



Chemical and
Fluid Solutions



Annual
Report
2002





Enerchem International Inc. is an oilfield services company providing chemical and hydrocarbon based well servicing fluid solutions to oilfield production problems.

Our mission is to enhance customer and 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.

The company's common shares are listed for trading on the Toronto Stock Exchange under the trading symbol "ECH".

Financial Highlights

	2002 ⁽¹⁾	Transition period ⁽²⁾	2001 ⁽³⁾
	\$	\$	\$
Results of operations			
Revenues	37,411,369	14,408,200	31,782,005
Net earnings for the period	1,895,163	955,232	2,257,579
Net earnings per share			
Basic	0.15	0.09	0.23
Diluted	0.14	0.08	0.22
EBITDA ⁽⁴⁾	4,019,359	2,026,761	4,763,195
EBITDA per share ⁽⁵⁾	0.32	0.19	0.48
Financial position			
Total assets	49,685,253	35,861,888	31,114,088
Working capital ⁽⁶⁾	5,222,893	2,660,427	7,255,739
Total bank indebtedness	6,084,421	1,402,160	1,521,419
Total long-term debt	-	7,368,363	4,394,209
Shareholders' equity	35,868,781	18,909,588	18,190,520
Number of shares			
Outstanding, end of period	14,041,873	10,787,229	10,665,803
Average during period	12,515,555	10,741,647	9,856,085

(1) Fiscal year (12 months ended December 31, 2002)

(2) Transition period (4 months ended December 31, 2001)

(3) Fiscal year (12 months ended August 31, 2001)

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

(5) Calculated on basic weighted average number of common shares outstanding for the year

(6) Fiscal 2002 includes demand bank loans of \$3,627,455 with terms of repayment extending beyond one year

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Annual General Meeting

The Annual General Meeting of the Shareholders will be held on:
Thursday, May 29, 2003 at 2:00 p.m. local time at:

"The Palace" Holiday Inn - Canterbury Room, 4235 Gateway Boulevard, Edmonton, Alberta



President's Message

Fiscal 2002 was by far the most challenging year in our corporate history.

While the year started off strong with record financial performance for the 1st quarter of 2002, management's expectation of a stellar financial year was gradually eroded by the extended slowdown in oil and gas activity in western Canada. While sales and gross margins associated with our specialty chemicals were on target with management's expectations, sales of our hydrocarbon based fracturing and drilling fluids were less than anticipated primarily as a result of the decline in drilling activity and hydrocarbon based fracturing. In fact, during the second half of 2002, hydrocarbon carrier fluid fracs experienced 9 year quarterly lows and 16 year lows for non-project hydrocarbon fracs. While several factors contributed to the decline in hydrocarbon fracs the most significant was the industry's focus in 2002 on shallow gas wells which required use of more economic fracturing solutions. Compounding the challenges of a difficult year for us were the operational issues associated with the start-up of the Slave Lake fractionation plant.

Notwithstanding, while falling short of our original expectations, Enerchem generated revenues of \$37,411,000 for 2002 up 18% from revenues of \$31,782,000 for the fiscal year ended August 31, 2001. Net earnings after tax were \$1,895,000, or \$0.14 per share diluted, for the year compared to net earnings of \$2,258,000, or \$0.22 per share diluted, for the year ended August 31, 2001. From an earnings perspective, 2002 was the third best year in our 15 year history.

Despite weak business conditions for the oilfield services industry in 2002, Enerchem achieved some significant accomplishments during the year.

- To strengthen our balance sheet we completed an equity financing generating gross proceeds of \$15,000,000. This enabled us to reduce our debt and bolster working capital.
- To improve our efficiency in manufacturing water and oil based specialty chemicals and to lower procurement costs of chemical ingredients most commonly used in our specialty product blends, we completed a \$1,748,000 expansion of the blend plant and bulk storage facilities located in Nisku. This expansion has contributed to reduce plant labour costs and, with the additional one million litres in bulk storage capacity, has facilitated substantial savings in base chemical costs.
- We committed to the investment in new technologies. As a beginning to this commitment we completed the construction of our new laboratory facilities in Nisku. We strengthened our research and technical capabilities by adding people and equipment dedicated to providing additional technical support to our field sales representatives and for the development of new technologies to build our future. We are further committed to strengthening our research and new product development capabilities in 2003.
- To commit to our growing customer base in northwestern Alberta and northeastern British Columbia we have commenced with the construction of a \$1,100,000 regional service centre in Grande Prairie. This facility will serve as a distribution centre for our specialty chemical and hydrocarbon based products and will be equipped with a laboratory and testing facility.

While we have yet to realize any direct financial reward from our 25% investment in the operations of the Egyptian Canadian Company for Chemicals Industries F.Z., ("ECC") we are particularly pleased to report that this Egyptian company generated strong growth in revenues in 2002 and reported its first profitable year. We are encouraged by these results and anticipate continued improvement in financial performance as this Egyptian company continues to increase its market share in the Middle East. Of particular note, I am pleased to report that the \$408,000 U.S. letter of guarantee provided by Enerchem in favour of the Egyptian Gulf Bank on behalf of ECC has been terminated effective February, 2003 as ECC has demonstrated to the Egyptian Bank prudent management and continued growth of its operations.

Over the past year our wholly owned U.S. subsidiary, Enerchem International Corporation, has essentially maintained its status quo as a manufacturer and distributor of specialty chemicals to the Permian Oil Basin of west Texas and a supplier of base chemicals to the Specialty Chemicals Group in Canada. While we have been able to maintain a stable

President's Message

market for our products in Texas we have not been aggressive pursuers of opportunities available to the company in this market as our focus for this operation has been primarily directed to manufacturing base chemicals for the Canadian operations. We are going to shift our focus in 2003. While the company will continue to provide base chemicals to Canada, in February 2003 we hired a new General Manager, a U.S. resident with an extensive senior background in specialty chemical marketing and operations, to develop a presence for our specialty chemicals and hydrocarbon based fluids in Texas and other U.S. markets. I look forward to reporting of our progress to you in 2003.

Over the past year I have received overwhelming interest from investors pertaining to our Slave Lake fractionation plant. As a result, I would like to take a few moments to talk about the plant.

Quite frankly, the start-up of this facility has been a disappointment for a number of reasons. The two that stand out are, first, our inability to have the plant commissioned and ready to produce all intended product lines, in particular our Drillsol® product, prior to the increase in oil and gas activity that commenced late in 2002. Second, the frequency of facility downtime due to numerous unforeseen processing and operational issues all of which combined to cause the delay in commissioning the plant. I would point out as well that the slowdown in oilpatch activity levels also affected the plant at a crucial stage of testing. To explain, the plant was designed with a finished product storage capacity which allows production for approximately four days. With the slowdown in activity, we were unable to run the plant for a sustained period of time in order to make the many complex adjustments necessary to optimize its operations. With most issues specific to the operation of this facility now resolved, the plant is capable of supplying the market with our Fracsol® and Waxsol® products. The Drillsol® fluid manufactured at this facility, however, has not yet been certified as a biodegradable product. This approval is in progress and we are confident that this fluid will be certified as biodegradable in the near term and available for future drilling programs in 2003. Drillsol® manufactured at the Sundre fractionation plant has always been an approved biodegradable product however, plant capacity at this facility limits our production capabilities.

Given hindsight, I remain confident in the capabilities of the Slave Lake facility and of the tremendous opportunities that will become available to us. One of our strategic initiatives in 2003 is to further optimize the capabilities of this facility by exploring and developing new product and market opportunities.

We anticipate that 2003 will be a strong year overall for the company. Current high commodity prices and low commodity inventory levels in North America have precipitated a very active market in western Canada which for Enerchem has resulted in record sales levels of our specialty chemicals and hydrocarbon based fluids thus far in 2003. We anticipate that, as a result of our commitment to technologies, services and business processes, 2003 will be a break-through year for the Specialty Chemicals Group. As an offset, however, the recent spike-up in world oil prices has dramatically increased the cost of acquiring hydrocarbon feedstocks used to manufacture our hydrocarbon based products. The increase in hydrocarbon feedstock costs coupled with a more competitive frac market have combined to reduce gross margins of our hydrocarbon based products. While we are guardedly optimistic that world oil prices will return to more normal levels in the near term, continued uncertainty in the world oil markets and unfavourable events in the Middle East could result in the continuation of high world oil prices. Recognizing this vulnerability to margin compression, Enerchem has established aggressive goals in 2003 that are targeted in part to minimize our exposure to unfavourable fluctuations in hydrocarbon feedstock costs.

Finally, I would like to thank the Board of Directors for their invaluable insight and guidance. To the employees, I am truly thankful and grateful for their dedication, hardwork and continued commitment to the future success of Enerchem.



Larry B. Phillips
President and Chief Executive Officer

Review of Operations

Enerchem International Inc. is a manufacturer of specialty chemicals and hydrocarbon based fluids designed to provide technologically advanced solutions to oil and gas processing and production problems. Enerchem's 18 proprietary product lines, comprised of over 300 chemical formulations, hydrocarbon based fracturing fluids and biodegradable drilling fluids, provide cost effective solutions to a wide variety of oilfield operations which include conventional and heavy oil production, natural gas processing, pipelines, compressor stations and resolving down-hole and surface equipment problems such as internal pipe corrosion and water-oil separation.

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
- Well fracturing

Enerchem's head office is located Nisku, Alberta. Nisku is located at the gateway to the northern Alberta and British Columbia oilpatch. This location houses the company's 16,000 sq. ft. chemical blending plant, railcar siding, tank farm, warehouse and main laboratory facilities. The Company's fractionation facilities are located in Sundre and Slave Lake, Alberta.

Enerchem services the western Canadian oil and gas industry through its network of strategically located distribution facilities. 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. Enerchem's technical team includes domestic and international specialists for every facet of oil and gas recovery; the best personnel will ensure that Enerchem remains a leader in product development, innovation and application.

Enerchem's laboratory group in Nisku, Alberta is comprised of highly dedicated R&D chemists and chemical technologists that provide timely, concise results with domestic "critical" project turnover times of 24 hours or less. Product development and testing is performed at 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 standard.

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 several years and has developed a complete line of specialty chemicals to support the state of the art manufacturing and laboratory facility located in the Free Zone area of Alexandria, Egypt. This facility, being the first domestically engineered and constructed specialty chemicals manufacturing facility in Egypt, employs qualified personnel to meet all the 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

This Management's Discussion and Analysis ("MD&A") of the financial condition and results of operations should be read in conjunction with the President's Message and the consolidated financial statements of Enerchem International Inc. for the year ended December 31, 2002, the four month period ended December 31, 2001, the year ended August 31, 2001 and the related notes to the consolidated financial statements.

Subsequent to the year ended August 31, 2001, the Board of Directors of Enerchem International Inc. approved a change in the fiscal year end of the company from August 31 to December 31 effective with the calendar year beginning January 1, 2002. A four month transition period from September 1, 2001 to December 31, 2001 ("Transition Period") preceded the commencement of the 2002 fiscal year.

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 year ended December 31, 2002 were \$37,411,000, an average of \$3,118,000 per month, compared to revenues of \$14,408,000 for the Transition Period, an average of \$3,602,000 per month, and revenues of \$31,782,000 for the year ended August 31, 2001, an average of \$2,649,000 per month. The decline in average monthly revenues for fiscal 2002 when compared to the Transition Period reflects the slowdown in oil and gas activity in western Canada that consumed a large part of the year. The increase in average monthly revenues for fiscal 2002 when compared to the year ended August 31, 2001 is acquisition related. On March 31, 2001, the Company acquired all of the issued and outstanding shares of Trysol Canada Ltd. The operating results of Trysol were included in the consolidated statement of operations effective the acquisition date.

Gross profit

Gross profit as a percentage of revenues for the year ended December 31, 2002 was 42% compared to 39% for the Transition Period and compared to 42% for the year ended August 31, 2001. The increase in gross profit as a percentage of revenues in 2002 when compared to the Transition Period was the result of the change in revenue mix which was largely influenced by sales of higher margin specialty chemicals versus lower margin hydrocarbon based fracturing and drilling fluids.

Salaries and employee benefits

Salaries and employee benefits for fiscal 2002 were \$5,752,000, an average of \$479,000 per month, compared to \$1,868,000 for the Transition Period, an average of \$467,000 per month, and \$4,458,000 for the year ended August 31, 2001, an average of \$371,000 per month. Salaries and employee benefits as a percentage of revenues were 15% in fiscal 2002 compared to 13% for the Transition Period and 14% for the year ended August 31, 2001. The increase in average monthly salaries expense in 2002 when compared to the Transition Period was the result of restructuring certain sales territories combined with increased staffing levels to 79 full time employees from 77 full time employees at December 31, 2001. The increase in average monthly salaries expense in 2002 when compared to the year ended August 31, 2001 is acquisition related.

Effective January 1, 2002 the company adopted the new recommendations of Section 3870 of The Canadian Institute of Chartered Accountants "Stock Based Compensation and Other Stock Based Payments" on a prospective basis. The standard requires either the recognition of a compensation expense for grants of stock and stock options to employees, based on the estimated fair value of stock based compensation at the date of grant, or, alternatively, the disclosure of pro-forma net earnings and earnings per share data, as if the stock based compensation has been recognized in earnings. The company has elected not to adopt the fair value method of accounting for compensation awards issued under the stock option plan (refer to notes 1(l) and 10(c)).

Selling, general and administration

Selling, general and administration expenses for the year ended December 31, 2002 were \$6,074,000, an average of \$506,000 per month, compared to \$1,869,000 for the Transition Period, an average of \$467,000 per month, and \$4,519,000 for the year ended August 31,

2001, an average of \$377,000 per month. Selling, general and administration expenses as a percentage of revenues were 16% in fiscal 2002 compared to 13% for the Transition Period and 14% for the year ended August 31, 2001. The increase in average expenses in 2002 when compared to the Transition Period was the result of the general increase in operating expenditures associated with maintaining the company's infrastructure. The increase in average monthly salaries expense in 2002 when compared to the year ended August 31, 2001 is acquisition related.

Depreciation and amortization

Depreciation and amortization charges for fiscal 2002 were \$1,094,000, an average of \$91,000 per month, compared to \$264,000 for the Transition Period, an average of \$66,000 per month, and \$655,000 for the year ended August 31, 2001, an average of \$55,000 per month. The average monthly depreciation expense in fiscal 2002 increased when compared to the Transition Period and the year ended August 31, 2001 due to the increased depreciable cost base of property, plant and equipment that resulted from the completion of the \$1,748,000 blend plant expansion and the addition of buildings under capital lease of \$907,000. Expenditures associated with the construction of the company's fractionation plant in Slave Lake, Alberta totaled \$15,092,000 at December 31, 2002. While the fractionation plant was capable of producing the company's line of hydrocarbon based products, the plant's inability to achieve its product optimization levels combined with on-going equipment modifications delayed the final commissioning of the facility during the year. As the facility was not fully operational, depreciation has not been recorded.

During 2002, the company adopted the recommendations of EIC 27 of The Canadian Institute of Chartered Accountants "Revenues and Expenditures During the Pre-Operating Period". In accordance with these recommendations, pre-operating costs incurred during the start-up of the company's fractionation plant in Slave Lake are capitalized until the plant is capable of consistently providing its intended commercial service. Revenues realized from the sale of products produced by the Slave Lake plant during the pre-operating period are recorded as a reduction of the pre-operating costs. Pre-operating costs will be amortized over a period of five years which will commence in January 2003 with the final commissioning of the plant.

Interest expense

Interest expense for fiscal 2002 totaled \$280,000, an average of \$23,000 per month, compared to \$171,000 for the Transition Period, an average of \$43,000 per month, and \$209,000 for the year ended August 31, 2001, an average of \$17,000 per month. During fiscal 2002 and the Transition Period ended 2001, the company used its available credit facilities to finance the construction of the Slave Lake fractionation plant and to meet its working capital requirements. During 2002 the company repaid \$6,888,000 of bank loans utilized to finance the construction of the Slave Lake fractionation plant.

Income taxes

Tax expense for the year ended December 31, 2002 totaled \$750,000 resulting in an effective tax rate of 28%, compared to tax expense of \$636,000 for the Transition Period, representing an effective tax rate of 40%, and tax expense of \$1,475,000 for the year ended August 31, 2001, representing an effective tax rate of 40%. In 2002 the company was able to defer current taxes as a result of utilizing capital cost allowance in excess of book depreciation. As a result of claiming maximum capital cost allowances the company has tax losses available to reduce current and prior years' federal and provincial income taxes.

Net earnings and earnings per share

Net earnings for the year ended December 31, 2002 totaled \$1,895,000, representing an after tax return of 5%, compared to net earnings for the Transition Period of \$955,000, representing an after tax return of 7%, and net earnings of \$2,258,000 for the year ended August 31, 2001, representing an after tax return of 7%. The decline in net earnings after tax as a percentage of total revenues resulted from the extended slowdown in oil and gas activity combined with the general increase in operating expenses associated with maintaining the company's infrastructure. Net earnings per share for fiscal 2002 were \$0.15 per common share basic and \$0.14 per common share diluted compared to net earnings per common share for the Transition Period of \$0.09 per common share basic and \$0.08 per common share diluted, and compared to net earnings per common share for the year ended August 31, 2001 of \$0.23 per share basic and \$0.22 per share diluted.

Management's Discussion and Analysis

Goodwill impairment

At the commencement of its Transition Period, 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. During fiscal 2002, management performed its annual evaluation of the carrying value of goodwill and concluded that goodwill of its reporting units was not impaired. For the Transition Period, management's evaluation of the carrying value of goodwill resulted in the recognition of an impairment loss of \$500,000 which has been recorded as an adjustment to opening retained earnings for the period. This impairment was attributed to the decline in value of business processes and assets acquired through acquisitions made in November of 1989 and August 1992.

Liquidity and capital resources

Working capital at December 31, 2002 increased by \$2,563,000 to a surplus of \$5,223,000 from a surplus of \$2,660,000 at December 31, 2001. The company's working capital ratio was 1.4:1 at December 31, 2002 and 1.3:1 at December 31, 2001. Effective January 1, 2002 the Company adopted the recommendations of EIC 122 of The Canadian Institute of Chartered Accountants' (refer to note 1(n)) which requires loan agreements that specify the company's repayment terms but enable the creditor, at its discretion, to demand payment at any time to be presented as a current liability. Prior to the adoption of the new recommendations, Enerchem presented the demand loans as long-term on the basis of the repayment terms specified by the bank. As a result of adopting these recommendations, current liabilities include bank loans of \$3,627,000 at December 31, 2002.

The company's earnings before interest, taxes, depreciation, amortization and unusual charges such as write-downs ("EBITDA"), were \$4,019,000, or \$0.32 EBITDA per share basic, for the year ended December 31, 2002, compared to EBITDA of \$2,027,000, or \$0.19 EBITDA per share basic, for the Transition Period and EBITDA of \$4,763,000, or \$0.48 EBITDA per share basic, for the year ended August 31, 2001. The decrease in EBITDA for fiscal 2002 when compared to the year ended August 31, 2001 was due to the slowdown in oil and gas activity levels coupled with increased costs associated with maintaining the company's infrastructure. 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 used in operating activities totaled \$1,846,000 for the year ended December 31, 2002 compared to cash provided by operating activities of \$5,540,000 for the Transition Period ended December 31, 2001 and \$3,760,000 for the year ended August 31, 2001. The reduction in operating cash flows in 2002 was due to the increase in accounts receivable resulting from increased activity levels at the end of the year, the increase of inventory levels in anticipation of increased business activity at the start of 2003 and reductions in trade payables combined with payments of corporate income taxes.

Net cash used in investing activities totaled \$10,884,000 in 2002 compared to \$8,659,000 for the Transition Period ended December 31, 2001 and \$8,691,000 for the year ended August 31, 2001. Investing activities during 2002 and the Transition Period were directed primarily 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 \$14,387,000 in 2002 compared to \$3,238,000 for the Transition Period ended December 31, 2001 and \$3,031,000 for the year ended August 31, 2001. During fiscal 2002 the company completed an equity financing generating gross proceeds of \$15,000,000 which was used to reduce bank debt and strengthen its working capital position. During the Transition 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. 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, 2002, the company had bank loans outstanding of \$6,084,000 compared to \$8,745,000 at December 31, 2001. At December 31, 2002, the company had a credit facility with a Canadian chartered bank that provides an operating line of credit of \$7,000,000, \$3,388,000 of demand non-revolving loans and \$500,000 of demand revolving loans. At December 31, 2002, the company had utilized \$3,388,000 of its demand non-revolving loans, \$239,000 of its demand revolving loans and \$2,457,000 of its available operating lines of credit.

Business risks and uncertainties

The magnitude of capital expenditures by oil and gas companies determines the demand for Enerchem's services in providing specialty chemical and hydrocarbon based fluid solutions to oil and gas production problems. The primary catalysts to high expenditures and activity levels in the oil and gas industry are 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. The company's profitability is sensitive to upward swings in crude oil prices and its ability to minimize price risks. 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 potentially significant losses.

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.

Outlook

In response to current high commodity prices and low commodity inventory levels in North America, capital expenditure programs of oil and gas companies are expected to strengthen in 2003. While Enerchem is well positioned to benefit from the anticipated increase in activity directed to its specialty chemical products and hydrocarbon based fracturing fluids, the company will not be in a position to gain substantial market entry for its hydrocarbon based drilling fluids until the second half of 2003.

The company will continue to pursue accretive acquisition opportunities or business synergies that provide substantial benefit to the company, its employees and 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, 2002 and December 31, 2001 and the consolidated statements of earnings, retained earnings and cash flows for the year ended December 31, 2002, 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, 2002 and December 31, 2001 and the results of its operations and its cash flows for the year ended December 31, 2002, 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
February 7, 2003

Consolidated Statement of Earnings and Retained Earnings

	Year ended December 31, 2002	Four months ended December 31, 2001	Year ended August 31, 2001
	\$	\$	\$
Revenues	37,411,369	14,408,200	31,782,005
Cost of sales	21,606,543	8,741,650	18,289,778
Gross profit	15,804,826	5,666,550	13,492,227
Expenses			
Salaries and employee benefits	5,751,949	1,867,937	4,457,641
Selling, general and administration	6,073,508	1,869,257	4,518,937
Depreciation and amortization	1,094,495	264,043	655,146
Interest expense (note 11)	280,140	171,096	208,564
	13,200,092	4,172,333	9,840,288
Earnings before other income (expense)	2,604,734	1,494,217	3,651,939
Other income (expense)			
Gain (loss) on disposal of property, plant and equipment	39,817	(7,536)	9,067
Write-down of investment and deferred costs - foreign operations (note 6)	-	-	(167,073)
Other	173	104,941	238,479
	39,990	97,405	80,473
Earnings before income taxes	2,644,724	1,591,622	3,732,412
Income taxes (note 12)			
Current	(638,139)	564,390	1,505,199
Future	1,387,700	72,000	(30,366)
	749,561	636,390	1,474,833
Net earnings for the period	1,895,163	955,232	2,257,579
Retained earnings, beginning of period	7,953,760	7,499,017	5,241,438
	9,848,923	8,454,249	7,499,017
Goodwill impairment (note 5)	-	(500,489)	-
Retained earnings, end of period	9,848,923	7,953,760	7,499,017
Net earnings per share (note 10(d))			
Basic	0.15	0.09	0.23
Diluted	0.14	0.08	0.22
Weighted average shares outstanding (note 10(d))			
Basic	12,515,555	10,741,647	9,856,086
Diluted	13,401,570	11,243,742	10,231,938

Consolidated Balance Sheet

As at December 31	2002	2001
	\$	\$
Assets		
Current assets		
Cash	255,052	-
Accounts receivable	10,183,945	8,916,164
Income taxes recoverable	1,103,737	-
Inventories	5,118,349	3,633,197
Prepaid expenses and deposits	382,130	499,608
	17,043,213	13,048,969
Property, plant and equipment (note 4)	25,259,376	15,861,816
Goodwill (note 5)	6,049,530	6,049,530
Other assets (note 6)	1,333,134	901,573
	49,685,253	35,861,888
Liabilities		
Current liabilities		
Bank indebtedness (note 7)	6,084,421	1,402,160
Accounts payable and accrued liabilities	5,645,899	6,396,501
Income taxes payable	-	1,693,276
Current portion of obligations under capital leases (note 9)	90,000	-
Current portion of long-term debt (note 8)	-	896,605
	11,820,320	10,388,542
Obligations under capital leases (note 9)	860,652	-
Long-term debt (note 8)	-	6,471,758
Future income taxes	1,135,500	92,000
	13,816,472	16,952,300
Contingent liabilities (note 14)		
Shareholders' equity		
Share capital (note 10)	26,019,858	10,955,828
Retained earnings	9,848,923	7,953,760
	35,868,781	18,909,588
	49,685,253	35,861,888

Signed on behalf of the Board,


Larry B. Phillips
Director

Kenneth A. Klein
Director

Consolidated Statement of Cash Flows

	Year ended December 31, 2002	Four months ended December 31, 2001	Year ended August 31, 2001
	\$	\$	\$
Operating activities			
Net earnings for the period	1,895,163	955,232	2,257,579
Items not affecting cash -			
Depreciation and amortization	1,094,495	264,043	655,146
(Gain) loss on disposal of property, plant and equipment	(39,817)	7,536	(9,067)
Future income taxes	1,387,700	72,000	(30,366)
Write-down of investment and deferred costs - foreign operations	-	-	167,073
	4,337,541	1,298,811	3,040,365
Changes in non-cash components of working capital			
Net change in accounts receivable	(1,267,781)	1,971,998	7,959,829
Net change in inventories and prepaid expenses	(1,367,674)	995,798	(2,195,762)
Net change in accounts payable and accrued liabilities	(750,602)	1,009,108	(4,059,939)
Net change in income taxes payable	(2,797,013)	264,008	(984,547)
	(6,183,070)	4,240,912	719,581
Net cash (used in) provided by operating activities	(1,845,529)	5,539,723	3,759,946
Investing activities			
Purchase of property, plant and equipment	(9,729,425)	(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	269,182	31,000	188,766
(Increase) decrease in other assets	(431,561)	1,328	(631,263)
Net cash used in investing activities	(9,891,804)	(8,658,943)	(8,690,943)
Financing activities			
Issuance of common shares	14,719,830	264,325	487,332
Increase in bank indebtedness	6,431,095	-	-
Increase in long-term debt	-	3,200,806	4,500,000
Repayment of long-term debt	(7,715,037)	(226,652)	(1,936,979)
Repayment of obligations under capital leases	(41,343)	-	(19,292)
Net cash provided by financing activities	13,394,545	3,238,479	3,031,061
Increase (decrease) in cash (Bank indebtedness) cash - beginning of period	1,657,212 (1,402,160)	119,259 (1,521,419)	(1,899,936) 378,517
Cash (bank indebtedness) - end of period	255,052	(1,402,160)	(1,521,419)
	\$	\$	\$
Supplementary information			
Cash interest income received	42,382	-	575,209
Cash interest expense paid	196,423	144,590	162,033

Notes to Consolidated Financial Statements

For the year ended December 31, 2002, 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 subsidiary Enerchem International Corporation. All significant inter-company balances and transactions have been eliminated. The company uses the cost method of accounting for its investment in foreign operations as the company does not exercise significant influence.

(b) Inventories

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

(c) 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:

Buildings	5%
Laboratory equipment	10%
Land improvements	10%
Oilfield equipment	10%
Fractionation processing facilities	5% to 10%
Blend plant facilities	20%
Leasehold improvements	10% to 20%
Automotive equipment	30%
Office, computer equipment and software	20% to 100%

(d) Capital leases

Capital leases are capitalized by recording as assets and liabilities the present value of the payments under the leases. The capitalized value of a depreciable asset under a capital lease is amortized over its estimated useful life on a basis that is consistent with the company's depreciation policy for similar assets. Lease payments are allocated to a reduction of the obligation and interest expense.

(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. The effect on future income tax liabilities and assets of a change in the tax rate is recognized in income in the period that the change occurs.

1. Accounting policies (continued)**(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

Basic earnings per common share are calculated based on the average number of common shares outstanding during the year. Diluted earnings per share are calculated based on the treasury stock method which assumes that any proceeds from the exercise of in the money stock options would be used to purchase the company's common shares at the average market price during the year. The computation of diluted earnings per share is 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.

(l) Stock based compensation

On January 1, 2002 the company adopted the new recommendations of Section 3870 of The Canadian Institute of Chartered Accountants "Stock Based Compensation and Other Stock Based Payments" on a prospective basis. The standard requires either the recognition of a compensation expense for grants of stock and stock options to employees, based on the estimated fair value of stock based compensation at the date of grant, or, alternatively, the disclosure of pro-forma net earnings and earnings per share data, as if the stock based compensation has been recognized in earnings. The company has two stock based compensation plans (see note 10(c)). The company has elected not to adopt the fair value method of accounting for compensation awards issued under its stock option plan. Compensation expense is recognized for the company's contributions to the Employee Share Purchase Plan when incurred.

(m) Pre-operating costs

During the period the company adopted the recommendations of the Emerging Issues Committee, EIC 27 of The Canadian Institute of Chartered Accountants "Revenues and Expenditures During the Pre-Operating Period". In accordance with these recommendations, pre-operating costs incurred during the start-up of the company's fractionation plant in Slave Lake, Alberta are capitalized until the plant is capable of consistently providing its intended commercial service. Revenues realized from the sale of products produced by the Slave Lake fractionation plant during the pre-operating period are recorded as a reduction of the pre-operating costs. Pre-operating costs are amortized over a period of five years commencing at the end of the pre-operating period.

(n) Bank indebtedness

Effective January 1, 2002, the company adopted the recommendations of the Emerging Issues Committee, EIC 122 "Balance Sheet Classification of Callable Debt Obligations and Debt Obligations Expected to be Refinanced", of The Canadian Institute of Chartered Accountants. As a result of adopting these recommendations, loan agreements that specify the company's repayment terms but enable the creditor, at its discretion, to demand payment at any time are now presented as a current liability. Prior to the adoption of the new recommendations, the company presented the demand loans as long-term on the basis of the repayment terms specified by the bank.

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.

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

3. Acquisition (continued)

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, the company paid a cash settlement in the amount of \$250,000 to the vendors and goodwill has been increased by \$601,630 as a result of this payment and adjustments to certain assets and liabilities.

4. Property, plant and equipment

	December 31, 2002			December 31, 2001		
	Cost	Accumulated depreciation	Net	Cost	Accumulated depreciation	Net
	\$	\$	\$	\$	\$	\$
Land	610,771	-	610,771	526,310	-	526,310
Buildings	3,191,464	617,630	2,573,834	1,709,237	512,267	1,196,970
Laboratory equipment	471,210	183,938	287,272	317,671	162,620	155,051
Land improvements	561,670	196,742	364,928	550,043	157,082	392,961
Oilfield equipment	1,429,414	727,347	702,067	1,360,308	655,206	705,102
Fractionation processing facilities	19,241,703	1,666,836	17,574,867	12,074,822	1,393,072	10,681,750
Blend plant facilities	2,991,125	1,015,497	1,975,628	2,343,243	713,159	1,630,084
Leasehold improvements	184,797	14,962	169,835	-	-	-
Automotive equipment	1,574,863	943,724	631,139	1,269,931	931,103	338,828
Office, computer equipment and software	774,726	405,691	369,035	539,899	305,139	234,760
	31,031,743	5,772,367	25,259,376	20,691,464	4,829,648	15,861,816

The above amounts include \$84,800 (December 31, 2001 - NIL) of land and \$907,195 (December 31, 2001 - NIL) of buildings under capital leases and related depreciation of \$45,360 (December 31, 2001 - NIL). Buildings includes \$549,329 (December 31, 2001 - NIL) of costs associated with a warehouse and distribution facility under construction. As the completion of the facility has not yet occurred, depreciation has not been recorded. Fractionation processing facilities includes \$15,091,830 (December 31, 2001 - \$7,955,790) of costs associated with the construction of a new fractionation plant. While the fractionation plant was capable of producing the company's line of hydrocarbon based products, the plant's inability to achieve its product optimization levels combined with on-going equipment modifications delayed the final commissioning of the facility during the year. As the facility was not fully operational, depreciation has not been recorded.

5. Goodwill

	December 31, 2002	December 31, 2001
	\$	\$
Goodwill, beginning of period	6,481,068	6,981,557
Less: accumulated amortization	431,538	431,538
impairment loss	-	500,489
Goodwill, end of period	6,049,530	6,049,530

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 has performed its annual evaluation of the carrying value of goodwill and concluded that goodwill of its reporting units was not impaired. During

5. Goodwill (continued)

the four month period ended December 31, 2001, the company recognized an impairment loss of \$500,489 which was recorded as an adjustment to retained earnings. The impairment of goodwill during this period was attributed to the decline in value of business processes and assets acquired through acquisitions made in November 1989 and August 1992.

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

	Year ended December 31, 2002	Four months ended December 31, 2001	Year ended August 31, 2001
Net earnings	\$	\$	\$
Net earnings for the period	1,895,163	955,232	2,257,579
Amortization of goodwill	-	-	79,212
Adjusted net earnings for the period	1,895,163	955,232	2,336,791
Earnings per share			
Basic	0.15	0.09	0.24
Diluted	0.14	0.08	0.23

6. Other assets

	December 31, 2002	December 31, 2001
	\$	\$
Investments - foreign operations	895,779	895,779
Pre-operating costs	434,355	-
Deferred costs - foreign operations	-	-
Other	3,000	5,794
	1,333,134	901,573

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), (December 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.

Pre-operating costs

Pre-operating costs represent the costs incurred during the start-up of the company's Slave Lake fractionation plant. Pre-operating costs will be amortized over a period of five years commencing at the end of the pre-operating period. The pre-operating period ended in January 2003.

Deferred costs - foreign operations

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

7. Bank indebtedness

The company has an \$10,888,446 credit facility with a Canadian chartered bank consisting of a \$7,000,000 demand operating loan that bears interest at the bank's prime rate plus 0.40%, a \$500,000 demand revolving loan at the bank's prime rate plus 0.90% and demand non-revolving loans totaling \$3,388,446 that bear interest at the bank's prime rate plus 0.90%. The company has pledged an assignment of accounts receivable and inventories, a general security agreement charging all present and after acquired equipment and demand collateral mortgages aggregating \$1,475,000 on land and buildings as collateral on the demand revolving and non-revolving loans. In addition, the company has operating loans available in the United States of \$400,000 USD, bearing interest at U.S. bank prime rate plus 1%. Collateral for the loans in the United States 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, 2002		December 31, 2001	
	\$		\$	
Demand loans				
Non-revolving	-		7,230,003	
Revolving	-		113,298	
Term loans	-		25,062	
	-		7,368,363	
Less: current portion of long-term debt	-		896,605	
	-		6,471,758	

During the year, the company repaid term loans of \$25,062 from a Canadian financial services company bearing interest at 7.9%. The loan was repayable in blended monthly payments of \$804 and had a maturity date in November 2004. A loader had been pledged as collateral for the loan. Long-term debt has been reclassified to bank indebtedness as described in note 1(n).

9. Obligations under capital leases

Obligations under capital leases are repayable in blended monthly payments of \$7,500 (December 31, 2001 – NIL) to July 31, 2004. The company has agreed to purchase the land and building comprising the obligation under capital lease for \$875,000 on or before August 1, 2004. The future minimum lease payments under capital leases amount to \$1,017,500 (December 31, 2001 – NIL) and for each of the next two years are as follows:

	2002
	\$
2003	90,000
2004	927,500
Total minimum lease payments	1,017,500
Less: amount representing interest at 4.6%	66,848
Balance of obligation	950,652
Less: current portion of obligations under capital leases	90,000
	860,652

During the year ended December 31, 2002 the interest portion of lease payments amounted to \$41,157.

10. 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, 2002		December 31, 2001	
	#	\$	#	\$
Balance - beginning of period	10,787,229	10,955,828	10,665,803	10,691,503
Issue of shares upon exercise of stock options	182,500	324,225	90,750	154,762
Issue of shares through employee share purchase plan	72,144	365,194	30,676	109,563
Issue of shares upon private placement	3,000,000	14,374,611	-	-
Balance - end of period	14,041,873	26,019,858	10,787,229	10,955,828

(c) Stock options

The company has reserved 2,700,000 common shares for issuance pursuant to an approved stock option plan ("Option Plan") granted to directors, management and employees of the company or affiliated company. Stock options granted to employees vest after one to three years from the date of grant and expire five years after the date of grant. Stock options granted to directors and officers of the company are exercisable immediately. The exercise price of each option equals the market price of the company's common shares at the date of grant. A summary of the status of the company's Option Plan is presented below:

	December 31, 2002		December 31, 2001	
	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price
	#	\$	#	\$
Common shares under option - beginning of period	1,639,500	2.49	1,750,250	2.46
Share options granted	235,000	5.15	-	-
Share options cancelled	(15,000)	3.04	(20,000)	3.04
Share options exercised	(182,500)	1.78	(90,750)	1.71
Common shares under option - end of period	1,677,000	2.94	1,639,500	2.49
Options exercisable at end of period	1,330,000	2.54	1,507,500	2.44

10. Share capital (continued)**(c) Stock options (continued)**

The following options were outstanding and exercisable under the Option Plan at December 31, 2002:

Expiry date	Outstanding			Weighted Average Remaining Years of Contractual Life	Exercisable	
	Exercise Price		Weighted Average Price		Options	Weighted Average Exercise Price
	Options	Price				
	#	\$	\$	#	\$	
February 2, 2003	122,000	1.90	1.90	0.1	122,000	1.90
May 5, 2003	290,000	3.15	3.15	0.3	290,000	3.15
December 20, 2004	25,000	2.15	2.15	1.9	25,000	2.15
January 28, 2005	493,000	1.95	1.95	2.1	493,000	1.95
January 4, 2006	50,000	2.95	2.95	3.0	50,000	2.95
April 17, 2006	462,000	3.04	3.04	3.3	350,000	3.04
May 9, 2007	235,000	5.15	5.15	4.4	-	-
	1,677,000		2.94	2.3	1,330,000	2.54

As the company has elected not to adopt the fair value method of accounting for compensation awards issued under its Option Plan, pro forma disclosure of net earnings and earnings per share is required as if the fair value method had been applied to stock based compensation awards after January 1, 2002. The pro forma disclosure is as follows:

Pro forma net earnings	December 31, 2002
	\$
Net earnings as reported	1,895,163
Less stock based compensation costs, net of tax	80,787
Pro forma net earnings for the period	1,814,376
Pro forma earnings per share	
Basic	0.14
Diluted	0.14

For purposes of pro forma disclosures, the estimated fair value of options is amortized to expense over the options' vesting period. The fair value of the options included in the pro forma amounts presented above have been estimated using the Black-Scholes option pricing model. The assumptions used in the pricing model are as follows:

Weighted average fair value per option (\$)	2.65
Risk free interest rate (%)	4.50
Expected life of option (years)	5
Expected volatility (%)	54
Dividend yield (%)	0

Under the Employee Share Purchase Plan ("Plan") an aggregate of 970,000 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. Common shares acquired under the Plan vest with the employee upon purchase and are distributed to the employees on an annual basis. The company's contributions to the Plan are recorded as compensation costs in the month incurred and totaled \$182,597 for the year ended December 31, 2002. During fiscal 2002, 72,144 shares (four month period ended December 31, 2001 - 30,676) were issued under the plan for proceeds totaling \$365,194.

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 per share are as follows:

10. Share capital (continued)

d) Net earnings per share (continued)

	December 31, 2002	December 31, 2001	August 31, 2001
	\$	\$	\$
Weighted average share reconciliation			
- Basic			
Common shares - opening	10,787,229	10,665,803	9,243,858
Weighted average of common shares issued during the period	1,728,326	75,844	612,228
	12,515,555	10,741,647	9,856,086
- Diluted			
Basic weighted average common shares - opening	12,515,555	10,741,647	9,856,086
Dilutive effect of stock options and equivalents	886,015	502,095	375,852
	13,401,570	11,243,742	10,231,938

11. Interest expense

Interest expense is comprised as follows:

	Year ended December 31, 2002	Four months ended December 31, 2001	Year ended August 31, 2001
	\$	\$	\$
Interest on bank indebtedness	155,266	-	-
Interest on capital leases	41,157	-	1,251
Other interest	83,717	35,288	56,868
Interest on long-term debt	-	135,808	150,445
	280,140	171,096	208,564

12. 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.

	Year ended December 31, 2002	Four months ended December 31, 2001	Year ended August 31, 2001
	\$	\$	\$
Income taxes based on combined statutory Canadian federal and provincial tax rate	1,070,450	662,433	1,616,881
Manufacturing and processing rate difference	(25,895)	(30,072)	(143,974)
Substantively enacted rates	(169,869)	1,157	(15,788)
Taxation authority reassessments	(142,029)	-	-
Foreign jurisdiction rate difference	(17,811)	(510)	(3,469)
Capital tax	12,278	-	-
Non-deductible and other	22,437	3,382	21,183
	749,561	636,390	1,474,833
	\$	\$	\$
Cash income taxes paid	2,213,954	300,496	2,421,831

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

	December 31, 2002	December 31, 2001	August 31, 2001
	\$	\$	\$
Property, plant and equipment	1,452,503	145,560	85,625
Other assets	58,728	57,640	46,475
Accounts payable and accrued liabilities	(88,572)	(91,700)	(89,600)
Share issuance costs	(287,159)	(19,500)	(22,500)
	1,135,500	92,000	20,000

13. Commitments

(a) Leases

The future minimum lease payments under the operating leases amount to \$683,937 (December 31, 2001 - \$625,889) and for each of the next five years are:

	\$
2003	373,014
2004	227,473
2005	41,725
2006	41,725
2007	-

(b) Letters of guarantee and credit

The company has provided a \$408,000 U.S. (\$644,558 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

13. Commitments (continued)**(b) Letters of guarantee and credit (continued)**

guarantee is payable to the bank upon demand. Subsequent to December 31, 2002, the Egyptian Gulf bank terminated its requirement for a letter of guarantee.

At December 31, 2002 the company had provided a \$250,000 U.S. (\$394,950 CDN) letter of credit, terminating November 2003, in favour of a supplier for ongoing purchases of petroleum feedstock from that company.

(c) Petroleum feedstock

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

(d) Financial contributions

The company has received Canadian International Development Agency ("CIDA") financial contributions for its projects in Egypt (\$435,000) and South America (\$440,000). 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.

14. 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, 2002, 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.

15. Segmented information

The company operates in one industry segment 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, 2002 and the four month period ended December 31, 2001 is shown in the following tables:

December 31, 2002

	Oilfield Chemicals		Total Oilfield Chemicals	Additions (Eliminations)	Total Operations
	Canada	United States			
	\$	\$	\$	\$	\$
Revenues	36,270,819	1,140,550	37,411,369	-	37,411,369
Inter-segment revenues	-	1,420,494	1,420,494	(1,420,494)	-
	36,270,819	2,561,044	38,831,863	(1,420,494)	37,411,369
Depreciation	1,033,338	61,157	1,094,495	-	1,094,495
Interest on bank indebtedness	155,266	-	155,266	-	155,266
Interest on capital leases	41,157	-	41,157	-	41,157
Earnings from operations	2,276,255	342,259	2,618,514	(13,780)	2,604,734
Other income (expense)	43,133	(1,262)	41,871	(1,881)	39,990
Income taxes	627,700	121,861	749,561	-	749,561
Net earnings	1,691,688	219,136	1,910,824	(15,661)	1,895,163
Goodwill	6,049,530	-	6,049,530	-	6,049,530
Identifiable assets	49,703,351	1,702,964	51,406,315	(1,721,062)	49,685,253
Capital expenditures	11,152,981	-	11,152,981	-	11,152,981

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 and amortization	242,161	21,882	264,043	-	264,043
Interest on long-term debt and capital leases	135,808	-	135,808	-	135,808
Earnings (loss) 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 (recoverable)	638,000	(1,610)	636,390	-	636,390
Net earnings	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

Corporate Governance

Full disclosure with respect to the Toronto Stock Exchange Corporate Committee requirements is contained in the Information Circular of Enerchem International Inc., prepared for the Annual General Meeting to be held May 29, 2003.

The main corporate governance practices followed by Enerchem involve the assumption by the directors of responsibility for stewardship of the company. Enerchem's Board of Directors comprises five members, four of whom qualify as unrelated directors by virtue of their independence from management or any interest, business or other relationship that could materially interfere with the directors' ability to act in the best interests of the company. The Board of Directors has three committees being: the Audit Committee, the Compensation Committee and the Environmental Committee.

Enerchem is committed to the objectives of the corporate governance policy established by the Toronto Stock Exchange and will continue to work toward complying with the objectives set forth therein.

Directors

Larry B. Phillips	Director President and Chief Executive Officer (3)
Kenneth A. Klein	Director (1), (2)
David F. Potter	Director (1), (2)
Hugh L. Planche	Director (1), (2)
Fred Pheasey	Director (1), (2)

Officers

Larry B. Phillips	President and Chief Executive Officer (3)
J. Barrie Brookman	Vice President, Operations (3)
Brian M. Zubach, CMA	Chief Financial Officer Member of: (1) Audit Committee (2) Compensation Committee (3) Environmental Committee

Corporate Information

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Auditors

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Edmonton, Alberta

Investor Information

Stock Exchange Listing

Toronto Stock Exchange
Trading symbol "ECH"

United States - Over the Counter
12g-3-2(b)

Shareholder and Investor Relations

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