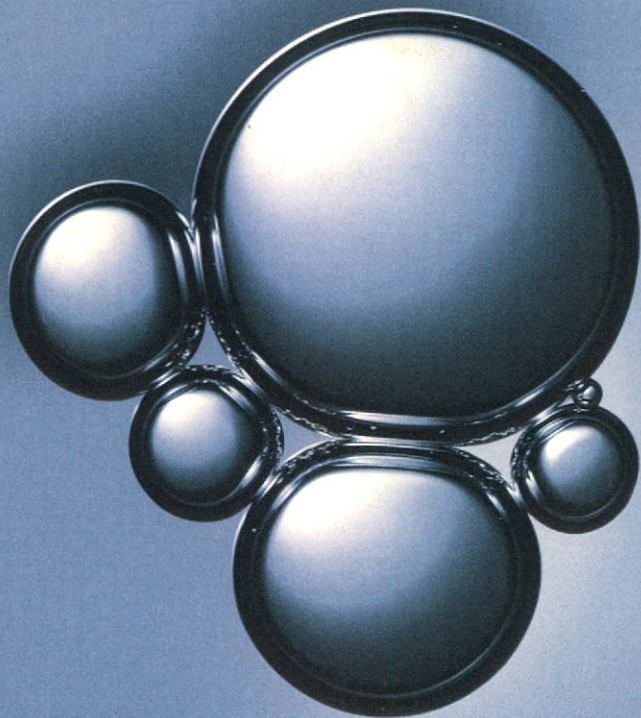


SMART SYSTEMS.

GLOBAL REACH.



**ENERFLEX**

ANNUAL REPORT 2004

CANADIAN COMPANIES A.R.

LIBRARY USE ONLY



Enerflex Systems Ltd. is a leading provider of products and services to the global oil and gas production industry.

Enerflex provides natural gas compression, power generation and process equipment for sale or lease; hydrocarbon production and processing facilities; electrical, instrumentation and controls services and a comprehensive package of field maintenance and contracting capabilities.

Enerflex provides these products and services in an integrated package or as stand-alone offerings – all part of a unique value proposition to Enerflex customers.

## ● CONTENTS

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## ● ANNUAL GENERAL MEETING

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Shareholders of Enerflex Systems Ltd. are invited to attend the Annual General Meeting which will be held on April 14, 2005 at the Sheraton Suites Eau Claire, 255 Barclay Parade S.W., Calgary, Alberta, at 11:00 a.m. Calgary time. Those unable to attend are encouraged to sign and return the proxy form mailed to them. The Annual General Meeting will be webcast on the Enerflex website at [www.enerflex.com](http://www.enerflex.com).

**Cover:** The cover is an artist's representation of a methane molecule, consisting of a carbon atom and four hydrogen atoms. In this annual report, we use the methane molecule as an apt metaphor for our corporate structure and for the regions we serve internationally.



Over the next decade, pipelines the world over will move more than 118 trillion cubic feet of natural gas per year to meet soaring demand.

Canada.

Australasia.

Middle East.

Europe/West Africa.

U.S./Latin America.

**THAT'S WHERE WE'LL BE.**



Ensuring natural gas delivery  
from wellhead to pipeline.

**ENERFLEX. A VITAL PART OF THE WORLDWIDE ENERGY PICTURE.**



## SMART SYSTEMS

Enerflex's Integrated Control and Information Systems ("ICIS") gives customers detailed, global command of what's happening throughout their entire oil and gas operations, including the remote monitoring, control and optimization of wellheads, compressors, process plants, heaters, or dehydration units. Customers can access information and control their entire operation through Enerflex's web-enabled smart system.

When customers access the Internet and click on the ICIS overview map, they can select any well or facility in the field. They are able to view and change with a mouse click; well and pipeline pressures, battery levels, and a vast range of other operating factors. The software is designed to proactively deliver the appropriate information to every member of an exploration and production company's team: reservoir engineers, production engineers, field operators and production accountants.

ICIS is more than software. It integrates hardware such as SCADA panels, compressor controls and plant control panels with an intelligent software package. It is an asset optimization tool that allows customers to optimize their equipment using real-time data. It is a safety system as well, incorporating vital alerts for gas, fire or flameout detection. And it is a communications tool that ties the entire business together from asset and production management to production accounting and key performance indicators for executive decision-making. With ICIS, the information flow is seamless and automatic, eliminating the need to fax reports or call for field data.

Imagine. Greater control. Greater efficiencies. Enerflex helps make it happen.

---

## GLOBAL REACH

In 2004, Enerflex fine-tuned its international operations, refining strategies for greater market penetration. The Company developed a comprehensive international sales plan, supported by experienced and skilled people who can design and deliver solutions that bridge product lines and service points. It all adds up to real value for customers.

A case in point. In Pakistan, Enerflex and its joint-venture, Presson-Descon International (Private) Limited, were awarded Enerflex's largest ever single contract for a natural gas processing facility. The contract will generate revenue of approximately \$30 million for the Company over 2004 and 2005, and includes products and services from four Enerflex divisions.

Headquartered in Calgary, Canada, Enerflex and its subsidiaries have approximately 2,000 employees worldwide. Enerflex, its subsidiaries, and its interests in joint-ventures, operate in Canada, the United States, the Netherlands, Germany, Australia, Pakistan and Indonesia.

Global reach. Enerflex has it.



## HELPING CUSTOMERS WORK SMARTER

### ● SMART SYSTEMS

Enerflex has replaced the hodgepodge of field monitoring systems with one integrated, smart package: ICIS.

Customers can view the entire operation – from wellhead to pipeline – from their desktop, making changes in pipeline pressures, fluid levels, pipeline throughput and other essential adjustments, with a mouse click. The system integrates an energy company's entire oil and natural gas operations into one seamless software package accessible from the Internet. Maintenance is easier too. The system schedules equipment maintenance as well as calibration of natural gas measuring devices.



ICIS detects low HP utilization.

**ICIS Response:**  
Automatically moves compressor to appropriate load step to maximize flow per HP.



ICIS detects dropping oil level without correct PIN number entry for authorized truck out.

**ICIS Response:**  
Automatically dispatches security to check if oil theft is occurring.



ICIS detects H<sub>2</sub>S gas.

**ICIS Response:**  
Automatically shuts well in and dispatches operator to well-site to protect public from potential gas leaks.



ICIS is aware of all instrumentation devices and maintenance history, maintenance schedule and device performance.

**ICIS Response:**  
ICIS automatically schedules maintenance services to maintain optimal systems performance.



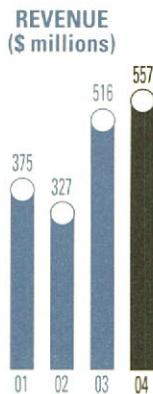
ICIS detects flame-out on pipeline heater, potentially causing hydrates to freeze.

**ICIS Response:**  
Automatically restarts line heater.



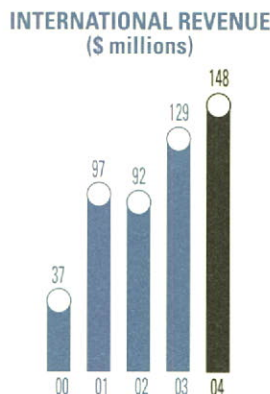
**What were the key drivers behind Enerflex's record-setting 2004 revenue?**

Strong revenue growth was generated in the Company's Fabrication and Leasing segments, which increased revenue by \$43.1 million and \$6.2 million respectively. This growth was largely achieved as a result of increased international sales in Production and Processing, higher customer demand for leased equipment and an increase in compressor package sales arising from improved market share.



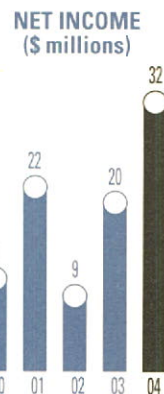
**How important is international revenue to Enerflex?**

International revenue accounted for 27% of total revenue in 2004 and is a key component of the Company's plans for growth. In 2004, the Company's international efforts to provide single-source solutions by cross-selling divisional expertise proved successful as Enerflex was awarded a number of projects involving multiple Enerflex divisions.



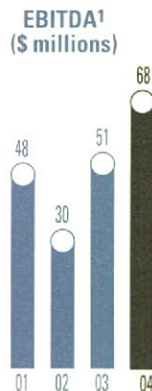
**Which factors contributed to the 57% increase in net income?**

Key factors included the completion of the Company's internal reorganization of business units around successful product lines, maintaining a focus on improved cost controls and expenditure reduction, and the pursuit of contracts on a global basis.

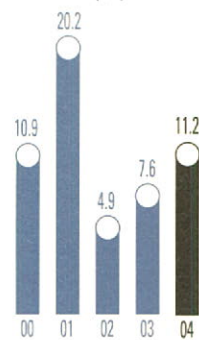


**EBITDA<sup>1</sup> in 2004 also set a record. How was this achieved?**

Many of the strategic fundamentals that drove the Company's record net income attributed to the record EBITDA<sup>1</sup>, particularly the commitment to cost controls and expenditure reduction.



**RETURN ON AVERAGE EQUITY (%)**



<sup>1</sup> Earnings before interest, taxes, depreciation and amortization ("EBITDA") is a non-GAAP (Generally Accepted Accounting Principles) earnings measure that does not have a standardized meaning prescribed by GAAP and therefore is unlikely to be comparable to similar measures presented by other issuers.



## 2004 PERFORMANCE HIGHLIGHTS

(\$ millions, except per share data and ratios)	2004	2003	2002
<b>RESULTS</b>			
Revenue	557.1	515.5	326.7
EBITDA <sup>1</sup>	68.2	51.2	30.0
Income before income taxes	49.2	31.2	14.3
Net income	32.1	20.4	9.2
Per common share – basic (\$)	1.44	0.92	0.51
Cash from operations	50.9	34.1	36.3
Capital expenditures, net			
Rental equipment	21.6	3.7	8.5
Property, plant and equipment	8.8	2.8	2.2
Dividends per common share (\$)	0.40	0.40	0.40
<b>FINANCIAL POSITION</b>			
Working capital	85.9	82.8	68.7
Total assets	486.9	457.7	451.2
Long-term debt	64.0	68.4	69.0
Shareholders' equity	297.9	274.5	260.9
<b>KEY RATIOS</b>			
Gross margin as a percentage of revenue	22.5	20.2	21.4
Pre-tax income as a percentage of revenue	8.8	6.1	4.4
Return on average equity <sup>2</sup> (%)	11.2	7.6	4.9

<sup>1</sup> Earnings before interest, taxes, depreciation and amortization ("EBITDA") is a non-GAAP (Generally Accepted Accounting Principles) earnings measure that does not have a standardized meaning prescribed by GAAP and therefore is unlikely to be comparable to similar measures presented by other issuers.

<sup>2</sup> Return on average equity is calculated as net income divided by the simple average of shareholders' equity at the beginning and end of the year.

## DISCLOSURE REGARDING FORWARD-LOOKING STATEMENTS

Certain statements contained in this annual report, including statements which may contain words such as "could", "should", "expect", "estimate", "likely", "believe", "will" and similar expressions and statements relating to matters that are not historical facts, are forward-looking statements including, but not limited to, statements as to: future capital expenditures, including the amount and nature thereof; oil and gas prices and demand; expansion and other development trends of the oil and gas industry; business strategy; expansion and growth of the Company's business and operations, including the Company's market share and position in the Canadian and international drilling markets; and other such matters.

These statements are based on certain assumptions and analyses made by the Company in light of its experience and its perception of historical trends, current conditions and expected future developments, as well as other factors it believes are appropriate in the circumstances. However, whether actual results, performance and achievements will conform with the Company's expectations and predictions are subject to a number of risks and uncertainties which could cause actual results to differ materially from the Company's expectations, including: fluctuations in the price and demand of oil and gas; fluctuations in the level of oil and gas exploration and development activities; fluctuations in the demand for well completion, production and natural gas infrastructure equipment, as well as electrical and mechanical services and ancillary oilfield services; the existence of competitors, technological changes and developments in the oil and gas industry; the ability of oil and gas companies to raise capital; the effects of severe weather conditions on operations and facilities; the existence of operating risks inherent in the oil and natural gas service business; political circumstances impeding the progress of work in any of the countries in which the Company does business; identifying and acquiring suitable acquisition targets on reasonable terms; general economic, market or business conditions, including stock market volatility; changes in laws or regulations, including taxation, environmental and currency regulations; the lack of availability of qualified personnel or management; and other unforeseen conditions which could impact on the use of products and services supplied by the Company.

Consequently, all of the forward-looking statements made in this report are qualified by these cautionary statements and there can be no assurance that the actual results or developments anticipated by the Company will be realized or, even if substantially realized, that they will have the expected consequences to, or effects on, the Company or its business or operations. The Company assumes no obligation to update publicly any such forward-looking statements, whether as a result of new information, future events or otherwise.





**P. JOHN ALDRED**  
Chairman, President  
and Chief Executive Officer

**J. BLAIR GOERTZEN**  
Executive Vice-President  
and Chief Operating Officer



## ENERFLEX LETTER TO SHAREHOLDERS

2004 marks the substantial completion of the restructuring process your Company embarked on in the spring of 2003. Specifically, we set out to put the right people in the right places, to provide the tools and accountability framework to drive improvement in pre-tax income and to make our processes more efficient.

While we have enjoyed strong market conditions for our products and services, our results reflect significant gains from internal improvements.

- Net income increased by 57% to \$32.1 million (\$1.43 per diluted share) compared with \$20.4 million (\$0.91 per diluted share) in 2003. This increase was achieved on a relatively modest 8% increase in revenue to \$557.1 million from \$515.5 million in 2003.
- Pre-tax income as a percentage of revenue improved to 8.8% in 2004 versus 6.1% in 2003.
- EBITDA<sup>1</sup> increased to \$68.2 million in 2004 compared to \$51.2 million in the prior year or 12.2% of revenue versus 9.9% in the prior year.
- Total debt, net of cash, declined by a further \$9 million to \$80.0 million from \$89.3 million at the end of the prior year, resulting in a conservative total debt to equity ratio of 0.3:1.

It is worth noting that revenues, EBITDA<sup>1</sup> and net income in 2004 represent record highs for Enerflex Systems Ltd.

We are pleased with both our operating performance and financial results for 2004. More importantly, we firmly believe we are now positioned to grow and further improve our results. The hard work of the management team and all our employees on improving your Company has resulted in a solid foundation that is allowing us to focus on strategic opportunities both domestically and outside North America.

Enerflex has the industry's broadest offering of products and services available from a single source focused between the natural gas wellhead and the pipeline. This represents a strong platform for the Company to significantly increase its scale and reach, a strategic objective we are committed to pursuing over the coming months and years.

<sup>1</sup> Earnings before interest, taxes, depreciation and amortization ("EBITDA") is a non-GAAP (Generally Accepted Accounting Principles) earnings measure that does not have a standardized meaning prescribed by GAAP and therefore is unlikely to be comparable to similar measures presented by other issuers.



While natural gas production in North America may well have peaked, the demand for compression, process equipment and services is growing as producers respond to accelerating reservoir decline rates. Coal-bed methane is emerging as a viable offset to declining conventional gas production and will drive substantial demand for compression equipment and services as production comes on stream.

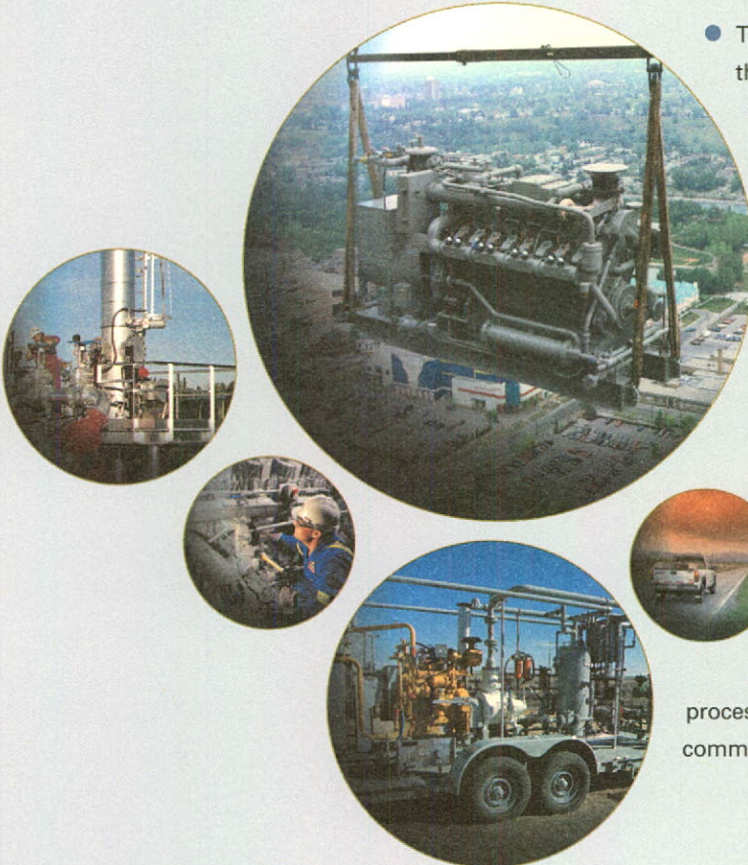
Compared to North America, the natural gas industry around the world is in its infancy and represents huge potential for Enerflex. The emergence of China and India as strong industrial economies, coupled with the ongoing development of liquefied natural gas, will drive increasing demand for natural gas production and the broad range of products and services we offer.

As I walk the hallways and shop floors of our facilities, I can sense the excitement. We have a very strong management team with the tools and authority to react quickly to our customers' needs. We have a strong balance sheet that allows us great flexibility, and above all else, we have momentum and are surrounded by opportunities for significant, sound growth. While not without challenges, the next several years hold great promise for Enerflex.

Your Board of Directors is committed to strong corporate governance. During the course of 2004 the Governance Committee completed a number of initiatives aimed at ensuring Enerflex adopts and complies with best practices in this area. These accomplishments include:

- The review and creation of new charters for the Board of Directors and all Committees of the Board.
- Reaffirmed the principle of having a lead director and renewed the appointment of a long-standing independent member of the Board to this role.
- Clearly defined the role of senior management, plus reviewed and approved the Company's Code of Business Conduct.
- Adopted policies and established clear accountability with respect to ethics and privacy.

By its very nature, good governance is a process of continuous improvement. Enerflex is committed to this process.





In September of 2004, Mr. Michael A. Grandin resigned from the Board to take on the role of Dean of the University of Calgary's Richard Haskayne School of Business. Michael served on the Enerflex Board for five years providing valuable counsel and guidance. On behalf of the Board and management, I would like to thank Michael for his considerable contribution to our success and to wish him well in the future.

The Hon. Barbara J. Sparrow has indicated that, as she is approaching the normal retirement age for our Board, she will not be standing for re-election at this year's Annual General Meeting. Bobbie has enjoyed a distinguished career as both a businesswoman and a federal politician. She has contributed a unique and valuable perspective to our Board. I would like to thank Bobbie for her solid contribution to our organization and extend our best wishes for the future.

Mr. Robert B. Hodgins joined our Board and concurrently assumed the role of Chair of the Audit Committee in July of 2004. Robert has an extensive finance and accounting background at a senior level in the Canadian energy sector and is a very welcome addition.

It is also with great pleasure that I announce that Ms. Nancy M. Laird has consented to stand for election to the Enerflex Board of Directors at the Annual General Meeting on April 14th, 2005. Nancy offers a tremendous depth of industry knowledge and has considerable experience in governance and other matters pertinent to the Company.

I would like to thank all our employees for their hard work and dedication. They deserve full credit for our results and the progress we have made this year. On behalf of management and our employees, I would like to express our gratitude to our Board. Their support and guidance has been invaluable.

Yours sincerely,

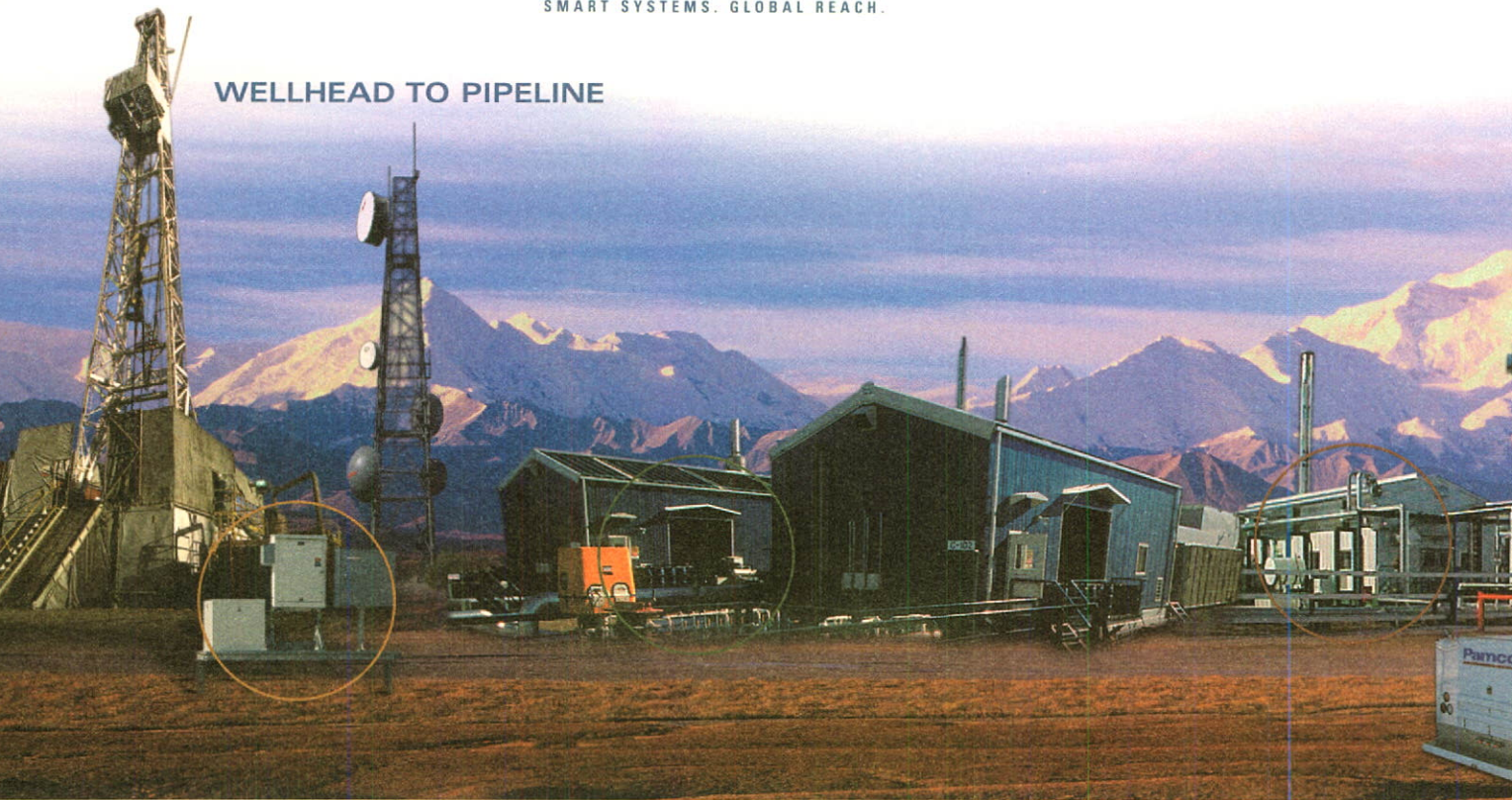


**P. John Aldred**  
Chairman, President and  
Chief Executive Officer

February 10, 2005



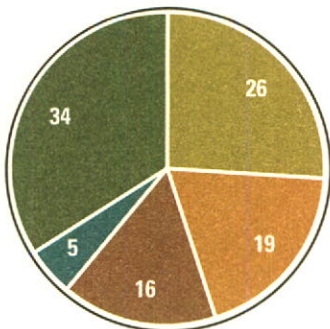
## WELLHEAD TO PIPELINE



Enerflex provides a wide range of products and services that ensure the flow of natural gas and crude oil through gathering pipelines to field level processing plants and into natural gas storage and transmission pipelines. Enerflex is a vital link between the wellhead and industrial and residential consumers.

Enerflex's company-wide efforts produced record results in 2004. During the fourth quarter, Enerflex generated its highest quarterly revenue. This contributed to a year in which Enerflex produced its highest annual net income from record revenue of \$557 million.

REVENUE BY DIVISION (%)



### ● COMPRESSION AND POWER

Enerflex is a world-class packager of natural gas compression and power generation equipment. Compression offers a complete line of reciprocating and screw compression packages from 5 to 6,000 horsepower and holds the required skills and experience to custom design and engineer customer solutions.

#### ● 2004

Compression's main Calgary facility improved product quality, reintroduced its Back-to-Basics standard product line and continued with the development and enhancement of new products, such as the Generation III package. The division targeted both traditional gas development projects and emerging markets such as coal-bed methane, while pursuing international opportunities. By the end of 2004, Compression had increased its Canadian market share.

#### ● Outlook

Compression will introduce new products in both its reciprocating and screw compressor lines along with new services to further optimize customers' compression assets and natural gas production.

### ● PRODUCTION AND PROCESSING

The division builds turnkey, integrated oil and gas production and processing facilities and flare systems for the worldwide crude oil and natural gas industry. This includes engineering, transportation and field services.

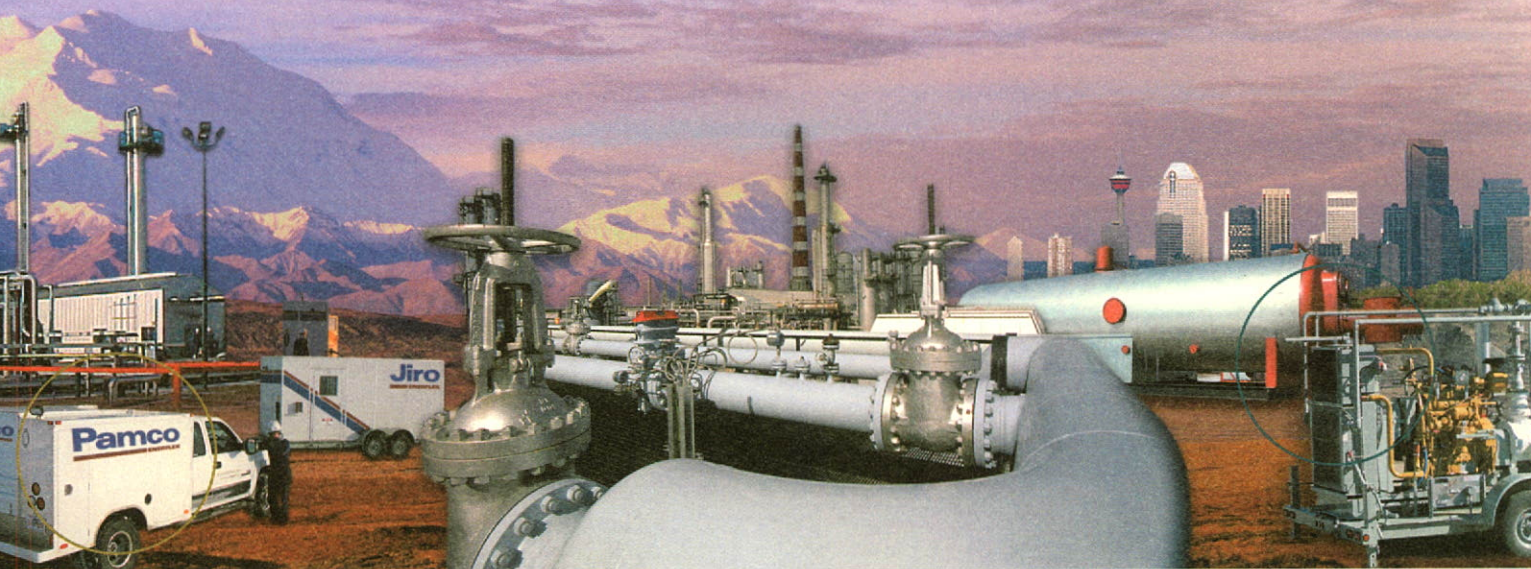
#### ● 2004

With experience in over 30 countries, Production and Processing grew its international business substantially while maintaining a strong Canadian market share. The division's most significant 2004 contribution was its international growth, including significant projects in Pakistan, Australia, Russia and Bangladesh. The Pakistani project was for the supply of a natural gas processing facility and had a total contract value of approximately \$47 million, of which Enerflex's share will be approximately \$30 million over 2004 and 2005.

#### ● Outlook

The division will build Canadian market share by diversifying into markets such as the oil sands. It will also continue exporting services internationally through strategic relationships and leveraging its Presson-Descon International (Private) Limited joint-venture. This division will lead the Company's growth in the Middle East.





● **MECHANICAL SERVICE**

The business units of Mechanical Service provide field maintenance services, equipment and parts to the oil and natural gas industry. With over 350 personnel, the division operates in Canada, the United States, the Netherlands, Germany, Australia and Indonesia.

● **2004**

Due to high Canadian commodity prices in the prior year, many customers deferred equipment maintenance until 2004. The division established a dedicated inventory and remanufacturing facility, making it easier for customers to exchange components. Mechanical Service was also active internationally, winning new maintenance contracts in Europe and Australia and expanding service operations in the United States to support Enerflex's Leasing division. In late 2004, the division was awarded the Waukesha Engine distributorship for Poland.

● **Outlook**

Active in Canada, Australasia and Europe, Mechanical Service will focus on expanding its proven full-service model in each region. While the developing international gas compression market offers numerous opportunities, the division faces a challenge in managing its parts delivery schedules.

● **ELECTRICAL, INSTRUMENTATION AND CONTROLS**

Syntech provides a comprehensive range of electrical, instrumentation and control technologies, products and services to the petrochemical, energy, forestry, pulp and paper, mining and agriculture industries worldwide.

● **2004**

Syntech generated lower revenue in 2004 as compared to 2003 but showed consistent margin improvement throughout the year. The division focused on streamlining operating practices and procedures to improve operating margins in an extremely competitive environment. With experienced field personnel and strategically located field offices, Syntech is well positioned within the Canadian market. Additionally, in 2004, Syntech provided key expertise on the majority of Enerflex's international projects.

● **Outlook**

Syntech will continue its operational and financial improvements throughout 2005, positioning itself for growth in 2006 and beyond. Syntech's focus on smart systems and proven solutions is key to remaining competitive globally.

● **LEASING**

Enerflex Leasing offers customers flexible and innovative financing for a broad range of gas compression, power generation and process equipment. Leasing has the second largest fleet of rental gas compressors in Canada, with the broadest range of products.

● **2004**

Leasing experienced an excellent year in 2004, maintaining market share while increasing revenue and improving overall utilization rates. Expansion into international markets commenced during 2004 and at December 31 the compression rental fleet had expanded to approximately 360 units, including 16 units located in the United States and 5 units in other international markets.

● **Outlook**

Leasing has excellent potential in the traditional Canadian market and emerging coal-bed methane applications. International expansion will be executed on a selective basis to minimize the risk from these new markets. Growth in the lease fleet is expected to be Enerflex's largest capital investment in 2005.



● GLOBAL REACH

**CANADA**

Production projected to grow at an average annual rate of 0.5% as consumption increases by 2.2% per year.

Gas production declining in the Western Canada Sedimentary Basin, which accounts for more than 75 percent of Canada's natural gas production.

Natural gas use by oil sands producers is expected to triple.

- COMPRESSION AND POWER
- PRODUCTION AND PROCESSING
- MECHANICAL SERVICE
- ELECTRICAL INSTRUMENTATION AND CONTROLS
- LEASING
- INTERNATIONAL ENERFLEX LOCATIONS
- ▲ ENERFLEX APPLICATIONS

**Global Locations of Enerflex Supplied Equipment and/or Services**

Algeria	Guatemala	Senegal
Angola	Hungary	Slovakia
Argentina	India	South Korea
Australia	Indonesia	Spain
Azerbaijan	Israel	Sudan
Bahrain	Italy	Switzerland
Bangladesh	Kazakhstan	Syria
Barbados	Kenya	Taiwan
Belgium	Kuwait	Tanzania
Bolivia	Libya	Thailand
Brazil	Malaysia	Trinidad & Tobago
Brunei	Mexico	Tunisia
Cameroon	Netherlands	Turkey
Canada	New Zealand	Turkmenistan
Chile	Nigeria	Ukraine
China	Norway	United Arab Emirates
Colombia	Oman	United Kingdom
Congo	Pakistan	United States
Croatia	Papua New Guinea	Venezuela
Ecuador	Peru	Vietnam
Egypt	Poland	Yemen
Equatorial Guinea	Qatar	
Finland	Russia	
France	(including Sakhalin Island)	
Gabon	Saudi Arabia	
Germany		
Greece		

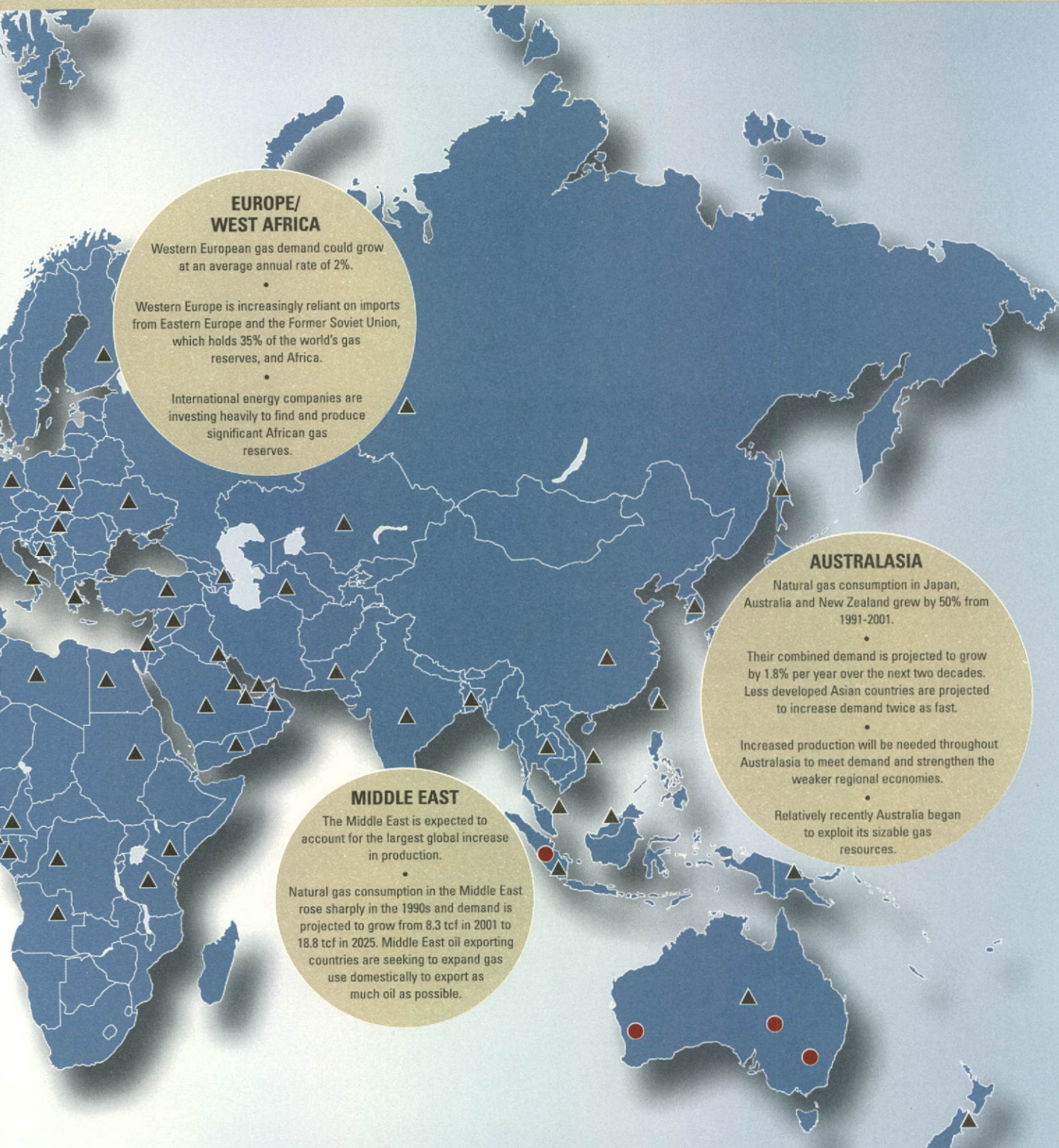
**U.S./LATIN AMERICA**

The U.S. holds 3% of the world's natural gas reserves but consumes more gas than any other nation.

The U.S. has produced more than 40% of its total estimated gas reserves and is already dependent on imports.

On average, Latin America has a gas reserve life of some 68.8 years.





**EUROPE/  
WEST AFRICA**

Western European gas demand could grow at an average annual rate of 2%.

Western Europe is increasingly reliant on imports from Eastern Europe and the Former Soviet Union, which holds 35% of the world's gas reserves, and Africa.

International energy companies are investing heavily to find and produce significant African gas reserves.

**MIDDLE EAST**

The Middle East is expected to account for the largest global increase in production.

Natural gas consumption in the Middle East rose sharply in the 1990s and demand is projected to grow from 8.3 tcf in 2001 to 18.8 tcf in 2025. Middle East oil exporting countries are seeking to expand gas use domestically to export as much oil as possible.

**AUSTRALASIA**

Natural gas consumption in Japan, Australia and New Zealand grew by 50% from 1991-2001.

Their combined demand is projected to grow by 1.8% per year over the next two decades. Less developed Asian countries are projected to increase demand twice as fast.

Increased production will be needed throughout Australasia to meet demand and strengthen the weaker regional economies.

Relatively recently Australia began to exploit its sizable gas resources.

Source: International Energy Outlook 2004  
Released April 2004  
Energy Information Administration,  
U.S. Department of Energy.



## REVIEW OF OPERATIONS



Enerflex is organized into three reporting segments: Service, Fabrication and Leasing, which together deliver a complete suite of products and services from wellhead to pipeline. The products and services are delivered through six divisions, each focused on meeting a specific area of customer need: Compression, Power, Mechanical Service, Production and Processing, Leasing, and Electrical, Instrumentation and Controls.

In turn, the divisions are comprised of 14 business units and two joint-ventures, each of which offers unique expertise and knowledge to customers either on a stand-alone basis, or as a powerfully integrated team solution.

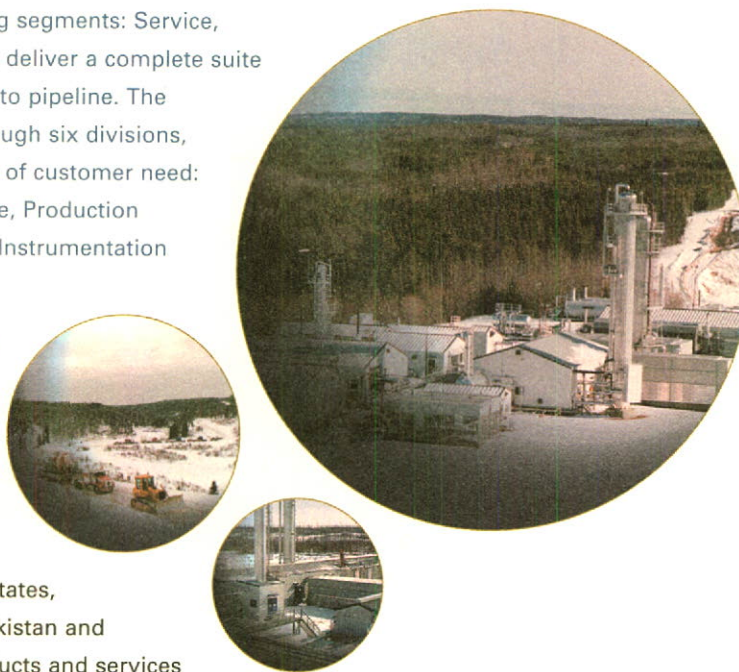
With operations in Canada, the United States, the Netherlands, Germany, Australia, Pakistan and Indonesia, Enerflex delivers quality products and services to customers worldwide.

Within the Canadian market, Enerflex's business units operate individually, with their own unique products, services, clients and market niches. Canadian customers tend to buy products or contract services from a variety of suppliers, rather than adopting a packaged solution from one provider.

Internationally, the situation is almost reversed, with buyers preferring to source from one provider. Over the last several years Enerflex has focused on international expansion. The Company is executing its strategy of global expansion through export sales and the establishment of international business units in various regions that are capable of representing the entire line of Enerflex products and services. The Company's international efforts are focussed on the following regions:

- Australasia
- The Middle East
- Europe and West Africa
- The United States and Latin America

Whether represented internationally as Enerflex or within Canada as particular business units, customers have come to rely upon the Company's commitment to providing quality products and services in a cost-effective and timely manner.





## 2004 HIGHLIGHTS

### COMPRESSION AND POWER

- The Compression division completed and shipped 315 compressor packages in 2004, compared to 230 in 2003.
- EFX Compression added a 1,250 horsepower compressor package to its standard product line.
- EFX Compression USA designed and manufactured a vapor recovery unit for a Floating Production, Storage and Offloading facility offshore West Africa.
- EFX Compression USA's Odessa facility continued to demonstrate leadership in the fabrication of specialty compressor packages.
- Jiro Compression introduced 3 new packages to its product offering: a 50 horsepower, a 325 horsepower and a 400 horsepower.
- Jiro Compression completed and shipped its 1,000th unit in 2004.
- Jiro Compression completed its first large, multi-unit order (37 units for coal-bed methane ("CBM") production) for Leasing.
- Compression Services developed a new compressor optimization service program – HPMAX.
- Compression Services' performance exceeded targets with a year-over-year revenue increase of 32%.
- Power completed and shipped 20 power generation packages in 2004, the largest of which was a 4 megawatt project destined for Pakistan.

### PRODUCTION AND PROCESSING

- Production and Processing increased its revenue by 37% year-over-year.
- Presson led the charge for Enerflex to expand internationally, earning almost 65% of its revenue from international business.
- Presson and PDIL together led the design and supply of a turnkey gas processing facility in Pakistan that will generate revenue of approximately \$30 million over 2004 and 2005 for Enerflex.
- Presson celebrated its 25th anniversary in 2004.
- Presson continued to expand internationally through the award of a contract for the design and supply of a gas processing plant in Australia.
- Presson completed an expansion of its office space.
- Presson began the design of its new heavy vessel fabrication facility that will be completed in 2005.
- Mactronic maintained its Canadian market share and increased its share of the Latin American market.

### MECHANICAL SERVICE

- Mechanical Service completed 44,896 service work-orders in 2004, compared to 42,829 in 2003.
- Mechanical Service's parts and service revenue increased 11% compared to 2003.
- Pamco continued to increase revenue, with 2004 its best year ever.
- Gas Drive Systems was appointed the authorized distributor for Altronic Inc. in Australia, Papua New Guinea and New Zealand.
- PT Gas Drive Systems Indonesia was awarded a three-year extension of its contract as the Waukesha Engine distributor for Indonesia.
- Landré Ruhaak increased their market share in diesel engine applications with Iveco Motors.
- Landré Ruhaak was awarded the Waukesha Engine distributorship for Poland.

### ELECTRICAL, INSTRUMENTATION & CONTROLS

- Syntech focused on process improvement and cost controls in 2004.
- Syntech's gross margin, as a percentage of revenue, increased in 2004 over 2003.
- Syntech launched its web-enabled smart system, ICIS (Integrated Control and Information System).

### LEASING

- Leasing's performance exceeded plan, with a year-over-year revenue increase of 28%.
- The division expanded its international presence by placing equipment in the United States and Australia.
- Leasing's compression rental utilization rate, based on capital deployed, averaged 84.7% in 2004, as compared to 83.4% in 2003.
- Leasing added 115 compression units and 55 power and process equipment units to its fleet in 2004.
- 45 compression units were sold from Leasing's fleet.



## CANADA

The energy service sector is largely dependent upon the spending levels of crude oil and natural gas exploration and production companies. The strength of both oil and natural gas prices in 2004 led to an increase in spending by producers in Canada, resulting in higher demand for Enerflex products and services.

Although it is believed that Canadian oil and natural gas reservoirs may be reaching maturity, which will ultimately result in a decline in production, the industry continues to provide Enerflex with a wide range of opportunities from conventional drilling to oil sands and CBM as declining reservoirs and the production of CBM gas have greater compression needs. Enerflex had a strong 2004, posting higher earnings each quarter over the same quarter of 2003, and generating its highest revenue ever.

The strength of the oil and natural gas industry provided the market fundamentals for Enerflex's strong Canadian performance; however, this was augmented by the wide range of products and services offered by the business units. In 2004, the Company completed its reorganization that was aimed at restructuring the business units around successful product lines, putting the right people in the right places, and improving internal processes and cost controls. These efforts enabled the Company to: respond to the increase in demand for products and services; increase revenues to \$557.1 million; improve gross margin to 22.5%; and generate earnings of \$1.43 per diluted share.

Each of the six Enerflex divisions worked diligently in 2004 to realize the goal of becoming the industry's partner of choice. Enerflex's primary market is Canada, where the Company generated \$409.4 million in revenue, employs 92% of personnel and holds 90% of assets.

### COMPRESSION AND POWER

In 2004, Compression regained the decline in market share experienced in its Canadian large horsepower compressor package business in late 2002. Through the development of new products and services from the Compression business units, Enerflex again earned its position as a market leader in Canada. During 2004, EFX Compression introduced a 1,250 horsepower standard screw-compressor package, reintroduced its Back-to-Basics ("BTB") product line, and developed a new CBM compressor that will be ready for market in 2005.

The reintroduction of the BTB product line offers clients the option of purchasing or leasing one of a number of standard compressor packages. Enerflex is able to provide clients with the equipment in a timely and cost-effective manner, as many of the components required are kept in inventory, decreasing the overall delivery schedule.

Jiro Compression also developed new products, introducing three new rotary screw compressor packages for the sub-600 horsepower market, including units of 50 horsepower, 325 horsepower and 400 horsepower. These low horsepower screw compressor packages have met higher demand from Canadian oil and gas companies due to increased activity in CBM development.





## CANADA

Compression Services developed a new service program in 2004, HPMAX, which will be launched in early 2005. The HPMAX program is a compressor optimization service program that analyzes field conditions and compressor performance prior to any revamp work. With rapidly changing field conditions and increased delivery time for major components, the HPMAX program allows clients to schedule the revamp of their existing compressor package, saving time and money.

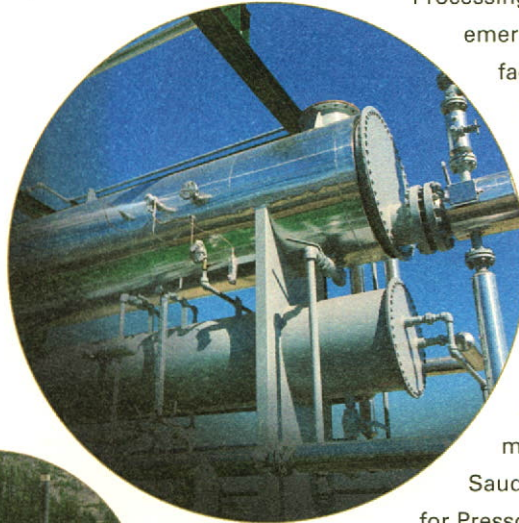
In 2005, the Compression division will continue to refine existing products and introduce new ones in order to better meet customer product and application needs. The division is also committed to helping producers increase equipment optimization and decrease downtime, thereby increasing the return on their investment in the initial compressor package.

Power had a difficult year, but continues to be an important part of Enerflex domestically and internationally. The division experienced an obsolescence provision of \$1.4 million against a contract for power generation equipment that was cancelled in late 2002, resulting in a pre-tax loss of \$1.3 million. This division supplied 20 power generation packages in 2004.

### PRODUCTION AND PROCESSING

Production and Processing, which consists of Presson and Mactronic, had an extremely strong year, growing its revenue by 37%. International activity contributed approximately 65% of this division's revenue. The division experienced continued strength in the competitive Canadian market while exploring new opportunities in both the oil sands and traditional natural gas markets in western Canada.

While maintaining its share of the Canadian market, Production and Processing began to lay the foundation for growth in emerging sectors. In 2004, Presson expanded its office facilities and in early 2005 will begin an expansion of its fabrication facility in Nisku, Alberta. The expansion will include a state-of-the-art heavy vessel fabrication shop designed to accommodate large equipment including the scale of equipment required for production needs in the Alberta oil sands. Presson is focusing on both oil sands opportunities and traditional natural gas markets in western Canada. Alberta's oil sands reportedly contain more potential for oil recovery than remains in Saudi Arabia, representing decades of opportunity for Presson.



Mactronic is also striving to penetrate emerging sectors through the development of new products and the re-emergence of some older models. New flaring legislation in Alberta posed challenges for Mactronic; however, the business unit was able to continue as a leader in the Canadian market.



## CANADA

### MECHANICAL SERVICE

The Canadian business units of Mechanical Service experienced continued success in 2004. As the demand for new equipment increased, Mechanical Service saw a similar demand for parts and service.

The Mechanical Service division focused on its parts and service business in 2004, including engine sales which remained consistent with 2003. The division established a Central Services facility to consolidate its complete inventory of parts into one warehouse. This facility is a dedicated inventory warehouse for the division's

branches across Canada and in the United States, the Netherlands, Australia and Indonesia. The Central Services facility also has a remanufacturing center for product components and engines. The facility will improve cost controls within the division and allow Mechanical Service to deliver products and services globally.

In 2004, Pamco experienced its highest revenue ever, positioning it for a strong 2005, which will mark Pamco's 35th anniversary as the premier supplier of parts and service for compression equipment in the Western Canada Sedimentary Basin ("WCSB").

Enerflex's sub-600 portable screw compression service business unit, Jiro Service, also had a successful 2004. As demand for low horsepower compressor packages increased, Jiro Service took advantage of the increased need for related products and services. Jiro Service is positioning itself to become a leader in the maintenance and service of CBM compression equipment in western Canada.



Activity from both conventional and emerging energy sectors is expected to continue increasing in Canada. Mechanical Service is well placed to offer a full range of products and services to the natural gas exploration and production sector.





## CANADA

### ELECTRICAL, INSTRUMENTATION AND CONTROLS

Like other Enerflex divisions, the Electrical, Instrumentation and Controls division (“Syntech”) has faced increased competition. Still, the division was able to refocus on its internal processes and cost controls, resulting in improved operational performance in 2004.

Syntech continued to improve its gross margin despite lower revenues. This important benchmark reflected both an internal commitment to pursuing higher margin contracts and a significant increase in international activity. Syntech partnered with Presson to supply electrical and control systems on a number of projects.

The division also focused on developing products and services that will differentiate it from competitors. One of the systems developed in 2004 was ICIS. This system allows producers to integrate desk-top remote control, data acquisition, production management, asset management and safety considerations for oil and natural gas field operations. Through improvements in its internal processes and the development of new products and innovations, Syntech is positioned for continued operational and financial improvements in 2005.

### LEASING

Enerflex’s Leasing division provides the Canadian oil and gas industry with the broadest range of compression equipment on the market. This division owns approximately 360 compression units and 97,000 horsepower and works closely with Enerflex’s Fabrication and Service segments to provide a full-service option in Canada. Leasing also offers customers a line of process equipment that meets their gas processing needs.

Leasing’s products are not generally manufactured until a contract is awarded, allowing producers to receive the quality of products and the choice of customization that are available through the Compression division. Enerflex’s largest investment in 2005 is expected to be additions to its lease fleet.

While Leasing’s fleet is primarily located in the WCSB, this division also had international successes in 2004. Leasing’s international expansion plan calls for a strategic approach to growth in targeted regions. In 2004, Leasing continued its penetration of the U.S. market and placed several units in an Australian CBM application – the division’s first entry into the Australian CBM market.

With commodity prices expected to remain high and producers acknowledging the financial benefits that leasing affords, the division’s 2005 outlook is solid.



The landscape of the Canadian energy sector is changing. Although Enerflex continues to increase its international presence, the Company’s financial successes are for the time being, largely tied to the Canadian market. Canadian producers are expected to increase their emphasis on emerging sectors in the coming years, in an effort to combat the effects of lower reserves and production per well. Enerflex is positioned to provide both conventional producers and emerging sectors with the products and services that they require in order to maximize production.





## AUSTRALASIA

Australasia is composed of two unique markets: the South Pacific and Asia. Enerflex has established two distinct business units to facilitate sales in these regions: Gas Drive Systems Pty. Limited in the South Pacific and PT Gas Drive Systems Indonesia in Asia.

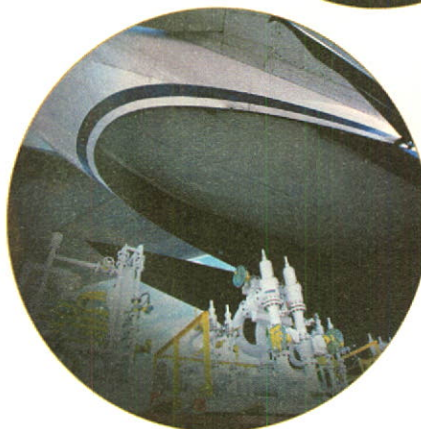
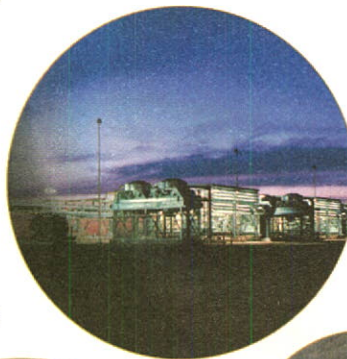
Working with Enerflex's divisions, both of these business units are directly involved in after-sales support and services for gas compression, power generation and co-generation equipment.

In 2004, Leasing and Compression secured a contract to lease three compressor packages to a CBM producer in Australia. These units were fabricated in the Jiro facility in Stettler, Alberta. This project is significant to Leasing as it marks the first time that the division has placed equipment in the growing Australasian CBM market. Other contracts to supply compressor packages to the region were won through the combined efforts of EFX Compression in Calgary and Gas Drive Systems in Australia.

Enerflex's Production and Processing division also expanded its sales efforts into Australia in 2004. Presson designed and fabricated a unique, natural gas processing facility that was required to be built vertically in order to fit space restrictions at the customer's existing facility on Varanus Island, off the northwest coast of Australia. Syntech also participated in supplying equipment to the Varanus Island facility, demonstrating Enerflex's ability to provide the international market with a bundled package of products and services from multiple business units.

Enerflex is growing its presence in Asia and 2005 will mark the first full year of operations for PT Gas Drive Systems Indonesia. Based on 2004 efforts, the business unit has solidified its position in the Asian market, which is creating opportunities for other Enerflex business units. The Production and Processing and Compression divisions have leveraged the presence of PT Gas Drive Systems Indonesia to earn business in Asia.

Australasia will continue to provide Enerflex with a number of opportunities. The Asian market has the fastest growing demand for natural gas in the world, and it is expected that increased production will be required in order to lessen the dependence on imports. Gas Drive Systems and PT Gas Drive Systems Indonesia are solidifying alliances with various major producers, and are working towards the goal of Enerflex becoming the region's partner of choice for all production needs.





## MIDDLE EAST

With over 60% of the world's proven oil reserves and 40% of proven natural gas reserves, the Middle East is the largest production basin in the world. Compared to other international regions, the Middle East represents the greatest opportunity – and the greatest challenge.

In the past, Enerflex has experienced limited success in the Middle East. Due to the similarities of the business environments, Enerflex includes Pakistan in its Middle Eastern business plan. In 2004, the Company won its largest contract ever for a job in Pakistan. The total contract value was approximately \$47 million, of which Enerflex's share will be approximately \$30 million over 2004 and 2005. The contract leveraged the presence of Enerflex's joint-venture partnership, Presson-Descon International (Private) Limited ("PDIL"), providing work for four Enerflex divisions. PDIL is a leader in the Pakistani market and through its affiliation with PDIL, Enerflex has been able to establish a significant market presence.

Also during 2004, Mactronic won a contract to supply twelve flare systems into the United Arab Emirates, and Compression supplied a variety of compression equipment for several different projects throughout the region. While Production and Processing and Compression have historically had the greatest success in the Middle East, the Service segment plays an active role and Leasing continued to have equipment active in the region.

The Middle East, which has a dynamic energy sector, represents a diverse range of opportunities, including the supply of compressor packages, production and processing facilities, and semi-turnkey projects that encompass a range of Enerflex products and services.

To better compete in the Middle East, Enerflex's international sales team will establish an office in the region by the end of 2005. The office will market Enerflex's entire range of products and services and will be responsible for building relationships with key industry personnel and establishing connections with industry leaders.

Over the next decade, the Middle East will strengthen its position as a world leader in the production of oil, natural gas, and liquefied natural gas. Enerflex has the products, services and capabilities to meet the needs of this market and will work diligently to become the partner of choice for the Middle East oil and gas industry.





## EUROPE/WEST AFRICA

Europe and West Africa are served primarily by the Landré Ruhaak business unit located in Vianen, the Netherlands.

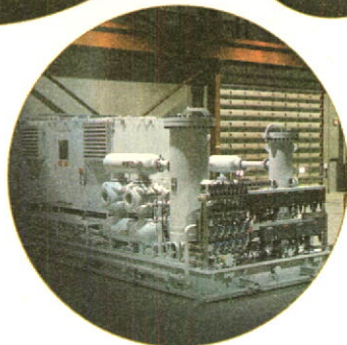
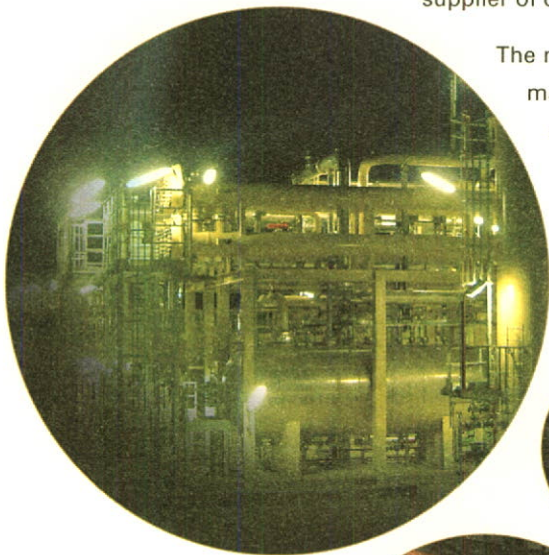
Landré Ruhaak is a leading supplier of parts and service to the gas compression and power generation industries in Europe. Through its affiliation with other Enerflex business units, Landré Ruhaak also provides this market with the full range of Enerflex products and services.

The relationship between Landré Ruhaak and other Enerflex business units is one of mutual benefit. Enerflex business units leverage Landré Ruhaak's presence in Europe when negotiating the sale of equipment into the region, while Landré Ruhaak is able to provide service contracts on equipment that Enerflex places in the region.

Enerflex was involved in a number of key projects in this region in 2004. These included supplying a vapor recovery unit to a Floating Production, Storage and Offloading facility off the coast of Equatorial Guinea; supplying a production and processing facility to Sakhalin Island, Russia, and supplying compression equipment to Turkey.

Europe and Africa continue to offer Enerflex significant opportunity. Enerflex has specifically targeted Eastern Europe and West Africa as growth areas. Both regions face increased pressure to industrialize and have recently begun to see greater activity from international oil and gas producers. The increased activity will lead to higher demand for compression and production equipment and services. Enerflex is working to establish itself as the supplier of choice in this region by seeking out strategic partnerships.

The next decade will be instrumental for oil and gas production in many regions of Europe and throughout Africa. Western Europe already accounts for more than 80% of African exports of natural gas and this dependence is only expected to increase. Demand for natural gas across this region is expected to rise dramatically as many nations further industrialize, resulting in increased consumption.





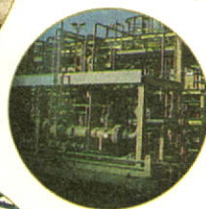
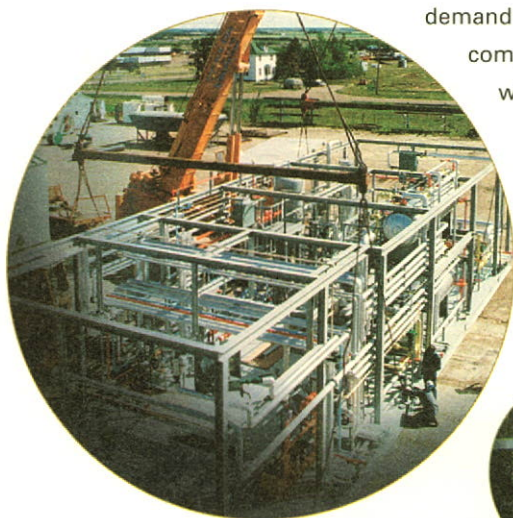
## U.S./LATIN AMERICA

The United States and Latin America are served through EFX Compression USA. The business unit is headquartered in Houston, Texas and has a fabrication facility in Odessa, Texas. The Odessa facility is also headquarters for Enerflex's U.S. service operations.

In 2004, all six of Enerflex's divisions experienced success in this market. Compression was the most active, providing a variety of compressor packages for many different applications, including sales gas, vapor recovery, acid gas and landfill gas. Power placed a power generation package in Trinidad and Tobago, establishing a relationship that may result in new opportunities. Production and Processing was involved in some projects in the United States; however, Latin America offers more opportunity. Syntech supplied electrical, instrumentation and controls equipment to clients in both the United States and Latin America.

Mechanical Service and Leasing continued to expand into the United States and Latin America in a strategic manner, in part by leveraging the success of the Compression division. To better serve the U.S. market, Mechanical Service strategically located a number of technicians throughout the region. The Leasing division placed several units in three different areas during the year, more than doubling the existing Enerflex rental horsepower in the United States. Leasing expects to continue its targeted growth in the U.S. and will also pursue additional opportunities in Latin America, a market that relies on lease contracts for much of its compression equipment.

Enerflex expects future growth in the U.S. market may arise from continued high demand for natural gas across the country which will require increased compression horsepower to maintain production levels. Additionally, with the United States' reliance on imports of natural gas and liquefied natural gas, production in Latin America is expected to grow. EFX Compression USA entered into a number of agent relationships in 2004 to secure Enerflex's future in Latin America. These relationships were established in Argentina, Brazil, Chile, Mexico, Trinidad and Tobago and Venezuela. The efforts put forth by all Enerflex business units in Latin America are expected to result in a number of new contracts.





## CORPORATE GOVERNANCE

### ● LETTER FROM THE BOARD OF DIRECTORS

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The Board of Directors and management of Enerflex Systems Ltd. consider good governance to be an important factor in the effective operation of the Company. The Board has overall responsibility for the conduct of the business and affairs of the Company and discharges this responsibility both directly and by the delegation of certain authority to committees of the Board and senior management of the Company.

The Corporate Governance Committee improves the Company's and Board's performance by assessing and making recommendations regarding Board effectiveness and by establishing a process for identifying, recruiting, appointing and re-appointing directors and providing for the ongoing development of current Board members. The Committee monitors the flow of information between the Board and management and, where necessary, makes recommendations on improving the lines of communication. This Committee is chaired by Enerflex's Lead Director. This ensures that all Board members have an impartial party available to review any area of conflict and it enables the Board the opportunity to operate independent of management at all times.

The Audit Committee assists the Board in fulfilling its oversight responsibility to shareholders, potential shareholders, the investment community and others with respect to the Company's financial statements, financial reporting process, systems of internal accounting and financial controls, external auditors' reports, insurance and risk mitigation. The Committee has independent access to the Company's auditors and is empowered to investigate any matter, with full access to all books, records, facilities and personnel of the Company. It is also empowered to instruct and retain outside counsel or other experts as required.

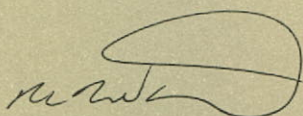
The Human Resources and Compensation Committee plans for the continuity of executive officers and other key employees. The Committee also reviews the Company's overall director and executive compensation plans as well as any changes to significant compensation programs adopted throughout the Company. This level of involvement is designed to ensure that the Company's policies and compensation programs are competitive and motivating, and assist the Company in attracting and retaining executive officers and other key employees. In all its deliberations, the Committee takes into account the cost of executive compensation and the interests of shareholders.

During 2004, the Board of Directors and its various committees have also provided oversight and direction in the establishment of the Company's response to, and compliance with, the various securities requirements around internal controls, disclosure controls and officer certifications, and monitored the development and implementation of Enerflex's disclosure policy, communication practices and its ethics and values policy. At Enerflex, we have always believed the Company should be managed in an ethical manner and as such, we have in place a Code of Business Conduct for our executives and employees. The code expanded in 2004 to include the documentation and behavioral expectations of our core values. In early 2005, it will be expanded further to include the Company's response to whistle-blower legislation. Readers requiring further information about the Company's governance practices are directed to Enerflex's SEDAR filings at [www.sedar.com](http://www.sedar.com).

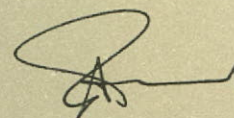


The Company's compliance with the Toronto Stock Exchange Corporate Governance Guidelines is highlighted below:

Board responsibility for overall stewardship of Company	Yes
Board constituted with majority of unrelated directors	Yes
Relationship of each director disclosed and explained	Yes
Corporate Governance Committee constituted with non-management directors	Yes
Process implemented to assess Board effectiveness	Yes
Orientation and education program provided for new directors	Yes
Directors' compensation reflective of risk and responsibility	Yes
Committees are composed of non-management directors	Yes
Committee assigned to supervise corporate governance	Yes
Limits to management responsibilities defined	Yes
Board functions independently of management	Yes
Audit Committee composed only of unrelated directors and has direct communication with the Company's auditors	Yes
System implemented for Board to engage outside advisors	Yes



**Robert C. Williams**  
Lead Director



**P. John Aldred**  
Chairman, President and  
Chief Executive Officer

February 10, 2005



## ● BOARD OF DIRECTORS

### **P. JOHN ALDRED**

Chairman of the Board

Mr. Aldred is the founder, Chairman, President and Chief Executive Officer of the Company. Mr. Aldred is the Chairman and founder of the Cadmus Foundation, a member of the Board of Directors for Careers: The Next Generation and is a past member of Alberta Junior Achievement. Mr. Aldred currently serves as Co-Chair of the SAIT Campaign Cabinet and as a public member and Vice-Chair of SAIT's Board of Governors and a member of its Audit Committee.

Prior to founding Enerflex in 1980, Mr. Aldred was President and Chief Executive Officer of Pamco, a compressor systems manufacturing and servicing company. Pamco is now part of the Enerflex group of companies.

### **PATRICK D. DANIEL**

Director

Mr. Daniel has been the President and Chief Executive Officer of Enbridge Inc. since January 2001 and has over 30 years of experience in the energy industry. In addition to serving on Enerflex's Board of Directors, Mr. Daniel is also a director for several Enbridge subsidiary companies, including Enbridge Energy Company Inc. and Enbridge Commercial Trust. He is also a Director of EnCana Corporation. Mr. Daniel earned his Bachelor of Science from the University of Alberta and his Masters of Science degree from the University of British Columbia, both in Chemical Engineering.

### **DOUGLAS J. HAUGHEY**

Director

Mr. Haughey is the President, Duke Energy Gas Transmission West, responsible for Duke Energy Gas Transmission's western North American operations since 1999 including its major pipeline and processing business in western Canada since 1992. Mr. Haughey serves as a director of various Duke Energy subsidiary companies and Saskferco Products Inc. Early in his career, Mr. Haughey held senior executive positions with Engage Energy and predecessor companies, was with the Canadian Energy Research Institute and an instructor in the Faculty of Management at the University of Calgary. Mr. Haughey graduated from the University of Regina with a Bachelor of Administration degree in 1977 and received his MBA from the University of Calgary in 1982.

### **ROBERT B. HODGINS**

Director

Mr. Hodgins is recently retired from a full-time executive position following a career that spanned more than 25 years with several senior Canadian corporations, and is now an investor and corporate director. From 2002 to 2004, Mr. Hodgins served as the Chief Financial Officer at Pengrowth Energy Trust. Prior to this, Mr. Hodgins was Vice President and Treasurer of Canadian Pacific Limited, Chief Financial Officer of TransCanada Pipelines Limited from 1993 to 1998 and held various other positions at TransCanada commencing in 1981. Mr. Hodgins is also a trustee of Calpine Power Income Fund. Mr. Hodgins holds a Bachelor of Arts in Business from the Richard Ivey School of Business and is a Chartered Accountant.

### **GEOFFREY F. HYLAND**

Director

Mr. Hyland is the President and Chief Executive Officer of ShawCor. Mr. Hyland joined ShawCor in 1967 and assumed his current role in 1994. In addition to his commitments at ShawCor, Mr. Hyland is a member of the Board of Directors for Fortis Inc. and Exco Technologies Ltd. Mr. Hyland holds an Engineering degree from McGill and an MBA from York University.



**JOHN R. KING**

Director

Mr. King is a Senior Vice-President, Technology Services Group at Precision Drilling, a position he has held since March 2003. Mr. King founded and served as Managing Director of Red Tree Capital Corporation in 1998, after a period from 1996 to 1998 with Peters & Co. Prior to that, Mr. King held various positions with both Enserv Corporation and Schlumberger Ltd. Mr. King graduated from the University of Calgary in 1988 with a Bachelor of Science degree in Mechanical Engineering. Mr. King is a licensed professional engineer in the Province of Alberta.

**J. NICHOLAS ROSS**

Director

Mr. Ross is the founder and Chairman of Rover Capital Corporation, a private merchant banking organization since 1996. From 1970 to 1996, Mr. Ross was a partner of Ernst & Young where he specialized in advising entrepreneurial businesses. From 1997 to 2004, Mr. Ross served as a Trustee of Atlas Cold Storage Income Trust formerly ACS Freezers Income Trust and had been Chairman of its subsidiary, Atlas Cold Storage Holdings Inc. His current directorships include two Sciti Trusts (Toronto), E.D. Smith & Sons (Winona) and Butterfield & Company in Bermuda. Mr. Ross holds a BA with Honours in English Language and Literature from the University of Toronto and an MA in Economics from Cambridge University. He is a Chartered Accountant having earned the Ontario Gold Medal on obtaining such designation in 1964.

**HON. BARBARA J. SPARROW**

Director

The Honorable Ms. Barbara J. Sparrow has had a lengthy career in Canadian politics. Ms. Sparrow served as a Member of Parliament from 1984-1993 and finished her political career as Natural Resources Minister in 1993. Ms. Sparrow is an active member of the community, serving on the University of Calgary Board of Governors and as a member of the Alberta initiative steering committee for Neuroscience Canada.

**ROBERT C. WILLIAMS**

Lead Director

Mr. Williams is a Managing Director and Head of Equity Capital Markets and Syndication at Scotia Capital Inc. He has spent his entire business career of 37 years with Scotia Capital (formerly McLeod, Young & Weir & Co.). Mr. Williams is on the board of Scotia Merchant Bank and a number of special purpose TSX listed companies that have been sponsored by Scotia Capital. He is also Chairman of the St. Andrew's College Foundation and is a member of that school's Board of Governors.



## ● GOVERNANCE OVERVIEW

The Board of Directors and its management are committed to maintaining a high standard of corporate governance and have adopted a number of guidelines to assist in its responsibilities.

### **Mandate**

The Board seeks to discharge its responsibility by reviewing, discussing and approving the Company's strategic planning and organization structure. It monitors management's efforts to develop and implement the strategic plan and reviews the Company's performance in order to preserve the business of the Company and its underlying value. In broad terms, the stewardship of the Company involves the Board in strategic planning, risk management and mitigation, senior management appointments, communication planning, safety and environment, and internal control integrity.

Enerflex's Board of Directors is committed to this mandate and pursues it through its diligence, integrity, respect, and honest and open dialogue. The Board of Directors works together with management to promote Enerflex's core values, thereby helping to realize the completeness of its mission and vision.

### **OUR MISSION**

Through innovation, technical excellence and expertise, our team provides world-class products and services to the global energy sector.

### **OUR VISION**

We are a values-led team which will be recognized as the industry partner of choice by creating:

- A productive and safe work environment
- Employee pride
- Customer success
- Vendor loyalty
- Sector leading returns for shareholders

### **OUR CORE VALUES**

#### **Integrity... "Do the right thing"**

- Be honest
- Be fair
- Be trustworthy
- Be respectful
- Be ethical

#### **Creativity... "Lead with innovation"**

- Value and reward creative thinking
- Explore new ideas
- Implement positive change
- Be bold

#### **Commitment... "Deliver on our promises"**

- Establish common goals and measure results
- Be safe
- Pursue excellence
- Understand customer needs, exceed expectations
- Be persistent

#### **Success... "Achieve sector-leading results"**

- Optimize growth and financial performance
- Champion training, development and opportunity
- Communicate effectively
- Develop sustained, loyal relationships with all stakeholders
- Recognize and celebrate achievement



## ● COMMITTEES

Enerflex's Board of Directors has three committees. The committees are as follows:

### **Audit Committee**

The Audit Committee is established to fulfill applicable public company obligations respecting audit committees and to assist the Board in fulfilling its oversight responsibilities with respect to financial reporting including responsibility to:

- Oversee the integrity of the Company's financial statements and financial reporting process, including the audit process and the Company's internal accounting controls and procedures and compliance with related legal and regulatory requirements;
- Monitor the management of the principal financial risks that could impact the financial reporting of the Company and ensure an appropriate mitigation strategy is adopted by management;
- Oversee the appointment, qualifications and independence of the external auditors;
- Oversee the work of the Company's financial management and external auditors in these areas; and
- Provide an open avenue of communication between the external auditors, the Board and Management.

**Members:** *Robert B. Hodgins (Chair), Patrick D. Daniel, J. Nicholas Ross, Barbara J. Sparrow*

### **Corporate Governance Committee**

The Corporate Governance Committee is responsible for overseeing and assessing the functioning of the Board, its committees and individual Board members. The Committee oversees the development, implementation and assessment of effective corporate governance principles and guidelines. The Committee's responsibilities also include identifying qualified candidates for director.

**Members:** *Robert C. Williams (Chair), Patrick D. Daniel, Geoffrey F. Hyland*

### **Human Resources and Compensation Committee**

The Human Resources and Compensation Committee shall assist the Board in discharging the Board's oversight responsibilities relating to the compensation and retention of key senior management employees, and in particular the Chief Executive Officer, with the skills and expertise needed to enable the Company to achieve its goals and strategies at fair and competitive compensation including appropriate performance incentives.

**Members:** *J. Nicholas Ross (Chair), Douglas J. Haughey, John R. King*

### **Evaluation**

The Board of Directors shall review and reassess the adequacy of its Mandate and each Committee shall evaluate its Charter at least annually, and otherwise as it deems appropriate, and recommend changes. The performance of the Board of Directors in its entirety, each Committee and each individual board member shall be evaluated on an annual basis.



**Attendance**

	Board Meetings	Audit Committee	Corporate Governance and Compensation Committee <sup>3</sup>	Human Resources and Compensation Committee <sup>3</sup>	Corporate Governance Committee <sup>3</sup>
P. John Aldred	6 of 6	–	–	–	–
Patrick D. Daniel	6 of 6	5 of 5	–	–	2 of 2
Douglas J. Haughey	6 of 6	–	–	5 of 5	–
Robert B. Hodgins <sup>1</sup>	4 of 4	3 of 3	–	–	–
Geoffrey F. Hyland	6 of 6	–	2 of 2	–	2 of 2
John R. King	5 of 6	–	–	4 of 5	–
J. Nicholas Ross	6 of 6	4 of 5	2 of 2	5 of 5	–
Barbara J. Sparrow	5 of 6	4 of 5	–	–	–
Robert C. Williams	6 of 6	–	2 of 2	–	2 of 2
Michael A. Grandin <sup>2</sup>	2 of 3	2 of 3	–	–	–

<sup>1</sup> Mr. Hodgins was named to the Board of Directors on July 22, 2004 and was appointed Chair of the Audit Committee.

<sup>2</sup> Mr. Grandin resigned from the Board of Directors on September 23, 2004.

<sup>3</sup> In February 2004, the Corporate Governance and Compensation Committee was split into two separate committees: the Corporate Governance Committee and the Human Resources and Compensation Committee.

**For further information**

To review any of the above mentioned documents, please visit the Corporate Governance Section of our website at [www.enerflex.com](http://www.enerflex.com), or see the Information Circular or Annual Information Form available at [www.sedar.com](http://www.sedar.com).



## MANAGEMENT'S DISCUSSION AND ANALYSIS

The Management's Discussion and Analysis ("MD&A") should be read in conjunction with the audited consolidated financial statements for the years ended December 31, 2004 and 2003 and the accompanying notes to consolidated financial statements contained on pages 57 to 74 of this annual report. The results reported herein have been prepared in accordance with Canadian Generally Accepted Accounting Principles ("GAAP") and are presented in Canadian dollars unless otherwise stated. The MD&A has been prepared taking into consideration information that is available up to February 28, 2005 and focuses on key statistics from the consolidated financial statements, and pertains to known risks and uncertainties relating to the oilfield service sector. This discussion should not be considered all-inclusive, as it excludes changes that may occur in general economic, political and environmental conditions. Additionally, other elements may or may not occur which could affect industry conditions and/or Enerflex Systems Ltd. ("Enerflex" or "the Company") in the future. The MD&A should be read in conjunction with the remainder of the 2004 annual report. Additional information relating to the Company, including the Company's Annual Information Form, is available on SEDAR at [www.sedar.com](http://www.sedar.com).

The annual report, which includes the MD&A, the audited consolidated financial statements and accompanying notes thereto, is reviewed and approved by the Company's Audit Committee and its Board of Directors prior to publication.

Enerflex is a leading supplier of products and services to the global oil and natural gas production industry. The Company's core expertise lies in its ability to provide products and services to the industry segment that operates between the wellhead and the pipeline. Enerflex's primary products and services are: natural gas compression, power generation and process equipment for sale or lease; hydrocarbon production and processing facilities; electrical, instrumentation and controls services; and a comprehensive package of field maintenance and contracting capabilities. Through our ability to provide these products and services in an integrated manner, or as stand-alone offerings, Enerflex believes it offers its global customers a unique value proposition.

Headquartered in Calgary, Canada, the Company has approximately 2,000 employees. Enerflex, its subsidiaries and its interests in joint-ventures, operate in Canada, the United States, the Netherlands, Germany, Australia, Pakistan and Indonesia. The Company's common shares trade on the Toronto Stock Exchange under the symbol "EFX".

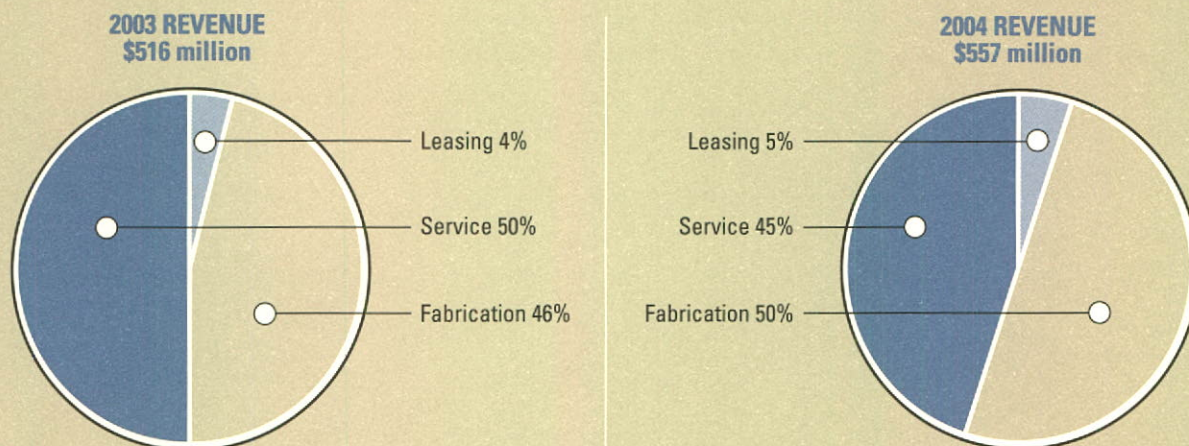
### FORWARD-LOOKING STATEMENTS

This MD&A contains forward-looking statements. The words "anticipate", "expect", "project" and similar expressions identify forward-looking statements. Such statements are subject to certain risks, uncertainties and assumptions pertaining to operating performance, economic conditions and other factors. Should one or more of these risks materialize, or should underlying assumptions prove incorrect, actual results may vary significantly from those expected.



## CONSOLIDATED RESULTS OF OPERATIONS

In 2004, the Company completed the re-organization it introduced during 2003. These efforts included the restructuring of business units around successful product lines, the establishment of product line managers, a focus on improved cost controls and expenditure reduction, the implementation of improved processes and practices, and the pursuit of contracts on a global basis. These efforts have enabled the Company to: respond to increased customer demand; increase revenues to \$557.1 million; improve gross margin to 22.5%; and generate earnings of \$1.43 per diluted common share of the Company ("common share"). They have also served as the initiation point for Enerflex's response to the expanded reporting and governance requirements for publicly traded organizations.



## ECONOMIC DRIVERS

The energy service sector, of which Enerflex is a part, is largely dependent upon the spending levels and activities of crude oil and natural gas (hydrocarbon) exploration and production companies. These spending patterns vary dramatically year-over-year and from one global region to another and are influenced by many factors including: the current and expected commodity prices of crude oil and natural gas; the availability, access and cost of transporting hydrocarbon products; current and anticipated global supply and demand estimates; and a wide array of economic and political factors. As such, the demand for oilfield products and services can be volatile and is impacted by factors that are outside the control and influence of oilfield service companies. In addition to activity levels, access to skilled personnel, the supply and availability of major components and repair parts, and the competitive nature of the oilfield service sector are other challenges that face the industry sector and Enerflex.

During 2004, and to a lesser extent 2003, the increase in oilfield activity and natural gas infrastructure development in Canada and other international markets has benefited the Company, primarily through increased demand for Enerflex's products and services, and improved facility and personnel utilization rates. In addition to meeting the escalating demand for products and services, it has been necessary for Enerflex to maintain its competitive position and market share. This has been achieved by negotiating fair prices for Enerflex's products and services, expanding the global reach of the Company's export sales, developing and maintaining the Company's relationships with key customers and suppliers, maintaining the skill levels of Enerflex's people, and monitoring and adjusting to the practices of the Company's competitors. The ability to meet these competitive pressures within a reasonable cost structure will continue to be key to Enerflex's future success.



## SUMMARY QUARTERLY STATISTICS

The oil and natural gas service sector in Canada, where Enerflex's operations are currently concentrated, has a distinct seasonal trend in activity levels which results from well-site access and drilling patterns being adjusted to take advantage of weather conditions. Generally, the Company's Fabrication segment experiences higher revenues in the fourth quarter of each year, its Service segment experiences higher revenues in the first quarter of each year and its Leasing segment experiences stable revenues throughout the year, impacted by the Company's capital investment decisions. Variations from this trend usually occur when hydrocarbon energy fundamentals are either improving, as in the third quarter of 2004, or deteriorating.

During 2004, the Company recorded stronger earnings in each quarter, as compared to the same quarter in 2003, as a result of increased natural gas infrastructure and maintenance spending by oil and natural gas producers in a period of high commodity prices, and cost and process efficiencies generated by the Company.

<i>(Thousands, except percent and per share amounts) (unaudited)</i>	2004				2003			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Revenue	\$ 167,677	\$ 141,293	\$ 119,833	\$ 128,274	\$ 144,185	\$ 124,153	\$ 115,311	\$ 131,879
Gross margin	37,391	30,610	27,744	29,465	27,822	26,617	23,833	25,687
Gross margin %	22.3	21.7	23.2	23.0	19.3	21.4	20.7	19.5
Operating margin <sup>1</sup>	18,092	11,535	9,215	11,225	11,415	9,009	5,742	7,279
Operating margin % <sup>1</sup>	10.8	8.2	7.7	8.8	7.9	7.3	5.0	5.5
Net income:	11,406	7,726	5,784	7,143	7,217	5,429	3,309	4,428
Per common share								
Basic (\$)	0.51	0.35	0.26	0.32	0.33	0.24	0.15	0.20
Diluted (\$)	0.51	0.34	0.26	0.32	0.32	0.24	0.15	0.20
EBITDA <sup>1</sup>	\$ 22,713	\$ 16,239	\$ 13,535	\$ 15,666	\$ 15,363	\$ 13,401	\$ 10,466	\$ 11,954

<sup>1</sup> Operating margin, operating margin percent and earnings before interest, taxes, depreciation and amortization ("EBITDA") are non-GAAP (Generally Accepted Accounting Principles) earnings measures that do not have a standardized meaning prescribed by GAAP and therefore are unlikely to be comparable to similar measures presented by other issuers. Enerflex calculates operating margin, operating margin percent and EBITDA as follows:

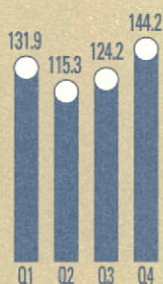
<i>Operating margin for December 31, 2004 (\$ thousands)</i>	<i>Three months ended</i>	
		<i>Year ended</i>
Gross margin	\$ 37,391	\$ 125,210
Selling, general and administrative expenses	20,510	77,372
Foreign currency gains	(1,211)	(2,229)
Operating margin	\$ 18,092	\$ 50,067
 <i>Operating margin percent</i>		
Operating margin divided by revenue (%)	10.8	9.0
 <i>EBITDA for December 31, 2004 (\$ thousands)</i>		
Earnings before interest and income taxes	\$ 19,026	\$ 53,051
Depreciation and amortization	3,687	15,102
EBITDA	\$ 22,713	\$ 68,153



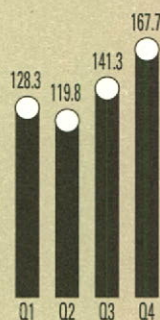
**FOR THE THREE MONTHS ENDED DECEMBER 31, 2004**

During the fourth quarter of 2004, the Company benefited significantly from the opportunities available in the current business environment and its focus on improving business processes. This enabled Enerflex to generate net income for the three months ended December 31, 2004 of \$11.4 million (\$0.51 per common share) from revenue of \$167.7 million. This represents an increase in net income of \$4.2 million (\$0.18 per common share) or 58%, resulting from a revenue increase of \$23.5 million or 16%, all as compared to the three month period ended December 31, 2003. The revenue improvements in the fourth quarter of 2004 were notable in a number of divisions. Revenue improved in Production and Processing due to the progress made on its contracts in Pakistan; Leasing, as a result of a larger rental fleet and improved utilization; Mechanical Service, where the division experienced increased activity in the quarter; and, Compression, due to increases in customer demand, all as compared to the same quarter in 2003. These increases were offset by reduced revenue in Syntech and Power which resulted from lower project activity.

**2003 QUARTERLY REVENUE**  
(\$ millions)



**2004 QUARTERLY REVENUE**  
(\$ millions)



Gross margin for the three months ended December 31, 2004 was \$37.4 million or 22.3% of revenue as compared to \$27.8 million or 19.3% of revenue for the three months ended December 31, 2003, an increase of \$9.6 million. The improved gross margin was a result of increased business activity, improved project management, greater emphasis on cost controls and the pursuit of higher margin contracts in the Company's electrical, instrumentation and controls ("EI&C" or "Syntech") business. These benefits were somewhat offset by higher input costs arising from increases in the prices of parts and components, utility prices and raw material costs, such as steel.

**2003 QUARTERLY GROSS MARGIN**  
(as a % of revenue)



**2004 QUARTERLY GROSS MARGIN**  
(as a % of revenue)





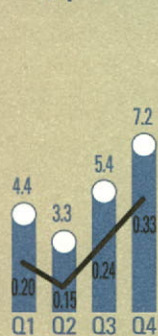
Selling, general and administrative (“SG&A”) expenses were \$20.5 million or 12.2% of revenue during the three months ended December 31, 2004, compared with \$18.2 million or 12.6% of revenue in the same period of 2003. Included in the SG&A for the fourth quarter of 2004 is \$0.3 million of stock-based compensation expense. In addition, the Company incurred \$0.5 million associated with its ongoing program for adopting compliance measures for Multilateral Instrument 52-109. Bonus and profit-sharing accruals have also increased in 2004 over the same period of 2003 by \$1.2 million, as a result of the Company’s improved profitability.

Operating margin<sup>1</sup> assists the reader in understanding the net margin contributions made from the Company’s core businesses after considering all SG&A expenses and the impact of the Company’s foreign exchange hedging strategy. For the three months ended December 31, 2004, Enerflex produced an operating margin of \$18.1 million, or 10.8% of revenue, as compared to an operating margin<sup>1</sup> of \$11.4 million, or 7.9% of revenue, for the same three month period in 2003. Taking into consideration the increased revenues, cost and process efficiencies gained, improved utilization and the impact of the Company’s hedging strategy, Enerflex realized an increase of 2.9 percentage points in its operating margin during the fourth quarter of 2004 as compared to the same period in 2003. This demonstrates that the restructuring efforts were successful and that the Company was capable of ensuring the improvements in gross margin of 3.0 percentage points against the prior year’s comparable period directly increased the Company’s operating margin<sup>1</sup>.

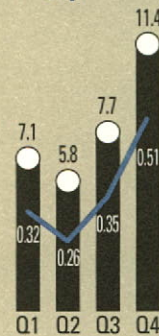
Income before interest and income taxes totalled \$19.0 million for the fourth quarter of 2004, as compared to \$11.7 million for the same period in 2003, an increase of \$7.3 million or 62%.

During the fourth quarter of 2004, Enerflex increased its net income by \$4.2 million to \$11.4 million over the same period of 2003.

**2003 QUARTERLY NET INCOME**  
 ■ (\$ millions)  
 — (\$ per basic share)



**2004 QUARTERLY NET INCOME**  
 ■ (\$ millions)  
 — (\$ per basic share)



<sup>1</sup> Operating margin and operating margin percent are non-GAAP earnings measures that do not have a standardized meaning prescribed by GAAP and therefore are unlikely to be comparable to similar measures presented by other issuers.



**SUMMARY ANNUAL HIGHLIGHTS***(Thousands, except percent and per share amounts)**For the years ended December 31 (unaudited)*

	2004	2003	2002 <sup>4</sup>
Revenue	\$ 557,077	\$ 515,528	\$ 326,706
percent change (%)	8.1	57.8	
Gross margin	125,210	103,959	69,777
percent change (%)	20.4	49.0	
Gross margin percent of revenue (%)	22.5	20.2	21.4
Selling, general and administrative expenses	77,372	72,499	53,348
percent change (%)	6.7	35.9	
Selling, general and administrative expenses			
percent of revenue (%)	13.9	14.1	16.3
Operating margin <sup>1</sup>	50,067	33,445	16,427
percent change (%)	49.7	103.6	
Operating margin percent <sup>1</sup> of revenue (%)	9.0	6.5	5.0
Earnings before interest and income taxes	53,051	36,504	17,919
percent change (%)	45.3	103.7	
Net Income	32,059	20,383	9,232
percent change (%)	57.3	120.8	
EBITDA <sup>1</sup>	68,153	51,184	29,973
percent change (%)	33.2	70.8	
EBITDA <sup>1</sup> percent of revenue (%)	12.2	9.9	9.2
Net capital spending	\$ 30,429	\$ 6,511	\$ 10,701
Earnings per share (basic)	\$ 1.44	\$ 0.92	\$ 0.51
Return on capital employed (%) <sup>2</sup>	14.0	10.0	6.9
Return on average equity (%) <sup>3</sup>	11.2	7.6	4.9
Cash dividends per common share	\$ 0.40	\$ 0.40	\$ 0.40
Total assets	486,865	457,674	451,211
Total long-term liabilities	\$ 62,472	\$ 63,561	\$ 63,458

**FINANCIAL POSITION AND RATIOS**

as at December 31	2004	2003	2002
Working capital	\$ 85,868	\$ 82,830	\$ 68,710
Working capital ratio	1.68	1.69	1.54
Total debt, net of cash	\$ 80,049	\$ 89,272	\$ 109,227
Total net debt to total net debt plus equity ratio (%)	21.2	24.5	29.5
Total net debt to EBITDA <sup>1</sup>	1.17	1.74	3.64
Earnings before interest and income taxes to interest expense ratio	13.86	6.91	4.92

<sup>1</sup> Operating margin, operating margin percent and EBITDA are non-GAAP earnings measures that do not have a standardized meaning prescribed by GAAP and therefore are unlikely to be comparable to similar measures presented by other issuers.

<sup>2</sup> Return on capital employed is a non-GAAP measure that does not have a standardized meaning prescribed by GAAP and therefore is unlikely to be comparable to similar measures presented by other issuers. Return on capital employed is calculated as pre-tax income plus interest expense divided by the simple average of capital employed at the beginning of the year and at the end of each quarter. Capital employed is the sum of shareholders' equity plus current and long-term bank indebtedness.

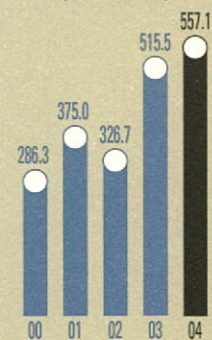
<sup>3</sup> Return on average equity is a non-GAAP measure that does not have a standardized meaning prescribed by GAAP and therefore is unlikely to be comparable to similar measures presented by other issuers. Return on average equity is calculated as net income divided by the simple average of shareholders' equity at the beginning and end of the year.

<sup>4</sup> The 2002 annual results include operations of EnSource Energy Services Inc., from the date of acquisition, July 18, 2002. The 2003 and 2004 results include those operations for the entire year.



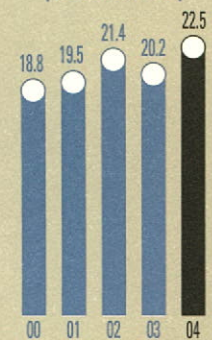
**Consolidated revenue** for the year ended December 31, 2004 totalled \$557.1 million, an increase of \$41.6 million, or 8%, as compared to 2003 consolidated revenue of \$515.5 million. The revenue growth in 2004 was generated in the Company's Fabrication segment, which increased revenue by \$43.1 million, or 18%, and the Leasing segment, which increased revenue by \$6.2 million, or 28%. This was offset by reduced Service segment revenue of \$7.8 million, or 3%. Fabrication revenue improved as a result of an increase in compressor package sales arising from an improved market share and higher customer demand, including demand from coal-bed methane ("CBM") production companies. Fabrication revenue also increased as a result of higher international project revenue in the Production and Processing division. Leasing revenues increased as a result of Enerflex's investment in additional rental compression horsepower and improved equipment utilization. Revenue from the Company's Service segment decreased by \$16.7 million as a result of increased competition and the decision to pursue specific contracts with higher margin potential in the Syntech division, offset by increased revenue in the Mechanical Service division as a result of growth in international business units, modest increases in the price of the division's products and services and increased customer demand. Revenue growth from 2002 to 2003 resulted principally from the inclusion of a full year of operations from the EnSource Energy Services Inc. ("EnSource") businesses and from an increase in compressor package sales.

**CONSOLIDATED REVENUE**  
(\$ millions)



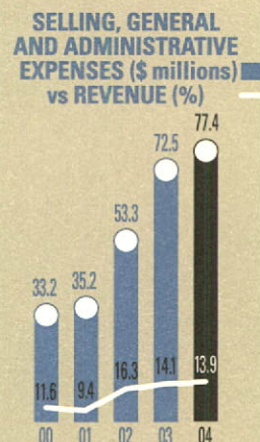
**Gross margin** has improved to \$125.2 million or 22.5% of revenue in 2004 as compared to \$104.0 million or 20.2% of revenue in 2003. Fluctuations in the Company's overall gross margin occur as a consequence of: changes in the mix of revenue generated in each segment; facility and personnel utilization; pricing; and operating efficiency. During 2004, as compared to 2003, gross margin improved as a result of modest increases in the price of all products and services offered by Enerflex, improved utilization of the Company's Fabrication facilities and Leasing equipment, higher international revenues in Production and Processing and cost efficiencies gained in the Syntech and Compression divisions. Gross margin was reduced by obsolescence provisions of \$1.4 million in the Power division and an increase in the proportionate amount of revenue generated in the Fabrication segment from 46.0% of consolidated revenue in 2003 to 50.3% in 2004. This occurs as revenue from the Fabrication segment tends to have lower margins than either Service or Leasing segment revenues. Gross margins in 2003 were lower than those in 2002 principally because of changing proportions of revenue from Fabrication. Gross margin improvement continues to be a main focus of management's attention as exhibited by the improvement in the gross margin percentage over recent years. In 2004, Enerflex produced a gross margin of 22.5% as compared to 20.2% in 2003, 21.4% in 2002 and 19.5% in 2001.

**GROSS MARGIN**  
(% of revenue)





**Selling, general and administrative expenses** were \$77.4 million in 2004, compared with \$72.5 million in 2003 and \$53.3 million in 2002. Total SG&A costs increased in 2003 over 2002 both due to the inclusion of a full year of operations from the EnSource businesses and the addition of international operations. In both 2004 and 2003, the Company incurred significant severance and other costs with respect to the previously mentioned restructuring program. SG&A as a percentage of revenue was 13.9% in 2004, 14.1% in 2003 and 16.3% in 2002. The increase in SG&A expenses in 2004 of \$4.9 million, or 6.7%, over 2003 was a result of increases in bonus and profit sharing accruals of \$2.3 million, in SG&A expenditures related to international expansion of \$1.1 million, stock-based compensation of \$1.0 million, Multilateral Instrument 52-109 compliance costs of \$0.9 million, variable selling expenses of \$0.6 million, and increased activity levels. These were offset by a \$1.2 million provision for a loss on a legacy international contract recorded in 2003 and a reduction of \$0.6 million in restructuring and employee departure costs.



In 2004, Enerflex adopted the fair value method of accounting for stock options and other stock-based compensation. Adoption of the policy resulted in a reduction of opening retained earnings of \$0.7 million on January 1, 2004, and an additional compensation expense related to stock options of \$0.7 million. Had this policy been adopted in 2003 the Company would have incurred an additional expense of \$0.2 million in that year.

During the year, the Board of Directors of the Company implemented a Restricted Share Unit ("RSU") and Deferred Share Unit ("DSU") Plan as a component of the Company's compensation policies. An RSU or DSU entitles the holder to receive a payment, as described below, from the Company equal to the implied market value calculated as the number of units multiplied by the closing share price of Enerflex common shares on the entitlement date.

RSUs may be granted to eligible participants on an annual basis and will generally vest on the third anniversary date of the grant subject to the achievement of any performance criteria which may, at the discretion of the Company, be attached as a condition of vesting at the date of grant. Performance criteria may include such performance measures as earnings per share or return on capital employed, either for the Company as a whole, or a portion thereof. Vested RSUs are to be settled by the end of the year following the year in which vesting occurs. The Company may at its sole discretion, satisfy, in whole or in part, its payment obligation through a cash payment to the participant or by instructing an independent broker to acquire a number of fully paid shares in the open market on behalf of the participant.

DSUs may be granted to eligible participants on an annual basis and will generally vest on the fifth anniversary date of the grant subject to the achievement of any performance criteria which may, at the discretion of the Company, be attached as a condition of vesting at the date of grant. Performance criteria may include such performance measures as earnings per share or return on capital employed, either for the Company as a whole, or a portion thereof. Vested DSUs are to be settled in cash, payable to the participant by the end of the year following the year in which their employment is terminated through departure, retirement or death.

The number of DSUs granted to an individual participant is limited, in the case of the initial grant, to an aggregate market value of the grant not in excess of 100% of the participant's regular annualized salary and, in the case of subsequent grants, to an aggregate market value of the grant not in excess of 50% of the participant's annualized salary and cash bonuses for the twelve months preceding the grant date.



RSU and DSU recipients are entitled to additional units over and above those granted based on the notional number of shares that could have been purchased using the proceeds of notional dividends, that would have been received had the units then subject to vesting been actual common shares of the Company, following each dividend paid to shareholders of the Company.

Both RSUs and DSUs represent an indexed liability of the Company relative to the Company's share price.

**Foreign exchange** gains in 2004 totalled \$2.2 million compared to \$2.0 million in 2003. Most international fabrication work is quoted in U.S. dollars. As the U.S. dollar depreciates, the Company's Canadian dollar revenue falls. The U.S. dollar depreciated by 7% against the Canadian dollar during 2004, as compared to 18% in 2003.

In mid-2003, Enerflex instituted a program to mitigate the impact of exchange rate fluctuations by matching expected future U.S. dollar-denominated cash inflows with U.S. dollar liabilities, principally bank debt and accounts payable. For example, when Enerflex is awarded a US\$1 million contract, it converts an equivalent amount of its bank debt from Canadian to U.S. dollars. The debt is repaid when Enerflex receives payment from its customer. The result is that any gain or loss in margins resulting from exchange rate fluctuations is offset by gains or losses in U.S. dollar liabilities. At December 31, 2004, the Company's bank debt included US\$29.6 million of bank overdrafts and LIBOR loans, compared to US\$30.7 million as at December 31, 2003.

Enerflex does not hedge its exposure to investments in foreign subsidiaries, which are largely self-sustaining. Exchange gains/losses on net investments in foreign subsidiaries are accumulated in shareholders' equity as a "cumulative translation adjustment". The cumulative translation adjustment credit decreased from \$1.5 million at the end of 2003 to a debit of \$0.4 million at the end of 2004. This change is the result of the decline of the Australian and U.S. dollars against the Canadian dollar.

**Operating margin**<sup>1</sup> assists the reader in understanding the net margin contributions made from the Company's core businesses after considering all SG&A expenses and the impact of the foreign exchange hedging strategy discussed above. During 2004, Enerflex produced an operating margin<sup>1</sup> of \$50.1 million or 9.0% of revenue, as compared to an operating margin<sup>1</sup> of \$33.4 million, or 6.5% of revenue in 2003. Operating margin<sup>1</sup> in 2002, which did not include a whole year of operations from the EnSource businesses, was \$16.4 million or 5.0% of revenue.

**Interest costs** totalled \$3.8 million in 2004, compared with \$5.3 million in 2003, a decrease of \$1.5 million. Interest costs in 2003 were higher than those in 2002 as a result of debt assumed and costs incurred for the acquisition of EnSource. In addition to lowering its total borrowings from an average of \$101.2 million in 2003 to an average of \$92.7 million in 2004, Enerflex has benefited from continued low interest rates as its bank debt is subject to floating rates. The Company pays its lenders a margin over the Canadian bankers' acceptance rate, or the U.S. LIBOR rate, which varies depending on the ratio of debt to earnings before EBITDA<sup>1</sup> for the trailing twelve months. Over the past year, Enerflex substantially reduced its debt while increasing EBITDA<sup>1</sup>. As a result, effective December 1, 2004, the lending margin was reduced by 0.3%, to 1.5% on the operating loan and 2.0% on the term loan.

<sup>1</sup> Operating margin, operating margin percent and EBITDA are non-GAAP earnings measures that do not have a standardized meaning prescribed by GAAP and therefore are unlikely to be comparable to similar measures presented by other issuers.

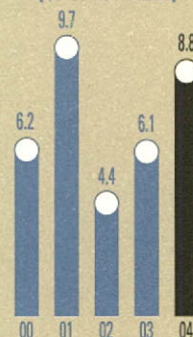


**Income tax expense** was \$17.2 million in 2004 compared with \$10.8 million in the prior year. The increase in tax expense is a result of higher pre-tax earnings in the current year. The effective rate of income tax in 2004 was 34.9%, compared to 34.7% in 2003. The Company expects the effective tax rate in 2005 will continue to be less than 35%.

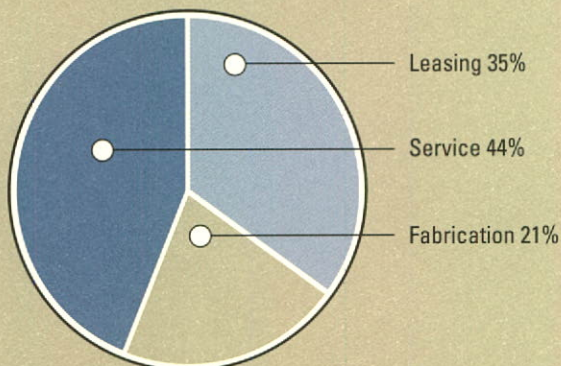
Income tax expense was higher in 2003 over 2002 due to higher pre-tax earnings, but the utilization of losses in 2003 arising from the EnSource Energy Services Inc. acquisition in 2002 resulted in a reduction of current taxes otherwise payable in 2003.

**Net income** for 2004 increased by 57% to \$32.1 million compared to \$20.4 million in 2003. On a per share basis, 2004 net income increased by 57% to \$1.43 per diluted common share as compared with \$0.91 per diluted common share in 2003 and \$0.51 per diluted common share in 2002, which did not include a whole year of operations from the EnSource businesses.

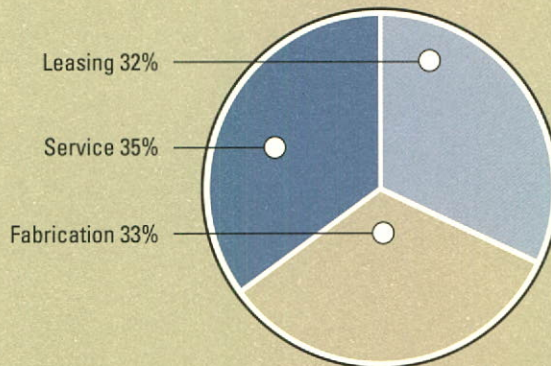
**PRE-TAX INCOME**  
(% of revenue)



**2003 INCOME**  
\$36.5 million before interest  
and income taxes



**2004 INCOME**  
\$53.1 million before interest  
and income taxes



**SEGMENTED RESULTS**

Enerflex has three business segments: Service, Fabrication and Leasing, which operate as follows:

1. Service is comprised of two divisions:
  - Syntech’s electrical, instrumentation and controls (“EI&C”) business in Canada; and
  - Mechanical Service, with business units operating in Canada (Pamco and Jiro Service), the United States (Enerflex Systems Inc.), the Netherlands (Landré Ruhaak bv), Australia (Gas Drive Systems Pty Limited) and Indonesia (PT Gas Drive Systems Indonesia) and its interest in S&L Energie Projekte GmbH, a 51% owned joint-venture in Germany.
2. Fabrication is comprised of three divisions:
  - Compression has four business units: EFX Compression located in Calgary, Alberta, providing custom and standard compression packages for both reciprocating and screw compressor applications; Enerflex Compression USA in Odessa, Texas, is a packager of specialty natural gas applications; Jiro Compression, located in Stettler, Alberta, focusing on lower horsepower screw compressor products; and Compression Services, located in Calgary, Alberta, re-engineering and refurbishing legacy compression equipment;



- Production and Processing has two business units: Presson's modular natural gas processing equipment manufacturing facility in Nisku, Alberta, and Mactronic's waste gas systems which are designed and fabricated in Red Deer, Alberta; and, the Company's 46.5% interest in the Presson-Descon International (Private) Limited ("PDIL") joint-venture, operating in Pakistan; and
  - Power: electrical generation equipment fabrication shares production space in the EFX Compression fabrication facility located in Calgary, Alberta.
3. Leasing: providing compression, power generation and natural gas processing equipment rentals, primarily in Canada.

### SERVICE

The Service business segment provides a complete line of mechanical, and electrical, instrumentation and controls services to the oil and gas industry through an extensive branch network in Canada, as well as operations in the United States, Germany, the Netherlands, Australia and Indonesia. Service is the Company's largest business segment. It employs 51% of staff, holds 35% of the total assets, and generates 44.6% of the Company's revenue. Key performance metrics include labour utilization, revenue, gross margin percent and income before interest and income taxes.

Enerflex, through various business units, is an authorized distributor for Waukesha engines and parts in Canada, Australia, Indonesia, Papua New Guinea, the Netherlands, Germany, Poland and Spain. Mechanical Service revenues tend to be fairly stable as ongoing equipment maintenance is generally required to preserve the customer's natural gas production. EI&C services are provided through Syntech where revenues are more cyclical as they are generated from both maintenance spending and from infrastructure investment.

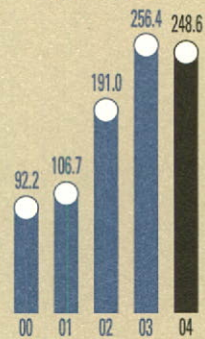
<i>(Thousands)</i>	<i>Years ended December 31</i>	<b>2004</b>	<b>2003</b>
Segment revenue		<b>\$ 264,740</b>	\$ 269,036
Intersegment revenue		<b>(16,105)</b>	(12,618)
Revenue		<b>\$ 248,635</b>	\$ 256,418
Gross margin		<b>\$ 67,050</b>	\$ 63,027
EBITDA <sup>1</sup>		<b>\$ 21,720</b>	\$ 19,166
Income before interest and income taxes		<b>\$ 18,346</b>	\$ 15,882

<sup>1</sup> Earnings before interest, taxes, depreciation and amortization ("EBITDA") is a non-GAAP (Generally Accepted Accounting Principles) earnings measure that does not have a standardized meaning prescribed by GAAP and therefore is unlikely to be comparable to similar measures presented by other issuers.



Service revenue was \$248.6 million in 2004 and comprised 44.6% of consolidated revenue. This compares to \$256.4 million and 49.7% of consolidated revenue in 2003. Mechanical Service generated 56.7% of the division's revenue in 2004 and 51.5% in 2003. Syntech contributed 43.3% of the division's revenue in 2004 and 48.5% in 2003. The decrease of 3%, or \$7.8 million, was a result of decreased revenue in Syntech of \$16.7 million, offset by increased international revenue and higher demand for products and services in Mechanical Service. During 2004, Enerflex deliberately pursued higher margin work in Syntech's operations, which, along with the arrival of additional competition, had the effect of reducing revenue. Gross margin for the segment totalled \$67.1 million, or 27.0%, as compared to 24.6% in 2003. The increase in gross margin percent was caused by higher demand for the Company's mechanical service, improved pricing and the pursuit of contracts with enhanced margin potential in Syntech. Income before interest and income taxes increased from 2003 by \$2.5 million, or 16%, to \$18.3 million as a result of these factors.

**SERVICE REVENUE**  
(\$ millions)



#### **Mechanical Service**

Mechanical Service revenue for 2004 was \$141.1 million, or 7% higher than 2003 revenue of \$132.1 million. In Canada, which accounted for 68% of the division's revenue, sales increased by 8% from 2003 as a result of steady utilization rates, increased customer demand and modest price increases for products and services. Contributing to this increase was the decision in 2003 of many customers to increase the number of hours their equipment operated before performing maintenance, in order to take advantage of higher commodity prices present at that time. In 2004, maintenance that was deferred in 2003 was required to be completed. International revenue also increased by 4% over 2003. The increase in international revenue resulted from higher utilization, new maintenance contracts in Europe and Australia and the commencement of service operations in the United States to support Enerflex's leasing and compression sales contracts in that country.

Gross margins for Mechanical Service increased by 10% over 2003 due to increased customer demand and improved pricing for the division's products and services. Mechanical Service is focused on increasing income before interest and income taxes as a percentage of revenue through enhanced customer relationships and vigilant cost control. During 2004, income before interest and income taxes increased by 31% over 2003. A challenge to achieving improved profitability in 2005 will be the timely availability of certain Original Equipment Manufacturer ("OEM") components and repair parts, which will be in steady demand as activity levels and demand for natural gas in North America remain high.



### Electrical, Instrumentation and Control

The Syntech division continued to improve its gross margin, as a percentage of revenue, in 2004 despite lower revenues. During the year, Syntech generated revenue of \$107.6 million, a decrease of \$16.7 million, or 13% as compared to \$124.3 million in 2003. The EI&C business in Canada is highly competitive. Consequently, this division realizes lower margins, compared with Mechanical Service and as such, it requires a focused and disciplined approach to the bidding and execution of the services provided. In 2004, the division intentionally reduced the scope of the contracts it would pursue and focused its efforts on obtaining projects with higher margin potential and reducing the cost of maintaining the branch infrastructure requirements throughout Alberta, Saskatchewan and northeast British Columbia. These efforts were successful since, despite the lower revenue, the dollar value of the division's gross margin was essentially unchanged from 2003. The division's earnings before interest and income taxes were 24% lower in 2004 than 2003 due to increased SG&A, largely resulting from severance costs incurred during the year. Excluding these items, the division's earnings before interest and income taxes declined by 9%.

In 2005, this division will continue to seek ways to improve its efficiency and increase its net income before interest and income taxes through cost reduction, process improvement and revenue enhancement initiatives, without reducing its margin potential.

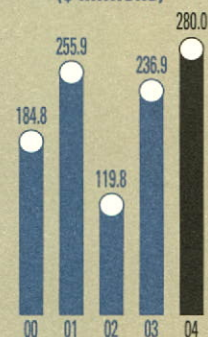
### FABRICATION

The Fabrication business segment engineers, fabricates and assembles standard and custom-designed compression packages, production and processing equipment and facilities, and power generation systems. The key performance metrics for this business segment are market share, plant utilization, overhead application rates and gross margin as a percentage of revenue. Fabrication is the Company's second largest business segment. It employs 47% of staff, holds 42% of the total assets, and generates 50.3% of the Company's revenue.

<i>(Thousands)</i>	<i>Years ended December 31</i>	<b>2004</b>	<b>2003</b>
Segment revenue		<b>\$ 319,503</b>	\$ 259,715
Intersegment revenue		<b>(39,460)</b>	(22,801)
Revenue		<b>\$ 280,043</b>	\$ 236,914
Gross margin		<b>\$ 40,040</b>	\$ 27,326
EBITDA <sup>1</sup>		<b>\$ 22,102</b>	\$ 13,200
Income before interest and income taxes		<b>\$ 17,469</b>	\$ 7,758

The Fabrication business tends to have more volatility in revenue, gross margin and income before interest and income taxes than Enerflex's other business segments. Revenues are derived primarily from the investments made in natural gas infrastructure by producers. Capital spending by Enerflex's customers was high in 2001, dropped sharply in 2002 and early 2003, and increased in late 2003 and 2004. It is presently estimated by industry commentators that this increased investment rate will continue in 2005, along with increased investments in CBM production.

**FABRICATION REVENUES**  
(\$ millions)



<sup>1</sup> Earnings before interest, taxes, depreciation and amortization ("EBITDA") is a non-GAAP (Generally Accepted Accounting Principles) earnings measure that does not have a standardized meaning prescribed by GAAP and therefore is unlikely to be comparable to similar measures presented by other issuers.



Fabrication revenue totalled \$280.0 million in 2004 and comprised 50.3% of consolidated revenue. This compares to \$236.9 million and 46.0% of consolidated revenue in 2003. Compression generated 65.1% of the division's revenue in 2004 and 68.0% in 2003. Production and Processing contributed 32.3% of the division's revenue in 2004 and 27.8% in 2003. Power contributed 2.6% of the division's revenue in 2004 and 4.2% in 2003. The increase of \$43.1 million, or 18%, in segment revenue for the year was a result of international growth in the Production and Processing division, increased demand and market share for the Company's compression products and modest increases in the pricing of the segment's products. Gross margin for the segment totalled 14.3%, or \$40.0 million, as compared to 11.5% in 2003. The increase in gross margin percent was a result of the same factors that improved the segment's revenue and improvements achieved in the costs incurred and processes followed in the Compression division, offset by a \$1.4 million obsolescence provision in the Power division. Income before interest and income taxes increased by \$9.7 million, or 125%, to \$17.5 million as a result of the above-mentioned factors. Income before interest and income taxes in 2003 was also reduced by approximately \$2 million of bad debt and warranty provisions for two projects completed in prior years.

### Compression

The Compression division contributed revenue of \$182.4 million, an increase of 13% and comprised 65.1% of the segment's revenue compared to 68.0% in 2003 on revenue of \$161.0 million. Improved market share, increased customer demand for compression equipment and pricing improvements accounted for the increased revenue. While definitive market share data is difficult to obtain, Enerflex estimates that its Canadian large horsepower compressor package market share increased in both 2003 and 2004. Over this period, Enerflex believes that it fully recovered the decline in market share that occurred in 2002, even though competition in this business segment remains strong. The Company attributes its increased market share to: the introduction of new products, such as its Generation III compressor package, a 1,250 horsepower screw compression package and the reintroduction of its Back-to-Basics ("BTB") product line; improved product quality; and, a return to its customer-focused business approach.

During 2004, gross margin increased by 61% as a result of the increased revenue, improved plant utilization, lower overhead application rates and a focused effort to improve product quality through enhancements in the processes and practices at the division's main facility in Calgary. At present, Enerflex owns approximately 370,000 square feet of compression shop floor space in North America and during 2004 management estimates that the average utilization rate, based on the theoretical plant capacity in labour hours, was 58% as compared to 41% in 2003. With the increase in customer demand and utilization of the facilities, overhead rates per hour were reduced by 22%, as compared to 2003. The Compression division's income before interest and income taxes increased by 136% as a result of the factors mentioned above, and certain contract losses incurred in 2003.

In 2005, the division will continue to introduce new products in both its reciprocating and screw compressor product lines and will introduce new services through its Compression Services business unit to further optimize its customers' compression assets and natural gas production. A challenge to achieving improved profitability in 2005 will be the timely availability of certain OEM components and repair parts, which will be in steady demand as activity levels and demand for natural gas in North America remain high.



### Production and Processing

The Production and Processing division contributed revenue of \$90.5 million, an increase of 37% and comprised 32.3% of the segment's revenue compared to 27.8% in 2003 on revenue of \$65.9 million. While definitive market share data is difficult to obtain, Enerflex estimates that it has maintained its Canadian market share and increased its international market share, particularly in Pakistan, through its PDIL joint-venture. In each market segment competition remains strong. The Company attributes its increased international market share to the extensive experience of both the Presson and Mactronic business units in these markets and Enerflex's willingness to work cooperatively with international partners. In 2005, the division will introduce new products to capitalize on the growth in northern Alberta's oil sands projects and will continue to pursue international projects through PDIL and independently through the collaboration of various Enerflex business units.

During 2004, gross margin also increased by 48% as a result of an increase in international projects, improved plant utilization and lower overhead application rates. At present, Enerflex owns approximately 100,000 square feet of production and processing shop floor space in Alberta, and during 2004 management estimates that the average utilization rate, based on labour hours, was 89.1% as compared to 87.6% in 2003. With the increase in international projects and utilization of the facilities, overhead application rates were reduced by 4%, as compared to 2003. The division's income before interest and income taxes increased by 151% as a result of the above mentioned factors.

### Power

The Power division contributed revenue of \$7.2 million, a decrease of 28% and contributed 2.6% of the segment's revenue as compared to 4.2% in 2003 on revenue of \$10.0 million. The division's loss before interest and income taxes increased by \$1.2 million, to a loss of \$1.3 million as a result of \$1.4 million in one-time obsolescence provisions.

### Other

In years prior to 2003, the Compression and Power divisions followed the policy of recording revenue upon substantial technical completion of a project (the "completed contract" method), while the Production and Processing division followed the percentage of completion method. The completed contract method can result in large fluctuations in results which do not reflect the activity levels and earnings generation potential in periods when large projects are being undertaken, as revenue and cost of sales are not recognized in the statement of income until the project is substantially complete. As the Company expects large turnkey projects will provide an increasing proportion of revenue, the percentage of completion method of revenue recognition was adopted throughout our Fabrication business segment in 2003.

### Fabrication Segment Bookings

During 2004, Enerflex increased its order bookings in the Fabrication segment by approximately 31% versus bookings recorded in 2003. The Fabrication segment's order backlog at December 31, 2004 was approximately 56% above the segment's order backlog at December 31, 2003.



## LEASING

The Leasing business segment provides a variety of rental and leasing alternatives for natural gas compression, power generation and processing equipment. At the end of 2004, the Enerflex lease fleet was comprised of approximately 360 compression units and 97,000 horsepower, as compared with 300 units and 77,000 horsepower in 2003. This resulted in an average fleet of 325 units and 89,000 horsepower. The key performance metrics in this business are fleet size, utilization rates and rental rates. The Leasing segment employs 1% of staff, holds 21% of the total assets and generates 5.1% of the Company's revenue.

The Company's lease fleet is located principally in western Canada. Expansion in international markets commenced during 2004, and is being executed on a selective basis to minimize the risk from these new markets. As of December 31, 2004, Enerflex's compression rental fleet included 16 units located in the United States and five units located in other international markets.

<i>(Thousands)</i>	<i>Years ended December 31</i>	<b>2004</b>	<b>2003</b>
Segment revenue		\$ 28,500	\$ 22,281
Intersegment revenue		(101)	(85)
Revenue		\$ 28,399	\$ 22,196
Gross margin		\$ 18,120	\$ 13,606
EBITDA <sup>1</sup>		\$ 24,331	\$ 18,818
Income before interest and income taxes		\$ 17,236	\$ 12,864
Capital expenditures, net of proceeds on disposal		\$ 21,646	\$ 9,888

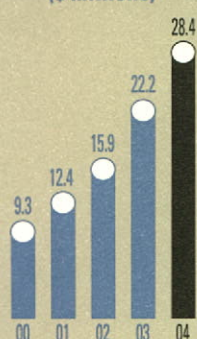
Revenue in 2004 increased by 28% to \$28.4 million compared with \$22.2 million in the prior year. Though the division owns and rents compression, power and processing equipment, the main driver for its revenue growth is compression equipment. In 2004, the division's revenue was generated 93.5% by compression and 6.5% by power and production process equipment. Overall, the division experienced compression rental utilization rates, based on capital deployed, of 84.7% compared to 83.4% in 2003. The increase in utilization rates was attributed to the increased drilling activity and subsequent production requirements for new wells in the division's core market of Canada, the increase in the number of CBM wells, and a desire by natural gas producers to maintain production during periods when their equipment required maintenance. In addition to increases in the number of leased units and the utilization thereof, revenue was also increased by modest increases in rental rates and the addition of higher horsepower compression units.

<sup>1</sup> Earnings before interest, taxes, depreciation and amortization ("EBITDA") is a non-GAAP (Generally Accepted Accounting Principles) earnings measure that does not have a standardized meaning prescribed by GAAP and therefore is unlikely to be comparable to similar measures presented by other issuers.

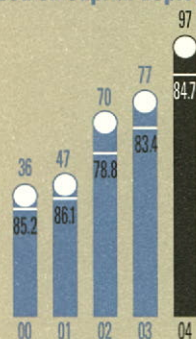


During 2004, Leasing sold 45 compression units and 91 power and process equipment units from its fleet, for gross proceeds of \$17.4 million and a gain on sale of \$2.9 million. This compares to 55 compression units and 72 power and process equipment units, for gross proceeds of \$13.4 million and a gain on sale of \$2.3 million in 2003. The sale of units generally occurs when customers exercise their contractual option to purchase equipment. To satisfy growing demand for leased compression, Enerflex added 115 compression units and 55 power and processing units to its fleet in 2004, for an investment of \$39.0 million. This turnover of assets renews the fleet, resulting in an average fleet age of less than five years.

**LEASING REVENUE**  
(\$ millions)



**RENTAL UTILIZATION RATES (%)**  
vs HORSEPOWER (000 hp)  
(based on capital deployed)



Leasing expects continued growth in demand for its products in Canada, and has targeted specific geographic regions for expansion in the United States and abroad. Leasing does not generally increase the capital invested in its fleet unless it has lease contracts. Growth in the lease fleet is expected to be the largest investment opportunity for the Company in 2005.

The leasing business is a significant contributor to earnings, despite its low proportion of overall Company revenue. In addition, Enerflex Leasing makes the Company's other business segments stronger. Leasing is a significant customer of the compression fabrication business units, as almost all of its equipment is purchased from Fabrication. Service also benefits because the majority of Leasing customers use Pamco and Jiro Service to perform routine maintenance over the term of the lease.

Accounting practices in the compression leasing business vary significantly from company to company. Key accounting policies followed by Enerflex's leasing business are as follows:

- All equipment and related debt are recorded on the balance sheet. No equipment is in special purpose entities. There is no "off-balance sheet" debt.
- Compression equipment is depreciated over its useful life, which has been estimated to be approximately 15 years. Depreciation expense is recorded regardless of whether the equipment is in service or idle.
- When, under the terms of a rental contract, the Company is responsible for maintenance and overhauls, the expense is accrued monthly to match maintenance expense with the related revenue. Maintenance and overhaul costs incurred are charged to the accrued maintenance liability and are not capitalized.



## FINANCIAL CONDITION AND LIQUIDITY

Enerflex generated cash flow from operations of \$50.9 million in 2004, compared with \$34.1 million in 2003. Cash generated funded a reduction in long-term debt of \$3.6 million, \$21.6 million of net additions to rental assets, \$8.8 million of net additions to property, plant and equipment and dividends to shareholders of \$8.9 million. In 2003, operating cash flow was impacted by a \$0.8 million increase in non-cash working capital. In 2004, non-cash working capital from operations increased to \$4.6 million as a result of a \$10.2 million increase in accounts and income taxes receivable, offset by an \$8.0 million decrease in inventory, and a \$6.8 million increase in total accounts payable. The increase in accounts receivable reflects the increase in revenue in 2004.

On February 28, 2005, the Company had 22,421,203 common shares outstanding. Enerflex has a dividend policy, which is reviewed on an annual basis. In 2004, the Company declared quarterly dividends equal to \$0.10 per common share for a total of \$0.40 per common share on an annualized basis. It is the Company's intention to continue the payment of dividends to its shareholders during 2005.

During 2004, there were no significant changes in the structure of the Company's bank credit facilities. The Credit Agreement provides for a \$100 million revolving operating facility and a \$75 million extendible revolving term loan facility. The availability of the operating facility is subject to a monthly borrowing base calculation that considers eligible accounts receivable and inventories. As of December 31, 2004, \$169.1 million of the \$175 million facility was available to the Company and Enerflex had drawn \$91.8 million, comprised of \$82.2 million in cash borrowings and \$9.6 million in letters of credit or guarantee, leaving approximately \$77.3 million available for future drawings. If the term loan is not extended at the end of its term, which is extendible at the bank's option on June 30 of each year, it will be repayable in 24 equal consecutive monthly principal installments. The loans are collateralized by a first floating charge over all of the assets of the Company, and require the Company to meet certain covenants, including a limitation on the debt-to-EBITDA<sup>1</sup> ratio. Enerflex was in full compliance with these covenants at December 31, 2004 and February 28, 2005.

On February 28, 2005, approximately \$169.6 million of the \$175 million facility was available to the Company and Enerflex had drawn approximately \$90.9 million, comprised of \$82.0 million in cash borrowings and \$8.9 million in letters of credit or guarantee, leaving approximately \$78.7 million available for future drawings. These credit facilities provide the financing required to support the Company's operating requirements, as well as the flexibility to pursue growth opportunities.

## CONTRACTUAL OBLIGATIONS AND COMMITTED CAPITAL INVESTMENT

The Company's contractual obligations, assuming that the extendible revolving term loan facility is renewed on June 30, 2005, are contained in the following table. (Details of the amounts payable if the term loan is not renewed are in Note 5 to the financial statements.)

### CONTRACTUAL OBLIGATIONS

(Thousands)	Payments due by period				
	Less than one year	1- 3 years	4-5 years	Thereafter	Total
Leases	\$ 7,665	\$ 10,488	\$ 3,480	\$ 4,198	\$ 25,831
Purchase obligations	4,488	555	44	—	5,087
Total	\$ 12,153	\$ 11,043	\$ 3,524	\$ 4,198	\$ 30,918

<sup>1</sup> Earnings before interest, taxes, depreciation and amortization ("EBITDA") is a non-GAAP (Generally Accepted Accounting Principles) earnings measure that does not have a standardized meaning prescribed by GAAP and therefore is unlikely to be comparable to similar measures presented by other issuers.



The majority of the Company's lease commitments are operating leases for Service vehicles.

The majority of the Company's purchase commitments relate to major components for the Fabrication segment and to long-term information technology and communications contracts entered into in order to reduce the overall costs of services received.

In addition to the contractual obligations above, Enerflex has budgeted for capital spending investments of \$52.4 million in 2005. Of that, \$39.0 million relates to the expansion of the Company's lease fleet; \$1.8 million relates to the construction of a facility for Presson's large vessel fabrication operations; \$4.2 million relates to business application software and information technology investments; and the balance is normal replacement and expansion needs. As of February 28, 2005, a total of \$16.0 million has been committed.

### CRITICAL ACCOUNTING ESTIMATES

The Company's significant accounting policies are described in Note 1 to the consolidated financial statements. The preparation of these statements requires the use of estimates and judgments that affect the reported revenues and expenses, assets, liabilities, and shareholders' equity. These estimates and judgments are based on historical experience and various assumptions, which management believes to be reasonable in the circumstances. Future events cannot be anticipated with certainty and as such, these estimates and assumptions may change as additional evidence is gathered, new circumstances arise and as the Company's operating environment changes.

The accounting estimates believed to be the most difficult to determine, or which depend on the most complex of judgments, and which have the most impact on the Company's results of operations and financial position are as follows:

#### Revenue Recognition

Enerflex's Fabrication segment applies the percentage of completion method of revenue recognition for determining periodic revenue allocations for projects in progress at each month-end. In general, these contracts are completed within a period not exceeding six months. This methodology requires the use of estimates, based on the historical knowledge and experience of the Company, the specific circumstances of the project and the anticipation of future events in order to determine various factors. These include the stage of project completion, future costs to be incurred in the completion of the project, timing of contract completion and delivery to the ultimate customer, and an estimate of the ultimate gross margin to be earned. These estimates are continually evaluated and may change based upon significant or unanticipated changes in future events; the cost, availability and timing of delivery of materials or components; and the occurrence of unanticipated difficulties in the fabrication or shipping process. In addition to affecting the determination of revenue and gross margin, these estimates could also impact the need for provisions related to late delivery penalties on contracts subject to such conditions. At every month-end, Enerflex reviews each of the projects in progress and evaluates the reasonableness of each estimate made. Upon the completion of the project, a gross margin analysis is prepared to ensure that over the course of the project appropriate revenues and costs have been recorded.

#### Stock Options and Other Stock-Based Compensation

In 2004, Enerflex adopted the fair value method of accounting for stock options. The determination of the stock-based compensation expense for stock options requires the use of estimates and assumptions based on market conditions and past experiences of the Company. Changes in these estimates and future events could alter the determination of the provision for such compensation. Details concerning the assumptions used are shown in the notes to the financial statements.



During 2004, Enerflex introduced an RSU and DSU compensation plan which is accounted for using the fair value method of accounting that requires the use of estimates and assumptions based on market conditions, vesting criteria, length of employment and past experiences of the Company. Changes in these estimates and future events could alter the determination of the provision for such compensation. Details concerning the assumptions used are shown in the notes to the Company's financial statements.

#### **Allowance for Doubtful Accounts Receivable**

Enerflex performs ongoing credit evaluations of its customers and grants credit based upon the customer's past payment history and financial condition, taking into consideration anticipated changes in industry, economic and political conditions. Customer payments are regularly monitored and a provision for doubtful accounts is established based upon specific situations. The Company's experience with respect to the incurrence of bad debt losses has been within expectations and has generally been limited to a select number of specific customer situations. However, given the cyclical nature of the global oil and natural gas services industry and the risk associated with finding and producing hydrocarbons, a customer's ability to fulfill its obligations can change without notice.

#### **Excess and Obsolete Inventory Provisions**

The Company regularly reviews the nature and quantities of inventory on hand and makes provisions for excess or obsolete inventory items based on historical usage patterns, known changes to equipment or processes and customer demand for specific products. Significant or unanticipated changes in business conditions could impact the magnitude and timing of the provisions for excess and obsolete inventory.

#### **Warranty Provisions**

Enerflex regularly reviews the nature, size and underlying cause of all warranty claims made by customers with respect to the Company's products and services and makes provisions for future warranty claims based on historical information, production patterns and known changes to equipment or processes. Significant or unanticipated changes in customer claim patterns, the quality of suppliers' delivered component parts, the availability of skilled labour or unforeseen effects of changes in the processes adopted by the Company could impact the magnitude and timing of future warranty costs.

#### **Rental Equipment Overhaul Expenditures**

The Company regularly reviews the nature and cost of all major or minor equipment overhaul expenditures incurred with respect to its rental fleet of compressors, power generation and process equipment. As Enerflex is generally responsible for these costs under the terms of its rental agreements, it makes provisions for future equipment overhaul costs associated with the current rental revenues based on historical information, changes in equipment specifications and changes in operating conditions. Significant or unanticipated changes in the cost of such expenditures, operating environments, the availability of repair and maintenance parts, or the availability of skilled labour could impact the magnitude and timing of estimates related to overhaul expenditures.

#### **Depreciation and Amortization**

Enerflex's rental assets, and property, plant and equipment are depreciated and amortized based upon estimates of useful lives and salvage values. These estimates may change as more experience is gained, market conditions shift or as future production methodologies are adopted by the Company's customers.



### **Goodwill and Long-lived Assets**

Goodwill and long-lived assets comprise a significant component of the Company's asset base. The carrying values of these assets are reviewed at least annually for impairment or whenever events or changing circumstances indicate that their carrying value may not be recovered. This requires the Company to forecast future cash flows to be derived from such assets based upon assumptions about a variety of future events. Significant unanticipated changes to these assumptions could materially alter the Company's estimates of any provision for impairment made by the Company in the future. It has been determined that there is no impairment in the value of goodwill or other long-lived assets in any of Enerflex's business segments.

### **Income Taxes**

The Company uses the liability method for determining its income tax provisions and liabilities. This methodology takes into consideration the differences between financial statement treatment and income tax treatment of certain transactions, assets and liabilities. Current and future income tax assets and liabilities are recognized for the income tax consequences attributed to the Company's current year operations and the differences between the financial statement treatment and income tax treatment of the matter. Valuation allowances are established to reduce future income tax assets when it is believed that some or a portion of the asset may not be realized. Estimates of future income tax rates, future income taxes payable and the continuation of prudent tax planning initiatives have been considered in making these valuation assessments. Changes in circumstances, assumptions and the clarification of uncertain taxation matters may require the valuation allowances to change.

### **ASSET RETIREMENT OBLIGATIONS**

The Canadian Institute of Chartered Accountants has issued new recommendations for accounting for Asset Retirement Obligations. The recommendations, which became effective in 2004, did not have a significant impact on the Company's financial statements.

### **INTERNAL CONTROLS**

There has been a great deal of discussion around issues of corporate governance in the media and the business community following the creation of Bill 198 by the Ontario legislature and Multilateral Instruments 52-109, 52-110 and 52-111 by the Canadian Securities Administrators. These instruments are the Canadian response to the Sarbanes-Oxley legislation in the United States. In June 2003, Enerflex began developing its VIPER (Value Improvement Program for Enhanced Results) program, which will assist Enerflex in the implementation of all aspects of Bill 198 and the attendant securities regulations, and will add shareholder value through improvements to processes throughout the Company. This project is on schedule. The Company had incurred costs of approximately \$0.9 million up to December 31, 2004 and at present estimates that an additional \$2.0 million will be incurred during 2005.

### **OUTLOOK FOR MARKETS AND COMPETITION**

As a Canadian-based provider of equipment and services to the global oil and natural gas industry, Enerflex's business prospects are influenced by several market factors. These include the business outlook for oil and natural gas producers, prospects for natural gas infrastructure development, as well as the business outlook and competitive environment within the oil and natural gas service industry.



### Industry Outlook – Oil and Gas Producers

While Enerflex continues to build its international presence, the Company's fortunes are largely tied to natural gas capital and operating expenditures in western Canada. Approximately 21,700 wells were completed in 2004, of which approximately 70% were natural gas wells. In 2005, industry analysts forecast that capital expenditures on plant and equipment will remain strong, and will be comparable to 2004. Many forecasters expect that, in the absence of significant discoveries, North American conventional natural gas production will decrease. Sustaining or increasing production volumes is progressively more dependent upon development of tight gas and CBM, both of which require more compression than traditional reservoirs, and expansion in frontier regions such as the Northwest Territories. The continuation of higher natural gas prices similar to or above those experienced in recent years will be required to support gas development in these areas.

### Competitive Issues in the Oil and Gas Service Industry

Although the Canadian market continues to have distinct differences from the U.S. market, it is clear that a single North American market is developing. For this reason, investors should be aware of certain competitive issues in Canada, the United States and overseas markets.

#### Canada

The Canadian production and processing equipment and compressor packaging markets are very competitive. Several fabricators target the same customers as Enerflex, and fabrication floor space is not a constraint. To be successful, the Company must compete on the basis of quality and service while remaining price competitive. The introduction of additional products is one way the Company maintains its competitive position. In 2004, the Company re-introduced the BTB Compression product line and expanded the screw compressor product line to 600 horsepower. In 2005, Enerflex will further expand the screw compressor product line and introduce a compression optimization service, HPMAX. The HPMAX service will give customers access to the unique capabilities of the Compression Services business unit when developing plans for enhanced production in existing fields.

A number of new competitors have emerged for both the Syntech and Pamco business units. Enerflex is a market leader in Canada and maintains an extensive branch network, as proximity to customer locations is key to earning business. Late in 2004, Pamco introduced a dedicated Central Services facility to better serve its customers and the Mechanical Service division's global branch network through improved supply-chain management and improved access to remanufactured parts. Pamco has a competitive advantage as the authorized Waukesha distributor. Syntech does not have exclusive distributorships, but has developed proprietary control technology to help differentiate its business from the competition.

While it is the Company's belief that more compression equipment is being rented each year in Canada, the majority of compression equipment, measured by horsepower, is owned by producers. Enerflex is a leader in the compression rental industry, supplying an estimated 30% of the Canadian market (calculated by horsepower).

#### United States

There are two major public competitors, one significant private competitor and a number of small regional competitors in the U.S. compression fabrication business. Management believes that the U.S. market may provide the Company with an opportunity to expand its business, through EFX Compression USA, a specialty natural gas compression equipment packager in Odessa, Texas.

In the United States there is no dominant service provider. In 2003, Enerflex used its Odessa, Texas, facility as a platform to establish a mechanical service business in this market. The Company believes it can expand its mechanical service capability in the U.S.



The U.S. market continues to be more heavily weighted towards compression rentals than the Canadian market. Approximately 30% of the U.S. market is served by rental compression equipment while 70% is owned by producers and pipeline companies (calculated by horsepower). In comparison to the Canadian market, rental rates are lower on certain product ranges in the United States as there has been a surplus of available equipment. Enerflex plans to compete in certain niche markets where returns on capital are appropriate.

### **International**

Internationally, Enerflex generally faces the same competitors as in North America. Most significant North American production equipment and compression fabricators pursue international business. International contacts developed by Presson and Mactronic over the past ten years, along with those compression products exported from the Company's Canadian facilities, have increased Enerflex's exposure to international opportunities, particularly in Pakistan and Australasia.

Through our Australian subsidiary, Gas Drive Systems Pty Limited, expansion into Indonesia, and the acquisition of Landré Ruhaak bv in late 2001, Enerflex has developed an international platform from which to expand into certain global regions including Europe and Australasia.

### **BUSINESS RISKS**

While demand for Enerflex's products and services is largely a function of the supply, demand and price of natural gas, many other factors can affect the fortunes of the business either positively or negatively. Enerflex encourages all investors to read and be aware of business risks and the Company's response to them.

### **Personnel**

The Company's Fabrication segment requires skilled engineering and design professionals in order to maintain customer satisfaction and engage in product innovation. The Company competes for these professionals, not only with other companies in the same industry, but with oil and gas producers and other industries. In periods of high energy activity, demand for the skills and expertise of these professionals increases, this makes the hiring and retention of these individuals more difficult.

Both the Fabrication and Service segments rely on the skills and availability of trained and experienced tradesmen and technicians to provide efficient and appropriate services to the Company and its customers. Hiring and retaining such individuals are critical to the success of the Company's businesses. Demographic trends are reducing the number of individuals entering the trades, making the Company's access to skilled individuals more difficult. There are few barriers to entry in a number of Enerflex's businesses, so retention of staff is essential in order to differentiate the Company's businesses and compete in its various markets.

Internal and external training programs have become a key component to ensuring the availability of skilled personnel in all aspects of the Company's activities. Both the Fabrication and Service segments are active in apprenticeship programs and the Company has developed an ongoing retention program. Career development is encouraged through both in-house training and outside education centers and the Company has recently undertaken an initiative to identify, train and retain skilled personnel for critical positions.



### Energy Prices

Energy prices affect Enerflex, as the majority of the Company's customers generate cash flow from both crude oil and natural gas. The prices for these commodities are determined by supply, demand, government regulations relating to natural gas production and processing, and international political events, none of which can be accurately predicted. During 2004, crude light price per barrel ranged from US\$32.48 to US\$55.17 and natural gas price per mcf ranged from CDN\$4.32 to a high of CDN\$8.74.

As free cash flow available for investment by producers varies with commodity prices, the market for capital goods required by the Company's customers is both cyclical and, at times, highly volatile. A sustained period of low natural gas prices or oversupply, could negatively impact the Company's fabrication businesses as natural gas producers would likely curtail investment in production equipment. Periods of extremely high natural gas prices can cause producers to delay routine maintenance on equipment, impacting the Service segment in the near-term.

Enerflex seeks to mitigate these risks through diversification in both products and services offered and geographical expansion.

### The Cyclical Nature of the Energy Industry

Changing political, economic or military circumstances throughout the energy producing regions of the world can impact the market price of oil for extended periods of time, which in turn impacts the price of natural gas, as industrial users often have the ability to choose to use the lower priced energy source.

Enerflex is structured to be profitable in both high and low periods of the energy cycle. This is done through product breadth, international diversification and access to a variety of equipment financing methods. Since becoming a public company in 1993, Enerflex has generated positive cash flow even in challenging times.

### Climatic Factors and Seasonal Demand

Demand for natural gas fluctuates largely with the heating and electrical generation requirements caused by the changing seasons in North America. Cold winters typically increase demand for, and the price of, natural gas. This increases customers' cash flow which can then have a positive impact on Enerflex. At the same time, access to many western Canadian oil and gas properties is limited to the period when the ground is frozen so that heavy equipment does not sink. As a result, the first quarter of the year is generally accompanied by increased winter deliveries of equipment. Warm winters in western Canada, however, can both reduce demand for natural gas and make it difficult for producers to reach well locations. This restricts drilling and development operations and can negatively impact Enerflex.

Enerflex seeks to reduce the impact of seasonality through geographic expansion and product diversification.

### Credit Risk

A substantial portion of the Company's accounts receivable are with customers involved in the oil and natural gas industry, whose revenues may be impacted by fluctuations in commodity prices. The Company does not have significant exposure to any individual customer or counter party other than one major Canadian independent oil and natural gas producer which accounted for 13.1% of Enerflex's revenue in 2004. No other customer accounted for more than 10% of the Company's revenues.



### Foreign Currency Exchange

Enerflex, a Canadian company, is exposed to foreign exchange risk when it buys or sells goods or services in foreign currencies. As these foreign currencies depreciate against the Canadian dollar, it makes the Company's products exported from Canada more expensive in the foreign currency, while reducing the relative cost of inputs purchased in the same currency.

The Company manages most of this inherent risk through a variety of contractual means, but currency risk cannot be eliminated entirely. Enerflex has foreign subsidiaries in Australia, Indonesia, the Netherlands and the United States, and interests in joint-ventures in Pakistan and Germany. These expose the Company to changes in the exchange rates for the currencies of each country in addition to changes in the Canadian and U.S. dollars.

### Foreign Operations

Enerflex sells products and services throughout the world. While this diversification is desirable, it can expose the Company to risks related to cultural, political and economic factors of foreign jurisdictions which are beyond the control of the Company. Other issues, such as the quality of receivables may also arise. Enerflex seeks to mitigate these risks by using staff experienced in foreign operations and closely monitoring the exposure it maintains in foreign currencies and international operations.

### Distribution Agreements

One of the Company's strategic assets is its distribution and OEM agreements with leading manufacturers, notably the Waukesha Engine division of Dresser Inc., for engines and parts, and Ariel Corporation for compressors. In the event that one or more of these agreements were to be terminated, Enerflex would lose a competitive advantage.

Enerflex and its people make it a priority to maintain and enhance these strategic relationships.

### Competition

The Company has a number of competitors in all aspects of its business, both domestically and abroad. Some of these competitors, particularly in the Fabrication segment, are large, multi-national companies with greater access to resources and more experience in international operations than Enerflex. Within Canada, particularly in the Service segment, the Company has a number of small to medium sized competitors, who may not have access to the capital and resources that Enerflex has, but may also face lower overhead costs than the Company.

### Availability of Raw Materials, Component Parts or Finished Products

Enerflex purchases a broad range of materials and components in connection with its manufacturing and service activities. The Company purchases most of its compressors and engines through distributor agreements with Ariel Corporation for compressors and Waukesha Engine, a division of Dresser Inc., for natural gas engines and parts. The Company has had a relationship with both of these companies since 1980. Additionally, the Company has relationships with a number of other suppliers including Kobelco Compressors (America) Inc., Mycom Group Inc., and Caterpillar Inc. The availability of the component parts and the delivery schedules provided by these suppliers affect the assembly schedules of the Company's production and services.

Enerflex purchases coolers for its compression packages from a limited number of suppliers. The production schedules and delivery time tables from these suppliers affects the assembly schedule of the Company's products.



Though the Company is generally not dependent on any single source of supply, the ability of suppliers to meet performance, quality specifications and delivery schedules is important to the maintenance of customer satisfaction. A challenge to achieving improved profitability in 2005 will be the timely availability of certain OEM components and repair parts, which will be in steady demand, as activity levels and production demands for natural gas in North America remain high.

#### **Environmental Considerations**

Enerflex's customers, particularly in North America and Europe, are subject to significant and ever-increasing environmental legislation and regulation. This legislation can impact Enerflex both through increasing technical difficulty in meeting environmental requirements in product design which could increase the cost of the Company's products, and a reduction in activity by producers in environmentally sensitive areas which would reduce the sales opportunities available.

At the same time, Enerflex itself operates in a number of jurisdictions and is also subject to environmental legislation and regulation. In order to maintain and enhance environmental compliance, the Company conducts routine property inspections and may engage third-party environmental companies to perform audits when deemed appropriate in the circumstances.

#### **Insurance**

Enerflex carries insurance to protect the Company in the event of destruction or damage to its property and equipment, subject to appropriate deductibles and the availability of coverage. Liability insurance is also maintained at prudent levels to limit exposure to unforeseen incidents. An annual review of insurance coverage is completed to assess the risk of loss and risk mitigation alternatives. Extreme weather conditions, natural occurrences and terrorist activity have strained insurance markets leading to substantial increases in insurance costs and limitations on coverage.



## MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL INFORMATION

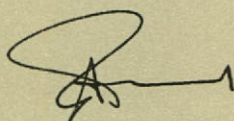
### To the Shareholders of Enerflex Systems Ltd.

The accompanying consolidated financial statements and all information in the Annual Report have been prepared by management and approved by the Board of Directors. The consolidated financial statements have been prepared in accordance with generally accepted accounting principles in Canada and, where appropriate, reflect management's best estimates and judgements. Management is responsible for the accuracy, integrity and objectivity of the consolidated financial statements within reasonable limits of materiality and for the consistency of financial data included in the text of the Annual Report with that in the consolidated financial statements.

To assist management in the discharge of these responsibilities, the Company maintains a system of internal controls designed to provide reasonable assurance that accounting records are reliable and assets are safeguarded.

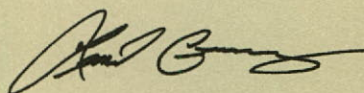
The Audit Committee is appointed by the Board of Directors. The Audit Committee meets with management, as well as with the external auditors, to satisfy itself that management is properly discharging its financial reporting responsibilities and to review the consolidated financial statements and the auditors' report. The Audit Committee reports its findings to the Board of Directors for consideration in approving the consolidated financial statements for presentation to the shareholders. The external auditors have direct access to the Audit Committee of the Board of Directors.

The consolidated financial statements have been audited independently by Deloitte & Touche LLP on behalf of the shareholders, in accordance with generally accepted auditing standards. Their report outlines the nature of their audits and expresses their opinion on the consolidated financial statements.



**P. John Aldred**

Chairman, President and Chief Executive Officer



**Leonard A. Cornez**

Vice-President and Chief Financial Officer

February 10, 2005



## AUDITORS' REPORT

### To the Shareholders of Enerflex Systems Ltd.

We have audited the consolidated balance sheets of Enerflex Systems Ltd. as at December 31, 2004 and 2003 and the consolidated statements of income, retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2004 and 2003 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.


*Deloitte & Touche LLP.*

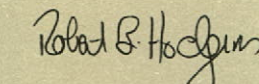
**Deloitte & Touche LLP**  
Chartered Accountants  
Calgary, Alberta

February 10, 2005



<b>Consolidated Balance Sheets</b>			
<i>(Thousands)</i>	<i>December 31</i>	<b>2004</b>	<b>2003</b>
<b>ASSETS</b>			
Current assets			
Cash		\$ 12,840	\$ 6,741
Accounts receivable		132,562	120,432
Inventory (Note 2)		63,176	71,162
Income taxes receivable		412	–
Future income taxes (Note 7)		3,402	4,065
Total current assets		212,392	202,400
Rental equipment (Note 3)		88,772	71,810
Property, plant and equipment (Note 4)		65,814	65,032
Future income taxes (Note 7)		4,425	2,748
Intangible assets		3,210	3,231
Goodwill		112,252	112,453
		\$ 486,865	\$ 457,674
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>			
Current liabilities			
Operating bank loans (Note 5)		\$ 28,853	\$ 27,627
Accounts payable and accrued liabilities		72,699	67,940
Dividends payable		2,234	2,223
Income taxes payable		6,729	4,683
Current portion of long-term debt (Note 5)		16,009	17,097
Total current liabilities		126,524	119,570
Long-term debt (Note 5)		48,027	51,289
Future income taxes (Note 7)		14,445	12,272
		188,996	183,131
Guarantees, commitments and contingencies (Note 6)			
Shareholders' equity			
Share capital (Note 8)		178,540	176,928
Cumulative translation adjustment		(414)	1,501
Contributed surplus (Note 1, Note 9)		1,203	–
Retained earnings		118,540	96,114
		297,869	274,543
		\$ 486,865	\$ 457,674
<i>See accompanying Notes to the Consolidated Financial Statements.</i>			

  
**P. John Aldred**  
 Director

  
**Robert B. Hodgins**  
 Director



<b>Consolidated Statements of Income</b>			
<i>(Thousands, except per share amounts)</i>	<i>Years ended December 31</i>	<b>2004</b>	<b>2003</b>
Revenue		\$ 557,077	\$ 515,528
Cost of goods sold		431,867	411,569
Gross margin		125,210	103,959
Selling, general and administrative expenses		77,372	72,499
Foreign currency gains		(2,229)	(1,985)
Gain on sale of assets		(2,984)	(3,059)
Income before interest and income taxes		53,051	36,504
Interest		3,828	5,280
Income before income taxes		49,223	31,224
Income taxes (Note 7)		17,164	10,841
Net income		\$ 32,059	\$ 20,383
Net income per common share - basic (Note 11)		\$ 1.44	\$ 0.92
- diluted		\$ 1.43	\$ 0.91
Weighted average number of common shares		22,304,429	22,212,700
<b>Consolidated Statements of Retained Earnings</b>			
<i>(Thousands)</i>	<i>Years ended December 31</i>	<b>2004</b>	<b>2003</b>
Retained earnings, beginning of year		\$ 96,114	\$ 84,618
Adjustment to retained earnings (Note 1)		(705)	-
Net income		32,059	20,383
Dividends		(8,928)	(8,887)
Retained earnings, end of year		\$ 118,540	\$ 96,114
<i>See accompanying Notes to the Consolidated Financial Statements.</i>			



<b>Consolidated Statements of Cash Flows</b>			
<i>(Thousands)</i>	<i>Years ended December 31</i>	<b>2004</b>	<b>2003</b>
<b>OPERATING ACTIVITIES</b>			
Net income		\$ 32,059	\$ 20,383
Depreciation and amortization		15,102	14,680
Future income taxes		1,354	2,877
Gain on sale of assets		(2,984)	(3,059)
Stock option expense		703	—
		46,234	34,881
Changes in non-cash working capital and other		4,620	(823)
		50,854	34,058
<b>INVESTING ACTIVITIES</b>			
Purchase of:			
Rental equipment		(38,965)	(23,682)
Property, plant and equipment		(9,957)	(6,310)
Proceeds on disposal of:			
Rental equipment		17,378	19,943
Property, plant and equipment		1,115	3,538
		(30,429)	(6,511)
Changes in non-cash working capital and other		(3,698)	952
		(34,127)	(5,559)
<b>FINANCING ACTIVITIES</b>			
Increase (decrease) in operating bank loans		1,226	(17,627)
Repayment of long-term debt		(3,630)	(1,647)
Stock options exercised		1,407	339
Dividends		(8,917)	(8,887)
		(9,914)	(27,822)
Changes in non-cash working capital and other		(714)	1,037
		(10,628)	(26,785)
Increase in cash		6,099	1,714
Cash, beginning of year		6,741	5,027
Cash, end of year		\$ 12,840	\$ 6,741
<i>See accompanying Notes to the Consolidated Financial Statements.</i>			
<i>Supplementary disclosure of cash flow information (Note 13).</i>			



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### SUMMARY OF ACCOUNTING POLICIES

(Tabular dollar amounts in thousands, except per share/option amounts.)

The consolidated financial statements are prepared in accordance with generally accepted accounting principles in Canada. Certain prior year amounts have been reclassified to conform with the current year's presentation.

#### **Incorporation and Basis of Presentation**

Enerflex Systems Ltd. (the "Company") is incorporated under the Canada Business Corporations Act. The consolidated financial statements include the accounts of Enerflex Systems Ltd., its subsidiaries and its 46.5% interest in the Presson-Descon International (Private) Limited joint-venture.

#### **Use of Estimates**

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities and contingencies at the date of the consolidated financial statements, and revenues and expenses during the reporting period. Actual results could differ from those estimated. Significant estimates in the financial statements include percentage of completion of fabrication contracts, allowance for doubtful accounts, depreciation, overhaul accrual, obsolescence provisions, warranty obligations, asset and liability valuations, and commitments and contingencies.

#### **Revenue Recognition**

Revenues from the design, fabrication and installation of compression and power generation equipment are recorded using the percentage of completion method. Revenues from the fabrication of production and processing equipment are recognized using the percentage of completion method. Unearned revenue is applied against work in progress for financial statement presentation. Any foreseeable losses on contracts are charged to operations at the time they become evident. Revenues from discreet parts and service sales are recorded when goods are shipped and services rendered. Revenues from the provision of integrated parts and service work are recognized on completion of the work. Revenue from equipment leases is recorded over the lease term. In 2004 and 2003, substantially all revenue from equipment leases was from operating leases.

#### **Stock-based Compensation Plans**

The Company's stock-based compensation plans are described in Note 10.

**Options** – In 2004, the Company adopted the fair value method of accounting for stock options issued on or after January 1, 2002. The value of options is calculated using a modified Black-Scholes method at the time of issuance, and is charged to income over the vesting period. Consideration paid by employees on exercise of stock options is credited to share capital, along with the related value previously expensed. No compensation expense is recognized on options granted before January 1, 2002.

Before January 1, 2004, the Company accounted for stock options based on their intrinsic value. As options were granted at market price, no compensation expense was recognized.

**Share Units** – During 2004, the Company adopted a Restricted Share Unit ("RSU") and Deferred Share Unit ("DSU") Plan as a component of the Company's compensation policies.

Both RSUs and DSUs represent an indexed liability of the Company relative to the Company's share price.

During the vesting period, the Company records as a compensation expense, an allocated portion of the market value of the number of units expected to vest under the plan. A portion of the RSUs and DSUs granted may vest subject to performance criteria to be achieved in the first year after granting, as set by the Board of Directors. During the first year, the compensation expense is recognized based on the Company's best estimate of the number of RSUs and DSUs expected to vest ultimately based on the Company's best estimates of whether the performance criteria will be met. The accrued liability is marked to market at each period end through a charge to compensation expense.

#### **Foreign Currency Translation**

Transactions and non-monetary balances denominated in a foreign currency are translated into Canadian dollars using the exchange rates at the dates of the transactions; monetary balances are translated using the exchange rate at the date of the balance sheet.



The assets and liabilities of foreign operations considered financially and operationally independent are translated into Canadian dollars from their functional currencies using exchange rates at the balance sheet dates. Revenue and expense items are translated using the average rates of exchange throughout the year. Gains and losses resulting from this translation process are included in the cumulative translation adjustment in shareholders' equity in the consolidated balance sheets.

The monetary assets and liabilities of foreign operations not considered financially and operationally independent are translated into Canadian dollars from their functional currencies using exchange rates at the balance sheet dates. Non-monetary assets and liabilities denominated in foreign currency are translated into Canadian dollars using the exchange rates at the dates of the transactions. Revenue and expense items are translated using the average rates of exchange throughout the year. Gains and losses resulting from this translation process are included in net income of the period.

#### **Warranty Obligations**

The Company accrues a liability for warranty obligations on the basis of historical claims experience, as a percentage of revenue, specific to each business unit. Warranty costs incurred are charged against this liability.

#### **Income Taxes**

The Company uses the liability method of accounting for income taxes. Under this method, temporary differences between the tax basis of the Company's assets and liabilities and their carrying amounts result in future income tax assets and liabilities. Future income taxes are measured using income tax rates that, at the balance sheet date, are expected to apply when the liability is settled or the asset is realized.

#### **Earnings Per Share**

Basic earnings per share are calculated using the weighted average shares outstanding in the period. The Company uses the treasury stock method of calculating diluted earnings per share.

#### **Cash**

Includes cash amounts and cheques in excess of cash on deposit not included in the Company's operating line of credit and, therefore, not subject to netting, and cash equivalents, being all highly liquid investments with original maturities of three months or less.

#### **Inventory**

Manufacturing materials are recorded at the lower of cost (principally on the first-in, first-out method) and net realizable value. Repair parts are recorded at the lower of weighted average cost and net realizable value. Work in progress includes material, labour and manufacturing overhead, and is recorded net of unearned revenue on a contract by contract basis.

#### **Rental Equipment and Property, Plant and Equipment**

Rental equipment and property, plant and equipment are recorded at cost. Depreciation is provided using the straight-line method over the estimated useful lives of the various classes of assets:

<u>Asset Class</u>	<u>Estimated Useful Life Range</u>
Rental assets	5 to 15 years
Buildings	5 to 25 years
Equipment	2 to 20 years

Major renewals and improvements are capitalized. A provision is made in advance for major overhauls on rental equipment. No depreciation is provided on assets under construction. Repairs and maintenance costs are charged to operations as incurred.

Fixed assets are assessed for impairment whenever changes in events or changes in circumstances indicate that the carrying value may not be recoverable.

#### **Intangible Assets**

Intangible assets represent the fair value of distributorship agreements acquired. Management has determined they have indefinite lives and, therefore, intangible assets are not amortized. Intangible assets are assessed for impairment at least annually.

#### **Goodwill**

Goodwill represents the excess of the purchase price over the value attributed to net tangible and intangible assets acquired.

Goodwill is assessed for impairment at least annually. The impairment test is based on management's best estimate of the fair value of the related segments compared to the carrying amounts of those segments.



**Note 1. CHANGE IN ACCOUNTING POLICY****2004 — Stock Option Expense**

Effective January 1, 2004, the Company adopted the fair value method of accounting for stock options, on a retroactive basis, without prior period restatement. In the past, the Company measured stock option compensation cost based on the intrinsic value of the award at the date of issuance. As the exercise price and the market price were the same at the grant date, no compensation cost was recognized on any option issuance. In 2003, the Company disclosed pro forma net income and earnings per share as if compensation cost for the Company's stock-based compensation plan had been determined based on the fair value at the grant date for awards made under the plan subsequent to January 1, 2002.

As a result of the adoption of this policy, the Company has recorded a charge to retained earnings of \$705,000 as at January 1, 2004, to reflect the accumulated stock option expense for awards made under the plan subsequent to January 1, 2002. The accumulated contribution, less amounts transferred to share capital on option exercise, are captured in contributed surplus. The estimated fair value of the options issued since that date has been determined using a modified Black-Scholes option pricing model.

In 2003, had the Company recorded compensation cost for the Company's stock-based compensation plan based on the fair value at the grant date for awards made under the plan subsequent to January 1, 2002, consistent with the fair value method of accounting for stock-based compensation, the Company's net income and earnings per share would have been as follows:

<b>Year Ended December 31</b>		<b>2003</b>
Net income	As reported	\$ 20,383
	Pro forma	\$ 20,167
Earnings per share – basic	As reported	\$ 0.92
	Pro forma	\$ 0.91
Earnings per share – diluted	As reported	\$ 0.91
	Pro forma	\$ 0.90

**Note 2. INVENTORY**

<b>December 31</b>	<b>2004</b>	<b>2003</b>
Finished goods	\$ 4,072	\$ 10,711
Manufacturing materials	13,836	14,981
Repair parts held for resale	34,166	31,559
Work in progress:		
Costs in excess of related billings	12,879	17,791
Billings in excess of related costs	(1,777)	(3,880)
	<b>\$ 63,176</b>	<b>\$ 71,162</b>

**Note 3. RENTAL EQUIPMENT**

<b>December 31</b>	<b>2004</b>	<b>2003</b>
Cost	\$ 107,867	\$ 87,121
Less accumulated depreciation	(19,095)	(15,311)
Net book value	<b>\$ 88,772</b>	<b>\$ 71,810</b>

Depreciation of rental equipment included in income in 2004 was \$7,080,000 (2003 – \$6,091,000) which was included in cost of goods sold.



**Note 4. PROPERTY, PLANT AND EQUIPMENT**

December 31	2004		2003	
	Cost	Accumulated Depreciation	Cost	Accumulated Depreciation
Land	\$ 9,411	\$ —	\$ 9,551	\$ —
Buildings	57,497	(14,152)	53,281	(11,387)
Equipment	54,049	(40,991)	49,825	(36,238)
Total	\$ 120,957	\$ (55,143)	\$ 112,657	\$ (47,625)
Net book value		\$ 65,814		\$ 65,032

Depreciation of property, plant and equipment included in income in 2004 was \$8,022,000 of which \$3,692,000 was included in cost of goods sold and \$4,330,000 was included in selling, general and administrative expenses. In 2003, depreciation of \$8,589,000 was included in income; \$4,092,000 in cost of goods sold and \$4,497,000 in selling, general and administrative expenses.

**Note 5. OPERATING BANK LOANS AND LONG-TERM DEBT**

In November 2002, the Company entered into a \$175,000,000 credit facility comprised of a \$100,000,000 extendible operating line and a \$75,000,000 extendible revolving term loan facility, which are collateralized by a \$250,000,000 demand debenture, a general security agreement, and a guarantee from each material subsidiary. The credit facilities require the Company to maintain certain covenants. The Company was in compliance with these covenants at December 31, 2004 and 2003. The Company may borrow under either facility through Bankers' Acceptances ("BAs") in Canadian dollars, London Interbank Offer Rate ("LIBOR") loans in U.S. dollars, Canadian Prime Rate loans or U.S. Base Rate loans.

The Company can also draw on the operating line through bank overdrafts in either Canadian or U.S. dollars and letters of credit.

Under the Credit Facility the Company pays a margin on the operating facility and a margin plus 50 basis points on the term facility, established in basis points ("bps") in addition to the quoted interest rate, based on the Company's Consolidated Debt to EBITDA<sup>1</sup> ratio, adjusted effective the first day of the third month following the end of each fiscal quarter as follows:

	Borrowings	
	LIBOR, BAs, Letters of Credit	Canadian Prime, U.S. Base Rate
Consolidated Debt to EBITDA <sup>1</sup> ratio		
<1.0 to 1.0	100 bps	—
≥1.0 to 1.0 and ≤1.5 to 1.0	125 bps	—
>1.5 to 1.0 and ≤2.5 to 1.0	150 bps	25 bps
>2.5 to 1.0	200 bps	50 bps

**a) Operating Line**

At December 31, 2004, \$28,853,000 (2003 – \$27,627,000) of the operating line was drawn and was financed through U.S. dollar LIBOR borrowings, which bear interest at the London Interbank Offer Rate plus a margin; and bank overdrafts offset by cash deposits. At times during 2004, and at December 31, 2003, the operating line was also financed through Canadian dollar BAs, which bear interest at bankers' acceptance rates plus a margin. The composition of the December 31 operating line borrowings is as follows:

December 31	2004	2003
Bankers' acceptances – CDN\$	\$ —	\$ 6,000
LIBOR borrowing – 2004 – US\$15,000 (2003 – US\$9,000)	18,054	11,632
Net overdraft – CDN\$ equivalent	10,799	9,995
Operating bank loans	\$ 28,853	\$ 27,627

If the operating facility is not renewed at the end of its term on June 29, 2005, it will be repayable on June 30, 2005.

<sup>1</sup> Earnings before interest, taxes, depreciation and amortization ("EBITDA") is a non-GAAP (Generally Accepted Accounting Principles) earnings measure that does not have a standardized meaning prescribed by GAAP and therefore is unlikely to be comparable to similar measures presented by other issuers.



**b) Long-term Debt**

At December 31, 2004, \$64,036,000 (2003 – \$68,386,000) of the extendible revolving term loan facility was drawn, and was financed through LIBOR borrowings, which bear interest at the London Interbank Offer Rate plus a margin, and Canadian dollar BAs, which bear interest at banker's acceptance rates plus a margin. The composition of the December 31 term loan borrowings is as follows:

December 31	2004	2003
Bankers' acceptances – CDN\$	\$ 52,000	\$ 49,000
LIBOR borrowing – 2004 – US\$10,000 (2003 – US\$15,000)	12,036	19,386
Total long-term debt	64,036	68,386
Less current portion	(16,009)	(17,097)
Long-term debt	\$ 48,027	\$ 51,289

If the term loan facility is not renewed at the end of its term on June 29, 2005, it will be repayable in 24 equal, consecutive monthly principal installments, commencing in July of 2005.

Canadian dollar equivalent principal payments which are due over the next three years, without considering renewal at similar terms, are:

2005	\$ 16,009
2006	32,018
2007	16,009
Total	\$ 64,036

c) Interest and financing costs on long-term debt were \$2,707,927 (2003 – \$3,640,000). The Company's effective interest rate on long-term debt was 4.3% (2003 – 5.3%).

**Note 6. GUARANTEES, COMMITMENTS AND CONTINGENCIES**

At December 31, 2004, the Company had outstanding letters of credit issued in lieu of holdbacks, performance guarantees and bid bonds of \$9,811,000 (2003 – \$6,078,000) of which \$380,000 (2003 – \$2,155,000) are insured by Export Development Canada, against wrongful call.

The aggregate minimum lease payments, primarily for operating leases for equipment, automobiles and premises are \$25,831,000 and amounts payable for the next five years and thereafter are:

2005	\$ 7,665
2006	6,217
2007	4,271
2008	2,317
2009	1,163
Thereafter	4,198
Total	\$ 25,831

In addition, the Company has purchase obligations over the next three years as follows:

2005	\$ 4,488
2006	\$ 474
2007	\$ 81

The Company is involved in litigation and claims associated with normal operations against which certain provisions have been made in the financial statements. Management is of the opinion that any resulting net settlement would not materially affect the financial position, results of operations or liquidity of the Company.



**Note 7. INCOME TAXES**

The provision for income taxes differs from that which would be expected by applying statutory rates. A reconciliation of these differences is as follows:

<b>Year Ended December 31</b>	<b>2004</b>	<b>2003</b>
Income before income taxes	\$ 49,223	\$ 31,224
Canadian statutory rate (%)	33.87	36.70
Expected income tax provision	16,672	11,459
Add (deduct)		
Manufacturing and processing profit reduction	–	(287)
Income taxed in jurisdictions with different tax rates	112	(468)
Other	380	137
Income tax provision	\$ 17,164	\$ 10,841

The composition of the income tax provision is as follows:

<b>Year Ended December 31</b>	<b>2004</b>	<b>2003</b>
Current income taxes	\$ 15,810	\$ 7,964
Future income taxes	1,354	2,877
Income tax provision	\$ 17,164	\$ 10,841

The computation of the Company's provision for income taxes involves tax interpretations, regulations and legislation that are continually changing. There are tax matters that have not yet been confirmed by the various tax authorities; however, management believes that the provision for income taxes is adequate.

The tax effect of the significant components of temporary differences that give rise to future income tax assets and liabilities as at year end are as follows:

<b>December 31</b>	<b>2004</b>		<b>2003</b>	
	<b>Assets</b>	<b>Liabilities</b>	<b>Assets</b>	<b>Liabilities</b>
Current:				
Provisions	\$ 3,402	\$ –	\$ 4,065	\$ –
	3,402	–	4,065	–
Long-term:				
Provisions	375	–	–	–
Tax losses	1,666	–	1,981	–
Capital assets	2,384	14,445	767	12,272
	4,425	14,445	2,748	12,272
	\$ 7,827	\$ 14,445	\$ 6,813	\$ 12,272

The Company has available tax losses of \$4,200,000, the benefit of which has been recognized based on the expected period of utilization. These losses expire from time to time up to 2023.

Current future income tax assets result primarily from deductible temporary differences between the tax basis of the Company's current assets and liabilities and their carrying amounts. These relate primarily to provisions for overhaul, doubtful accounts receivable and warranty expense.

Long-term future income tax assets result primarily from deductible temporary differences between the tax basis of the Company's property, plant and equipment and its carrying amount and non-capital loss carry forwards not expected to be utilized in the following year.



Long-term future income tax liabilities result primarily from taxable temporary differences between the tax basis of the Company's rental equipment and its carrying amount.

#### Note 8. SHARE CAPITAL

**Authorized** – The Company is authorized to issue an unlimited number of common shares and first preferred shares.

Issued December 31	2004		2003	
	Common Shares	Amount	Common Shares	Amount
Balance, beginning of year	22,227,188	\$ 176,928	22,191,188	\$ 176,589
Stock options exercised	110,250	1,612	36,000	339
Balance, end of year	22,337,438	\$ 178,540	22,227,188	\$ 176,928

In 2003, the Company did not purchase any shares pursuant to its Normal Course Issuer Bid and did not renew the issuer bid when it expired in 2003.

#### Shareholder Rights Plan

In 1997, the Company implemented a shareholder rights plan (the "Rights Plan"). In 2003, the Board of Directors approved the continuation of the Rights Plan and certain amendments in order to update the Rights Plan and conform its provisions to current shareholder rights plan design practices prevalent for Canadian issuers. These amendments were confirmed by the Toronto Stock Exchange and the shareholders of the Company (the "Amended Rights Plan").

The primary objectives of the Amended Rights Plan are to ensure that, in the context of a bid for control of the Company through an acquisition of Common Shares, the Board of Directors has sufficient time to explore for and develop alternatives for maximizing shareholder value, to provide adequate time for competing bids to emerge, to ensure that shareholders have an equal opportunity to participate in such a bid and have adequate time to properly assess the bid and to lessen the pressure to tender typically encountered by a shareholder of a corporation that is subject to a bid. The Amended Rights Plan utilizes the mechanism of the Permitted Bid (as defined in the 2003 Agreement) to ensure that a person seeking control of the Company allows shareholders and the Board of Directors sufficient time to evaluate the bid. The purpose of the Permitted Bid is to allow a potential bidder to avoid the dilutive features of the Amended Rights Plan by making a bid that conforms with the conditions specified in the Permitted Bid provisions. If a person makes a takeover bid that is a Permitted Bid, the Amended Rights Plan will not affect the transaction in any respect.

#### Note 9. CONTRIBUTED SURPLUS

Charges and credits to contributed surplus are related to stock options and are as follows:

Year Ended December 31	2004
Change in accounting policy – January 1, 2004	\$ 705
Compensation expense	703
Options exercised	(205)
	\$ 1,203

#### Note 10. STOCK-BASED COMPENSATION

##### a) Stock Options

At December 31, 2003, the Company had reserved 1,500,000 common shares under the terms of its stock option plan. In addition, in 2002, the Company reserved 175,174 common shares under the terms of the conversion plan for EnSource stock option holders. On April 15, 2004, at the Company's Annual and Special Meeting of Shareholders, the Company received shareholder approval for an increase in the number of shares reserved for issuance under the Company's stock option plan by 548,326 common shares. As a result, at December 31, 2004, the Company has reserved 2,223,500 common shares under the terms of the stock option plan, of which 777,978 were available for issuance at December 31, 2004.



On February 23, 2004, the Company issued 314,050 stock options to employees and directors at an exercise price of \$ 22.19. On August 10, 2004, the Company issued 27,000 stock options to an employee at an exercise price of \$ 22.61. The exercise price of each option equals the average of the market price of the Company's shares on the five days preceding the date of the grant. The options normally vest at a rate of 20% on each of the five anniversaries of the date of the grant and expire on the tenth anniversary.

Stock options outstanding as of December 31 are as follows:

	2004		2003	
	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price
Outstanding, beginning of year	951,422	\$ 19.59	975,334	\$ 23.05
Granted	341,050	22.22	430,900	13.84
Exercised	(110,250)	12.76	(36,000)	9.43
Forfeited	(96,499)	20.21	(222,793)	19.01
Expired	(22,951)	26.57	(196,019)	26.68
Outstanding, end of year	1,062,772	\$ 20.94	951,422	\$ 19.59
Options exercisable, end of year	461,581		462,291	

	Options Outstanding			Options Exercisable	
	Number Outstanding	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
\$7.81 – \$9.33	82,800	0.62	\$ 8.72	82,800	\$ 8.72
\$9.34 – \$21.54	417,572	7.01	16.29	137,132	18.46
\$21.55 – \$29.50	453,800	7.28	24.34	142,729	27.93
\$29.51 – \$38.18	108,600	4.08	33.91	98,920	33.95
\$7.81 – \$38.18	1,062,772	6.33	\$ 20.94	461,581	\$ 22.96

The estimated fair value of the options used for accounting purposes has been determined using a modified Black-Scholes option pricing model with the following assumptions:

	2004	2003
Weighted average fair value per option	\$ 7.13	\$ 2.94
Weighted average risk-free interest rate (%)	3.5	4.1
Weighted average expected life (in years)	5.7	5.0
Estimated volatility in the market price of the common shares (%)	35.4	25.1
Expected dividend yield (%)	1.8	2.9



**Subsequent Event**

On February 10, 2005, the Board of Directors approved the granting of 120,880 options effective February 21, 2005. The exercise price will equal the average of the market price of the Company's shares on the five days preceding the date of the grant.

**b) Share Units**

During the year, the Board of Directors of the Company adopted an RSU and DSU Plan as a component of the Company's compensation policies. An RSU or DSU entitles the holder to receive a payment, as described below, from the Company equal to the implied market value calculated as the number of units multiplied by the closing price of Enerflex common shares on the entitlement date.

RSUs may be granted to eligible participants on an annual basis and will generally vest on the third anniversary date of the grant subject to the achievement of any performance criteria which may, at the discretion of the Company, be attached as a condition of vesting at the date of grant. Performance criteria may include such performance measures as earnings per share or return on capital employed, either for the Company as a whole, or a portion thereof. Vested RSUs are to be settled by the end of the year following the year in which vesting occurs. The Company may at its sole discretion, satisfy, in whole or in part, its payment obligation through a cash payment to the participant or by instructing an independent broker to acquire a number of fully paid shares in the open market on behalf of the participant.

DSUs may be granted to eligible participants on an annual basis and will generally vest on the fifth anniversary date of the grant subject to the achievement of any performance criteria which may, at the discretion of the Company, be attached as a condition of vesting at the date of grant. Performance criteria may include such performance measures as earnings per share or return on capital employed, either for the Company as a whole, or a portion thereof. Vested DSUs are to be settled in cash, payable to the participant by the end of the year following the year in which their employment is terminated through departure, retirement or death.

The number of DSUs granted to an individual participant is limited, in the case of the initial grant, to an aggregate market value of the grant not in excess of 100% of the participant's regular annualized salary and, in the case of subsequent grants, to an aggregate market value of the grant not in excess of 50% of the participant's annualized salary and cash bonuses for the twelve months preceding the grant date.

RSU and DSU recipients are entitled to additional units over and above those granted based on the notional number of shares that could have been purchased using the proceeds of notional dividends, that would have been received had the units then subject to vesting been actual common shares of the Company, following each dividend paid to shareholders of the Company.

Both RSUs and DSUs represent an indexed liability of the Company relative to the Company's share price.



Share units outstanding as of December 31, 2004 are as follows:

#### Restricted Share Units

Grant Date	Vesting Date	Not Subject to Performance Criteria	In Lieu of Dividends	Subject to Performance Criteria	In Lieu of Dividends	Weighted Average Grant Date Fair Value
September 28, 2004	August 15, 2006	12,500	366	—	—	\$ 256
September 28, 2004	February 15, 2007	2,500	44	2,500 <sup>A</sup>	4	103
September 28, 2004	September 28, 2007	6,250	26	6,250 <sup>B</sup>	26	256
November 1, 2004	November 1, 2007	19,300	80	19,300 <sup>B</sup>	80	824
		40,550	516	28,050	110	\$ 1,439
Performance criteria not met:						
	February 15, 2007	—	—	(2,188)	—	(45)
		—	—	(2,188)	—	(45)
Outstanding		40,550	516	25,862	110	\$ 1,394
	Total RSUs Outstanding at Year End					67,038

#### Deferred Share Units

Grant Date	Vesting Date	Not Subject to Performance Criteria	In Lieu of Dividends	Subject to Performance Criteria	In Lieu of Dividends	Weighted Average Grant Date Fair Value
September 28, 2004	August 15, 2008	12,500	366	—	—	\$ 256
September 28, 2004	February 15, 2009	2,500	44	2,500 <sup>A</sup>	4	103
		15,000	410	2,500	4	359
Performance criteria not met:						
	February 15, 2009	—	—	(2,188)	—	(45)
		—	—	(2,188)	—	(45)
Outstanding		15,000	410	312	4	\$ 314
	Total DSUs Outstanding at Year End					15,726

#### Subsequent Event

On February 10, 2005, the Company granted 50,550 RSUs to employees of the Company, of which 50% are subject to performance criteria.<sup>B</sup>

#### Performance Criteria

<sup>A</sup> 50% of the units granted were subject to sliding scale performance criteria based on basic earnings per share for fiscal 2004. Earnings per share of \$1.35 or less would have resulted in 0% of the units subject to performance criteria being eligible for vesting. Basic earnings per share of \$2.03 would have resulted in 100% of the units subject to performance criteria vesting. Basic earnings per share of \$1.44 resulted in 12.5% of the units subject to performance criteria being eligible for vesting.

<sup>B</sup> 50% of the units granted are subject to sliding scale performance criteria based on the increase in Return on Capital Employed ("ROCE") in fiscal 2005 over that achieved in fiscal 2004. An increase in ROCE of 0.0% will result in 0% of the units subject to performance criteria being eligible for vesting. An increase in ROCE of 2.0% will result in 100% of the units subject to performance criteria being eligible for vesting. Each 0.1% increment between 0.0% and 2.0% in the change of ROCE increases by 5% the number of units eligible for vesting.

#### c) Stock-based Compensation Expense

The stock-based compensation expense included in income is:

Year Ended December 31	2004
Stock options	\$ 703
Share units	300
Total	\$ 1,003



**Note 11. RECONCILIATION OF EARNINGS PER SHARE CALCULATIONS**

Year Ended December 31	2004			2003		
	Net Income	Weighted Average Shares Outstanding	Per Share	Net Income	Weighted Average Shares Outstanding	Per Share
Basic	\$ 32,059	22,304,429	\$ 1.44	\$ 20,383	22,212,700	\$ 0.92
Options assumed exercised		540,856			453,650	
Shares assumed purchased		(398,410)			(361,736)	
Diluted	\$ 32,059	22,446,875	\$ 1.43	\$ 20,383	22,304,614	\$ 0.91

**Note 12. FINANCIAL INSTRUMENTS**

**Foreign Currency** – In the normal course of operations, the Company is exposed to movements in the U.S. dollar, the Australian dollar, the Pound Sterling, the EURO, the Pakistani rupee and the Indonesian rupiah. The Company does not hedge the net exposure in foreign subsidiaries.

The Company also enters into contracts denominated in currencies other than Canadian dollars for the export of goods from its Canadian facilities, usually in U.S. dollars. In order to mitigate the exposures from such contracts, the Company matches future foreign currency cash inflows with foreign currency denominated liabilities, primarily through the currency mix in short and long-term borrowings.

From time to time, the Company also utilizes financial instruments to create offsetting positions to specific exposures. These instruments are employed in connection with an underlying asset, liability or anticipated transaction, and are not used for speculative purposes.

**Credit Risk** – A substantial portion of the Company's accounts receivable are with customers in the oil and gas industry and are subject to normal industry credit risks. The carrying amount of accounts receivable reflects management's assessment of the credit risk associated with these customers.

**Interest Rate Risk** – The Company's liabilities include certain long-term debt and bank indebtedness that are subject to fluctuations in interest rates. For each 1.0% change in the rate of interest on these loans, the change in interest expense would be approximately \$929,000, based upon the loan balances at December 31, 2004.

**Fair Values of Financial Assets and Liabilities** – The fair values of financial instruments that are included in the consolidated balance sheets, other than long-term debt, approximate their carrying amounts due to the short-term maturity of those instruments. The fair value of long-term debt does not differ significantly from its carrying amount.

**Note 13. SUPPLEMENTAL CASH FLOW INFORMATION**

Supplemental disclosure of cash flow information

Year Ended December 31	2004	2003
Interest paid	\$ 3,797	\$ 5,354
Interest received	\$ 237	\$ 321
Income taxes paid	\$ 15,874	\$ 5,080
Income taxes received	\$ 1,834	\$ 6,953



**Note 14. INTEREST IN JOINT-VENTURE**

The Company proportionately consolidates its 46.5% share of the assets, liabilities, results of operations and cash flows of its joint-venture in Pakistan, Presson-Descon International (Private) Limited. Those proportionate amounts are:

<b>December 31</b>	<b>2004</b>	<b>2003</b>
<b>Balance Sheet</b>		
Current assets	\$ 6,012	\$ 169
Long-term assets	149	35
Current liabilities	4,624	59
Long-term liabilities and equity	\$ 1,537	\$ 145
<b>Income Statement</b>		
Revenue	\$ 7,081	\$ 1,135
Expenses	6,022	1,209
Net income	\$ 1,059	\$ (74)
<b>Cash Flows</b>		
From operations	\$ 1,995	\$ (24)
From financing activities	48	—
From investing activities	\$ (153)	\$ (43)

**Note 15. SEGMENTED INFORMATION**

The Company has three reportable segments: Service, Fabrication and Leasing. The Service reportable segment is the aggregation of the Mechanical Service and Syntech divisions. The Fabrication reportable segment is the aggregation of the Production and Processing, Compression and Power divisions.

<b>Year Ended December 31</b>	<b>Service</b>		<b>Fabrication</b>		<b>Leasing</b>		<b>Consolidated</b>	
	<b>2004</b>	<b>2003</b>	<b>2004</b>	<b>2003</b>	<b>2004</b>	<b>2003</b>	<b>2004</b>	<b>2003</b>
Segment revenue	\$ 264,740	\$ 269,036	\$ 319,503	\$ 259,715	\$ 28,500	\$ 22,281	\$ 612,743	\$ 551,032
Intersegment revenue	(16,105)	(12,618)	(39,460)	(22,801)	(101)	(85)	(55,666)	(35,504)
Revenue	248,635	256,418	280,043	236,914	28,399	22,196	557,077	515,528
Gross margin	67,050	63,027	40,040	27,326	18,120	13,606	125,210	103,959
Depreciation and amortization	3,374	3,284	4,633	5,442	7,095	5,954	15,102	14,680
Income before interest and income taxes	18,346	15,882	17,469	7,758	17,236	12,864	53,051	36,504
Segment assets	117,363	111,779	150,120	150,163	93,659	74,536	361,142	336,478
Corporate							13,471	8,743
Goodwill	52,814	52,972	52,082	52,125	7,356	7,356	112,252	112,453
Total segment assets	170,177	164,751	202,202	202,288	101,015	81,892	486,865	457,674
Capital expenditures	\$ 4,992	\$ 3,559	\$ 3,886	\$ 2,063	\$ 39,026	\$ 23,644	47,904	29,266
Corporate							1,018	726
							\$ 48,922	\$ 29,992
Proceeds on disposal of assets	\$ 883	\$ 1,858	\$ 186	\$ 8,110	\$ 17,380	\$ 13,419	\$ 18,449	\$ 23,387
Corporate							44	94
							\$ 18,493	\$ 23,481



Revenue from foreign countries was:

<b>Year Ended December 31</b>	<b>2004</b>	<b>2003</b>
Australia	\$ 27,810	\$ 33,832
Indonesia	1,834	8,821
Netherlands	18,495	17,496
Pakistan	37,760	2,617
United States	21,500	14,503
Other	40,305	51,337
	<b>\$ 147,704</b>	<b>\$ 128,606</b>
Included in these amounts are gross exports from domestic operations of:	<b>\$ 81,599</b>	<b>\$ 70,154</b>

Revenue is attributed to countries by the destination of the sale.

Revenues from one domestic customer represent approximately \$73,000,000 (13.1%) of the Company's total revenue, across all segments, for the year.

Total assets in foreign countries were as follows:

<b>December 31</b>	<b>2004</b>	<b>2003</b>
Netherlands	\$ 21,605	\$ 14,491
United States	12,896	6,729
Other	15,374	5,941
<b>Total assets</b>	<b>\$ 49,875</b>	<b>\$ 27,161</b>

Total assets are attributed to countries by the location of the business.



## TEN YEAR HISTORICAL REVIEW

(\$ millions, except per share data and ratios)  
(unaudited)

	2004	2003	2002	2001	2000	1999	1998	1997	1996	1995
<b>Results</b>										
Revenue	557.1	515.5	326.7	375.0	286.3	256.7	314.5	336.2	245.9	222.7
EBITDA <sup>1</sup>	68.2	51.2	30.0	47.8	28.9	29.1	42.4	46.7	32.4	32.2
Income before income taxes	49.2	31.2	14.3	36.5	17.7	20.4	38.1	42.7	27.8	26.9
Net income	32.1	20.4	9.2	22.5	11.3	12.1	22.6	25.2	16.5	16.1
Per common share – basic (\$)	1.44	0.92	0.51	1.51	0.76	0.81	1.50	1.67	1.10	1.07
Interest expense (income)	3.8	5.3	3.6	2.7	3.6	1.9	(0.3)	(0.1)	0.7	1.3
Depreciation and amortization	15.1	14.7	12.1	8.6	7.6	6.8	4.6	4.1	3.9	4.0
Cash from operations	50.9	34.1	36.3	29.1	16.2	5.3	1.4	29.9	15.6	11.6
Capital expenditures, net										
Rental equipment	21.6	3.7	8.5	10.0	7.9	5.6	10.2	0.6	(2.2)	0.2
Property, plant and equipment	8.8	2.8	2.2	2.5	4.3	14.8	23.5	3.3	2.7	3.7
Dividends on common shares	8.9	8.9	7.4	6.0	6.0	6.0	6.0	4.5	3.8	3.8
<b>Financial Position</b>										
Working capital	85.9	82.8	68.7	62.1	57.9	60.0	56.0	58.0	37.7	26.9
Rental equipment	88.8	71.8	68.1	39.0	31.7	26.0	22.2	13.4	13.8	16.9
Property, plant and equipment	65.8	65.0	70.3	45.1	47.3	47.7	36.7	16.2	15.5	15.2
Total assets	486.9	457.7	451.2	222.1	192.7	186.1	159.5	142.7	106.4	91.8
Long-term debt	64.0	68.4	69.0	30.0	30.0	30.0	15.2	–	–	4.6
Shareholders' equity	297.9	274.5	260.9	118.5	104.1	103.0	100.1	87.0	66.4	53.6
<b>Key Ratios</b>										
Gross margin as a percentage of revenue	22.5	20.2	21.4	19.5	18.8	19.8	22.4	21.7	21.4	22.3
Pre-tax income as a percentage of revenue	8.8	6.1	4.4	9.7	6.2	8.0	12.1	12.7	11.3	12.1
Return on average equity <sup>2</sup> (%)	11.2	7.6	4.9	20.2	10.9	11.9	24.1	32.9	27.6	33.9
Return on capital employed <sup>3</sup> (%)	14.0	10.0	6.9	24.0	13.9	15.7	36.7	54.6	41.1	43.2

<sup>1</sup> EBITDA is a non-GAAP earnings measure that does not have a standardized meaning prescribed by GAAP and therefore is unlikely to be comparable to similar measures presented by other issuers. Enerflex calculates EBITDA as follows:

EBITDA for the year ended December 31, 2004: (\$ thousands)

Earnings before interest and income taxes	\$	53,051
Depreciation and amortization		15,102
EBITDA	\$	68,153

<sup>2</sup> Return on average equity is calculated as net income divided by the simple average of shareholders' equity at the beginning and end of the year.

<sup>3</sup> Return on capital employed is calculated as pre-tax income plus interest expense divided by the simple average of capital employed at the beginning of the year and at the end of each quarter. Capital employed is the sum of shareholders' equity plus current and long-term bank indebtedness.



QUARTERLY DATA

(\$ millions, except per share data)  
(unaudited)

	2004				2003			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Revenue	167.7	141.3	119.8	128.3	144.2	124.1	115.3	131.9
EBITDA <sup>1</sup>	22.7	16.2	13.5	15.7	15.4	13.3	10.5	12.0
Income before income taxes	17.9	11.5	8.8	11.0	10.6	8.4	5.3	6.9
Net income	11.4	7.7	5.8	7.1	7.2	5.5	3.3	4.4
Per common share – basic	0.51	0.35	0.26	0.32	0.33	0.24	0.15	0.20
Depreciation and amortization	3.7	3.9	3.8	3.7	3.6	3.7	3.7	3.7
Cash from operations	14.6	16.0	10.5	9.7	6.7	12.0	8.8	6.5
Capital expenditures, net								
Rental equipment	7.0	4.7	5.1	4.8	5.8	3.5	0.0	(5.6)
Property, plant and equipment	1.7	3.4	2.6	1.1	2.3	1.0	(0.7)	0.2
Dividends on common shares	2.2	2.3	2.2	2.2	2.2	2.2	2.2	2.2
Dividends per common share (¢)	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0
Pre-tax income as a percentage of revenue	10.7	8.1	7.4	8.6	7.4	6.8	4.6	5.2

<sup>1</sup> EBITDA is a non-GAAP earnings measure that does not have a standardized meaning prescribed by GAAP and therefore is unlikely to be comparable to similar measures presented by other issuers.

Enerflex calculates EBITDA as follows: (\$ thousands)

	Q4 2004
Earnings before interest and income taxes	\$ 19,026
Depreciation and amortization	3,687
EBITDA	\$ 22,713

COMMON SHARE DATA

	2004	2003	2002	2001	2000	1999
Trading price range of common stock: – high	26.30	20.20	26.50	32.40	42.00	40.00
– low	19.25	12.05	13.20	18.60	25.00	29.50
– close	23.56	20.20	15.00	19.75	31.00	37.50
Trading volume (millions)	9.5	8.9	7.0	5.2	6.8	5.0
Common shares (millions)						
Outstanding at end of year	22.3	22.2	22.2	14.9	15.0	15.0
Weighted average – basic	22.3	22.2	18.2	14.9	15.0	15.0



## DIRECTORS AND OFFICERS

**P. JOHN ALDRED***Director**Officer of the Corporation*

Chairman, President and Chief

Executive Officer

Enerflex Systems Ltd.

Calgary, Alberta

**PATRICK D. DANIEL** <sup>(1) (2)</sup>*Director*

President and Chief Executive Officer

Enbridge Inc.

Calgary, Alberta

**DOUGLAS J. HAUGHEY** <sup>(3)</sup>*Director*

President

Gas Transmission West

Duke Energy Corporation

Calgary, Alberta

**ROBERT B. HODGINS** <sup>(1\*)</sup>*Director*

Investor and Corporate Director

Calgary, Alberta

**GEOFFREY F. HYLAND** <sup>(2)</sup>*Director*

President and Chief Executive Officer

ShawCor Ltd.

Rexdale, Ontario

**JOHN R. KING** <sup>(3)</sup>*Director*

Senior Vice-President

Technology Services Group

Precision Drilling Corporation

Calgary, Alberta

**J. NICHOLAS ROSS** <sup>(1) (3\*)</sup>*Director*

Chairman and Chief Executive Officer

Rover Capital Corporation

Toronto, Ontario

**HON. BARBARA J. SPARROW** <sup>(1) \*</sup>*Director*

President

Sparrow Holdings Ltd.

Calgary, Alberta

**ROBERT C. WILLIAMS** <sup>(2\*)</sup>*Lead Director*

Managing Director

Equity Capital Markets/Syndication

Scotia Capital Inc.

Toronto, Ontario

**LEONARD A. CORNEZ***Officer of the Corporation*

Vice-President and

Chief Financial Officer

Calgary, Alberta

**THOMAS D. GAMBLE***Officer of the Corporation*

Vice-President

U.S. &amp; Latin American Operations

Houston, Texas

**J. BLAIR GOERTZEN***Officer of the Corporation*

Executive Vice-President and

Chief Operating Officer

Red Deer, Alberta

**WILLIAM A. MOORE***Officer of the Corporation*

Vice-President

Mechanical Service

Calgary, Alberta

**KELLY R. SMITH***Officer of the Corporation*

Vice-President

Production &amp; Processing

Edmonton, Alberta

**YVES J. TREMBLAY***Officer of the Corporation*

Vice-President

Syntech

Calgary, Alberta

**SEAN R. ULMER***Officer of the Corporation*

Vice-President

Leasing

Calgary, Alberta

*(1) Audit Committee**(2) Corporate Governance Committee**(3) Human Resources and Compensation Committee**\* Denotes Chairman of the Committee**\* Not returning to the Board in 2005*

## CORPORATE OFFICE

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Canada T2B 3R1

Tel: 1.403.236.6800

Fax: 1.403.236.6816

Email: [ir@enerflex.com](mailto:ir@enerflex.com)Website: [www.enerflex.com](http://www.enerflex.com)



## SHAREHOLDER INFORMATION

### Shares

The common shares of the Company are listed and traded on the Toronto Stock Exchange under the share symbol "EFX". The Company is a constituent of the S&P/TSX Composite Index.

### Registrar and Transfer Agent

Computershare Trust Company of Canada  
600, 530 8 Avenue SW  
Calgary, Alberta T2P 3S8  
Tel: 1.800.564.6253  
Dir: 1.403.267.6555  
Fax: 1.403.267.6592

Internet: [www.computershare.com](http://www.computershare.com)  
Email: [service@computershare.com](mailto:service@computershare.com)

All questions about accounts, stock certificates or dividend cheques should be directed to the Registrar and Transfer Agent.

### Auditors

Deloitte & Touche LLP  
Calgary, Alberta

### Bankers

Canadian Imperial Bank of Commerce  
HSBC Bank Canada  
Calgary, Alberta

### Solicitors

Bennett Jones LLP  
Calgary, Alberta

### Investor Information

Requests for the Company's Annual Report, Quarterly Reports and other corporate communications should be directed to:

Investor Relations  
Enerflex Systems Ltd.  
4700 47 Street S.E.  
Calgary, Alberta T2B 3R1  
Tel: 1.403.236.6800  
Email: [ir@enerflex.com](mailto:ir@enerflex.com)

### Shares Held in Nominee Name

To ensure that shareholders whose shares are not held in their name receive all Company reports and releases on a timely basis, a direct mailing list is maintained by the Company. If you would like your name to be added to this list, please forward your request to Investor Relations at Enerflex.







