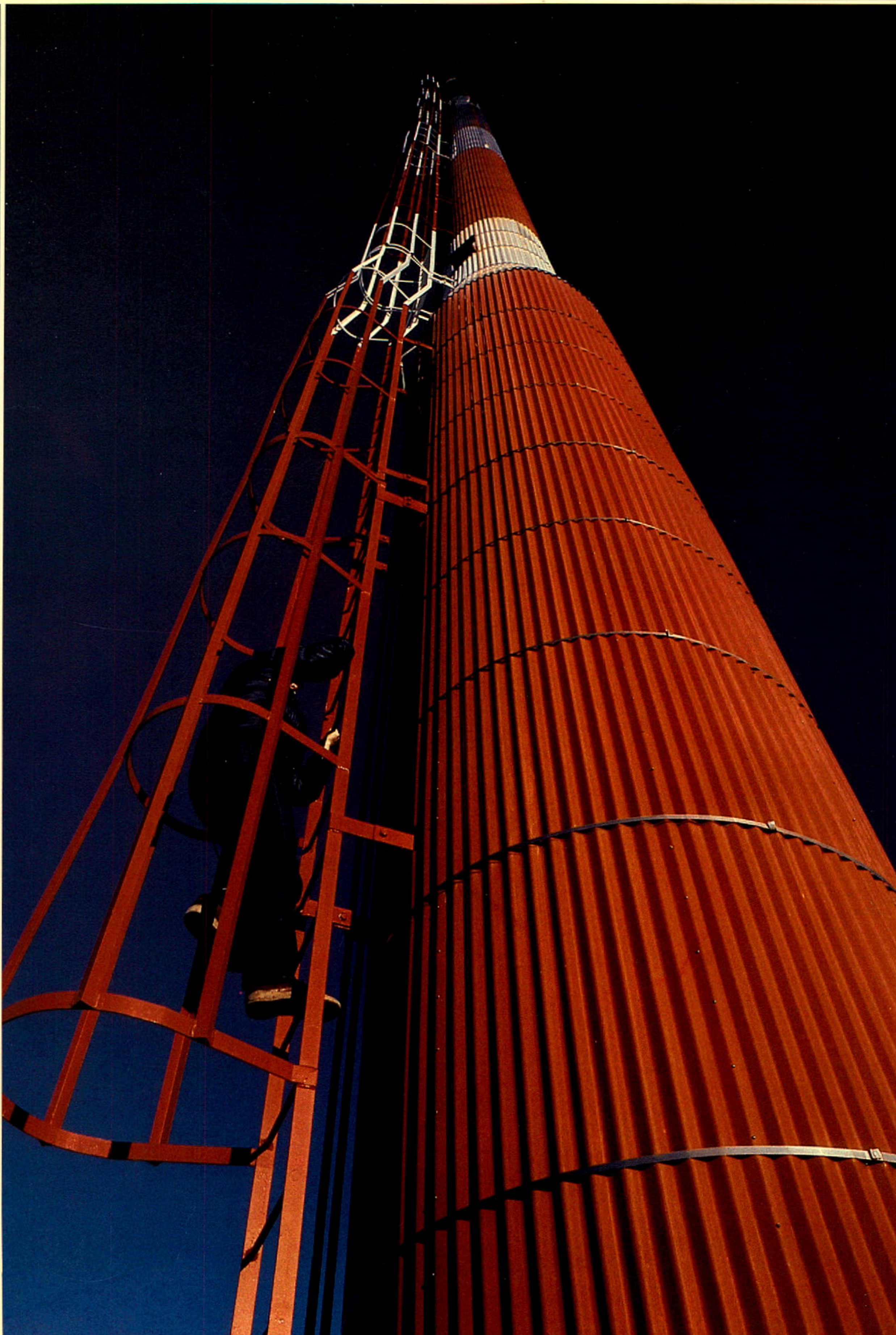
Penn West Petroleum Ltd.
1986 Annual Report



Corporate Profile

Penn West Petroleum Ltd. is a Canadian energy company with its headquarters in Calgary, Alberta. The Company is engaged in the acquisition, exploration, development and production of oil and natural gas in Canada, the United States and Australia. Operations in the United States are carried out through a wholly owned subsidiary, Penn West Petroleum, Inc., and those in Australia through Penn West Petroleum Ltd., and Springwest-Page Petroleum N.L. The Company's shares are publicly traded on The Toronto Stock Exchange.

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Annual Meeting of Shareholders

The Annual Meeting of the Shareholders of Penn West Petroleum Ltd. will be held in the Glenmore Room of the Calgary Convention Centre at 120 - 9th Avenue S.E., Calgary, Alberta on Thursday, June 11, 1987 at 10:00 a.m.

Financial and Operating Highlights

Financial

	Year Ending Dec. 31, 1986	Year Ending Dec. 31, 1985
Gross Oil and Gas Sales	$ 5,748,362	$ 9,035,974
Total Revenue, net of royalties	$ 5,049,487	$ 7,506,233
Net Earnings (Loss) for the Year	$ (564,846)	$ 120,158
Funds Generated from Operations	$ 1,249,613	$ 4,052,628
Additions to Property and Equipment	$ 4,934,729	$ 7,000,762
Working Capital (Deficiency)	$ (1,368,712)	$ (765,654)
Bank Loan	$ 11,800,000	$ 9,300,000
Shareholders' Equity	$ 27,887,214	$ 27,755,840
Total Assets	$ 45,126,058	$ 45,915,177
Common Shares Outstanding	20,275,608	19,946,067
Registered Common Shareholders	916	941

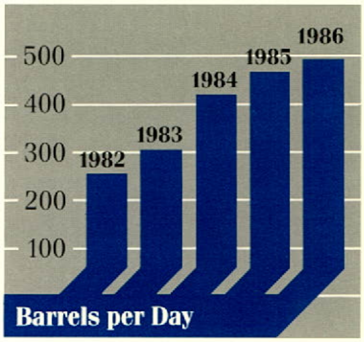
Operations

Production (Gross before royalties)		
Crude Oil (Barrels)	179,468	167,957
Barrels per day	492	460
Natural Gas (Mcf)	1,400,334	1,310,358
Mcf per day	3,837	3,590
Reserves (Gross Proven & Probable)		
Crude Oil (Barrels)	2,897,100	2,764,100
Natural Gas (Mmcf)	59,567	49,177
Drilling Activity		
Gross Wells Drilled	56	66
Net Wells Drilled	7.83	19.75
Net Wells Productive	7.61	15.94
Net Wells Dry	0.22	3.81

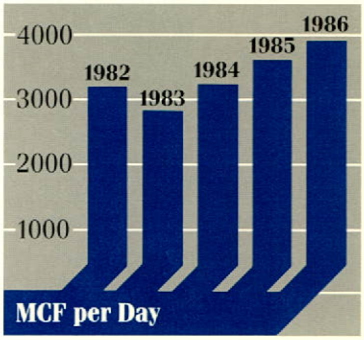
Land Holdings (Undeveloped)

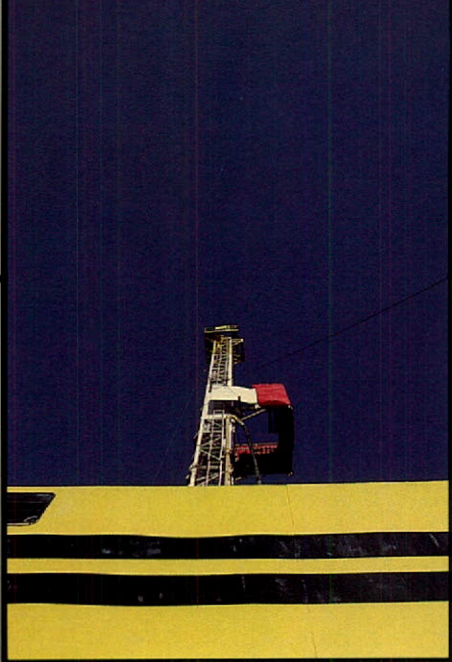
Gross Acres	324,531	411,775
Net Acres	111,929	100,881
Gross Royalty and Net Profits Interest	214,302	312,607

Daily Oil Production



Daily Gas Production





President's Report to the Shareholders

Penn West entered 1986 armed with optimism and projecting a cash flow which would provide a solid base from which to launch the Company into new and expanded exploration and development programs. During the first quarter, the Company participated in 37 wells which ultimately represented more than half the wells drilled for the total year. The drastic decline in oil prices resulted in a severe cut back in projected cash flow and forced the Company to defer its planned exploration activity and to assume a policy of low risk spending. Expenditures during the latter nine months of the year were directed to improving production from existing properties. A concentrated effort to lower operating costs fell in line with this policy.

The Company has a number of operating areas which are being expanded upon to provide improved cash flow while staying within budgetary constraints. Waterflood studies are being conducted at Hoosier and Barons and initial results have been very positive. Preliminary analyses indicate that waterflood schemes could potentially double the recoverable oil reserves, and substantially increase profitability. These projects would require additional drilling in 1987 together with plans to initiate the secondary recovery schemes by early 1988.

The Princess area has provided Penn West with some encouraging results to date. One well produced gas from the Basal Colorado formation at rates upwards of two million cubic feet per day while a second well produces oil from the Pekisko formation at a rate of fifty barrels per day. Penn West has built an impressive land position in the area and a seismic program is being conducted to delineate additional drilling locations.

A considerable number of problems have been experienced in obtaining reasonable production rates from the Rimbey area. Drastic equipment changes have recently been made by the operator and it appears that, at last Penn West can expect significant oil production from this area. Recent production tests indicate that an increased oil rate of seventy barrels per day will accrue to the Company as a result of the equipment changes.

Oil and gas production increased 7 percent to average 492 barrels of oil per day and 3,837 thousand cubic feet of gas per day during the year. On an oil equivalent basis new oil discoveries added 1,072,700 barrels of proven oil reserves to inventory. This amounts to 3.36 barrels of proven oil being discovered for each barrel produced during 1986. The cost of finding these new reserves amounted to $4.60 per barrel. These statistics are considered impressive when compared to industry averages.

A flow-through share issue funded a major portion of the Company's 1985 capital requirements for its exploration program with $1.1 million being spent during the first quarter of 1986. Since terms of the issue required all the funds to be expended on exploration projects a significant amount of development capital was required in 1986 to complete the projects. A result of this occurrence was that bank borrowings were required which increased the Company's loan by $2.5 million. Penn West borrowings are being maintained below its line of credit.

Penn West is well positioned at this time to commence an aggressive exploration and development program. The Company will not use new bank borrowings for these programs, but will pursue equity financing. The Company has accumulated tax pools which are sufficient to offset income for a number of years to prevent the Company from becoming taxable. This will be an important benefit when investment tax incentives are instituted by the Federal Government to encourage a demand for flow-through share issues.

Changes in Federal and Provincial Government policies during the year have been encouraging. The elimination of the Federal Petroleum and Gas Revenue Tax coupled with increased Royalty holidays by both the Alberta and Saskatchewan Governments provide improvement to corporate economics. If these are followed by incentives which encourage outside capital investment, reasonable growth will return to the petroleum industry.

A change in ownership of a major block of Penn West common shares occurred subsequent to year-end. Approximately 49 percent of the Company's shares were acquired by Poco Petroleums Ltd. as a result of their purchase of Bonanza Oil & Gas Ltd.

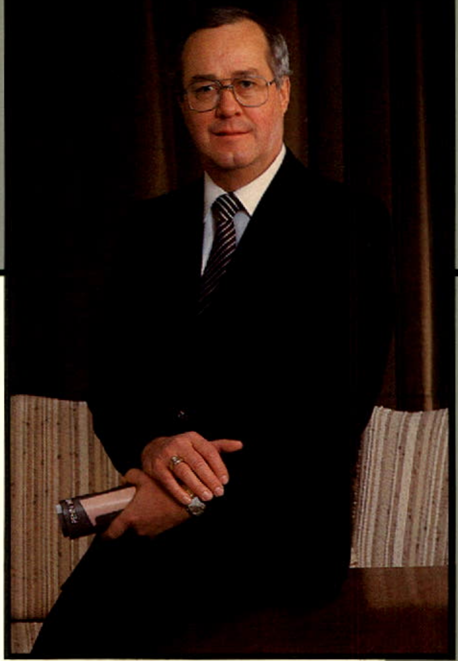
Four of Penn West's current Directors will not stand for re-election at this year's Annual Meeting. We wish to express our sincere gratitude to Mr. Wesley G. Ismond, Mr. F. K. Roy Gillespie, Dr. Gilbert J. McMurtry and Mr. Orval K. Horn for their outstanding guidance and assistance to Penn West.

We acknowledge the contribution and dedication of Penn West's management and staff and look forward to a profitable future.

Submitted on behalf of the Board,

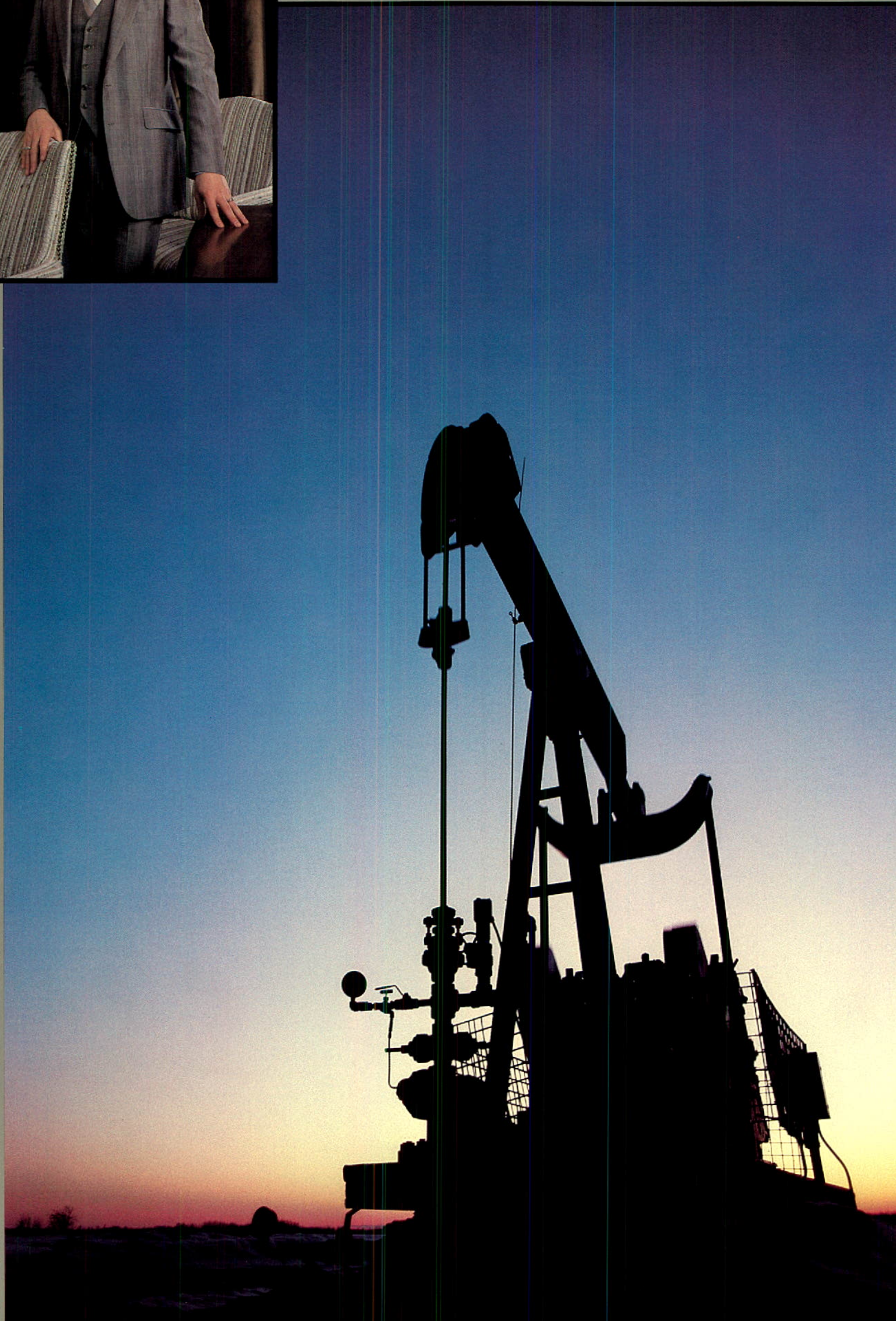
Dale F. Duprey,
President

Calgary, Alberta
March 12, 1987



Dale F. Duprey
President

Floyd N. Krukoff
Operations Manager



Operations Review

In 1986, Penn West participated in the drilling of 59 wells in western Canada. This resulted in 32 oil wells and 18 gas wells for a success ratio of 85%. The Company now has working interests in 693 oil and gas wells in Canada and the United States, with royalty and net profits interests in an additional 93 wells.

The 1986 drilling program substantially increased reserves. Total reserves of crude oil and natural gas liquids increased 4.8 percent from 2,764,100 barrels to 2,897,100 barrels, while natural gas reserves increased 21.1 percent from 49,177 million cubic feet to 59,567 million cubic feet. Of the total gas volumes, 80.2 percent or 47,753 million cubic feet are classified as proven reserves.

Penn West expended $4,934,000 on its exploration and development program in 1986. Proven reserves increased by 343,600 barrels of oil and 7,291 million cubic feet of gas. Using a conversion factor of 10 thousand cubic feet of gas per barrel of oil, 1,072,700 barrels of oil equivalent were discovered. The successful drilling added 3.36 barrels of oil equivalent for each barrel produced. Based on total capital expenditures the finding cost of proven reserves was $4.60 per barrel for the year.

Reservoir engineering studies are currently in progress to evaluate the economics of installing secondary recovery waterflood systems in the Barons area in Alberta and the Hoosier area in Saskatchewan. Recent royalty structure changes have extended royalty holidays on new oil wells to a maximum of three years in Saskatchewan and five years in Alberta. This change will considerably improve the economics of placing these pools on waterflood.

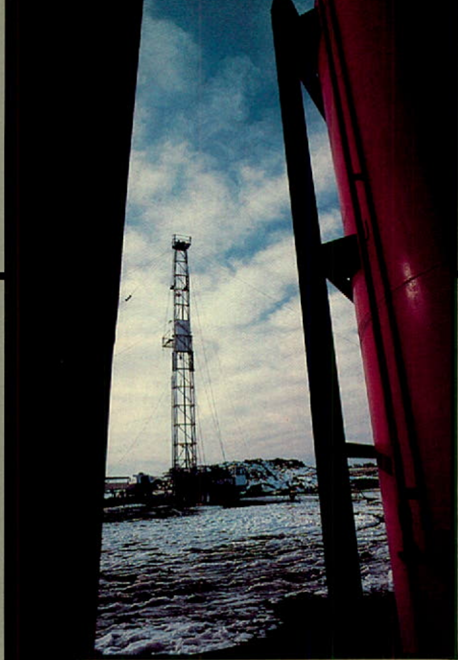
Production equipment problems on the 14-15 well in the Rimbey area necessitated a redesign of the facility. Subsequent to year end, the gas lift system was replaced with conventional bottom hole pumping equipment. Recent tests have proven the well capable of producing at rates in excess of 200 barrels of oil per day compared to 60 barrels per day during 1986. Reservoir studies have now been completed and the operator is preparing an application to have the well placed on good production practice. Once all approvals are in place, Penn West should expect an increase of approximately 70 barrels of oil per day from its 50 percent interest in this well.

An independent engineering evaluation effective January 1, 1987 has estimated the undiscounted value of Penn West's reserves at $269,232,200. Using a discount factor of 15%, the value is $52,053,000, a reduction of 18 percent from last year. Lower projected price forecasting has had the most significant impact on this decline.

Production of crude oil and natural gas increased this year as a result of the exploitation and development of existing reserves along with exploration successes. In 1986, crude oil and natural gas liquids were produced at a rate of 492 barrels per day, up from 460 barrels per day in 1985. Increases in oil production volumes were realized in the Barons, Misty Lake and Hoosier areas. Natural gas production this year averaged 3,837 thousand cubic feet per day compared to 3,590 thousand cubic feet per day in 1985. Increases in gas production volumes occurred at Berry, Sylvan Lake, Little Bow, and Long Coulee.

Based on current production and planned development of existing reserves, the Company forecasts increases in 1987 of 19 percent and 39 percent respectively in oil and gas production.

Operations Group
Left to Right
Floyd N. Krukoff, Operations Manager
Elaine Y. Leung, Executive Assistant
Brian E. Brausen, Operations Engineer



Operations Review

Oil and Gas Reserves

Penn West has proven reserves and probable additional reserves in Saskatchewan, Alberta, British Columbia, North Dakota, Kansas and Texas.

The following table provides a summary of the Company's oil and gas reserves at January 1, 1987, determined by the independent petroleum consulting firm, Martin Petroleum & Associates, together with comparative volumes for 1985.

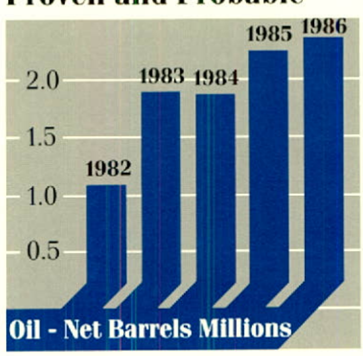
Reserves

	1986		1985	
	Gross	Net	Gross	Net
Crude Oil (Bbls)				
Proven	1,966,200	1,620,800	1,896,400	1,559,000
Proven & Probable	2,897,100	2,343,600	2,764,100	2,241,800
Natural Gas (Mmcf)				
Proven	47,753	37,806	43,998	34,708
Proven & Probable	59,567	47,335	49,177	39,001

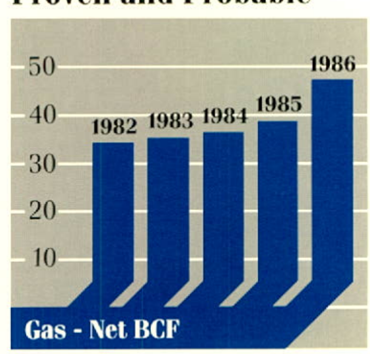
Crude Oil & Natural Gas Discounted Future Net Cash Flow, Before Income Tax

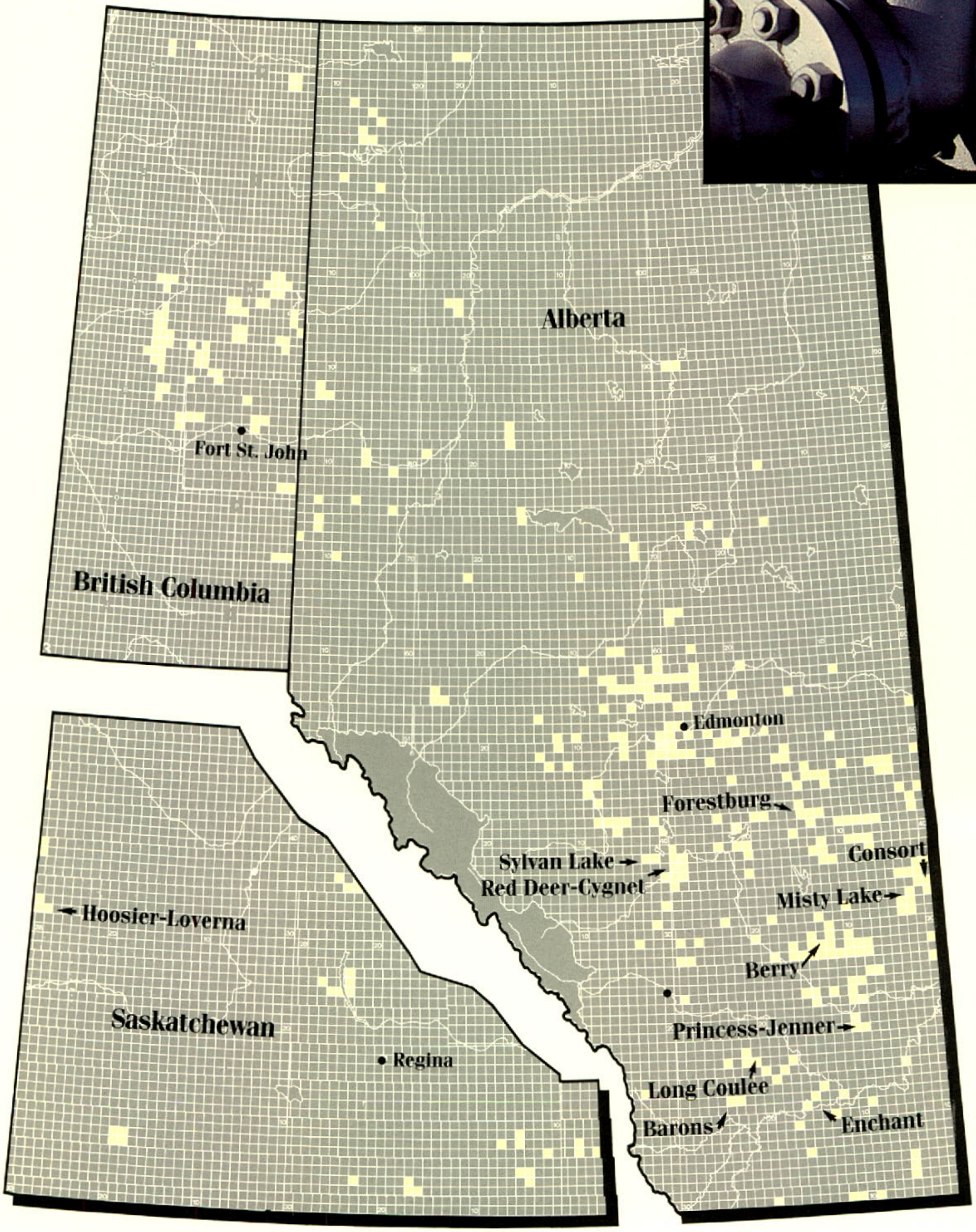
	Undiscounted	10%	15%	20%
1985 Proven	\$252,828,600	\$77,380,200	\$54,850,900	\$42,284,600
Proven & Probable	\$322,674,900	\$91,836,500	\$63,492,900	\$47,960,500
1986 Proven	\$204,088,500	\$60,945,100	\$42,592,300	\$32,307,100
Proven & Probable	\$269,232,200	\$76,280,300	\$52,053,100	\$38,577,600

Reserves
Proven and Probable



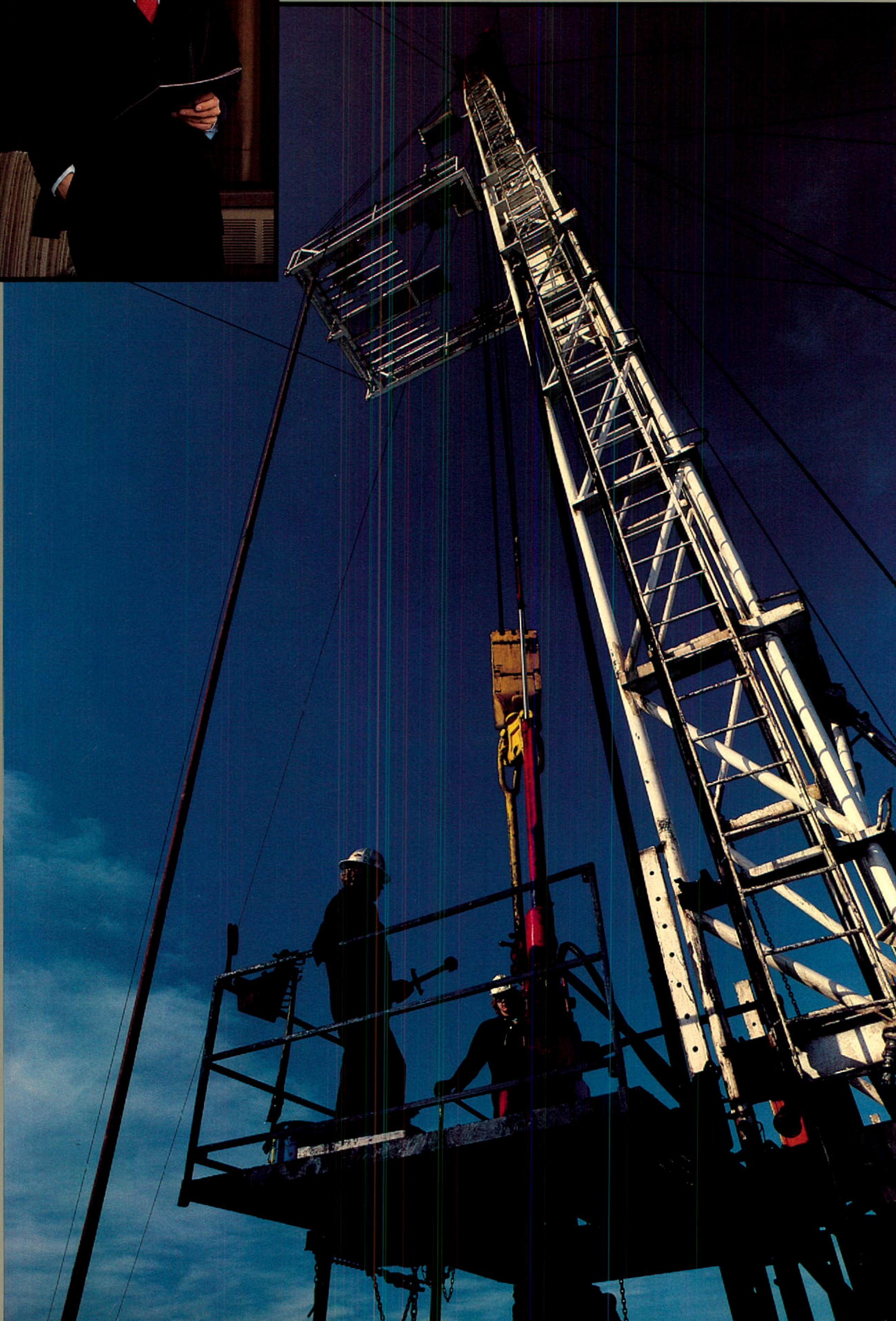
Reserves
Proven and Probable





Townships Within Which Penn West Holds Interests

Fred P. Rumak
Exploration Manager



Land and Exploration Review

Penn West is well represented in the Western Sedimentary Basin where it concentrates its exploration activity.

The Company continues a philosophy of acquiring larger working interests in new lands. In 1986, its average interest in net undeveloped lands increased to 34 percent from a 24 percent average in 1985. The larger interests make it feasible for Penn West to control its direction of exploration and to operate more of its prospective properties.

At December 31, 1986 the Company held working interests in 500,266 gross and 138,452 net acres in western Canada. The Company's land position includes 175,735 gross, 26,523 net, producing acres; and 324,531 gross, 111,929 net, undeveloped acres. In addition to the Company's working interest lands it also has royalty and net profits interest in 214,302 acres in Alberta and British Columbia. Penn West does not incur any expenditures in regards to the maintenance or development of the royalty and net profits land but receives a share of any production revenues generated.

An independent evaluation of Penn West's non-producing lands by Supplementary Land Services Ltd. valued the Company's holdings at $6,285,703 at December 31, 1986.

Penn West began 1986 with an aggressive exploration program utilizing the balance of the flow-through share funds raised in 1985. Fourteen of the Company's year-end total of 19 exploratory wells were drilled during the first quarter. Eleven exploratory wells were successful oil or gas discoveries.

Exploration and development activity was curtailed significantly during the latter nine months of the year as a result of the collapse of oil prices. The Company did, however, pursue a number of low risk development and exploration projects, participating in a total of 59 wells, with an 85 percent success rate. The success encountered in 1986 can be built upon with an expanded program of land acquisitions, seismic and drilling.

Penn West has a strong land position at Cygnet which continues to be an important area for exploration and development. A new pool Viking oil well at Cygnet was put on stream at a rate of 80 barrels of oil per day.

Further development of the Hoosier pool in which the Company has an average of 35 percent is being evaluated as a result of increased oil prices and the royalty free period recently announced by the Province of Saskatchewan. Consideration is being given to a secondary recovery scheme which would significantly increase the oil recovery from the pool.

In addition, the Company has interests averaging 35 percent in 2,560 undeveloped acres in the area. A number of drillable anomalies are indicated on seismic owned by Penn West. Further land acquisitions are required to enhance our position with drilling proposed in 1987.

Three successful wells were drilled in the Princess area, with Penn West participating for a 50 percent interest. One well was placed on production from the Pekisko formation at a rate of fifty barrels of oil per day while a second has produced at rates up to two million cubic feet of gas per day from the Basal Colorado formation.

To date, production in this area has been primarily natural gas from shallow formations. The Company is exploring the deeper potential of the area and has acquired a significant land position. An extensive seismic program will be conducted in the spring of 1987, and follow-up drilling is anticipated.

The Barons area, where the Company has drilled three Barons sandstone formation oil wells, continues to be of major interest. Potential exists on lands held by the Company for low risk development and exploratory drilling. Installation of a secondary recovery system to enhance ultimate oil recovery is anticipated upon completion of a successful drilling program.

As a result of an extensive seismic program conducted in 1985, 10 sections of land were acquired in the Consort area. Penn West now has an average interest of 40 percent in 15 sections in the area. Industry activity during the latter part of the year is expected to continue, with the Company benefiting as a result of its well-distributed land position and seismic coverage.

Ownership of in excess of 1,500 miles of seismic and land in more than 200 prospective areas places Penn West in a beneficial position for exposure to industry activity and new discoveries.

Robert A. Fuller
Land Manager

Land & Exploration Group
Left to Right
Cori L. Sabados, Land Secretary
Robert A. Fuller, Land Manager
Lori A. Petrie, Landman
Fred P. Rumak, Exploration Manager

Land and Exploration Review

Land Holdings

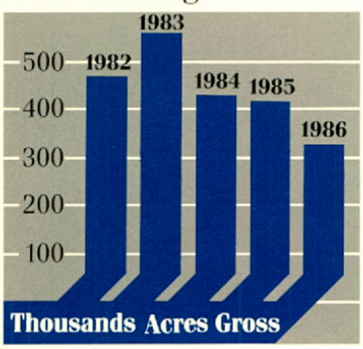
A report by Supplementary Land Services Ltd. has determined that the fair market value of the Company's net acreage in its Canadian undeveloped lands was $6,138,414 on December 31, 1986, while royalty and net profit interests in undeveloped lands was $147,289. Penn West's undeveloped land holdings in the United States and Australia are deleted as a result of the lack of activity in the two countries.

The following table is a comparative summary of the undeveloped land holdings:

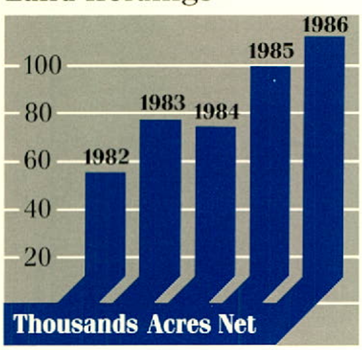
Undeveloped Petroleum and Natural Gas Rights

	Total 1986		Total 1985	
Working Interests	Gross Acres	Net Acres	Gross Acres	Net Acres
Alberta	275,943	94,969	364,996	84,199
British Columbia	21,755	1,483	21,743	1,218
Saskatchewan	26,833	15,477	25,036	15,464
Sub Total	324,531	111,929	411,775	100,881
Royalty and Net Profit Interests				
Alberta	14,540		25,440	
British Columbia	199,762		286,847	
Saskatchewan	–		320	
Sub Total	214,302		312,607	
Total	538,833	111,929	724,382	100,881

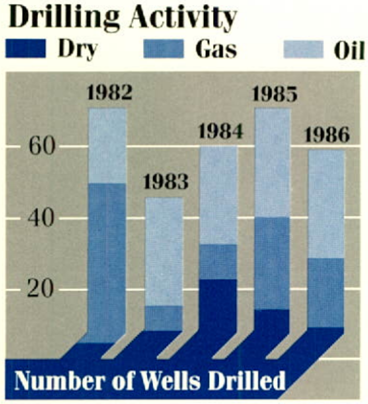
Land Holdings



Land Holdings



Drilling Activity



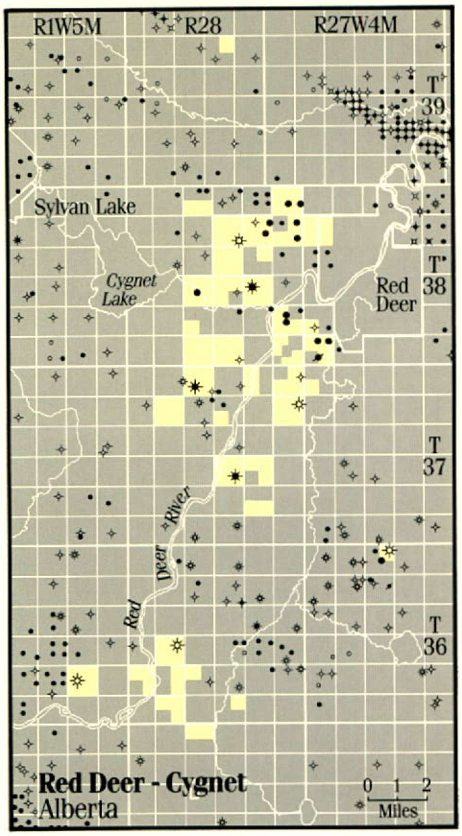
Drilling Activity

During 1986 the Company participated in the drilling of 56 wells in Western Canada. In addition, the Company holds an interest in 3 wells drilled at no cost to Penn West. The results of our 1986 drilling activities are shown in the following table:

1986 Drilling Results

	Gross Working Interest Wells			
Status	Alberta	Sask.	B.C.	Total
Gas	16	0	1	17
Oil	26	2	3	31
Dry	8	0	0	8
Sub Total	50	2	4	56
	Royalty and Net Profit Wells			
Gas	1	0	0	1
Oil	1	0	0	1
Dry	1	0	0	1
Sub Total	3	0	0	3
Total	53	2	4	59

Property Review

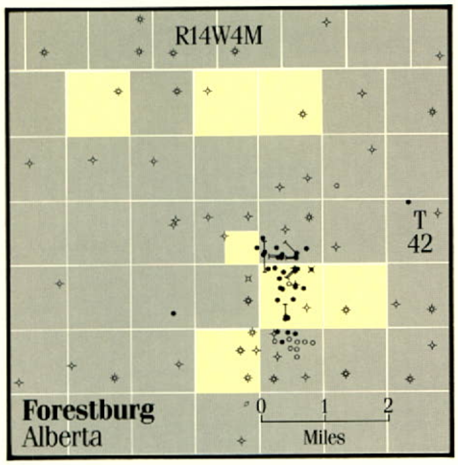


Cygnet, Alberta

The Company continues to have significant land holdings in the Cygnet area, adjacent to the City of Red Deer. Penn West's interests range from 5 percent to 33.33 percent in 17,000 gross acres.

A discovery well drilled at 6-16-38-28 W4M is currently producing at an average rate of eighty barrels of oil per day. The Company has a 33.33 percent interest in this new Viking oil pool. Exploration activity is continuing in the area and additional drilling in 1987 by Penn West and partners is anticipated.

The Company has developed a significant volume of proven gas reserves in the area. A gas plant is accessible and the operator of the properties is negotiating a gas purchase contract. A number of wells are expected to be placed on production by year-end.

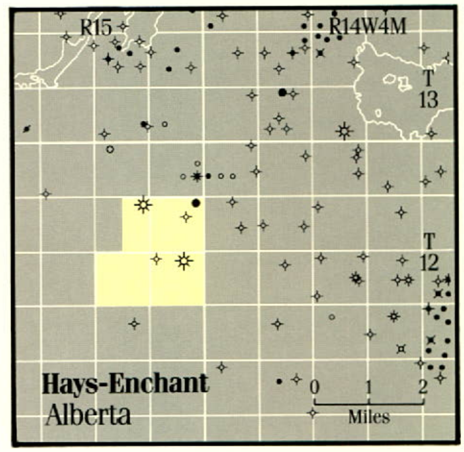


Forestburg

During 1986, Penn West participated in drilling 18 wells in the Killam Glauconite "S" pool. The drilling resulted in the addition of 14 Glauconite oil wells to this prolific pool in which the Company holds a 2.5 percent working interest.

During the reporting period, the Energy Resources Conservation Board approved the doubling of the oil recovery factor for the pool to 40 percent. This increased the pool production rate two-fold and added substantially to the reserves. Development of the pool is on ten-acre spacing units and an independent engineering evaluation has assigned average recoverable oil reserves of approximately 100,000 barrels of oil per well.

Drilling has continued in 1987, with the addition of a number of new development wells.



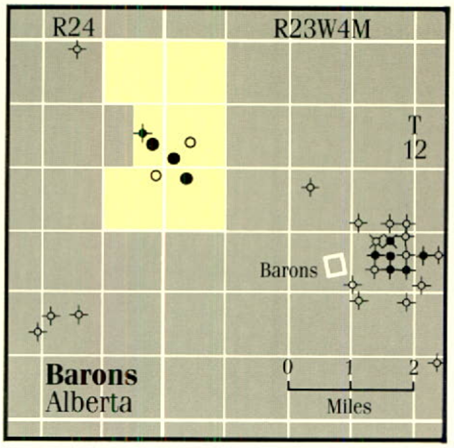
Enchant, Alberta

The Company holds a 100 percent interest in 2,240 acres in the Enchant area. Three successful wells have been drilled on the acreage, all of which were shut in at year-end.

This area, originally considered to be highly prospective for Devonian Nisku oil, is now regarded as a promising gas project. A number of shut-in gas wells owned by Penn West and other operators exist in the area and a study is being carried out to evaluate the feasibility of constructing a processing and gas gathering system to tie-in the wells to a sales facility.

Seismic shot in 1985 is being reprocessed and interpreted in the expectation that additional well locations will be defined for drilling during 1987.

Property Review



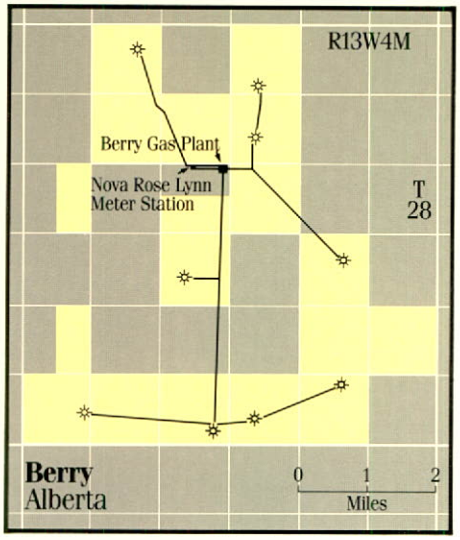
Barons, Alberta

Two Barons Sandstone formation wells drilled by the Company in the fall of 1985 and early 1986 are continuing to produce a light gravity water-free oil. The initial well at 4-30-12-23 W4 is producing at an average rate of 45 barrels of oil per day, while the 14-19-12-23 W4 well is averaging 10 barrels of oil per day. A well, drilled subsequent to year end, at 8-25-12-24 W4 is now awaiting completion.

A development pattern of eighty-acre spacing has been approved which will allow for low risk drilling.

Reservoir studies have suggested a significant extension to the pool and plans for 1987 include further step-out drilling and potentially the installation of a secondary recovery scheme.

Penn West holds working interests ranging from 48.25 to 96.5 percent in 3,520 acres, offsetting these two wells. This includes 3,200 acres which are Crown leases and, if developed, would be eligible for a royalty holiday of up to five years.

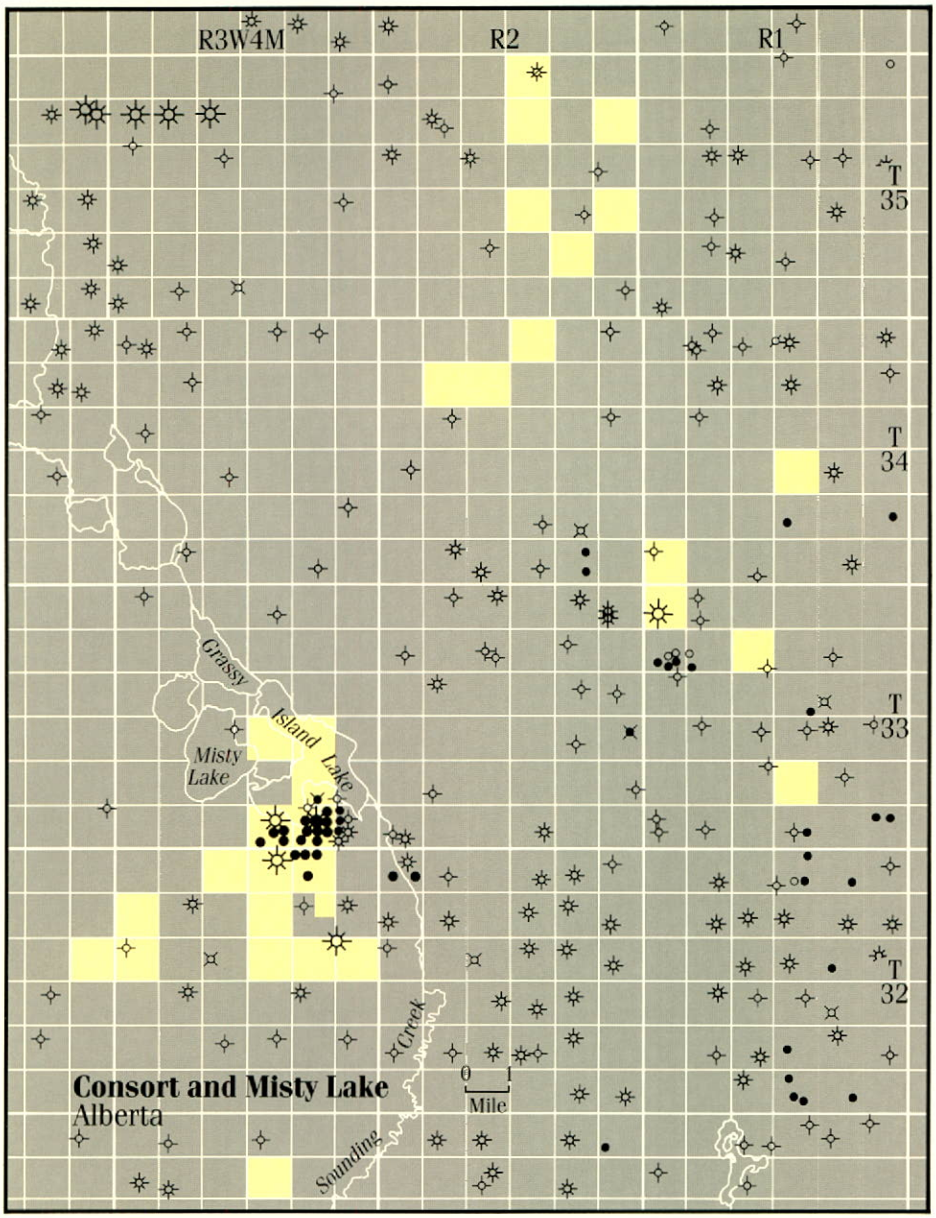


Berry, Alberta

In the Berry area in which Penn West has an average working interest of 11 percent, nine gas wells were tied-in to sales facilities during the second quarter. The wells are committed to an eight-million cubic feet per day gas contract.

A new gas plant capable of delivering ten million cubic feet per day was constructed in 1986. Production commenced in July at an initial rate of five million cubic feet per day. Deliverability tests during November and December have shown that the existing wells will easily meet the contracted rate of eight million cubic feet per day. Sales from the area are expected to have a significant impact on cash flow in 1987.

The Company's interests in the Berry area range from 5 percent to 43 percent in 10,560 gross acres, of which 4,160 acres are undeveloped. Potential exists on these lands for additional wells to be drilled if required to meet increased gas contract demands.



Misty Lake-Consort, Alberta

In the combined areas of Misty Lake and Consort, Penn West has working interests ranging from 26 to 100 percent in 20,000 acres.

Three Colony formation oil wells in which Penn West holds interests varying from 34 to 50 percent were drilled at Misty Lake in the first quarter.

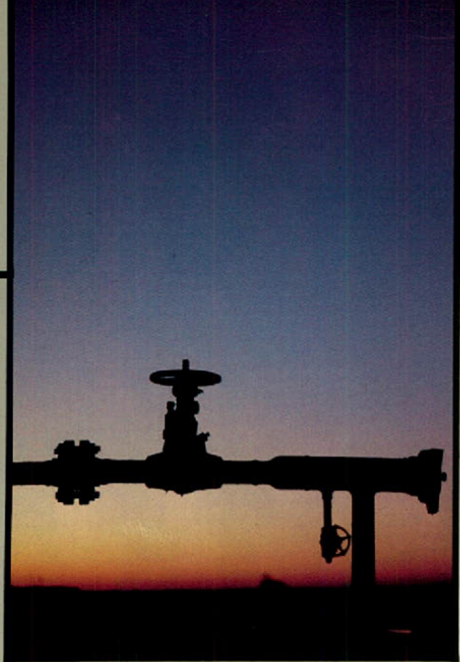
To date, 19 successful wells have been drilled of which 14 currently produce oil from the Colony zone. The remaining five are gas wells that continue to be shut-in pending negotiation of a gas sales contract.

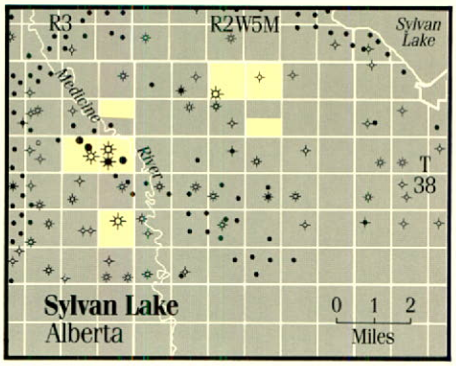
The Company has sixty miles of seismic coverage across 9,760 gross acres at Misty Lake. Much of this land is undeveloped but is highly prospective for both oil and gas. A number of seismically delineated well locations will be drilled when marketing conditions improve.

At Consort, Penn West has a 20 percent working interest in a dual zone gas well drilled at 3-31-33-1 W4. The well was completed in two zones and had absolute open flow tests of 31.9 million cubic feet per day from the Detrital zone and 5.5 million cubic feet per day from the Glauconite zone. It is scheduled to be tied-in to production facilities in 1987.

Penn West has interests ranging from 20 to 40 percent in 10,240 acres in the area. Ten sections of this land were acquired in 1986. The Company has an interest in over 300 miles of seismic that was utilized in land acquisitions. Industry interest in the area is generating an upsurge of activity which should enhance the value of Penn West's seismic data and land.

Property Review





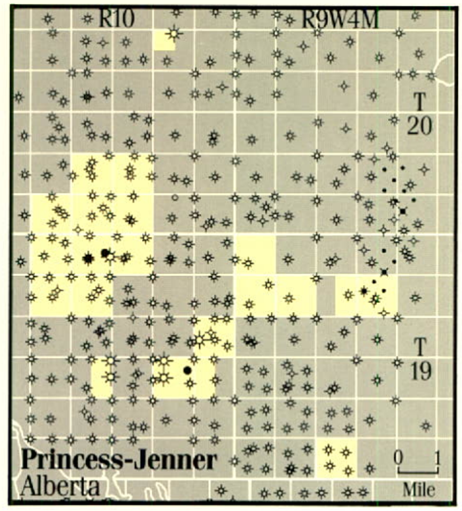
Sylvan Lake, Alberta

Penn West holds working interests ranging from 5 percent to 100 percent in 3,865 acres in the Sylvan Lake area.

A Basal Quartz gas well at 4-33-38-2 W5, in which the Company has a 25 percent interest, was placed on production during the second quarter. Following a shut-in period to allow the installation of a compressor unit, the well was returned to production subsequent to year-end at a rate of 1.5 million cubic feet per day.

Negotiations for pooling section 23-38-3 W5, which involve Penn West's 8-23-38-3 W5 Basal Quartz gas well are in the final stage. Production contracted to a major gas purchaser is expected to commence by early summer at a rate of two million cubic feet per day. Penn West will have an initial 25 percent working interest reverting to 18.75 percent after payout.

The Company has initiated a second pooling proposal which should result in the drilling of an exploratory well in which Penn West would have a 50 percent working interest.



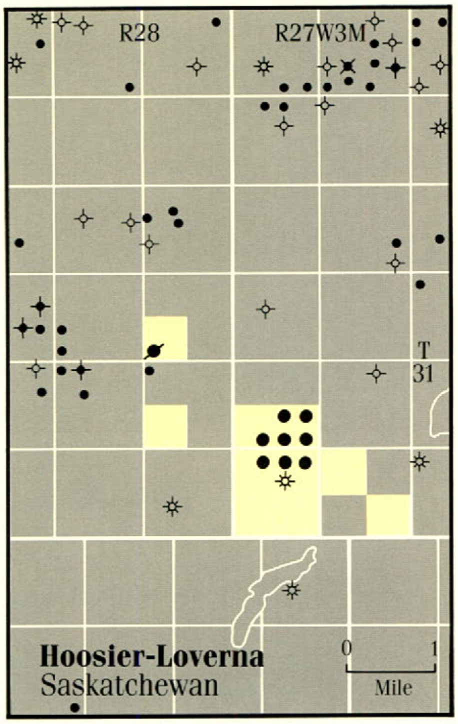
Princess, Alberta

Penn West holds interests ranging from 25 percent to 100 percent in 12,000 gross acres in the Princess area. This includes interests in 9,600 acres acquired at land sales and as a result of drilling during 1986.

Production in the area is primarily natural gas from the shallow Milk River, Medicine Hat and Second White Specks formations. Penn West has interests in five shallow gas wells that are currently on production from these horizons.

During the first quarter of 1986, Penn West participated for a 50 percent interest in three wells. Oil was discovered in the Detrital and Pekisko formations and gas was tested in significant rates from the Basal Colorado and Viking formations. Two of the three wells have been placed on production. The Pekisko oil well at 9-33-19-10 W4 is producing at a rate of fifty barrels of oil per day and the Basal Colorado gas well at 5-24-19-10 W4 was tied into sales gas facilities during the reporting period at a rate of two million cubic feet per day. The 5-24 well is expected to produce at an average annual rate of 800 thousand cubic feet per day.

A seismic program will be shot across the Company's lands in 1987. Further drilling is contemplated during the year dependent on results of this seismic program.

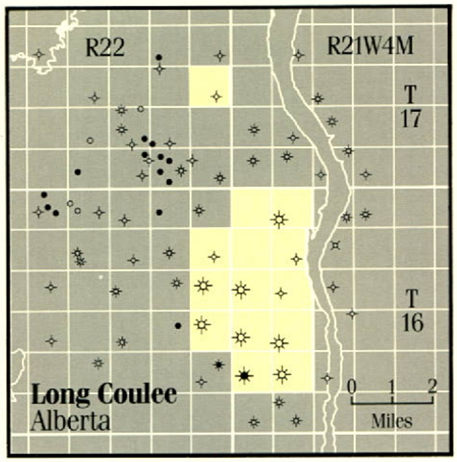


Hoosier, Saskatchewan

The Company has interests averaging 35 percent in eight Bakken oil wells at Hoosier in west-central Saskatchewan. Two of the wells which were drilled during the reporting period increased the production rate by 65 barrels of oil per day, bringing the field rate to approximately 200 barrels of oil per day.

Improved oil prices and the newly announced royalty incentives offered by the Province of Saskatchewan encourage the Company to pursue the extension of the Hoosier Pool and to explore a number of other prospects in the immediate vicinity. This area is delineated by extensive seismic data owned by the Company.

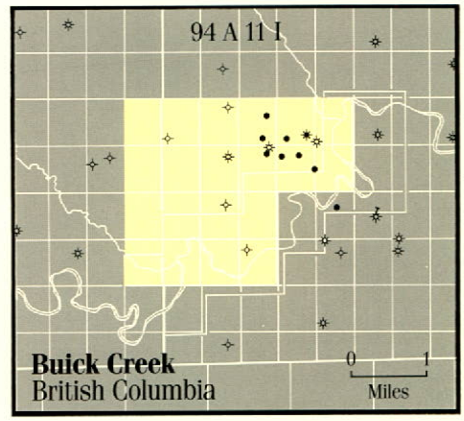
Penn West has initiated a study to evaluate the merits of placing the Hoosier Pool on a secondary recovery water flood scheme. A significant increase in the field production rate and additional recoverable oil reserves would be expected based on the success in the area of water flooding Bakken oil reservoirs.



Long Coulee

Penn West drilled two additional wells in the Long Coulee area this year. The Company holds an 11.7 percent interest in a Viking gas well drilled at 4-17-16-21 W4M and a 30 percent working interest in a Glauconite gas well located at 4-32-16-21 W4M. Both wells are included in an existing gas contract. The 4-32 well which tested at a rate of 3.5 million cubic feet per day added 5 billion cubic feet of reserves to the gas contract. This well has been completed and was tied into sales facilities during the fourth quarter.

The Company has an interest in 3,200 acres of undeveloped land in this area which offsets productive wells. Further drilling can be carried out when required to maintain gas contract rates.

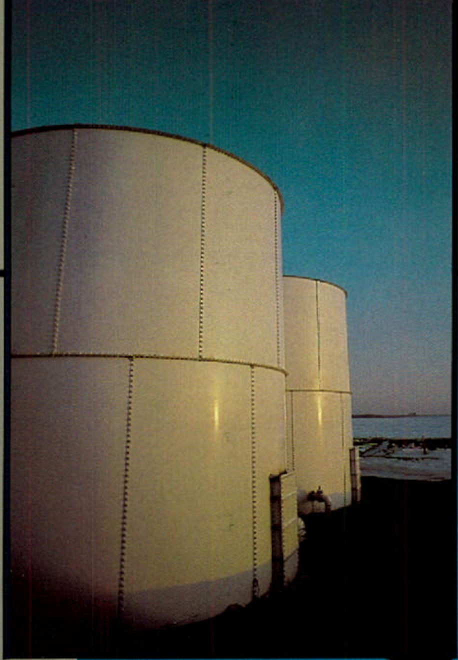


Buick Creek, B.C.

A number of changes were implemented during 1986 in the Buick Creek area. Three infill Doig oil wells and one Buick Creek gas source well drilled in the first quarter preceded the initiation of an immiscible gas injection scheme in April. This major project, undertaken to enhance production, included enlargement of battery and processing facilities and the installation of gas re-injection facilities.

Oil recovery from this pool is expected to increase by a factor of 9 percent, with recoverable reserves increasing by more than one million barrels of oil.

As a result of pooling and the acquisition of the minor interest of one of its former partners, Penn West retains a 7.725 percent working interest in all the wells and facilities in this area.



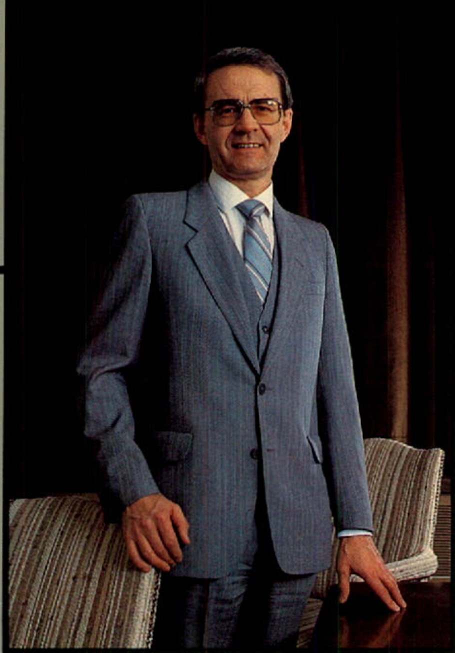
Five Year Statistical Review

Financial

	1986	1985	1984	1983	1982
Revenue	$ 5,049	$ 7,507	$ 6,956	$ 5,140	$ 4,728
Funds Generated from Operations	1,250	4,053	3,272	1,938	527
Net Earnings (Loss)					
Before Write Downs	(564)	1,270	998	247	(680)
After Write Downs	(564)	120	998	(2,571)	(1,787)
Exploration & Development Expenditures	4,934	7,001	4,584	2,808	1,797
Working Capital	(1,368)	(766)	457	(153)	1,098
Total Assets	45,126	45,915	40,489	35,765	38,581
Shareholders' Equity	27,888	27,756	24,896	17,391	19,994
Per Share					
Funds Generated from Operations	$ .06	$ .22	$ .20	$ .14	$ .04
Net Earnings (Loss)	$ (.03)	$ .01	$ .06	$ (.18)	$ (.12)

Operating

	1986	1985	1984	1983	1982
Oil and Natural Gas Liquids Sales					
Barrels	179,468	167,957	153,301	111,157	92,447
Barrels per Day	492	460	420	305	253
Natural Gas Sales					
Millions of Cubic Feet	1400.3	1310.4	1179.0	1002.7	1101.1
Millions of Cubic Feet per Day	3.8	3.6	3.2	2.7	3.0
Reserves — Proven and Probable					
Oil and Natural Gas Liquids (Bbls)	2,897,100	2,764,100	2,331,400	2,354,000	1,357,800
Natural Gas (MMCF)	59,567	49,177	46,780	45,369	42,894
Petroleum and Natural Gas Rights (thousands of acres)					
Gross Working Interest	325	412	426	559	473
Net Working Interest	112	101	76	77	56
Drilling Activity					
Gross	56	66	53	38	65
Net	7.8	19.8	11.5	6.7	6.9



Ronald G. Sparrow
Controller

Financial Review

Penn West's success in increasing production volumes during 1986 is evidenced by a 7 percent improvement in both oil and gas production. Oil production increased to 179,468 barrels from 167,957 barrels while gas production rose to 1,400,334 thousand cubic feet, from 1,310,358 thousand cubic feet in 1985. However, financial results do not reflect these increases. Depressed commodity prices saw the Company's average oil price in 1986 drop to $16.39 per barrel compared to $33.27 in 1985 while its average gas price dropped to $1.94 per thousand cubic feet from $2.44. These drastic price changes resulted in revenues decreasing by 32 percent to $5,049,000 while funds generated from operations dropped 69 percent to $1,250,000. Based on 20.2 million common shares outstanding in 1986, funds from operations generated 6 cents per share during the year compared to 22 cents in 1985. Revenue sources during the year were 52 percent from oil sales and 48 percent from gas sales.

A positive aspect of this year's financial climate was the long overdue elimination of the Petroleum and Gas Revenue Tax. The recorded tax for 1986 of $2,594 was down dramatically from $162,064 in 1985. In addition, the Alberta Royalty Tax Credit rate was increased from 50 percent to 95 percent for small explorers during the year. Penn West's tax rebate of $349,240 was down slightly from $389,653 last year, as a result of a reduction in Crown Royalties paid.

An increase of 4 percent in production expenses during the year to $1,759,000 resulted from additional production. General and administrative expenses increased in 1986 by 11 percent to $761,000. Overhead costs of $469,000 which relate to exploration and development programs were capitalized during the reporting period. No interest charges were capitalized by the Company.

1986 capital expenditures in oil and gas investments, net of petroleum incentive recoveries, were reduced by 30 percent to $4,934,000. The expenditure of $5,688,000 before incentives was funded by $1,071,000 of a flow-through share issue, while the remaining amount was paid out of bank borrowings and funds generated from operations. The Company issued 329,541 treasury shares during the year in exchange for the $1,071,000 expenditure on exploration costs from the flow-through share issue.

Penn West's income calculated for Canadian income tax purposes is expected to be offset by existing tax pools for a number of years. The following tabulation sets out the estimated pools and allowances which are available to be applied against income tax for tax purposes at rates and in the manner prescribed by the Income Tax Act:

Canadian Exploration Expense	$10,726,530
Canadian Development Expense	6,736,785
Canadian Oil & Gas Property Expense	3,402,958
Unclaimed Capital Cost	5,556,548
Earned Depletion	6,803,977
	$33,226,798

The dramatic oil price drop early in 1986 appears to have bottomed and average prices for oil are expected to increase in 1987. Gas prices may experience downward pressure for the short term, but only a slight drop in average prices is projected for 1987. With stable oil and gas prices and increased production in 1987 the Company expects to increase revenues by more than 25 percent which will result in a doubling of funds generated from operations.

Accounting Group
Left to Right
Gale S. Bleviss, Accountant
Margaret A. Taylor, Receptionist
Ronald G. Sparrow, Controller
Gerry L. Baillie, Production Accountant

Financial Statements

Consolidated Balance Sheet
as at December 31, 1986
(in thousands of dollars)

Assets	1986	1985
Current Assets		
Cash	$ –	$ 173
Accounts receivable	1,642	5,154
	1,642	5,327
Property and Equipment		
Oil and gas properties, together with exploration, development and equipment thereon	53,455	48,521
Accumulated depletion and depreciation	9,971	7,933
	43,484	40,588
	$45,126	$45,915

Liabilities and Shareholders' Equity		
Current Liabilities		
Bank overdraft	$ 159	$ –
Accounts payable	1,888	6,093
Due to affiliated company	963	–
	3,010	6,093
Bank Loan (note 1)	11,800	9,300
Gas Production Prepayments	874	988
Deferred Taxes	1,554	1,778
Shareholders' Equity		
Capital Stock (note 2)		
Authorized		
Unlimited number of common and preferred shares, without par value		
Issued		
20,275,608 Common shares (1985 - 19,946,067)	31,569	30,873
Contributed Surplus	656	656
Deficit	(4,337)	(3,773)
	27,888	27,756
	$45,126	$45,915

Approved by the Board

John J. Fleming

Director

Director

Consolidated Statement of Earnings and Deficit
Year Ended December 31, 1986

(in thousands of dollars)

	1986	1985
Revenue		
Oil and gas sales	$ 5,049	$ 7,507
Expenses		
Production	1,759	1,693
General and administrative	761	688
Interest	1,279	1,073
	3,799	3,454
Funds Generated from Operations	1,250	4,053
Items Not Requiring Funds		
Depletion and depreciation	2,038	1,903
Deferred income taxes (reduction) (note 3)	(224)	791
Deferred Petroleum and Gas Revenue Tax	–	89
	1,814	2,783
Earnings (Loss) Before Write-Downs	(564)	1,270
Write-down of U.S. oil and gas properties	–	402
Write-down of investment in affiliated company	–	748
	–	1,150
Net Earnings (Loss)	(564)	120
Deficit at beginning of year	(3,773)	(3,893)
Deficit at End of Year	$(4,337)	$(3,773)
Per Common Share, based on weighted average number of shares outstanding		
Funds generated from operations	$ 0.06	$ 0.22
Net earnings (loss)	$ (0.03)	$ 0.01

Consolidated Statement of Changes in Financial Position
Year Ended December 31, 1986

(in thousands of dollars)

	1986	1985
Cash Provided By (Used For):		
Operating Activities		
Funds generated from operations	$ 1,250	$ 4,053
Investing Activities		
Property and equipment	(4,934)	(7,001)
Investment in affiliated company	–	(485)
	(4,934)	(7,486)
Financing Activities		
Bank loan	2,500	(500)
Issue of capital stock	696	2,740
Gas production prepayments	(114)	(130)
Changes in non-cash working capital	270	1,533
	3,352	3,643
Increase (Decrease) in Cash Position	(332)	210
Cash (bank overdraft) at beginning of year	173	(37)
Cash (Bank Overdraft) at End of Year	$ (159)	$ 173

Auditors' Report

To the Shareholders of Penn West Petroleum Ltd.

We have examined the consolidated balance sheet of Penn West Petroleum Ltd. as at December 31, 1986 and the consolidated statements of earnings and 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 consolidated 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
February 20, 1987

Chartered Accountants

Notes to Consolidated Financial Statements

Year Ended December 31, 1986

(tabular amounts in thousands of dollars)

Summary of Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include the accounts of Penn West Petroleum Ltd. (the "Company") and its wholly-owned subsidiary, Penn West Petroleum, Inc.

Oil and Gas Operations

The Company follows the "full cost" method of accounting for oil and gas operations whereby all costs of exploring for and developing oil and gas reserves are capitalized. Such costs, including the costs of production equipment, are accumulated in centres established on a country-by-country basis and depleted using the unit-of-production method based upon estimated gross proved oil and gas reserves (converted to equivalent units on the basis of estimated relative energy content) in each cost centre. During 1986, the Company capitalized $469,000 of overhead costs relating to exploration and development activities (1985 - $503,000).

Costs of acquiring and evaluating unproved properties are initially excluded from depletion calculations. These unevaluated properties are assessed periodically to ascertain whether impairment has occurred. When proved reserves are assigned or the property is considered to be impaired, the cost of the property or the amount of the impairment is added to costs subject to depletion calculations. As at December 31, 1986 oil and gas property costs included $2,258,000 relating to unproved properties which have been excluded from depletion calculations.

In applying the full cost method, the Company calculates a "cost ceiling" which restricts the capitalized costs less accumulated depletion and depreciation and deferred income taxes from exceeding an amount equal to the estimated future net revenues from proved reserves (based on prices and operating costs in effect as at the balance sheet date) plus the lower of cost and estimated fair value of unproved properties, and 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.

Oil and Gas Sales

Revenue from oil and gas sales is stated net of all royalties and current Petroleum and Gas Revenue Tax and includes the Alberta Royalty Tax Credit.

Comparative Accounts

During the year the Company changed its method of presentation of the statement of changes in financial position from the working capital basis to the cash basis. Comparative accounts have been reclassified to conform with the method of presentation adopted in the current year.

Notes to Financial Statements

1. Bank Loan

The bank loan is evidenced by demand promissory notes, bears interest at the bank's prime lending rate plus ¼% and is secured by the Company's oil and gas properties.

The loan has been advanced under an operating credit facility which is based upon the value of the Company's oil and gas properties. The facility is reviewed annually and can be extended each year provided the borrowing base is in excess of the principal amount of the loan outstanding at the time or may be converted to a term loan of up to five years payable in monthly instalments out of the Company's net production revenues.

2. Capital Stock

(a) During the year the Company issued 329,541 common shares in consideration of exploration expenditures of $696,000, net of related Petroleum Incentive Program Payments of $375,000.

(b) Stock Options
As at December 31, 1986, 439,000 common shares of the Company were reserved for issue under employee stock options, exercisable from time to time to November 1, 1991 at prices ranging from $1.00 to $1.65 per share.

3. Income Taxes

Oil and gas properties include approximately $12,500,000 of unamortized costs at December 31, 1986 which are not deductible for income tax purposes by the Company.

Deferred income tax provisions are less than the taxes which would result from applying the expected tax rate of 50% (1985 - 47%) to consolidated earnings (loss) before income taxes of $(788,000) and $911,000 for the years ended December 31, 1986 and 1985, respectively. The differences between the computed "expected" tax provisions and the actual tax provisions are summarized as follows:

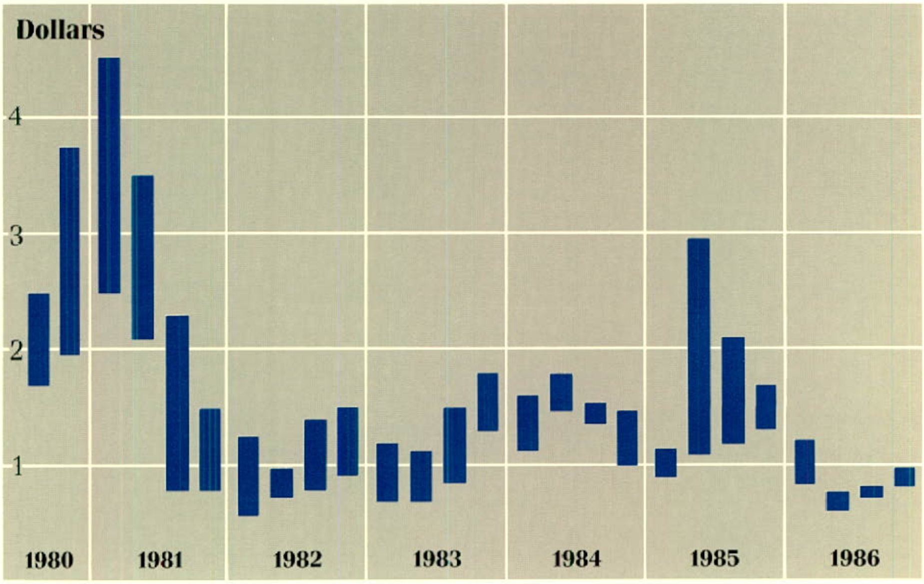
	1986	1985
Computed "expected" tax expense (reduction)	$(394)	$428
Increase (decrease) in taxes resulting from:		
Non-deductible Crown charges, net of provincial credits	143	524
Depletion expense relating to non-deductible property costs	288	253
Federal resource allowance	(322)	(751)
Earned depletion allowance	–	(258)
Non-deductible losses of foreign subsidiary and affiliated company	4	582
Other	57	13
Actual deferred income tax expense (reduction)	$(224)	$791

Board of Directors

Seated Left to Right:
James Duncan McNeill, Dale F. Duprey, John J. Fleming.
Standing Left to Right:
F. K. Roy Gillespie, Orval K. Horn, Dr. Gilbert J. McMurtry, Denis L. Russell, Wesley G. Ismond.

Trading History

Quarterly Price Range



Corporate Information

Directors
John J. Fleming
Chairman of the Board
Calgary, Alberta
Dale F. Duprey
President and Treasurer
Calgary, Alberta
Denis L. Russell
Vice President
Vancouver, British Columbia
*Wesley G. Ismond
Secretary
Calgary, Alberta
F. K. Roy Gillespie
Calgary, Alberta
*Dr. Gilbert J. McMurtry
Calgary, Alberta
*James Duncan McNeill
Calgary, Alberta
*Orval K. Horn
Calgary, Alberta

*Audit Committee

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MacLeod Lyle Smith McManus
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Calgary, Alberta T2P 3H7

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Washington County State Bank
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Stock Exchange Listing
Toronto Stock Exchange
Symbol – PWT

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