NOVA, AN ALBERTA CORPORATION

Annual Report 1985

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Annual Meeting

Thursday, May 1, 1986, 10 a.m.
Calgary Convention Centre
120 Ninth Avenue S.E.
Calgary, Alberta

About the Cover

The map is a graphic representation of NOVA's activities worldwide, including facilities, projects and markets.

Dollar amounts in this report are stated in Canadian dollars unless otherwise specified.

Measurements throughout the report are stated in imperial units, as most of our shareholders have expressed a preference for this system.

NOVA, AN ALBERTA CORPORATION

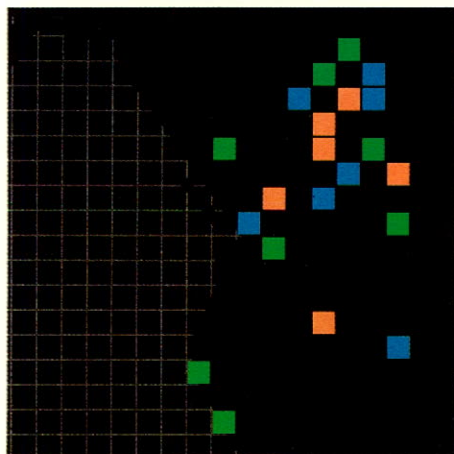
Incorporated by special act of the Province of Alberta, NOVA is a major Canadian energy company headquartered in Calgary.

The Company was created in 1954 to build, own and operate a province-wide natural gas transportation system. In recent years, NOVA has expanded its business base through development of additional energy-related activities.

Current areas of activity comprise gas transportation and marketing, petroleum, petrochemicals, manufacturing, consulting and research. Although most operations are located in Canada, products and services are marketed worldwide.

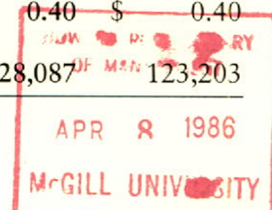
NOVA is a public, shareholder-owned company trading on the Toronto, Montreal and Alberta stock exchanges. Assets total $6.4 billion, and the NOVA companies employ about 7,800 people.

Consolidated Financial Highlights



(Thousands of dollars except for per share data)

Year ended December 31	1985	1984
Operating revenue	$3,347,236	$3,793,533
Net operating income	$ 673,572	$ 676,988
Income before extraordinary items	$ 134,111	$ 155,268
Extraordinary items	$ (216,522)	$ 48,082
Net income (loss)	$ (82,411)	$ 203,350
Earnings (loss) per common share		
Before extraordinary items		
Basic	$ 0.38	$ 0.63
Fully diluted	$ 0.38	$ 0.60
After extraordinary items		
Basic	$ (1.31)	$ 1.02
Fully diluted	$ (1.31)	$ 0.77
Dividends paid per Class "A" common share	$ 0.40	$ 0.40
Average number of common shares outstanding (thousands)	128,087	123,203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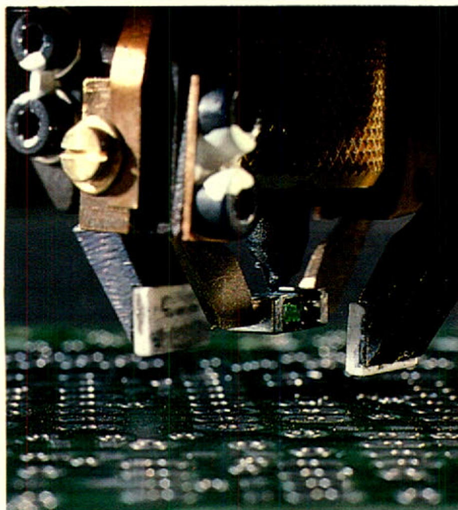
Report to Shareholders

Earnings per share growth, increased value in share prices and maintenance of the dividend level are major priorities for NOVA management.



Advanced technology, such as this robot arm used in manufacturing cellular telecommunication products, is being put to work throughout the NOVA companies.

At time of writing, crude oil prices have dropped very quickly and deeply to levels such as $12 (U.S.) for light crude and $10 (Canadian) for heavy crude, which if continued would cause tremendous adverse change in earnings, cash flow and petroleum development viability in North America.

The future financial consequences of such oil prices can not be evaluated clearly until more is understood of the adjustments that must occur in energy-based industries and government policies. The Company has begun preparing to meet any new situations it may encounter.

NOVA continues to be one of the strong and leading energy companies in Canada. Outlook over the longer term is positive, obligations for the present are met readily from a good cash flow position, and operations are profitable overall although certainly below our expectations for the mid-1980s.

For common shareholders, the market price of the shares showed superior performance from 1976 to 1981 (well above the average indices) but has since been followed by four straight years of trailing well below market averages. The Board and management are highly aware of the disappointment these last four years have caused and feel it acutely themselves.

In years of rapid growth encompassing construction of new petrochemical plants, aggressive new domestic heavy oil investment and the building of high technology industry in western Canada, there is limited ability for a large company to make sudden improvement which will translate into renewed growth in the market price of shares. However, the effort is unflagging and we believe the fundamentals are sound for the future. Shareholders may rely on every professional effort being given to all situations in this uncertain business climate.

EARNINGS

Earnings for 1985 at 38 cents per common share (before extraordinary items) were 40% below our original target. This was mainly because polyethylene market prices tumbled to a cyclical low of 22 cents (U.S.) per pound in April before recovering partially to 29 cents (U.S.) by December.

During the fourth quarter of 1985, with the crude oil price averaging about $29 (U.S.) per barrel and polyethylene prices averaging 28 cents (U.S.) per pound, the net income per common share (before extraordinary items) amounted to 14 cents and was substantially ahead of earnings performance during each of the first three quarters of 1985.

In the first few weeks of 1986, polyethylene prices have continued to firm and are being quoted at 33 cents (U.S.) per pound, contributing to net income performance. However, this improvement may be more than offset by the serious decline in crude oil prices through the contribution to NOVA of Husky Oil Ltd. (57% owned).

If the price of crude oil stays below $17 (U.S.) per barrel for the whole of 1986, with no adjustments to either the provincial or federal royalty and tax regimes, then earnings would probably be below those reported for 1985. At lower price levels, cash flow would be further reduced but will be sufficient to pay all present obligations and fund necessary capital programs.

Until the price of crude oil has stabilized, it is not possible to portray an accurate picture of the months ahead. However, even in these times, NOVA through its steady returns from rate base activities and certain other investments is well suited to conduct its range of business activity.

MANAGEMENT RESPONSIBILITIES

Management's present perspective of its main responsibilities in 1986 include:

- To continue to pursue, under all conditions, growth targets for earnings per share and increased value in the stock market price of the common shares.
- To rearrange steadily for better financial results from assets under our control.
- To control expense while maintaining strength for the future.
- To keep good upside potential in place for large future earnings when commodity prices increase.
- To build valuable technology and business at moderate or low investment cost.
- To maintain the common dividend as a priority.

1985 OVERVIEW

In Gas Transportation & Marketing, the Company has a steady source of net operating income. Income contributions of the Alberta Gas Transmission Division were level at $87 million in 1985 and will be about the same in 1986. The regular need of our customers for additional gas gathering service keeps the Company's rate base growing modestly. This division operates one of the largest gas pipeline systems in North America and, during 1985, it moved record volumes of 2.25 trillion cubic feet of natural gas. This increase was accompanied by another reduction in average charges for transmission service, which have declined over three consecutive years from 27 cents per thousand cubic feet in 1983 to 24 cents per thousand cubic feet in 1985.

In other gas transportation investments, there was modest decline in operating income from Foothills Pipe Lines (Yukon) Ltd. and Trans Québec & Maritimes Pipeline Inc. (both 50% owned) to the extent of normal rate base depreciation. There was also a new contribution in income from Novacorp Pipelines Ltd., a wholly owned subsidiary providing gas transportation service to industrial customers outside of the overall rate system of the Alberta Gas Transmission Division.

In 1985, the gas pipeline industry in the United States began to experience great changes brought about by deregulation and the rapid decline of natural gas prices. This was combined with corresponding changes in Canada to achieve better flexibility in marketing gas to the United States. These changes in the natural gas business will be increasingly important to Canada in 1986, and the effects will continue for several years. It is a period when Foothills and Pan-Alberta Gas Ltd. (50% owned), both heavily dependent on U.S. gas customers, are making considerable adjustments.

However, the policy in our Alberta Gas Transmission Division has always been to provide a universal service to all present and prospective customers, to move gas to any point upon request without limiting service to others for reasons of our own marketing activities, and to charge the same tariffs for all comparable transmission operations. These are the policies to which other gas pipeline operators are being pushed by regulatory reforms governing the industry. Basically, we are already there.

In Petroleum operations, 1985 was an excellent year for Husky Oil which reported net income of $126 million after taxes, and also for the Company's wholly owned Novalta Resources Ltd. which contributed over $4 million of earnings after taxes. As emphasized at the beginning of this report, 1986 has started as a very difficult year for Husky in respect to earnings. Some achievements in 1985 will help both Husky and Novalta, while others will not produce financial results for several years but have certainly added to asset values.

Novalta Resources increased gross proven and probable gas reserves by 28% for a year-end total of 475 billion cubic feet and gross proven and probable oil and natural gas liquids reserves by 55% for a year-end total of 7.4 million barrels.

Husky's exploration, development and enhanced oil recovery efforts added gross proved and probable reserves of 2.3 million barrels of conventional oil and 27.9 million barrels of heavy oil in the Western Canadian Basin. Husky also added 140 million barrels of light oil potential reserves and several hundred billion cubic feet of potential gas reserves in the Canadian frontier areas.

In Petrochemicals, we experienced great difficulty with the financial results of our polyethylene operation in 1985. Meanwhile, manufacturing operations of our wholly owned Alberta Gas Ethylene Company contributed good profits under contracted cost-of-service arrangements. Our methanol company, Alberta Gas Chemicals Ltd. (50% owned), continued to experience low market prices and had a small operating loss. During the year, we sold our half interest in Diamond Shamrock Alberta Gas and are now completely out of the polyvinyl chloride business.

Petrochemicals results are expected to be better overall in 1986,

largely because of the strengthening polyethylene price, but also because improvements are being made constantly in operations and through the marketing of increased production. The extraordinary loss taken on our polyethylene investment for 1985 was disturbing because that manufacturing plant is brand new, state of the art in design, and has shown it can operate at over-nameplate capacity. However, we came to the realization that the projections made when the investment was committed in 1982, for prices and margins in 1985 and beyond, were not likely to occur. Therefore, the investment was written down to a level we believe can be profitable in the years ahead.

In Manufacturing, the Grove Valve companies (100% owned) did well in 1985 and are steady profit contributors in early 1986. The best results have come from our Italian company and, during 1985, our U.S. company was placed under the direction of the senior Italian management. In 1986, this arrangement will be completed by the actual purchase of the U.S. company by the Italian company so that our valve business will be completely integrated internationally. In NovAtel Communications Ltd. (50% owned), we recorded another loss in 1985; however, we believe this new business could be a profit contributor in 1986.

Novacorp International Consulting Ltd., our wholly owned engineering subsidiary, is a competitive bidder on several of the world's larger gas pipeline projects being tendered in early 1986, so we hope it will produce sufficient revenues to cover all costs and perhaps contribute a profit. The start-up of an international operation, based on the expertise built up in NOVA over 30 years, is a valid and logical business objective. We are committed to its success, already demonstrated in several small projects throughout the world.

One of our most successful projects commercially was the construction of the Company's head office building for $104 million in 1981 and its sale in 1985 for $175 million. The 12-year leaseback will furnish space at rental rates considered reasonable in this market, and the gain on the sale will contribute positively to earnings per share for the next several years.

Chairman Robert Blair (right) and recently appointed President Robert Pierce, both of whom serve as NOVA directors, confer prior to the monthly board meeting.

In November, two members of the Board of Directors resigned to move on to senior government positions. Donald R. Getty became Premier of Alberta. In his seven years on our Board, he was a great source of business and investment policy suggestion. J. Edward Baugh was a director for the last three years and had also been a director for 10 years in a previous term. Throughout all of those years, his knowledge of the oil and gas business in Alberta was of real help to his colleagues.

Subsequently, Dr. Edward W. Best was appointed a director to succeed Mr. Baugh.

About 2,000 of NOVA's management and other employees own over 2.5 million of the Company's common shares. It is positive that, after the approximately 200 investment institutions that own some 80% of the common shares, 10% of the remaining shares are held by individual employee investors.

These are far from easy years, and many things get done well through very hard work that is not really visible when attention is focused on overall results. Despite the significant effects commodity price changes have on our financial results, major improvements have been made in both operating and administrative functions. This report provides one of the occasional opportunities to commend the other management and staff of the Company for their diligent and very positive performance.

S. Robert Blair, Chairman
and Chief Executive Officer

Robert L. Pierce,
President

March 14, 1986

Board of Directors

William A. Howard, left, and H. J. Sanders Pearson. Mr. Pearson is vice chairman of the Board and chairman of the management resources and compensation committee. Mr. Howard is a member of that committee.

From left, Frederick A. McKinnon, A. Ernest Pallister, Arthur J. E. Child and Ronald D. Southern. Messrs. McKinnon and Southern are members of the audit committee; Mr. Child, of the management resources and compensation committee.

Far photo, clockwise from left, Edward W. Best, John R. McCaig, J. Joseph Healy and Daryl K. Seaman. Near photo, Peter L. P. Macdonnell, left, and Harley N. Hotchkiss. Mr. Macdonnell chairs the audit committee, of which Mr. McCaig is a member; Mr. Seaman is a member of the management resources and compensation committee.

Commentary on International Marketing

Over the past decade, NOVA has positioned itself for growth in the international market through a series of strategies centred on development of technology and expansion of the Company's capital base.

Containers of polyethylene resin from NOVA's Alberta plant are loaded in Vancouver for delivery to customers in the Pacific Rim.

The evolution of NOVA from a provincial pipeline company with restricted growth potential to an international organization with most of its activities tied to the world marketplace is now complete.

The Company today is a highly technological corporation with three main operating sectors and several smaller, potentially lucrative profit centres. With state-of-the-art operations and a strong capital base, NOVA is well positioned for growth and expansion in these new markets.

Since trade has become so important to our financial performance, this special report has been included to provide shareholders with an appreciation of the scope and implications of that activity.

Although commodity prices have been weak in many sectors that are key to NOVA and the outlook for the world's economy is currently uncertain in some areas, we expect to maintain the principal elements of our portfolio of investments, which should provide significant profits when cyclical markets turn upward. As a major, Canadian-owned corporation, we can—and must—compete in international markets to best serve our shareholders.

Over the past 10 years of expansion, NOVA has concentrated its efforts on the development of technological excellence, hands-on expertise and international marketing techniques. To remain in step with the changing world trade environment, we will continue to develop and refine these skills to allow us to compete worldwide.

And since unrestricted access to international markets can only enhance the Company's ability to compete, we support fully Canada's efforts to achieve freer trade with the United States, our major trading partner, and with the rest of the world. In addition to favouring bilateral free trade with the United States, the Company supports the ongoing efforts of most of the industrialized world to achieve multilateral free trade through the General Agreement on Tariffs and Trade negotiations.

We have moved carefully and deliberately to enhance our ability to compete internationally in all major operating sectors. Hard marketing efforts continue to position NOVA for success in established industries such as commodity petrochemicals and engineering services, as well as developing industries such as cellular telephones.

PIPELINE OPERATIONS PROVIDE VALUABLE MARKETING EXPERTISE

In natural gas transmission and marketing—the base of our activities—NOVA has earned valuable experience in pipeline planning, construction and operation through the design and management of the Alberta gas transmission system, one of the most technologically advanced pipeline systems in the world. Almost completely automated and operating with highly specialized technology, the system gives NOVA valuable expertise that is marketed around the world by Novacorp International Consulting Ltd.

Novacorp made progress in several parts of the world last year, including two successful engineering bids for pipeline construction projects in China and activity in several other Pacific Rim countries. That company has been operating for only a short time, but its early

success has helped it establish a reputation as a world-class consulting organization.

NOVA is also involved in natural gas exports through two subsidiaries: Foothills Pipe Lines (Yukon) Ltd., which operates the southern or "prebuild" section of the Alaska Highway Gas Pipeline, and Pan-Alberta Gas Ltd., a gas marketing company with contracts to sell over one billion cubic feet per day to buyers in the United States.

Gas exports have been under severe pricing pressure in recent years and volumes sold have been erratic—higher in some markets, lower in others, with demand changing dramatically over short time periods—as the United States works through a current surplus of domestic gas supply. However, regulatory changes are under way that will alter the face of gas transportation and marketing in both the United States and Canada.

As the two countries move toward a market-sensitive pricing and distribution system—and U.S. gas reserves continue to decline—NOVA expects exports will increase and the industry will assume new significance in the early 1990s. Since our distribution and marketing systems are already established, the Company is well placed to profit as the industry expands.

PRODUCTS DEPENDENT ON EXPORT SALES

NOVA is active internationally in petroleum production and sales through its majority ownership of Husky Oil Ltd., one of the largest Canadian-owned integrated oil companies. Husky is recognized as an industry leader in the development and production of heavy oil, a thick and viscous substance found in abundance in Alberta and Saskatchewan.

At present, most of Husky's heavy oil production is exported to the United States for uses including asphalt in road-building projects. These oil exports are an important source of revenue.

In the commodity petrochemical business, we are a major participant in the development of a world-scale industry in Alberta. From a standing start in the mid-1970s, NOVA is now, on an asset basis, one of the largest petrochemical companies in Canada.

For products such as ethylene, linear low-density polyethylene and methanol, NOVA's state-of-the-art facilities are operating efficiently. More than 75% of our production is exported to customers in the United States, Europe and the Pacific Rim countries.

NOVA and other companies have invested close to $5 billion in petrochemical plants in western Canada over the past 10 years on the sound belief that petrochemical production from the area can compete in world markets. Performance was disappointing last year as the industry worldwide continued to experience persistent overcapacity and associated low prices. However, we believe most of the negative factors affecting the market have dissipated and the outlook is beginning to appear more positive.

But a significant problem remains: Trade access and tariff policies are crucial to this industry. Most of our production is exported to the United States and these exports must cross tariff barriers ranging from 10% to 18%. A bilateral and comprehensive free trade agreement with the United States would remove this significant disadvantage, so that is, in part, why NOVA is lending support and active participation to discussions on this topic.

CELLULAR JOINT VENTURE HAS GROWTH POTENTIAL

In manufacturing, NOVA has developed a series of complementary investments that we expect will provide profit in the future. One of the most promising of these profit centres is NovAtel Communications Ltd., a joint venture company owned equally by NOVA and Alberta Government Telephones.

In 1985, its third year of operation, shipments by NovAtel suggest that it has become the fourth largest supplier of cellular telephones for the North American market. Despite an extremely competitive environment, that company won contracts in 1985 in the United States, England, China and, of course, Canada. We expect about 80% of NovAtel's mobile products to be sold in international markets.

To sum up, NOVA has achieved the size and scope it needs to compete around the world. We have demonstrated our expertise in several areas—oil and gas marketing, pipeline engineering, petrochemicals, cellular telephones, and consulting and research. And since we are committed to the international arena, we will continue to work for unrestricted access to markets because trade liberalization will be of direct benefit to our shareholders and employees.

Gas Transportation & Marketing

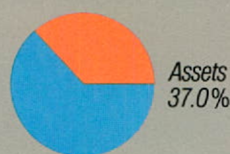
For the second straight year, NOVA's Alberta gas transmission system moved record volumes of Canadian gas for customers in Canada and the United States. Deliveries are expected to continue at high levels in 1986.

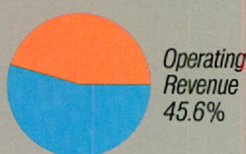
Investments in natural gas transportation include the 100%-owned Alberta gas gathering and transmission system, and 50% ownership of Foothills Pipe Lines (Yukon) Ltd. and Trans Québec & Maritimes Pipeline Inc. NOVA also owns 50.005% of Pan-Alberta Gas Ltd., a major Canadian marketer of natural gas.

GAS RECEIPTS REACH RECORD LEVEL FOR SECOND YEAR IN A ROW

For the second straight year, NOVA's Alberta Gas Transmission Division moved record volumes of natural gas through its system, as petrochemical production and demand for Alberta gas in Canada and the United States continued to increase.

1985 Gas Transportation & Marketing Contribution





The NOVA system in Alberta transported a record 2.25 trillion cubic feet in 1985, an increase of 11.4% over deliveries of 2.02 trillion cubic feet in 1984, as a result of industrial growth in Alberta, continued expansion of markets in Quebec and increased deliveries to the United States owing to price-related contract renegotiations.

A record 1.83 trillion cubic feet was exported from the province, including 424.1 billion cubic feet destined for California and a record 150.0 billion cubic feet delivered to the U.S. Midwest via the Foothills pipeline system. Daily export volumes reached a peak of 6.79 billion cubic feet on December 27, 1985.

Deliveries within Alberta totalled 413.6 billion cubic feet, up 15.9% over 1984 volumes of 356.9 billion cubic feet. Daily deliveries remained high throughout the year and a record day delivery of 1.88 billion cubic feet was set on November 26, 1985. Growth in the Alberta market is due primarily to development of the province's petrochemical industry, the largest growth market for Alberta gas in recent years.

Transportation service rates, which averaged 24 cents per thousand cubic feet overall in 1985, continued to decline as a result of ongoing cost control and improved throughput. The NOVA average postage stamp rate charged on exports from the province was 25 cents per thousand cubic feet and charges for transmission service for delivery within the province were lower than the export service rate.

At December 31, 1985, NOVA's system comprised 8,559 miles of pipeline, 37 compressor stations with a combined compression rating of 539,862 horsepower, and 756 receipt and major delivery points. The 1985 rate of return, set on a rate base of $1.3 billion, was 13.67% and incorporated a 15% rate of return on a deemed 32% common equity.

NEW CANADIAN GAS POLICIES SET STAGE FOR PERIOD OF CONTINUED GROWTH

Canadian gas policy changes, aimed at deregulation of the industry by November 1, 1986, set the stage for continued growth in deliveries of Alberta natural gas.

The open market contemplated

by the agreement will increase the workload to NOVA's Alberta Gas Transmission Division, particularly in areas such as system planning, gas control, measurement, rates and contract administration, because of additional customers and more contracts dealing with smaller sales.

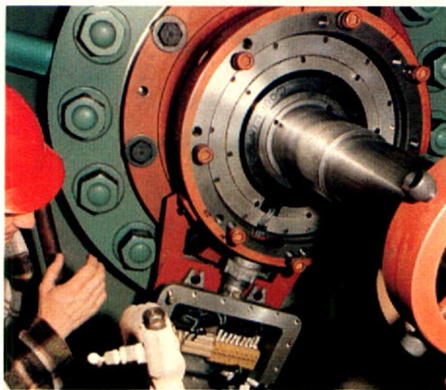
As part of the deregulation process, NOVA has initiated discussions with gas shippers and producers to review the existing rate structure, taking into account all of the legislative changes now in place and those expected during the year.

CAPITAL SPENDING TO INCREASE

Capital spending for pipeline system expansion in Alberta is budgeted to rise to about $110 million this year from some $74 million in 1985.

As Canada and the United States move to a deregulated market for gas—and U.S. reserves are diminished —NOVA expects demand for Canadian gas to rise sharply starting in the late 1980s.

The system, operating at record levels for the past two years, will be expanded as required by adding looping and compression to increase throughput capability and by constructing lateral pipelines designed to connect Alberta gas that has been shut in for several years.



New magnetic bearing technology, installed at NOVA's Hussar facility, increases compressor operating efficiency.

Currently, design work is under way on major projects at Tanghe Creek in northern Alberta and Milo in south-central Alberta. The Tanghe Creek project comprises a meter station, 44 miles of 12-inch lateral pipeline and a three-inch parallel pipeline for natural gas condensate. At Milo, a meter station and 25 miles of eight-inch pipeline are planned for construction. The Company is also building two new compressor stations, with a combined compression rating of 6,610 horsepower, at Pelican Lake and Buffalo Creek in the northeastern part of the province.

In 1985, about 140 miles of small-diameter pipeline were installed at various locations around the province and one new compressor station was built near Whitecourt, Alberta.

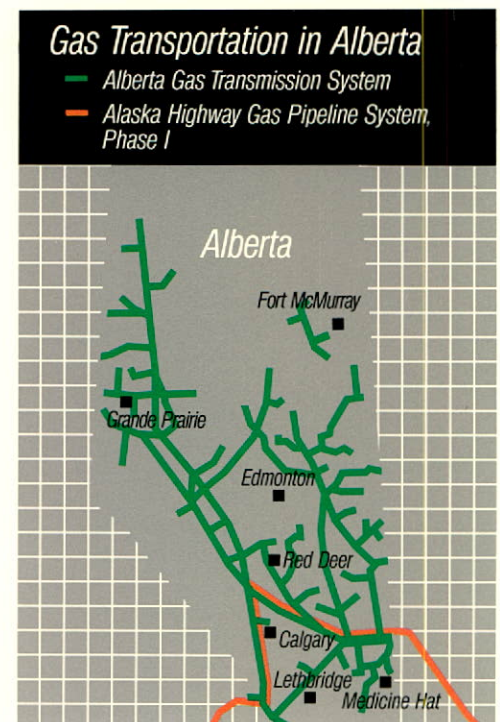
NOVA also opened a new service centre during 1985 on a 50-acre site at Airdrie, Alberta.

NEW TECHNOLOGY MORE EFFICIENT, EFFECTIVE

New technology has been developed that allows NOVA to operate its gas pipeline centrifugal compressors without the use of oil.

An active magnetic bearing that rotates free of contact with its surroundings and a mechanical dry seal that eliminates the need for lubricant have been installed in some of NOVA's equipment. The new process can reduce operating expenses by 10% or more, depending on the application, and increases overall efficiency of compressor systems.

A group of specialized employees has been formed to further develop and install the new bearings in NOVA equipment and to market the technology to others. NOVA holds exclusive rights to sell the magnetic bearings in the western hemisphere for the oil, gas and petrochemical industries. International marketing efforts are being conducted in conjunction with Novacorp International Consulting Ltd.



FOOTHILLS FOCUSES EFFORTS ON MAXIMIZING USE OF PHASE I PIPELINE

Efforts to increase deliveries of natural gas to U.S. buyers will intensify this year as Foothills Pipe Lines (Yukon) Ltd. seeks to optimize use of Phase I of the Alaska Highway Gas Pipeline system to ensure maximum efficiency.

The western leg operated at its capacity of 240 million cubic feet per day in 1985; the eastern leg, with current transportation contracts of 975 million cubic feet of gas daily, operated at about a 40% load factor. Foothills' objectives are to make maximum use of existing capacity and to expand the eastern leg to its optimum design capacity as volumes demand. With the addition of compression at a relatively modest cost, this leg could move 1.8 billion cubic feet per day.

Although total deliveries of Alberta gas to the United States are

not expected to rise dramatically this year, Foothills hopes to increase its deliveries as a result of existing customers taking more gas.

Also under examination are various methods of using the pipeline to transport additional gas recently authorized for sale to U.S. buyers. The eastern leg cuts across several major U.S. pipelines; by establishing a system of displacement/exchange for Canadian exports, access could be gained to most major U.S. gas markets.

An application to expand the eastern leg will be filed this year with Canadian and U.S. regulatory agencies but it is not expected that hearings will be held until 1987.

At the end of 1985, the eastern and western legs comprised 528 miles of pipeline, four compressor stations with a combined compression rating of about 142,000 horsepower, and two meter stations. The rate of return during the year, determined on an average rate base of $731 million, was 12.52%.

NEW LATERALS HIKE TQM GAS DELIVERIES

Natural gas deliveries in Quebec last year increased to about 85 billion cubic feet from 65 billion cubic feet in 1984 as Trans Québec & Maritimes Pipeline (TQM) increased the use of pipeline laterals built to service industrial customers north of Quebec City. Above-average increases in Quebec deliveries are expected in 1986.

In the fall of 1985, the National Energy Board set a monthly toll on the TQM system at $7.2 million and authorized a 13.2% rate of return on a rate base of $428.5 million, with a 14.75% after-tax return to a 25% equity component.

TQM facilities comprise 213 miles of pipeline, 10 meter stations and five sales taps.

Also in 1985, TQM announced the appointment of Robert Turgeon as president. Mr. Turgeon, an employee since 1981, was most recently vice president, administration. He replaced Benoit Baribeau, who retired last November.

PAN-ALBERTA GEARS UP FOR EXPANSION UNDER NEW SALES RULES

Pan-Alberta Gas Ltd., NOVA's gas marketing affiliate, had total sales of 260 billion cubic feet in 1985, up 24% from 1984, with customers in California taking all contracted volumes for the entire year. About 90% of Pan-Alberta's sales are made to U.S. buyers. Although total industry gas sales are not expected to grow significantly in 1986, Pan-Alberta hopes to increase its share of the market through the use of innovative and aggressive marketing techniques. Recent changes in Canadian gas policies make it possible for Canadian gas to compete with U.S. gas in markets that were previously inaccessible.

Early this year, Pan-Alberta announced the signing of several sales agreements, including a new contract with a Houston-based natural gas marketer, to export up to 200 million cubic feet per day of Canadian gas.

Pan-Alberta has also formed two gas marketing organizations. Natgas (U.S.) Inc., incorporated in Delaware, will seek out and develop short-term sales contracts with U.S. buyers. It has applied to U.S. regulatory officials for blanket approval to import up to 730 billion cubic feet of Canadian gas over a two-year period commencing on the date of first delivery. Natgas Canada Inc., headquartered in Calgary, will perform similar functions in Canada. It has authorization to export up to 70 million cubic feet per day, through December 1987, at two export points in British Columbia.

A total 2.7 trillion cubic feet of Canadian natural gas was marketed in 1985, more than a third of it into the U.S. Gas going to California passes through NOVA's meter station on the Alberta-British Columbia border.

Petroleum

NOVA's petroleum activities are carried out through Husky Oil Ltd. (57% owned) and Novalta Resources Ltd. (100% owned). Husky, which publishes its own annual report, is a major Canadian-owned integrated oil company. Novalta Resources is a small oil and gas producer with activities centred in Alberta.

FRONTIER EXPLORATION YIELDS SIGNIFICANT DISCOVERIES

Husky participated in 11 wells drilled in Canada's frontier exploration areas in 1985 and early 1986, maintaining its position as one of the most active Canadian participants in offshore exploration, with interests in over five million gross acres of land.

On the East Coast, Husky was involved in two significant oil discoveries on the Grand Banks off Newfoundland and two natural gas finds on the Scotian Shelf off Nova Scotia.

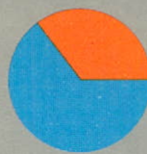
In the Grand Banks area, North Ben Nevis P-93 tested oil from two zones at a cumulative rate of 6,760 barrels per day. A third zone tested gas at 16.8 million cubic feet per day and 576 barrels of condensate per day. Test results indicate the reservoir would support daily oil production of more than 12,000 barrels. A follow-up well is currently drilling. At Whiterose J-49, oil flowed at a cumulative rate of 3,098 barrels per day from the second well drilled on the structure. A third well is being drilled to further delineate the discovery. Three additional wells on the Grand Banks were abandoned.

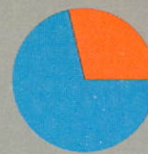
On the Scotian Shelf, Chebucto K-90 tested natural gas and condensate from three zones at cumulative rates of 44.5 million cubic feet per day and 324 barrels per day. A second well will be drilled in 1986. Early this year, tests of two productive zones at North Triumph G-43 produced at daily rates of 72.2 million cubic feet of gas and 360 barrels of condensate. The drilling of a follow-up well is under way. Two additional wells drilled on the Scotian Shelf were abandoned.

In the Beaufort Sea, a second successful well was drilled on the Amauligak structure. Four tests of this well, Amauligak I-65, produced flow rates of between 6,800 and 7,500 barrels per day, the highest rates recorded from a frontier well in Canada. The flow rate for a fifth test was about 4,800 barrels per day. Discovered in 1984, the Amauligak structure has potential reserves of 500 to 800 million barrels of oil. It is considered the best discovery to date in the area and the most likely candidate for early development. Additional delineation drilling will continue in 1986.

Several promising oil and gas discoveries were made in Canada's eastern and northern frontiers during 1985, and development in the heavy oil areas of Alberta and Saskatchewan continued to progress.

1985 Petroleum Contribution


Assets
35.7%


Operating Revenue
28.8%

Net Operating Income
39.6%

ACTIVITIES INCREASE IN WESTERN CANADA

Husky, an established industry leader in heavy oil activities, made significant progress in 1985 as record levels of production and drilling were achieved, in addition to a strong exploration and land acquisition program.

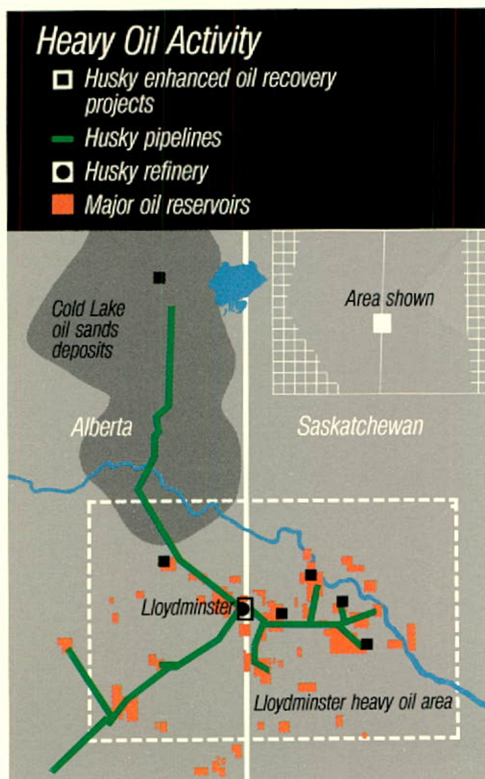
Some 419 net development wells

were drilled, including 92 wells drilled as part of Husky's 1985 enhanced oil recovery (EOR) program, which is designed to evaluate experimental oil recovery techniques such as cyclic steam injection, steamflooding and fireflooding.

EOR projects contributed over 7,000 barrels per day to total gross heavy oil production of 34,314 barrels per day. Production of light oil averaged 9,991 barrels per day and natural gas sales averaged 62.6 million cubic feet per day.

Exploratory drilling for both heavy and light oil continued at high levels last year. In 1986, heavy oil exploratory drilling is projected at 33 gross wells, mainly in the Primrose Lake, Cold Lake and Beacon Hill areas. An exploration program that includes drilling 85 wells over a three-year period began early this year on the Caribou Lake block in the Primrose Lake area. Land acquisition programs will continue in 1986.

More detailed information on



Husky has a 17.5% interest in the Amauligak oil structure, considered the best discovery to date in the Beaufort Sea and a prime candidate for early development.

Husky's 1985 exploration and production activity in western Canada can be found in the Husky annual report.

BLENDED CRUDE, ASPHALT SALES REMAIN STRONG

Sales of both blended crude oil and asphalt remained strong in 1985 as Husky's refining and marketing division continued to develop new and existing markets in Canada and the United States.

Blended crude oil sales rose 18% to average 95,330 barrels per day and asphalt deliveries set a record for the third consecutive year at 7,810 barrels per day, up 31% from 1984. Sales of light oil rose slightly to average 12,430 barrels per day.

Husky's two refineries are located at Lloydminster, Alberta, and Prince George, British Columbia. The Lloydminster refinery recorded throughput of 14,440 barrels per day, up 9% from 1984, and the Prince George refinery averaged 6,400 barrels per day, up 4% from 1984. Respectively, the refineries have daily design capacities of 25,000 barrels and 10,000 barrels.

Husky's retail marketing network, extending from Vancouver Island to the Ontario/Quebec border, is continually upgraded through a controlled program of remodelling and new construction. In 1985, some $7 million was invested in the renovation and construction of diversified service facilities.

NOVALTA RESOURCES SHOWS STRONG PERFORMANCE

Novalta Resources Ltd., a wholly owned oil and gas exploration company, continued to show operating profit in 1985 on the strength of strong increases in both oil and natural gas production.

Gas production rose 13% to an average of 35 million cubic feet per day, compared with 31 million cubic feet per day in 1984. Oil production increased by about 20% to an average of 453 barrels per day, compared with 385 barrels per day in 1984.

Novalta drilled 53 gross (30 net) wells in 1985, which resulted in 18 gross (5 net) oil discoveries and 22 gross (16 net) gas discoveries, for a drilling success rate of 76%.

Novalta's landholdings total 1.3 million gross (700,000 net) acres. During the year, a natural gas plant and gathering system capable of processing 22 million cubic feet per day was constructed in the West Edson area and sales commenced in late 1985.

Novalta will continue to direct a substantial portion of its exploratory efforts towards medium- and long-term opportunities arising from the NOVA group's activities in western Canada.

Petrochemicals

NOVA's petrochemical assets, totalling $1.2 billion, are managed by wholly owned Novacor Chemicals Ltd. Based on these assets—developed over the past 10 years—Novacor has become one of the largest petrochemical companies in Canada.

Novacor operates facilities for the production of ethylene and polyethylene, and manages NOVA's investment in ethane extraction and gathering systems, product pipelines and storage facilities. It also oversees NOVA's 50% interest in methanol production facilities at Medicine Hat, Alberta, owned by Alberta Gas Chemicals Ltd.

The majority of Novacor's petrochemical production is exported, mainly to the United States and the Pacific Rim countries.

FEEDSTOCK PRICING TO BE NEGOTIATED

Novacor, together with other companies which operate ethane-based petrochemical facilities, will be negotiating market-responsive prices for natural gas during 1986. Ethane feedstock is extracted from natural gas and used to produce ethylene, which is upgraded to produce a range of petrochemical commodities including polyethylene, styrene, vinyl chloride, ethylene glycol and vinyl acetate.

In the past, provincial legislation required the petrochemical industry to buy gas at the Alberta border price for exports. Late in 1984, the Alberta government determined that petrochemical producers should have access to market-responsive gas prices within the province, as is the case with other industrial users. A special program, in effect until June 30, 1986, was put in place, while producers and buyers negotiate new contracts.

Through 1985, the two ethylene plants, which provide product to customers on a cost-of-service basis, continued to operate reliably and efficiently. The design capacity of the two plants is 2.7 billion pounds of ethylene per year.

POLYETHYLENE MARKETS REGAIN SOME LOST GROUND

NOVA's polyethylene business was buffeted by severe price drops in the first half of 1985 as the industry worldwide tried to cope with overcapacity and flagging demand. Since the fall, however, demand and supply have been gradually coming into balance and a recent upward trend in prices is expected to continue this year.

The linear low-density polyethylene plant, designed for annual production of 600 million pounds of polyethylene resin, was completed ahead of schedule and under budget late in 1984. Production averaged 80% of capacity last year and reached 100% in the fourth quarter, a level which the Company hopes to maintain throughout 1986.

When production began in the summer of 1984, the price for polyethylene was 35 cents (U.S.) per pound. It declined steadily to a low of 22 cents (U.S.) in May and June before beginning a rise to the current quoted level of about 33

Despite severe market conditions worldwide, NOVA's petrochemical interests continued to operate reliably and efficiently last year. Commodity markets are expected to strengthen in 1986.

1985 Petrochemicals Contribution

NOVA's state-of-the-art plants at Joffre, Alberta, were designed to produce petrochemicals that are competitive in markets around the world.

cents (U.S.) per pound. The polyethylene business is forecast to improve this year based on the expectation that prices will maintain their current strength.

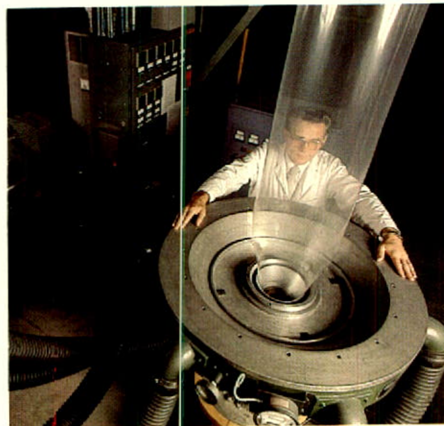
The carrying value of NOVA's plant has been written down to $125 million, and the Company believes that, at this new book value, the unit can provide sufficient cash flow from operations to recover its existing and future investment requirements.

METHANOL GROUP TESTS ALCOHOL/GASOLINE MARKET IN CANADA

Alberta Gas Chemicals, in conjunction with a major integrated oil company, began to test the market last year for a blend of unleaded gasoline and methanol at 16 service stations in Ontario.

For the first time in central Canada, the public can purchase a high octane blended fuel which also reduces engine emissions. The product is being tested as an alternative to regular unleaded gasoline and could provide a significant new market for methanol. Methanol is established as a viable gasoline blending component in several countries, including West Germany, New Zealand and parts of the United States.

Around the world, methanol continues to be in severe oversupply, causing depressed prices. Although little improvement is expected this year, Alberta Gas Chemicals expects to maintain its position as the world's leading merchant marketer of methanol.



Through extrusion, polyethylene resins are adapted to create a large variety of useful products.

Alberta Gas Chemicals' three methanol plants at Medicine Hat, Alberta, have a combined design capacity of 2,400 short tons per day. Production is sold primarily to customers in the Pacific Rim countries. That company also has a 49% interest in a New Zealand methanol plant with a design capacity of 1,320 short tons per day.

NOVACOR SELLS INTEREST IN PVC PLANT

Late in 1985, NOVA sold its 50% interest in the Diamond Shamrock Alberta Gas joint venture to B. F. Goodrich Canada Inc. The plant, located at Fort Saskatchewan, Alberta, has an annual capacity of 220 million pounds of polyvinyl chloride and employs about 100 people. The sale generated an after-tax gain to the Company of approximately $10 million.

NEW AMMONIA PLANT TO PROVIDE MARKET FOR HYDROGEN

Novacor has agreed to provide hydrogen to the owners of a proposed ammonia plant that will be built near the Company's petrochemical complex at Joffre, Alberta.

Hydrogen will be extracted from a co-produced gas stream at the ethylene plant site and will be piped to the ammonia plant, which is scheduled for construction this year and start-up in 1987.

Other Businesses

In addition to its primary businesses, NOVA has interests in international consulting, telecommunications, manufacturing, and research and development.

NOVACORP SUCCESSFUL IN CHINA, MALAYSIA; ACTIVE IN INDIA

Novacorp International Consulting Ltd., a wholly owned subsidiary, markets engineering and technical expertise to clients around the world.

In 1985, Novacorp won engineering contracts for the construction of two pipeline projects in China and participated in a feasibility study for a third. For the first time, employees lived and worked in that country. Future prospects in China are considered to be positive, given the anticipated level of oil and gas activity in that country and the beneficial working relationship that has been established over the years between the Chinese and Novacorp.

Novacorp was also active in Malaysia last year, where the first stage of the Peninsular Gas Utilisation Project was completed and commissioned in mid-year. A bid has been submitted to manage the second stage of the project.

Novacorp is leading a Canadian consortium seeking the contract to build an 1,100-mile gas pipeline system across India. The turnkey project includes four compressor stations, telecommunications and controls systems, and terminal facilities required for the operation of a large gas pipeline system. A decision on this major project is expected during the first half of this year.

During 1985, Novacorp was active in several other countries, including Thailand, Australia, New Zealand, Egypt, Hungary, Finland, Norway, Argentina, Peru, Ecuador, Pakistan, Colombia, Korea, Bahrain and Bangladesh. In addition, projects were completed in Canada and the United States.

TELECOMMUNICATIONS AFFILIATE POISED FOR GROWTH

NovAtel Communications Ltd. (50% owned) won contracts during 1985 in the United Kingdom, China and other countries that will broaden its marketing base. Last year, about 90% of total sales were in the United States. This year, with continued U.S. growth, that percentage is forecast to be about 66% of total sales, with the remainder achieved in domestic and other international markets.

NovAtel plans to sell more than 150,000 mobile telephones in world markets during 1986. Some 80% of these sales are already under contract.

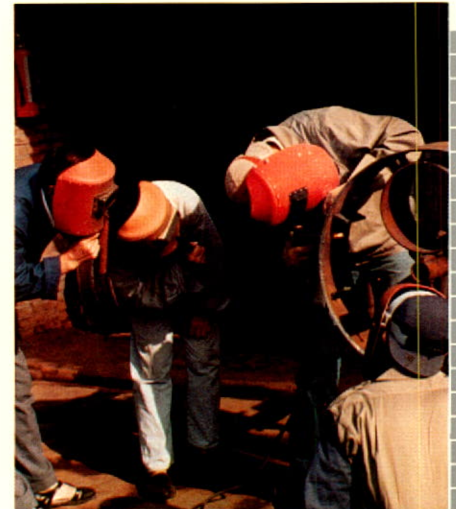
NovAtel accelerated product research and development activities dramatically last year and several new products were introduced. Additional products with new features will be introduced by mid-year and are expected to provide a significant edge over competitors.

NovAtel continues to increase productivity, partly as a result of consolidating production into a new, highly automated plant in Lethbridge, Alberta. This has created some 150 new jobs in Alberta.

MANUFACTURING OPERATIONS PROFITABLE DESPITE POOR MARKETS

Even though markets remained poor worldwide for pipeline valve and flow control products, NOVA's

NOVA's international consulting activities accelerated in 1985 as services were provided to several countries worldwide. Manufacturing operations did well in spite of weak world markets.



NOVA's consulting experts demonstrate techniques for Chinese welders during training sessions conducted in China last year.

wholly owned manufacturing facility, Grove Italia S.p.A. of Voghera, Italy, posted a profit of approximately $14 million in 1985 and is expected to remain profitable this year. In the United States, Grove Valve and Regulator Company, which has been scaled down to reflect current market conditions, had a small operating loss in 1985 and should break even in 1986. This is a dramatic improvement over the large losses of the previous two years.

The valve manufacturing operations were offered for sale in 1984. However, the initiative was halted in 1985 when it became clear a deal could not be struck that would reflect an adequate value for the companies and, in particular, for the Italian operation which has been consistently profitable since its formation in 1960. The two companies have been combined under the management of the Italian group, and action is under way to merge them into a single operating unit.

Western Star Trucks Inc. (50% owned) held its own in 1985 against tough competition in the manufacture and sale of heavy-duty trucks for North American and international markets. The U.S. market was particularly weak, and Western Star's dealer organization was faced with significant product oversupply as major competitors attempted to maintain their 1984 production rates despite reduced demand. Although unit sales for the year were near the 1984 level of 2,500 trucks, margins were negatively impacted. Western Star was aided substantially by the successful introduction of the 1986 model.

By prudent production cuts early in the year, profitable operations were maintained, although operating profits were reduced from 1984. The 1986 outlook is for a more orderly market, and Western Star expects overall results to improve.

CNG Fuel Systems (50% owned) also had a successful year in 1985, with a dramatic increase in business activity. Forty-five hundred vehicles were converted, 70 authorized dealerships activated and 40 refuelling stations installed.

In addition to the efforts of CNG Fuel Systems to encourage the use of compressed natural gas in vehicles, Novacorp Pressure Transport Ltd. (NPT), a 50%-owned subsidiary, is using trucks with specially designed trailers in northern Alberta to provide compressed fuel to the heavy oil industry and to towns and rural gas co-operatives on an emergency basis.

Technicians analyse circuit boards as part of ongoing quality control programs for NovAtel's cellular products.

RESEARCH GROUP SEEKS NEW TECHNOLOGY FOR NOVA APPLICATIONS

NOVA/Husky Research Corporation, formed in late 1981 to pursue research and development for both companies and their affiliates, continues to develop new technology that will benefit the NOVA group.

Research focuses on petroleum, petrochemical and pipeline technology. Particular areas of interest include heavy oil upgrading and enhanced recovery, gas dynamics and corrosion in pipeline systems, and polyethylene catalysis.

In addition, one group is working on methods of improving measurement and data collection in natural gas fields using equipment controlled by microprocessors. In 1985, the group developed an oil and gas well-control package that includes a remote data terminal unit and software which allow wells to be operated automatically, thereby increasing efficiency through reduced costs and increased production. Six units were installed in a gas field in New Mexico on a pilot basis for site evaluation.

The research group is also continuing to seek new ways of improving oil production through enhanced recovery techniques. Because it can limit production unless controlled, the flow of water in heavy oil reservoirs is a major problem facing the industry. NOVA/Husky researchers are developing an x-ray technique that provides three-dimensional photographs of oil and water flow in samples of reservoir rock. The technique allows scientists to study the effectiveness of water-flow control methods under field-like conditions; it is expected to result in designs that can be tested in the field.

Corporate Programs

NOVA SUPPORTS EXPO 86, WINTER OLYMPICS

NOVA has made commitments in conjunction with two major international events that will bring rich returns to western Canada and to the country as a whole over the next two years—Expo 86 and the XV Olympic Winter Games.

For Expo 86, NOVA is participating in a cross-Canada radio program, "Today at Expo," broadcast each weekday live from the Expo 86 site in Vancouver. The program will allow all Canadians a chance to share in this exciting world exposition. Funds to support the project have been redirected from the Company's annual advertising budget.

NOVA has also agreed to participate as a corporate sponsor of the Olympic Winter Games in Calgary in February 1988, contributing goods and services and providing some personnel to the groups responsible for organizing and managing the games. We do not expect any cash outlay for this project in 1986, as the major portion of the contribution is for space in NOVA facilities.

The Company also continues its ongoing program of contributions to non-profit voluntary organizations across the country and, during 1985, contributed about $1.5 million to these groups. The contributions budget is established each year, with funded programs falling into five major areas: health and welfare, education, arts and culture, civic activities and recreation.

In 1985, significant contributions were made to Skate Canada, the Fort Calgary Preservation Society (in conjunction with the National Parks Centennial Citizens' Committee), several United Way campaigns in cities in Alberta, major hospital campaigns throughout the country and The Canadian Encyclopedia project.

ENVIRONMENTAL GROUP TO MARKET EXPERTISE AROUND THE WORLD

NOVA's environmental group, already one of the most active organizations of its type in the Canadian industry, will increase activities this year by offering environment-related services to potential clients around the world.

Set up about 10 years ago, the group works primarily with NOVA's pipeline division to conduct environmental impact studies, obtain construction permits and ensure land reclamation programs are carried out when projects are completed. It also does research and development studies on issues such as soil conservation, chemical usage and corrosion.

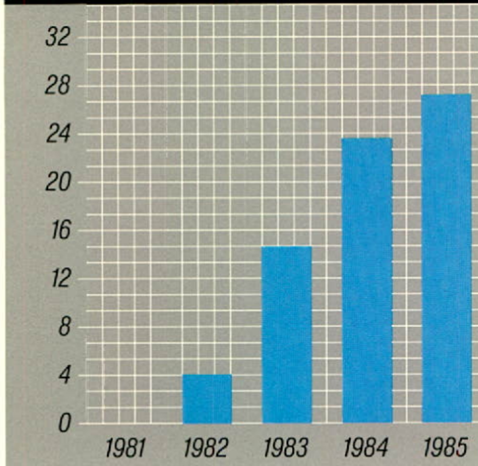
In addition, the group has developed a hazardous materials management training program for NOVA employees in the pipeline division. The program teaches participants how to handle, transport and dispose of hazardous materials such as mercury, methanol, lead acetate and corrosion inhibitors. The program is monitored by a special committee that includes experts from NOVA's occupational health and safety group.

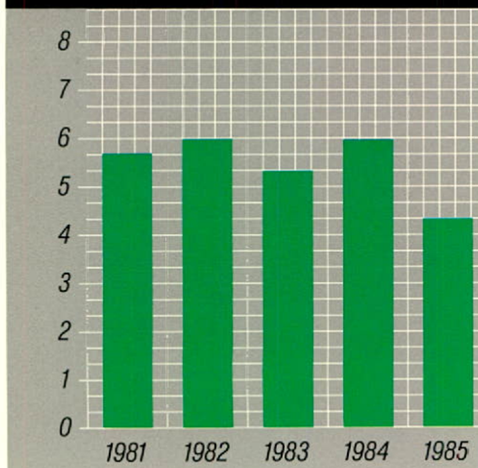
About 100 employees have taken the course and an additional 150 people will be involved this year. Plans are under way to offer the pipeline training program to other companies in Canada and internationally.

Protection of the environment is part of NOVA's normal business practice in activities both at home and around the world.

Prior to building pipelines through water, NOVA environmentalists analyse species of fish to ensure that spawning cycles are not disrupted.

Shareholder Information





NOVA shareholders are invited to attend the Company's annual meeting to be held on Thursday, May 1, 1986, at 10 a.m. in the Calgary Convention Centre, 120 Ninth Avenue S.E., Calgary, Alberta.

DIVIDEND REINVESTMENT PLAN BENEFITS SHAREHOLDERS

Since it was implemented in 1982, NOVA's dividend reinvestment and share purchase plan has attracted total investment of about $69 million and increased the number of Class "A" common shares outstanding by some 10.9 million shares.

Nearly a third of the common dividends paid by the Company are reinvested, mainly by institutional investors. The plan provides a convenient method for shareholders to reinvest dividends automatically on all or some of their NOVA shares—both common and preferred—at 95% of the weighted average sale price of Class "A" common shares on dividend payment dates.

It also allows shareholders to make cash payments of $50 to $5,000 per quarter to buy common shares at 100% of the same average sale price, and a small number of shareholders take advantage of this option.

Both options are offered to shareholders without any brokerage or administrative fees attached. The plan is not available to residents of the United States.

Shareholders seeking additional information on the plan are invited to contact the transfer agent charged with its administration: National Trust Company, Corporate Trust Services, Suite 1008, 320 Eighth Avenue S.W., Calgary, Alberta, T2P 3B2. For shareholders not resident in Calgary, information may be obtained by calling the Company's toll-free number: (800) 661-8686.

NOVA SHARES WIDELY HELD, ACTIVELY TRADED BY CANADIANS

NOVA's Class "A" common shares are among the most actively traded securities on Canadian stock exchanges.

It is difficult to obtain accurate information on shareholders because many shares are held in nominee accounts that do not identify the investor by name.

However, at December 31, 1985, a total of some 130.7 million Class "A" common shares were held in about 36,800 shareholder accounts. Although NOVA shares are a standard component in the portfolios of many Canadian institutions—banks, trust companies, pension funds and brokerage firms—more than two-thirds of the shareholder accounts are registered to individuals who hold 500 or fewer shares.

NOVA also had 11 preferred share issues outstanding at December 31, 1985, totalling over 34.3 million shares held in about 37,000 shareholder accounts. Three of the 11 issues are convertible into Class "A" common shares and, if converted, would increase total common shares outstanding by some 56.8 million shares to about 187.4 million shares.

Geographically, over 97% of both common and preferred shares are registered in Canada. About two-thirds of total shares outstanding are registered in Ontario, a reflection of the number of institutional investors headquartered in that province. Many Albertans continue to own shares, as over 40% of NOVA's common shareholder accounts are registered in the Company's home province.

STOCK EXCHANGE LISTINGS

NOVA's Class "A" common shares are listed on three Canadian exchanges: the Alberta Stock Exchange, The Montreal Exchange and The Toronto Stock Exchange.

The Company's preferred shares are listed on the Alberta Stock Exchange, The Montreal Exchange (for 7.60%, 6⅜%, 6½%, 15%, 12%, 11.24% and 9⅛% preferred shares only) and The Toronto Stock Exchange.

NOVA's various share issues are designated in newspaper listings as follows:

Nva AltA f	Class "A" Common
Nova C	4¾% Series C Preferred
Nova E	7¾% Preferred
Nova F	9¾% Preferred
Nova G	9.76% Preferred
Nova H	7.60% Preferred
Nova J	6⅜% Convertible Second Preferred
Nova K	6½% Convertible Second Preferred
Nova L	15% Preferred
Nova M	12% Convertible Second Preferred
Nova N	11.24% Preferred
Nova O	9⅛% Preferred

TRANSFER AGENTS AND REGISTRARS

Class "A" common shares are registered with National Trust Company in Vancouver, Calgary, Edmonton, Regina, Winnipeg, Toronto and Montreal.

Class "B" common shares are registered with National Trust Company in Calgary.

The Company's preferred shares are registered as follows: The Canada Trust Company in Vancouver, Calgary, Edmonton, Regina, Winnipeg, Toronto and Montreal for all share issues, and The Canada Trust Company in Halifax for the 7.60%, 6⅜%, 6½%, 15%, 12%, 11.24% and 9⅛% preferred shares only.

REQUESTS FOR INFORMATION

NOVA welcomes questions from shareholders, and these may be directed to senior officers or to the investor relations department by writing or telephoning the Company's head office. NOVA's toll-free number (800) 661-8686 may be used by Canadian callers residing outside of Calgary.

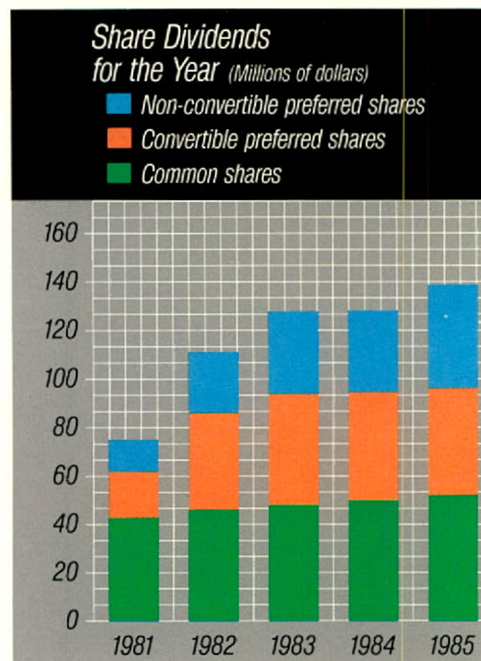
Literature on various aspects of the Company's business is also available and may be obtained by writing to our head office or calling our toll-free number.

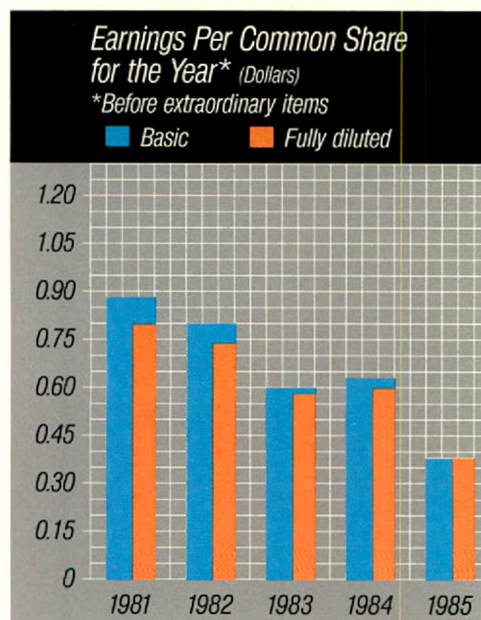
DUPLICATE ANNUAL REPORTS

Holders of NOVA securities may receive more than one copy of our annual and quarterly reports. Duplication can not always be avoided because our Class "A" common shares and our preferred shares are registered with two separate transfer agents. Class "A" common shareholders who receive more than one communication due to some difference in registered name or address should contact National Trust Company to have their holdings consolidated. The holders of each distinct issue of preferred shares who are in the same situation should make similar arrangements with The Canada Trust Company.

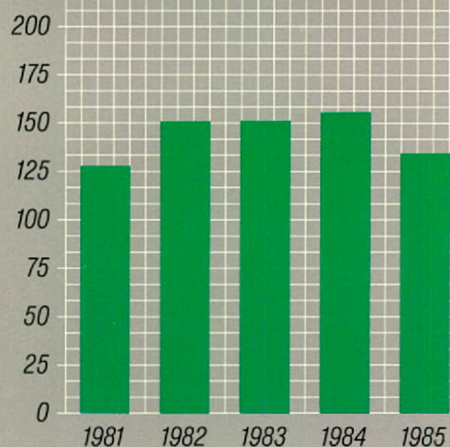
RAPPORTS ANNUELS EN FRANÇAIS

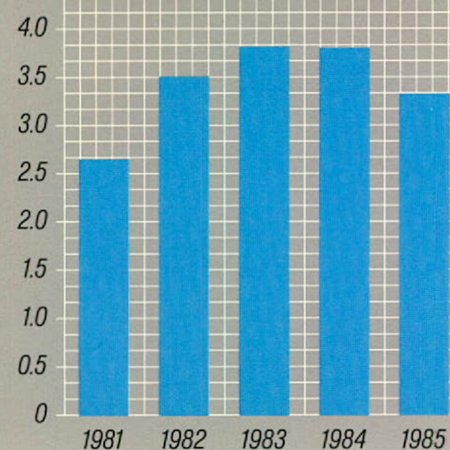
Veuillez vous adresser au secrétaire de la Compagnie si vous désirez recevoir un exemplaire de la version française de ce rapport.





Financial Review





In 1985, the Company recorded annual consolidated income before extraordinary items of $134.1 million or 38 cents per common share. Extraordinary losses of $216.5 million resulted in a net consolidated loss for 1985 of $82.4 million or $1.31 per common share.

REVENUE

Consolidated operating revenue was $3.347 billion compared with $3.794 billion in 1984, a decrease of $446.3 million or 12%. Petroleum revenue was down $641.9 million, primarily attributable to the sale of United States petroleum assets in May 1984, which contributed revenues in that year of $717.7 million. Increased revenue, however, was recorded for Canadian operations, where both heavy oil production volumes and refining and marketing activities exceeded 1984 levels. Petrochemical revenue increased $169.1 million, principally the result of the full year of operations of the second ethylene plant and the linear low-density polyethylene plant. Higher volumes of gas marketed by Pan-Alberta Gas Ltd. (50.005% owned) contributed to the $35.3 million increase in revenue in Gas Transportation & Marketing.

COSTS AND EXPENSES

Total costs and expenses were $2.674 billion compared with $3.117 billion in 1984, a decrease of $442.9 million or 14%. Operating expenses were down $468.2 million, again due to the sale of the United States petroleum operations in 1984, as offset by the full year of operations of the second ethylene plant and the linear low-density polyethylene plant and increased gas marketed by Pan-Alberta.

The increase of $20.9 million in depreciation and depletion reflects increased depreciation in Gas Transportation & Marketing and Petrochemicals from new plant placed into service in 1985, and was offset by lower depletion and depreciation in Petroleum as a result of the disposition of the United States assets in 1984.

Petroleum and gas revenue tax decreased by $2.6 million in 1985 due to its lower effective rate, as partially offset by higher production.

Loss on foreign currency translation increased by $7.1 million in 1985 principally because of an increase in the amortization of unrealized foreign exchange losses on foreign denominated long term debt of Canadian operations, resulting from a 6% decline in the Canadian dollar vis-à-vis the United States dollar. After allowing for minority interest, amounts billed under cost-of-service contracts and income taxes, this resulted in a loss of 7 cents per common share in both 1985 and 1984.

NET OPERATING INCOME

Net operating income was $673.6 million compared with $677.0 million in 1984. Improvements through better product margins and cost control measures in the valve manufacturing companies, the operating return from the second ethylene plant, and higher margins and increased production for Canadian refining and marketing operations and crude oil production, respectively, were offset by the effect of weak prices experienced in 1985 for linear low-density polyethylene and by the sale of the United States petroleum assets in 1984.

OTHER ITEMS

The Company's share in losses of affiliated companies in Petrochemicals and Manufacturing, which are

accounted for on an equity basis, was $7.2 million in 1985 compared with $6.4 million in 1984. Improvements in world methanol markets were more than offset by a decline in the demand for transportation equipment and steel products.

Allowance for funds used during development and construction was down by $28.6 million, reflecting the completion of the second ethylene plant in mid-1984. This was offset at the net operating income level by the operating return recorded on this plant.

INTEREST

Net interest expense of $315.9 million, compared with $341.8 million in 1984, was down $25.9 million, principally due to the reduction in average outstanding debt.

INCOME TAXES

Income tax expense of $155.9 million was up $5.7 million as a result of higher earnings in the petroleum operations and increased income taxes billed and recovered under cost-of-service contracts.

MINORITY INTEREST

Minority interest share of income of $65.5 million was up $8.8 million which reflects the improved results of Husky Oil Ltd. (56.73% owned).

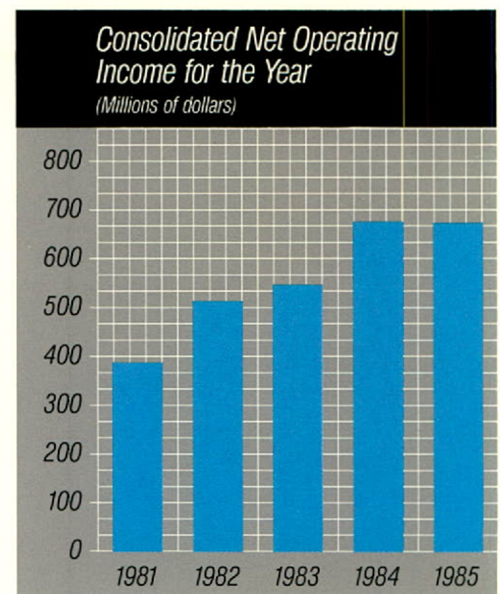
NET INCOME

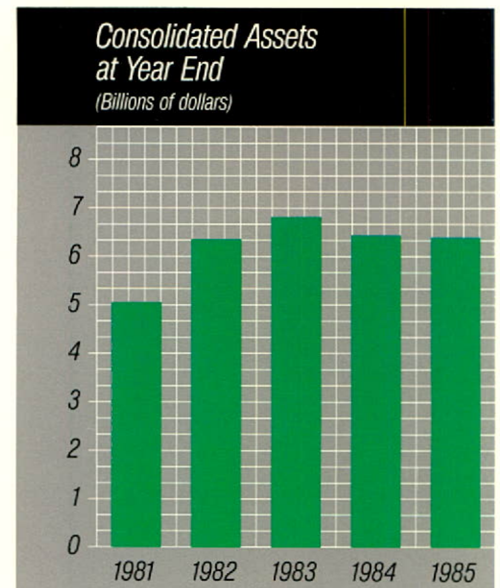
In 1985, consolidated income before extraordinary items was $134.1 million compared with $155.3 million in 1984. Basic earnings per common share before extraordinary items were 38 cents in 1985 on a total of 128.1 million average common shares outstanding, compared with 63 cents on a total of 123.2 million average common shares outstanding in 1984. Earnings per common share on a fully diluted basis before extraordinary items were 38 cents in 1985, compared with 60 cents in 1984.

Extraordinary items in 1985 resulted in a loss of $216.5 million compared with an income contribution of $48.1 million in 1984. As a result, in 1985, the Company recorded a net loss of $82.4 million compared with net income of $203.4 million in 1984. The loss per common share after extraordinary items was $1.31, both basic and fully diluted, compared with basic and fully diluted earnings per common share in 1984 of $1.02 and 77 cents respectively.

The extraordinary items in 1985 started in the second quarter with a non-cash deemed accounting loss in NOVA of $58.9 million arising from the dilution of its ownership in Husky Oil Ltd. (from approximately 67% to 57%) as a result of the conversion to common shares of Husky's 13% convertible preferred shares. In November, the Company recorded a gain of $10.3 million on the sale of its share of a polyvinyl chloride plant. At December 31, 1985, the Company recorded a write-down of $157.4 million in the carrying value of its linear low-density polyethylene plant and a write-down of $10.5 million in the value of an engineering division, CanOcean Resources, in which the Company's ownership will be reduced and some operations curtailed during the first quarter of 1986.

The extraordinary items in 1984 consisted of a gain of $132.6 million from the sale of the United States petroleum assets; write-downs of $34.6 million, primarily relating to the Company's investment in its telecommunications joint venture and its polyvinyl chloride plant; and a further $49.9 million write-down to estimated net realizable value of certain investments then held for sale, primarily in its United States and Italian valve and flow control equipment manufacturing operations.





ASSETS

Total consolidated assets of $6.352 billion at December 31, 1985, declined from $6.428 billion at the end of 1984. This decline reflects the write-downs discussed previously as partially offset by additions to plant, property and equipment, principally in petroleum.

DIVIDENDS

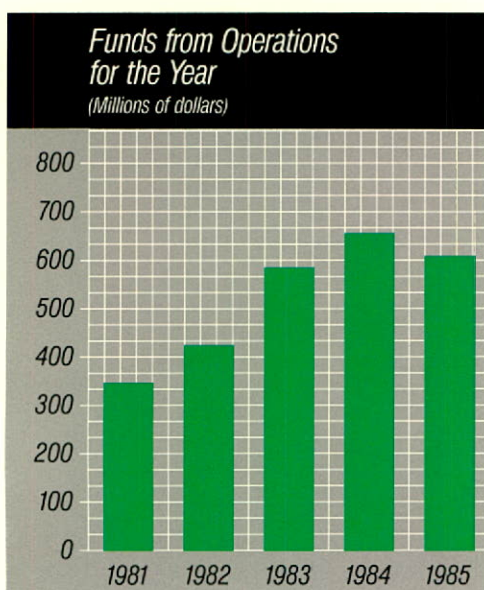
Dividends paid or payable for 1985 totalled $138.3 million compared with $127.4 million for 1984. Common share dividends were $51.6 million

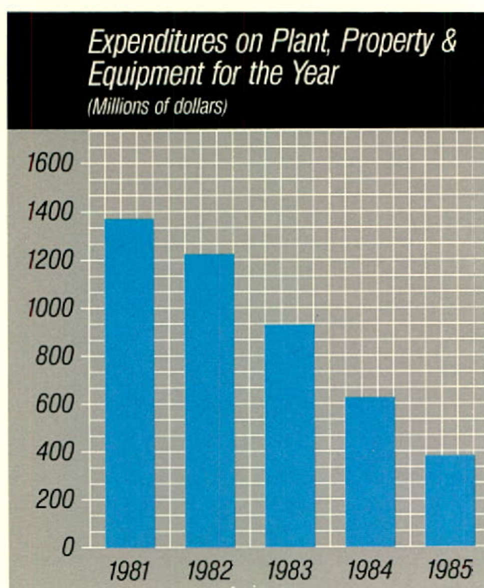
($49.4 million in 1984); dividends on convertible preferred shares were $43.9 million ($44.7 million in 1984); and dividends on non-convertible preferred shares were $42.8 million ($33.3 million in 1984). In 1985, the common shareholder received total dividends equal to 40 cents per common share.

CASH FLOW

In 1985, the Company has presented a consolidated statement of changes in financial position prepared on the basis of changes in the Company's cash resources, which comprise cash and short term deposits, net of short term bank loans. In prior years, the Company prepared this statement on the basis of changes in working capital.

Funds from operations of $609.8 million, compared with $658.7 million in 1984, were down $48.9 million principally through the sale of the United States petroleum operations in 1984 and reduced cash generated from Petrochemicals. Cash from financing activities in 1985 amounted to $248.2 million including $123.8 million in additions to long term debt, $96.8 million (net) from the issue of the 9⅛% cumulative redeemable fixed/floating rate first preferred shares of the Company and $27.5 million from the issuance of the Company's common stock. The total cash generated from operating, financing and investment activities of $1.001 billion were used principally for capital expenditures of $387.3 million; debt repayment of $234.3 million; dividend payments to shareholders of the Company of $138.3 million; and subsidiary dividends to minority interests of $30.1 million. The consolidated cash position of the Company increased by $57.0 million in 1985.





CAPITAL EXPENDITURES

Expenditures for plant, property and equipment amounted to $387.3 million in 1985 compared with $624.1 million in 1984. The 1985 capital expenditures were incurred principally for petroleum properties and refining and marketing facilities ($295.4 million) and the Alberta Gas Transmission Division facilities expansion ($73.7 million).

SHARE CAPITAL

Class "A" common shares outstanding at December 31, 1985, totalled 130.7 million compared with 125.3 million a year previous. The increase in the number of Class "A" common shares occurred primarily as a result of shares issued under the Dividend Reinvestment and Share Purchase Plan and the conversion of 6⅜% cumulative redeemable convertible second preferred shares.

REPORTING ON INFLATION

The subject of disclosing the effects of inflation has been rigorously debated over the past few years. In response, The Canadian Institute of Chartered Accountants has issued its standard on "Reporting the Effects of Changing Prices."

This standard recommends that companies supplement their historical cost financial statements with financial information based on measurements of the current cost of inventory and plant, property and equipment and disclosure of the effects of changes in the general price level.

The Company has reviewed the standard and determined that such supplemental information might be misinterpreted and would not provide realistic information to shareholders attempting to assess the Company's operating and capital maintenance capabilities. This position is based on the fact that in excess of 50% of the Company's plant, property and equipment is subject to rate regulation and cost-of-service agreements, which require rates of return and revenues on the basis of historical costs, as opposed to current costs. In addition, the Company is of the opinion that estimates of the value of its oil and gas reserves and undeveloped acreages based on price indexes, or other means as suggested in the standard, would be subject to considerable uncertainty and could result in information that is potentially misleading to its shareholders. The Company plans to continue to closely monitor the development and practice of this standard within Canadian industry.

Management's Statement of Financial Reporting

The December 31, 1985, consolidated financial statements of NOVA, AN ALBERTA CORPORATION presented in the Annual Report have been prepared by management on a consistent basis, except for the change in the method of accounting for investment tax credits (see Note 2 to the consolidated financial statements), in accordance with accounting principles generally accepted in Canada and conform in all material respects with International Accounting Standards. The consolidated financial statements have, in management's opinion, been properly prepared within reasonable limits of materiality and within the framework of the accounting policies as outlined in Note 1 to the consolidated financial statements. The financial information contained elsewhere in this Annual Report is consistent with that in the consolidated financial statements.

The Company maintains systems of internal accounting controls, policies and procedures in order to provide, on a reasonable basis, assurance as to the reliability of the financial information and the safeguarding of assets.

Clarkson Gordon, the Company's external auditors, have examined the December 31, 1985, consolidated financial statements, and their report follows.

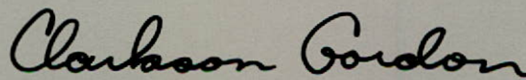
The Audit Committee of the Board, which comprises directors who are not employees of the Company, has reviewed the consolidated financial statements, including the notes thereto, with management and both the internal and external auditors. The consolidated financial statements have been approved by the Board on the recommendation of the Audit Committee.

Auditors' Report

TO THE SHAREHOLDERS OF
NOVA, AN ALBERTA CORPORATION

We have examined the consolidated balance sheet of NOVA, AN ALBERTA CORPORATION as at December 31, 1985, and the consolidated statements of income, reinvested earnings, contributed surplus and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Company as at December 31, 1985, and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied, except for the change in the method of accounting for investment tax credits as explained in Note 2 to the consolidated financial statements, on a basis consistent with that of the preceding year.



Chartered Accountants

Calgary, Canada
March 7, 1986

Consolidated Statement of Income

(Thousands of dollars except for per share data)

	Total	
Year ended December 31	1985	1984
Revenue		
Operating revenue	$3,347,236	$3,793,533
Intersegment revenue	—	—
	3,347,236	3,793,533
Costs and expenses		
Operating expenses	2,288,419	2,756,599
Intersegment expenses	—	—
Depreciation and depletion	310,180	289,283
Petroleum and gas revenue tax	52,903	55,550
Loss on foreign currency translation	22,162	15,113
	2,673,664	3,116,545
Net operating income	673,572	676,988
Equity in losses of affiliated companies	(7,235)	(6,367)
Allowance for funds used during construction	3,171	31,800
	(4,064)	25,433
Income before the undernoted items	669,508	702,421
Other (income) expenses	(1,921)	(1,551)
Interest expense (net) (Note 8)	315,915	341,765
Income before income taxes, minority interest and extraordinary items	355,514	362,207
Income taxes (Note 9)		
Current	75,340	3,679
Deferred	80,552	146,521
	155,892	150,200
Income before minority interest and extraordinary items	199,622	212,007
Minority interest	65,511	56,739
Income before extraordinary items	134,111	155,268
Extraordinary items (Note 15)	(216,522)	48,082
Net income (loss)	$ (82,411)	$ 203,350
Earnings (loss) per common share (Note 16)		
Before extraordinary items		
Basic	$ 0.38	$ 0.63
Fully diluted	$ 0.38	$ 0.60
After extraordinary items		
Basic	$ (1.31)	$ 1.02
Fully diluted	$ (1.31)	$ 0.77

See accompanying notes to consolidated financial statements.

Gas Transportation & Marketing		Petroleum		Petrochemicals		Manufacturing	
1985	1984	1985	1984	1985	1984	1985	1984
$1,527,785	$1,492,489	$965,228	$1,607,090	$756,819	$587,685	$97,404	$106,269
2,172	2,809	13,658	15,264	—	—	—	—
1,529,957	1,495,298	978,886	1,622,354	756,819	587,685	97,404	106,269
1,077,592	1,051,648	508,566	1,123,502	623,728	474,408	78,533	107,041
9,201	8,688	730	608	5,899	8,777	—	—
91,620	84,276	138,267	159,829	74,949	38,679	5,344	6,499
—	—	52,903	55,550	—	—	—	—
6,066	3,276	11,889	9,408	4,207	2,429	—	—
1,184,479	1,147,888	712,355	1,348,897	708,783	524,293	83,877	113,540
345,478	347,410	266,531	273,457	48,036	63,392	13,527	(7,271)
—	—	—	—	(671)	(3,898)	(6,564)	(2,469)
3,171	3,123	—	—	—	28,677	—	—
3,171	3,123	—	—	(671)	24,779	(6,564)	(2,469)
$ 348,649	$ 350,533	$266,531	$ 273,457	$ 47,365	$ 88,171	$ 6,963	$ (9,740)

NOVA, AN ALBERTA CORPORATION

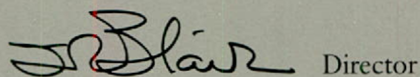
Consolidated Balance Sheet

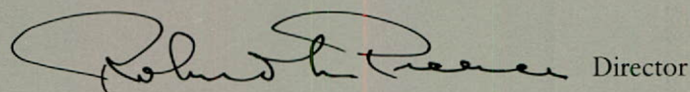
(Thousands of dollars)

ASSETS

December 31	1985	1984
Current Assets		
Cash and short term deposits	$ 44,776	$ 7,070
Accounts receivable	678,982	660,238
Inventories (Note 4)	225,417	224,097
Secured bond (Notes 10 and 21)	157,500	–
Subsidiaries and assets held for sale (Note 15)	–	111,142
Prepaid expenses	7,340	8,315
	1,114,015	1,010,862
Long Term Investments (Note 5)	171,738	103,019
Plant, Property and Equipment (Note 6)	6,025,673	6,080,891
Less accumulated depreciation and depletion	(1,162,092)	(890,595)
	4,863,581	5,190,296
Other Assets (Note 7)	202,730	123,712
	$6,352,064	$6,427,889

On behalf of the Board:

 Director

 Director

See accompanying notes to consolidated financial statements.

LIABILITIES AND SHAREHOLDERS' EQUITY

December 31	1985	1984
Current Liabilities		
Bank loans (Note 8)	$ 71,147	$ 90,416
Accounts payable and accrued liabilities	654,801	657,974
Income taxes payable	74,549	80,548
Dividends payable	34,414	31,926
Bank indebtedness (Note 21)	154,625	–
Long term debt instalments due within one year (Note 8)	98,965	111,474
	1,088,501	972,338
Long Term Debt (Note 8)	2,738,979	2,874,278
Deferred Income Taxes	425,983	496,802
Deferred Gain (Note 10)	62,359	–
Minority Interest in Subsidiary Companies (Note 11)	611,015	560,954
Shareholders' Equity		
Capital stock		
Non-convertible preferred shares (Note 12)	405,096	312,286
Convertible preferred shares (Note 12)	456,861	468,308
Common shares (Note 13)	205,148	172,734
Contributed surplus	227,943	228,171
Cumulative translation adjustment (Note 14)	14,503	5,676
Reinvested earnings	115,676	336,342
	1,425,227	1,523,517
Contingencies and Commitments (Note 20)		
	$6,352,064	$6,427,889

Consolidated Statement of Reinvested Earnings

(Thousands of dollars)

Year ended December 31	1985	1984
Balance at beginning of year	$336,342	$260,431
Net income (loss)	(82,411)	203,350
	253,931	463,781
Less dividends paid or payable		
Preferred shares	86,636	77,992
Common shares	51,619	49,447
	138,255	127,439
Balance at end of year	$115,676	$336,342

Consolidated Statement of Contributed Surplus

(Thousands of dollars)

Year ended December 31	1985	1984
Balance at beginning of year	$228,171	$226,567
Gain on purchase of preferred shares for cancellation	1,445	1,604
Capital stock issue expenses	(1,673)	–
Balance at end of year	$227,943	$228,171

See accompanying notes to consolidated financial statements.

Consolidated Statement of Changes in Financial Position

(Thousands of dollars)

Year ended December 31	1985	1984
Operating activities		
Funds provided from operations (Note 17)	$ 609,766	$ 658,681
Other (Note 18)	78,896	(66,466)
	688,662	592,215
Financing activities		
Long term debt additions	123,788	411,197
Preferred shares issued	96,844	—
Common shares issued	32,414	29,208
Less common shares issued on conversion of preferred shares	(4,874)	(5,421)
	248,172	434,984
Investment activities		
Proceeds on sale of subsidiaries and partnership interests	12,348	638,912
Subsidiaries and assets held for sale (Note 18)	46,429	33,551
Other	5,012	4,152
	63,789	676,615
Financial resources generated for investments and financial obligations	1,000,623	1,703,814
Investments		
Plant, property and equipment additions (Note 22)	387,318	624,073
Other assets and long term investments	48,185	48,750
Income taxes paid on sale of subsidiary (Note 18)	70,000	—
	505,503	672,823
Financial obligations		
Long term debt repayments	234,271	812,250
Preferred shares purchased for cancellation	12,318	13,288
Preferred shares of subsidiaries redeemed	25,725	25,725
Dividends—shareholders	138,255	127,439
—minority shareholders	30,064	31,167
Other (Note 18)	(2,488)	(94)
	438,145	1,009,775
Total investments and financial obligations	943,648	1,682,598
Increase in cash position	56,975	21,216
Cash position at beginning of year	(83,346)	(104,562)
Cash position at end of year	$ (26,371)	$ (83,346)
Cash and short term deposits	$ 44,776	$ 7,070
Bank loans	(71,147)	(90,416)
Cash position at end of year	$ (26,371)	$ (83,346)

See accompanying notes to consolidated financial statements.

Notes to Consolidated Financial Statements

December 31, 1985

1. SUMMARY OF ACCOUNTING POLICIES

The consolidated financial statements have been prepared on the historical cost basis in accordance with accounting principles generally accepted in Canada and conform in all material respects with International Accounting Standards. The accounting policies of significance to the Company are as follows:

PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of the Company and all subsidiaries, principally:

100% Owned
- The Alberta Gas Ethylene Company Ltd.
- A. G. Investments Ltd.
- A. G. Pipe Lines (Canada) Ltd.
- A. G. Pipe Lines Inc.
- Energy Holding S.p.A. (formerly WAGI International S.p.A.)
- Grove Valve and Regulator Company
- NOVA Energy Systems Inc.
- Novacor Chemicals Ltd.
- Novacorp Engineering Services Ltd.
- Novacorp International Consulting Ltd.
- Novacorp Pipelines Ltd.
- Novalta Resources Ltd.

Partially Owned
- Husky Oil Ltd. (1985—56.73% owned; 1984—67.05% owned)
- Pan-Alberta Gas Ltd. (50.005% owned)

Companies acquired have been accounted for using the purchase method.

Investments in the Alaska Highway Gas Pipeline Project, the Trans Québec & Maritimes Pipeline Project (TQM Pipeline) and certain petrochemical investments are accounted for by the proportionate consolidation method and, accordingly, the accounts reflect only the Company's proportionate interest in such activities. The Company's investment in the Alaska Highway Gas Pipeline Project is represented by its direct and indirect ownership in Foothills Pipe Lines (Yukon) Ltd. and its subsidiaries.

COST OF SERVICE

Gas Transportation & Marketing and certain Petrochemicals operations are subject to cost-of-service or tariff agreements. Under such agreements, as approved by governmental or regulatory bodies, the Company is entitled to recover reasonable and necessary operating expenses, cost of feedstock and fuel, depreciation, amortization, income and other taxes, foreign exchange gains or losses in respect of debt service and a rate of return on investment.

FOREIGN CURRENCY TRANSLATION

Foreign operations which are considered financially and operationally independent of the parent have been translated to Canadian dollars using the year end rate of exchange ("current rate") for assets and liabilities and average rates for the year for the statement of income. Gains or losses resulting from these translation adjustments are deferred in a separate component of shareholders' equity (the "cumulative translation adjustment" account) until there is a realized reduction of the net investment in the foreign operation.

Foreign operations which are considered financially and operationally dependent on the parent company together with foreign operations which are operating under highly inflationary economic conditions have been translated to Canadian dollars using current rates of exchange for monetary assets and liabilities, historical rates of exchange for non-monetary assets and liabilities and average rates for the year for revenue and expenses, except depreciation and depletion which are translated at the rate of exchange applicable to the related assets. Gains or losses resulting from these translation adjustments are included in income.

Foreign denominated long term monetary items of Canadian operations are translated at the current rate of exchange. The unrealized translation gains or losses are deferred and amortized over the remaining lives of the long term monetary items, except for translation gains or losses relating to cost-of-service activities which are recovered from customers.

INVENTORIES

Inventories are carried at the lower of cost, as determined on a first-in, first-out basis, and net realizable value. Refined oil product inventory costs are determined by allocating costs to products on the basis of the relative market value of the product.

INVESTMENTS

The Company accounts for its investments in Alberta Gas Chemicals Ltd., CNG Fuel Systems,

NovAtel Communications Ltd., Steel Alberta Ltd. and Western Star Trucks Inc. (all 50% owned) by the equity method. Under this method, the investment is carried at cost plus the related equity in undistributed earnings less the amortization of the excess of the purchase price over the net book value at date of acquisition. Other investments are carried at cost.

PLANT, PROPERTY AND EQUIPMENT

Plant, property and equipment are carried at cost; maintenance and repair costs of a routine nature are expensed as incurred; and renewals and betterments which extend the economic useful life of plant, property and equipment are capitalized.

Upon retirement or sale of items of plant, property and equipment, which are utilized in cost-of-service activities, the asset costs associated with such items are charged against the applicable accumulated depreciation accounts and the net proceeds of disposal are credited to accumulated depreciation. Normal retirements of the costs of depletable oil and gas properties are charged against the accumulated allowance for depletion. For other items in plant, property and equipment, upon disposition, the accounts are relieved of the asset costs and associated accumulated depreciation and any resulting charges or credits are carried to earnings.

The Company follows the full cost method of accounting for oil and gas interests whereby all costs of acquisition, exploration for and development of oil and gas reserves are capitalized within cost centres. Such costs are generally limited by a "ceiling test" to the value of the estimated future net revenues from production of proved reserves, at prices and costs in effect at the year end date, plus the estimated value of unproved properties.

DEPRECIATION AND DEPLETION

Plant, property and equipment (except for Gas Transportation & Marketing plant, intangible petroleum costs and tangible petroleum costs in the Philippines prior to May 31, 1984) are depreciated on a straight-line basis at annual rates varying from 4% to 33⅓% which rates are designed to write these assets off over their estimated useful lives. Depreciation for the Alberta Gas Transmission Division plant approximated a composite rate of 3.4% on costs in 1985 (1984 - 3.3%). Depreciation for the Alaska Highway Gas Pipeline—Phase I plant approximated a composite rate of 4% on costs in 1985 and 1984. Depreciation for the TQM Pipeline plant approximated a composite rate of 3.7% in 1985 (1984 - 3%).

In Canada, oil and gas interests are segregated into three major cost centres: the Lloydminster heavy oil area, the frontier regions and all other areas of Canada. In 1985, in response to changed circumstances resulting from the agreement between the federal government and the producing provinces, known as the "Western Accord," the Company has computed depletion expense relative to intangible costs in each of the Canadian cost centres by the unit of production method based on proved reserves as estimated by the Company's engineers. The Company previously calculated depletion expense by the revenue method. This change in methodology did not have a material effect on the financial statements. Depletion expense is not calculated relative to the frontier regions of Canada until such time as economically recoverable reserves are established. Costs incurred in all frontier regions at December 31, 1985 and 1984, amounted to $167,632,000 and $114,008,000 respectively.

The Company sold its oil and gas operations in the United States and most of its producing interests outside of North America effective May 31, 1984. Prior to May 31, 1984, oil and gas interests in the United States and the Philippines were segregated into single cost centres for each country, and intangible costs were depleted on a composite unit of production method based upon proved developed reserves, as estimated by the Company's engineers. Tangible costs in the Philippines were depreciated on the composite unit of production method. Depletion expense was not calculated relative to certain major exploration and development projects in the United States until such time as economically recoverable reserves were established.

The costs of acquiring and exploring for oil and gas reserves in each area where the Company has an interest outside of Canada are amortized on a straight-line basis at an annual rate of 20%. When it is determined that proved reserves exist, the unamortized costs will be depleted by the composite unit of production method. The unamortized costs of an abandoned area are charged against earnings at the time of abandonment. Unamortized costs at December 31, 1985 and 1984, amounted to $30,857,000 and $19,042,000 respectively.

ALLOWANCE FOR FUNDS USED DURING CONSTRUCTION

For Gas Transportation & Marketing and in certain Petrochemicals operations, government or regulatory authorities provide for a return on capital invested in new plant while under construction by capitalizing, at an approved rate, an allowance for funds used during construction.

CAPITALIZED INTEREST

Interest is capitalized, based on long term debt interest rates, on certain oil and gas interests undergoing exploration and development activities that are not subject to depletion or amortization and

on costs incurred during the construction of major additions to plant, property and equipment. Once the exploration and development activities are complete, or the facility commences operations, subsequent interest costs are charged to income.

DEFERRED PROJECT COSTS

Costs relating to projects which are expected to benefit future periods are deferred during the development phase. Deferred costs applicable to projects which have been terminated or significantly delayed are expensed.

LONG TERM DEBT

Short term borrowings which are expected to be repaid from the proceeds of long term financing are included in long term debt.

Debt discount and expense is amortized over the terms of the respective issues.

INCOME TAXES

The Company follows the deferral method of tax allocation accounting on all income except for certain Gas Transportation & Marketing and Petrochemicals operations which are subject to cost-of-service or tariff agreements. Under this method, the Company makes a full provision for income taxes deferred principally as a result of claiming capital cost allowance and exploration and development costs for income tax purposes in excess of depreciation and depletion provided in the accounts. Income taxes on certain operations subject to cost-of-service or tariff agreements, where there is reasonable expectation that all income taxes payable will be included in the future cost of service or tariff and recovered in revenues at that time, are provided on the taxes payable method whereby the income tax provision represents only the income taxes deemed to be currently payable and thus recoverable under the billing mechanism in place. Investment tax credits are recorded as a reduction in the cost of the related asset, provided there is reasonable assurance that the credits will be realized. Prior to 1985 they were recorded as a reduction to the income tax provision when realization was reasonably assured.

PETROLEUM INCENTIVES

Federal and provincial exploration and development incentives (principally, the Petroleum Incentive Program) are accounted for as a reduction of plant, property and equipment. Amounts received from the Saskatchewan provincial government relative to its oil and gas incentive regulations are credited against provincial royalties.

PENSION PLANS

The Company and most of its subsidiaries maintain pension plans for substantially all employees. Charges to income are determined from actuarial valuations of the pension plans.

EARNINGS (LOSS) PER COMMON SHARE

Basic earnings (loss) per common share before and after extraordinary items are calculated after deducting the dividend entitlement on preferred shares from the income before extraordinary items and net income (loss), respectively, and dividing the resulting amounts using the weighted average number of shares outstanding during the period. The calculation includes the Company's share of the reported income of subsidiaries based on its undiluted interest.

The calculation of earnings (loss) per common share on a fully diluted basis before and after extraordinary items also assumes conversion of those securities of the Company and its subsidiaries and the exercise of all stock options of the Company and its subsidiaries, as at the beginning of the year, which would have had a dilutive effect on basic earnings (loss) per common share.

2. CHANGE IN ACCOUNTING POLICY

On January 1, 1985, the Company changed its method of accounting for investment tax credits by adopting prospectively the recommendations issued by The Canadian Institute of Chartered Accountants. The effect of this change in accounting policy for the year ended December 31, 1985, has been a decrease in net income of $4,482,000 and a decrease in basic and fully diluted earnings per common share before and after extraordinary items of approximately 3 cents.

3. PROPORTIONATE CONSOLIDATION OF CERTAIN OF THE COMPANY'S INVESTMENTS

The Company has proportionately consolidated certain of its Gas Transportation & Marketing and Petrochemicals investments (Note 1). The components of the Company's consolidated statement of income and consolidated balance sheet relating to its share of the activities of these investments are shown below:

(Thousands of dollars)

	December 31		Year ended December 31	
	Assets	Liabilities	Operating Revenue	Operating Expenses
Gas Transportation & Marketing				
1985	$732,466	$495,623	$151,840	$ 49,491
1984	773,189	516,266	156,493	45,762

(Thousands of dollars)

	December 31		Year ended December 31	
	Assets	Liabilities	Operating Revenue	Operating Expenses
Petrochemicals				
1985	153,640	98,526	89,502	76,258
1984	173,958	112,922	125,253	116,120
Totals				
1985	$886,106	$594,149	$241,342	$125,749
1984	947,147	629,188	281,746	161,882

4. INVENTORIES

(Thousands of dollars)

December 31	1985	1984
Gas Transportation	$ 30,309	$ 27,775
Petroleum	125,715	148,614
Petrochemicals	32,823	47,708
Manufacturing	36,570	–
	$225,417	$224,097

5. LONG TERM INVESTMENTS

(Thousands of dollars)

December 31	1985	1984
Alberta Gas Chemicals Ltd.	$ 16,961	$ 16,652
CNG Fuel Systems	20,046	16,609
NovAtel Communications Ltd.	58,399	33,037
Steel Alberta Ltd.	19,822	20,269
Western Star Trucks Inc.	13,461	12,339
Notes receivable and other investments	43,049	4,113
	$171,738	$103,019

6. PLANT, PROPERTY AND EQUIPMENT

(Thousands of dollars)

December 31	1985			1984
	Cost	Accumulated Depreciation and Depletion	Net	Net
Gas Transportation & Marketing				
Plant in service	$2,613,605	$ 599,005	$2,014,600	$2,000,705
Plant under construction	25,017	–	25,017	50,156
Petroleum				
Petroleum properties and production equipment	1,471,855	226,745	1,245,110	1,131,466
Refining, marketing and pipeline facilities	307,890	19,510	288,380	280,715
Offshore drilling equipment	162,925	18,962	143,963	150,599
Heavy oil upgrader development costs	51,639	–	51,639	21,075
Other facilities	84,039	24,641	59,398	78,180
Petrochemicals	1,183,750	234,085	949,665	1,309,194
Manufacturing and other	124,953	39,144	85,809	168,206
	$6,025,673	$1,162,092	$4,863,581	$5,190,296

7. OTHER ASSETS

December 31	1985	1984
	(Thousands of dollars)	
Deferred project costs	$ 8,496	$ 9,892
Unamortized debt discount and expense	11,423	11,909
Foreign exchange translation adjustments	182,811	101,911
	$202,730	$123,712

8. LONG TERM DEBT

December 31	*(Maturity)*	1985	1984
		(Thousands of dollars)	
NOVA, AN ALBERTA CORPORATION			
First Mortgage Sinking Fund Bonds			
5½% Series C		$ —	$ 1,812
8¾% Series D (1984—U.S. $25,700)		—	33,968
Secured Debentures			
5¾% Series B		—	14,954
Unsecured Debentures			
9¾% Series 2	1990	14,884	15,027
9¼% Series 3	1990	13,426	13,990
8% Series 4	1991	38,366	39,762
8⅛% Series 5	1992	27,860	28,768
11⅜% Series 6	1995	48,064	49,285
17½% Series 7	1987	75,000	75,000
17¾% Series 8	1997	47,500	50,000
12⅛% Series 9	1993	100,000	100,000
14% Series 10	1989	100,000	100,000
12% Series 11	1990	125,000	125,000
16¼% (1985 and 1984—U.S. $100,000)	1989	139,750	132,170
Unsecured Term Notes			
16⅛%—average (1985 and 1984—U.S. $110,000)	1987	153,725	145,386
6¼% (1985—Swiss Francs 175,000,000; 1984—Swiss Francs 75,000,000)	1991-1992	119,053	38,085
		1,002,628	963,207
Bank loans and notes (unsecured)		262,306	352,598
		1,264,934	1,315,805
Foothills (Yukon)—Phase I	1996	245,033	288,431
TQM Pipeline			
First Mortgage Bonds			
13.10% Series A	1994	50,000	50,000
13.20% Series B	2004	50,000	50,000
11.70% Series C	1990	42,500	—
Term loans	1987	25,834	70,000
		168,334	170,000
Husky Oil Ltd. and subsidiaries			
Sinking Fund Debentures			
6¾% Series B	1987	9,001	9,750
8½% Series C	1991	8,596	9,338
Notes payable and other loans—secured and unsecured with interest rates averaging 10⅕% (1984—11%)			
Canadian dollars	1989	122,000	120,000
United States dollars (1985—U.S. $73,433; 1984—U.S. $85,209)	Various	102,682	112,613
		242,279	251,701

December 31	(Maturity)	(Thousands of dollars) 1985	1984
Novalta Resources			
Income Debentures			
(1985–U.S. $31,705; 1984–U.S. $35,723)	1986-1989	44,308	47,215
Alberta Gas Ethylene			
Ethylene Plant I			
8¼% Secured Notes			
(1985–U.S. $185,455; 1984–U.S. $199,720)	1998	259,174	263,970
5⅜% First Income Debentures			
(1985–U.S. $185,455; 1984–U.S. $199,720)	1987	259,174	263,970
Less 8¼% certificates of deposit (1985–U.S. $185,455; 1984–U.S. $199,720) pledged as security against the First Income Debentures	1987	(259,174)	(263,970)
		259,174	263,970
Ethylene Plant II			
DCS loans			
(1985–U.S. $245,722; 1984–U.S. $251,836)	2004	343,396	332,851
13¾% Series A Secured Notes			
(1985–U.S. $46,458; 1984–U.S. $48,958)	2004	64,925	64,708
Secured bank loans	1986	34,800	34,800
		443,121	432,359
		702,295	696,329
Cochin Pipe Line and Ethane Gathering System			
A. G. Pipe Lines (Canada) Ltd.	1998	23,700	25,400
A. G. Pipe Lines Inc.			
(1985–U.S. $30,375; 1984–U.S. $32,400)	2000	42,449	42,823
		66,149	68,223
Other loans	Various	104,612	148,048
		2,837,944	2,985,752
Less instalments due within one year		98,965	111,474
		$2,738,979	$2,874,278

NOVA, AN ALBERTA CORPORATION

The interest rate on the unsecured bank loans and notes is a function of generally prevailing money market interest rates and Canadian bank prime rates and at December 31, 1985, was approximately 10% (11% at December 31, 1984).

FOOTHILLS (YUKON)–PHASE I

In connection with the financing of Phase I of the Alaska Highway Gas Pipeline, Foothills Pipe Lines (Yukon) Ltd. has arranged long term financing with Canadian chartered banks. At December 31, 1985, $490,379,000 ($571,881,000 at December 31, 1984) was outstanding pursuant to this financing of which the Company's proportionate share is $245,033,000 ($288,431,000 at December 31, 1984). The repayment schedule provides for the major portion of this financing to have matured by December 31, 1992, with the balance maturing December 31, 1996. This financing is secured by the assignment of the interest of Foothills (Yukon) and three of its subsidiaries in certain agreements and floating charges on their respective properties and assets. The interest rate fluctuates with Canadian bank prime rates and at December 31, 1985, was approximately 10¾% (12% at December 31, 1984).

TQM PIPELINE

The First Mortgage Bonds and the term loans are secured by a first fixed and specific charge on the TQM Pipeline system, a pledge, charge and assignment of gas transportation service contracts and gas sales agreements and a floating charge on other property. The term loans bear interest at fluctuating rates related to Canadian bank prime rates. The interest rate at December 31, 1985, was approximately 9½% (11⅕% at December 31, 1984).

HUSKY OIL LTD. AND SUBSIDIARIES

The Series B and C Sinking Fund Debentures are secured by the common shares of a wholly

owned subsidiary of Husky and a first floating charge on certain other assets of Husky. Notes payable and other loans of $224,682,000 at December 31, 1985, ($232,613,000 at December 31, 1984) are secured by assets, properties and the assignment of contracts.

NOVALTA RESOURCES

Security for the Income Debentures includes natural gas properties and a general assignment of book debts. Interest on these Income Debentures varies with the London Inter Bank Offered Rate and was approximately 6½% at December 31, 1985 (6¾% at December 31, 1984).

ETHYLENE PLANT I

The proceeds from the issuance of the 8¼% Secured Notes are invested in certificates of deposit which bear interest equivalent to that due on the Secured Notes. The Secured Notes are guaranteed by The Alberta Gas Ethylene Company Ltd. and are secured by a first fixed and floating charge on the first ethylene plant, the ethylene pipeline and related assets of Alberta Gas Ethylene and by the assignment of certain related contracts.

The 5⅜% First Income Debentures were issued simultaneously with the issuance of the Secured Notes and are secured by the certificates of deposit referred to in the previous paragraph.

ETHYLENE PLANT II

In respect of financing a portion of the second ethylene plant, Alberta Gas Ethylene entered into a loan agreement with DCS Capital Partnership, a Delaware partnership. The partners of DCS Capital Partnership are affiliates of The Dow Chemical Company, Union Carbide Corporation and Shell Canada Limited. The loans are secured, pursuant to a trust deed, by charges on certain of the proceeds of the ethylene sales contracts for the second ethylene plant, a first charge on the related performance guarantees of Dow and Union Carbide and a first fixed charge on a 76% undivided interest in the second ethylene plant and certain related agreements. The cost of such loans is directly tied to the cost of third-party financing undertaken by DCS Capital Partnership. The interest rate at December 31, 1985, was approximately 12⅕% (12% at December 31, 1984).

Alberta Gas Ethylene has issued U.S. $50,000,000 of 13¾% Series A Secured Notes due July 1, 2004, to five financial institutions. The Series A Secured Notes, of which U.S. $46,458,000 were outstanding at December 31, 1985, (U.S. $48,958,000 at December 31, 1984) are secured, pursuant to the DCS Capital Partnership trust deed, by charges on certain of the proceeds of the ethylene sales contracts related to the second ethylene plant, a second charge on the related performance guarantees of Dow and Union Carbide and a first fixed charge on a 24% undivided interest in the second ethylene plant and certain related agreements. In addition, the Company has given a guarantee, applicable in certain events, in respect of a portion of the interest payable on the Series A Secured Notes.

Alberta Gas Ethylene has entered into an agreement with two Canadian banks to provide a revolving credit facility, of which $34,800,000 was outstanding at December 31, 1985 and 1984, to finance on an interim basis a portion of the costs related to the second ethylene plant not otherwise financed. The facility is secured, on a pari passu basis, in the same manner as the Series A Secured Notes. The Company has undertaken to use its best efforts to cause Alberta Gas Ethylene to arrange alternate financing to replace this credit facility and to retain beneficial ownership and control of at least 51% of the issued common shares of Alberta Gas Ethylene. The interest rate fluctuates with Canadian bank prime rates and at December 31, 1985, was approximately 10% (11⅖% at December 31, 1984).

COCHIN PIPE LINE AND ETHANE GATHERING SYSTEM

A. G. Pipe Lines (Canada) Ltd., in connection with long term financing of its share of the cost of the Canadian segment of the Cochin Pipe Line and of the Ethane Gathering System, has entered into a loan agreement with certain banks which provides for a term credit facility consisting of term loans and/or bankers' acceptances of which $23,700,000 was outstanding at December 31, 1985 ($25,400,000 at December 31, 1984). The term credit facility expires on December 31, 1998, and is secured by a first floating charge on a portion of the assets of A. G. Pipe Lines (Canada) Ltd., and a first fixed charge on certain agreements. The interest rate on the term credit facility was approximately 10⅜% at December 31, 1985 (11⅝% at December 31, 1984).

A. G. Pipe Lines Inc., in connection with the long term financing of its share of the cost of the United States segment of the Cochin Pipe Line, pursuant to a loan agreement, has issued promissory notes of which U.S. $30,375,000 were outstanding at December 31, 1985, (U.S. $32,400,000 outstanding at December 31, 1984) which mature on various dates to December 31, 2000. These promissory notes are secured by an assignment of the interest of A. G. Pipe Lines Inc. in certain agreements (insofar as they relate to the United States segment of the Cochin Pipe Line), by the guarantee of A. G. Pipe Lines (Canada) Ltd., and by a pledge of the outstanding shares of A. G. Pipe Lines Inc. The interest rate varies with the London Inter Bank Offered Rate and was approximately 8¾% at December 31, 1985 (9⅕% at December 31, 1984).

OTHER LOANS

Other loans of $104,612,000 at December 31, 1985, ($148,048,000 at December 31, 1984) include loans of $91,427,000 ($135,479,000 at December 31, 1984) which are secured by certain assets and agreements. The average interest rate on the other loans approximated 9⅘% at December 31, 1985 (11⅛% at December 31, 1984).

SINKING FUND AND REPAYMENT REQUIREMENTS

Sinking fund and repayment requirements in respect of long term debt maturing within five years following December 31, 1985, are: 1986–$98,965,000; 1987–$336,571,000; 1988–$122,506,000; 1989–$398,364,000; 1990–$322,935,000.

CURRENT BANK LOANS

Current bank loans of $71,147,000 at December 31, 1985, ($90,416,000 at December 31, 1984) include loans of $56,541,000 ($73,337,000 at December 31, 1984) which are secured by certain assets and agreements.

The interest rates on the current bank loans ranged from 9½% to 10¾% at December 31, 1985 (10¾% to 12¼% at December 31, 1984).

INTEREST EXPENSE (NET)

(Thousands of dollars)

Year ended December 31	1985	1984
Interest and expense on long term debt	$336,648	$372,458
Interest on short term debt	19,222	18,855
Interest capitalized	(18,839)	(30,477)
Interest income	(21,116)	(19,071)
	$315,915	$341,765

9. INCOME TAXES

For Gas Transportation & Marketing and certain of the Petrochemicals operations, charges to customers are based on cost-of-service or tariff agreements. Because income taxes related to these operations are a component of the charges, the billing for such income taxes on either a taxes payable or tax allocation basis does not affect net income.

Income tax expense varies from the amounts that would be computed by applying the Canadian federal and provincial income tax rates to income before income taxes, minority interest and extraordinary items as shown in the following table:

(Thousands of dollars)

Year ended December 31	1985	1984
Income before income taxes, minority interest and extraordinary items	$355,514	$362,207
Less: Cost-of-service activities		
Gas Transportation & Marketing	203,304	196,754
Petrochemicals	66,240	25,106
Equity component in allowance for funds used during construction	1,587	13,225
Equity in losses of affiliated companies	(7,235)	(6,367)
	$ 91,618	$133,489
Effective Canadian tax rate	47.9%	47.0%
Calculated income tax expense	$ 43,885	$ 62,740
Add (deduct) adjustments to income taxes resulting from–		
Royalties, lease rentals and mineral taxes payable to the Crown	35,797	37,713
Petroleum and gas revenue tax	24,388	25,614
Resource allowance on Canadian production income	(50,671)	(50,280)
Earned depletion	(9,507)	(7,662)
Investment tax credits	–	(14,843)
Alberta royalty tax credit	(4,000)	(4,002)
Non-allowable depreciation and depletion	13,566	13,901
Earnings from foreign subsidiaries with lower effective tax rates	(5,047)	(3,904)
Other	2,378	7,870
	50,789	67,147
Add income taxes billed under cost-of-service contracts	105,103	83,053
Income tax expense	$155,892	$150,200

10. DEFERRED GAIN

On December 18, 1985, the Company sold its head office building in Calgary, Alberta, (the "Property") for $175,000,000. Proceeds received amounted to $1,750,000 cash, a secured bond in the amount of $157,500,000 and a second mortgage to the Company in the amount of $15,750,000. On the same date, the Company agreed to lease the Property for a term extending to December 31, 1997. On February 13, 1986, cash was received for the secured bond (see Note 21).

The second mortgage to the Company of $15,750,000 bears interest at the rate of approximately 10.9%, compounded annually. The principal sum, together with interest accrued thereon, becomes due and payable December 31, 1997. It is secured by a second fixed and specific mortgage on the Property. The second mortgage is included in long term investments under the caption "notes receivable and other investments."

A gain of $62,359,000 resulting from the sale/leaseback of the Company's head office building has been deferred.

11. MINORITY INTEREST IN SUBSIDIARY COMPANIES

(Thousands of dollars)

December 31	1985	1984
A. G. Investments Ltd.		
Canadian dollars	$ 76,500	$ 89,250
United States dollars (1985–U.S. $65,253; 1984–U.S. $76,129)	91,190	100,620
	167,690	189,870
Husky Oil Ltd.	432,273	360,429
Other	11,052	10,655
	$611,015	$560,954

In connection with the acquisition of Husky Oil Ltd., A. G. Investments Ltd. issued $255,000,000 variable rate, cumulative, redeemable, senior preferred shares. The preferred shares are redeemable at the option of A. G. Investments and are required to be redeemed as to 10% of the initial issue on September 30 of each year to 1988, with the balance payable on September 30, 1989. These shares are redeemable at the option of the holder in certain events. The dividend rate is 52% of the prime commercial lending rate of a Canadian chartered bank plus 1¼% for those shares denominated in Canadian dollars and 52% of the London Inter Bank Offered Rate of a Canadian chartered bank plus 1¼% for those shares denominated in United States dollars. The variable dividend rate approximated 6¼% at December 31, 1985 (7¼% at December 31, 1984). The Husky shares owned by A. G. Investments have been pledged as collateral security.

The minority interest in Husky Oil Ltd. at December 31, 1984, included Husky's 13% cumulative, redeemable, convertible, retractable, junior preferred shares, Series A of a par value of $25.00 (the "Series A preferred shares") of which $90,655,000 was outstanding. The Series A preferred shares were converted into common shares of Husky during 1985 on the basis of four common shares for each Series A preferred share (Note 15).

12. PREFERRED SHARES

(a) AUTHORIZED

2,000,000 cumulative redeemable non-convertible first preferred shares of a par value of $100 each.
20,500,000 cumulative redeemable non-convertible first preferred shares of a par value of $25 each.
26,120,000 cumulative redeemable convertible second preferred shares of a par value of $25 each.

(b) ISSUED AND OUTSTANDING

December 31	*(Par value)*	*(Number of shares)* 1985	1984	*(Thousands of dollars)* 1985	1984
Non-convertible first preferred shares					
4¾% Series C	$100	61,638	71,700	$ 6,164	$ 7,170
7¾%	$ 25	702,531	736,986	17,564	18,425
9¾%	$ 25	971,091	1,003,433	24,277	25,086
9.76%	$ 25	1,389,448	1,480,024	34,736	37,000
7.60%	$ 25	2,394,200	2,484,200	59,855	62,105
15%	$ 25	2,500,000	2,500,000	62,500	62,500
11.24%	$ 25	4,000,000	4,000,000	100,000	100,000
9⅛%	$ 25	4,000,000	–	100,000	–
		16,018,908	12,276,343	$405,096	$312,286
Convertible second preferred shares					
6⅜%	$ 25	877,650	1,092,955	$ 21,941	$ 27,324
6½%	$ 25	7,200,525	7,443,075	180,013	186,077
12%	$ 25	10,196,270	10,196,270	254,907	254,907
		18,274,445	18,732,300	$456,861	$468,308

(c) COMMENTARY

The following is a summary of material characteristics of the preferred shares:

Preferred Share Issue (i)	Par Value	Redeemable at the Company's Option (ii)	Sinking Fund and Purchase Fund Requirements (vii)
Non-convertible First Preferred Shares			
4¾% Series C	$100	at $101.00 per share	purchase funds of $825,000 annually, or such lesser amount as would increase the funds to $1,650,000 for the purchase for cancellation, if and when available at a price not in excess of $100.00 per share plus costs of purchase (vii) (x)
7¾%	$ 25	at $26.00 per share on or before May 15, 1989, and at reducing amounts thereafter	purchase funds of $750,000 annually, or such lesser amount as would increase the funds to $1,500,000 for the purchase for cancellation, if and when available at a price not in excess of $25.00 per share (vii) (x)
9¾%	$ 25	at $25.00 per share	purchase 64,000 shares annually at a price not in excess of $25.00 per share on May 15 of each year under a cumulative mandatory sinking fund (vii) (viii) (x)
9.76%	$ 25	at $25.25 per share on or before November 15, 1986, and at $25.00 thereafter	purchase 96,000 shares annually at a price not in excess of $25.00 per share on November 15 of each year under a cumulative mandatory sinking fund (vii) (viii) (x)
7.60%	$ 25	at $25.75 per share on or before February 15, 1986, and at reducing amounts thereafter	purchase 90,000 shares annually at a price not in excess of $25.00 per share (vii) (x)
15%	$ 25	on or after August 15, 1987, to August 15, 1988, at $26.50 and at reducing amounts thereafter (iii)	purchase 100,000 shares annually at a price not in excess of $25.00 per share to August 15, 1987, and thereafter 4% of the outstanding balance on an annual basis (vii)

Preferred Share Issue (i)	Par Value	Redeemable at the Company's Option (ii)	Sinking Fund and Purchase Fund Requirements (vii)
11.24%	$ 25	on or after May 15, 1988, to May 15, 1989, at $26.25 per share and at reducing amounts thereafter (iv)	purchase 80,000 shares annually at a price not in excess of $25.00 per share to May 15, 1988, and thereafter 4% of the outstanding balance on an annual basis (vii)
9⅛% (v)	$ 25	at $25.00 on or after February 15, 1990 (v)	purchase 3% of the shares outstanding annually, commencing February 16, 1995, at a price not in excess of $25.00 per share (vii)
Convertible Second Preferred Shares			
6⅜%	$ 25	at $25.75 per share on or before November 15, 1986, and at reducing amounts thereafter	purchase 216,000 shares annually at a price not in excess of $25.00 per share (vii) (ix) (x)
6½%	$ 25	at $26.25 per share on or before February 15, 1986, and at reducing amounts thereafter	purchase 240,000 shares annually at a price not in excess of $25.00 per share (vii) (ix) (x)
12%	$ 25	on or after May 15, 1987, to May 15, 1988, at $26.25 per share and at reducing amounts thereafter (vi)	purchase 204,000 shares annually commencing May 16, 1986, up to and including May 15, 1990, at a price not in excess of $25.00 per share and thereafter 4% of the outstanding balance on an annual basis (vii) (ix)

(i) The preferred shareholders are entitled to cumulative dividends at the respective rates set out in the titles of each issue.

(ii) Redeemable at the indicated price per share plus accrued and unpaid dividends.

(iii) The 15% Preferred Shares are retractable at the option of the holder by deposit of the shares on or before August 7, 1987, for redemption on August 15, 1987, at $25.00 per share plus accrued and unpaid dividends.

(iv) The 11.24% Preferred Shares are retractable at the option of the holder by deposit of shares on or before May 6, 1988, for redemption on May 15, 1988, at $25.00 per share plus accrued and unpaid dividends.

(v) Commencing in 1990, the dividend payment on the 9⅛% Preferred Shares will be equal to 70% of the average of the Canadian prime rate for the dividend period.

The 9⅛% Preferred Shares are retractable at the option of the holder by deposit of shares on or before February 6, 1995, for redemption on February 15, 1995, at $25.00 per share plus accrued and unpaid dividends.

(vi) The 12% Preferred Shares are redeemable on or before May 15, 1987, at $26.25 per share only if the weighted average price at which the Class "A" common shares were traded was not less than 130% of the conversion price.

(vii) Sinking and purchase fund requirements cannot be purchased at prices in excess of the stated price per share plus accrued and unpaid dividends and costs of purchase.

(viii) The Company, in addition to the cumulative mandatory sinking funds, may call for redemption and redeem annually, through the operation of non-cumulative optional sinking funds, 48,000 9¾% Preferred Shares on May 15 of each year and 72,000 9.76% Preferred Shares on November 15 of each year at par value plus accrued and unpaid dividends.

The cumulative mandatory sinking fund requirements of the 9¾% and 9.76% Preferred Shares may be satisfied otherwise by the Company through acquisition in the open market or by an invitation for tenders.

(ix) The cumulative redeemable convertible second preferred shares are convertible to Class "A" common shares on the following conversion basis:

Preferred Shares	Preferred to Common Conversion Basis	Convertible Until
6⅜%	1 for 4.2	November 15, 1986
6½%	1 for 2.586	February 15, 1990
12%	1 for 3.38	May 15, 1990

During the year ended December 31, 1985, 194,805 6⅜% Preferred Shares were converted into 818,181 Class "A" common shares and 150 6½% Preferred Shares were converted into 387 Class "A" common shares.

(x) During the year ended December 31, 1985, the Company purchased for cancellation 10,062 4¾% Preferred Shares; 34,455 7¾% Preferred Shares; 32,342 9¾% Preferred Shares; 90,576 9.76% Preferred Shares; 90,000 7.60% Preferred Shares; 20,500 6⅜% Preferred Shares; and 242,400 6½% Preferred Shares at an aggregate discount of $1,445,000 which has been credited to contributed surplus.

13. COMMON SHARES

(a) AUTHORIZED

300,000,000 Class "A" common shares without par value, non-voting except for the election of seven directors.

2,004 Class "B" common shares of the par value of $5.00 each.

(b) ISSUED AND OUTSTANDING

	(Number of shares)		*(Thousands of dollars)*	
December 31	1985	1984	1985	1984
Class "A" common	130,656,702	125,251,870	$205,140	$172,726
Class "B" common	1,665	1,665	8	8
	130,658,367	125,253,535	$205,148	$172,734

The Class "B" common shares are precluded upon the reduction or redemption of such shares or the winding-up of the Company from participating in assets of the Company to a greater extent than the amount paid up thereon. The Class "B" common shares are divided into four Groups which are allotted: Group I to utility companies, Group II to gas export companies, Group III to gas producers and Group IV to four directors appointed by the Lieutenant Governor in Council of the Province of Alberta. Holders of Class "B" common shares have full voting rights except for the election of the seven directors elected by the holders of Class "A" common shares. The holders of Class "B" common shares Group IV have full voting rights in all circumstances.

(c) ISSUED DURING THE YEAR ENDED (CLASS "A" COMMON SHARES)

	(Number of shares)		*(Thousands of dollars)*	
December 31	1985	1984	1985	1984
For cash on exercise of options granted to officers and employees	67,277	42,559	$ 468	$ 291
For cash under the Dividend Reinvestment and Share Purchase Plan	4,518,987	3,636,399	27,072	23,496
On conversion of–				
6⅜% Preferred Shares	818,181	908,905	4,870	5,410
6½% Preferred Shares	387	905	4	9
12% Preferred Shares	–	338	–	2
	5,404,832	4,589,106	$32,414	$29,208

(d) RESERVED (CLASS "A" COMMON SHARES) *(Number of shares)*

December 31	1985	1984
For conversion of the 6⅜% Preferred Shares	3,686,130	4,590,411
For conversion of the 6½% Preferred Shares	18,620,558	19,247,792
For conversion of the 12% Preferred Shares	34,463,393	34,463,393
Under the Incentive Stock Option Plan (1982), options are outstanding to officers and employees to purchase 4,004,850 common shares at prices ranging from $6.125 to $7.375 per share (4,047,100 shares at December 31, 1984, at prices ranging from $6.625 to $7.375 per share) with expiration dates between 1987 to 1993, and 885,500 common shares are reserved but unallocated (910,500 shares at December 31, 1984).	4,890,350	4,957,600
Under the Dividend Reinvestment and Share Purchase Plan	7,711,417	4,281,345
	69,371,848	67,540,541

14. CUMULATIVE TRANSLATION ADJUSTMENT

The movement in the cumulative translation adjustment account is as follows:

(Thousands of dollars)

Year ended December 31	1985	1984
Balance at beginning of year	$ 5,676	$ 8,889
Unrealized balance sheet translation gains (losses):		
Non-working capital items	3,027	5,138
Working capital items	5,800	(1,069)
	8,827	4,069
Realized (gains) losses:		
Subsidiaries sold or held for sale—United States	—	(21,603)
—Italy	—	14,321
	—	(7,282)
Balance at end of year	$14,503	$ 5,676

15. EXTRAORDINARY ITEMS

(a) FOR THE YEAR ENDED DECEMBER 31, 1985 *(Thousands of dollars)*

Provision for the write-down of the linear low-density polyethylene plant (net of income taxes of $144,658)	$(157,342)
Loss on dilution of ownership in Husky Oil Ltd.	(58,921)
Provision for write-down of engineering division (net of income taxes of $6,099)	(10,523)
Gain on disposition of polyvinyl chloride plant (net of income taxes of $2,304)	10,264
Extraordinary loss	$(216,522)

At December 31, 1985, the Company reduced the carrying value of its investment in its linear low-density polyethylene plant to approximately $125,000,000. The Company anticipates that it will earn sufficient cash flow from operations to recover its investment.

In the second quarter of 1985, the Company recorded a non-cash deemed accounting loss relating to the dilution of its ownership in Husky Oil Ltd. The dilution in ownership from approximately 67% to 57% was due to the conversion to common shares of Husky's 13% convertible preferred shares in June 1985.

At December 31, 1985, the Company wrote down the value of an engineering division, CanOcean Resources, in which the Company's ownership will be reduced and some operations curtailed during the first quarter of 1986.

In November 1985, the Company sold its investment in a polyvinyl chloride plant.

(b) FOR THE YEAR ENDED DECEMBER 31, 1984	*(Thousands of dollars)*
Gain on sale of Husky Oil Company (net of income taxes of $87,000 and minority interest of $69,337)	$ 132,619
Provision for write-down to estimated net realizable value of certain assets and subsidiaries held for sale	(49,872)
Provision for write-down of certain other investments (net of income taxes of $27,835)	(34,665)
Extraordinary income	$ 48,082

In May 1984, Husky Oil Ltd. sold Husky Oil Company, its operating subsidiary in the United States, for net proceeds of $625,695,000. This sale resulted in a gain to the Company of $132,619,000. As required by the sale agreement, the refining and marketing sector of Husky Oil Company was retained. Husky had formalized plans to dispose of substantially all of these operations. At December 31, 1984, these subsidiaries and assets were carried at their net realizable value on the consolidated balance sheet as "subsidiaries and assets held for sale." The sale of these subsidiaries and assets was completed December 31, 1985, and resulted in no gain or loss.

At December 31, 1984, the Company had formalized plans to dispose of its investments in valve and flow control manufacturing subsidiaries in the United States and Italy and certain other assets held for sale. The Company provided $49,872,000 with respect to the write-down of such investments to their net realizable value. The principal portion of the write-down, which related to the valve and flow control subsidiaries, amounted to $44,000,000, a significant portion of which resulted from the decline in value of the lira in 1984 and 1983. At December 31, 1984, these subsidiaries were carried at their net realizable value in the consolidated balance sheet as "subsidiaries and assets held for sale." During the second quarter of 1985, the Company decided to continue ownership of its valve and flow control manufacturing subsidiaries since a suitable sale had not been made. Concurrently, these subsidiaries were re-consolidated into the consolidated financial statements.

At December 31, 1984, the Company provided for the write-down of certain of its other investments. This principally included a write-down of the Company's investment in its telecommunications joint venture (NovAtel Communications Ltd.) by $13,092,000 (net of income taxes of $11,610,000) with respect to the costs associated with the design and development of a prototype mobile terminal acquired in early 1983 and the write-down by $19,612,000 (net of income taxes of $14,486,000) of the Company's remaining interest in its polyvinyl chloride plant.

16. EARNINGS (LOSS) PER COMMON SHARE

Earnings (loss) per common share before and after extraordinary items are calculated after deducting the dividend entitlement on preferred shares ($85,511,000 in 1985 and $77,992,000 in 1984) from the income before extraordinary items and net income (loss), respectively, and dividing the resulting amounts using the weighted average number of common shares outstanding during the period (128,087,000 in 1985 and 123,203,000 in 1984).

17. FUNDS PROVIDED FROM OPERATIONS

(Thousands of dollars)

Year ended December 31	1985	1984
Income before extraordinary items	$134,111	$155,268
Add (deduct) items not resulting in a flow of funds		
Depreciation and depletion	310,180	289,283
Deferred income taxes	80,552	146,521
Minority interest	65,511	56,739
Equity component in allowance for funds capitalized during construction	(1,587)	(13,225)
Equity in losses of affiliated companies	7,235	6,367
Other (net)	13,764	17,728
	$609,766	$658,681

18. CHANGES IN NON-CASH WORKING CAPITAL ITEMS

(Thousands of dollars)

Year ended December 31	1985	1984
Accounts receivable	$ (18,744)	$ 38,180
Inventories	(1,320)	83,061
Secured bond	(157,500)	–
Subsidiaries and assets held for sale	111,142	(111,142)
Prepaid expenses	975	1,812
Accounts payable and accrued liabilities	(3,173)	(54,852)
Income taxes payable	(5,999)	74,767
Deferred income taxes	–	(21,074)
Dividends payable	2,488	94
Bank indebtedness	154,625	–
Changes in non-cash working capital items	82,494	10,846
Reclassifications and other items not having a cash effect	(24,681)	(43,667)
Changes in items having a cash effect	$ 57,813	$ (32,821)

These changes relate to the following activities:

(Thousands of dollars)

Year ended December 31	1985	1984
Operating activities	$ 78,896	$ (66,466)
Investment activities	46,429	33,551
Investments	(70,000)	–
Financial obligations	2,488	94
Changes in items having a cash effect	$ 57,813	$ (32,821)

19. PENSION PLANS

The Company and most of its subsidiaries maintain pension plans for substantially all employees. At December 31, 1985, there were no significant unfunded liabilities with respect to any of these plans.

20. CONTINGENCIES AND COMMITMENTS

Pursuant to decisions released by the National Energy Board in 1982 approximately $108,572,000 (the Company's proportionate share) of preliminary Phase II expenditures on the Alaska Highway Gas Pipeline Project were approved. The after-tax amount of these expenditures, approximately $72,669,000, is being amortized on a straight-line basis at an annual rate of 4% and earns a 16% pre-tax rate of return on the unamortized portion. The unamortized balance at December 31, 1985, was $62,978,000 ($65,885,000 at December 31, 1984). In this regard, amounts collected, along with appropriate interest, will be repaid when Phase II commences operations. The Company's proportionate share of the after-tax contingent liability in this regard is $21,453,000 at December 31, 1985 ($16,030,000 at December 31, 1984).

The Company has agreed on a cost-of-service basis under take or pay contracts to purchase, for a term extending to December 31, 1998, ethane acquired by Alberta Gas Ethylene in excess of its requirements for its ethylene plants but not exceeding approximately 8,800 barrels per day.

The Company is responsible for the purchase, directly and indirectly, of approximately 38% of the output of the second ethylene plant, which amount is sufficient to meet the feedstock requirements of the linear low-density polyethylene plant.

The lease for the Company's head office building in Calgary provides, among other matters, for the following:

(a) that the Company, on or after January 1, 1995, make an irrevocable offer to purchase the Property on December 31, 1997. If the offer is accepted, the Company must pay a purchase price equal to the outstanding principal of the first mortgage on the Property, which is expected to be in the amount of $157,500,000, and assume any other outstanding permitted encumbrances registered against the Property.

(b) that the Company is required under a tax indemnity agreement to indemnify the lessor in respect of certain matters calculated by reference to changes in Canadian tax laws in place at the time of entering into the lease and assumptions made in applying these laws including certain matters that would impact on the full availability of rent under the lease.

It is the opinion of management that the occurrence of the events described in (a) and (b) above is remote.

The Company's subsidiary, Husky Oil Ltd., was contingently liable at December 31, 1985, for guarantees of the indebtedness of others. These guarantees are limited to a maximum of $46,791,000.

Husky Oil Ltd. is participating in discussions with the Governments of Canada, Alberta and Saskatchewan regarding the fiscal and financial arrangements for the construction of a heavy oil upgrader, the Bi-Provincial Project, pursuant to the agreement executed by these parties on June 6, 1984. Husky has invested in the planning and design of the heavy oil upgrader plant pursuant to this agreement. This investment totalled $51,639,000 at December 31, 1985. In addition, Husky has made investments in the development of heavy oil for feedstock and has also recorded royalty reductions totalling $17,906,000 in respect of production during the period from June 6, 1984, to December 31, 1985.

Various lawsuits and claims are pending by and against the Company. It is the opinion of management that final determination of these claims will not materially affect the financial position or the results of the Company.

The Company and its subsidiaries have obligations under long term leases for certain office space and equipment. The approximate annual rental payments for the next five years, under these leases, excluding operating expenses, are disclosed below together with income from sub-leases, amounts recovered under cost-of-service operations and other eliminations.

(Thousands of dollars)

	1986	1987	1988	1989	1990
NOVA head office building	$16,654	$16,099	$16,099	$16,099	$17,749
Husky head office building	23,051	23,051	25,340	29,915	29,915
Other real estate and equipment	19,561	15,549	13,034	11,707	10,880
	59,266	54,699	54,473	57,721	58,544
Less income from sub-leases, amounts recovered under cost-of-service operations and other eliminations	(33,791)	(31,747)	(32,286)	(35,981)	(37,122)
	$25,475	$22,952	$22,187	$21,740	$21,422

Husky Oil Ltd. has a 50% interest in a joint venture which owns and operates its head office building. Husky has leased the office space for its own use and this lease is pledged, together with the joint venture's assets of $140,372,000, as security for long term mortgage bonds issued by the joint venture totalling $137,019,000 at December 31, 1985.

21. SUBSEQUENT EVENT

On February 13, 1986, the Company received $157,500,000 on redemption of the Secured Bond. These proceeds, after the payment of expenses incurred on the sale/leaseback arrangement for the Company's head office building, were used to reduce "bank indebtedness" shown as a current liability on the balance sheet at December 31, 1985 (Note 10).

22. SEGMENTED INFORMATION

(a) FINANCIAL INFORMATION BY BUSINESS SEGMENT

The management of the Company has determined that the following are the principal business segments of the Company:

Gas Transportation & Marketing—transportation and marketing of natural gas.

Petroleum —exploration, development, production and refining activities for crude oil and natural gas, together with consulting and research.

Petrochemicals —production, transportation and marketing activities for various petrochemical products.

Manufacturing —design, development, manufacture and marketing of various products primarily for use in the resource, transportation and telecommunications industries.

(Thousands of dollars)

	1985	1984	1983
Revenue			
Gas Transportation & Marketing	$1,527,785 45.6%	$1,492,489 39.3%	$1,496,813 39.1%
Petroleum	$ 965,228 28.8%	$1,607,090 42.4%	$1,674,872 43.8%
Petrochemicals	$ 756,819 22.6%	$ 587,685 15.5%	$ 521,988 13.7%
Manufacturing	$ 97,404 3.0%	$ 106,269 2.8%	$ 129,332 3.4%
Consolidated	$3,347,236 100%	$3,793,533 100%	$3,823,005 100%
Net operating income			
Gas Transportation & Marketing	$ 345,478 51.3%	$ 347,410 51.3%	$ 314,022 57.7%
Petroleum	$ 266,531 39.6%	$ 273,457 40.4%	$ 178,967 32.9%
Petrochemicals	$ 48,036 7.1%	$ 63,392 9.4%	$ 50,257 9.2%
Manufacturing	$ 13,527 2.0%	$ (7,271) (1.1%)	$ 817 0.2%
Consolidated	$ 673,572 100%	$ 676,988 100%	$ 544,063 100%
Identifiable assets			
Gas Transportation & Marketing	$2,351,636 37.0%	$2,425,761 37.7%	$2,350,681 34.6%
Petroleum	$2,270,621 35.7%	$2,120,960 33.0%	$2,708,467 39.8%
Petrochemicals	$1,198,535 18.9%	$1,520,289 23.7%	$1,291,129 19.0%
Manufacturing	$ 265,863 4.2%	$ 154,616 2.4%	$ 243,848 3.6%
Other	$ 265,409 4.2%	$ 206,263 3.2%	$ 201,931 3.0%
Consolidated	$6,352,064 100%	$6,427,889 100%	$6,796,056 100%

(Thousands of dollars)

	1985	1984	1983
Plant, property and equipment additions			
Gas Transportation & Marketing	$ 79,201	$ 79,969	$ 154,612
	20.4%	12.8%	16.6%
Petroleum	$ 295,424*	$ 312,736*	$ 373,881*
	76.3%	50.1%	40.0%
Petrochemicals	$ 11,313	$ 220,592	$ 376,587
	2.9%	35.4%	40.3%
Manufacturing and Other	$ 1,380	$ 10,776	$ 28,727
	0.4%	1.7%	3.1%
Consolidated	$ 387,318	$ 624,073	$ 933,807
	100%	100%	100%

(b) FINANCIAL INFORMATION BY GEOGRAPHIC AREA

(Thousands of dollars)

	1985	1984	1983
Revenue			
Canada	$3,197,026	$2,941,760	$2,713,643
	95.5%	77.5%	71.0%
United States	$ 87,955	$ 754,983	$ 958,839
	2.6%	19.9%	25.1%
Other	$ 62,255	$ 96,790	$ 150,523
	1.9%	2.6%	3.9%
Consolidated	$3,347,236	$3,793,533	$3,823,005
	100%	100%	100%
Net operating income			
Canada	$ 658,562	$ 655,588	$ 518,613
	97.8%	96.8%	95.3%
United States	$ 6,795	$ 24,797	$ 26,835
	1.0%	3.7%	4.9%
Other	$ 8,215	$ (3,397)	$ (1,385)
	1.2%	(0.5%)	(0.2%)
Consolidated	$ 673,572	$ 676,988	$ 544,063
	100%	100%	100%
Identifiable assets			
Canada	$6,094,934	$6,210,924	$5,684,591
	96.0%	96.6%	83.6%
United States	$ 127,479	$ 157,132	$ 888,003
	2.0%	2.5%	13.1%
Other	$ 129,651	$ 59,833	$ 223,462
	2.0%	0.9%	3.3%
Consolidated	$6,352,064	$6,427,889	$6,796,056
	100%	100%	100%

*Net of Petroleum Incentive Program grants of $123,953 in 1985, $161,703 in 1984 and $97,614 in 1983.

Supplemental Financial Information

(unaudited)

CONSOLIDATED LONG TERM DEBT

The Company's consolidated long term debt, including the portion due within one year, amounted to $2.838 billion at December 31, 1985, down $148 million from the 1984 year end amount of $2.986 billion.

Of the total of $2.838 billion at December 31, 1985, $1.895 billion or about 67% relates to the Company's investments in gas transportation and marketing activities and certain petrochemical facilities[1], which operate under contracts or other agreements that provide for recovery of the principal portion of the associated cost-of-service debt through collection of depreciation and amortization. These arrangements also protect the Company from interest rate and foreign currency fluctuation. Interest expense is recovered through the rate of return, along with a return to NOVA's common shareholders. Any foreign exchange gains or losses are for the account of the customer.

The table below outlines the mix of NOVA's consolidated long term debt at December 31, 1985 and 1984, and helps to measure the degree to which the Company's consolidated earnings are affected by changes in interest rates and foreign currency exchange rates.

(Thousands of dollars)

December 31	1985		1984	
Operation Mix				
Cost of service	$1,895,395	67%	$1,888,278	63%
Non-cost of service	942,549	33%	1,097,474	37%
	$2,837,944	100%	$2,985,752	100%
Interest Mix				
Floating rate				
Cost of service	$ 431,327	15%	$ 429,054	14%
Non-cost of service	483,739	17%	715,000	24%
	915,066	32%	1,144,054	38%
Fixed rate	1,922,878	68%	1,841,698	62%
	$2,837,944	100%	$2,985,752	100%
Currency Mix				
Foreign currency debt[2]				
Cost of service	$ 989,955	35%	$ 973,053	33%
Non-cost of service	336,213	12%	253,536	8%
	1,326,168	47%	1,226,589	41%
Canadian dollars	1,511,776	53%	1,759,163	59%
	$2,837,944	100%	$2,985,752	100%

Notes: [1] The Company is directly and indirectly responsible for 38% of the second ethylene plant's output, which is used as feedstock in the linear low-density polyethylene plant.

[2] Foreign currency debt is mainly in U.S. dollars. Included in foreign currency debt at December 31, 1985, are unrealized translation adjustments, arising on the translation of foreign denominated debt of Canadian operations, of $177 million (1984—$95 million); of this amount, $134 million (1984—$85 million) relates to cost-of-service activities.

SUMMARIZED QUARTERLY FINANCIAL DATA

(Thousands of dollars except for per share data)

Three months ended	March 31		June 30		September 30		December 31	
	1985	1984	1985	1984	1985	1984	1985	1984
Operating revenue	$ 873,682	946,200	808,640	959,629	796,265	1,032,416	868,649	855,288
Net operating income	$ 163,025	162,058	164,055	157,523	176,894	177,583	169,598	179,824
Income before extraordinary items	$ 31,593	34,964	30,726	38,992	32,492	37,216	39,300	44,096
Extraordinary items	$ —	—	(58,921)	133,509	—	—	(157,601)	(85,427)

Three months ended	March 31		June 30		September 30		December 31	
	1985	1984	1985	1984	1985	1984	1985	1984
Net income (loss)	$ 31,593	34,964	(28,195)	172,501	32,492	37,216	(118,301)	(41,331)
Earnings per common share before extraordinary items								
Basic	$ 0.08	0.13	0.07	0.16	0.09	0.14	0.14	0.20
Fully diluted	$ 0.08	0.12	0.07	0.16	0.09	0.14	0.14	0.18
Earnings (loss) per common share after extraordinary items								
Basic	$ 0.08	0.13	(0.39)	1.25	0.09	0.14	(1.09)	(0.50)
Fully diluted	$ 0.08	0.12	(0.39)	0.80	0.09	0.14	(1.09)	(0.29)
Market price per common share								
High	$ 7⅝	7⅞	6⅝	7⅝	7	7¾	7¼	8⅛
Low	$ 6¼	6⅜	5½	6½	5¾	6⅝	5¾	6¾

OIL AND GAS ACTIVITIES

The following information provides the estimated quantities of proved oil and gas reserves of the Company, including 100% of Husky's reserves.

	Total		Canada		United States		Philippines
	Oil	Gas	Oil	Gas	Oil	Gas	Oil
PROVED DEVELOPED AND UNDEVELOPED RESERVES							
At January 1, 1984	153,122	587,721	108,359	478,202	42,601	109,519	2,162
Revisions of previous estimate	6,110	16,652	5,956	15,242	154	1,410	–
Improved recovery	742	–	742	–	–	–	–
Purchases of minerals in place	950	42,000	950	42,000	–	–	–
Extensions, discoveries and other additions	12,714	36,864	12,688	34,638	26	2,226	–
Production	(15,895)	(30,283)	(13,058)	(25,789)	(2,321)	(4,494)	(516)
Sales of minerals in place	(42,023)	(108,661)	–	–	(40,460)	(108,661)	(1,563)
At December 31, 1984	115,720	544,293	115,637	544,293	–	–	83
Revisions of previous estimate	(3,122)	(9,097)	(3,122)	(9,097)	–	–	–
Improved recovery	6,221	–	6,221	–	–	–	–
Extensions, discoveries and other additions	14,559	66,955	14,559	66,955	–	–	–
Production	(13,967)	(27,521)	(13,902)	(27,521)	–	–	(65)
Sales of minerals in place	(18)	–	–	–	–	–	(18)
At December 31, 1985	**119,393**	**574,630**	**119,393**	**574,630**	–	–	–
PROVED DEVELOPED RESERVES							
At December 31, 1983	147,466	531,211	108,209	442,202	37,095	89,009	2,162
At December 31, 1984	114,645	455,293	114,562	455,293	–	–	83
At December 31, 1985	**115,793**	**448,630**	**115,793**	**448,630**	–	–	–

Crude oil, including natural gas liquids, is expressed in thousands of barrels. A barrel represents a stock tank barrel equivalent to 42 U.S. gallons or 35 Imperial gallons. Natural gas is expressed in millions of cubic feet measured at 60° F and 14.65 psia.

Volumes represent the net reserves owned after deduction of royalties, reversionary interests and net profit interests owned by others.

Ten-Year Financial Review

(Thousands of dollars except for share data)

	1985	1984
Statement of Income		
Operating revenue	$3,347,236	3,793,533
Operating expenses	$2,288,419	2,756,599
Depreciation and depletion	$ 310,180	289,283
Petroleum and gas revenue tax	$ 52,903	55,550
Loss (gain) on foreign currency translation	$ 22,162	15,113
Net operating income	$ 673,572	676,988
Equity in earnings (losses) of affiliated companies	$ (7,235)	(6,367)
Allowance for funds used during construction	$ 3,171	31,800
Other (income) expenses	$ (1,921)	(1,551)
Interest expense (net)	$ 315,915	341,765
Income before income taxes, minority interest and extraordinary items	$ 355,514	362,207
Income taxes	$ 155,892	150,200
Minority interest	$ 65,511	56,739
Income before extraordinary items	$ 134,111	155,268
Extraordinary income (loss)	$ (216,522)	48,082
Net income (loss)	$ (82,411)	203,350
Assets		
Working capital at year end	$ 25,514	38,524
Additions to plant, property and equipment	$ 387,318	624,073
Investment in plant, property and equipment (cost)	$6,025,673	6,080,891
Investment in plant, property and equipment (net)	$4,863,581	5,190,296
Deferred costs and other assets (net)	$ 202,730	123,712
Total assets	$6,352,604	6,427,889
Capital Employed		
Long term debt (less due within one year)	$2,738,979	2,874,278
Deferred income taxes	$ 425,983	496,802
Deferred gain	$ 62,359	–
Minority interest	$ 611,015	560,954
Shareholders' equity		
Preferred shareholders	$ 861,957	780,594
Common shareholders	$ 563,270	742,923
Share Data		
Earnings per common share before extraordinary items		
Basic	$ 0.38	0.63
Fully diluted	$ 0.38	0.60
Earnings (loss) per common share after extraordinary items		
Basic	$ (1.31)	1.02
Fully diluted	$ (1.31)	0.77
Dividends paid per Class "A" common share	$ 0.40	0.40
Average common shares outstanding during year (thousands)	128,087	123,203
Number of common shares outstanding at year end (thousands)	130,658	125,254
Book value per common share	$ 4.31	5.93
Market value per common share		
High	$ 7⅝	8⅛
Low	$ 5½	6⅜

1983	1982	1981	1980	1979	1978	1977	1976
3,823,005	3,500,066	2,666,120	2,114,520	1,218,541	431,952	348,779	271,397
2,916,826	2,702,220	2,059,457	1,586,124	871,241	280,802	186,725	146,992
307,959	246,315	185,517	157,207	93,817	37,217	38,599	29,493
43,610	33,571	16,105	—	—	—	—	—
10,547	6,261	17,347	7,734	231	(6,168)	(2,184)	—
544,063	511,699	387,694	363,455	253,252	120,101	125,639	94,912
(8,605)	5,038	14,054	16,267	18,580	16,924	3,184	1,620
50,168	85,928	74,398	17,399	21,180	23,777	13,831	8,544
1,434	3,108	11,916	6,720	2,076	3,970	—	904
317,031	348,376	248,869	93,606	64,677	41,113	28,055	29,470
267,161	251,181	215,361	296,795	226,259	115,719	114,599	74,702
78,080	65,221	45,281	103,700	72,347	24,070	49,372	30,338
38,348	35,436	42,639	51,320	38,629	5,743	7,756	4,947
150,733	150,524	127,441	141,775	115,283	85,906	57,471	39,417
(115,605)	—	—	—	—	—	—	—
35,128	150,524	127,441	141,775	115,283	85,906	57,471	39,417
59,273	16,168	11,889	60,457	121,512	125,431	64,305	87,279
933,807	1,221,953	1,371,230	569,389	313,905	233,154	233,988	152,244
6,589,882	5,658,708	4,338,590	2,995,523	2,428,530	1,368,054	1,110,991	863,007
5,541,801	4,870,523	3,753,956	2,549,880	2,114,209	1,137,686	923,420	712,674
69,100	143,332	197,641	126,568	110,578	68,421	46,358	29,120
6,796,056	6,333,029	5,012,175	3,671,523	3,144,422	2,062,096	1,443,625	945,356
3,404,578	2,740,612	2,206,283	1,043,009	1,038,193	821,091	744,255	411,311
434,729	388,632	359,181	319,686	251,813	90,754	62,653	40,747
—	—	—	—	—	—	—	—
485,075	495,383	441,649	442,819	412,270	218,208	15,915	10,293
800,907	826,122	441,235	492,723	363,581	392,593	210,597	142,254
639,413	692,479	627,846	527,295	402,061	318,245	270,546	239,936
0.60	0.80	0.88	1.08	0.98	0.77	0.55	0.47
0.58	0.74	0.80	0.90	0.81	0.71	0.53	0.45
(0.38)	0.80	0.88	1.08	0.98	0.77	0.55	0.47
(0.38)	0.74	0.80	0.90	0.81	0.71	0.53	0.45
0.40	0.40	0.38666	0.36	0.30833	0.25907	0.2448	0.20453
118,478	114,341	107,583	99,001	89,223	85,083	82,263	66,063
120,664	116,189	110,961	103,351	92,253	87,354	83,474	80,807
5.30	5.96	5.66	5.10	4.36	3.64	3.24	2.97
9½	9⅞	14⅜	13⅜	9⅜	5½	5½	4⅞
6	5⅛	7¼	8	4⅞	4⅝	4¼	3⅝

Corporate Directory

BOARD OF DIRECTORS*

Edward W. Best
Partner, Foster Research, Calgary, Alberta (Economic Research)

S. Robert Blair, C.C.
Chairman and Chief Executive Officer of the Company

Arthur J. E. Child, O.C.
President and Chief Executive Officer, Burns Foods Limited, Calgary, Alberta (Food Processor)

J. Joseph Healy
President, Healy Motors Limited, Edmonton, Alberta (Transportation)

Harley N. Hotchkiss
President, Harman Resources Ltd., Calgary, Alberta (Private Investor—Oil and Gas, Real Estate and Agriculture)

William A. Howard
Senior Partner, Howard, Mackie, Calgary, Alberta (Barristers and Solicitors)

Peter L. P. Macdonnell, C.M.
Partner, Milner & Steer, Edmonton, Alberta (Barristers and Solicitors)

John R. McCaig
Chairman and Chief Executive Officer, Trimac Limited, Calgary, Alberta (Transportation and Energy Resources)

Frederick A. McKinnon
Retired, Calgary, Alberta

A. Ernest Pallister
President, Pallister Resource Management Ltd., Calgary, Alberta (Resource Management)

H. J. Sanders Pearson
Chairman and Chief Executive Officer, Century Sales & Service Limited, Edmonton, Alberta (Industrial Tools and Fasteners Distribution); Vice Chairman of the Board of Directors of the Company

Robert L. Pierce
President of the Company

Daryl K. Seaman
Chairman, Bow Valley Industries Ltd., Calgary, Alberta (Natural Resource Services, Exploration and Development)

Ronald D. Southern
Deputy Chairman and Chief Executive Officer, ATCO Ltd., Calgary, Alberta (Manufacturing, Utilities, Natural Resources and Real Estate)

*There was one vacancy on the Board at the time of publication of this report.

CORPORATE OFFICERS

S. Robert Blair
Chairman and Chief Executive Officer

Robert L. Pierce
President

John E. Feick
Senior Vice President

Dianne I. Hall
Senior Vice President and Secretary to the Board

William C. Rankin
Senior Vice President

Bruce W. Simpson
Senior Vice President

John W. F. Cowell, M.D.
Vice President, Occupational Health and Safety

Georges Dubé
Vice President, General Counsel and Corporate Secretary

Richard C. Milner
Vice President and Treasurer

Brian F. Olson
Vice President

John Patterson
Vice President and Controller

Joan A. Dennis
Assistant Secretary

Thomas G. Milne
Assistant Treasurer

Note: Peter C. Flynn and Edmond A. Lemieux, both vice presidents, are currently assigned on a full-time basis to affiliated companies.

SENIOR OFFICERS, ALBERTA GAS TRANSMISSION DIVISION

Donald G. Olafson
Division Senior Vice President

Robert B. Snyder
Division Senior Vice President

Design
The Design Works
Typesetting
Duffoto Process Company Ltd.
Production
NOVA Creative/Graphic Arts Services
Printing
Mitchell Press Limited

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SENIOR OFFICERS, PRINCIPAL SUBSIDIARIES AND AFFILIATES

Arthur R. Price
President, Husky Oil Ltd.

John E. Feick
President, Novacor Chemicals Ltd.

C. Kent Jespersen
President, Foothills Pipe Lines (Yukon) Ltd.

Luigi Fiore
Chairman, Grove Italia S.p.A.

Donald G. Olafson
President, Novacorp International Consulting Ltd.

Del Lippert
President and Chief Executive Officer, NovAtel Communications Ltd.

Gordon W. Cameron
President and Chief Executive Officer, Pan-Alberta Gas Ltd.

PRINCIPAL COMPANIES IN THE NOVA GROUP

Gas Transportation & Marketing
Alberta Gas Transmission Division of NOVA (100%)
Trans Québec & Maritimes Pipeline Inc. (50%)
Foothills Pipe Lines (Yukon) Ltd. (50%)
Pan-Alberta Gas Ltd. (50.005%)

Petroleum
Husky Oil Ltd. (57%)
Novalta Resources Ltd. (100%)

Petrochemicals
Novacor Chemicals Ltd. (100%)
The Alberta Gas Ethylene Company Ltd. (100%)
Alberta Gas Chemicals Ltd. (50%)
A. G. Pipe Lines Companies (100%)

Manufacturing
Grove Italia S.p.A. (100%)
Grove Valve and Regulator Company (100%)
NovAtel Communications Ltd. (50%)
Western Star Trucks Inc. (50%)
CNG Fuel Systems (50%)

Consulting & Research
Novacorp International Consulting Ltd. (100%)
NOVA/Husky Research Corporation Ltd. (50%/50%)
Noval Enterprises Division of NOVA (100%)

Other
Novalta Property Services Ltd. (100%)

SOLICITORS

Howard, Mackie
Calgary, Alberta

AUDITORS

Clarkson Gordon
Calgary, Alberta

PRINCIPAL OFFICES

Corporate Headquarters

NOVA, AN ALBERTA CORPORATION
801 Seventh Avenue S.W.
P.O. Box 2535, Postal Station M
Calgary, Alberta T2P 2N6
(403) 290-6000
Telex 038-21503
Telecopier (403) 290-6379

Other Principal Offices

ALBERTA GAS TRANSMISSION DIVISION
Operations Office
9888 Jasper Avenue
P.O. Box 2330
Edmonton, Alberta T5J 2R1
(403) 423-6111

FOOTHILLS PIPE LINES (YUKON) LTD.
3000 - 707 Eighth Avenue S.W.
Calgary, Alberta T2P 3W8
(403) 294-4111

GROVE ITALIA S.p.A.
Strada Campoferro 15
27058 Voghera (PV) Italy
(39) 383-6911

HUSKY OIL LTD.
707 Eighth Avenue S.W.
P.O. Box 6525, Postal Station D
Calgary, Alberta T2P 3G7
(403) 298-6111

NOVACOR CHEMICALS LTD.
1600 - 734 Seventh Avenue S.W.
Calgary, Alberta T2P 3P9
(403) 290-8977

NOVACORP INTERNATIONAL CONSULTING LTD.
P.O. Box 2535, Postal Station M
Calgary, Alberta T2P 2N6
(403) 290-6000

NOVALTA PROPERTY SERVICES LTD.
P.O. Box 2535, Postal Station M
Calgary, Alberta T2P 2N6
(403) 290-6000

NOVATEL COMMUNICATIONS LTD.
700 Ninth Avenue S.W.
Calgary, Alberta T2P 3V4
(403) 298-0444

PAN-ALBERTA GAS LTD.
500 - 707 Eighth Avenue S.W.
Calgary, Alberta T2P 3V3
(403) 234-6600