AEC

ALBERTA ENERGY COMPANY LTD.



# 1989

# ANNUAL

# REPORT

OUR COMPANY

**Alberta Energy Company Ltd. is a Canadian natural resource development corporation with approximately 45,000 shareholders. AEC participates in Canada's natural gas, oil, pipelines, forest products and petrochemicals industries.**

*Contents*



*Cover*

Represented are AEC's major activities. From top to bottom, gas and oil exploration and production, pipelines, forest products, petrochemicals.

# HIGHLIGHTS

## Operating Highlights

Gas sales remained strong at 272 million cubic feet per day, but prices declined by 4 percent.

Sales of synthetic and conventional oil and NGLs were at near-record levels of 21,210 barrels per day, while prices increased by 22 percent.

Profitable exploration results continued, with finding and development costs below published industry averages.

Lumber and medium density fibreboard shipments each increased by 16 percent to 201 million board feet and 63 million square feet, respectively. Prices for lumber were up 3 percent, while those for MDF were down by 6 percent.

Fertilizer sales volumes were 19 percent higher, with prices comparable to 1988 levels.

Coal sales totalled 548,300 tons, similar to 1988.

Construction commenced on the chemi-thermo-mechanical pulp mill near Slave Lake, Alberta.

Development of Primrose Range gas reserves began.

Construction commenced on the Vancouver Island natural gas pipeline.

## Financial Highlights

Net earnings were $37.3 million, compared with $36.1 million before an extraordinary item in 1988.

Cash flow was $187.1 million, 95 percent of 1988 cash flow.

Revenues, net of royalties, were $505.9 million, a 6 percent increase.

Capital investment totalled $197.5 million.

The annual Common Share dividend was increased to 33 cents per share.

A $100 million Common Share issue was completed.

Higher interest costs and a continued high exchange rate on the Canadian dollar impacted adversely on financial results.

The AEC Act was amended to ease share ownership constraints.

The Corporation sold its non-Canadian oil and gas assets to Chieftain International, Inc. for $96 million and purchased a 50 percent interest in Chieftain International. At year-end the stock market value of the Chieftain shares owned by AEC was $110 million.

## PRESIDENT'S REMARKS TO SHAREHOLDERS

STRONG PIPELINE EARNINGS, HIGHER CRUDE OIL PRICES AND GOOD PERFORMANCE AT SYNCRUDE LARGELY OFFSET THE SIGNIFICANT NEGATIVE IMPACT OF THE LOWEST PRICES SINCE 1978 FOR OUR MAJOR COMMODITY, NATURAL GAS.

Earnings per Common Share of $0.52 were equal to those in the prior year. At year-end, Common Shares outstanding had increased from 59.8 million to 65.8 million, the Common Share market price was up 26 percent, and the total stock market value of outstanding Common Shares was approximately $1.3 billion.

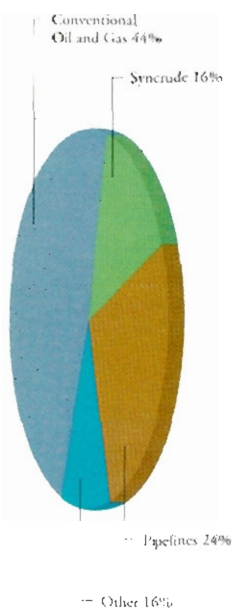
A $100 million Common Share issue was completed, materially strengthening the Corporation's financial position. At year-end, AEC had a debt-to-equity ratio of 41:59, an average interest cost of 9.4 percent and an average debt term of 10 years. All of AEC's mandatory debt repayments for the next five years could be covered with one month's cash flow – further illustrating our strong financial position.

Constraints on the ownership of AEC Common Shares were significantly lessened in 1989. The maximum shareholding for any beneficial owner has been increased from one to five percent. And, for the first time, foreign ownership is possible, although the total ownership by all foreign investors is limited to ten percent. These changes improve the ability of AEC's shares to achieve competitive market value by facilitating the purchase of shares by very large pension funds and institutions, which comprise an important segment of the investment community.

During the year, the Corporation's non-Canadian oil and gas assets were sold for $96 million. AEC also invested $76 million for a 50 percent interest in Chieftain International, an Edmonton-based oil and gas exploration company with activities mainly in the United States; this investment had a market value of $110 million at year-end, up 45 percent.

Capital investment in 1989 totalled $197.5 million, of which 79 percent was in gas and oil, 7 percent in pipelines and 14 percent in all other activities.

**Sources of Cash Flow**




As illustrated by the relative size of our various capital investments, AEC's major activity continues to be gas and conventional oil exploration and production. During the past year, the Oil and Gas division explored profitably, maintained high production levels and low operating costs, and marketed its production using a variety of resourceful strategies.

Syncrude had a good year despite an operating set-back near year-end. AEC's share of synthetic oil production averaged 14,800 barrels per day compared with 15,000 barrels per day a year earlier.

AEC Pipelines continued to deliver strong and stable earnings. The Corporation's ownership of crude oil and ethane pipelines is being augmented by investments in two natural gas pipelines, one to Vancouver Island and the other to the northeastern United States.

For many years, AEC has owned and operated a large lumber mill and a medium density fibreboard plant. A chemi-thermo-mechanical pulp (CTMP) mill in northern Alberta, now under construction and due to be completed near year-end 1990, will add approximately $55 million to our investment in forest products. AEC owns 75 percent of the new mill and MoDo Canada, a subsidiary of Mo och Domsjö, a major Swedish forest products company, the other 25 percent.

David E. Mitchell, O.C.
President and Chief
Executive Officer

In development of the CTMP mill project, AEC has adhered to its philosophy of joining with an experienced, capable partner. The CTMP mill, which will employ state-of-the-art technology, will meet very stringent environmental standards. It will not produce the chlorinated dioxins and furans that have gained so much public attention. The fast growing, plentiful aspen hardwood will be the main wood feedstock.

The Petrochemicals division recorded mixed results. While our fertilizer business exhibited strong performance in the United States, demand slowed in Canada as the year progressed.

Other Investments, as classified in the financial accounts, had cash flow of $29.7 million versus $27.5 million in the prior year. Other Investments include 67 percent of the plant that supplies Syncrude with steam and electric power, 25 percent of a coal mine, and interests in forest products and petrochemicals. It also includes revenues from a 25 percent interest in a natural gas liquids extraction plant and 50 percent of Pan-Alberta Gas, a natural gas marketing company which had an outstanding year in meeting a number of marketing and regulatory challenges.

AEC is sometimes asked whether or not it has any interest in, or plans for, further diversifying its cash flow by investment in other businesses. The Corporation has no such plans, and, in fact, either has sold or will be selling certain of its smaller, non-strategic ventures. AEC's equity base is strong, and the Corporation is not anticipating a public Common Share issue in the coming year.

Environmental protection is inherent in each of AEC's operations, and the Corporation has received several official commendations for its accomplishments and efforts in this regard. The Corporation has taken steps to maintain that reputation, including the establishment of an internal environmental affairs coordinating group with representatives from all operating divisions. AEC is extremely keen, as are others worldwide, on protecting and preserving our environment in a responsible way.

AEC employees, and their supportive families, contribute greatly to the strength of the organization. The positive effects of employee talents, attitude and dedication – key factors in our progress – are much appreciated. Special congratulations are in order for the attention employees are giving to the safety of all AEC operations, and as mentioned above, they share our common goal of environmental awareness and preservation.

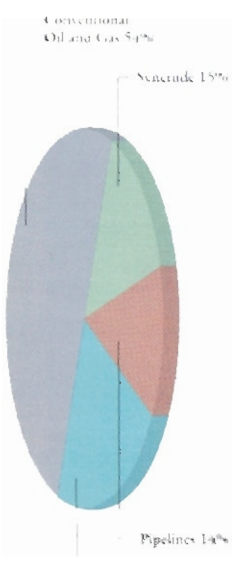
AEC is taking a leadership role in the new national "Imagine" program which sets and encourages commitment to standards for minimum corporate donations to various community endeavours.

Earnings in 1990 are expected to be up from 1989 levels. The outlook for the coming year is for higher gas prices, a tapering off of interest rates and some reduction in the exchange rate of the Canadian dollar. Recent oil price strengthening hopefully will continue. Small changes in any of these variables can markedly influence results. For example, a one-dollar-per-barrel change in oil price would affect AEC's 1990 cash flow by $9 million; and a one cent variation in the Canadian/U.S. exchange rate would change cash flow by $4 million. Beyond 1990, the Corporation's strong position in the natural gas business, extensive in situ heavy oil resources, strong pipelines division, and other resource opportunities continue to offer good promise for the future.

February 16, 1990

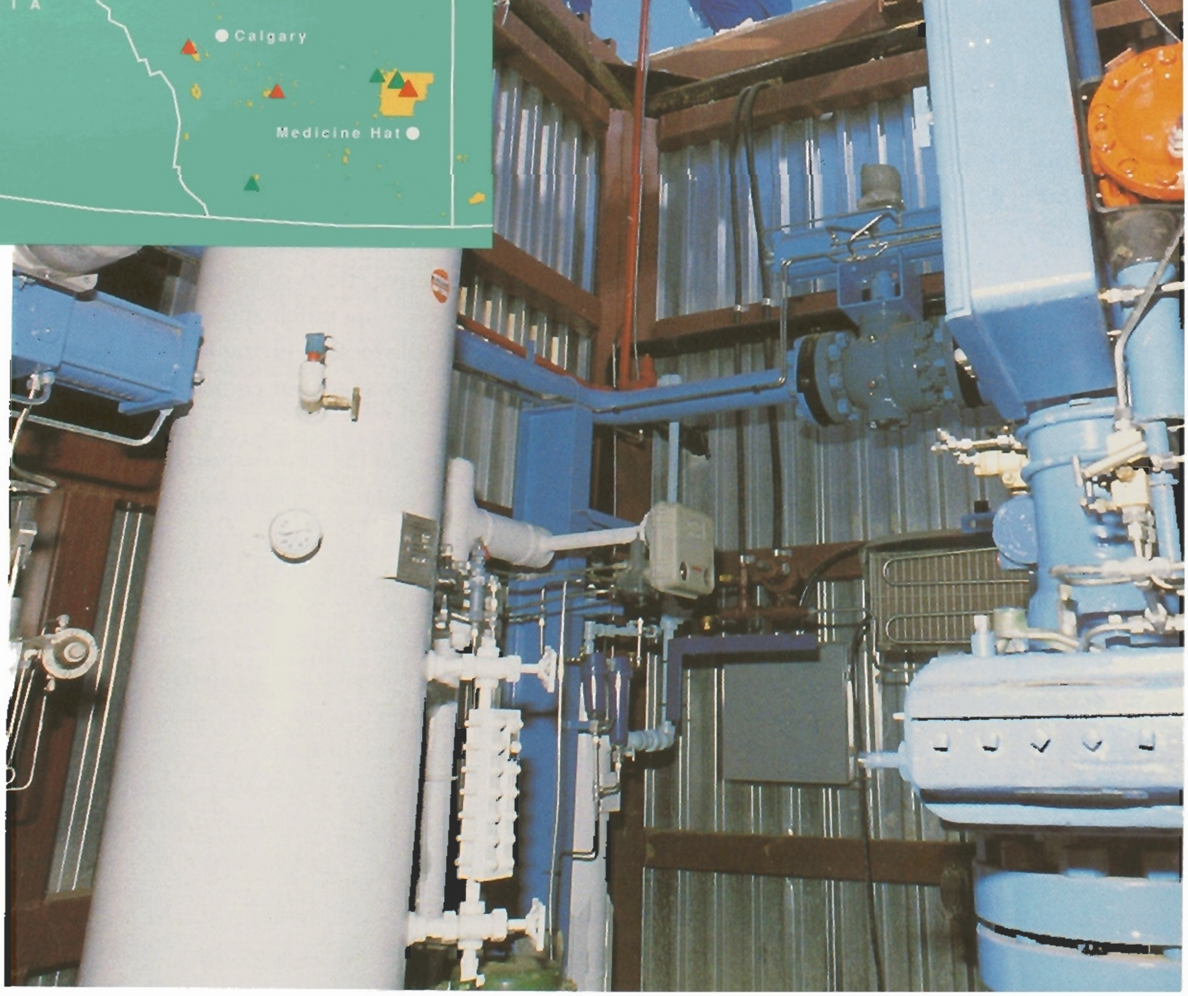
David E. Mitchell, O.C.
President and Chief Executive Officer

**Total Assets by Segment**




Western Canadian Oil and Gas Landholdings

- AEC Interest Land
- Natural Gas
- Conventional Oil
- In Situ Heavy Oil
- Syncrude



Alberta Energy Company Ltd.

## OIL AND GAS DIVISION

FINANCIAL RESULTS WERE [illegible] ENCIES AEC [illegible] ILIZING ITS NATURAL GAS STORAGE ACILITY AT SUFFIELD — IN CONCERT WITH [illegible] RKETING [illegible]

Conventional oil and gas production was maintained at near-record levels, while finding and development costs continued to be lower than industry average. Syncrude made major contributions to cash flow and income.

AEC Oil and Gas is a large natural gas producer, a significant producer of conventional and synthetic crude oil, the holder of some of Canada's highest quality undeveloped in situ heavy oil deposits, and a major explorer in the Western Canadian Sedimentary Basin.

During the past year, the Canadian assets formerly held by Chieftain Development Co. Ltd. were merged with those of AEC.

The exploration program continued to show good reserve additions and low finding costs in 1989. However, proven and probable gas reserves were negatively impacted due to a one-time, five percent downward adjustment resulting from an assessment of additional technical information on certain properties. At 1989 production rates, the proven and probable reserve life is 16 years for natural gas and 9 years for conventional oil and natural gas liquids. The reserve life index for Syncrude, which produces a high quality light oil, is 38 years.

AEC Oil and Gas ranks among the top ten companies in Canada in terms of reserves, production levels and exploratory landholdings in the Western Canadian Sedimentary Basin. AEC is the fifth largest publicly traded oil and gas firm in Canada.

### Reserves

AEC's oil and gas reserves at year-end 1989 are estimated to be:

**Natural Gas** (BILLION CUBIC FEET)

| | |
|---|---|
| Proven | 1,412 |
| Probable | 225 |
| Total | 1,637 |

**Conventional Oil & Natural Gas Liquids** (MILLION BARRELS)

| | |
|---|---|
| Proven | 15.9 |
| Probable | 5.2 |
| Total | 21.1 |

**Synthetic Oil** (MILLION BARRELS)

| | |
|---|---|
| Proven Developed | 207 |

**AEC's facility at Suffield is the largest producer-owned underground natural gas storage system in Canada.**

**In Situ Heavy Oil**

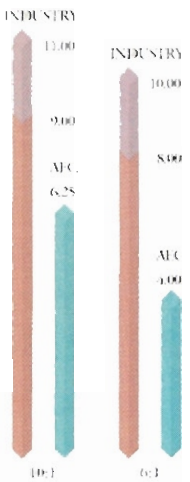
AEC holds an estimated 25 billion barrels of heavy oil in place, primarily on the Primrose Range in northern Alberta. This estimate is net of the portion that joint venture participants have earned or are entitled to earn. Although no commercial heavy oil production has been realized from Primrose to date, the Corporation's share of commercial projects which are currently envisioned over the next five years would yield the equivalent of 10,000 barrels per day, with long-term ultimate potential of over 50,000 barrels per day. Price, markets and fiscal terms will determine the development time frame for this resource.

## Exploration

With a major focus on finding natural gas reserves, AEC's exploration strategy is to concentrate activity in areas that have the right combination of geological potential, development economics, and AEC competitive position. The Corporation also supplements its exploration results through selective acquisitions of reserves and interests with the objective of developing significant new production centres. AEC is active predominantly in the Alberta portion of the Western Canadian Sedimentary Basin.

The graph opposite compares AEC's finding and development costs with industry results, utilizing the two most often applied gas-to-oil conversion ratios. (The 10:1 ratio tends to reflect historic economic value equivalence, while the 6:1 ratio reflects heating or energy value equivalence.) The comparison provided is for the 1986-1988 three-year period because industry data for 1989 is unavailable at the time of this report. Incorporation of AEC's 1989 results into the average would maintain the favourable comparison.

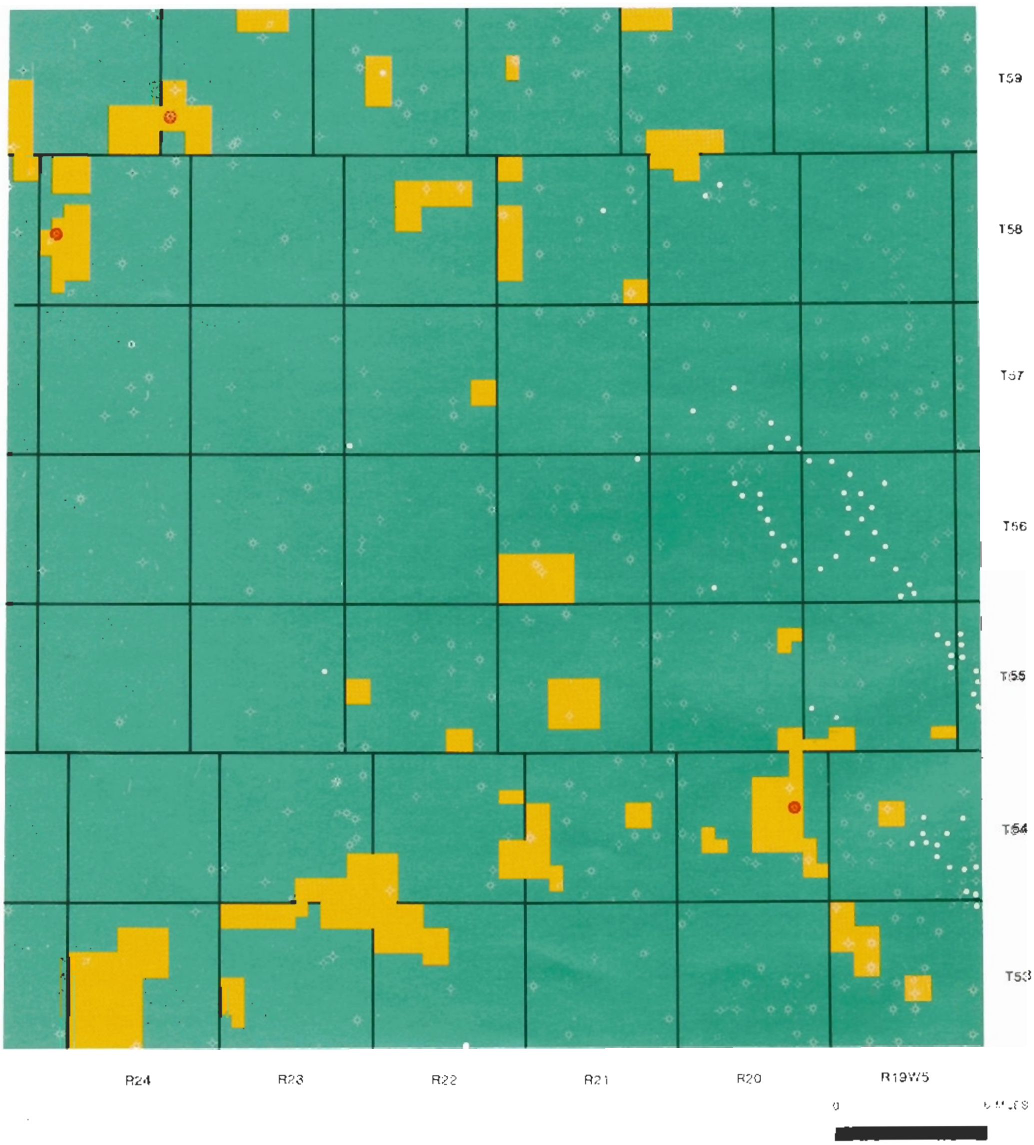
Finding and Development Costs 1986-88 ($ barrel of oil equivalent)




Note: The range in value for industry results reflects AEC's interpretation of data from the Canadian Energy Research Institute and Canadian Petroleum Association published data.

Berland River/ Fir/Obed

- AEC Interest Well
- Oil Well
- Gas Well
- Suspended Well
- Abandoned Well
- Location Drilling
- AEC Interest Land

## 1989 Well Statistics

### Exploratory

| | Gross | Net |
|---|---|---|
| Oil | 7 | 1 |
| Gas | 14 | 5 |
| Cased-Awaiting Evaluation | 7 | 3 |
| Dry and Abandoned | 18 | 9 |
| Total | 46 | 18 |

### Development

| | Gross | Net |
|---|---|---|
| Oil | 9 | 4 |
| Gas | 26 | 17 |
| Cased-Awaiting Evaluation | 4 | 2 |
| Dry and Abandoned | 5 | 3 |
| Total | 44 | 26 |
| **Total Wells** | **90** | **44** |

## 1989 Landholdings (ACRES)

| | Total | | Undeveloped | Developed |
|---|---|---|---|---|
| | Gross | Net | Net | Net |
| Alberta | 4,834,640 | 3,022,084 | 950,522 | 2,071,562 |
| Saskatchewan | 156,324 | 94,205 | 92,154 | 2,051 |
| British Columbia | 247,827 | 87,600 | 70,513 | 17,087 |
| Beaufort | 851,330 | 24,737 | 24,737 | – |
| Total | 6,090,121 | 3,228,626 | 1,137,926 | 2,090,700 |

One area of major exploration focus in 1989 was Waskahigan/Karr/Gold Creek in west-central Alberta. Activity in the 100-mile-long trend included the drilling of 4 exploratory wells and 10 development wells, with after-payout working interests averaging 54 percent. Landholdings have grown to 330,000 gross acres, equivalent ro 184,000 net acres, through the trend. AEC holds reserves of 100 billion cubic feet of natural gas and 3.6 million barrels of oil and natural gas liquids in the trend, with daily production levels expected to exceed 18 million cubic feet of gas and 600 barrels of natural gas liquids by the fourrh quarter of 1990. Exploration and development of the trend will continue for several years.

During 1989, AEC increased its exploration focus for deep, higher potential gas reservoirs in wesrern Alberta. The 1989 program has resulted in AEC having interests in two discoveries and rhe initiation of drilling on four additional prospects, where the wells will reach total depth in 1990. Three of these exploratory wells are located in the Berland River/Fir/Obed area where AEC holds interests in 78,000 gross acres, equivalent to 40,000 net acres.

Waskahigan

Karr/Gold Creek

AEC Interest Well

Oil Well

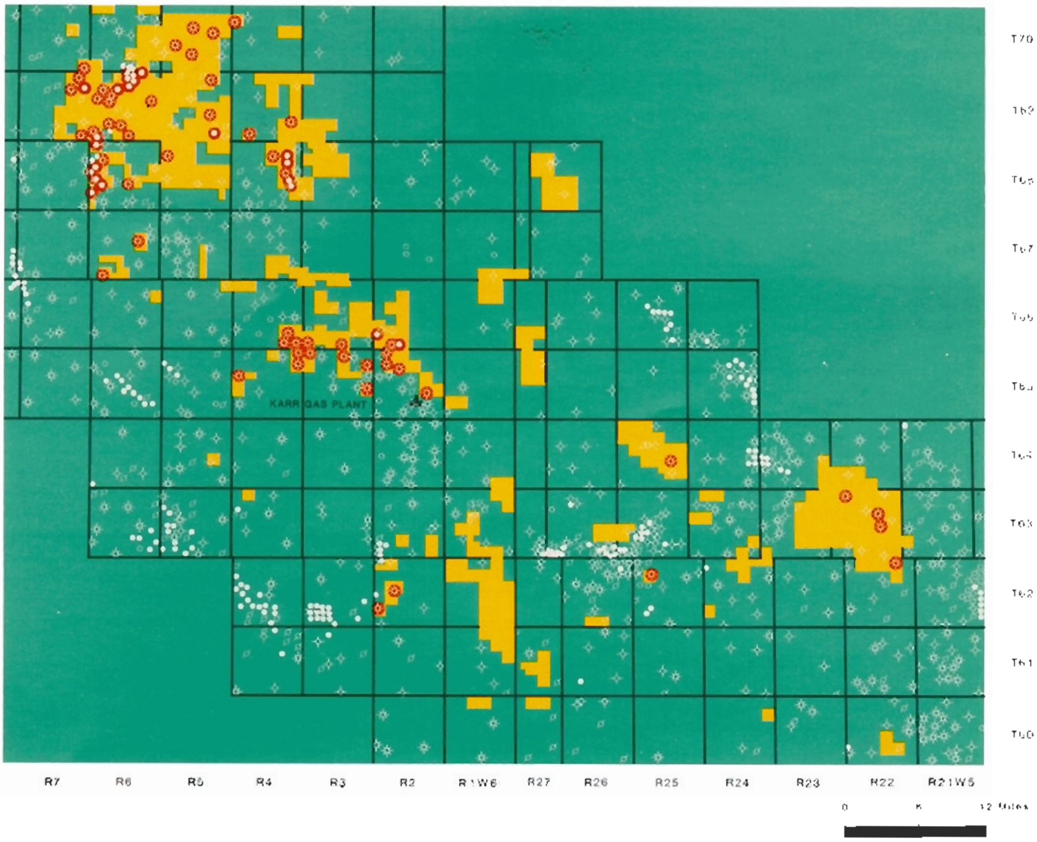
Gas Well

Suspended Well

Abandoned Well

Location Drilling

AEC Interest Land


## Natural Gas

AEC achieved sales of 272 million cubic feet per day from its interests in more than 3,300 natural gas wells. This compares with a daily average of 280 million cubic feet sold last year. While most of the gas was delivered from Suffield, other AEC-controlled production areas, primarily Hythe and Craigend, contributed 46 million cubic feet per day.

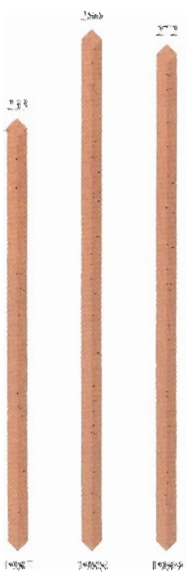
The first full operating year for the Suffield natural gas storage facility, the largest producer-owned underground gas storage system in Canada, was very successful. The facility enhances production from the Suffield gas field by allowing consistent production rates throughout the year. It has injection and withdrawal capability in excess of 100 million cubic feet daily. In addition to injection of produced gas into storage during the summer months, AEC purchased gas on the spot market at lower seasonal prices for injection into storage and subsequent resale to higher priced winter markets.

AEC's 1989 average direct production cost of 22 cents per thousand cubic feet is among the lowest in the industry, helping to buffer the impact of low gas prices.

In 1989, AEC initiated the development of major natural gas production facilities on the Primrose Range in northeastern Alberta and at Karr in northwestern Alberta. These facilities will be on stream in the fourth quarter of 1990. Production from these areas and other new fields, combined with further development of existing fields, will more than offset normal productivity declines and increase sustainable average calendar day sales capacity to approximately 300 million cubic feet per day by year-end 1990.

Natural Gas Sales

(million cubic feet per day)



United States gas supply is tightening in the face of increasing gas demand and continually falling U.S. gas reserve levels. AEC has positioned itself to expand participation in three major U.S. natural gas market regions – California, the Midwest and the northeast.

AEC signed a new contract with Alberta and Southern Gas to supply natural gas to the California market through existing pipeline facilities. Deliveries under this contract commenced in November 1989 at a level of 10 million cubic feet per day, to build to 50 million cubic feet per day by November 1991.

Regulatory approvals, export licences and producer support were received for gas supply contracts between western Canadian marketers and a group of northeastern U.S. natural gas distribution utilities in New York, Connecticut, and New Jersey. AEC's share is 45 million cubic feet per day, slightly less than half of which is through a direct contract, with the remainder through a major gas marketer. The gas will be delivered in the United States via the Iroquois Pipeline System, in which an AEC subsidiary has a 6 percent ownership interest.

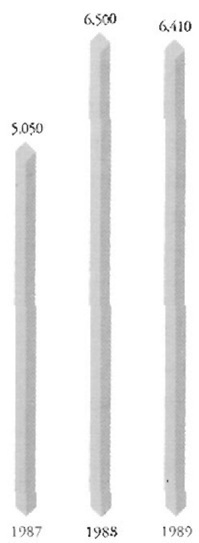
AEC reached a long-term agreement with Northern Border Pipeline to ship up to 30 million cubic feet per day through the proposed expansion of the pipeline to the Chicago area. The agreement is subject to Northern Border's decision to proceed with the project, which is expected by the second quarter of 1990. This project, the lowest cost pipeline expansion to U.S. markets, is expected to be completed in the mid-1990s. It will provide opportunities for new sales from AEC's gas exploration program.

The outlook for increased revenues from AEC's substantial natural gas assets is very promising. Natural gas is selling substantially below the equivalent energy price of fuel oil, despite its indisputable value as the premium fuel for environmental reasons. It is interesting to note that, at the oil prices which prevailed in 1989, natural gas prices to consumers could increase on average by 22 percent if natural gas were to achieve competitive energy value with fuel oil in the markets served by Canadian gas. Since most of the consumer's natural gas cost is related to transportation and distribution, even this relatively small consumer price increase would result in a 90 percent gain in AEC's wellhead price.

AEC's natural gas strategy is to maintain a very strong natural gas supply base, to continue to be one of the lowest cost gas producers, and to position new natural gas contracts towards the most attractive markets.

**Conventional Oil and NGL Sales**

(barrels per day)




### Conventional Oil

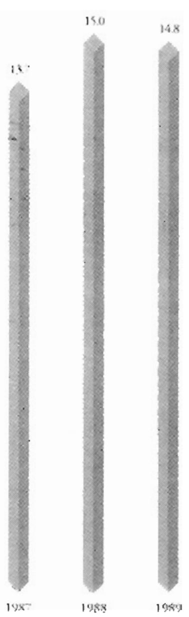
Sales of conventional oil and natural gas liquids averaged 6,410 barrels per day, compared with 6,500 barrels per day in 1988. Production in 1990 is expected to grow slightly, with additional production coming from discoveries in the Valhalla and Kitty areas. A low-cost conventional oil producer, AEC's average 1989 cash operating cost was $3.64 per barrel.

OPEC-influenced oil markets strengthened in 1989 and the price of West Texas Intermediate and Canadian crude also firmed relative to world markets.

Years of field testing have resulted in AEC Oil and Gas and its research partners patenting AWACT (anti-water coning technology) to extend the production capability of existing conventional oil wells. This recovery enhancement is achieved through the injection of gas and chemicals to retard water encroachment which inhibits a well's full producing capability. The technology is now being made available to industry for commercial application.

Synthetic Oil Sales

(thousand barrels per day)




### In Situ Heavy Oil Sands

Heavy oil is an untapped AEC asset with the potential to replace a significant portion of Canada's declining conventional oil supplies. AEC's holdings include some of the highest quality, most valuable undeveloped heavy oil resources in Canada. The Corporation's deposits will be among the first to be profitably developed as oil prices continue to become more attractive.

AEC and a co-venturer are now proceeding with a major pilot project in the Caribou Lake region of the 2,000-square-mile Primrose Range north of Cold Lake, Alberta. AEC retains a 40 percent working interest in this pilot project with attractive financial terms which will extend into commercial development should it proceed.

Another pilot, at Ipiatik in the northwest portion of the Range, has been suspended because other areas of Primrose have greater potential for future commercial development.

Two approved, but pending, commercial heavy oil projects remain suspended. Construction of one commercial project was suspended in 1988 by the operator. The second project remains as an earning obligation of AEC's farmee. AEC believes that oil prices have demonstrated sufficient strength and stability to warrant proceeding with these commercial projects.

### Syncrude

AEC has a 10 percent joint venture interest in Syncrude and an average 7 percent overriding royalty on another 10 percent of revenue. Syncrude is the world's largest oil sands mining plant.

Syncrude is a safe, cost-efficient plant. In 1989, AEC's share of production totalled 14,800 barrels per day, compared with 15,000 barrels per day in the previous year. Despite a variety of set-backs, including a labour disruption among contract workers and other unexpected operational incidents, cash operating costs were held to $17.17 per barrel compared with $14.82 per barrel in 1988. Lower unit operating costs and higher production levels are expected in 1990.

Syncrude produces a high quality light oil that competes with other light oils in the North American marketplace. During the past year, AEC further diversified into this market by securing a U.S. buyer for a portion of its output.

Syncrude is a major developer and pioneer of new technology for oil sands. The $680 million hydrocracker upgrader now integrated into Syncrude's operation is a first in the oil sands industry and will probably form the base technology for future oil sands plants. The naphtha recovery unit, designed by Syncrude to recover naphtha from extraction tailings, was successfully licensed in 1989 to an industrial third party.

In 1989, Syncrude – an environmentally aware and proactive operation – emphasized community involvement in the process of successfully renewing all of Syncrude's key environmental approvals.

Synthetic oil now comprises about 20 percent of Canada's light and medium oil production. While conventional light oil production will continue to decline, Syncrude has a reserve base capable of sustaining current production levels well into the next century.

## Pan-Alberta Companies

AEC owns one-half of Pan-Alberta Gas Ltd. and Pan-Alberta Resources Inc.

Pan-Alberta Gas, the second largest exporter of Canadian natural gas to the United States, continued to strengthen its position in U.S. markets. Operational highlights included the fifth consecutive year of "100 percent performance" on its sales to California and regulatory approvals for a five-year extension of an export licence to the U.S. Midwest. All required producer and regulatory approvals were received by year-end to settle, on terms favourable to Canadian producers, a major, long-standing contract dispute between Pan-Alberta and a major U.S. gas buyer.

Pan-Alberta Resources has a 50 percent interest in the Empress natural gas liquids extraction plant, which operates on a cost-of-service basis.

## Chieftain International, Inc.

Participation in international oil and gas activities is through 50 percent owned Chieftain International, Inc. (CII) which in 1989 purchased all of AEC's non-Canadian oil and gas assets.

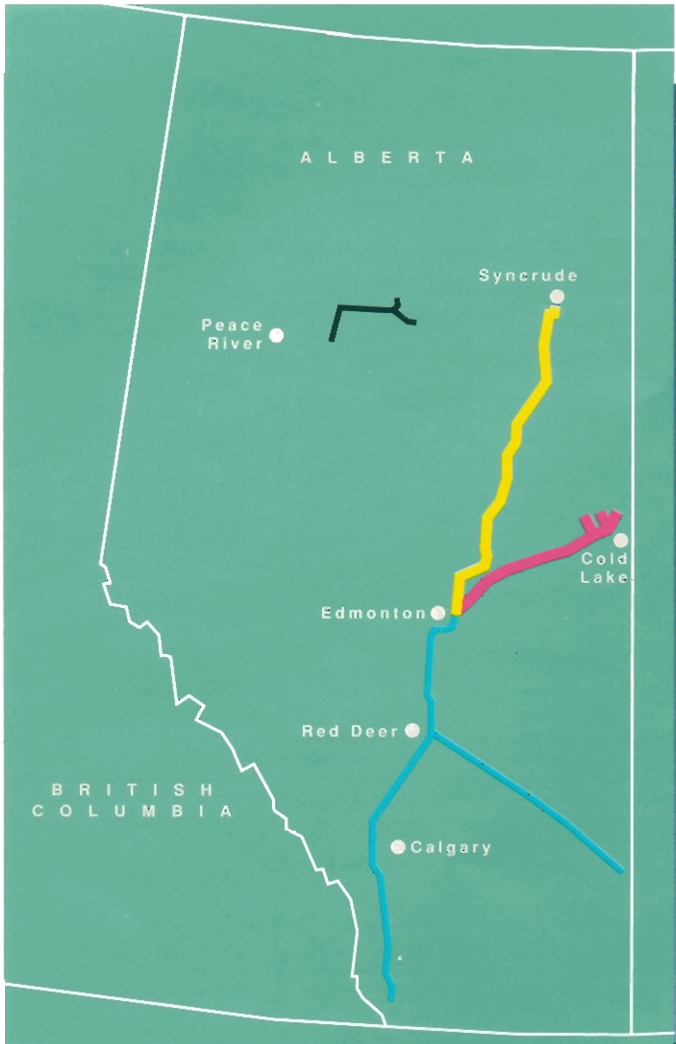
1989 CII Landholdings (ACRES)

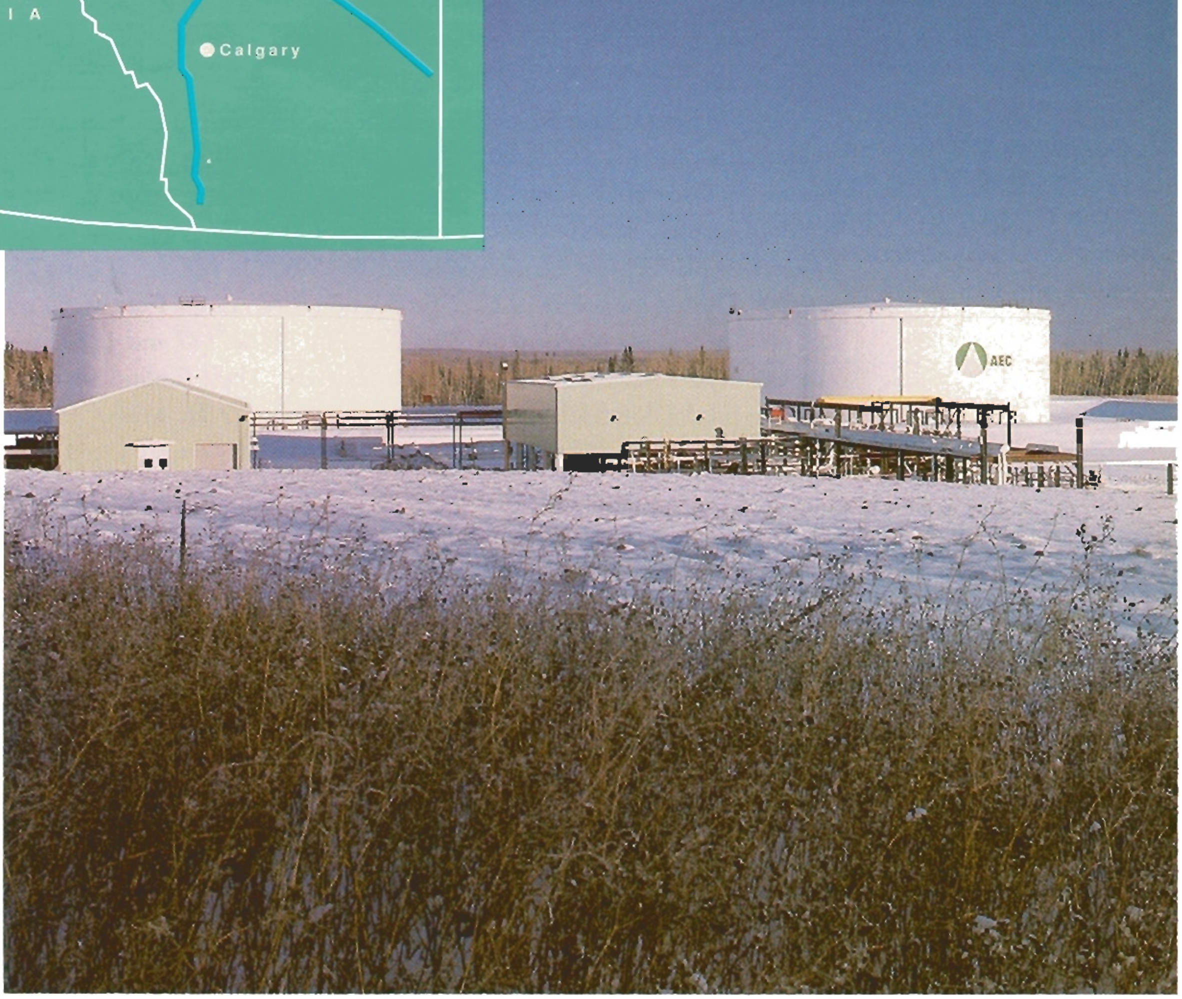
| | Gross | Net |
|---|---|---|
| United States | 213,000 | 63,000 |
| North Sea | 101,000 | 34,000 |
| Total | 314,000 | 97,000 |

Oil sales averaged 1,650 barrels per day, and natural gas sales averaged 16 million cubic feet per day during 1989. CII participated in the development of two natural gas discoveries in the U.S. waters of the Gulf of Mexico during the year. Late in the third quarter, gas sales commenced from a 200 million cubic feet per day capacity production platform on Matagorda Island Block 604 in which CII has a 25 percent interest. During the fourth quarter, production commenced from an 80 million cubic feet per day capacity platform on West Cameron Blocks 187 and 188 in which CII has interests of 23 percent and 33 percent, respectively. These facilities increased average daily gas production from about 1 million cubic feet per day when CII commenced operations in April 1989 to 48 million cubic feet per day during December.

CII's exploratory and development drilling program in the Gulf of Mexico included participation, with a 25 percent interest, in a gas discovery and a successful follow-up well on Eugene Island Block 265 and in the drilling of five gas wells on Matagorda Island Block 604 and a gas discovery on Matagorda Island Block 589. CII increased its exploration base in the Gulf of Mexico by acquiring six federal leases, covering 33,800 gross (8,450 net) acres, at offshore lease sales.

As of December 31, 1989, independent consultants estimated CII's proven reserves in the United States at 66.1 billion cubic feet of natural gas, located primarily in the Gulf of Mexico, and 6.3 million barrels of oil and natural gas liquids, located mainly in southeastern Utah.




Alberta
Pipeline
Systems

- Alberta Oil Sands Pipeline (100%)
- Cold Lake Heavy Oil Pipeline (100%)
- Alberta Ethane Gathering System (33.33%)
- Wabasca River Pipeline (19%)

Alberta
Energy
Company
Ltd.

## PIPELINES DIVISION

**SIGNIFICANT STEPS WERE TAKEN IN 1989 TO DIVERSIFY ACTIVITY BOTH GEOGRAPHICALLY AND WITH RESPECT TO PRODUCTS TRANSPORTED, THEREBY ENHANCING PIPELINE INVESTMENT AND PROVIDING AN EXPANDED SOURCE OF STEADY CASH FLOW.**

**Vancouver Island Natural Gas Pipeline**



Following successful negotiation of fiscal arrangements with the federal and British Columbia governments, Pacific Coast Energy Corporation (50 percent AEC-owned) commenced construction of the Vancouver Island Natural Gas Pipeline. This $280 million project, which will deliver natural gas to the southwestern B.C. mainland and Vancouver Island, represents the first major geographic and product diversification for AEC Pipelines. AEC's equity investment will be approximately $14 million.

AEC owns, through a subsidiary, a 6 percent interest in the proposed Iroquois Gas Transmission System. During the past year, the State of New York approved the New York portion of rhe route which stretches from Iroquois, Ontario, to Long Island, New York. The Federal Energy Regulatory Commission issued a Draft Environmental Impact Statement for the pipeline, a significant step forward in the regulatory process. Western Canadian natural gas producers supported the project through the firm commitment of supply to the Iroquois shippers. The project will cost $583 million (U.S.), and AEC's equity investment will be $9 million (U.S.).

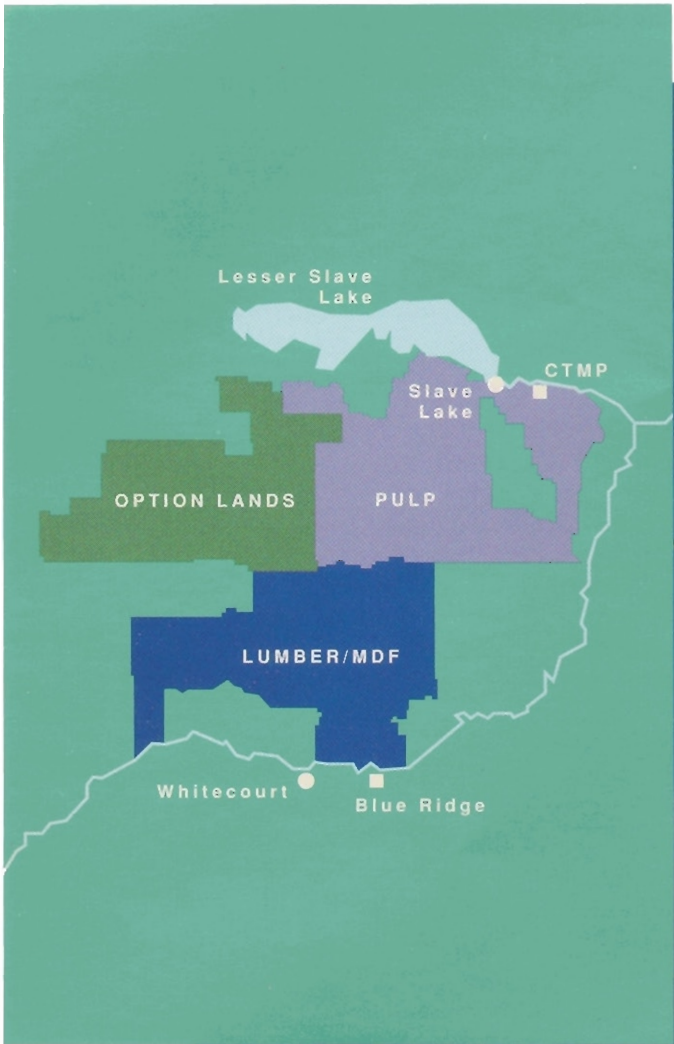
AEC Pipelines completed a major expansion and modification of its Cold Lake Heavy Oil Pipeline with the construction of the La Corey Pipeline Terminal. This modification, which incorporates cost effective, state-of-the-art variable speed pump technology, increases AEC's capability to transport larger volumes of heavy oil from northeastern Alberta to Edmonton.

On November 18, AEC Pipelines completed its third year without a lost-time accident. Two awards were received from the Canadian Petroleum Association in recognition of AEC Pipelines' excellent safety and operating performance.

**The La Corey Pipeline Terminal modification and expansion increases AEC's capability to transport heavy oil from northeastern Alberta to Edmonton.**

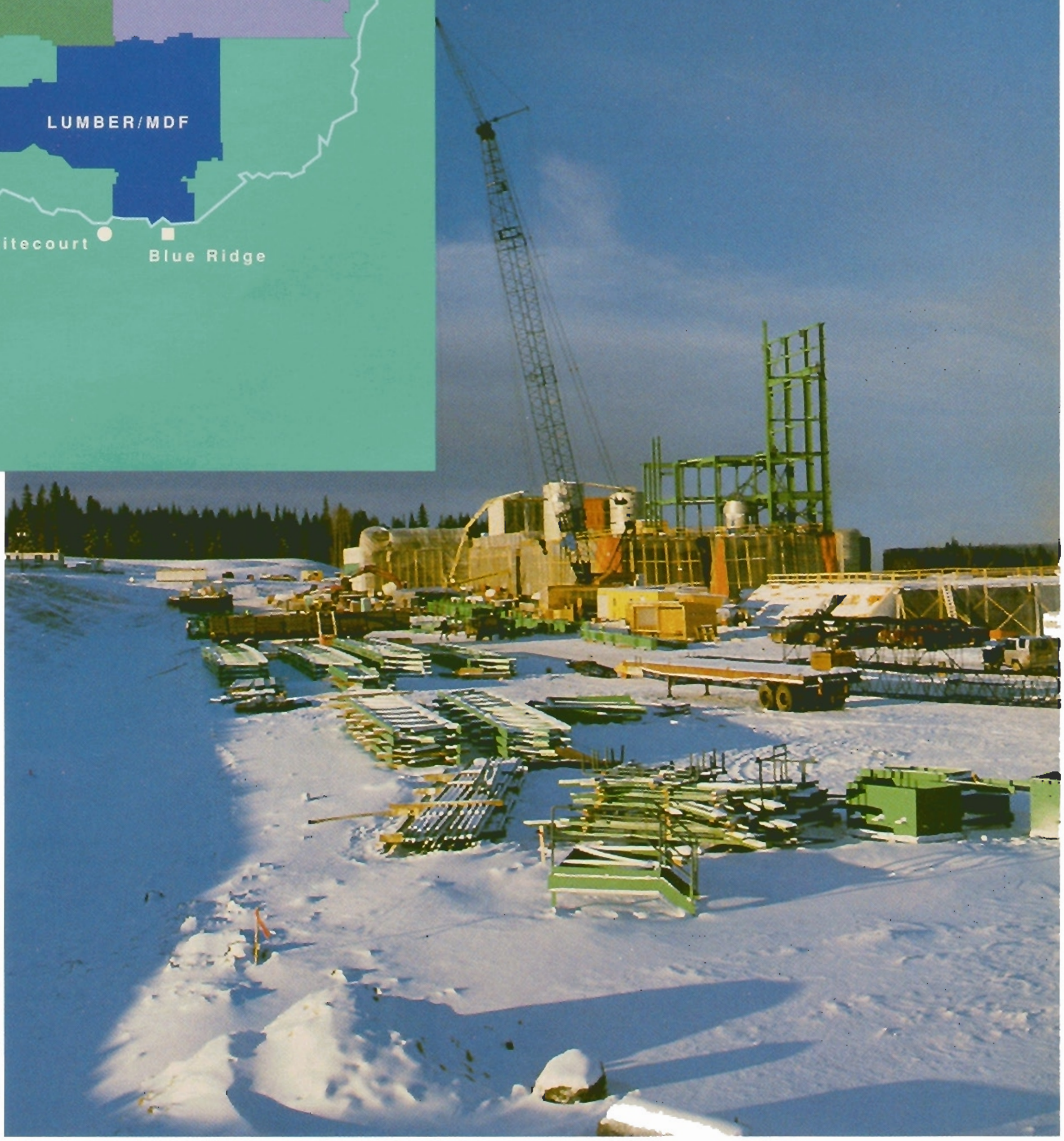
### AEC Pipelines Profile

| | Alberta Oil Sands Pipeline | Cold Lake Pipeline | |
|---|---|---|---|
| Product | Synthetic Crude Oil | Blended Bitumen | Condensate (Diluent) |
| 1988 Throughput *(barrels/day)* | 149,000 | 135,000 | 38,000 |
| 1989 Throughput *(barrels/day)* | 148,000 | 129,500 | 35,500 |
| Pipeline Size *(inches)* | 22 | 24 | 12 |
| Length of Pipeline *(miles)* | 280 | 150 | 150 |
| Gross Capital Investment *($ millions)* | 124 | 137 | 68 |




Forest Lands

Note: Option lands are lands reserved for possible expansion

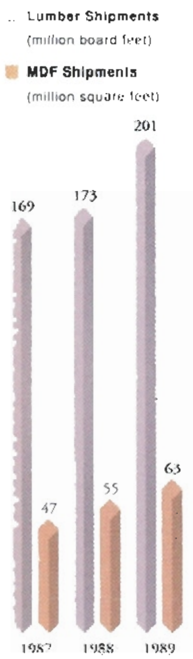



Alberta Energy Company Ltd.

## FOREST PRODUCTS DIVISION

AE[illegible] partnership with MoDo Canada [illegible] major Swedish pulp and [illegible]

**Lumber and MDF Shipments**




Construction of AEC's CTMP Mill near Slave Lake began in August.

A total of 3.8 million seedlings were planted by Blue Ridge Lumber in 1989.

### Wood Produ[illegible]

Wholly owned Blue Ridge Lumber (1981) Ltd. enjoyed a strong year, with record shipments of both lumber and medium density fibreboard (MDF).

Lumber shipments were 201 million board feet. Strong North American markets resulted in higher average mill net prices than those in 1988. Significant operating efficiencies were realized as mill modifications implemented in 1988 became fully effective. Chip sales also made an important contribution to profitability.

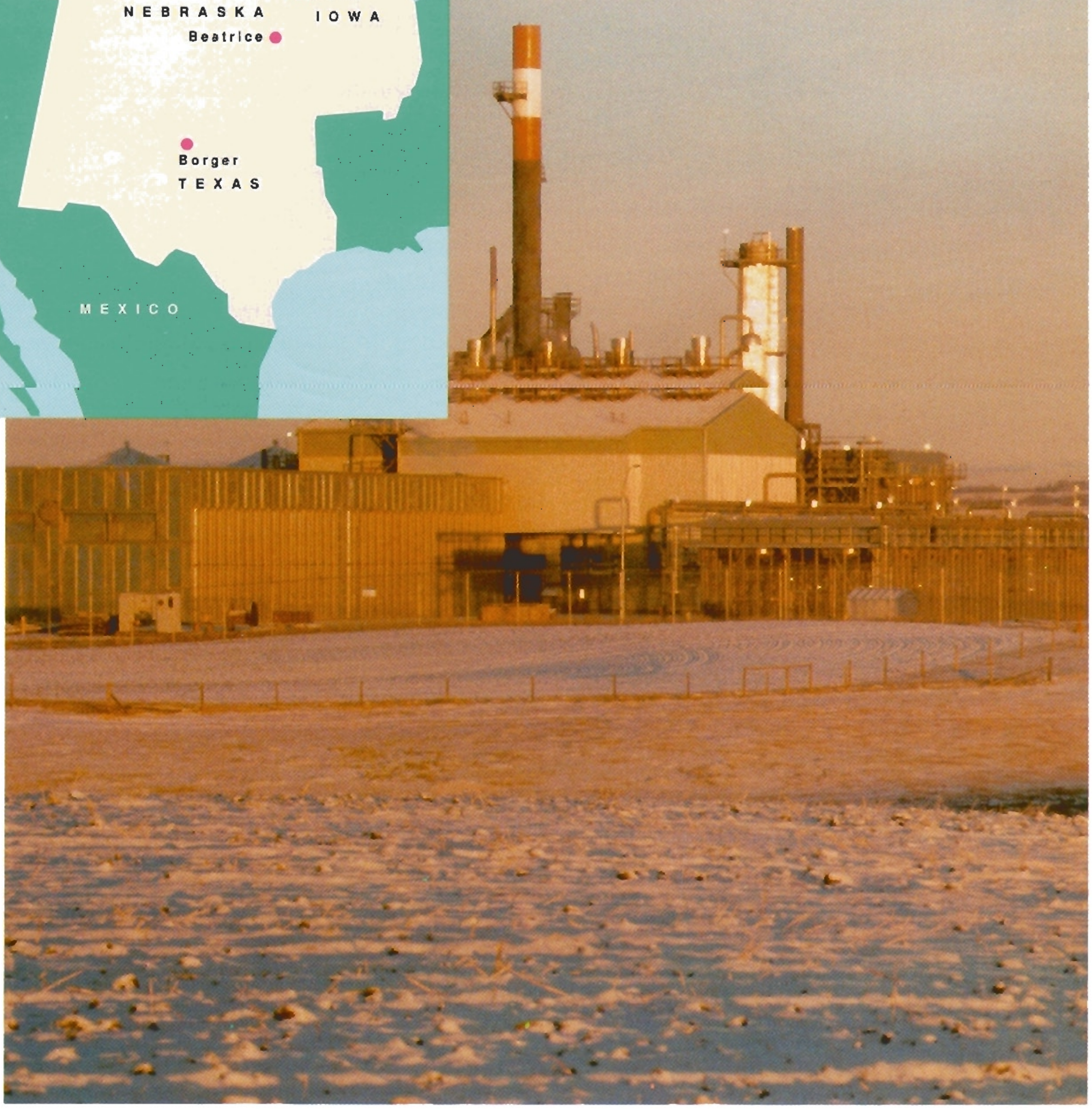
Shipments of medium density fibreboard reached 63 million square feet although increased competition, higher transportation rates and the appreciation of the Canadian dollar resulted in decreased average mill net prices and lower financial results. The commitment to product quality and the provision of full technical customer support continued to reinforce a very favourable reputation within a highly competitive global market.

Extensive ongoing reforestation programs resulted in more than 8,700 acres being either planted or seeded to establish regeneration of cutover areas. AEC manages its timberlands on a sustainable yield basis.

Slave Lake Pulp Corporation was formed to build and operate the bleached chemi-thermo-mechanical pulp (CTMP) mill near the community of Slave Lake, Alberta. AEC has a 75 percent partnership interest in this facility.

At year-end, construction of the Slave Lake pulp mill was 16 percent complete. Provincial government permits to construct are in place, and start-up is targeted for December 1990. Key operations personnel have been hired, and arrangements now are being finalized to market the production to high-grade printing and writing paper manufacturers around the world under the "Ranger" trade name.

The process and environmental design of the facility have been subject to extensive technical analyses and will meet very stringent air and water quality standards. The CTMP process does not involve the use of chlorine in the bleaching of the pulp. As a result, no chlorinated organics, particularly chlorinated dioxins or furans, will be produced by the AEC mill.

AEC/Cominco
Fertilizer
Business

- Production Facilities
- Storage Facilities
- Market Area

Alberta
Energy
Company
Ltd.

## PETROCHEMICALS DIVISION

DURING 1989, THE CARSELAND, ALBERTA, AND BORGER, TEXAS, AMMONIA PLANTS WERE SUCCESSFULLY MODIFIED TO REDUCE OPERATING COSTS, IMPROVE RELIABILITY AND INCREASE PRODUCTION CAPACITY. IN AEC'S FIRST FULL YEAR OF OPERATIONS IN THE U.S., THE AMMONIUM NITRATE PLANT IN NEBRASKA PRODUCED 10 PERCENT OVER THE PREVIOUS BEST OUTPUT WHICH OCCURRED IN 1977.

AEC holds a 25 percent interest in the North American nitrogen fertilizer business operated by Cominco. In Canada, products are marketed under Cominco's "Elephant Brand" trademark.

A large oversupply of nitrogen fertilizer depressed prices for the second half of 1989. Some price strengthening occurred toward year-end, and srrong sales volumes in the last quarter helped return fertilizer inventories to their normal level. The fact that 1989 world wheat inventories were the lowest in fifteen years bodes well for 1990 fertilizer sales volumes although prices are expected to be comparable to 1989 levels.

AEC Cominco Fertilizer Business

| | 1989 | 1988* |
|---|---|---|
| AEC nitrogen fertilizer sales *(thousand tonnes)* | 349 | 292 |
| Average plant gate nerback *($/tonne)* | 126 | 122 |

* includes only 6 months of U.S. operations.

AEC will continue to invesrigate opportunities in the petrochemicals industry. In evaluating potential new petrochemicals projects, AEC seeks joint ventures with experienced and capable parrners. Projects musr provide low-cost production, rhrough factors such as feedstock advantage; growing markets, and opportunities for further growth and diversification.

**AEC's plant at Joffre, near Red Deer, Alberta, is one of the most energy efficient anhydrous ammonia plants in North America.**

## OTHER INVESTMENTS

AEC ALSO PARTICIPATES [illegible] ELECTRIC UTILITY, COAL [illegible] GAS [illegible] AND VEHICLE LEASING BUSINESSES.

### AEC Power

AEC holds a two-thirds interest in AEC Power Ltd., owner of the $322 million power plant which supplies electricity and steam for the Syncrude operation. Profits are earned on a contractually set cost-of-service basis.

### Coal Valley

AEC's 25 percent joint venture share of 1989 coal sales from the Coal Valley Mine 130 miles northwest of Edmonton totalled 548,300 tons, comparable to 1988.

### [illegible]-City Drilling (1968) [illegible]

Based in Edmonton, Tri-City operates 14 drilling rigs, primarily in Alberta. The wholly owned AEC subsidiary specializes in shallow to medium depth contract drilling for oil and natural gas. In 1989 Tri-City's rig utilization was 46 percent, compared with the industry-wide utilization rate of 30 percent.

### Hartfield Chieftain Leasing [illegible]

A wholly owned subsidiary of AEC, Hartfield Chieftain Leasing owns and leases automobiles, trucks and other industrial and commercial equipment. The company has offices in Calgary and Edmonton and serves individual and corporate customers throughout western Canada. AEC is planning to sell its interest in Hartfield Chieftain.

## AEC IN THE COMMUNITY

AEC [illegible] A MAJOR ATTRIBUTE OF A GOOD CORPORATE CITIZEN IS THE SUPPORT OF SOCIAL [illegible] ATHLETIC AND EDUCATIONAL ORGANIZATIONS WITHIN THE COMMUNITY.

During 1989, AEC made contributions to numerous local, provincial and national charities and took a leadership role in encouraging other businesses in Canada to increase their financial support of such activities.

Volunteerism and "people helping people" is the essence of the "pioneering spirit", and AEC is proud to be encouraging this tradition.

Amateur hockey coach and AEC Pipelines Engineering Manager Larry Drader, left, is just one of hundreds of AEC employees who donate their time, expertise and money to worthwhile charities and non-profit organizations which contribute to the betterment of the community.

The Corporation also participates with its employees in supporting charitable groups by matching employee donations to qualifying organizations.

# FINANCIAL SECTION

*Contents*

Consolidated net earnings before an extraordinary item rose modestly in 1989. The major factors include higher equity earnings, lower general and adminisrrative expenses and increased operating income from oil and gas and pipelines, partially offset by higher interest expense and an increase in the value of the Canadian dollar against the U.S. dollar. However, cash flow fell in 1989 because of lower dividends from affiliates and a higher provision for current tax. The new Large Corporations Tax on capital amounted to $1.6 million in 1989 and reduced earnings by the same amount.

Oil and gas operating income increased, despite the lowest gas sales prices in more than a decade, because of higher synthetic and conventional oil prices. Investment in the explorarion for natural gas and oil yielded profitable results. Oil and gas contributed 52 percent of the Corporation's operating income.

Pipeline operating income increased due to additional capital being invested in 1988, which resulted in a higher rate base for 1989. Pipelines contributed 40 percent of the Corporation's operating income.

Forest products operating income increased in 1989 as a result of record shipments of lumber and medium density fibreboard (MDF) and higher lumber sales prices. The stronger Canadian dollar adversely affected borh lumber and MDF sales prices.

Income from petrochemical operations improved in 1989. The inclusion of results from the U.S. partnership for the full year was partially offset by two extended plant retrofits to improve efficiency and reliability.

In 1989 AEC invested $156 million in oil and gas, $14 million in pipelines, $15 million in forest products, $6 million in petrochemicals and $7 million in other corporate operations, for a total of $198 million. Cash inflow consisted of $187 million from operations, $96 million from the sale of non-Canadian oil and gas assets, $110 million from the issue of Common Shares and $15 million from other sources.

Long-term debt was reduced by $60 million and the debt-to-equity ratio was improved from 46:54 to 41:59. Approximately 94 percent of total long-term debt is unsecured with an average term of 10 years, and the mandatory long-term debt repayments over the next five years toral $16 million, equivalent to one month's cash flow. At year-end, over $300 million was available in unused long-term lines of credit.

The Corporation's financial condition is very sound and has been strengthened in 1989 to provide a solid base. Oil and gas prices are the key ingredients for 1990 results, but the Corporation's earnings also will be significantly influenced by the value of the Canadian dollar and interest rates. Capital investment in 1990 is expecred to be approximately at the 1989 level, and it is anticipated that the majority will be invested in gas and oil. The capital program will be financed largely by cash from operations.

AEC's equity base is strong, and the Corporation does not anricipate a public offering of Common Shares in 1990. There are no plans to expand into businesses in which the Corporation is not presently involved.

## CONSOLIDATED STATEMENT OF EARNINGS

| * except per share amounts | Note Reference | YEAR ENDED DECEMBER 31 ($ MILLIONS*) 1989 | 1988 |
|---|---|---|---|
| *Revenues, Net of Royalties* | | $ 505.9 | $ 477.2 |
| *Costs and Expenses* | | | |
| Operating | | 253.3 | 244.1 |
| General and administrative | | 20.9 | 26.2 |
| Interest, net | 2 | 54.5 | 39.1 |
| Depreciation, depletion and amortization | | 129.2 | 123.0 |
| | | 457.9 | 432.4 |
| *Earnings before the Undernoted* | | 48.0 | 44.8 |
| Deduct: Income taxes | 3 | 17.4 | 10.6 |
| Minority interest | | – | 1.7 |
| Add: Equity earnings | | 6.7 | 3.6 |
| | | 10.7 | 8.7 |
| *Earnings before Extraordinary Item* | | 37.3 | 36.1 |
| *Extraordinary Item* | 4 | – | 15.3 |
| *Net Earnings* | | $ 37.3 | $ 51.4 |
| *Earnings per Common Share* | | | |
| Before Extraordinary Item | | $ 0.52 | $ 0.52 |
| After Extraordinary Item | | $ 0.52 | $ 0.79 |

## CONSOLIDATED STATEMENT OF RETAINED EARNINGS

| | YEAR ENDED DECEMBER 31 ($ MILLIONS) 1989 | 1988 |
|---|---|---|
| *Balance, Beginning of Year* | $ 220.7 | $ 192.7 |
| *Net Earnings* | 37.3 | 51.4 |
| | 258.0 | 244.1 |
| *Dividends – Preferred Shares* | 7.3 | 5.8 |
| *– Common Shares* | 19.7 | 17.6 |
| *Affiliate's Financing Costs, Net of Income Taxes* | 2.2 | – |
| | 29.2 | 23.4 |
| *Balance, End of Year* | $ 228.8 | $ 220.7 |

SEE ACCOMPANYING NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS.

## CONSOLIDATED BALANCE SHEET

**AS AT DECEMBER 31 ($ MILLIONS)**

| | Note Reference | 1989 | 1988 |
|---|---|---|---|
| **Assets** | | | |
| *Current Assets* | | | |
| Cash and short-term investments at cost which approximates market | | $ 60.7 | $ 56.9 |
| Accounts receivable and accrued revenue | | 69.1 | 55.0 |
| Inventories | | 26.7 | 25.7 |
| Prepaid expenses | | 5.4 | 2.3 |
| Notes receivable | | – | 6.0 |
| | | 161.9 | 145.9 |
| *Investments* | 5 | 145.8 | 48.2 |
| *Property, Plant and Equipment* | 6 | 1,683.5 | 1,724.4 |
| *Deferred Charges and Other Assets* | 7 | 12.2 | 12.8 |
| | | $ 2,003.4 | $ 1,931.3 |

| | Note Reference | 1989 | 1988 |
|---|---|---|---|
| **Liabilities and Shareholders' Equity** | | | |
| *Current Liabilities* | | | |
| Notes payable | | $ 35.0 | $ – |
| Accounts payable and accrued liabilities | | 101.4 | 113.9 |
| Current portion of deferred revenue and other liabilities | | 9.8 | 25.9 |
| Current portion of long-term debt | 8 | 3.2 | 3.1 |
| | | 149.4 | 142.9 |
| *Long-Term Debt* | 8 | 538.2 | 597.8 |
| *Deferred Revenue and Other Liabilities* | | 65.4 | 76.3 |
| *Deferred Income Taxes* | | 418.4 | 401.1 |
| | | 1,171.4 | 1,218.1 |
| *Shareholders' Equity* | | | |
| Share capital | 9 | 605.8 | 494.5 |
| Retained earnings | | 228.8 | 220.7 |
| Foreign currency translation adjustment | | (2.6) | (2.0) |
| | | 832.0 | 713.2 |
| | | $ 2,003.4 | $ 1,931.3 |

Approved by the Board:

Director Merv Leitch Director

SEE ACCOMPANYING NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS.

## CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

YEAR ENDED DECEMBER 31 ($ MILLIONS)

| | Note Reference | 1989 | 1988 |
|---|---|---|---|
| *Operating Activities* | | | |
| Earnings before extraordinary item | | $ 37.3 | $ 36.1 |
| Depreciation, depletion and amortization | | 129.2 | 123.0 |
| Deferred income taxes | | 16.4 | 20.8 |
| Dividends from affiliates, net of equity earnings | | 2.9 | 12.5 |
| Minority interest | | – | 1.7 |
| Other | | 1.3 | 2.1 |
| *Cash flow* | | 187.1 | 196.2 |
| Net change in non-cash working capital | | (30.0) | 6.7 |
| Reduction of deferred revenue | | (9.1) | (8.9) |
| | | 148.0 | 194.0 |
| *Investing Activities* | | | |
| Purchase of property, plant and equipment | | (98.7) | (161.3) |
| Additions to equity investments | | (98.8) | (10.3) |
| Proceeds on disposal of assets | | 15.0 | 7.9 |
| Acquisition of subsidiary's minority interest | 10 | – | (230.5) |
| Proceeds on disposal of investment | 4 | – | 25.7 |
| Other | | (2.9) | (0.6) |
| | | (185.4) | (369.1) |
| *Dividends* | | | |
| Preferred share dividends | | (7.3) | (5.8) |
| Common share dividends | | (19.7) | (17.6) |
| Preferred share dividends paid to minority interests | | – | (2.8) |
| | | (27.0) | (26.2) |
| ***Decrease in Cash before Financing Activities*** | | (64.4) | (201.3) |
| *Financing Activities* | | | |
| Issue of common shares | | 110.0 | 102.4 |
| Net issue (repayment) of revolving debt | | (56.6) | 55.1 |
| Repayment of non-revolving debt | | (3.1) | (2.8) |
| Issue of non-revolving debt | | – | 24.0 |
| Payment of other liabilities | | (17.1) | (17.0) |
| Other | | – | 8.7 |
| | | 33.2 | 170.4 |
| Decrease in cash and short-term investments less notes payable | | $ (31.2) | $ (30.9) |
| Cash and short-term investments less notes payable, end of year | | $ 25.7 | $ 56.9 |

SEE ACCOMPANYING NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS.

(tabular amounts in $ millions, unless otherwise indicated)

## 1. Summary of Significant Accounting Policies

### *(a) Principles of consolidation*

The consolidated financial statements include the accounts of Alberta Energy Company Ltd. (the "Corporarion") and its subsidiaries, all of which are wholly owned.

Investments in unincorporated joint ventures are accounted for using the proportionate consolidation method, whereby the Corporation's proportionate share of revenues, expenses, assets and liabilities are included in the accounts.

Investments in companies and partnerships over which the Corporation has significant influence or joint control are accounted for using the equity method.

A listing of major subsidiaries, affiliates, unincorporated joint ventures and partnerships is included on page 36.

### *(b) Property, plant and equipment*

**OIL AND GAS**

CONVENTIONAL

The Corporation accounts for conventional oil and gas properties in accordance with the Canadian Institute of Chartered Accountants' guideline on full cost accounting in the oil and gas industry.

Under this method all costs associated with the acquisition, exploration and development of oil and gas reserves are capitalized in cost centres on a country by country basis. Direct general and administrative costs related to exploration activities are capitalized; interest is not capitalized.

Depletion and depreciation is calculated using the unit-of-production method based on estimated proven reserves, before royalties. For purposes of rhis calculation, oil is converted to gas on an energy equivalent basis. All capitalized costs are subject to depletion and depreciation including costs related to unproved properties as well as estimated future costs to be incurred in developing proven reserves.

A ceiling test is applied to ensure that capitalized costs do not exceed estimated future net revenues less certain costs.

OIL SANDS

Property, plant and equipment associated with both surface mineable and in situ commercial oil sands projects are accumulated, at cost, in separate cost centres. Substantially all of these costs are amortized using the unit-of-production method based on estimated proven reserves applicable to each project. Project expenditures during the exploratory and pilot phases are depreciated using the straight-line method over terms up to five years.

**PIPELINES**

Property, plant and equipment related to pipelines is carried at cost and is depreciated using the straight-line method over the remaining minimum term of each applicable pipeline service agreement.

**OTHER**

Other property, plant and equipment is carried at cost and is depreciated over the useful life of the assets.

### *(c) Deferred charges and other assets*

**PROJECT INVESTIGATION COSTS**

Project investigation costs for new business opportunities are charged to earnings as incurred until such time as the commercial viability of the project is established. Subsequent expenditures are capitalized and amortized on a basis appropriate for the project.

**FINANCING COSTS**

Financing costs relating to long-term debt are deferred and amortized over the life of the related debt.

### *(d) Foreign currency translation*

The accounts of self-sustaining foreign subsidiaries are translated using the current rate method. Under this method, assets and liabilities are translated at year-end exchange rates while revenues and expenses are converted using average annual rates. Translation gains and losses relating to subsidiaries are deferred and included in shareholders' equity.

### *(e) Inventories*

Inventories are valued at the lower of cost or estimated net realizable value.

### *(f) Interest capitalization*

Interest is capitalized during the construction phase of large capital projects.

### *(g) Deferred revenue*

Amounts received by the Corporation under take-or-pay provisions of gas sales contracts are recorded as deferred revenue. These amounts are recognized as revenue as the gas is delivered. The contracts provide for deliveries over a ten year period ending in 1994.

### *(h) Comparative figures*

Certain 1988 figures have been reclassified for comparative purposes.

## 2. Interest, Net

| | 1989 | 1988 |
|---|---|---|
| Interest expense – on long-term debt | $ 60.4 | $ 43.9 |
| – other | 0.4 | 0.4 |
| Interest income | (4.5) | (4.7) |
| Capitalized interest | (1.8) | (0.5) |
| | $ 54.5 | $ 39.1 |

(tabular amounts in $ millions unless otherwise indicated)

## 3. Income Taxes

| | 1989 | 1988 |
|---|---|---|
| Current | $ 2.4 | $ (7.2) |
| Deferred | 16.4 | 20.8 |
| Large corporations tax | 1.6 | – |
| Alberta royalty tax credit | (3.0) | (3.0) |
| Income tax expense | $ 17.4 | $ 10.6 |

The following table reconciles the income tax expense calculated at statutory rates with the recorded income tax expense:

| | 1989 | 1988 |
|---|---|---|
| Earnings before income taxes, minority interest, equity earnings, and extraordinary item | $ 48.0 | $ 44.8 |
| Income tax expense at statutory rates (1989 – 43.8%; 1988 – 47.4%) | $ 21.0 | $ 21.2 |
| Effect on taxes resulting from: | | |
| Nondeductibility of: | | |
| Crown royalties and leases | 10.0 | 9.1 |
| Income debenture interest | – | 0.6 |
| Depreciation and depletion | 5.7 | 1.5 |
| Federal allowances: | | |
| Resource allowance | (17.4) | (15.6) |
| Earned depletion | (0.3) | (2.6) |
| Large corporations tax | 1.6 | – |
| Alberta royalty tax credit | (3.0) | (3.0) |
| Other, net | (0.2) | (0.6) |
| Income tax expense (Effective Rate: 1989 – 36.3%; 1988 – 23.7%) | $ 17.4 | $ 10.6 |

## 4. Extraordinary Item

The investment in IPSCO Inc. was sold in 1988 for $25.7 million resulting in an extraordinary gain of $15.3 million.

## 5. Investments

| | Percent Interest | 1989 | 1988 |
|---|---|---|---|
| Corporations: | | | |
| AEC Power Ltd. (50% voting) | 66⅔ | $ 31.1 | $ 29.5 |
| Chieftain International, Inc. | 50 | 74.5 | – |
| Pacific Coast Energy Corporation | 50 | 5.4 | – |
| Pan-Alberta Gas Ltd. (40% voting) | 49.995 | 7.8 | 7.4 |
| Pan-Alberta Resources Inc. (40% voting) | 49.995 | 0.9 | 1.0 |
| Partnerships: | | | |
| Iroquois Gas Transmission System | 6 | 1.7 | 2.2 |
| Slave Lake Pulp Partnership | 75 | 12.0 | – |
| U.S. Fertilizer Partnership | 25 | 12.4 | 8.1 |
| | | $ 145.8 | $ 48.2 |

## 6. Property, Plant and Equipment

| | 1989 | | | 1988 |
|---|---|---|---|---|
| | Cost | Accumulated depreciation, depletion and amortization | Net | Net |
| Oil and gas | $ 1,816.4 | $ 567.0 | $ 1,249.4 | $ 1,261.0 |
| Pipelines | 353.8 | 94.8 | 259.0 | 266.8 |
| Forest products | 83.8 | 36.8 | 47.0 | 53.1 |
| Petrochemicals | 101.6 | 14.5 | 87.1 | 92.4 |
| Other | 113.6 | 72.6 | 41.0 | 51.1 |
| | $ 2,469.2 | $ 785.7 | $ 1,683.5 | $ 1,724.4 |

## 7. Deferred Charges and Other Assets

| | 1989 | 1988 |
|---|---|---|
| Unamortized financing costs | $ 8.0 | $ 8.7 |
| Other | 4.2 | 4.1 |
| | $ 12.2 | $ 12.8 |

(tabular amounts in $ millions, unless otherwise indicated)

## 8. Long-Term Debt

| | 1989 | 1988 |
|---|---|---|
| Fixed rate debt: | | |
| Unsecured debentures | | |
| 10.50%, due June 1996 | $ 100.0 | $ 100.0 |
| 6.75% convertible subordinated, due June 2002 | 125.0 | 125.0 |
| 7.25% convertible subordinated, due September 2003 | 150.0 | 150.0 |
| First Mortgage Sinking Fund Bonds | | |
| Series A, 9⅝%, due June 1997 | 13.7 | 15.0 |
| Series B, 9¾%, due June 1997 | 15.9 | 17.3 |
| Mortgage, 11.75%, due September 2000 | 5.1 | 5.2 |
| Other | 1.8 | 2.1 |
| | 411.5 | 414.6 |
| Floating rate debt: | | |
| Revolving credit and term loan borrowings | | |
| Notes payable | 110.8 | 184.6 |
| Term loans | 22.1 | 5.0 |
| | 132.9 | 189.6 |
| | 544.4 | 604.2 |
| Current portion of long-term debt | 3.2 | 3.1 |
| Unamortized portion of debt discount | 3.0 | 3.3 |
| | 6.2 | 6.4 |
| | $ 538.2 | $ 597.8 |

*(a) Mandatory five year debt repayments*

The minimum annual repayments of long-term debt required over each of the next five years are as follows:

| | |
|---|---|
| 1990 | $ 3.2 |
| 1991 | 3.4 |
| 1992 | 3.5 |
| 1993 | 3.0 |
| 1994 | 2.9 |

*(b) Convertible debentures – 6.75%*

Each debenture is convertible at the option of the holder into Common Shares at any time until June 29, 1997 or the last business day prior to the date fixed for redemption, whichever is earlier, at a conversion price of $23.375 per Common Share.

Subject to certain conditions, the debentures are redeemable at the option of the Corporation, at prices varying from 105.25% to 100.00% of the principal amount.

*(c) Convertible debentures – 7.25%*

Each debenture is convertible at the option of the holder into Common Shares at any time until September 29, 1997 or the last business day prior to the date fixed for redemption, whichever is earlier, at a conversion price of $25.50 per Common Share.

Subject to certain conditions, the debentures are redeemable at the option of the Corporation, at prices varying from 105.6% to 100.0% of the principal amount.

*(d) First Mortgage Sinking Fund Bonds*

Alberta Oil Sands Pipeline Ltd. ("AOSPL"), a wholly owned subsidiary of the Corporation, is obligated to retire $2.8 million of these bonds annually. The bonds are secured by both a fixed and floating charge on AOSPL's assets that relate to the Syncrude project. The participants in the Syncrude project, including the Corporation to the extent of 10%, are committed to provide funds for the repayment of these bonds.

*(e) Revolving credit and term loan borrowings*

The Corporation has $375 million of revolving credit and term loan facilities available with three banks. One agreement is fully revolving until converted to a five year revolving reducing facility at the option of the lender and upon 24 months' notice to the Corporation. The other two agreements are fully revolving until 1991 and 1992, respectively, with provisions for yearly extensions at the option of the lenders following 19 months' notice from the Corporation. If not extended, the two agreements convert to revolving reducing facilities over seven and four years, respectively.

All three facilities are unsecured and are available in Canadian and/or U.S. dollar equivalent amounts and currently bear interest at the lenders' rates for Canadian prime commercial or U.S. base rate loans, or at Bankers' Acceptance rates or LIBOR plus applicable margins.

The Corporation also has a $75 million unsecured revolving credit and term loan facility with a trust company. The agreement is fully revolving until 1995 and provides for an extension to 1997 and successive anniversaries thereafter, subject to satisfactory annual review by the lender commencing in 1990. If not extended, the facility is repayable in full on expiry of the revolving term. Amounts advanced under this facility bear interest at the lender's prime commercial lending rates minus a factor up to ¾% or at Bankers' Acceptance rates plus an applicable margin.

Alenco Inc., a wholly owned subsidiary of the Corporation, has a U.S. $20 million unsecured revolving credit and term loan facility available. This facility has similar terms to the revolving credit and term loan facilities discussed above and is guaranteed by the Corporation.

Notes payable consist of Commercial Paper and Bankers' Acceptances maturing at various dates to January 29, 1990, with a weighted average interest rate of 12.53% (1988 – 10.82%). Notes payable shown as long-term debt represent amounts which are not expected to require the use of working capital during the year and are supported by the availability of term loans under the revolving credit facilities.

(tabular amounts in $ millions, unless otherwise indicated)

## 9. Share Capital

| | 1989 | 1988 |
|---|---|---|
| First Preferred Shares: | | |
| Authorized – 20,000,000 shares | | |
| Issued – None | $ – | $ – |
| Second Preferred Shares: | | |
| Authorized – 20,000,000 shares | | |
| Issued – 2,999,700 7.75% Deferred Convertible Redeemable, Series 2 shares with a paid up amount of $25 each | 75.0 | 75.0 |
| Third Preferred Shares: | | |
| Authorized – 20,000,000 shares | | |
| Issued – None | – | – |
| Common Shares: | | |
| Authorized – 300,000,000 shares | | |
| Issued – 65,849,537 shares (1988 – 59,773,585) | 530.8 | 419.5 |
| Non-Voting Shares: | | |
| Authorized – 5,000,000 shares | | |
| Issued – None | – | – |
| | $ 605.8 | $ 494.5 |

*(a) Second Preferred Shares – Series 2*

Subject to certain conditions, the shares are redeemable at the option of the Corporation at prices varying from $26.50 to $25.00 per share. Dividends relating to these shares are cumulative.

The holders of Series 2 Preferred Shares have the option, until May 16, 1995, to convert each Series 2 Preferred Share into 1.28 Common Shares.

*(b) Common Shares*

| | 1989 | | 1988 | |
|---|---|---|---|---|
| | Number of Shares | Amount | Number of Shares | Amount |
| Issued, beginning of year | 59,773,585 | $ 419.5 | 53,814,652 | $ 316.4 |
| Issued for cash: | | | | |
| Public offering | 5,263,158 | 100.0 | 4,539,008 | 80.0 |
| Shareholder Investment Plan | 639,199 | 10.9 | 214,625 | 3.5 |
| Employee Share Option Plan | 173,595 | 1.9 | 59,190 | 0.6 |
| Issued in exchange for shares of | | | | |
| Chieftain Development Co. Ltd. | – | – | 1,146,110 | 20.6 |
| Common share issue costs, net of | | | | |
| income taxes | – | (1.5) | – | (1.6) |
| Issued, end of year | 65,849,537 | $ 530.8 | 59,773,585 | $ 419.5 |

*(c) Employee Share Option Plan*

The Employee Share Option Plan provides for granting to employees of the Corporation and its subsidiaries options to purchase Common Shares of the Corporation. Each option granted under the plan expires after seven years and may be exercised in cumulative annual amounts of 25% on or after each of the first four anniversary dates of the grant.

As at December 31, 1989, options, exercisable between 1990 and 1996, were outstanding to purchase 1,144,860 Common Shares at minimum prices ranging from $9.79 to $21.60 per share.

*(d) Common Shares Reserved*

At December 31, 1989, Common Shares were reserved for issuance as follows:

| | |
|---|---|
| Conversion of Subordinated Debentures | 11,229,946 |
| Conversion of Second Preferred Shares | 3,839,616 |
| Employee Share Option Plan | 1,785,985 |
| Employee Savings Plan | 500,000 |
| Shareholder Investment Plan | 371,304 |
| Share Purchase Plan (presently inactive) | 100,108 |
| | 17,826,959 |

*(e) Alberta Energy Company Act*

Pursuant to the Alberta Energy Company Act, which was amended during the year, aggregate ownership of voting shares in the Corporation by non-residents of Canada is limited to 10% and the maximum ownership of any one shareholder, excluding the Government of Alberta, is limited to 5% of the total number of issued and outstanding voting shares of each class of the Corporation.

## 10. Acquisition of Subsidiary's Minority Interest

In 1988, the Corporation completed the purchase of all the outstanding common shares and all other securities of Chieftain Development Co. Ltd. for total consideration of $230.5 million.

## 11. Supplementary Information

*(a) Unincorporated joint ventures*

The Corporation has included in its accounts the following aggregate amounts in respect of major unincorporated joint ventures:

| | 1989 | 1988 |
|---|---|---|
| Assets | $ 414.1 | $ 444.1 |
| Liabilities | 40.3 | 44.3 |
| Revenues, net of royalties | 176.1 | 158.8 |
| Expenses | 139.8 | 144.1 |

(tabular amounts in $ millions, unless otherwise indicated)

### *(b) Capitalized general and administrative expenses*

General and administrative expenses capitalized to oil and gas properties during the year amounted to $7.2 million (1988 – $9.4 million).

### *(c) Ceiling test prices*

The prices used in the ceiling tesr evaluation of the Corporation's conventional reserves at December 31, 1989 were as follows:

| | |
|---|---|
| Natural gas | $1.58 per thousand cubic feet |
| Oil and natural gas liquids | $17.62 per barrel |

### *(d) Pension plans*

At December 31, 1989, the market value of pension fund assets was $23.4 million (1988 –$18.4 million) and rhe accrued pension liability, as estimated by rhe Corporation's acruaries, was $20.7 million (1988 – $16.6 million).

### *(e) Related party transactions*

During the year, the Corporation sold approximately $35.9 million (1988 – $42.8 million) of natural gas to affiliates of which $6.3 million (1988 – $2.7 million) is included in accounts receivable at year end.

During the year, the Corporation sold its non-Canadian oil and gas assets to Chieftain International, Inc. (CII) for $96 million. The Corporation acquired 50 percent of the common shares issued by CII for $76.1 million pursuanr ro an Initial Public Offering that was completed in April, 1989.

### *(f) Commitments*

The Corporation is a 75 percent parrner in a partnership which is constructing a pulp mill estimated to cost $170 million when fully operational. Project financing has been arranged in the amount of $96 million which requires the partners to complete construction of rhe plant by 1995.

The Corporation is a 50 percent shareholder in a company constructing a natural gas pipeline from the mainland to Vancouver Island, British Columbia, which is expected to cosr $280 million when completed in 1991. Project financing of $80 million and Government financing of $175 million are in place. The shareholders are required ro complete the pipeline by late 1992.

## 12. Segmented Information

| | Revenues, Net of Royalties | | Operating Income (Loss) and Equity Earnings | | Identifiable Assets | | Additions to Property, Plant & Equipment and Investments | | Depreciation, Depletion & Amortization | |
|---|---|---|---|---|---|---|---|---|---|---|
| | **1989** | 1988 | **1989** | 1988 | **1989** | 1988 | **1989** | 1988 | **1989** | 1988 |
| Oil and Gas | **$ 290.7** | $ 277.1 | **$ 69.1** | $ 62.3 | **$ 1,385.2** | $ 1,317.9 | **$ 156.4** | $ 203.8 | **$ 90.6** | $ 87.1 |
| Pipelines | **84.9** | 76.6 | **53.1** | 48.1 | **275.6** | 276.7 | **13.7** | 39.1 | **15.5** | 13.3 |
| Forest Products | **66.8** | 56.5 | **2.2** | (0.6) | **74.6** | 70.0 | **14.9** | 7.8 | **6.1** | 6.0 |
| Petrochemicals | **27.5** | 27.7 | **0.8** | (0.5) | **115.4** | 116.3 | **5.7** | 8.6 | **5.9** | 5.9 |
| Other | **36.0** | 39.3 | **8.6** | 7.6 | **64.6** | 72.3 | **4.2** | 6.2 | **7.4** | 7.5 |
| | **505.9** | 477.2 | **133.8** | 116.9 | **1,915.4** | 1,853.2 | **194.9** | 265.5 | **125.5** | 119.8 |
| Corporate | **–** | – | **(96.5)** | (80.8) | **88.0** | 78.1 | **2.6** | 4.6 | **3.7** | 3.2 |
| Total | **$ 505.9** | $ 477.2 | **$ 37.3** | $ 36.1 | **$ 2,003.4** | $ 1,931.3 | **$ 197.5** | $ 270.1 | **$ 129.2** | $ 123.0 |

## AUDITORS' REPORT

To the Shareholders of Alberta Energy Company Ltd.:

We have examined the consolidated balance sheets of Alberta Energy Company Ltd. as at December 31, 1989 and 1988 and the consolidated statements of earnings, retained earnings and changes in financial position for the years then ended. Our examinations were 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 Corporation as at December 31, 1989 and 1988 and the results of its operations and the changes in its financial position for the years then ended in accordance with generally accepted accounting principles applied on a consistent basis.

Price Waterhouse

Chartered Accountants
Edmonton, Alberta
February 7, 1990

## HISTORICAL REVIEW

UNAUDITED ($ MILLIONS *)

* All dollar amounts, except per share amounts

| | 1989 | 1988 | 1987 | 1986 | 1985 |
|---|---|---|---|---|---|
| ***Financial*** | | | | | |
| Earnings before extraordinary items | $ 37.3 | $ 36.1 | $ 60.5 | $ 47.8 | $ 80.5 |
| Net earnings (loss) | 37.3 | 51.4 | 60.5 | (35.5) | 80.5 |
| Cash flow | 187.1 | 196.2 | 207.0 | 201.5 | 252.6 |
| Revenue, net of royalties | 505.9 | 477.2 | 464.0 | 443.3 | 525.3 |
| Property, plant and equipment | 1,683.5 | 1,726.6 | 1,584.5 | 1,546.2 | 1,428.8 |
| Long-term debt | 538.2 | 597.8 | 537.9 | 534.5 | 606.8 |
| Share capital | 605.8 | 494.5 | 391.4 | 384.0 | 354.3 |
| Total assets | 2,003.4 | 1,931.3 | 1,858.8 | 1,806.3 | 1,860.3 |
| ***Per Share Data*** | | | | | |
| Basic earnings before extraordinary items | $ 0.52 | $ 0.52 | $ 1.02 | $ 0.72 | $ 1.44 |
| Basic net earnings (loss) after extraordinary items | 0.52 | 0.79 | 1.02 | (1.12) | 1.44 |
| Cash flow | 2.99 | 3.24 | 3.68 | 4.01 | 5.06 |
| Common shareholders' equity | 11.49 | 10.68 | 9.48 | 8.62 | 9.62 |
| Common dividend | 0.33 | 0.30 | 0.30 | 0.30 | 0.30 |
| ***Shares*** | | | | | |
| Registered shareholders | 45,326 | 45,339 | 46,528 | 51,125 | 52,974 |
| Common Shares outstanding | 65,849,537 | 59,773,585 | 53,814,652 | 52,757,339 | 44,876,570 |
| Total volume of Common Shares traded | 17,275,199 | 12,014,918 | 21,188,500 | 15,327,109 | 8,542,225 |
| Common Share price range (TSE) | | | | | |
| High | $ 22.75 | $ 19.50 | $ 25.25 | $ 17.38 | $ 22.13 |
| Low | 15.63 | 13.63 | 14.38 | 9.75 | 16.13 |
| Close | 19.88 | 15.75 | 15.88 | 14.88 | 17.38 |
| ***Operating Data*** | | | | | |
| Gas sales *(billion cubic feet)* | 99.3 | 102.3 | 85.0 | 92.0 | 85.4 |
| Synthetic oil sales *(million barrels)* | 5.4 | 5.5 | 5.0 | 4.7 | 4.7 |
| Conventional oil sales *(million barrels)* | 2.3 | 2.4 | 1.8 | 1.7 | 0.7 |
| Lumber sales *(million board feet)* | 201 | 173 | 169 | 152 | 140 |
| Medium density fibreboard sales *(million square feet)* | 63 | 55 | 47 | 8 | — |
| Nitrogen fertilizer sales *(thousand tonnes)* | 349 | 292 | 135 | — | — |
| Coal sales *(thousand tons)* | 548 | 544 | 501 | 448 | 432 |
| Pipeline throughput *(all systems)* *(million barrels)* | 166.8 | 173.0 | 160.0 | 118.8 | 97.8 |

## AT YEAR-END 1989

| | |
|---|---|
| Net petroleum and natural gas rights | 3.2 million acres |
| Natural gas reserves *(billion cubic feet)* Proven 1,412 Probable 225 | Total 1,637 |
| Proven and probable natural gas reserve life* | 16 years |
| Oil and natural gas liquids reserves *(million barrels)* Proven 15.9 Probable 5.2 | Total 21.1 |
| Proven and probable oil and natural gas liquids reserve life* | 9 years |
| Proven synthetic oil reserves | 207 million barrels |
| Synthetic oil reserve life* | 38 years |
| Net Primrose heavy oil in place | 25 billion barrels |
| Timber lands | 2.4 million acres |
| Coal reserves | 5.4 million clean short tons |
| Coal reserve life* | 10 years |
| Pipelines *(in 5 pipelines)* | 1,400 miles |

* At 1989 production rates

# DIRECTORS AND OFFICERS

## Board of Directors

Mathew M. Baldwin
Company Director
Edmonton, Alberta

C. Merv Leitch, Q.C.
Partner
Macleod Dixon
Barristers & Solicitors
Calgary, Alberta

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

John E. Maybin
President
Colmac Energy Inc.
Calgary, Alberta

Stanley A. Milner
President
Chieftain International, Inc.
Edmonton, Alberta

David E. Mitchell, O.C.
President
Alberta Energy Company Ltd.
Calgary, Alberta

Raymond J. Nelson
President
Nelson Lumber Company Ltd.
Lloydminster, Alberta

Gordon H. Sissons
Chairman of the Board
I-XL Industries Ltd.
Medicine Hat, Alberta

J. Harry Tims
President & General Manager
McTavish McKay & Company Limited
Calgary, Alberta

H. Richard Whittall
Vice Chairman and Director
Placer Dome Inc.
Vancouver, British Columbia

## Corporate Officers and Senior Personnel

David E. Mitchell, O.C.
President & Chief Executive Officer

Gwyn Morgan
Senior Vice-President

Frank W. Proto
Senior Vice-President

Roger D. Dunn
Vice-President

Edward J. Martin
Vice-President, Administration

Hector J. McFadyen
Vice-President

John D. Watson
Vice-President, Finance and
Chief Financial Officer

Barry D. Gilchrist
Corporate Secretary

Sydney R. Chen-See
Assistant Corporate Secretary

David W. Richardson
Assistant Treasurer

Derek S. Bwint
Director
Planning

Keith O. Fowler
Director
Tax & Risk Management

Vincent J. Gallant
Comptroller

Donald R. Gardner
Advisor, Finance

Wayne G. Holt
General Counsel

Ronald D. Jones
Director
Computer Services

Robert A. Towler
Director
Petrochemicals

Richard H. Wilson
Director
Public Affairs

## Principal Officers of Divisions

### AEC Oil and Gas

Gwyn Morgan
President

Roger D. Dunn
Senior Vice-President

Ronald A. McIntosh
Senior Vice-President

Dennis W. Cornelson
Vice-President
Marketing

Allan F. Kiernan
Vice-President

R. William Oliver
Vice-President

Wayne G. Thomson
Vice-President
Production

### AEC Pipelines

Frank W. Proto
President

Bernie J. Bradley
Senior Vice-President

Wallace W. Scott
Vice-President, Engineering

John D. Watson
Vice-President, Finance

### AEC Forest Products

Hector J. McFadyen
President

Richard E. Huff
Vice-President

John D. Watson
Vice-President, Finance

# CORPORATE INFORMATION

### Offices

#1200, 10707 - 100 Avenue
Edmonton, Alberta T5J 3M1
(Registered Office)

#2400, 639 - 5 Avenue S.W.
Calgary, Alberta T2P 0M9
(Executive Office)

### Transfer Agent and Registrar
(COMMON SHARES)

National Trust Company
Calgary, Edmonton, Vancouver,
Regina, Winnipeg, Toronto,
Montreal, Halifax

### Transfer Agent and Registrar
(SECOND PREFERRED SHARES, SERIES 2) **and Trustee** (CONVERTIBLE DEBENTURES AND 10.50% DEBENTURES)

The Royal Trust Company
Calgary, Edmonton, Vancouver,
Regina, Winnipeg, Toronto,
Montreal, Halifax

### Auditors

Price Waterhouse
Chartered Accountants
Edmonton, Alberta

### Stock Exchange Listings

The Alberta Stock Exchange
The Montreal Exchange
The Toronto Stock Exchange
Vancouver Stock Exchange

In newspaper listings, AEC's share issues are shown as follows:

| | |
|---|---|
| Alt Energy | Common |
| Al Enr 775 | Second Preferred, Series 2 |

### Major Subsidiaries, Affiliates and Partnerships

| | |
|---|---|
| AEC Power Ltd. (50% voting) | 66.67% |
| Alberta Oil Sands Pipeline Ltd. | 100% |
| Alenco Inc. | 100% |
| Alenco Iroquois Pipelines Inc. | 100% |
| Alenco Petrochemicals Inc. | 100% |
| Alenco Pipelines Inc. | 100% |
| Alenco Resources Inc. | 100% |
| Blue Ridge Lumber (1981) Ltd. | 100% |
| Chieftain Energy Resources Ltd. | 100% |
| Chieftain International, Inc. | 50% |
| Cominco Fertilizers Partnership | 25% |
| Hartfield Chieftain Leasing Ltd. | 100% |
| Iroquois Gas Transmission System, L.P. | 6% |
| Pacific Coast Energy Corporation | 50% |
| Pan-Alberta Gas Ltd. (40% voting) | 49.995% |
| Pan-Alberta Resources Inc. (40% voting) | 49.995% |
| Ranger Forest Products Ltd. | 100% |
| Slave Lake Pulp Corporation | 75% |
| Slave Lake Pulp Partnership | 75% |
| Tri-City Drilling (1968) Ltd. | 100% |

### Major Joint Ventures

| | |
|---|---|
| Coal Valley | 25% |
| Ethane Gathering System | 33.33% |
| Nitrogen Fertilizer | 25% |
| Syncrude | 10% |

### Duplicate Annual Reports

Receipt of duplicate shareholder material results from shareholders having shares of the same class or series registered in different names or addresses. You can avoid receiving duplicates and help AEC save money by contacting your Transfer Agent (see Transfer Agent and Registrar) to have your holdings registered under one name and address.

### Annual Meeting

The Annual Meeting of Shareholders of Alberta Energy Company Ltd. will be held in Macleod Hall, Salon D, Calgary Convention Centre, 120 - 9 Avenue S.E., Calgary, Alberta at 3:00 p.m. local time on Wednesday, April 4, 1990.

### Annual Reports

Copies of AEC's 1989 Annual Report may be obtained by contacting the Corporate Secretary at Alberta Energy Company Ltd., #2400, 639 - 5 Avenue S.W., Calgary, Alberta T2P 0M9.

# SHAREHOLDER INVESTMENT PLAN

**Shareholders wishing to increase their holdings of Common Shares of Alberta Energy Company Ltd. may take advantage of the Shareholder Investment Plan which offers two options.**

The dividend reinvestment option provides a convenient method for shareholders to invest their cash dividends in new Common Shares at 95 percent of Average Market Price.

The share purchase option allows a shareholder to purchase up to $5,000 per calendar quarter (minimum $50 per remittance) of new Common Shares at Average Market Price.

No commissions, service charges or brokerage fees are payable by shareholders to acquire Common Shares via the Plan, as all administrative costs are borne by AEC.

Registered shareholders of Common Shares or 7.75% Deferred Convertible Redeemable Second Preferred Shares, Series 2, are eligible to participate.

Detailed information and copies of the Plan may be obtained from:
National Trust Company
Corporate Trust Services
Suite 1008, 324 - 8 Avenue S.W.
Calgary, Alberta T2P 3B2
Telephone (403) 263-1460

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