Bralorne Resources Limited

1988 Annual Report

1988 Highlights

(in thousands of dollars)

	1988	1987
From continuing operations:		
Gross revenue	**$10,189**	$12,010
Cash flow	**$ 2,811**	$ 5,540
Loss (income) after taxes	**$10,942**	$(1,233)
Loss from discontinued operations	**$17,523**	$37,332
Extraordinary items	**—**	$(7,248)
Loss for the year	**$28,465**	$28,851
Per common share (in dollars):		
Loss from continuing operations	**$ 0.56**	$ 0.06
Loss for the year	**$ 1.28**	$ 1.35

Contents

Annual Meeting

The annual meeting of shareholders will be held in the Auditorium, Bow Valley Square 2, 205 - 5th Ave. S.W., Calgary, Alberta on Wednesday, May 24, 1989 at 1:30 p.m.

Report to Shareholders

Overview

1988 was another challenging year for Bralorne. Oil prices dropped to a low of U.S. $12 per barrel in November, with an average price of U.S. $16 per barrel compared to U.S. $19 per barrel in 1987. Concurrently, natural gas prices declined by approximately 10% as a result of gas-to-gas and gas-to-oil competition in Canada and the United States. Drilling and seismic activity in the United States remained low, resulting in minimal demand for the Corporation's U.S. manufactured products. Bralorne's Canadian manufacturing units experienced better market conditions as new equipment was purchased by natural gas exporters and government incentives improved general drilling and seismic activity levels.

Notwithstanding these market conditions I am pleased to report to all shareholders that Bralorne has now stabilized its financial condition and is positioned to consider new investment opportunities and return to profitability. As a result of the comprehensive reorganization approved by shareholders and lenders in the fourth quarter of 1988, along with an agreement reached in the first quarter of 1989 to sell our Barber Industries manufacturing unit, the Corporation's long-term debt will be significantly reduced and funds will be available for expansion of the Corporation's oil and gas exploration and production activities. Debt will be further reduced when the remaining industrial units in the United States have been sold.

Reorganization

As 1988 progressed and market conditions deteriorated, it became evident that the Corporation would be unable to meet the debt servicing requirements of the rescheduling agreements signed with its lenders in 1987. With the support of B.C. Pacific Capital Corporation, our major shareholder, the Corporation developed a comprehensive financial restructuring proposal that called for conversion of some debt to equity, conversion of the preferred to common shares and the raising of new capital. Lenders agreed to the reorganization proposal in October 1988 and shareholders overwhelmingly approved the proposal at the November 22, 1988 Special Meeting of Shareholders. Under the terms of this reorganization:

(1) On January 20, 1989, lenders converted $28,560,000 of long-term debt and $3,307,000 of accrued interest to equity. As part of these transactions, B.C. Pacific Capital Corporation purchased the $14,000,000 of Bralorne 12⅞% debentures now outstanding;

(2) Effective February 8, 1989, preferred shareholders converted their shares into common shares on the basis of 12 common shares for each preferred share; and

(3) New equity was raised through a rights offering to all shareholders for new common shares and new Participating Special shares. B.C. Pacific Capital

Corporation participated in the rights offering to ensure that a minimum $15,000,000 of common share equity and $25,000,000 of Participating Special share equity was raised. On February 28, 1989, the proceeds were received on the issue of common shares. The rights offering for Participating Special shares was completed on March 22, 1989.

The Corporation used the $15,000,000 of proceeds from the common share rights offering to repay debt. The $25,000,000 raised from the issue of Participating Special shares will be retained in the Corporation for investment purposes.

The Corporation's future activities will focus on the exploration and development of oil and natural gas. Consequently, offering memorandums have been prepared and discussions have commenced with prospective buyers of the United States industrial units. The sale of our Canadian Division, Barber Industries, was completed on February 28, 1989.

Financial Results

When negotiations began in February and March 1989 with qualified purchasers for the United States manufacturing units, it became evident that the carrying value of these operations was higher than their net realizable value and a non-cash write-down of these assets would ultimately be required. As a result it was decided to reflect, in the 1988 financial statements rather than the 1989 first quarter report, a $8,989,000 non-cash write-down of the carrying value of the United States manufacturing units.

In the 1988 financial statements, these units have been recorded on the equity method of accounting under which the net investment in the manufacturing units is segregated into one item on the Balance Sheet (referred to as Net Investment in Industrial Units Held for Sale) and their operating results are shown on the Consolidated Statement of Operations under the caption, Discontinued Businesses and Units Held for Sale.

Revenue from continuing oil and gas operations was $10,189,000 for the year compared to $12,010,000 in 1987. The loss for the year from continuing operations was $10,942,000 after providing for additional depletion of $13,500,000 on the write-down of oil and gas assets reported in the third quarter as a result of declines in oil and natural gas prices. For 1987, net income from continuing operations was $1,233,000.

The 15% decline in revenue from continuing oil and gas operations for 1988, referred to above, reflects lower oil and natural gas prices and normal declines in the Corporation's mature gas fields. Capital expenditures have been restricted for the past several years due to Bralorne's financial condition and, as a result, few reserves have been developed.

Outlook

The Corporation has taken a major step towards being repositioned as an oil and gas exploration and production company with the recent completion of the sale of Barber Industries. Negotiations for the disposition of the two remaining United States operations, OMSCO Industries and Mark Products, are proceeding satisfactorily.

With the new cash injection, Bralorne has in place the capital base for building a strong oil and gas company and is well positioned to increase asset values, improve production revenues and return to profitability. The first step will be to develop strategies aimed at expanding our reserves and oil and natural gas production base.

I would like to take this opportunity to thank Reginald Worsley for his significant contribution to Bralorne as a Director and as the Corporation's Vice President Manufacturing, Canada. Mr. Worsley left the Corporation to continue as President of Barber Industries when Bralorne sold that unit.

Once again, Bralorne's employees have performed admirably in trying times and I would like to thank them for their efforts and hard work.

On behalf of the Board:

William F. Limin

March 22, 1989

Financial Review

Bralorne's financial statements reflect the new strategy of the Corporation to divest of its Canadian and United States manufacturing businesses and concentrate its operations in the exploration for and production of oil and natural gas. As a result, in the Balance Sheet as at December 31, 1988 the net investment in the industrial units is being carried as one item called Net Investment in Industrial Operations Held for Sale. Similarly, the Consolidated Statement of Operations shows the continuing oil and natural gas operations and the discontinued businesses separately.

In 1988, the Corporation developed and negotiated the financial reorganization which was completed in the first quarter of 1989. Under this reorganization:

(1) Lenders converted $28,560,000 of long-term debt and $3,307,000 of accrued interest into equity;

(2) Preferred shareholders exchanged their shares (including $7,575,000 of dividends in arrears) for common shares on the basis of 12 common shares for each preferred share; and

(3) New equity was raised through rights issues. On February 28, 1989, $15,000,000 was raised through the issue of common shares and an additional $25,000,000 was raised through the issue of Participating Special shares pursuant to a rights offering that closed March 22, 1989. Bralorne's major shareholder, B.C. Pacific Capital Corporation, participated in these offerings.

As part of the debt conversion referred to in (1) above, B.C. Pacific Capital Corporation acquired the Corporation's 12⅞% Debentures, Series A and is the sole holder of the $14,000,000 of these debentures outstanding.

The Subsequent Events Note (Note 10 to the Financial Statements) provides details of the capital reorganization and the sale of the Barber Industries Division which were completed in the first quarter of 1989. In the notes to the Financial Statements, a proforma column has been added to the Long-Term Debt Note 6 and the Share Capital Note 7 to show the effects of the major capital reorganization completed in 1989.

Operations

Revenue from continuing operations was $10,189,000 compared to $12,010,000 in 1987. The loss from continuing operations was $10,942,000 (56 cents per share), after a charge for additional depletion of $13,500,000 reflecting the third quarter write-down of oil and natural gas properties as a result of declines in oil and natural gas prices. For 1987, income from continuing operations of $1,233,000 (6 cents per share loss after preferred share dividend requirements) was reported.

The loss from discontinued businesses has two components: firstly, a loss of $8,534,000 ($15,667,000 in 1987) from operations; and secondly, an $8,989,000 write-down of the net investment in these manufacturing units to the estimated net realizable value. The 1987 write-down of $21,665,000 consists mainly of the write-off of the goodwill associated with the United States manufacturing units. Note 2 to the Financial Statements provides further information on the discontinued businesses.

The combined loss for 1988 was $28,465,000 ($1.28 per share) compared to $28,851,000 ($1.35 per share) in the prior year. The 1987 loss included extraordinary gains of $7,248,000 consisting of the gain on settlement of long-term debt and on the sale of mining property.

The 15% decline in gross revenue from continuing operations to $10,189,000 reflects the lower oil and natural gas prices experienced in 1988. The 1988 average wellhead price that Bralorne received for its natural gas was $1.44 per thousand cubic feet compared to $1.63 per thousand cubic feet in 1987. Similarly, the average price per barrel for Bralorne's oil production was $17.01 in 1988 compared to $22.84 in 1987. Production expenses increased to $3,561,000 from $2,720,000 in 1987 due primarily to a large number of shallow gas well workovers aimed at reducing normal production declines. The lower administration costs reflect the downsizing of Bralorne as well as the continued cost control programs.

A ceiling test was carried out at August 31, 1988 and again at December 31, 1988 in accordance with the CICA requirements to determine that the book value of the oil and gas assets will be recovered from the estimated future net revenues from production of proven reserves at current prices. With continued declines in crude oil and natural gas prices and unfavourable reserve adjustments, a provision for additional depletion of $13,500,000 was recorded at August 31, 1988. No further provision was required at December 31, 1988.

The balance of the Corporation's deferred taxes was recovered in 1988 and allocated as to $5,067,000 to continuing operations and as to $1,585,000 to discontinued Canadian business units. Deferred taxes applicable to the United States operations have been recovered previously as a result of prior losses. Note 8 to the Financial Statements shows additional information for the income taxes for continuing operations.

The details of the loss of $8,534,000 from discontinued operations are shown in Note 2 to the Financial Statements. The $8,989,000 write-down of the investment in the discontinued businesses consists mainly of adjustments necessary to reflect the estimated net realizable value of the United States subsidiaries, OMSCO Industries, Inc. and Mark Products, Inc. The need for this provision became evident as a result of negotiations with qualified purchasers in February and March of 1989.

Changes in Financial Position

The $741,000 cash contributed from operating units is net of funds of $4,886,000 used by the discontinued businesses. This cash flow, along with the proceeds from the sale of oil and gas assets and the sale of the assets from discontinued businesses, provided the funds for Bralorne's necessary oil and gas capital programs. Debentures issued to the bank as payment of accrued interest account for the increase in long-term debt of $3,806,000 in 1988.

Balance Sheet

The Balance Sheet at December 31, 1988 reflects the continuing oil and gas operations with the net investment in industrial operations held for sale shown on a one line basis. Although the 1988 Balance Sheet shows a working capital deficiency, the working capital ratio would be 1.71 to 1 after giving effect to the reorganization and sale of Barber Industries discussed in Note 10 to the Financial Statements.

Since the finalization of the reorganization occurred subsequent to the year-end, a proforma long-term debt position and a proforma share capital position are shown in Notes 6 and 7 to the Financial Statements, respectively. The proforma long-term debt is $46,782,000 (before the application of the proceeds from the Barber Industries sale) compared to $88,064,000 reported at December 31, 1988. The proforma shareholders' equity becomes $64,857,000 compared to the deficit of $5,592,000 at December 31, 1988. The proforma shareholders' equity consists of share capital of $71,087,000 (see Note 7) less the proforma deficit of $6,230,000 resulting from the transfer of $70,000,000 from share capital to deficit in February of 1989 as discussed in Note 7 to the Financial Statements.

Bralorne Resources Limited Five Year Financial Summary

(in thousands of dollars except per share)

	1988	1987	1986	1985	1984
Income					
From continuing operations:					
Gross revenue	**$ 10,189**	12,010	14,642	20,351	20,224
Cash flow from operations	**$ 2,811**	5,540	7,473	11,353	11,674
Income (loss)	**$ (10,942)**	1,233	2,400	5,036	6,098
Income (loss) from discontinued operations	**$ (17,523)**	(30,084)	(62,972)	(8,158)	(5,990)
Net income (loss)	**$ (28,465)**	(28,851)	(60,572)	(3,122)	108
Balance Sheet					
Working capital	**$ (16,007)**	25,073	19,254	37,336	65,428
Total assets	**$106,544**	161,646	191,593	294,387	297,604
Long-term debt	**$ 88,064**	98,702	101,205	107,004	94,893
Shareholders' equity	**$ (5,592)**	23,673	49,660	118,378	121,802
Capital Expenditures					
Oil and gas interests	**$ 4,166**	3,126	5,967	15,650	6,803
Property, plant and equipment	**$ 1,384**	658	1,600	5,869	11,573
	$ 5,550	3,784	7,567	21,519	18,376
Per Share (in dollars)					
Cash flow from continuing operations	$ —	0.12	0.20	0.36	0.38
Income (loss) from continuing operations	$ **(0.56)**	(0.06)	(0.02)	0.10	0.14
Loss	$ **(1.28)**	(1.35)	(2.70)	(0.25)	(0.11)
Dividends — Common	$ —	—	—	0.06	0.05
— Preferred	$ —	—	0.44	1.75	1.75

Review of Operations

Production

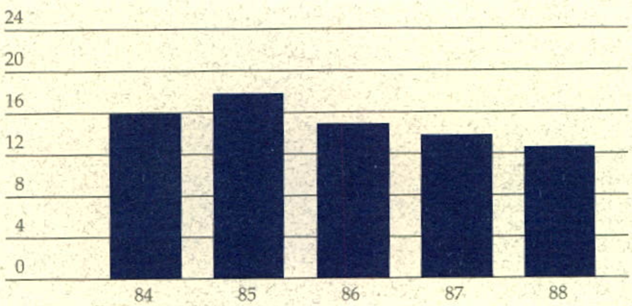
Natural gas production totalled 4,575 million cubic feet in 1988 compared to 5,095 million cubic feet in 1987. This 10% decline in deliveries is attributable to normal production decreases at our mature fields in addition to pipeline capacity constraints in Northern Alberta. Crude oil production increased to 186,000 barrels in 1988 from 164,000 barrels in 1987 as the result of two wells drilled in the last quarter of 1987.

The following table illustrates the Company's 1988 production:

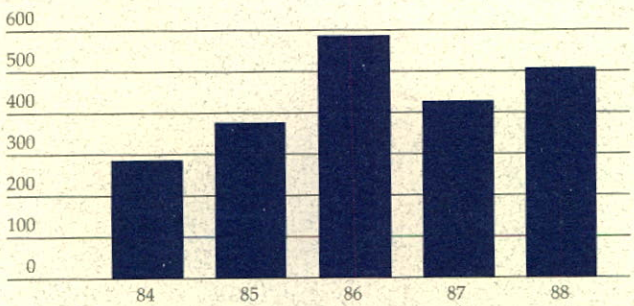
Oil and Natural Gas Production

	1988	1987
Gas *(million cubic feet)*		
Annual	**4,575**	5,095
Per Day	**12.5**	14.0
Liquid *(barrels)*		
Annual	**186,000**	164,000
Per Day	**508**	449

Gas Production
(millions of cubic feet per day)



Oil Production
(barrels of oil per day)

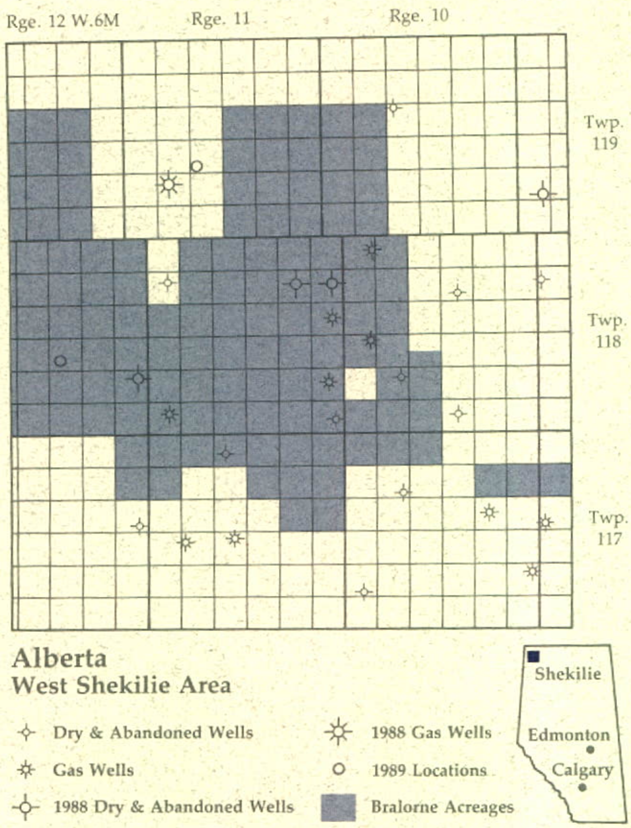


Exploration and Development

Bralorne's capital expenditures were $4,166,000, net of Canadian Exploration and Development Incentive Payments (CEDIP). These expenditures were financed from cash flow from operations and proceeds on the disposal of minor properties. The majority of the Company's capital program was directed towards the development of gas reserves at West Shekilie to meet threshold economics for facility construction to fill a long-term sales contract. The balance of the 1988 capital expenditures were related to existing gas contracts with infill drilling and facility improvements.

During 1988, Bralorne participated in four gross wells (1.57 net). One development well (.5 net) resulted in a producing gas well. All three exploratory wells (1.07 net) were unsuccessful. In addition, a significant amount of the Company's undeveloped acreage was farmed out to industry partners. This farmout program enabled 16 wells to be drilled on Company lands that resulted in 6 oil wells, 2 gas wells and 8 abandonments.

West Shekilie was Bralorne's major area of activity during 1988 to follow up on the two Slave Point gas pools discovered in 1985 and 1987. The Company acquired 5 blocks of exploratory land totalling 39,680 gross (18,368 net) acres adjacent to the two gas pools. The Company now holds an average working interest of 47% in 79,366 gross acres. A joint seismic program totalling 206 km was conducted during the year that resulted in the identification of numerous drillable locations and gave an evaluation of available land. Bralorne participated in 1 well (.5 net) that was unsuccessful. With limited cash flow from operations, the Company farmed out the balance of the 1988 West Shekilie drilling program that resulted in the drilling of two wells that were both abandoned. During 1988, the Company's



engineers re-examined the extended flow tests. The results show some limitations to each reservoir. As a consequence there was a shift from proven to probable reserves shown in the reserve reconciliation table. Marketing activities were successful during 1988 as the Company signed a long-term contract for gas deliveries from West Shekilie to commence as early as July 1990.

At Iosegun Lake, Alberta, the Company operates 10,004 gross acres (3,826 net) and currently has 2 producing and 3 shut-in gas wells. The Company is producing 2.0 million cubic feet per day into Company owned facilities capable of processing 6.0 million cubic feet per day. In order to utilize this excess capacity, Bralorne will be building a gathering system in 1989 to enable it to produce the 3 shut-in wells. In addition, this pipeline extension will allow Bralorne to drill additional development wells for new gas contracts.

The Medicine Hat area of Alberta emerged as Bralorne's second largest area of activity during 1988. A workover program evolved from a study of the recent production declines experienced in this mature field. 30 wells were reworked and measured for incremental production. The results of this pilot project were favourable enough to consider additional wells for potential production improvements during 1989.

At Donnelly, Alberta, the Company drilled a Debolt gas well on existing acreage to meet a long-term sales contract. This well is currently producing at 2.0 million cubic feet per day gross (1.0 million cubic feet net to Bralorne). The success of this well has defined more drillable locations on Company lands that will be evaluated and drilled when contract deliverability requires it.

At Crossfield, Alberta, one well was drilled on Company lands through a farmout agreement to test the extent of the Beaverhill Lake trend discovered by Shell at Caroline. This well was abandoned as was a second farmout well spudded late in 1988. The seismic related to this prospect will now be re-evaluated and the Company is optimistic another well could be drilled on this acreage block.

During 1988 the Company purchased additional land and conducted a seismic program over the Dreau prospect to follow up on the 1987 oil discovery. The first delineation well resulted in a dry hole and a second well is planned for 1989.

Reserves

The Company's undeveloped lands and reserves were evaluated by the independent consulting firm Sproule and Associates Limited. The tables below outline the present worth of Bralorne's crude oil, natural gas and natural gas liquids reserves at December 31, 1988. The estimated values resulted from escalating product prices as outlined below for proven and probable reserves before income taxes but after royalties, lifting costs and future capital development costs relating to the undeveloped and probable reserves. The estimated values include the effects of the Alberta Royalty Tax Credit and take or pay gas repayments.

Present Value of Reserves:
(in thousands of dollars)

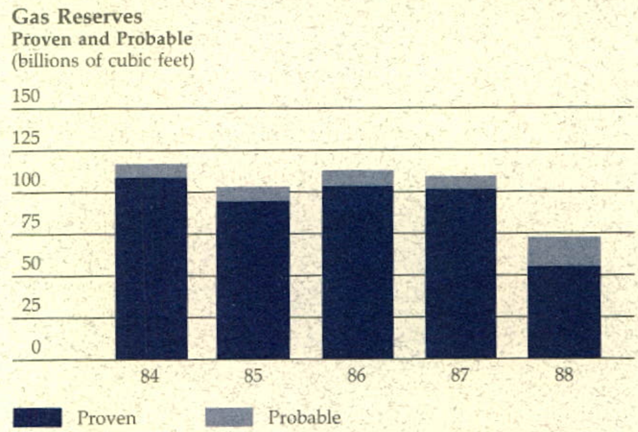
Discount rate	15%	20%
Proven	$43,169	$33,829
Probable	4,662	2,990
	47,831	36,819
Alberta Royalty Tax Credits	7,070	5,437
Take or pay repayments	(1,146)	(1,035)
Total reserve value	53,755	41,221
Undeveloped land value	5,698	5,698
Total	$59,453	$46,919
Net book value (at cost less accumulated depletion and depreciation)	$50,336	

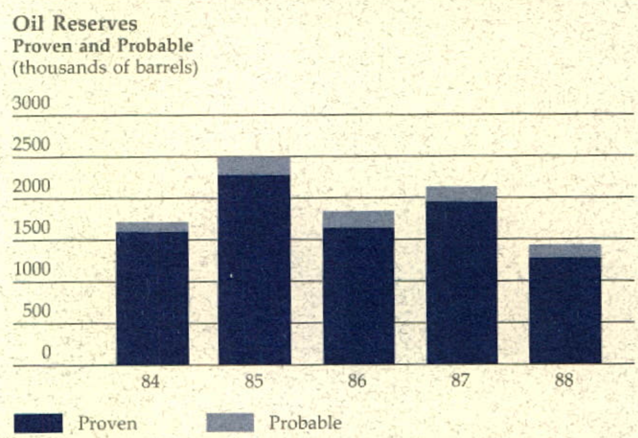
Reserve Reconciliation

	Gas MMCF	Oil MBBLS
Proven reserves at January 1, 1988	100,428.0	1,944.1
Reserves added through drilling	1,500.0	93.5
1988 production	(4,575.0)	(186.0)
Engineering re-evaluations*	(19,294.0)	(470.2)
Minor working interest properties**	(17,842.0)	(90.3)
Reserves sold	(4,919.0)	(11.2)
Reserves at December 31, 1988	55,298.0	1,279.9
Probable reserves at December 31, 1988	17,903.0	167.5
Total reserves	73,201.0	1,447.4

* The Company's gas reserves at West Shekilie were re-evaluated during 1988 using information gathered from the 1988 drilling and testing programs. The proven gas reserves at West Shekilie were reduced by 19,294 million cubic feet of which 7,720 million cubic feet moved into the probable category.

** Minor working interest properties that Bralorne is attempting to sell were removed from our reserve evaluation.





Price Forecast *(in Canadian dollars)*

Year	Gas $/MCF	Oil $/BBL
1989	1.63	17.76
1990	1.75	18.97
1991	1.92	20.61
1992	2.34	24.78
1993	2.55	27.64
1994	2.78	29.54

Prices thereafter are escalated at anticipated inflation rates.

Outlook

A promising gas well drilled in early 1989 is encouraging Bralorne to continue the development program at West Shekilie which, together with development and rework programs at other locations, should improve reserves and production rates.

In anticipation of completing a sale of the remaining U.S. manufacturing units and the resulting elimination of the majority of the remaining debt, a longer term strategic plan for the acquisition and development of new oil and gas properties is now being developed to begin in the second half of 1989.

Consolidated Statement of Operations

For the year ended December 31
(in thousands of dollars)

	1988	1987 (Restated) *(note 2)*
Gross revenue	$10,189	$12,010
Royalties	1,866	1,921
	8,323	10,089
Expenses:		
Production	3,561	2,720
Administration	2,099	2,611
Reorganization	559	150
Depletion and depreciation	5,320	4,307
Additional depletion *(note 4)*	13,500	—
	25,039	9,788
Loss (income) from continuing operations before income taxes	16,716	(301)
Income taxes (recovery) *(note 8):*		
Alberta Royalty Tax Credit	(707)	(932)
Deferred	(5,067)	—
	(5,774)	(932)
Loss (income) from continuing operations after income taxes	10,942	(1,233)
Discontinued businesses and units held for sale:		
Loss from operations net of taxes of $1,558 (1987 — $3,246) *(note 2)*	8,534	15,667
Write-down of investments in discontinued businesses	8,989	21,665
	17,523	37,332
Extraordinary items *(note 3)*	—	(7,248)
Loss for the year	$28,465	$28,851
Loss per common share:		
From continuing operations	$ 0.56	$ 0.06
For the year	$ 1.28	$ 1.35

Auditors' Report

To the Shareholders of Bralorne Resources Limited

We have examined the consolidated balance sheet of Bralorne Resources Limited as at December 31, 1988 and the consolidated statements of operations, changes in financial position and deficit 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, these consolidated financial statements present fairly the financial position of the Company as at December 31, 1988 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.

Calgary, Alberta
March 1, 1989

Price Waterhouse
Chartered Accountants

Consolidated Balance Sheet

December 31
(in thousands of dollars)

	1988	1987
Assets		
Current assets:		
Accounts receivable	$ 2,056	$ 20,627
Prepaid interest	4,140	3,806
Inventories	—	30,996
Other prepaid expenses	182	512
	6,378	55,941
Capital assets *(note 4)*	50,336	97,735
Other assets	1,823	7,970
Net investment in industrial operations held for sale *(note 2)*	48,007	—
	$106,544	$161,646
Liabilities and Shareholders' Equity		
Current liabilities:		
Bank loans, secured *(notes 5 and 10)*	$ 10,305	$ 9,982
Accounts payable and accrued liabilities	9,121	19,169
Current portion of long-term debt	2,959	1,717
	22,385	30,868
Long-term debt *(notes 6 and 10)*	88,064	98,702
Prepayment of natural gas sales	1,687	1,751
Deferred income taxes	—	6,652
Shareholders' equity:		
Share capital *(notes 7 and 10)*	70,638	70,638
Foreign exchange adjustment	—	800
Deficit	(76,230)	(47,765)
	(5,592)	23,673
	$106,544	$161,646

See Subsequent Events *(note 10)*.

Approved by the Board:

Director

Director

Consolidated Statement of Changes in Financial Position

For the year ended December 31
(in thousands of dollars)

	1988	1987 (Restated) (note 2)
Cash provided by (used in) operating activities:		
(Loss) income from continuing operations	$(10,942)	$ 1,233
Add charges to operations not requiring a current cash payment:		
Depreciation and depletion	18,820	4,307
Deferred income taxes	(5,067)	—
Funds from continuing operations	2,811	5,540
Funds used by discontinued operations	(4,886)	(10,493)
Net change in non-cash working capital balances*	2,816	947
	741	(4,006)
Cash provided by (used in) investment activities:		
From continuing operations:		
Proceeds from sale of oil and gas interests	1,334	2,619
Additions to oil and gas interests	(4,166)	(3,126)
Changes in other assets and liabilities	(64)	(250)
	(2,896)	(757)
From discontinued operations	3,841	5,847
	945	5,090
Cash provided by (used in) financing activities:		
Repayments of long-term debt	(5,015)	(6,565)
Increase in long-term debt	3,806	3,968
Issuance of share capital	—	1,735
	(1,209)	(862)
Net increase (decrease) in cash during the year	477	222
Effects of exchange rate changes	(800)	(608)
Cash position at beginning of year	(9,982)	(9,596)
Cash position at end of year	$(10,305)	$ (9,982)

Cash position comprises bank indebtedness less cash.

* These consist of changes in accounts receivable, inventories, prepaid expenses and accounts payable.

Consolidated Statement of Deficit

For the year ended December 31
(in thousands of dollars)

	1988	1987
Deficit at beginning of year	$47,765	$18,914
Loss for the year	28,465	28,851
Deficit at end of year	$76,230	$47,765

Notes to Consolidated Financial Statements

(tabular amounts in thousands)

1. **Accounting Policies**

(a) Principles of consolidation: At the end of 1988, the Company indicated its intention to sell its remaining Industrial Operations which are comprised of the Barber Industries and Mark Products Divisions in Canada and the OMSCO Industries, Inc. and Mark Products, Inc. subsidiaries in the United States. As a result, the Company has adopted the equity method of accounting for such operations with effect from December 31, 1988. The Company's 49% interest in a joint venture company is also accounted for by the equity method. Substantially all of the Company's oil and gas exploration and development activities are conducted jointly with others and accordingly these consolidated financial statements reflect only the Company's proportionate interest in such activities.

(b) Oil and gas interests: The Company follows the full cost method of accounting for oil and gas properties whereby the costs associated with the exploration for and development of oil and gas reserves are capitalized. These capitalized costs include land acquisition, geological and geophysical expenses, costs of drilling both productive and non-productive wells and administrative costs directly related to exploratory activities. Sales of oil and gas properties are recorded as reductions of capitalized costs with no gain or loss being recorded in income, except on significant dispositions. Costs are accumulated in cost centres established on a country-by-country basis.

Capitalized costs are depleted by the unit of production method based on estimated proven reserves of oil and gas as determined by independent petroleum engineers, with products being converted to a common unit of measure based on energy content.

The Company applies a ceiling test to each cost centre to determine that the capitalized costs will be recovered from the estimated future net revenues from the production of proven reserves at year-end oil and gas prices.

(c) Property, plant and equipment: Property, plant and equipment are carried at cost, and are being depreciated mainly on a straight-line basis over the estimated useful life of the assets at annual rates from 2½% to 30%.

Expenditures for repairs and maintenance are charged to operating expenses. Betterments and major renewals are capitalized. Gains or losses on retirement or disposal of property, plant and equipment are recognized in income.

(d) Earnings or loss per share: The Company calculates earnings or loss per share based on the weighted monthly average of common shares outstanding after providing for preferred share dividend requirements.

(e) Foreign currency translation: Until December 31, 1988, the Company translated foreign currency transactions and accounts of its financially or operationally independent (self-sustaining) foreign operations to Canadian dollars using the current rate method. Assets and liabilities were translated at year-end rates, while income and expenses were translated at average rates in effect during the year. Resulting gains or losses are included in the foreign exchange adjustment account, a component of Shareholders' equity.

Since the Company intends to sell the remaining foreign operating units, effective December 31, 1988, the net investment in foreign subsidiaries was translated at the year-end rate and gains or losses recorded in income.

2. **Discontinued Businesses and Business Units Held for Sale**

With Bralorne's plan to focus its activities in the oil and gas exploration and production operations, it has disposed of its Canadian manufacturing divisions Jarco and Polesystems, and its U.S. subsidiary ESSE International, Inc. during 1988. As at December 31, 1988 the Company is holding its remaining manufacturing business units for sale. These remaining units are the Barber Industries and Mark Products Divisions in Canada and its United States subsidiaries OMSCO Industries, Inc. and Mark Products, Inc. Accordingly, the operating results for these units have been accounted for on the equity basis and the net investment in these units has been written down to the estimated net realizable value. The net investment in the discontinued businesses held for sale has been segregated on the balance sheet.

The results of the discontinued operations are as follows:

	1988	1987
Gross revenue	$84,905	$69,972
Expenses:		
Cost of sales and services	67,413	59,818
Selling, general and administrative	12,853	12,978
Interest on long-term debt	10,060	10,077
Interest on working capital loans	1,294	992
Depreciation	3,377	5,020
	94,997	88,885
Loss before income taxes	10,092	18,913
Income taxes (recovery):		
Current	27	45
Deferred	(1,585)	(3,291)
	(1,558)	(3,246)
Loss from operations net of taxes	$ 8,534	$15,667

The above loss from operations, when combined with the write-down of the net investment in discontinued operations resulted in a loss per share of $0.72 and $1.60 for 1988 and 1987 respectively.

3. Extraordinary Items

The extraordinary items for 1987 consist of a $1,600,000 gain on the sale of mining properties net of deferred taxes of $900,000 and a gain on the settlement of long-term debt of $5,648,000. These extraordinary items have decreased the loss per share by $0.31 in 1987.

4. Capital Assets

	1988		1987	
	Cost	Net Book Value	Cost	Net Book Value
Oil and gas interests	$90,390	$50,336	$ 87,638	$66,410
Property, plant and equipment	—	—	68,787	31,325
	$90,390	$50,336	$156,425	$97,735

Oil and gas interests include capitalized administrative costs. The amount capitalized in 1988 was $509,000 (1987 — $522,000).

An impairment provision of $13,500,000 was recorded during 1988 as a result of the ceiling test performed under the full cost accounting policy. The Company's estimated average wellhead prices used in this test at December 31, 1988 were $17.00 per barrel for oil and $1.40 per MCF for natural gas.

5. Bank Loans

Operating bank loans of $10,305,000 at December 31, 1988 ($9,982,000 at December 31, 1987) are secured by certain inventories and an assignment of accounts receivable.

6. Long-Term Debt

	Proforma December 31, 1988 After Reorganization and Rights Offering (see Note 10)	December 31, 1988	December 31, 1987
Sinking fund debentures, Series A, bearing interest at 12⅞% due August 15, 1995, secured by certain producing oil and gas properties	$14,000	$27,560	$ 28,000
Debentures, secured, bearing interest at 12% beginning 1990, due 2001	—	8,900	8,900
Bank loans, secured			
— bearing interest at 1% above the prime rate of a Canadian bank	34,746	53,568	10,705
— bearing interest at 1% above the prime rate of a U.S. bank (principal amount U.S. $8,204,000)	—	—	10,663
— bearing interest at ¾% above the U.S. base rate of a Canadian bank (principal amount U.S. $3,868,000)	—	—	5,029
— bearing interest (prepaid until 1990) at ¾% above the U.S. base rate of a Canadian bank (principal amount U.S. $27,422,000)	—	—	35,643
Other	995	995	1,479
	49,741	91,023	100,419
Less: Current portion	2,959	2,959	1,717
	$46,782	$88,064	$ 98,702

The Proforma December 31, 1988 After Reorganization and Rights Offering column above reflects the following transactions affecting long-term debt which occurred on January 20, 1989 as part of the Company's financial reorganization (see Subsequent Events Note 10):

(i) the repayment of $10,000,000 of bank debt;

(ii) the conversion of $13,560,000 of 12⅞% Series A debentures and $15,000,000 of bank debt into equity of the Company; and

(iii) the cancellation of $2,722,000 of 12% debentures that were issued to the bank in 1987 as a prepayment of interest for 1989.

In order to make the $10,000,000 long-term debt payment in (i) above, the Company's parent corporation provided interim financing for the period from January 20, 1989 until the closing of the rights offering on February 28, 1989. The interim financing loan was repaid from the proceeds of this rights offering.

Under the provisions of the Trust Deed securing the $14,000,000 debenture, $2,000,000 will be paid annually until 1995. As security for these debentures, the Company has pledged certain oil and natural gas properties and executed a subordinated floating charge debenture in the amount of $14,000,000.

The bank debt will be repaid in quarterly payments over a six year period beginning in April of 1990. As security for the bank debt, the Company has pledged certain oil and natural gas properties, executed a first floating charge debenture in the amount of $40,000,000 and executed a first fixed charge debenture of $23,000,000 mortgaging certain real properties.

The aggregate maturities of long-term debt in each of the six years subsequent to December 31, 1989 are as follows:

1990 — $6,379,000	1992 — $7,791,000	1994 — $7,791,000
1991 — $7,791,000	1993 — $7,791,000	1995 — $7,791,000

Since the proceeds from the sale of Industrial Units will be applied on the operating bank loans and long-term debt, this repayment schedule will be accelerated as the disposals occur.

7. Share Capital

At a special shareholders' meeting on November 22, 1988 the following changes to the Company's authorized share capital were approved:

(i) the number of authorized First Preferred shares was changed to an unlimited number;

(ii) an additional class of shares designated "Participating Special shares" was authorized, unlimited in number; and

(iii) an additional class of shares, limited in number to 30,000,000 and designated as "Non-Voting Convertible shares", was authorized. Such shares may be converted at any time into Common shares;

(iv) the stated capital of the Common shares was reduced by $70,000,000, which amount was transferred to retained earnings on completion of the rights offering on February 28, 1989.

As a consequence the authorized capital of the Company is as follows:
Unlimited First Preferred shares, issuable in series
Unlimited Second Preferred shares, issuable in series
Unlimited Participating Special shares, issuable in series
30,000,000 Non-Voting Convertible shares
Unlimited Common shares

	Proforma December 31, 1988 After Reorganization and Rights Offering (see Note 10)	December 31, 1988	December 31, 1987
Issued:			
1,574,039 — 8.75% cumulative, redeemable, convertible First Preferred shares, Series A (Dividends are in arrears in the amount of $7,575,000)	$ —	$31,481	$31,481
5,000,000 Participating Special shares, Series I	25,000	—	—
30,000,000 Non-Voting Convertible shares	15,000	—	—
24,461,586 Common shares (1987 — 24,461,586 shares; Proforma December 31, 1988 — 115,471,152 shares)	29,958	36,610	36,610
1,504,747 common share purchase warrants	1,129	1,129	1,129
1,890,864 warrant purchase options	—	1,418	1,418
1,900,000 lender common share warrants	—	—	—
	$71,087	$70,638	$70,638

The Proforma December 31, 1988 After Reorganization and Rights Offering column reflects the following transactions that occurred subsequent to December 31, 1988 (see Subsequent Events Note 10):

(i) the conversion of $15,000,000 of bank debt into 30,000,000 Non-Voting Convertible shares on January 20, 1989;

(ii) the conversion of $13,560,000 of debentures and $3,307,000 of accrued interest into 34,613,864 Common shares on January 20, 1989;

(iii) the issue on January 20, 1989 of 1,900,000 common share purchase warrants to lenders as partial consideration for the conversion of long-term debt to equity, each warrant exercisable for 5 years at an exercise price of $1.00 per share;

(iv) the cancellation of options to acquire 1,890,864 warrants granted to the Company's bank as payment for interest deferrals in 1989;

(v) the conversion of 1,574,039 Series A First Preferred shares into 18,888,468 Common shares effective February 8, 1989;

(vi) the issue of 37,507,234 Common shares pursuant to the rights offering which expired on February 28, 1989; and,

(vii) the transfer of $70,000,000 from share capital to deficit.

In addition, the Proforma column above reflects the issue of 5,000,000 Participating Special shares, Series I at $5.00 per share which is the minimum proceeds to be received from the exercise of rights expiring on March 22, 1989. The Company's major shareholder has agreed to subscribe for sufficient Participating Special shares, Series I to ensure that $25,000,000 is raised.

Options to acquire 1,890,864 warrants and 300,000 Common shares, which were issued in 1987 to compensate the bank for the lost compound interest factor for the cash deferral of interest for 1989, were cancelled on January 20, 1989 as part of the Company's reorganization. In addition, the exercise price of the 1,504,747 common share purchase warrants was reduced from $2.75 to $1.50 per share.

On November 22, 1988, as part of the Company's reorganization, shareholders approved the conversion of First Preferred shares, Series A into Common shares of the Company. The articles of amendment effecting the change of each First Preferred share, Series A into 12 Common shares were filed with the Alberta Registrar of Corporations on February 8, 1989. As of that date, this series of First Preferred shares ceased to exist.

At December 31, 1988, options to purchase 787,000 Common shares (1,028,000 at December 31, 1987) under the incentive share option plan for key employees were outstanding at a price of $1.90 per share. The options are exercisable on a cumulative basis at the rate of one third of the total in each of the three years ending in 1990 and expire in 1997. During the year, options on 241,000 Common shares were cancelled and no options were granted. There are 713,000 shares available for future options which may be granted.

At December 31, 1988, 33,004,747 Common shares have been set aside for the conversion of Non-Voting Convertible shares, for the exercise of the share purchase warrants and options issued to lenders and for the exercise of the options granted under the incentive share option plan.

8. Income Taxes

The provision for income taxes in the Consolidated Statement of Operations reflects an effective tax rate which differs from the combined Canadian federal and provincial corporate tax rate for the following reasons:

	1988	1987
Income tax recovery at the Canadian corporate tax rate of 47.5% (1987 — 49%)	**$(7,940)**	$ 147
Add (deduct) effect of:		
Crown charges disallowed for tax purposes	**717**	762
Resource profits rate reductions	**(521)**	(878)
Provincial resource industry rebates	**(707)**	(932)
Losses for which no tax benefit has been recorded	**730**	—
Rate differential on deferred tax recovery	**1,852**	—
Other	**95**	(31)
Income tax (recovery)	**$(5,774)**	$(932)

The Company has tax pools in excess of the related accounting values totalling approximately $2,000,000. The future benefit of this item has not been recorded in the accounts due to lack of certainty of realization.

9. Segmented Information

By Geographic Location

The continuing business of the Company operates only in the oil and gas exploration and production segment and all operations are in Canada. The geographic distribution of the discontinued businesses which constituted the manufacturing segment is illustrated in the table below.

	Discontinued Business Units Held for Sale					
	Canada		**United States**		**Total**	
	1988	1987	**1988**	1987	**1988**	1987
Sales to customers outside the enterprise	**$43,997**	33,839	**40,908**	36,133	**84,905**	69,972
Segmented operating profit (loss)	**$13,814**	9,235	**(12,552)**	(17,079)	**1,262**	(7,844)
Interest					**11,354**	11,069
Income taxes (recovery)						
Current					**27**	45
Deferred					**(1,585)**	(3,291)
Loss before extraordinary items					**8,534**	15,667
Identifiable assets	**$28,421**	38,204	**25,678**	53,871	**54,099**	92,075

10. Subsequent Events

(a) On January 20, 1989, the Company completed a significant portion of the comprehensive reorganization of its debt and capital structure which had been approved by the Common and Preferred Shareholders at a meeting held on November 22, 1988. Under this part of the reorganization:

(i) the 12⅞% Secured Debentureholders converted $5,000,000 of their loans and $3,307,000 of accrued interest to equity;

(ii) Bralorne's major shareholder acquired the remaining $22,560,000 of the 12⅞% Secured Debentures outstanding;

(iii) $8,560,000 of the 12⅞% Secured Debentures acquired by the Company's major shareholder were converted into Common shares;

(iv) the Bank converted $15,000,000 of its term loans to equity;

(v) 1,900,000 lender common share warrants were issued to the original 12⅞% debentureholders and the Company's bank, each warrant exercisable for a period of 5 years at an exercise price of $1.00 per share; and

(vi) the options to acquire 1,890,864 warrants and 300,000 Common shares granted to the Company's bank as payment for interest deferrals in 1989 were cancelled and the exercise price on the 1,504,747 warrants issued in 1987 was reduced from $2.75 to $1.50.

Prior to the closing of this part of the reorganization the Company's major shareholder advanced $15,000,000 to the Company to allow it to repay $10,000,000 of long-term bank indebtedness and $5,000,000 of its operating loan. Such repayments were required prior to the closing of this part of the reorganization. The advance from the major shareholder was repaid from the proceeds of the rights offering referred to in note 10(c) below.

(b) Preferred shareholders exchanged their shares for Common shares on the basis of 12 Common shares for each First Preferred share, Series A effective February 8, 1989. This change of Preferred to Common shares was approved at the November 22, 1988 shareholders meeting.

(c) On February 28, 1989, the Company raised $15,000,000 pursuant to a rights offering to Common shareholders. Each Right entitled the holder to purchase, for $0.80, two Common shares and two transferable rights to purchase Participating Special shares. The Participating Special share purchase rights, which expire on March 22, 1989, each entitle the holder to purchase one Participating Special share, Series I for $5.00 per share. The Company's major shareholder has agreed to subscribe for sufficient Participating Special shares to ensure that, at least, an additional $25,000,000 is raised.

(d) At the shareholders' meeting on November 22, 1988, approval was given to reduce the stated capital of the Company by $70,000,000. On February 28, 1989, this amount was transferred from share capital to retained earnings.

(e) On February 28, 1989 the Company closed the sale of its Barber Industries Division for cash. $13,000,000 of the net proceeds of $18,100,000 was applied on the Company's long-term bank debt with the remaining $5,100,000 being applied on the operating loan.

Corporate Information

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Vancouver, British Columbia
President, B.C. Pacific Capital Corporation

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Managing Partner and President
Hees International Bancorp Inc.

William F. Limin
Calgary, Alberta
President and Chief Executive Officer
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Vancouver, British Columbia
Senior Vice President
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Officers

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President and
Chief Executive Officer

Rodger D. Conner
Secretary

William G. Crossley
Vice President Finance and Treasurer

Pete W. Samoff
Vice President Manufacturing, United States

Reginald (Reg) Worsley
Vice President Manufacturing, Canada

Auditors

Price Waterhouse

Banker

The Royal Bank of Canada
Calgary, Alberta

Transfer Agent and Registrar

Common Shares:
The Royal Trust Company
Vancouver, Calgary, Toronto and Montreal

Preferred Shares:
The Royal Trust Company
Vancouver, Calgary and Toronto

Co-Transfer Agent

Common Shares:
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Stock Exchange Listings

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