ASHLAND OIL CANADA LIMITED

Annual Report 1978

ASHLAND OIL CANADA LIMITED

Registered head office

1800 Standard Life Building,
639 - 5th Avenue S.W.,
Calgary, Alberta T2P 0N1

Registrars and transfer agents of common shares

Guaranty Trust Company of Canada:
Calgary, Toronto, Montreal, Winnipeg, Regina and Vancouver

Bank of New York:
New York, N.Y.

Trustees of $10^{3}/_{8}\%$ sinking fund debentures, due 1996

Montreal Trust Company:
Montreal, Toronto, Winnipeg, Calgary and Vancouver

Annual general meeting

The Annual General Meeting of shareholders of Ashland Oil Canada Limited will be held on Friday, March 23rd, 1979 at 8:00 a.m. at the Calgary Inn, Calgary, Alberta.

Annual report on form 10-K

The Company will, upon written request, provide free of charge to each person who is a beneficial shareholder, a copy of the most recent Annual Report on Form 10-K filed by the Company with the United States Securities and Exchange Commission, including the financial statement and schedules thereto. Requests for a copy of this report should be directed to the Secretary, Ashland Oil Canada Limited, 639 Fifth Avenue S.W., Calgary, Alberta, Canada, T2P 0N1.

Unless otherwise indicated, all dollar figures herein are stated in Canadian dollars.

ANNUAL REPORT 1978

CONTENTS

REPORT OF THE DIRECTORS

Ashland Canada, in the fiscal year ended September 30, 1978, recorded net income before extraordinary items, of $30 million, a 36% increase over fiscal 1977 earnings of $22 million.

Highlights of the year's results are summarized below:

	Year ended September 30		
	1978	1977	% Change
Financial Data	in thousands		
Net income before extraordinary items	**$30,358**	$22,398	+36
Net income	**29,143**	22,398	+30
Cash flow	**51,482**	46,171	+12
Capital expenditures — net	**45,112**	51,831	−13
	per share		
Net income per common share	**$2.20**	$1.73	+27
Operating Data			
Average daily production			
Crude oil and ngl — thousand barrels per day	**25.2**	22.4	+12
Natural gas — million cubic feet per day	**66.3**	64.1	+ 3

	At September 30	
	1978	1977
Proven and probable reserves		
Oil and gas equivalent — million barrels	**230.0**	230.2
Petroleum and natural gas rights		
Gross acres — thousands	**13,833**	14,212
Net acres — thousands	**3,867**	3,796

The significant improvement in net income in fiscal 1978 was generated in oil & gas operations, as a result of increases in production volumes and in crude oil and natural gas prices. Earnings from other segments, asphalt paving & materials, and chemical & petroleum products, declined slightly in the year. Cash settlements on cancellation of employee stock options, net of a gain on disposal of shares and income tax, gave rise to an extraordinary cost of $1,215,000.

Outstanding Securities

During the fiscal year ended September 30, 1978 1,027,516 common shares of the Company were issued on conversion of $14,119,000 of 5% convertible subordinated debentures, on exercise of employees' stock options, and on conversion of 55,942 6% cumulative redeemable convertible preferred shares.

On November 22, 1977 the Company called the 6% cumulative redeemable convertible preferred shares for redemption, effective December 22, 1977.

On September 1, 1978, $2 cumulative redeemable preferred shares of Canadian Ashland Exploration Ltd., a subsidiary of the Company, were called for redemption, effective October 6, 1978.

On October 4, 1978 the Company called the 5% convertible subordinated debentures for redemption, effective November 6, 1978.

Change in Control

Pursuant to an agreement (the "Agreement") entered into on July 12, 1978 between Ashland Oil, Inc. and Kaiser Resources Ltd., a company incorporated under the laws of the Province of British Columbia, on October 3, 1978 Ashland Oil, Inc. sold to Kaiser Resources Ltd. 10,990,462 of Ashland Canada's common shares for a total cash purchase price of $368,180,477, being $33.50 per share. The common shares purchased by Kaiser Resources Ltd. represented approximately 79% of the Ashland Canada common shares then outstanding.

On October 3, 1978 following completion of the purchase by Kaiser Resources Ltd. of common shares from Ashland Oil, Inc., Vernon Van Sant, Jr. resigned as President and Chief Executive Officer and as a director of Ashland Canada; and the four members of the board of directors who were senior officers of Ashland Oil, Inc. resigned as directors of Ashland Canada. The remaining directors then appointed the following new directors: Edgar F. Kaiser, Jr., Chairman and Chief Executive Officer of Kaiser Resources Ltd.; Graham R. Dawson, President of Dawson Construction Limited and Vice-Chairman of Kaiser Resources Ltd.; Howard E. Cadinha, Executive Vice-President, Finance and Administration of Kaiser Resources Ltd.; and Christopher H. Hebb, Vice-President, General Counsel and Secretary of Kaiser Resources Ltd. In addition, Edgar F. Kaiser, Jr. was elected Chairman of the Board and Chief Executive Officer of Ashland Canada; William J. Whelan (formerly Executive Vice President) was elected President; Colin M. Evans and Lawrence G. Link (formerly Senior Vice Presidents) were elected Executive Vice Presidents.

The Agreement provided that as soon as practicable after the purchase of the common shares from Ashland Oil, Inc., Kaiser Resources Ltd. would make an offer for the Company's remaining common shares. On November 9, 1978, Kaiser Resources Ltd. made an offer to purchase at a price of $33.50 per share, the same price paid to Ashland Oil, Inc., all of the Ashland Canada outstanding common shares not already owned by Kaiser. This offer expires on March 9, 1979. Kaiser's objective in making the offer is to acquire all of the common shares so that Ashland Canada will become, directly or indirectly, a wholly-owned subsidiary of Kaiser Resources Ltd. As a result of the offer, Kaiser Resources Ltd. had purchased, as of January 31, 1979, an additional 3,056,294 shares of Ashland Canada, and, as of January 31, 1979, Kaiser Resources Ltd. held 14,046,756 shares (98.2% of those outstanding).

On November 2, 1978 the Company changed its fiscal year end to December 31 to conform with the fiscal year end of Kaiser Resources Ltd. On December 1, 1978, Touche Ross & Co. were appointed by the Board of Directors as auditors of the Company for the fiscal period October 1, 1978 to December 31, 1978.

Sale of Chemical and Petroleum Product Operations

The Agreement also provided that, subject to approval of Ashland Canada's board of directors, Ashland Oil, Inc. and/or one or more of its wholly-owned subsidiaries would purchase the Ashland Canada chemical and petroleum product marketing operations. The cash purchase price was to be the net book value of those operations as at the date of purchase, and the purchaser was to assume all of the liabilities and obligations relating to these operations. Ashland Canada entered into an agreement for the sale of these operations with Valvoline Oil & Chemicals Ltd., an Alberta corporation wholly-owned by Ashland Oil, Inc. On September 29, 1978 the sale was completed, and the final adjusted cash purchase price was $26,834,302, being the difference between the book value of the operations (approximately $31 million) and the book value of the liabilities related thereto (approximately $4 million).

Eventful Year

In retrospect, 1978 was a most eventful year for the Company and its employees. Considerable progress was made in operations, while a smooth transition was effected in the change of company control. The Company's staff are to be congratulated on their accomplishments, and the Directors express their appreciation for the manner in which employees continue to carry out their responsibilities efficiently and effectively.

Edgar F. Kaiser, Jr. Chairman & Chief Executive Officer	W. J. Whelan President

January 31, 1979

OIL & GAS OPERATIONS

The oil & gas exploration and production operations, headquartered at Calgary, are conducted principally through a wholly-owned subsidiary, Kaiser Oil Ltd. (formerly Ashland Oil & Gas Limited).

The Company's production of crude oil and natural gas liquids (''ngl'') averaged 25,200 barrels per day in fiscal 1978, while natural gas production averaged 66.3 million cubic feet per day.

Oil & Gas Production

	1978	1977
Crude oil and ngl (barrels)		
Annual production	**9,188,000**	8,191,000
Daily production	**25,200**	22,400
Natural gas (thousands of cubic feet)		
Annual production	**24,213,000**	23,391,000
Daily production	**66,300**	64,100

During the year, Ashland Canada made substantial additions to natural gas reserves. On a combined basis, with natural gas converted at a ratio of 8,000 cubic feet of gas to one barrel of oil, the total oil-equivalent reserves remained virtually unchanged in the year.

Oil & Gas Reserves
Proven developed and probable additional reserves

	Oil	**Gas**	**Total oil equivalent**
	Million barrels	Billion cubic feet	Million barrels
September 30, 1977	153.2	615.7	230.2
1978 additions	0.8	89.4	12.0
	154.0	705.1	242.2
1978 production	(9.2)	(24.2)	(12.2)
September 30, 1978	144.8	680.9	230.0

Reserves by category	September 30	
	1978	1977
Crude oil and ngl — million barrels		
proven developed	**91.2**	97.0
probable additional	**53.6**	56.2
	144.8	153.2
Natural gas — billion cubic feet		
proven developed	**558.8**	494.8
probable additional	**122.1**	120.9
	680.9	615.7

The Company conducted an active drilling program in 1978 and continues to acquire and maintain extensive holdings of petroleum and natural gas rights.

Canadian Drilling Activity — 1978

	Gross	Net	Success Ratio (Net)
Exploratory wells			
Oil	7	3.2	
Gas	37	13.2	
Abandoned	20	8.5	
	64	24.9	66%
Development wells			
Oil	20	10.8	
Gas	159	60.2	
Abandoned	6	3.1	
	185	74.1	96%
Total	249	99.0	88%

In addition to the above working-interest wells, 60 wells were drilled by others on Company lands under farm-out arrangements, at no cost to the Company.

Petroleum & Natural Gas Rights — September 30, 1978

	Gross acres	Net acres
Traditional areas:		
Alberta	4,708,220	2,056,387
British Columbia	594,167	226,604
Saskatchewan	219,850	139,042
Manitoba and Ontario	19,927	14,919
Frontier areas:		
Northwest Territories	1,554,558	216,805
Arctic Islands	3,687,650	205,324
East Coast Offshore	2,005,933	446,141
Fee mineral titles:		
Saskatchewan	400,373	197,795
Manitoba	642,000	363,690
Total holdings	13,832,678	3,866,707

Exploration Activity

In the Jeans-Fireweed area of British Columbia, the Company conducted a drilling program through 1978 to develop gas reserves and production on an approximate 10,000 acre block of leases. The drilling success ratio has been attractive, but construction and marketing problems have hindered bringing gas onstream in significant volumes in 1978. In the same area, the Company made an oil discovery. Further exploitation work will be commenced in 1979 to establish the extent of this reserve.

During 1978, the Company increased its holdings of petroleum & natural gas rights in the Elmworth gas trend area of Alberta-British Columbia. Significant investments were made in the acquisition of rights in permit and reservation form in the British Columbia sector of the trend. Exploration drilling and geophysical activity will be pursued on these lands in the 1978-79 winter period. In the Gold Creek-Musreau Lake sector of the trend in Alberta, one exploratory well was completed as a gas well in early 1978, and a multi-well exploration program is planned for the 1978-79 winter drilling season. Additional land interests in this area were acquired in the latter part of 1978.

In the West Pembina Nisku reef trend in Alberta, significant investments were made in purchasing selected Crown acreage parcels evaluated through seismic techniques as having potential for significant oil reserves. These parcels remain to be tested by drilling. The Company retains interests in a number of attractive leases adjacent to Nisku reef discoveries made by others in the industry, and the Company will maintain a selective exploratory program in this extremely competitive area.

In the Limestone Mountain area of Alberta, the location of a deep gas discovery in 1975, the Company has interests which vary from 20% to 50% in 20,080 net acres. The joint venture operator is planning a gas gathering system for the field. Participation is planned in at least two more exploratory tests in the Limestone Mountain structure.

The Company continued exploration drilling in the Majorville area of southern Alberta to evaluate gas and oil potential over a large block of leases. Two small oil pools were discovered by the Company in 1974-75; further drilling has not encountered additional oil reserves of significance, but the Company continues to add to proven and probable gas reserves from shallower secondary horizons.

Development Activity

The combination of gas price increases, exploration drilling incentives and energy conservation measures has resulted in a significant increase in new gas reserves being developed by the Canadian industry, particularly in Alberta. The increase in gas reserves, coupled with a decline in market growth, resulted in a gas oversupply situation in 1978, and virtually no new gas sales contracts were available to producers during the year.

In 1978, the Company concentrated its gas development efforts in optimizing those gas production properties presently under contract, while the exploration program was limited to selected areas with potential for new gas reserves.

A project to produce gas cap reserves and to maintain pressure in the oil zone was completed at the Cherhill Banff "A" Pool in 1978. The effect of this will be to increase cash flow by the production of gas cap reserves early in the life of the project and, at the same time, optimize the rate of oil production. The Company has a 25% interest in and is operator of the project.

In Southern Alberta, at the Grand Forks Lower Mannville "D" Unit, in which the Company has an 82% interest, well stimulation work, larger capacity pumps and infill drilling have increased oil production capacity from 6,900 barrels per day to approximately 10,000 barrels per day. Water injection problems were encountered in late 1978 resulting in reduced oil production at year-end. Remedial work has been commenced to restore productive capability.

In September 1978, the Company agreed to participate in an experimental thermal recovery project in the Suffield area of Alberta. The project is being undertaken to evaluate the applicability of "insitu" combustion methods for the recovery of heavy crude oil in association with an aquifer. The project will be located in a small portion of the Jenner Mannville "J" Pool and will be operated by Alberta Energy Company. Ashland Canada has a 12.5 per cent interest in the project. The pool is similar to several pools operated by the Company in the area, which contain heavy crude oil underlain by an aquifer. Valuable experience in thermal recovery should be gained from the Suffield experiment.

Through a wholly-owned subsidiary, the Company owns a 1.4% interest in Blocks 16-3 and 16-7 and a 1.75% interest in Block 16-2 in the United Kingdom North Sea. A discovery on Block 16-7 has been named the Brae Field. Since the Company acquired its interest, five exploratory wells have been drilled as dry holes or have been deemed to be non-commercial. However, Brae #8, drilled in 1977, encountered a significant oil column in the south sector of Block 16-7. Delineation drilling of four additional wells surrounding the Brae #8 discovery indicates a major accumulation, estimated at 225 million barrels. This accumulation is proposed for development to include a 30-36 slot production platform facility. The objective is to bring the reserve onstream by 1984. Feasibility studies are being conducted by the operator, and an application will be made to the British government for approval to proceed with the proposed Brae development.

ASPHALT PAVING & MATERIALS

The Company's Asphalt Paving & Materials operations, headquartered in Toronto, are geographically dispersed, with five regional offices covering seven provinces. Operations in the regions are performed by 20 wholly-owned subsidiaries, active in 40 major urban centres. The broad geographical diversification has been an underlying strength.

The operations include asphaltic concrete paving, road construction, installation of municipal services, production and sale of asphaltic concrete and granular materials, and some bridge and related construction. The Company owns 46 asphalt batching plants and 25 crushing units in Nova Scotia, New Brunswick, Prince Edward Island, Quebec, Ontario, Alberta and British Columbia.

Supplies of aggregate materials (sand, gravel and stone) are generally obtained from sources owned or leased. The Company's reserves of 233 million tons of aggregate materials are contained in approximately 9,600 acres of land owned by the Company. Additional leased properties contain approximately 22 million tons of aggregate materials. The Company also owns 722 acres of land for plant, shop and office sites.

Substantially all the Company's asphalt and construction activities result from successful competitive bidding on projects offered for public tender by Canadian federal, provincial and municipal governments, and by commercial and industrial enterprises. In 1978, total revenue increased to $126 million from $122 million in 1977. Because of reduced margins, operating profit declined slightly to $4.9 million from $5.0 million.

As of September 30, 1978, the backlog of contract work remaining to be completed was $34 million, as against $35 million at September 30, 1977.

CHEMICAL & PETROLEUM PRODUCTS

As described in the Report of the Directors, the Company sold its chemical and petroleum product marketing operations on September 29, 1978.

During 1978, revenue of these operations totalled $42 million, as against $37 million in 1977. Operating profit declined slightly to $556,000 in 1978, as compared with $609,000 in 1977. Chemical operations showed a marked improvement. However, this was more than offset by a decline in profit margins in the petroleum marketing operation.

SUMMARY OF OPERATIONS

	Year ended September 30,				
	1978	1977*	1976*	1975*	1974*
		in thousands, except per share data			
Revenue					
Sales and operating revenue	**$214,352**	$189,620	$163,410	$152,318	$127,340
Other income	**2,029**	1,763	1,681	1,369	1,499
	216,381	191,383	165,091	153,687	128,839
Cost and expenses					
Costs of sales and operating costs	**118,884**	113,963	104,301	99,732	87,741
Selling, administrative and general expenses	**13,872**	12,453	11,373	10,144	7,891
Depreciation, depletion and amortization	**20,484**	19,700	15,317	13,261	12,531
Interest	**4,122**	4,196	2,073	1,992	1,786
	157,362	150,312	133,064	125,129	109,949
Income before income taxes and other items	**59,019**	41,071	32,027	28,558	18,890
Income taxes					
Current	**27,300**	15,811	13,681	13,230	1,352
Deferred	**1,200**	2,768	2,455	479	8,172
	28,500	18,579	16,136	13,709	9,524
Income from continuing operations	**30,519**	22,492	15,891	14,849	9,366
Income from discontinued operations, net of applicable income taxes	**556**	609	48	857	1,396
Income before extraordinary items and minority interest	**31,075**	23,101	15,939	15,706	10,762
Extraordinary items, net of applicable income taxes	**(1,215)**	—	—	—	1,314
Income before minority interest	**29,860**	23,101	15,939	15,706	12,076
Interest of minority preferred shareholders in the net income of a subsidiary	**717**	703	703	704	704
Net income	**29,143**	22,398	15,236	15,002	11,372
Preferred dividend requirement	**41**	89	92	98	100
Net income applicable to common shares	**$ 29,102**	$ 22,309	$ 15,144	$ 14,904	$ 11,272
Net income per common share:					
Based on average shares outstanding					
Income before extraordinary items	**$ 2.29**	$ 1.73	$ 1.17	$ 1.16	$ .77
Extraordinary items	**(.09)**	—	—	—	.10
Net income — basic	**$ 2.20**	$ 1.73	$ 1.17	$ 1.16	$ .87
Based on average shares and equivalent shares outstanding					
Income before extraordinary items	**$ 2.15**	$ 1.60	$ 1.10	$ 1.09	$ .75
Extraordinary items	**(.08)**	—	—	—	.09
Net income — fully diluted	**$ 2.07**	$ 1.60	$ 1.10	$ 1.09	$ .84
Cash dividends per common share	**$ .30**	$ .25	$ .20	$ .50	$ —
Average shares outstanding	**13,235**	12,922	12,912	12,886	12,868
Average shares and equivalent shares outstanding	**14,307**	14,422	14,398	14,406	14,396

*Prior year figures are restated to show separately the income from discontinued operations.

MANAGEMENT'S ANALYSIS OF THE SUMMARY OF OPERATIONS

1978 Compared with 1977

The Company's operations in 1978 showed improvement over 1977 in revenue, net income and cash flow. Revenue increased 13% to $216.4 million, net income 30% to $29.1 million and cash flow 11% to $51.5 million.

The increase in revenue of $25 million was due, for the most part, to increases in prices and production of crude oil and prices and sales of natural gas. Crude oil prices increased 20% and natural gas prices increased 26%. Crude oil production increased 12% to 25.2 thousand barrels per day as a result of increased exports of heavy crude oil. Natural gas sales increased 3% to 66.3 million cubic feet per day.

The increase in other income was attributable to an increase in interest earned on short-term investments, partially offset by a decline in profit on the disposal of capital assets.

The Company's operating income before taxes increased 44% to $59 million during 1978. Oil and gas operations showed a 49% increase in operating income. Operating costs in relation to income showed a decline as a result of increased gas sales relative to overall sales. Operating profit also increased because of the effect of increased prices. Amortization of foreign exploration costs decreased due to decreased foreign exploration expenditures.

Changes in specific expense items as shown in the Summary of Operations are explained as follows:

Selling, administrative and general expenses increased $1.4 million due to the effect of inflation on expenses, salaries and wages and increased volume of business requiring staff expansion.

Depreciation, depletion and amortization expense increased $0.8 million due in part to increased production of crude oil and natural gas as shown above. Under the full cost accounting policy adopted by the Company for its oil and gas operations, the amortization of the traditional area pool of costs is directly related to production of proven reserves.

Income taxes increased by $9.9 million. The rate of tax relative to income before tax increased by comparison with the previous year. Note G to the Company's consolidated financial statement indicates the factors that had a bearing on the increase in the effective rate of income tax.

1977 Compared with 1976

The Company's operations in 1977 showed significant improvement over 1976 in revenue, net income and cash flow. Revenue increased 16% to $191.4 million, net income 47% to $22.4 million and cash flow 36% to $44.8 million.

The increase in revenue of $26.3 million was due, for the most part, to increases in prices and production of crude oil and prices and sales of natural gas. Crude oil prices increased 18% and natural gas prices increased 23%. Crude oil production increased 16% to 22.4 thousand barrels per day as a result of more favourable export treatment for heavy crude oil. Natural gas sales increased 40% to 64.1 million cubic feet per day as the result of the bringing into production of a number of projects developed in recent years.

Other income, while only marginally different, saw interest earned on short-term investments increase, offset by a decline in profit on the disposal of capital assets.

The Company's operating income before taxes increased 28% to $41.1 million during 1977.

Oil and gas operations showed a 58% increase in operating income. Operating costs in relation to income showed a decline as a result of increased gas sales relative to overall sales. Operating profit also increased because of the effect of increased prices. Foreign exploration costs were amortized in similar amounts in each year.

The asphalt paving and materials operations showed a decline of 20% in operating income. The main cause of the decline was very adverse weather conditions in most operating regions during the construction season.

Changes in specific expense items as shown in the Summary of Operations are explained as follows:

Selling, administrative and general expenses increased $1.1 million due to the effect of inflation on expenses, salaries and wages, increased volume of business and increased capital expenditures.

Depreciation, depletion and amortization expense increased $4.6 million due in part to the significantly higher level of capital expenditures which increased from $31.7 million to $51.8 million and to increased production of crude oil and natural gas as shown above. Under the full cost accounting policy adopted by the Company for its oil and gas operations, the amortization of the traditional area pool of costs is directly related to production of proven reserves.

Interest expense increased by $2.1 million. This increase arose from the issue of $30 million of $10^3/_8$% sinking fund debentures in November 1976, offset in part by the concurrent repayment of a $10 million unsecured income debenture.

Income taxes increased by \$2.4 million. However, the rate of the tax relative to income before tax declined by comparison with the previous year.

STOCK MARKET INFORMATION

The principal markets for the Company's common shares are the Toronto Stock Exchange ("TSE") and the American Stock Exchange ("ASE"). The following table sets forth the reported high and low sale prices of the Company's common shares on the TSE and ASE, and the dividends paid per share for the past two fiscal years.

	Common Share Prices				Dividends
	TSE		ASE		
	High	Low	High	Low	
	Canadian dollars		U.S. dollars		Canadian dollars
1977					
First Quarter	10 3/4	8 1/2	10 7/8	8 5/8	—
Second Quarter	12	10	11 3/4	9 1/2	.10
Third Quarter	12 3/4	10 5/8	12 1/8	10 1/8	—
Fourth Quarter	14 1/2	12	13 3/4	11 3/8	.15
1978					
First Quarter	19	13 3/8	17 1/8	12	—
Second Quarter	18	16	16 1/4	14 1/4	.15
Third Quarter	23 3/4	16 1/4	21 1/8	14 1/8	—
Fourth Quarter	32 5/8	23 1/2	28 3/8	20 5/8	.15

AUDITORS' REPORT

To the Shareholders
Ashland Oil Canada Limited

We have examined the consolidated balance sheet of Ashland Oil Canada Limited and subsidiaries as at September 30, 1978 and September 30, 1977 and the consolidated statements of income, retained earnings and changes in financial position for the years then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of Ashland Oil Canada Limited and subsidiaries as at September 30, 1978 and September 30, 1977 and the results of their operations and changes in financial position for the years then ended, in accordance with generally accepted accounting principles applied on a consistent basis.

Ernst & Ernst

Calgary, Alberta
November 2, 1978

Ernst & Ernst
Chartered Accountants

Consolidated Balance Sheet

Assets

	September 30 1978	September 30 1977
	(In thousands)	
Current Assets		
Cash and short-term notes	**$ 54,341**	$ 6,727
Accounts receivable	**61,249**	74,279
Asphalt paving contracts completed and in progress	**7,036**	9,198
Inventories	**12,933**	16,316
Deposits and prepaid expenses	**2,814**	2,000
Total Current Assets	**138,373**	108,520
Investments and Other Assets		
Investments in other companies	**1,838**	1,854
Receivables, deposits and other assets	**3,999**	3,557
	5,837	5,411
Property and Equipment		
Petroleum, natural gas and mineral properties	**215,626**	185,313
Production equipment	**38,287**	34,499
Chemical and marketing	**—**	19,678
Asphalt paving	**72,837**	66,247
Other	**3,822**	2,748
	330,572	308,485
Less allowances for depreciation and depletion	**127,839**	112,102
	202,733	196,383
	$346,943	$310,314

See accompanying notes to consolidated financial statement.

Liabilities and Shareholders' Equity

	September 30 1978	September 30 1977
	(In thousands)	
Current Liabilities		
Bank indebtedness	**$ 1,144**	$ 755
Accounts payable and accrued liabilities	**51,463**	52,266
Crude oil export taxes	**1,704**	7,068
Income taxes payable	**32,032**	17,376
Accrued minority dividends	**197**	176
Current maturities of long-term debt	**102**	125
Provision for redemption of minority interest in a subsidiary	**7,446**	—
Total Current Liabilities	**94,088**	77,766
Deferred Production Income	**2,323**	1,109
Long-Term Debt — less current maturities	**36,245**	50,268
Deferred Income Taxes	**50,611**	49,954
Minority Interest in Preferred Shares of a Subsidiary	**—**	7,032
Shareholders' Equity		
Share capital		
6% cumulative redeemable convertible preferred shares of a par value of $25 Authorized and issued 200,000 shares; outstanding — 1977 — 57,079 shares	**—**	1,427
Common shares of a par value of 45¢ Authorized 30,000,000 shares; issued and outstanding 14,175,937 shares (1977 — 13,148,421 shares)	**6,379**	5,917
Capital in excess of par value	**38,995**	23,433
Retained earnings	**119,793**	94,899
	165,167	125,676
Less cost of 215,683 common shares held by a subsidiary	**1,491**	1,491
Total Shareholders' Equity	**163,676**	124,185
	$346,943	$310,314

Approved by the Board on November 2, 1978:

W. J. Whelan, Director

H. E. Cadinha, Director

ASHLAND OIL CANADA LIMITED AND SUBSIDIARIES

Consolidated Statement of Income

	Year Ended September 30 1978	1977 (Restated)
	(In thousands)	
Revenue		
Sales and operating revenue*	**$214,352**	$189,620
Gain on disposal of assets	**585**	628
Other	**1,444**	1,135
	216,381	191,383
Costs and Expenses		
Cost of sales and operating costs	**118,884**	113,963
Selling, administrative and general expenses	**13,872**	12,453
Depreciation, depletion and amortization	**20,484**	19,700
Interest	**4,122**	4,196
	157,362	150,312
Income Before Income Taxes and Other Items	**59,019**	41,071
Income Taxes		
Current	**27,300**	15,811
Deferred	**1,200**	2,768
	28,500	18,579
Income From Continuing Operations	**30,519**	22,492
Income from discontinued operations, net of applicable income taxes	**556**	609
Income Before Extraordinary Items and Minority Interest	**31,075**	23,101
Extraordinary items, net of applicable income taxes	**1,215**	—
Income Before Minority Interest	**29,860**	23,101
Interest of minority preferred shareholders in the net income of a subsidiary	**717**	703
Net Income for the Year	**$ 29,143**	$ 22,398
Net income per common share before extraordinary items	**$ 2.29**	$ 1.73
Net income per common share after extraordinary items	**$ 2.20**	$ 1.73

*Excludes royalties, excise taxes and resale of purchased crude oil.

Consolidated Statement of Retained Earnings

	1978	1977
Retained earnings beginning of year	**$ 94,899**	$ 75,814
Net income for the year	**29,143**	22,398
	124,042	98,212
Dividends		
Common shares	**4,062**	3,224
6% preferred shares	**41**	89
Premium on redemption of minority interest in a subsidiary	**146**	—
	4,249	3,313
Retained Earnings End of Year	**$119,793**	$ 94,899

See accompanying notes to consolidated financial statement.

ASHLAND OIL CANADA LIMITED AND SUBSIDIARIES

Consolidated Statement of Changes in Financial Position

	Year Ended September 30 1978	1977
	(In thousands)	
Working Capital was Provided From		
Net income	**$ 29,143**	$ 22,398
Depreciation, depletion and amortization	**21,682**	20,861
Deferred income taxes	**657**	2,912
Provided From Operations	**51,482**	46,171
Issue of common shares	**16,024**	104
Less amount related to conversion of 5% debentures and 6% preferred shares.	**(15,262)**	—
	762	104
Proceeds from disposal of fixed assets used in discontinued operations	**17,252**	—
Property and equipment disposals	**1,823**	389
Deferred production income	**1,214**	1,109
Issue of long-term debt	**188**	30,000
Increase in minority interest	**268**	—
Total Working Capital Provided	**72,989**	77,773
Working Capital was Used For		
Property and equipment additions	**46,935**	42,825
Net non-current assets of business acquired	**—**	9,395
Reduction of long-term debt	**92**	10,125
Dividends	**4,103**	3,313
Provision for redemption of minority interest in a subsidiary	**7,446**	—
Investments, notes receivable and other items	**882**	1,225
Total Working Capital Used	**59,458**	66,883
Increase in Working Capital	**$ 13,531**	$ 10,890
Changes in Components of Working Capital		
Increase (decrease) in current assets		
Cash and short-term notes	**$ 47,614**	$ 3,577
Accounts receivable	**(13,030)**	9,597
Asphalt paving contracts completed and in progress	**(2,162)**	2,258
Inventories	**(3,383)**	247
Deposits and prepaid expenses	**814**	320
Increase in Current Assets	**29,853**	15,999
Increase (decrease) in current liabilities		
Bank indebtedness	**389**	(9,485)
Accounts payable and accrued liabilities	**(803)**	6,555
Crude oil export taxes	**(5,364)**	845
Income taxes payable	**14,656**	7,764
Current maturities of long-term debt	**(23)**	(570)
Minority dividends	**21**	—
Provision for redemption of minority interest in a subsidiary	**7,446**	—
Increase in Current Liabilities	**16,322**	5,109
Increase in Working Capital	**$ 13,531**	$ 10,890

See accompanying notes to consolidated financial statement

ASHLAND OIL CANADA LIMITED AND SUBSIDIARIES

Notes to Consolidated Financial Statement

September 30, 1978 and September 30, 1977

Note A — Accounting Policies

The following information summarizes the significant accounting policies of the Companies.

Principles of Consolidation: The consolidated financial statement includes the accounts of the Company and all domestic and foreign subsidiary companies.

The current assets and all liabilities of the foreign subsidiaries have been translated into Canadian dollars at the exchange rate prevailing at the end of the fiscal year. Long-term assets have been translated at historical rates. The exchange adjustment is included in the statement of income.

The minority interest in preferred shares of a subsidiary company together with dividends thereon accrued from the date of the last semi-annual dividend payment are provided for on consolidation. By resolution dated August 25, 1978 the minority preferred shares were called for redemption on October 6, 1978.

Inventories: Inventories are stated at cost as determined under the first-in, first-out or average cost methods. The aggregate of such inventories is not in excess of market.

Petroleum, Natural Gas and Mineral Properties: For all oil and gas activities, both domestic and foreign, the Companies follow the full cost method of accounting, whereby all costs relative to the exploration for and development of petroleum and natural gas reserves are capitalized. Such costs include lease acquisition costs, geological and geophysical costs, carrying charges on non-producing properties and costs of drilling both productive and non-productive wells less any proceeds from the disposal of properties.

The net costs incurred in Canada, except as noted in the following paragraph, are depleted by the unit of production method based on estimated proven oil and gas reserves.

Separate full cost centres are maintained for the Arctic Islands, Northwest Territories and East Coast Offshore areas of Canada. Net costs incurred in each of these areas are amortized on a straight line basis over five years. Should exploration activity in an area prove successful, the unamortized balance of the cost centre will be depleted by the unit of production method. Should exploration activity in an area prove unsuccessful and management decides that there is little prospect for further work in the area, the unamortized balance of the cost centre will be written off entirely.

Separate full cost centres are established for each foreign country in which the Companies are engaged in exploration activities. Such costs are amortized over varying periods (not exceeding five years) during which exploration activities are expected to continue.

Equipment and Other Property: All equipment and other property is carried at cost. Petroleum and natural gas production equipment is depreciated by the unit of production method. Other equipment and property is depreciated generally on a straight line basis over estimated useful life at rates varying from 4% to 30%.

Maintenance and repairs are charged to income at the time the expenditures are made. Expenditures for betterments are capitalized.

At the time the Companies retire or otherwise dispose of equipment or other property, the cost of the asset and the related allowance for depletion or depreciation is removed from the respective accounts. Gain or loss on disposals is included in income.

Income Taxes: The Companies follow the tax allocation method of accounting whereby the income tax provision is based on reported net income. Under this method the Companies make full provision for income taxes deferred as a result of claiming capital cost allowances and exploration and development costs in excess of the related depreciation, depletion and amortization provisions recorded in the accounts.

The Companies make full provision for income taxes relating to net holdbacks and unbilled work in progress, while actual payment of such taxes is related to the realization of these amounts.

Investment tax credits and earned depletion benefits are accounted for as a reduction of current income taxes.

Net Income Per Common Share: Net income per common share is based on the weighted average number of common shares outstanding during each year after providing for dividends on the 6% cumulative redeemable convertible preferred shares. Fully diluted net income per share is calculated on the assumptions that: (i) the 6% cumulative redeemable convertible preferred shares were converted at the beginning of the year; (ii) the 5% convertible subordinated debentures were converted at the beginning of the year and, (iii) the employee stock options were exercised at the beginning of the year and interest was earned on the proceeds.

Other Accounting Policies: Income (including holdbacks) from asphalt paving contracts is recognized on the basis of actual work completed in the fiscal period.

The Company purchases crude oil from other producers for resale to refiners along with its own crude oil production. Crude oil purchases are offset against crude oil sales thus excluding such transactions from both revenues and costs. The tax collected and remitted to the Federal Government on exports of crude oil is also excluded from revenues and costs.

Long-term investments in other companies are carried at cost less an appropriate provision where there has been a decline in value.

Long-term debt discount and expenses of issue are amortized over the terms of the respective issues.

Note B — Amounts Owing by Ashland Oil, Inc.

Accounts receivable include $1,156,000 ($22,823,000 in 1977) receivable from the sale of purchased and produced crude oil to Ashland Oil, Inc.

Note C — Inventories

Inventories at September 30, 1978 and 1977 consisted of the following:

	1978	1977
Asphalt paving materials	**$ 9,104,000**	$ 8,900,000
Crude oil	**2,669,000**	1,740,000
Plastics, resins and chemicals	**—**	3,397,000
Refined and semi-refined products	**—**	1,049,000
Other operating supplies	**1,160,000**	1,230,000
	$12,933,000	$16,316,000

Note D — Long-Term Debt

The long-term debt consists of:

	1978	1977
$10^3/_8$% sinking fund debentures due November 1, 1996	**$30,000,000**	$30,000,000
5% convertible subordinated debentures due January 15, 1993	**5,783,000**	19,902,000
Other notes and mortgages	**564,000**	491,000
	36,347,000	50,393,000
Less current maturities included in current liabilities	**102,000**	125,000
	$36,245,000	$50,268,000

The 5% convertible subordinated debentures are convertible into common shares of the Company at the rate of 60 shares per $1,000 principal amount until January 14, 1983 and are subject to sinking fund provisions commencing January 15, 1984. See Note N.

The amounts of long-term debt due during the four years following September 30, 1979 are: 1980 — $103,000; 1981 — $69,000; 1982 — $66,000; and 1983 — $47,000.

Current amortization of long-term debt discount and expenses of issue amounting to $67,000 (1977 — $67,000) is included in interest expense. The unamortized balance at September 30, 1978 amounted to $910,000 (1977 — $1,232,000). Unamortized expenses of issue of $256,000 relating to 5% convertible debentures which were converted during 1978 have been charged to capital in excess of par value.

Note E — Shareholders' Equity

Changes in the Company's share capital and capital in excess of par value during the two years ended September 30, 1978 are as follows:

	Number of Shares	Par Value	Capital in Excess of Par Value
6% cumulative redeemable convertible preferred shares			
September 30, 1976	60,244	$ 1,506,000	
Converted to common shares	(3,165)	(79,000)	
September 30, 1977	57,079	1,427,000	
Converted to common shares	(55,942)	(1,399,000)	
Redeemed	(1,137)	(28,000)	
September 30, 1978	—	$ —	
Common shares			
September 30, 1976	13,132,837	$ 5,910,000	$23,258,000
Issued for cash on exercise of employee stock options	9,300	4,000	99,000
Issued on the conversion of preferred shares	6,284	3,000	76,000
September 30, 1977	13,148,421	5,917,000	23,433,000
Issued for cash on exercise of employee stock options	69,383	31,000	731,000
Issued on the conversion of preferred shares	110,993	50,000	1,349,000
Issued on conversion of 5% convertible debentures	847,140	381,000	13,482,000
September 30, 1978	14,175,937	$ 6,379,000	$38,995,000

At September 30, 1978 and 1977 common shares of the Company were reserved as follows:

	1978	1977
Shares for the conversion of 5% convertible subordinated debentures	346,980	1,194,120
Shares for the conversion of 6% cumulative redeemable convertible preferred shares	—	113,432
Shares under employee stock options — Note F	—	192,103
Shares reserved for additional employee stock options which may be granted	—	71,200
	346,980	1,570,855

Note F — Employee Stock Options

Under an agreement dated July 11, 1978 Kaiser Resources Ltd. acquired effective control of the Company from Ashland Oil, Inc. Pursuant to that agreement the Company was required to (i) make an offer to each of its employees who held an employee stock option to obtain the cancellation of such option upon the payment by the Company to such employee of an amount per share covered by such option equal to the difference between the exercise price per share under such option and $33.50 per share and (ii) upon the request of any such employee, to the extent such employee's options may not be exercisable by its terms, amend such terms so that the option shall become immediately exercisable.

The Board of Directors of the Company has made the required amendment to the stock option plan, and the Company has obtained written consent of all holders of employee stock options to the cancellation of their options. Provision for the required payments in the aggregate amount of $2,772,000 has been made in the financial statement. Subsequently, the Board cancelled the Preferred Employees Stock Option Plan.

Changes in the number of common shares under option during the two years ended September 30, 1978 were as follows:

	1978	1977
Outstanding, beginning of year	**192,103**	171,953
Granted at $10.75	**—**	38,000
Exercised at $6.75 to $12.00	**(69,383)**	(9,300)
Cancelled	**(122,720)**	(8,550)
Outstanding, end of year	**—**	192,103

Note G — Income Taxes

Income tax provisions on income from continuing operations amounted to $28,500,000 (48.3%) in 1978 and $18,579,000 (45.3%) in 1977. A reconciliation of these effective rates with the normal combined Canadian Federal and Provincial tax rates is as follows:

	Percentage of Income Before Income Taxes	
	1978	1977
Normal combined Canadian Federal and Provincial tax rates	**48.0%**	48.0%
Increase (decrease) resulting from:		
Inclusion of royalties and other payment to the Crown in taxable income	**36.8**	36.4
Federal resource allowance	**(23.9)**	(23.5)
Provincial rebates	**(5.3)**	(5.2)
Depletion allowance	**(6.5)**	(10.5)
Other items	**(.8)**	.1
Effective Federal and Provincial tax rates	**48.3%**	45.3%

The provision for income taxes currently payable includes $6,138,000 ($6,654,000 in 1977) which becomes payable only after net holdbacks and unbilled work in progress are realized.

Note H — Lease Commitments

At September 30, 1978 the Companies were committed under non-cancellable leases for the following minimum annual rentals: 1979 — $635,000; 1980 — $693,000; 1981 — $913,000; 1982 — $1,013,000; 1983 — $912,000; and 1984 to 1988 — $4,562,000.

Note I — Retirement Plans

The Company has retirement plans which cover substantially all employees. The contributions by employees, together with those made by the Company, are deposited with insurance companies and/or trustees according to the terms of the plans. Pensions at retirement are related to remuneration and years of service.

The plans were amended in 1978 to provide for increases in retirement benefits. The unfunded past service pension liability at December 31, 1977, after giving effect to the 1978 amendments, was approximately $1,709,000. The liability will be funded and charged to income over the next fourteen years.

Note J — Discontinued Operations

On September 29, 1978 the Company sold all of the assets less liabilities of its chemical and marketing operations to Ashland Oil, Inc., for a cash consideration equal to net book value. Operating results of the two years have been segregated from those of the ongoing operations of the Company. The following information relates to the discontinued operations.

	1978	1977
Sales and other income	**$42,436,000**	$36,682,000
Depreciation	**$ 1,131,000**	$ 1,094,000
Income taxes		
Current	**$ 983,000**	$ 419,000
Deferred	**(543,000)**	144,000
	$ 440,000	$ 563,000
Net income	**$ 556,000**	$ 609,000

Note K — Extraordinary Items

Payments to holders of employee stock options to obtain cancellation thereof — Note F	$ 2,772,000
Gain on disposal of the parent company's holdings of preferred shares of a subsidiary company	(405,000)
	2,367,000
Less net reduction in income taxes payable	1,152,000
	$ 1,215,000

Note L — Remuneration of Directors and Senior Officers

Direct remuneration of the Company's directors and senior officers for the year ended September 30, 1978 amounted to $1,035,000 (1977 — $884,000).

Note M — Earnings per Common Share

	1978	1977
Income from continuing operations	**$2.25**	$1.68
Income from discontinued operations	**.04**	.05
Extraordinary items	**(.09)**	—
Net income for year	**$2.20**	$1.73
Fully diluted earnings per share	**$2.07**	$1.60

Note N — Subsequent Events

On October 4, 1978 the Company gave notice that the 5% convertible subordinated debentures are to be redeemed on November 6, 1978 at the redemption price of 103.75% of the principal amount thereof. Holders of such debentures may exercise conversion privileges up to the close of business November 3, 1978.

Note O — Replacement Cost Information (Unaudited)

The Company has calculated the estimated replacement cost of the equivalent productive capacity of property, plant and equipment (excluding land and mineral resource assets which amount to approximately 77% of the total property, plant and equipment) and inventories together with the related effect on income. When the Company files its Form 10-K with the United States Securities and Exchange Commission it will contain the required replacement cost information.

FIVE YEAR REVIEW — BY INDUSTRY SEGMENT [1]

	Year ended September 30				
	1978	1977	1976	1975	1974
			in thousands		
Sales to Unaffiliated Customers [2]					
Oil & Gas	**$ 87,598**	$ 66,312	$ 45,991	$ 36,138	$ 31,984
Asphalt Paving & Materials	**125,970**	122,413	116,776	113,338	93,992
Chemical & Petroleum Products [3]	**42,436**	36,681	29,249	23,628	23,016
Other	**2,813**	2,652	2,332	3,142	2,146
	$258,817	$228,058	$194,348	$176,246	$151,138
Cash flow from operations					
Oil & Gas	**$ 48,375**	$ 37,572	$ 24,370	$ 18,425	$ 24,967
Asphalt Paving & Materials	**10,512**	9,814	11,363	11,468	7,482
Chemical & Petroleum Products	**1,145**	1,854	2,931	3,595	1,509
Unallocated items [4]	**(8,550)**	(3,069)	(2,746)	(1,980)	(1,531)
	$ 51,482	$ 46,171	$ 35,918	$ 31,508	$ 32,427
Operating profit [5]					
Oil & Gas	**$ 28,312**	$ 19,839	$ 11,232	$ 10,057	$ 8,092
Asphalt Paving & Materials	**4,915**	4,987	6,339	6,530	3,462
Chemical & Petroleum Products	**556**	616	48	857	1,346
Unallocated items [4]	**(4,640)**	(3,044)	(2,383)	(2,442)	(2,842)
	$ 29,143	$ 22,398	$ 15,236	$ 15,002	$ 10,058
Capital expenditures					
Oil & Gas	**$ 35,563**	$ 41,718	$ 22,533	$ 12,582	$ 20,343
Asphalt Paving & Materials	**7,827**	8,411	7,265	8,974	5,389
Chemical & Petroleum Products	**1,500**	1,660	1,744	11,671	2,028
Other	**222**	42	131	270	206
	$ 45,112	$ 51,831	$ 31,673	$ 33,497	$ 27,966
Identifiable assets					
Oil & Gas	**$188,955**	$158,273	$126,270	$117,780	$116,413
Asphalt Paving & Materials	**91,099**	87,743	77,533	76,362	67,632
Chemical & Petroleum Products	**31,652**	28,339	26,364	20,175	10,951
Other	**35,237**	35,959	31,953	42,190	33,758
	$346,943	$310,314	$262,120	$256,507	$228,754

(1) These figures have been taken from reports and records of the Company but have not been subjected to an independent audit.

(2) Sales from one of the Company's industry segments to another are insignificant and have been eliminated on consolidation.

(3) The Company sold its chemical and petroleum products marketing operations on September 29, 1978.

(4) Unallocated items include interest expense, corporate overhead, minority interest and other income (net of income tax).

(5) Operating profit is after income taxes but before unallocated overhead, interest and extraordinary items.

DIRECTORS

Edgar F. Kaiser, Jr.(1), Vancouver, British Columbia
Chairman of the Board, Chairman of the Executive Committee, Chief Executive Officer and President, Kaiser Resources Ltd.(3)

William J. Whelan(1), Calgary, Alberta
President, Ashland Oil Canada Limited

Howard E. Cadinha(2), Vancouver, British Columbia
Executive Vice-President, Finance and Administration, Kaiser Resources Ltd.(3)

Eric Connelly(1)(2), Calgary, Alberta
Chartered Accountant (self-employed)

Graham R. Dawson, Vancouver, British Columbia
President, Dawson Construction Ltd., a heavy construction company

Colin M. Evans, Calgary, Alberta
Executive Vice President, Oil & Gas, Ashland Oil Canada Limited

Christopher H. Hebb, Vancouver, British Columbia
Vice-President, General Counsel and Secretary, Kaiser Resources Ltd.(3)

Lawrence G. Link, Mississauga, Ontario
Executive Vice President; President, Asphalt Paving & Materials Division, Ashland Oil Canada Limited

James A. Millard(1)(2), Calgary, Alberta
Partner, MacKimmie Matthews, Barristers and Solicitors

Carl O. Nickle(1), Calgary, Alberta
President and Chief Executive Officer, Conventures Limited, an energy resources company

(1) Member of the Compensation Committee
(2) Member of the Audit Committee
(3) Kaiser Resources Ltd., a British Columbia corporation, is principally engaged in the extraction, processing and sale of metallurgical or coking coal and is the parent of Ashland Oil Canada Limited.

EXECUTIVE OFFICERS

Edgar F. Kaiser, Jr.
Chairman of the Board and Chief Executive Officer

William J. Whelan
President

Colin M. Evans
Executive Vice President, Oil & Gas

Lawrence G. Link
Executive Vice President; President Asphalt Paving & Materials Division

Joseph S. Irwin, Jr.
Vice President; General Manager Oil & Gas Division

Christopher H. Hebb
Secretary

Arthur R. Morison
Comptroller

G. Arnold Wright
Treasurer and Director of Administration

All Executive Officers are full time employees of Ashland Oil Canada Limited, with the exception of Edgar F. Kaiser, Jr. and Christopher H. Hebb (see "Directors").

lawson graphics western limited
PRINTED IN CANADA