

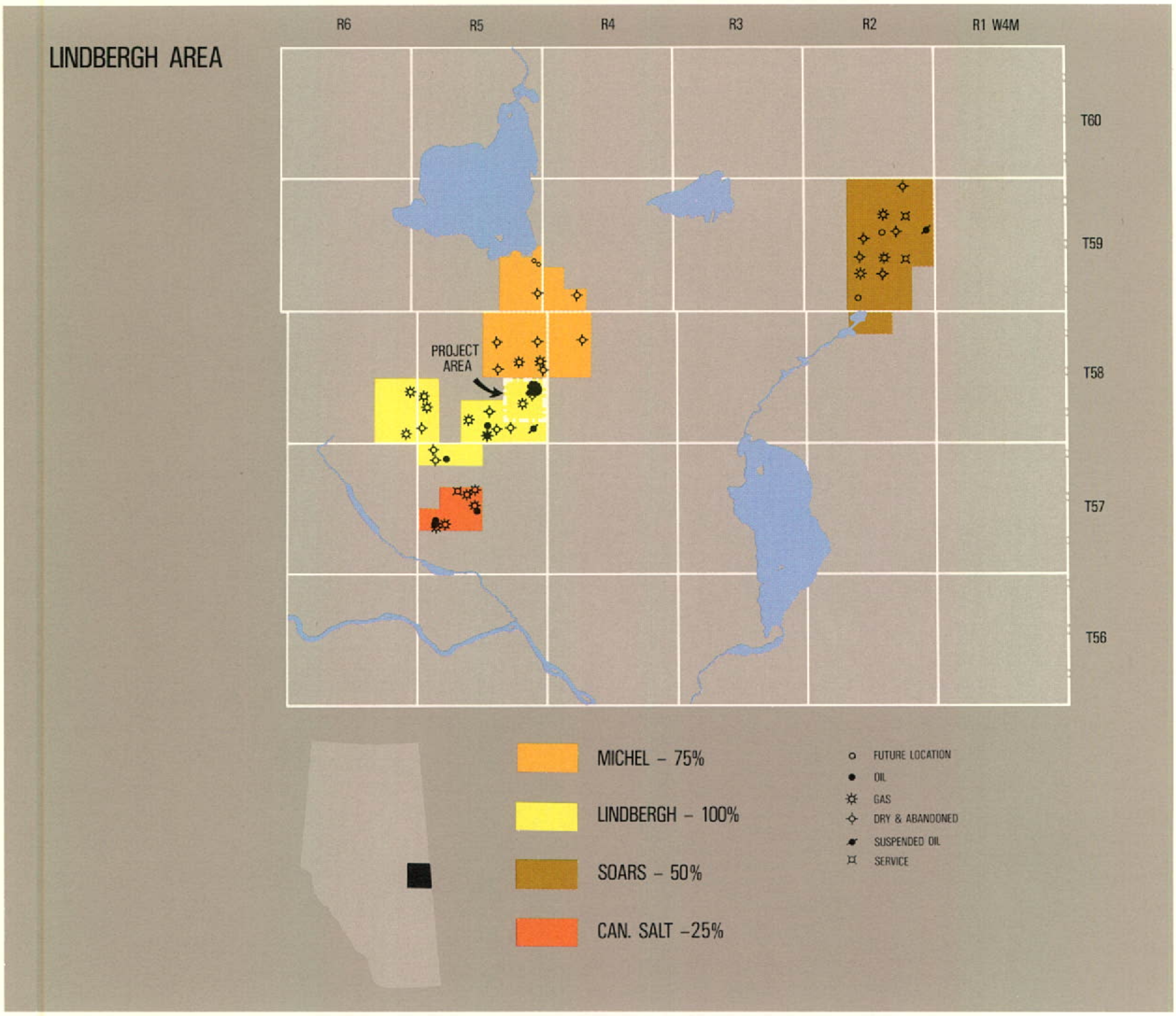
The Company has available to it a long list of development investment opportunities. Once again these are being ranked for economic potential. Priority will be given to those generating early cash flow.

As a result, 1986 will very likely see a concentration of effort to developing recent oil discoveries and placing on stream newly contracted gas.



Pumpjack and drilling rig, Lindbergh


Universal



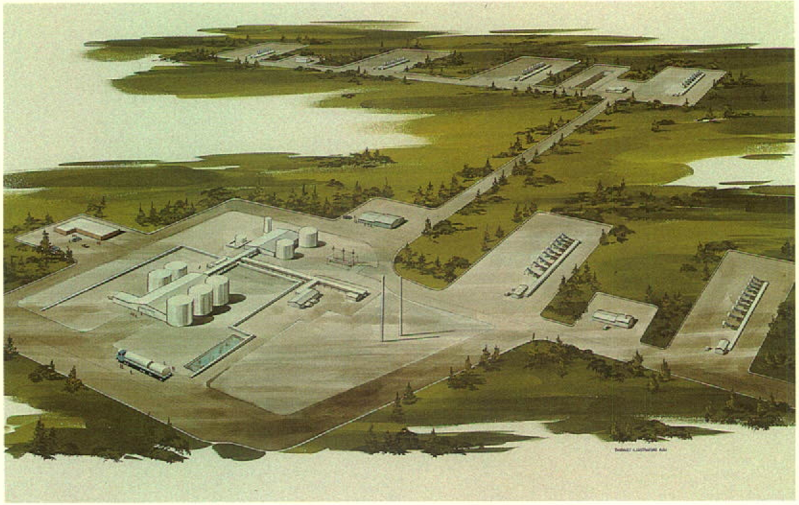
LINDBERGH THERMAL RECOVERY PROJECT

In late September of 1985 an Order-In-Council from the Province of Alberta granted the province's approval for a commercial thermal project at Murphy Lindbergh leases. This brought to a conclusion a long series of negotiations with the government for fiscal and regulatory arrangements necessary to encourage investment in enhanced oil recovery using steam injection.

Evaluation of the Lindbergh leases was started in 1974 when a seven-well pattern was drilled to initiate a steam pilot for the purpose of testing recovery potential. For ten years, during which time market and prices of heavy oil fluctuated adding to the uncertainty of the project, the Company tackled successfully the technical and operational challenges. The solution to field problems led to a number of innovations helpful to the industry.

Technical success led to expansion of the pilot in 1984 when nine wells were drilled to develop three seven-spot patterns. Test results of the expansion area materially surpassed the results of the original pilot. As a consequence, application for the Lindbergh Thermal Recovery Project was filed with the Alberta Energy Resources Conservation Board in late 1984.

The application requested approval to construct and operate Phase I of a four phase 1600 cubic metres of oil per day steam stimulation project. Phase I was intended to develop 400 cubic metres of oil per day with production wells, a water source, steam generation, treating and water disposal facilities. The



Artist conception of Phase I Lindbergh Heavy Oil Project.

Calgary-based design and engineering group

application addressed the technical considerations of the process and operations, as well as environmental, socio-economic and economic aspects. A public awareness program, including town meetings, an open house and individual information sessions, was conducted throughout the area with a positive response.

Phase I was projected to generate 80 jobs during peak construction and add 35 permanent positions. The Phase I capital cost is $32 million with annual operating costs of $12 million. To maintain production volumes over a 20 year project life a total of 400 wells will eventually be drilled, dwarfing the initial investment requirements. Phase I of the project is currently under construction and is scheduled to be on production in the spring of 1986.

If the results of the first phase are encouraging, additional expansion may be added at two-year intervals bringing the fully developed scheme to a 1600 cubic metres of oil per day level. Phase I of the Lindbergh Thermal Recovery Project will have a significant impact on proven reserves and oil revenues of the Company. If economically and technically successful, this project alone could in time double production and quadruple reserves over 1985 year-end levels.

The expanded pilot is significantly out performing expectations. Project drilling has proven that more oil is in place than expected as thicker oil columns were penetrated. If markets and prices allow aggressive investment, the Company may reach the equivalent performance of Phase II, up to 800 cubic metres per day, during 1987.

SUPPLY AND TRANSPORTATION

The federal government deregulation of crude oil controls effective June 1, 1985 affected a substantial portion of S&T's operations. Deregulation, although welcome, quadrupled the amount of paperwork required to carry out specific responsibilities, but it is believed a substantial amount of this workload will decrease with time. The industry is undergoing a shake-out period in both crude oil pricing and strategy. Prices are expected to be very uncertain throughout 1986 with the trend leaning toward the strengths and weaknesses in spot sales and seasonal demands. The retention of the Alberta Petroleum Marketing Commission and its system of maintaining control of royalty crude oil from wellhead has placed a substantial logistical burden on industry.

Storage tank construction, Lindbergh

Demand for crude oil by the United States' refiners increased following deregulation. Although this demand has a profound impact on crude oil and condensate gathered and distributed by S&T, it also created further problems obtaining pipeline space within Interprovincial Pipe Line which is the main artery to markets in the United States and eastern Canada.

Expansion of the Milk River Pipeline system highlighted an active 1985. This expansion was completed in July and included a pipeline connection to the Cenex Big Sky Pipeline at the United States/Canadian border and a connection to the Home Oil Manyberries pipeline. Average throughput volumes increased accordingly. The Milk River Pipeline system averaged 605 cubic metres per day during the first half of 1985 and 2150 cubic metres per day during the second half of 1985, as compared to 606 cubic metres per day in 1984. Murphy's truck terminal facilities, connected to this system, were also expanded to complement the program.

The Manito Pipeline system transported an average of 4370 cubic metres per day of Lloydminster Blend during 1985, as compared to 4260 in 1984. Minor construction programs continued with the completion of additional pumping capacity at the Lone Rock Station. Engineering and design work for two lateral pipeline connections and more condensate tankage is currently underway. Construction contracts are scheduled to be awarded in 1986.

The Cactus Lake Pipeline, operated by Murphy, carried an average of 1608 cubic metres per day during 1985, as compared to 1229 during 1984.

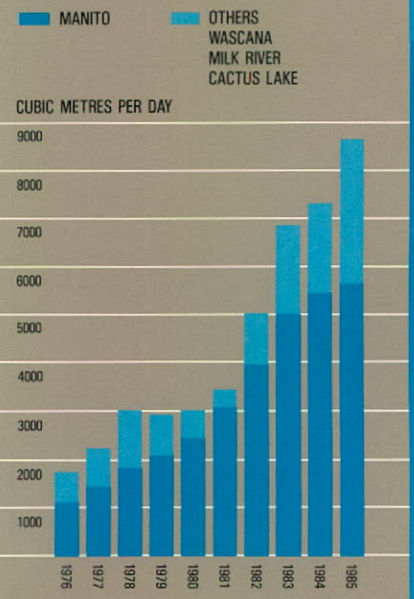
To facilitate the expansion of the Lindbergh project, Murphy has developed a long-range program for the handling and marketing of the expected production volumes. A 1600 cubic metre crude oil tank and a 1600 cubic metre condensate tank were constructed near the Manito Pipeline Blackfoot Terminal to provide adequate insurance against any possible disruption of producing rates. In addition, engineering and design work is underway for a 15 000 cubic metre crude oil tank at Kerrobert, Saskatchewan to complement the overall project. Crude oil contracts for the sale of Lindbergh crude are in place.

Road oil sales from the facilities in Lloydminster for 1985 were very encouraging. Sales volumes doubled over 1984 and are anticipated to increase once again in 1986.

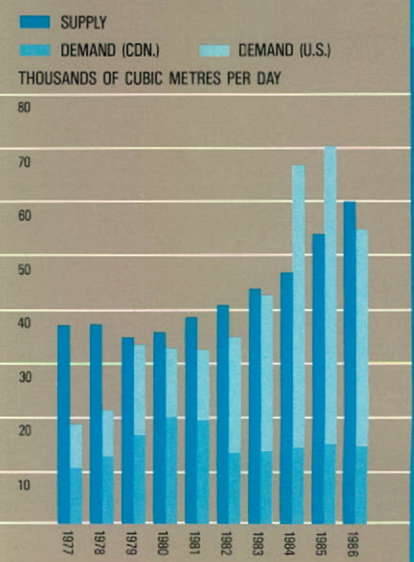
Murphy's cleaning plant and trucking operations surpassed financial projections. The Company expects this area of operations to provide support to the Lindbergh project in its development stage throughout next year.

Supply and Transportation operations of the Company are generally expected to maintain a steady growth throughout 1986 with much of this optimism depending upon crude oil prices.

PIPELINE THROUGHPUTS



CANADIAN HEAVY OIL SUPPLY VS. DEMAND



HUMAN RESOURCES

While industry hiring trends continued to be viewed with cautious optimism, Murphy again was in a position to realize growth with an addition of 33 new positions. At December 31, 1985, the Company employed 304 persons of whom over 35 percent were management, technical and professional personnel. The majority of employees (166) are based in Calgary, with the rest dispersed throughout operations in the provinces of Alberta, Saskatchewan and Ontario.

Geophysicists examining Lindbergh seismic data

Murphy became more cognizant of the challenges presented to the human resources practitioner throughout 1985 as a result of: pending legislative changes in the Employment Standards Act, Occupational Health and Safety, the impact of the Charter of Rights, and pending legislation on pension reform. Major policy issues seemed to proliferate and "employment equity – equal pay for work of equal value", "right-to-know", "affirmative action", to name a few, were phrases that were echoed throughout industry and became commonplace both federally and provincially.

An equal opportunity employer, Murphy reviews on an ongoing basis the implication of legislative changes in each of the Company's stated policies and practices in order to ensure the continued equal treatment of all employees.

The Company maintains a broad range of benefits including illness, disability, life insurance, pension and savings plans for its employees.

Murphy is committed to the pursuit of excellence and leadership needed to act upon the Company's vision to focus on achieving the objectives of the organization – through teamwork. The management style of the Company is participative, advocating and fostering open communication, innovation, responding positively to change and maintaining a dynamic team spirit.

Murphy's perception of training as an investment is evident in its successful Employee Development Program. Through continuous expansion of in-house training programs, participation in the Educational Assistance Program, attendance at seminars and conventions sponsored by professional associations and educational institutions, opportunities for employee development and job enrichment were exercised at all levels in the organization.

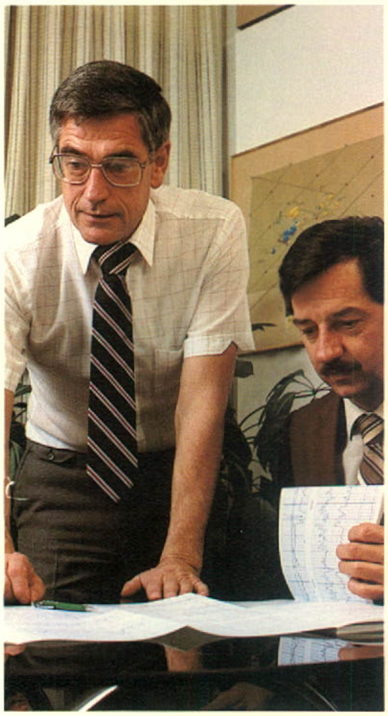
Recognizing the importance of assisting young adults through the efforts of the Summer Student Program, Murphy's student employee population reached a record high of 35 during 1985. As well, the Company Scholarship Program continued to assist employees' children in advancing their education through annual awards.

Murphy has always been conscious of its responsibilities as a corporate citizen and contributes to social, cultural, educational, welfare and community projects across Canada by means of the Corporate Donations Committee. To encourage individual support by employees, the Employee Gift Matching Program initially matched dollar-for-dollar funds donated by staff members. This practice was further enhanced this year with the Company now matching two-for-every-one employee dollar donated.

Through corporate and employee donations, the Company continued its active support of the annual United Way Campaign achieving 90 percent employee participation in 1985.

The most important strength Murphy has is people. Through the proper utilization of human and financial resources, the Company anticipates a bright future.

FINANCIAL REVIEW



Monitoring Lindbergh project

CONSOLIDATED

Total revenues for 1985 were $130,866,000, reflecting an increase of nine percent when compared to 1984. Significant and contributing factors were an increase in crude oil and natural gas production volumes and increased revenues from the handling and transportation of crude oil in Company vehicles and pipeline facilities.

Consolidated net income for 1985 was $21,088,000 which represented an increase of five percent over 1984. The current year's net income was adversely affected by a change in accounting treatment for investment tax credit. In 1985 the credit was reported as a reduction of capital expenditures (cost reduction method) while for 1984 the credit was reported as a reduction of income tax expense (flow through method). The 1985 investment tax credit totalled $1,843,000, as compared to $1,120,000 for 1984.

Cash flow for 1985 totalled $62,760,000, up 21 percent over the $51,960,000 reported in 1984. In addition to the revenue increases previously mentioned, cash flow was further enhanced by a significant reduction in income taxes as discussed in the General Corporate Section. The cash flow amount for 1985 set a new record for the Company's operations.

The year 1985 should be regarded as a year of change within the Canadian petroleum industry and in particular with regard to government regulation and control of the industry. The decision-making process with respect to pricing and marketing has been placed back in the hands of the industry, in general, and individual companies, in particular. The federal government has agreed to eliminate, or at least phase out, various special taxes and incentive programs. As a follow-up, the Alberta Government has improved netbacks to the industry through reduction of royalty rates. While the tax and royalty changes will be phased in over a three-year period, the Company has already seen some modest improvement in 1985. A more significant improvement will be reported in 1986 with approximately $3 million being added to net income from the reduction of Petroleum and Gas Revenue Tax and Alberta royalties. These benefits will continue to grow over the next few years.

EXPLORATION AND PRODUCTION

Production revenues for 1985 were higher due to increased production volumes of both light and heavy crude oil. After allowing for a deduction of royalties, crude oil production increased 11 percent over the prior year. Higher crude oil prices during 1985 also contributed to increased revenues. On average, crude oil prices in 1985 were three percent more than the prior year. The volume of natural gas sold during the current year increased marginally by five percent after allowing for royalty deductions. Partially offsetting the volume increase was a nine percent reduction in average prices for natural gas, responding to the increased competitiveness in the marketplace.

Lifting costs for the current reporting period were approximately 23 percent higher than the prior year. The significant factors contributing to the increase were:

- New properties brought on stream during the year
- An increase in the number of wells operated on older properties resulting from infill drilling
- Increased activity on research projects

Exploration costs in 1985 were higher than the prior year by more than 11 percent primarily due to an increase in exploration drilling and consequently an increase in the number of dry holes drilled. Overall exploration activity was at a significantly higher level with more than twice the number of wells drilled in the current year compared to 1984.

SUPPLY AND TRANSPORTATION

Revenues for the current period were 25 percent higher than last year, reflecting an increase in the activity of handling and transporting crude oil. Margins resulting from the trading of crude oil were up by 25 percent and pipeline tariffs from higher volumes were increased by 11 percent. In spite of the higher volumes, operating costs were controlled effectively and represent only a three percent increase when compared to last year.

GENERAL CORPORATE

Total interest costs were higher in 1985, compared to 1984, as a result of higher levels of borrowing throughout the year. The increase in debt is in response to additional capital expenditures as the Company launched its commercial project at Lindbergh in late summer. Because of the significance of the Lindbergh project and the magnitude of its capital cost, the Company elected to capitalize interest against that project by transferring slightly more than $700,000 of gross interest cost to capital expenditures. General and administrative expenses were 19 percent higher than the prior year, primarily as a result of an increase in the number of staff required for the new projects initiated during 1985.

Income taxes were 13 percent less as compared to last year, mainly resulting from earned depletion applicable to expenditures on the Lindbergh Enhanced Oil Recovery Project. When the Lindbergh project is completed in early 1986, the elimination of earned depletion will have the effect of increasing income taxes. This should be offset by the phase-in of a reduction in Petroleum and Gas Revenue Tax and an increase in the Alberta Royalty Tax Credit.

CAPITAL EXPENDITURES

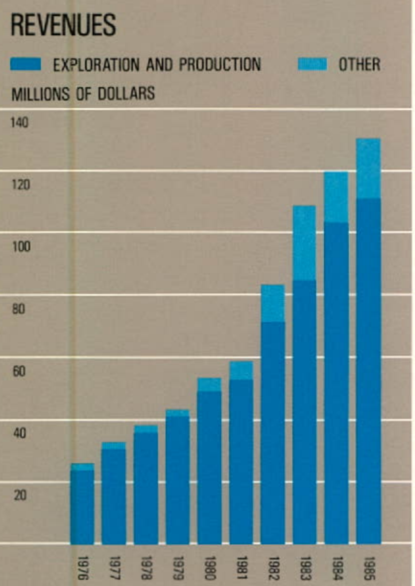
During 1985 another record level of capital project activity was achieved with total expenditures reaching $77,981,000. Exploration expenditures totalled $27,755,000, $4,300,000 more than the prior year. Production Department expenditures totalled $47,002,000 and included $20 million for the commercial development of an enhanced oil recovery project at Lindbergh, Alberta. In the third quarter the Company received final approval from the Province of Alberta to proceed with the Lindbergh project and it is anticipated that the first phase expansion will be completed during the first quarter of 1986. The Company holds a 100 percent working interest in the project which is expected to come on stream in the second quarter.

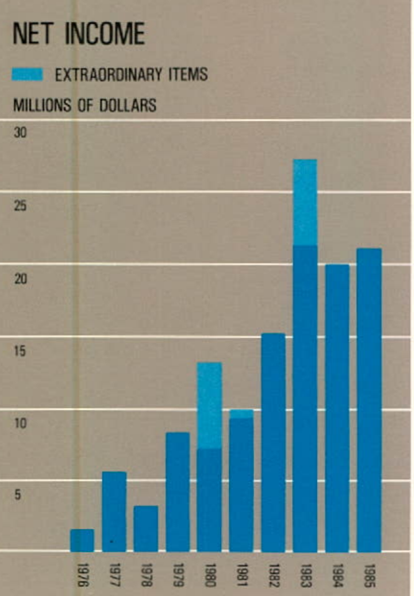
SOURCES AND USES OF FUNDS

Approximately 70 percent of the total funds employed in the current year's business was generated from the normal operating functions of the Company. The balance was made available through an increase in long-term debt in support of the Lindbergh project and from a modest reduction in working capital. Funds employed during 1985 totalled over $81 million of which $78 million was directed to capital expenditures. In addition, the Company distributed to shareholders a total of $3,770,000 representing common share dividends totalling 30 cents per share disbursed on a semi-annual basis.

FINANCIAL CONDITION

Throughout 1985 the Company remained in a very strong financial





position. Short-term investments have been liquidated and applied to capital projects. Total assets have increased approximately 20 percent to $362,851,000. In support of the significant capital expenditure on the Lindbergh project, long-term debt has been increased to a total of $25 million at year-end. It is anticipated that a further small increase in long-term debt will be experienced early next year, just prior to completion of the Lindbergh project. At this debt level the Company has used only a small portion of its borrowing capacity. The debt-equity ratio is quite conservative and certainly within the Company's debt service capabilities. Management will continue to maintain a conservative debt position and operate within a very strong financial framework.

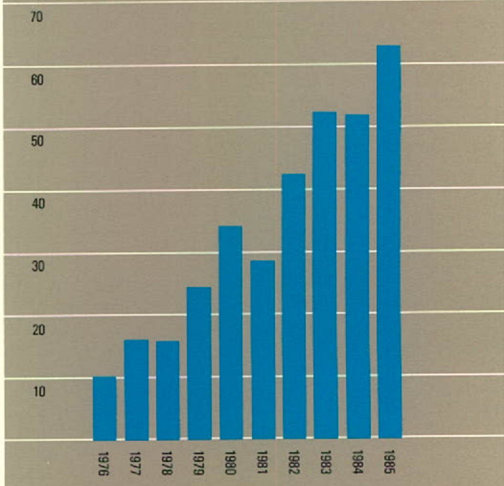
MARKET INFORMATION

Market Price Per Share (The Toronto Stock Exchange)

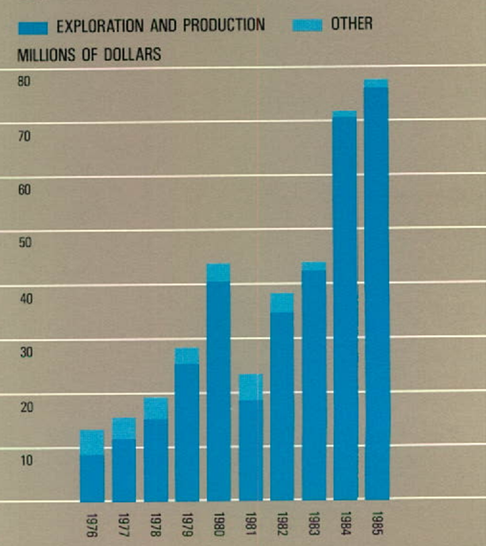
		First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Common Shares					
1985:	High	$23.00	$25.50	$24.00	$27.00
	Low	$19.75	$20.00	$20.00	$21.00
1984:	High	$23.75	$24.50	$24.00	$24.75
	Low	$20.50	$23.13	$20.50	$20.13
Dividends per share					
1985			$.15		$.15
1984			$.15		$.15

CASH FLOW

MILLIONS OF DOLLARS



CAPITAL EXPENDITURES



CONSOLIDATED STATEMENTS OF INCOME

Years ended December 31, 1985 and 1984
(thousands of dollars)

	1985	1984
REVENUES		
Sales and operating revenues	$128,157	117,722
Interest and other income	2,709	2,275
Total revenues	130,866	119,997
COSTS AND DEDUCTIONS		
Crude oil and related operating expenses	32,412	27,058
Exploration costs, including amortization of undeveloped leaseholds	17,711	15,972
General and administrative	12,474	10,453
Interest on long-term debt	448	129
Interest – other	642	980
Depreciation and amortization	6,509	4,917
Depletion	9,658	6,816
Total costs and deductions	79,854	66,325
Income before taxes	51,012	53,672
TAXES		
Petroleum and gas revenue tax	10,278	11,085
Income taxes (note 6)		
Current	12,134	17,343
Deferred	7,512	5,224
Total income taxes	19,646	22,567
Total taxes	29,924	33,652
NET INCOME	$ 21,088	20,020
Net income per share	$ 1.68	1.59

See accompanying notes.

CONSOLIDATED BALANCE SHEETS

December 31, 1985 and 1984
(thousands of dollars)

	1985	1984
ASSETS		
Current assets		
Cash and short-term deposits	$ 7,351	19,073
Accounts receivable	96,528	62,129
Due from parent company	5,578	7,522
Inventories (note 3)	13,747	17,638
Deferred income taxes	573	291
Total current assets	123,777	106,653
Property, plant and equipment – net (note 4)	236,002	192,088
Other assets – at cost	3,072	3,180
	$362,851	301,921
LIABILITIES		
Current liabilities		
Bank loans	$ —	19,010
Accounts payable and accrued liabilities	111,215	65,207
Income and other taxes payable	—	9,389
Current portion of long-term debt	—	500
Current portion of other deferred credits	1,200	—
Total current liabilities	112,415	94,106
Long-term debt (note 5)	25,000	4,524
Deferred credits		
Deferred income taxes	54,297	46,503
Other	9,079	11,434
Total deferred credits	63,376	57,937
SHAREHOLDERS' EQUITY (note 8)		
Preferred shares		
Authorized unlimited shares without par value issuable in series; issued Nil		
Common shares		
Authorized unlimited shares without par value: issued and outstanding 12,548,595 shares, 1984 – 12,572,826 shares	4,549	4,271
Retained earnings	157,511	141,083
Total shareholders' equity	162,060	145,354
	$362,851	301,921

See accompanying notes.

Approved on behalf of the Board of Directors

Director

Director

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended December 31, 1985 and 1984
(thousands of dollars)

	1985	1984
OPERATING ACTIVITIES		
Net income	$ 21,088	20,020
Depreciation, depletion and amortization	16,167	11,733
Exploration costs including amortization of undeveloped leases	17,711	14,838
Deferred taxes	7,794	5,369
Cash flow from operations	62,760	51,960
Decrease (increase) in working capital, excluding cash and short-term deposits, short-term bank loans and current maturities of long-term debt	7,773	(10,641)
Increase (decrease) in deferred credits	(1,155)	(1,324)
Total cash flow	69,378	39,995
FINANCING ACTIVITIES		
Additions to long-term debt	25,000	5,097
Reductions in long-term debt	(5,024)	(73)
Issue of common shares	291	504
Purchase of common shares	(904)	(797)
	19,363	4,731
Total cash provided	88,741	44,726
INVESTING ACTIVITIES		
Capital expenditures		
Oil and gas properties	64,107	60,431
Exploration	12,005	9,438
Supply and transportation	1,869	1,027
Disposition of assets	(190)	(902)
Increase (decrease) in other assets	(108)	531
	77,683	70,525
DIVIDENDS PAID	3,770	3,778
Total cash used	81,453	74,303
INCREASE (DECREASE) IN CASH AND SHORT-TERM DEPOSITS	$ 7,288	(29,577)

See accompanying notes.

CONSOLIDATED STATEMENTS OF RETAINED EARNINGS

Years ended December 31, 1985 and 1984
(thousands of dollars)

	1985	1984
Retained earnings, beginning of year	$141,083	125,626
Net income	21,088	20,020
Dividends	(3,770)	(3,778)
Purchase of common shares	(890)	(785)
Retained earnings, end of year	$157,511	141,083

See accompanying notes.

AUDITORS' REPORT TO THE SHAREHOLDERS

We have examined the consolidated balance sheets of Murphy Oil Company Ltd. as at December 31, 1985 and 1984 and the consolidated statements of income, retained earnings and changes in cash flows for the years then ended. Our examinations were made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Company as at December 31, 1985 and 1984 and the results of its operations and the changes in its cash flows for the years then ended in accordance with generally accepted accounting principles applied, except for the change in the method of accounting for investment tax credits as described in Note 2, on a consistent basis.

Calgary, Canada
February 7, 1986

PEAT, MARWICK, MITCHELL & CO.
Chartered Accountants

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 1985 and 1984

1. SIGNIFICANT ACCOUNTING POLICIES

a) Principles of consolidation

The consolidated financial statements include the accounts of Murphy Oil Company Ltd. and its subsidiary companies. The Company operates as an explorer, developer and producer of hydrocarbons primarily in Western Canada.

b) Property, plant and equipment

The Company follows the successful efforts method of accounting for costs of oil and gas properties. Exploratory drilling costs are initially capitalized, however, if determined to be unsuccessful they are charged to expense. All other exploratory costs are charged to expense as incurred. All development costs, including dry holes, are capitalized. The Company capitalizes interest on significant capital projects.

The costs of undeveloped leaseholds are capitalized when acquired and are amortized over the life of the lease. If such properties are surrendered, the costs are charged against the allowance for amortization. When leaseholds are proven to be productive, the costs are transferred to the developed oil and gas leasehold account and together with drilling and equipment costs, are written off by the unit-of-production method based upon estimated proven recoverable oil and gas reserves as calculated by Company engineers.

Depreciation of the following assets is computed on a straight-line method based upon their estimated useful lives:

Pipelines	5%
Other	5% to 50%

c) Inventories

The inventories are stated at lower of cost and net realizable value. Crude oil inventories are valued at cost on a last-in, first-out basis and other inventories are stated at average cost.

d) Joint ventures

Substantially all of the Company's exploration and production activities and certain pipeline activities related to oil and gas are conducted jointly with others and accordingly the accounts reflect only the Company's proportionate interest in such activities.

e) Take-or-pay agreements

Proceeds received from gas take-or-pay agreements are deferred and taken into income as production occurs.

f) Oil and gas incentive recoveries

The amounts received relative to the oil and gas incentive regulations of the province of Saskatchewan are accounted for as a reduction of provincial royalties.

The incentive recoveries from federal and provincial governments, relative to exploration activities, are accounted for as a reduction of capital expenditures.

g) Net income per common share

Net income per share is calculated on the weighted average method. If the outstanding share options had been exercised at the beginning of the year, net income per share would not have been changed by a material amount.

h) Retained earnings

Retained earnings include contributed surplus of $15,011,000 (1984, $15,901,000).

2. CHANGE IN ACCOUNTING POLICY

Effective January 1, 1985 the Company adopted the Canadian Institute of Chartered Accountants recommended method of accounting for investment tax credits whereby allowable investment tax credits are treated as a reduction of the related capital expenditures. Prior to January 1, 1985 allowable investment tax credits reduced the income tax expense. This change in accounting policy has the effect of reducing net earnings by $1,843,000 ($.15 per share) for the year ended December 31, 1985.

3. INVENTORIES

	1985	1984
	(thousands of dollars)	
Crude oil	**$12,727**	16,467
Other	**1,020**	1,171
	$13,747	17,638

Inventories valued at cost under the last-in, first-out method totalled $12,727,000 at December 31, 1985 and $16,467,000 at December 31, 1984. These amounts were $1,164,000 and $608,000 respectively, less than such inventories would have been valued using the first-in, first-out method.

4. PROPERTY, PLANT AND EQUIPMENT

December 31, 1985

			Allowance for		Net Book
	Cost	Depreciation	Depletion	Amortization	Value
			(thousands of dollars)		
Developed oil and gas properties	$280,075	29,772	59,551	–	190,752
Undeveloped oil and gas properties	52,673	–	–	22,417	30,256
Pipelines	14,071	4,486	–	–	9,585
Other properties	9,795	4,386	–	–	5,409
	$356,614	38,644	59,551	22,417	236,002

December 31, 1984

			Allowance for		Net Book
	Cost	Depreciation	Depletion	Amortization	Value
			(thousands of dollars)		
Developed oil and gas properties	$226,039	24,507	50,630	–	150,902
Undeveloped oil and gas properties	45,965	–	–	17,954	28,011
Pipelines	12,779	4,062	–	–	8,717
Other properties	8,341	3,883	–	–	4,458
	$293,124	32,452	50,630	17,954	192,088

Additions to developed oil and gas properties include $717,882 of capitalized interest (1984, $Nil).

5. LONG-TERM DEBT

	1985	1984
	(thousands of dollars)	
Revolving term loan, bearing interest at prime less 1/2%, due August 21, 1992	$15,000	–
Revolving term loan, bearing interest at the lesser of the bank's cost of funds plus 1/2% or prime rate until September, 1989, thereafter at the above rates plus 1/8%, repayable in six equal semi-annual installments commencing March, 1990	10,000	–
Bank loan, non-recourse as to principal, bearing interest at prime and repayable from net cash flow of certain oil properties	–	5,024
	25,000	5,024
Less current portion	–	500
	$25,000	4,524

6. INCOME TAXES

The total income taxes charged to earnings of $19,646,000 in 1985 and $22,567,000 in 1984 resulted in an effective rate of 39 percent and 42 percent respectively. These totals are different from the "expected" tax expense computed by applying the combined expected Canadian federal and provincial tax rates to income from continuing operations before taxes and extraordinary item. The reasons for these differences are as follows:

	1985	1984
	(thousands of dollars)	
Computed "expected" tax expense	$24,944	25,797
Additions to income taxes resulting from royalties, lease rentals and mineral taxes payable to the Crown	13,322	13,072
	38,266	38,869
Reductions in income taxes resulting from		
Resource allowance on Canadian production income	11,658	11,350
Earned depletion on Canadian production income	4,013	1,477
Royalty credit and rebates receivable from the Provinces	2,364	2,355
Investment tax credits	–	1,120
Other	585	–
	$19,646	22,567

7. PENSION PLAN

The actuarial present value of the accumulated benefits as of December 31, 1985 is $7,425,000 in respect of service rendered to December 31, 1985. The market value of the assets held in the pension trust fund to cover this liability is $8,887,000 as of December 31, 1985.

8. COMMON SHARES

a) Acquisition of Company shares

During the year the Company renewed its Normal Course Issuer Bid through the facilities of The Toronto Stock Exchange and the Montreal Stock Exchange for the purchase of up to 150,000 of its outstanding common shares. During 1985, 36,800 shares were purchased for the aggregate value of $903,664. In 1984, 35,000 shares were purchased for the aggregate value of $796,555. Share capital has been reduced by the average value of each share on the Company's books at the time of acquisition times the number of shares purchased. During the year 1985, the total reduction in share capital amounted to $13,031 (1984, $11,648) with the balance of $890,632 (1984, $784,907) charged against contributed surplus which is included in retained earnings.

b) Share option plan

Under the terms of the share option plan, 400,000 common shares of the Company were reserved for issuance to key employees of the Company. In lieu of purchasing the amount of shares granted in the option, the optionee may elect to receive the "net value of the option" in shares, in return for surrendering the option. The "net value of the option" means the difference in the market price of the share and the option price stipulated in the option.

At December 31, 1985 options have been exercised for an aggregate of 112,580 shares and 103,920 remain available under the plan for the granting of options. Outstanding options to purchase 183,500 shares in 1985 and 175,940 shares in 1984, at prices ranging from $8.00 to $24.50 per share, are exercisable to May 2, 1995.

During 1985, options to purchase 32,500 shares were granted, 1,200 forfeited and options to purchase 23,740 shares were exercised. The net number of shares issued relating to the exercised options was 12,569 shares (gross 23,740 shares) valued to the Company at $290,890. In 1984, options to purchase 36,000 shares were granted, 3,160 forfeited and options to purchase 29,720 shares were exercised. The net number of shares issued relating to the exercised options was 22,677 shares (gross 29,720 shares) valued to the Company at $504,212.

Since inception of the plan to December 31, 1985, 71,687 shares have been issued pursuant to exercise of options valued to the Company at $1,436,724.

9. ACQUISITION OF F.W.B. RESOURCES, LTD.

On November 9, 1984 the Company acquired the shares of F.W.B. Resources, Ltd. for a total payment of $4,800,000. The values assigned are summarized as follows:

	(Thousands of Dollars)
Oil and gas properties	$ 8,969
Deferred income taxes	1,030
	9,999
Long-term debt assumed	(5,097)
Working capital deficiency assumed	(102)
Net cash payment	$ 4,800

The operations of F.W.B. Resources, Ltd. were included in the accounts of the Company from November 9, 1984 to date of liquidation.

10. COMMITMENTS AND CONTINGENCIES

The Company has entered into a long-term contract to lease office space. The annual rentals to November 1, 1987 are $1,218,000. In addition, the lease provides that the Company is responsible for the payment of property taxes and operating expenses.

During 1982 the Company recognized a gain into income on the sale of its interest in three leases in the Athabasca area to a consortium developing a tar sands mining project. In the event that this project is approved by the Alberta government and is developed by the consortium, the Company may elect to reacquire its interest by refund of the proceeds of the 1982 sale and payment of its share of accumulated capital expenditures. Should the Company elect not to participate in the developed project it would receive additional funds based on estimated minable reserves. If the project is abandoned, the funds received on the sale are nonrefundable.

TEN YEAR STATISTICAL SUMMARY

(thousands of dollars except per share amounts)

	1985	1984
FINANCIAL		
Revenues		
Oil and gas sales	**$110,999**	103,336
Supply and transportation	**17,158**	14,386
Other revenue	**2,709**	2,275
Total revenues*	**130,866**	119,997
Income before extraordinary items†	**21,088**	20,020
Income per share before extraordinary items**	**1.68**	1.59
Extraordinary items	**–**	–
Net income†	**21,088**	20,020
Net income per share**	**1.68**	1.59
Cash flow	**62,760**	51,960
Cash flow per share**	**5.00**	4.13
Capital expenditures		
Exploration and production	**76,112**	70,899
Supply and transportation	**1,869**	1,027
Marketing	**–**	–
Total capital expenditures	**77,981**	71,926
Working Capital††	**11,362**	12,547
Total assets††	**362,851**	301,921
Long-term debt††	**25,000**	4,524
OPERATING		
Gross crude oil and NGL produced (thousands of cubic metres)	**597**	558
Net crude oil and NGL produced (thousands of cubic metres)	**464**	421
Gross natural gas produced (millions of cubic metres)	**264**	256
Net natural gas produced (millions of cubic metres)	**213**	204
Net oil and gas wells owned††	**1,229**	1,103
Net undeveloped property†† (thousands of hectares)	**302**	269
Gross proven oil and gas liquid reserves†† (millions of cubic metres)	**5.8**	5.1
Net proven oil and gas liquid reserves†† (millions of cubic metres)	**4.5**	3.8
Gross proven natural gas reserves†† (billions of cubic metres)	**6.8**	7.2
Net proven natural gas reserves†† (billions of cubic metres)	**5.3**	5.6
SHAREHOLDERS AND EMPLOYEES		
Number of common shares outstanding**††	**12,548,595**	12,572,826
Number of common shareholders††	**824**	935
Number of employees††	**304**	271
Salaries, wages and benefits	**$12,927**	11,860

* Restated for 1982 and prior years to reflect sale of marketing assets

† Restated for 1978 and prior years to reflect successful efforts method of accounting

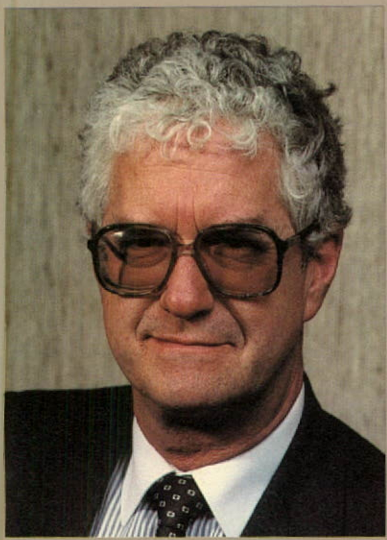
** Restated for 1982 and prior years to reflect two for one share split

†† Year-end

1983	1982	1981	1980	1979	1978	1977	1976
84,496	71,006	52,502	49,141	40,424	35,766	30,622	23,924
16,888	6,954	2,506	3,218	2,394	1,950	1,515	993
7,170	5,360	3,437	692	76	142	482	477
108,554	83,320	58,445	53,051	42,894	37,858	32,619	25,394
21,250	15,224	9,341	7,241	8,183	3,139	5,589	1,492
1.69	1.21	0.74	0.58	0.65	0.25	0.45	0.12
5,919	–	600	5,840	–	–	–	–
27,169	15,224	9,941	13,081	8,183	3,139	5,589	1,492
2.16	1.21	0.79	1.04	0.65	0.25	0.45	0.12
52,488	42,595	28,783	34,108	24,597	15,755	16,040	10,159
4.17	3.39	2.29	2.72	1.96	1.26	1.28	1.31
42,328	34,955	18,295	40,950	25,475	15,427	12,619	8,953
306	542	3,759	1,501	1,329	276	405	8
1,466	3,001	1,356	1,577	1,490	3,375	2,548	4,358
44,100	38,498	23,410	44,028	28,294	19,078	15,572	13,319
31,983	11,646	18,702	11,398	3,660	8,614	15,327	14,761
254,062	250,675	219,494	203,260	157,689	140,598	149,680	131,349
–	26,664	35,156	44,263	25,539	30,646	30,000	30,000
523	504	479	577	552	545	562	548
381	356	322	375	358	354	362	401
211	218	230	239	271	291	286	248
171	171	176	176	203	210	206	185
1,069	1,019	965	930	868	800	751	704
251	261	290	385	1,053	1,183	1,192	1,213
4.9	5.0	5.0	5.4	6.0	6.4	6.5	6.5
3.6	3.6	3.3	3.5	3.8	4.0	4.1	4.3
7.3	7.8	7.7	7.8	9.1	7.4	7.0	6.6
5.7	6.1	5.8	5.9	6.7	5.5	5.2	4.9
12,585,149	12,570,626	12,568,638	12,551,144	12,548,708	12,548,708	12,548,708	12,548,708
1,023	1,179	1,407	1,439	1,429	1,566	1,565	1,497
237	296	276	264	276	296	326	297
12,333	9,973	8,191	7,201	6,546	6,462	5,764	4,937

CORPORATE DIRECTORY

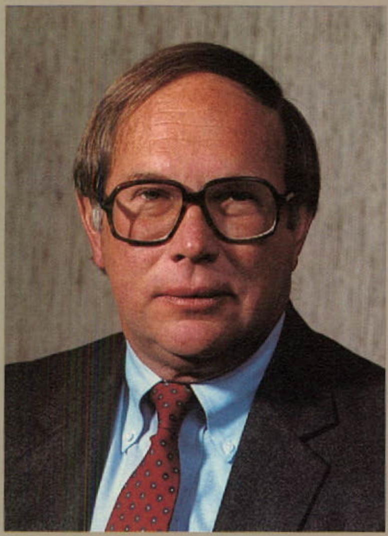
DIRECTORS



Robert G. Farquharson
President and Chief Executive Officer of
Murphy Oil Company Ltd.
Calgary, Alberta
Board Member since April, 1981

Thomas S. Dobson*
Chairman of
Easton United Securities Ltd.
Calgary, Alberta
Board Member since April, 1982

F. Richard Matthews, Q.C.*
Secretary of Murphy Oil Company Ltd.
and Partner in MacKimmie Matthews
Barristers, Solicitors and Notaries
Calgary, Alberta
Board Member since October, 1961



George S. Dembroski*
Vice Chairman of
Dominion Securities Pitfield Limited
Toronto, Ontario
Board Member since May, 1977

Jack W. McNutt
Executive Vice President of
Murphy Oil Corporation
El Dorado, Arkansas, U.S.A.
Board Member since October, 1985

Lorne C. Webster*
Chairman of the Board and
Chief Executive Officer of
Prenor Group Ltd.
Montreal, Quebec
Board Member since July, 1976

*Member, Audit Committee

B. Harold Monzingo*
President and Chief Executive Officer of
Deltic Farm and Timber Co., Inc.
El Dorado, Arkansas, U.S.A.
Board Member since April, 1982

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Leonard E. Pasychny
Vice President, Supply and Transportation

Ernest S. Spurgeon
Vice President, Exploration

F. Richard Matthews, Q.C.
Secretary

John A. Gould
Vice President and Treasurer

Donald R. Craig
Vice President and Controller

REGISTRAR AND TRANSFER AGENT

National Trust Company
Calgary, Alberta

AUDITORS

Peat, Marwick, Mitchell & Co.
Calgary, Alberta

STOCK LISTED

The Toronto Stock Exchange
Montreal Stock Exchange
Symbol MO

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