

A  
Commitment  
to Quality.



Enerchem International Inc. is an oilfield services company providing specialty chemical and hydrocarbon based fluid solutions to oil and gas production problems.

## Financial Highlights

	For the four month period ended December 31, 2001	For the year ended August 31, 2001
	\$	\$

## Results of operations

Revenues	14,408,200	31,782,005
Net earnings for the period	955,232	2,257,579
Net earnings per share		
Basic	0.09	0.23
Diluted	0.08	0.22
EBITDA (1)	2,026,761	4,763,195
EBITDA per share - continuing operations (2)	0.19	0.48

## Financial position

Total assets	35,861,888	31,114,088
Total long-term debt	7,368,363	4,394,209
Shareholders' equity	18,909,588	18,190,520
Number of shares		
Outstanding, end of period	10,787,229	10,665,803
Average during period	10,741,647	9,856,086

(1) Earnings before interest, taxes, depreciation, amortization and writedowns

(2) Based on weighted average number of common shares outstanding for the period

## Annual General Meeting

The Annual General Meeting of the Shareholders  
will be held on Monday, June 10, 2002 at 10:00 a.m. local time at:  
Enerchem International Inc. Corporate Head Office - Conference Room  
1406 - 8 Street, Nisku, Alberta

Annual Report, 2001  
(for the four month period ended December 31, 2001)

## President's Message

---

We are pleased with the financial results achieved for the four month period ended December 31, 2001. This four month reporting period was precipitated as a result of our change in year end from August 31 to December 31. Effective January 1, 2002 Enerchem's financial results will be reported on a calendar year and quarter basis.

Our focus over the past several months, from an operational and logistical perspective, has been on integrating the operations of Trysol Canada Ltd. into Enerchem International Inc. We are pleased to report that this integration has been completed. Our combined operations have been structured to capture the synergies of a dynamic group of people. As has been stated previously, there is a new level of enthusiasm at Enerchem and it is this enthusiasm combined with our focus on providing our customers with quality products and services that will take Enerchem to a higher level of achievement.

We look forward to 2002.



L.B. Phillips  
President and Chief Executive Officer

## Operations Review

---

### Who we are

Enerchem International Inc. is a supplier of specialty chemicals and hydrocarbon based well servicing fluids to the oil and gas industry. We serve clients in a diverse range of applications that include conventional and heavy oil production facilities, natural gas processing plants and pipelines and compressor stations.

Our areas of demonstrated expertise include among others:

- Control of paraffin and asphaltene deposition
- Demulsification of hydrocarbon emulsions
- Treatment of work over fluids
- Corrosion control in upstream petroleum production
- Scale control

Enerchem's head office is located in Nisku, Alberta. This location houses the company's 16,000 sq. ft. chemical blending plant, railcar siding, tank farm, warehouse and main laboratory facilities. Through its production facilities in Nisku, the company manufactures 18 product lines encompassing over 300 oil and gas based formulations including corrosion inhibitors, demulsifiers, paraffin and asphaltene products. In addition to its product base of specialty chemicals and solvents, Enerchem provides hydrocarbon based fracturing and drilling fluids which are manufactured through its fractionation plant located in Sundre, Alberta. During fiscal 2001, Enerchem committed to the construction of a new fractionation facility in Slave Lake, Alberta. This plant is in its final construction phase and when completed in Spring 2002 will produce a full range of the company's hydrocarbon based fluids.

Enerchem services the western Canadian oil and gas industry through its network of strategically located product storage sites. Enerchem's sales and service representatives are situated in their respective sales territories facilitating quick response times to troubleshoot problems and to accommodate high customer call frequency. The experience and technical abilities of Enerchem's sales representatives are key to the company's success.

Enerchem prides itself on providing rapid response to problems and finding solutions that are innovative, effective and concise. The Enerchem technical team includes domestic and international specialists for every facet of oil and gas recovery.

Enerchem's 3,000 sq. ft. laboratory facility is located in Nisku, Alberta. The company's highly dedicated R&D chemists and chemical technologists provide timely, concise results with domestic "critical" project turnover times of 24 hours or less. Product development and testing is performed in this facility, including performance testing of products. The laboratory is equipped with a complete oil and water chemistry group which is capable of all forms of analytical oil and water testing and chemical product selection testing required for the oil and gas industry. This includes complete water analysis, solids identification, chemical residual monitoring for scale and corrosion inhibitors and microbiological work. In addition, the company ensures product and service quality through the use of a Quality Management System that has been registered to the ISO - 9001: 1994 standard.

## Operations Review (continued)

Enerchem has technical support in Midland, Texas through the operations of its wholly owned subsidiary, Enerchem International Corporation, which includes the manufacturing of raw materials and finished specialty chemical products. The manufacturing of quality raw and finished products is achieved through a state of the art blending and reactor facility located in Midland.

Enerchem's international presence has been focused on the oil and gas markets of Egypt and North Africa through its investment in the Egyptian Canadian Company for Chemicals Industries F.Z. ("ECC"). Enerchem has supplied drilling fluid products to ECC for the last three years, and has developed a complete product line of specialty chemicals to support the new state of the art manufacturing and laboratory facility located in the Free Zone area of Alexandria, Egypt. This facility, being the first Egyptian engineered and constructed specialty chemicals manufacturing facility in Egypt, employs qualified personnel to meet all of its customers product requirements. ECC has successfully secured long term contracts for its products and services with several major oil producers based in the Middle East.

## Management's Discussion and Analysis

Enerchem International Inc. has changed its year end from August 31 to December 31 and herein has presented results which reflect a four month reporting period ended December 31, 2001. The new reporting year for Enerchem will commence January 1, 2002 with quarters ending March 31, June 30, September 30 and December 31.

This Management's Discussion and Analysis of the financial condition and results of operations ("MD&A") should be read in conjunction with the consolidated financial statements of Enerchem International Inc. for the four month period ended December 31, 2001 and for the year ended August 31, 2001 and the related notes to the consolidated financial statements.

*Statements throughout this report that are not historical facts may be considered "forward looking statements." Such statements are based on current expectations that involve risks and uncertainties which could cause actual results to differ from those anticipated.*

### Results of operations

#### Revenues

Revenues for the four month period ended December 31, 2001 were \$14,408,000, an average of \$3,602,000 per month. This is an increase of 36% over the monthly average of \$2,649,000 during the year ended August 31, 2001. This growth in average revenues is primarily acquisition related.

#### Gross profit

Gross profit for the four month period ended December 31, 2001 totaled \$5,667,000, an average of \$1,417,000 per month. This is an increase of 26% over the monthly average of \$1,124,000 during the year ended August 31, 2001. Gross profit as a percentage of revenues was 39% for the four month period ended December 31, 2001 compared to 42% for the year ended August 31, 2001. This decrease in gross profit as a percentage of revenues is attributable to the company's shift to a lower margin product mix which largely represents sales of hydrocarbon based fracturing and drilling fluids.

#### Operating expenses

	Four months ended December 31, 2001			For the year ended August 31, 2001		
	\$ Actual	\$ Average <sup>(1)</sup>	% of revenues <sup>(2)</sup>	\$ Actual	\$ Average <sup>(1)</sup>	% of revenues <sup>(2)</sup>
Salaries and employee benefits	1,867,937	466,984	13%	4,457,641	371,470	14%
Selling, general and administration	1,869,257	467,314	13%	4,518,937	376,578	14%
Depreciation and amortization	264,043	66,011	2%	655,146	54,596	2%
Interest on long-term debt	135,808	33,952	1%	150,445	12,537	0%

<sup>(1)</sup> For the four month period ended December 31, 2001, average expense is calculated by dividing the specific actual expense by 4 months.

For the year ended August 31, 2001, average expense is calculated by dividing the specific actual expense by 12 months.

<sup>(2)</sup> % of revenues represents the specific actual expense as a percentage of revenues for the period.

## Management's Discussion and Analysis (continued)

---

### Salaries and employee benefits

Salaries and employee benefits for the four month period ended December 31, 2001 totaled \$1,868,000, an average of \$467,000 per month. This is an increase of 26% over the monthly average of \$371,000 during the year ended August 31, 2001. This increase is primarily acquisition related and is also attributable to the addition of technical and field support staff during the second half of the year ended August 31, 2001. However, at December 31, 2001, the total number of employees of 77 remained unchanged from August 31, 2001.

### Selling, general and administration

Selling, general and administration expenses for the four month period ended December 31, 2001 totaled \$1,869,000, an average of \$467,250 per month. This is an increase of 24% over the monthly average of \$377,000 during the year ended August 31, 2001. This higher average cost structure is largely acquisition related.

### Depreciation and amortization

Depreciation and amortization charges totaled \$264,000 for the four month period ended December 31, 2001, an average of \$66,000 per month. This is an increase of 21% over the monthly average of \$55,000 during the year ended August 31, 2001 and is largely acquisition related. Property, plant and equipment expenditures during the four month period ended December 31, 2001 totaled \$8,316,000 of which \$7,956,000 was expended on the construction of the fractionation plant in Slave Lake, Alberta. As the completion of the company's plant in Nisku and the fractionation plant in Slave Lake has not yet occurred, depreciation on these facilities has not been recorded. The accumulated costs associated with these projects are reported in note 4 to the consolidated financial statements.

Effective September 1, 2001, the company adopted the new recommendations of Section 3062 of The Canadian Institute of Chartered Accountants "Goodwill and Other Intangible Assets." As a result of adopting these recommendations, goodwill with a deemed indefinite life is no longer amortized, but tested for impairment annually, or more frequently, if changes in circumstances indicate a potential impairment. Management's evaluation of the carrying value of goodwill has resulted in the recognition of an impairment loss of \$500,489 which has been recorded as an adjustment to opening retained earnings. This impairment was attributed to the decline in value of business processes and assets acquired through acquisitions made in November 1989 and August 1992.

### Interest on long term debt

Interest on long term debt for the four month period ended December 31, 2001 totaled \$136,000, an average of \$34,000 per month. This is an increase of 171% over the monthly average of \$13,000 during the year ended August 31, 2001. This increase in average interest costs is the result of the company's use of its available credit facilities to finance its acquisition of Trysol Canada Ltd. during the year ended August 31, 2001 and to construct its fractionation facility in Slave Lake.

### Income taxes

Tax expense for the four month period ended December 31, 2001 totaled \$636,000 representing an effective tax rate of 40%. For the year ended August 31, 2001 the effective tax rate was 40%. Cash income taxes paid during the four month period ended December 31, 2001 totaled \$300,496 compared to \$2,421,831 during the year ended August 31, 2001. Taxes paid during the year ended August 31, 2001 reflected the tax payment associated with the company's sale of its discontinued operations.

### Net earnings and earnings per share

Net earnings for the four month period ended December 31, 2001 totaled \$955,000, an average of \$239,000 per month. This is an increase of 27% over the monthly average of \$188,000 during the year ended August 31, 2001. Basic earnings per common share were \$0.09 and diluted earnings per common share were \$0.08 for the four month period ended December 31, 2001

### Fractionation plant

The forecasted costs to construct the company's fractionation plant have increased by approximately \$1 million from \$12,104,000 to \$13,100,000. The forecasted increase in expenditures is primarily due to the increased scope of the project. As a result, the start up of the plant, which was scheduled to be fully operational by the end of March 31, 2002, has been targeted for start up during the second quarter of fiscal 2002. At December 31, 2001, the company has incurred 61% of the forecasted costs to complete the facility of which \$4,841,000 has been funded from the company's cash flow.

### Liquidity and capital resources

Working capital at December 31, 2001 decreased by \$4,596,000, to a surplus of \$2,660,000 from a surplus of \$7,256,000 at August 31, 2001. The company's working capital ratio was 1.3:1 at December 31, 2001 and 1.8:1 at August 31, 2001. This decline

## Management's Discussion and Analysis (continued)

---

### Liquidity and capital resources (continued)

in working capital is primarily the result of the company's cash investment of \$4,841,000 into the construction of its fractionation plant.

The company's earnings before interest, taxes, depreciation, amortization and unusual charges such as write-downs ("EBITDA"), was \$2,027,000 for the four month period ended December 31, 2001 and the corresponding EBITDA per share was \$0.19. Management considers EBITDA an appropriate measure of the company's ability to fund current operations and service debt. Management believes that its cash flow from operations combined with access to its existing bank credit facilities adequately provides for the company's operating cash requirements for the next year.

Cash flows from operating activities increased to \$5,540,000 for the four month period ended December 31 2001 compared to \$3,760,000 for the year ended August 31, 2001. The increase in cash provided by operating activities is due to reductions in receivables and inventory resulting from activity declines and additional management focus combined with an increase in accounts payable and other liabilities which is primarily associated with the construction of the Slave Lake plant.

Net cash used in investing activities totaled \$8,659,000 during the four month period ended December 31, 2001 compared to \$8,691,000 during the year ended August 31, 2001. Investing activities during the four months ended December 31, 2001 were primarily directed to the construction of the company's Slave Lake plant. Investing activities during the year ended August 31, 2001 were directed to the acquisition of Trysol Canada Ltd. (see note 3) and the expansion of the company's blending facilities in Nisku, Alberta.

Net cash inflows from financing activities totaled \$3,238,000 during the four month period ended December 31, 2001 compared to \$3,031,000 during the year ended August 31, 2001. During the four month period ended December 31, 2001, the company increased its long term debt by \$3,201,000 largely to finance construction of its Slave Lake plant. Comparatively, during the year ended August 31, 2001, the company increased its long-term debt by \$4,500,000 to finance, in part, its acquisition of Trysol Canada Ltd. and also reduced long-term debt by \$1,937,000 primarily from proceeds realized on the sale of the company's discontinued operations

At December 31, 2001, the company had long-term debt of \$7,368,000 compared to \$4,394,000 at August 31, 2001. At December 31, 2001, the company has a credit facility with a Canadian chartered bank that provides an operating line of credit of \$7,000,000, \$11,763,000 of demand non-revolving loans and \$500,000 of demand revolving loans. At December 31, 2001, the company has utilized \$7,584,000 of its demand non-revolving loans, \$113,000 of its demand revolving loans and \$1,400,000 of its available operating lines of credit.

### Business risks and future outlook

The capital expenditure programs of oil and gas companies largely affect the services provided by the company. The magnitude of capital expenditures determines the demand for the company's services in providing specialty chemical and hydrocarbon based fluid solutions to oil and gas production problems. The primary catalyst to high expenditures and activity levels in the oil and gas industry is energy prices. The ability to forecast the price of crude oil or natural gas is extremely difficult as many global factors affecting commodity prices are beyond the control of the company. Other factors that affect the company's business include weather, competition and environmental risks. Enerchem has managed its risks in these areas by maintaining a strong financial position and maintaining a streamlined operation. In addition, a comprehensive insurance and risk management program exists to protect the company against losses due to disruptions or accidents.

The regulatory environment in which the company operates is becoming increasingly complex and the costs and potential effects of non-compliance are ever increasing. Furthermore, industry in general and specifically the oil and gas industry, are faced with increasing concerns regarding the environmental impact of its operations. In this regard, management has implemented a comprehensive set of environmental and safety policies. A safety awareness and training program has been established for all employees and the company has developed a safety procedures manual and emergency response plan to deal with situations which may jeopardize the environment or public safety.

While current forecasts for the western Canadian oil and gas industry project activity levels to be considerably less than experienced over the past eighteen months, the projections still anticipate better than average activity over the next year. Management shares this view and as a result expects business prospects will remain encouraging into fiscal 2002. With the planned completion of our new fractionation facility in Slave Lake, Alberta scheduled for the second quarter of fiscal 2002 and the anticipated expansion opportunities for our products, management remains confident that the company will provide solid returns for its shareholders.

## Management's Responsibility

---

The management of Enerchem International Inc. is responsible for the preparation of the accompanying consolidated financial statements and the preparation of all information in the annual report. The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in Canada and are considered by management to present fairly the financial position and operating results of the company.

The company maintains various systems of internal control to provide reasonable assurance that transactions are appropriately authorized and recorded, that assets are safeguarded and that financial records are properly maintained to provide accurate and reliable financial statements.

The Board of Directors of the company carries out its responsibility for the financial statements through its Audit Committee. The Audit Committee has and will meet periodically with the company's management and independent auditors to review financial reporting matters and internal controls and to review the consolidated financial statements. The Audit Committee reported its findings to the Board of Directors who have approved the consolidated financial statements.

The company's independent auditors, PricewaterhouseCoopers LLP, Chartered Accountants, have examined the consolidated financial statements whose findings are contained in this annual report.



Larry B. Phillips  
President &  
Chief Executive Officer



Brian M. Zubach  
Chief Financial Officer

## Auditors' Report

---

### To the Shareholders of Enerchem International Inc.

We have audited the consolidated balance sheets of Enerchem International Inc. as at December 31, 2001 and August 31, 2001 and the consolidated statements of earnings, retained earnings and cash flows for the four month period ended December 31, 2001 and for the year ended August 31, 2001. 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 Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the company as at December 31, 2001 and August 31, 2001 and the results of its operations and its cash flows for the four month period ended December 31, 2001 and for the year ended August 31, 2001 in accordance with Canadian generally accepted accounting principles.



PricewaterhouseCoopers LLP  
PricewaterhouseCoopers LLP  
Chartered Accountants

Edmonton, Alberta  
March 15, 2002,  
except for notes 3 and 11(b)  
which are as of April 17, 2002

## Consolidated Statement of Earnings

	Four month period ended December 31, 2001	Year ended August 31, 2001
	\$	\$
<b>Revenues</b>	<b>14,408,200</b>	31,782,005
<b>Cost of sales</b>	<b>8,741,650</b>	18,289,778
<b>Gross profit</b>	<b>5,666,550</b>	13,492,227
<b>Expenses</b>		
Salaries and employee benefits	1,867,937	4,457,641
Selling, general and administration	1,869,257	4,518,937
Depreciation and amortization	264,043	655,146
Interest on long-term debt	135,808	150,445
Interest on capital leases	-	1,251
Other interest	35,288	56,868
	<b>4,172,333</b>	9,840,288
<b>Earnings before other income (expense)</b>	<b>1,494,217</b>	3,651,939
<b>Other income (expense)</b>		
(Loss) gain on disposal of property, plant and equipment	(7,536)	9,067
Write-down of investment and deferred costs - foreign operations (note 6)	-	(167,073)
Other	104,941	238,479
	<b>97,405</b>	80,473
<b>Earnings before income taxes</b>	<b>1,591,622</b>	3,732,412
<b>Income taxes (note 10)</b>		
Current	564,390	1,505,199
Future income tax	72,000	(30,366)
	<b>636,390</b>	1,474,833
<b>Net earnings for the period</b>	<b>955,232</b>	2,257,579
<b>Net earnings per share (note 9 (d))</b>		
Basic	0.09	0.23
Diluted	0.08	0.22

## Consolidated Statement of Retained Earnings

	Four month period ended December 31, 2001	Year ended August 31, 2001
	\$	\$
<b>Balance - beginning of period</b>	<b>7,499,017</b>	5,241,438
Goodwill impairment (note 5)	(500,489)	-
Net earnings for the period	955,232	2,257,579
<b>Balance - end of period</b>	<b>7,953,760</b>	7,499,017

## Consolidated Statement of Cash Flows

	Four month period ended December 31, 2001	Year ended August 31, 2001
	\$	\$
<b>Operating activities</b>		
Net earnings for the period	955,232	2,257,579
Items not affecting cash -		
Depreciation and amortization	264,043	655,146
Loss (gain) on disposal of property, plant and equipment	7,536	(9,067)
Future income taxes	72,000	(30,366)
Write-down of investment and deferred costs - foreign operations	-	167,073
	<b>1,298,811</b>	<b>3,040,365</b>
Changes in non-cash components of working capital		
Net change in accounts receivable	1,971,998	7,959,829
Net change in inventories and prepaid expenses	995,798	(2,195,762)
Net change in accounts payable and accrued liabilities	1,009,108	(4,059,939)
Net change in income taxes payable	264,008	(984,547)
	<b>4,240,912</b>	<b>719,581</b>
Net cash provided by operating activities	<b>5,539,723</b>	<b>3,759,946</b>
<b>Investing activities</b>		
Purchase of property, plant and equipment	(8,316,269)	(1,405,185)
Acquisition of subsidiary operations (note 3)	(375,002)	(6,843,261)
Proceeds from disposal of property, plant and equipment	31,000	188,766
Decrease (increase) in other assets	1,328	(631,263)
Net cash used in investing activities operations	<b>(8,658,943)</b>	<b>(8,690,943)</b>
<b>Financing activities</b>		
Issuance of common shares	264,325	487,332
Increase in long-term debt	3,200,806	4,500,000
Repayment of obligations under capital leases	-	(19,292)
Repayment of long-term debt	(226,652)	(1,936,979)
Net cash provided by financing activities	<b>3,238,479</b>	<b>3,031,061</b>
<b>Increase (decrease) in cash</b>	<b>119,259</b>	<b>(1,899,936)</b>
<b>(Bank indebtedness) cash - beginning of period</b>	<b>(1,521,419)</b>	<b>378,517</b>
<b>(Bank indebtedness) - end of period</b>	<b>(1,402,160)</b>	<b>(1,521,419)</b>
<b>Supplementary information</b>		
	\$	\$
Cash interest income received	-	575,209
Cash interest expense paid	<b>144,590</b>	162,033

## Consolidated Balance Sheet

	December 31, 2001	August 31, 2001
	\$	\$
<b>Assets</b>		
Current assets		
Accounts receivable	8,916,164	11,286,069
Inventories	3,633,197	4,003,293
Prepaid expenses and deposits	499,608	1,125,310
	<b>13,048,969</b>	<b>16,414,672</b>
Property, plant and equipment (note 4)	15,861,816	7,848,126
Goodwill (note 5)	6,049,530	5,948,389
Other assets (note 6)	901,573	902,901
	<b>35,861,888</b>	<b>31,114,088</b>
<b>Liabilities</b>		
Current liabilities		
Bank indebtedness (note 7)	1,402,160	1,521,419
Accounts payable and accrued liabilities	6,396,501	5,558,672
Income taxes payable	1,693,276	1,429,268
Current portion of long-term debt (note 8)	896,605	649,574
	<b>10,388,542</b>	<b>9,158,933</b>
Long-term debt (note 8)	6,471,758	3,744,635
Future income taxes	92,000	20,000
	<b>16,952,300</b>	<b>12,923,568</b>
<b>Contingent liabilities (note 12)</b>		
<b>Shareholders' equity</b>		
Share capital (note 9)	10,955,828	10,691,503
Retained earnings	7,953,760	7,499,017
	<b>18,909,588</b>	<b>18,190,520</b>
	<b>35,861,888</b>	<b>31,114,088</b>

Signed on behalf of the Board,


Larry B. Phillips  
Director

Kenneth A. Klein  
Director**Notes to Consolidated Financial Statements**

For the four month period ended December 31, 2001 and the year ended August 31, 2001

**1. Accounting policies****(a) Basis of presentation**

These consolidated financial statements include the accounts of the parent company and its wholly owned subsidiaries Enerchem International Corporation and Trysol Canada Ltd. All significant inter-company balances and transactions have been eliminated. The company uses the cost method of accounting for its investments in foreign operations as the company does not exercise significant influence.

**(b) Change in year-end**

The Board of Directors of Enerchem International Inc. approved the amalgamation of Trysol Canada Ltd. with Enerchem International Inc. effective January 1, 2002. The amalgamated companies will be continued under Enerchem International Inc. As a result, the fiscal year end of the company will change from August 31 to December 31. A four month transition period from September 1, 2001 to December 31, 2001 will precede the start of the 2002 fiscal year beginning January 1, 2002.

## Notes to Consolidated Financial Statements (continued)

For the four month period ended December 31, 2001 and the year ended August 31, 2001

### 1. Accounting policies (continued)

#### (c) Inventories

Inventories are carried at the lower of average cost or estimated net realizable value. For finished goods inventory, cost includes direct labour and an allocation of overhead that can be attributed to production.

#### (d) Property, plant and equipment

Property, plant and equipment are recorded at cost and are depreciated over their estimated useful lives on a declining balance basis using the following annual rates:

Land improvements	10%
Buildings	5%
Laboratory equipment	10%
Plant and office equipment	20%
Automotive equipment	30%
Oilfield equipment	10%
Processing facilities	10%

#### (e) Goodwill

The excess of the cost of investments in subsidiaries over the fair market value of their net tangible assets is recorded as goodwill. Effective September 1, 2001, the company adopted the new recommendations of Section 3062 of The Canadian Institute of Chartered Accountants "Goodwill and Other Intangible Assets". As a result of adopting these recommendations, goodwill with a deemed indefinite life is no longer amortized, but tested for impairment annually, or more frequently, if changes in circumstances indicate a potential impairment.

#### (f) Deferred costs - foreign operations

Costs incurred during the start-up of foreign operations are capitalized until operations in these regions have commenced. These start-up costs are classified as deferred costs - foreign operations and are amortized over a maximum of five years once operations in these regions have commenced. Management periodically assesses the recoverability and the continued deferral of these start-up costs with reference to expected future operations. If estimated net cash flows expected to result from foreign operations, over a reasonable period of time, are less than the carrying value, then the start-up costs are written down to the estimated recoverable amount.

#### (g) Foreign currency translation - foreign operations

The accounts of the self-sustaining foreign subsidiary company are translated into Canadian dollars as follows:

- Assets and liabilities at the exchange rate prevailing at the balance sheet date.
- Revenue and expenses at average exchange rates for the year.

The resulting translation adjustment is not significant and has been included in net earnings for the year.

#### (h) Future income taxes

Income taxes are calculated using the liability method of accounting. Temporary differences arising from the difference between the tax basis of an asset or liability and its carrying amount on the balance sheet are used to calculate future income tax liabilities or assets. Future income tax liabilities or assets are calculated using tax rates anticipated to apply in periods that the temporary differences are expected to reverse.

#### (i) Revenue recognition

Revenues from the sale of the company's products are recorded in the period in which the products are delivered to the customer.

#### (j) Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

#### (k) Earnings per share

Effective September 1, 2001, the company adopted the new recommendations of Section 3500 of The Canadian Institute of Chartered Accountants "Earnings per Share." As a result of adopting this method, the treasury stock method is used to calculate diluted earnings per share. Diluted earnings per share are computed similar to basic earnings per share except that the weighted average number of shares outstanding is increased to include additional shares from the assumed exercise of stock options, if dilutive. The number of additional shares is calculated by assuming that outstanding stock options were exercised and that the proceeds from such exercises were used to acquire shares of common stock at the average market price during the reporting period. For the year ended August 31, 2001 application of the new recommendations increased the diluted earnings per share by \$0.01.

### 2. Financial instruments

Substantially all of the company's receivables are within the oil and gas industry. Although diversified among many companies, collectability is dependent upon the general economic conditions of the industry.

## Notes to Consolidated Financial Statements (continued)

For the four month period ended December 31, 2001 and the year ended August 31, 2001

**2. Financial instruments (continued)**

The company carries a number of financial instruments. It is management's opinion that the company is not exposed to significant interest, currency or cash flow risk arising from these financial instruments. The fair values of these financial instruments approximate their carrying values, unless otherwise noted.

**3. Acquisition**

On March 31, 2001, the company acquired 100% of the issued and outstanding shares of Trysol Canada Ltd., a company engaged in the distribution and sale of hydrocarbon based well servicing fluids to companies in the oil and gas industry. The purchase has been accounted for by the purchase method with the results of operations included from April 1, 2001. The cost of the purchase has been allocated to the acquired assets based on their fair values at the date of acquisition.

The assets and liabilities acquired are as follows:

Assets		\$
Accounts receivable		9,106,913
Inventories and other assets		1,048,740
Property, plant and equipment		3,041,111
Goodwill		6,106,875
Liabilities		
Current liabilities		(8,455,126)
Long term debt		(30,250)
		10,818,263
The consideration was by way of:		
Cash		7,218,263
Common shares		3,600,000
		10,818,263

On April 17, 2002, the company reached a settlement agreement with the vendors of Trysol Canada Ltd. respecting post-closing adjustments to the purchase price. As a result of this agreement goodwill has been adjusted by \$601,630 and the company has agreed to a cash settlement in the amount of \$250,000 payable to the vendors.

**4. Property, plant and equipment**

	December 31, 2001			August 31, 2001		
	Cost	Accumulated depreciation	Net	Cost	Accumulated depreciation	Net
	\$	\$	\$	\$	\$	\$
Land	526,310	-	526,310	525,298	-	525,298
Land improvements	550,043	157,082	392,961	532,962	143,865	389,097
Buildings	1,709,237	512,267	1,196,970	1,697,078	489,011	1,208,067
Laboratory equipment	317,671	162,620	155,051	316,290	156,860	159,430
Office equipment	539,899	305,139	234,760	526,192	274,877	251,315
Plant	2,343,243	713,159	1,630,084	2,010,119	676,271	1,333,848
Automotive equipment	1,269,931	931,103	338,828	1,270,763	920,905	349,858
Oilfield equipment	1,360,308	655,206	705,102	1,354,671	628,010	726,661
Processing facilities	12,074,822	1,393,072	10,681,750	4,198,291	1,293,739	2,904,552
	20,691,464	4,829,648	15,861,816	12,431,664	4,583,538	7,848,126

Plant includes \$1,141,900 (August 31, 2001 - \$817,223) of costs associated with a building under construction and processing facilities includes \$7,955,790 (August 31, 2001 - \$NIL) of costs associated with a fractionation plant under construction. As the completion of the building has not yet occurred, depreciation has not been recorded.

**5. Goodwill**

	December 31, 2001	August 31, 2001
	\$	\$
Goodwill - at cost	6,981,557	6,379,927
Less: accumulated amortization	431,538	431,538
impairment loss	500,489	-
Unamortized balance	6,049,530	5,948,389

As described in note 1(e), the company adopted the new recommendations of Section 3062 of The Canadian Institute of Chartered Accountants "Goodwill and Other Intangible Assets". Management's evaluation of the carrying value of goodwill has resulted in the recognition of an impairment loss of \$500,489 which has been recorded as an adjustment to opening retained earnings. The impairment of goodwill was attributed to the decline in value of business processes and assets acquired through acquisitions made in November 1989 and August 1992.

## Notes to Consolidated Financial Statements (continued)

For the four month period ended December 31, 2001 and the year ended August 31, 2001

**5. Goodwill (continued)**

The following table shows the effect of applying the new standard on net earnings and basic and diluted earnings per share.

Net earnings	December 31, 2001	August 31, 2001
	\$	\$
Net earnings for the period	955,232	2,257,579
Amortization of goodwill	-	79,212
Adjusted net earnings for the period	955,232	2,336,791
<b>Earnings per share</b>		
Basic	0.09	0.24
Diluted	0.08	0.23

**6. Other assets**

	December 31, 2001	August 31, 2001
	\$	\$
Investments - foreign operations	895,779	895,779
Other	5,794	7,122
	<b>901,573</b>	<b>902,901</b>

*Investments - foreign operations*

Investments - foreign operations represent the company's investment in its operations in Egypt. During fiscal 1996, the company entered into an agreement to construct a blend plant in Egypt with Blend Oil Services & Supply. This agreement led to the incorporation of the Egyptian Canadian Company for Chemicals Industries - F.Z., operating in the freezone area of Alexandria, Egypt. The company has invested \$600,000 U.S. (\$895,779 CDN), (August 31, 2001 - \$600,000 U.S. (\$895,779 CDN.) maintaining its 25% interest in this Egyptian company. The company accounts for its investment in this Egyptian company on the cost basis, as it does not exercise significant influence. Earnings from the company's Egyptian investment will be recognized only to the extent received or receivable. While management believes that the investment in the Egyptian company is fully recoverable, there could be future developments and additional information could become available that may indicate that the carrying value should be revised. Management believes that future revisions to the carrying value, if any, would not have a material adverse affect on the company's financial condition. However, should such revisions be necessary, the amounts could be material to the results of operations for the period in which they are reported.

*Deferred costs - foreign operations*

During August 31, 2001, as part of its periodic evaluation of the carrying value of its deferred costs - foreign operations, the company wrote off all deferred costs incurred during the year in Egypt in the amount of \$37,201 and in Mexico in the amount of \$129,872.

**7. Bank indebtedness**

Bank indebtedness is in the form of operating loans bearing interest at bank prime rate plus 0.4% per annum or at Bankers Acceptance rates plus a stamping fee of 1.40%. The operating loans and Bankers Acceptance are available pursuant to a credit facility with a Canadian chartered bank. Through this credit facility, the company has operating loans available of \$7,000,000 (August 31, 2001 - \$7,000,000). In addition, the company has operating loans available of \$400,000 USD (August 31, 2001 - \$400,000 USD), bearing interest at U.S. bank prime rate plus 1%, pursuant to a credit facility with a Canadian chartered bank. Collateral for the loans comprises a general security agreement covering all present and after acquired personal property, a general assignment of accounts receivable and pledge of inventories.

**8. Long-term debt**

	December 31, 2001	August 31, 2001
	\$	\$
Demand loans		
Non-revolving	7,230,003	4,366,632
Revolving	113,298	-
Term loans	25,062	27,577
	<b>7,368,363</b>	<b>4,394,209</b>
Less: current portion of long-term debt	<b>896,605</b>	<b>649,574</b>
	<b>6,471,758</b>	<b>3,744,635</b>

Demand loans are drawn under a credit facility with a Canadian chartered bank bearing interest at the bank's prime rate plus 0.9% to 1.15%. Non-revolving demand loans are repayable in blended monthly payments of \$136,070 (August 31, 2001 - \$76,070) and mature at varying dates from March 2006 to March 2016. Revolving demand loans are repayable in blended monthly payments of \$2,270 (August 31, 2001 \$NIL) and mature in October 2006. While the credit facility is demand in nature repayment in advance of the agreed terms is not anticipated provided that there is no adverse change in the financial position of the company. Accordingly, the loans have been classified as long term. The credit facilities are reviewed annually by the bank. A general security agreement charging all present and after acquired equipment, assignment of all risk insurance related to the Slave

## Notes to Consolidated Financial Statements (continued)

For the four month period ended December 31, 2001 and the year ended August 31, 2001

**8. Long-term debt (continued)**

Lake plant and demand collateral mortgages aggregating \$1,475,000 on land and buildings have been pledged as collateral on the demand loans. Term loans include an equipment loan of \$25,062 (August 31, 2001 - \$27,577) from a Canadian financial services company bearing interest at 7.9%. The loan is repayable in blended monthly payments of \$804 and matures November 2004. A loader has been pledged as collateral for the loan.

Approximate principal repayments due over the next five years are as follows:

	\$
2003	896,605
2004	1,376,280
2005	1,446,246
2006	1,473,860
2007	926,606

**9. Share capital****(a) Authorized**

20,000,000 non-voting, preferred shares, rights to be determined upon issue  
 Unlimited number of common shares

**(b) Issued**

Common	December 31, 2001		August 31, 2001	
	#	\$	#	\$
Balance - beginning of period	10,665,803	10,691,503	9,243,858	6,604,171
Issue of shares upon exercise of stock options	90,750	154,762	159,750	289,363
Issue of shares through employee share purchase plan	30,676	109,563	62,195	197,969
Issue of shares upon acquisition of Trysol Canada Ltd.	-	-	1,200,000	3,600,000
<b>Balance - end of period</b>	<b>10,787,229</b>	<b>10,955,828</b>	<b>10,665,803</b>	<b>10,691,503</b>

**(c) Stock options**

The company has reserved 2,000,000 common shares for issuance pursuant to an approved stock option plan ("Option Plan") granted to directors, management and employees of the company or affiliated companies.

	December 31, 2001	August 31, 2001
	# of shares	# of shares
Common shares under option - beginning of period	1,750,250	1,394,000
Share options granted	-	552,000
Share options cancelled	(20,000)	(36,000)
Share options exercised	(90,750)	(159,750)
<b>Common shares under option - end of period</b>	<b>1,639,500</b>	<b>1,750,250</b>

The following options were outstanding under the Option Plan at:

Expiry date	December 31, 2001		August 31, 2001
	Exercise Price \$	# of shares	# of shares
May 5, 2002	1.55	109,500	164,250
February 2, 2003	1.90	145,000	175,000
January 28, 2005	1.95	505,000	505,000
January 31, 2005	2.00	25,000	25,000
December 20, 2004	2.15	28,000	34,000
January 4, 2006	2.95	50,000	50,000
April 17, 2006	3.04	482,000	502,000
May 5, 2003	3.15	295,000	295,000
		<b>1,639,500</b>	<b>1,750,250</b>

Under the Employee Share Purchase Plan ("Plan") an aggregate of 470,000 common shares have been reserved for sale to employees of the company. Employees electing to participate in the Plan may contribute a minimum of two percent to a maximum of five percent of monthly salaries. The employees' contributions are matched equally by the company. The share purchase price is equal to the weighted average of the trading prices of the common shares of the company on the Toronto Stock Exchange for the five days on which the shares traded on or before the last day of the month for which contributions were remitted. During the four month period ended December 31, 2001, 30,676 shares (August 31, 2001 - 62,195) were issued under the Plan.

## Notes to Consolidated Financial Statements (continued)

For the four month period ended December 31, 2001 and the year ended August 31, 2001

## 9. Share capital (continued)

## d) Net earnings per share

Basic earnings per share is calculated using the reported net earnings divided by the weighted average number of common shares outstanding during the period. Diluted earnings per share is calculated on the basis of the weighted average number of common shares outstanding recognizing the effect of outstanding stock options and their equivalent using the treasury stock method.

A reconciliation of the denominators used for the computation of basic and diluted earnings per share are as follows:

	December 31, 2001	August 31, 2001
	# of shares	# of shares
Weighted average share reconciliation		
- Basic		
Common shares - opening	10,665,803	9,243,858
Weighted average of common shares issued during the period	75,844	612,228
	<b>10,741,647</b>	<b>9,856,086</b>
- Fully diluted		
Basic weighted average common shares	10,741,647	9,856,086
Dilutive effect of stock options and equivalents	502,095	375,852
	<b>11,243,742</b>	<b>10,231,938</b>

## 10. Income taxes

The following table reconciles income taxes from operations calculated at the combined statutory federal and provincial tax rate with the income tax provision in the financial statements.

	December 31, 2001	August 31, 2001
	\$	\$
Income taxes based on combined statutory Canadian federal and provincial tax rate	662,433	1,616,881
Manufacturing and processing rate difference	(30,072)	(143,974)
Future tax rate draw-down difference	1,157	(15,788)
Foreign jurisdiction rate difference	(510)	(3,469)
Non-deductible and other	3,382	21,183
	<b>636,390</b>	<b>1,474,833</b>
	\$	\$
Cash income taxes paid	300,496	2,421,831

Significant components of the company's future tax liabilities (assets) are as follows:

	December 31, 2001	August 31, 2001
	\$	\$
Fixed assets	145,560	85,625
Other assets	57,640	46,475
Accounts payable and accrued liabilities	(91,700)	(89,600)
Share issuance costs	(19,500)	(22,500)
	<b>92,000</b>	<b>20,000</b>

## 11. Commitments

## (a) Leases

The future minimum lease payments under the operating leases amount to \$625,889 (August 31, 2001 - \$351,772) and for each of the next five years are:

	\$
2002	328,340
2003	156,229
2004	57,870
2005	41,725
2006	41,725

## b) Letters of guarantee

The company has provided a \$408,000 U.S. (\$650,678 CDN) letter of guarantee, terminating February 28, 2003, in favour of the Egyptian Gulf Bank on behalf of the Egyptian Canadian Company for Chemicals Industries - F.Z. for bank loans advanced to that company. In the event the Egyptian company fails to comply with the terms and conditions of its credit facility with the Egyptian bank, the amount of the guarantee is payable to the bank upon demand.

At December 31, 2001, the company has provided a \$750,000 CDN letter of guarantee, terminating July 31, 2002, in favour of a supplier for ongoing purchases of petroleum feedstock from that company. Subsequent to December 31, 2001, the supplier terminated its requirement for a letter of guarantee for ongoing purchases.

## Notes to Consolidated Financial Statements

For the three months ended November 30, 2001

### 11. Commitments (continued)

#### (c) Capital expenditure commitment

The company has committed to the construction of a fractionation facility in the Slave Lake area of Northern Alberta. The company's investment in the project will be approximately \$13,100,000 of which \$4,841,000 will be funded by the company and the balance of \$8,259,000 by a loan and use of its operating credit facilities arranged through a Canadian chartered bank.

#### (d) Petroleum feedstock

The company has entered into contracts of varying terms and quantities for the purchase of petroleum feedstock for processing.

#### (e) Financial contributions

The company has received Canadian International Development Agency ("CIDA") financial contributions for its projects in Egypt and South America. CIDA contributions received have been applied to reduce deferred costs – foreign operations. Under the terms of the CIDA agreement, Enerchem International Inc. will have to repay the CIDA financial contributions received if each project meets, within a specified time frame, certain parameters specified in the agreement.

#### (f) Purchase agreement

Subsequent to December 31, 2001, the company entered into a lease to purchase agreement for land and a building situated thereon in Nisku, Alberta, containing 10,000 square feet office and laboratory space. The term of lease is 30 months commencing February 2002 with monthly lease payments of \$7,500. At the end of the lease term, the company has agreed to purchase the land and building for \$875,000.

### 12. Contingent liabilities

In the normal course of business, the company is party to various claims and legal proceedings. While the final outcome with respect to the claims and legal proceedings pending, as at December 31, 2001, cannot be determined with certainty, it is the opinion of management that their resolution will not have a material adverse effect on the company's financial position or results of operations.

### 13. Segmented information

The company operates in one industry which encompasses the blending, manufacture and distribution of a wide variety of specialty products to the oil and gas industry. Inter-segment revenues are accounted for at prices comparable to open market prices for similar products and services. Summarized financial information concerning the industry segment and geographic areas in which the company operated at December 31, 2001 and August 31, 2001 is shown in the following tables:

December 31, 2001	Oilfield Chemicals		Total Oilfield Chemicals	Additions (Eliminations)	Total Operations
	Canada	United States			
	\$	\$	\$	\$	\$
Revenues	14,155,476	252,724	14,408,200	-	14,408,200
Inter-segment revenues	-	418,479	418,479	(418,479)	-
	14,155,476	671,203	14,826,679	(418,479)	14,408,200
Depreciation	242,161	21,882	264,043	-	264,043
Interest on long-term debt	135,808	-	135,808	-	135,808
Earnings from operations	1,501,678	(4,393)	1,497,285	(3,068)	1,494,217
Other income	91,738	5	91,743	5,662	97,405
Income taxes	638,000	(1,610)	636,390	-	636,390
Net earnings (loss)	955,416	(2,778)	952,638	2,594	955,232
Goodwill	6,049,530	-	6,049,530	-	6,049,530
Identifiable assets	36,257,686	1,394,399	37,652,085	(1,790,197)	35,861,888
Capital expenditures	8,316,269	-	8,316,269	-	8,316,269

August 31, 2001	Oilfield Chemicals		Total Oilfield Chemicals	Additions (Eliminations)	Total Operations
	Canada	United States			
	\$	\$	\$	\$	\$
Revenues	30,527,066	1,254,939	31,782,005	-	31,782,005
Inter-segment revenues	-	1,407,158	1,407,158	(1,407,158)	-
	30,527,066	2,662,097	33,189,163	(1,407,158)	31,782,005
Depreciation	520,069	77,731	597,800	57,346	655,146
Interest on long-term debt	151,175	521	151,696	-	151,696
Earnings from operations	3,799,524	(98,603)	3,700,921	(48,982)	3,651,939
Other income	(53,637)	124,643	71,006	9,467	80,473
Income taxes	1,453,044	21,789	1,474,833	-	1,474,833
Net earnings (loss)	2,292,843	4,251	2,297,094	(39,515)	2,257,579
Goodwill	5,948,389	-	5,948,389	-	5,948,389
Identifiable assets	33,235,611	1,426,756	34,662,367	(3,548,279)	31,114,088
Capital expenditures	1,840,068	196,380	2,036,448	-	2,036,448

Our mission is to enhance shareholder value through the marketing of specialty chemicals and hydrocarbon based well servicing fluids to the oil and gas industry in a safe and environmentally conscious manner.

## Corporate Information

### Head Office

Enerchem International Inc.  
 1406 - 8 Street  
 Nisku, Alberta T9E 7M1  
 Tel: (780) 955-3388  
 Fax: (780) 955-2064  
 website: www.enerchem.com



### Oilfield Chemical Operations

Specialty Chemicals Group  
 1406 - 8 Street  
 Nisku, Alberta T9E 7M1  
 Tel: (780) 955-3388  
 Fax: (780) 955-2064  
 e-mail: ech@enerchem.com



### Enerchem International Corporation

5500 East Highway 80  
 Midland, Texas 79710  
 Tel: (915) 570-6799  
 Fax: (915) 570-7826  
 e-mail: jbell@enerchem.com



### Hydrocarbon Fluids Group

Suite 450, 630 - 6 Avenue S.W.  
 Calgary, Alberta T2P 0S8  
 Tel: (403) 269-1500  
 Fax: (403) 269-1559  
 e-mail: ech@enerchem.com



### Directors and Officers

Larry B. Phillips	President and Chief Executive Officer, Director
Brian M. Zubach, CMA	Chief Financial Officer
J. Barrie Brookman	Vice President, Operations
Kenneth A. Klein	Director
Hugh L. Planche	Director
David F. Potter	Director
Fred Pheseay	Director

### Registrar and Transfer Agent

CIBC Mellon Trust Company  
 Toronto, Ontario

### Principal Bank

HSBC Bank Canada  
 Edmonton, Alberta

### Legal Counsel

Chamberlain Hutchison  
 Edmonton, Alberta

### Auditors

PricewaterhouseCoopers LLP  
 Edmonton, Alberta

### Stock Exchange Listing

Toronto Stock Exchange United States - Over  
 Trading symbol "ECH" the Counter: 12g-3-2(b)

## Investor Information

Larry B. Phillips  
 President and Chief Executive Officer

Tel: (780) 955-2335  
 Fax: (780) 955-2336  
 e-mail: lbphillips@enerchem.com

For copies of our annual and quarterly reports  
 or other investor material, please contact:

Enerchem International Inc.

1406 - 8 Street,  
 Nisku, Alberta T9E 7M1

Tel: (780) 955-3388

Fax: (780) 955-2064

e-mail: ech@enerchem.com

or visit our website: www.enerchem.com