



**TRUE** energy inc.

2001  
ANNUAL  
REPORT

**TRUE ENERGY INC.** WAS FORMED AUGUST 31, 2000 THROUGH THE AMALGAMATION OF SUNDANCE RESOURCES INC. AND TWO PRIVATE ALBERTA COMPANIES. AS A RESULT OF THESE TRANSACTIONS, DRILLING, AND ADDITIONAL ACQUISITIONS, THE COMPANY'S INITIAL CORE AREA INCLUDES OIL AND GAS PRODUCING PROPERTIES IN WEST CENTRAL SASKATCHEWAN. PRIMARY PROPERTIES INCLUDE COLEVILLE, COLEVILLE SOUTH, KERROBERT, SMILEY AND DODSLAND.

SINCE INCEPTION, TRUE ENERGY HAS GROWN ITS UNDEVELOPED LAND BASE FROM 18,000 NET ACRES TO MORE THAN 116,000 NET ACRES, ITS PROVED AND PROBABLE RESERVES FROM 1.4 MILLION BARRELS OF OIL EQUIVALENT TO 5.0 MILLION BARRELS OF OIL EQUIVALENT AND ITS PRODUCTION FROM 160 BARRELS OF OIL EQUIVALENT PER DAY TO 2,200 BARRELS OF OIL EQUIVALENT PER DAY. THE COMPANY'S RESERVE LIFE INDEX IS 5.5 YEARS.

CURRENTLY, THE COMPANY'S PRODUCTION MIX IS 68 PERCENT NATURAL GAS, 27 PERCENT HEAVY OIL AND 5 PERCENT LIGHT OIL AND ITS RESERVE MIX IS 61 PERCENT NATURAL GAS, 26 PERCENT HEAVY OIL AND 13 PERCENT LIGHT OIL.

TRUE ENERGY'S STRATEGY INCLUDES EXTERNAL GROWTH THROUGH CORPORATE AND PROPERTY ACQUISITIONS, FARMINS AND SWAPS AS WELL AS INTERNAL GROWTH THROUGH EXPLORATION AND DEVELOPMENT DRILLING AND FACILITIES CONSTRUCTION.

TRUE ENERGY INC. TRADES ON THE TORONTO STOCK EXCHANGE UNDER THE SYMBOL **TUI**.

**ANNUAL GENERAL MEETING** The Annual General Meeting of True Energy Inc. shareholders will be held at the Devonian Room, Calgary Petroleum Club, Calgary, Alberta on May 28th, 2002 at 3:00 p.m.

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# FINANCIAL HIGHLIGHTS 2001 OPERATING

## 2001 TRUE ENERGY

### FINANCIAL AND OPERATIONAL SUMMARY

#### FINANCIAL

(\$000s, except per share amounts)

Twelve months ended December 31	2001	2000	% Change
Revenue	<b>18,103</b>	3,633	398
Cash Flow from Operations	<b>4,159</b>	1,075	287
per share – basic	<b>0.21</b>	0.11	91
per share – diluted	<b>0.21</b>	0.11	91
Net Earnings (loss)	<b>(19,300)</b>	176	(11,066)
per share – basic	<b>(0.99)</b>	0.02	(5,050)
per share – diluted	<b>(0.99)</b>	0.02	(5,050)
Total Assets	<b>30,564</b>	15,672	95
Debt, net of working capital	<b>17,243</b>	3,438	402
Shareholders' Equity	<b>8,942</b>	7,195	24
Capital Expenditures, net of dispositions	<b>37,804</b>	8,525	343
Shares Outstanding	<b>28,775</b>	12,575	129
Weighted Average shares			
basic	<b>19,459</b>	9,382	107
diluted	<b>20,109</b>	9,679	108

#### OPERATIONAL

Twelve months ended December 31	2001	2000	% Change
Production			
Oil and NGLs (bbls/d)	<b>566</b>	69	720
Natural Gas (Mcf/d)	<b>7,887</b>	1,710	361
Combined (BOE/d)	<b>1,880</b>	354	431
Prices			
Oil and NGLs (\$/bbls)	<b>20.61</b>	34.46	(40)
Natural Gas (\$/Mcf)	<b>4.81</b>	4.42	9
Combined (\$/BOE)	<b>26.38</b>	28.06	(6)
Per BOE (@ 6:1)			
Operating Netback	<b>10.83</b>	15.63	(31)
Operating Expenses	<b>7.23</b>	7.20	0
General and Administrative	<b>2.37</b>	4.85	(43)
Undeveloped Land			
Gross (acres)	<b>189,586</b>	93,542	83
Net (acres)	<b>115,555</b>	26,000	305
Reserves			
Oil and NGLs (Mbbbls)	<b>1,975</b>	1,003	97
Natural Gas (MMcf)	<b>18.12</b>	9.31	95
Combined (MBOE)	<b>4,994</b>	2,555	95

## 2001 HIGHLIGHTS

**JANUARY** True Energy Inc. completes construction of the Company-operated Smiley natural gas compressor station, enabling continued recovery of existing reserves and providing firm capacity for future drilling locations.

**FEBRUARY** True Energy lists on the Toronto Stock Exchange, retaining its CDNX symbol TUI.

**MARCH** True Energy closes acquisition of Marengo Exploration Ltd. for \$16.3 million, gaining 10,920 net acres of undeveloped land and 722 barrels of oil equivalent per day of production consisting of approximately 65 percent natural gas. ■ True Energy closes private placement of 4,166,667 special warrants at a price of \$1.20 per special warrant for gross proceeds of \$5 million.

**MAY** True Energy completes Phase 1 of the Coleville South farm in with eight successful wells, adding initial production of 300 barrels per day of oil.

**JUNE** True Energy closes acquisition of petroleum and natural gas assets in the Kerrobert, Dodsland and Bayhurst areas of west central Saskatchewan for \$15.5 million, gaining 146,456 gross acres of undeveloped land, 1.1 million barrels of oil equivalent of established reserves and 571 barrels of oil equivalent per day of production consisting of roughly 75 percent natural gas. ■ True Energy closes private placement of 7.2 million special warrants at a price of \$1.90 per special warrant for gross proceeds of \$13.7 million.

**NOVEMBER** True Energy closes private placement of 3.7 million flow-through common shares for gross proceeds of \$3.5 million. ■ True Energy realizes \$1.9 million from the sale of non-core assets, bringing total dispositions for 2001 to \$3.5 million.

# LETTER TO THE SHAREHOLDERS

## INTRODUCTION

True Energy Inc. is pleased to report on its financial and operating results for the year ended December 31, 2001. The past year proved to be a successful year in which the Company experienced growth in revenue, undeveloped land, reserves and production. The Company also significantly expanded natural gas processing capacity in its initial core area. On February 13, 2001, True Energy moved its stock listing from the Canadian Venture Exchange to the Toronto Stock Exchange, retaining its original trading symbol, TUI.

## ON TRACK

### Strategy

December 31, 2001 marked the end of the first full calendar year of operations for True Energy as a publicly traded company. Our initial strategy was to establish the Company's asset base through both acquisitions of new properties and drilling on the Company's existing properties. Our key considerations when evaluating new project areas included the potential for multi-zone development and access to operated processing facilities. We were also looking for areas and specific commodities that were out of favour and thus could be purchased for less than those that were demanding higher prices. Consequently, our first core area is characterized by shallow gas and heavy oil which did not command the higher prices of liquids-rich, gas prone areas. Once these criteria were met, the Corporation expanded its land and production base through further acquisitions, farmins, swaps, crown land sales, drilling, and infrastructure additions. Our strategy was devised to accomplish four primary goals:

- establish a strong initial core area
- obtain substantial cash flow through high production volumes
- capture high working interests and operatorship
- achieve the above in a short period of time

### Growth History

Since inception, True Energy has successfully concluded five additional, separate transactions resulting in a land position more than six times greater than its initial holdings. These transactions, complemented by drilling programs on the Company's established properties, have also added 3.6 million barrels of oil equivalent in reserves and 2,040 barrels of oil equivalent per day in production. As a result of pursuing our strategy, we have increased revenue approximately 400 percent and cash flow 300 percent. Our strategy is working and our growth picture is on track.

True  
Energy  
experienced growth  
in revenue,  
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capacity in its  
initial core area.

## Challenges

Because of our substantial growth over a relatively short period of time, True Energy faced some predictable, but rectifiable, challenges. Our expenditures for 2001 included \$10.9 million on exploration and development activities, \$15.7 million on the acquisition of producing assets in the Corporation's core area, and \$14.7 million (cash basis) on the acquisition of Marengo Exploration Ltd. for total expenditures of \$41.3 million. As anticipated, this activity resulted in a working capital deficit and increased bank debt. However, beginning in the second quarter, True Energy stepped up its asset stewardship, addressing these challenges through property dispositions, limited capital spending, operating cost reductions, and a flow-through share offering. The sale of non-core assets resulted in proceeds of \$3.5 million, while reducing our land position by 65,500 acres, reserves by 59 thousand barrels of oil equivalent and production by only 175 barrels of oil equivalent per day. By year end, we had reduced our bank debt net of working capital to \$17.2 million.

## The Team

As well as adding to our land position, reserves and production, True Energy augmented its staff, adding operational capacity and expertise. We now have all the key people required to continue our growth and asset stewardship into the next year and beyond. However, as we initiate a second core area, we will again evaluate our core competencies to determine if additional technical staff are needed to augment the team.

## YEAR IN REVIEW

### Industry Conditions

Prices for the benchmark West Texas Intermediate crude oil decreased steadily from more than US\$30.00 per barrel in January to less than US\$19.00 per barrel at year end, with the average price for 2001 dropping 14.2 percent to US\$25.90 per barrel from US\$30.20 per barrel in 2000. Similarly, prices for Canadian light crude dropped 31.8 percent to C\$29.25 per barrel in December 2001 from C\$42.87 per barrel in December 2000. The average price for 2001 decreased 10.5 percent to C\$39.82 per barrel from C\$44.52 per barrel in 2000.

Canadian heavy oil suffered even more. Average prices for Koch Lloyd Blend dropped 27.8 percent to C\$23.54 per barrel from C\$32.59 per barrel in 2000, with the heavy/light differential increasing 36.5 percent to C\$16.28 per barrel from C\$11.93 per barrel in 2000.

Canadian natural gas prices also eroded from 2000 levels, averaging C\$5.20 per gigajoule in 2001 compared to C\$5.39 per gigajoule in 2000. However, the real story is the drop from a high of C\$13.00 per gigajoule in January to a low of C\$3.50 per gigajoule by the end of the year.

### True Energy

For the year ended December 31, 2001, revenue increased 398 percent to \$18.1 million from \$3.6 million in 2000. Cash flow from operations amounted to \$4.2 million compared to \$1.1 million, an increase of 287 percent. Cash flow per share increased to \$0.21 (\$0.21 diluted) from \$0.11 (\$0.11 diluted) in 2000. The Company reported a loss of \$19.3 million in 2001 compared to earnings of \$176,000 in 2000. The 2001 loss was primarily the result of a ceiling test writedown in the carrying value of the Company's assets.

Debt, net of working capital, at December 31, 2001 was \$17.2 million compared to \$3.4 million at December 31, 2000. Capital expenditures for 2001 amounted to \$41.3 million, before proceeds of \$3.5 million resulting from disposition of assets during the year.

Oil and gas production increased significantly in 2001 averaging 1,880 barrels of oil equivalent, an increase of 431 percent from 354 barrels of oil equivalent in 2000. Proved plus probable reserves increased by 95 percent to 5.0 million barrels of oil equivalent.

## **OUTLOOK**

The forecast for industry conditions in 2002 is somewhat uncertain. Most analysts agree that economic recovery has begun, and are forecasting average prices for West Texas Intermediate will range from US\$21.00 per barrel to US\$30.00 per barrel. We believe that US\$22.50 per barrel is a reasonable level. Estimates of heavy to light oil differentials range from US\$3.50 per barrel to US\$8.00 per barrel; however, with the addition of heavy oil refining capacity coming on stream in 2002, we anticipate the heavy oil differential will average around US\$6.00 per barrel. The forecast average price for Canadian natural gas ranges from C\$2.75 per gigajoule to C\$3.50 per gigajoule. We believe an AECO average price of C\$3.75 per gigajoule is attainable. Although lower than last year, oil and natural gas prices are still solid compared to recent years, and may strengthen as the economy improves later in the year.

A combination of lower commodity prices and asset rationalization in the industry as an outcome of recent acquisition and merger activity may provide for significant acquisition opportunities in 2002. Higher commodity prices will have a positive impact on the rate of return for internal projects, allowing accelerated growth from drilling prospects on the Company's substantial undeveloped land base.

True Energy plans to establish and grow a new core area as well as focusing on projects with high netbacks and high recycle ratios.

## **ACKNOWLEDGEMENTS**

The significant growth True Energy Inc. has achieved over the past 16 months, and in particular, over the past year, is due to the contributions of our suppliers, our employees, our management and our Board of Directors. I would like to take this opportunity to thank them, as well as our shareholders for their continued support.

## **Signed by**

Paul R. Baay  
President and CEO

True Energy's main properties are Coleville, Coleville South, Kerrobert, Smiley and Dodsland, all of which are in west central Saskatchewan.

**OVERVIEW**

Strategy

Our initial core area is located in west central Saskatchewan along the Alberta/Saskatchewan border. In developing this core area, our strategy is to dominate by acquiring opportunistically and then to refine our focus by divesting non-core assets and to solidify our position by exploiting core assets. Inherent in the acquisition aspect of the cycle is a strategic and predictable fluctuation in cash flow which is addressed in the exploitation and divesting aspect of the cycle.

Second Core Area

In 2002, True Energy plans to establish and grow a new core area following the Company's proven strategy of seeking areas that have:

- multi-zone development potential
- processing capacity and transportation infrastructure
- opportunities for high working interests and operatorship

The criteria for the new core area include production and reserves that are predominantly natural gas, provide high netbacks and have a high recycle ratio.

## PROPERTIES

### Coleville

- **Description** The Coleville property, centered approximately 25 kilometres northwest of Kindersley, Saskatchewan, produces gas from the shallow Bakken and Mannville zones. Six wells (4.3 net) are currently producing to the company-operated gas facility. This is True Energy's main natural gas producing property, having grown from less than 1.0 million cubic feet per day (0.8 million cubic feet per day net) to more than 4.0 million cubic feet per day (3.2 million cubic feet per day net) during 2001. Current net production at Coleville is 4.1 million cubic feet per day.
- **Facilities** One natural gas compression, dehydration and sweetening facility in which True Energy holds an interest of approximately 76 percent. The Company expanded the capacity of this facility by adding compression in December 2000. Subsequent to year-end, sweetening facilities were upgraded to match compression capacity.
- **2001 Highlights** Q3: One additional Bakken gas well (0.75 net) was successfully drilled, completed and tied in and is currently averaging more than 1 million cubic feet per day.
- **Future Activities** 2002 activity will focus on additional gas drilling. Three 100 percent working interest wells are currently planned for the year.

AT-A-GLANCE COLEVILLE		
	2001	2000
Land Holdings (acres)	9,400	
Reserves		
oil (Mbbbls)	254	201
gas (MMcf)	3,423	2,467
Production		
oil (bbls/d)	22	1
gas (Mcf/d)	2,591	426

### Coleville South

- **Description** Located 18 kilometres north of Kindersley, Saskatchewan, the Coleville South property consists of eight wells producing Bakken heavy oil, currently at 300 barrels per day. The Corporation holds a 100 percent working interest in the property subject to convertible overriding royalty.
- **Facilities** Each well is equipped with a screw pump and heated treating and storage tanks.
- **2001 Highlights** Q2: The Company drilled, completed and placed on production the first eight wells of a multi-well project located on 3.5 net sections, of farm-in lands.
- **Future Activities** Next phase development of up to 16 wells is planned for 2002. Ultimate full development of the project is forecast to be 50 to 60 wells as defined by 3D seismic. It is anticipated that central treating and water handling facilities would be installed upon full development and that a water flood would be implemented.

AT-A-GLANCE COLEVILLE SOUTH		
	2001	2000
Land Holdings (acres)	2,500	
Reserves		
oil (Mbbbls)	284	0
gas (MMcf)	0	0
Production		
oil (bbls/d)	162	0
gas (Mcf/d)	0	0

## Kerrobert

- Description** Located approximately 40 kilometres north of Kindersley, Saskatchewan, Kerrobert is part of the Kerrobert/Dodsland property acquisition successfully completed in 2001. The property consists of both light and heavy oil production from the Viking and McLaren formations respectively and is currently producing approximately 240 barrels per day net to True Energy. The McLaren channel on the Company's lands, as defined by well control, is 35 meters thick and contains more than 25 million barrels of oil in place. The Company's working interest on these particular lands is 100 percent.

AT-A-GLANCE KERROBERT		
	2001	2000
Land Holdings (acres)	8,500	
Reserves		
oil (Mbbbls)	586	0
gas (MMcf)	493	0
Production		
oil (bbls/d)	68	0
gas (Mcf/d)	113	0

- 2001 Highlights** Following acquisition of the property the Company re-activated two McLaren formation oil wells, including one horizontal well.
- Future Activities** True Energy will commence further development of the McLaren channel by drilling up to four horizontal wells, the first being drilled in the first quarter of 2002. The Company's lands immediately offset a portion of the channel developed with horizontal wells. These wells have produced at rates of up to 200 barrels per day and recovered as much as 100,000 barrels of oil on primary. Rates and recoveries under SAGD have been as high as 1,000 barrels per day and 600,000 barrels of oil respectively.

In the Viking light oil formation, the Company has identified 60 locations that will be drilled over the next three to five years in conjunction with an oil price hedging program that assures the Corporate internal rate of return hurdle rates.

## Smiley

- Description** Located approximately 35 kilometers northwest of Kindersley, Saskatchewan, the Smiley property consists of both shallow gas and heavy oil development projects. Light oil is also produced from the Viking formation. The natural gas project currently comprises eight gas wells (3.85 net) producing through a compression dehydration facility installed by True Energy in January 2001. In addition, solution gas from four oil wells (2.25 net) is conserved through this facility. Current Smiley net production is 1.4 million cubic feet per day and 70 barrels per day.

AT-A-GLANCE SMILEY		
	2001	2000
Land Holdings (acres)	10,100	
Reserves		
oil (Mbbbls)	262	502
gas (MMcf)	4,621	5,969
Production		
oil (bbls/d)	72	56
gas (Mcf/d)	1,202	1,252

- Facilities** One light oil treatment facility, one heavy oil tank treating facility and a gas compression-dehydration-sweetening facility.
- 2001 Highlights** Q1: True Energy completed construction of a gas compression and dehydration facility in January 2001 enabling continued production and extending the project reserve life. The facility also provides capacity for future planned gas drilling locations. A gas sweetening unit was added to the facility in March. Q2: A 3D seismic program was conducted primarily to delineate the Bakken oil formation. In addition, True Energy has located several gas targets. Q3: A 100 percent working interest suspended oil well was successfully re-completed, tied in and is producing as a gas well.
- Future Activities** Three gas and one oil/gas drilling locations are planned for 2002 from the 3D seismic program, targeting the Bakken, Detrital and Waseca formations. Future development of the Bakken oil pools could involve up to 28 drilling locations as delineated by the 3D seismic program. Additional seismic work is planned on lands acquired in 2001 to further define leads identified by the 2001 3D program.

## Doddsland

- Description** The Company's Doddsland property is located approximately 30 kilometres north of Kindersley, Saskatchewan and was part of Kerrobert/Doddsland property acquisition concluded in 2001. The Company's principal Doddsland interest is approximately 69 percent in the Doddsland Viking Gas Unit, which it operates. Current net production from Doddsland is 720 thousand cubic feet per day. The property acquisition also included a large undeveloped land base in the surrounding area.

- Facilities** Unit facilities include a small gas plant with compression, dehydration and liquids extraction. This facility handles Unit and Non-unit gas production from the Viking and Bakken formation and is strategically located relative to the Company's undeveloped land in the area.

- 2001 Highlights** Geological work conducted subsequent to the property acquisition has identified several prospects that are analogous to the Company's Coleville gas producing area.

- Future Activities** Seismic programs will be conducted in 2002 to further evaluate the targets identified on the Company's undeveloped land. One gas drilling prospect, located near existing facilities, is currently being refined by 2D seismic.

AT-A-GLANCE DODSLAND		
	2001	2000
Land Holdings (acres)	24,300	
Reserves		
oil (Mbbbls)	57	0
gas (MMcf)	2,581	0
Production		
oil (bbls/d)	3	0
gas (Mcf/d)	310	0

## True Energy's

production for 2001 averaged 1,880 barrels of oil equivalent per day, an increase of 431 percent over production in 2000.

### LAND HOLDINGS

	Gross	Net
Developed (acres)	79,656	40,610
Undeveloped (acres)	189,586	115,555
Total	269,242	156,165

### DRILLING ACTIVITY

During the 12 months ended December 31, 2001 True Energy drilled or participated in the drilling of 24 wells and 1 re-completion. The Company operated 18 of these wells and its overall working interest averaged 76.8 percent. These activities resulted in 12 oil wells (9.0 net) and 8 gas wells (6.1 net) with an overall success rate of 80.0 percent.

	Gross	Net	Success Rate
Exploratory Wells	8	6.7	50.0%
Development Wells	16	11.5	93.8%
Recompletions	1	1	100.0%
Total Wells	25	19.2	80.0%

	Gross	Net
Oil Wells	12	9.0
Gas Wells	8	6.1
Dry Holes	5	4.1
Total Wells	25	19.2

### PRODUCTION

True Energy's daily production for the year ended December 31, 2001 averaged 1,880 barrels of oil equivalent, consisting of 566 barrels of oil per day and 7.9 million cubic feet of gas per day.

## RESERVES

### Reserves Summary

	Natural Gas (Bcf)	Crude Oil & NGLs (Mbbbls)	Combined (MBOE)
December 31, 2001			
Proved Producing	9.82	881	2,517
Proved Non-producing	2.89	135	618
Total Proved	12.71	1,016	3,135
Probable	5.41	959	1,859
Total Proved Plus Probable	18.12	1,975	4,994

Reserves Reconciliation	Natural Gas (Bcf)		Crude Oil & NGLs (Mbbbls)		Combined (MBOE)	
	Proved	Proved + Probable	Proved	Proved + Probable	Proved	Proved + Probable
Total, December 31, 2000	7.06	9.31	424	1,003	1,601	2,555
Acquisitions	8.77	11.77	645	1,082	2,107	3,044
Dispositions	(0.30)	(0.86)	–	–	(50)	(143)
Discoveries	0.91	1.21	255	346	407	548
Production	(2.88)	(2.88)	(207)	(207)	(686)	(686)
Revisions	(0.85)	(0.43)	(101)	(249)	(244)	(324)
Total, December 31, 2001	12.71	18.12	1,016	1,975	3,135	4,994

Estimated Future Net Cash Flow (\$000)	Present Worth Discounted At		
	10%	12%	15%
December 31, 2001			
Proved Producing	20,900	19,900	18,700
Proved Non-producing	4,900	4,600	4,200
Total Proved	25,800	24,500	22,900
Probable	11,300	10,500	9,400
Total Proved Plus Probable	37,100	35,000	32,300

Net Asset Value (\$000s except per share values)	Present Worth Discounted At		
	10%	12%	15%
Future Net Cash Flow Established Reserves	31,500	29,800	27,600
Undeveloped Land	6,000	6,000	6,000
Debt, Net of Working Capital	(17,200)	(17,200)	(17,200)
Net Assets	20,300	18,600	16,400
Common Shares Outstanding	28,775	28,775	28,775
Net Asset Value Per Share	0.71	0.65	0.57

### Reference Price Forecasts

Gilbert Laustsen Jung Associates, January 1, 2002

	Crude Oil			Natural Gas		
	WTI Cushing, OK US\$/bbl	Par Edmonton Cdn\$/bbl	Heavy (12° API) Cdn\$/bbl	NYMEX Henry Hub US\$/MMBtu	AECO C Spot Cdn\$/GJ	Exchange Rate Cdn\$/US\$
2002	20.00	30.75	16.75	3.20	4.30	0.635
2003	21.00	31.25	17.50	3.50	4.65	0.650
2004	21.00	30.50	19.50	3.60	4.70	0.670
2005	21.00	29.50	19.25	3.65	4.70	0.690
2006	21.25	29.50	19.25	3.70	4.70	0.700

True  
Energy's  
approach to  
Corporate  
Governance is  
substantially  
compliant with TSE  
recommendations.

### **RECOGNITION OF AND ADHERENCE TO TSE GUIDELINES**

The Corporation's approach to Corporate Governance is substantially compliant with TSE recommendations.

### **BOARD'S RESPONSIBILITIES**

Board has assumed responsibility for the stewardship of the Corporation, including:

- adoption of a strategic planning process
- identification of the principle risks of the Corporation's business and the implementation of appropriate systems to manage these risks
- succession planning, including appointing, training and monitoring senior management
- the Corporation's communication policy
- integrity of the Corporation's internal control and management information systems

### **THE BOARD COMPOSITION**

The True Energy Board of Directors comprises seven members, only one of whom, Paul R. Baay, is a member of management, and is therefore considered an inside and related director. The other six directors are unrelated as defined in the TSE recommendations. The Corporation does not have a Chairman of the Board, but will be filling that position in the coming year.

### **BOARD COMMITTEES**

#### Corporate Governance Committee

The Board has appointed a Corporate Governance Committee, comprising Kenneth P. Acheson, Michael S. Vandale and John H. Cuthbertson, all of whom are outside directors. The Corporate Governance Committee is responsible for enhancing corporate governance through a continuing assessment of governance issues and a mandate which includes recommending a broad list of topics of interest that are important for discussion and/or action by the Board, and undertaking on behalf of the Board, such other initiatives as are needed to assist the Board in delivering exemplary governance of the Corporation. The Committee's mandate also includes the responsibility for recommending suitable candidates for nomination to the Board and maintaining an overview of the entire membership of the Board. This includes assessing the effectiveness of the Board as a whole, the committees of the Board, the appointments to those committees and the mandates thereof, as well as the contribution of individual directors on an ongoing basis. The Corporate Governance Committee recommends to the Board following each annual meeting of shareholders the allocation of Board members to each Board committee.

#### Audit Committee

The Corporation's Audit Committee comprises Kenneth P. Acheson, W. C. Mickey Dunn and Robert G. Rowley, all of whom are outside directors. While W. C. Mickey Dunn is the Corporate Secretary, he is not considered by the Board to be a part of management and thus is an outside director for purposes of the Guidelines. The Audit Committee meets at least once each quarter and, among other things with the assistance of the external auditors, is responsible for reviewing management programs and policies regarding the adequacy and effectiveness of the internal controls over the accounting and financial reporting systems within the Corporation, including management's response to internal control recommendations of the external auditors.

The Committee reviews management plans regarding changes in accounting practices and policies and the financial impact thereof and is responsible for reviewing the major areas of management judgement and estimates that have a significant effect upon the financial statements. The Committee receives a yearly report from the Corporation's external auditors with respect to the Corporation's financial control and information systems, which comes to their attention during the course of conducting the year end audit. Results of those reports are relayed by the Committee to the full Board for its consideration. At least once a year, the Audit Committee meets with the Corporation's external auditors without management present and may do so at any time throughout the rest of the year. All financial statements, quarterly reports and other financial information that are publicly disseminated are reviewed by the Audit Committee prior to release for approval.

#### Compensation Committee

The Board has appointed a Compensation Committee comprising W. C. Mickey Dunn, Robert G. Rowley and Michael S. Vandale, each of whom are outside directors. The mandate of the Compensation Committee is to formulate and to make recommendations to the Board in respect of compensation issues relating to directors, senior management and the staff of the Corporation, including reviewing and recommending performance objectives and the compensation package for the Chief Executive Officer. The compensation of directors of the Corporation, and whether they will be paid an annual and/or meeting retainer, in addition to stock options, is currently being reviewed.

#### Reserves Committee

The Board is in the process of setting up a reserves committee. The Reserves Committee will be responsible for reviewing the independent engineering report provided to the Company. The Committee will also meet with the independent engineers without management present to discuss the submitted report.

#### Other Committees

The Board does not have a nominating Committee; the responsibilities of such a committee form part of the mandate of the Corporate Governance Committee.

As new directors have joined the Board, management has provided these individuals with, among other things, historical information about the Corporation and its performance, background information regarding the Corporation and its strategic plan with an outline of the general duties and responsibilities entailed in carrying out their duties. The Board believes that these procedures have proved to be a practical and effective approach in light of the Corporation's particular circumstances, including the size of the Corporation, limited turnover of the directors and the experience and expertise of the Board members.

MANAGEMENT'S DISCUSSION AND ANALYSIS

True Energy

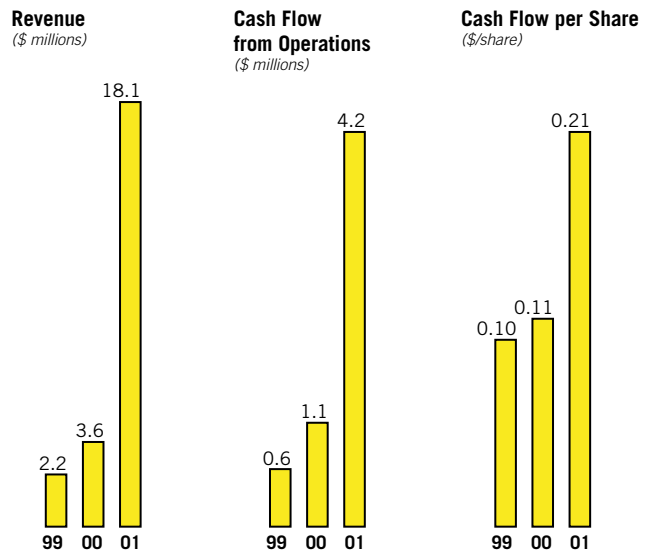
recorded a 403 percent increase in revenue and a 282 percent increase in cash flow from operations in 2001.

2001 HIGHLIGHTS

- Revenue increased 403 percent to \$18.1 million.
- Cash flow from operations was \$4.2 million, up 282 percent from 2000.
- Cash flow per share increased to \$0.21 (\$0.21 diluted), up 91 percent from \$0.11 (\$0.11 diluted) in 2000.
- The Company reported a loss of \$19.3 million in 2001, primarily as a result of a ceiling test writedown in the carrying value of its assets.
- Debt, net of working capital, at December 31, 2001 was \$17.2 million.
- Capital expenditures for 2001 amounted to \$41.3 million, before proceeds of \$3.5 million resulting from disposition of assets during the year.
- Oil and gas production increased significantly in 2001 averaging 1,880 barrels of oil equivalent, up 431 percent from 354 barrels of oil equivalent in 2000.
- Proved plus probable reserves increased by 95 percent to 5.0 million barrels of oil equivalent.

The following discussion is intended to present the reader with a detailed analysis of the Company's financial and operating results for 2001 and the prior year, and should be read in conjunction with the Company's consolidated financial statements included in this annual report.

Information provided herein for 2002 is based on assumptions regarding future events and is subject to risks and uncertainties that may cause actual results to vary materially from these estimates.



Where amounts are expressed on a barrel of oil equivalent basis, natural gas volumes have been converted to barrels of oil at six thousand cubic feet per barrel, unless otherwise stated. References to oil in this discussion include crude oil and natural gas liquids (NGLs). NGLs include condensate, butane and propane.

## RESULTS OF OPERATIONS

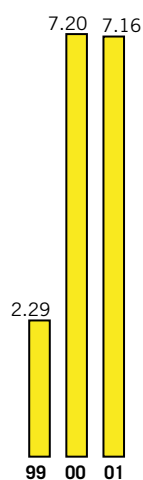
The year 2001 proved to be a significant growth year for True Energy, after commencing operations in September 2000. The oil and gas industry participated in an unprecedented amount of consolidation during the year, triggered by historically high natural gas and high crude oil prices during the first half of 2001. Oil and gas industry activity slowed down significantly in the fourth quarter after commodity prices declined steeply, reacting to the slowdown in the global economy. True Energy was active in the first half of 2001, completing the corporate acquisition of Marengo Exploration Ltd. effective February 28, 2001 and the purchase of oil and gas assets located in the Kerrobert/Dodsland area of west central Saskatchewan on June 26, 2001 along with the successful drilling at Coleville South and Coleville.

### Revenue

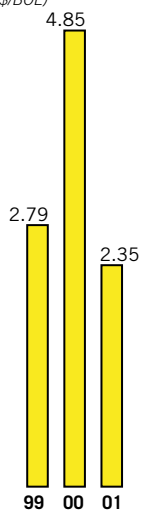
Revenue, after royalties, for 2001 was \$12.3 million, an increase of 310 percent from \$3.0 million in the previous year. The breakdown of revenue is summarized in the following table:

Revenue	2001	2000	Change
Years ended December 31 (\$ thousands)			
Oil revenue	4,256	872	388%
Natural gas revenue	13,847	2,761	402%
Royalties	(5,819)	(677)	760%
Revenue	12,284	2,956	315%

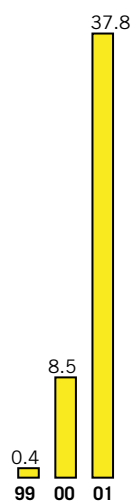
**Operating Expenses**  
(\$/BOE)



**G&A Expenses**  
(\$/BOE)



**Capital Expenditures, net**  
(\$ millions)



### Cash Flow from Operations and Net Earnings

Cash flow from operations was \$4.2 million, an increase of 287 percent from \$1.1 million in 2000. On a per share basis, cash flow from operations was \$0.21 basic (\$0.21 diluted), up 91 percent from \$0.11 basic (\$0.11 diluted) in 2000. True Energy reported a loss of \$19.3 million (\$0.99 per share) in 2001. In the previous year, the Company reported net earnings of \$0.2 million (\$0.02 per share).

### Oil Operations

Oil revenue was \$4.3 million, up 378 percent from \$0.9 million in 2000. Significant increases in oil production more than offset lower oil prices. Oil production averaged 566 barrels per day, up 720 percent from 69 barrels per day in 2000. The average WTI index price was US\$25.90 per barrel, down 14.2 percent from US\$30.20 per barrel in the previous year. As a result, True Energy received an average price of \$20.61 per barrel for oil sales, a decrease of 40 percent from \$34.46 per barrel selling price in 2000.

#### Oil Netbacks

Years ended December 31 (\$ per bbl)	2001	2000	% Change
Sales price	20.61	34.46	(40)
Royalties, as a % of sales	(15.0%)	(13.3%)	12
Production expense	(13.23)	(12.12)	9
Netback	4.27	17.82	(76)
Production (bbls/d)	566	69	720

### Natural Gas Operations

Natural gas revenue increased 393 percent to reach \$13.8 million in 2001, up from \$2.8 million in the previous year. The Company benefited from increased production volumes in 2001. True Energy's average natural gas selling price was \$4.81 per thousand cubic feet (\$4.14 before hedging), up 9 percent from \$4.41 in 2000.

Natural gas production in 2001 averaged 7.89 million cubic feet per day, up 361 percent from 1.71 million cubic feet per day in the previous year. Higher natural gas production volumes in 2001 were partly due to the acquisitions during the year, but more so as a result of the Company's successful drilling program in the Coleville/Driver area of west central Saskatchewan.

#### Natural Gas Netbacks

Years ended December 31 (\$ per Mcf)	2001	2000	% Change
Sales price	4.14	4.41	(6)
Hedging gain (loss)	0.67	-	-
Royalties, as a % of sales	(43.5%)	(20.3%)	114
Production expense	(0.76)	(1.00)	(24)
Netback	2.25	2.51	(10)
Production (MMcf/d)	7.89	1.71	361

## Hedging

In 2001, True Energy entered into transactions to put into effect a costless collar for natural gas sales of 3,000 gigajoules per day for the period February 1, 2001 to December 31, 2001. These transactions established a floor price of \$7.50 per gigajoule and a ceiling price of \$8.50 per gigajoule at the AECO-C Hub. Effective August 1, 2001, the Company sold the collar and received a lump sum payment of \$1.6 million. Total hedging gain resulting from this transaction was \$1.9 million and is included in natural gas revenue.

## General and Administrative Expense

General and administrative expense, before recoveries, increased by 200 percent to \$2.1 million in 2001, from \$0.7 million in the previous year. General and administrative expenses are reduced by overhead recovered on Company operated properties. Accordingly, net expenses were \$1.6 million in 2001, up 167 percent from \$0.6 million in 2000. On a barrel of oil equivalent basis, general and administrative expense improved in 2001 by 52 percent, at \$2.35 compared to \$4.85 in 2000.

General and Administrative Expense			
Years ended December 31 (\$ thousands except per BOE amounts)	2001	2000	% Change
General and administrative expense, gross	2,143	686	212
Operator recoveries			
Capital	(298)	–	–
Operating	(230)	(58)	297
General and administrative expense, net	1,615	628	157
General and administrative expense per BOE			
Gross	3.12	5.29	(41)
Net	2.35	4.85	(52)
Staff at year-end			
Employees	15	5	200
Consultants	6	2	200

## Interest Expense

The following table is a summary of interest expense and relevant statistics for the past two years:

Interest Expense			
Years ended December 31 (\$ thousands except per BOE amounts)	2001	2000	% Change
Interest expense	737	31	2,277
Interest expense per BOE	1.07	0.24	346

Higher interest charges in 2001 reflect higher debt levels incurred to finance a portion of the year's capital expenditures.

## Capital Tax

Capital taxes paid by the Company are in respect of the Federal Large Corporations Tax and are based on year-end equity, debt and future income tax levels. Capital taxes were \$30,054 in 2001.

### Depletion and Depreciation

In 2001, depletion and depreciation increased by 870 percent from \$1.0 million in 2000 to \$9.7 million. On a barrel of oil equivalent basis depletion and depreciation was \$14.14 in 2001, up from \$7.90 in the previous year. Higher depletion charges in 2001 reflect the higher net book value recorded as a result of the "spiral-up" effect relating to the Marengo acquisition.

Under the Canadian Institute of Chartered Accountants (CICA) full cost accounting guidelines, the Company calculates a ceiling test whereby the carrying value of petroleum and natural gas properties is compared to estimated future cash flow from the production of proven reserves.

At December 31, 2001, the Company calculated the ceiling test using prices of \$18.25 per barrel for oil and \$3.24 per thousand cubic feet for natural gas. As a result, the Company realized a write-down of its oil and gas properties by \$16.0 million, net of future income taxes of \$11.0 million. For comparative purposes, commodity prices used in the ceiling test calculation at December 31, 2000 were \$22.28 per barrel for oil and \$9.15 per thousand cubic feet for natural gas.

### Income Taxes

True Energy utilizes the asset and liability method of tax allocation for income taxes. In 2001, future income tax recovery was \$12.6 million compared to an expense of \$165,000 in 2000. The effective tax rate in 2001 was 39.6 percent, down from 48.3 percent in the previous year. The effective tax rate differs from the Company's statutory income tax rate of 44.35 percent due to differences between the resource allowance deduction compared to non-deductible Crown charges. An analysis of the income tax provision is included in the notes to the financial statements.

At December 31, 2001, True Energy had unused income tax deductions available totalling \$30.8 million compared to \$11.4 million in the previous year. A summary of these deductions with corresponding rate of deductibility is shown in the table below:

Income Tax Deductions			
As at December 31 (\$ thousands)	2001	2000	Deduction Rate
Canadian Exploration Expense (CEE)	2,642	1,168	100%
Canadian Development Expense (CDE)	4,573	3,033	30%
Canadian Oil and Gas Property Expense (COGPE)	13,068	3,166	10%
Undepreciated Capital Cost (UCC)	8,606	3,630	25%
Share Issue Costs	1,897	397	20%
Total	30,786	11,394	

### LIQUIDITY AND CAPITAL RESOURCES

Funding for capital expenditures in 2001 was provided by cash flow from operations in conjunction with new equity issues and additional bank debt. Net capital expenditures for 2001 were \$37.8 million, after \$3.5 million in proceeds from property dispositions. Cash flow from operations was \$4.2 million; proceeds, after costs, from new equity issues were \$20.8 million and bank debt increased by \$11.8 million during the year. At December 31, 2001, the Company's working capital deficiency, before bank debt, was \$4.1 million, up \$2.2 million from the previous year-end. True Energy expects to eliminate its working capital deficiency in 2002 through the disposition of certain non-strategic assets.

True Energy has a \$14.0 million revolving demand loan facility with its bank, of which \$13.1 million was drawn at December 31, 2001. The credit facility revolves until May 31, 2002, however, due to the revolving nature of the credit facility, it will continue to be replaced by new debt provided that the Company continues to be in compliance with the lending agreement. At December 31, 2001, the bank acknowledges contravention and non-compliance with the working capital covenant (current ratio of not less than 1:1 as at the end of each fiscal quarter).

Effective for fiscal periods commencing on January 1, 2002, the Canadian Institute of Chartered Accountants has amended Canadian Generally Accepted Accounting Principles to require all borrowings where the lender has a right to demand repayment within 12 months (other than in the event of a default or breach of covenants) or where the lender has the right to refuse to rollover the borrowing for a further lending period longer than 12 months to be classified as current liabilities.

The Company has already adopted this requirement effective for the reporting period ended December 31, 2001. The impact of the change in Canadian GAAP was that current liabilities, at December 31, 2001, were increased by \$13.1 million and long-term debt was reduced by a similar amount. For comparative purposes, the classification change is also reflected as at December 31, 2000.

## CAPITAL EXPENDITURES

True Energy is committed to future growth through its strategy of acquisition, exploitation, exploration and rationalization of assets. The Company's capital expenditure program in 2001 was concentrated on acquisitions and follow-up development in its core producing area of west central Saskatchewan. True Energy spent \$41.3 million in 2001, an increase of 386 percent from the \$8.5 million spent in 2000. During the year, the Company sold non-core assets for proceeds of \$3.5 million.

True Energy's capital expenditure program over the past two years is summarized below:

Capital Expenditures Years ended December 31 (\$ thousands)	2001	2000	% Change
Exploration and development costs			
Lease acquisitions and retention	549	616	(11)
Geological and geophysical activity	1,035	233	344
Drilling and completion of wells	6,244	3,506	78
Facilities and equipment	2,992	2,402	25
Total exploration and development costs	10,820	6,757	60
Corporate acquisitions	14,659	–	–
Asset acquisitions	15,663	1,609	873
Head office expenditures	135	159	(15)
Total capital expenditures	41,277	8,525	384
Proceeds from sale of assets	3,473	–	–
Net capital expenditures	37,804	8,525	343

The Company's capital expenditures in 2001 resulted in a replacement cost of \$17.03 per barrel of oil equivalent for net proven reserves added. Cash flow per barrel of oil equivalent was \$6.06, resulting in a recycle ratio of 0.4 times.

Recycle Ratio			
Years ended December 31 (\$ thousands except per BOE amounts)	2001	2000	% Change
Cash flow from operations	4,159	1,075	287
Production (MBOE)	686	129	432
Cash flow per BOE	6.06	8.34	(27)
Net capital expenditures	37,804	8,525	343
Net proven reserve additions (MBOE)	2,220	908	144
Replacement cost per BOE	17.03	9.39	81
Recycle ratio	0.4	0.9	

## BUSINESS RISKS

True Energy's production and exploration activities are concentrated in the Western Canadian Sedimentary Basin, where activity is highly competitive and includes a variety of different sized companies ranging from smaller junior producers to the much larger integrated petroleum companies. True Energy is subject to the following types of business risks:

- Finding and developing oil and natural gas reserves at economic costs;
- Production of oil and natural gas in commercial quantities; and
- Marketability of oil and natural gas produced.

In order to reduce exploration risk, the Company employs highly qualified and motivated professional employees who have demonstrated the ability to generate quality proprietary geological and geophysical prospects. To maximize drilling success, True Energy explores in areas that afford multi-zone prospect potential, targeting a range of low to moderate risk prospects with some exposure to select high risk with high reward opportunities.

The Company mitigates its risk related to producing hydrocarbons through the utilization of the most advanced technology and information systems. In addition, True Energy seeks to maintain operational control of the majority of its prospects.

External factors beyond the Company's control may affect the marketability of oil and natural gas produced. These factors include commodity prices and variations in the Canadian Dollar/United States Dollar exchange rate, which in turn respond to economic and political circumstances throughout the world. True Energy may periodically use futures and options contracts to hedge its exposure against the potential adverse impact of commodity price volatility.

## ENVIRONMENTAL AND SAFETY RISKS

Oil and gas exploration and production can involve environmental risks such as pollution of the environment and destruction of natural habitat, as well as safety risks such as personal injury. In order to mitigate such risks, True Energy conducts its operations at high standards and follows safety procedures intended to reduce the potential for personal injury to employees, contractors and the public at large. The Company maintains current insurance coverage for general and comprehensive liability as well as limited pollution liability. The amount and terms of this insurance are reviewed on an ongoing basis and adjusted as necessary to reflect changing corporate requirements, as well as industry standards and government regulations.

## BUSINESS PROSPECTS AND 2002 OUTLOOK

True Energy is optimistic about its future prospects. The Company has been successful in growing its production and land base since its formation in September 2000 and is expected to continue with future growth through development of its core assets and new exploration on the Company's inventory of geological prospects. Currently, the majority of the Company's producing properties are located in west central Saskatchewan. True Energy will endeavour to establish a second core area, likely in Alberta. In doing so, the Company will continue to focus its exploration efforts in areas of multi-zone potential for natural gas.

The outlook for 2002 is promising with incremental production from drilling activities in the first quarter commencing in March. Further production gains are anticipated in the second half of the year resulting from continued exploration efforts in west central Saskatchewan. The Company expects to spend \$7.0 million in capital for 2002 and to sell non-strategic assets for approximately \$6.0 million. As a result, the Company expects to produce an average of 2,000 barrels of oil equivalent per day (762 barrels per day of oil and NGLs and 7.43 million cubic feet per day of natural gas). At this production level, the Company anticipates generating cash flow from operations of \$5.0 million (\$0.17 per share).

## QUARTERLY INFORMATION

The following table provides a summary by quarter for 2001 and the previous year:

2001 – Quarter ended (\$ thousands, except per share amounts)	Mar. 31	Jun. 30	Sep. 30	Dec. 31
Revenue	3,188	4,653	5,664	4,598
Cash flow from operations	1,105	697	2,577	(220)
Cash flow per share, diluted	0.08	0.04	0.13	(0.01)
Net earnings (loss)	(110)	(558)	(1,073)	(17,559)
Earnings (loss) per share, diluted	(0.01)	(0.03)	(0.05)	(0.65)
Capital expenditures, net	16,782	20,604	(37)	455
2000 – Quarter ended (\$ thousands, except per share amounts)	Mar. 31	Jun. 30	Sep. 30	Dec. 31
Revenue	468	552	746	1,867
Cash flow from operations	39	85	174	777
Cash flow per share, diluted	0.00	0.01	0.02	0.07
Net earnings (loss)	20	(29)	(37)	222
Earnings (loss) per share, diluted	0.00	0.00	0.00	0.02
Capital expenditures, net	204	500	680	3,624

## MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL STATEMENTS

The management of True Energy Inc. is responsible for the preparation and integrity of the accompanying consolidated financial statements and all other information contained in this annual report. The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in Canada and include amounts that are based on management's informed judgements and estimates where necessary.

The Company maintains internal accounting control systems which are adequate to provide reasonable assurance that assets are safeguarded, transactions are executed in accordance with management's authorization and accounting records are reliable as a basis for the preparation of the consolidated financial statements.

The Board of Directors, through its Audit Committee, monitors management's financial and accounting policies and practices and the preparation of these financial statements. The Audit Committee meets periodically with the external auditors and management to review the work of each and the propriety of the discharge of their responsibilities.

Specifically, the Audit Committee reviews with management and the external auditors the financial statements and annual report of the Company prior to submission to the Board of Directors for final approval. The external auditors have full and free access to the Audit Committee to discuss auditing and financial reporting matters.

The shareholders have appointed KPMG LLP as the external auditors of the Company and, in that capacity, they have examined the financial statements for the period ended December 31, 2001.

### **Signed by**

Paul R. Baay  
President and Chief Executive Officer

### **Signed by**

Sadiq H. Lalani  
Vice President, Finance and Chief Financial Officer

## AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the consolidated balance sheets of True Energy Inc. as at December 31, 2001 and 2000 and the statements of operations and deficit and cash flows for the years then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Corporation as at December 31, 2001 and 2000 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

### **Signed by**

Chartered Accountants  
Calgary, Canada  
March 30, 2002

## CONSOLIDATED BALANCE SHEETS

As at December 31	2001	2000
<b>ASSETS</b>		
Current assets		
Accounts receivable	\$ 3,952,052	\$ 3,500,627
Property, plant and equipment (Note 3)	26,612,128	12,171,304
	<b>\$ 30,564,180</b>	<b>\$ 15,671,931</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current Liabilities		
Accounts payable and accrued liabilities	\$ 7,876,472	\$ 4,742,773
Current portion of prepaid gas contract (Note 5)	176,700	693,500
Bank debt (Note 4)	13,141,933	1,325,461
	<b>21,195,105</b>	<b>6,761,734</b>
Prepaid gas contract (Note 5)	-	176,700
Future income taxes (Note 7)	-	1,455,631
Future site restoration and abandonment costs	426,584	82,947
Shareholders' equity		
Share capital (Note 6)	28,484,577	7,436,579
Deficit	(19,542,086)	(241,660)
	<b>8,942,491</b>	<b>7,194,919</b>
Commitments (Note 11)		
Subsequent events (Note 13)		
	<b>\$ 30,564,180</b>	<b>\$ 15,671,931</b>

See accompanying notes to the consolidated financial statements.

On behalf of the Board,

**Signed by**  
Kenneth Acheson

Director

**Signed by**  
W.C. Dunn

Director

## CONSOLIDATED STATEMENTS OF OPERATIONS AND DEFICIT

For the year ended December 31	2001	2000
<b>REVENUE</b>		
Oil and NGLs	\$ 4,255,658	\$ 871,962
Natural gas	13,847,212	2,760,564
	<b>18,102,870</b>	3,632,526
<b>ROYALTIES</b>		
Crown	(3,500,536)	(493,062)
Other	(2,318,461)	(183,670)
	<b>(5,818,997)</b>	(676,732)
	<b>12,283,873</b>	2,955,794
<b>EXPENSES</b>		
Production	4,915,433	932,733
General and administrative	1,615,026	628,026
Interest on long-term debt	736,654	30,744
Bad debt expense	250,782	-
Capital taxes	30,054	-
Depletion, depreciation and site restoration	9,704,593	1,022,960
Writedown of oil and gas properties (Note 3)	27,000,000	-
	<b>44,252,542</b>	2,614,463
<b>EARNINGS (LOSS) BEFORE INCOME TAXES</b>	<b>(31,968,669)</b>	341,331
Current income tax (recovery) (Note 7)	(116,388)	-
Future income tax (recovery) (Note 7)	(12,551,855)	165,000
Net earnings (loss)	<b>(19,300,426)</b>	176,331
Deficit, beginning of year	(241,660)	(408,086)
Change in accounting policy relating to future income taxes (Note 7)	-	(9,905)
Deficit, end of year	<b>\$ (19,542,086)</b>	\$ (241,660)
Weighted average common shares	<b>19,458,954</b>	9,382,411
Net earnings (loss) per share		
basic	\$ (0.99)	\$ 0.02
diluted	\$ (0.99)	\$ 0.02

## CONSOLIDATED STATEMENT OF CASH FLOWS

For the year ended December 31 (audited)	2001	2000
Cash provided by (used in):		
<b>OPERATIONS</b>		
Net earnings (loss)	\$ (19,300,426)	\$ 176,331
Charges not involving cash:		
Depletion, depreciation and site restoration	9,704,593	1,022,960
Writedown on oil and gas properties	27,000,000	–
Future income tax (recovery)	(12,551,855)	165,000
Prepaid gas revenue	(693,500)	(288,800)
Cash flow from operations	4,158,812	1,075,491
Change in non-cash working capital	996,946	1,040,008
	5,155,758	2,115,499
<b>FINANCING</b>		
Issuance of common shares	22,332,250	2,887,500
Share issue costs	(1,500,258)	(495,839)
Repayment of debt acquired on acquisition of 887733 Alberta Ltd.	–	(700,000)
Increase in bank debt	11,816,472	1,200,761
	32,648,464	2,892,422
<b>INVESTING</b>		
Additions to property, plant and equipment	(10,954,212)	(6,916,545)
Acquisition of property, plant and equipment	(15,663,423)	(1,608,756)
Proceeds on sale of property, plant and equipment	3,472,604	–
Cash acquired on acquisition of 851431 Alberta Ltd.	–	3,517,380
Cash paid on acquisition of Marengo Exploration Ltd.	(14,659,191)	–
	(37,804,222)	(5,007,921)
Increase (decrease) in cash	–	–
Cash, beginning of period	–	–
Cash, end of period	–	–
Weighted average common shares	19,458,954	9,382,411
Cash flow from operations per share		
– basic	\$ 0.21	\$ 0.11
– diluted	\$ 0.21	\$ 0.11

See accompanying notes to the consolidated financial statements.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

years ended December 31, 2001 and 2000

## GENERAL:

True Energy Inc. ("True" or the "Corporation") was formed on the amalgamation of Sundance Resources Inc. ("Sundance"), 851431 Alberta Ltd. ("851431") and 887733 Alberta Ltd. ("887733") effective August 31, 2000 (note 2).

Results of operations prior to August 31, 2000 are those of Sundance. Sundance was incorporated under the Business Corporation Act (Alberta) on February 9, 1996.

## 1. SIGNIFICANT ACCOUNTING POLICIES:

The financial statements of the Corporation have been prepared by management in accordance with generally accepted accounting principles in Canada. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. The amounts recorded for depletion and depreciation, the provision for future site restoration, ceiling test factors such as proved reserves production rates, oil and natural gas prices and future costs are estimated. Actual results could differ from those estimates. The financial statements have, in management's opinion, been properly prepared using careful judgment with reasonable limits of materiality and within the framework of the significant policies summarized below:

### (a) Petroleum and natural gas properties:

The Corporation follows the full cost method of accounting for petroleum and natural gas operations whereby all costs related to the exploration and the development of petroleum and natural gas reserves are capitalized. These costs include land acquisition costs, geological and geophysical expenses, the costs of drilling both productive and non-productive wells and directly related overhead. Proceeds from the disposal of properties are deducted from the full cost pool without recognition of a gain or loss unless such a sale would significantly alter the rate of depletion and depreciation.

Depletion of petroleum and natural gas properties is provided using the unit-of-production method based on production volumes before royalties in relation to estimated proved reserves as determined by independent engineers. Natural gas reserves and production are converted at the energy equivalent rate of six thousand cubic feet to one barrel of oil.

The costs of acquiring and evaluating unproved properties are excluded from depletion calculations. These properties are assessed periodically to ascertain whether impairment has occurred. When the property is considered to be impaired, the cost of the property or the amount of the impairment is added to costs subject to depletion.

The Corporation applies a ceiling test to capitalized costs to ensure that such costs do not exceed the aggregate of the costs of unproved properties plus future net revenues from production of proved reserves at year end product prices less future administrative, financing, site restoration and income tax expenses.

### (b) Joint interests:

Substantially all of the Corporation's exploration and development activities are conducted jointly with others and, accordingly, the financial statements reflect only the Corporation's proportionate interest in such activities.

### (c) Future site restoration and abandonment costs:

Future site restoration and abandonment costs are based on management's estimates and amortized using the unit-of-production method over the remaining proved reserves. The provision is included in depletion, depreciation and site restoration in the statement of operations.

### (d) Prepaid contracts:

Advance payments received under prepaid contracts for oil and gas which is not delivered are deferred and are recognized as revenue when deliveries are made. Revenue is recognized on a straight line basis by dividing the advance payment by the total contracted volumes.

(e) Flow-through common shares:

Resource expenditure deductions for income tax purposes related to exploration and development activities funded by flow-through share issues are renounced to investors in accordance with income tax legislation. The estimated tax benefits transferred to shareholders are recorded as future income taxes and reduce share capital.

(f) Financial instruments and hedging transactions:

The Company periodically enters into derivative instrument contracts to manage exposure related to petroleum and natural gas prices. Settlement amounts on commodity and foreign currency hedge contracts are recognized in earnings as the related production revenues are recorded.

The carrying value of current assets and current liabilities approximate their fair value due to the relatively short period to maturity of the instruments.

(g) Stock-based compensation plan:

The Corporation has one stock-based compensation plan, which is described in note 6(c). No compensation expense is recognized for these plans when stock options are issued to employees. Any consideration paid by employees is credited to share capital.

(h) Income taxes:

Income taxes are recorded using the liability method of tax allocation. Future income tax assets and liabilities are determined based on "temporary differences" and are measured using the current, or substantively enacted, tax rates and laws expected to apply when these differences reverse. A valuation allowance is recorded against any future income tax assets if it is more likely than not that the asset will not be realized.

(i) Cash and cash equivalents:

Cash and cash equivalents include bank balances and highly liquid temporary money market instruments with original maturities of three months or less.

## 2. ACQUISITIONS:

On July 20, 2000, the Corporation negotiated the terms of an amalgamation with 851431 and 887733. Both 851431 and 887733 were private companies that had no operations and held certain assets. The result of the business combination was that the shareholders of the Corporation obtained control of more than 50 percent of the total issued and outstanding common shares of the amalgamated entity and, accordingly was deemed to have acquired 851431 and 887733. The acquisitions have been accounted for using the purchase method, and the results of operations are included from the effective date of August 31, 2000. The owner of 887733 was an existing director and shareholder of the Corporation, thus was considered to be a related party. As a result, this portion of the transaction has been accounted for at the carrying values of 887733.

The net assets acquired and consideration given were:

	851431	887733	Total
Net assets acquired:			
Cash	\$ 3,517,380	\$ -	\$ 3,517,380
Property, plant and equipment	-	1,821,111	1,821,111
Bank debt	-	(700,000)	(700,000)
Future income tax liability	-	(132,339)	(132,339)
	\$ 3,517,380	\$ 988,772	\$ 4,506,152
Consideration:			
Issued 3,876,904 shares of True Energy valued at \$0.907 per share	\$ 3,517,380	\$ -	\$ 3,517,380
Issued 2,950,001 shares of True Energy at an attributed value of \$0.335 per share	-	988,772	988,772
	\$ 3,517,380	\$ 988,772	\$ 4,506,152

On February 6, 2001 the Company made an offer to acquire substantially all of the outstanding shares of Marengo Exploration Ltd. ("Marengo"). Marengo is engaged in exploration for and development and production of crude oil and natural gas primarily in the province of Saskatchewan. The acquisition has been accounted for using the purchase method and was effective February 28, 2001 being the date the majority of Marengo shares were taken up and paid for by True Energy.

The net assets acquired and consideration given were:

Net assets acquired:	
Cash	\$ 708,085
Property, plant and equipment	27,795,228
Working capital	(1,685,327)
Future site restoration and abandonment	(66,046)
Future income tax liability	(10,429,163)
	\$ 16,322,777

Consideration:	
Cash	\$ 15,000,545
Issued 947,250 shares of True Energy valued at \$1.20 per share	1,136,700
Acquisition costs, net of future income tax	185,532
	\$ 16,322,777

On June 18, 2001 the Corporation entered into an agreement with an arm's length third party to purchase certain petroleum and natural gas assets located in west central Saskatchewan, specifically in the Dodsland, Bayhurst and Kerrobert areas (the "Acquisition"). Closing of the Acquisition occurred on June 26, 2001 and the Corporation has accounted for this acquisition as a purchase on this date. The purchase price of \$15,473,901 was fully allocated to petroleum and natural gas properties and has an equivalent tax basis.

In September 2001 the Corporation entered into an agreement with an arm's length third party to dispose certain petroleum and natural gas assets located in the West Bayhurst area in west central Saskatchewan (the "Bayhurst Disposition"). The Bayhurst Disposition was effective September 1, 2001 and closed on September 28, 2001. The proceeds from this disposition amounted to \$1,936,246 and was fully allocated to petroleum and natural gas properties, having an equivalent tax basis.

In October 2001 the Corporation entered into an agreement with an arm's length third party to acquire and dispose certain petroleum and natural gas assets located in the North Smiley area in west central Saskatchewan (the "Swap"). This Swap was effective September 1, 2001 and closed on October 16, 2001. The net proceeds from this swap amounted to \$486,285 (acquisition of \$143,155 and disposition of \$629,440) and was fully allocated to petroleum and natural gas properties, having an equivalent tax basis.

In November 2001 the Corporation entered into an agreement with an arm's length third party to dispose certain petroleum and natural gas assets located in the Brock area in west central Saskatchewan (the "Brock Disposition"). The Brock Disposition was effective November 1, 2001 and closed on December 7, 2001. The proceeds from this disposition amounted to \$905,556 and were fully allocated to petroleum and natural gas properties, having an equivalent tax basis.

### 3. PROPERTY, PLANT AND EQUIPMENT:

Under the Canadian Institute of Chartered Accountants (CICA) full cost accounting guidelines, the Corporation realized a write down of its oil and gas properties by \$16.0 million, net of future income taxes of \$11.0 million. This write-down was determined based on estimated future cash flows calculated using year-end commodity prices of \$18.25 per barrel of oil and NGLs (\$12.65 per barrel for heavy oil, \$27.16 per barrel for light oil and \$28.88 per barrel for NGLs) and \$3.24 per thousand cubic feet for natural gas.

	Cost	Accumulated depletion and depreciation	Net book value
December 31, 2001			
Petroleum and natural gas properties	\$ 68,430,414	\$ 42,051,729	\$ 26,378,685
Office furniture and equipment	414,663	181,220	233,443
	\$ 68,845,077	\$ 42,232,949	\$ 26,612,128
December 31, 2000			
Petroleum and natural gas properties	\$ 13,886,533	\$ 1,835,068	\$12,051,465
Office furniture and equipment	230,631	110,792	119,839
	\$ 14,117,164	\$ 1,945,860	\$ 12,171,304

At December 31, 2001, the estimated future site restoration costs to be accrued over the remaining proved reserves are \$1,743,000 (2000 – \$355,000) of which \$278,000 has been recorded as additional depletion and depreciation during 2001 (2000 – \$37,000).

Unproved properties with a cost of approximately \$6,450,000 included in property, plant and equipment have not been subject to depletion.

#### 4. BANK DEBT:

The Corporation has arranged a demand revolving credit facility with an authorized borrowing amount of \$14,000,000 with a Canadian chartered bank. Interest is payable at the bank's prime rate plus one percent. Security is provided by a general assignment of book debts of the Corporation, a \$10,000,000 floating charge debenture over all assets of the Corporation, a fixed charge over certain producing petroleum and natural gas reserves at Smiley and a first floating charge supplemental debenture of \$35,000,000. In addition, the Marengo assets have been included as security for this facility (See Note 13).

An annual review of this facility will be completed on or before May 31, 2002. At December 31, 2001, the bank acknowledges contravention and non-compliance with the working capital covenant (current ratio of not less than 1:1 as at the end of each fiscal quarter). The Corporation expects to remedy this negative financial covenant through dispositions of non-strategic assets in the first half of 2002 (See Note 13).

#### 5. PREPAID GAS CONTRACT:

The Corporation entered into a prepaid contract for future delivery of natural gas commencing November 1, 1998. The Corporation received \$1,387,000 on November 1, 1998 for 1,000 gigajoules of natural gas per day at \$1.90 per gigajoule at the wellhead for a period of two years. If the Corporation does not make delivery of 1,000 gigajoules per day determined on a monthly basis, interest at 2 percent above the prime rate will be charged for any deliveries not made and will accrue from the date the delivery was due until made.

On July 18, 2000, an amending agreement was signed with the consumer which stated that the Corporation did not have to deliver any gas for the seven months from June 1 to December 31, 2000. The completion of the 458,000 gigajoules of pre-purchase gas delivery restarted at the 1,000 gigajoules per day rate on January 1, 2001.

Based on this amending agreement, the Corporation's scheduled delivery obligations of natural gas for the remaining period from January 1, 2002 to April 3, 2002 is 93,000 gigajoules and the corresponding amortization is \$176,700.

#### 6. SHARE CAPITAL:

(a) Authorized:

Unlimited number of voting Common Shares

Unlimited number of non-voting First Preferred Shares

(b) Issued:

	Number of Shares	Amount
Common shares:		
Balance, December 31, 1999	8,610,413	\$ 1,605,447
Converted on amalgamation	(4,787,383)	–
Issued on acquisition of 851431 (Note 2)	3,876,904	3,517,380
Issued on acquisition of 887733 (Note 2)	2,950,001	988,772
Flow-through shares issued for cash on public offering	1,670,000	2,505,000
Flow-through shares issued for cash on private placement	255,000	382,500
Share issue costs, net of future income taxes of \$221,144	–	(274,695)
Future income taxes relating to flow-through shares	–	(1,287,825)
Balance, December 31, 2000	12,574,935	7,436,579
Issued on acquisition of Marengo Exploration Ltd. (Note 2)	947,250	1,136,700
Conversion of Special Warrants	11,366,667	18,680,000
Issued for debt	11,250	11,250
Options exercised	175,000	126,000
Flow-through shares issued for cash on private placement	3,700,000	3,515,000
Share issue costs, net of future income taxes of \$646,996	–	(853,262)
Future income taxes relating to flow-through shares	–	(1,567,690)
Balance, December 31, 2001	28,775,102	\$ 28,484,577

The Company has commitments to incur \$3,515,000 of qualifying expenditures during 2002 to satisfy flow-through share agreements.

(c) Stock options:

Following completion of the amalgamation on August 31, 2000, the 731,300 existing Sundance stock options were cancelled and the board of directors approved a new stock option plan (the "Plan") for directors, officers, employees and consultants of True Energy. The exercise price shall not be lower than the closing sale price for board lots of common shares on the trading day immediately prior to the day on which the options are granted. The vesting period is determined by the Board.

The following table summarizes the changes in stock options outstanding for the years ended December 31:

	2001		2000	
	Options	Weighted-Average Exercise Price	Options	Weighted-Average Exercise Price
Outstanding at beginning of year	1,405,000	\$ 0.77	731,300	\$ 0.20
Cancelled	(110,000)	1.59	(731,300)	0.20
Granted	902,500	1.18	1,405,000	0.77
Exercised	(175,000)	0.72	–	–
Outstanding at end of year	2,022,500	\$ 0.91	1,405,000	\$ 0.77

The following table summarizes information about stock options outstanding at December 31, 2001:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number Outstanding	Weighted Average Remaining Life (years)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
\$0.72 to \$1.00	1,715,000	3.8	\$ 0.77	1,043,336	\$ 0.73
\$1.50 to \$1.80	307,500	4.3	\$ 1.71	–	–
\$0.72 to \$1.80	2,022,500	3.9	\$ 0.91	1,043,336	\$ 0.73

## 7. INCOME TAXES:

Effective January 1, 2000, the Corporation changed its accounting policy to account for income taxes using the liability method of tax allocation in accordance with new recommendations to Canadian Generally Accepted Accounting Principles. Prior thereto, the Company had followed the deferral method. The new method was applied retroactively without restatement of prior period financial statements. On adoption, the deficit and future income tax liability were increased by \$9,905.

The provision for income taxes differs from the expected amount calculated by applying the combined Federal and Provincial corporate income tax rate to loss before income taxes. This difference results from the following items:

	2001	2000
Expected income tax expense (recovery) @ 44.35%	\$(14,178,105)	\$ 152,000
Crown royalties and charges	1,552,284	220,000
Resource allowance	(809,591)	(215,000)
Change in valuation allowance	898,723	–
Other	(15,166)	8,000
	<u>\$ (12,551,855)</u>	<u>\$ 165,000</u>

The components of the net future income tax liability at December 31 are as follows:

	2001	2000
Future income tax liabilities:		
Petroleum and natural gas properties	\$ 107,388	\$ 1,660,011
Future income tax assets:		
Future site restoration	141,893	27,764
Share issue costs	864,218	176,616
	<u>1,006,111</u>	<u>204,380</u>
Valuation allowance	(898,723)	–
Net future income tax liability	<u>\$ –</u>	<u>\$ 1,455,631</u>

During 2001, current income tax recovery of \$116,388 was recorded to reflect overestimated income taxes owing by Marengo.

## 8. PER SHARE AMOUNTS:

The Corporation uses the treasury stock method to determine the dilutive effect of stock options and other dilutive instruments. Under the treasury stock method, only “in the money” dilutive instruments impact the diluted calculations in computing diluted earnings per share.

In computing diluted earnings and cash flow from operations per share, 650,429 (2000 – 297,018) shares were added to the 19,458,954 (2000 – 9,382,411) weighted average number of common shares outstanding during the year for the dilutive effect of stock options. A total of 1,372,071 options were excluded from the diluted calculation as they were not dilutive.

## 9. SUPPLEMENTAL CASH FLOW INFORMATION:

	2001	2000
Cash paid:		
Interest	\$ 736,654	\$ 30,744
Taxes	1,205,489	–
Non-cash investing and financing activities:		
Issue of common shares on acquisitions (Note 2)	\$ 1,136,700	\$ 4,506,152
Net assets acquired on acquisitions (Note 2)	16,322,777	(4,506,152)

## 10. RELATED PARTY TRANSACTIONS:

The Corporation undertakes certain joint ventures with companies owned by directors and officers of the Corporation. These transactions are at similar terms to those with third parties and are recorded at the exchange amount. The amounts due from these related parties at December 31, 2001 total \$208,988 (2000 – \$25,409).

## 11. COMMITMENTS:

The Corporation is committed to payments under an operating lease for office space as follows:

Year	Gross Amount	Expected Recoveries	Net amount
2002	\$ 231,238	\$ (30,990)	\$ 200,248
2003	232,013	(41,320)	190,693
2004	219,875	(30,990)	188,885
2005	183,462	–	183,462
2006	45,866	–	45,866
	\$ 912,454	\$ (103,300)	\$ 809,154

## 12. FINANCIAL INSTRUMENTS:

### (a) Credit risk:

A substantial portion of the Company's accounts receivable are with customers and joint venture partners in the petroleum and natural gas industry and are subject to normal industry credit risks. The Company sells substantially all of its production to three primary purchasers under normal industry sale and payment terms. Purchasers of the Company's natural gas, crude oil and natural gas liquids are subject to an internal credit review to minimize the risk of non-payment.

### (b) Fair value of financial instruments:

The carrying amounts of financial instruments included in the balance sheet, other than long-term debt, approximate their fair value due to their short-term maturity. The carrying value of long-term debt approximates fair value due to the cost of borrowing being at a floating rate.

### (c) Commodity risk:

The Company seeks to reduce its exposure to commodity price risk in its business through the use of physical product arrangements, futures, and options.

During January 2001, the Corporation entered into transactions to put into effect a costless collar for 3,000 gigajoules per day for the period February 1, 2001 to December 31, 2001. These transactions established a floor price of \$7.50 per gigajoule and a ceiling price of \$8.50 per gigajoule at the AECO-C Hub. Effective August 1, 2001, the Corporation sold the costless collar and received a lump sum payment of \$1,575,000. The total gain included in natural gas revenue relating to this hedging transaction in 2001 is \$1,935,973.

## 13. SUBSEQUENT EVENTS:

On April 10, 2002 the Company announced that it had entered into definitive agreements to sell certain non-strategic assets for proceeds of \$6.25 million, effective April 1, 2002. Closing is expected to occur by the end of April 2002. At closing, the authorized borrowing amount of the Company's credit facility will be reduced by the lending value associated with these assets. The Company cannot be sure that the resulting authorized borrowing amount will be in excess of outstanding indebtedness (See Note 4).

Estimated proved producing reserves relating to the assets sold were 154,000 barrels of oil and 2.1 billion cubic feet of natural gas. Approximately 11,000 acres of net undeveloped land were also included in the disposition.

## **BOARD OF DIRECTORS**

Kenneth P. Acheson  
President, Kennington Properties  
Calgary, Alberta

Paul R. Baay  
President and C.E.O., True Energy Inc.  
Calgary, Alberta

John Cuthbertson  
Partner, Burnet Duckworth & Palmer  
Calgary, Alberta

W. C. (Mickey) Dunn  
Independent Businessman  
Edmonton, Alberta

Robert G. Rowley, Q.C.  
Independent Businessman  
Calgary, Alberta

Michael S. Vandale  
Chairman and President, Vandale Oil, Inc.  
Calgary, Alberta

Kim Ward  
Independent Businessman  
Toronto, Ontario

## **KEY MANAGEMENT**

Paul R. Baay  
President and C.E.O.

Sadiq H. Lalani  
Vice President, Finance and C.F.O.

Clinton T. Broughton  
Vice President

Gordon L. Reese  
Vice President

## **HEAD OFFICE**

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## **AUDITORS**

KPMG LLP  
Calgary, Alberta

## **BANKERS**

National Bank of Canada  
Calgary, Alberta

## **ENGINEERING CONSULTANTS**

Gilbert Laustsen Jung

## **REGISTRAR AND TRANSFER AGENT**

Computershare International Inc.  
Calgary, Alberta

## **STOCK EXCHANGE LISTING**

The Toronto Stock Exchange  
Symbol: TUI

## **GLOSSARY**

AECO	a storage and pricing hub for Canadian natural gas markets
/d	per day
BOE	barrels of oil equivalent (6 Mcf of natural gas = 1 barrel of oil equivalent)
bbls	barrels
Established Reserves	proved reserves plus one half probable reserves
Mcf	thousand cubic feet
MMBOE	million barrels of oil equivalent
MMcf	million cubic feet
WTI	West Texas Intermediate, a benchmark crude oil used for pricing comparison

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