

C

# **rio alto exploration ltd.**

HOWARD ROSS LIBRARY  
OF MANAGEMENT  
JAN 5 1982  
MCGILL UNIVERSITY

**ANNUAL REPORT 1978**



**CORPORATE INFORMATION**

**DIRECTORS**

Ronald J. Allen	Vancouver, B.C.
Carman W. Byler	Calgary, Alberta.
H. Graham Gammell	Calgary, Alberta.
Douglas W. Hilland	Calgary, Alberta.
Julio Poscente	Calgary, Alberta.
Robert W. Termuende	Calgary, Alberta

**OFFICERS**

Julio Poscente	Chairman of the Board
Douglas W. Hilland	President
Lori C. Todrick	Secretary
John J. Barclay	Treasurer

**HEAD OFFICE**

710, 610 - 8th Ave. S.W.,  
Calgary, Alberta.  
T2P 1G5

**SUBSIDIARIES**

North American Nuclear Limited  
Rio Alto Petroleums Ltd.  
Gamma Resources Ltd.

**BANK**

Royal Bank of Canada

**TRANSFER AGENT AND REGISTRAR**

Canada Trust Company

**LEGAL COUNSEL**

McLaws & Company

**AUDITORS**

Collins Barrow

**STOCK LISTING**

Alberta Stock Exchange

# RIO ALTO EXPLORATION LTD.

## TO THE SHAREHOLDERS

The Company's mineral activities during 1978 were largely concentrated in continuing exploration of our large block of mineral claims, comprising approximately 20,000 acres, situated in the Rusty Springs area of the Ogilvie Mountains, Yukon Territory. The 1978 summer field program of geological sampling, mapping and diamond drilling was conducted between May and October under the direction of Frederick M. Beck, geological consultant, of Yarmouth, Maine and our resident consulting engineer, Paul S. White of Whitehorse, Yukon. The drilling program was designed to test the geological model of the prospect as well as to provide core samples to delineate or extend known mineralization indicated by previous exploration. Both objectives were accomplished despite limited core recoveries due to the highly fractured and friable nature of the mineralized zones encountered, which contrast severely with the competent host rock strata. The program also resulted in the discovery of two new areas of significant mineralization.

The 1978 field program continued confirmation of the existence of Mississippi Valley type silver, lead, zinc and copper mineralization having characteristics similar to successfully mined North American ore bodies of this type. However, in the case of Rusty Springs, silver values encountered are higher than normal.

A further program of exploration has been designed and is currently being carried out to complement and add to the geological model developed to date and to further evaluate the mineralized zones at Rusty Springs. This work commenced on May 10, 1979 and geophysical surveys will be performed in June and July as summarized in the accompanying information on our Yukon exploration.

Rio Alto continued to examine other mineral prospects in various parts of Canada and participate in the exploration of certain mineral prospects in which we hold an interest, such as the Elliot Lake area of Ontario.

Your Management is pleased to report that the gas well operated by our Company's subsidiary corporation, Gamma Resources Ltd., which blew wild and was

brought under control in 1978, has been placed on regular production and appears to be an excellent well.

At the time of writing this Report, Rio Alto is in the process of conducting a rights issue providing for the sale of some 574,487 treasury shares at \$1.45 per share. It is expected that this issue will add approximately \$780,000. to the Company's working capital. Since the end of 1978, our Company's expenditures have been consistent with those of past years. The proceeds of the rights issue will be used to increase our activities in both the mining and petroleum industries.

Plans to drill some six development wells on our petroleum properties at Kindersley, Saskatchewan during 1978 were postponed until 1979, due to the shortage of available drilling rigs. The result of this delay caused your Company's subsidiary corporation, Rio Alto Petroleum Ltd., to be subject to payment of some \$69,723. in income taxes. We are assured that these taxes will be recovered when the drilling program referred to in this Report is completed during 1979. Activities in the petroleum industry proposed for 1979 are expected to add significantly to Rio Alto's cash flow.

Looking to the future, it is expected that this summer's field activities will virtually complete our expenditures at the Rusty Springs prospect. Further exploration will be carried out by other corporations having the expertise and funds necessary to conduct presently projected programs. It will be the policy of your Management to continue to examine mining prospects of merit and explore, with associates, mining properties now held by Rio Alto. However, it is expected that greater emphasis will be placed on petroleum activities which, to date, have generated virtually all of our Company's income.

As a result of his desire to be relieved of administrative duties, Mr. R. W. Termuende resigned as President of the Company effective January 1, 1979 and was replaced by Douglas W. Hilland, one of the Company's original shareholders, who has been Secretary and Director of the Company since its formation. Lori C. Todrick, formerly Assistant Secretary, was appointed Secretary of the Company. The Company is indebted to Mr. Termuende for his contribution to its growth over the past six years. Mr. Termuende has agreed to remain available to the Company in a consulting capacity.

# RIO ALTO EXPLORATION LTD.

Significant changes are now taking place in our Company's direction and activities. Your Directors believe this is an opportune time to advise the shareholders of Rio Alto's current status and plans.

Your Directors appreciate the support we have received in the past from our shareholders, officers and professional advisors. We look forward to and will appreciate the continued support of all concerned.

Respectfully submitted on behalf of the Board

A handwritten signature in black ink, appearing to read "D. W. Hilland". The signature is written in a cursive, flowing style.

D. W. Hilland,  
President

## MINING ACTIVITIES

### Rusty Springs — Yukon Territory

The Company continues to hold a 100% interest in a large claim block known as the Rusty Springs prospect situated some 175 miles north of Dawson City in the Yukon. High grade silver, lead, zinc and copper mineralization has been encountered in exploratory work to date. Since original staking in 1975, these claims have been under active exploration by the Company during the 1976 to 1978 field seasons.

Reference is made at the beginning of this Report to the diamond drilling program carried out during the summer of 1978. Results of this program increased the area of mineralization. Its economic potential remains promising but as yet uncertain due to the nature of the formations tested by drilling and the limited amount of core recovered from the mineralized zones encountered by drilling. However, as previously indicated in this Report, considerable geological data was obtained and a significant geological model has been developed for the prospect which requires further exploration to properly evaluate its economic potential.

In addition to drilling completed last season, other significant exploratory work was carried out at Rusty Springs, including: some forty miles of new line cutting; obtaining some 800 soil samples on a grid pattern and completing geochemical assays of such samples; geological prospecting and mapping, as well as bulk sampling of some 800 pounds of silver-bearing galena and tetrahedrite. The geological work conducted during 1978 resulted in the discovery of two new areas of mineralization known as the Rowan and Bek showings. All of this data has been analyzed and mapped for the purpose of determining structural and mineralization controls as well as for planning future exploratory programs.

Concerning the question of accessibility, tractor-train sleighs travelled some eighty miles over a previously established winter road during March of 1978 to move in supplies and fuel for the summer program. This we believe to be significant in that it was carried out with all governmental and environmental approvals and indicates that the Rusty Springs prospect could be adequately serviced by a winter road. Further, this work was carried out with financial assistance from the Governments of Canada and the Yukon. While the equipment was on site, an air strip was built near the prospect for future use. Accordingly, the matter of access for movement of larger drilling equipment and other heavy equipment appears economically feasible.

While it is still difficult to provide a consistent pattern of mineral occurrences from exploratory work completed to date, significant mineralization was indicated by soil samples and resultant geochemical assays, by diamond drilling carried out on a pattern over two zones of the prospect and by a bulk sampling program. The mineralization encountered can be described as follows:

Assays of anomalous soil samples in the new Mike zone (compared to normal background) ranged as follows in parts per million:

	<b>Samples Tested</b>	<b>Normal Background</b>
Silver	1 - 17 ppm	0.4 - 0.6 ppm
Lead	1,000 - 5,000 ppm	10 - 100 ppm
Copper	300 - 600 ppm	20 - 40 ppm
Zinc	300 - 6,000 ppm	30 - 70 ppm

Diamond drilling on a grid basis provided necessary sub-surface data and encountered mineralization more or less consistent with that indicated by the previous soil sampling. Hole #78-17, for example, from the 28' to 43' interval assayed:

Silver	11.08 oz/ton
Lead	2.18%
Copper	.35%
Zinc	1.66%



Helicopter slinging fuel to the drill site at Rusty Springs.

# RIO ALTO EXPLORATION LTD.

An area which contained anomalous geochemical values and abundant surface mineralization was bulk sampled in the fall of 1978 to provide data on potential ore concentrates. Resultant tests assayed as follows:

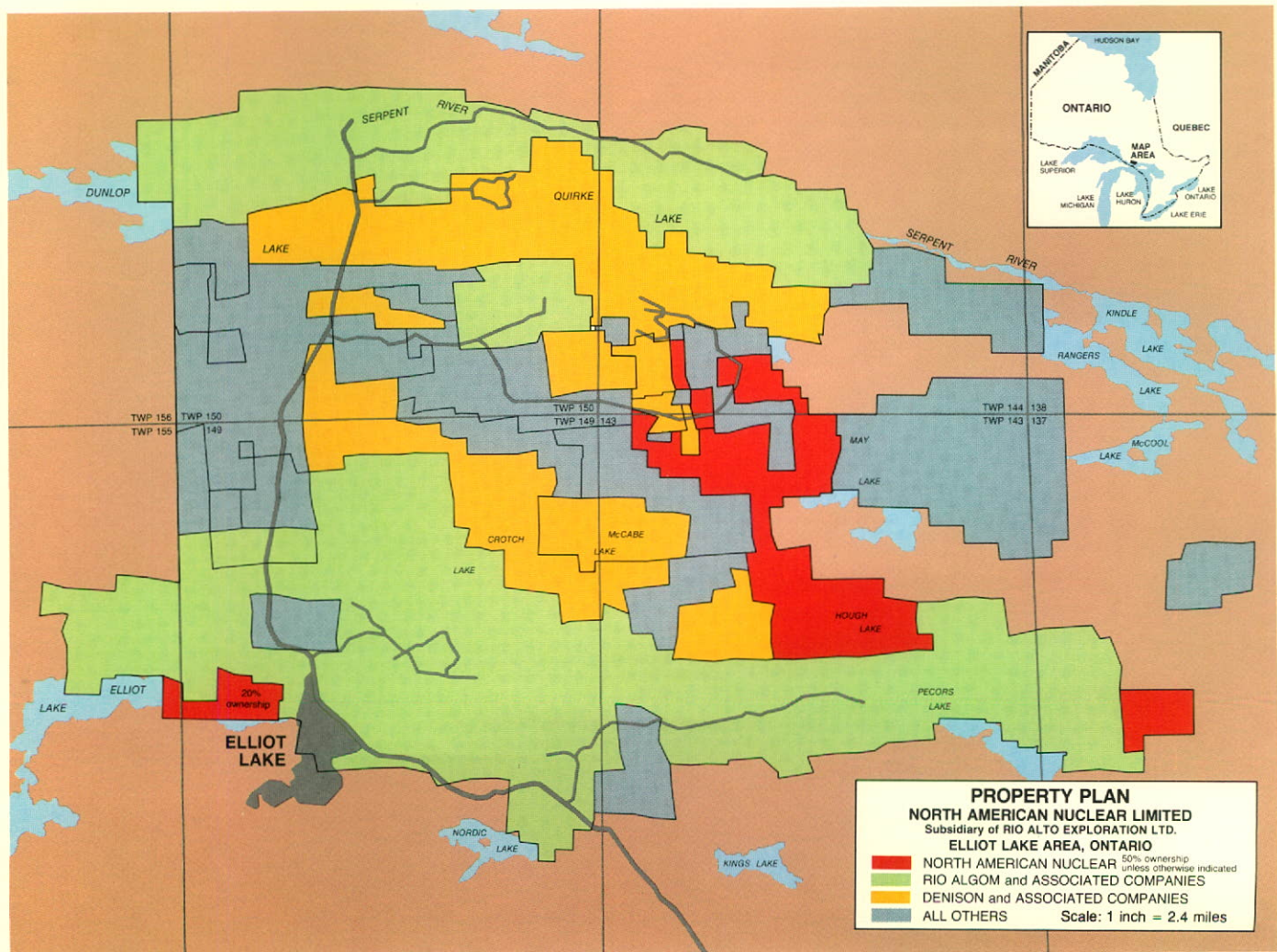
	<b>Sample 1</b>	<b>Sample 2</b>
Silver	59.04 oz/ton	63.20 oz/ton
Lead	24.8%	24.7%
Copper	2.24%	2.44%
Zinc	0.06%	0.07%

It will be obvious from the above spectrum of mineralization obtained to date that the Rusty Springs prospect has significant sub-surface mineralization in place and that the source of mineralization and the geological model is critical to appraising the economic potential of the prospect. No glacial impact has been observed, which enhances the potential of the area.

It is the opinion of your Directors that before completing a comprehensive report on all exploration to date, as well as the potential of the Rusty Springs prospect, further field work is required consisting of geophysical surveys, supplemented by infill geological mapping and prospecting. This work is now in progress. If time permits, during the 1979 field season, certain drilling may be conducted using the Company's Hydra-Wink diamond core drilling unit now stored on location. It is expected that completion of the 1979 work program and compilation of all exploratory and support data will enhance the prospect to the point that investors in the natural resource industry will join the Company in a long range evaluation program of the Rusty Springs area.

## Elliot Lake and Other Areas

The Company continues to hold (through its subsidiary, North American Nuclear Limited) and in associa-



# RIO ALTO EXPLORATION LTD.

tion with Long Lac Minerals Ltd., a significant block of claims in the uranium producing area of Elliot Lake, Ontario. Further claims were added to the block in 1978. Certain exploration was carried out during the past year in association with Long Lac Minerals Ltd. Major expansions of productive capacity have been commenced by the two major corporations presently producing from the area. Further activity on the claims in which the Company holds an interest must await general development of the area and will probably be of a long term nature.

Some 84 uranium claims continue to be held in the Quartet Lakes area of the Yukon and are being operated by Marline Oil Corporation. The Company holds a 30% interest in 60 claims and a 15% interest in 24 claims. It is expected that a limited work program will be carried out during 1979.

The Company also holds some 1,200 acres of freehold mineral leases situated near Sooke on Vancouver Island, B.C. Prior diamond drilling indicated encouraging grades of copper and further drilling is planned for these properties. Current copper prices and the political climate in British Columbia now justifies work on these leases.

## **Stormy Mountain Molybdenum Prospect**

Consistent with Management's policy regarding mining activities, the Company's present inventory of mining prospects will be added to as opportunities appear but always on the basis that the Company's future should not be dependent on one or two prospects.

We believe that with its background and experience, the Company is in an excellent position to explore and develop prospects in the Yukon. Accordingly, your Management took the opportunity to acquire a small high-grade molybdenum property presented to the Company during March of 1979, at a time when molybdenum is in short supply and provides excellent potential for economic production. The apparent economics are substantiated by leading industry and financial publications verifying the present and near future marketing data given to your Management at the time of acquisition of the Stormy Mountain prospect. The relevant background data on this prospect may be summarized as follows: The prospect has been the subject of various geological examinations since 1955, including

reports by W. E. Field, P. Eng., in 1959 for Canol Metal Mines Ltd. and subsequent reports by James Mason, P. Eng. for Jason Explorers Ltd. in 1967. In addition Canol Metal Mines Ltd. built a limited access road (some fourteen miles to the property) from the South Canol Road at a point situated thirty-six miles south-easterly from Ross River in the Yukon. Exploration by Canol in the 1959-60 field seasons included underground exploration, diamond drilling and a detailed geological survey. No exploratory work has been conducted since 1967.

Since acquiring the original four claims comprising the prospect in March of 1979, the Company has staked an additional 96 claims and plans an exploration and evaluation program for the 1979 field season. Planned operations include: evaluation of the existing underground adit, geological mapping, limited diamond drilling, extraction of presently indicated minerals in bulk for shipping and assay as well as other related work. A budget of \$100,000. has been allocated to this program and such expenditure is expected to be supplemented by contributions from a joint venture partner, if required.

Estimates of molybdenum on the original four claims based upon past reports of underground development and diamond drilling, indicate gross ore values, which may be economically mined, at current prices of some \$13,600,000. It is estimated that this ore could be mined over a period of two years using portable milling equipment. Any production program will probably be deferred until completion of the 1979 exploratory and evaluation work, but satisfactory results from bulk sample ore shipment may lead to production from the prospect prior to the 1980 field season.

## **PETROLEUM AND NATURAL GAS**

The Company was originally formed in 1970 for the purpose of acquiring and exploring mining and coal properties. While this was actively pursued, it became obvious that the Company required a source of income to cover the cost of normal administrative expenses and day to day operations; thus enabling the Company to use equity capital for acquisition and exploration of new prospects in both the mining and petroleum industries. The Company's first petroleum interests were acquired in 1973 and since that time, your Management has pur-



# RIO ALTO EXPLORATION LTD.

sued a program, secondary to mining, of acquiring and developing petroleum and natural gas interests. This program will be accelerated during 1979. The main petroleum and natural gas properties are summarized in this part of the Report.

## Kindersley — Dodsland Field

As part of its original petroleum acquisitions, the Company now holds Saskatchewan Crown leases covering some 2320 acres in the Dodsland Viking oil field situated near Kindersley in Western Saskatchewan. Under an agreement with the Operator, Western Resources Production Ltd., the Company agreed to participate to the extent of 50% in certain proven locations to be drilled on these properties. Two such wells were drilled and placed on production in the fall of 1977 and are projected to pay out all costs within eighteen months. Further wells planned in the area are expected to return all costs or payout in approximately two years. Four new wells are projected to be drilled in the summer of 1979 with an additional two or more wells projected for the fall of 1979 (this was the original 1978 drilling program).

Subject to certain governmental approvals with respect to 40 acre spacing units, our Consulting Geologist, in a Report prepared during March of 1979, recommends drilling the six locations mentioned as well as a possible five further locations. This over-all program comprises our objectives in the Dodsland field during 1979. It is expected that approximately \$270,000. will be used for this project from funds raised in the current rights issue. Any additional required funds will be obtained from uncommitted sums on hand after the rights issue, or use of conventional financing from the Company's Bank.

Your Company has no debt with respect to its oil production. Certain Bank production loans obtained in the fall of 1977 were repaid in January, 1979.

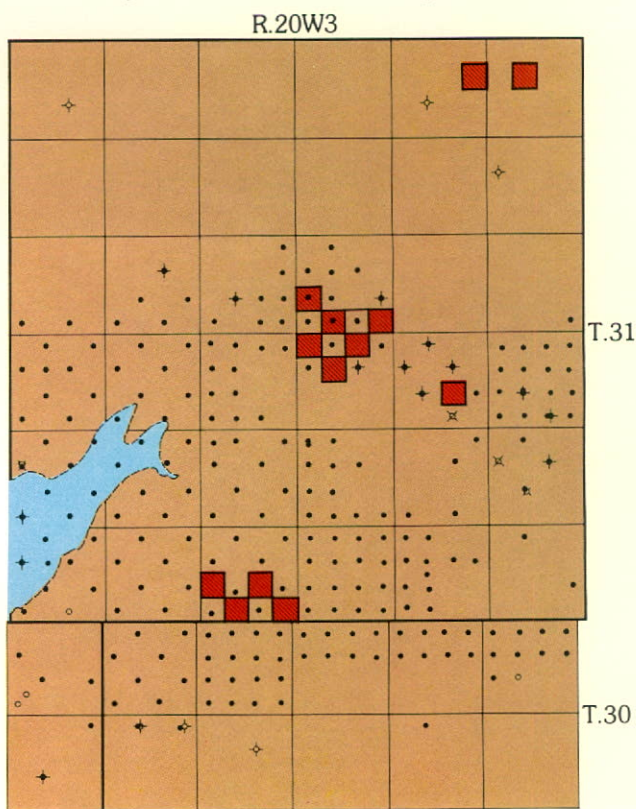
## Gamma Resources Ltd. and Cessford

Gamma Resources Ltd., as reported in the 1976 Annual Report to Shareholders, was formed to acquire and finance, by means of a private drilling fund, an interest in some eighty-five gas wells in the Hilda area of

Alberta. This fund's income has exceeded original projections and the Company currently holds a 0.7% working interest in the subject wells and properties, increasing to 1.75% after recovery of all investment costs by the investors in the fund.

In 1977 the Company formed a new drilling fund using its subsidiary corporation, Gamma Resources Ltd., and previous experience.

Due to pressing time commitments, the only property acquired and drilled during 1977 comprised the Cessford prospect. Unfortunately, the earning well encountered a relatively high pressure gas zone and blew wild during the course of final drilling on December 19,



## Kindersley, Sask.

- OIL WELL
- ◇ ABANDONED
- LOCATION
- RIO ALTO UNDRILLED LOCATIONS

1977. After considerable extra expenditures on the part of the Company and its drilling fund investors, the subject well was brought under control early in 1978 by means of a directional well. Regulatory approval was finally obtained to enter and test the directional well, which was placed on production during March of 1979. Production tests over a period of 30 days show a minimum productive capacity of 3.5 million cubic feet of gas per day, ranking the well as a discovery for the area. The well is presently on steady production with the daily production rate and payout of all costs being dependent upon the Gas Purchase Contract applicable to the area in question. Gamma and its investors hold an interest in some three sections of petroleum and natural gas rights comprising the above well and adjacent lands. Current plans call for the drilling of a second well during the fall of 1979 on the spacing unit adjoining the producing well.

By virtue of agreements between Gamma Resources Ltd., its farmout partners and investors, the Company will participate in the proceeds of production from the Cessford well and adjacent properties to the extent of 11.97% until payout of all costs and thereafter to the extent of 5.98% of proceeds of production. However, the Company's participation in the Cessford well and adjoining properties originates through Gamma Resources Ltd. and Rio Alto Development Co. Ltd., a private corporation operated by Gamma Resources Ltd. in which your Company holds a 15.96% share interest. The future direction and use of funds generated by Rio Alto Development Co. Ltd. is now being examined by the Company and its investors. It is expected that the Cessford well will produce net income (directly and indirectly) to the Company of approximately \$9,000. per month until payout of all costs (depending always upon available capacity under the existing Gas Purchase Contract). After payout this income will decrease by 50% for the duration of production pursuant to the original acquisition agreements.

## OTHER ACTIVITIES

The Company holds royalty interests in three blocks of coal leases situated in the Nordegg-Clearwater areas of the foothills belt of Alberta. One of these blocks, comprising approximately 39,000 acres, has been actively explored during the 1978/79 season. We understand that further exploration is planned by a major American coal operator during the forthcoming winter season.

All operations in Spain were terminated and our interests in this country have been disposed of at no cost to your Company.

Prior to 1976, the Company acquired a minor interest in a mining exploration corporation engaged in mineral exploration in Australia. This corporation has been re-organized and has extended its activities to offshore Australian petroleum and natural gas rights in association with Canada Northwest Land Limited and other Canadian corporations. Our interest comprises some 130,150 common shares of the Australian corporation, Cultus Pacific N.L., which is now listed on the Alberta Stock Exchange and had a market value of approximately \$.40 per share as of December 29, 1978. The investment appears on the Consolidated Balance Sheet under the caption "Other Assets" in the amount of \$21,337. We are advised that Cultus will be actively involved in the Australian petroleum industry.

Your Management is exploring the formation of a 1979 Drilling Fund using Canadian and European private investors. The formation of such a Fund will depend on the availability of petroleum and natural gas prospects meeting the Company's economic requirements and our obtaining qualified personnel to properly operate and administer the Fund.

Rio Alto Exploration Ltd. will continue to examine various areas of participation in resource exploration and development in Canada and abroad. Only the significant activities are summarized in this Report.

**AUDITORS' REPORT**

To the Shareholders  
Rio Alto Exploration Ltd.

We have examined the consolidated balance sheet of Rio Alto Exploration Ltd. as at December 31, 1978 and the consolidated statements of income, deficit and changes in financial position for the year then ended. Our examination was 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, subject to the realization of mining properties as outlined in note 1, these consolidated financial statements present fairly the financial position of the company as at December 31, 1978 and the results of its operations and changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Calgary, Alberta  
March 2, 1979

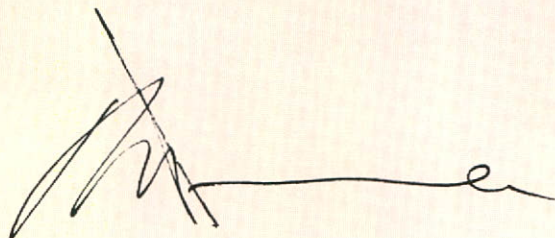
COLLINS BARROW  
CHARTERED ACCOUNTANTS

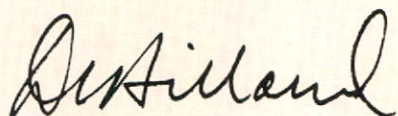
# RIO ALTO EXPLORATION LTD.

## CONSOLIDATED BALANCE SHEET DECEMBER 31, 1978

ASSETS		<u>1978</u>	<u>1977</u>
Current assets			
Cash .....	<b>\$ 28,191</b>	\$109,750	
Term deposits .....	<b>61,000</b>	96,500	
Due on disposal of oil and gas properties .....	<b>—</b>	60,000	
Accounts receivable .....	<b>78,736</b>	30,078	
Loan to a director of the company (note 2) .....	<b>2,000</b>	2,000	
	<b><u>169,927</u></b>	<u>298,328</u>	
Property and equipment (note 3) .....	<b><u>1,274,559</u></b>	<u>604,267</u>	
Other assets			
Loan to a director of the company (note 2) .....	<b>25,385</b>	27,385	
Investment in shares, at cost less amounts written off .....	<b>21,337</b>	21,337	
Drilling and exploration deposits, at cost .....	<b>7,512</b>	5,012	
	<b><u>54,234</u></b>	<u>53,734</u>	
	<b><u>\$1,498,720</u></b>	<u>\$956,329</u>	

Approved on behalf of the Board,

 , Director

 , Director

The accompanying notes are an integral part of these consolidated financial statements

## LIABILITIES

	<u>1978</u>	<u>1977</u>
Current liabilities		
Bank demand loans (note 4) .....	<b>\$ 54,268</b>	\$ 55,500
Accounts payable and accrued liabilities .....	<b>73,835</b>	103,211
Funds advanced by joint venture participants .....	—	89,382
Income taxes payable .....	<b>69,723</b>	961
	<u><b>197,826</b></u>	<u>249,054</u>
Deferred income taxes .....	—	1,319

## SHAREHOLDERS' EQUITY

Share capital (note 5)		
Authorized		
6,000,000 shares of no par value		
Issued		
2,872,435 shares (1977 — 2,488,722 shares) .....	<b>1,446,181</b>	791,271
Deficit .....	<b>(145,287)</b>	(85,315)
	<u><b>1,300,894</b></u>	<u>705,956</u>
	<u><b>\$1,498,720</b></u>	<u>\$956,329</u>

# RIO ALTO EXPLORATION LTD.

## CONSOLIDATED STATEMENT OF INCOME YEAR ENDED DECEMBER 31, 1978

	<u>1978</u>	<u>1977</u>
Income		
Oil and gas sales, net of royalties .....	<b>\$ 184,827</b>	\$177,254
Sale of mining properties .....	—	44,000
Preproduction royalties .....	<b>18,000</b>	18,000
Interest, management fees and other .....	<b>21,357</b>	7,874
	<b><u>224,184</u></b>	<u>247,128</u>
Expenses		
Production .....	<b>64,908</b>	68,846
Cost of mining properties sold .....	—	43,690
Cost of mining property abandoned .....	<b>7,631</b>	—
General and administrative .....	<b>131,294</b>	115,516
Depreciation .....	<b>11,194</b>	12,492
Depletion .....	<b>1,686</b>	3,050
	<b><u>216,713</u></b>	<u>243,594</u>
Income before income taxes and extraordinary item .....	<b>7,471</b>	3,534
Income taxes — current (recovered) .....	<b>68,762</b>	(5,791)
— deferred (recovered) .....	<b>(1,319)</b>	6,804
	<b><u>67,443</u></b>	<u>1,013</u>
Income (loss) before extraordinary item .....	<b>(59,972)</b>	2,521
Income tax reduction as a result of utilization of loss carryforwards .....	—	5,485
Net income (loss) .....	<b><u>\$ (59,972)</u></b>	<u>\$ 8,006</u>
Earnings per share		
Income (loss) before extraordinary item .....	<b>\$ (0.02)</b>	\$ —
Net income (loss) .....	<b><u>\$ (0.02)</u></b>	<u>\$ —</u>

The accompanying notes are an integral part of these consolidated financial statements

# RIO ALTO EXPLORATION LTD.

## CONSOLIDATED STATEMENT OF DEFICIT YEAR ENDED DECEMBER 31, 1978

	<u>1978</u>	<u>1977</u>
Deficit, beginning of year .....	<b>\$ 85,315</b>	\$93,321
Net income (loss) .....	<b>(59,972)</b>	8,006
Deficit, end of year .....	<b><u>\$145,287</u></b>	<b><u>\$85,315</u></b>

The accompanying notes are an integral part of these consolidated financial statements

## CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION YEAR ENDED DECEMBER 31, 1978

	<u>1978</u>	<u>1977</u>
Source of funds		
Proceeds on disposal of property and equipment .....	<b>\$ —</b>	\$142,133
Proceeds on issuance of share capital .....	<b>654,910</b>	243,678
Total source of funds .....	<b><u>654,910</u></b>	<b><u>385,811</u></b>
Use of funds		
Current operations		
Loss (net income) .....	<b>59,972</b>	(8,006)
Add (deduct) items not involving funds		
Cost of mining properties sold .....	<b>—</b>	(43,690)
Cost of mining property abandoned .....	<b>(7,631)</b>	—
Depreciation and depletion .....	<b>(12,880)</b>	(15,542)
Deferred income taxes .....	<b>1,319</b>	(6,804)
Extraordinary item .....	<b>—</b>	5,485
	<b><u>(19,192)</u></b>	<b><u>(60,551)</u></b>
Funds required (provided) by operations .....	<b>40,780</b>	(68,557)
Additions to property and equipment .....	<b>690,803</b>	424,683
Increase in other assets .....	<b>500</b>	28,431
Total use of funds .....	<b><u>732,083</u></b>	<b><u>384,557</u></b>
Increase (decrease) in working capital .....	<b>(77,173)</b>	1,254
Working capital, beginning of year .....	<b>49,274</b>	48,020
Working capital (deficiency), end of year .....	<b><u>\$ (27,899)</u></b>	<b><u>\$ 49,274</u></b>

The accompanying notes are an integral part of these consolidated financial statements

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 1978

### 1. Summary of significant accounting policies

#### (a) Principles of consolidation

The consolidated financial statements include the accounts of the company and all of its subsidiaries as follows:

Rio Alto Petroleum Ltd.  
Rio Alto (España), S.A.  
Gamma Resources Ltd.  
North American Nuclear Limited

Any excess of cost of shares in the subsidiaries over the underlying net book value at dates of acquisition have been allocated to the property and equipment accounts.

#### (b) Oil and gas operations

The company follows the full cost method of accounting for oil and gas operations wherein all costs relating to the exploration for and development of oil and gas reserves are capitalized and depleted on the unit of production method based on estimated recoverable reserves of oil and gas as determined by independent and company engineers. Proceeds on minor property sales are credited to the net book value of property and equipment without recognizing any gain or loss on disposition. Gains or losses on major property sales are recognized in the income statement.

#### (c) Joint venture accounting

A substantial portion of the company's exploration and production activities related to oil and gas, are conducted jointly with others and accordingly the accounts reflect only the company's proportionate interest in such activities.

#### (d) Mining operations

The company follows the practice of capitalizing all acquisition and exploration costs relating to mining operations on a prospect area. If a prospect area is subsequently abandoned or sold, all capitalized costs relating to the area are charged to income. Realization of the amounts represented by mining properties is dependent upon future development, since the properties are substantially unexplored or undeveloped.

#### (e) Depreciation

Depreciation of production equipment is also provided for on the unit of production method. Depreciation of sundry equipment is provided for on the declining balance method at rates varying from 20% to 30% per annum.

#### (f) Income taxes

The company follows the tax allocation method of accounting for income taxes whereby deferred taxes are provided to the extent that current taxes have been reduced by claiming capital cost allowances and exploration, development and lease acquisition costs in excess of the related depreciation and depletion provided in the financial statements.

During the year the company issued 250,000 shares for cash as outlined in note 5. By agreement, these funds were expended on exploration and development activities. For income tax purposes, these costs were renounced to the investors.

#### (g) Earnings per share

Earnings per share is based on the weighted average number of shares outstanding during the year which for 1978 was 2,751,633 (1977 — 2,258,829). The exercising of share options would not be dilutive.

### 2. Loan to a director of the company

During 1977 the company advanced \$29,385 to the director of the company by way of a non-interest bearing promissory note to enable the director to purchase capital stock of the company. The company has received \$2,000 at December 31, 1978 and the remaining amount is due as follows:

July 1, 1979	\$ 2,000
July 1, 1980	25,385
	<u>\$ 27,385</u>



3. Property and equipment

The following is a summary of property and equipment:

	1978			1977
	Cost	Accumulated Depreciation And Depletion	Net	Net
North America .....				
Oil and gas properties including exploration and development costs .....	\$ 160,300	\$ 36,799	\$ 123,501	\$ 82,025
Mining properties including exploration costs .....	1,094,955	—	1,094,955	453,035
Production equipment .....	58,050	24,094	33,956	38,416
Sundry equipment .....	44,586	22,439	22,147	24,390
Europe .....				
Mining properties .....	—	—	—	6,401
	<u>\$1,357,891</u>	<u>\$ 83,332</u>	<u>\$1,274,559</u>	<u>\$604,267</u>

4. Bank demand loans

The bank demand loans are secured by an undertaking to assign certain oil and gas properties and the production proceeds therefrom.

5. Share capital

(a) During the year the company increased its authorized share capital from 3,000,000 shares of no par value to 6,000,000 shares of no par value.

(b) During 1978 the company issued 383,713 additional shares for \$654,910 as follows:

	1978		1977	
	Number of Shares	Amount	Number of Shares	Amount
Exercise of employee share options .....	21,100	\$ 31,650	90,000	\$ 31,500
Exercise of other share option .....	70,000	52,500	—	—
Shares issued for cash .....	250,000	495,760	—	—
Exercise of share purchase warrants, net of issuance costs .....	—	—	414,787	212,178
Shares issued as consideration for mining properties .....	42,613	75,000	—	—
	<u>383,713</u>	<u>654,910</u>	<u>504,787</u>	<u>243,678</u>
Shares issued pursuant to 1976 subscription contract .....	—	—	20,000	10,000
	<u>383,713</u>	<u>\$654,910</u>	<u>524,787</u>	<u>\$253,678</u>

(c) At December 31, 1978, 70,000 shares reserved for options granted in 1976 as partial consideration for the acquisition of mining properties. The options are exercisable as follows:

Exercise Date	Option Price Per Share
To September 1, 1979	\$ 0.80
To September 1, 1980	\$ 0.85
To September 1, 1981	\$ 0.90

# RIO ALTO EXPLORATION LTD.

(d) At December 31, 1978, 6,900 shares were reserved for options granted during the year. The options are exercisable at a price of \$1.50 per share until February 16, 1980.

6. Limited partnership and contingent liability

Gamma Resources Ltd. (Gamma), a subsidiary of the company, is the sole general partner of Rio Alto Drilling Fund (1976), a limited partnership formed pursuant to the laws of the Province of Alberta, for the purpose of developing oil and gas properties. The limited partnership agreement provides that Gamma is required to pay 10% of all tangible equipment costs of all wells drilled by the partnership. Operating income, operating expenses and proceeds from the sale of properties will be prorated 90% to the limited partners, and 10% to Gamma until payout of the costs of the limited partners. After payout the proration will be 75% and 25% respectively.

Gamma has guaranteed the bank indebtedness of the limited partners in the amount of \$284,000. This bank indebtedness of the limited partners is also secured by the oil and gas properties of the limited partnership and revenue from production.

An officer and director of the company is a limited partner of Rio Alto Drilling Fund (1976) and as outlined above, Gamma has guaranteed bank indebtedness of this limited partner in the amount of \$25,000.

7. Remuneration of senior officers and directors

The total remunerations paid to directors and officers of the company amounted to \$33,502.

8. Reclassification of prior year's amounts.

Certain figures for 1977 have been reclassified to conform with the presentation of the current year. This includes an investment in an incorporated joint venture of \$59,000 at December 31, 1977 which has been reclassified as property and equipment to conform with the proportionate consolidation of this investment at December 31, 1978.



