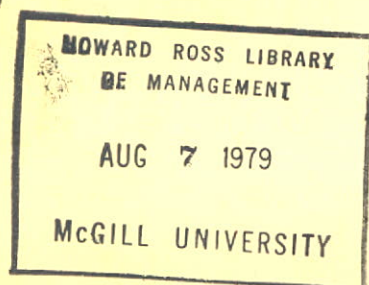


PACIFIC PETROLEUMS LTD.



1978 ANNUAL REPORT



the year in brief

	1978	Increase Over 1977
Financial		
Net Earnings	\$ 95,660,000	12%
Per Common Share	\$4.44	
Funds Generated	\$172,586,000	20%
Per Common Share	\$8.01	
Cash Dividends	\$ 22,517,000	18%
Per Common Share	\$1.03	
Total Revenue	\$471,535,000	7%
Capital Expenditures	\$185,072,000	27%

Operating

Production — Daily

Crude Oil and Liquids (barrels) . .	52,300
Natural Gas (millions of cubic feet)	311

Sales — Yearly

Gasoline and Distillates (gallons) .	286,000,000
Natural Gas Liquids (gallons) . . .	263,000,000

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president's message

The company's net earnings for 1978 increased 12 per cent to a record \$95.7 million, compared with \$85.5 million in 1977. Based on the weighted average of common shares outstanding during each year, earnings per common share increased from \$4.00 to \$4.44 in 1978. Dividends for the year totalled \$1.03 per common share, compared with 89 cents per common share in 1977. Additional financial details, as well as operating highlights, are contained in other sections of this report.

On January 19, 1979, Petro-Canada Inc., an indirectly-owned subsidiary of Petro-Canada, announced an offer to purchase the remaining shares of the company not then owned

by Petro-Canada Inc. at a price of \$65.02 (Canadian) or the U.S. equivalent for U.S. holders of the shares. On the date of the offer, Petro-Canada Inc. owned 11,497,519 shares (slightly in excess of 50 per cent of the common shares outstanding), including a block of 10,326,321 shares which were acquired on November 10, 1978, from Phillips Petroleum Company of Bartlesville, Oklahoma, at \$55.50 (U.S.), the U.S. dollar equivalent of \$65.02 on that date.

Based on an independent evaluation of the company obtained from an investment firm, the board of directors recommended acceptance of the offer. As of March 12, 1979, Petro-Canada Inc., owned in

excess of 98 per cent of the outstanding shares of the company.

On November 16, 1978, Wilbert H. Hopper, chairman and chief executive officer of Petro-Canada, was appointed a director of the company. On the same date, Wm. C. Douce, president and chief operating officer, and W. A. Roberts, executive vice president, of Phillips Petroleum Company, resigned as directors of the company.



L. Merrill Rasmussen
President and
Chief Executive Officer

management's analysis of the summary of operations

1978 Compared With 1977

Net earnings for 1978 were \$95.7 million, an increase of \$10.2 million or 12 per cent over 1977. Funds generated from operations amounted to \$172.6 million in 1978, an increase of \$28.6 million or 20 per cent over the previous year. Higher prices for crude oil, natural gas and refined oil products were the major reasons for the increase in net earnings. Financial and operating statistics for the last five year period are shown on pages three and four.

Revenues

Revenues in 1978 from all sources increased \$30.2 million to \$471.5 million, a rise of seven per cent.

Production volumes of crude oil and field liquids remained at the same level as 1977, but as a result

of \$1 per barrel increases in the wellhead price of crude oil on January 1 and July 1 of 1978, revenue from this source increased 20 per cent to \$112 million.

Natural gas revenue amounted to \$100.9 million in 1978 compared with \$97.7 million in 1977. After deduction of royalties, the average price received by Pacific increased by 18 per cent in 1978. The effect of the higher prices was substantially offset by a 14 per cent decrease in production. Due to surplus capacity in Canada, buyers had to reduce purchases to levels below minimum contract volumes.

Natural gas liquids revenue in 1978 amounted to \$67.7 million, a decrease of nine per cent. Sales volumes were 15 per cent lower than the previous year due to an

oversupply of natural gas liquids and alternate products. Average prices increased, but not sufficiently to offset the increased raw product costs.

Gross margins on the sale of refined oil products improved in 1978 on sales volumes that were six per cent higher.

Expenses

Product and merchandise purchases increased seven per cent in 1978 to \$163 million. The increase was primarily due to higher raw product costs at the company's plants, partially offset by reduced natural gas liquids sales. The unit cost of feedstock at the Taylor refinery rose by 20 per cent and the unit cost of natural gas liquids at the Empress plant increased 23 per cent.

Operating and general expenses increased to \$83.3 million in 1978. The increase of \$6.4 million was due to increased wage and material costs, increased oil and natural gas well work-overs and additional lifting costs associated with new producing wells brought on production.

Depletion and depreciation in 1978 decreased by seven per cent to \$33.2 million. The decrease was due to the establishment of proved reserves in Spain, which resulted in decreased amortization provisions on foreign operations, and a \$1.8 million gain realized in 1978 on disposal of assets.

Interest expense on long term debt of \$9.1 million in 1978 was \$3.9 million lower, mainly due to amounts capitalized during the construction of the Cochin pipeline and the ethane extraction facility.

Effective income tax rates were 47.7 per cent in 1978 and 47.6 per cent in 1977. However, the portion of the total provision currently payable decreased substantially in 1978 as a result of increased capital spending and accelerated write-offs available on several major capital programs.

1977 Compared With 1976

In comparison with 1976, net earnings for 1977 increased by \$19.1 million or 29 per cent and funds generated from operations increased by \$37.6 million or 35 per cent.

Revenues

Total revenue of \$441 million in 1977 increased \$88.9 million over

the previous year. The major contributing factors were higher prices for natural gas and crude oil together with increased crude oil production.

Average daily production of crude oil and field liquids in 1977 was up 19 per cent from 1976, primarily due to completion of a major development program in the Kinsella-Wainwright area of east central Alberta. Average prices for crude oil and field liquids, after deducting all royalties, were \$6.79 per barrel in 1977 and \$5.41 in 1976.

Natural gas production declined nine per cent in 1977, largely due to reduced export demand. Significant price increases during the year, however, resulted in higher total natural gas revenue. The after-royalty average price of natural gas was 74.2 cents per thousand cubic feet in 1977 and 47.1 cents in 1976. A portion of the January 1, 1977, price increase for British Columbia gas was compensation paid by that province for discontinuing its tax indemnification program. The program had been instituted to recognize increased federal government income taxes brought about by the disallowance of deemed royalties as a deductible expense. The indemnification of \$9.3 million in 1976 was accounted for as a reduction in income taxes.

Average prices for natural gas liquids rose by 18 per cent in 1977. Refined oil product prices increased by amounts sufficient to offset crude oil price increases and to recover the majority of increased operating costs.

Investment income increased \$3.0 million in 1977 as a result of an increase in surplus funds invested in term deposits. Equity in earnings of investments was up from 1976 due to increased earnings by Westcoast Transmission Company Limited.

Expenses

Product and merchandise purchases of \$152.5 million increased \$17.3 million. Higher prices for crude oil and natural gas were the main reasons for the 13 per cent increase over the previous year. Unit costs of refined oil products purchased and feedstock used in the Taylor refinery rose by 21 per cent, and the cost of the natural gas liquids extracted at the company's Empress plant increased by 23 per cent.

Operating and general expenses amounting to \$76.9 million in 1977 increased by 20 per cent due to increased wage, material and fuel costs and additional operating costs related to increases in crude oil production in the Kinsella-Wainwright area.

Depletion and depreciation in 1977 rose by \$7.5 million or 27 per cent due to increased crude oil production, and to higher per unit depletion rates brought about by the increased cost of finding and developing new reserves. Included in depletion is amortization of foreign exploration expenditures amounting to \$4.1 million in 1977 and \$2.3 million in 1976.

New financings undertaken in June, 1976 and during 1977 resulted in a \$4.1 million increase in interest expense.

five year financial and operating summary

(In thousands of dollars except per share figures)

	1978	1977	1976	1975	1974
SUMMARY OF OPERATIONS					
Revenue					
Sales Revenue					
Crude oil and field liquids	\$112,049	\$ 93,261	\$ 62,015	\$ 55,924	\$ 53,757
Natural gas	100,947	97,686	68,302	50,925	36,933
Natural gas liquids	67,655	74,424	64,382	58,704	47,913
Refined oil products	156,434	142,544	127,485	111,707	80,790
Other	16,009	13,224	13,766	10,780	10,557
Total Sales Revenue	453,094	421,139	335,950	288,040	229,950
Investment income	4,775	6,538	3,499	5,364	7,313
Equity in earnings of investments	13,666	13,629	12,964	8,086	7,476
Total Revenue	471,535	441,306	352,413	301,490	244,739
Expenses					
Product and merchandise purchases	162,992	152,540	135,244	108,504	77,321
Operating and general expenses	83,320	76,904	63,851	53,629	45,644
Depletion and depreciation	33,172	35,566	28,060	30,667	31,593
Interest on debt	9,115	12,991	8,917	7,629	7,885
Total Expenses	288,599	278,001	236,072	200,429	162,443
Earnings Before Income Taxes	182,936	163,305	116,341	101,061	82,296
Income Taxes					
Provision for taxes payable	37,671	48,655	31,967	33,074	24,444
Provision for future taxes	49,605	29,139	17,943	10,720	12,457
Total Income Taxes	87,276	77,794	49,910	43,794	36,901
Net Earnings	\$ 95,660	\$ 85,511	\$ 66,431	\$ 57,267	\$ 45,395
Funds Generated From Operations	\$172,586	\$143,972	\$106,417	\$ 95,777	\$ 86,436
Weighted Average Common Shares Outstanding					
(thousands)	21,538	21,375	21,342	21,334	21,329
Per Common Share					
— Earnings	\$ 4.44	\$ 4.00	\$ 3.11	\$ 2.68	\$ 2.13
— Funds generated	\$ 8.01	\$ 6.74	\$ 4.99	\$ 4.49	\$ 4.05
— Dividends	\$ 1.03	\$.89	\$.832	\$.80	\$.75
FINANCIAL POSITION					
Capital Employed					
Working capital	\$ 57,285	\$ 85,863	\$ 80,829	\$ 46,128	\$ 58,593
Investments (Book Value)	116,904	113,385	106,683	79,983	69,712
Property, plant & equipment (Net)	758,329	610,435	503,006	451,322	407,263
Total Capital Employed	\$932,518	\$809,683	\$690,518	\$577,433	\$535,568
Return on Average Capital Employed	12.0%	13.1%	11.8%	11.7%	10.2%
Long Term Debt	\$153,435	\$193,625	\$170,899	\$124,519	\$133,741
Shareholders' Equity	\$577,686	\$470,374	\$403,074	\$354,312	\$313,945
Debt/Equity Ratio	21:79	29:71	30:70	26:74	30:70

	1978	1977	1976	1975	1974
CAPITAL EXPENDITURES					
Crude Oil, Natural Gas and Field Liquids	\$116,238	\$101,725	\$ 72,859	\$ 65,027	\$ 41,256
Refined Oil Products	1,859	2,497	5,075	8,710	7,017
Natural Gas Liquids	47,161	15,740	324	1,033	183
Cochin Pipeline	11,628	24,239	—	—	—
Other	8,186	1,252	1,787	318	771
Total	<u><u>\$185,072</u></u>	<u><u>\$145,453</u></u>	<u><u>\$ 80,045</u></u>	<u><u>\$ 75,088</u></u>	<u><u>\$ 49,227</u></u>
DAILY PRODUCTION (Before Deduction for Royalties)					
Oil and Liquids Production from Oil and Gas Wells (Barrels)					
British Columbia	3,550	4,250	4,510	4,200	5,200
Alberta	33,170	32,570	26,600	27,950	31,600
Saskatchewan	600	640	540	500	750
Foreign	180	140	—	1,500	1,850
Total	<u>37,500</u>	<u>37,600</u>	<u>31,650</u>	<u>34,150</u>	<u>39,400</u>
Liquids Production from Empress Plant (Barrels)	14,800	16,450	17,000	17,900	18,650
Total Oil and Liquids Production	<u><u>52,300</u></u>	<u><u>54,050</u></u>	<u><u>48,650</u></u>	<u><u>52,050</u></u>	<u><u>58,050</u></u>
Natural Gas (Millions of Cubic Feet)					
British Columbia	184	225	251	330	369
Alberta	126	134	143	148	147
Saskatchewan	1	2	2	2	2
Total	<u><u>311</u></u>	<u><u>361</u></u>	<u><u>396</u></u>	<u><u>480</u></u>	<u><u>518</u></u>
MARKETING					
Sales Volumes (Millions of Gallons)					
Gasoline & distillates	286	271	291	290	288
Natural gas liquids	263	311	317	318	315
Marketing Outlets	426	428	444	453	438
LAND (Thousands of Net Acres)					
Western Canada	4,088	4,105	3,865	3,514	3,407
Arctic, N.W.T. Yukon and Eastern Canada	3,307	3,562	5,132	5,791	5,220
Foreign	125	129	305	243	192
Total	<u><u>7,520</u></u>	<u><u>7,796</u></u>	<u><u>9,302</u></u>	<u><u>9,548</u></u>	<u><u>8,819</u></u>
DRILLING RECORD (Net Wells — Canadian and Foreign)					
Oil	35	24	96	164	31
Gas	42	56	50	33	31
Dry	29	38	38	37	53
Total	<u><u>106</u></u>	<u><u>118</u></u>	<u><u>184</u></u>	<u><u>234</u></u>	<u><u>115</u></u>
Number of Employees	1,185	1,148	1,100	1,061	993

NOTE: In some instances figures for earlier years have been changed from those previously published to reflect subsequent changes in reporting practices.

exploration — canada

Pacific's exploration expenditures in Canada reached a record \$62.2 million in 1978. Of this total, \$30.8 million was spent on drilling activities, primarily in Alberta and British Columbia. A further \$5.9 million was spent on seismic surveys of potential oil and gas properties, and \$25.5 million was used for land acquisitions and rentals.

The company participated in 55 successful exploratory and development oil wells and 67 natural gas wells for an overall success ratio of 67 per cent.

CANADIAN DRILLING SUMMARY

	1978		1977	
	Gross	Net	Gross	Net
EXPLORATORY				
Oil	13	6	5	4
Gas	43	27	48	32
Dry	47	20	45	29
Total	103	53	98	65
DEVELOPMENT				
Oil	42	28	26	20
Gas	24	15	58	23
Dry	14	8	12	8
Total	80	51	96	51
TOTAL				
Oil	55	34	31	24
Gas	67	42	106	55
Dry	61	28	57	37
Total	183	104	194	116

At the end of 1978, the company held 18.3 million gross acres (7.1 million net acres), of producing and prospective oil and natural gas lands in Canada.

West Pembina

In the West Pembina area of west central Alberta, where the company has recorded its most

significant oil discoveries in a decade, Pacific strengthened its land position and conducted an active exploration and development program during the year. The company now has participated in 11 successful oil wells and three natural gas wells in the Nisku formation of West Pembina. The company holds interests ranging from 33 $\frac{1}{3}$ per cent to 100 per cent in 26,880 gross acres (11,386 net acres). Two exploratory and six development wells are scheduled to be drilled in the West Pembina area during 1979 to increase field reserves and productivity.

The company has also participated in four oil discoveries, with interests ranging from eight to 100 per cent, in the Bigoray area 15 miles northeast of the West Pembina area. Six exploratory and one development well will be drilled in the Bigoray area in 1979.

Elmworth

In the Elmworth Deep Basin area of northwestern Alberta, where Pacific holds 66,600 gross acres (21,240 net acres), the company drilled two successful natural gas wells. The company has a 75 per cent interest in one discovery and a 25 per cent interest in the other. The company now has three commercial wells in the Elmworth Deep Basin area. Additional drilling is planned during 1979.

Primrose Air Weapons Range

A group led by Pacific was the successful bidder for the right to explore the heavy oil and natural gas potential of a portion of the former Primrose Lake Air Weapons Range in eastern Alberta. Known as Ipiatik Lake — West Block, the block of land was one of two made available for exploration after the Alberta

government secured surface access rights from the federal government. The Pacific program involves the expenditure of \$13 million (\$6.5 million net to Pacific) over three years to drill 100 wells and conduct 75 miles of seismic surveys. Pacific can earn a 25 per cent interest in the 124,000 acres of land in the block.

Northeastern British Columbia

In British Columbia, where the company holds 1.6 million net acres, an active exploration program was maintained during 1978. The company participated in 12 successful exploratory gas wells, and in five oil and nine gas development wells.

Frontier Exploration

In the western Beaufort Sea, the Natsek E-56 well was drilled to a depth of 8,840 feet before its planned winter suspension. Drilling will be resumed during 1979 to complete the well to its target depth of 13,000 feet. Pacific has a 9.8 per cent interest in the well.

During 1979, Pacific will participate in the drilling of the Hekja well on the Labrador Shelf. In preparation for drilling, a supply base camp was established in 1978 and environmental studies were undertaken. Pacific will earn a 15 per cent interest in 1.8 million acres with the drilling of the well.

Southwestern Ontario

During 1978, the company drilled two wells under a southwestern Ontario natural gas exploration program. Three more will be drilled in 1979. The 100 per cent-owned wells are being drilled on 112,000 acres in Bruce, Huron and Perth counties.

exploration — international

The company holds 1.4 million gross acres of prospective oil and gas lands outside Canada — mainly in Spain, the United Kingdom and the United States. During 1978, the company spent \$10.6 million on exploratory surveys, drilling and other activities on these lands.

Spain

Approval was received from the government of Spain in late 1978 to proceed with a \$370 million plan to place the Casablanca — Montanazo field on full production in 1982 at a rate of 40,000 barrels per day. A semi-submersible rig will be utilized early in 1979 to take production of approximately 7,000 barrels per day from the Casablanca 1A well using a sea floor wellhead. Successful operation of this well over a six-month period will lead to a second well also being placed on production, which would bring production to about 16,000 barrels per day. In 1981, these two wells will be tied to a fixed production platform from which additional wells will be drilled into the reservoir. A pipeline on the ocean floor will carry the oil 31 miles north to refinery facilities at the port of Tarragona. Pacific has a 7.7 per cent interest in the Casablanca/Montanazo field.

During 1979, the company will spend \$9 million on exploratory surveying, drilling and development in the Spanish Mediterranean.

United Kingdom

In the British sector of the North Sea, further drilling is being conducted on Block 21/2, 200 miles northeast of Edinburgh, Scotland, to follow up two

discoveries, one oil, the other gas. Pacific has a five per cent interest in the block.

One or two wells will be drilled during 1979 on Block 13/18, 250 miles northeast of Edinburgh. Pacific has a 12.5 per cent interest in the Block which was acquired by the company and partners in early 1978.

Pacific has the right to earn a 62.5 per cent interest in 298,000 acres of prospective oil and gas lands on the English mainland near Banbury, 37 miles southeast of Birmingham. An exploratory test well will be drilled in 1979 when final approval is obtained from regulatory authorities.

United States

In the Gulf of Mexico, additional drilling is planned to delineate two natural gas discoveries. One of the discoveries is on the East Cameron Block 359 offshore Louisiana. Pacific has a 15.4 per cent interest in this block. The other discovery, in which the company has a 25 per cent interest, is on the Brazos Block 446L offshore Texas. In addition, an exploratory well will be drilled during 1979 on the Vermilion Block 48 offshore Louisiana. Pacific has a 12.5 per cent interest in this block.

In Hidalgo County, Texas, potential gas zones were being tested at year end in a well drilled on 5,960 acres of land. Completion of the well will earn Pacific a 12.5 per cent interest.

production

For the third successive year, Pacific added more crude oil and natural gas to its reserves than it produced.

Reserves

At October 31, 1978, proved reserves of crude oil and natural gas liquids were 186 million barrels, and natural gas reserves were 3.3 trillion cubic feet. A year earlier, crude oil and natural gas liquids reserves were 183 million barrels and natural gas reserves were 3.2 trillion cubic feet. Additional reserves will be included in the estimates when continuous production is established from recent discoveries.

(Pacific determines its estimates of reserves as net to the company after all other deductions, excepting Crown and freehold royalties. The estimates include only those reserves recoverable under existing economic and operating conditions and do not include reserves contained in untested zones. The published estimates do not include reserves available through enhanced recovery schemes until the system is operating and performance is proved. Reserves delineated on the company's properties in the Athabasca oil sands region and reserves identified in other oil sands areas of northeastern Alberta are not included. No reserves estimates are carried for natural gas liquids recoverable from the natural gas stream processed at the company's Empress plant.)

Production of crude oil and natural gas liquids, including 14,800 barrels per day from the Empress plant, totalled 52,300 barrels per day during 1978, down from the 54,050 barrels per day achieved during 1977. The decrease in total production resulted mainly from lower output at the Empress liquids

plant. Crude oil and field natural gas liquids production at 37,500 barrels per day was at approximately the same level as in 1977.

Production from the new West Pembina field averaged 1,300 barrels per day, net to Pacific, by year end. Production from this field would increase substantially should the demand improve for shut-in western Canadian oil. At the Caroline-Bearberry crude oil field in southwestern Alberta, a \$23 million (net to the company) development drilling and secondary recovery program was completed during the year. Additional production of 1,800 barrels per day, net to Pacific, will be achieved by April of 1979.

Natural gas production decreased 14 per cent to 311 million cubic feet per day. The decrease was due mainly to lower demand for both Alberta and British Columbia natural gas. In Alberta, buyers had to reduce purchases below minimum contract volumes. However, producers are paid currently for these minimum contract volumes with an obligation to deliver in the future such gas "paid for and not taken". By the end of 1978 the company had received \$6.2 million for gas not taken. These funds are not currently taken into income but are recorded on the Consolidated Statement of Financial Position as deferred natural gas revenue.

Heavy Oil

During 1978, Pacific was involved in six projects to develop new ways and means of improving the recovery of the vast energy potential of Alberta's heavy oil deposits. These deposits, extending from the southeast border to the Athabasca

oil sands in the north, are difficult to produce because of their high viscosity and differing reservoir characteristics.

In late 1978, the Alsands Project Group applied to the Alberta government for a permit to build a \$4.9 billion, 140,000 barrel per day mining and processing plant in the Athabasca oil sands. Pacific has a nine per cent interest in the project. Changes in existing tax and royalty legislation are required to make the plant economically viable.

At Gregoire Lake, also in the Athabasca oil sands, work progressed on a pilot scheme that utilizes a combination of fire and water in the reservoir to produce the oil. The first phase of the project is projected for completion by 1980 at a total cost of \$46 million. Pacific has a 12.5 per cent interest.

In the North Kinsella field, near Kinsella, an \$11.8 million research program was begun during 1978 to compare, simultaneously, two separate recovery methods. In the first method, steam will be injected into one well to heat the oil to a temperature sufficiently high to enable the oil to be pumped to the surface from an offsetting well. The second method will involve air injection to heat the reservoir by the combustion of part of the oil. The test will continue until 1981 and can be extended an additional four years. The Alberta government, through its heavy oil research agency, is paying half of the cost.

At Muriel Lake, 15 miles southeast of Bonnyville, a seven-well drilling program was completed in 1978. The company will spend \$4 million during

1979 on a steam stimulation program under which the same well will be used, first to inject heat into the reservoir, and then to pump the oil to the surface. The expenditure will earn Pacific a 50 per cent interest in 7,040 acres of land.

In the Primrose Lake area, immediately north of the Primrose Air Weapons Range, the company completed three heavy oil wells on a 25,600 acre block of land in 1978. During 1979, the company will spend \$500,000 on a pilot test similar to the Muriel Lake experiment.

Pacific is leading a group of companies investigating the economics of building a plant to upgrade eastern Alberta heavy oil into a feedstock that could be used by existing Canadian refineries. During 1978, work progressed on the preparation of an application to the Alberta government for approval to build the plant.

mining

During 1978, the company spent \$3.1 million to explore for and to evaluate coal, uranium and other mineral properties, mainly in Alberta and British Columbia. At year end, the company held an interest in a total of 389,846 gross acres (280,768 net acres) of prospective coal and mineral lands.

Coal

At the Monkman Pass metallurgical coal property in northeastern British Columbia, Pacific spent about \$2 million during 1978 to delineate reserves. This expenditure, together with

work undertaken in previous years, has earned the company a 50 per cent interest in the reserves and operating rights in 66,000 acres. An additional 7,705 adjacent acres, in which the company has a 50 per cent interest, were also acquired in 1978. Drilling so far has confirmed reserves of 135 million tons of marketable coal capable of being mined by open-pit methods. Indicated reserves are more than one billion tons.

An additional \$2.4 million, \$1.2 million net to Pacific, will be spent on the property in 1979. Included in the expenditures are the costs of continued field delineation work. In addition, socio-economic and environmental studies will be completed for British Columbia government regulatory requirements leading to approval to develop the mine. The establishment of a mine is dependent upon an improvement in world markets for metallurgical coal, and the provision by government of rail, port and other facilities. Several Monkman Pass coal prospects in the advanced planning stages by other companies will help support the cost of these facilities.

At Lethbridge, Alberta, Pacific has an 80 per cent interest in 31,473 acres that contain an estimated 30 million tons of thermal coal. A total of \$1.7 million, \$1.4 million net to Pacific, will be spent in 1979 to begin construction of an underground mine to test the most efficient mining method.

Minerals

Sufficiently encouraging results were achieved from a diamond

drilling program in 1978 to warrant additional mapping and drilling on 46,000 acres of potential uranium claims in the Okanagan area of British Columbia. Pacific is also participating in uranium exploration in the Foster River area of northern Saskatchewan where the company holds a 22.25 per cent interest in 3,590 acres. A diamond drilling program is underway.

In the Northwest Territories, adjacent to the lead-zinc mine at Pine Point, Pacific will undertake a diamond drilling program to test a base metal prospect. Pacific has the right to earn an 85 per cent interest in the 1,185 acres involved.

In the state of Washington, near the British Columbia border, the company has a 20 per cent interest in a molybdenum prospect. Encouraging results were obtained during 1978 and further drilling is planned for 1979.

manufacturing and marketing

The Cochin pipeline, a 1,870-mile natural gas liquids transmission pipeline that runs from Edmonton, Alberta, to Sarnia, Ontario, was completed in 1978 at a total cost to the company of \$35.9 million. The company has a 10 per cent interest in the line. By early 1979, deliveries had reached 60,000 barrels per day and are expected to rise to the pipeline's capacity of 85,000 barrels per day by the end of 1979. The line carries Alberta produced ethane and propane to markets in the United States and eastern Canada. Ethylene will be added in 1979.

Empress

Construction is progressing satisfactorily on the expansion of the company's natural gas liquids plant at Empress, Alberta, to provide for the extraction of ethane. The expansion is due for completion in the second half of 1979. The ethane production of 27,000 barrels per day will be in addition to the 14,800 barrels per day of natural gas liquids produced at Empress. The ethane will be sold to an ethylene manufacturer under a 20 year contract under which Pacific will recover all operating costs and obtain a guaranteed return on capital employed.

Refined Products

Total refined product sales increased 5.5 per cent to 286 million gallons in 1978.

Part of the improvement resulted from a 10 per cent increase in retail sales of gasoline, distillates and other refined products through Pacific outlets.

During the past two years, Pacific established a balanced marketing program of full-service, self-serve and specialty outlets to improve retail efficiency. In 1978, the program contributed to a continued improvement in the rate of return on capital employed and in profitability.

Natural Gas Liquids

Revenue from natural gas liquids sales in 1978 declined nine per cent to \$67.7 million. The decrease was due largely to lower production caused by a reduction in the liquid content of the gas processed at the Empress plant, less demand for propane in U.S. markets and to lower prices.

Financial Statements

PACIFIC PETROLEUMS LTD.

consolidated statement of earnings

Years Ended December 31, 1978 and 1977

	1978	1977
Revenue		
Sales of crude oil, gas and refined products	\$453,094,000	\$421,139,000
Investment income	4,775,000	6,538,000
Equity in earnings of investments (Note 2)	13,666,000	13,629,000
	<u>471,535,000</u>	<u>441,306,000</u>
Expenses		
Product and merchandise purchases	162,992,000	152,540,000
Producing, refining and selling expenses	72,794,000	67,753,000
General and administrative expenses	10,526,000	9,151,000
Depletion	22,611,000	22,872,000
Depreciation	10,561,000	12,694,000
Interest on long term debt (Note 3)	9,115,000	12,991,000
	<u>288,599,000</u>	<u>278,001,000</u>
Earnings Before Income Taxes	<u>182,936,000</u>	<u>163,305,000</u>
Income Taxes		
Provision for income taxes payable	37,671,000	48,655,000
Provision for future income taxes	49,605,000	29,139,000
	<u>87,276,000</u>	<u>77,794,000</u>
Net Earnings (Notes 2, 3 and 6)	<u>\$ 95,660,000</u>	<u>\$ 85,511,000</u>
Net Earnings Per Common Share		
Basic	\$ 4.44	\$ 4.00
Fully diluted (Note 8)	\$ 4.23	\$ 3.78

consolidated statement of retained earnings

Years Ended December 31, 1978 and 1977

Retained earnings at beginning of year	\$238,955,000	\$172,472,000
Net earnings for the year	<u>95,660,000</u>	<u>85,511,000</u>
	334,615,000	257,983,000
Dividends paid		
(per common share, 1978 — \$1.03; 1977 — \$.89)	<u>22,517,000</u>	<u>19,028,000</u>
Retained earnings at end of year	<u>\$312,098,000</u>	<u>\$238,955,000</u>

See accompanying notes

consolidated statement of financial position

December 31, 1978 and 1977

	1978	1977
Assets		
Current		
Cash and term deposits	\$ 14,461,000	\$ 74,440,000
Accounts receivable	79,265,000	78,686,000
Inventories	31,664,000	21,581,000
	<u>125,390,000</u>	<u>174,707,000</u>
Investments (Note 2)		
Westcoast Transmission Company Limited —		
11,116,845 shares (quoted market value:		
1978 — \$133,303,000; 1977 — \$126,917,000)	106,672,000	100,892,000
Other investments	10,232,000	12,493,000
	<u>116,904,000</u>	<u>113,385,000</u>
Property, Plant and Equipment (Note 3)	758,329,000	610,435,000
	<u>\$1,000,623,000</u>	<u>\$898,527,000</u>
Liabilities and Shareholders' Equity		
Current Liabilities		
Accounts payable and accrued liabilities	\$ 61,666,000	\$ 73,686,000
Income taxes payable	—	5,889,000
Debt due within one year	6,439,000	9,269,000
	<u>68,105,000</u>	<u>88,844,000</u>
Deferred Natural Gas Revenue (Note 7)	6,159,000	—
Long Term Debt (Note 4)	128,431,000	134,553,000
Provision for Future Income Taxes	195,238,000	145,684,000
5% Convertible Subordinated Debentures (Note 13)	25,004,000	59,072,000
Shareholders' Equity		
Share capital (Note 5)		
Authorized:		
— \$200,000,000 preferred shares		
— 30,000,000 common shares without		
nominal or par value		
Issued 22,293,307 common shares		
(1977 — 21,386,439)	265,588,000	231,419,000
Retained earnings	312,098,000	238,955,000
	<u>577,686,000</u>	<u>470,374,000</u>
	<u>\$1,000,623,000</u>	<u>\$898,527,000</u>

On Behalf of the Board:

Director



Director



See accompanying notes

consolidated statement of changes in financial position

Years Ended December 31, 1978 and 1977

	1978	1977
Source of Funds		
Operations		
Net earnings for the year	\$ 95,660,000	\$ 85,511,000
Add (deduct) items not involving funds:		
Depletion and depreciation	33,319,000	35,695,000
Provision for future income taxes	49,605,000	29,139,000
Equity in earnings of investments net of dividends received	(5,998,000)	(6,373,000)
Funds generated from operations (per common share, 1978 — \$8.01; 1977 — \$6.74)	172,586,000	143,972,000
Deferred natural gas revenue	6,159,000	—
Proceeds of borrowing	—	32,196,000
Issuance of common shares (net of debentures converted, 1978 — \$34,068,000; 1977 — \$3,000).	494,000	814,000
Sale of assets	5,894,000	2,000,000
	<u>185,133,000</u>	<u>178,982,000</u>
 Use of Funds		
Additions to property, plant and equipment	185,072,000	145,453,000
Reduction of long term debt	6,122,000	9,467,000
Payment of dividends	22,517,000	19,028,000
	<u>213,711,000</u>	<u>173,948,000</u>
 Increase (Decrease) in Working Capital	<u>\$ (28,578,000)</u>	<u>\$ 5,034,000</u>
 Changes in Components of Working Capital		
Increase (decrease) in current assets		
Cash and term deposits	\$ (59,979,000)	\$ 34,606,000
Accounts receivable	579,000	17,942,000
Inventories	10,083,000	(255,000)
Recoverable income taxes	—	(16,518,000)
	<u>(49,317,000)</u>	<u>35,775,000</u>
Increase (decrease) in current liabilities		
Accounts payable and accrued liabilities	(14,850,000)	24,852,000
Income taxes payable	(5,889,000)	5,889,000
	<u>(20,739,000)</u>	<u>30,741,000</u>
 Increase (Decrease) in Working Capital	<u>\$ (28,578,000)</u>	<u>\$ 5,034,000</u>
 Working Capital at End of Year	<u>\$ 57,285,000</u>	<u>\$ 85,863,000</u>

See accompanying notes

summary of significant accounting policies

The consolidated financial statements of Pacific Petroleum Ltd. have been prepared in accordance with generally accepted accounting principles in Canada. Certain of the 1977 accounts have been reclassified to conform to the 1978 presentation.

Consolidation

Included in the consolidated financial statements are the accounts of Pacific Petroleum Ltd. and all its subsidiaries.

Investments

The equity method of accounting is followed for the company's investments in Westcoast Transmission Company Limited and Pacific Northern Gas Ltd. Investments in other companies are carried at the lower of aggregate cost and market value with provision for losses recorded when there has been a permanent reduction in value and with income recorded when dividends are received.

Inventories

Inventories of crude oil, refined products and merchandise are valued at the lower of average cost and net realizable value. Materials and supplies are valued at the lower of average cost and current replacement cost.

Property, Plant and Equipment

The company follows the full cost method of accounting whereby all costs related to exploration for and development of oil and gas reserves are capitalized. Unamortized costs in those areas capable of economic production (North America and Spain) are depleted individually on the unit-of-production method based on total proved reserves. Costs incurred in other areas, pending establishment of economic production, are amortized at 20 per cent annually.

Plant and equipment, including significant improvements, are capitalized, and repair and maintenance costs are charged against earnings as incurred.

The interest cost of debt borrowed for the construction of major new facilities is capitalized during the construction period.

Depreciation is provided on the unit-of-production and straight line methods at rates sufficient to amortize the major plant and equipment over periods ranging from 20 to 35 years.

Translation of Foreign Currency

Current assets and current liabilities are translated at the rate of exchange in effect at the close of the period. The resulting gains and losses are included in earnings. Long term assets and liabilities are translated at rates in effect at the date the assets were acquired or the obligations incurred. Revenue and expense items are translated at the weighted average of rates in effect during the year with the exception of depletion and depreciation which reflect rates in effect when the assets were acquired.

Income Taxes

The company accounts for income taxes by the tax allocation method, whereby income tax expense is determined as the amount that would be payable if statutory tax deductions for drilling, exploration and lease acquisition costs and for capital cost allowances did not exceed the related depletion and depreciation provisions charged against earnings. The excess of income tax expense over income tax payable is reported as provision for future income taxes.

notes to consolidated financial statements

1. Subsidiaries

Aquila Holdings Ltd.

Asher American, Inc.

Bailey Selburn Oil & Gas Ltd.

Big Eagle Oil & Gas Ltd.

GMI Co. (Bahamas) Limited

Opal Oils Limited

Pacific Energy Resources Ltd.

Pacific Petroleum España, S.A.

Pacific Petroleum, Inc.

Pacific Petroleum (Overseas) Limited

Pacific Petrochemicals Ltd. — Les Produits

Petrochimiques du Pacifique Ltee

Pacific Petroleum (U.K.) Limited

Pacific Pipelines, Inc.

Petroleum Transmission Company

Tri-Mountain Petroleum Ltd.

Value Serve Stations Ltd.

Venezuelan Canadian Oils, C.A.

Venezuelan Pacific Petroleum, C.A.

Western Natural Gas Company Ltd.

All subsidiaries of the company are wholly owned and included in the consolidated accounts.

2. Investments

At December 31, 1978, the company owned 11,116,845 shares or 32.1 per cent of the total outstanding shares of Westcoast Transmission Company Limited. Westcoast has 5,765,128 shares reserved for issuance to holders of convertible securities and share purchase warrants at various prices between \$8.33 and \$9.44. If all of the reserved shares had been issued, the company's interest in Westcoast would have been reduced to 27.3 per cent. Dividends amounting to \$7,667,000 were received from Westcoast during 1978 and \$7,256,000 in 1977.

The cost of investments in Westcoast Transmission Company Limited and Pacific Northern Gas Ltd., which are accounted for by the equity method, is not materially different from the underlying net assets recorded in the accounts of these corporations at dates of acquisition. Westcoast follows the taxes payable method of accounting for income taxes in accordance with generally accepted accounting principles for certain utilities. If the tax allocation method was used by Westcoast, equity in earnings of investments and net earnings of the company would be reduced by \$6,613,000 (\$.31 per common share) in 1978 and \$6,270,000 (\$.29 per common share) in 1977, and the accumulated reduction to retained earnings of the company to December 31, 1978, would amount to \$39,900,000.

3. Property, Plant and Equipment

	1978	1977
Crude oil, natural gas and field liquids	\$ 879,846,000	\$764,734,000
Refined oil products	78,508,000	77,406,000
Natural gas liquids	43,943,000	43,934,000
Other	51,365,000	13,008,000
Construction in progress	61,609,000	38,753,000
	1,115,271,000	937,835,000
Depletion	250,128,000	227,829,000
Depreciation	106,814,000	99,571,000
	356,942,000	327,400,000
Property, Plant and Equipment at net cost	\$ 758,329,000	\$610,435,000

Interest was capitalized during the construction of major facilities in the amount of \$5,833,000 in 1978 and \$415,000 in 1977. The unamortized balance of capitalized interest was \$6,813,000 at December 31, 1978 and \$1,043,000 at December 31, 1977. During 1978, \$63,000 (1977 — \$44,000) was amortized and included in depreciation.

4. Long Term Debt

Long term debt due after one year consists of the following:

	Maturity Date	1978		1977
6 ¹ / ₂ % Secured Notes	1982	\$ 1,916,000	(\$ 1,777,000 US)	\$ 2,778,000
6 ¹ / ₄ % - 6 ³ / ₄ % Mortgages . . .	1985	1,743,000		2,168,000
5 ¹ / ₄ % Unsecured Notes	1985	28,046,000	(26,000,000 US)	32,253,000
8.45% Unsecured Notes	1987	32,196,000	(30,000,000 US)	32,196,000
5 ³ / ₄ % - 6 ¹ / ₄ % Mortgages . . .	1988	4,832,000	(4,474,000 US)	5,460,000
9% Unsecured Notes	1996	59,698,000	(60,000,000 US)	59,698,000
		<u>\$128,431,000</u>		<u>\$134,553,000</u>

Annual payments are required to be made commencing in 1982 on the 8.45% Unsecured Notes and in 1981 on the 9% Unsecured Notes. All of the other issues are currently subject to annual repayment. Repayment requirements on all issues are as follows:

1979 — \$ 6.4 million
1980 — \$ 6.0 million
1981 — \$10.0 million
1982 — \$14.4 million
1983 — \$14.4 million

If the long term debt payable in United States funds was translated at exchange rates in effect at the end of the period, long term debt would total \$146,733,000 at December 31, 1978 and \$141,712,000 at December 31, 1977.

5. Share Capital

(See also Note 13)

	1978	1977
Common shares issued during the year		
To holders of employee stock options for cash upon exercise of options	21,100	42,900
To holders of 5% Convertible Subordinated Debentures upon conversion	885,768	78
Total	<u>906,868</u>	<u>42,978</u>
Amount credited to share capital	<u>\$34,169,000</u>	<u>\$ 817,000</u>
Common share options granted during the year under the Key Employee Stock Option Plan	18,000	6,000
Common shares reserved at December 31		
Outstanding options under the Key Employee Stock Option Plan	146,100	149,200
For conversion of 5% Convertible Subordinated Debentures	650,104	1,535,872
For issuance to trustee for Employees Thrift Plan	147,361	147,361
For granting of options under the Key Employee Stock Option Plan	210,800	228,800

6. Unrealized exchange gains or losses

United States accounting practice requires that long term debt payable in foreign funds be translated at exchange rates in effect at the end of the period and the unrealized exchange gain or loss included in earnings currently. If Pacific, Westcoast Transmission Company Limited, and Pacific Northern Gas Ltd. followed this practice, net earnings would be reduced by \$11,720,000 (\$.54 per common share) in 1978 and \$11,970,000 (\$.56 per common share) in 1977.

7. Deferred Natural Gas Revenue

Under the terms of contracts for the sale of the company's natural gas, purchasers are required to pay for specified minimum quantities of gas each year. Due to lower than anticipated demand, buyers had to reduce purchases below minimum contract volumes. During 1978 the company received payments for gas not delivered amounting to \$6,159,000. Buyers have from six to ten years to take delivery of this gas.

8. Earnings Per Share

Calculations of fully diluted earnings per common share assume the conversion of the 5% Convertible Subordinated Debentures.

9. Retirement Plan

All regular employees participate in the company's retirement plan. Benefits are payable to employees commencing at age 65, the amount being based on earnings and length of service, with provision for earlier retirement. All costs are paid by the company. All obligations under the retirement plan are fully funded at December 31, 1978.

10. Legal Actions

Legal actions which are in process involving the company are incidental to its business and it is anticipated that any amounts which may be required to be paid are not material. Accordingly, no provision has been made in the accounts with respect to these actions.

11. Anti-Inflation Program

Under the federal government's anti-inflation program, which was phased out by the end of 1978, the company was subject to legislation which controlled prices, profit margins, employee compensation and shareholder dividends. Petroleum and natural gas prices which are subject to the Petroleum Administration Act were exempt from the application of this program.

12. Directors' and Senior Officers' Remuneration

The aggregate direct remuneration of the directors and senior officers of the company amounted to \$880,000 in 1978 (18 directors and senior officers) and \$691,000 in 1977 (14 directors and senior officers).

13. Subsequent Events

On December 18, 1978, the company called for redemption, effective January 17, 1979, all of the 5% Convertible Subordinated Debentures. Prior to January 17, 1979, the debentures were convertible into common shares of the company at the rate of 26 shares per \$1,000 principal amount. Subsequent to December 31, 1978, 638,716 shares were issued on the conversion of \$24,566,000 of the debentures. The remaining \$438,000 principal amount of the debentures was redeemed.

On January 10, 1979, the company and holders of common share options under the Key Employee Stock Option Plan agreed to cancel all share option agreements. Holders of exercisable options were paid the difference between the option exercise price and \$65.02 per share. Options which were exercisable in the future will be paid for on the same basis on the dates the options would have become exercisable provided such employees are then employed by the company, a subsidiary, an affiliate or a successor company. Petro-Canada Inc. has undertaken to reimburse the company for all such payments.

On January 19, 1979, Petro-Canada Inc., the majority holder of the common shares of the company, made an offer to the remaining shareholders to acquire all shares outstanding at a price of \$65.02 per share.

auditors' report

To the Shareholders of
Pacific Petroleum Ltd.

We have examined the consolidated statement of financial position of Pacific Petroleum Ltd. as at December 31, 1978 and 1977 and the consolidated statements of earnings, retained earnings and changes in financial position for the years 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, 1978 and 1977 and the results of its operations and the changes in its financial position for the years then ended in accordance with generally accepted accounting principles applied on a consistent basis during the years.

Calgary, Canada
February 2, 1979

CLARKSON, GORDON & CO.
Chartered Accountants

corporate information

DIRECTORS

H. C. BENTALL **

Chairman and Chief Executive Officer
The Dominion Construction Company
Limited
Vancouver, British Columbia

K. H. GIBSON **

Chairman of the Board
Foothills Pipe Lines (Yukon) Ltd.
Calgary, Alberta

W. H. HOPPER

Chairman and Chief Executive Officer
Petro-Canada
Calgary, Alberta

A. M. McINTOSH*

Executive Vice President
Pacific Petroleum Ltd.
Calgary, Alberta

C. F. MURPHY **

Barrister and Solicitor
Farris and Company
Vancouver, British Columbia

L. M. RASMUSSEN *

President and Chief Executive Officer
Pacific Petroleum Ltd.
Calgary, Alberta

W. H. TYE * **

Senior Vice President
Pacific Petroleum Ltd.
Calgary, Alberta

C. W. WEBSTER

Vice Chairman of the Board
Canadian Fuel Marketers Ltd.
Montreal, Quebec

* Member of Executive Committee

** Member of Audit Committee

REGISTERED

EXECUTIVE OFFICE

700 - 6 Avenue S.W.
P.O. Box 6666
Calgary, Alberta, Canada
T2P 6T6
Telephone (403) 268-6666

EXCHANGE LISTINGS

New York, Toronto, Montreal,
Vancouver, Alberta and
Pacific Stock Exchanges

TRANSFER AGENTS AND REGISTRARS

National Trust Company, Limited
(Registrar)

Vancouver, Calgary, Winnipeg,
Toronto, Montreal

Montreal Trust Company
(Transfer Agent)

Vancouver, Calgary, Winnipeg,
Toronto and Montreal

The Chase Manhattan Bank, N.A.
New York, New York

Bank of America National Trust
and Savings Association
Los Angeles, California

AUDITORS

Clarkson, Gordon & Co.
Calgary, Alberta, Canada

PRICE RANGE OF SHARES

The following are the price ranges of the common shares of Pacific Petroleum Ltd. on the Toronto and New York Stock Exchanges during 1977 and 1978.

	YEAR	1st Quarter		2nd Quarter		3rd Quarter		4th Quarter	
		High	Low	High	Low	High	Low	High	Low
TORONTO STOCK									
EXCHANGE	1977	29 ³ / ₄	26 ¹ / ₂	31 ³ / ₄	27 ¹ / ₄	33 ³ / ₄	30 ¹ / ₄	43 ³ / ₄	33
(expressed in									
Canadian Dollars)	1978	43 ⁷ / ₈	35 ¹ / ₂	41 ¹ / ₂	33 ⁵ / ₈	48	35	62	36 ³ / ₄
NEW YORK STOCK									
EXCHANGE	1977	29 ¹ / ₈	25 ⁷ / ₈	29 ⁷ / ₈	25 ⁷ / ₈	31 ⁵ / ₈	28 ⁵ / ₈	40 ¹ / ₈	29 ³ / ₄
(expressed in									
U.S. Dollars)	1978	40 ¹ / ₈	31 ³ / ₄	36 ¹ / ₄	30 ¹ / ₄	41	31 ¹ / ₈	52 ³ / ₈	31



1978 ANNUAL REPORT