

CANBAIKAL RESOURCES INC.



1999

ANNUAL REPORT



CORPORATE PROFILE

CanBaikal Resources Inc. is a Canadian based oil and gas company operating in Russia. Its mission is to create wealth for shareholders by acquiring and producing large scale reserves of oil and gas in the prolific western Siberian basin in Russia.

CanBaikal's strengths lie in our close relationship with the major players in the Russian oil and gas industry and the government bodies which administer to it. We will use these strengths to both accelerate our entry into the production of our existing reserves as well as to add to our reserve base through tenders and commercial acquisitions.



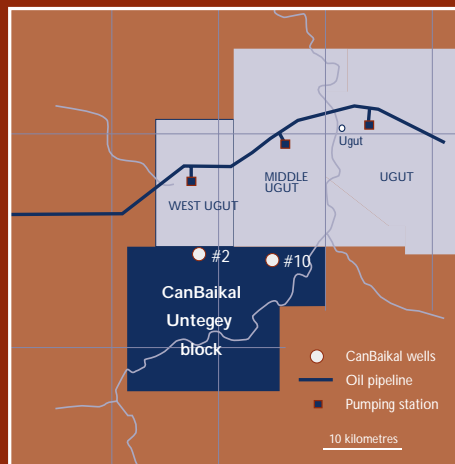
CanBaikal combines extensive senior management experience in the Russian oil and gas sector with Siberia's known enormous and relatively untapped reserves and an increasingly favourable operating environment. This unusual combination offers CanBaikal's investors a ground floor opportunity to participate in the emerging Russian oil and gas industry. CanBaikal's common stock trades on the Canadian Venture Exchange under the symbol "CBO".

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ANNUAL MEETING

The Annual Meeting of the Shareholders of CanBaikal Resources Inc. will be held at 3:00 p.m. on June 15, 2000 in the McMurray Room of the Calgary Petroleum Club, 319-5 Avenue S.W., Calgary, Alberta.



MESSAGE TO SHAREHOLDERS



1999

DEAR SHAREHOLDER:

Your Company has “Weathered the Storm” of the 1999 depressed world oil prices and has emerged having maintained our assets and the Company has remained debt-free. In late 1999, CanBaikal began to reinstate our original development plan for the 100% owned Block 146, the Untegey Block. We have been able to raise sufficient equity capital to execute a strategy of growth even though the large-scale capital markets were closed to Russian start-up oil projects in 1999. Our development program will now accelerate to meet our original objectives.

We are currently building a 28 km, 159mm diameter permanent pipeline and delivery system connected to our eastern Kulun pool and to our western Untegey pool. The scheduled completion of the pipeline in May 2000 will provide continuous production and cash flow from our current wells. Future wells may be connected to our delivery system as soon as they are completed, without significant delay between expenditure of drilling expense and receipt of revenue.

The Company was encouraged to build the pipeline by the positive results achieved by an oil company drilling immediately to the north of our Untegey Block. Their successful drilling program confirms the depositional model put forward by CanBaikal and we now believe that the risk of proving large scale reserves in the CanBaikal pools has been diminished which warranted the immediate construction of our pipeline and facilities.

CanBaikal plans to drill at least 2 wells into the Kulun pool in the coming winter of 2000 – 2001. Your management expects these wells to create a cash flow sufficient to self-fund a continuing drilling program.

Russia, as evidenced by the orderly succession of governments in the 2000 democratic presidential election, continues to demonstrate stability. CanBaikal has continued to be encouraged and supported by the various levels of Russian governments in 1999. The Company has been placed on the list of licenses eligible for a Production Sharing Agreement and has also been placed on the registry of operating Russian oil companies. These events ensure the orderly and continuing implementation of CanBaikal's development and production plan.

The Management and Directors of CanBaikal thank the staff and shareholders of the Company for their continued confidence. We believe that your Company will provide the increase in share value to meet your expectations.

Robert J. Bolton
Chairman and C.E.O.

OPERATIONS

1999



CanBaikal's operational activity mirrored the price trend for petroleum. The first nine months of the year were a period of low operations activity and low expenditures. With the resurgent oil prices, and subsequent investor interest in the oil industry, your management raised sufficient capital to re-initiate production from the Untegey Block. Our immediate strategy is to raise shareholder value through year round production and cash flow from our existing wells in order to then structure a larger financing under more favorable terms that will allow full development of the Block.

In the last quarter of 1999, CanBaikal moved quickly to reopen the Untegey Block and to build the infrastructure for future sustained production. The operational staff in Russia was enlarged with the addition of both Canadian and Russian staff.

In late 1999, construction began on our planned roads and Well #10 was brought onto production in February 2000, despite the abnormally warm weather conditions in December and January that delayed the road construction. Well #10 is capable of an initial production rate of 600 bbls per day. The Company also re-entered Well #2 to prepare it for production, which will begin in late 2000.

The Company has carried out the design and construction of a 28 km pipeline connecting wells #2, #10 and the main distribution pipeline. This pipeline will be completed in May 2000.

In the past year, CanBaikal's Untegey Block license was included in the list of licenses approved by the Regional Administration to be eligible for a Production Sharing Agreement. The Regional Administration is currently awaiting Russian Federal approval of this list that will ensure a stable fiscal regime for the life of the CanBaikal license. As well, on April 11, 2000 the Company was included in the formal list of Russian petroleum producing companies. This recognition ensures that CanBaikal may produce, access pipelines and transportation systems and sell oil on the internal Russian market or on the export market at its sole discretion and without recourse to Russian intermediaries or Joint Venture partners.

OIL RESERVES

The Company's oil reserves were evaluated, as at March 7, 2000 by the independent engineering firm of Gilbert Laustsen Jung Associates Ltd. (GLJ) and are summarized as follows:

| | Proved | Proved plus Probable | Proved plus Probable plus Possible |
|--|--------|----------------------|------------------------------------|
| Marketable Oil Reserves (000s barrels) | | | |
| Gross Company Interest (100%) | 5,518 | 19,806 | 67,729 |
| Gross after State Share | 5,229 | 14,293 | 41,608 |
| Present Value of Future net Cash Flow After Tax (million \$) | | | |
| Undiscounted | 49.6 | 143.3 | 437.2 |
| @ 10% | 30.3 | 99.2 | 251.9 |
| @ 15% | 24.4 | 85.0 | 200.2 |

The above reserves values are based on GLJ's January 1, 2000 forecasted prices, which assumes 25% of the production will be sold on the export market and the balance to the Russian domestic market. GLJ's forecasted Brent Blend crude oil price for 2000 is \$19.50 U.S./bbl. All reserve values are presented in Canadian dollars assuming a U.S. dollar to Canadian dollar conversion rate of 1.48. Although the Company produces natural gas in association with oil, the gas volumes are small and will be consumed locally in the treating facilities.

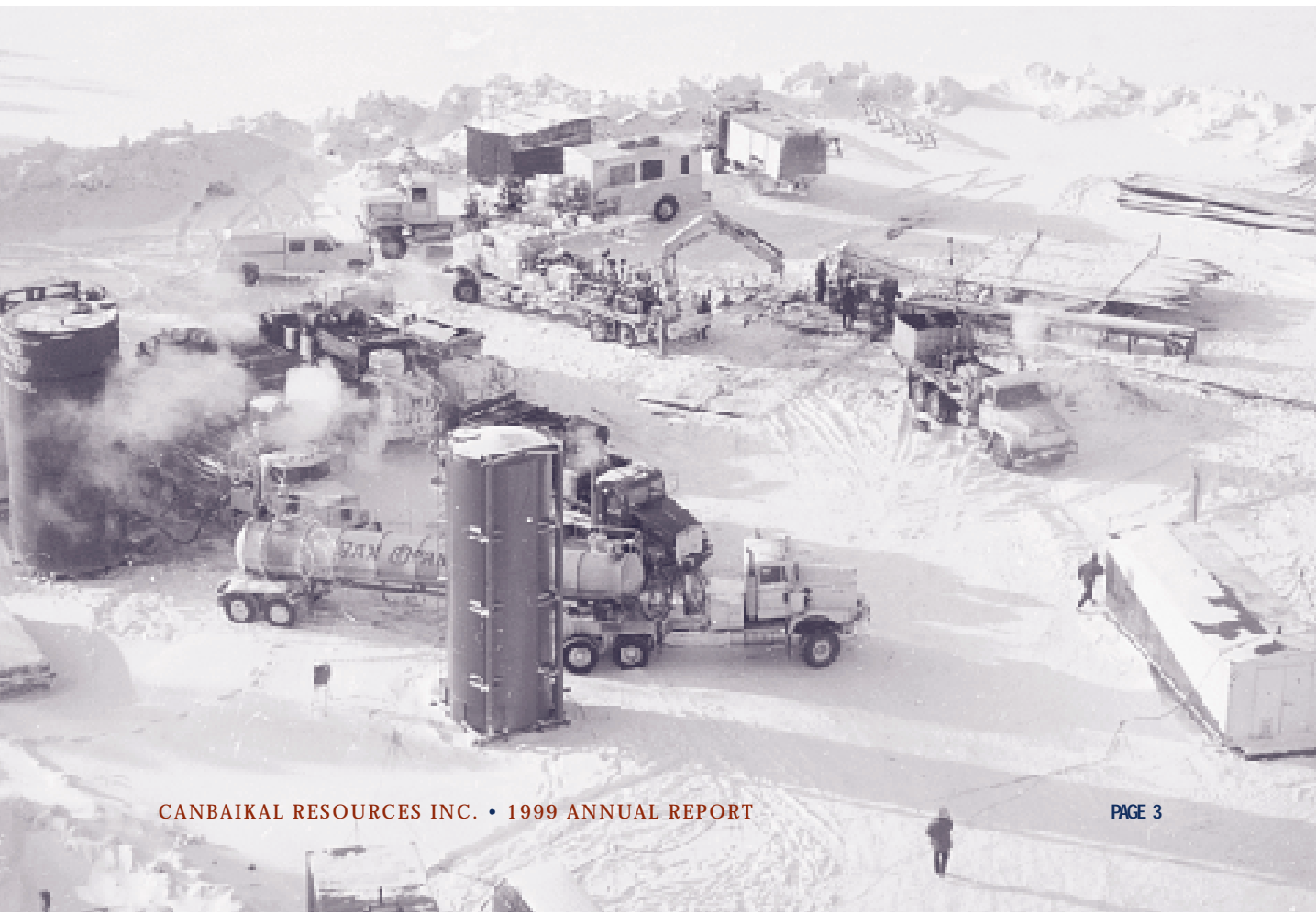


1999

RESERVE DEFINITIONS

Proven Reserves: Those reserves estimated as recoverable with a high degree of certainty under current technology. In the estimates that use constant price and cost analysis, the estimates are made using the existing economic conditions. In the estimates that use escalated price and cost analysis, the estimates are made using anticipated economic conditions. In both cases the Proven Reserves are extracted from that portion of the reservoir which can be reasonably evaluated as economically productive when analyzed using drilling, geological, geophysical and engineering data. Proven Reserves include the reserves obtained by enhanced recovery processes demonstrated to be economic and technically successful in the subject reservoir.

Probable Reserves: Those reserves, estimated by the analysis of drilling, geological, geophysical and engineering data, that do not meet the requirements for Proven Reserves, but where the analysis suggests the likelihood of their existence and future recovery under current technology and existing or anticipated economic conditions. Additional Probable Reserves may be estimated by the application of existing enhanced recovery processes that may be reasonably expected to be instituted in the future. These additional reserves are calculated as over and above those calculated by enhanced recovery in Proven Reserves.



MANAGEMENT'S DISCUSSION & ANALYSIS

1999



For most of 1999, CanBaikal was engaged in a program of conservation of capital while maintaining all aspects of our Untegey Block license through reporting and negotiating the rescheduling of planned operations. Several avenues to raise capital through debt, mergers or acquisition activities were investigated thoroughly. Early in 1999, a plan was instituted to merge CanBaikal with a producing Canadian company to combine conventional Canadian production with a large Russian reserve base that would be developed when the world oil markets regained stronger prices. CanBaikal did not complete this proposed alliance as fewer than 90% of the target companies common shares were tendered. During this process, Humboldt Capital Corporation lead by Robert Lamond became interested in the Company's Russian projects and made a significant investment into CanBaikal. As of December 31, 1999, Humboldt held 12.1% of the outstanding shares, and is the Company's largest single shareholder. Mr. Lamond joined the CanBaikal Board of Directors October 31, 1999, replacing Mr. Robert Niven, who resigned from the Board.

As world oil prices began to rise in the final quarter of 1999, and as financing became available, the Company reconstituted the original development plans for the Untegey Block. A private placement of \$230,000 was completed in November and was utilized in the beginning of this development process. A second private placement of \$1,250,000 was completed in late January 2000, which was used to build roads and to construct a pipeline to allow year round production. The pipeline is expected to be completed in May 2000.

REVENUES

In 1999 the Company's revenues consisted of interest revenue of \$7,684 and a loss on currency exchanges of \$12,802. Oil sales from well #10 commenced on February 17, 2000.

EXPENSES

1999 Expenses (excluding depreciation and depletion) realized a decrease from 1998 of 56%. The major decreases were in Salaries (\$193,733), General and administrative (\$195,086) and Rent (\$98,284). All of these decreases are a result of the Companies austerity program implemented in 1999 in response to a prolonged oil price depression.

CAPITAL EXPENDITURES

CanBaikal incurred capital expenditures of \$254,119. Of this, the petroleum and natural gas (P&NG) expenses were \$145,044, deferred financing charges were \$94,745, leasehold improvements and fixed assets \$14,330.

CAPITAL RESOURCES

In November 1999, a \$230,000 equity placement to the Directors of the Company reinitiated the Untegey Block development program. A further \$1,250,000 public equity financing occurred in January 2000, with the Company's Directors and close associates taking 31% of this placement. The funds raised are being used for the capital and operational development of the Untegey Block and for future business projects in Russia. It is expected that future cash flows from the sale of oil will allow the Company to continue with a modest program of development. The management and Directors believe that the price of oil will continue to be satisfactory in 2000 and that market conditions will strengthen, which will allow a more aggressive approach to raising new capital and rapid development of production facilities.



1999

NET ASSETS VALUE PER SHARE

CanBaikal's net assets value per share, based upon Proven plus Probable reserves as calculated by Gilbert Laustsen Jung Associates Ltd. on March 7, 2000 are as follows:

(000s, except share data)

| | | |
|---|----|------------|
| Reserve value | | |
| NPV Proved plus Probable @ 15 % after tax | \$ | 84,952 |
| Working Capital @ December 31, 1999 | | 145 |
| Undeveloped Land | | 1,000 |
| Total Asset Value | \$ | 86,097 |
| Basic Shares Outstanding | | 15,047,731 |
| Fully Diluted Shares Outstanding | | 15,243,951 |
| Basic Asset Value per share | \$ | 5.72 |
| Fully Diluted Asset Value per share | \$ | 5.65 |

BUSINESS RISK

The Company's operations are currently based entirely in Russia. The political situation, income tax legislation, banking regulations and general operating environment are changing continuously as Russia makes the transition from a command to a market oriented economy. The Company's operations and financial position will continue to be affected by Russian political developments, including the application and interpretation of existing and future legislation and regulations pertaining to production, imports, exports, oil and natural gas and income tax. Management is continuously monitoring potential developments and adjusting to changes as they occur. The senior management team at CanBaikal is confident that the political and economic environment in Russia today is viable for economic operations and will only improve over time.

OUTLOOK

As always in a cyclical resource industry, one must take a long enough view to incorporate both the highs and lows of the cycle. Your management believes that the petroleum pricing low at the beginning of 1999 is behind us for a few years and the highs at the end of 1999 are more reflective of the value of the reserve base. The Russian political situation is stabilizing and both Russian federal and provincial legislation in 1999 is designed to encourage investment in the petroleum sector.

It is our intention to use all the resources at our disposal to acquire the capital required to initiate sustained commercial production of the Untegey Block and to acquire additional reserves while the current market is favorable. We have continuing plans to enlarge the current reserve base and to form strategic alliances with other companies interested in the development of the western Siberian basin.

MANAGEMENT'S REPORT

To the Shareholders of CanBaikal Resources Inc.:

Management is responsible for the integrity and objectivity of the information contained in the accompanying financial statements and other financial and operational data contained elsewhere in the report. The accompanying financial statements have been prepared by management in accordance with accounting principles generally accepted in Canada using estimates and careful judgement, particularly in those circumstances where transactions affecting a current period are dependent upon future events. The accompanying financial statements have been prepared using policies and procedures established by management and reflect fairly CanBaikal's financial position, results of operations and cash flow, within the framework of the accounting policies in the notes to the financial statements.

Management has established and maintains a system of internal control designed to provide reasonable assurance that assets in Canada and Russia are safeguarded from loss or unauthorized use and that the financial information is reliable and accurate.

Grant Thornton LLP, the independent auditors appointed by the shareholders, have audited the Company's financial statements in accordance with generally accepted auditing standards and their report follows. Their examination provides an independent view as to management's responsibilities insofar as they relate to the fairness of reported operating results and financial position of CanBaikal.

The Audit Committee of the Board of Directors has reviewed the financial statements with management and the external auditors. The Board of Directors has approved the financial statements on the recommendation of the Audit Committee.



Robert J. Bolton
Chairman and Chief Executive Officer
May 1, 2000



John W. McGruther
Controller

AUDITORS' REPORT

To the Shareholders of CanBaikal Resources Inc.:

We have audited the balance sheets of CanBaikal Resources Inc. as at December 31, 1999 and 1998 and the statements of operations and deficit and cash flow for each of the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 1999 and 1998 and the results of its operations and its cash flow for each of the years then ended in accordance with generally accepted accounting principles.



Grant Thornton LLP
Chartered Accountants

Calgary, Alberta
February 17, 2000

BALANCE SHEETS

As at December 31,



| | 1999 | 1998 |
|---|------------------|------------------|
| ASSETS | | |
| Current Assets | | |
| Cash and cash equivalents | \$ 177,723 | \$ 463,669 |
| Accounts receivable | 24,864 | 21,663 |
| | <hr/> 202,587 | <hr/> 485,332 |
| Deferred financing charges (Note 3) | 94,745 | – |
| Fixed assets (Note 4) | 160,921 | 197,371 |
| Petroleum and natural gas properties (Note 5) | 145,044 | – |
| | <hr/> \$ 603,297 | <hr/> \$ 682,703 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Accounts payable and accrued liabilities | \$ 58,248 | \$ 691 |
| Subscriptions payable (Note 6) | 200,200 | – |
| | <hr/> 258,448 | <hr/> 691 |
| Shareholders' Equity | | |
| Capital stock (Note 6) | 7,034,982 | 6,822,086 |
| Deficit | (6,690,133) | (6,140,074) |
| | <hr/> 344,849 | <hr/> 682,012 |
| | <hr/> \$ 603,297 | <hr/> \$ 682,703 |

Commitments and contingencies (Note 8)

See accompanying notes to the financial statements

On behalf of the Board

Director

Director

STATEMENT OF OPERATIONS AND DEFICIT

For the years ended December 31,



| | 1999 | 1998 |
|------------------------------------|-----------------------|-----------------------|
| REVENUE | | |
| Interest and foreign exchange, net | \$ (5,118) | \$ 78,003 |
| EXPENSES | | |
| Consulting fees | 21,902 | 35,482 |
| Corporate financing | 26,573 | 299,144 |
| Depreciation | 50,780 | 4,490,301 |
| General and administrative | 89,786 | 284,872 |
| Professional fees | 71,425 | 27,728 |
| Rent | 96,142 | 194,426 |
| Salaries and wages | 177,037 | 370,770 |
| Travel | 11,296 | 37,677 |
| | 544,941 | 5,740,400 |
| Net Loss | (550,059) | (5,662,397) |
| Deficit, Beginning of Year | (6,140,074) | (477,677) |
| Deficit, End of Year | \$ (6,690,133) | \$ (6,140,074) |
| Basic Loss per Share | \$ (0.04) | \$ (0.40) |
| Weighted Average Number of Shares | 14,135,101 | 14,046,930 |

See accompanying notes to the financial statements

STATEMENT OF CASH FLOW

For the years ended December 31,



| | 1999 | 1998 |
|---|-------------------|--------------------|
| Operating Activities | | |
| Net Loss | \$ (550,059) | \$ (5,662,397) |
| Depreciation | 50,780 | 4,490,301 |
| Deferred financing charges | – | 205,732 |
| | (499,279) | (966,364) |
| Change in non-cash operating working capital items | 46,357 | (30,625) |
| Cash flow used in operating activities | (452,922) | (996,989) |
| Investing Activities | | |
| Additions to petroleum and natural gas properties | (145,044) | (1,877,629) |
| Acquisition of fixed assets | (14,330) | (136,017) |
| Cash flow used in investing activities | (159,374) | (2,013,646) |
| Financing Activities | | |
| Issue of convertible debentures, net of issue costs | 212,896 | 11,500 |
| Deferred financing charges | (94,745) | – |
| Subscriptions payable | 200,200 | – |
| Change in non-cash working capital items | 7,999 | – |
| Cash flow from financing activities | 326,350 | 11,500 |
| Net Change in Cash | (285,946) | (2,999,135) |
| Cash and Cash Equivalents, Beginning of Year | 463,669 | 3,462,804 |
| Cash and Cash Equivalents, End of Year | \$ 177,723 | \$ 463,669 |
| Operating Cash Flow per share | \$ (0.04) | \$ (0.07) |

See accompanying notes to the financial statements

NOTES TO THE FINANCIAL STATEMENTS

December 31, 1999

1. Nature of operations and business risks

The Company was incorporated August 14, 1996 and is engaged primarily in the exploration for and development of petroleum and natural gas in Russia. Since inception, the efforts of the Company have been devoted to the acquisition of exploration and production licenses and the development thereof. To date, the Company has not earned revenue from these operations and is considered to be in the development stage. The costs incurred to date in respect to the acquisition of the licenses and development thereon, are recognized in these financial statements in accordance with the accounting policies outlined in Note 2 and do not necessarily reflect present or future values. The recoverability of these amounts is uncertain and dependent upon achieving commercial production or sale, the ability of the Company to obtain additional financing to complete their development and upon future profitable operations.

The Company's petroleum and natural gas operations are currently based entirely in Russia. The political situation, income tax legislation, banking regulations and the general operating environment are changing continuously as Russia makes the transition from a command to a market orientated economy. The Company's operations and financial position will continue to be affected by Russian political developments including the application and interpretation of existing and future legislation and regulations pertaining to petroleum and natural gas exploration and production, imports, exports and income tax. It is possible that these developments may have a significant impact on the Company's ability to continue operations. The likelihood of such developments is not determinable. Management is continuously monitoring potential developments and changes as they occur.

2. Summary of significant accounting policies

Basis of presentation

The financial statements relating to the comparative year include the accounts of the Company and its wholly owned subsidiary, PolarQuest Petroleum Corporation (PolarQuest). In 1999, PolarQuest was wound up into the Company under Section 88(1) of the Income Tax Act. PolarQuest was then immediately dissolved.

Use of estimates

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

Depreciation

Depreciation of fixed assets is computed using the declining balance method at the rates indicated in Note 4. In the year of acquisition only one-half of the normal depreciation is recorded.

Petroleum and natural gas properties and depletion

The Company follows the full cost method of accounting for its petroleum and natural gas operations. Under this method all costs related to the exploration for and development of petroleum and natural gas reserves are capitalized. Costs include lease acquisition costs, geological and geophysical expenses, overhead directly related to acquisition, exploration and development activities and costs of drilling both productive and non-productive wells. Proceeds from the sale of properties are applied against capitalized costs, without any gain or loss being realized, unless such sale would significantly alter the rate of depletion and depreciation.

Upon the commencement of economic production quantities, depletion will be provided based upon estimated proved petroleum and natural gas reserves using the unit of production method.

In applying the full cost method, the Company calculates a ceiling test whereby the carrying value of petroleum and natural gas properties and production equipment, net of recorded deferred income taxes and the accumulated provision for site restoration and abandonment costs, is compared annually to an estimate of future net cash flows from the production of proved reserves. Net cash flow is estimated using year-end prices, less estimated future general and administrative expenses, financing costs and income taxes. Should this comparison indicate an excess carrying value, the excess is charged against earnings as additional depletion and depreciation.

Financial instruments

The Company has estimated the fair value of its financial instruments, which include cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, and subscriptions payable. The Company has used valuation methodologies and market information available as at year-end and has determined that the carrying amounts of such financial instruments approximate fair value in all cases.

Future site restoration and abandonment costs

Estimated future costs relating to site restorations and abandonments will be provided for over the life of proved reserves on a unit of production basis.

Costs will be estimated, net of expected recoveries, based upon Russian legislation, technologies and industry standards. The annual provision will be recorded as additional depletion.

Foreign currency translation

Accounts denominated in foreign currency are translated into Canadian dollars using the year-end rate of exchange for monetary assets and liabilities and the rate of exchange in place on the transaction date for non-monetary assets and liabilities and revenues and expenses. Foreign currency gains and losses are charged to operations.

Cash and cash equivalents

Cash and cash equivalents consist of cash on hand, balances with banks and investments in term deposits.

3. Deferred financing charges

The deferred charges incurred during the year relate to costs associated with future financing efforts. If a financing offering is successful these costs will be allocated to the cost of the offering. If a financing offer is not successful these costs will be expensed.

4. Fixed assets

| | % Rate | Cost | 1999 Accumulated Depreciation | 1999 Net Book Value | 1998 Net Book Value |
|---------------------------------|--------|------------|-------------------------------------|---------------------------|---------------------------|
| Computer hardware | 30 | \$ 74,507 | \$ 39,899 | \$ 34,608 | \$ 47,773 |
| Computer software | 100 | 2,136 | 2,136 | – | 45 |
| Office equipment and Leaseholds | 20 | 130,058 | 42,183 | 87,875 | 94,642 |
| Vehicles | 30 | 69,322 | 30,884 | 38,438 | 54,911 |
| | | \$ 276,023 | \$ 115,102 | \$ 160,921 | \$ 197,371 |

5. Petroleum and natural gas properties

| | 1999 | 1998 |
|-------------------------------------|------------|--------------|
| Capitalized costs | \$ 145,044 | \$ 4,440,987 |
| Accumulated depletion and writedown | – | (4,440,987) |
| | \$ 145,044 | \$ – |

During the year, \$145,044 (\$884,538 in 1998) of overhead expenses directly related to exploration and development activities were capitalized. Total anticipated costs for site restoration and abandonment for the Russian properties as at December 31, 1999 are approximately \$100,000.

6. Capital stock

Authorized:

Unlimited common shares, without par value

Unlimited preferred shares, issuable in series

Issued and outstanding common shares:

| | 1999 | | 1998 | |
|---|------------|--------------|------------|--------------|
| | Number | Amount | Number | Amount |
| Balance, beginning of year | 14,047,401 | \$ 6,822,086 | 14,038,151 | \$ 6,810,586 |
| Rights offering exercised | – | – | 5,500 | 5,500 |
| Warrants exercised for cash | – | – | 3,750 | 6,000 |
| Convertible debentures exercised, net of issue costs | 1,000,330 | 212,896 | – | – |
| Balance, end of year | 15,047,731 | \$ 7,034,982 | 14,047,401 | \$ 6,822,086 |

1999

On November 30, 1999 the Company issued 1,000,330 common shares and 500,165 purchase warrants upon conversion of outstanding convertible debentures. These purchase warrants are convertible to 250,082 common shares at \$0.28 per common share and are held in escrow until November 30, 2000.

As at December 31, 1999 1,063,654 issued common shares are held in escrow. The escrow agreement provides for the release of one-third of the common shares on each of the first three anniversaries of the prospectus issued on June 16, 1997.

As at December 31, 1999 cash in the amount of \$200,200 relating to the January 28, 2000 private placement was received in advance of common shares being issued (See also Note 12).

Stock Options

On June 24, 1997 the Company adopted a stock option plan available to officers, directors and employees of the Company and to key consultants and contractors. The options are exercisable up to five years from the date of granting. The following is the distribution of outstanding vested stock options:

| Date of expiry | Number of Shares | Option price |
|----------------|------------------|--------------|
| December 2002 | 540,000 | \$ 1.00 |
| July 2002 | 200,000 | \$ 1.31 |
| March 2003 | 50,000 | \$ 1.30 |
| November 2003 | 275,000 | \$ 0.16 |

A total of 1,065,000 common shares (December 31, 1998 – 1,365,000) have been reserved for these options. During the year, 300,000 previously granted stock options were cancelled.

7. Income taxes

a) The Company is required to file tax returns in each of the jurisdictions in which it operates. The prime operating jurisdictions are Canada and Russia.

The Company has incurred losses for Canadian income tax purposes of approximately \$2,389,622, the related benefit of which has not been recognized in the financial statements. Unless sufficient taxable income is earned these losses will expire as follows:

| | | |
|------|----|------------------|
| 2003 | \$ | 31,359 |
| 2004 | \$ | 566,311 |
| 2005 | \$ | 1,127,295 |
| 2006 | \$ | 664,657 |
| | \$ | <u>2,389,622</u> |

b) The Company has available the following amounts which may be deducted, at the annual rates indicated, in determining taxable income for Canadian income tax purposes of future years:

| | | 1999 | 1998 |
|---|-------------|--------------|--------------|
| Undepreciated capital costs | 30% to 100% | \$ 326,000 | \$ 310,703 |
| Foreign exploration and development expense | 10% | \$ 4,271,000 | \$ 4,183,089 |
| Cumulative eligible capital | 7% | \$ 14,300 | \$ 15,363 |
| Financing and share issue costs | 20% | \$ 336,000 | \$ 482,560 |

8. Commitments and contingencies

a) Within the first five years of the term of the exploration and production license, the Company must achieve certain targets for seismic exploration and evaluation and has planned to drill at least two wells by the end of 2000. Under the license, the taxes and payments required to be paid by the Company include: 1% of estimated exploration evaluation costs; 3% of the estimated exploration costs for delineation wells; 7% of the value of production; and other taxes stipulated by the authorities.

b) On January 30, 1998 the Company entered into a rental agreement for office premises. The office lease expires on February 28, 2003. The future estimated operating and rental costs are as follows:

| | | |
|------|----|---------|
| 2000 | \$ | 85,000 |
| 2001 | \$ | 217,000 |
| 2002 | \$ | 217,000 |
| 2003 | \$ | 36,000 |

9. Segmented disclosures

The Company's petroleum and natural gas exploration and development activities are conducted in Canada and Russia. Management of the Company considers the operations of the Company as one operating segment. The following information relates to the Company's geographic areas of operation:

| | 1999 | | 1998 | |
|--------|------------|------------|-----------|------------|
| | Revenue | Assets* | Revenue | Assets* |
| Canada | \$ (5,118) | \$ 95,892 | \$ 78,003 | \$ 114,967 |
| Russia | \$ - | \$ 210,073 | \$ - | \$ 82,404 |
| | \$ (5,118) | \$ 305,965 | \$ 78,003 | \$ 197,371 |

* Includes fixed assets and petroleum and natural gas properties.

10. Loss and operating cash flow per share

Loss and operating cash flow per share have been calculated using the weighted average number of shares outstanding for the year. Outstanding stock options and warrants have no dilutive effect on loss and cash flow per share.

11. Comparative figures

Certain of the 1998 comparative figures have been reclassified in order to conform to the presentation adopted in the current year.

12. Subsequent events

On January 28, 2000 the Company closed a fully subscribed private placement sale of 4,166,667 common shares at \$0.30 per common share for a net proceeds of \$1,145,311, after deducting \$70,689 share issue costs, \$14,000 legal fees and the \$20,000 agency working fee. Directors, officers and associates of the Company purchased approximately 30% of the issue. The shares will be held in escrow until May 28, 2000.

On February 9, 2000 the Company issued 760,000 stock options to directors, officers and employees at \$0.37 per common share.

CORPORATE INFORMATION

MANAGEMENT

Robert J. Bolton
Chairman and C.E.O.

Alexander A. Borissov
Vice-President, Business Development

John W. McGruther
Controller

Robert James
Corporate Secretary

DIRECTORS

Daryl E. Birnie
Director

Robert J. Bolton
Chairman and C.E.O.

Fred C. Coles
Director

Kevin Flaherty
Director

H. Douglas Hunter
Director

Robert W. Lamond
Director

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RUSSIAN OFFICE

Nefteyugansk, Russia

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