Peyto Oils Ltd.

1980 Annual Report

PEYTO OILS LTD.

Peyto Exploration Inc.	100%
Giant Reef Petroleums Limited	82%
Not included in consolidation:	
Enjay Holdings Limited . . .	40%

HEAD OFFICE:

Suite 1460, 639 - 5th Avenue S.W.
CALGARY, Alberta T2P 0M9
Area Code 403-233-6600

OFFICERS:

P. D. WILLIAMS — *President*
J. A. REILLY — *Secretary*
J. K. TOMS — *Treasurer*

DIRECTORS:

P. D. WILLIAMS
R. T. VANDERHAM
D. R. YONT

BANKERS:

BANK OF MONTREAL
604 - 8th Avenue S.W.
CALGARY, Alberta. T2P 1G4

REGISTRAR AND TRANSFER AGENT:

MONTREAL TRUST COMPANY
411 - 8th Avenue S.W.
CALGARY, Alberta. T2P 1E7
15 King Street West
TORONTO, Ontario. M5H 1B4

AUDITORS:

PEAT, MARWICK, MITCHELL & CO.
2500, 700 - 2nd Street S.W.
CALGARY, Alberta. T2P 2W2

STOCK LISTING:

TORONTO STOCK EXCHANGE
STOCK SYMBOL — PYT

PEYTO OILS LTD.

COMPANY PROFILE

May, 1966 — Company incorporated in Alberta as private oil and gas exploration and producing company.

Jan., 1969 — Public share offering, 300,000 shares at $.75/share.

Nov., 1969 — Private share placement, 300,000 shares at $2.25/share.

May, 1970 — Issuance of 573,293 shares to acquire 65% controlling interest in Giant Reef Petroleums Limited.

Nov., 1970 — TORONTO STOCK EXCHANGE listing 1,755,293 shares outstanding.

Nov., 1971 — Private share placement 200,000 shares at $2.00/share.

1971-1972 — Drilling Fund obtained for $750,000.

Jan., 1973 — Issuance of 383,328 shares to acquire Polaris Oil Ltd. and its subsidiary companies.

Nov., 1973 — Private share placement 350,000 shares at $6.00/share to Francarep one of the French Rothschild group of companies. Subsequently M. Jean LeReun joined the Board of Directors as their representative.

Jan. 1977 — Drilling fund obtained for $3 million, granted option to acquire 150,000 shares at $5.50/share.

Jan., 1979 — Expanded drilling fund above to $5 million. Option to acquire 150,000 shares at $5.50 extended to Dec. 31, 1980.

Jan. 1980 — Purchase by Westburne International Industries Ltd. of 51.3% of Peyto's outstanding shares.

March, 1980 — Change of our year end to March 31 from May 31.

May 1, 1980 — Westburne offer to purchase remaining Peyto shares for $22.75 Cdn. or exchange 4 Westburne shares for 5 Peyto shares.

Dear Shareholder:

Submitted herewith are the financial results of your company for the 10 month period ending March 31, 1980.

As a result of the takeover of your company by Westburne International Industries Ltd., Peyto's year end has been changed to March 31.

Westburne as of July 10, 1980 owned 90% of Peyto's outstanding shares. Westburne's takeover offer of 5 shares of Peyto for 4 shares of Westburne remains open for your acceptance until September 2, 1980. Previously you have been advised that your directors recommend your acceptance of the offer. It is expected that an overwhelming percentage of the Peyto shareholders will accept the Westburne offer. Should this be the case Peyto's shares will no longer be actively traded and the company could lose its eligibility to remain on the Toronto Stock Exchange.

For the 10 month period under review oil and gas sales, after royalties, rose to \$8,190,000. Cash flow reached \$5,865,000 or \$2.05 per share and earnings were \$2,076,000 or 71 cents per share.

Production of oil and condensate reached new records at 952 barrels per day, production of gas at 8.7 million cubic feet per day was down fractionally from last year's average of 9.3 MMcf/d. This decline is due to lack of market for natural gas.

Drilling activity consisted of a total of 10 gaswells, 2 oilwells and 6 dry holes. In addition, 10 gaswells and 2 oilwells were drilled by others on the company's royalty acreage. A further 4 dry holes and 1 gaswell were drilled by others at no cost to your company.

The more significant exploration prospects in progress are as follows:

Hipper — Kimea, B.C.

Two exploratory wells were drilled this past winter on a total of 655 net acres of leases farmed in from others or purchased at Crown sales. Both wells are cased as potential gaswells; one is a dual zone discovery. Both wells require further testing during this coming winter season. The marketing of the gas awaits export approval. The pipeline is within 10 miles of the indicated gaswells.

Your company's interest varies from 20% to 33¹/₃%.

Nig Creek, B.C.

An exploration drilling reservation containing 3,163 hectares was purchased for \$753,000 with your company owning a 20% interest. A testwell is required to be drilled in the winter of '80 - '81.

Bearberry, Alberta

Your company (25%) participated in a 4,000 meter Mississippian test. Unfortunately this expensive (\$3.6 million) well proved to have only small amounts of non-commercial gas and as a result your company declined to participate in the completion of this well which would have cost an additional \$1.5 million. As a result Peyto forfeited all rights to the acreage on which this well was located.

Taber, Alberta

Your company leased to others its 800 acre block of mineral titles. To date 2 oilwells have been completed on this tract. Your company retains a 17¹/₂% royalty in this production.

Viking — Kinsella, Alberta

Your company has initiated legal action to repossess its 27,125 mineral acres from the lessee. Peyto claims that the lessee is in default of its obligation to market natural gas from the area and to safeguard the lands from drainage by adjoining producers. There are currently 26 indicated gaswells on the lands in question.

In the United States your company is very active and spending 80% of the company's budget there. Natural gas is readily marketable and no undue delays are encountered. Oil production in the U.S. is now sold at world prices and despite President Carter's windfall profit tax this return to the producers is roughly four times that of Canadian production.

The areas of your company's activities are:

Houston and Trinity Counties, Texas

Peyto is participating for a 30% interest in the acreage costs and the drilling of the Pullen prospect in Houston County and has an option to participate for a like interest in the West Glendale and Groveton prospects in Trinity County to the southeast.

If all three prospects are drilled, Peyto could have a 30% interest in 17,577 gross acres consisting of 6477 acres on the Pullen prospect, 5200 acres on West Glendale and 5900 acres on Groveton.

These prospects are located in the East Texas Basin, some 120 miles north of Houston and the Lower Cretaceous Buda and Glen Rose carbonates form the major objectives.

The Pullen prospect is seismically controlled and shows many similarities to the SW Ft. Trinidad field situated on trend to the southwest which produces mainly from the Glen Rose "B". The earning well on this prospect, Bonanza King #1, a proposed 13,000′ Glen Rose test, was drilled to just below 9000 feet when, due to mechanical problems with the rig, intermediate casing had to be run and operations suspended.

Drilling will continue on this venture as soon as a suitable drilling rig can be obtained.

Walker County, Texas

Peyto purchased a 25% interest in a gross 38,092 acres or a net 9,523 acres of leases in Walker County, in the East Texas Basin, some 100 miles north of the city of Houston. In addition to the lease purchase, Peyto agreed to assume its share of a commitment to drill four (4) wells to evaluate the Lower Cretaceous Buda, Georgetown and Glen Rose carbonates at depths of approximately 12,000 feet.

The Gibbs A-3 well has been drilled to a depth of 11,500 feet and yielded gas from the Buda at rates up to 8 MMcf/d. This well is now being placed on production.

The Gibbs A-4 has just reached total depth at 12,700 feet and casing is being run in preparation for completion.

Garfield County, Oklahoma

Peyto is participating for a 25% interest in a 14-well development drilling program along the Sooner oil producing trend in Garfield County, located some 75 miles north of Oklahoma City. The main objective is the Devonian Hunton/Misener carbonates which occur at a depth of approximately 8200 feet.

The drilling of these 14 wells will earn Peyto an interest in 2080 gross acres or a net 520 acres. This program is expected to commence the end of June, 1980.

Crawford and Erie Counties, Pennsylvania

Peyto has committed to participate for 50% in the drilling of an initial program of 15 wells, to develop gas reserves in the Silurian Medina sands on a 17,500 acre spread in northwestern Pennsylvania, around Titusville, the site of the original Drake oil discovery.

Six gaswells have already been drilled on the acreage which, upon completion flowed gas at rates of up to 2 MMcf/d. after fracing, from the Medina sands encountered at a depth of about 4,000 feet.

The initial drilling program is to commence immediately and Peyto may elect to continue its participation after the first 15 wells for the drilling of up to 140 wells in total. Peyto's 50% participation in this program will result in it receiving 50% of the net income until payout after which its interest will reduce to 35%.

A "take or pay" gas contract has already been signed with Columbia Gas and a pipeline connection is being constructed in the area.

Worldwide Exploration

Australia

The BP Phoenix No. 1 scheduled 14,500 foot test drilling on Offshore Permit WA-62-P in the northwest shelf area of Australia has encountered high pressured, apparent gas bearing sands and as a result, drilling operations have been suspended until a more suitably equipped rig becomes available to re-enter the hole for deepening and further appraisal.

This well is being drilled on a farmout basis on the most southwesterly of two, 5 million acre blocks in which Peyto has a 15% interest in this offshore area of Australia. When BP have fulfilled their drilling commitment, Peyto's interest in the 5 million acre block in which the well is being drilled will be reduced to 6.75%.

Sri Lanka

Peyto is a 25% interest partner in a group that was recently awarded a 3,500 sq. km. Production Licence in the offshore area of Sri Lanka. A 1,000 km. seismic program is to be carried out over this acreage during the next 18 months.

SUBMITTED ON BEHALF OF THE BOARD OF DIRECTORS

P. D. Williams

Consolidated Balance Sheet March 31, 1980

(with comparative figures as at May 31, 1979)
(Thousands of Dollars)

Assets

	March 31, 1980	May 31, 1979
Current assets:		
Deposit receipts, including accrued interest	$ 503	713
Accounts receivable	2,796	1,780
Prepaid expense	33	18
Total current assets	3,332	2,511
Property, plant and equipment, at cost (Note 2)	25,433	19,250
Less accumulated depletion and depreciation	5,384	4,185
	20,049	15,065
Other assets:		
Agreement for sale due December, 1980	—	212
Investments at cost less amounts written off (quoted market value — $251,000; May 31, 1979 — $164,000) (Cost $230,000)	109	109
Due from employees and other company	52	56
Sundry	169	173
	330	550
	$23,711	18,126

On behalf of the Board:

P. D. Williams, Director

R. T. Vanderham, Director

See accompanying notes.

Liabilities and Shareholders' Equity

	March 31, 1980	May 31, 1979
Current liabilities:		
Due to bank		
Outstanding cheques less cash on deposit	$ 432	154
Demand loans (Note 3)	626	1,749
	1,058	1,903
Accounts payable and accrued liabilities	3,182	1,043
Income taxes payable	55	166
Current portion of long-term debt	192	—
Total current liabilities	4,487	3,112
Long-term debt, less amount due within one year (Note 4)	575	—
Deferred revenue	388	151
Deferred income taxes	4,180	2,978
Minority interest in subsidiary company	404	309
Shareholders' equity:		
Share capital (Note 5):		
Authorized — 6,000,000 common shares without nominal or par value.		
Issued — 2,864,883 shares (May 31, 1979 — 2,854,583 shares)	6,352	6,327
Retained earnings	7,325	5,249
	13,677	11,576
	$23,711	18,126

Auditors' Report to the Shareholders

We have examined the consolidated balance sheet of Peyto Oils Ltd. and subsidiary companies as at March 31, 1980 and the consolidated statements of earnings, retained earnings and changes in financial position for the ten months 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 and subsidiary companies as at March 31, 1980 and the results of their operations and the changes in their financial position for the ten months then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Calgary, Canada
May 16, 1980

Peat, Marwick, Mitchell & Co.
Chartered Accountants

Consolidated Statement of Earnings
Ten months ended March 31, 1980

(with comparative figures for the year ended May 31, 1979)
(Thousands of dollars except per share data)

	Ten months ended March 31, 1980	Year ended May 31, 1979
Revenues:		
Oil and gas	$ 8,190	6,940
Interest earned	21	56
Management and other income	70	126
Net profit on drilling agreements	—	969
Gain on sale of properties and investments	9	43
	8,290	8,134
Expenses:		
Production	1,481	1,664
Lease rentals	182	133
Geological and geophysical	57	262
General and administrative	547	382
Interest — long-term	105	206
— short-term	153	110
Depreciation	429	472
Depletion	778	728
Dry holes and abandonments	1,290	1,153
Net loss on drilling agreements	198	—
	5,220	5,110
Earnings before income taxes, minority interest and extraordinary items	3,070	3,024
Income taxes		
Current	84	276
Deferred	1,202	1,071
Province of Alberta Royalty Tax Credit	(390)	(420)
	896	927
Earnings before minority interest and extraordinary items	2,174	2,097
Minority interest	98	63
Earnings before extraordinary items	2,076	2,034
Extraordinary items:		
Gain on sale of foreign properties, net of related income taxes of $750,000 and minority interest of $36,000	—	1,950
Reduction in income taxes due to application of loss carry forward from prior years	—	154
	—	2,104
Net earnings	$ 2,076	4,138

See accompanying notes.

Consolidated Statement of Earnings (Continued)
Ten months ended March 31, 1980

(with comparative figures for the year ended May 31, 1979)
(Thousands of dollars except per share data)

	Ten months ended March 31, 1980	Year ended May 31, 1979
Earnings per share:		
Basic		
Before extraordinary items	**$ 0.73**	$ 0.71
Extraordinary items	**—**	0.74
Net earnings	**0.73**	1.45
Fully diluted		
Before extraordinary items	**0.71**	0.67
Extraordinary items	**—**	0.70
Net earnings	**$ 0.71**	1.37

See accompanying notes.

Consolidated Statement of Retained Earnings
Ten months ended March 31, 1980

(with comparative figures for the year ended May 31, 1979)
(Thousands of Dollars)

Retained earnings at beginning of period	**$ 5,249**	1,824
Add:		
Net earnings	**2,076**	4,138
	7,325	5,962
Deduct:		
Dividends — common shares	**—**	713
Retained earnings at end of period	**$ 7,325**	$ 5,249

See accompanying notes.

Consolidated Statement of Changes in Financial Position
Ten months ended March 31, 1980

(with comparative figures for the year ended May 31, 1979)
(Thousands of Dollars)

	Ten months ended March 31, 1980	Year ended May 31, 1979
Funds provided:		
Earnings before minority interest and extraordinary items	**$ 2,174**	2,097
Add: Items not requiring (providing) funds:		
Depreciation	**429**	472
Depletion	**778**	728
Deferred income taxes	**1,202**	1,071
Dry holes and abandonments	**1,290**	1,153
Other	**(8)**	183
Funds from operations	**5,865**	5,704
Increase in deferred revenue	**237**	104
Issuance of share capital	**25**	—
Proceeds from long-term debt	**767**	—
Proceeds on sale of property and investments, net of current income taxes of $394,000	**—**	2,483
Decrease in agreement for sale	**212**	—
Decrease in due from employees and other company	**4**	21
Decrease in sundry assets	**4**	—
	7,114	8,312
Funds applied:		
Purchase of property, plant and equipment	**7,473**	5,243
Decrease in long-term debt	**192**	3,050
Increase in sundry assets	**—**	16
Increase in agreement for sale	**—**	212
Purchase of additional shares in subsidiary	**3**	3
Dividends paid	**—**	713
	7,668	9,237
Decrease in working capital	**554**	925
Working capital deficiency, beginning of period	**601**	(324)
Working capital deficiency, end of period	**$ 1,155**	601

See accompanying notes.

Notes to Consolidated Financial Statements
March 31, 1980

1. Summary of significant accounting policies:

(a) Accounting principles:

The consolidated financial statements have been prepared in accordance with generally accepted accounting principles in Canada.

(b) Principles of consolidation:

The consolidated financial statements include the accounts of all wholly-owned subsidiary companies and an 82% held subsidiary, Giant Reef Petroleums Limited.

The excess of the purchase price of the shares of Giant Reef Petroleums Limited over the underlying net book values, at dates of acquisition, has, on consolidation, been added to the cost of developed oil and gas properties and is being depleted on the unit-of-production method.

(c) Petroleum and natural gas properties:

The Company follows the successful efforts method of accounting for costs of oil and gas properties. The costs of drilling and equipping successful wells are capitalized. Lease acquisition costs are capitalized and are subsequently expensed in the year of disposal, abandonment or surrender. All other exploration costs, including lease carrying costs, geological and geophysical costs and drilling costs of unsuccessful wells are expensed. Costs pertaining to producing properties are depleted on the unit-of-production method based on proven reserves as calculated by independent engineers.

Lease and well equipment and gas plants are being depreciated on the unit-of-production method. A subsidiary company's gas plant is being depreciated on the straight-line basis using a rate of 5% per annum.

Expenditures on maintenance and repairs are charged to operations as incurred, while expenditures on renewals and betterments are capitalized.

Upon the sale or retirement of properties and improvements, the cost and accumulated depletion and depreciation are removed from the respective accounts and any gain or loss is included in earnings.

(d) Joint Ventures:

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

(e) Drilling agreements:

In 1976, the Company entered into drilling agreements with limited partnerships (the Partnerships) under which the Partnerships have the right to acquire working interests in certain undeveloped properties. Pursuant to the agreements, the Partnerships incur the cost for the acquisition of oil and gas rights, geological costs and drilling costs under a turnkey drilling arrangement with the Company. The Company bears the cost of completing and equipping successful wells, subject to limits within the agreement, in excess of which the Partnerships share such costs. Under the Company's accounting policies, profits on the turnkey drilling arrangements are deferred until all drilling has been completed in an area of mutual interest. Losses are recognized in the accounts as they are identified.

In addition to the turnkey cost, further payments of specified amounts plus interest are to be made to the Company by the Partnership over the period up to January 1, 1999. These amounts are secured by and payable from net revenue interests in the properties and the unpaid balance, if any, is payable by the Partnership on January 1, 1999. After payout of such amounts, the Company retains a reduced interest in each property. Amounts to be paid from the net revenue interests aggregate approximately $8,600,000 at March 31, 1980 (May 31, 1979 — $7,100,000). Further payments of specified amounts plus interest, which are derived from the net revenue interests, are reflected in earnings when production is realized.

(f) Deferred revenue:

Payments received for undelivered gas are deferred and are taken into income when the deliveries are made or the make-up period expires.

(g) Foreign currency translation:

Accounts of a foreign subsidiary are translated to Canadian dollars. Current assets and liabilities are translated at year end rates of exchange. Non-current assets and liabilities are translated at rates in effect when acquired or incurred. Income accounts other than depreciation, depletion and dry holes and abandonments are translated at the average rate in effect throughout the year. Depreciation, depletion and dry holes and abandonments are translated at historical rates. Gains or losses on translation of foreign currencies are included in net earnings.

At March 31, 1980 the Canadian dollar was quoted at $0.84 United States equals $1.00 Canadian (May 31, 1979 — $0.86). The average rate for the year ended May 31, 1979 was $0.86 United States equals $1.00 Canadian and for the ten months ended March 31, 1980 was $0.85.

(h) Income taxes:

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

(i) Comparative figures:

Certain of the 1979 comparative figures have been reclassified to conform with the financial statement presentation in 1980.

2. Property, plant and equipment:

	March 31, 1980		May 31, 1979	
	Cost	Net Book Value	Cost	Net Book Value
Developed oil and gas properties and equipment thereon	$ 18,474,000	14,268,000	14,374,000	11,166,000
Gas plants	3,310,000	2,132,000	3,188,000	2,211,000
Undeveloped oil and gas properties	3,649,000	3,649,000	1,688,000	1,688,000
	$ 25,433,000	20,049,000	19,250,000	15,065,000

3. Due to bank:

Demand bank loans are secured by a general assignment of interests in certain oil and gas properties and accounts receivable.

4. Long-term debt:

	March 31, 1980	May 31, 1979
Agreement for sale payable in four annual installments commencing September 1980 of $192,000 with interest at bank prime rate plus 1%. The annual payments are secured by letters of credit issued by the Company's bankers. A standby charge of 1% per annum is charged on the letters of credit	$ 767,000	—
Less amount due within one year	192,000	—
	$ 575,000	—

5. Share capital:

During the ten months ended March 31, 1980, 10,300 shares were issued under an employee stock option plan for a total consideration of $25,000. No shares were issued during the year ended May 31, 1979.

As at March 31, 1980 the Company has reserved 55,000 shares for employee stock options. 50,000 options were granted on October 12, 1979 and are exercisable at a price of $15.30 per share, at the rate of 5,000 options per year in each of the following ten years. 5,000 options were granted in January, 1980 and are exercisable at a price of $14.40 per share, at the rate of 1,000 options per year in each of the following five years.

In connection with drilling agreements entered into by the Company and limited partnerships, the Company granted to a third party, Prodeco Oil and Gas Co. Ltd. (Prodeco), options to purchase up to a maximum of 150,000 Peyto common shares. The options were earned by Prodeco at the rate of 50 options exercisable at $5.50 per share, in exchange for each $1,000 of drilling costs expended by the partnerships. The partnerships had expended sufficient monies by May 31, 1979 to entitle Prodeco to the maximum number of shares under option. The options expire December 31, 1980 and none had been exercised at March 31, 1980.

6. Remuneration of directors and officers:

The aggregate remuneration paid to senior officers (as defined by the Companies Act, Alberta, which term includes the five highest paid employees of the Company) during the year amounted to $171,558 (1979 — $142,725). No remuneration was paid to directors as such.

Peyto Oils Ltd.

lawson graphics western limited