1986

NOWSCO WELL SERVICE LTD.

Annual Report

NOWSCO

Contents

Corporate Profile

Nowsco Well Service Ltd. is a Canadian-based company which provides, on an international basis, specialized products, equipment and technology principally to owners and operators of oil and gas wells for use in the drilling, completion and re-working of such wells. The Company's specialized products, equipment and technology are applied primarily in the cementing and stimulation (including acidizing and fracturing) of wells and in related applications involving nitrogen, carbon dioxide, endless tubing and leak detection. In Canada, the Company also designs and fabricates specialized equipment for its own use world-wide and for sale to third parties and provides training to a variety of customers. In addition, the Company conducts research and development activities which have resulted in technological advances in those areas of the oil and gas industry in which it operates.

The Annual Meeting of the Shareholders of Nowsco Well Service Ltd. will be held at the Calgary Petroleum Club, 319 - 5th Avenue, S.W., Calgary, Alberta on Friday, April 24, 1987 at 4:00 o'clock in the afternoon (local time).

	1986	1985	% Change
	(thousands of dollars)		
Year			
Revenue	**$155,667**	$203,340	– 23
Net income before extraordinary item	**$ 6,192**	$ 19,411	– 68
Percent of revenue	**4.0%**	9.5%	
Net income per common share before extraordinary item	**$0.46**	$1.43	– 68
Net (loss) income	**$ (37,607)**	$ 19,411	–294
Net (loss) income per common share	**$(2.77)**	$1.43	–294
Cash flow from operations	**$ 25,328**	$ 28,002	– 10
Cash flow from operations per common share	**$1.87**	$2.07	– 10
Capital expenditures — net	**$ 13,957**	$ 23,812	– 41
Dividends paid	**$ 2,033**	$ 4,062	– 50
Number of shares issued and outstanding at year end	**13,556,800**	13,550,245	
Shareholders	**888**	956	
Employees at year end	**827**	1,348	

4th Quarter

	1986	1985	% Change
	(thousands of dollars)		
Revenue	**$ 33,667**	$ 62,807	– 46
Net income before extraordinary item	**$ 1,752**	$ 7,470	– 77
Net income per common share before extraordinary item	**$ 0.13**	$ 0.55	– 76
Net (loss) income	**$ (42,047)**	$ 7,470	–663
Net (loss) income per common share	**$ (3.10)**	$ 0.55	–664
Capital expenditures — net	**$ 1,247**	$ 2,280	– 45

1986 was one of the most challenging years we have experienced in our 24 years in the oil service industry. Both Internationally and in Canada the petroleum industry has been beset with roller-coaster oil prices, cash-flow constraints, changing tax laws and incentives and conflicting economic forecasts. As the industry acted and reacted to the changing environment so too was the service sector required to keep pace.

Although disappointing, we are satisfied that Nowsco's results reflect the efforts of Management to react swiftly to industry changes while maintaining an aggressive marketing policy. As could be expected, revenues decreased from last year's $203.3 million to $155.7 million, a 23.4% decrease. Net income before extraordinary item for 1986 was $6.2 million, a decrease of 68.1% from the 1985 level of $19.4 million. Net income before extraordinary item per share was $0.46 compared with $1.43 in 1985.

In the fourth quarter the directors of the Company decided to address an evaluation of the Company's assets in view of the current reduced market place. This review has resulted in an extraordinary item, being a one-time write-down of property, plant and equipment of $43.8 million, net of deferred income taxes of $23.0 million, which more accurately reflects an appropriate carrying value of Nowsco's assets. The benefits of this write-down will be felt commencing in 1987. Following this write-down a net loss of $37.6 million was recorded in 1986.

The year's results reflect the severely negative consequences of the oil price collapse working through the industry and all geographic areas of our operation have felt the impact: in Canada, activity levels at a near record high in the first quarter, dropped dramatically; the United States was affected thoughout the year with drilling activity posting the largest single year-to-year decline ever recorded; and Internationally we felt a gradual market decline as the year progressed and most North Sea operators cut budgets by 30% on average.

Despite the problems of severe price competition as a result of this cash-constrained market-place, we were able to achieve an operating profit during 1986 without the sacrifice of our tenet of providing customer satisfaction of our products and technology. Throughout this past year we have concentrated our efforts on controlling expenses and implementing operational efficiencies in order to support our weaker profit margin and to maintain a competitive edge under declining market conditions.

The unfailing loyalty and efforts of our entire staff during this difficult year was a credit to this company, and management sincerely appreciates their support.

Recent developments could indicate a strengthening and stabilizing of world oil prices, although many companies have adopted a "wait-and-see" attitude before committing themselves to any long-term exploration and development programs. In the United States low prices caused a growth in demand and total imports increased by some 22% (over 1 million barrels per day) in 1986 while production decreased to near record lows. This situation actually enabled Canada to increase its export of crude to the United States and the large U.S. stock levels built up in 1986 are also expected to be used to partially fill this gap between production and demand.

In Canada there is hope for activity improvement; the Petroleum and Gas Revenue Tax (PGRT) has been eliminated, foreign investment is again welcome and royalty-reduced holidays for up to five years are available.

Now a slow but steady industry recovery could be expected. Finding costs in Canada have always been an attraction with vast areas of geologically attractive acreage and with a return to minimal Government involvement we look for many investors to place Canada much higher on their priority list. Certainly the price of energy is a major factor in any recovery, but we do expect Canada to be an early benefactor of such a recovery. Already there are indications of a major company resuming drilling activity in the Canadian Arctic where vast oil reserves have been predicted. Although we do not foresee 1987 being more active than 1986, we do expect this industry to recover and we intend to be in a position to take full advantage of the turnaround when it does happen.

A significant corporate development during the year involved the sale by Big Three Industries Inc., of its 61% interest in our company. In October, the 8.3 million shares of Nowsco stock held by Big Three were acquired by Gordon Capital Corporation and Dominion Securities Inc., two Toronto based brokerage firms. Nowsco assisted these firms in the filing of a prospectus and the appropriate U.S. registrations during the fourth quarter of 1986. While Nowsco received no proceeds from this secondary offering, we are pleased with the resulting broad distribution of this control block of shares to numerous investors and institutions. This redistribution of stock was completed in January, 1987. Our many years of association with Big Three and its management were most beneficial and cordial however we do look forward to operating under this broader ownership. Our financial and technical strength is not weakened by this change.

Following the Big Three sale of its Nowsco stock, it was decided to broaden our Board of Directors with the addition of two new outside directors, Messrs D. J. Anderson and B. W. Douglas. Messrs R. J. Dunlop and R. G. Wells resigned their positions on the Board and we extend our appreciation for their contributions during their tenure.

S. P. Shouldice
Chairman of the Board,
President and Chief
Executive Officer

D. A. Richardson
Senior Vice President and
Chief Operating Officer

Canada

The Canadian oil and gas industry experienced complete extremes of activity levels during 1986. As the year commenced, there was optimism about recent Government price de-regulation and drilling activity was very aggressive as companies took full advantage of various Government drilling incentives and grants scheduled to terminate on March 31, 1986. Drilling activities approached record highs in Canada during the first quarter, a contributing factor to our record revenues over that period. When the reality of the unforeseen drop in world energy prices and the end of Government grants hit the Canadian industry, rig activity dropped suddenly and dramatically as companies adapted to oil in the ten to fifteen U.S. dollar range.

Nowsco reacted by cutting staff some 45% over a period of 60 days, and in the face of severe price competition also instituted numerous other cost-cutting measures including salary reductions to ensure our ability to remain competitive in this depressed market. To date we have maintained all our operating bases in Canada and though some bases are much smaller in staff-count it has been "business as usual" in all cases. Close attention to all areas of operations, from purchasing to equipment utilization, has enabled us to maintain a positive cash flow.

All segments of our Canadian business have been effected by this volatile business environment but we are confident that our reduced staff and attention to efficient fleet utilization puts us in a good position to effectively maintain our position in the market.

During 1986, Nowsco delivered some $15 million of new custom designed equipment to foreign buyers. All of this equipment was designed and assembled at our Fabrication Centre in Calgary. In many cases, these equipment sales also included a transfer of technology involving Nowsco technicians travelling to numerous countries in Europe, Asia, and South America to assist the purchaser in the operation and maintenance of this equipment. Although we are encountering increased competition in this area, we continue to pursue this market as our growing experience in this field is beneficial to future business.

Despite the downturn of the industry, research and development continued on many fronts in 1986. We maintained an aggressive program in operations research, developing new equipment and products as well as simulation technology and job application methods.

We depend on the advancements made by our research and development team, and we will continue our commitment to technology for the future.

United States

Following the very disappointing 1985 results of our U.S. operation, we have succeeded in achieving a reasonable turn-around in 1986. Now operating from two bases in Appalachia, we have reduced staff by some 50% over the year and together with other cost effective measures have achieved a positive cash flow from operations for 1986.

Market conditions in the U.S. are very tight and prices very depressed but we are determined to maintain our presence for the eventual turn-around. We have now established a good customer base, developed a strong local staff, and look to 1987 for even more improvement. While market conditions may not change in 1987, our operating efficiencies now give us more confidence. When market conditions do improve Nowsco will be there to benefit.

International

Declining world oil prices affected industry activity in all corners of the world during 1986. Southeast Asia and the Middle East experienced a significant slow-down late in 1985 while Europe was subject to a more steady decline starting in mid-1986.

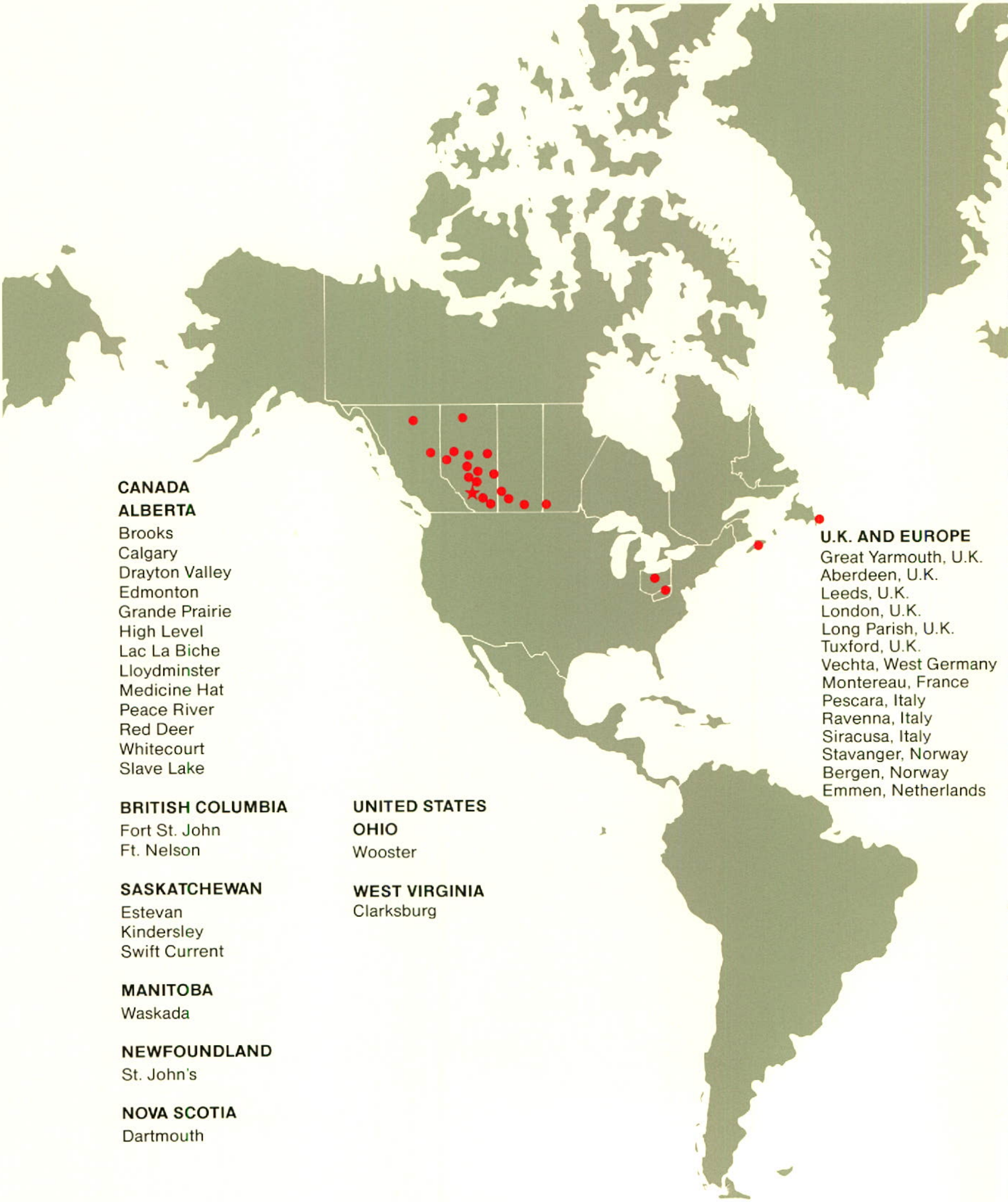
Nowsco has adapted to these market changes as needed. Our Southeast Asia operation has been down-sized significantly with staff reductions of some 60% during the year. We will maintain an effective but reduced presence in Southeast Asia. In the Middle East, we have also reduced staff with operating emphasis being placed in Oman where we have an ongoing contract commitment.

Early in 1986 we opened an operational base in Rabat, Morocco under contract with the local Government oil company. This move has enabled us to open discussions with other companies operating in Morocco and additional work is expected in 1987.

In U.K./Europe, our business both on and offshore, has experienced a gradual decline since mid-1986 in response to the weak price of crude. Exploration drilling has essentially stopped while development and maintenance work has been somewhat reduced. Staff reductions of some 15% have taken place to address this reduced market and many efficiencies have been effected to cope with an increase in price discounting.

To give us a competitive edge in a declining market, our European staff continued their aggressive approach to technology and innovative job design that led to the successful performance of numerous unique treatments during the year. In both the North Sea and Continental Europe, we have a strong presence with a qualified staff of local employees whose efforts have been a major contributor in our European operations.

Operating Locations



CANADA

ALBERTA

Brooks
Calgary
Drayton Valley
Edmonton
Grande Prairie
High Level
Lac La Biche
Lloydminster
Medicine Hat
Peace River
Red Deer
Whitecourt
Slave Lake

BRITISH COLUMBIA

Fort St. John
Ft. Nelson

SASKATCHEWAN

Estevan
Kindersley
Swift Current

MANITOBA

Waskada

NEWFOUNDLAND

St. John's

NOVA SCOTIA

Dartmouth

UNITED STATES

OHIO

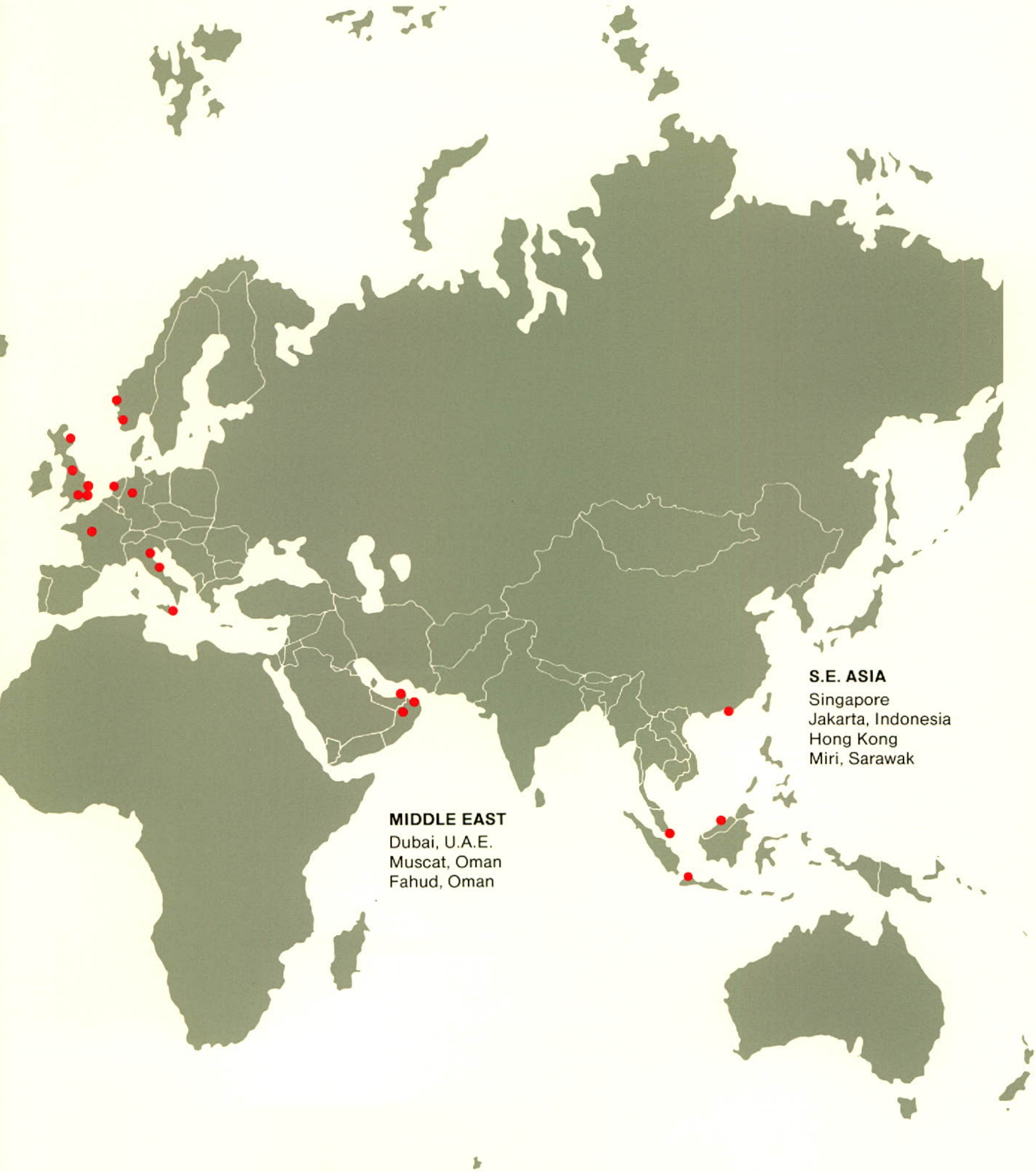
Wooster

WEST VIRGINIA

Clarksburg

U.K. AND EUROPE

Great Yarmouth, U.K.
Aberdeen, U.K.
Leeds, U.K.
London, U.K.
Long Parish, U.K.
Tuxford, U.K.
Vechta, West Germany
Montereau, France
Pescara, Italy
Ravenna, Italy
Siracusa, Italy
Stavanger, Norway
Bergen, Norway
Emmen, Netherlands


S.E. ASIA
Singapore
Jakarta, Indonesia
Hong Kong
Miri, Sarawak
MIDDLE EAST
Dubai, U.A.E.
Muscat, Oman
Fahud, Oman

Financial Condition, Liquidity and Capital Resources

Year Ended December 31, 1986

The Company experienced a downturn in revenues and profitability after the first quarter of 1986 following the reduction in activity levels arising from the sharp decline in oil prices throughout the world. As a result, cash flow from operations during the year of $25.3 million decreased 9.5% compared to 1985.

In order to maintain a strong liquidity position and in response to current and projected future activity levels, the Company significantly reduced two major areas of cash outflow. Capital expenditures during the year of $14.0 million decreased 41.4% compared to 1985 and principally represented the completion of expenditures in U.K./ Europe started or approved in 1985. Dividends paid during the year of $2.0 million decreased 50% compared to 1985. The suspension of the traditional dividend in the second half of the year was in response to the evident decline in profitability.

Surplus cash was used during the year to reduce long term debt to $40.2 million, a $6.2 million reduction compared to a year before.

At December 31, 1986 the Company remained in a good financial position, enhanced by the absense of any major capital expenditure commitments or any significant scheduled long term debt repayments in 1987.

In addition, at December 31, 1986 the Company's total unused lines of credit were $34.4 million. Ongoing operating expenses are expected to be met from cash flow generated by continuing operations.

Operating Results

1986 Compared to 1985

Revenue

Revenue during 1986 of $155.7 million showed a 23.4% decrease compared to 1985, reflecting the impact during 1986 of depressed world oil prices on activity levels throughout the oil industry. This has affected the Company's business in all geographic areas, noticeably since the end of the first quarter of 1986.

In the first quarter of 1986, revenues increased as a result of higher activity levels in U.K./Europe and Canada. In Canada, this increase was due to the oil and gas industry taking advantage of the final months of federal government petroleum incentive programs.

During the second and third quarters of 1986, a decline in industry activity levels caused a significant downturn in the Company's operations in Canada, the

United States and Southeast Asia. This decrease in general activity levels was accompanied by intensified price competition. U.K./Europe operations continued their growth performance from the previous year. In addition, the financial results benefited from the strengthening of certain European currencies against the Canadian dollar.

During the fourth quarter of 1986, activity levels increased in Canada as advantage was taken of expiring short term provincial government incentives. This was offset however by a decline in revenue in U.K./Europe where price discounting increased.

Costs and expenses

Material and operating

The 15.5% reduction in material and operating expenses to $114.5 million compared to 1985 resulted from the decreased sales activity discussed above. In addition, significant cost saving measures were implemented throughout all areas of operations, which contributed to the decline in expenses. This reduction in expenses was not as great as the revenue decrease because of the impact of increased levels of price discounting. Management continues to monitor closely all areas of operations.

General and administrative

The 14.7% decrease compared to 1985 resulted from the decreased activity levels during 1986.

Interest

Interest expense for the year of $4.9 million was similar to 1985.

Depreciation and amortization

The 6.3% increase in depreciation and amortization expense compared to 1985 showed the impact of the significant capital expenditures made during 1985 in U.K./Europe.

Income taxes

The total provision for income taxes for the year represented an effective tax rate of only 4.5% compared to 38.5% in 1985. This significant decrease resulted from increased earnings in low tax jurisdictions, coupled with the availability of tax losses from higher tax-rate areas.

Net income before extraordinary item

Net income before extraordinary item for the year of $6.2 million represented a 68.1% decrease compared to 1985. All areas of operations experienced a significant decline in profitability as a result of the downturn in the Company's revenue since the first quarter of 1986.

Extraordinary item

In the 4th quarter of 1986, a write-down of property, plant and equipment of $43.8 million (net of deferred income taxes of $23.0 million) was recorded to recognize a significant reduction in the economic value of certain property and oilfield equipment in all geographic areas. The Company's decision to write-down the assets was a result of anticipated lower future activity levels combined with a projection of continued intense price competition within the industry. The asset write-down was recorded as an extraordinary item in accordance with Canadian generally accepted accounting principles (GAAP) whereas under United States' GAAP it would have been recorded in results from operations.

1985 Compared to 1984

Revenue

The 3.3% increase in consolidated revenue from $196.8 million to $203.3 million was a result of record levels of activity in Canada as well as growth in U.K./Europe which more than offset decreases in other non-Canadian operations, principally in Southeast Asia and the United States. Throughout 1985 there continued to exist an excess supply of oilfield equipment used in the drilling and completion of oil and gas wells in North America resulting in the Company's prices being subjected to heavy discounting. Revenue in the United States decreased 32.0% resulting, in an operating loss.

Non-Canadian operations in 1985 represented 39.2% of total consolidated revenue as compared to 48.4% in 1984. Revenue from international operations amounted to $53.9 million in 1985, a 6% decrease from 1984 despite the benefit of strengthening European currencies during the year. In December, 1984 a long-term contract for the use of certain stimulation equipment in Southeast Asia ended in the ordinary course of business, significantly reducing revenue during 1985.

Costs and expenses

Material and operating

The 7.8% increase compared to 1984 reflected the increased activity level in the Canadian and U.K./Europe areas of operation. Careful review and control of all operating costs was maintained; however, the continued impact of significant price discounting within the industry had an adverse effect on profit margins.

General and administrative

The increase in 1985 compared to 1984 reflected the administrative overhead associated with the increased activity level and continued geographic expansion of the Company in U.K./Europe.

Interest

The 25.7% increase to $4.9 million was a result of increased borrowings used to finance capital expenditures and the acquisition of the minority interest in the Company's foreign operations in September, 1984.

Depreciation and amortization

The 3.1% decrease reflected the write-down of stimulation equipment in Southeast Asia in 1984 following the end of the long-term contract referred to above.

Income taxes

The 6.9% increase in income taxes to $12.2 million during the year was principally the result of a change in the Company's accounting policy for investment tax credits recommended by the Canadian Institute of Chartered Accountants, whereby the Company now accounts for such credits as a reduction in cost of the relevant expenditures rather than as a reduction of income tax expense. Increased earnings in high tax jurisdictions also contributed to the overall increase in income taxes. The result of these factors was to increase the effective tax rate from 31.1% to 38.5%.

Net income

Net income for 1985 of $19.4 million represented an 8.3% decrease compared to 1984 principally due to a loss from United States operations. 1985 net income, as well as net income for the fourth quarter of 1984, includes 100% of earnings from international operations, whereas previously 49% of such earnings were attributable to minority interest.

Market information

The principal public trading market for the Company's Common Shares is The Toronto Stock Exchange (TSE) in Canada (symbol NWS). In the United States, the Common Shares are quoted on the NASDAQ System (symbol NWELF). The following table sets forth the high and low prices for the Company's Common Shares on The Toronto Stock Exchange and the NASDAQ System for the periods indicated.

At December 31, 1986, there were 888 shareholders of record of the Company's common shares.

	TSE		NASDAQ	
	High	Low	High	Low
	(Canadian dollars)		(United States dollars)	
1986				
1st Quarter	17.500	9.500	12.375	6.750
2nd Quarter	12.750	9.375	9.000	6.750
3rd Quarter	12.875	10.250	8.875	7.250
4th Quarter	11.500	10.500	8.250	7.375
1985				
1st Quarter	24.750	18.500	17.500	13.750
2nd Quarter	26.375	18.500	19.000	13.500
3rd Quarter	21.000	19.000	14.875	13.500
4th Quarter	19.625	17.125	14.000	12.250

	For The Three Months Ended March 31	June 30	Sept. 30	Dec. 31	Total
	(thousands of dollars)				
1986					
Revenue	$61,444	$27,466	$33,090	$ 33,667	$155,667
Costs and expenses of operations	46,455	28,027	26,782	27,646	128,910
Interest	1,589	1,082	1,116	1,152	4,939
Depreciation and amortization	4,126	3,851	3,395	3,965	15,337
	52,170	32,960	31,293	32,763	149,186
Net income (loss) before income taxes and extraordinary item	9,274	(5,494)	1,797	904	6,481
Income taxes	3,846	(2,718)	9	(848)	289
Net income (loss) before extraordinary item	5,428	(2,776)	1,788	1,752	6,192
Extraordinary item	—	—	—	43,799	43,799
Net (loss) income	$ 5,428	$ (2,776)	$ 1,788	$(42,047)	$ (37,607)
Net (loss) income per common share before extraordinary item	$.40	$(.20)	$.13	$.13	$.46
Net (loss) income per common share	$.40	$(.20)	$.13	$(3.10)	$(2.77)
1985					
Revenue	$46,357	$39,589	$54,587	$ 62,807	$203,340
Costs and expenses of operations	33,964	32,740	39,765	45,976	152,445
Interest	1,234	1,310	1,062	1,286	4,892
Depreciation and amortization	3,631	3,511	3,653	3,631	14,426
	38,829	37,561	44,480	50,893	171,763
Net income before income taxes	7,528	2,028	10,107	11,914	31,577
Income taxes	3,211	452	4,059	4,444	12,166
Net income	$ 4,317	$ 1,576	$ 6,048	$ 7,470	$ 19,411
Net income per common share	$.32	$.12	$.44	$.55	$1.43
1984					
Revenue	$51,123	$40,236	$52,419	$ 53,014	$196,792
Costs and expenses of operations	36,466	31,777	37,010	36,160	141,413
Interest	771	918	913	1,290	3,892
Depreciation and amortization	3,027	2,959	3,937	4,962	14,885
	40,264	35,654	41,860	42,412	160,190
Net income before income taxes	10,859	4,582	10,559	10,602	36,602
Income taxes	3,969	798	3,766	2,844	11,377
Minority interest	1,113	1,517	1,041	*378	4,049
Net income	$ 5,777	$ 2,267	$ 5,752	$ 7,380	$ 21,176
Net income per common share	$.43	$.16	$.43	$.54	$1.56

*Prior-quarters' adjustments

Contents

	December 31 1986	1985
	(thousands of dollars)	
Assets		
Current assets		
Cash and short-term deposits	**$ 9,641**	$ 4,995
Accounts receivable	**27,688**	55,105
Income taxes recoverable	**11,074**	1,901
Inventories	**21,310**	23,160
Prepaid expenses	**1,504**	1,880
	71,217	87,041
Property, plant and equipment		
Buildings	**20,970**	20,076
Equipment	**123,278**	169,845
	144,248	189,921
Less accumulated depreciation and amortization	**70,306**	58,265
	73,942	131,656
Land	**3,829**	3,780
	77,771	135,436
Goodwill (net of accumulated amortization of **$1,164,000**; 1985 — $658,000)	**19,057**	19,563
	$168,045	$242,040

Approved by the Board

Director

Director

See notes to consolidated financial statements.

	December 31 1986	1985
	(thousands of dollars)	
Liabilities		
Current liabilities		
Bank indebtedness	**$ 6,856**	$ 4,938
Accounts payable and accrued liabilities	**16,400**	26,249
Income taxes payable	**1,513**	7,395
Current maturities of long-term debt	**3,411**	1,797
Due to affiliates	**—**	859
	28,180	41,238
Long-term debt	**40,161**	46,342
Deferred income taxes	**4,719**	23,092
Shareholders' Equity		
Share capital		
13,556,800 common shares issued and outstanding (1985 — 13,550,245)	**3,171**	3,154
Retained earnings	**80,847**	120,487
Equity translation adjustment	**10,967**	7,727
	94,985	131,368
	$168,045	$242,040

Consolidated Statements of Income

	Year Ended December 31		
	1986	1985	1984
	(thousands of dollars)		
Revenue			
Operations	**$153,593**	$202,406	$194,732
Interest and other income	**2,074**	934	2,060
	155,667	203,340	196,792
Costs and expenses			
Material and operating	**114,483**	135,526	125,705
General and administrative	**14,427**	16,919	15,708
Interest	**4,939**	4,892	3,892
Depreciation and amortization	**15,337**	14,426	14,885
	149,186	171,763	160,190
Net income before income taxes and extraordinary item	**6,481**	31,577	36,602
Income taxes			
Current	**(3,954)**	13,637	9,619
Deferred	**4,243**	(1,471)	1,758
	289	12,166	11,377
Net income before minority interest and extraordinary item	**6,192**	19,411	25,225
Minority interest in net income of consolidated subsidiaries	**—**	—	4,049
Net income before extraordinary item	**6,192**	19,411	21,176
Extraordinary item			
Write-down of property, plant and equipment, net of deferred income taxes of $22,995,000	**43,799**	—	—
Net (loss) income for the year	**$ (37,607)**	$ 19,411	$ 21,176
Net income per common share before extraordinary item	**$0.46**	$1.43	$1.56
Net (loss) income per common share	**$(2.77)**	$1.43	$1.56

Consolidated Statements of Retained Earnings

	Year Ended December 31		
	1986	1985	1984
	(thousands of dollars)		
Retained earnings at beginning of year	**$120,487**	$105,138	$ 88,022
Net (loss) income for the year	**(37,607)**	19,411	21,176
	82,880	124,549	109,198
Dividends paid	**2,033**	4,062	4,060
Retained earnings at end of year	**$ 80,847**	$120,487	$105,138

See notes to consolidated financial statements.

Consolidated Statements of Changes in Cash Position

	Year Ended December 31		
	1986	1985	1984
	(thousands of dollars)		
Cash provided from operating activities			
Net (loss) income for the year	**$ (37,607)**	$ 19,411	$ 21,176
Add (deduct) items not affecting cash:			
Extraordinary item	**43,799**	—	—
Depreciation and amortization	**15,337**	14,426	14,885
Deferred income taxes	**4,243**	(1,471)	1,758
Minority interest in net income of consolidated subsidiaries	**—**	—	4,049
(Increase) decrease in non-cash working capital	**(444)**	(4,364)	(1,270)
Cash flow from operations	**25,328**	28,002	40,598
Investing activities			
Purchase of property, plant and equipment — net	**(13,957)**	(23,812)	(24,296)
Acquisition of minority interest	**—**	—	(32,500)
Cash (out) flow resulting from investing activities	**(13,957)**	(23,812)	(56,796)
Cash in (out) flow before financing and other activities	**11,371**	4,190	(16,198)
Financing and other activities			
Net (reduction) increase in long-term debt	**(5,830)**	2,085	25,525
Issue of common shares	**17**	173	46
Dividends paid	**(2,033)**	(4,062)	(4,060)
Cash (out) in flow resulting from financing and other activities	**(7,846)**	(1,804)	21,511
Increase in net cash position	**3,525**	2,386	5,313
Effect of exchange rate changes on cash	**(797)**	(652)	660
Net cash position at beginning of year	**57**	(1,677)	(7,650)
Net cash position at end of year	**$ 2,785**	$ 57	$ (1,677)

Net cash position comprises cash and short-term deposits less bank indebtedness.

Analysis of decrease (increase) in non-cash working capital items:			
Accounts receivable	**$ 24,793**	$ (13,609)	$ (5,066)
Income taxes recoverable	**(9,173)**	(1,901)	—
Inventories	**267**	(2,820)	309
Prepaid expenses	**376**	(315)	130
Accounts payable and accrued liabilities	**(11,195)**	5,048	2,318
Income taxes payable	**(5,882)**	4,761	(357)
Current maturities of long-term debt	**1,614**	88	886
Due to affiliates	**(859)**	609	244
Effect of exchange rate changes	**(385)**	3,775	266
	$ (444)	$ (4,364)	$ (1,270)

See notes to consolidated financial statements.

Note A — Significant Accounting Policies

Basis of consolidation: The consolidated financial statements include the accounts of Nowsco Well Service Ltd. and its subsidiaries (hereinafter referred to as the "Company").

Translation of foreign currency financial statements and balances: Foreign subsidiaries' financial statements are translated from the foreign entity currency to Canadian dollars at the following rates: assets and liabilities at the rates prevailing at balance sheet date and revenues and expenses at the weighted average rates throughout the period. Adjustments arising from translation are accumulated as a separate component of shareholders' equity. Foreign currency denominated liabilities for which hedges have been identified are translated at historic exchange rates. An appropriate portion of exchange gains and losses resulting from both the translation of foreign currency monetary items and reductions in the Company's net investment in subsidiaries is included in income.

Inventories: Inventories are carried at cost determined under the first-in, first-out or average cost method. The aggregate of such inventories is not in excess of net realizable value.

Revenue recognition: The Company recognizes revenue on equipment construction contracts by the percentage of completion method.

Goodwill: Goodwill resulting from the acquisition of shares of subsidiaries is amortized on a straight-line basis over 40 years.

Property, plant and equipment: Property, plant and equipment are stated at cost, net of provisions for permanent impairment of carrying values. The net cost of assets retired or otherwise disposed of and the related accumulated allowance for depreciation are eliminated from the accounts in the year of disposal and the resulting gain or loss is included in income at that time.

The provision for depreciation is computed principally using the straight-line method over the estimated useful lives of the assets (buildings and improvements — 5 to 40 years; equipment — 2 to 20 years).

Leases: Leases which transfer substantially all of the benefits and risks incident to ownership of property are recorded as the acquisition of an asset and the incurrence of an obligation. The asset is amortized on a straight-line basis over the term of the lease.

Capitalization of interest: Interest is capitalized on all costs incurred in construction of equipment and buildings.

Income taxes: The Company follows the tax allocation method of accounting under which the income tax provision is based on reported net income. Full provision is made for income taxes deferred to future years as a result of claiming allowances for income tax purposes in excess of related depreciation and amortization provisions recorded in the accounts.

Net income per common share: Net income per common share is based on the average number of shares outstanding during the year. Fully diluted net income per common share is not presented because the dilutive effect of common shares under option, if such options were exercised, would not be material.

Comparative financial information: Certain comparative information for the years ended December 31, 1985 and 1984, has been reclassified to conform with the current year's presentation.

Note B — Change in Accounting Policy

Investment tax credits: Effective January 1,1985, the Company was required to change its method of accounting for investment tax credits to adopt, on a prospective basis, the cost reduction method, whereby investment tax credits are accounted for as a reduction of the costs to which they relate. Previously, investment tax credits were accounted for by the flow-through method as a reduction in income tax expense in the year realized. The effect of this change in accounting policy in 1985 was to reduce net income by $753,000.

Note C — United States Accounting Principles

The consolidated financial statements, prepared in accordance with Canadian generally accepted accounting principles (GAAP), conform with accounting principles generally accepted in the United States, except as follows:

Extraordinary Item

Under United States GAAP, the write-down of property, plant and equipment in the current year would not have been recorded as an extraordinary item but would be included in income (loss) before extraordinary item. The effect of this difference between Canadian and United States GAAP is summarized below:

	Canadian GAAP	United States GAAP
	(thousands of dollars)	
Net income (loss) before extraordinary item	$ 6,192	$(37,607)
Extraordinary item	43,799	—
Net loss for the year	$(37,607)	$(37,607)
Net income (loss) per common share before extraordinary item	$0.46	$(2.77)
Net loss per common share	$(2.77)	$(2.77)

Note D — Equipment Under Capital Leases

Property, plant and equipment includes the following equipment under capital leases:

	1986	1985
	(thousands of dollars)	
Equipment	**$ 7,213**	$ 11,408
Less accumulated amortization	**3,333**	2,023
	$ 3,880	$ 9,385

Note E — Share Capital

Authorized — 48,000,000 common shares without nominal or par value.
Issued and outstanding — 13,556,800 Shares(1985 — 13,550,245)

Details of changes in issued share capital, for the two year period ended December 31, 1986 are:

	Number of Shares	Amount (thousands of dollars)
Balance January 1, 1985	13,533,245	$ 2,981
Issued upon exercise of employee stock options	17,000	173
Balance December 31, 1985	13,550,245	3,154
Issued upon exercise of employee stock options	6,555	17
Balance December 31, 1986	**13,556,800**	**$ 3,171**

Under the terms of the Incentive Stock Option Plan, options may be granted at the discretion of the Board of Directors to full-time officers and employees of the Company at an option price equal to the market price of the Company's shares on the date of grant discounted to the maximum amount permitted by The Toronto Stock Exchange. The options are not assignable, are earned as to 20% of the total shares covered thereby for each full year of employment over a five year period commencing on the first anniversary of the date of grant and are exercisable over a ten year period.

The purchase price of common shares of the Company under options granted to certain directors, officers and key employees and outstanding as at December 31, 1986 ranged from \$9.675 to \$10.24. The Company has reserved 108,800 shares (1985 — 51,300) for possible future allocations.

Changes in the number of common shares under option during the two years ended December 31, 1986 are summarized as follows:

	1986	1985
Outstanding, beginning of year	**134,055**	129,055
Granted	**450,000**	23,000
Cancelled	**(7,500)**	(1,000)
Exercised	**(6,555)**	(17,000)
Outstanding, end of year	**570,000**	134,055

Note F — Long-term Debt

	Maturity	1986	1985
		(thousands of dollars)	
Revolving term bank loans[1]	1991	**$ 33,494**	$ 35,872
Industrial Revenue Bond[2]	1992	**829**	981
Capital lease obigations[3]	1987-1994	**9,249**	11,286
		43,572	48,139
Less current maturities		**3,411**	1,797
		$ 40,161	$ 46,342

[1] Secured by a demand debenture and a general assignment of accounts receivable. These loans are repayable in pounds sterling, deutschemarks, guilders and U.S.dollars. The rates of interest under these facilities are variable based on LIBOR, the prime rate or U.S. base rate established from time to time by the Company's Canadian bankers.

[2] Secured by certain land and buildings and repayable in U.S. dollars. The rate of interest is 75% of the Company's U.S. banker's prime rate.

[3] Repayable in U.S. dollars with fixed interest rates ranging from 2.5% to 9.5% per annum.

The aggregate principal repayments required in each of the four years after 1987 are as follows: 1988 — $9,643,000; 1989 — $9,422,000; 1990 — $9,413,000; and 1991 — $8,931,000. In addition, the Company is entitled to make prepayments of any portion of the term bank loans. Interest on long-term debt in 1986 was **$3,181,000** (1985 — $4,252,000; 1984 — $2,208,000).

At December 31, 1986, the Company's unused long-term loan facilities totalled $7,600,000, upon which a standby fee of ¼% per annum is payable. Other unused lines of credit at December 31, 1986 totalled $26,800,000.

Note G — Contingencies and Commitments

1. The Income Tax Act provides tax incentives to Canadian corporations carrying on manufacturing and processing activities in the form of accelerated capital cost allowance and a reduced rate of income tax (introduced into the Act in 1972) and investment tax credits (introduced into the Act in 1975). The Company has claimed these tax incentives since they were introduced into the Act.

   Taxation authorities, Federal and Alberta, have carried out a review of the Company's business activities to determine whether, in their opinion, they qualify as manufacturing and processing activities. As a result of the review, the Federal taxation authorities have concluded that the Company's business activities do not so qualify but have indicated that they will continue to treat them as such up to March 23, 1977.

   In 1981, Federal taxation authorities issued Notices of Reassessment in respect of the Company's 1977, 1978 and 1979 taxation years disallowing accelerated capital cost allowances and investment tax credits claimed by the Company on a substantial portion of its machinery and equipment on the basis that they do not constitute manufacturing and processing assets and disallowing the reduced rate of tax on income earned by the Company subsequent to March 23, 1977 on the basis that the Company's activities do not constitute manufacturing and processing activities. In 1986, the Alberta taxation authorities issued a Notice of Assessment in respect of the Company's 1985 taxation year on a similar basis.

The Company filed Notices of Objection in respect of the Notices of Assessment and Reassessment claiming continued entitlement to utilize the income tax incentives available to corporations carrying on manufacturing and processing activities. In 1984, the Federal taxation authorities confirmed the reassessments for 1977, 1978 and 1979 and the Company has appealed therefrom in the Federal Court of Canada.

The Notices of Assessment and Reassessment claim additional income taxes and interest of approximately $6,570,000 for the years assessed and reassessed. If the Company had computed its income tax provisions for the reassessable years subsequent to 1976 on a basis taking into consideration the Notices of Assessment and Reassessment and a subsequent Federal taxation authorities' interpretation with respect to investment tax credits, retained earnings at December 31, 1986 would be reduced by $13,029,000.

The Company has received an opinion from special legal counsel that the Company's business activities constitute manufacturing and processing activities and that the Company's machinery and equipment constitute manufacturing and processing machinery and equipment. Management of the Company is of the firm opinion that the Company's tax returns, as filed, are substantially correct. Accordingly, no provision has been made in the Company's accounts to reflect any position other than the Company's continued entitlement to claim the tax incentives available to Canadian corporations carrying on manufacturing and processing activities.

2. Claims have been brought against the Company and certain other parties in the United States District Court for the Northern District of West Virginia totalling U.S. $23,000,000 alleging breach of covenant and negligence, among other things, related to certain fracturing operations conducted by the Company. The Company has commenced various counter-claims and cross-claims against all other parties to the action. At the present stage of the proceedings, it is impossible to assess the Company's potential liability or the extent of damages, if any, and, as a result, no provision has been made in the consolidated financial statements.
3. The Company has been named as defendant in various legal actions arising in the normal course of business with claims totalling approximately $1,900,000. Although, at the present stage of proceedings, legal counsel is unable to give opinions with respect to the merits of these actions, management of the Company believes these claims are without merit and as such, no provision has been made in the consolidated financial statements.
4. The Company has guaranteed the borrowings of an affiliate. The potential liability at December 31, 1986 under this guarantee is $900,000.
5. The Company has letters of credit outstanding totalling $900,000 relating to performance under contracts.

Note H — Retirement Plans

The Company has defined benefit pension plans covering most employees. Current costs are provided for, and funded, based upon actuarial estimates. Based upon most recent actuarial valuations, all of which were completed in 1986, the total actuarial present value of accrued benefits and market values of the assets of the plans are as follows:

	1986
	(thousands of dollars)
Actuarial present value of accrued benefits of the plans	
Vested	$11,045
Non-vested	618
	$11,663
Market value of assets of the plans	$21,005

The assumed rates of return used to determine the actuarial present value of accrued benefits of the plans ranged from 7% to 9.5%.

A comparison of the market value of assets of the plans to the actuarial present value of accrued benefits of the plans is not a meaningful determination of the funding status of the plans. The actuarial present value of accrued benefits of the plans is an estimate of the liability of the plans to participants at retirement, based upon years of service and compensation as at the valuation dates. The plans are funded however, in part, on the basis of factors such as projected employee compensation levels and years of service.

Total pension expense for 1986 was **$803,000** (1985 — $1,494,000; 1984 — $1,355,000).

Note I — Related Party Transactions

Purchases were made from affiliated companies as follows:

	1986	1985	1984
	(thousands of dollars)		
Equipment	**$ 2,043**	$ 3,450	$ 379
Inventory	**$ 427**	$ 399	$ 498

These transactions arose in the normal course of operations.

Note J — Segmented Information

The Company provides specialized products, equipment and technology to the oil and gas industry for use during the drilling, completion and production stages of oil and gas wells.

The Company has identified three geographic segments; Canada, the United States, and International, which includes operations in U.K./Europe, Southeast Asia and the Middle East. The following information relates to these geographic segments.

	1986	1985	1984
	(thousands of dollars)		
Revenue			
Canada	**$ 85,030**	$123,602	$101,452
United States	**17,795**	25,853	38,043
International	**52,842**	53,885	57,297
	$155,667	$203,340	$196,792
Net income before income taxes and extraordinary item:			
Canada	**$ 5,816**	$ 24,229	$ 18,196
United States	**(1211)**	(5,206)	2,343
International	**1,876**	12,554	16,063
	$ 6,481	$ 31,577	$ 36,602
Identifiable assets:			
Canada	**$ 67,234**	$ 99,620	$ 86,200
United States	**15,538**	29,336	34,215
International	**66,216**	93,521	62,890
Corporate	**19,057**	19,563	20,068
	$168,045	$242,040	$203,373

Note K — Income Taxes

The Canadian and foreign components of income before income taxes and extraordinary item are as follows:

	1986	1985	1984
	(thousands of dollars)		
Income before income taxes and extraordinary item:			
Canadian	**$ 2,700**	$ 27,610	$ 18,811
Foreign	**3,781**	3,967	17,791
	$ 6,481	$ 31,577	$ 36,602
Income taxes:			
Current			
Canadian	**$ (2,099)**	$ 10,074	$ 6,150
Foreign	**(1,855)**	3,563	3,469
	$ (3,954)	$ 13,637	$ 9,619
Deferred			
Canadian	**$ 3,621**	$ (3,402)	$ 279
Foreign	**622**	1,931	1,479
	$ 4,243	$ (1,471)	$ 1,758

The provision for deferred income taxes results from timing differences in the recognition of revenues and expenses for income tax and financial statement purposes. The tax effects of these differences are as follows:

	1986	1985	1984
	(thousands of dollars)		
Tax and book depreciation	**$ 4,070**	$ (1785)	$ 1,745
Other, net	**173**	314	13
Provision for deferred income taxes	**$ 4,243**	$ (1,471)	$ 1,758

The Company's consolidated provision for income taxes is based upon tax rates and allowances applicable to the earnings of each of the companies in their respective jurisdictions. As a result, the consolidated tax provision differed from that expected by applying the combined Canadian federal and provincial income tax rate to consolidated net income before income taxes and extraordinary item for the following reasons:

	1986	1985	1984
Combined federal and provincial tax rate	**49.2%**	48.4%	47.3%
Differences in foreign statutory tax rates	**(44.0)%**	(6.0)%	(9.9)%
Manufacturing and processing rate reduction	**(0.7)%**	(3.9)%	(3.1)%
Government assistance in the form of tax credits (see Note B — Change in accounting policy)	**—**	—	(3.2)%
Effective consolidated tax rate	**4.5%**	38.5%	31.1%

Auditors' Report

To the Shareholders
Nowsco Well Service Ltd.

We have examined the consolidated balance sheets of Nowsco Well Service Ltd. as at December 31, 1986 and December 31, 1985 and the consolidated statements of income, retained earnings and changes in cash position for each of the three years in the period ended December 31, 1986. Our examinations were made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Company as at December 31, 1986 and December 31, 1985 and the results of its operations and the changes in its cash position for each of the three years in the period ended December 31, 1986, in accordance with generally accepted accounting principles applied on a consistent basis.

Ernst & Whinney
Chartered Accountants

Calgary, Alberta
February 23, 1987

	1986	1985	1984
		(thousands of dollars)	
Revenue	**$155,667**	$203,340	$196,792
Costs and expenses			
Material and operating	**114,483**	135,526	125,705
General and administrative	**14,427**	16,919	15,708
Interest	**4,939**	4,892	3,892
Depreciation and amortization	**15,337**	14,426	14,885
	149,186	171,763	160,190
Net income before income taxes and extraordinary item	**6,481**	31,577	36,602
Income taxes	**289**	12,166	11,377
Minority interest	**—**	—	4,049
Net income before extraordinary item	**6,192**	19,411	21,176
Extraordinary item	**43,799**	—	—
Net (loss) income for the year	**$ (37,607)**	$ 19,411	$ 21,176
Net income per common share before extraordinary item	**$0.46**	$1.43	$1.56
Net income per common share	**$(2.77)**	$1.43	$1.56
Cash flow from operations	**$ 25,328**	$ 28,002	$ 40,598
Cash flow from operations per common share	**$1.87**	$2.07	$3.00
Working capital	**$ 43,037**	$ 45,803	$ 35,930
Capital expenditures — net	**$ 13,957**	$ 23,812	$ 24,296
Dividends	**$ 2,033**	$ 4,062	$ 4,060
Shares outstanding	**13,556,800**	13,550,245	13,533,245
Shareholders	**888**	956	1,158
Number of employees	**827**	1,348	1,352

1983	1982	1981	1980	1979	1978	1977
$161,087	$146,217	$140,850	$135,544	$81,144	$65,184	$42,237
101,683	90,501	90,189	84,733	52,608	42,457	26,226
14,835	12,284	10,429	7,169	5,339	4,873	3,047
3,408	3,899	1,604	1,338	1,228	712	211
11,177	10,100	7,825	5,270	3,812	3,094	1,844
131,103	116,784	110,047	98,510	62,987	51,136	31,328
29,984	29,433	30,803	37,034	18,157	14,048	10,909
10,460	11,025	11,059	14,270	7,538	5,455	4,416
3,461	3,329	2,908	2,423	33	407	364
16,063	15,079	16,836	20,341	10,586	8,186	6,129
—	—	—	—	—	—	—
$ 16,063	$ 15,079	$ 16,836	$ 20,341	$10,586	$ 8,186	$ 6,129
$1.19	$1.12	$1.25	$1.51	$0.79	$0.62	$0.47
$1.19	$1.12	$1.25	$1.51	$0.79	$0.62	$0.47
$ 25,024	$ 29,065	$ 26,121	$ 26,085	$15,421	$ 5,836	$ 8,462
$1.85	$2.15	$1.94	$1.94	$1.16	$0.44	$0.64
$ 28,421	$ 14,518	$ 16,480	$ 13,709	$ 5,094	$ 5,349	$ 4,201
$ 16,570	$ 35,770	$ 25,397	$ 19,823	$15,654	$16,220	$ 9,917
$ 3,787	$ 3,649	$ 4,848	$ 2,683	$ 1,596	$ 1,215	$ 769
13,526,345	13,522,045	13,478,045	13,428,945	13,328,250	13,284,300	13,217,700
1,348	1,611	1,664	1,783	1,067	963	654
1,208	1,048	1,020	983	783	638	470

Board of Directors

DONALD J. ANDERSON Calgary, Alberta	Retired
ALAN J. DAY Calgary, Alberta	Vice President of and Chief Financial Officer of the Company
BRYCE W. DOUGLAS Toronto, Ontario	Vice President and Director, Dominion Securities Inc.
CLIFFORD F. DOW Wooster, Ohio	Vice President and General Manager of the U.S. Operation of the Company
WILLIAM A. ELSER Calgary, Alberta	President and Chief Executive Officer, ATCOR Ltd.
MACLEAN E. JONES Calgary, Alberta	Senior Partner, Bennett Jones, Barristers and Solicitors
DOUGLAS A. RICHARDSON Calgary, Alberta	Senior Vice President and Chief Operating Officer of the Company
S. PATRICK SHOULDICE Calgary, Alberta	President and Chief Executive Officer of the Company

Officers

S.PATRICK SHOULDICE	Chairman of the Board, President and Chief Executive Officer
DOUGLAS A. RICHARDSON	Senior Vice President and Chief Operating Officer
ALAN J. DAY	Vice President, Chief Financial Officer, Secretary and Treasurer
CLIFFORD F. DOW	Vice President
ROBERT G. WELLS	Vice President
ALASTAIR J. ROBERTSON	Corporate Controller
GRANT TREVATHAN	Assistant Secretary

REGISTRAR AND TRANSFER AGENT	The Canada Trust Company Vancouver, Calgary, Regina, Winnipeg, Toronto and Montreal
SOLICITORS	Bennett Jones Calgary, Alberta
BANKERS	Canadian Imperial Bank of Commerce Calgary, Alberta
	Citibank Canada Calgary, Alberta
AUDITORS	Thorne Ernst & Whinney, Chartered Accountants Calgary, Alberta
STOCK LISTED	The Toronto Stock Exchange NASDAQ
HEAD OFFICE	1300, 801 - Sixth Avenue, S.W., Calgary, Alberta, Canada, T2P 4E1
SUBSIDIARY COMPANIES	Nowsco Well Service (U.K.) Limited Nowsco Well Service Norge A/S Nowsco Well Service GmbH Nowsco Well Service Srl Nowsco Well Service (S.E. Asia) PTE. Ltd. Nowsco Well Service International Ltd. Nowsco (U.K.) Group Limited Nowsco Well Service (Europe) B.V. Nowsco (Neth) Group B.V. Nowsco of Canada Ltd. Nowsco (IFC) B.V. Nowsco International Limited Nowsco Well Service Company Limited N.W.S. Administrative Services Limited
AVAILABILITY OF FORM 10-K	Upon request of any shareholder, the Company will provide, without charge, a copy of its annual report on Form 10-K, as filed with The Securities and Exchange Commission. Please direct your request to The Secretary, Nowsco Well Service Ltd., 1300, 801 - Sixth Avenue S.W., Calgary, Alberta, Canada, T2P 4E1.

Designed by R. Lorieau and Associates
lawson graphics western

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NOWSCO

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