PanCanadian Petroleum Limited

ANNUAL
REPORT
1987

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Company Profile

PanCanadian Petroleum Limited, headquartered in Calgary, Alberta, is engaged, directly and through subsidiaries, in the exploration for and production, transportation and wholesale marketing of crude oil, natural gas, natural gas liquids and sulphur. It is a major producer of crude oil and natural gas in Canada. At year-end PanCanadian had 1 447 employees.

Shareholders' Meeting

The Annual Meeting of Shareholders will be held in the Turner Valley Room of the Palliser Hotel, Calgary, Alberta, at 10:00 a.m. local time on Tuesday, April 12, 1988. Notice of Meeting, Management Proxy Circular and Form of Proxy are being mailed to each shareholder with this report.

Contents

Highlights

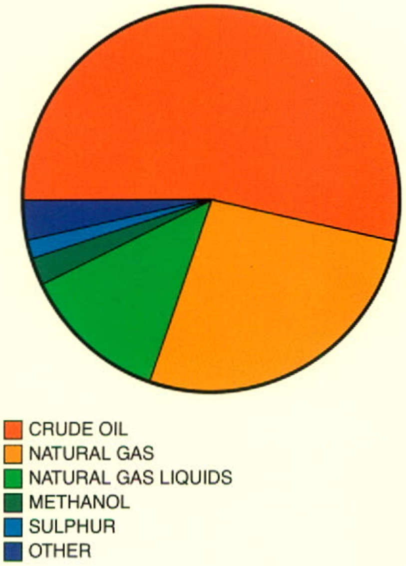
Financial

(Dollar amounts in thousands except per share figures)	1987	1986	% Increase (Decrease)
Gross Income	**$698 651**	$717 001	(2.6)
Funds from Operations	**359 834**	315 689	14.0
Per Share	**2.88**	2.53	14.0
Net Income before unusual item	**181 084**	155 074	16.8
Per Share	**1.45**	1.24	16.8
Net Income	**181 084**	60 320	200.2
Per Share	**1.45**	0.48	200.2
Dividends	**74 926**	87 414	(14.3)
Per Share	**0.60**	0.70	(14.3)
Capital Expenditures	**220 776**	181 071	21.9

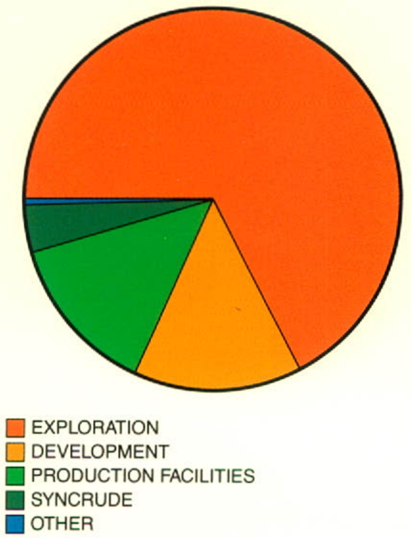
Operating

Daily Production (After Royalty)			
Conventional Crude Oil and Natural Gas Liquids — barrels	**60 204**	59 435	1.3
Synthetic Crude Oil — barrels	**5 377**	5 190	3.6
Natural Gas — million cubic feet	**324.4**	322.2	0.7
Drilling Statistics — Working Interest Wells			
Exploratory Wells Drilled	**258**	134	92.5
Indicated Successes	**161**	69	133.3
Development Wells Drilled	**200**	182	9.9
Indicated Successes	**175**	164	6.7

1987 GROSS INCOME
$698.7 million



1987 CAPITAL EXPENDITURES
$220.8 million



Robert W. Campbell
Chairman of the Board

Bartlett B. Rombough
President and Chief Executive Officer

To the Shareholders

The oil industry faced a changed environment in 1987. Oil prices, although volatile, were on average higher than in 1986, but natural gas prices trended downward until late in the year. In this challenging environment, PanCanadian had a successful year, finishing with a positive view of the future.

PanCanadian's gross income for the year was $698.7 million, a decrease of 3% or $18.4 million from 1986. Net income was up 17% from net income before unusual item in 1986, to $181.1 million or $1.45 per share. Funds from operations of $359.8 million, or $2.88 per share, were 14% higher than last year. Capital expenditures prior to deduction of petroleum incentives were $220.8 million, 22% higher than in 1986. The quarterly dividend rate of 15 cents per share was maintained in 1987.

In 1981, anticipating a prolonged period of difficulties in natural gas markets and having a sufficiency of natural gas reserves, your Company shifted the emphasis of its exploration and development programs towards crude oil. The success of this strategy is reflected in conventional oil production reaching a record high of 42 704 barrels per day in 1987, up 7% over 1986, and an increase of 29% over 1980. Increased pipeline capacities and a relaxation of oil prorationing during the year also contributed to PanCanadian's ability to benefit from strong market demands. Sales of natural gas liquids from field operations were up substantially from the 1986 rate of 5 514 to 7 109 barrels per day in 1987. Production declines at the Empress extraction plants contributed to an overall 10% decline in natural gas liquids to 17 500 barrels per day. PanCanadian's share of synthetic crude oil production from the Syncrude plant in northeastern Alberta was 5 377 barrels per day, also a record high. Natural gas sales in 1987 were 324.4 million cubic feet per day, up 1% from the 1986 rate of 322.2 million cubic feet.

This was the second full year of oil deregulation in Canada. The fluctuation of oil prices in the domestic market reflected the fragile international prices during the year. The sharp decline in Canadian oil prices in December further demonstrated this volatility and the susceptibility of Canadian producers to the crude oil supply and demand imbalances. Concerns are expected to continue with respect to the oversupply and stability of oil prices over the next few years, and your Company will be responsive to these uncertainties through its ongoing cost reduction programs in all areas of operations.

Throughout the last three years, Syncrude has steadily increased production, reduced operating costs and improved safety and loss control, while at the same time constructing a large addition to the plant. Over this period, Syncrude has demonstrated the viability and reliability of mineable oil sands plants, at operating costs which can now be expected to approach competitiveness with conventional crude oil. In 1987 production exceeded design capacity, averaging 137 000 barrels per day. PanCanadian believes that it is now timely to plan the next such plant, which should be the Kearl Lake, or OSLO, project in which your Company has a 5% interest. It is located approximately 20 miles northeast of Syncrude and will be designed to produce approximately 75 000 barrels per day of a premium quality synthetic crude, though the ore body will permit substantial expansion. Negotiations with the provincial and federal governments have begun. If early agreement can be reached, production could commence by 1994 and provide another stepping stone in the growth of your Company.

Natural gas deregulation entered its second year in 1987. In keeping with the concept of deregulation, the National Energy Board adopted new rules for determining the volume of gas which is surplus to domestic needs. This action removed the long-standing mandated gas surplus supply requirement and positioned the industry to capture future export opportunities that may otherwise have been denied. The replacement of surplus tests, with long-term market-based contractual arrangements between a financially sound producing industry and the consuming sector, is a positive means of ensuring adequate markets and the availability of future gas deliveries. The deregulation of natural gas also provided producers with the option of continuing to market gas through traditional resellers or to deal directly with large consumers. Discounts associated with direct sales contributed to a decline in prices, with some indications of prices stabilizing during the fourth quarter.

Reluctance on the part of some provincial regulatory bodies to recognize the necessary distinction in pricing natural gas to reflect the service provided and the manner by which sales should be made to residential and commercial consumers remain as critical issues. Without resolution of these matters, deregulation will remain unfair to producers. Although there are difficulties which have to be resolved before an acceptable level of deregulation is achieved, your Company believes that the outlook for natural gas over the longer term is positive. Accordingly, new programs have been initiated to find and develop additional gas reserves and thereby position the Company to capture the opportunities that will occur.

The year-end estimate of proven plus probable reserves of crude oil and natural gas liquids, before deduction of royalties, increased by 9% from 194.4 million barrels in 1986 to 211.1 million in 1987. Additions of 36.5 million barrels replaced 184% of the 1987 production of 19.8 million barrels. The success and importance of the oil exploration and development program is further evidenced when comparison is made to the 1980 year-end reserves of 156.2 million barrels. Even with this emphasis placed upon oil exploration, marketable natural gas reserves have declined by only 7% since 1980. The estimate of 1987 proven plus probable gas reserves, before deduction of royalties, was 3 508 billion cubic feet as compared to the 1986 estimate of 3 778 billion.

The petroleum industry has been a positive contributor to Canada's balance of trade for more than a decade, and will be able to maintain this role under the Canada-United States Free Trade Agreement. For the petroleum industry, the Agreement is consistent with the Western Accord and the move towards deregulation. Furthermore, it will provide economic incentives in both countries to revitalize businesses and industries, which will experience reduced tariffs and the removal of other non tariff barriers to trade. Long-term security of future oil and gas supplies will be assured by the terms contained in the Free Trade Agreement and by a vigorous petroleum industry participating in a more open market place. Large-scale capital-intensive projects are dependent upon access to a consumer base which provides the necessary economies of scale. These major projects lead to increased employment not only in western Canada but in other regions of the country as well. The alternative to the Free Trade Agreement will not be the status quo but more likely a slide towards policies of isolationism which are untenable in the global business community of today. For these reasons your Company supports the Free Trade Agreement, not only for the benefits it will receive but more importantly for the benefits to future generations of all Canadians.

The combination of financial strength, a large resource base and the demonstrated abilities of our employees to work as an efficient team places PanCanadian in a strong and competitive position in the new industry environment.

The Board of Directors congratulates the following six Company officers upon their new appointments: J.J. Doolan as Comptroller; G.E. Little as Vice President and Corporate Secretary; L.D. MacDonald as Vice President, Human Resources; D.N. Maxwell as Vice President, Accounting and Information Services; J.A. Tamblyn as Vice President, Law; and K.A. Wurzer as Vice President and Treasurer.

Submitted on behalf of the Board of Directors,

Robert W. Campbell

Robert W. Campbell
Chairman of the Board

Bartlett B. Rombough

Bartlett B. Rombough
President and Chief Executive Officer

Calgary, Alberta
February 18, 1988

"... your Company believes that the outlook for natural gas over the longer term is positive."

Markets

The oversupply of world crude oil and North American natural gas continued to have an impact on, and contributed to, the restructuring of the North American oil and gas industry during 1987. The crude oil price environment remained fragile, and the surplus of natural gas intensified competition for gas markets in North America throughout the year.

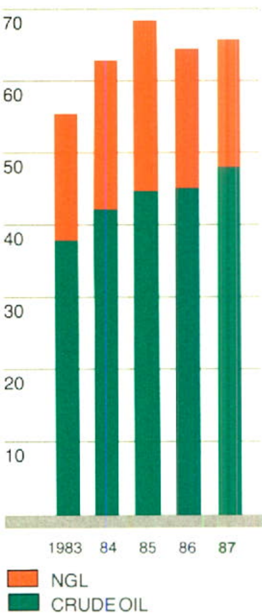
Canadian demand for domestic crude oil increased 1% over 1986 and exports, mainly to United States markets, increased by 8%. Natural gas demand by Canadian consumers was down marginally from 1986, with exports increasing by 20%. Demand and prices for natural gas liquids were both weaker in 1987, resulting from considerably higher North American inventories of these products and warmer than normal temperatures throughout traditional market areas.

Crude Oil

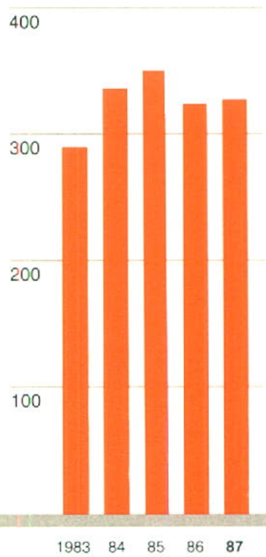
Throughout most of 1987, the world light crude oil price remained at or above US $18.00 per barrel and was reflected by refiner postings at Edmonton ranging between $22.00 and $27.00 per barrel for most of 1987, closing the year at $20.50. Although instances of overproduction by members of the Organization of Petroleum Exporting Countries (OPEC) occurred as early as the first quarter, it became very apparent by the third quarter that OPEC producers were surpassing the quotas set at their December, 1986 meeting. These actions, combined with continuing non-OPEC production increases and modest demand increases, reduced confidence in OPEC's ability to maintain steady crude oil prices near year-end.

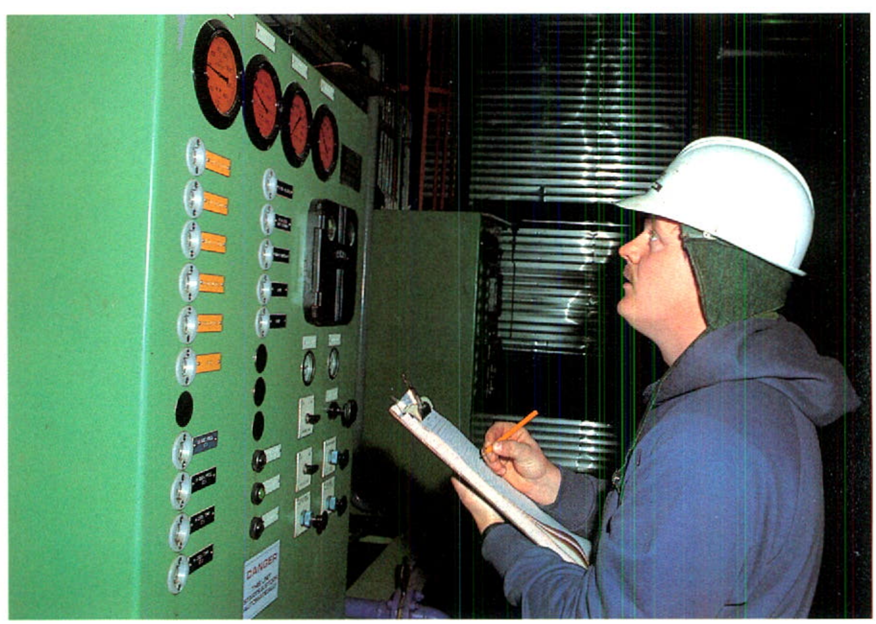
Interprovincial Pipeline Limited completed a major expansion program late in the year. This pipeline expansion, combined with the implementation of a modified

NET CRUDE OIL & NGL PRODUCTION
(thousand barrels per day)



NET NATURAL GAS SALES
(million cubic feet per day)





Checking control panel at Carseland gas plant crude oil market proration plan, improved access to the highest value markets. The marketing efforts of your Company resulted in crude oil deliveries to these markets being maintained at high levels.

Although Canadian refiners remain the largest buyer for Canadian crudes, the refineries in the United States northern tier provide a strong market for a broad range of Canadian crude oils. Their ability to process large volumes of heavy crudes contributed to an increase in Canadian crude exports during 1987. PanCanadian sold nearly half of its crude oil production into this market.

Natural Gas

Surplus supplies of natural gas continued to encourage intense competition between gas suppliers and to depress natural gas field prices during 1987. Deregulation initiatives in both Canada and the United States allowed considerably more gas to be sold on a direct basis, putting even more downward pressure on prices.

Several new natural gas pipeline projects were announced in 1987. These projects, which require approval by the National Energy Board, would provide access for Canadian natural gas to several additional market areas. Application has been made for the expansion of TransCanada PipeLines Limited's eastern Canadian pipeline facilities which would enable gas to reach the northeastern United States market through the proposed Iroquois project. Two of PanCanadian's resellers would be suppliers to this venture. In addition, Northern Border Pipeline Company has applied to the United States regulatory authorities to extend its pipeline in the midwest and to expand capacity on the rest of its system.

The first full year of natural gas price deregulation in Canada was 1987. With the intensified competition for markets, prices declined sharply throughout the year but strengthened somewhat at year-end. Direct sellers, under short-term contracts, captured a larger share of the gas markets at the expense of long-term contracted gas supply. Despite these difficulties, PanCanadian succeeded in securing new long-term sales contracts for solution gas from the Rycroft, Hythe and Halkirk areas of Alberta.

Other Products

Prices of natural gas liquids remained depressed during 1987 because of oversupply conditions. PanCanadian's sales volumes decreased, reflecting the decline in the volume of natural gas processed at the Company's straddle plant facilities at Empress. This decline was partially offset by increased production from field operations.

Gas facilities at Hussar-Crowfoot

PanCanadian's sales volumes of sulphur decreased 3% and prices declined significantly in response to reduced demand for sulphur for fertilizer manufacture due to the depressed worldwide agricultural industry. The global methanol supply and demand balance improved during 1987 and resulted in an increase in the price of methanol by year-end.

"... conventional oil production reached a record high of 42 704 barrels per day."

Operations

PanCanadian directed its 1987 activities in areas identified to be most promising for early cash flow and to those offering longer-term potential. Overall capital expenditures increased for exploration, development and production activities. Primary emphasis was in Alberta where economic factors and the potential for significant reserves additions are most favourable. Inherent in the performance of these activities was continued emphasis on operating expense reduction and enhancement of reserves, productivity and profitability.

The year 1987 was highlighted by the recovery of oil prices to levels in the US $18 to $20 per barrel range for most of the year. Your Company acted upon this positive development with cautious optimism. While total capital expenditures for conventional exploration, development and production were 30% higher than in 1986, a cost-effective emphasis was maintained in all operations. Oil exploration, development and production activities maintained priority, with a decided focus on increasing production and sales while replacing and enlarging oil reserves.

With respect to natural gas, Company efforts were directed principally towards maintaining contractual deliverability and market share. Exploration activity included commencement of some projects aimed towards finding large gas reserves, to ensure your Company's ability to maintain and increase production capability into the future.

In 1987, PanCanadian had an interest in 717 wells drilled, up from 492 in 1986. These drilling activities included a total of 458 working interest wells, of which 423 were in the western provinces of Canada and 35 were in the

Working Interest Holdings in Petroleum and Natural Gas Rights

	December 31, 1987		December 31, 1986	
	Gross Acres	**Net Acres**	Gross Acres	Net Acres
CANADA				
Alberta	**8 238 180**	**6 765 308**	8 287 255	6 819 388
British Columbia	**369 537**	**118 340**	416 803	144 486
Manitoba	**270 740**	**265 840**	270 358	265 503
Northwest Territories and Yukon Territory	**31 770**	**12 125**	281 313	58 767
Offshore — East Coast	**49 873**	**5 103**	49 873	5 103
Saskatchewan	**637 406**	**574 272**	681 809	593 770
	9 597 506	**7 740 988**	9 987 411	7 887 017
UNITED STATES				
California	**18 432**	**8 399**	36 499	25 343
Colorado	**17 644**	**8 879**	10 784	5 519
Kansas	**57 503**	**52 250**	80 519	78 076
Mississippi	**28 283**	**10 833**	49 981	22 232
Montana	**3 404**	**2 775**	3 445	2 825
Nebraska	**12 822**	**10 101**	11 297	9 311
Nevada	**—**	**—**	10 442	10 442
North Dakota	**22 955**	**4 370**	13 328	2 234
Offshore	**21 520**	**3 493**	10 000	3 075
Texas	**70 961**	**28 751**	67 342	39 866
Utah	**151 276**	**48 106**	156 268	60 828
Wyoming	**46 078**	**20 537**	48 856	25 730
Other	**22 467**	**12 009**	30 320	14 642
	473 345	**210 503**	529 081	300 123
INTERNATIONAL				
United Kingdom — North Sea	**—**	**—**	244 826	44 732
	10 070 851	**7 951 491**	10 761 318	8 231 872

Notes:
Does not include:
1. PanCanadian's interest in Minerals Ltd. and Panarctic Oils Ltd. lands of 30 366 and 53 987 net acres, respectively.
2. Acreage under lease or sublease, reserving to PanCanadian, or its subsidiaries, royalties or other interests — 3 056 108 acres.

United States. Of these wells, PanCanadian was the operator of 268 in Canada and 16 in the United States. Participation in exploratory drilling totalled 258 wells, resulting in 129 oil wells and 32 gas wells, while a total of 200 development wells were drilled, of which 153 were oil wells and 22 were gas wells.

During the year, PanCanadian recorded 2 000 miles of seismic data in western Canada, an increase of 36% over 1986. The program included an increase in the amount of three-dimensional seismic data obtained on both exploration and development plays. Advanced technological equipment has been acquired to supplement current interpretative techniques and is expected to increase significantly the efficiency with which geophysical data can be analyzed.

The recovery in oil prices stimulated industry competition for petroleum and natural gas rights in Canada, with expenditures approaching 1985 levels. PanCanadian was successful in acquiring such rights, principally in Alberta, covering 150 000 net acres at a cost of $26 million. The Company's year-end land holdings remain relatively unchanged from 1986 and consist of 10.1 million gross acres or 8.0 million net acres.

The implementation of new waterflood schemes, in combination with successful drilling projects, generated increased oil production which more than offset the natural declines in the long established working and royalty interest properties.

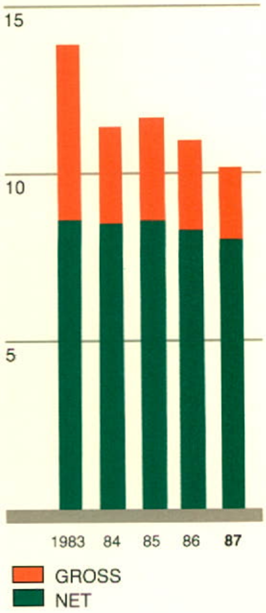
Production

(After Royalty)	**1987**	1986	% Increase (Decrease)
Conventional crude oil — barrels per day	**42 704**	39 995	6.8
Natural gas liquids — barrels per day			
field facilities	**7 109**	5 514	28.9
Empress plants	**10 391**	13 926	(25.4)
Synthetic crude oil — barrels per day	**5 377**	5 190	3.6
Natural gas — million cubic feet per day	**324.4**	322.2	0.7
Sulphur — long tons per day	**322**	332	(3.0)
Methanol — tonnes per day	**574**	502	14.3

A comparison of net daily average production volumes for 1987 and 1986, using sales where appropriate, is presented in the above table.

Single well facility at Ferrybank

LAND HOLDINGS
(millions of acres)



"Oil exploration, development and production activities maintained priority . . ."

Areas of Major Activity

Southern Alberta

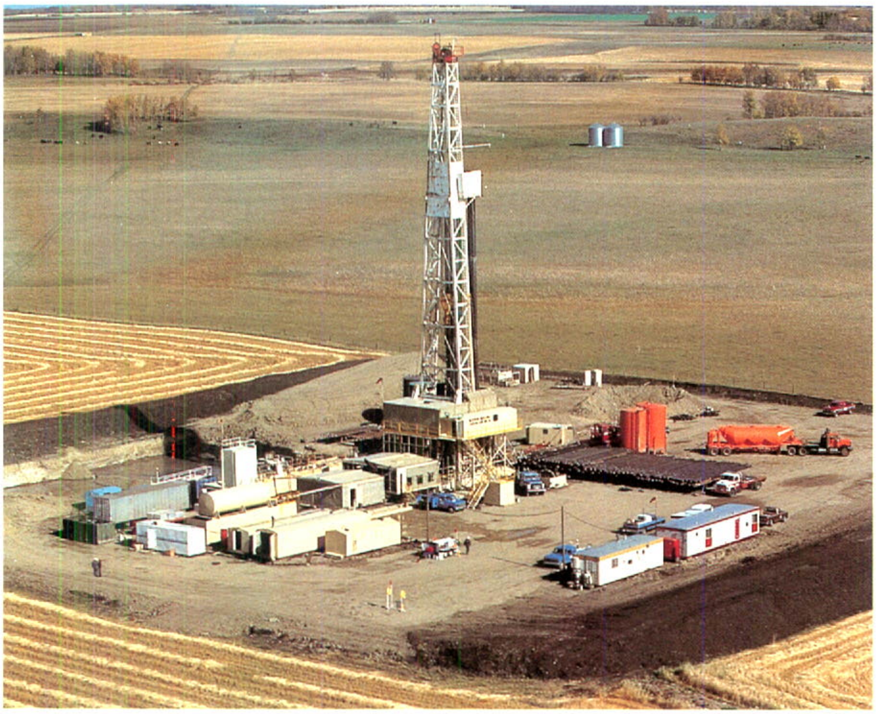
New oil plays in the Carseland and Rockyford areas were tested by the drilling of six successful exploratory wells. Potential oil reserves for these combined areas are 2.5 million barrels based on current mapping of the reservoirs. Further exploratory drilling and subsequent development plans are expected to verify and expand this new potential.

The production capability of several oil pools in the Alderson West area was increased by 180 barrels per day as a result of the drilling of five successful exploratory and development wells. An additional 350 barrels of daily oil production were realized, beginning in April, from the implementation of the Johnson "B" waterflood. PanCanadian's net daily oil production from this area is now up to 3 200 barrels.

In the Medicine Hat area, PanCanadian extended its 1986 oil play by drilling four successful exploratory wells on the trend. Earlier finds were further delineated in 1987 by the drilling of ten development wells which increased oil production in the area by 400 barrels of oil per day to 760 barrels per day. The Company made significant additions to land holdings in this prospective area in order to facilitate the continuing search for more oil reserves.

With the tie-in of six wells at Hussar Crowfoot and the drilling of five infill wells at Makepeace, gas production and contract deliverability were maintained at these properties.

The in situ combustion pilot project operated by PanCanadian at Countess continues to operate successfully. The caustic-polymer pilot at Horsefly, which has been terminated because of insufficient incremental oil, provided valuable technical information for future enhanced oil recovery schemes.



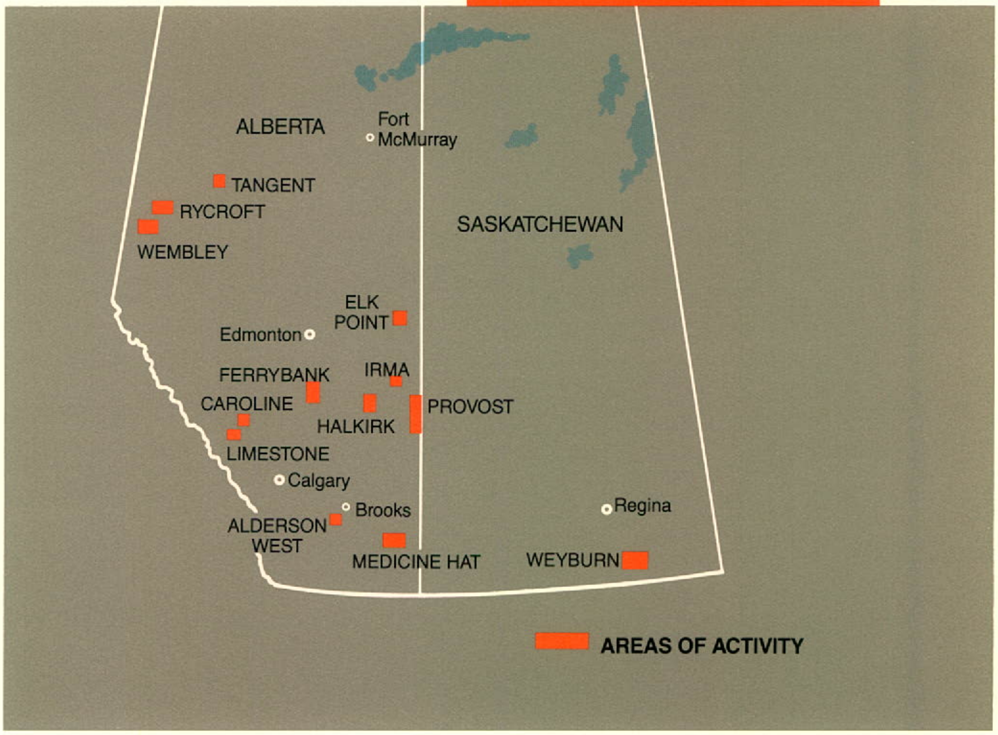
PanCanadian drill site near Olds, Alberta

Central Alberta

PanCanadian continued to explore new oil plays and develop existing pools in the large Provost area, where significant potential exists and sustained activity is planned. The 1987 exploration program resulted in nine oil wells in three different geological zones. During the same period 17 development wells were also drilled, increasing the total number of PanCanadian operated wells to 43. Net Company production from these, plus 89 additional working interest wells in the area, doubled to 3 000 barrels per day at year-end. Planning is well underway for the installation of three central batteries and oil gathering systems, as well as a waterflood scheme, in order to recover more efficiently and economically the oil reserves added throughout this area. Production from the Company's heavy oil project at North Bodo was expanded to 880 barrels per day with the drilling of six wells. The possibility of an enhanced oil recovery scheme utilizing steam stimulation adds to the productivity potential of this project.

In the Halkirk area, unitization of the Rio Bravo oil field was finalized and PanCanadian netted a 77% interest in the resulting Halkirk Upper Mannville Unit. Facilities were constructed for a major waterflood and a gas conservation installation was completed. Water injection commenced by mid-year and waterflood status was received September 1, 1987. At year-end, the Company's net daily oil production from this Unit was 3 300 barrels compared with 1 000 barrels at year-end 1986. A ten well development program, commenced in late 1987, is expected to increase the recovery factor and the allowable production rates. Additional geophysics and exploratory drilling are planned to evaluate further Company lands in this area.

At Ferrybank, PanCanadian commenced a drilling program to delineate Belly River oil reserves under its acreage. This program resulted in 36 oil wells, providing an aggregate production capacity of 1 500 barrels of oil per day from 100% PanCanadian-held lands. By year-end, 15 of these wells were on



production, yielding a total of 750 barrels of oil per day. Designing of battery facilities for installation in 1988 and initial planning for future waterflood was also initiated. Reduced spacing has allowed a large number of infill wells to be drilled in order to tap reserves, initially established at 28 million barrels of oil-in-place, with the primary oil recovery factor expected to be 9%.

Another oil field discovered this year, in the Irma area, represents a rapidly expanding oil play evaluated to date by the drilling of 59 wells. PanCanadian has a 50% interest in 35 wells, representing current net production of 450 barrels of oil per day, from net recoverable reserves presently established at 1.5 million barrels. PanCanadian's share of future production is expected to approach 800 barrels of oil per day, following an infill drilling program on reduced spacing and the implementation of a waterflood scheme planned for 1988.

Production from PanCanadian's heavy oil reserves at Elk Point approximated 1986 levels of 1 800 barrels of oil per day. Six wells were drilled in late 1987 and resulting production increases will be realized in 1988. Experimentation with steam stimulation, deviated wells and crude transportability by pipeline continued through 1987 and is expected to advance through 1988. Cost reductions and productivity gains, together with increased oil prices, contributed to this project's improved operating income in 1987.

PanCanadian drilled four successful gas wells in the Hoadley area, resulting in a net increase of 15 billion cubic feet in proven gas reserves, with an excellent deliverability potential. Further activity is planned for this area.

One of the highlights of PanCanadian's search for large deep gas reserves was the acquisition of a 62.5% interest in 11 200 acres at Limestone Mountain, at a cost of $5.8 million. Shortly after this acquisition, a 50-mile seismic program was carried out to supplement existing data. Interpretation of this information is complete and drilling plans are finalized. Drilling at the first location will commence during 1988 upon completion of the critical gas well licensing process required by the Alberta Energy Resources Conservation Board.

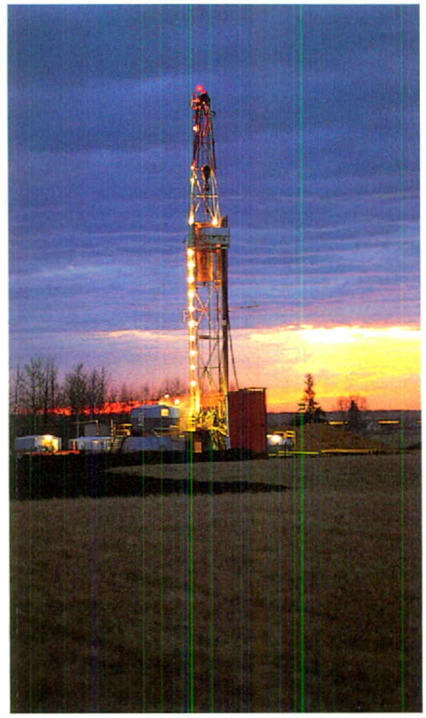
Strap jack at Medicine Hat

A highly competitive deep gas play is also being pursued by the Company in the Caroline area. Two exploratory deep gas tests have commenced on 100% Company acreage. These wells, and anticipated future wells on Company lands, will contribute to the delineation of the large Caroline Swan Hills gas field, which has been estimated to cover more than 50 sections of land and contain over two trillion cubic feet of sour gas reserves. Unitization plans are currently under discussion for the area. PanCanadian has a royalty interest in nine sections of land, including one on which the second well in this pool was drilled, and 100% ownership in five other sections, all of which are in or immediately adjoining the area under discussion. This representation could be significant to the Company for both royalty and working interest income.

At Chedderville, to the northwest of Caroline, two 100% PanCanadian exploratory wells were also under way to test the deep gas potential of over 4 000 acres of Company-held lands. Successful results from one or both of these wells should encourage further drilling evaluation of these holdings.

Northern Alberta

The Company continued its high level of activity in northern Alberta in 1987. Further development of the oil play in the Rycroft area, in which your Company has a 50% interest, involved the drilling of six development wells, installation of a battery, start-up of a second waterflood scheme and construction of a gas plant to process solution gas. The drilling program, along with the waterflood, enhanced Company interest production by 700 barrels per day by year-end.



Drilling at Ferrybank

In the Wembley area, a unitized gas cycling scheme involving a 14% participation by the Company is successfully enhancing the recovery of natural gas liquids from the large gas cap overlying the main oil pool. Company representation in the oil pool is approximately 35%. This property contributes daily production of approximately 1 350 barrels of oil, 1 400 barrels of liquids and 3.5 million cubic feet of gas to the Company.

A continuing program in the Tangent field in 1987 involved conducting a 2.5 square mile three-dimensional seismic program which contributed directly to the drilling of five successful oil wells. PanCanadian has working interests of 25% to 50% in this field and net production of 1 200 barrels of oil per day at year-end.

Saskatchewan

The 1987 development drilling program in the Weyburn Unit added 12 infill oil wells, completing an 84-well infill program conducted over the past three years. The results of the 1987 wells increased total Unit production by 750 barrels of oil per day of which your Company's share is approximately 21%. The entire program has resulted in a total pool increase, by 18 million barrels, to 78 million barrels of projected recoverable reserves, while increasing sustained total daily oil production capacity by 50%, from 10 000 barrels per day to 15 000 barrels per day. A polymer pilot project is being planned to enhance production levels by improving on current waterflood performance and thereby further increasing the amount of oil recoverable from this reservoir.

United States

In 1987, PanCanadian Petroleum Company participated in the drilling of 24 exploratory and 11 development wells which resulted in one gas and 10 oil wells. Of significance, two PanCanadian-operated wells in Jones County, Mississippi, were completed as oil wells. It is anticipated that they will produce at a combined rate of 120 net barrels per day. A working interest well located in the Powder River Basin of Wyoming was completed and is currently producing 140 net barrels of oil per day. A waterflood was initiated in the West Kiehl Field in Wyoming and the Company expects to realize resulting production increases during 1988. A wholly-owned Company well located in Rooks County, Kansas, was completed as an oil well with a current production rate of 130 barrels of oil per day. Also in Kansas, four additional wells were drilled in the Pen Field and planning for a waterflood scheme has commenced. The 1987 completion of a gas and gas liquids plant at the Anschutz Ranch East Unit in Utah is expected to more than double the rate of such gas liquids production from this field.

During the year, PanCanadian continued its active leasing program by acquiring 40 000 net acres of land primarily in Mississippi, Nebraska, Kansas and Wyoming.

United Kingdom North Sea

In 1987, PanCanadian sold its United Kingdom subsidiary including all of its working interests, varying from 4.5% to 20%, in North Sea properties. PanCanadian received CDN $3.7 million and retained a 4.25% overriding royalty on the interests sold in the properties.

Testing shutdown valves in Weyburn water injection system

"... total reserves before royalty ... were 848.1 million barrels of oil equivalent."

Reserves

PanCanadian's 1987 year-end proven plus probable reserves, before deduction of royalties were 211.1 million barrels of conventional crude oil and natural gas liquids, 3.5 trillion cubic feet of marketable natural gas, 2.1 million long tons of sulphur and coal reserves amounted to 2.2 billion short tons. The Company's share of permitted Syncrude reserves was 52.3 million barrels of synthetic crude oil.

At year-end, PanCanadian's total reserves before royalty, including synthetic crude oil, were 848.1 million barrels of oil equivalent, compared to 878.4 million barrels in 1986.

Conventional Crude Oil and Natural Gas Liquids

The year-end estimates of total proven plus probable reserves of crude oil and natural gas liquids were 211.1 million barrels, before deduction of royalties. This is a 9% increase from the 1986 total of 194.4 million barrels. Total additions of 36.5 million barrels replaced 184% of the 1987 production of 19.8 million barrels.

Waterflood additions, reservoir performance and additions from drilling were the chief contributors to the increase in the total reserves.

At 1987 production levels, which were 11% higher than in 1986, the reserve life index for conventional crude oil and natural gas liquids is 10.7 years, compared to the previous year's 10.9 years.

Natural Gas

The Company's remaining total proven plus probable marketable natural gas reserves, before royalty, decreased by 7% to 3 508 billion cubic feet from the 1986 year-end total of 3 778 billion cubic feet. Reserves additions due to drilling were more than offset by overall downward revisions, primarily in the Company's capped gas inventory as well as in its outside-operated properties.

Based on the 1987 production rate of 125 billion cubic feet, the Company's reserve life index for natural gas is 28.1 years compared to 30.2 years in 1986.

Sulphur

PanCanadian's sulphur reserves increased by 555 thousand long tons to 2 110 thousand long tons at year-end. The increase is due mainly to a revised yield factor in the Calgary Crossfield Wabamun "A" Pool and new reserves additions in a royalty interest well in Caroline.

Coal

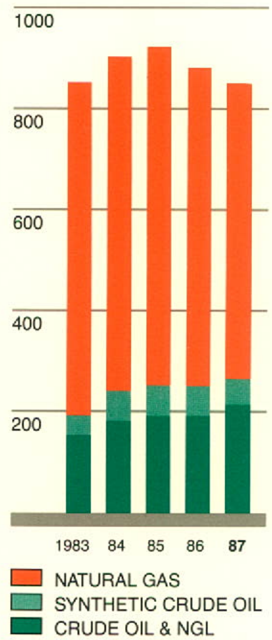
PanCanadian's remaining recoverable proven plus probable reserves of coal, before royalty, totalled 2.2 billion short tons, of which 1.0 billion short tons are surface mineable.

Operator at heavy oil facilities in Lindbergh

Proven and Probable Reserves

	Conventional Crude Oil & Natural Gas Liquids (thousand barrels)	Marketable Natural Gas (billion cubic feet)	Sulphur (thousand long tons)	Coal (million short tons)	Synthetic Crude Oil (thousand barrels permitted)
Reserves at January 1, 1987 Before Royalty	194 366	3 778	1 555	2 249	54 345
Addition (Deletion):					
Drilling	12 843	48	138	—	
Reviews and Other Revisions	23 662	(193)	530	—	
	36 505	(145)	668	—	
Less: Production	19 803	125	113	1	
Reserves at December 31, 1987 Before Royalty	211 068	3 508	2 110	2 248	52 332
Less: Royalty Deductions	16 519	157	142	11	
Reserves at December 31, 1987 After Royalty	194 549	3 351	1 968	2 237	
Proven Reserves at December 31, 1987					
Before Royalty	150 418	2 401	1 403	1 027	
After Royalty	138 322	2 293	1 286	1 021	
Probable Reserves at December 31, 1987					
Before Royalty	60 650	1 107	707	1 221	
After Royalty	56 227	1 058	682	1 216	

TOTAL RESERVES
(millions of barrels of oil equivalent before royalty)



Six thousand cubic feet of natural gas equals one barrel of oil equivalent.

Notes:

The reserves estimates were calculated by Company engineers.

Volumes do not include the Company's interest in Panarctic Oils Ltd., Minerals Ltd. or sulphur from the Syncrude project.

Proven reserves are those quantites of crude oil, natural gas, natural gas liquids and sulphur which geological and engineering data demonstrate with reasonable certainty to be recoverable from known oil or gas reservoirs under existing economic and operating conditions.

Probable reserves are those additional quantities estimated to be recoverable from known oil and gas reservoirs but that lack, for various reasons, the certainty required to classify the reserves as proven.

Marketable natural gas comprises gases from which certain hydrocarbon and nonhydrocarbon compounds have been removed or partially removed by processing where necessary to meet pipeline or other market specifications.

Surface mineable coal reserves comprise coal to a maximum strip ratio of 15 cubic yards of overburden to one ton of coal, to a maximum depth of 150 to 200 feet.

Synthetic crude oil reserves represent the Company's share of Syncrude volumes remaining under the Alberta Energy Resources Conservation Board permit.

"Improved results were primarily due to higher crude oil prices and produc- tion ..."

Financial

Results of Operations

In 1987, PanCanadian recorded increased net income and funds from operations, while gross income reflected a marginal decrease from 1986. Gross income of $698.7 million decreased 3% from 1986. Net income increased $26.0 million to $181.1 million or $1.45 per share, from $155.1 million or $1.24 per share before unusual item in 1986. Funds from operations increased 14% to $359.8 million or $2.88 per share, from $315.7 million or $2.53 per share the previous year. Improved results were primarily due to higher crude oil prices and production and the elimination of the Petroleum and Gas Revenue Tax in 1986.

Net income for 1986 reflected a $94.8 million unusual item, representing a ceiling test write-down of the carrying value of the Company's non-Canadian properties resulting from the adoption of the guideline for full cost accounting issued by the Canadian Institute of Chartered Accountants.

Income

During 1987, conventional crude oil revenue increased $82.2 million or 34% to $326.8 million. Of this increase, $67.3 million was attributable to higher prices and $14.9 million to increased volumes. The weighted average price per barrel for conventional crude oil received by PanCanadian was $20.96 compared with $16.75 in 1986.

Quarterly Results
(millions of dollars except per share figures)

1987 by Quarter

	1st	2nd	3rd	4th	Total Year
Gross income	**$171.2**	**$160.2**	**$173.6**	**$193.7**	**$698.7**
Net income	**45.6**	**34.3**	**49.0**	**52.2**	**181.1**
— per share	**0.37**	**0.27**	**0.39**	**0.42**	**1.45**
Funds from operations	**89.6**	**74.5**	**90.8**	**104.9**	**359.8**
— per share	**0.72**	**0.59**	**0.73**	**0.84**	**2.88**

1986 by Quarter

	1st	2nd	3rd	4th	Total Year
Gross income	$237.5	$156.6	$137.1	$185.8	$717.0
Net income before unusual item	57.3	38.5	19.5	39.8	155.1
— per share	0.46	0.31	0.15	0.32	1.24
Funds from operations	98.6	75.0	52.4	89.7	315.7
— per share	0.79	0.60	0.42	0.72	2.53

Synthetic crude oil sales increased $9.4 million from $36.9 million in 1986 to $46.3 million in 1987. Higher prices contributed $8.1 million and increased volumes $1.3 million to this gain. The weighted average price per barrel rose 21% to $23.59 in 1987 compared to $19.48 in 1986.

Natural gas liquids sales from the Company's field operations were $38.3 million compared to $33.5 million in 1986. The increase of $4.8 million or 14% was due to higher sales volumes resulting from the installation of additional field facilities, partially offset by decreased prices. PanCanadian received a weighted average price per barrel of $14.74 compared to $16.63 in 1986.

Revenue from natural gas liquids extracted at the Empress plants decreased $23.1 million from $73.1 million in 1986 to $50.0 million in 1987, mainly due to a reduction in natural gas throughput at the plants. Of this decrease, $20.0 million or 87% was attributable to decreased sales volumes. The weighted average price per barrel realized for Empress production decreased from $14.26 in 1986 to $12.04 in 1987.

Natural gas sales amounted to $187.1 million, a $63.2 million or 25% decrease from the $250.3 million recorded in 1986. Of this decrease, $67.4 million was attributable to lower selling prices, partially offset by a $4.2 million increase due to volume. The weighted average price per thousand cubic feet received by PanCanadian in 1987 was $1.57, 26% less than the $2.12 received in 1986.

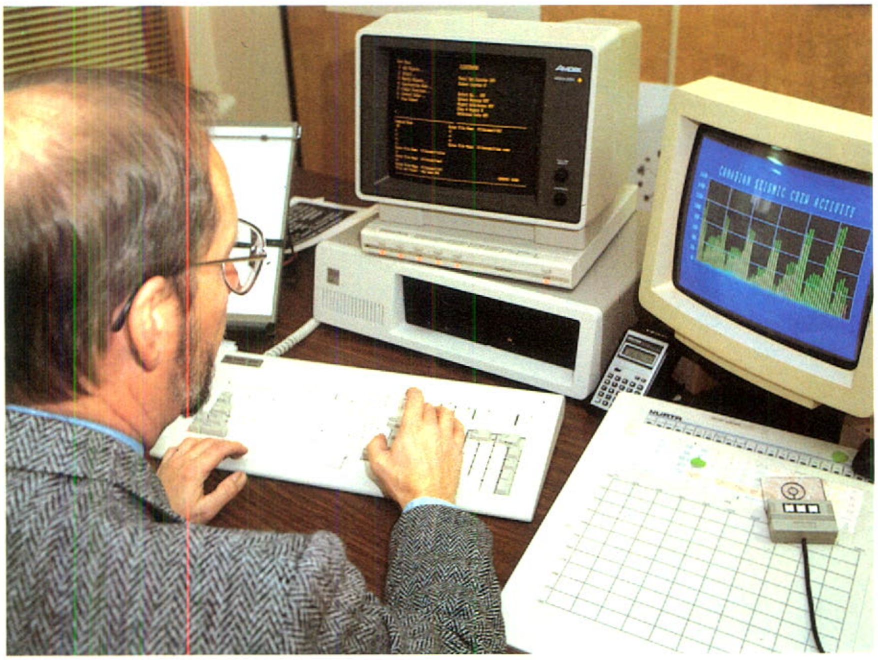
Income
(thousands of dollars)

	1987		1986		Increase (Decrease)	
	Amount	**%**	Amount	%	Amount	%
Crude oil						
conventional	**$326 768**	**46.8**	$244 582	34.1	$ 82 186	33.6
synthetic	**46 303**	**6.6**	36 909	5.1	9 394	25.5
Natural gas liquids						
field facilities	**38 243**	**5.5**	33 462	4.7	4 781	14.3
Empress plants	**49 962**	**7.1**	73 059	10.2	(23 097)	(31.6)
Natural gas	**187 093**	**26.8**	250 266	34.9	(63 173)	(25.2)
Methanol	**16 918**	**2.4**	18 444	2.6	(1 526)	(8.3)
Sulphur	**9 530**	**1.4**	16 247	2.3	(6 717)	(41.3)
Other	**23 834**	**3.4**	44 032	6.1	(20 198)	(45.9)
	$698 651	**100.0**	$717 001	100.0	$(18 350)	(2.6)

Methanol sales decreased 8% or $1.5 million from 1986, primarily as a result of lower prices during the early part of the year.

Revenue from sulphur sales decreased $6.7 million to $9.5 million, primarily due to a 39% decline in prices. The weighted average price per long ton received in 1987 was $81.07 compared to $133.98 in 1986.

Revenue from other sources decreased $20.2 million, primarily due to the recording in 1986 of a $15.1 million gain related to the purchase of income tax credits and a $10.8 million gain resulting from the exercise of an option pertaining to the Company's investment in the methanol plant. These decreases were partially offset by an increase in interest income of $5.5 million.



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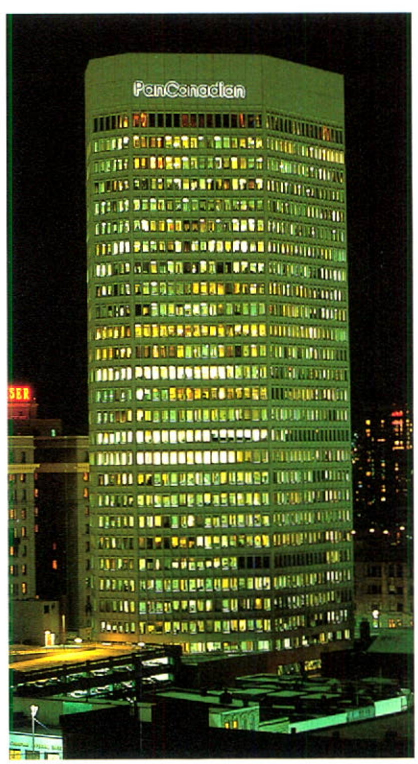
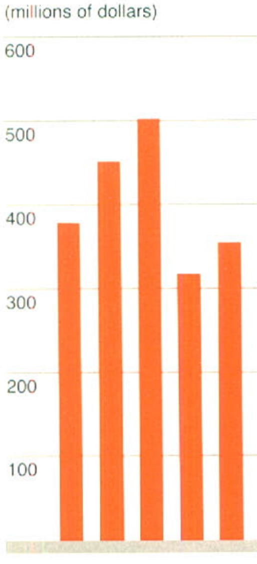


Corporate headquarters in Calgary

FUNDS FROM OPERATIONS
(millions of dollars)



Expenses

Operating expenses totalled $186.3 million, a decrease of 15% from $219.1 million in 1986. Expenses for conventional crude oil decreased $3.1 million or 5% to $62.6 million despite a 7% increase in production, and expenses for natural gas and related products decreased $5.2 million or 11% to $40.4 million. Syncrude operating expenses were $29.9 million, a 5% increase over last year as a result of increased plant production. Operating expenses related to the Empress plants decreased 41% to $34.0 million due to decreased production volumes and lower natural gas prices. Methanol plant expenses were $19.4 million, a decrease of $2.1 million resulting from lower natural gas feedstock costs.

Administrative expenses decreased 12% from $45.8 million in 1986 to $40.4 million in 1987 as a result of measures taken in 1986 and 1987 to improve efficiency.

Interest expense for 1987 decreased $12.9 million from the previous year as a result of debt retirement during 1986.

Depreciation and depletion expenses increased from $143.7 million to $156.6 million in 1987 as a result of increased production and costs of finding and developing new reserves.

Taxes

Income and revenue taxes amounted to $124.8 million in 1987, a decrease of $6.1 million or 5% from 1986. The effective tax rate decreased from 46% in 1986 to 41% in 1987, primarily due to the elimination of the Petroleum and Gas Revenue Tax effective October 1, 1986. The 1987 provision for current income taxes of $103.1 million, compared to $89.2 million in 1986, reflects an increase in the Alberta income tax rate from 11% to 15% effective April 1, 1987 and higher operating revenue, partially offset by increased exploration and development expenditures. The provision for deferred income taxes increased 26% to $21.7 million.

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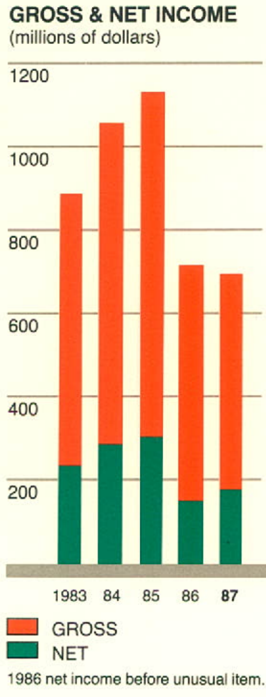
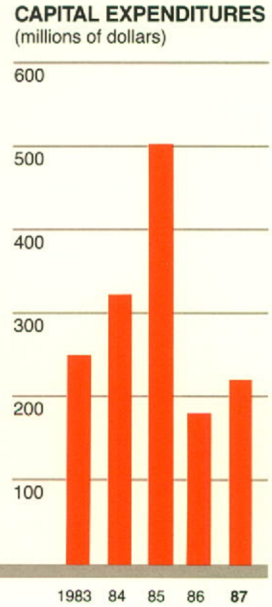
Expenses
(thousands of dollars)

	1987		1986		Increase (Decrease)	
	Amount	**%**	Amount	%	Amount	%
Operating expenses						
Crude oil						
conventional	**$ 62 601**	**15.9**	$ 65 750	15.2	$ (3 149)	(4.8)
synthetic	**29 925**	**7.6**	28 472	6.6	1 453	5.1
Natural gas liquids						
Empress plants	**33 970**	**8.6**	57 798	13.4	(23 828)	(41.2)
Natural gas and related products	**40 364**	**10.3**	45 540	10.6	(5 176)	(11.4)
Methanol	**19 447**	**5.0**	21 547	5.0	(2 100)	(9.7)
	186 307	**47.4**	219 107	50.8	(32 800)	(15.0)
Administrative	**40 376**	**10.3**	45 815	10.6	(5 439)	(11.9)
Interest	**9 496**	**2.4**	22 408	5.2	(12 912)	(57.6)
Depreciation	**57 660**	**14.7**	52 720	12.3	4 940	9.4
Depletion	**98 951**	**25.2**	90 999	21.1	7 952	8.7
	$392 790	**100.0**	$431 049	100.0	$(38 259)	(8.9)





Capital Expenditures
(thousands of dollars)

	1987		1986		Increase (Decrease)	
	Amount	**%**	Amount	%	Amount	%
Exploration						
Land acquisition and rental — net	**$ 32 028**	**14.5**	$ 7 949	4.4	$ 24 079	302.9
Geological and geophysical	**20 395**	**9.2**	12 781	7.0	7 614	59.6
Exploratory drilling	**53 757**	**24.4**	36 748	20.3	17 009	46.3
Overhead and mineral acreage tax	**43 277**	**19.6**	44 893	24.8	(1 616)	(3.6)
	149 457	**67.7**	102 371	56.5	47 086	46.0
Development drilling	**31 822**	**14.4**	20 812	11.5	11 010	52.9
Facilities and equipment						
Well equipment	**9 839**	**4.5**	7 119	4.0	2 720	38.2
Oil facilities	**11 463**	**5.2**	13 939	7.7	(2 476)	(17.8)
Gas facilities	**7 590**	**3.4**	17 043	9.4	(9 453)	(55.5)
Syncrude	**9 184**	**4.2**	9 800	5.4	(616)	(6.3)
Other	**1 421**	**0.6**	9 987	5.5	(8 566)	(85.8)
	39 497	**17.9**	57 888	32.0	(18 391)	(31.8)
	$220 776	**100.0**	$181 071	100.0	$ 39 705	21.9

Capital Expenditures

During 1987, capital expenditures prior to petroleum incentives totalled $220.8 million, an increase of $39.7 million or 22% from 1986 expenditures of $181.1 million. Canadian expenditures were $201.8 million or 91% of the total. Petroleum incentives earned during the year amounted to $6.5 million.

The reinvestment rate, representing capital expenditures before petroleum incentives as a percentage of funds from operations, was 61% in 1987, an increase from 57% in 1986.

Expenditures on exploration activities totalled $149.5 million compared to $102.4 million in 1986. These amounts represent 42% and 32% of funds from operations for 1987 and 1986, respectively. Expenditures for development drilling were $31.8 million, 53% higher than the $20.8 million recorded in 1986. Production facilities and equipment amounted to $39.5 million in 1987 compared to $57.9 million the previous year.

Financial Position

Working capital was $163.0 million at December 31, 1987, compared to $98.0 million at the end of 1986. Long-term debt at year-end was $85.5 million compared to $86.9 million in 1986.

Deferred production income, resulting from take-or-pay provisions of gas purchase contracts, decreased to $61.1 million at December 31, 1987. This amount represents the Company's obligation to deliver natural gas in future contract years, ending October 31, 1994. At year-end, $10.5 million was reclassified to current liabilities in recognition of anticipated 1988 deliveries.

Shareholders' equity increased to $1 361.5 million as a result of $181.1 million in net income, less dividends of $74.9 million. Dividends for the year amounted to $74.9 million compared to $87.4 million in 1986, as a result of a decrease in the quarterly dividend rate from 25¢ to 15¢ per share subsequent to the first quarter of 1986. Dividend payout as a percentage of net income was 41% in 1987 compared to 56% of net income before unusual item in 1986.

Auditors' Report

To the Shareholders of
PanCanadian Petroleum Limited:

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

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

PRICE WATERHOUSE
Chartered Accountants

Calgary, Alberta
February 12, 1988

Consolidated Balance Sheet

December 31, 1987

ASSETS

(thousands of dollars)	1987	1986
Current assets:		
Cash	$ 201	$ 165
Deposits with affiliated company (Note 3)	230 593	54 110
Accounts receivable	99 348	99 003
Petroleum incentives receivable	3 862	10 463
Income and revenue taxes recoverable	—	7 471
Current portion of long-term notes receivable (Note 5)	9 329	9 903
Inventories, at lower of cost or net realizable value —		
Products	17 514	14 503
Materials	3 675	4 095
	364 522	199 713
Property, plant and equipment, at cost (Note 4):		
Petroleum, natural gas and mineral properties	2 273 910	2 099 146
Plant, production and other equipment	1 003 950	968 530
	3 277 860	3 067 676
Less: Accumulated depletion and depreciation	(1 312 541)	(1 160 302)
	1 965 319	1 907 374
Long-term notes receivable (Note 5)	9 329	19 806
Deferred charges and other assets	14 853	12 525
	$2 354 023	$2 139 418

LIABILITIES AND SHAREHOLDERS' EQUITY

(thousands of dollars)	1987	1986
Current liabilities:		
Accounts payable and accrued liabilities	$ 123 940	$ 101 073
Income taxes payable	77 006	—
Current portion of long-term debt	625	625
	201 571	101 698
Long-term debt (Note 6)	85 500	86 875
Deferred credits:		
Production income	61 147	71 607
Other	945	2 272
	62 092	73 879
Deferred income taxes	643 321	621 585
Shareholders' equity:		
Common shares —		
Authorized — unlimited number		
Issued — 124 899 916	31 225	31 225
Paid in surplus	41 828	41 828
Retained income	1 288 486	1 182 328
	1 361 539	1 255 381
	$2 354 023	$2 139 418

APPROVED BY THE BOARD:

Robert W. Campbell

Director

Bartlett B. Rombaugh

Director

Consolidated Statement of Income and Retained Income

For the Year Ended December 31, 1987

(thousands of dollars)	1987	1986
Income:		
Operating revenue	$ 679 651	$ 676 785
Interest from affiliated company	12 276	4 080
Miscellaneous	6 724	36 136
	698 651	717 001
Expenses:		
Operating	186 307	219 107
Administrative	40 376	45 815
Interest —		
Long-term	9 496	21 162
Other	—	1 246
Depreciation	57 660	52 720
Depletion	98 951	90 999
	392 790	431 049
Income before income and revenue taxes	305 861	285 952
Provision for income and revenue taxes:		
Income taxes (Note 7) —		
Current	103 041	89 228
Deferred	21 736	17 194
Petroleum and gas revenue tax	—	24 456
	124 777	130 878
Net income before unusual item	181 084	155 074
Unusual item (Note 2)	—	94 754
Net income	181 084	60 320
Retained income at beginning of year	1 182 328	1 209 422
	1 363 412	1 269 742
Dividends — $0.60 per share (1986 — $0.70)	74 926	87 414
Retained income at end of year	$1 288 486	$1 182 328

Earnings per share:		
Net income before unusual item	$1.45	$1.24
Net income	$1.45	$0.48

Consolidated Statement of Changes in Financial Position

For the Year Ended December 31, 1987

(thousands of dollars)	1987	1986
Operating activities:		
Net income before unusual item	$181 084	$155 074
Amounts not requiring a current outlay of funds —		
Depreciation	57 660	52 720
Depletion	98 951	90 999
Deferred income taxes	21 736	17 194
Other	403	(298)
Funds from operations	359 834	315 689
Decrease in deferred production income	(10 460)	(11 849)
Increase in deferred charges	(3 325)	—
Net change in non-cash working capital balances	111 583	68 752
Cash from operations	457 632	372 592
Dividends	74 926	87 414
Financing activities:		
Reduction of long-term debt	1 375	66 375
Reduction of long-term notes receivable	(9 329)	(9 903)
	(7 954)	56 472
Investing activities:		
Petroleum, natural gas and mineral properties	181 279	123 183
Petroleum incentives	(6 515)	(8 552)
Plant, production and other equipment	39 497	57 888
	214 261	172 519
Other	(120)	(374)
	214 141	172 145
Increase in cash	176 519	56 561
Cash at beginning of year	54 275	(2 286)
Cash at end of year	$230 794	$ 54 275

Cash is comprised of cash and deposits, net of short-term bank loans.

Notes to Consolidated Financial Statements

December 31, 1987

1. Significant Accounting Policies:

a) Consolidation

The consolidated financial statements include the accounts of PanCanadian Petroleum Limited and its subsidiaries, all of which are wholly-owned, and are presented in accordance with Canadian generally accepted accounting principles.

b) Foreign Currency Translation

Foreign currency balances, including those of foreign subsidiaries, have been expressed in Canadian dollars on the following basis:

Current and long-term monetary assets and liabilities — at the year-end rate of exchange.
Other assets and liabilities — at historical rates of exchange.
Income and expenses — at monthly rates of exchange except provisions for depreciation and depletion which are translated on the same basis as the related assets.

Gains or losses on conversion to Canadian dollars of long-term monetary items are deferred and amortized over the estimated lives of the respective assets and liabilities.

c) Full Cost Method of Accounting

The Company follows the full cost method of accounting as promulgated by the Canadian Institute of Chartered Accountants whereby all costs relating to the exploration for and the development of conventional oil and natural gas reserves are capitalized on a country-by-country cost centre basis. Costs accumulated within each cost centre are depleted and depreciated using the unit of production method, based on estimated proven reserves, with net production and reserve volumes of natural gas and natural gas liquids converted to equivalent energy units of crude oil.

In determining the depletion and depreciation provisions, the Company includes any excess of the net book value of conventional oil and natural gas assets over the unescalated, undiscounted future net operating revenues from its proven oil and natural gas reserves for each cost centre (ceiling test). A second ceiling test calculation is conducted on an enterprise basis, by including in the depletion and depreciation provisions any excess of the net book value of conventional oil and natural gas assets for all cost centres over the total unescalated, undiscounted future net operating revenues from proven oil and natural gas reserves, less future general and administrative expenses, financing costs, and income taxes. Prices utilized in the ceiling test calculations are the weighted average product prices prevailing at year-end which the Company receives for its production.

d) Depreciation of Plant and Equipment

Depreciation of conventional oil and natural gas plant, production and other equipment is provided for on the unit of production basis. The Empress natural gas liquids extraction facilities, Syncrude and the methanol plant are depreciated on the straight-line basis at the following rates:

Empress — 4%
Syncrude — 3%
Methanol — 10%

e) Deferred Production Income

Pursuant to take-or-pay provisions included in certain natural gas purchase contracts, payments are received for natural gas to be delivered at future dates. The Company records these payments as deferred production income and takes them into income when the natural gas is delivered. The contracts provide that the natural gas is to be delivered over a 10-year period ending October 31, 1994.

f) Capitalization of Interest

Interest related to financing arrangements on major projects is capitalized during the construction period.

g) Government Incentives

Government incentives related to exploration, development and production activities, which are earned by the Company, are recorded as a reduction of the related expenditures.

h) Retirement Plan

The Company determines the cost of pension entitlements earned by its employees utilizing the projected benefit method prorated on service. This cost is charged to operations as services are rendered, and reflects management's best estimates of expected plan investment performance, salary growth, future terminations, mortality rates and retirement ages of plan members. Adjustments which may be occasioned by plan amendment, changes in assumptions, and experience gains and losses are amortized on the straight-line basis over the expected average remaining service life of the employee group covered by the plan.

2. Unusual Item:

As a result of the significant decline in world oil prices in 1986, it was necessary to write down the carrying value of petroleum and natural gas properties for the Company's non-Canadian operations by $94.8 million.

3. Related Party Transactions:

Substantially all of the Company's funds which were surplus to its day-to-day requirements were invested in deposits of Canadian Pacific Limited. These deposits earned interest at rates at least equal to the interest rates paid by a leading Canadian chartered bank on equivalent deposits.

In the normal course of business the Company purchases materials, utilizes services and leases office space from other companies with which it is affiliated. A further transaction is more fully described in Note 6. All such transactions have been conducted on an arm's length basis.

4. Property, Plant and Equipment:

	1987		1986	
(thousands of dollars)	Cost	Accumulated Depletion & Depreciation	Cost	Accumulated Depletion & Depreciation
Petroleum, natural gas and mineral properties	$2 273 910	$ 969 587	$2 099 146	$ 870 773
Plant, production and other equipment				
Petroleum and natural gas	625 310	211 925	598 686	178 984
Syncrude	195 479	44 691	186 968	39 422
Methanol	130 332	64 291	130 327	51 431
Empress	52 829	22 047	52 549	19 692
	$3 277 860	$1 312 541	$3 067 676	$1 160 302

Administrative expenses incurred during 1987 of $42.8 million (1986 — $44.7 million) which are directly related to exploration and development activities were capitalized as part of petroleum, natural gas and mineral properties expenditures.

5. **Long-Term Notes Receivable:**

Uncer the terms of a 1979 agreement for sale of equipment, the Company received notes which are payable in U.S. funds in four equal annual instalments ending December 31, 1989. Interest accrues at 10⅞% and is payable semiannually.

6. **Long-Term Debt:**

(thousands of dollars)	1987	1986
8⅛% secured debentures due March 1, 1992, sinking fund payments 1989-1991, secured by a first mortgage upon certain producing properties	$16 750	$17 500
8¾% secured debentures due November 1, 1992, sinking fund payments 1988-1991, secured by a first mortgage upon certain producing properties	19 375	20 000
12½% unsecured debentures due April 1, 1993	50 000	50 000
	86 125	87 500
Less: Current portion	625	625
	$85 500	$86 875

With regard to the unsecured debentures, the Company has agreed that it and, subject to certain exceptions, its subsidiaries will not create any mortgage or other charge on their assets to secure any loan or other indebtedness which at the time of issue are intended to be traded on any stock exchange or publicly traded in the over-the-counter market in any part of the world unless the debentures then outstanding are similarly secured.

The annual maturities for long-term debt for each of the five years ending December 31 are as follows:

(thousands of dollars)

1988 — $ 625
1989 — 1 375
1990 — 1 375
1991 — 1 375
1992 — 31 375

As part of an acquisition of income tax credits in 1985 the Company assumed long-term indebtedness payable to affiliated companies. This indebtedness matures within three years and is comprised of CDN $49.1 million and US $180.0 million. These amounts are fully offset by notes receivable with the same terms and conditions, from one of the affiliated companies. With respect to the notes receivable, Canadian Pacific Enterprises Limited, a wholly-owned subsidiary of Canadian Pacific Limited, has agreed to indemnify the Company against any losses sustained on realization or otherwise. Accordingly, this indebtedness and the related notes receivable have been offset and are not included in the consolidated financial statements.

7. Income Taxes:

The statutory rates of income taxes are reconciled to the effective rates as follows:

	1987	1986
Statutory rate	50.7%	49.1%
Increase (decrease) resulting from:		
Provincial royalties and other levies	6.1	6.1
Depletion and resource allowances	(16.2)	(14.9)
Other	0.2	(3.1)
Effective rate	40.8%	37.2%

8. Segmented Information:

The Company's only industry segment is the exploration for and the development and production of petroleum, natural gas and related products. The major geographic segments are as follows:

	1987			1986		
(thousands of dollars)	Canada	United States & Other	Total	Canada	United States & Other	Total
Income	$ 672 882	$ 25 769	$ 698 651	$ 688 555	$ 28 446	$ 717 001
Segment operating income (loss)	316 672	(1 315)	315 357	319 375	(11 015)	308 360
Segment income (loss)	316 672	(1 315)	315 357	319 375	(105 769)	213 606
Interest expense			(9 496)			(22 408)
Income and revenue taxes			(124 777)			(130 878)
Net income			181 084			60 320
Indentifiable assets	$2 224 345	$129 678	$2 354 023	$2 006 226	$ 133 192	$2 139 418

9. Retirement Plan:

Substantially all of the Company's eligible employees are covered by a defined benefit pension plan. The plan provides pensions based on length of service and final average earnings. Effective January 1, 1987 the Company adopted, on a prospective basis, the accounting recommendations for pension costs and obligations issued by the Canadian Institute of Chartered Accountants in 1986. This change in accounting policy did not have a material effect on net income for the year. Actuarial projections of employees' compensation levels to the time of retirement, indicate that the present value of accrued pension benefits is $57.6 million, and the market related value of the net assets available to provide these benefits is $98.2 million as at December 31, 1987.

Supplementary Information

Standardized Measure of Discounted Future Net Cash Flows (Unaudited)

The United States Financial Accounting Standards Board Statement No. 69 entitled "Disclosure About Oil and Gas Producing Activities" contains definitive rules for computing the discounted future net cash flows from proved conventional oil and gas reserves. The rules provide that the carrying value discounted at 10% of proved conventional oil and gas reserves be measured by applying year-end sales prices, or scheduled prices if contractual arrangements so provide, to the related reserve quantities less deductions for future costs which will be required to develop and produce those reserves, and estimated future income taxes. The change in carrying value of proved oil and gas reserves from year-end to year-end due to production and development expenditures, additions and revisions to proved oil and gas reserves, and price changes are to be reported in a separate table.

The Financial Accounting Standards Board acknowledges that the standardized measure of discounted net cash flows cannot be considered an estimate of fair market value. Likewise, it follows that the inclusion of this information should not be interpreted as indicating that PanCanadian believes that valid inferences as to PanCanadian's probable measure of fair market value or future economic position can be derived therefrom.

For the benefit of those investors interested in such information, PanCanadian has prepared the data below.

1987 (thousands of dollars)	Canada	United States	Total
Future cash inflows	$6 702 695	$155 246	$6 857 941
Future production and development costs	1 962 371	45 054	2 007 425
Future income tax expenses	1 759 439	—	1 759 439
Future net cash flows	2 980 885	110 192	3 091 077
10% annual discount for estimated timing of cash flows	1 496 555	45 911	1 542 466
Standardized measure of discounted future net cash flows	$1 484 330	$ 64 281	$1 548 611

1986 (thousands of dollars)	Canada	United States	Total
Future cash inflows	$6 595 507	$162 237	$6 757 744
Future production and development costs	1 950 304	57 285	2 007 589
Future income tax expenses	1 582 487	—	1 582 487
Future net cash flows	3 062 716	104 952	3 167 668
10% annual discount for estimated timing of cash flows	1 570 174	41 614	1 611 788
Standardized measure of discounted future net cash flows	$1 492 542	$ 63 338	$1 555 880

The following are the principal sources of change in the standardized measure of discounted future net cash flows:

(thousands of dollars)	1987	1986
Standardized measure of discounted future net cash flows at beginning of year	$1 555 880	$2 545 520
Add:		
Revisions of previous estimates	176 318	—
Additions to proved reserves, net of capital and production costs	139 623	83 951
Net changes in prices and production costs	2 812	—
Expenditures that reduced estimated future development costs	15 538	22 705
Accretion of discount	211 773	392 228
Net changes in income and revenue taxes	—	915 456
	546 064	1 414 340
Less:		
Net changes in prices and production costs	—	1 585 916
Sales of oil and gas produced, net of production costs and mineral taxes	456 154	430 605
Revisions of previous estimates	—	387 459
Net changes in income taxes	97 179	—
	553 333	2 403 980
Standardized measure of discounted future net cash flows at end of year	$1 548 611	$1 555 880

Future net cash flows were computed using year-end prices, and year-end statutory tax rates (adjusted for permanent differences and for known scheduled future rate changes) that relate to existing proved oil and gas reserves.

Oil and Gas Reserves (Unaudited)

The Company's net proved reserves of conventional oil, natural gas and natural gas liquids as estimated by PanCanadian engineers are summarized below. Net reserves are the gross reserves underlying the properties in which PanCanadian has either a working interest, less all royalties and interests owned by others, or a royalty interest.

	Crude Oil (including natural gas liquids) (thousand barrels)			Natural Gas (billion cubic feet)		
	Canada	United States	Total	Canada	United States	Total
Net proved reserves: December 31, 1985	120 688	6 716	127 404	2 707	36	2 743
Revisions of previous estimates	(1 127)	(299)	(1 426)	(273)	1	(272)
Extensions and discoveries	6 698	693	7 391	33	—	33
1986 production	(15 837)	(773)	(16 610)	(112)	(6)	(118)
Net proved reserves: December 31, 1986	110 422	6 337	116 759	2 355	31	2 386
Revisions of previous estimates	27 230	92	27 322	(25)	3	(22)
Extensions and discoveries	11 900	523	12 423	47	—	47
1987 production	(17 523)	(659)	(18 182)	(113)	(5)	(118)
Net proved reserves: December 31, 1987	132 029	6 293	138 322	2 264	29	2 293

Proved reserves are those reserves which geological and engineering data demonstrate with reasonable certainty to be recoverable in the future at commercial production rates under present depletion methods and current operating conditions, prices and costs. Essentially all of PanCanadian's proved crude oil reserves are considered to be developed and recoverable through existing wells with existing facilities. In the case of PanCanadian's proved natural gas and associated liquids reserves, sufficient wells exist in most instances to meet required initial withdrawal rates from the respective reservoirs. As a result, the natural gas and natural gas liquids are considered to be developed even though additional drilling will be required in certain cases to drain effectively the respective reservoirs in a desirable length of time.

Directors and Officers

Directors

F.S. Burbidge
Montreal, Quebec
Director and former Chairman of the Board, Canadian Pacific Limited

Robert W. Campbell*
Calgary, Alberta
Chairman of the Board of PanCanadian Petroleum Limited; Director, Chairman of Canadian Pacific Limited; Director and Officer of Canadian Pacific Enterprises Limited; Director of: The Algoma Steel Corporation, Limited; AMCA International Limited; Canadian Pacific Hotels Corporation; Canadian Pacific Securities Limited and Great Lakes Forest Products Limited

S.E. Eagles
Toronto, Ontario
Vice-President Corporate of Canadian Pacific Limited

Jock K. Finlayson
Montreal, Quebec
Corporate Director, Chairman, Royal Insurance Company of Canada, Toronto

J.F. Hankinson*
Calgary, Alberta
Group Vice-President, Canadian Pacific Limited

Vernon L. Horte*†
Calgary, Alberta
President of V.L. Horte Associates Limited

G. Donald Love
Toronto, Ontario
President and Chairman of the Board of Oxford Development Group Ltd.

Maurice P. Paulson
Calgary, Alberta
Retired Executive

C. Douglas Reekie†
Toronto, Ontario
Vice Chairman of the Board, CAE Industries Ltd.

Bartlett B. Rombough*
Calgary, Alberta
President and Chief Executive Officer of PanCanadian Petroleum Limited; Director of: Fording Coal Limited; Great Lakes Forest Products Limited and Marathon Realty Company Limited

John C. Ross†
Lethbridge, Alberta
Rancher; President of The Milk River Cattle Company Limited

R. Ross Smith
Winnipeg, Manitoba
Vice-President, Enterprise Operations, James Richardson & Sons, Limited

William W. Stinson*
Montreal, Quebec
President and Chief Executive Officer of Canadian Pacific Limited

Vernon Van Sant, Jr.†
Calgary, Alberta
Consultant, oil and gas industry

Fabricating pipe at the Rycroft oil battery

Officers

Robert W. Campbell
Chairman of the Board

Bartlett B. Rombough
President and Chief Executive Officer

C. Barrie Clark
Executive Vice President

Kenneth B. Cusworth
Senior Vice President — Corporate Research

Richard C. Verner
Senior Vice President — Operations

William S. Bishai
Vice President — Production

J. Joseph Doolan
Comptroller

Richard J. Innes
Vice President — Economics and Planning

George E. Little
Vice President and Corporate Secretary

L. Dale MacDonald
Vice President — Human Resources

Donald N. Maxwell
Vice President — Accounting and Information Services

Guido A. Montemurro
Vice President — Development

William C. Reinwart
Vice President — Marketing

James A. Tamblyn
Vice President — Law

C. Rolf V. Thomson
Vice President — Exploration

Keith A. Wurzer
Vice President and Treasurer

Ronald B. Zavediuk
Assistant Treasurer

Donald R. Reeves
Vice President — Exploration, PanCanadian Petroleum Company, Denver, Colorado

* Member of Executive Committee
† Member of Audit Committee

Corporate Information

Head Office

Street Address
PanCanadian Plaza
150 - 9th Avenue S.W.
Calgary, Alberta
T2P 3H9

Mailing Address
P.O. Box 2850
Calgary, Alberta
T2P 2S5

United States

PanCanadian Petroleum Company
Dominion Plaza, Suite 1800
600 - 17th Street
Denver, Colorado 80202

Texas Commerce Tower
Suite 4545, 600 Travis
Houston, Texas 77002

Shares Listed

Alberta Stock Exchange
Montreal Stock Exchange
Toronto Stock Exchange
Vancouver Stock Exchange

Registrar and Transfer Agent

Guaranty Trust Company of Canada
Calgary, Montreal, Toronto, Vancouver

Auditors

Price Waterhouse
Chartered Accountants
Calgary, Alberta

Subsidiary and Affiliate Companies

Wholly-Owned
- Blackfoot Pipelines Ltd.
- PanCanadian Gas Products Ltd.
- PanCanadian Petroleum Company
- PanCanadian Petroleum (U.K.) Limited
- PanCanadian Kerrobert Pipeline Ltd.

Other
- Minerals Ltd. — 50%
- Panarctic Oils Ltd. — 7.92%
- Syncrude Canada Ltd. — 4%

Financial and Operating Information

In April, each year, PanCanadian Petroleum Limited publishes a supplementary report entitled "Financial and Operating Information." The report contains more detailed information than is given in the Annual Report, and is mainly provided for the use of security analysts. Any shareholder requiring a copy may direct a request to the Manager — Budgetary Control and Statistics.

Extracting core at a Ferrybank drilling site

SI Conversion Table

To Convert From	To	Multiply By
Acre (ac)	hectare (ha)	0.404 69
Foot (ft)	metre (m)	0.304 80
Barrel (bbl)	cubic metre (m^3)	0.158 91
Thousand Cubic Feet (mcf)	cubic metre (m^3)	28.173 99
Long Ton (l.t.)	tonne (t)	1.016 05
Short Ton (s.t.)	tonne (t)	0.907 18

Five Year Statistical Review

(Dollar amounts in thousands except per share figures)	1987	1986	1985	1984	1983
Earnings					
Gross Income	$ 698 651	$ 717 001	$1 137 105	$1 055 358	$ 884 387
Funds from Operations[(2)]	359 834	315 689	500 730	457 333	379 670
Per Share[(2)]	2.88	2.53	4.01	3.66	3.04
Net Income before unusual item[(2)]	181 084	155 074	306 672	287 703	233 985
Per Share[(2)]	1.45	1.24	2.46	2.30	1.87
Net Income[(2)]	181 084	60 320	306 672	287 703	233 985
Per Share[(2)]	1.45	0.48	2.46	2.30	1.87
Balance Sheet					
Working Capital	162 951	98 015	110 206	161 859	107 319
Property, Plant & Equipment — Net[(2)]	1 965 319	1 907 374	1 949 856	1 664 499	1 527 063
Investments & Other Assets	24 182	32 331	67 712	76 478	72 481
Long-Term Debt	85 500	86 875	153 250	154 625	156 000
Deferred Income Tax[(2)]	643 321	621 585	604 391	546 795	511 679
Capital Expenditures					
Exploration[(2)]	149 457	102 371	244 436	212 647	167 244
Development Drilling	31 822	20 812	60 160	45 222	33 015
Production Facilities & Equipment	30 308	47 864	100 294	57 436	50 036
Syncrude	9 184	9 800	13 094	7 454	6 021
Methanol	5	224	41	(313)	(1 858)
	220 776	181 071	418 025	322 446	254 458
Property Acquisition	—	—	81 546	—	—
Petroleum Incentives	(6 515)	(8 552)	(76 438)	(50 384)	(44 269)
Proven & Probable Reserves (After Royalty except Synthetic Oil)					
Conventional Crude Oil & Natural Gas Liquids — thousand barrels	194 549	177 771	181 657	165 572	141 447
Synthetic Oil — thousand barrels before royalty	52 332	54 345	56 358	58 371	39 664
Natural Gas — billion cubic feet	3 351	3 579	3 807	3 748	3 753
Sulphur — thousand long tons	1 968	1 407	1 246	1 380	2 035
Coal — million short tons	2 237	2 238	2 239	2 136	2 093
Production (After Royalty)					
Conventional Crude Oil & Natural Gas Liquids Production — barrels per day	49 813	45 509	46 231	43 646	38 222
Synthetic Crude Oil — barrels per day	5 377	5 190	4 590	3 407	3 692
Empress Plants Natural Gas Liquids Sales — barrels per day	10 391	13 926	17 146	15 655	13 776
Natural Gas Sales — thousand cubic feet per day	324 403	322 155	348 171	336 884	288 301
Sulphur Sales — long tons per day	322	332	454	306	267
Methanol — tonnes per day	574	502	726	725	582
Acreage					
Gross — thousand acres	10 071	10 761	11 503	11 306	13 654
Net — thousand acres	7 951	8 232	8 525	8 421	8 526
Shares & Dividends					
Number of Shares Outstanding	124 899 916	124 899 916	124 899 916	124 899 916	124 899 916
Number of Shareholders	2 294	2 594	3 041	3 396	3 464
Dividends	74 926	87 414	124 886	118 626	112 384
Per Share	0.60	0.70	1.00	0.95	0.90
Market Price Per Share — High	36¾	32⅞	36¼	29¾	31
— Low	22½	21¼	25½	22	20

Notes:
(1) Valuation Day (December 22, 1971) Share Price $15¼ (before the 1983 4-for-1 share division).
(2) Restated retroactively to reflect adoption of the Canadian Institute of Chartered Accountants Full Cost Accounting Guideline.

C

PanCanadian Petroleum Limited

NOTICE OF ANNUAL MEETING

TAKE NOTICE that the Annual Meeting of Shareholders of PanCanadian Petroleum Limited (PCP) will be held in the Turner Valley Room of the Palliser Hotel, Calgary, Alberta, on Tuesday, the 12th day of April, 1988, at the hour of 10:00 a.m., local time, for the following purposes:

1. Receiving the Report of the Directors and the Consolidated Financial Statements of PCP together with the Report of the Auditors thereon for the year ended December 31, 1987.

2. Electing Directors.

3. Appointing the Auditors for the ensuing year and authorizing the Board of Directors to fix their remuneration.

4. To consider and, if thought advisable, to pass a resolution approving the establishment of the Key Employee Stock Option Plan. The text of the resolution is set out in Schedule I to the accompanying Management Proxy Circular which forms part of this notice.

5. Transacting such other business as may properly come before the meeting.

AND FURTHER TAKE NOTICE that all persons will be entitled to notice of the above-mentioned meeting who are Shareholders of PCP of record at the close of business on Friday the 26th day of February, 1988, which the Directors have fixed as a record date for that purpose in accordance with By-law No. 1 of PCP.

If you are not able to be present at the above-mentioned meeting, please date, sign and return the accompanying proxy, which, in order to be treated as valid, must be received at the head office of PCP, PanCanadian Plaza, 150 - 9th Avenue S.W., Calgary, Alberta, not later than forty-eight (48) hours preceding the meeting.

DATED at Calgary, Alberta this 18th day of February, 1988.

By Order of the Board of Directors,

GEORGE E. LITTLE
Vice President and
Corporate Secretary

Registrar and Transfer Agent:
GUARANTY TRUST COMPANY OF CANADA

Calgary, Alberta — Vancouver, B.C. — Toronto, Ontario — Montreal, Quebec

MANAGEMENT PROXY CIRCULAR

This circular is provided pursuant to the Canada Business Corporations Act in connection with the solicitation of proxies for the Annual Meeting of PanCanadian Petroleum Limited (PCP) to be held on the 12th day of April, 1988 and at any adjournment thereof.

PERSONS MAKING THE SOLICITATION

This solicitation of proxies is made by or on behalf of the management of PanCanadian Petroleum Limited. This solicitation is being made by mail and the cost thereof will be borne by PCP.

REVOCABILITY OF PROXY

Any shareholder who is present at the meeting may withdraw his proxy and vote in person if he so desires. A shareholder executing the accompanying form of proxy has the power to revoke it at any time before it is exercised by instrument in writing executed by the shareholder, or by his attorney authorized in writing or, if the shareholder is a corporation, under its corporate seal or by an officer or attorney thereof duly authorized, and deposited either at the head office of PCP at any time up to and including the last business day before the day of the meeting, or any adjournment thereof, or with the Chairman of the meeting on the day of the meeting, or any adjournment thereof.

VOTING OF PROXIES

The shares represented by a proxy will be voted on any ballot that may be called on any matter which is to be dealt with at the meeting and where the shareholder specifies the manner in which the shares represented by the proxy are to be voted on any such matter, the shares represented by the proxy will be voted in accordance with such direction.

Unless the shareholder has otherwise directed, the shares represented by the proxy will be voted "FOR" the election of Directors, the appointment of the Auditors and the granting of authority to the Board of Directors to fix the Auditors' remuneration and the passing of a Resolution approving the Key Employee Stock Option Plan as stated under the headings "Election of Directors", "Key Employee Stock Option Plan" and "Appointment of Auditors" in this Circular. It is not intended to use the proxy for the purpose of voting upon the Consolidated Financial Statements of PCP and its subsidiaries for the year ended December 31, 1987 and reports of the Directors and Auditors thereon.

The form of proxy confers discretionary authority with respect to amendments or variations to matters identified in the notice convening the meeting or other matters which may properly come before the meeting.

VOTING SHARES AND PRINCIPAL HOLDERS THEREOF

PCP has only one class of shares outstanding. There are, at the date hereof, 124,899,916 common shares issued and outstanding. Shareholders are entitled to one vote for each share held.

Only shareholders of PCP of record at the close of business on Friday the 26th day of February, 1988, will be entitled to receive notice of the meeting.

To the knowledge of the directors or senior officers of PCP, at the date hereof, the only beneficial owner, directly or indirectly, of equity shares of PCP which carry more than 10% of the voting rights attached to all equity shares of PCP is Canadian Pacific Enterprises Limited, Calgary, Alberta, which has reported that it owns 108,762,656 shares, representing 87.08% of all outstanding equity shares of PCP.

Election of Directors

The Articles of PCP provide that the Board of Directors shall consist of such number, not less than 12 nor more than 17, as may be determined from time to time by the directors. The Directors have determined that effective at the Annual Meeting on April 12, 1988, the number of directors comprising the Board of Directors will be 15 and the undermentioned persons will be nominated at the meeting. Each director elected will hold office until the next Annual Meeting of Shareholders and until his successor is duly elected. Except for Mr. C. Barrie Clark and Mr. George F. Michals, the persons listed below are presently directors of PCP, all of whom retire as such at the forthcoming Annual Meeting of Shareholders on April 12, 1988 and are standing for re-election. It is the intention of the persons named in the enclosed form of proxy to vote such proxy for the election of the following persons as directors of PCP. The management does not contemplate that any of the nominees will be unable to serve as directors but, if that should occur for any reason prior to the meeting, the persons named in the enclosed form of proxy shall have the right to vote for another nominee in their discretion. Information as of February 18, 1988, as to the 15 nominees is as follows:

Names of nominees, offices held in PCP and principal occupation or employment	Director since	Major positions and offices held in significant affiliated companies	No. of shares of PCP and of Canadian Pacific Limited (CPL) beneficially owned
F. S. BURBIDGE Director and former Chairman of the Board, Canadian Pacific Limited (transportation, natural resource development and manufacturing).	1982	**Director of:** AMCA International Limited Canadian Pacific Limited Marathon Realty Company Limited Soo Line Railroad Company	PCP: 400 Common (indirect) CPL: 3,242 Ordinary (direct) 27,973 Ordinary (indirect)
*ROBERT W. CAMPBELL Chairman of the Board of PCP and Chairman, Canadian Pacific Limited (transportation, natural resource development and manufacturing).	1971	**Director & Officer of:** Canadian Pacific Enterprises Limited Canadian Pacific Limited **Director of:** The Algoma Steel Corporation, Limited AMCA International Limited Canadian Pacific Hotels Corporation Canadian Pacific Securities Limited Great Lakes Forest Products Limited	PCP: 13,760 Common CPL: 7,651 Ordinary
C. BARRIE CLARK Executive Vice President of PCP, for more than five years.		Nil	PCP: 500 Common (indirect) CPL: 305 Ordinary (indirect)
JOCK K. FINLAYSON Corporate Director. Chairman, Royal Insurance Company of Canada, Toronto, Ontario (insurance company).	1972	Nil	PCP: 400 Common CPL: Nil
*J. F. HANKINSON Group Vice-President, Canadian Pacific Limited (transportation, natural resource development and manufacturing).	1986	**Director & Officer of:** Canadian Pacific Enterprises Limited **Director of:** The Algoma Steel Corporation, Limited AMCA International Limited Canadian Pacific Securities Limited Canadian Pacific (U.S.) Inc. CIP Inc. Fording Coal Limited	PCP: Nil CPL: Nil

Names of nominees, offices held in PCP and principal occupation or employment	Director since	Major positions and offices held in significant affiliated companies	No. of shares of PCP and of Canadian Pacific Limited (CPL) beneficially owned
*†VERNON L. HORTE President, V. L. Horte Associates Limited (a consulting firm).	1982	Nil	PCP: 400 Common (indirect) CPL: Nil
G. DONALD LOVE President and Chairman of the Board, Oxford Development Group Ltd. (a commercial real estate development and management company).	1979	Nil	PCP: 2,000 Common CPL: 1,000 Ordinary
GEORGE F. MICHALS Vice-President Finance and Accounting, Canadian Pacific Limited (transportation, natural resource development and manufacturing) since October 1, 1987; Executive Vice-President, Genstar Corporation (engaged in diversified industrial operations), from 1979 to December 1986 and President, Baymount Corporation (a personal holding company) from January 1987 to September 1987.		**Director & Officer of:** Canadian Pacific Enterprises Limited **Director of:** Canadian Pacific Securities Limited CNCP Telecommunications Marathon Realty Company	PCP: Nil CPL: Nil
MAURICE P. PAULSON Retired Executive.	1985	Nil	PCP: Nil CPL: Nil
†C. DOUGLAS REEKIE Vice Chairman of the Board, CAE Industries Ltd. (a holding and management company).	1985	**Director of:** AMCA International Limited Canadian Pacific Limited Marathon Realty Company Limited	PCP: 1,500 Common CPL: 14,017 Ordinary
*BARTLETT B. ROMBOUGH President and Chief Executive Officer of PCP.	1980	**Director of:** Fording Coal Limited Great Lakes Forest Products Limited Marathon Realty Company Limited	PCP: 1,500 Common CPL: 267 Ordinary
†JOHN C. ROSS Rancher; President, The Milk River Cattle Company Limited (a livestock producer).	1963	Nil	PCP: 126,008 Common CPL: 4,172 Ordinary
R. ROSS SMITH Vice-President, Enterprise Operations, James Richardson & Sons, Limited (financial, grain and management holding company).	1986	Nil	PCP: 200 Common CPL: Nil
*WILLIAM W. STINSON President and Chief Executive Officer, Canadian Pacific Limited (transportation, natural resource development and manufacturing).	1984	**Director & Officer of:** Canadian Pacific Enterprises Limited Canadian Pacific Limited **Director of:** AMCA International Corporation AMCA International Limited Canada Maritime Limited Canadian Pacific (Bermuda) Limited Canadian Pacific Express & Transport Ltd. Great Lakes Forest Products Limited Marathon Realty Company Limited Soo Line Railroad Company	PCP: 100 Common CPL: 18,874 Ordinary

Names of nominees, offices held in PCP and principal occupation or employment	Director since	Major positions and offices held in significant affiliated companies	No. of shares of PCP and of Canadian Pacific Limited (CPL) beneficially owned
†VERNON VAN SANT, JR.	1984	Nil	PCP: Nil CPL: Nil
Consultant, oil and gas industry.			

*Member of Executive Committee
†Member of Audit Committee

Statement of Executive Remuneration

Aggregate cash remuneration paid by PCP to its 16 executive officers for the period in which they were officers in 1987 was $2,344,773. Other remuneration paid to the executive officers does not exceed the lesser of $160,000 or 10% of the aggregate cash remuneration paid such officers.

Total remuneration paid by PCP to its 13 directors during 1987, excluding the President who was included in executive officers, was $147,403. During 1987 PCP paid each director a meeting attendance fee of $500 for each meeting and, except for the President, an annual retainer of $7,500. The Chairman of the Audit Committee received a retainer of $1,000 and one director received non-cash remuneration of $5,903.

Pursuant to agreements between PCP and two executive officers, upon their attaining their 65th birthdays, each is to receive on the last day of each calendar month an amount which will provide a monthly pension equal to 25.95% and 18.1% respectively, of the average salary per month paid to the executives during the last five years immediately preceding their 65th birthdays. Pursuant to an agreement between PCP and its major shareholder, Canadian Pacific Limited (CPL), PCP will reimburse CPL for 40% of any payments that may be made to a former employee of PCP pursuant to an agreement between CPL and the employee. The agreement between CPL and the employee provides for CPL to make a total monthly payment, after retirement, in an amount equal to 69.5% of the employee's average monthly salary during the last 60 months of employment immediately preceding his 65th birthday, less any benefits he is entitled to receive from pension plans of previous employers. Under the agreement, if such former employee defers retirement beyond age 65 at the request of CPL, he will be paid by CPL, upon retirement, a supplementary allowance of 1% of his monthly basic retirement entitlement multiplied by the number of months he defers his retirement beyond age 65. During 1987, such former employee accrued a supplementary allowance based on two months of service beyond normal retirement age. PCP has not accrued any amounts with respect to these agreements.

Key Employee Stock Option Plan

The management of PCP believes that the executive compensation policy of PCP should foster a sense of employee proprietorship and stress long-term goals, thereby serving to promote the long-term profitability of PCP and its subsidiaries and to attract and retain key executives. On February 18, 1988, as part of an ongoing program to implement this policy, the Board of Directors approved the Key Employee Stock Option Plan (the "Plan"), subject to the approval of the shareholders at the 1988 Annual Meeting of Shareholders.

The Plan is being submitted to the shareholders for approval to satisfy the policy requirements of the stock exchanges on which PCP's common shares are listed, and is required to be approved by a resolution passed by more than 50% of the votes cast in respect of the resolution. The text of the Plan is set out in Schedule I to this Management Proxy Circular, as well as the text of the resolution for approval of the establishment of the Plan and the issuance of up to 2,500,000 common shares in the aggregate in connection therewith. The description of the Plan set forth below is qualified in its entirety by reference to the text.

The principal purposes of the Plan are to promote a proprietary interest in PCP among its executives, to retain and attract the qualified managers PCP requires, to provide a long-term incentive element in overall compensation and to promote the long-term profitability of PCP.

The Plan will be administered by a committee of the Board of Directors of PCP (the "Committee"). The plan provides for the granting of options for the purchase from PCP of its common shares ("Shares") to salaried officers and other key employees of PCP and its subsidiaries who are designated for participation by the Committee. No more than 2,500,000 Shares in the aggregate may be issued pursuant to the exercise of options granted under the Plan, subject to alteration in certain events. The terms, conditions and limitations of the options will be determined by the Committee with respect to each option, within certain limitations.

The Committee may from time to time grant options to purchase a specific number of Shares, at a subscription price of not less than 90% of the market value of the Shares on the trading date immediately preceding the date on which the option is granted. The number of Shares subject to an option will be determined by the Committee. Options may be exercised no later than ten years after the date on which the option is granted. The Committee may, with the consent of the Optionee, cancel any unexercised option, or the unexercised balance of any option.

The Committee may authorize the making of a loan by PCP to an Optionee to be applied to the purchase of Shares upon exercise of the option. It is currently intended that no loan will exceed 50% of the subscription price of Shares purchased through the exercise of an option and that any such loan will be secured by the Shares purchased.

No options have been granted under the Plan and none will be granted until the Plan has been approved by the shareholders.

Directors and Officers Liability Insurance

Canadian Pacific Limited carries on its own behalf, and on behalf of its participating subsidiaries, a directors and officers liability insurance policy. This policy has a coverage limit of $60,000,000 in each policy year. PCP elected to participate in such policy. The annual premium paid by PCP in 1987 in respect of its directors and officers as a group was $102,027.27. The aggregate amount of premium paid in 1985 for a three year period by the directors as a group was $70 and by the officers as a group was $425. The policy provides for PCP to absorb a deductible amount of $250,000 on each loss.

Appointment of Auditors

Price Waterhouse will be nominated for reappointment to the office of Auditors of PCP for a term expiring at the close of the next annual meeting of shareholders to be held in 1989 at a remuneration to be fixed by the Board of Directors. The said firm has been the Auditors of PCP and its predecessor companies in excess of five years.

General

The management knows of no matters to come before the meeting other than the matters referred to in the notice of meeting. If any other matters should properly come before the meeting, the proxy will be voted on such matters in accordance with the best judgment of the person or persons voting the proxy.

The contents and the sending of this circular have been approved by the directors.

Dated as of the 18th day of February, 1988.

GEORGE E. LITTLE
Vice President and
Corporate Secretary

SCHEDULE I

RESOLUTION OF SHAREHOLDERS
KEY EMPLOYEE STOCK OPTION PLAN

RESOLVED that the establishment of the Key Employee Stock Option Plan of the Corporation, and the issuance of up to 2,500,000 Common Shares of the Corporation be and the same is hereby approved.

PanCanadian Petroleum Limited
KEY EMPLOYEE STOCK OPTION PLAN
Effective April 12, 1988

I. PURPOSES OF THE PLAN

The principal purposes of the Key Employee Stock Option Plan (the "Plan") of PanCanadian Petroleum Limited (the "Corporation") and its subsidiaries are:

(a) to promote a proprietary interest in the Corporation among its executives;
(b) to retain and attract the qualified managers the Corporation requires;
(c) to provide a long-term incentive element in overall compensation; and
(d) to promote the long-term profitability of the Corporation.

II. ADMINISTRATION

The Plan shall be administered by such committee of the Board of Directors of the Corporation as is designated from time to time by the Board (the "Committee"). The Committee shall have full and complete authority to interpret the Plan and to prescribe such rules and regulations and make such other determinations as it deems necessary or desirable for the administration of the Plan.

III. SHARES

The shares that may be issued pursuant to the exercise of options granted under the Plan are common shares of the Corporation ("Shares"). The number of Shares that may be issued pursuant to the exercise of options under the Plan shall not exceed 2,500,000 Shares in the aggregate.

IV. GRANT OF OPTIONS

The Committee may from time to time designate salaried officers and other full time employees who, in the opinion of the Committee, are key employees of the Corporation and its subsidiaries to whom options to purchase Shares shall be granted, and determine the number of Shares to be optioned to each and, subject as herein contained, the terms, conditions and limitations of the options. An option granted under the Plan will not be exercisable by an optionee until such option has been evidenced by a written option agreement duly executed and delivered by the Corporation and such optionee. An optionee may hold more than one option at any time. Any option granted to a member of the Committee shall be conditional upon the granting of such option being ratified by the Board of Directors of the Corporation.

V. SUBSCRIPTION PRICE

The subscription price for each Share that may be purchased through the exercise of an option (the "Subscription Price") shall be fixed by the Committee for each option, but shall not be less than 90% of the Market Value of the Shares. For this purpose, "Market Value" means the closing price for a board lot of Shares on The Toronto Stock Exchange on the trading day immediately preceding the date on which the option is granted, or, if at least one board lot of Shares shall not have been traded that day, on the next preceding day on which a board lot was traded.

VI. TERM

The Shares subject to each option shall become purchasable at such time or times after the option is granted as may be determined by the Committee at the time of the grant of the option.

Each option, unless sooner terminated in accordance with the terms, conditions and limitations of the option, shall expire at the close of business on the date determined by the Committee when the option is granted, which date shall not be later than 10 years from the date on which the option is granted. The Committee may, with the consent of the optionee, cancel any unexercised option or the unexercised balance of any option. Shares in respect of which options are not exercised or in respect of which options are cancelled shall be available for subsequent options.

VII. SHARE PURCHASE LOANS

The Committee may, either at the time of the grant of an option or thereafter, authorize the making of a loan by the Corporation to the optionee at the time of exercise of the option, the amount of which will be applied in full towards the aggregate Subscription Price of the Shares in respect of which the option is being exercised. Any such loan shall be made on such terms as may be prescribed by the Committee or by the Board of Directors of the Corporation. The Committee may forgive all or any portion of any such loan where it determines that the enforcement of the terms of the loan would cause extreme hardship and the forgiveness of the loan would be consistent with the best interests of the Corporation.

VIII. EXERCISE OF OPTIONS

An option may be exercised from time to time by delivery to the Corporation at its principal office in the City of Calgary, Alberta of a written notice of exercise specifying the number of Shares with respect to which the option is being exercised and accompanied by payment in full of the purchase price of the Shares then being purchased. No person shall have any of the rights of a shareholder in respect of any Shares subject to an option until such Shares have been paid for in full and issued.

IX. NON-ASSIGNABILITY

No option or any right conferred by an option shall be assignable, negotiable or otherwise transferable other than by will or the laws of descent and distribution. Options or rights conferred by an option shall be exercisable during the optionee's lifetime only by such optionee or by the optionee's guardian or legal representative.

X. EFFECTS OF ALTERATION OF SHARE CAPITAL

In the event of any change in the outstanding common shares of the Corporation by reason of any stock dividend, split, recapitalization, merger, consolidation, combination or exchange of shares or other similar corporate change, equitable adjustments shall be made in the maximum number and kind of shares issuable under the Plan and in the maximum number and kind of and the subscription price for shares issuable under outstanding options. Such adjustments shall be made by the Committee and shall be conclusive and binding for all purposes of the Plan.

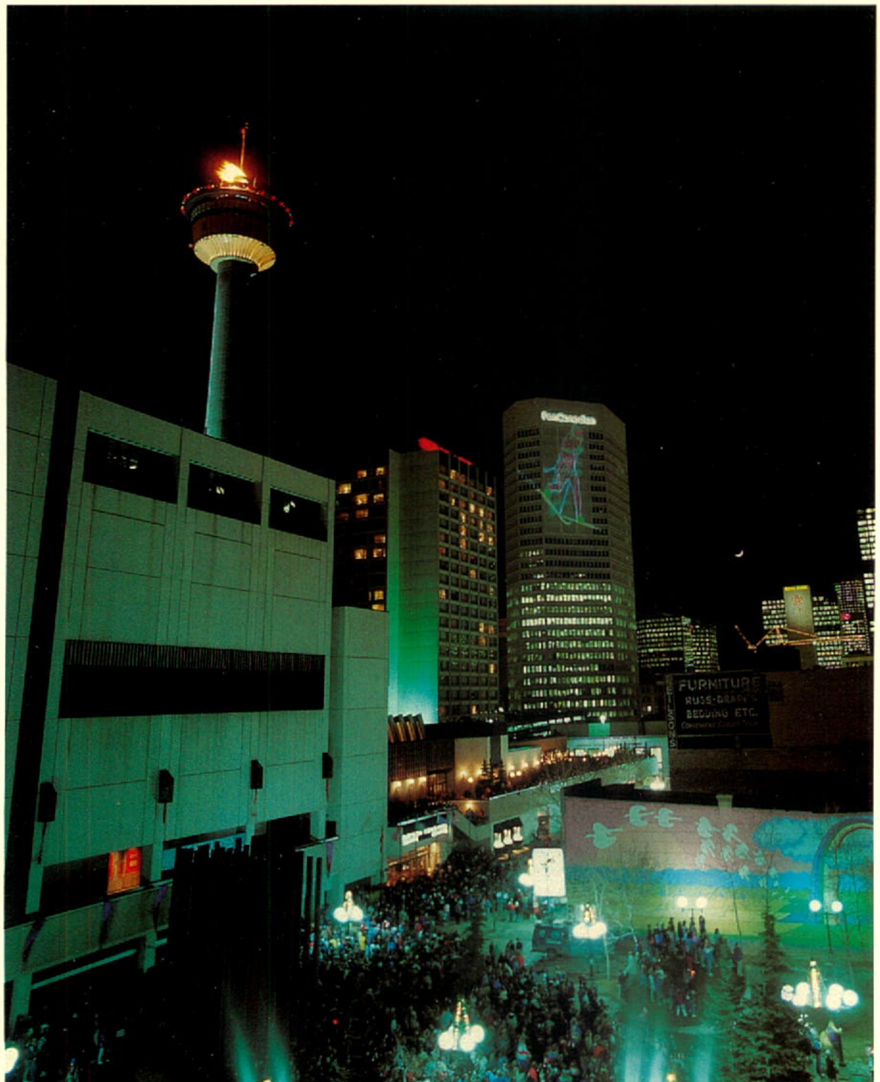
XI. EFFECTIVE DATE OF THE PLAN

The Plan shall become effective upon approval by the shareholders at the 1988 Annual Meeting of the Shareholders of the Corporation.

XII. AMENDMENT AND TERMINATION

The Board of Directors of the Corporation may at any time and from time to time amend, suspend or terminate the Plan in whole or in part, subject to obtaining any required stock exchange or regulatory approval. No such amendment, suspension or termination shall adversely affect rights under any options theretofore granted, without the consent of the optionee to whom such options were granted.

PanCanadian in the Community



Laser projections on PanCanadian Plaza during the Olympic Festival of Lights.

3 - PanCanadian Christmas Chorus

Award winning Stampede display in the Plaza lobby

1 - PCP's "Helping Hand" in United Way Parade

2 - Weyburn Slo-Pitch Champions

4 - PCP Voyageurs in United Way Canoe Race

The following employees have contributed photos to this year's annual:

B. Ries	Bottom left, page 10
L. T. Truong	Bottom, page 16
R. Claussner	Page 31
A. Yahya	This page, photo 1
T. Bell	This page, photo 2
S. Parr-Tomes	This page, photo 3
A. Nicholson	This page, photo 4