

Petro-Canada

Annual Report 1978

Board of Directors

as at December 31, 1978

Wilbert H. Hopper
Acting Chairman of the Board,
President and Chief Executive Officer,
Petro-Canada
Calgary

Donald Harvie
Deputy Chairman of the Board,
Petro-Canada,
Chairman,
The Devonian Group of
Charitable Foundations,
Calgary

Hon. John B. Aird, O.C., Q.C.
Senior Partner,
Aird and Berlis,
Toronto

Marshall A. Cohen
Deputy Minister,
Energy, Mines and Resources,
Ottawa

J. Claude Hébert
Business Consultant,
Montreal

Arthur Kroeger
Deputy Minister,
Indian and Northern Affairs,
Ottawa

David McD. Mann
Partner,
Cox, Downie, Nunn and Goodfellow,
Halifax

T. K. Shoyama
Deputy Minister,
Finance,
Ottawa

Donald G. Willmot
Chairman of the Board,
The Molson Companies Limited,
Toronto

appointed March 9, 1979

William C. Hood
Deputy Minister,
Finance,
Ottawa

Ian A. Stewart
Deputy Minister,
Energy, Mines and Resources,
Ottawa

Senior Personnel

as at December 31, 1978

Wilbert H. Hopper
President and Chief Executive Officer

Joel I. Bell
Senior Vice-President —
Finance and Planning

Andrew Janisch
Senior Vice-President and
Chief Operating Officer

Sam Stewart
Senior Vice-President —
Athabasca Development

Donald M. Wolcott
Senior Vice-President —
Project Development

John M. Godfrey
Vice-President — Land

Ronald P. Havelock
Vice-President — Law and Secretary

Joseph W. Martinelli
Vice-President — Production

Robert A. Meneley
Vice-President — Exploration

William Morrow
Controller

Robert Niven
Vice-President — Corporate Planning

David P. O'Brien
General Counsel

James Scurr
Vice-President — Human Resources and
Corporate Administration

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AUDITORS

Peat, Marwick, Mitchell & Co.
Calgary, Alberta
Canada

Subsidiaries

as at December 31, 1978

Petro-Canada Exploration Inc. — 100%
Petro-Canada Industries Inc. — 100%
Petro-Canada Inc. — 100%
Petro-Canada Consulting
Corporation — 100%
Pacific Petroleum — 51.6%

With the compliments of

W. H. Hopper
Chairman & Chief Executive Officer

Petro-Canada

NO ACKNOWLEDGMENT IS EXPECTED

March 31, 1979

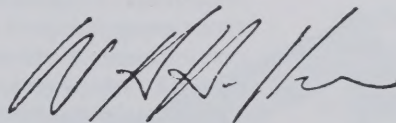
The Honorable Alastair Gillespie, P.C., M.P.
Minister of Energy, Mines and Resources
House of Commons
Ottawa, Canada
K1A 0A7

Dear Minister:

On behalf of the Board of Directors, I am pleased to present this 1978 Annual Report of Petro-Canada for the fiscal year ended December 31, 1978.

In accordance with the provisions of the Financial Administration Act, the Report includes the Consolidated Balance Sheet and the related statements together with the auditor's report thereon.

I wish on behalf of the Board and management of Petro-Canada to thank Maurice F. Strong, the founding President and Chairman of the Corporation for the significant contribution he has made to the initial important years of Petro-Canada's development. I would also like to express my appreciation to Gordon M. MacNabb, a founding director, who with Mr. Strong, resigned from the Board in 1978.



W. H. Hopper
Chairman of the Board and
Chief Executive Officer

Corporate Summary

Petro-Canada's third year was marked by a very substantial event along with its continuing exploration and development activities. In early November, the Corporation purchased the controlling interest in Pacific Petroleum Ltd., a Calgary based oil and gas company. The subsequent acquisition of all the shares of Pacific in early 1979 makes the transaction, at a cost of approximately \$1.5 billion, the largest acquisition ever made in Canada. With this acquisition added to its other assets and activities, Petro-Canada becomes a significant oil and gas producer and an integrated company with a small presence in refining and marketing. In fact, Petro-Canada becomes the largest of the Canadian-owned companies in the industry, albeit smaller than other large companies operating in Canada.

This acquisition is a major step in the development of Petro-Canada and provides a cash flow to help support the longer-term and higher-risk frontier exploration and technology development projects which are important for Canada's future energy supplies. Petro-Canada now has a meaningful presence in the active areas of the oil and gas business as well as an active presence in longer-term Canadian energy ventures.

The year also saw a continued and growing level of activity in frontier exploration and new development projects which have dominated the Corporation's budget and priorities from its inception.

While the anxieties which surrounded the world energy scene in 1973 may have lessened, there is still cause for concern for the future supply of reasonably priced Canadian energy. Continued instability in the Middle East and rapid increases in world oil prices are a constant reminder to Canada that security of energy supply must be a crucial national priority.

The successful response to the concerns for security of supply by governments and industry has lessened the immediacy but has not dealt with the long range problem. Positive governmental policies in pricing, incentives and other areas have resulted in record exploration activity and an increase in supply, most noticeably gas. The discoveries of gas at Elmworth and oil at West Pembina show that there are hydrocarbons yet to be found in the Western Canada Sedimentary Basin. To date, they have only marginally contributed to meeting Canada's long term requirements. Petro-Canada believes that substantial efforts must continue to be made in the frontiers, in the search for new facilities and technologies to develop heavy oils and oil sands, and in the investigation of alternative opportunities for bringing energy supplies to Canadian markets. The high-risks, long-lead-times and magnitude of capital investments for these energy projects mean that commitments made on projects now will only begin to affect energy supply late in the 1980's.

Frontier Activities

Petro-Canada pursued an aggressive frontier program in 1978, again being a significant partner in almost all frontier activities. A discovery wildcat well offshore near Hopedale,

drilled by a consortium in which Petro-Canada holds a major interest, gave cause for renewed optimism for explorers in the Labrador Shelf area. In addition, Petro-Canada continued to be the most active company in Arctic and offshore Nova Scotia exploration. It conducted extensive environmental studies in Baffin Bay in preparation for applying for a permit to drill in the area and moved to become a major participant in future Labrador/Newfoundland exploration activities.

Technological Development

Petro-Canada in the first two years of its operations put considerable emphasis on the investigation of projects which would, through pushing back technological barriers, open up greater opportunities to increase the supply of reasonably priced energy for Canada. In 1978 these projects became viable alternatives for meeting Canada's energy requirements.

In 1978 Petro-Canada and its partners concluded two years of study on the Arctic Pilot Project and prepared applications to regulatory authorities for permission to proceed with construction.

A major breakthrough in Arctic resource development was the successful underwater completion of Drake F-76 demonstrating for the first time that Arctic gas could be produced from offshore.

The Corporation, in concert with the Alberta Gas Trunk Line Company Limited concluded a two year \$4.6 million study of the possibility of extending the Canadian gas pipeline system from its present terminus at Montreal through to Quebec and the Maritimes. The Q & M project has been submitted by AGTL to the National Energy Board for approval. Petro-Canada retains the right to take a 20% equity interest in the project if it is approved.

Although Petro-Canada is not a direct participant in its application to the National Energy Board, the Corporation continued to support related research studies of the Polar Gas project in 1978.

Petro-Canada has assigned a significant role to oil sands and heavy oils development in its activities. In October, Petro-Canada, Gulf Canada Limited and the Saskatchewan Oil and Gas Corporation reached an agreement with the Saskatchewan government on a major program of heavy oil exploration, development and enhanced recovery in Saskatchewan.

In November, 1978, Petro-Canada and its partners in the PCE group signed an agreement with Japanese interests directed at developing economical in-situ recovery

processes for the group's 1.2 million acres of leases in the Alberta Oil Sands. The field pilots and research activity associated with this project will help develop the technologies necessary to turn this vast resource base into an economic source of energy.

The Corporation is also investigating the potential of developing oil sands properties by the drilling of horizontal wells into oil sands zones in a mine assisted in-situ program (MAISP).

The Syncrude project, in which Petro-Canada has a 15 per cent interest, commenced operation in 1978 and was officially opened in September.

Research and Development

Petro-Canada, since its inception, has expressed a keen awareness of the importance of research and development oriented to Canadian energy problems and opportunities as a significant factor in contributing to Canada's energy supply. In December, the Corporation began construction of a \$10 million research facility in Calgary. Activities at the centre, scheduled for completion in late 1979, will be directed towards specific Canadian energy-related research concerns, particularly in the areas of

exploration and production in the frontiers, enhanced recovery, oil sands and heavy oil development. The facility will provide the means to increase Canada's research effort and will provide substantive opportunities for both professional and technical growth of petroleum-related research for Canadian scientists.

Petro-Canada continues to examine and develop an appropriate role for the Corporation in searching for ways to ensure that renewable energy sources are developed to make a contribution to Canada's energy supply.

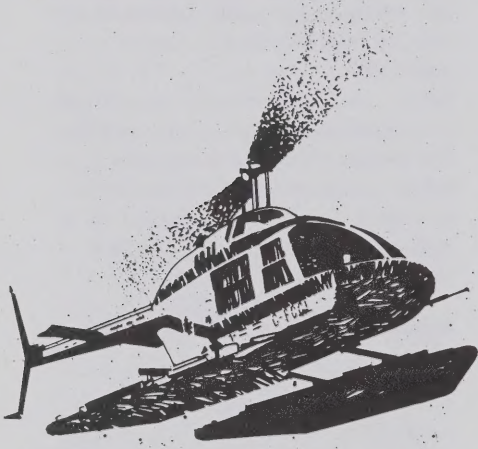
International Activities

Petro-Canada continues to pursue international activities where it believes such activities will secure access to future energy supplies and where Petro-Canada might assist the Canadian Government or private Canadian companies to pursue opportunities in the international field.

In June of 1978 Petro-Canada agreed to advise the Canadian International Development Agency in a program of assistance for Pakistan's energy development program.



Petro-Canada has also applied, in competition with other major corporations, to the Norwegian government for an interest in various blocks of land in the North Sea now available for exploration permits.



The Corporation is pursuing research and development studies on various technologies for heavy oil upgrading in conjunction with Venezuela's national oil company, *Petróleos de Venezuela*, to develop the vast reserves of oil sands and heavy oil that exist in both countries.

Petro-Canada and its partners have been invited to make submissions with respect to offshore oil exploration in the People's Republic of China.

Finally, Petro-Canada is holding discussions with Mexico's national oil company, *Petróleos Mexicanos (PEMEX)* regarding the best way for Canada to secure future oil supplies from that country.

In a world which has become increasingly aware of the strategic importance of energy supplies, state-to-state relationships may well play an increasingly important role in the worldwide allocation of energy resources. In addition, there are no Canadian companies engaged in foreign exploration with the specific purpose of bringing oil to Canadian markets. By its own efforts, as well as by assisting Canadian companies in such ventures where access might otherwise be difficult for them, Petro-Canada hopes to advance Canadian interests in the world energy scene, recognizing that Canada will have to rely on foreign sources for some part of its energy supplies for the foreseeable future.

Environmental and Social Affairs

Petro-Canada is continuing to implement its policy of minimizing the negative impact and maximizing the positive benefits of its projects relative to both the physical environment and the local communities where it operates. Environmental and social concerns are integrated in every phase of corporate activity and Petro-Canada includes local people in project planning through active programs of community liaison.

In January of 1978, Petro-Canada was among the first of many companies to sign agreements providing native communities in northern Alberta access to employment, education, and participation in activities in the area. In the Baffin Bay region, Petro-Canada's Eastern Arctic Marine Environmental Studies (EAMES)

program is keeping local communities up-to-date on its activities, and ensuring that local employment and local entrepreneurial activity is encouraged. A substantial program has been undertaken by the Corporation to inform and include Inuit communities and associations in the Arctic Pilot Project. In addition to its on-going programs, Petro-Canada maintains industry, government, and international contacts so that its activities are known to others and the most recent advances in the rapidly changing field of environmental and social affairs management are available to the Corporation.

Human Resources

At year end Petro-Canada employed 850 people. The Corporation continued to develop its human resources programs recognizing that experienced industry personnel are its most important asset.

Petro-Canada recognizes its responsibility as a good corporate citizen. Through its donations programs Petro-Canada has contributed both manpower and financial assistance to local, regional and national charitable organizations and responded to requests from small communities in areas where it has personnel and operations.

Exploration

In 1978 Petro-Canada continued its exploration activity in the frontier and in the Western Basin.

The Corporation was involved in 16 of 26 wells completed in Canada's frontier regions in 1978.

A total of \$60 million was spent in frontier exploration activities in 1978 bringing total expenditures since inception to \$152 million. The Corporation now has a total of 82 million gross acres of permits in the frontier areas — not including lands held by Panarctic Oils Ltd. in which Petro-Canada has a 45 per cent interest.

In Alberta, successful exploration and delineation drilling continued in the Elsworth-Gold Creek Deep Basin Play, at Utikuma Lake and at Bison Lake. The Corporation spent \$32 million in 1978 on exploration and development activities in the Western Canadian Sedimentary Basin.

Offshore Nova Scotia

Exploration continued throughout 1978 on a five well farmin program in the Sable Basin to earn Petro-Canada a 30 per cent interest and Kaiser Resources Ltd. a 10 per cent interest in a significant block of Mobil Oil Canada Ltd. land. Four wells were completed in 1978. Drilling at Venture D-23, the final well of the

program, was progressing at year end. The Thebaud I-94 well, a stepout to an earlier discovery, confirmed the extension of a gas bearing sand found in the original discovery. The Migrant N-20 and Cohasset L-97 wildcat wells found minor shows of gas. The Cohasset P-42 well, a stepout to an earlier well which tested oil, was unsuccessful.

An important but unsuccessful wildcat test was drilled by Petro-Canada and Chevron Standard Limited on Shell Canada Resources Limited land at Acadia K-62 with the *Ben Ocean Lancer*, a dynamically-positioned drillship in 864 metres of water. This was the first use of such sophisticated drilling equipment in water of this depth in Canada.

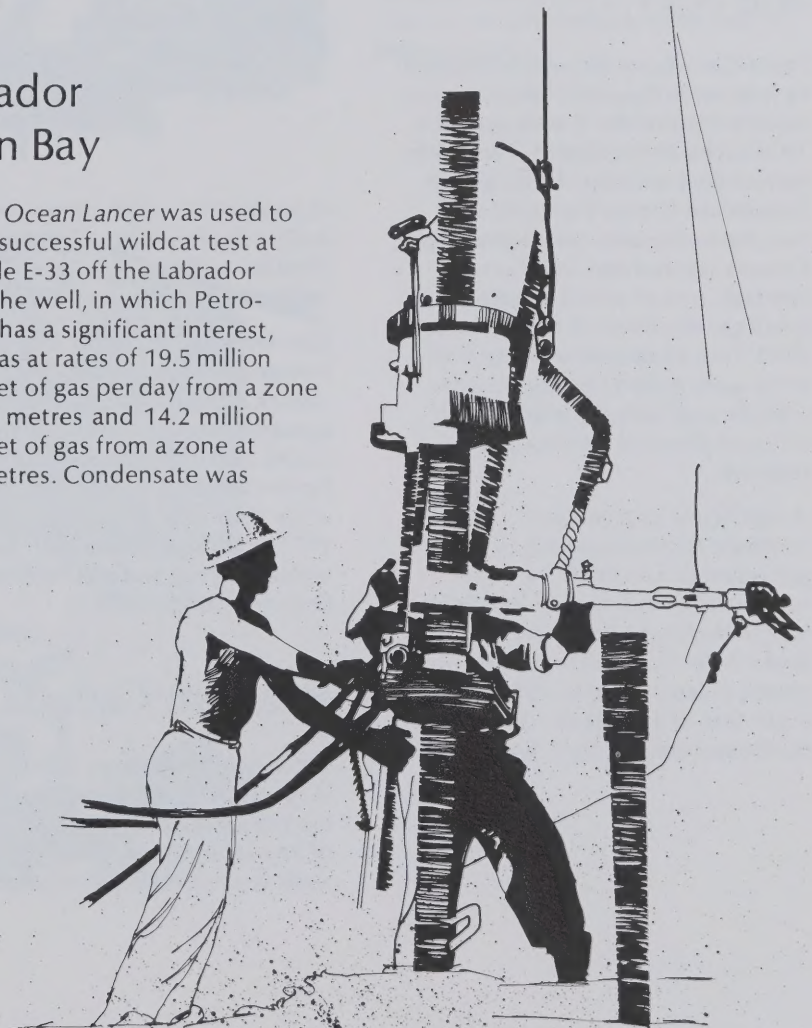
Labrador Baffin Bay

The *Ben Ocean Lancer* was used to drill the successful wildcat test at Hopedale E-33 off the Labrador Coast. The well, in which Petro-Canada has a significant interest, tested gas at rates of 19.5 million cubic feet of gas per day from a zone at 1 983 metres and 14.2 million cubic feet of gas from a zone at 1 948 metres. Condensate was

produced with the gas at rates ranging from 300 to 500 barrels per day. Further drilling will be undertaken in 1979 to evaluate the significance of this wildcat discovery.

As a result of seismic and site specific environmental surveys which were carried out in 1978 and earlier years, Petro-Canada will be involved in several exploration programs in 1979 in other offshore East coast areas.

Petro-Canada participated in seismic surveys off the Labrador coast in the Fogo/Hare Bay area, with a group operated by British Petroleum, to select drilling sites for 1979.



In Baffin Bay, Petro-Canada as operator of the EAMES Project conducted an extensive regional environmental and site specific environmental program costing \$7.0 million. Studies involving ice movements, water currents and other aspects of the operating environment were carried out to determine appropriate safety requirements. North Baffin Bay represents a highly prospective, but as yet undrilled, sedimentary basin in which natural live oil seepages are present, and where a number of large potential structures have been mapped.

Arctic and N.W.T.

Petro-Canada, on its own or through its interest in Panarctic Oils Ltd., was involved in 8 of the 9 wells drilled in 1978 in the Arctic Islands. Two wells were drilled with the Arctic Islands Exploration Group (Panarctic Oils Ltd., Petro-Canada, Esso Resources Canada Limited and Gulf Canada Limited), one of which resulted in a small gas discovery at Roche Point 0-43. Two additional unsuccessful wells were drilled by Panarctic on Melville and Bathurst Islands in an effort to discover onshore gas reserves.

A significant step toward commercial development of Arctic gas reserves was made with the successful completion of an offshore well in the Drake Point gas field at Drake F-76. This well was flow tested at rates of up to 75 million cubic feet of gas per day. It confirmed the excellent producing



characteristics of the reservoir as well as the feasibility of connecting offshore wells by pipeline to onshore gas treatment facilities.

One well was drilled by Dome Petroleum in the Beaufort Sea at Natsek E-56, under a farmout agreement which will require Dome to drill two wells to earn part of Petro-Canada's interest in 643 000 acres. This well, which was started in 1977, was drilled to a depth of 2 695 metres in 1978 and will be drilled to final total depth in 1979.

Western Canada

In Alberta, exploratory efforts were focused on lands already owned by the Corporation. During 1978, a total of 44 exploratory and delineation wells were completed as part of a

major western basin program. As part of an active industry exploration effort in the Gold Creek-Elmworth area, Petro-Canada and its partners have drilled twelve wells, ten of which have been completed as gas wells. Of significance is the Lator 2-29 well, a gas discovery tested at a rate of 6 million cubic feet per day. Additional drilling and reservoir studies are in progress to fully evaluate the volume of this new gas discovery.

At Bison Lake, four successful wells were drilled during a six well program to evaluate a wholly-owned Petro-Canada shallow gas pool. Drilling continued in the Hanlan area where a gas discovery was made in 1977.

In the Utikuma Lake area four exploratory wells were drilled, one of which was a successful oil well.

In other areas, a gas discovery was made at Betts Creek and a bitumen saturated reservoir was found in the Golden Lake area.

To accelerate the exploration and development of heavy oil reserves, Petro-Canada, Gulf Canada Limited and the Saskatchewan Oil and Gas Corporation entered into an agreement with the Government of Saskatchewan which could involve the expenditure of \$99 million over an eight year period on exploration, development and enhanced recovery projects. The consortium will earn a maximum of 162 500 acres from an initial selection of 500 000 acres of Crown lands.

Production and Operations

Conventional Production

During 1978 revenue from sales of crude oil, natural gas liquids and natural gas increased compared to 1977. Despite this, the Corporation's crude oil, natural gas liquids and gas production was less than capacity reflecting continued prorationing to compensate for market constraints.

The construction of the Connorsville gas plant in southwestern Alberta, in which Petro-Canada as operator has a fifty per cent interest, was completed and the plant was put on stream in 1978.

Construction of another Petro-Canada operated gas plant was also well under way at year end at Paddle Prairie in northwestern Alberta. This plant, designed to process 30 million cubic feet of natural gas per day, will be completed the first part of 1979.

As a part of its development drilling program, Petro-Canada participated in 174 gross wells. This compares to 128 gross wells in 1977.

Production

The Corporation's production of oil and natural gas liquids averaged 27.2 thousand barrels per day before royalty.

Gas production averaged 83.6 million cubic feet per day before royalty.

Reserves

In 1978 Petro-Canada completed an extensive reserves evaluation. At year end after 1978 production and reserves additions the Corporation estimated reserves before royalty of 143 million barrels of oil and natural gas liquids compared to 151.6 million barrels at the end of 1977.

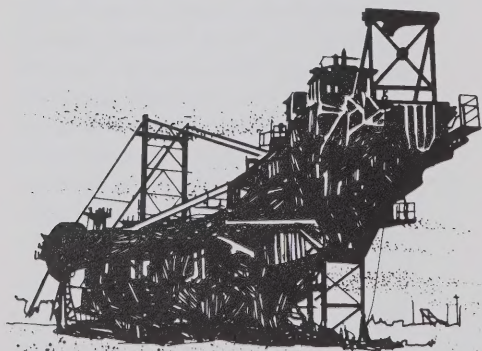
The Corporation's estimated gas reserves at year end after production and reserves additions were 878 billion cubic feet before royalty. This compares to 1977 reserves of 821.8 billion cubic feet before royalty.



Syncrude Canada

During 1978, a major milestone was reached by Syncrude Canada Ltd. (in which Petro-Canada has a 15 per cent interest) with the completion of construction and the commencement of plant start-up. The first synthetic crude oil product entered the Alberta Oil Sands pipeline on July 30. By year-end, synthetic crude shipments to the pipeline totalled 3.6 million barrels. The Syncrude project was officially opened on September 15, 1978, at a ceremony attended by Federal, Alberta, Ontario and industry representatives.

Petro-Canada's 1978 net expenditures of \$78.7 million, (after start-up costs and net of product revenue) brought its total expenditures in the Syncrude project to \$337.8 million at year-end. Estimated total cost of the project is



\$2.3 billion, including post-start-up construction alterations, but excluding the related utilities plant and pipelines which are not directly owned by the participants. Gross revenue earned by Petro-Canada was much lower than expected due to plant start-up problems that resulted in lower production for the year.

In 1978, amendments to the Petroleum Administration Act allowed synthetic crude production from the Syncrude project to be sold at international prices.

Arctic Pilot Project

On January 17, 1979 Petro-Canada and its partners, AGTL and Melville Shipping Ltd. (composed of Federal Commerce & Navigation Co. Ltd., Canada Steamship Lines Ltd. and Upper Lakes Shipping Ltd.) applied to various regulatory authorities for permission to proceed with the Arctic Pilot Project. The project will be the first of its kind to move Arctic resources to the south on a year round basis. Hearings are expected to commence late in 1979.

The project involves the production of gas from eight onshore wells, pipelining it 160 km to the southern shore of Melville Island, liquefying and shipping it to a southern terminus in Eastern Canada for regasification and use. The two ice-breaking carriers are built to Arctic Class 7 standards and have a capacity of 140 000 cubic metres of liquefied natural gas. Total cost of the project will be approximately \$1.5 billion. Petro-Canada is currently seeking purchasers for the gas and arranging a supply contract with the owner of the gas. The production of the project will be 250 million cubic feet of gas per day.

Extensive studies over two years costing \$11 million were undertaken into the technological, environmental and safety aspects of the project prior to filing.

PCE Project

In November, 1978, the PCE Group, consisting of Petro-Canada, Canada-Cities Service Ltd., and Esso Resources Canada Limited executed a three phase, 15 year farmout agreement with Japan Canada Oil Sands Limited (JACOS) whereby JACOS could earn an undivided 25 per cent interest in 34 leases covering 1.25 million acres in the in situ portion of the Athabasca Oil Sands Deposit. In addition, JACOS will earn rights to an in situ recovery method, owned by the PCE Group, known as the electric preheat/steam drive process.

The group, with Petro-Canada as operator, has been investigating the feasibility of the electric preheat/steam drive process for a number of years. The group has begun plans to test the process under field conditions in a small pilot approximately 40 km south of Fort McMurray. Construction of the pilot plant is scheduled to begin in May, 1979, with plant start-up expected in mid 1980.

In addition to basic research required to support the field pilot, during 1978 the PCE Group continued its systematic program to evaluate the in place reserves on the 34 leases by drilling 16 core holes. This program will continue drilling an additional 87 core holes over the next three years.

Purchase of Pacific Petroleum Ltd.

On November 10, 1978 Petro-Canada commenced the first step in the largest acquisition ever made in Canada. On that date, the Corporation purchased from Phillips Petroleum Co. of Bartlesville, Oklahoma a block of 10,326,321 shares of Pacific Petroleum Ltd. of Calgary for a price of \$55.50 (U.S.) which was the equivalent on that date to \$65.02 (Cdn.) per share. The Corporation announced that it had finalized arrangements to raise \$1.25 billion (U.S.) from a group of Canadian chartered banks by the sale of preferred shares in a subsidiary of Petro-Canada.

At year end Petro-Canada owned 11,497,519 common shares of Pacific Petroleum — slightly in excess of 50 per cent of the common shares outstanding.

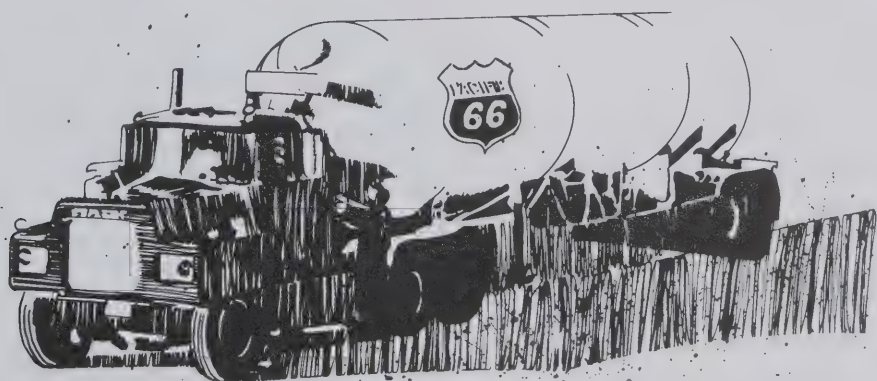
The fundamental goal of Petro-Canada in proceeding with the acquisition of Pacific Petroleum was to become a significant and balanced presence in Canada's oil and gas industry. The first three years of Petro-Canada's activity and expenditures have been predominantly and disproportionately oriented to high-risk, long-lead-time projects. Its investments in the Syncrude Project, Panarctic and the Polar Gas Project, taken over at the request of the

Government of Canada, do not provide an immediate cash return, nor does the investment in frontier exploration, technological development projects and initiatives in the search for new energy opportunities. These activities, undertaken in the pursuit of the Corporation's mandate are, as participation by private sector partners shows, well within the same business parameters of the industry, but only when they are balanced by less risky and profitable immediate returns. While still devoting a comparatively large part of its budget to the longer-term projects when viewed by purely commercial standards, Petro-Canada now has greater immediate cash flow to help support these activities. The Corporation now has a meaningful presence in exploration and production and some involvement in other aspects of the Canadian oil and gas industry.

Pacific Petroleum Ltd. not already owned by it at \$65.02 (Cdn.) net per share in cash. On January 17, 1979 the Board of Directors of Pacific, based on an independent evaluation of the shares, recommended acceptance of the offer. On March 12, 1979 Petro-Canada announced that its offer was closed. At that time the Corporation had acquired 96 per cent of the shares to which the offer applied or 98 per cent of all the shares of Pacific. Petro-Canada also announced that the Corporation intended to exercise the right to acquire, pursuant to the provisions of the Canada Business Corporations Act, the shares held by those shareholders who had not yet tendered their shares pursuant to the offer.

Subsequent Events

On January 15, 1979 Petro-Canada announced that it would make a tender offer for any and all shares of

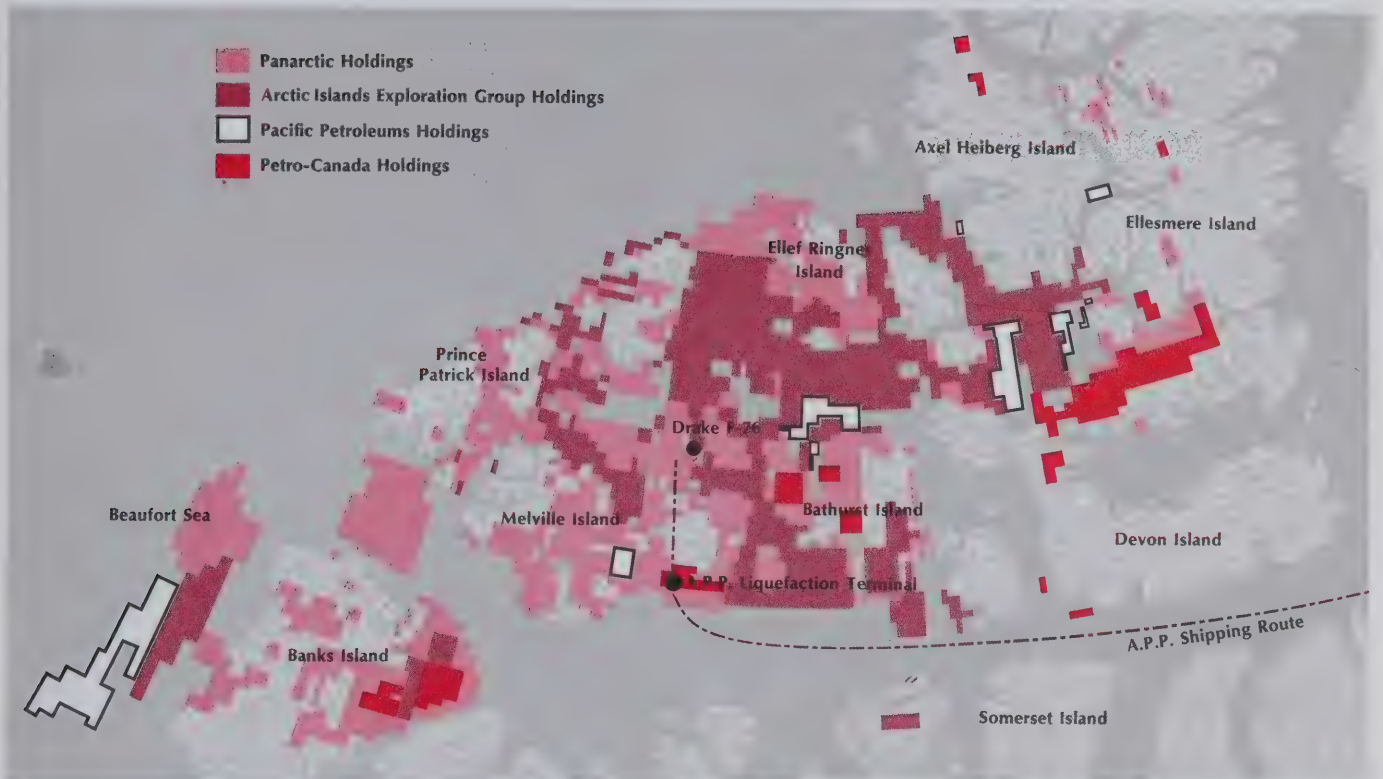


Combined Operations

While Petro-Canada did not acquire control of Pacific until late in 1978, a full description is presented with the activities of Petro-Canada to give a more effective understanding of the nature and magnitude of the Corporation's future operations. The reported financial results, however, only account for 51.6 per cent of Pacific being owned by Petro-Canada and only take account of the financial results of the acquisition from November 11, 1978, the effective date on which Petro-Canada acquired control.

Petro-Canada, after the acquisition, has become one of the most significant Canadian-owned corporations involved in the oil and gas business in Canada. The Corporation is now involved in frontier exploration, technology development, major conventional production areas, new Western Basin exploration plays and some downstream operations in refining, marketing and transportation.





Exploration

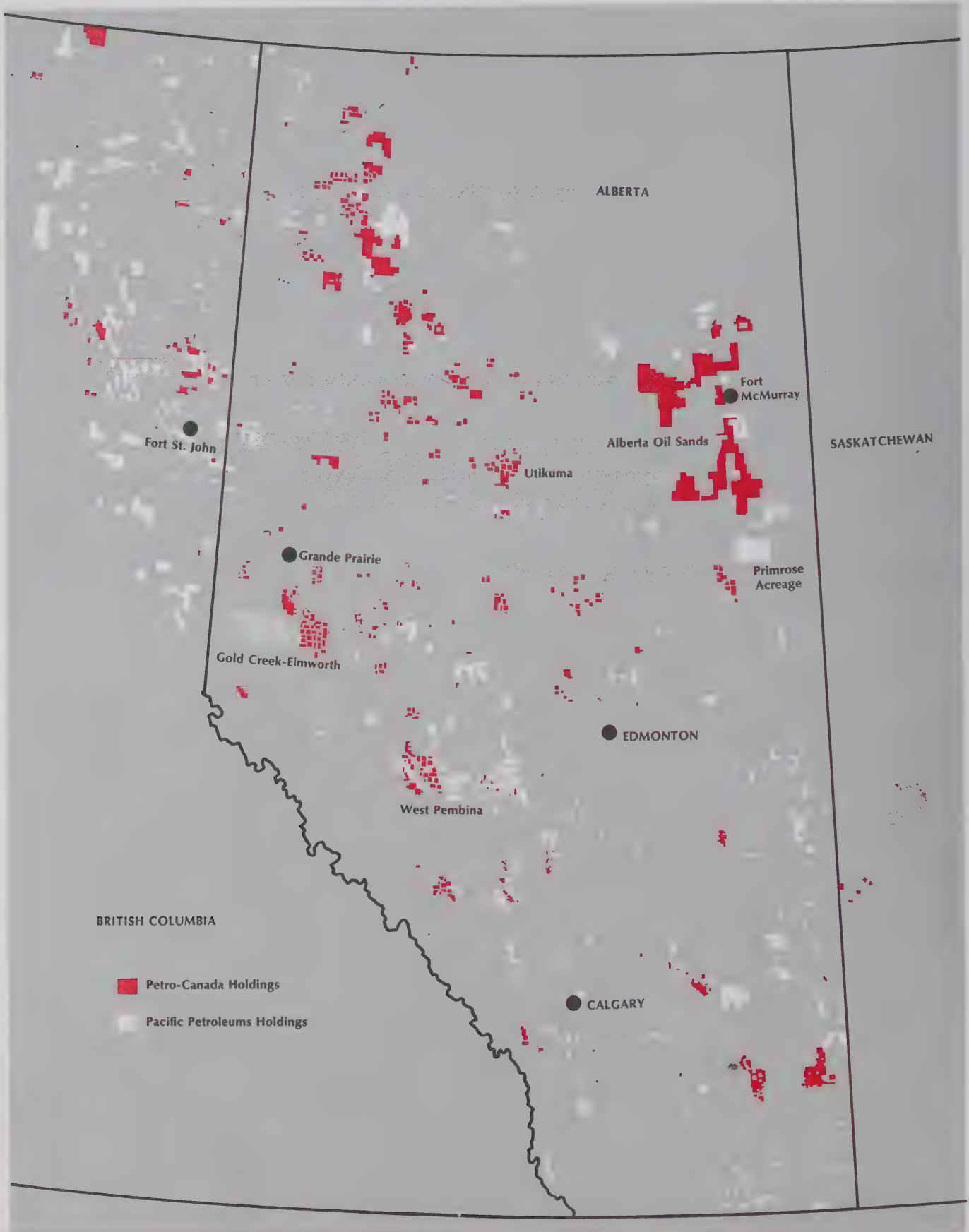
The acquisition of Pacific Petroleum further augments the substantial land position of the Corporation. Of particular interest is the significant acreage in currently producing western sedimentary basin areas which complements Petro-Canada's substantial frontier exploratory acreage. The Corporation acquires a significant interest in three exciting areas in the Western Basin; interest in 66 600 gross acres in the Elsworth area, varying interests in 27 000 acres in West Pembina and rights to explore in a portion of the Primrose Range.

These, added to Petro-Canada's interests in the Elsworth-Gold Creek area and in Utikuma, provide an opportunity to explore and develop challenging potential areas in the Western Basin. Petro-Canada will pursue these exploration activities vigorously since they have the potential to increase its productive capacity and reserves within a relatively short-time frame and at relatively low cost in comparison with frontier activities.

In the frontiers, the acquisition brings a further interest in exploration leases in the Beaufort Sea, the Arctic Islands and the Labrador Shelf.

The combined wells drilled graph gives an indication of the level of activity undertaken by the companies.

The acquisition of Pacific will for the first time give Petro-Canada concrete international exploration interests in the United States, in the Spanish Mediterranean where discoveries are nearing production, and in the United Kingdom, both offshore and on the mainland.



Oil Sands and Heavy Oil

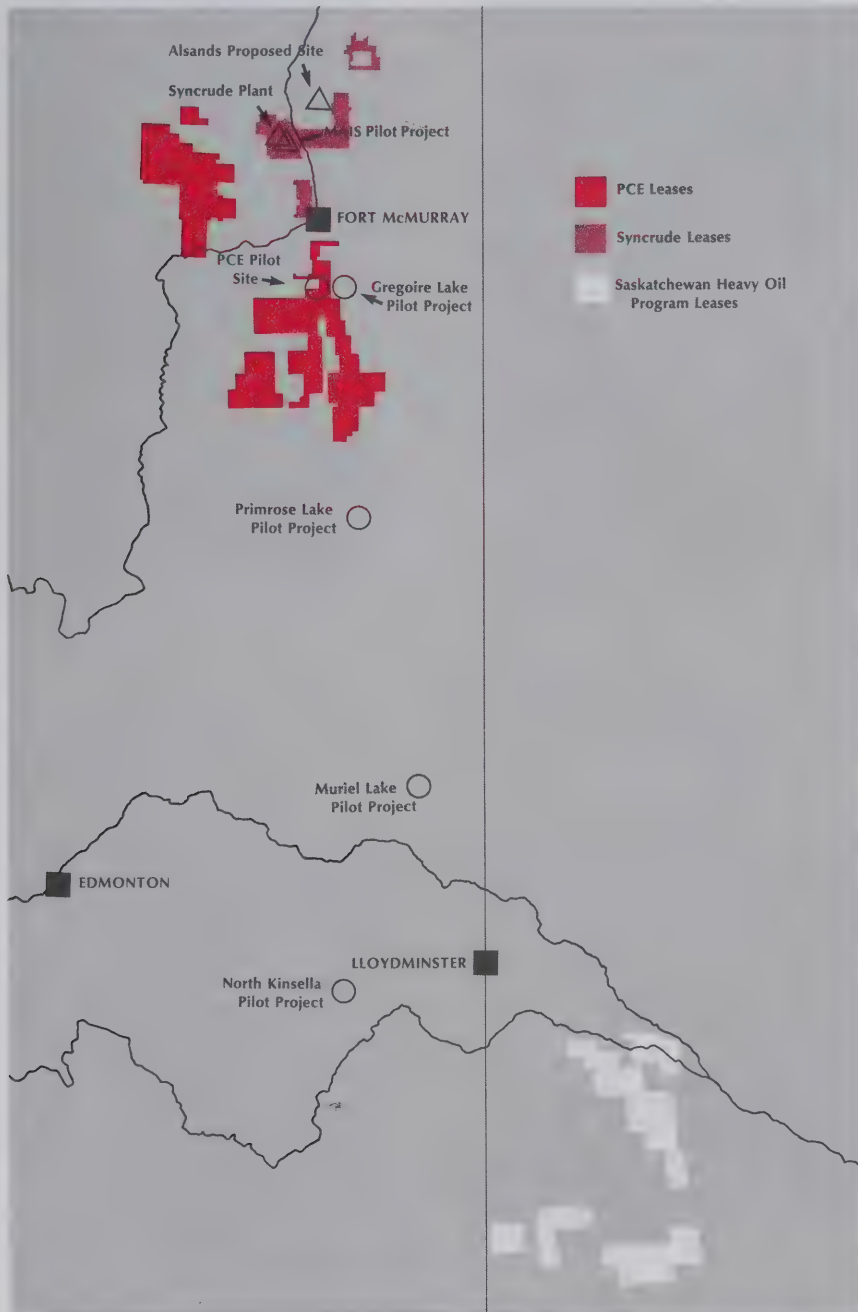
Petro-Canada has, in pursuing its mandate to work to assure energy self-reliance for Canada, attached significant importance to the development of Canada's enormous oil sands and heavy oil reserves. The exploration and development of oil sands and heavy oil requires efforts

which must be pursued on many fronts. Petro-Canada through its participation in Syncrude, the PCE project, the MAIS project and the Saskatchewan conventional heavy oil program, has vigorously pursued the development of oil sands and heavy oils. The acquisition of Pacific brings Petro-Canada into six more major oil sands and heavy oil activities.

The Corporation, through its acquisition, becomes a member of the Alsands group which is currently planning to build a third oil sands mining plant in the Alberta Oil Sands.

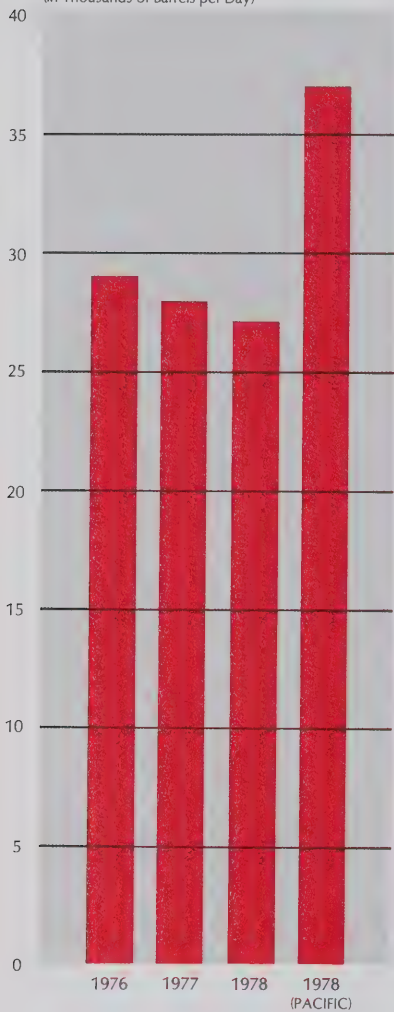
In the in-situ area of the oil sands, Petro-Canada will, with its acquisition, also become involved in a Forward Combustion and Water Flood pilot project at Gregoire Lake, a steam stimulation pilot at Muriel Lake, a steam/air injection pilot in the North Kinsella field, and an exploratory development program near Primrose Lake in the Cold Lake oil sands deposit.

As well as its involvement in the Saskatchewan heavy oil program, Petro-Canada will assume leadership of a group of companies investigating the economics of building a plant to upgrade heavy oil into feedstock that could be used by existing Canadian refineries — supplementing work which the Corporation has already done in the investigation of heavy oil upgrading.



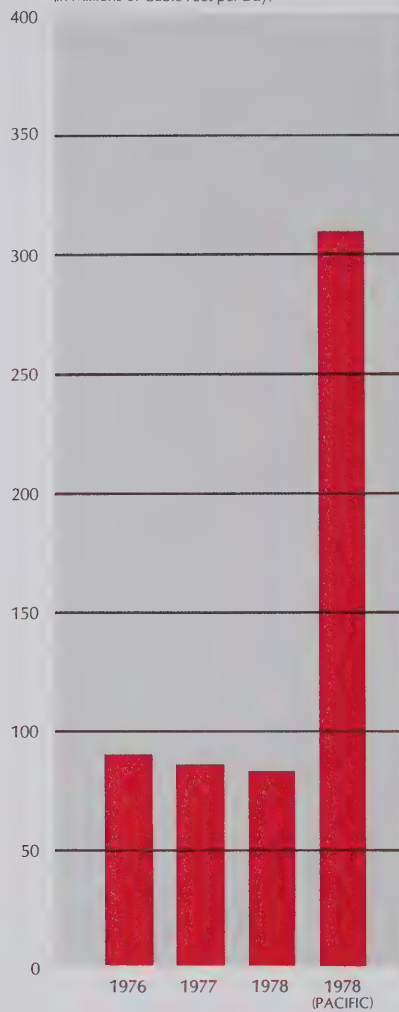
PRODUCTION VOLUMES

CRUDE OIL & NATURAL GAS LIQUIDS
(in Thousands of Barrels per Day)



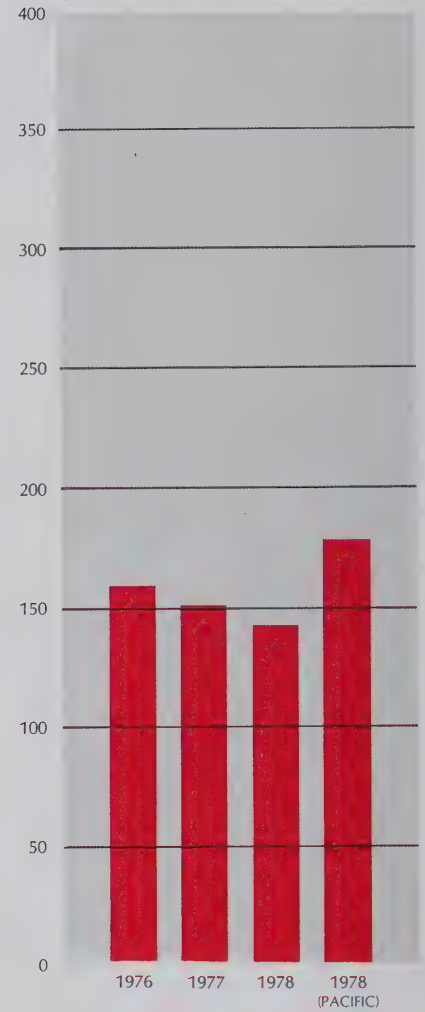
PRODUCTION VOLUMES

NATURAL GAS
(in Millions of Cubic Feet per Day)



RESERVES

CRUDE OIL & NATURAL GAS LIQUIDS
(in Millions of Barrels)



Production

The production summary graphs provide production levels of oil and natural gas liquids for the past three years for Petro-Canada and for the year 1978 as reported by Pacific. Total production of oil and natural gas liquids of the combined companies for 1978 was 23.6 million barrels, making Petro-Canada seventh largest in Canada for oil and natural gas liquids production. Total production of natural gas of the combined companies for 1978 was 144 billion cubic feet, making Petro-Canada the second largest in

Canada for natural gas production. The reserves graphs provide basic estimates by both companies of reserves as of year-end 1978:

Coal/Mining

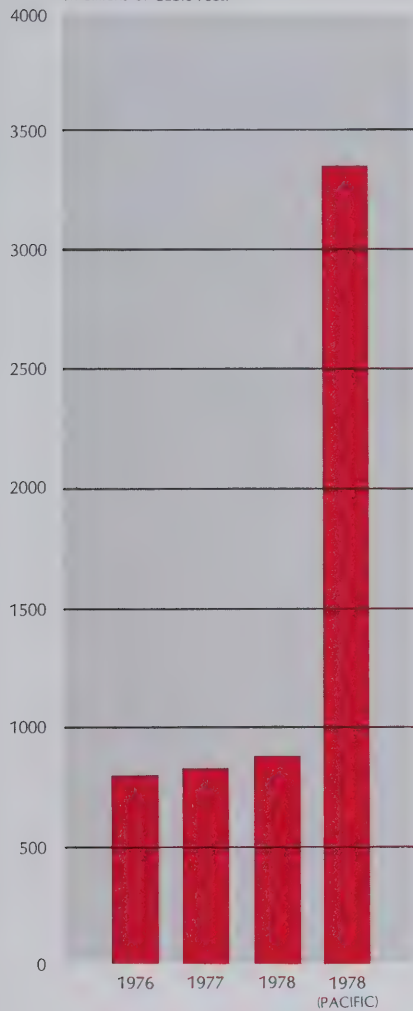
Petro-Canada has not, to date, been actively involved in either coal exploration or mining activity. The acquisition of Pacific brings to the Corporation several opportunities in

these areas. The Corporation will have a 50 per cent interest in the coal reserves in approximately 74 000 acres at the Monkman Pass metallurgical coal property in northeastern B.C. and an 80 per cent interest in 31 473 acres of thermal coal properties at Lethbridge, Alberta.

In mining, the Corporation acquires an interest in two uranium properties in British Columbia and North Saskatchewan and mining prospects near Pine Point, N.W.T. and in Northern Washington State near the B.C. border.

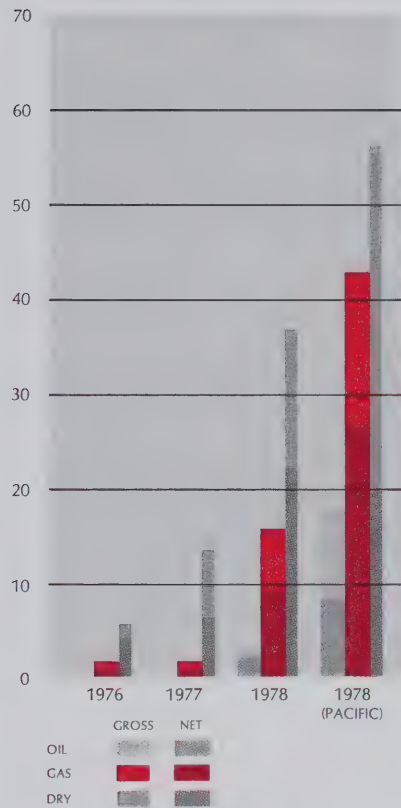
RESERVES

NATURAL GAS
(in Billions of Cubic Feet)

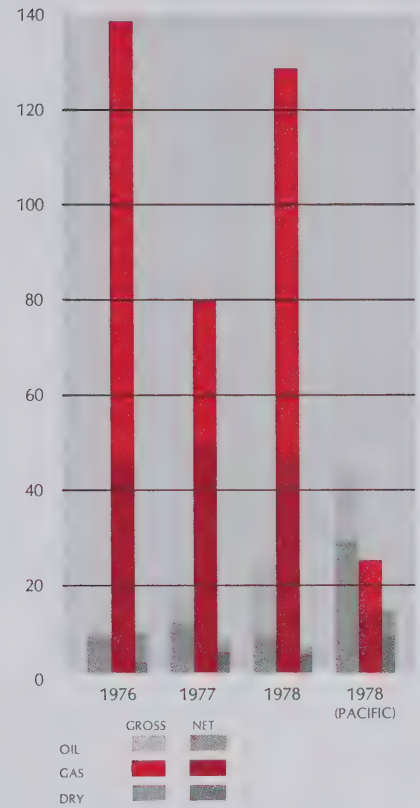


WELLS DRILLED

EXPLORATORY



DEVELOPMENT AND PRODUCTION



Downstream Activities

Petro-Canada acquires a 10% interest in the Cochin pipeline, a 3 000 km natural gas liquids pipeline running from Edmonton to Sarnia. The line, completed in 1978 at a total cost of \$320 million, began deliveries in late 1978 of ethane, ethylene and propane to markets in Eastern Canada and the U.S. Total capacity of the pipeline of 85 000 barrels per day is expected to be reached by the end of 1979.

The Corporation acquires through its purchase of Pacific, a 32 per cent interest in Westcoast Transmission

Co. Ltd., the major natural gas gathering and transmission company in British Columbia.

At Empress, Alberta, the Corporation has acquired a major natural gas liquids plant, currently producing about 14 800 barrels per day of propane, butanes and natural gasoline. The plant is being expanded to provide for the additional production of 27 000 barrels per day of ethane.

Refining and Marketing

The Corporation will have a small refinery at Taylor, B.C. with a capacity of 15 400 barrels per day of crude oil and condensate, and 426 retail and wholesale marketing outlets extending from Vancouver Island to Thunder Bay, Ontario.

Pacific's sales of branded products, principally motor gasoline and distillate, constituted about five per cent of industry sales in Western Canada in 1978.

Corporate Activities

The Corporation recognizes that the acquisition of a company is not just a matter of purchasing capital goods, hardware and property. More than 1 100 employees of Pacific will come to the Corporation and Petro-Canada has moved to ensure that these employees become an integral part of the operation of Petro-Canada. The Corporation looks forward to the development and melding of operations so that the result will be a stronger and even more dynamic organization.

Financial Summary

Petro-Canada's financial results for 1978 reflect dramatic growth due mainly to the purchase in November of a controlling interest in Pacific Petroleum Ltd. At December 31, 1978, the Corporation held 51.6% of Pacific's common shares purchased at a cost of \$746.9 million and subsequently acquired all of the remaining shares resulting in a total consideration of \$1,496 million.

Funds for the Pacific purchase were provided mainly from the proceeds of a \$1,250 million U.S. preferred share issue by the Corporation's subsidiary, Petro-Canada Exploration Inc. ("PEX"), to a group of Canadian chartered banks. The shares, which are redeemable at the option of PEX, require the payment of quarterly dividends which at PEX's option are based on a percentage of either the United States Base Rates, or the London Inter-Bank Offered Rates of the banks. The current dividend rate approximates 6.3% per annum.

The Corporation's financial results include those of Pacific Petroleum Ltd. from November 11, 1978, the effective date of the acquisition. Operating revenue of \$174.3 million includes \$70 million generated by Pacific during the control period. If the contribution made by Pacific is deducted from operating revenue, the resultant \$104.3 million generated from Petro-Canada's operations compares with \$88.7 million in 1977, or an increase of 17%. This increase was entirely due to higher prices for oil and gas. Interest income of \$20.9 million and a gain on foreign exchange of \$8.1 million results mainly from investment of and conversion to Canadian currency of the temporarily surplus funds obtained from the preferred share issue referred to above. Additional income of \$1.8 million from Pacific's equity in the net earnings of their affiliate, Westcoast Transmission Company Limited, brought Petro-Canada's consolidated total revenue to \$205.1 million, an increase of \$112.4 million from 1977.

Earnings before income taxes and minority interest were \$76.5 million compared with \$30.4 million in 1977. Provision for deferred and current income taxes of \$42.1 million resulted in consolidated earnings before minority interest of \$34.4 million which includes \$14.4 million net earnings of Pacific from November 11, 1978 to December 31, 1978. Seven million dollars of the Pacific net earnings was apportioned to the holders of the shares which were not held by Petro-Canada (48.4%). This minority interest, plus a dividend payment of \$13.6 million on the PEX preferred shares resulted in a total minority interest of \$20.6 million, leaving net earnings for the year of \$13.7 million. This compares with \$9.5 million in 1977, representing an increase of 44%.

Funds of \$99.5 million were provided from operations, which compares with \$55.9 million in 1977. In addition, the sale of the preferred shares by PEX generated \$1,464.4 million, Petro-Canada issued shares to the Government of Canada for \$239.5 million, and \$8.3 million in deferred revenue was received for natural gas paid for, but not yet taken, for a total source of working capital of \$1,811.7 million. This was used as follows:

	(millions)
Purchase of 51.6% interest in Pacific Petroleum Ltd. (net of \$47.8 million working capital)	\$ 699.0
Reserved for completion of Pacific acquisition	749.0
Oil and Gas exploration and development	140.6
Panarctic Oils Ltd.	16.7
Syncrude Project	78.7
Polar Gas, Heavy Oil, Arctic LNG and other feasibility studies (deferred charges)	11.3
Reduction of long-term debt	31.1
Share issue of expense (PEX)	1.7
Increase in working capital	83.6
	<u>\$1,811.7</u>

At December 31, 1978, consolidated assets totalled \$3,348.9 million compared to \$878.7 million at the end of the previous year. The major increase results from the inclusion of 100% of Pacific's assets at their historical cost, plus the excess of the consideration paid for the shares of Pacific over their book values. Also contributing to the increase in consolidated net assets is the \$749 million cash balance at December 31, 1978, which was being held to complete the Pacific purchase. Consolidated assets consists of current assets, \$243.9 million; cash held for Pacific acquisition, \$749 million, investments (mainly Westcoast Transmission Company Limited and Panarctic Oils Ltd.), \$235.5 million; property, plant and equipment, \$2,087.2 million, and deferred charges of \$33.3 million.

Deduction of liabilities, deferred income taxes and minority interest in subsidiaries, totalling \$2,546.2 million results in shareholder's equity at December 31, 1978 of \$802.7 million, an increase of \$251.6 million from the balance at December 31, 1977. Working capital at December 31, 1978 was \$82.8 million, compared with a working capital deficit of \$0.7 million at December 31, 1977.

PEAT, MARWICK, MITCHELL & CO.
CHARTERED ACCOUNTANTS

To The Honorable Alastair W. Gillespie, P.C., M.P.
The Minister of Energy, Mines and Resources
House of Commons
Ottawa, Canada

We have examined the consolidated balance sheet of Petro-Canada as at December 31, 1978 and the consolidated statements of earnings and retained earnings 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 corporation as at December 31, 1978 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.

We further report as required by Section 77(1) of the Financial Administration Act that, in our opinion, proper books of account have been kept by the corporation and the transactions that have come under our notice have been within the powers of the corporation.

Calgary, Canada
March 15, 1979

Peat, Marwick, Mitchell & Co.
Chartered Accountants

Consolidated Balance Sheet

As at December 31, 1978

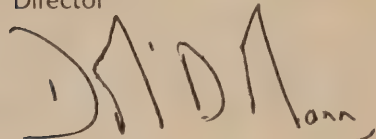
(stated in thousands of dollars)

	<u>1978</u>	<u>1977</u>
Assets		
CURRENT ASSETS		
Cash and short-term deposits	\$ 76,471	\$ 21,453
Accounts receivable	127,984	24,088
Inventories	38,171	4,009
Deposits and prepaid expenses	<u>1,232</u>	<u>1,583</u>
	243,858	51,133
CASH HELD FOR INVESTMENT (Note 13)	<u>749,000</u>	<u>—</u>
INVESTMENTS (Note 3)	<u>235,485</u>	<u>91,807</u>
PROPERTY, PLANT AND EQUIPMENT, net (Note 4)	<u>2,087,244</u>	<u>718,846</u>
DEFERRED CHARGES (Note 6)	<u>33,326</u>	<u>16,910</u>

Approved on behalf of the Board



Director



Director

March 15, 1979

\$3,348,913

\$878,696

	<u>1978</u>	<u>1977</u>
Liabilities		
CURRENT LIABILITIES		
Accounts payable and accrued liabilities	\$ 124,195	\$ 31,466
Portion of long-term debt due within one year	36,839	20,400
	<u>161,034</u>	<u>51,866</u>
LONG-TERM DEBT (Note 7)	300,277	193,600
DEFERRED NATURAL GAS REVENUE	8,290	—
DEFERRED INCOME TAXES	307,452	82,082
5% CONVERTIBLE SUBORDINATED DEBENTURES (Note 13)	25,004	—
MINORITY INTEREST IN SUBSIDIARIES (Note 8)	1,744,165	—
Shareholder's Equity		
CAPITAL (Note 9)		
Preferred shares	337,800	258,300
Common shares	440,000	280,000
	777,800	538,300
RETAINED EARNINGS	24,891	12,848
	<u>802,691</u>	<u>551,148</u>
COMMITMENT (Note 8)		
	<u>\$3,348,913</u>	<u>\$878,696</u>

Consolidated Statement of Earnings and Retained Earnings

For the year ended December 31, 1978

(stated in thousands of dollars)

	1978	1977
	(Note 2)	
REVENUE		
Operating	\$174,344	\$88,718
Interest	20,926	3,975
Gain on foreign exchange	8,046	—
Equity in earnings of affiliates	1,779	—
	<u>205,095</u>	<u>92,693</u>
EXPENSES		
Operating	53,763	13,810
General and administrative	23,196	13,198
Interest on long-term debt	11,289	10,553
Other interest	1,839	—
Depreciation, depletion and amortization	38,388	24,471
Research	125	248
	<u>128,600</u>	<u>62,280</u>
EARNINGS BEFORE INCOME TAXES AND MINORITY INTEREST	<u>76,495</u>	<u>30,413</u>
PROVISION FOR INCOME TAXES (Note 10)		
Deferred	38,763	21,898
Current	3,346	(1,000)
	<u>42,109</u>	<u>20,898</u>
EARNINGS BEFORE MINORITY INTEREST	34,386	9,515
MINORITY INTEREST IN SUBSIDIARIES	20,646	—
NET EARNINGS FOR YEAR	13,740	9,515
RETAINED EARNINGS AT BEGINNING OF YEAR	12,848	3,333
	26,588	12,848
PREFERRED SHARE ISSUE EXPENSE OF SUBSIDIARY	1,697	—
RETAINED EARNINGS AT END OF YEAR	<u>\$ 24,891</u>	<u>\$12,848</u>

Consolidated Statement of Changes in Financial Position

For the year ended December 31, 1978

(stated in thousands of dollars)

	1978	1977
	(Note 2)	
SOURCES OF WORKING CAPITAL		
Net earnings for year	\$ 13,740	\$ 9,515
Add charges not involving an outlay of working capital	85,792	46,369
Working capital provided from operations	99,532	55,884
Proceeds from issue of preferred shares by subsidiary	1,464,375	—
Proceeds from issue of shares	239,500	154,500
Proceeds from issue of long-term debt	—	4,000
Deferred natural gas revenue	8,290	—
	<u>1,811,697</u>	<u>214,384</u>
USES OF WORKING CAPITAL		
Acquisition of Pacific Petroleum Ltd. Net assets, at attributed values, less working capital acquired of \$47,838 (Note 2)	699,023	—
Cash held for investment in subsidiary (Note 13)	749,000	—
Increase in investments	16,746	11,807
Purchase of property, plant and equipment	219,236	166,958
Increase in deferred charges	11,322	9,940
Reduction of long-term debt	31,116	40,400
Preferred share issue expense of subsidiary	1,697	—
	<u>1,728,140</u>	<u>229,105</u>
INCREASE (DECREASE) IN WORKING CAPITAL	83,557	(14,721)
WORKING CAPITAL (DEFICIENCY) AT BEGINNING OF YEAR	(733)	13,988
WORKING CAPITAL (DEFICIENCY) AT END OF YEAR	<u>\$ 82,824</u>	<u>\$ (733)</u>

Notes to Consolidated Financial Statements

December 31, 1978

(tabular amounts shown in thousands of dollars)

1. Summary of Significant Accounting Policies

(a) Basis of Consolidation

The consolidated financial statements include the accounts of Petro-Canada ("the Corporation") and all subsidiaries, the principal of which are Petro-Canada Exploration Inc. and Pacific Petroleum Ltd.

The excess of the consideration paid for the shares of subsidiaries over the underlying net book values at the dates of acquisition has been attributed to the related assets acquired.

(b) Inventories

Inventories are valued at the lower of cost and net realizable value.

(c) Investments

The Corporation accounts for investments in companies over which it has significant influence on the equity basis. Other long-term investments are accounted for by the cost method.

(d) Property, Plant and Equipment

The Corporation follows the full cost method of accounting for oil and gas properties whereby all costs relating to the exploration for and development of oil and gas reserves are capitalized. Such costs include those related to lease acquisitions, geological and geophysical activities, carrying charges of non-producing properties, drilling both productive and non-productive wells and overhead related to exploration.

Separate cost centres have been established for non-frontier Canada, each of four Canadian frontier areas, United States, North Sea and Spain. Costs incurred in non-frontier Canada and Spain are depleted separately on the unit of production method based on estimated proven oil and gas reserves. For purposes of calculating depletion, natural gas production and reserves are converted to equivalent barrels of crude oil based on the relative energy content of each commodity. Annual costs incurred in the other cost centres are amortized on a straight line basis over the period during which exploration activity in each cost centre is expected to continue. Where exploration proves to be successful, amortization is suspended and the unamortized balance of the cost centre is depleted on the unit of production method when production commences. Where exploration proves to be unsuccessful and the cost centre is condemned or abandoned, the unamortized balance of that cost centre will be charged to earnings at that time.

Substantially all of the Corporation's exploration and production activities related to oil and gas are conducted jointly with others. Only the Corporation's proportionate interest in such activities is reflected in the financial statements.

Costs of property, plant and equipment associated with the Syncrude Project and related leases are accumulated in a separate cost centre and will be depleted on the unit of production method when production commences (Note 5). Expenditures on other bituminous sands leases are also accumulated in a separate cost centre and are amortized, depleted or otherwise charged to earnings in accordance with the policy described above for the Canadian frontier and foreign areas.

Depreciation of plant and equipment (except as noted above) is provided on either the unit of production or straight line methods as appropriate. Straight line depreciation rates range from 3% to 25%.

(e) Deferred Charges

The Corporation is deferring costs incurred on feasibility studies involving economic evaluation and preliminary engineering relating to:

- (a) Production of hydrocarbons from conventional heavy oil deposits
- (b) Polar Gas Project
- (c) Arctic Liquefied Natural Gas Project
- (d) Other — transportation and drilling related technologies.

When production or commercial activity of a particular project commences the applicable expenditures will be amortized based on the estimated useful life of the project. In the event that a decision is made not to proceed with a particular project, all associated costs will be charged to earnings at that time.

The costs of the Polar Gas Project relate to feasibility studies in connection with a gas transmission system from the Arctic Islands to Eastern Canada. Under the participation agreement, subject to the project's feasibility and approval by the necessary regulatory authorities, the participants shall be entitled to have the costs they have incurred treated as an equity investment in a company incorporated to construct and operate the transmission facilities, or be reimbursed out of any financing of such company.

Debt issue expense is being amortized on a straight line basis over the life of the debt.

(f) Research Costs

Research costs are charged against income as incurred.

(g) Income Taxes

The Corporation makes full provision for income taxes deferred as the result of claiming tax depreciation, exploration, development and other costs which exceed the related amounts charged to expense in the financial statements.

(h) Translation of Foreign Currency

Current assets, current liabilities and cash held for investment are translated at the rate of exchange in effect at the end of the year. The resulting gains and losses are included in earnings. Long term assets, liabilities and minority interest are translated at rates in effect at the dates the assets were acquired, the obligations incurred or the capital stock issued to the minority interest (Note 8). Revenue and expense items are translated at the average rates in effect during the year with the exception of depletion, depreciation and amortization which reflect rates in effect when the assets were acquired.

2. Acquisition of Subsidiary Company

Effective November 11, 1978, the Corporation, through a subsidiary, acquired 11,497,519 common shares of Pacific Petroleum Ltd. for a cash consideration of \$746,861,000 (including related expenses), representing 51.6% of the issued common shares of Pacific at December 31, 1978. The Corporation's consolidated earnings include its share of the earnings of Pacific from November 11, 1978. Details of the acquisition, which has been accounted for by the purchase method, are as follows:

Book value of acquired assets		\$ 908,164
Book value of assumed liabilities		<u>617,598</u>
		290,566
Excess of attributed value over book value of acquired net assets:		
Petroleum and natural gas properties	\$454,913	
Investment in Westcoast Transmission Company Limited	10,028	
Long-term debt	<u>(8,646)</u>	456,295
Cost of acquisition		<u><u>\$ 746,861</u></u>

The net assets acquired, at attributed values, consist of:

Investments		\$ 128,563
Property, plant and equipment		1,187,550
Deferred charges		5,145
Long-term debt		(137,793)
5% Convertible Subordinated Debentures		(25,004)
Deferred income taxes		(186,607)
Minority interest		(272,831)
		<u>\$ 699,023</u>
Working capital		
Current assets	\$126,256	
Current liabilities	(78,418)	47,838
		<u>\$746,861</u>

3. Investments

The Corporation's investments consist of:

	1978	1977
At equity		
Westcoast Transmission Company Limited	\$116,700	\$ —
Panarctic Oils Ltd.	108,553	91,807
Pacific Northern Gas Ltd.	1,996	—
Other, at cost	8,236	—
	<u>\$235,485</u>	<u>\$91,807</u>

Westcoast Transmission Company Limited

At December 31, 1978, Pacific (51.6% owned by the Corporation) held 11,116,845 shares, or 32.1% of the total outstanding shares of Westcoast Transmission Company Limited. Westcoast has 5,765,128 shares reserved for issuance to holders of convertible securities and share purchase warrants. If all of the reserved shares had been issued, Pacific's interest in Westcoast would have been reduced to 27.3%. Westcoast follows the taxes payable method of accounting for income taxes in accordance with generally accepted accounting principles prescribed for certain utilities.

If the tax allocation method were followed by Westcoast, equity in earnings of investments, net earnings, and retained earnings of the Corporation would be reduced by \$863,000 in 1978.

At December 31, 1978 the quoted market value of Pacific's investment in Westcoast was \$133,303,000.

Panarctic Oils Ltd.

During 1978, the Corporation subscribed to a further financing of Panarctic Oils Ltd., increasing its investment at December 31, 1978 to \$108,553,000. This additional investment maintained the Corporation's ownership of the issued common shares of Panarctic at approximately 45%. These shares are not traded on the open market and therefore do not have a quoted market value. The activities of Panarctic Oils Ltd. are in the exploratory stage and all expenses less sundry income have been capitalized; the company is deemed not to have earned a profit or sustained a loss. The Corporation is committed to expenditures of approximately \$14,000,000 in connection with the ongoing financing of Panarctic.

4. Property, Plant and Equipment

Property, plant and equipment consists of:

	1978			1977
	Cost	Accumulated Depreciation, Depletion and Amortization	Net	Net
Oil and gas				
Canada				
— non-frontier areas	\$1,418,247	\$51,340	\$1,366,907	\$373,619
— frontier areas	162,757	14,742	148,015	72,413
Foreign	40,671	1,458	39,213	425
Bituminous sands				
— Syncrude Project and related leases (Note 5) . . .	337,763	—	337,763	259,064
— Other bituminous sands leases and expenditures thereon	12,140	1,522	10,618	10,385
Refining and marketing	44,239	54	44,185	—
Natural gas liquids	85,898	209	85,689	—
Pipelines, and other property and equipment	56,217	1,363	54,854	2,940
	<u>\$2,157,932</u>	<u>\$70,688*</u>	<u>\$2,087,244</u>	<u>\$718,846</u>

*Consists of depreciation — \$7,248,000, depletion — \$45,718,000 and amortization — \$17,722,000 (at December 31, 1977 — \$3,346,000, \$23,990,000 and \$5,085,000 respectively).

5. Syncrude Project

The Corporation has a 15% participation in a project operated by Syncrude Canada Ltd. to produce synthetic crude oil from the Athabasca Oil Sands. The Corporation considers this project to be in the start-up phase as at December 31, 1978 and consequently start-up expenses, net of revenues are included in the capital cost of the project. Associated with the Syncrude Project are facilities which are not owned by the participants, consisting of a steam and electricity generating plant, a field gas supply pipeline and a pipeline to transport plant product to Edmonton. The Corporation, together with the other participants, has minimum usage commitments relating to these facilities.

Under the terms of an option agreement, which expires September 1, 1979, Alberta Energy Company Ltd. has the right to purchase up to 20% of the project from the participants by reimbursement of an amount based on the option percentage exercised.

6. Deferred Charges

Deferred charges consist of:

	1978	1977
At cost:		
Heavy oil projects	\$12,645	\$ 3,504
Polar Gas Project	12,062	10,887
Arctic Liquefied Natural Gas Project	4,950	2,000
Other	2,703	211
Unamortized debt expense	966	308
	<u>\$33,326</u>	<u>\$16,910</u>

7. Long-Term Debt

Long-term debt consists of:

	Maturity	1978	1977
In Canadian dollars			
Bank Income Debentures	1983	\$190,000	\$210,000
6-1/4% — 6-3/4% mortgages	1985	2,055	—
Other long-term debt, non-interest bearing	1987	3,600	4,000
In United States dollars			
9% unsecured notes (\$60,000,000 U.S.)	1996	65,161	—
8.45% unsecured notes (\$30,000,000 U.S.)	1987	33,717	—
5-1/4% unsecured notes (\$29,900,000 U.S.)	1985	33,926	—
5-3/4% — 6-1/4% mortgages (\$4,978,000 U.S.)	1988	5,686	—
6-1/2% secured notes (\$2,577,000 U.S.)	1982	2,971	—
		<u>337,116</u>	<u>214,000</u>
Less portion due within one year.		36,839	20,400
		<u>\$300,277</u>	<u>\$193,600</u>

Bank Income Debentures

The Bank Income Debentures are held by a Canadian chartered bank and bear interest at approximately 52% of the bank's prime lending rate as announced from time to time. No deduction is allowed under the Income Tax Act for interest expense relating to the Bank Income Debentures (Note 10).

While the Bank Income Debentures are not secured by any charge against the assets of the Corporation, there are certain restrictions with respect to the disposition or encumbrance of the investment by the Corporation in Petro-Canada Exploration Inc.

Long-term debt in United States dollars

Issues denominated in United States dollars are the obligations of Pacific and have been translated into Canadian dollars at the exchange rate in effect on November 11, 1978, the effective date on which the Corporation acquired control of Pacific.

Repayment of long-term debt

Annual repayments of the 9% and 8.45% unsecured notes will commence in 1981 and 1982 respectively. All the other issues are currently subject to annual repayments.

The minimum repayment of long-term debt in each of the next five years is as follows:

1979 — \$36,839,000, 1980 — \$46,887,000, 1981 — \$61,548,000, 1982 — \$66,325,000, 1983 — \$36,386,000.

8. Minority Interest in Subsidiaries

Minority interest in subsidiaries consists of:

	1978	1977
Preferred shares of Petro-Canada Exploration Inc. (\$1,250,000,000 U.S.)	\$1,464,375	\$ —
Common shares of Pacific Petroleum Ltd.	279,790	—
	<u>\$1,744,165</u>	<u>\$ —</u>

On November 10, 1978, Petro-Canada Exploration Inc. ("PEX") issued 12,500,000 floating rate, cumulative, redeemable, non-voting, preferred shares to a group of Canadian chartered banks at \$100 U.S. per share for an aggregate consideration of \$1,250,000,000 U.S. (\$1,464,375,000 Canadian at date of issue).

The shares are redeemable, at the option of PEX, at \$100 U.S. per share, plus accrued dividends, except to the extent that shares in excess of 3,125,000 are redeemed during the three years ending November 10, 1981, such excess shares are redeemable at a premium of \$2 U.S. per share.

Cumulative dividends, payable quarterly, are based on a percentage of, at the option of PEX, either the United States Base Rates, or the London Inter-Bank Offered Rates of the banks. The current dividend rate approximates 6.7% per annum.

Under the terms of an agreement between the banks and the Corporation, in the event that PEX does not exercise its option to redeem the shares over a ten year period beginning December 31, 1983, or in the event of certain occurrences under the provisions of the agreement, the banks have the option to require the Corporation to purchase the shares at \$100 U.S. per share, plus accrued dividends.

9. Capital

Authorized:

The initial authorized capital of the Corporation was \$500 million divided into 100 common shares of the par value of \$5 million each. This was increased to 116 common shares on the acquisition of the capital stock of Panarctic Oils Ltd. previously owned by the Government of Canada.

Pursuant to the Petro-Canada Act, and subject to certain conditions and limitations as to the aggregate amount, the authorized capital of the Corporation is increased by the issue of preferred shares. Accordingly, at any time, the authorized and issued preferred shares are identical. The preferred shares have a par value of \$1 each, are redeemable at par at the option of the Corporation, carry no stated rate of dividend and are non-cumulative.

Issued (to the Government of Canada):

	1978		1977	
	Number of Shares	Consideration	Number of Shares	Consideration
Common Shares				
Balance at beginning of year	56	\$280,000	45	\$225,000
For cash	32	160,000	11	55,000
Balance at end of year	<u>88</u>	<u>\$440,000</u>	<u>56</u>	<u>\$280,000</u>
Preferred Shares				
Balance at beginning of year	258,299,853	\$258,300	158,799,853	\$158,800
For cash	79,500,000	79,500	99,500,000	99,500
Balance at end of year	<u>337,799,853</u>	<u>\$337,800</u>	<u>258,299,853</u>	<u>\$258,300</u>

10. Income Taxes

The provision for income taxes of \$42,109,000 (1977 — \$20,898,000) differs from the result which would be obtained by applying the combined Canadian Federal and Provincial income tax rate of 47% to the earnings before income taxes and minority interest of \$76,495,000 (1977 — \$30,413,000). This difference results from the following items:

	1978		1977	
	Amount	% of earnings before income taxes	Amount	% of earnings before income taxes
Computed "expected" tax expense	\$ 35,953	47.0%	\$14,294	47.0%
Increase (decrease) in taxes resulting from:				
Royalties and other payments to				
Provincial Governments	37,342	48.8	25,311	83.2
Provincial income tax rebate plans	(5,408)	(7.1)	(4,463)	(14.7)
Federal allowances				
Resource allowance	(19,547)	(25.6)	(13,156)	(43.3)
Tax depletion on				
Canadian production income	(10,430)	(13.6)	(8,611)	(28.3)
Frontier exploration allowances	(4,093)	(5.3)	(2,568)	(8.4)
Scientific research allowance	(1,214)	(1.6)	—	—
Non-deductible interest on Bank				
Income Debentures (Note 7)	4,891	6.4	4,960	16.3
Amortization of excess of attributed				
value over book value of				
assets acquired on purchase of				
subsidiary companies	6,436	8.4	5,131	16.9
Equity earnings and dividends	(902)	(1.2)	—	—
Other	(919)	(1.2)	—	—
Provision for income taxes	<u>\$ 42,109</u>	<u>55.0%</u>	<u>\$20,898</u>	<u>68.7%</u>

11. Anti-Inflation Program

The Federal Anti-Inflation Program was discontinued during 1978. During the period the program was in force, the Corporation was subject to and complied with the controls on profit margins and compensation to employees.

12. Comparative Figures

Certain reclassifications have been made to the 1977 comparative figures to conform with the current year's presentation.

13. Subsequent Events

(a) 5% Convertible Subordinated Debentures

On December 18, 1978 Pacific called for the redemption, effective January 17, 1979, of all of the outstanding 5% Convertible Subordinated Debentures. Subsequent to December 31, 1978 \$24,566,000 principal amount of the debentures was converted, at the rate of 26 shares per \$1,000 principal amount, into 638,716 common shares of Pacific and the balance was redeemed.

(b) Acquisition of shares of Pacific

On January 19, 1979 the Corporation, through a subsidiary, made a tender offer to purchase for cash at \$65.02 per share, any and all of the outstanding common shares of Pacific not already held by the Corporation. The offer, as extended, was open until March 12, 1979. By March 15, 1979 the Corporation had acquired approximately 11,000,000 additional shares of Pacific at a cost of \$720,000,000 bringing its total holding to 98% of the issued shares for an aggregate consideration of \$1,467,000,000.

Substantially all of the funds for the above purchases were obtained from the proceeds of the preferred shares issued by PEX (Note 8). The Corporation proposes to acquire the remaining 2.0% of the issued shares of Pacific under the provisions of Section 199 of the Canada Business Corporations Act for an estimated additional consideration of \$29,000,000.