



AKITA

1998 ANNUAL REPORT

ANNUAL MEETING:

The Annual General Meeting of Shareholders will be held at 11:00 a.m. M.D.T. on Thursday, May 13, 1999 at the Sheraton Suites Calgary, 255 Barclay Parade S.W., Calgary, Alberta. Shareholders and other interested parties are encouraged to attend.

CONTENTS

| | |
|---|-----|
| Corporate Profile | 1 |
| 1998 Achievements | 2 |
| Share Performance | 3 |
| Letter to the Shareholders | 4 |
| Operations Review | 7 |
| Management's Discussion and Analysis of Financial Condition and Results of Operations | 11 |
| Management's Responsibility for Financial Reporting | 19 |
| Auditors' Report | 19 |
| Financial Statements | 20 |
| Notes to Financial Statements | 23 |
| Financial Review from the Commencement of Operations | 28 |
| Corporate Information | IBC |

COVER:

Rig #47 drilling for natural gas in the Alberta Foothills.

CORPORATE PROFILE

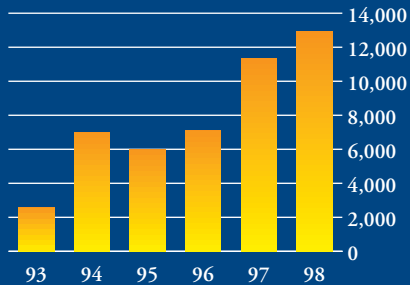
AKITA Drilling Ltd. is a premium oil and gas drilling contractor with operations throughout Western Canada. The Company's objective is to be the industry leader in matters of equipment quality, safe and efficient drilling performance by top quality personnel and overall customer satisfaction. In addition to conventional drilling services, the Company is active in directional, horizontal and underbalanced drilling and provides specialized drilling services to a broad range of independent and multinational oil and gas companies. AKITA employs approximately 500 people operating 30 drilling rigs in all depth ranges.



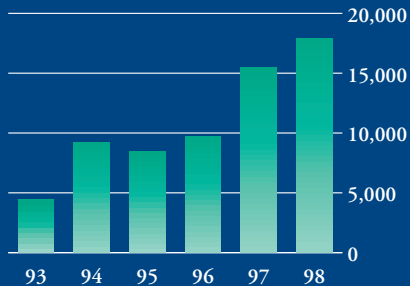
AKITA has a comprehensive safety program with policies and procedures designed to improve work site safety and prevent accidents. The Company maintains one of the best safety records in the industry.

1998 ACHIEVEMENTS

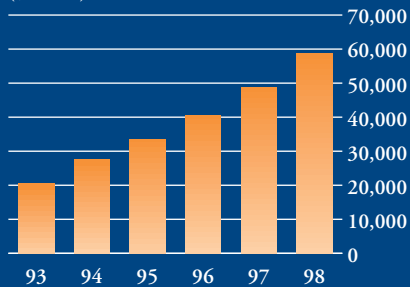
NET EARNINGS
(\$ 000's)



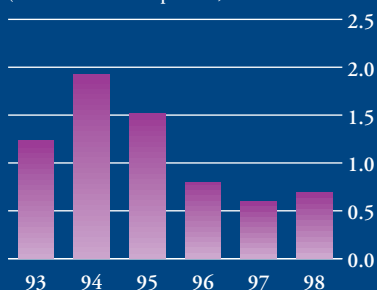
CASH FLOW
(\$ 000's)



SHAREHOLDERS' EQUITY
(\$ 000's)



LOST TIME
ACCIDENT FREQUENCY
(Lost time accidents per 200,000 man hours worked)



AKITA ACHIEVED RECORD PROFITS FOR THE THIRD CONSECUTIVE YEAR IN 1998 BASED UPON RECORD FIRST QUARTER PROFITABILITY, ABOVE AVERAGE UTILIZATION FOR THE FINAL THREE QUARTERS AND A ONE-TIME DIVIDEND FROM WESTERN ROCK BIT.

AKITA ACHIEVED RECORD CASH FLOW FROM OPERATIONS IN 1998. IN ADDITION TO THE ITEMS NOTED ABOVE, THE COMPANY POSTED SIGNIFICANT CONTRIBUTIONS FROM DEEP WELL DRILLING AS WELL AS FROM ADDITIONAL RIGS CONSTRUCTED IN THE PREVIOUS YEAR.

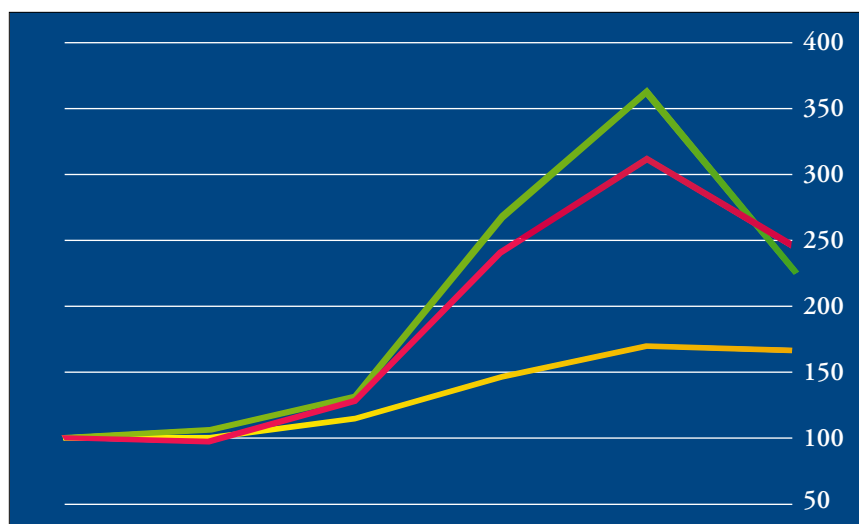
AKITA MAINTAINS A VERY STRONG BALANCE SHEET. AFTER PAYMENT OF AN INCREASED DIVIDEND, THE 1998 CONTRIBUTION TO SHAREHOLDERS' EQUITY WAS THE LARGEST IN THE COMPANY'S HISTORY.

AKITA HAS CONSISTENTLY AND SIGNIFICANTLY OUTPERFORMED INDUSTRY WITH RESPECT TO SAFETY. FOR THE FIFTH TIME IN SIX YEARS, AKITA'S LOST TIME ACCIDENT FREQUENCY WAS LESS THAN ONE HALF OF THE INDUSTRY AVERAGE.

SHARE PERFORMANCE

Five-Year Total Return on \$100 investment

The graph to the right compares the cumulative return over the last five years on the Class A Non-Voting Shares and Class B Common Shares of the Company on December 31, 1993 with the cumulative total return of the TSE 300 Stock Index over the same period, assuming reinvestment of dividends.



| | | 31 Dec 1993 | 31 Dec 1994 | 31 Dec 1995 | 31 Dec 1996 | 31 Dec 1997 | 31 Dec 1998 |
|---------------------------------------|---------------|----------------|----------------|----------------|----------------|----------------|----------------|
| — | AKITA Class A | 100 | 106 | 131 | 268 | 364 | 224 |
| — | AKITA Class B | 100 | 95 | 129 | 243 | 312 | 245 |
| — | TSE 300 | 100 | 100 | 114 | 147 | 169 | 166 |

| | | 1994 | 1995 | 1996 | 1997 | 1998 |
|---|-------|-----------|-----------|-----------|-----------|-----------|
| Weighted average number of Class A and Class B Shares | | 9,097,005 | 9,120,005 | 9,231,205 | 9,497,563 | 9,499,521 |
| Market prices for Class A Shares | High | \$ 5.25 | \$ 4.70 | \$ 11.00 | \$ 16.35 | \$ 12.80 |
| | Low | \$ 3.15 | \$ 2.30 | \$ 4.60 | \$ 8.60 | \$ 5.60 |
| | Close | \$ 3.80 | \$ 4.70 | \$ 9.50 | \$ 12.90 | \$ 7.85 |
| Volume | | 2,431,706 | 5,044,479 | 9,833,974 | 8,552,552 | 5,329,046 |
| Market prices for Class B Shares | High | \$ 5.25 | \$ 4.85 | \$ 9.80 | \$ 16.30 | \$ 10.80 |
| | Low | \$ 3.40 | \$ 2.60 | \$ 5.00 | \$ 9.50 | \$ 9.00 |
| | Close | \$ 3.55 | \$ 4.85 | \$ 9.00 | \$ 11.50 | \$ 9.00 |
| Volume | | 89,888 | 69,585 | 39,746 | 22,584 | 7,254 |

Dividend History

AKITA began paying dividends to shareholders in 1996. It is the current intention of the Board of Directors to continue to pay quarterly dividends in the future. Nevertheless, the payment of any dividend is at the discretion of the Board of Directors and depends upon the financial condition of the Company and other factors.

| | 1994 | 1995 | 1996 | 1997 | 1998 |
|-------------------------------|------|------|------|------|------|
| Dividends paid per share (\$) | Nil | Nil | 0.10 | 0.20 | 0.24 |

LETTER TO THE SHAREHOLDERS



RONALD D. SOUTHERN

Chairman of the Board

Earnings for the year ended December 31, 1998 were \$12,907,000 or \$1.36 per share on revenue of \$75,463,000. Comparative figures for 1997 were \$11,363,000 or \$1.20 per share on revenue of \$89,100,000. Cash flow from operations for the current year was \$17,914,000 or \$1.89 per share as compared to \$15,467,000 or \$1.63 per share in 1997. Results for the current year include the receipt of a nonrecurring \$3,655,000 dividend.

Unlike previous years, the 1998 drilling market was characterized by two distinct periods. During the first quarter, AKITA achieved record earnings and cash flow resulting from a combination of strong market conditions and its recently expanded fleet. However, by the end of March, market conditions rapidly deteriorated for shallow and medium depth segments. This situation provided a new set of challenges for the Company.

AKITA faced these challenges by relying upon its key strengths – the operation of quality equipment by highly skilled employees, a commitment to customer satisfaction including the servicing of key term contracts, and the benefit of significant exposure to deep sector drilling.

AKITA's utilization rate reflects these strengths. Although AKITA's 1998 annual utilization rate was 53.8%, down from 73.5% in the previous year, during the last nine months of 1998, AKITA's 46.8% utilization rate significantly exceeded the industry rate of 33.9% for the same period.

AKITA's safety performance during 1998 was bittersweet. For the first time in five years, AKITA's lost time accident frequency rose slightly on a year over year basis - increasing to 0.69 from 0.60 in 1997. However, AKITA has reduced its lost time accident frequency rate by a factor of two over a five-year period. As well, AKITA's lost time accident frequency has been at least three times better than the industry average during each of the past three years.

The small increase in the 1998 accident frequency and the reduced utilization rate are reminders that despite past achievements, our search for excellence is a continuing one.

With the reduction in rig utilization for the shallow and medium depth segments, AKITA focussed a significant proportion of its 1998 capital resources on deep capacity drilling, including the purchase of two portable electric top drives for its fleet. By year-end, AKITA had top drives on its three largest rigs. AKITA continually seeks to find cost effective enhancements to increase drilling efficiency.

The development and retention of highly skilled employees is of fundamental importance at AKITA. The Company has a well established and comprehensive program that includes detailed policies, procedure manuals, classroom and on the job training, as well as regular safety meetings and random drug and alcohol testing. Prior to the reduction in activity AKITA had proactively implemented strategies to provide for the retention of key personnel.

AKITA's continuing strong cash position provides the Company with the flexibility to evaluate a broad range of alternatives to enhance shareholder value. Your Management and Board are actively considering appropriate investment opportunities.

In November 1998, the AKITA Board of Directors approved the payment of an increased quarterly dividend to \$0.07 per share. This represents an increase of 17% calculated on an annualized basis.

Management does not anticipate a significant improvement in market conditions unless the recent increase in world oil prices is sustained and provides improved financial conditions for oil and gas operators. AKITA has demonstrated its ability to compete effectively in weaker markets and will continue to do so.

We would like to express our appreciation of the support of our shareholders in these difficult market conditions. The Company also appreciates the continuing support of its customers as well as the reliability of its many suppliers. To these groups we express our sincere thanks. Of course, much of the credit for AKITA's success lies with our dedicated employees, to whom we offer congratulations for a job well done. Finally, we wish to acknowledge the contribution of our directors whose wise counsel and guidance have helped to create and maintain a strong and successful Company.

On behalf of the Board of Directors,

(Signed)

Ronald D. Southern
Chairman of the Board

(Signed)

John B. Hlavka
President



JOHN B. HLAVKA

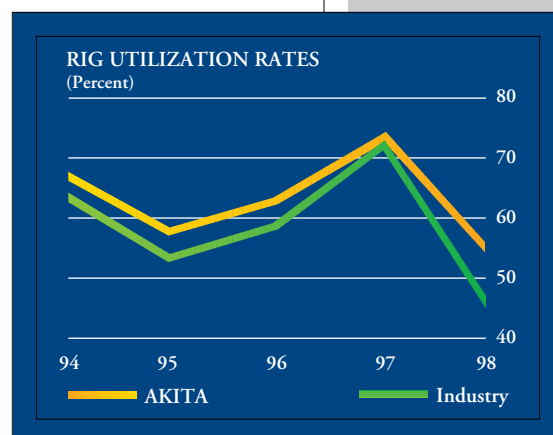
President

OPERATIONS REVIEW

Deep rig activity led the market in 1998. AKITA's 75% utilization for its deep rigs exceeded the industry average by 15 percentage points.



In 1998, Western Canadian drilling activity began at a record pace. However, a lack of operational cash flow coupled with a reduction in external capital for exploration and development companies resulted in the last nine months of the year being characterized by a marked reduction in the number of wells drilled. Although AKITA was negatively affected by this slowdown, the Company's annual utilization rate exceeded industry average by a record 8.9 percentage points as highlighted in the following table:



Rig Utilization Rates (Percent)

| | 1998 | 1997 | 1996 | 1995 | 1994 |
|------------|------|------|------|------|------|
| AKITA | 53.8 | 73.5 | 62.9 | 57.8 | 67.0 |
| Industry | 44.9 | 72.1 | 58.7 | 53.4 | 63.5 |
| Difference | 8.9 | 1.4 | 4.2 | 4.4 | 3.5 |

AKITA drilled 974 wells for a total of 895,000 metres or approximately 10% of the total wells drilled in Western Canada in 1998.

AKITA operates a well-maintained, diversified and efficient fleet of 30 drilling rigs within the Western Canadian Sedimentary Basin. As a consequence of weak world oil prices throughout much of 1998, most of AKITA's drilling activity was related to exploration and development of natural gas. The Company's large percentage of both shallow and deep capacity equipment assures particularly favourable exposure to deep gas drilling which occurs in the foothills and some mountain regions of Alberta and British Columbia, as well as shallow gas drilling which is typical of Southern Alberta and Saskatchewan. AKITA's rig mix ensures that it is able to participate effectively in changing markets. The following table compares the range of drilling capabilities for the Company's fleet to the industry:

DRILLING DEPTH CAPABILITY

| Depth Capacity | AKITA | | INDUSTRY | |
|-----------------------|-------------|-------------|-------------|-------------|
| | No. of Rigs | % of Fleet | No. of Rigs | % of Fleet |
| 0 to 950 metres | 7 | 23% | 17 | 3% |
| 951 to 1,850 metres | 6 | 20% | 139 | 24% |
| 1,851 to 2,450 metres | 5 | 17% | 185 | 31% |
| 2,451 to 3,050 metres | 6 | 20% | 129 | 22% |
| 3,051 to 3,700 metres | 0 | 0% | 62 | 11% |
| 3,701 to 6,700 metres | 6 | 20% | 55 | 9% |
| Total | 30 | 100% | 587 | 100% |

Since much of the shift in activity was towards deep gas drilling, AKITA increased its proportion of capital and major maintenance expenditures to upgrade and enhance the capabilities of its deeper capacity rigs. In addition to purchasing top drives for two of these rigs, the Company spent significant sums replacing drill pipe and increasing rig productivity with the purchase of lighter, more fuel efficient engines and the rebuilding of mud pumps.

AKITA also addressed the shallow gas market by rebuilding one of its single sized rigs. Notably, this one rig drilled 153 wells totalling over 100,000 metres during 1998. This represented 16% of the total wells drilled by AKITA in 1998.

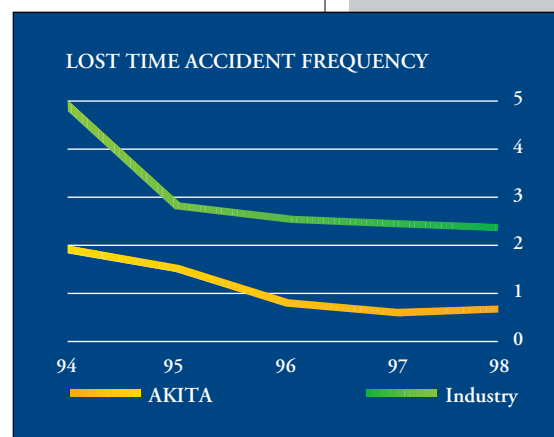
During 1997, AKITA constructed four rigs, each continuing to work under the terms of contracts having either a three or four year duration. AKITA is now benefiting from the stability of the income stream from rigs working under term contracts through increased utilization and fixed day rates.

AKITA is strongly committed to the ongoing safety of its employees and continually achieves one of the safest working records in the Canadian drilling industry. The Company considers

methods to eliminate or reduce hazards in the design of equipment and through the execution of standardized operating procedures. AKITA's lost time accident frequency, which represents lost time accidents per 200,000 hours worked, has been consistently and significantly better than the industry average as demonstrated in the following table:

LOST TIME ACCIDENT FREQUENCY

| | Five Year Average | 1998 | 1997 | 1996 | 1995 | 1994 |
|---|-------------------|------|------|------|------|------|
| AKITA | 1.10 | 0.69 | 0.60 | 0.80 | 1.52 | 1.92 |
| Industry | 3.01 | 2.32 | 2.45 | 2.54 | 2.82 | 4.93 |
| AKITA's frequency as a percentage of industry | 36.5 | 29.7 | 24.5 | 31.5 | 53.9 | 38.9 |



AKITA has had a long-standing commitment to ensure that its daily operations do not have a negative impact on the environment. The Company continually monitors products used and procedures followed in its operations as well as changes in regulations to ensure responsible management of environmental issues. The Board of Directors receives regular reports regarding compliance with AKITA's comprehensive environmental protection programs.

There is clear evidence that Western Canadian drilling activity will not immediately return to previous high levels experienced. Management is moderately optimistic about the outlook for natural gas drilling opportunities in the near term and expect that they could improve significantly in the longer term with sustained higher prices. Western Canadian pipeline capacity has been recently increased to supply Midwestern U.S. markets. In order to fill this enhanced takeaway capacity for natural gas on a continuing basis, an increase in reserves will ultimately be required. AKITA is well positioned for any increase in natural gas drilling. Recent developments curtailing production have resulted in an improvement in oil prices. Should prices continue at current levels or improve for a prolonged period, management anticipates increasing oil drilling opportunities will occur.

AKITA has drilling rigs
and specialized equipment
capable of servicing all
depth ranges.



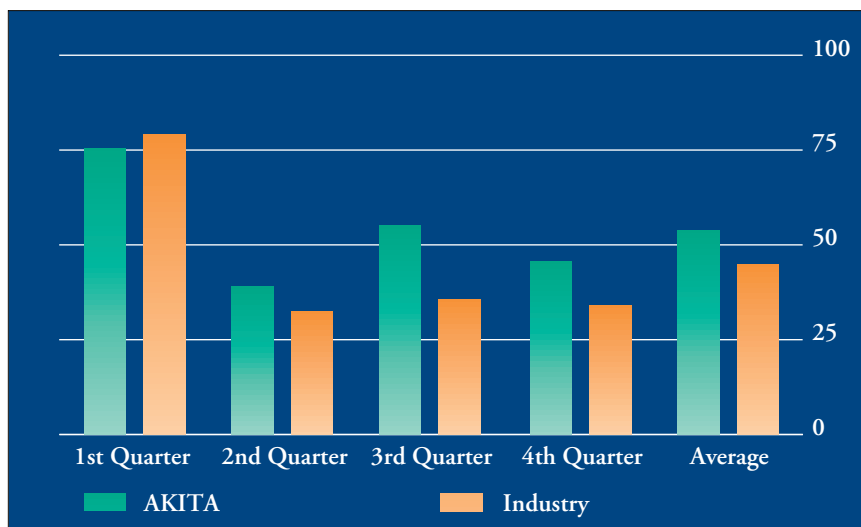
MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis should be read in conjunction with AKITA’s audited financial statements and related notes contained in this annual report.

FLEET AND UTILIZATION

Utilization rates are a key statistic for the drilling industry since they measure sales volume and influence pricing. During 1998, AKITA’s utilization rate was 53.8%, which was 19.7 percentage points lower than the previous year and 8.9 percentage points higher than the 1998 industry average. Deep rig activity targeting natural gas led the market, while shallow capacity rig activity was the slowest segment. During 1997, approximately 60 shallow capacity rigs were added to the Western Canadian drilling fleet. This additional rig capacity combined with an overall reduction in drilling activity resulted in the decline in shallow rig utilization.

The following graph highlights AKITA’s 1998 utilization rates compared to the industry average:



The Canadian drilling industry is seasonal with activity building in the fall and peaking during the winter months as northern transportation routes become available when areas with muskeg conditions freeze sufficiently to allow the movement of rigs and other heavy equipment. The peak Canadian drilling season ends with “spring breakup”, at which time drilling operations are curtailed due to seasonal road bans (temporary prohibitions on road use) and restricted access to agricultural land.

Although the oil and gas industry's shift away from oil exploration and development had a negative impact on horizontal drilling, this form of drilling continues to be a distinct and important market segment for the contract drilling industry. Horizontal drilling, in comparison to conventional drilling practices, exposes more of the oil and gas bearing geological formation to the well bore and is particularly effective for heavy oil reservoirs, thin production zones and thicker zones with marginal permeability. AKITA has the equipment to remain an active participant in the horizontal drilling market.

REVENUE AND EXPENSES

Overall revenue decreased to \$75,463,000 during 1998 from \$89,100,000 during 1997 as a result of lower utilization. However, higher utilization of deep capacity rigs coupled with recently constructed rigs working under fixed rate contracts resulted in the average revenue per day increasing to \$12,810 in 1998 from \$12,093 per day in 1997. Operating and maintenance costs vary directly with revenue and amounted to \$48,205,000 or \$8,183 per operating day during 1998 compared with \$58,186,000 or \$7,897 per operating day for the prior year.

The difference between revenue and operating and maintenance expenses represents the contribution level for AKITA.

AKITA depreciates its rigs using the unit of production method based on an estimated life of 2,000 operating days per rig. Depreciation increased to \$5,022,000 during 1998 from \$4,247,000 during 1997. This increase resulted from depreciating four rigs constructed during 1997 for a complete year in 1998 and from a general increase in the average cost base of the fleet as a result of ongoing major capital upgrades. Assets other than rigs are depreciated over their estimated remaining lives using a straight line or declining balance basis of calculation.

Selling and administrative expenses were 10.0% of total revenue in 1998 compared to 7.5% of total revenue in 1997. The single largest component was salaries and benefits, which accounted for 61% of these expenses (68% in 1997).

Other income increased to \$5,058,000 in 1998 from \$1,440,000 in 1997. On May 1, 1998 AKITA received a \$3,655,000 dividend on its 9.3% equity investment in Western Rock Bit Company Limited which sold substantially all of its assets to Baker Hughes of Texas earlier in the year. AKITA received a \$430,000 dividend from Western Rock Bit in 1997. A formal plan to wind up Western Rock Bit has been approved and AKITA anticipates that any future dividends from Western Rock Bit will not have a material impact on its earnings or cash flow. Interest income increased to \$1,356,000 in 1998 from \$977,000 in 1997 as a result of increased cash balances coupled with higher interest rates.

Income tax expense decreased to \$6,855,000 in 1998 from \$10,058,000 in 1997 due to lower pretax earnings and a lower effective income tax rate. The average effective income tax rate decreased to 35% in 1998 from 47% in 1997 as a result of higher dividend income in 1998. Canadian income tax rules treat dividends differently from other forms of income earned by a corporation and consequently, no income tax expense is recorded by a recipient corporation. During 1998, AKITA reversed a portion of its previously recorded provision relating to the deductibility of crew subsistence allowances following a determination of the deductibility of these amounts by Revenue Canada.

NET EARNINGS AND CASH FLOW

Net earnings increased to \$12,907,000 or \$1.36 per Class A Non-Voting and Class B Common share for 1998 from \$11,363,000 or \$1.20 per share in 1997. Cash flow from operations increased to \$17,914,000 or \$1.89 per share in 1998 from \$15,467,000 or \$1.63 per share in 1997. The 1998 results represent record earnings and cash flow for AKITA, attributable largely to the increased dividend income from Western Rock Bit.

LIQUIDITY AND CAPITAL RESOURCES

As a result of AKITA's strong financial position, capital expenditures were funded entirely out of internally generated cash flow for both 1998 and 1997. At December 31, 1998, AKITA had \$31,146,000 in working capital including \$27,944,000 in cash, compared to \$23,883,000 in working capital and \$25,273,000 in cash for the previous year.

In addition to cash reserves, AKITA has a \$5,000,000 bank operating line of credit at prime interest rates secured by accounts receivable. The total amount of available financing varies with receivable balances. As a result of current and anticipated cash flows from operations, AKITA expects to retain a positive net cash position throughout 1999. AKITA has no long term debt.

DIVIDENDS

During 1998, AKITA declared and paid dividends totalling \$0.24 per share (\$2,280,000) on its Class A Non-Voting and Class B Common shares compared to \$0.20 per share (\$1,900,000) for 1997. The payment of any dividends is at the discretion of the Board of Directors and depends upon the financial condition of AKITA Drilling Ltd. and other factors.

NORMAL COURSE ISSUER BID

On January 18, 1999, AKITA filed a notice of intention to make a normal course issuer bid for the purchase of up to 5% of its outstanding Class A Non-Voting shares during the period January 22, 1999 to January 21, 2000. As at March 15, 1999, 113,100 shares had been purchased at a cost of \$755,000.

CAPITAL ASSETS

Net fixed asset additions were \$7,832,000 in 1998 compared with \$15,372,000 in the previous year. The highlight of 1998's capital expenditure program was the addition of two portable top drives to AKITA's fleet, coupled with the upgrading and modification of Rig #7 at a combined cost of \$4,419,000. Tubulars accounted for \$1,314,000 of 1998 expenditures. The balance of capital expenditures related to the purchase of vehicles and other equipment.

AKITA's net book values for rigs and related equipment are significantly lower than current replacement costs. At year-end, the average carrying value of AKITA's rig fleet was less than \$1,000,000 per rig. AKITA's conservative depreciation policy is designed to reduce the risk of its asset carrying values being overstated at any point in the drilling cycle.

INVESTMENTS

AKITA owns 430 of the 4,644 shares issued and outstanding in 31323 Alberta Ltd. (formerly Western Rock Bit Company Limited), a private company. In March 1998, Western Rock Bit Company Limited sold substantially all of its assets to Baker Hughes Inc. of Texas for approximately \$44.6 Million. AKITA and other shareholders received approximately 85% of the proceeds from this sale as dividends during 1998.

BUSINESS RISKS AND RISK MANAGEMENT

The drilling industry is cyclical and the business of AKITA is directly affected by fluctuations in the level of exploration and development activity carried on by its customers. Customer activity is, in turn, directly affected by a variety of factors, including world oil and North American natural gas prices, access to capital markets and government policies. Any prolonged or significant decrease in energy prices or economic activity, or adverse change in government regulation could have a significant negative impact on exploration and development drilling activity in Canada. AKITA's marketing program emphasizes the continuous development of long term relationships with a core base of customers who maintain ongoing drilling programs during all phases of the economic cycle.

The success of AKITA also depends on other factors, including competition and the management of operational and environmental risks.

AKITA manages its risks in these areas by:

- *employing well trained, experienced and responsible employees*
- *improving the skills of its employees through training programs*
- *maintaining an efficient fleet of rigs through a rigorous ongoing maintenance program*
- *constantly upgrading its rig fleet*
- *maintaining comprehensive insurance policies with respect to its operations*
- *ensuring that all employees comply with clearly defined safety standards*
- *reducing environmental risk through the implementation of industry leading standards, policies and procedures*

AKITA is subject to federal, provincial and local environmental protection laws concerning emissions to the air, discharges to surface and subsurface waters and the handling, use, emission and disposal of materials and wastes from drilling operations. In Alberta, environmental compliance is generally governed by the Alberta Environmental Protection and Enhancement Act.

AKITA is committed to preserving and protecting the environment and minimizing the discharge of deleterious materials into the environment in accordance with environmental protection laws and regulations. AKITA verifies compliance with these laws and regulations as well as its own well developed and closely monitored internal procedures through a program of regular environmental audits. Some risk of unintentional breaches of environmental protection laws and potential liability is occasionally inherent in particular operations of the industry.

AKITA does not expect that environmental protection laws and regulations affect its operations differently from other responsible companies in the contract drilling industry. Ongoing capital and operating costs of compliance with existing laws and regulations have not been quantified but are not expected to have a material impact on the earnings or competitive position of AKITA.

AKITA maintains comprehensive insurance policies with respect to its operations in amounts that it believes are adequate and in accordance with industry standards. AKITA's liability with respect to its well-site activities is limited by provisions of its agreements with oil and gas well operators that either limit AKITA's liability or provide for indemnification of AKITA against certain risks, in the absence of negligence. As a matter of policy, AKITA ensures blowout insurance has been obtained by its customers and thereby reduces its related risk.

YEAR 2000

The Year 2000 issue arises because many computer systems use two digits rather than four digits to identify a year. Date sensitive systems may recognize the year 2000 as 1900, or some other date, resulting in errors when information using dates beyond 1999 is processed. In addition, similar problems may arise in some systems that use certain numeric combinations that coincidentally correspond to dates in 1999 to represent something other than a date.

The effects of the Year 2000 issue may be experienced before, on, or after January 1, 2000, and, if not addressed prior thereto, the impact on operations and financial reporting may range from minor errors to significant system failures that could affect an entity's ability to conduct normal business operations.

Like other companies, AKITA is vulnerable to failure of its computerized systems and those of its key business partners, such as customers, suppliers, government agencies and other third parties. Although computers, information technology and electronics are used at rig sites and administration locations for AKITA, systems in place are generally simple in design and the level of overall reliance on computers is not considered to be high. In all cases, systems are provided by third parties. In most instances, systems are designed for the drilling industry in general or specifically for AKITA.

AKITA has been evaluating the impact of the Year 2000 issue throughout its operations. The Company formed a team to coordinate the identification, evaluation and implementation of changes to address the issue. Using outside consultants, a three stage process is being undertaken to identify, assess and convert/test all of its computer and operational equipment affected by the Year 2000 Issue by mid-1999.

During the fourth quarter of 1998, AKITA completed an inventory and assessment of all potentially affected equipment and has estimated the funding and staffing requirements to resolve this issue for its own operations, as well as for electronic interfaces with its customers.

Preliminary contingency plans have been put in place for all high-risk systems to provide for the continuity of safety for employees, the ability to process data on a timely basis and to identify alternatives for all material suppliers. Further contingency planning will be undertaken during the first six months of 1999.



AKITA's crews receive specialized training to help ensure the safe operation of large equipment.

AKITA estimates that the cost to remediate its systems will be approximately \$250,000 of which approximately one-half of these expenditures have been reflected in the 1998 results. To the extent that costs incurred also result in extending the service lives of assets beyond the year 2000, those costs have been capitalized. The Company is on schedule to complete the necessary systems upgrading, replacement and testing by mid-calendar year 1999.

AKITA continues to inquire as to the Year 2000 compliance of its key suppliers and its customers. While there can be no guarantees of their preparedness, AKITA believes that the best safeguard is to actively communicate with customers and suppliers about their progress, and to work with them to improve their understanding of AKITA's goals and to assist them in reaching their goals.

Due to the complexity of the Year 2000 issue, including AKITA's dependence on third parties for important products and services, there can be no assurances that the Year 2000 remediation efforts by AKITA or of such third parties will be completely successful. The impact of a failure to complete such remediation efforts could have a material adverse effect on the results of operations and financial condition of AKITA. While there can be no guarantees that disruptions will not occur, based on the approach taken by AKITA and its understanding of work done by third parties, AKITA does not expect widespread or extended interruptions in its business or service.

FUTURE OUTLOOK

The drilling industry is cyclical and certain key factors which have an impact on AKITA's results are beyond management's control. Like other drilling contractors, AKITA is exposed to the effects of fluctuating oil and gas prices and changes in the exploration and development budgets of its customers.

During 1998, the drilling industry experienced a decrease in activity levels. AKITA anticipates a further reduction in activity levels during 1999. The current industry forecast prepared by the Canadian Association of Oilwell Drilling Contractors projects approximately 8,500 wells to be drilled in 1999, compared to 9,744 wells in 1998. In light of currently low commodity prices, it is management's view that this forecast will be difficult to achieve.

AKITA expects demand for its rigs will nevertheless remain stronger than industry average, as has been the case in each of AKITA's previous years.

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

The accompanying financial statements of AKITA Drilling Ltd., Management's Discussion and Analysis and other information relating to the organization contained in this Annual Report are the responsibility of management and have been approved by the Board of Directors. The financial statements have been prepared in accordance with accounting policies detailed in the notes to the financial statements and are in conformity with accounting principles generally accepted in Canada using methods appropriate for the industry in which the Company operates. Where necessary, estimates of transactions and operations that were incomplete at year-end have been made by management. Financial information throughout the Annual Report is consistent with the financial statements.

Management ensures the integrity of the financial statements by maintaining systems of internal control. These systems are designed to provide assurance that assets are safeguarded from loss or unauthorized use, that transactions are properly recorded and that the financial records are reliable for preparing the financial statements.

PricewaterhouseCoopers LLP, the Company's independent auditors, have conducted an examination of the financial statements, which included an evaluation of internal controls to the extent they considered necessary, and have had full access to the Audit Committee. Their report appears on the bottom half of this page.

The Board of Directors, through its Audit Committee comprised of three non-management directors, oversees management's responsibilities for financial reporting. The Audit Committee meets regularly with management and the independent auditors to discuss auditing and financial matters and to gain assurance that management is carrying out its responsibilities.

(Signed)

John B. Hlavka
President

(Signed)

Murray J. Roth
Secretary-Treasurer

AUDITORS' REPORT

To the Shareholders of AKITA Drilling Ltd.

We have audited the balance sheets of AKITA Drilling Ltd. as at December 31, 1998 and 1997 and the statements of earnings and retained earnings and changes in cash position for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits 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 financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 1998 and 1997 and the results of its operations and changes in its cash position for the years then ended in accordance with generally accepted accounting principles.

(Signed)

PricewaterhouseCoopers LLP

Chartered Accountants
Calgary, Alberta

March 5, 1999

BALANCE SHEET

(Dollars in thousands)

| December 31 | | 1998 | 1997 |
|--|--------|-----------|-----------|
| ASSETS | | | |
| Current assets | | | |
| Cash | | \$ 27,944 | \$ 25,273 |
| Accounts receivable | | 11,885 | 20,856 |
| Other | | 283 | 755 |
| | | 40,112 | 46,884 |
| Investments | Note 1 | 364 | 364 |
| Capital assets | Note 2 | 29,556 | 26,699 |
| | | \$ 70,032 | \$ 73,947 |
| LIABILITIES | | | |
| Current liabilities | | | |
| Accounts payable and accrued liabilities | | \$ 8,490 | \$ 18,705 |
| Income taxes payable | | 476 | 4,296 |
| | | 8,966 | 23,001 |
| Deferred income taxes | | 2,211 | 2,179 |
| CLASS A AND CLASS B SHAREHOLDERS' EQUITY | | | |
| Share capital | Note 3 | 18,876 | 18,876 |
| Retained earnings | | 39,979 | 29,891 |
| | | 58,855 | 48,767 |
| | | \$ 70,032 | \$ 73,947 |

Approved by the Board

(Signed)

DALE R. RICHARDSON

Director

(Signed)

C. PERRY SPITZNAGEL

Director

STATEMENT OF EARNINGS AND RETAINED EARNINGS

(Dollars in thousands, except per share)

| Year Ended December 31 | 1998 | 1997 |
|---|----------------------|----------------------|
| Revenue | \$ 75,463 | \$ 89,100 |
| Costs and expenses | | |
| Operating and maintenance | 48,205 | 58,186 |
| Depreciation | 5,022 | 4,247 |
| Selling and administrative | 7,532 | 6,686 |
| | 60,759 | 69,119 |
| | 14,704 | 19,981 |
| Other income | Note 4 | |
| | 5,058 | 1,440 |
| Earnings before income taxes | 19,762 | 21,421 |
| Income taxes | Note 5 | |
| Current | 6,823 | 10,168 |
| Deferred | 32 | (110) |
| | 6,855 | 10,058 |
| Net earnings | 12,907 | 11,363 |
| Retained earnings, beginning of year | 29,891 | 21,646 |
| Dividends | (2,280) | (1,900) |
| Refundable dividend tax | (459) | 39 |
| Cancellation of stock options | (80) | (1,257) |
| Retained earnings, end of year | \$ 39,979 | \$ 29,891 |
| Earnings per Class A and Class B Share | | |
| Basic | \$ 1.36 | 1.20 |
| Fully diluted | \$ 1.35 | 1.18 |

STATEMENT OF CHANGES IN CASH POSITION

(Dollars in thousands, except per share)

| Year ended December 31 | 1998 | 1997 |
|--|-----------|-----------|
| Operating activities | | |
| Net earnings | \$ 12,907 | \$ 11,363 |
| Non-cash items included in earnings | | |
| Depreciation | 5,022 | 4,247 |
| Deferred income taxes | 32 | (110) |
| Gain on disposal of capital assets | (47) | (33) |
| Cash flow from operations | 17,914 | 15,467 |
| Decrease (increase) in non-cash working capital | (4,592) | 6,842 |
| | 13,322 | 22,309 |
| Financing activities | | |
| Issue of Class A Non-Voting shares | — | 62 |
| Dividends paid | (2,280) | (1,900) |
| Cancellation of stock options | (80) | (1,257) |
| | (2,360) | (3,095) |
| Cash available for investing | 10,962 | 19,214 |
| Investing activities | | |
| Capital expenditures | (7,832) | (15,372) |
| Refundable dividend tax | (459) | 39 |
| | (8,291) | (15,333) |
| Increase in cash | 2,671 | 3,881 |
| Cash position, beginning of year | 25,273 | 21,392 |
| Cash position, end of year | \$ 27,944 | \$ 25,273 |
| Cash flow from operations per Class A and Class B Share | | |
| Basic | \$ 1.89 | \$ 1.63 |
| Fully diluted | \$ 1.87 | \$ 1.61 |

NOTES TO FINANCIAL STATEMENTS

December 31, 1998

(tabular amounts in thousands of dollars)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Revenue recognition on contracts

Revenue resulting from the supply of contracted services is recorded by the percentage of completion method. Any anticipated loss is provided for in its entirety when the estimated loss is identified.

Depreciation

Drilling rigs are depreciated using the unit of production method based on an initial estimated life of 2,000 days per rig.

Replacement drill pipe and other ancillary drilling equipment are depreciated using a straight-line basis at rates varying from 6% to 12.5% per annum.

Buildings, furniture, fixtures and equipment are depreciated using the declining balance method at rates varying from 10% to 25% per annum.

Investments

The Company records ownership of its investment in 31323 Alberta Ltd. (formerly Western Rock Bit Company Limited), a private company, at cost. The Company also has an investment in a Joint Venture, AKITA Equitak Drilling Ltd. which it records using the proportionate method of consolidation. The joint venture was inactive during 1998 and 1997.

2. CAPITAL ASSETS

| | 1998 | | 1997 | |
|--|-----------|-----------------------------|-----------|-----------------------------|
| | Cost | Accumulated Depreciation | Cost | Accumulated Depreciation |
| Drilling rigs and related equipment | \$ 44,271 | \$ 15,768 | \$ 36,830 | \$ 11,005 |
| Other | 2,175 | 1,122 | 1,911 | 987 |
| | \$ 46,446 | \$ 16,890 | \$ 38,741 | \$ 12,042 |
| Net Book Value | \$ 29,556 | | \$ 26,699 | |

3. SHARE CAPITAL

Authorized

An unlimited number of Series Preferred shares, issuable in series, designated as First Preferred Shares

An unlimited number of Series Preferred shares, issuable in series, designated as Second Preferred Shares

An unlimited number of Class A Non-Voting Shares

An unlimited number of Class B Common Shares

Issued

| | Class A Non-Voting | | Class B Common | | Total | |
|-----------------------------------|---------------------|-----------------|---------------------|----------------|---------------------|-----------------|
| | Number of Shares | Consideration | Number of Shares | Consideration | Number of Shares | Consideration |
| December 31, 1996 | 8,637,719 | \$17,442 | 830,902 | \$1,372 | 9,468,621 | \$18,814 |
| Stock option plans | 30,900 | 62 | — | — | 30,900 | 62 |
| Conversions Class B to Class A | 950 | 2 | (950) | (2) | — | — |
| December 31, 1997 | 8,669,569 | 17,506 | 829,952 | 1,370 | 9,499,521 | 18,876 |
| Stock option plans | — | — | — | — | — | — |
| Conversions Class B to Class A | — | — | — | — | — | — |
| December 31, 1998 | 8,669,569 | \$17,506 | 829,952 | \$1,370 | 9,499,521 | \$18,876 |

Each Class B Common share may be converted into one Class A Non-Voting share at the shareholder's option. If a takeover bid is made for the Class B Common shares, holders of Class A Non-Voting shares are entitled, in certain circumstances, for the duration of the bid, to exchange each Class A Non-Voting share for one Class B Common share for the purpose of depositing the resulting Class B Common shares pursuant to the terms of the takeover bid. The two classes of shares rank equally in all other respects.

The Company has established a stock option plan for directors, officers, key employees and other persons providing services to the Company. At December 31, 1998, 95,000 options to acquire an equivalent number of Class A Non-Voting shares were outstanding. The options are exercisable cumulatively over periods of up to 10 years from the date of grant at prices ranging from \$0.76 to \$4.55 per share. These options expire at various dates to 2004.

On January 22, 1999, the Company commenced a Normal Course Issuer Bid for the purchase of up to 5% of the outstanding Class A Non-Voting shares. The offer will expire on January 21, 2000.

Basic earnings per share and cash flow per share have been calculated on the basis of the weighted average number of Class A Non-Voting and Class B Common shares outstanding during the year. Fully diluted earnings per share and fully diluted cash flow per share have been calculated using the weighted average number of Class A Non-Voting and Class B Common shares that would have been outstanding had all of the stock options been exercised at the beginning of the year.

4. OTHER INCOME

| | 1998 | 1997 |
|--------------------------------|-----------------|-----------------|
| Interest | \$ 1,356 | \$ 977 |
| Dividends | 3,655 | 430 |
| Gain on sale of capital assets | 47 | 33 |
| | \$ 5,058 | \$ 1,440 |

On May 1, 1998, the Company received a \$3,655,000 dividend on its investment in Western Rock Bit Company Limited which had sold substantially all of its assets as part of a plan to wind up the company. Management does not anticipate that any future dividend will have a material effect on the Company's earnings or cash flow.

5. INCOME TAXES

The income tax provision differs from that which would be computed using the statutory rates. A reconciliation of the differences is as follows:

| | 1998 | 1997 |
|--|-----------|-----------|
| Earnings before income taxes | \$ 19,762 | \$ 21,421 |
| Expected income tax at statutory rate of 45% | 8,893 | 9,639 |
| Add (Deduct): | | |
| Dividend income | (1,645) | (193) |
| Other | (393) | 612 |
| Income tax provision | \$ 6,855 | \$ 10,058 |

The “Other” category included a provision in 1997 for potentially non-deductible meal costs paid to employees at out of town work sites. The provision was partially reversed in 1998 following resolution of the matter by taxation authorities.

6. RELATED PARTY

The Company is affiliated to the ATCO Group of companies through its majority shareholder. The accompanying table summarizes transactions and year end balances with those affiliates. These transactions were in the ordinary course of business and were considered to be at fair market value.

| | 1998 | 1997 |
|------------------------------|------|------|
| Revenue | \$ — | \$ — |
| Purchases | | |
| Capital | — | 410 |
| Operating | 91 | 82 |
| Year end accounts receivable | — | — |
| Year end accounts payable | 5 | 183 |

7. PENSIONS

The Company has a defined contribution Pension Plan which covers substantially all of its employees. Under the provisions of the Plan, the Company contributes 5% of regular earnings for eligible employees on a current basis.

The Company has also established an unfunded defined benefit Pension Plan for selected employees. At December 31, 1998 the unfunded actuarial present value of accrued pension benefits amounted to \$2,002,000 of which \$1,572,000 has been provided for in the financial statements. The balance will be amortized over the estimated remaining service lives of the respective employees.

8. FINANCIAL INSTRUMENTS

The Company's financial assets and liabilities as at December 31, 1998 included cash, accounts receivable, accounts payable and the 9.3% equity investment in 31323 Alberta Ltd. (formerly Western Rock Bit Company Limited) (WRB). During the year, the Company did not hold or issue any derivative financial instruments.

The credit risk associated with accounts receivable is generally considered to be low since substantially all counterparties are well established and financed oil and gas companies. Provisions have been estimated by management and included in the accounts to satisfy any anticipated bad debts.

Due to the current nature of cash, accounts receivable and accounts payable, fair value of these items is considered to be equal to book value.

The Company's investment in WRB is carried at cost which, in the opinion of management, approximates fair value.

9. COMMITMENT

The Company leases its office space at an annual cost of approximately \$153,000 per year. Lease expiry will occur in 2005.

10. UNCERTAINTY DUE TO THE YEAR 2000 ISSUE

The Year 2000 Issue arises because many computerized systems use two digits rather than four to identify a year. Date-sensitive systems may recognize the year 2000 as 1900 or some other date, resulting in errors when information using year 2000 dates is processed. In addition, similar problems may arise in some systems which use certain dates in 1999 to represent something other than a date. The effects of the Year 2000 issue may be experienced before, on, or after January 1, 2000, and, if not addressed, the impact on operations and financial reporting may affect an entity's ability to conduct normal business operations. While the Company has implemented a Year 2000 program, it is not possible to be certain that all aspects of the Year 2000 Issue affecting the Company, including those related to the efforts of customers, suppliers, or other third parties, will be fully resolved.

FINANCIAL REVIEW FROM THE COMMENCEMENT OF OPERATIONS

(Dollars in thousands, except per share and per operating day)

| | 1998 | 1997 | 1996 | 1995 | 1994 | 1993 |
|--------------------------------|-----------|-----------|-----------|-----------|-----------|-----------|
| SUMMARY OF OPERATIONS | | | | | | |
| Revenue | \$ 75,463 | \$ 89,100 | \$ 63,340 | \$ 57,429 | \$ 61,498 | \$ 44,142 |
| Earnings before income taxes | \$ 19,762 | \$ 21,421 | \$ 12,841 | \$ 11,200 | \$ 12,401 | \$ 4,751 |
| Income taxes | \$ 6,855 | \$ 10,058 | \$ 5,728 | \$ 5,147 | \$ 5,377 | \$ 2,166 |
| Net earnings | \$ 12,907 | \$ 11,363 | \$ 7,113 | \$ 6,053 | \$ 7,024 | \$ 2,585 |
| As a percentage of average | | | | | | |
| Shareholders' Equity | 24.0% | 25.5% | 19.3% | 19.8% | 29.1% | 15.5% |
| Earnings per Class A and | | | | | | |
| Class B Share | \$ 1.36 | \$ 1.20 | \$ 0.77 | \$ 0.66 | \$ 0.77 | \$ 0.32 |
| Cash flow from operations | \$ 17,914 | \$ 15,467 | \$ 9,713 | \$ 8,475 | \$ 9,184 | \$ 4,458 |
| As a percentage of average | | | | | | |
| Shareholders' Equity | 33.3% | 34.7% | 26.3% | 27.8% | 38.1% | 26.8% |
| Cash flow per Class A and | | | | | | |
| Class B Share | \$ 1.89 | \$ 1.63 | \$ 1.05 | \$ 0.93 | \$ 1.01 | \$ 0.55 |
| EBITDA ^(Note) | \$ 19,726 | \$ 24,228 | \$ 13,715 | \$ 12,192 | \$ 13,262 | \$ 5,404 |
| EBITDA per operating day | \$ 3,348 | \$ 3,288 | \$ 2,272 | \$ 2,222 | \$ 2,133 | \$ 1,055 |
| FINANCIAL POSITION AT YEAR END | | | | | | |
| Working capital | \$ 31,146 | \$ 23,883 | \$ 26,844 | \$ 20,932 | \$ 16,351 | \$ 10,675 |
| Current ratio | 4.47:1 | 2.04:1 | 3.47:1 | 3.28:1 | 2.29:1 | 2.38:1 |
| Total assets | \$ 70,032 | \$ 73,947 | \$ 53,603 | \$ 44,610 | \$ 41,999 | \$ 29,937 |
| Shareholders' equity | \$ 58,855 | \$ 48,767 | \$ 40,460 | \$ 33,388 | \$ 27,574 | \$ 20,650 |
| Per share | \$ 6.20 | \$ 5.13 | \$ 4.27 | \$ 3.66 | \$ 3.03 | \$ 2.27 |
| OTHER | | | | | | |
| Capital expenditures | \$ 7,832 | \$ 15,372 | \$ 3,760 | \$ 3,655 | \$ 3,408 | \$ 1,737 |
| Depreciation | \$ 5,022 | \$ 4,247 | \$ 2,547 | \$ 2,206 | \$ 1,986 | \$ 1,254 |

Note: EBITDA is calculated as earnings before interest, dividend income, taxes, depreciation and amortization.

CORPORATE INFORMATION

DIRECTORS

William L. Britton, Q.C.

Partner, Bennett Jones

Deputy Chairman of the

Board of the Corporation

Calgary, Alberta

Linda A. Heathcott

Executive Vice President, Spruce Meadows

Calgary, Alberta

John B. Hlavka

President of the Corporation

Calgary, Alberta

Dale R. Richardson

Vice President, Sentgraf Enterprises Ltd.

Calgary, Alberta

Margaret E. Southern, O.C., L.V.O., LL.D.

President, Spruce Meadows

Calgary, Alberta

Nancy C. Southern

Deputy Chairman, ATCO Ltd. and

Canadian Utilities Limited

Calgary, Alberta

Ronald D. Southern, C.B.E., C.M., LL.D.

Chairman of the Board and Chief

Executive Officer, ATCO Ltd.

and Chairman of the Board and

Chief Executive Officer, Canadian

Utilities Limited, Chairman of the

Board of the Corporation

Calgary, Alberta

C. Perry Spitznagel

Partner, Bennett Jones

Calgary, Alberta

OFFICERS

John B. Hlavka

President

Robert J. Hunt

Vice President, Sales and Marketing

Craig W. Kushner

Assistant Secretary

Murray J. Roth

Secretary-Treasurer

Karl A. Ruud

Vice President, Operations

HEAD OFFICE

AKITA Drilling Ltd.

#1110, 505 - 3rd Street S.W.

Calgary, Alberta T2P 3E6

(403) 292-7979

BANKER

Alberta Treasury Branches

Calgary, Alberta

COUNSEL

Bennett Jones

Calgary, Alberta

AUDITORS

PricewaterhouseCoopers LLP

Calgary, Alberta

REGISTRAR AND TRANSFER AGENT

CIBC Mellon Trust Company

Calgary, Alberta and Toronto, Ontario

1-800-387-0825

SHARE SYMBOL/TSE

Class A Non-Voting (AKT.A)

Class B Common (AKT.B)

