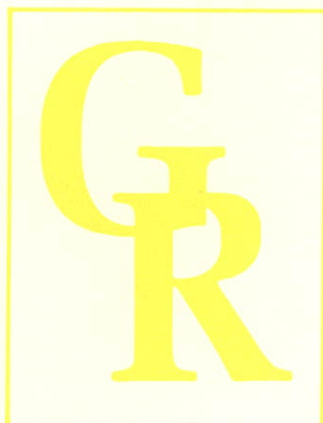


**GIANT
REEF
PETROLEUMS
LIMITED**



**1986
ANNUAL
REPORT**



A. Land holdings at March 31, 1986

	1986		1985	
	Gross Acres	Net Acres	Gross Acres	Net Acres
Alberta	59,193	6,293	59,804	7,708
British Columbia	697	233	3,337	641
Saskatchewan	6,038	1,508	9,287	1,635
TOTAL	65,928	8,034	72,428	9,984

B. Production and sales for the year ended March 31, 1986

	Gross before Royalties	Net after Royalties
Crude oil & liquids — bbl	66,492	50,309
Natural gas — mcf	665,135	486,898
Sulphur — tonnes	1,818	1,454

C. Net proven and probable reserves as determined by independent reservoir engineers at March 31, 1986

	Crude Oil and Natural Gas Liquids (Barrels)	Natural Gas (Millions of Cubic Feet)
Proven	398,000	5,294
Probable	216,000	1,549
Total proven and probable	614,000	7,473

D. Future net revenues and present value of proven and probable reserves as determined by independent reservoir engineers at March 31, 1986

Future net revenues	\$21,100,000
Present worth discounted @ 12%	\$10,122,000
Present worth discounted @ 18%	\$ 7,659,000

FIVE YEAR SELECTED DATA

Fiscal year end	1986	1985	1984	1983	1982
				(Restated)	(Restated)
Thousands of dollars (except per share data)					
Net operating revenue	\$2,911	\$3,146	\$2,175	\$1,856	\$1,486
Net earnings	908	1,443	1,040	1,172	890
Earnings per common share	0.28	0.44	0.31	0.35	0.27
Cash flow from operations	1,862	2,018	1,488	1,757	1,218
Cash flow per common share	0.57	0.62	0.45	0.53	0.37
Working capital	2,066	2,781	2,506	2,051	1,720
Dividends per common share	0.20	0.20	0.17	0.12	0.06

Report to the Shareholders

A spirit of optimism was evident in the Canadian petroleum industry following the announcement of the Western Energy Accord in March 1985. Commencing in January 1986, however, a financially disastrous collapse in the world price of crude oil occurred as a result of the inability of the major producing nations to agree on an acceptable formula for limiting and sharing production in relation to the market available. The present low price for crude oil not only causes severe financial problems for the exporting nations but adversely affects the financial stability of the petroleum industry worldwide.

Giant Reef's revenues and earnings for the year ending March 31, 1986 were down from last year's record performance reflecting the decline in world oil prices that occurred during the final quarter of our fiscal year. Despite the reduction in oil revenues, we maintained our strong financial position.

Revenues for fiscal 1986 were \$2.9 million compared with \$3.1 million last year and net earnings declined to \$0.9 million from \$1.4 million last year reflecting reduced oil and gas revenues and increased operating costs. Earnings per common share were \$0.28 down from \$0.44 in fiscal 1985 and cash flow was \$1.86 million, compared with \$2.02 million last year.

At the date of this report, the world price for crude oil remains at U.S. \$10 to \$12 which will reduce the petroleum industry's earnings and cash flow in the coming months. In order to assist the Canadian petroleum industry, the Federal Government responded this spring by increasing the annual exemption from the Petroleum Gas Revenue Tax and the Government of Alberta increased its Royalty Tax Credit. Alberta has also implemented two major incentive programs to spur development and exploratory drilling this year.

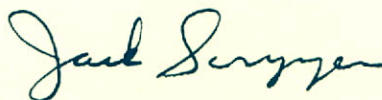
Giant Reef participated in a total of 26 wells in fiscal 1986 which resulted in 20 oil wells and six dry holes for a success ratio of 77 percent. Exploration and development was focused on oil properties at existing land holdings in the Lochend and Ferguson Lake area of Alberta and at Coleville, Saskatchewan.

In addition, Giant Reef and producing partners have negotiated an "Interruptable Best Efforts" gas sales contract for the Quirk Creek area which will provide additional cash flow during the spring and summer months when this plant is normally shut down.

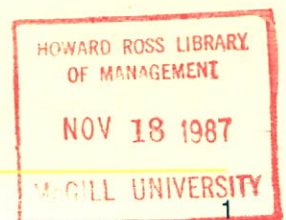
In the coming year, Giant Reef expects to participate in a projected ten wells. Activity will again be concentrated in Western Canada on low risk prospects with immediate cash flow potential and commitment wells required to maintain our acreage position. However, this proposed drilling program may be curtailed if cash flow from operations is seriously impaired by low crude oil prices.

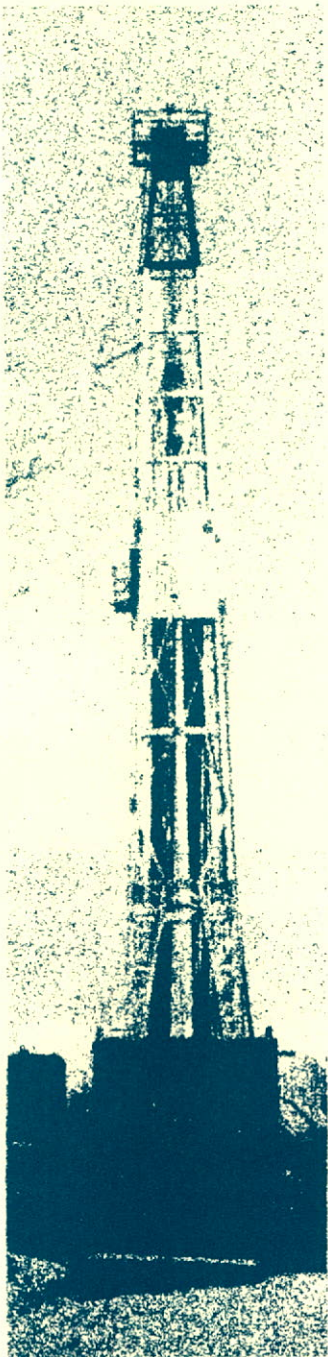
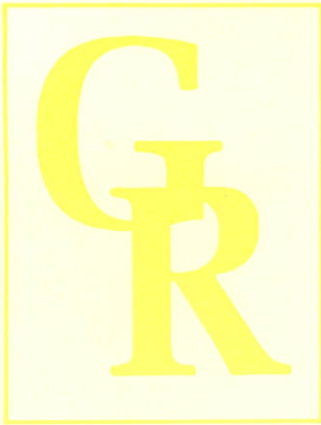
The payment of dividends to common shareholders commenced in 1982. Our policy on dividends will be decided at each quarterly meeting of the Board of Directors. The quarterly dividend is presently set at \$0.05 per common share.

On behalf of the Board,



Jack Scrymgeour
President
July 15, 1986





Alberta

— **Ferguson Lake:** Giant Reef participated in three oil completions in this Halfway sand pool and now has an interest in 16 wells capable of production.

— **Medicine River:** The Company earned a 12.5 percent working interest in a potential Jurassic oil/gas discovery in this area of Central Alberta.

— **Lochend:** Development drilling continued in this Cardium Sand oil pool. Giant Reef participated in six oil wells and earned interests varying from 6.6 to 16.5 percent. Gas conservation facilities were installed to gather field gas, recover liquids and transport residue gas for sale.

— **Crossfield East:** The Company participated in a successful Cardium Sand oil well in which it has a 25 percent working interest. This well is capable initially of producing at 40 barrels per day.

The Company's major gas production is from the Quirk Creek, Eyremore and Majorville areas of southern Alberta. Giant Reef and producing partners negotiated an "Interruptable Best Efforts" gas sales contract with Esso Resources which will permit the Quirk Creek Gas Plant to operate all or part of the normal shut-in period from April 1 to October 1, 1986. The additional 1,300 mcf/D sale of natural gas during peak production will provide further significant cash flow to Giant Reef.

Saskatchewan

— **Coleville South:** Six additional oil wells were successfully drilled and completed as Bakken heavy oil producers. The operator proposes to begin implementation of a partial pressure maintenance scheme during the coming year.

— **Hoosier North:** Giant Reef has a 12.5 percent interest in a Basal Mannville heavy oil well drilled as a pool extension.

British Columbia

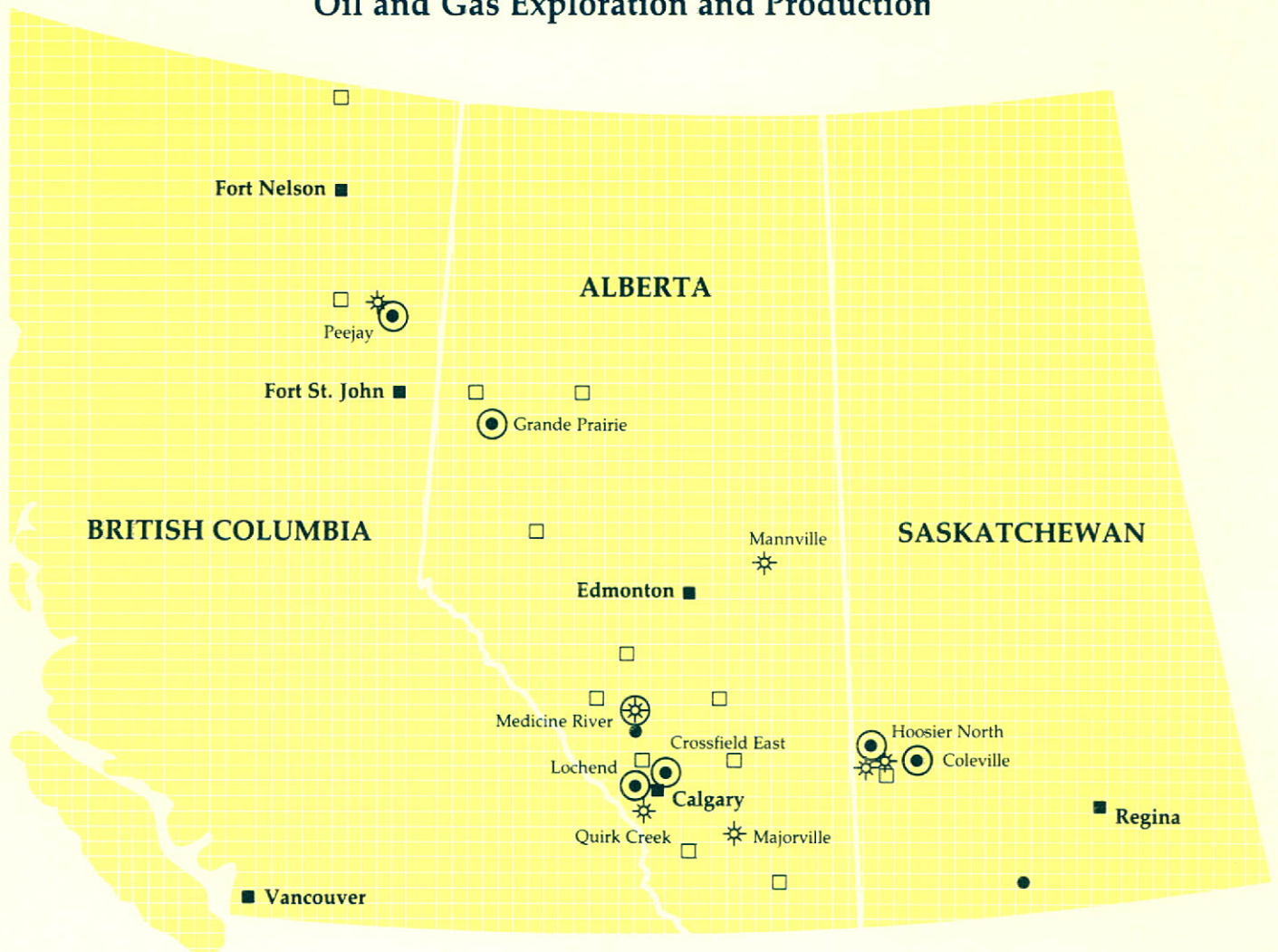
— **Peejay:** The Company has a 25 percent interest before payout (and 12.5 percent after payout) in an oil well drilled offsetting the Peejay Halfway pool. The well flowed at rates of 75 barrels of oil per day on initial tests.

Drilling Participation

	<u>Alberta</u>	<u>Saskatchewan</u>	<u>British Columbia</u>	<u>Total</u>
Gross wells drilled	17	8	1	26
Net wells drilled	2.42	1.18	.25	3.85
Gross producers	11	8	1	20
Net producers	1.45	1.18	.25	2.88
Gross dry and abandoned	6	—	—	6
Net dry and abandoned ..	0.97	—	—	0.97
SUCCESS RATIO:	64.7%	100%	100%	76.9%



Oil and Gas Exploration and Production



WESTERN CANADA

- Exploration Areas
- ★ Major Gas Development Areas
- Major Oil Development Areas
- ⊗ Gas Wells Drilled in Past Year
- ⊙ Oil Wells Drilled in Past Year



Balance Sheet

As At March 31, 1986

Assets

	1986	1985
Current		
Cash and short-term deposits	\$ 715,897	\$1,565,983
Marketable securities	1,395,605	1,283,749
Accounts receivable	499,789	472,119
Income taxes recoverable	26,000	35,631
Prepaid expenses	4,598	4,598
Due from parent company	—	175,850
	<u>2,641,889</u>	<u>3,537,930</u>
Investments, at cost (market value \$1,274; 1985 — \$2,548)	3,242	3,242
Property, plant and equipment (Note 3)	6,902,549	5,859,533
	<u>\$9,547,680</u>	<u>\$9,400,705</u>

Liabilities

Current		
Accounts payable and accrued liabilities	\$ 131,034	\$ 2,303
Dividends payable	163,467	163,467
Income taxes payable	34,918	590,942
Due to parent company	246,249	—
	<u>575,668</u>	<u>756,712</u>
Deferred revenue	1,570,964	1,755,865
Deferred income taxes	1,726,696	1,467,696
	<u>3,873,328</u>	<u>3,980,273</u>

Shareholders' Equity

Share capital		
Authorized		
5,000,000 common shares without nominal or par value		
Issued		
3,269,352 shares	1,082,699	1,082,699
Retained earnings	4,591,653	4,337,733
	<u>5,674,352</u>	<u>5,420,432</u>
	<u>\$9,547,680</u>	<u>\$9,400,705</u>

On behalf of the Board

 Director

 Director

Statement of Earnings and Retained Earnings

For the Year Ended March 31, 1986



	1986	1985
Revenues		
Oil and gas production	\$2,910,975	\$3,146,018
Operating expenses		
Oil and gas production	970,236	810,945
General and administrative	190,620	190,419
Lease rentals	4,280	1,867
Depletion and depreciation	695,198	633,874
	1,860,334	1,637,105
Earnings from operations	1,050,641	1,508,913
Other revenue (expenses)		
Interest and other income	281,932	301,712
Interest and bank charges	(17,841)	(8,656)
	264,091	293,056
Earnings before income taxes	1,314,732	1,801,969
Provision for (recovery of) income taxes (Note 5)		
Current	147,937	417,822
Deferred	259,000	(58,850)
	406,937	358,972
Net earnings for the year	907,795	1,442,997
Retained earnings at beginning of year	4,337,733	3,804,699
	5,245,528	5,247,696
Redemption of shares	—	(253,071)
Dividends	(653,875)	(656,892)
Retained earnings at end of year	\$4,591,653	\$4,337,733
Earnings per share	\$0.28	\$0.44

Auditors' Report

The Shareholders
Giant Reef Petroleum Limited

We have examined the balance sheet of Giant Reef Petroleum Limited as at March 31, 1986 and the statements of earnings and retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these financial statements present fairly the financial position of the Company as at March 31, 1986 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.

Calgary, Alberta
June 11, 1986

Touche Ross & Co.
Chartered Accountants



Statement of Changes in Financial Position

For the Year Ended March 31, 1986

	1986	1985
Cash provided by operating activities		
Net earnings for the year	\$ 907,795	\$1,442,997
Add charges to earnings not requiring a current cash payment		
Depletion and depreciation	695,198	633,874
Deferred income taxes	259,000	(58,850)
	<u>1,861,993</u>	<u>2,018,021</u>
Net change in working capital balances other than cash	<u>(23,233)</u>	<u>336,513</u>
	<u>1,838,760</u>	<u>2,354,534</u>
Cash provided by (used in) financing activities		
Deferred revenue	(184,901)	(158,222)
Redemption of shares	—	(273,019)
Dividends	(653,875)	(656,892)
	<u>(838,776)</u>	<u>(1,088,133)</u>
	<u>999,984</u>	<u>1,266,401</u>
Cash provided by (used in) investment activities		
Property, plant and equipment	(1,971,509)	(832,998)
Petroleum Incentives Program grants	206,295	177,894
Investment tax credits	27,000	—
	<u>(1,738,214)</u>	<u>(655,104)</u>
Net increase (decrease) in cash during the year	<u>(738,230)</u>	<u>611,297</u>
Cash position at beginning of year	<u>2,849,732</u>	<u>2,238,435</u>
Cash position at end of year	<u>\$ 2,111,502</u>	<u>\$ 2,849,732</u>
Cash comprises		
Cash and short-term deposits	\$ 715,897	\$1,565,983
Marketable securities	1,395,605	1,283,749
	<u>\$ 2,111,502</u>	<u>\$ 2,849,732</u>
Net change in working capital balances other than cash		
Accounts receivable	\$ (27,670)	\$ 206,116
Income taxes recoverable	9,631	70,689
Prepaid expenses	—	1,301
Due from parent company	175,850	(245,976)
Accounts payable and accrued liabilities	128,731	(32,849)
Dividends payable	—	(3,023)
Income taxes payable	(556,024)	340,255
Due to parent company	246,249	—
	<u>\$ (23,233)</u>	<u>\$ 336,513</u>

Notes to the Financial Statements

March 31, 1986



1. Summary of Significant Accounting Policies

a) Parent Company

84% of the Company's shares are owned by Westburne Petroleum & Minerals Ltd., a wholly-owned subsidiary of Westburne International Industries Ltd.

b) Petroleum and natural gas properties

The Company follows the full cost method of accounting for exploration and development expenditures, whereby all costs relating to the exploration for and development of oil and gas reserves are capitalized. The Company employs a ceiling test annually whereby capitalized costs are written off if they exceed the value of future net revenues from estimated production of proven recoverable reserves and the estimated value of undeveloped properties. For the determination of the value of future net revenues for the ceiling test the Company has used reservoir engineering reports as at March 31, 1986 based on prices in effect at that date. Proceeds from disposal of properties are normally deducted from costs without recognition of gain or loss.

Grants receivable under Provincial and Federal Petroleum Incentives Programs and investment tax credits are recorded in the accounts at the time qualifying expenditures are applied for. The full cost pool is reduced by the amount of these grants and credits.

Depreciation of production equipment and the gas plant and depletion of oil and gas properties have been provided on a unit of production method based on estimated proven recoverable reserves as determined by independent engineers.

c) Deferred revenue

Payments received for undelivered gas are deferred and taken into income when deliveries are made or the makeup period expires. Deliveries of prepaid gas were made during the year and are expected to continue over the next eight years until all prepaid gas is delivered.

d) Income taxes

The Company follows the tax allocation method of accounting for income taxes. Provincial Government royalty refunds are taken into account in calculating the current year's income tax provision.

e) Joint Ventures

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

2. Petroleum Incentives Program

Under government legislation, the Company is eligible to apply for grants based on qualifying oil and gas expenditures. Included in accounts receivable is \$166,945 (1985 — \$135,589) with respect to grants for which application has been made.



3. Property, Plant and Equipment

	<u>1986</u>	<u>1985</u>
Property, plant and equipment, at cost		
Oil and gas leases and development expenditures	\$7,088,136	\$5,721,044
Gas plant	1,492,180	1,347,628
Equipment	<u>1,607,072</u>	<u>1,380,502</u>
	10,187,388	8,449,174
Accumulated depletion and depreciation	<u>3,284,839</u>	<u>2,589,641</u>
	<u>\$6,902,549</u>	<u>\$5,859,533</u>

4. Related Party Transactions

The majority of the Company's recent activities have been conducted jointly with its parent which administers the affairs of the Company.

The Company has been charged \$120,000 (1985 — \$120,000) by its parent for administrative services.

Payments of \$1,774,514 (1985 — \$792,832) have been made to the parent company for the Company's proportionate share of the purchase and development costs of lands in which the Company has an interest.

	<u>1986</u>	<u>1985</u>
Drilling and completion costs	\$1,321,278	\$540,150
Tangible equipment	267,706	254,751
Geological and seismic	—	(2,069)
Land acquisition	<u>185,530</u>	<u>—</u>
	<u>\$1,774,514</u>	<u>\$792,832</u>

The Company earned net revenue of \$1,044,301 (1985 — \$1,300,047) on properties operated jointly with its parent.

5. Income Taxes

Income tax expense varies from the amount that would be computed by applying the combined Federal and Provincial income tax rates to earnings before income taxes as shown below:

	<u>1986</u>		<u>1985</u>	
	<u>Amount</u>	<u>% of pre-tax income</u>	<u>Amount</u>	<u>% of pre-tax income</u>
Expected tax expense	\$631,071	48.0	\$846,925	47.0
Effect on taxes from:				
Non-deductible crown payments	391,680	29.8	507,153	28.1
Petroleum and gas revenue tax	28,800	2.2	143,987	8.0
Depletion allowance	—		(177,602)	(9.9)
Resource allowance	(269,760)	(20.5)	(377,837)	(21.0)
Alberta royalty tax credit	(366,128)	(27.8)	(519,895)	(28.9)
Other	<u>(8,726)</u>	<u>(.8)</u>	<u>(63,759)</u>	<u>(3.4)</u>
Actual income tax provision	<u>\$406,937</u>	<u>30.9</u>	<u>\$358,972</u>	<u>19.9</u>

6. Dominant Industry

The Company has substantially all of its operations in the petroleum and natural gas industry in Canada. The majority of the Company's revenue is derived from oil and gas sales.

Corporate Information

Head Office:

200, 535 7th Ave. S.W.
CALGARY, Alberta T2P 0Y4
Area Code (403) 233-6600

Officers:

P.D. WILLIAMS — Chairman
J. SCRYMGEOUR — President
J.E. FORSYTH — Secretary
G.D. RICHARDS — Controller
K.I. DRADER — Treasurer

Directors:

P.D. WILLIAMS
J. SCRYMGEOUR
C.A. RAUGUST
H.M. ARMSTRONG
H.A. McQUEEN

Bankers:

BANK of MONTREAL
604 - 8th Ave. S.W.
CALGARY, Alberta T2P 1G4

Registrar and

Transfer Agent:

CANADA TRUST COMPANY,
505 - 3rd St. S.W.
CALGARY, Alberta T2P 3Y8

1055 Dunsmuir Street
VANCOUVER, B.C. V7X 1B1

Auditors:

TOUCHE ROSS & CO.
3500, 700 - 2 St. S.W.
CALGARY, Alberta T2P 0S7

Stock Listing:

VANCOUVER STOCK EXCHANGE



**GIANT REEF
PETROLEUMS
LIMITED**

**1986
ANNUAL
REPORT**