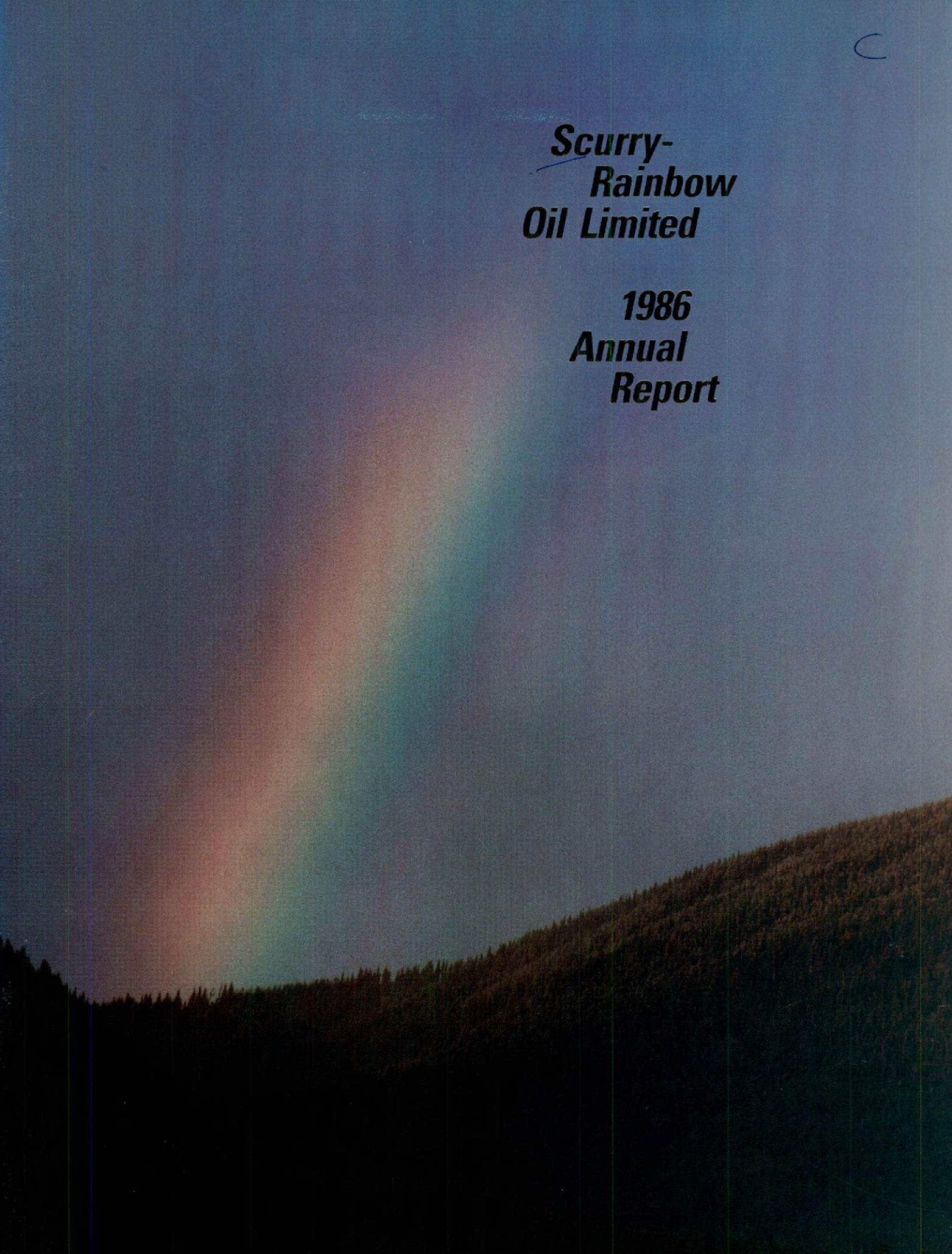


***Scurry-
Rainbow
Oil Limited***

***1986
Annual
Report***



Corporate Profile

Scurry-Rainbow Oil Limited is a Canadian company incorporated in 1954 under the laws of the Province of Alberta. The Company is engaged primarily in the exploration for, and the development and production of crude oil, natural gas and natural gas liquids. These activities are conducted mainly in British Columbia, Alberta, Saskatchewan, and Manitoba. In addition, the Company owns substantial undeveloped coal reserves in southern Alberta and British Columbia.

Scurry-Rainbow is 88.1 percent owned by Home Oil Company Limited, a wholly-owned subsidiary of Hiram Walker Resources Ltd. as of September 30, 1986. On August 7, 1986, Hiram Walker announced that it had signed a definitive agreement for the sale of Home Oil to Interprovincial Pipe Line Limited. The closing of the sale occurred on December 5, 1986.

Annual General Meeting

The Annual General Meeting of Shareholders will be held on Monday, March 16, 1987 at 2:30 p.m. in the Company's head office, 29th floor Auditorium, Home Oil Tower, 324 Eighth Avenue S.W., Calgary, Alberta, Canada. Formal notice of this meeting and proxy materials have been mailed to all registered shareholders with this annual report.

Form 10-K

The Company files annually with the Securities and Exchange Commission of the United States a report known as the Annual Report on Form 10-K. Copies of the Form 10-K are available to shareholders, free of charge, upon written request to Mr. E. Jorgensen, Comptroller, Scurry-Rainbow Oil Limited, 1700 Home Oil Tower, 324 Eighth Avenue S.W., Calgary, Alberta, Canada, T2P 2Z5.

Metric Conversion Factors

1 kilometre	=	0.62 mile
1 metre	=	3.28 feet
1 hectare	=	2.47 acres
1 cubic metre	=	6.2898 barrels (petroleum liquids)
1 cubic metre	=	35.49373 cubic feet (natural gas)
1 tonne	=	0.984 long tons (sulphur)

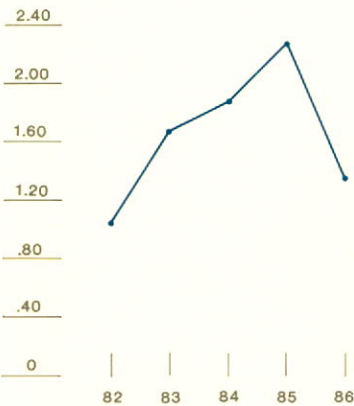
Contents

Highlights	1
Report To The Shareholders	2
Review of Operations	
Exploration and Development	4
Production/Sales	8
Proved Reserves	9
Financial Review	
Management's Discussion and Analysis	10
Statement of Financial Position	12
Statement of Earnings and Retained Earnings	13
Auditors' Report	13
Statement of Changes in Financial Position	14
Statement of Changes in Non-Cash Working Capital	14
Notes to Financial Statements	15
Unaudited Supplementary Information	19
Five-Year Financial Review	23
Five-Year Operating Review	24

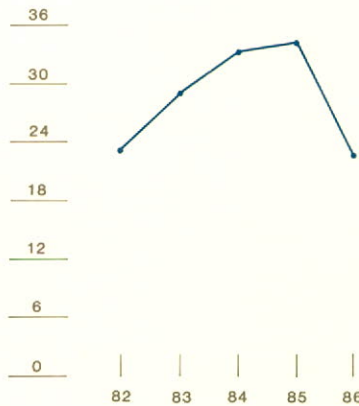
HIGHLIGHTS

	Year ended September 30,		
	1986	1985	1984
Financial (thousands of dollars)			
Revenue	79,652	102,882	95,508
Net earnings	17,754	30,132	24,898
Funds from operations	45,978	62,213	61,831
Capital expenditures			
Before incentives	67,337	80,296	91,868
After incentives	45,785	46,236	45,192
Working capital	58,777	63,427	53,877
Per Common Share (dollars)			
Net earnings	1.32	2.25	1.86
Funds from operations	3.42	4.64	4.62
Dividends declared	0.50	—	—
Operating			
Average Daily Production/Sales			
Crude oil (barrels)	7,543	7,101	7,304
Natural gas liquids (barrels)	849	369	405
Natural gas (thousands of cubic feet)	24,845	24,391	21,711
Sulphur (long tons)	58	104	67
Proved Reserves			
Crude oil (millions of barrels)	22.1	19.7	17.2
Natural gas liquids (millions of barrels)	2.2	2.2	2.0
Natural gas (billions of cubic feet)	207.2	201.5	192.8
Sulphur (thousands of long tons)	305	324	341
Working Interest Wells Drilled			
Gross	339	413	272
Net	35.4	29.0	31.2
Undeveloped Oil & Gas Landholdings			
Gross (thousands of acres)	5,943	4,424	3,388
Net (thousands of acres)	1,217	1,143	1,072

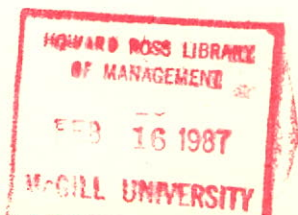
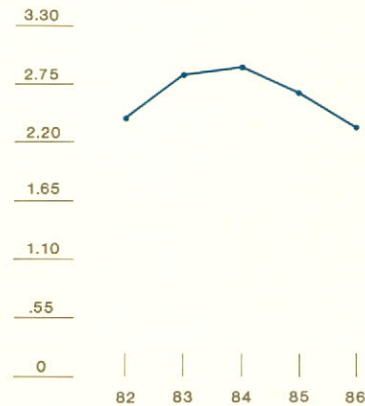
Earnings Per Share
(dollars)



Company's Average Crude Oil Price
(dollars per barrel)



Company's Average Natural Gas Price
(dollars per thousand cubic feet)



The decline of world oil prices and deregulation of domestic markets and prices for both oil and natural gas were the most significant events of 1986. Crude oil prices experienced a sharp decline in response to the efforts of major petroleum exporting countries to increase their market share. Canadian energy policy initiatives moved toward a less regulated climate for oil and gas.

Although depressed oil and gas prices limited Scurry-Rainbow's financial performance, the Company's operational accomplishments were impressive. Production of oil, natural gas and natural gas liquids surpassed 1985 levels, and additions to proved reserves exceeded production.

Financial Results

The Company's net earnings for the year were \$17.8 million or \$1.32 per share, a 41 percent decline primarily due to lower revenue. As a result of the dramatic reduction in oil and gas prices, revenue fell 23 percent to \$79.7 million. At the beginning of the year, Scurry-Rainbow received an average price of \$36.38 per barrel of oil compared with \$19.48 at year end.

Funds from operations totalled \$46.0 million and were sufficient to support a capital expenditure program of \$45.8 million. Capital expenditures, after deduction of government incentives, were only slightly lower than last year.

Operating Performance

In 1986, Scurry-Rainbow participated in the drilling of 339 working interest wells, a decline of 18 percent. The reduced drilling activity resulted from the price-related deterioration in project economics and cash flow that occurred in the last half of the year.

The Company participated in the most prolific deep oil find ever made in Saskatchewan and in the discovery of a promising new oil field in Manitoba.

Oil and natural gas liquids production, at 8,392 barrels per day, was 12 percent higher than last year. Sales of natural gas rose marginally to 24.8 million cubic feet per day. Despite a reduced drilling program, the Company was able to increase its year-end reserves. Additions to proved oil and natural gas liquids reserves exceeded annual production for the second consecutive year; natural gas additions now have exceeded sales for three consecutive years.

Industry Review

The collapse of world oil prices confronted the industry with a critical challenge during 1986 — one that undoubtedly will endure throughout 1987. The sharp and sustained price decline forced companies to re-evaluate planned exploration and development expenditures in light of the changed economics and reduced cash flow.

The federal government and the Governments of Alberta and Saskatchewan reacted to the price decline with several measures intended to increase the industry's cash flow and encourage capital spending.

The federal government increased the small producer's Petroleum and Gas Revenue Tax (PGRT) exemption effective May 1986. As overall industry conditions worsened, the PGRT was eliminated effective October 1, 1986 to increase industry cash flow for reinvestment purposes.

The Government of Alberta implemented a number of short-term incentives. These included enrichment of the Royalty Tax Credit to 95 percent from 75 percent of royalties payable, and four special assistance programs under which companies can recover a substantial portion of their drilling and operating costs until December 31, 1986. As the year progressed, it became obvious that more effective and longer-term incentives were necessary. In October 1986, the province extended through 1987 the enriched Royalty Tax Credit and reduced royalties to improve the industry's cash flow. Marginal royalty rates for oil and gas were lowered effective November 1, 1986, and a system of extended royalty holidays for oil wells drilled outside the boundaries of existing pools was introduced.

The Saskatchewan government implemented royalty reductions and introduced a program designed to stimulate service sector activity. These initiatives expired October 31, 1986. They have not been replaced by longer-term initiatives.

Scurry-Rainbow welcomes the efforts of the various governments to ease the industry's tax and royalty burden. The measures adopted, however, do not adequately address the industry's dual need for improved economics to justify reinvestment at current and expected price levels, and for additional cash flow from existing production to fund this reinvestment. The Alberta initiatives result in much improved oil exploration and development economics for Scurry-Rainbow, but do little to increase its cash flow because royalties on existing production are only slightly reduced. Royalty

levels generally remain excessive in all of the producing provinces in relation to the prices expected over the long-term. The new pricing environment warrants lower and more price-sensitive royalties. At the federal level, the treatment of royalties for tax purposes should be revised and the reintroduction of the depletion allowance should be considered.

In October 1985, the federal government and the Governments of Alberta, British Columbia and Saskatchewan signed an agreement to adopt less regulated markets and prices for gas. The Governments of Canada and Alberta announced additional proposals in October 1986 designed to ensure that the tenets of market access and surplus determination are compatible with a less regulated marketplace. Following a one-year transition period, the new and more flexible system came into effect on November 1, 1986. The resulting competition for customers in an oversupplied marketplace will likely cause gas prices to decline in 1987, which will offset the positive effect of the anticipated increase in sales.

Corporate Strategy

During 1987, the Company's exploration and development strategy will be similar to that pursued in 1986. Exploratory strategy will continue to place emphasis on higher interest prospects on Company lands in the Western Sedimentary Basin. The economics of typical farmin opportunities, where a disproportionate share of initial costs is assumed, are less favorable at prevailing oil and gas prices. Scurry-Rainbow views the decline in Crown land values, which took place throughout the year, as an opportunity to enhance its land position in western Canada. The Beaufort Sea exploratory program was concluded and future frontier activities will be delayed until the economic climate improves. Development activities will continue to emphasize optimization and enhancement of production from existing fields, and development of exploration successes. Every effort will be made, despite a reduced drilling program, to maintain the growth in reserves.

Oil and natural gas liquids production is not expected to change significantly during 1987. Increased production from drilling successes and optimization projects will be offset by the natural decline in mature fields. World oil prices are expected to remain near U.S. \$15 per barrel throughout the year.

Gas sales are expected to increase modestly in 1987, although the marketplace will be highly competitive. The Company will aggressively pursue incremental sales where the selling prices are not deeply discounted and the proceeds yield positive operating results.

Scurry-Rainbow's 1987 capital expenditure program is necessarily limited by the depressed oil and gas prices expected. The Company, however, has the financial strength and operational flexibility to take advantage of other investment opportunities created by this pricing downturn.

Corporate Control

Scurry-Rainbow is 88.1 percent owned by Home Oil Company Limited, which was wholly-owned by Hiram Walker Resources Ltd. at year end. On August 7, 1986, Hiram Walker announced that it had signed a definitive agreement for the sale of Home Oil to Interprovincial Pipe Line Limited. The closing of the sale occurred on December 5, 1986.

As a consequence of new ownership, Scurry-Rainbow will change its fiscal year end to December 31 from September 30. An interim report and Form 10-K will be issued for the three months ending December 31, 1986.

Dividend Payment

During the 1986 fiscal year, the Company initiated a semi-annual dividend of \$0.25 per common share. Dividends were paid on January 1, 1986 and July 1, 1986. The next semi-annual dividend of the same amount has been declared and will be paid on January 1, 1987.

Director Resigns

Effective November 1, 1986, W.P. Wilder resigned from the Board of Directors. Mr. Wilder's extensive experience was extremely valuable and Scurry-Rainbow is grateful for his enthusiastic support.

Submitted on behalf of the Board of Directors.



R.F. Haskayne,
President and Chief
Executive Officer.

Calgary, Alberta, Canada.
November 26, 1986.



**REVIEW
OF
OPERATIONS**

EXPLORATION AND DEVELOPMENT

During the first quarter of 1986, Scurry-Rainbow maintained an active exploration and development program. The activity declined, however, for the duration of the year due to depressed world oil prices. The Company participated in the drilling of 339 gross working interest wells compared with 413 in 1985. The total net well count rose to 35.4 from 29.0 one year earlier, reflecting a larger number of proprietary wells and higher average interests in farmin wells.

Exploration and development expenditures in 1986 totalled \$67.3 million compared with \$80.3 million last year. After deducting Petroleum Incentives Program (PIP) grants and Investment Tax Credits, net expenditures were \$45.8 million, virtually unchanged from the prior year.

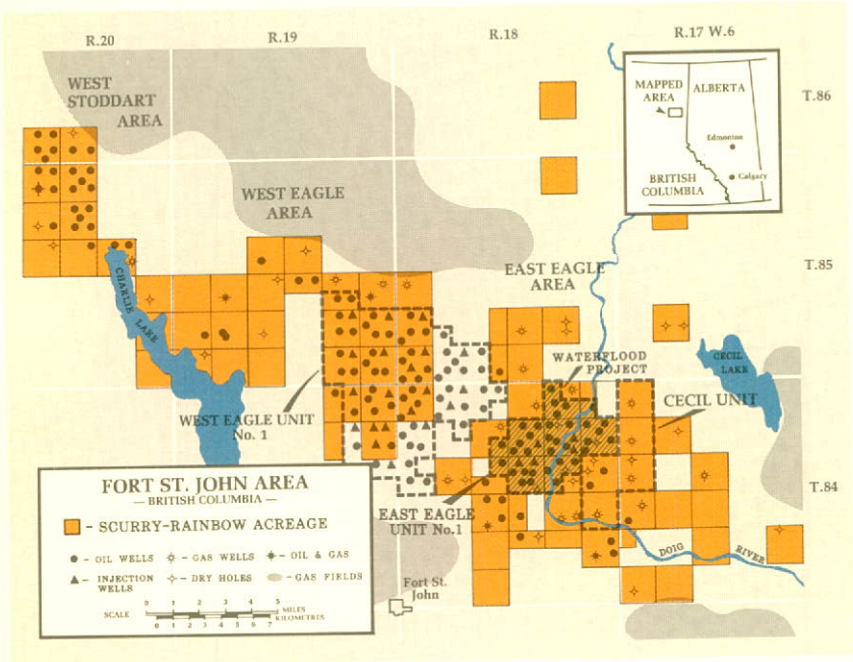
Drilling Activity

In 1986, the Company participated in the drilling of 142 (12.2 net) exploratory and 197 (23.2 net) development wells. The exploration activity yielded 46 (4.6 net) oil and 30 (1.3 net) gas wells. Development drilling successes totalled 156 (17.7 net) oil and 13 (0.8 net) gas wells. During the year, the Company retained gross overriding royalty interests in an additional 29 wells, which yielded 18 oil producers and one gas producer.



"Shooting" a seismic line in southern Alberta. Information collected will enable the Company to gain a better understanding of geological formations.

In 1983, Scurry-Rainbow entered into farmin agreements with Dome Petroleum Limited covering lands held by Dome in western Canada, the Beaufort Sea and offshore Nova Scotia. At the close of fiscal 1986, the Company had earned oil and gas landholdings in western Canada of 450,148 (17,694 net) undeveloped acres and 82,344 (2,862 net) developed acres. A further 5,664,941 (91,323 net) undeveloped acres were earned in the Beaufort Sea and 95,783 (7,000 net) offshore Nova Scotia. Of the 339 working interest wells drilled during 1986, 159 were on lands to which Scurry-Rainbow gained access through the farmin arrangements.



British Columbia

The Company focused its efforts in British Columbia on waterflood and infill drilling programs. Exploratory activity declined from the previous year. Scurry-Rainbow was involved in the drilling of 35 (13.0 net) development and five (0.5 net) exploratory wells during 1986. Development drilling yielded 33 (12.5 net) oil producers, and exploratory efforts added one (0.3 net) oil and one (0.01 net) natural gas well.

Of the 26 development wells operated by the Company, 25 were completed as oil producers. These are located in the West and East Eagle, and West Stoddart fields where the Company holds significant interests.

A waterflood project at the East Eagle field resulted in the recognition of an additional 1.9 million barrels of proved oil reserves. The original project commenced operations in November 1985. A 10-well infill drilling program associated with the second phase was completed and the wells were placed on production in March 1986. With the addition to the second phase of the waterflood, Scurry-Rainbow's share of production increased by 440 barrels per day. The Company holds a 50 percent interest and is the Operator.

At West Eagle Unit No. 1, a 10-well infill drilling program was implemented to improve reservoir performance and production. The project increased the Company's share of proved oil reserves by 1.4 million barrels, and production by 800 barrels per day. The Company holds a 31.5 percent interest in the West Eagle field.

A three-well infill program at the West Stoddart field added 600,000 barrels of oil to Scurry-Rainbow's proved reserves and increased the Company's production by 150 barrels per day. Interests in the wells range from 50 to 85 percent. Additionally, a step-out well drilled at a 100 percent working interest, is currently producing approximately 70 barrels of oil per day.

Development drilling activity in 1987 will consist of about six wells to delineate reservoirs in the East Eagle, West Eagle and West Stoddart areas.

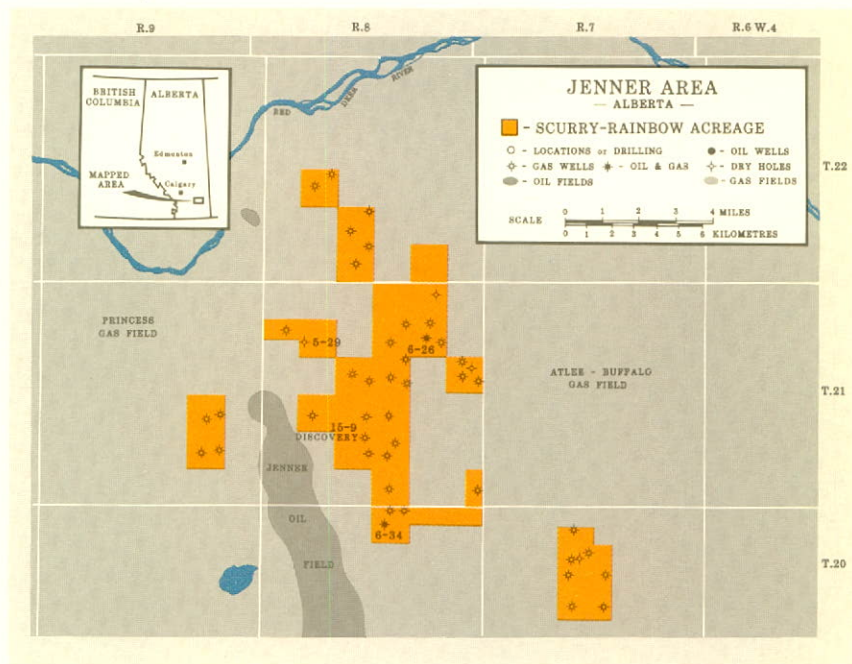
Through a farmout agreement with another company, Scurry-Rainbow holds a 26.6 percent interest in a natural gas discovery in the Sikanni area of north-eastern British Columbia. Further drilling will not be considered until a market is found for the gas.

Alberta

Scurry-Rainbow participated in 117 (5.9 net) exploratory and 88 (7.9 net) development wells drilled in Alberta. Of the exploratory wells, 34 (1.5 net) were oil and 29 (1.3 net) were natural gas. Development drilling resulted in 51 (2.9 net) oil and 13 (0.8 net) gas wells.

During 1986, the Company was involved in five oil discoveries in the Rainbow-Zama area of north-western Alberta. Of these, four were drilled on Dome lands, with working interests varying from 2.3 to five percent. Three of the discovery wells were brought on stream. The fourth was abandoned due to mechanical difficulties, but will be redrilled. At Tehze, a 16.7 percent interest is held in the fifth discovery. Further exploration is planned in the area on other acreage where Scurry-Rainbow holds varying interests.

In the Jenner area of southeastern Alberta, a gas discovery in which the Company holds a 4.4 percent interest, tested at a rate of 15 million cubic feet per day. Jenner is a significant natural gas play, because of potentially large gas reserves at the relatively shallow depth of 3,500 feet. Follow-up drilling yielded two dual gas and heavy oil wells in which interests of 3.3 percent and 4.2 percent are held. Further drilling is planned along the geological trend of the discoveries, where Scurry-Rainbow holds land interests of up to 16.7 percent.



Scurry-Rainbow holds a 4.5 percent interest in a gas discovery in the Albright area of the Alberta Deep Basin. The Company will participate, at a higher working interest, in the drilling of a minimum of two follow-up wells.

In the Seal area of the Peace River Arch, a step-out well from an earlier discovery was completed as an oil producer after year end. The Company holds a 4.2 percent interest in the well. Further step-out wells and some exploratory drilling are planned in the area.

Saskatchewan

The Company participated in 79 (5.5 net) working interest wells, of which 11 (3.4 net) were exploratory and 68 (2.1 net) were development. Exploratory drilling yielded three (0.5 net) oil wells and development drilling resulted in 67 (2.1 net) oil wells.

Scurry-Rainbow holds a 25 percent interest in the province's first significant deep oil discovery. The North Tableland well in southeastern Saskatchewan is currently producing at an allowable rate of 750 barrels per day, compared with the average for wells in the province of 19 barrels per day. Scurry-Rainbow has assembled more than 20 sections of land on the play at interests ranging from 25 to 50 percent. A multi-well exploratory drilling program is planned in 1987.

The Company pursued further exploratory and development drilling in the Weyburn field to follow-up an oil discovery of last year. The two wells drilled this year encountered oil and are currently producing at a combined rate of 100 barrels per day. An average 22 percent interest is held in the two wells.

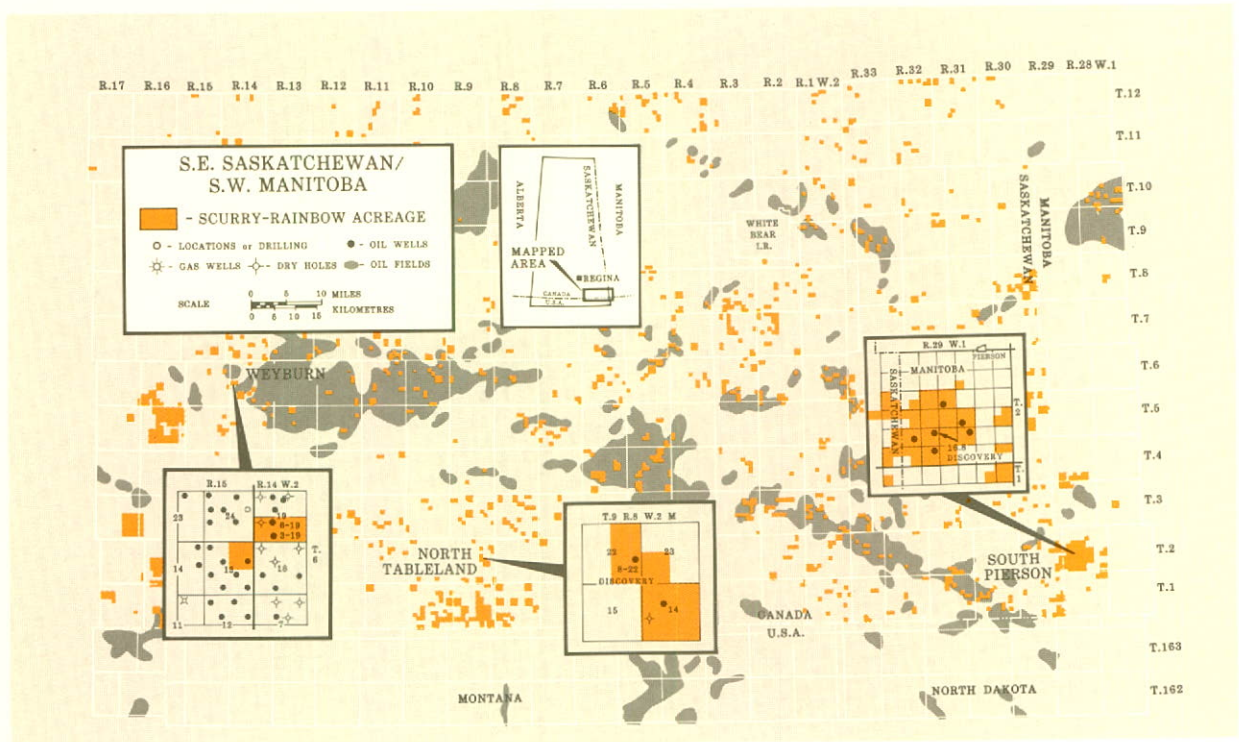
In the Parkman field, Scurry-Rainbow has a 50 percent interest in a successful step-out well which is producing an average 50 barrels of oil per day. A

30-well infill drilling program in the Midale Unit of southeastern Saskatchewan provided 945 gross barrels of oil per day. A 2.4 percent interest is held in these wells.

Manitoba

Scurry-Rainbow participated in 12 (2.2 net) working interest wells, of which six (2.0 net) were exploratory and six (0.2 net) were development. All of the exploratory wells and five (0.2 net) of the development wells were oil producers.

In the South Pierson area of southwestern Manitoba, Scurry-Rainbow was involved in the discovery of a new oil field. Six wells were drilled and all encountered oil. Four of the wells were completed and are each currently producing between 45 and 75 barrels per day. The Company has a 33.3 percent interest in the wells and in approximately 12 sections of land in the vicinity. Three step-out wells are planned for this winter and a development drilling program is under consideration.



Beaufort Sea

During 1986, Scurry-Rainbow participated in the testing of three (0.4 net) wells in the Beaufort Sea under a farmin agreement with Dome.

In October 1985, the Adlartok P-09 and Arluk E-90 wells were tested. The Adlartok well flowed oil at a cumulative rate of 4,130 barrels per day from four zones. The Company initially held a proprietary interest of seven percent in the prospect and has now earned a further 3.1 percent interest in the well and surrounding lands. The Arluk well was dry and abandoned.

In the 1986 drilling season, the Havik B-41 well tested oil at a cumulative flow rate of 746 barrels per day. The well was drilled on proprietary lands in which Scurry-Rainbow holds a 20 percent interest.

Testing of the Havik well concluded the Company's commitments under the Beaufort Sea farmin agreement with Dome. The seven-well exploratory commitment earned Scurry-Rainbow interests varying from 1.9 percent to 8.3 percent in the structures drilled, and an approximate 1.5 percent interest in Dome's remaining undrilled lands in the Beaufort Sea. The Company also has a 20 percent interest in two blocks that it held previously.

North Sea

In 1986, Scurry-Rainbow surrendered its three percent working interest in the K/4 Block in the Dutch sector of the North Sea. A 1985 delineation well to an earlier gas and condensate discovery yielded gas in non-commercial quantities.

Land Position

The industry-wide reduction in activity during the year resulted in significantly lower prices for Crown lands in western Canada. The Company was able to take advantage of this situation, and thus improve its land position and at much lower average prices per acre than last year. During the year, 270,354 (59,003 net) acres were purchased at a weighted average price of \$55.37 per acre. One year earlier, 221,623 (38,913 net) acres were acquired at an average of \$143.01 per acre.

Land Purchases

	1986		1985	
	Net Acres	Average Price Per Acre	Net Acres	Average Price Per Acre
Alberta	38,520	\$51.11	23,700	\$138.40
British Columbia	5,688	\$30.46	5,659	\$145.64
Manitoba	1,534	\$59.38	684	\$108.93
Saskatchewan	13,261	\$77.99	8,870	\$156.26
Total	59,003		38,913	
Average Price		\$55.37		\$143.01

Oil and Gas Landholdings

	Undeveloped Acreage	
	Gross	Net
Western Provinces		
Alberta	1,539,178	202,580
British Columbia	268,520	60,511
Manitoba	36,809	28,988
Saskatchewan	687,178	621,892
	2,531,685	913,971
Frontiers		
Arctic Islands	326,507	33,556
Beaufort Sea	2,989,055	262,794
East Coast	95,783	7,000
	3,411,345	303,350
Total	5,943,030	1,217,321

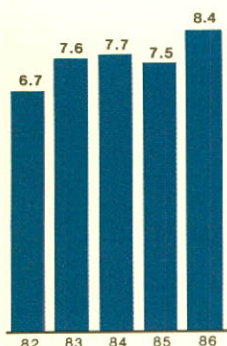
Undeveloped acreage is defined as exploratory lands on which wells have not been drilled or completed to a point that would permit production.

Gross includes the interests of others; net excludes the interests of others. Overriding royalty interests are included in gross acres, but excluded in net acres.

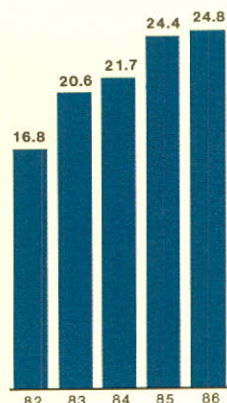
The table excludes 622,897 (95,883 net) acres of developed lands in western Canada. Developed acreage is defined as lands from which production is being obtained or is capable of being obtained.

The 1986 landholdings reflect the acreage earned from the farmin agreement with Dome, but exclude earned lands for which the title documentation has yet to be received. Prior to 1986, earned lands lacking title documentation were included.

Average Daily Production
Oil and Gas Liquids
(thousands of barrels)



Average Daily Sales
Natural Gas
(millions of cubic feet)



PRODUCTION/SALES

Crude oil and natural gas liquids production averaged 8,392 barrels per day, a 12 percent increase over the previous year.

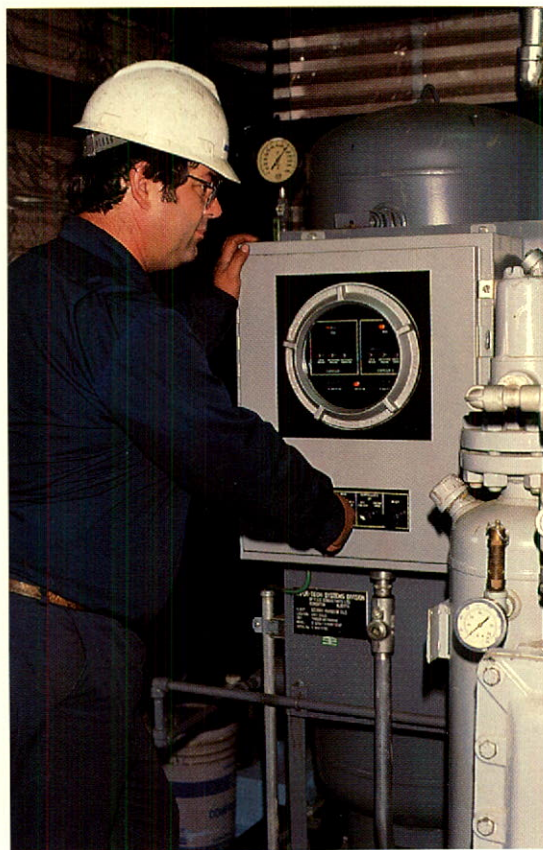
Oil production increased by 442 barrels per day to 7,543 barrels per day, primarily due to the successful implementation of secondary recovery projects in the Fort St. John area of British Columbia. Drilling successes in the Shouldice area of Alberta, the Tableland and Parkman areas of Saskatchewan, and growing production from lands earned under the western Canada farmin agreement with Dome also contributed to the increase. Production from these sources was more than sufficient to offset natural decline in mature fields.

Scurry-Rainbow's natural gas liquids production more than doubled to 849 barrels per day. The increase mainly resulted from the start-up in October 1985 of the Wapiti natural gas liquids recovery facility, which is designed to extract additional amounts of liquids from the gas throughput of the Wapiti processing plant. The Company's 6.3 percent interest in the project resulted in an average 370 barrels per day increase in production.

Natural gas sales rose to an average of 24.8 million cubic feet per day from 24.4 million cubic feet per day. Higher sales originated from the South Wapiti and Garrington fields in Alberta, and the Cecil and East Eagle areas of British Columbia. These increases were sufficient to offset lower sales from the Coleman and Crossfield areas of Alberta, and the West Eagle field in British Columbia.

Average Daily Production/Sales (Before Royalties and Minority Interests)

	1986		1985		1984	
	Oil and Gas Liquids (barrels)	Natural Gas (thousands of cubic feet)	Oil and Gas Liquids (barrels)	Natural Gas (thousands of cubic feet)	Oil and Gas Liquids (barrels)	Natural Gas (thousands of cubic feet)
Alberta	1,949	19,580	1,460	19,526	1,541	16,730
British Columbia	4,571	5,075	4,129	4,636	4,307	4,718
Saskatchewan	1,743	190	1,780	229	1,761	263
Manitoba	129	—	101	—	100	—
Total	8,392	24,845	7,470	24,391	7,709	21,711



Operator inspecting air compressors at East Eagle as part of regular maintenance procedures.

PROVED RESERVES

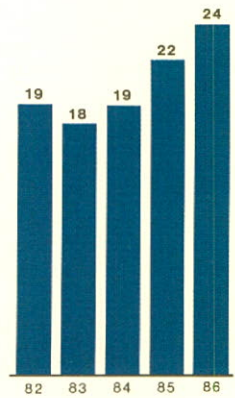
Proved oil reserves amounted to 22.1 million barrels at year end, a 12 percent increase over 1985. For the second consecutive year, additions to proved reserves through successful drilling exceeded annual production. Discoveries and extensions added 4.7 million barrels, while production totalled 2.8 million barrels. Significant additions were recorded in the East and West Eagle, and West Stoddart areas of British Columbia; the Tableland area of Saskatchewan; and the South Pierson area of Manitoba.

Natural gas liquids reserves were 2.2 million barrels at year end, relatively unchanged from 1985. Discoveries and extensions added 314,000 barrels compared with sales of 310,000 barrels.

Proved gas reserves were up three percent over last year, reaching 207.2 billion cubic feet. This is the third consecutive year that additions through drilling successes were more than sufficient to replace gas sales. Discoveries and extensions accounted for 12.9 billion cubic feet of reserve additions compared with sales of 9.1 billion cubic feet. The primary areas contributing these additions were the Shouldice, Garrington, Carstairs, and Grand Prairie areas of Alberta; and the Sikanni, and East and West Eagle areas of British Columbia.

Total proved reserves added by discoveries and extensions amounted to 7.2 million barrels of oil equivalent (BOE). The exploration and development costs incurred to add these reserves were \$45.6 million after incentives, or \$6.40 per BOE, down substantially from the \$7.36 experienced in 1985.

Proved Reserves
Oil and Gas Liquids
(millions of barrels)

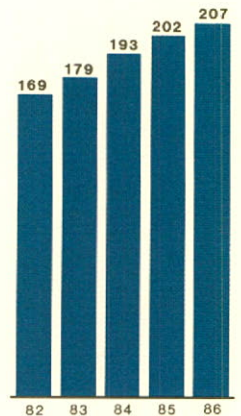


Proved Reserves

(Before Royalties and Minority Interests)

	Crude Oil (thousands of barrels)	Natural Gas Liquids (thousands of barrels)	Natural Gas (billions of cubic feet)	Sulphur (thousands of long tons)
October 1, 1985	19,675	2,183	201.5	324.0
Discoveries/Extensions	4,664	314	12.9	0.4
Revisions	478	27	1.9	1.5
Production/Sales	(2,753)	(310)	(9.1)	(21.3)
September 30, 1986	22,064	2,214	207.2	304.6

Proved Reserves
Natural Gas
(billions of cubic feet)



Proved reserves are the estimated quantities of crude oil, natural gas liquids, natural gas and sulphur which geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic and operating conditions. The reserve estimates are prepared by Company engineers.

FINANCIAL REVIEW

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Management's discussion relates to the results of operations, financial condition, and changes in financial condition for the three years ended September 30, 1986. These comments should be read in conjunction with the consolidated financial statements, the unaudited supplementary information, and the five-year financial and operating reviews.

Earnings

Scurry-Rainbow's earnings suffered in 1986 from declining oil and gas prices which resulted in net earnings of \$17.8 million, down from \$30.1 million in 1985 and \$24.9 million in 1984. Depressed earnings reflect reduced prices, lower investment income, and higher depletion; offset, in part, by increased production. Earnings per share amounted to \$1.32 compared with \$2.25 in 1985 and \$1.86 in 1984.

The rate of return on average shareholders' equity was 9.8 percent, down from the 18.9 percent recorded in each of the previous two years.

Revenue

Oil revenue during the year amounted to \$49.5 million, a 27 percent decline from the prior two years. Falling world oil prices, in combination with deregulation of prices and markets on June 1, 1985, resulted in a reduction in the Company's average oil prices to \$22.77 per barrel compared with \$34.26 in 1985 and \$33.42 in 1984. Development drilling in north-eastern British Columbia increased average oil production to 7,543 barrels per day during 1986 compared with 7,101 in 1985 and 7,304 in 1984.

Gas revenue for 1986 declined to \$17.2 million compared with \$20.5 million in 1985 and \$18.7 million in 1984. During the three-year period, lower prices for gas sold into United States markets were offset, in part, by increased sales. Gas prices averaged \$2.37 per thousand cubic feet compared with \$2.73 in 1985 and \$2.84 in 1984. Gas sales increased to 24.8 million cubic feet per day during 1986 compared with 24.4 in 1985 and 21.7 in 1984.

Natural gas liquids revenue improved during 1986 to \$4.6 million, a 52 percent increase over the revenue achieved in 1985 and 1984. Commencement of production from the liquids recovery facility in the Wapiti area of Alberta increased volumes to 849 barrels per day from 369 and 405 barrels per day in 1985 and 1984, respectively.

Expenses and Taxes

Operating, general and administrative expenses amounted to \$17.1 million, marginally lower than in 1985 and eight percent greater than that recorded in 1984. The Company's capital expenditure program resulted in an increase in depletion rates to \$4.13 per barrel of oil equivalent from \$3.82 and \$3.54 recorded in 1985 and 1984, respectively.

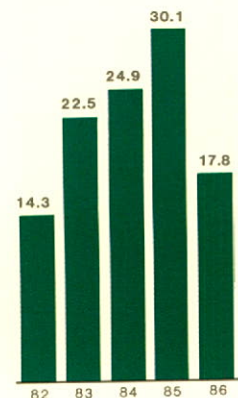
Income taxes, as a percentage of pretax earnings, averaged 50.9 percent during 1986, up from 42.8 percent in 1985 and 46.8 percent in 1984. The increase in rates is due to the introduction of a five percent surtax effective July 1, 1985; a change in the accounting treatment of Investment Tax Credits; and the phase out of earned depletion.

The Petroleum and Gas Revenue Tax (PGRT) declined to \$5.1 million, from \$11.0 million in 1985 and \$12.1 million in 1984. Lower prices, exempt production, and a rate reduction from 12 percent to 10 percent, effective January 1, 1986, caused this reduction. The PGRT was terminated October 1, 1986. Since inception of the tax in 1981, the Company incurred \$46.4 million in PGRT.

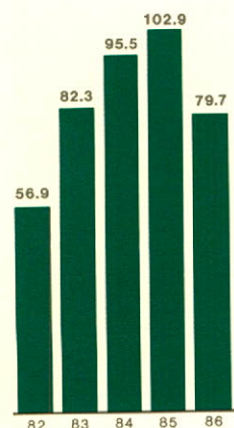
Capital Expenditures and Corporate Liquidity

Capital expenditures after incentives were \$45.8 million, essentially unchanged from the prior two years. Land acquisition and exploration activity in western Canada accounted for \$22.3 million, with an additional \$4.1 million being spent in the Beaufort Sea. Development expenditures increased \$3.5 million to \$19.4 million in 1986, most of which again occurred in the Fort St. John area of British Columbia.

Net Earnings
(millions of dollars)



Revenue
(millions of dollars)



The Company's Petroleum Incentives Program (PIP) grants totalled \$20.9 million in 1986 compared with \$34.1 million in 1985 and \$46.7 million in 1984. To date, the Company has qualified for grants totalling \$132.2 million. PIP grants were terminated on March 31, 1986, though certain activities were "grandfathered" to December 31, 1987.

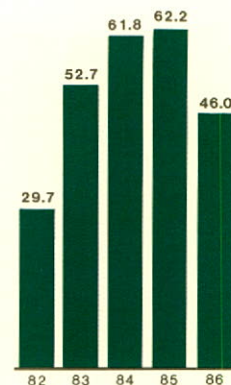
Lower prices reduced funds from operations to \$46 million, down from approximately \$62 million in both 1985 and 1984. The capital expenditure program plus an initial dividend of \$6.7 million more than offset funds generated from operations, resulting in a reduction of \$4.6 million in working capital. At year end, the Company's working capital totalled \$58.8 million.

The Company adopted the Canadian Institute of Chartered Accountants Guidelines with respect to full cost accounting. Under the ceiling test guidelines, the estimated recoverable amount of the Company's proved reserves and unproved properties is significantly greater than the net book value of oil and gas properties less deferred taxes.

The Alberta government introduced four short-term incentive programs with a budget of \$500 million for 1986 to encourage exploratory drilling; development drilling and completions; reflective seismic; and service and repair for wells, batteries and pipelines. The exploratory drilling program began April 1, 1986 and the other programs started June 4, 1986. All of these programs expire on December 31, 1986. Through royalty credits and cash grants, these programs pay for 35 to 50 percent of eligible capital expenditures. This reduced the cash requirements and improved the economic return for capital projects, but did not stimulate a substantial increase in capital expenditure plans for Scurry-Rainbow or other oil and gas companies operating within Alberta. To September 30, 1986, the Company qualified for \$0.5 million under these programs.

On October 29, 1986, the Alberta government announced a reduction in royalty rates for old and new oil and gas, and a new drilling incentive program based on crude oil royalty holidays of one, three and five years, depending on the drilling commencement date. These government initiatives are expected to encourage increased exploratory activity.

Funds From Operations (millions of dollars)



Financial reporting and analysis is continually being enhanced through the use of modern computer technology.

Capital Expenditures After Incentives (millions of dollars)



**CONSOLIDATED
STATEMENT
OF FINANCIAL
POSITION**

(Expressed in thousands of dollars)	September 30,	
	1986	1985
ASSETS		
Current Assets		
Short-term investments	\$ 14,896	\$ 15,066
Advances to parent company (Note 10)	24,800	40,086
Accounts receivable		
Trade	11,935	13,736
Petroleum incentives program	28,644	34,808
Inventories, at lower of cost or net realizable value	647	698
	80,922	104,394
Investment in 50% Owned Company	791	951
Property, Plant and Equipment (Note 2)	227,135	202,957
Other Assets (Note 2)	3,583	4,201
	\$312,431	\$312,503
LIABILITIES		
Current Liabilities		
Bank indebtedness	\$ 519	\$ 1,481
Accounts payable	11,840	21,858
Taxes payable	6,779	14,834
Due to parent company	3,007	2,794
	22,145	40,967
Deferred Production Revenue (Note 4)	3,706	3,831
Long-Term Debt (Note 5)	4,134	4,189
Deferred Income Taxes	95,796	87,889
SHAREHOLDERS' EQUITY		
Capital Stock (Note 7)	10,922	10,922
Contributed Surplus	23,334	23,334
Retained Earnings	152,394	141,371
	186,650	175,627
	\$312,431	\$312,503

Approved by the Board

R. J. Huskey, Director

Robert G. Black, Director

**CONSOLIDATED
STATEMENT
OF EARNINGS AND
RETAINED EARNINGS**

(Expressed in thousands of dollars except per share amounts)	Year ended September 30,		
	1986	1985	1984
Revenue			
Operating	\$ 73,764	\$ 94,567	\$ 90,431
Other (Note 10)	5,888	8,315	5,077
	79,652	102,882	95,508
Expense			
Operating	14,304	13,765	13,159
General and administrative	2,762	3,535	2,591
Depletion and depreciation (Note 2)	20,166	16,942	15,715
Interest (Note 5)	669	420	520
Minority interest (Note 6)	—	372	445
	37,901	35,034	32,430
Earnings Before Taxes	41,751	67,848	63,078
Taxes (Note 8)	23,997	37,716	38,180
Net Earnings	17,754	30,132	24,898
Retained Earnings at Beginning of Year	141,371	111,239	86,341
	159,125	141,371	111,239
Dividends	6,731	—	—
Retained Earnings at End of Year	\$152,394	\$141,371	\$111,239
Earnings Per Share	\$1.32	\$2.25	\$1.86

To the Shareholders of Scurry-Rainbow Oil Limited

We have examined the consolidated statement of financial position of Scurry-Rainbow Oil Limited as at September 30, 1986 and 1985 and the consolidated statements of earnings and retained earnings, changes in financial position and changes in non-cash working capital for each of the three years in the period ended September 30, 1986. Our examinations were made in accordance with generally accepted auditing standards in Canada, 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 September 30, 1986 and 1985 and the results of its operations and the changes in its financial position for each of the three years in the period ended September 30, 1986 in accordance with generally accepted accounting principles in Canada, consistently applied.

Calgary, Alberta, Canada.
November 14, 1986.


Chartered Accountants

**AUDITORS'
REPORT**

**CONSOLIDATED
STATEMENT
OF CHANGES IN
FINANCIAL
POSITION**

	Year ended September 30,		
	1986	1985	1984
(Expressed in thousands of dollars)			
Cash Was Obtained From			
Operations			
Net earnings	\$ 17,754	\$ 30,132	\$ 24,898
Charges (credits) not affecting funds			
Depletion and depreciation	20,166	16,942	15,715
Deferred income taxes	7,907	14,890	20,919
Other	151	249	299
Funds from operations	45,978	62,213	61,831
Changes in non-cash working capital	(9,844)	23,801	(20,678)
	36,134	86,014	41,153
Cash Was Used For			
Investment			
Capital expenditures	45,785	46,236	45,192
Disposal of property, plant and equipment	(1,441)	(255)	(311)
Purchase of minority interest	—	5,904	—
Other	(624)	(702)	(479)
	43,720	51,183	44,402
Increase (decrease) in cash before financing	(7,586)	34,831	(3,249)
Financing			
Deferred production revenue	(125)	(488)	1,459
Reduction of long-term debt	(52)	(2,540)	(699)
Issue of common shares	—	1,548	—
Dividends	(6,731)	—	—
	(6,908)	(1,480)	760
Increase (Decrease) in Cash	(14,494)	33,351	(2,489)
Cash at Beginning of Year	53,671	20,320	22,809
Cash* at End of Year	\$ 39,177	\$ 53,671	\$ 20,320

* Cash is defined as short-term investments and advances to parent company, less bank indebtedness.

**CONSOLIDATED
STATEMENT OF
CHANGES IN
NON-CASH
WORKING CAPITAL**

	Year ended September 30,		
	1986	1985	1984
(Expressed in thousands of dollars)			
Changes in Non-Cash Working Capital			
Accounts receivable			
Trade	\$ 1,801	\$ 1,057	\$ (1,172)
Petroleum incentives program	6,164	6,934	(17,910)
Inventories	51	364	(412)
Accounts payable	(10,018)	3,974	3,346
Taxes payable	(8,055)	10,125	(5,041)
Due to parent company	213	1,347	542
Current portion of long-term debt	—	—	(31)
	\$ (9,844)	\$23,801	\$(20,678)

(Tabular amounts,
except per share amounts,
are expressed in thousands)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Company's significant accounting policies, which conform with accounting principles generally accepted in Canada, are summarized below:

Principles of Consolidation

The consolidated financial statements include the accounts of all companies in which the Company has ownership of more than 50 percent of the voting capital stock.

The Company follows the equity method of accounting for its investment in a 50 percent owned company. Under this method, the Company's investment is carried at cost plus its share of undistributed earnings since the date of acquisition.

Substantially all of the exploration and production activities of the Company are conducted jointly with the parent company and other companies and these financial statements reflect the Company's proportionate interest in such activities.

Oil and Gas Operations

The Company follows the full cost method of accounting for oil and gas operations, whereby all exploration and development costs are capitalized and charged against earnings as set out below. Capitalized costs include land acquisition costs, geological and geophysical costs, lease rentals and related charges applicable to non-producing property, costs of drilling both productive and non-productive wells, and overhead charges related to exploration and development activities. Such costs, net of accumulated depletion and depreciation, and deferred income taxes, are generally limited to the future net revenues from estimated production from proved reserves at current prices and costs, and the lower of cost or estimated fair market value of unproved properties, less estimated future financing, general and administrative and income tax expense. A separate cost centre is established for each country. Proceeds of disposals are generally credited to cost and no gains or losses are recognized unless such disposals constitute a major disposition. Costs are depleted using the unit of production method based upon estimated proved reserves, as determined by Company engineers. Natural gas reserves and production are converted to equivalent volumes of crude oil based on the relative energy content. Costs of acquiring and evaluating significant unproved properties and costs of major development projects are excluded from the computation of depletion until such time as additional reserves are proved, the project is completed, or an impairment in value has occurred.

Buildings and equipment, other than production equipment, are depreciated on a straight-line basis at rates which are estimated to amortize the costs of the assets, less salvage values, over their useful lives. Production equipment is depreciated using the unit of production method.

Mining Costs

Mining costs are charged to earnings in the year incurred (included in depletion) until such time as the presence of economically recoverable reserves is established. Proceeds on partial disposition of properties are generally deducted from the related costs without recognition of gain or loss.

2. PROPERTY, PLANT AND EQUIPMENT

	September 30, 1986		
	Cost	Accumulated depletion and depreciation	Net
Petroleum and natural gas properties and equipment	\$358,487	\$135,226	\$223,261
Mining properties and equipment			
Developed	4,603	2,636	1,967
Undeveloped	2,386	604	1,782
Land, buildings and other equipment	527	402	125
	\$366,003	\$138,868	\$227,135

	September 30, 1985		
	Cost	Accumulated depletion and depreciation	Net
Petroleum and natural gas properties and equipment	\$314,288	\$116,277	\$198,011
Mining properties and equipment			
Developed	4,603	1,602	3,001
Undeveloped	2,380	598	1,782
Land, buildings and other equipment	506	343	163
	\$321,777	\$118,820	\$202,957

Costs of petroleum and natural gas properties at September 30, 1986 have been reduced by incentives of \$132,801,000 (1985 — \$111,249,000). Exploration and development expenditures for the year ended September 30, 1986, have been reduced by incentives of \$21,552,000 (1985 — \$34,060,000; 1984 — \$46,676,000).

Costs of evaluating unproved properties excluded from the computation of depletion amounted to \$2,384,000 at September 30, 1986 (1985 — \$3,826,000).

Oil and gas depletion and depreciation expense per equivalent unit of production for the year ended September 30, 1986, amounted to \$4.13 per barrel (1985 — \$3.82; 1984 — \$3.54).

The developed mining properties and equipment pertain to a net profits interest in mining operations in Nevada. On January 10, 1983, the Company sold the Gooseberry gold and silver mine in Nevada for a cash consideration of U.S. \$3 million and non-interest bearing notes aggregating U.S. \$6 million payable equally over ten years ending January 31, 1993. In recording the transaction, the proceeds were credited to cost and the Canadian value of the notes was discounted at a rate of 10 percent to \$4,535,000; currently \$3,672,000 is included in other assets. The Company has retained a net profits interest in the mine ranging from 15 percent to 30 percent depending on the price of gold.

3. OPERATING LINE OF CREDIT

As at September 30, 1986, the Company had an unused operating line of credit of approximately \$5 million, which upon drawdown would bear interest at the prime rate.

4. DEFERRED PRODUCTION REVENUE

Amounts paid to the Company by purchasers, for annual contracted gas volumes not taken, are recorded as deferred production revenue. These amounts will be reported as revenue when the gas to which the payments relate is delivered to the purchaser. Deliveries or repayments are to be made over a maximum 10-year period ending November 1, 1994.

5. LONG-TERM DEBT

The long-term debt consists of 7.25 percent Subordinated Debentures, due in 1988. Interest on long-term debt for the year ended September 30, 1986 amounted to \$312,000 (1985 — \$317,000; 1984 — \$452,000).

As at September 30, 1986, the Company had an unused bank revolving capital loan facility of \$10 million, which upon drawdown would bear interest at the prime rate. The loan can be drawn on a revolving basis for two years and thereafter will be convertible into a six-year term loan with interest at prime plus one-quarter percent.

6. PURCHASE OF MINORITY INTEREST

As of July 22, 1985, the Company acquired the 27.8 percent minority interest in its subsidiary company, Plains Petroleums Limited (Plains), and subsequently amalgamated Plains with the Company. The minority shareholders were given the option of exchanging 22 common shares of Plains for one common share of the Company or receiving one dollar for each common share of Plains. The acquisition price of \$5,904,000 was settled by payment of \$4,356,000 cash and issuance of 70,349 common shares of the Company valued at \$1,548,000. This transaction gave rise to \$3,165,000 in excess costs which have been allocated to property, plant and equipment. There would have been no material effect on net earnings had the transaction occurred October 1, 1984.

7. CAPITAL STOCK

The authorized capital stock of the Company consists of 100 million preferred shares, without par value, and 200 million common shares, without par value. As at September 30, 1986 and 1985, the Company had 13,462,129 common shares issued and outstanding.

8. TAXES

Taxes are comprised of the following:

	Year ended September 30,		
	1986	1985	1984
Income taxes			
Current	\$13,359	\$14,169	\$ 8,628
Deferred	7,907	14,890	20,919
	21,266	29,059	29,547
Petroleum and gas revenue tax	5,081	10,970	12,051
Alberta royalty tax credit	(2,350)	(2,313)	(3,418)
Total taxes	\$23,997	\$37,716	\$38,180
Total taxes as a percentage of earnings before taxes	57.5%	55.6%	60.5%

Deferred income taxes arise mainly from deducting exploration and development costs for income tax purposes in excess of the related provision for depletion.

8. TAXES (continued)

Income taxes differ from the amounts which would be obtained by applying the Canadian statutory federal income tax rate of 46 percent to pretax earnings. These differences result from the following:

	Year ended September 30,		
	1986	1985	1984
Earnings before taxes	\$41,751	\$ 67,848	\$ 63,078
Computed "expected" income taxes	\$19,205	\$ 31,210	\$ 29,016
Royalties and other non-deductible payments to provincial governments	7,883	10,553	11,037
Federal resource allowance	(7,349)	(10,079)	(10,917)
Depletion allowances on Canadian oil and gas production income	(37)	(943)	(1,125)
Manufacturing and processing allowance	(866)	(1,079)	—
Corporate surtax	463	160	125
Investment tax credits	—	(2,103)	(581)
Provincial income taxes, net of federal income tax abatement	1,267	2,274	1,549
Other	700	(934)	443
Income taxes	\$21,266	\$ 29,059	\$ 29,547
Income taxes as a percentage of earnings before taxes	50.9%	42.8%	46.8%

9. BUSINESS AND GEOGRAPHIC SEGMENTS

The Company has only one significant business segment being its oil and gas operations which are conducted in Canada.

10. RELATED PARTY TRANSACTIONS

Home Oil Company Limited (Home) owns approximately 88.1 percent of the issued and outstanding shares of the Company. During the year ended September 30, 1986, Home provided certain management, accounting, administrative, technical and other services to the Company at cost, which amounted to \$11,020,000 (1985 — \$10,216,000; 1984 — \$9,200,000). Of this amount, \$7,913,000 has been capitalized and allocated to property, plant and equipment (1985 — \$7,002,000; 1984 — \$6,218,000).

Advances to parent company carry interest at one-quarter percent above the cost of funds in the commercial paper market and are repayable on demand. Interest received from the parent company for the year ended September 30, 1986, amounted to \$2,705,000 (1985 — \$4,963,000; 1984 — \$3,605,000).

(a) Selected Quarterly Financial Data

	September 30, 1986	Quarter ended		December 31, 1985
		June 30, 1986	March 31, 1986	
Revenue	\$14,465	\$14,221	\$23,751	\$27,215
Gross margin	\$ 9,956	\$ 9,861	\$19,769	\$23,000
Net earnings	\$ 2,975	\$ 2,124	\$ 5,571	\$ 7,084
Earnings per share	\$ 0.22	\$ 0.16	\$ 0.41	\$ 0.53

	September 30, 1985	Quarter ended		December 31, 1984
		June 30, 1985	March 31, 1985	
Revenue	\$24,747	\$25,742	\$26,716	\$25,677
Gross margin	\$19,347	\$21,802	\$22,460	\$21,973
Net earnings	\$ 7,505	\$ 7,527	\$ 7,448	\$ 7,652
Earnings per share	\$ 0.56	\$ 0.56	\$ 0.56	\$ 0.57

(b) Oil and Gas Exploration and Production Activities

The Company's oil and gas exploration and production activities are carried out in Canada. The following unaudited supplementary oil and gas information is provided in accordance with the United States' Statement of Financial Accounting Standards No. 69, "Disclosures about Oil and Gas Producing Activities".

Capitalized Costs

	1986	September 30,	
		1985	1984
Petroleum and natural gas properties	\$ 358,487	\$ 314,288	\$ 273,743
Accumulated depletion and depreciation	(135,226)	(116,277)	(108,371)
Net capitalized costs	\$ 223,261	\$ 198,011	\$ 165,372

Costs Incurred

	Year ended September 30,		
	1986	1985	1984
Acquisition of unproved properties	\$ 3,427	\$ 5,203	\$ 4,421
Exploration	22,969	24,994	23,194
Development	19,250	15,741	17,438
	\$ 45,646	\$ 45,938	\$ 45,053

Results of Operations

	Year Ended September 30,		
	1986	1985	1984
Revenue, net of royalties	\$ 73,764	\$ 94,567	\$ 90,431
Production costs	14,304	13,765	13,159
Petroleum and gas revenue tax	5,081	10,970	12,051
Depletion and depreciation	18,985	16,240	14,870
	38,370	40,975	40,080
Income before income taxes from oil and gas operations	35,394	53,592	50,351
Income taxes (net of Alberta royalty tax credit)	17,929	23,733	25,887
Results of oil and gas operations (excluding general and administrative overhead, and interest costs)	\$ 17,465	\$ 29,859	\$ 24,464

Proved Oil and Gas Reserve Quantities

The Company's proved reserves are based on estimates made by Company engineers. Proved oil and gas reserves are the estimated quantities of crude oil and natural gas liquids, and natural gas which geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic and operating conditions. Proved developed oil and gas reserves are reserves that can be expected to be recovered through existing wells with existing equipment and operating methods. The process of estimating reserves is complex, requiring subjective judgements in the evaluation of available geological, engineering, economic, and other data.

The calculation of reserves of crude oil and natural gas liquids, and natural gas is based on the Company's share of proved reserves, after the deduction of royalties. The net reserves set forth below have been calculated on the basis of royalty rates and regulations in effect at each year end.

	Crude oil and natural gas liquids (thousands of barrels)			Natural gas (billions of cubic feet)		
	1986	1985	1984	1986	1985	1984
Proved Reserves						
Beginning of year	16,950	14,225	13,733	167	145	146
Revisions of previous estimates and improved recovery	1,621	2,182	742	(3)	15	(6)
Extensions and discoveries	4,180	2,640	1,882	10	14	12
Production	(2,429)	(2,097)	(2,132)	(7)	(7)	(7)
End of year	20,322	16,950	14,225	167	167	145
Proved Developed Reserves						
Beginning of year	16,834	14,202	12,936	152	133	132
End of year	20,220	16,834	14,202	150	152	133

Standardized Measure of Discounted Future Net Cash Flows and Changes Therein

Future cash inflows are computed by applying year-end prices, except for fixed and determinable escalation provisions in contracts, to year-end quantities of proved oil and gas reserves. Future development costs, production costs, Petroleum and Gas Revenue Tax (PGRT), and income taxes (net of Alberta Royalty Tax Credit), are deducted from future cash inflows to arrive at future net cash flows. Future development and production costs are based on year-end costs and assume continuation of existing economic and operating conditions. Future PGRT is computed based on rates and regulations in effect at year end; the tax was terminated effective October 1, 1986. Future income taxes are computed by applying the year-end statutory rates to the future pretax net cash flows, after making provision for the tax basis of the oil and gas properties. Future net cash flows are discounted at a rate of 10 percent per annum to arrive at discounted future net cash flows.

The Company cautions that the discounted future net cash flows from proved oil and gas reserves is neither an indication of fair market value of the Company's oil and gas properties, nor of the future net cash flows expected to be generated from such properties. The discounted future net cash flows do not include the fair market value of exploratory properties and probable or possible oil and gas reserves, nor give consideration to the effect of anticipated future changes in crude oil and natural gas prices, development and production costs, and possible changes to tax and royalty regulations. The prescribed discount rate of 10 percent may not appropriately reflect future interest rates.

Standardized Measure of Discounted Future Net Cash Flows

	1986	September 30, 1985	1984
Future cash inflows	\$ 816,447	\$1,056,934	\$ 872,770
Future costs			
Production	(202,452)	(210,502)	(175,206)
Development	(17,180)	(35,477)	(24,306)
PGRT	—	(22,254)	(114,361)
Future pretax cash flows	596,815	788,701	558,897
Future income taxes	(187,577)	(328,631)	(239,808)
Future net cash flows	409,238	460,070	319,089
10% annual discount for estimated timing of cash flows	(194,123)	(270,597)	(172,348)
Discounted future net cash flows	\$ 215,115	\$ 189,473	\$ 146,741

Changes in Standardized Measure of Discounted Future Net Cash Flows

	Year Ended September 30,		
	1986	1985	1984
Revisions to reserves proved in prior years			
Revisions of previous quantity and timing estimates	\$ 51,647	\$ 6,759	\$ (8,310)
Net changes in prices, net of production costs and PGRT	(143,158)	83,392	(3,323)
Termination of PGRT	16,503	—	—
Net changes in estimated future development costs	2,800	(19,615)	(4,321)
Other	(43)	110	1,097
Accretion of discount	35,449	27,181	28,052
	(36,802)	97,827	13,195
Changes during the year			
Extensions, discoveries and improved recovery, net of related costs	37,919	45,702	34,468
Previously estimated development costs incurred during the year	12,484	8,989	8,845
Sales of oil and gas produced, net of production costs and PGRT	(54,379)	(69,832)	(65,221)
	(3,976)	(15,141)	(21,908)
Total revisions and changes before income taxes	(40,778)	82,686	(8,713)
Net changes in income taxes	66,420	(39,954)	2,735
Total revisions and changes	25,642	42,732	(5,978)
Discounted future net cash flows, at beginning of year	189,473	146,741	152,719
Discounted future net cash flows, at end of year	\$ 215,115	\$189,473	\$146,741

(Expressed in thousands of dollars except per share amounts)	1986	1985	1984	1983	1982
Statement of Earnings					
Revenue					
Crude oil	\$ 49,496	\$ 68,137	\$ 67,356	\$ 57,056	\$ 40,727
Natural gas	17,213	20,461	18,722	17,943	12,503
Natural gas liquids	4,612	3,038	3,036	2,599	1,406
Sulphur	2,443	2,931	1,317	1,381	1,149
Other	5,888	8,315	5,077	3,367	1,142
	79,652	102,882	95,508	82,346	56,927
Expense					
Operating and general	17,066	17,300	15,750	14,437	14,144
Depletion and depreciation	20,166	16,942	15,715	15,029	9,713
Other	669	792	965	1,040	2,452
	37,901	35,034	32,430	30,506	26,309
Earnings before taxes	41,751	67,848	63,078	51,840	30,618
Taxes	23,997	37,716	38,180	29,377	16,294
Net earnings	\$ 17,754	\$ 30,132	\$ 24,898	\$ 22,463	\$ 14,324
Earnings per share	\$ 1.32	\$ 2.25	\$ 1.86	\$ 1.68	\$ 1.07
Statement of Changes in Financial Position					
Funds from operations	\$ 45,978	\$ 62,213	\$ 61,831	\$ 52,704	\$ 29,709
Changes in non-cash working capital	(9,844)	23,801	(20,678)	(14,872)	(344)
Cash used for investment	(43,720)	(51,183)	(44,402)	(15,513)	(20,188)
Cash obtained from (used for) financing	(6,908)	(1,480)	760	(546)	(5,860)
Increase (decrease) in cash ²	\$ (14,494)	\$ 33,351	\$ (2,489)	\$ 21,773	\$ 3,317
Funds from operations per share	\$ 3.42	\$ 4.64	\$ 4.62	\$ 3.94	\$ 2.22
Capital Expenditures After Incentives					
Oil and gas					
Land acquisition	\$ 3,427	\$ 5,203	\$ 4,421	\$ 773	\$ —
Exploration	22,969	24,994	23,194	9,760	3,594
Development	19,250	15,741	17,438	9,355	15,325
	45,646	45,938	45,053	19,888	18,919
Other	139	298	139	315	1,798
	\$ 45,785	\$ 46,236	\$ 45,192	\$ 20,203	\$ 20,717
Working capital (deficiency)	\$ 58,777	\$ 63,427	\$ 53,877	\$ 35,688	\$ (957)
Total assets	\$312,431	\$312,503	\$256,600	\$211,535	\$177,412
Long-term debt (including current portion)	\$ 4,134	\$ 4,189	\$ 6,897	\$ 7,720	\$ 9,417
Shareholders' equity	\$186,650	\$175,627	\$143,947	\$119,049	\$ 96,586
Shares outstanding at end of year	13,462,129	13,462,129	13,391,780	13,391,780	13,391,780
Dividends per share	\$ 0.50	\$ —	\$ —	\$ —	\$ —
Return on average shareholders' equity	9.8%	18.9%	18.9%	20.8%	16.0%

¹ The above data incorporates retroactive adjustments.

² Cash is defined as short-term investments and advances to parent company, less bank indebtedness.

**FIVE-YEAR
OPERATING
REVIEW**

	1986	1985	1984	1983	1982
Production/Sales Data¹					
Crude oil					
— barrels per day	7,543	7,101	7,304	7,227	6,460
— average price per barrel	\$22.77	\$34.26	\$33.42	\$29.16	\$23.19
— average royalty rate	21.1%	23.3%	24.6%	26.1%	25.6%
Natural gas liquids					
— barrels per day	849	369	405	371	264
— average price per barrel	\$17.76	\$28.37	\$26.92	\$24.82	\$18.67
— average royalty rate	16.2%	20.6%	23.8%	22.2%	21.8%
Natural gas					
— thousands of cubic feet per day	24,845	24,391	21,711	20,622	16,824
— average price per thousand cubic feet	\$2.37	\$2.73	\$2.84	\$2.80	\$2.46
— average royalty rate	19.7%	16.0%	16.9%	14.9%	17.4%
Sulphur					
— long tons per day	58	104	67	62	53
— average price per long ton	\$134.00	\$90.23	\$63.74	\$67.10	\$72.70
— average royalty rate	14.6%	14.4%	15.3%	9.6%	19.3%
Drilling Activity (working interest wells)²					
Gross exploratory					
Oil	46	65	31	4	2
Gas	30	51	23	1	1
Dry	66	94	59	4	4
Gross development					
Oil	156	129	102	28	15
Gas	13	27	22	7	12
Dry	28	47	35	9	8
Total	339	413	272	53	42
Net exploratory					
Oil	4.56	6.68	5.07	1.20	0.28
Gas	1.30	2.69	2.23	0.08	0.67
Dry	6.34	5.25	4.99	1.49	0.49
Net development					
Oil	17.67	9.40	15.81	6.87	6.49
Gas	0.80	0.74	0.61	0.42	1.67
Dry	4.73	4.24	2.45	1.87	5.47
Total	35.40	29.00	31.16	11.93	15.07
Proved Reserves (before royalties)					
Crude oil — thousands of barrels	22,064	19,675	17,203	15,945	17,259
Natural gas liquids — thousands of barrels	2,214	2,183	1,975	1,610	1,686
Natural gas — billions of cubic feet	207.2	201.5	192.8	178.9	169.0
Sulphur — thousands of long tons	304.6	324.0	340.7	366.9	366.0
Additions cost ³ — per barrel of oil equivalent ⁴	\$6.40	\$7.36	\$8.84	\$9.23	\$4.26
Oil and Gas Landholdings (thousands of acres)^{2,5}					
Gross Undeveloped	5,943	4,424	3,388	3,561	4,054
Net Undeveloped	1,217	1,143	1,072	1,350	1,395
Gross Developed	623	639	776	730	739
Net Developed	96	97	131	124	126

1 Average daily production/sales and average prices are before the deduction of royalties.

2 Gross includes the interests of others; net excludes the interest of others.

3 Net capital expenditures for land acquisition and exploration/development activities (including capitalized overhead) are divided by barrels of oil equivalent of proved reserves resulting from additions through discoveries and extensions.

4 The barrel of oil equivalent (BOE) conversion rate for natural gas is 6,000 cubic feet equals one BOE and for sulphur is one long ton equals one BOE.

5 Overriding royalty interests are included in gross acres, but excluded in net acres.

CORPORATE INFORMATION

BOARD OF DIRECTORS

- + **Robert G. Black, O.C.**,
Calgary, Alberta.
Barrister and Solicitor.
- Richard F. Haskayne, F.C.A.**,
Calgary, Alberta.
President and
Chief Executive Officer of
Home Oil Company Limited.
President and Chief Executive
Officer of the Company.
- + **J. Gordon Hutchison, F.C.A.**,
Calgary, Alberta.
Financial Consultant.
- + **John F. Langston**,
Calgary, Alberta.
Petroleum Engineer.
- Brian F. MacNeill**,
Calgary, Alberta.
Vice President Finance of
Home Oil Company Limited.
Vice President Finance of
the Company.
- Stanley G. Olson**,
Spokane, Washington.
Corporate Director.

David E. Powell,
Calgary, Alberta.
Senior Vice President Exploration
of Home Oil Company Limited.
Senior Vice President Exploration
of the Company.

* **William P. Wilder**,
Toronto, Ontario.
Chairman of the Board of
The Consumers' Gas Company Ltd.

+ Member of Audit Committee
* Effective November 1, 1986,
W. P. Wilder resigned from the Board
of Directors.

SENIOR OFFICERS

R. F. Haskayne
President and Chief
Executive Officer

D. E. Powell
Senior Vice President Exploration

H. Alfaro
Vice President Production

F. Callaway
Vice President Corporate Affairs

B. F. MacNeill
Vice President Finance and
Chief Financial Officer

K. A. McNeill
Vice President Administration

R. G. Watkins
Vice President Government and
Industry Relations

D. E. Deakin
Corporate Secretary

A. R. Hagerman
Treasurer

E. Jorgensen
Comptroller

PRINCIPAL AFFILIATE

Minerals Limited (50 percent)
P.O. Box 2850
Calgary, Alberta.
T2P 2S5

AUDITORS

Price Waterhouse
Calgary, Alberta.

REGISTRAR AND TRANSFER AGENTS

Guaranty Trust Company of Canada.
Calgary, Toronto, Montreal &
Vancouver.

The Canadian Imperial Bank of
Commerce (New York).
New York City, New York.

SHARE INFORMATION

	Prices			
	Toronto Stock Exchange (Cdn. dollars)		American Stock Exchange (U.S. dollars)	
	High	Low	High	Low
Year Ended September 30, 1986				
1st quarter	26½	21¼	19¼	15
2nd quarter	22½	14¾	16¾	10½
3rd quarter	20½	18¾	15¾	13¾
4th quarter	20¼	18¾	15	13¼
Year Ended September 30, 1985				
1st quarter	19¾	16¾	14¾	12½
2nd quarter	21½	16¾	16¾	12¼
3rd quarter	22½	20½	17	14¾
4th quarter	27	21½	20	15¾

At September 30, 1986, the Company had 13,462,129 common shares issued and outstanding, held by 3,864 shareholders. Effective November 27, 1985, the Board of Directors authorized a semi-annual dividend of \$0.25 per common share.

Stock Exchange Listings	Symbols
Toronto Stock Exchange	SCR
American Stock Exchange	SRB

**Scurry-Rainbow
Oil Limited**

1700 Home Oil Tower,
324 Eighth Avenue S.W.,
Calgary, Alberta, Canada.
T2P 2Z5
Telephone: (403) 232-7101