ONYX PETROLEUM EXPLORATION COMPANY LTD.

1986 ANNUAL REPORT

Corporate Profile

Onyx Petroleum Exploration Company Ltd. is an independent oil and gas exploration company with established oil and gas reserves in Alberta and British Columbia. At the end of 1986, the Company's proven and probable reserve base consisted of 2.8 million barrels of crude oil and liquids and 16 billion cubic feet of natural gas. The reserve base generated cash flow of $2.7 million in 1986.

The Company also conducts an active exploration program in Alberta and has accumulated a substantial land position throughout the province. Approximately 28 exploration and development wells are budgeted for drilling in 1987.

Onyx was continued under the Business Corporations Act of Alberta on May 26, 1983 and its Common Shares are listed for trading, under the symbol ONX, on the Toronto, Montreal and Alberta Stock Exchanges.

Annual Meeting

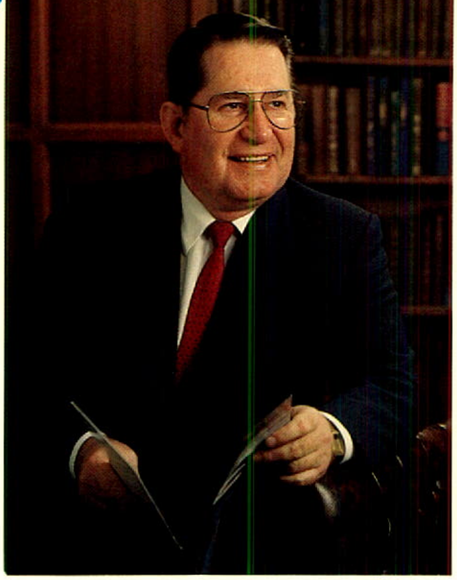
The Annual Meeting of Onyx Petroleum Exploration Company Ltd. will be held in the Mayfair Room of the Westin Hotel in Calgary at 2:00 p.m. on April 30, 1987.

Highlights

	1986	1985
Financial		
(in thousands of dollars except per share data)		
Revenue	**$ 6,202**	$ 7,641
Net earnings (loss)*	**(10,556)**	1,286
Cash flow from operations	**2,710**	4,889
Per share		
Net earnings (loss)	**(2.82)**	.35
Cash flow from operations	**.72**	1.33
Capital expenditures		
Oil and gas properties	**2,853**	6,430
Acquisitions	**5,463**	—
Total assets	**31,903**	40,662
Long term debt**	**16,000**	13,100
Shareholders' equity**	**12,867**	23,428
Operating		
Production of crude oil and liquids		
(barrels per day)	**700**	525
Production of natural gas		
(thousand cubic feet per day)	**2,116**	1,987
Reserves of crude oil and liquids		
(millions of barrels)		
Proven	**2.2**	1.8
Proven plus Probable	**2.8**	2.2
Reserves of natural gas		
(billion cubic feet)		
Proven	**14.0**	16.3
Proven plus Probable	**16.3**	20.1

*The 1986 net loss includes a pretax writedown of $13.552 million in oil and gas property values pursuant to the full cost accounting guidelines recently issued by the Canadian Institute of Chartered Accountants.

**Long term debt was decreased and shareholders' equity was increased by $7.344 million in February 1987 as a result of the conversion of debentures into Common shares.



President's Report

Much has been written to document the very negative impact of declining oil and natural gas prices on the health of Canada's petroleum industry. After almost 40 years of stable or increasing prices, the industry was exposed during 1986 to the most critical 12-month period in its history as crude oil prices were more than halved by mid-year. By year end, prices had moved upwards and now appear to have stabilized in the U.S. $15.00 to U.S. $17.00 range but the loss in revenues attributable to this major price dislocation is reflected in the disappointing financial results achieved in 1986.

Growth for the remainder of this decade will be a reflection of reserve additions and increased levels of production — the principal gauge of success prior to the inflationary period of the 1970's when price increases alone were often sufficient to ensure growth. Onyx has aggressively addressed its capital structure and overheads during this past year and, as a consequence, is now better equipped to successfully operate within this more conservative environment. Results from these efforts have already materialized and are reflected in increased levels of exploration and development success. We look forward to a continuation of this trend throughout 1987 and anticipate satisfactory growth and a meaningful addition to both reserves and production.

Acquisition of Gallita Oils Limited

In spite of the devastating price adjustments experienced in 1986, one of the highlights of the year for Onyx was the acquisition of Gallita Oils Limited. After netting out the working capital position of Gallita, Onyx acquired reserves and land for approximately $5.5 million. At the time of the acquisition, Gallita had oil reserves of 600 thousand barrels and 1.3 billion cubic feet of gas. These reserves produce approximately 260 barrels of oil per day and 300 thousand cubic feet of gas per day, and represent one of our largest producing properties. In addition to the reserves, the acquisition resulted in a substantial tax saving which will be reflected in future cash flows.

Financial

The decrease in oil and natural gas prices has precipitated an industry wide re-evaluation of oil and gas reserve values. The Canadian Institute of Chartered Accountants has initiated a "ceiling test" which measures a value based upon a predetermined formula and the book value. If the book value exceeds this value, then a write down of assets is required. Based upon this test, Onyx is writing down its book value of oil and natural gas assets by $13,552,000 or $10,282,353 after allowing for a reduction in deferred taxes. As a result of the write down, the Company had a net loss of $10,556,478 or $2.82 per share for 1986 compared to $1,286,341 or $0.35 per share income last year. Cash flow for 1986 was $2,709,795 compared to $4,889,312 and revenues were $6,202,157 compared to $7,641,290 in 1985.

Subsequent to year end, holders of $7,344,000 of 11% convertible debentures converted the debentures into Common shares at $2.60 per share. Interest saving on this conversion will amount to approximately $800,000 per year effective September 1, 1986 and further removes the obligation to pay the principal in 1993. While this transaction resulted in the issuance of 2,824,611 shares, management considers the elimination of debt more important than the resultant dilution because of the increased financial and operating flexibility achieved.

In addition to the substantial interest saving, several measures have been taken to reduce overhead costs including a reduction of personnel.

1987 Capital Projects

Capital expenditures for 1987 provide for the drilling of a number of development wells or projects in which the Company has an ongoing involvement. The Gallita acquisition has created several development drilling opportunities in the Grand Forks area of southern Alberta. A new oil zone has been discovered at our Keystone property which will be developed during the year. Additional drilling is required at Ogston and will commence soon. The Otter/Ogston project in the northern part of Alberta is one of the Company's major interest areas and follow-up drilling to our successful 1986 exploration program is now underway. Development drilling will also be carried out at Milo in southern Alberta following a detailed seismic program. In February 1986, a successful gas well was drilled on this prospect which tested 3 million cubic feet per day. Onyx has a 20% interest in the well and 2,560 acres surrounding the well. While all of the cash grants from both levels of government expired during 1986, the Alberta government has extended the qualification for five year royalty free wells to include development wells drilled outside existing field boundaries. We will endeavor to take maximum advantage of these incentives during 1987.

Employees

We would like to extend our appreciation to the employees for their contribution over the past year. It will be a challenge for them to adjust to the new circumstances which exist in our industry now and in the future, but we feel comfortable that these challenges will be met and that Onyx will continue to grow and prosper in the years ahead.

D. G. Flanagan
President
March 31, 1987

Michael Webb, Vice President — Exploration

Exploration and Development

Exploration and development drilling activity in 1986 was concentrated in the first three months of the year in order to take maximum advantage of the petroleum incentive grants which expired at the end of March. Twenty six wells were drilled, resulting in eight oil wells, two gas wells and sixteen dry and abandoned. Drilling at Otter East resulted in the discovery of a Granite Wash oil pool with significant reserve potential. A gas discovery made at Pageant (Milo) provides Onyx with substantial productive capacity. The drilling program allowed Onyx to evaluate several large land blocks and several other expiring leases, but the concurrent decline in oil prices curtailed further development and exploitation activity.

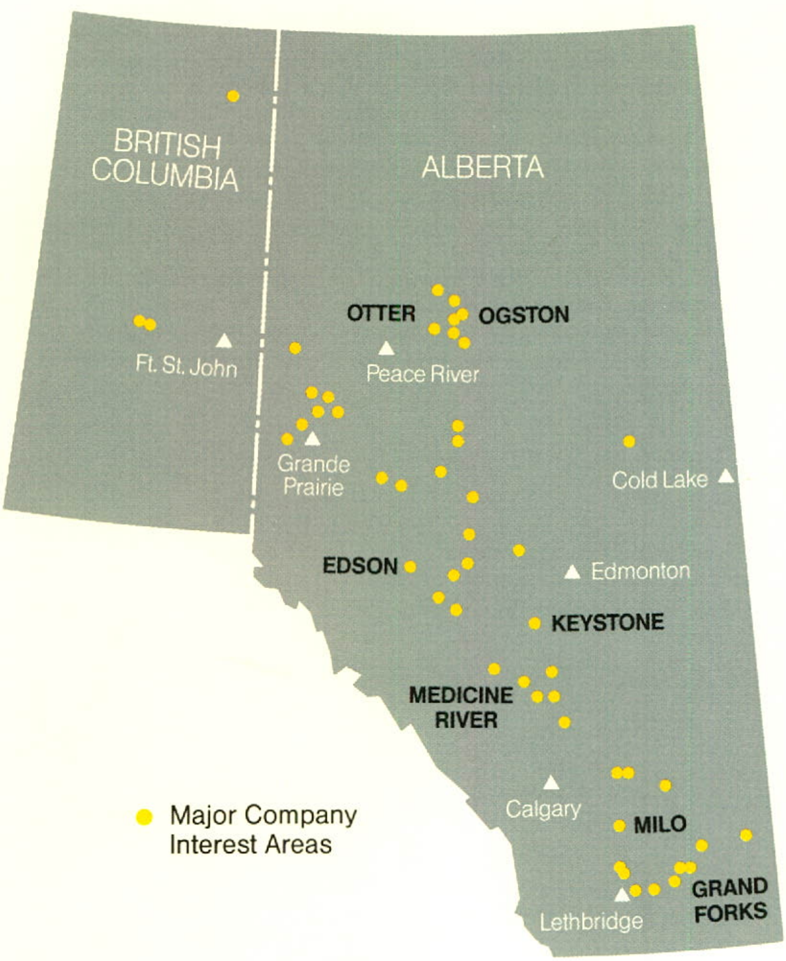
Development activity resumed in the second half of the year when the Company drilled five oil wells on prospects at Spirit River, Keystone and Grand Forks. The five new wells have all been completed and are now on production at a combined rate of 400 barrels of oil per day or 60 barrels of oil per day net to Onyx.

Exploration and development expenditures totalled $2.85 million, net of government grants.

Detailed mapping of the Company's southern Alberta properties has revealed several prospective development drilling locations in the Grand Forks area. In addition, some 30 development locations have been identified on Onyx lands that meet economic criteria for drilling with oil prices in the $15.00 U.S. range. The Company's exploration and development efforts are focused on oil-prone, low- to medium-risk prospects. In 1987 Onyx will emphasize exploitation and development plays in the Grand Forks, Keystone and Otter East areas. Efforts will be concentrated on the delineation and extension of the recent pool discovery at Otter East and development of the newly-identified productive zones at Keystone.

Land

At December 31, 1986, Onyx held 59,924 net acres of undeveloped land in western Canada. This inventory provides Onyx with a diversified land position for the generation of new oil and gas drilling prospects. It also exposes the Company to emerging plays being developed in the immediate vicinity of Onyx's acreage.



Summary of Undeveloped Acreage
as at December 31, 1986

	Gross Acres	Net Acres
Alberta	179,972	54,323
British Columbia	29,470	5,095
Saskatchewan	1,520	506
Total Company Land	**210,962**	**59,924**

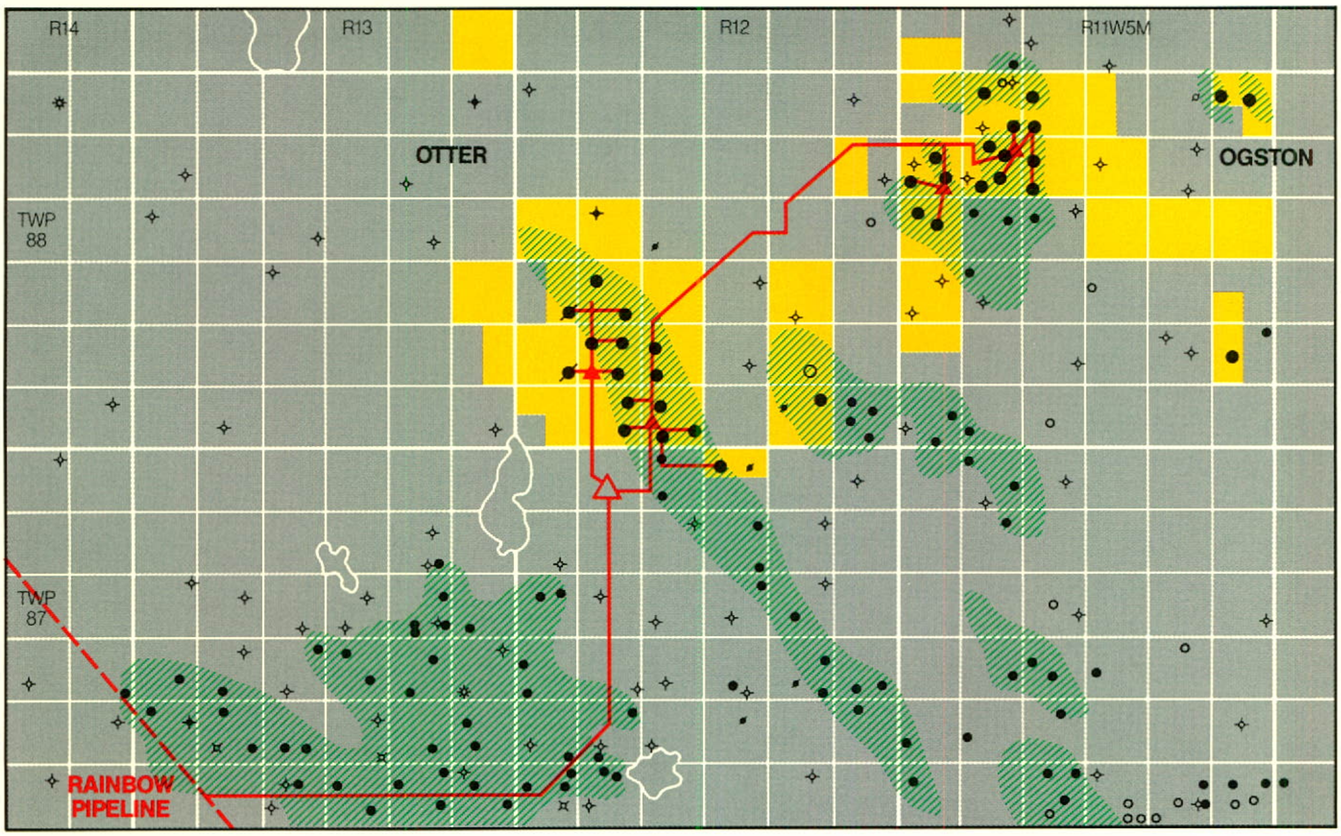
Ross Douglas, Senior Engineer
Pat Genaille, Technical Secretary

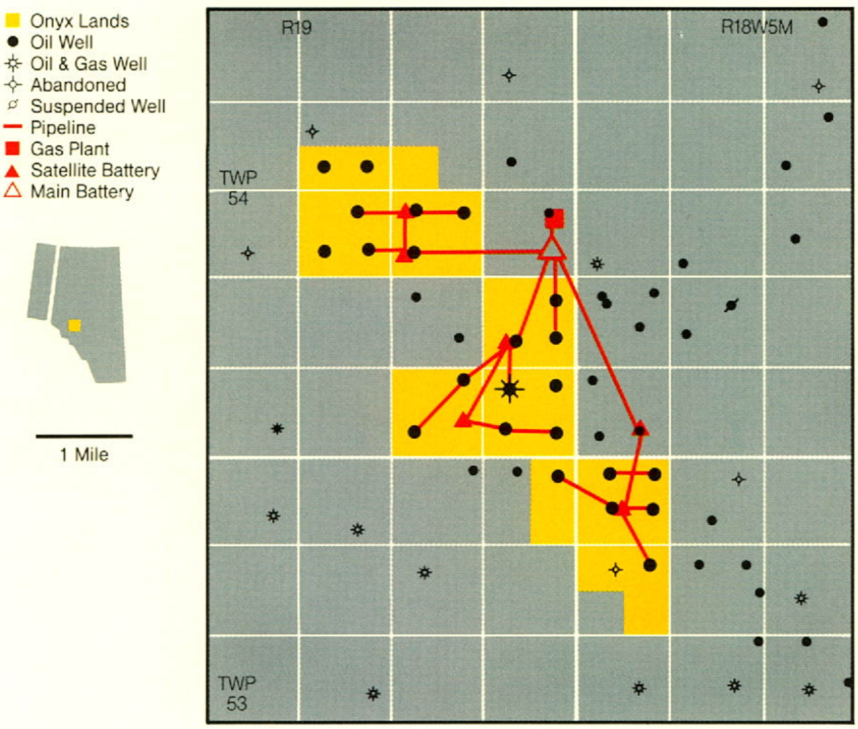
Otter/Ogston

The Otter/Ogston region continues to be one of the Company's major oil producing areas, with production from the Slave Point and Granite Wash formations contributing 33 per cent to total Company production. The Company's share of production in this region averaged 234 barrels of oil per day during 1986.

At Otter, the Company has a 37.5 per cent working interest in a pipeline facility and a major oil terminal capable of processing up to 2,000 barrels of oil per day. The terminal is tied into the Rainbow pipeline and is used by Onyx as well as other producers in the area, who pay a fee to process their production through the Onyx facility. Onyx's share of net processing revenue from the terminal amounts to approximately $115,000 annually. In the Otter region, Onyx is studying an infill drilling program which should result in the drilling of at least one development well in 1987. Depending upon the results of this well, as many as four additional wells may be required to fully develop the pool.

At Otter East, Onyx participated in the drilling of three exploration wells and one development well in 1986, which resulted in the completion of two Granite Wash oil wells. The most important of the two is 16-2-88-12 W5M which appears to be a significant Granite Wash oil pool that may rival Ogston in terms of size, productivity and reserves. A follow-up well is scheduled to be drilled in the first quarter of 1987.

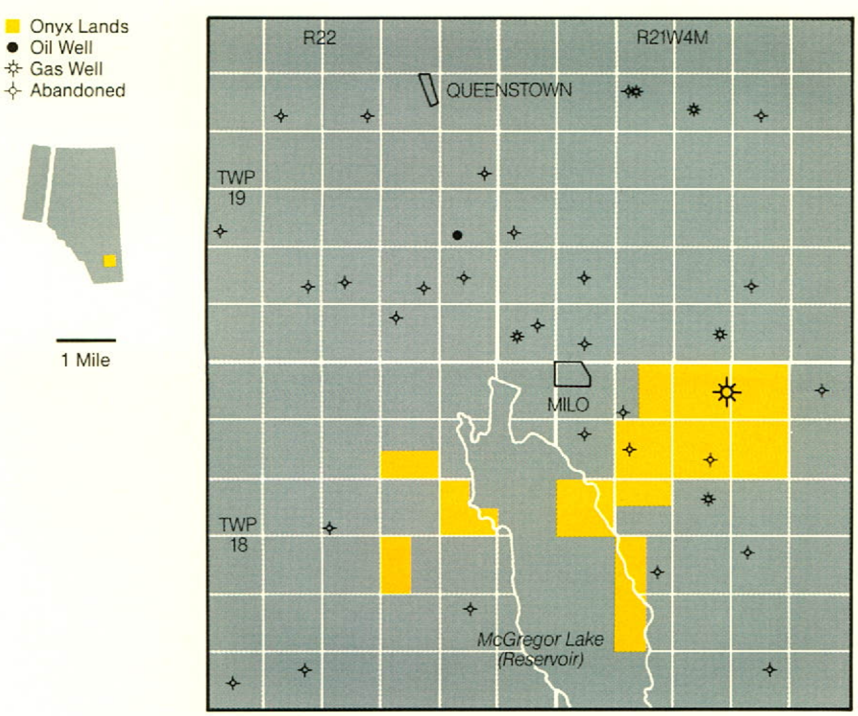




Edson

Edson, in central Alberta, continues to be the Company's major revenue producing area, contributing approximately 25 per cent of Onyx's gross production revenue.

Onyx has a 20 per cent working interest in 20 oil wells in the Edson area, 14 of which have been dually completed for production from more than one zone. These wells produce a high volume of natural gas associated with the oil production, and as a result generate excellent revenue. In addition to the wells, Onyx has a 20 per cent working interest in a natural gas plant capable of processing up to 10 million cubic feet of gas per day, and in oil terminal facilities with a capacity of 1,500 barrels of oil and liquids per day. These facilities generate annual processing revenue of approximately $250,000 net to Onyx.

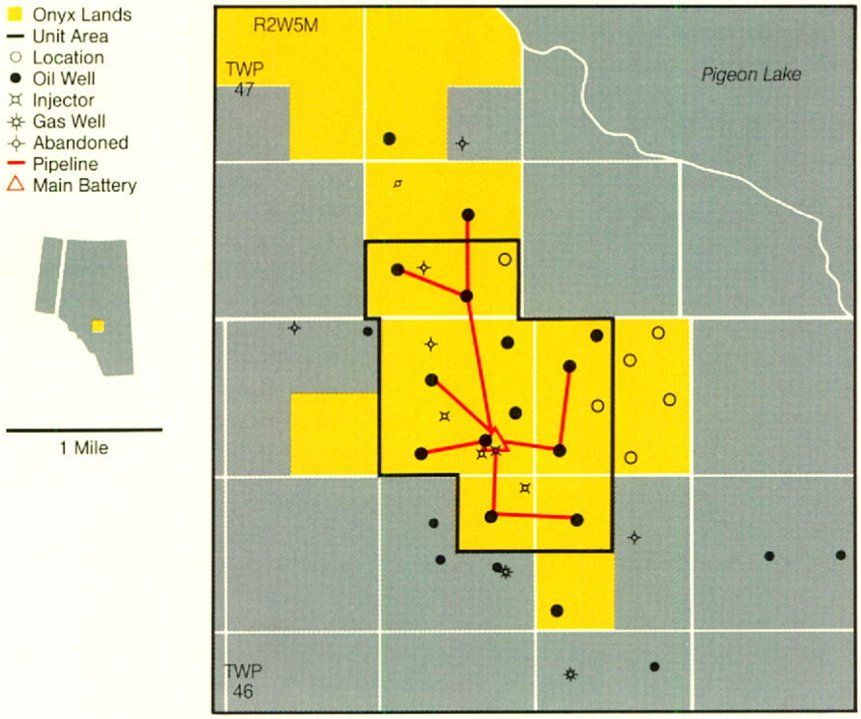


Milo

At Milo, Onyx has interests ranging from 20 to 50 per cent in 6,240 gross acres. The Company drilled two wells on these properties during 1986, resulting in one gas well and one dry hole. The successful well drillstem tested at a rate of 3.3 million cubic feet per day and was subsequently completed for production pending marketing opportunities.

The Company plans a detailed seismic program on its Milo lands during 1987. However, further expansion in this area may be temporarily delayed as major discoveries in a similar geologic setting at Queenstown, 10 miles to the northwest, have raised activity levels and tripled land prices.

Keystone

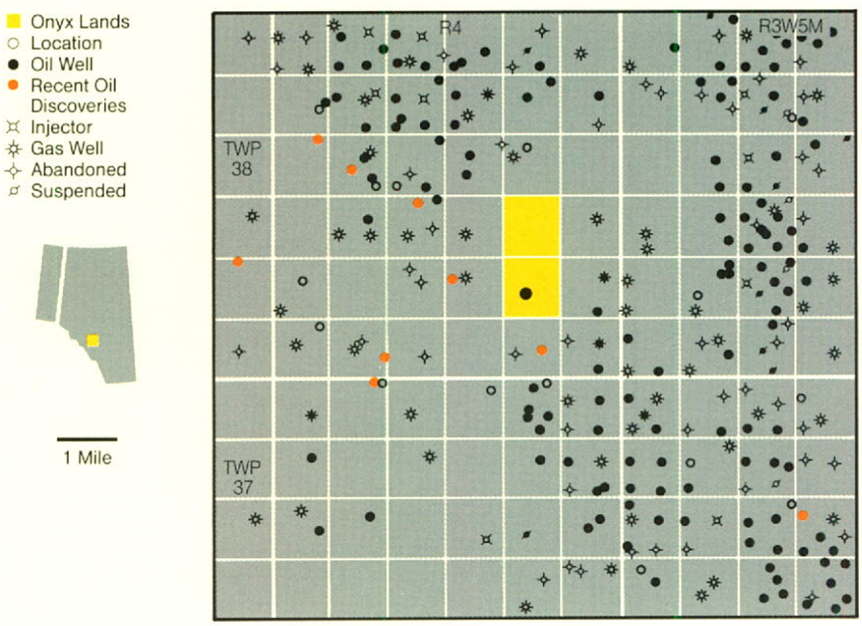


At Keystone, in central Alberta, Onyx has an interest in 5,426 gross (786 net) acres containing 15 producing oil wells. Most of the wells in the area have been unitized, with Onyx having a 13.49 per cent working interest in a dual-zone oil unit.

Three additional wells were drilled in 1986, one of which tested a third productive zone. All three were completed as oil wells with production from each well ranging from 100 to 115 barrels per day.

Onyx has identified 12 potential drilling locations on working interest lands located within and immediately outside the unit boundary. Three wells will be drilled early in 1987, with three more follow-up wells expected to be drilled later in the year.

Medicine River



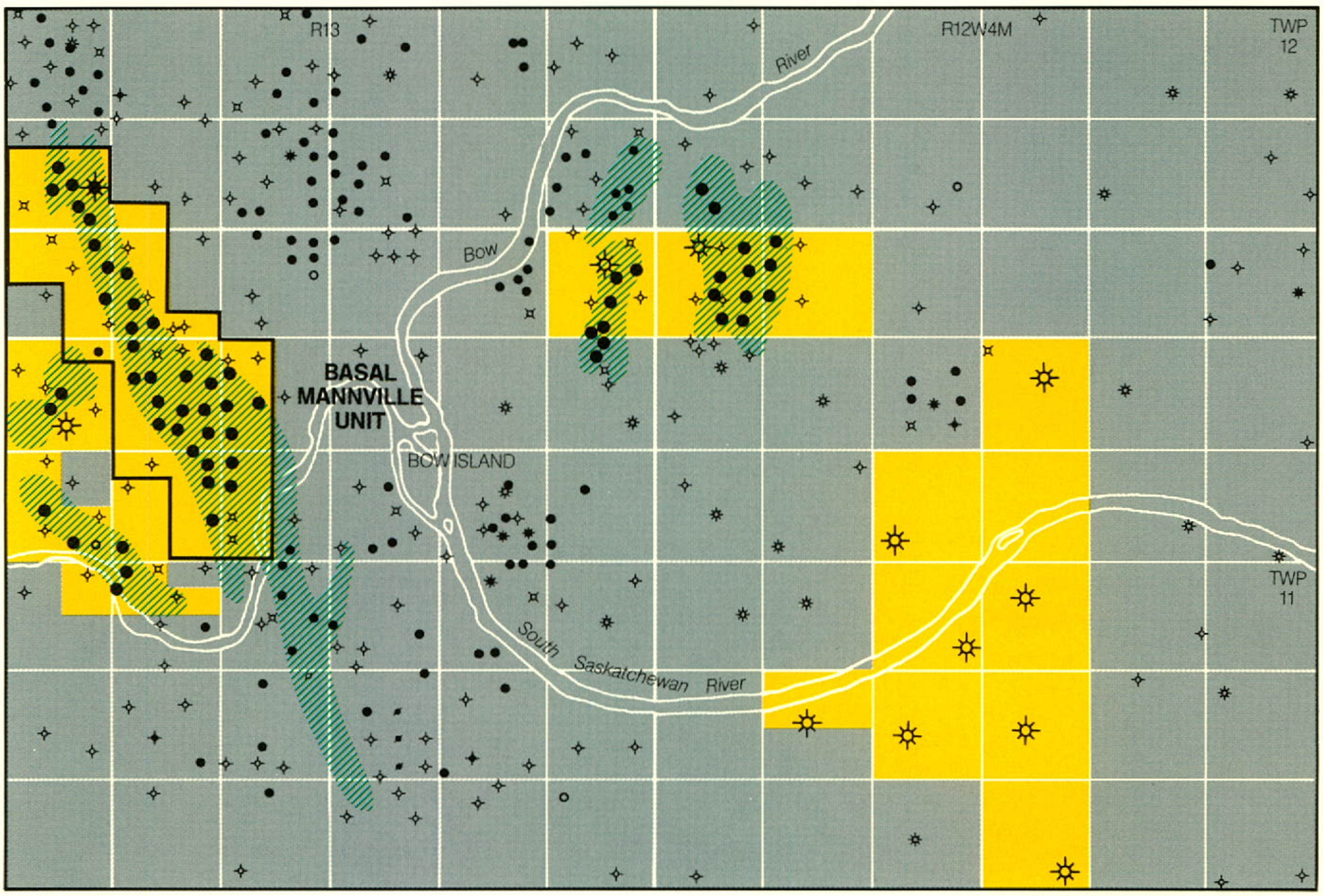
The Company has working interests ranging from 12.5 to 50 per cent in 1,280 gross acres in this area. Recent oil discoveries by other companies in the Nisku and Leduc reefs at 9,000 feet, and in the Jurassic sands at 7,250 feet have heightened interest in this prospect. Recent announcements regarding a well one mile south of Company lands cite as many as four productive zones, and diagonal offsets to these lands produce at rates up to 400 barrels of oil per day from the reefs.

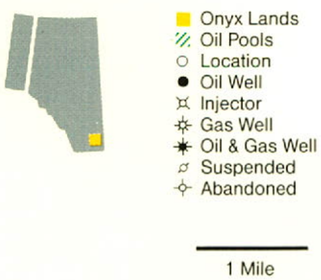
The Company expects interest in this prospect to remain high and will proceed with its own plans once the new play is further developed. Medicine River offers attractive targets, multiple horizons and year-round access.

Grand Forks

Onyx owns interests ranging from one to 15 per cent in 9,264 gross (1,350 net) acres at Grand Forks in southern Alberta. These properties were acquired through the Gallita Oils Limited purchase and, as a group, represent one of the Company's major oil producing areas. This area accounts for approximately 35 per cent of Onyx's oil production.

The properties in which Onyx has a working interest were mapped and reviewed during 1986, and several prospective future drilling locations were identified. In addition to the drilling prospects, several areas were identified as requiring more detailed seismic work. While already a significant producing area, Grand Forks offers good potential for further exploration and development drilling. Reserves in these pools are among the largest in Alberta for objectives at depths of less than 1,000 meters. Onyx, with the cooperation of its partners, could drill up to ten wells in this area during 1987.



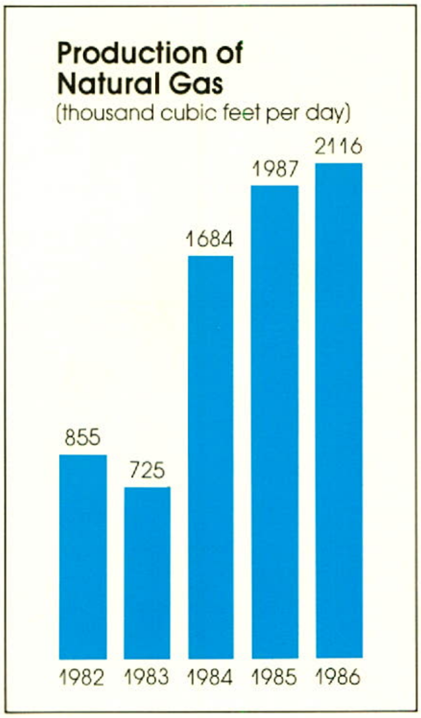


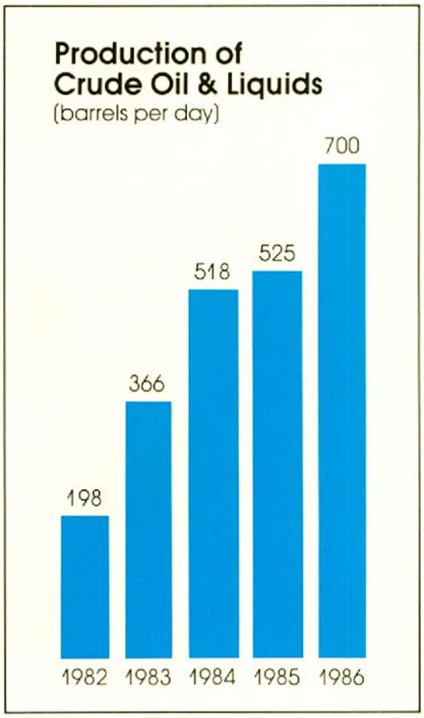
Production

During 1986, Onyx achieved record levels of crude oil, liquids and natural gas production. Crude oil and natural gas liquids production totalled 252,761 barrels or approximately 700 barrels per day, an increase of 32 per cent over the 525 barrels per day produced in 1985.

Natural gas sales also increased to 2.11 million cubic feet per day, a six per cent increase over 1985 sales volumes of 1.99 million cubic feet per day.

The increase in both production and sales includes the addition of the Gallita properties which were acquired in 1986. This acquisition enabled Onyx to diversify its production base and increase the Company's exposure in southern Alberta. Crude oil production from the Grand Forks and Keho areas in southern Alberta now accounts for approximately 40 per cent of the Company's total production. Other major oil-producing areas, at Keystone in central Alberta, and in the Otter/Ogston region of northern Alberta, account for 12 per cent and 33 per cent, respectively, of the Company's production.





As a result of the deregulation of oil prices in 1985, the Alberta Petroleum Marketing Commission ceased to act as the exclusive agent for the marketing of crude oil and natural gas liquids. In response to this change, Onyx now sells its oil and liquids production at posted prices to major oil companies. Revenue from the sale of crude oil and natural gas liquids in 1986 represented approximately 70 per cent of the Company's total production revenue for the year.

Natural gas sales were up marginally in 1986, with production from the acquired Gallita properties averaging approximately 300 thousand cubic feet per day. This production helped to mitigate the loss of sales at Carrot Creek and Verger Matziwin, where lower contract demand and prices created a drop in sales from 1985 levels. Solution gas, which is being produced in association with crude oil production from wells in the Edson field, continues to account for approximately 45 per cent of the Company's total natural gas sales. Approximately 60 per cent of Onyx's natural gas reserves are dedicated under contract to major pipeline companies. With deregulation and the resulting drop in natural gas prices effective November 1, 1986, Onyx expects to see an increasingly competitive natural gas market throughout 1987.

Reserves

The Company's crude oil and natural gas reserves were evaluated as of December 31, 1985, by D&S Petroleum Consulting Group Ltd. The reserves acquired with the purchase of Gallita Oils Limited were evaluated by McDaniel & Associates Consultants Ltd. as of January 1, 1986. The accompanying table summarizes the combined total reserves which have been updated and evaluated by Onyx as at December 31, 1986.

Through a combination of exploration and development drilling and the acquisition of oil and gas properties, proven oil reserves, net of current year's production, increased 394.5 thousand barrels or 22 per cent above the level of proven reserves held at the beginning of the year. New reserves were added at each of Otter/Ogston, Spirit River, Keystone and the Grand Forks region of Alberta.

Reserves of Crude Oil, Liquids and Natural Gas

	Crude Oil and Liquids (mbbls)			Natural Gas (mmcf)		
	Proven	Probable	Total	Proven	Probable	Total
At January 1, 1986	1,800.9	386.8	2,187.7	16,342	3,734	20,076
Extensions and discoveries	152.9	—	152.9	347	296	643
Acquisitions	494.4	106.3	600.7	1,000	280	1,280
Production	(252.8)	—	(252.8)	(772)	—	(772)
Revisions of prior estimates	2.6	61.3	63.9	(2,953)	(2,012)	(4,965)
At December 31, 1986	2,198.0	554.4	2,752.4	13,964	2,298	16,262

Proven natural gas reserves, net of current year's production, declined 2.4 billion cubic feet or approximately 15 per cent from the level of proven reserves held at the beginning of the year. The decrease is due to the elimination of 2.7 billion cubic feet of proven undeveloped reserves that were previously assigned to properties at Carrot Creek. A drilling program undertaken to evaluate the Company's Carrot Creek property necessitated an adjustment to the proven undeveloped reserves previously included in the independent engineering evaluation.

The present value of the Company's oil and gas reserves, as estimated by Onyx at December 31, 1986, was calculated before income taxes, assuming appropriate deductions for future capital expenditures, operating costs, crown and other royalties, and by using a current price forecast. The estimate also reflects the impact of the Alberta Royalty Tax Credit.

Present Value of Reserves

	Present Value Discounted At			
	10%	12%	15%	20%
	(thousands of dollars)			
Proven	$41,732	$37,006	$31,675	$25,603
Probable	9,475	8,270	6,849	5,176
Total	**$51,207**	**$45,276**	**$38,524**	**$30,779**

Lloyd Hansen, Vice President — Finance

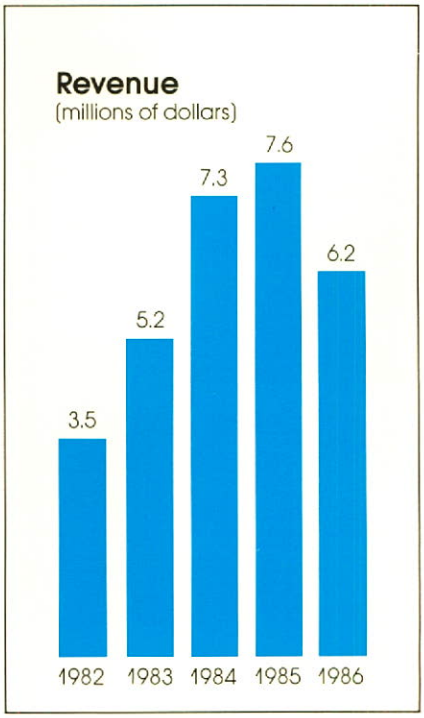
Financial Review

In 1986, revenue, net of royalties, amounted to $6,202,157 or approximately 81 per cent of the $7,641,290 recorded in 1985. Crude oil and liquids production recorded a 32 per cent increase, but average prices declined 51 per cent from $37.12 per barrel in 1985 to $18.10 per barrel in 1986. Natural gas revenues were similarly affected with average prices for the year off 16 per cent from $2.99 per Mcf in 1985 to $2.49 per Mcf in 1986. The natural gas price adjustment more than offset the additional revenue generated by a six per cent increase in natural gas sales over 1985. An increase in the Alberta Royalty Tax Credit to 95 per cent of crown royalties payable, combined with an increase in interest income and elimination of the Petroleum Gas Revenue Tax, partially offset the impact of reduced prices.

Cash flow from operations reached $2,709,795 in 1986 or $0.72 per share versus $4,889,312 or $1.33 per share recorded in 1985.

The 1986 loss, amounting to $10,556,478 or $2.82 per share, includes an after-tax writedown of oil and gas property values amounting to $10,282,353 or $2.75 per share. The net operating loss from operations before the write-down was $274,125, or $0.07 per share, compared to net earnings of $1,286,341 or $0.35 per share recorded in 1985.

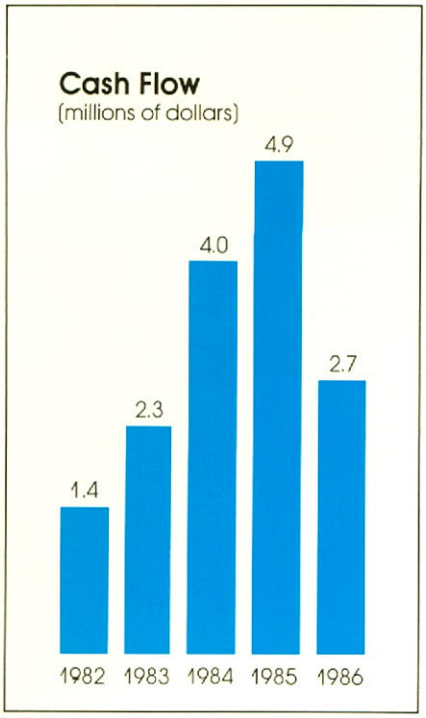
As a result of the precipitous fall in prices in 1986, oil and gas reserves lost considerable value in terms of future revenue generating expectations. To recognize this decline in value in accordance with the recently announced accounting guidelines issued by the Canadian Institute of Chartered Accountants, Onyx management wrote down oil and gas property costs by $10,282,353 on an after tax basis. The guideline pertains to oil and gas companies that use the full cost method of



accounting and establishes a uniform method for calculating "ceiling test" values.

Costs and Expenses

Onyx's production expenses in 1986 were up 14 per cent to $1,078,570 over the $949,205 recorded in 1985 as a result of a 32 per cent increase in crude oil and natural gas liquids production. Throughout the year, management has endeavored to reduce and minimize operating costs in all producing areas.



General and administrative expenses of $737,637 were maintained at a level consistent with the $727,827 reported in 1985. Expenses in this area are under continuing management review, and staff reductions and other cost cutting measures undertaken in late 1986 will be reflected in 1987 results.

Early in 1986, Onyx acquired all of the outstanding shares of Gallita Oils Limited, a private Canadian oil and gas company, for a net cost of $5.5 million. The acquisition was financed by additional bank borrowing which resulted in higher 1986 interest expense.

The 1986 interest expense of $1,663,516 includes interest on the $7.4 million 11 per cent convertible debentures for the eight month period ended August 31, 1986. Conversion of the debentures prior to the interest payment date of March 1, 1987, resulted in an interest saving for Onyx of approximately $400,000. Conversion of the debentures also reduces the Company's ongoing borrowing costs by approximately $800,000 per year.

Onyx adheres to the full cost method of accounting, and with the increase in production, 1986 depletion and depreciation expenses were up 16 per cent to $2,996,559 over the $2,575,528 recorded in 1985.

Liquidity and Financial Resources

During 1986, Onyx spent just over $2.8 million on fixed asset additions and approximately $5.5 million net for all the issued and outstanding shares of Gallita Oils Limited. These expenditures were financed from working capital, internally generated cash flow of $2.7 million and a net increase in bank borrowing of $5.2 million.

Long term debt at year end 1986 included bank debt of $8.6 million and convertible debentures of $7.4 million. In February 1987, Onyx finalized arrangements to convert all but $56,000 of the Company's $7.4 million 11 per cent convertible debentures into 2,824,611 Common shares at a price of $2.60 per share. This transaction effectively reduces the Company's long term liabilities to $8.8 million, or 45 per cent of the amount outstanding at December 31, 1986. This reduction in debt not only creates a substantial saving in interest expense, but gives management the flexibility needed to pursue new drilling opportunities, potential acquisitions and other business combinations that will enhance and strengthen the Company's future growth and development.

Kathy Smith, Executive Secretary
Curtis Hicks, Chief Accountant
Trish Burland, Receptionist

Onyx Petroleum Exploration Company Ltd.

Consolidated Balance Sheet

As at December 31

	1986	1985
Assets		
Current Assets		
Cash	$ 175,517	$ 85,694
Accounts receivable	850,364	1,767,362
Government incentive grants receivable	43,211	934,052
Income taxes recoverable (note 7)	1,119,374	—
	2,188,466	2,787,108
Property, Plant and Equipment (note 2)		
Petroleum and natural gas properties including exploration, development and equipment thereon, at cost	52,322,341	44,017,021
Accumulated depletion and depreciation	23,170,746	6,806,467
	29,151,595	37,210,554
Other Assets (note 3)	562,829	664,649
	$31,902,890	$40,662,311
Liabilities and Shareholders' Equity		
Current Liabilities		
Accounts payable	$ 562,706	$ 1,773,607
Current portion of bank loans (note 4)	2,300,000	—
	2,862,706	1,773,607
Bank Loans (note 4)	8,600,000	5,700,000
11% Convertible Debentures (note 5)	7,400,000	7,400,000
Gas Production Prepayments	172,965	210,174
Deferred Taxes	—	2,150,273
	19,035,671	17,234,054
Shareholders' Equity		
Capital stock (notes 5 and 6)		
Issued		
5,033 Restricted Return shares (1985 - 5,185)	503,300	518,500
3,740,149 Common shares	18,962,138	18,962,138
	19,465,438	19,480,638
Contributed surplus	692,734	682,094
Retained earnings (deficit)	(7,290,953)	3,265,525
	12,867,219	23,428,257
	$31,902,890	$40,662,311

Approved by the Board:

Director

Director

Onyx Petroleum Exploration Company Ltd.

Consolidated Statement of Operations

Year ended December 31

	1986	1985
Revenue		
Oil and gas sales, net of royalties	$ 5,056,306	$7,097,863
Alberta Royalty Tax Credit	947,019	846,300
Petroleum and Gas Revenue Tax	—	(302,873)
	6,003,325	7,641,290
Interest and other income	198,832	—
	6,202,157	7,641,290
Expenses		
Operating	1,078,570	949,205
General and administrative	737,637	727,827
Interest on long term debt	1,663,516	1,402,389
Depletion and depreciation	2,996,559	2,575,528
Write-down of petroleum and natural gas properties (note 2)	13,552,000	—
	20,028,282	5,654,949
Income (loss) before income taxes	(13,826,125)	1,986,341
Deferred Income Taxes (Reduction)	(3,269,647)	700,000
Net Income (Loss)	$(10,556,478)	$1,286,341
Net Income (Loss) Per Common Share	$ (2.82)	$ 0.35
Weighted average number of Common shares outstanding	3,740,149	3,669,422

Consolidated Statement of Retained Earnings (Deficit)

Year ended December 31

	1986	1985
Retained Earnings at Beginning of Year	$ 3,265,525	$1,979,184
Net income (loss)	(10,556,478)	1,286,341
Retained Earnings (Deficit) at End of Year	$ (7,290,953)	$3,265,525

Onyx Petroleum Exploration Company Ltd.

Consolidated Statement of Changes in Financial Position

Year ended December 31

	1986	1985
Cash Provided By (Used For):		
Operating Activities		
Net income (loss)	$(10,556,478)	$1,286,341
Non-cash items		
Depletion and depreciation	2,996,559	2,575,528
Write-down of petroleum and natural gas properties	13,552,000	—
Deferred income taxes (reduction)	(3,269,647)	700,000
Deferred Petroleum and Gas Revenue Tax	—	302,873
Other	(12,639)	24,570
Cash flow from operations	2,709,795	4,889,312
Termination payments (note 2)	(174,000)	—
	2,535,795	4,889,312
Investing Activities		
Additions to property, plant and equipment	(2,852,971)	(6,429,707)
Acquisition of Gallita Oils Limited (note 1)	(5,462,629)	—
	(8,315,600)	(6,429,707)
Financing Activities		
Bank loans	5,200,000	1,600,000
Net change in receivable/payable balances	596,938	(234,646)
Common shares issued	—	465,850
Other	72,690	(293,400)
	5,869,628	1,537,804
Increase (Decrease) in Cash	89,823	(2,591)
Cash at beginning of year	85,694	88,285
Cash at End of Year	$ 175,517	$ 85,694

Auditors' Report

To the Shareholders of
Onyx Petroleum Exploration Company Ltd.

We have examined the consolidated balance sheet of Onyx Petroleum Exploration Company Ltd. as at December 31, 1986 and the consolidated statements of operations, retained earnings (deficit) and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

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

Thorne Riddell

Calgary, Alberta
March 2, 1987

Thorne Riddell
Chartered Accountants

Onyx Petroleum Exploration Company Ltd.

Notes to Consolidated Financial Statements

Year ended December 31, 1986

Summary of Significant Accounting Policies

These consolidated financial statements are prepared on a historical cost basis in accordance with accounting principles generally accepted in Canada and conform in all material respects with the accounting standards recommended by the International Accounting Standards Committee.

Consolidated Financial Statements

The consolidated financial statements include the accounts of Onyx Petroleum Exploration Company Ltd. (the "Company") and its wholly-owned subsidiary Onyx Petroleum Inc. (formerly Gallita Oils Limited).

Oil and Gas Operations

The Company follows the full cost method of accounting for oil and gas operations as prescribed by the Guideline on Full Cost Accounting in the Oil and Gas Industry issued by the Canadian Institute of Chartered Accountants. All costs of exploring for and developing oil and gas reserves, including the cost of production equipment, are capitalized and depleted using the unit of production method based on estimated proved oil and gas reserves (converted to equivalent units on the basis of estimated relative energy content).

In applying the full cost method, the capitalized costs less accumulated depletion, depreciation and deferred income taxes are limited to an amount equal to the estimated future net revenues from proved reserves (based on prices and operating costs in effect at the balance sheet date) plus the cost (net of impairments) of unproved properties after deducting estimated future general and administrative expenses, financing costs and income taxes.

Substantially all the Company's exploration and development activities related to oil and gas are conducted jointly with others. The accounts reflect only the Company's proportionate interest in such activities.

Consolidated Statement of Changes in Financial Position

During the year ended December 31, 1986, the Company changed its method of presentation of the consolidated statement of changes in financial position from the working capital basis to the cash basis to comply with the method of presentation now required under generally accepted accounting principles. The comparative accounts have been reclassified from those previously reported to conform with the method of presentation adopted in 1986.

1. Business Combination

During 1986, the Company acquired 100% of the outstanding shares of Gallita Oils Limited, a Canadian private oil and gas company. This acquisition has been accounted for as a purchase and the results of operations of the acquired company have been included in these financial statements since January 1, 1986, the effective date of acquisition.

The acquisition is summarized as follows:

Net assets acquired	
Cash, treasury bills and term deposits	$ 4,892,565
Other current assets	490,282
	5,382,847
Current liabilities	34,796
	5,348,051
Petroleum and natural gas properties and equipment	5,384,150
Acquisition price	$10,732,201
Purchase consideration	
Acquisition price	$10,732,201
Acquisition costs	78,479
	10,810,680
Working capital acquired	5,348,051
Net consideration	$ 5,462,629

2. Property, Plant and Equipment

During 1986, the Company capitalized $706,000 (1985 - $832,000) of overhead costs relating to acquisition, exploration and development activities. In addition, termination payments of $174,000 relating to staff reductions in the Company's exploration department have been included in the write-down of petroleum and natural gas properties in the consolidated statement of operations.

3. Other Assets

	1986	1985
Notes receivable from officers and employees, non-interest bearing, due from time to time to November 1990	**$ 474,910**	$ 565,810
Deferred financing charges	**151,519**	176,089
	626,429	741,899
Less current portion of notes receivable	**63,600**	77,250
	$ 562,829	$ 664,649

4. Bank Loans

	1986	1985
Bank production loan	**$ 3,500,000**	$ 5,700,000
Bank term loan	**7,400,000**	—
	10,900,000	5,700,000
Less current portion	**2,300,000**	—
	$ 8,600,000	$ 5,700,000

The bank production loan is evidenced by demand promissory notes and bears interest at the bank's prime lending rate. The loan has been advanced under a revolving credit facility and no specific terms of payment have been established. The loan facility is reviewed annually and is to be paid out of future oil and gas production revenues.

The bank term loan bears interest at the bank's prime lending rate plus ½% per annum and is payable in instalments of $100,000 per month with periodic lump sum reductions that will effect full payment by December 1990.

The bank loans are secured by the Company's interest in certain petroleum and natural gas properties and an assignment of accounts receivable.

5. 11% Convertible Debentures

Subsequent to December 31, 1986 the conversion price of the debentures was reduced from $10.25 to $2.60 per Common share and $7,344,000 principal amount of the outstanding debentures were converted to 2,824,611 Common shares. In conjunction with the conversion of such debentures, the debenture holders agreed to waive interest accrued on the debentures from September 1, 1986.

The pro-forma loss per Common share for the period ended December 31, 1986, giving effect as at January 1, 1986 to the issue of shares on conversion as described above, is $1.53 per Common share.

The balance ($56,000 principal amount) of the debentures are convertible into Common shares of the Company at a price of $10.25 per share to March 1, 1993, at which time any debentures not converted or redeemed become due and payable. The debentures may be redeemed, after March 1, 1988, without restriction at a price not exceeding 104.4% of the principal amount plus accrued interest to the date of redemption.

6. Capital Stock

(a) **Authorized Capital**
The authorized capital of the Company is comprised of 6,552 Restricted Return shares, 10,000,000 Preferred shares and 10,000,000 Common shares.

(b) **Restricted Return Shares**
During 1986, the Company purchased and cancelled 152 Restricted Return shares for $4,560 cash. The difference ($10,640) between the stated value of the shares and the purchase price has been credited to contributed surplus.

The holders of Restricted Return shares have voting rights, limited dividend entitlements, and priority over Common shareholders in case of liquidation, dissolution or winding-up. The shares are redeemable under certain circumstances at the option of the Company at a redemption price of $100 per share.

(c) No dividends may be paid on Common shares until dividends aggregating $100 per Restricted Return share have been paid. Thereafter, dividends may be paid on Common shares provided that an amount equal to any such dividends is applied to the redemption of Restricted Return shares. To December 31, 1986, no dividends have been paid on Restricted Return shares.

(d) **Key Employee Incentive Share Option Plan**
As of December 31, 1986, 360,000 Common shares of the Company were reserved for issue under the Company's Key Employee Incentive Share Option Plan, of which options to purchase 237,000 shares are outstanding, exercisable from time to time to December 1991 at prices ranging from $6.00 to $8.25 per share.

(e) 5,463 Common shares are reserved for issue on conversion of the remaining debentures after giving effect to the conversion of the debentures as described in note 5.

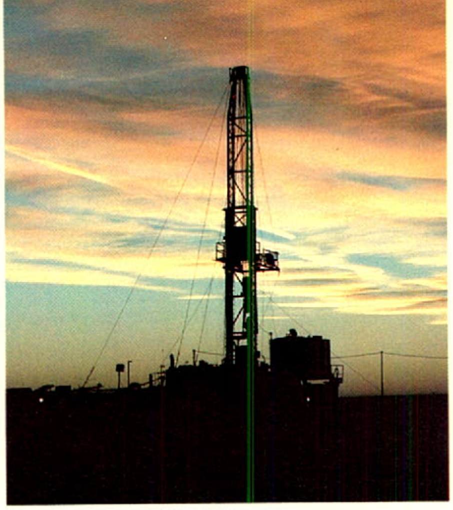
7. Income Taxes

Income taxes recoverable of $1,119,374 as at December 31, 1986 represent income taxes paid in prior years by a subsidiary company.

Petroleum and natural gas properties include approximately $4,800,000 of unamortized costs at December 31, 1986 which are not deductible for income tax purposes by the Company.

Deferred income tax provisions for 1986 and 1985 are less than the taxes which would result from applying the expected tax rate of 49% (1985 - 47%) to income (loss) before income taxes. The components of the income tax provisions are summarized as follows:

	1986		1985	
	Amount	**%**	Amount	%
Computed expected income taxes (reduction)	**$(6,775,000)**	**(49)**	$ 934,000	47
Increase (decrease) in income tax provision resulting from:				
Non-deductible crown charges, net of provincial credits	**103,000**	**1**	543,000	27
Depletion expense relating to non-deductible petroleum and natural gas property costs	**356,000**	**2**	238,000	12
Write-down of non-deductible petroleum and natural gas property costs	**3,437,000**	**26**	—	—
Federal resource allowance	**(389,000)**	**(3)**	(781,000)	(39)
Earned depletion allowance	**—**	**—**	(242,000)	(12)
Other	**(1,647)**	**—**	8,000	—
Actual deferred income taxes (reduction)	**$(3,269,647)**	**(23)**	$ 700,000	35



Historical Financial Summary

	1986	1985	1984	1983	1982
	(thousands of dollars except per share data)				
Revenue	**$ 6,202**	$ 7,641	$ 7,326	$ 5,166	$ 3,519
Operating costs	**1,079**	949	775	803	587
General and administrative	**738**	728	675	639	472
Depletion and depreciation	**2,997**	2,576	2,016	1,041	642
Write-down of petroleum and natural gas properties	**13,552**	—	—	—	—
Interest on long term debt	**1,664**	1,402	1,892	1,432	1,094
Income (loss) before income taxes	**(13,826)**	1,986	1,969	1,250	725
Deferred income taxes (reduction)	**(3,270)**	700	730	360	220
Net income (loss)	**(10,556)**	1,286	1,239	890	504
Cash flow from operations	**2,710**	4,889	4,010	2,312	1,366
Per Common share:					
Net income (loss)	**(2.82)**	.35	.42	.07	—
Cash flow	**.72**	1.33	1.35	.79	.47
Weighted average shares outstanding (thousands)	**3,740**	3,669	2,971	2,913	2,907
Capital expenditures	**8,316**	6,430	6,481	7,616	9,018
Total assets	**31,903**	40,662	36,030	31,033	23,760
Bank loans	**10,900**	5,700	4,100	7,000	8,500
Convertible debentures	**7,400**	7,400	7,400	7,400	—
Deferred taxes	**—**	2,150	1,147	580	220
Total shareholders' equity	**12,867**	23,428	21,680	14,574	13,614

Corporate Information

Directors

R. J. Engbloom
(Calgary, Alberta)
Partner, MacKimmie Matthews

D. G. Flanagan
(Calgary, Alberta)
President of the Company

J. M. Hallward
(Montreal, Quebec)
Self Employed

H. G. MacNeill
(Toronto, Ontario)
President and Chief
Executive Officer
Jannock Limited

V. R. B. Nordheimer
(Calgary, Alberta)
Business Executive

L. Waisberg
(Toronto, Ontario)
Partner, Goodman & Goodman

Officers and Senior Personnel

D. G. Flanagan
President

L. L. Hansen
Vice President — Finance

M. G. Webb
Vice President — Exploration

R. D. S. Douglas
Senior Engineer

C. W. Hicks
Chief Accountant

Head Office

#2000, 444 - 5th Avenue S.W.
Calgary, Alberta
T2P 2T8

Corporate Registrar and Transfer Agents

The Canada Trust Company

Bankers

Bank of Montreal
Calgary, Alberta

Auditors

Thorne Ernst & Whinney
Calgary, Alberta

Solicitors

MacKimmie Matthews
Calgary, Alberta

Share Listing

The Toronto Stock Exchange
The Alberta Stock Exchange
The Montreal Exchange

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