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Ocelot Industries Ltd.

Annual Report

1987

Cover Story

New Management Creates Positive Change

As the fern and maple characterize resiliency, strength and adaptability in a sometimes harsh and always changing Canadian environment — so does Ocelot Industries Ltd.

Ocelot experienced a year of positive change in 1987, seizing every opportunity to position itself securely for growth now and in the seasons to come.

Contents

Ocelot is a Canadian-owned company based in Calgary, Alberta. Since 1973 Ocelot has grown into a diversified natural resource enterprise with interests in oil and gas exploration and development, petroleum services and supplies and petrochemicals.

In 1987, a new management team began to reshape Ocelot. The goal: to reduce the company's debt to a manageable level and to restore a balance to its overall operations.

In July 1987, the management group established a two year program during which the company's unwieldy debtload would be made manageable while other operating activities were pursued. Because of the need to give the company's debt position top priority, the program was, by necessity, a long-term plan to return to stability and growth. The three strategies identified to achieve this were (1) to sell producing properties and properties with large capital requirements and high operating costs for cash, which would be used to reduce long-term debt; (2) to rationalize underperforming business segments to create a leaner, more profitable base; and (3) to continue to develop oil and gas properties, with an emphasis on the natural gas side of operations.

In March 1988, Ocelot was able to speed up the recovery process by agreeing to sell its Saskatchewan and Alberta producing properties for a total price of $754 million, of which $80 million is dependent on future natural gas prices. This reduces the debt burden to a very manageable level.

Ocelot can now focus on exploration and development, with an emphasis on rebuilding its natural gas reserves and production, as well as the operation of its petrochemical facilities and its services and supplies segment.

The remarkable return to a healthy financial base has transformed Ocelot into a strong, growing energy company with the potential to record a solid financial performance for its shareholders.

Ocelot's shares are listed on The Toronto Stock Exchange, The Montreal Stock Exchange and the Alberta Stock Exchange.

Annual Meeting

Ocelot's Annual and Special Meeting of Shareholders will be held in the Bonavista Room of the Westin Hotel in Calgary, Alberta on June 8, 1988 at 10:30 a.m. The formal meeting notice and proxy materials are enclosed.

Cash used for operations decreased by $10.7 million.

Operating bank loans reduced by $33 million.

Facts at a Glance

Year Ended December 31, 1987
(thousands of dollars)

	1987	1986
Financial		
Revenue	**$124,195**	$146,313
Cash used for operations	**33,043**	43,777
Loss for the year	**93,882**	221,325
Loss per common share (in dollars)	**6.36**	15.29
Cash used for operations per common share (in dollars)	**2.24**	3.02
Capital expenditures	**31,300**	9,085
Operating bank loans at end of year	**31,302**	64,264
Long-term debt at end of year	**723,082**	723,663
Operations		
Crude oil and natural gas liquids production (barrels per day)	**1,634**	2,495
Natural gas production (millions of cubic feet per day)	**97**	96
Number of drilling and service rigs	**44**	62

Massive debtload dealt with through major asset sales.

As our report illustrates, 1987 has been a year of positive change for Ocelot. The impact of this change has been to return Ocelot to a position of strength — financially and organizationally.

The change in management which occurred in July acted as a catalyst to initiate action on all fronts. We set out to create a strong company clearly aimed at maximizing shareholder value and ensuring long-term survival. To achieve a healthy financial position, we knew we had to aggressively develop our existing assets, dispose of poor quality assets, and reduce expenses. Through the innovative talents and energies of all members of the Ocelot team, we were able to successfully address all three of these corporate directives.

Prior to our change in direction, we were faced with a situation where the combined total of all cash flow from our operations was not enough to pay the principal and interest on our debt. Our primary objective, therefore, was to remove this massive weight of debt by the judicious sale of assets and provide a solid base from which to grow.

The most fortunate and unexpected event over the past few months was the opportunity to sell our Hatton shallow gas reserves and production in Saskatchewan. During 1987, we began an aggressive program of developing and marketing the natural gas from our extensive land holdings in this area to add to short-term cash flow. These value-adding activities opened the door to correct our financial problems when we agreed to sell the entire property in March, 1988. At the same time, we seized an opportunity to dispose of our Alberta producing properties. The total price of these two sales is approximately $754 million, of which $80 million is dependent on future gas prices. Once these two transactions are complete, Ocelot will once and for all, be back on its feet.

We are now in a position to resume our growth and building process, working from a strong financial base to make strategic investments and build upon what will clearly be a healthy cash flow. Even though Ocelot has only a small portion of natural gas production remaining, we have the reserve potential and capability to immediately start replacing the gas production we have agreed to sell.

Ocelot to build upon healthy cash flow from strong financial base.

Chemicals proving to be source of strength and stability.

The major source of strength and stability which will allow us to begin rebuilding our asset base is the cash flow being generated by our Chemicals division. During 1987, the management of the Chemicals division — operating through our Ocelot Ammonia Company partnership — took dramatic action to improve plant efficiencies and cut production costs. These accomplishments prepared the Chemicals group to run at full steam — ideally positioned in the market place to take advantage of the excellent recovery in methanol prices. Although methanol prices are still historically low in real terms, they have risen to a reasonable level and even if prices remain at present levels, the resulting cash flow will provide a solid rate of return and long-term stability. We believe the Chemicals division will be a major source of cash flow to be reinvested in our oil and gas operations.

Parts of our Services and Supplies segment were also solid sources of cash flow last year. To rationalize the overall operations, weaker divisions were sold or shut down and staff levels were reduced in 1987. We will continue to concentrate the segment's strengths into the few strongest and most promising operations. Our investment in this group was written down to more fairly reflect its value and allow us to go forward from a strong, lean base. We look forward to much better operating results from this division as the general level of activity in the oil and gas industry continues to steadily improve.

The new management team at Ocelot could not have accomplished all of these positive changes without the full support, confidence and wise counsel of our Chairman, Mr. Verne Lyons. His experience and long-term perspective have been invaluable to our team. We would also like to acknowledge the key role played by The Royal Bank of Canada in providing rapid and thoughtful response to our requests for support — particularly in supplying the financial backing needed to go ahead with our Hatton development program this past year.

The changes we have outlined were especially attributable to the energy, creativity and loyalty of all the employees on the Ocelot team. We thank them for their patience and dedication.

In 1988, we look forward to continuing the positive changes that have been the focus of our recent activities and pursuing new opportunities as they are identified. From our new position of strength, we can now focus on the exploration, development and acquisition of properties to add new reserves to Ocelot's asset base, and look at strategic investments in the other segments of our operations. We are enthusiastic and strongly committed to the future of the natural gas industry in western Canada and are anticipating an excellent 1988 performance for Ocelot.

Brooke N. Wade
President
April 25, 1988

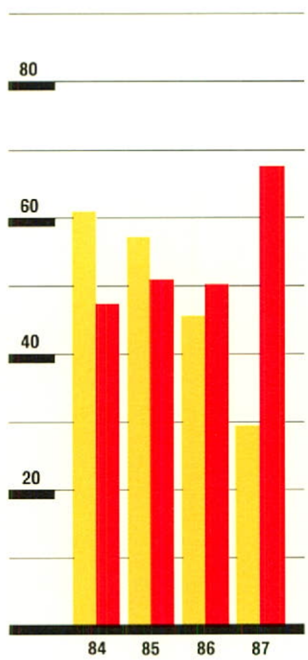
Alberta and Saskatchewan gas-producing assets sold for approximately $754 million of which $80 million is dependent on future gas prices.

Grand Forks/ Ronalane properties sold for $27 million.

Asset Sales Will Restore Ocelot's Financial Health

To dramatically reduce the company's debtload, Ocelot entered into agreements to sell substantially all of its Alberta and Saskatchewan producing oil and gas assets. On March 16, 1988, Esso Resources Canada Limited offered to purchase the Alberta oil and gas properties for approximately $370 million, of which $80 million is dependent on future gas prices. Production from the properties averaged 70 net million cubic feet a day in 1987 and reserves were estimated at a half trillion cubic feet. Then on March 22, 1988 Ocelot announced the sale of a wholly-owned subsidiary holding its interests in the Hatton shallow gas block in southwestern Saskatchewan. The sale was made to Bow Valley Industries Ltd. for approximately $384 million. This included field deliverability of 120 (110 net) million cubic feet a day and reserves comparable to the Alberta properties. Ocelot did not sell its Bigstick natural gas property in southwestern Saskatchewan, and plans are underway to continue to develop these reserves. Ocelot also retained all of its exploratory lands throughout both provinces, as well as in British Columbia.

The move to dispose of properties began early in 1987. A number of oil and gas assets were singled out for sale as the company began to focus on its strength in the low cost production and sale of natural gas. In January, 1988, oil properties in the Grand Forks/Ronalane area of southeastern Alberta were sold for $27 million. Although the properties generated a high level of cash flow, management had set a price at which to sell in order to achieve its first priority of reducing long-term debt. Other dispositions included those with large capital requirements, fully developed properties unable to make substantial contributions to short-term cash flow, and minority interest properties. Interests in Australia were sold, as were properties in Falun, Alberta, Flatrock, British Columbia and Dodsland and Success in Saskatchewan, for a combined total of $9.8 million.



Strong Marketing Increased Direct Gas Sales Under Deregulation
(millions of cubic feet per day)
Western Gas Marketing (TransCanada PipeLines Ltd.)
Direct Gas Sales

Strength in Gas Marketing

Ocelot's gas marketing team has adapted quickly to the competitive and increasingly volatile natural gas market place, capitalizing on new opportunities in the expanding gas markets of North America. Ocelot's team was the first to make a direct sale to Canada's eastern

Ocelot first producer to sell gas directly to Saskatchewan consumers.

Gas sales of 50 million cubic feet per day added.

industrial markets when deregulation became a reality. Ocelot was also the first producer to sell gas directly to Saskatchewan consumers when that province moved to deregulate domestic markets.

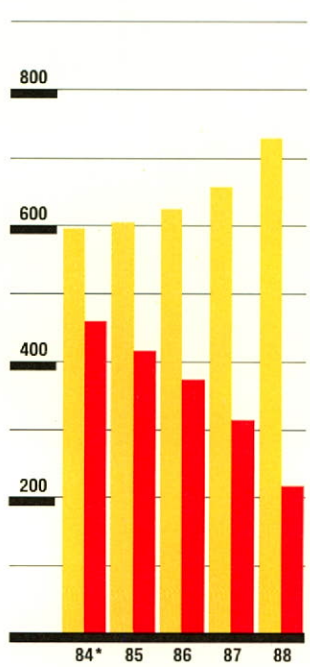
Long-term contracts were secured and new contacts were established in a variety of market areas, adding 50 million cubic feet per day of natural gas sales.

Ocelot has set the stage for future gas contract opportunities as new gas reserves are added. Until now, Ocelot has focused its marketing efforts on selling its own gas but there is potential to sell joint venture participants' and other producers' gas by diversifying into new markets in Canada and the United States.

Natural Gas Prices Put to the Test

Over the past few years, the North American natural gas industry has been characterized by oversupply and a tightly regulated environment for gas pricing and exports. This began to change in 1985 as a trend to deregulation became federal policy and a free market system took shape. In the winter of 1987-1988, cold weather put natural gas prices to the test. Spot market prices increased sharply, and in many cases went beyond long-term contract price levels. But the full effect of prolonged icy temperatures on the supply and demand balance in the United States remains to be seen. What *is* apparent, is that increasing exports to the United States may provide stability for 1988 Canadian natural gas prices and at higher levels than received in 1987. It is also evident that supply and demand on a North American-wide basis is now considerably more balanced than over the last three or four years. Canada's elimination of the surplus test and export floor price on gas exports is a positive development, though total deregulation has yet to be realized and the average selling price of gas suffered a 33 percent decrease during 1987.

The outlook for natural gas pricing is promising. After a series of decreases in United States' gas consumption between 1984 and 1986, natural gas demand is on the increase, and some price stability is expected to be restored. As full deregulation comes into effect and United States pipeline accessibility continues to improve, a decrease in the gas surplus will provide excellent export opportunities for Canadian gas producers.



*April 1

Accelerated Development of Gas Reserves Boosts Production Capability
(billions of cubic feet)

Ocelot Most Active Saskatchewan Gas Developer in 1987

Saskatchewan opened the door to full-scale gas development when its government moved towards more complete deregulation of the province's natural gas pricing and marketing structure in

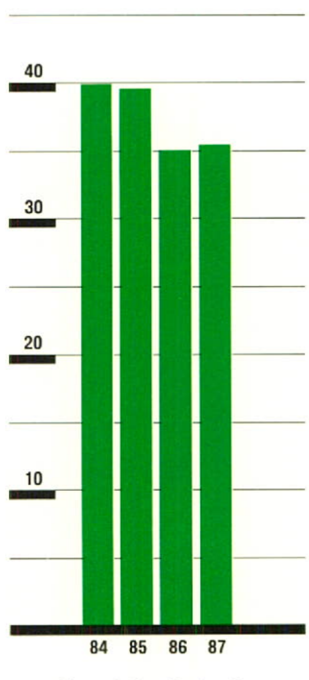
317-well program raised daily Hatton field deliverability by 60 million cubic feet.

Hatton fully developed, setting the stage for subsequent sale of properties.

1987. Government price regulation was eliminated, a new price-sensitive royalty system was introduced, and consumers were given the option to purchase gas directly from producers. Free market access also provided more opportunities to sell gas to markets outside Saskatchewan.

Ocelot was Saskatchewan's most active gas developer in 1987 as a result of an ambitious 317-well program in the Hatton area of southwest Saskatchewan. The high level of activity also placed Ocelot at the top of the charts for the 'Most Wells Drilled' in the Canadian oil and gas industry during the month of November 1987. Ocelot added 60 million net cubic feet to daily gas deliverability, raising the total to 110 net million cubic feet a day from Hatton. All gas was contracted to markets in Saskatchewan, eastern Canada and the United States. Contracts were signed with a number of major North American industrial companies for a total of 35 million cubic feet a day in three and five-year contracts, capturing approximately one-half of Saskatchewan's industrial gas market. A sale was also negotiated to supply a large mid-western United States utility with 15 million cubic feet a day for 15 years.

Once the Hatton program was completed, the number of producing wells in Saskatchewan in which Ocelot held an interest rose from 500 to 817. By accelerating the development of its gas reserves in the Hatton block, Ocelot brought the property from a minor producing asset in 1983 to rank as one of its largest and most valuable assets. This then led to the subsequent sale of the properties as described in the beginning of this operations section.



Natural Gas Production
(billions of cubic feet)

Exploration Focus

In July, with the placement of a new management team, Ocelot marked the beginning of an exciting new direction. Priorities became focused on financial recovery with emphasis on areas of strength and expertise. This plan involved both a review of Ocelot's existing exploratory acreage and a selective rebuilding of its land inventory in areas with proven potential for gas development. As well, farm-ins were being arranged in areas with potential to add new reserves of shallow and conventional gas.

Most of Ocelot's 1987 drilling activity centered on the prolific Grand Forks/Ronalane areas of south-eastern Alberta. The program added substantial value to Ocelot's holdings in the area — setting the stage for the profitable sale of the

70 percent improvement in 1987 Canadian gas sales.

Drilling Activity	December 31, 1987 Gross	December 31, 1987 Net*	December 31, 1986 Gross	December 31, 1986 Net*
Development				
Gas	318	299.0	184	128.0
Oil	17	3.7	13	3.8
Dry	10	2.8	4	2.4
Service	1	0.1	5	0.9
Total	346	305.6	206	135.1

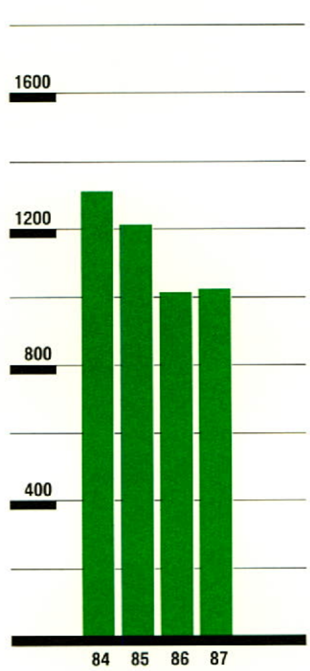
	December 31, 1987 Gross	December 31, 1987 Net*	December 31, 1986 Gross	December 31, 1986 Net*
Exploration				
Gas	7	3.3	4	2.6
Oil	4	0.9	3	1.4
Dry	5	2.4	5	2.0
Total	16	6.6	12	6.0

*Includes Ocelot's working interest in the Development Drilling Programs after payout.

properties in early 1988. Ocelot also started to accelerate its exploration activities in Saskatchewan late in 1987 through a $1.8 million program financed by a flow-through share issue. This program, and others in Alberta and British Columbia, were designed to evaluate and eventually develop existing exploratory lands into productive gas properties. Additional exploratory drilling is planned for 1988.

Canadian Natural Gas Sales Increases

Natural gas production averaged 96.6 million cubic feet a day in 1987, essentially unchanged from 1986. However, the inclusion of Ocelot's Peco properties in 1986 production figures distorts the comparative gas sales picture. Peco was sold late in 1986, so by excluding the Peco sales from 1986, net gas sales from Ocelot's remaining properties in Alberta and Saskatchewan were up by almost 60 million cubic feet a day by the end of 1987 — a 70 percent improvement.



Natural Gas Reserves
(billions of cubic feet)

Canadian Crude Oil Production

Canadian crude oil and natural gas liquids production averaged 1,590 barrels a day, representing a 27 percent drop as a result of property dispositions. The Grand Forks/Ronalane sale will reduce Ocelot's 1988 crude oil sales dramatically, with daily sales of crude oil and natural gas liquids expected to average 175 barrels a day in February, 1988. New programs will be aimed at developing new reserves of gas, with lesser attention to oil development in the short term.

Impact of Asset Sales

Once the major asset sales are final, Ocelot will have average daily natural gas production of 7.3 million cubic feet in western Canada. Canadian landholdings will

Future focus on developing new gas production from remaining landholdings and reserves.

be approximately 200,000 net acres and management's estimate of remaining proven and probable natural gas reserves in Canada totals over 300 billion cubic feet, based on the assumptions outlined in the table on this page.

New exploration and development programs are being planned for a variety of existing properties and Ocelot will pay particular attention to adding prospective gas properties to its land portfolio. In this way, the company can capitalize on new gas deliverability and future gas sales opportunities by using the marketing expertise developed over the last few years selling to industrial consumers throughout North America.

Reserves

	Crude Oil and Natural Gas Liquids (thousands of barrels)		Natural Gas (billions of (cubic feet)
Proven Reserves	Canada	International	Canada
Reserves at January 1, 1987	7,338	462	1,041
Added by drilling	255*	—	1
Revisions & Dispositions	(5,386)	(448)	67
Production	(582)	(14)	(35)
Reserves at January 1, 1988	1,625	—	1,074
Probable Reserves	963	—	64
Total Proven and Probable Reserves	2,588**	—	1,138 **

* Reserve values for certain wells drilled at Grand Forks are not included in these figures as a result of the property disposition effective January 1, 1988.

** Includes 80% of the Ocelot 1978 Development Fund.

Ocelot's proven and probable reserves are shown on a before royalty basis. The Canadian reserve evaluations including estimated net cash flows have been carried out by independent consultants. The definitions for proven and probable reserves are as follows:

Proven Reserves — Quantities of crude oil, natural gas, and natural gas by-products, which, upon analysis of geologic and engineering data, appear with a high degree of certainty to be recoverable at commercial rates in the future from known oil and gas reservoirs under presently anticipated economic and operating conditions.

Probable Reserves — Reserves which may be recovered in the future by using pressure maintenance or other secondary recovery methods, or by more favourable performance of the existing recovery mechanism than that which would be deemed proven at the present time. They may also be reserves which are assumed to exist because of geophysical or geological indications and drilling done in regions which contain proven reserves.

Impact of 1988 Asset Sales — Management estimates remaining proven plus probable reserves of natural gas will total over 300 billion cubic feet in western Canada once the March 1988 major asset sales are completed. Certain of these reserves will require further drilling activity to develop and confirm their potential.

Reserves

	Estimated Net Cash Flows Discounted at 10%	Estimated Net Cash Flows Discounted at 12%
Proven Reserves		
Canada	$968,887,000	$843,092,000
Probable Reserves		
Canada	$ 24,774,000	$ 22,230,000
Total Proven and Probable Reserves	$993,661,000	$865,322,000

Gas production capacity maintained in 1987 despite earlier asset sales.

Production Summary

	Crude Oil and Natural Gas Liquids (thousands of barrels)		Natural Gas (millions of cubic feet)	
	Year Ended December 31,			
Canada	1987	1986	1987	1986
Alberta	533	738	29,286	30,849
Saskatchewan	31	41	3,337	2,367
British Columbia	18	18	2,630	1,677
	582	797	35,253	34,893
International	14	114	–	117
Total	596	911	35,253	35,010

Natural Gas Production After 1988 Asset Sales Completed*

	Yearly[1]	Daily Average[1]
	(millions of cubic feet)	
British Columbia	2,516	6.9
Alberta	33	0.1
Saskatchewan	130	0.3
Total	2,679	7.3

*Note: These are management's estimates assuming the March 1988 asset sales are completed.

[1]Net to Ocelot.

Landholdings — Developed and Undeveloped
as at December 31, 1987

	Gross Acres	Net Acres
Canada (1)		
Alberta	825,720	436,583
Saskatchewan	260,084	162,891
British Columbia	211,586	63,551
Manitoba	158	64
	1,297,548	663,089
International		
Cameroon	194,527	30,359
Senegal	511,500	511,500
	706,027	541,859
Total	2,003,575	1,204,948

(1) Does not include varying royalty interests in 121,558 gross acres.

Canadian Landholdings After 1988 Asset Sales Completed*

	Gross Acres	Net Acres
British Columbia	211,586	63,551
Alberta	144,960	37,616
Saskatchewan	112,640	88,787
Manitoba	158	64
Total	469,344	190,018

*Includes developed and undeveloped properties, assuming the March 1988 asset sales are completed.

$5.4 million cash flow signals improvement from $0.1 million deficit.

$8.0 million pipeline contract gets O.J. Pipelines off to good start for 1988.

Focus on Strength Leads to Positive Cash Flow

Ocelot is working to adapt its Services and Supplies segment to changing industry demand and align the operations with Ocelot's overall financial objectives. Staff levels have been reduced and non-profitable operations have been curtailed, producing a positive cash flow in 1987 of $5.4 million — a major improvement from a $0.1 million cash flow deficit in 1986. In addition, during the year the Company wrote-down certain drilling and other assets in this segment totalling $33.2 million in order to more fairly reflect estimated recoverable values of the assets.

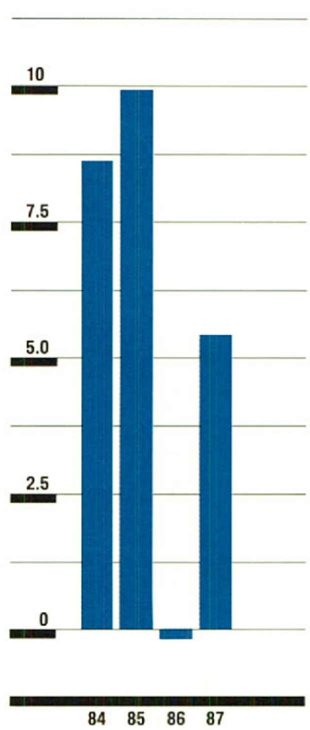
Tough competition in the service rig industry precipitated the sale of Brooks Field Service. Lynx Oilfield Supply of Billings, Montana was also sold during the year.

Wilson Oilfield Supply's revenues increased from $28.8 million to $33.6 million during the year. Staff levels were reduced substantially and the oilfield supply company reshaped its overall operations to respond to market demand for its products.

O.J. Pipelines had improved results in 1987. Bonding arrangements were put in place to facilitate bids on larger contracts, and a variety of projects were undertaken. A $3 million construction project was completed early in the year in northern Alberta and a $5 million Ontario project was underway in June. Two more contracts were signed for a total of $3 million to build large-diameter pipelines in Alberta and Ontario late in the year. Early in 1988, O.J. Pipelines was awarded an $8.0 million contract to construct a pipeline in northern Alberta. The project is scheduled for completion in the spring of 1988, representing a good start for the pipeline construction operations for 1988. South Eastern Pipeline's operations remained steady, generating revenues almost equal to 1986.

Contract drilling in Canada failed to gain momentum in 1987. Early in the year, drilling activity appeared to be on the increase, but unstable oil and gas prices created industry uncertainty during the second half of the year, resulting in minimal gains. Cactus Drilling achieved a 36 percent rig utilization, up from 31 percent in 1986. Cardinal Drilling had only a marginal increase in rig utilization owing to low levels of industry activity in the United States.

In 1988, Ocelot expects good improvement in pipeline construction operations and some advances in Canadian drilling operations, provided oil and gas prices remain stable.



Services and Supplies Operations Achieve Positive Cash Flow
(millions of dollars)

Methanol prices increased by 120 percent during 1987.

Methanol production costs reduced by 28 percent.

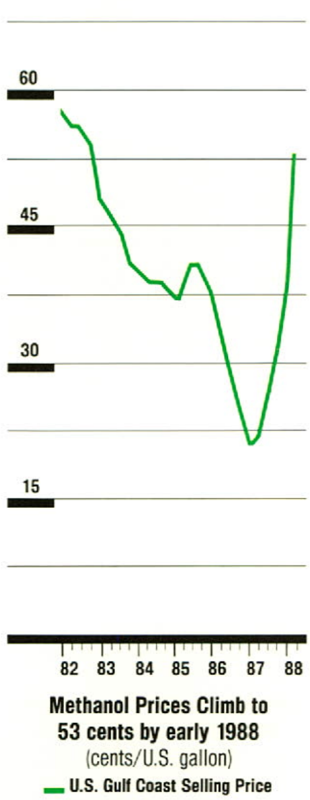
Methanol Price Recovery Provides Solid Source of Cash Flow

The petrochemical operations have become a major source of strength and stability for Ocelot. There was a spectacular 120 percent recovery of methanol prices during 1987 from 22 cents per U.S. gallon at the beginning of 1987, to 49 cents per U.S. gallon at the end of the year.

Although methanol prices are still low, in real terms, management is confident the operations will provide a solid source of cash flow. Now that the supply and demand balance has begun to reach equilibrium in world methanol markets, Ocelot expects additional methanol price increases with some levelling off in 1989.

Adaptability: The Key to Effectively Competing in World Methanol Markets

Adaptability has been Ocelot's key to effectively competing in the ever-changing and highly complex world methanol markets. Over the past few years, oversupply and market uncertainty placed steady pressure on suppliers, forcing prices down. When prices recovered, the chemicals team was positioned to take full advantage of the market resurgence. Plant efficiencies were improved throughout 1987 with overhead and operating costs reduced to their lowest levels since the plant opened in 1983. This provided a good competitive base from which to operate and Ocelot is now one of the most cost-effective and efficient methanol and ammonia producers in the industry. Ocelot's major market areas are Japan, the Gulf Coast and the west coast of the United States. A smaller percentage of sales are made in the Canadian provinces of British Columbia, Alberta and Ontario. The company is optimistic that international trading opportunities for increased sales will continue to arise.



Methanol Prices Climb to 53 cents by early 1988
(cents/U.S. gallon)

Record Methanol Production Achieved

Ocelot's 1987 methanol operations achieved the highest level of production since the plant opened in Kitimat, British Columbia in 1983.

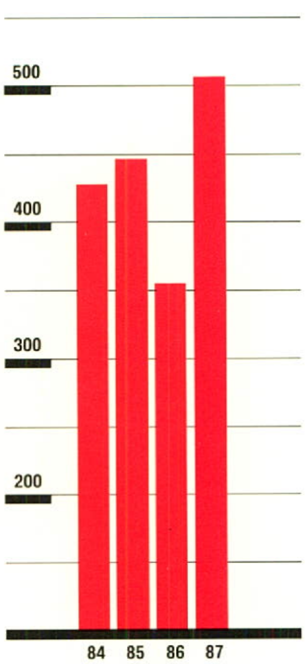
Methanol production up 43 percent.

Ammonia plant completed first full year of operation.

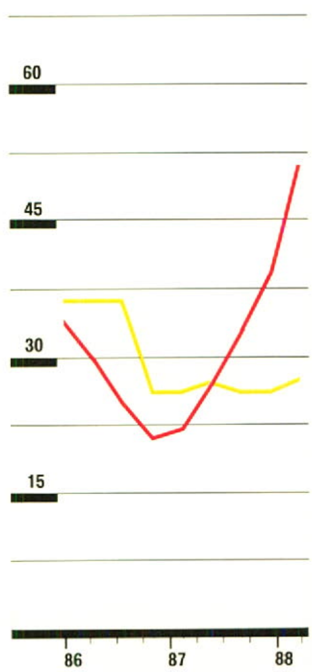
Production exceeded 500,000 tonnes, up 43 percent from 1986, with the plant operating at 117 percent of rated capacity. Overall production costs were lowered by 28 percent and staff levels were reduced by 30 percent. This was achieved at the same time as the start-up of Ocelot's new 51 percent-owned ammonia plant.

California Proves to be Stable Market for Ammonia

Ocelot's ammonia plant had its first full year of operations in 1987. Production reached the forecasted level of 180,000 tonnes and California continued to be a stable long-term market. Ocelot's strong marketing capabilities enabled the company to make additional sales by acquiring Alberta ammonia and selling it to Taiwan, the Phillipines and Costa Rica. Prices remained soft throughout the year owing to a world surplus of ammonia, but are expected to be seasonally adjusted upward in the first quarter of 1988, then remain steady throughout the rest of the year.

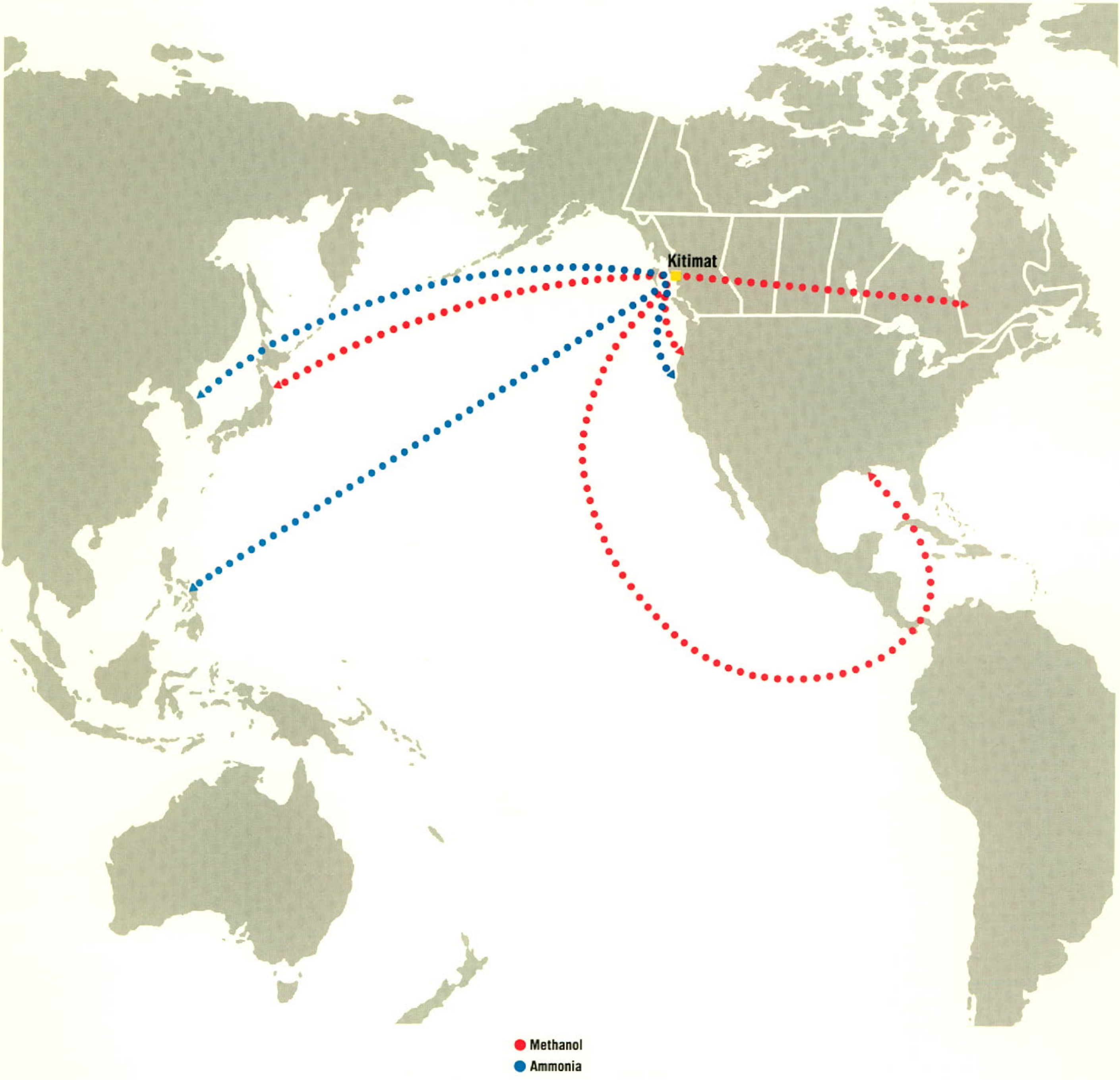


Methanol Production Reaches Record 500,000 tonnes
(thousand tonnes)



Improved Profit Margins in Methanol Operations
(cents/U.S. gallon)
U.S. Gulf Coast Selling Price
Unit Production Costs

Methanol and Ammonia World Markets



Lower interest rates reduced interest expense by $11.8 million.

Summary of Operations

Cash flow from operations before interest expense was $40.0 million in 1987 as compared to $41.1 million in 1986. Interest expense was reduced by $11.8 million in 1987 due to lower interest rates, which yielded a positive impact on cash used for operations amounting to $33.0 million in 1987 as compared to $43.8 million in 1986.

Ocelot's consolidated statement of earnings reflects a loss before extraordinary items of $60.6 million ($4.11 per share) as compared to a loss of $53.9 million ($3.72 per share) in 1986. The 1986 results are not comparable with 1987 as 1986 includes a gain on the sale of natural gas and petroleum properties of $53.8 million offset by subsidiary companies' losses of $26.7 million.

Ocelot recognized an extraordinary loss on the writedown of certain assets in the Petroleum Industry Services and Supplies segment in the amount of $33.2 million. This resulted in a loss for the year of $93.9 million ($6.36 per share) for 1987 as compared to a 1986 loss of $221.3 million ($15.29 per share).

Revenue from the Natural Gas and Petroleum Operations segment was $49.6 million in 1987 compared to $66.5 million in 1986; down $16.9 million. Earnings from operations from this segment were $11.6 million in 1987, down $8.7 million from 1986. The revenue decrease was principally the result of a 33 percent drop in average natural gas prices. This was offset by cash savings in both operating expenses and general and administrative expenses of $3.0 million and $2.5 million, respectively.

The Petroleum Industry Services and Supplies segment generated revenues of $84.0 million (1986 - $82.0 million) and incurred a loss from operations of $3.0 million (1986 - $8.7 million). The loss from operations was reduced by $5.7 million from 1986, as a direct result of increased revenues, improved gross margins and substantially lower general and administrative expenses.

Changes in Financial Position

Operating bank loans at December 31, 1987 amounted to $31. 3 million, a decrease of $33.0 million from the 1986 total of $64.3 million. The major source of cash attributing to this reduction was the receipt of proceeds, in 1987, from the 1986 Peco property disposition. The remainder of these funds, along with proceeds received from other minor property dispositions, were utilized to finance long-term debt repayments of $19.2 million and

Oil and gas revenue decreases partially offset by $5.5 million reduction in expenses.

Services and Supplies loss reduced by $5.7 million.

current year's interest expense in excess of cash generated from earnings.

Ocelot expended $31.3 million on capital projects during 1987, the majority of which was spent on the Hatton development project in Saskatchewan. This compares to capital expenditures of $9.1 million in 1986. The 1987 capital program was funded by long-term debt and a flow-through share issue, reflecting management's intention of maximizing short-term cash flows by financing development projects with bank debt rather than drilling funds.

Outlook

In keeping with the Company's thrust to reduce debt to a manageable level, Ocelot's management identified an opportunity to restructure its existing drilling funds to accelerate cash flow. In early 1988, Ocelot negotiated an agreement to exchange certain land interests with the development program participants and collapse the drilling fund arrangements. In this way, profits are fully recognized as soon as production and sales are in place, rather than waiting for development programs to reach "payout" under the drilling fund format. This restructuring, in turn, set the stage for Ocelot to enter into two major agreements to sell its producing oil and gas assets in Alberta and Saskatchewan for a combined price of approximately $754 million, of which $80 million is dependent on future natural gas prices. Ocelot's management has ascertained that no cash income taxes will result from these two dispositions, and therefore the full proceeds are available to the Company to be applied to substantially reduce its debt load.

The Petrochemicals segment made a dramatic recovery in 1987. Methanol prices improved significantly and the segment began to show a positive cash flow. Since November, 1986, Ocelot's control of the petrochemical operations has been severely limited due to restrictions imposed by a major creditor of Ocelot Investments Ltd. This is currently being rectified so that in the very near future, Ocelot will be able to benefit from the excellent cash flow being generated from the Petrochemicals segment.

Ocelot will be in a strong financial position once the major asset sales are finalized. The Company will have a manageable debt load, positive cash flow from its Petrochemicals and Petroleum Industry Services and Supplies operations, and excellent potential to capitalize on its remaining oil and gas properties.

Auditors' Report

To the Shareholders of Ocelot Industries Ltd.

We have examined the consolidated balance sheet of Ocelot Industries Ltd. as at December 31, 1987 and the consolidated statements of earnings, deficit and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Company as at December 31, 1987 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Thorne Ernst & Whinney

Chartered Accountants
Calgary, Canada, March 22, 1988

Consolidated Financial Statements

Ocelot Industries Ltd.
Consolidated Balance Sheet
as at December 31, 1987
(thousands of dollars)

Assets	1987	1986
Current Assets		
Cash	**$ 1,489**	$ 740
Accounts receivable	**34,997**	104,040
Inventories, at lower of cost and net realizable value	**3,917**	6,618
	40,403	111,398
Long-term Investments (Note 2)	**40,979**	39,911
Property, Plant and Equipment (Note 3)	**333,803**	370,889
Deferred Charges and Other Assets (Note 4)	**17,312**	29,602
	$432,497	$551,800

Approved by the Board

J V Lyons

Director

M M Hannon

Director

Liabilities	1987	1986
Current Liabilities		
Bank indebtedness, secured	**$ 32,791**	$ 65,004
Accounts payable and accrued liabilities	**79,193**	67,567
Deferred gas revenue	**5,000**	6,584
Current maturities on long-term debt	**104,013**	52,973
	220,997	192,128
Deferred Gas Revenue (Note 5)	**32,208**	35,275
Long-term Debt (Note 6)	**619,069**	670,690
Deferred Taxes	**17,270**	21,406
	889,544	919,499
Commitments and Contingencies (Notes 1 and 11)		
Capital Stock and Deficit		
Capital Stock (Note 7)		
Authorized		
25,000,000 Preferred shares without nominal or par value		
7,500,000 Class A Common shares without nominal or par value		
25,000,000 Class B Subordinate voting shares without nominal or par value		
Issued and to be issued		
3,724,422 (1986- 3,552,351) Class A shares	**7,622**	6,635
11,553,910 (1986 - 10,927,540) Class B shares	**58,443**	54,896
Deficit	**(523,112)**	(429,230)
	(457,047)	(367,699)
	$432,497	$551,800

Subsequent Events (Note 13)

Ocelot Industries Ltd.
Consolidated Statement of Earnings
Year Ended December 31, 1987
(thousands of dollars)

	1987	1986
Revenue		
Operating (Note 8)	**$124,195**	$146,313
Costs and Expenses		
Cost of sales and operating expenses	**95,877**	110,806
Depletion and depreciation	**21,258**	24,056
	117,135	134,862
Earnings From Operations Before Undernoted Items (Note 8)	**7,060**	11,451
Interest on long-term debt	**66,924**	77,882
Other interest	**6,103**	6,963
Other (income) expense	**(1,118)**	3,889
Share of subsidiary companies' losses	**67**	26,684
Gain on sale of natural gas and petroleum properties	**—**	(53,824)
Write-down of foreign natural gas and petroleum properties	**—**	1,679
Minority interest	**—**	(192)
	71,976	63,081
Loss Before Taxes and Extraordinary Items	**64,916**	51,630
Income and other taxes (Note 9)	**(4,280)**	2,269
Loss Before Extraordinary Items	**60,636**	53,899
Extraordinary Items		
Write-down of company's assets to estimated recoverable values	**33,246**	—
Write-down of subsidiary companies' assets to estimated realizable values	**—**	171,595
Tax benefit from utilization of a subsidiary company's loss carried-forward	**—**	(4,169)
Loss for the Year	**$ 93,882**	$221,325
Per Share		
Weighted average number of Class A and Class B shares outstanding during the year	**14,763,910**	14,479,773
Loss per Class A and Class B share		
Before extraordinary items	**$4.11**	$ 3.72
After extraordinary items	**$6.36**	$15.29
Cash used for operations per Class A and Class B share	**$2.24**	$ 3.02

Ocelot Industries Ltd.
Consolidated Statement of Changes in Financial Position
Year Ended December 31, 1987
(thousands of dollars)

	1987	1986
Cash Provided By (Used For)		
Internally Generated Cash		
Cash from operations before interest expense (Note 12)	**$ 39,984**	$ 41,068
Interest expense	**(73,027)**	(84,845)
Cash used for operations	**(33,043)**	(43,777)
Financing Activities		
Long-term debt — borrowings	**29,994**	1,067
— repayments	**(19,180)**	(22,644)
Issue of shares	**4,534**	9
Deferred charges and other assets	**(1,000)**	3
Accounts receivable and accounts payable	**69,500**	(69,500)
Deferred gas revenue	**—**	(6,229)
	83,848	(97,294)
Investing Activities		
Property, plant and equipment — acquisitions	**(31,300)**	(9,085)
— disposals	**14,008**	86,179
Long-term investments — advances (to) from	**(3,061)**	18,416
— disposals	**4,478**	—
Minority interest	**—**	(3,110)
Deferred charges and other assets	**(1,968)**	(1,169)
	(17,843)	91,231
Increase (Decrease) in Operating Bank Loans	**(32,962)**	49,840
Operating Bank Loans* at Beginning of Year	**64,264**	14,424
Operating Bank Loans* at End of Year	**$ 31,302**	$ 64,264

*Operating bank loans are net of cash

Ocelot Industries Ltd.
Consolidated Statement of Deficit
Year Ended December 31, 1987
(thousands of dollars)

	1987	1986
Balance at Beginning of Year	**$429,230**	$207,905
Loss for the year	**93,882**	221,325
Balance at End of Year	**$523,112**	$429,230

Summary of Significant Accounting Policies
(Note 1)

(a) Principles of Consolidation

The consolidated financial statements include the accounts of the Company and certain of its subsidiaries. The subsidiary companies which have been excluded from consolidation and the underlying reasons for not consolidating these subsidiaries are described in Note 2.

(b) Natural Gas and Petroleum Operations

The Company follows the full cost method of accounting for natural gas and petroleum operations as prescribed in the Guideline on Full Cost Accounting in the Oil and Gas Industry issued by the Canadian Institute of Chartered Accountants.

All costs of exploration for and development of natural gas and petroleum reserves are capitalized on a country-by-country cost centre basis. Such costs include land acquisition costs, geological and geophysical expenses, carrying charges of non-producing property, costs of drilling both productive and non-productive wells and overhead charges related to exploration and development activities. Grants received and accrued under Federal and Provincial incentive programs are applied as a reduction of the related capitalized costs. Proceeds received on the sale of natural gas and petroleum properties are credited to the capitalized costs except for dispositions which would significantly alter the relationship between capitalized costs and proven natural gas and petroleum reserves.

Capitalized costs are depleted and depreciated using the unit of production method based on gross proven reserves of natural gas and petroleum in each cost centre, as determined by Company engineers and substantiated periodically by independent engineers. Reserves and production quantities, for depletion and depreciation calculations, are converted to equivalent units of gas based on the relative sales value.

The Company places limits on the aggregate costs of natural gas and petroleum assets which may be carried forward for amortization against revenues of future periods (the "Ceiling Test"). The Ceiling Test is a cost recovery test whereby the capitalized costs less accumulated depletion and depreciation in each cost centre are limited to an amount equal to estimated future net revenues from proven reserves (based on current prices and costs as at the balance sheet date) plus unproved properties at cost, less impairment (the "Cost Centre Ceiling").

The total capitalized costs less depletion and depreciation and deferred income taxes of all cost centres are further limited to the aggregate estimated future net revenues for all cost centres less recurring general and administrative expenses, future financing costs and income taxes (the "Enterprise Ceiling"). Any costs carried on the balance sheet in excess of the ceiling test limits are charged to earnings.

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

(c) Drilling Rigs and Related Property and Equipment

Costs of new equipment and upgrading existing equipment are capitalized. Repairs and replacements which do not extend the useful lives of assets are expensed as incurred. The cost and related accumulated depreciation are removed from the accounts when an asset is sold or retired and the resulting gain or loss is included in earnings.

(d) Depreciation

Depreciation of drilling and construction assets is provided on methods and at rates which will amortize the cost of the assets over their estimated useful lives. The annual rates of depreciation on major classes of assets are:

Drilling rigs	— 10 percent (based on operating days)
Construction equipment	— 20 percent to 35 percent

(e) Revenue Recognition

The revenues and expenses on drilling and construction contracts are recorded on the percentage of completion basis.

(f) Foreign Currency Translation

The Company follows the temporal method when translating foreign currency transactions and the financial statements of integrated foreign subsidiaries. Under this method:

(i) monetary items are translated at the rates of exchange prevailing at the balance sheet date;
(ii) non-monetary items are translated at historic exchange rates; and
(iii) revenue and expenses (other than depletion and depreciation) are translated at average rates of exchange during the year.

The resulting gains or losses are credited or charged to earnings except for those relating to monetary items having a fixed life which are deferred and amortized over the life of the particular item.

Note 1
Financial Position and Future Operations

During the year and subsequent to December 31, 1987, the Company's principal banker agreed to temporarily defer certain scheduled payments on the bank loans. Based upon present financial forecast for ongoing operational and capital expenditure requirements, further rescheduling of bank loan repayments may be required. The Company's principal banker has indicated that it intends to work closely with the Company to establish an appropriate repayment schedule. Subsequent to December 31, 1987, the Company entered into three property sale agreements, the cumulative impact of which represents a disposition of substantially all of the Company's producing natural gas and petroleum properties; two of these agreements are pending approvals from regulatory and other authorities. Reference is made to Note 13. Upon closing these transactions, the Company will obtain a significant amount of cash which will be used to substantially reduce existing long-term debt. Management believes that, in light of the existing collateral security, either a refinancing or other arrangement can be achieved with its principal banker to warrant presentation of consolidated financial statements which assume the Company's continuing operations.

Note 2
Long-term Investments

Investment in and advances to non-consolidated subsidiary companies consists of:

	1987	1986
	(thousands of dollars)	
Petrochemical subsidiaries		
Ocelot Investments Ltd. (100% owned)	$30,723	$26,892
Ocelot Ammonia Company, a British Columbia Partnership (51% owned)	10,256	10,691
Ocelot Chemical Corp. (1986 - 100% owned)	–	1
	40,979	37,584
Other	–	2,327
	$40,979	$39,911

From November of 1986 through 1987, the Company's ability to control the operations of the petrochemical subsidiaries was curtailed as a result of restrictions imposed by a major creditor of Ocelot Investments Ltd. ("Investments"). Management believes that, as a result of the strengthened financial condition of these subsidiaries, all restrictions will be lifted in 1988 and control will be returned to the Company.

During 1987, Investments was and continues to be in default of the repayment of a loan secured by a debenture which it issued. Although the Company is contingently liable, under the terms of the debenture, the debenture holder has taken no formal steps to realize on the debenture. Investments has made considerable progress in remedying the default and it is anticipated that the debenture will be out of default by the end of fiscal 1988. Reference is made to Note 11.

Note 3
Property, Plant and Equipment

	1987			1986
	Cost	Accumulated Depletion and Depreciation	Net	Net
	(thousands of dollars)			
Natural gas and petroleum leases and rights together with exploration, development and equipment thereon	$387,141	$111,411	$275,730	$265,575
Contract drilling equipment	81,982	47,419	34,563	71,732
Pipeline construction equipment	32,110	20,913	11,197	13,384
Land, buildings and other equipment	33,544	21,231	12,313	20,198
	$534,777	$200,974	$333,803	$370,889

Overhead charges related to exploration and development activities of $2.2 million (1986 - $3.1 million) have been capitalized and included in the cost of properties.

Note 4
Deferred Charges and Other Assets

	1987	1986
	(thousands of dollars)	
Unrealized foreign exchange losses on long-term debt, less accumulated amortization of $5,340,000 (1986 - $2,565,000)	$ 7,835	$ 22,005
Deferred financing charges, less accumulated amortization of $4,356,000 (1986 - $3,193,000)	4,319	4,482
Other assets	5,158	3,115
	$ 17,312	$ 29,602

Note 5
Deferred Gas
Revenue

The December 31, 1987 balance of deferred gas revenue represents payments received under take-or-pay provisions of major gas contracts. These amounts received for natural gas not yet delivered are to be repaid by deliveries of natural gas at a minimum rate of 10% of prepaid volumes per contract year. During the year, $4.65 million (1986 - $6.3 million) of natural gas was delivered and recognized as revenue.

Note 6
Long-term
Debt

	1987	1986
	(thousands of dollars)	
Canadian dollar bank loans (a)	**$531,277**	$514,005
U.S. dollar bank loans (a) (1987 - $105,000,000 U.S.; 1986 - $105,000,000 U.S.)	**136,479**	144,953
9½% Senior secured notes due March 31, 1998 (b) (1987 - $36,200,000 U.S.; 1986 - $39,487,500 U.S.)	**47,053**	54,512
10½% Senior secured notes due March 31, 1998 (b)	**7,819**	8,529
Other	**454**	1,664
	723,082	723,663
Less current maturities included in current liabilities	**104,013**	52,973
	$619,069	$670,690

(a) The principal balance of fully hedged bank loans (i.e. U.S. London Interbank Offer Rate ["Libor"] Notes) is included in the accounts at $500 million Canadian and bears an interest cost of Libor plus 1%. The cost of the hedge is being amortized over the life of the Notes (which is limited to a maximum of 90 day periods). The remaining Canadian dollar loans bear interest at ½% and 1¼% above bank prime rate. The U.S. dollar loans bear interest at 1½% above a certain United States bank base rate, ¼% above a certain United States bank prime rate and at 1% and 2% above Libor. The Company and its subsidiaires have pledged all of their assets against these bank loans, subject only to prior specific charges.

(b) The notes are secured by mortgages on certain producing petroleum and natural gas properties. During 1987, the Company was and continues to be technically in default of a provision contained in the note agreement with its noteholders. Under the terms of the note agreement, the noteholders have the right to make formal demand on the Company for repayment of the notes, however, no action has been taken by the noteholders to date. If the noteholders make a formal demand for repayment, management believes that the noteholders' security more than satisfies the indebtedness.

As described in Note 1, the Company and its principal banker are presently reviewing the repayment terms of the bank loans. Based upon present projections of the Company's future cash flow and its corresponding capability to make principal repayments, revisions to established repayment schedules will be required. Subsequent to December 31, 1987, the Company received offers to purchase its producing natural gas and petroleum properties in Alberta and Saskatchewan. Upon the closing of these transactions, the Company will obtain a significant amount of cash which will be used to substantially reduce existing long-term debt.

The estimated minimum amount of long-term debt maturities set out below have been determined on the basis of existing repayment schedules for the bank loans. The accompanying consolidated financial statements would be affected by the reclassification of the amount of any additional payments deferred in 1988 from current liabilities to long-term debt or by the early retirement of long-term debt with proceeds received from the disposal of assets.

The estimated minimum amount of long-term debt maturities for the five years subsequent to 1987 are as follows: 1988 - $104.0 million; 1989 - $88.1 million; 1990 - $121.1 million; 1991 - $121.0 million; and 1992 - $121.0 million. In accordance with arrangements made with the Company's principal banker, the Company may be required to make additional payments on bank loans such that total payments would equal 60% of the net annual cash flow generated from operations.

Note 7
Capital Stock

(a) The Class A and Class B shares rank equally one with the other except that each Class A share carries twenty votes and each Class B share carries one vote, and Class A shares are convertible at the option of the holder into Class B shares on a one-for-one basis.

(b) The declaration of dividends on all issued and outstanding shares is subject to the approval of the Company's principal banker.

Note 7
Capital Stock
(continued)

(c) Changes in the capital stock of the Company during the year were as follows:

	Number of Shares		Consideration	
	Class A	Class B	Class A	Class B
			(thousands of dollars)	
Balance issued, December 31, 1986	3,552,351	10,927,540	$ 6,635	$ 54,896
Issued on exercise of employee stock options	—	170,100	—	871
Conversion of shares	(6,500)	6,500	(13)	13
Issued under a flow-through share agreement	—	90,080	—	649
Issued under private placement agreements	178,571	301,886	1,000	1,600
Balance issued, December 31, 1987	**3,724,422**	**11,496,106**	**7,622**	**58,029**
To be issued under a flow-through share agreement	—	57,804	—	414
Balance issued and to be issued, December 31, 1987	**3,724,422**	**11,553,910**	**$ 7,622**	**$58,443**

(d) As of December 31, 1987, there were 1,351,700 Class B shares of the Company reserved for exercise of employee stock options to 1992 at prices ranging from $4.65 to $6.875 per share as follows:

Outstanding at December 31, 1986	643,200
Granted at $5.75 to $6.875 per share	1,033,000
Exercised at $4.65 to $5.75 per share	(170,100)
Expired	(154,400)
Outstanding at December 31, 1987	**1,351,700**

All options were granted under employee stock option plans and at December 31, 1987, an additional 100,400 Class B shares were reserved for future options which may be granted under these plans.

Note 8
Segmented Information

The Company's operations are conducted through two business segments. These segments are natural gas and petroleum operations and petroleum industry services and supplies (which comprises contract drilling of oil and gas wells, sales of oilfield equipment and supplies, and pipeline construction). Presented below are data relative to each business and geographic segment.

Business Segments

	Natural gas and petroleum operations	Petroleum industry services and supplies	Petro-chemicals	Eliminations (b)	Total
		(thousands of dollars)			
Revenue					
1987	**$ 49,553**(a)	**$ 83,991**	**$ —**	**$(9,349)**	**$124,195**
1986	$ 66,475(a)	$ 81,907	$ —	$ (2,069)	$ 146,313
Earnings (loss) from operations					
1987	**$ 11,613**	**$ (3,030)**	**$ —**	**$(1,523)**	**$ 7,060**
1986	$ 20,337	$ (8,664)	$ —	$ (222)	$ 11,451
Total assets					
1987	**$313,928**	**$ 77,590**	**$40,979**	**$ —**	**$432,497**
1986	$ 394,041	$120,175	$ 37,584	$ —	$ 551,800
Capital expenditures					
1987	**$ 29,523**	**$ 1,777**	**$ —**	**$ —**	**$ 31,300**
1986	$ 7,706	$ 1,379	$ —	$ —	$ 9,085
Provision for depletion and depreciation					
1987	**$ 12,803**	**$ 8,455**	**$ —**	**$ —**	**$ 21,258**
1986	$ 15,509	$ 8,547	$ —	$ —	$ 24,056

Geographic Segments

	Canada	United States	Other Foreign	Total
		(thousands of dollars)		
Revenue				
1987	**$116,659**	**$ 7,162**	**$ 374**	**$124,195**
1986	$ 137,098	$ 8,089	$ 1,126	$ 146,313
Earnings (loss) from operations				
1987	**$ 9,504**	**$ (2,159)**	**$ (285)**	**$ 7,060**
1986	$ 18,815	$ (4,107)	$ (3,257)	$ 11,451
Total assets				
1987	**$415,505**	**$16,992**	**$ —**	**$432,497**
1986	$ 505,600	$ 40,292	$ 5,908	$ 551,800

Note 8
Segmented Information
(continued)

(a) Natural gas and petroleum revenue is net of royalties (1987 - $10.1 million; 1986 - $16.8 million) and includes the Alberta Royalty Tax Credit (1987 - $2.8 million; 1986 - $2.8 million).

(b) Eliminations relate to inter-segment transactions which are priced at market prices for similar products and services.

Note 9
Income and Other Taxes

(a) Income tax expense differs from the amounts which would be obtained by applying the Canadian basic federal income tax rate to the respective year's loss before taxes and extraordinary items. These differences result from the following items:

	1987	1986
	(thousands of dollars)	
Expected Canadian Federal tax rate	**47.8%**	47.8%
Computed "expected" tax reduction	**$(31,030)**	$(24,679)
Royalties and other payments to federal and provincial governments	**738**	2,836
Other non-deductible costs	**3,278**	3,535
Federal resource allowance	**(3,861)**	(7,259)
Provincial income tax less federal abatements	**(393)**	9
Non-deductible losses and unrecognized benefits carried forward	**27,132**	26,039
Petroleum and gas revenue tax	**(144)**	1,788
Total actual tax (reduction)	**$ (4,280)**	$ 2,269
Actual tax represented by:		
Deferred income tax (reduction)	**$ (4,136)**	$ 481
Petroleum and gas revenue tax	**(144)**	1,788
	$ (4,280)	$ 2,269

(b) As at December 31, 1987, the Company had available for deduction against future years' taxable income the following amounts (subject to final determination by taxation authorities):

	Canada	**United States**
	(thousands of dollars)	
Loss carry-forwards (expiring in varying amounts to the year 2002)	$ 77,831	$54,496
Property and capital costs (deductible at varying rates and methods)	$230,414	$ 6,124

The Company estimates that it has earned investment tax credits of $2.5 million as at December 31, 1987 which have not been recognized in the accounts. These credits can be applied in future years to reduce federal taxes otherwise payable and are subject to final determination by the taxation authorities.

(c) The Company has potential income tax benefits of $49.3 million which relate to accumulated accounting losses to December 31, 1987 on which no tax benefit has been recorded in the accounts. These benefits will be recognized in the accounts as an extraordinary item in future years upon their realization.

Note 10
Other Information

(a) The Company and its United States subsidiary have non-contributory pension plans covering substantially all permanent, full-time employees. The plans provide a defined benefit pension at retirement based on employees' earnings and length of service.

Pension costs are actuarially computed on an annual basis and take into consideration management's best estimate assumptions. Based on these assumptions, the estimated present value of accrued pension benefits amounted to approximately $11.0 million at December 31, 1987. The December 31, 1987 market value of the net assets of the pension plans amounted to $11.2 million. Any surplus or deficiencies in the pension plans are amortized over the expected average remaining life of the employees.

(b) During 1987, certain non-consolidated U.S. subsidiary companies were sold to relatives of two directors and shareholders of the Company. Prior to the sale, the Company received a fairness opinion from independent investment counsel on the aggregate purchase price of $4.5 million. As a result of this transaction, a gain of $2.6 million was recognized in the Company's accounts.

Note 11
Commitments and Contingencies

(a) The Company is contingently liable as guarantor of a secured debenture granted by Ocelot Investments Ltd. in the amount of $56.2 million. Management is confident that realization on the secured assets would satisfy these obligations with no additional funding required by the Company. Reference is made to Note 2.

(b) A statement of claim was served in June, 1983 by the contractor of the Kitimat methanol plant for monies owing pursuant to its construction. Subsequent to December 31, 1987, this matter has been verbally settled with the contractor at no cost to the Company.

Note 11
Commitments and Contigencies
(continued)

(c) A United States subsidiary of the Company is in a dispute with a customer over certain work performed under a construction contract. Management believes that adequate provision has been made in the accounts for all anticipated losses under this contract.

(d) The Company has been named as a co-defendant in a legal action for amounts owing pursuant to a specific capital project. In view of the fact that the Company and its legal counsel feel the claim is without merit, no provision has been made for amounts claimed.

Note 12
Consolidated Statement of Changes in Financial Position

	1987	1986
	(thousands of dollars)	
Loss before extraordinary items	$(60,636)	$(53,899)
Add (deduct)		
Depletion and depreciation	21,258	24,056
Interest expense	73,027	84,845
Deferred income tax (reduction)	(4,136)	481
Other non-cash items	1,260	8,322
Share of subsidiary companies' losses	67	26,684
Gain on sale of natural gas and petroleum properties	–	(53,824)
Write-down of foreign natural gas and petroleum properties	–	1,679
	30,840	38,344
Accounts receivable and accounts payable	11,169	4,685
Inventories	2,701	4,711
Deferred charges and other assets	(75)	(358)
Deferred gas revenue	(4,651)	(6,314)
	9,144	2,724
Cash from operations before interest expense	$ 39,984	$ 41,068

Note 13
Subsequent Events

(a) Subsequent to December 31, 1987, the Company sold its interests in the Grand Forks/Ronalane area for $27 million. Proceeds received on this transaction reduced both operating and long-term bank loans.

(b) In March, 1988 the Company entered into an agreement to sell substantially all of its producing Alberta natural gas and petroleum assets for approximately $370 million of which $80 million is contingent on future natural gas prices. In addition, the Company entered into an agreement to dispose of its interests in the Hatton area of Saskatchewan for approximately $384 million. These transactions are subject to approvals from regulatory and other authorities. On consummation of these two transactions, together with the disposition of the Grand Forks/Ronalane interests, the Company will have effectively disposed of substantially all of its producing natural gas and petroleum operations and, as such, the 1988 operating revenues from natural gas and petroleum operations would be substantially reduced. Reference is made to Notes 1 and 6.

Five Year Summary — Financial

(thousands of dollars)

	Years Ended December 31,				Nine Months Ended December 31,	Year Ended March 31,
	1987	1986	1985	1984	1984	1984
				(unaudited)		
Operating revenue	**$ 124,195**	$ 146,313	$ 260,712	$ 226,127	$ 160,097	$ 193,036
Costs and Expenses						
Cost of sales and operating expenses	**95,877**	110,806	181,602	141,254	98,544	122,609
Depletion and depreciation	**21,258**	24,056	27,743	29,564	21,266	29,367
	117,135	134,862	209,345	170,818	119,810	151,976
Earnings from Operations Before Undernoted Items	**7,060**	11,451	51,367	55,309	40,287	41,060
Interest on long-term debt	**66,924**	77,882	84,348	92,293	71,526	81,459
Other interest	**6,103**	6,963	3,906	5,827	4,496	7,699
Other expense (income)	**(1,118)**	3,889	300	(2,156)	(1,326)	(2,525)
Share of subsidiary companies' losses	**67**	26,684	8,982	15,677	7,277	27,602
Gain on sale of natural gas and petroleum properties	—	(53,824)	(31,418)	—	—	—
Write-down of foreign natural gas and petroleum properties	—	1,679	9,625	—	—	—
Minority interest	—	(192)	123	123	99	51
	71,976	63,081	75,866	111,764	82,072	114,286
Loss before Undernoted Items	**64,916**	51,630	24,499	56,455	41,785	73,226
Income and other taxes (reduction)	**(4,280)**	2,269	15,879	607	130	(13,443)
Loss from Continuing Operations	**60,636**	53,899	40,378	57,062	41,915	59,783
Loss from operations of discontinued mining segment	—	—	—	2,036	1,404	2,599
Loss before Extraordinary Items	**60,636**	53,899	40,378	59,098	43,319	62,382
Extraordinary items						
Write-down of company's assets to estimated recoverable values	**33,246**	—	—	—	—	—
Write-down of subsidiary companies' assets to estimated realizable values	—	171,595	—	—	—	—
Tax benefit from utilization of a subsidiary company's loss carried forward	—	(4,169)	—	—	—	—
Write-down of mining assets, net of applicable income taxes of $4,353	—	—	—	5,929	5,929	—
Loss for the Period	**$ 93,882**	$ 221,325	$ 40,378	$ 65,027	$ 49,248	$ 62,382
Weighted average number of Class A and B shares outstanding during the period	**14,763,910**	14,479,773	14,423,521	14,380,553	14,382,909	14,369,488
Loss per Class A and B share						
Before extraordinary items	**$4.11**	$ 3.72	$2.80	$4.11	$3.01	$4.34
After extraordinary items	**$6.36**	$15.29	$2.80	$4.52	$3.42	$4.34
Revenue by Segment						
Natural gas and petroleum operations	**$ 49,553**	$ 66,475	$ 96,747	$ 96,567	$ 67,225	$ 86,571
Petroleum industry services and supplies	**74,642**	79,838	163,965	129,560	92,872	106,465
	$ 124,195	$ 146,313	$ 260,712	$ 226,127	$ 160,097	$ 193,036

Five Year Summary — Operations

	Years Ended December 31,				Nine Months Ended December 31,	Year Ended March 31,
	1987	1986	1985	1984	1984	1984
Production						
Net crude oil and natural gas liquids						
Barrels	**596,244**	910,731	1,093,887	1,030,817	732,293	887,219
Barrels per day	**1,634**	2,495	2,997	2,816	2,663	2,424
Net natural gas						
Millions of cubic feet	**35,253**	35,010	39,613	39,839	28,532	37,221
Millions of cubic feet per day	**97**	96	109	109	104	101
Methanol — tonnes	**508,233**	355,973	446,902	428,679	319,672	347,774
Ammonia — tonnes	**184,312**	—	—	—	—	—
Proven Reserves						
Crude oil and natural gas liquids						
Thousands of barrels	**4,961**	7,800	30,096	16,366	16,366	12,808
Natural gas						
Billions of cubic feet	**1,079**	1,041	1,291	1,350	1,350	1,023
Shareholders and Employees						
Number of employees at year end	**901**	984	1,528	1,510	1,510	1,417
Number of common shareholders at year end	**1,140**	1,358	1,477	1,675	1,675	1,910

Wells Drilled

	Years Ended December 31,								Nine Months Ended December 31,		Year Ended March 31,	
	1987		1986		1985		1984		1984		1984	
	Gross	**Net**	Gross	Net	Gross	Net	Gross	Net	Gross	Net	Gross	Net
Exploratory												
Gas	**7**	**3.3**	4	2.6	10	2.6	7	3.0	6	2.8	13	4.8
Oil	**4**	**0.9**	3	1.4	9	1.1	7	1.0	5	0.6	6	1.2
Dry	**5**	**2.4**	5	2.0	22	4.5	15	3.8	10	2.8	17	2.4
	16	**6.6**	12	6.0	41	8.2	29	7.8	21	6.2	36	8.4
Development												
Gas	**318**	**299.0**	184	128.0	301	158.5	284	192.2	278	189.8	86	41.6
Oil	**17**	**3.7**	13	3.8	27	6.6	72	17.8	50	13.5	81	28.7
Dry	**10**	**2.8**	4	2.4	16	3.5	10	3.5	9	2.7	11	3.6
Service	**1**	**0.1**	5	0.9	8	1.3	18	3.4	14	2.4	10	3.9
	346	**305.6**	206	135.1	352	169.9	384	216.9	351	208.4	188	77.8
Total	**362**	**312.2**	218	141.1	393	178.1	413	224.7	372	214.6	224	86.2

Annual Meeting

The Annual and Special Meeting of Shareholders of Ocelot Industries Ltd. will be held in the Bonavista Room, Westin Hotel, Calgary, Alberta on June 8, 1988 at 10:30 a.m. Formal notice of this meeting and proxy materials are enclosed.

Share Information

Ocelot's common shares are listed for trading on the Toronto, Montreal and Alberta Stock Exchanges. The Class A shares and Class B subordinate voting shares carry voting rights of 20 votes per share and one vote per share respectively.

At December 31, 1987 the aggregate Class A and Class B shares outstanding was 15,278,332 and the shareholders of record totalled 1,140. Over 90 percent of the outstanding shares are owned by Canadians. The stock market designations for the shares are Ocelot A and Ocelot B with the respective Toronto Stock Exchange computer symbols being OILA and OILB.

Market Information

Market Price Per Share*	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
		(dollars)		
Class A Common Shares				
1988 High	**11½**			
Low	**7¼**			
1987 High	**6¾**	**8½**	**6½**	**7½**
Low	**5**	**5**	**5⅜**	**4⅛**
1986 High	6½	4½	4¾	5
Low	4	3⅛	3	2⅛
Class B Subordinate Voting Shares				
1988 High	**10¾**			
Low	**6¾**			
1987 High	**6¼**	**7**	**6⅜**	**7⅛**
Low	**4**	**4¾**	**5⅛**	**3½**
1986 High	7	3½	3¼	5
Low	3	2½	2⅝	2¼

*As per The Toronto Stock Exchange

Transfer Agents and Registrars

National Trust Company offices are at Toronto, Montreal, Calgary, Vancouver and Regina.

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(Left top to bottom)

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Brooke N. Wade
President

W. David Lyons
Executive Vice President

Glenn D. Gradeen
Vice President, Production and Engineering

(Right top to bottom)

Kenneth E. Vidalin
Vice President, Petrochemicals

William R. Kelsay
Vice President, Petroleum Industry Services and Supplies

Ronald J. Russell
Vice President, General Counsel and Secretary

Ivor J. Bond
Vice President, Exploration

Board of Directors

William J. Bushnell*
Corporate Director
Toronto, Ontario

Basil R. Cheeseman*
Partner
McCarthy & McCarthy
(Barristers and Solicitors)
Toronto, Ontario

Royden O. Fisher*
Corporate Director
Calgary, Alberta

Norbert M. Hannon*
President
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(a private investment company)
Calgary, Alberta

J. Verne Lyons
Chairman of the Board and Chief Executive Officer
Ocelot Industries Ltd.

George C. Solomon
President
Western Limited
(a private investment and property development company)
Regina, Saskatchewan

**Audit Committee Member*

Officers

J. Verne Lyons
Chairman and
Chief Executive Officer

Brooke N. Wade
President

W. David Lyons
Executive Vice President

Ivor J. Bond
Vice President, Exploration

Douglas A. Cutts
Vice President,
Administration

Glenn D. Gradeen
Vice President,
Production and Engineering

William R. Kelsay
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