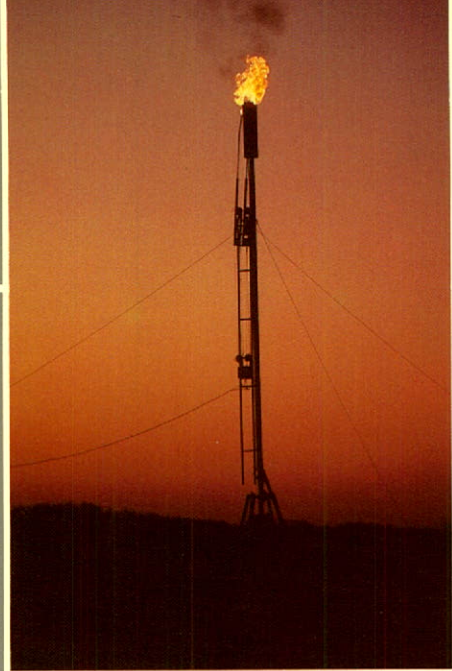


PENN WEST PETROLEUM LTD.

1985

The number '1985' is rendered in a large, bold, sans-serif font. The digits '9' and '8' are filled with a dark silhouette of an oil rig structure, including a tall derrick and various platforms. The background of the entire graphic is a warm, golden-orange sunset or sunrise sky with some light clouds. The overall composition is centered and occupies most of the page.

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 Wednesday, April 30, 1986 at 10:00 a.m.

Financial and Operating Highlights

Financial

	Year Ending Dec. 31, 1985	Year Ending Dec. 31, 1984
Gross Oil and Gas Sales	\$ 9,035,974	\$ 8,586,198
Total Revenue, net of royalties	\$ 7,506,233	\$ 6,955,046
Oil and Gas Sales, net of royalties	\$ 7,410,152	\$ 6,841,878
Investment Income	\$ 96,081	\$ 113,168
Net Earnings for the Year	\$ 120,158	\$ 997,803
Working Capital Generated from Operations	\$ 4,052,628	\$ 3,271,365
Additions to Property, Plant and Equipment	\$ 7,000,762	\$ 4,583,764
Working Capital (Deficiency)	\$ (765,654)	\$ 457,186
Long Term Debt	\$ 9,300,000	\$ 9,700,000
Shareholders' Equity	\$ 27,755,840	\$ 24,895,353
Total Assets	\$ 45,915,177	\$ 40,488,800
Common Shares Outstanding	19,946,067	18,635,821
Registered Common Shareholders	941	989

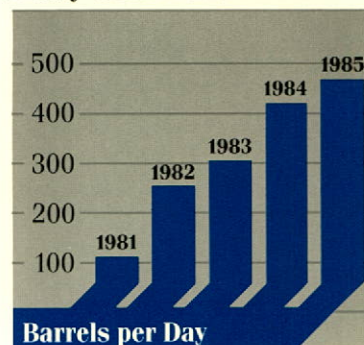
Operations

Production (Gross before royalties)		
Crude Oil (Barrels)	167,957	153,301
Barrels per day	460	420
Natural Gas (Mcf)	1,310,358	1,179,007
Mcf per day	3,590	3,230
Reserves (Gross Proven & Probable)		
Crude Oil (Barrels)	2,764,100	2,331,400
Natural Gas (Mmcf)	49,177	46,780
Drilling Activity		
Gross Wells Drilled	66	53
Net Wells Drilled	19.75	11.52
Net Wells Productive	15.94	7.00
Net Wells Dry	3.81	4.52

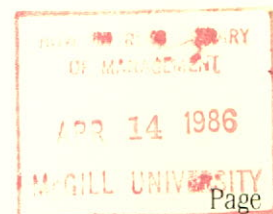
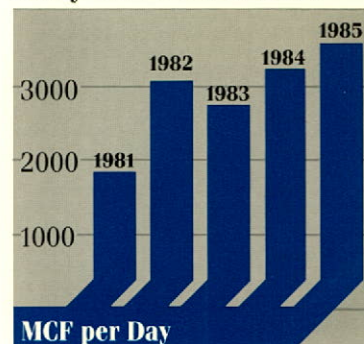
Land Holdings (Undeveloped)

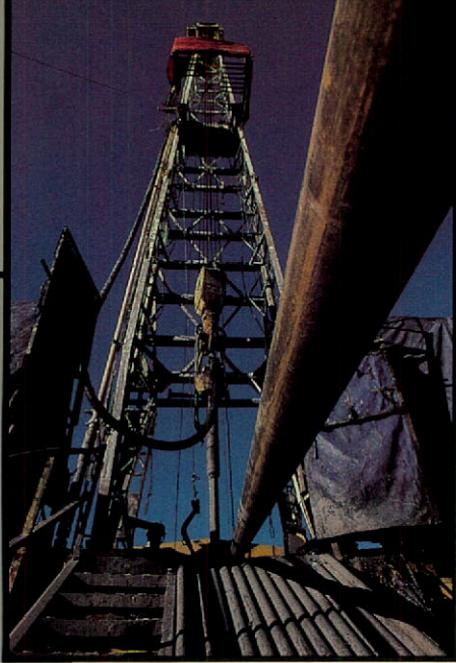
Gross Acres	411,775	426,351
Net Acres	100,881	75,695
Gross Royalty and Net Profits Interest	312,607	308,381

Daily Oil Production



Daily Gas Production





President's Report to the Shareholders

In 1985, Penn West's expenditures for exploration and development increased dramatically to \$7 million from \$4.6 million in 1984. As a result of the substantial increase in funds budgeted for these expenditures, the Company moved from a cautious close-in development drilling approach to higher risk exploration.

Funds for the 1985 exploration and development program were provided from cash flow and from a \$5.3 million private placement of flow-through common shares. A condition of the issue was that the funds were to be spent totally on exploration projects prior to March 31, 1986 to qualify for a 35 percent rebate from the Petroleum Incentive Program. These funds have now been expended, \$4.2 million in 1985 and \$1.1 million subsequent to year-end.

During 1985, Penn West added 30 oil wells and 26 gas wells to the Company's well count, with a success ratio of 79 percent. On an oil equivalent basis, this added 830,700 barrels of proven oil to the Company's reserves. The new reserves resulted in 2.78 barrels of oil equivalent being discovered per barrel produced. An independent engineering study values the Company's oil and gas reserves at year-end at \$63.5 million based on a 15 percent discount factor. This represents a 9 percent increase over 1984.

The highlight of Penn West's 1985 drilling program was the discovery of five new oil pools and six new gas pools. Exploration discoveries are important for the Company's growth. They provide low risk development drilling opportunities, which are the most efficient application of Company funds.

Penn West's success during 1985 is reflected in average production rates of 460 barrels of oil per day and 3.59 million cubic feet of gas per day, increases of 10 percent and 11 percent respectively, over the previous year. This provided an improvement in cash flow of 24 percent to \$4 million for the year. Increased drilling activity which resulted in new discoveries improved the Company's production capability during the year. This was evident in the fourth quarter which saw average production rates rise to 562 barrels of oil per day and 3.84 million cubic feet of gas per day.

The new exploration emphasis led Penn West to an increased use of seismic data during the year. A number of extensive seismic programs were undertaken in Alberta and Saskatchewan, and in excess of 1,000 miles of data were shot and evaluated. The Company now has a library of more than 2,000 miles of seismic data for western Canada. This data is used to delineate drilling anomalies in the Company's exploration and development programs, and sales of seismic data have the potential to provide significant revenue to the Company.

A seismic program during the year in west-central Saskatchewan resulted in Penn West's most significant discovery, a Bakken oil pool in Hoosier. Nine wells have been drilled, eight of them successful. By year-end, the wells contributed approximately 40 barrels of oil per day to Penn West's production, which doubled as a result of additional drilling in the first quarter of 1986. Further drilling is planned for 1986, and the area has the potential to add significantly to the Company's reserves.

Penn West continued its philosophy of assuming larger working interests in all land acquisitions and of strengthening the Company's land position. During the year, the Company recorded a 33 percent increase in its net land position, primarily by increasing its participation in acquisitions from an average 18 percent in 1984 to 25 percent in 1985. Penn West's undeveloped land holdings in western Canada were evaluated independently at \$7.2 million at year-end.

In addition to acquiring land on defined geological and geophysical prospects, the Company continues to accumulate land positions in areas where drilling prospects can be generated on geological trends. As a result, Penn West has developed a strong land representation in more than 211 prospective areas in western Canada. The Company's diversified land position exposes it to numerous areas of activity by other industry operators. This exposure gives Penn West an insight into exploration beyond the boundaries of its own programs and will enhance the Company's growth.

The Company's success in its concentrated oil exploration program produced a very satisfactory increase in production rates, especially during the latter part of the year. This success is expected to continue during 1986 and beyond and will be reflected in cash flow improvement and in the growth of Penn West.

The Company acknowledges the essential contribution of the management and staff to the progress achieved during 1985.

Submitted on behalf of the Board,

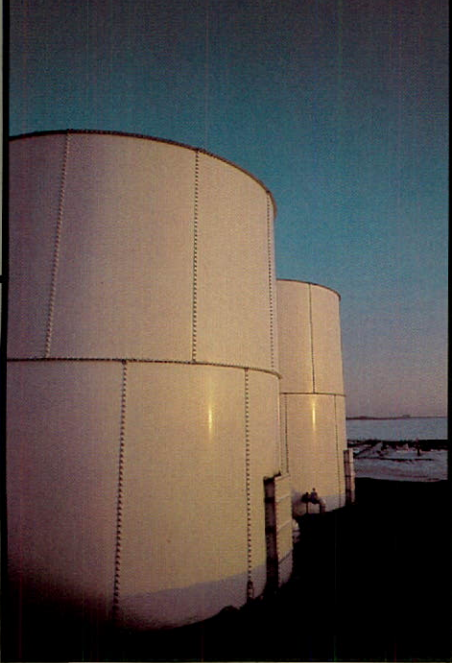


Dale F. Duprey,
President

Calgary, Alberta
March 26, 1986



Dale F. Duprey
President



Summaries

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, 1986, determined by the independent petroleum consulting firm, Martin Petroleum & Associates, together with comparative volumes for 1984.

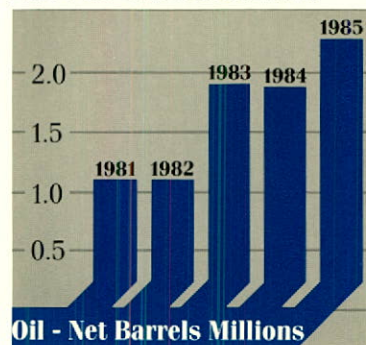
Reserves

	1985		1984	
	Gross	Net	Gross	Net
Crude Oil (Bbls)				
Proven	1,896,400	1,559,000	1,719,000	1,386,000
Proven & Probable	2,764,100	2,241,800	2,331,400	1,865,000
Natural Gas (Mmcf)				
Proven	43,998	34,708	41,117	31,573
Proven & Probable	49,177	39,001	46,780	36,161

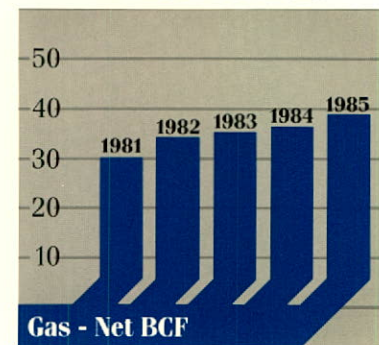
Crude Oil & Natural Gas Discounted Future Net Cash Flow, Before Income Tax

	Undiscounted	10%	15%	20%
1984 Proven	\$188,090,700	\$68,720,400	\$51,025,800	\$40,544,900
Proven & Probable	\$249,104,800	\$80,487,900	\$58,118,000	\$45,360,900
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

Reserves Proven and Probable



Reserves Proven and Probable



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 \$6,975,161 on December 31, 1985, while royalty and net profit interests in undeveloped lands was \$229,994. 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 1985		Total 1984	
	Gross Acres	Net Acres	Gross Acres	Net Acres
Working Interests				
Alberta	364,996	84,199	382,339	60,590
British Columbia	21,743	1,218	23,155	1,350
Saskatchewan	25,036	15,464	20,797	13,749
Manitoba	0	0	60	6
Sub Total	411,775	100,881	426,351	75,695
Royalty and Net Profit Interests				
Alberta	25,440		25,960	
British Columbia	286,847		282,101	
Saskatchewan	320		320	
Sub Total	312,607		308,381	
Total	724,382	100,881	734,732	75,695

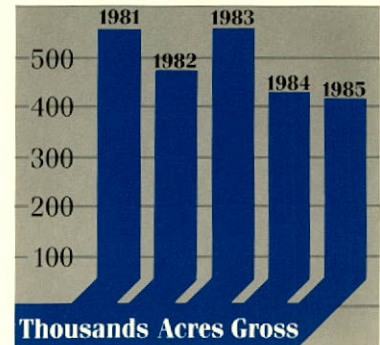
Drilling Activity

During 1985 the Company participated in the drilling of 66 wells in Western Canada. In addition, the Company holds an interest in 5 wells drilled at no cost to Penn West. The results of our 1985 drilling activities are shown in the following table:

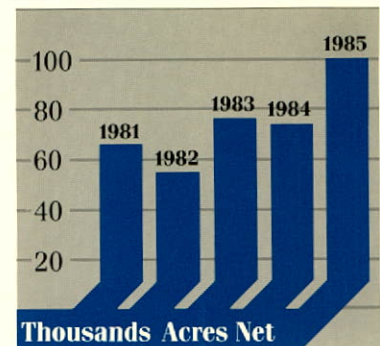
1985 Drilling Results

Status	Gross Working Interest Wells		
	Alberta	Sask.	Total
Gas	25	0	25
Oil	22	7	29
Dry	10	2	12
Sub Total	57	9	66
	Royalty and Net Profit Wells		
	Alberta	Sask.	Total
Gas	1	0	1
Oil	1	0	1
Dry	3	0	3
Sub Total	5	0	5
Total	62	9	71

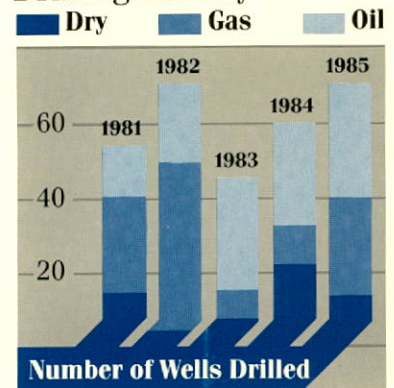
Land Holdings



Land Holdings

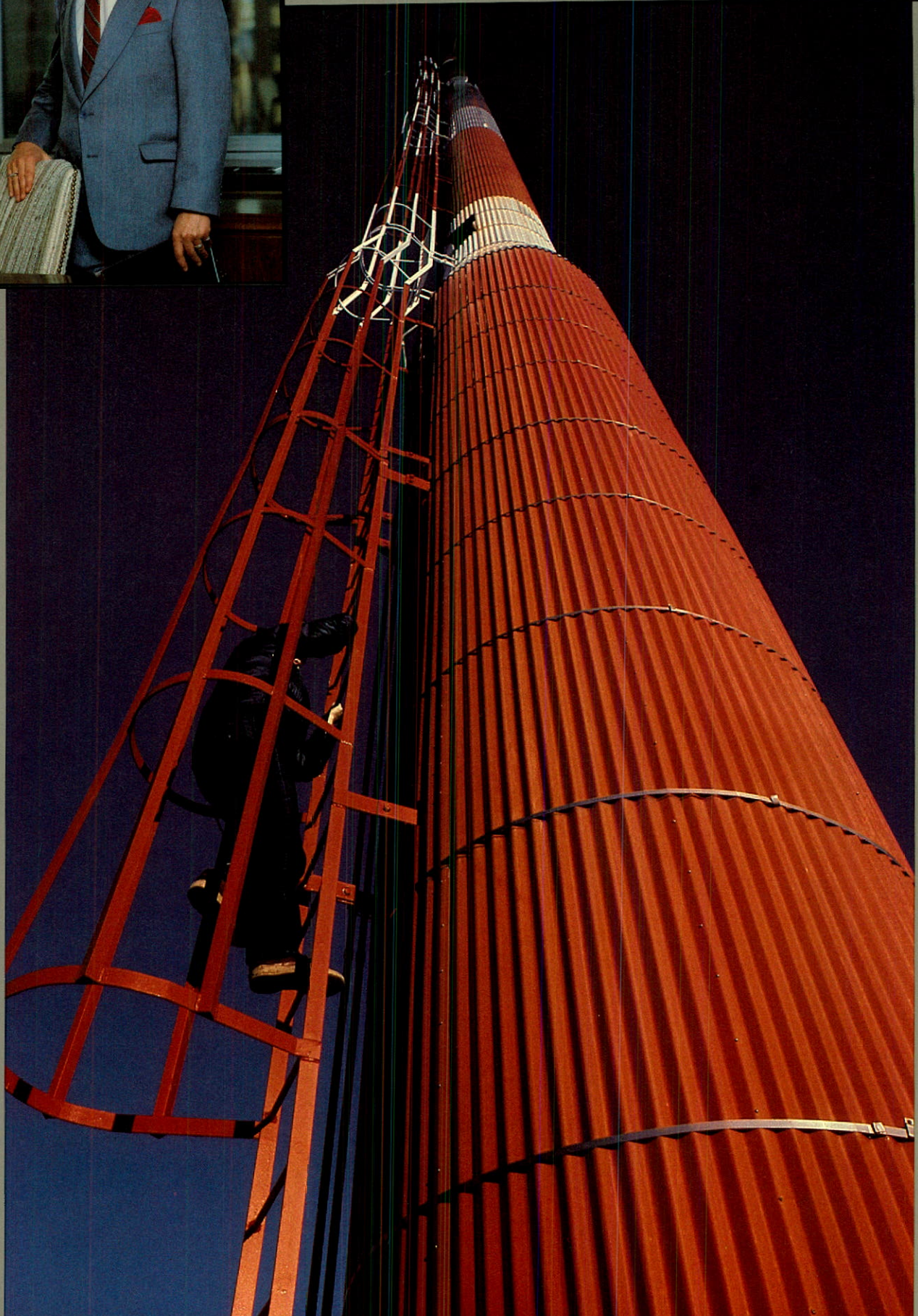


Drilling Activity





Floyd N. Krukoff
Operations Manager



Operations Review

In 1985, Penn West participated in the drilling of 71 wells in western Canada, resulting in 30 oil wells, 26 gas wells and 15 abandonments for a success ratio of 79 percent. The Company now holds interests in 649 oil and gas wells in Canada and the United States, and royalty and net profits interests in an additional 92 wells.

Oil production during 1985 averaged 460 barrels per day compared to 420 barrels per day the previous year, an increase of 10 percent. Gas production rose to an average 3.59 million cubic feet per day, an 11 percent increase over the previous year's average of 3.23 million cubic feet per day. These increases in production resulted in a 24 percent increase in cash flow to \$4,052,628 from \$3,271,365 in 1984. Revenue from oil and gas sales increased 8 percent from \$6,841,878 in 1984 to \$7,410,512 during 1985.

An exploration discovery in Hoosier, Saskatchewan, followed by a development program, contributed approximately 40 barrels of oil per day to the Company's production by the end of 1985. Additional drilling subsequent to year-end has doubled the Company's share of production to 80 barrels of oil per day. Drilling at Hoosier resulted in the addition of 169,700 barrels of oil to the Company's reserves. All wells receive the Saskatchewan royalty holiday.

In Alberta, a new discovery well drilled in the Barons area added 45 barrels of oil per day to the Company's production and 58,500 barrels of oil to the Company's reserves. Additional new oil and gas discoveries at Enchant, Thorsby, Little Bow, Misty Lake and Sylvan Lake added significant reserves and productivity to the existing producing properties.

The equivalent of 830,700 barrels of proven oil reserves were discovered during 1985. This is comprised of 380,400 barrels of proven oil and 4.5 billion cubic feet of proven gas. For the conversion, 10,000 cubic feet of gas are considered equivalent to one barrel of oil. During the year, the equivalent of 2.78 barrels of oil were found for every barrel produced.

An independent engineering evaluation, effective January 1, 1986, placed the Company's gross share of proven and probable reserves at 2,764,100 barrels of oil and 49,177 million cubic feet of natural gas, increases during the year of 18 and 5 percent respectively. Of the total reserves evaluated, proven reserves account for 69 percent of the oil reserves and 89 percent of the gas reserves.

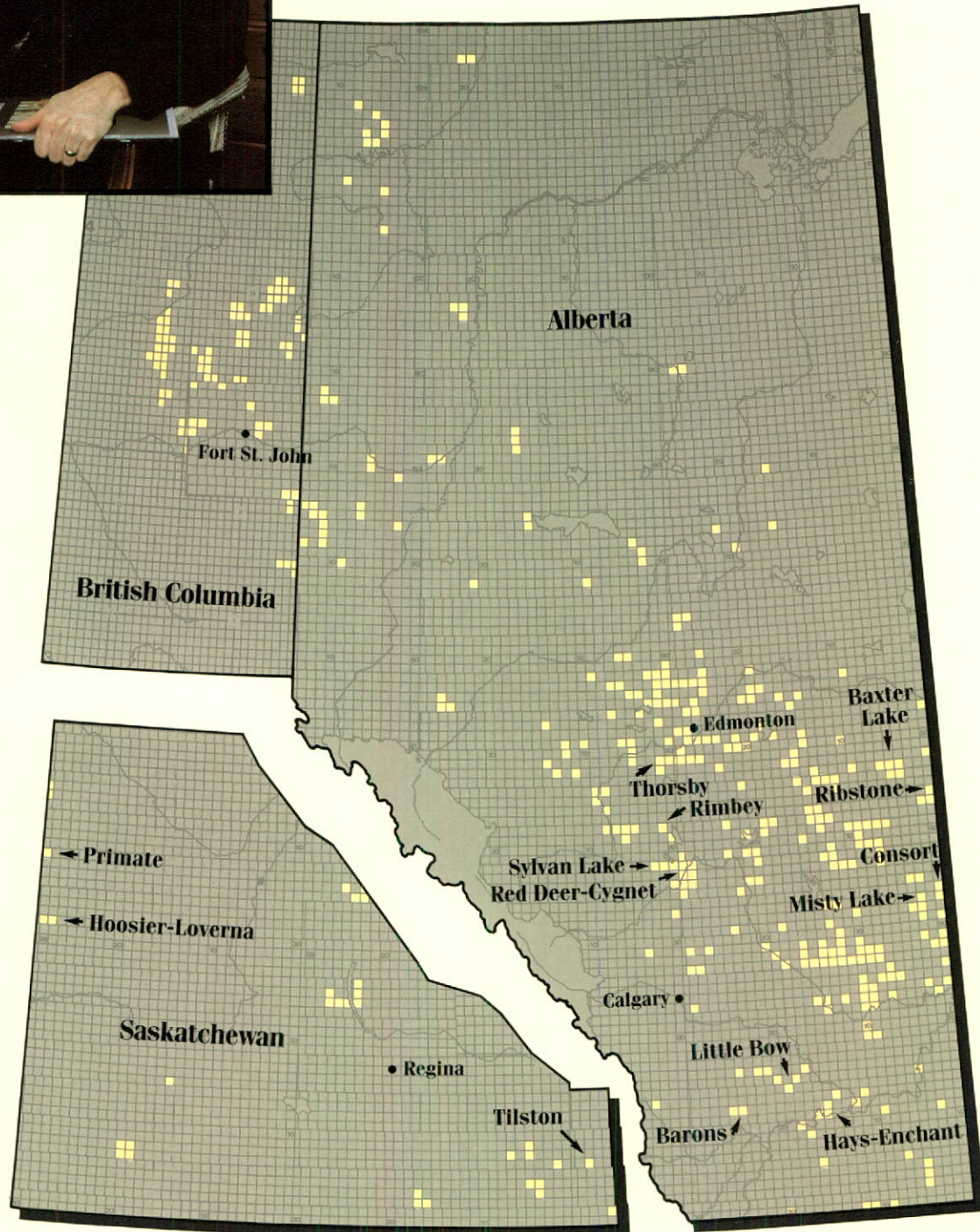
An estimate of cash flow before income tax is prepared on an annual basis by independent engineering consultants. As of December 31, 1985 the Company's undiscounted future net cash flow was determined to be \$322,674,900, a 30 percent increase from the previous year. Applying a 15 percent discount factor, the future net cash flow was determined to be \$63,492,900, a 9 percent increase over 1984.



*The Operations and Exploration Group
From Left
Elaine Y. Leung, Executive Assistant
Brian E. Brausen, Operations Engineer
Fred P. Rumak, Exploration Manager
Floyd N. Krukoff, Operations Manager
Gerry L. Baillie, Production Accountant*



Robert A. Fuller
Land Manager



Townships Within Which Penn West Holds Interests

Land Review

Penn West continues to emphasize a strong land position with a mixture of exploration and development lands which contribute strongly to the Company's growth.

The Company holds land in Canada, Australia and the United States, with its most significant area of activity being the three western provinces of Canada.

At December 31, 1985 Penn West held working interests in 546,778 gross acres and 128,715 net acres in western Canada. Of the total Canadian holdings, 27,834 net acres have been developed, leaving 100,881 for potential future development. In addition to the Company's working interest lands, it has royalty and net profits interests in an additional 312,607 acres in Alberta, British Columbia and Saskatchewan.

In 1985 Penn West recorded a 33 percent increase in its net undeveloped land holdings in Canada, as a direct result of the Company's philosophy of assuming larger working interests in new land acquisitions. The larger interests allow Penn West the opportunity to choose either to participate for its full interest in sound prospects or to farmout while maintaining a significant interest at no cost to the Company.

An independent land evaluation by Supplementary Land Services Ltd. valued the Company's Canadian undeveloped land holdings at \$7,205,155 as of December 31, 1985. The Company curtailed its activities in Australia and the United States during 1985 and as a result attributes no land values to properties held in these countries.

Penn West participated in a number of extensive seismic programs in Alberta and Saskatchewan in 1985 which provided the basis for an active leasing program together with farmin and seismic option negotiations. This activity resulted in a significant land representation in new prospective areas and in the drilling of a number of exploratory and development wells during the year.

Penn West has in excess of 2,000 miles of seismic data which will be utilized to develop new prospects and evaluate Crown lands. The trading rights to seismic provide the Company with a potential source of revenue should it choose to make it available to the industry.

In addition to acquiring land on defined geological and geophysical prospects, Penn West is continuing its policy of tendering nominal bids on available Crown lands, based on geological trends and drilling activity. This policy has afforded the Company the opportunity to become involved in a number of prospective areas and has given it a strong land representation in most areas of Alberta.

The Company has land interests in 211 prospective areas in western Canada. With a continued aggressive approach to land acquisitions, Penn West will have a presence in numerous new exploratory developments.



*The Land Department
From Left
Lori A. Petrie, Landman
Robert A. Fuller, Land Manager
Cori L. Sabados, Land Secretary*



Fred P. Rumak
Exploration Manager



Exploration and Development Review

A dramatic 53 percent increase in exploration and development expenditures from \$4,584,000 in 1984 to \$7,001,000 in 1985 occurred during the reporting period. This increase was directly related to the Company's \$5,300,000 flow-through share issue, which provided additional funds for an aggressive exploration program. A condition of the issue was that the funds were to be expended totally on exploration projects prior to March 31, 1986 to qualify for a 35 percent rebate from the Petroleum Incentive Program.

Exploration in 1985 led to the discovery of five new oil pools and six new gas pools.

In the Enchant area, three exploratory wells resulted in the discovery of gas and oil in the Devonian Nisku formation.

A well drilled in the fall of 1985 in the Barons area produces oil from the Barons sandstone.

At Little Bow, a two-well drilling program discovered the presence of two prolific gas zones in the Glauconite and the Basal Quartz formations.

Exploration in the Thorsby area resulted in the discovery of two new pools, oil in the Glauconite formation and gas in the Viking formation. The Company's significant land holdings contiguous to the discoveries will enhance an assertive development and exploration program in 1986.

At Misty Lake, additional new oil and gas reserves were discovered in the drilling of nine wells by Penn West. The discoveries contributed significantly to the Company's 1985 oil production. The gas reserves were found in the Basal Quartz, Colony, Viking, Edmonton and Bakken formations.

In the Consort area a well that produces gas from the Detrital formation is being evaluated.

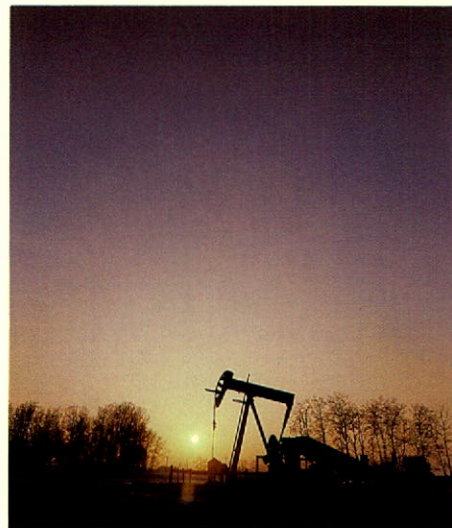
One of Penn West's major finds in 1985 is considered to be the discovery of a Bakken sand oil pool at Hoosier, Saskatchewan. Development drilling was 100 percent successful, and delineation drilling in 1986 should add considerably to the pool's deliverability and reserves.

Seismic was used extensively by Penn West in 1985 to delineate prospective anomalies. The Company participated, at interests ranging from 25 to 40 percent, in the shooting of more than 1,000 miles of new seismic data in five major programs in Alberta and Saskatchewan.

Penn West has the rights to proceeds from seismic data sales from these programs varying from 20 to 25 percent. In certain areas, where seismic has served the Company's exploration requirements, the data will be made available to industry, and the revenue from this will offset a portion of Penn West's seismic investment.

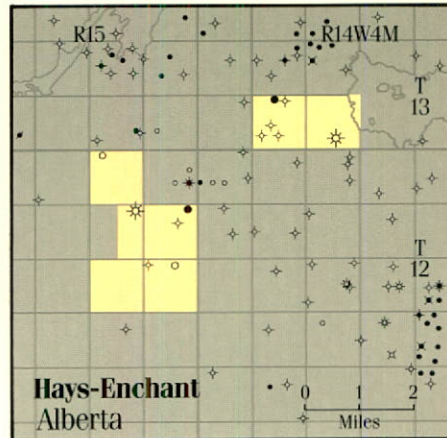
These programs added significantly to Penn West's existing seismic data. The Company now has a well-established seismic data base which will play an important role in defining exploration plays.

The Company's 1985 exploration and development program resulted in a 79 percent drilling success ratio. In 1986, Penn West will continue to rely heavily on a combination of seismic interpretation and geology to add to the reserve base of the Company and improve its cash flow.





Property Reviews

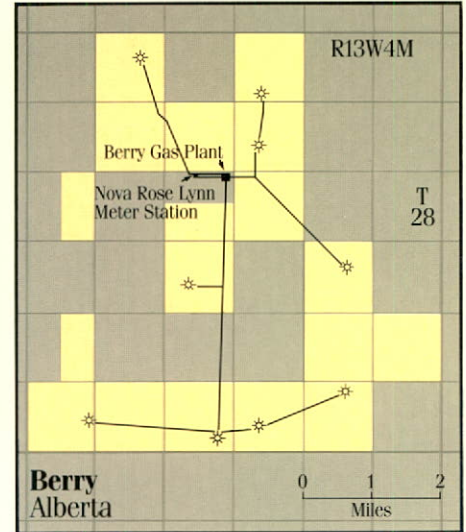


Enchant, Alberta

The Company has a 100 percent working interest in 2,880 acres in the Enchant area on which two Devonian wells were drilled during the year. The discovery well, located at 16-25-12-15 W4M, commenced production at a rate in excess of 60 barrels of oil per day. A rapid increase in gas production necessitated remedial work to attempt to restore the well's oil production potential. The results will be known when an acid stimulation has been completed and the well is subjected to a production test. The second well, at 16-26-12-15 W4M, was completed as a Devonian Nisku gas well with flow rates of 1.8 million cubic feet per day.

An extensive seismic program was conducted on the lands during the year, and the Company now has 88 miles of data which is being used to delineate additional drilling locations.

In the first quarter of 1986, a third well was drilled on the acreage at 15-24-12-15 W4M. The well is awaiting completion to determine its potential.

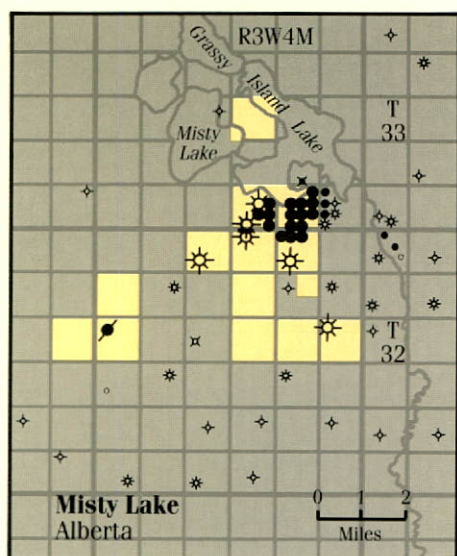


Berry, Alberta

Nine gas wells in the Berry area will be tied into sales facilities during the first half of 1986. Design of the pipeline and compression facilities is complete, and construction is expected to begin after the spring break-up.

A gas sales contract has been negotiated which provides for peak delivery volumes of eight million cubic feet per day to commence July 1, 1986. Penn West's interest will be approximately 11 percent of the total sales, which should increase the Company's cash flow by more than \$500,000 per year.

The Company's interests range from 5 to 43 percent in 10,880 acres in the Berry area which include 4,480 undeveloped acres. The undrilled lands have the potential to provide additional reserves to meet gas contract demand when the producing reserves experience depletion.

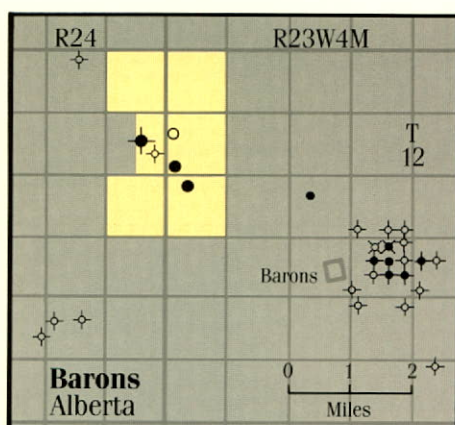


Misty Lake, Alberta

Penn West continues to be very active in the Misty Lake area. During 1985 the Company participated in drilling nine wells, resulting in five oil and four gas wells. Penn West now holds interests in 16 oil wells in the area, which produce at a combined rate of 200 barrels of oil per day. Misty Lake wells contributed 12.4 percent of the Company's oil production during 1985.

A study is being conducted to evaluate the economics of tying a number of gas wells in the area into a pipeline sales facility. The large volume of gas reserves owned by Penn West and other operators in the area makes it feasible to obtain a gas purchase contract.

Seismic data has been used extensively to select the Company's drilling locations. Penn West now has 60 miles of data across 8,480 acres in the area, in which the Company holds working interests ranging between 26 and 100 percent. The majority of the acreage held in the Misty Lake area remains undeveloped, and a number of additional locations delineated by seismic are expected to be drilled in 1986.



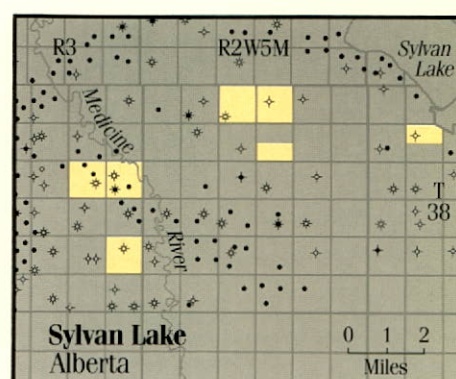
Barons, Alberta

Penn West holds working interests ranging from 48.25 to 96.5 percent in 3,520 acres in the Barons area.

A discovery well, drilled at 4-30-12-23 W4M in the fall of 1985, is producing at a rate of 45 barrels of oil per day. A second well, drilled at 14-19-12-23 W4M subsequent to year-end, is producing at a rate of 15 barrels of oil per day. The Company holds a 96.5 percent working interest, reverting to 48.25 percent after recovery of costs, in each of the wells.

The wells, which produce a light gravity oil from the Barons sand, are water-free and are entitled to a one-year royalty-free period.

Additional drilling is planned, and it is expected that the field will be developed on 40-acre spacing units.



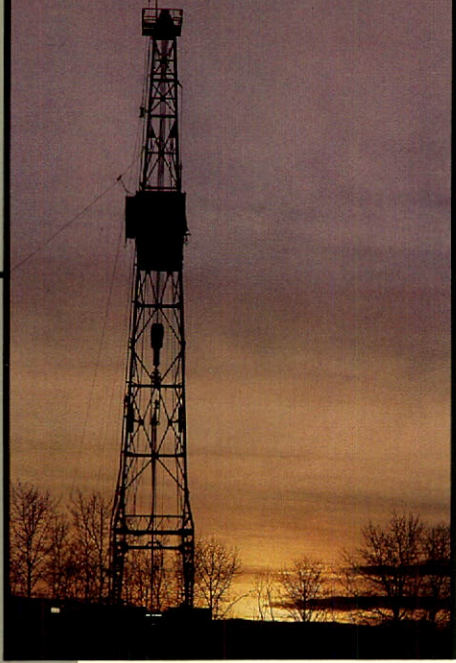
Sylvan Lake, Alberta

Penn West holds working interests ranging from 5 to 100 percent in 4,480 acres in this area.

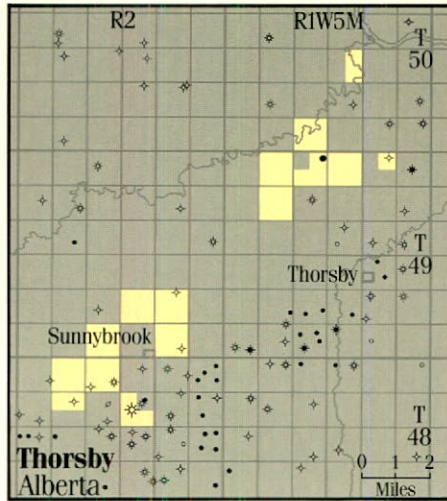
A well, drilled at 4-33-38-2 W5M during the year, tested gas from the Basal Quartz formation at an absolute open flow rate of 8.1 million cubic feet per day. The well is being tied into an existing gas plant for sales.

The Company has a 25.3 percent interest in the 4-33 well, and a short term gas contract is being negotiated at a delivery rate of three million cubic feet per day. A longer term contract will be pursued after the well has been placed on stream.

Penn West holds interests varying from 37.5 to 100 percent in 960 acres in close proximity to the 4-33 well. A geological evaluation is in progress to delineate additional drilling prospects.



Property Reviews

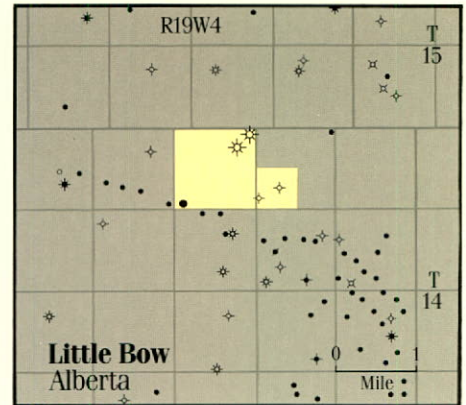


Thorsby, Alberta

During 1985, Penn West acquired interests ranging from 19 to 100 percent in 8,160 acres in the Thorsby area. Two successful wells were drilled on the lands, resulting in one oil well at 16-33-49-1 W5M and one gas well at 6-27-48-2 W5M. The Company holds working interests of 80 percent and 38 percent respectively in the wells.

The 16-33 well produces at a rate of 20 barrels of oil per day from the Glauconite formation, and additional drilling is planned to develop this new oil pool.

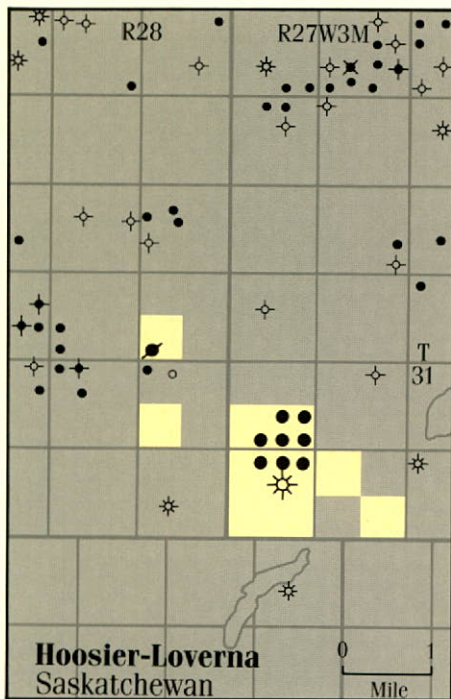
The 6-27 well tested gas at a rate of 3.6 million cubic feet per day from the Viking formation. The well is close to a gas plant, and the economics favour an industrial contract. The well is expected to be completed and tied into sales facilities during the spring of 1986.



Little Bow, Alberta

The Company participated as to a 50 percent working interest in two wells in the Little Bow area in 1985, which resulted in a dual zone gas discovery at 16-34-14-19 W4M. The well tested gas at a rate of 11.3 million cubic feet per day from the Basal Quartz formation and 11.8 million cubic feet per day from the Glauconite formation.

The 16-34 well is located on the north half of Section 34, and a pooling arrangement is being negotiated with the operator of the southern half of the section to complete a 640-acre gas spacing unit. The pooling would give Penn West a 25 percent interest in a well located at 4-34-14-19 W4M, which is currently producing at a rate of one million cubic feet of gas per day from the Basal Quartz formation. After pooling, the 16-34 well, which is capable of delivering gas at a significant rate, could then be tied in to produce from the Glauconite formation, when a gas sales contract can be obtained. The 16-34 well is close to pipeline and compression facilities.



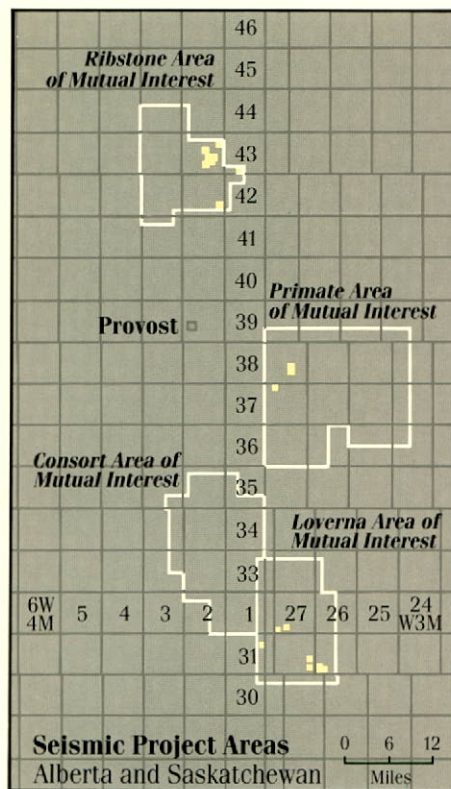
Hoosier, Saskatchewan

A 104-mile seismic program conducted by Penn West and partners in west-central Saskatchewan led to the drilling of a well at 2-7-31-27 W3M, which resulted in a significant oil discovery in the Hoosier area.

To date nine wells have been drilled, which include eight successful Bakken oil wells placed on production at a current combined rate of 260 barrels of oil per day.

An engineering study is being conducted to evaluate the merits of constructing a central treating system, which would facilitate the sale of solution gas, and the initiation of a secondary waterflood system. If feasible, the facilities could be in place by mid-summer of 1986.

Penn West's working interests average 35 percent in 1,600 acres in the Hoosier area, and further drilling is planned for 1986 to delineate the pool and to evaluate additional seismic anomalies. The area has potential to add significantly to the Company's reserves.

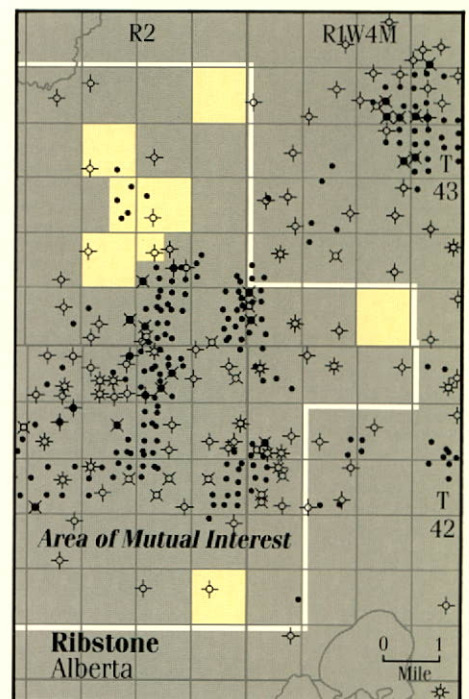


Seismic Projects

During 1985 Penn West participated in four extensive seismic programs conducted adjacent to the Alberta/Saskatchewan border and in a large program in southeastern Saskatchewan.

In the Loverna area, 166 miles of seismic were run, earning Penn West the right to participate as to a 37.5 percent interest in land and drilling prospects in the area. The Company owns 25 percent of the rights to data sales. This program resulted in the discovery of the Hoosier oil pool, which has eight Bakken oil wells producing at a combined rate of 260 barrels of oil per day. Penn West has interests averaging 35 percent in 3,040 acres in this area.

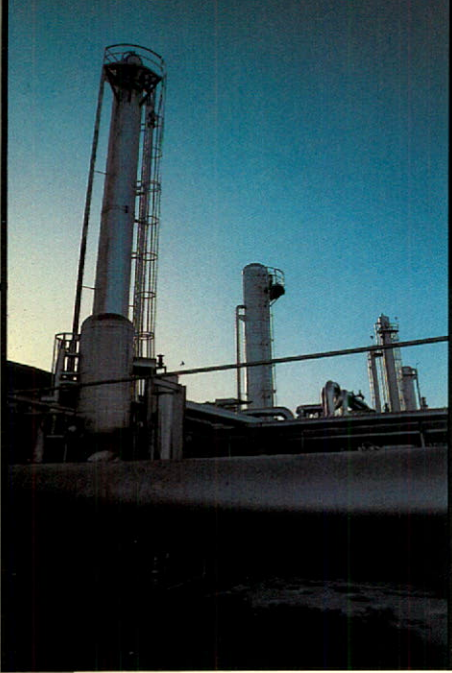
In the Primate area, 368 miles of seismic were run. Penn West holds a 25 percent interest in all data sales and in 800 acres of land which have been purchased. The seismic has been released to industry, and sales are expected to offset a significant portion of the costs incurred. Seismic has delineated a number of prospects, and one well is expected to be drilled in 1986.



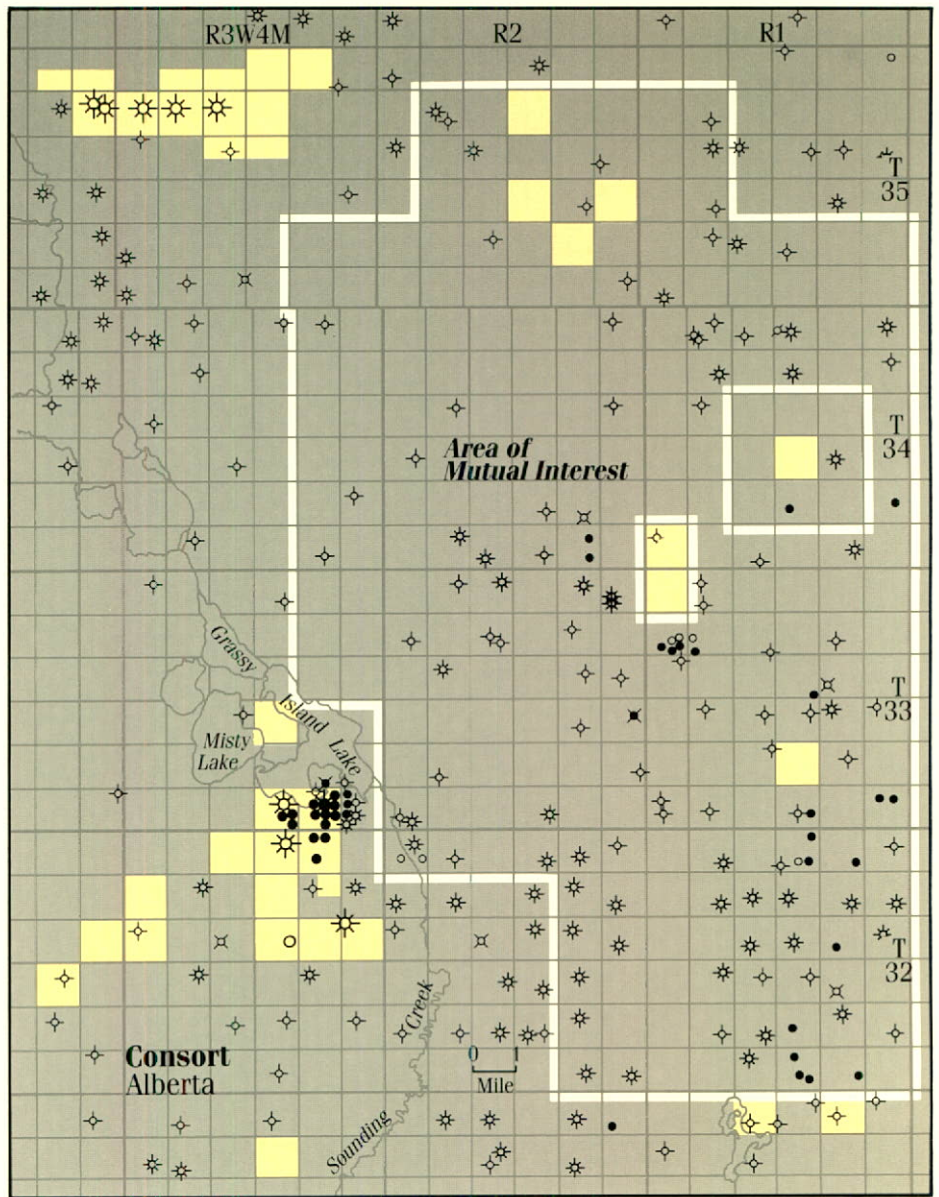
In the Ribstone area, 90 miles of seismic were run. Penn West will participate as to a 40 percent working interest in all land acquisitions and drilling programs and will receive a 20 percent interest in all data sales.



In the Tilston area of southeastern Saskatchewan, Penn West participated in a 150-mile program and earned a 20 percent interest in all data sales. The Company participated as to a 40 percent interest in the acquisition of 800 acres in the prospect area, and exploratory drilling is expected to follow final evaluation of geological and geophysical data.



Property Reviews



In the Consort area, Penn West participated as to a 40 percent working interest in a 300-mile seismic program and in the purchase of 5,120 acres of land. Subsequent to year-end a successful gas well was drilled, in which Penn West earned a 20 percent working interest. A number of prospects have been identified by seismic, and, with success in land acquisitions and farmins, additional drilling could be carried out during 1986. Penn West has a 20 percent interest in all data sales.

Financial Review

Penn West continued to sustain its pattern of growth in 1985. Revenue increased 8 percent over the previous year to \$7,507,000. Funds generated from operations increased by 24 percent to \$4,053,000 while earnings from operations, before write down of assets, increased 27 percent to \$1,270,000. Based on an average 18.8 million common shares outstanding in 1985, funds from operations generated 22 cents per share in 1985 compared with 20 cents in 1984. Earnings from operations were 7 cents per share in 1985 and 6 cents in 1984. Final net earnings in 1985, after write down, were \$120,000 or 1 cent per share.

Increased revenue resulted primarily from new oil well discoveries during the reporting period. Revenue per barrel of oil averaged \$33.27 in 1985 compared with \$33.66 in 1984. Revenue per MCF of gas averaged \$2.44 compared with \$2.77 the previous year. Sixty-three percent of 1985 production revenue was generated from oil sales and 37 percent from gas sales.

Alberta Royalty Tax Credits of \$390,000 received during the year were 21 percent less than the \$494,000 received in 1984. This resulted from the reduction in Alberta Crown Royalty rates announced subsequent to the signing of the Western Accord. Petroleum and Natural Gas Revenue Tax of \$251,000 incurred in 1985 compares with the \$384,000 expense incurred in 1984.

Production expenses increased 27 percent in 1985 to \$1,693,000. Increased revenue for the year is substantially attributed to increases in oil production. On a per unit revenue basis, oil production operating costs are significantly higher than for gas resulting in the noted increase in production expenses. General and administrative expenses decreased 14 percent in 1985 to \$688,000. Overhead costs of \$353,000 relating to our exploration and development program were capitalized in 1985. The Company does not capitalize any interest charges.

While the Company continues to own certain oil and gas assets in the United States, it is unlikely that the future income to be received from these properties will recover the cost of their investment. Accordingly, we have chosen to write off our entire carrying cost of \$402,000 relative to this investment. Additionally our investment of \$748,000 representing a 28.6 percent interest in Springwest Page Petroleum N.L. has been written off. Springwest continues to own and operate a drilling rig in Australia however the ultimate recovery of our investment in this venture is uncertain.

The Company does not anticipate the necessity of write downs to the carrying value of its Canadian oil and gas assets despite the recent downturn in oil and gas pricing.

Capital expenditures in oil and gas investments, net of petroleum incentive recoveries, increased 52 percent in 1985 to \$7,001,000. Expenditures, before incentive recoveries, of \$9,257,000 were funded in part by an issue of flow-through shares in June of 1985. Under this program the Company committed to issue 1,630,770 treasury shares in exchange for the expenditure of \$5,300,000 in exploration costs. At December 31, 1985 \$4,229,000 of costs had been incurred and 1,301,231 shares had been issued. The remaining shares were issued in exchange for costs incurred subsequent to year-end.



*Ronald G. Sparrow
Controller*



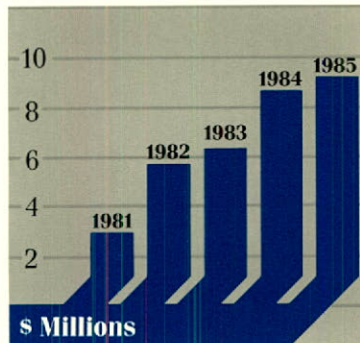
Financial Review

Sufficient income tax pools exist at year-end to offset income, calculated for Canadian income tax purposes, for a number of years. Subject to final determination the undernoted pools and allowances are available to be applied against income for tax purposes at rates and in the manner prescribed by the Income Tax Act:

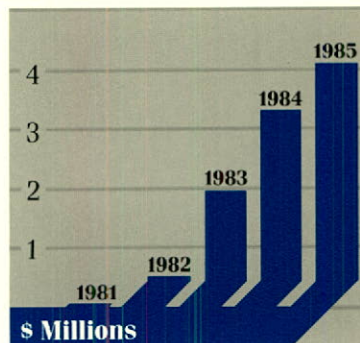
Canadian Exploration Expense	\$ 9,816,000
Canadian Development Expense	6,000,000
Canadian Oil & Gas Property Expense	3,202,000
Unclaimed Capital Cost	4,045,000
Earned Depletion	7,267,000
	<u>\$30,336,000</u>

The current oil and gas marketing and pricing environment is very unstable. Oil prices have declined from \$25 U.S. per barrel in December of 1985 to a current price of \$12 U.S. per barrel. Gas prices, while presently regulated, are expected to come under pressure subsequent to deregulation in November 1986. Despite the severe decline in prices, the Company expects to sustain revenue from oil and gas sales for 1986 at a level comparable to that of 1985 with the funds from operations showing a slight reduction to \$3.9 million. Under pricing conditions that existed in December of 1985 the Company had projected cash from operations of \$6.7 million for 1986. The Company has reduced its 1986 capital budget to \$4.4 million as a result of the reduced funds available from operations.

Gross Sales



Net Cash Flow



While exploration expenditures are currently restricted the Company intends to examine production acquisitions as an attractive growth alternative in the current market. At year-end, the Company had an unused bank line of credit available of \$8.7 million. Should the opportunity present itself the Company would utilize a portion of this unused credit for an acquisition in the coming year.



The Accounting Group From Left
 Diane P. Yates, Accountant
 Margaret A. Taylor, Receptionist
 Sandra J. Ellwood, Accounting Clerk
 Ronald G. Sparrow, Controller
 Susan N. Campbell, Manager of Accounting

Consolidated Balance Sheet as at December 31, 1985

(in thousands of dollars)

Assets	1985	1984
Current Assets		
Cash	\$ 173	\$ —
Accounts receivable	5,154	4,334
	5,327	4,334
Fixed Assets		
Oil and gas properties, together with exploration, development and equipment thereon	48,521	41,922
Accumulated depletion and depreciation	7,933	6,030
	40,588	35,892
Investment in Affiliated Company (note 2)	—	263
	\$45,915	\$40,489
Liabilities		
Current Liabilities		
Bank indebtedness	\$ —	\$ 37
Accounts payable	6,093	3,840
	6,093	3,877
Bank Loan (note 3)	9,300	9,700
Gas Production Prepayments	988	1,118
Deferred Taxes	1,778	898
Shareholders' Equity		
Capital Stock (note 4)	30,873	28,133
Contributed Surplus	656	656
Deficit	(3,773)	(3,893)
	27,756	24,896
	\$45,915	\$40,489

Approved by the Board



Director



Director

Financial Statements

Consolidated Statement of Earnings and Deficit Year Ended December 31, 1985

(in thousands of dollars)

	1985	1984
Revenue		
Oil and gas sales	\$ 7,411	\$ 6,843
Interest and other income	96	113
	7,507	6,956
Expenses		
Production	1,693	1,333
General and administrative	688	797
Interest	1,073	1,554
	3,454	3,684
Funds Generated from Operations	4,053	3,272
Depletion and depreciation	1,903	1,642
Deferred income taxes (note 5)	791	632
Deferred Petroleum and Gas Revenue Tax	89	—
	2,783	2,274
Earnings Before Write-Downs	1,270	998
Write-down of U.S. oil and gas properties	402	—
Write-down of investment in affiliated company	748	—
	1,150	—
Net Earnings	120	998
Deficit at beginning of year	(3,893)	(4,891)
Deficit at End of Year	\$ (3,773)	\$ (3,893)
Per Common Share , based on weighted average number of shares outstanding		
Funds generated from operations	\$.22	\$.20
Earnings before write-downs	\$.07	\$.06
Net earnings	\$.01	\$.06

Consolidated Statement of Changes in Financial Position Year Ended December 31, 1985

(in thousands of dollars)

	1985	1984
Working Capital Derived From		
Operations	\$ 4,053	\$ 3,272
Issue of capital stock	2,740	6,664
	6,793	9,936
Working Capital Applied To		
Investment in affiliated company	485	263
Fixed asset additions	7,001	4,584
Bank loan reduction	400	4,100
Gas production prepayments	130	221
Purchase of shares of the Company	—	157
	8,016	9,325
Increase (Decrease) in Working Capital Position	(1,223)	611
Working capital (deficiency) at beginning of year	457	(154)
Working Capital (Deficiency) at End of Year	\$ (766)	\$ 457

Notes to Financial Statements

Notes to Consolidated Financial Statements Year Ended December 31, 1985

(tabular amounts in thousands of dollars)

1. Accounting Policies

(a) 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.

(b) 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 proved oil and gas reserves (converted to equivalent units on the basis of estimated relative energy content) in each cost centre or charged to earnings if exploration in any centre is determined to be unsuccessful. During 1985, the Company capitalized \$353,000 of overhead costs relating to exploration and development activities (1984 - \$276,000).

In applying the full cost method, the Company calculates a "cost ceiling" which restricts the capitalized costs less accumulated depletion and depreciation in each cost centre from exceeding an amount equal to the estimated value of 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.

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.

(c) Foreign Currency Translation

All monetary assets and liabilities denominated in U.S. currency are translated into Canadian dollars at the rate of exchange in effect at the balance sheet date. Other assets are translated at historical exchange rates. Revenue and expense items (excluding depreciation and depletion which are translated at the same rates as the related assets) are translated at the average rate of exchange for the year. Exchange gains and losses arising on translation are included in earnings.

(d) 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.

2. Investment in Affiliated Company

	1985	1984
Springwest-Page Petroleums N.L.		
Investment in shares, at cost (representing 26.3% interest)	\$ 1,742	\$ 1,742
Advances, non-interest bearing with no specific terms of repayment	1,104	619
Allowance for losses	(2,846)	(2,098)
	\$ —	\$ 263

The Company is contingently liable in the amount of \$438,000 in respect of loans of Springwest-Page Petroleums N.L.

Notes to Financial Statements

3. Bank Loan

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

The loan has been advanced under an operating credit facility the amount of 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 six and one-half years payable in monthly instalments out of the Company's net production revenues.

4. Capital Stock

(a) Authorized Capital

The authorized share capital of the Company consists of an unlimited number of Common and Preferred shares without par value.

(b) Common Shares

Changes in the Company's outstanding Common share capital during the year were as follows:

	Number of Shares	Amount
Balance, December 31, 1984	18,635,821	\$28,133
Shares issued		
For cash on exercise of options and warrants	9,015	9
In exchange for exploration expenditures, less related Petroleum Incentive Program Payments of \$1,480,000 and share issue expenses of \$18,000	1,301,231	2,731
Balance, December 31, 1985	19,946,067	\$30,873

During the year, the Company entered into agreements to issue, by way of private placement, up to a total of 1,630,770 Common shares in consideration of the share subscribers incurring up to \$5,300,000 of expenditures in the Company's exploration program, of which \$4,229,000 had been expended as of December 31, 1985.

(c) Stock Options

As at December 31, 1985, 432,000 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.

Notes to Financial Statements

5. Income Taxes

Oil and gas properties include approximately \$12,300,000 of unamortized costs at December 31, 1985 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 47% to consolidated earnings before income taxes of \$911,000 and \$1,630,000 for the years ended December 31, 1985 and 1984, respectively. The differences between the computed "expected" tax provisions and the actual tax provisions are summarized as follows:

	1985	1984
Computed "expected" tax expense	\$ 428	\$766
Increase (decrease) in taxes resulting from:		
Non-deductible Crown charges, net of provincial credits	524	551
Depletion expense relating to non-deductible property costs	253	192
Federal resource allowance	(751)	(686)
Earned depletion allowance	(258)	(201)
Non-deductible losses of foreign subsidiary and affiliated company	582	—
Other	13	10
Actual deferred income tax expense	\$ 791	\$632

Auditors' Report

To the Shareholders of Penn West Petroleum Ltd.

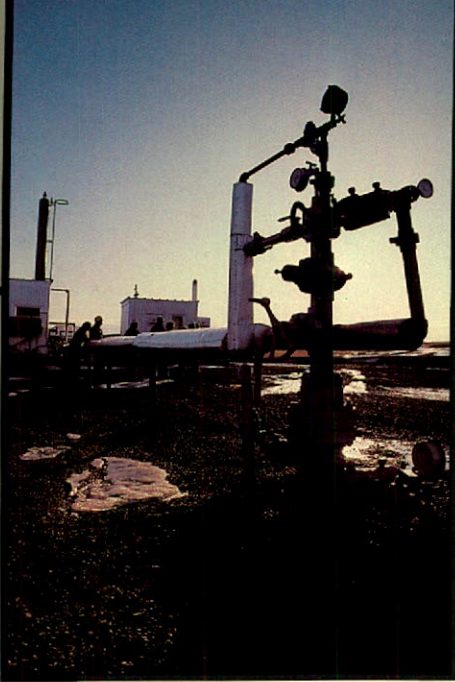
We have examined the consolidated balance sheet of Penn West Petroleum Ltd. as at December 31, 1985 and the consolidated statements of earnings and deficit and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and 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, 1985 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.

Calgary, Alberta
February 28, 1986



Chartered Accountants



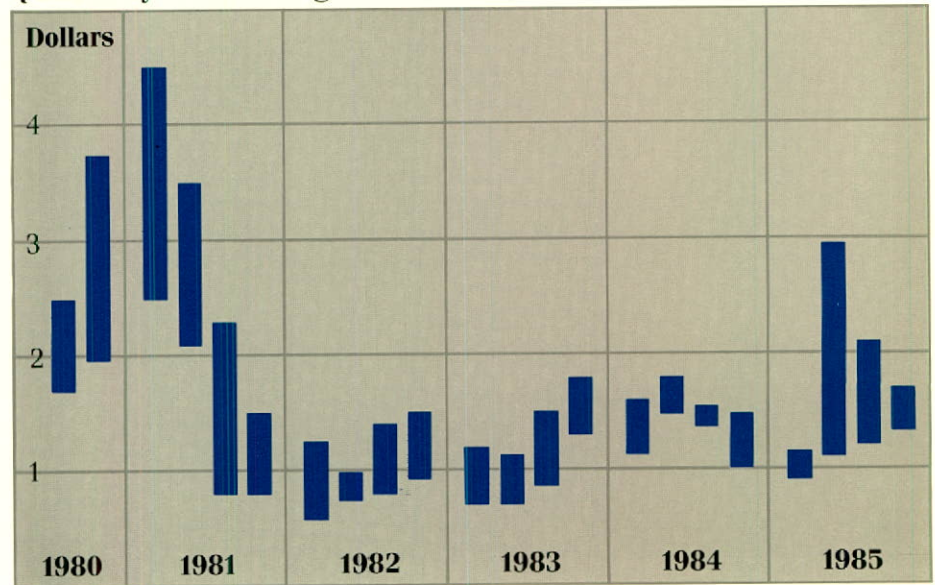
Board of Directors



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

Head Office

1250 Elveden House
717 - 7th Avenue S.W.
Calgary, Alberta T2P 0Z3

Solicitors

Bennett Jones
3200 Shell Centre
400 - 4th Avenue S.W.
Calgary, Alberta T2P 0X9

McManus, McLeod, Lyle, Smith
2200 Bow Valley Square 4
250 - 6th Avenue S.W.
Calgary, Alberta T2P 3H7

Bankers

Bank of Montreal
705 - 7th Avenue S.W.
Calgary, Alberta T2P 0Z2

Washington County State Bank
200 West Vulcan
Brenham, Texas, U.S.A. 77833

Stock Exchange Listing

Toronto Stock Exchange
Symbol - PWT

Auditors

Thorne Riddell
Suite 1200, Bow Valley Square 2
205 - 5th Avenue S.W.
Calgary, Alberta T2P 2W4

Transfer Agent

National Trust Company
1008, Home Oil Tower
324 - 8th Avenue S.W.
Calgary, Alberta T2P 3B2



PENN WEST PETROLEUM LTD.
1985 ANNUAL REPORT