

**F**REEHOLD ROYALTY TRUST

*Annual Report* **1996**

## CORPORATE PROFILE

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FREEHOLD ROYALTY TRUST (THE "TRUST") IS A CLOSED-END INVESTMENT TRUST FORMED UNDER THE LAWS OF THE PROVINCE OF ALBERTA PURSUANT TO A TRUST INDENTURE DATED SEPTEMBER 30, 1996 AND AMENDED ON NOVEMBER 25, 1996. THE TRUST RECEIVES AND DISTRIBUTES ROYALTY INCOME FROM A DIVERSIFIED ASSET BASE OF HIGH QUALITY OIL AND GAS PROPERTIES ACROSS WESTERN CANADA. THE TRUST WAS FORMED TO ACQUIRE VARIOUS ROYALTY INTERESTS FROM CANPAR HOLDINGS LTD. (CANPAR) AND CERTAIN WORKING INTEREST PROPERTIES FROM CANPAR AND RIFE RESOURCES LTD. (RIFE), BOTH WHOLLY OWNED SUBSIDIARIES OF THE CN PENSION FUND.

**F**reehold Royalty Trust Units entitle investors to participate in the net cash flow from the royalties and working interest properties as well as any additional royalties or properties that the Trust may acquire in the future. Cash distributions are made to Unitholders on a quarterly basis. The objectives of the Trust are to maximize the distributable income to Unitholders while striving to achieve significant growth in the unit value of the Trust.

The Trust is headquartered in Calgary, Alberta. Its Trust Units trade on The Toronto Stock Exchange under the symbol "FRU.UN".

The Trust Units are qualified investments for Registered Retirement Savings Plans (RRSPs), Registered Retirement Income Funds (RRIFs) and Deferred Profit Sharing Plans (DPSPs).

## ANNUAL MEETING

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The Annual Meeting of Freehold Resources Ltd. and Freehold Royalty Trust, at which the Unitholders of Freehold Royalty Trust are entitled to vote, will be held on Friday, June 6th, 1997 at 10:30 a.m. in the Strand/Tivoli Room, Metropolitan Centre, 333 - 4th Avenue S.W., Calgary, Alberta. Unitholders are encouraged to attend. Those who are unable to attend are requested to complete, sign and return the Form of Proxy.



## HIGHLIGHTS

FOR THE 37-DAY PERIOD FROM NOVEMBER 25 TO DECEMBER 31, 1996

	1996
<b>Financial</b> (\$000s, except per Trust Unit)	
Revenue	
Royalty income	2,640
Working interest sales (net of royalties)	1,343
Total revenue	3,983
Funds generated from operations	3,455
Per Trust Unit	0.131
Net income	1,057
Per Trust Unit	0.04
Capital expenditures	13
Working capital	833
Long-term debt	10,719
Total assets	263,264
Unitholders' equity	248,464
Units outstanding at year end	26,408,000
<b>Operating</b>	
Production	
Crude oil (Bbls/d)	3,016
NGLs (Bbls/d)	340
Natural gas (Mmcf/d)	13.5
Barrels of oil equivalent (Boe/d)	4,704
Potash (Tons/d)	14
Average prices	
Crude oil (\$/Bbl)	25.55
NGLs (\$/Bbl)	19.88
Natural gas (\$/Mcf)	1.72
Barrels of oil equivalent (\$/Boe)	22.75
Potash (\$/Ton)	105.00
Present value of reserves (discounted at 10%, before taxes) (\$000s)	221,289

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# HISTORY OF THE HUDSON'S BAY LANDS

THESE LANDS GENERATE THE MAJORITY OF THE TRUST'S INCOME.

1670



## King Charles

Charles II, King of England, grants the first charter to the Hudson's Bay Company for the sole trade and commerce rights in, and title to, all lands encompassing the watershed of Hudson's Bay. This covers an area of nearly 1.5 million square miles or nearly 40% of what is Canada today.

1867



## Confederation

The British North America Act, 1867, makes provision for the admission of these lands into Canada. The Hudson's Bay Company surrenders its title to these lands to Canada for a cash consideration and the right to hold in perpetuity one-twentieth of the land in Western Canada south of the North Saskatchewan River between the Rocky Mountains, Lake Winnipeg and Lake of the Woods.

1974



## Hudson's Bay Company

In 1974, the Hudson's Bay Company sells the mineral titles on its 4.5 million acres of land in the three prairie provinces, a portion of which are eventually acquired by Canpar in 1979.

1996



## The Trust

Freehold Royalty Trust is established in 1996 for the purpose of purchasing the Hudson's Bay (HB) Lands Royalties from Canpar as well as several working interest properties from Canpar and Rife.

1996



## The Public Offering

The Freehold Royalty Trust prospectus describes a unique opportunity to invest in oil and gas assets. Through the Trust, investors participate in true royalties on the more than 550,000 acres once belonging to the Hudson's Bay Company.



WE ARE PROUD OF OUR STRONG BEGINNING.

**O**n the occasion of our first annual report, I would like to welcome our Freehold Royalty Trust investors. Through ownership of the Trust Units, you are participating in an attractive investment with uniquely desirable attributes. This report provides important background and operating information for Unitholders and outlines our plans for the future. Our most important long-term goals are to maximize the distributable income to Unitholders while striving to achieve significant growth in the unit value of the Trust.

### *Start-up of the Trust*

Our initial public offering of 26.4 million Trust Units was completed on November 25, 1996. Gross proceeds of \$264 million were used to acquire royalty interests from Canpar and working interest properties from Canpar and Rife.

Rife Resources Management Ltd. was formed to be the "Manager" of the Trust. The management group has a long association with and extensive knowledge of all of the Trust's properties. The Manager's senior officers have been with Rife or Canpar since at least 1984. In addition, each individual participated in assembling or managing all of the royalties and working interest properties that were acquired by the Trust.

Although the Trust is relatively new in terms of its operations, the history of the HB Lands actually extends back more than 300 years. The Trust receives the majority of its revenues from the mineral rights of certain properties acquired from Canpar; properties that were originally granted to the Hudson's Bay Company during the settlement of Canada. These properties, covering more than 550,000 acres, are a vital part of the Western Canadian landscape – from the Rocky Mountains, across the prairies, to Manitoba.

### *1996 Results*

I am pleased to report on the results of our initial operating period – the 37 days from November 25 to December 31, 1996. Production averaged 3,016 barrels per day of crude oil, 340 barrels per day of natural gas liquids and 13,477 thousand cubic feet per day of natural gas. This production amounted to 4,704 barrels of oil equivalent per day as expected. Our performance, combined with high commodity prices and lower operating expenses, resulted in a distribution of \$0.13 per Trust Unit for the period. The Trust's net earnings from operations were \$1.0 million, or \$0.04 per Unit.

An active drilling program by our lessees and operators during 1996 resulted in 143 wells being drilled on the HB Lands at no cost to the Trust. We also participated in the drilling of 33 gross (3.4 net) wells on the Trust's working interest properties. Reserves associated with these wells fully replaced those produced during the year. Promising results were achieved at our working interest property at Hayter, Alberta. The wells drilled by our partner commenced production in the latter part of the year, adding approximately 300 barrels per day of net production by year end. This success enhances prospects for internal production growth in 1997.

## *Business Plan*

To ensure the future success of the Trust, our efforts in 1997 are directed to adding value. While the active drilling programs of the lessees on the HB Lands should sustain the Trust's royalty income, this cannot be relied upon solely to increase asset values in the long-term. The Manager has established a dedicated acquisition group. This team of senior professionals is pursuing a number of oil and gas acquisition opportunities identified as being appropriate to achieving our objectives.

## *Outlook*

We are proud of our strong beginning. Today, the Trust has a highly diversified asset base generating revenue from a wide range of properties and maintains a reserve life index of 14.6 years.

As we enter 1997, our outlook for the future is excellent. For the six-month period ending June 30, 1997, as stated in the November 1996 prospectus, revenues are forecast to be \$15.4 million, with expenses of \$3.0 million. As a result, total distributable income is anticipated to be \$12.4 million (\$0.47 per Trust Unit) for the first half of 1997.

The Canadian oil and gas industry is drilling new wells this year at a pace expected to surpass the 1996 record. A continued high number of wells drilled on the Trust's HB Lands will sustain both our reserves and production levels at no cost to the Trust.

Development activity at Hayter will continue with the decision to drill another eight horizontal wells in the second quarter of 1997. This will raise productivity from the property and develop additional reserves.

Our financial forecast was based on production rates of 4,575 barrels of oil equivalent per day and commodity prices of U.S. \$19.55 per barrel of oil and \$1.65 per thousand cubic feet of gas. We have every confidence we will achieve forecast levels.

With wells drilled on the HB Lands being placed on production, successful development efforts continuing at Hayter, and commodity price expectations consistent with our forecast, we are confidently looking forward to 1997. Success in acquiring additional high quality assets for the Trust will ensure growth for Unitholders.

*On behalf of the Board of Directors of Freehold Resources Ltd.,*



*David J. Sandmeyer*

*President & Chief Executive Officer*

*April 15, 1997*



UNITHOLDERS RECEIVE CASH DISTRIBUTIONS AND THE POTENTIAL FOR INCREASED UNIT VALUE.

## A Royalty Trust

Royalty trusts represent a way to invest in oil and gas assets. Investors (called “unitholders”) purchase a small interest in a large pool of oil and gas properties. The trust receives the cash flow from those properties as reserves are produced, and pays it out on a regular basis to unitholders over the economic life of the properties.

The trust units can be traded in a liquid market, with the value of the units dependent on the trust manager’s ability to maintain cash flow and effect long-term growth in the value of the trust. Royalty trusts conduct their activities to minimize the corporate level of taxation and pass on the tax benefits associated with ownership of oil and gas properties directly to the unitholders.

Royalty trusts reduce exposure to one of the riskiest aspects of the oil and gas business — exploring for new reserves. The focus of a royalty trust manager is on acquiring and exploiting existing reserves, rather than on exploring for new ones. The level of cash distributions of a royalty trust is subject to virtually the same industry risks and conditions faced by conventional oil and gas companies.

### *Advantages of Freehold Royalty Trust*

Freehold is uniquely attractive to investors for the following reasons:

#### **True “off the top” royalties**

*The majority, about three-quarters, of the Trust’s cash flow comes from the royalties associated with the HB Lands which are held in perpetuity. The HB Land Royalties have two sources — royalties on leased producing mineral title properties and gross overriding royalty interests on other producing mineral title properties and Crown leases.*

#### **High netbacks**

*Freehold does not pay any capital expenditures, operating costs or environmental costs on the HB Lands. The high percentage of true royalty income results in superior netbacks, which maximizes the distributable income of the Trust.*

#### **Strong prospects for internal growth**

*The Trust receives a royalty percentage of all production generated by third parties operating on its HB Lands. Drilling and development activity on the HB Lands continues to result in reserves and production growth.*

#### **Diversified sources of revenue**

*Revenue from crude oil, natural gas, natural gas liquids and potash operations is based on production from over 1,000 individual properties, including more than 180 production units. As a result, the Trust receives royalty revenue from over 9,700 producing wells in Western Canada.*

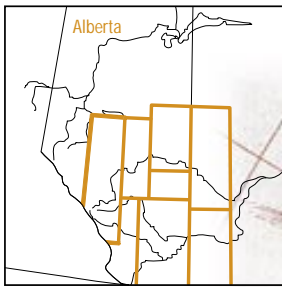
#### **Long reserve life index at 14.6 years**

*Reserves associated with the Trust are “long life”, meaning they are capable of generating oil and gas production for many years. Therefore, a high level of cash distribution to Unitholders will continue for an extended period of time.*

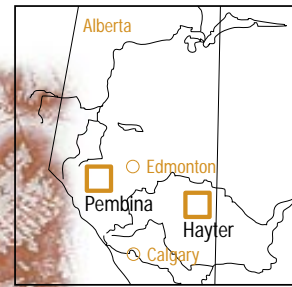


THE TRUST GENERATES REVENUE FROM A WIDE RANGE OF PROPERTIES.

## HB Lands —



## Working Interest Properties □



## Core Property Review

### I. Hudson's Bay Lands

The HB Lands are comprised of a large and widely diversified portfolio of properties extending from northeast British Columbia to southwest Manitoba. The majority of the lands are in the central area of southern Alberta and southwest Saskatchewan.

The area of "leased mineral title lands" covers about 400,000 gross acres. The royalties received from all oil, gas and potash produced and sold from the leased lands are determined by the individual lease agreements. However, the majority are a 20% royalty on Freehold's portion of the title interests.

The "gross overriding royalty lands" consist of producing mineral title properties owned by a number of third-party oil and gas companies. The Trust receives revenue from gross overriding royalty interests in approximately 92,000 acres. The Trust also has varying royalty interests in 62,000 acres of Crown lands leased by other parties.

### Drilling Activity HB Lands

<i>Year ended December 31</i>	1996	1995	1994	1993	1992
Oil	99	82	72	106	68
Gas	23	24	57	54	10
Service/Other Wells	–	7	3	8	1
Dry and Abandoned	21	19	13	16	16
Total	143	132	145	184	95
Success Rate	85%	86%	91%	91%	83%

Although the Trust is not responsible for any drilling, development activity or expenditures on the HB Lands, it receives royalty income from all producing wells. Drilling activity on the HB Lands has historically been quite active — 1996 was no exception. With 143 new wells drilled, it was the third most active year for drilling, adding production of approximately 300 barrels of oil equivalent per day.

### HB Lands Production By Geographical Area

<i>Production (Boe/d)</i>	1996
Western Alberta	883
Lloydminster/Bonnyville	399
Saskatchewan Heavy Oil	435
Bashaw/Leduc	315
Provost	289
Southeast Alberta	350
Hatton/Gull Lake	69
Other	286
Total	3,026

## II. Working Interest Properties

The Trust has 43 working interest properties which include both unitized and non-unitized oil and gas production. These properties represent about one-quarter of the total cash flow of the Trust, with production comprised of approximately 80% oil and 20% gas.

Nearly 76% of the present worth of the estimated future net cash flow from all the working interest properties is represented by two major properties — Pembina Cardium Unit No. 9 and Hayter, both in Alberta. These properties provide a solid reserve and production base, with Hayter offering continued growth potential. Operating costs for the working interest properties, at \$2.78 per barrel of oil equivalent, are among the lowest in the industry.

### Drilling Activity Working Interest Properties

Year ended December 31	1996		1995	
	Gross	Net	Gross	Net
Oil	16	3.3	7	1.3
Gas	16	0.1	3	0.1
Dry and Abandoned	1	-	-	-
Other	-	-	-	-
<b>Total</b>	<b>33</b>	<b>3.4</b>	<b>10</b>	<b>1.4</b>

### Working Interest Properties

Production (Boe/d)	1996
Hayter	995
Pembina	242
Other	441
<b>Total</b>	<b>1,678</b>

### Hayter

The Trust holds participating and mineral title interests of 21.8% in 640 acres in the Hayter Dina "B" oil pool in east central Alberta. The pool extends over approximately 3,500 acres, producing 15 degree API oil. Production rates and oil recovery are enhanced by an active aquifer underlying the pool.

Hayter provides ongoing growth potential. Horizontal drilling has increased both productivity and recoverable reserves, with central battery facilities constructed in 1994 to handle the increased production volumes. From 1993 to 1996, gross production from the property increased dramatically from 340 to over 4,200 barrels of oil per day as a result of these activities. In addition, costs have been reduced with increased operating efficiencies resulting from investment in the new facilities.

The Trust's share of production for the period was 995 barrels of oil per day from both horizontal and vertical wells. In 1996, 13 horizontal wells were drilled at Hayter, eight of which were drilled in the fourth quarter. The first of these eight wells commenced production before year end, adding approximately 100 barrels of oil per day in December. Total production from the new wells by year end was 300 barrels of oil per day.

In 1997 and beyond, horizontal drilling and development activity will continue to occur. Eight additional horizontal wells have been planned by the operator of this property for the second quarter of 1997.

### Pembina Cardium Unit No. 9

The Trust has a 9.9% interest in the Pembina Cardium Unit No. 9 located in central Alberta. The Unit encompasses approximately 25,280 acres, and has been on an 80-acre, five-spot waterflood pattern for more than 40 years. The Pembina Cardium Pool is one of the largest oil reservoirs in Western Canada and is characterized by high-quality crude oil of 37 degree API.

The Trust's share of Pembina Cardium Unit No. 9 reserves is estimated at approximately 3.5 million barrels of oil equivalent with a reserve life index of about 40 years. The Trust's current production is 242 barrels of oil equivalent per day.

### III. Potash Interests

As part of its HB Land Royalties, the Trust receives royalty income from leased potash rights. Of the total distributable income, approximately 2% is attributable to the potash rights. Potash production for the period averaged 14 tons per day.

The Trust has an interest in over 9,750 gross acres of leases issued to various operators of seven producing potash mines in Saskatchewan. These leases are included within larger potash units which cover the total mine areas.

The outlook is relatively stable for potash markets. These assets are expected to provide a modest, but reliable source of income.

### Production

During the Trust's initial 37-day period of operations ended December 31, 1996, production averaged 3,016 barrels per day of crude oil, 340 barrels per day of natural gas liquids and 13,477 thousand cubic feet per day of natural gas. This production amounted to 4,704 barrels of oil equivalent per day.

<i>Production Volumes</i>	<i>1996</i>	<i>1995</i>	<i>1994</i>	<i>1993</i>	<i>1992</i>	<i>1991</i>
Crude oil and NGLs (Bbls/d)	3,356	3,150	2,401	1,888	1,692	1,625
Gas (Mcf/d)	13,477	15,373	13,065	13,467	11,584	12,737
Total (Boe/d)	4,704	4,688	3,708	3,235	2,850	2,899
HB Land Royalties (Boe/d)	3,026	3,280	2,662	1,484	1,339	1,263
Working interest properties (Boe/d)	1,678	1,408	1,046	1,751	1,511	1,636
Total (Boe/d)	4,704	4,688	3,708	3,235	2,850	2,899

The HB Lands generated 64% of the oil and gas production associated with the Trust. The Trust's production is comprised of 71% crude oil and natural gas liquids and 29% natural gas. Oil production for the 37-day period was higher than 1995, primarily as a result of the drilling that occurred on the Trust's Hayter property and also on the HB Lands. Gas production lagged behind 1995 results, due to delays in tying-in recently drilled gas wells.

## Reserves

The active drilling by lessees on the HB Lands and the operator at Hayter, combined with reserve revisions, have effectively replaced the reserves of oil and gas produced from the Trust's properties during 1996. Established oil and gas reserves (proven plus half of probable) were 25.1 million barrels of oil equivalent at year end 1996, essentially unchanged from year end 1995.

The Trust's proven plus half probable reserve life index is 14.6 years. This does not include the estimated 130-year life of the potash reserves.

### Summary Of Reserves

As at December 31	1996		1995	
	Proven	Proven & Probable*	Proven	Proven & Probable*
Crude oil and NGLs (Mbbbl)	15,172	18,493	14,921	18,166
Natural gas (Mmcf)	56,352	65,657	57,253	68,981
Total (Mboe)	20,807	25,060	20,646	25,064
Potash (Tons)	81,223	81,223	81,860	81,860

### Reserves Reconciliation HB Land Royalty Interest

	Crude Oil (Mbbbl)		Natural Gas (Mmcf)		NGL (Mbbbl)		MBoe	
	Proven	Probable*	Proven	Probable*	Proven	Probable*	Proven	Probable*
Balance January 1, 1996	7,445	1,726	44,862	10,773	1,375	321	13,306	3,125
Reserve additions/revisions	758	108	3,559	(2,716)	532	36	1,646	(128)
Acquisitions/divestitures	-	-	-	-	-	-	-	-
Production	581	-	3,916	-	118	-	1,091	-
Balance December 31, 1996	7,622	1,834	44,505	8,057	1,789	357	13,861	2,997
Change over prior year	177	108	(357)	(2,716)	414	36	555	(128)

### Reserves Reconciliation Working Interest Properties

	Crude Oil (Mbbbl)		Natural Gas (Mmcf)		NGL (Mbbbl)		MBoe	
	Proven	Probable*	Proven	Probable*	Proven	Probable*	Proven	Probable*
Balance January 1, 1996	5,757	1,169	12,392	954	344	29	7,340	1,293
Reserve additions/revisions	222	(117)	(61)	293	(77)	49	139	(39)
Acquisitions/divestitures	-	-	-	-	-	-	-	-
Production	470	-	484	-	14	-	532	-
Balance December 31, 1996	5,509	1,052	11,847	1,247	253	78	6,947	1,254
Change over prior year	(248)	(117)	(545)	293	(91)	49	(393)	(39)

\* Probable reserves are risked at 50%.

### Present Worth Of Future Cash Flow (\$000s)

<i>Discounted at</i>	0%	10%	12%	15%
Proven producing	782,109	<b>177,857</b>	156,749	134,460
Proven non-producing	32,150	<b>14,751</b>	13,332	11,645
Total proven	814,259	<b>192,608</b>	170,081	146,105
Probable*	235,213	<b>23,678</b>	19,091	14,766
Total reserves	1,049,472	<b>216,286</b>	189,172	160,871
Potash	22,609	<b>5,003</b>	4,309	3,599
ARTC	-	-	-	-
Total	1,072,081	<b>221,289</b>	193,481	164,470

\* Probable reserves are risked at 50%.

### Net Asset Value

Based on the independent evaluation of the Trust's established reserves at December 31, 1996, discounted at 10%, the Trust's net asset value was \$8.01 per Trust Unit.

<i>(\$000s, except per Trust Unit amounts)</i>	1996
Present value of crude oil and natural gas reserves discounted at 10%	\$ 216,286
Present value of potash reserves discounted at 10%	5,003
Working capital (including site restoration reserve)	833
Bank debt	(10,719)
Net asset value	\$ 211,403
Net asset value per Trust Unit	\$ 8.01
Trust Units outstanding	26,408,000

The cash flow estimates provided by Grant Trimble Engineering Ltd. in the reserve report were based on the following price forecast provided by Sproule and Associates Limited. The potash price forecast was provided by LAS Energy in its report dated July 1, 1996.

### Price Forecast Of Sproule Associates Limited Effective October 1, 1996

Year	Oil		Gas	Natural Gas Liquids		
	WTI Cushing Oklahoma*	Edmonton Par Price	TransCanada Gas Services Limited (Mmbtu)	Propane (Bbls)	Butane (Bbls)	Pentane (Bbls)
	(Bbls)	40° API (Bbls)	Limited (Mmbtu)			
	\$U.S.	\$Cdn.	\$Cdn.	\$Cdn.	\$Cdn.	\$Cdn.
1997	20.00	26.58	1.65	15.77	15.26	25.24
1998	20.39	26.85	1.80	15.04	15.81	25.50
1999	21.27	27.77	2.08	15.56	16.56	26.38
2000	22.18	29.00	2.19	16.24	17.29	27.54
2001	23.13	30.28	2.32	16.96	18.05	28.75

\* 40° API, 0.4% sulphur

Approximately +4.25% per year to 2011; +3% thereafter. The U.S./Cdn. dollar exchange rate is forecast to be \$0.73 throughout the period.

#### Potash Price Forecast

<i>Year</i>	<i>1997</i>	<i>1998</i>	<i>1999</i>	<i>2000</i>	<i>2001</i>
\$U.S. (Ston)	77.00	79.00	81.00	83.00	85.00
\$Cdn. (Ton)	105.48	108.22	110.96	113.70	116.44

+2% thereafter.

### *Marketing*

#### **Crude Oil**

The Trust markets its working interest production using 30-day contracts to ensure the highest competitive pricing. Due to the large number of royalty oil properties, the Trust relies upon the marketing capabilities of the individual lessees. The average wellhead price for the 37-day period was \$24.97 per barrel for crude oil and natural gas liquids. The West Texas Intermediate price as quoted on the NYMEX for December 1996, was U.S. \$25.32 per barrel, compared to the 1996 average of U.S. \$22.03 per barrel.

#### **Natural Gas**

The Trust does not market its natural gas production. The diverse number and modest size of the working interest properties, and a provision of the leases which calls for the Trust's royalty gas to be marketed with the lessees' production, minimizes the ability to do so. As the opportunity arises, the Trust will market its working interest production to ensure the highest possible price.

The average price for the 37-day period was \$1.72 per thousand cubic feet. As with crude oil, the Trust maintains an aggressive auditing program which is designed to maximize royalty income and ensure its timely receipt.



**M** THE MD&A SHOULD BE READ IN CONJUNCTION WITH THE COMBINED FINANCIAL STATEMENTS.  
*ajor Transaction*

In September 1996, Freehold Royalty Trust was formed to acquire various royalty interests on mineral title lands once owned by the Hudson's Bay Company from Canpar and certain working interests from Canpar and Rife, both wholly owned subsidiaries of the CN Pension Fund. The acquisition of the properties and the listing of the Trust Units for trading were completed on November 25, 1996.

The purchase price of the properties was \$261.5 million, comprised of \$250.8 million in net proceeds from the initial public offering plus \$10.7 million in bank debt.

Strong investor interest in royalty trust offerings during the latter half of 1996 resulted in an oversubscription of Trust Units at the initial offering price of \$10.00 per Unit. The Trust Units were subsequently bid up to a high of \$12.70 on the first day of trading. While we believe Freehold's opportunities for growth are exceptional relative to other conventional oil and gas royalty trusts, this price proved unsustainable at the outset. Trading values have returned to levels near the issue price at the time of this report.

### 1996 Highlights

Highlights for the first 37 days of operations include:

- successful closure of initial public offering of 26.4 million Trust Units
- strong oil and gas production
- higher than anticipated commodity prices
- lower than anticipated expenses
- cash distribution of \$0.13 per Trust Unit
- net income \$1.0 million (\$0.04 per Trust Unit)

### Analysis of Financial Results

#### Revenues

Oil and gas revenues of \$4 million for the period benefitted from strong commodity prices that were received.

Production volumes of 4,704 barrels of oil equivalent per day were realized during this period, near the estimated production of 4,694 barrels of oil equivalent per day as provided in the initial prospectus forecast.

#### Pricing

<i>Q4 1996</i>	<i>Oil</i>	<i>Gas</i>	<i>NGLs</i>	<i>Potash</i>
	<b>(\$/Bbl)</b>	<b>(\$/Mcf)</b>	<b>(\$/Bbl)</b>	<b>(\$/Ton)</b>
\$ Cdn.	25.55	1.72	19.88	105.00

#### Revenue by Type

<i>(\$000s)</i>	<i>HB Lands</i>	<i>Working Interest Properties</i>	<i>Total</i>	<i>Percent</i>
Crude oil	1,657	1,157	2,814	71
NGLs	229	17	246	6
Natural gas	658	169	827	21
Potash/lease rentals	96	–	96	2
<b>Total</b>	<b>2,640</b>	<b>1,343</b>	<b>3,983</b>	<b>100</b>

### Royalties Paid

A unique attribute of the Trust is that no royalties are paid on the HB Lands. Additionally, no royalties are paid on the Hayter working interest property which represents 59% of the working interest volumes. As a result, total royalties paid to government or third parties by the Trust were only \$73,000, or 1.8% of revenue. This generates higher netbacks to Unitholders.

### Alberta Royalty Tax Credit (ARTC)

Neither the HB Land Royalties nor the working interest properties are eligible for ARTC because they are considered "restricted resource properties" within the meaning of the *Alberta Corporate Tax Act*. The Trust will be entitled to claim ARTC on royalties paid from eligible properties which are acquired in the future.

### Expenses

#### Operating Expenses

The Trust's total operating expenses for the working interest properties for the period were \$172,514, or \$2.78 per barrel of oil equivalent. This level is low by industry standards. For the total operations of the Trust, including the HB Land Royalties, expenses averaged \$0.99 per barrel of oil equivalent. This exemplifies the advantage of the HB Land Royalties for which the Trust does not pay operating expenses. Total Trust operating expenses are expected to remain low in comparison to conventional oil and gas companies.

#### General and Administrative Expenses

General and administrative expenses were \$199,138, or \$1.14 per barrel of oil equivalent. Of this amount, \$90,366 was reimbursed to the Manager, which includes non-recurring start-up expenses for the period.

General and administrative expenses are charged to Resources and to the Trust by the Manager based on the time spent and direct costs incurred, as outlined in the Management Agreement.

#### Management Fee

The Manager is a wholly owned subsidiary of Rife which is owned 100% by the CN Pension Fund. The Trust engaged the Manager to handle all management and administrative matters relating to the Trust. The Trust has no employees.

Pursuant to the Management Agreement, the Manager will receive a Management Fee paid in Trust Units on a quarterly basis in order to align its economic interests with the interests of the Unitholders. The Management Fee will be based on the number of issued and outstanding Trust Units at the end of each quarter. The quarterly Management Fee will initially be 20,000 Trust Units. The Manager has agreed with the Trust that it will not sell any Trust Units received as a Management Fee for a period of one year after closing. Thereafter, sales of the Trust Units will be subject to applicable laws and regulations. Consistent with these initial agreements, the Manager received 8,000 Trust Units for the 37-day period.

#### Interest Expense and Financing

The Trust borrowed \$10.7 million as a portion of the cost to acquire the working interest properties. Interest expense on the long-term debt was \$53,971.

### Reclamation Fund

The Trust will be liable for its share of environmental obligations as they arise and for the ultimate reclamation expenses for its ownership interest in the working interest properties upon abandonment. As a royalty owner of the HB Lands, the Trust is not responsible for any reclamation or abandonment expenses. Current environmental obligations are expected to be funded out of cash flow. The Trust estimates the future environmental and reclamation obligations in respect of the working interest properties to be approximately \$1,830,000. The Trust has established a reclamation fund to which it will deposit annually, in quarterly installments, up to \$122,000, less any amounts actually expended in that period, for the purpose of funding its future environmental and reclamation obligations. This will result in the estimated future environmental and reclamation obligations being fully funded within 15 years. This payment may be adjusted by the Trust from time to time based on its assessment of its share of expected environmental and final site reclamation costs. An amount of \$12,367 was contributed to the fund for 1996.

### Depletion and Depreciation

The provision for depletion costs is calculated on a unit of production basis utilizing proven reserves, before royalties. During the period, the depletion charge was \$2.4 million.

### Taxes

**Unitholder Taxation** The Trust is able to claim certain tax deductions for the benefit of Unitholders which are available to all owners of oil and gas properties. By utilizing two principal deductions — the Canadian oil and gas property expense (COGPE) and the resource allowance deduction — cash distributions in the initial years are sheltered from income tax. Over time, an increasing percentage of the annual distributions will be taxable.

Cash distributions received which are not subject to income tax are considered a return of capital, and the cost base of the Units must be reduced by the amount of the distributions. Therefore, the payment of tax is deferred until such time as the Units are sold.

It is anticipated that the Trust will have sufficient deductions to offset Royalty Income until the taxation year 2000 based upon the production and cash flow estimates in the Trimble Oil and Gas report, the LAS Energy Potash Report and current income tax legislation.

**Taxation of the Trust** Although there was no provision during the period for Large Corporations Tax (LCT), the Trust will be liable for this tax to a nominal extent in the future. The prospectus forecast the LCT to be \$2,000 in 1997.

### Cash Flow and Net Earnings

#### Cash Flow

Cash flow from operations before management fees was \$3,545,017. While the HB Land Royalties provide 65% of gross revenue, they provided 70% of cash flow before general and administrative and interest expenses as they are not subject to third-party royalty payments or operating expenses.

### Net Earnings

The Trust's net earnings from operations for the period were \$1.0 million, which represents \$0.04 per Trust Unit.

### Netback Analysis

	<i>HB Lands</i>			<i>Working Interest Properties</i>			<i>Total</i>
	<i>Oil &amp; NGLs</i>	<i>Gas</i>	<i>Boe</i>	<i>Oil &amp; NGLs</i>	<i>Gas</i>	<i>Boe</i>	<i>Boe</i>
	<b>(\$/Bbl)</b>	<b>(\$/Mcf)</b>	<b>(\$/Boe)</b>	<b>(\$/Bbl)</b>	<b>(\$/Mcf)</b>	<b>(\$/Boe)</b>	<b>(\$/Boe)</b>
Selling price	25.39	1.75	23.59	24.35	1.65	22.80	23.30
Royalties (net of ARTC)	-	-	-	0.83	0.27	1.18	0.42
Production expenses	-	-	-	3.03	0.18	2.78	0.99
Operating netback	25.39	1.75	23.59	20.49	1.20	18.84	21.89
General and administrative							1.14
Interest							0.31
Cash flow netback							20.44
Depletion, depreciation and site restoration							14.37
Taxes							-
Net earnings							6.07

### Distributable Income

The Trust's mandate is to distribute cash flow on a quarterly basis. Distributable income for the period was \$3,532,000 (\$0.13 per Trust Unit). The record date was January 31, 1997, with payment made on February 28, 1997.

<i>Calculation of Distributable Income</i> <i>(\$000s)</i>	<i>HB Land</i> <i>Royalties</i>	<i>Working Interest</i> <i>Properties</i>	<i>Total</i>
Revenues:			
Oil and gas sales	2,544	1,416	3,960
ARTC	-	-	-
Other income (potash and lease rentals)	96	-	96
	2,640	1,416	4,056
Less Expenses:			
Royalties	-	73	73
Operating costs	-	173	173
Capital expenditures	-	13	13
Site restoration and reclamation fund	-	12	12
Sub-Total	2,640	1,145	3,785
Less:			
General and administrative			199
Interest on long-term debt			54
Distributable income			3,532
Trust Units outstanding			26,408,000
Distributable income per Trust Unit			\$0.13

The Trust's distributable income is sensitive to, among other things, the volume of oil and gas produced, prevailing commodity prices, the level of drilling activity by others on the HB Lands and the amount of capital expenditures on the working interest properties.

The following table provides analysis of some of the key factors which affect distributable income.

#### Sensitivities Analysis

	<i>Cash Amount</i>	<i>Distributions</i>
	(\$000s)	Per Trust Unit (\$)
Change of US \$1.00/Bbl in the price of crude oil	1,655	0.060
Change of \$0.10/Mcf in the price of natural gas	550	0.020
Change of \$0.01 in the US/Cdn. dollar exchange rate	336	0.010
Change of 1% in interest rates	107	0.004
Change of 100 Bbl/d of oil and NGLs	749	0.028
Change of 1,000 Mcf/d of gas	541	0.020

#### Capital Expenditures

For the period, capital expenditures related to the Trust's share of drilling and development costs on working interest properties totalled \$13,500.

On the working interest properties, capital expenditures may be made to maintain or improve production. These expenditures may be financed by income from the working interest properties, borrowings, farmouts or working capital. Exploratory drilling may not be initiated by the Trust. The Trust Indenture limits the amount of capital which can be funded from cash flow to ensure distributions are not significantly impacted.

With respect to the Trust, the HB Lands are not subject to capital spending obligations as they are the responsibility of the lessee and operator under each lease.

#### Liquidity and Capital Resources

During 1996, \$250.8 million (net of issue costs) was raised through a new issue of 26,400,000 Trust Units at a price of \$10.00 per Trust Unit. Bank debt outstanding at December 31, 1996 was \$10.7 million.

#### Credit Facility and Borrowing

The Trust currently has available an operating facility of \$20 million and a production facility of \$30 million. Under the terms of the operating facility, \$10.7 million was used to finance part of the purchase price of the working interest properties.

The Trust may borrow funds for royalty or working interest acquisitions, capital expenditures on working interest properties, or working capital.

### Business Risks

The risks faced by the Trust while pursuing its business activities and achieving its objectives can be categorized as to operational, financial and regulatory.

### Operational Risks

Operational risks include acquisition, development, production and marketing of oil and natural gas reserves. Failure to acquire additional oil and gas properties, delays in development of current properties, well operating or production problems, and marketing difficulties resulting from pipeline capacity availability or market demands can all result in failure to achieve objectives in levels of distributions and asset values. To mitigate these risks, the Manager employs a staff of experienced professionals in the areas of geology, geophysics, engineering, land management, accounting and marketing. Sophisticated business systems ensure the timely, effective operation and monitoring of the Trust's properties. These systems ensure the highest level of income flows to the Trust and the effective implementation of operational plans and acquisition strategies.

### Financial Risks

Factors such as oil and gas commodity prices, interest rates and currency exchange levels which are outside the control of the Trust or the Manager, may have a significant impact on the financial results of the Trust. World market forces establish oil prices in the Canadian market, while the North American supply-demand situation determines Canadian natural gas prices. Where the Manager has control over the marketing of the Trust's production, the Trust will pursue the best access to markets and returns available. Crude oil is priced based on the West Texas Intermediate price which is U.S.-dollar denominated. The Canadian/U.S. exchange rates can impact the Trust's revenue from oil sales.

The Trust did not enter into any forward product sales, hedging, or any currency hedging transactions in 1996. In the future, these mechanisms may be utilized if such action would be appropriate to minimize downside risks or capture upside potential.

Entering 1997, interest rates appear to be at risk of rising. Since the Trust has relatively low levels of debt, possible interest rate increases currently have a low impact on the operations of the Trust.

Trust Units will have no value when reserves from the properties can no longer be economically produced. As a result, cash distributions do not represent a "yield" in the traditional sense as they represent both return of capital and return on investment.

### Regulatory Risks

The Canadian oil and gas industry is subject to a comprehensive set of acts and regulations governing all aspects of its operations. At the same time, the industry is subject to tax laws and regulations applied to all businesses in Canada. There can be no assurance that those operating, business, and tax laws and regulations, will not be changed in a manner which would adversely affect Unitholders.

In recent years the tax and regulatory environment has been conducive to the industry undertaking consecutive record years of business activity. The Manager, through active involvement in industry associations, maintains a current understanding of potential or proposed changes to regulatory and tax proposals to permit adjustments to the Trust's activities and plans when appropriate.

The oil and gas industry is subject to environmental regulation at the local, provincial and federal levels. Any breach of such legislation may result in the imposition of fines or issuance of clean up orders. The Manager has established policies and procedures designed to ensure its operations meet regulatory requirements and which are consistent with good environmental practice. The Trust has established a reclamation fund for the purpose of funding abandonment and environmental reclamation obligations in the future.

### Business Strategy

The Manager's objectives for the Trust are to achieve the highest level of distributable income and to increase the assets of the Trust to provide attractive returns to Unitholders.

With the widely distributed property base and active drilling programs of the lessees on the HB Lands, the Manager has developed and maintains a program of continuous auditing of lessees and royalty payments to ensure timely receipt of all royalties. This program has proven to be very successful at identifying errors in royalty calculations and delays in initiating payments from wells recently commencing production.

To ensure growth for the Trust, the Manager has established a dedicated acquisition group. This team of senior oil and gas professionals is pursuing a number of oil and gas acquisition opportunities identified as being appropriate to achieving the Trust's objectives. Efforts are focused on identification and evaluation of desirable properties or groups of properties not being widely marketed, providing the Trust with opportunities to make acquisitions on a negotiated basis rather than competing in auction type sales.

To maintain the advantages the Trust realizes from receiving a high percentage of income from off-the-top royalties, the acquisition program is focusing on royalty properties.

### *1997 Outlook*

During 1997, capital expenditures for the working interest properties are forecast at \$1.9 million. About \$1.4 million will be used to drill approximately 12 horizontal wells on the Trust's Hayter property. The results from last year's program at Hayter (13 wells) were very encouraging, adding approximately 300 barrels of oil per day, of which approximately 100 barrels of oil per day was reflected in the period. Eight of the 12 planned wells for 1997 have been approved for drilling by the owners. With the planned drilling, this increase in production should be maintained throughout 1997. The remaining four wells are to be drilled near year end and will have little impact on the 1997 production rate from the pool.

The remaining funds will be used to drill a multilateral horizontal well on the North Scallion Unit, infill drilling of four wells on the Dodsland Viking property, and facility installation for a gas well at Leaman which is expected to commence production before summer. These projects are estimated to add a further 100 barrels of oil equivalent per day above the 1996 production rates.

The Canadian oil and gas industry is drilling new wells this year at a pace expected to surpass the 1996 record. A continued high number of wells drilled on the Trust's HB Lands will sustain both our reserves and production levels at no cost to the Trust.

Commodity prices in the first three months of 1997 have exceeded those forecast by the Trust, although at the time of writing, oil prices have dropped back to forecast levels. We believe the commodity prices used in our year end reserve evaluation; oil at U.S. \$20.00 per barrel and natural gas at \$1.65 per thousand cubic feet are appropriate estimates for the year. These prices reflect a small increase in oil price compared to the forecast, and if realized, would have a modest impact on distributions to Unitholders.

## MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL STATEMENTS

The accompanying combined financial statements of Freehold Royalty Trust have been prepared by management in accordance with generally accepted accounting principles.

Management is responsible for the preparation of the combined financial statements for Freehold Royalty Trust and for the consistency therewith of all other financial and operating data presented in the annual report.

Management maintains a system of internal controls to provide reasonable assurance that all assets are safeguarded and to facilitate the preparation of relevant, reliable and timely information.

External auditors, KPMG, have examined the combined financial statements of Freehold Royalty Trust. The Audit Committee, consisting primarily of independent directors of Resources, has reviewed these statements with Management and the auditors, and has recommended their approval to the Board of Directors. The Board has approved the combined financial statements contained in this annual report.



*David J. Sandmeyer*  
*President & Chief Executive Officer*



*Joseph N. Holowisky*  
*Vice-President, Finance and Administration*  
*& Chief Financial Officer and Secretary*

## AUDITORS' REPORT

To the Unitholders of Freehold Royalty Trust

We have audited the combined balance sheet of Freehold Royalty Trust as at December 31, 1996 and the combined statements of income, distributable income, unitholders' equity and changes in financial position for the period from commencement of operations on November 25, 1996 to December 31, 1996. These combined financial statements are the responsibility of the Trust's management. Our responsibility is to express an opinion on these combined financial statements based on our audit.

We conducted our audit in accordance with 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 combined financial statements present fairly, in all material respects, the financial position of the Trust as at December 31, 1996 and the results of its operations and the changes in its financial position for the period from commencement of operations on November 25, 1996 to December 31, 1996 in accordance with generally accepted accounting principles.

*Calgary, Canada*  
*February 7, 1997*



*KPMG, Chartered Accountants*

# COMBINED BALANCE SHEET

December 31, 1996

## Assets

### Current assets:

Cash	\$ 311,214
Accounts receivable	4,603,598
	<u>4,914,812</u>

Petroleum and natural gas interests, net of accumulated depletion and depreciation of \$2,398,510	258,349,306
	<u>\$ 263,264,118</u>

## Liabilities and Unitholders' Equity

### Current liabilities:

Distributions payable to unitholders	\$ 3,531,523
Accounts payable and accrued liabilities	483,493
Interest payable	53,961
Provision for future site restoration	12,367
	<u>4,081,344</u>

Long-term debt (note 2)	10,719,144
Unitholders' equity (note 3)	248,463,630
	<u>\$ 263,264,118</u>

See accompanying notes to combined financial statements.

Approved on behalf of Freehold Royalty Trust  
by Freehold Resources Ltd., as Administrator:



William B. Siebens, Director



D. Nolan Blades, Director

## COMBINED STATEMENT OF INCOME

*Period from commencement of operations on November 25, 1996 to December 31, 1996*

Revenues:	
Royalty income	\$ 2,640,439
Working interest sales (net of royalties)	1,342,568
	<u>3,983,007</u>
Expenses:	
Operating	172,514
Administrative	199,138
Interest on long-term debt	53,971
Site restoration	12,367
	<u>437,990</u>
Income before non-cash expenses	3,545,017
Depletion and depreciation	2,398,510
Management fee	89,600
	<u>2,488,110</u>
Net income	\$ 1,056,907
Net income per Trust Unit	<u>\$ 0.04</u>

*See accompanying notes to combined financial statements.*

## COMBINED STATEMENT OF DISTRIBUTABLE INCOME

*Period from commencement of operations on November 25, 1996 to December 31, 1996*

Income before non-cash expenses	\$ 3,545,017
Capital expenditures	(13,494)
Distributable income	<u>\$ 3,531,523</u>
Distributable income per Trust Unit	<u>\$ 0.13</u>

*See accompanying notes to combined financial statements.*

## COMBINED STATEMENT OF UNITHOLDERS' EQUITY

*Period from commencement of operations on November 25, 1996 to December 31, 1996*

	Units	Dollars
Proceeds on issue of trust units	26,400,000	\$ 264,000,000
Proceeds on issue of Freehold Resources Ltd. shares (100 shares)	-	100
Trust unit issue costs	-	(13,151,454)
Net income	-	1,056,907
Unit distribution	-	(3,531,523)
Trust units to be issued in lieu of management fee	8,000	89,600
Unitholders' equity, end of period	26,408,000	\$ 248,463,630

*See accompanying notes to combined financial statements.*

## COMBINED STATEMENT OF CHANGES IN FINANCIAL POSITION

*Period from commencement of operations on November 25, 1996 to December 31, 1996*

Cash provided by (used in):	
Operating:	
Net income	\$ 1,056,907
Item not involving cash:	
Depletion and depreciation	2,398,510
Funds generated from operations	3,455,417
Changes in non-cash operating working capital	(4,053,777)
	(598,360)
Financing:	
Trust units to be issued in lieu of management fee	89,600
Issue of trust units	264,000,000
Issue of Freehold Resources Ltd. shares	100
Trust unit issue costs	(13,151,454)
Long-term debt	10,719,144
	261,657,390
Investing:	
Property and royalty acquisitions	(260,734,322)
Additions to petroleum and natural gas properties	(13,494)
	(260,747,816)
Cash, at end of period	\$ 311,214

*See accompanying notes to combined financial statements.*

## NOTES TO COMBINED FINANCIAL STATEMENTS

### **B** PERIOD FROM COMMENCEMENT OF OPERATIONS ON NOVEMBER 25, 1996 TO DECEMBER 31, 1996 *asis of presentation*

Freehold Royalty Trust ("the Trust") is a closed-end investment trust formed under the laws of the Province of Alberta pursuant to a trust indenture dated September 30, 1996 and amended on November 25, 1996. The Trust issued 26,400,000 Trust Units for \$250,848,546, net of trust unit issue costs of \$13,151,454, pursuant to an offering dated November 14, 1996.

Freehold Resources Ltd. ("Resources") was incorporated on June 3, 1996 and derives its income from certain oil and gas working interest properties.

During the period: (i) the Trust acquired interests in certain oil and gas royalties for \$186,371,000; (ii) Resources acquired \$74,363,000 of working interest properties; and (iii) the Trust acquired a 99% royalty interest in the Resources properties.

These combined financial statements included the accounts of the Trust and Resources. All inter-entity transactions have been eliminated.

#### **I. Significant accounting policies**

##### **a. Property, plant and equipment:**

The Trust follows the full cost method of accounting. All costs of acquiring, exploring for and developing oil and gas and related reserves are capitalized. Such costs include land acquisition, geological and geophysical, carrying charges of unproved properties, costs of drilling both productive and non-productive wells and directly related general and administrative costs. Costs are reduced by proceeds from the sale of oil and gas properties and by government grants. Gains and losses are not recognized upon disposition of oil and gas properties unless such a disposition would alter the rate of depletion by 20% or more.

##### **b. Ceiling test:**

The Trust applies a ceiling test to the carrying value of oil and gas assets, net of the provision for site restoration, plus future development costs to ensure that such costs do not exceed future estimated net revenues from production of proven reserves at year end prices and costs. Future revenues are calculated after deducting future general and administrative costs, site restoration costs and Resource's income taxes.

##### **c. Depletion:**

Oil and gas properties and royalty interests, including the costs of production equipment and future capital costs associated with proven reserves, are depleted on the unit-of-production method based on estimated proven oil and gas reserves before royalties. Reserves are converted to equivalent units on the basis of relative energy content.

##### **d. Provision for site restoration:**

Estimated future site restoration costs are provided for using the unit-of-production method. Costs are estimated by the Trust based on current regulations, costs, technology and industry standards. Actual site restoration costs will be charged to the accumulated provision account as incurred.

##### **e. Income and other taxes:**

###### **Taxation of the Trust**

The Trust is an inter vivos trust for income tax purposes. As such, the Trust is subject to tax on any taxable income which is not distributed to the unitholders. No provision has been made for income taxes in these financial statements as the Trust allocates all of its income to its unitholders. Therefore, income taxes are the responsibility of the individual unitholders.

###### **Taxation of Resources**

The Resources Royalty payment by Resources to the Trust is deductible in computing Resources taxable income and consequently will generally be liable for income taxes only on its one percent interest.

## ***2. Long-term debt***

The Trust has a \$20,000,000 committed operating facility on which \$10,719,144 is drawn at December 31, 1996. The facility is secured by a General Security Agreement from the Trust and Resources providing a first priority security interest in both Resource's and the Trust's assets and specific assignment of royalties. A demand debenture is pledged from both Resources and the Trust in the amount of \$75,000,000 conveying a first floating charge over all property. The facility is subject to an annual review by the lender. The facility bears interest at prime and has no fixed repayment terms.

In addition, the Trust has available a \$30,000,000 demand production facility at December 31, 1996.

## ***3. Unitholders' equity***

The Trust has authorized an unlimited number of Trust Units of which 26,408,000 were issued or to be issued at December 31, 1996. Resources has authorized share capital of an unlimited number of common shares. One hundred shares are issued and outstanding as at December 31, 1996.

The Trust has reserved 1,980,000 Trust Units pursuant to a Trust Unit Option Plan. Options to purchase Trust Units may be issued to the directors of Resources or to Rife Resources Management Ltd. (the manager of the Trust).

As at December 31, 1996, options to purchase 1,130,000 Trust Units were outstanding. These options were held by directors and Rife Resources Management Ltd. and are exercisable at a price of \$10.00 per unit to November 14, 2001.

The Trust has reserved 420,000 Trust Units pursuant to its management agreement with Rife Resources Management Ltd. (see note 5).

## ***4. Distributions***

The Trust Indenture provides that Distributable Income shall be distributed on the 15th day of February, May, August and November in each year except that the December 31, 1996 amount will be paid on February 28, 1997.

## ***5. Related party transactions***

Rife Resources Management Ltd. ("Management") provides certain services pursuant to a management agreement for an initial term of 5 years for a fee equal to 20,000 trust units per quarter. The management fee charged was 8,000 Trust Units with an ascribed value of \$89,600.

During the period Management charged the Trust \$90,366 in operating costs. These charges are included in accounts payable at year end.

## ***6. Future site restoration and reclamation cost***

The Trust and Resources are liable for their share of ongoing environmental obligations and for the ultimate reclamation of the working interest properties upon abandonment. Ongoing environmental obligations are expected to be funded out of cash flow. The estimated future environmental and reclamation obligations in respect of the working interest properties is approximately \$1,830,000. A reclamation fund has been established and requires quarterly cash payments, up to \$122,000 per year, less any amounts actually expended in the year.

During the period \$12,367 in site restoration was provided for and this amount was paid to the fund subsequent to year end.



### ACCOUNTABILITY TO UNITHOLDERS THROUGH RESPONSIBLE GOVERNANCE.

The corporate governance structure of Freehold Royalty Trust (the "Trust") is not the same as for a conventional corporation. The way in which the Trust is governed reflects its situation as a trust holding a royalty granted by Freehold Resources Ltd. ("Resources"), with certain rights under a Unanimous Shareholder Agreement and a Management Agreement. While the Trust is technically not a shareholder of Resources, when the Trust was established a Unanimous Shareholder Agreement was entered into between Resources, Rife Resources Management Ltd. (the "Manager") and Montreal Trust Company of Canada (the "Trustee"), with the intention that the Trust and the Unitholders would be given rights substantially equivalent to those which they would have if they were shareholders in Resources.

The Trust has no directors. The Manager operates in accordance with the requirements of the Trust Indenture, the Royalty Agreement and related agreements. When the Trust was established, Resources and the Trustee entered into a Management Agreement with the Manager. Under this agreement, the Manager is responsible for the day-to-day management of the business of the Trust subject to a supervisory role of the board of directors of Resources. In exercising its powers and discharging its duties under the Management Agreement, the Manager must exercise the degree of care, diligence and skill that a reasonably prudent advisor and manager in respect of petroleum and natural gas properties in Western Canada would exercise in comparable circumstances. The Manager is paid for providing its services and is entitled to reimbursement for general and administrative costs which constitute a deduction in the determination of income.

### *TSE Guidelines on Corporate Governance*

In February 1995, The Toronto Stock Exchange ("TSE") Committee on Corporate Governance in Canada issued a report (the "TSE Report") setting out a series of guidelines for effective corporate governance. The TSE requires that each listed company disclose on an annual basis its approach to corporate governance with reference to the guidelines. A full description of the approach of the Trust to corporate governance with reference to the guidelines is set forth in the Trust's Information Circular provided to Unitholders in connection with the 1997 Annual Meeting.

### *Management of the Trust*

#### **Trustee**

Montreal Trust Company of Canada is the initial trustee of the Trust and will also act as the transfer agent for the Trust Units. The Trustee is responsible for, among other things: (a) accepting subscriptions for Trust Units and issuing Trust Units pursuant thereto; (b) maintaining the books and records of the Trust and providing timely reports to holders of Trust Units; and (c) paying cash distributions to Unitholders. The Trust Indenture provides that the Trustee shall exercise its powers and carry out its functions thereunder as Trustee honestly, in good faith and in the best interests of the Trust and the Unitholders and, in connection therewith, shall exercise that degree of care, diligence and skill that a reasonably prudent trustee would exercise in comparable circumstances.

#### **Resources**

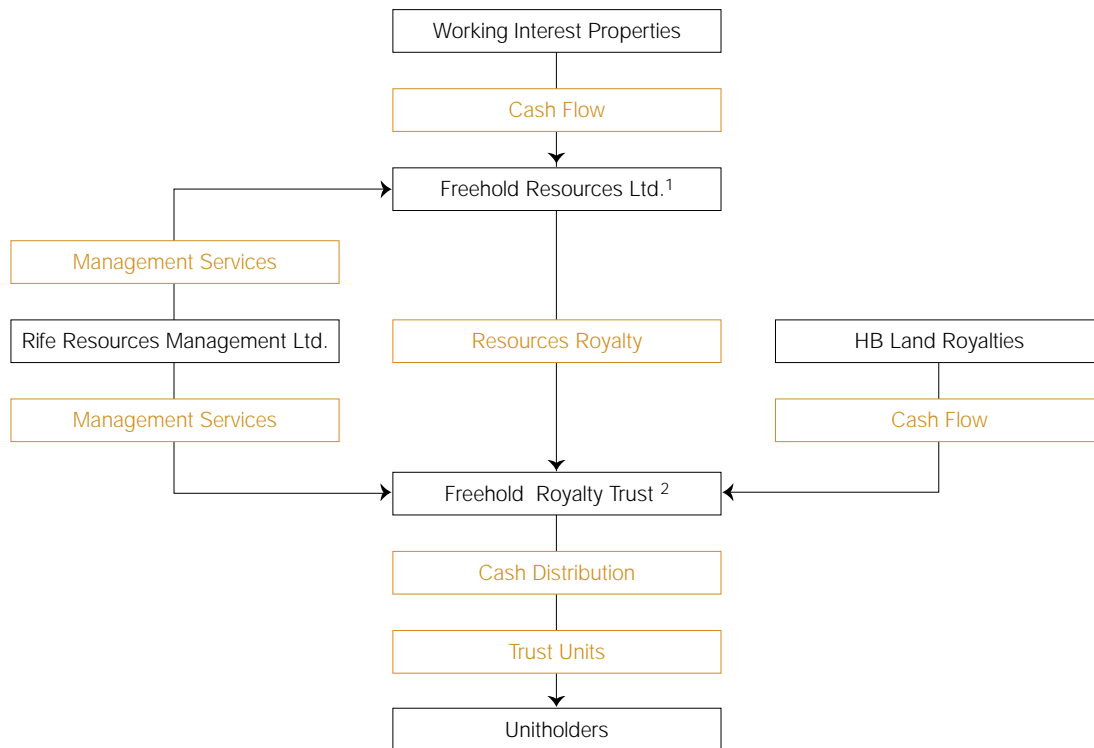
Resources has a board of directors consisting of six individuals, two of whom have been elected by the Manager and four of whom are independent directors. The four independent directors were initially appointed by the Manager, after consultation with the underwriters under the Trust's initial public offering, and thereafter will be elected by the Unitholders at the annual meeting of Unitholders. The Chairman of the board of directors of Resources will be one of the independent directors. Unitholders will always be entitled to elect the majority of the board of directors of Resources.

The board of directors of Resources is required to approve all matters referred to in items (d), (e), (f), (g) and (h) below and, in addition, will be required to approve any amendment to the Management Agreement, the HB Lands Royalty Agreement or the Resources Royalty Agreement.

## The Manager

Pursuant to the provisions of the Management Agreement, the Manager will provide certain administrative and support services to the Trust, including those necessary: (a) to ensure compliance by the Trust with continuous disclosure obligations under applicable securities legislation; (b) to provide investor relations services; (c) to provide or cause to be provided to Unitholders all information to which Unitholders are entitled under the Trust Indenture; (d) to call, hold and distribute materials including notices of meetings and information circulars in respect of all necessary meetings of Unitholders; (e) to determine the amounts payable from time to time to Unitholders and to arrange for distributions to Unitholders of Distributable Income; (f) to determine the timing and terms of future offerings of Trust Units, if any; (g) to determine the terms and conditions upon which the Trust may acquire Additional Royalties; and (h) to determine the terms and conditions upon which the Trust may from time to time borrow money.

The structure and relationship of the components of the Trust are summarized in the following diagram:



<sup>1</sup> owned by the Share Trust, owns the working interest properties

<sup>2</sup> owns the HB Land Royalties and the Resources Royalty

# CORPORATE AND UNITHOLDER INFORMATION

## Directors

**William W. Siebens**, *Chairman*  
President & C.E.O.  
Candor Investments Ltd.

**D. Nolan Blades**<sup>1</sup>  
President & C.E.O.  
Pursuit Resources Corp.

**Harry S. Campbell**  
Partner  
Burnet, Duckworth & Palmer

**Peter T. Harrison**<sup>1</sup>  
Manager, Investments  
CN Pension Fund

**P. Michael Maher**<sup>1</sup>  
Dean, Faculty of Management  
University of Calgary

**David J. Sandmeyer**  
President  
Rife Resources Ltd.

<sup>1</sup> Audit Committee

## Officers

**David J. Sandmeyer**  
President & C.E.O.

**J. Frank George**  
Vice-President, Exploitation

**Joseph N. Holowisky**  
Vice-President,  
Finance/Administration & C.F.O.  
and Secretary

**William O. Ingram**  
Vice-President, Production

**Michael J. Okrusko**  
Vice-President, Land

## Head Office

**Freehold Resources Ltd.**  
**Freehold Royalty Trust**  
1530, 140 - 4th Avenue S.W.  
Calgary, Alberta T2P 3N3  
Telephone: (403) 221-0802  
Fax: (403) 269-6617

## Investor Relations Contact

**For more information contact:**  
Karen C. Taylor  
Manager, Corporate Communications  
Telephone: (403) 221-0891  
E-mail: kctaylor@freeholdtrust.com

## Distribution Dates for 1997

Record Date	Payment Date
Jan. 31, 1997	Feb. 28, 1997
Apr. 30, 1997	May 15, 1997
July 31, 1997	Aug. 15, 1997
Oct. 31, 1997	Nov. 15, 1997

## Distribution Direct Deposit Plan

A Direct Deposit Plan has been established for the Trust to provide Unitholders who have Canadian bank accounts with a method of receiving cash distributions as a direct deposit into their bank account. Please contact the Trustee for more information.

## Distribution Reinvestment Plan

Subject to receipt of all required regulatory approvals, a Trust Unit Cash Distribution reinvestment plan will be established in April 1997 for the Trust to provide Unitholders who are residents of Canada with a method of reinvesting cash distributions into new Trust Units. Please contact the Trustee for more information.

## Trust Unit Trading

	1996
Issue price	\$ 10.00
High	\$ 12.70
Low	\$ 11.15
Close	\$ 11.20
Volume (TSE)	12,942,929
Trust Units outstanding	26,408,000
Market capitalization	\$295,769,600

## Trustee and Transfer Agent Information

Unitholders' change of address or inquiries regarding Trust Units or distributions should be directed to:

**Montreal Trust Company of Canada**  
600, 530 - 8th Avenue S.W.  
Calgary, Alberta T2P 3S8  
Telephone: (403) 267-6555  
Fax: (403) 267-6592  
1-800-558-0046

## Transfer Points

Calgary, Toronto, Montreal

## Stock Exchange Listings

The Toronto Stock Exchange  
Trading Symbol: FRU.UN

## Legal Counsel

**Burnet, Duckworth & Palmer**  
Calgary, Alberta

## Auditors

**KPMG**  
Calgary, Alberta

## Banker

**Canadian Imperial Bank of Commerce**  
Calgary, Alberta

## Evaluation Engineers

**Grant Trimble Engineering Ltd.**  
Calgary, Alberta

## Annual Information Form

Freehold Royalty Trust was not required to produce an Annual Information Form for the year ended December 31, 1996.

## Abbreviations

API	American Petroleum Institute
ARTC	Alberta Royalty Tax Credit
Bbl	barrel
Bbls/d	barrels per day
Bcf	billion cubic feet
Boe	barrels of oil equivalent (10 mcf = 1 bbl)
Boe/d	barrels of oil equivalent per day
Mbbls	thousand barrels
Mboe	thousands of barrels of oil equivalent
Mcf	thousand cubic feet
Mmcf	million cubic feet
NGLs	natural gas liquids
NYMEX	New York Mercantile Exchange
Ston	one short ton
WTI	West Texas Intermediate

