C

Annual Report

Alberta Natural Gas Company Ltd

1986

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Annual Meeting

The ANNUAL MEETING of Shareholders will be held in the Bel Aire Room, Westin Hotel, Calgary, Alberta, on Thursday the 23rd day of April, 1987 at 9:30 a.m.

The notice of meeting and proxy form are being mailed with this report to all shareholders of record.

Corporate Profile

Alberta Natural is a Calgary-based company whose operations encompass three main areas; natural gas transportation, natural gas liquids and ethane extraction operations, and the production of specialty chemicals.

Pacific Gas Transmission Company, a U.S. federally-regulated pipeline company, owns 49.4% of the issued and outstanding common shares of Alberta Natural; in turn, Pacific Gas and Electric Company, a major investor-owned utility based in San Francisco, California, owns 100% of Pacific Gas
a major investor-owned utility based in San Francisco, California, owns 100% of Pacific Gas
Transmission. The balance of the shares of Alberta Natural are held predominantly by the Canadian public.

The Company owns and operates a large-diameter natural gas pipeline which links the systems of Nova, An Alberta Corporation and Pacific Gas Transmission Company, to move gas from Alberta to California. Alberta Natural has a 49% interest in and operates Foothills Pipe Lines (South B.C.) Ltd., a pipeline which parallels about one-half of Alberta Natural's line in southeastern British Columbia, as a "pre-build" portion of the Alaska Highway Pipeline Project.

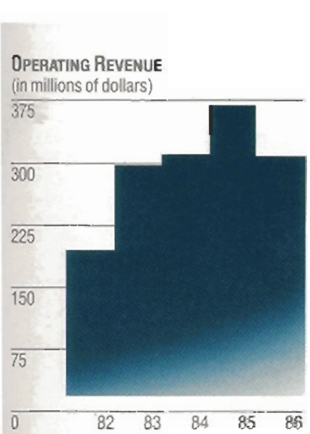
Alberta Natural owns and operates a world-scale natural gas liquids and ethane extraction facility near Cochrane, Alberta, on the western leg of Nova's pipeline system. The plant also has the capability to remove carbon dioxide (CO_2) from the ethane product.

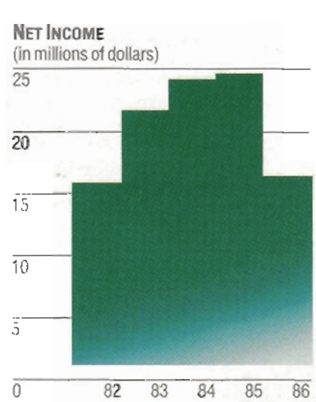
Through its 56% owned subsidiary, ANGUS Chemical Company, the Company is engaged in the production of nitroparaffins and their derivatives, and the manufacture of fine chemicals in the United States and abroad. Alberta Natural also owns 20% of ANGUS Petroleum Corporation, which is engaged in enhanced oil recovery operations in the western United States.

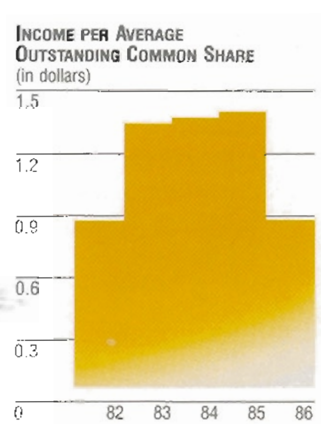
Alberta Natural has a 24% interest in International Permeation Inc., a private Alberta company which has developed a membrane technology for the separation and recovery of various components from gas mixtures and natural gas streams.

Financial Highlights

	1986	1985
Operating revenue ($)	**308,454,000**	372,806,000
Net income ($)	**16,247,000**	24,968,000
Income per average outstanding common share ($)		
– first quarter	**.30**	.33
– second quarter	**.22**	.35
– third quarter	**.26**	.32
– fourth quarter	**.11**	.37
– annual	**.89**	1.37
Common equity ($)		
– total at year end	**128,977,000**	124,584,000
– per share	**7.08**	6.86
Return on average common shareholders' equity (%)	**12.82**	21.51
Dividends paid per common share ($)		
– annual rate	**.64**	.60
Total assets ($)	**371,262,000**	340,183,000
Capital expenditures ($)	**54,620,000**	27,801,000
Average number of common shares outstanding	**18,210,696**	18,174,171
Number of shareholders at year-end	**1,351**	1,419







To our Shareholders

Consolidated net earnings in 1986 amounted to $16,247,000 which is equivalent to 89¢ per average outstanding common share, a decrease of 48¢ per share from last year. While these results are disappointing, they reflect the dramatic decline in oil and gas prices experienced during 1986. Detailed financial results of the Company are set forth in a later section of this report.

The combination of several factors, including price competition and low demand, resulted in a decline in the export sales of natural gas by the shippers through our pipeline. Although the decline in export sales did not affect our pipeline return, it led to a reduction in the volume of gas available for processing at the Cochrane plant, with the result that the production of natural gas liquids (NGL) and ethane from that facility also declined. The decline in production and the fall in NGL prices to levels that were substantially below those of recent years, resulted in significantly reduced marketing profits. One positive effect of the decline in energy prices on the Company's overall business activities was reflected in the decrease in raw material costs experienced by our subsidiary, ANGUS Chemical Company.

John E. Goudie, Chairman of the Board

The Company continues to devote significant efforts toward accomplishing its stated objective of expansion and diversification. In December, 1986, we announced agreement in principle to acquire all of the issued and outstanding shares of Rankin Holdings Ltd. This private Calgary-based company is engaged in various aspects of the NGL business in both Canada and the United States, which it conducts in partnership with subsidiaries of Polysar Limited through the CanStates group. The CanStates Energy partnership, headquartered in Calgary, is one of Canada's leading independent NGL marketing organizations. Other related partnerships, headquartered in the United States, have interests in liquified petroleum gas storage and fractionation facilities located in Michigan. The entry by Alberta Natural into the liquids marketing business complements the Company's existing expertise in the liquids processing field and will provide a vehicle to enable the Company to pursue additional investment opportunities in this business sector.

The year saw the commencement of operation of several projects initiated earlier and which have been referred to in previous communications with the shareholders. Alberta Natural's pipeline, which serves the Shell Canada Resources Limited heavy oil recovery plant, located in the Peace River area of Alberta, was completed during the first half of the year at a cost of $13 million. Deliveries through the pipeline commenced on September 1. Construction of the carbon dioxide (CO_2) recovery facility at the Cochrane plant was completed during the spring of 1986 at a cost of $4 million. Production of food grade CO_2 commenced in June. Currently, approximately 60 tonnes per day of product are being delivered to our customer, Foothills CO_2 Ltd. It is expected that sales will increase as further business opportunities are exploited.

ANGUS Chemical Company completed the first phase of its new specialty chemicals plant in Ireland and has commenced limited production for specific customers. ANGUS continued its pursuit of new investment opportunities and in May, 1986, it incorporated ANGUS Biotech, Inc. to acquire a facility in Long Beach, California for the commercial manufacture and sale of bulk erythromycin. Erythromycin is a fermentation-derived antibiotic with wide use in the treatment of infections. The acquired facility is currently being renovated and remodelled. Completion is scheduled for mid-year with commercial production expected by July or August.

Alberta Natural is also involved in a joint venture with Olympia & York Developments Limited to construct a 32 storey office building in downtown Calgary, scheduled for completion in the summer of 1988.

Douglas R. Fenton, President and Chief Executive Officer

During 1986, several changes were made with respect to the Board of Directors and the senior management of the Company. Harry Booth, who held the position of Chairman of the Board and Chief Executive Officer since April, 1983, retired from that position following the Annual Meeting in April, 1986. He continues to serve the Company as a Director and as Chairman of the Executive Committee. His many contributions to the growth and development of the Company during more than sixteen years as Chief Executive Officer of both Alberta Natural and its affiliate, Alberta and Southern Gas Co. Ltd. have provided a solid base for the Company's future. Subsequent to Mr. Booth's retirement, John E. Goudie was appointed Chairman of the Board and Douglas R. Fenton was appointed President and Chief Executive Officer. Norman E. Wagner was elected to the Board at the Annual Meeting of Shareholders on April 22, replacing Carl O. Nickle who retired from the Board.

While aware of the recent world-wide instability of crude oil prices, we remain convinced that excellent opportunities exist in the energy sector which provide the basis for long term growth for Alberta Natural. We are continuing our search to identify a suitable entry into the upstream oil and gas and enhanced oil recovery field.

Management recognizes the maturity of the Company's existing business activities following twenty-five years of growth and development, and intends to utilize both its financial strength and the talents of its employees as a base upon which to create and manage a new period of corporate growth.

The Board of Directors takes this opportunity to acknowledge, with sincere appreciation, the loyalty and continued dedication of our employees and their substantial contributions to our operations.

For the Board of Directors

J. E. Goudie

Chairman of the Board

D.R. Fenton

President and Chief Executive Officer

March 4, 1987

Review of Operations

Petrochemical
Cochrane Plant

Construction of the $4 million food-grade CO_2 facility at the plant site, which began in the fall of 1985, was completed during June, 1986. The new facility is capable of producing up to 150 tonnes (165 tons) per day of liquid CO_2. For the balance of the year, following completion, approximately 7 780.0 tonnes (8,577 tons) were shipped to customers in Alberta and British Columbia for use primarily in gas well stimulation operations with lesser volumes being used in the carbonated beverage industry.

Comparative average daily production and feed gas volumes:

	1986		1985	
Feed gas volumes	$23.8\ 10^6 m^3$	846 Mmcf	$27.8\ 10^6 m^3$	987 Mmcf
NGL production	$1\ 802.0\ m^3$	11,345 bbls	$2\ 235.0\ m^3$	14,070 bbls
Ethane production	$5\ 050.0\ m^3$	31,935 bbls	$6\ 160.0\ m^3$	38,940 bbls

The 14% decrease in feed gas volumes as compared with 1985, was due primarily to the lower overall requirements of the California market area. However, gas volumes were at or near maximum processing capabilities over year-end 1986, and this has continued into 1987. Production of NGL and ethane was reduced due to a combination of a leaner inlet composition and lower feed gas volumes. Ethane produced at the plant is used primarily as feedstock for ethylene plants at Joffre, Alberta. Approximately 3% of the total ethane production was re-injected into the residue gas stream during the year at the request of the buyer, The Alberta Gas Ethylene Company Ltd. Re-injection has no financial impact on Alberta Natural.

Technology enables the Company to monitor constantly its major operations in natural gas liquids and natural gas transportation

The plant operated continuously during 1986, with the exception of two minor shutdowns, one during a major spring storm and another to accommodate the scheduled facility upgrade shutdowns of connecting pipeline systems. These two shutdowns amounted to less than one operating day.

During the year, capital expenditures at the plant amounted to $3.3 million, principally for the completion of the CO_2 facility and modifications to increase the process thermal recovery efficiency and reduce overall operating costs. In 1987, modifications to two of the cryogenic expanders at an estimated cost of $1.2 million will increase the plant design capacity from an inlet flow of 29.0 million cubic metres (1,025 Mmcf) per day to 31.1 million cubic metres (1,100 Mmcf) per day. The extra capacity will accommodate the additional volumes to be processed following completion of an extraction contract between the Company and Pan-Alberta Resources Inc.

State-of-the-art control equipment at the Cochrane plant (Photo to right)

ANGUS Chemical Company

ANGUS Chemical continued to make a significant contribution to Alberta Natural's overall results during 1986, with operating earnings from its core nitroparaffins business at record levels. Reduced feedstock costs were the main reason for the improvement and more than offset the effects of slightly lower sales volumes in certain markets.

ANGUS Fine Chemicals Ltd., 100% owned by ANGUS Chemical, is completing construction of a fine chemicals facility in Ireland. This plant will offer fully integrated process development and manufacturing capabilities to the pharmaceutical and fine chemicals markets on a world-wide basis. Limited production commenced in July of 1986.

In mid-1986, ANGUS Chemical entered into a joint venture to produce the antibiotic erythromycin. The 85% owned joint venture, ANGUS Biotech, Inc., is retrofitting an existing fermentation facility located in Long Beach, California. Commercial production of erythromycin is scheduled for July 1, 1987. Capital cost is estimated at $14 million. The venture represents another major diversification opportunity for ANGUS Chemical.

Final net earnings of ANGUS Chemical declined from levels achieved in 1985, due primarily to pre-operating expenses associated with both the Irish and California facilities.

ANGUS Petroleum Corporation

Alberta Natural's earnings were negatively affected due to the disposition by ANGUS Petroleum of marginally successful properties at current market prices and the write-down of others to reflect the current market value of oil.

In the light of the world oil market, which at present appears to be firming but not yet stable, ANGUS Petroleum continues to focus its enhanced oil recovery operations by concentrating on core properties.

ANGUS Chemical reported record earnings from its core nitroparaffins business, continuing to make a significant contribution to the Company's overall results.

Pipeline

Deliveries of natural gas for export on behalf of the shippers, Alberta and Southern Gas Co. Ltd., Westcoast Transmission Company Limited, and Pan-Alberta Gas Ltd. averaged 27.0 million cubic metres (953 Mmcf) per day, a decrease of 15% from 31.9 million cubic metres (1,127 Mmcf) per day for 1985.

Capital expenditures in 1986 amounted to $7 million, which included $1 million for the completion of the upgrading of the compressor station unit control systems and $4.7 million for the completion of the Peace River pipeline. The remaining $1.3 million was used for minor equipment replacements and improvements to the compressor facilities.

The control system upgrading continued with the installation of new programmable computerized control panels at each of the three compressor stations, Crowsnest, Elko and Moyie. This program should be completed in 1987.

Construction was completed on the $13 million, 76 km (48 mile) pipeline to supply natural gas to Shell Canada Resources Limited for fuel for its Peace River heavy oil recovery expansion project. The line was commissioned in June and gas deliveries commenced on September 1. For the operational period in 1986, an average of approximately 340 thousand cubic metres (12 Mmcf) per day were delivered.

Loyal and dedicated employees make substantial contributions to Alberta Natural's operations

Engineering plays a vital role in the Company's expansion and diversification plans

Other Business

Office Building

Construction began in November of 1986, on the downtown Calgary property jointly held by the Company and Olympia & York Developments Limited. Construction of the substructure to ground level, has been completed in 1985. The 32 storey, 630,000 square foot building will be the new headquarters of Amoco Canada Petroleum Company Ltd., and is scheduled to be completed during the summer of 1988.

Acquisitions and Diversification

In an effort to expand into the marketing segment of the NGL business, Alberta Natural is finalizing the acquisition of a 50% equity position in the CanStates group of partnerships. The acquisition will be accomplished through the purchase of the issued and outstanding shares of Rankin Holdings Ltd. and related asset purchase arrangements with subsidiaries of Polysar Limited. Polysar Hydrocarbons Ltd., and Polysar Hydrocarbons, Inc., both beneficially owned by Polysar Limited, hold the remaining 50% interest in the CanStates group of partnerships.

CanStates Energy will continue to operate in its established business as a marketer and broker of natural gas liquids and chemical and refined products, including the petrochemical feedstock requirements to Polysar, and may expand to include marketing of other hydrocarbon products.

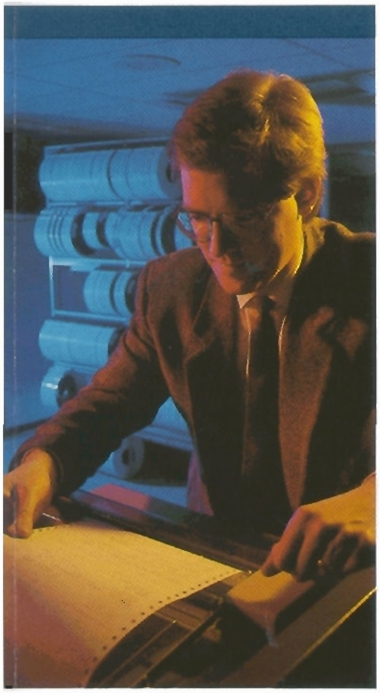
In addition to the marketing operations of CanStates, Alberta Natural acquired interests in certain fractionation and NGL storage facilities. These assets consist of a 24% interest in a 5 085 m^3 (32,000 barrels) per day fractionator and a 12% interest in a 794 550 m^3 (5 million barrels) underground storage reservoir, both located in Marysville, Michigan across the St. Clair River from Sarnia, Ontario.

Alberta Natural views the Rankin Holdings acquisition as an important extension and enhancement of its present NGL extraction business.

Alberta Natural is well-positioned to fund future corporate investments and acquisitions.

Another project involves Soligaz (Société de Liquides de Gaz Natural), a consortium consisting of Alberta Natural, Soquip, Gaz Métropolitain, and the SNC Group, which was officially formed in April, 1986. Its purpose is to study the feasibility of transporting NGL by pipeline from western Canada to Montreal, fractionating the liquids in Quebec, and marketing the product in Quebec, the Maritimes, and the northeastern United States. Alberta Natural has a 20% interest in the consortium. Completion of the feasibility study and the issuance of favourable regulatory approvals will determine the level of further activity. Alberta Natural believes that the project will be beneficial to both western Canadian producers and consumers in Quebec, the Maritimes and northeastern United States.

The precipitous drop in oil and gas prices in early 1986 severely reduced all exploration and development activity in the oil and gas sector, particularly new enhanced recovery activity which requires large capital expenditures. As a result of lower prices, the industry is going through a period of rationalization and consolidation which provides opportunities for acquisitions. We are confident that the price of oil will recover in the next decade, and consequently we are actively seeking opportunities to acquire a producing oil company to provide Alberta Natural access to resources which can be profitably developed in the future.



Forecasts of firming trends promise higher profits for 1987

Construction of the $4 million food-grade CO_2 facility at Cochrane was completed in June, 1986

Regulatory Review

In December, 1986, following a review of the submission of Alberta Natural with respect to the appropriate capital structure and cost factors included in its pipeline rate of return, the National Energy Board reduced the rate from 12.81% to 11.78%. The Board maintained Alberta Natural's deemed common equity ratio at the 35% level but reduced the rate of return on common equity from 15.0% to 13.25%.

On January 13, 1987, Pacific Gas Transmission Company applied to the Federal Energy Regulatory Commission for approval to become a "non-discriminatory" transporter under provisions of the FERC's Order No. 436 to allow open access transportation on its Canada-to-California natural gas pipeline. Initiation of the new service is subject to FERC approval.

Financial strength and employee talent provide the base for new corporate growth

Alberta Natural is willing and prepared to transport gas on an interruptible basis for parties other than those who have firm transportation commitments with Alberta Natural; however, its commitments to firm customers will take priority over any interruptible transportation requirements.

An application to the National Energy Board by affiliate and major transmission customer, Alberta and Southern Gas Co. Ltd. to consolidate its seven existing natural gas export licences was approved during November, 1986. In addition, the Board approved the extension of the term of the consolidated licence by one year, to October 31, 1994, without altering the maximum quantity of gas authorized for export, of 10.6 billion cubic metres (373.5 Bcf) per year. The licence changes will allow Alberta and Southern to export quantities of "trapped gas", gas that was authorized to be exported but was not sold previously. In 1985, Alberta and Southern applied to the Board to extend the current level of authorized annual volumes through to the year 2010. This application will be pursued in 1987.

The Company's commitment to the community is carried out, in part, by the Donations Committee

During 1986, markets for gas supplied by Alberta and Southern continued to be very competitive, particularly in terms of price. It was necessary for Alberta and Southern to implement several decreases in the commodity rate portion of the export price of sales to Pacific Gas Transmission in order to retain market share.

At the end of October, 1986, the Federal and Provincial Governments announced various commitments to allow for more flexible competition in the marketing of Canadian natural gas. Since that date, there has been a noticeable reduction in the Federal Government involvement; however, there has been an increase in Provincial involvement in the process of regulating natural gas sales.

In early 1987, the National Energy Board will review its May, 1986 decision from Phase I of the 1985 Gas Export Omnibus Hearing, which reviewed natural gas surplus determination procedures. The new procedure for determining the exportable surplus of natural gas was intended to increase available quantities for export. Proceedings will also be held to review current determination procedures in place for Alberta and British Columbia.

With the aid of solid planning, Alberta Natural plans to expand and diversify its operations

Economic forecasts indicate a solid future for Alberta Natural

Safety

Promotion of safety is a major corporate goal and Alberta Natural is proud of the achievements of its employees during the past year. The Cochrane plant completed fifteen consecutive years, and the Pipeline division five consecutive years, without lost time due to injury. Recognition of these achievements was received from the Canadian Gas Association, Canadian Gas Processors Association and the Alberta Workers' Health, Safety and Compensation Division.

In order to provide proper training for our personnel in various aspects of fire fighting, a new training facility for the Pipeline division was completed during the year.

CPR training is just one of the many programs the Company provides in its on-going commitment to safety

Financial Review

The consolidated net income of Alberta Natural for 1986, was $16,247,000 or 89¢ per average outstanding common share. In 1985, consolidated net income was $24,968,000 or $1.37 per share. Net income has been adversely influenced by factors affecting the operations of the Cochrane plant, ANGUS Chemical and ANGUS Petroleum.

Earnings from Alberta Natural's share of the profits on the downstream sale of NGL by Dome Petroleum Limited and Amoco Canada Petroleum Company Ltd., were reduced from previous levels. The major contributing factors were a combination of the lower volumes processed, higher year-end inventories, and the low market price of the end products. With some firming of prices, it is anticipated that marketing profits will return to higher levels in 1987.

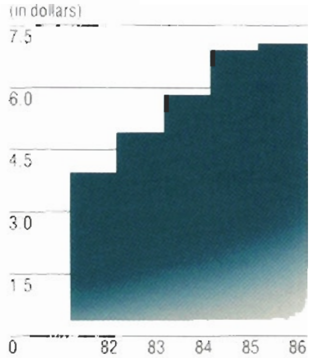
Reduced feedstock costs had a positive affect on the results achieved by ANGUS Chemical. These benefits were offset, however, by the expensing of start-up costs of the facilities in Ireland and California.

Low oil prices and the disposition of certain properties adversely affected the results of ANGUS Petroleum. The disposition and write-down of properties reduced Alberta Natural's net income by $1.1 million.

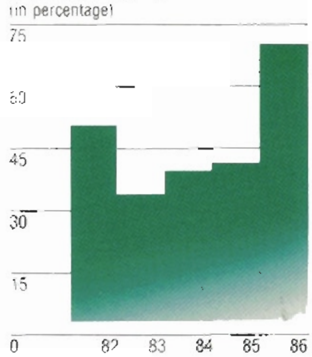
During the fourth quarter of 1986, the Company issued $60 million (Canadian) Debentures in the Euro market. The debentures mature in 1993 and carry an annual interest payment rate of 10 ⅛%. The proceeds of the debentures have been used to reduce short term debt. Alberta Natural is well positioned to fund future corporate investments and acquisitions to satisfy its plan to expand and diversify its operations.

The annual dividend rate paid on the Company's common shares was increased to 64¢ per share from 60¢, effective with the March, 1986 quarterly dividend payment, and was further increased to 68¢ per share, effective with the quarterly payment in March, 1987.

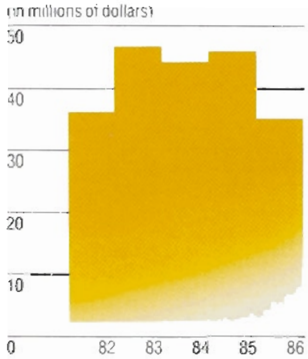
Common Shareholders' Equity per Average Outstanding Common Share
(in dollars)



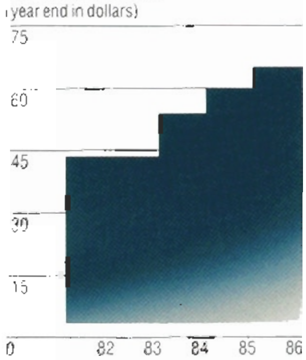
Dividend Payout Ratio
(in percentage)



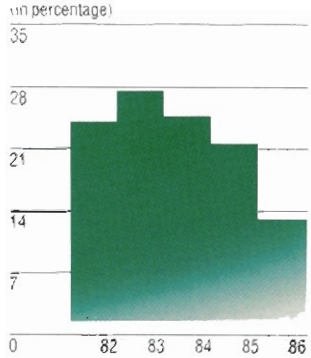
Funds Provided from Operations
(in millions of dollars)



Annual Dividend Rate per Common Share
(year end in dollars)



Return on Average Common Shareholders' Equity
(in percentage)



ALBERTA NATURAL GAS COMPANY LTD

Consolidated Financial Statements

for the Year Ended December 31, 1986
and Auditors' Report
to the Shareholders

Report of Management

The accompanying consolidated financial statements have been prepared by management, which is responsible for the integrity and objectivity of this information. These financial statements, prepared on an historic cost basis, are in accordance with generally accepted accounting principles in Canada and are also in conformity with International Accounting Standards with respect to historic cost. Where appropriate, amounts based on estimates and judgements are included. Other financial information included in the Annual Report is consistent with that in the financial statements.

Management has established and maintains appropriate systems of internal control, policies and procedures which are designed to meet its responsibility for reliable and accurate reporting. These systems of control include periodic reviews by the internal auditors.

Arthur Andersen & Co., independent auditors appointed by the shareholders, have reviewed the systems of internal control and examined the consolidated financial statements in accordance with generally accepted auditing standards, to enable them to express an opinion on the fairness of the statements. Their report is included herewith.

Through its appointed Audit Committee, the Board of Directors oversees management's responsibilities for financial reporting. The Audit Committee meets annually with management, the internal auditors and the independent auditors to review auditing and financial matters. Internal and external auditors have free access to the Audit Committee. The consolidated financial statements have been approved by the Board on the recommendation of the Audit Committee.

To the Shareholders of Alberta Natural Gas Company Ltd:

We have examined the consolidated balance sheet of Alberta Natural Gas Company Ltd (a Canada corporation) as at December 31, 1986 and 1985 and the related consolidated statements of income, reinvested earnings, contributed surplus 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 Alberta Natural Gas Company Ltd as at December 31, 1986 and 1985, 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.

ARTHUR ANDERSEN & CO.
Chartered Accountants

Calgary, Alberta
February 6, 1987

Consolidated Statement of Income

ALBERTA NATURAL GAS COMPANY LTD

December 31, 1986
(with 1985 figures for comparison)

(thousands of dollars)	1986	1985
Operating Revenue:		
Petrochemical	$262,066	$314,397
Transportation and sale of gas	46,388	58,409
Total operating revenue	308,454	372,806
Operating Expenses:		
Operating and maintenance	187,299	233,002
Gas purchases	26,050	33,898
Selling, administrative and research	35,141	28,153
Depreciation	17,388	14,841
Taxes – excise	—	3,491
– property and other	4,554	5,076
Total operating expenses	270,432	318,461
Operating Income	38,022	54,345
Interest and Other Income	5,944	5,475
Income Before Income Deductions	43,966	59,820
Income Deductions:		
Interest on long term debt	3,143	2,042
Interest on other debt	5,074	4,618
Other	74	49
Total income deductions	8,291	6,709
Income Before Income Taxes	35,675	53,111
Provision For Income Taxes	14,911	21,802
	20,764	31,309
Minority Interest	4,517	6,341
Net Income	$ 16,247	$ 24,968
Earnings Per Share	$ .89	$ 1.37

See accompanying summary of significant accounting policies and notes.

Consolidated Balance Sheet

December 31, 1986
(with 1985 figures for comparison)

Assets	1986	1985
(thousands of dollars)		
Plant, Property and Equipment	**$329,681**	$277,058
Less accumulated depreciation	**121,616**	105,307
Net plant, property and equipment	**208,065**	171,751
Current Assets:		
Cash and interest bearing deposits	**48,437**	54,003
Accounts and notes receivable	**50,949**	58,762
Inventories	**34,715**	30,852
Other	**2,094**	1,989
Total current assets	**136,195**	145,606
Investments and Advances	**23,213**	21,072
Deferred Charges	**3,789**	1,754
Total	**$371,262**	$340,183

Approved by the Board:

Director Director

SHAREHOLDERS' EQUITY AND LIABILITIES	1986	1985
(thousands of dollars)		
SHAREHOLDERS' EQUITY:		
18,205,130 common shares (1985 - 18,223,430)	**$ 17,687**	$ 17,705
Reinvested earnings	**105,205**	100,866
Cumulative translation adjustment	**6,085**	6,013
Total shareholders' equity	**128,977**	124,584
MINORITY INTEREST	**50,156**	47,437
LONG TERM DEBT	**104,917**	34,503
DEFERRED INCOME TAXES	**31,317**	36,569
CURRENT LIABILITIES:		
Notes payable	**16,343**	56,774
Accounts payable	**28,547**	33,299
Income taxes payable	**778**	1,785
Other	**10,123**	5,128
Total current liabilities	**55,791**	96,986
CONTRIBUTIONS IN AID OF CONSTRUCTION	**104**	104
Total	**$371,262**	$340,183

See accompanying summary of significant accounting policies and notes.

Consolidated Statement of Reinvested Earnings

December 31, 1986
(with 1985 figures for comparison)

(thousands of dollars)	1986	1985
Balance At Beginning of the Year	$100,866	$ 87,779
Net Income	16,247	24,968
	117,113	112,747
Purchase and Cancellation of Common Shares	255	970
Dividends	11,653	10,911
Balance at End of the Year	$105,205	$100,866

Consolidated Statement of Contributed Surplus

December 31, 1986
(with 1985 figures for comparison)

(thousands of dollars)	1986	1985
Balance At Beginning of the Year	$ –	$ 2,169
Purchase and Cancellation of Common Shares	–	2,169
Balance at End of the Year	$ –	$ –

Consolidated Statement of Changes in Financial Position

December 31, 1986
(with 1985 figures for comparison)

(thousands of dollars)	1986	1985
Operating Activities:		
Operations:		
Net Income	**$ 16,247**	$ 24,968
Add (deduct) non-cash items:		
Depreciation	**17,388**	14,841
Provision for deferred income taxes	**(5,176)**	(530)
Equity earnings	**1,355**	136
Other income deductions	**74**	49
Minority interest	**4,517**	6,341
	34,405	45,805
Working capital:		
Change in non-cash working capital	**3,081**	(17,502)
Effect of exchange rate changes on working capital	**(854)**	4,302
	2,227	(13,200)
Financing Activities:		
Common shares:		
Issued	**–**	2,818
Purchased and cancelled	**(273)**	(3,328)
Increase in long term debt	**71,370**	3,447
	71,097	2,937
Cash available for investments and dividends	**107,729**	35,542
Investment Activities:		
Net additions to plant, property and equipment	**54,620**	27,801
Investments and advances	**5,328**	4,738
Deferred charges	**2,950**	(606)
Dividends received from Foothills Pipe Lines (South B.C.) Ltd.	**(1,482)**	(1,960)
Other	**(2,059)**	(1,153)
	59,357	28,820
Dividends:		
On common shares	**11,653**	10,911
Paid by subsidiary to minority shareholders	**1,854**	1,892
	13,507	12,803
Total investments and dividends	**72,864**	41,623
Increase (Decrease) in Cash:		
Decrease (increase) in short term borrowings	**40,431**	(10,987)
Increase (decrease) in cash and short term deposits	**(5,566)**	4,906
	$ 34,865	$ (6,081)

See accompanying summary of significant accounting policies and notes.

Summary of Significant Accounting Policies December 31, 1986

Operations: Alberta Natural owns and operates an extraction plant near Cochrane, Alberta which removes propane and heavier liquids (NGL) and ethane from the gas stream.

Alberta Natural also owns and operates two pipeline transportation facilities:

a) a 914 mm (36 inch) pipeline from a point near Coleman, Alberta to Kingsgate, on the British Columbia-Idaho border for the transportation of gas owned by Alberta and Southern Gas Co. Ltd. and Westcoast Transmission Company Limited, and for the transportation of gas for Foothills Pipe Lines (South B.C.) Ltd. Alberta Natural also operates the pipeline facilities owned by Foothills Pipe Lines (South B.C) Ltd. located in southeastern British Columbia.

b) a 324 mm (12 inch) pipeline from a point near Warrensville, Alberta to an oil sands recovery facility owned by Shell Canada Resources Limited for the transportation of gas owned by Shell Canada.

The sale agreements with the purchasers of NGL and ethane and the gas transportation contracts and operating agreement with the gas shippers provide for the full recovery of all operating expenses, depreciation, property and income taxes, together with a return on the unrecovered investment. In addition, Alberta Natural is entitled to approximately 25% of the cumulative net marketing profits arising from the sale of the NGL by each of the buyers, Dome Petroleum Limited and Amoco Canada Petroleum Company Ltd. Alberta Natural is also entitled to a share of the annual net profit realized by the buyer, The Alberta Gas Ethylene Company Ltd., on the sale outside Alberta of ethane surplus to ethylene plant requirements.

ANGUS Chemical Company, a subsidiary of Alberta Natural, owns and operates nitroparaffin production facilities located in the United States and West Germany. The facilities utilize feedstocks derived from natural gas in the production of nitroparaffins and other derivative products that are marketed worldwide. ANGUS Chemical, through a subsidiary, also owns and operates a specialty chemical production facility located in Ireland.

Regulation: The gas transmission segment of Alberta Natural's operations is subject to the National Energy Board Act and to the jurisdiction of the Board created thereby. This Board regulates accounting matters, export of gas, construction and operation of gas pipelines and rates, tolls and tariffs charged for such operations.

Consolidation: The consolidated financial statements include the accounts of Alberta Natural and its 56% owned U.S. subsidiary ANGUS Chemical Company.

Investments: Alberta Natural follows the equity method of accounting for its investment in a 49%-owned affiliate, Foothills Pipe Lines (South B.C.) Ltd., its 20% investment in ANGUS Petroleum Corporation and its 24% investment in International Permeation Inc.

Foreign Currency Translation: The accounts of ANGUS Chemical Company have been translated into Canadian dollars using current rates of exchange for all assets and liabilities and average rates of exchange for revenue and expenses. The cumulative effects of foreign currency translations are included in shareholders' equity.

First mortgage pipeline bonds that are denominated in United States dollars are recorded in Alberta Natural's accounts at the current rate of exchange.

Plant, Property and Equipment: Plant, property and equipment is carried at cost.

An allowance for funds used during construction is capitalized for plant under construction. Any such allowance recorded is included in other income.

Depreciation on the portion of the extraction plant used for the removal of NGL is calculated at an annual rate of 2.5% on a straight-line basis. The ethane portion of the extraction facility is being depreciated at an initial rate of approximately 6.3% decreasing to 4.6% in 1994.

The pipeline located in southeastern British Columbia is being amortized at an annual rate (approximately 3.9%) based on the proportion that the annual volume of throughput authorized for export bears to the total volume remaining under the licences granted by the National Energy Board to the major shippers.

The pipeline located in Alberta is being depreciated on a straight-line basis over a 30 year term ending August 31, 2016.

Nitroparaffin production facilities are being depreciated on a straight-line basis over the estimated useful life of the assets. Buildings are depreciated over 9 to 25 years and equipment is depreciated over 3 to 15 years.

Inventories: Nitroparaffin product inventories are carried at the lower of cost or market on the last-in, first-out (LIFO) method of accounting for inventory cost. Inventories of materials and supplies are carried at average cost.

Income Taxes: Income taxes are provided on the tax allocation basis for all income except liquids extraction income which is subject to cost of service contracts. Income taxes will be provided on this source of income only to the extent that taxes are included in costs of service under such contracts.

Deferred Charges: Project costs are initially recorded as deferred charges pending evaluation of the projects. Deferred charges applicable to projects which have been terminated are expensed.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 1986

(Tabular amounts shown in thousands of dollars)	**1986**	1985
1. PLANT, PROPERTY AND EQUIPMENT:		
Petrochemical	**$213,743**	$187,441
Pipeline transport	**75,770**	61,894
Under construction	**40,168**	27,723
	329,681	277,058
Less accumulated depreciation	**121,616**	105,307
Net plant, property and equipment	**$208,065**	$171,751

During 1986, an allowance for funds used during construction of $2,145,000 (1985 - $931,000) has been capitalized and included in other income.

	1986	1985
2. INVESTMENTS AND ADVANCES:		
Foothills Pipe Lines (South B.C.) Ltd.	**$ 6,959**	$ 7,446
Foothills Pipe Lines (Yukon) Ltd. (preferred shares at cost)	**3,141**	3,210
ANGUS Petroleum Corporation	**8,599**	6,206
International Permeation Inc.	**936**	588
Other	**3,578**	3,622
	$ 23,213	$ 21,072

The principal assets of ANGUS Petroleum Corporation consist of investments in enhanced oil recovery properties in various stages of development. The realization of these investments is dependent on the success of future development of these properties.

3. SHAREHOLDERS' EQUITY:

The classes of shares Alberta Natural is authorized to issue consist of an unlimited number of preference shares, having such rights and privileges attached to them as the Directors may by resolution determine, and an unlimited number of common shares.

In accordance with the provisions of a Senior Management Stock Option Plan, 1,140,000 common shares were reserved for issuance under the Plan. Options have been made available on 617,500 shares at prices ranging from $7.55 to $13.92 per share. As of December 31, 1986, all of the options have been exercised in the amount of $6,024,000. Of this amount $3,602,000 (1985 - $3,770,000) is included in accounts receivable. A cumulative total of 304,700 common shares has been purchased by the Company at market prices and cancelled in accordance with the provisions of the Plan.

Restrictions on the payment of cash dividends under certain circumstances are contained in the Deed of Mortgage and Trust securing Alberta Natural's bonds. At December 31, 1986, $3,082,000, otherwise available for dividends, was restricted in this manner.

4. LONG TERM DEBT:	Year Issued	Maturity	**1986**	1985
First mortgage pipe line bonds:				
6⅛% Series A	1961	1986	**$ –**	$ 759
9⅛% Series B ($2,500,000 U.S.)	1969/70	1991	**3,451**	4,193
8⅞% Series C	1971	1992	**4,413**	4,500
Debentures 10⅛% - unsecured	1986	1993	**60,000**	–
Office building financing commitment			**10,875**	–
Revenue bonds 6¾% ($13,008,000 U.S.)	1978/79	2004/08	**17,958**	18,179
Other ($6,935,000 U.S.)			**9,573**	8,330
			106,270	35,961
Less sinking fund instalments due within one year			**1,353**	1,458
			$104,917	$34,503

Sinking fund requirements for the next five years are:

	Series B ($U.S.)	Series C ($CDN.)	Other ($U.S.)
1987	500	750	–
1988	500	750	705
1989	500	750	1,410
1990	500	750	1,410
1991	500	750	1,410

The 1987 sinking fund requirement for the Series C Bonds has been provided for, in part, by the purchase and cancellation of $87,000 principal amount of such bonds and consequently the liability for sinking fund instalments due within one year has been reduced by this amount.

During 1986 the Company sold $60,000,000 of debentures in the international capital market. This issue will mature in October, 1993 with no repayment requirements before that time.

The Company has entered into an agreement with Olympia & York Developments Limited for the joint development of Alberta Natural's property in downtown Calgary. In accordance with the terms of the development agreement, Olympia & York is responsible for financing the project during the construction period. The project is under construction and Alberta Natural's share of construction expenditures total $10,875,000 at December 31, 1986. Alberta Natural's security pledged for construction loans is restricted to its share of the project land.

NOTES CONTINUED

5. INCOME TAXES:

The provision for income taxes varies from the amount that would be computed by applying current federal and provincial income tax rates for the reasons shown in the following table.

	1986	1985
Income before income taxes and minority interest	$35,675	$53,111
Less: Income which is not subject to tax allocation	6,042	6,170
Equity earnings	(1,355)	(136)
Income subject to tax allocation	$30,988	$47,077
Expected provision for income taxes at 49.6% (1985 - 48.8%)	$15,370	$22,974
Add (deduct) adjustments to income taxes:		
Manufacturing and processing profits deduction	(864)	(1,447)
Other tax credits	(1,154)	(972)
Provision for withholding taxes on foreign income	286	416
Other	1,273	831
Actual provision for income taxes	$14,911	$21,802

6. SEGMENTED INFORMATION:

a) Financial information by segment:

	Petro-Chemical	Pipeline Transport	Other	Total
1986				
Operating revenue	$262,066	$18,869	$27,519	$308,454
Depreciation expense	$ 14,804	$ 2,584	$ –	$ 17,388
Operating income	$ 35,378	$ 4,257	$ (1,613)	$ 38,022
Total identifiable assets	$302,046	$30,728	$38,488	$371,262
Total capital expenditures during the year	$ 36,696	$ 7,026	$10,898	$ 54,620
1985				
Operating revenue	$314,397	$23,444	$34,965	$372,806
Depreciation expense	$ 12,582	$ 2,259	$ –	$ 14,841
Operating income	$ 51,566	$ 4,024	$ (1,245)	$ 54,345
Total identifiable assets	$289,795	$24,343	$26,045	$340,183
Total capital expenditures during the year	$ 19,846	$ 7,955	$ –	$ 27,801

b) Financial information by reportable geographic area:

	1986		1985	
	Domestic	Foreign	Domestic	Foreign
Operating revenue	$201,778	$106,676	$268,775	$104,031
Operating income	$ 21,741	$ 16,281	$ 30,469	$ 23,876
Total identifiable assets	$185,868	$185,394	$178,946	$161,237

7. RELATED PARTY TRANSACTIONS:

Alberta and Southern Gas Co. Ltd. and Pacific Gas Transmission Company are wholly owned subsidiaries of Pacific Gas and Electric Company. Pacific Gas Transmission Company in turn owned 49.40% of the outstanding capital stock of Alberta Natural Gas Company Ltd at December 31, 1986. Alberta Natural owns 49% of the outstanding capital stock of Foothills Pipe Lines (South B.C.) Ltd., 56% of ANGUS Chemical Company, 20% of ANGUS Petroleum Corporation and 24% of International Permeation Inc. Significant transactions with these related companies were as follows:

	1986	1985
(a) Net charges for personnel and related administrative costs from:		
Alberta and Southern	**$ 7,522**	$ 6,606
Pacific Gas Transmission	**238**	261
(b) Charges for liquids extraction feedstock and fuel purchased from		
Alberta and Southern	**68,696**	113,746
(c) Net charge for transportation of gas to:		
Alberta and Southern	**11,160**	11,933
Foothills (South B.C.) Ltd.	**1,731**	2,063
(d) Interest paid to		
Pacific Gas Transmission	**185**	–
(c) Amounts outstanding at December 31:		
Payable to:		
Alberta and Southern	**8,084**	13,596
Pacific Gas Transmission	**69**	39
Receivable from:		
Alberta and Southern	**2,534**	1,803
Foothills (South B.C.) Ltd.	**123**	176
ANGUS Petroleum Corporation	**4,114**	2,633

8. COMMITMENT:

The Company announced on December 19, 1986 an agreement in principle to buy a one-half interest in the CanStates Group of partnerships, an independent natural gas liquids marketing organization, carrying on business in both Canada and the United States. CanStates has an interest in a liquified petroleum gas storage facility and fractionation plant both located at Marysville, Michigan.

The Company expects to complete the purchase during the first quarter of 1987 at a cost of approximately $12,500,000.

Eleven Year Comparative Highlights

	1986	1985
Financial and Share Data		
Operating revenue ($000's)	**308,454**	372,806
Net income ($000's)	**16,247**	24,968
Earnings per average outstanding common share ($)	**.89**	1.37
Common shareholders' equity per average outstanding common share ($)	**7.08**	6.86
Capital provided: ($000's)		
Common shareholders' equity – total	**128,977**	124,584
Long term debt (including current portion)	**104,917**	35,961
Short term debt	**16,343**	56,774
Minority interest	**50,156**	47,437
Deferred income taxes	**31,317**	36,569
Average equity outstanding ($000's)	**126,781**	116,067
Average debt outstanding ($000's)	**107,674**	85,251
Return on average common shareholders' equity – (%)	**12.82**	21.51
Cash dividends ($000's)	**11,653**	10,911
Annual dividend rate per common share ($) – year end	**.64**	.60
Dividend payout ratio (%)	**71.7**	43.7
Working capital ($000's)	**80,404**	48,620
Average number of common shares outstanding	**18,210,696**	18,174,171
Plant		
At year end: ($000's)		
Original cost	**329,681**	277,058
Depreciated cost	**208,065**	171,751
Capital Expenditures ($000's)	**54,620**	27,801
Operational		
Daily volume of gas exported:		
average (10^6m^3)	**27.0**	31.9
(MMcf)	**953**	1,127
Daily production: (average)		
NGL (m^3)	**1 802**	2 235
(Bbls)	**11,345**	14,070
Ethane (m^3)	**5 050**	6 160
(Bbls)	**31,935**	38,940

Notes:
Accounts of ANGUS Chemical Company have been consolidated since July, 1982.
1981 results include the effect of an extraordinary item ($4,786,000, or $.27 per share).
Operational data does not include production from ANGUS Chemical Company.
Share information has been adjusted to give retroactive effect to the five-for-one stock split on May 16, 1980 and the three-for-one stock split on May 18, 1984.

1984	1983	1982	1981	1980	1979	1978	1977	1976
309,201	290,257	214,618	130,904	116,135	110,207	62,150	52,387	47,317
24,178	22,779	16,004	18,800	12,304	10,057	7,271	5,787	5,701
1.32	1.27	.89	1.05	.69	.56	.41	.32	.32
5.89	5.04	4.04	3.64	2.92	2.52	2.15	1.87	1.65
107,549	90,635	72,282	65,171	52,335	45,040	38,442	33,426	29,601
31,979	30,546	31,374	17,755	20.128	22,502	24.875	27,249	29,604
45,787	54,687	69,102	13,083	–	–	11,011	4,999	–
39,917	32,164	28,596	–	–	–	–	–	–
36,882	40,116	34,521	23,209	20,475	22,476	18,974	14,118	9,530
99,092	81,459	68,727	58,753	48,687	41,741	35,934	31,513	27,663
81,500	92,855	65,657	25,483	21,315	29,194	34,067	30,926	30,794
24.40	27.96	23.29	32.00	25.27	24.09	20.23	18.36	20.61
10,234	7,932	7,873	5,964	5,009	3,459	2,255	1,962	1,825
.56	.44	.44	.33	.28	.19	.13	.11	.10
42.3	34.8	49.2	31.7	40.7	34.4	31.0	33.9	32.0
37,199	6,447	(15,606)	616	12,341	6,740	(1,550)	3,255	11,642
18,256,683	17,982,677	17,892,330	17,892,330	17,892,330	17,892,330	17,892,330	17,892,330	17,892,330

245,878	232,912	221,750	137,488	120,921	119,449	114,419	90,503	75,213
156,239	160,052	163,842	89,320	73,984	78,308	79,112	59,162	47,220
10,243	13,875	40,982	22,569	1,499	5,073	23,926	15,318	271

23.17	24.66	26.64	26.58	27.82	33.99	30.57	35.13	34.56
818	871	940	938	982	1,200	1,079	1,240	1,220
1 625	1 630	1 970	1 600	1 705	1 930	1 680	1 840	2 020
10,230	10,270	12,385	10,085	10,730	12,160	10,540	11,600	12,700
4 695	3 920	3 025	3 370	3 480	3 485	2 630	–	–
29,575	24,780	19,105	21,230	21,800	21,920	16,530	–	–

Common Share Market Information

Toronto Stock Exchange

	High	Low	Close	Shares Traded	Dividends Paid
1986					
First quarter	$16.00	$12.50	$12.75	1,253,820	$0.16
Second quarter	13.75	11.00	12.50	1,203,634	0.16
Third quarter	14.00	12.62	13.75	350,956	0.16
Fourth quarter	15.50	13.25	13.37	477,334	0.16
Year	**16.00**	**11.00**	**13.37**	**3,285,744**	**0.64**
1985	$16.25	$12.75	$15.87	6,917,476	$0.60

Closing price – Valuation Day, December 22, 1971 - $1.33

Corporate Information

CORPORATE OFFICE
East Tower, Esso Plaza
24th Floor,
425 - 1st Street S.W.
Calgary, Alberta
T2P 3L8
(403) 260-9911

SUBSIDIARY COMPANY
ANGUS Chemical Company
Northbrook, Illinois
(56% owned by
Alberta Natural)

SUBSIDIARY COMPANY
EXECUTIVES
R.E. Secrist,
Chairman and Chief
Executive Officer
O.W. Chandler,
President and
Chief Operating Officer
R.B. Kayser,
Executive Vice President

STOCK EXCHANGE LISTINGS
Common shares are listed for
trading on the Alberta,
Montreal, Toronto
and Vancouver
Stock Exchanges, and trade
under the symbol ANG.

TRANSFER AGENT
AND REGISTRAR
(Capital Stock and 8⅞% First
Mortgage Pipeline Bonds,
Series C)
Montreal Trust Company
Calgary, Montreal, Regina,
Toronto, Vancouver,
Winnipeg
(10⅛% Debentures)
Royal Trust, Calgary,
Toronto,
London, England

AUDITORS
Arthur Andersen & Co.
Chartered Accountants
Calgary, Alberta

Notice of change of address
should be sent to the
Transfer Agent.

Directors and Officers

Directors

John F. Bonner,
San Francisco, California
Executive Consultant.
Former President and
Chief Executive Officer,
Pacific Gas and Electric Company

§ Harry Booth,
Calgary, Alberta
Consultant
Former Chairman of the Board
and Chief Executive Officer,
Alberta and Southern Gas Co. Ltd.

†§ D.R. Fenton,
Calgary, Alberta
President
and Chief Executive Officer,
Alberta and Southern Gas Co. Ltd.

§ J.E. Goudie,
Calgary, Alberta
Chairman of the Board,
Alberta and Southern Gas Co. Ltd.

* R.A. MacKimmie, Q.C.,
Calgary, Alberta
Counsel, MacKimmie Matthews

* Frederick W. Mielke, Jr.,
San Francisco, California
Consultant.
Former Chairman of the Board
and Chief Executive Officer,
Pacific Gas and Electric Company

R.H. Peterson,
San Francisco, California
Consultant.
Former Chairman of the Board,
Pacific Gas and Electric Company

*† J.S. Poyen,
Calgary, Alberta
Oil and Gas Management Consultant

B.W. Shackelford,
San Francisco, California
Consultant.
Former President,
Pacific Gas and Electric Company

†§ John A. Sproul
San Francisco, California
Chairman of the Board and
Chief Executive Officer,
Pacific Gas Transmission Company
and Executive Vice President,
Pacific Gas and Electric Company

N.E. Wagner
Calgary, Alberta
President and Vice-Chancellor,
The University of Calgary

* Member of Audit Committee
† Member of Compensation Committee
§ Member of Executive Committee

Officers

J.E. Goudie,
Chairman of the Board

D.F. Fenton,
President and
Chief Executive Officer

R.K. Craig,
Senior Vice-President

D. McMorland,
Senior Vice-President

W.J. Demcoe,
Vice-President,
Finance and Administration

E.W. Mychaluk,
Vice-President,
Business Development

G.T. Noland,
Vice-President,
Corporate Planning

D.A. Sharp,
Vice-President,
Operations and Engineering

G.R. Walsh,
Vice-President

F.G. Homer,
Secretary and Assistant to the
Chairman of the Board

P.M. Mahoney,
Treasurer

A. Kenney,
Assistant Secretary

Alberta Natural Gas Company Ltd
1986 Annual Report

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