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Temagami Oil & Gas ltd.

Annual Report 1979

OFFICERS AND DIRECTORS

John Kenneth Grove, President, Chief Executive Officer and Director
Carl Roland Jonsson, Secretary and Director
Richard Roy Kennedy, Director
William Hilliard Price, Vice-President and Director
Andrew Sarlos, Director and Chairman of the Board
Barry Zukerman, Treasurer and Director

TRANSFER AGENT AND REGISTRAR

Guaranty Trust Company of Canada
800 West Pender Street
Vancouver, British Columbia V6C 2V7

GENERAL COUNSEL

Tupper, Jonsson, Shroff & Zink
Vancouver, British Columbia

AUDITORS

Collins Barrow
Calgary, Alberta

BANKERS

Bank of British Columbia
Canadian Imperial Bank of Commerce

HEAD OFFICE

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

CORPORATE OFFICE

Suite 1050, 444 - 5th Avenue S.W.
Calgary, Alberta T2P 2T8

TO OUR SHAREHOLDERS:

Your Company commenced active operations on October 1, 1978, and with the dedicated effort, support and co-operation of the major shareholders, management and staff, the Company, in that short period of time, has made significant progress.

In order to generate the cash flow, necessary to maintain a new company, the Directors have concentrated on exploration within the United States where the market for oil and gas is readily available.

The Company initially entered into an agreement whereby it participated in six wells in four prospects in Texas. Two wells were completed in the Giddings field, in Lee County, resulting in oil production from the Austin Chalk formation. An additional two wells were drilled in the Pierce Junction field in Harris County with one producing oil from the Frio Sand and the other well being abandoned after unsuccessful completion attempts in the same formation. One well was drilled in Burleson County which is producing oil from the Austin Chalk formation. The sixth well was drilled to a depth of 2925 feet in the Lentz Area of Bastrop County resulting in a dry hole.

In November, 1978, the Company participated in the drilling of a well in the Northwest Territories on a known but previously undrilled structure near the Liard River. The well, Paramount et al Liard D-29 was drilled to 8200 feet prior to suspension due to early spring break-up. We intend to re-enter the well and drill into the Middle Devonian during the 1979 - 1980 winter drilling season.

The Company then entered into joint-venture agreements in April and May, of this year wherein, we are participating, with various companies, in the drilling of one well in Texas and four wells in Wyoming. The Burleson County Texas well, in which the Company has a net revenue interest of 13.520%, has been completed as an Austin Chalk oil well with an initial production potential of 215 barrels per day. The first well in Washakie County, Wyoming was completed in the Frontier sand and flowed oil at the rate of 70 barrels per day. That well has been successfully sand fractured resulting in a current production rate of 136 barrels per day. The Company has a net revenue interest of 17.42% in this well. The second well in Washakie County has been completed and is currently waiting on a service rig to commence production testing. Two Park County Wyoming wells have completed drilling to the Phosphoria formation with additional testing required to ascertain their production capability.

The Company has recently acquired a 1,000 acre lease in Washakie County, Wyoming which is offset on three sides by wells producing from the Phosphoria formation. The most recent well drilled has an indicated production potential of 720 barrels of oil per day. It is our intention to commence development drilling on this 100% owned lease prior to the end of 1979.

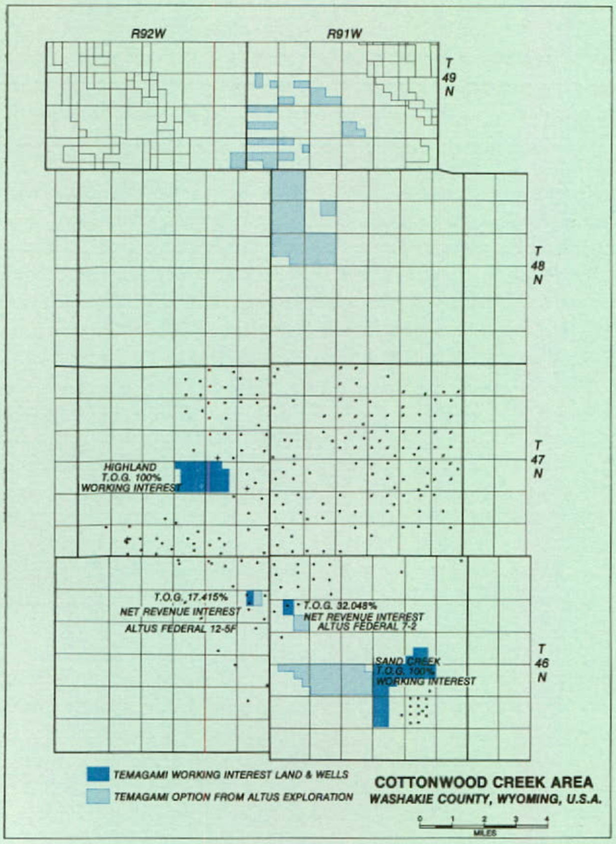
The company has recently negotiated an agreement to participate in a nine project drilling program, with varying interests, in Alberta and British Columbia. Our indicated share of costs will be approximately $1 million and involves, among others, a deep Devonian test well and a shallower Mississippian well in the Turner Valley area in Alberta. The Company intends to bring in a partner to share in the costs of the program.

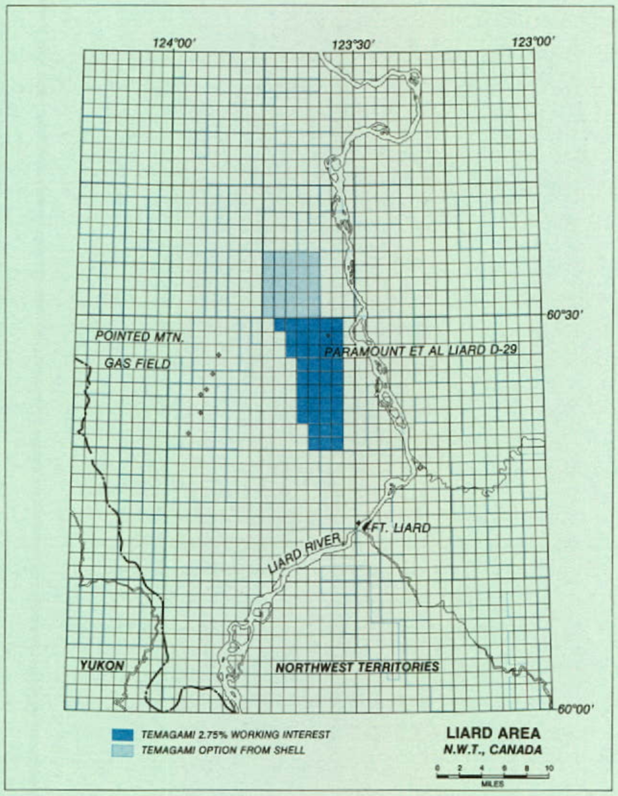
In order to provide exploration funds, in excess of that raised through the issue of share capital, the Company secured a $2 million bank line of credit. The Company is in the process of negotiating a convertible debenture which would repay the bank loan and provide necessary funds for our proposed exploration projects.

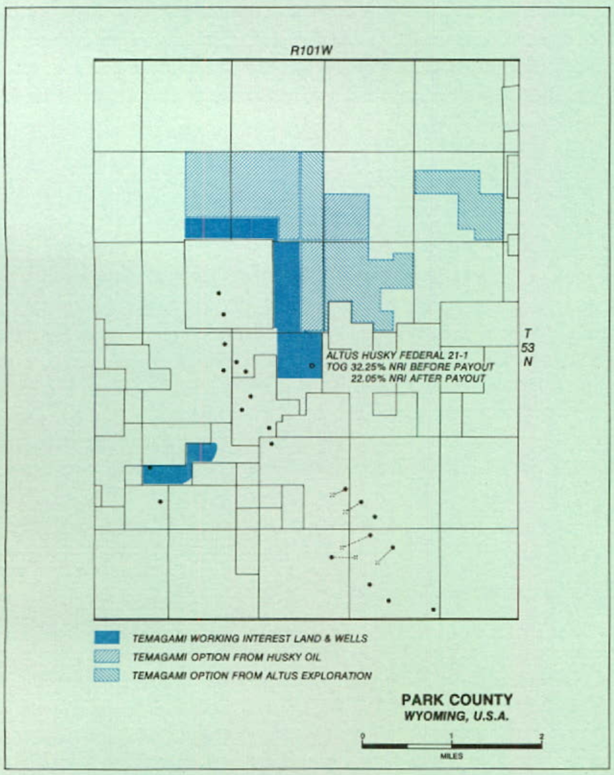
We look forward to the first full year of operation with an active exploration program and the establishment of operating cash flow which will provide a solid base for the future growth of your company. This will be accomplished with the continued effort and support of those people associated with the Company.

J. K. Grove
President

September 26, 1979







Cottonwood Creek, Wyoming

The map shows the location of wells and lands in which the Company owns an interest or has an option to earn an interest. As soon as drilling equipment is available we intend to drill a well offsetting our Altus Federal 12-5F oil well which is producing from the Frontier Sand at the current rate of 136 barrels per day.

The company has participated in the drilling of the Altus Federal 7-2 well, located to the east of the Altus Federal 12-5F oil well. This well was drilled, with production casing run, to a depth of 10,570 feet in the Phosphoria formation. We are waiting for a service rig to evaluate the potential pay zone.

The map also displays our recently acquired Sand Creek and Highland leases.

Park County, Wyoming

This map shows the location of the Altus Federal 21-1 well and lands in which the Company has earned an interest or lands which the Company has an option to earn an interest.

The Altus Federal 21-1 well was drilled, with production casing run, to a depth of 9028 feet. A service rig is presently on location testing the Phosphoria formation and the Curtis sand formation.

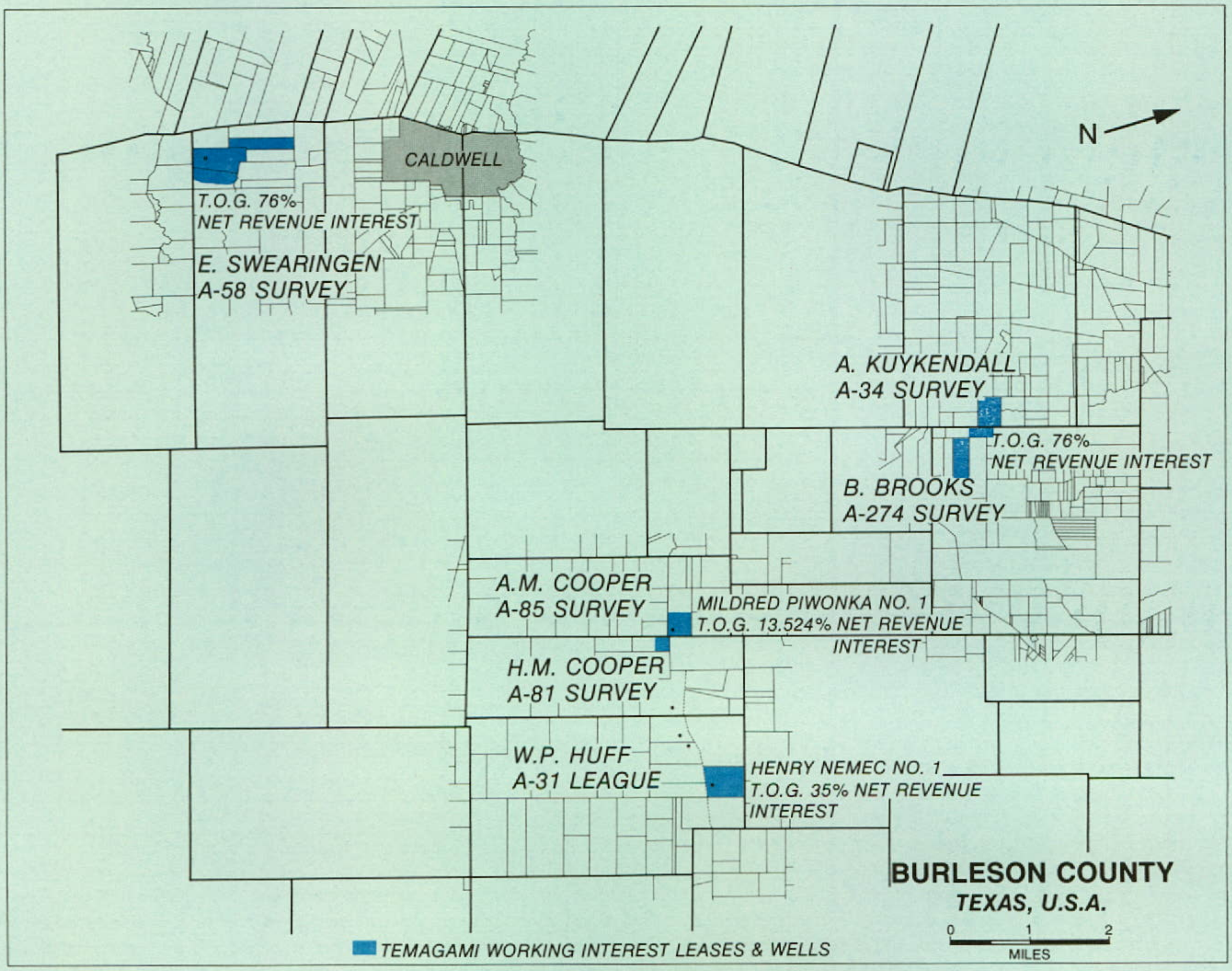
Liard Area, N.W.T.

This map shows the location of the Paramount Liard D-29 well and the lands in which the Company owns or has a right to earn an interest.

The D-29 well was drilled to a depth of 8200 feet during the 1978 winter drilling season and will be deepened during the 1979-1980 drilling season.

Burleson County, Texas

This map shows the location of the Henry Nemec No. 1 oil well which is producing 90 BOPD from the Austin Chalk formation and the Mildred Piwonka No. 1 oil well producing approximately 135 BOPD from the same horizon. The Company has acquired additional leases, as shown, and will evaluate the Austin Chalk formation through additional drilling.



TEMAGAMI OIL & GAS LTD.

(Incorporated under the laws of the Province of British Columbia)

CONSOLIDATED BALANCE SHEET

May 31, 1979

ASSETS

Current assets	
Cash	$ 280,380
Accounts receivable	1,135,912
Total current assets	1,416,292
Property and equipment, at cost (note 2)	1,514,220
Other assets, at unamortized cost (note 3)	80,137
	$3,010,649

LIABILITIES

Current liabilities	
Bank loan (note 4)	$1,000,000
Accounts payable and accrued liabilities	531,213
Total current liabilities	1,531,213

SHAREHOLDERS' EQUITY

Share capital (note 5)	
Authorized	
5,000,000 shares without par value	
Issued	
2,150,000 shares	1,490,000
Deficit, being net loss from date of commencement of operations, August 1, 1978 to May 31, 1979	(10,564)
	1,479,436
	$3,010,649

Approved on behalf of the Board,

, Director

, Director

The accompanying notes are an integral part of these financial statements.

TEMAGAMI OIL & GAS LTD.

CONSOLIDATED STATEMENT OF EARNINGS AND DEFICIT

Period from Date of Commencement of Operations,

August 1, 1978 to May 31, 1979

Revenue	
Oil and gas sales	$ 68,388
Other	9,074
	77,462
Expenses	
Production	12,225
General and administrative	38,037
Depletion	21,899
Depreciation	3,265
Amortization	12,600
	88,026
Loss for the period, being deficit at May 31, 1979	$ (10,564)
Loss per share	$ (0.006)

TEMAGAMI OIL & GAS LTD.

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

Period from Date of Commencement of Operations,

August 1, 1978 to May 31, 1979

Working capital was provided from:	
Operations	$ 27,200
Issue of common shares	1,490,000
	1,517,200
Working capital was used for:	
Acquisition of property and equipment	1,539,384
Incorporation costs	1,608
Deferred financing charges	91,129
	1,632,121
Working capital deficiency, end of period	$ (114,921)

The accompanying notes are an integral part of these financial statements.

TEMAGAMI OIL & GAS LTD.

Notes to the Consolidated Financial Statements

May 31, 1979

1. **Significant accounting policies**

The consolidated financial statements of the company have been prepared by management in accordance with generally accepted accounting principles consistently applied. These financial statements have, in management's opinion been properly prepared within reasonable limits of materially and in light of information available up to September 10, 1979. 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 costs

The company follows the full cost method of accounting for exploration and development expenditures, wherein all costs related to the exploration for and the development of oil and gas reserves are initially capitalized. Costs capitalized include land acquisition cost, 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. 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 earnings.

Exploration and development costs are allocated to one cost centre, namely, North America (Canada and the United States).

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

(c) Mining properties

The company follows the practice of capitalizing all acquisition and exploration costs relating to mining properties on a prospect area basis. If a prospect area is subsequently abandoned, all capitalized costs relating to producing properties are charged to earnings. Capitalized costs relating to producing properties will be depleted on the unit-of-production method based on estimated recoverable reserves of the area.

(d) Depreciation

Depreciation of production equipment is provided for on the composite unit-of-production method. Depreciation of sundry equipment is computed on the declining-balance method at 20% per annum.

(e) Unamortized deferred financing charges

Deferred financing charges included in other assets in connection with the issue of shares in the amount of $91,129 are being amortized using the straight-line method over six years.

(f) Translation of foreign currencies

The accounts of the foreign subsidiary have been translated to Canadian dollars on the following basis: Current assets and current liabilities at the rate of exchange in effect at the year end. Other assets and liabilities at the rate of exchange in effect at the date of settlement. Revenue and expense items are translated using average rates of exchange prevailing throughout the year.

(g) Joint venture

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.

(h) Loss per share

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

2. Property and equipment

Property and equipment consists of the following:

	Cost	Accumulated Depletion and Depreciation	Net
Oil and gas properties including exploration and development costs thereon	$1,339,939	$21,899	$1,318,040
Mining properties	75,000	—	75,000
Production equipment	117,304	2,075	115,229
Other	7,141	1,190	5,951
	$1,539,384	$25,164	$1,514,220

3. Other assets

Other assets consist of:

Unamortized deferred financing charges	$78,529
Incorporation costs	1,608
	$80,137

4. Bank loan

The bank loan is secured by a general assignment of accounts receivable and certain oil and gas properties. The bank loan bears interest at 1% over a Canadian bank's minimum lending rate and is repayable in full on September 30, 1979 unless a mutually acceptable repayment schedule over a five to seven years duration can be established.

5. Share capital

During the period the following shares were issued:

Number of Shares		Amount
400,000	Shares issued for a cash consideration of $0.10 per share	$ 40,000
500,000	Shares issued for a cash consideration of $1.00 per share	500,000
750,000	Shares issued in exchange for certain mining properties	75,000
250,000	Shares issued for cash consideration of $2.00 per share	500,000
250,000	Shares issued for a cash consideration of $1.50 per share	375,000
2,150,000		$1,490,000

6. Remuneration of directors and officers

The total remuneration paid to directors and officers of the company amounted to $70,000.

7. Incorporation

The company was incorporated under the laws of the Province of British Columbia on June 2, 1978 and commenced operations on August 1, 1978.

8. Subsequent event

(a) The company issued 35,000 shares to certain shareholders as consideration for their giving of guarantees in respect of the bank loan (note 4).

(b) On September 10, 1979, the Company entered into a preliminary agreement with an individual whereby the Company will issue a $5,000,000 secured convertible debenture due November 15, 1984.

The debenture will bear interest at the rate of 10% per annum and will be secured by first specific and floating charges on all of the assets and undertakings of the Company.

The debenture is convertible into common shares of the Company at a rate escalating from $4.00 per share to $6.00 per share from the date of issue to the date of maturity. The Company may convert the debenture into common shares when the average trading price of the shares on the Vancouver Stock Exchange exceeds twice the conversion price for a specified period of time.

The Company may redeem the debenture at 115% of the principal amount after November 15, 1981, subject to the exercise of any conversion privileges.

The debenture is subject to a final agreement with approval of the shareholders of the Company and regulatory agencies.

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, 1979 and the consolidated statements of earnings and deficit and changes in financial position for the period from date of commencement of operations August 1, 1978 to May 31, 1979. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the company as at May 31, 1979 and the results of its operations and changes in its financial position for the period then ended in accordance with generally accepted accounting principles applied on a consistent basis.

Calgary, Canada
September 10, 1979

COLLINS BARROW
Chartered Accountants

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