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Discovery

1989 Annual Report

Discovery West corp.

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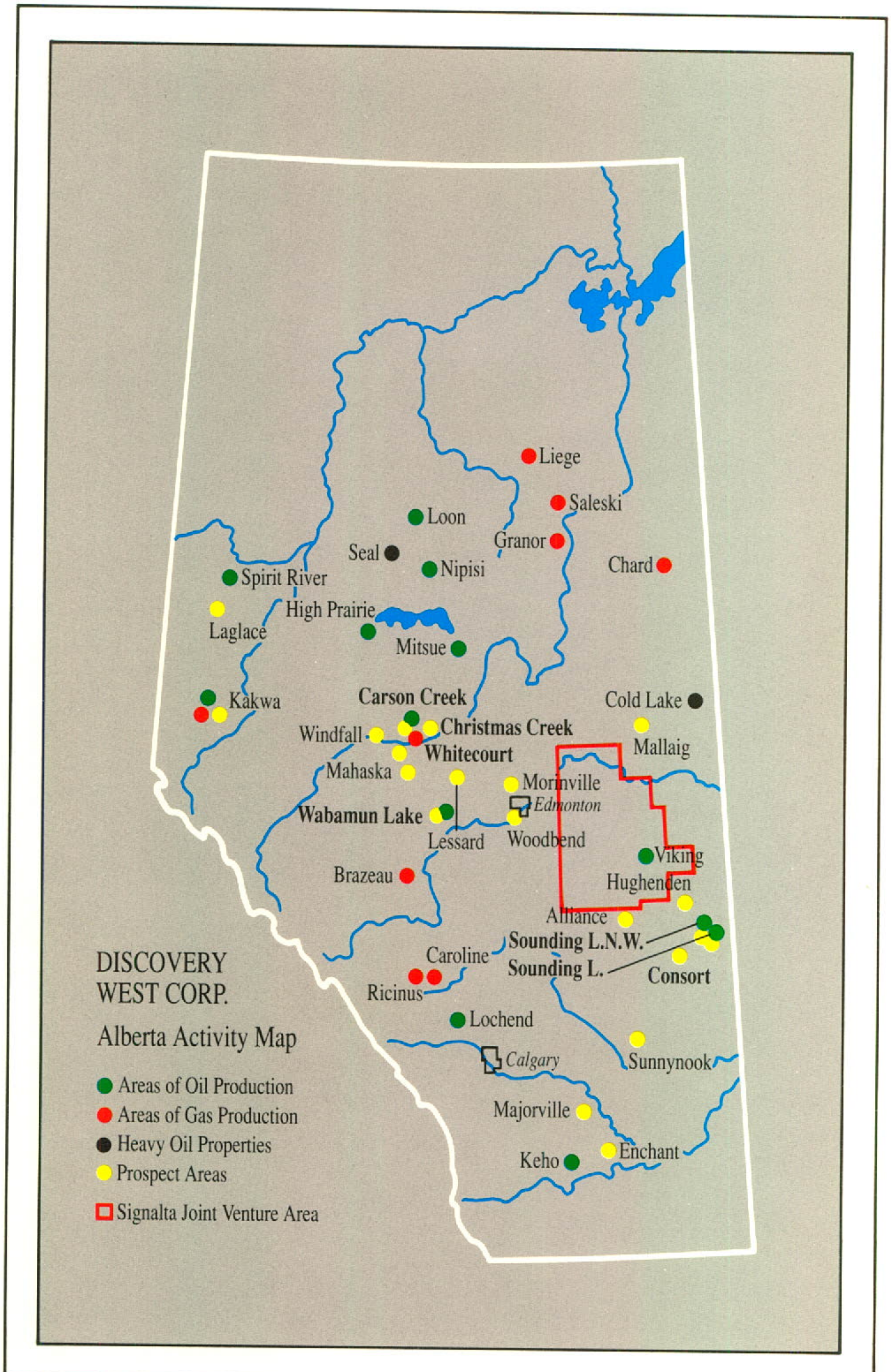


Corporate Profile

Discovery West Corp. is a Canadian independent oil and gas company with offices in Toronto and Calgary. Discovery's petroleum exploration and development program in Alberta concentrates on medium to large reserve prospects with acceptable risk levels. In addition, the Company holds a 65% interest in a Cold Lake oil sands lease in partnership with Norcen Energy Resources Ltd.

Discovery West Corp. also owns a 23.2% equity interest in Rayrock Yellowknife Resources Inc. (TSE:RAY) a successful mineral exploration, development and operating company, with three operating gold mines in Nevada. In addition, Rayrock owns 100% of Western Ag-Minerals Company, an specialty agricultural mineral, underground mine in New Mexico and owns 58.7% of Minera Rayrock Inc. (TSE:MRN), a mineral exploration and development company active in Latin America.

Corporate Highlights

	1989	1988	1987
Funds provided by			
Operations	**$3,986,000**	$3,083,000	$3,499,000
Per share	**$0.24**	$0.19	$0.18
Earnings	**$1,287,000**	$1,238,000	$906,000
Per share	**$0.07**	$0.07	$0.04
Production			
Oil (bbls/day)	**722**	658	556
Gas (mcf/day)	**2,929**	3,279	2,560
Barrels of oil equivalent/day	**1,015**	986	812
Land (acres)			
Gross	**1,181,780**	1,000,500	911,200
Net	**57,500**	52,500	36,500
Net undeveloped	**44,600**	40,900	25,000
Drilling (wells)			
Oil	**34**	63	63
Gas	**17**	16	12
Other	**16**	33	35
Total	**67**	112	110
Reserves			
Oil and NGL (million bbls)	**3.6**	3.0	3.2
Gas (bcf)	**16.1**	12.4	12.8
Value per reserve report, discounted at 15%	**$34,600,000**	$32,900,000	$36,000,000
Per share(1)	**$2.10**	$1.97	$1.85
Investment in Rayrock			
Market Value at December 31	**$34,100,000**	$22,500,000	$16,570,000
Per share(1)	**$2.07**	$1.35	$0.85

(1) based on number of shares outstanding, net of reciprocal holdings

During the year since our last report to you, Discovery has:

- increased its land position an additional 10% to over 57,500 net acres,
- participated in drilling 17 successful gas wells and 34 successful oil wells,
- increased reserves 23% to 5.2 million barrels of oil equivalent,
- made promising new oil discoveries in the Sounding Lake area of east central Alberta,
- identified several new high quality prospects on Company lands for drilling in 1990,
- increased production to over 370,000 barrels of oil equivalent or 1,015 boe per day. Over 70% was oil. Currently almost 25% of oil production is coming from the Company's new higher-interest areas developed in the last two years,
- realized higher average oil prices at $20.98 per barrel, up from $18.60 per barrel and lower gas prices at $1.42 per mcf compared with $1.55 per mcf,
- increased funds flow from operations 29% to $3,986,000 or $0.24 per share from $3,083,000 or $0.19 per share,
- increased earnings marginally to $1,287,000 or $0.07 per share from $1,238,000 or $0.07 per share.

1990 promises to be an exciting year in the development of Discovery West Corp.

Gas production increased 15% in early 1990 as the Carson Creek property in central Alberta was brought on stream. Increased oil production is anticipated from the Sounding Lake and Wabamun areas where successful drilling during 1989 and early 1990 will be reflected for a full year.

Discovery intends to build aggressively on its asset base in 1990. The Board has approved a threefold increase of the Company's capital expenditure program for exploration, development and property acquisitions. Our objective is to double oil and gas production without significantly increasing overhead costs. The planned emphasis on exploration and development will be on Discovery's existing properties in addition to increasing its land inventory. The emphasis on acquisitions will be on purchasing producing gas reserves.

The Company would also consider merging with another oil and gas company whose shares are discounted by the market to the same extent as those of Discovery. Historically, Discovery's shares have traded significantly below their intrinsic value. Discovery has been recognized either as a holding company for Rayrock or as a junior oil and gas company, but not as both. Your management intends to make a significant effort during 1990 to communicate Discovery's activities, growth and true-value and to expand the Company's investor base.

There is generally renewed optimism toward increasing prices of both oil and gas. This, combined with some exciting exploration prospects and the fact that the Company's shares are currently trading at a large discount to asset value, makes Discovery West Corp. an excellent investment opportunity for the 1990's. On behalf of the Directors, we would like to thank all of our employees for their continuing commitment, hard work and enthusiasm shown during the year.

On behalf of the Board,

M. A. Upham

M. A. Upham
Chairman of the Board

D. R. Crombie
President and Chief
Executive Officer

March 2, 1990

LAND

Discovery continued to acquire acreage on both oil and gas prospects in Alberta and on gas prospects in north west Saskatchewan. During 1989, interests in 13,440 gross acres (8,380 net acres) situated in approximately nine prospect areas were acquired at Crown sales. Capital expenditures on land in 1989 totalled $763,000. The Company continued to be highly selective in its exploration programs, acquiring acreage only on prospects where specific drilling targets have been identified or are reasonably well defined.

The value of Discovery's land holdings are not included in the value of its oil and gas reserves.

	Net Undeveloped Acres		Total Net Acres		Total Gross Acres	
	1989	1988	1989	1988	1989	1988
Alberta	**42,500**	40,500	**55,100**	51,900	**1,153,200**	984,300
British Columbia	**100**	300	**300**	400	**25,400**	14,800
Saskatchewan	**2,000**	100	**2,100**	200	**3,100**	1,400
Total	**44,600**	40,900	**57,500**	52,500	**1,181,700**	1,000,500

RESERVES

The volumes and estimated value of Discovery West Corp.'s reserves, as evaluated by Martin Petroleum and Associates, are as follows:

	1989	1988
Company Reserves Oil & NGL (Mbbls):		
Proven Producing	**2,355**	2,445
Proven Non-Producing	**505**	335
Probable	**755**	188
Total	**3,615**	2,968
Company Reserves of Gas (Mmcf):		
Proven Producing	**12,731**	10,935
Proven Non-Producing	**2,361**	903
Probable	**1,052**	524
Total	**16,144**	12,362

Discounted Value of Reserves(1)(2)(3)
($000)

	10%		15%		20%	
	1989	1988	1989	1988	1989	1988
Proven Producing	**$34,200**	$37,600	**$26,500**	$28,500	**$21,600**	$22,800
Proven Non-Producing	**4,600**	3,300	**3,400**	2,200	**2,500**	1,400
Probable	**6,800**	2,700	**4,700**	2,200	**3,400**	1,900
Total	**$45,600**	$43,600	**$34,600**	$32,900	**$27,500**	$26,100

(1) Does not consider general and administrative expenses or corporate income taxes.
(2) After allowing for Alberta Royalty Tax Credits.
(3) For pricing forecast, see table on page 19.

During 1989, the Alberta government introduced a new price sensitive formula for calculating ARTC. The net effect of this change was to reduce the net present value of oil and gas reserves in later years when oil prices are expected to rise. It is estimated that this reduction exceeds $2 million on the 15% discount value of the Company's reserves.

In spite of a writedown of the Company's producing and non-producing reserves in the Nipisi area, the Company made good overall gains in reserves during 1989. Proven plus probable reserves increased 23% on a barrels of oil equivalent basis over 1988 reserves, increasing to 5.2 million barrels.

Discovery's high quality reserves have an anticipated long production life. The reserve life, based upon 1989 year end production levels, is 13 years for oil and 15 years for gas production.

New discoveries are becoming an important part of the Company's production base. At the present time, however approximately 70% of Discovery's oil and gas production comes from the unitized oil fields at Mitsue, Nipisi, Spirit River, the Brazeau River Gas Unit and a large number of gas wells in eastern Alberta operated by Signalta Resources Ltd.

DRILLING ACTIVITY

The results of drilling programs in which Discovery participated are as follows:

	1989	1988
Gas Wells	**17**	16
Oil Wells	**34**	63
Dry Holes	**14**	27
Injection Wells	**1**	5
Salt Water Disposal	**1**	1
Total	**67**	112

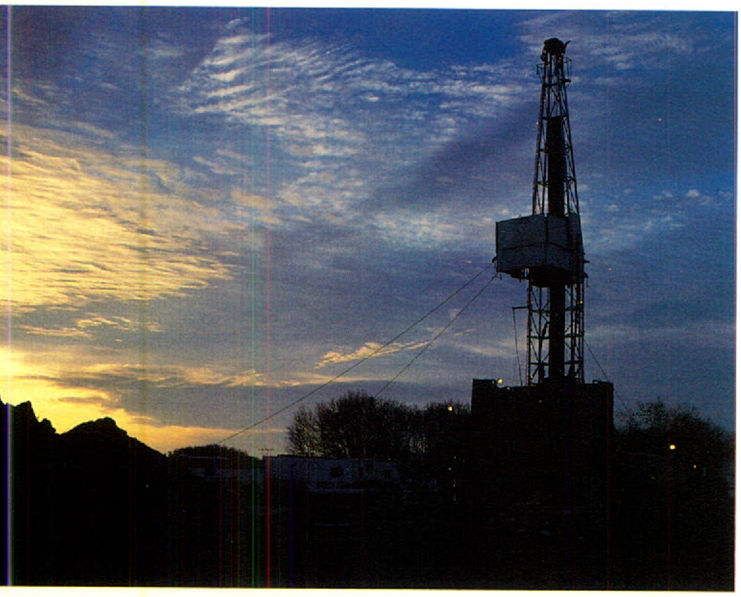
As a result of the strategy of participating in larger interest plays, the number of wells being drilled has reduced. However, increases in production and reserves are being maintained.

PRODUCTION

Production in 1989 totalled 263,700 working interest Bbls of oil (722 Bbls per day) and 1,069 working interest Mmcf of gas (2,929 Mcf per day). This represents an increase of 10% in oil production and an 11% decrease in gas production from 1988.

Oil production continued to rise in 1989 as a result of new exploration and development successes. Approximately 25% of the Company's oil production is from new, higher interest areas developed in the last two years. An important feature of this new production is that in almost all cases, Discovery has accumulated good land holdings and there is significant potential for further production increases at acceptable costs. 1990 oil production is expected to increase over 50% as new development wells are put into production, particularly in the Sounding Lake and Sounding Lake North West areas.

With no significant new gas production on stream, production declined in 1989. Early in 1990 the Carson Creek gas property commenced production at approximately 450 Mcf per day net to Discovery.



A review of production from the Company's main producing areas is as follows:

Signalta Joint Venture

The Company's working interest production from the Signalta Joint Venture properties averaged 1,640 Mcf of gas per day and 28 Bopd in 1989. During the year, a secondary recovery and gas conservation facility was completed on a one section lease in the Viking area, resulting in significantly increased oil production. Oil was initially discovered on this lease in 1988. Discovery's year end 1989 working interest share of production from Viking increased to 36 Bopd.

Mitsue

Discovery's share of working interest production from the Mitsue unit averaged 269 Bopd during 1989. Over the past several years the field has experienced a favourable response to tertiary hydrocarbon miscible flood projects first initiated in 1985. In addition, the operator of this field is conducting a continued successful infill drilling program to add additional reserves. In 1989, 121,000 barrels of additional proven producing reserves were added by Discovery. This exceeded 1989 production from Mitsue of 98,000 barrels.

Nipisi

Discovery's share of working interest production from the Nipisi Unit averaged 207 Bopd during 1989. This field is also subject to an ongoing tertiary hydrocarbon miscible flood program. A year end appraisal of the performance of the tertiary miscible flood at Nipisi has led to a downward revision of 235,000 barrels to the Company's proven producing oil and NGL reserves. An additional downward revision of 145,000 barrels of oil and NGL's has been made to the Company's proven non-producing and probable reserves.

Sounding Lake

At year end, two wells were producing from the Cretaceous Dina oil pool discovered earlier in the year. Year end working interest production net to Discovery was averaging 40-45 Bopd. As is the case with most Dina wells in the area, oil production is accompanied by a significant amount of water production and the wells have produced at restricted rates pending the completion of salt water disposal facilities. Discovery has recently completed a salt water disposal well in the area. When it becomes operational, production rates for the original two producing wells could be increased to an anticipated 60 Bopd net to Discovery. Since December 31, 1989, two additional wells have been drilled on this prospect and have added 95 barrels of oil per day to the Company's working interest production.

Wabamun Lake

An on-going successful drilling program was conducted in this area during 1989. Working interest production net to Discovery was averaging 40 Bopd at year end. Secondary recovery is being contemplated for this area and, if successfully implemented, should further enhance reserves and productivity.

Carson Creek

A second successful gas well was drilled on this prospect in 1989. During the year, Discovery participated in the construction of a gas plant and gas pipeline facilities to tie in two existing Jurassic/Nordegg gas wells and two Viking oil wells previously shut in due to high gas-oil ratios. These facilities were started up in early 1990. Company working interest production is now averaging 450 Mcf of gas per day and 15 Bbls of oil per day. Further development drilling is anticipated on this prospect.

For the past three years, the Company has concentrated on the identification and acquisition of high-quality land positions, primarily in central and east central Alberta. Exploration drilling was undertaken on some of these properties in 1988 and 1989.

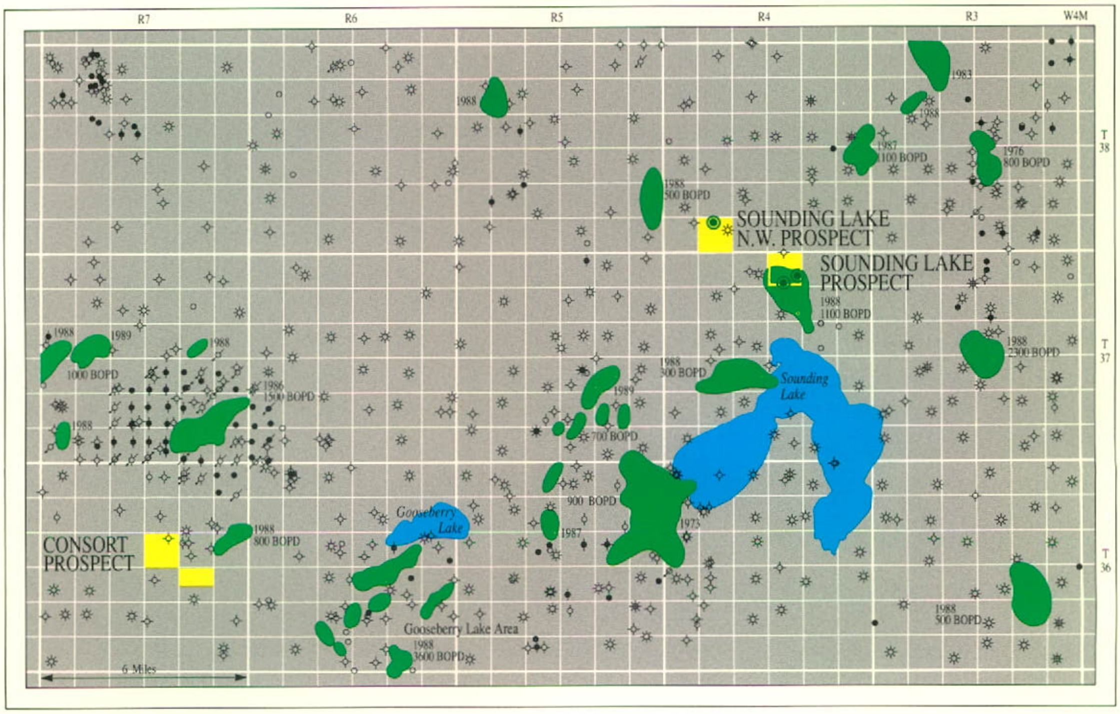
For 1990, Discovery has budgeted for a significant increase in its exploration, development and property acquisition expenditures. Exploration will be primarily on the Company's existing properties where the increased use of seismic has identified a number of high quality drilling targets. Major development drilling programs are scheduled for the Sounding Lake area as well as continued development drilling at Wabamun Lake and Carson Creek.

Sounding Lake/Consort Area

For several years Discovery West has been pursuing geological leads in this area of east central Alberta. Currently the Company is pursuing three prospects in this area, namely: Sounding Lake, Sounding Lake North West and Consort.

Over the past several years a number of prolific Lower Cretaceous medium to light gravity oil pools have been discovered in the region by several different companies. The wells are characterized by high water cuts with high reserves, even on ten acre spacing. This, combined with good production characteristics, make the Sounding Lake region an extremely attractive exploration area. The key to success on this trend is in the discovery of pools of sufficient size to justify the construction and implementation of the central battery treating and disposal facilities. These facilities are necessary to extract oil from the associated large volumes of water produced and to maintain low operating costs. Discovery's Sounding Lake prospect seems to have this potential.

The two producing wells on the original Sounding Lake play are situated approximately one-half mile apart and are interpreted to represent a significant extension, onto Company lands, of a large pool developing on competitor acreage immediately to the south. A three dimensional seismic survey was conducted during the last quarter of 1989 on the property. Drilling began again in late February, 1990 and since that time, two more successful wells have been drilled. The plan is to continue to drill direct offsets to current producers and step out well by well until the field is developed. Discovery operates this prospect and will maintain a 75% to 100% working interest in a large scale development drilling program planned for 1990 on this 640 acre lease.



○ Location
✲ Gas Well
● Oil Well
✧ Abandoned Well
◇ Suspended Well
Injection Well
Service Well

1989 Year of Discovery
2300 BOPD Current Production
Lower Cretaceous Oil Pool

Discovery West Acreage
Discovery West Oil Well

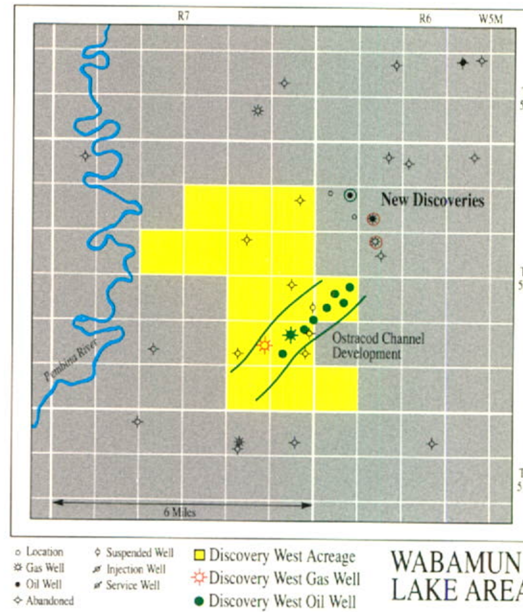
SOUNDING LAKE AREA

Also in the Sounding Lake area, the Company has recently made a significant discovery of 27 degree API oil in a Lower Cretaceous sandstone reservoir on a new prospect located approximately two miles northwest of the original discoveries. The discovery well has been producing since January, 1990 at a sustained rate of 55 Bopd. Discovery holds a 50% interest in the well and the 640 acre tract upon which it was drilled. Additional seismic and drilling activity will be undertaken upon the Company receiving approval for reduced spacing.

At Consort, the Company will participate for a 39% interest in a well to test a Lower Cretaceous Dina sand prospect indicated on previously acquired seismic. This 640 acre lease is near several good Dina producing fields.

Alliance

The Company has recently acquired two high quality seismic anomalies in the Alliance area of Alberta located approximately sixty miles west of Sounding Lake but along the same trend of Lower Cretaceous oil fields. The anomalies, although somewhat small in areal extent, appear to be similar in nature to those associated with several nearby highly prolific oil pools. Discovery holds a 100% interest in one feature that spills over onto competitor acreage and a 75% interest in another feature totally contained in the land recently acquired. It is the Company's intention to drill these prospects this summer.



Wabamun Lake

During 1989, Discovery participated in four new oil wells to expand existing production and develop a new Cretaceous Ostracod oil pool. The Company now has interests varying from 12.5% to 17.5% in eight wells producing from the Cretaceous Ostracod formation. During 1989, the Company continued to add to its extensive land holdings in the area and now holds interests varying from 12.5% to 100% in 9,600 acres of prospective land. Recently, several discoveries of oil and gas have been made in close proximity to this land by a competitor. An extensive seismic program was recently completed in the area and two wells are to be drilled on this play in the near future, one on Discovery's 50% interest acreage and the other on 12.5% interest acreage.

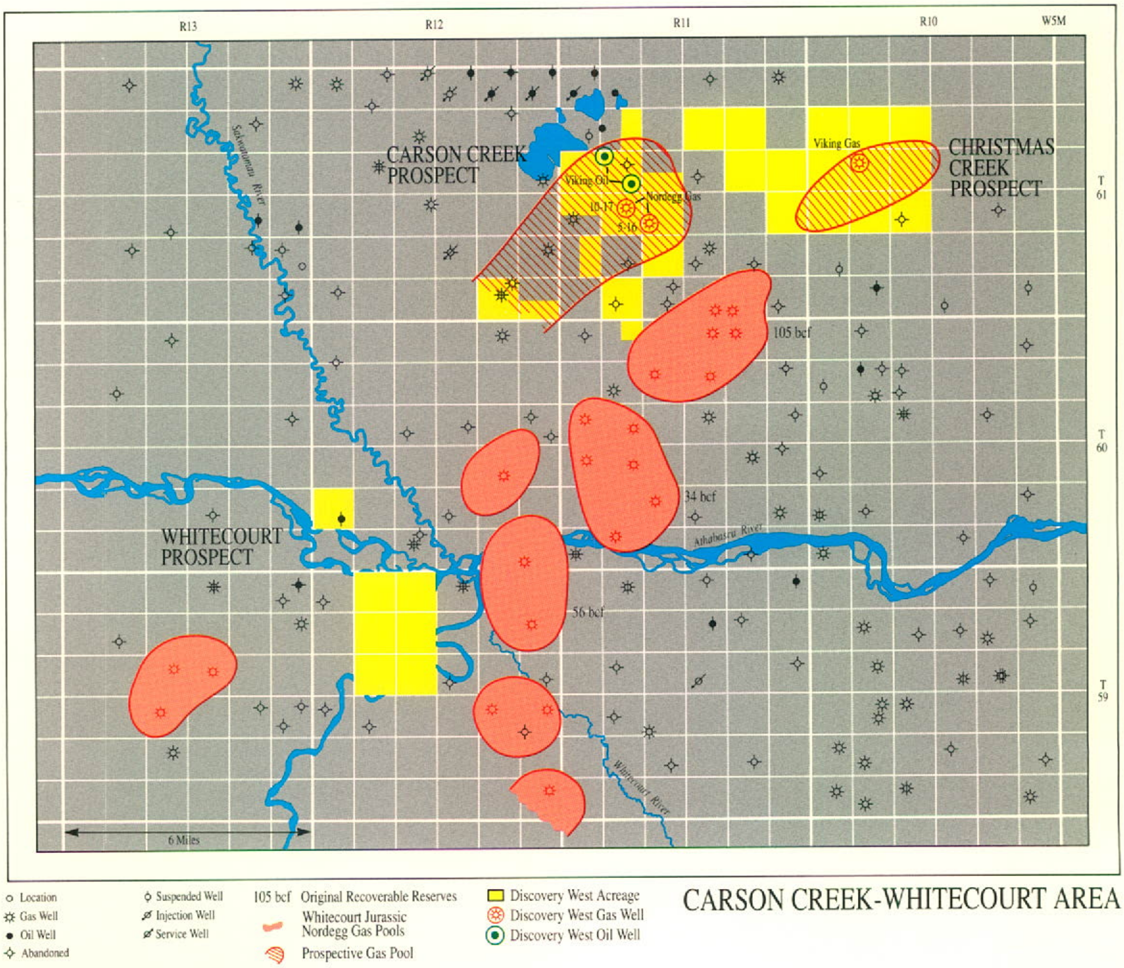
Carson Creek/Whitecourt Area

During 1989 Discovery continued to expand its interests on several Jurassic/Nordegg gas plays in this area of west central Alberta. The area has historically yielded some very large Nordegg gas reserves and appears to have potential for additional large scale discoveries. The Company also participated in plant and pipeline construction resulting in the commencement of gas and oil sales from the Carson Creek prospect early in 1990. During the year, Discovery continued to add to its large land holdings and to acquire seismic data. As a result of this activity, a number of potential drilling targets have been identified on our land. Discovery now holds interests varying from 12% to 50% in 19,700 acres located on three separate prospects in this area.

Cold Lake Area - Oil Sands Lease #80

Discovery West currently holds a working interest in 4,480 acres of Oil Sands Lease #80 containing 700 million barrels of bitumen in place. A total of 300 million barrels are suitable for exploitation using current steam recovery methods and it is estimated that in excess of 36 million barrels of bitumen will be recovered. Discovery will have the right to participate for a 50% interest when this project is ultimately developed.

The Cold Lake property's potential will be evident once world oil prices have undergone sufficiently sustained price increases to justify development. The Company has no immediate plans to reactivate this project where it previously contemplated construction of a pilot facility with its partner, Norcen Energy Resources Limited.



CARSON CREEK-WHITECOURT AREA

Rayrock Yellowknife Resources Inc., in which the Company holds a 23.2% equity interest, is a successful mineral exploration, development and operating company. Rayrock in turn holds 62.8% of the equity in Discovery West Corp.

Net earnings for the year declined to $3,171,000 or $0.32 per share from $6,612,000 or $0.68 per share in 1988 due to lower gold profits. Rayrock's gold production totalled 37,357 ounces in 1989 compared with 36,253 in 1988. Average prices realized by the Company during 1989 were US$37 per ounce lower. Reduced production due to the phasing out of the Preble heap leach operation and somewhat lower grades and recoveries at Dee increased direct cash operating costs by US$38 per ounce. Funds flow provided by operations was $9,268,000 or $0.93 per share compared with $8,850,000 or $0.92 per share in 1988 due to the increased funds flow from Western Ag-Minerals Company.

Several events occurred in 1989 which will have a significant impact on the future of Rayrock:

- The remaining 65% interest in Western Ag-Minerals was acquired, increasing revenues and providing the Company with a long term source of funds flow.
- The new Marigold gold mine in Nevada commenced production in September. The mill is running at its capacity of 1,250 tons per day with gold recovery averaging almost 93%. Heap leaching operations started in March, 1990.
- Rayrock increased its ownership in the Dee gold mine in Nevada to 44% on October 30th when it acquired U.S. Gold Corporation's interest jointly with Corona Corporation.
- A significant new gold deposit called Stonehouse was discovered on the Marigold property. Drilling to date indicates that the area of mineralization is extensive, however the geology is very complex. A US$2.2 million delineation drilling program is budgeted for 1990.
- The exploration phase on the two advanced-stage projects in Latin America, held through Minera Rayrock Inc. are nearing completion. Positive results have been achieved during the year and reserves at both properties have increased, or are expected to increase dramatically. Minera raised $4 million at year end through a private placement with Westlake Industries Ltd. Rayrock also restructured its advances to equity and convertible debt, thereby increasing its ownership to 64% on a fully diluted basis.

Rayrock's short term outlook depends, to a considerable extent, on the price of gold. Gold production will increase significantly in 1990 due to Marigold and its increased interest in Dee. Western Ag-Minerals is anticipating increasing volumes and profits for the year. The longer term growth of Rayrock remains dependent on its exploration successes.

MANAGEMENT'S DISCUSSION AND ANALYSIS

GENERAL

The following discussion pertains to the risks and uncertainties currently known to management which are likely to have a material impact on the financial condition of the Company and are reasonably expected to occur. This discussion, by its nature, is not all inclusive as it excludes changes in general economic, political and environmental matters nor is it a guarantee that other factors may or may not occur which will affect the Company in the future. This discussion should be read in conjunction with material contained in other sections of this annual report.

Discovery is active in the oil and gas industry in Canada, and through Rayrock Yellowknife Resources Inc., is active in the mining and agricultural minerals businesses in the Americas. Like other international natural resource companies, Discovery is exposed to fluctuating commodity prices (in particular, oil and gas prices) and foreign exchange rates, changes in legislation affecting property ownership, environmental legislation, safety matters, income remittances and taxation, new technology and industry practices affecting operations, unpredictable weather occurrences and competition.

Although the Company has assessed the reserve figures presented in this report and believes that the methods used to estimate the reserves are appropriate, such figures are only estimates. Furthermore, no assurance can be given that the indicated level of recovery of oil or gas will be realized. In addition, ore grades, tons of material processed and recoveries achieved in the mining business are not assured, due to variations within an orebody and disruptions in material handling and processing.

FINANCIAL REVIEW

Discovery West Corp. has two significant assets; oil and gas properties in western Canada and a significant holding in Rayrock Yellowknife Resources Inc. The following discussion identifies factors to be considered in an on-going evaluation of the Company's financial position and results of operations.

OIL AND GAS

Companies in the oil and gas industry make significant investments for long-term profits. Short-term fluctuations in commodity prices impact the Company's periodically measured income and funds flow. The true success of natural resource organizations can only be reasonably evaluated over a number of years.

Since Discovery was re-organized as an active oil and gas company in early 1987, its emphasis has been on growth through exploration. All of the Company's operating funds flow has been re-invested in oil and gas properties, as detailed in the following table:

PERCENTAGE OF FUNDS FLOW INVESTED IN OIL AND GAS (C$000)

	1989	1988	1987	Total
Funds from operations	**$3,986**	$3,083	$3,499	$10,568
Investment in oil and gas properties				
Land	**$ 763**	$1,384	$ 368	$2,515
Exploration Drilling	**1,633**	1,291	1,255	4,179
Development Drilling	**987**	928	300	2,215
Tangible Production Equipment	**1,020**	943	141	2,104
	$4,403	$4,546	$2,064	$11,013
Percent of Funds flow from Operations	**110%**	148%	59%	104%

During this period, the Company:

(1) increased its land position by 24,400 net acres

(2) participated in drilling 289 wells resulting in 160 new oil wells and 45 new gas wells

(3) produced a total of 707,000 barrels of oil and 3.2 bcf of natural gas

(4) replaced production and increased reserves 23% from 1988 on an oil equivalent basis to 5.2 million barrels.

Funds flow from oil and gas operations, before administrative expenses, fluctuated as a result of fluctuations in prices and production volumes, as indicated in the following table:

ANALYSIS OF OIL AND GAS FUNDS FLOW

	1989	1988	1987
Oil			
Volume (bbls)	**263,700**	240,300	203,000
Price (C$/bbl)	**20.98**	18.60	23.91
Operating cost (C$/bbl)(1)	**5.85**	7.06	6.50
Funds flow (C$000)	**3,989**	2,781	3,534
Gas			
Volume (mmcf)	**1,069**	1,197	933
Price (C$/mcf)	**1.42**	1.55	1.64
Operating cost (C$/mcf)	**.61**	.56	.66
Funds flow (C$000)	**873**	1,080	914
Funds flow (C$000)(2)	**4,862**	3,861	4,448

(1) includes costs of miscible flood expenses incurred at Mitsue and Nipisi which totalled $530,000 for 1989, $479,000 for 1988 and $721,000 for 1987.

(2) excludes plant revenues and royalty expenses.

The percentage of funds flow from operations spent on administration has decreased, as indicated in the following table:

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONT'D)

PERCENTAGE OF FUNDS FLOW ON ADMINISTRATION

1987	23.4%
1988	22.8%
1989	17.8%

During 1989, Discovery's management began devoting more time to developing exploration plays and accordingly, a portion of its time was charged to these projects.

The profitability of the oil and gas operations is also impacted by higher non-cash expenses for depreciation and dry hole costs, as illustrated in the following table:

PROFITS FROM OIL AND GAS BEFORE ADMINISTRATION
(C$000)

	1989	1988	1987
Revenue less operating expenses	**$4,684**	$4,164	$4,785
Depreciation	**3,112**	3,038	2,828
Dry hole costs	**803**	413	406
Profit	**$ 769**	$ 713	$1,551

Depreciation charges are based on units of production and therefore increase with production. Dry hole costs, on the other hand, are a result of the Company's increasing involvement in larger interest plays and its continuing commitment to exploration.

RAYROCK YELLOWKNIFE RESOURCES INC.

The net income of Discovery is affected by its proportionate share of Rayrock's net income. During 1989, Rayrock's net income declined by 52% as a result of lower gold prices and higher costs of production. Discovery's share of Rayrock's earnings declined to $518,000 from $985,000 in 1988. This decline in earnings has no impact on the Company's funds flow.

OTHER

Other income increased significantly as a result of the non-cash realization of $334,000 of deferred gain on the sale of mining properties during 1989, as explained in Note 5(b) to the financial statements and a gain on the sale of investments.

LIQUIDITY AND CAPITAL RESOURCES

The following section discusses Discovery's ability to generate cash to meet its commitments and to carry out its plans. The principal source of funding for Discovery's on-going business has been funds flow from operations. In 1989, funds flow increased to $3,986,000.

The majority of the Company's oil and gas assets are mature and require minimal capital expenditure for maintenance. The vast majority of the Company's capital expenditures on oil and gas properties are discretionary. If, in 1989, the Company had limited its expenditures to only mandatory maintenance and participation in existing joint ventures in order to avoid dilution of its interests, its investment in oil and gas properties would have only been $600,000 or 15% of funds flow. As at December 31, 1989, Discovery had a working capital position of $1,275,000 and an unutilized bank line of credit of $1,495,000.

In 1990, the Company intends to build aggressively on its asset base with a threefold increase in the budget for exploration, development and property acquisitions. The intent is to significantly increase production and funds flow without increasing overhead. This strategy is being undertaken because of the high quality of the Company's prospects and a general optimism concerning future oil and gas prices.

The only debt currently outstanding is $8 million in subordinate convertible debentures. Discovery holds $5 million in convertible debentures of Rayrock reducing its net financial exposure to $3 million. As a result, the Company's debt-to-equity ratio is as follows:

DEBT TO EQUITY
(C$000)

	1989	1988	1987
Debt			
Bank debt	$ –	$ –	$ 637
Convertible debenture	**8,000**	8,000	8,000
Gross	**8,000**	8,000	8,637
Rayrock debenture	**5,000**	5,000	5,000
Net	**$ 3,000**	$ 3,000	$ 3,637
Equity	**$28,643**	$27,971	$31,317
Gross debt-to-equity	**.28:1**	.29:1	.28:1
Net debt-to-equity	**.11:1**	.11:1	.12:1

The Company is currently arranging a new $10 million revolving line of credit to bridge finance its increased expenditure objectives. Ultimately, under proper market conditions, this debt will be replaced by additional new equity. The Company intends to maintain a low debt-to-equity ratio over the medium to long term.

The Company also has the flexibility to cut back on its discretionary expenditures should its development program prove unsatisfactory. In addition, the Company holds certain non-strategic, smaller-interest producing properties that are available for disposal.

Management would also consider further enhancing its exploration and development efforts with acquisitions of high quality producing oil and gas properties. This could be accomplished through outright purchases, which would be self financed, or through mergers with equally valued entities in order to achieve economies of scale.

Consolidated Balance Sheets

As At December 31, 1989 and 1988

Assets	1989	1988
Current assets		
Cash and short-term investments	$ 920,000	$ 1,740,000
Accounts receivable	1,256,000	1,386,000
	2,176,000	3,126,000
Long-term investments (note 2)	16,812,000	16,490,000
Oil and gas properties		
Petroleum and natural gas leases and equipment—at cost, less accumulated depletion and amortization of $20,801,000 (1988—$17,761,000)	33,082,000	32,564,000
Other assets	389,000	386,000
	$52,459,000	$52,566,000

Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	$ 901,000	$ 981,000
Long-term debt (note 3)	8,000,000	8,000,000
Deferred gain on sale of mining properties (note 5(b))	5,931,000	6,265,000
Deferred revenue	228,000	272,000
Deferred income taxes	8,634,000	8,961,000
Minority interest	122,000	116,000
	23,816,000	24,595,000

Shareholders' Equity		
Capital stock (note 4)	19,815,000	20,265,000
Contributed surplus	1,749,000	1,749,000
Retained earnings	11,664,000	10,446,000
	33,228,000	32,460,000
Deduct reciprocal shareholdings	4,585,000	4,489,000
	28,643,000	27,971,000
	$52,459,000	$52,566,000

Signed on behalf of the Board

Director

Director

CONSOLIDATED STATEMENTS OF INCOME

FOR THE YEARS ENDED DECEMBER 31, 1989 AND 1988

	1989	1988
INCOME		
Revenue from oil and gas operations	$7,367,000	$6,697,000
EXPENSES		
Oil and gas	2,683,000	2,533,000
Administrative and general	862,000	909,000
Depreciation, amortization and depletion	3,112,000	3,038,000
Current and deferred exploration expenditures written off	803,000	413,000
	7,460,000	6,893,000
LOSS FROM OPERATIONS	(93,000)	(196,000)
OTHER INCOME (EXPENSES)		
Interest expense	(640,000)	(640,000)
Investment and other income	1,219,000	577,000
	579,000	(63,000)
INCOME (LOSS) BEFORE INCOME TAXES	486,000	(259,000)
RECOVERY OF (PROVISION FOR) INCOME TAXES (note 7)		
Current	(38,000)	4,000
Deferred	327,000	503,000
	289,000	507,000
INCOME BEFORE UNDERNOTED ITEMS	775,000	248,000
SHARE IN EARNINGS OF RAYROCK (note 1(a))	518,000	985,000
MINORITY INTEREST IN (INCOME) LOSS OF SUBSIDIARY	(6,000)	5,000
NET INCOME FOR THE YEAR	$1,287,000	$1,238,000
NET INCOME PER PARTICIPATING SHARE (note 4(c))	$0.07	$0.07

CONSOLIDATED STATEMENTS OF RETAINED EARNINGS

FOR THE YEARS ENDED DECEMBER 31, 1989 AND 1988

	1989	1988
RETAINED EARNINGS — BEGINNING OF YEAR	$10,446,000	$ 9,303,000
Net income for the year	1,287,000	1,238,000
Dividends on preferred shares	(69,000)	(95,000)
RETAINED EARNINGS — END OF YEAR	$11,664,000	$10,446,000

CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION

FOR THE YEARS ENDED DECEMBER 31, 1989 AND 1988

	1989	1988
OPERATING ACTIVITIES		
Net income for the year	**$1,287,000**	$1,238,000
Non-cash charges	**2,699,000**	1,845,000
Funds provided by operations	**3,986,000**	3,083,000
Increase (decrease) in working capital excluding cash	**50,000**	(244,000)
Cash provided by operating activities	**4,036,000**	2,839,000
INVESTMENT ACTIVITIES		
Increase in investment in Rayrock		(10,647,000)
Deferred revenue on sale of mining properties		6,359,000
Proceeds on sale of investments	**100,000**	591,000
Expenditure on oil and gas properties	**(4,403,000)**	(4,546,000)
Increase in other assets	**(34,000)**	(14,000)
Cash (used in) investment activities	**(4,337,000)**	(8,257,000)
FINANCING ACTIVITIES		
Redemption of capital stock	**(450,000)**	
Dividends on preferred shares	**(69,000)**	(95,000)
Cash (used in) financing activities	**(519,000)**	(95,000)
DECREASE IN CASH	**(820,000)**	(5,513,000)
CASH – BEGINNING OF YEAR	**1,740,000**	7,253,000
CASH – END OF YEAR	**$ 920,000**	$1,740,000

Cash consists of cash and short-term investments including treasury bills, bankers acceptances and commercial paper.

AUDITORS' REPORT TO THE SHAREHOLDERS

We have examined the consolidated balance sheets of Discovery West Corp. as at December 31, 1989 and December 31, 1988 and the consolidated statements of income, retained earnings and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Company as at December 31, 1989 and December 31, 1988 and the results of its operations and the changes in its financial position for the years then ended in accordance with generally accepted accounting principles applied on a consistent basis.

Coopers & Lybrand

Chartered Accountants
Toronto, Ontario

February 23, 1990

Notes To Consolidated Financial Statements

For the Years Ended December 31, 1989 and 1988

1. Accounting Policies

The accounting policies of the Company are in accordance with accounting principles generally accepted in Canada, consistently applied. Those policies considered significant are outlined below.

(a) Basis of presentation

The consolidated financial statements include the accounts of the Company and its subsidiaries.

The investment in shares of Rayrock Yellowknife Resources Inc. ("Rayrock") is carried at cost adjusted by the Company's share of the earnings since significant influence was acquired. Rayrock owns 47.7% of the Company's common shares, 99.9% of the Company's non-voting shares and 83.0% (1988 - 60.8%) of the Company's preferred shares. As a result, Rayrock has a 49.5% voting interest (1988, 49.5%) and a 62.8% equity interest (1988, 62.8%) in the Company. The Company's effective interest in the cost of its shares held by Rayrock has been deducted from the shareholders' equity.

The Company's equity in the earnings of Rayrock reflected in the consolidated statements of income is based on the earnings of Rayrock excluding the latter's interest in the earnings of the Company due to the existence of the reciprocal shareholdings. The excess of the purchase price paid by the Company over the underlying equity of $2.9 million is being amortized over ten years.

(b) Property acquisition, exploration and development expenditures

Costs incurred in exploring for oil and gas, including participation in joint ventures, are capitalized until completion of the particular exploration and drilling program, at which time the costs of unsuccessful programs are written-off. Acquisition costs of oil and gas properties and the cost of drilling and equipping successful wells are capitalized.

The Company carries its oil and gas properties at the lower of capitalized cost and net recoverable value. Net recoverable value is the aggregate of future net revenues from proven reserves plus unproved properties at the lower of cost and fair value, where fair value has been determined. Net revenues are determined using year-end prices and costs including operating, general and administrative, and interest costs, on an after-tax basis.

(c) Depreciation, depletion and amortization

Depreciation and depletion of oil and gas properties, including equipment, is determined on the unit-of-production method on an aggregate basis, based on commercially recoverable proven reserves estimated by managment and revised as data becomes available. Costs of acquiring and evaluating unproved properties are excluded from costs subject to depreciation and depletion until it is determined whether or not proved reserves are attributable to the properties or impairment occurs. Major non-producing development projects are excluded from costs subject to depreciation and depletion. Amounts included in oil and gas properties not subject to depletion are $1,184,000 (1988 - $1,700,000).

The costs incurred on the issuance of debentures, is deferred and amortized over the life of the debenture.

(d) Income taxes

The Company follows the deferral method of tax allocation whereby the provision for income taxes is based on the income reported in the accounts. Principal timing differences result from exploration and development expenditures claimed for tax purposes in excess of amounts written-off for accounting purposes.

Management Report

The annual report and financial statements have been prepared by management and approved by the Board of Directors. The financial statements have been prepared in accordance with generally accepted accounting principles applied on a consistent basis. Management acknowledges responsibility for the fairness, integrity and objectivity of all financial information contained in the annual report including the financial statements.

D.R. Crombie
President

C.B. Burton
Vice President, Finance

February 28, 1990

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

2. LONG-TERM INVESTMENTS

	1989	1988
Investment in shares and debentures of Rayrock Yellowknife Resources Inc. - Subordinate voting shares (quoted market value $28,550,000; 1988 - $16,995,000)	**$14,122,000**	$14,122,000
Equity in earnings	**1,503,000**	985,000
	15,625,000	15,107,000
Deduct Company's interest in its shares held by Rayrock	**(4,585,000)**	(4,489,000)
	11,040,000	10,618,000
Preferred shares	**550,000**	550,000
Subordinate debentures (note 2 (c))	**4,961,000**	4,961,000
	16,551,000	16,129,000
Investments in other companies - (quoted market value $501,000; 1988 - $719,000)	**183,000**	233,000
Non-interest bearing advances to officers and employees under a stock purchase plan, due, on or before December 31, 1991	**78,000**	128,000
	$16,812,000	$16,490,000

(a) The Company owns 23.2% (1988, 23.8%) of the subordinate voting shares and 59.5% of the preferred shares of Rayrock giving it a total voting interest of 34.8% (1988, 35.5%).

(b) The quoted market values referred to above do not necessarily represent the realizable value of these holdings which may be more or less than indicated by market quotations.

(c) Interest received from Rayrock on the subordinated debentures during 1989 was $375,000 (1988 - $372,000).

3. LONG TERM DEBT

	1989	1988
8% convertible subordinated debentures	**$8,000,000**	$8,000,000

(a) The $8,000,000 8%, convertible, subordinated debentures are convertible into 4,000,000 common shares at a conversion price of $2.00 per share. The debentures mature on March 31, 1997 and are redeemable, at par, after March 31, 1990 under certain circumstances. The holder has a retraction right exercisable on March 31, 1993.

(b) As at December 31, 1989, the Company has an unutilized $1,495,000 bank line of credit which is secured by certain of its petroleum and natural gas leases and equipment. Funds drawn under this line will bear interest at prime plus 1/2% per annum. The line decreases at the rate of $27,000 per month.

4. CAPITAL STOCK

(a) AUTHORIZED AND ISSUED

		1989		1988	
	Authorized	Number of shares	Stated value	Number of shares	Stated value
Partipating	Unlimited				
Non-voting shares		5,608,499		5,611,399	
Common shares		13,812,811		13,809,913	
		19,421,310	$18,825,000	19,421,312	$18,825,000
Preferred shares	Unlimited				
$0.06 cumulative redeemable Series A carrying one vote per share		500,000	500,000	500,000	500,000
Floating rate cumulative, redeemable convertible, retractable non-voting Series B		131,250	210,000	412,500	660,000
$0.03 non-cumulative redeemable convertible non-voting Series C		140,000	280,000	140,000	280,000
			$19,815,000		$20,265,000

i) The common and non-voting shares rank equally with each other and are interchangeable.

ii) The Series A preferred shares are redeemable at a price of $1.00 per share. The Series B preferred shares are redeemable at a price of $1.60 per share. The Series C preferred shares are redeemable at any time after January 1, 1991 at a price of $2.50 per share.

iii) Monthly dividends payable on the Series B preferred shares are calculated at a rate of one percentage point below the prime rate. During 1989 a shareholder exercised his retraction right on 281,250 Series B preferred shares at $1.60 per share.

iv) The Series B and C preferred shares are convertible into common shares on a one-for-one basis.

(b) STOCK OPTIONS

Stock options on 576,000 common shares are outstanding and exercisable at prices from $1.18 to $1.50. The Directors have approved the establishment of a stock option plan whereunder 10% of the issued common and non-voting shares less any outstanding options are available for the granting of an incentive stock option. The plan is subject to shareholder and regulatory approvals.

(c) Income per participating share is calculated on the basis of the weighted average number of participating shares outstanding during the year after deducting the Company's pro-rata interest in its own shares held by Rayrock.

The stock options, convertible preferred shares and convertible debentures have no dilutive effect for any of the years included.

5. RELATED PARTY TRANSACTIONS

(a) Rayrock pays a portion of the remuneration of senior officers together with the rent and other joint costs of associated companies and is reimbursed by those companies for their proportionate share thereof. The amount paid during the year by the Company in respect of such charges was $60,000 (1988 - $60,000). The Company has charged Rayrock for $144,000 in 1989 (1988 - $144,000) for the management of Rayrock's western oil and gas properties.

(b) Effective January 1, 1988, the Company sold its mining properties to Rayrock for a total of 850,714 subordinate voting shares. These shares were assigned a value of $7.71 per share by the Directors of Rayrock. As Discovery has significant influence over Rayrock, the gain on the sale has been deferred until the value is realized outside the two companies. During 1989, exploration work on certain properties in northern Ontario was inconclusive and the properties were abandoned by Rayrock. As a result, Discovery recognized in 1989 the gain, previously deferred, on the sale from these two properties of $334,000, which offsets the loss recorded by Rayrock.

(c) Effective January 1, 1988, the Company purchased the Cold Lake and Seal heavy oil leases from Rayrock for a cash amount of $624,000. Under an agreement, Rayrock holds an option to re-acquire these leases at the original sale price, plus any subsequent expenditures, should the Company in the future decide not to participate in the development of a pilot plant.

(d) During 1988, the Company purchased 518,807 subordinate voting shares of Rayrock at a price of $7.71 per share for a total cost of $4,000,000 cash.

(e) As a condition of certain employees of the Company purchasing $1,000,000 of its 8% convertible subordinated debentures in 1987, the Company entered into an agreement with these employees and a financial institution to acquire the debentures at par if called upon to do so by the financial institution. During 1989, Rayrock acquired the debenture for $1,000,000 from the employees.

6. SEGMENTED INFORMATION

The Company operates substantially in Canada in one industry - the development of and participation in the operation of oil and gas properties.

The revenues, operating earnings, depreciation and depletion, identifiable assets and capital expenditures are self-evident in the balance sheets, statements of income and statements of changes in financial position.

7. INCOME TAXES

The variations from the basic statutory income taxes and the Company's effective income tax recovery are as follows:

	1989	1988
Income tax at statutory rates	**$ 234,000**	$(121,000)
Resource allowance	**(463,000)**	(391,000)
Crown royalties not allowed net of Alberta Royalty tax credit	**112,000**	(14,000)
Non taxable gains	**(176,000)**	–
Other	**$ 4,000**	$ 19,000
	$(289,000)	$(507,000)

8. COMMITMENTS AND CONTINGENCIES

(a) The Company is a defendent in an action against the Company claiming an interest in, and royalties from, certain heavy oil leases in Alberta, together with damages. While the outcome of this action cannot be predicted, no amounts have been provided for costs, if any, for resolution of this matter and any such costs would be accounted for as a prior period adjustment.

(b) The Company entered into a long-term agreement with a senior officer of the Company which provides for an annual retirement allowance in amounts ranging from $47,500 to $75,000.

(c) The Company has entered into an agreement with associated companies whereby certain Canadian current account balances are pooled in a concentration account. Each of the companies guarantees the overdrafts (if any) of the other companies in this arrangement. At the year-end no such overdrafts existed which were guaranteed by the Company.

OTHER INFORMATION

CONDENSED FINANCIAL POSITION
(C$000)

	1989	1988	1987
Working capital	$ 1,275	$ 2,145	$ 7,412
Long term investments	16,812	16,490	10,011
Investment in oil and gas properties	33,082	32,564	31,349
	51,169	51,199	48,772
Long term debt	8,000	8,000	8,000
Deferred and other items	14,526	15,228	9,455
Shareholders' equity	$28,643	$27,971	$31,317
Book value per share	$ 1.74	$ 1.70	$ 1.61

CONDENSED RESULTS OF OPERATIONS
(C$000)

	1989	1988	1987
Revenue	$7,367	$6,697	$7,072
Profit from oil and gas	769	713	1,551
Administration	(862)	(909)	(1,071)
Other income (expense)	573	(58)	305
	480	(254)	785
Income tax recoveries	289	507	121
	769	253	906
Equity in Rayrock	518	985	
Net income	$1,287	$1,238	$ 906
Net income per share	$ 0.07	$ 0.07	$ 0.04

CONDENSED CHANGES IN FINANCIAL POSITION
(C$000)

	1989	1988	1987
Funds flow from operations	$3,986	$3,083	$3,499
Investment in oil and gas properties	(4,403)	(4,546)	(2,064)
Investment in long term investments		(3,697)	(4,965)
Increase in long term debt			6,933
Other	(403)	(353)	323
Net increase (decrease) in cash	$ (820)	($5,513)	$3,726
Funds flow per share	$ 0.24	$ 0.19	$ 0.18

Other Information (cont'd)

Pricing Forecast Table:

Martin Petroleum and Associates current estimate of future prices are as follows:

	Crude Oil CdnS/bbl (Light Sweet, Edmonton)		Gas (Cdn$/mcf) WGM D^1/D^2 Average Field Price	
	1989	1988	**1989**	1988
1990	**$22.28**	$20.08	**$1.55**	$1.85
1991	**23.35**	22.03	**1.70**	2.11
1992	**25.04**	24.61	**1.90**	2.35
1993	**27.82**	27.17	**2.21**	2.60
1994	**30.62**	29.81	**2.53**	2.89
1995	**33.51**	32.52	**2.83**	3.17
1996	**36.50**	35.23	**3.26**	3.46
1997	**39.46**	37.89	**3.65**	3.74
1998	**42.38**	40.58	**4.05**	4.00
1999	**45.36**	43.30	**4.48**	4.24
Thereafter	**+6%/year**	+6%/year	**+6%/year**	+6%/year

The preceding prices are benchmark prices only. The Company's future net revenues are calculated according to the quality of oil and gas reserves and the terms of any gas sales contracts in place for individual properties.

Metric Conversion Table

To assist readers of our annual report, we provide the following:

To convert from:	To:	Multiply by:
Thousand cubic feet (Mcf gas)	Thousand cubic metres (10^3 m^3)	0.028
Barrels (Bbls oil)	Cubic metres (m^3)	0.159
Feet (well depths)	Metres (m)	0.305
Miles (distance)	Kilometres (km)	1.609
Acres (land)	Hectares (ha)	0.405
Tons	Tonnes	0.907

Abbreviations:

Bbls	barrels
Bcf	billions of cubic feet
Boe	barrels of oil equivalent (calculated on the basis of 10 mcf = 1 bbl)
Bopd	barrels of oil per day
Mbbls	thousands of barrels
Mmbbls	millions of barrels
Mcf	thousands of cubic feet
Mcf/d	thousands of cubic feet per day
Mmcf	millions of cubic feet
NGL	natural gas liquids

Other Information (cont'd)

Shareholder Profile as at December 31, 1989

	No. Shares Held	No. Shareholders
Canada	16,447,925	4,018
U.S.A.	2,965,891	4,111
Other	7,494	40
	19,421,310	8,169

Rayrock Yellowknife Resources Inc. holds 12,193,629 common and non-voting shares of Discovery West Corp.

Share Trading History

	High	Low	Close	Volume
1984	$2.55	$1.53	$1.60	916,758
1985	2.50	1.35	1.80	1,034,404
1986	2.25	1.10	1.30	1,146,457
1987	2.70	1.00	1.27	3,139,505
1988	1.91	1.02	1.11	1,226,624
1989	1.80	1.05	1.50	1,819,144

Directors

C. Bruce Burton
Vice President, Finance
Discovery West Corp.
Toronto, Ontario

David R. Crombie*
President
Discovery West Corp.
Toronto, Ontario

Earl E. Curry
Retired Chairman
PreCambrian Shield Resources Ltd.
Christina Lake, British Columbia

O. Michael Isaac
Executive Vice President
Discovery West Corp.
Calgary, Alberta

Hugh Mogensen*
Professional Geologist
Victoria, British Columbia

John W. Sabine*
Partner
Fasken Campbell Godfrey
Toronto, Ontario

Walter Steuerman
Vice President and Secretary
Discovery West Corp.
Toronto, Ontario

Mervyn A. Upham
Chairman of the Board
Discovery West Corp.
Toronto, Ontario

*Member of Audit Committee

Officers

Mervyn A. Upham
Chairman of the Board

David R. Crombie
President and
Chief Executive Officer

O. Michael Isaac
Executive Vice President

C. Bruce Burton
Vice President, Finance

David A. Hutton
Vice President

James C. Mawdsley
Vice President, Exploration

Walter Steuerman
Vice President and Secretary

Joan I. Conway
Treasurer

Glen F. Lonsdale
Controller

Donna J. Forgrave
Assistant Treasurer

Betty-Ann Lipke
Assistant Secretary

Head Office

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O. Michael Isaac
Executive Vice President
James C. Mawdsley
Vice President, Exploration

Auditors

Coopers & Lybrand
Toronto, Ontario

Legal Counsel

Fasken Campbell Godfrey
Toronto, Ontario

Stock Symbol

The Toronto
Stock Exchange – DSW

Bankers

Canadian Imperial Bank of Commerce
Toronto, Ontario
Calgary, Alberta

Royal Bank of Canada
Calgary, Alberta

Transfer Agent

The Royal Trust Company
Correspondence should be sent to The Royal Trust Company, Corporate Trust Services, P.O. Box 7010, Adelaide Street Postal Station, Toronto, Ontario, M5C 2W9 and should include certificate numbers.

Inquiries about shareholdings, address changes, or lost certificates, should be directed to Royal Trust's AnswerLine: Within Canada: (800) 387-0825; Toronto or Outside Canada: (416) 981-8997 or to the Assistant Secretary at Discovery's Head Office.

Investor Relations

Jane E. Wilson
Manager, Investor Relations
Discovery West Corp.
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M4S 1V6
Tel: (416) 489-0022
Fax: (416) 489-0096

Annual Meeting

Tuesday, May 15, 1990
The Sheraton Centre Hotel
123 Queen Street West
Toronto, Ontario
Kent Room
11:30 a.m.

Designed by Craib Corporate Graphics Inc.

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