



***NORTH CANADIAN OILS LIMITED***

***Corporate Profile***

***July 1, 1986***



# Contents

| Item                               | Page              |
|------------------------------------|-------------------|
| Highlights .....                   | 1                 |
| Industry environment .....         | 2                 |
| NCO's competitive advantage .....  | 2                 |
| Future strategies .....            | 3                 |
| Oil and gas reserves .....         | 4                 |
| Finding costs .....                | 4                 |
| Reserve values .....               | 5                 |
| Production .....                   | 6                 |
| Drilling activity .....            | 7                 |
| Major areas of activity .....      | 8                 |
| Map of western Canada .....        | 9                 |
| Land position .....                | 10                |
| Other assets .....                 | 10                |
| Marketing and transportation ..... | 11                |
| Financial review .....             | 12                |
| Financial statements .....         | 14                |
| Corporate information .....        | inside back cover |

## The Company

North Canadian Oils Limited is an oil and gas exploration and development company whose activities are primarily concentrated in the Western Canadian Sedimentary Basin. The Company's net proven natural gas reserves are the 18th largest in Canada and it ranks 12th in natural gas production. The Company is also involved in the mining of lead and zinc through its 87% owned subsidiary, Bankeno Mines Limited.

The largest shareholder is Hees International Corporation, a Canadian company which provides a wide range of merchant banking services to a select group of clients and

invests in established companies where it believes its initiatives can enhance values. On a fully diluted basis Hees owns 25% of the common shares of North Canadian. The Company has a large common shareholder float with 6,780,000 shares owned by 6,800 shareholders.

For the year ended December 31, 1985 the Company had \$800 million in assets, \$70 million in annual cash flow and \$28 million in net earnings. NCO's long term debt of \$302 million is completely offset by \$305 million of securities which provides a debt free balance sheet.

## Purpose of Report

This Corporate Profile has been prepared to provide information relating to the new amalgamated North Canadian Oils Limited which was created when Merland Explorations Limited was amalgamated with the existing North

Canadian Oils Limited on July 1, 1986. Accordingly all information is presented on a pro forma basis with Merland and North Canadian material combined to illustrate the current position and future potential of the new NCO.

### Metric Conversion

The measurements presented in this report are in the Imperial System of Units. The table below is provided to assist in converting to the International measurement system equivalents.

| To convert from           | to  | Multiply by |
|---------------------------|---|-------------|
| Barrels (bbls)            | Cubic metres (m <sup>3</sup> )                          | 0.1590      |
| Thousand cubic feet (mcf) | Thousand cubic metres (10 <sup>3</sup> m <sup>3</sup> ) | 0.0282      |
| Acres (ac)                | Hectares (ha)   | 0.4050      |





Dear Sirs:

As you are likely aware Merland Explorations Limited was amalgamated with North Canadian Oils Limited effective July 1, 1986. We thought it would be useful to produce a corporate profile on the new NCO and are pleased to enclose a copy.

NCO is in an advantageous position compared to most companies in the Industry and we hope the booklet will help to tell our story. We also intend to continue to communicate effectively in the future with the investment community.

If you have any questions please call either Grant Billing, Senior Vice President, Finance and Administration at 403-261-3207 or myself at 403-261-3210. Thank you for your interest.

Yours very truly,

NORTH CANADIAN OILS LIMITED

Norman R. Gish  
President and Chief Executive Officer



**NORTH CANADIAN OILS LIMITED**

700 - SUN LIFE PLAZA III, 112 - FOURTH AVENUE S.W. CALGARY, ALBERTA T2P 4B2  
TELEPHONE (403) 261-3100 TELECOPIER (403) 261-3297 TELEX 03 - 827559





## Financial

(Dollars in thousands except per share amounts)

|   | Six months ended<br>June 30, 1986 | Year ended<br>Dec. 31, 1985 |
|---|-----------------------------------|-----------------------------|
| Gross revenues net of royalties .....     | \$ 70,669                         | \$149,816                   |
| Net earnings .....                        | 13,317                            | 28,009                      |
| Per common share .....                    |                                   |                             |
| Basic .....                               | 0.39                              | 1.11                        |
| Fully diluted .....                       | 0.39                              | 1.04                        |
| Cash flow .....                           | 36,056                            | 71,959                      |
| Dividends on preferred shares .....       | 8,311                             | 13,007                      |
| Capital expenditures .....                | 15,419                            | 51,474                      |
| Investments and note receivable .....     | 305,232                           | 313,397                     |
| Long-term debt .....                      | 302,271                           | 316,122                     |
| Shareholders' equity .....                | 380,063                           | 374,549                     |
| Number of common shares outstanding ..... | 12,866,872                        | 12,782,372                  |

## Operating

### Production

|   |         |         |
|---|---------|---------|
| Natural gas .....                       |         |         |
| Millions of cubic feet .....            | 25,917  | 48,610  |
| Millions of cubic feet per day .....    | 143     | 133     |
| Crude oil and natural gas liquids ..... |         |         |
| Barrels .....                           | 412,795 | 747,767 |
| Barrels per day .....                   | 2,275   | 2,050   |

### Reserves

|   |       |       |
|---|-------|-------|
| Natural gas, billions of cubic feet ..... |       |       |
| Proved .....                              | 769   | 784   |
| Probable .....                            | 130   | 130   |
| Crude oil, thousands of barrels .....     |       |       |
| Proved .....                              | 6,168 | 5,264 |
| Probable .....                            | 1,269 | 1,269 |

|                     |      |      |
|---------------------|------|------|
| Finding costs ..... | 4.67 | 3.67 |
|---------------------|------|------|

### Land holdings (thousands of acres)

|             |       |       |
|-------------|-------|-------|
| Gross ..... | 3,899 | 3,653 |
| Net .....   | 1,598 | 1,633 |

### Wells drilled

|             |     |     |
|-------------|-----|-----|
| Gross ..... | 121 | 286 |
| Net .....   | 46  | 153 |

|                           |     |     |
|---------------------------|-----|-----|
| Number of employees ..... | 230 | 258 |
|---------------------------|-----|-----|



**“... to enhance  
shareholder  
values both in  
the short and  
long term”**

### **Industry Environment**

The North American oil and gas industry is going through a fundamental change. It is no longer exploring for, producing and selling in a regulated environment what was considered to be a scarce resource. It is now faced with a highly competitive, volatile, commodity based market with resulting instability in pricing.

The production and pricing of crude oil in North America has been particularly affected by the following:

- the large volumes being produced by the Organization of Petroleum Exporting Countries (O.P.E.C.) which has depressed prices;

- the lack of confidence that O.P.E.C. will be able to maintain a long term agreement on production and pricing and therefore both production and pricing will continue to be highly volatile;
- the lower price for crude oil places in jeopardy the high cost frontier, offshore, heavy oil and tar sands projects;
- the large quantities of low cost crude available in the world, particularly in the Middle East where development costs are minimal, which keeps prices lower on purely economic grounds;
- because crude oil is truly an international commodity, readily transportable, events in the Middle East and elsewhere will continue to impact on prices for the foreseeable future;

The above factors mean that to achieve profit through the sale of its crude oil a company is going to have to be a low cost producer.

In the case of natural gas the prospects are more encouraging. Although the current excess supply of natural gas in North America is causing downward pressure on natural gas prices this situation is not likely to continue beyond the next couple of years for the following reasons:

- the United States gas supply is not backed by a long reserve life and drilling activity is at an all time low, therefore, longer term domestic deliverability is in question;

- substitution of residual fuel oil for natural gas is limited because refiners are not going to accumulate huge inventories of higher valued gasoline and diesels just to produce fuel oil. Further, only 20 to 25% of the North American market is prone to switch between fuels;
- lower prices will slow down exploration and development of higher cost gas thereby reducing additions of reserves which should help bring supply/demand back into balance;
- natural gas is not readily or economically transportable by tanker over long distances, therefore supply and prices in North America are not significantly affected by events in the Middle East;

These factors should provide Canadian suppliers with the opportunity to increase their share of the natural gas market in the U.S. above the current level of 4%.

### **NCO's Competitive Advantage**

In this current environment NCO is in an advantageous position because:

- it has a very strong balance sheet;
- it is a major natural gas producer and relies on crude oil for less than 15% of its cash flow;
- it has virtually no involvement in the high cost, high risk, environmentally sensitive frontier, offshore, heavy oil and tar sands areas;
- it is a cost effective, successful explorer, developer and producer of conventional crude oil and natural gas;
- it has a significant inventory of prospective acreage for future development.



## Senior Management



left to right: Bill A. Trickett, Don F. Christensen, Norm R. Gish, Chuck K. Lough, Grant D. Billing

### Future Strategies

The Company's main strategies to meet the short term challenges and to take advantage of future opportunities are as follows:

- operate in an efficient and cost effective manner to maximize the return on existing cash generating assets;
- develop and place on stream low cost natural gas reserves utilizing where possible existing gas contracts, production facilities and transportation infrastructure;
- concentrate activity in the Western Canadian Sedimentary Basin with emphasis on natural gas;
- continue to acquire quality exploratory lands during this period of lower land costs to provide the foundation from which to make meaningful discoveries in the future;
- maintain a strong technical staff to generate economically viable exploration prospects from within the organization;
- participate in oil and gas plays or projects only where NCO can have a significant working interest and continue to be the operator for the majority of the Company's production in order to effect cost controls;
- further develop its internal marketing capability to ensure sales of existing and newly discovered oil and gas reserves;
- manage growth carefully by keeping exploration and development expenditures within cash flow generated from operations and only consider projects or acquisitions which will be substantially self-financing and have future upside potential.

Management is confident that with the Company's land, operational, human, and financial strengths it will be possible to enhance shareholder values both in the short and long term.



***"Finding costs  
... were  
favourable  
compared to  
industry  
averages ..."***

### **Oil and Gas Reserves**

The Company's total proved and probable reserves at December 31, 1985, as determined by independent engineering consultants, were 914 billion cubic feet (bcf) of natural gas and 6.5 million barrels (mmbbls) of crude oil and natural gas liquids (NGL).

In Management's opinion, the current depressed prices for crude oil may moderately reduce proved oil reserves but this will not have a major impact on the Company because of its low ratio of oil to natural gas. As virtually all of NCO's natural gas reserves are from shallow depths, where development costs are among the lowest in Western Canada, the change in natural gas prices is not likely to significantly reduce proved gas reserves.

### **Proved and Probable Reserves**

|                                 | NATURAL GAS<br>(bcf) |          |       | CRUDE OIL AND NGL<br>(mmbbls) |          |         |
|---------------------------------|----------------------|----------|-------|-------------------------------|----------|---------|
|                                 | Proved               | Probable | Total | Proved                        | Probable | Total   |
| Reserves at Dec. 31, 1984.....  | 1,025                | 108      | 1,133 | 4,582                         | 2,031    | 6,613   |
| Reserves added....              | 105                  | 11       | 116   | 2,167                         | —        | 2,167   |
| Reserves produced               | (48)                 | —        | (48)  | (747)                         | —        | (747)   |
| Revisions to previous estimates | (298)                | 11       | (287) | (738)                         | (762)    | (1,500) |
| Reserves at Dec. 31, 1985.....  | 784                  | 130      | 914   | 5,264                         | 1,269    | 6,533   |
| Reserves added....              | 11                   | —        | 11    | 1,316                         | —        | 1,316   |
| Reserves produced               | (26)                 | —        | (26)  | 412                           | —        | (412)   |
| Reserves at June 30, 1986.....  | 769                  | 130      | 899   | 6,168                         | 1,269    | 7,437   |

### **Finding Costs**

Finding costs for proved developed reserve additions for oil and natural gas during 1985 and the first six months of 1986 were favourable compared to industry averages.

A review of Western Canada expenditures and reserves data reported by the Canadian Petroleum Association indicates an industry

average finding cost, calculated on the same basis, of \$6.44 per barrel for 1985. However, caution must be exercised in comparing NCO's finding costs to those of another company since the proportion of exploration and development drilling may be different and undeveloped and probable reserves may be included by other companies.

### **NCO Finding Costs**

|   | Six months ended<br>June 30, 1986 |        | Year ended<br>Dec. 31, 1985 |        |
|---|-----------------------------------|--------|-----------------------------|--------|
|   | \$ million                        | \$/bbl | \$ million                  | \$/bbl |
| Proved Developed Reserves Added *(mmbbls) ..... | 2,416                             |        | 9,637                       |        |
| Finding Costs                                   |                                   |        |                             |        |
| Drill & complete .....                          | 7.5                               | 3.10   | 19.4                        | 2.01   |
| Land .....                                      | 2.1                               | 0.87   | 11.3                        | 1.17   |
| Seismic .....                                   | 1.7                               | 0.70   | 4.7                         | 0.49   |
| Total .....                                     | 11.3                              | 4.67   | 35.4                        | 3.67   |

\*gas converted to oil equivalent using 10 thousand cubic feet (mcf) per barrel



## Reserve Values

The estimated present value of NCO's proved and probable reserves based on December 31, 1985 volumes and an independent consultant's estimate of future oil and natural gas prices is outlined in the accompanying table. These values represent the forecast of income derived from the production and sale of net reserves less capital expenditures, wellhead taxes and operating costs but before the deduction of interest, income tax or

other corporate costs. Average oil and natural gas prices used for the next five years are outlined below with real price increases, above a 6% inflation factor, averaging 1% and 1½% respectively, from 1991 onward.

|           | Oil      | Natural Gas |
|-----------|----------|-------------|
|           | (\$/bbl) | (\$/mcf)    |
| 1986..... | 17.90    | 2.00        |
| 1987..... | 22.95    | 1.70        |
| 1988..... | 24.10    | 1.80        |
| 1989..... | 25.50    | 1.90        |
| 1990..... | 27.00    | 2.10        |

## Reserve Values (\$000)

|                   | Undiscounted       | 10% Discount     | 15% Discount     |
|-------------------|--------------------|------------------|------------------|
| Proved .....      | \$1,364,262        | \$532,022        | \$391,418        |
| Probable .....    | 275,318            | 58,650           | 32,374           |
|                   | <u>1,639,580</u>   | <u>590,672</u>   | <u>423,792</u>   |
| Tax credits ..... | 110,594            | 43,822           | 33,168           |
| Total .....       | <u>\$1,750,154</u> | <u>\$634,494</u> | <u>\$456,960</u> |

The Company is subject to the regulations of the United States Securities and Exchange Commission as NCO has a substantial number of U.S. shareholders. In the United States, generally accepted accounting principles require oil and gas companies, on a quarterly basis, to compare the carrying cost of the Company's oil and gas assets to the value, using a 10% discount rate, of the assets at existing prices and after the deduction of income tax. Using the SEC rules, at June 30, 1986, the value of the assets exceeds the carrying cost of the assets on the balance sheet by approximately \$55,000,000. The reserve value table shown does not provide the value as required for accounting purposes.



**“... success ratios of 74% and 92% on exploratory and development drilling”**

### Production

NCO's gas production averaged 143 million cubic feet per day (mmcf) for the first six months of 1986. However as the rate of take is normally reduced during July and August in the Medicine Hat and Hatton areas, the average gas production rate for 1986 is expected to be up only slightly from the 1985 rate.

NCO's oil production was up significantly to 2,275 barrels of oil per day (bopd) for the first six months of 1986. These production levels are expected to be maintained through the end of 1986.

The following tables summarize gas and oil production by geographical area.

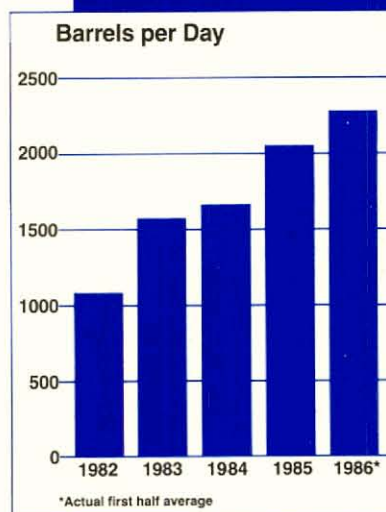
### Natural Gas Production

|                            | Six months ended<br>June 30, 1986 |            | Year ended<br>Dec. 31, 1985 |            |
|----------------------------|-----------------------------------|------------|-----------------------------|------------|
|                            | mmcf                              | %          | mmcf                        | %          |
| Saskatchewan .....         | 45.3                              | 32         | 40.5                        | 30         |
| Southeast Alberta .....    | 34.2                              | 24         | 37.5                        | 28         |
| Southern Alberta .....     | 12.1                              | 8          | 18.3                        | 14         |
| East Central Alberta ..... | 47.0                              | 33         | 31.3                        | 24         |
| Northern Alberta .....     | 4.4                               | 3          | 5.6                         | 4          |
|                            | <u>143.0</u>                      | <u>100</u> | <u>133.2</u>                | <u>100</u> |

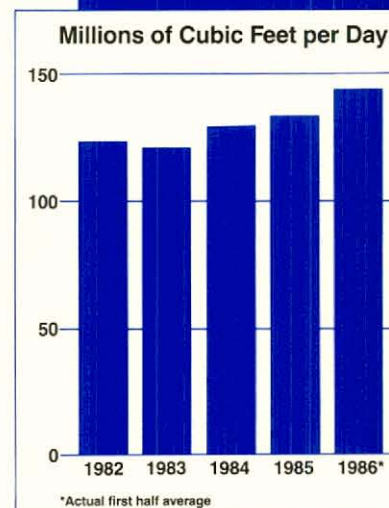
### Oil Production

|                            | Six months ended<br>June 30, 1986 |            | Year ended<br>Dec. 31, 1985 |            |
|----------------------------|-----------------------------------|------------|-----------------------------|------------|
|                            | bopd                              | %          | bopd                        | %          |
| Saskatchewan .....         | 978                               | 43         | 631                         | 31         |
| Southern Alberta .....     | 647                               | 29         | 606                         | 30         |
| East Central Alberta ..... | 233                               | 10         | 350                         | 17         |
| Northern Alberta .....     | 417                               | 18         | 463                         | 22         |
| Total .....                | <u>2,275</u>                      | <u>100</u> | <u>2,050</u>                | <u>100</u> |

### Oil and NGL Production



### Natural Gas Production





## Drilling Activity

In light of prevailing low product prices the Company's exploratory drilling will be confined to the following for the foreseeable future:

- earning large blocks of land by farming-in on sound geological plays;
- maintaining crown lands already owned;
- evaluating properties for crown land sales;
- proving geological theories relating to highly prospective areas to assist in evaluating the acquisition of trend acreage.

Development drilling during this same period will be restricted primarily to developing low cost oil and gas reserves to maintain deliverability under existing contracts and to meet new market opportunities.

The following tables summarize the Company's recent drilling activity. In the eighteen months since January 1, 1985 success ratios of 74% and 92% on exploratory and development drilling have been realized. According to Oilweek's Annual Review and Forecast this compares to industry averages over the same 18 month period of 57% for exploratory drilling and 88% for development drilling.

### Exploratory Drilling

|                       | Six months ended<br>June 30, 1986 |             | Year ended<br>Dec. 31, 1985 |             |
|-----------------------|-----------------------------------|-------------|-----------------------------|-------------|
|                       | Gross                             | Net         | Gross                       | Net         |
| Oil Wells .....       | 26                                | 9.2         | 36                          | 12.3        |
| Gas Wells .....       | 18                                | 5.2         | 43                          | 17.3        |
| Dry & Abandoned ..... | 12                                | 3.6         | 31                          | 11.9        |
| Total .....           | <u>56</u>                         | <u>18.0</u> | <u>110</u>                  | <u>41.5</u> |

### Development Drilling

|                       | Six months ended<br>June 30, 1986 |             | Year ended<br>Dec. 31, 1985 |              |
|-----------------------|-----------------------------------|-------------|-----------------------------|--------------|
|                       | Gross                             | Net         | Gross                       | Net          |
| Oil Wells .....       | 40                                | 21.0        | 87                          | 46.1         |
| Gas Wells .....       | 18                                | 5.0         | 76                          | 61.1         |
| Dry & Abandoned ..... | 7                                 | 2.3         | 13                          | 4.3          |
| Total .....           | <u>65</u>                         | <u>28.3</u> | <u>176</u>                  | <u>111.5</u> |



***“the Company places a high priority on operatorship . . .”***

### **Major Areas of Activity**

The Company places a high priority on operatorship and presently operated wells account for 84% of its gas and 60% of its oil production.

#### **Saskatchewan**

In the Hatton Area NCO operates 550 wells (510 net) producing to five processing plants. The gas is being sold to the Saskatchewan Power Corporation (SPC). Exploration by North Canadian in the past two years led to the discovery of large gas reserves in formations below present gas producing zones. The Company recently farmed-in on lands totalling some 100 sections in this area which have a high potential for additional gas reserves.

Significant reserves of medium gravity crude have been added through a successful exploration and development program in the North Plato field in the Dodsland area where the Company currently has working interests in 94 gross (65 net) producing wells.

#### **Southeast Alberta**

In the Medicine Hat area, the Company has a working interest in 1,320 wells (1,070 net) producing to ten processing plants. Gas production is primarily from the Medicine Hat and Milk River formations and is contracted to TransCanada PipeLines Limited (TCPL) and SPC. Approximately 95% of the production from this area is operated by the Company.

#### **Southern Alberta**

The Company owns varying interests in approximately 112,000 acres of

land in the Delia/Michichi area of southern Alberta. The recent discovery of oil in deeper formations has rejuvenated interest in this area and the Company plans to continue an active land acquisition and development program.

In the Taber area, the Company operates 41 gross (16 net) oil wells in an established field.

#### **East Central Alberta**

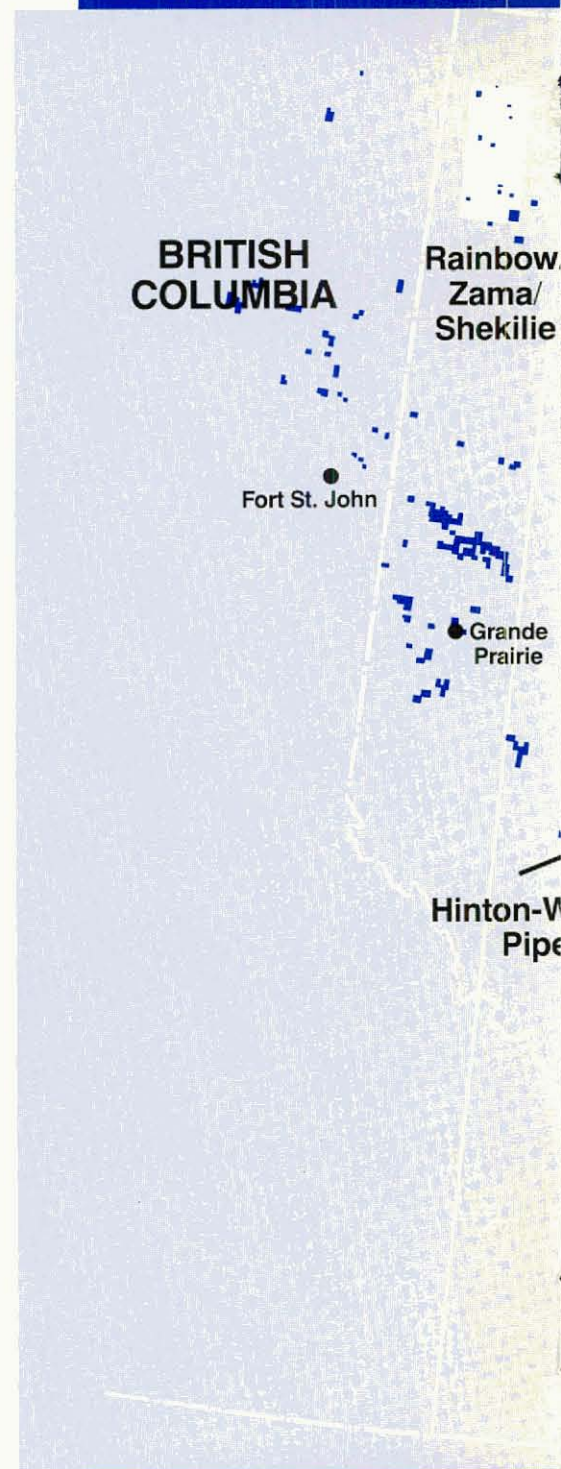
In the Birchwavy gas development area the Company has a working interest in approximately 693,000 gross acres of land, 650 wells (460 net) and 18 processing plants, 12 of which are Company operated. Approximately 98% of the gas is contracted to TCPL and the remainder to Pan Alberta Gas Ltd. Annual gas deliveries from the area will increase with the addition of reserves through exploration and development drilling.

During 1985 a thorough geological and geophysical study was undertaken which resulted in the identification of extensions to existing pools and also prospects for oil and gas in deeper zones. The aggressive land acquisition program initiated in late 1985 was highly successful and it is expected to continue through 1986 and 1987.

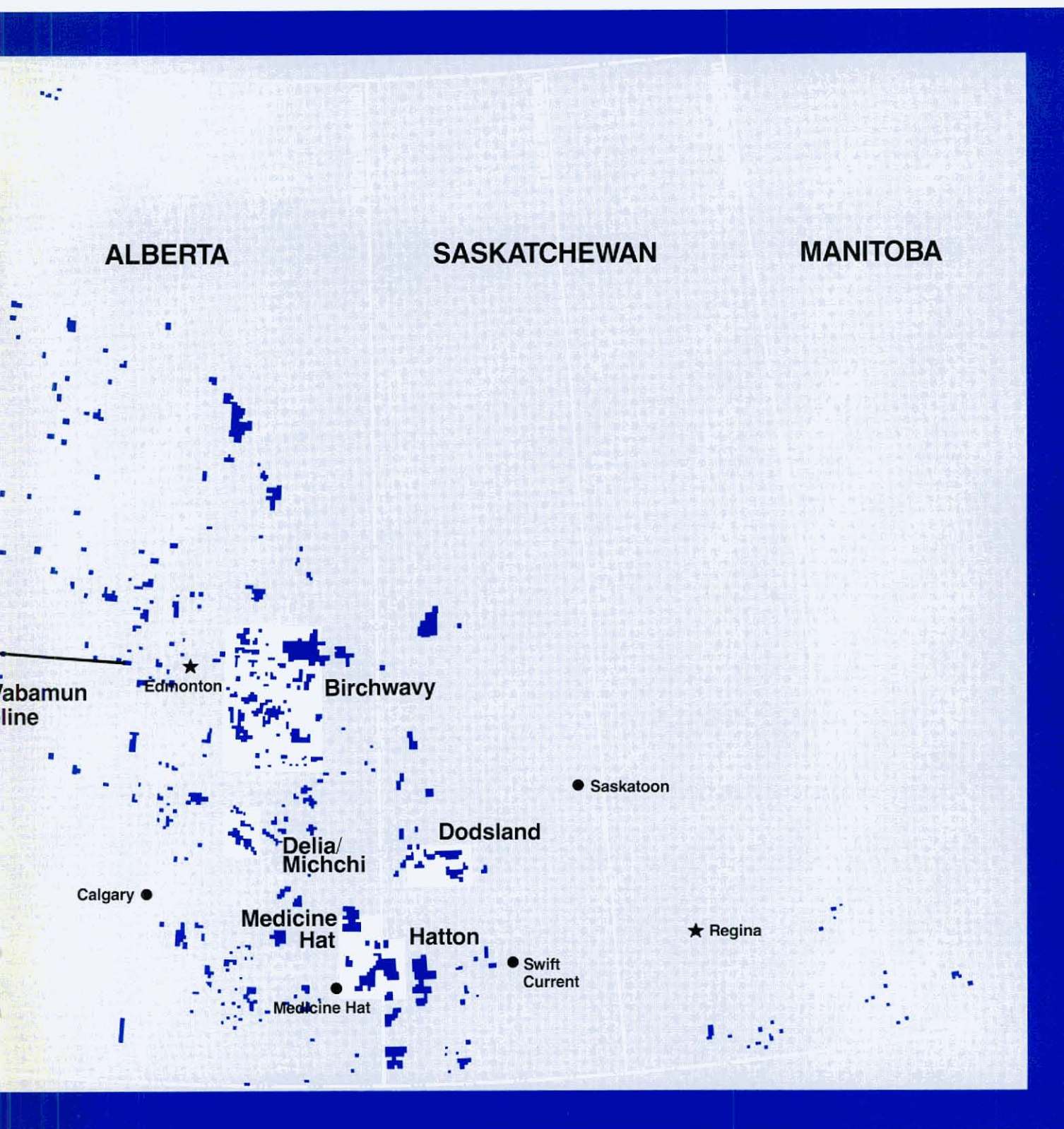
#### **Northern Alberta**

During the past three years the Company has been successful in exploring the Rainbow/Zama/Shekille area of northwestern Alberta. In this region, 18,700 gross acres of land were acquired, 1,850 miles of seismic were run and 14 oil wells were drilled. Of the fourteen wells drilled, seven are producing oil, while the remaining seven wells will be evaluated during the 1986/87 winter drilling season. Numerous drillable prospects and geophysical leads uncovered by this program will form the basis for several winter seasons of exploratory drilling.

### **Western Canada**









**"... the  
Company has  
expanded its  
marketing  
group ..."**

### Industry Land Cost Comparison



### Land Position

North Canadian regards land as the basic element in successful oil and gas exploration. In the first six months of 1986 the number of companies bidding on land and land prices dropped substantially. The Company views the current environment as a

unique opportunity to build a significant portfolio of quality land.

During the first six months of 1986 North Canadian acquired 104,500 gross (63,500 net) acres of land at an average price of \$45 per acre in Alberta and \$36.50 per acre in Saskatchewan.

### Land Holdings as of June 30, 1986.

|                          | Developed Acres |         | Undeveloped Acres |         |
|--------------------------|-----------------|---------|-------------------|---------|
|                          | Gross           | Net     | Gross             | Net     |
| British Columbia . . . . | 99,857          | 18,075  | 17,910            | 3,265   |
| Alberta . . . . .        | 1,641,765       | 535,315 | 1,286,120         | 561,920 |
| Saskatchewan . . . . .   | 607,988         | 292,147 | 232,918           | 181,615 |
| Manitoba . . . . .       | 12,160          | 5,600   | 160               | 0       |
| Total . . . . .          | 2,361,770       | 851,137 | 1,537,108         | 746,800 |

### Other Assets

Through its subsidiary, Bankeno Mines Limited, the Company has a 1.37% interest in Panarctic Oils Limited and a 25% royalty interest in the net proceeds of production from the Polaris lead/zinc mine which is operated by Cominco Ltd. on Little Cornwallis Island in the high Arctic.

Panarctic Oils Ltd., which explores for oil and natural gas in the Canadian Arctic Islands is a consortium of Petro-Canada Explorations, Inc. and 36 corporate and individual shareholders.

The Polaris mine had reserves as reported by Cominco, of indicated ore at December 31, 1985 of 21.0 million tons containing 3.8% lead and 14.3% zinc. Inferred ore reserves were 4.7 million tons containing 2.1% lead and 10.7% zinc. Based on current production rates of approximately 1,000,000 tons of ore per year, the Polaris mine has an expected life of over 20 years.

During 1985 some 43,400 tons of lead concentrate and 210,000 tons of zinc concentrate were produced. The lead and zinc concentrates are sold under contracts to European smelters.

The 25% royalty interest is payable after Cominco has recouped the cost of developing the mine, the initial start-up costs, plus operating costs including interest. These amounts totalled approximately \$250 million at the end of 1985. Based on currently projected prices and production levels, the first royalty income to Bankeno from the mine is forecast to be payable in 1991.

The royalty extends to any additional expansion that might take place to increase the capacity of the Polaris mine and to any other mines developed by Cominco on Little Cornwallis Island and to all metallic minerals discovered on Cornwallis Island.



## Marketing and Transportation

The Western Accord of March 1985 set in motion the deregulation of the Canadian oil and natural gas industry. The drastic and rapidly occurring changes have made the marketing of the Company's oil and gas production of prime importance. In response to this the Company has expanded its marketing group and placed high priority on this area of activity.

### Gas

In Canada and the United States legislative decisions have introduced amendments to pipeline tariffs and to the rules under which gas is transported. These changes, if and when fully implemented, will open the way for producers to sell natural gas directly to markets in Canada and the United States.

Approximately 90% of NCO's natural gas reserves are under contract to the Saskatchewan Power Corporation, TransCanada PipeLines Ltd., Pan Alberta Gas Ltd. and Sulpetro Limited. However, in many cases the requested deliveries have been only 50% of the contract volumes and therefore the Company has a significant amount of excess gas to sell.

The Company's natural gas sales prices averaged \$2.30 per mcf during the first quarter and \$2.04 per mcf during the second quarter of 1986.

### Natural Gas Sales

|                     | Six Months Ended<br>June 30, 1986 |            | Year ended<br>Dec. 31, 1985 |            |
|---------------------|-----------------------------------|------------|-----------------------------|------------|
|                     | mmcf                              | %          | mmcf                        | %          |
| Purchaser           |                                   |            |                             |            |
| Trans Canada .....  | 63.4                              | 44         | 70.7                        | 53         |
| Sask Power .....    | 51.7                              | 36         | 42.8                        | 32         |
| Intra-Alberta ..... | 5.3                               | 4          | 1.3                         | 1          |
| Other .....         | 22.6                              | 16         | 18.4                        | 14         |
|                     | <u>143.0</u>                      | <u>100</u> | <u>133.2</u>                | <u>100</u> |

### Oil

Approximately 45% of the Company's crude oil from operated properties is being sold to Canpet Marketing Ltd., 30% to Mobil Oil Canada Ltd., 20% to Murphy Oil Canada Ltd. and 5% to others. Oil from non-operated properties is being sold on the Company's behalf by the field operator.

The prices posted by buyers are based on prices in the world oil market and therefore subject to considerable fluctuations. The Company's crude oil price averaged \$24.11 per barrel during the first quarter and \$16.39 per barrel during the second quarter of 1986.

### Gas Pipelines

NCO owns two pipeline systems for the transportation of sales gas to customers in Alberta. The largest is a 136 mile, 10 inch diameter mainline with several miles of connecting laterals serving industrial and other customers in the Wabamun-Hinton area located west of Edmonton. The second is a 1.7 mile, 4 inch diameter line serving an industrial customer in the Balzac area north of Calgary. The average daily throughput in the two systems in 1985 totalled 28.7 mmcf and generated an operating revenue of \$8.4 million. In the first six months of 1986 the average throughput was 32.8 mmcf for an operating revenue of \$3.6 million.

### Revenue Net Backs

|                       | Six months ended<br>June 30, 1986 |               | Year ended<br>Dec. 31, 1985 |               |
|-----------------------|-----------------------------------|---------------|-----------------------------|---------------|
|                       | Oil                               | Gas           | Oil                         | Gas           |
|                       | (\$/bbl)                          | (\$/mcf)      | (\$/bbl)                    | (\$/mcf)      |
| Revenue .....         | \$20.73                           | \$2.18        | \$35.47                     | \$2.36        |
| Royalties .....       | 2.36                              | .44           | 7.31                        | .46           |
| Operating costs ..... | 4.06                              | .34           | 6.00                        | .36           |
| PGRT .....            | 1.29                              | .14           | 2.92                        | .20           |
| Net back .....        | <u>\$13.02</u>                    | <u>\$1.26</u> | <u>\$19.24</u>              | <u>\$1.34</u> |



**“... which  
provides NCO  
with a debt free  
balance sheet”**

The strong financial position of NCO ensures that the present downturn in oil prices and anticipated reductions in natural gas prices will not jeopardize the Company's current operational and financial initiatives.

North Canadian's current capital structure consists primarily of shareholders' equity of \$380 million, long term debt of \$302 million (of which \$50 million is convertible into shareholders' equity), deferred income and resource taxes of \$41 million and deferred revenue of \$22 million. The long term debt of \$302 million is completely offset by the securities portfolio of \$305 million which provides NCO with a debt free balance sheet.

## Financial Review

### Securities Portfolio

North Canadian's current securities portfolio of \$305 million consists of \$240 million of marketable securities and \$65 million in notes receivable from the American Express Company. The marketable securities consist of preferred and common shares of companies with large market capitalizations whose market values are considered by North

Canadian to be at substantial discount from their underlying value. The securities portfolio was established through surplus funds from debt and equity issues and is being maintained pending utilization of the funds in the oil and gas business which has been delayed due to the current industry environment.

### Long Term Debt

| Issue  | Amount<br>(\$000) |
|--|-------------------|
| 10% debentures which bear interest at floating rates based on bankers acceptances with a 10% cap, are unsecured and mature in September 1994 . . . . . | \$ 70,143         |
| 8% debentures which are unsecured and are convertible into convertible preferred shares . . . . .  | 50,000            |
| Revolving loans bearing interest at floating rates based on the bank prime rate or bankers acceptances . . . . .                                       | 167,289           |
| Income debentures which bear interest at one half of the bank prime rate plus 1 1/8% . . . . .   | 7,427             |
| Other loans and debentures . . . . .   | 7,412             |
|  | <u>\$302,271</u>  |

On a pro forma basis, interest expense for the six months ended June 30, 1986, was \$17,048,000 and for the year ended December 31, 1985 was \$31,895,000. The net earnings of NCO available for payment of interest (before interest on long-term debt and provision for

deferred income taxes) for the six month period ended June 30, 1986 was \$33,394,000 and for the year ended December 31, 1986 was \$70,172,000 which is 2.0 and 2.2 times the estimated interest expense respectively.



## Shareholders' Equity

| Share Type                        | Conversion Price | Dividend        | Shares Outstanding (000) | Amount (\$000)   |
|-----------------------------------|------------------|-----------------|--------------------------|------------------|
| 5½ Preferred                      | Not convertible  | 5½%             | 16                       | \$ 777           |
| Class A Preferred                 | Not convertible  | 70% of prime    | 2,000                    | 50,000           |
| Class B Preferred                 |                  |                 |                          |                  |
| Series 1                          | \$13.33          | ½ of prime + 1% | 1,000                    | 20,000           |
| Series 2                          | \$16.67          | ½ of prime + 1% | 800                      | 20,000           |
| Series 3                          | \$20.00          | ½ of prime      | 1,159                    | 64,756           |
| Series 6                          | \$73.53          | 8%              | 1,304                    | 32,595           |
| Series 7                          | \$27.47          | 7½%             | 1,100                    | 27,509           |
|                                   |                  |                 |                          | 164,860          |
| Common shares                     |                  |                 | 12,867                   | 68,423           |
| Retained earnings                 |                  |                 |                          | 96,003           |
| <b>Total shareholders' equity</b> |                  |                 |                          | <b>\$380,063</b> |

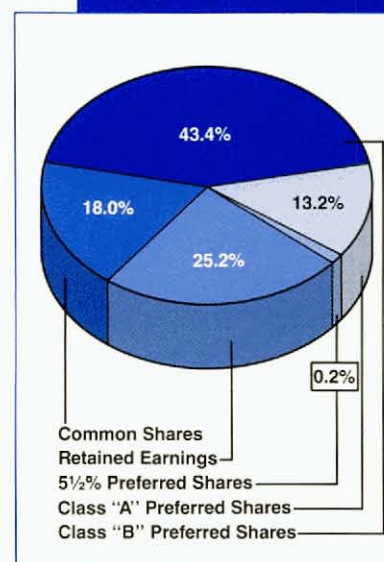
Class A Preferred Shares rank junior to the 5½% cumulative redeemable preferred shares with respect to all rights, privileges, restrictions and other conditions and holders of these shares are entitled to dividends, when declared, on a semi-annual basis. These shares are redeemable by the Company under certain conditions after June 30, 1989 and prior to June 30, 1993.

The Class B Preferred Shares rank junior to the 5½% preferred shares with respect to all rights, privileges, restrictions and other conditions attaching to the preferred shares. The series 1, 2, 3, 6 and 7 preferred shares earn cumulative dividends and are redeemable by the Company under certain conditions. The series 4 and 5 preferred shares earn dividends on a non-cumulative basis until September 30, 1993 and are redeemable by the Company after September 30, 1990 under certain conditions. There were no Series 4 and 5 shares outstanding at June 30, 1986.

At June 30, 1986, the Company has reserved for issue a total of 11,349,810 common shares under conversion rights of the issued debentures, preferred shares, stock options and management share purchase plan.

The estimated maximum annual dividend requirements on all Preferred Shares of NCO based on the assumption of an average prime rate of 10%, will be \$11,348,000. This amount will decrease as conversions, redemptions or purchases for cancellation of the Class B Preferred Shares take place. The pro forma consolidated net income of NCO for the six month period ended June 30, 1986 was \$13,317,000 and for the year ended December 31, 1985 was \$28,009,000 which is approximately 1.2 and 2.5 times the estimated maximum annual dividend requirement respectively.

## Shareholders' Equity





## ***Pro Forma Consolidated Balance Sheet***

As At June 30, 1986 and December 31, 1985  
(thousands of Canadian dollars)  
(Unaudited)

|  | June 30<br>1986  | December 31<br>1985 |
|--|------------------|---------------------|
| <b>Assets</b>                                      |                  |                     |
| Current  |                  |                     |
| Investments .....                                  | \$240,232        | \$248,397           |
| Accounts receivable .....                          | 40,072           | 33,841              |
| Prepaid expenses .....                             | 846              | 560                 |
|  | <u>281,150</u>   | <u>282,798</u>      |
| Note receivable .....                              | 65,000           | 65,000              |
| Oil, gas and mining properties and equipment ..... | 441,462          | 443,651             |
| Other assets .....                                 | 9,060            | 9,256               |
|  | <u>\$796,672</u> | <u>\$800,705</u>    |
| <b>Liabilities</b>                                 |                  |                     |
| Current  |                  |                     |
| Accounts payable .....                             | \$ 35,062        | \$ 32,929           |
| Current portion of deferred revenue .....          | 3,095            | 2,912               |
| Current portion of long-term debt .....            | 7,427            | 6,949               |
|  | <u>45,584</u>    | <u>42,790</u>       |
| Deferred revenue .....                             | 21,679           | 24,506              |
| Long-term debt .....                               | 302,271          | 316,122             |
| Deferred income and resource taxes .....           | 40,986           | 36,677              |
| Minority interest .....                            | 6,089            | 6,061               |
| <b>Shareholders' Equity</b>                        |                  |                     |
| Share capital                                      |                  |                     |
| Preferred shares .....                             | 215,637          | 215,644             |
| Common shares .....                                | 68,423           | 68,423              |
| Retained earnings .....                            | 96,003           | 90,482              |
|  | <u>380,063</u>   | <u>374,549</u>      |
|  | <u>\$796,672</u> | <u>\$800,705</u>    |



## **Pro Forma Consolidated Statement of Earnings**

For The Six Months Ended June 30, 1986 and  
The Year Ended December 31, 1985  
(thousands of Canadian dollars)  
(Unaudited)

|  | <u>Six Months Ended<br/>June 30, 1986</u> | <u>Year Ended<br/>Dec. 31, 1985</u> |
|--|---|-------------------------------------|
| <b>Revenue</b>                                   |   |                                     |
| Oil and gas, net .....                           | <b>\$52,681</b>                           | \$113,980                           |
| Pipeline operations .....                        | <b>5,347</b>                              | 9,757                               |
| Investment and other .....                       | <b>12,641</b>                             | 26,079                              |
|  | <u><b>70,669</b></u>                      | <u>149,816</u>                      |
| <b>Expenses</b>                                  |   |                                     |
| Operating .....                                  | <b>10,962</b>                             | 22,514                              |
| Gas purchased for resale .....                   | <b>2,978</b>                              | 5,809                               |
| General and administrative .....                 | <b>3,794</b>                              | 8,664                               |
| Interest on long-term debt .....                 | <b>17,048</b>                             | 31,895                              |
| Depreciation and depletion .....                 | <b>17,007</b>                             | 34,037                              |
|  | <u><b>51,789</b></u>                      | <u>102,919</u>                      |
| Earnings before taxes and undernoted items ..... | <b>18,880</b>                             | 46,897                              |
| Income and resource taxes .....                  | <b>5,482</b>                              | 18,910                              |
| Earnings before minority interest .....          | <b>13,398</b>                             | 27,987                              |
| Minority interest .....                          | <b>81</b>                                 | (22)                                |
| Net earnings .....                               | <u><b>\$13,317</b></u>                    | <u>\$ 28,009</u>                    |
| Net earnings per common share                    |   |                                     |
| Basic .....                                      | <u><b>\$0.39</b></u>                      | <u>\$1.11</u>                       |
| Fully diluted .....                              | <u><b>\$0.39</b></u>                      | <u>\$1.04</u>                       |
| Number of common shares outstanding              |   |                                     |
| Basic .....                                      | <u><b>12,866,872</b></u>                  | <u>12,782,372</u>                   |
| Fully diluted .....                              | <u><b>17,224,015(1)</b></u>               | <u>19,440,347(2)</u>                |

- (1) Includes, on a weighted average basis, 4,357,143 common shares issuable, in the aggregate, upon the conversion of Amalgamated NCO Class B Series 1 and 8% convertible debentures.
- (2) Includes, on a weighted average basis, 6,657,975 common shares issuable, in the aggregate, upon the conversion of Amalgamated NCO Class B series 1, 2 and 3 Shares and 8% convertible debentures.



## ***Pro Forma Consolidated Statement of Changes in Financial Position***

For The Six Months Ended June 30, 1986 and  
The Year Ended December 31, 1985  
(thousands of Canadian dollars)  
(Unaudited)

|   | Six Months Ended<br>June 30, 1986 | Year Ended<br>Dec. 31, 1985 |
|---|-----------------------------------|-----------------------------|
| <b>Operating Activities</b>                               |                                   |                             |
| Net earnings from operations .....                        | \$ 13,317                         | \$ 28,009                   |
| Non-cash items:   |                                   |                             |
| Minority interest .....                                   | 81                                | (22)                        |
| Deferred income and resource taxes .....                  | 5,214                             | 11,993                      |
| Depletion and depreciation .....                          | 17,007                            | 34,037                      |
| Other .....   | 437                               | (2,058)                     |
|   | <u>36,056</u>                     | <u>71,959</u>               |
| Changes in current accounts .....                         | (3,938)                           | (3,774)                     |
| Cash generated from operations .....                      | <u>32,118</u>                     | <u>68,185</u>               |
| <b>Investing Activities</b>                               |                                   |                             |
| Expenditure on oil, gas and mining properties — net ..... | \$ (15,419)                       | \$ (51,474)                 |
| Sale of oil and gas properties .....                      | 170                               | —                           |
| Changes in current accounts .....                         | (153)                             | —                           |
| Cash utilized in investing activities .....               | <u>(15,402)</u>                   | <u>(51,474)</u>             |
| <b>Financing Activities</b>                               |                                   |                             |
| Issue of debentures .....                                 | —                                 | 50,000                      |
| Issue of common shares .....                              | 993                               | 22,766                      |
| Cancellation of common shares .....                       | (653)                             | —                           |
| Decrease in other assets .....                            | (899)                             | —                           |
| Dividends paid .....                                      | (8,311)                           | (13,007)                    |
| Decrease in deferred revenue .....                        | (2,644)                           | (3,119)                     |
| (Decrease) increase in long term debt .....               | (13,373)                          | 46,525                      |
| Issue of preferred shares .....                           | —                                 | 12,341                      |
| Conversion of floating rate debentures .....              | —                                 | (21,460)                    |
| Increase in notes receivable .....                        | —                                 | (65,000)                    |
| Proceeds on sale of investment in subsidiary .....        | —                                 | 13,888                      |
| Other .....   | 6                                 | (22)                        |
| Cash generated (utilized) from financing activities ..... | <u>(24,881)</u>                   | <u>42,912</u>               |
| <b>(Decrease) increase in investments</b> .....           | <u>\$ (8,165)</u>                 | <u>\$ 59,623</u>            |
| <b>Investments, beginning of year</b> .....               | <u>248,397</u>                    | <u>188,774</u>              |
| <b>Investments, end of year</b> .....                     | <u>\$240,232</u>                  | <u>\$248,397</u>            |

### ***Notes to the Pro Forma Consolidated Financial Statements***

1. The accompanying unaudited pro forma consolidated financial statements were prepared from the unaudited consolidated financial statements as at June 30, 1986 and the consolidated financial statements for the year ended December 31, 1985 of NCO.
2. The unaudited pro forma consolidated balance sheet at June 30, 1986 and December 31, 1985 gives effect to the transactions for the assumed elimination of the 45.9% minority interest in Merland by the Amalgamation of NCO and Merland as if it had occurred at the beginning of the reporting periods.



# Corporate Information

---

## Directors

- (1) Member, Executive Committee
- (2) Member, Audit Committee
- (3) Member, Compensation Committee

Walter J. Adams (3)  
President of Canadian American Loan and Investment  
Corporation Limited,  
Calgary, Alberta

Norman R. Gish (1)  
President and Chief Executive Officer of the Company  
Calgary, Alberta

Marshall A. Jacobs (1)  
Member of the law firm of Jacobs Persinger & Parker,  
New York, New York

James F. Kay (1)  
Chairman of the Board of Dylex Limited  
Toronto, Ontario

David W. Kerr (1) (2)  
Chief Operating Officer of Hees  
International Corporation  
Toronto, Ontario

Willard J. L'Heureux, Q.C. (1) (3)  
Senior Vice President of Hees  
International Corporation  
Toronto, Ontario

Ross A. MacKimmie, Q.C.  
Counsel to the law firm of MacKimmie Matthews  
Calgary, Alberta

Douglas W. Miller (2)  
Executive Vice-President, and President  
Petroleum Div. of Westmin Resources Limited  
Calgary, Alberta

E. Donald Patterson (2)  
General Manager,  
Canadian Equity Investments of  
Ontario Hospital Association  
Toronto, Ontario

## Head Office

Suite 700  
Sun Life Plaza III  
112 - Fourth Avenue S.W.  
Calgary, Alberta  
T2P 4B2  
(403) 261-3100

## Regina Office

Suite 600  
2500 - Victoria Avenue  
Regina, Saskatchewan  
S4P 3X2  
(306) 525-0143

## Officers

Grant D. Billing  
Senior Vice-President Finance and Administration  
and the Corporate Secretary

Donald F. Christensen  
Senior Vice President Exploration and Land

Norman R. Gish  
President and Chief Executive Officer

Larry F. Kanuit  
Vice President Land

Marlin D. Locken  
Vice President Production

Charles K. Lough  
Senior Vice President Corporate Development

Donald D. McKechnie  
Controller

W. Keith Miller  
Vice President Marketing and Transportation

William A. Trickett  
Senior Vice President Operations

John H. Williams  
Vice President Exploration

## Auditors

Touche Ross & Co.

## Bankers

The Royal Bank of Canada  
Bank of Montreal

## Solicitors

MacKimmie Matthews  
(Calgary)  
Jacobs Persinger & Parker  
(New York)

## Registrar and Transfer Agents

The Royal Trust Company  
(Canada for all issues)  
The Bank of Nova Scotia Trust Company  
(U.S. for Common shares only)

## Stock Exchange Listings

Toronto Stock Exchange  
The Montreal Exchange  
American Stock Exchange





**NORTH CANADIAN OILS LIMITED**