# Interprovincial Pipe Line Limited

## Annual Report 1986

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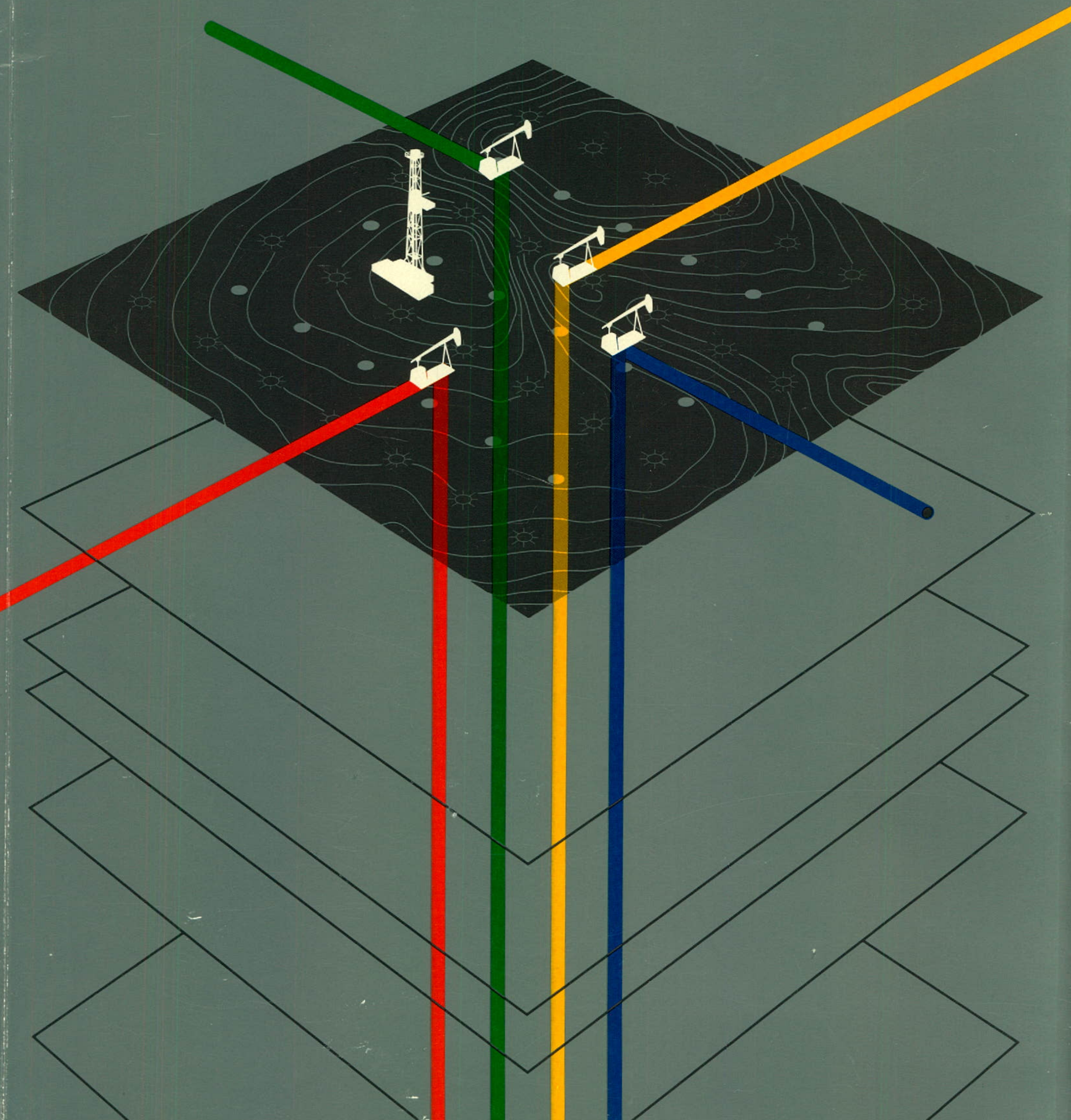
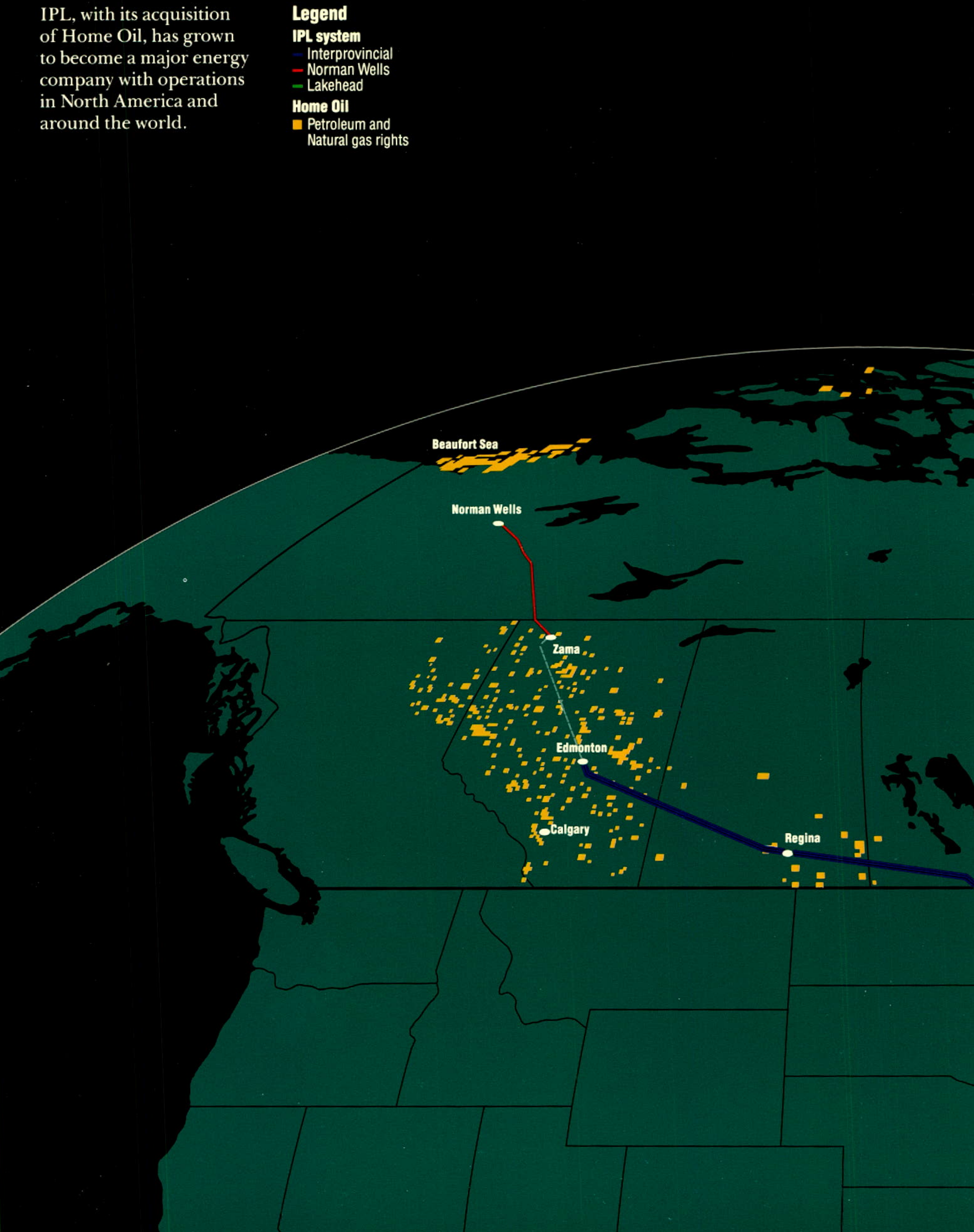



Worldwide interests of Home Oil


Superior
Montreal
Toronto
Buffalo
Sarnia
Chicago

# Operations

IPL, with its acquisition of Home Oil, has grown to become a major energy company with operations in North America and around the world.



# Interprovincial Pipe Line Limited

## Corporate profile

Interprovincial Pipe Line Limited ("IPL"), which commenced operations in 1950, is engaged in the business of transporting crude oil and other liquid hydrocarbons through a common carrier pipeline system.

The system extends from Edmonton, Alberta across the Canadian Prairies through the Great Lakes region of the United States to Toronto, Ontario and Montreal, Quebec. In 1985 the Norman Wells crude oil pipeline, which extends from Norman Wells in the Northwest Territories to Zama in northwestern Alberta, began transporting oil.

In December, 1986, IPL diversified into the upstream oil and gas sector with the acquisition of all of the shares of Home Oil Company Limited. Home is an exploration and production company with activities concentrated in Canada where it has been one of the most prominent players in Western Canada and has an established position in the Canadian frontier. Home is also active internationally with interests currently held in Australia, Indonesia, the United Kingdom, Colombia and Italy.

IPL has total assets approaching $3 billion, shareholders' equity of $924 million and employs 1,900 people. Its 11,000 shareholders own 39.5 million common shares. The Company's common stock is listed on the Toronto and Montreal Stock Exchanges under the symbol IPL.

## Annual meeting

The Annual Meeting of Shareholders is scheduled for Thursday, April 9, 1987, 2:30 p.m., in the Ballroom of the Royal York Hotel, 100 Front Street West, Toronto, Ontario, Canada.

The Notice of Meeting, Management Proxy Circular and Form of Proxy are being mailed with this report to all shareholders of record.

Shareholders are encouraged to complete and sign the enclosed Proxy and to attend the Annual Meeting.

## Contents



## Cover

**The process of bringing energy to the marketplace progresses from finding the deeply concealed resources to drilling for them, assessing their potential, developing a commercial well and delivering the oil or gas to markets...all activities in which IPL plays a prominent role.**

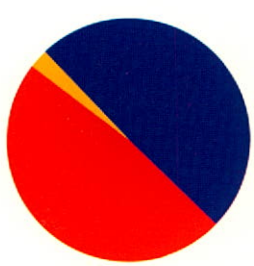
# Highlights

| | Year Ended December 31 | | |
|---|---|---|---|
| | **1986*** | 1985 | 1984 |
| **Financial** (in millions of $ except per share amounts) | | | |
| Operating revenue | **$561.8** | $509.4 | $444.4 |
| Expenses | **365.4** | 330.9 | 275.9 |
| Taxes | **111.9** | 105.8 | 104.3 |
| Earnings | **130.8** | 138.8 | 129.6 |
| per share | **3.36** | 3.71 | 3.47 |
| Dividends per share | **2.00** | 1.85 | 1.70 |
| Capital expenditures | **284.7** | 169.8 | 185.6 |
| Cash provided from operations | **233.4** | 186.8 | 164.4 |
| per share | **5.99** | 5.00 | 4.41 |
| **Operating** | | | |
| Deliveries (barrels per day) | **1,366,560** | 1,388,467 | 1,330,928 |
| Barrel miles (millions) | **665,724** | 698,262 | 708,488 |
| Average daily production/sales | | | |
| Crude oil and natural gas liquids (barrels) | **27,826** | 26,962 | 27,565 |
| Natural gas (thousands of cubic feet) | **112,884** | 113,467 | 108,283 |
| Proved reserves | | | |
| Crude oil and natural gas liquids (millions of barrels) | **107.7** | 108.2 | 104.9 |
| Natural gas (billions of cubic feet) | **949.2** | 956.8 | 950.7 |

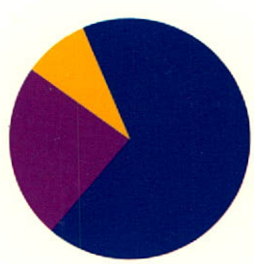
*The financial highlights reflect the acquisition of Home Oil Company Limited in early December.
Home's production/sales and proved reserves statistics have been provided for three years for comparative purposes.

| | | | |
|---|---|---|---|
| 1 barrel of oil | = .159 cubic metres ($m^3$) | 1 mile | = 1.61 kilometres (km) |
| 1 cubic foot of natural gas | = .028 cubic metres ($m^3$) | 1 acre | = .405 hectare (ha) |
| 1 foot | = .305 metres (m) | | |

**Capital employed at December 31, 1986**
($000,000)
Total capital employed
$2,676.7 (100%)
- Pipeline $1,319.7 (49.3%)
- Oil and gas $1,295.5 (48.4%)
- Working capital and other $61.5 (2.3%)



**Capital employed at December 31, 1985**
($000,000)
Total capital employed
$1,618.1 (100%)
- Pipeline $1,109.6 (68.6%)
- HWR $376.1 (23.2%)
- Working capital and other $132.4 (8.2%)



# Report to shareholders

**The long term outlook is positive. The more volatile oil and gas business provides higher rate of growth potential and complements the stability of pipeline operations. This combination ensures a solid base for future earnings growth and reinvestment opportunities.**

The year 1986 was one of significant achievement for IPL. The acquisition of Home Oil Company Limited ("Home") completed in December and the undertaking of a major pipeline expansion program represented principal accomplishments. The combination of these developments has substantially increased the size and complexity of the Company and assets are now approaching $3 billion.

Earnings in 1986 were $131 million or $3.36 per share compared with $139 million or $3.71 per share in 1985. Cash provided from operations amounted to $233 million or $5.99 per share in 1986 versus $187 million or $5.00 per share in 1985. Pipeline earnings improved modestly primarily due to a tariff increase in Canada. The increase in pipeline earnings, however, was offset by reduced income from the Company's investment in Hiram Walker Resources Ltd. ("HWR") and lower investment income. Earnings per share were based on the weighted average shares outstanding of 38.9 million in 1986 compared with 37.4 million in 1985.

The total dividend paid to shareholders in 1986 was $2.00 per share versus $1.85 paid in 1985.

The Report to Shareholders for the first quarter of 1986 outlined the transaction whereby Gulf Canada acquired a controlling interest in HWR. As a result Gulf acquired HWR's 34 percent interest in IPL and this, together with its initial 7 percent investment, makes Gulf the single largest shareholder of IPL. Imperial Oil's holdings remain unchanged at 22 percent and the balance of the shares are held publicly by some 11,000 shareholders.

In the past few years we have referred to our strategic objective to diversify beyond the pipeline business, specifically to pursue appropriate investments in the upstream oil and gas sector. The sharp decline in oil prices in 1986 provided a period of opportunity as the values of potential investments more closely reflected the lower prices of oil. The Company entered into extensive negotiations culminating with the announcement in July that IPL had reached an agreement in principle with HWR to purchase all of the outstanding shares of Home.

The cost of approximately $900 million was satisfied by the exchange of IPL's holdings of HWR, the issuance of oil indexed debentures in the amount of $200 million and a cash payment. The acquisition was completed in early December and accordingly there was no material impact on IPL's 1986 results. Home is a highly regarded oil and gas exploration and production company. Its activities are concentrated in Western Canada and the Canadian frontier where it has been one of the most active players. In addition, Home owns 88 percent of Scurry-Rainbow Oil Limited, a publicly traded Canadian company, 60 percent of Home Energy Company Ltd. (Australia) and a 26 percent interest in Sovereign Oil and Gas PLC (U.K.). The purchase did not include any oil and gas assets located in the U.S. With the Home acquisition IPL is now well positioned to participate in the medium to long term growth in the energy industry.

**Effective January 1, 1987, R.K. Heule (right) was appointed Chairman of the Board and R.F. Haskayne, President of Home Oil and an IPL director since 1983, became President and Chief Executive Officer.**

With respect to pipeline operations, system deliveries of crude oil and other liquid hydrocarbons averaged 1.4 million barrels per day, down slightly from 1985. Increased deliveries to Western Canada and the United States largely offset a decline in deliveries to Eastern Canada. As a result of deregulation of oil prices and increased volumes, particularly in heavy crudes, the pipeline system operated at capacity for most of 1986.

Currently IPL is in a period of rapid growth with major pipeline construction projects underway to meet the changing oil transportation requirements of the industry. The 1986 construction program, completed on time and under budget, placed the Company well along its three-phase expansion program begun in 1985.

In September IPL filed a rate application with the National Energy Board ("NEB") to update cost of service and rate of return based on a 1987 test year, and clarify certain rate design issues. The NEB recently completed a lengthy hearing on this matter and a decision is expected in the spring. Interim tolls were approved, effective January 1, 1987.

The outlook for 1987 earnings is uncertain. While pipeline operating earnings are forecast to remain relatively stable, the contribution from energy operations is dependent on oil and gas prices. In 1987, the inclusion of earnings from Home may not be sufficient to match acquisition financing costs and the 1986 investment earnings from HWR.

Home is well positioned for near term growth in the upstream sector and has an impressive inventory of economic exploration and development projects in Canada. A gradual expansion of international operations will be undertaken to provide exposure to different geological and economic environments.

The long term outlook is positive. The more volatile oil and gas business provides higher rate of growth potential and complements the stability of pipeline operations. This combination ensures a solid base for future earnings growth and reinvestment opportunities.

During 1986 M.A. Cohen, S.K. McWalter and G.I. Newman were appointed to the Board, replacing A.E. Downing, W.D.H. Gardiner and A.R. McCallum. In addition, P.A. Nadeau resigned from the Board. The advice and counsel of these retiring directors was much appreciated by the Company. The Board was saddened by the untimely death of Mr. Nadeau in January 1987.

Following the acquisition of Home it was decided to relocate the corporate offices of IPL from Toronto to Calgary in order to be more closely aligned with the oil and gas operations in Calgary and the pipeline operations in Edmonton.

In addition, a number of organizational changes occurred. R.K. Heule, formerly Chairman and Chief Executive Officer, was appointed Chairman of the Board and R.F. Haskayne, President of Home and a director of IPL since 1983, was appointed President and Chief Executive Officer. Principal corporate officers include B.F. MacNeill, Vice-President Finance and Chief Financial Officer; D.R. Martin, Vice-President Planning and Corporate Development; E.G. Sheasby, Vice-President Law; and K.A. McNeill, Vice-President Corporate Services. G.A. Cole was appointed Executive Vice-President and Chief Operating Officer of IPL's pipeline operations in Edmonton and D.E. Powell was appointed Executive Vice-President and Chief Operating Officer of Home's oil and gas operations in Calgary.

In summary, 1986 was an extremely busy year for IPL highlighted by the ongoing pipeline expansion program and the acquisition of Home. IPL's successes in these endeavours were the result of the dedication and skill of its employees. Their contribution and that of the Home employees is highly valued and sincerely appreciated. With strong financial and human resources, the Company is confident of its ability to continue to grow and achieve positive results for shareholders.

On behalf of the Board of Directors:

R.K. Heule

R. K. Heule,
Chairman

R.F. Haskayne

R. F. Haskayne,
President &
Chief Executive Officer

The pipeline expansion program is proceeding on time and under budget. When completed in late 1987, IPL will be well positioned to meet forecast demands and respond to future opportunities.

## Review of pipeline operations

### Deliveries

System deliveries of crude oil and other liquid hydrocarbons averaged 1,367,000 barrels per day during 1986 compared with 1,388,000 barrels per day for 1985.

Deliveries of Western Canadian crude oil to Eastern Canada in 1986 were down 14 percent to 613,000 barrels per day because of lower refinery crude runs. Canadian crude oil destined for Montreal continued to face stiff competition from offshore crudes as a result of crude oil price deregulation and capacity constraints on the IPL system.

Prairie deliveries of crude oil were greater than 1985 mainly because of increased condensate deliveries for use as heavy crude oil diluent.

Deliveries of Canadian crude oil to U.S. refiners continued to climb, averaging 477,000 barrels per day in 1986, an increase of 16 percent.

Natural gas liquids delivered to the Sarnia area averaged 59,000 barrels per day, down from 67,000 barrels per day in the previous year.

Receipts of synthetic crude oil in 1986 were greater than last year because of improved operating performance of the synthetic crude oil plants.

The Norman Wells pipeline has continued to operate successfully throughout 1986 with deliveries averaging 26,000 barrels per day.

In 1987 total system deliveries are forecast to increase slightly.

| **Deliveries** (barrels per day) | **1986** | 1985 | 1984 |
|---|---|---|---|
| **Prairies** | | | |
| Light oil | **105,807** | 85,170 | 59,627 |
| Medium & heavy oil | **4,485** | 3,151 | 2,139 |
| Refined products | **85,415** | 86,850 | 90,762 |
| | **195,707** | 175,171 | 152,528 |
| **United States** | | | |
| Light oil | **247,862** | 232,660 | 167,478 |
| Medium & heavy oil | **286,916** | 246,837 | 219,219 |
| | **534,778** | 479,497 | 386,697 |
| **Eastern Canada** | | | |
| Light oil | **490,234** | 577,875 | 648,415 |
| Medium & heavy oil | **86,994** | 88,931 | 76,616 |
| Natural gas liquids | **58,847** | 66,993 | 66,672 |
| | **636,075** | 733,799 | 791,703 |
| Total Deliveries | **1,366,560** | 1,388,467 | 1,330,928 |

### Impact of deregulation of crude oil prices

As reported last year, the Federal Government moved to deregulate the Canadian oil industry in the spring of 1985 within the parameters of the Western Accord. As a result, 1986 represented the first full year for the oil and gas industry under the new deregulated environment.

In the first half of 1986 world crude oil prices declined 50 percent from levels reached near the end of 1985. Prior to that, prices had declined by more than 30 percent in real terms between 1981 and 1985. Most oil and gas producers had expected some softening in crude oil prices in 1986; however, few in the industry expected the collapse seen in the first half of the year.

During 1986 the industry had planned to at least match the $10.5 billion of capital expenditures committed in 1985. By March of 1986, however, the industry had started to react to the new price environment. Producers reduced 1986 capital programs by almost 50 percent with the potential for further cuts in 1987. These capital program reductions have been achieved, for the most part, through budget cuts, layoffs and other cost-saving measures. The emphasis to date has been to cut costs and not crude oil production.

In Edmonton, pipeline control operators (from top) Gordon Johnson, Ivan Ewanicke and Gerry Strevens monitor pipeline activities along the IPL system.


Gordon A. Cole, Executive Vice-President and Chief Operating Officer of IPL, reviews capital expenditures with management.

**The 1986 pipeline construction program resulted in the near completion of the second phase of the Company's three-phase expansion program and completion of a major portion of the third phase.**

## Industry outlook

During 1986 the outlook changed significantly for crude oil, petroleum product and energy markets. These changes were predicated on new perceptions of future energy prices, economic activity and available supply. Government policy also changed at the federal and provincial levels in Canada, as well as in the United States, in response to the new environment.

Crude oil prices in the future will depend largely on international supply and demand conditions and the extent to which the Organization of Petroleum Exporting Countries can exercise control of supply. The industry is positioning itself to deal with a gradual recovery in crude oil prices. Few producers expect prices to recover quickly to 1985 levels because of the fundamental changes in the market place. As prices firm in response to supply and increasing demand, the industry should be stronger and ready to concentrate resources in those areas where the greatest success can be achieved.

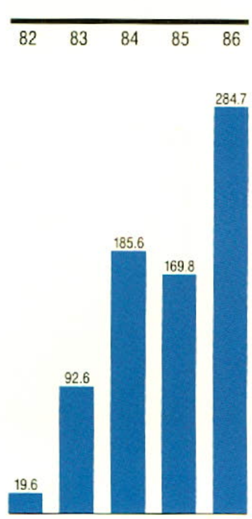
## 1986 system expansion activity

During 1986 the Company continued the pipeline construction and system modifications necessary to meet the changing oil transportation requirements of the industry. The construction program resulted in the near completion of the second phase of the Company's three-phase expansion program started in 1985, and completion of a major portion of the third phase.

The first expansion phase, completed in the fall of 1985 at a cost of $18 million, provided a system capacity increase of 75,000 barrels per day resulting from the construction of new pumping facilities and mainline piping modifications. The second phase of expansion was completed early in 1987 at a cost of $90 million. This involved the installation of new pumping equipment and certain mainline and terminal modifications which will provide a 157,000 barrels per day capacity increase.

The third phase includes both mainline and station construction between Edmonton and Superior at a cost of $245 million. This work, which will result in a system capacity increase of 95,000 barrels per day, is well underway with completion scheduled for late 1987. Phase three work completed during 1986 included 334 miles of 20 inch diameter pipeline between Regina and Gretna and 18 miles of 48 inch pipeline at various locations in Saskatchewan, Manitoba and Minnesota. The balance of the program will involve pump station construction between Edmonton and Superior.

**Capital expenditures**
(in millions of $)




As a result of the changing demands on the system, construction undertaken during the past two years has, to a great extent, constituted a capacity maintenance program. Light crude oil production has largely been sustained while the production of heavy crude oil is increasing. On completion of the third expansion phase in 1987 the Company will be well positioned to meet current and forecast system demands and to respond to future oil transportation needs as they are identified.

## 1987 and future system expansion

During 1987 the station construction and modifications included in the third phase of the expansion pro-

Mary Pirrolas (right), executive secretary responsible for the administration of charitable donations, views a model of Toronto's Hospital for Sick Children's New Patient Care Centre with Dr. Reva Gerstein, Vice-Chairman of the hospital. The Centre is one of the many worthy projects supported by IPL.

**The NEB recently completed a public hearing on IPL's application for new tolls and tariffs for transporting crude oil and other hydrocarbons in Canada during 1987. Interim tolls were approved, effective January 1, 1987 and the NEB's decision on the application is expected within a few months.**

gram will be completed. A further undertaking will involve the upgrading of Line 1 between Edmonton and Regina. This will include the replacement of 47 miles of 20 inch diameter pipe at a cost of $40 million. This program, currently before the NEB, is expected to be completed during the 1987 construction season.

Present demand forecasts for the near term indicate that adequate pipeline capacity will be available following completion of the current expansion program. There is continuing interest, however, regarding oil transportation needs associated with the potential development of the vast heavy crude resources in Western Canada. The IPL system is geographically well positioned to move heavy crude production from this area to the primary markets in the U.S. Midwest and beyond.

The Company is also encouraged by the recent announcement of the renewal of exploration and development activity in the Beaufort Sea area. With the Norman Wells pipeline already in place, IPL has a keen interest in the long term need for pipelines from this region.

### Tariffs and rate regulation

IPL's earnings on pipeline operations in Canada are regulated by the NEB on the basis of a return on rate base. For the year 1986 the NEB authorized a 15.25 percent equity rate of return on assets of the Canadian system, excluding the Montreal Extension which operates on a break-even basis after deficiency payments from the Federal Government.

The NEB recently completed a public hearing into the Company's application for new tolls and tariffs for the transportation of crude oil and other hydrocarbons in Canada during 1987. Interim tolls were approved effective January 1, 1987. A decision by the NEB is expected in the next few months.

IPL's Norman Wells pipeline is regulated by the NEB on a full cost of service basis. Lakehead's rates are regulated by the Federal Energy Regulatory Commission ("FERC"). Since the start of operations Lakehead's rates were based on a return on a valuation rate base, a method of regulation that incorporated a weighted average of the original cost and replacement cost. In 1985 FERC announced a decision that is a guide for future rate regulation of oil pipelines in the United States. A net depreciated trended original cost methodology has been adopted for rate making together with a transitional rate base related to the valuation rate base previously used.

Rates at January 1, 1987 in Canadian funds for representative shipments of light crude oil from Edmonton to Sarnia and Montreal are $1.21 and $1.51 per barrel, respectively. The rates for heavier crude oil, natural gas liquids and refined products are slightly higher than light crude oil rates.

### Other corporate activities

IPL continues to stress safety and efficiency in the operation of its facilities and is dedicated to enhance the integrity of its pipeline system as well as the operation of its recently acquired oil and gas facilities.

The Company also recognizes its obligations to contribute to the communities it serves. IPL strives to protect and preserve the environment; it supports the communities in which it operates by making local purchases where practicable, employing local residents and encouraging employees to participate in the life of their communities.

The Company believes that it has a responsibility to provide financial assistance to national and local charitable organizations, institutions of higher learning and agencies in the fields of art and culture, welfare, research and medical care.

# Operations review

## Review of oil and gas operations

### Home Oil Company Limited

In December 1986 IPL completed the purchase of Home Oil and certain affiliated companies. During 1986 the most significant events which affected Home were the dramatic decline in world oil prices and the transition to a less regulated marketing environment for natural gas which exerted downward pressure on prices. The overall operating performance of Home improved during the year, although the financial results were impaired to a certain extent by depressed oil and gas prices.

### Review of Home's 1986 activities

Production of crude oil and natural gas liquids during 1986 increased modestly to 27,826 barrels per day from 26,962 barrels per day last year, primarily due to higher production in Canada. Natural gas sales declined marginally to 112.9 million cubic feet per day because of lower exports to the United States.

During the year Home participated in the drilling of 453 (101 net) working interest wells compared with 671 (143 net) wells in 1985. Exploratory drilling resulted in 74 (23 net) oil and 33 (6 net) gas wells, while development drilling yielded 209 (35 net) oil and 20 (3 net) gas producers.

Following two consecutive years of growth, proved reserves of crude oil and natural gas liquids declined marginally to 107.7 million barrels in 1986 from 108.2 million barrels one year earlier. Additions from successful drilling activity provided 8.9 million barrels which replaced 87 percent of production. Proved reserves of natural gas after three years of continuous increases fell slightly to 949.2 billion cubic feet in 1986 compared with 956.8 billion cubic feet in 1985. Additions of 41.8 billion cubic feet exceeded sales but net downward revisions due to reservoir performance resulted in an overall decline. The cost of the additions to proved reserves in Western Canada averaged $8.42 per barrel of oil equivalent in 1986, compared with $8.59 in 1985.

The industry-wide reduction in exploration and development activity during the year caused the price of Crown lands in Western Canada to decline significantly. Home took advantage of these lower costs to improve its land position. During the year Home was one of the most aggressive land purchasers, buying 198,800 net acres at an average price of $47 per acre compared with 129,900 net acres of similar quality land at $160 per acre in 1985.

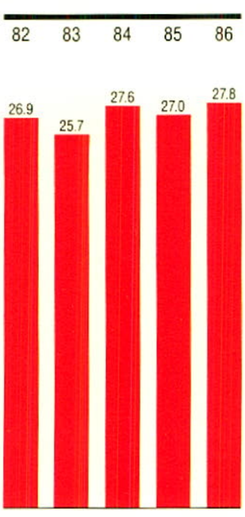
The downturn in oil and gas prices caused a re-evaluation of exploration and development economics and, as a result, Home significantly reduced its activities in the last half of the year. Total capital expenditures declined to $228 million in 1986 from $350 million one year ago. After deducting government incentives of $50 million, net capital expenditures amounted to $178 million, a 21 percent decline from last year.

### Exploration and development

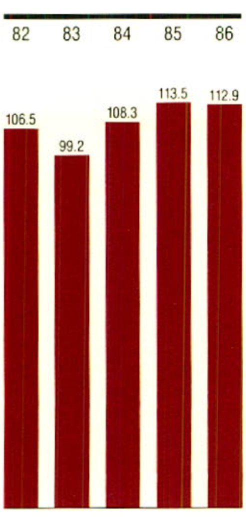
*Canada*

Exploration and development activity in Canada was focused primarily in the Western Sedimentary Basin. Operations were conducted both on Home's undeveloped properties and the extensive landholdings of Dome Petroleum

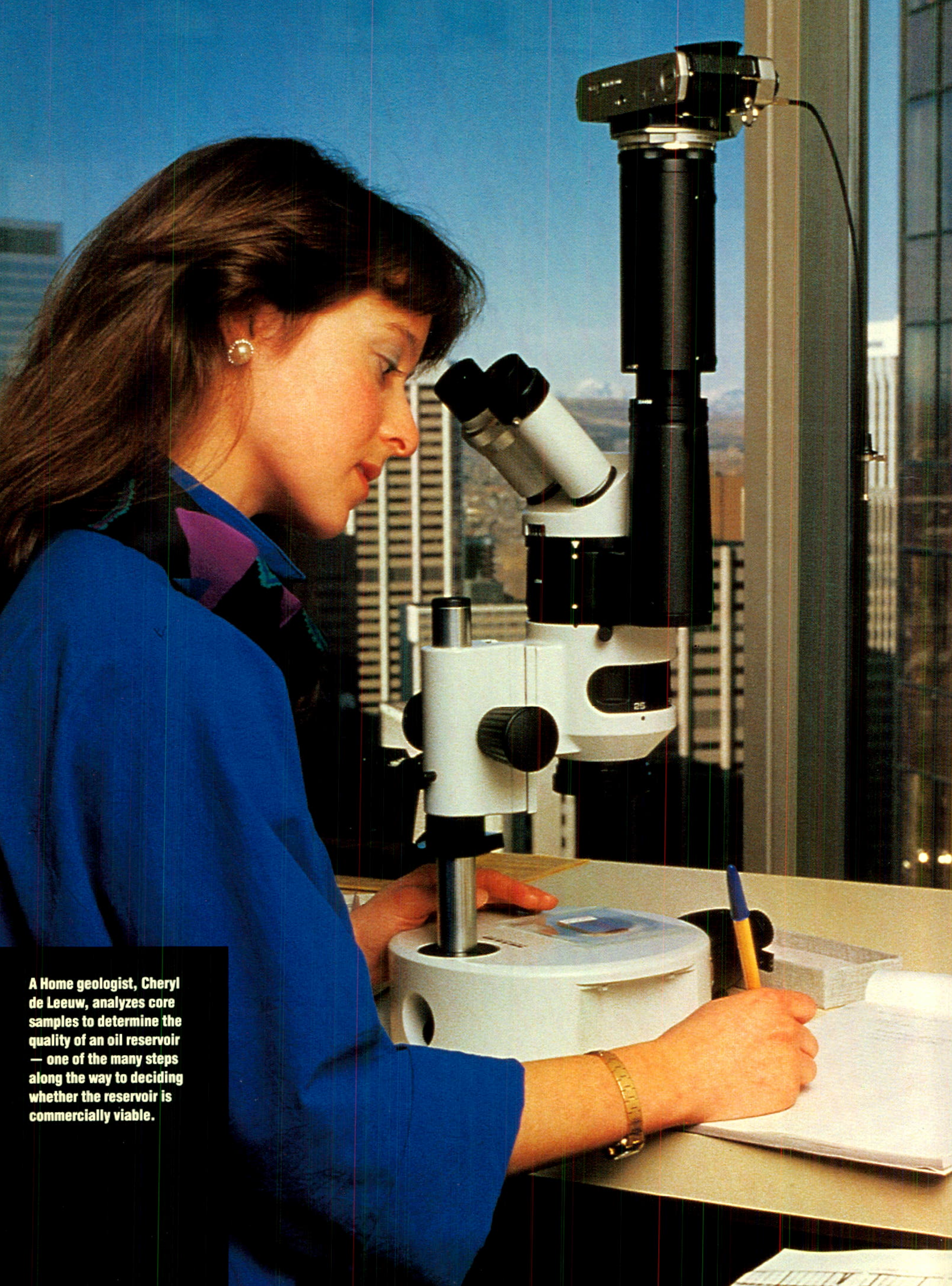
**Average daily crude oil and natural gas liquids production**
(thousands of barrels)




**Average daily natural gas sales**
(millions of cubic feet)



Home is the operator of the first significant deep oil find in Saskatchewan and the most prolific producer in the province. Home holds a 50 percent interest in the project.



A Home geologist, Cheryl de Leeuw, analyzes core samples to determine the quality of an oil reservoir — one of the many steps along the way to deciding whether the reservoir is commercially viable.

**Canadian exploration and development by Home in 1986 focused mainly on the Western Sedimentary Basin. Significant discoveries occurred in the North Tableland area of Saskatchewan, the Medicine River and Jenner regions of Alberta, and the South Pierson area of Manitoba.**

Limited ("Dome"). Home gained access to the Dome lands through a 1983 farmin agreement which extends until mid-1989. After government incentives of $13 million, net capital expenditures in the four western provinces totalled $155 million. Although drilling activity in Western Canada declined in the latter half of 1986 due to the downturn in prices, Home participated in several major discoveries.

Home is the operator and holds a 50 percent interest in the first significant deep oil find in Saskatchewan and the most prolific producer ever completed in the province. The well, located in the North Tableland area, is producing at an allowable rate of 750 barrels per day. Substantial landholdings containing several similar prospects were assembled in the region and further drilling is planned.

In the Medicine River area of Alberta, two oil wells were granted allowable production rates of 535 and 315 barrels per day, and are waiting to be tied into processing facilities. Home holds interests in these wells of 23 and 20 percent, respectively. Further drilling is underway to determine the areal extent of the reservoir.

A well in the Jenner area of Alberta tested natural gas at a stabilized flow rate of 15 million cubic feet per day. Two subsequent wells discovered both gas and heavy oil. Home's interests range from 10 to 15 percent in the three wells and up to 50 percent in adjacent lands on which additional drilling is planned.

A new oil field was discovered by Home in the South Pierson area of Manitoba. Ten of the 11 wells drilled encountered oil. Three of the wells are currently on production at rates varying from 30 to 60 barrels per day. Six of the wells are awaiting completion and the remaining well is shut-in. Home holds interests of between 75 and 100 percent in the wells and in approximately 7,700 acres of land in the vicinity. A development drilling program during the summer is under consideration.

In Alberta Home is involved in two major tertiary recovery projects to recover additional oil from mature reservoirs. These projects involve the injection of miscible hydrocarbons into the reservoirs to displace otherwise unrecoverable oil. At Swan Hills Unit No. 1, operated by Home with a 17 percent interest, the first phase of a miscible flood project is underway and is expected to recover an additional 57 million gross barrels of oil over the project's 30-year life. Approval is expected shortly to start a second phase which should recover a further 49 million gross barrels. The first phase of a miscible flood project commenced operation in Mitsue Unit No. 1, where Home holds a seven percent interest. This is expected to recover an incremental 25 million gross barrels of oil. A second phase was started in May, 1986 and should yield a further 22 million gross barrels.

In the Beaufort Sea/Mackenzie Delta area of northern Canada, a number of exploratory wells were

**Proved reserves of crude oil and natural gas liquids**
(millions of barrels)

drilled under farmin agreements with Esso Resources Canada Limited ("Esso") and Dome. After deducting government grants of $37 million, Home's share of net capital expenditures in this region totalled $12 million during 1986.

On Esso lands located just south of Tuktoyaktuk, six onshore wells were drilled and tested during the 1985/86 winter drilling season to delineate an earlier oil discovery. All but one of the wells confirmed the presence of crude oil and additional work will be required to determine the potential for future development. Home's interest in the wells is approximately 10 percent.

Elsewhere on Esso lands, an additional six onshore wells were drilled during 1986 with Home earning interests between 11 and 22 percent. As a result of participating in these wells, Home also earned a 13 percent interest in Esso's remaining onshore lands. The most significant of the wells tested 204 million cubic feet per day of natural gas and 2,580 barrels per day of oil/condensate from 12 intervals.

In the Beaufort Sea, Home earned an 11 percent interest in Esso's Minuk well, drilled from an artificial island. The well tested 55.6 million cubic

**Five-year review of Home**

| | Year Ended December 31 | | | | |
|---|---|---|---|---|---|
| | **1986** | 1985 | 1984 | 1983 | 1982 |
| **Financial** | | | | | |
| Operating revenue (millions) | **$258.3** | $361.2 | $347.6 | $296.0 | $277.1 |
| Capital expenditures (millions) | | | | | |
| Before government incentives | **$228.0** | $350.4 | $325.4 | $220.1 | $145.6 |
| After government incentives | **$178.1** | $226.0 | $189.6 | $128.8 | $ 97.0 |
| **Production/sales data**[1] | | | | | |
| Oil & natural gas liquids production | | | | | |
| Barrels per day | **27,826** | 26,962 | 27,565 | 25,687 | 26,915 |
| Price per barrel | **$18.87** | $33.93 | $32.22 | $30.25 | $24.62 |
| Royalty rate | **19.8%** | 26.4% | 27.9% | 30.4% | 31.0% |
| Natural gas sales | | | | | |
| Thousands of cubic feet per day | **112,884** | 113,467 | 108,283 | 99,189 | 106,460 |
| Price per thousand cubic feet | **$2.24** | $2.66 | $2.95 | $2.89 | $2.80 |
| Royalty rate | **20.2%** | 21.4% | 23.0% | 23.9% | 26.0% |

| **Drilling Activity**[2] (working interest wells) | **1986 Gross** | **1986 Net** | 1985 Gross | 1985 Net | 1984 Gross | 1984 Net | 1983 Gross | 1983 Net | 1982 Gross | 1982 Net |
|---|---|---|---|---|---|---|---|---|---|---|
| Exploratory | | | | | | | | | | |
| Oil | **74** | **23** | 93 | 22 | 61 | 16 | 20 | 9 | 10 | 4 |
| Gas | **33** | **6** | 54 | 8 | 31 | 6 | 10 | 3 | 4 | 2 |
| Dry | **80** | **22** | 133 | 28 | 93 | 21 | 23 | 12 | 15 | 6 |
| | **187** | **51** | 280 | 58 | 185 | 43 | 53 | 24 | 29 | 12 |
| Development | | | | | | | | | | |
| Oil | **209** | **35** | 281 | 50 | 208 | 49 | 129 | 33 | 47 | 17 |
| Gas | **20** | **3** | 42 | 10 | 45 | 7 | 37 | 9 | 37 | 8 |
| Dry | **37** | **12** | 68 | 25 | 61 | 15 | 31 | 7 | 18 | 8 |
| | **266** | **50** | 391 | 85 | 314 | 71 | 197 | 49 | 102 | 33 |
| Total | **453** | **101** | 671 | 143 | 499 | 114 | 250 | 73 | 131 | 45 |

[1] Daily production/sales and prices are before the deduction of royalties.
[2] Gross includes the interests of others; net excludes the interests of others.

feet per day of natural gas and 185 barrels per day of condensate from three intervals. An offshore option well at South Arnak, where Home earned a 12 percent interest, tested 2,580 barrels per day of oil/condensate and 30 million cubic feet per day of natural gas from four intervals. Kaubvik, the final well under the farmin agreement with Esso, failed to encounter hydrocarbons and was abandoned early in 1987.

The Havik well, drilled in the Beaufort Sea under the farmin agreement with Dome, tested 745 barrels per day of oil and a small amount of natural gas from two intervals. Home retained a 20 percent interest in Havik, which was the last of a seven-well exploratory program with Dome.

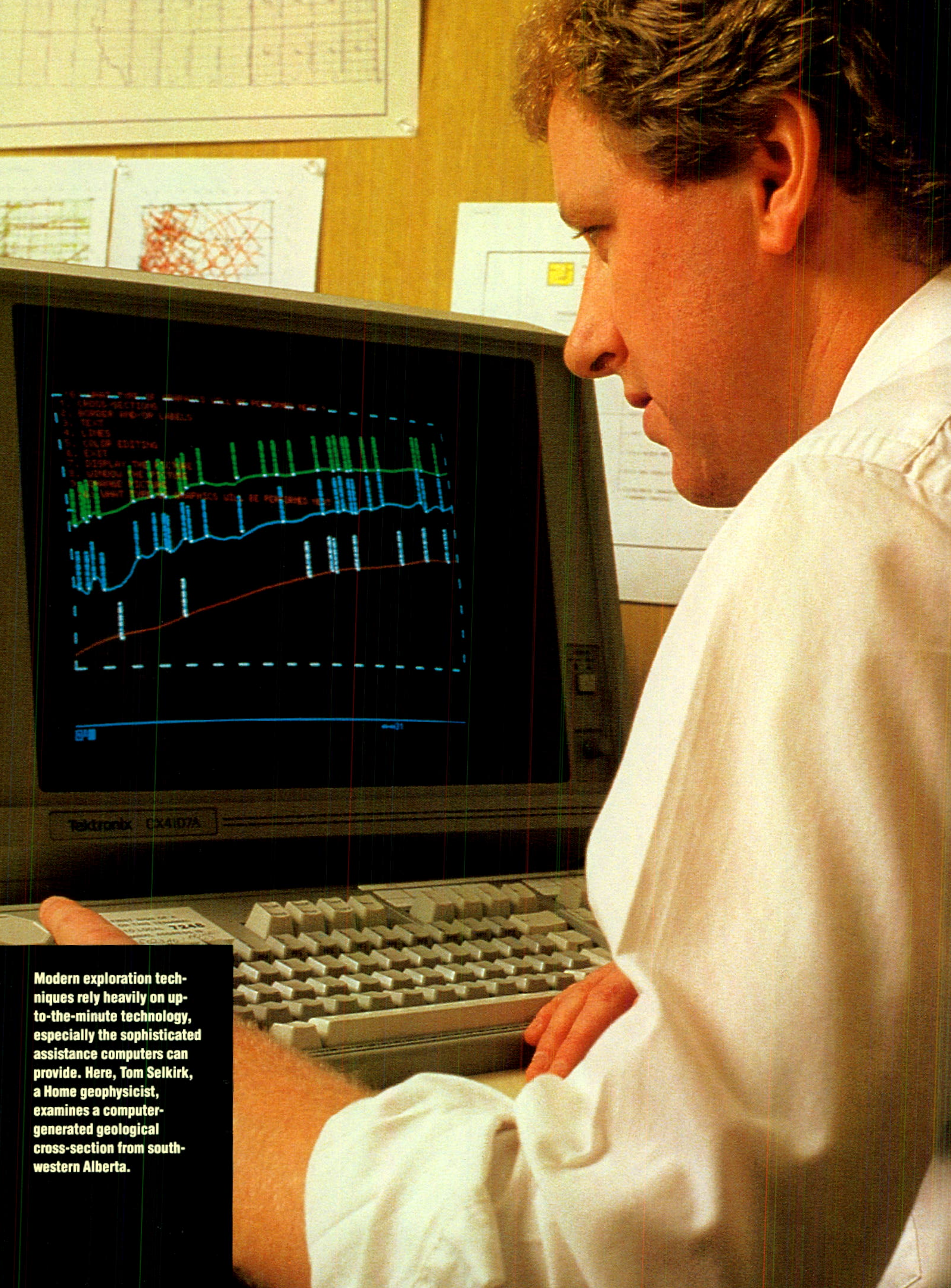
The exploratory drilling programs with Esso and Dome in the Beaufort Sea/Mackenzie Delta over the past four years were among the largest commitments ever made by Home. Total capital expenditures were $399 million. After deducting government incentives of $316 million, Home's net capital expenditures amounted to $83 million. Home participated in 36 wells, 19 of which were successful, and earned 0.8 million net acres of land. Home's share of potential

| | Year Ended December 31 | | | | |
|---|---|---|---|---|---|
| | **1986** | 1985 | 1984 | 1983 | 1982 |
| **Proved Reserves**[3] | | | | | |
| Oil & natural gas liquids (millions of barrels) | | | | | |
| Beginning of year | **108.2** | 104.9 | 103.5 | 105.6 | 114.7 |
| Revisions | **0.8** | 2.1 | 3.0 | 2.6 | (2.5) |
| Extensions & discoveries | **8.9** | 11.0 | 8.5 | 4.7 | 3.2 |
| Production | **(10.2)** | (9.8) | (10.1) | (9.4) | (9.8) |
| End of year | **107.7** | 108.2 | 104.9 | 103.5 | 105.6 |
| Natural gas (billions of cubic feet) | | | | | |
| Beginning of year | **956.8** | 950.7 | 944.6 | 919.3 | 939.2 |
| Revisions | **(8.2)** | (7.0) | (11.8) | 30.5 | (24.0) |
| Extensions & discoveries | **41.8** | 54.5 | 57.5 | 31.0 | 43.0 |
| Sales | **(41.2)** | (41.4) | (39.6) | (36.2) | (38.9) |
| End of year | **949.2** | 956.8 | 950.7 | 944.6 | 919.3 |

| **Oil & gas landholdings** (millions of acres)[2] | **Gross** | **Net** | Gross | Net | Gross | Net | Gross | Net | Gross | Net |
|---|---|---|---|---|---|---|---|---|---|---|
| Canada | | | | | | | | | | |
| Western provinces | **6.5** | **2.4** | 7.0 | 2.4 | 6.9 | 2.4 | 6.8 | 2.6 | 7.4 | 2.7 |
| Beaufort/Mackenzie delta | **5.3** | **0.6** | 4.3 | 0.5 | 1.3 | 0.2 | 1.0 | 0.2 | 0.6 | 0.1 |
| Arctic islands & other | **2.4** | **0.2** | 5.5 | 0.5 | 5.8 | 0.4 | 13.4 | 1.0 | 20.5 | 1.1 |
| | **14.2** | **3.2** | 16.8 | 3.4 | 14.0 | 3.0 | 21.2 | 3.8 | 28.5 | 3.9 |
| International | | | | | | | | | | |
| Australia | **5.4** | **0.7** | 4.7 | 0.7 | 4.7 | 0.7 | 6.8 | 0.9 | 8.5 | 1.6 |
| Indonesia | **4.4** | **0.3** | 3.0 | 0.1 | 3.0 | 0.1 | 2.9 | 0.1 | 3.9 | 0.1 |
| Other | **0.3** | **0.1** | 2.2 | 0.2 | 3.6 | 1.1 | 1.7 | 0.9 | 4.0 | 1.4 |
| | **10.1** | **1.1** | 9.9 | 1.0 | 11.3 | 1.9 | 11.4 | 1.9 | 16.4 | 3.1 |
| Total | **24.3** | **4.3** | 26.7 | 4.4 | 25.3 | 4.9 | 32.6 | 5.7 | 44.9 | 7.0 |

[3]Proved reserves are before the deduction of royalties.

Note: The financial and operating data of Sovereign Oil & Gas PLC are excluded from the five-year review of Home.




**Modern exploration techniques rely heavily on up-to-the-minute technology, especially the sophisticated assistance computers can provide. Here, Tom Selkirk, a Home geophysicist, examines a computer-generated geological cross-section from southwestern Alberta.**

reserves is estimated at 27 million barrels of oil and 97 billion cubic feet of gas. Despite these positive results, any further activity in the Beaufort Sea/Mackenzie Delta will be delayed until the economic climate improves.

*International*

Home's net capital expenditures internationally during 1986 totalled $11 million.

In the Eromanga Basin of Queensland, Australia, Home Energy holds a 10 percent interest in a small oil field discovered during the year. Identical interests are also held in five similar oil fields in this basin. In the Canning Basin of Western Australia, Home Energy has interests ranging from 26 to 28 percent in three oil fields. Home Energy's share of production from the nine fields averaged 378 barrels per day in 1986.

In Indonesia, Home holds a two percent interest in the Malacca Strait Block, which covers three million acres. The principal producing property in this block, the Lalang oil field, averaged 25,800 gross barrels per day in 1986. Two additional oil fields, Mengkapan and Melibur, were placed on stream in December, 1986. A multi-well exploratory and delineation drilling program was completed recently and resulted in the discovery of six new oil fields. Further work will be necessary to determine if these fields are large enough to warrant commercial production.

During 1986 Sovereign Oil & Gas PLC, in which Home holds a 26 percent equity interest, made a significant gas/condensate discovery on Block 21/3a in the British sector of the North Sea. An exploratory well tested 44.5 million cubic feet of natural gas per day and 3,000 barrels of condensate from a 40-foot pay zone. Higher flow rates were precluded by limitations of the surface test equipment. By participating in the well, Sovereign earned a 13 percent interest in the block and holds an option to increase its interest to 25 percent by drilling a second well on a separate structure.

## Home's outlook

The outlook for 1987 remains unsettled due to fluctuating crude oil prices, downward pressure on natural gas prices,

**Proved reserves of natural gas**
(billions of cubic feet)


**During 1987 production of crude oil and natural gas liquids is expected to rise modestly to 29,000 barrels per day. A 12 percent increase to 127 million cubic feet per day is foreseen for natural gas volumes.**

and uncertain domestic and export markets for gas.

During 1987 production of crude oil and natural gas liquids is expected to rise modestly to approximately 29,000 barrels per day. The increase should result primarily from anticipated exploratory successes and optimization projects in Canada.

A 12 percent increase to approximately 127 million cubic feet per day in 1987 is foreseen for natural gas volumes. The increase will result from anticipated new direct sales to customers in both Canada and the United States. In order to remain competitive, the average price during 1987 is expected to be in the range of $1.75 to $1.85 per thousand cubic feet, a significant decline from the $2.24 per thousand cubic feet received in 1986.

Net capital expenditures during 1987 will be approximately $160 million, down from $178 million in 1986. More than 90 percent of these expenditures are planned for Canada, with spending equally divided between exploration and development projects. About half of the $12 million committed to foreign capital expenditures is allocated to Indonesia and Australia.

## Results of Operations

Earnings in 1986 were $131 million or $3.36 per share on 38.9 million average shares outstanding compared with $139 million or $3.71 per share on 37.4 million shares in 1985 and $130 million or $3.47 per share on 37.3 million shares in 1984.

The increase in average shares outstanding in 1986 was the result of a change in the method of accounting for the Company's investment in Hiram Walker Resources Ltd. effective April 1. This change was made due to Gulf Canada Corporation's acquisition of a controlling interest in HWR on April 23.

Higher pipeline earnings in 1986 were offset by lower earnings from HWR and lower investment and other income.

In 1985 the improvement in earnings over 1984 was the result of higher income from HWR. Earnings from Norman Wells operations and exchange gains on U.S. dollars offset a decline in earnings from Canadian pipeline operations and investment income. Earnings for 1984 to 1986 are analyzed in the table above.

Higher pipeline earnings in Canada in 1986 resulted from a 12 percent tariff increase, effective January 1, which more than offset a continued decline in volumes transported and increased power and other costs. In 1985 Canadian pipeline earnings dropped relative to 1984 as a result of reduced shipments, higher power costs and a 4.4 percent decrease in transportation rates, effective September 1984.

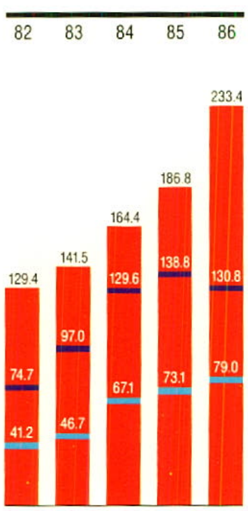
**Earnings**

| (in millions of $) | 1986 | 1985 | 1984 |
|---|---|---|---|
| Canadian pipeline operations | $ 27 | $ 13 | $ 19 |
| U.S. pipeline operations | | | |
| In U.S. dollars | 48 | 53 | 53 |
| U.S. exchange | 19 | 20 | 16 |
| Withholding taxes | (7) | (8) | (8) |
| Norman Wells pipeline | 14 | 15 | 9 |
| Investment and other income | 8 | 11 | 16 |
| | 109 | 104 | 105 |
| Earnings from HWR/Home | 22 | 35 | 25 |
| Total earnings | $131 | $139 | $130 |

The decline in earnings from U.S. pipeline operations in 1986 was due to reduced long-haul shipments to Eastern Canada which were only partially offset by higher deliveries in the U.S.

Norman Wells earnings were comparable with 1985 reflecting a 16 percent return on approximately $90 million of equity under the negotiated full cost of service tariff. The Norman Wells pipeline was completed early in 1985. Earnings in 1984 therefore were based on a lower level of equity invested.

**Earnings, dividends and cash flow**
(in millions of $)
— Cash flow
— Earnings
— Dividends




Investment and other income continued to drop in 1986 due to significantly lower cash balances and lower investment yields. Additionally, large gains on debt repurchases in 1984 did not recur in 1985 and were minimal in 1986 as a result of falling interest rates. A $3 million gain on tax benefits purchased in 1982 partially offset the decline in 1986. This gain resulted from recognition of reduced income tax rates under the U.S. Tax Reform Act of 1986.

## Cash from Operations

Cash provided from operations increased by 25 percent from $187 million in 1985 to $233 million in 1986. Cash flow per share was $5.99 in 1986 compared with $5.00 in 1985. Higher pipeline earnings in IPL, a full year's operations in Norman Wells and significant deferral of taxes due to pipeline construction expenditures contributed to the increase. In 1985, the increase of 14 percent was largely attributed to the start-up of Norman Wells operations in April 1985.

## Liquidity and Capital Resources

In 1986, as in the previous two years, cash from operations was more than sufficient to cover working capital needs, dividend payments, debt retirements and normal capital expenditures on the pipeline system. Furthermore, dividends paid were increased to $2.00 per share in 1986 from $1.70 per share in 1984.

There was an extraordinary utilization of cash resources in the year due to the pipeline capacity expansion program and the purchase of Home Oil. As a result, cash and net short term investments dropped from $158 million at the end of 1985 to $16 million at year end 1986.

Additions to property, plant and equipment totalled $285 million in 1986. Of this, $241 million related to phases two and three of the pipeline capacity expansion program. The Company funded some of the pipeline expenditures on a long term basis through the issue in December of $125 million of 10% Series H Debentures, maturing in 2006. Further long term financing is expected in 1987 as funds are required to complete the construction program.

The acquisition of Home Oil was financed by an exchange of HWR's preference shares held by IPL, the issuance of $200 million oil indexed debentures and $320 million cash. The majority of this cash was obtained through interim financing facilities and proceeds from the exchange of the Company's holdings of common shares of HWR. Interim financing includes both commercial paper and bankers' acceptances and is supported by a bank credit agreement for up to $300 million, maturing in 1995.

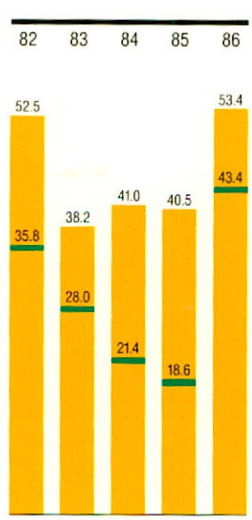
The $200 million oil indexed debentures carry a 5% fixed coupon rate plus a variable rate, based upon future oil prices. The variable rate cannot exceed 16.8% per annum.

With the $125 million Series H Debentures, the $200 million oil indexed debentures, interim financing for the Home acquisition, and obligations of Home assumed, the ratio of long term debt to long term debt plus equity increased to 53.4 percent at December 31, 1986 compared with 40.5 percent at the end of 1985. In addition, earnings coverage of interest dropped from 5.5 times in 1985 to 4.9 times in 1986 due to a full year's interest expense on Norman Wells debt.

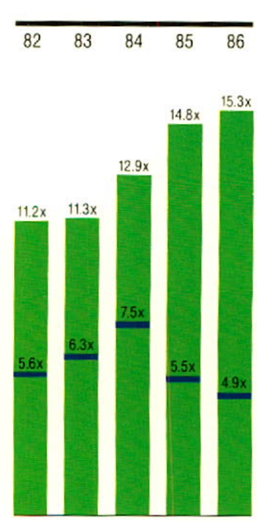
## Outlook

While market conditions may affect short term earnings, the long term outlook is positive given the excellent business mix of oil and gas and pipeline operations. Furthermore, cash provided from operations is projected to increase significantly reflecting the inclusion of Home's cash flow in substitution for dividends from HWR. A higher debt proportion in the capital structure and lower interest coverage is anticipated with additional debt funds required to complete the construction program and a full year's interest on borrowings in late 1986. However, the demonstrated ability to handle the major Home acquisition attests to the financial credit and strength of the Company which remains in a healthy position to meet its internal and external financial commitments.

**Long term debt/ long term debt & equity**
(%)
— Consolidated
— Excluding project debt




**Earnings coverage of interest**
(times)
— Excluding project debt
— Consolidated



## Summary of Significant Accounting Policies:

The consolidated financial statements are prepared in accordance with accounting principles generally accepted in Canada and conform in all material respects with the historical cost accounting standards of the International Accounting Standards Committee.

**Principles of consolidation**
The consolidated financial statements include the accounts of the company and all of its subsidiaries. Investments in companies which are not subsidiaries but over which the company exercises significant influence are accounted for using the equity method. Other investments are recorded at cost.

Substantially all of the company's natural resource activities are conducted jointly with others. These financial statements reflect the company's proportionate interest in such activities.

**Regulation of pipeline system**
The company owns and operates a pipeline system in Canada and the United States for the transportation of crude oil and other liquid hydrocarbons.

Construction, operations, accounting and rates in Canada are under the regulatory authority of the National Energy Board. Rates, accounting and other practices in the United States are under the regulatory authority of the Federal Energy Regulatory Commission.

**Foreign currency translation**
The company follows the current rate method under which the operations of foreign subsidiaries are translated into Canadian dollars in accordance with procedures recommended for self-sustaining foreign operations. Revenue and expense items, including depletion, depreciation and amortization, are translated at monthly rates of exchange. Assets and liabilities are translated at rates of exchange in effect at the date of the statement of financial position. Foreign currency translation adjustments are recorded as a separate component of Shareholders' Equity.

**Discount and expense on long term debt**
The balance of unamortized discount and expense is being amortized on the straight-line basis over the life of the debt.

**Property, plant and equipment**
*Pipeline Operations*
Expenditures for system expansion and major renewals and betterments are capitalized whereas maintenance and repair costs are charged to operating expenses as incurred. Canadian operations follow the accounting practice of capitalizing, at rates authorized by the National Energy Board, an allowance for debt and equity funds required to finance construction in Canada. U.S. operations capitalize an allowance for interest incurred on external borrowings in accordance with the Financial Accounting Standards statement, Capitalization of Interest Cost.

*Natural Resources*
The company follows the full cost method of accounting for oil and gas operations, whereby all exploration and development costs are capitalized. Separate cost centres are established for each country and the Athabasca oil sands. Capitalized costs include land acquisition costs, geological and geophysical costs, lease rentals and related charges applicable to non-producing property, costs of drilling both productive and non-productive wells and overhead charges related to exploration and development activities. The net book value of such costs, net of deferred income taxes, is limited by a "ceiling test" amount. This amount is the sum of future net revenues from proved reserves at current prices and costs, plus the lower of cost or estimated fair market value of unproved properties, less estimated future financing, administrative and income tax expense.

**Depletion and depreciation**
Oil and gas costs are depleted using the unit of production method based upon estimated proved reserves, before royalties, as determined by company engineers. Natural gas reserves and production are converted to equivalent volumes of crude oil based on relative energy content.

Costs of acquiring and evaluating significant unproved properties and costs of major development projects are excluded from the computation of depletion until such time as additional reserves are proved, the project is completed, or an impairment in value has occurred.

The company provides for depreciation of buildings, plant, pipeline and equipment, other than oil and gas production equipment and the Montreal Extension Pipeline, on the straight-line basis over their estimated service lives. In accordance with the terms of the Deficiency Agreement with the Canadian Government, the company is providing for depreciation of the Montreal Extension depreciable facilities on a 20-year straight-line basis. Oil and gas production equipment is depreciated using the unit of production method.

When fixed assets are retired, or otherwise disposed of, the proceeds are credited to property, plant and equipment, except for unusual disposals for which the gain or loss is included in earnings.

**Deferred income and withholding taxes**
The company follows the tax allocation basis of accounting. Under income tax regulations, depletion, depreciation and other costs deducted for tax purposes may differ from the amounts recorded in the accounts. The company claims deductions permitted for tax purposes which result in maximum benefits and deferral of taxes to years when amounts deductible will be less than amounts recorded in the accounts.

Earnings of a U.S. subsidiary are subject to a 10% U.S. withholding tax when paid as dividends to Interprovincial. It has not been considered necessary to provide for this tax on retained earnings of $83.1 million U.S. at December 31, 1986 because these retained earnings are expected to remain a part of its permanent capital.

**Earnings per share**
Earnings per share are computed on the weighted average number of shares outstanding of 38,943,921, 37,378,611 and 37,304,538 in 1986, 1985 and 1984 respectively. There would have been no material dilution of earnings per share if outstanding stock options had been exercised during the year. Prior to April 1, 1986 the weighted average number of shares outstanding was reduced by the company's pro rata interest in its own shares resulting from the equity investment in Hiram Walker Resources Ltd.

## Consolidated statement of earnings

| (in millions of dollars except per share amounts) | Year ended December 31 1986 | 1985 | 1984 |
|---|---|---|---|
| **Revenue:** | | | |
| Operating | **$561.8** | $509.4 | $444.4 |
| Interest and other income | **18.8** | 25.0 | 30.8 |
| Allowance for equity funds used during construction | **7.1** | 5.9 | 9.7 |
| | **587.7** | 540.3 | 484.9 |
| **Expenses:** | | | |
| Power | **116.1** | 112.8 | 100.7 |
| Operating and administrative | **113.6** | 105.3 | 93.0 |
| Depletion, depreciation and amortization | **73.1** | 58.6 | 45.9 |
| Interest (Note 12) | **62.6** | 54.2 | 36.3 |
| | **365.4** | 330.9 | 275.9 |
| **Earnings before the undernoted** | **222.3** | 209.4 | 209.0 |
| **Taxes** (Note 13) | **111.9** | 105.8 | 104.3 |
| | **110.4** | 103.6 | 104.7 |
| **Investment earnings from Hiram Walker Resources Ltd.** | **20.4** | 35.2 | 24.9 |
| **Earnings for the year** | **$130.8** | $138.8 | $129.6 |
| **Earnings per share** | **$3.36** | $3.71 | $3.47 |
| **Dividends per share** | **$2.00** | $1.85 | $1.70 |

## Consolidated statement of retained earnings

| (in millions of dollars) | Year ended December 31 1986 | 1985 | 1984 |
|---|---|---|---|
| **Balance at beginning of year** | **$436.6** | $366.9 | $300.7 |
| Earnings for the year | **130.8** | 138.8 | 129.6 |
| | **567.4** | 505.7 | 430.3 |
| Dividends | **77.9** | 69.1 | 63.4 |
| **Balance at end of year** | **$489.5** | $436.6 | $366.9 |

| **Consolidated statement of financial position** (in millions of dollars) | December 31 **1986** | 1985 |
|---|---|---|
| **Assets** | | |
| *Current Assets:* | | |
| Cash, including bank term deposits | **$ 39.5** | $ 101.7 |
| Short term investments, at lower of cost and market | **43.9** | 93.5 |
| Accounts receivable – | | |
| Trade | **102.7** | 35.5 |
| Petroleum Incentives Program | **45.5** | |
| Inventories, at lower of cost or net realizable value | **19.7** | 5.2 |
| | **251.3** | 235.9 |
| *Deferred Charges and Other Assets (Note 4)* | **32.7** | 20.6 |
| *Investments (Note 5)* | **36.8** | 376.1 |
| *Property, Plant and Equipment (Note 6)* | **2,615.2** | 1,109.6 |
| | **$2,936.0** | $1,742.2 |

The financial statements have been approved by the Board:

R.K. Heule

Director

E. H. Crawford

Director

| | December 31 | |
|---|---|---|
| | **1986** | 1985 |
| **Liabilities and Shareholders' Equity** | | |
| *Current Liabilities:* | | |
| Short term borrowings (Note 7) | **$ 67.4** | $ 36.8 |
| Accounts payable | **124.6** | 49.1 |
| Income and other taxes | **16.3** | 16.6 |
| Current portion of long term liabilities | **51.0** | 21.6 |
| | **259.3** | 124.1 |
| *Long Term Debt (Note 7)* | **1,059.7** | 562.8 |
| *Deferred Credits (Note 8)* | **74.8** | 20.8 |
| *Deferred Taxes* | **590.7** | 208.4 |
| *Minority Interest (Note 9)* | **27.3** | |
| *Commitments (Note 17)* | | |
| | **2,011.8** | 916.1 |
| *Shareholders' Equity* | | |
| Capital stock (Note 10) | **385.9** | 385.3 |
| Contributed surplus | **23.3** | 23.3 |
| Retained earnings | **489.5** | 436.6 |
| Foreign currency translation adjustments | **25.5** | 41.6 |
| Reciprocal shareholding | | (60.7) |
| | **924.2** | 826.1 |
| | **$2,936.0** | $1,742.2 |

## Auditors' report

To the Shareholders of Interprovincial Pipe Line Limited:

We have examined the consolidated statements of financial position of Interprovincial Pipe Line Limited as at December 31, 1986 and 1985 and the consolidated statement of earnings, retained earnings and changes in financial position for each of the three years in the period ended December 31, 1986. Our examinations were made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these financial statements present fairly the financial position of the company as at December 31, 1986 and 1985 and the results of its operations and the changes in its financial position for each of the three years in the period ended December 31, 1986 in accordance with generally accepted accounting principles in Canada applied on a basis consistent with that of the preceding year.

Price Waterhouse

Chartered Accountants

Edmonton, Alberta
February 6, 1987

**Consolidated statement of changes in financial position**
(in millions of dollars)

| | Year ended December 31 | | |
|---|---|---|---|
| | **1986** | 1985 | 1984 |
| **Cash generated internally:** | | | |
| Earnings for the year | **$130.8** | $138.8 | $129.6 |
| Charges (credits) to earnings not affecting cash – | | | |
| Depletion, depreciation and amortization | **73.1** | 58.6 | 45.9 |
| Deferred taxes | **41.1** | 18.8 | 11.4 |
| Deferred credits | **(1.4)** | (.2) | (1.1) |
| Unremitted equity income | **(.6)** | (15.6) | (6.7) |
| Allowance for equity funds used during construction | **(7.1)** | (5.9) | (9.7) |
| Other | **(2.5)** | (7.7) | (5.0) |
| Provided from operations | **233.4** | 186.8 | 164.4 |
| Decrease (increase) in non-cash working capital | **(52.0)** | 10.9 | (2.0) |
| | **181.4** | 197.7 | 162.4 |
| **Cash required:** | | | |
| Dividends – | | | |
| Regular | **77.9** | 69.1 | 63.4 |
| Reciprocal shareholding | **1.1** | 4.0 | 3.7 |
| Long term debt retirements | **26.1** | 23.6 | 42.7 |
| | **105.1** | 96.7 | 109.8 |
| **Net cash generated internally** | **76.3** | 101.0 | 52.6 |
| **Cash invested:** | | | |
| Property, plant and equipment | **284.7** | 169.8 | 185.6 |
| Investment in Home Oil Company Limited, net of working capital acquired | **275.8** | | |
| Purchase (sale) of shares of Hiram Walker Resources Ltd. | **(46.8)** | 33.5 | |
| Other | **.6** | (1.3) | 12.7 |
| | **514.3** | 202.0 | 198.3 |
| **Net cash deficiency before financing** | **438.0** | 101.0 | 145.7 |
| **Financing:** | | | |
| Debentures issued | **125.0** | 80.0 | 175.0 |
| Interim financing | **170.0** | (12.0) | (26.1) |
| Mortgage | | 14.9 | |
| Capital stock issued | **.6** | 1.0 | 1.1 |
| | **295.6** | 83.9 | 150.0 |
| **Increase (decrease) in cash** | **(142.4)** | (17.1) | 4.3 |
| **Cash at beginning of year** | **158.4** | 175.5 | 171.2 |
| **Cash at end of year** | **$ 16.0** | $158.4 | $175.5 |

For purposes of this statement cash is defined as cash and short term investments less short term borrowings.

## Notes to consolidated financial statements December 31, 1986

(tabular amounts expressed in millions of dollars except number of shares and per share amounts)

### 1. Accounting Policies:

The information on page 22 presents a summary of significant accounting policies and is an integral part of these consolidated financial statements.

### 2. Acquisition of Home Oil Company Limited:

On December 5, 1986 the company completed the acquisition, from Hiram Walker Resources Ltd. ("HWR"), of all the issued and outstanding common shares and participating preference shares of Home and a 26% interest in Sovereign Oil & Gas PLC. The acquisition was accounted for as a purchase and the results of Home's operations subsequent to November 30, 1986 have been included in the consolidated financial statements.

The investment in Home exceeded the book value of Home's net assets by $60.9 million. This excess has been allocated to the assets acquired on the basis of their estimated fair values.

| | |
|---|---|
| Net assets acquired: | |
| Assets | $1,501.2 |
| Liabilities | 603.3 |
| | $ 897.9 |
| Financed by: | |
| Exchange of HWR preferred shares, at book value | $ 377.9 |
| Oil indexed debentures | 200.0 |
| Cash | 320.0 |
| | $ 897.9 |

The following pro forma information is presented as if the acquisition had occurred on January 1, 1986 and January 1, 1985 respectively. This information may not be indicative of results that actually would have occurred had the acquisition been consummated on the dates indicated, or the results of future operations of the company.

| | Year ended December 31 (unaudited) | |
|---|---|---|
| | **1986**[1] | 1985 |
| Total revenue | **$837.3** | $922.6 |
| Earnings | **116.1** | 147.4 |
| Earnings per share | **2.94** | 3.73 |
| Weighted average shares outstanding (000's) | **39,531** | 39,507 |

[1] Excludes an $11.3 million write-down of foreign properties which Home recorded effective September 30, 1986 in accordance with the Canadian Institute of Chartered Accountants' guidelines on full cost accounting in the oil and gas industry.

### 3. Montreal Extension Deficiency Agreement:

Interprovincial and the Canadian Government are parties to a Deficiency Agreement whereby the Government will pay the deficiency if operating revenue in respect of the Extension is not sufficient to meet the fixed and variable costs of the Extension. Under the Agreement the Government has an option to purchase the Extension at its capital cost less depreciation, plus related expenses.

Tariffs prescribed by the National Energy Board in respect of the Montreal Extension do not produce sufficient operating revenue to meet the fixed and variable costs of the Extension. For the years ended December 31, 1986, 1985 and 1984, deficiencies amounting to $10.6 million, $8.3 million and $7.4 million respectively, have been included in Operating revenue.

### 4. Deferred Charges and Other Assets:

| | **1986** | 1985 |
|---|---|---|
| Purchased tax benefits | **$ 3.8** | $ 6.1 |
| Unamortized discount and expense on long term debt | **7.5** | 5.7 |
| Deferred transportation charges | **6.0** | 6.6 |
| Insurance claim | **7.0** | |
| Other | **8.4** | 2.2 |
| | **$32.7** | $20.6 |

**Purchased tax benefits**

United States tax legislation permitted the transfer of tax benefits (investment tax credits and accelerated depreciation deductions) from one entity to another through transactions structured as leases for tax purposes. A subsidiary of the company entered into such a transaction in 1982. The purchased tax benefits continue to be realized through the deferral of taxes during the first five years over the 11-year life of the lease.

Effective July 1, 1987, the U.S. corporate income tax rate will be reduced from 46% to 34% following passage of the Tax Reform Act of 1986. Since the deferral of taxes related to the lease will reverse at a lower rate than provided, the company recognized a gain in 1986 of $3.3 million net of unamortized acquisition costs.

### 5. Investments:

| | **1986** | 1985 |
|---|---|---|
| Hiram Walker Resources Ltd. | | $376.1 |
| Federated Pipe Lines Ltd., equity method | **$29.3** | |
| Minerals Limited, equity method | **.8** | |
| Sovereign Oil & Gas PLC, cost method | **6.7** | |
| | **$36.8** | $376.1 |

Prior to April 1, 1986 investment earnings from HWR were accounted for by the equity method and subsequent thereto by the cost method.

## 6. Property, Plant and Equipment:

| | 1986 | | | 1985 |
|---|---|---|---|---|
| | Cost | Accumulated depletion, depreciation & amortization | Net | Net |
| Pipelines | $2,097.0 | $777.3 | $1,319.7 | $1,109.6 |
| Natural resources | 1,303.6 | 8.1 | 1,295.5 | |
| | $3,400.6 | $785.4 | $2,615.2 | $1,109.6 |

Costs of evaluating unproved properties excluded from the computation of depletion amounted to $70 million at December 31, 1986.

It is estimated that 1987 capital expenditures for Pipelines and Natural resources will amount to approximately $100 million and $180 million respectively.

The Canadian oil and gas depletion and depreciation expense per equivalent unit of production for the month ended December 31, 1986 amounted to $5.00 per barrel.

## 7. Indebtedness:

| Short term borrowings | 1986 | 1985 |
|---|---|---|
| Bank loans | $44.2 | $ 2.1 |
| Commercial paper | 23.2 | 34.7 |
| | $67.4 | $36.8 |

| Long term debt | Maturity | 1986 | 1985 |
|---|---|---|---|
| Sinking Fund Debentures | | | |
| Unsecured | | | |
| 6½% | 1986 | | $ 10.3 |
| 6½% (1986 U.S. $7.8; 1985 U.S. $8.6) | 1992 | $ 10.7 | 12.0 |
| 7⅛% (1986 U.S. $18.3; 1985 U.S. $18.3) | 1993 | 25.2 | 25.6 |
| 7¼% | 1988 | 4.1 | |
| 7.60% (1986 U.S. $18.1; 1985 U.S. $20.0) | 1997 | 24.9 | 27.9 |
| 8⅝% | 1993 | 27.4 | 29.2 |
| 9⅞% | 1990 | 29.8 | 30.9 |
| 9⅞% | 1998 | 44.9 | |
| 10.00% | 2006 | 125.0 | |
| 10⅛% | 1996 | 26.6 | 29.2 |
| 10⅞% | 1996 | 48.8 | 48.8 |
| 11⅜% | 1996 | 50.0 | 50.7 |
| Secured[1] | | | |
| 9.80% to 11.10%[2] | 1986-99 | 74.3 | 80.0 |
| 12.70% | 2004 | 75.0 | 75.0 |
| 13.40% | 2004 | 100.0 | 100.0 |
| Other Debentures – Unsecured | | | |
| 5.00%[3] | 2000 | 200.0 | |
| 12¼% | 1993 | 50.0 | 50.0 |
| Mortgage[4] | | | |
| 11¾% | 1987 | 14.7 | 14.8 |
| Interim financing – at varying interest rates, currently averaging 8.3%[5] | 1995 | 170.0 | |
| | | 1,101.4 | 584.4 |
| Less: Current portion | | 41.7 | 21.6 |
| | | $1,059.7 | $562.8 |

## 7. Indebtedness: – cont.

[1]Secured by an assignment of the Norman Wells Pipeline Agreement and a first mortgage.

[2]Comprised of 9.8% to 10.75% Serial Debentures due 1986 to 1990 in annual payments of $5.7 million and 11.10% Sinking Fund Debentures of $51.5 million due in 1999.

[3]Oil indexed debentures bear interest at a fixed rate of 5% per annum plus a variable rate (together not to exceed 21.8% per annum) based upon future oil prices.

[4]Secured by the IPL Tower office building.

[5]Supported by a bank credit agreement for up to $300 million.

Principal repayments required on Long Term Debt for the years ending December 31, 1987 through 1991 are $41.7 million, $36.7 million, $40.1 million, $64.7 million and $45.7 million respectively.

## 8. Deferred Credits:

| | 1986 | 1985 |
|---|---|---|
| Deferred production revenue | | |
| Take or pay | $37.4 | |
| Reversionary working interest | 24.3 | |
| | 61.7 | |
| Less: Current portion | 9.3 | |
| | 52.4 | |
| Deferred investment tax credits | 19.5 | $20.3 |
| Other | 2.9 | .5 |
| | $74.8 | $20.8 |

**Deferred production revenue**
Amounts paid to the company by purchasers, for annual contracted gas volumes not taken, are recorded as deferred production revenue. These amounts will be recorded as revenue when the gas to which the payments relate is delivered to the purchaser. Deliveries or repayments are to be made over a maximum 10-year period ending November 1, 1994.

The reversionary working interest represents the unremitted portion of the proceeds from the sale of certain resource properties. (See Note 15)

**Deferred investment tax credits**
Prior to January 1, 1986 the U.S. subsidiaries were allowed credits against income taxes payable of a specified percentage of the cost of some depreciable assets acquired and placed into service. These credits have been deferred and are being taken into earnings over the life of the related assets.

## 9. Minority Interest:

The minority shareholders' interest shown on the statement of financial position represents an 11.9% interest in Scurry-Rainbow Oil Limited, amounting to $22.4 million, and a 40.0% interest in Home Energy Company Ltd., amounting to $4.9 million.

## 10. Capital Stock:

Interprovincial is authorized to issue 42,000,000 common shares and an unlimited number of preferred shares. No preferred shares have been issued.

| | Common Shares | |
|---|---|---|
| | Number | Amount |
| Balance at December 31, 1983 | 39,448,416 | $383.1 |
| Exercise of stock options | 15,000 | .2 |
| Stock dividends | 30,475 | .9 |
| Balance at December 31, 1984 | 39,493,891 | 384.2 |
| Exercise of stock options | 2,850 | .1 |
| Stock dividends | 25,621 | 1.0 |
| Balance at December 31, 1985 | 39,522,362 | 385.3 |
| Exercise of stock options | 5,250 | .1 |
| Stock dividends | 12,329 | .5 |
| Balance at December 31, 1986 | 39,539,941 | $385.9 |

## 11. Stock Options:

| | 1986 | 1985 | 1984 |
|---|---|---|---|
| Shares under option, beginning of year | 101,550 | 58,900 | 29,500 |
| Options granted | 84,100 | 45,500 | 44,400 |
| Options exercised | (5,250) | (2,850) | (15,000) |
| Options cancelled | (3,000) | | |
| Shares under option, end of year | 177,400 | 101,550 | 58,900 |

At December 31, 1986 options granted under the Employee Incentive Stock Option Plan (1969) were outstanding for 8,500 common shares of Interprovincial at a price of $14.75 per share exercisable until December 1988.

The Incentive Stock Option Plan (1984) authorized the issue of a maximum of 400,000 common shares of Interprovincial. Under the Plan full-time key employees of the company may be granted options until December 31, 1988 to purchase unissued common shares at not less than 90% of the fair market value of the shares on the day of the grant (100% for employees of a U.S. subsidiary). At December 31, 1986, options were outstanding on 39,300 shares at $27.00 per share, on 45,500 shares at $42.25 per share, on 64,100 shares at $44.13 per share and on 20,000 shares at $38.75 per share.

## 12. Interest:

| | 1986 | 1985 | 1984 |
|---|---|---|---|
| Interest expense – on Long Term Debt | **$67.8** | $63.2 | $53.2 |
| – on Short term borrowings | **.6** | | |
| Capitalized interest | **(5.8)** | (9.0) | (16.9) |
| | **$62.6** | $54.2 | $36.3 |

## 13. Taxes:

The geographic components of Earnings before Taxes and Investment Earnings From HWR were as follows:

| | 1986 | 1985 | 1984 |
|---|---|---|---|
| Earnings before Taxes and Investment Earnings From HWR | | | |
| Canada | **$ 84.5** | $ 63.0 | $ 61.5 |
| United States | **138.2** | 146.4 | 147.5 |
| Other | **(.4)** | | |
| | **$222.3** | $209.4 | $209.0 |
| Current taxes | | | |
| Canada | **$ 8.1** | $ 14.9 | $ 23.5 |
| United States | **56.2** | 64.3 | 63.0 |
| United States withholding taxes | **7.0** | 8.0 | 7.5 |
| | **71.3** | 87.2 | 94.0 |
| Deferred taxes and investment tax credits | | | |
| Canada | **30.6** | 12.3 | 1.4 |
| United States | **10.0** | 6.3 | 8.9 |
| | **40.6** | 18.6 | 10.3 |
| Total Taxes | **$111.9** | $105.8 | $104.3 |

The provision for deferred taxes results from timing differences in the recognition of items for tax and financial statement purposes. The types of these differences and the tax effect of each were as follows:

| | 1986 | 1985 | 1984 |
|---|---|---|---|
| Excess of tax over book depletion and depreciation | **$35.2** | $10.7 | $ 3.0 |
| Purchased tax benefits | **5.5** | 5.6 | 5.0 |
| Other | **.4** | 2.5 | 3.4 |
| | **$41.1** | $18.8 | $11.4 |

## 13. Taxes: – cont.

The tax provision exceeds amounts computed by applying the Canadian statutory federal income tax rate to Earnings before Taxes and Investment Earnings From HWR. The differences were as follows:

| | **1986** | 1985 | 1984 |
|---|---|---|---|
| Canadian federal income tax rate | **46.0%** | 46.0% | 46.0% |
| Computed income tax provision | **$102.3** | $ 96.3 | $ 96.1 |
| Provincial and state income taxes after abatement | **9.1** | 7.3 | 8.4 |
| U.S. withholding tax on dividends from a U.S. subsidiary | **7.0** | 8.0 | 7.5 |
| Other | **(6.5)** | (5.8) | (7.7) |
| Total Taxes | **$111.9** | $105.8 | $104.3 |
| Effective tax rate | **50.3%** | 50.5% | 49.9% |

## 14. Pension Plans:

The company has defined benefit pension plans which cover substantially all employees and require contributions by participants in some cases. At December 31, 1985, the date of the last actuarial valuations, a net surplus of $5.1 million was calculated related to past service benefits. For the years ended December 31, 1986, 1985 and 1984, total pension plan expense amounted to $1.6 million, $3.6 million and $3.3 million respectively, of which $.8 million in both 1985 and 1984 was applicable to past service benefits.

Accumulated plan benefit information and net plan assets at December 31, as estimated by consulting actuaries, were as follows:

| | 1985 | 1984 |
|---|---|---|
| Actuarial present value of accumulated plan benefits – | | |
| Vested | $62.4 | $53.1 |
| Nonvested | 1.9 | 1.3 |
| | $64.3 | $54.4 |
| Market value of net assets available for benefits | $92.6 | $71.3 |

The above information at December 31, 1985 excludes Home's pension plans. At December 31, 1985 Home's pension plans had a net surplus of $8.4 million, the actuarial present value of accumulated plan benefits was $46.4 million and the market value of net assets available for benefits was $53.9 million.

## 15. Related Party Transactions:

At December 31, 1986 Imperial Oil Limited owned 21.7% (1985 and 1984 – 21.8%) of the outstanding common shares of Interprovincial. During the years ended December 31, 1986, 1985 and 1984 shipments through the pipeline system by Imperial Oil under published pipeline tariff terms accounted for approximately 24%, 19% and 13% of consolidated transportation revenue. At December 31, 1986, 1985 and 1984 transportation revenue receivable from Imperial Oil amounted to $12.2 million, $5.2 million and $2.2 million respectively.

As a result of Gulf Canada Corporation's acquisition of HWR in 1986, Gulf acquired HWR's 34.4% interest in Interprovincial's common shares. This, combined with Gulf's previous shareholding of 6.5%, resulted in Gulf owning 40.9% of Interprovincial's common shares at December 31, 1986. During 1986 shipments through the pipeline system by Gulf under published pipeline tariff terms accounted for approximately 2% of consolidated transportation revenue. At December 31, 1986 accounts receivable from Gulf, including transportation revenue receivable of $.7 million, amounted to $3.7 million.

A subsidiary of the company sold its working interest in certain resource properties to the Hiram Walker Resources Ltd. Pension Fund Master Trust. The working interest will revert to the subsidiary when the Fund has recovered its investment plus the contracted return thereon.

## 16. Segmented Information:

| Business segment | 1986 | 1985 | 1984 |
|---|---|---|---|
| **Earnings** | | | |
| Pipelines | | | |
| Operating revenue | $ 541.6 | $ 509.4 | $ 444.4 |
| Less: Power | 116.1 | 112.8 | 100.7 |
| Operating and administrative | 106.5 | 105.3 | 93.0 |
| Depreciation and amortization | 65.4 | 58.6 | 45.9 |
| Operating income | 253.6 | 232.7 | 204.8 |
| Natural Resources | | | |
| Operating revenue | 20.2 | | |
| Less: Operating and administrative | 7.1 | | |
| Depletion, depreciation and amortization | 7.7 | | |
| Operating income | 5.4 | | |
| Total operating income | 259.0 | 232.7 | 204.8 |
| Investment and other income | 46.3 | 66.1 | 65.4 |
| | 305.3 | 298.8 | 270.2 |
| Less: Interest | 62.6 | 54.2 | 36.3 |
| Taxes | 111.9 | 105.8 | 104.3 |
| Earnings for the Year | $ 130.8 | $ 138.8 | $ 129.6 |
| **Identifiable assets** | | | |
| Pipelines | $1,391.1 | $1,170.9 | $1,032.6 |
| Natural resources | 1,424.7 | | |
| Other | 120.2 | 571.3 | 524.8 |
| | $2,936.0 | $1,742.2 | $1,557.4 |
| **Additions to Property, plant and equipment** | | | |
| Pipelines | $ 272.4 | $ 169.8 | $ 185.6 |
| Natural resources | 12.3 | | |
| | $ 284.7 | $ 169.8 | $ 185.6 |

| Geographic area | 1986 | 1985 | 1984 |
|---|---|---|---|
| **Operating revenue** | | | |
| Canada | $ 291.1 | $ 231.6 | $ 183.6 |
| United States | 270.2 | 277.8 | 260.8 |
| Other | .5 | | |
| | $ 561.8 | $ 509.4 | $ 444.4 |
| **Earnings** | | | |
| Canada | $ 66.4 | $ 71.0 | $ 61.6 |
| United States | 65.0 | 67.8 | 68.0 |
| Other | (.6) | | |
| | $ 130.8 | $ 138.8 | $ 129.6 |
| **Identifiable assets** | | | |
| Canada | $2,506.3 | $1,345.0 | $1,180.5 |
| United States | 409.0 | 397.2 | 376.9 |
| Other | 20.7 | | |
| | $2,936.0 | $1,742.2 | $1,557.4 |

## 17. Commitments:

The company has signed a cash deficiency agreement with respect to Frontier Pipeline Company and is committed to support, to the extent of its interest, the financial obligations of the partnership.

A subsidiary of the company is involved in the development of two large tertiary recovery projects. Management estimates that, based on regulations and prices in effect at December 31, 1986, the net cost of material to be used in the projects will amount to $60 million.

## 18. United States Accounting Principles:

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in Canada. These principles differ in certain respects from those applicable in the United States. Under United States generally accepted accounting principles, ("U.S. GAAP"), the exchange of the company's investment in shares of HWR for shares of Home would have been treated as two separate and distinct accounting transactions and would have resulted in the company recognizing a gain on disposal of its investment in HWR with a corresponding increase in its investment in Home. However, under U.S. GAAP the company would also be subject to the Securities and Exchange Commission's ("SEC") accounting rules on full cost accounting for its oil and gas producing activities. These rules would require a reduction in the carrying value of Home's oil and gas properties pursuant to the SEC's ceiling test. This reduction would offset the gain on disposal of the investment in HWR and the impact on consolidated earnings would not be material.

## Oil and Gas Exploration and Production Activities (unaudited)

The following unaudited supplementary oil and gas information is provided in accordance with the United States Statement of Financial Accounting Standards No. 69 "Disclosures about Oil and Gas Producing Activities". As the company did not engage in oil and gas exploration and production activities prior to the acquisition of Home, (see Note 2), the following information is provided as at December 31, 1986 only.

Oil and gas exploration and production activities are carried out principally in Canada and to a lesser extent in other areas internationally.

### (a) Capitalized Costs

| | December 31, 1986 | | |
|---|---|---|---|
| | Cost | Accumulated Depletion & Depreciation | Net |
| **Capitalized costs** | | | |
| Canada | $1,248.0 | $6.5 | $1,241.5 |
| International | 10.6 | 1.2 | 9.4 |
| | $1,258.6 | $7.7 | $1,250.9 |

### (b) Proved Oil and Gas Reserves

Net proved oil and gas reserves are estimated quantities of crude oil (including natural gas liquids) and natural gas which geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic and operating conditions. The company's proved reserves are located in Canada, Australia and Indonesia and are based on estimates made by company engineers.

The calculation of net proved reserves is based on the company's share of proved reserves after the deduction of royalties which were calculated on the basis of royalty regulations in effect on the date the estimates were made. Federal and provincial government royalty rates vary depending on price, production volume and the timing of initial production.

Net proved developed oil and gas reserves are reserves that can be expected to be recovered through existing wells with existing equipment and operating methods.

| | December 31, 1986 | | | | | |
|---|---|---|---|---|---|---|
| | Canada | | International | | Total | |
| | Oil[1] | Gas[2] | Oil[1] | Gas[2] | Oil[1] | Gas[2] |
| **Proved reserves** | 86,430 | 780 | 704 | – | 87,134 | 780 |
| **Proved developed reserves** | 80,905 | 742 | 704 | – | 81,609 | 742 |

[1]Thousands of barrels

[2]Billions of cubic feet

### (c) Standardized Measure of Discounted Future Net Cash Flows

The standardized measure of future cash flows are computed by applying year-end prices to year-end quantities of proved oil and gas reserves and deducting future development costs, production costs and income taxes (net of Alberta Royalty Tax Credit). Future development and production costs are based on year-end costs and assume continuation of existing economic and operating conditions. Future income taxes are computed by applying the appropriate year-end statutory rates to the future pretax net cash flows, after making provisions for the tax basis of the oil and gas properties. Future net cash flows are discounted at a rate of 10% per annum to arrive at discounted future net cash flows.

The company cautions that the standardized measure of discounted future net cash flows from proved oil and gas reserves is not an indication of fair market value of the company's oil and gas properties. The standardized measure does not include the fair market value of exploratory properties, probable or possible oil and gas reserves, anticipated changes in crude oil and natural gas prices, development and production costs and possible changes to tax and royalty regulations. The prescribed discount rate of 10% may not appropriately reflect future interest rates.

| | December 31, 1986 |
|---|---|
| **Future cash inflows** | |
| Canada | $3,467.8 |
| International | 16.3 |
| | 3,484.1 |
| **Future production and development costs** | |
| Canada | 1,110.2 |
| International | 6.8 |
| | 1,117.0 |
| **Future pretax cash flows** | |
| Canada | 2,357.6 |
| International | 9.5 |
| | 2,367.1 |
| **Future income taxes** | |
| Canada | 783.9 |
| International | 2.4 |
| | 786.3 |
| **Future net cash flows** | |
| Canada | 1,573.7 |
| International | 7.1 |
| | 1,580.8 |
| **10% annual discount for timing of future cash flows** | |
| Canada | 743.3 |
| International | 1.0 |
| | 744.3 |
| **Discounted future net cash flows** | |
| Canada | 830.4 |
| International | 6.1 |
| | $ 836.5 |

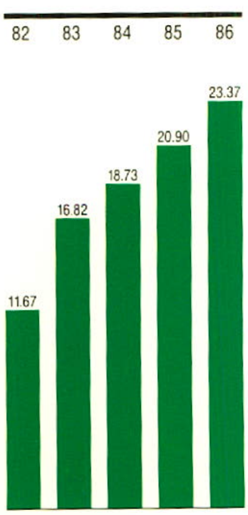
## Summarized Quarterly Information (unaudited)

| | 1986 | | | | 1985 | | | |
|---|---|---|---|---|---|---|---|---|
| | **First** | **Second** | **Third** | **Fourth** | First | Second | Third | Fourth |
| **Financial** | | | | | | | | |
| (in millions of dollars except per share amounts) | | | | | | | | |
| Operating revenue | **$135.7** | **$135.4** | **$134.7** | **$156.0** | $114.2 | $125.8 | $129.6 | $139.8 |
| Earnings | **32.9** | **31.7** | **32.5** | **33.7** | 37.7 | 30.1 | 27.7 | 43.3 |
| per share | **0.89** | **0.80** | **0.82** | **0.85** | 1.01 | 0.80 | 0.74 | 1.16 |
| Dividends* | **19.7** | **19.7** | **19.8** | **19.8** | 17.8 | 17.8 | 17.8 | 19.7 |
| per share | **0.50** | **0.50** | **0.50** | **0.50** | 0.45 | 0.45 | 0.45 | 0.50 |
| **Share Trading**** | | | | | | | | |
| High | **43** | **45** | **43 3/4** | **41 3/8** | 37 1/2 | 42 1/2 | 43 3/4 | 46 |
| Low | **37 1/8** | **42** | **37 7/8** | **38 1/4** | 33 1/2 | 35 5/8 | 41 3/8 | 42 |
| Volume (in thousands) | **1,110** | **1,191** | **1,137** | **985** | 1,187 | 1,038 | 731 | 590 |

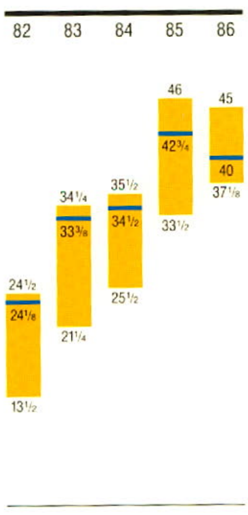
*Cash dividends paid to shareholders resident in most countries with which Canada has a tax convention, including the United States, are generally subject to Canadian withholding tax at a rate of 15%. Cash dividends paid to other non-residents of Canada are usually subject to withholding tax at a maximum rate of 25%.

**The Company's stock is traded on the Toronto and Montreal stock exchanges in Canada and on a limited basis in the over-the-counter market in the United States. Prices and volumes shown are for the Toronto Stock Exchange.

**Shareholders' equity per share**
($)




**Share price – high, low & close (TSE)**
($)
— Closing price



## Five-year review

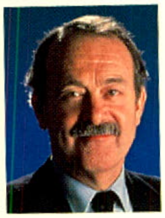
| **Financial** (in millions of dollars except per share amounts) | **1986** | 1985 | 1984 | 1983 | 1982 |
|---|---|---|---|---|---|
| **Operations:** | | | | | |
| Revenue | | | | | |
| Operating | **$561.8** | $509.4 | $444.4 | $412.7 | $366.0 |
| Interest and other income | **18.8** | 25.0 | 30.8 | 19.1 | 18.0 |
| Allowance for equity funds | **7.1** | 5.9 | 9.7 | 6.5 | 2.7 |
| Expenses | | | | | |
| Power | **116.1** | 112.8 | 100.7 | 79.9 | 65.5 |
| Operating and administrative | **113.6** | 105.3 | 93.0 | 91.0 | 89.0 |
| Depletion, depreciation & amortization | **73.1** | 58.6 | 45.9 | 45.5 | 44.1 |
| Interest | **62.6** | 54.2 | 36.3 | 36.8 | 33.5 |
| Taxes | **111.9** | 105.8 | 104.3 | 96.8 | 79.9 |
| Investment earnings from HWR | **20.4** | 35.2 | 24.9 | 8.7 | |
| Earnings for the year | **130.8** | 138.8 | 129.6 | 97.0 | 74.7 |
| Dividends paid | **79.0** | 73.1 | 67.1 | 46.7 | 41.2 |
| Dividend payout | **60%** | 53% | 52% | 48% | 55% |
| Cash provided from operations | **233.4** | 186.8 | 164.4 | 141.5 | 129.4 |
| Net cash generated internally | **76.3** | 101.0 | 52.6 | 69.7 | 71.7 |
| **Per Share:** | | | | | |
| Earnings | **3.36** | 3.71 | 3.47 | 3.38 | 2.90 |
| Dividends | **2.00** | 1.85 | 1.70 | 1.60 | 1.60 |
| Cash provided from operations | **5.99** | 5.00 | 4.41 | 4.94 | 5.02 |
| Shareholders' equity | **23.37** | 20.90 | 18.73 | 16.82 | 11.67 |
| **Assets:** | | | | | |
| Working capital | **(8.0)** | 111.8 | 153.7 | 146.3 | 81.8 |
| Property, plant & equipment at cost less accumulated depletion, depreciation and amortization | **2,615.2** | 1,109.6 | 960.4 | 793.0 | 694.4 |
| Total assets | **2,936.0** | 1,742.2 | 1,557.4 | 1,346.5 | 857.4 |
| **Capital employed:** | | | | | |
| Long term debt | **1,059.7** | 562.8 | 515.1 | 409.6 | 332.6 |
| Deferred taxes and credits | **665.5** | 229.2 | 202.0 | 183.9 | 160.7 |
| Minority interest | **27.3** | | | | |
| Shareholders' equity | **924.2** | 826.1 | 739.7 | 663.4 | 301.1 |
| Total capital employed | **2,676.7** | 1,618.1 | 1,456.8 | 1,256.9 | 794.4 |
| **Ratios:** | | | | | |
| Long term debt to long term debt plus equity | **53.4%** | 40.5% | 41.0% | 38.2% | 52.5% |
| Earnings coverage of interest | **4.9 x** | 5.5 x | 7.5 x | 6.3 x | 5.6 x |
| Return on average capital employed | **8.6%** | 10.8% | 10.9% | 12.6% | 11.6% |
| Return on average shareholders' equity | **14.7%** | 17.7% | 18.5% | 25.0% | 26.3% |

## Statistical

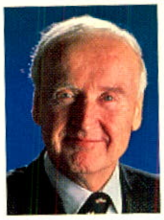
| | 1986 | 1985 | 1984 | 1983 | 1982 |
|---|---|---|---|---|---|
| Shares outstanding at year end (thousands) | **39,540** | 39,522 | 39,494 | 39,448 | 25,795 |
| Percentage of shares registered in Canada | **97%** | 97% | 97% | 97% | 96% |
| Shareholders at year end | **11,041** | 12,725 | 14,392 | 15,879 | 17,912 |
| Number of employees at year end | **1,903** | 876 | 825 | 798 | 782 |
| **Receipts (b/d)** | | | | | |
| Northwest Territories | **22,983** | 14,825 | | | |
| Alberta | **1,030,571** | 1,042,748 | 1,022,828 | 964,012 | 887,969 |
| Saskatchewan | **201,204** | 201,620 | 188,103 | 162,774 | 141,552 |
| Manitoba | **16,983** | 16,291 | 15,184 | 13,580 | 10,768 |
| Ontario | **15,328** | 24,348 | 7,686 | 3,258 | 4,095 |
| United States | **80,478** | 88,604 | 98,926 | 107,323 | 160,050 |
| | **1,367,547** | 1,388,436 | 1,332,727 | 1,250,947 | 1,204,434 |
| **Deliveries (b/d)** | | | | | |
| Canada | | | | | |
| Canadian Production | | | | | |
| Prairie Provinces | **195,707** | 175,171 | 152,528 | 142,049 | 136,482 |
| Ontario | **492,473** | 528,154 | 549,892 | 517,386 | 493,731 |
| Quebec | **120,116** | 183,071 | 225,816 | 246,441 | 250,535 |
| | **808,296** | 886,396 | 928,236 | 905,876 | 880,748 |
| U.S. and offshore production | | | | | |
| Ontario | **22,404** | 18,756 | 14,385 | 14,309 | 40,085 |
| Quebec | **1,082** | 3,818 | 1,610 | 2,264 | 17,637 |
| | **23,486** | 22,574 | 15,995 | 16,573 | 57,722 |
| Total Canadian deliveries | **831,782** | 908,970 | 944,231 | 922,449 | 938,470 |
| United States | | | | | |
| Canadian production | **476,824** | 411,510 | 304,753 | 235,389 | 157,132 |
| U.S. and offshore production | **57,954** | 67,987 | 81,944 | 92,926 | 105,316 |
| Total U.S. deliveries | **534,778** | 479,497 | 386,697 | 328,315 | 262,448 |
| | **1,366,560** | 1,388,467 | 1,330,928 | 1,250,764 | 1,200,918 |
| Barrel miles (millions) | **665,724** | 698,262 | 708,488 | 668,783 | 623,935 |
| Average haul (miles) | **1,335** | 1,378 | 1,454 | 1,465 | 1,423 |
| Average transportation revenue (including Deficiency Agreement) | | | | | |
| per barrel | **$1.09** | $1.00 | $0.91 | $0.90 | $0.83 |
| per 100 barrel miles | **8.1¢** | 7.3¢ | 6.3¢ | 6.2¢ | 5.9¢ |

# Corporate directory

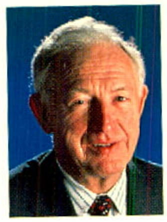
## Directors



Michael Bregazzi
Vice-President, Development,
Gulf Canada Corporation

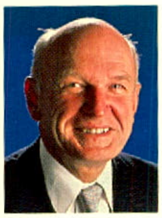


William A. Dimma[1,2]
Deputy Chairman,
Royal LePage Limited

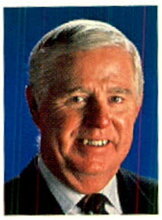


H. Gordon MacNeill[2]
President & Chief
Executive Officer,
Jannock Limited

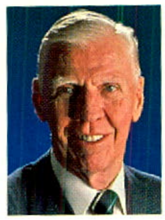
Robert B. Peterson
Executive Vice-President &
Chief Operating Officer,
Imperial Oil Limited



Donald G. Campbell[3]
Chairman of the Board,
Maclean Hunter Limited



F. William Fitzpatrick[1]
Chairman, President &
Chief Executive Officer,
Bralorne Resources Limited



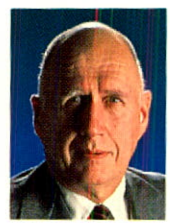
S. Keith McWalter[3]
President & Chief
Executive Officer,
Gulf Canada Resources

Gordon H. Thomson[2]
President,
Esso Petroleum Canada

Marshall A. Cohen
President, Olympia &
York Enterprises Limited

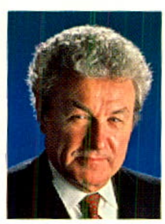
Richard F. Haskayne
President & Chief
Executive Officer,
Interprovincial Pipe Line
Limited

Gilbert I. Newman[2]
Executive Vice-President,
Olympia & York
Developments Limited



William J. Young[3]
Executive Vice-President &
Chief Financial Officer,
Imperial Oil Limited

Robert K. Heule[2]
Chairman of the Board,
Interprovincial Pipe Line
Limited



Earl H. Orser[1]
President & Chief
Executive Officer,
London Life Insurance
Company

Member of:
1. Audit Committee
2. Finance & Investment Committee
3. Compensation Committee

## Corporate Officers

Robert K. Heule
Chairman of the Board

Richard F. Haskayne
President & Chief Executive Officer

Brian F. MacNeill
Vice-President – Finance & Chief Financial Officer

Douglas R. Martin
Vice-President – Planning & Corporate Development

Kenneth A. McNeill
Vice-President – Corporate Services

E. Gordon Sheasby
Vice-President – Law

Allen R. Hagerman
Treasurer

J. Neil St. John
Corporate Secretary

## Pipeline Operations

Gordon A. Cole
Executive Vice-President & Chief Operating Officer

Donald J. Ross
Vice-President – Operations & Engineering

Derek P. Truswell
Vice-President & Controller

George W. Kirkwood
Vice-President – Business Planning & Systems

Andrew B. McCarroll
Vice-President – Rates & Administration

William M. Pearce
Vice-President – Special Projects

Donald B. MacDermott
General Counsel

## Lakehead Pipe Line

Wesley C. Cochrane
President & General Manager

## Home Oil

David E. Powell
Executive Vice-President & Chief Operating Officer

Humberto Alfaro
Vice-President – Production

Fred Callaway
Vice-President – Corporate Affairs

Ernest C. Hambrook
Vice-President – International Operations

Andrew P. Holder
Vice-President – Canadian Exploration

Edgar Jorgensen
Vice-President & Controller

Ronald G. Watkins
Vice-President – Government & Industry Relations

Douglas E. Deakin
Corporate Secretary

# Corporate information

## Registered and Executive Office
Interprovincial Pipe Line Limited
Box 96, 26th Floor
150 King Street West
Toronto, Ontario M5H 1J9
Telephone: (416) 586-0490

## Operating Headquarters
Interprovincial Pipe Line Limited
IPL Tower
10201 Jasper Avenue
Edmonton, Alberta T5J 3R3
Telephone: (403) 420-5210

Home Oil Company Limited
1700 Home Oil Tower
324 Eighth Avenue S.W.
Calgary, Alberta T2P 2Z5
Telephone: (403) 232-7100

## Stock Transfer Agents
The Royal Trust Company
Halifax, Montreal, Toronto, Winnipeg, Regina, Edmonton, Vancouver

Harris Trust Company of New York

(Change of address should be sent to the closest branch of the Transfer Agent)

## Stock Registrars
Montreal Trust Company
Halifax, Montreal, Toronto, Winnipeg, Regina, Edmonton, Vancouver

Harris Trust Company of New York

## Dividend Disbursing Agent
The Royal Trust Company
P.O. Box 7500, Postal Station "A"
Toronto, Ontario M5W 1P9

## Dividend Payment
Quarterly dividend cheques are mailed out several days prior to the payable dates which are the first day of March, June, September and December.

## Stock Dividend Program
Interprovincial has a Stock Dividend Program which enables shareholders to receive dividends in the form of Company shares rather than cash. Details may be obtained by contacting:

The Royal Trust Company
Corporate Trust Services
P.O. Box 7500, Postal Station "A"
Toronto, Ontario M5W 1P9
Telephone: (416) 867-2346

## Stock Listed
Toronto and Montreal Stock Exchanges
Stock market symbol – IPL

## Form 10-K
A Form 10-K Annual Report is filed with the United States Securities and Exchange Commission. This report will be made available upon written request to the Corporate Secretary of the Company.

## Trustee and Registrar for Debentures
Montreal Trust Company
Montreal, Toronto, Winnipeg, Edmonton, Vancouver

## Auditors
Price Waterhouse
Edmonton, Alberta

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