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1981

OMEGA HYDROCARBONS LTD.

ANNUAL REPORT 1981

OMEGA
HYDROCARBONS LTD.

Contents

Directors

T. Jack Hall, Calgary
D. S. Morgan, Calgary
D. M. Mawdsley, Calgary
D. E. Hall, Calgary

Officers

President — T. Jack Hall
Vice President Exploration — John Henderson
Secretary-Treasurer — Bonnie C. Hall

Head Office

Suite 630, 330 - 5th Avenue S.W.
Calgary, Alberta T2P 0L4

Auditors

Thorne Riddell
Chartered Accountants
1200 Bow Valley Square 2
205 - 5th Avenue S.W.
Calgary, Alberta T2P 2W4

Registrar

The Canada Trust Company
505 - 3rd Street S.W.
Calgary, Alberta T2P 3E6

Transfer Agents

The Canada Trust Company
505 - 3rd Street S.W.
Calgary, Alberta T2P 3E6

Solicitors

Howard, Mackie
3rd Floor, One Calgary Place
330 - 5th Avenue S.W.
Calgary, Alberta T2P 0L4

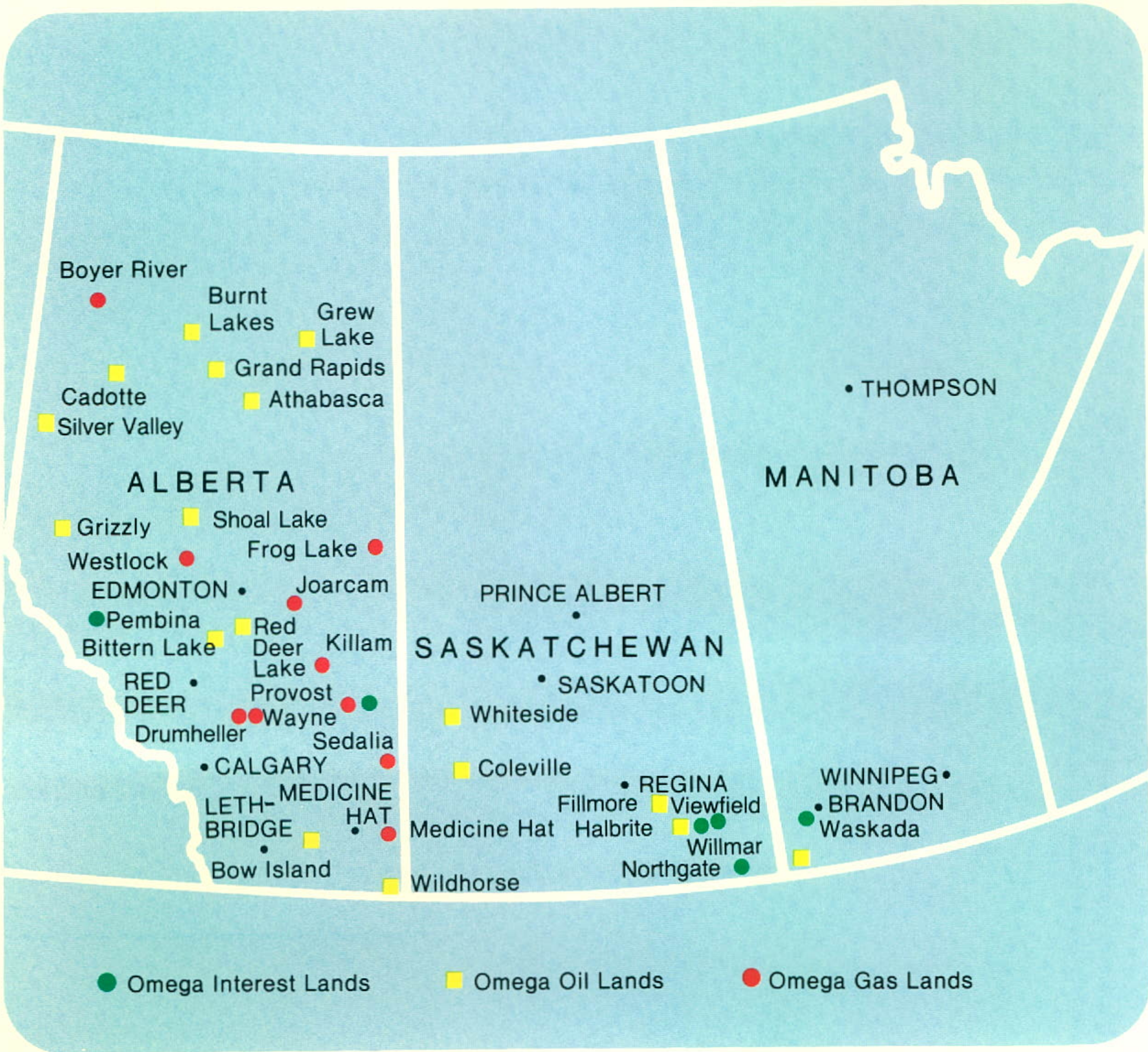
Main Bankers

Toronto Dominion Bank
2 Calgary Place
340 - 5th Avenue S.W.
Calgary, Alberta T2P 2P6

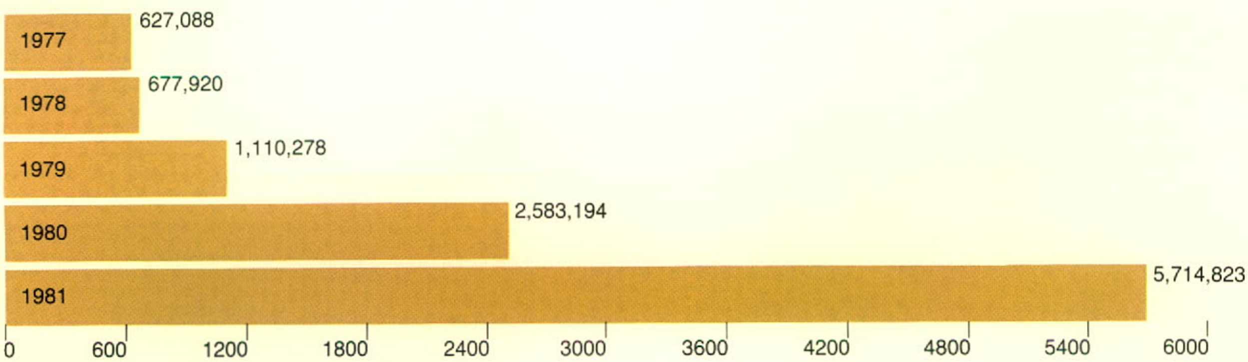
Annual General Meeting

The Annual General Meeting of the shareholders of Omega Hydrocarbons Ltd. will be held at the Westin Hotel (Britannia Room) at 4th Avenue and 3rd Street S.W., Calgary, Alberta on Thursday, the 27th day of May, 1982 at 3:30 p.m. (local time).

Highlights



Revenue Sales



To Our Shareholders:

T. Jack Hall, President

John Henderson, Vice President Exploration

On behalf of Omega Hydrocarbons Ltd.'s Board of Directors, I am pleased to report that the 1981 year was an exceptional one for the Company, particularly in view of the severe cross currents that characterized the general economic environment. Omega's achievements again demonstrate its ability to locate and develop new sources of energy while at the same time show record earnings, cash flow and a satisfactory return on shareholders' equity. This performance will continue throughout the present and subsequent years. All items (Revenue, Cash Flow, Earnings before and after provision for taxes and Expenditures) shown in the consolidated statements are summarized as follows:

— Capital expenditures $11.2 million, up from $8.4 million

— Net revenue of $5.7 million, up 121% from $2.6 million

— Cash flow $2.8 million (63¢/share), up 55% from $1.8 million

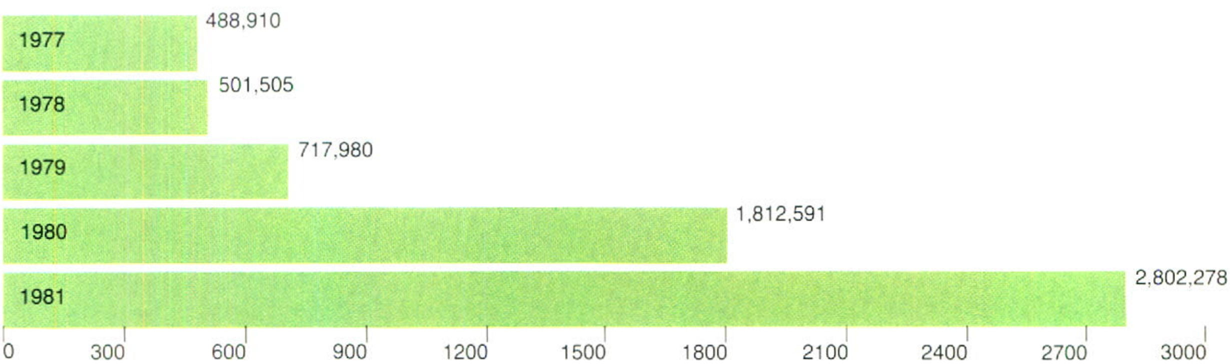
— Net earnings before taxes $2.0 million (44¢/share), up from $1.4 million

— Net earnings after provisions for taxes $1.04 million (23¢/share), up 14% from $912 thousand.

— Estimated Petroleum Incentive Payments (PIP) receivable for the year amount to $1.2 million.

The major improvement in the Company's performance during the year was the expansion of the West Provost oil pool and the discovery and subsequent development of the Waskada Spearfish and Mississippian oil producing horizons at Waskada, Manitoba. Unquestionably, the Waskada find has already proven to be a very

Cash Flow



significant source of oil and future net revenue. It is situated on 6,700 acres of one hundred percent owned land along with two farm-in blocks amounting to a 50% interest in 3,200 acres. The Company's net proven and probable reserves of petroleum and natural gas as estimated by D & S Consultants (1974) Ltd. as at March 1, 1982 are 9.3 million barrels and 36.8 billion cubic feet respectively. This represents an increase in oil reserves of 173% over 3.4 million barrels of crude oil one year ago. The reduction in gas reserves results from a re-evaluation of the performance at Boyer, Alberta. The net asset value of proven and probable reserves discounted at 15% adding the value of land holdings ($65/acre) and deducting bank debt is estimated to be 152.7 million dollars or $32.72 per share as compared to the value of $14.61 per share in 1980.

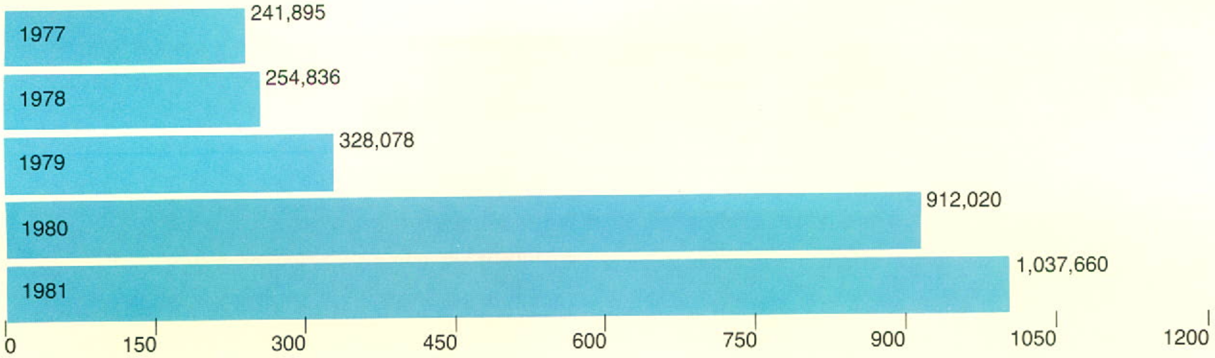
Omega had an extremely active and successful year in drilling performance. The Company participated in a total of forty-five wells, most of which were development wells at West Provost, Alberta and Waskada, Manitoba. Eleven gross wells were drilled and completed as oil producers at West Provost, four of which were connected to the gathering system by year-end. Nine Mississippian oil wells and fifteen Spearfish oil wells were drilled at Waskada during the year, all of which are 100% owned by the Company with two wells subject to conversion to 50% interest after payout. Seventeen of these wells were completed and/or connected to the gathering system in 1981 before extremely severe winter conditions set in. At the time of reporting, all of the foregoing wells have been placed on production including several recently drilled 1982 wells. The total number of new wells drilled at Waskada at last count was thirty-five of which thirty-two are completed and capable of producing. All of the Mississippian wells have a similar Spearfish pay section as that of the wells completed in the Spearfish zone. Numerous offset locations and newly selected stepout locations will be drilled in 1982.

Although a large number of land parcels purchased in previous years are approaching lease expiry date, Omega has been vigorously pursuing a program to replace its land inventory. Most of the new acquisitions made during 1981 are located in the oil prone areas of southeast Saskatchewan and southwest Manitoba. This new emphasis on oil exploration results from the new energy agreements between the provinces and the federal government. New oil reference prices (NORP) provide for a substantial net-back over those for natural gas or old oil.

Land acquisitions have encompassed a large area of North Dakota trending along the same geological features as those found in southwest Manitoba. Your Company has obtained a 50% interest in a partnership agreement with a large Canadian independent firm covering net holdings of some 5,000 acres. Firm plans have yet to be formulated for drilling these prospective lands in the United States.

The directors are particularly pleased to announce the appointment of Mr. George Patey as Production Manager who will become Vice President of Production following the Annual General Meeting. Mr. Patey will report to President Jack Hall and will be responsible for all phases of the Company's drilling and production activities.

Net Earnings



Omega is also pleased to announce the employment of Edward Wyse in the capacity of Petroleum Engineer. He is responsible for initiating and developing many of the Company's engineering projects.

Donald Mawdsley, who has served as a director for the past two years has requested, due to increasing demands from his own business affairs, that he not stand for re-election to the Board of Directors. His valuable contribution to the Board has been appreciated and he will be difficult to replace.

The outlook for the current and future years remains very encouraging, based on Omega's strategic position as a supplier of petroleum and natural gas in the western provinces of Canada. The Company's fundamental strengths represented by its valuable land holdings, financial resources, reserves of oil and gas and experienced management comprise the vital elements for further appreciation of assets, while at the same time enjoying a most favorable growth in net income and cash flow.

Several months have transpired since the proposed Oakwood Petroleums Ltd. stock exchange takeover offer made to all shareholders of Omega Hydrocarbons Ltd. and it now seems appropriate that management repeat its expression of appreciation for the loyal support of its shareholders, particularly in view of management's assessment of the Waskada discovery which has already proven to be more significant in terms of future net value than originally estimated.

The efforts and dedication of the Company's excellent staff in Calgary and in its many field operations have played a vital role in the growth of the Company and for this, management and the directors wish to express their utmost appreciation.

On behalf of the Board

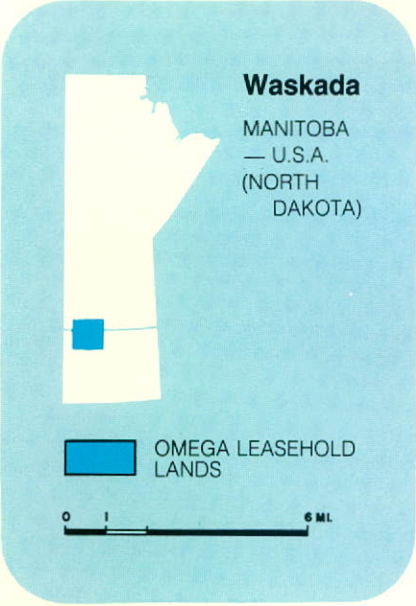
T. J. Hall
President

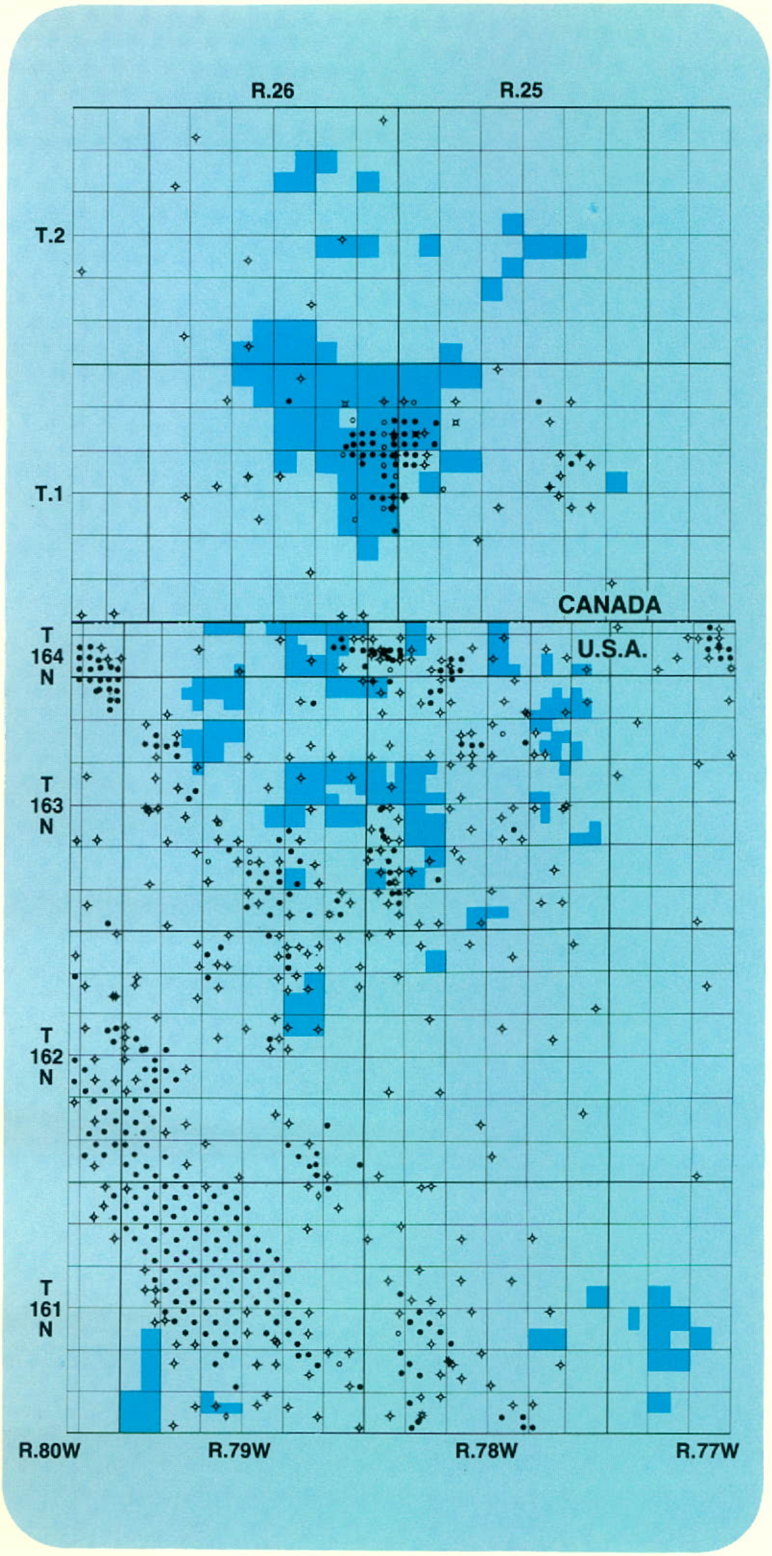
April 15, 1982

Left: Bonnie Hall, Secretary - Treasurer
Right: Doug McMillan, Management Consultant

Left: Rhonda Watkins, Accounting
Centre: Bernie Soubolsky, Production Accounting
Right: Gwyneth Sillett, Accounting Clerk

Review of Holdings



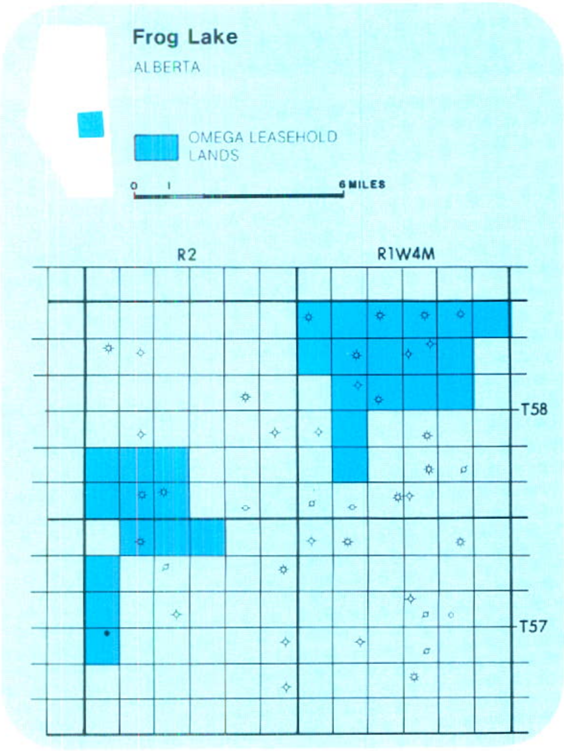


Drilling Rig at Omega Waskada 6-26-1-26

Waskada, Manitoba

Omega's land holdings in the Waskada area have improved over the last year as a result of new developments. Twenty-two new wholly-owned oil wells and two fifty percent earning wells were drilled in 1981 and that number has been enhanced by wells drilled subsequent to year-end. The Company has encountered a very interesting and extremely significant oil development amounting to two separate horizons. There have been nine Mississippian wells drilled and placed on production and all others, including the Mississippian wells, contain a significant section of Spearfish sand. The first well was drilled as a Mississippian well in January of 1981 and the follow-up program was initiated in June of 1981. A number of completion problems which are typical to this kind of development were responsible for delays in placing wells on production late in the year. Following that, old man winter struck with a vengeance and although drilling continued throughout, two full months into 1982 were lost due to freezing and stormy weather. Most of that inclement weather is now behind us and completions are progressing favorably. As our previous objective of 1,000 b/d has been achieved, with further completions following as time permits, hopefully we will see 2,000 b/d before mid-year. This project is attracting the full attention of the entire staff as it entails receipts of full NORP price ($45.00/bbl) for all wells drilled since January, 1981. Omega is indeed very fortunate to have discovered oil in a province which is not yet self-sufficient in oil production. Demands for Omega's sweet light Waskada crude has in recent months precluded shut-in production which is currently prevalent in Alberta and Saskatchewan.

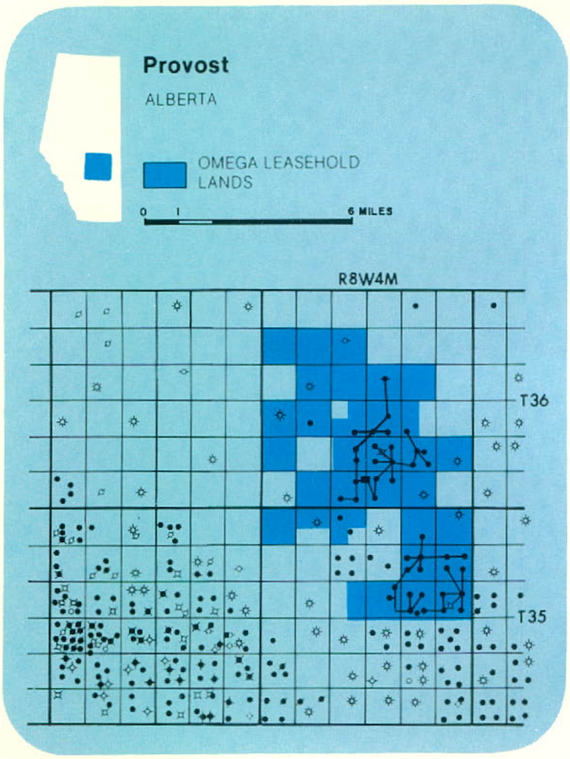
Current estimates of reserves and delivery rates have encouraged the Company to consider a sixty-mile pipeline facility from Waskada to Cromer. The convenience of pipeline operation, if constructed, will overcome reduced production during spring break-up and the consequent period of road ban.



Frog Lake, Alberta

Omega's lands consist of a 25% interest in 17,920 acres and a 50% interest in 640 acres of P. & N. G. Crown lands having nine shut-in gas wells not yet committed to market and one shut-in oil well. No further activity in this area is anticipated until gas marketing conditions improve.

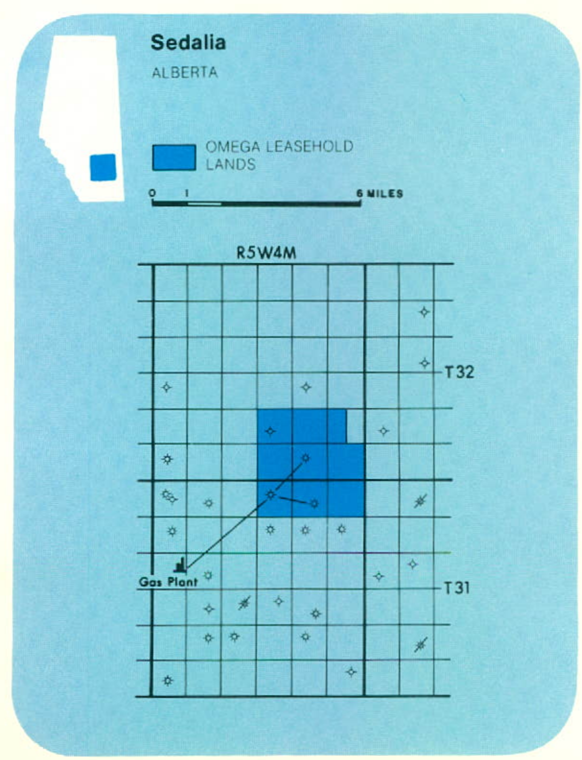
The aforementioned shut-in oil well has proven up a substantial reserve of heavy oil for which ownership is currently under dispute by the Department of Energy and Natural Resources. This issue results from the tar sands policy conflicting with company contentions that the oil is producible by conventional means and is therefore owned by the lessee. A resolution of this matter is expected promptly.

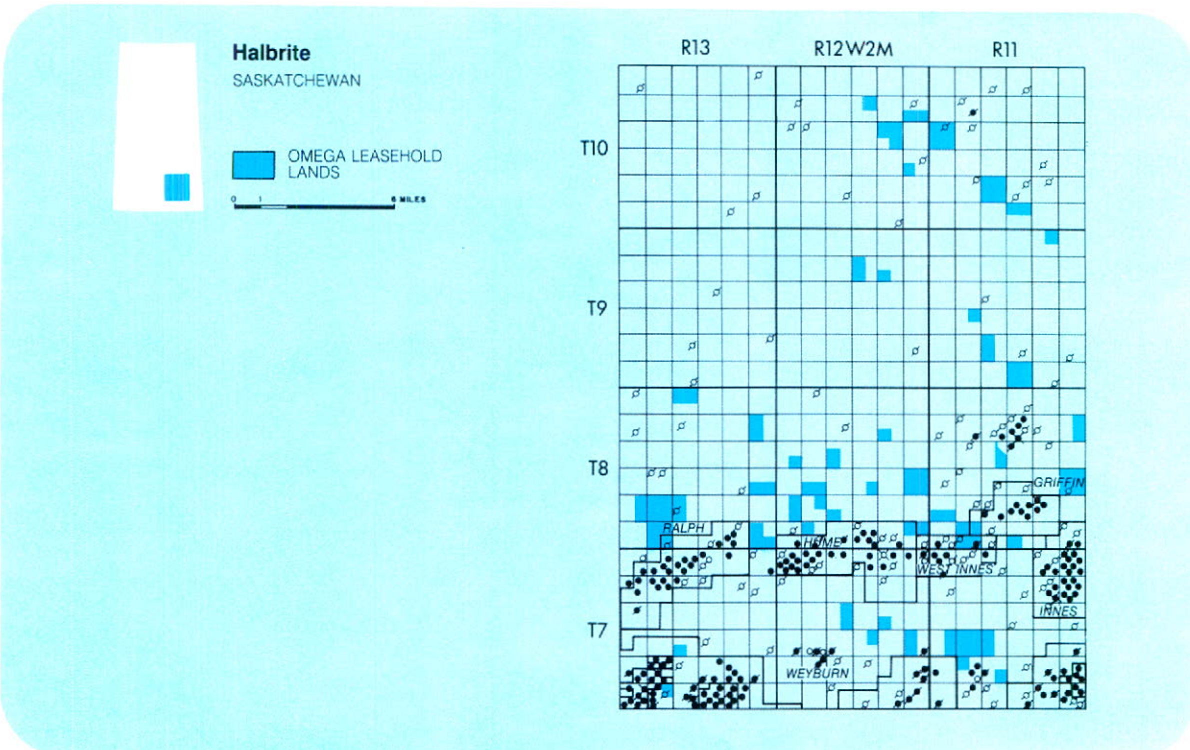


Office and Field Staff on Location at Omega et al Provost 2-24-35-8

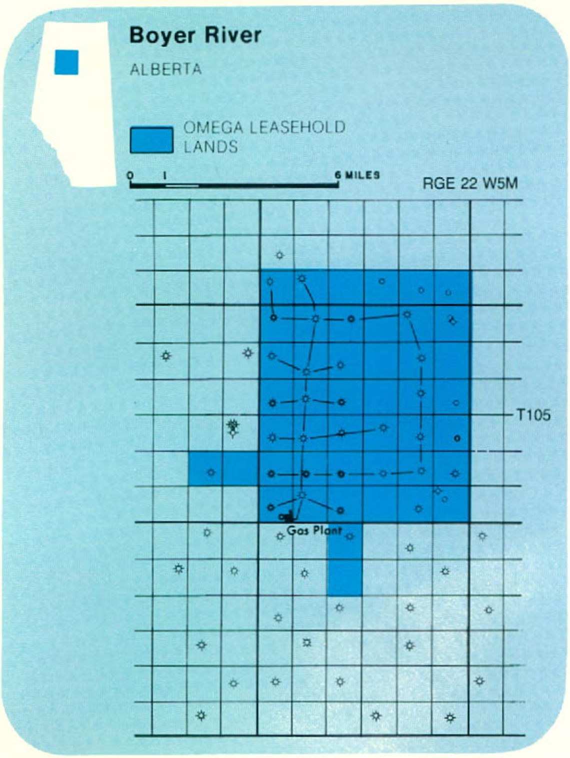
West Provost, Alberta

The Company drilled eleven additional wells in 1981, completing all wells as Viking oil producers. This brings the total number of wells to forty-nine, approximately 75% owned, of which forty-one are oil wells, four are gas wells, two are water injection wells and two are water source wells. Nine wells were connected to the gathering system before year-end while another nine wells were connected subsequent to year-end. Of the eleven new oil wells drilled in 1981, only one well qualified for NORP oil. As a result of this, an appeal has been launched to effect the other ten wells and we are hopeful that approval will be granted. On the assumption that NORP wells can be qualified, several locations can be drilled as offsets to existing producers and they are scheduled to be drilled in the second quarter of 1982. A waterflood study is now underway and its result should effect an early start on that program. Currently, oil and gas deliveries amount to approximately 600 B/D of oil and 2.3 MMcf/d of solution gas.

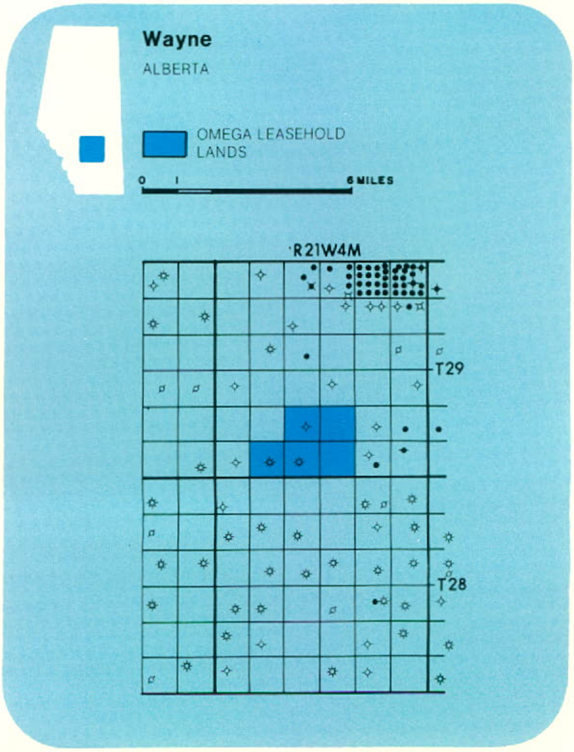




Completion Treatment at Water Injection Pilot Omega et al Provost 6-24-35-8



Producing Well at Omega et al Provost 2-25-35-8

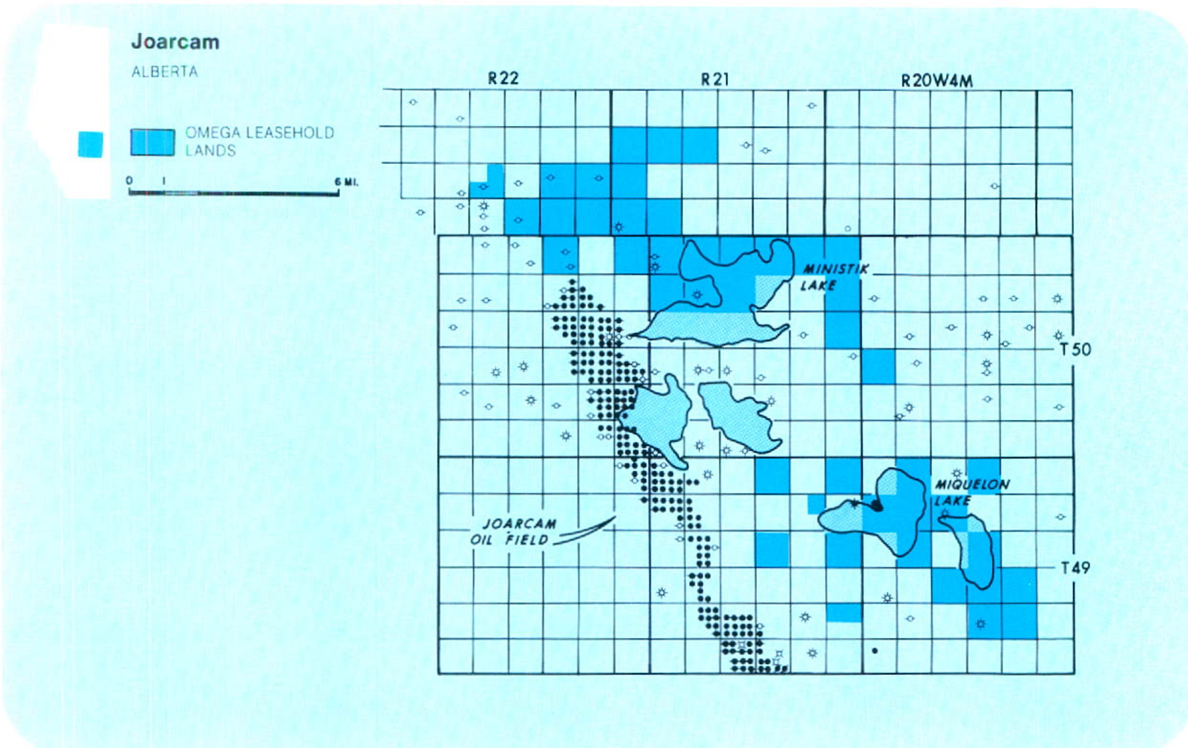


Boyer, Alberta

Boyer is currently producing at plant capacity of approximately 2.6 MMcf/d and no further plans have been made to increase production through infill drilling. Individual well performance has not lived up to earlier expectations and for that reason, D & S Consultants (1974) Ltd. has reduced gross ultimate proven and probable pool reserves to 40 BCF from earlier estimates of 60 BCF. As economic conditions in gas marketing improve, Omega will carry out its long term objective of increasing well density and compression requirements.

Wayne — Drumheller, Alberta

Omega's shut-in gas at Drumheller and Wayne is scheduled to go on stream in September of 1982 and the exact time will depend on availability of processing facilities and the construction schedule. The Company estimates production rates to be in the range of 3.0 MMcf/d during the peak period, declining during the summer season.



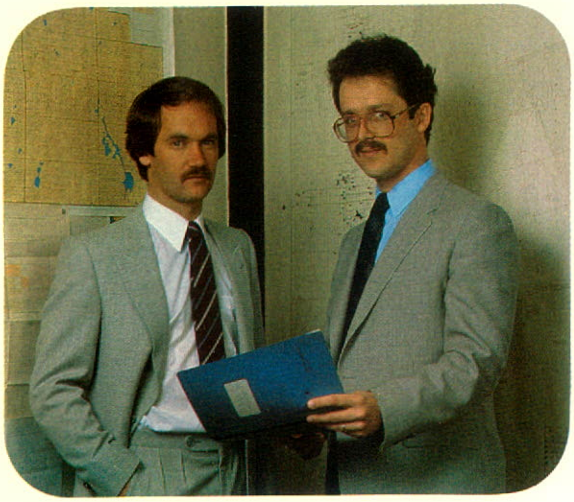
Joarcam, Alberta

Omega's interest in this property varies between 15% and 50% in 26,880 acres of Crown lands divided between the Ministik area which is non-operated and the Miquelon area which is company operated. The latter area has been committed to Kanngaz, an organization of small producers intending to market gas into the U.S. export market. Several wells have been drilled during 1981 by parties owning interests bordering company lands, thus enhancing marketability of the gas reserves owned by Omega. Although two wells were scheduled to be drilled in 1981, these wells and others have been deferred to 1982 in preparation for potential deliveries of gas in the fourth quarter of 1983. The full extent of gas reserves has not yet been determined; however, several producing zones have been tested, indicating good productivity. Company estimates of gross reserves covering the entire area are in the range of 50 BCF.

Other Areas

Omega has been actively acquiring land in areas which have a high probability for discovering new oil and to this end, has acquired a considerable spread of prime prospective land in the Williston Basin area of southeast Saskatchewan, Manitoba and North Dakota. Additional lands have been acquired in both Alberta and southwest Saskatchewan where prospects for finding new oil are attractive in today's environment. A new well location has been staked at Halbrite, Saskatchewan and drilling is expected to commence during the second quarter of 1982.

Review of Operations



Left: Dennis Hall, Operations Manager
Right: Ed Wyse, Petroleum Engineer

Production Program

A new discovery at Waskada, Manitoba was the highlight of the year's drilling and development program. Company production revenue increased by 143% to $5.5 million from $2.2 million of the previous year. Eleven new oil wells were drilled at Provost, four of which along with five others were connected to the gathering system at year-end, increasing both oil and gas sales substantially. The new discovery at Waskada resulted in a total of twenty-four wells being drilled in 1981. All but one were drilled during the second half of the year. Production from these wells was adversely affected by abnormally cold weather, the consequence of which contributed only marginally to third and fourth quarter earnings. Subsequent to year-end, several wells have been drilled and completed, showing a marked improvement in oil sales. Gas sales from Boyer and Sedalia were limited by freezing conditions in the gathering system over a two-month period in the first quarter of 1981, whereas solution gas at Provost was unaffected.

The September 1, 1981 Accord between the province of Alberta and the federal government created a two-price system for petroleum and natural gas production. Omega is fortunate to be in the position to take full advantage of new oil developments at Provost and Waskada, thus benefiting from the new pricing provisions. This, along with newly developed prospects to be drilled in 1982 should add to Omega's already escalating revenue, earnings and cash flow.

Drilling Activity

Omega participated in the drilling of forty-five wells during 1981 of which forty-two were successful. Thirty-six wells were completed as oil wells of which twenty-five wells have been approved as NORP (New oil reference price) wells. Ten wells drilled at Provost should have qualified initially as NORP oil wells, however, they are currently subject to an appeal. Approval of these wells including the adjoining lands will provide substantial incentive towards initiating the 1982 drilling program where ten to fifteen offset locations could be drilled with minimum risk. The drilling program already well advanced at Waskada will continue throughout most of 1982 and possibly well into 1983.

Omega's high success ratio of completions as compared to wells drilled resulted from the development drilling programs at West Provost and Waskada and we see that trend continuing throughout 1982.

Wells Drilled During the Year Ended:

	December 31, 1981		**December 31, 1980**	
	Gross Wells	**Net Wells**	**Gross Wells**	**Net Wells**
Gas	**6**	**1.0**	30	17.6
Oil	**36**	**32.9**	15	10.7
Waterflood	**0**	**0**	4	2.7
Dry and Abandoned	**3**	**1.2**	2	0.6
TOTAL	**45**	**35.1**	51	31.6

Left: Sharon Van Middlesworth, Land Administration
Right: Daphne Colquhoun, Secretarial

Exploration Activity

The year 1981 was unquestionably the most successful one in the Company's twenty-four year history as a result of the discovery of the Lower Alida oil section of the Mississippian horizon complemented by the development of the Spearfish oil sand of the Jurassic age of an earlier discovery in 1980. The discovery well is located in Lsd. 1-25-1-26W1M at Waskada, Manitoba. This find prompted a drilling program which to date has proven up approximately ten sections of land, most of which is owned or controlled by Omega. Further development drilling to be carried out in 1982 and possibly 1983 will be required to fully delineate the field.

The light gravity oil discovered at Joarcam, Alberta in 1980 and completed in 1981 was found to have a limited reservoir similar to that of a single well pool and offers less favourable prospects than originally anticipated for further exploration of crude oil.

Three gas wells, one heavy gravity crude oil well and one dry hole were drilled at Frog Lake, Alberta during the year, resulting in a substantial improvement in the already established gas reserves along with an important discovery of heavy gravity crude oil which is presently awaiting ruling of the oil sands policy of the provincial government.

Land Holdings

Land acquisitions during the year and extending into the first quarter of 1982 were concentrated in the oil prone areas of southeast Saskatchewan and southwest Manitoba. This increased emphasis on land holdings is consistent with management's policy of taking full advantage of the agreements reached between Alberta, the other producing provinces and the federal government. Land holdings as at March 19, 1982 are shown in the accompanying table:

Reserves of Oil and Gas

The successful drilling program at West Provost and Waskada generated a substantial increase in crude oil reserves whereas a re-evaluation of the performance at Boyer resulted in a reduction of gas reserves. Omega's net reserves of proven and probable crude oil as of March 1, 1982 is estimated by the Company's consultants to be 9.3 million barrels, an increase of 173% from 3.4 million barrels of the previous year. Net proven and probable reserves of natural gas are estimated to be 36.8 BCF, down 14% from 42.8 BCF of one year ago.

Company estimates of proven, probable and

Land Holdings (acres) as at:

	March 19, 1982		February 26, 1981	
	Gross	**Net**	**Gross**	**Net**
Alberta	**197,435**	**131,725**	208,227	135,841
Manitoba	**17,107**	**14,319**	14,108	12,228
Saskatchewan	**24,828**	**20,628**	4,315	3,116
North Dakota, U.S.A.	**28,000**	**5,000**	—	—
TOTAL	**267,370**	**171,672**	226,650	151,185

potential crude oil reserves at Waskada are in the range of 20 million barrels as compared to the consultants estimates indicated above. The difference in these figures is mainly attributable to the use of a higher recovery factor, more undrilled acreage and a greater assessment of net pay in the Spearfish zone.

The current evaluation of the Company's holdings has shown a dramatic improvement over the previous year. The present value using a 15% discount factor is $153.7 as compared to $56.6 million, amounting to a 171% increase in value. Using the same discount value, adding the value of land holdings (assuming a value of $65/acre) and deducting the Company's bank debt of $12.1 million results in a net present worth value before tax of $152.7 million. Additional development drilling proposed for 1982 at both West Provost and Waskada will result in a further increase in crude oil reserves and net worth of the Company.

Petroleum and Natural Gas Reserves as at March 1, 1982

	Gross Reserves		Net Reserves	
	Petroleum (bbls)	Natural Gas (MMcf)	Petroleum (bbls)	Natural Gas (MMcf)
Proven Remaining Reserves	5,781,526	38,898	4,300,747	30,654
Probable Additional Reserves	6,472,032	8,825	5,022,687	6,170
Total Proven and Probable Additional Reserves	12,253,558	47,723	9,323,434	36,824

Present Worth of Future Oil and Gas Net Production Revenue Discounted at:

	0%	12%	15%	20%
		($000)		
Proven Remaining Reserves	385,784	120,397	101,347	79,898
Probable Additional Reserves	467,713	68,487	52,317	35,795
Total Proven and Probable Additional Reserves	853,497	188,884	153,664	115,693

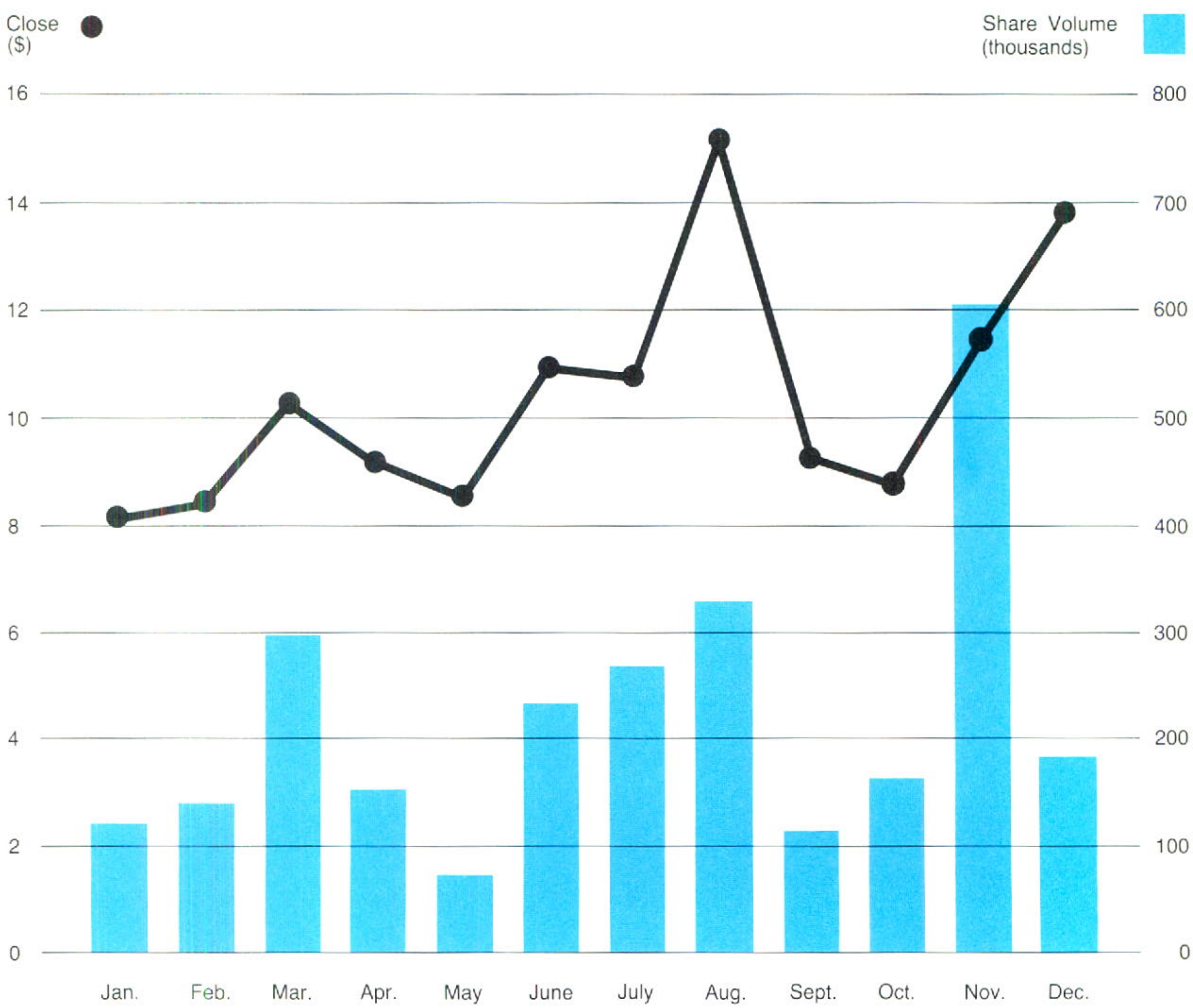
Capital Expenditures

	1977	1978	1979	1980	1981
Land and Acquisitions	$ 175,542	$ 202,030	$ 700,606	$ 410,330	**$ 3,986,490**
Drilling and Exploration	$ 217,915	$ 766,515	$2,254,865	$4,358,544	**$ 4,151,348**
Production Equipment	$ 148,507	$ 153,650	$1,090,811	$3,629,565	**$ 3,048,872**
TOTAL	$ 541,964	$1,122,195	$4,046,282	$8,398,439	**$11,186,710**

Capital Market Review

Toronto Stock Exchange Trading Summary for 1981

Month of 1981	High	Low	Close	Volume
January	9¼	7¾	8⅛	119,640
February	8⅞	7¾	8⅜	135,335
March	10⅝	8⅜	10¼	296,749
April	10½	9⅛	9⅛	150,859
May	9¾	8¼	8½	72,120
June	11	8	10⅞	230,560
July	12	10¼	10¾	267,185
August	16	10¼	15⅛	328,992
September	15½	8	9¼	111,591
October	11¼	8¼	8¾	160,344
November	12⅜	8⅝	11½	604,533
December	13¾	11¼	13¾	186,139
Total for Year	**16**	**7¾**	**13¾**	**2,664,047**



OMEGA HYDROCARBONS LTD.

Consolidated Balance Sheet

as at December 31, 1981

	1981	1980
ASSETS		
CURRENT ASSETS		
Accounts receivable	$ 1,323,064	$ 1,175,677
Due from affiliated partnerships	25,520	985,303
Income taxes recoverable	316,372	162,266
Petroleum incentive payments receivable	1,228,078	—
Current portion of notes receivable (note 3)	343,836	183,166
	3,236,870	2,506,412
NOTES RECEIVABLE (note 3)	2,705,998	905,834
FIXED ASSETS (note 4)		
Petroleum and gas properties and equipment	26,171,382	14,984,672
Accumulated depletion and depreciation	(2,164,826)	(1,218,208)
	24,006,556	13,766,464
OTHER ASSETS	135,097	24,512
	$30,084,521	$17,203,222
LIABILITIES		
CURRENT LIABILITIES		
Bank indebtedness	$ 97,540	$ 364,096
Accounts payable and accrued liabilities	3,126,452	1,460,688
Petroleum and gas revenue tax payable	318,480	—
	3,542,472	1,824,784
BANK PRODUCTION LOANS (note 5)	9,703,333	4,950,000
DEFERRED GAS REVENUE	348,643	263,027
DEFERRED INCOME TAXES	1,581,600	763,600
SHAREHOLDERS' EQUITY		
CAPITAL STOCK (note 6)		
Authorized		
10,000,000 Preferred shares with a par value of $10 each		
20,000,000 Common shares of no par value		
Issued		
4,666,026 Common shares	13,433,510	8,906,016
RETAINED EARNINGS	1,533,455	495,795
	14,966,965	9,401,811
SHARES ACQUIRED (note 6)		
5,000 Common shares, at cost	(58,492)	—
	14,908,473	9,401,811
	$30,084,521	$17,203,222

Approved by the Board

Director

Director

OMEGA HYDROCARBONS LTD.

Consolidated Statement of Earnings and Retained Earnings

Year Ended December 31, 1981

	1981	1980
REVENUE		
Oil and gas sales, net of royalties	$5,461,620	$2,243,717
Other oil and gas operations	237,203	222,658
Interest	16,000	116,819
	5,714,823	2,583,194
EXPENSES		
Production	1,051,626	453,962
General and administrative	325,632	235,018
Interest on bank production loans	1,415,760	246,798
Depletion and depreciation	946,618	287,071
	3,739,636	1,222,849
Earnings before taxes	1,975,187	1,360,345
TAXES		
Petroleum and gas revenue tax	431,527	—
Alberta Royalty Tax Credit	(312,000)	(165,175)
Deferred income taxes	818,000	613,500
	937,527	448,325
NET EARNINGS	1,037,660	912,020
Retained earnings (deficit) at beginning of year	495,795	(416,225)
RETAINED EARNINGS AT END OF YEAR	$1,533,455	$ 495,795
NET EARNINGS PER COMMON SHARE, based on weighted average number of shares outstanding	$.23	$.22

Consolidated Statement of Changes in Financial Position

Year Ended December 31, 1981

	1981	1980
WORKING CAPITAL DERIVED FROM		
Operations		
Net earnings	$ 1,037,660	$ 912,020
Items not involving working capital		
Depletion and depreciation	946,618	287,071
Deferred income taxes	818,000	613,500
	2,802,278	1,812,591
Bank production loans	4,360,000	4,950,000
Deferred gas revenue	85,616	159,633
Issue of common shares	4,527,494	480,000
	11,775,388	7,402,224
WORKING CAPITAL APPLIED TO		
Acquisition of limited partnership (note 2)	2,327,494	—
Add working capital deficiency assumed	818,221	—
	3,145,715	—
Notes receivable	1,800,164	296,834
Fixed assets	7,647,662	8,394,663
Purchase of common shares	58,492	—
Other assets	110,585	—
	12,762,618	8,691,497
DECREASE IN WORKING CAPITAL POSITION	(987,230)	(1,289,273)
Working capital at beginning of year	681,628	1,970,901
WORKING CAPITAL (DEFICIENCY) AT END OF YEAR	$ (305,602)	$ 681,628

Auditors' Report

To the Shareholders of
Omega Hydrocarbons Ltd.

We have examined the consolidated balance sheet of Omega Hydrocarbons Ltd. as at December 31, 1981 and the consolidated statements of earnings and retained earnings 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, these consolidated financial statements present fairly the financial position of the company as at December 31, 1981 and the results of its operations and the 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.

Thorne Riddell & Co.

Chartered Accountants

Calgary, Canada
April 2, 1982

OMEGA HYDROCARBONS LTD.

Notes to Consolidated Financial Statements

Year Ended December 31, 1981

1. ACCOUNTING POLICIES

(a) Principles of Consolidation

The consolidated financial statements include the accounts of Omega Hydrocarbons Ltd. (the "Company") and its wholly-owned subsidiary, Omega Oil & Gas Ltd.

(b) Oil and Gas Operations

The Company follows the full cost method of accounting for its oil and gas operations whereby all costs of exploring for and developing oil and gas reserves, including production equipment costs, are capitalized by cost centre. A separate cost centre is established for Canada and the United States. Costs include land acquisition costs, geological and geophysical costs, carrying charges on non-producing property, costs of drilling both productive and non-productive wells and overhead expenditures related to exploration activities. Such costs are depleted by cost centre using the unit of production method based on estimated recoverable oil and gas reserves.

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

2. BUSINESS COMBINATION

Effective January 1, 1981 the Company acquired substantially all of the limited partnership units of Omega Oil & Gas Fund #1 (an Alberta Limited Partnership) for consideration of $2,327,494 comprised of 182,120 common shares of the Company. The limited partnership is managed by the Company and is engaged in oil and gas exploration and production activities in Alberta. This business combination has been accounted for as a purchase and the Company's interest in the results of operations of the partnership has been included in the consolidated financial statements of the Company from date of acquisition.

The net assets acquired and the purchase consideration are summarized as follows:

Petroleum and gas properties	$3,226,048
Production equipment	313,000
	3,539,048
Working capital deficiency	(818,221)
Bank production loans	(393,333)
	$2,327,494

3. NOTES RECEIVABLE

Under the terms of a share purchase plan, common shares of the Company are issued to officers and employees in consideration for notes receivable. The notes are non-interest bearing and receivable as follows: 1982 — $343,836; 1983 — $1,042,665; 1984 — $939,999; 1985 — $723,334.

4. FIXED ASSETS

	1981			1980
	Cost	Accumulated Depletion and Depreciation	Net	Net
Petroleum and gas properties including exploration, development and equipment thereon				
Canada	$25,956,583	$2,164,826	$23,791,757	$13,766,464
United States	214,799	—	214,799	—
	$26,171,382	$2,164,826	$24,006,556	$13,766,464

5. BANK PRODUCTION LOANS

The bank production loans are evidenced by demand promissory notes, bear interest at ½% above the bank's prime lending rate and are secured by the Company's interest in certain oil and gas properties and a general assignment of accounts receivable. The loans are repayable out of future production proceeds and, accordingly, are not expected to require the use of existing working capital; therefore no portion of the loans has been reclassified to current liabilities.

The estimated amount of bank loan repayments for the five years subsequent to December 31, 1981 is $1,941,000 per year.

6. CAPITAL STOCK

(a) Authorized

In September 1981, the authorized share capital of the Company was amended by:

(i) the creation of 10,000,000 preferred shares with a par value of $10 each; and

(ii) an increase in the number of common shares authorized from 5,000,000 to 20,000,000 common shares.

(b) Issued

Changes in issued common shares during the two years ended December 31, 1981 were as follows:

	Number of Shares	Consideration
Balance at December 31, 1979	4,183,906	$ 8,426,016
Issued for promissory notes under share purchase plan	80,000	480,000
Balance at December 31, 1980	4,263,906	8,906,016
Issued for promissory notes under share purchase plan	220,000	2,200,000
Issued on acquisition of limited partnership (note 2)	182,120	2,327,494
Balance at December 31, 1981	4,666,026	$13,433,510

(c) Shares Acquired

Pursuant to a Notice of Intention dated November 25, 1981, the Company advised its shareholders of a program to purchase from time to time up to a maximum of 1% of its issued and outstanding common shares each month during the term of the program. The program will expire no later than November 25, 1982. During the year ended December 31, 1981, 5,000 of the issued and outstanding common shares were purchased under this program.

Subsequent to December 31, 1981 the Company purchased 106,300 common shares under this program at a cost of $1,233,229.

7. RELATED PARTY TRANSACTIONS

(a) Prior to 1981 the Company entered into a number of farmin and other similar agreements with Alberta Gas Products System Ltd. ("AGP"), a private company controlled by the president of the Company. Under these agreements, the Company acquired interests in oil and gas properties held by AGP, with AGP retaining an overriding royalty or other interest in the properties.

(b) New North Oil & Gas Ltd. ("New North"), a private company controlled by the president of the Company, participated with the Company as a joint venture partner in nine development wells in the Provost area.

(c) As at December 31, 1981 accounts receivable include $29,530 (1980 — $62,952) due from AGP and New North.

(d) The president of the Company, personally and through AGP, held units of two limited partnerships managed by the Company. During the year, the units of one limited partnership were sold to the Company on the same terms as offered to the other participants in the fund.

8. CONTINGENT LIABILITIES

Pursuant to the terms of partnership agreements, the Company is contingently liable for the payment of bank loans totalling $1,983,667 of two limited partnerships managed by the Company.

9. LEASE COMMITMENTS

Future minimum lease payments for the rental of office premises are as follows: 1982 — $64,320; 1983 — $64,320; 1984 — $48,240.

10. STATUTORY INFORMATION

Two directors of the Company received remuneration of $800 in their capacity as directors during 1981. Remuneration paid to senior officers (including the five highest paid employees) of the Company during the year amounted to $259,513.

OMEGA HYDROCARBONS LTD.
CONSOLIDATED STATEMENT OF EARNINGS

	Year Ended December 31,				
	1977	1978	1979	1980	1981
Revenue					
Oil and gas sales, net of royalties	$612,860	$487,522	$ 897,088	$2,243,717	**$5,461,620**
Interest income	14,228	29,012	91,638	116,819	**16,000**
Other oil and gas operations	—	161,386	121,552	222,658	**237,203**
	627,088	677,920	1,110,278	2,583,194	**5,714,823**
Expense					
Production	98,137	114,214	231,026	453,962	**1,051,626**
General and administrative	66,414	92,798	117,766	235,018	**325,632**
Interest and expense on long-term debt	9,542	7,973	123,938	246,798	**1,415,760**
Depletion and depreciation	71,000	77,517	170,102	287,071	**946,618**
	245,093	292,502	642,832	1,222,849	**3,739,636**
Earnings (loss) before income taxes and extraordinary items	381,995	385,418	467,446	1,360,345	**1,975,187**
Income Taxes					
Deferred	175,000	165,600	219,800	613,500	**818,000**
Alberta Royalty Tax Credit	(34,900)	(35,018)	(80,432)	(165,175)	**(312,000)**
Petroleum and gas revenue tax	—	—	—	—	**431,527**
	140,100	130,582	139,368	448,325	**937,527**
Earnings (loss) before extraordinary items	241,895	254,836	328,078	912,020	**1,037,660**
Extraordinary items					
Gain on repurchase of debentures, net of applicable income taxes	500	—	—	—	—
Recovery of deferred income taxes	175,000	13,600	—	—	—
	175,500	13,600	—	—	—
Net Earnings (Loss)	$417,395	$268,436	$ 328,078	$ 912,020	**$1,037,660**
Earnings (Loss) Per Share					
(based on weighted average number of shares outstanding)					
Earnings before extraordinary items	$.08	$.08	$.10	$.22	**$.23**
Extraordinary items	.06	.01	—	—	—
Net earnings (loss)	$.14	$.09	$.10	$.22	**$.23**

OMEGA HYDROCARBONS LTD.
CONSOLIDATED STATEMENT OF RETAINED EARNINGS (DEFICIT)

	Year Ended December 31,				
	1977	1978	1979	1980	1981
Balance at Beginning of Period	$(1,430,134)	$(1,012,739)	$(744,303)	$(416,225)	**$ 495,795**
Net earnings (loss)	417,395	268,436	328,078	912,020	**1,037,660**
Balance at End of Period	$(1,012,739)	$(744,303)	$(416,225)	$ 495,795	**$1,533,455**

OMEGA HYDROCARBONS LTD.
CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

	Year Ended December 31,				
	1977	1978	1979	1980	1981
Working Capital Derived From					
Operations					
Earnings (loss) before extraordinary items	$241,895	$ 254,836	$ 328,078	$ 912,020	**$ 1,037,660**
Items not involving working capital					
Depletion and depreciation	71,000	77,517	170,102	287,071	**946,618**
Amortization and debenture issue expenses	1,015	3,552	—	—	—
Deferred income taxes	175,000	165,600	219,800	613,500	**818,000**
	488,910	501,505	717,980	1,812,591	**2,802,278**
Bank production loan	—	300,000	—	4,950,000	**4,360,000**
Issue of common shares	85,000	117,000	6,188,355	480,000	**4,527,494**
Deferred gas revenue	—	50,447	52,947	159,633	**85,616**
	573,910	968,952	6,959,282	7,402,224	**11,775,388**
Working Capital Applied to					
Acquisition of limited partnership	—	—	—	—	**2,327,494**
Add: working capital deficiency assumed	—	—	—	—	**818,221**
	—	—	—	—	**3,145,715**
Bank Production Loan	—	—	300,000	—	—
Notes receivable	56,667	20,668	531,665	296,834	**1,800,164**
Fixed assets	545,703	1,128,281	4,050,260	8,394,663	**7,647,662**
Drilling deposits	5,000	—	—	—	—
Debentures — converted	—	43,500	—	—	—
— retired	1,500	49,500	—	—	—
Purchase of common shares	—	—	—	—	**58,492**
Other assets	—	—	—	—	**110,585**
	608,870	1,241,949	4,881,925	8,691,497	**12,762,618**
Increase (Decrease) in Working Capital	(34,960)	(272,997)	2,077,357	(1,289,273)	**(987,230)**
Working capital at beginning of period	201,501	166,541	(106,456)	1,970,901	**681,628**
Working Capital (Deficiency) at End of Period	$166,541	$ (106,456)	$1,970,901	$ 681,628	**$ (305,602)**