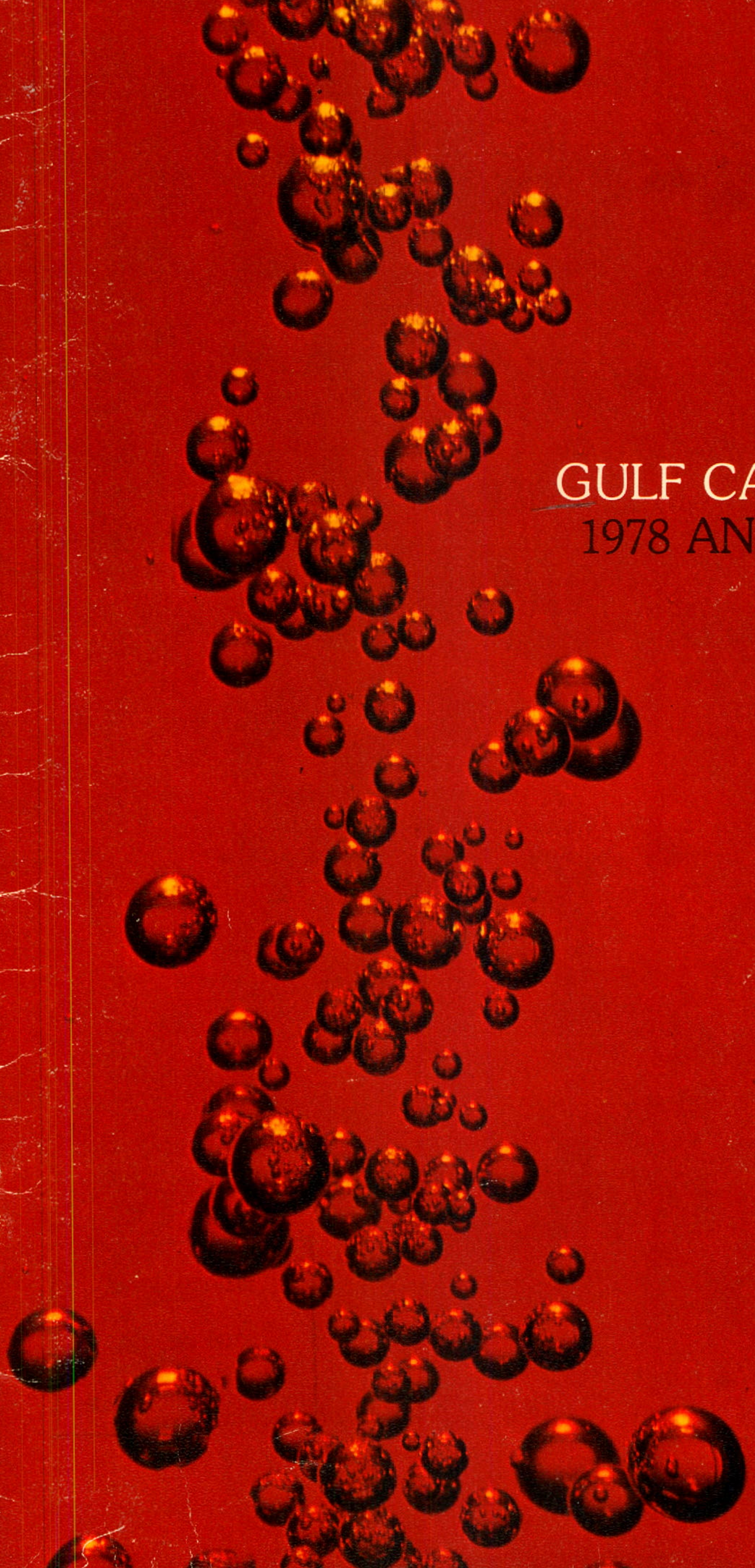


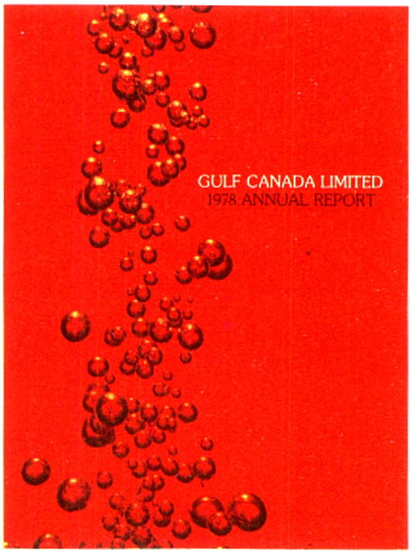
GULF CANADA LIMITED
1978 ANNUAL REPORT

Gulf Canada Limited 1978 Annual Report

Contents

Annual Meeting
The Annual Meeting of Shareholders will be held in the Concert Hall of the Royal York Hotel, Toronto, at 2:00 p.m. E.S.T., Thursday, April 26, 1979.

Disponible en français sur demande.



Front Cover
While production at Gulf Canada's new $213-million lubricating oil facility at Clarkson refinery commenced early in 1979, exhaustive testing at the Corporation's Research Centre had already confirmed the quality of the finished products. During tests to establish anti-foaming characteristics of the new motor oils, air bubbles created thousands of impressionistic patterns similar to the cover photo.

The year in brief

Financial	1978	1977
	Millions of dollars	
Earnings for the year	$ 182.9	$ 185.0
Taxes and other government revenues generated	$ 790.6	$ 793.6
Total dividends declared	$ 51.9	$ 49.2
Shareholders' equity at year-end	$1,419.0	$1,288.0
Capital expenditures	$ 369.8	$ 385.1
Working capital	$ 482.4	$ 538.4
Long-term liabilities	$ 350.1	$ 332.7
Return on average capital employed	9.8%	11.4%
Per Share Data		
Earnings for the year	$ 4.02	$ 4.07
Total dividends declared	$ 1.14	$ 1.08
Shareholders' equity at year-end	$ 31.19	$ 28.31
Operating		
	Barrels per day	
Crude and natural gas liquids produced		
— gross	112,000	115,000
— net	75,000	76,000
Crude oil processed by and for the Corporation	301,000	339,000
Petroleum products sold	269,000	286,000
	Thousands of cubic feet per day	
Natural gas produced and sold		
— gross	373,000	417,000
— net	271,000	302,000
	Pounds per day	
Petrochemical sales	2,855,000	2,542,000

Report to the shareholders

Since the enunciation in 1976 of Canada's energy strategy, government and industry have been working to achieve its goal of self-reliance. During 1978 several important events within the energy industry signalled an effective step for Canada towards increased security of supply.

Progress continued in the development and utilization of the vast reserves of the Alberta oil sands. Syncrude Canada Limited came on stream in August, 1978, and Great Canadian Oil Sands Limited announced expansion plans to increase significantly its productive capacity. These two oil sands operations alone are expected to account for ten per cent of the crude oil produced in Western Canada in 1979. Additional projects using existing and new technology could supply 50 per cent of oil demand by the year 2000, according to Gulf Canada forecasts. New undertakings are already in the proposal stage: another major oil sands mining venture in the Fort McMurray area and a heavy oil project at Cold Lake. These non-conventional oil sources will provide Canada's future energy needs and Gulf Canada intends to be an active participant in their development.

High activity levels continued for the third consecutive year in the exploration for crude oil and natural gas in the western provinces. Drilling activity showed major increases in completions and footage over gains made in 1977. Much of the action was concentrated in the West Pembina region of Alberta where exploration has only begun to penetrate the prospective deeper producing zones. Another promising exploration play is the Elmworth area which should result in the addition of substantial new natural gas reserves. As a major explorer, Gulf Canada continues to have a well-balanced program with good representation in the most prospective areas, including the frontiers. This strong position and a commitment to an aggressive exploration program should enable the Corporation to maintain its place as the second largest gas producer and third largest oil and gas liquids producer in Canada.

Uncertainty with respect to domestic oil price increases was removed at year-end with the announcement of a new federal-provincial agreement on oil and gas pricing. Over the past three to four years, as an element of the federal government's energy strategy, there has been a steady escalation in both oil and gas prices to induce conservation and the development of additional supplies. While there will be a six-month "pause" in the upward movement of energy prices in January, 1979 (in contrast to the Organization of Petroleum Exporting Countries' decision to raise world oil prices by 14.5 per cent in 1979), the long-term policy is for Canadian prices to move to world levels, but not to exceed U.S. prices at Chicago. The anticipation of a continued and stable upward price movement, along with continued legislative support to expedite heavy oil and oil sands plants, should ensure continued exploration and development activity and thus increased supplies.

During the year the industry had an opportunity to review the outlook for both oil and natural gas in hearings before the National Energy Board. Industry exploration successes, coupled with continued conservation efforts by energy consumers, have resulted in the build-up of significant volumes of shut-in oil and gas. The extra amount of oil that could be produced from wells in Western Canada is estimated at 500,000 barrels per day, while the excess supply of natural gas is placed at one billion cubic feet per day. Growth in the demand for petroleum products and natural gas — one and four per cent in 1978 respectively — has not been high enough to absorb these surpluses.

The NEB findings for oil supply and requirements reported in October reflected Canada's brighter petroleum situation since the last hearing in 1976. On the basis of higher supply and lower demand estimates, the NEB recommended that current permitted export levels for crude oil be extended for the next three years and that the throughput of the Sarnia-Montreal pipeline be increased from 250,000 to 315,000 barrels a day. As for natural gas, the general view of the industry, as reflected in Gulf Canada's submission, was that new markets were needed for the growing surplus. The NEB's February, 1979, report on natural gas supply and requirements confirmed an improved outlook and indicated that sufficient supplies exist in Western Canada until 1992 to meet all demands, including some additional exports above those currently authorized. Later in 1979 the NEB will weigh the costs and benefits of an extended natural gas transmission system, as well as a number of proposals to export. There are indications that some solution to this imbalance between supply and demand for natural gas will be found during 1979 or early 1980.

In the refined products business, low growth in demand together with about 35 per cent surplus refining capacity resulted in the continuation of extremely depressed product prices in Eastern Canada. The last six months of the year saw some price firming as refiners reduced their crude throughput and inventories but, even with this improvement, prices generally remained below the levels approved by the Anti-Inflation Board. In order to utilize surplus capacity, industry — and Gulf in particular — has been working closely with governments in both Canada and the United States to develop export markets for refined products in the New England area. If successful, refiners will be in a position to utilize their excess capacity and improve their returns.

Lower earnings from refined products and chemicals, due to the severe market competition, offset improved natural resource earnings for Gulf Canada in 1978. As a result, consolidated net earnings amounted to $182.9 million or $4.02 per share, about one per cent lower than the $185 million or $4.07 per share earned in 1977. Net revenues totalled $2,584 million, an increase of $227 million from the previous year. Details of financial and operating results appear later in this report.

Gulf Canada Resources Inc., a wholly-owned, Calgary-based subsidiary, began operations on January 1, 1979, assuming responsibility for the Corporation's resource activities.

President and Chief Executive Officer of the resource company is S. K. McWalter, formerly a Senior Vice-President of Gulf Canada. In October, 1978, Mr. McWalter had succeeded S. G. B. Pearson as a Senior Vice-President with executive responsibility for Exploration and Production following Mr. Pearson's retirement after 33 years of service. R. H. Carlyle and E. M. Lakusta, former Vice-Presidents of Gulf Canada, were appointed Senior Vice-Presidents of the new company. All three will serve on Gulf Canada Resources' five-man Board of Directors which also includes C. D. Shepard and J. L. Stoik. Approximately 1,070 Gulf Canada employees in the western provinces are employed with the resource company, which will be headquartered in the Gulf Canada Square building in Calgary when completed this fall.

Following shareholder approval at the Annual Meeting to be continued under the Canada Business Corporations Act and to raise the number of Directors from 12 to 14, J. C. Phillips, Q.C., and W. P. Wilder were elected to the Board. Shareholders also approved changing the name of the Corporation to Gulf Canada Limited and, in French, Gulf Canada Limitée.

During the year E. E. Walker was appointed a Vice-President with executive responsibility for Corporate Planning; and R. C. Beal, Vice-President of New Business Development and Chemicals, assumed executive responsibility for the Research and Development Department.

At a regular Board meeting on February 14, 1979, John D. Allan, President of the Steel Company of Canada, Limited, succeeded J. Peter Gordon as a Director following Mr. Gordon's resignation after election to the Board of Gulf Oil Corporation; and W. P. Wilder submitted his resignation as an Officer and Director to accept the presidency of The Consumers' Gas Company. Also at this meeting W. H. Burkhiser, Treasurer of Gulf Canada, was appointed a Vice-President; L.G. Dodd was appointed a Vice-President and Controller; and approval was given to reduce the number of Directors from 14 to 13.

Canada's movement toward energy self-reliance in 1978 was the result of increasing cooperation and understanding between government and industry. Gulf Canada remains committed to maintaining this spirit in 1979 and beyond in the belief that such an environment is vital for a healthy industry.

Once again we take this opportunity to acknowledge the outstanding teamwork of the men and women in our organization whose loyalty, dedication and ability enable us to look to the future with confidence.

On behalf of the Board,

C D Shepard — J L Stoik

Chairman of the Board. — President.

Toronto, Ontario, March 23, 1979.

Financial review

Earnings

Earnings for the year amounted to $182.9 million or $4.02 per share, compared with $185.0 million or $4.07 per share for 1977. Net revenues rose $227.2 million to $2,583.7 million, but the improvement was almost entirely offset by higher purchase costs and other expenses. Income and other taxes charged to income amounted to $242.0 million compared with $235.5 million in 1977. Total taxes and other payments to governments together with taxes collected from customers on their behalf are shown in Table I.

As shown below in the statement of earnings by major business segment, profits from Natural Resources increased due to higher prices for crude oil, natural gas and natural gas liquids. Earnings from the Refined Products and Chemicals operations declined due to severe market competition which prevented price increases authorized under the Anti-Inflation Program to cover higher costs and expenses from being fully realized.

Financial position

Working capital declined $56.0 million to $482.4 million at the end of 1978. While external long-term borrowings were much lower than in 1977, the funds generated from operations were not sufficient to cover capital expenditures of $369.8 million, details of which are shown in Table II, as well as debt repayments and dividends to shareholders. However, total capital and exploration expenditures decreased slightly to $485 million in 1978 from $493 million in 1977, and a planned reduction of some 13 million barrels of crude oil and refined product inventories lowered funds employed by

Financial Results by Major Business Segments

	Revenues		Net earnings after tax		Capital employed at December 31	
	1978	1977	1978	1977	1978	1977
	(millions of dollars)					
Natural resources	$ 619.1	$ 551.4	$149.9	$139.3	$ 813.5	$ 619.4
Refined products and chemicals	2,305.3	2,092.6	29.9	41.1	1,198.5	1,154.4
Investment and sundry income	27.9	31.0	16.6	16.3	110.3	131.4
Interest on long-term debt	—	—	(13.5)	(11.7)	N/A	N/A
Inter-segment transfers	(368.6)	(318.5)	—	—	N/A	N/A
	$2,583.7	$2,356.5	$182.9	$185.0	$2,122.3	$1,905.2

The above information by segment is shown as though each segment were a separate business activity and, therefore, inter-segment transfers of products are eliminated to reflect total Corporation revenues as reported in the statement of earnings.

The natural resources segment includes exploration, development and production activities related to crude oil, natural gas, natural gas liquids, oil sands and minerals. The refined products and chemicals segment includes the manufacture, distribution and sale of petroleum and chemical products, as well as the business of Gulf Canada's wholly-owned subsidiary, Superior Propane Limited

General administration and other common costs have been allocated to each of the segments on an appropriate and consistent basis and income taxes calculated in accordance with the legislation applicable to each. Interest on long-term debt has not been allocated to the business segments and is shown separately.

The components of capital employed are set out in the five-year financial summary on page 32.

about $92.0 million despite increased per unit costs. As a result cash and short-term investments declined only $20.9 million. Dividends declared during 1978 totalled $51.9 million, or $1.14 per share. Actual payments to shareholders were $1.12½ per share as the dividend for the last quarter is not paid until January 1 of the following year.

The 1978 earnings represent a rate of return of 9.8 per cent on average capital employed, compared with 11.4 per cent in 1977 and 11.9 per cent in 1976. These rates are calculated on the basis of current earnings of each year measured against capital employed, much of which has accumulated at historic costs over many years. It is obvious that earnings and rates of return must be improved if funds are to be available to finance replacement and expansion of facilities. This is particularly true in the case of companies charged with providing future sources of energy for Canada. Replacement of existing crude oil and natural gas reserves will involve extremely costly projects for the development of synthetic or heavy oil deposits and exploration and development work in remote frontier areas.

Accounting developments

As indicated in our 1977 Annual Report, the Financial Accounting Standards Board (FASB) in the United States had issued a statement which was intended to standardize accounting practices for the oil and gas exploration and production activities of the petroleum industry beginning in 1979. During 1978 the effective date of the FASB statement was deferred following the release of a series of regulations by the Securities and Exchange Commission (SEC) which permitted companies to practice a method of full cost accounting as an alternative to the successful efforts method proposed by the FASB. Gulf Canada believes it is appropriate to revise its practices in line with the successful efforts method proposed by the FASB.

The major changes will be the capitalization of development dry hole expenses, changes in the timing of the write-off of unsuccessful exploratory drilling, and changes in the methods of amortizing capitalized costs and in the method of providing impairment reserves for unproved properties.

These changes, which will be implemented effective January 1, 1979, are not expected to have a material effect on either retained earnings or net income.

The Canadian Institute of Chartered Accountants recently issued a recommendation regarding accounting for leases entered into after January 1, 1979. The recommendation would require that a lease which transfers substantially all of the benefits and risks incident to the ownership of property should be accounted for as the acquisition of an asset and the incurrence of an obligation by the lessee. The Corporation leases various assets and certain of these would qualify as capital leases. Such capitalization would have little effect on earnings and the increase in net assets and liabilities would not be material.

Table I — Taxes and Other Government Revenues

	1978	1977	1976
	(millions of dollars)		
From Gulf Canada			
Income taxes — current	$ 34.1	$ 46.5	$ 84.7
— deferred	68.1	64.2	37.6
Federal sales tax, property taxes, etc.	139.8	124.8	111.1
Petroleum and natural gas lease payments	44.0	46.4	18.2
*Crown royalties, less incentive credits	187.4	163.9	140.3
	$ 473.4	$ 445.8	$ 391.9
Collected for governments			
Gasoline, fuel, excise and export taxes	317.2	347.8	346.6
Grand total	$ 790.6	$ 793.6	$ 738.5

* Included in purchased crude oil, products and merchandise in the consolidated statement of earnings.

Table II — Expenditures on Property, Plant and Equipment

	1978	1977	1976
	(millions of dollars)		
Exploration and Production	$ 152.8	$ 121.0	$ 52.7
Syncrude project	82.3	102.6	97.4
Transportation	1.8	1.2	14.1
Refining	74.3	113.0	57.4
Petrochemicals	19.0	1.9	2.8
Marketing	28.8	34.2	31.8
Other	10.8	11.2	4.0
Total	$ 369.8	$ 385.1	$ 260.2

Natural resources

A record $350 million was invested by Gulf Canada during 1978 in the exploration for, and the production and development of petroleum resources, coal and minerals.

The Corporation's 16.75 per cent share of Syncrude costs for 1978 was $82 million. Exploration expenditures and natural resource capital expenditures, other than Syncrude, totalled $268 million, an increase of $39 million over 1977.

As shown in the financial review, 1978 after-tax earnings from natural resources were almost $150 million, $10 million higher than 1977, and accounted for 82 per cent of Gulf Canada's consolidated net earnings. The $10-million improvement reflected higher prices for crude oil and natural gas which more than offset the continuing decline in production volumes and higher operating costs.

Exploratory expenditures remained about the same as in 1977. Increased expenditures were incurred in non-conventional oil projects during 1978 to ensure improved results in future years.

Exploration

Land

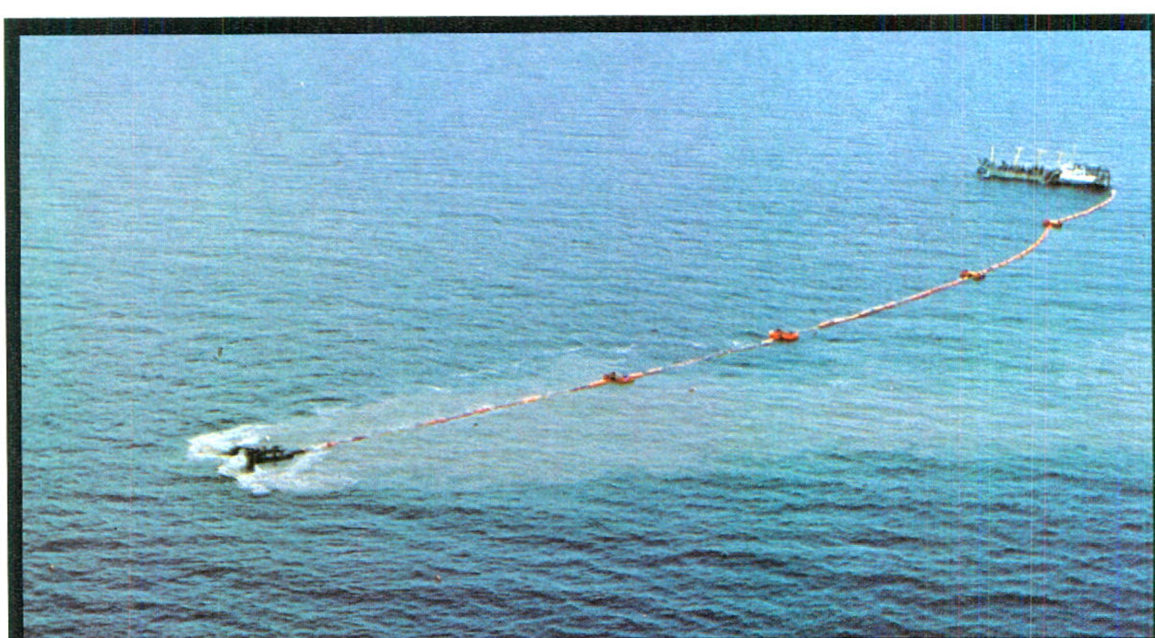
The Corporation continued to upgrade the quality of its strong land position in 1978. At year-end Gulf Canada had a 27.1 million net acre interest in 104.2 million gross acres, up two million net acres from 1977.

This land is strategically located in Western Canada's conventional oil and gas areas, frontier regions, and in oil sands, coal and prospective mineral locations.

Near year-end a one-third interest in 500,000 acres of Saskatchewan crown land in the Lloydminster conventional heavy oil area was acquired. Under an agreement which requires expenditures by the three partners of up to $99 million, Gulf Canada will earn a one-third interest in 162,500 lease acres.

Western Canada

Exploration expenditures of $103 million in Western Canada repre-



Drilling in shallow Beaufort Sea is carried out from artificial islands like the one being prepared for the Issungnak well (left). On another man-made island, drilling at the Isserk E-27 location (right) probes into the Beaufort basin.

sented nearly 70 per cent of total exploration expenses. Of this total amount, $31 million was directed to drilling in Western Canada where 53 exploratory wells resulted in 12 gas discoveries.

Although wildcat drilling was widely spread through Western Canada, about 19 per cent of the expenditures went into foothills drilling where continued successes have added to gas reserves in the Robb-Hanlan and Stolberg areas of west-central Alberta.

Acreage Position as of December 31, 1978

	Gross	Net
	(millions of acres)	
Western Canada	8.8	5.4
Northwest Territories and Delta	6.1	3.1
Beaufort Sea	3.0	1.4
Arctic Islands	30.8	5.9
Atlantic	55.5	11.3
Total	104.2	27.1

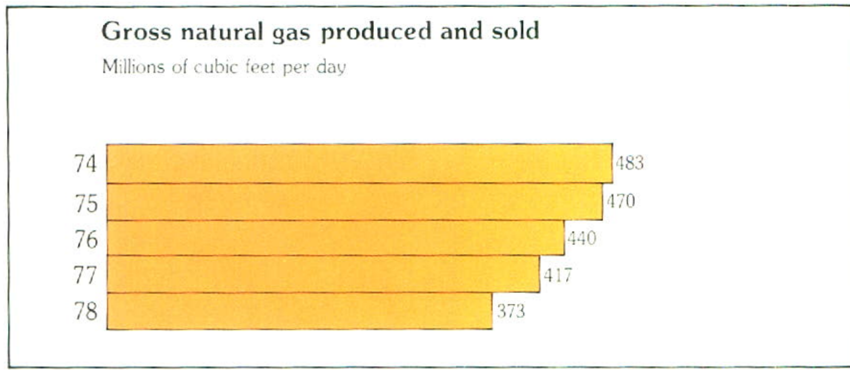
Of significant interest is the Coalspur 6-26 success which confirmed a four-mile extension of the Robb gas field. To the southeast, the Stolberg 6-5 success was an important delineation of the Stolberg gas field which is expected to go into production this year.

Gulf Canada also has a substantial acreage position in the British Columbia portion of the deep basin gas play, an area of considerable industry activity highlighted by the discovery of the Elmworth field in Alberta.

Near Magrath, in southern Alberta, a shallow farm-in well drilled by Gulf Canada resulted in a sweet gas discovery. By drilling the wildcat, the Corporation earned a 50 per cent interest in 18,000 acres.

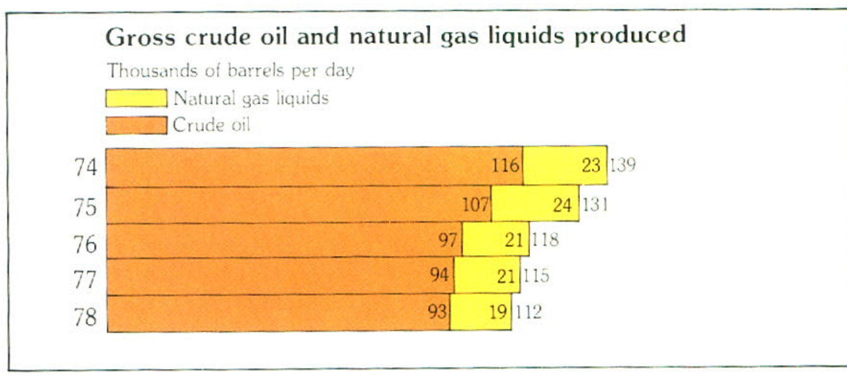
Frontier Exploration

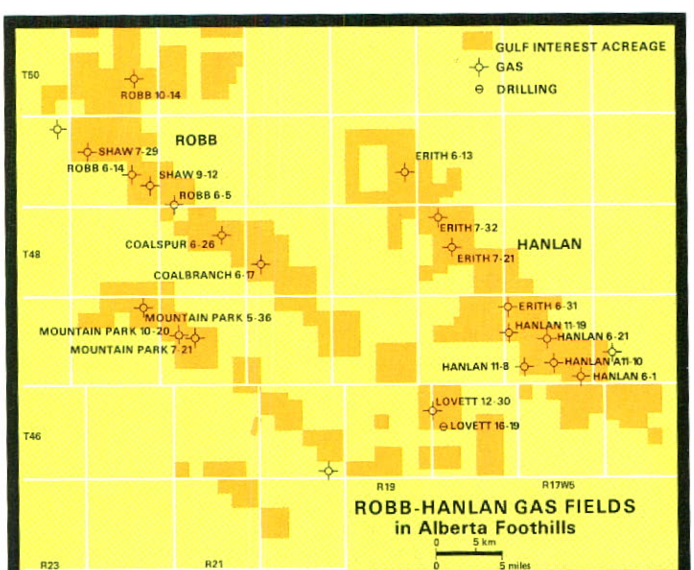
Frontier expenditures of $47 million, about 30 per cent of Gulf Canada's exploration outlay, provided participation in wildcat drilling in the Beaufort Sea, Arctic Islands and East Coast offshore. No work was conducted on the 75-per-cent-net-interest Mackenzie Delta acreage, where two trillion cubic feet of gas had been delineated by Gulf Canada prior to the federal government's decision against a Mackenzie Valley pipeline.

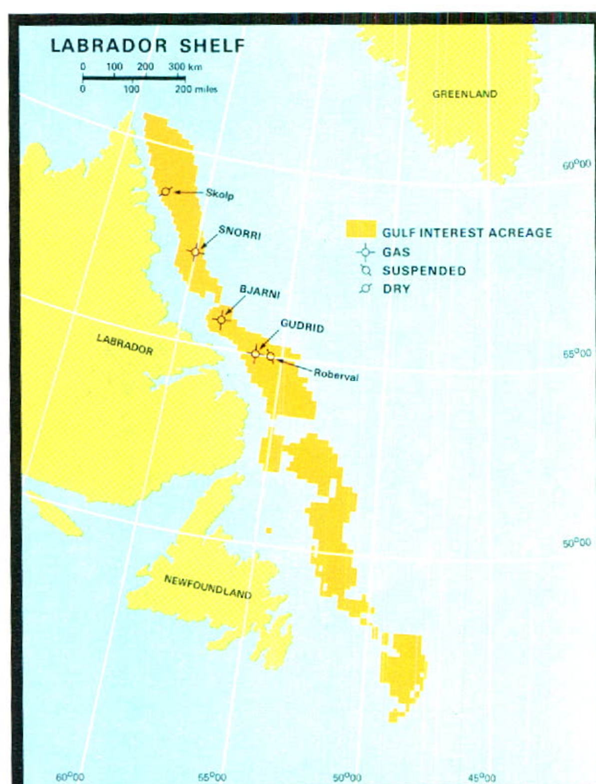


Beaufort Sea

In the Beaufort Sea where Gulf Canada's interest accounts for 1.4 million net acres in several blocks totalling 3.0 million gross acres, the Corporation participated in three wells from drillships during the short summer season. The Ukalerk and Kopanoar wells were drilled to total depth but, because of time restrictions, testing was held over until 1979. The third well, Tarsiut, will also be completed this summer.







In addition, construction of a drilling island was begun at the Issungnak location, six miles north of Isserk E-27 which previously had encountered a significant gas flow. Gulf Canada has a 29 per cent interest in both wells.

Arctic Islands
As a 25 per cent partner in the Arctic Islands Exploration Group, Gulf Canada participated in two wildcat wells, one of which was the Roche Point 0-43 gas success. Located off Melville's Sabine peninsula, 20 miles north of the Hecla gas field, the well flowed 20 million cubic feet of gas per day. Drilling from ice islands was underway at year-end at two additional wildcat locations — Desbarats, 35 miles northeast of Cameron Island, and Whitefish, 56 miles northeast of the Drake Point gas field.

East Coast Offshore
Exploration continued during the summer on the Labrador agreement blocks in which Gulf Canada has 16⅔ per cent interest in some 28 million acres. One well, Skolp, was drilled and abandoned, and a second, Roberval, was suspended for completion in 1979.

Natural Resource Capital and Exploration Spending

(millions of dollars)	1978		1977	
Exploration				
Western Canada	$103	69%	$108	71%
Frontiers	$ 47	31%	$ 44	29%
Total Exploration	$150	100%	$152	100%
Production				
Conventional	$ 59	30%	$ 41	23%
Non-Conventional				
Mineable oil sands (Syncrude)	$ 82	41%	$103	57%
In-situ oil sands	$ 11	6%	$ 36	20%
Coal-acquisition and development	$ 48	23%	—	—
Total non-conventional	$141	70%	$139	77%
Total Production	$200	100%	$180	100%
Total Resources	$350		$332	

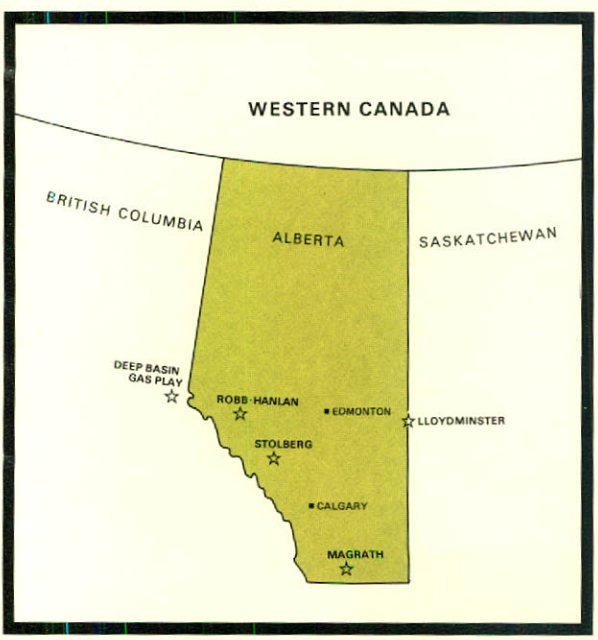
Drilling activity	(gross wells) 1978	1977
Exploration	59	50
Development	116	123
Total	175	173

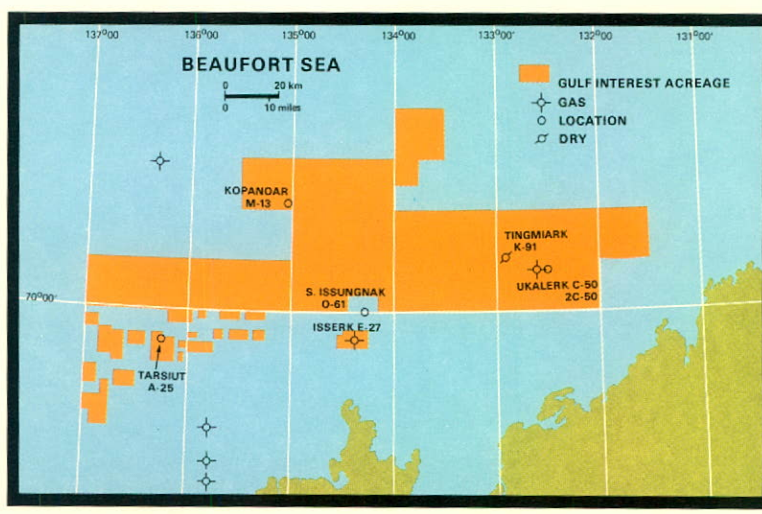
Production

Although Gulf Canada's production of crude oil, natural gas and gas products declined in 1978, price increases resulted in higher earnings.

Crude oil and natural gas production was limited by reduced industry demand. The gas supply surplus is expected to continue well into the 1980s. At present, approximately 20 per cent of Gulf Canada's production capacity is shut-in.

In a submission to the National Energy Board, the Corporation projected an optimistic supply picture for natural gas, recognizing the potential for continued increases in supply until the year





2000. As a partial solution to problems of surplus deliverability, Gulf Canada recommended trading off existing gas surpluses through exports to help finance the development of other domestic energy sources.

Production Operations and Reserves

Gross crude oil and natural gas liquids production declined from 115,000 to 112,000 barrels per day, while reserves decreased from 434 to 386 million barrels.

Efforts to arrest declining production in some producing oil fields included miscible flood recovery projects at South Swan Hills, Alberta, and Willmar, Saskatchewan. Both qualify for provincial government incentives.

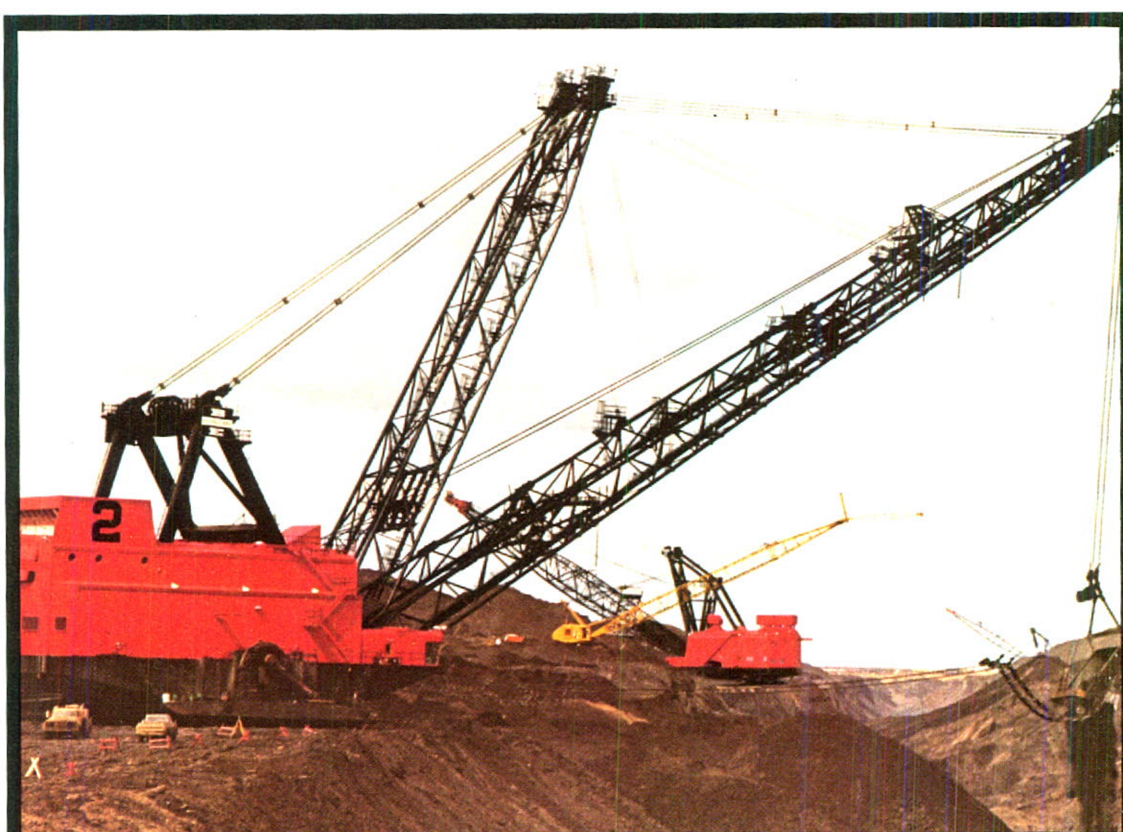
Gross natural gas production dropped from 417 to 373 million cubic feet per day due to the oversupply situations which saw the Corporation's principal gas purchaser gain industry support to limit production voluntarily to 80 per cent of minimum contractual obligations, thereby sharing eastern markets more equitably among producers.

Gross natural gas reserves declined only slightly in 1978. Delineation drilling in the Robb and Hanlan areas of the northern foothills region of Alberta added 112 billion cubic feet of gas reserves, helping to almost offset 1978 production. Plans for a gas plant to serve these areas are being developed, with production expected to commence during 1983.

Gulf Canada drilled 116 gross development and infill wells, of which 41 were oil and 54 were gas successes. Major development drilling was undertaken in the Ricinus, Swan Hills, South Swan Hills, Wimborne and Hastings oil fields, while gas development programs were carried out in the Robb-Hanlan and the shallow Alberta plains fields.

To maintain gas deliverability, compression facilities were added at the Strachan, Brazeau and Ghost Pine gas plants. Installation of a major pipeline from the Stolberg field to the Ram River gas plant was well underway at year-end to bring on new gas reserves.

In December the Corporation awarded a contract for the construction of North America's first sulphur prilling facility to supply 1,000 tonnes per day of premium



Gross Crude and Natural Gas Liquids Production	1978	1977
	(thousands of barrels per day)	
Major Fields		
South Swan Hills	23	22
Fenn Big Valley	15	13
Swan Hills	11	13
Redwater	5	6
Westerose	5	5
Other	34	35
Total	93	94
Natural gas liquids	19	21
Total production	112	115

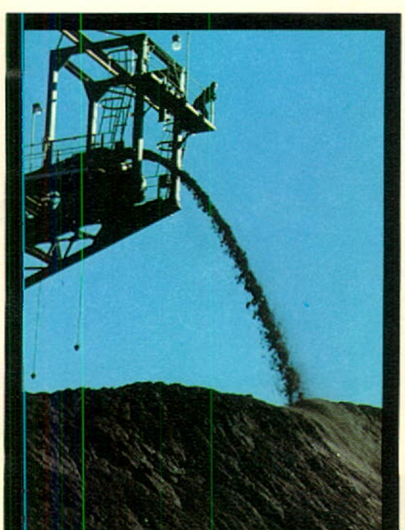
Gross Natural Gas Sales	1978	1977
	(millions of cubic feet per day)	
Major Fields		
Strachan	59	68
Westerose South	59	68
Nevis Unit	19	18
Gilby	17	20
Rimbey Unit	15	18
Other	216	239
Total	385	431
Less: from purchased raw gas	12	14
Produced and sold	373	417

quality product to overseas markets. To be built at the Strachan gas plant, it is expected to be on stream in late 1979.

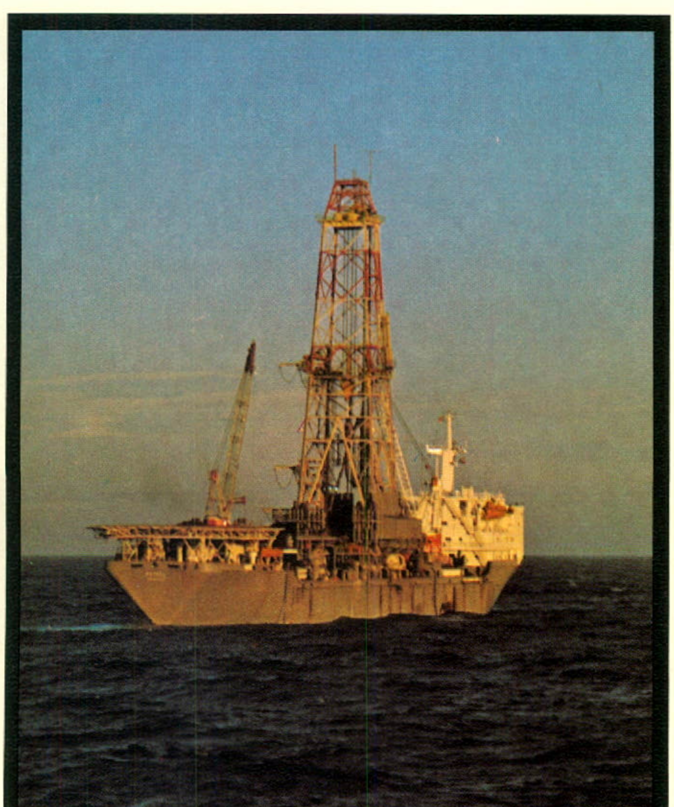
New Energy Resources
The high levels of expenditures for coal acreage acquisitions and in-situ oil sands experimental programs, amounting to $59 million, confirmed a continuing emphasis in those areas other than conventional oil and gas exploration and development.

Mineable Oil Sands
The Syncrude oil sands project came on stream in August. Gulf Canada's 16.75 per cent interest in Syncrude represents the largest single investment in the Corporation's history. Start-up difficulties continued into 1979, but progressively higher levels of production are expected to be achieved throughout the year.

Gulf Canada is an eight per cent participant in the Alsands project. An application to construct and operate the plant has been submitted and is under consideration by the Alberta Energy Resources Conservation Board. Alsands, a mineable oil sands venture similar to



With each bite, a massive dragline at Syncrude lifts 80 cubic yards of oil sand from the Athabasca deposit for treatment in the newly-operating plant.



Dynamically-positioned drillship located on Gulf Canada interest acreage off Labrador.

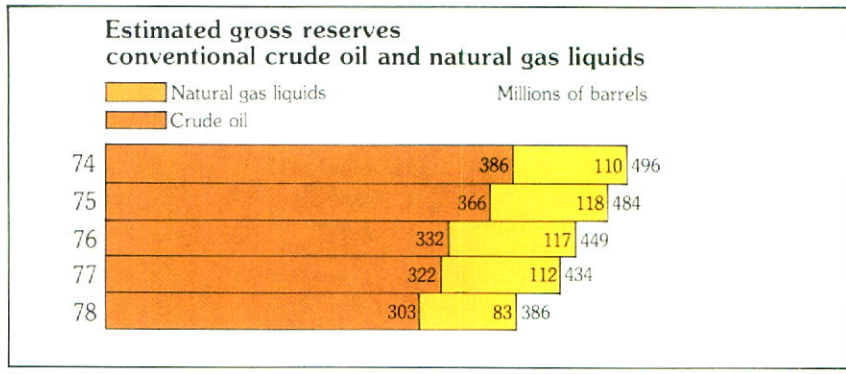
Syncrude, will have a capacity of 140,000 barrels per day of synthetic crude oil and is expected to be operating as early as 1986.

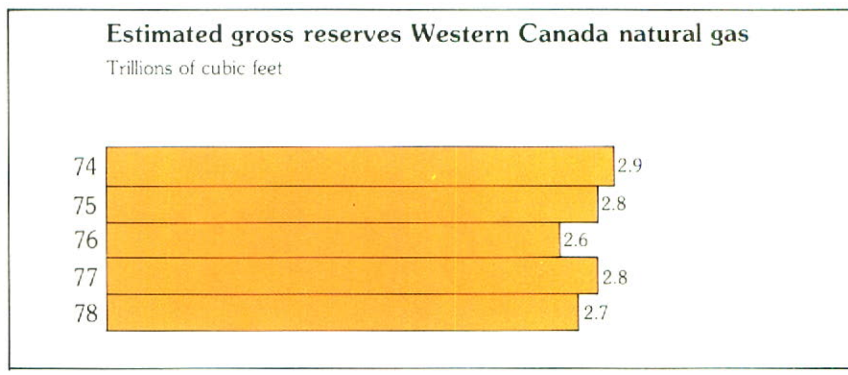
In-situ Oil Sands

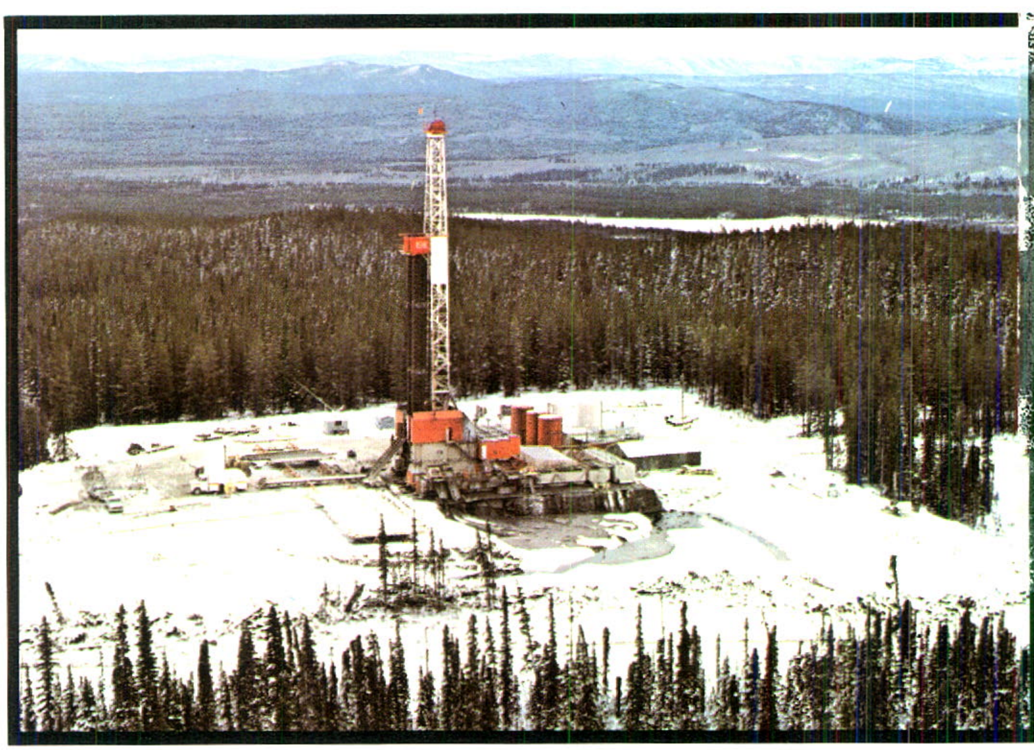
Among Corporation-operated heavy oil pilot projects, the steam flood experiment at Cold Lake has yielded informative results, and a steam solvent injection experiment was in progress at year-end.

At the Wabasca site, a fire flooding test began in July and the results of the project's steam flood experiment are currently being evaluated.

In addition, engineering plans and feasibility studies are underway for a proposed in-situ pilot project on Gulf Canada's Surmont oil sands property in the Athabasca oil sands deposit.







The deep basin area of Alberta and British Columbia is a centre of considerable industry exploration activity. The Gulf Dome Norcen Thunder well, shown, was drilling at year-end.

Wellhead pumps at the Cold Lake pilot project draw bitumen from deep underground deposits in steam injection experiment.

Coal and Minerals
The Corporation's first major coal exploration venture got underway with the acquisition of a 40 per cent interest in a 116,000-acre metallurgical coal property at Belcourt, in northeastern B.C. Gulf Canada also acquired 76,000 acres of coal property in the Chip Lake area west of Edmonton. An exploratory drilling program was conducted during the summer in the Mount Head area southwest of Calgary.

Gulf Canada continued to benefit from its 5.1 per cent interest in the Rabbit Lake uranium mine in Saskatchewan, and to share interests of up to 50 per cent in exploration activities undertaken through a joint venture with Gulf Minerals Canada Limited.

Estimated Recoverable Reserves

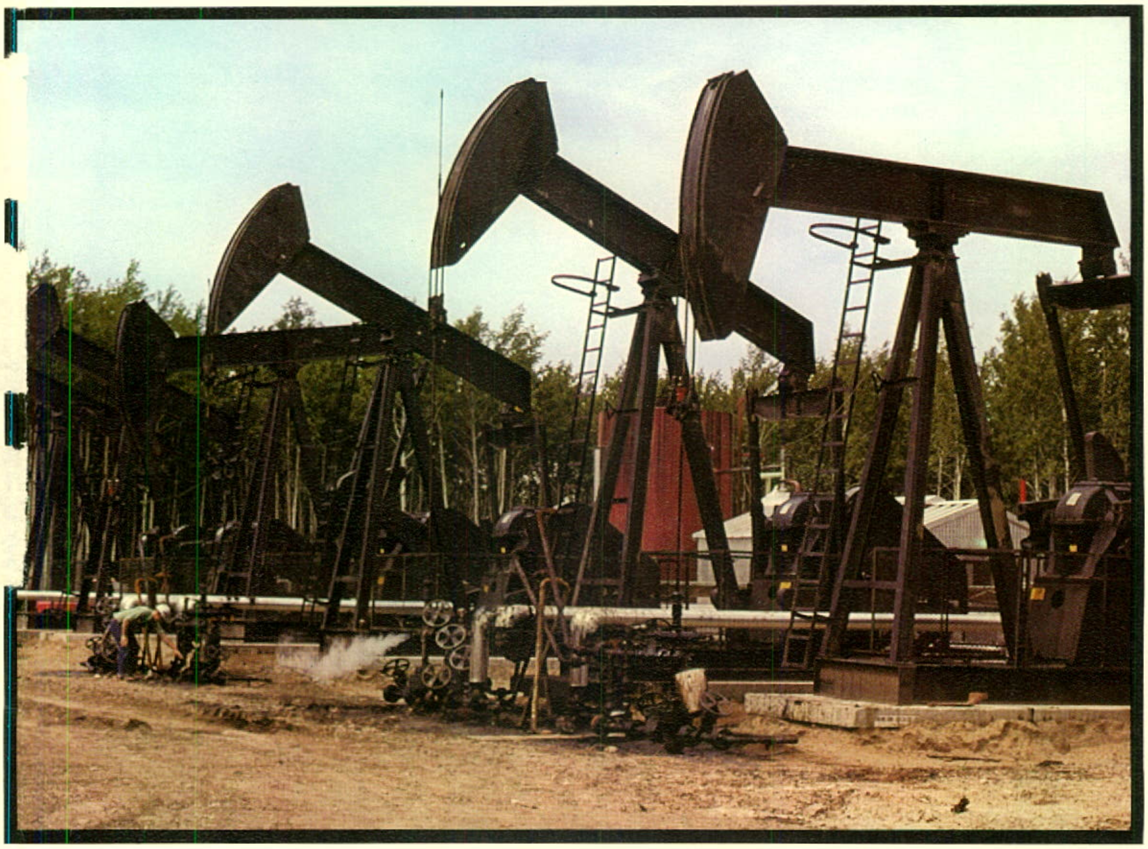
	Gross (1)		Net (2)	
	1978	1977	1978	1977
Proven Reserves Western Canada				
Crude oil and natural gas liquids (millions of barrels)	386	434	256	296
Natural gas (4) (trillions of cubic feet)	2.7	2.8	2.1	2.1
Other Reserves				
Syncrude (3) (millions of barrels)	190	191		
Sulphur (millions of long tons)	5.3	4.2	4.3	4.0

(1) Gross reserves are before deducting royalties. The reserve estimates include only those volumes considered to be proven and which appear with reasonable certainty to be recoverable in the future from known oil and gas reservoirs under existing economic and operating conditions.

(2) Government royalty rates can vary depending on prices, production volumes, the timing of initial production and changes in legislation. Net reserves have been calculated on the basis of the royalty rates experienced in late 1978.

(3) Synthetic crude oil reserves resulting from Gulf Canada's interest in the Syncrude Canada Ltd. project are shown in gross barrels only. The Alberta government's share from the Syncrude project is 50 per cent of net profits, as defined in an agreement between the project participants and the government, with an option to convert to a 7.5 per cent gross royalty. On either basis, the Alberta government has the right to take its share in kind. These reserves will be extracted by mining and processing tar sands.

(4) Natural gas reserves in the Mackenzie Delta are not included as their recovery depends on approval and construction of a pipeline to transport the gas to markets. Gulf Canada's share of gross reserves in the Parsons Lake area of the Mackenzie Delta is estimated to be approximately 1.3 trillion cubic feet.



Refined products and chemicals

Supply and distribution

In view of the larger volumes of Mexican crude oil being made available, a trial cargo was arranged for Montreal East refinery. The crude was found to be suitable and plans are being made to obtain regular supplies in 1979.

Members of the Organization of Petroleum Exporting Countries continued their crude oil price freeze through 1978. However, a political crisis in Iran removed about one-fifth of the OPEC supply from the world market and in the last quarter spot prices of crude rose to \$1.-\$2.00 per barrel above the official level. Because of contractual arrangements, Gulf Canada was not exposed to these premiums in 1978. However, since most of Gulf Canada's foreign crude supply has historically come from Iran, arrangements have been made for supplies from other sources. In December OPEC members decided on quarterly price increases during 1979 totalling 14.5 per cent.

As a result of federal government direction that Canadian crude should have preference over imports, throughput of the Sarnia-Montreal pipeline was increased from 250,000 to 315,000 barrels per day. Gulf Canada's allocated share of the line is being fully utilized. Increased use of Canadian crude at Montreal resulted in a corresponding one-third decline in the throughput of the Portland-Montreal pipeline.

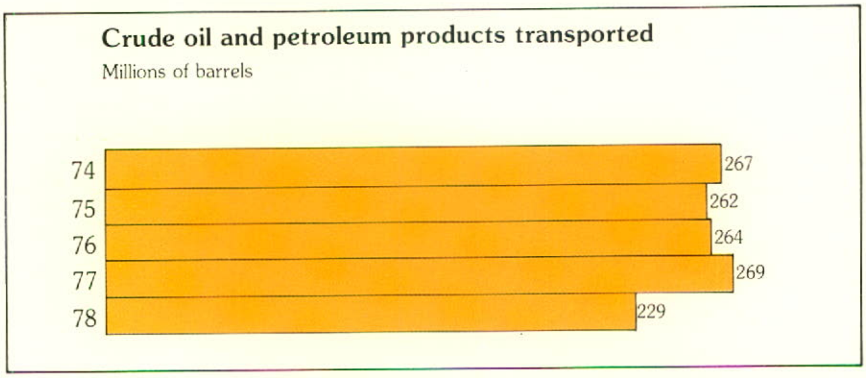
Prices for Canadian crude were increased \$1.00 per barrel January 1 and July 1, 1978, as agreed by the federal and provincial governments.

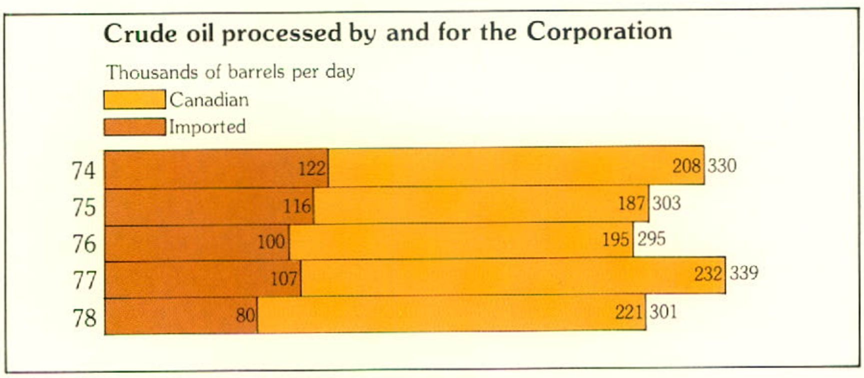
The Syncrude tar sands plant started delivering 40,000 barrels per day of crude in August, with test batches being processed at Edmonton, Montreal East and Port Moody refineries.

Refining

Crude oil processed amounted to 110 million barrels, down eleven

per cent from the 1977 record throughput of 124 million barrels. Lower product demands, particularly in Eastern Canada, together with inventory reductions, were responsible for significant decreases at Point Tupper, Montreal East and Clarkson refineries. Improved markets in British Columbia resulted in both Kamloops and Port Moody refineries exceeding last year's production levels.





Production commenced at the new $213-million lubricating oil plant at Clarkson refinery in early 1979. This is the largest investment in a wholly-owned facility ever made by the Corporation and is representative of the special type of investment opportunity Gulf Canada is pursuing to improve returns from refined products operations. Capable of quadrupling the refinery's previous lubricating oil output, the plant is designed to displace the approximately 25 per cent of Canada's requirements that were previously imported. During the year process unit control computer

Improved performance of Gulf Canada's three tankers, including the M/T Gulf Gatineau, *resulted in larger volumes being moved at reduced cost and use of outside charter vessels.*

Aerial view of Clarkson refinery where new lubricating oil plant is now in production.

projects were put into service at Edmonton and Port Moody refineries.

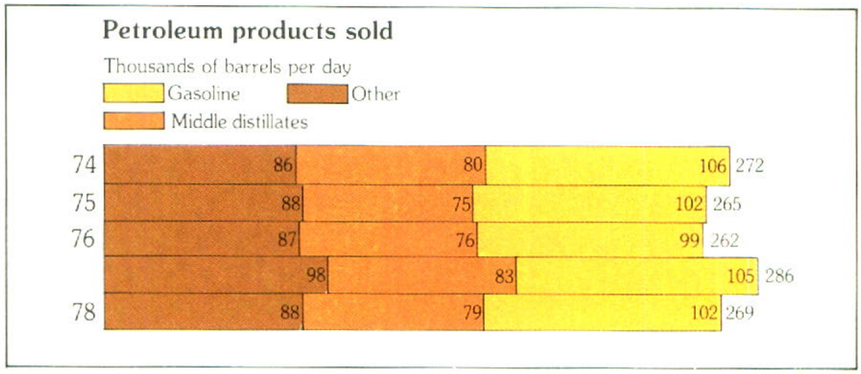
A maintenance productivity improvement program at all refineries will result in potential savings of about $15 million in the 1979-1983 period. In addition, a comprehensive energy-saving program will reflect substantial benefits over a similar period.

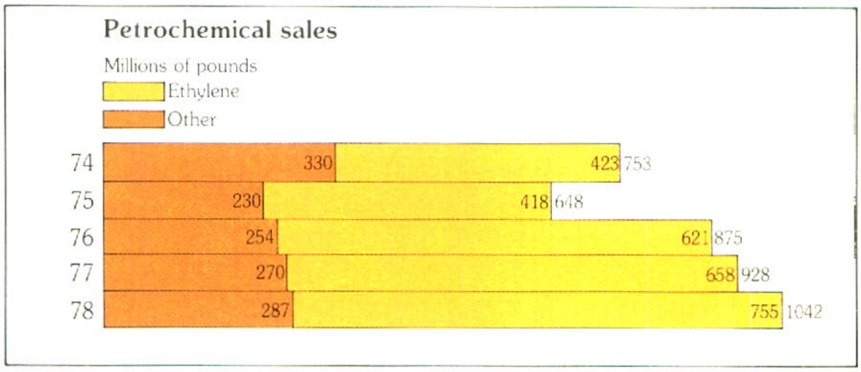
Marketing

Demand for petroleum products in Canada was essentially unchanged from the previous year, with moderate growth in transportation fuels being offset by lower sales of heating products. Consumer conservation continued to affect the level of consumption in all areas.

Gulf Canada's sales volumes were down over five per cent from 1977. Declines were significantly larger in Eastern Canada where surplus refining capacity has produced a keenly competitive market in which some selling prices barely cover the incremental costs of manufacture. Gulf Canada has opted to forego business not yielding a reasonable return, provided that the Corporation's long-term position in the refined products business is not jeopardized.

During the year about 600 service stations were closed as part of a program to phase out smaller





locations in favor of larger facilities, thereby not only reducing costs and ensuring a profitable operation for dealers but also providing better service to motorists. Since 1970 Gulf Canada's retail network has declined by nearly half to about 3,200 locations.

As a convenience to the growing number of "do-it-yourself" car owners who prefer to change their own motor oil, Gulf Canada introduced its lubricating oils through supermarkets and mass merchandising outlets in 1978. Seasonal service packages covering a variety of car maintenance programs at attractive prices continued to prove popular.

The petroleum industry's conversion period to metric measurement began on January 1, 1979. Extensive planning prior to that date enabled orderly conversion of the thousands of retail outlets and the millions of transactions involved. This year, as use of the metric measure increases, mutual understanding and patience by both the customer and Corporation will be required to adjust to the new measurement. Dealers and other personnel have been trained to assist customers in making the change.

Superior Propane increased both volumes and earnings in 1978.

The trend toward summer outdoor living combined with the popularity of recreational vehicles, heated swimming pools and gas barbeques attracted new users and helped correct the unbalanced winter-summer demand ratio.

With excess Canadian production available, propane is creating new fuel price relationships which should attract a larger share of the total energy market in the future.

Chemicals

Although sales volumes were relatively strong, earnings dropped 43 per cent below last year as a result of the inability to recover rising costs in the marketplace. Under-utilized world capacities were the main reasons for the declining margins. The price situation, particularly severe in the early part of the year, began to recover near the end of 1978.

The combined ethylene and propylene sales volumes were 14 per cent ahead of last year with the aromatics segment also showing improvement. In inorganic operations, calcium carbide production slipped to 95 per cent of last year. A modernization program at the Shawinigan Works carbide production facilities was started during 1978 and will be completed in 1979.

Effective December 31, 1978, Gulf Canada acquired the operation of Commercial Alcohols Limited at Varennes, Quebec. Commercial Alcohols produces and markets ethanol, which is derived from ethylene. The new acquisition will be operated as a wholly-owned subsidiary and managed independently of the existing Chemicals operations.

In conjunction with Union Carbide Canada Limited and the Quebec government, Gulf Canada is continuing to study the possibility of forming a consortium for the operation and ownership of current and future olefins facilities in the province of Quebec.

Closing of small retail outlets in favor of larger-volume self-serve locations, this one in Newfoundland, continues.

Installation of computers and electronic process controls, such as this new system at Port Moody, have reduced refinery operating costs and optimized yields.

Other activities

Research and development

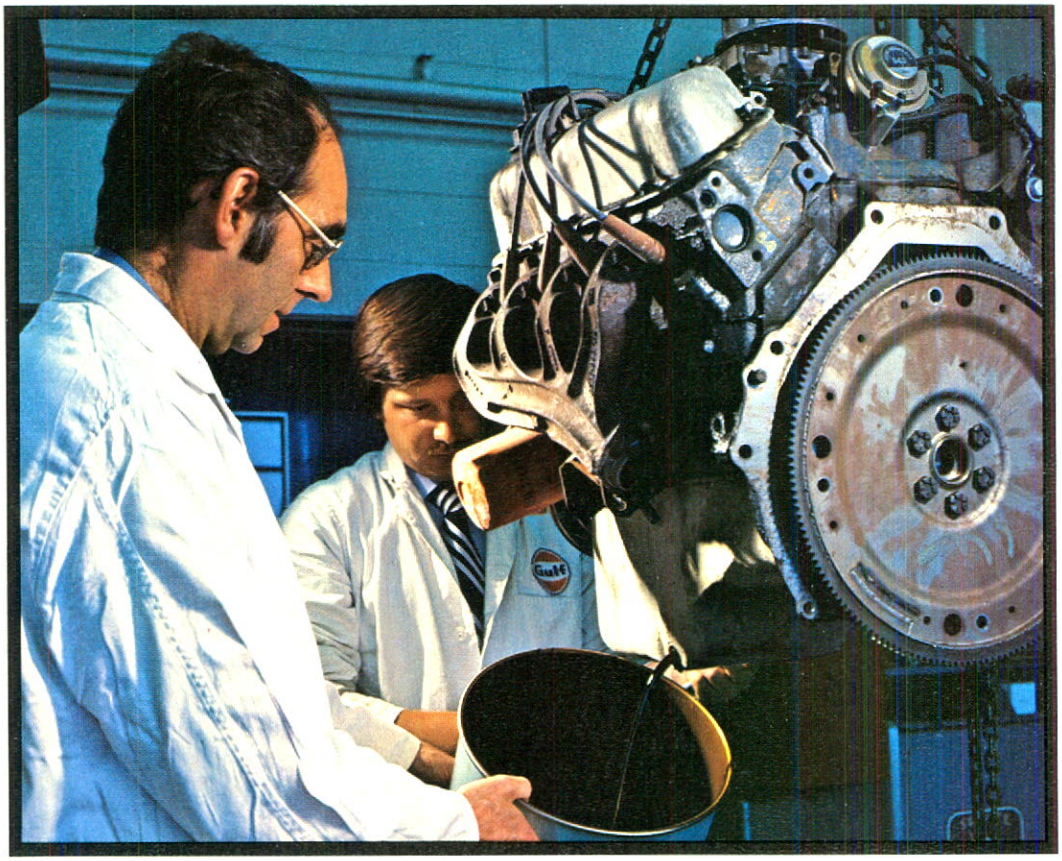
A full range of high quality automotive and industrial lubricants was formulated and tested prior to the start-up of Gulf Canada's new HydroTreating lubricating oil plant at Clarkson refinery. In addition, a semi-automatic X-ray spectrometer was developed to monitor product quality at the new lube plant.

R&D is investigating with the Production department techniques related to enhanced recovery from both conventional oil fields and heavy oil deposits. Also, in co-operation with the Refining department, alternate upgrading processes for heavy oil are currently being assessed.

Data supplied by Gulf Canada's computer-equipped mobile laboratory has enabled gas plants to make significant improvements in the recovery of propane.

The phasing down of lead in gasoline has attracted much interest in process technology for high-octane oxygenated gasoline components. Gulf Canada has developed this technology and patent applications for the process have been filed in a number of countries.

During the year sulphur-asphalt roads were built in Ontario, Louisiana and the Netherlands to further demonstrate the performance characteristics of Gulf Canada's unique process. An agreement was reached with the Research Institute of the University of Petroleum and Minerals in Saudi Arabia to make this technology available for highway pavements in that country.



Realty
Construction of the Gulf Canada Square building in Calgary continued on schedule. On November 30 a "topping off" ceremony of the 20-storey office tower signalled completion of the final cement pour and most of the building was enclosed at year end. Only 25 per cent of the space in the building remains to be leased. The complex is expected to be ready for occupancy by the Corporation's Calgary staff this September.

Human resources
Gulf Canada, jointly with Gulf Oil Corporation, provided on loan a total of 67 skilled employees to Syncrude Canada for start-up duties at the tar sands plant. By mid-1979 the majority of these employees will have returned to their home bases in Canada and the United States.

A one-year wage agreement providing for a six per cent increase was negotiated by all bargaining units in accordance with Anti-Inflation Board guidelines. The board rigidly applied its regulations by rejecting Gulf Canada's application for negotiated adjustments that exceeded six per cent, thereby creating further inequities within the petroleum industry. Salaried employees were also given a six per cent general increase.

On January 1, 1979, a dental plan was added to employee benefits. The plan, fully paid by the Corporation, covers regular active employees and dependents.

Ontario Premier William Davis opened new wing of Research and Development Centre at Sheridan Park.

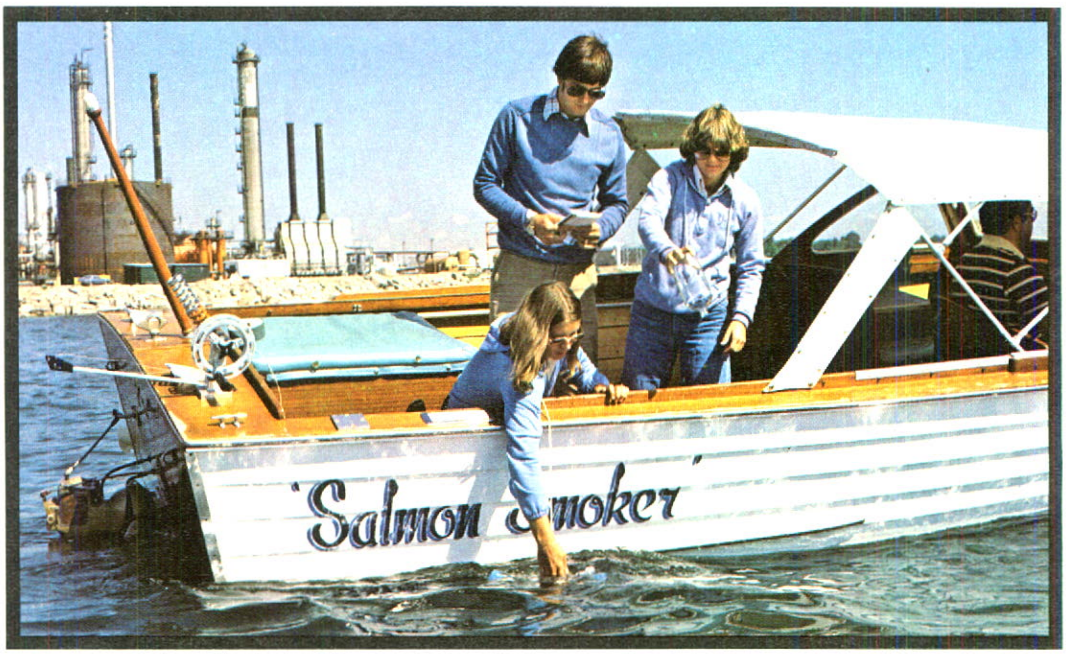
Field testing of lubricating and transmission oils from new Clarkson facilities was conducted by research teams.

Public affairs

Gulf Canada, like most other companies, finds itself increasingly subjected to social issues, environmental considerations and government involvement in the performance of its business. The Corporation recognizes that its activities do have an impact on the Canadian public, acknowledges its social responsibility, and intends to continue to operate as a good corporate citizen.

During 1978 Gulf Canada continued communications with governments and other publics, drawing attention to surplus capacity problems in the industry; providing information on other issues including security of supply, pricing, dealer relations, environmental matters; and discussing possible solutions. A beginning was made in developing a process for early identification of significant issues and in assisting the operating management to understand and reflect social and political factors. The Corporation maintained its francization momentum in Quebec and received provisionary certificates well within the legal time frame.

In the interest of fostering better understanding between Canada's French and English-speaking cultures, Gulf Canada conducted an exchange program for children of employees in the summer of 1978. Forty youngsters



A continuing monitoring of air and water samples is carried out at Gulf Canada installations. Here, a water sample is collected.

Last summer 80 children of employees visited La Citadelle, Quebec City, as part of the Corporation's first cultural exchange program.

from the Montreal area spent two weeks with the families of 20 children in Toronto and 20 others in Calgary, who later paid return visits with the Quebec families. The Corporation also co-sponsored the translation and publication in French of the book "Must Canada Fail?," dealing with the national unity question.

To strengthen industry relations with the academic community, a Faculty Forum seminar was held at Banff where members of Gulf Canada's management held open discussions on subjects of mutual interest with faculty representatives from 12 Canadian universities.

Gulf Canada's corporate advertising on national television featured energy conservation within the Corporation, the search for new reserves, and technical expertise relative to research and the new lubricating oil plant at Clarkson. Several industry awards were won by the Corporation's publications and newsletters, which form an important part of Gulf Canada's internal communications program for employees, dealers and shareholders.

To provide a more co-ordinated approach to the development of corporate positions and responses to current and future public issues that could affect Gulf Canada, a re-organization of the Corporate Affairs and Public Relations departments into a new Public Affairs department was announced late in 1978.

Gulf Canada Limited

Consolidated statement of financial position

December 31, 1978

Assets

	1978	1977
	(millions of dollars)	
Current:		
Cash and term deposits	$ 19.4	$ 26.5
Marketable securities, at cost (approximates market value)	133.8	147.6
Accounts receivable	527.7	519.4
Inventories of crude oil, products and merchandise	400.7	483.3
Materials, supplies and prepaid expenses	39.0	30.0
Total current assets	1,120.6	1,206.8
Investments, long-term receivables and other assets:		
Investments in associated and other companies (note 3)	17.9	20.5
Long-term receivables, deferred charges and other assets	63.4	49.7
	81.3	70.2
Property, plant and equipment at cost less accumulated depreciation, depletion and amortization (note 4)	1,558.6	1,296.6
	$2,760.5	$2,573.6

(See accompanying notes to consolidated financial statements)

Auditors' Report

To the Shareholders of
Gulf Canada Limited:

We have examined the consolidated statement of financial position of Gulf Canada Limited as at December 31, 1978 and the consolidated statements of 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 corporation as at December 31, 1978 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.

Toronto, Canada,
February 2, 1979.

Clarkson, Gordon & Co.,
Chartered Accountants

Liabilities and shareholders' equity

	1978	1977
	(millions of dollars)	
Current:		
Short-term loans	$ 30.2	$ 25.6
Accounts payable and accrued liabilities (note 7)	491.1	534.6
Income and other taxes payable	69.4	67.1
Current portion of long-term liabilities	34.5	28.8
Dividends payable	13.0	12.3
Total current liabilities	638.2	668.4
Long-term liabilities (note 8)	350.1	332.7
Deferred income taxes	353.2	284.5
Shareholders' equity:		
Capital stock (note 9)	281.0	281.0
Retained earnings	1,138.0	1,007.0
Total shareholders' equity	1,419.0	1,288.0
	$2,760.5	$2,573.6

On behalf of the Board:

A. Powis, Director

C.D. Shepard, Director

Gulf Canada Limited

Consolidated statements of earnings

Year ended December 31, 1978

Earnings

	1978	1977
	(millions of dollars)	
Revenues:		
Gross sales and other operating revenues	$4,665.0	$4,235.2
Deduct —		
Crude oil sales (note 1)	(1,797.4)	(1,565.3)
Taxes collected for governments	(317.2)	(347.8)
Net sales and other operating revenues	2,550.4	2,322.1
Investment and sundry income	33.3	34.4
Net revenues	2,583.7	2,356.5
Expenses:		
Purchased crude oil, products and merchandise (note 1)	1,327.0	1,193.1
Operating expenses	266.0	227.5
Exploration, dry hole and other frontier area expenditures	115.2	107.9
Selling, general and administrative expenses	328.3	300.3
Depreciation, depletion and amortization (note 5)	96.3	85.8
Interest on long-term liabilities	26.0	21.4
	2,158.8	1,936.0
Earnings before income and other taxes	424.9	420.5
Taxes:		
Taxes other than taxes on income	139.8	124.8
Income taxes (includes deferred taxes of $68.1 in 1978; $64.2 in 1977) (note 2)	102.2	110.7
	242.0	235.5
Earnings for the year	$ 182.9	$ 185.0
Earnings per share	$ 4.02	$ 4.07

Retained earnings

	1978	1977
Balance, beginning of the year	$1,007.0	$ 871.2
Add earnings for the year	182.9	185.0
	1,189.9	1,056.2
Deduct dividends on common shares	51.9	49.2
Balance, end of the year	$1,138.0	$1,007.0

(See accompanying notes to consolidated financial statements)

Gulf Canada Limited

Consolidated statement of changes in financial position

Year ended December 31, 1978

	1978	1977
	(millions of dollars)	
Source of funds:		
From operations*	$349.8	$335.7
Sales of properties	17.6	15.7
Long-term obligations	33.9	180.6
Sales of investments	4.0	1.2
	405.3	533.2
Use of funds:		
Additions to property, plant and equipment	369.8	385.1
Reduction in long-term liabilities	37.3	30.6
Dividends	51.9	49.2
Other (net)	2.3	3.6
	461.3	468.5
(Decrease) increase in working capital	$(56.0)	$ 64.7
Working capital changes:		
Increase (decrease) in current assets —		
Cash and marketable securities	$(20.9)	$ 39.9
Accounts receivable	8.3	63.6
Inventories and materials	(73.6)	123.9
	(86.2)	227.4
Increase (decrease) in current liabilities —		
Accounts payable and other	(38.2)	126.1
Income and other taxes payable	2.3	16.3
Current portion of long-term liabilities	5.7	20.3
	(30.2)	162.7
(Decrease) increase in working capital	(56.0)	64.7
Working capital, beginning of the year	538.4	473.7
Working capital, end of the year	$482.4	$538.4

*Earnings for the year adjusted for charges or credits not affecting working capital.

(See accompanying notes to consolidated financial statements)

Gulf Canada Limited

Notes to consolidated financial statements

December 31, 1978

1. Accounting policies

The financial statements of the corporation have been prepared by management in accordance with generally accepted accounting principles consistently applied. Because a precise determination of many assets and liabilities is dependent upon future events, the preparation of periodic financial statements necessarily involves the use of numerous estimates and approximations. Such estimates and approximations have been made using careful judgment and in the light of information available up to February 2, 1979. These financial statements are, in management's opinion, correct within limits of materiality and within the framework of the accounting policies summarized below.

Principles of consolidation —
The accounts of the corporation and all subsidiary companies are included in the financial statements.

Investments in joint venture companies owned 50 per cent or less are accounted for on the equity basis.

Inventories —
Inventories of crude oil, products and merchandise are valued generally at the lower of cost applied on a "first-in, first-out" basis or market value determined on the basis of replacement cost or net realizable value.

Oil and gas properties —
The initial acquisition costs of oil and gas properties together with the costs of drilling and equipping successful wells (other than wells in remote frontier areas) are capitalized.

Exploration expenditures, including geological and geophysical costs, annual rentals on exploratory acreage and dry hole costs are charged to expense. All expenditures in remote frontier areas where future production is not reasonably assured, including the cost of discovery wells, are also charged to expense.

Depreciation, depletion and amortization —
Capitalized costs of oil and gas properties and drilling and equipping wells are charged against earnings on the unit-of-production method using estimated recoverable oil and gas reserves. Charges are made against earnings for depreciation of investment in plant and equipment based on the estimated remaining useful lives of the assets using either the straight-line or the unit-of-production method, whichever is appropriate. No charges are made against earnings for the capitalized costs of certain heavy oil and coal properties pending development.

Syncrude tar sand operations —
The corporation's share of all costs net of revenues received to December 31, 1978, has been capitalized and included with its share of the costs of the Syncrude plant and equipment. These capitalized preproduction costs will be amortized on a unit-of-production basis related to the corporation's share of the production and the estimated recoverable reserves beginning with the commencement of commercial production.

U.S. dollar liabilities —
Liabilities in U.S. dollars are translated to Canadian dollars at year-end rates of exchange. Gains or losses arising on translation of short-term liabilities are included in earnings. Unrealized gains or losses arising on translation of long-term liabilities are deferred and amortized over the remaining term of the liabilities.

Income taxes —
Income tax expense is computed on the basis of revenues and expenses reflected in the statement of earnings. A portion of such taxes is not currently payable as tax legislation permits the deduction of certain costs and allowances prior to the time they are recorded as expenses for financial statement purposes. The

amount not currently payable is included in the statement of financial position as deferred income taxes.

Investment tax credits are applied to reduce the cost of the related fixed assets.

Pensions —
Pension costs, which are determined by independent actuaries, are charged against earnings in the year premiums or funding requirements are payable. Prior service pension costs are being funded and charged to earnings over varying periods not exceeding fifteen years.

Crude oil transactions —
In addition to its own net production, the corporation purchases large volumes of crude oil from other producers and sells crude oil not required for its own refineries to other oil companies. It is the corporation's practice to offset such crude oil sales against crude oil purchases and thus exclude these transactions from both net revenues and costs.

Oil import compensation program —
Under the oil import compensation program the federal government compensates eligible importers with respect to petroleum imported for consumption in Canada, provided the importing company voluntarily maintains prices for products obtained from imported petroleum at the level suggested by the government. Compensation received or recoverable under this program is reflected as a reduction of the cost of purchased crude oil.

2. Income tax

Total income tax expense was $102.2 million in 1978 and $110.7 million in 1977 which represents an effective tax rate of 35.8 per cent and 37.5 per cent on earnings before income taxes for 1978 and 1977 respectively. The following schedule shows the main differences between the combined Federal and Provincial statutory tax rate and these effective rates:

	1978		1977	
	(millions of dollars)			
	Amount	%	Amount	%
Provision for income taxes at statutory rates	$137.4	48.2%	$141.9	48.0%
Add (deduct) the tax effect of:				
Inclusion in taxable income of crown royalties and other provincial payments	99.0	34.7	85.0	28.7
Resource allowance to partially offset inclusion of crown royalties	(73.8)	(25.9)	(63.1)	(21.4)
Depletion allowance earned by exploration and development expenditures	(36.5)	(12.8)	(33.3)	(11.3)
Frontier exploration allowance earned by frontier drilling expenditures	(10.6)	(3.7)	(9.4)	(3.0)
Inventory allowance to partially offset the effect of inflation	(7.0)	(2.5)	(5.1)	(1.7)
Other	(6.3)	(2.2)	(5.3)	(1.8)
Provision for income taxes reflected in the statement of earnings	$102.2	35.8%	$110.7	37.5%

3. Investment in associated and other companies

	1978	1977
	(millions of dollars)	
At cost:		
With quoted market value (based on closing prices at end of each year) 1978 — $34.9 million; 1977 — $35.4 million	$ 3.0	$ 3.9
Without quoted market value	.1	.1
	3.1	4.0
At equity:		
Investment in joint venture companies, at cost plus equity in undistributed earnings	14.8	16.5
	$17.9	$20.5

4. Property, plant and equipment

	Range of depreciation rates	Gross investment at cost (1)	Accumulated depreciation, depletion and amortization	Net investment 1978	Net investment 1977
		(millions of dollars)			
Exploration and production (2) .	(3)	$ 843.7	$ 367.5	$ 476.2	$ 364.4
Syncrude project		360.2		360.2	278.0
Transportation .	4% to 10%	55.7	24.9	30.8	31.5
Refining and petrochemicals	(4)	814.1	361.9	452.2	392.2
Marketing	2.5% to 10%	361.6	152.7	208.9	205.2
Other	2.5% to 10%	44.5	14.2	30.3	25.3
		$2,479.8	$ 921.2	$1,558.6	$1,296.6

(1) Additions during the year have been reduced by investment tax credits of $8.4 million ($10.2 million in 1977).

(2) Included in exploration and production assets are the initial acquisition costs of heavy oil and coal properties totalling $69 million at December 31, 1978.

(3) Unit of production.

(4) Processing units on unit of production, other items from 2.5% to 10%.

5. Depreciation, depletion and amortization

Depreciation, depletion and amortization in the statement of earnings consists of:

	1978	1977
	(millions of dollars)	
Depreciation of plant and equipment	$73.6	$66.4
Depletion and amortization of capitalized costs of oil and gas properties, drilling costs and other intangible assets	22.7	19.4
	$96.3	$85.8

6. Syncrude

The corporation is a 16.75 per cent participant in the $2.2 billion dollar Syncrude project, constructed and operated by Syncrude Canada Ltd., to produce synthetic crude oil from the Athabasca Oil Sands. Initial production began on August 1, 1978 but start-up problems continued to occur throughout the balance of the year. Costs during this period less revenues from the corporation's share of the production have been deferred as pre-production charges and included in property, plant and equipment.

The Alberta Energy Company Ltd. holds an option to acquire up to 20 per cent of the present participating interests in the Syncrude project. This option can be exercised up to six months after the start of production which is defined as the first of the month following production of 5 million barrels, which is expected to occur in the early months of 1979. Should the option be exercised to the maximum extent, Gulf Canada's 16.75 per cent interest would be reduced to 13.4 per cent with a proportionate recovery of its investment in the project.

Part of the corporation's interest in the project was financed through a $100 million convertible loan from the Government of Alberta. For a period of five years following the start of production, as defined, the Government of Alberta can convert all or part of the principal amount into an equity interest in the project based on the relationship of the amount converted to the total project costs. Should this option be exercised to the maximum extent, Gulf Canada's interest could be reduced by approximately 4.5 percentage points.

7. Accounts payable and accrued liabilities

Accounts payable and accrued liabilities include:

(1) Amounts owing to and from affiliated companies, all of which arose in the normal course of business, of $20.0 million and $4.2 million, respectively at December 31, 1978 ($152.4 million and $7.8 million, respectively at December 31, 1977).

(2) Payments of $12.5 million received during 1978 under 'take-or-pay' gas contracts. These amounts have been deferred and will be credited to revenue when the gas is delivered at the option of the purchaser.

8. Long-term liabilities

	Maturity	Amount
		(millions of dollars)
Debentures (1):		
5¾%, Series B	1982	$ 2.8
5¼%, Series C (2)	1982	7.8
7⅜%, Series E	1988	31.5
8½%	1989	3.7
8½%	1990	3.1
8⅜% (2)	1997	148.2
8⅛% loan re Syncrude (3)		117.0
Interest-free loans (4)		27.3
Other long-term obligations	varying dates	43.2
		384.6
Less instalments due within one year included in current liabilities		34.5
		$350.1

(1) All debenture issues require sinking fund payments.

(2) Payable in U.S. dollars. Amounts outstanding in U.S. dollars:
5¼% Series C 1982 $6.6 million
8⅜% Notes 1997 $125.0 million

(3) The Syncrude loan from the Government of Alberta is evidenced by an 8⅛% Convertible Debenture which, as indicated in note 6, may be converted into a portion of the corporation's equity interest in the Syncrude project. In the event that the conversion option is not exercised, the loan is repayable in ten equal annual instalments commencing no earlier than 1984.

(4) These interest-free loans, originally borrowed under the terms of an agreement for exploration and development of certain properties, are repayable in 1979.

Approximate annual instalments of long-term debt due in the next five years are (millions of dollars): 1979 — $34.5; 1980 — $18.4; 1981 — $20.0; 1982 — $8.7; 1983 — $9.5

9. Capital stock

Shares without nominal or par value:

Authorized —
Upon continuation under the Canada Business Corporations Act the authorized shares of the corporation (which prior to continuance were 68,000,000 common shares without nominal or par value) became: Common — unlimited number without nominal or par value; Preferred — unlimited number without nominal or par value. The Preferred Shares shall rank in priority to the Common Shares and may be issued from time to time in series with the designation, rights, restrictions, conditions and limitations of each series in a manner as more particularly set out in the Articles of Continuance.

Issued —
Common — 45,497,406

The corporation's incentive stock option plan provides for the granting of options to purchase its common shares at the market price on the day when the options are granted. Under the plan, options become exercisable after one year's continuous employment immediately following the date the options are granted and are for a period of ten years. During 1978 no options were granted or exercised and at December 31, 1978, no options were outstanding.

10. Pension plans

The corporation has pension plans covering substantially all employees. The contributions by employees, together with those made by the corporation, are deposited with insurance companies and/or trustees according to the terms of the plans. Pensions at retirement are related to remuneration and years of service. The amounts charged to earnings (including amounts paid to government pension plans and amortization of prior service costs) were $19.9 million during 1978 and $13.9 million during 1977.

The plans were amended in 1978, with a further amendment effective January 1, 1979 to provide for increases in retirement benefits. The effective unfunded prior service pension costs at December 31, 1978, after giving effect to the 1979 amendments, were approximately $91.8 million of which approximately $74.0 million represents the excess of the actuarially computed value of vested benefits over the assets of the plans. These are currently being funded and charged to earnings over periods up to twelve years.

11. Commitments and contingent liabilities

The corporation has commitments in the ordinary course of business (for the acquisition or construction of properties and the purchase of materials and services) and contingent liabilities under various guarantees, all of which are not significant in relation to net assets.

Rentals under long-term leases for real property and other facilities approximate $20 million annually. Under certain of these long-term leases, the corporation has the option to purchase the leased assets and is obligated to make advances from time to time which will be applied against the purchase price if the option is exercised. It is estimated that such advances will aggregate approximately $20.9 million over the terms of the lease agreements (which expire in 1982) of which $13.8 million have been advanced to December 31, 1978 and of which $1.8 million will be payable in 1979.

12. Remuneration of directors and officers

The aggregate remuneration in 1978 of the corporation's fourteen directors as directors was $90,700. Five directors were also officers of the corporation during the same period. The aggregate remuneration during 1978 of the corporation's officers (including fourteen past officers) as officers was $2,393,903. No directors or officers of the corporation received any remuneration from a subsidiary of the corporation.

13. Anti-inflation program

Under the federal government's Anti-Inflation Act which was in force until December 31, 1978 the corporation was subject to mandatory compliance with legislation which controls prices, profit margins (excluding crude oil and natural gas operations which were controlled under the Petroleum Administration Act), employee compensation and shareholder dividends. Management is of the opinion that the corporation was in compliance with the requirements of the anti-inflation legislation.

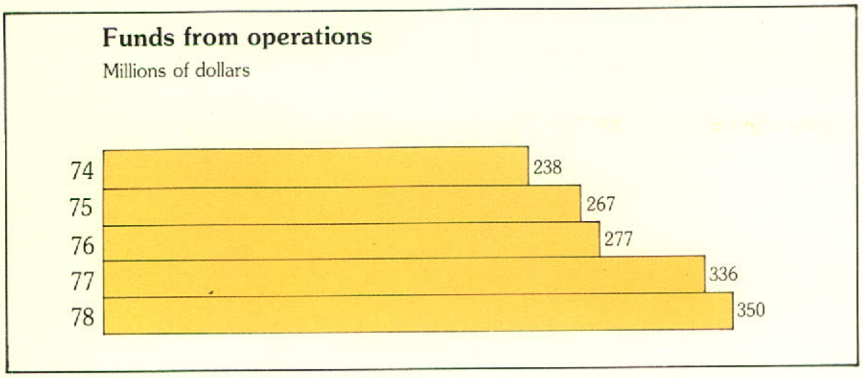
14. Research and development costs

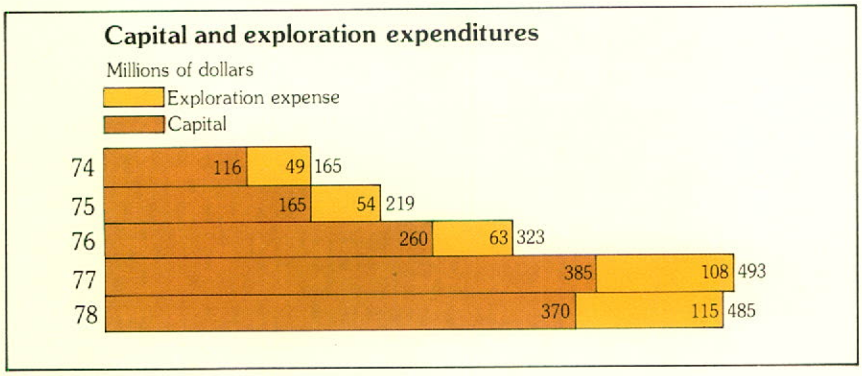
Research and development costs, which are charged to earnings as incurred, were $29.8 million for 1978 and $23.4 million for 1977.

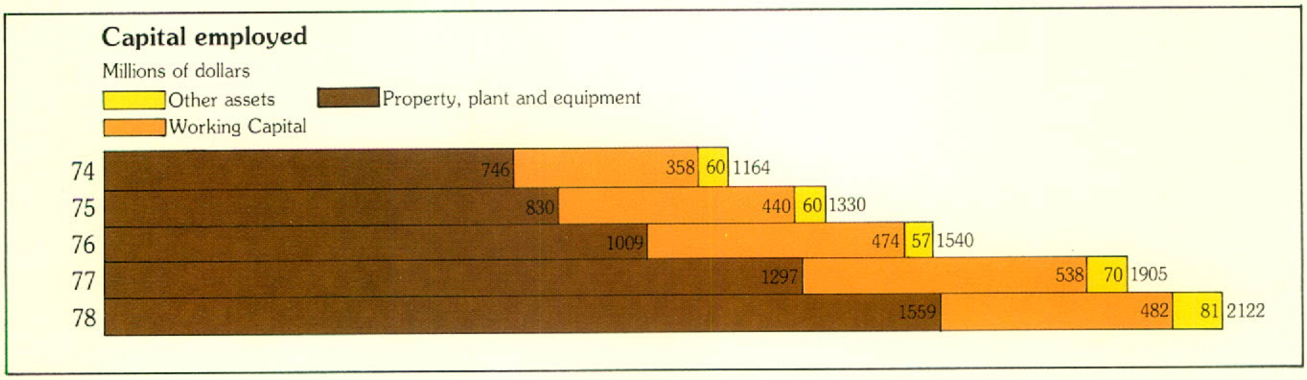
Five year financial summary

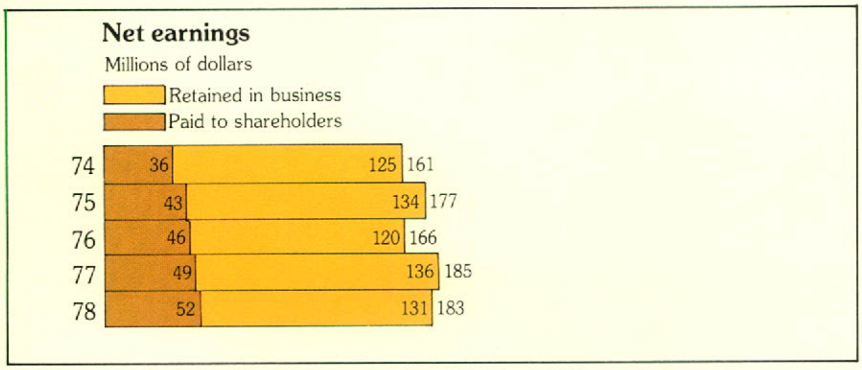
Amounts, except for unit statistics, expressed in millions of dollars

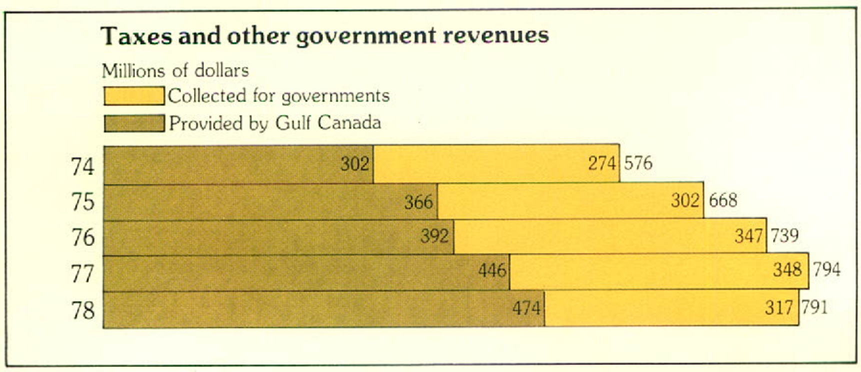
	1978	1977	1976	1975	1974
Balance Sheet					
Current assets	$1,120.6	$1,206.8	$ 979.4	$ 836.1	$ 825.2
Deduct: Current liabilities	638.2	668.4	505.7	396.2	467.5
Working capital	482.4	538.4	473.7	439.9	357.7
Property, plant and equipment — net	1558.6	1,296.6	1,008.7	830.3	746.1
Investments, long-term receivables and other assets	81.3	70.2	57.1	60.1	59.9
Capital employed	2,122.3	1,905.2	1,539.5	1,330.3	1,163.7
Deduct: Long-term debt	350.1	332.7	167.1	115.9	102.6
Deferred income taxes	353.2	284.5	220.3	182.7	162.8
Shareholders' equity	$1,419.0	$1,288.0	$1,152.1	$1,031.7	$ 898.3
Per share	$ 31.19	$ 28.31	$ 25.32	$ 22.68	$ 19.75
RIE **Capital Expenditures**	1,138.0	1,007.0	871.2	750.8	617.4
Property, plant and equipment	$ 369.8	$ 385.1	$ 260.2	$ 165.1	$ 115.9
Earnings					
Net revenues	$2,583.7	$2,356.5	$1,953.6	$1,729.9	$1,516.2
Deduct:					
Exploration and dry hole costs	115.2	107.9	63.2	53.9	48.9
Depreciation, depletion and amortization	96.3	85.8	73.2	71.0	70.4
Purchases and other expenses	1,947.3	1,742.3	1,417.9	1,186.6	1,030.5
	2,158.8	1,936.0	1,554.3	1,311.5	1,149.8
Earnings before taxes	424.9	420.5	399.3	418.4	366.4
Taxes:					
Taxes, other than income taxes	139.8	124.8	111.1	98.1	80.9
Income taxes	102.2	110.7	122.3	143.7	124.5
	242.0	235.5	233.4	241.8	205.4
Earnings for the year	$ 182.9	$ 185.0	$ 165.9	$ 176.6	$ 161.0
Rate of Return (per cent)					
On average capital employed	9.8	11.4	11.9	14.5	14.7
On average shareholders' equity	13.5	15.2	15.2	18.3	19.3
Funds from Operations	$ 349.8	$ 335.7	$ 277.3	$ 266.8	$ 237.8
Dividends Declared	$ 51.9	$ 49.2	$ 45.5	$ 43.2	$ 36.4
Per Share					
Earnings for the year	$ 4.02	$ 4.07	$ 3.65	$ 3.88	$ 3.54
Cash dividends	$ 1.14	$ 1.08	$ 1.00	$ .95	$ .80


Funds from operations
Millions of dollars
74 238
75 267
76 277
77 336
78 350


Capital and exploration expenditures
Millions of dollars
Exploration expense
Capital
74 116 49 165
75 165 54 219
76 260 63 323
77 385 108 493
78 370 115 485


Capital employed
Millions of dollars
Other assets
Working Capital
Property, plant and equipment
74 746 358 60 1164
75 830 440 60 1330
76 1009 474 57 1540
77 1297 538 70 1905
78 1559 482 81 2122


Net earnings
Millions of dollars
Retained in business
Paid to shareholders
74 36 125 161
75 43 134 177
76 46 120 166
77 49 136 185
78 52 131 183


Taxes and other government revenues
Millions of dollars
Collected for governments
Provided by Gulf Canada
74 302 274 576
75 366 302 668
76 392 347 739
77 446 348 794
78 474 317 791

Five year summary of operations

	1978	1977	1976	1975	1974
Crude and Natural Gas Liquids Produced					
(thousands of barrels)					
Gross	40,833	42,030	43,310	47,657	50,784
Net	27,258	27,841	29,546	33,125	36,210
Per day — gross	112	115	118	131	139
— net	75	76	81	91	99
Crude Oil Processed by and for the Corporation					
(thousands of barrels)					
Total	110,019	123,704	108,107	110,750	120,623
Per day	301	339	295	303	330
Petroleum Products Sold					
(thousands of barrels)					
Total	98,301	104,281	96,022	96,904	99,426
Per day	269	286	262	265	272

In addition to capital expenditures of $21 million for environmental conservation in 1978, Gulf Canada supported continuing "on the spot" training programs. At Point Tupper refinery (above) Corporation personnel participated in full-fledged government/industry exercises; crew members of the Gulf Mackenzie (right) carry out regularly scheduled oil spill simulation exercise at Clarkson refinery.

	1978	1977	1976	1975	1974
Natural Gas Produced and Sold					
(millions of cubic feet)					
Gross	136,270	152,063	161,071	171,603	176,473
Net	98,736	110,152	118,083	134,779	148,011
Per day — gross	373	417	440	470	483
— net	271	302	323	369	406
Petrochemical Sales					
(thousands of pounds)					
Total	1,042,211	927,769	875,322	647,624	752,827
Per day	2,855	2,542	2,392	1,774	2,063
Sulphur Sales					
(long tons)					
Total	310,879	343,999	254,525	202,741	272,985
Per day	852	942	695	556	748
Net Wells (Bore Holes) Capable of Producing at Year-End	1,546	1,499	1,437	1,400	1,400
Net Wells Drilled	89	108	59	45	37
Net Acreage under Lease, Reservation and Option (Hydrocarbons) *(thousands of acres)*	27,089	25,039	25,561	26,077	24,631

The Matter of Corporate Responsibility

The Board of Directors approved the following Statement of Business Principles which establishes ethical standards for the conduct of business by Gulf Canada.

I. Basic Business Principles of Gulf Canada

Gulf Canada adheres to the highest standards of ethics in the conduct of its business operations. Accordingly, the following specific principles represent the policy of the Corporation and are binding on all employees:

(i) In the conduct of its business operations Gulf Canada will comply with both the letter and the spirit of the laws of Canada or any other country in which the Corporation carries on business.

(ii) In addition to compliance with the law, the highest standards of integrity will be observed throughout the Corporation at all times.

(iii) The business of the Corporation will be conducted fairly and openly at all times.

II. Operating Principles of Gulf Canada

The basic principles of Gulf Canada will apply to all the operations of the Corporation. In the application of these principles, the Corporation will conduct its business with a sense of responsibility to its various constituencies, among them shareholders, employees, dealers, agents and distributors, customers, suppliers, governments and the community.

(i) *Shareholders*

In addition to its primary obligation to provide a fair return to shareholders, the Corporation will recognize a responsibility to conduct relations with them in an open and factual manner and in conformity with a policy of appropriate and timely disclosure.

(ii) *Employees*

Gulf Canada will continue to consider its employees as one of its greatest strengths. The Corporation will recognize as fundamental the obligation to encourage the development and well-being of its employees.

In its dealings with employees the Corporation will: ensure that employees and candidates for employment have equality of opportunity based on ability without regard for race, religion, national origin, sex, color or marital status; assist employees in improving and broadening job skills, encourage employee self-development and provide a work environment that is clean, safe, and that offers employees a sense of challenge and satisfaction; in recognition of the importance of employment stabilization, refrain from capricious hiring or firing practices; and communicate openly with employees on all aspects of Corporation policy and activity in which they have a legitimate interest.

(iii) *Dealers, Agents and Distributors*

Gulf Canada will continue to deal fairly and equitably with dealers, agents, distributors and others in similar positions by seeking to help them realize their aspirations for compensation, security and tenure while respecting their status as independent businessmen.

(iv) *Customers and Consumers*

Gulf Canada will continue to supply products of competitive quality at competitive prices supported by a level of service which will respond effectively to the needs of its customers. To meet and satisfy changing consumer demand, the Corporation will continue research programs to develop new and better products.

The Corporation will recognize the importance of energy conservation and will provide advice to customers in their efforts to utilize the Corporation's products efficiently.

Hand in hand with its commitment to conservation policies, the

Corporation will support government efforts aimed at securing adequate supplies of energy for all Canadians.

(v) *Suppliers*
Gulf Canada will purchase goods and services on the basis of cost, quality, reliability, and terms of delivery and service. On this basis, the Corporation will encourage purchases from Canadian manufacturers and will encourage the manufacture in Canada of materials essential to the Corporation's operations.

(vi) *The Community (Public)*
In addition to its responsibilities to shareholders, employees, customers and suppliers, Gulf Canada will recognize its responsibilties to the public at large.

Responsibilities will include: the conduct of Corporation business in an open, forthright and ethical manner in accordance with recognized norms in Canadian society; the assignment of a high priority to providing safe and clean facilities and services in all regions and communities of Canada where the Corporation operates; compliance with laws and regulations pertaining to the protection of the environment and the undertaking of additional efforts in instances where the Corporation considers further steps desirable and feasible; the encouragement of public awareness and understanding of the energy industry including problems associated with supply, demand, cost and environmental impact; the active participation in the resolution of public policy issues where the Corporation's expertise and experience will be useful; and the support of recognized educational, health, welfare and cultural objectives of the community.

(vii) *Governments*
Gulf Canada will continue to comply with all the laws and regulations of Canada and any country in which the Corporation carries on business.

In its relations with governments at the national, provincial and local levels, the Corporation will act in an open and forthright manner.

Gulf Canada will provide governments with information, advice and assistance where appropriate to help governments enact responsible policy and legislative measures in energy and related matters.

Gulf Canada will continue to stress its conviction that in any democratic society proper and constructive participation in the political process is a continuing responsibility of individuals and groups, including employees of the Corporation. Such participation must be in full accord with the regulations, laws and generally accepted practices of Canadian society.

The Corporation will not provide elected members or employees of any government department, agency, board or commission, directly or indirectly, with gifts, gratuities or anything of value through the use of corporate funds, services or facilities. Nothing in this paragraph prevents or prohibits employees of the Corporation from holding public office at the municipal or regional level when the duties of that office are part-time only and the discharge of which does not unreasonably interfere with the employee's ability to properly carry out the duties of his employment with the Corporation.

In any association with elected members or public servants, employees will continue to exercise careful judgment to avoid expenditures and other acts that might be perceived as improper or in violation of applicable laws.

Gulf Canada believes that it is socially responsible to support democratically constituted political organizations which support the concepts of the free enterprise system and that contributions to such organizations will help strengthen the political process in Canada. In accordance with Canadian laws, political contributions may be made from time to time to political parties, not to individuals or candidates for election, provided they are properly accounted for in the books of the Corporation and are within the aggregate annual amounts approved by the Board of Directors for such purposes.

III. Application

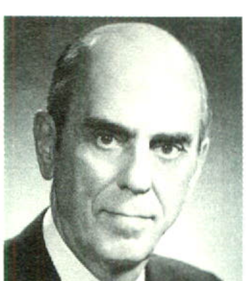
Strict compliance with the guidelines contained in the foregoing Business Principles is a condition of continued employment for all employees. Specific policies and procedures relating to a number of these principles are contained in the Corporate Policy Manual, of which this Statement forms a part. Observance of these principles includes the responsibility of each employee to seek interpretation in case of doubt about their application to a specific business situation and to report violations. Requests for interpretation and reports of violations should be made in writing, in the employee's discretion, to one of the following: the Chairman of the Board, the President, the Vice-President responsible for the department concerned, or the employee's immediate Supervisor.

The Chairman of the Board or the President shall be promptly notified of all requests for interpretation and reports of violations received by a Vice-President or a Supervisor, and the approval of either or both of them will be required for all decisions.

The Chairman of the Board will report to the Board of Directors from time to time on matters of major significance.

Directors

Kathleen M. Richardson
Director, James Richardson & Sons, Limited, Winnipeg, Manitoba. Director: Sun Life Assurance Company of Canada.



C.D. Shepard
Chairman of the Board and Chief Executive Officer, Gulf Canada Limited, Toronto, Ontario. Director: The Toronto-Dominion Bank.

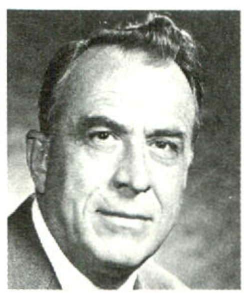
J.L. Stoik
President and Chief Operating Officer, Gulf Canada Limited, Toronto, Ontario.

Alfred Powis
Chairman of the Board and President, Noranda Mines Limited, Toronto, Ontario. Director: British Columbia Forest Products Limited; Canadian Imperial Bank of Commerce; Placer Development Limited; Simpsons Limited; Sun Life Assurance Company of Canada.

***J. Peter Gordon**
Chairman and Chief Executive Officer, The Steel Company of Canada, Limited, Toronto, Ontario. Director: The International Nickel Company of Canada Limited; Bank of Montreal; Sun Life Assurance Company of Canada; Gulf Oil Corporation.
*Resigned February 14, 1979

E.F. Crease
Chairman, Alfred J. Bell & Grant Limited, Halifax, Nova Scotia. Director: Canada Permanent Trust Company.

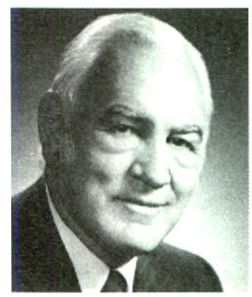
J.C. Phillips, Q.C.
Executive Vice-President, Gulf Canada Limited, Toronto, Ontario.



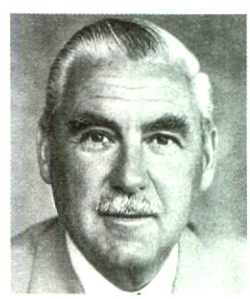
Gérard Plourde
Chairman and Chief Executive Officer, UAP Inc., Montreal, Quebec. Vice-President and Director: Alliance Compagnie Mutuelle d'assurance-vie; The Toronto-Dominion Bank. Director: Bell Canada; Editions du Renouveau Pedagogique Inc.; Northern Telecom Ltd.; The Molson Companies Limited; Rolland Paper Company Limited; Steinberg's Inc.

***W.P. Wilder**
Executive Vice-President, Gulf Canada Limited, Toronto, Ontario. Director: Canada Systems Group (EST) Limited.
*Resigned February 14, 1979

E.H. Crawford
President, The Canada Life Assurance Company, Toronto, Ontario. Director: Canadian Imperial Bank of Commerce; Moore Corporation Limited; Canadian Enterprise Development Corporation Limited.



L.P. Blaser
Executive Vice-President, Gulf Canada Limited, Toronto, Ontario. President: Alberta Products Pipe Line Ltd. Director: Interprovincial Pipe Line Limited; Trans Mountain Pipe Line Company Limited.

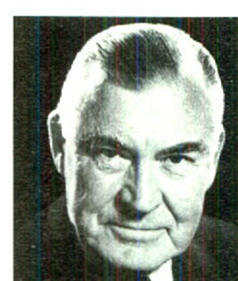


R.G. Rogers
Chairman of the Board and Chief Executive Officer, Crown Zellerbach Canada Limited, Vancouver, British Columbia. Director: Canadian Imperial Bank of Commerce; Genstar Limited; Hilton Canada Limited.

W.H. Young
President, The Hamilton Group Limited, Burlington, Ontario. Director: The Steel Company of Canada, Limited; Gore Mutual Insurance Company; National Trust Company Limited; Drummond, McCall & Co. Ltd.

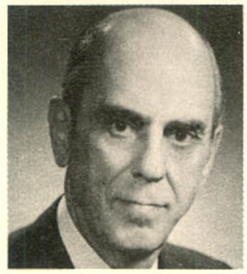
***J.D. Allan**
President, The Steel Company of Canada, Limited, Toronto, Ontario. Director: The Royal Trust Company; Royal Trustco Limited; Rockwell International of Canada, Ltd.
*Appointed February 14, 1979

D.S.R. Leighton
Director: Banff Centre, Banff, Alberta. Director: Canadian Appliance Manufacturing Co. Ltd.; GSW Limited; Lomex Mining Corporation; Rio Algom Limited; Standard Brands Limited; John Wiley and Sons Limited.



Beverley Matthews, Q.C.
Director Emeritus, Toronto, Ontario.

Officers



C.D. Shepard, Chairman of the Board and Chief Executive Officer.

J.L. Stoik, President and Chief Operating Officer.

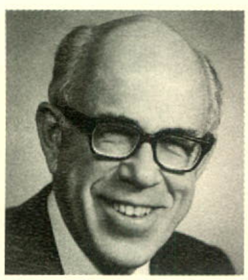
L.P. Blaser, Executive Vice-President.

J.C. Phillips, Q.C., Executive Vice-President.

***W.P. Wilder,** Executive Vice-President.

*Resigned February 19, 1979

****S.K. McWalter,** Calgary, Senior Vice-President responsible for Exploration and Production.



R.C. Beal, Vice-President responsible for New Business Development, Chemicals and Research.

****R.H. Carlyle,** Calgary, Vice-President responsible for exploration.

J.D. DeGrandis, Vice-President responsible for Supply and Distribution.

***L.G. Dodd,** Vice-President and Controller.

*Effective March 1, 1979

W.H. Griffin, Vice-President responsible for Marketing.

R.E. Harris, Vice-President responsible for Human Resources and Realty.

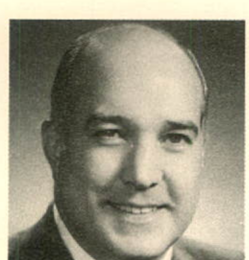
****E.M. Lakusta,** Calgary, Vice-President responsible for Production.

K.C. Reeves, Vice-President responsible for Refining.

C.G. Walker, Vice-President responsible for Public Affairs.

E.E. Walker, Vice-President responsible for Corporate Planning.

W.M. Winterton, Vice-President General Counsel and Secretary.



***W.H. Burkhiser,** Vice-President and Treasurer.

*Appointed Vice-President Effective March 1, 1979

***J.A. Scobie,** Comptroller.

*Retiring April 1, 1979

**Resigned December 31, 1978.

Effective January 1, 1979, S.K. McWalter was appointed President and Chief Executive Officer of Gulf Canada Resources Inc.; R.H. Carlyle and E.M. Lakusta were appointed Senior Vice-Presidents of the new company.

Gulf Canada Limited

Officers

C. D. Shepard, Chairman of the Board and Chief Executive Officer
J. L. Stoik, President and Chief Operating Officer
L. P. Blaser, Executive Vice-President
J. C. Phillips, Q.C., Executive Vice-President
*W. P. Wilder, Executive Vice-President
*Resigned February 19, 1979
*S. K. McWalter, Senior Vice-President
*Resigned December 31, 1978
R. C. Beal, Vice-President
*W. H. Burkhiser, Vice-President and Treasurer
*Appointed Vice-President Effective March 1, 1979
*R. H. Carlyle, Vice-President
*Resigned December 31, 1978
J. D. DeGrandis, Vice-President
*L. G. Dodd, Vice-President and Controller
*Effective March 1, 1979
W. H. Griffin, Vice-President
R. E. Harris, Vice-President
*E. M. Lakusta, Vice-President
*Resigned December 31, 1978
K. C. Reeves, Vice-President
C. G. Walker, Vice-President
E. E. Walker, Vice-President
W. M. Winterton, Vice-President, General Counsel and Secretary
*J. A. Scobie, Comptroller
*Retiring April 1, 1979

Directors

*J. D. Allan, Toronto
L. P. Blaser, Toronto
E. H. Crawford, Toronto
E. F. Crease, Halifax
**J. Peter Gordon, Toronto
Dr. D. S. R. Leighton, Banff
J. C. Phillips, Q.C., Toronto
Gérard Plourde, Montreal
Alfred Powis, Toronto
Kathleen M. Richardson, Winnipeg
R. G. Rogers, Vancouver
C. D. Shepard, Toronto
J. L. Stoik, Toronto
**W. P. Wilder, Toronto
W. H. Young, Hamilton

*Appointed February 14, 1979
**Resigned February 14, 1979

Director Emeritus

Beverley Matthews, Q.C., Toronto

Head Office

800 Bay Street, Toronto, Ontario
M5S 1Y8

Marketing Region Offices

Montreal, Quebec; Toronto, Ontario; Calgary, Alberta

Chemicals

Plants: Montreal East, Shawinigan and Varennes, Quebec

Accounting and Data Processing Centres

Montreal, Quebec; Toronto, Ontario; Calgary, Alberta

Research and Development Centre

Sheridan Park, Ontario

Exploration/Production Offices

Calgary, Edmonton and Stettler, Alberta; Estevan, Saskatchewan

Operated gas plants: Bashaw West, Buffalo Lake North, Gilby, Morrin-Ghost Pine, Nevis, North Sibbald, Pincher Creek, Rimbey, Strachan and Swalwell, Alberta

Pipelines

Operated pipelines: Alberta Products, Gulf Alberta, Gulf Saskatchewan, Rimbey, Saskatoon, Shawinigan and Valley

Refineries

Point Tupper, Nova Scotia; Montreal East, Quebec; Clarkson, Ontario; Edmonton, Alberta; Kamloops and Port Moody, British Columbia

Asphalt Plants

Moose Jaw, Saskatchewan; Calgary, Alberta

Principal Affiliates (wholly-owned)

COMMERCIAL ALCOHOLS LIMITED
Head Office: Montreal, Quebec
President: W. A. Rogers

*GULF CANADA RESOURCES INC.
Head Office: Calgary, Alberta
President: S. K. McWalter

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