

CONTINUING GROWTH

TALISMAN

E N E R G Y



1998 ANNUAL REPORT

Talisman Energy Inc. is the largest Canadian based independent oil and gas producer. Talisman's main business activities include exploration, development, production and marketing of crude oil, natural gas and natural gas liquids. The Company's main operating areas are Canada, the North Sea, Indonesia and Sudan. Each of Talisman's core areas has substantial exploration and development potential which we expect will provide future growth. The Company is also pursuing a select number of high potential exploration projects in these areas in addition to ventures in Algeria and Trinidad.

Over the past five years, Talisman has increased production at an average annual growth rate of 30%. Talisman has a proven track record of successful exploration and development, supported by strategic acquisitions. The Company has consistently increased its reserve base, while maintaining competitive finding and development costs.

Talisman (TLM) is a widely held company listed in Canada on The Toronto Stock Exchange and the Montreal Exchange and in the United States on the New York Stock Exchange. The Company currently has 118.9 million common shares issued and outstanding and is included in the TSE 35 and the S&P/TSE 60 indices.

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# TALISMAN

## E N E R G Y

### Why Invest in Talisman

J.W. Buckee

**T**alisman provides the opportunity to invest in a company which is a premium participant in the hydrocarbon industry. Current weak prices notwithstanding, this industry is here to stay and provides 60% of the world's energy needs. Oil is the world's largest globally traded commodity.

Talisman continues to demonstrate its ability to generate value from the hydrocarbon industry, using strong technical and commercial skills and showing a propensity to action.

The Company has achieved sufficient size to have greater stability and liquidity than most other Canadian producers. Our size and activity level have also resulted in widespread analyst coverage in Canada, the US and the UK.

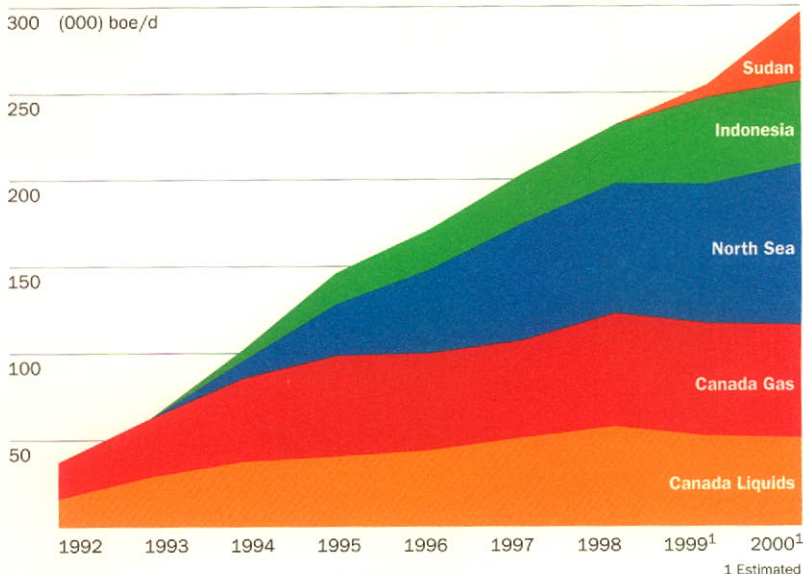
Companies that are limited to domestic opportunities either face the treadmill of large numbers of smaller prospects or must take the often perilous step into foreign areas. Talisman has successfully made the transition and is a recognized player on the world scene. This provides Talisman with access to the larger prizes available in the global arena.

Talisman's asset base is highly desirable: natural gas in Canada, a dominant position in the Moray Firth in the North Sea, large gas reserves coming on production in the Corridor Block in Indonesia, and large upside in Sudan.

Talisman's balance sheet and flexibility in capital spending can weather extended US\$12/bbl oil if necessary. In late 1999, several large projects currently under development will start production. If oil prices improve as expected, there is tremendous upside in Talisman's cash flow per share.

Talisman expects production to increase 10-15% compounded annually through 2000.

300 (000) boe/d



Talisman acquired an entry position in the North Sea in 1994 with about 20,000 boe/d of non-operated production and 88 mmbœ of proved reserves. In 1998, production averaged 74,749 boe/d with year end proved reserves of 171 mmbœ.

**Major Objectives for 1999 include:**

- operating cost reduction programs
- start of production from the Ross field
- development and start of production from the Orion field
- exploration drilling in the Moray Firth

Production is expected to increase by approximately 10% in 1999 and again in 2000 as both the Ross and Orion oil fields come on stream.

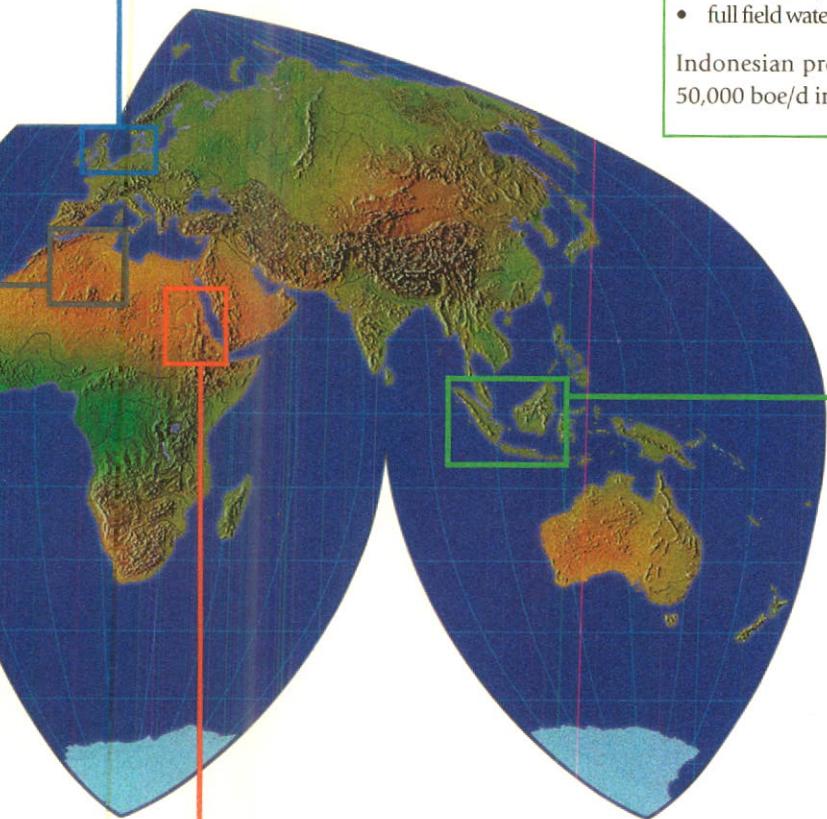
**INDONESIA**

Talisman's strategy in Indonesia has focused on exploitation and growth from existing oil properties and the development of a strategic position in an emerging new gas market. Our liquids production has grown from approximately 14,000 bbls/d in 1994, on an annualized basis, to 31,684 bbls/d in 1998. Production from the Corridor Gas Project began in October 1998. Large reserves in the Corridor Block will provide substantial long-term growth of gas sales.

**Major Objectives for 1999 include:**

- pursuit of expansion options for the Corridor Gas Project
- continuation of the development program at Tanjung Raya
- full field waterflood sanction at Ogan Komering

Indonesian production is expected to reach 50,000 boe/d in 1999.



**SUDAN**

In early October, Talisman acquired Arakis Energy Corporation for \$277 million in Talisman shares. Arakis held a 25% interest in the Greater Nile Oil Project in Sudan. Talisman owns a 25% interest in the concession, which covers Blocks 1, 2 and 4 — an area of 12.1 million acres.

Sudan presents us with a ground floor opportunity to participate in the development of a new basin with low operating costs and significant upside.

In early 1999, drilling on existing field developments was near completion and the gathering systems and main processing plant were under construction. Oil will be transported by a 1,500 kilometre pipeline to Port Sudan for export. Virtually all of the pipeline has been welded and the majority has been trenched and buried. Production is expected by the end of the third quarter of 1999, with rates of 37,500 bbls/d net to Talisman.

## TALISMAN'S EXPLORATION AND OPERATIONS AREAS

### CANADA

Our domestic strategy is based on a high level of operatorship, control and developing core areas near infrastructure.

Our long-term growth in Canada will come from oil development and gas exploration. The remaining potential in the Western Canada Basin is predominantly natural gas.

Over the past five years, Talisman has grown its domestic production 9% per annum to 121,926 boe/d and maintained very competitive drilling and operating costs.

#### Major Objectives for 1999 include:

- capital spending of approximately \$245 million, 75% to be directed at gas projects
- continuing emphasis on drilling programs within the Greater Arch and Alberta Foothills

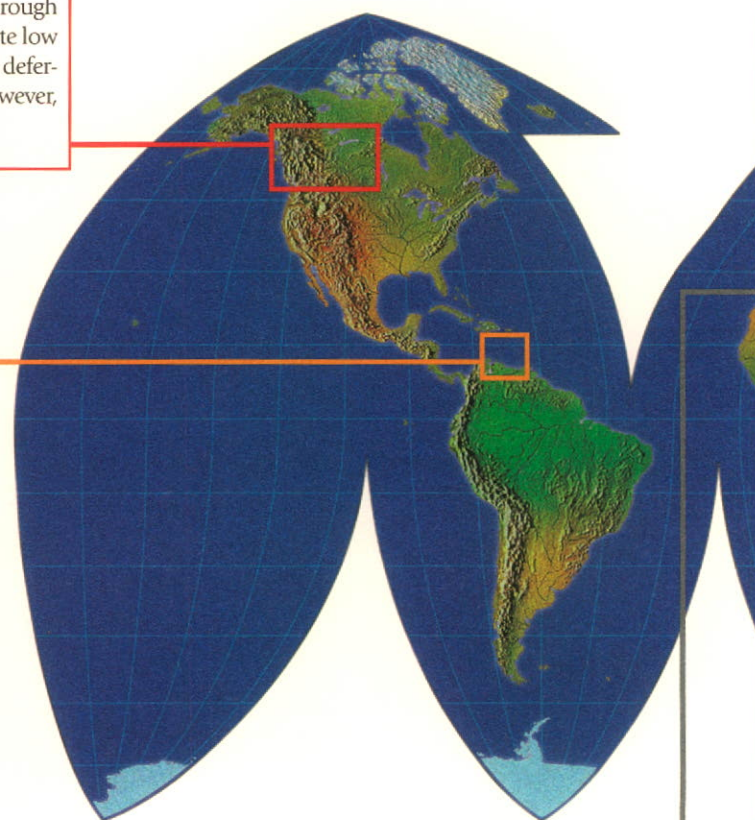
Production in Canada is expected to decline slightly through 2000 as we reduce domestic spending to accommodate low oil prices and major international projects. Talisman is deferring a number of oil projects until prices recover, however, natural gas production will continue to increase.

### NORTH SEA

Talisman's North Sea strategy is to develop core properties using Talisman-operated infrastructure.

These commercial hubs include an existing production base, identified upside and underutilized infrastructure. Once established, Talisman endeavours to increase working interests, add to its opportunity inventory in the area and reduce costs.

Talisman is creating value and extending the life of these assets through low-risk development opportunities, nearby exploration, secondary recovery, cost reductions and third-party tariff revenues.



### TRINIDAD

In 1998, Talisman completed a seismic program over Block 2ab and Block 2c in Trinidad, in an area along trend from recent oil discoveries in Venezuela. The Company plans to drill two wells in 1999, the first of which will spud in the second quarter.

### ALGERIA

Talisman's program in Algeria was very successful in 1998, with the discovery of three new fields. Four wells were drilled with capital spending of \$47 million.

Drilling success continued in the MLN field with the latest appraisal well testing 6,820 bbls/d and 7 mmcf/d. Talisman expects development approval for MLN later in 1999, leading to first production in 2001.

# Highlights

	1998	1997	1996	1995	1994
<b>FINANCIAL</b> (millions of Canadian dollars unless otherwise stated)					
Cash flow	631.1	797.4	697.4	502.3	361.5
Net income (loss) <sup>1</sup>	(258.8)	77.1	94.9	40.5	64.0
EBITDAX	813.0	902.4	848.7	633.6	449.6
Exploration and development expenditures	1,145.2	950.6	556.9	378.5	327.4
Total assets at December 31	5,457.2	5,030.9	3,757.4	3,040.3	3,259.3
Long-term debt at December 31	2,086.3	1,738.8	898.7	906.0	1,202.6
Shareholders' equity at December 31	2,214.0	2,186.6	2,094.0	1,626.3	1,580.3
Per common share (dollars)					
Cash flow	5.64	7.29	6.71	5.21	4.63
Net income (loss) <sup>1</sup>	(2.31)	0.70	0.91	0.42	0.82
<b>PRODUCTION</b> (daily average production)					
Oil and liquids (bbls/d)					
Canada	57,585	51,217	44,301	40,643	37,738
North Sea	57,480	50,502	33,038	18,778	7,652
Indonesia	31,684	28,458	22,621	18,121	6,392
Total oil and liquids	146,749	130,177	99,960	77,542	51,782
Natural gas (mmcf/d)					
Canada	631	558	557	581	481
North Sea	104	100	90	69	15
Indonesia	13	-	-	-	-
Total natural gas	748	658	647	650	496
Total (mboe/d)	231	203	171	147	102
<b>PRICES</b>					
Oil and liquids (\$/bbl)					
Canada	15.56	22.26	24.24	20.78	18.82
North Sea	18.14	25.49	27.31	23.18	22.09
Indonesia	17.61	25.62	27.22	23.76	21.50
Total oil and liquids	17.02	24.25	25.93	22.06	19.63
Natural gas (\$/mcf)					
Canada	2.03	1.98	1.71	1.37	1.89
North Sea	3.93	3.89	3.37	3.63	3.78
Indonesia	1.65	-	-	-	-
Total natural gas	2.28	2.27	1.94	1.61	1.95
Total (\$/boe)	18.21	22.91	22.50	18.74	19.38
Shares outstanding at					
December 31 (millions)	118.9	109.6	109.1	96.7	96.3
Number of permanent employees at December 31					
	986	945	791	750	750

1 The net loss for 1998 was \$75.8 million (\$0.68/share) excluding writedowns.

## 1993-1998: Continuing Growth

Talisman has over 45 years' operating experience in Canada and became a widely held Canadian independent oil and gas producer in 1993. The Company has continuously achieved double digit production growth and is currently the largest Canadian based independent oil and gas producer.

Recognizing that the competitive nature and maturity of the Western Canada Basin would constrain growth, management decided to expand into less mature areas with proven potential elsewhere in the world. Many of Talisman's senior management and technical staff have extensive international experience. Talisman now carries on business in Canada, the North Sea, Indonesia, Sudan, Algeria and Trinidad.

### FROM 1993 TO 1998, TALISMAN HAS:

- increased production from 63,000 to 231,000 boe/d, a 30% compound annual growth rate
- increased proved reserves from 222 to 772 mmbae
- achieved proved finding and development costs of \$5.80/boe
- drilled approximately 3,400 wells, averaging 90% success
- increased cash flow per share from \$3.17 to \$5.64, despite a 23% drop in world oil prices
- increased exploration and development spending from \$153 million to \$1.1 billion

Approximately half of Talisman's growth has come from drilling and half from strategic acquisitions, which added substantial undeveloped acreage and drilling opportunities. Talisman acquired five companies for a total of \$3.7 billion and spent \$3.5 billion on exploration and development.

The purchase of Encor Inc. in 1993 doubled production and added critical mass prior to international diversification. In 1994, Bow Valley Energy Inc. provided Talisman with a platform for international expansion with assets in the North Sea, Indonesia and Algeria. Talisman increased production and quadrupled its North Sea land position with the purchase of Goal Petroleum plc in 1996. In 1997, Pembina Resources Limited added large landholdings in Western Canada and a new area in Ontario.

In 1998, Talisman added a new core area in Sudan with the acquisition of Arakis Energy Corporation. The Sudan property is a long-life strategic asset with large exploration and development upside.

The Company is now positioned for 10-15% production growth compounded annually through 2000 from known projects, and has a large exploration and development inventory worldwide.

Cash Flow  
Per Share

dollars



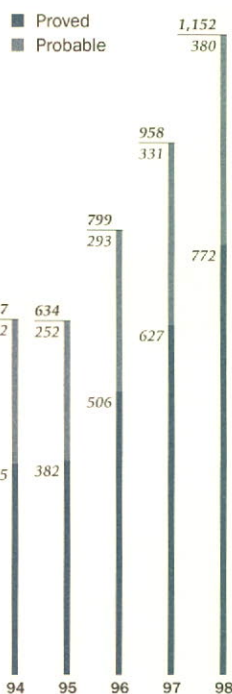
Net Income  
(Loss) Per Share

dollars



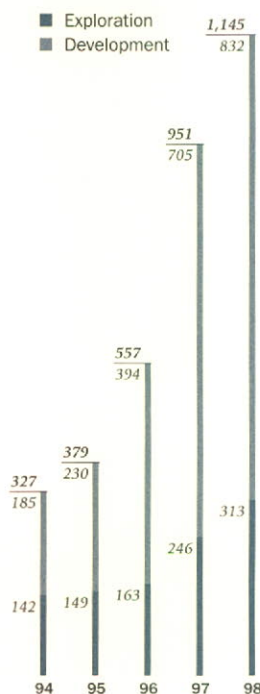
Proved & Probable  
Reserves

mmbae



Capital  
Expenditures

millions of dollars



## 1998 Overview

Nineteen ninety-eight saw record production and reserve additions combined with very competitive finding and development costs. Talisman completed a major gas project in Indonesia and added a new core area in Sudan. These accomplishments provide the basis for continuing production growth through 1999 and 2000.

Although oil prices declined 30% in 1998, cash flow per share was down by only 23%. The impact of low prices was cushioned by large Canadian natural gas volumes and the royalty structure in Indonesia. The substantial loss in income during 1998 reflected both low oil prices and the after tax writedown of \$183 million in North Sea properties.

In Canada, nine of 12 core areas set production records, highlighted by growing gas volumes from the Alberta Foothills. Year end natural gas production averaged 682 mmcf/d.

New production records were set for both oil and natural gas in the North Sea, notwithstanding delays to the Talisman-operated Ross field. The Company was awarded five blocks in the 18th licensing round and Orion field development was approved in early 1999. Talisman felt it prudent to write down the carrying value of its North Sea assets by 14%, or \$246 million. These write-downs were associated with southern North Sea gas properties, Beatrice and Ross.

Talisman's Indonesian oil production reached record levels and the Corridor Gas Project was commissioned in October. Despite political changes and the economic slowdown in Indonesia, Talisman's operations continue without disruption.

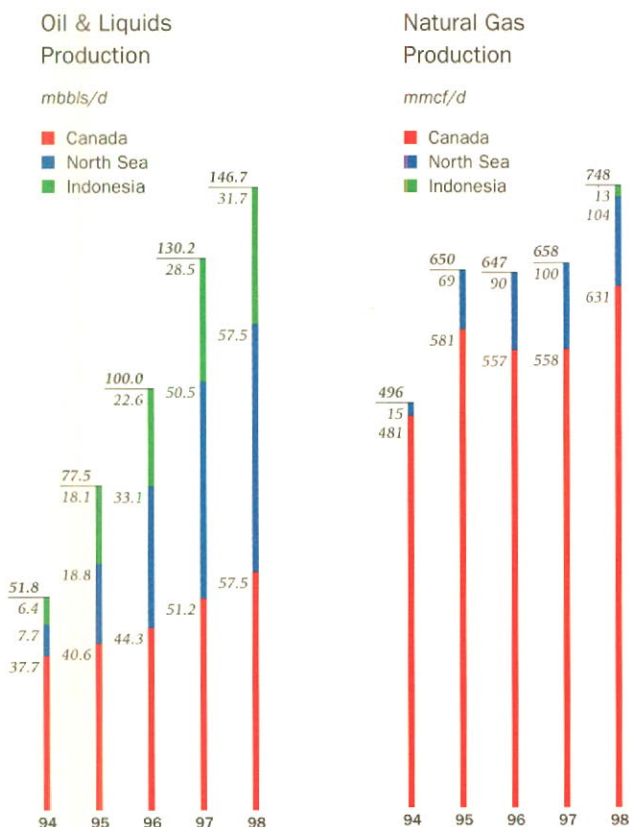
With the purchase of Arakis Energy Corporation in October, Talisman acquired a 25% interest in a major oil development project in Sudan which could potentially contain gross oil reserves of several billion barrels. Production is expected by the end of the third quarter of 1999, with 37,500 bbls/d net to Talisman.

There were three oil discoveries in Algeria during 1998. Early in 1999, Talisman was preparing to drill the first of two exploration wells in Trinidad.

### MAJOR OPERATING AND FINANCIAL HIGHLIGHTS INCLUDE:

- production of 231,000 boe/d, up 14%, with year end production of 242,000 boe/d
- oil and liquids production up 13% to 146,749 bbls/d and natural gas up 14% to 748 mmcf/d
- gross sales down 10% to \$1.5 billion
- cash flow of \$5.64 per share, down 23%; total cash flow of \$631 million
- net loss of \$2.31 per share, or \$0.68 per share before writedowns
- total capital spending of \$1.1 billion
- 549 successful oil and gas wells, with an 87% success rate
- proved plus half probable reserve additions of 253 mmbbl, replacing 304% of production
- finding and development costs of \$6.60/boe, proved plus half probable
- general and administrative expenses of \$0.70/boe, down from \$0.77/boe in 1997

At year end, Talisman's long-term debt was \$2.1 billion. Operating costs averaged \$6.62/boe, a 7% increase, reflecting higher unit costs in the North Sea. At year end 1998, Talisman had an enterprise value of approximately \$5.3 billion.



## Executive



(left to right)

**Jackie Sheppard**, Vice-President, Legal and Corporate Projects, and Corporate Secretary  
**Bruce Waterman**, Vice-President, Finance and Chief Financial Officer  
**Mike McDonald**, Vice-President, Business Development



(left to right)

**Bob Redgate**, Vice-President, Human Resources and Corporate Services  
**Nigel Hares**, Vice-President, Frontier and International Operations  
**Jim Buckee**, President and Chief Executive Officer



(left to right)

**Joe Horler**, Vice-President, Marketing  
**Bob Mitchell**, Vice-President, Canadian Operations  
**Ted Bogle**, Vice-President, Exploration

## Strategy for Continuing Growth

Talisman's strategy is predicated on continuing demand for crude oil and natural gas in a world where large new discoveries are increasingly rare. Talisman has kept its replacement costs low, while significantly and consistently increasing both reserves and production. Talisman's five year proved finding and development costs have averaged \$5.80/boe, while netbacks (revenue less royalties and operating costs) have been \$11.67/boe.

Our return to shareholders will be measured by continued per share growth in reserves, production and cash flow.

### MAJOR ELEMENTS OF TALISMAN'S STRATEGY INCLUDE:

**Upstream and production driven** – Talisman will continue to focus on oil and natural gas exploration and development with short production lead times. Risky, expensive exploration with long development lead times destroys value. We will also invest in upstream pipelines, plants and equipment where there is a clear link to our core business.

**Low-risk growth** – We target regions with demonstrated hydrocarbon potential, close to infrastructure. Talisman's growth has come equally through drilling and acquisitions. The Company will continue to replenish its large inventory of development projects through drilling or acquisition, whichever is most effective.

**Large domestic base** – Canada provides a steady source of cash flow as well as operating expertise and support for a growing slate of international operations. Numerous, small-scale opportunities within the Western Canada Basin give us flexibility to scale spending up or down.

**Diversity** – Basin and market diversity allow us to choose the best among a number of competing investment decisions worldwide. Talisman's international ventures offer the large-scale opportunities needed to grow in a cost effective manner. As evidenced in 1998, exposure to different fiscal regimes provides a cushion against volatile prices. With our growing international success, Talisman

continues to seek out additional opportunities in less mature basins with significant oil and gas potential.

**Operating control** – Talisman prefers to hold controlling interests and operate in its core areas. We will also participate in ownership structures which provide control over capital spending, drilling locations, project timing and operating costs.

**Exploration upside** – In addition to its core, low risk exploration and exploitation program, Talisman also invests 5-10% of its annual budget in higher-risk higher-potential exploration plays.

Increasingly, Talisman is using its momentum and size to take advantage of global opportunities. Talisman has demonstrated project management, operating and technical skills. We have the size and skills to participate in several large-scale projects at one time.

# President's Letter to Shareholders

## A YEAR OF CHALLENGES

Nineteen ninety-eight was a bruising year for oil companies and their stakeholders. As a result of OPEC boosting oil production quotas in October 1997, the return of Iraqi supply and the Asian currency crisis reducing demand, all occurring at about the same time, the price of oil fell throughout the year to a level that, in inflation-adjusted terms, was its lowest point ever.

The stock market reaction to the sliding price of oil was harsh. Not only did companies' cash flow fall as a result of the oil price slide, but trading multiples also fell, the industry being "out of favour". The performance of most oil stocks was woeful and Talisman was no exception. The Company, however, displayed some resilience due to its significant gas production in Canada, a light crude oil slate and the flexibility afforded by geographical diversity.

The industry's fall from grace had the effect of limiting the ability of some companies to raise capital and, combined with significant declines in cash flow, resulted in cutbacks in capital spending. This, in turn, exacerbated the downturn of the industry, but also sowed the seeds for recovery.

Most importantly, it is necessary to stress that this is not a moribund industry. Even in these times of turmoil, demand for oil continues to rise and everyday experience reinforces the knowledge that the world is deeply wedded to gasoline. Natural gas is one of Canada's largest exports and oil is still the largest globally traded commodity in the world. Shareholders will be rewarded when prices recover.



Jim Buckee, President and Chief Executive Officer

Talisman continued to grow net asset value, not only through increasing oil reserves per share, but also by securing projects that we expect to result in continuing production growth. In fact, operationally and strategically, Talisman had a good year. Broadly speaking, we drilled for gas in Western Canada and looked for oil volume growth in foreign jurisdictions. Production increased 14% over 1997 and, importantly, Talisman achieved 200% proved reserve replacement before net acquisitions and 275% when acquisitions are included. Proved reserves increased by 23% over the year.

Talisman's operational highlights included: the growing importance of the Alberta Foothills as a long-term source of Canadian gas, a developing hydrocarbon complex in the Inner Moray Firth of the North Sea, and the successful completion of the Corridor Gas Project with a growing Indonesian reserve base that will use the newly constructed plant and pipeline.

The most notable strategic move during the year was achieving entry to a less mature hydrocarbon basin in Sudan. This fulfilled our stated objective of gaining access to large volumes of low cost reserves. The successful completion of the Corridor project

and the Sudanese oil field development will provide Talisman with two major sources of production that will underpin the Company's long-term growth.

Nineteen ninety-eight saw continuing consolidation in the global hydrocarbon industry with the formation of a few "super-independents" trumped by the emergence of "super-majors". Both these phenomena are driven by the desire to reduce costs and to have the size necessary to compete on the world stage.

In the case of the large scale mergers, there is plenty of scope for "synergies". This is less of a source of value in upstream only independents since, in most cases, staff costs are a relatively small part of expenses. I believe, however, that sufficient size is imperative to compete internationally. Size increases the statistical chance of success in exploration and provides the ability to undertake larger projects in less mature basins.

Talisman moved early and successfully into the fiercely competitive international arena in order to gain access to hydrocarbon volumes more commensurate with its size. In contrast, it becomes increasingly difficult for the more substantial domestic producers to maintain growth in mature basins which require faster and faster running on the treadmill in pursuit of many small opportunities.

Talisman has made its mark on the world scene and continues to pursue a breadth of opportunities. We have sufficient diversity and balance such that the Company cannot be endangered by unforeseen occurrences in any one of its areas of operations. This diversity has more than once proved to be

a source of stability as each area has its own advantages. Canada provides a reliable base of production and cash flow, the North Sea provides sizeable opportunities left untapped by the majors, while Indonesia provides a newly developing gas market. Sudan, Algeria and Trinidad provide big upside. At the same time, we keep a careful eye on the balance of style of operation, our ability to operate and political risk.

Although I believe it highly unlikely that US\$12/bbl oil prices will continue, Talisman can, if necessary, weather such prices for two years or more, and maintain its strategic stance. Our capital program has been constrained and is mostly directed to major projects. Project spending at Ross, Orion, Corridor and Sudan will all convert from cash absorbers to cash generators by late 1999, and thereafter spending can be drastically reduced if necessary. When oil prices strengthen, Talisman is positioned to make large gains.

A few words are in order concerning our participation in development of Sudan's petroleum resources. Because Sudan presents significant challenges, we realized that this project would attract questions from varied sources. However, careful study last summer persuaded management that this is a sound business investment and our involvement could be carried out in a responsible, ethical manner. Experience to date confirms that judgment.

We recognize that Sudan's chronic troubles, including poverty and conflict running along political and tribal "fault lines", create special challenges. Like many other

international companies who operate in similar environments, Talisman is taking the necessary steps to ensure the safety of our employees.

While some critics of Sudan's government oppose our involvement, we hope that these groups will come to understand two facts: Talisman is not taking sides in the country's complex politics and our presence will be an asset to Sudanese society. Over time, resource development will help raise living standards which can assist this divided society to find the stability it sorely needs. In the short run, Talisman's presence will also bring road construction, safer drinking water and a hospital to the impoverished area around the oil field. We are looking at other initiatives to make a positive and lasting contribution.

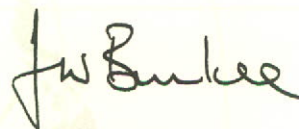
Management will provide more details as our Sudan project progresses. Meanwhile, I would remind you that the situation that has persisted for decades lends itself, understandably, to passionate debate. Despite this, we are determined to deliver a high quality project, operated in a responsible manner.

There are now some 25 Talisman employees resident in Sudan and that number will increase to 40 or so in the near term. I believe every employee and shareholder of Talisman can be proud of our involvement and the benefits we can bring to a country where they are desperately needed.

Shareholders have been hurt by the fall in the share price and so too have employees. With continued hard work we will be well positioned when the oil price recovers.

I appreciate everybody's efforts and contribution to belt tightening in these hard times. Both employees and shareholders can look forward to better times ahead.

Talisman has a knowledgeable Board of Directors with a wealth of experience in many facets of the industry. I would like to thank them for their continued support of management and our strategic plan.



James W. Buckee  
President and Chief Executive Officer  
March 10, 1999

## Market Overview

### CRUDE OIL

**D**riven by population growth and improved living standards, crude oil and natural gas demand will continue to increase over the long term. There are no easy, cost-effective substitutes for crude oil, especially in the transport sector. The world consumes roughly three times as much oil as it has been discovering for the past 25 years, and increasingly relies on the large oil reserves in the Middle East.

Approximately two-thirds of Talisman's production revenue (including Corridor natural gas) is tied to the price of oil. World oil prices fell 30% in 1998, with the benchmark West Texas Intermediate (WTI) price averaging US\$14.40/bbl. Prices continued to decline throughout the year averaging US\$16.73/bbl in January 1999 and falling below US\$11.00/bbl in mid-December.

A resumption of oil exports from Iraq, increased OPEC quotas, and growing non-OPEC production added 3-4 mmbbls/d of crude oil into the marketplace between July 1997 and April 1998. Over the same period of time, demand was falling due to mild winter weather in North America and the economic downturn in southeast Asia. As a result, there was an inventory surplus of 350-400 mmbbls at the start of 1999.

As of March 1999, there are a number of positives. Lower prices have reduced investments in productive capacity and it now appears that non-OPEC production has declined by 500,000-700,000 bbls/d over the past 12 months. Production from individual oil fields typically declines at rates of 5-10% annually without reinvestment. Declines in non-OPEC production, worldwide demand growth of about one million bbls/d this year and improved adherence to quotas by OPEC members could lead to oil being in short supply. History indicates a sudden \$4-5/bbl price increase is possible. The major risk to a strong recovery in oil prices would be a recession, leading to lower oil demand in the OECD countries. However, recent economic indicators, particularly in the US, continue to appear robust.

<b>OIL SUPPLY AND DEMAND</b> (mmbbls/d)	<b>1998</b>	<b>1997</b>	<b>1996</b>
World demand	<b>73.9</b>	73.6	71.7
OPEC crude supply	<b>27.8</b>	27.1	25.8
Rest of world supply	<b>47.2</b>	47.0	46.2
	<b>75.0</b>	74.1	72.0
<b>OIL PRICES</b>	<b>1998</b>	<b>1997</b>	<b>1996</b>
US\$/bbl, WTI price	<b>14.40</b>	20.60	22.10
C\$/bbl, Talisman price	<b>17.02</b>	24.25	25.93
<b>NATURAL GAS PRICES</b> (\$/mcf)	<b>1998</b>	<b>1997</b>	<b>1996</b>
Alberta spot C\$	<b>1.95</b>	1.70	1.25
Alberta average C\$	<b>1.95</b>	1.95	1.70
Talisman Canada C\$	<b>2.03</b>	1.98	1.71
Henry Hub US\$	<b>2.10</b>	2.50	2.75

### CANADIAN NATURAL GAS

**D**emand for Canadian natural gas is also growing as new infrastructure provides potential for greater volumes of gas flowing into US markets. The addition of new Canadian export pipeline capacity has connected Western Canadian supplies to the North American natural gas price grid. Alberta prices, relative to NYMEX, are now less than transportation costs.

Essentially all new markets for Canadian production over the past two years have come from exports to the US. In 1998, gas well completions in Canada totalled about 4,650, down 5% from the previous year and most Canadian producers are at or near productive capacity. As export pipeline capacity continues to be added over the next two years, domestic prices will continue to be linked closely to US prices.

Alberta spot prices have increased significantly over the past 24 months with the historic gap between US export prices and domestic prices narrowing. However, US prices have been volatile in the early months of 1999 as mild weather and excess US storage, at levels almost 25% higher than a year ago, have pushed spot Henry Hub prices down to US\$1.75/mcf in early March.

Recognizing this historically high level of domestic gas prices, Talisman locked in prices averaging approximately \$2.40/mcf for over 60% of our Canadian natural gas production for the 1998/99 gas contract year. Our average domestic gas price was \$2.49/mcf in January 1999.

Gas prices should strengthen over the next 18 months, with a recovery in US gas demand, the effect of lower drilling and continued expansion of export pipeline capacity. The risk to this scenario is weaker gas demand resulting from a US downturn or less demand for chemical feedstock. With long-term growth in demand and a positive view of prices, future Canadian natural gas supplies will increasingly come from complex, expensive, technically challenging plays, similar to Monkman and the Alberta Foothills, where Talisman continues to be very successful.



## STRATEGY AND OBJECTIVES

**T**alisman's large domestic base underpins continuing growth worldwide.

Our domestic strategy is based on a high level of operatorship, control and developing core areas near infrastructure. The Company focuses on development projects, supported by low-risk exploration and an active acquisition and divestiture program. We operate 75% of our Canadian production. Our diversity of operations provides Talisman with operating expertise and technical skills which are being applied worldwide. Numerous small-scale opportunities give us spending flexibility.

Our long-term growth in Canada will come from oil development and gas exploration. The remaining potential in the Western Canada Basin is predominantly natural gas, especially in the deeper horizons which are relatively unexplored compared with the US. These are technically challenging and expensive plays, but reward participants with 10-20 times the typical reserves found elsewhere in North America. Talisman's success in areas

such as Monkman and the Alberta Foothills allows us to continue to be a major gas producer in Canada.

The likelihood of large quantities of new oil being discovered in Canada is remote and Talisman will focus its oil efforts on cost-effective recovery. The majority of Talisman's Canadian oil properties have cumulative recoveries of less than 25%. There is significant remaining potential in and around these areas.

Over the past five years, Talisman has grown its domestic production 9% per annum to 121,926 boe/d and maintained very competitive drilling and operating costs. Despite reduced 1998 capital spending, the Company maintained its proved reserve base of 346 mmboe, up substantially from 222 mmboe five years ago. Our five year finding and development costs have averaged \$6.90/boe.

We have pursued a very active asset rationalization program in Western Canada. This

upgrading of assets is an essential part of Talisman's strategy. The Company continually divests its non-strategic assets and acquires producing properties that complement existing core areas. Over the past three years, these transactions have totalled \$490 million, resulting in the sale of 4,084 wells in which Talisman had minor interests.

### MAJOR OBJECTIVES FOR 1999 INCLUDE:

- capital spending of approximately \$245 million, 75% to be directed at gas projects
- continuing emphasis on drilling programs within the Greater Arch and Alberta Foothills

Production in Canada is expected to decline slightly through 2000 as we reduce domestic spending to accommodate low oil prices and major international projects. Talisman is deferring a number of oil projects until prices recover.

## CANADA 1998

Talisman increased both oil and natural gas production to new highs in 1998, setting production records in nine of 12 core areas.

### HIGHLIGHTS FOR THE YEAR INCLUDE:

- Production of 121,926 boe/d, an increase of 13% over 1997.
- Natural gas production of 631 mmcf/d, an increase of 13% over 1997. Production records were established in the Alberta Foothills, Northern Plains and Greater Arch.
- Liquids production of 57,585 bbls/d, an increase of 12%. Growth came from a number of areas including Chauvin, the Greater Arch, Northern Plains and Central Alberta.
- Proved reserve additions of 53 mmboe through exploration and development drilling, replacing 121% of production. Talisman's domestic finding and development costs were \$7.20/boe in 1998.
- Talisman participated in 518 wells with an 86% success rate, compared with the industry average of 79%. Talisman drilled 234 gas and 210 oil wells in 1998.
- Substantial reduction in operating costs on former Pembina properties.

Talisman continued its active asset rationalization program in 1998. In Western Canada, 130 transactions involving \$270 million in assets, generated approximately \$46 million in net proceeds and added new development opportunities in the Greater Arch, Alberta Foothills, and Chauvin.

In light of falling oil prices, Canadian capital spending was curtailed as 1998 progressed, resulting in lower than expected reserve additions and production volumes in certain core areas. Exploration and development spending was \$404 million with approximately 68% directed at gas programs.

CANADA HIGHLIGHTS		1998	1997	1996
Production				
Oil and liquids (bbls/d)		57,585	51,217	44,301
Natural gas (mmcf/d)		631	558	557
Total production (boe/d)		121,926	107,346	100,016
Proved reserves				
Oil and liquids (mmbbls)		156.7	155.4	115.1
Natural gas (bcf)		1,835.4	1,846.7	1,551.4
Total reserves (mmboe)		346.1	345.8	270.2
Capital expenditures (millions of dollars)				
Exploration		126.9	140.9	91.1
Development		276.8	270.9	236.1
Total capital expenditures		403.7	411.8	327.2
		1998	1997	
Drilling (number of wells)	Gross	Net	Gross	Net
Oil	210.0	151.5	558	283.0
Gas	234.0	105.4	217	97.1
Dry	74.0	46.4	79	46.0
Total wells drilled	518.0	303.3	854	426.1
Landholdings (000 acres)				
	Gross	Net	Gross	Net
Developed	2,674.4	1,239.2	2,774.6	1,253.4
Undeveloped	9,567.0	3,909.8	10,737.2	4,261.8
Total acreage	12,241.4	5,149.0	13,511.8	5,515.2

Details can be found under "Supplementary Information".

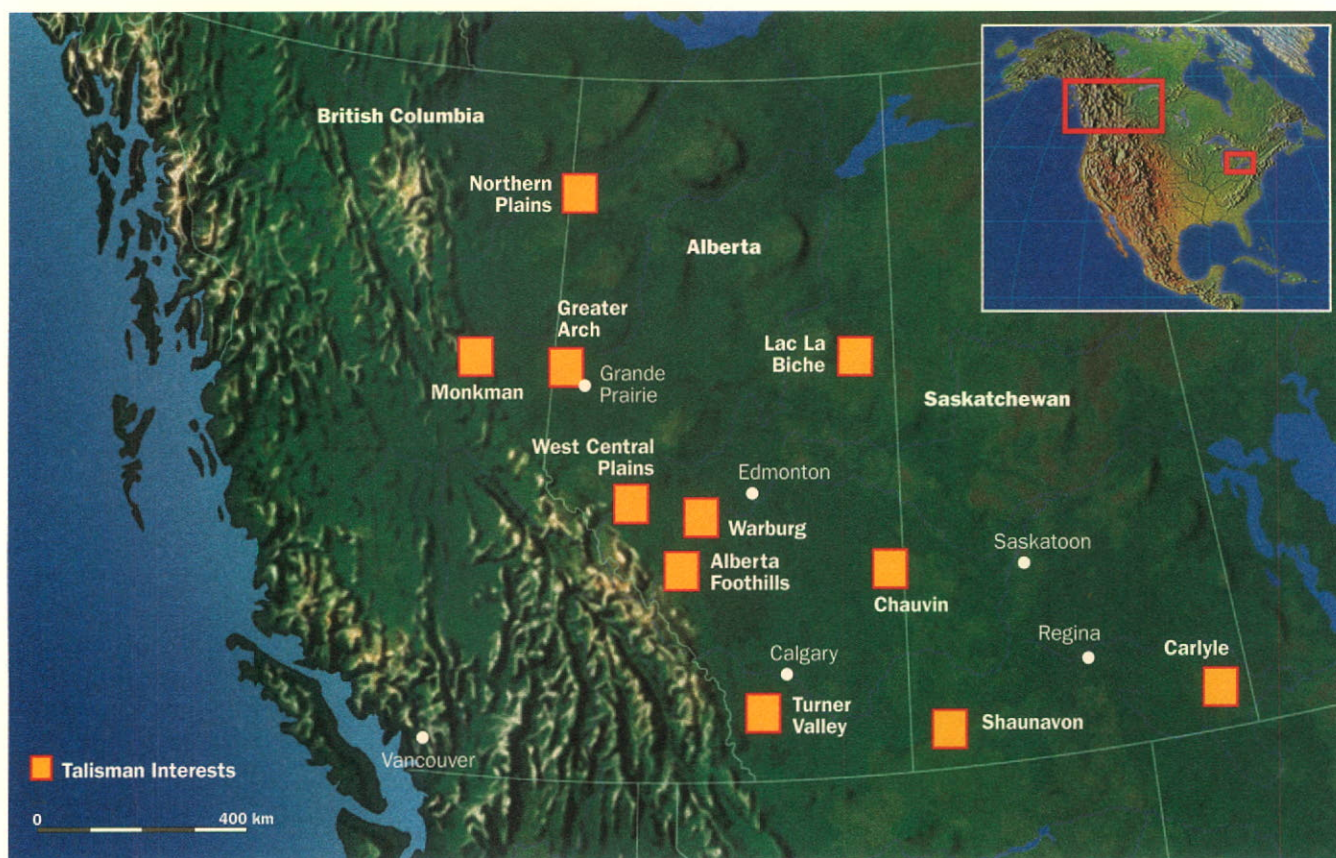
In Western Canada, 10 mcf of natural gas equals one boe; in Ontario, six mcf of natural gas equals one boe.

Moving into 1999, Talisman expects to spend approximately \$245 million in Canada. The reduced spending reflects lower oil prices and funding requirements for overseas development projects, not a

lack of domestic opportunities. Talisman will continue to increase its natural gas production, while oil volumes will decline, resulting in a slight decrease in 1999 Canadian production levels.



Teepee Creek gas plant



## PROPERTY REVIEW

**T**alisman has 12 core areas in Canada, accounting for about 74% of its domestic production.

## CORE GAS AREAS

**T**alisman continued to shift its emphasis in Canada towards gas, drilling 234 gas wells and adding 271 bcf of proved gas reserves.

### Monkman

**M**onkman is a prolific deep gas area, with substantial long-term potential, both in the Triassic and the virtually unexplored Mississippian/Permian horizons. Talisman has operated in this area for over ten years, with drilling success of 84%, the best performance in the region.

Production at Monkman fell 5% to 111.6 mmcf/d in 1998, reflecting reduced spending.

To ensure continued economic development in the area, Talisman has entered into a long-term agreement for gathering and processing its gas at Westcoast's Pine River Gas Plant. In return for this supply commitment, Westcoast has guaranteed a toll structure that ensures these facilities are the most economic location for Talisman to process its natural gas from this area.

Talisman spent \$8.8 million in 1998, drilling three successful Triassic wells which tested at 33.7 mmcf/d, 44 mmcf/d and 56.5 mmcf/d. One of these wells, at Mink/High-hat, opens a new development area for Talisman and a number of follow-up locations have been identified on related structures. Plans for 1999 include one to two exploration wells and infrastructure to tie in the recent discoveries.

### Greater Arch

**T**he Peace River Arch is Talisman's largest core area in Canada. This region has significant potential for new natural gas and liquids discoveries in multiple zones. There is extensive infrastructure in the area which enables new discoveries to come on production relatively quickly. With 488,000 net acres of land, and a large prospect inventory, the Arch will continue to be a core growth area for the Company.

Talisman's oil and gas properties in the Greater Arch include Teepee, Progress, Belloy and Pouce Coupe. Through a combination of acquisitions and drilling, we expanded our interests in the Bear Canyon exploration area, and acquired additional interests and operatorship in the Manir and Halfway A pools. The latter two provide excellent synergies with our existing Teepee operations. Total oil and natural

gas production averaged 13,220 boe/d, an increase of 17% over the previous year. Natural gas production averaged 97.4 mmcf/d, an increase of 14%.

We spent \$59.5 million in 1998, which included drilling 36 exploration and 22 development wells. Drilling success was 62% with 23 gas and 13 oil wells. Talisman also optimized the Teepee gas plant to increase raw capacity by 30% to 47 mmcf/d.

The 1999 capital program will focus on gas, including approximately 45 wells. About 75% of the drilling program will emphasize shallow to medium depth, low-risk exploration prospects.

### West Central Plains

Talisman's major asset in this region is the Edson natural gas plant. When we acquired the plant in 1993, it was operating at half capacity. A major program was concluded in 1998, and the plant is now full. Last year, Talisman spent \$43.4 million in this area.

During the year, Talisman participated in an expansion of the plant's LPG system, doubling capacity to 4,000 bbls/d. Also in 1998, the Alberta Foothills gas gathering system pipeline was commissioned, bringing an incremental 30 mmcf/d of raw gas to Edson. Talisman's discovery at Apetowun was tied in, flowing at rates as high as 28 mmcf/d.

The Minehead gas line to Edson, also commissioned in 1998, is contributing 39 mmcf/d of raw gas with an additional 29 mmcf/d of capacity. The Alberta Foothills gas gathering system and the Minehead pipeline together constitute 300 kilometres of new pipeline connected to the plant which will provide future custom gas processing opportunities.

Edson is now processing 165 mmcf/d raw gas versus 120 mmcf/d at the start of 1998. Unit operating costs through the plant are among the lowest in the province. With Edson now at capacity, the 1999 development program will focus on well completions to sustain volumes.

## CANADIAN GAS PRODUCTION

Natural gas (mmcf/d)	Average working interest (%) <sup>1</sup>	1998	1997	1996
Monkman	62	111.6	116.9	135.2
Greater Arch	78	97.4	85.2	72.7
West Central Plains	73	87.4	71.9	75.8
Lac La Biche	84	82.5	76.8	73.5
Northern Plains	70	42.0	28.4	17.9
Alberta Foothills	93	35.7	17.2	13.7
Ontario	65	18.9	5.2	—
Other		155.3	156.2	168.4
Total		630.8	557.8	557.2

Talisman operates approximately 73% of its natural gas production.

<sup>1</sup> Average working interest at December 31, 1998 in Talisman-operated properties only.

Certain properties have been reallocated between core areas and, accordingly, prior year volumes have been restated to conform with current year presentation.

At Whitecourt, Talisman is developing a new core area. Production averaged 23.3 mmcf/d of natural gas and 678 bbls/d of oil and liquids in 1998, and 24 wells were drilled. In 1999, 13 wells are planned, with the majority of drilling scheduled for the first quarter. This former Pembina property was successfully integrated and lifting costs have been reduced by 15%.

### Alberta Foothills

The Alberta Foothills is a very prospective area, with large pool sizes, low-porosity reservoirs, and high quality natural gas; however, drilling is expensive. Talisman, over the past five years, has emerged as a leader in the area in terms of both exploration success and as a low-cost driller.

The Alberta Foothills is Talisman's fastest growing area in Canada. Production averaged 36 mmcf/d, more than double 1997 volumes because of new production from Cordel and commissioning the Talisman-operated Lovett River pipeline in September. At year end, production was 56 mmcf/d. Talisman spent \$76 million in 1998, which included 11 wells with a success rate of 100%.

At Lovett River, six wells were tied in and 40 mmcf/d of pipeline capacity was added to accommodate existing and future volumes.

The project started up only two years after Talisman purchased a sizeable land position in the area. Two of three wells completed in 1998 were exceptional, testing at 17 mmcf/d and 19 mmcf/d.

In the Cordel area, one well tested in excess of 20 mmcf/d with first production only two months after completion.

The Stolberg and Voyageur pipeline expansions provide an additional 50 mmcf/d of capacity. We currently have over 100 mmcf/d of pipeline capacity in the area with access to the Hanlan Robb and Ram River gas plants.

Volumes for the new infrastructure will come partially from lands acquired at Red Cap, Basing, Lovett, Shaw and Brown Creek. We currently hold 93,750 net acres of land in the Alberta Foothills with working interests averaging 85% in properties operated by Talisman. The Company has an inventory of prospects that will sustain drilling beyond 2000.

In 1999, the Alberta Foothills will remain a focus area for Talisman and we are positioned for growth with the recent completion of additional infrastructure. We expect to spend approximately \$54 million in the area, which includes 14 gross wells and additional pipeline infrastructure at Brown Creek and Red Cap.

## CORE OIL PROPERTIES

**W**ith low oil prices prevailing throughout the year, Talisman reduced its oil drilling program, which resulted in 210 wells in 1998. The majority of 1999 oil expenditures are planned for the latter part of the year, depending on prevailing prices.

### Carlyle

**T**alisman has enjoyed considerable success at Carlyle over the past five years, in particular with our horizontal and multi-leg horizontal drilling programs. Production increased from 7,355 bbls/d to a peak of 13,271 bbls/d in 1997. Although drilling is still economic in the region at current oil prices, spending has been deferred until prices recover. Drilling was reduced from 105 wells in 1997 to 46 wells, including 41 successful oil wells last year. We plan to drill fewer than five wells in 1999.

Production in 1998 averaged 11,618 bbls/d, down 12% from the previous year as Talisman reduced spending in the area to \$29.1 million.

Talisman also drilled seven wells in the Ordovician deep play in Saskatchewan in 1998, resulting in four oil wells; however, results, as measured by reserve size, were mixed. We plan to drill two wells in 1999 as we continue to test this play.

## CANADIAN OIL PRODUCTION

Oil and liquids (bbls/d)	Average working interest (%) <sup>1</sup>	1998	Production 1997	1996
Carlyle	79	<b>11,618</b>	13,227	11,255
Chauvin	96	<b>8,715</b>	7,130	5,564
Warburg	85	<b>3,695</b>	3,495	3,136
Shaunavon	63	<b>3,657</b>	3,600	3,097
Greater Arch	74	<b>3,483</b>	2,811	2,424
Northern Plains	100	<b>3,196</b>	1,776	598
West Central Plains	72	<b>1,762</b>	1,623	995
Syncrude		<b>2,664</b>	2,536	2,534
Other		<b>18,795</b>	15,019	14,698
<b>Total</b>		<b>57,585</b>	<b>51,217</b>	<b>44,301</b>

Talisman operates approximately 79% of its oil and liquids production.

<sup>1</sup> Average working interest at December 31, 1998 in Talisman-operated properties only.

Certain properties have been reallocated between core areas and, accordingly, prior year volumes have been restated to conform with current year presentation.

The average crude oil and equivalent gravity of Talisman's Canadian production is 35° API.



Drilling at Chauvin

### Chauvin

**C**hauvin continues to be a growing core area for Talisman, averaging 27% compound production growth over the past four years. The advantages of the region include low decline rates, long reserve life, low-cost reserves, high working interest properties and the Talisman-operated custom treating, processing and pipeline facilities. Drilling activity was also reduced at Chauvin in 1998 reflecting low oil prices and capital constraints. However, Talisman continues to add to its core holdings in the area.

Oil production increased 22% in 1998, reaching a record 8,715 bbls/d. A total of 69 wells were drilled, including eight exploration wells, with a success rate of 97%. Capital spending totalled \$30.1 million.

In 1998, Talisman added approximately 100 potential drilling locations to its development inventory in the area through an active land acquisition program.

Spending in 1999 will be dependent on oil prices and the overall availability of capital.

## OTHER CORE PROPERTIES

### Lac La Biche

In 1998, production increased 7% to 82.5 mmcf/d at Lac La Biche, Talisman's lowest cost, operated area. In the 1998/99 winter drilling program, 24 wells were drilled at a success rate of 80%. The number of wells drilled was lower than planned due, in part, to the continuing issue of shallow gas drilling and its effect on bitumen recovery. This is currently under discussion with the Alberta Energy Utility Board and major shallow gas producers.

### Ontario

Talisman is the largest oil and gas producer in Ontario. Production in 1998 averaged 19 mmcf/d for natural gas and 2,291 bbls/d for oil.

Although pool sizes are relatively small, Ontario offers premium netbacks due to its proximity to market. Over the course of the year, operating costs were reduced by 38% from \$5.60/boe in the fourth quarter of 1997 to \$3.50/boe in the fourth quarter of 1998.

Talisman drilled 42 wells in 1998, resulting in 20 gas and 20 oil discoveries, with a 95% success rate. Plans for 1999 include the construction of an offshore pipeline to tie in gas to our existing facilities and the installation of offshore compression to optimize production from the 1998 drilling program. Onshore oil drilling will depend on capital availability and oil prices.

### DRILLING SUMMARY

Area	Oil	Gas	Dry	Total	Success Rate (%)
Chauvin	67	—	2	69	97
Carlyle	41	—	5	46	89
Lac La Biche	—	36	11	47	77
Greater Arch	13	23	22	58	62
Shaunavon	9	—	1	10	90
Warburg	18	—	1	19	95
Alberta Foothills	—	11	—	11	100
Monkman	—	3	—	3	100
Northern Plains	1	3	4	8	50
Ontario	20	20	2	42	95
Other	8	61	10	79	87
Total operated	177	157	58	392	85
Total non-operated	33	77	16	126	87
Total gross wells	210	234	74	518	86
Total net wells	151.5	105.4	46.4	303.3	85

### Northern Plains

Record production rates were achieved in 1998. Gas production increased 48%, averaging 42 mmcf/d while liquids production was up 80%, averaging 3,196 bbls/d. Most of these production gains came from tying in successful wells drilled in 1997. Three gas wells and one oil well were drilled in 1998 for a success rate of 50%. Seven wells are planned for 1999.

### Shaunavon

Shaunavon was Talisman's fourth largest domestic oil property in 1998. Ten wells were drilled resulting in nine oil discoveries. A limited program is planned for 1999.

### Warburg

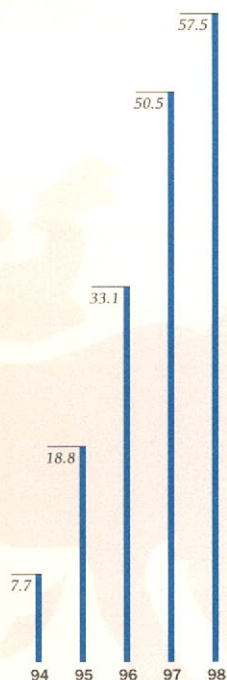
Warburg is a high working interest operated area with extensive infrastructure and high netbacks. A total of 19 wells, resulting in a 95% success rate, were drilled in 1998. The number of wells planned in 1999 will be reduced due to low oil prices.

### Turner Valley

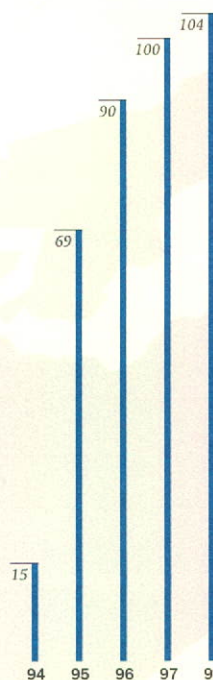
During the year, Turner Valley achieved a five year production high of 3,003 bbls/d. In 1998, development included drilling two horizontal wells. Operating costs were reduced from \$7.48/boe in the fourth quarter of 1997 to \$5.28/boe in the fourth quarter of 1998. A detailed review is being undertaken in 1999 to evaluate the potential of tertiary recovery in the oil field. Studies have indicated that an incremental 30 mmbbls of oil could be recovered using the appropriate technology. A pilot project is planned for 2000.



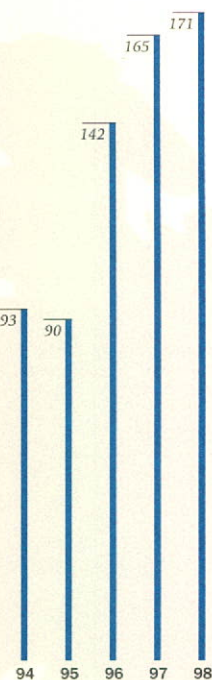
Oil & Liquids  
Production  
mbbls/d



Natural Gas  
Production  
mmcf/d



Proved  
Reserves  
mmboe



## STRATEGY AND OBJECTIVES

Talisman's North Sea strategy is to develop commercial hubs around core properties using Talisman-operated infrastructure. This strategy is complimented with a portfolio of high quality non-operated assets with growth potential. A key entry mechanism has been to acquire assets from the majors as the size of new fields fall below their threshold of interest. However, numerous opportunities remain in the 20-50 mmboe range which are material to a company of our size.

Criteria for acquisitions include an existing production base, identified upside and underutilized infrastructure. Once a hub is established, Talisman endeavours to increase working interests, add to its opportunity inventory in the area and reduce costs.

Talisman is creating value and extending the life of these assets through low-risk development opportunities, nearby exploration, secondary recovery, cost reductions and third-party tariff revenues.

Talisman's North Sea assets are generally subject to low tax rates offsetting this relatively high-cost environment. Consequently, changes in oil and gas prices have a greater impact on cash flow in the North Sea than in Canada or Indonesia. However, Talisman's North Sea core area strategy remains effective and any recovery in prices will result in significant increases to netbacks.

Talisman acquired an entry position in the North Sea in 1994 with about 20,000 boe/d of non-operated production and 88 mmboe of proved reserves. In 1998, production averaged 74,749 boe/d with year end proved reserves of 171 mmboe. Approximately 60% of the growth in proved reserves has come through discoveries, additions, transfers and extensions and 40% through acquisitions.

We expect to spend approximately \$290 million in 1999 on programs that will focus on our operated oil fields in the Central North Sea.

### MAJOR OBJECTIVES FOR 1999 INCLUDE:

- cost reduction programs, with an average target below \$10/boe.
- start of production from the Ross field
- development and start of production from the Orion field
- exploration drilling in the Moray Firth
- start of the redevelopment program at Buchan

Production is expected to increase by approximately 10% in 1999, and again in 2000 as the Ross and Orion oil fields come on stream.

## North Sea 1998

Nineteen ninety-eight was a difficult year in the North Sea. The year started under the threat of tax increases and, with the deterioration in oil prices, ended with discussions about tax relief.

### HIGHLIGHTS FOR THE YEAR INCLUDE:

- Talisman's North Sea production increased to 74,749 boe/d, an increase of 11%, despite the delay of Ross production.
- Liquids production increased 14%, averaging 57,480 bbls/d.
- Natural gas production increased to 104 mmcf/d, from 100 mmcf/d in 1997.
- Talisman added interests in seven blocks in the Moray Firth and now holds interests in 52 Central North Sea blocks. Talisman is the leading operator and the largest net acreage holder in the Inner Moray Firth, one of the most active areas in the North Sea.
- Exploration and development spending in 1998 was \$366 million. The majority of capital spending was on Ross field development.
- Talisman participated in 32 wells with a 78% success rate including an appraisal well on the Orion field which led to field development approval.
- Proved reserves of 27 mmboe were added through discoveries, additions and extensions replacing 100% of production.

High fixed costs, production interruptions and a significant strengthening of the UK pound against the Canadian dollar continued to put pressure on operating costs. Unit operating costs increased 17% to \$11.21/boe in 1998. Talisman commenced a major cost reduction program with an average target below \$10/boe in 1999.

At year end, the Company announced \$183 million in after tax writedowns associated with Ross, Beatrice and certain properties in the Southern Gas Basin. Talisman felt it prudent to take these writedowns due to a combination of low oil prices, higher costs and changed gas contract terms at Trent and Tyne. Additional information can be found in the Management's Discussion and Analysis (pages 32 and 33).

NORTH SEA HIGHLIGHTS	1998	1997	1996
Production			
Oil and liquids (bbls/d)	57,480	50,502	33,038
Natural gas (mmcf/d)	104	100	90
Total production (boe/d)	74,749	67,200	48,077
Proved reserves			
Oil and liquids (mmbbls)	107.0	103.8	71.8
Natural gas (bcf)	383.9	364.3	418.3
Total reserves (mmboe)	171.0	164.5	141.5
Capital expenditures (\$millions)			
Exploration	101.9	44.6	28.1
Development	263.9	221.9	96.7
Total capital expenditures	365.8	266.5	124.8

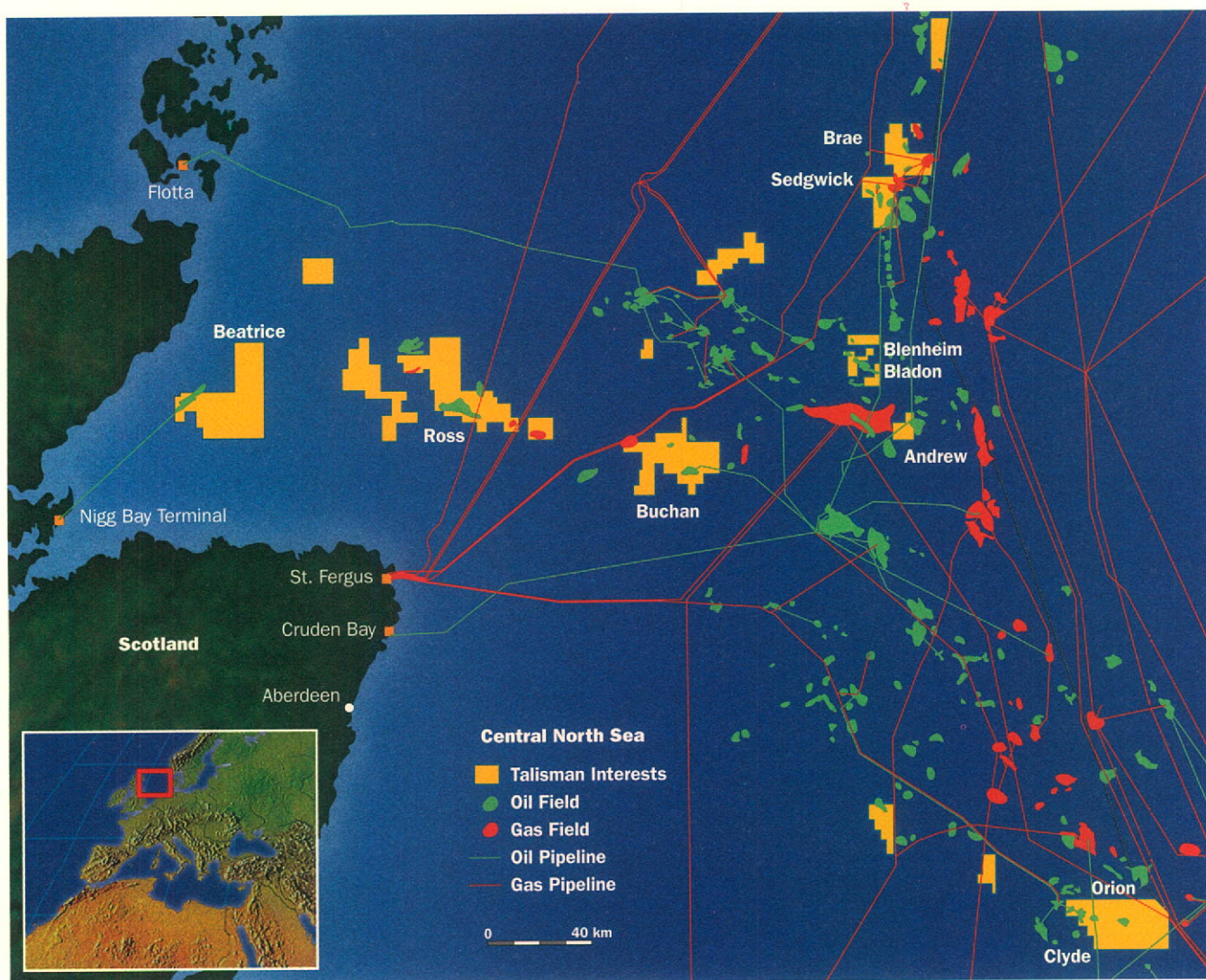
	1998		1997	
Drilling (number of wells)	Gross	Net	Gross	Net
Oil	21	4.7	22	3.2
Gas	4	0.3	7	1.4
Dry	7	2.6	4	0.7
Total wells drilled	32	7.6	33	5.3
Landholdings (000 acres)	Gross	Net	Gross	Net
Developed	86.7	21.9	85.8	19.6
Undeveloped	1,788.9	593.5	1,759.5	481.5
Total acreage	1,875.6	615.4	1,845.3	501.1

Details can be found under "Supplementary Information".

Six mcf of natural gas equals one boe.



Drilling in the North Sea



## PROPERTY REVIEW

**T**alisman operates seven properties in the Central North Sea, accounting for 46% of our 1998 production. This level of operatorship is uncommonly high in the North Sea but consistent with our strategy.

Beatrice, Buchan and Clyde were acquired in 1996. These three Talisman-operated fields became the base of Talisman's infrastructure and operations in the Central North Sea. These fields are at the core of Talisman's new exploration and development activities.

Talisman is now the largest net acreage holder in the Inner Moray Firth area in the Central North Sea. This is one of the most

active exploration regions in the UK, and several major new oil and gas discoveries have been announced over the past 18 months.

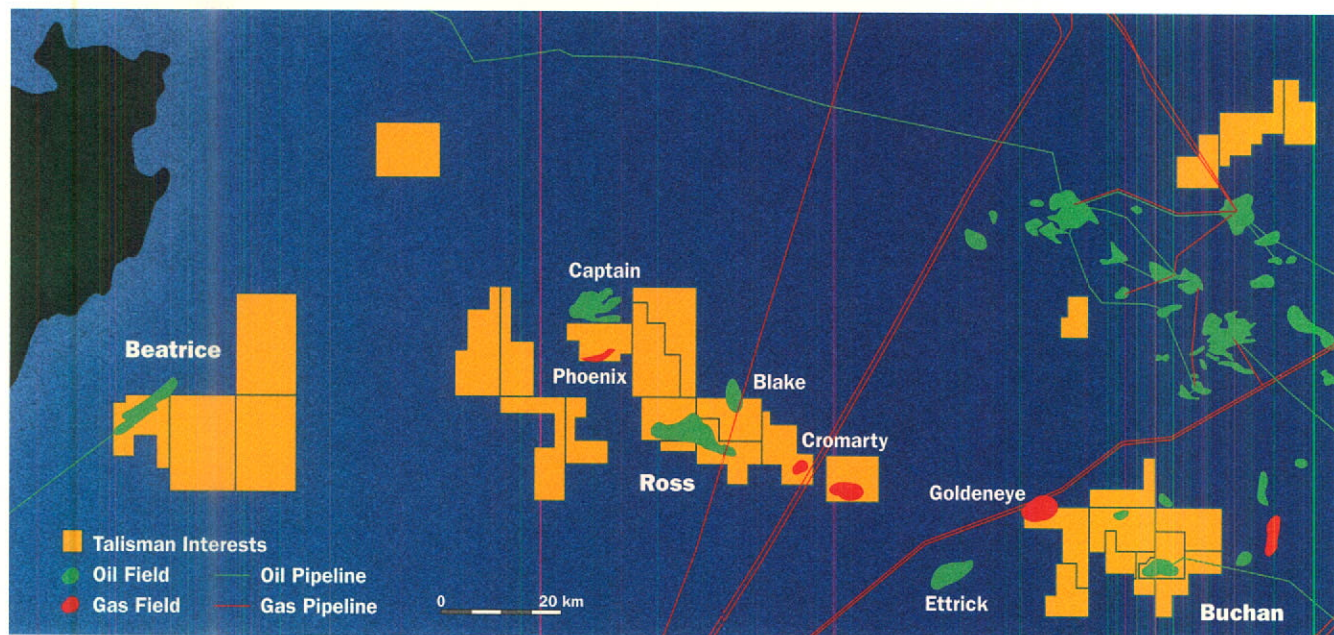
The Talisman-operated Ross and Orion oil fields are currently under development with first production from both expected in 1999. Talisman also operates the Blenheim and Bladon fields.

### Beatrice and Nigg

**B**eatrice was acquired in 1996 with the expectation that abandonment could occur as early as 1998 without additional development work. Over the past two years, Talisman enhanced production through infill drilling and waterflood optimization and recently initiated a major cost reduction program. At

current prices, an element of exploration success is required to extend production beyond mid-2000. As a result of this uncertainty, Talisman announced a \$36 million after tax writedown. Due to circumstances unique to the Beatrice field, abandonment expenditures will not be incurred until well after 2005.

Talisman spent \$10 million at Beatrice in 1998 and oil production averaged 7,531 bbls/d. In 1997, a 3-D seismic survey identified an exploration prospect on adjacent acreage. This acreage, acquired in the 1998 license round, will be drilled in 1999.



Talisman also acquired major interests in two new prospective blocks adjacent to the Beatrice field and has a farm in option on another. With success in this area, Beatrice should continue producing for many more years.

#### Buchan

**T**alisman spent \$9.3 million in the area in 1998, with production averaging 6,234 bbls/d.

A review of the Buchan reservoir has indicated significant remaining potential. The first phase of a redevelopment program started in late 1998 and will convert the existing fixed risers to a flexible riser system. These modifications will provide better access for maintenance, lower operating costs, less weather-related downtime and, most importantly, the ability to undertake well intervention activity to enhance reservoir performance. Sidetrack drilling using coiled tubing through the flexible risers is planned for 2000.

In early 1998, Talisman participated in an appraisal well at Goldeneye, 20 kilometres west of Buchan. The well tested at 41.5 mmcf/d of gas and 2,055 bbls/d of liquids. A 1996 oil discovery at Hannay, eight kilometres north of Buchan, could be tied in to the Buchan platform if further appraisal drilling is successful.

#### Ross

**T**he startup of the Talisman-operated Ross oil field will be a milestone in 1999. Not only will Ross contribute significant oil volumes, but the Ross vessel will act as a development hub in an area with substantial oil potential. Production startup planned for late 1998 was delayed due to slow construction progress at the shipyard. Sailaway of the Ross production vessel occurred in mid-February 1999 and first production is expected early in the second quarter.

To date, three production wells and one injection well have been completed. One planned production well was drilled on the flank of the reservoir and four additional wells are planned for 1999.

In 1998, \$154.2 million was spent on Ross and \$98.7 million is planned for 1999 to complete installation of the vessel and the development drilling program. Talisman wrote down \$49 million after tax on the Ross field in 1998 due to low oil prices and cost overruns on the first two development wells. Drilling performance has improved significantly on recent wells.

In the area, an appraisal well on the Cromarty gas discovery was disappointing. A wildcat exploration well to the west of Ross is still classified as confidential.

The nearby undeveloped Blake field, five kilometres north of Ross, was appraised in 1998. A well on Block 13/29b proved that the Blake field extends onto Talisman acreage. The Company is discussing options to tie Blake back to the Ross facilities. Talisman is evaluating other opportunities in the area.

#### Clyde and Orion

**T**alisman spent \$51.5 million in this area in 1998. During the year, Talisman acquired additional interests in Clyde and production averaged 9,300 bbls/d, an increase of 17%.

The horizontal drilling program continued in 1998 and one well was drilled with initial production of 4,000 bbls/d. A number of promising locations have been identified, one of which will be drilled in 1999.

During the year, Talisman increased its interests and became operator of the Orion field. An appraisal well drilled in 1998 tested at constrained rates of 13,300 bbls/d oil and 26.5 mmcf/d gas, confirming the reserves necessary for development. Government approval was received early in 1999 and Orion will be developed by a 16 kilometre tieback to the Clyde platform. Production is expected to start in the fourth quarter of 1999, with initial rates of 8,000 bbls/d of oil and 12 mmcf/d of natural gas.

## NORTH SEA PRODUCTION

Oil and liquids (bbls/d)	Average working interest (%) <sup>1</sup>	Production		
		1998	1997	1996
Brae Area	13.1-20	15,350	14,036	16,067
Clyde	81.5	9,300	7,952	461
Blenheim and Bladon	68.2-100	8,913	4,212	5,414
Beatrice	100	7,531	7,746	227
Buchan	86.08	6,234	6,864	2,042
Wytch Farm	4.95	5,361	5,126	5,174
Other	2.5-3.2	4,791	4,566	3,653
<b>Total</b>		<b>57,480</b>	<b>50,502</b>	<b>33,038</b>
Natural gas (mmcf/d)				
Brae Area	13.1-14	59.9	56.4	57.8
Netherlands	5.4-10.25	22.2	23.3	26.2
Trent and Tyne	20	17.8	17.0	3.7
Other	2.5-4.95	3.7	3.5	2.5
<b>Total</b>		<b>103.6</b>	<b>100.2</b>	<b>90.2</b>

<sup>1</sup> Average working interest at December 31, 1998.

Talisman operates approximately 46% of its production.

Working interest at Clyde increased from 51% to 63% in the first half of 1998 and to 81.5% in the second half of 1998.

Brae area includes Talisman-operated Sedgwick production for the second half of 1998.

The average crude oil gravity of Talisman's North Sea production is 40° API.

### Brae Area

Talisman has interests ranging from 13-20% in seven producing fields in the Brae complex: South Brae, Central Brae, West Brae, Sedgwick, North Brae, Beinn and East Brae. This area has significant remaining exploration and development potential. Capital expenditures in 1998 totalled \$32.7 million and seven wells were drilled.

West Brae/Sedgwick production commenced in late 1997 and performed well above expectations in 1998. Appraisal drilling of West Brae demonstrated an extension of the proven reservoir to the north and additional development drilling is being evaluated.

An oil discovery was made at 16/7a-B28z, drilled from the Brae B platform. The well commenced production in August 1998 at rates in excess of 2,000 bbls/d. The Deep East Brae exploration well was unsuccessful.

An appraisal well at Braemar was disappointing; however, the field remains commercial and is expected to be developed after 2000 when export gas ullage becomes available.

### Blenheim and Bladon

Production from Blenheim and Bladon averaged 8,913 bbls/d in 1998, approximately 1,000 bbls/d above expectations. At the end of 1998, Talisman renegotiated terms for the use of the production vessel to extend field life well into 1999. Nevertheless, cessation of production is expected in 1999 due to low oil prices. Decommissioning costs will not be significant.

A small oil discovery was made from an exploration well on Block 16/21c, close to Blenheim. The well is suspended and options for development are being evaluated.

## OTHER PROPERTIES

### Andrew, Magnus, Wytch Farm

Successful development and infill drilling continued in all three fields in 1998 with capital spending of \$11 million. At Andrew, appraisal of the lower Cretaceous reservoir was conducted and gas sales commenced by year end. At Wytch Farm, technological advances in extended reach drilling continue to generate significant opportunities to access more reserves in the offshore area of the field.

### Southern North Sea

At Trent and Tyne, litigation of the gas sales contracts arose from a widening gap between contract and spot prices. Talisman was unsuccessful in the Trent litigation. A technical infringement on contract terms resulted in the termination of a long-term gas sales contract.

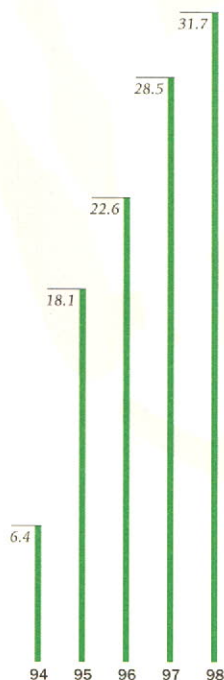
In the Tyne litigation, a long-term contract was also terminated as a result of a settlement reached between the parties. Talisman wrote down the carrying value of its Southern North Sea gas properties by \$98 million, after tax, to reflect the continuing expected low market price for gas. The litigation had a major impact in 1998 on sales nominations and, therefore, production.

### Netherlands

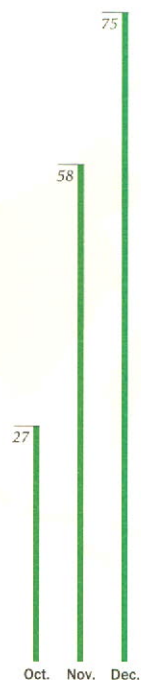
The K4a platform commenced production and a number of successful exploration wells drilled from existing production platforms were brought on stream. A number of discoveries in the region have proven the extension of the existing fields.



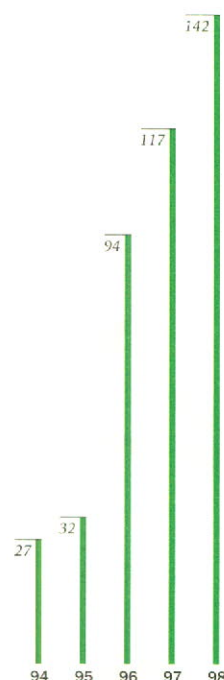
Oil & Liquids  
Production  
mbbls/d



1998  
Natural Gas  
Production  
mmcf/d



Proved  
Reserves  
mmboe



## STRATEGY AND OBJECTIVES

Talisman's strategy in Indonesia has focused on exploitation and growth from existing oil properties and the development of a strategic position in an emerging new gas market. Our oil operations are highly successful with liquids production growing from approximately 14,000 bbls/d in 1994, on an annualized basis, to 31,684 bbls/d in 1998. Production from the Corridor Gas Project began in October 1998. Large reserves in the Corridor Block will provide substantial long-term growth of gas sales.

The current low oil price has relatively little impact on the viability of Talisman's projects in Indonesia, since Indonesian fiscal terms provide for recovery of capital costs from current production. Even at current

oil prices, most of Talisman's Indonesian investment opportunities will pay out in about one year.

The dramatic political and economic events in 1998 had little effect on Talisman. Political reforms, including planned elections, are underway and a review of Pertamina and a potential restructuring of the oil and gas industry could provide opportunities for Talisman.

Foreign participation in the oil and gas industry is not an issue among any of the political parties. The industry provides hard currency and has served as a model for privatization. Elections are planned for 1999 to extend democracy in Indonesia and are not expected to adversely affect the upstream oil and gas industry.

Expansion of the Corridor Gas Project is planned as a result of successful exploration drilling in 1998.

### MAJOR OBJECTIVES FOR 1999 INCLUDE:

- pursuit of expansion options for the Corridor Gas Project
- continuation of the development program at Tanjung Raya
- full field waterflood sanction at Ogan Komering, based on pilot results

Indonesian production is expected to reach 50,000 boe/d in 1999.

## Indonesia 1998

In 1998, Talisman again achieved record oil production levels in Indonesia through drilling and waterflood operations. Initial gas sales from the Corridor Gas Project started in October.

### HIGHLIGHTS FOR THE YEAR INCLUDE:

- Production in 1998 increased 19% to 33,920 boe/d.
- Corridor Gas Project started production on time and on budget. Sales during the fourth quarter averaged 53 mmcf/d.
- Oil production increased 11%, to 31,684 bbls/d, mainly through continuing success in the Tanjung waterflood, where annual production more than doubled to 7,258 bbls/d.
- Low operating costs combined with the fiscal structure resulted in netbacks relatively insensitive to oil prices. Our 1998 netback averaged \$6.21/bbl.
- Exploration and development expenditures totalled \$179.6 million, of which 66% was spent on the Corridor Gas Project. Talisman participated in 60 wells with a 97% success rate.
- Operating costs decreased 14% over the year and averaged \$4.89/bbl.
- Despite the difficult economic situation, payments from Pertamina are current.

The Indonesian currency situation did not impact our operations, other than to reduce operating costs, as some costs are denominated in rupiah. Corridor gas revenues are obtained from oil liftings at Duri and are paid into an offshore account in US dollars. Other Indonesian production is sold to Pertamina for US dollars.

### PROPERTY REVIEW

#### Ogan Komering

At Ogan Komering, Talisman spent \$16.4 million, which included drilling and completion of 12 oil wells. Injection in the waterflood pilot area commenced in mid-1998 and results are expected in the first half of 1999. Consideration of a gas project for the area was postponed due to market uncertainty.

INDONESIA HIGHLIGHTS		1998	1997	1996
Production				
Oil and liquids (bbls/d)		31,684	28,458	22,621
Natural gas (mmcf/d)		13	—	—
Total production (boe/d)		33,920	28,458	22,621
Proved reserves				
Oil and liquids (mmbbls)		39.9	41.1	39.0
Natural gas (bcf)		615.1	452.5	332.0
Total reserves (mmboe)		142.4	116.5	94.3
Capital expenditures (millions of dollars)				
Exploration		32.9	20.4	11.0
Development		146.7	212.3	61.5
Total capital expenditures		179.6	232.7	72.5

		1998		1997	
Drilling (number of wells)	Gross		Net	Gross	Net
		46	31.3	42	24.8
Gas	Gross		Net	Gross	Net
		12	4.3	2	1.4
Dry	Gross		Net	Gross	Net
		2	1.4	5	4.2
Total wells drilled		60	37.0	49	30.4
Landholdings (000 acres)	Gross		Net	Gross	Net
		308.8	134.1	314.9	137.3
Undeveloped	Gross		Net	Gross	Net
		2,592.4	1,780.9	3,098.4	1,960.6
Total acreage		2,901.2	1,915.0	3,413.3	2,097.9

Details can be found under "Supplementary Information".  
Six mcf of natural gas equals one boe.



## INDONESIA PRODUCTION

Oil and liquids (bbls/d)	Average working interest (%) <sup>1</sup>	1998	1997	1996
Ogan Komering	100	15,602	16,513	12,593
Tanjung EOR	100	7,258	3,313	1,360
Corridor TAC	40	4,952	4,856	5,344
Corridor PSC	36	2,565	2,453	2,068
Jambi EOR	40	1,307	1,323	1,256
<b>Total</b>		<b>31,684</b>	<b>28,458</b>	<b>22,621</b>
<b>Natural gas (mmcf/d)</b>				
Corridor PSC	36	13.4	—	—
<b>Total</b>		<b>13.4</b>	<b>—</b>	<b>—</b>

<sup>1</sup> Interests of the Indonesian national oil company, Pertamina, other than working interests, are accounted for as royalties. Pertamina royalties are recorded using contractual rates in effect at the time of production.

The average crude oil gravity of Talisman's Indonesia production is 34° API.

Ogan Komering received recognition by Pertamina and the Government of Indonesia as the lowest-cost producer in Indonesia. Operating costs were \$2.03/bbl, which was 15% below plan.

Plans for 1999 include 8-10 development wells, commencement of the main waterflood project and drilling the Tebong exploration prospect.

### Tanjung Raya

Tanjung Raya is a major oil field located in Kalimantan with original oil in place of 600 mmbbls. Cumulative recovery to date has been about 20%, compared to 25-35% typical for fields of this nature. The reservoir had been on primary production from 1961 to 1995 when Talisman commenced water injection.

Waterflood operations in 1998 continued to be successful and Talisman's share of Tanjung production reached 9,000 bbls/d late in 1998. The average 1998 production of 7,258 bbls/d was up 119%.

Capital spending totalled \$22 million. During 1998, 15 wells were drilled, including one horizontal well, and 20 fracture stimulations were performed. Production should increase again in 1999 with continuation of the development program.

### Jambi

In 1998, oil production declines in the Jambi Block were offset by the successful drilling of two wells and several workovers. The first phase of the Tempino field waterflood commenced in 1997 with some response detected in 1998. Based on encouraging initial results, Phase Two of the waterflood operations was implemented in late 1998.

Capital spending at Jambi in 1998 was \$1.9 million. In 1999, two oil wells are planned, the Phase Two waterflood implementation will be completed and the workover program will be continued.

### Corridor

In 1998, Phase One of the Corridor Gas Project was successfully completed and, building on the project's success, plans for Phase Two development commenced. Negotiations are underway with potential customers in Indonesia and Singapore. The Corridor Gas Project is at the centre of potential future developments of domestic and export gas expansion in Indonesia.

The Corridor Gas plant construction was completed within budget and on schedule. Gas sales commenced in October 1998 with production of 75 mmcf/d in Decem-

ber 1998, reaching a daily production high of 87 mmcf/d during the month. Production is expected to reach 110 mmcf/d in 1999. Liquids production from the Corridor PSC and TAC blocks averaged 7,517 bbls/d net in 1998, up 3%.

Total capital spending for 1998 was \$134.4 million. Of this, \$94.4 million was spent on Corridor Gas plant construction and development drilling and \$24.5 million on exploration in the block. In addition, \$3.9 million was spent on oil development in the Corridor PSC and \$11.6 million on development in the Corridor TAC.

A total of 31 wells were drilled, with a 97% success rate. Of these, 12 were gas wells and 18 were oil wells.

Drilling success in three gas fields, Sumpal, Suban and Rebonjaro-Dalam, added substantial gas reserves. Sumpal exploration wells were tested at rates between 12 and 24 mmcf/d, while Suban and Rebonjaro-Dalam wells tested at 43 mmcf/d and 6 mmcf/d, respectively.

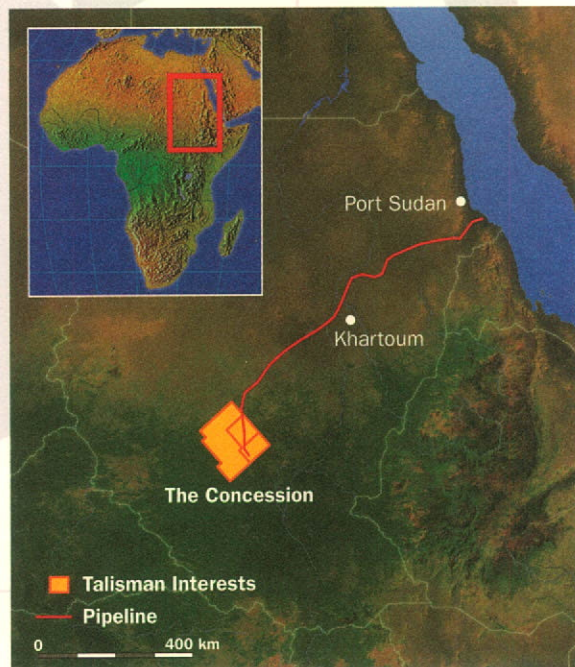
In 1999, planning will continue for Phase Two development and expansion of the Corridor Gas plant in preparation for production from the Sumpal field. Exploration efforts will focus on appraisal of the Suban field including two appraisal wells and a 3-D seismic survey.

### Madura

Technical evaluation will be completed in 1999 prior to spudding an exploration well in mid-2000. Talisman holds a 100% interest in the Madura Offshore PSC, located southeast of Madura Island in the East Java Sea. This data is currently being evaluated and results to date look promising. In 1998, Talisman completed a major seismic reprocessing project comprising approximately 7,000 kilometres of existing 2-D marine seismic.

### Langsa

Engineering studies will continue in 1999 to determine if the Kuala Langsa gas discovery, which is partly in this block, can be developed economically.



In early October, Talisman acquired Arakis Energy Corporation for \$277 million in Talisman shares. Arakis held a 25% interest in the Greater Nile Oil Project located in southcentral Sudan, about 700 kilometres southwest of the capital city of Khartoum. Talisman owns a 25% interest in the concession, which covers Blocks 1, 2 and 4. Talisman also owns a 25% interest in a 1,500 kilometre pipeline under construction. The pipeline agreement grants the operating company exclusive rights to build and own pipelines in the Muglad Basin area. There are five discovered oil fields under development: Heglig, Unity, El Toor, El Nar and Toma South. Ten significant discoveries have been made, five since the acquisition. An active exploration and appraisal program is currently underway and early results have been encouraging.

Sudan presents us with a ground floor opportunity to participate in the development of a new basin with low operating costs and significant upside.

Initial discoveries in Sudan were made almost 25 years ago. This means virtually all of the exploration risks have been taken and a large portion of the capital spent. This is a proven hydrocarbon basin with over 100 wells drilled on these blocks, 75% of which are oil discoveries.

Talisman holds a 25% interest in 12.1 million (3 million net to Talisman) acres of land. Our share of current proved reserves is 101 mmbbls, with significant upside potential. Of this, 68 mmbbls were booked on acquisition, with 33 mmbbls subsequently added from drilling and appraisals. Our acquisition case conserva-

tively assumes 232 mmbbls of reserves with a finding, development and acquisition cost of \$3.95/bbl.

In early 1999, drilling on existing field developments was near completion and the gathering systems and main processing plant were under construction. Oil will be transported by a 1,500 kilometre pipeline to Port Sudan for export. Virtually all of the pipeline has been welded and over half has been trenched and buried. Production is expected by the end of the third quarter of 1999, with rates of 37,500 bbls/d net to Talisman.

The project is operated by the Greater Nile Petroleum Operating Company (GNPOC), a joint operating company owned and staffed by the project participants; this allows the participants to apply the best expertise available to the project. Talisman has already had significant technical, operating and commercial input within this framework.

In the pipeline portion of the project, Talisman's 1998 post-acquisition capital expenditures totalled \$112 million.

Near Port Sudan, a marine export terminal is under construction with 2 mmbbls of storage and an offshore loading buoy.

Talisman's post-acquisition 1998 capital expenditures in the exploration and production blocks totalled \$36.7 million. Third and fourth quarter drilling focused on development and appraisal wells in and around the Unity 1b and Heglig 2b blocks, where development drilling is almost complete. In 1998, subsequent to the acquisition, four drilling rigs completed 19 wells, comprising 18 development wells and one exploration well. By the end of December, a total of 84 successful oil wells had been drilled. Since the acquisition in October 1998, five of six exploration and appraisal wells have been successful.

In 1999, the GNPOC plans a comprehensive exploration and drilling program aimed at increasing the planned production rates from Sudan. The large inventory of untested prospects, leads and anomalies is being matured. Many of these are low-risk and on trend with existing discoveries. In 1999, a 2,600 kilometre seismic program and 18 exploration and appraisal wells are planned. Development planning for some of the eight undeveloped discoveries will also start in 1999.

## Exploration Areas

### ALGERIA

**T**alisman holds a 35% interest in Blocks 215 and 405. The participants in Blocks 215 and 405 relinquished 50% of the acreage in the first quarter of 1998 under the terms of the Production Sharing Contract with the Algerian state oil company.

Talisman's program in Algeria was very successful in 1998, with the discovery of three new fields. Four wells were drilled with capital spending of \$47.1 million.

In the centre of Block 405, new fields were discovered at MLW-1 and MLC-1, close to the MLN field. MLW tested at 1,545 bbls/d and 3.3 mmcf/d. Initial results from MLC-1 look promising with testing still to come. Appraisal work at these fields will continue in 1999.

Drilling success continued in the MLN field with the MLN-5 appraisal well testing 6,820 bbls/d and 7 mmcf/d. Talisman expects development approval for MLN later in 1999, leading to first production in 2001.

In the southern part of Block 405, the MLSE-1 discovery well tested at 14,638 bbls/d and 107 mmcf/d. Appraisal work will continue in 1999. Elsewhere in Block

405, plans for 1999 include the continued acquisition of what will be one of the largest land 3-D surveys in the world. An exploration well is planned to test a structure near Qoubba.

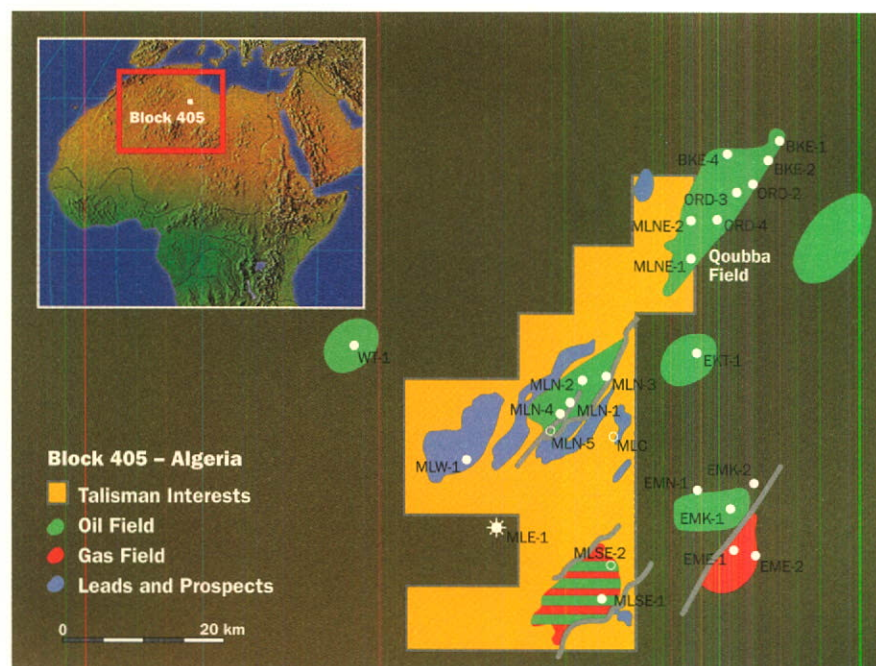
The Qoubba development is underway and production is expected to start in 2002. This giant field contains an estimated 2.5 billion barrels of oil in place and extends into the northeast portion of Block 405. Talisman will have an initial interest of about 2%. At year end 1998, Talisman booked 12 mmbbls of proved reserves in Qoubba. Talisman's share of the capital expenditures at Qoubba totalled \$1.4 million for initial field development. In 1999, development drilling and facilities design and construction will commence.

### TRINIDAD

**I**n 1998, Talisman completed a bottom-cable seismic program over Block 2ab and Block 2c in an area along trend from recent oil discoveries in Venezuela. The Company plans to drill two wells in 1999, the first of which will spud in the second quarter.

### UNITED STATES

**T**alisman has a substantial land position in Nevada. There are no plans for drilling in 1999.



## Corporate

### HUMAN RESOURCES

**T**alisman added 41 employees in 1998, bringing the total permanent staff complement to 986 at year end. Staff turnover remained low at 8.5% and within executive and management levels there was no turnover. In October, the Company successfully integrated the staff of Arakis, adding eight permanent employees in Calgary and 43 staff in Khar-toum and the Heglig field location.

In August, Michael McDonald, former Managing Director of Talisman's UK operations was appointed Vice-President, Business Development. The focus of this new executive position is on international transactions and new country opportunities.

Talisman continues to provide technical and personal development programs for its employees, locally and internationally.

### HEALTH, SAFETY AND ENVIRONMENT (HSE)

**H**ealth, safety and protection of the environment are of prime importance to Talisman. Talisman's Directors are updated on Company HSE performance and issues at every Board meeting.

With Talisman's growing international operations, HSE issues have expanded in scope. We have a core of expertise in Calgary and Aberdeen which support our operations worldwide. The broad objectives of our program are derived from Talisman's corporate HSE Policy: to provide safe and healthy operations, to continuously improve the Company's environmental performance, and to respect the interests of neighbors and other stakeholders. Talisman's comprehensive, global HSE management system serves to "operationalize" the Policy objectives.



Safety and environmental audits were completed in Canada, the UK, and Indonesia, in order to confirm compliance and support continuous improvement of the Company's operations.

The UK Health & Safety Executive approved the Operational Safety Case for the Ross Development. This was a key milestone in the lead-up to first oil production.

During the year, Pembina properties were fully integrated into Talisman's HSE management system. An important focus was safety and loss control program development in Ontario and Turner Valley. All domestic asset transactions were reviewed for environmental concerns in order to manage acquired environmental liability.

The Company made excellent progress against its routine abandonment and reclamation obligations. Approximately 100 inactive wells were abandoned in Canada.

Talisman continues to participate in the Canadian Voluntary Challenge and Registry (VCR) program. In terms of energy efficiency on a unit-of-production basis, Talisman remains in the top quartile among the Canadian Association of Petroleum Producers member companies reporting to the VCR. Talisman's carbon dioxide emissions are among the lowest in the Canadian oil and gas sector.

Local and regional emergency response plans were reviewed and tested to ensure that the Company is prepared to respond to operational and other emergencies worldwide. Improvements were made to the corporate Crisis Management Plan, based on feedback from a crisis response exercise involving the senior management team in Calgary.

## FACILITIES

In early 1998, Talisman signed an agreement to become the prime tenant of the new Bankers Hall West tower. The Company will relocate its head office to the adjacent tower in March 2000.

## MARKETING

Talisman's marketing department continued to focus on ensuring that the Company's production flows to market, unimpeded by changing conditions. Given deteriorating oil prices, a strong effort was made to ensure that transportation costs were optimized and service utilized at very high load factors.

Talisman has implemented a natural gas price risk management strategy to ensure a stable cash flow stream from the Company's domestic gas producing properties.

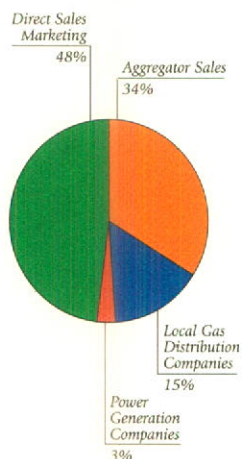
## CORPORATE CONTRIBUTIONS

Talisman supports the communities in which it operates as a matter of good corporate citizenship.

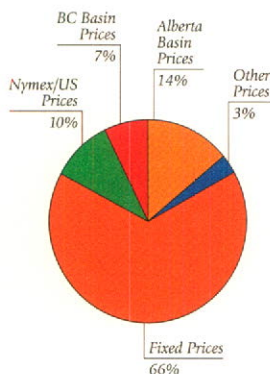
In 1998, Talisman donated almost \$475,000 to health and social services, art and cultural initiatives, environmental, educational, civic activities and community based programs in areas where the Company has employees and operations.

Many organizations were supported by the Company during the year. In Canada, Talisman and its employees supported a number of organizations, including the United Way. In the UK, support was given to various environmental research programs as well as education scholarship programs, and in Indonesia, the Company matched employee contributions in support of a help the needy program. In Sudan, the Company is developing specific programs for 1999 and beyond. These programs will be significant in this very poor country, particularly in areas near Talisman's operations.

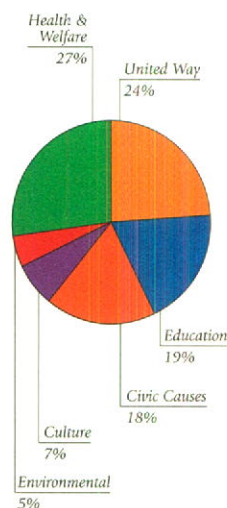
Canadian Gas Sales  
1998/99 Contract Year



Canadian Gas Pricing  
1998/99 Contract Year



Corporate Contributions



# Management's Discussion and Analysis

The following discussion and analysis should be read in conjunction with the Consolidated Financial Statements included on pages 39 to 67 of this annual report. In particular, note 15 provides segmented financial information which forms the basis for much of the following discussion and analysis. All comparative percentages included in this discussion and analysis are between the year ended December 31, 1998 and the year ended December 31, 1997, unless stated otherwise.

Talisman has maintained strong production growth. Volumes for 1998 are up 14% to 230,600 boe/d, with production increasing in each of the Company's core areas. Growth should average 10-15% compounded over the next two years with incremental production from the anticipated completion of Ross and Orion fields in the North Sea, the Greater Nile Oil Project in Sudan, and increased volumes from the Corridor Gas Project in Indonesia. Canadian volumes are expected to decline slightly over the next two years, although gas production is expected to continue to increase.

Low oil prices had the greatest impact on financial results with 1998 cash flow down 21% to \$631.1 million (\$5.64 per share). Talisman's total oil and liquids price averaged \$17.02/bbl during the year, down 30%. Production gains partially offset the effect of low oil prices.

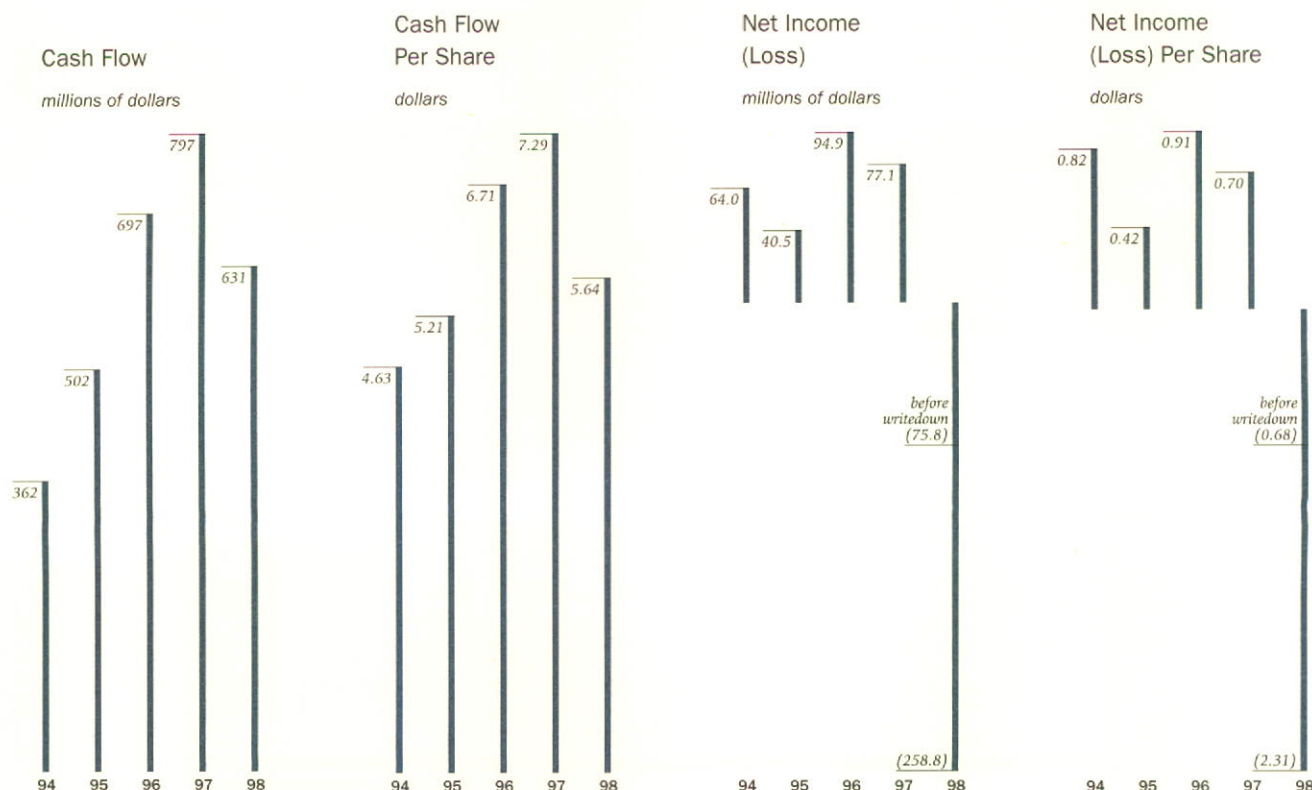
The Arakis Energy Corporation ("Arakis") acquisition in October 1998 provided the Company with a fourth core development area with production expected in the third quarter of 1999. While significant capital is required to complete the Greater Nile Oil Project in Sudan, the assigned value of the shares issued to purchase Arakis was less than \$3/bbl of proved and probable reserves.

Talisman's gross expenditures on exploration and development projects totalled \$1,145.2 million in 1998. The Company replaced 200% of production through drilling with an average proven finding and development cost of \$6.31/boe.

## FINANCIAL HIGHLIGHTS

Talisman's total revenue of \$1.4 billion in 1998 was down only 4% from 1997 despite the 30% reduction in oil prices as production was up 14%. Oil and liquids revenue constituted 59% of 1998 gross sales (1997 - 68%; 1996 - 67%) as natural gas prices remained strong throughout the year.

Cash flow in 1998 decreased 21% from 1997 as the impact of the 14% increase in natural gas production and the 13% rise in crude oil and natural gas liquids was outweighed by the impact of lower oil prices and increased North Sea operating costs. Current year operating expenses averaged \$6.62/boe, up 7%, primarily attributable to an increased cost per barrel in the North Sea resulting from the strengthening UK pound and an additional proportion of volumes from higher cost fields. Talisman's overall royalty rate decreased to 14% of sales in 1998, from 18% in 1997, largely a result of lower oil prices.



## NET INCOME & CASH FLOW VARIANCE

(millions of dollars)

1997 Net income	\$ 77.1
Favorable (unfavorable)	
<b>Cash flow variance</b>	
Oil and liquids volumes	158.2
Natural gas volumes	70.5
Oil and liquids prices	(401.8)
Natural gas prices	6.9
Royalties	98.6
Other revenue	8.4
Operating expense	(101.3)
Interest expense	(39.9)
Current taxes	38.2
Other	(4.1)
Total cash flow variance	(166.3)
<b>Non-cash variance</b>	
Depreciation, depletion and amortization expense	(73.6)
Impairment writedowns	(245.7)
Dry hole expense	(48.8)
Exploration expense	(10.1)
Deferred taxes	145.6
Other	63.0
Total non-cash variance	(169.6)
<b>1998 Net loss</b>	<b>\$(258.8)</b>

The majority of the Company's 1998 loss of \$258.8 million was the result of estimates of impairment on certain North Sea assets of \$245.7 million (\$183 million after tax). A large portion arose from litigation resulting in the cancellation of two gas marketing contracts. Excluding the writedowns, Talisman incurred a loss of \$75.8 million (\$0.68/share).

## DAILY PRODUCTION VOLUMES

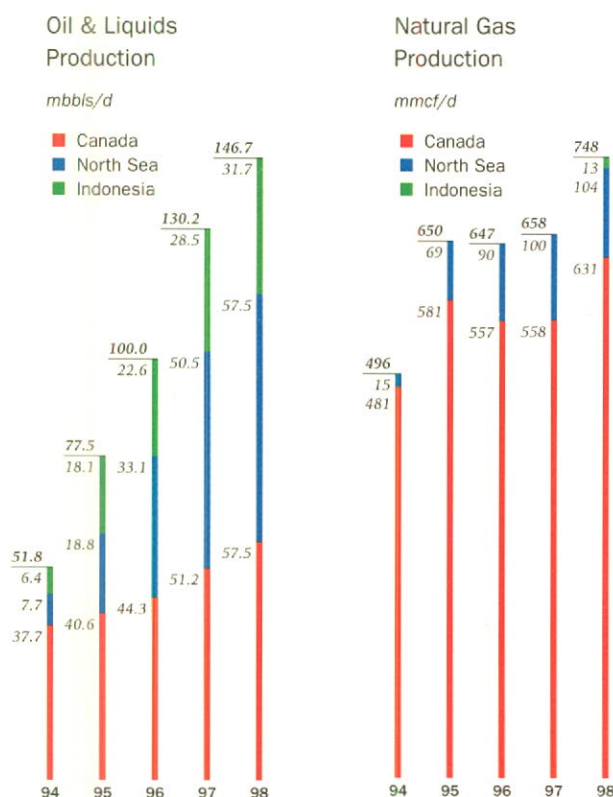
Talisman's production has steadily increased over the past six years, adding 27,800 boe/d in 1998 and achieving an average rate for the year of 230,600 boe/d, up 14%.

Canadian production rose by 13% in 1998. Natural gas volumes accounted for 57% of the increase due partly to development work at Talisman's Alberta Foothills, Greater Arch, and Northern Plains core areas. The majority of oil gains arose from Chauvin, Northern Plains and Ontario. A full year of production from the Pembina properties, acquired in October 1997, also added to the production growth of both oil and natural gas. These gains were partially

offset by a decline in gas from Monkman, due to processing constraints, and less drilling in southeastern Saskatchewan causing a decline in the region's oil production. A slight fall in non-operated production reflects the result of low oil prices on industry activity. Talisman expects Canadian production to decline slightly over the short term as capital is reallocated to higher-potential projects overseas. Oil production in Canada is expected to decline while the Company will continue to grow its natural gas production as spending is reallocated to capitalize on higher natural gas prices.

North Sea volumes increased 11% in 1998, led by a 14% increase in oil production. This growth came from a full year of production from West Brae/Sedgwick and Blenheim/Bladon along with a full year of production from the additional interests in Beatrice and Clyde. Production should continue to grow in 1999, as first oil from the Ross field is now planned for the second quarter of 1999 and from the Orion field in the fourth quarter by way of a sub-sea tieback to the Clyde platform.

Indonesian volumes were up 19% in 1998 due largely to the Corridor Gas Project which commenced in October and increased production from the Tanjung waterflood. Production from the Ogan Komering ("OK") Block, while below the prior year's level, was above expectations. The Corridor Gas Project was in its start-up phase of production in the fourth quarter of 1998, with an increase to the Phase One plateau rate of 110 mmcf/d (net to Talisman) expected in 1999.



## NETBACKS

### Prices

Low oil prices continue to have a significant impact on earnings and cash flow. West Texas Intermediate ("WTI") steadily declined over the year, reaching lows of US\$10.72/bbl in December of 1998. WTI recovered slightly in the new year, averaging about US\$12.49/bbl in January 1999, up US\$1.18/bbl from December. Talisman's total oil and liquids price averaged \$17.02/bbl in 1998, a drop of 30% from 1997. In the current low oil price environment, Talisman benefits, in comparison to its peers, from the relatively light specific gravity of its crude oil.

In 1998, Talisman's reported prices were shown net of hedging gains and losses, which amounted to a net \$0.40/bbl reduction in realized oil prices (1997 - \$0.66/bbl reduction; 1996 - \$0.60/bbl reduction). The loss for 1998 was predominantly from foreign exchange hedges, while the 1997 and 1996 hedging losses were mainly commodity-related. Hedging activities in the last three years did not have a material impact on the Company's realized natural gas prices. In the second half of 1998, the Company locked in the price of a large portion of its Canadian natural gas production, ending 1998 with an estimated 60% of 1999 volumes fixed at an average price of approximately \$2.40/mcf. Refer to note 9 of the Consolidated Financial Statements for additional details regarding Talisman's financial instruments.

The Company's realized average natural gas price remained strong during 1998, increasing slightly from the prior year. Natural gas prices received from the Corridor field are referenced to the price of Duri crude oil. North Sea natural gas price realization will be lower in 1999 due to the cancellation of gas contracts for production associated with the Trent and Tyne fields. The North Sea natural gas spot market for 1999 is expected to be below the original Trent and Tyne contracted prices.

## CANADA

Canadian oil royalties declined 41%, cushioning the fall in oil prices. Oil royalties as a percentage of sales fell to 20.2% in 1998 (1997 - 23.9%; 1996 - 25.1%), mainly a result of the price sensitivities in the Alberta and Saskatchewan crown royalty calculations.

Natural gas royalties dropped to 14.8% of natural gas sales in 1998 (1997 - 16.2%;

1996 - 11.1%), largely due to reduced volatility in British Columbia natural gas prices as compared with 1997 and also from gas cost allowance recoveries from previous production years.

Canadian unit operating costs remained relatively constant at \$4.27/boe in 1998 (1997 - \$4.26/boe; 1996 - \$3.63/boe). The \$0.22/bbl reduction in oil unit operating costs was mainly the result of improving

CANADA	1998	1997	1996
Oil and liquids (\$/bbl)			
Sales price	\$15.32	\$21.97	\$23.95
Royalties	(3.09)	(5.26)	(6.01)
Operating costs	(3.50)	(3.72)	(3.01)
Netback	\$ 8.73	\$12.99	\$14.93
Natural gas (\$/mcf)			
Sales price	\$ 2.03	\$ 1.98	\$ 1.71
Royalties	(0.30)	(0.32)	(0.19)
Operating costs	(0.50)	(0.48)	(0.41)
Netback	\$ 1.23	\$ 1.18	\$ 1.11
Netback (\$/boe)	\$10.52	\$12.36	\$12.67

Netbacks include hedging activities, but do not include synthetic oil or pipeline operations.



efficiency from the Pembina oil properties, added development volumes and the disposition of higher operating cost non-core properties. Natural gas unit operating costs increased slightly because of higher pipeline tolls at Monkman.

## NORTH SEA

North Sea netbacks have declined significantly, with low oil prices moving North Sea oil netbacks from leading the Company in 1997 to trailing Canada and Indonesia in 1998. While other core areas receive a buffering effect of royalty reductions when energy prices are low, the North Sea does not see the same impact due to low royalty rates. In the UK, royalties are only payable on fields developed prior to 1983.

North Sea unit operating expenses increased 17% to average \$11.21/boe in 1998 (1997 – \$9.56/boe; 1996 – \$5.89/boe). North Sea costs were impacted by the strengthening UK pound, pushing up Talisman's sterling-denominated North Sea operating costs in Canadian dollars, and the Buchan field shutdown for 38 days in the fourth quarter for repairs. The sterling exchange rate climbed to an average of \$2.46 per UK pound in 1998 from \$2.27 in 1997. This roughly translated into an increase of \$1/bbl in production costs. Twelve months of production from Beatrice's increased working interest, now 100%, also contributed to the increase in costs. Excluding Beatrice, North Sea oil lifting costs would have averaged \$10.48/bbl in 1998. Beatrice's high unit operating cost is a combination of specific well workovers, not expected to be repeated in 1999, and inherent production declines. North Sea unit operating costs are expected to decline in 1999 with the addition of production from Ross and Orion and an aggressive cost reduction program on operated assets, particularly Beatrice.

NORTH SEA	1998	1997	1996
Oil and liquids (\$/bbl)			
Sales price	\$18.14	\$25.49	\$27.31
Royalties	(0.24)	(1.35)	(1.23)
Operating costs	(12.70)	(10.92)	(6.50)
Netback	\$ 5.20	\$13.22	\$19.58
Natural gas (\$/mcf)			
Sales price	\$ 3.93	\$ 3.89	\$ 3.37
Royalties	(0.04)	(0.16)	(0.15)
Operating costs	(1.04)	(0.91)	(0.76)
Netback	\$ 2.85	\$ 2.82	\$ 2.46
Netback (\$/boe)	\$ 7.95	\$14.14	\$18.08

Netbacks include hedging activities, but do not include pipeline operations.

INDONESIA	1998	1997	1996
Oil and liquids (\$/bbl)			
Sales price	\$17.61	\$25.62	\$27.22
Royalties	(6.51)	(11.41)	(8.06)
Operating costs	(4.89)	(5.68)	(6.17)
Netback	\$ 6.21	\$ 8.53	\$12.99
Natural gas (\$/mcf)			
Sales price	\$ 1.65	\$ –	\$ –
Royalties	(0.11)	–	–
Operating costs	(0.76)	–	–
Netback	\$ 0.78	\$ –	\$ –
Netback (\$/boe)	\$ 6.11	\$ 8.53	\$12.99

Netbacks include hedging activities.

## INDONESIA

First natural gas from the Corridor Gas Project was achieved on October 3, 1998. Production averaged 53 mmcf/d in the fourth quarter, and is expected to reach its Phase One plateau rate of 110 mmcf/d (net) in 1999. Once produced, the natural gas is transported 540 kilometers to the Duri steamflood for use as fuel. Talisman receives Duri crude oil, on an energy equivalent basis in exchange for Corridor natural gas, which is sold offshore under a nine year marketing agreement, payable in US dollars.

Royalties include Pertamina's share of profit oil from all producing areas and oil committed to the domestic market at reduced prices pursuant to contract terms. Talisman accounts for Indonesian royalties based on rates in effect at the time of production. Rates increase significantly when Talisman's cost recovery pools are depleted. These pools represent capital and operating expenditures that are deductible on a contract by contract basis from sales revenue, prior to determining Pertamina's share. This provides the operator with accelerated cost recovery; however, contract terms also restrict the return on investment. The timing and extent of royalty rate increases depend on future cost recovery pools, production, and prices.

The drop in the Indonesian royalty rate to 35.8% as a percentage of sales in 1998 (1997 – 44.5%; 1996 – 29.6%) is due to a combination of low oil prices and increased volumes from the Corridor and Tanjung areas, where there are large cost recovery pools. The royalty rate was higher in 1997 because the OK Block's cost recovery pools were fully depleted in 1996.

Oil unit operating expenses declined 14% in 1998, as increased volumes and cost efficiencies at Tanjung drove the field's unit operating costs down 46%. The Corridor natural gas sales price was net of pipeline tariffs of \$0.95.

### DEPRECIATION, DEPLETION AND AMORTIZATION EXPENSE

Depreciation, depletion and amortization ("DD&A") expense increased by \$73.6 million to \$614.8 million for 1998, reflecting the continued capital growth of the Company. The unit DD&A rate has remained steady at \$7.30/boe; however, the mix has changed slightly. The increase in the Canadian per unit rate comes mainly from the Pembina properties, which have a higher net book value per boe. Offsetting this increase was a \$1.15 per unit decrease in the North Sea rate, reflecting a year's worth of DD&A expense from higher working interests in Blenheim, Bladon, Beatrice, and Clyde. These properties have lower DD&A rates compensating for their higher operating costs.

### DEPRECIATION, DEPLETION AND AMORTIZATION EXPENSE

DD&A per boe	1998	1997	1996
Canada	\$ 6.89	\$ 6.08	\$ 6.01
North Sea	9.27	10.42	9.31
Indonesia	4.43	4.51	4.45
Total Company	\$ 7.30	\$ 7.30	\$ 6.73

### DRY HOLE EXPENSE

Dry hole expense can vary substantially from year to year due to the uncertainty related to exploratory drilling. Included in the 1998 balance of \$91.2 million (1997 – \$42.4 million; 1996 – \$65.4 million) were costs in Algeria associated with land that was relinquished to the Algerian government. Even though these costs have been written off for accounting purposes, they are still eligible for cost recovery from Algerian production. The remaining increase in dry hole expense is due mainly to certain North Sea wells.

### EXPLORATION EXPENSE

Exploration expense consists of geophysical and geological expenses, seismic, lease rentals and indirect exploration expenses. A portion of the 1998 expense of \$102.4 million (1997 – \$92.3 million; 1996 – \$63.5 million) comes from work in the North Sea, largely from the Moray Firth and surrounding area. This work assisted Talisman in being awarded five North Sea blocks in the 18th offshore oil and gas licensing round. The Moray Firth has become the Company's focal point in the North Sea.

### CORPORATE EXPENSES

#### General and Administrative Expense

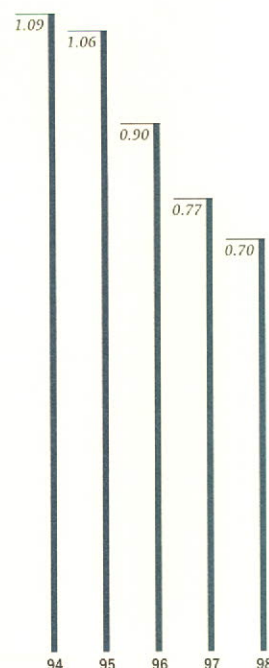
Talisman has increased its total production by 267% over the past six years with only a 69% increase in general and administrative ("G&A") expense. As a result, G&A expense per unit further declined to \$0.70/boe in 1998 (1997 – \$0.77/boe; 1996 – \$0.90/boe). The Company expects unit G&A expense to be relatively unchanged in 1999.

### Interest Cost

Total interest cost increased 77% in 1998 due to higher debt levels, the result of Talisman's 1998 net capital expenditure program having exceeded cash flow by \$436 million. A large part of the higher debt levels comes from the acquisition of an interest in the Greater Nile Oil Project. This acquisition required the Company to spend \$140 million (excluding capitalized interest) in the last quarter of 1998 on the project's development, in addition to the financing provided to Arakis between the acquisition bid and close of the purchase. Interest expense increased \$40 million, net of capitalized interest of \$51.0 million (1997 – \$29.1 million; 1996 – \$5.1 million) related to development of the Ross, Corridor and Greater Nile projects. Interest will no longer be capitalized for the Corridor Gas Project in 1999 due to the completion of the construction phase in 1998. Interest expense is expected to increase in 1999 from continued higher levels of debt; however, capitalization of interest associated with the Greater Nile Oil Project should partially compensate.

General & Administrative Expense

\$/boe



## Other Revenue

Pipeline and custom treating tariffs were up in 1998 due to a year's worth of revenue from the higher working interest and increased activity at the Nigg terminal in the North Sea. Talisman acquired an interest in the Nigg terminal as part of the acquisition of the Beatrice field in 1996 and further increased its interest through a series of acquisitions in 1997. Other components of pipeline and tariff revenue, including Talisman's interest in the Brae Forties pipeline in the North Sea, were similar to the prior year.

## Other Expenses (Income)

Other income in 1998 included net gains on asset dispositions of \$89.3 million (1997 - \$20.7 million; 1996 - \$25.4 million) primarily from gains of \$51.3 million from the sale of assets on the east coast of Canada and \$33.6 million from the disposition of the Company's interest in Ricinus.

Other income in 1998 also included a \$14.3 million gain received from the cancellation of a marketing contract related to North Sea natural gas production at Tyne.

Note 11 to the Consolidated Financial Statements includes details of the components of other expenses, which includes non-recurring sources of income.

## Income Taxes

While the Company incurred a consolidated loss before taxes of \$312.3 million in 1998, cash income taxes were still payable in the current year by certain Talisman subsidiaries. The Indonesian concessions of OK Block and Corridor Technical Assistance Contract reached cost recovery in prior years and comprise most of the Indonesian current tax charge of \$15.2 million. Another \$5.3 million of current taxes relates to Netherlands operations. Canada's payable portion of \$5.3 million is primarily large corporation tax.

Talisman currently has income tax pools expected to be sufficient to defer payment of cash income taxes in Canada until 2003.

The UK government also levies Petroleum Revenue Tax ("PRT") on certain fields in the North Sea. Lower crude oil prices in 1998 reduced PRT expense.

Non-deductible DD&A shown in note 12 to the Consolidated Financial Statements relates to the difference between the purchase price allocated to acquired assets and associated income tax pools. The difference is amortized against income and has the effect of increasing the effective income tax rate.

## PROPERTY, PLANT AND EQUIPMENT

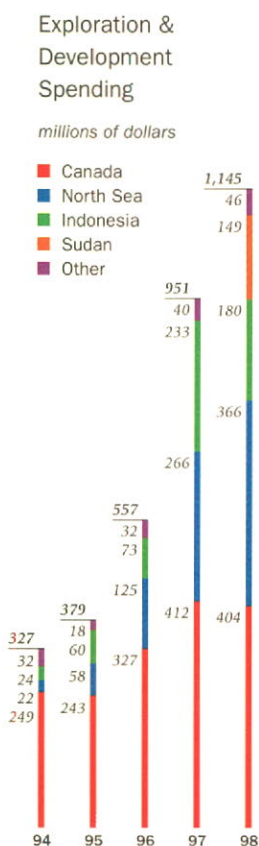
On October 8, 1998, Talisman completed the acquisition of Arakis, which added \$377.7 million to property plant and equipment (refer to note 2 of the Consolidated Financial Statements). The project involves

exploration for, development and production of crude oil in a contract area of Sudan comprising approximately 12 million acres and the construction and operations of a 1,500 kilometre pipeline from the contract area to the Red Sea. As of December 31, 1998, a total of 84 successful oil wells had been drilled in the contract area. Total exploration and development spending in Sudan was \$305 million in 1998 (including \$156 million incurred by Arakis prior to the acquisition) and is expected to be approximately \$265 million in 1999.

Talisman continued to fund exploration and development activities in its traditional core areas, spending \$949.1 million in 1998. Due to the continued impact on cash flows of the low price of oil, the 1999 capital budget has been reduced to approximately \$880 million, with a large portion of the money going to completing the Greater Nile Oil Project in Sudan and Ross development in the North Sea.

Ross field development resulted in the substantial increase in North Sea expenditures in 1998. Development is nearing completion, with the FPSO (Floating, Production, Storage and Offloading) vessel Bleo Holm setting sail on February 17, 1999. First production is now expected early in the second quarter. Predevelopment work commenced on the Orion field in 1998, with initial production anticipated for the fourth quarter of 1999. North Sea spending totalled \$365.8 million, including drilling costs of \$239.6 million, facility and development work of \$88.6 million and other costs of \$37.6 million.

The Company recorded impairment write-downs associated with certain North Sea assets of \$245.7 million (\$183 million after tax) for the year ended December 31, 1998. The writedowns relate to the Southern Gas Basin and the Beatrice and Ross fields. The writedowns associated with the Southern Gas Basin are a result of significantly lower natural gas prices at the Trent and Tyne fields due to the cancellation of



gas contracts resulting from litigation, together with a reduction in probable reserves. The writedown relating to the Beatrice field results from an assumption for accounting purposes that the Company will not realize success from its planned exploration wells. That assumption will cause the estimated Beatrice abandonment costs to be fully accrued by mid-2000 even though major abandonment expenditures are not expected to be incurred until after 2005. The writedown associated with the Ross field is due to lower oil price expectations together with higher than anticipated capital spending on drilling the first two development wells and a stronger than expected UK pound.

In Canada, Talisman continued to focus on natural gas exploration and development in 1998, with about two thirds of expenditures on natural gas programs. This activity resulted in the drilling of 518 wells (303 net) in 1998 with a success rate of 86%. Total Canadian expenditures of \$403.7 million included drilling costs of \$217.8 million, property, plant and equipment spending of \$116.9 million, and other spending of \$69.0 million.

The reduced spending in Indonesia reflects the completion of the construction phase of the Corridor Gas Project in September 1998.

Exploration expenditures in Algeria have increased substantially to \$47.1 million in 1998, from \$16.0 million in 1997. A plan of development was submitted in 1998 for the Qoubba field and is awaiting approval from Sonatrach, the Algerian state oil company. The Company has drilled four successful wells on the MLN field in Block 405. Talisman expects that the operator will submit a plan of development for Block 405 to Sonatrach in 1999 with first production expected to begin in 2001.

Talisman's overall investment focus will continue to shift towards international projects in 1999 with approximately 70% of forecast capital expenditures related to international activities.

## LIQUIDITY AND CAPITAL RESOURCES

### Debt and Equity

In 1998, Talisman's net capital expenditures exceeded cash flow, largely the result of depressed world oil prices. The Company was also committed to significant development expenditures on Corridor, Ross and the Greater Nile projects. In light of this excess, Talisman reduced previously planned capital expenditures by \$100 million and realized net disposition proceeds of \$92 million. Traditionally, Talisman has funded substantially all of its capital expenditure program with operating cash flow; however, large-scale development projects have temporarily pushed capital expenditures above operating cash flow.

At the end of 1998, Talisman's debt-to-cash flow ratio was 3.3:1 and debt to debt plus equity was 49%. These amounts exceeded the Company's long-term targets of less than 2:1 and 40%, respectively, primarily due to low oil prices and capital expenditures on large international development projects which only begin to appreciably contribute to cash flow in 1999 and 2000. Talisman remains committed to reattaining its target ratios through a combination of asset sales and spending restraint in 1999 and 2000.

Sources of funding in 1998 included the issuance of \$180 million of 5.7% unsecured medium term notes maturing 2003, the US\$200 million private placement of 6.96% unsecured notes due in 2005 and the securitization of \$150 million of accounts receivable. Also, in early 1999, Talisman issued US\$150 million of 9% Preferred Securities due in 2048. Due to continuing depressed world oil prices, credit rating agencies reviewed the credit profiles of companies in the oil and gas industry, resulting in a number of downgrades. Talisman's senior unsecured long-term debt credit ratings were reaffirmed at Baa1 by Moody's and BBB+ by Standard and Poor's and were downgraded by both the Canadian Bond Rating Service ("CBRS") and the Dominion Bond Rating Service ("DBRS") from A to A (low). Due to the subordinated nature of

the Preferred Securities, they were assigned a credit rating of Baa2 by Moody's, BBB- by Standard and Poor's, and BBB(low) by CBRS. Talisman's commercial paper rating was reaffirmed by both DBRS and Moody's and was downgraded from A-1 to A-1 (low) by CBRS. All of Talisman's current credit ratings are investment grade.

Talisman continues to maintain significant financial flexibility. The Company has a shelf prospectus in place that could be used to issue up to \$470 million of medium term notes in the Canadian public debt markets by May 2000. Towards the end of 1998, the Company put in place a new \$300 million revolving credit facility maturing in late 1999. At the beginning of 1999, Talisman increased the aggregate amount available under its main corporate revolving facilities by \$200 million to \$1.1 billion. The Company's revolving bank credit facilities fully backstop its commercial paper program. Additionally, in December 1998, Talisman put in place a facility that enables the Company to offer for sale to a third party up to \$150 million of accounts receivable on a revolving basis until the end of 1999. Maturities of Talisman's debt portfolio are spread over a number of years to mitigate refinancing risk and maximize operational flexibility.

In October 1998, Talisman acquired Arakis in exchange for issuing common shares of the Company. Under the terms of the transaction, Arakis shareholders received one Talisman common share for every ten Arakis common shares, amounting to a total of 8.9 million Talisman common shares issued for an assigned value of \$277.5 million.

Based on the December 31, 1998 price of \$26.95 per common share, Talisman's market capitalization was \$3.2 billion (\$5.3 billion including long-term debt). Talisman has not declared a dividend on its common shares since 1991 in order to retain funds for reinvestment. Dividend policy is reviewed annually by the Board of Directors. The Company has no plans to pay dividends in the foreseeable future.

**FINANCIAL LEVERAGE & COVERAGE RATIOS**

	1998	1997	1996
Long-term debt <sup>1</sup> to cash flow <sup>2</sup> (times)	3.3	2.2	1.3
Interest coverage – cash flow <sup>2,3</sup> (times)	5.2	11.1	11.1
EBITDAX <sup>4</sup> (millions of dollars)	813.0	902.4	848.7
Interest coverage – EBITDAX <sup>5</sup> (times)	5.7	11.3	11.5
Long-term debt to debt plus equity <sup>1</sup> (%)	49	44	30

1 Based on balances at December 31.

2 Cash flow is defined in note 13 to the Consolidated Financial Statements.

3 Cash flow plus current income taxes and interest expense, divided by the sum of interest expense and capitalized interest.

4 Earnings before interest, income taxes, depreciation, depletion and amortization, impairment writedowns, dry hole and exploration expense.

5 Earnings before interest, income taxes, depreciation, depletion and amortization, impairment writedowns, dry hole and exploration expense; divided by the sum of interest expense and capitalized interest.

**SENSITIVITIES**

Approximate impact in 1999 (millions of dollars)	Net Income	Cash flow <sup>1</sup>
<b>Volume changes</b>		
Oil – 1,000 bbls/d	1.2	3.9
Natural gas – 10 mmcf/d	2.3	6.7
<b>Price changes <sup>2</sup></b>		
Oil – US\$1.00/bbl	45.9	63.2
Natural gas (Canada) <sup>3</sup> – \$0.10/mcf	4.0	7.2
<b>Exchange rate changes</b>		
C\$ decrease by US\$0.01 <sup>2</sup>	2.0	4.2
£ increase by C\$0.03	(1.5)	(0.4)

1 Cash flow is defined in note 13 to the Consolidated Financial Statements.

2 The impact of hedging contracts in place at December 31, 1998 is included.

3 Price sensitivity on natural gas relates to Canadian gas only. The Company's exposure to changes in North Sea gas prices is limited, as fixed price and oil price referenced contracts constitute a significant portion of sales.

A majority of Talisman's long-term debt at December 31, 1998 is fixed rate; accordingly, changes in market interest rates would not currently have a material effect on the Company.

Talisman has little exposure to fluctuations in currency exchange rates other than the US dollar and UK pound. All of the Company's Indonesian revenues are referenced to world oil prices and are received in US dollars. A majority of Talisman's North Sea oil revenues are US dollar-denominated. A substantial portion of Talisman's North Sea operating and capital costs are denominated in UK pounds; however, this exposure is partially mitigated by the fact that a majority of the Company's UK natural gas sales are denominated in UK pounds.

**Financial Instruments**

Talisman manages its exposure to fluctuations in foreign exchange rates and commodity prices in part through the use of financial instruments. Instruments outstanding at December 31, 1998 are detailed in note 9 to the Consolidated Financial Statements.

In addition to limits established by the Board of Directors, Talisman maintains a system of internal controls to minimize risks associated with its derivatives program and credit risk associated with derivatives counterparties. The status of the Company's derivatives program is reviewed at each Board of Directors meeting.

Talisman's gross revenue benefits from a weak Canadian dollar relative to the US dollar, as a significant proportion of the Company's revenues are effectively denominated in US dollars. To protect against the

effects of a strengthening Canadian dollar, Talisman entered into forward foreign exchange contracts to fix the exchange rate on a portion of future revenues to be received in 1999 through 2001. The Canadian dollar continued to weaken against the US dollar in 1998, resulting in a realized net loss on these contracts of \$32.5 million in 1998 (1997 – \$3.4 million loss; 1996 – \$2.9 million gain).

Talisman uses both financial and physical contracts to manage prices received and mitigate the risk associated with fluctuations in commodity prices. Financial hedging contracts resulted in a net increase to recorded sales of \$15.3 million in 1998 (1997 – \$25.9 million reduction; 1996 – \$19.5 million reduction).

**RISKS AND UNCERTAINTIES**

Talisman is exposed to operational risks inherent in exploring for, developing and producing crude oil and natural gas. A comprehensive insurance program is maintained to mitigate risks and to protect against significant losses, while maintaining certain acceptable levels of risk within the Company. Liability, property and business interruption insurance is considered adequate and consistent with common industry practice. Talisman also maintains comprehensive programs and contingency plans necessary to control health, safety and environmental risks across its operations that comply with existing legislative and regulatory requirements. Regular audits of operations ensure compliance with applicable regulations and standards. Compliance with health, safety and environmental standards are reviewed at each Board of Directors meeting. Long-term abandonment and restoration provisions have been recorded in accordance with generally accepted accounting principles.

The Company's international operations may be adversely affected by changes in governmental policies or social instability or other political, economic or diplomatic developments which are not within the control of Talisman including, among other things, a change in crude oil or nat-

ural gas pricing policy, the risks of war, terrorism, expropriation, nationalization, renegotiation or nullification of existing concessions and contracts, taxation policies, foreign exchange and repatriation restrictions, changing political conditions, international monetary fluctuations and currency controls. Indonesia, Algeria and Sudan have been subject to recent economic or political instability and social unrest or military hostilities. In Indonesia, the election issues relate to the succession of former President Suharto. The oil and gas industry is a major source of hard currency to the government, so its well-being is essential to the successful political party and also, foreign involvement is welcomed. There is civil unrest in Sudan, which, apart from the period 1972 to 1983, has continued inconclusively since 1956. The oil fields and pipeline may be the targets of guerrilla attacks, although security measures have been taken to minimize the risk.

The United States has imposed economic sanctions against Sudan which, among other things, prohibit the facilitation by a US person of the export of goods, technology or services to or from Sudan and the performance by any US person of any contract, including a financing contract, in support of any project in Sudan. The Company is not a "US person" and therefore is not bound by the sanctions. However, the imposition of such sanctions against US persons could reduce the supply of materials and services to the project, the availability of financing sources and the number of export markets for Sudanese crude oil. Talisman does not believe the foregoing restrictions will significantly impede the construction and operation of the project. Talisman has also implemented comprehensive procedures to ensure that none of its activities will result in a contravention of the Sudanese sanctions by any US person.

#### Year 2000

As a major international petroleum exploration and production company, Talisman is exposed to risk of failure of its computerized systems and those of its key business associates, such as customers, suppliers, utilities, government agencies and other third parties. Computers, information technology, and electronics are used widely throughout Talisman to facilitate effective and efficient operations and administration.

The Company has established a special committee of the Board of Directors, which meets regularly to specifically review results of the Company's Year 2000 program. Talisman's Year 2000 project team, in place since the third quarter of 1997, reports to a steering committee, which in turn reports to the special committee of the Board of Directors. Talisman is also actively involved in industry association committees and task forces.

Talisman's Year 2000 program is a Company-wide effort involving the identification of all systems and processes which are potentially impacted by the Year 2000 computer issue, extensive testing for Year 2000 readiness, and remediation or replacement where necessary. As part of this program, Talisman has established specialized teams to handle corporate systems, domestic field operations, Indonesian systems and operations, United Kingdom systems and operations as well as its external supply chain.

An active corporate awareness program has been in place since early 1998. Talisman has completed its Year 2000 inventory and risk assessment, and has substantially completed the process of conducting compliance checks and testing its infrastructure and products to verify the status and complexity of the Year 2000 issue.

Upgrades and replacements of non-compliant systems within the Company are well underway, with the majority of its high risk systems Year 2000 ready. The Company has a target to have the remainder of its systems ready by the end of the second quarter of 1999. Currently, Talisman is not aware of any critical internal systems which are non-compliant and incapable of timely remediation.

The Company is currently developing a contingency plan that will provide for appropriate responses to operational interruptions that may be associated with Year 2000 failures. The contingency plan will provide guidelines intended to reduce the impact to the Company and its personnel, as well as to the general public and the environment, of any failure of Talisman's systems due to Year 2000 issues. Talisman expects to have contingency plans substantially completed by mid-1999. Following that, the contingency plan will be continually reviewed and modified as necessary.

In addition to any issues identified within the Company, Talisman is reviewing the potential impact of non-compliance by its business associates including suppliers, manufacturers, banks, utility and telecommunications providers, government, and joint venture partners. Talisman has, to date, communicated with over 1000 business associates to assess their preparedness. Throughout the remainder of 1999, Talisman will continue to gather such information, with a particular concentration on those third parties whose operations could pose a high risk to Talisman. While the Company is making all reasonable efforts to assess and manage its risk, it is not possible to obtain comprehensive information with respect to all third parties. In the event that significant failure occurs in the activities of these business associates, it could have a material adverse effect on the Company's operations and financial results. Talisman's contingency plan includes measures to minimize this effect.

The cost of Talisman's Year 2000 program is currently estimated to be \$11 million, of which \$5.5 million has been spent to December 31, 1998.

Talisman believes that it will be able to effect remediation to, or replacement of Talisman-owned systems on a timely basis. Nonetheless, there can be no assurance that the Company will not experience unanticipated negative consequences or material costs caused by undetected errors or defects in the technology used in its business or production systems or Year 2000 failure by third party business associates.

## OUTLOOK – CONTINUING GROWTH

With WTI prices hovering around US\$12/bbl in the first two months of 1999, oil prices will continue to dominate any analysis of Talisman. However, each dollar per barrel change in world oil prices impacts cash flow by about \$65 million. Oil prices rebounded to \$13.95 in early March in advance of the OPEC meeting.

Nonetheless, the Company is managed based on low oil price expectations, keeping a tight reign on capital spending and remaining vigilant about operating costs and G&A expense. Talisman's activities in 1999 will be directed at low-risk exploration in core areas and development and the completion of major projects in the North Sea and Sudan. With this spending on major projects, the expected capital budget this year will be approximately \$880 million. However, these projects will move quickly from cash absorbers to cash generators later this year, adding significant production and cash flow in 2000.

Over the next 12-18 months, Talisman's oil production is expected to increase from 147,000 bbls/d, currently, to approximately 190,000 bbls/d. The Company is still investing in high quality, low cost oil opportunities when prices are low and anticipating first production at a time of relatively higher prices.

As these major projects come on stream, Talisman has substantial flexibility to reduce capital spending and repay debt if necessary. The Company also has a substantial inventory of new investment opportunities. In recognition of low oil prices, we deferred capital spending of almost \$500 million in 1999. However, these opportunities are still available to provide additional growth and value for Talisman shareholders.

The Company has borrowing capacity in place to fund its 1999 capital program and fully expects to return to target debt-to-cash flow and debt-to-debt plus equity ratios over the next two years. Talisman is also examining the possibility of certain non-core asset sales in 1999, providing they can attract reasonable prices. The impact on production, if the sales are successful, will be minimal.

The major operating objective this year will be to bring the Sudan oil project on production. Talisman's contribution to the operating consortium has been well received during these first few months and the Company remains optimistic that first oil production will be achieved before the end of the third quarter in 1999. Technically, this project has minimal risks. Welding of the pipeline is almost complete and current production capacity from the field is at or near 150,000 bbls/d. Talisman continues to monitor civil unrest in southern Sudan and has contingency plans in place, with the safety and well-being of Talisman employees a priority. Talisman recognizes that Sudan presents a challenging environment. The company in no way takes sides in the political and tribal conflicts that have been ongoing for decades. One of Sudan's chronic problems is poverty caused in large part by underdevelopment of resources and lack of infrastructure. In the long run, development of Sudan's large energy resources will raise living standards and contribute to stability in a society sorely in need of both.

Talisman expects its growth to continue in the North Sea as both the Ross and Orion fields come on production this year. A major objective this year will be to reduce unit operating costs. In addition, Talisman has an exciting drilling program in the Moray Firth area.

Talisman's objective in Indonesia in 1999 will be to attain full production volumes from the Corridor Gas Project and to progress options for expansion of sales in this very prolific gas basin. Political events appear to be moving forward with plans for elections and the Company is confident that foreign ownership and the oil and gas industry will not be substantive political issues.

In Canada, Talisman's activities will focus on natural gas opportunities, particularly within the Alberta Foothills and Greater Arch areas. The Company has taken advantage of relatively high Canadian natural gas prices by locking in roughly 60% of its 1999 production at prices averaging \$2.40/mcf.

In addition, 1999 will see the first exploration drilling in Trinidad and a continuation of the very successful program in Algeria. Talisman expects to obtain development approval for the MLN field sometime in 1999, with first production in 2001.

Talisman's stated objective is to achieve 15% annual compound production growth. Although low oil prices have curtailed capital spending and slowed the rate of increase slightly, the Company expects continued production growth of 10-15% annually over the next two years, the result of the current investment program.

# Corporate Governance

Talisman's approach to corporate governance aligns closely with The Toronto Stock Exchange's guidelines for effective corporate governance.

## COMPOSITION OF THE BOARD

The Board of the Company is composed of nine directors. Eight directors, including the Chairman of the Board, are independent of management and are otherwise unrelated, that is, free from any interests that could interfere with their ability to act in the best interest of the Company. The President and Chief Executive Officer is the only member of the Company's management who is a director. The Company has no principal shareholder; accordingly, no director is a representative of any particular shareholder or shareholder group.

The Chairman of the Board is specifically charged with responsibility for leading and managing the Board in discharging its responsibilities and acts as the Board's spokesman to management. The composition of the Board, including the independence of the Chairman and his specified role, ensures that the Board is able to function independently of management. The Board believes that it can operate effectively at its current size.

## RESPONSIBILITIES OF THE BOARD

The Board of Directors has explicitly assumed responsibility for the stewardship of the Company. As part of that responsibility, the Board ensures that the Company has established long-term goals and a strategic planning process, the principal risks of the Company's business are identified and appropriate systems are implemented to manage those risks, there is sufficient succession planning to manage and monitor management risk, the Company has a communications policy, and the Company's internal controls and management information systems have sufficient integrity. The Board of Directors has plenary power over all matters not explicitly

delegated to a committee of the Board. In particular, it is responsible for approving the Company's debt and borrowing policy and its dividend policy, and it has established authorities regarding the Company's hedging and derivative activities. In addition, prior Board approval is required of all major debt financing agreements, the annual capital expenditure plan, and all acquisitions, dispositions or expenditures exceeding specified limits. The Board of Directors, together with the President and Chief Executive Officer, have developed mandates for the Board embodying the foregoing, and for the President and Chief Executive Officer, indicating limits to management's authority. To assist Board members in performing their responsibilities, the Company has adopted a policy whereby, with the approval of the Governance and Nominating Committee, a Board member may engage an outside advisor at the Company's expense.

## COMMITTEES OF THE BOARD

There are six committees of the Board: the Executive Committee, the Governance and Nominating Committee, the Audit Committee, the Management Succession and Compensation Committee; the Pension Funds Committee; and the recently formed Year 2000 Committee. The President and Chief Executive Officer is a member of the Executive Committee, the Pension Funds Committee and the Year 2000 Committee and is the only inside and related director on these committees. The Governance and Nominating Committee, the Audit Committee and the Management Succession and Compensation Committee are composed exclusively of outside directors. Other than the Year 2000 Committee which is composed of three Board members, each of the other committees of the Board is composed of four Board members. With the exception of the Executive Committee, for which there are no regularly scheduled meetings, the committees of the Board convene in accordance with an annually developed schedule.

## Executive Committee

The Executive Committee is an extension of the full Board and convenes to take action when necessary and when it is not practicable to call a meeting of the full Board.

## Governance and Nominating Committee

The Governance and Nominating Committee, together with the Board, develops the Company's approach to corporate governance. The Committee, in consultation with the President and Chief Executive Officer, is responsible for establishing a long-term plan for the composition of the Board and for identifying new Board nominees when required. In determining appropriate nominees, the Committee considers the strengths, skills and experience level of Board members and the Company's strategic objectives. In addition, an orientation and education program has been implemented to assist new Board recruits. The Committee reviews and determines the compensation to be paid to board members with a view to ensuring that the compensation reflects the responsibilities and risks involved in being a director. The Committee is also responsible for regularly assessing the effectiveness of the Board as a whole, the committees of the Board and the contribution of each director.

## Audit Committee

The Audit Committee oversees the Company's internal accounting and financial systems and its controls to ensure that the Company maintains effective internal control systems and adequate processes for detecting risks and controlling weaknesses. The Committee has direct access to the Company's internal and external auditors and meets separately with each group on a regular basis.

### **Management Succession and Compensation Committee**

The Management Succession and Compensation Committee is responsible for reviewing succession plans for key management positions within the Company. It also reviews management development and staffing plans, compensation and benefit plans and, in conjunction with the Board, annual performance contracts of the Company's Chief Executive Officer and Vice-Presidents.

### **Pension Funds Committee**

The Pension Funds Committee is responsible for approving the investment policy and strategy, and reviewing the performance of the Company's pension plans.

### **Year 2000 Committee**

The Year 2000 Committee was formed in August 1998 with responsibility for overseeing the Company's approach to Year 2000 matters and will function until satisfactory conclusion of all Year 2000 matters affecting the Company. The Committee is responsible for confirming that management has established appropriate initiatives to manage Year 2000 risks and it oversees the progress of the Company's Year 2000 initiatives.

### **DIRECTOR SHARE OWNERSHIP POLICY**

In August, 1998, the Board adopted a policy regarding Company share ownership by directors. The policy prescribes that each director should own at least 2,500 Talisman shares and sets out a timeframe over which that accumulation should occur.

### **MANAGEMENT PERFORMANCE**

The terms of the mandate of the Board ensures that the Company annually confirms or redetermines its long-term strategy and strategic objectives and sets its budget and development plan for the ensuing year. This process produces specific annual goals for the Company which are then further developed into specific contracts for each of the officers of the Company based upon that officer's role in the Company. Through this process, each officer individually (including the President and Chief Executive Officer), and the officers as a whole, are made directly responsible for achieving the annual goals of the Company. A significant portion of the annual compensation of each officer is based upon achieving these Company and individual goals.

### **SHAREHOLDER COMMUNICATIONS**

Talisman's policy regarding shareholder communications specifically adopts the principles of timely, accurate and efficient disclosure of information concerning the Company to all shareholders. In addition to the required annual, quarterly and timely reporting of information, the Company regularly makes presentations to industry analysts and investors. The Company also meets informally upon request with investors and analysts and its Corporate Communications Department has the specific mandate of responding in a timely manner to all inquiries received from shareholders, analysts and potential investors.

**THE BOARD OF DIRECTORS IS RESPONSIBLE FOR THE CONSOLIDATED FINANCIAL STATEMENTS BUT HAS DELEGATED RESPONSIBILITY FOR THEIR PREPARATION TO MANAGEMENT.**

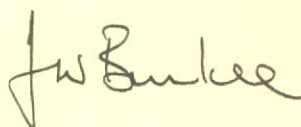
Management has prepared the Consolidated Financial Statements in accordance with accounting principles generally accepted in Canada (with a reconciliation to accounting principles generally accepted in the United States). If alternative accounting methods exist, management has chosen those it deems most appropriate in the circumstances. Financial statements are not precise since they include certain amounts based on estimates and judgements. Management has ensured that the Consolidated Financial Statements are presented fairly in all material respects. Management has also prepared the financial information presented elsewhere in the annual report and ensured that it is consistent with information in the Consolidated Financial Statements.

Talisman maintains internal accounting and administrative controls designed to provide reasonable assurance that the financial information is relevant, reliable and accurate and that assets are appropriately accounted for and adequately safeguarded.

The Board of Directors is responsible for reviewing and approving the Consolidated Financial Statements and Management's Discussion and Analysis and, primarily through its Audit Committee, ensures that management fulfills its responsibilities for financial reporting.

The Audit Committee is appointed by the Board and is composed of directors who are not employees of the Company. The Audit Committee meets regularly with management, and with the internal and external auditors, to discuss internal controls and reporting issues and to satisfy itself that each party is properly discharging its responsibilities. It reviews the Consolidated Financial Statements and the external auditors' report. The Audit Committee also considers, for review by the Board and approval by the shareholders, the engagement or reappointment of the external auditors.

Ernst & Young LLP, the external auditors, have audited the Consolidated Financial Statements in accordance with generally accepted auditing standards on behalf of the shareholders. Ernst & Young LLP have full and free access to the Audit Committee.



James W. Buckee  
President and Chief  
Executive Officer

February 19, 1999



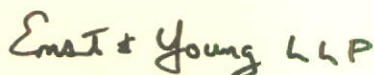
Bruce G. Waterman  
Vice-President, Finance  
and Chief Financial Officer

**TO THE SHAREHOLDERS OF TALISMAN ENERGY INC.**

We have audited the Consolidated Balance Sheets of Talisman Energy Inc. as at December 31, 1998 and 1997 and the Consolidated Statements of Income, Retained Earnings and Cash Flows for each of the years in the three year period ended December 31, 1998. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these Consolidated Financial Statements present fairly, in all material respects, the financial position of the Company as at December 31, 1998 and 1997 and the results of its operations and the changes in its financial position for each of the years in the three year period ended December 31, 1998 in accordance with accounting principles generally accepted in Canada.



Ernst & Young LLP  
Chartered Accountants

Calgary, Canada  
February 19, 1999

# CONSOLIDATED BALANCE SHEETS

December 31

(millions of Canadian dollars)

1998

1997

## Assets

### Current

Cash	\$ -	\$ 7.1
Accounts receivable	192.5	403.9
Inventories (note 3)	64.8	43.9
Prepaid expenses	14.4	15.8
	271.7	470.7

Deferred pension costs (note 4)	57.0	47.7
Other assets	131.7	71.5
Property, plant and equipment (notes 5 and 7)	4,996.8	4,441.0
	5,185.5	4,560.2

<b>Total assets</b>	<b>\$5,457.2</b>	<b>\$5,030.9</b>
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## Liabilities

### Current

Bank indebtedness	\$ 2.5	\$ -
Accounts payable and accrued liabilities	530.1	449.7
Income and other taxes payable	28.0	47.6
Current portion of long-term debt (note 7)	15.6	-
	576.2	497.3

Deferred credits	21.5	23.2
Provision for future site restoration (note 6)	210.3	144.2
Long-term debt (note 7)	2,070.7	1,738.8
Deferred taxes	364.5	440.8
	2,667.0	2,347.0

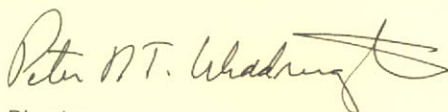
Contingencies and commitments (note 6)

### Shareholders' equity

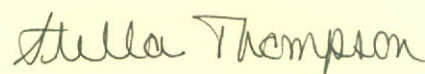
Share capital and contributed surplus (note 8)	2,165.3	1,879.1
Retained earnings	48.7	307.5
	2,214.0	2,186.6

<b>Total liabilities and shareholders' equity</b>	<b>\$5,457.2</b>	<b>\$5,030.9</b>
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On behalf of the board:



Director



Director

See accompanying notes.

## CONSOLIDATED STATEMENTS OF INCOME

Years ended December 31	(millions of Canadian dollars)	1998	1997	1996
<b>Revenue</b>				
Gross sales		\$1,533.6	\$1,699.9	\$1,406.9
Less royalties		213.5	312.1	224.0
Net sales		1,320.1	1,387.8	1,182.9
Other (note 10)		50.6	42.2	29.9
<b>Total revenue</b>		<b>1,370.7</b>	<b>1,430.0</b>	<b>1,212.8</b>
<b>Expenses</b>				
Operating		581.0	479.7	299.5
General and administrative		58.9	57.4	56.3
Depreciation, depletion and amortization		614.8	541.2	420.6
Impairment writedowns (note 5)		245.7	—	—
Dry hole		91.2	42.4	65.4
Exploration		102.4	92.3	63.5
Interest on long-term debt (note 5)		91.0	51.1	68.7
Other (note 11)		(102.0)	(41.4)	(26.2)
<b>Total expenses</b>		<b>1,683.0</b>	<b>1,222.7</b>	<b>947.8</b>
Income (loss) before taxes		(312.3)	207.3	265.0
Taxes (note 12)				
Current		14.6	37.9	51.3
Deferred (recovery)		(87.9)	60.4	84.3
Petroleum revenue tax		19.8	31.9	34.5
		(53.5)	130.2	170.1
<b>Net income (loss)</b>		<b>\$ (258.8)</b>	<b>\$ 77.1</b>	<b>\$ 94.9</b>
Net income (loss) per common share		\$ (2.31)	\$ 0.70	\$ 0.91
Average number of common shares outstanding (millions)		111.9	109.4	103.9
See accompanying notes.				

## CONSOLIDATED STATEMENTS OF RETAINED EARNINGS

Years ended December 31	(millions of Canadian dollars)	1998	1997	1996
	Retained earnings, beginning of year	\$ 307.5	\$ 230.4	\$ 135.5
	Net income (loss)	(258.8)	77.1	94.9
	<b>Retained earnings, end of year</b>	<b>\$ 48.7</b>	<b>\$ 307.5</b>	<b>\$ 230.4</b>
	See accompanying notes.			

# CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended December 31	(millions of Canadian dollars)	1998	1997	1996
<b>Operating</b>				
Net income (loss)		\$ (258.8)	\$ 77.1	\$ 94.9
Items not involving current cash flow (note 13)		787.5	628.0	539.0
Exploration		102.4	92.3	63.5
Cash flow		631.1	797.4	697.4
Changes in non-cash working capital (note 13)		(64.1)	(46.8)	37.0
Cash provided by operating activities		567.0	750.6	734.4
<b>Investing</b>				
Corporate acquisitions (note 2)		(305.9)	(623.6)	(344.9)
Capital expenditures				
Exploration, development and corporate		(1,158.7)	(961.9)	(564.3)
Acquisitions		(130.1)	(126.6)	(218.8)
Proceeds of dispositions				
Resource properties		221.9	71.2	57.8
Investments		—	164.2	1.5
Investments		0.1	(146.6)	(6.8)
Increase in other assets		—	(25.3)	—
Changes in non-cash working capital		76.4	39.6	14.4
Cash used in investing activities		(1,296.3)	(1,609.0)	(1,061.1)
<b>Financing</b>				
Increase in long-term debt on corporate				
acquisitions (note 2)		—	605.1	333.0
Long-term debt repaid		(740.8)	(963.7)	(795.1)
Long-term debt issued		1,029.0	1,172.7	453.5
Common shares issued		286.2	15.5	366.0
Deferred credits and other		(5.0)	(17.4)	(3.4)
Increase in site restoration provision on acquisition		—	12.3	20.0
Changes in non-cash working capital		150.3	(0.1)	(0.2)
Cash provided by financing activities		719.7	824.4	373.8
Net (decrease) increase in cash		(9.6)	(34.0)	47.1
Cash (bank indebtedness), beginning of year		7.1	41.1	(6.0)
Cash (bank indebtedness), end of year		\$ (2.5)	\$ 7.1	\$ 41.1
See accompanying notes.				

(tabular amounts in millions of Canadian dollars ("C\$") except as noted)

## 1. SIGNIFICANT ACCOUNTING POLICIES

The Consolidated Financial Statements of Talisman Energy Inc. ("Talisman" or the "Company") have been prepared by management in accordance with accounting principles generally accepted in Canada. A summary of the differences between accounting principles generally accepted in Canada and those generally accepted in the United States ("US") is contained in note 16 to these statements.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the period. Actual results could differ from those estimates.

### a) Consolidation

All subsidiaries are wholly owned and included in the Consolidated Financial Statements. A substantial portion of Talisman's activities is conducted jointly with others and the Consolidated Financial Statements reflect only the Company's proportionate interest in such activities.

### b) Inventories

Product inventories are valued at the lower of average cost and market value. Materials and supplies are valued at the lower of average cost and net realizable value.

### c) Property, Plant and Equipment

The successful efforts method is used to account for oil and gas exploration and development costs. Under this method, acquisition costs of oil and gas properties and costs of drilling and equipping development wells are capitalized. Costs of drilling exploratory wells are initially capitalized and, if subsequently determined to be unsuccessful, are charged to dry hole expense. All other exploration costs, including geological and geophysical costs and annual lease rentals, are charged to exploration expense when incurred. Producing properties and significant unproved properties are assessed annually, or as economic events dictate, for potential impairment.

### d) Depreciation, Depletion and Amortization

Capitalized costs of proved oil and gas properties are depleted using the unit of production method. For purposes of these calculations, production and reserves of natural gas are converted to barrels on an energy equivalent basis.

Successful exploratory wells and development costs are depleted over proved developed reserves while acquired resource properties with proved reserves, including offshore platform costs, are depleted over proved reserves. Acquisition costs of probable reserves are not depleted or amortized while under active evaluation for commercial reserves. Costs are transferred to depletable costs as proved reserves are recognized. At the date of acquisition, an evaluation period is determined after which any remaining probable reserve costs associated with producing fields are transferred to depletable costs; costs not associated with producing fields are amortized over a period not exceeding the remaining lease term.

Costs associated with significant development projects are not depleted until commercial production commences. Unproved land acquisition costs that are individually immaterial are amortized on a straight-line basis over the average lease term until properties are determined to be productive or impaired. Gas plants, net of estimated salvage values, are depreciated on a straight-line basis over their estimated remaining useful lives, not to exceed the estimated remaining productive lives of related fields. Pipelines and corporate assets are depreciated using the straight-line method at annual rates of 7%, and 5% to 33%, respectively.

### e) Future Site Restoration

Estimated costs of future dismantlement, site restoration and abandonment of oil and gas properties, including offshore production platforms, are provided for using the unit of production method while those of gas plants and facilities are provided for using the straight-line method at rates approximating their useful lives but not exceeding the estimated remaining productive lives of related

fields. The annual provision is included with depletion, depreciation and amortization expense and is based on engineering estimates using current costs and technology and in accordance with existing legislation and industry practice. Expenditures are charged against the accumulated provision as incurred. When a property is disposed of, the associated accumulated provision is eliminated and included in determination of the gain or loss on disposal.

**f) Capitalized Interest**

Interest costs associated with major development projects are capitalized until commercial production commences.

**g) Indonesian Royalties**

Indonesian operations conducted jointly with the Indonesian national oil company ("Pertamina") are reflected in the Consolidated Financial Statements based on the Company's proportionate interest in such activities. All other Pertamina stakes, other than income taxes, are considered to be royalty interests. Royalties on production from Indonesian properties represent the entitlement of the Indonesian government and Pertamina to a portion of Talisman's share of crude oil, liquids and natural gas production and are recorded using rates in effect under the terms of contracts at the time of production.

**h) Petroleum Revenue Tax**

United Kingdom Petroleum Revenue Tax ("PRT") is accounted for using the life of the field method whereby total future PRT is estimated using current reserves and anticipated costs and prices and charged to income based on current revenues as a proportion of estimated future revenues. Changes in the estimated total future PRT are accounted for prospectively.

**i) Foreign Currency Translation**

Monetary assets and liabilities denominated in foreign currencies are translated at exchange rates in effect at the balance sheet date. Non-monetary assets and liabilities denominated in foreign currencies are translated at rates in effect on the dates the assets were acquired or liabilities were assumed. Revenues and expenses are translated at rates of exchange prevailing on the transaction dates. Gains and losses on translation are reflected in income when incurred, except for gains or losses on translation of foreign currency denominated long-term debt, which are deferred and amortized using the straight-line method over the expected minimum period to settlement.

**j) Financial Instruments**

The Company enters into foreign exchange forward and option contracts to hedge anticipated and committed future foreign currency transactions. Interest rate swap contracts and options are used to hedge against adverse fluctuations in interest rates. The Company uses various instruments to hedge against unfavorable fluctuations in commodity prices. Payments or receipts on contracts that are designated and effective as hedges are recognized in income concurrently with the hedged transaction. The fair values of these contracts are not reflected in the Consolidated Financial Statements. If the hedge of an anticipated future transaction is terminated or if a hedge ceases to be effective, the gain or loss at that date is deferred and recognized concurrently with the anticipated transaction. Subsequent changes in value are reflected in income. Any instrument that does not constitute a hedge is recorded at fair value with any resulting gain or loss reflected in income.

**k) Post-Retirement Benefits**

**Pension Plans**

The Company sponsors both defined benefit and defined contribution pension arrangements covering substantially all employees. The cost of defined benefit pensions is determined using the projected benefit method prorated on employment services and is expensed as employment services are rendered. Pension fund assets are measured at fair value. Adjustments arising from plan amendments, experience gains and losses and changes in assumptions are amortized on a straight-line basis over the expected average remaining service life of the employee group. Gains or losses arising from plan curtailments and settlements are recognized in the year in which they occur. A majority of the Company's defined benefit pension plans have plan assets that significantly exceed the present value of accrued defined benefit obligations. Other defined benefit plans are funded in accordance with the plan agreements.

The cost of defined contribution pensions is expensed as earned by employees. The Company makes monthly contributions in accordance with the plan agreement to the employees' individual accounts, which are administered by a plan trustee.

#### **Other Post-Retirement Benefits**

The cost of post-retirement benefits, other than pensions, including dental, group life and supplemental health insurance to eligible retired employees, is determined using the projected benefit method prorated on employment services and is expensed as employment services are rendered.

#### **1) Income Taxes**

The allocation basis is used to account for income taxes by applying the deferral method. This basis relates the provision for income taxes to the accounting income for the period. Timing differences between income for accounting purposes and income tax purposes are recognized as deferred income taxes at tax rates enacted at the time of initial recognition. Accumulated deferred tax balances are not adjusted for subsequent changes in tax rates.

## **2. CORPORATE ACQUISITIONS**

### **Arakis Energy Corporation**

In October 1998, Talisman purchased all the issued shares of Arakis Energy Corporation ("Arakis") in exchange for issuing 8.9 million common shares valued at \$277.5 million.

Net Assets Acquired	
Property, plant and equipment	\$377.7
Net non-cash working capital	(79.9)
Other	8.1
	305.9
Indebtedness due to Talisman	(71.8)
Cash	54.4
Less acquisition costs	(11.0)
	\$277.5

### **Pembina Resources Limited**

In October 1997, Talisman purchased all the issued shares of Pembina Resources Limited ("Pembina") for cash of \$501.0 million and long-term debt assumed of \$104.1 million.

Net Assets Acquired	
Property, plant and equipment	\$697.5
Net non-cash working capital	(15.7)
Deferred income taxes and other	(58.2)
	623.6
Bank indebtedness	(1.7)
Less acquisition costs	(16.8)
	\$605.1

### **Goal Petroleum plc**

In January 1996, Talisman purchased all the issued common shares of Goal Petroleum plc for cash of \$276.1 million and long-term debt assumed of \$56.9 million.

Net Assets Acquired	
Property, plant and equipment	\$380.2
Net non-cash working capital	(7.9)
Deferred income taxes and other	(27.4)
	344.9
Cash	3.9
Less acquisition costs	(15.8)
	\$333.0

### 3. INVENTORIES

December 31	1998	1997
Materials and supplies	\$ 60.7	\$ 39.7
Product	4.1	4.2
	<b>\$ 64.8</b>	<b>\$ 43.9</b>

### 4. PENSION PLANS

At December 31, 1998, the Company's defined benefit pension arrangements consisted of accrued pension obligations with an actuarial net present value of \$80.3 million (1997 – \$66.3 million) and pension plan assets with a market-related value of \$145.9 million (1997 – \$139.1 million). The Company uses actuarial reports prepared by independent actuaries for funding and accounting purposes, the most recent was prepared as at January 1, 1998. The following assumptions were employed to determine the periodic pension expense and the net present value of the accrued pension obligations:

	1998	1997	1996
Expected long-term rate of return on plan assets (%)	7	8	8
Discount rate on accrued pension obligations (%)	7	8	8
Rate of compensation increase (%)	5.5	5	5
	<b>1998</b>	<b>1997</b>	<b>1996</b>
<b>Net pension credit – defined benefit plans</b>			
Current service cost	\$ 1.4	\$ 0.9	\$ 0.7
Interest cost of projected benefit obligations	4.7	4.5	4.3
Return on plan assets	(9.0)	(9.9)	(9.0)
Net amortization and deferral and other	(7.1)	2.4	1.5
	<b>\$ (10.0)</b>	<b>\$ (2.1)</b>	<b>\$ (2.5)</b>
<b>Pension expense – defined contribution plan</b>			
Current service cost	\$ 3.0	\$ 2.6	\$ 2.6
<b>Total net pension (credit) expense – all plans</b>	<b>\$ (7.0)</b>	<b>\$ 0.5</b>	<b>\$ 0.1</b>

At December 31, 1998, the actuarial net present value of the accrued obligation for other post-retirement benefits was \$5.0 million (1997 – \$6.7 million).

### 5. PROPERTY, PLANT AND EQUIPMENT

	Cost	Accumulated depreciation, depletion and amortization	Net book value
<b>December 31, 1998</b>			
Oil and gas properties	\$4,617.0	\$1,555.5	\$3,061.5
Gas plants, pipelines and production equipment	2,450.1	555.8	1,894.3
Corporate assets	110.7	69.7	41.0
	<b>\$7,177.8</b>	<b>\$2,181.0</b>	<b>\$4,996.8</b>
<b>December 31, 1997</b>			
Oil and gas properties	\$4,156.1	\$1,241.1	\$2,915.0
Gas plants, pipelines and production equipment	1,952.9	453.8	1,499.1
Corporate assets	86.1	59.2	26.9
	<b>\$6,195.1</b>	<b>\$1,754.1</b>	<b>\$4,441.0</b>

In the year ended December 31, 1998, interest expense of \$51.0 million (1997 – \$29.1 million) was capitalized relating to the Corridor Gas Project in Indonesia, Ross field development in the North Sea and the Greater Nile Oil Project in Sudan.

In 1998, Talisman recorded impairment writedowns associated with certain North Sea assets of \$245.7 million, largely the result of gas contract cancellations and low oil prices. The writedowns relate to the Southern Gas Basin and the Beatrice and Ross fields.

Included in property, plant and equipment are the following costs that were not subject to depreciation, depletion or amortization ("DD&A"):

	1998	1997
Non-depleted capital at December 31		
Acquired probable reserve costs		
Canada – associated with producing fields	\$ 88.5	\$107.9
North Sea – associated with producing fields	33.4	58.3
North Sea – not associated with producing fields	94.7	141.8
Sudan – not associated with producing fields	35.0	–
Exploration costs	131.6	95.1
	<b>\$383.2</b>	<b>\$403.1</b>

Exploration costs consist of drilling in progress and wells awaiting determination of proved reserves or commencement of production.

In addition, at December 31, 1998, \$359 million in development costs relating to the North Sea and \$480.7 million of development costs and acquisition costs relating to proved reserves in Sudan were not being depleted pending initial production. Development costs were \$535.4 million at December 31, 1997, consisting of \$231.2 million relating to the North Sea and \$304.2 million relating to Indonesia.

The carrying values of property, plant and equipment, including acquired probable reserve costs, are subject to uncertainty associated with the quantity of oil and gas reserves, future production rates, commodity prices and other factors. Future events could result in material changes to the carrying values recognized in the financial statements.

## 6. CONTINGENCIES AND COMMITMENTS

Talisman is party to various legal claims associated with the ordinary conduct of business. In connection with the Corridor Block Gas Project, a local court has ruled against Pertamina and the other Corridor Block PSC participants concerning a surface land claim involving the Corridor gas plant site. Pertamina and the other Corridor Block PSC participants consider the claim to be without merit and are appealing the decision. This and all other claims are not currently expected to have a material impact on the Company's financial position.

Talisman's estimated total future dismantlement, site restoration and abandonment liability at December 31, 1998 is \$650 million (1997 – \$580 million), more than half of which is denominated in UK pounds sterling. At December 31, 1998, Talisman had accrued \$210.3 million (1997 – \$144.2 million) of this liability and will continue to accrue the remaining balance in accordance with the Company's policy as set out in note 1(e). The Company has provided letters of credit in the amount of £58.6 million (\$149.2 million) as collateral against future dismantlement, site restoration and abandonment costs for certain North Sea fields included in the above total. Estimated future dismantlement, site restoration and abandonment costs and the related provision in the financial statements are subject to uncertainty associated with the method, timing and extent of future dismantlement, site restoration and abandonment. For example, changes in legislation or technology may result in actual future costs that differ materially from those estimated.

Talisman leases certain production facilities and its corporate offices, all of which are accounted for as operating leases. Talisman is under contract to lease the Ross floating production, storage and offloading vessel ("FPSO") from a third party. The term of the lease depends on the expected life of the Ross field. In addition to future minimum lease payments, Talisman also has certain operating commitments associated with the FPSO. Talisman's total future minimum lease payments from the FPSO and corporate offices are as follows:

Year	Estimated future minimum lease payments <sup>1</sup>
1999	\$ 46.9
2000	42.0
2001	42.3
2002	42.3
2003	88.0
Subsequent to 2003	109.2
Total	<b>\$370.7</b>

<sup>1</sup> Future minimum payments denominated in US dollars have been translated into Canadian dollars based on the December 31, 1998 exchange rate.

To support production and marketing operations, Talisman has firm commitments for gathering, processing and transmission services that require the Company to deliver certain minimum quantities of crude oil and liquids and natural gas to third parties or pay the corresponding tariffs. The average term for gathering and processing services is less than three years, while transmission commitments tend to be for five to ten years.

The Company has committed to spending approximately US\$12.8 million prior to 2009 to fund exploration and appraisal work on the Corridor Production Sharing Contract ("PSC").

#### Year 2000

The Year 2000 Issue arises because many computerized systems use two digits rather than four to identify a year. Date sensitive systems may recognize the year 2000 as 1900 or some other date, resulting in errors when information using year 2000 dates is processed. In addition, similar problems may arise in some systems which use certain dates in 1999 to represent something other than a date. The effects of the Year 2000 Issue may be experienced before, on, or after January 1, 2000, and, if not addressed, the impact on operations and financial reporting may range from minor errors to significant systems failure which could affect an entity's ability to conduct normal business operations. It is not possible to be certain that all aspects of the Year 2000 Issue affecting the Company, including those related to the efforts of customers, suppliers, or other third parties, will be fully resolved.

### 7. LONG-TERM DEBT

December 31	1998	1997
Bank Credit Facilities <sup>1</sup>		
Project Loan Facility (1998 – US\$162.7 million, 7.92%; 1997 – US\$101.2 million, 7.90%)	\$ 249.0	\$ 143.8
Non-Revolving Bank Credit Facility (1998 – 5.86%; 1997 – 4.50%) <sup>2</sup>	74.2	243.3
Commercial Paper (1998 – 5.41%; 1997 – 4.22%) <sup>1,2</sup>	340.0	412.9
Debentures and Notes (Unsecured) <sup>3</sup>		
7.25% debentures (US\$300 million), due 2027	459.2	428.7
6.96% notes (US\$200 million), due 2005	306.1	–
7.125% debentures (US\$175 million), due 2007	267.8	250.1
5.70% medium term notes, due 2003	180.0	–
9.45% debentures, Series A, due 1999 <sup>2</sup>	100.0	100.0
9.80% debentures, Series B, due 2004	75.0	75.0
9.66% medium term notes, due 2002	35.0	35.0
9.18% medium term notes, due 1998	–	50.0
	<b>2,086.3</b>	<b>1,738.8</b>
Less current portion	<b>(15.6)</b>	<b>–</b>
	<b>\$2,070.7</b>	<b>\$1,738.8</b>

<sup>1</sup> Rates reflect the weighted-average interest rate of instruments outstanding at December 31. Rates are floating rate-based and vary with changes in short-term market interest rates.

<sup>2</sup> The non-revolving bank credit facility, commercial paper and unsecured debentures maturing in 1999 have been classified as long-term debt since the Company has both the ability to replace these instruments with borrowings under the revolving bank credit facilities and the intention to refinance these instruments in 1999.

<sup>3</sup> Interest on all debentures and notes is payable semi-annually.

#### Project Loan Facility

Talisman, through an indirect wholly owned subsidiary, has a credit agreement with an international banking syndicate to indirectly finance a portion of the construction costs for the Corridor Gas Project within the Corridor PSC.

The credit agreement allows borrowings to a maximum of US\$450 million, of which Talisman's 40% share is US\$180 million. Borrowings consist of US dollar London Interbank Offered Rate ("LIBOR") based loans. The principal of the loan must be repaid in semi-annual installments, together with accrued interest, commencing on August 8, 1999. Final principal repayment is to be paid no later than February 26, 2007.

The lenders' security is restricted to the shares and underlying assets of the indirect wholly owned subsidiary that entered into the credit agreement, and includes the Company's interest in the Corridor PSC.

#### **Revolving Bank Credit Facilities**

- a) Talisman has unsecured extendible revolving-term credit facilities totaling \$1.1 billion, consisting of two \$550 million facilities. The term dates of these facilities are June 24, 1999 and December 6, 1999, respectively. Until each term date, the Company may borrow, repay and re-borrow at its discretion. Annually, upon agreement between the Company and the syndicate of lenders, each term date may be extended for an additional 364 days.

Facility borrowings are available in the form of prime loans, Canadian or US dollar bankers' acceptances, US dollar base rate loans or LIBOR-based loans.

Each facility expires five years after the then current term date and, if the term date is not extended, must be repaid in equal semi-annual payments beginning six months after the term date.

- b) In October 1998, Talisman established an additional \$300 million unsecured extendible revolving-term credit facility. The facility matures on October 12, 1999, however, the maturity date can be extended once by 364 days, upon agreement between the Company and the syndicate of lenders. Facility borrowings are available in the form of prime loans and Canadian bankers' acceptances.

#### **Non-Revolving Bank Credit Facility**

Unsecured non-revolving term credit facility borrowings are available by way of prime loans, Canadian dollar bankers' acceptances, US dollar base rate loans or US dollar LIBOR-based loans. Facility borrowings have been by way of Canadian dollar bankers' acceptances.

The Company may repay the facility, in whole or in part, at any time prior to maturity. The facility matures and must be repaid in full on October 15, 1999.

#### **Commercial Paper**

Commercial paper is issued in the form of unsecured discount notes for terms that do not exceed 364 days.

#### **Repayment Schedule**

The Company's contractual minimum repayments of long-term debt in the next five years are as follows:

Year	
1999	\$ 15.6
2000	133.9
2001	133.9
2002	168.9
2003	313.9
Subsequent to 2003	1,320.1
Total	\$2,086.3

Repayments of the non-revolving bank credit facility, commercial paper and unsecured debentures maturing in 1999 have been presented based on the five year repayment terms of the revolving bank credit facilities assuming no extensions to existing term dates.

## 8. SHARE CAPITAL AND CONTRIBUTED SURPLUS

Talisman's authorized share capital consists of an unlimited number of common shares without nominal or par value and first and second preferred shares. No preferred shares have been issued.

	1998		1997		1996	
	Shares	Amount	Shares	Amount	Shares	Amount
<b>Common shares</b>						
Balance, beginning of year	109,644,306	\$1,800.1	109,078,281	\$1,784.6	96,679,831	\$1,411.8
Issued during year						
Acquisition of Arakis	8,921,839	277.5	-	-	-	-
Exercise of stock options	341,175	8.7	566,025	15.5	398,450	9.4
Share issue	-	-	-	-	12,000,000	363.4
Balance, end of year	118,907,320	2,086.3	109,644,306	1,800.1	109,078,281	1,784.6
<b>Contributed Surplus</b>		79.0		79.0		79.0
	118,907,320	\$2,165.3	109,644,306	\$1,879.1	109,078,281	\$1,863.6

Talisman has stock option plans that allow employees and directors to receive options to purchase common shares of the Company. Options granted under the plans are generally exercisable after three years and expire ten years after the grant date. Option exercise prices approximate the market price for the common shares on the date the options are issued.

Continuity of stock options	1998		1997		1996	
	Number of Options	Average Exercise Price	Number of Options	Average Exercise Price	Number of Options	Average Exercise Price
Outstanding at January 1	5,004,675	\$ 31.84	4,005,150	\$ 26.47	3,596,500	\$ 25.11
Granted	1,412,506	37.79	1,721,550	42.55	915,000	31.11
Exercised	(341,175)	24.77	(566,025)	26.48	(398,450)	24.80
Forfeited	(129,027)	39.65	(156,000)	31.82	(106,900)	26.53
Expired	-	-	-	-	(1,000)	26.31
Outstanding at December 31	5,946,979	\$ 33.49	5,004,675	\$ 31.84	4,005,150	\$ 26.47
Exercisable at December 31	2,153,800	\$ 25.10	1,053,825	\$ 25.73	999,350	\$ 23.67
Options available for future grants pursuant to the Company's stock option plans	2,751,571		4,035,050		100,600	

Additional details on the Company's outstanding stock options are as follows:

December 31, 1998	Outstanding Options			Exercisable Options	
	Number of Options	Weighted Average Exercise Price (\$/share)	Weighted Average Years to Expiry	Number of Options	Weighted Average Exercise Price (\$/share)
Range of Exercise Prices (\$/share)					
\$11.94 to \$24.99	1,320,025	\$ 22.76	6	1,320,025	\$ 22.76
\$25.00 to \$29.99	809,275	28.41	5	809,275	28.41
\$30.00 to \$39.99	1,512,408	32.49	8	-	-
\$40.00 to \$45.30	2,305,271	42.06	9	24,500	41.88
\$11.94 to \$45.30	5,946,979	\$ 33.49	7	2,153,800	\$ 25.10

Exercise of outstanding options would not have a dilutive effect on net income (loss) per common share.

At December 31, 1998, 9,538,073 common shares were reserved for issuance primarily related to the stock option plans.

## 9. FINANCIAL INSTRUMENTS

### Financial Contracts

The following financial contracts were outstanding at December 31:

#### a) Foreign Exchange Rates

The Company entered into the following forward contracts to sell US dollars in exchange for Canadian dollars to fix the exchange rate on anticipated and committed future sales that are effectively denominated in US dollars.

Year	1998		1997	
	Notional Contract Amount (US\$)	Weighted Average Contractual Exchange Rate (US\$/C\$)	Notional Contract Amount (US\$)	Weighted Average Contractual Exchange Rate (US\$/C\$)
1998	\$ -	\$ -	\$283.0	\$0.7294
1999	351.0	0.7474	351.0	0.7474
2000	235.0	0.7291	235.0	0.7291
2001	41.1	0.6965	-	-

#### b) Interest Rates

In December 1994, in anticipation of issuing the US\$175 million 7.125% debentures, the Company entered into interest rate swap contracts to hedge against possible adverse interest rate fluctuations. These contracts result in the Company paying interest at a rate of 8.295% in exchange for receiving the three-month LIBOR rate on notional principal of US\$100 million until May 16, 2005. Based on the LIBOR rate at December 31, 1998, these contracts result in an effective rate of interest on the debentures of 8.81%.

#### c) Natural Gas Prices

Talisman entered into natural gas price swap contracts to fix the price on anticipated revenues which are price sensitive to the New York Mercantile Exchange ("NYMEX"), Nova Inventory Transfer ("NIT") and Sumas indices.

Contract Period	1998			1997		
	Notional Contract Amount (Units)	Talisman Receives (US\$/unit)	Talisman Pays	Notional Contract Amount (mmcf/d)	Talisman Receives (US\$/mcf)	Talisman Pays
January to March 98	-	-	-	65	\$2.08	SUMAS
January to March 99	60 mmcf/d	\$2.20	SUMAS	-	-	-
January to March 99	90 mmcf/d	2.40	NYMEX	-	-	-
January to March 99	30 mGJ/d	2.71	NIT	-	-	-
April to October 99	55 mmcf/d	1.67	SUMAS	-	-	-
April to October 99	30 mmcf/d	2.23	NYMEX	-	-	-
April to October 99	40 mGJ/d	2.42	NIT	-	-	-
November 99 to October 01	15 mmcf/d	1.78	SUMAS	-	-	-
November 99 to October 00	5 mmcf/d	2.34	NYMEX	-	-	-
November 99 to October 01	5 mGJ/d	2.35	NIT	-	-	-

## Carrying Amounts and Estimated Fair Values of Financial Instruments

Asset (liability) at December 31	1998		1997	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Debentures and notes	\$(1,423.1)	\$(1,435.0)	\$ (938.8)	\$ (991.0)
Foreign exchange forward contracts	-	(108.5)	-	(54.8)
Interest rate swap contracts	-	(24.5)	-	(18.1)
Natural gas price swap contracts	-	7.6	-	4.8

Borrowings under bank credit facilities and issuance of commercial paper are for short terms and are market rate-based, thus, carrying values approximate fair value. The fair value of debentures and notes is based on market quotations, which reflect the discounted present value of the principal and interest payments using the effective yield at December 31 for instruments having the same term and risk characteristics. Fair values for derivative instruments are determined based on the estimated cash payment or receipt necessary to settle the contract at December 31. Cash payments or receipts are based on discounted cash flow analysis using current market rates and prices.

The fair values of other financial instruments, including cash and short-term investments, accounts receivable, accounts payable, and income and other taxes payable, approximate their carrying values.

### Credit Risk

A significant portion of the Company's accounts receivable are due from entities in the oil and gas industry. Concentration of credit risk is mitigated by having a broad domestic and international customer base, which includes a significant number of companies engaged in joint operations with Talisman. The Company routinely assesses the financial strength of its partners and customers, including parties involved in marketing or other commodity arrangements. At December 31, 1998, amounts due from any one party are not material, except that a substantial portion of the Company's Indonesian accounts receivable are due from Pertamina, representing approximately 18% of consolidated accounts receivable.

The Company is exposed to credit risk associated with possible non-performance by derivative instrument counterparties. The Company does not generally require collateral from its counterparties, but believes the risks of non-performance are minimal as the counterparties are major financial institutions that have an investment-grade credit rating as determined by recognized credit rating agencies. The Company also limits its total exposure to individual counterparties.

### Sale of Accounts Receivable

In December 1998, the Company entered into an agreement, expiring December 31, 1999, that enables it to offer for sale to a third party, on an ongoing basis, certain Canadian, US and UK pounds denominated accounts receivable to a maximum Canadian dollar equivalent amount of \$150 million. In accordance with the agreement, discounted sale proceeds are determined using Canadian and US bankers' acceptance rates and the Company remains exposed to an insignificant amount of potential credit losses and foreign exchange rate fluctuations. At December 31, 1998, the Company sold the Canadian dollar equivalent of \$150 million of accounts receivable.

## 10. OTHER REVENUE

Year ended December 31	1998	1997	1996
Pipeline and custom treating tariffs	\$ 37.6	\$ 31.9	\$ 23.0
Investment income	9.8	8.0	3.9
Marketing income	3.2	2.3	3.0
	\$ 50.6	\$ 42.2	\$ 29.9

## 11. OTHER EXPENSES (INCOME)

Year ended December 31	1998	1997	1996
Net gain on asset disposals	\$ (89.3)	\$ (20.7)	\$ (25.4)
Gain on marketing contract settlements	(15.9)	(11.4)	–
Foreign exchange loss (gain)	8.6	(4.2)	(6.4)
Other (income) expense	(5.4)	(5.1)	5.6
	<b>\$(102.0)</b>	<b>\$ (41.4)</b>	<b>\$ (26.2)</b>

## 12. TAXES

### Income Taxes

Year ended December 31	1998	1997	1996
Current income taxes (recovery)			
Canada <sup>1</sup>	\$ 5.3	\$ 2.8	\$ 2.4
United Kingdom	(13.4)	14.2	22.1
Netherlands	5.3	0.6	–
Indonesia	15.2	19.0	26.8
Other	2.2	1.3	–
	<b>14.6</b>	<b>37.9</b>	<b>51.3</b>
Deferred income taxes (recovery)			
Canada	6.8	52.0	43.9
United Kingdom	(59.9)	20.8	29.4
Netherlands	1.9	5.9	7.0
Indonesia	(21.5)	(6.2)	8.8
Other	(15.2)	(12.1)	(4.8)
	<b>(87.9)</b>	<b>60.4</b>	<b>84.3</b>
Income taxes	<b>\$ (73.3)</b>	<b>\$ 98.3</b>	<b>\$ 135.6</b>

1 Current Canadian income taxes include the federal tax on large corporations, net of Alberta royalty tax credits.

Deferred distribution taxes associated with operations in the United Kingdom have not been recorded because, based on current plans, repatriation of funds in excess of foreign reinvestment will not result in material amounts of tax expense. Unremitted earnings in other foreign jurisdictions are not material.

Income taxes vary from the amount that would be computed by applying the Canadian statutory income tax rate of 43.8% for the year ended December 31, 1998 (1997 – 43.2%, 1996 – 43.5%):

Year ended December 31	1998	1997	1996
Income taxes calculated at the statutory rate	<b>\$(136.9)</b>	\$ 89.6	\$ 115.2
Increase (decrease) in income taxes resulting from:			
Non-deductible royalties, mineral taxes and expenses	50.6	63.4	56.5
Resource allowances	(41.4)	(52.1)	(49.0)
Non-deductible depreciation, depletion & amortization	66.2	37.8	37.8
Deductible PRT expense	(8.1)	(13.0)	(14.0)
Lower foreign tax rates (net)	(7.6)	(27.7)	(12.0)
Provincial rebates and credits	(4.1)	(6.5)	(5.8)
Federal tax on large corporations	4.2	3.0	2.7
Other	3.8	3.8	4.2
Income taxes	<b>\$ (73.3)</b>	<b>\$ 98.3</b>	<b>\$ 135.6</b>

### Petroleum Revenue Taxes

PRT expense primarily relates to the North Sea and is comprised of current taxes of \$8.2 million (1997 – \$23.1 million; 1996 – \$30.2 million) and deferred taxes of \$11.6 million (1997 – \$8.8 million; 1996 – \$4.3 million). The measurement of PRT expense and the related provision in the Consolidated Financial Statements is subject to uncertainty associated with future recoverability of oil and gas reserves, commodity prices and the timing of future events, which could result in material changes to deferred amounts.

### 13. CONSOLIDATED STATEMENTS OF CASH FLOWS

Year ended December 31	1998	1997	1996
Net income (loss)	<b>\$(258.8)</b>	\$ 77.1	\$ 94.9
Items not involving a current cash flow			
Depreciation, depletion and amortization	<b>614.8</b>	541.2	420.6
Impairment writedowns	<b>245.7</b>	—	—
Dry hole	<b>91.2</b>	42.4	65.4
Net gain on asset disposals	<b>(89.3)</b>	(20.7)	(25.4)
Deferred taxes (recovery)	<b>(76.3)</b>	69.2	88.6
Other	<b>1.4</b>	(4.1)	(10.2)
	<b>787.5</b>	628.0	539.0
Exploration	<b>102.4</b>	92.3	63.5
Cash flow	<b>\$ 631.1</b>	\$ 797.4	\$ 697.4
Cash flow per common share	<b>\$ 5.64</b>	\$ 7.29	\$ 6.71
Fully diluted cash flow per common share	<b>5.50</b>	7.05	6.52
Cash interest paid (net of capitalized interest)	<b>\$ 78.2</b>	\$ 43.2	\$ 71.6
Cash income taxes paid	<b>34.5</b>	37.5	22.4

Changes in operating non-cash working capital consisted of the following:

Year ended December 31	1998	1997	1996
Accounts receivable	<b>\$ 34.3</b>	\$ (71.0)	\$ (36.6)
Inventories	<b>(7.6)</b>	0.5	3.0
Prepaid expenses	<b>1.8</b>	(0.7)	3.5
Accounts payable and accrued liabilities	<b>(72.9)</b>	35.3	24.5
Income and other taxes payable	<b>(19.7)</b>	(7.9)	40.1
Deferred credits	<b>—</b>	(3.0)	2.5
Net (use) source of cash	<b>\$ (64.1)</b>	\$ (46.8)	\$ 37.0

### 14. SUBSEQUENT EVENT

In February 1999, Talisman issued 6,000,000 9% Preferred Securities ("Securities"), US\$25 per Security, due February 15, 2048, for net proceeds of \$215.5 million. The Securities will be classified within shareholders' equity as principal and interest obligations may be satisfied by the payment of cash or through the issuance of common shares. Under accounting principles generally accepted in the United States, the Securities will be treated as a long-term liability.

## 15. SEGMENTED INFORMATION

Talisman's activities are conducted in five geographic segments: Canada, the North Sea, Indonesia, Sudan and other international locations. The North Sea segment includes operations in the United Kingdom and the Netherlands. All activities relate to the exploration, development and production of oil, liquids and natural gas.

	Canada			North Sea		
	1998	1997	1996	1998	1997	1996
<b>Revenue</b>						
Gross sales						
Oil and liquids	\$ 307.2	\$ 390.4	\$ 366.1	\$ 380.6	\$ 469.9	\$ 330.2
Natural gas	466.4	403.7	345.9	148.6	142.1	111.3
Synthetic oil	20.0	25.7	27.0	-	-	-
Sulphur	(1.0)	2.0	1.0	-	-	-
Total gross sales	792.6	821.8	740.0	529.2	612.0	441.5
Royalties	131.0	162.9	137.6	6.7	30.7	19.7
Net sales	661.6	658.9	602.4	522.5	581.3	421.8
Other	19.5	18.2	15.5	28.6	23.8	14.4
Total revenue	681.1	677.1	617.9	551.1	605.1	436.2
<b>Segmented expenses</b>						
Operating						
Oil and liquids	70.2	66.1	46.0	266.4	201.4	77.8
Natural gas	115.9	96.9	83.3	39.5	33.1	25.1
Synthetic oil	13.0	13.9	12.8	-	-	-
Pipeline	3.0	3.4	3.4	14.4	8.5	-
Total operating expenses	202.1	180.3	145.5	320.3	243.0	102.9
DD&A	306.7	238.3	219.5	253.0	255.6	163.8
Dry hole	22.5	24.1	26.0	48.2	9.3	34.7
Exploration	39.9	41.9	33.8	37.5	15.3	13.6
Other	(57.8)	(36.0)	(20.3)	190.3	(9.5)	(7.6)
Total segmented expenses	513.4	448.6	404.5	849.3	513.7	307.4
Segmented income (loss) before taxes	167.7	228.5	213.4	(298.2)	91.4	128.8
<b>Corporate expenses</b>						
General and administrative						
Interest on long-term debt						
Total corporate expenses						
<b>Income (loss) before taxes</b>						
Property, plant and equipment	\$2,304.7	\$2,258.3	\$1,409.8	\$1,537.1	\$1,682.1	\$1,600.5
Segmented assets	\$2,393.3	\$2,438.4	\$1,574.3	\$1,654.9	\$1,880.8	\$1,693.8
Add corporate						
<b>Total assets</b>						
<b>Capital expenditures</b>						
Exploration	\$ 126.9	\$ 140.9	\$ 91.1	\$ 101.9	\$ 44.6	\$ 28.1
Development	276.8	270.9	236.1	263.9	221.9	96.7
Exploration & development	403.7	411.8	327.2	365.8	266.5	124.8
Acquisitions <sup>1</sup>						
Proceeds on dispositions						
Corporate						
<b>Net capital expenditures</b>						

<sup>1</sup> Excluding corporate acquisitions.

Indonesian oil revenue in 1998, 1997 and 1996 consists entirely of sales to Pertamina. North Sea total revenue for the year ended December 31, 1998 and property, plant and equipment as at December 31, 1998 were \$518.6 million (1997 - \$570.0 million;

Indonesia			Sudan		Other		Total		
1998	1997	1996	1998	1998	1997	1996	1998	1997	1996
\$ 203.7	\$ 266.1	\$ 225.4	\$ -	\$ -	\$ -	\$ -	\$ 891.5	\$1,126.4	\$ 921.7
8.1	-	-	-	-	-	-	623.1	545.8	457.2
-	-	-	-	-	-	-	20.0	25.7	27.0
-	-	-	-	-	-	-	(1.0)	2.0	1.0
211.8	266.1	225.4	-	-	-	-	1,533.6	1,699.9	1,406.9
75.8	118.5	66.7	-	-	-	-	213.5	312.1	224.0
136.0	147.6	158.7	-	-	-	-	1,320.1	1,387.8	1,182.9
0.3	-	-	0.4	1.8	0.2	-	50.6	42.2	29.9
136.3	147.6	158.7	0.4	1.8	0.2	-	1,370.7	1,430.0	1,212.8
54.9	56.4	51.1	-	-	-	-	391.5	323.9	174.9
3.7	-	-	-	-	-	-	159.1	130.0	108.4
-	-	-	-	-	-	-	13.0	13.9	12.8
-	-	-	-	-	-	-	17.4	11.9	3.4
58.6	56.4	51.1	-	-	-	-	581.0	479.7	299.5
54.9	46.8	36.9	-	0.2	0.5	0.4	614.8	541.2	420.6
3.9	5.6	2.7	-	16.6	3.4	2.0	91.2	42.4	65.4
10.0	6.7	4.2	2.5	12.5	28.4	11.9	102.4	92.3	63.5
7.7	2.0	1.6	(0.6)	4.1	2.1	0.1	143.7	(41.4)	(26.2)
135.1	117.5	96.5	1.9	33.4	34.4	14.4	1,533.1	1,114.2	822.8
1.2	30.1	62.2	(1.5)	(31.6)	(34.2)	(14.4)	(162.4)	315.8	390.0
							58.9	57.4	56.3
							91.0	51.1	68.7
							149.9	108.5	125.0
							\$ (312.3)	\$ 207.3	\$ 265.0
\$ 579.6	\$ 466.1	\$ 294.9	\$ 523.9	\$ 51.5	\$ 34.5	\$ 27.4	\$4,996.8	\$4,441.0	\$3,332.6
\$ 701.6	\$ 600.5	\$ 395.4	\$ 553.5	\$ 55.9	\$ 42.3	\$ 29.8	\$5,359.2	\$4,962.0	\$3,693.3
							98.0	68.9	64.1
							\$5,457.2	\$5,030.9	\$3,757.4
\$ 32.9	\$ 20.4	\$ 11.0	\$ 4.3	\$ 47.4	\$ 39.6	\$ 32.4	\$ 313.4	\$ 245.5	\$ 162.6
146.7	212.3	61.5	144.4	-	-	-	831.8	705.1	394.3
179.6	232.7	72.5	148.7	47.4	39.6	32.4	1,145.2	950.6	556.9
							130.1	126.6	218.8
							(221.9)	(71.2)	(57.8)
							13.5	11.3	7.4
							\$1,066.9	\$1,017.3	\$ 725.3

1996 – \$404.1 million) and \$1,500.3 million (1997 – \$1,644.0 million; 1996 – \$1,556.7 million), respectively, from the UK and \$32.5 million (1997 – \$35.1 million; 1996 – \$32.1 million) and \$36.8 million (1997 – \$38.1 million; 1996 – \$43.8 million), respectively, from the Netherlands.

## 16. INFORMATION FOR UNITED STATES READERS

### Accounting Principles Generally Accepted in the United States

The Consolidated Financial Statements have been prepared in accordance with accounting principles generally accepted in Canada ("Canadian GAAP") which, in most respects, conform to accounting principles generally accepted in the United States ("US GAAP"). Significant differences between Canadian and US GAAP are as follows:

Year ended December 31	Notes	1998	1997	1996
<b>Net income (loss) - Canadian GAAP</b>		<b>\$(258.8)</b>	<b>\$ 77.1</b>	<b>\$ 94.9</b>
Foreign exchange loss on long-term debt	1	(58.6)	(21.8)	(1.5)
Depreciation, depletion and amortization	2,3,4	(179.7)	(53.0)	(42.6)
(Loss) gain on foreign exchange forward contracts	5	(1.6)	(21.4)	8.7
Deferred income taxes	3	28.2	43.6	22.1
		(211.7)	(52.6)	(13.3)
<b>Net income (loss) - US GAAP</b>		<b>\$(470.5)</b>	<b>\$ 24.5</b>	<b>\$ 81.6</b>
<b>Net income (loss) per common share - US GAAP</b>		<b>\$ (4.20)</b>	<b>\$ 0.22</b>	<b>\$ 0.79</b>

Stock options outstanding do not have a material dilutive effect on US GAAP net income (loss) per common share. There are no comprehensive income items other than net income (loss).

Balance sheet items in accordance with US GAAP are as follows:

December 31	Notes	1998		1997	
		Canadian GAAP	US GAAP	Canadian GAAP	US GAAP
Other assets	5	\$ 131.7	\$ 52.5	\$ 71.5	\$ 50.9
Property, plant and equipment	2,3,4	4,996.8	5,152.1	4,441.0	4,773.3
Deferred credits	1	21.5	30.4	23.2	30.5
Deferred income taxes	3	364.5	718.3	440.8	820.1
Share capital and contributed surplus	6	2,165.3	2,181.8	1,879.1	1,895.6
Retained earnings (deficit)	1-6	48.7	(254.4)	307.5	216.1

The following are the investing and financing cash flows as they would be reported under US GAAP:

Year ended December 31	Notes	1998		1997		1996	
		Canadian GAAP	US GAAP	Canadian GAAP	US GAAP	Canadian GAAP	US GAAP
Cash used in investing activities	7	\$(1,296.3)	\$(1,018.8)	\$(1,609.0)	\$(1,504.9)	\$(1,061.1)	\$(1,004.2)
Cash provided by financing activities	7	719.7	444.7	824.4	720.3	373.8	310.9

- 1 **Foreign exchange on long-term debt** – US GAAP requires long-term debt denominated in foreign currencies be translated at the rates of exchange in effect on the balance sheet date, with inclusion of the resulting gain or loss in net income for the period. Canadian GAAP requires these gains or losses be amortized over the life of the long-term debt.
- 2 **Gains on property exchanges** – Under both US and Canadian GAAP, property exchanges are recorded at the carrying value of the assets given up unless the exchange transaction includes significant cash consideration, in which case it is recorded at fair value. Under US GAAP, asset exchange transactions are recorded at fair value if cash consideration is greater than 25% (10% under Canadian GAAP) of the fair value of total consideration given or received. The resulting differences in the recorded carrying values of these properties further results in differences in depreciation, depletion and amortization expense in subsequent years.
- 3 **Income taxes and depreciation, depletion and amortization expense** – Under US GAAP, companies are required to recognize deferred income taxes based on the liability method in accordance with Statement of Financial Accounting Standards ("SFAS") No. 109, while Canadian GAAP currently permits use of the deferral method until 1999. The Company recognized a greater deferred income tax liability under US GAAP for corporate acquisitions due to the differences between assigned values and the tax bases of assets acquired and liabilities assumed. The increased deferred income tax liability was offset by an increase in the assigned values of property, plant and equipment acquired and results in additional depreciation, depletion and amortization expense.
- 4 **Impairment writedowns** – Under both US and Canadian GAAP, property, plant and equipment must be assessed for potential impairments. Under US GAAP, if the sum of the expected future cash flows (undiscounted and without interest charges) is less than the carrying amount of the asset, then an impairment loss (the amount by which the carrying amount of the asset exceeds the fair value of the asset) should be recognized. Fair value is calculated as the present value of estimated expected future cash flows. Under Canadian GAAP, the impairment loss is the difference between the carrying value of the asset and its net recoverable amount (undiscounted). The resulting differences in recorded carrying values of impaired assets further results in differences in depreciation, depletion and amortization expense in subsequent years.
- 5 **Forward foreign exchange contracts** – The Company has designated certain of its forward foreign exchange contracts as hedges of Indonesian and Canadian production subject to firm production and marketing contracts for delivery in 1999 through 2001.

In addition, some of the Company's forward foreign exchange contracts also hedge anticipated future US dollar denominated sales that are not firmly committed. In accordance with Canadian GAAP, payments or receipts on these contracts are recognized in income concurrently with the hedged transaction. The fair values of the contracts are not reflected in the financial statements. In accordance with US GAAP, forward foreign exchange contracts associated with anticipated future transactions that do not constitute firm commitments are recognized in the financial statements at fair value, with any resulting gain or loss immediately reflected in income.

- 6 **Appropriation of contributed surplus** – In 1992, concurrent with a change in control of the Company, \$16.5 million of contributed surplus was appropriated to retained earnings to eliminate the deficit at June 30, 1992. This restatement of retained earnings is not permitted under US GAAP as the events that precipitated it did not constitute a quasi-reorganization.
- 7 **Consolidated Statement of Cash Flows** – Under US GAAP, only the cash paid pursuant to a corporate acquisition is presented in the Consolidated Statement of Cash Flows as an investing activity. Under this approach, common shares issued or liabilities assumed on corporate acquisitions and certain property acquisitions are not included as a financing activity, but are netted against corporate assets acquired, to present only the assets acquired for cash. Furthermore, bank indebtedness (\$2.5 million at December 31, 1998) is not considered to be a component of cash and short-term investments under US GAAP. Accordingly, under US GAAP, the annual change in bank indebtedness is included in the Consolidated Statement of Cash Flows as a financing activity.

## Pension Plans

SFAS No. 132 revised employers' disclosures about pension plans, however, there were no changes in the measurement or recognition of pension plans under the new standards. The revised disclosures are as follows:

	1998	1997
<b>Change in benefit obligation</b>		
Benefit obligation, beginning of year	\$ 75.1	\$ 64.0
Service cost	1.4	0.9
Interest cost	4.7	4.5
Actuarial losses	3.8	10.7
Benefits paid	(4.7)	(5.0)
Benefit obligation, end of year <sup>1</sup>	80.3	75.1
<b>Change in plan assets</b>		
Fair value of plan assets, beginning of year	139.1	126.3
Actual return on plan assets	14.3	20.3
Employer contributions	0.2	0.1
Surplus applied to defined contribution plan	(3.0)	(2.6)
Benefits paid	(4.7)	(5.0)
Fair value of plan assets, end of year <sup>2</sup>	145.9	139.1
Funded status	65.6	64.0
Unrecognized net actuarial gains	(10.4)	(11.4)
Unrecognized prior service cost <sup>3</sup>	(0.3)	—
Unrecognized transition obligation	(5.6)	(6.3)
Other	(1.8)	(6.0)
Prepaid benefit	\$ 47.5	\$ 40.3

1 The pension benefit obligation for a plan with a benefit obligation in excess of plan assets is \$17.3 million as at December 31, 1998 (1997 - \$14.5 million).

2 The fair value of pension assets from a plan with a benefit obligation in excess of plan assets is \$4.0 million as at December 31, 1998 (1997 - \$4.6 million).

3 Includes certain plan amendments.

## Stock Option Plan

No amount of compensation expense has been recognized in the financial statements for stock options granted to employees and directors. The following table provides pro forma measures of net income (loss) and net income (loss) per common share in accordance with US GAAP had stock options been recognized as compensation expense based on the estimated fair value of the options on the grant date in accordance with SFAS No. 123.

	1998		1997		1996	
	As Reported	Pro Forma	As Reported	Pro Forma	As Reported	Pro Forma
Net income (loss)	\$(470.5)	\$(481.9)	\$ 24.5	\$ 7.9	\$ 81.6	\$ 73.6
Net income (loss) per common share	(4.20)	(4.30)	0.22	0.07	0.79	0.71

The pro forma amounts above are not indicative of future results as options generally vest over three years (and are reflected as compensation expense in the above table over this period) and SFAS No. 123 does not apply to options granted prior to 1995. Additional awards in future years are anticipated.

Stock options granted in 1998 had an estimated weighted-average fair value of \$14.21 per option (1997 - \$20.34 per option; 1996 - \$16.41 per option). All options issued by the Company permit the holder to purchase one common share of the Company at the stated exercise price.

The estimated fair value of stock options issued was determined using the Black-Scholes model using the following weighted average assumptions:

	1998	1997	1996
Risk-free interest rate (%)	5.4	5.7	7.0
Estimated hold period prior to exercise (years)	5.6	5.1	5.1
Volatility in the price of the Company's common shares (%)	28	45	50

The Company has not paid dividends since 1991; no future dividend payments were assumed in estimating the fair value of the options.

### Income Taxes

The net deferred tax liability calculated pursuant to SFAS No. 109 comprised the following:

December 31	1998	1997
<b>Deferred tax liabilities</b>		
Differences between tax bases and reported amounts of property, plant and equipment	<b>\$(759.8)</b>	\$(865.6)
Differences between tax bases and reported amounts of pension assets	<b>(25.0)</b>	(20.6)
Other taxable temporary differences	<b>(38.7)</b>	(24.7)
	<b>(823.5)</b>	(910.9)
<b>Deferred tax assets</b>		
Tax credits carried forward <sup>1</sup>	<b>20.2</b>	31.9
Provision for site restoration	<b>72.1</b>	50.7
Other deductible temporary differences	<b>18.6</b>	15.2
	<b>110.9</b>	97.8
Valuation allowance	<b>(5.7)</b>	(7.0)
Net deferred income tax liability	<b>\$(718.3)</b>	\$(820.1)

<sup>1</sup> The deferred tax effects associated with tax credits carried forward at December 31, 1998 expire subsequent to 2000.

### Changes in Accounting Standards

In June 1998, the United States Financial Accounting Standards Board ("FASB") issued SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, which is effective for fiscal years beginning after June 15, 1999. SFAS No. 133 establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. It requires that an entity recognize all derivatives as either assets or liabilities and measure those instruments at fair value. The impact that adoption of the standard is expected to have on the financial statements is not currently known.

### Summary US\$ Information

Unless otherwise noted, all amounts in the Consolidated Financial Statements, including *Accounting Principles Generally Accepted in the United States* above, are reported in millions of Canadian dollars. The following information reflects summary financial information prepared in accordance with US GAAP translated from Canadian dollars to US dollars at the average exchange rate prevailing in the respective year. The US dollar amounts below are approximations only and are not indicative of the Company's actual financial results had US dollars been used as the reporting currency. For example, depreciation, depletion and amortization expense is translated in each year using the average exchange rate in that year, which may not reflect the prevailing exchanges rate when the capital assets were acquired.

US\$ million (except as noted)	1998	1997	1996
Total revenue	<b>US\$924.0</b>	US\$1,029.5	US\$888.9
Cash flow	<b>425.4</b>	574.0	511.1
EBITDAX <sup>1</sup>	<b>507.4</b>	618.5	627.3
Net income (loss)	<b>(317.2)</b>	17.6	59.8
Net income (loss) per common share (US\$/share)	<b>(2.83)</b>	0.16	0.58
Average exchange rate (US\$/C\$)	<b>0.6741</b>	0.7199	0.7329

<sup>1</sup> Earnings before interest, income taxes, depreciation, depletion and amortization, impairment writedowns, exploration and dry hole expense.

## SUPPLEMENTARY OIL AND GAS INFORMATION

(unaudited)

The following supplemental data on the Company's oil and gas activities were prepared in accordance with the FASB's SFAS No. 69: Disclosures About Oil and Gas Producing Activities. Activities not directly associated with conventional crude oil and natural gas production, including synthetic oil operations, are excluded from all aspects of this supplementary oil and gas information.

### RESULTS OF OPERATIONS FROM OIL & GAS PRODUCING ACTIVITIES

Years ended December 31

(millions of Canadian dollars)	Canada	North Sea	Indonesia	Sudan	Other	Total
<b>1998</b>						
Net oil and gas revenue derived from proved reserves	\$ 652.6	\$ 549.1	\$ 136.0	\$ -	\$ -	\$1,337.7
Less:						
Production costs	189.1	320.3	60.3	-	-	569.7
Exploration & dry hole expense	62.3	85.8	13.9	2.5	27.5	192.0
Depreciation, depletion and amortization	294.0	498.7	54.8	-	0.2	847.7
Tax expense (recovery)	50.2	(64.2)	7.0	(0.8)	(12.1)	(19.9)
Results of operations	\$ 57.0	\$ (291.5)	\$ -	\$ (1.7)	\$ (15.6)	\$ (251.8)
<b>1997</b>						
Net oil and gas revenue derived from proved reserves	\$ 647.6	\$ 601.3	\$ 147.5	\$ -	\$ -	\$1,396.4
Less:						
Production costs	166.5	243.0	56.4	-	-	465.9
Exploration & dry hole expense	65.9	24.7	12.2	-	31.8	134.6
Depreciation, depletion and amortization	223.2	255.5	46.8	-	0.5	526.0
Tax expense (recovery)	98.5	65.6	18.6	-	(13.9)	168.8
Results of operations	\$ 93.5	\$ 12.5	\$ 13.5	\$ -	\$ (18.4)	\$ 101.1
<b>1996</b>						
Net oil and gas revenue derived from proved reserves	\$ 590.9	\$ 434.7	\$ 158.7	\$ -	\$ -	\$1,184.3
Less:						
Production costs	132.7	102.9	51.1	-	-	286.7
Exploration & dry hole expense	59.8	48.3	6.9	-	13.9	128.9
Depreciation, depletion and amortization	207.4	163.8	36.9	-	0.4	408.5
Tax expense (recovery)	94.8	85.5	37.8	-	(6.2)	211.9
Results of operations	\$ 96.2	\$ 34.2	\$ 26.0	\$ -	\$ (8.1)	\$ 148.3

Net oil and gas revenue derived from proved reserves is net of applicable royalties.

## CAPITALIZED COSTS RELATED TO OIL & GAS ACTIVITIES

As at December 31

(millions of Canadian dollars)

	Canada	North Sea	Indonesia	Sudan	Other	Total
<b>1998</b>						
Proved properties	\$2,726.2	\$2,221.5	\$ 745.1	\$ -	\$ 1.4	\$5,694.2
Unproved properties	514.2	255.8	7.6	1.9	50.0	829.5
Incomplete wells and facilities	-	3.8	0.9	522.0	-	526.7
	<b>3,240.4</b>	<b>2,481.1</b>	<b>753.6</b>	<b>523.9</b>	<b>51.4</b>	<b>7,050.4</b>
Less: accumulated depreciation, depletion and amortization	(991.4)	(944.0)	(173.9)	-	-	(2,109.3)
Net capitalized costs	<b>\$2,249.0</b>	<b>\$1,537.1</b>	<b>\$ 579.7</b>	<b>\$ 523.9</b>	<b>\$ 51.4</b>	<b>\$4,941.1</b>
<b>1997</b>						
Proved properties	\$2,927.3	\$1,934.6	\$ 561.9	\$ -	\$ -	\$5,423.8
Unproved properties	374.8	221.0	3.9	-	29.8	629.5
Incomplete wells and facilities	2.6	21.8	2.3	-	3.3	30.0
	<b>3,304.7</b>	<b>2,177.4</b>	<b>568.1</b>	<b>-</b>	<b>33.1</b>	<b>6,083.3</b>
Less: accumulated depreciation, depletion and amortization	(1,066.4)	(507.1)	(119.3)	-	-	(1,692.8)
Net capitalized costs	<b>\$2,238.3</b>	<b>\$1,670.3</b>	<b>\$ 448.8</b>	<b>\$ -</b>	<b>\$ 33.1</b>	<b>\$4,390.5</b>
<b>1996</b>						
Proved properties	\$2,181.9	\$1,569.5	\$ 357.5	\$ -	\$ -	\$4,108.9
Unproved properties	160.7	329.8	6.2	-	24.9	521.6
Incomplete wells and facilities	5.7	1.0	1.2	-	0.9	8.8
	<b>2,348.3</b>	<b>1,900.3</b>	<b>364.9</b>	<b>-</b>	<b>25.8</b>	<b>4,639.3</b>
Less: accumulated depreciation, depletion and amortization	(974.6)	(302.4)	(72.6)	-	-	(1,349.6)
Net capitalized costs	<b>\$1,373.7</b>	<b>\$1,597.9</b>	<b>\$ 292.3</b>	<b>\$ -</b>	<b>\$ 25.8</b>	<b>\$3,289.7</b>

## COSTS INCURRED IN OIL & GAS ACTIVITIES

Years ended December 31

(millions of Canadian dollars)

	Canada	North Sea	Indonesia	Sudan	Other	Total
<b>1998</b>						
Property acquisition costs						
Proved	\$ 107.1	\$ 12.1	\$ -	\$ 342.8	\$ -	\$ 462.0
Unproved	20.8	10.8	0.4	35.0	0.1	67.1
Exploration costs	106.1	101.9	32.4	4.3	47.4	292.1
Development costs	271.0	263.8	146.7	144.4	-	825.9
Total costs incurred	\$ 505.0	\$ 388.6	\$ 179.5	\$ 526.5	\$ 47.5	\$1,647.1
<b>1997</b>						
Property acquisition costs						
Proved	\$ 508.7	\$ 22.9	\$ -	\$ -	\$ -	\$ 531.6
Unproved	208.1	46.0	2.0	-	1.8	257.9
Exploration costs	105.7	44.6	18.4	-	37.8	206.5
Development costs	267.6	222.0	212.3	-	-	701.9
Total costs incurred	\$1,090.1	\$ 335.5	\$ 232.7	\$ -	\$ 39.6	\$1,697.9
<b>1996</b>						
Property acquisition costs						
Proved	\$ 52.4	\$ 212.1	\$ -	\$ -	\$ -	\$ 264.5
Unproved	19.7	303.5	-	-	-	323.2
Exploration costs	71.5	28.1	11.0	-	32.4	143.0
Development costs	228.2	96.7	61.5	-	-	386.4
Total costs incurred	\$ 371.8	\$ 640.4	\$ 72.5	\$ -	\$ 32.4	\$1,117.1

## STANDARDIZED MEASURE OF DISCOUNTED FUTURE NET CASH FLOWS FROM PROVED RESERVES

Future net cash flows were calculated by applying the respective year end prices to the Company's estimated future production of proved reserves and deducting estimates of future development and production costs and income taxes. Future development and production costs have been estimated based on the assumed continuation of cost levels and economic conditions existing at each year end. Similarly, future income taxes have been estimated based on statutory tax rates enacted at year end. The present values of the estimated future cash flows were determined by applying a 10% discount rate prescribed by the FASB.

In order to increase the comparability between companies, the standardized measure of discounted future net cash flows necessarily employs uniform assumptions that do not necessarily reflect management's best estimate of future events and anticipated outcomes. Accordingly, the Company does not believe that the standardized measure of discounted future net cash flows will be representative of actual future net cash flows and should not be considered to represent the fair market value of the oil and gas properties. Actual future net cash flows will differ significantly from those estimated due to, but not limited to, the following:

- production rates will differ from those estimated both in terms of timing and amount. For example, future production may include significant additional volumes from unproved reserves;
- future prices and economic conditions will differ from those at year end. For example, changes in prices reduced the discounted future net cash flows by \$1.1 billion in 1998;
- future production and development costs will be determined by future events and will differ from those at year end; and
- estimated income taxes will differ in terms of amounts and timing dependent on the above factors, changes in enacted rates and the impact of future expenditures on unproved properties.

## DISCOUNTED FUTURE NET CASH FLOWS FROM PROVED RESERVES

As at December 31

(millions of Canadian dollars)

	Canada	North Sea	Indonesia	Sudan	Other	Total
<b>1998</b>						
Future cash inflows	\$5,861	\$3,203	\$1,160	\$1,248	\$ 99	\$11,571
Future costs    Production	(1,664)	(1,464)	(459)	(388)	(39)	(4,014)
Development & site restoration	(303)	(781)	(149)	(162)	(16)	(1,411)
Future net inflows before income taxes	3,894	958	552	698	44	6,146
Future income and production revenue taxes	(1,042)	(215)	(79)	(116)	-	(1,452)
Future net cash flows	2,852	743	473	582	44	4,694
10% discount factor	(1,013)	(247)	(184)	(255)	(26)	(1,725)
Discounted future net cash flows	\$1,839	\$ 496	\$ 289	\$ 327	\$ 18	\$ 2,969
<b>1997</b>						
Future cash inflows	\$5,842	\$4,054	\$2,046	\$ -	\$ -	\$11,942
Future costs    Production	(1,769)	(1,746)	(836)	-	-	(4,351)
Development & site restoration	(324)	(605)	(213)	-	-	(1,142)
Future net inflows before income taxes	3,749	1,703	997	-	-	6,449
Future income and production revenue taxes	(969)	(484)	(261)	-	-	(1,714)
Future net cash flows	2,780	1,219	736	-	-	4,735
10% discount factor	(1,025)	(320)	(231)	-	-	(1,576)
Discounted future net cash flows	\$1,755	\$ 899	\$ 505	\$ -	\$ -	\$ 3,159
<b>1996</b>						
Future cash inflows	\$5,854	\$4,314	\$2,144	\$ -	\$ -	\$12,312
Future costs    Production	(1,056)	(1,402)	(701)	-	-	(3,159)
Development & site restoration	(180)	(426)	(295)	-	-	(901)
Future net inflows before income taxes	4,618	2,486	1,148	-	-	8,252
Future income and production revenue taxes	(1,651)	(829)	(470)	-	-	(2,950)
Future net cash flows	2,967	1,657	678	-	-	5,302
10% discount factor	(793)	(527)	(242)	-	-	(1,562)
Discounted future net cash flows	\$2,174	\$1,130	\$ 436	\$ -	\$ -	\$ 3,740

Future cash inflows are revenues net of royalties.

## PRINCIPAL SOURCES OF CHANGES IN DISCOUNTED CASH FLOWS

Years ended December 31

(millions of Canadian dollars)

	1998	1997	1996
Sales of oil and gas produced, net of production costs	\$ (768)	\$ (931)	\$ (898)
Net change in prices	(1,089)	(1,591)	1,479
Net change in production costs	232	(60)	41
Net change in future development & site restoration costs	(129)	(21)	56
Development costs incurred during the year	438	300	60
Extensions, discoveries and improved recovery	611	652	1,219
Revisions of previous reserve estimates	46	65	189
Net purchases and sales of reserves in place	105	391	452
Accretion of discount	416	575	301
Net change in taxes	(25)	215	(1,325)
Other	(27)	(176)	(160)
Net change	(190)	(581)	1,414
Balance, beginning of year	3,159	3,740	2,326
Balance, end of year	\$2,969	\$3,159	\$3,740

## CONTINUITY OF PROVED RESERVES

Conventional Crude Oil and Natural Gas Liquids (millions of barrels)	Canada <sup>1</sup>		North Sea	
	Gross <sup>5</sup>	Net <sup>6</sup>	Gross <sup>5</sup>	Net <sup>6</sup>
<b>Total Proved</b>				
Proved reserves at December 31, 1995	104.5	80.6	31.1	30.3
Discoveries, additions and extensions	23.2	18.0	24.3	23.6
Dispositions and acquisitions	1.5	1.3	34.1	32.5
Net revisions and transfers <sup>7</sup>	1.2	(1.3)	(5.6)	(5.6)
Production during the year	(15.3)	(11.3)	(12.1)	(11.8)
Proved reserves at December 31, 1996	115.1	87.3	71.8	69.0
Discoveries, additions and extensions	29.0	23.3	30.1	29.7
Dispositions and acquisitions	22.3	20.7	6.7	6.7
Net revisions and transfers <sup>7</sup>	6.8	8.2	13.6	13.6
Production during the year	(17.8)	(13.5)	(18.4)	(17.7)
Proved reserves at December 31, 1997	155.4	126.0	103.8	101.3
Discoveries, additions and extensions	19.3	16.5	21.4	20.8
Dispositions and acquisitions	(3.9)	(2.9)	3.2	3.2
Net revisions and transfers <sup>7</sup>	5.9	9.4	(0.4)	-
Production during the year	(20.0)	(16.4)	(21.0)	(20.6)
Proved reserves at December 31, 1998	156.7	132.6	107.0	104.7
<b>Proved Developed</b>				
December 31, 1995	100.8	77.9	24.2	23.5
December 31, 1996	109.9	83.3	52.0	49.8
December 31, 1997	149.9	121.9	75.6	73.5
December 31, 1998	153.0	129.9	80.4	78.5

### Natural Gas (billions of cubic feet)

<b>Total Proved</b>				
Proved reserves at December 31, 1995	1,550.4	1,351.0	351.4	341.6
Discoveries, additions and extensions	233.4	209.3	50.8	48.0
Dispositions and acquisitions	(14.3)	(12.8)	48.6	48.2
Net revisions and transfers <sup>7</sup>	(14.2)	10.1	0.5	(1.3)
Production during the year	(203.9)	(182.9)	(33.0)	(31.7)
Proved reserves at December 31, 1996	1,551.4	1,374.7	418.3	404.8
Discoveries, additions and extensions	265.8	227.5	21.3	20.9
Dispositions and acquisitions	289.6	247.9	-	-
Net revisions and transfers <sup>7</sup>	(56.5)	(93.6)	(38.7)	(35.8)
Production during the year	(203.6)	(170.9)	(36.6)	(34.8)
Proved reserves at December 31, 1997	1,846.7	1,585.6	364.3	355.1
Discoveries, additions and extensions	256.8	209.8	36.0	35.8
Dispositions and acquisitions	(51.7)	(50.7)	-	-
Net revisions and transfers <sup>7</sup>	14.5	(32.8)	21.4	27.8
Production during the year	(230.9)	(193.6)	(37.8)	(37.4)
Proved reserves at December 31, 1998	1,835.4	1,518.3	383.9	381.3
<b>Proved Developed</b>				
December 31, 1995	1,355.3	1,184.3	292.4	283.2
December 31, 1996	1,357.5	1,203.9	345.0	334.6
December 31, 1997	1,631.2	1,400.5	330.6	322.2
December 31, 1998	1,648.4	1,364.7	315.5	313.6

1 Canadian proved reserves exclude synthetic crude oil reserves of (gross/net): December 31, 1996 - 22.6/18.4 mmbbls; December 31, 1997 - 23.5/19.2 mmbbls; December 31, 1998 - 26.7/22.7 mmbbls.

2 Interests of Pertamina, other than working interests, are accounted for as royalties. Pertamina royalties are reflected in net reserves using effective rates over the life of the contract.

3 Interests of the Government of Sudan and its agencies ("Sudanese"), other than working interests, are accounted for as royalties. Sudanese royalties are reflected in net reserves using effective rates over the life of the contract.

Indonesia <sup>2</sup>		Sudan <sup>3</sup>		Algeria <sup>4</sup>		Total	
Gross <sup>5</sup>	Net <sup>6</sup>	Gross <sup>5</sup>	Net <sup>6</sup>	Gross <sup>5</sup>	Net <sup>6</sup>	Gross <sup>5</sup>	Net <sup>6</sup>
32.3	22.3	-	-	-	-	167.9	133.2
6.3	2.6	-	-	-	-	53.8	44.2
-	-	-	-	-	-	35.6	33.8
8.7	4.4	-	-	-	-	4.3	(2.5)
(8.3)	(5.8)	-	-	-	-	(35.7)	(28.9)
39.0	23.5	-	-	-	-	225.9	179.8
9.6	5.5	-	-	-	-	68.7	58.5
-	-	-	-	-	-	29.0	27.4
2.8	3.6	-	-	-	-	23.2	25.4
(10.3)	(5.9)	-	-	-	-	(46.5)	(37.1)
41.1	26.7	-	-	-	-	300.3	254.0
9.7	6.7	32.9	26.4	-	-	83.3	70.4
-	-	68.0	54.5	-	-	67.3	54.8
0.7	2.9	-	-	12.0	6.1	18.2	18.4
(11.6)	(7.5)	-	-	-	-	(52.6)	(44.5)
39.9	28.8	100.9	80.9	12.0	6.1	416.5	353.1
31.7	21.8	-	-	-	-	156.7	123.2
32.3	18.5	-	-	-	-	194.2	151.6
34.9	21.6	-	-	-	-	260.4	217.0
37.8	27.0	-	-	-	-	271.2	235.4
-	-	-	-	-	-	1,901.8	1,692.6
332.0	273.3	-	-	-	-	616.2	530.6
-	-	-	-	-	-	34.3	35.4
-	-	-	-	-	-	(13.7)	8.8
-	-	-	-	-	-	(236.9)	(214.6)
332.0	273.3	-	-	-	-	2,301.7	2,052.8
120.5	104.1	-	-	-	-	407.6	352.5
-	-	-	-	-	-	289.6	247.9
-	13.4	-	-	-	-	(95.2)	(116.0)
-	-	-	-	-	-	(240.2)	(205.7)
452.5	390.8	-	-	-	-	2,663.5	2,331.5
103.2	91.0	-	-	-	-	396.0	336.6
-	-	-	-	-	-	(51.7)	(50.7)
64.3	65.0	-	-	-	-	100.2	60.0
(4.9)	(4.3)	-	-	-	-	(273.6)	(235.3)
615.1	542.5	-	-	-	-	2,834.4	2,442.1
-	-	-	-	-	-	1,647.7	1,467.5
-	-	-	-	-	-	1,702.5	1,538.5
-	-	-	-	-	-	1,961.8	1,722.7
338.4	298.4	-	-	-	-	2,302.3	1,976.7

4 Interests of the Government of Algeria and its agencies ("Algerian"), other than working interests, are accounted for as royalties. Algerian royalties are reflected in net reserves using effective rates over the life of the contract.

5 Gross reserves are the remaining reserves of Talisman, before deduction of estimated royalties.

6 Net reserves are the remaining reserves of Talisman, after deduction of estimated royalties.

7 Revisions include revisions that reflect actual performance, reassessment of data and adjustments to cumulative production.

## PROBABLE RESERVES SUMMARY

	1997 Total (mmboe)	1998 Crude Oil and Natural Gas Liquids (mmbbls)	1998 Natural Gas (mmboe)	1998 Total (mmboe)
Canada	159.4	65.4	93.9	159.3
North Sea	94.8	54.5	18.7	73.2
Indonesia	61.1	18.3	36.2	54.5
Sudan	-	54.1	-	54.1
Algeria	16.1	38.9	-	38.9
<b>Total</b>	<b>331.4</b>	<b>231.2</b>	<b>148.8</b>	<b>380.0</b>

In Western Canada, 10 mcf of natural gas equals one boe; in Ontario and international, six mcf of natural gas equals one boe.

## 1998 LANDHOLDINGS

Acres (000)	Developed		Undeveloped		Total	
	Gross	Net	Gross	Net	Gross	Net
<b>Canada</b>						
Western Canada	2,247.2	959.5	5,155.2	2,976.5	7,402.4	3,936.0
Ontario	426.5	279.7	910.3	624.7	1,336.8	904.4
Other	0.7	-	3,501.5	308.6	3,502.2	308.6
<b>Total Canada</b>	<b>2,674.4</b>	<b>1,239.2</b>	<b>9,567.0</b>	<b>3,909.8</b>	<b>12,241.4</b>	<b>5,149.0</b>
<b>North Sea</b>	<b>86.7</b>	<b>21.9</b>	<b>1,788.9</b>	<b>593.5</b>	<b>1,875.6</b>	<b>615.4</b>
<b>Indonesia</b>	<b>308.8</b>	<b>134.1</b>	<b>2,592.4</b>	<b>1,780.9</b>	<b>2,901.2</b>	<b>1,915.0</b>
<b>Sudan</b>	<b>129.9</b>	<b>32.5</b>	<b>11,956.5</b>	<b>2,989.1</b>	<b>12,086.4</b>	<b>3,021.6</b>
<b>Other<sup>1</sup></b>	<b>-</b>	<b>-</b>	<b>4,112.6</b>	<b>1,261.3</b>	<b>4,112.6</b>	<b>1,261.3</b>
<b>Total</b>	<b>3,199.8</b>	<b>1,427.7</b>	<b>30,017.4</b>	<b>10,534.6</b>	<b>33,217.2</b>	<b>11,962.3</b>

1 Includes Algeria, Nevada, Trinidad, Peru and Australia.

## 1998 DRILLING SUMMARY

		Exploration				Development				Total			
		Oil	Gas	Dry	Total	Oil	Gas	Dry	Total	Oil	Gas	Dry	Total
<b>Canada</b>	Gross	24.0	35.0	31.0	90.0	186.0	199.0	43.0	428.0	210.0	234.0	74.0	518.0
	Net	19.7	19.5	24.4	63.6	131.8	85.9	22.0	239.7	151.5	105.4	46.4	303.3
<b>North Sea</b>	Gross	4.0	3.0	5.0	12.0	17.0	1.0	2.0	20.0	21.0	4.0	7.0	32.0
	Net	1.0	0.3	2.0	3.3	3.7	-	0.6	4.3	4.7	0.3	2.6	7.6
<b>Indonesia</b>	Gross	-	4.0	2.0	6.0	46.0	8.0	-	54.0	46.0	12.0	2.0	60.0
	Net	-	1.4	1.4	2.8	31.3	2.9	-	34.2	31.3	4.3	1.4	37.0
<b>Sudan</b>	Gross	1.0	-	-	1.0	18.0	-	-	18.0	19.0	-	-	19.0
	Net	0.3	-	-	0.3	4.5	-	-	4.5	4.8	-	-	4.8
<b>Algeria</b>	Gross	3.0	-	1.0	4.0	-	-	-	-	3.0	-	1.0	4.0
	Net	1.1	-	0.4	1.5	-	-	-	-	1.1	-	0.4	1.5
<b>Total</b>	Gross	32.0	42.0	39.0	113.0	267.0	208.0	45.0	520.0	299.0	250.0	84.0	633.0
	Net	22.1	21.2	28.2	71.5	171.3	88.8	22.6	282.7	193.4	110.0	50.8	354.2

Water injection, source and disposal wells are not included.

## FIVE YEAR FINDING AND DEVELOPMENT COSTS

	1994	1995	1996	1997	1998	3-year	5-year
<b>Proved Reserves Additions <sup>1</sup></b>							
Canada (mmboe)	31.6	37.5	46.2	56.7	<b>53.0</b>	155.9	225.0
International (mmboe)	11.7	19.8	97.6	73.3	<b>113.7</b>	284.6	316.2
<b>Total</b>	<b>43.3</b>	<b>57.3</b>	<b>143.8</b>	<b>130.0</b>	<b>166.7</b>	<b>440.5</b>	<b>541.2</b>
<b>Proved Net Acquisitions <sup>2</sup></b>							
Canada (mmboe)	32.5	1.9	0.1	57.0	<b>(9.0)</b>	48.1	82.4
International (mmboe)	114.0	-	42.2	6.7	<b>71.2</b>	120.0	234.0
<b>Total</b>	<b>146.5</b>	<b>1.9</b>	<b>42.3</b>	<b>63.7</b>	<b>62.2</b>	<b>168.1</b>	<b>316.4</b>
<b>Capital Spending (millions of dollars) <sup>3</sup></b>							
Exploration & Development							
Canada	234.8	229.5	311.2	397.1	<b>381.3</b>	1,089.5	1,553.8
International	69.4	129.7	215.5	498.7	<b>670.7</b>	1,385.0	1,584.0
<b>Total Company</b>	<b>304.2</b>	<b>359.2</b>	<b>526.7</b>	<b>895.8</b>	<b>1,052.0</b>	<b>2,474.5</b>	<b>3,137.8</b>
Net Acquisitions and Divestitures <sup>4</sup>	1,724.2	7.1	505.9	679.0	<b>214.1</b>	1,399.0	3,130.3
<b>Total Capital</b>	<b>2,028.4</b>	<b>366.3</b>	<b>1,032.6</b>	<b>1,574.8</b>	<b>1,266.1</b>	<b>3,873.5</b>	<b>6,268.1</b>
<b>Proved F&amp;D Cost (\$/boe)</b>							
Canada	7.43	6.11	6.73	7.00	<b>7.20</b>	6.99	6.90
International	5.91	6.54	2.21	6.80	<b>5.90</b>	4.87	5.01
<b>Total</b>	<b>7.02</b>	<b>6.26</b>	<b>3.66</b>	<b>6.89</b>	<b>6.31</b>	<b>5.62</b>	<b>5.80</b>
<b>Proved plus 1/2 Probable F&amp;D Cost (\$/boe)</b>							
Canada	7.32	6.15	7.18	6.72	<b>7.70</b>	7.17	7.02
International	2.98	9.95	2.56	8.66	<b>6.10</b>	5.50	5.50
<b>Total</b>	<b>5.49</b>	<b>7.14</b>	<b>4.13</b>	<b>7.68</b>	<b>6.60</b>	<b>6.13</b>	<b>6.16</b>
<b>Proved FD&amp;A Cost (\$/boe)</b>							
Canada	8.91	5.65	6.51	9.03	<b>7.63</b>	8.15	7.99
International	11.59	7.23	5.23	6.86	<b>5.03</b>	5.46	6.93
<b>Total</b>	<b>10.69</b>	<b>6.18</b>	<b>5.55</b>	<b>8.13</b>	<b>5.53</b>	<b>6.36</b>	<b>7.31</b>
<b>Proved plus 1/2 Probable FD&amp;A Cost (\$/boe)</b>							
Canada	8.51	5.40	6.46	7.23	<b>7.64</b>	7.16	7.21
International	6.84	10.99	4.58	7.73	<b>4.45</b>	5.03	5.72
<b>Total</b>	<b>7.24</b>	<b>6.74</b>	<b>5.01</b>	<b>7.40</b>	<b>5.00</b>	<b>5.76</b>	<b>6.23</b>

<sup>1</sup> Proved discoveries and revisions only, excluding acquisitions, conventional oil only.

<sup>2</sup> Reserve purchases less dispositions, includes asset sales, dispositions, swaps and corporate acquisitions.

<sup>3</sup> Exploration and development spending excludes indirect exploration expenses, Syncrude, enhanced oil recovery, Chauvin pipeline and capitalized interest.

<sup>4</sup> Corporate and property acquisitions less dispositions.

In Western Canada, 10 mcf of natural gas equals one boe; in Ontario and international, six mcf of natural gas equals one boe.

## FIVE YEAR OPERATIONS SUMMARY

Years ended December 31

	1998	1997	1996	1995	1994
<b>Daily average production</b>					
(gross bbls/d except as noted)					
Crude oil					
Canada	45,103	40,627	34,169	31,019	29,801
North Sea	54,988	48,065	30,675	16,987	7,114
Indonesia	31,684	28,458	22,621	18,121	5,919
Other	-	-	-	-	473
Natural gas liquids					
Canada	9,818	8,054	7,598	7,097	5,512
North Sea	2,492	2,437	2,363	1,791	538
Synthetic oil (Canada)	2,664	2,536	2,534	2,527	2,425
Total oil and liquids	146,749	130,177	99,960	77,542	51,782
Natural gas (mmcf/d)					
Canada	631	558	557	581	481
North Sea	104	100	90	69	15
Indonesia	13	-	-	-	-
Total natural gas	748	658	647	650	496
Total (mboe/d)	231	203	171	147	102
<b>Average unit prices</b>					
(\$/bbl except as noted)					
Crude oil					
Canada	\$15.38	\$21.89	\$24.57	\$21.16	\$19.00
North Sea	18.28	25.56	27.76	23.63	22.43
Indonesia	17.61	25.62	27.22	23.76	22.40
Other	-	-	-	-	10.17
Natural gas liquids					
Canada	15.07	22.39	21.13	18.04	16.56
North Sea	15.22	24.19	21.41	18.90	17.61
Synthetic oil (Canada)	20.53	27.78	29.09	23.81	21.71
Total oil and liquids	\$17.02	\$24.25	\$25.93	\$22.06	\$19.63
Natural gas (\$/mcf)					
Canada	\$ 2.03	\$ 1.98	\$ 1.71	\$ 1.37	\$ 1.89
North Sea	3.93	3.89	3.37	3.63	3.78
Indonesia	1.65	-	-	-	-
Total natural gas	\$ 2.28	\$ 2.27	\$ 1.94	\$ 1.61	\$ 1.95
Total (\$/boe)	\$18.21	\$22.91	\$22.50	\$18.74	\$19.38

## FIVE YEAR FINANCIAL SUMMARY

Years ended December 31  
(millions of Canadian dollars  
unless otherwise stated)

	1998	1997	1996	1995	1994
<b>Balance sheets</b>					
Current assets	\$ 271.7	\$ 470.7	\$ 361.7	\$ 255.8	\$ 426.0
Other assets	188.7	119.2	63.1	51.0	61.2
Property, plant and equipment	4,996.8	4,441.0	3,332.6	2,733.5	2,772.1
Total assets	\$5,457.2	\$5,030.9	\$3,757.4	\$3,040.3	\$3,259.3
Current liabilities	\$ 576.2	\$ 497.3	\$ 337.7	\$ 224.9	\$ 241.4
Deferred credits and other liabilities	596.3	608.2	427.0	283.1	235.0
Long-term debt	2,070.7	1,738.8	898.7	906.0	1,202.6
Shareholders' equity	2,214.0	2,186.6	2,094.0	1,626.3	1,580.3
Total liabilities and shareholders' equity	\$5,457.2	\$5,030.9	\$3,757.4	\$3,040.3	\$3,259.3
<b>Results of operations</b>					
Revenue	\$1,370.7	\$1,430.0	\$1,212.8	\$ 899.2	\$ 613.4
Expenses	1,683.0	1,222.7	947.8	803.1	518.9
Income (loss) before taxes	(312.3)	207.3	265.0	96.1	94.5
Taxes (recovery)	(53.5)	130.2	170.1	61.3	55.3
Net income (loss) from continuing operations	(258.8)	77.1	94.9	34.8	39.2
Discontinued mining operations	-	-	-	5.7	24.8
Net income (loss)	\$ (258.8)	\$ 77.1	\$ 94.9	\$ 40.5	\$ 64.0
Cash flow	\$ 631.1	\$ 797.4	\$ 697.4	\$ 502.3	\$ 361.5
Capital expenditures	1,288.8	1,088.5	783.1	488.7	429.3
<b>Per common share (Canadian dollars)</b>					
Net income (loss)	\$ (2.31)	\$ 0.70	\$ 0.91	\$ 0.42	\$ 0.82
Cash flow	5.64	7.29	6.71	5.21	4.63

## SELECTED QUARTERLY FINANCIAL DATA

(Unaudited)

(millions of Canadian dollars  
unless otherwise stated)

	Total Year	Three months ended			
		Dec 31	Sep 30	Jun 30	Mar 31
	<b>1998</b>		<b>1998</b>		
Total revenue	\$1,370.7	\$ 364.5	\$ 326.8	\$ 326.8	\$ 352.6
Net income (loss)	(258.8)	(233.8)	(32.8)	1.9	5.9
Cash flow	631.1	200.2	126.1	139.7	165.1
Per common share (dollars)					
Net income (loss)	(2.31)	(1.98)	(0.30)	0.02	0.05
Cash flow	5.64	1.69	1.15	1.27	1.51
Daily average production					
Oil and liquids (bbls/d)	146,749	141,510	146,829	145,719	153,062
Natural gas (mmcf/d)	748	835	687	707	762
Total (mboe/d)	231	237	222	224	239
	<b>1997</b>		<b>1997</b>		
Total revenue	\$1,430.0	\$ 432.8	\$ 319.4	\$ 301.9	\$ 375.9
Net income	77.1	11.0	15.6	5.0	45.5
Cash flow	797.4	246.7	169.9	150.2	230.6
Per common share (dollars)					
Net income	0.70	0.10	0.14	0.05	0.42
Cash flow	7.29	2.25	1.55	1.37	2.11
Daily average production					
Oil and liquids (bbls/d)	130,177	150,259	124,928	120,828	124,465
Natural gas (mmcf/d)	658	759	600	610	668
Total (mboe/d)	203	235	190	188	199

## CONSOLIDATED FINANCIAL RATIOS

The following financial ratios are provided in connection with the Company's continuous offering of medium term notes pursuant to the short form prospectus dated May 1, 1998 and a prospectus supplement dated May 8, 1998.

The asset coverage ratios are calculated as at December 31, 1998. The interest coverage ratios are for the 12-month period then ended.

	<b>1998</b>
Interest coverage (times)	
Income	(1.70) <sup>1</sup>
Cash flow	5.19 <sup>2</sup>
Asset coverage (times)	
Before deduction of deferred income taxes and deferred credits	2.36 <sup>3</sup>
After deduction of deferred income taxes and deferred credits	2.07 <sup>4</sup>

1 Net income (loss) plus income taxes and interest expense; divided by the sum of interest expense and capitalized interest.

2 Cash flow plus current income taxes and interest expense; divided by the sum of interest expense and capitalized interest.

3 Total assets minus current liabilities; divided by long-term debt.

4 Total assets minus current liabilities and long-term liabilities excluding long-term debt; divided by long-term debt.

## INVESTOR INFORMATION

### COMMON SHARES

Montreal Trust Company of Canada,  
Calgary, Toronto, Montreal, Vancouver  
Co-transfer agent: The Bank of Nova Scotia Trust  
Company of New York  
Authorized: unlimited number of common shares  
and unlimited number of first and  
second preferred shares  
Issued: 118,907,320 common shares

### PREFERRED SECURITIES

Trustee: The Chase Manhattan Bank, New York  
Issued: 6,000,000 Preferred Securities each  
having principal amount of US\$25  
Talisman's Preferred Securities are currently rated as:  
CBRS – BBB (low); Moody's – Baa2; S&P – BBB-

### SHARE PRICE PERFORMANCE

Weekly Closing Price – January 1994 to December 1998:



### STOCK EXCHANGE LISTINGS

#### Common Shares

Symbol: TLM  
Canada: The Toronto Stock Exchange  
and Montreal Exchange  
United States: New York Stock Exchange

#### Preferred Securities

Symbol: TLM PrA  
United States: New York Stock Exchange

### PUBLIC DEBT

Trustee: Montreal Trust Company of Canada, Calgary  
7.125% (US\$) unsecured debentures  
7.25% (US\$) unsecured debentures  
9.45% unsecured debentures, Series A  
9.80% unsecured debentures, Series B  
9.66% unsecured medium term notes  
5.70% unsecured medium term notes  
Talisman's public long-term debt is currently rated as:  
CBRS – A (low); DBRS – A (low);  
Moody's – Baa1; S&P – BBB+  
Talisman's commercial paper is currently rated as:  
CBRS – A-1 (low); DBRS – R-1 (low); Moody's – P-2

### PRIVATE DEBT

6.96% (US\$) unsecured notes  
Talisman's private long-term debt is currently rated as:  
CBRS – A (low); Moody's – Baa1; S&P – BBB+

### DIVIDEND POLICY

The Company has not paid dividends since 1991 in order to retain funds for reinvestment in the Company's operations.

### MARKET INFORMATION

Common Shares		1998		1997		1996
		Canada (C\$)	United States (US\$)	Canada (C\$)	United States (US\$)	(C\$)
Share Price (dollars)	High	45.60	32.1875	55.25	37.125	47.000
	Low	22.50	14.6250	37.05	28.750	27.375
	Close	26.95	17.5000	43.75	30.375	45.600
Shares Traded (millions)	First quarter	28.7		29.3		34.1
	Second quarter	22.5		18.8		22.9
	Third quarter	30.3		20.9		30.7
	Fourth quarter	37.7		25.8		26.1
	Year	119.2		94.8		113.8
Year end shares outstanding (millions)		118.9		109.6		109.1
Weighted average shares outstanding (millions)		111.9		109.4		103.9
Stock options outstanding at year end (millions)		5.9		5.0		4.0

## DIRECTORS AND EXECUTIVE

### BOARD OF DIRECTORS

**Peter N.T. Widdrington** <sup>1,3,5</sup>  
London, Ontario  
Chairman, Talisman Energy Inc.

**Donald J. Anderson** <sup>1,2</sup>  
Calgary, Alberta  
President, Glassell Ventures Inc.

**Robert A. Bandeen, O.C.** <sup>3,5</sup>  
Toronto, Ontario  
Chairman and President,  
Cluny Corporation

**James W. Buckee** <sup>1,4,6</sup>  
Calgary, Alberta  
President and Chief Executive  
Officer, Talisman Energy Inc.

**Paul J. Hoenmans** <sup>3,4</sup>  
Aspen, Colorado  
Corporate Director

**Dale G. Parker** <sup>2,5</sup>  
Vancouver, British Columbia  
Public Administration and  
Financial Institution Advisor

**David E. Powell** <sup>2,4,6</sup>  
Calgary, Alberta  
Chairman of the Board, Petroleum  
Industry Training Service

**Stella M. Thompson** <sup>3,4,5,6</sup>  
Calgary, Alberta  
Principal, Governance West Inc.  
President, Stellar Energy Ltd.

**Margaret K. Witte** <sup>1,2</sup>  
Medina, Washington  
Chairman, President and Chief  
Executive Officer,  
Royal Oak Mines Inc.

- 1 Member of Executive Committee
- 2 Member of Audit Committee
- 3 Member of Management Succession  
and Compensation Committee
- 4 Member of Pension Funds Committee
- 5 Member of Governance and  
Nominating Committee
- 6 Member of Year 2000 Committee

### EXECUTIVE

**James W. Buckee**  
President and Chief Executive Officer

**Edward W. Bogle**  
Vice-President, Exploration

**T. Nigel D. Hares**  
Vice-President, Frontier and  
International Operations

**Joseph E. Horler**  
Vice-President, Marketing

**Michael D. McDonald**  
Vice-President, Business Development

**Robert W. Mitchell**  
Vice-President, Canadian Operations

**Robert M. Redgate**  
Vice-President, Human Resources  
and Corporate Services

**M. Jacqueline Sheppard**  
Vice-President, Legal and Corporate  
Projects, and Corporate Secretary

**Bruce G. Waterman**  
Vice-President, Finance and Chief  
Financial Officer

## CORPORATE INFORMATION

### EXECUTIVE OFFICE

Talisman Energy Inc.  
2400, 855 - 2 Street S.W.  
Calgary, Alberta, Canada T2P 4J9  
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Facsimile: (403) 237-1902  
E-mail: [tlm@talisman-energy.com](mailto:tlm@talisman-energy.com)  
Website: [www.talisman-energy.com](http://www.talisman-energy.com)

### INVESTOR RELATIONS CONTACTS

**M. Jacqueline Sheppard**  
Vice-President, Legal and Corporate  
Projects, and Corporate Secretary  
(403) 237-1183

**David Mann**  
Manager, Investor Relations and  
Corporate Communications  
(403) 237-1196

### SELECTED SUBSIDIARIES

**Talisman Energy (UK) Limited**  
Talisman House  
1 Berry Street  
Aberdeen AB1 1DL, Scotland  
Telephone: (1224) 413-200  
Facsimile: (1224) 413-400

**Talisman (Asia) Ltd.**  
Setiabudi Atrium Office,  
Suite 410  
Jl. H.R. Rasuna Said Kav.62  
Jakarta, 12920, Indonesia  
Telephone: (021) 521-0650  
Facsimile: (021) 521-0660

**Talisman (Greater Nile) B.V.**  
Street 15, House 35, Plot 12  
New Extension, Khartoum, Sudan  
Telephone: (249) 11 472-890  
Facsimile: (249) 11 471-781

### ANNUAL MEETING

The annual meeting of shareholders of Talisman Energy Inc. will be held at 11:00 a.m. on Tuesday, May 4, 1999 in the Crystal Ballroom of the Palliser Hotel, 133 - 9th Avenue S.W., Calgary, Alberta. Shareholders are encouraged to attend the meeting, but those who are unable to do so are requested to sign and return the form of proxy mailed with this report.

## ABBREVIATIONS

API	American Petroleum Institute	mmcf	million cubic feet
Arakis	Arakis Energy Corporation	mmcf/d	million cubic feet per day
bbls	barrels	Moody's	Moody's Investor Service
bbls/d	barrels per day	NYMEX	New York Mercantile Exchange
bcf	billion cubic feet	OPEC	Organization of Petroleum Exporting Countries
boe	barrels of oil equivalent	Pembina	Pembina Resources Limited
Bow Valley	Bow Valley Energy Inc.	PSC	Production Sharing Contract
C\$	Canadian dollars	S&P	Standard & Poor's Ratings Group
CAPP	Canadian Association of Petroleum Producers	TAC	Technical Assistance Contract
CBRS	Canadian Bond Rating Service	3-D	three-dimensional
DBRS	Dominion Bond Rating Service	2-D	two-dimensional
EBITDAX	Earnings before interest, income taxes, depreciation, depletion and amortization, impairment writedowns, exploration and dry hole expense	UK	United Kingdom
Encor	Encor Inc.	US	United States of America
FPSO	Floating, Production, Storage and Offloading	WTI	West Texas Intermediate
Goal	Goal Petroleum plc		
LPG	liquid petroleum gas		
liquids	natural gas liquids		
mcf	thousand cubic feet		
mGJ/d	thousand gigajoules per day		
mm\$	millions of dollars		
mmbbls	million barrels		
mmboe	million barrels of oil equivalent		

## CONVERSION & EQUIVALENCY FACTORS

Imperial		Metric
1 ton	=	.907 tonnes
1 acre	=	.40 hectares
1 barrel	=	.159 cubic metres
1 cubic foot	=	.0282 cubic metres
Barrels of oil equivalent have been calculated on the basis of:		
International and Ontario gas – six mcf equals one boe		
Western Canada gas – 10 mcf equals one boe		

## FORWARD-LOOKING STATEMENTS

Certain statements in this report contain forward-looking statements. These statements include, among others, statements regarding outlook on oil and gas prices, estimates of future production, business plans for drilling and exploration, the estimated amounts and timing of capital expenditures, expectations with respect to the effects of the Year 2000 computer issue, anticipated future debt levels and royalty rates, or other expectations, beliefs, plans, objectives, assumptions or future events or performance (often, but not always, using words or phrases such as "expects" or "does not expect", "is expected", "anticipates" or "does not anticipate", "plans", "estimated" or "intends", or stating that certain actions, events or results "may", "could", "would", "might" or "will" be taken, occur or be achieved). Statements concerning oil and gas reserves contained in the annual consolidated financial statements for the year ended December 31, 1998 and elsewhere may also be deemed to be forward-looking

statements as they involve the implied assessment, based on certain estimates and assumptions, that the resources described can be profitably produced in the future. Forward-looking statements are based on current expectations, estimates and projections that involve a number of risks and uncertainties which could cause actual results to differ from those anticipated by the Company. These risks include, but are not limited to: the risks of the oil and gas industry (for example, operational risks in exploring for, developing and producing crude oil and natural gas; risks and uncertainties involving geology of oil and gas deposits; the uncertainty of reserve estimates; the uncertainty of estimates and projections relating to production, costs and expenses; potential delays or changes in plans with respect to exploration or development projects or capital expenditures; and health, safety and environmental risks); risks in conducting foreign operations (for example, political and fiscal instability or the possibility of civil

unrest or military action in countries such as Indonesia, Sudan or Algeria); the effect of United States sanctions against Sudan; fluctuations in oil and gas prices and exchange rates; and the possibility that government policies may change or governmental approvals may be delayed or withheld. Additional information on these and other factors which could affect the Company's operations or financial results are included in this report under the headings "Management's Discussion and Analysis — Sensitivities", "— Risks and Uncertainties", and "— Outlook", and in the Company's other reports on file with Canadian securities regulatory authorities and the United States Securities and Exchange Commission. Forward-looking statements are based on the estimates and opinions of the Company's management at the time the statements are made. The Company assumes no obligation to update forward-looking statements should circumstances or management's estimates or opinions change.

**TALISMAN**

E N E R G Y

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