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Canterra Energy Ltd.



Annual Report 1986

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Corporate Mission

Canterra will be a leading force in the Canadian petroleum and sulphur industries.

It will be an aggressive and successful participant in the various facets of the exploration, production and marketing of oil, gas and sulphur in Western Canada and in the offshore regions of Canada.

It will apply its expertise to selective international operations.

Canterra will stimulate professional excellence and promote innovation, initiative and responsibility throughout the organization while applying rigorous standards of profitability to achieve financial strength and sustained growth.

Canterra will recognize growth in the market value of its equity as the primary measure of success in realizing this Corporate Mission.

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Corporate Profile



Canterra Energy Ltd., based in Calgary, Alberta, is a major Canadian producer of oil, natural gas and natural gas liquids and is the largest marketer and second largest producer of sulphur in Canada.

Oil is produced from numerous fields throughout Alberta. A large portion of production is from major pools in the Rainbow-Zama-Shekilie area in northwestern Alberta; Nipisi, West Pembina and Hussar are also major company oil producing areas. Natural gas and sulphur are produced from the Ricinus, Strachan, Blackstone, Hanlan and Stolberg gas fields in the Ram River area. Gas and sulphur are also produced from fields at Okotoks and Nordegg and gas from fields at Hussar and Sinclair.

Canterra has established a strong position in discoveries in the frontier regions, particularly on the Grand Banks off Newfoundland and on the Scotian Shelf off Nova Scotia. In the United States, Canterra produces natural gas on the Gulf Coast area of Louisiana and oil in the Williston Basin of North Dakota and Montana. The company is a medium-sized producer of coal in Pennsylvania.

The company was formed in 1981 through the merger of Aquitaine Company of Canada Ltd., CDC Oil & Gas Ltd. and the Canadian oil, natural gas and sulphur assets of Texasgulf Inc. Canada Development Corporation owns 95.7 per cent of Canterra on an undiluted basis and 86.0 per cent on a fully-diluted basis.

Glossary

Delineation well A well drilled to assess the extent of an oil or gas discovery.

Development well A well drilled with the expectation of producing from a known productive crude oil or natural gas reservoir.

Enhanced oil recovery Oil recovery technique, where fluids such as water, gas and liquified petroleum gases are injected into the reservoir to increase recovery.

Exploratory well A well drilled in unproved territory or to depths previously unpenetrated to find commercial deposits of crude oil, natural gas or sulphurous gas.

Farmin An agreement whereby an operator earns an interest in another operator's land by carrying out certain work.

Farmout An agreement whereby the owner of a lease allows another operator to earn an interest in the lease by doing certain work.

Heavy oil Crude oil which is heavier and more viscous than normal crudes and therefore does not flow as freely.

Natural gas liquids (NGLs) These are condensate, propane, butane, and other readily liquifiable hydrocarbons that are normally found in natural gas. NGLs can be extracted using special processing facilities.

Netback The amount of revenue left to the producer after the deduction of royalties, taxes and other operating costs.

Oil equivalent Natural gas converted to an equivalent volume of oil using a heating content basis (930 cubic metres of gas equals one cubic metre of oil).

PIP (Petroleum Incentive Program) Enacted as part of the National Energy Program (NEP) of October 1980 to provide cash incentives for oil and gas exploration and development in Canada.

Probable reserves Reserves which, after further drilling or production performance, may be considered proved.

Proved reserves Amount of hydrocarbon which is economically recoverable using technically feasible and economically practical recovery methods.

Reservoir A body of porous rock containing an accumulation of crude oil and/or natural gas (including sulphurous gas) and water.

Resources Amount of hydrocarbon which is technically recoverable from the reservoir without consideration of economics.

Royalty A percentage of production which an oil company pays to the owner of mineral rights. The owner may be a provincial or federal government or a freehold lease owner.

Seismic An exploration technique that measures the configuration and character of rocks beneath the surface of the earth by using a sensitive receiver (geophone) to record the response to a sound or vibration pulse.

Shut-in A condition due to low market demand or lack of production facilities which prevents a well from producing oil or gas.

Sour gas Natural gas containing carbon dioxide, hydrogen sulphide or other sulphurous compounds which must be removed or partially removed before the gas can be used for commercial or domestic purposes.

Working interest A company's operating or participating interest percentage under an oil or gas joint venture agreement before the deduction of royalty interests.



“Exploratory success, aggressive development and marketing of reserves and increased financial strength are the keys to our primary goal — building value for shareholders.”

Production foreman Gene Kuprowski turns a valve which controls gas flow at the Ricinus gas field into Canterra's Ram River gas and sulphur processing plant.

Highlights

Corporate Achievements

During 1986, Canterra:

- *Added record reserves of 4.3 million cubic metres of oil and natural gas liquids and 3.2 billion cubic metres of natural gas through discoveries and revisions.*
 - replaced 250 per cent of 1986 oil and liquids production
 - replaced 170 per cent of 1986 gas production
- *Reduced long-term debt by \$88.9 million.*
- *Raised \$217.5 million to extend maturity on non-syndicated debt.*
- *Negotiated two new oil sales contracts with Canadian refiners.*
- *Initiated two direct gas sales with a Canadian industrial user and a U.S. distributor which contributed to 1986 sales volumes.*

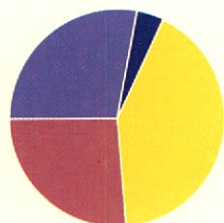
Financial

	1986	1985	% Change
<i>(millions of dollars except per share data)</i>			
Net revenues (after royalties)	\$ 577.0	\$ 790.8	- 27
Earnings (loss) before write-down	\$ (17.7)	\$ 86.9	-120
Earnings (loss)	\$ (373.2)	\$ 86.9	-530
Free cash flow	\$ 174.0	\$ 310.3	- 44
Free cash flow per share	\$ 2.12	\$ 3.94	- 46

Operations

Sales volumes (gross before royalties)			
Oil and natural gas liquids (thousands of cubic metres)	1,670.0	1,837.6	- 9
Natural gas (millions of cubic metres)	1,936.3	1,958.2	- 1
Sulphur (thousands of tonnes)	1,740.1	2,105.0	- 17
Coal (thousands of tonnes)	499.0	469.9	+ 6
Proved reserves (gross before royalties)			
Oil and natural gas liquids (millions of cubic metres)	22.3	19.7	+ 13
Natural gas (billions of cubic metres)	39.9	38.6	+ 3
Sulphur (millions of tonnes)	12.3	12.9	- 5
Coal (millions of tonnes)	33.5	34.2	- 2

Net sales of \$551.7 million by product



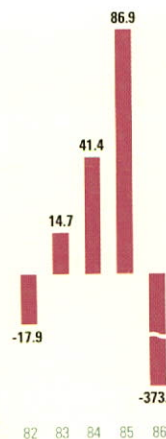
■ Sulphur 42%
■ Oil and NGLs 29%
■ Gas* 26%
■ Coal 3%

* includes processing income

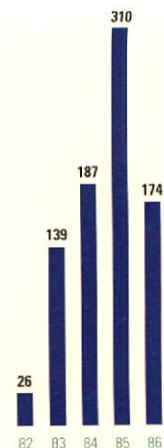
Net Revenues
millions of dollars



Earnings
millions of dollars



Free Cash Flow
millions of dollars





Bernard F. Isautier (left) is chairman and chief executive officer of Canterra. John B. Hague is president and chief operating officer.

For Canterra, 1986 was both challenging and rewarding during a difficult period in the oil and gas industry.

After four consecutive years of excellent improvement in operating results, in 1986 Canterra, like the industry generally, faced challenges posed by the abrupt and severe decline in world petroleum prices. A new environment of reduced cash flows and revenues and changes in the economics of capital spending made major adjustments necessary.

At Canterra we responded quickly and decisively to adapt to this new environment. To meet the challenges and continue to thrive as an organization we:

- reduced and refocused capital spending,
- streamlined the corporation through a functional reorganization,
- reduced operating and administrative expenses,
- strengthened the marketing function, and
- improved financial strength.

These measures helped to maximize cash flow and have contributed to a stronger organization for both the near and long term. Financial results are reviewed on page 17.

The thrust of our strategy remains essentially the same as when the company was founded; however, the focus of operations changed in 1986 as economics dictated greater attention to traditional areas of success. Canterra's primary operational activity is exploration for and production of oil, natural gas and sulphur in Western Canada.

We concentrated a smaller capital spending pool on the regions best known to us, those in which we have established particular expertise in Western Canada where we have always been among the more successful explorers. We are focusing on better analytical work and better use of new information technology; in short, more analysis and less drilling. At the same time, we continue to concentrate on optimizing our production base.

The results of this strategic realignment included a record increase in the gross proved reserve additions of oil, natural gas liquids and natural gas in Western Canada in 1986. These reserve additions build value for shareholders and help secure the company's future.

In frontier Canada, we completed farmin commitments in 1986 and maintained investment at levels appropriate to protect discovered resources for future commercial development.

Production at our Athabasca tar sands pilot project near Fort McMurray, Alberta increased in 1986. Further technological developments will be undertaken in 1987 and 1988 at no cost to the company. As a result of prevailing low oil prices and because the technology was essentially proven, the heavy oil pilot plant activities near North Battleford, Saskatchewan were suspended during 1986.

Exploration activities in the United States were cut back in the face of low oil prices. Existing reserves continue to be produced to maximize revenues. Canterra's U.S. coal holdings, not a primary business for the company, have been written down to estimated market value and this business will be disposed of if market conditions permit.

Canterra entered 1987 as a leaner and more efficient organization. The company was reorganized along the functional areas of exploration and production. William L. Kaufmann is senior vice-president of exploration; J. Lindsay Milne is senior vice-president of production.

Overall, our administrative and operating costs were reduced \$15.8 million in 1986. This decline is the result of lower oil and gas operating costs, staff and salary reductions, and stringent cost controls in all areas of our business.

In a deregulated environment, marketing takes on an immediate and critical role. At Canterra, our marketing thrust was strengthened with increased manpower and resources.

Pipeline capacity constraints frustrated oil sales in 1986 but bottlenecks are expected to diminish in 1987 as pipeline expansions are completed. Two new oil sales contracts were negotiated with Canadian refiners in 1986.

The number of gas marketers increased dramatically as more producers chose to sell directly to end users. As part of efforts to pursue direct gas sales, the company began significant sales to an industrial user in Ontario and successfully penetrated the U.S. spot market where transportation was available. We are aggressively seeking ongoing transportation arrangements for increased deliveries to those markets.

Canterra is well positioned to meet its interest and debt obligations. In 1986, we extended the maturity of \$217.5 million of debt by borrowing to prepay loans that would otherwise have matured in 1987 and 1988. Most of the replacement loans expire in six years and are at lower interest rates. These loans do not increase total debt.

Governments responded in diverse ways to the new environment. Rationalization of the federal

government's oil and gas fiscal regime was on balance positive for Canterra. Elimination of the Petroleum and Gas Revenue Tax in October had the effect of increasing future cash flow. Changes associated with the deregulation of natural gas should help the industry maintain and add markets in the United States.

In Alberta, while changes in the fiscal regime are mostly positive for Canterra, we continue to believe that further provincial royalty adjustments, especially a general reduction in royalty rates, are required to improve industry cash flow.

While oil prices at the beginning of 1987 have improved from the lows experienced in 1986, the adjustments we have made over the past year have prepared us to meet further uncertainty.

Exploratory success, aggressive development and marketing of reserves and increased financial strength are the keys to our primary goal — building value for shareholders. Our stewardship is committed to that goal in 1987 and beyond.

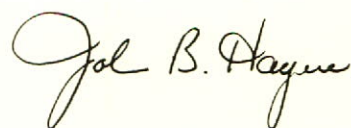
We recognize that the commitment of employees to fulfill stated goals is fundamental to building value; the innovative and hard work of Canterra employees during a difficult year demonstrated their commitment.

We appreciate the contributions of Allan F. Waters, a director of Canterra for five years who retired at year end. We are pleased to welcome Paul W. Douglas and E. Kendall Cork as new company directors. Mr. Douglas is chairman and chief executive officer of The Pittston Company of Greenwich, Connecticut, and Mr. Cork is senior vice-president and treasurer of Noranda Inc. of Toronto.

On behalf of the board,



Bernard F. Isautier,
Chairman and Chief Executive Officer



John B. Hague,
President and Chief Operating Officer

February 27, 1987

Capital Expenditures

*gross
millions of dollars*





*Canterra management committee (from left):
J. Lindsay Milne, senior vice-president, production;
John B. Hague, president;
John H. Currie, senior vice-president, administration;
William L. Kaufmann, senior vice-president,
exploration; D. Michael G. Stewart, vice-president,
corporate development and marketing;
T. Sean Ahern, vice-president, finance and
W. Stewart Wright, general counsel and
corporate secretary.*

Exploration and production companies traditionally build value through the addition of low-cost reserves and through maximizing recovery and production of existing and new reserves. With deregulation of oil in 1985 and natural gas in 1986, effective marketing has been added as a means to enhance value of reserves. The first priority of Canterra management is to increase value for shareholders through four central strategies which have remained essentially constant since the company was formed in 1981:

- successful exploration for conventional reserves,
- aggressive development, production and marketing of reserves,
- frontier and tar sands development, and
- increased financial strength.

At present, our activities are increasingly focused on Western Canada where we have our greatest technical expertise and infrastructure for production and delivery of our three main products: conventional oil, natural gas and sulphur.

Exploration

Our key objective of adding low-cost reserves over the next five years will be achieved primarily through exploration in Western Canada, although assets will be purchased where favourable conditions exist. In 1987, about one third of total exploration capital expenditures of \$38 million will be invested in the search for oil.

Demand for Canadian gas is expected to increase as the current surplus in the United States dissipates. In anticipation of stronger gas markets, about two thirds of exploration expenditures will be allocated to the search for natural gas. The bulk of this will be dedicated to finding sour gas containing hydrogen sulphide which is recovered as sulphur.

Production and Marketing

Production activities involve optimization and extension of existing reserves and rapid development of new discoveries to maximize production. About one third of total 1987 production expenditures of \$38 million will be invested in the Rainbow Lake area where nearly two thirds of company oil revenues are derived.

Successful exploration and production activities have added considerable reserves at Rainbow over the past few years and this trend is expected to continue. Technological developments in enhanced oil recovery methods at eight Rainbow pools have contributed significantly to increased reserves. Enhanced recovery involves injecting

fluids into a reservoir to maintain pressure, increase production and increase oil recovery. In the largest oil reservoir, the Rainbow B pool, following 14 years of water flood operations, a solvent of natural gas liquids blended with natural gas is being injected to increase significantly the recoverable reserves in this pool. An estimated 3.2 million cubic metres of natural gas liquids are being injected over a nine-year period. When this phase is completed in 1991, the natural gas liquids, which are primarily propane and butanes, will be recovered and sold, adding substantially to future oil and natural gas liquid sales and revenues.

As a result of this project, Canterra has to date booked 4.5 million cubic metres as proved reserves. A further 800 000 cubic metres are expected to be added as this project continues to show success.

Production capital will also be invested in expanding natural gas development and sulphur processing facilities.

Canterra is the largest marketer of sulphur in Canada. The company intends to maintain this leadership position through continued production technique improvements and aggressive and effective marketing. Our objective is to maintain an annual sales capacity of 1.5 million tonnes over time.

To obtain the best return for crude oil, the company will further diversify its purchaser mix. Sales under existing long-term natural gas contracts, which account for the majority of gas sales, will be supplemented with direct sales of gas from excess developed capacity and from new properties. Canterra's gas marketing activities continue to focus on securing additional long-term contracts at prices reflecting the supply commitment involved. Short-term or spot markets are generally not economically attractive enough to support development activities, which require significant investment, and are utilized to optimize production.

Frontier and Tar Sands

To maximize cash flow generating projects in the near term, the company's investment in the frontier regions and heavy oil development has been significantly reduced.

Since 1981, Canterra's frontier exploration program has yielded established resources, before deduction of royalties, estimated at 8.0 billion cubic metres of natural gas and 3.4 million cubic metres of oil and liquids. Canterra will

maintain interests in these resources and prepare for future development. In 1987, Canterra plans to invest \$5.1 million — \$1.6 million after PIPs — in the frontier.

To offset high technological development costs at Canterra's Athabasca tar sands pilot project near Fort McMurray, Canterra has entered an agreement with the Alberta Oil Sands Technology and Research Authority (AOSTRA) whereby AOSTRA will pay all operating costs for the next two years. This will allow continued assessment of the pilot project technology which is necessary to determine its commercial potential.

Financial Strength

Over the next five years, the company will pursue a program of debt reduction to increase financial flexibility, allowing for a sustained increase in exploration capital expenditures.

Free cash flow in 1987 will be in excess of capital requirements and debt repayment obligations. Debt repayments in 1987 include the first installment of \$51.3 million on the company's syndicated bank debt of \$1.6 billion.

Long-term debt also includes \$447.3 million in a variety of debt facilities. The company will follow its practice started in 1986 of extending the maturity on loans through replacement loans.

In addition, the company has \$222.5 million in convertible subordinated debentures which become due in June 2000. Interest payments on debentures will continue to be funded from cash flow.

Operations Review



Major additions in reserves, new approaches in marketing and continued success in enhanced oil recovery techniques characterized 1986 operations.



Canterra's Ram River plant in central Alberta processes gas and recovers sulphur from a number of gas fields including Ricinus, Strachan, Blackstone, Hanlan and Stolberg.

Exploration

Western Canada

Canterra conducted an active and successful exploration program in Western Canada during 1986, primarily focused on adding new gas and sour gas reserves in anticipation of more favourable markets for gas and sulphur.

Proved reserves from exploration added 1.9 billion cubic metres of gas and 0.7 million cubic metres of oil and natural gas liquids. This compares to proved reserve additions of 0.7 billion cubic metres of gas and 1.3 million cubic metres of oil and liquids in 1985. Hydrocarbon reserves added directly through exploration replaced 70 per cent of 1986 production.

A program to increase sulphur reserves through sour gas exploration resulted in proved reserve additions of 132 000 tonnes, the first sulphur reserves added from new discoveries in several years. Further sulphur reserve additions are anticipated in 1987 as a result of this program.

Exploration capital expenditures for the year totalled \$63.0 million, down from \$113.8 million in 1985. The decrease in expenditures was due to reduced cash flow, consequently lowering the capital available for re-investment.

Exploration finding costs* were reduced to just \$3.92 per barrel as a result of lower land, drilling, and geophysical expenses, an internal cost-control program and concentration on higher-quality exploration projects.

During the year, Canterra acquired 78 590 hectares of new lands. The average per hectare cost was \$157, down 20 per cent from 1985. At year end, Canterra held 950 800 hectares of land in Western Canada.

** For exploration finding cost determinations, Canterra recognizes only current proved hydrocarbon reserve additions. The further appreciation of these reserves through engineering revisions, although frequently substantial, is not considered. Sulphur reserves are excluded. Natural gas to oil conversions are calculated on a heating equivalency of 930 cubic metres of gas to one cubic metre of oil.*

Drilling Activity

	Exploratory		Development	
	Gross	Net	Gross	Net
Oil	26	12.0	137	24.2
Gas	23	9.7	50	9.9
Dry, abandoned or suspended	34	19.1	4	2.7
Other (water injection)	—	—	2	1.0
Total	83	40.8	193	37.8
Success rate (%)	59	53	89	8

Wells drilled in Western Canada and United States in 1986.

Exploration Activity

Exploration in Western Canada is concentrated in three areas:

Northern Alberta: primarily oil but also natural gas

Peace River Area: oil and gas

West Central Alberta: natural gas, including sour gas for sulphur

Northern Alberta

Rainbow Lake: Canterra acquired 10 880 hectares and conducted a \$2.2 million seismic program in the Rainbow Lake area, the company's largest oil-producing region. Two oil discoveries and one gas discovery were made in 1986. Four exploratory wells are planned for this area, 900 km northwest of Edmonton, in 1987.

Shekilie: Canterra has assembled land holdings of 5 533 hectares in this oil-prone area, 100 km north of Rainbow Lake. Canterra's substantial geophysical data base in the Shekilie area contributed to two oil discoveries. Three wells are planned for 1987.

Fire: A total of 3 818 hectares was acquired, raising company holdings to 5 558 in this area, 30 km north of Rainbow Lake. Four exploratory wells resulted in one gas and three oil discoveries. One well is planned for 1987.

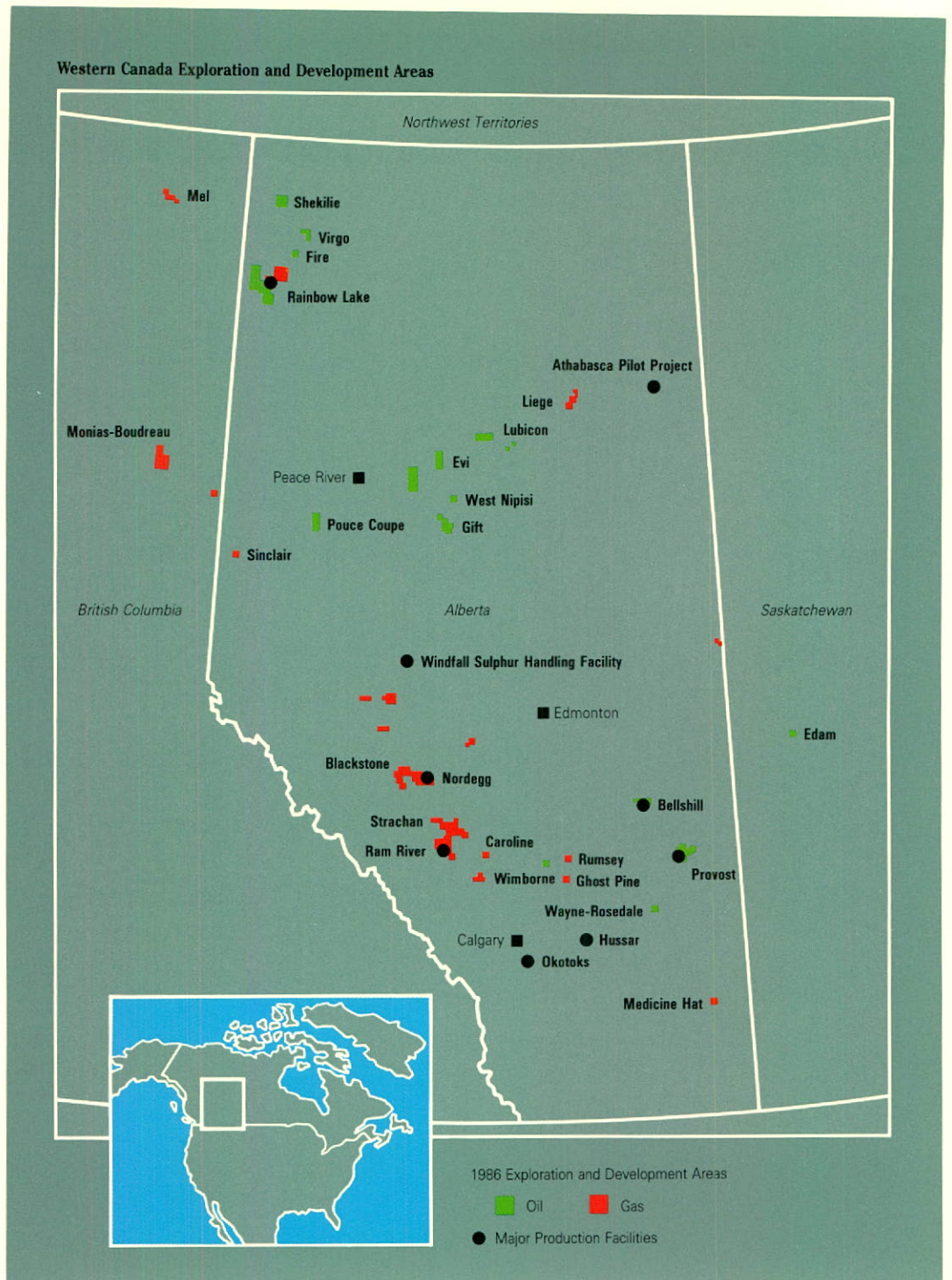
Peace River Area

Pouce Coupe: In this promising region 150 km west of the Peace River townsite, Canterra has assembled a net interest in 8 847 hectares. Three exploratory tests were drilled in 1986, resulting in three gas discoveries. Five additional exploratory wells are planned for this area in 1987.

Monias-Boudreau: Delineation drilling added gas reserves at Monias-Boudreau in British Columbia, 35 km west of Fort St. John. Production from this pool is expected to begin early in 1987.



Canterra's oil exploration program is concentrated in northwestern Alberta.



Land record supervisor Beverly Shields and her group are responsible for administering 7,600 lease documents covering Canterra's petroleum and natural gas rights in Western Canada.

West Central Alberta

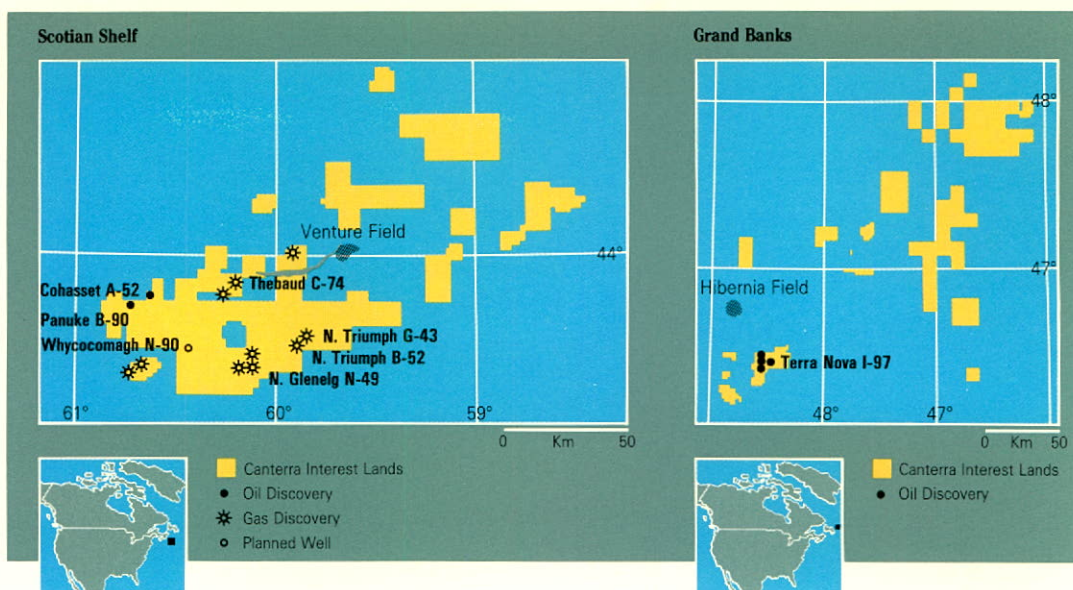
Shell Caroline 10-15-35-5 W5M, a well in which Canterra has a 7.5 per cent interest, penetrated a major accumulation of sour gas. The productive trend is at least 17 km in length and the natural gas, which has a hydrogen sulphide content of between 30 to 35 per cent, is rich in natural gas liquids.

Canterra holds interests varying from 4.1 per cent to 87.5 per cent, averaging 27.8 per cent in 15 sections in the discovery area.

Modest reserves of gas, gas liquids and sulphur were booked in 1986 as a result of Canterra's interest in the 10-15 discovery well. More substantial reserves bookings are expected in 1987 with the commencement of delineation drilling. Two delineation tests began drilling in 1986 and should reach the productive zone during the first quarter of 1987.

Strategy

A number of significant strategic changes were implemented in 1986 to improve success



in a more selective and less drilling-oriented environment. A focus on technical expertise and an emphasis on geophysics, as well as increased work on modelling and geophysical assessments, are geared to provide more information and improve drilling success.

Frontier Exploration and Development

In 1986, Canterra's frontier objectives were to complete farmin commitments and emphasize delineation drilling of previous discoveries. With the collapse of the world oil price, frontier investment has been reduced and is limited to projects that will protect discovered resources.

Canterra participated in 13 wells, resulting in five gas and three oil discoveries with most of this activity on the Grand Banks off Newfoundland and on the Scotian Shelf off Nova Scotia.

The Thebaud C-74 delineation well on the Scotian Shelf has significantly increased the natural

gas resources of this field, while on the Grand Banks, the Terra Nova I-97 farmin wildcat added important resource potential to the Terra Nova field and increased Canterra's working interest from eight per cent to approximately 13 per cent.

Canterra invested \$48.2 million in frontier areas during 1986 and received \$36.2 million in Petroleum Incentive Program (PIP) grants. During the year, Canterra completed earning under all major farmins. Gross exploratory acreage was reduced by 58 per cent from 3.2 million hectares with high-graded lands being retained only where there is a reasonable chance of drilling before the terms expire. Consequently, all deep water lands off Nova Scotia and 99 per cent of 3.8 million gross hectares on the Labrador Shelf have been relinquished.

During 1986, the company participated in development studies on the Thebaud-Venture gas project and on the Terra Nova discovery.

Land Holdings

thousands of hectares

	Gross	1986 Net	Gross	1985 Net
Alberta	1 879	747	1 909	729
British Columbia	331	163	440	218
Saskatchewan	87	40	101	47
Northwest Territories/Yukon	472	116	432	289
Offshore Nova Scotia	496	84	338	62
Grand Banks	564	36	690	46
Labrador Sea	39	9	3 816	685
Beaufort Sea	499	98	765	178
Arctic Islands	602	90	667	105
Other (Hudson Bay and Nova Scotia on-shore)	527	19	860	22
Canada	5 496	1 402	10 018	2 381
United States	114	23	187	81
Total	5 610	1 425	10 205	2 462



The installation of a compressor on the Blackstone-Stolberg pipeline system in November 1986 significantly increased production from the Blackstone gas field in western Alberta. A redrill of a well in this field early in 1987 qualifies for one-year royalty-free status.

Frontier Outlook

The company will maintain the objective of protecting its interests in discovered resources at minimal capital investment and will engage in detailed exploration and production studies on selected discoveries to be prepared for future development opportunities.

United States Exploration and Production

Major declines in prices for oil and gas in the United States and a 17 per cent drop in oil production from Canterra's U.S. petroleum subsidiary resulted in a decline in free cash flow to U.S. \$6.9 million from U.S. \$18.9 million in 1985. Oil production was 298 cubic metres per day compared with 357 cubic metres per day in 1985. Natural gas production remained essentially constant at 395 000 cubic metres per day in 1986.

During the year, Canterra drilled nine gross (2.4 net) exploratory wells, resulting in three (1.3 net) oil wells and four (0.7 net) gas wells in the U.S. Seven wells were drilled on farmout lands at no cost to the company.

As a result of the oil price decline, capital spending was significantly reduced and exploration for oil in the Williston Basin of Montana and North Dakota was discontinued early in 1986. Exploration efforts on a reduced basis were concentrated in the Gulf Coast area, primarily on the Mecom Ranch in Louisiana.

In 1986, U.S. \$3.3 million was invested in the U.S. operation compared to U.S. \$17.0 million in 1985. Future capital expenditures will be limited to developing the existing land base and will be in the order of U.S. \$1 million per year.

Frontier Exploratory Wells Drilled in 1986

Status/Results	Well Name	Cost Interest %	Net Interest %
Oil	Pex Cohasset A-52	9.0	9.0
	Shell Panuke B-90	17.5	8.75
	Pex Terra Nova I-97	50.0	17.5
Gas	Pex Bele O-35	25.0	25.0
	Shell Glenelg N-49	30.0	20.92
	Mobil Thebaud C-74	9.0	9.0
	Shell N. Triumph B-52	27.5	16.875
	Shell N. Triumph G-43	30.0	15.0
Dry and abandoned	Pex Nogha O-47	50.0	25.0
	Esso Kyle L-11	10.725	5.3625
	HBV Panther P-52	12.5	6.25
	Canterra St. George J-55	22.5	22.5
	Shell Tantallon M-41	25.0	12.5
		Gross	Net
Oil		3	(.353)
Gas		5	(.868)
Dry and abandoned		5	(.716)
Total		13	1.936

Production

Western Canada

Production activity in 1986 was directed at sustaining production from existing fields, drilling development wells tying in new producing areas and on enhanced oil recovery schemes. Production capital expenditures of \$48 million, down from \$79 million in 1985, were invested in numerous projects in Western Canada.

In Western Canada, Canterra drilled 192 (37.5 net) development wells, resulting in 137 (24.2 net) oil and 50 (9.9 net) gas wells. New exploratory and development wells brought on-stream from Canterra and partner-operated properties in Alberta added more than 500 cubic metres per day of oil and 500 000 cubic metres per day of gas by year end.

Cost-constraint programs, initially implemented in February, reduced oil and gas operating costs, despite the addition of new wells and facilities.

Oil

A number of projects increased oil production at the company's Rainbow Lake properties, where injection of natural gas and natural gas liquids is used to optimize oil recovery in eight of the Rainbow Keg River pools. Improvements in enhanced oil recovery management increased productive capacity from the Rainbow B pool, Canterra's largest oil pool. An expanded system to dispose of water recovered from the B pool was completed early in 1986. A lift system that utilizes gas to help lift oil from the reservoir increased productive capacity from the Rainbow F pool.

Significant discoveries of sweet gas in the shallow Bluesky formation in the Rainbow area provided an important source of gas supply for enhanced oil recovery projects as this gas does not require expensive treatment.

Pipeline systems were installed to connect the Shekilie and Virgo oil discovery areas in northwestern Alberta in June and six new oil wells were tied into the Interprovincial-Rainbow oil transmission system, allowing full-time production from these wells.

New oil was brought on production from exploratory and development successes at the following fields: Rainbow, Provost, Wayne Rosedale, Wimborne, Edam, Bellshill, West Nipisi, Evi and Gift.

Natural Gas

The capacity of the gas pipeline system from Blackstone-Stolberg to the Ram River plant was increased in December to six million cubic metres per day. The increased gas sales resulting from this pipeline expansion will optimize production of royalty-free gas from the Blackstone field. As a further step in the optimal depletion of this pool, Canterra and its partners plan to

redrill and place on production a second Blackstone well in which the company has a 23.7 per cent interest. This new well qualifies for one-year royalty-free status under Alberta regulations and should double the production capability of the pool from its present level of 2.5 million cubic metres per day.

The Sinclair gas plant near Beaverlodge in northwestern Alberta was brought on-stream in late August at rates of 215 000 cubic metres per day. This was an area where the company owned shut-in gas reserves and was able to purchase additional reserves, allowing the rapid development of a new 100 per cent owned gas sales project. Two outside-operated gas wells at Monias-Boudreau in northeastern British Columbia were tied in for direct industrial gas sales in December. Canterra holds a 21 per cent interest in the wells which can deliver 350 000 cubic metres per day. New gas wells were also placed on production at Rumsey, Ghost Pine, Liege, Strachan and Medicine Hat in Alberta and Mel in British Columbia.

Sulphur

A \$4-million contaminated sulphur reclamation facility with a design capacity of up to 100 000 tonnes of sulphur per year is scheduled to start production at the company's Ram River plant by July 1987. More than one quarter of Canada's contaminated sulphur — a mixture of commercial sulphur and dirt resulting from sulphur storage and handling operations — is located in the Ram River area. As well as using the facility for reclaiming its own contaminated sulphur, Canterra will pursue custom processing of contaminated sulphur from other sulphur producers.

The facility will use a proprietary froth-flotation process that will recover a high percentage of saleable sulphur. The process was developed by Canterra's research and development program. More than one third of the research and development budget in 1987 will be allocated to developing sour gas processes, including production of very sour gas.



Operator Dale Rangen checks the sulphur slater at the Ram River sulphur facility. Sulphur is formed into slates before shipment to offshore markets.

Tar Sands Production

Production from Canterra's Athabasca tar sands pilot plant in northeastern Alberta increased 25 per cent from 1985. Total bitumen production from the pilot plant, 110 km northeast of Fort McMurray, exceeded 26 500 cubic metres. Canterra holds a 51 per cent interest in the 19 770 hectare lease and is testing a proprietary modified steam-drive process to produce the heavy bitumen. The Alberta Oil Sands Technology and Research Authority (AOSTRA) will fund 100 per cent of operating costs at the pilot project in 1987 and 1988. Two new test patterns will be added in early 1987, enabling the company to test improved production start-up procedures. Because results to date at this project have been very encouraging, two additional years of testing will significantly advance the technology and allow for a better assessment of commercial viability.

The North Battleford heavy oil pilot project was suspended during the summer because of prevailing low oil prices. The Saskatchewan Department of Energy and Mines has granted a five-year continuation of Crown leases associated with this pilot project.

Coal Production

Weak coal demand coupled with an industry-wide upward trend in productivity resulted in continued oversupply of coal in Eastern United States markets. As a result, coal prices remained soft throughout 1986.

Canterra's two mining subsidiaries operate surface and underground mines and coal preparation facilities in Pennsylvania. Shipments from the surface mines increased by 31 per cent over the prior year. Lower fuel costs, strong productivity gains and higher shipment levels more than offset the effect of lower selling prices.

The underground subsidiary has been on strike since August 1985. Production of coal by salaried personnel continued throughout the year and modest shipments resumed during the second quarter. Illegal actions by picketing strikers in defiance of court injunctions severely affected the underground operations during the fourth quarter. Failure to achieve a satisfactory settlement to the strike could lead to closure of the underground mines.

As a result of continued depressed market conditions and the extended strike of mine workers affecting underground operations, the company wrote down the value of its coal property, plant and equipment, resulting in a charge against earnings of U.S. \$44 million at December 31, 1986. Canterra intends to dispose of all its coal operations as part of its strategy to concentrate on oil, gas and sulphur exploration and production.

For coal reserves and sales volumes, refer to pages 37 and 38.

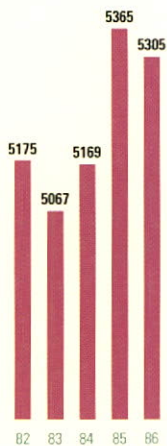
Oil and Natural Gas Liquids Sales

gross
cubic metres per day



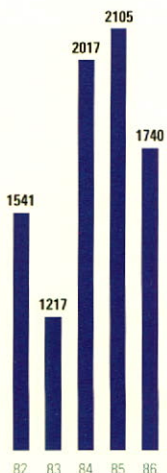
Natural Gas Sales

gross
thousand cubic metres per day



Sulphur Sales

gross
thousands of tonnes per year



Oil and Natural Gas Liquids

Volumes of conventional crude oil and natural gas liquids produced and sold were 4 575 cubic metres per day in 1986. This is a decrease of nine per cent from 1985 levels, primarily the result of pipeline capacity constraints on Interprovincial Pipe Line Limited's system. Since price discounts for supplemental markets were unacceptably high, Canterra elected not to sell excess capacity into these markets. Shut-in production should diminish in 1987 as expansions to Interprovincial's system are completed and a modified pro-rationing system is introduced in Alberta.

The average sales price for Canadian oil declined 45 per cent from 1985. An agreement on oil production quotas and prices reached by the Organization of Petroleum Exporting Countries (OPEC) in late 1986 prompted an increase in the oil price to around U.S. \$18 per barrel in early 1987.

Since deregulation of oil marketing in Canada in June 1985, Canterra has managed the marketing of essentially all of its crude oil production, including production from properties operated by others. During 1986, the company signed two new contracts with Canadian refiners and by year end, more than one third of oil production was marketed directly to refiners. The company is continuing to evaluate new marketing opportunities to secure higher netbacks and minimize shut-in production.

With deregulation, a variety of price mechanisms are available to marketers. Canterra used a mixture of them to optimize return and reduce price volatility in 1986. Through a combination of sales under refiner-posted prices and prices related to futures contracts traded on the New York Mercantile Exchange, Canterra realized an average price equivalent to the prices paid by the major Canadian refiners.

A futures trading program using the New York Mercantile Exchange was started in May and has resulted in hedging 12 per cent of company net crude oil production against future major price fluctuations.

Natural Gas

Natural gas volumes produced and sold in 1986 were 5.3 million cubic metres per day, in line with 1985 volumes. Canterra's deliveries of Canadian gas during 1986 represented approximately 55 per cent of its developed capability. The Canadian natural gas industry is expected to continue to operate below capacity until export markets expand.

More than 90 per cent of Canterra's 1986 Canadian gas sales were delivered to the company's traditional buyers under long-term contracts. About 59 per cent of their commitments to purchase gas were realized, compared with 63 per cent in 1985.

Natural gas markets in Canada and the United States during the year were characterized by intense competition, both among suppliers and from alternate fuels. In Canada, deregulation resulted in a dramatic increase in the number of natural gas marketers, as more producers opted for direct selling, adding to price competition and loss of sales by traditional sellers. Distribution companies and industrial end-users took advantage of the continuing supply and demand imbalance by significantly increasing the volume of gas purchased directly on a short-term or spot basis.

Gas prices eroded throughout 1986 with the average sales price for Canadian gas decreasing by 15 per cent. The price clause of contracts with the company's major long-term purchasers was renegotiated effective November 1, 1986 to provide for netback pricing.

Canterra is actively pursuing direct sales of Canadian gas to distribution companies and end users in Canada and the United States. In April 1986, Canterra began sales to Polysar Limited, an industrial user in Ontario, at a negotiated set price for a specified period. Volumes under this contract were increased in November.

Selling Canadian natural gas into markets in the United States continues to be restricted by U.S. regulations which limit access to transportation on major interstate gas pipeline systems. Where transportation was available, Canadian gas penetrated U.S. spot markets which, in 1986, accounted for more than 40 per cent of the total U.S. market. In September, Canterra successfully bid into the California spot market and delivered gas to a utility customer until transportation arrangements were discontinued. The company is pursuing transportation arrangements to facilitate delivery of gas into California and other U.S. markets starting in early 1987. In 1987, marketing efforts will be targeted at increasing market share provided that satisfactory netbacks can be achieved.

Sulphur

After record sales in 1984 and 1985, Canadian sulphur industry sales volumes declined by 17 per cent in 1986 as a result of lower export demand in the United States and offshore markets. These reductions are largely the result of a downturn in consumption by the phosphate fertilizer industry. Canterra's sales results mirrored the performance of the Canadian industry with gross sales volumes of 1.7 million tonnes in 1986, compared with more than two million tonnes in both 1984 and 1985.

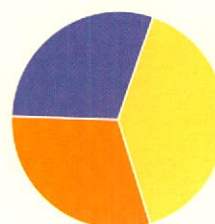
Average prices received in 1986 were consistent with 1985 levels. Pricing, however, weakened throughout the year. Offshore contract prices declined at mid-year to U.S. \$130 per tonne from the U.S. \$135 per tonne levels that prevailed during the second half of 1985 and the first half of 1986. Lower contract prices were preceded by downward movements in spot prices. Spot prices declined from record levels of U.S. \$150 per tonne in the first quarter of 1985 to a 1986 year-end closing price of approximately U.S. \$110 to \$115 per tonne.

Canterra's sulphur supply from production and purchases remained relatively constant in 1985 and 1986 at approximately one million tonnes. As a result of lower sales volumes in 1986, drawdowns from above-ground sulphur inventories were approximately 0.4 million tonnes lower than in 1985.

Sulphur demand is cyclical and is heavily influenced by conditions affecting world agricultural economies. Sulphur pricing, however, is determined by the differential between global sulphur production and consumption. Although contract prices are expected to soften in 1987 due to continuing weak demand for sulphur from the phosphate fertilizer industry and aggressive competition among independent marketers for export markets, consumption is expected to continue to exceed production on a global basis and will necessitate continued, although reduced, drawdowns from inventories to balance the market.

Global sulphur inventories at the end of 1986 totalled approximately 14 million tonnes, representing less than six months' consumption at current demand levels. Canterra's ownership of approximately 15 per cent of the world's inventories represents a strategic asset which will continue to provide substantial returns during cyclical upturns in the sulphur supply and demand cycle.

Source of sulphur sales volumes of 1.7 million tonnes



Production 38%
Inventories 33%
Purchases 29%

Sulphur is a primary business for Canterra. In 1986, sulphur sales provided 42 per cent of company net sales.

Canterra's sulphur supply is derived from natural gas processing in western Alberta. Three sources of supply are used to meet market demand: liquid sulphur production recovered from the processing of sour natural gas; remelting of solid block inventories accumulated during periods when

available markets were insufficient to absorb total production; and volumes purchased for resale from other sulphur producers.

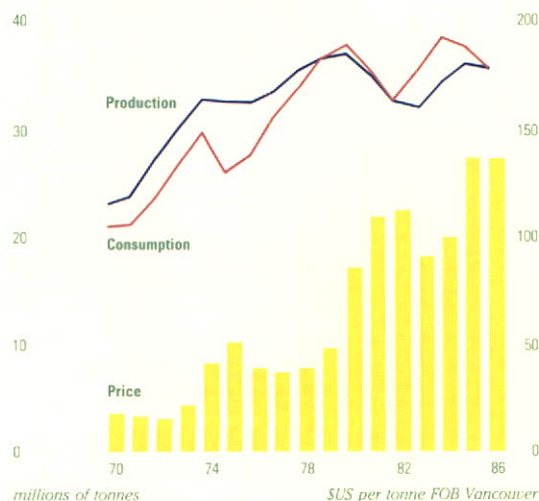
Most of the company's sulphur originates from Canterra's natural gas fields in the Ram River and Okotoks areas and from a long-term purchase contract at the Windfall natural gas processing plant. Sulphur production is also obtained at company-operated plants at Nordegg and Rainbow Lake, as well as through minority interests in 12 outside-operated gas processing plants in Alberta.

Elemental sulphur is primarily used in the manufacture of sulphuric acid with the phosphate fertilizer industry being the principal end user. More than 80 per cent of Canterra's gross sulphur is sold into markets outside North America through Cansulex Limited, a Vancouver-based sulphur marketing company owned by 22 Alberta sulphur producers.

Canterra also markets sulphur directly into the North American market through sales offices in Calgary, Alberta and Pittsburgh, Pennsylvania.

Rising cyclical sulphur prices reflect increasing demand for this commodity.

Global Elemental Sulphur Production, Consumption and Price



Reserves

Proved Oil and Natural Gas Liquids Reserves

gross
million cubic metres



Proved Natural Gas Reserves

gross
billion cubic metres



Proved Sulphur Reserves

gross
million tonnes



Oil and natural gas liquids reserves in Western Canada and the United States increased a record 13 per cent over 1985. Gas reserves increased three per cent and sulphur reserves declined five per cent. The company replaced about 210 per cent of 1986 production of oil, gas liquids and natural gas on an oil-equivalent basis. This was accomplished through discoveries, property purchases, optimized production practices and reservoir performance re-appraisal of several oil and gas pools.

At the end of 1986, total proved reserves of oil, gas liquids and natural gas before royalty, on an oil-equivalent basis, were 65.2 million cubic metres, an increase of seven per cent over 1985. Reserves of both oil and gas in the United States declined during 1986. U.S. reserves represent approximately three per cent of the company's total reserves.

Oil and Natural Gas Liquids

Record additions of oil and natural gas liquids reserves are primarily the result of re-assessments of several major properties in Alberta. A three-dimensional seismic program identified significantly more oil in place in the Rainbow Keg River F pool. Based on projected reservoir performance, remaining recoverable oil in this pool was increased by approximately 900 000 cubic metres. The Rainbow Keg River B pool enhanced recovery scheme, which was expanded in 1984 to include the remaining portions of the pool, continues to operate successfully and has confirmed projections of significant reserve additions. Reserves of 750 000 cubic metres were added as revisions to this pool in 1986. Additional reserves may be added pending the results of development drilling and further analysis which includes three-dimensional seismic, further geological and petrophysical work, and a comprehensive reservoir engineering study of the pool. The enhanced recovery scheme in the B pool will contribute an

estimated 5.3 million cubic metres to Canterra's reserves.

Based on constant 1986 production rates, the Company's reserve life index of proved oil and natural gas liquids is 13 years.

Natural Gas

Gas reserves increased in 1986 as a result of discoveries, acquisitions, and extensions and revisions to existing pools. The most significant additions were in the Rainbow area of Alberta (0.75 billion cubic metres), in the Limestone area in the Alberta foothills (0.5 billion cubic metres) and in the Monias-Boudreau area in British Columbia (0.4 billion cubic metres). A re-evaluation of the Cranberry gas discovery in northwestern Alberta resulted in a reserves increase of 0.4 billion cubic metres with associated condensate reserves. Most gas additions are the result of discoveries, information obtained through development drilling and assessment of production performance. Based on constant 1986 production rates, the company's reserve life index of proved natural gas is 21 years.

Sulphur

Proved sulphur reserves of 1.1 million tonnes were added as a result of performance re-appraisal, discoveries and inventory adjustments for several properties. The most significant additions were in the Okotoks-Chestermere (250 000 tonnes) and Caroline (125 000 tonnes) areas of Alberta. Basepad inventories have been assessed at about 250 000 tonnes. These additions were offset by sulphur sales of 1 740 000 tonnes. Based on constant 1986 sales, the company's reserve life index of sulphur is seven years.

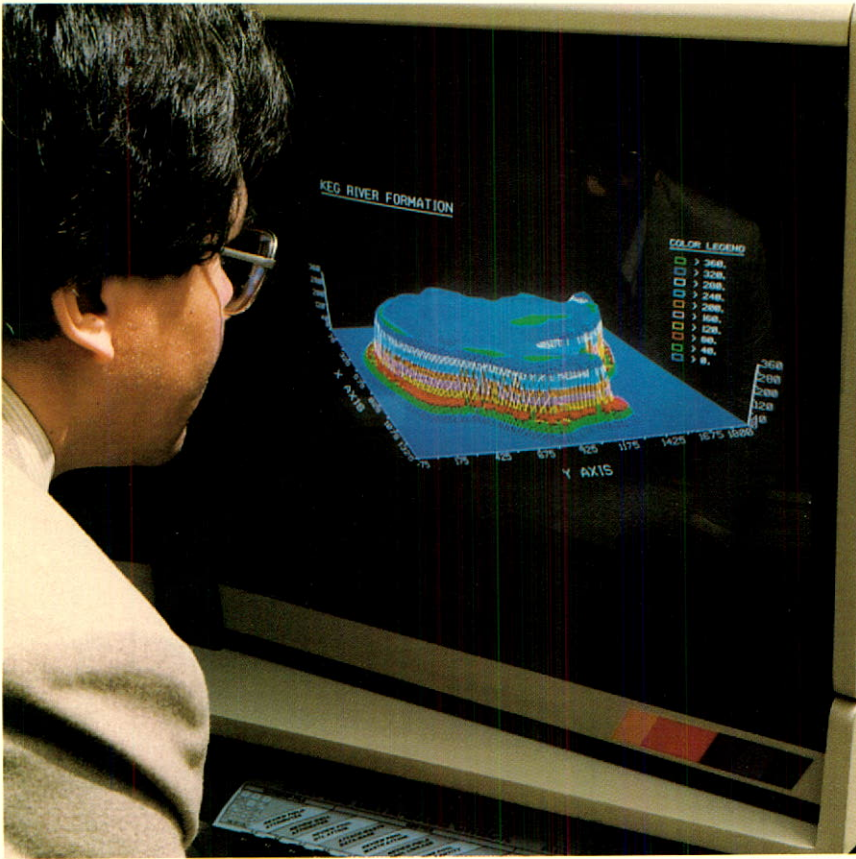
Coal

Coal reserves were 33.5 million tonnes at year-end 1986, compared with 34.2 million tonnes at year-end 1985.

Proved Reserves

	Crude oil and natural gas liquids (million cubic metres)		Natural gas (billion cubic metres)		Sulphur (million tonnes)	
	Gross Working Interest	Net After Royalties	Gross Working Interest	Net After Royalties	Gross Working Interest	Net After Royalties
Proved Reserves						
December 31, 1985	19.7	15.2	38.6	29.7	12.9	11.8
Revisions	3.6	3.1	1.3	1.5	1.0	0.9
Discoveries	0.7	0.5	1.9	1.4	0.1	0.1
Production/sale	(1.7)	(1.3)	(1.9)	(1.5)	(1.7)	(1.6)
December 31, 1986	22.3	17.5	39.9	31.1	12.3	11.2
Proved Developed						
December 31, 1986	20.8	16.5	32.5	25.3	12.1	11.0
Probable Additional						
December 31, 1986	1.8	1.5	3.9	2.8	0.4	0.4

Western Canada and United States



Senior engineer David Fong performs a computer simulation of a Rainbow oil pool. This image is developed from information obtained from three-dimensional seismic surveys and allows reservoir engineers to visualize the structure of a pool to optimize oil recovery.

Information Management System

In 1986, the company completed the first phase of a data management system designed to enhance business effectiveness. This system makes use of the best available computer technologies and information management concepts and is expected to contribute significantly to company performance by providing easy access to accurate information.

The first phase produced a user-designed blueprint of data organization for the company. The scope of the project addressed the data management needs of the company as a whole, rather than developing distinct systems for particular needs. The project crossed divisional lines and involved employees from all parts of the company.

All future company computer applications will be implemented following this master blueprint. One of the first applications will be a new financial and operations reporting system scheduled to begin implementation late in 1987.

Environment

The environmental impact of sulphur recovery, forming, storage and shipping operations can be minimized by conscientious management. Canterra has developed a leadership position in this area and further reduced the environmental impact of sulphur operations during 1986 in several ways. Sulphur dust and vapour emissions at the company's Okotoks plant were reduced and a state-of-the-art weather monitoring system was installed at the Ram River plant to ensure sulphur dioxide concentrations continue to meet regulatory air quality standards.

Canterra's environmental programs are directed at preserving the environment where the company operates and consulting with interested parties on potential environmental effects of Canterra's operations.

Safety

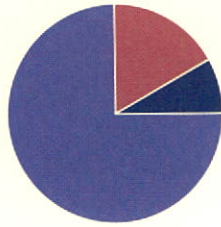
In 1986, Canterra continued to strengthen safety and health programs for employees. In this regard, advanced safety seminars for supervisors were conducted by Occupational Health and Safety of Alberta. These seminars covered expanded training in safety awareness, regulations and safe work practices. They supplement regular training safety programs in place for all field and operations employees.

Regular safety inspections, employee feedback questionnaires and monthly reviews by an advisory group reporting to senior management continued to contribute to a high level of safety performance.

As a result of strong safety performance over the past three years, Canterra will receive a reduction in the Workers' Compensation Board assessment for 1987. In 1986, Canterra was one of the top six companies in the industry for safety performance. The company's 17 operated plants received safety awards from the Canadian Gas Processors Association for no lost-time accidents.

Financial Review

Cash provided of \$236.2 million



Free cash flow	74%
Share capital issue	15%
Change in working capital	11%

Canterra reported \$174.0 million (\$2.12 per share) of free cash flow in spite of depressed product prices in 1986. This compares with \$310.3 million (\$3.94 per share) in 1985 and \$187.1 million (\$2.47 per share) in 1984. Consolidated revenue for the year was \$577.0 million, down from \$790.8 million in 1985.

A loss of \$373.2 million (\$4.56 per share) was reported for 1986,

primarily due to a write-down of assets of \$355.5 million after-tax. This compares with earnings of \$86.9 million (\$1.10 per share) for 1985. The loss from operations before the write-down was \$17.7 million. The decision taken in 1986 to cease capitalization of interest on frontier properties reduced earnings before the write-down by \$18.4 million after taxes.

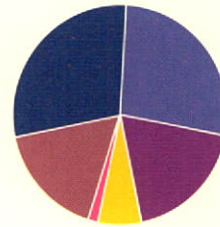
The write-down reduces the carrying value of Canadian frontier properties, United States oil and gas assets, coal properties in the United States and real estate. A significant portion of the write-down relates to reduced value of frontier properties.

Interest payments on debt, including interest for long-term debentures, are funded from cash flow. The interest coverage ratio in 1986 was 1.9, down from 2.4 in 1985 due to lower revenues, but higher than the 1984 ratio of 1.7 because of lower interest rates and lower debt levels.

Canterra invested \$168.4 million in exploration and production activities during the year. Of this amount, \$57.5 million was funded by various government programs, leaving net expenditures of \$110.9 million, compared with \$213.9 million in 1985. Lower drilling and land acquisition costs helped to offset reduced expenditures.

Through a number of financing activities, the company raised \$217.5 million that was used to extend the maturity of debt through the prepayment of loans that would otherwise have matured in 1987 and 1988. The new loans, most of which expire in six years, are at a lower interest rate and do not increase the company's outstanding debt. One of these loans was through a bond issue of 100 million deutsche marks. To protect against fluctuation in this currency, this loan was fixed in U. S. dollars through currency swap agreements. In addition, interest rates on \$172.6 million of floating rate bank loans was fixed for a five-year period at 8.4 per cent through interest rate swap agreements.

Cash used of \$236.2 million



Exploration*	27%
Production*	19%
Other*	1%
Increase in cash	30%
Repayment of debt	14%
Other transactions	9%

* capital expenditures

Long-term debt was reduced by \$88.9 million in 1986, the result of payments of \$32.3 million and an increase in current debt of \$51.3 million that will be paid out of 1987 cash flow. The balance of the reduction is attributable to foreign exchange fluctuations. Long-term debt is more fully described in Note 5.

The company has \$347.0 million of cash, short-term investments

and unutilized committed bank lines of credit. Current assets and bank lines, together with future cash flows from operations, will enable the company to meet debt obligations and provide for future capital investment programs.

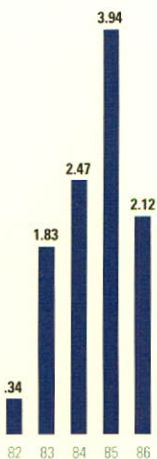
In the medium term, the company will not pay dividends on common shares. Instead, earnings will be reinvested to generate growth in the value of shareholders' equity.

Canterra's financial objectives over the next five years are to increase share value through selective investment in operations and through debt reduction. To retire debt in excess of required amounts, the company intends to divest non-strategic assets if appropriate values can be realized.

Production Revenues gross



Free Cash Flow per Share dollars



before parent company transactions

Consolidated Balance Sheet

December 31, 1986

(millions)

	1986	1985
Assets		
Current assets		
Cash and short-term investments	\$ 126.0	\$ 62.1
Accounts receivable	54.8	101.1
Petroleum Incentive Program grants receivable	11.3	26.5
Inventories (Note 2)	58.2	71.8
Prepaid expenses	5.6	3.6
	255.9	265.1
Investments and other assets	79.8	61.4
Property, plant and equipment (Notes 3 and 4)	2,711.9	3,149.8
Deferred foreign exchange	284.3	308.6
	\$3,331.9	\$3,784.9
Liabilities and Shareholders' Equity		
Current liabilities		
Bank indebtedness	\$ 16.6	\$ 22.9
Accounts payable and accrued liabilities	73.7	121.3
Current portion of deferred production revenue	4.4	3.6
Current portion of long-term debt (Note 5)	51.6	.3
	146.3	148.1
Long-term debt (Note 5)	2,042.3	2,131.2
Convertible subordinated debentures (Note 6)	222.5	222.5
Deferred production revenue and other credits	42.6	33.8
Deferred Petroleum and Gas Revenue Tax	39.6	24.3
Deferred income taxes	348.6	397.7
	2,841.9	2,957.6
Shareholders' equity		
Capital (Note 7)	770.0	734.1
Retained earnings (deficit)	(280.0)	93.2
	490.0	827.3
	\$3,331.9	\$3,784.9

Approved by the Board:



B. F. Isautier, Director



H. G. Pearce, Director

Discussion of Consolidated Balance Sheet

Working Capital

Working capital, which indicates the ability to meet short-term obligations, was \$109.6 million, compared with \$117.0 million in 1985. Cash and short-term investments doubled to \$126.0 million from \$62.1 million in 1985. This increase gives the company increased flexibility for debt repayment or capital investment. The current portion of long-term debt of \$51.6 million will be paid out of 1987 cash flow.

Investments and Other Assets

Investments and other assets include Canterra's investment in three companies: Penmore, S.A. (100 per cent owned and based in Switzerland), Rainbow Pipe Line Company, Ltd. (33 $\frac{1}{3}$ per cent owned) and a 40 per cent working interest in the Allan Potash Mine in Saskatchewan. Penmore is an insurance company that insures the employees of Canterra's coal operation against occupational health disease. In 1986, Penmore paid a dividend of \$25 million to Canterra. The Rainbow Pipe Line is a strategic oil pipeline from northern Alberta to Edmonton. Canterra acquired the interest in the potash mine in 1986. See Note 12 (d).

Property, Plant and Equipment

Property, plant and equipment includes all capital investments related to acquiring properties, exploring for and developing hydrocarbons and sulphur. During 1986, \$345.0 million of frontier costs from prior years were transferred to depletable assets, leaving \$94.5 million of frontier costs not subject to depletion.

Canterra's write-down of frontier assets complies with the Canadian Institute of Chartered Accountants' new guideline on full cost accounting. Other reductions in costs of assets were taken for U. S. oil and gas properties, coal properties and for certain real estate properties. The total reduction in property, plant and equipment through write-downs was \$431.2 million. For more details on Canterra's policy regarding property, plant and equipment, ceiling tests, and depreciation and depletion, refer to Note 1.

Foreign Exchange

The company's long-term foreign currency debt is converted to Canadian dollars at the exchange rate in effect at year end. Canterra has a U.S. dollar-related revenue stream which acts as a hedge against the company's U.S. dollar-denominated debt. Any foreign exchange exposure is charged to earnings as debt repayments occur or is amortized on a straight-line basis over the life of the debt. The balance of unamortized foreign exchange is deferred and reported as

deferred foreign exchange on the balance sheet. Deferred foreign exchange in 1986 decreased \$24.3 million, the result of debt payments and a stronger Canadian dollar.

Long-term Debt

Long-term debt of \$2,042.3 million at December 31, 1986 is primarily composed of a \$1,646.3 million syndicated term loan. Interest on this loan averaged 6.72 per cent at year end (8.84 per cent at December 31, 1985). Other long-term debt is made up of floating-rate bank loans, Swiss franc notes and deutsche mark bearer bonds. Repayments on the syndicated loan begin in July 1987 (\$51.3 million) and continue semi-annually to December 1992. More details are provided in Note 5. In addition, the company has \$222.5 million in convertible subordinated debentures. See Note 6 for details.

Other

Deferred production revenue is revenue received under various natural gas sales contracts with pipeline purchasers such as Topgas to provide for payment from those unable to take delivery of the minimum contract amount. Revenue will be recognized as deliveries are completed over an eight-year period ending in 1994.

A portion of Petroleum and Gas Revenue Tax (PGRT) for 1985 and up to October 1, 1986, when PGRT was eliminated, is deferred and will be offset with exploration and development expenditures that are not needed to reduce taxable income. PGRT will become payable when the company utilizes these expenditures to reduce taxable income. See Note 1 (j).

Shareholders' equity is \$490.0 million despite the significant write-down of assets in 1986.

Shareholders' Equity
millions of dollars



Consolidated Statement of Earnings

Year ended December 31, 1986

<i>(millions)</i>	1986	1985
Revenues		
Sales (Note 8)	\$ 551.7	\$767.3
Investment and other income	25.3	23.5
	577.0	790.8
Expenses		
Operating	164.8	179.9
Financing costs	172.2	158.9
Administrative	38.8	45.6
Foreign exchange	19.0	18.1
Depletion and depreciation	159.5	148.8
Write-down of property, plant and equipment (Note 3)	431.2	—
	985.5	551.3
Earnings (loss) before income and other taxes	(408.5)	239.5
Income and other taxes (Note 9)		
Current	(1.0)	(2.1)
Deferred	(49.1)	105.6
Petroleum and gas revenue and other production taxes	(.5)	24.8
Deferred Petroleum and Gas Revenue Tax	15.3	24.3
	(35.3)	152.6
Earnings (loss)	\$(373.2)	\$ 86.9
Earnings (loss) per common share (Note 14)		
Basic	\$ (4.56)	\$ 1.10
Fully diluted	\$ (4.56)	\$ 1.07

Consolidated Statement of Retained Earnings (Deficit)

Year ended December 31, 1986

<i>(millions)</i>	1986	1985
Retained earnings at beginning of year	\$ 93.2	\$ 6.3
Earnings (loss)	(373.2)	86.9
Retained earnings (deficit) at end of year	\$(280.0)	\$93.2

Discussion of Consolidated Statement of Earnings

Revenues

Consolidated revenue after deducting royalties was \$577.0 million compared with \$790.8 million in 1985. Royalties were down 41 per cent from 1985, largely the result of lower prices and royalty rate reductions made by provincial governments in 1986. Oil and natural gas liquids contributed 29 per cent to net sales (\$159.1 million, 1986; \$308.5 million, 1985), natural gas contributed 26 per cent (\$142.9 million, 1986; \$162.2 million, 1985) and sulphur contributed 42 per cent (\$229.5 million, 1986; \$273.7 million, 1985). Refer to Note 8 for more details on sales.

Operating and Administrative Costs

Administrative costs were held below 1985 levels on the basis of constraint measures taken by the company during the year. Total operating costs were down eight per cent from 1985. The reduction resulted largely from lower sulphur purchases and lower coal operating costs. Western Canadian oil and gas operating costs were down one per cent for the year, despite an increase in the number of wells and facilities operated.

Financing Costs

Total interest paid in 1986 was \$187.0 million, 17 per cent below 1985. The reduction results from lower debt levels and lower interest rates. The average rate of interest paid was 7.6 per cent, down from 9.1 per cent in 1985. Capitalized interest was \$14.8 million, compared with \$65.6 million in 1985, resulting in a net charge against earnings of \$172.2 million (1985 — \$158.9 million) for financing costs. Of the reduction in capitalized interest, \$34.7 million resulted from management's decision in 1986 to not continue capitalizing interest on frontier properties.

Write-down

As a result of the downturn in hydrocarbon and coal prices, Canterra reviewed and reduced the carrying value of its investments in property, plant and equipment. The write-down, detailed in Note 3, brings these assets more in line with expected values.

Income and Other Taxes

Income taxes were recovered in 1986 as a result of the operating loss and write-down. Note 1(j) describes the company's policy with respect to booking deferred income and other taxes. Petroleum and Gas Revenue Tax is significantly below 1985 due to lower revenues, elimination in 1985 of PGRT on new production and the final removal of the tax on October 1, 1986. Details on income and other taxes, including the reconciliation to the expected corporate tax rate of 47 per cent, are outlined in Note 9.

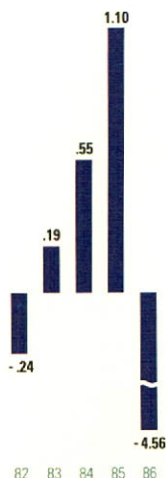
Free Cash Flow

Free cash flow of \$174.0 million (\$2.12 per share) was down from \$310.3 million (\$3.94 per share) in 1985 but generally in line with 1984 free cash flow of \$187.1 million (\$2.47 per share). Free cash flow is the amount of cash available after all expenses including capitalized charges. This amount more than adequately covered capital expenditures of \$110.9 million (net of government grants of \$57.5 million), and debt repayment of \$32.3 million, net of foreign exchange adjustments of \$5.3 million. The components of the cash flows of the company are detailed on the Statement of Changes in Financial Position on page 22.

Interest Coverage
per cent



Earnings per Share
dollars



before parent company transactions

Consolidated Statement of Changes in Financial Position

Year ended December 31, 1986

(millions)

	1986	1985
Cash provided from (used for)		
Operating activities		
Earnings (loss)	\$(373.2)	\$ 86.9
Non-cash items and financing costs less capitalized exploration overhead	734.2	447.9
Cash flow before interest payments	361.0	534.8
Interest payments	(187.0)	(224.5)
Free cash flow *	174.0	310.3
Change in operating working capital (Note 11)	26.3	4.7
Cash provided from operations	200.3	315.0
Investing activities		
Expenditures on property, plant and equipment	(110.9)	(213.9)
Acquisition of potash mining assets (Note 12(d))	(33.0)	—
Other	10.2	(8.2)
Cash used for investing	(133.7)	(222.1)
Financing activities		
Share capital issue	35.9	77.9
Convertible subordinated debenture issue	—	222.5
Refinancing share capital and debenture issue costs	—	(18.9)
Syndicated loan proceeds	—	1,935.9
Repayment of parent company note	—	(1,935.9)
Repayment of long-term debt	(32.3)	(352.9)
Cash provided from (used for) financing	3.6	(71.4)
Increase in cash	70.2	21.5
Cash net of bank indebtedness at beginning of year	39.2	17.7
Cash net of bank indebtedness at end of year	\$ 109.4	\$ 39.2
Refer to Note 11.		
Free cash flow per common share (Note 14)		
Basic	\$ 2.12	\$ 3.94
Fully diluted	\$ 1.91	\$ 3.68

* Free cash flow represents funds available for capital expenditures and debt repayment after deducting all expenses including capitalized interest and capitalized exploration overhead.

Notes to Consolidated Financial Statements

(tabular dollar amounts shown in millions of dollars)

1. Summary of Significant Accounting Policies

Canterra Energy Ltd. (the "Company") follows accounting policies generally accepted in Canada. The following significant policies are presented to assist the reader in evaluating these financial statements and together with the following notes should be considered an integral part of the consolidated financial statements.

(a) Principles of Consolidation

The consolidated financial statements include the accounts of the Company, subsidiary companies and a limited partnership, all of which are wholly owned.

A wholly-owned subsidiary providing certain insurance coverage to the Company is accounted for by the equity method and is included in investments and other assets. The Company's 33 $\frac{1}{3}$ per cent interest in Rainbow Pipe Line Company, Ltd. is also accounted for by the equity method.

The Company has an equity interest in Cansulex Limited, a producer-owned company that markets sulphur outside North America. The ownership in this company is reallocated annually depending on annual volume commitments by the respective owners. The Company records its proportionate interests in sales and accounts receivable.

(b) Foreign Exchange Translation

All foreign subsidiaries are considered to be integrated. Accordingly, monetary assets and monetary liabilities of such subsidiaries are translated at the rate of exchange in effect at the balance sheet date. Non-monetary assets and liabilities together with revenues and expenses are translated at rates in effect at the time of the transactions. Foreign assets written down are translated at exchange rates in effect at the time of the write-down. Provisions for depletion, depreciation and deferred income are translated at the same rates as the related items. Exchange gains or losses resulting from this translation method are included in the determination of earnings for the year in which realized.

The Company's U.S. dollar-denominated debt is translated at the exchange rate in effect at the balance sheet date. To the extent that the Company's U.S. dollar-denominated debt is hedged by future U.S. dollar revenue streams, the resulting foreign exchange exposure is deferred and charged to earnings in the period in which debt repayments occur. Any unhedged foreign exchange exposure is amortized to earnings over the life of the debt.

(c) Inventories

Inventories include materials, supplies, purchased sulphur and coal and are stated at the lower of cost or net realizable value.

(d) Property, Plant and Equipment

The Company follows the full cost method of accounting as prescribed in the Guideline on Full Cost Accounting in the Oil and Gas Industry issued by the Canadian Institute of Chartered Accountants. All costs of acquiring properties, exploring for and developing oil, natural gas and sulphur and related reserves are capitalized and accumulated in country-by-country cost centres. Such expenditures include land acquisition costs, geological and geophysical expenses, capitalized financing costs and other carrying charges of undeveloped properties, costs of drilling productive and non-productive wells, and overhead costs directly related to exploration and development activities.

Maintenance and repairs are charged against earnings and renewals and enhancements which extend the economic life of the properties, plant and equipment are capitalized.

Gains or losses are not recognized upon disposition of oil and natural gas properties unless such a disposition would significantly alter the rate of depletion and depreciation. Gains or losses are recognized upon disposition of other assets.

(e) Ceiling Test

The Company places limits on the aggregate costs of oil and natural gas assets which may be carried forward for amortization against revenues of future periods (the "Ceiling Test"). The "Ceiling Test" is a cost recovery test whereby the capitalized costs less accumulated depletion and depreciation in each cost centre are limited to an amount equal to estimated future net revenues from proved reserves (based on current prices and costs as at the balance sheet date) plus unproved properties (at cost less impairment, the "Cost Centre Ceiling"). The total capitalized costs less depletion and depreciation and deferred income taxes of all cost centres are further limited to the aggregate estimated future net revenues for all cost centres less recurring general and administrative expenses, future financing costs and income taxes (the "Enterprise Ceiling"). Any costs carried on the balance sheet in excess of the ceiling test limits are charged to earnings.

(f) Depletion and Depreciation

The provision for depletion and depreciation for oil, natural gas and sulphur operations is calculated on the unit of production method based on gross proved reserves in each cost centre. Reserves are estimated by the Company's petroleum engineers and are converted to equivalent units on the basis of approximate relative energy content.

Costs of acquiring and evaluating unproved properties are excluded from the calculation of depletion and depreciation until it is determined that proved reserves are attributable to the properties or that impairment has occurred. On this basis the costs of acquiring and evaluating unproved properties in Western Canada and in Canadian Frontier areas, including exploration drilling in the Canadian Frontier, have been excluded from capitalized costs subject to depletion until determination of whether or not reserves have been proved or impairment has occurred. All dry hole costs are included in costs subject to depletion. Details of excluded costs are presented in Note 4 to the consolidated financial statements.

note 1 continued

(g) Capitalized Financing Costs

Financing costs are capitalized on costs incurred during the construction of major facilities and on unproved properties. Financing costs are charged to earnings when constructed facilities commence operations and when the exploration of unproved properties is completed or impairment has occurred.

(h) Deferred Production Revenue

Amounts received for annual contracted natural gas volumes not taken by pipeline purchasers are deferred. Revenue will be recognized as deliveries are completed over an eight-year period ending in 1994.

(i) Joint Venture

The Company conducts substantially all of its oil, natural gas and sulphur exploration and production activities on a joint venture basis and the accounts reflect the Company's proportionate interest in such activities.

(j) Income Taxes

The Company provides for income taxes which are deferred by claiming exploration, development and other costs for income tax purposes in amounts greater than related depletion, depreciation and write-downs charged to expense in the financial statements.

The Company also provides for Petroleum and Gas Revenue Tax (PGRT) which is deferred by claiming exploration and development costs not currently claimed for income tax purposes. When such costs are claimed for income tax purposes, the deferred PGRT will become a current liability.

(k) Comparative Accounts

Certain of the comparative accounts have been reclassified to conform with the financial statement presentation adopted in 1986.

2. Inventories

	1986	1985
Materials and supplies		
— oil, natural gas and sulphur	\$ 5.9	\$10.8
— coal	2.9	2.9
Purchased sulphur	48.5	56.2
Coal	.9	1.9
	\$58.2	\$71.8

3. Write-down of Property, Plant and Equipment

The Company has reviewed the carrying value of its investments in property, plant and equipment as a result of the downturn in world product prices. As a result of this review, these values have been reduced.

(a) Oil and Natural Gas Properties

(i) Included in the Canadian cost centre are proved and unproved properties. Unproved properties in the Canadian Frontier previously carried at \$439.5 million have been assessed on the basis of expected future oil and gas prices and economic conditions. As a result of this assessment, \$94.5 million has been attributed to these unproved properties. There is no Canadian cost centre ceiling deficiency.

(ii) As a result of applying the "Ceiling Test", a write-down of \$75.2 million was attributed to the U.S. cost centre.

(iii) Application of the "Enterprise Ceiling Test" has resulted in a pre-tax write-down of \$281.0 million which has been allocated to the Canadian cost centre.

(b) Coal Properties

Due to continued depressed market conditions and an extended strike of the mine workers at one of the Company's mines, the Company has reassessed the value of its coal properties in the United States and provided for a permanent impairment in the value of these properties.

(c) Real Estate

The value of real estate properties held for disposition was reviewed and a provision for impairment was made.

The following table summarizes the above write-downs:

Oil and natural gas properties	
Canada	\$281.0
United States	75.2
Coal	
United States	52.7
Real Estate	
Canada	10.0
United States	12.3
	431.2
Deferred income taxes	(75.7)
	\$355.5

4. Property, Plant and Equipment		1986	1985
	Cost	Accumulated Provisions	Net
Oil, natural gas and sulphur			
Canada	\$3,381.7	\$ 811.6	\$2,570.1
United States	295.2	231.3	63.9
	3,676.9	1,042.9	2,634.0
Coal			
United States	40.2	19.1	21.1
Office buildings			
Canada	57.1	5.8	51.3
Other			
United States	5.5	—	5.5
	\$3,779.7	\$1,067.8	\$2,711.9
			\$3,149.8

Included in property, plant and equipment are \$954.2 million (1985 — \$1,227.7 million) of costs which are not deductible for income tax purposes.

Costs of unproved properties excluded from depletion after giving effect to the December 31 transfer to the depletion base are as follows:

	1986			1985
	Western Canada	Frontier	Tar Sands	Total
Balance at beginning of year	\$180.5	\$ 439.5	\$34.0	\$ 654.0
Acquisitions	15.4	—	—	15.4
Exploration	—	12.0	—	12.0
Capitalized financing costs	14.8	—	—	14.8
Transfers to depletion base*				
— land and exploration	(35.1)	(12.0)	—	(47.1)
— impairment	—	(345.0)	—	(345.0)
Balance at end of year	\$175.6	\$ 94.5	\$34.0	\$ 304.1

* Transferred costs are subject to depletion in subsequent years.

5. Long-term Debt	1986	1985
Syndicated term loan with average interest of 6.72% (1985 — 8.84%) (U.S. \$1,192.5 million)	\$1,646.3	\$1,666.5
Floating rate notes and bank loans:		
Payable in Canadian funds due 1990 with average interest of 8.75% (1985 — 9.88%)	9.9	37.3
Payable in U.S. funds due 1988 to 1992 with average interest of 7.33% (1985 — 8.60%) (1986 — U.S. \$179.3 million; 1985 — U.S. \$275.5 million)	247.6	385.0
5.75% notes (Swiss francs 50.0 million)	—	28.4
5.625% notes due in 1992 (Swiss francs 125.0 million)	107.0	—
6.75% bearer bonds due in 1992 (deutsche marks 100.0 million)	69.1	—
Other	14.0	14.3
	2,093.9	2,131.5
Less current portion	(51.6)	(.3)
Long-term debt at current rates	\$2,042.3	\$2,131.2

(a) Syndicated Term Loan

The syndicated term loan is payable to a group of international banks. The loan bears interest at a rate equal to the London Inter-Bank Offer Rate (LIBOR) plus 5/8 of 1%, increasing to LIBOR plus 3/4 of 1% in 1987, with provision for a reduction in such rates by 1/8 of 1% in certain circumstances.

The loan agreement contains certain restrictive covenants. The primary covenants require the Company to maintain a specified ratio of current assets to current liabilities, a specified fixed charge coverage and a specified ratio of debt to the value of proved reserves. Certain other covenants include a limitation on the payment of dividends on the common shares relative to the ratio of debt to the value of proved reserves.

The loan is repayable in semi-annual installments commencing July 1987 and ending December 1997 and is unsecured.

(b) Interest Rate and Currency Swaps

The Company has entered into interest rate swap agreements which effectively convert the interest cost on \$172.6 million (U.S. \$125.0 million) of its existing floating rate notes and bank loans to a fixed rate of approximately 8.4% for five years.

The Company has also entered into currency swap agreements which effectively fix the repayment of the 6.75% deutsche mark bearer bonds at a principal amount of U.S. \$50.1 million and results in an effective cost of funds of 8.85%.

(c) Long-term Debt Repayments

Repayments of long-term debt for the next five years are as follows:

1987 — \$51.6 million; 1988 — \$117.9 million; 1989 — \$148.3 million; 1990 — \$227.5 million; and 1991 — \$250.2 million.

The Company has cash, short-term investments and undrawn committed credit facilities of \$347.0 million which may be applied to these repayments.

6. Convertible Subordinated Debentures

The convertible subordinated debentures bear interest at 8.5% per annum and mature June 15, 2000. The debentures are direct unsecured obligations of the Company and are subordinated to all other indebtedness of the Company. The 222,500 debentures are convertible at the holder's option into common shares in the capital of the Company any time prior to June 15, 1995, at 58.824 shares per debenture. The debentures may be redeemed by the Company after December 15, 1988 at a reducing premium until June 15, 1994, at which time they are redeemable at par. A sinking fund will be established in the years 1996 to 2000 inclusive in a sufficient amount to retire in each of such years 10% of the aggregate principal amount of debentures outstanding on June 15, 1995.

7. Capital

Authorized:

Unlimited number of preferred and common shares without par value.

Issued and to be issued:

	1986		1985	
	Shares	Amount	Shares	Amount
Balance at beginning of year	81,369,530	\$734.1	27,566,193	\$658.0
Stock split	—	—	48,240,837	—
Issued and to be issued for:				
— potash mining assets	6,382,141	35.9	—	—
— cash	—	—	5,562,500	76.1
Balance at end of year	87,751,671	\$770.0	81,369,530	\$734.1

- (a) During the year, the Company approved for issue 6,382,141 common shares at an ascribed value of \$35.9 million to acquire potash mining assets. See Note 12(d). The issue of these shares is subject to the parent company (Canada Development Corporation) obtaining certain consents under the terms of its bank loans.
- (b) The Company subdivided its issued and outstanding common shares on a 2.75-for-1 basis, effective April 26, 1985.
- (c) At December 31, 1986, options to purchase 1,836,585 common shares had been granted by the Company. The option price, the date at which options vest and become exercisable by the participants, and the date at which the options expire are summarized below:

Number of Shares Under Option	Exercise Price	Vesting Date	Expiry Date
34,148	\$6.50	January 1, 1987	January 31, 1987
873,887	\$6.50	January 1, 1987	January 1, 1992
873,550	\$6.50	January 1, 1988	January 1, 1992
27,500	\$6.50	January 1, 1988	December 5, 1993
27,500	\$6.50	January 1, 1990	December 5, 1993

- (d) The Company has reserved for issuance 13,088,235 common shares for purposes of the conversion privileges for the convertible subordinated debentures more fully discussed in Note 6.

8. Sales

The Company's sales are composed of oil, natural gas, sulphur and coal. Details of sales by product are as follows:

					1986	1985
	Oil	Natural Gas	Sulphur	Coal	Total	Total
Gross sales						
Produced	\$204.5	\$160.6	\$151.3	\$ 20.2	\$536.6	\$803.4
Purchased	—	—	96.5	—	96.5	120.4
Processed	—	23.7	—	—	23.7	21.3
	204.5	184.3	247.8	20.2	656.8	945.1
Royalties	45.4	41.4	18.3	—	105.1	177.8
Net sales	\$159.1	\$142.9	\$229.5	\$ 20.2	\$551.7	\$767.3

Sulphur sales are made from production or draw-down of stock-piles and are supplemented by buying sulphur from other producers. Cost of sulphur purchased and resold was \$59.8 million in 1986 (1985 — \$65.7 million) and is included in operating expenses.

9. Income and Other Taxes

A reconciliation of effective tax rates is set out below:

	1986	1985
Expected income tax rate	47%	47%
Computed "expected" income tax expense	\$(192.0)	\$112.6
Increase (decrease) in income tax resulting from:		
Non-deductible Crown charges less resource allowance and provincial rebates	9.3	8.3
Non-allowable depletion and depreciation	25.7	26.3
Non-allowable write-down of property, plant and equipment	126.9	—
Tax deductions allowed in excess of available book amounts	—	(9.8)
Earnings of subsidiaries	(4.5)	(5.7)
Processing tax credit	(9.3)	(17.2)
Other	(6.2)	(11.0)
Income tax expense	(50.1)	103.5
Petroleum and gas revenue and other production taxes	14.8	49.1
Total income and other taxes	\$ (35.3)	\$152.6

Included in the above are deferred PGRT of \$15.3 million (1985 — \$24.3 million) and a deferred income tax reduction of \$49.1 million (1985 — deferred income taxes of \$105.6 million). Deferred income taxes result from timing differences in recognition of income and expenses for income tax and financial statement purposes. The source of these differences and the tax effect of each were as follows:

	1986	1985
Capital cost allowance deducted for income tax purposes greater (less) than depreciation	\$ (.8)	\$ (7.3)
Exploration expenditures deducted for income tax purposes greater (less) than the provision for depletion	(23.6)	2.3
Write-down of property, plant and equipment	(75.7)	—
Capitalized interest deducted for income tax purposes	5.1	30.8
Net capital loss	—	(4.5)
Non-capital loss	—	51.3
Income deferred for income tax purposes	43.8	40.6
Other	2.1	(7.6)
Deferred income tax expense	\$ (49.1)	\$105.6

Certain U.S. subsidiary companies have tax loss carry forwards available for income tax purposes at December 31, 1986 of U.S. \$88.4 million and investment tax credits of U.S. \$5.0 million which expire from 1992 to 2001. The realization of these tax benefits is dependent upon the future taxable incomes of these subsidiaries. No recognition of the potential tax benefits has been taken into account.

10. Business Segments	1986				1985			
	Canada	United States	Other Foreign	Total	Canada	United States	Other Foreign	Total
Revenues								
Oil, natural gas and sulphur	\$ 487.6	\$ 43.9	\$ —	\$ 531.5	\$ 689.0	\$ 55.4	\$ —	\$ 744.4
Coal	—	20.2	—	20.2	—	22.9	—	22.9
Office buildings	6.9	—	—	6.9	6.6	—	—	6.6
Other	6.3	5.5	6.6	18.4	9.2	6.0	1.7	16.9
	\$ 500.8	\$ 69.6	\$ 6.6	\$ 577.0	\$ 704.8	\$ 84.3	\$ 1.7	\$ 790.8
Operating profits (losses) after write-down								
Oil, natural gas and sulphur	\$ (64.5)	\$ (68.3)	\$ —	\$ (132.8)	\$ 388.2	\$ 12.8	\$ —	\$ 401.0
Coal	—	(57.2)	—	(57.2)	—	(5.5)	—	(5.5)
Office buildings	(6.6)	(12.3)	—	(18.9)	2.6	—	—	2.6
Other	6.3	5.5	6.6	18.4	9.2	6.0	1.7	16.9
	\$ (64.8)	\$ (132.3)	\$ 6.6	\$ (190.5)	\$ 400.0	\$ 13.3	\$ 1.7	\$ 415.0
Administrative				(38.8)				(45.6)
Foreign exchange				(19.0)				(18.1)
Financing costs				(172.2)				(158.9)
Earnings (loss) before income taxes				(420.5)				192.4
Income taxes				47.3				(105.5)
Earnings (loss)				\$ (373.2)				\$ 86.9
Depletion and depreciation								
Oil, natural gas and sulphur	\$ 132.3	\$ 21.4	\$ —	\$ 153.7	\$ 117.8	\$ 25.1	\$ —	\$ 142.9
Coal	—	4.7	—	4.7	—	4.7	—	4.7
Office buildings and other	1.1	—	—	1.1	1.2	—	—	1.2
	\$ 133.4	\$ 26.1	\$ —	\$ 159.5	\$ 119.0	\$ 29.8	\$ —	\$ 148.8
Write-down								
Oil, natural gas and sulphur	\$ 281.0	\$ 75.2	\$ —	\$ 356.2				
Coal	—	52.7	—	52.7				
Office buildings and other	10.0	12.3	—	22.3				
	\$ 291.0	\$ 140.2	\$ —	\$ 431.2				
Identifiable assets								
Oil, natural gas and sulphur	\$3,020.2	\$ 215.6	\$.4	\$3,236.2	\$3,311.2	\$304.6	\$.5	\$3,616.3
Coal	—	29.0	—	29.0	—	72.7	—	72.7
Office buildings	51.3	—	—	51.3	62.4	—	—	62.4
Other	—	—	15.4	15.4	—	—	33.5	33.5
	\$3,071.5	\$ 244.6	\$15.8	\$3,331.9	\$3,373.6	\$377.3	\$34.0	\$3,784.9

11. Consolidated Statement of Changes in Financial Position

The consolidated statement of changes in financial position has been prepared on the basis of changes in cash and short-term investments net of bank indebtedness.

(a) Operating Activities

- (i) Non-cash items and financing costs less capitalized exploration overhead

	1986	1985
Financing costs	\$ 172.2	\$ 158.9
Depletion and depreciation	159.5	148.8
Write-down of property, plant and equipment	431.2	—
Deferred income and other taxes	(33.8)	129.9
Foreign exchange	19.0	18.1
Capitalized exploration overhead	(13.9)	(7.8)
	\$ 734.2	\$ 447.9

- (ii) Changes in operating working capital
(bracketed items reflect decreases in working capital)

	1986	1985
Accounts receivable	\$ (46.3)	\$ 21.0
Petroleum Incentive Program grants receivable	(15.2)	13.1
Inventories	(13.6)	(22.6)
Prepaid expenses	2.0	(4.3)
Accounts payable and accrued liabilities	47.6	(38.9)
Due to parent company	—	27.5
Current portion of deferred production revenue	(.8)	(.5)
	\$ (26.3)	\$ (4.7)

Operating working capital consists of working capital other than cash and short-term investments net of bank indebtedness and current portion of long-term debt.

(b) Investing Activities

- Expenditures on property, plant and equipment

	1986	1985
Canadian Frontier	\$ 48.2	\$ 73.8
Western Canada exploration	63.0	113.8
Western Canada production	48.2	79.9
United States and other	9.0	31.0
	168.4	298.5
Less Petroleum Incentive Program and provincial grants	57.5	84.6
	\$ 110.9	\$ 213.9

The above capital expenditures do not include capitalized financing costs and exploration overhead of \$28.7 million in 1986 (1985 — \$73.4 million).

12. Related Party Transactions

- (a) Sulphur sales after royalties by the Company through Cansulex Limited were \$188.5 million (1985 — \$247.5 million). At December 31, 1986 and 1985, Cansulex Limited was indebted to the Company for \$9.4 million and \$25.4 million, respectively.
- (b) Included in financing costs are \$6.2 million paid to the parent company in respect of \$72.5 million of convertible subordinated debentures held by the parent company.
- (c) The Company entered into agreements with Polysar Limited, a subsidiary of the parent company, to sell natural gas and oil. During the year, 52.5 million cubic metres of natural gas were sold for an aggregate value of \$3.8 million, and 213.7 thousand cubic metres of oil were sold for an aggregate value of \$22.9 million.
- (d) Effective November 30, 1986, the Company purchased from the parent company potash mining assets consisting of a 40% interest in the Allan Potash Mine, Allan, Saskatchewan for \$33.0 million. Consideration was \$35.9 million in shares less a cash adjustment of \$2.9 million.

13. Other Information**(a) Pensions**

The Company contributes to pension plans and coal union health and retirement benefit plans for employees. The plans maintained by the Company are funded based on determinations by the Company's independent actuarial consultant and costs were nil in 1986 (1985 — \$1.2 million). In addition, costs of contributions to the coal union health and retirement plans were nil in 1986 (1985 — \$0.6 million).

In the case of pension plans covering Canadian employees, the present value based on an interest factor of 7.5% of vested and non-vested benefits was \$26.9 million, determined as at July 1, 1986, the date of the latest actuarial valuation of the plan. The plan earned an effective net rate of return of 25.5% for the year. The pension plan covering United States employees not covered by coal union health and retirement plans had present values of vested and non-vested benefits of \$2.6 million computed using a rate of return of 8.5% and determined as at January 1, 1986, the date of the latest actuarial valuation. The assets of these plans are approximately equal to plan liabilities.

Under the provisions of the coal union agreements, the companies have guaranteed the benefits provided during the terms of the contract. Vested benefits under these plans may be underfunded and the companies may have future liabilities under the provisions of the U.S. pension legislation. It is not anticipated that the Company's share of such liabilities will have a material effect on the Company's financial position.

(b) Rental Obligations

The annual rental obligations for buildings and equipment under long-term leases are: 1987 — \$4.5 million; 1988 — \$7.6 million; 1989 — \$14.8 million; 1990 — \$14.2 million; 1991 — \$13.2 million.

14. Earnings and Free Cash Flow per Common Share

Earnings and free cash flow per common share have been calculated on the basis of the weighted average number of common shares outstanding for the year ended December 31, 1986. Refer to Note 7. Fully diluted amounts per share have been calculated assuming the conversion of all convertible subordinated debentures at date of issue and exercise of all options at date of issue.

	1986	1985
Weighted average number of shares		
Basic	81,911,576	78,809,257
Fully diluted	96,814,988	86,294,554

15. Quarterly Financial Information (unaudited)

	1st Quarter		2nd Quarter		3rd Quarter		4th Quarter	
	1986	1985	1986	1985	1986	1985	1986	1985
Revenues	\$ 181.0	\$ 211.0	\$ 132.2	\$ 201.2	\$ 134.4	\$ 180.4	\$ 129.4	\$ 198.2
Expenses	(142.7)	(128.6)	(131.1)	(145.3)	(142.4)	(135.0)	(569.3)	(142.4)
Income and other taxes	(24.9)	(60.2)	(9.7)	(37.3)	(5.5)	(29.2)	75.4	(25.9)
Earnings (loss)	\$ 13.4	\$ 22.2	\$ (8.6)	\$ 18.6	\$ (13.5)	\$ 16.2	\$(364.5)	\$ 29.9
Free cash flow	\$ 81.1	\$ 90.1	\$ 34.6	\$ 70.3	\$ 27.5	\$ 60.8	\$ 30.8	\$ 89.1
Earnings (loss) per share								
Basic	\$ 0.16	\$ 0.29	\$ (0.10)	\$ 0.25	\$ (0.17)	\$ 0.19	\$ (4.45)	\$ 0.37
Fully diluted	\$ 0.16	\$ 0.29	\$ (0.10)	\$ 0.24	\$ (0.17)	\$ 0.19	\$ (4.45)	\$ 0.35
Free cash flow per share								
Basic	\$ 1.00	\$ 1.19	\$ 0.42	\$ 0.92	\$ 0.34	\$ 0.73	\$ 0.36	\$ 1.10
Fully diluted	\$ 0.87	\$ 1.19	\$ 0.39	\$ 0.89	\$ 0.31	\$ 0.62	\$ 0.34	\$ 0.98

Auditors' Report

To the Shareholders of Canterra Energy Ltd.

We have examined the consolidated balance sheet of Canterra Energy Ltd. as at December 31, 1986 and the consolidated statements of earnings, retained earnings (deficit) and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, the consolidated financial statements referred to above (pages 18, 20 and 22 to 30) present fairly the financial position of the Company as at December 31, 1986 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Thorne Ernst + Whinney

Chartered Accountants

Calgary, Alberta
January 29, 1987

Management's Responsibility for Financial Statements

The preceding consolidated financial statements of the Company were prepared by management in accordance with accounting principles generally accepted in Canada and consistently applied. The significant accounting policies, which management believes are appropriate for the Company, are described in Notes to Consolidated Financial Statements (Note 1). The financial information contained elsewhere in this annual report is consistent with that in the financial statements.

Management is responsible for the integrity and objectivity of the financial statements. In the preparation of these statements, estimates are sometimes necessary when transactions affecting the current accounting period cannot be finalized with certainty until future periods. Such estimates are based on careful judgements and have been properly reflected in the financial statements. Management has established systems of internal control that are designed to provide reasonable assurance that assets are safeguarded from loss or unauthorized use and to produce reliable accounting records for the preparation of financial information.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal control. The board exercises its responsibilities through the Audit Committee of the board, comprising directors who are not employees of the Company. The committee meets with management as well as with the internal and external auditors to satisfy itself that each group is properly discharging its responsibilities and to review the financial statements and the external auditors' report. The

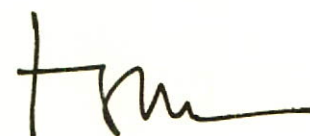
Audit Committee reports its findings to the board for consideration in approving the financial statements for issuance to the shareholders.

In management's opinion, the financial statements fairly present the financial position, the operations and cash resources of the Company.

Management recognizes its responsibility for conducting the Company's affairs in compliance with established financial standards and applicable laws and maintains proper standards of conduct for its activities.



B. F. Isautier
*Chairman and
Chief Executive Officer*



T. S. Ahern
Vice-President, Finance

Five-Year Financial Summary

Earnings (millions)

	1986	1985	1984	1983	1982
Revenues					
Sales (net after royalties)					
Oil and natural gas liquids	\$ 159.1	\$ 308.5	\$ 280.3	\$ 271.1	\$ 231.1
Natural gas	119.2	140.9	144.7	135.4	131.8
Sulphur	229.5	273.7	157.3	85.8	142.2
Coal	20.2	22.9	40.5	34.7	43.3
Processing income	23.7	21.3	24.4	22.3	18.6
Investment and other income	25.3	23.5	22.4	34.2	33.9
Total revenues	577.0	790.8	669.6	583.5	600.9
Expenses					
Production					
Oil, natural gas and sulphur	84.8	89.2	72.7	60.7	60.9
Sulphur cost of sales	59.8	65.7	2.3	22.0	32.1
Coal	20.2	25.0	34.2	28.1	40.4
Financing costs	172.2	158.9	165.3	148.2	229.6
Administrative	38.8	45.6	40.0	41.0	42.3
Foreign exchange	19.0	18.1	(3.7)	—	—
Depletion and depreciation	159.5	148.8	142.2	127.6	123.0
Write-down of property, plant and equipment	431.2	—	—	—	—
Total expenses	985.5	551.3	453.0	427.6	528.3
Earnings (loss) before undernoted items	(408.5)	239.5	216.6	155.9	72.6
Income and other taxes					
Current	(1.0)	(2.1)	(1.1)	(3.5)	(20.7)
Deferred	(49.1)	105.6	120.2	86.1	53.0
Petroleum and gas revenue and other taxes	(0.5)	24.8	56.1	58.6	58.2
Deferred Petroleum and Gas Revenue Tax	15.3	24.3	—	—	—
	(35.3)	152.6	175.2	141.2	90.5
Earnings (loss) before parent company transactions	(373.2)	86.9	41.4	14.7	(17.9)
Parent company transactions	—	—	—	10.1	(42.0)
Earnings (loss)	\$(373.2)	\$ 86.9	\$ 41.4	\$ 24.8	\$ (59.9)

Earnings by Lines of Business (millions)

Oil, natural gas and sulphur					
Canada	\$ (64.5)	\$ 388.2	\$ 351.8	\$ 259.4	\$ 248.0
United States	(68.3)	12.8	(9.0)	(3.1)	15.0
Coal					
United States	(57.2)	(5.5)	2.4	3.1	1.3
Office buildings					
Canada	(6.6)	2.6	4.7	5.4	5.0
United States	(12.3)	—	—	—	—
Other					
Canada	6.3	9.2	10.1	13.3	13.0
United States	5.5	6.0	1.2	2.1	1.9
Other foreign	6.6	1.7	2.9	10.3	6.7
Unallocated expenses	(230.0)	(222.6)	(201.6)	(189.2)	(271.9)
Income taxes	47.3	(105.5)	(121.1)	(86.6)	(36.9)
Parent company transactions	—	—	—	10.1	(42.0)
Earnings (loss)	\$(373.2)	\$ 86.9	\$ 41.4	\$ 24.8	\$ (59.9)

The Company was formed in 1981. However, as 1982 was the first full year of Company operations, all summarized historical data are shown for five years.

Five-Year Financial Summary

	1986	1985	1984	1983	1982
Financial Position					
(millions)					
Current assets	\$ 255.9	\$ 265.1	\$ 229.6	\$ 196.2	\$ 247.0
Investments and other assets	79.8	61.4	48.6	66.7	42.7
Property, plant and equipment (net)	2,711.9	3,149.8	3,012.7	2,869.7	2,729.7
Deferred foreign exchange	284.3	308.6	202.7	62.4	37.7
	\$3,331.9	\$3,784.9	\$3,493.6	\$3,195.0	\$3,057.1
Current liabilities	\$ 146.3	\$ 148.1	\$ 130.4	\$ 137.0	\$ 126.9
Long-term debt	2,264.8	2,353.7	493.3	457.3	463.6
Notes payable to parent company	—	—	1,865.8	1,757.1	1,735.9
Deferred production revenue and other credits	42.6	33.8	38.2	39.3	37.3
Deferred Petroleum and Gas Revenue Tax	39.6	24.3	—	—	—
Deferred income taxes	348.6	397.7	301.6	181.4	95.3
Shareholders' equity	490.0	827.3	664.3	622.9	598.1
	\$3,331.9	\$3,784.9	\$3,493.6	\$3,195.0	\$3,057.1
Property, Plant and Equipment					
(millions)					
Gross investment					
Oil, natural gas and sulphur					
Canada	\$3,381.7	\$3,249.8	\$2,991.7	\$2,726.3	\$2,487.5
United States	295.2	290.9	269.3	256.2	227.6
Coal					
United States	40.2	81.4	79.2	75.5	75.3
Office buildings					
Canada	57.1	67.1	67.1	67.1	67.1
Other	5.5	17.9	17.9	17.8	17.8
	\$3,779.7	\$3,707.1	\$3,425.2	\$3,142.9	\$2,875.3
Net investment					
Oil, natural gas and sulphur					
Canada	\$2,570.1	\$2,848.2	\$2,707.2	\$2,538.5	\$2,391.0
United States	63.9	156.0	159.4	183.8	186.8
Coal					
United States	21.1	65.3	66.0	65.7	68.4
Office buildings					
Canada	51.3	62.4	62.2	63.9	65.7
Other	5.5	17.9	17.9	17.8	17.8
	\$2,711.9	\$3,149.8	\$3,012.7	\$2,869.7	\$2,729.7

Five-Year Financial Summary

Capital Expenditures* (millions)

	1986	1985	1984	1983	1982
Exploration					
Frontier Canada	\$ 48.2	\$ 73.8	\$ 92.0	\$ 165.3	\$ 119.8
Less PIP grants	(36.2)	(53.1)	(71.3)	(130.5)	(82.0)
	12.0	20.7	20.7	34.8	37.8
Western Canada	63.0	113.8	87.3	87.8	107.6
Less PIP grants	(15.7)	(22.2)	(19.5)	(20.7)	(45.6)
	47.3	91.6	67.8	67.1	62.0
United States	4.4	19.5	10.2	14.6	25.1
	\$ 63.7	\$ 131.8	\$ 98.7	\$ 116.5	\$ 124.9
Production					
Western Canada	\$ 47.8	\$ 79.0	\$ 43.8	\$ 49.0	\$ 52.2
Less PIP grants	(5.6)	(9.2)	(2.9)	(2.0)	1.8
	42.2	69.8	40.9	47.0	54.0
United States					
Oil, natural gas and sulphur	0.4	3.6	4.1	4.0	15.4
Coal	0.8	3.7	4.7	1.9	1.7
	\$ 43.4	\$ 77.1	\$ 49.7	\$ 52.9	\$ 71.1
Heavy oil and tar sands	\$ 0.4	\$ 0.9	\$ 2.5	\$ 1.4	\$ 8.9
Less PIP grants	—	(0.1)	(0.4)	(0.2)	(2.1)
	\$ 0.4	\$ 0.8	\$ 2.1	\$ 1.2	\$ 6.8
Adjustment of prior year PIP claims	\$ —	\$ —	\$ 8.0	\$ —	\$ —
Other	\$ 3.4	\$ 4.2	\$ 2.0	\$ 2.3	\$ 7.2
Total expenditures	\$ 168.4	\$ 298.5	\$ 246.6	\$ 326.3	\$ 337.9
Petroleum Incentive Program and provincial grants	(57.5)	(84.6)	(86.1)	(153.4)	(127.9)
Net capital expenditures	\$ 110.9	\$ 213.9	\$ 160.5	\$ 172.9	\$ 210.0

* Capital expenditures do not include capitalized financing costs and exploration overhead of \$28.7 million in 1986, \$73.4 million in 1985, \$113.0 million in 1984, \$89.6 million in 1983 and \$132.3 million in 1982.

Government Taxes and Royalties (millions)

Property taxes	\$ 2.8	\$ 2.7	\$ 2.7	\$ 2.6	\$ 2.5
Petroleum and Gas Revenue Tax					
Current	(1.9)	21.6	52.4	54.0	51.9
Deferred	15.3	24.3	—	—	—
Windfall profits and severance taxes	1.4	3.2	3.7	4.6	6.3
Income taxes					
Current	(1.0)	(2.1)	(1.1)	(3.5)	(20.7)
Deferred	(49.1)	105.6	120.2	86.1	15.7
Royalties	95.1	130.6	148.8	153.8	140.5
	\$ 62.6	\$ 285.9	\$ 326.7	\$ 297.6	\$ 196.2

Five-Year Financial Summary

	1986	1985	1984	1983	1982
Ratios					
Current ratio (1)	1.7	1.8	1.8	1.4	1.9
Debt to equity (2), (3)	4.7	2.8	3.6	3.6	3.7
Debt to equity plus deferred taxes (4)	2.8	1.9	2.4	2.8	3.2
Interest coverage (5)	1.9	2.4	1.7	1.6	1.1
Reinvestment of cash flow (6)	0.6	0.7	0.9	1.2	8.1
(1) Current ratio	= Current assets divided by current liabilities.				
(2) Debt	= Long-term debt, convertible subordinated debentures, syndicated loan and current portion of long-term debt.				
(3) Equity	= Shareholders' equity.				
(4) Deferred taxes	= Deferred PGRT and deferred income taxes.				
(5) Interest coverage	= Cash flow before interest payments divided by interest payments.				
(6) Reinvestment of cash flow	= Net capital expenditures divided by free cash flow.				

	Change	Impact on Free Cash Flow	Impact on Earnings
Financial Sensitivities (millions of dollars)			
Interest rate (U.S.)	1%	17.1	9.8
Oil price	\$1.00 (Cdn.)/bbl (\$6.29/m ³)	6.6	4.0
Gas price	\$0.10/mcf (\$3.55/10 ³ m ³)	5.3	3.3
Sulphur	\$1.00 (Cdn.)/tonne	0.8	0.5
Exchange rate *	1¢ decline	5.0	3.0

* A strengthening U.S. dollar relative to the Canadian dollar (e.g. from \$0.73 to \$0.72) has a positive impact on the company's cash flow and earnings.

Five-Year Operating Summary

	1986	1985	1984	1983	1982
Sales Volumes					
Oil and natural gas liquids (m ³ per day)					
Before royalties					
Canada	4,277	4,678	4,734	5,003	5,074
United States	298	357	375	444	463
After royalties					
Canada	3,392	3,519	3,388	3,323	3,378
United States	244	293	308	363	378
Natural gas (10 ³ m ³ per day)					
Before royalties					
Canada	4,910	4,978	4,894	4,802	4,863
United States	395	387	275	265	312
After royalties					
Canada	3,653	3,572	3,513	3,419	3,225
United States	288	293	209	201	233
Sulphur (10 ³ t per year)					
Before royalties					
Canada	1,579	1,968	1,704	1,096	1,388
United States	161	137	313	121	153
After royalties					
Canada	1,444	1,776	1,420	1,003	1,247
United States	161	137	313	121	153
Coal (10 ³ t per year)					
United States	499	470	887	804	924
Average Prices (dollars) (gross)					
Oil and natural gas liquids (per m ³)					
Canada	\$122	\$222	\$207	\$197	\$158
United States	122	218	234	233	249
Gas (per 10 ³ m ³)					
Canada	82	96	103	101	100
United States	89	142	166	145	164
Sulphur (per t)					
Consolidated	142	142	89	74	100
Coal (per t)					
United States	40	49	46	43	47
Net Land Holdings (thousands of hectares)					
Oil and natural gas					
Western Canada	956	995	927	1,012	1,142
Frontier Canada	446	1,386	1,295	2,571	2,510
United States	23	81	226	268	370
Coal					
United States	13	13	15	15	15

Five-Year Operating Summary

	1986	1985	1984	1983	1982
Proved Reserves					
Oil and natural gas liquids (10 ⁶ m ³)					
Before royalties					
Canada	21.9	19.2	17.8	16.2	14.7
United States	0.4	0.5	0.5	0.4	0.5
After royalties					
Canada	17.2	14.8	13.3	11.8	10.1
United States	0.3	0.4	0.4	0.4	0.4
Natural gas (10 ⁹ m ³)					
Before royalties					
Canada	38.6	37.2	37.3	37.7	41.8
United States	1.3	1.4	1.3	1.3	0.8
After royalties					
Canada	30.2	28.7	27.9	27.7	30.3
United States	0.9	1.0	0.9	0.9	0.6
Sulphur (10 ⁶ t)					
Before royalties					
Canada	12.3	12.9	14.3	15.7	16.1
After royalties					
Canada	11.2	11.8	12.9	14.2	15.1
Coal (10 ⁶ t)					
United States	33.5	34.2	51.1	55.4	55.4
Seismic Activity					
Two dimensional (10 ³ km)					
Western Canada	4.3	14.5	10.7	9.5	10.8
Frontier Canada	5.5	30.4	67.7	15.4	126.3
United States	0.2	1.8	0.6	0.9	0.6
Three dimensional (10 ³ km ²)					
Western Canada	0.1	0.2	—	—	—
Sulphur Operations (10 ³ t)					
Sulphur volumes (gross)					
Canada	71	85	178	109	139
United States	161	137	313	121	153
Offshore	1,508	1,883	1,526	987	1,249
	1,740	2,105	2,017	1,217	1,541
Source of supply					
Production	668	714	805	820	800
Purchases	504	395	382	416	448
Inventories	568	996	830	(19)	293
	1,740	2,105	2,017	1,217	1,541
Year-end inventories	2,469	3,038	3,954	4,631	4,650

Five-Year Operating Summary

Wells Drilled

	1986		1985		1984		1983		1982	
	Gross	Net	Gross	Net	Gross	Net	Gross	Net	Gross	Net
Western Canada — Exploratory										
Oil	20	10.4	41	22.8	58	22.5	34	13.9	22	12.4
Gas	14	8.1	15	6.3	19	3.5	27	10.0	54	24.8
Dry and abandoned/ suspended	27	18.0	58	30.2	59	25.7	47	27.5	27	12.5
	61	36.5	114	59.3	136	51.7	108	51.4	103	49.7
Western Canada — Development										
Oil	137	24.2	119	38.2	95	21.5	65	15.7	56	13.1
Gas	50	9.9	108	11.7	9	5.7	10	3.5	13	5.2
Dry and abandoned/ suspended	3	2.4	25	9.4	7	1.4	3	0.9	3	0.8
Water injection	2	1.0	—	—	—	—	—	—	—	—
	192	37.5	252	59.3	111	28.6	78	20.1	72	19.1
United States — Exploratory										
Oil	3	1.3	11	2.4	9	2.2	4	0.8	10	3.7
Gas	4	0.7	7	1.6	5	1.2	8	1.3	2	0.5
Dry and abandoned/ suspended	2	0.4	20	5.8	13	3.0	14	6.1	17	4.5
	9	2.4	38	9.8	27	6.4	26	8.2	29	8.7
United States — Development										
Oil	—	—	—	—	2	0.3	3	0.4	6	0.6
Gas	—	—	2	0.5	1	0.5	—	—	6	0.9
Dry and abandoned/ suspended	1	0.3	1	0.4	—	—	—	—	6	2.2
	1	0.3	3	0.9	3	0.8	3	0.4	18	3.7
Frontier Canada										
Oil	3	0.3	4	0.3	1	0.1	—	—	2	0.1
Gas	5	0.9	6	0.8	4	0.5	1	0.2	2	0.1
Dry and abandoned/ suspended	5	0.7	10	0.9	8	0.8	8	1.1	4	0.9
	13	1.9	20	2.0	13	1.4	9	1.3	8	1.1

Number of Employees

	1986	1985	1984	1983	1982
Canada	923	1,063	1,100	1,089	1,071
United States — oil and gas	33	60	59	63	75
United States — coal	215	214	241	232	340
	1,171	1,337	1,400	1,384	1,486

Corporate Information

Directors

Bernard F. Isautier*‡
*Chairman and
 Chief Executive Officer
 Canterra Energy Ltd.
 Toronto, Ontario*

Edward W. Best*
*Consultant
 Foster Research
 Calgary, Alberta*

E. Kendall Cork
*Senior Vice-President
 and Treasurer
 Noranda Inc.
 Toronto, Ontario*

Paul W. Douglas‡
*Chairman and
 Chief Executive Officer
 The Pittston Company
 Greenwich, Connecticut*

John B. Hague*
*President and
 Chief Operating Officer
 Canterra Energy Ltd.
 Calgary, Alberta*

H. Anthony Hampson‡
*Deputy Chairman and
 Chief Executive Officer
 Canada Development
 Corporation
 Toronto, Ontario*

John R. McCaig‡
*Chairman and
 Chief Executive Officer
 Trimac Limited
 Calgary, Alberta*

John O. O'Brien*†
*President
 J. O'Brien Petroleum Inc.
 Calgary, Alberta*

Daniel P. Owen†
*Vice-President
 Canada Development
 Corporation
 Toronto, Ontario*

H. Gordon Pearce†
*President
 Pearce Consulting Services
 Limited
 Calgary, Alberta*

Stanley G. B. Pearson*
*President
 S.G.B. Pearson Holdings Ltd.
 Cremona, Alberta*

John D. Redfern‡
*Chairman
 Lafarge Corporation
 Montreal, Quebec*

Officers

Bernard F. Isautier
*Chairman and
 Chief Executive Officer*

John B. Hague
*President and
 Chief Operating Officer*

John H. Currie
*Senior Vice-President,
 Administration*

W. Stewart Wright
*General Counsel and
 Corporate Secretary*

Lawrence E. Dunn
Assistant Secretary

William L. Kaufmann
*Senior Vice-President,
 Exploration
 President,
 Canterra Petroleum Inc.*

William W. Taylor
*Vice-President,
 Exploration Operations*

Douglas K. Thompson
*Executive Vice-President,
 Canterra Petroleum Inc.
 (Officer of Canterra Petroleum Inc.)*

J. Lindsay Milne
*Senior Vice-President,
 Production*

Kenneth J. Fitzgerald
*Vice-President,
 Production Operations*

T. Sean Ahern
Vice-President, Finance

Clarence E. Glessing
Controller

Richard P. Norris
Treasurer

Jean-Jacques Pascal
Vice-President, Coal

D. Michael G. Stewart
*Vice-President,
 Corporate Development
 and Marketing*

Auditors

Thorne Ernst & Whinney
*Chartered Accountants
 12th Floor,
 Bow Valley Square Two
 205 - 5 Avenue S.W.
 Calgary, Alberta
 T2P 4B9*

Corporate Offices

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 Telefax: (303) 575-0456*

Canterra Coal Inc.
*Three Parkway Center
 Pittsburgh, Pennsylvania
 U.S.A. 15220
 Phone: (412) 928-4100
 Telex: 86-6387*

Canterra Sulphur Inc.
*Three Parkway Center
 Pittsburgh, Pennsylvania
 U.S.A. 15220
 Phone: (412) 928-8626*

† Audit Committee

‡ Compensation Committee

* Executive Committee

Conversion Table

To Convert from	To	Multiply by
metres (m)	feet (well depths)	3.2808
kilometres (km)	miles (distance)	0.6214
hectares (ha)	acres (land)	2.47
1,000 cubic metres (10 ³ m ³)	thousand cubic feet (mcf gas)	35.494
cubic metres (m ³)	barrels (oil)	6.29
tonnes (t)	long tons (sulphur)	0.9842
tonnes (t)	short tons (coal)	1.10231
gigajoules (GJ)	Millions of British Thermal Units (Mmbtu - gas)	0.948

Shareholder Information

The Annual General Meeting of Shareholders will be held on Friday, May 8, 1987 at 10:00 a.m. at the Aquitaine Tower Auditorium, second floor, 540 - 5 Avenue S.W., Calgary, Alberta.

Canterra became a public company during 1985. Shares are listed on the Toronto, Montreal and Alberta stock exchanges and trade under the symbol "CEN".

1986 share prices on The Toronto Stock Exchange:
High \$9.125, low \$4.75
December 31, 1986 \$5.125

The registrar and transfer agent is the Royal Trust Company. Offices are located in Calgary, Halifax, Montreal, Toronto, Winnipeg, Regina and Vancouver.

For information regarding share certificates, registration and change of address, share valuation, dividends, proxies and other related shareholder business, contact:

William H. Murphy
Director,
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Formed sulphur is transported by conveyor belt into storage prior to shipment.

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