Scurry-Rainbow Oil Limited

Annual Report 1981

Scurry-Rainbow Oil Limited

Head Office: 2300 Home Oil Tower, 324 Eighth Avenue S.W., Calgary, Alberta T2P 2Z5

Board of Directors

\+ ROBERT G. BLACK, Q.C., *Calgary, Alberta*
Barrister and Solicitor.

DOUGLAS E. DEAKIN, *Calgary, Alberta*
Vice-President, Finance of Home Oil Company Limited
Vice-President, Finance, of the Company

ANTHONY G.S. GRIFFIN, *Toronto, Ontario*
Corporate Director.

*+ J. GORDON HUTCHISON, F.C.A.
Calgary, Alberta
Financial Consultant.

*+ JOHN F. LANGSTON, *Calgary, Alberta*
Petroleum Engineer.

WILLIAM H. WADDELL, *Calgary, Alberta*
Senior Vice-President, Exploration and Production, of Home Oil Company Limited.
Senior Vice-President, Exploration and Production, of the Company

WILLIAM P. WILDER, *Toronto, Ontario*
President and Chief Executive Officer and Director of Hiram Walker Resources Ltd.

\+ Member of Audit Committee
* Member of Executive Committee

Senior Officers

R.F. HASKAYNE
President and Chief Executive Officer.*

W.H. WADDELL
Senior Vice-President, Exploration & Production.

H. ALFARO
Vice-President, Production.

D.E. DEAKIN
Vice-President, Finance.

E.C. HAMBROOK
Vice-President, Administration.

J.P. LEESON
Vice-President, Exploration.

G. LOKHORST
Vice-President, Mining.

R.G. WATKINS
Vice-President, Corporate Development.

T.S. HOAR
Secretary.

E. JORGENSEN
Treasurer.

G.K. PALMER
Comptroller.

*Effective January 1, 1982

Bankers

Canadian Imperial Bank of Commerce
Calgary, Alberta

Auditors

Thorne Riddell,
Calgary, Alberta

Registrar and Transfer Agents

Guaranty Trust Company of Canada
Calgary, Toronto, Montreal, Vancouver
The Canadian Bank of Commerce Trust Company
New York, N.Y.

Stock Exchange Listings

Toronto Stock Exchange
Vancouver Stock Exchange
American Stock Exchange

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HIGHLIGHTS

	Year Ended September 30, 1981	1980
FINANCIAL		
(Thousands of dollars except per share amounts)		
Revenue	$ 52,637	$ 59,354
Flow of funds from operations	21,552	37,034
Per share	8.05	13.83
Net earnings before extraordinary item	9,414	19,236
Per share	3.51	7.18
Net earnings	9,414	22,131
Per share	3.51	8.26
Working capital (deficiency)	(4,618)	3,724
Long term debt (net of current maturities)	15,878	25,183
Shareholders' equity	85,861	76,447
Total assets	157,310	151,197
OPERATIONAL		
Gross daily production		
Crude oil and natural gas liquids (cubic metres)	1 164	1 210
Natural gas (thousands of cubic metres)	467	528
Gross proven reserves		
Crude oil and natural gas liquids (thousands of cubic metres)	3 943	3 309
Natural gas (millions of cubic metres)	5 158	4 918
Sulphur (thousands of tonnes)	591	464
Landholdings (thousands of acres)		
Oil and gas		
Gross	5,052	6,135
Net	1,681	1,778
Mining		
Gross	672	773
Net	217	249

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CORPORATE PROFILE

Scurry-Rainbow Oil Limited, incorporated in Alberta in 1954, is engaged in the exploration, development and production of petroleum and natural gas, and in the exploration for various minerals. The Company is approximately 88.5 percent indirectly owned by Home Oil Company Limited, the energy company of Hiram Walker Resources Ltd. The Company's head office is located in Calgary, Alberta. Exploration activities are conducted in Canada and the United States. Production of petroleum and natural gas is primarily located in the four western provinces of Canada. The Company does not engage in refining or retail marketing. The Company has substantial undeveloped coal reserves in southwestern Alberta and southeastern British Columbia, and a silver-gold mine in Nevada which has temporarily suspended producing operations.

Annual General Meeting

The Annual General Meeting of the Shareholders will be held on Tuesday, February 2, 1982 at 9:30 a.m. at the head office of the Company in Calgary, Alberta. Formal notice of this meeting and proxy material have been mailed to all registered shareholders with this report.

The Company files annually with the United States Securities and Exchange Commission, a report on its operations known as the Annual Report on Form 10-K. Copies of the SEC Form 10-K are available to shareholders free of charge upon written request to G. K. Palmer, Comptroller, Scurry-Rainbow Oil Limited, 2300 Home Oil Tower, 324 Eighth Avenue S.W., Calgary, Alberta, T2P 2Z5.

COMMON SHARE MARKET DATA

The common shares of the Company are listed on the Toronto, Vancouver, and American stock exchanges. The high and low sales prices for the common shares on the Toronto and American stock exchanges by quarter for the two fiscal years 1981 and 1980 are tabulated below. The Company has not paid any dividends on its common shares.

	Toronto Stock Exchange (Canadian dollars)		American Stock Exchange (U.S. dollars)	
	High	Low	High	Low
Fiscal Quarter Ended				
1980				
December 31, 1979	75	50	69½	42
March 31, 1980	104½	60	93½	49
June 30, 1980	109	75¼	96½	62
September 30, 1980	113½	83	96¾	74⅞
1981				
December 31, 1980	104½	61	89½	53
March 31, 1981	70	62½	60	54
June 30, 1981	65⅛	55	58	48
September 30, 1981	69	41½	56½	35

At December 11, 1981 there were 3,774 holders of record of the common shares of the Company.

There are no restrictions on the export or import of capital which affect the remittance of dividends, interest or other payments to non-resident holders of the Company's securities.

The Foreign Investment Review Act requires prior approval by the Government of Canada of the acquisition by or transfer to, non-residents of Canada of direct or indirect control of a Canadian business entity, such as the Company. The Act does not apply to the purchase of shares or securities of a corporation where such purchases would not give the purchasers effective control of the corporation.

Cash dividends paid to shareholders resident in the United States of America, the United Kingdom and most Western European countries are generally subject to Canadian withholding tax at a rate of 15%. Cash dividends paid to other non-residents of Canada will also generally be subject to Canadian withholding tax at a maximum rate of 20%, depending upon applicable tax treaties. Interest payable on the Company's debt securities held by non-Canadian persons may also be subject to Canadian withholding tax depending upon the terms and provisions of such securities.

DIRECTORS' REPORT

TO THE SHAREHOLDERS

Oil and Gas

The Company participated in the drilling of 18 exploratory and 56 development wells during the year ended September 30, 1981. Exploratory drilling resulted in 4 oil wells, 9 gas wells, 4 dry holes and 1 drilling at September 30, 1981. Development drilling resulted in 24 oil wells, 21 gas wells, 5 dry holes and 3 drilling at September 30, 1981. Three water injection wells were also drilled. Exploration and development efforts were principally concentrated in the Fort St. John area of British Columbia and in the Gold Creek and Latornell areas of Alberta.

Average daily production of crude oil and natural gas liquids for the year ended September 30, 1981, before the deduction of royalties, amounted to 1 164 cubic metres (7,324 barrels) compared with 1 210 cubic metres (7,610 barrels) for the same period in 1980. Average daily natural gas sales amounted to 467 thousand cubic metres (16.6 MMcf) compared with 528 thousand cubic metres (18.7 MMcf) in 1980.

Mining

Production at the Company's Gooseberry Mine in Nevada was temporarily suspended on May 20, 1981 due to declining precious metals prices. Shaft sinking has continued to the planned depth of 1,450 feet.

Engineering studies are continuing for assessment of thermal coal production in the Blairmore area of Alberta. Limited work is continuing on the Elk River metallurgical coal property in southeastern British Columbia. In addition, the Company participated in 4 uranium programs in Canada during the year ended September 30, 1981.

Financial

Net earnings for the year ended September 30, 1981 amounted to $9,414,000 or $3.51 per share. This compares with net earnings, before an extraordinary item, of $19,236,000 or $7.18 per share for the same period in 1980. The reduction in earnings is principally attributable to the losses arising on the Company's mining operations coupled with the introduction of the Petroleum and Gas Revenue Tax, effective January 1, 1981.

Flow of funds from operations for the year ended September 30, 1981, amounted to $21,552,000 or $8.05 per share compared with $37,034,000 or $13.83 per share for the same period a year earlier.

Gross revenues for the year ended September 30, 1981 amounted to $52,637,000 compared with $59,354,000 a year earlier. Oil and gas revenues increased from $38,272,000 to $44,015,000, resulting primarily from higher prices offset by production declines in older fields. Mining revenues dropped sharply from $20,224,000 to $7,731,000 reflecting lower millhead grades, lower prices received for the sale of silver and gold and the suspension of the production operations at the Gooseberry mine, effective May 20, 1981.

Capital expenditures for the year ended September 30, 1981, net of applicable government grants, amounted to $21,667,000 compared with $37,253,000 a year earlier.

Corporate

Home Oil Company Limited ("Home") indirectly owns approximately 88.5% of the Company. Home is a wholly owned indirect subsidiary of Hiram Walker Resources Ltd.

Since the last report to shareholders, J. Howard Geddes and A. M. McIntosh have resigned as directors of the Company. D. E. Deakin was elected a director of the Company.

Mr. R. F. Haskayne has been appointed President and Chief Executive Officer of the Company effective January 1, 1982.

Submitted on behalf of the Board of Directors.

W H Waddell

W. H. Waddell
Director

Calgary, Alberta, Canada
December 24, 1981

REVIEW OF OPERATIONS/OIL AND GAS

Drilling

During the year ended September 30, 1981, the Company participated in the drilling of 18 exploratory and 56 development wells. Four of the exploratory wells were wells in which the Company had working interests and 14 were farmout or overriding royalty wells. Forty-three of the development wells were wells in which the Company had working interests and 13 were farmout or overriding royalty wells.

Exploratory drilling resulted in 4 oil wells, 9 gas wells and 4 dry holes while one well was still drilling on September 30, 1981.

Development drilling resulted in 24 oil wells, 21 gas wells, 5 dry holes; 3 were still drilling on September 30, 1981. In addition, 3 wells drilled are being used for water injection.

Principal exploration, drilling, and completion efforts continued in the Fort St. John area of British Columbia and the Gold Creek/Latornell sections of the Alberta Deep Basin area. In the latter area, efforts were confined to those required to maintain landholdings due to the unfavourable market conditions for natural gas. Further results of a multi-well completion program at Gold Creek included a natural gas flow of 24 million cubic feet per day from the Fahler formation at the Amoco Steep Creek 7-28 well. The Shell Home Waterton 6-3 exploratory well located in the southern Alberta Foothills, in which a subsidiary of the Company retains a 3.5% gross overriding royalty interest, was successfully completed as a Devonian gas well.

Three farmout wells were drilled on a Netherlands North Sea block in which the Company has an approximate 2.5% working interest. The first well F/18-5 tested an average of 2,600 barrels of oil per day, while the second well F/18-6 was dry and abandoned. A third well F/18-7 found 11 metres of pay which was deemed non-commercial and therefore not tested. The operator has indicated that a development proposal will be made shortly.

A total of nine development wells were drilled and completed during the year in the Fort St. John area of B.C. Four of the locations were infill wells designed to increase oil recovery from the Belloy formation in West Eagle Unit No. 1. Three of the development wells were at Cecil and completed in the North Pine formation as oilwells, and the remaining 2 wells were successfully completed as Belloy oil producers at East Eagle. During 1982 10 stepout wells are expected to be drilled in the Fort St. John area to test the presence of hydrocarbons in potential extensions of the existing Eagle pools.

Production

During the year ended September 30, 1981, daily crude oil and gas liquids production averaged 1 164 cubic metres (7,324 barrels) per day and natural gas sales averaged 467 thousand cubic metres (16.6 MMcf) per day. This represents a decrease in crude and liquid production of approximately 46 cubic metres (289 barrels) per day compared with the production rate established during the previous year. Gas sales decreased by 61 cubic metres (2.1 MMcf) per day. Continued decline in productivity from older fields more than offset higher production from the Eagle pools in B.C. Low gas sales nominations in Alberta coupled with lower U.S. export demand for B.C. gas were the main factors contributing to the lower gas sales.

West Eagle Unit #1 in B.C. continued under a fully operational water flood scheme with current water injection volumes averaging 1 670 cubic metres (10,500 barrels) of water per day. Installation of artificial lift equipment and completion of four infill wells has improved the Unit's average production capacity from 1 090 cubic metres (6,860 barrels) of oil per day early in the year to a current 1 250 cubic metres (7,860 barrels) of oil per day. Conversion of additional wells to water injection service and drilling of infill wells are being proposed to efficiently produce the reservoir.

Gas sales from the Karr area in west central Alberta have commenced in November, 1981 with the Company's share at approximately 1.8 MMcf per day from 7 wells.

Summarized below is crude oil production and natural gas sales, before deduction of royalty and minority interests, by province for the periods indicated:

	Year Ended September 30,				Nine Months Ended September 30,	
	1981		1980		1980	
	Crude oil	Natural gas	Crude oil	Natural gas	Crude oil	Natural gas
Alberta	89 540	114 190	116 220	127 010	79 540	87 460
British Columbia	218 700	54 250	190 600	63 590	141 250	46 020
Saskatchewan	108 880	2 030	125 940	2 420	91 620	1 860
Manitoba	7 530	—	8 650	—	6 150	—
Other	310	160	1 340	160	1 310	110
Total	424 960	170 630	442 750	193 180	319 870	135 450
Average per day	1 164	467	1 210	528	1 167	494

Crude oil includes natural gas liquids and is stated in cubic metres.
Natural gas is stated in thousands of cubic metres.

Landholdings

The Company's landholdings are summarized in the following table.

	Petroleum and Natural Gas Leases		Reservations, and Licences/Permits		Total	
	Gross	Net	Gross	Net	Gross	Net
Canada						
Alberta	1,281,093	317,853	131,121	25,050	1,412,214	342,903
Arctic	—	—	637,305	70,377	637,305	70,377
B.C.	297,123	77,163	433,061	43,644	730,184	120,807
Manitoba	26,211	22,211	—	—	26,211	22,211
N.W.T.	81,521	17,607	474,060	94,812	555,581	112,419
Ontario	479	287	—	—	479	287
Quebec	—	—	533,576	219,358	533,576	219,358
Saskatchewan	795,949	754,879	—	—	795,949	754,879
	2,482,376	1,190,000	2,209,123	453,241	4,691,499	1,643,241
Europe						
Netherlands-Offshore	—	—	151,327	4,346	151,327	4,346
United States						
Michigan	28,544	7,390	—	—	28,544	7,390
Montana	4,400	2,033	—	—	4,400	2,033
North Dakota	28,473	7,136	—	—	28,473	7,136
Utah	33,002	3,418	—	—	33,002	3,418
Wyoming	114,274	13,924	—	—	114,274	13,924
	208,693	33,901	—	—	208,693	33,901
Total Acreage at September 30, 1981	2,691,069*	1,223,901*	2,360,450	457,587	5,051,519	1,681,488
Total Acreage at September 30, 1980	3,417,384*	1,257,925*	2,718,231	520,498	6,135,615	1,778,423

*Includes 682,671 (September 30, 1980 — 491,803) gross and 130,839 (September 30, 1980 — 101,824) net acres from which production is being obtained or is capable of being obtained.

Reserves

The Company's gross proven crude oil, natural gas liquids, natural gas and sulphur reserves as of September 30, 1981 and 1980 are summarized in the table below. The Company's gross reserves are defined as the Company's share of reserves from working interests and overriding royalties, but before the deduction of any royalty interest owned by others and before the deduction of minority interests.

Development drilling in the Eagle, Stoddart, Cecil and Latornell areas has been largely responsible for the increase in proven oil reserves. Further testing and development in the Gold Creek area has resulted in additional proven gas reserves.

	September 30, 1981	September 30, 1980
Crude Oil - cubic metres	3 476 300	3 061 210
Natural Gas Liquids - cubic metres	467 170	247 340
Natural Gas - thousand cubic metres	5 158 360	4 918 103
Sulphur - tonnes	591 200	464 002

REVIEW OF OPERATIONS/MINING

Gooseberry Mine

Production at the Gooseberry Mine in Nevada, was temporarily suspended on May 20, 1981. Declining precious metals prices combined with decreasing ore grade delivered to the mill caused operating losses during the eight month period to May, 1981.

Mill production, during the approximate eight month period of operation, averaged 6,687 tons of ore per month which was approximately 1,100 tons per month more than that milled in the previous year. The average grade of ore milled was lower with recoveries of 4.536 troy ounces of silver and 0.100 troy ounces of gold per ton compared to 7.176 troy ounces of silver and 0.141 troy ounces of gold per ton milled for the nine months ended September 30, 1980.

During the shut down period a small staff has been retained at the mine to reorganize and plan for a reopening. Shaft sinking below the 1,000 foot level continued and as of September 30, 1981, was within 25 feet of the planned 1,450 foot level. Drilling from the two proposed new production levels of 1,150 and 1,300 feet indicates that the ore body continues at those depths. Further exploration is planned for the 1,450 foot horizon.

Evaluations of the applicable mining and milling techniques indicate that improvements in productivity may be achieved by modifications to the existing extraction and processing system. It is anticipated that the mine will resume production pending receipt of favourable results from the current evaluation studies and an increase in the price of silver and gold.

Coal

Two properties within the extensive coal leases held jointly with Consolidation Coal Company of Canada in the Blairmore area of Alberta continued to be assessed for thermal coal production. A detailed coal quality and open pit reserve evaluation study of the Grassy Mountain property was completed. Current plans in respect of the Grassy Mountain property call for a one million ton thermal mine in operation by 1984/85. Fill-in drilling was undertaken on twenty locations on the Lynx Creek property. The drilling indicates three million tons of mineable thermal coal with a productive capacity of up to 300,000 tons per year. Introductory technical presentations on the Blairmore properties were made to potential Pacific Rim customers. These efforts will be continued as more detailed engineering studies are made available. A 24,000 ton shipment of coal from Blairmore was successfully marketed in Japan.

An initial drill assessment program indicated plains coal reserves on leases held in the Big Valley-Nevis and Alix areas of Alberta. Fill-in drilling, to outline potential underground and strip reserves, is scheduled for 1982.

During 1981 limited work consisting of studies required to obtain provincial government permits was continued on the Elk River metallurgical coal property in southeastern British Columbia. The Company has a 10 percent working interest, plus a royalty interest in the property. This deposit could be capable of producing at rates of up to 4 million tons per year. A decision to proceed with mine development is dependent upon improvement in export markets for coking coal.

Metallics

The Company, as operator, undertook three diamond drill programs on a uranium property in the Northwest Territories, two uranium properties in Saskatchewan and participated in a diamond drill program on a uranium property in New Brunswick. Although geological environments favourable for uranium mineralization were tested, no mineralization of economic significance was outlined.

Detailed geophysical and geological surveys were completed on several uranium prospects held in the East Arm of Great Slave Lake, N.W.T. and several gold base metal properties held north of Timmins, Ontario. Drilling is planned in both areas in 1982.

Mining Acreage

The Company's mining acreage is summarized in the following table.

	Gross	Net
Coal Mining Properties	130,342	58,165
Coal Lease Applications	46,987	39,467
Mining Claims	494,749	119,561
Total	672,078	217,193
Canada		
Alberta	157,169	94,877
British Columbia	37,172	7,419
Saskatchewan	414,336	89,370
Ontario	10,199	7,959
Northwest Territories	51,922	16,288
United States		
Nevada	1,280	1,280
Total Acreage at September 30, 1981	672,078	217,193
Total Acreage at September 30, 1980	772,675	249,279

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

The Company's 1980 fiscal year covered the nine months ended September 30, 1980. To provide meaningful comparisons, results for the year ended September 30, 1980 are included in the five year review of operations on page 24. Management's discussion relates to analysis of financial condition and results of operations for the years ended September 30, 1981 and 1980 and the year ended December 31, 1979. The comments contained herein should be read in conjunction with the consolidated financial statements, unaudited supplementary information, the five year review of operations and other data contained in this Annual Report.

Results of Operations

Net earnings for the year ended September 30, 1981 amounted to $9,414,000 or $3.51 per share compared with $22,131,000 or $8.26 per share for the year ended September 30, 1980 and $20,877,000 or $7.80 per share for the year ended December 31, 1979.

Net earnings, before an extraordinary item, for the year ended September 30, 1981 amounted to $9,414,000 or $3.51 per share. This compares with net earnings, before an extraordinary item, of $19,236,000 or $7.18 per share for the year ended September 30, 1980 and earnings, before the gain on sale of North Sea properties and before an extraordinary item, of $13,258,000 or $4.95 per share for the year ended December 31, 1979. The decline in earnings in 1981 is principally attributable to losses experienced on the Company's mining operations and the imposition of Petroleum and Gas Revenue Tax ("P.G.R.T."). Improved earnings in 1980 resulted from higher oil, gas and precious metal prices coupled with increased silver production.

During 1979, the Company disposed of its entire interest in Block 3/7 in the North Sea, resulting in a gain of $5,157,000 or $1.93 per share. Extraordinary items of $2,895,000 and $2,462,000 in 1980 and 1979 respectively represent income tax reductions on application of prior years' losses.

Operating revenues from oil and gas operations have been rising steadily from $33,156,000 in 1979, to $38,272,000 in 1980 and $44,015,000 in 1981. Average prices, after royalties, for crude oil have increased by 12.1% and 21.5% in 1980 and 1981 respectively, whereas gas prices increased by 19.7% and 12.5% in 1980 and 1981 respectively. Average production of crude oil and natural gas liquids, has declined by 2% and 4% respectively in 1980 and 1981. Continued decline in productivity from older fields more than offset higher production from the Eagle pools in British Columbia. Average gas sales during 1980 were maintained at a level established in 1979. However, low gas sales nominations in Alberta coupled with lower U.S. export demand for B.C. gas reduced gas sales during 1981 by 11.7%.

Revenue from mining operations increased from $10,866,000 in 1979 to $20,224,000 in 1980 and fell to $7,731,000 in 1981. Sales in 1981 of 242,691 troy ounces of silver and 5,337 troy ounces of gold averaged $16.62 and $631 per troy ounce respectively. Revenue in 1980 resulted from the sale of 481,185 troy ounces of silver and 7,052 ounces of gold at an average price of $23.70 and $714.30 per ounce respectively.

Operating and general expenses increased from $14,954,000 in 1979 to $19,952,000 in 1980 rising to $22,179,000 in 1981. The increase in 1980 resulted from well repairs and maintenance costs, higher operating costs at the mine and continuing inflation. Mining operating expenses in 1981 increased reflecting higher underground mining costs and inflation. Oil and gas operating expenses increased in 1981 resulting from higher costs of operating the Eagle pools in B.C., increased freehold mineral taxes in Alberta and general cost increases due to inflation.

The increase in depletion and depreciation charges from $7,350,000 in 1979, to $8,289,000 in 1980 and to $8,906,000 in 1981 reflects an increase in the rate per barrel from $1.28 in 1979, to $1.65 in 1980 and to $2.11 in 1981 resulting from the replacement of oil and gas reserves at substantially higher finding costs.

Interest expense increased from $2,247,000 in 1979 to $2,965,000 in 1980 and to $3,390,000 in 1981. The increases arise from higher borrowings to finance the Company's capital program and a substantial rise in the level of interest rates.

Tax expense has increased from an average of 33% of pretax income in 1979 and 1980 to 48% in 1981, the increase being attributable to the imposition of the P.G.R.T., effective January 1, 1981 which amounted to $2,820,000. The P.G.R.T. is assessed at a rate of 8% of oil and gas production income before the deduction of crown royalties and is not deductible for income tax purposes. Under the Alberta - Ottawa energy accord reached September 1, 1981, the rate of P.G.R.T. is projected to rise to 12% on working interest income and to 16% on royalty income from January 1, 1982 onwards and it continues to be non-deductible for income tax purposes.

rise to 12% on working interest income and to 16% on royalty income from January 1, 1982 onwards and it continues to be non-deductible for income tax purposes.

Capital resources and corporate liquidity

Total assets have risen from $97 million at December 31, 1978 to $157 million at September 30, 1981. This growth was achieved as a result of the capital programs which amounted to $38 million in 1979; $26 million in the nine months ended September 30, 1980 and $22 million, net of applicable Petroleum Incentive Program payments, for the year ended September 30, 1981. The bulk of the capital expenditures were concentrated on the oil and gas segment of the business. The ratio of oil and gas exploration to development spending declined during the past three years. During 1979, $21 million was expended on oil and gas exploration, compared with $14 million on development activities. During the year ended September 30, 1981, only $4 million was spent on oil and gas exploration, compared with approximately $14 million on the development programs. This trend was accentuated by the National Energy Program introduced in October 1980 which has made investment in oil and gas exploration less attractive in Canada. Curtailment of exploration spending in 1981 is also a result of continuing unfavourable market conditions for natural gas. Exploration efforts in the Gold Creek area have been confined to maintaining existing landholdings. Increased emphasis has been placed on exploratory farmouts to other companies. Development programs took place primarily in the Fort St. John area of B.C. and the Gold Creek area of Alberta.

During 1982, oil and gas capital spending is anticipated to approximate 1981 levels.

The Company's capital spending on mining operations over the last three years' has been concentrated on the continued development of the Gooseberry mine, feasibility and other studies relating to Elk River coal deposits and a modest program for coal and uranium exploration. Shaft sinking and related development work has continued at the Gooseberry mine in Nevada since the suspension of its production operations. It is anticipated that the mine will resume production pending receipt of favourable results from the current evaluation studies and pending an increase in the price for silver and gold.

Increased emphasis is being given to the development of coal properties, particularly Grassy Mountain and Lynx Creek properties which continue to be assessed for thermal coal production.

Funds from operations amounted to $27,286,000 in 1979; $37,034,000 in 1980 and $21,552,000 in 1981. The increase in 1980 is primarily from higher silver production and a substantial rise in the prices received on the sale of silver and gold and higher oil and gas prices. The decline in 1981 is attributable to mining losses and the imposition of P.G.R.T.

The Canadian federal government proposed the Petroleum Incentives Program as part of its National Energy Program. Varied amounts of grants are available under the proposed program depending on the nature of expenditures and the degree of Canadian ownership of a company. The Company anticipates that it will qualify for the most favorable treatment under the Program. For the nine months ended September 30, 1981, these grants are estimated to amount to $3.3 million.

The Company's short term bank borrowings and long term debt amounted to $22 million at December 31, 1979; $29 million at September 30, 1980 and $21 million at September 30, 1981. During the last three years, the Company has purchased sufficient of its 7¼% debentures to satisfy its sinking fund obligations. At September 30, 1981, the Company had approximately $30 million in unused bank lines of credit which together with funds from operations will be available to finance anticipated capital expenditures. The Company's working capital deficiency at September 30, 1981 amounted to $4.6 million.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

(a) The consolidated financial statements include the accounts of the companies in which the Company has ownership of more than 50% of the voting capital stock.

(b) The Company follows the equity method of accounting for its investment in a 50% owned company. Under this method the Company's investment is carried on the balance sheet at cost plus its share of undistributed earnings or losses since the date of acquisition.

(c) The excess of the cost of shares over the underlying book value at dates of acquisition in subsidiaries and of the investment in a company accounted for by the equity method has been allocated to property, plant and equipment and is subject to the accounting policies outlined below.

Oil and Gas Operations

The Company follows the full cost method of accounting for oil and gas operations whereby all costs of exploring for and developing oil and gas and related reserves are capitalized and charged against earnings as set out below. Such costs include land acquisition costs, geological and geophysical expenditures, carrying charges of non-producing property, costs of drilling both productive and non-productive wells and overhead charges related to exploration activities. The costs are accumulated in cost centres as follows:

(a) North America — Canada and the United States
(b) North Sea

Costs accumulated in the North America cost centre are depleted using the unit of production method based upon estimated proven 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.

Expenditures in the North Sea were amortized on a straight-line basis to date of disposition in 1979.

Oil and gas production equipment and related facilities are depreciated on a straight-line basis at rates varying from 4 percent to 25 percent, which rates are estimated to amortize the costs of the assets less salvage values over their useful lives.

Upon retirement or sale of oil and gas production equipment, the cost is eliminated from the asset accounts and the difference between proceeds and cost is ordinarily treated as an adjustment to accumulated depreciation; a gain or loss is recognized on disposal of a complete asset class.

Substantially all of the exploration and production activities of the Company are conducted jointly with others and accordingly these financial statements reflect only the Company's proportionate interest in such activities.

Mining Operations

Mining costs are charged to earnings in the period of expenditure (included in depletion) until such time as the presence of economically recoverable reserves is established. Subsequent expenditures are capitalized and charged to earnings as set out below. Proceeds on partial disposition of non-producing properties are deducted from the related costs without recognition of gain or loss.

Costs are accumulated by producing area and are depleted using the unit of production method based upon estimated economically recoverable reserves, as determined by Company engineers.

Mining equipment is depreciated using the unit of production method based upon estimated recoverable ore reserves.

Inventories

Precious metal inventories are valued at market. All other inventories are valued at the lower of cost and net realizable values.

Foreign Currency Translation

Current assets and current liabilities are translated to Canadian dollars using the exchange rate at the date of the balance sheet. Other assets and liabilities are translated at the rate in effect at the time the original transactions took place. Revenue and expense items (excluding depletion and depreciation which are translated at the rate of exchange applicable to the related asset) are translated using average rates of exchange throughout the period. Foreign currency gains and losses are included in the determination of net earnings.

CONSOLIDATED STATEMENT OF EARNINGS AND RETAINED EARNINGS

	Year Ended September 30, 1981	Nine Months Ended September 30, 1980	Year Ended December 31, 1979
	(Expressed in thousands except per share amounts)		
REVENUE			
Operating	$51,746	$43,544	$44,022
Equity income	88	50	35
Other income	803	697	244
	52,637	44,291	44,301
EXPENSES			
Operating and general	22,179	15,605	14,954
Depletion and depreciation	8,906	7,011	7,350
Interest on long-term debt	2,635	1,820	1,470
Other interest	755	474	777
Minority interest	23	85	127
	34,498	24,995	24,678
EARNINGS BEFORE TAXES AND OTHER ITEMS	18,139	19,296	19,623
TAXES (note 6)	8,725	6,339	6,365
EARNINGS BEFORE UNDERNOTED ITEMS	9,414	12,957	13,258
GAIN ON SALE OF NORTH SEA PROPERTIES (net of applicable income taxes of $803,000)	—	—	5,157
NET EARNINGS BEFORE EXTRAORDINARY ITEM	9,414	12,957	18,415
EXTRAORDINARY ITEM			
Income tax benefits realized on application of prior years' losses	—	1,805	2,462
NET EARNINGS	9,414	14,762	20,877
RETAINED EARNINGS AT BEGINNING OF PERIOD	43,739	28,977	8,100
RETAINED EARNINGS AT END OF PERIOD	$53,153	$43,739	$28,977
EARNINGS PER SHARE			
Earnings before undernoted items	$ 3.51	$ 4.84	$ 4.95
Gain on sale of North Sea properties	—	—	1.93
Net earnings before extraordinary item	3.51	4.84	6.88
Extraordinary item	—	0.67	0.92
Net earnings	$ 3.51	$ 5.51	$ 7.80

Auditors' Report

To the Shareholders of Scurry-Rainbow Oil Limited

We have examined the consolidated balance sheet of Scurry-Rainbow Oil Limited as at September 30, 1981 and 1980 and the consolidated statements of earnings and retained earnings and changes in financial position for the year ended September 30, 1981, for the nine months ended September 30, 1980 and for the year ended December 31, 1979. 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 September 30, 1981 and September 30, 1980 and the results of its operations and the changes in its financial position for each of the periods then ended in accordance with generally accepted accounting principles applied on a consistent basis.

Calgary, Canada
November 17, 1981

Thorne Riddell
Chartered Accountants

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

	Year Ended September 30, 1981	Nine Months Ended September 30, 1980	Year Ended December 31, 1979
	(Expressed in thousands)		
FUNDS WERE OBTAINED FROM			
Operations			
Earnings before gain on sale of North Sea properties and extraordinary item	$ 9,414	$12,957	$13,258
Items not affecting funds			
Depletion and depreciation	8,906	7,011	7,350
Deferred income taxes	3,467	7,075	6,437
Other	(235)	(98)	241
	21,552	26,945	27,286
Long-term debt	—	13,700	10,000
Sale of assets	451	189	13,493
Deferred production revenue	521	315	418
	22,524	41,149	51,197
FUNDS WERE USED FOR			
Property, plant and equipment	21,667	25,666	38,051
Reduction in long-term debt	9,104	7,460	6,832
Acquisition of minority interest	—	—	484
Other	95	158	37
	30,866	33,284	45,404
INCREASE (DECREASE) IN WORKING CAPITAL POSITION	(8,342)	7,865	5,793
WORKING CAPITAL (DEFICIENCY) AT BEGINNING OF PERIOD	3,724	(4,141)	(9,934)
WORKING CAPITAL (DEFICIENCY) AT END OF PERIOD	$ (4,618)	$ 3,724	$ (4,141)
CHANGES IN COMPONENTS OF WORKING CAPITAL POSITION			
INCREASE (DECREASE) IN CURRENT ASSETS			
Cash	$ (131)	$ (316)	$ (1,251)
Note receivable from an affiliated company	(4,020)	6,554	—
Accounts receivable	(223)	(835)	6,993
Income taxes recoverable	(1,527)	121	(82)
Inventories	(449)	(547)	1,479
	(6,350)	4,977	7,139
INCREASE (DECREASE) IN CURRENT LIABILITIES			
Bank indebtedness	1,162	273	(3,379)
Accounts payable	(3,008)	(1,349)	4,385
Taxes payable	3,840	—	—
Due to parent company, Home Oil Company Limited	(3)	718	79
Current maturities on long-term debt	1	(2,530)	261
	1,992	(2,888)	1,346
INCREASE (DECREASE) IN WORKING CAPITAL POSITION	$ (8,342)	$ 7,865	$ 5,793

CONSOLIDATED BALANCE SHEET

ASSETS	September 30, 1981	September 30, 1980
	(Expressed in thousands)	
CURRENT ASSETS		
Cash	$ 65	$ 196
Notes receivable from an affiliated company	2,534	6,554
Accounts receivable		
Trade	8,363	11,892
Petroleum Incentives Program	3,306	—
Income taxes recoverable	—	1,527
Inventories	2,044	2,493
	16,312	22,662
INVESTMENT IN 50% OWNED COMPANY	1,074	986
PROPERTY, PLANT AND EQUIPMENT (note 3)	138,878	126,568
OTHER ASSETS	1,046	981
	$157,310	$151,197
LIABILITIES		
CURRENT LIABILITIES		
Bank indebtedness (note 4)	$ 4,880	$ 3,718
Accounts payable	11,097	14,105
Taxes payable	3,840	—
Due to parent company, Home Oil Company Limited	1,083	1,086
Current maturities on long-term debt	30	29
	20,930	18,938
DEFERRED PRODUCTION REVENUE	1,632	1,111
LONG-TERM DEBT (note 5)	15,878	25,183
DEFERRED INCOME TAXES	31,451	27,984
MINORITY INTEREST	1,558	1,534
SHAREHOLDERS' EQUITY		
CAPITAL STOCK		
Authorized		
7,500,000 Shares, par value $3.50 each		
Issued		
2,678,356 Shares	9,374	9,374
CONTRIBUTED SURPLUS	23,334	23,334
RETAINED EARNINGS	53,153	43,739
	85,861	76,447
	$157,310	$151,197

Approved by the Board

W.A. Waddey Director

D. E. Deakin Director

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

1. ACCOUNTING POLICIES

The summary of significant accounting policies set out on page 9 forms an integral part of these financial statements.

2. CHANGE IN YEAR END

The Company changed its year end from December 31 to September 30 effective September 30, 1980; accordingly, these financial statements present the consolidated statement of earnings and retained earnings and the consolidated statement of changes in financial position for the year ended September 30, 1981, the nine months ended September 30, 1980 and the year ended December 31, 1979.

3. PROPERTY, PLANT AND EQUIPMENT

	1981		
	Cost	Accumulated Depletion and Depreciation	Net
Petroleum and natural gas leases and rights, including exploration, development and equipment thereon	$ 196,069	$ 69,565	$ 126,504
Mining properties and equipment			
Producing	13,128	2,832	10,296
Non-producing	3,786	3,102	684
Land, buildings and other equipment	1,970	576	1,394
	$ 214,953	$ 76,075	$ 138,878

	1980		
	Cost	Accumulated Depletion and Depreciation	Net
Petroleum and natural gas leases and rights, including exploration, development and equipment thereon	$ 178,900	$ 61,767	$ 117,133
Mining properties and equipment			
Producing	10,806	2,243	8,563
Non-producing	3,540	3,438	102
Land, buildings and other equipment	1,258	488	770
	$ 194,504	$ 67,936	$ 126,568

The producing mining properties and equipment pertain to the mining operations in Nevada. The mine's production operations were suspended in 1981 pending an improvement in the price of silver. The Company is continuing with shaft sinking and other related development work.

4. BANK INDEBTEDNESS

Bank indebtedness is secured by certain accounts receivable and interests in certain petroleum and natural gas properties. At September 30, 1981 the Company had unused lines of credit totalling $15,120,000 (September 30, 1980 — $17,183,000).

5. LONG-TERM DEBT

	September 30, 1981	September 30, 1980
Bank revolving term loan	$ 5,375	$13,700
7.25% subordinated debentures	10,311	11,266
Non-interest bearing agreement (1981 — $224,000 U.S.; 1980 — $249,000 U.S.)	222	246
	15,908	25,212
Less: Current minimum maturities	30	29
	$15,878	$25,183

The Company has a bank revolving term loan facility of which $14,625,000 remains unused at September 30, 1981. The bank revolving term loan can be drawn on a revolving basis up to April 30, 1983 at which time the loan balance is convertible into a term loan, repayable over a period of six years. The loan bears interest at a Canadian bank's prime lending rate (at September 30, 1981 — 21.25%; at September 30, 1980 — 12.25%) and is secured by certain accounts receivable and interests in certain petroleum and natural gas properties.

The 7.25% subordinated debentures are subject to annual sinking fund requirements of $1,067,000 on November 1, of each year. Debentures purchased by the Company may be applied against its sinking fund obligations. Debentures purchased to September 30, 1981 satisfy instalment requirements to November 1, 1981 and a balance of $86,000 remains to be applied against subsequent sinking fund payments.

The non-interest bearing agreement is repayable at $25,000 U.S. per annum.

The estimated amount of long-term debt maturities and sinking fund requirements for the five years subsequent to September 30, 1981 are as follows:

1982 —	$ 30
1983 —	1,377
1984 —	1,987
1985 —	1,987
1986 —	1,987

6. TAXES

Earnings before taxes and other items, and taxes by geographic area are as follows:

	Year Ended September 30, 1981	Nine Months Ended September 30, 1980	Year Ended December 31, 1979
Earnings before taxes and other items			
Canada	$22,187	$13,023	$17,200
United States	(4,048)	6,273	2,423
	$18,139	$19,296	$19,623
Taxes			
Current income taxes — Canada	$ 2,438	$ (736)	$ (72)
Deferred income taxes			
Canada	4,536	4,235	5,294
United States	(1,069)	2,840	1,143
	3,467	7,075	6,437
Petroleum and gas revenue tax — Canada	2,820	—	—
	$ 8,725	$ 6,339	$ 6,365

Deferred income tax expense arises from the following:

	Year Ended September 30, 1981	Nine Months Ended September 30, 1980	Year Ended December 31, 1979
Exploration and development expenditures deducted for income tax purposes in excess of related provision for depletion	$ 2,137	$ 4,571	$ 4,479
Excess of capital cost allowance claimed for income tax purposes in excess of related provision for depreciation	2,399	733	815
Application of loss carry forwards against income for tax purposes	—	1,771	1,143
Reduction in deferred income taxes resulting from losses	(1,069)	—	—
	$ 3,467	$ 7,075	$ 6,437

Taxes differ from the amounts which could be obtained by applying the Canadian statutory federal income tax rate to the respective periods' pretax earnings before the gain on the sale of North Sea properties and before extraordinary item. These differences result from the following:

	Year Ended September 30, 1981	Nine Months Ended September 30, 1980	Year Ended December 31, 1979
Earnings before taxes and other items	$18,139	$19,296	$19,623
Canadian expected income tax rate	46%	46%	46%
Computed "expected" income tax expense	$ 8,344	$ 8,876	$ 9,027
Royalties and other payments to provincial governments	6,568	4,874	5,836
Petroleum and gas revenue tax	2,820	—	—
Federal resource allowance	(5,312)	(3,699)	(4,539)
Depletion allowances on Canadian oil and gas production income	(3,093)	(2,571)	(2,250)
Refund of taxes under incentive plans	(1,735)	(1,527)	(2,247)
Losses not currently recognized for income tax purposes	676	—	—
Provincial income taxes less federal income tax abatement	351	293	252
Other	106	93	286
Actual tax expense	$ 8,725	$ 6,339	$ 6,365
Actual tax rate as a percentage of earnings before taxes and other items	48.1%	32.9%	32.4%

7. BUSINESS AND GEOGRAPHIC SEGMENTS

The operations of the Company consist of two business segments, oil and gas and mining, conducted mainly in Canada and the United States. Presented below is financial information by business segment and geographic area:

(a) Business Segments

	Year Ended September 30, 1981	Nine Months Ended September 30, 1980	Year Ended December 31, 1979
Operating revenues			
Oil and gas	$ 44,015	$ 28,394	$ 33,156
Mining	7,731	15,150	10,866
	$ 51,746	$ 43,544	$ 44,022
Operating income (loss)			
Oil and gas	$ 25,279	$ 15,467	$ 19,990
Mining	(4,618)	5,461	1,728
	20,661	20,928	21,718
Equity income	88	50	35
Other income	803	697	244
Interest expense	(3,390)	(2,294)	(2,247)
Minority interest expense	(23)	(85)	(127)
Taxes	(8,725)	(6,339)	(6,365)
Earnings before gain on sale of North Sea properties and extraordinary item	$ 9,414	$ 12,957	$ 13,258
Identifiable assets			
Oil and gas	$142,760	$135,067	$109,931
Mining	13,411	13,407	14,329
Corporate	65	1,737	2,253
Investment in 50% owned company	1,074	986	1,011
	$157,310	$151,197	$127,524
Capital expenditures			
Oil and gas	$ 17,743	$ 23,478	$ 35,523
Mining	3,924	2,188	2,528
	$ 21,667	$ 25,666	$ 38,051
Depletion and depreciation			
Oil and gas	$ 7,930	$ 5,770	$ 5,536
Mining	976	1,241	1,814
	$ 8,906	$ 7,011	$ 7,350

(b) Geographic Areas

	Year Ended September 30, 1981	Nine Months Ended September 30, 1980	Year Ended December 31, 1979
Operating revenues (i)			
Canada	$ 44,466	$ 28,284	$ 33,169
United States	7,280	15,260	10,853
	$ 51,746	$ 43,544	$ 44,022
Operating income (ii)			
Canada	$ 25,260	$ 15,084	$ 19,025
United States	(4,599)	5,844	2,693
	20,661	20,928	21,718
Identifiable assets			
Canada	$137,047	$126,464	$110,139
United States	20,263	24,733	17,385
	$157,310	$151,197	$127,524
Capital expenditures			
Canada	$ 18,275	$ 23,935	$ 36,361
United States	3,392	1,731	1,690
	$ 21,667	$ 25,666	$ 38,051
(i) Net of royalties	$ 17,009	$ 12,282	$ 14,228
(ii) Net of Maintenance and repairs	$ 1,454	$ 1,341	$ 730
Taxes, other than income and petroleum and gas revenue taxes	$ 1,480	$ 870	$ 953

8. RELATED PARTY TRANSACTIONS

Home Oil Company Limited ("Home") owns approximately 88.5 percent of the issued and outstanding shares of the Company. During the two years and nine months ended September 30, 1981, Home has furnished certain management, accounting, administrative, technical and other services to the Company and its subsidiaries at charges equal to the cost of services rendered.

The notes receivable from an affiliated company of $2,100,000 U.S. at September 30, 1981 ($5,600,000 U.S. at September 30, 1980) bear interest at U.S. treasury bill rates plus ¼%.

9. REMUNERATION PAID TO DIRECTORS AND SENIOR OFFICERS

Remuneration paid to directors during the year ended September 30, 1981 was $38,000. No remuneration was paid to senior officers.

10. OIL AND GAS EXPLORATION AND PRODUCTION ACTIVITIES

(a) Capitalized Costs

	As at		
	September 30, 1981	September 30, 1980	December 31, 1979
Oil and gas	$196,069	$178,900	$155,565
Accumulated depletion and depreciation	69,565	61,767	56,065
	$126,504	$117,133	$ 99,500

(b) Costs Incurred in Oil and Gas Exploration and Production Activities

	Year Ended September 30, 1981	Nine Months Ended September 30, 1980	Year Ended December 31, 1979
Acquisition of unproved properties	$ 1,407	$ 383	$ 5,334
Exploration costs	2,476	7,292	15,609
Development costs	13,771	15,739	14,449
Other	89	64	131
Production (lifting) costs	9,504	5,534	5,684

The exploration and development costs are net of proposed Petroleum Incentives Program payments of $3,306,000 for the year ended September 30, 1981. A claim will be filed for this grant following the enactment of proposed legislation. In addition, exploration and development costs are net of other government incentives totalling $83,000 for the year ended September 30, 1981, $ nil for the nine months ended September 30, 1980 and $1,596,000 for the year ended December 31, 1979.

(c) Net Revenues from Oil and Gas Production

	Year Ended September 30, 1981	Nine Months Ended September 30, 1980	Year Ended December 31, 1979
Gross revenues, net of royalties	$ 44,015	$ 28,394	$ 33,156
Production (lifting) costs	(9,504)	(5,534)	(5,686)
Petroleum and gas revenue tax	(2,820)	—	—
Net revenues from oil and gas producing activities	$ 31,691	$ 22,860	$ 27,470

(d) Depletion and Depreciation

	Year Ended September 30, 1981	Nine Months Ended September 30, 1980	Year Ended December 31, 1979
Depletion and depreciation expense	$ 7,930	$ 5,770	$ 5,536
Average depletion and depreciation rate per equivalent barrel of oil	$2.11	$1.98	$1.28

11. SIGNIFICANT DIFFERENCES BETWEEN CANADIAN AND UNITED STATES GENERALLY ACCEPTED ACCOUNTING PRINCIPLES

The Company follows accounting principles generally accepted in Canada which differ in some respects from those applicable in the United States. These differences are as follows:

(a) Oil and Gas Operations

The Company follows the full cost method of accounting (described in the Summary of Significant Accounting Policies) which differs from the full cost method prescribed by the United States Securities and Exchange Commission (S.E.C.) Under the S.E.C. rules the Company's expenditures in North America would be accumulated in separate cost centres for Canada and the United States. In addition, amortization would not have been provided on the costs in the North Sea cost center prior to the sale in 1979.

(b) Currency Translation

Under United States accounting principles the U.S. dollar long-term debt would have been translated into Canadian dollars at the exchange rate in effect at balance sheet dates.

The following table summarizes the adjustments required to reported net earnings before extraordinary item, net earnings and related per share amounts to conform to United States accounting principles.

	Year Ended September 30, 1981	Nine Months Ended September 30, 1980	Year Ended December 31, 1979
Net earnings before extraordinary item, as reported	$ 9,414	$ 12,957	$ 18,415
Adjustments to conform to United States accounting principles			
Application of S.E.C. full cost accounting rules	(832)	245	(2,333)
Foreign currency translation	5	5	258
Net earnings before extraordinary item, on a United States basis	8,587	13,207	16,340
Extraordinary item, on a United States basis	—	2,585	2,214
Net earnings, on a United States basis	$ 8,587	$ 15,792	$ 18,554
Earnings per share, on a United States basis			
Net earnings before extraordinary item	$ 3.21	$ 4.93	$ 6.10
Net earnings	$ 3.21	$ 5.90	$ 6.93

12. UNAUDITED SUPPLEMENTARY INFORMATION

(a) Selected Quarterly Financial Data

	Quarter Ended			
	December 31, 1980	March 31, 1981	June 30, 1981	September 30, 1981
Revenue	$13,744	$15,222	$12,101	$11,570
Gross margin	$ 8,010	$ 8,586	$ 6,952	$ 6,973
Net earnings	$ 3,535	$ 2,572	$ 1,078	$ 2,229
Net earnings per share	$1.32	$0.96	$0.40	$0.83

	March 31, 1980	June 30, 1980	September 30, 1980
Revenue	$17,666	$12,014	$14,611
Gross margin	$13,214	$ 6,794	$ 8,676
Net earnings before extraordinary item	$ 6,656	$ 2,279	$ 4,017
Net earnings	$ 8,466	$ 2,279	$ 4,017
Net earnings per share before extraordinary item	$2.48	$0.85	$1.51
Net earnings per share	$3.16	$0.85	$1.50

(b) Proved Oil and Gas Reserves

	Year Ended September 30, 1981		Nine Months Ended September 30, 1980		Year Ended December 31, 1979	
	Crude Oil* (Thousands of barrels)	Natural Gas (Billions of cubic feet)	Crude Oil* (Thousands of barrels)	Natural Gas (Billions of cubic feet)	Crude Oil* (Thousands of barrels)	Natural Gas (Billions of cubic feet)
Beginning of period	20,810	175	22,559	180	21,894	152
Revisions of previous estimates and improved recovery	6,134	6	680	(1)	3,392	11
Discoveries and other extensions	520	8	—	2	115	24
Production	(2,660)	(6)	(2,429)	(6)	(2,842)	(7)
End of period	24,804	183	20,810	175	22,559	180

*Includes condensate and natural gas liquids

All of the Company's reserves are developed.

Proved oil and gas reserves are the estimated quantities of crude oil, natural gas and natural gas liquids which geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing operating conditions assuming current prices and costs.

The calculation of reserves of crude oil, natural gas and natural gas liquids is based on the Company's share of gross proved reserves, before the deduction of royalties and minority interests, as estimated by Company engineers.

(c) Estimated Future Net Revenues from Production of Proved Crude Oil and Natural Gas Reserves

Estimated future net revenues from production of proved reserves	
1982	$ 32,034
1983	21,490
1984	15,885
Thereafter	346,155
	$415,564

The estimated future net revenues were computed by applying September 30, 1981 prices, adjusted only for fixed and determinable escalation provisions in contracts, to the estimated future production of proved oil and gas reserves as of September 30, 1981 less estimated future expenditures (based on current costs) to be incurred in developing and producing the proved reserves and assuming the continuation of existing economic conditions. Specifically, the increase in the wellhead price of oil amounting to $2.50 per barrel effective October 1, 1981 has not been taken into account. The price increase schedule agreed upon by the government of Canada and the government of Alberta on September 1, 1981 covering the period to December 31, 1986 has also not been taken into account. Crown and other royalties, and the petroleum and gas revenue tax are deducted in arriving at estimated future net revenues. No provision, however, is made for income taxes.

Present value of estimated future net revenues from production of proved oil and gas reserves discounted at 10%	
September 30, 1981	$167,052
September 30, 1980	$187,839
December 31, 1979	$173,175
December 31, 1978	$158,846

(d) Reserve Recognition Accounting ("RRA")

(i) Statement of RRA Policies

The accounting policies set forth below have been followed in the preparation of RRA statements. These policies comply with the rules of the S.E.C.

Recognition of Assets and Earnings Under RRA.

Under RRA, an asset is recognized and earnings are recorded when proved oil and gas reserves are added through exploration and development activities. A dollar valuation (the "RRA valuation") of proved oil and gas reserves is developed as follows:

(1) Estimates are made of quantities of proved oil and gas reserves and the future periods during which they are expected to be produced based on economic and operating conditions at the end of each period.

(2) The estimated future production is valued on the basis of oil and gas prices at the end of each period except that future prices of gas are increased for fixed and determinable escalation provisions in contracts.

(3) The resultant gross revenue streams, net of applicable crown and freehold royalties, are reduced by estimated future costs to develop and produce the proved oil and gas reserves, including the petroleum and gas revenue tax introduced effective January 1, 1981, based on cost estimates at each period end. However, no provision is made for income taxes.

(4) The resulting future net revenue streams are reduced to net present values by applying a 10 percent factor.

The S.E.C. acknowledges, and the Company cautions, that this valuation procedure does not necessarily yield an accurate estimate of the fair market value of a company's oil and gas reserves. An estimate of fair market value would take into account, among other factors, the following:

(i) the likelihood of future recoveries of oil and gas in excess of proved reserves

(ii) anticipated increases in future prices of oil and gas and related development and production costs

(iii) the use of a discount factor that is more appropriate in the circumstances other than an arbitrary 10% rate and

(iv) the impact of income taxes.

Subsequent revisions to the RRA valuation of proved reserves are included in RRA earnings as they occur and are calculated as follows:

(1) "Additions to estimated proved reserves" represents proved reserves added from drilling exploratory and development wells.

(2) "Changes in prices" represents the approximate effect of changes from one period to the next in the prices and lifting costs used in the RRA valuations.

(3) "Petroleum and gas revenue tax" is the estimated impact of the petroleum and gas revenue tax introduced by the Canadian federal government effective January 1, 1981.

(4) "Accretion of discount" is computed by applying 10 percent per annum to the RRA valuation as of the beginning of each period in recognition of the increase resulting from the impact of the passage of time on the discounted cash flow approach to the valuation of the proved reserves.

(5) "Other" represents the net effect of all changes affecting the RRA valuation not separately reported. Major factors that have given rise to this amount are changes in the estimates of the timing of future oil and gas production, changes in the present value of estimated future development costs and revisions to estimates of oil and gas reserves proved in prior periods.

Exploration and Development Costs

The costs of acquiring unproved properties and drilling exploratory wells are deferred until the properties are evaluated and determined to be either productive or non-productive, at which time they are charged to expense. Other exploration costs are expensed as incurred.

Estimated future costs (at current prices) to develop and produce the proved reserves are deducted in the RRA valuation of proved reserves. Subsequent revisions to estimated future development costs are included in revisions to reserves proved in prior periods. Other development costs are charged to expense when related proved reserves are recognized.

Sale of Unproved Properties

Gains or losses on sale of significant unproved properties are included in the determination of earnings under RRA. During 1979, the Company sold its unproved properties in the North Sea which resulted in a gain under RRA of $3,274,000.

Production and Funds Flow

Under RRA, because earnings are recognized when proved reserves are discovered and as the RRA valuation of proved reserves changes, no earnings are reported when oil and gas is produced. Consequently, RRA earnings may differ substantially from funds generated or required by current exploration, development, and producing operations.

Income Taxes

Income taxes have been computed by applying current statutory tax rates to the future taxable income to be generated from proved reserves and after making provision for the tax basis of the oil and gas properties and after giving effect to the applicable federal and provincial tax credits and rebates, deductions for resource and depletion allowances and provisions for non-allowable crown royalties and other permanent differences.

(ii) RRA Statements

The RRA statements consist of the following tables for the year ended September 30, 1981, nine months ended September 30, 1980 and the year ended December 31, 1979.

(1) Summary of oil and gas producing activities on the basis of RRA and

(2) Summary of changes in the present value of estimated future net revenues from proved oil and gas reserves.

SUMMARY OF OIL AND GAS PRODUCING ACTIVITIES ON THE BASIS OF RRA

	Year Ended September 30, 1981	Nine Months Ended September 30, 1980	Year Ended December 31, 1979
Additions and revisions to estimated proved oil and gas reserves			
Additions to estimated proved reserves	$ 2,853	$ 601	$ 5,836
Revisions to estimates of reserves proved in prior periods			
Changes in prices, net of changes in lifting costs	16,257	46,465	14,214
Petroleum and gas revenue tax	(35,239)	—	—
Other	(2,148)	(29,275)	(8,188)
Accretion of discount	18,784	12,988	15,885
	(2,346)	30,178	21,911
Total	507	30,779	27,747
Deduction for costs incurred	14,472	11,211	13,461
RRA earnings (loss) before income taxes and gain on sale of unproved properties	(13,965)	19,568	14,286
Gain on sale of unproved properties	—	—	3,274
RRA earnings (loss) before income taxes*	(13,965)	19,568	17,560
Income taxes	3,653	5,319	3,564
Earnings (loss) from oil and gas producing activities on the basis of RRA	$ (17,618)	$ 14,249	$ 13,996

*The corresponding amount included in the consolidated statement of earnings (before earnings (losses) from mining operations, equity and other income, interest expense, minority interest and income tax expenses) for the year ended September 30, 1981 amounted to $24,001,000 (nine months ended September 30, 1980 — $17,090,000; year ended December 31, 1979 — $21,934,000).

The above summary is prepared utilizing the RRA accounting policies described on pages 21 and 22. The methods of calculating earnings under RRA and under the historical cost convention, used in the primary financial statements, are based on different concepts as to the recognition of revenues and expenses, the valuation of reserves and the timing of reporting the results of oil and gas exploration and production activities.

While the full cost method of accounting used by the Company may have shortcomings, the Company does not believe the RRA method of calculating earnings is realistic. Underlying the RRA disclosures are estimates of proved oil and gas reserves. These estimates are inherently imprecise and may change significantly from year to year as additional reservoir performance data becomes available and as changes in economic and operating conditions occur. Other shortcomings of using the RRA method are described on page 21. Accordingly, the Company considers the RRA method to be potentially misleading.

SUMMARY OF CHANGES IN THE PRESENT VALUE OF ESTIMATED FUTURE NET REVENUES FROM PROVED OIL AND GAS RESERVES ON THE BASIS OF RRA

	Year Ended September 30, 1981	Nine Months Ended September 30, 1980	Year Ended December 31, 1979
Beginning of period	$187,839	$173,175	$158,846
Revisions to reserves proved in prior periods	(2,346)	30,178	21,911
Additions	2,853	601	5,836
Projected development costs incurred	10,397	6,745	14,052
Production, net of lifting costs and petroleum and gas revenue tax	(31,691)	(22,860)	(27,470)
End of period	$167,052	$187,839	$173,175

FIVE YEAR REVIEW OF OPERATIONS

CONSOLIDATED STATEMENT OF EARNINGS

	Year Ended September 30, 1981	Year Ended September 30, 1980	Nine Months Ended September 30, 1980	Year Ended December 31, 1979	Year Ended December 31, 1978	Year Ended December 31, 1977
Revenue						
Crude oil	$30,106,000	$25,022,000	$18,586,000	$22,590,000	$17,337,000	$13,851,000
Natural gas and related products	13,909,000	13,250,000	9,808,000	10,566,000	7,671,000	7,520,000
Mining	7,731,000	20,224,000	15,150,000	10,866,000	4,128,000	1,092,000
Equity income (loss)	88,000	58,000	50,000	35,000	71,000	(2,950,000)
Other income	803,000	800,000	697,000	244,000	357,000	207,000
	52,637,000	59,354,000	44,291,000	44,301,000	29,564,000	19,720,000
Expenses						
Operating and general	22,202,000	19,952,000	15,690,000	15,081,000	11,983,000	6,980,000
Depletion and depreciation	8,906,000	8,289,000	7,011,000	7,350,000	6,516,000	6,651,000
Interest	3,390,000	3,098,000	2,294,000	2,247,000	2,317,000	1,172,000
	34,498,000	31,339,000	24,995,000	24,678,000	20,816,000	14,803,000
	18,139,000	28,015,000	19,296,000	19,623,000	8,748,000	4,917,000
Taxes	8,725,000	8,779,000	6,339,000	6,365,000	3,999,000	3,312,000
Earnings before undernoted items	9,414,000	19,236,000	12,957,000	13,258,000	4,749,000	1,605,000
Gain on sale of North Sea properties (net of applicable income taxes)	—	—	—	5,157,000	—	—
Net earnings before extraordinary items	9,414,000	19,236,000	12,957,000	18,415,000	4,749,000	1,605,000
Extraordinary items	—	2,895,000	1,805,000	2,462,000	747,000	(6,205,000)
Net earnings (loss)	$ 9,414,000	$22,131,000	$14,762,000	$20,877,000	$ 5,496,000	$ (4,600,000)
Earnings per share						
Earnings before undernoted items	$ 3.51	$ 7.18	$ 4.84	$ 4.95	$ 1.78	$ 0.60
Gain on sale of North Sea properties	—	—	—	1.93	—	—
Net earnings before extraordinary items	3.51	7.18	4.84	6.88	1.78	0.60
Extraordinary items	—	1.08	0.67	0.92	0.28	(2.34)
Net earnings (loss)	$ 3.51	$ 8.26	$ 5.51	$ 7.80	$ 2.06	$ (1.74)

FLOW OF FUNDS	From Operations	$21,552,000	$37,034,000	$26,945,000	$27,286,000	$15,579,000	$13,245,000
CONSOLIDATED BALANCE SHEET	Working Capital (deficiency)	$ (4,618,000)	$ 3,724,000	$ 3,724,000	$ (4,141,000)	$ (9,934,000)	$ (4,712,000)
	Investments and advances	1,074,000	986,000	986,000	1,011,000	1,076,000	1,366,000
	Capital assets — net	138,878,000	126,568,000	126,568,000	108,058,000	84,965,000	70,859,000
	Other assets	1,046,000	981,000	981,000	770,000	685,000	929,000
	Deferred production revenue	1,632,000	1,111,000	1,111,000	796,000	378,000	—
	Long term debt — net	15,878,000	25,183,000	25,183,000	19,054,000	15,780,000	18,539,000
	Deferred income taxes	31,451,000	27,984,000	27,984,000	22,714,000	17,936,000	13,784,000
	Minority interest	1,558,000	1,534,000	1,534,000	1,449,000	1,890,000	1,821,000
	Shareholders' equity	85,861,000	76,447,000	76,447,000	61,685,000	40,808,000	34,298,000
CAPITAL EXPENDITURES	Acquisition of property	$ 1,407,000	$ 2,453,000	$ 383,000	$ 5,685,000	$ 1,687,000	$ 2,539,000
	Exploration and development expenditures	13,573,000	27,977,000	19,606,000	27,761,000	16,462,000	11,486,000
	Production equipment	6,426,000	6,643,000	5,584,000	4,474,000	2,545,000	2,545,000
	Other capital assets	261,000	180,000	93,000	131,000	204,000	441,000
	Total capital expenditures	$21,667,000	$37,253,000	$25,666,000	$38,051,000	$20,898,000	$17,011,000
LANDHOLDINGS	Petroleum and natural gas						
	Gross acreage	5,052,000	6,136,000	6,136,000	5,578,000	6,853,000	8,058,000
	Net acreage	1,681,000	1,778,000	1,778,000	1,645,000	2,000,000	2,633,000
	Mining						
	Gross acreage	672,000	773,000	773,000	597,000	767,000	283,000
	Net acreage	217,000	249,000	249,000	259,000	418,000	259,000
DRILLING ACTIVITY	Gross wells drilled	70	118	72	162	169	108
	Net oil and gas wells — working interest	10	18	9	25	20	11
	— royalty interest	3	—	—	1	12	7
PRODUCTION	Crude oil and natural gas liquids — cubic metres per day	1 164	1 210	1 167	1 238	1 055	1 040
	Natural gas — thousand cubic metres per day	467	528	494	530	433	470
SHARES	Shares outstanding end of period	2,678,356	2,678,356	2,678,356	2,678,356	2,678,356	2,647,921
	average for the period	2,678,356	2,678,356	2,678,356	2,678,356	2,668,211	2,647,921

The above data incorporate retroactive adjustments.