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**TEMAGAMI**  
Oil & Gas Ltd.

Annual Report  
1987

NOV 09 1987

HOWARD ROSS LIBRARY OF MANAGEMENT  
MCGILL UNIVERSITY

1001 Sherbrooke St., W.,  
Montreal, Quebec, Canada  
H3A 1G5



**Officers and Directors**

Donald C. Campbell  
President, Chief Executive Officer and Director

R. Bruce Boyden  
Director

John S. Grant, Jr.  
Director

Carl R. Jonsson  
Secretary and Director

Frederick G. Roman  
Vice-President and Director

Irene Huntley  
Vice-President and Controller

**Transfer Agent and Registrar**

Guaranty Trust Company of Canada  
88 University Avenue  
Toronto, Ontario  
M5J 1T8

**General Council**

Tupper, Jonsson, Shroff & Zink  
Vancouver, British Columbia

**Auditors**

Collins Barrow  
Calgary, Alberta

**Registered Office**

1710, 1177 West Hastings Street  
Vancouver, British Columbia  
V6E 2L3

**Corporate Office**

2300, 300 - 5th Avenue S.W.  
Calgary, Alberta  
T2P 0L3



## To Our Shareholders:

A steady improvement in crude prices, a significant restructuring of our long-term debt, an important gas discovery on the Liard Lease in the Northwest Territories in which we hold an interest, and continual improvements in our on-going operations have combined to improve the future outlook for your Company.

Following the lows reached in mid-1985, crude prices have been steadily improving. While prices are still a long way from the \$35 levels of a few years ago, the trend is positive.


Your Company's activities have been severely limited over the past several years due to the high debt service requirements. In July, 1987, following Roman Corporation Limited's purchase of the rights to the Company's indebtedness to the First Interstate Bank of California, an agreement was reached on the restructuring of the terms of such indebtedness. As a result of this restructuring, future interest costs will be reduced substantially, due to part of the indebtedness being non-interest bearing. In addition, all of the indebtedness has been reclassified as long-term, repayable only to the extent the Company has net cash flow to make such repayments.

The farmee on the Liard Lease in the Northwest Territories successfully completed a discovery gas well which was drilled at no cost to the Company. This well tested at a final stabilized rate of 8.8 MMCF/day through a 3/4" choke, with 20 barrels of water/MMCF, from perforations at 10,664 feet to 10,690 feet. No signs of depletion were apparent after producing 77.4 MMCF of gas. Preliminary reserve estimates, prepared by Sproule Associates, indicate proven recoverable gas reserves for this well of 13 Bcf and ultimate potential recoverable gas reserves for the structure of 110 Bcf. Your Company holds a 25% Net Revenue Interest in a 4.91 percent Working Interest in the 63,150 acre lease and has no further financial obligations in the development of this discovery.

Operations at the Company's principal producing property, the Hiland Leases in Wyoming, continue to be better than budgeted. Production from the eight producing wells, attributable to Temagami's Net Revenue Interest, was 31,520 bbls for the last fiscal year. A recent report by our outside consulting engineers estimated remaining proved developed producing reserves net to our interest at 255,520 bbls. In addition, the report points out that there are at least two well locations on the Hiland Leases that could be classified as proved undeveloped reserves and one well location for probable reserves. Each of these locations could be assigned 150,000 bbls of unrisks reserves. Under existing farmout agreements, the farmees can drill these additional wells at no cost to the Company and the Company would hold a 12.5 percent Working Interest before payout increasing to 36 percent after payout.

While the above events have greatly improved the outlook for your Company, there is still much more to be accomplished. Interest costs have been reduced substantially but the long-term debt is still high; oil and gas prices are improving, but developments in the world beyond our control could quickly disrupt this favourable trend; and while our existing properties are performing satisfactorily, we need to develop new ventures.

On Behalf of the Board,



Donald C. Campbell  
President

October 21, 1987.

# Auditors' Report

To the Shareholders  
TEMAGAMI OIL & GAS LTD.

We have examined the consolidated balance sheet of Temagami Oil & Gas Ltd. as at May 31, 1987 and the consolidated statements of income and deficit and cash flow for the year then ended. Our examination was made in accordance with generally accepted auditing standards in Canada, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the company as at May 31, 1987 and the results of its operations and cash flow for the year then ended in accordance with generally accepted accounting principles in Canada applied on a basis consistent with that of the preceding year.

COLLINS BARROW  
Chartered Accountants

Calgary, Canada  
July 16, 1987

## Comments on Difference in Canada - United States Reporting Standards For Auditors

In the United States, reporting standards for auditors require the expression of an opinion qualified as being subject to the outcome of significant uncertainties affecting the financial statements such as the uncertainties referred to in the attached balance sheet as at May 31, 1987 and as described in notes 1, 5 and 7 to the financial statements. The opinion in our above report is expressed in accordance with Canadian standards and is not qualified with respect to, and provides no reference to, these uncertainties since such an opinion would not be in accordance with Canadian reporting standards for auditors when the uncertainties are adequately disclosed in the financial statements.

COLLINS BARROW  
Chartered Accountants

Calgary, Canada  
July 16, 1987

TEMAGAMI OIL & GAS LTD.

(Incorporated under the laws of British Columbia)

# Consolidated Balance Sheet

May 31, 1987

	1987	1986
<b>Assets</b>		
Current assets		
Cash	\$ 51,373	\$ 77,449
Accounts receivable	106,826	39,468
Marketable securities (market value — \$24,500; 1986 — \$47,200)	1,750	1,750
Current portion of agreement receivable	—	34,850
	<u>159,949</u>	<u>153,517</u>
Agreement receivable (note 3)	—	3,123
Property and equipment (note 4)	9,914	18,648
	<u>\$ 169,863</u>	<u>\$ 175,288</u>

## Liabilities


Current liabilities		
Accounts payable and accrued liabilities	\$ 274,856	\$ 1,333,566
Current portion of long-term debt	—	1,688,602
	<u>274,856</u>	<u>3,022,168</u>
Long-term debt (note 5)	<u>7,822,651</u>	<u>5,442,522</u>

## Shareholders' Deficiency

Share capital (note 6)	6,880,000	6,880,000
Unrealized foreign exchange gain	1,899,361	1,670,357
Deficit	<u>(16,707,005)</u>	<u>(16,839,759)</u>
	<u>(7,927,644)</u>	<u>(8,289,402)</u>
Contingent liabilities (note 7)	<u>\$ 169,863</u>	<u>\$ 175,288</u>

Approved on behalf of the Board,

  
\_\_\_\_\_, Director

  
\_\_\_\_\_, Director



TEMAGAMI OIL & GAS LTD.

(Incorporated under the laws of British Columbia)

# Consolidated Statement of Income and Deficit

Year ended May 31, 1987

	1987	1986
Revenue		
Oil and gas sales	\$ 704,767	\$ 1,233,630
Interest and other	56,279	5,922
	<u>761,046</u>	<u>1,239,552</u>
Expenses		
Production and production taxes	291,492	379,726
General and administrative	75,240	151,668
Interest on long-term debt	619,321	714,444
Depreciation	1,101	4,510
	<u>987,154</u>	<u>1,250,348</u>
Loss from operations	(226,108)	(10,796)
Provision for (recovery of) impairment in value of oil and gas properties and equipment	<u>(59,698)</u>	<u>6,548,531</u>
Loss before extraordinary item	(166,410)	(6,559,327)
Forgiveness of interest on long-term debt	<u>299,164</u>	<u>—</u>
Net income (loss)	132,754	(6,559,327)
Deficit, beginning of year	<u>(16,839,759)</u>	<u>(10,280,432)</u>
Deficit, end of year	<u>\$ (16,707,005)</u>	<u>\$ (16,839,759)</u>
Income (loss) per share		
— before extraordinary item	<u>\$ (0.016)</u>	<u>\$ (0.626)</u>
— after extraordinary item	<u>\$ 0.013</u>	<u>\$ (0.626)</u>

TEMAGAMI OIL & GAS LTD.

(Incorporated under the laws of British Columbia)

# Consolidated Statement of Cash Flow

Year ended May 31, 1987

	1987	1986
Operating activities		
Net oil and gas receipts	\$ 341,622	\$ 934,051
Interest and other receipts	56,279	5,922
General and administrative payments	(47,424)	(126,290)
Interest payments	(673,959)	(726,694)
Extraordinary item — forgiveness of interest on long-term debt	299,164	—
	<u>(24,318)</u>	<u>86,989</u>
Investing activities		
Decrease in agreement receivable	—	31,247
Proceeds on disposal of property and equipment	5,490	—
	<u>5,490</u>	<u>31,247</u>
Financing activities		
Repayment of long-term debt	(5,490)	(120,101)
Cash outflow	<u>(24,318)</u>	<u>(1,865)</u>
Cash, beginning of year	77,449	78,972
Foreign exchange gain (loss) on cash account	<u>(1,758)</u>	<u>342</u>
Cash, end of year	<u>\$ 51,373</u>	<u>\$ 77,449</u>

# Notes to the Consolidated Financial Statements

May 31, 1987

## 1. Financial presentation

These financial statements have been prepared in accordance with generally accepted accounting principles. An assumption underlying the preparation of financial statements in accordance with generally accepted accounting principles is that the company will be able to realize assets and discharge liabilities in the normal course of business for the foreseeable future rather than through a process of forced liquidation. At May 31, 1987, however, the company had a shareholders' deficiency of \$7,927,644 and a working capital deficiency of \$114,907. The ability of the company to continue operating as a going concern is dependent on the continued management and financial support of the related party referred to in note 5.

## 2. Significant accounting policies

The consolidated financial statements of the company have been prepared by management in accordance with accounting principles generally accepted in Canada, which, in the case of the company, conform in all material respects with International Accounting Standards. These financial statements have in management's opinion been properly prepared within reasonable limits of materiality and in light of information available up to July 16, 1987. The principal accounting policies are summarized as follows:

### (a) Principles of consolidation

The consolidated financial statements include, in addition to the accounts of the company, the accounts of its wholly-owned subsidiary, Temagami Oil & Gas Inc.

### (b) Exploration and development expenditures

The company follows the full cost method of accounting for exploration and development expenditures, whereby all costs related to the exploration for and the development of oil and gas reserves are initially capitalized and accumulated in country-by-country cost centres (Canada and the United States). Costs capitalized include land acquisition costs, geological and geophysical expenditures, rentals on undeveloped properties, costs of drilling productive and non-productive wells together with overhead and interest directly related to exploration and development activities and production equipment. Proceeds on minor property sales are credited to the net book value of the property and equipment. Gains or losses on major property sales are normally recognized in the statement of income.

Costs capitalized in each of the cost centres are depleted and depreciated on the composite unit-of-production method based on estimated proven oil and and gas reserves as determined by independent and company engineers.

In applying the full cost method, the company performs a ceiling test which restricts the capitalized costs less accumulated depletion and depreciation for each cost centre from exceeding an amount equal to the estimated undiscounted value of future net revenues from proven oil and gas reserves, based on current prices and costs, and after deducting estimated future general and administrative expenses, financing costs and income taxes for each cost centre. In calculating the above cost centre ceiling tests, gas was converted to oil on a 6 MCF to 1 BBL equivalent basis and \$18 U.S. per barrel of oil was used as the current price of oil.

### (c) Depreciation

Depreciation of other equipment is provided on the declining balance method at rates varying from 20 to 30 percent per annum.

### (d) Joint ventures

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

### (e) Translation of foreign currencies

The U.S. operations are considered financially and operationally independent of the parent company and have been translated into Canadian dollars as follows: assets and liabilities at the rate of exchange at the balance sheet date, revenues and expenses at the average rate of exchange during the year. Gains or losses on translation are shown as a separate component in shareholders' deficiency.



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TEMAGAMI OIL & GAS LTD.

CONSOLIDATED STATEMENT OF INCOME AND DEFICIT

THREE MONTHS ENDED AUGUST 31, 1987

(unaudited)

	<u>1987</u>	<u>1986</u>
Revenue		
Oil and gas sales	\$ <u>193,717</u>	\$ <u>154,933</u>
Expenses		
Production and production taxes	55,075	50,348
General and administrative	19,018	21,844
Interest on long-term debt	<u>80,942</u>	<u>165,722</u>
	<u>155,035</u>	<u>237,914</u>
Income (loss) from operations	38,682	(82,981)
Income taxes	<u>10,640</u>	<u>-</u>
Income (loss) before extraordinary items	<u>28,042</u>	<u>(82,981)</u>
Extraordinary items		
Forgiveness of interest on long-term debt	16,840	-
Reduction of income taxes resulting from application of prior year's losses	<u>10,640</u>	<u>-</u>
	<u>27,480</u>	<u>-</u>
Net income (loss)	55,522	(82,981)
Deficit, beginning of period	<u>16,707,005</u>	<u>16,839,759</u>
Deficit, end of period	\$ <u><u>16,651,483</u></u>	\$ <u><u>16,922,740</u></u>
Income (loss) per share		
- before extraordinary item	\$ <u>.003</u>	\$ <u>(.008)</u>
- after extraordinary item	\$ <u><u>.005</u></u>	\$ <u><u>(.008)</u></u>

TEMAGAMI OIL & GAS LTD.

CONSOLIDATED STATEMENT OF CASH FLOW

THREE MONTHS ENDED AUGUST 31, 1987

(unaudited)

	<u>1987</u>	<u>1986</u>
Operating activities		
Net oil and gas receipts	\$ 129,510	\$ 96,187
General and administrative payments	(16,429)	(22,511)
Interest payments	(80,942)	(111,077)
Extraordinary item - forgiveness of interest on long-term debt	<u>16,840</u>	<u>-</u>
	<u>48,979</u>	<u>(37,401)</u>
Investing activities		
Proceeds on disposal of property and equipment	<u>-</u>	<u>5,490</u>
Financing activities		
Advances on long-term debt	2,374	-
Repayment of long-term debt	<u>(24,547)</u>	<u>(5,490)</u>
	<u>(22,173)</u>	<u>(5,490)</u>
Cash inflow (outflow)	26,806	(37,401)
Cash, beginning of period	51,373	77,449
Foreign exchange gain (loss) on cash account	<u>(1,175)</u>	<u>409</u>
Cash, end of period	<u>\$ 77,004</u>	<u>\$ 40,457</u>



**(f) Marketable securities**

Marketable securities are carried at the lower of cost or estimated net realizable value.

**(g) Loss per share**

Net loss per share is based on the weighted average number of common shares outstanding during the year.

**3. Agreement receivable**

The agreement receivable bears interest at 10¾% and was due in monthly installments of \$3,104 including interest. As no installments have been received in the current year, an allowance for non-collection has been made.

	1987	1986
Balance, beginning of year	\$ 37,973	\$ 37,973
Less: Current portion	—	34,850
	37,973	3,123
Less: Allowance for non-collection	(37,973)	—
	<u>\$ —</u>	<u>\$ 3,123</u>

**4. Property and equipment**

	1987		1986
	Cost	Accumulated Depletion and Depreciation	Net
Oil and gas properties including exploration and development costs	\$ 19,733,433	\$ 19,733,431	\$ 2
Other equipment	56,033	46,121	18,646
	<u>\$ 19,789,466</u>	<u>\$ 19,779,552</u>	<u>\$ 18,648</u>

On May 31, 1986, an impairment in value of oil and gas properties in the amount of \$6,548,531 was recorded based on the results of the ceiling test calculated using the May 31, 1986 price of oil of \$12 U.S. per barrel. This impairment has resulted in the oil and gas properties being carried in the accounts at a nominal value of \$2.

**5. Long-term debt**

Long-term debt consists of the following:

	1987	1986
(a) Roman Corporation Limited ("Roman"), a related company		
(i) Note payable, bearing interest at Roman's "borrowing rate" plus 1% (U.S. \$885,000)	\$ 1,184,750	\$ —
(ii) Note payable, bearing interest at Roman's "borrowing rate" plus 1%	492,626	—
(iii) Note payable, non-interest bearing (U.S. \$4,280,000)	5,729,636	—
	<u>7,407,012</u>	<u>—</u>
(b) Seagull International Exploration Inc. ("Seagull"), a related company		
Agreement payable (U.S. \$310,480)	415,639	—
(c) First Interstate Bank of California		
Bank loan	—	7,125,634
(d) Obligations under capital leases	—	5,490
	<u>7,822,651</u>	<u>7,131,124</u>
Less: Current portion	—	1,688,602
	<u>\$ 7,822,651</u>	<u>\$ 5,442,522</u>

On June 30, 1987, Roman Corporation Limited ("Roman") purchased all right, title and interest of the First Interstate Bank of California loan payable, as shown in (c) above. The restructured terms of the loan and other indebtedness to Roman are reflected above.

The notes payable to Roman are secured by all assets of the company. Monthly payments of principal and interest are to be made in amounts equal to 95% of the company's "net cash flow" (as defined in the agreement). The unpaid balance, after paying the above monthly payments, shall become due and payable on December 31, 1990. No portion of the notes payable has been classified as current as they are repayable from future production proceeds and accordingly will not require the use of existing working capital.

The agreement payable is non-interest bearing and is due and payable, at the option of Seagull, on December 31, 1988, unless certain conditions of the agreement are not met, in which case the amount becomes immediately due and payable.

## 6. Share capital

	<u>1987</u>	<u>1986</u>
Authorized		
100,000 Preferred Shares Series A with a par value of \$1 each		
100,000 Preferred Shares Series B with a par value of \$1 each		
100,000 Preferred Shares Series C with a par value of \$1 each		
15,000,000 Common Shares without par value		
Issued		
10,470,000 Common Shares	<u>\$ 6,880,000</u>	<u>\$ 6,880,000</u>

## 7. Contingent Liabilities

During 1986, the company's Wyoming leases were investigated by the Wyoming State Auditor's Office, on behalf of the Minerals Management Service of the United States Department of the Interior, for the period from August, 1980 through December, 1985. Preliminary findings were that Temagami underpaid gas royalties and compensation by U.S. \$1,562,679, as follows:

Natural gas royalty	U.S. \$ 99,727
Flared gas compensation	1,460,671
Ad valorem tax reimbursement	<u>2,281</u>
	U.S. \$ <u>1,562,679</u>

Temagami has presented documentation to the Wyoming State Auditor to refute the preliminary findings concerning the flared gas compensation.

The Minerals Management Service subsequently issued a formal demand for the natural gas royalty and Temagami posted a bond in the amount of \$92,152 U.S. while formally appealing this assessment.

The assessment of the Wyoming State Auditor's Office and the Minerals Management Service relate to the total working interest value of the leases operated by Temagami. In the event the assessment becomes payable, Temagami would have a claim against its joint venture participants for approximately 40% of the assessment.

In the opinion of management, this assessment is without merit and Temagami is vigorously defending its rights in connection therewith. Any assessment which may become payable as a result of the above action will be retroactively adjusted to income for the period in question.

## 8. Remuneration of directors and officers

The total remuneration paid to directors and officers of the company amounted to \$48,000 (1986 — \$48,000).

## 9. Loss carry-forwards

As at May 31, 1987, the company has non-capital losses for income tax purposes available to be carried forward and applied against taxable income of future years. The potential income tax benefits associated with the losses have not been recorded in the financial statements.



	<u>Year Incurred</u>	<u>Approximate Amount</u>	<u>Year of Expiry</u>
Canadian Operations	1983	\$ 136,699	1988
	1984	138,196	1991
	1985	12,428	1992
	1986	15,000	1993
	1987	12,000	1994
		<u>\$ 314,323</u>	
U.S. Operations	1979	\$ 838,471 (U.S.)	1994
	1980	2,272,501 (U.S.)	1995
	1981	666,331 (U.S.)	1996
	1982	2,017,659 (U.S.)	1997
	1983	1,320,545 (U.S.)	1998
	1984	674,629 (U.S.)	1999
	1985	360,673 (U.S.)	2000
	1986	101,939 (U.S.)	2001
	1987	641,332 (U.S.)	2002
		<u>\$ 8,894,080</u>	



