# NORTHSTAR ENERGY
## CORPORATION

1986
ANNUAL REPORT

# Corporate Profile

Northstar Energy Corporation is a Calgary based Canadian controlled company incorporated in Alberta in 1981. Northstar is actively engaged in crude oil and natural gas exploration, production and processing in Canada. Its principal assets are located in the province of Alberta. The Company is listed on The Alberta and The Toronto Stock Exchanges and has over 1,000 shareholders.

In June, 1986 the Company's name was changed to Northstar Energy Corporation from Gane Energy Corporation Ltd. to reflect the close association with its majority shareholder, Canadian Northstar Corporation.

# Annual Meeting

The annual meeting of the shareholders will be held at the Calgary Petroleum Club, 319 - 5th Avenue S.W., Calgary, Alberta at 3:30 P.M., on Wednesday, May 27, 1987.

# Contents

# NORTHSTAR ENERGY CORPORATION

# FIRST QUARTER REPORT TO THE SHAREHOLDERS

For the three months ended March 31, 1987

## Consolidated Statement of Earnings
(Unaudited)

| | 1987 | 1986 |
|---|---|---|
| | (in thousands) | |
| **Revenue** | | |
| Oil and gas | $1,654 | $1,810 |
| Less: Royalties (net) | (207) | (350) |
| Processing | 1,230 | 1,229 |
| Fees, interest and other | 523 | 414 |
| | 3,200 | 3,103 |
| **Expenses** | | |
| Operating — oil and gas | 318 | 343 |
| — processing | 485 | 611 |
| General and administrative | 313 | 415 |
| Interest and lease payments | 660 | 566 |
| Depreciation and depletion | 726 | 784 |
| Deferred taxes | 359 | 221 |
| | 2,861 | 2,940 |
| Net earnings | $ 339 | $ 163 |
| Earnings per share* | $0.02 | $0.00 |

* After deduction of cumulative preferred share dividends.

## Consolidated Statement of Changes in Cash Position
(Unaudited)

| | 1987 | 1986 |
|---|---|---|
| | (in thousands) | |
| **Provided by (used for) operating activities** | | |
| Cash flow from operations | $1,406 | $1,126 |
| Deferred revenue | (160) | (174) |
| | 1,246 | 952 |
| **Provided by (used for) financing activities** | | |
| Long term debt, net | 2,808 | 709 |
| Equity — common shares | 206 | — |
| Preferred share dividends | (68) | (68) |
| Change in non-cash working capital | (486) | (801) |
| | 2,460 | (160) |
| **Provided by (used for) investment activities** | | |
| Property and equipment | (3,834) | (927) |
| Investments | 256 | (155) |
| Sales — investments | — | 184 |
| | (3,578) | (898) |
| Increase (decrease) in cash position | 128 | (106) |
| Cash position, beginning of period | 5 | 845 |
| Cash position, end of period | $ 133 | $ 739 |

## Financial and Operations Review

Earnings for the first quarter more than doubled the 1986 level, primarily on the strength of improved efficiency from both oil and gas production and gas processing operations. Operating and administration costs declined 19% overall, while revenue improved 3% compared to an estimated industry decline of 28%. The revenue increase, small compared to volume increases, results from lower 1987 oil and gas prices in comparison to regulated gas prices and relatively strong oil prices which buoyed the first quarter of 1986.

Cash flow from operations was $1.4 million, or $0.17 per share, for the quarter.

Oil production averaged 456 BPD (1986 — 411 BPD) while gas production increased 37% to 5.9 MMSCF/D (1986 — 4.3 MMSCF/D). Oil production does not fully reflect the Company's recent successes at Peerless Lake and Seal as development of these properties progressed throughout the first quarter.

At the Turin Plant, gas throughput volumes increased 29% to 31 MMSCF/D but were offset by lower field compression volumes.

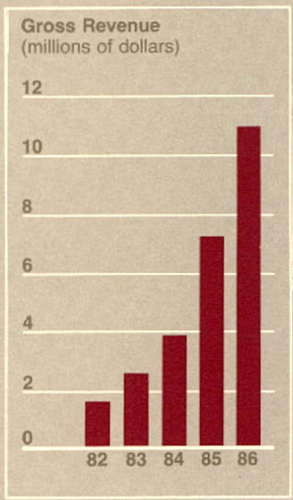
On the capital expenditures side, the Liege Plant was completed in March at a cost of $1.8 million. Oil and gas expenditures were focused primarily on the Peerless Lake and Seal plays and along the Glauconite channel trend in the Birch Wavy area.

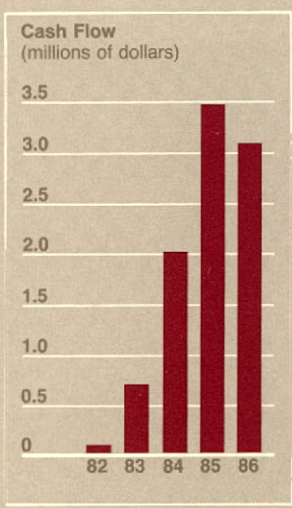


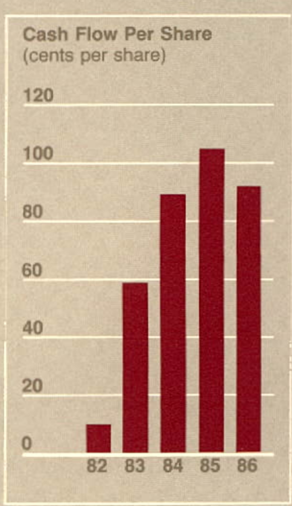
Northstar Energy Corporation is a Canadian company actively engaged in the businesses of oil and gas exploration and production and gas processing. Its principal assets are located in the province of Alberta. The Company is listed on the Alberta and the Toronto Stock Exchanges under the trading symbol NEN.

Northstar Energy Corporation
1130, 140 Fourth Avenue S.W.
Calgary, Alberta
T2P 3N3
Telephone (403) 261-4830

# Corporate Highlights




| | | 1986 | 1985 |
|---|---|---|---|
| **Financial** (thousands, except per share data) | Gross revenues | **$ 11,000** | $ 7,289 |
| | Net earnings | **36** | 968 |
| | per common share* | **(0.18)** | 0.21 |
| | Cash flow from operations | **3,061** | 3,499 |
| | per common share* | **0.92** | 1.05 |
| | Total assets | **53,749** | 65,848 |
| | Long-term debt | **8,258** | 22,904 |
| | Shareholders' equity | **34,609** | 24,292 |
| **Operating** | Crude oil production (gross bbls) | | |
| | Annual | **156,000** | 118,000 |
| | Per day | **427** | 324 |
| | Natural gas production (gross mcf) | | |
| | Annual | **1,461,000** | 899,000 |
| | Per day | **4,000** | 2,500 |
| | Gross reserves | | |
| | Crude oil and liquids (bbls) | **1,481,000** | 1,341,000 |
| | Natural gas (mmcf) | **51,500** | 53,300 |
| | Land holdings | | |
| | Gross acres | **513,000** | 570,000 |
| | Net acres | **68,000** | 80,000 |
| | Wells drilled | | |
| | Oil | **15** | 14 |
| | Gas | **10** | 16 |
| | Service | **1** | — |
| | Dry | **10** | 20 |
| | Total | **36** | 50 |
| **Share Information** | Common shares outstanding at December 31 | **8,297,000** | 33,168,000 |
| | Average common shares outstanding for the year | **3,316,800** | 33,061,000 |

In June, 1986, shareholders approved a 1 for 10 consolidation of outstanding common shares.

In December, 1986, 5 million common shares were issued pursuant to a private placement.

* 1986 and 1985 earnings per share and cash flow per share data shown post consolidation.

*"Long term debt was reduced from $23 million down to $8 million"*

### Overview of 1986

During the year the Company made considerable progress despite the difficult economic conditions which severely affected the petroleum industry.

The precipitous fall in oil prices in the first quarter of the year brought about a virtual restructuring of the oil and gas business. The oil sector's net cash flow dropped in half, as did investment. Many wells and capital projects were relegated to an uneconomic status. Many companies did not survive the year and were merged or liquidated.

The major accomplishments for the Company during the past year were:

- restructuring of the share capital and change of name to Northstar Energy Corporation.
- participation in the two most prolific oil discoveries in the Company's history at Peerless Lake/Trout and Seal.
- expansion of the daily process capacity at the Turin Plant by approximately 10 million cubic feet per day to a peak of over 50 MMSCF/D.
- construction of the 12 MMSCF/D Liege Plant in a record 10 weeks.
- reduction of long term debt from $22.9 million to $8.3 million ($3.6 million net of offsetting notes receivable).
- increase in shareholders' equity from $24.3 to $34.6 million.

### Financial Results

Gross revenues were $11.0 million, an increase of 52% over the $7.3 million reported in 1985. Significantly lower prices were offset by higher production volumes and the full year's revenues from the Company's expanding custom processing division.

Reduced operating margins caused a decline in cash flow from operations to $3.1 million, or $0.92 per share, from $3.5 million, or $1.05 per share, in 1985.

Low prices and higher depletion and depreciation charges also reduced net earnings from $968,000 in 1985 to $36,000 in 1986.

The outlook for 1987 is for a return to growth and improved results. Increased revenues, cash flow and earnings are expected.

### Debt Reduction

During the latter part of the year the Company undertook several significant transactions which strengthened the balance sheet considerably.

Shareholders equity was increased by approximately $11 million through the private placement of $6 million of common shares and $5 million of nonconvertible second preferred shares. These issues were approved at the special shareholders meeting held on November 19, 1986.

In another transaction in December, an additional $12 million was raised through the sale and leaseback over a 10 year term of certain processing facilities.

At year end, the Company's long term debt had been reduced to $8.3 million, resulting in a healthy ratio of debt to capital of 19%.

### Exploration and Production

The Company participated in drilling 36 wells during the year, 17 of which were drilled in the first quarter. While the drop in oil and gas prices brought about an increasingly rigorous assessment of exploration economics, and some reduction in drilling activity, the Company has achieved outstanding exploration success in recent months.

In the Peerless Lake/Trout area of north-central Alberta the Company has now participated in 3 exploratory discoveries, the most prolific of which recently tested from two zones at a combined rate of over 2500 barrels per day. Northstar has an 11.5% interest in these wells and an average 10.2% interest in 24,000 undeveloped acres on the play.

In the Seal area, also in northern Alberta, the test results from 3 Slave

Point reef discoveries remain on confidential status pending the results of an upcoming Crown land sale.

The other area of major focus has been along the Glauconite channel trend in east-central Alberta where the Company has shot several hundred kilometers of new seismic data in recent months. A significant drilling program is planned for the balance of the year and, based upon results to date, we expect to achieve finding and on-stream costs of $0.10-0.20 per mcf.

Oil production averaged 427 barrels per day during the year, as compared to 324 barrels per day in 1985. Natural gas production increased to 4.0 million cubic feet per day, up from 2.5 million cubic feet per day the previous year. Production at year end was up a further 50% from the average levels reported in 1986. The recent discoveries will contribute to substantial increases in average production rates over the next year.

**Processing and Facilities**

The Company has made a concentrated effort over the past 2 years to expand its involvement in gas plant operations, particularly where opportunities have been available to provide custom processing services to other producers.

We have been attracted by certain lower risk aspects of this sector of the industry which is protected to some extent from the fluctuations in oil and gas prices. In addition, control over substantial processing volumes provides the Company with a unique opportunity to expand our gas marketing efforts.

The Company is operating gas processing facilities with total capacity of approximately 70 MMSCF/D which, on average, are being utilized at approximately 50% of capacity. Anticipated increases in processing volumes over the next year will contribute significantly to bottom line performance.

The construction of the Liege plant through the first quarter of 1987 was completed on an exceptionally tight schedule. Our excellent operations and engineering organization is to be congratulated for this record performance.

**Retirements**

Peter Rainier, Executive Vice-President of the Company, retired effective January 15, 1987. Mr. Rainier has had a distinguished 35 year career in the international oil industry and we are pleased that he will be continuing to serve the Company on its board of directors.

Anthea Lister, Vice-President and Corporate Secretary has also left the Company since the year end. Mrs. Lister has worked in the Northstar group for the past 8 years. She has made a significant contribution to the Company's development.

Finally, I would like to pay tribute to Jack Lee, one of the Company's founders, who will be retiring from the Board at the upcoming annual meeting.

The difficulties faced by the oil industry over the past year have created opportunity for Northstar. We are operating in a new world of deregulation that is well suited to the broad technical and financial skills of our management group.

During the next year I am confident that we will be able to meet our objectives and create satisfactory growth in value for the shareholders.

We are fortunate to have such a dedicated group of employees who have been prepared to share the work and sacrifice necessary for success. I thank each of them for their efforts.

On behalf of the Board,

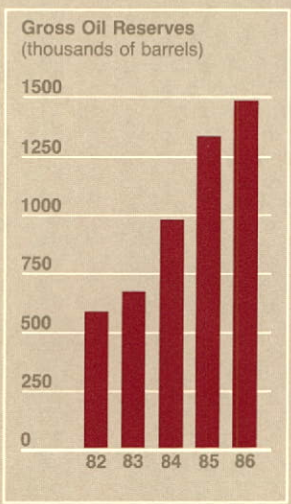
John A. Hagg,
Chairman and President.

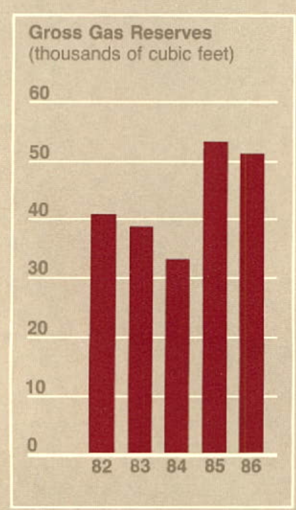
April 15, 1987.

***"At Peerless Lake the most prolific well tested 2,500 barrels per day"***

# Oil and Gas Operations






### Production and Reserves

Nineteen eighty six was a year of dramatic change for Northstar Energy. Oil prices fell precipitously from $35.25/BBl in 1985 to $17.45/BBl in 1986 and gas markets decayed from their already poor position. While many companies had difficulty adjusting to this new environment, Northstar's operational performance was strong.

Daily oil and gas production increased by 32% and 60% respectively averaging 427 barrels per day of oil and 4.0 million standard cubic feet per day of gas. The fourth quarter volumes reached record levels at 510 barrels per day and 5.9 million standard cubic feet per day.

Through our drilling activity, net reserves totalling 289,000 BBls of liquids and 4.9 BCF of gas were added at an all in finding and developing cost, including exploration administrative expense, of $5.20/BOE using a 10:1 gas equivalent conversion. When corrected for production to year end and revisions to previous estimates, the Company's total proven plus probable liquid reserves increased 10% to 1,481,000 barrels from 1,341,000 barrels in December of 1985 and gas reserves declined marginally to 51.5 BCF from 53.3 BCF in 1985.

More significantly, Northstar continued the trend to aggressively produce and market its reserves. Over the period from 1983 to 1986, the oil and gas Reserves Life Indices dropped to 10 years and 35 years respectively from 16 years and 91 years.

**Undeveloped Land**
**December 31, 1986**

| | Acreage | |
|---|---|---|
| | Gross Acres | Net Acres |
| Alberta | 471,800 | 60,850 |
| British Columbia | 23,500 | 4,600 |
| Saskatchewan | 6,550 | 1,200 |
| United States | 10,800 | 1,550 |
| | 512,650 | 68,200 |
| Appraised Value | | $2,865,000 |

**Oil and Natural Gas Reserves**
**December 31, 1986**

| | Gross Reserves | | Present Value | |
|---|---|---|---|---|
| | Oil (MBBLS) | Gas (BCF) | Undiscounted | Discounted @ 15% |
| | | | ($000's) | |
| Proven Producing | 1,223 | 18.8 | $ 68,000 | $24,000 |
| Proven Non-Producing | 168 | 24.6 | 85,000 | 13,000 |
| Total Proven | 1,391 | 43.4 | 153,000 | 37,000 |
| Probable Additional | 90 | 8.1 | 39,000 | 4,000 |
| Total | 1,481 | 51.5 | $192,000 | $41,000 |

**Notes**

1. The reserves were evaluated by in-house staff with assistance from John P. Hunter and Associates.
2. The evaluation was based on the following near term prices:

| Year | Oil(1) $Cdn/BBl | Gas(2) $Cdn/MCF |
|---|---|---|
| 1987 | 23.00 | 1.80 |
| 1988 | 24.00 | 1.82 |

(1) Edmonton par price for 40°API sweet crude
(2) TCPL field price for $B_1B_2$ gas at 1000 BTU/SCF
(3) Future prices are comparable to those used by the oil and gas industry engineering firms.

3. The present values shown are before income taxes and include the benefit of the Alberta Royalty Tax Credit.

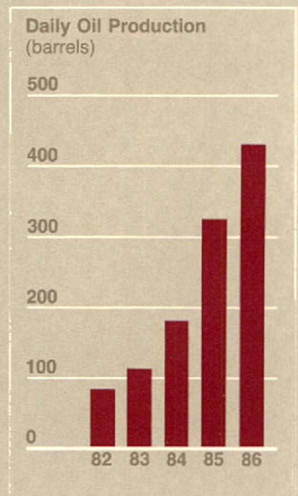
## Drilling Activity

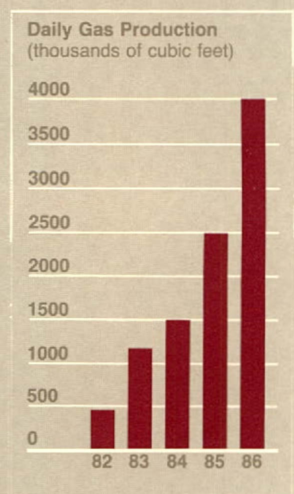
Drilling activity in 1986, consistent with the industry, was down compared to 1985. Northstar participated in 29 locations and farmed out an additional 7. With an overall success ratio of 70%, these operations resulted in 15 oil wells, 10 gas wells, and one service well.

Regionally, two wells were drilled in Saskatchewan, both successful oil wells, and the remaining 34 locations were drilled in Alberta.

The most active area continued to be the land within our Birch-Wavy gas contract in eastern Alberta. Six wells were drilled on that acreage. Four wells were drilled in each of the Seal and Peerless fields in northern Alberta and in the Grand Forks/Turin area of southern Alberta. The remaining 18 wells were drilled on various prospects in Delia, Michichi, Simonette, Cessford, and other areas.

The successful results of late 1986 continued into early 1987. Over the past winter, Northstar participated in locations in each of the Peerless, Seal and Birch-Wavy areas. While information concerning these wells remains confidential, the results were excellent and, in concert with a general strengthening of oil prices and the recently announced tax incentives, create a very positive outlook for the remainder of 1987. We expect to see a significant increase in the number of wells drilled by year end, primarily in these three active plays.



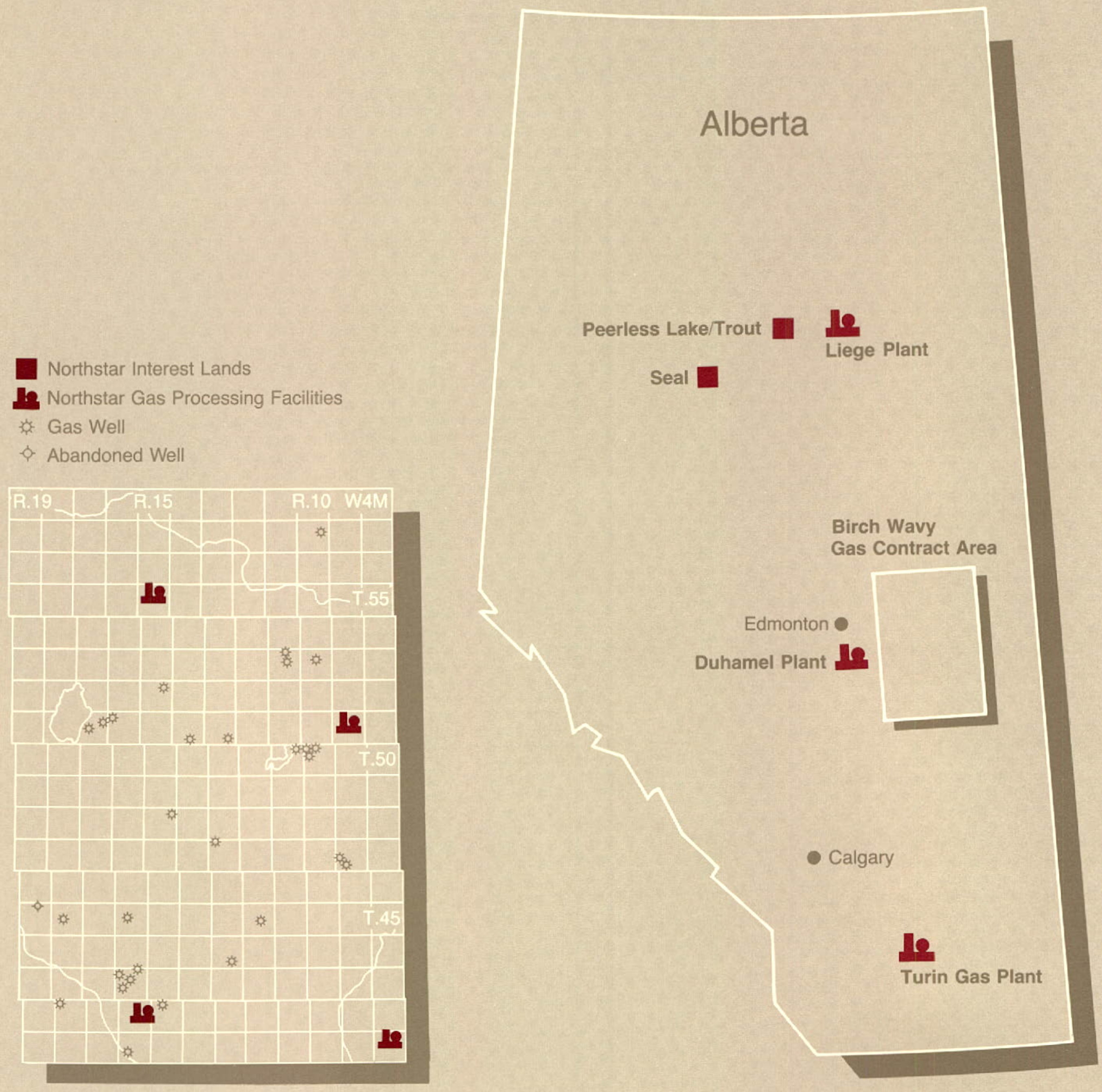




### Historical Reserves and Production Performance

| Year | Year End Reserves | | Production | | Reserves Life | |
|---|---|---|---|---|---|---|
| | Oil MBBLS | Gas BCF | Oil BPD | Gas MSCF/D | Oil Years | Gas Years |
| | | (000's) | | | | |
| 1983 | 666 | 39 | 112 | 1,175 | 16 | 91 |
| 1984 | 978 | 34 | 180 | 1,500 | 15 | 62 |
| 1985 | 1,341 | 53 | 324 | 2,500 | 11 | 58 |
| 1986 | 1,481 | 51 | 427 | 4,000 | 10 | 35 |

### Major Producing Properties

| Oil Production (BPD Before Royalty) | 1986 | Gas Production (MSCF/D Before Royalty) | 1986 |
|---|---|---|---|
| **Alberta** | | **Alberta** | |
| Buffalo Lake | 70 | Birch-Wavy | 748 |
| Misty Lake | 54 | Retlaw/Turin | 334 |
| Cessford | 48 | Wardlow | 286 |
| Virgo | 40 | Warwick | 282 |
| Fenn West | 33 | Birch | 250 |
| Kaybob | 23 | Abee | 219 |
| Delia | 19 | Baptiste | 211 |
| Alderson | 15 | Steele | 197 |
| Hayter | 13 | Flatbush | 193 |
| Peerless | 9 | Delia | 192 |
| Other | 85 | Meanook | 174 |
| **British Columbia** | | Hollow | 126 |
| Peejay | 18 | Other | 788 |
| Total Daily Average | 427 | Total Daily Average | 4,000 |


Alberta
Peerless Lake/Trout
Liege Plant
Seal
Birch Wavy
Gas Contract Area
Edmonton
Duhamel Plant
Calgary
Turin Gas Plant
Northstar Interest Lands
Northstar Gas Processing Facilities
Gas Well
Abandoned Well
R.19
R.15
R.10
W4M
T.55
T.50
T.45

### Property Acquisitions

Over the course of 1986, the Company reviewed numerous opportunities to purchase existing reserves. In general, the opposing perspectives of buyers and sellers respecting market prices hindered most transactions. However, we were successful in increasing our interest in 5½ sections of land in Township 10, Ranges 17 and 18 W4M in the Turin area from 12% to 42% through the purchase of a partner's interest. The property has two shut-in gas wells and the interest purchased has corresponding proven reserves of approximately 1 BCF. Both wells will be tied in and on production before the end of 1987.

In a second transaction, Northstar purchased a 14% interest in a well in the Willingdon area. TransCanada PipeLines recognizes 8 BCF of reserves underlying the lands and through a production sharing agreement, Northstar has dedicated the reserves to our Birch-Wavy contract for withdrawal through a 100% interest well. First production was nominated and delivered in November, 1986.

In the Salinas Valley area of central California, the Company purchased a 15% working interest in over 10,000 acres of undeveloped land. Although this basin is surrounded by a number of the largest oil fields in North America, most of the relatively sparse drilling activity took place in the 1940's and 1950's, generally at shallower depths.

### Birch-Wavy Gas Contract Area

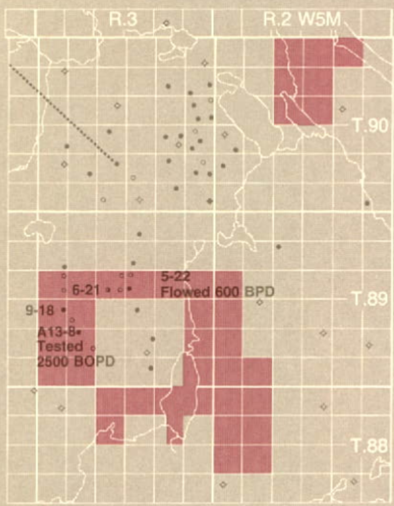
The Company's activity in the Birch-Wavy Gas Contract Area continued through 1986. The six wells drilled on our acreage resulted in four excellent gas wells and an oil well. Net reserves of 2.9 BCF were added to the contract base and reflected in TransCanada PipeLines' nominations starting in November, 1986.

Virtually all of the Company's gas from the contract area is sold to TCPL. While their nominations have continued to decline from 54% of Daily Contract Quantity in 1985 to 48% in 1986 and are expected to be as low as 40-42% in 1987, Northstar's deliveries from the area have climbed steadily from 272 MCF/d in 1985 to 748 MCF/d in 1986. Those volumes seem small currently, but with continued drilling success, that progress will accelerate in 1987.

Our exploration and development focus in Birch-Wavy in recent months has concentrated on the very prolific glauconitic sands. Our activities are primarily based on the use of an innovative interpretation technique for the seismic and geological data.

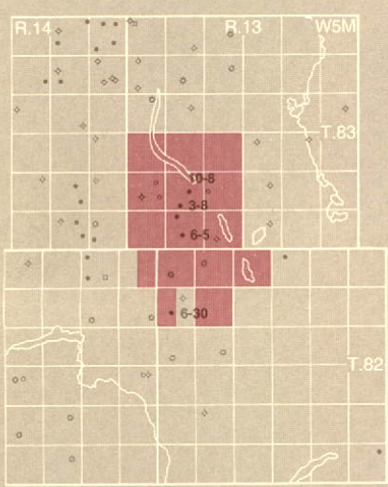
In a very significant commitment to the area, the Company participated in a $1.2 million seismic program shot in late 1986. This program generated 210 miles of data, and when coupled with our much refined ability to interpret that data, positions the Company for a very active and aggressive program in 1987.

The first of the locations picked using the new information was drilled prior to breakup in 1987 and early indications are that the successful gas well has gross marketable reserves in excess of 5 BCF on a half section. Continued results of a similar nature should translate to an all in finding cost of approximately 10¢/MCF.




**Peerless Lake/Trout**
Alberta

- Northstar Interest Lands
- Location
- Oil Well
- Gas Well
- Abandoned Well
- Awaiting Completion
- Crude Oil Pipeline




**Seal**
Alberta

- Northstar Interest Lands
- Location
- Oil Well
- Gas Well
- Abandoned Well

## Peerless Lake

The Company continued development of the Devonian play at Peerless Lake. Four wells were drilled through 1986 resulting in two producing oil wells. The only abandonment, 13-8-89-3W5M, was junked due to downhole problems and redrilled over year-end as A13-8-89-3W5M, the recently announced dual zone producer that tested 2500 BPD. 6-21-89-3W5M, offsetting the initial well in 5-22-89-3W5M, as yet remains uncompleted.

Again, the early 1987 results were very positive. 9-18-89-3W5M, a location drilled and completed into breakup, is currently being tested. It encountered the thickest reef section of any of our wells to date. The character of the reservoir in 9-18 shows a close correlation with our other producing wells confirming the large aerial extent of the pool.

The discovery well, 5-22-89-3W5M, initially completed and tested at 600 BPD in February, 1986 was back on stream after breakup. By December, the well had produced in excess of 24,000 BBLs with only a 10 psi drop in shut in pressure, indicative of a very high quality reservoir.

All-weather roads and treating facilities have been constructed to service the area thereby allowing continued production and development drilling this coming summer.

Prior to breakup, sixty miles of two-dimensional seismic data and four square miles of three-dimensional seismic data were shot to define the development offsets to be drilled and the additional exploratory locations planned for next winter. The preliminary information indicates that as many as six to nine immediate offsets to existing production will be drilled by the end of 1987.

Northstar's acreage position in this play remains unchanged with an average of 10.2% working interest in 24,640 acres.

## Seal

In the Seal area, the Company holds interests varying between 5% and 10% in 9,440 acres offsetting two producing oil fields. In 1986, four wells were drilled on Northstar acreage resulting in three completed oil wells. The Company participated in three of the locations and farmed out its interest in the fourth.

The reservoir, a Slave Point Carbonate, is encountered in thick and very productive structures with large volumetric reserves.

Dome et al Seal 6-5-83-13W5M was completed and placed on production late in 1986. It is an excellent producer but remains on tight hole status as do the follow-up producers in 10-8-83-13W5M and 6-30-82-13W5M. The most recent well 3-8-83-13W5M drilled into the recent breakup, has been cased for production.

The Company, through participation in 20 miles of two-dimensional seismic and five square miles of three-dimensional seismic, has identified numerous offset and exploratory locations on our acreage.

The area is served by all-weather roads and will see continued activity throughout 1987.

# Facilities Operations



### Turin

The Company's entry into the custom processing business was through the acquisition of a private Alberta company, Turalta Resources, in late 1985. The principal asset involved in that transaction was the Turin Gas Plant located in the Lethbridge area of southern Alberta. When acquired, the plant consisted of a 40 MMSCF/D sour processing facility and an associated network of gathering lines and field compressors.

Through 1986, Northstar spent considerable effort effecting numerous critical additions and modifications to the facility. A major turnaround debottlenecked several process problems and, combined with a solvent replacement program, increased the peak capacity in winter months to in excess of 50 MMSCF/D. Fifteen hundred barrels of additional NGL storage were added and through the installation of two major pipelines 14 MMSCF/D of incremental deliverability connected to the plant.

With these improvements, Turin was able to withstand the general downturn in gas sales associated with poor markets. In spite of the throughput loss created by the two week turnaround, average volumes increased in 1986 to 22 MMSCF/D from 21 MMSCF/D in 1985.

### Liege

In an agreement finalized on December 24, 1986, Northstar undertook the construction of a 12 MMSCF/D compression and dehydration facility in a remote area approximately 90 miles west of Fort McMurray. Due to the remote location, the construction of the facility had to be completed before breakup. Initial design began immediately after year-end and the facility was commissioned in mid-March 1987, a total elapsed time of less than 10 weeks.

Through its investment in the plant, Northstar was carried to a seven percent working interest position in 24 sections of land, five completed gas wells and approximately eight miles of gathering system. The Company retains a 53% working interest position in, and will operate the plant.

Gas from the field is produced from the Nisku Carbonate zone. Typical of the Liege and adjacent fields, the reservoir pressure is very low but is more than offset by the exceptional porosity and permeability encountered. In fact, the 6-7-89-21W4M well acquired with the acreage tested an absolute open flow potential of 18 MMSCF/D.

Under the terms of the agreement, 53% of the gas produced from the Northstar lands will be processed in the plant on a custom fee basis. The remaining 47% is owned and will be processed by our partner in the plant.

### Duhamel

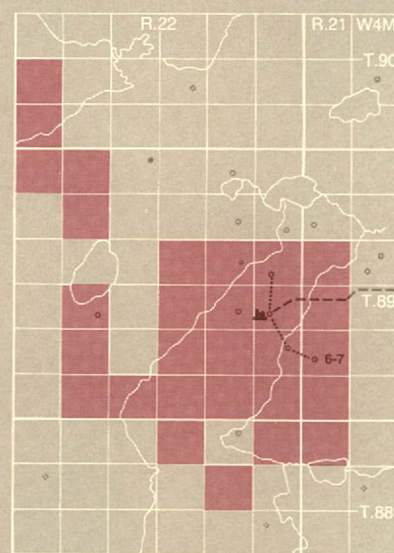
Although not finalized, Northstar has reached an agreement in principle to purchase the interest of several participants in an under-utilized 10 MMSCF/D sour processing plant and associated reserves strategically located in our Birch-Wavy play. We anticipate that operatorship will be transferred to Northstar enabling the Company to maximize this investment.

### Market Opportunities

In 1985, Northstar identified a specific opportunity to provide contract processing and facilities services to the oil and gas industry. Turin and Liege represent the first evidence of our entry into that market and we will continue in our dedication to development of stable long-term growth through these investments. Key staff additions in 1986 have added substantial experience in all phases of facility design, construction and operation, and will continue the development of strong technical management to optimize the Company's assets.


**Turin Gas Plant & Gathering System**
Alberta

Northstar Interest Lands
Oil Well
Gas Well
Abandoned Well
Plant Site




**Liege**
Alberta

Northstar Interest Lands
Location
Oil Well
Gas Well
Abandoned Well
Gathering System
Sales Line
Plant Site

# Consolidated Balance Sheet



December 31, 1986

## Assets

| | 1986 | 1985 |
|---|---|---|
| | (in thousands) | |
| **Current assets** | | |
| Cash | $ 5 | $ 845 |
| Accounts receivable | 4,198 | 4,577 |
| Petroleum incentive grants receivable | 348 | 1,409 |
| Secured notes (note 4) | 335 | 2,318 |
| | 4,886 | 9,149 |
| Investments (note 4) | 4,933 | 4,388 |
| Property and equipment (note 5) | 43,930 | 52,311 |
| | $53,749 | $65,848 |

## Liabilities and Shareholders' Equity

| | 1986 | 1985 |
|---|---|---|
| **Current liabilities** | | |
| Accounts payable and accrued liabilities | $ 5,387 | $ 7,120 |
| Note payable | 256 | 1,403 |
| Current portion of long-term debt | 25 | 637 |
| | 5,668 | 9,160 |
| Long-term debt (note 6) | 8,258 | 22,904 |
| Deferred revenue | 2,849 | 2,399 |
| Deferred income taxes | 2,365 | 2,132 |
| Minority interest | — | 4,961 |
| **Shareholders' equity** | | |
| Share capital (note 7) | 33,462 | 22,556 |
| Retained earnings | 1,147 | 1,736 |
| | 34,609 | 24,292 |
| | $53,749 | $65,848 |

Approved on behalf of the Board,

, Director , Director

# Consolidated Statement of Earnings

Year Ended December 31, 1986

| | 1986 | 1985 |
|---|---|---|
| | (in thousands) | |
| **Revenue** | | |
| Oil and gas sales | $ 5,820 | $ 6,443 |
| Less: Royalties (net) | (824) | (1,235) |
| Processing | 4,518 | 776 |
| Fees, interest and other | 1,486 | 1,305 |
| | 11,000 | 7,289 |
| **Expenses** | | |
| Operating — oil and gas | 1,557 | 1,124 |
| — processing | 2,500 | 433 |
| General and administrative | 1,069 | 1,105 |
| Interest on long-term debt | 2,734 | 1,306 |
| Depletion and depreciation | 2,825 | 1,518 |
| | 10,685 | 5,486 |
| Earnings before income taxes | 315 | 1,803 |
| **Income taxes** (note 9) | | |
| Current (recovered) | 45 | (175) |
| Deferred | 234 | 1,010 |
| | 279 | 835 |
| Net earnings | $ 36 | $ 968 |
| Earnings (loss) per share | $ (0.18) | $ 0.21 |
| Cash flow from operations | $ 3,061 | $ 3,499 |
| Cash flow per share | $ 0.92 | $ 1.05 |

Earnings and cash flow per share for 1985 have been restated after giving effect to the consolidation of shares described in note 7.

# Consolidated Statement of Retained Earnings

Year Ended December 31, 1986

| | 1986 | 1985 |
|---|---|---|
| | (in thousands) | |
| Retained earnings, beginning of year | $1,736 | $1,038 |
| Net earnings | 36 | 968 |
| Preferred share dividends | (625) | (270) |
| Retained earnings, end of year | $1,147 | $1,736 |

# Consolidated Statement of Changes in Cash Position



Year Ended December 31, 1986

| | 1986 | 1985 |
|---|---|---|
| | (in thousands) | |
| **Provided by operating activities** | | |
| Cash flow from operations | $ 3,061 | $ 3,499 |
| Deferred revenue | (247) | (104) |
| | 2,814 | 3,395 |
| **Provided by (used for) financing activities** | | |
| Long term debt, net | (15,258) | 18,247 |
| Equity — common shares (net) | 5,945 | 41 |
| — preferred shares | — | 4,961 |
| Preferred share dividends | (625) | (270) |
| Change in non-cash working capital | (1,440) | 3,103 |
| | (11,378) | 26,082 |
| **Provided by (used for) investment activities** | | |
| Property and equipment | (6,022) | (15,857) |
| Petroleum incentive grants | 513 | 904 |
| Acquisition | — | (9,315) |
| Investments | 1,212 | (6,635) |
| Sales — facilities | 10,894 | — |
| — resource properties | 943 | 1,480 |
| — investments | 184 | 188 |
| | 7,724 | (29,235) |
| Increase (decrease) in cash | (840) | 242 |
| Cash, beginning of year | 845 | 603 |
| Cash, end of year | $ 5 | $ 845 |

# Auditors' Report

**To the Shareholders**
**Northstar Energy Corporation**
**(formerly Gane Energy Corporation Ltd.)**

We have examined the consolidated balance sheet of Northstar Energy Corporation (formerly Gane Energy Corporation Ltd.) as at December 31, 1986 and the consolidated statements of earnings, retained earnings and changes in cash position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the company as at December 31, 1986 and the results of its operations and changes in cash position for the year then ended in accordance with generally accepted accounting principles applied, except for the change in the method of accumulating exploration and development costs as explained in note 3 to the financial statements, on a basis consistent with that of the preceding year.

Calgary, Canada
March 6, 1987

COLLINS BARROW
Chartered Accountants

December 31, 1986

## 1. CHANGE OF NAME

On June 26, 1986, as part of the reorganization of share capital described in note 7, the shareholders approved the change of name to Northstar Energy Corporation.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) **Principles of consolidation**
The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary companies, together with its proportionate share of the assets and liabilities of various limited partnerships and joint ventures in which the Company participates.

(b) **Investments**
Investments are carried at the lower of cost or net realizable value.

(c) **Exploration and development costs**
The Company follows the full cost method whereby exploration and development costs are capitalized on a country by country basis. Such costs include direct acquisition, exploration and development costs together with applicable overhead and carrying charges, net of government incentives and tax credits. Proceeds from disposals are normally deducted from the full cost pool without recognition of gains or losses.

A ceiling test is employed annually to ensure costs accumulated by cost centre and for the Company as a whole do not exceed future cash flows from estimated proven reserves and the cost of undeveloped properties. For purposes of this test, future cash flows are determined using year-end prices and costs, including deductions for applicable overhead, financing and income tax expenses.

(d) **Depletion and depreciation**
Petroleum and natural gas properties, excluding undeveloped properties, are depleted using the unit-of-production method based on estimated proven reserves before deduction of royalties and after conversion to units of common measure based on relative energy content.

Processing facilities are depreciated using the unit-of-throughput method based on estimated total processing volumes over the life of each facility.

(e) **Revenue recognition**
Payments received for undelivered gas are initially deferred and are recognized as revenue when deliveries are made or on expiry of the period allowed for such deliveries.

(f) **Foreign currency translation**
The accounts of the foreign subsidiary and other foreign operations have been translated to Canadian dollars on the following basis: monetary assets and liabilities at the rate of exchange at the year-end; other assets and liabilities at the historical rate of exchange; revenue and expense accounts at the average rates of exchange prevailing during the year except for depletion and depreciation which are translated at the same rates as used for the related assets.

## 3. CHANGE IN ACCOUNTING POLICY

Effective January 1, 1986, the Company prospectively adopted the new CICA Full Cost Accounting Guideline. This change does not have a material effect on the financial statements for the current year.

## 4. INVESTMENTS

| | 1986 | 1985 |
|---|---|---|
| | (in thousands) | |
| Secured notes | **$4,673** | $6,308 |
| Other | **595** | 398 |
| | **5,268** | $6,706 |
| Less current portion of secured notes | **335** | 2,318 |
| | **$4,933** | $4,388 |

The secured notes are due December 31, 1995, bear interest at the prime rate plus 1% and are secured solely by an assignment and pledge of partnership interests in the Gane Energy 1985-86 Production and Development Fund. The notes will be repaid out of cash distributions from the partnership.

## 5. PROPERTY AND EQUIPMENT

| | 1986 | | | 1985 |
|---|---|---|---|---|
| | Cost | Accumulated depletion & depreciation | Net | Net |
| | | | (in thousands) | |
| Petroleum and natural gas properties including exploration and development thereon | **$50,695** | **$7,847** | **$42,848** | $42,798 |
| Natural gas processing facilities | **1,097** | **15** | **1,082** | 9,513 |
| | **$51,792** | **$7,862** | **$43,930** | $52,311 |

Undeveloped acreage not subject to depletion amounted to $2.8 million at December 31, 1986 (1985 — $2.0 million).

Property and equipment with a net book value of approximately $10 million has a zero cost base for income tax purposes.

Administrative overhead capitalized in 1986 amounted to $671,000 (1985 - $514,000).

A gain of $697,466 realized from the sale of certain processing facilities, which were subsequently leased back to the Company, is being amortized over the term of the lease.

## 6. LONG-TERM DEBT

| | 1986 | 1985 |
|---|---|---|
| | (in thousands) | |
| Bank operating loan | **$3,543** | $ 4,170 |
| Production loan | **598** | 11,548 |
| Due to parent | **4,117** | 6,828 |
| Promissory notes | **—** | 372 |
| Bank loan | **25** | 623 |
| | **8,283** | 23,541 |
| Less current portion | **25** | 637 |
| | **$8,258** | $22,904 |

The bank operating loan is repayable on demand, bears interest at the bank prime rate plus ½% and is secured by a first fixed charge on certain of the Company's oil and gas properties and a general assignment of accounts receivable. The loan is repayable out of future production revenues and is not expected to require the use of existing working capital; therefore, no portion of the loan has been classified as current. Unutilized operating loan facilities of $2.7 million existed at December 31, 1986 (1985 - $2.3 million).

The production loan is repayable on demand and bears interest at the bank prime rate plus ⅜%. The loan is secured by an assignment and pledge of the Company's entire interest in certain limited partnerships and the secured notes (note 4). The loan will be repaid out of cash flow from these partnerships.

The amount due to parent is repayable on demand, bears interest at the bank prime rate plus ⅜% and is secured by an assignment and pledge of the Company's entire interest in certain limited partnerships. No principal repayments are required in 1987.

## 7. SHARE CAPITAL

| | **1986** | 1985 |
|---|---|---|
| | (in thousands) | |
| First Preferred Shares, authorized 100,000,000 shares issuable in one or more series; | | |
| Issued: Nil | **$ —** | $ — |
| Second Preferred Shares, authorized 100,000,000 shares issuable in one or more series; | | |
| Issued: 225,000 12% cumulative redeemable convertible Series B shares (1985 — 225,000 shares) | **2,250** | 2,250 |
| 1,224,924 7% cumulative redeemable Series C shares (1985 - nil) | **4,961** | — |
| Common Shares, authorized - unlimited shares; | | |
| Issued: 8,297,098 shares (1985 — 3,316,798) | **26,251** | 20,306 |
| | **$33,462** | $22,556 |

(a) On June 26, 1986, the shareholders of the Company approved a special resolution to reorganize the Company's share capital as follows:

(i) consolidate the issued and outstanding Common Shares on the basis of one new Common Share for each ten old Common Shares previously outstanding;

(ii) increase the number of Common Shares that the Company may issue to an unlimited number.

On November 19, 1986, the shareholders approved a special resolution to create a new series of Second Preferred Shares, the Second Preferred Shares, Series C.

(b) The Second Preferred Shares, Series B, may be converted to Common Shares at $6.26 per Common Share until April 30, 1987, and shall be redeemed by the Company if the average price of Common Shares exceeds 125% of the conversion price for a period of 20 consecutive trading days.

(c) During the year the Company issued 1,224,924 7% Cumulative Redeemable Second Preferred Shares, Series C, with a stated value of $4.05 in exchange for similar shares of a subsidiary. The Second Preferred Shares, Series C, are retractable at the option of the holder on January 1, 1991, at a price of $4.05. The shares are redeemable on January 1, 1995, or at any time thereafter at a price of $4.05.

(d) During the year, after giving effect to the consolidation of issued and outstanding Common Shares, 19,700 Common Shares were redeemed and cancelled for $35,000. On December 30, 1986, the Company sold 5,000,000 Common Shares by private placement to its parent company at $1.20 per share; share issue expenses in connection with the sale amounted to $20,000.

(e) As at December 31, 1986, the Company has reserved Common Shares as follows:

(i) 359,425 shares for the conversion of 225,000 Second Preferred Shares, Series B.

(ii) 119,433 shares under stock option agreements granted to officers and senior employees of the Company. These options become exercisable at various times at a price of $1.20 per share and expire on the earlier of termination of employment and February 14, 1995.

(f) On June 29, 1984, the shareholders approved an extraordinary resolution to reduce the common share capital of the Company by $11,777,000, thereby eliminating the deficit as at December 31, 1983.

## 8. LEASE OBLIGATIONS

The Company has lease obligations covering gas plant equipment and office premises as follows: 1987 — 1,801,000; 1988 — 1,929,000; 1989 — 1,936,000; 1990 — 1,936,000; 1991 — 1,936,000; thereafter, $1,936,000 per year until 1996.

## 9. INCOME TAXES

Income tax expense varies from the amounts that would be computed by applying the Canadian federal and provincial income tax rates to earnings before income taxes and extraordinary items as shown below:

| | **1986** | 1985 |
|---|---|---|
| | (in thousands) | |
| Effective Canadian tax rate | **47%** | 47% |
| Computed "expected" income taxes | $ 148 | $ 847 |
| Increase (decrease) in income taxes resulting from: | | |
| Non-deductible crown payments | 337 | 426 |
| Resource allowance | (278) | (486) |
| Earned depletion | — | (60) |
| Alberta Royalty Tax Credit | (138) | (120) |
| Non-deductible depletion | 208 | 156 |
| Other | 2 | 2 |
| Provision for taxes on acquisition | — | 70 |
| Actual income tax provision | $ 279 | $ 835 |

## 10. RELATED PARTY TRANSACTIONS

(a) During the year the Company performed management and geological services for, and received financing and advances in the normal course of business from various limited partnerships for which it acts as general partner.

(b) In December, 1986, the Company sold to its parent company its interest in a partnership owning certain gas processing facilities for proceeds of approximately $4.8 million.

# Corporate Information

**Officers and Senior Management**
Louis D'Abadie,
Land Manager

Nick H. Antonenko
Operations Manager

Roger H. G. Baines
Chief Geologist

John A. Hagg
Chairman, President
and Chief Executive Officer

Karen M. Hutson
Controller

S. Barry Jackson
Vice-President

Brian K. Lemke
Treasurer and Corporate Secretary

Carl J. Svoboda
Chief Engineer

**Directors**
Jack C. Lee, Calgary (1)
President,
Facet Resources Ltd.

John A. Hagg, Calgary
Chairman and
President of the Company

Michael M. Kanovsky, Calgary
President,
Canadian Northstar Corporation

James A. Kishpaugh, Oklahoma City
Chairman and Chief Executive Officer,
Texas International Company

Douglas W. Miller, Calgary
President,
Petroleum Division
Westmin Resources Limited

Peter W. Rainier, Calgary
President,
Unicorn Resources Ltd.

R. D. Barry Sullivan, Calgary
Lawyer and Businessman

(1) Not standing for re-election

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