HOUSTON OILS LIMITED

1974 ANNUAL REPORT

inside

HOUSTON OILS LIMITED and Subsidiary Companies

1974 highlights

- Oil, gas and ore sales, after royalties, increased 66% to $1,590,760.
- A large real estate purchase was made 20 miles northwest of Dallas at Lewisville, Texas.
- A $5,250,000, interest-free loan agreement entered into with Michigan Wisconsin Pipe Line Company for development of Company's Beaver County, Oklahoma properties.
- 49 gaswells completed, equivalent to 15.8 net wells.
- U.S. exploration office opened in Dallas, Texas.
- Federal and Provincial confrontation over jurisdiction of oil and gas created considerable uncertainty within industry.

CALGARY SKYLINE

OIL PRODUCING FACILITY

report to the shareholders

During the past year, Houston Oils Limited realized a 66% increase in oil, gas and ore revenue, after royalties, primarily as a result of higher wellhead prices and new gas production from several properties.

Cash flow for the year before writing down the loss on securities, was $624,081 or 8¢ per share compared to $880,904 or 12.7¢ per share last year. Due to interest payments on the 15 year, $5,000,000 convertible subordinated note and the reduction in market value of securities held in other companies, the Company had a net loss of $953,568 or 12¢ per share for the year compared to a restated net profit of $351,501 or 5¢ per share last year. The reported loss on securities is due to the method of accounting dictated by the Canadian Institute of Chartered Accountants. The securities have not been sold and your management has no intention of selling the securities at a loss.

The Company participated in the drilling of 105 exploratory and development wells, of which 49 were completed as gas wells and 56 were abandoned as dry holes. Our overall success ratio for the year was 46.6% as compared to 39.3% last year.

Our most successful exploration programs were conducted in the Hairy Hill-Hollow Cossack areas of Alberta and in Beaver County, Oklahoma, where the Company's U.S. subsidiary, Bridger Petroleum Corporation drilled 23 wells with 11 resulting in gas wells. The Beaver County program is being financed through a development loan agreement with Michigan Wisconsin Pipe Line Company whereby the amount of $5,250,000 is advanced to Bridger interest free. These funds are being used to drill 40 gross wells (minimum 30 net wells) and in return for the loan, Michigan Wisconsin has the exclusive right to purchase any gas found under the program. At year-end, four of the wells had commenced producing gas and additional wells are expected to be producing by February, 1975. This new production will add substantially to the Company's revenue in the coming year.

Houston's search for new oil and gas reserves will be accelerated during the next fiscal year with the major portion of a 9.7 million dollar budget to be spent on exploration and development projects. Revenues from all sources are forecast at $8.2 million. The source of funds for the anticipated deficit of $1.5 million dollars, will be either through the sale of securities owned in other companies, the sale of certain properties or through bank financing.

The real estate property containing 967 acres located near Lewisville, Texas, which was purchased as a short term investment by the Company through Bridger in December, 1973, continues to appreciate in value as evidenced by recent sales of adjacent and nearby parcels. The Xerox Corporation, the owner of adjacent acreage, will likely commence construction of its manufacturing facility in 1975. This facility will have a pronounced effect on enhancing

ACKNOWLEDGMENT

During the year Mr. Neil A. McConnell resigned as a Director of the Company. Mr. McConnell was a valued member of the Board of Directors and Executive Committee. On behalf of the shareholders we wish to extend our sincere thanks for his service to the Company.

the future sale value of our land. The Company continues to view both this tract as well as the 202 acre parcel purchased on Lake Dallas, as secure investments. We presently intend to apply any net proceeds from the ultimate disposition of these properties toward the Company's oil and gas exploration and development programs.

Often we receive inquiries from shareholders and the investment community as to the reason exploration on certain projects, which have been mentioned in previous reports, is not always carried out on schedule. Many factors govern the timing of a particular project. In most cases, especially in wildcat projects carrying a high degree of risk, we seek out desirable partners to participate with us, and frequently, finding participants on terms favourable to the Company takes longer than anticipated. There is a scarcity of drilling rigs virtually all over the world, and shortages of oilfield equipment and supplies, which often are a delaying influence.

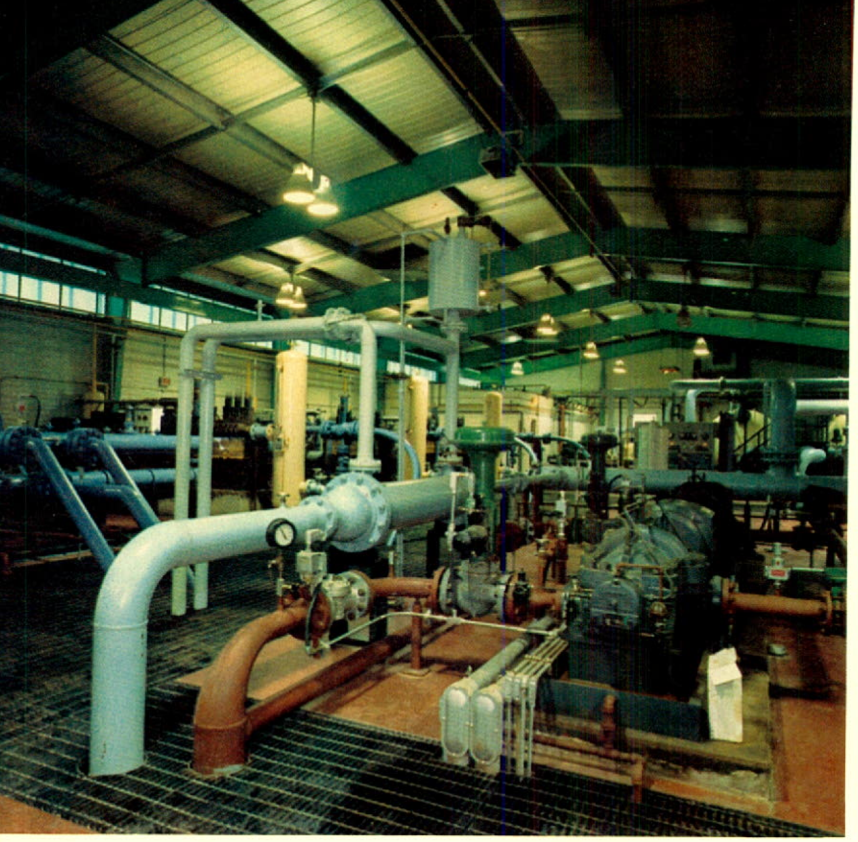
In 1974, the oil and gas industry found itself in the midst of considerable turmoil. The oil embargo, used as an economic weapon by the OPEC nations, not only had a dramatic effect on the world price of crude oil, but focused for North America the harsh reality of an acute energy supply shortage, especially in the United States. In Canada, rapidly rising oil and gas prices were accompanied by increased royalties and confrontation over resource taxation rights in a power struggle between the Federal and Provincial Governments. This governmental conflict together with market controls, price controls, export tax and the recent November budget proposal for non-deductibility of Provincial royalties when calculating Federal corporate taxes, has resulted in the reassessment and curtailment of exploration plans for Canada by a number of companies. In order to ensure a healthy Canadian oil and gas industry, it will be necessary to resolve the governmental conflicts quickly and once again create a hospitable investment and economic climate in order to rebuild the confidence necessary to attract those willing to risk venture capital for exploration and development programs in Canada.

Because of the additional burdens and the present uncertainties regarding prices, royalties and taxes in Canada, Houston plans to restrict its exploration to Alberta, where it will continue to aggressively search for shallow gas reserves. The Company will also accelerate its exploration efforts in the United States during the coming year.

ON BEHALF OF THE BOARD

A. E. Whitehead

A. E. Whitehead,
President



GAS PROCESSING PLANT

exploration and development

During 1974, exploration and development of petroleum and mineral properties was significantly increased in the continental U.S., maintained in Canada, and somewhat decreased in foreign areas.

Houston participated in a total of 105 gross and 38 net wells of which 48 gross and 15.8 net wells were successfully completed as gas producers. The U.S. effort resulted in a substantial increase in land holdings on new prospects in Texas, Oklahoma and the Rocky Mountain states.

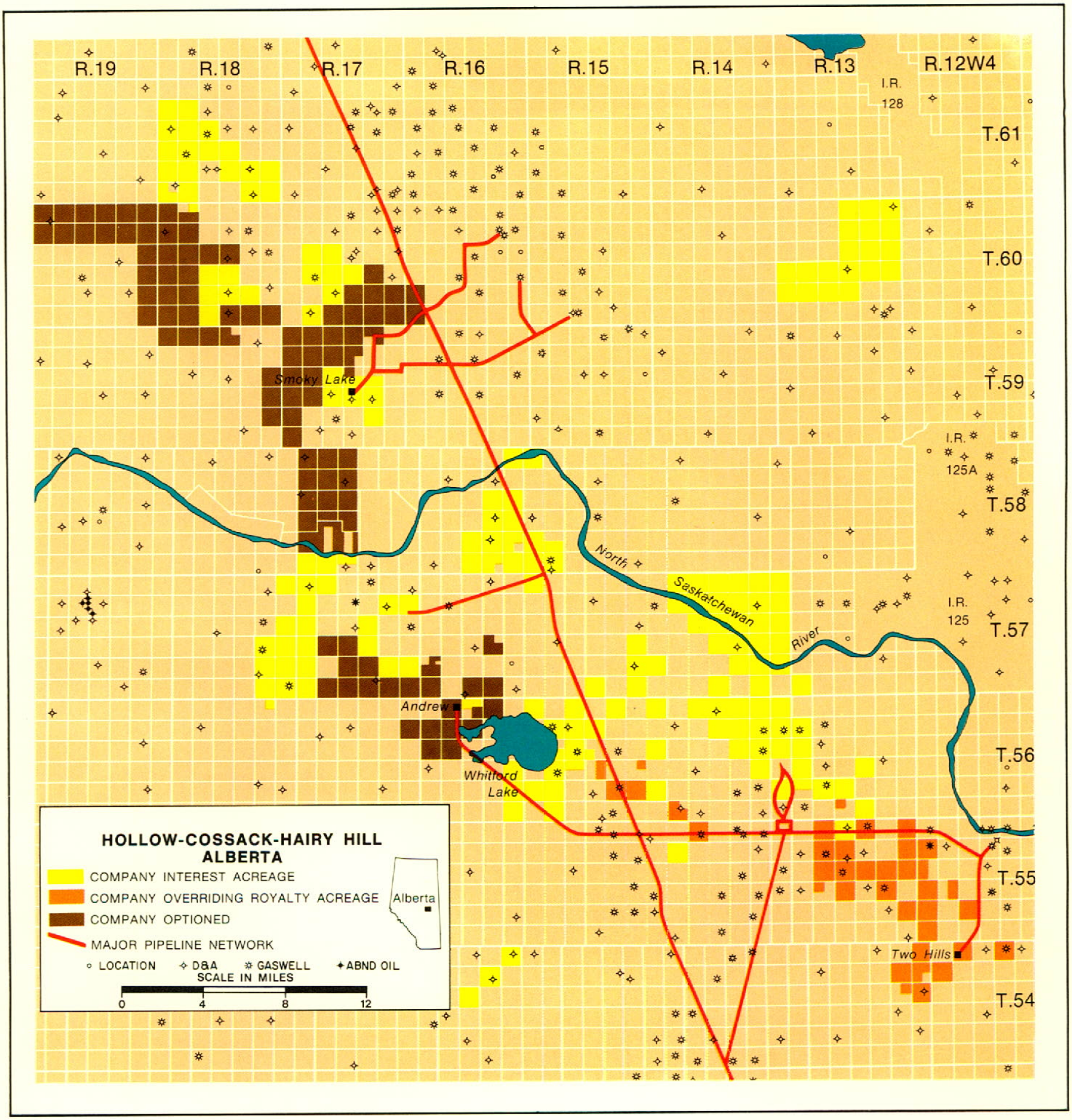
Significantly increased cash flow will be seen in 1975 through improved producing revenues as several 1974 gas successes in Alberta and Oklahoma are placed on stream.

CANADA

Arctic — Houston owns 10.5% of the common shares of Magnorth Petroleum Ltd. which holds 14,412,144 acres of oil and gas permits located primarily offshore in extensive geological basins of the Arctic Islands. These permits are farmed out to Norlands Petroleums Limited, a wholly-owned Canadian subsidiary of Northern Natural Gas Company of Omaha, Nebraska. A total of 13,767 miles of seismic data has been shot and interpreted with favourable results. Under terms of the Magnorth-Norlands agreement, Norlands can earn up to 50% of Magnorth's acreage by spending approximately $36,000,000. Because environmental impact studies have not been completed by the Federal Government and the lead time required to obtain sophisticated drilling equipment, it now appears a test well cannot be drilled on Magnorth acreage before 1977.

Northeast British Columbia — Marketing of gas from three wells in the Buick Creek field commenced on April 24, 1974 at a rate of 3.5 million cubic feet of gas per day. Houston is the operator of these wells and has net daily gas sales of 1.2 million cubic feet of gas per day. During 1974, the pool was declared by the British Columbia Petroleum Corporation to be "new gas" resulting in the new wellhead price of 22¢ per Mcf.

At the Grizzly-Monkman Pass prospect, Houston has a gross overriding royalty varying from .75% to 3% on 22,440 acres. During 1974, the operator of the project completed one additional gas well and has indicated that it is attempting to finalize a contract so that gas sales may commence in 1976.



Alberta — A total of 9 exploratory tests were drilled in the Wandering River area of north-eastern Alberta, of which three were indicated gas wells. Negotiations are currently underway for the marketing of gas from this area, with an anticipated commencement of sales in late 1976-77. During the 1975 winter, the drilling of 15 exploration and development wells is scheduled.

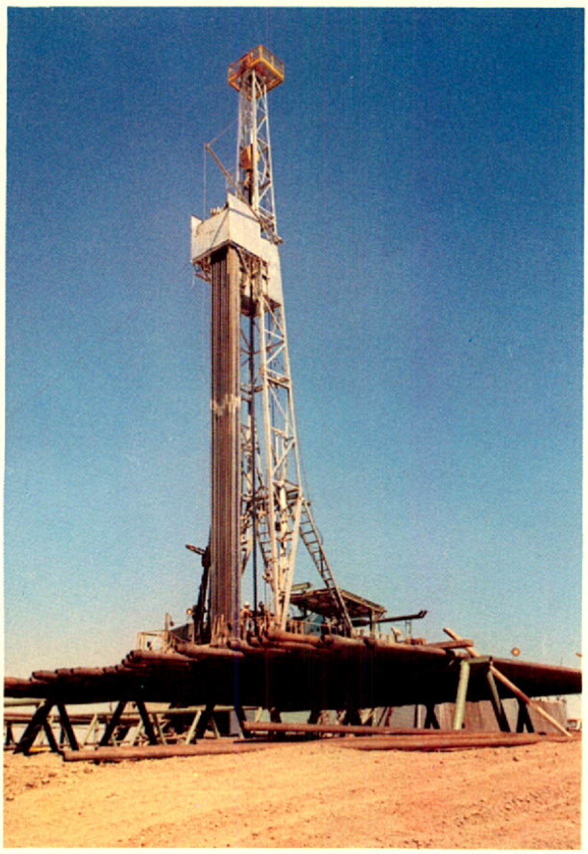
In the shallow gas areas of central Alberta at Hairy Hill and Hollow Cossack, the company participated in the drilling of 16 wells of which 9 wells were successful gas completions as shown on the accompanying maps. At Hairy Hill, negotiations on a gas contract were being finalized at year end and construction of a gathering system and joint gas plant will be commenced early in 1975. Initial gas sales for Houston and its partners are expected to start early in the spring with full plant capacity of 26 million cubic feet of gas a day being reached in September. Houston's working interest share will be approximately 12.5% of the gathering system and plant which will yield to the Company an average daily gas flow between 3.5 and 5.0 million cubic feet at an initial price of 60¢ per MCF. At Hollow Cossack, it is expected that gas production will be contracted and placed on stream in late 1975 or early 1976.

East Coast — There were two gas discoveries reported on the Labrador coast in 1974 by other operators. Houston's 1,603,865 acre block, in which the Company has a 25% working interest, is located approximately 300 miles south of the new discoveries. A detailed marine geophysical evaluation is to be carried out on this block in the first quarter of our next fiscal year with results of interpretation expected in the second quarter.

UNITED STATES

General — Bridger Petroleum Corporation, Houston's wholly owned United States subsidiary, opened its principal U.S. exploration office in Dallas, Texas on the first of August. This will generate a much wider range of participation in new projects in a substantially expanded U.S. operation.

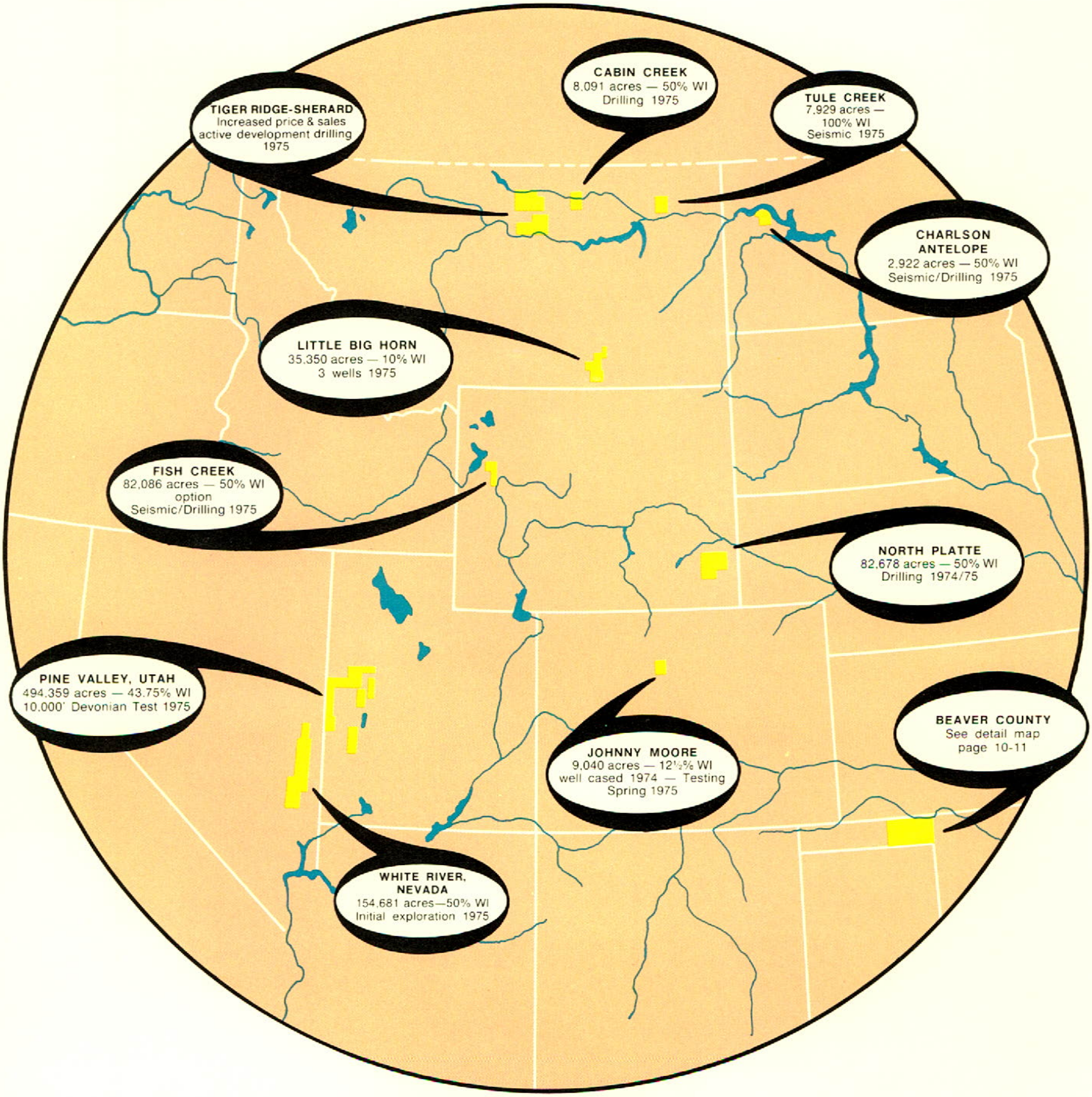
Rocky Mountain Area — Land holdings were increased by 139,494 net acres by acquisition of 5 major properties containing 288,728 gross acres in Montana, Wyoming and Nevada as shown on the map on page 7. In addition, options to earn after geophysical evaluation were taken on 82,000 acres on two prospects in North Dakota and Wyoming. These new projects have excellent wildcat potential and several exploratory wells will be drilled during 1975. In Utah, where we hold an interest in 494,359 acres of leases, plans are being finalized to bring in partners and drill a 10,000' Devonian test; this well will commence drilling during December. In Montana, gas sales commenced in January at Sherard and new gas wells were completed at Tiger Ridge and Sherard after the Federal Power Commission set an area rate of 50¢ per thousand cubic feet (MCF) for new gas.



OKLAHOMA DRILLING OPERATION

Oklahoma — Bridger's primary area of interest during 1974 was Beaver County in the Oklahoma Panhandle of the Anadarko Basin as shown on accompanying maps. A total of 23 gross and 19.38 net wells were drilled of which 8.5 net gas wells were completed. Gas sales commenced July 11th and at year end 2.5 net wells were flowing some 3 million cubic feet of gas and 100 barrels condensate per day with a further 6 net wells scheduled to go on stream late in the year or early 1975. These wells were all drilled under the contract and prepayment agreement with Michigan Wisconsin Pipe Line Company, who advanced a cumulative $3,391,500 of the interest-free loan to drill the wells. During 1975 a minimum of 10 net wells will be drilled under this contract along with at least 10 more in Beaver County and in Major-Garfield Counties some 75 miles east. Bridger's working interest in these projects will range from 25% to 100%.

Gulf Coast — During the year a total of 18,935 lease acres were acquired on 5 prospects in Louisiana, Texas and Mississippi. Bridger has a 100% working interest in four of the projects on which two wells will be drilled in 1975. On the fifth prospect, it is anticipated a 20,000' Wilcox test will be drilled in mid 1975 if casing and a rig capable of deep drilling is available. Bridger has 6¼% working interest in this seismically controlled structure which overlies a deep seated salt dome.



NORTHERN USA — ROCKY MOUNTAIN AREA

COMPANY INTEREST ACREAGE

Scale 1" — 189 miles

FOREIGN

Dutch North Sea — The company increased its interest in Block E/7 to 11.58% as a result of the seismic program carried out in 1973. Four large structures have been delineated and each is located partially on Block E/7; a fifth structure, located entirely on this block, is being evaluated further by seismic rework. Natomas Company, as operator, is hopeful that an agreement with offsetting Block holders can be reached so that a test well might be drilled during 1975. On Block Q-11, additional seismic work was commenced, but the project will not be completed until 1975 due to equipment problems.

British North Sea — Additional seismic evaluations have been carried out on the three British North Sea blocks in which the company has a 33 1/3% interest. It would appear that the structure is not sufficiently attractive to merit our drilling and, unless the Company can arrange a farm-out to third parties we will let the blocks terminate at the end of the present term.

Spain — During the year, a reconnaissance seismic program of approximately 100 miles was conducted on the four exploratory blocks located offshore in the Gulf of Cadiz. The information obtained from this survey looks promising enough to proceed with the second phase of our exploration program which involves a detailed seismic program of some 400 miles. This will be conducted during 1975. The company has a 33 1/3% interest in these blocks which contain a total of 376,224 acres.

Ethiopia — Photogeological studies and a gravity survey comprising 635 stations were completed on the 8,302,200 acre petroleum concession in which the company has a 25% interest. Subsequent to the gravity survey, an attempt was made to bring in third parties to do a more detailed seismic program over subsurface leads on this block; however, due to the political unrest in the country, we were unable to find any interest within the industry. Unless we can find interested parties prior to December, 1974, the concession will be surrendered.

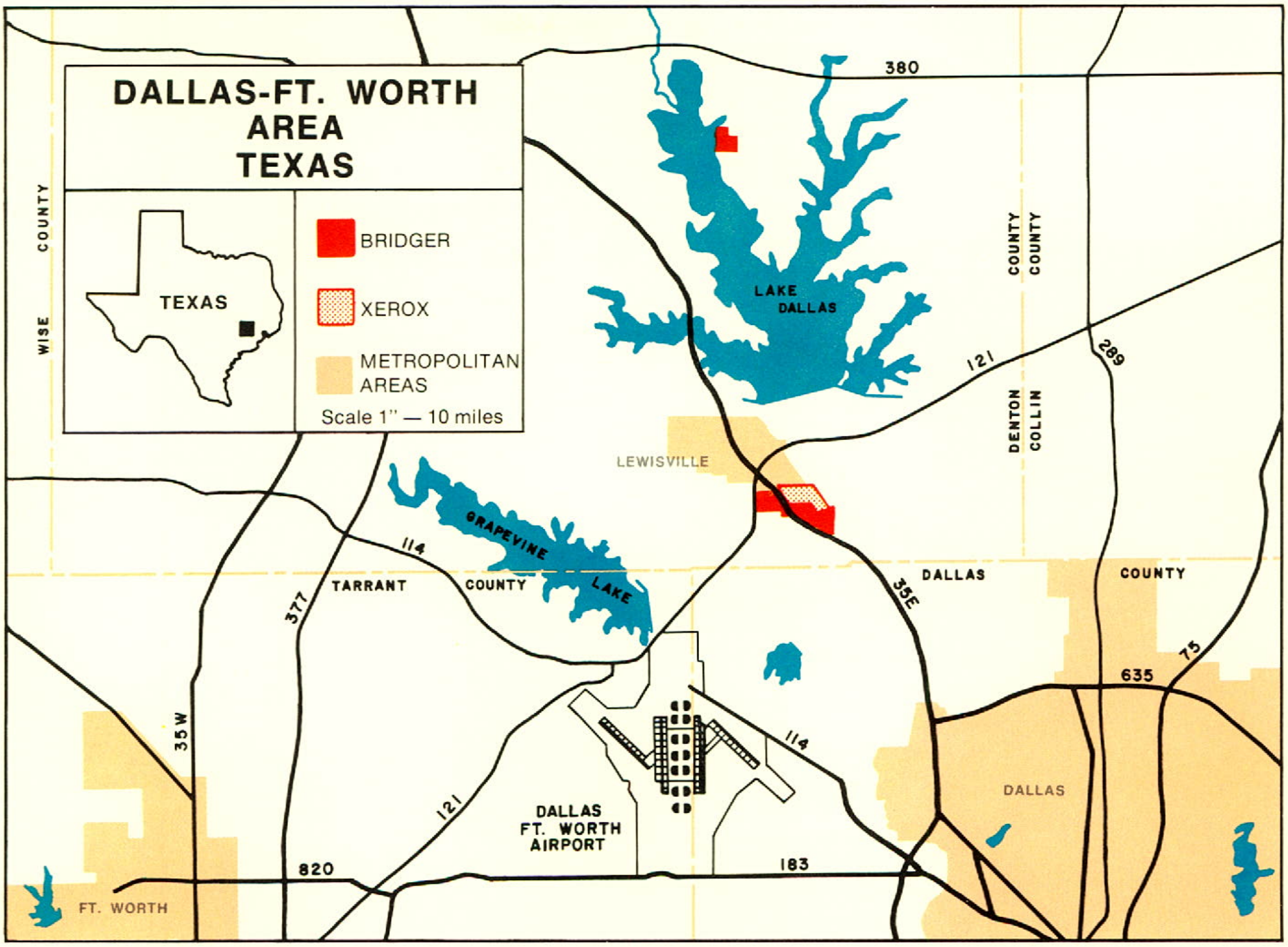
Indonesia — Additional seismic work was carried out during the year and several new prospects were delineated. ARCO, as operator on this project, was unable to secure an offshore type drilling rig with which to test some of the more prominent offshore features; however, they have located a land rig and we anticipate drilling 3 test wells on prospects located on the islands contained in our concession block. The anticipated drilling date of the first test in this program is expected to be early in February, 1975. Caltex has offset its No. 1 Padada oil discovery with another oilwell and has a rumored discovery at its Sabak No. 1. The Padada discovery is eight miles from our concession while the Sabak rumored discovery is five miles.

Abu Dhabi — During the year, Amerada Hess Corporation completed a discovery and a follow-up well on the offshore Abu Dhabi concession. The wells tested high gravity, low sulphur oil at rates of up to 4000 and 7000 barrels per day respectively. Drilling plans are being completed for a third test which will be located on the same structure and north of the original discovery well. Bridger holds a 5% carried working interest in this project.

MINERAL EXPLORATION

Mineral exploration was conducted in several areas of the world through companies in which we have a small share equity, a mining syndicate participation and a limited partnership. Aquarius Mines Ltd. continued exploration on several gold properties in British Columbia. The Southern Ventures Mining Syndicate initiated drilling by another party for uranium on exploration licences held by the syndicate in South Australia. The BNB Limited Partnership commenced exploration on a large gold prospect in Northwestern Brazil. This program is being carried out in association with several prominent Brazilians and the Louis Dreyfus Corporation.

MINERAL DRILLING IN ARIZONA



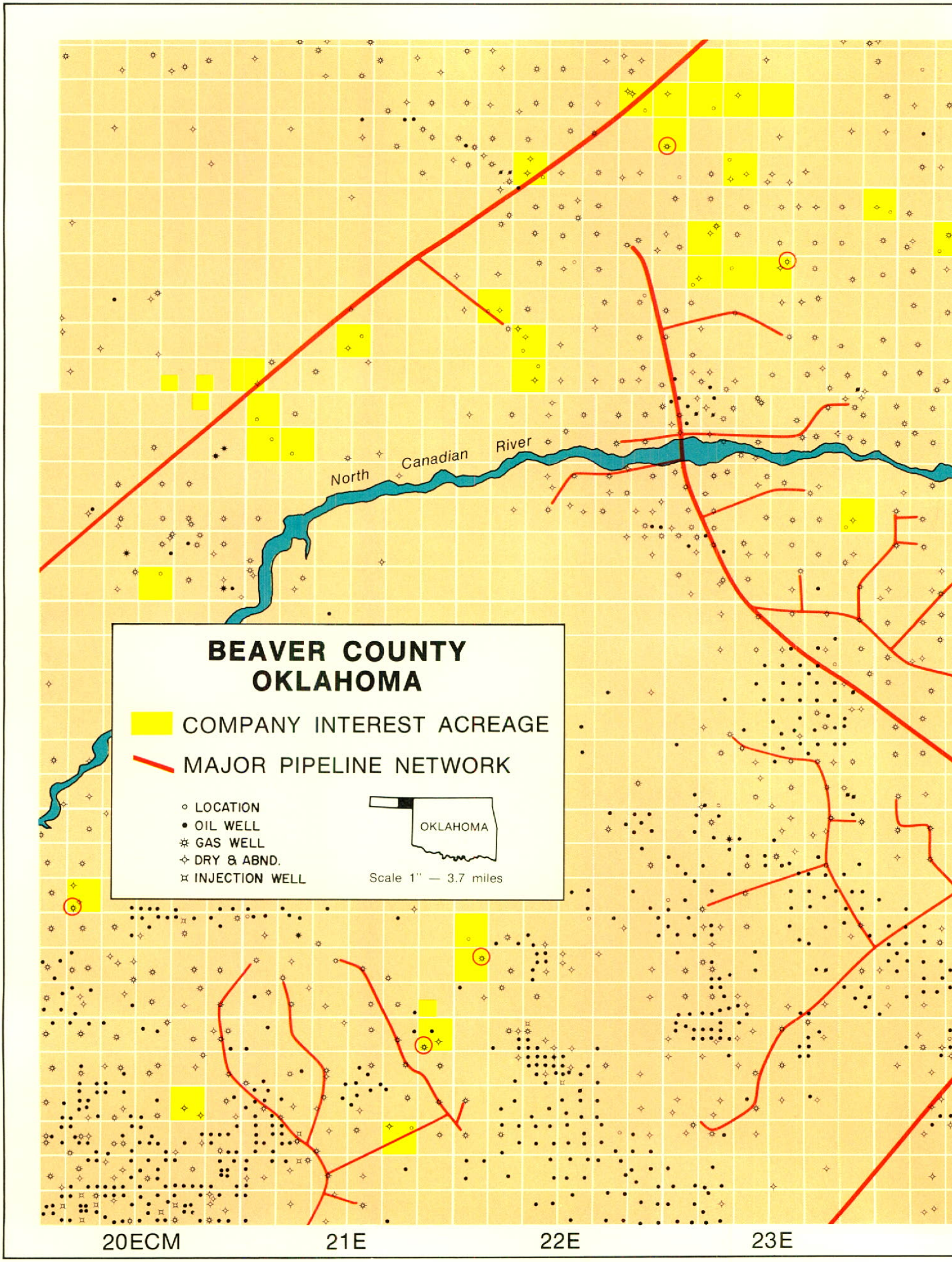
Apart from the Brazilian project, late in the year, a new limited partnership was formed between BNB, of which Bridger is a limited partner, and the Louis Dreyfus Corporation of New York and Paris. The new partnership will double the previous three year exploration budget to $600,000 which will be utilized to explore mining prospects in Costa Rica (gold and copper), Scotland (molybdenite), Arizona (silver-lead), New Mexico (copper), Indonesia (gold) and several other areas presently under consideration.

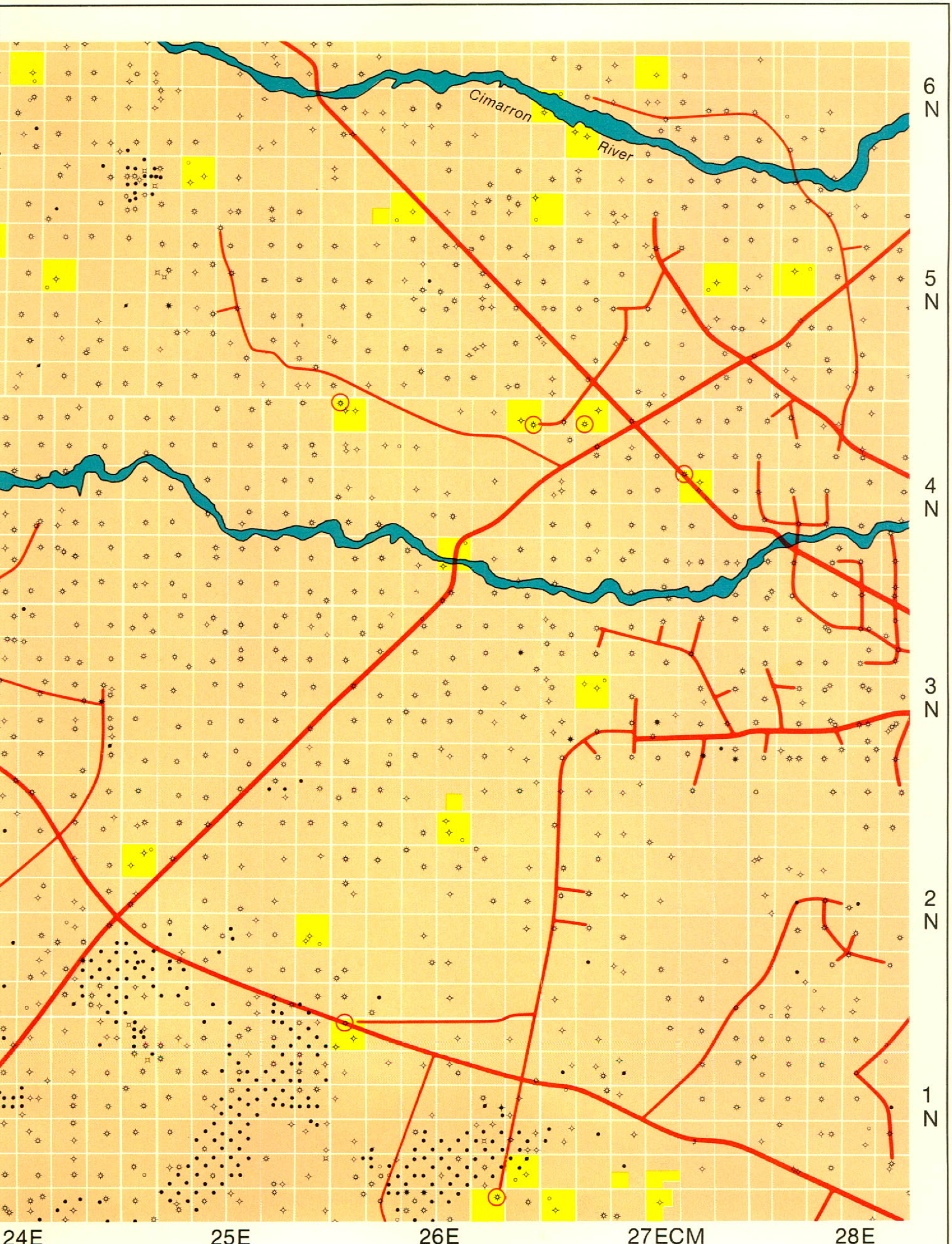
Uranium and vanadium ore continues to be mined from the Sun Cup and Dolores River Mines in Colorado. Bridger has a 15% interest in these mines.

REAL ESTATE

A large real estate purchase was made during the year in which Bridger has a 70 percent interest. The property consists of 967 acres located within the city limits of Lewisville, Texas and some 20 miles northwest of Dallas. This property was acquired simultaneously with a purchase by Xerox Corporation of a 496 acre tract which adjoins the Bridger property. Xerox, who plan an advanced production, development and manufacturing facility, had hoped to commence construction in 1974, however, it has been delayed and, though not yet confirmed by Xerox, construction is expected to commence in 1975. The Bridger and Xerox property has been zoned by the City of Lewisville for light industrial development.

Bridger also acquired a 70% interest in 202 acres located on the east side of the Garza Little Elm Reservoir, which is also known as Lake Dallas. This tract has approximately 4,000 feet of lake frontage and much of it is tree covered which makes it an excellent recreational or exclusive development type property. The purchase terms were very favourable, and we are presently discussing a potential sale or development type arrangement with interested parties. This tract was acquired with the same objective as the Lewisville tract, and that is with the view to a short term investment for capital appreciation.


BEAVER COUNTY
OKLAHOMA
COMPANY INTEREST ACREAGE
MAJOR PIPELINE NETWORK
LOCATION
OIL WELL
GAS WELL
DRY & ABND.
INJECTION WELL
OKLAHOMA
Scale 1" — 3.7 miles
North Canadian River
20ECM
21E
22E
23E


Cimarron
River
6 N
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24E
25E
26E
27ECM
28E

land holdings summary

WORKING INTEREST IN OIL & GAS RIGHTS

	Gross Acres	Net Acres
CANADA		
Alberta	782,947	229,044
British Columbia	21,122	8,666
East Coast (Offshore)	2,762,749	690,687
Manitoba	1,480	813
Ontario	2,722	647
Saskatchewan	10,211	4,184
Canadian TOTAL	3,581,231	934,041
U.S.A.		
Alaska	2,552	2,552
Colorado	10,320	1,490
Louisiana	2,120	265
Mississippi	1,034	1,034
Montana	464,097	79,120
New Mexico	160	160
Nevada	154,681	77,341
North Dakota	17,505	6,566
Oklahoma	48,190	35,262
Texas	23,065	5,531
Utah	494,359	234,037
Wyoming	87,182	41,339
U.S. TOTAL	1,060,635	484,697
INTERNATIONAL		
Abu Dhabi	583,786	29,120
British North Sea	91,602	30,534
Dutch North Sea	138,000	11,635
Ethiopia	8,302,200	2,075,550
Indonesia	8,000,000	344,000
Spain	376,224	125,407
International TOTAL	17,491,812	2,616,246
TOTAL Working Interest in Oil & Gas Properties	22,133,678	4,034,984

NET CARRIED INTEREST IN OIL & GAS RIGHTS

	Gross Acres	Net Acres
Arctic Islands	737,286	11,059
Northwest Territories	55,167	2,069
	792,453	13,128
Royalty Interests		
Arctic Islands	6,455,637	.25% overriding royalty
Turkey	494,200	1.523% overriding royalty
Various Canadian and U.S. Lands	352,163	Overriding royalty varies 1 - 15%
	7,302,000	
Mineral Titles Owned		
Alberta	39,382	39,382
Montana	320	160
	39,702	39,542
Working Interests in Mining Rights		
Colorado	14,000	2,100
Northwest Territories	9,320	4,303
Saskatchewan	2,800	1,400
Utah	14,900	2,235
	41,020	10,038
Lease Applications		
Alaska	107,520	28,800
Equity Interest		
Magnorth	14,412,144	1,513,275

exploration and production summary

TESTING A GAS WELL

DRILLING ACTIVITY

	1974	1973
Gross Wells	105	155
Net Wells	38	63.9
Net Gas Wells	15.8	20.7
Net Oil Wells	—	3.2

PRODUCTION NET TO HOUSTON & SUBSIDIARIES
***Before Royalty**

PRODUCTION	1974	1973
Daily Oil (Bbls)	901.9	777.1
Yearly Oil (Bbls) ...	329,198	283,650
Daily Gas (MCF) ...	6,802,000	4,300,000
Yearly Gas (MMCF)	2,482,746	1,569,358

* In past years we have reported production after deduction of royalties, however, this method was not practical this year due to the many changes in royalty rates, surcharges, net payments, etc. Using the before royalty method of calculation comparable figures for 1973 are shown above.

*** RESERVES (Net after Royalty)**

PROVEN	1974	1973
Oil (Bbls)	2,313,585	2,789,496
Gas (MCF)	64,323,000	97,954,000
PROBABLE		
Oil (Bbls)	1,546,000	3,359,000
Gas (MCF)	26,464,000	37,995,000
TOTALS		
Oil (Bbls)	3,859,585	6,148,496
Gas (MCF)	90,787,000	135,949,000

* OIL AND GAS RESERVES

The engineering firm of DeGolyer and MacNaughton was retained to evaluate the Company's oil and gas reserves and undeveloped leasehold interests. DeGolyer and MacNaughton's reserve estimates on several properties are less than those previously assigned by other engineers. The new reserves calculation, when combined with this year's production, higher Provincial royalties and a partial sale of our Wandering River, Alberta gas reserves, results in a reduction from those reported last year. Particularly hard hit by the new evaluation was the probable oil reserves. No probable reserves were assigned to any oil properties except those assigned to our Senlac Saskatchewan property. Another property on which the gas reserves were reduced significantly was Tiger Ridge in Montana. This reduction was justified due to disappointing producing results. The Degolyer and MacNaughton evaluation projects future net revenues from the Company's oil and gas reserves at year end to be $54,871,397, and they also assign a value of $19,296,278 to its undeveloped leasehold interests.

HOUSTON OILS LIMITED and Subsidiary Companies

consolidated balance sheet

	September 30, 1974	September 30, 1973 (Restated)
ASSETS		
Current assets		
Cash	$ 689,658	$ 1,231
Deposit certificates	697,242	8,921,520
Accounts receivable, trade	1,258,431	927,616
Marketable securities, at cost less provision for loss (quoted market value 1974 — $845,772; 1973 — $1,885,303)	845,772	1,527,132
Joint venture drilling funds receivable (note 3)	1,135,508	622,519
Inventory of drilling and production equipment, at cost	862,914	—
Prepaid expense and other	146,175	107,302
	5,635,700	12,107,320
Property and equipment (note 4)	15,956,704	10,227,569
Undeveloped land held for investment (note 5)	9,858,503	—
Other assets, at cost	531,973	269,781
	$31,982,880	$22,604,670
LIABILITIES		
Current liabilities		
Accounts payable	$ 2,423,547	$ 1,120,630
Accrued interest payable	537,742	—
Unexpended joint venture drilling fund advances (note 3)	—	2,232,171
Current portion of long term debt	635,359	180,000
	3,596,648	3,532,801
Long term debt (note 6)	16,093,344	5,848,091
Deferred income taxes (note 1)	63,662	130,241
SHAREHOLDERS' EQUITY		
Capital stock (note 8)		
Authorized		
20,000,000 shares of no par value		
Issued		
7,817,207 shares (1973 — 7,760,607)	13,103,801	13,014,544
Retained earnings (deficit)	(874,575)	78,993
	12,229,226	13,093,537
	$31,982,880	$22,604,670

Approved on behalf of the Board,

A. E. Whitehead, Director

J. O. [illegible], Director

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

consolidated statement of income

	Year Ended September 30, 1974	Year Ended September 30, 1973 (Restated)
Income		
Oil, gas and ore sales, net of royalties	$ 1,590,760	$ 958,430
Royalties	59,763	8,611
Interest	222,748	296,327
Management fees	380,787	596,566
Other	95,957	34,211
	2,350,015	1,894,145
Expenses		
Production	420,404	246,232
Interest	628,905	180,957
General and administrative	676,625	586,052
	1,725,934	1,013,241
	624,081	880,904
Depletion	665,574	287,749
Depreciation	181,612	86,622
	847,186	374,371
Income (loss) before the following	(223,105)	506,533
Provision for loss due to decline in market value of marketable securities	(797,042)	—
Income (loss) before income taxes	(1,020,147)	506,533
Deferred income tax (expense) recovery (notes 1 and 7)	66,579	(155,032)
Net income (loss)	$ (953,568)	$ 351,501
Net income (loss) per share (note 1)	$ (.12)	$ .05

consolidated statement of deficit

	Year Ended September 30, 1974	Year Ended September 30, 1973
Retained earnings (deficit), beginning of year as previously reported	$ 209,234	$ (297,299)
Less: Adjustment of prior years (note 2)	(130,241)	24,791
As restated	78,993	(272,508)
Net income (loss) for the year	(953,568)	351,501
Retained earnings (deficit) end of year	$ (874,575)	$ 78,993

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

consolidated statement of changes in financial position

	Year Ended September 30, 1974	September 30, 1973
Source of funds		
Funds provided (lost) from operations (note 11)	**$ (172,961)**	$ 880,904
Capital stock issued	**89,257**	3,229,753
Long term debt issued	**10,426,600**	5,127,556
Proceeds on disposal of property and equipment	**739,583**	33,481
	11,082,479	9,271,694
Application of funds		
Repayment and reclassification of long term debt	**181,347**	162,234
Acquisition of property and equipment	**7,315,904**	5,134,124
Acquisition of undeveloped land held for investment	**9,858,503**	—
Increase in other assets and sundry items	**262,192**	71,375
	17,617,946	5,367,733
Increase (decrease) in working capital	**(6,535,467)**	3,903,961
Working capital, beginning of year	**8,574,519**	4,670,558
Working capital, end of year	**$ 2,039,052**	$8,574,519

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

auditors' report

To the Shareholders
Houston Oils Limited

We have examined the consolidated balance sheet of Houston Oils Limited and subsidiary companies as at September 30, 1974 and the consolidated statements of income and deficit and changes in financial position for the year then ended. Our examination included a general review of the accounting procedures and such tests of accounting records and other supporting evidence as we considered necessary in the circumstances.

In our opinion these consolidated financial statements present fairly the financial position of the companies as at September 30, 1974 and the results of their operations and the changes in their 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, except for the change in accounting for income taxes (with which we concur) as outlined in note 2 to the consolidated financial statements.

Calgary, Alberta
January 11, 1975

COLLINS LOVE EDDIS VALIQUETTE & BARROW
Chartered Accountants

notes to financial statements

1. ACCOUNTING POLICIES

(a) PRINCIPLES OF CONSOLIDATION

(i) The consolidated financial statements include the accounts of the Company and all of its subsidiaries. Any excess of initial cost of shares in subsidiaries over the underlying net book value at dates of acquisition has been allocated to the property and equipment accounts and depletion is provided thereon.

(ii) The accounts of foreign subsidiaries have been converted to Canadian dollars on the following basis: Current assets and current liabilities at the rate of exchange in effect at the year end. Other assets and liabilities at the rate of exchange in effect at the date of settlement. Revenue and expense items are converted using average rates of exchange prevailing throughout the period.

(b) OIL AND GAS OPERATIONS

The companies follow the full cost method of accounting for oil and gas operations. Under this concept, all costs, including a portion of administrative expenses, relating to exploration for and development of oil and gas reserves are capitalized. Proceeds on disposal of properties are ordinarily deducted from costs without recognition of profit or loss. These capitalized costs are depleted on the unit of production method based on the total estimated proven oil and gas reserves as determined by independent and company engineers.

(c) MINING PROPERTIES

The companies follow the practice of capitalizing all acquisition and exploration costs relating to mining properties on a prospect area basis. If a prospect area is subsequently abandoned, all capitalized costs relating to the area are charged to income. Capitalized costs relating to producing properties are amortized on the unit of production method based on estimated recoverable reserves of the area.

(d) UNDEVELOPED LAND HELD FOR INVESTMENT

The companies capitalize the following items as a part of the cost of the land:

(i) Interest on agreements relating directly to the acquisition of the land

(ii) Real estate taxes

(iii) Other direct costs including commissions, legal fees and related charges

Revenue received from the land is deducted from the total costs capitalized.

(e) DEPRECIATION

Depreciation of production and other equipment is provided on a straight line basis at rates designed to amortize the costs over the estimated useful lives of the assets.

(f) INCOME TAXES

The companies follow the tax allocation method of accounting for all timing differences between taxable income and recorded income including differences relative to exploration and development expenditures. Under this method, provisions for deferred income taxes are made currently on the excess of deductions claimed for tax purposes over the related depletion, depreciation and other charges recorded in the accounts on the premise that such taxes will become payable in future years when recorded charges exceed the amounts available for tax purposes.

The provision for loss due to decline in market value of marketable securities has not been recognized as a deductible expense for income tax purposes.

(g) EARNINGS PER SHARE

Earnings (loss) per share are calculated on the weighted average number of shares of the Company outstanding during the year. The conversion of the outstanding convertible subordinated note would not be dilutive.

2. CHANGE IN ACCOUNTING POLICIES

During the 1974 fiscal year the Company and its subsidiaries changed accounting policies with regard to income taxes. In response to a ruling of the Canadian Provincial Securities Administrators in March 1974, the companies retroactively adopted the allocation method of accounting for income taxes as required by the Canadian Institute of Chartered Accountants which is explained in note 1(f). As a result of this change a deferred income tax recovery of $66,579 has been reported in 1974 ($.01 per share). The comparative figures have been restated to give effect to the retroactive adoption of income tax allocation accounting. These changes reduced 1973 earnings by $155,032 ($.02 per share).

3. JOINT VENTURE PARTICIPATION AGREEMENTS

(a) 1972 - 1973 DRILLING PROGRAM

During the year the Company acted as manager of certain drilling programs which had commenced in a prior year. The investors in these programs were also shareholders of the Company. At September 30, 1974 a balance of $145,813 was owing to the Company on account of this program which amount was paid in December, 1974.

(b) 1973 - 1974 DRILLING PROGRAM

During the prior year the Company and Marline Oil Corporation (Marline) entered into an agreement which required Marline to contribute $6,000,000 to a 1973 - 1974 drilling program. The Company is responsible for the overall direction of the program and for its services will be entitled to receive a management fee of 12½% of Marline's $6,000,000 commitment. (To date $695,500 has been earned). Marline will receive 100% of the revenues accruing to the program and the Company is to receive a 2% gross overriding royalty on such revenues until such time as Marline has recovered its $6,000,000 contribution, whereupon the Company has the option to convert such royalty into a 40% working interest. At September 30, 1974 the Company had incurred expenditures of $5,564,000 on behalf of Marline, of which Marline had advanced $4,576,000.

4. PROPERTY AND EQUIPMENT

Property and equipment consists of the following:

	Cost	Accumulated depletion and depreciation	Net 1974	Net 1973
Oil and gas properties including exploration and development costs thereon	$15,747,760	$1,300,263	$14,447,497	$ 9,406,737
Mining properties including exploration and development costs thereon	485,182	108,137	377,045	352,398
Production and other equipment	1,633,121	500,959	1,132,162	468,434
	$17,866,063	$1,909,359	$15,956,704	$10,227,569

5. UNDEVELOPED LAND HELD FOR INVESTMENT

During the year the Company's wholly owned subsidiary, Bridger Petroleum Corporation, acquired a 70% undivided interest in certain real property in Denton County, Texas, for a cash consideration and assumption of certain notes and other liabilities. A 20% net profit interest in the property has been assigned to residents of Texas for realty and consulting services.

6. LONG TERM DEBT

Long term debt is comprised of the following:

	1974	1973
Development loans	$ 3,536,141	$ 178,447
Prepayment of future gas deliveries	863,767	849,644
Notes payable on acquisition of land held for investment	7,328,795	—
	11,728,703	1,028,091
Less: Portion due within one year	635,359	180,000
	11,093,344	848,091
Convertible subordinated note	5,000,000	5,000,000
	$16,093,344	$5,848,091

(a) DEVELOPMENT LOANS AND PREPAYMENTS OF FUTURE GAS DELIVERIES

These liabilities are interest free. The loans are to be offset at various rates against the proceeds from the sale of gas from certain properties. Repayments are applied first against the development loans. The debt is secured by a pledge of future production from certain properties and by a letter of credit in the amount of $3,575,625.

(b) NOTES PAYABLE

Long term debt includes 70% of various notes payable on the undeveloped land acquired by Bridger Petroleum Corporation in Denton County, Texas. The interest rates on the notes vary between 7½% and 8% and the due dates of the notes range from 4 years to 20 years.

(c) CONVERTIBLE SUBORDINATED NOTE

On June 13, 1973 the company issued a $5,000,000 convertible subordinated note due May 31, 1988. The note bears interest at a rate of 1½% over the best rate which Bankers Trust Company shall charge from time to time on 90 day unsecured commercial loans. The note is convertible up to May 31, 1988 into 1,176,471 shares of the common stock of the Company at a price of $4.25 per share (note 8).

7. INCOME TAXES

On November 18, 1974 the Canadian Government introduced budgetary proposals to amend the Income Tax Act. These included a number of changes, several having retroactive effect to the date of an earlier budget on May 6, 1974, that will substantially increase the income taxes of the resource industries. The proposals, among other measures, deny the deduction of royalties and similar payments to governments and impose limitations on the deduction of certain development expenses and on depletion allowances; they are accompanied by some reduction in the rate of income tax applicable to resource production profits. Responding to this action, some provinces are proposing to make rebates or grants in order to provide some measure of relief to resource companies from the additional Federal tax levies. Although the legislative amendments have not yet been enacted, and indeed some of the proposals have not yet been set out in sufficient detail to remove doubt as to their ultimate effect, the 1974 income tax provision in the accompanying financial statements has been computed on the basis of taking them into account on the best information available.

8. CAPITAL STOCK

Issued capital stock of the Company consists of the following:

	Number of Shares	Stated value
Balance, September 30, 1973	7,760,607	$13,014,544
Stock options exercised	56,600	132,257
Balance, September 30, 1974	7,817,207	13,146,801
Less: Share subscriptions receivable		43,000
		$13,103,801

At September 30, 1974, 1,335,572 shares of the capital stock were reserved as follows:

159,101 shares for options granted to officers and employees exercisable on various dates to July 21, 1977 at prices ranging from $0.936 to $3.285 per share.

1,176,471 shares for the conversion of the $5,000,000 convertible subordinated note (note 6)

Included in other assets are notes receivable totalling $100,000 from officers and employees to enable them to purchase shares of the Company. These notes are non-interest bearing and are secured by the related shares.

9. COMMITMENTS AND CONTINGENCIES

(a) The Company has issued non-interest bearing demand promissory notes and letters of guarantee as security for the performance of work obligations by the Company and others in respect of normal exploration activities. The aggregate of such notes and guarantees amount to $122,645 at September 30, 1974.

(b) A subsidiary is obligated to pay $67,000 in connection with certain lease applications in Alaska, if and when, the relevant leases are issued.

10. REMUNERATION OF DIRECTORS AND SENIOR OFFICERS

The aggregate direct remuneration of the directors and senior officers of the Company during the year amounted to $141,910 (1973 — $151,825).

11. FUNDS PROVIDED (LOST) FROM OPERATIONS

Represents cash flow from operations after deducting the provision for loss due to decline in market value of marketable securities.

corporate

directors

John A. Downing, *Calgary, Alberta*
James A. Millard, *Calgary, Alberta*
Albert E. Whitehead, *Calgary, Alberta*
Montague H. Hackett, Jr., *New York City*
Jack L. Cummings, *Montreal, Quebec*

officers

Albert E. Whitehead, *President*
Montague H. Hackett, Jr., *Executive Vice President*
Harvey S. Robinson, *Vice President*
Darrell R. Long, *Vice President, Exploration*
Thomas M. M. Bender, *Treasurer*
James A. Millard, *Secretary*

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4925 Greenville Ave.
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subsidiary companies

Bridger Petroleum Corporation
Houston Oils of Norway, Limited
Houston Oils of Spain, Limited
Houston Oils (U.K.) Limited
Transalta Minerals Ltd.
Bluenose Oils Limited

auditors

Collins, Love, Eddis, Valiquette & Barrow
Calgary, Alberta

bankers

The Toronto-Dominion Bank
Calgary, Alberta

Republic National Bank of Dallas
Dallas, Texas

legal counsel

MacKimmie Matthews
Calgary, Alberta

Passman, Jones, Andrews, Coplin, Holley & Co.
Dallas, Texas

affiliated companies

Magnorth Petroleum Limited *(10.5% equity)*
Ensign Oils of Spain Limited *(50% equity)*

transfer agent and registrar

The Canada Trust Company
Vancouver, Calgary, Toronto, Montreal

stock exchange listings

Toronto Stock Exchange
Montreal Stock Exchange

Ticker Tape Symbol: HCO

highlights subsequent to year end

- Twenty-five gas wells completed in which Company has working interest.
- Interest-free loan from Michigan Wisconsin Pipe Line Company increased from $5,250,000 to $7,000,000, in order to drill 10 additional net wells.
- Major gas contract signed with Northwestern Utilities on Hairy Hill, Alberta gas reserves.
- Arzanah #3 test well commenced drilling on offshore Abu Dhabi concession. Bridger has 5% carried interest.
- Bridger Federal No. 1 commenced drilling in late December on 493,000 acre Pine Valley, Utah prospect. Bridger has 27.5% working interest.
- The MsM1 test well commenced drilling in the Malacca Strait area of Indonesia. Bridger has a 4.33% working interest.
- Six new gas wells placed on production in Beaver County, Oklahoma.
- Province of Alberta introduced proposal for reduced royalty rates, additional exploration incentives and a tax rebate plan due to proposed non-deductibility of Provincial royalty payments when calculating Federal Government taxes.
- Xerox announced delay of construction plans for Lewisville manufacturing facility.

HOUSTON OILS LIMITED

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