Alberta Eastern Gas Limited

Annual Report June 30, 1972

The Historic Marker — Page 2

Alberta Eastern Gas Limited

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Calgary, Alberta T2P 1G5
Telephone 261-7040

LISTED

Toronto Stock Exchange
Calgary Stock Exchange

DIRECTORS

W. J. Bushnell, Toronto, Ontario
R. A. McCullough, Calgary, Alberta, Vice-President
F. G. Vetsch, Calgary, Alberta, President
John T. Wood, Calgary, Alberta

OFFICERS

F. G. Vetsch, President and Chief Executive Officer
R. A. McCullough, Vice-President and Treasurer
A. D. Rogan, Vice-President Production
W. G. Fyfe, Secretary

TRANSFER AGENTS

Montreal Trust Company
Toronto, Calgary
Vancouver, Regina
Winnipeg, Montreal

AUDITORS

Riddell, Stead & Co.

BANKERS

Canadian Imperial Bank of Commerce
The Royal Bank of Canada

HIGHLIGHTS

(September 30, 1972)

	1972(1)	1971	1970
LAND AND WELLS			
Total Gross Acreage	885,340	651,509	629,487
Total Net Acreage	477,094	413,984	355,582
Total Productive Oil and Gas Wells Drilled (Gross)	347	175	89
(Net)	307.5	175	89
Total Oil and Gas Wells on Production (Net)	148.2	122	43
Total Oil and Gas Wells Capped (Net)	159.2(2)	50	45
Deep Tests, Productive in Shallow Zones, completed in deep zones, sold or abandoned (Net)	13.9	9	8
Total Shallow Wells Abandoned (Net)	5.5	5.5	1
RESERVES (billions cubic feet)			
Proven (developed and undeveloped)	896	345	72
Probable	897	1,301	1,494
	1,793(1)	1,646	1,566
PRODUCTION (Fiscal Year) billion cubic feet	5.939	2.817	1.542
million cubic feet per day	16.30	7.72	4.25

(1) Excluding Redcliff lands and wells sold in September, 1972.

(2) About 128 capped wells will commence production in late 1972.

THE HISTORIC MARKER

Photo on Front Cover

This historic marker was erected on the Trans-Canada Highway this year near the site of the now abandoned town of Alderson. The well referred to produced gas for nearly 50 years from the Milk River formation and is about one mile from AEG's major holdings and developments in that area. Its history, and that of wells drilled to supply domestic needs led your Company to acquire lands and find methods to develop the extensive gas reserves in that formation.

The former town of Alderson was the center of a farming "boom" area during World War I when a combination of more than normal rainfall and high prices of grain crops led to homesteading and cultivation of the area. The return of normal precipitation, and the beginning of soil erosion which reached its heights in "Dust Bowl" conditions of the 1930's led to the abandonment of the country by the farmers. Through the efforts of government agencies, the land was gradually returned to grass growing and the soil conditions stabilized.

Today, all land that is not irrigated is reserved for grazing of livestock only, "dry land" cultivation is not permitted due to the high risk of a recurrence of the soil erosion previously experienced.

Your Company, and others who operate in the area exercise great care to minimize the breaking of the grass cover. Only main access roads are graded, access to the wells is over trails by light vehicles which do not break down this sod cover. Pipeline routes and wellsites, where the grass cover has been broken, are immediately reseeded to grass. This work is performed by persons in the area who are familiar with the local conditions and who can best handle this restoration.

REPORT TO SHAREHOLDERS:

I have pleasure in presenting the Annual Report of Alberta Eastern Gas Limited for the year ended June 30, 1972.

I am particularly pleased to report that for the first time in the Company's short history, in the fiscal year ended June 30, 1972, a net profit of $62,281 after deferred income tax and a net cash flow of $263,474 or 7¢ per share were achieved. These results have been obtained from production of natural gas amounting to 5.939 billion cubic feet or an average of 16.30 million cubic feet of gas per day.

We are now entering a new phase for the Company in terms of profitability and production and we expect to be on stream at a capacity of about 50 million cubic feet of gas per day at the end of 1972, of which the Company's share is about 93%. This increase in production will reflect a sharp growth of revenue and cash flow.

In a report to the Company dated October 18, 1972, James A. Lewis Engineering Co. Ltd., Calgary, Alberta, estimated the reserves of the Company to be 1.793 trillion cubic feet consisting of proven developed and proven undeveloped reserves of 896 billion cubic feet and probable reserves of 897 billion cubic feet. The reserves and valuations represent our position after the sale of our Redcliff acreage mentioned below. James A. Lewis Engineering Co. Ltd. estimated the Company's net cash flow to be generated by such proven reserves during the course of production over the next 25 years to be $133,217,500. Using a discount rate of 9% per year, the present value of such proven reserves was estimated to be $42,550,000. Both of these values are based on current gas sales contract prices without regard to the Favored Nations provisions or price renegotiations and the trend to higher prices, nor do they include a value of probable reserves or for prospective lands of our Company. I should like to draw your attention to the fact that neither our Medicine Hat and Second White Specks acreage in Alberta nor our Saskatchewan shallow reserves are committed to any sales contracts at this time and thus are free to benefit in the near future from any natural gas price increases.

In our fiscal 1971 Annual Report we outlined our land earning progress to November 1, 1971. I am pleased to advise that all remaining land earning options were exercised by the Company or farmees by July, 1972. In addition, our Saskatchewan lands were broadly evaluated with 17 Company wells and adjacent industry activity which together have provided highly encouraging results. These results along with the prospects for more attractive gas sales prices in this uncommitted area provides the Company with excellent long-term development prospects.

While our shallow gas development is proceeding as scheduled, and I draw your attention to recent industry reports naming the Company the most active driller in western Canada in the first nine months of 1972 with 168 completed wells, I am pleased to confirm our first entry in association with other companies in a land acquisition and exploration programme in other areas. As we reported recently, we have acquired a 15% interest in approximately 200,000 acres located in northeastern British Columbia and northwestern Alberta. Most of these lands are in the vicinity of recent important natural gas discoveries in the Grizzly Valley area where existing capped wells and drilling activity by other companies are less than one mile from parts of our holdings. We feel that these lands have an excellent potential for large natural gas reserves and the exploration of our lands will start in the near future.

The recent sale of our Redcliff properties consisting of about 56,000 net acres and representing about 11% of our total shallow gas reserves netted the Company $4,000,000. Our recent activities and further development of shallow gas will require additional funds and your Company is in the course of completing an equity financing of 940,000 treasury shares which is expected to net the Company approximately $6,780,000. This money together with the proceeds of $4,000,000 from the Redcliff sale puts your Company in an excellent financial position to continue development of its shallow gas reserves along with the exploration and development of lands in other areas.

You must all be aware of the energy crisis in the United States and the pressure it will exert on the price structure for petroleum and natural gas. Alberta Eastern Gas Limited owns very large uncommitted potential gas reserves which are bound to benefit from any future price increases and with this in mind your management is looking forward to the future with utmost confidence. I would like to remind you that our present natural gas contracts have a "Favored Nations Letter" plus the availability of a price renegotiation every five years with the first price renegotiation being available to us in late 1976. Other circumstances may result in price increases within this period, perhaps as early as November 1973.

We reported to shareholders previously that we were to obtain a loan of $3,000,000 at 3¾% to complete our Tilley Project. This loan has been delayed pending a Provincial decision but in the meantime your Company has commenced the project by bank financing. When a favorable decision has been obtained, the low interest loan will be taken up and the present interim financing will be repaid.

To strengthen your Company's management team, I am pleased to announce that effective last August, A. D. Rogan, who joined us in mid 1971 as Production Manager, has now been appointed Vice-President, Production.

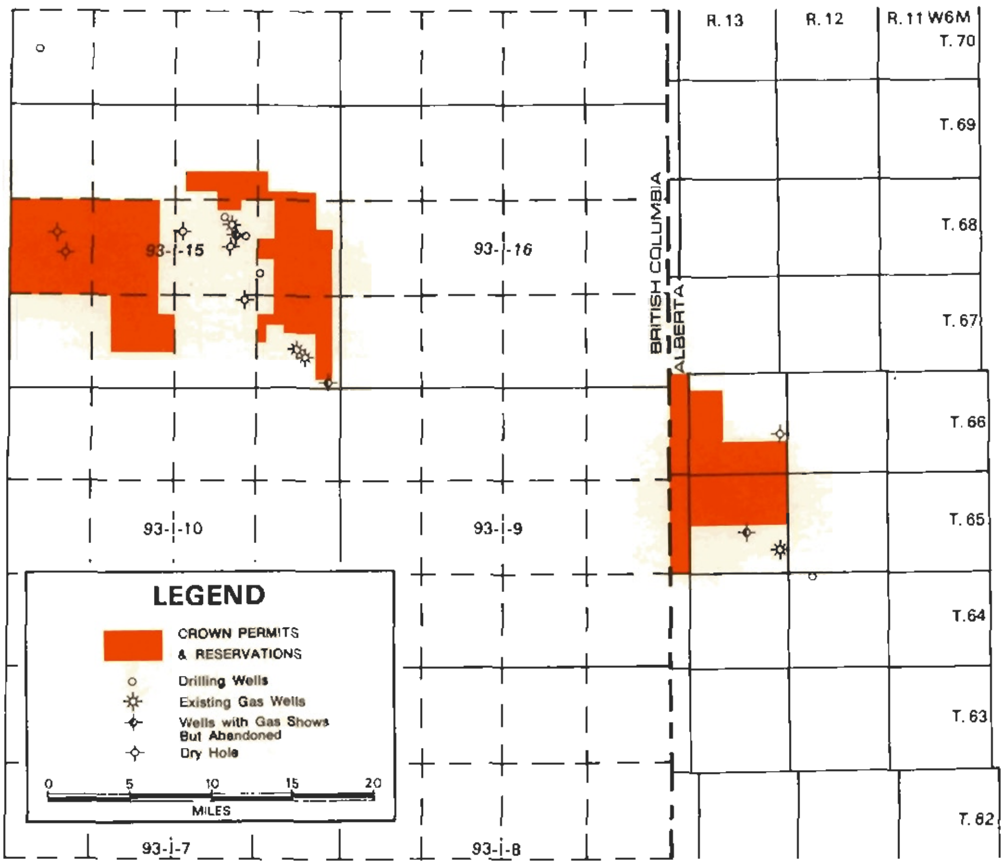
Shareholders will find an up-to-date map in this Report showing our lands in southeastern Alberta and southwestern Saskatchewan and a sketch showing the location of our new exploratory holdings.

Our Annual Meeting will be held in Calgary on December 28, 1972 at 10:00 a.m. in the Marquis Room of the Hotel Palliser. We look forward to seeing shareholders at that time.

On Behalf of the Board of Directors,

F. G. Vetsch,
President and Chief Executive Officer

Calgary
Nov. 24, 1972



This map shows part of the recently acquired lease rights in the Grizzley-Chinook Area of Northwestern Alberta and Northeastern British Columbia. The Company's interest in these lands is 15%.

AUDITORS' REPORT

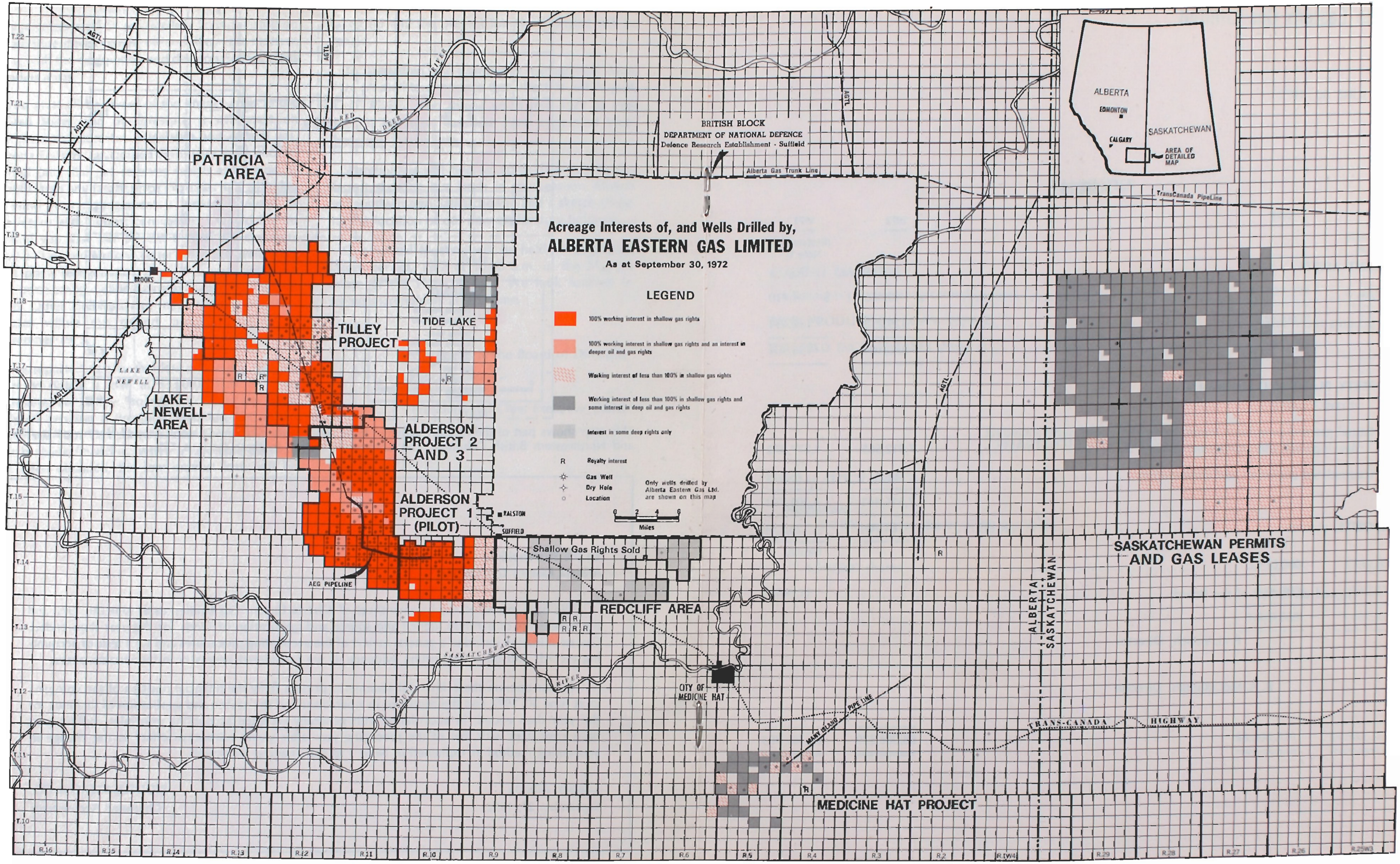
To the Shareholders
Alberta Eastern Gas Limited

We have examined the balance sheet of Alberta Eastern Gas Limited as at June 30, 1972 and the statements of earnings, 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, 1972 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 after giving retroactive effect to the change in accounting method as explained in Note 1 to the financial statements.

Calgary, Alberta
September 27, 1972

RIDDELL, STEAD & CO.
Chartered Accountants



Acreage Interests of, and Wells Drilled by,
ALBERTA EASTERN GAS LIMITED
As at September 30, 1972
LEGEND
100% working interest in shallow gas rights
100% working interest in shallow gas rights and an interest in deeper oil and gas rights
Working interest of less than 100% in shallow gas rights
Working interest of less than 100% in shallow gas rights and some interest in deep oil and gas rights
Interest in some deep rights only
R Royalty interest
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
PATRICIA AREA
TILLEY PROJECT
TIDE LAKE
LAKE NEWELL AREA
ALDERSON PROJECT 2 AND 3
ALDERSON PROJECT 1 (PILOT)
AEG PIPELINE
Shallow Gas Rights Sold
REDCLIFF AREA
CITY OF MEDICINE HAT
MEDICINE HAT PROJECT
SASKATCHEWAN PERMITS AND GAS LEASES
ALBERTA
SASKATCHEWAN
EDMONTON
CALGARY
AREA OF DETAILED MAP
BROOKS
RALSTON
SUFFIELD
LAKE NEWELL
AGTL
RED DEER RIVER
SOUTH SASKATCHEWAN RIVER
MANY ISLAND PIPE LINE
TRANS-CANADA HIGHWAY
T.22
T.21
T.20
T.19
T.18
T.17
T.16
T.15
T.14
T.13
T.12
T.11
T.10
R.16 R.15 R.14 R.13 R.12 R.11 R.10 R.9 R.8 R.7 R.6 R.5 R.4 R.3 R.2 R.1W4 R.29 R.28 R.27 R.26 R.25W3

Alberta Eastern Gas Limited

BALANCE SHEET

AS AT JUNE 30, 1972

ASSETS

	1972	1971 (Restated—Note 1)
CURRENT ASSETS		
Cash	$ 40,866	$ 4,410
Accounts receivable	329,238	132,491
	370,104	136,901
PROPERTY, PLANT AND EQUIPMENT, at cost (Note 1)		
Natural gas and petroleum leases, reservations and rights including development and equipment thereon	7,812,565	4,277,572
Accumulated depletion and depreciation	196,124	75,829
	7,616,441	4,201,743
DEPOSITS, at cost	81,784	23,739
	$8,068,329	$4,362,383

Signed on behalf of the Board:

F. G. Vetsch, Director

R. A. McCullough, Director

LIABILITIES

	1972	1971 (Restated— Note 1)
CURRENT LIABILITIES		
Accounts payable and accrued charges	$1,527,233	$ 219,220
BANK PRODUCTION LOAN (Note 2)	2,950,000	655,836
DEFERRED INCOME TAXES (Note 4)	41,488	—

SHAREHOLDERS' EQUITY

CAPITAL STOCK (Note 3)		
Authorized		
5,000,000 common shares of no par value		
Issued		
4,000,000 shares	3,730,000	3,730,000
DEFICIT	(180,392)	(242,673)
	3,549,608	3,487,327
	$8,068,329	$4,362,383

Alberta Eastern Gas Limited

STATEMENT OF EARNINGS

FOR THE YEAR ENDED JUNE 30, 1972

	1972	1971 (Restated— Note 1)
REVENUE		
Sale of gas production, net of royalty $119,740 (1971—$34,242)	$859,415	$345,433
Other income	5,445	15,165
	864,860	360,598
EXPENSES		
Production	236,323	149,910
General and administrative	184,520	122,900
Interest	137,567	15,936
Depletion and depreciation	123,329	52,532
Unproductive development and exploration	69,772	22,121
Engineering and consulting	9,580	41,971
	761,091	405,370
NET EARNINGS (LOSS) before provision for income taxes	103,769	(44,772)
Deferred income taxes (Note 4)	41,488	–
NET EARNINGS (LOSS)	$ 62,281	$ (44,772)
EARNINGS (LOSS) PER SHARE (based on weighted average number of shares outstanding)	2¢	(1)¢

STATEMENT OF DEFICIT

FOR THE YEAR ENDED JUNE 30, 1972

	1972	1971
DEFICIT at beginning of year		
As previously reported	$610,862	$397,717
Retroactive adjustment for change in accounting method (Note 1)	368,189	199,816
As adjusted	242,673	197,901
Net earnings (loss)	62,281	(44,772)
DEFICIT at end of year	$180,392	$242,673

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, 1972

	1972	1971 (Restated— Note 1)
SOURCE OF FUNDS		
Operations		
Earnings (loss) for the year	$ 62,281	$ (44,772)
Add non-cash charges	201,193	54,771
Cash flow from operations	263,474	9,999
Bank production loan	2,294,164	655,836
Disposal of fixed assets	210,657	–
Deposits refunded	–	14,863
	2,768,295	680,698
APPLICATION OF FUNDS		
Property, plant and equipment	3,785,060	1,382,459
Deposits	58,045	–
	3,843,105	1,382,459
DECREASE IN WORKING CAPITAL	(1,074,810)	(701,761)
Working capital (deficiency) at beginning of year	(82,319)	619,442
WORKING CAPITAL DEFICIENCY AT END OF YEAR	$(1,157,129)	$ (82,319)

The accompanying notes are an integral part of this financial statement.

NOTES TO FINANCIAL STATEMENTS
AS AT JUNE 30, 1972

NOTE 1 ACCOUNTING POLICIES

In prior years, exploration expenses and the carrying costs applicable to non-producing properties were charged to income as incurred. Property acquisition costs were capitalized and charged to income if the property was subsequently surrendered. The costs of productive wells were capitalized and the costs of non-productive wells were charged to income when the wells were determined to be dry.

In 1972, the company retroactively adopted the full cost method of accounting whereby all costs of exploration for and development of its gas reserves are capitalized by project area. Costs associated with producing areas are amortized using the unit of production method based upon estimated recoverable reserves of gas within each area as determined by the company and its consulting engineers. If exploration activities within an area prove unsuccessful, costs accumulated therein are written off to income.

The retroactive adjustment described above resulted in an increase in the net fixed assets of the company as at July 1, 1971 of $368,189 and a credit to deficit of the same amount. Net earnings for the year ended June 30, 1972 calculated on the previous basis would have been $14,377. Comparative 1971 financial statements have been restated to the new basis of accounting.

NOTE 2 BANK PRODUCTION LOAN

During the year the company completed arrangements with a bank to borrow up to $5,230,000 secured by accounts receivable, specified properties and production proceeds. The loan balance of $2,950,000 as at June 30, 1972 is evidenced by demand promissory notes; the bank has agreed to accept payment from production revenue at a minimum of $50,000 per month.

Subsequent to June 30, 1972 the company completed arrangements with a bank to borrow up to an additional $2,500,000 secured by specified properties and production proceeds, repayable from production revenue in equal monthly instalments within five years from the date of draw-down.

NOTE 3 CAPITAL STOCK

At June 30, 1972, 60,000 shares of the capital stock of the company were reserved under stock options granted to employees. The options are exercisable in varying amounts at $4.20 to $4.50 per share until 1976.

NOTE 4 INCOME TAXES

The company provides for deferred income taxes to the extent that current income taxes are reduced or eliminated by claiming capital cost allowances and exploration and development costs in excess of the amounts provided for depreciation and depletion in the financial statements.

NOTE 5 REMUNERATION OF DIRECTORS AND SENIOR OFFICERS

Remuneration paid during the year ended June 30, 1972 to directors and senior officers totalled $113,945. No directors' fees were paid.

NOTE 6 SUBSEQUENT EVENTS

(a) Subsequent to June 30, 1972, the company sold certain natural gas properties having a book value of $375,000 for $4 million.

(b) Reference is made to Note 2.

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