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BANKENO MINES LIMITED
1984 Annual Report



CORPORATE INFORMATION

Board of Directors

Donald F. Christensen, Calgary
Senior Vice-President &
Chief Operating Officer
North Canadian Oils Limited

Douglas A. Cox, Edmonton
President & Chief Executive Officer
Branjeff Holdings Ltd.

Frederick H. Hemming, Calgary
President
Bankton & Associates
Management Consultants Ltd.

David W. Kerr, Toronto
Executive Vice-President &
Chief Operating Officer
Hees International Corporation

William J. L'Heureux, Q.C., Toronto
President
Carena-Bancorp Inc.

Charles K. Lough, Calgary
Senior Vice-President &
Chief Operating Officer
North Canadian Oils Limited

Corporate Officers

David W. Kerr
Chairman & Chief Executive Officer

Charles K. Lough
Senior Vice-President & Secretary

Donald F. Christensen
Senior Vice-President

W. Keith Miller
Vice-President

Bill A. Kurucz
Treasurer

Head Office

630 - 4th Avenue S.W.
CALGARY, Alberta T2P 0K2
Telephone: (403) 269-2511
Telex: 03-826866

Subsidiary Companies

Bankeno Resources Ltd.
Leaside Resources, Inc.
Merland Explorations Limited (54%)

Auditors

Deloitte Haskins & Sells
Calgary, Alberta

Bankers

Canadian Imperial Bank of Commerce
Calgary, Alberta

The Royal Bank of Canada
Calgary, Alberta

Registrar and Transfer Agent

Guaranty Trust Company of Canada
Calgary, Alberta
Toronto, Ontario
Montreal, Quebec

Stock Exchange Listings

Toronto Stock Exchange

SHAREHOLDERS MEETING

A special and annual general meeting of shareholders will be held on Thursday, May 23, 1985, at 1:30 p.m. at the Westin Hotel, 4th Avenue and 3rd Street S.W., Calgary, Alberta.

TO THE SHAREHOLDERS

Consolidated operating and financial performance of the Company fiscal 1984 exceeded the results achieved in 1983. While crude oil and natural gas production increased over 1983, natural gas production was at only approximately 50% of contract volumes due to current weak natural gas demand conditions.

Although the Western Accord which was recently signed between the federal government and producing provinces will be beneficial to the oil and gas industry we do not anticipate material changes in the company results in the near short term.

Financial

Consolidated 1984 gross revenue after royalties from the sale of petroleum and natural gas amounted to \$69.9 million an increase of 10.4% over the comparative 1983 figure. Net Earnings for the year were \$2.0 million or \$0.07 per common share versus a loss of \$5.77 per common share in 1983. Cash flow from operations was \$31.8 million up 6% from last year.

Production

Production of natural gas averaged 76.8 million cubic feet per day up 5.6% from the daily average of 72.6 million cubic feet recorded the previous year. On a comparative basis crude oil and natural gas liquids production for the year was 429,000 barrels or 1,173 barrels per day compared to the 1983 average of 1,156 barrels per day.

Capital Expenditure

Net consolidated capital expenditure of \$29.7 million was primarily directed towards infill drilling in the Company's natural gas fields in east central Alberta and the Sandhills area of southwest Saskatchewan. Drilling, which increased crude oil production and proved up additional reserves, was also conducted in the Taber and Highvale areas of Alberta and Kindersly/Dodsland areas of southwest Saskatchewan.

Reserves and Land Holdings

At December 31, 1984 the Company's, including those of Merland Exploration, proved and probable reserves of natural gas and crude oil and natural gas liquids before the deduction of royalties were 533 billion cubic feet and 4,261,000 barrels. Undeveloped land holdings at December 31, 1984 were 3,627,000 gross (1,439,000 net) acres.

Panarctic Oils Ltd.

Bankeno's royalty extends to any additional expansion that might take place to increase the Polaris Mine's capacity and to any other mines developed by Cominco on Little Cornwallis Island.

Bankeno owns 933,372 common shares of Panarctic Oils Ltd. ("Panarctic"), representing a 1.37% interest. Panarctic, an industry/government consortium, is owned more than 50% by the Government of Canada through Petro-Canada Explorations, Inc. with the remainder of the shares held by 36 corporate or individual shareholders, most of whom are Canadian. Panarctic explores for oil and natural gas in the Canadian Arctic Islands.

Mineral Interests

Bankeno owns a 25% royalty interest in the total net proceeds of production from the Polaris lead/zinc mine (the "Polaris Mine") located on Little Cornwallis Island in the Canadian Arctic. The Polaris Mine, developed and operated by Cominco, is one of the richest lead/zinc producers in the world. The cost of developing the mine, the initial start-up costs, and the operating costs, net of sales, together with interest incurred on those amounts totalled approximately \$253,000,000 at the end of 1984. These costs must be recouped by the operator before any payment will be made under Bankeno's royalty interest.

The Polaris Mine achieved commercial production in March, 1982 and the first shipments of concentrate

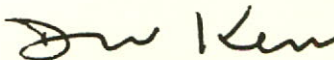
took place in July, 1982. Due to the northerly location of the mine, the concentrate production is shipped in a 12 week season at the end of the Arctic summer when the sea is open for navigation. During the remainder of the year concentrate is stored in mine site facilities having 10 month storage capacity. During 1984, 900,300 tons were mined yielding 191,900 tons of zinc concentrate and 40,700 tons of lead concentrate. The lead and zinc concentrations are sold under contracts to European smelters.

Corporate

During 1984 North Canadian Oils Limited purchased 96.6% of the common shares of the Company. As a result Messrs. Brawn, Gish, Moore, Travis and McClinton resigned as directors of the Company. These vacancies have been filled by Messrs. Kerr, L'Heureux, Christensen and Lough. On behalf of the shareholders, we extend to the former directors and to Mr. Connelly and Mr. Taylor who are not standing for re-election our sincere appreciation for their contribution to the Company.

In April 1985 Bankeno's 54.1% owned subsidiary Merland Explorations Limited completed a \$27.5 million rights offering of Convertible First Preferred shares. The Company has exercised its rights in respect of this offering.

At the Special and Annual General Meeting to be held on May 23, 1985, the shareholders will be asked to vote in favor of a resolution to continue the Company under the Business Corporation Act of Alberta. This continuation is a requirement under the laws of the Province of Alberta.



DAVID W. KERR
Chairman and Chief Executive Officer
April 29, 1985

AUDITORS' REPORT

To The Shareholders of
Bankeno Mines Limited

We have examined the consolidated balance sheet of Bankeno Mines Limited as at December 31, 1984 and the consolidated statements of earnings, deficit and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Company as at December 31, 1984 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, after giving retroactive effect to the change in the method of accounting for foreign currency translation as explained in Note 2 to the consolidated financial statements, on a basis consistent with that of the preceding year.

Calgary, Canada
February 20, 1985

Delitte Haskins + Sells.

Chartered Accountants

BANKENO MINES LIMITED

CONSOLIDATED BALANCE SHEET

December 31, 1984
(thousands of dollars)

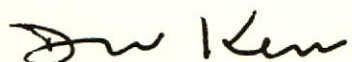
ASSETS

	<u>1984</u>	<u>1983</u>
CURRENT ASSETS		
Accounts receivable	\$ 19,622	\$ 20,520
Prepaid expenses	408	350
	<u>20,030</u>	<u>20,870</u>
INVESTMENTS (Note 3)	11,284	11,016
PROPERTY, PLANT AND EQUIPMENT (Note 4)	295,424	287,743
DEFERRED FOREIGN EXCHANGE	574	286
	<u>\$327,312</u>	<u>\$319,915</u>

LIABILITIES AND SHAREHOLDERS' EQUITY

CURRENT LIABILITIES		
Demand bank loans	\$ —	\$ 5,218
Accounts payable and accrued liabilities	28,390	22,298
Current portion of deferred revenue	2,812	1,120
Current maturities of long-term debt	5,119	15,418
	<u>36,321</u>	<u>44,054</u>
DEFERRED REVENUE (Note 5)	27,725	30,771
LONG-TERM DEBT (Note 6)	105,609	95,677
DEFERRED INCOME TAX	26,735	23,047
MINORITY INTEREST	53,723	51,416
SHAREHOLDERS' EQUITY		
Share Capital (Note 7)	244,999	244,799
Deficit	(167,800)	(169,849)
	<u>77,199</u>	<u>74,950</u>
CONTINGENCY (Note 11)	<u>\$327,312</u>	<u>\$319,915</u>

On behalf of the Board:



Director



Director

BANKENO MINES LIMITED
CONSOLIDATED STATEMENT OF EARNINGS

Year Ended December 31, 1984
(thousands of dollars)

	<u>1984</u>	<u>1983</u>
REVENUE		
Sales of petroleum and natural gas	\$ 92,536	\$ 83,043
Less royalties	<u>22,655</u>	<u>19,722</u>
	<u>69,881</u>	<u>63,321</u>
EXPENSES		
Production	12,470	12,258
General and administrative	8,145	7,218
Interest on long-term debt	13,074	12,710
Depletion	14,749	23,802
Depreciation	<u>6,761</u>	<u>6,482</u>
	<u>55,199</u>	<u>62,470</u>
EARNINGS BEFORE UNDERNOTED ITEMS	<u>14,682</u>	<u>851</u>
TAXES		
Deferred income tax (Note 8)	3,688	3,630
Alberta royalty tax credit	(2,756)	(4,770)
Petroleum and gas revenue tax	<u>7,956</u>	<u>6,100</u>
	<u>8,888</u>	<u>4,960</u>
MINORITY INTEREST	<u>3,745</u>	<u>3,443</u>
EARNINGS (LOSS) BEFORE UNUSUAL ITEM	<u>2,049</u>	<u>(7,552)</u>
UNUSUAL ITEM		
Provision for impairment of property, plant and equipment (Note 4)	<u>—</u>	<u>155,000</u>
NET EARNINGS (LOSS)	<u>\$ 2,049</u>	<u>\$(162,552)</u>
NET EARNINGS (LOSS) AFTER UNUSUAL ITEM		
Per common share (dollars)	<u>\$.07</u>	<u>\$ (5.77)</u>

BANKENO MINES LIMITED
CONSOLIDATED STATEMENT OF DEFICIT

Year Ended December 31, 1984
(thousands of dollars)

	<u>1984</u>	<u>1983</u>
DEFICIT AT BEGINNING OF YEAR		
As previously reported	\$169,209	\$ 6,695
Prior period adjustments (Note 2)		
Retroactive change in accounting policy	184	146
Settlement of prior years' lawsuits	<u>456</u>	<u>456</u>
As restated	<u>169,849</u>	<u>7,297</u>
NET EARNINGS (LOSS)	<u>2,049</u>	<u>(162,552)</u>
DEFICIT AT END OF YEAR	<u>\$167,800</u>	<u>\$ 169,849</u>

BANKENO MINES LIMITED
CONSOLIDATED STATEMENT OF CHANGES
IN FINANCIAL POSITION

Year Ended December 31, 1984
(thousands of dollars)

	<u>1984</u>	<u>1983</u>
SOURCE OF FUNDS		
Operations	\$ 31,835	\$ 29,875
Reduction in current maturities of long-term debt	11,111	—
Issue of common shares	200	—
Deferred revenue	(234)	4,150
Sale of property, plant and equipment	176	7,389
Issue of common shares by subsidiary	1,058	1,482
	<u>\$ 44,146</u>	<u>\$ 42,896</u>
DISPOSITION OF FUNDS		
Purchase of property, plant and equipment	\$ 33,086	\$ 33,624
Less Petroleum Incentives Program grants	3,390	7,749
	<u>29,696</u>	<u>25,875</u>
Repayment of long-term debt	1,981	8,067
Dividends paid by subsidiary	2,496	2,528
Current portion of deferred revenue	2,812	1,120
Increase in investments	268	515
Increase in working capital	6,893	4,791
	<u>\$ 44,146</u>	<u>\$ 42,896</u>
CHANGES IN COMPONENTS OF WORKING CAPITAL		
Increase (decrease) in current assets		
Accounts receivable	\$ (898)	\$ (8,580)
Prepaid expenses	58	(195)
	<u>(840)</u>	<u>(8,775)</u>
Increase (decrease) in current liabilities		
Demand bank loans	(5,218)	2,760
Accounts payable and accrued liabilities	6,092	(19,608)
Current portion of deferred revenue	1,692	1,120
Current maturities of long-term debt	(10,299)	2,162
	<u>(7,733)</u>	<u>(13,566)</u>
Increase in working capital	<u>\$ 6,893</u>	<u>\$ 4,791</u>

BANKENO MINES LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 1984

1. Significant accounting policies

a) Principles of consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, Bankeno Resources Ltd. (Resources) and Leaside Resources, Inc. (Leaside) and its 54% owned subsidiary, Merland Explorations Limited (Merland).

b) Investments

Investments are recorded at cost.

The investment in Panarctic Oils Ltd. represents the accumulated costs of common shares purchased less the proceeds from the partial disposition of the shares and the proceeds from grants received pursuant to the Petroleum Incentives Program.

The investment in mining property represents the cost of the royalty interest plus directly associated interest and other expenditures incurred until such time as revenues are realized. Depletion of the accumulated cost of the investment will be recognized when revenues commence.

c) Property, plant and equipment

The Company follows the full cost method of accounting for petroleum and natural gas properties and related expenditures, under which all costs related to the exploration and development of petroleum and natural gas reserves are capitalized recognizing a North American cost centre. Capitalized costs include those related to lease acquisitions, geological and geophysical activities, lease rentals on non-producing properties, drilling of productive and non-productive wells and overhead related to exploration and development.

Depletion of petroleum and natural gas properties and depreciation of production equipment and facilities are calculated on the unit-of-production method based upon estimated proven reserves as determined by independent engineers. Other equipment is depreciated at rates of 5% to 30% calculated on a declining balance basis.

The Company applies a ceiling test to capitalized costs to ensure that such costs do not exceed estimated present value of future net revenues from production of proven reserves at current prices and costs, plus the estimated fair market value of unevaluated properties.

d) Foreign currency translation

Monetary assets and liabilities in foreign currencies are translated at year-end rates with non-monetary assets and liabilities translated at rates prevailing at the transaction dates. Revenues and expenses (other than depletion and depreciation which are translated at the rate applicable to the related assets) are translated at the average rate for the year. Gains or losses arising on translation are included in earnings for the current period except those relating to long-term debt which are deferred and amortized over the life of the debt.

e) Joint interest operations

Substantially all of the Company's petroleum and natural gas exploration and production activities are conducted jointly with others and, accordingly, these financial statements reflect only the Company's proportionate interest in such activities.

f) Income tax

The Company follows the deferral method of tax allocation accounting under which the income tax provision is based on the income reported in the financial statements. Under this method, the Company makes full provision for income tax deferred principally as a result of claiming capital cost allowance and exploration and development costs in excess of depreciation and depletion provided in the financial statements.

2. Prior period adjustments

Change in accounting policy

In 1984, the Company retroactively adopted the recommendations of the Canadian Institute of Chartered Accountants on foreign currency translation. The effect of this change is to translate long-term debt repayable in foreign currency at the rate of exchange prevailing at the balance sheet date. The resulting exchange loss is deferred and amortized over the life of the

related debt. As a result of the change, long-term debt has been increased and a foreign exchange loss has been deferred resulting in the deficit increasing at December 31, 1983 by \$184,000 with \$38,000 of this amount applicable to 1983.

Settlement of prior years' lawsuits

During 1984, Merland settled certain legal actions originating in prior years in the amount of \$456,000 (net of deferred income taxes and minority interest).

3. Investments

	1984	1983
	(thousands of dollars)	
Panarctic Oils Ltd.	\$ 2,678	\$ 2,787
Mining property	8,606	8,229
	<u>\$11,284</u>	<u>\$11,016</u>

At December 31, 1984, the Company holds a 1.38% interest in Panarctic Oils Ltd. Panarctic was formed to explore the oil and gas potential in the Arctic Islands with joint funding from private enterprises and Petro-Canada Exploration Inc.

The Company holds a 25% royalty interest after payout in the net proceeds of production from the Polaris mine and from any future mines on Little Cornwallis Island. Operations from the Polaris mine commenced in 1982 and it is currently estimated that the Company will recognize revenue from its royalty interest commencing in 1987.

4. Property, plant and equipment

(thousands of dollars)

	December 31, 1984		1983
	Cost	Accumulated Depletion and Depreciation	Net Book Value
CANADA			
Petroleum and natural gas properties	\$374,376	\$154,782	\$219,594
Production equipment and facilities	88,316	17,008	71,308
Other equipment	3,170	648	2,522
	<u>\$465,862</u>	<u>\$172,438</u>	<u>293,424</u>
UNITED STATES			2,000
			<u>\$295,424</u>
			<u>\$287,743</u>

In 1983 the Company determined that the combined effect of depressed natural gas and oil prices, reduced natural gas demand and the decline in production profiles necessitated a reduction in the carrying value of certain of its natural resource property, plant and equipment. This determination was confirmed by the results of proven reserve studies by independent engineers. The impairment was computed under conditions existing at December 31, 1983 and was based on the aggregate present value, using a 10% discount rate, of estimated future net revenues of proven reserves using prices in accordance with the existing Federal/Alberta Government pricing agreements in effect until 1986 with no price increases thereafter, plus the estimated fair value of undeveloped properties. Accordingly, the carrying value of the oil and gas assets was reduced by \$155,000,000 with \$57,896,000 attributable to the United States' properties and \$97,104,000 to the Canadian properties.

5. Deferred revenue

Pursuant to take-or-pay provisions included in certain natural gas purchase contracts, payments were received principally by Merland in respect of annual contract gas volumes not taken by the purchaser. Beginning in November, 1984 the purchaser began to take delivery of the gas and the Company began to recognize revenue related to the gas taken. The purchaser's delivery schedule for the gas will allow recognition after 1985 of \$27,725,000 of revenue over 9 years with \$2,897,000 annually in 1986 through 1988, \$3,400,000 annually in 1989 through 1993 and \$2,034,000 in 1994.

6. Long-term debt

	1984	1983
	(thousands of dollars)	
Merland Explorations Limited		
Revolving loans		
Canadian	\$ 77,158	\$74,379
United States (1983 and 1984 - U.S. \$5,000)	6,607	6,222
	<u>83,765</u>	<u>80,601</u>
Income debentures		
Canadian	15,500	18,500
United States (1983 U.S. \$6,475; 1984 - U.S. \$5,425)	7,396	8,284
	<u>22,896</u>	<u>26,784</u>
Total long-term debt	<u>106,661</u>	<u>107,385</u>
Less current portion		
Revolving loans	—	11,111
Income debentures	5,119	4,307
	<u>5,119</u>	<u>15,418</u>
	<u>101,542</u>	<u>91,967</u>
Bankeno Mines Limited		
Mining loan payable	4,067	3,710
	<u>\$105,609</u>	<u>\$95,677</u>

Merland Explorations Limited

The revolving loans consist of \$60,000,000 from an affiliate with the remainder from a Canadian Chartered bank, bear interest at rates approximating the Canadian bank prime rate and have no fixed repayment terms. At December 31, 1984, accounts payable includes approximately \$1,300,000 of interest payable on the revolving loan, from an affiliate, which was paid subsequent to year end.

The income debentures have a final maturity date of June, 1988, with quarterly principal repayments. Principal repayments by year are as follows:

Year	Canadian Dollars	United States Dollars
1985	\$ 3,500,000	\$1,225,000
1986	4,500,000	1,575,000
1987	5,000,000	1,750,000
1988	2,500,000	875,000
	<u>\$15,500,000</u>	<u>\$5,425,000</u>

The income debentures bear interest at one half of the bank's prime lending rates plus 1 1/8% to maturity and are secured by certain of Merland's Canadian producing petroleum and natural gas properties.

Bankeno Mines Limited

The mining loan payable bears interest at the bank prime rate and will be repaid to the mine operator from the Company's royalty interest as described in Note 3. Accrued interest is repaid first with any residual royalty revenue to reduce the \$3,000,000 principal portion of the loan. Based on estimated production, mineral prices and interest rates, principal repayments of \$600,000 in 1987, \$1,400,000 in 1988 and \$1,000,000 in 1989 are expected.

7. Share capital

First Preferred Shares	Authorized	—	50,000,000 shares, issuable in series, with a par value of \$10.00 each
	Issued	—	Nil
Common Shares	Authorized	—	100,000,000 shares
	Issued	—	

	<u>Number</u>	<u>Consideration</u>
Balance January 1, 1983 and 1984	28,170,721	\$244,799,000
Issued for cash upon exercise of share options	100,000	200,000
Balance December 31, 1984	<u>28,270,721</u>	<u>\$244,999,000</u>

The Company has issued 15,427,093 warrants entitling the holder of each warrant to purchase one common share for \$9.00 up to March 17, 1986.

8. Deferred income tax

The provision for deferred income tax of \$3,688,000 differs from the result which would be obtained by applying the combined Canadian Federal and Provincial income tax rate of 47.9% (1983 - 47.9%) to the income (loss) before unusual item, minority interest and deferred income tax of \$9,482,000 (1983-(\$479,000)). This difference results from the following items:

	<u>1984</u>	<u>1983</u>
	(thousands of dollars)	
Computed expected tax	\$4,542	\$(229)
Increase (decrease) in deferred income tax resulting from:		
Effect of subsidiaries and consolidation	(608)	5,967
Royalties and other payments to provincial governments	6,281	5,161
Petroleum and gas revenue tax	3,811	2,922
Interest on income debentures	878	935
Federal resource allowance	(8,060)	(7,192)
Alberta royalty tax credit	(1,320)	(2,284)
Earned depletion on Canadian production income	(2,280)	(1,727)
Other	444	77
Deferred income tax provision	<u>\$3,688</u>	<u>\$3,630</u>

As at December 31, 1984, Merland's United States subsidiaries have accumulated losses of approximately U.S. \$20,000,000, the potential future income tax benefits of which have not been recognized in these financial statements. The ability to realize these benefits expires in intervals over the years 1995 to 1999.

9. Comparative amounts

Certain of the 1983 comparative amounts have been reclassified to conform with current presentation.

10. Statutory information

The aggregate direct remuneration paid or payable to 9 directors and 9 individuals performing the functions of senior officers for the Company, as defined in The Companies Act (Alberta) amounted to \$960,000 (1983 - \$750,000).

11. Contingency

The Company is defendant in an action by certain of its minority shareholders claiming that the 1982 acquisition of Merland, Leaside and Resources caused substantial dilution and loss of value of their shareholdings.

The Company is not able to determine the outcome of the foregoing action and accordingly, is not able to estimate the effect, if any, on earnings, deficit, or on the reclassification of assets which may result from settlement in the plaintiffs' favour.

12. Subsequent event

On February 19, 1985, Merland announced its intentions to issue one right for each common and Series A Preferred share outstanding, with 20 rights entitling a holder to purchase one Series B Convertible First Preferred share for \$25.00 per share. The Series B Preferred shares will have a dividend rate of 7½% per annum and will be convertible at any time until June 30, 1990 into 5¼ common shares. In addition, they will be redeemable at anytime after the common shares of Merland trade for 20 consecutive days above 120% of the conversion price. Pending utilization in its oil and gas business, the proceeds will be invested in low risk, high yield marketable securities or used to reduce debt. The Company has agreed to subscribe for its proportionate share, being 51%, of the Series B Preferred shares.

