Alberta Eastern Gas Limited
Annual Report June 30, 1971

ALBERTA EASTERN GAS LIMITED

515 Barron Building
610 - Eighth Ave. S.W.
Calgary 2, Alberta
Telephone 261-7040

LISTED

Toronto Stock Exchange
Calgary Stock Exchange

DIRECTORS

J. V. Lyons, Calgary, Alberta, Chairman of the Board
W. J. Bushnell, Toronto, Ontario
R. A. McCullough, Calgary, Alberta, Vice-President
F. G. Vetsch, Calgary, Alberta, President
John T. Wood, Calgary, Alberta

OFFICERS

J. V. Lyons, Chairman of the Board
F. G. Vetsch, President & Chief Executive Officer
R. A. McCullough, Vice-President & Treasurer
W. G. Fyfe, Secretary

TRANSFER AGENTS
Montreal Trust Company
Toronto - Calgary

AUDITORS
Riddell, Stead & Co.

BANKERS

Canadian Imperial Bank of Commerce

CHAIRMAN'S REPORT

In the Interim Report of February 26, 1971, I reported to you that your Company's Alderson Milk River Pilot Project was performing to our satisfaction and in accordance with independent forecasts prepared by our Company's consultants, James A. Lewis Engineering Co. Ltd. Accordingly, your Board of Directors, wishing to aggressively pursue the development of production from the Milk River lands held by your Company, felt that a new emphasis was necessary to assure optimum economic operations. To this end, your Company engaged Mr. E. G. Vetsch as President and Chief Executive Officer on March 1, 1971, and I became Chairman of the Board.

Mr. Vetsch is a Petroleum Engineer with 20 years experience in various phases of gas and oil production, development, engineering and management in the industry. Prior to his joining your Company, he was Vice President, Operations, and a Director of Atlantic Richfield Canada Limited a company which has been and is active in the Milk River producing areas of Southern Alberta.

Sincerely,

Chairman of the Board.

Calgary
November 23, 1971

HIGHLIGHTS

	1971	1970
LAND AND WELLS	as at Nov. 15	
TOTAL GROSS ACREAGE EARNED OR OPTIONED	651,509	629,487
TOTAL NET ACREAGE EARNED TO DATE	413,984	355,582
TOTAL PRODUCTIVE MILK RIVER WELLS DRILLED	175	89
TOTAL MILK RIVER WELLS ON PRODUCTION	118	43
TOTAL MILK RIVER WELLS CAPPED	48	38
PRODUCTIVE MILK RIVER WELLS COMPLETED IN OTHER ZONES, SOLD OR ABANDONED	9	8
OTHER GAS WELLS ON PRODUCTION (Net)	4¼	–
OTHER GAS WELLS CAPPED (Net)	1¾	7
RESERVES (billions cubic feet)		
MILK RIVER GAS RESERVES:		
ALBERTA – Proved	345	72
– Additional potential	651	800
SASKATCHEWAN – Potential	600	624
OTHER GAS RESERVES – Potential	50	70
Total	1,646	1,566
PRODUCTION (Fiscal year July 1 to June 30)		
GAS (billions cubic feet)	2.817	1.542

PRESIDENT'S REPORT

Your Company has entered the most important phase of its programme designed to develop for production large tracts of Milk River natural gas acreage, which are indicated as economically productive by our widely spaced drilling activities. I am very pleased to be associated with Alberta Eastern Gas Limited and to contribute to its future.

In the past six months, the outlook of your Company has materially improved because of the following developments:

(a) The reservoir performance of our Alderson No. 1 Pilot Project has been confirmed as satisfactory by the Company's consultants, James A. Lewis Engineering Co. Ltd. Technical and mechanical improvements have been made to this Pilot Project, and these will be applied in future production units.

(b) The industry has achieved an important breakthrough in the stimulation of Milk River gas wells by hydraulically fracturing the zone in fully cased and cemented wells at only a slight increase in the cost per well. The result of this operation is to further improve the economics of Milk River gas production by providing more deliverability for each dollar spent. Some of our Alberta Milk River gas lands previously assessed as perhaps marginal will now become economically attractive by application of this stimulation technique.

(c) We have concluded a major renegotiation of natural gas sales contracts involving Trans-Canada Pipe Lines Limited and another buyer.

Under the terms of the new contract, Alberta Eastern Gas Limited will commit all of its uncontracted gas reserves in South Eastern Alberta, Townships 12 to 20, Ranges 1 to 15, W4M, to Trans-Canada at an initial price of 19½¢/mcf delivered to Alberta Gas Trunk Line Co. Ltd., escalating ¼ cent/mcf/yr. All old contracts at 13½¢ for Alderson Project 1, and 17¢ for Alderson Project 2 are upgraded to 19½¢/mcf effective March 1, 1972. In addition, a volume of 20 mmcf/d from the Tilley area, will be made available to another Buyer under the exchange agreements with Trans-Canada Pipe Lines Ltd., for which the other Buyer will advance $3,000,000 for development at an interest rate of 3½ percent repayable out of production over a five year period. Alberta Eastern's interest in this 20 mmcf/d project will be approximately 80%. Delivery from the "Tilley Project" to satisfy this portion of the contract is planned for March, 1972. Under this new blanket contract Alberta Eastern undertakes to expand production to Trans-Canada to not less than 40 mmcf/d by November, 1972, not counting deliveries from the "Tilley Project". In summary, by November 1972 Alberta Eastern's producing rate will be at least as below:

Alderson 1, Alderson 2 and other projects		40.0 mmcf/d
Bantry Bow Island & Medicine Hat		3.0 mmcf/d
Tilley Project (80%)		16.0 mmcf/d
	Total	59.0 mmcf/d

This blanket contract contains provisions for price renegotiation every five years and a "Favored Nations Clause" for the area of interest.

(d) Natural Gas prices have continued to improve as illustrated in the renegotiations related in part (c) above, as summarized below:

1. The Alderson Project 1 price will increase by 42%, from 13¼ to 19½¢ mcf,
2. The Alderson Project 2 price will increase by 15%, from 17¢ to 19½¢ mcf,

both effective March 1, 1972. These price changes provide a material improvement in your Company's revenue and the value of natural gas reserves in the ground.

Your Company expects to achieve a daily production rate in the range of 60 to 80 million cubic feet by late 1972 and to have the major portion of its Alberta Milk River acreage on production within two years.

Yours sincerely,

F. G. Vetsch
President.

Calgary
November 25, 1971.

ALDERSON PROJECT NO. 1 (PILOT PROJECT)

Although the existence of natural gas in the Milk River formation has been known for some 80 years, this project, placed on production by us in December 1969, was the first attempt to produce gas from the Milk River reservoir commercially on a large scale. Originally we placed 43 wells on production and a further four wells were added to this project in June 1971, thus 47 of our gas wells are currently supplying this project. The gas contract covering this unit provides for deliveries of up to 10 million cubic feet per day, but due to complications mentioned in our previous communications, delivery targets have been reduced to approximately 8.0 million cubic feet of gas per day.

All of these wells were drilled with air through the Milk River zone and completed "open hole" (that is with the 300 ft. Milk River zone unsupported by any type of casing). After about one year of production, your Company and others have found that production could be improved at a slight additional cost per well by setting in slotted steel liners. To date, 29 of the 47 wells have been so lined.

Experience gained by us in this No. 1 Project and by other producing companies in the general area is continually being assessed and where beneficial results are evident by the application of new techniques, they are being incorporated in our projects.

Two land earning wells, as required by an option agreement, were drilled in the third quarter of 1971, one of which will be fractured on completion. The connection of these wells to the system later in the year will bring the total of productive wells in No. 1 Project to 49.

As mentioned in the President's letter, the upward renegotiation of the natural gas price in this project will encourage your Company to keep the compressor station loaded to its capacity at all times.

ALDERSON PROJECT NO. 2

In mid 1971 your Company finalized a gas sales contract with Trans-Canada Pipe Lines providing for delivery of an additional 25 million cubic feet per day by November 1972 from a unit to be known as Alderson No. 2 Project. Fifteen million cubic feet per day is scheduled for production in November 1971. The initial price for this gas under the contract was 17¢ per thousand cubic feet, escalating ¼¢ per year, and subject to price redetermination after five years. This contract has been revised to 19½¢ per thousand cubic feet as outlined in the President's letter. Acreage committed for delivery of this gas comprises about 55,000 acres as indicated on the centre spread map in this report.

The productive area of Alderson No. 2 Project had been largely delineated during 1970 by our wells in Alderson No. 1 Project, those of Atlantic Richfield Canada Limited on adjoining lands and by six wells drilled by ourselves in the course of earning lease rights. Additional wells were drilled within the area in June and August of this year to further prove the area, and to evaluate other well completion techniques, including hydraulic fracturing. This was followed by the drilling of an additional 50 wells to supply the 15 million cubic feet per day volume.

Of the 50 wells about half were completed "open hole" with slotted liners set over the producing zone. The other half were cased and cemented to the base of the Milk River zone and hydraulically fractured to stimulate daily production rates. This technique has been used by others in the Milk River zone with good results and your Company experimented with it in the six wells drilled during August. Test results were sufficiently encouraging to justify the completion in this manner. In all, 69 wells will be connected this year.

The gas gathering system and a compressor station of improved design has been installed and commenced gas deliveries on Nov. 15, 1971.

Although the Company has applied for and received permission to drill this area on 160 acres spacing, similar to Alderson No. 1, original drilling has been done largely on 320 acres spacing. To maintain deliverability, further drilling may be on 320 acres or infill drilling on 160 acres spacing, depending on well performance and economics.

THE TILLEY PROJECT

As referred to in the President's letter, arrangements had been completed to sell 20 million cubic feet per day of Milk River gas from the Tilley area. This area is outlined on the centre spread map in this report and comprises approximately 95,000 acres. Our share of this project is about 80%. This contract calls for an initial sales price of 19½¢ per thousand cubic feet with an escalation clause of ¼¢ per annum.

The gas buyer has arranged for an immediate advance of $3,000,000 to Alberta Eastern Gas Limited and partners for the overall project. This advance will bear interest at a rate of 3½%/year, and will be repaid over five years commencing with the assignment of 40% of proceeds of gas sales from the project.

The area designated for supply of this gas was largely delineated by drilling in 1969 and 1970. Ten additional wells were drilled in late October of this year to evaluate the relative effectiveness of the air drilling and fracturing techniques. Most of these wells, together with an additional 90 wells, will be used to produce sufficient gas to meet the initial requirements of the contracts.

Production from this project is expected to commence in March 1972, reaching full rate by July 1, 1972.

MEDICINE HAT PROJECT

While your Company has been producing gas from lands in the Medicine Hat area since January 1971, the future prospects now look less attractive than originally expected. To offset the extra costs which your Company could have been called upon to make to maintain production at reasonable rates, we have sold 50% of our interest in the lands within this area and the money received from this sale can be utilized in the future to maintain our remaining interest. This property will provide us with production of approximately one million cubic feet per day.

BANTRY BOW ISLAND POOL

Negotiations with Trans-Canada Pipe Lines resulted in a reserve type contract and the recognition of a reserve of 17 billion cubic feet of pipeline gas which will support a producing rate of about 2.4 mmcf/d for 20 years, 50% owned by your Company.

This reserve is based on the gas buyer's mapping of the formation which denies continuity of the producing zone between the existing wells, a concept which your Company believes to be invalid.

GAS RESERVES

In our report to shareholders last year, management estimated potential gas reserves at 1,566 billion cubic feet. Of this total, only one area, Alderson No. 1, had been studied and assigned proven reserves by the Company's consultants, James A. Lewis Engineering Co. Ltd., amounting to 76 billion cubic feet. Since that time, at our request, detailed studies of Milk River reserves have been made by these consultants in other areas.

Alderson Project No. 1, reserves were reconfirmed at 72 billion cubic feet after allowance for production. In our Alderson No. 2 Project area at June 1, 1971, these consultants assigned reserves of 101 billion cubic feet of proven recoverable gas over 25 years to 23,040 acres. Since that time delineation drilling has enlarged the productive area adjoining Alderson No. 2 and additional acreage has been acquired. Your management estimates that these add some 150 billion cubic feet of potential reserves in that vicinity.

In the Tilley area, the 80% interest of your Company in 66,560 acres was assigned proven recoverable reserves over 25 years, of 172 billion cubic feet and probable reserves of an additional 93 billion cubic feet by the same consultant. Further, the company has 26,240 net acres in adjoining lands not included in this consultant's report. Potential reserves in this and the remainder of our Alberta lands are estimated by the management to be 608 billion cubic feet and those in the 189,240 net acres in Saskatchewan at 600 billion cubic feet.

The total of the above quoted reserves is as follows:

Consultants' proven gas reserves	345 billion cubic feet
Consultants' probable gas reserves	93 billion cubic feet
Management's estimated additional potential	1208 billion cubic feet
Total	1646 billion cubic feet

The reserves in Alberta have been placed under contract to Trans-Canada Pipe Lines at an initial price of 19½¢ per Mcf in the new blanket agreement. The reserves estimated to exist in the Saskatchewan lands are not contracted to any gas buyer and remain free to be dealt with in the future on such terms as may be arranged. However, we expect that in view of the favorable climate for natural gas sales and the upward trend of prices, these will be sold on conditions no less favorable and probably more favorable than those recently negotiated for the Alberta reserves.

The recent report and recommendations of the National Energy Board with reference to the export of gas does not affect the Company's sales arrangement for the Alberta reserves since these are committed for sale to Trans-Canada Pipe Lines under the new blanket agreement.

LAND HOLDINGS

In the past year, additional adjustments have been made in our land holding portfolio. As of November 1, 1971, your Company held lease rights, options and permits on 651,509 gross acres (524,859 net acres). Of these net acreage holdings, lease rights have been earned in 413,984 acres. Our present plans indicate that by the end of 1972 our gross acreage could possibly be about 610,000 acres with an indicated net interest in about 480,000 acres. As our land earning plans required considerable future expenses, your Company accepted participants to assist us to earn some of our land rights in the Tilley area of Alberta and in Saskatchewan.

In the Tilley area of Alberta, a participant has earned rights to some 8,560 net acres by contributions to drilling costs of deep test land earning wells, totalling approximately $100,000.

In Saskatchewan, where we hold three Crown Permits totalling 283,360 acres, a partner may earn a 50% interest in 88,960 acres and a 25% interest in 189,120 acres by performing drilling requirements and paying rentals for two years at an estimated total cost to them of about $250,000. Nine wells have been drilled on the permits under this arrangement. We expect that a total of about 15 gas wells in all will be drilled under this agreement by the end of 1971. Of the nine wells drilled, three have been hydraulically fractured and evaluation continues with most encouraging results to date. Three wells were drilled with air and are potential economic wells awaiting further treatment; three have only very recently been drilled and no evaluation has been carried out to this time. The Company will be the Manager-Operator of these lands after the participant's earning operations are completed.

Two option agreements to earn land are still in effect and in good standing. At Bantry, option to earn a further 34,720 acres has been extended to December 31, 1972, and in Alderson 19,155 acres of option land expires in February of 1972. Negotiations to extend or revise this agreement are currently taking place.

The Company has purchased an additional 21,720 acres of shallow gas rights in Alberta in the Alderson-Bantry trend providing a nearly solid block of leases through this area as shown on the acreage map.

On Crown lands in Alberta an additional four shallow wells need to be drilled before the end of 1972 to complete earning of the gas leases in the Crown Permits at Tide Lake and Redcliff in Alberta.

The widespread drilling performed to explore and evaluate our acreage is indicated on the accompanying map.

PERSONNEL

In light of our rapidly expanding operations, A. Douglas Rogan was engaged as our Production Manager on August 15, 1971. Mr. Rogan holds Bachelor and Master Degrees in Geological Engineering from the University of Saskatchewan and has in excess of 15 years of diversified engineering and operations management experience in the gas industry. An operating department under his direction is being developed.

In December 1970 W. G. Fyfe, a Barrister & Solicitor and a Chartered Accountant, was appointed Secretary of your Company.

FINANCIAL

The Financial Statements show a loss of $213,145.00 for the year. The largest single item of expense was lease rentals in the amount of $177,666.00, reflecting the large undeveloped acreage of your Company. Large areas of gas rights containing substantial reserves are held, but to the date of the Financial Statements only about 3% of the lands have been placed on production.

As outlined in this report, additional land in the Alderson #2 Project is now on production and the Tilley Project is scheduled for production early in 1972. These additions, at substantially higher sales prices, are expected to more than triple gross revenue for the fiscal year ending June 30, 1972.

Funds for the initial Alderson #2 Project have been provided from the bank loan referred to in Note #4 to the Balance Sheet, funds for the Tilley Project have been provided by the low interest rate advance from a gas buyer, as described in this report.

AUDITORS' REPORT

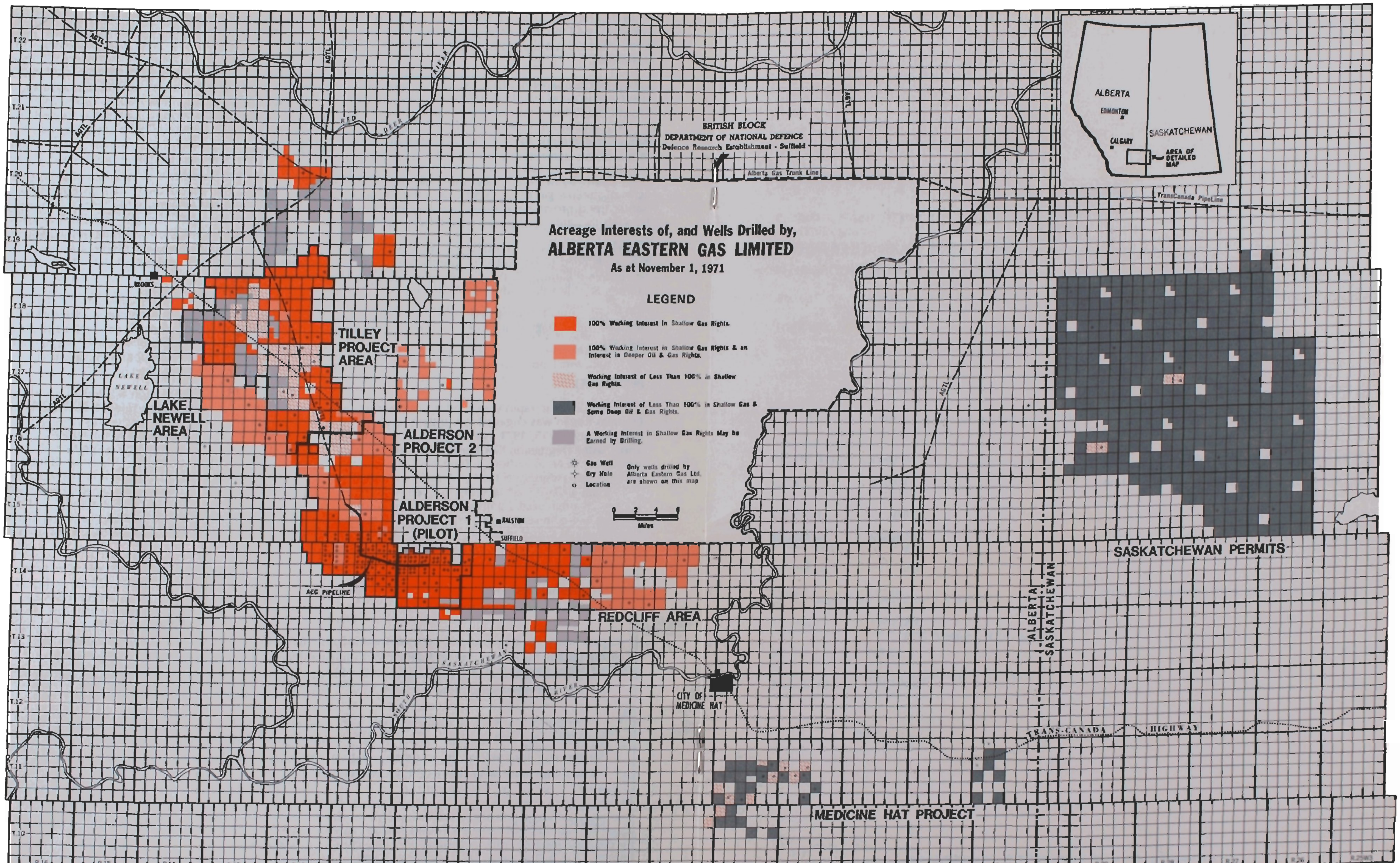
To the Shareholders
Alberta Eastern Gas Limited

We have examined the balance sheet of Alberta Eastern Gas Limited as at June 30, 1971 and the statements of earnings and deficit and source and application of funds for the year then ended. Our examination included a general review of the accounting procedures and such tests of accounting records and other supporting evidence as we considered necessary in the circumstances.

In our opinion, these financial statements present fairly the financial position of the company as at June 30, 1971 and the results of its operations and the source and application of its funds for the year then ended, in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

August 10, 1971.
Calgary, Alberta

RIDDELL, STEAD & CO.,
Chartered Accountants



Acreage Interests of, and Wells Drilled by,
ALBERTA EASTERN GAS LIMITED
As at November 1, 1971
LEGEND
100% Working Interest in Shallow Gas Rights.
100% Working Interest in Shallow Gas Rights & an Interest in Deeper Oil & Gas Rights.
Working Interest of Less Than 100% in Shallow Gas Rights.
Working Interest of Less Than 100% in Shallow Gas & Some Deep Oil & Gas Rights.
A Working Interest in Shallow Gas Rights May be Earned by Drilling.
Gas Well
Dry Hole
Location
Only wells drilled by Alberta Eastern Gas Ltd. are shown on this map
0 2 4 6
Miles
BRITISH BLOCK
DEPARTMENT OF NATIONAL DEFENCE
Defence Research Establishment - Suffield
Alberta Gas Trunk Line
TransCanada PipeLine
ALBERTA
EDMONTON
CALGARY
SASKATCHEWAN
AREA OF DETAILED MAP
TILLEY PROJECT AREA
LAKE NEWELL AREA
ALDERSON PROJECT 2
ALDERSON PROJECT 1 (PILOT)
REDCLIFF AREA
AEG PIPELINE
RALSTON
SUFFIELD
BROOKS
CITY OF MEDICINE HAT
SASKATCHEWAN PERMITS
MEDICINE HAT PROJECT
ALBERTA
SASKATCHEWAN
TRANS-CANADA HIGHWAY
RED DEER RIVER
SOUTH SASKATCHEWAN RIVER
LAKE NEWELL
AGTL

Alberta Eastern Gas Limited

BALANCE SHEET

AS AT JUNE 30, 1971

ASSETS

	1971	1970
CURRENT ASSETS		
Cash	$ 4,410	$ 58,755
Short-term deposits	—	650,000
Accounts receivable	132,491	160,048
	136,901	868,803
FIXED ASSETS, at cost (Note 1)		
Natural gas and petroleum leases, reservations and rights including development and equipment thereon		
Producing natural gas properties	2,075,836	1,300,218
Accumulated depletion and depreciation	69,626	21,709
	2,006,210	1,278,509
Capped gas wells and undeveloped properties	1,816,589	1,391,008
	3,822,799	2,669,517
Other equipment less accumulated depreciation	10,755	4,722
	3,833,554	2,674,239
DEPOSITS, at cost	23,739	38,602
	$3,994,194	$3,581,644

The accompanying notes are an integral part of this financial statement

LIABILITIES

	1971	1970
CURRENT LIABILITIES		
Accounts payable and accrued charges	$ 219,220	$ 249,361
BANK PRODUCTION LOAN (Note 4)	655,836	—

SHAREHOLDERS' EQUITY

	1971	1970
CAPITAL STOCK (Note 2)		
Authorized		
5,000,000 common shares of no par value		
Issued		
4,000,000 shares	3,730,000	3,730,000
DEFICIT	(610,862)	(397,717)
	3,119,138	3,332,283
	$3,994,194	$3,581,644

Signed on behalf of the Board:

F. G. Vetsch, Director

R. A. McCullough, Director

Alberta Eastern Gas Limited

FOR THE YEAR ENDED JUNE 30, 1971

Revenue	1971	1970
Sale of gas production, net of royalty $34,242 (1970—$17,489)	$345,433	$181,561*
Interest	15,165	63,641
	360,598	245,202
Expenses		
Production	127,372	49,483
Repairs of a non-recurring nature	19,273	—
General and administrative	122,900	85,517
Lease rentals on non-producing properties	177,666	137,123
Unproductive development and exploration	18,035	57,001
Engineering and consulting	41,971	59,783
Interest	15,936	—
Depletion and depreciation	50,590	22,889
	573,743	411,796
Loss for the year	213,145	166,594
Deficit at beginning of year	397,717	161,245
Share issue expense	—	69,878
Deficit at end of year	$610,862	$397,717
Loss per share		
(Based on weighted average number of shares outstanding)	$.05	$.05

*The company's properties commenced production in December, 1969

The accompanying notes are an integral part of this financial statement

Alberta Eastern Gas Limited

STATEMENT OF SOURCE AND APPLICATION OF FUNDS
FOR THE YEAR ENDED JUNE 30, 1971

	1971	1970
SOURCE OF FUNDS		
Issue of shares for cash	$ —	$3,000,000
Issue of notes payable	—	60,000
Bank production loan	655,836	—
Deposits refunded	14,863	—
	670,699	3,060,000
APPLICATION OF FUNDS		
In operations		
Loss for the year	213,145	166,594
Less non-cash charges		
Depletion and depreciation	50,590	22,889
	162,555	143,705
Fixed assets		
Producing natural gas properties including development and equipment thereon	775,618	1,165,954
Capped gas wells	119,634	518,875
Undeveloped properties	305,947	440,162
Other	8,706	5,426
Other assets	—	20,561
Share issue expense	—	69,878
	1,372,460	2,364,561
INCREASE (DECREASE) IN WORKING CAPITAL FOR THE YEAR	(701,761)	695,439
Working capital (deficiency) at beginning of year	619,442	(75,997)
WORKING CAPITAL (DEFICIENCY) AT END OF YEAR	$ (82,319)	$ 619,442

The accompanying notes are an integral part of this financial statement

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