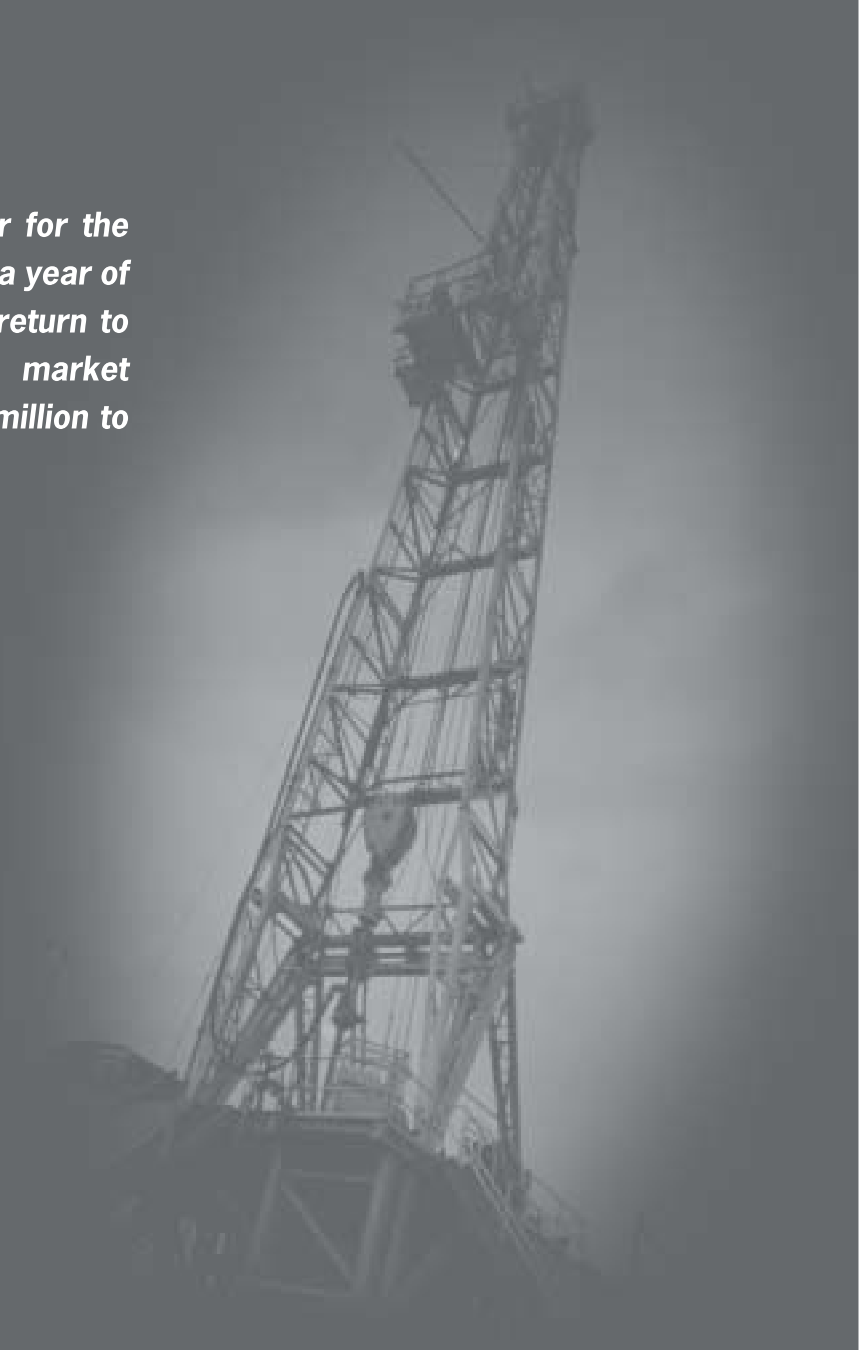
# AVENIR DIVERSIFIED INCOME TRUST

ANNUAL REPORT 2003

*"2003 was a very successful first year for the Avenir Diversified Income Trust. It was a year of growth as the Trust delivered a 60% return to shareholders and grew the Trust in market capitalization from approximately $4 million to $24 million."*



## 2003 FINANCIAL HIGHLIGHTS

| | Three months ended Dec. 31 | | Year Ended Dec. 31[1] | |
|---|---|---|---|---|
| For the periods ended | 2003 | 2002 | 2003 | 2002 |
| FINANCIAL | | | | |
| Gross Revenue | $2,079,584 | $112,911 | $5,219,610 | $187,211 |
| Net Revenue | $1,730,350 | $112,911 | $4,455,418 | $187,211 |
| Cash Flow From Operations[2] | $853,418 | $174,780 | $2,362,525 | ($70,889) |
| Cash Flow Per Unit[2] - Basic | $0.02 | $0.02 | $0.09 | ($0.01) |
| Distributions | $725,892 | — | $1,853,871 | — |
| Distributions Per Unit - Basic | $0.018 | — | $0.045 | — |
| Distribution Payout Ratio | — | — | 78% | — |
| % of Distributions Taxed as Income | — | — | 68% | — |
| Net Earnings (loss) | ($116,403) | $174,780 | $519,180 | ($70,889) |
| Net Earnings (loss) Per Unit - Basic | ($0.00) | $0.02 | $0.02 | ($0.01) |
| Total Assets | $21,301,243 | $2,028,316 | $21,301,243 | $2,028,316 |
| Net Debt[2] | $4,241,206 | | $4,241,206 | |
| Wtd. Avg. Common Shares Outstanding | 41,503,282 | 8,000,000 | 27,621,558 | 7,342,468 |
| Common Shares Outstanding at YE | 41,503,282 | 8,000,000 | 41,503,282 | 8,000,000 |
| OPERATING | | | | |
| Production (6:1) | | | | |
| Oil and NGL's – bbls per day | 299 | — | 239 | — |
| Gas – mcf per day | 2,009 | — | 767 | — |
| Total BOE per day | 634 | — | 367 | — |
| Average Pricing | | | | |
| Oil & NGL ($/Bbl) before hedging | $33.95 | — | $36.19 | — |
| Oil & NGL ($/Bbl) after hedging | $32.21 | — | $35.08 | — |
| Natural Gas ($/mcf) | $5.34 | — | $5.97 | — |
| Average Price Per BOE before hedging | $33.55 | — | $36.35 | — |
| Average Price Per BOE after hedging | $32.73 | — | $35.62 | — |
| Gross Reserves (Proved plus Probable 6:1) | | | | |
| Natural Gas (Mmcf) | — | — | 4,375.5 | — |
| Oil & NGL (Mbbl) | — | — | 730.0 | — |

1 Trust was created January 16, 2003. 2002 comparatives are those of 928719 Alberta Ltd.

2 Cash flow from operations, cash flow per unit, and net debt are not recognized measures under Canadian generally accepted accounting principles (GAAP). Cash flow from operations is calculated by taking net earnings and adding back non-cash balances such as depletion and depreciation, site restoration and abandonment, gain on sale of investments, compensation expense and unsuccessful acquisition and re-organizational costs. Net debt is calculated by taking current assets less current liabilities. Management believes that these measures are useful supplemental measures to analyze operating performance and provide an indication of the results generated by the Trust's principal business activities. Avenir Diversified Income Trust's method of calculating these measures may differ from other companies, and accordingly, they may not be comparable to measures used by other companies.

### Forward Looking Statements

Except for historical financial information contained herein, the matters discussed in this document may be considered forward-looking statements. Such statements include declarations regarding management's intent, belief or current expectations. Prospective investors are cautioned that any such forward-looking statements are not guarantees of future performance and involve a number of risks and uncertainties; actual results could differ materially from those indicated by such forward-looking statements. Among the important factors that could cause actual results to differ materially from those indicated by such forward-looking statements are: (i) that the information is of a preliminary nature and may be subject to further adjustment, (ii) the possible unavailability of financing, (iii) risks related to the exploration and development of oil and gas properties, (iv) the impact of price fluctuations and the demand and pricing for oil and natural gas, (v) the seasonal nature of the business, (vi) start-up risks, (vii) general operating risks, (viii) dependence on third parties, (ix) changes in government regulation, (x) the effects of competition, (xi) dependence on senior management, (xii) financial condition of real estate tenants and financial services counter parts, (xiii) impact of Canadian economic conditions or the demand for real estate leasing opportunities, (xiv) fluctuations in currency exchange rates and interest rates.

## PRESIDENT'S MESSAGE

2003 was a very successful first year for the Avenir Diversified Income Trust. From the Trust's inception in January 2003 to the year-ended December 31, 2003, the Trust delivered a 61% return to unit holders, including $0.18 per unit capital appreciation and $0.063 per unit in distributions paid. Distributions were increased twice for a total of 30% and represented 78% of the cash flow for the year.

It was a year of growth. The market capitalization of the Trust grew from approximately $4 million to $24.0 million by the end of December 2003. The units outstanding increased through two private placement financings, one that closed in January and February 2003 at a price of $0.40 per unit for proceeds of $4.5 million and the second, which closed in September 2003 at a price of $0.50 per unit for proceeds of $8.0 million. In addition, two acquisitions, Outback Energy Ltd. and 728409 Alberta Ltd were completed with units issued from treasury.

The Trust's strategy is to have three distinct business units: Oil and Gas, Financial Services, and Real Estate. The Trust combines the stability of cash flows from both real estate and financial services with a more volatile cash flow stream from oil and gas production. The Trust's first real estate assets were purchased March 31, 2004.

Highlights from 2003 include:

- The completion of two equity financings;
- The completion of approximately $15.7 million in oil and gas acquisitions;
- The completion of $3.2 million in financial services contracts;
- A signed letter of intent for the Trust's first real estate acquisition;
- Two increases in distributions during the year; and
- A positive reserve revision with the implementation of NI 51-101.

Looking ahead to 2004, we continue to see and evaluate opportunities in all three segments of our Trust. With the closing of the Western Spirit Investments Ltd. real estate acquisition, we have filled out our business plan and are well positioned to add to each piece of our Trust. As we add to our oil and gas production, we will continue to implement a strategic commodity hedging program for a portion of our production, that will allow us to protect ourselves from any price weakening but still afford us the opportunity to participate in any continuing commodity appreciation. We are comfortable that with the deal flow we expect to grow our Trust both in size, to increase liquidity and market following, and in distributions, as we have demonstrated since our inception.

We would like to acknowledge Rick Tanner, founder and president of Western Spirit. Sadly, Rick passed away early in 2004 and unfortunately was unable to see the completion of the Western Spirit / Avenir transaction. Rick was a first class individual and Gary and I were privileged to have known Rick both personally and professionally. I would also like to thank Randy Holt and his entire team who worked through this difficult time to complete the transaction.

In closing, I would like to express my sincere appreciation to our employees and consultants for their tireless efforts, to our Board of Directors and our Advisors for their guidance and experience and to our stakeholders for their continued belief in us as we move forward with our plan. I am looking forward to a great 2004.

On behalf of management and the Board of Directors,

William M. Gallacher
President & CEO

## FINANCIAL REVIEW

Cash flow from operations increased in the fourth quarter to $853,418 or $0.02 per unit up 60% over the third quarter. The increase in cash flow was due primarily to the natural gas acquisitions made in the late third and early fourth quarters. For the year ended December 31, 2003 the cash flow from operations totaled $2,362,525 or $0.09 per unit.

The Trust distributed $725,892 or $0.018 per unit to unitholders in the fourth quarter and distributed $1,853,871 for the year ended December 31, 2003. The year-end distribution payout ratio of 78% was in line with the Trust's target ratio. Of the distributions paid, 68% of the amount was classified as taxable income and 32% was tax deferred (return of capital).

The Trust recorded a net loss of $116,403 for the fourth quarter and earnings of $519,180 or $0.02 per unit for the year ended December 31, 2003. The fourth quarter earnings were reduced by $119,868 as a result of the early adoption of the stock based compensation rules that come into effect January 1, 2004. In addition, higher year end audit, accounting legal and reserve evaluation costs associated with the Trust's first year of operation negatively impacted fourth quarter earnings and cash flow.

Avenir Operating Corp.
Location of Major Properties


## OIL & GAS OPERATIONS REVIEW

Operationally, the Oil and Gas business unit had a busy year growing through acquisition and development with production increasing from 246 barrels of oil equivalent per day (BOE/d) at the end of the first quarter to 634 BOE/d at the end of the fourth quarter. Operating costs were reduced by 21% from $9.51 per BOE in the first quarter to $7.48 per BOE in the fourth quarter as the Trust targeted acquisitions with lower cost structures. The Trust drilled five wells in 2003: three oil wells, one gas well and a water disposal well and farmed out two oil wells in southeast Saskatchewan at no cost to the Trust.

Current production is approximately 630 BOE/d split 60% natural gas and 40% oil and liquids. The major properties of the Corporation are as follows:

### Mills/Grouse Properties, Alberta

The Mills and Grouse properties are located 170 kilometres south of Fort McMurray. These properties were acquired by the Trust, effective October 24, 2003. The properties consist of 13,450 acres of developed land and 15,500 acres of undeveloped land. For the year ended December 31, 2003, the Trust's annualized share of production for the Mills and Grouse properties was 260 mcf/d of natural gas. Since the date of the acquisition, the properties have averaged 1,390 mcf/d. All production is from shallow, sandstone reservoirs occurring at depths between 250 and 500 metres. During the first quarter of 2004, the Trust has selectively participated in low risk drilling and re-completion opportunities that the various operators have identified.

### Cherhill Property, Alberta

The Cherhill property is located 80 kilometres northwest of Edmonton. The property consists of 3 (3 net) Banff oil wells that produce a medium gravity sour crude from the Banff formation at a depth of 1,350 metres. The Trust operates all of the Cherhill oil wells. The Trust has interests in 1,920 acres of developed land (net acres). For the year ended December 31, 2003, the Trust's annualized share of production for the Cherhill property was 33 bpd of crude oil and 95 mcf/d of natural gas.

### Weyburn Property, Saskatchewan

The Weyburn property is located 115 kilometres southeast of Regina. The property consists of 13 (4.3 net) producing oil wells and one injecting well (0.3 net) situated on 1,120 gross acres (400 net acres) of developed land. The Weyburn wells produce light quality sweet crude from the Midale formation at a depth of 1,300 metres. For the year ended December 31, 2003, the Trust's annualized share of production for the Weyburn property was 41 bpd of crude oil. The Trust plans to drill one (0.5 net) Midale horizontal oil well on the Weyburn property in the second half of 2004.

### Calmar Property, Alberta

The Calmar property is located 38 kilometres southwest of Edmonton. The Trust acquired the Calmar property as part of an acquisition of a private oil and gas company effective September 24, 2003. The property consists of 2 (2 net) producing gas wells situated on 1,280 acres (net acres) of developed land. The Calmar wells produce sweet gas from the Cardium formation. For the year ended December 31, 2003, the Trust's annualized share of production from the Calmar property was 87 mcf/d. Since the date of the acquisition the property has averaged 343 mcf/d.

**Carrot Creek Property, Alberta**

The Carrot Creek property is located 150 kilometres west of Edmonton. The Trust acquired the Carrot Creek property effective December 31, 2003. The property consists of an 18.05% interest in the Carrot Creek South D Unit, a 2.3% interest in the Carrot Creek D Pool Unit and royalty interests in three gas wells. Total producing wells are 9 (1 net), 6 (0.6 net) injecting wells. Oil production is from the Cardium sand at a depth of 1,600 metres. Both of the Units are under water flood and, in addition, the Cardium D pool Unit has a gas re-injection scheme. The Cardium crude is a light (40 API) sweet crude.

For the year ended December 31, 2003 (prior to the acquisition) the Trusts Carrot Creek interests had total net production of 24 bpd crude oil and natural gas liquids and 30 mcf/d of natural gas. The Carrot Creek property covers 5,280 acres of developed land (163 net acres).

**Bow Island Property, Alberta**

The Bow Island property is located 200 kilometres southeast of Calgary. The Trust acquired interests in the Bow Island area through the Onward and Outback acquisitions. The property consists of interests varying from 10.0% to 32.71%. The Bow Island wells produce a medium gravity crude (26 API) from the Sawtooth F Pool at a depth of 1,100 metres.

In the Bow Island property, the Trust has interests in 14 producing wells (3.4 net), 1 injecting well (0.3 net) and 3 suspended wells (0.8 net). For the year ended December 31, 2003, the Trust's annualized share of production for the Bow Island property was 47 bpd of crude oil.

In 2003, the Trust participated in the drilling of 3 successful oil wells and one water injection well. All of the wells were targeting the Sawtooth F pool. The water injection well has the objective of supplying pressure support to the oil pool while increasing oil recovery. The water injector, in conjunction with a recent battery expansion, will enable the operating costs to be reduced as well.

**Pembina Property, Alberta**

The Pembina property is located 90 kilometres west of Edmonton. The Trust acquired interests in the Pembina property as part of an acquisition of a private company effective September 24, 2003. The property consists of a single gas well that the Trust has a 100% interest in. The well produces gas from the Ostracod zone at a depth of 1,800 metres.

For the year ended December 31, 2003, the Trust's annualized share of production for the Pembina property was 56 mcf/d of natural gas and 1 bpd of natural gas liquids. Since the date of the acquisition the property has averaged 167 mcf/d and 4 bpd of liquids.

**Reserves Summary**

The Trust's oil and gas reserves as at December 31, 2003 were evaluated by McDaniel & Associates Ltd. McDaniel was appointed by the Board of Directors of Avenir in 2003 as the independent reserves evaluators for all of Avenir's oil and gas properties. Their evaluation report is prepared in accordance with National Instrument ("NI") 51-101, the new standards of disclosure for oil and gas activities as mandated by the Canadian Securities Administrators for year-ends beginning with December 31, 2003.

NI 51-101 replaces the former National Policy 2-B ("NP 2-B") and requires a higher degree of confidence in the assignment of oil and gas reserves. Under NI 51-101, proved reserves are defined to have a 90% probability that the actual reserves recovered will equal or exceed the assigned estimates compared to the previous definition of "reasonable certainty" as stipulated by NP 2-B. Also, under NI 51-101, probable reserves are defined to have a 50% probability that the actual reserves recovered will equal or exceed the assigned estimates compared to the previous definition of "likelihood of existence" in NP 2-B. Because of the more stringent requirements under NI 51-101, the industry has adopted the interpretation that the new proved plus probable (P-50) reserves represent the most "realistic" estimates of remaining recoverable reserves. The following reserves information also adopts the general industry practice of comparing the new P-50 reserves to the previous proved plus risk adjusted (50%) probable reserves, commonly referred to as "established reserves", under NP 2-B.

Under McDaniel's NI 51-101 evaluation, technical revisions caused proved plus probable reserves for Avenir's light and medium crude oil, natural gas liquids and natural gas properties to increase by 12.5%, on a combined basis, compared to the prior year.

The following tables summarize certain information with regard to Avenir's oil and gas reserves as evaluated by McDaniel as at December 31, 2003.

### Oil and Gas Reserves

Forecast Prices and Costs

As at December 31, 2003

| | Light and Medium Crude Oil | | Heavy Oil | | Natural Gas Liquids | |
|---|---|---|---|---|---|---|
| | Gross[1] | Net[2] | Gross[1] | Net[2] | Gross[1] | Net[2] |
| | (Mbbls) | | (Mbbls) | | (Mbbls) | |
| Proved: | | | | | | |
| Developed Producing | 528.0 | 484.8 | 0.0 | 0.0 | 31.5 | 23.2 |
| Developed Non-Producing | 0.0 | 0.0 | 0.0 | 0.0 | 3.0 | 2.1 |
| Undeveloped | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Total Proved | 528.0 | 484.8 | 0.0 | 0.0 | 34.5 | 25.3 |
| Probable | 159.2 | 141.1 | 0.0 | 0.0 | 8.3 | 6.1 |
| Total Proved Plus Probable | 687.2 | 625.9 | 0.0 | 0.0 | 42.8 | 31.4 |

| | Natural Gas | | Oil Equivalent | |
|---|---|---|---|---|
| | Gross[1] | Net[2] | Gross[1] | Net[2] |
| | (Mmcf) | | (MBOE) | |
| Proved: | | | | |
| Developed Producing | 3,410.8 | 2,908.3 | 1,128.0 | 992.7 |
| Developed Non-Producing | 74.4 | 59.0 | 15.4 | 12.0 |
| Undeveloped | 83.1 | 70.1 | 13.8 | 11.7 |
| Total Proved | 3,568.3 | 3,037.3 | 1,157.3 | 1,016.4 |
| Probable | 807.2 | 693.2 | 302.0 | 262.7 |
| Total Proved Plus Probable | 4,375.5 | 3,730.5 | 1,459.3 | 1,279.0 |

Notes:

1. "Gross" reserves include working interest reserves only and are before royalty deductions. Gross reserves do not include 33.6 MBOEs of royalty interest reserves.

2. "Net" reserves include working interest after royalty deductions plus royalty interest reserves.

3. Oil equivalent amounts have been calculated using a conversion rate of six thousand cubic feet of natural gas to one barrel of oil.

### Reserves Life Index

| | Q4/2003 | Reserves Life Index (RLI) | |
|---|---|---|---|
| | Production | Total Proved | Proved Plus Probable |
| Crude Oil (bbl/d) | 299 | 5.7 | 7.7 |
| Natural Gas (mcf/d) | 2,009 | 4.4 | 5.4 |
| Oil Equivalent (BOE/d) | 634 | 5.0 | 6.4 |

Note: Reserve Life index is calculated by dividing the Company interest reserve the estimated annual production of the corresponding product category.

### Net Present Value of Reserves

It should not be assumed that the estimates of future net revenues presented in the tables below represent the fair market value of the reserves. There is no assurance that the constant prices and forecast prices and costs assumptions will be attained and variances could be material.

Summary of Net Present Value of Future Net Revenue
As at December 31, 2003

| Forecast Prices and Costs | Before Income Taxes Discounted at (%/year) | | | |
|---|---|---|---|---|
| | 0% | 5% | 10% | 15% |
| Proved: | ($mms) | ($mms) | ($mms) | ($mms) |
| Developed Producing | 18.03 | 15.59 | 13.83 | 12.50 |
| Developed Non-Producing | 0.32 | 0.20 | 0.14 | 0.11 |
| Undeveloped | 0.16 | 0.15 | 0.14 | 0.13 |
| Total Proved | 18.51 | 15.94 | 14.11 | 12.74 |
| Probable | 4.95 | 3.48 | 2.63 | 2.08 |
| Total Proved Plus Probable | 23.46 | 19.41 | 16.74 | 14.82 |

### McDaniel January 1, 2004 Escalating Price Forecast

The escalating crude oil and natural gas pricing, inflation factors and the exchange rate utilized in the McDaniel Report are as follows:

| Year | WTI Cushing (US$/bbl) | Edmonton Par Price (Cdn$/bbl) | Hardisty Heavy 12° API (Cdn$/bbl) | AECO C-Spot (Cdn$/Mmbtu) | Inflation Rate (%/Year) | Exchange Rate (US$/Cdn$) |
|---|---|---|---|---|---|---|
| 2004 | 29.00 | 37.70 | 22.70 | 5.84 | 2.0 | 0.750 |
| 2005 | 26.50 | 34.30 | 21.55 | 5.50 | 2.0 | 0.750 |
| 2006 | 25.50 | 33.00 | 21.56 | 5.16 | 2.0 | 0.750 |
| 2007 | 25.00 | 32.30 | 20.63 | 4.97 | 2.0 | 0.750 |
| 2008 | 25.00 | 32.30 | 20.39 | 4.81 | 2.0 | 0.750 |
| 2009 | 25.50 | 32.90 | 20.76 | 4.85 | 2.0 | 0.750 |
| 2010 | 26.00 | 33.50 | 21.11 | 4.88 | 2.0 | 0.750 |

### McDaniel January 1, 2004 Constant Price Forecast

The constant crude oil and natural gas benchmark references pricing and the exchange rate utilized in the McDaniel Report are as follows:

| | OIL | | | | NATURAL GAS LIQUIDS | | |
|---|---|---|---|---|---|---|---|
| Year | WTI Cushing Oklahoma (US$/bbl) | Edmonton Par Price 40° API (Cdn$/bbl) | Hardisty Heavy 12° API (Cdn$/bbl) | Cromer Medium 29.3° API (Cdn$/bbl) | NATURAL GAS AECO Gas Price (Cdn$/MMBtu) | FOB Field Gate (Cdn$/bbl) | EXCHANGE RATE[1] (US$/Cdn$) |
| Historical[2] | | | | | | | |
| 2003 | 32.78 | 39.76 | 22.75 | 34.25 | 5.87 | 31.50 | 0.80 |

Notes:
1. The exchange rate used to generate the benchmark reference prices in this table.
2. As at December 31.

## Reserves Reconciliation Table AS AT DECEMBER 31, 2003

Constant Prices and Costs

| | Light and Medium Crude Net Crude Oil (Mbbl) | Heavy Crude Net Crude Oil (Mbbl) | Total Net Crude Oil (Mbbl) | Net NGL's (Mbbl) | Net Natural Gas Mmcf | Oil Equiv. 2003 (Mbbl) |
|---|---|---|---|---|---|---|
| Proved Producing | | | | | | |
| Opening Balance: December 31, 2002[1] | 465.3 | 0.0 | 465.3 | 8.6 | 396.8 | 540.0 |
| Extensions | 4.4 | 0.0 | 4.4 | 0.0 | 101.0 | 21.3 |
| Improved Recovery | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Technical Revisions | 0.0 | 0.0 | 0.0 | 3.9 | 29.4 | 8.8 |
| Discoveries | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Acquisitions | 111.3 | 0.0 | 111.3 | 14.9 | 2,696.0 | 575.5 |
| Dispositions | -22.1 | 0.0 | -22.1 | -0.8 | -100.4 | -39.6 |
| Economic Factors | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Production | -68.9 | 0.0 | -68.9 | -3.4 | -214.6 | -108.1 |
| Closing Balance: December 31, 2003 | 490.0 | 0.0 | 490.0 | 23.2 | 2,908.2 | 997.9 |
| Total Proved | | | | | | |
| Opening Balance: December 31, 2002 | 465.3 | 0.0 | 465.3 | 8.6 | 396.8 | 540.0 |
| Extensions | 4.4 | 0.0 | 4.4 | 0.0 | 101.0 | 21.3 |
| Improved Recovery | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Technical Revisions | 0.0 | 0.0 | 0.0 | 3.8 | 30.1 | 8.8 |
| Discoveries | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Acquisitions | 111.3 | 0.0 | 111.3 | 17.1 | 2,941.0 | 618.6 |
| Dispositions | -22.1 | 0.0 | -22.1 | -0.8 | -217.0 | -59.0 |
| Economic Factors | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Production | -68.9 | 0.0 | -68.9 | -3.4 | -214.6 | -108.1 |
| Closing Balance: December 31, 2003 | 490.0 | 0.0 | 490.0 | 25.3 | 3,037.3 | 1,021.5 |
| Proved Plus Probable | | | | | | |
| Opening Balance: December 31, 2002 | 528.3 | 0.0 | 528.3 | 9.4 | 439.4 | 610.8 |
| Extensions | 6.6 | 0.0 | 6.6 | 0.0 | 109.5 | 24.8 |
| Improved Recovery | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Technical Revisions | 56.9 | 0.0 | 56.9 | 4.5 | 174.8 | 90.5 |
| Discoveries | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Acquisitions | 130.7 | 0.0 | 130.7 | 21.6 | 3,445.0 | 726.5 |
| Dispositions | -22.1 | 0.0 | -22.1 | -0.7 | -222.8 | -59.8 |
| Economic Factors | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Production | -68.9 | 0.0 | -68.9 | -3.4 | -214.6 | -108.1 |
| Closing Balance: December 31, 2003 | 631.4 | 0.0 | 631.4 | 31.4 | 3,731.3 | 1,284.7 |

Notes:

1. The evaluation as at December 31, 2002 was prepared using National Policy 2-B reserves definitions. Under those definitions, probable reserves were adjusted by a factor to account for the risk associated with their recovery. The Corporation previously applied a risk factor of 50% in reporting probable reserves. Under current NI 51-101 reserves definitions, estimates are prepared such that the full proved plus probable reserves are estimated to be recoverable (proved plus probable reserves are effectively a "best estimate"). The above reconciliation reflects current probable reserves versus previous risk adjusted (50%) probable reserves reported by the Corporation.

## FINANCIAL SERVICES OPERATIONS REVIEW

At December 31, 2003 the Trust's financial services business unit, Avenir Financial Services Acquisition Corp. ("Avenir Financial"), consisted of:

**Financial Services Contracts**

In connection with the Trust Conversion, Avenir Financial acquired a financial services contract with an affiliate of a financial services provider, to provide funding of $600,000 for a cash advance company providing cash advance, cheque cashing and payday loan services. The contract has a term of ten years and provides for the payment of a fixed fee per amount provided per day at a rate of $0.07 per $100 loaned per day and 25% per annum on unpaid amounts. On January 31, 2003, Avenir Financial entered into an additional $600,000 financial services contract to provide funding for additional ten year contracts on identical terms as that set forth above.

The underlying contracts are fully collateralized, have a ten-year term recallable at Avenir Financial's option and pay a fixed fee over the life of the contract. Since inception, the contracts have performed as outlined.

**Subordinated Debenture**

On December 15, 2003, the Trust entered into a three-year agreement with Rentcash Inc. ("Rentcash") to fund a subordinated debenture in the aggregate principal amount of $2,000,000. The debenture yields a monthly coupon equivalent to a 12% annualized yield plus additional associated fees of 4% per annum. Management understands that Rentcash will use the funds for its continued expansion and operation of it's "Insta-rent" business within The Brick stores and for the further build out of The Cash Stores, its cash advance brokering business across Canada.

Rentcash is a growth company and currently has over 100 Cash Stores and 27 Insta-rent stores. They are expanding and the Trust expects to continue a relationship with Rentcash in the future.

## REAL ESTATE OPERATIONS REVIEW

The Trust recently announced its first real estate acquisition, which closed on March 31, 2004. With this acquisition, the Trust inherited long life leases with triple net fees (all costs are paid by the leasee including property management fees). Going forward the Trust will look to take advantage of the current low interest rate environment and blend the mortgage rates to a lower level. Tonko Realty Advisors are the Trust's advisors for our real estate business unit and have been contracted as property managers and operating administrators of this business unit.

With the real estate acquisition, the Trust acquired five properties. A description of the five properties follows:


## 2305 - 84th Avenue, Edmonton, Alberta

The building was constructed for Canada Dry Bottling Co. in 1979, and was updated in 1995. This large warehouse and office facility is on a 4.57 acre parcel located in the Sherwood Industrial subdivision and can service Edmonton's industrial sector. It backs onto and has exposure to the Sherwood Park Freeway. The property's 90,800 square feet are fully leased to a manufacturer and distributor of packaging materials.

## 8225 - 30th Street SE, Calgary, Alberta

This warehouse was constructed in 1978 with an addition completed in 1994 and is located in the Foothills industrial area just north of Glenmore Trail and west of Barlow Trail. The building is approximately 70,296 square feet. It has been occupied by the current tenant since 1985. It has substantial cold storage area in the warehouse along with a conveyor throughout the main storage area for a "pick-and-fill" order system.

## 6875 - 8th Street NE, Calgary, Alberta

This research and manufacturing facility, constructed in 1991, is in the Deerfoot industrial area in northeast Calgary, immediately adjacent to the Calgary International Airport. Built in 1991 by Novatel, this facility comprises approximately 119,600 square feet resting on 9.65 acres, resulting in site coverage of 26%. It enjoys convenient access to Deerfoot Trail, and is partially leased to two international tenants.

## 222 Snidercroft Road, Vaughan, Ontario

This office and manufacturing facility is located in Greater Toronto's 600 million square foot industrial market, backing onto Highway 407 in a well-established business park in Vaughan. Built in two stages (1970 and 1980) for the present tenant, this renovated facility comprises approximately 71,000 square feet resting on 4.0 acres, with site coverage of only 29%. The Trust owns a 50% interest in this property.

## 1800 Huron Street, London, Ontario

This manufacturing/warehouse facility sits adjacent to London International Airport in the northeast industrial area of London, Ontario. The tenant is a large automotive parts manufacturer. Built in 1989, the building is fully air-conditioned and comprises approximately 112,000 square feet on 12.65 acres.

Except for historical financial information contained herein, the matters discussed in this document may be considered forward-looking statements. Such statements include declarations regarding management's intent, belief or current expectations. Prospective investors are cautioned that any such forward-looking statements are not guarantees of future performance and involve a number of risks and uncertainties; actual results could differ materially from those indicated by such forward-looking statements. Among the important factors that could cause actual results to differ materially from those indicated by such forward-looking statements are: (i) that the information is of a preliminary nature and may be subject to further adjustment, (ii) the possible unavailability of financing, (iii) risks related to the exploration and development of oil and gas properties, (iv) the impact of price fluctuations and the demand and pricing for oil and natural gas, (v) the seasonal nature of the business, (vi) start-up risks, (vii) general operating risks, (viii) dependence on third parties, (ix) changes in government regulation, (x) the effects of competition, (xi) dependence on senior management, (xii) financial condition of real estate tenants and financial services counter parts, (xiii) impact of Canadian economic conditions or the demand for real estate leasing opportunities, (xiv) fluctuations in currency exchange rates and interest rates.

MANAGEMENT'S DISCUSSION AND ANALYSIS should be read in conjunction with the audited annual consolidated financial statements for the year ended December 31, 2003.

The Trust's strategy is comprised of having three distinct business units: Oil and Gas, Financial Services, and Real Estate. These three units combine the stability of cash flows from both real estate and financial services with a more variable cash flow stream from oil and gas production. These 2003 results do not include any contribution from the real estate business unit as the Trust's first real estate transaction was not concluded until March 31, 2004.

For comparative purposes the Trust has used the Third quarter results instead of those from 2002. The Trust's operations were not established until January 16, 2003, as such the 2002 comparatives would not provide a meaningful assessment of the Trust's 2003 operating results.

**Significant Events**

- **January 2003 Creation of Avenir Diversified Income Trust ("Avenir" or the "Trust")**
  The Trust was created on January 16, 2003 through a plan of arrangement with Onward Energy Inc. Since inception, the Trust's strategy has been to have three distinct business units: Oil and Gas, Financial Services, and Real Estate. In connection with the Arrangement, the Trust also completed a private placement of an aggregate of 11,325,551 Trust Units at $0.40 per unit, which closed in a series of two allocations. Proceeds from the private placement were used for the purchase of assets from Response Energy Ltd. and Aventura Energy Ltd., as well as a $600,000 financial services contract with a cash-advance company.
- **May 2003 Acquisition of Outback Energy Ltd. ("Outback")**
  Pursuant to an acquisition agreement dated May 21, 2003, the Trust closed the acquisition of Outback Energy Ltd., a junior private oil and gas company, in the second quarter. This acquisition added approximately 50 BOE/d. In conjunction with the transaction, the Trust issued 2,333,358 units and assumed approximately $465,000 in debt and working capital deficiency.
- **September 2003 $8.0 million Private Placement**
  On September 24, 2003, the Trust closed an $8,000,000 private placement. There were a total of 16,000,000 units issued from treasury, at a price of $0.50 per unit. Subsequent to the quarter, approximately $6.2 million of the proceeds from the financing were used for the

purchase of 215 BOE/d of natural gas assets in late October. The remaining funds from the financing were invested in a portfolio of trust units until the funds were deployed for an investment in the financial services business unit.

- **September 2003 Acquisition of 728409 Alberta Ltd. ("728409")**
  On September 24, 2003 the Trust acquired all of the issued and outstanding common shares of 728409, thereby acquiring approximately 90 BOE/d of natural gas. Under the terms of the agreement, the Trust issued an aggregate of 2,000,000 Trust Units from treasury at a price of $0.50 per unit and $1,282,829 in cash to shareholders of 728409 as consideration.

- **October 2003 Purchase of Natural Gas Assets**
  The Trust entered into an agreement in September to purchase certain gas assets from a major oil and gas producer. This transaction, closed on October 24, 2003, and added approximately 215 BOE/d of natural gas production. This transaction was funded by the proceeds of the September financing as described above.

- **December 2003 Issuance of $2 million Subordinated Debenture with Rentcash Inc. ("Rentcash")**
  On December 5, 2003 the Trust entered into a subordinated debenture agreement with Rentcash Inc., a publicly listed company traded on the TSXV under the symbol "RCS". The debenture yields a monthly coupon equivalent to a 12% annualized yield, plus associated fees equating to an annualized 4% return.

- **Western Spirit Investments Ltd. ("Western Spirit")**
  On January 21, 2004 the Trust announced that it had entered into its first real estate agreement pursuant to which the Trust would acquire Western Spirit under a plan of arrangement. Western Spirit was a public real estate investment company with a portfolio consisting of five properties with approximately 433,000 square feet of leasable area. The properties are located in Toronto, London (Ontario), Calgary and Edmonton. Through this transaction, shareholders of Western Spirit received, at their election, $3,000,000 in cash and approximately 5,000,000 trust units of Avenir. The Trust also assumed all of Western Spirit's outstanding debt, including mortgages, of approximately $16.38 million as at December 31, 2003. The Trust also issued to each Western Spirit shareholder one performance right for each Western Spirit share, each right entitling the holder to acquire 0.05 of a trust unit, for no additional consideration, provided that, at any time on or prior to January 21, 2005, either a signed lease agreement is in place for that portion of the area in Western Spirit's Harris Building, which is currently vacant, or the Trust should sell the Harris Building for $8.5 million or more.

**Revenue and Production**

Oil and gas revenues (net of royalties) were $1,558,709 for the fourth quarter of 2003, up 96% from the third quarter attributable in most part to the acquisition of 728409 and the natural gas asset purchase in late October. Gross revenue from petroleum and natural gas sales were $1,907,943 for the fourth quarter up from $930,905 in the third quarter. The average price received for crude oil and natural gas liquids during the fourth quarter of 2003 was $32.21 per barrel, up slightly from the previous quarter and $5.34 per mcf for natural gas, down 27% from the third quarter average of $6.77 per mcf due to a decline in the overall commodity price. In

2003, the Trust had a hedging program in place for oil with 85 barrels per day hedged at US$28.00 WTI per barrel for the period April 2003 to March 2004; 33 barrels per day hedged at US$27.45 WTI per barrel for the period July 2003 to September 2004; 85 barrels per day hedged at US$27.70 WTI per barrel for the period April 2004 to June 2004; and 100 barrels per day hedged at US$27.78 WTI per barrel for the period July 1, 2004 to June 01, 2005.

For the year ended December 31, 2003, oil and gas revenues (net of royalties) were $3,796,376. Gross oil and gas revenues totaled $4,560,568 with the average price per BOE being $35.08. As a result of its hedging program to ensure stability of distributions, the Trust recorded a hedging loss of $47,659 for the fourth quarter of 2003 and $92,949 for the year ended December 31, 2003.

Average daily production volumes for the quarter ending December 31, 2003 were 634 BOE/d, up 108%, compared to 304 BOE/d in the in the third quarter. Fourth quarter production consisted of 299 bbls/d of crude oil and natural gas liquids and 2,009 mcf/d of natural gas (compared to 241 bbls/day and 378 mcf/d for the third quarter respectively). The 24% increase in oil and liquids production came mostly from new infill development drilling in Southern Alberta. The 431% increase in natural gas production was the result of the natural gas purchases in late September and October.

**Netbacks**

| | Three months ended | | | | Twelve months |
|---|---|---|---|---|---|
| | Mar 31 $/BOE | Jun 30 $/BOE | Sep 30 $/BOE | Dec 31 $/BOE | Dec 31, $/BOE |
| Gross revenue after hedging | 46.74 | 36.31 | 33.67 | 32.73 | 35.62 |
| Royalties | 7.62 | 5.81 | 4.96 | 5.99 | 5.97 |
| Operating costs | 9.51 | 8.46 | 7.76 | 7.48 | 8.01 |
| Operating netback | 29.61 | 22.05 | 20.95 | 19.26 | 21.64 |

**Royalties**

The Trust's royalty costs net of ARTC for the quarter ending December 31, 2003 were $349,234, up 156% over the third quarter; however, on a BOE basis, royalty costs averaged $5.99 per BOE in the period, which is up 21% over the third quarter's cost of $4.96 per BOE. The royalty costs net of ARTC for the year totaled $764,192 or $5.97 per BOE. The Trust's royalty rate of 16.42% is low by industry standards, even though most of the Trust's properties do not receive ARTC.

**Operating Expenses**

The Trust's operating costs for the quarter ending December 31, 2003 were $436,153, up 94% over the third quarter. The operating costs were higher as a result of the third and fourth quarter natural gas acquisitions. However, on a BOE basis, operating costs averaged $7.48 per BOE in the period, which is down 4% over the third quarter's cost of $7.76 per BOE. The operating expenses for the year totaled $1,025,986 or $8.01 per BOE. The Trust continues to focus on means of reducing overall operating costs and believes they will decline on a comparative basis for 2004 as they did over the course of 2003.

### Financial Services

Since inception the Trust has held two cash advance contracts, fully collateralized, with a 10-year term recallable at the Trust's option. These contracts pay a fixed fee over the life of the contract. The Trust recognized income of $84,204 relating to the financial services contracts in the fourth quarter of 2003 and total revenues on these contracts for the year ended December 31, 2003 of $298,404. The Rentcash subordinated debenture, which closed in December 2003, will have monthly payments beginning January 2004.

### Gain (Loss) on Short-Term Investments

At inception, the Trust held a portfolio investment of 100,000 units in an oil and gas trust. The units were sold on June 30, 2003 and a gain of $75,190 was recognized and the capital was redeployed. On July 26, 2003 the Trust purchased units of three publicly trading energy trusts. Total cost of the acquisitions was $1,088,111. On September 25, 2003, in order to partially deploy funds prior to closing long-term investments, the Trust purchased a diverse basket of publicly traded income trusts at a cost of $1,959,579. Income earned on these investments in the fourth quarter amounted to $31,423 and $226,975 for the year ended December 31, 2003. All of these short-term investments in units were sold during the fourth quarter of 2003 to finance activities in line with the Trust's business plan and a gain of $53,319 was realized.

### General and Administrative Expenses

General and administrative expenses were $430,460 (not includes $119,868 relating to non-cash stock based compensation expense) in the fourth quarter 2003, up from the third quarter of $140,542. In the fourth quarter the Trust incurred additional staffing costs associated with the doubling of the Trust's production, as well, costs increased with the Trust's early adoption of the new stock-based compensation rules. On a year to date basis, general and administration costs for oil and gas was $569,916 or $4.44 per BOE and the corporate trust and financial services general and administration costs amount to $298,998 (including compensation expense of $119,868 due to the early adoption of the compensation rules). In addition, as this was the Trust's first year in operation, the year's accounting, audit, legal and reserve evaluation costs were higher for this initial year end and required reporting.

### Interest Expense

Interest expense was $64,020 for the fourth quarter with bank debt of $4,505,000 at year end. Bank debt increased from the third quarter, as a portion of the previously described natural gas acquisitions, were funded by debt. The quarterly expense included banking fees associated with increasing the Trust's revolving line to $5.2 million from $3.1 million.

### Depletion, Depreciation and Amortization

Provision for depletion and depreciation was $736,909 for the quarter ending December 31, 2003, with the Trust's depletion and depreciation rate at $12.64 per BOE up slightly from $11.84 per BOE in the third quarter. This increase reflects the increasing cost per BOE of acquisitions in the current market.

### Future Site Restoration and Abandonment Costs

Total estimated future site restoration costs relating to the oil and gas properties owned by the Trust is $1,539,600, with the total provision recorded to date at $567,156.

### Income Taxes

The Trust did not provide for income taxes as it expects that all taxable income will be passed to unit holders in the form of distributions. The Trust did record a capital tax expense of $12,848 associated with the holding of the oil and gas assets.

### Cash Flow and Earnings

Cash flow from operations was $853,418 or $0.02 per unit for the fourth quarter up 60%, compared to $532,540 in the third quarter or $0.01 per unit. The increase in cash flow was primarily the natural gas acquisitions made in the third and early in the fourth quarter. The impact of the December financial services investment will not be realized until 2004.

For the year ended December 31, 2003 the cash flow from operations was $2,362,525 or $0.09 per unit. The Trust recorded a net loss of $116,403 for the fourth quarter and net earnings of $519,180 or $0.02 per unit for the year ended December 31, 2003. The fourth quarter loss was attributable to the early adoption of the stock-based compensation rules and additional general and administration costs associated with the Trust's first year-end and resulting reporting requirements. The Trust distributed $725,892 or $0.02 per unit, to unitholders in the fourth quarter and has distributed $1,853,871 for the year ended December 31, 2003. The year to date distribution payout of 78% was in line with the Trust's target. Of the distributions paid, 68% of the amount was classified as taxable income and 32% was tax deferred (return of capital). Cash distributions declared per Trust unit issued and outstanding:

| Period covered | Date of Distribution | Per Unit $ |
|---|---|---|
| January 16, 2003 to February 28, 2003 | 03/14/2003 | 0.00675 |
| March 1, 2003 to March 31, 2003 | 04/15/2003 | 0.00525 |
| April 1, 2003 to April 30, 2003 | 05/15/2003 | 0.00525 |
| May 1, 2003 to May 31, 2003 | 06/15/2003 | 0.00525 |
| June 1, 2003 to June 30, 2003 | 07/15/2003 | 0.00525 |
| July 1, 2003 to July 31, 2003 | 08/15/2003 | 0.00583 |
| August 1, 2003 to August 31, 2003 | 09/15/2003 | 0.00583 |
| September 1, 2003 to September 30, 2003 | 10/15/2003 | 0.00583 |
| October 1, 2003 to October 31, 2003 | 11/15/2003 | 0.00583 |
| November 1, 2003 to November 30, 2003 | 12/15/2003 | 0.00583 |
| December 1, 2003 to December 31, 2003 | 01/15/2004 | 0.00583 |

As at December 31, 2003 the Trust had distributions owing of $241,964 (2002 - $nil).

### Quarterly Information

Historical quarterly information, prepared by the Trust in accordance with GAAP, is as follows:

| | Fiscal 2003 Three months ended | | | |
|---|---|---|---|---|
| | Mar 31 $ | Jun 30 $ | Sep 30 $ | Dec 31 $ |
| Revenue | 989,004 | 1,068,917 | 1,082,105 | 2,079,584 |
| Revenue net of royalties | 848,135 | 931,230 | 945,703 | 1,730,350 |
| Net income (loss) | 320,710 | 98,706 | 216,167 | (116,403) |
| Net income (loss) per unit basic and diluted | 0.02 | 0.00 | 0.01 | (0.00) |

**Capital expenditures**

| | Year End Dec. 31, 2003<br>$ |
|---|---|
| Land | 3,984 |
| Geological and geophysical | 12,328 |
| Drilling | 450,972 |
| Production equipment and facilities | 187,665 |
| Other | 75,937 |
| Development expenditures | 730,886 |
| | |
| Corporate acquisitions | 6,263,909 |
| Property acquisitions | 9,480,647 |
| Proceeds received on property dispositions | (65,000) |
| Other | 13,472 |
| Net capital expenditures | 16,423,914 |
| | |
| Property, plant and equipment December 31, 2003 | 14,915,876 |

**Liquidity and Debt**

The Trust's net debt position of $4,241,206 at December 31, 2003 is a result of bank indebtedness of $4,505,000 and positive working capital of $263,794. The Trust has a revolving demand facility with up to $5,200,000 bearing interest at bank prime plus one percent. The Trust also has an acquisition and development line of $2,000,000, bearing interest at bank prime plus one and one-half percent, to fund additional oil and gas acquisitions and a bridge demand facility of $3,000,000 bearing interest at bank prime plus two percent, to fund real estate acquisitions. As at December 31, 2003 there was $4,505,000 outstanding on the revolving demand facility. The bridge facility was subsequently drawn on March 31, 2004 to fund the acquisition of Western Spirit.

**Contractual Obligations**

The contracts outstanding with respect to the physical deliveries of oil and gas at December 31, 2003 are as follows:

- A physical fixed price swap for the period April 1, 2004 to October 31, 2004 on 700 GJ per day of gas at a price of $5.91 per GJ.
- A physical fixed price swap for the period November 1, 2004 to October 31, 2005 on 700 GJ per day of gas at a price of $5.94 per GJ.
- The Trust also has a capital lease on gas compression equipment, which is repayable in monthly installments of $5,537 including interest at a fixed interest rate of 8% per annum. The lease matures on June 6, 2005 and is collateralized by specific equipment purchased.

**Share Capital**

| Trust Units | Number of Units | Amount $ |
|---|---|---|
| **Balance December 31, 2002** | — | — |
| Units issued on 928719 corporate purchase | 7,650,000 | 1,325,182 |
| Units issued on Onward Trust conversion | 2,194,373 | 877,749 |
| Units from Special Warrants financing January 16, 2003 | 10,158,801 | 4,063,520 |
| Units financing February 27, 2003 | 1,166,750 | 466,700 |
| Units issued on Outback Acquisition | 2,333,358 | 1,050,011 |
| Units issued on private placement | 16,000,000 | 8,000,000 |
| Units issued on 728409 Acquisition | 2,000,000 | 1,000,000 |
| Trust unit issue costs | — | (931,220) |
| **Balance December 31, 2003** | 41,503,282 | 15,851,942 |

For the year ended December 31, 2003 the Trust had a weighted average of 27,621,558 trust units outstanding and the diluted per unit amount was calculated assuming the exercise of outstanding in-the-money options resulting in 28,182,317. The Trust's weighted average unit price at year end was $0.511. As at April 1, 2004 the total units outstanding for the Trust were 46,490,779 (which includes the 4,987,497 issued in the Western Spirit transaction).

**Related Party Transactions**

The Trust's two financial services contracts are with 19695 Yukon Inc., an affiliate of a financial services provider, which is related to a member of the Trust's Board of Directors. These contracts provide funding to a cash advance company providing cash advance, cheque cashing and payday loan services.

In addition, the Trust paid $85,654 during the year ended December 31, 2003 for corporate administrative and financial services provided by Avenir Capital Corporation, a major unitholder of the Trust.

**Risks and Uncertainties**

The business of developing and producing oil and natural gas reserves is inherently risky. There is risk that the sale of the Trust's reserves may be delayed indefinitely due to process constraints, lack of pipeline capacity or lack of markets. The price the Trust receives for its oil and gas reserves fluctuates continuously and for the most part is beyond its control. The Trust is also subject to the risks associated with owning oil and gas properties, including environmental risks such as the pollution of air, land and water. In all areas of the Trust business, it competes against entities that have greater technical and financial resources. The Trust's growth is dependent upon external sources of financing which may not be available on acceptable terms.

The Trust mitigates these risks by contracting professional services when required. The Trust diversifies its oil and gas market portfolio among various marketers and aggregators and among a variety of contracts with respect to pricing and term. Finally, all levels of the Trust's operations are adequately insured.

The Trust's existing Financial Services Contracts are with affiliates of a financial services provider and with a chain of cash advance stores. The stated return on the Financial Services Contracts is subject to a degree of credit risk and risk of not realizing on collateral in the event of default. The Trust is afforded full collateral on a customer's pay cheque or other security on the transaction entered into by the cash advance stores. As each transaction is generally between $100 and $300, the impact of default on any one transaction is quite small when spread over a number of customers. As with respect to all financial instruments, the Trust could be exposed to losses if a counter party fails to perform in accordance with the terms of the contracts.

**Critical Accounting Estimates**

The MD&A is based on the Trust's consolidated financial statements, which have been prepared in accordance with GAAP. The application of GAAP requires management to make estimates, judgments and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities, if any, at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. The Trust bases its estimates on historical experience and various other assumptions that are believed to be reasonable under the circumstances. Actual results could differ from these estimates under different assumptions or conditions.

The following is a discussion of the critical accounting estimates that are inherent in the preparation of the Company's consolidated financial statements and notes thereto.

**Reserve Estimates**

Estimates of the Trust's reserves in its consolidated financial statements are prepared in accordance with guidelines established by the Alberta Securities Commission. Reserve engineering is a subjective process of estimating underground accumulations of petroleum and natural gas that cannot be measured in an exact manner. The process relies on interpretations of available geological, geophysical, engineering and production data. The accuracy of a reserve estimate is a function of the quality and quantity of available data, the interpretation of that data, the accuracy of various mandated economic assumptions and the judgment of the persons preparing the estimate.

The Trust's reserve information is based on estimates prepared by its independent petroleum consultants. Estimates prepared by others may be different than these estimates. Because these estimates depend on many assumptions, all of which may differ from actual results, reserve estimates may be different from the quantities of petroleum and natural gas that are ultimately recovered. In addition, the results of drilling, testing and production after the date of an estimate may justify revisions to the estimate.

The present value of future net revenues should not be assumed to be the current market value of the Trust's estimated reserves. Actual future prices, costs and reserves may be materially higher or lower than the prices, costs and reserves used for the future net revenue calculations.

The estimates of reserves, impact depletion, dry hole and site restoration expenses. If reserve estimates decline, the rate at which the Trust records depletion and site restoration expenses increases, reducing net earnings. In addition, changes in reserve estimates may impact the outcome of the Trust's assessment of its petroleum and natural gas properties for impairment.

**Future Site Restoration and Abandonment Costs**

Future site restoration and abandonment costs are provided for using the unit of production method based on the estimated net proved reserves. Costs are estimated each year by management in consultation with the Trust's independent reservoir engineers based on current regulations, costs, technology, and industry standards. Such costs are included in income and are accumulated in the provision account based on proven reserve estimates and current production levels. When expenditures are made to restore a property, the accrued provision is charged with these expenditures.

Beginning in 2004, the Trust will adopt the Canadian Institute of Chartered Accountants ("CICA") Handbook section 3110 – Asset Retirement Obligation, which will result in changes in accounting for site restoration and abandonment costs. See "Recent Accounting Pronouncements" section.

### Income Taxes

The Trust's operating entity is a taxable entity under the Income Tax Act of Canada and is taxable only on income that is not distributed or distributable to the unitholders. As the Trust distributes all of its taxable income to the unitholders pursuant to the Trust Indenture and meets the requirements of the Income Tax Act of Canada applicable to the Trust, no provision for income taxes have been made.

## RECENT ACCOUNTING PRONOUNCEMENTS AND THE IMPACT ON THE TRUST

### Impairment of Long-Lived Assets

The CICA recently issued Handbook Section 3063 – Impairment of Long-Lived Assets, which will impact the Trust's Financial Services and Real Estate segments. This new section establishes standards for the recognition, measurement and disclosure of the impairment of long-lived assets by profit-oriented enterprises. The section is effective for fiscal years beginning on or after April 1, 2003. This section will require a new calculation of impairment based on undiscounted future cash flows. The Trust's oil and gas segment follows the full cost method and this new section is not applicable for full cost, the Trust will be required to follow the new CICA accounting guideline 16, Oil & Gas Accounting - Full Costs. This new guideline is designed to ensure consistency with the Impairment of Long-Lived Assets section, described above, for the oil and gas industry. This guideline is applicable to fiscal years beginning on or after January 1, 2004 and will be applied on a prospective basis. The Trust anticipates the adoption of these pronouncements will not have a material effect on its consolidated financial statements.

### Asset Retirement Obligation

The CICA recently issued Handbook Section 3110 – Asset Retirement Obligation, which addresses statutory, regulatory, contractual and other legal obligations associated with the retirement of a long-lived asset that results from its acquisition, construction, development or normal operation. The asset retirement obligations are initially measured at fair value at the time the obligation is incurred with a corresponding amount capitalized as part of the asset's carrying value and depreciated over the asset's useful life using a systematic and rational allocation method. This guideline is applicable to fiscal years beginning on or after January 1, 2004 and will be applied on a retroactive basis. The impact of this has not yet been determined.

**Stock-Based Compensation and Other Stock-Based Payments**

In October 2003, the CICA amended Handbook Section 3870 to require recognition of expense, based on the fair value method, for all employee stock-based compensation transactions for fiscal years beginning on or after January 1, 2004.

The recommendations of the Section should also be applied to the following awards that were outstanding at the start of the fiscal year beginning on or after January 1, 2002 in which adoption of this Section was initially applied; awards that call for settlement in cash or other assets and stock appreciation rights that call for settlement by the issuance of equity instruments. The award should be accounted for as a new award, and not using modification accounting. The cumulative amount that would have been recognized in prior years had this section been applied, less any amount previously recognized, should be recorded as the effect of a change in accounting policy and charged to opening retained earnings for the fiscal year in which this section is initially applied, without restatement of prior periods.

The Trust early adopted the requirement to use the fair value method to account for all stock based compensation awards and has used the fair value method of accounting for stock options for fiscal 2003. The fair value based method has been applied prospectively, whereby compensation costs have been recognized for all options granted on or after January 1, 2003. Adoption of this accounting policy has resulted in an expense of $119,868 being recorded in the Trusts consolidated financial statements for the year ended December 31, 2003.

## 2004 OUTLOOK

With the first year of operation complete, the Trust looks forward to 2004 without the costs and complexities associated with setting up the Trust in 2003.

The start to 2004 resulted in the Trust continuing the rounding out of its business plan by adding real estate assets to the portfolio in March. Looking ahead the Trust will concentrate on further expanding each business unit ensuring the stability of distributions and the growth in distributions per unit.

For additional information on the Trust, please go to the company's profile on SEDAR at www.sedar.com or the Trust's website at www.avenirtrust.com.

Submitted on behalf of the Board of Directors by:

William M. Gallacher
President & CEO

Gary Dundas
Vice President Finance & CFO

## AUDITORS' REPORT

**To the Unitholders of**

**Avenir Diversified Income Trust**

We have audited the consolidated balance sheets of Avenir Diversified Income Trust as at December 31, 2003 and 2002 and the consolidated statements of operations and accumulated earnings/(deficit) and cash flows for the years then ended. These financial statements are the responsibility of the Trust'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 Trust as at December 31, 2003 and 2002 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Ernst + Young LLP

Calgary, Alberta
March 29, 2003

Chartered Accountants

## CONSOLIDATED BALANCE SHEETS

As at December 31,

| | 2003 | 2002 |
|---|---|---|
| | $ | $ |
| **ASSETS** [note 12] | | |
| **Current** | | |
| Cash and cash equivalents | 256,872 | 82,497 |
| Accounts receivable and prepaid expenses [note 10] | 1,799,803 | 335,819 |
| Short-term investments [note 9] | — | 1,010,000 |
| | 2,056,675 | 1,428,316 |
| **Capital assets** [note 7] | 14,915,876 | — |
| **Financial services contracts** [note 11] | 3,241,963 | 600,000 |
| **Goodwill** [note 4] | 1,086,729 | — |
| | 21,301,243 | 2,028,316 |
| **LIABILITIES AND UNITHOLDERS' EQUITY** | | |
| **Current** | | |
| Bank indebtedness [note 12] | 4,505,000 | 602,859 |
| Accounts payable and accrued liabilities | 1,489,755 | 588,829 |
| Distributions payable [note 8] | 241,964 | — |
| Current portion of capital lease obligations [note 13] | 61,162 | — |
| | 6,297,881 | 1,191,688 |
| **Capital lease obligations** [note 13] | 32,459 | — |
| **Provision for future site restoration and abandonment** | 567,156 | — |
| **Commitments** [notes 7 and 17] | | |
| **Shareholders'/Unitholders' equity** | | |
| Shareholder capital [note 14] | — | 1,070,000 |
| Unitholder capital [note 14] | 15,851,942 | — |
| Contributed surplus [notes 3 and 15] | 119,868 | — |
| Accumulated earnings/(deficit) | 285,808 | (233,372) |
| Accumulated cash distributions | (1,853,871) | æ |
| | 14,403,747 | 836,628 |
| | 21,301,243 | 2,028,316 |

*See accompanying notes to the consolidated financial statements*

On behalf of the Board

Director

Director

## CONSOLIDATED STATEMENTS OF OPERATIONS AND ACCUMULATED EARNINGS/(DEFICIT)

For the year ended December 31,

| | 2003<br>$ | 2002<br>$ |
|---|---|---|
| **REVENUE** | | |
| Oil and gas | 4,560,568 | — |
| Royalties net of ARTC | (764,192) | — |
| | 3,796,376 | — |
| Financial services fees [note 11] | 298,404 | 44,100 |
| Investment income | 226,975 | 143,111 |
| Interest and other income | 5,154 | — |
| Gain on sale of short-term investments [note 9] | 128,509 | — |
| | 4,455,418 | 187,211 |
| **EXPENSES** | | |
| Oil and gas operating | 1,025,986 | — |
| General and administrative [notes 3, 15 and 16] | 868,914 | 249,515 |
| Unsuccessful acquisition and re-organizational costs | 233,057 | — |
| Bank fees and interest | 176,504 | 8,585 |
| Capital tax | 12,848 | — |
| Depletion and depreciation | 1,508,038 | — |
| Site restoration | 110,891 | — |
| | 3,936,238 | 258,100 |
| Income (loss) before income tax | 519,180 | (70,889) |
| Income tax expense | — | — |
| Net income (loss) for the year | 519,180 | (70,889) |
| Accumulated earnings/(deficit), beginning of year | (233,372) | (162,483) |
| Accumulated earnings/(deficit), end of year | 285,808 | (233,372) |
| Net income (loss) per unit/share basic and diluted | 0.02 | (0.01) |

*See accompanying notes to the consolidated financial statements*

## CONSOLIDATED STATEMENTS OF CASH FLOWS

For the year ended December 31,

| | 2003<br>$ | 2002<br>$ |
|---|---|---|
| **OPERATING ACTIVITIES** | | |
| Net income (loss) for the year | 519,180 | (70,889) |
| Add (deduct) non-cash items | | |
| Depletion and depreciation | 1,508,038 | — |
| Non-cash general and administrative [note 15] | 119,868 | — |
| Site restoration | 110,891 | — |
| Gain on sale of short-term investments | (128,509) | — |
| Unsuccessful acquisition and re-organizational costs | 233,057 | — |
| Funds from (used in) operations | 2,362,525 | (70,889) |
| Change in non-cash working capital | (506,904) | 32,869 |
| Cash provided by operating activities | 1,855,621 | (38,020) |
| **FINANCING ACTIVITIES** | | |
| Issue of trust units/shares [note 14] | 12,530,220 | — |
| Trust unit issue costs | (931,220) | — |
| Distribution to unitholders [note 8] | (1,611,907) | — |
| Change in bank indebtedness | 3,642,141 | 602,859 |
| Repayments of capital lease obligations | (14,544) | — |
| Change in non-cash working capital | (2,386) | 156,818 |
| Cash provided by financing activities | 13,612,304 | 759,677 |
| **INVESTING ACTIVITIES** | | |
| Purchase and conversion of Onward Energy Inc. [note 4] | (1,643,458) | — |
| Purchase of Outback Energy Inc. [note 5] | (141,592) | — |
| Purchase of 728409 Alberta ltd. [note 6] | (1,319,863) | — |
| Oil and gas property acquisitions [note 7] | (9,480,647) | — |
| Oil and gas property disposals | 65,000 | |
| Purchase of financial services contract | (2,641,963) | (600,000) |
| Oil and gas development expenditures | (730,886) | — |
| Purchase of other assets | (17,377) | — |
| Sale of other assets | 3,905 | |
| Sale of short-term investments [note 9] | 4,186,199 | — |
| Purchase of short-term investments [note 9] | (3,047,690) | — |
| Unsuccessful acquisition and re-organizational costs | (233,057) | — |
| Changes in non-cash working capital | (292,121) | (39,160) |
| Cash used in investing activities | (15,293,550) | (639,160) |
| **Increase in cash and cash equivalents during the year** | 174,375 | 82,497 |
| Cash and cash equivalents, beginning of year | 82,497 | — |
| **Cash and cash equivalents, end of year** | 256,872 | 82,497 |
| | | |
| Cash interest paid | 144,359 | 5,812 |

*See accompanying notes to the consolidated financial statements*

## 1. NATURE OF THE ORGANIZATION

Avenir Diversified Income Trust ("ART" or the "Trust") is an open-end unincorporated investment trust governed by the laws of the Province of Alberta and created through a trust indenture dated effective September 24, 2002 between Onward Energy Inc. ("Onward") and Olympia Trust Company. Pursuant to a Plan of Arrangement (the "Arrangement") dated effective January 16, 2003 involving the Trust and Onward, Onward was converted from a corporate entity to the Trust. To facilitate this conversion, all of the common shares and options of Onward were exchanged for an aggregate of 2,194,373 Trust Units and $2,351,305 in cash.

In conjunction with the completion of the Arrangement, the Trust acquired all the issued and outstanding shares of a private company, 928719 Alberta Ltd. ("928719"), in exchange for an aggregate of 7,650,000 Trust Units. This transaction was in effect a reverse takeover as the shareholders of 928719 controlled the majority of units in the Trust after the transaction and the management and directors of 928719 have carried on the management of the Trust.

Also as part of the Arrangement, the Trust acquired all of the trust units of Avenir Operating Trust and the shares of the general partners of two newly created limited partnerships involved in oil and gas and financial services activities.

In connection with the Arrangement, the Trust also completed a private placement of an aggregate of 11,325,551 Trust Units at $0.40 per unit, which closed in a series of two allocations.

The beneficiaries of the Trust are the unitholders. The Trust, a public income trust trading on the TSX Venture exchange, distributes a portion of its cash flow on a monthly basis to its Unitholders. It currently carries on businesses in the areas of exploration and development of oil and gas properties in western Canada and financial services.

Cash flow is currently provided to the Trust from the oil and gas properties owned and operated by Avenir Operating Corp. and the financial services income of its wholly owned subsidiary Avenir Financial Services Acquisition Corp. Cash flow is paid from these corporations to the Trust by way of net profit payments, interest payments and principal repayments. The cash payments received by the Trust are subsequently distributed to the unitholders monthly.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements of the Trust have been prepared by management in accordance with Canadian generally accepted accounting principles. The consolidated financial statements have, in management's opinion, been properly prepared within reasonable limits of materiality and within the framework of the Trust's accounting policies noted below.

While the Trust commenced operations on January 16, 2003, these consolidated financial statements include the financial results of the Trust's predecessor, 928719. This basis is intended to provide Unitholders with meaningful and comparable financial information. As a result, comparative figures are those of 928719, while the results of operations for 2003 include 928719's results of operations from January 1, 2003 to January 15, 2003, and the Trust's results of operations from January 16, 2003 to December 31, 2003. Also, certain comparative figures have been reclassified to conform to the current year's presentation.

**a) Principles of Consolidation**

The consolidated financial statements include the accounts of the Trust and it's wholly owned subsidiaries and partnerships.

**b) Capitalized costs**

The Trust follows the full cost method of accounting for its oil and gas activities whereby all costs associated with the acquisition of, exploration for and development of oil and gas reserves are capitalized. Such costs include those related to lease acquisition, geological and geophysical activities, lease rentals on unproved properties, drilling both productive and non-productive wells, and equipping costs directly related to acquisition, exploration and development activities.

Proceeds from the disposal of properties are normally applied as a reduction of the costs unless crediting proceeds to the full cost pool results in a change of 20% or more in the depletion rate, in which case a gain or loss is recorded.

**c) Depletion and depreciation**

Depletion of oil and gas properties and depreciation of production equipment is provided using the unit of production method based on estimated proven oil and gas reserves, after royalties, as determined by the Trust's independent reservoir engineers. The relative volumes of oil and gas reserves and production are converted to a common unit of measure on the basis of relative energy content at a ratio of six (6) mmcf to one (1) barrel of oil equivalent (BOE).

Costs of unproved properties on undeveloped land are initially excluded from oil and gas properties for the purposes of calculating depletion. When proven reserves are assigned or the property is considered to be impaired, the cost of the property or the amount of the impairment is added to oil and gas properties.

Furniture and computer equipment are depreciated using the declining balance method at rates of 20% and 30% respectively.

**d) Future site restoration and abandonment costs**

Future site restoration and abandonment costs are provided for using the unit of production method based on the estimated net proved reserves. Costs are estimated each year by management in consultation with the Trust's independent reservoir engineers based on current regulations, costs, technology and industry standards. Such costs are included in income and are accumulated in the provision account based on proven reserve estimates and current production levels. When expenditures are made to restore a property, the accrued provision is charged with these expenditures.

**e) Ceiling test**

The net carrying value of the Trust's oil and gas properties and production equipment is limited to an ultimate recoverable amount. This amount is the aggregate of estimated undiscounted future net revenues from production of gross proven reserves plus the cost of undeveloped properties, net of impairment allowances, less future estimated production costs, administrative costs, financing costs, site restoration costs and income taxes. Future net revenues are estimated using prices and costs, and the income tax and Alberta Royalty Tax Credit legislation in effect at the year end. Any reduction in the net carrying value of oil and gas properties as a result of the ceiling test is charged to operations as additional depletion and depreciation. The carrying value of the undeveloped properties is reviewed periodically and written down to net realizable value if impairment is determined.

**f) Joint activities**

Substantially all of the Trust's petroleum and natural gas exploration activities are conducted jointly with others. These financial statements reflect only the Trust's proportionate interest in such activities.

**g) Revenue recognition**

Oil and gas sales are recognized as revenue when the commodities are delivered to customers.

Income from financial services contracts is recognized on a monthly basis as earned based on the stipulations in the individual contracts and agreements.

**h) Use of estimates**

The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the reporting period. The amounts recorded for depletion and depreciation, the ceiling test calculations and the provision for future site restoration costs are based on estimates of gross proven reserves, production rates, commodity prices, future costs and other relevant assumptions. By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future periods could be significant. These estimates are reviewed periodically and as adjustments become necessary, they are reported in earnings in the period in which they become known.

**i) Stock Based Compensation**

Under the Trust's Unit Option Plan the exercise price of an option may be reduced in future periods, based upon the cash distributions made on the trust units, at the discretion of the option holder. Therefore, it is not possible to determine a fair value for options granted using a traditional option pricing model. The Trust accounts for the unit option plan bassed on the intrinsic value of unexercised options at the financial statement date. Compensation expense associated with the options is deferred and recognized in earnings over the vesting period of the options with a corresponding increase in contributed surplus. Any changes in the intrinsic value of unexercised options are recognized in earnings in the period of change with a corresponding increase or decrease to contributed surplus. Recoveries of compensation expense will only be recognized to the extent of previously recorded cumulative compensation expense associated with exercised and outstanding options as of the date of the financial statements. Consideration upon exercise of the options, along with the amount recorded as contributed surplus, is recorded as an increase in unitholders' contributions.

Direct awards of units to employees and stock option awards granted to non-employees have been accounted for in accordance with the fair value method of accounting for stock based compensation. The fair value of direct awards of units is determined by the quoted market price of the Trust's units on the date of grant.

**j) Per unit/share amounts**

The Trust utilizes the treasury stock method in determining diluted per unit/share amounts whereby the diluted number of units/shares is calculated assuming that the proceeds that arise from the exercise of outstanding, in-the-money options are used to purchase units/shares of the Trust at their average market price for the period.

**k) Goodwill**

Goodwill represents the excess of purchase price over fair value of net assets acquired and liabilities assumed. Goodwill is not subject to amortization, but is tested for impairment on an annual basis by applying a fair value based test. The amount of impairment is determined by deducting the fair value of the reporting unit's assets and liabilities from the fair value of the reporting unit to determine the implied fair value of goodwill and comparing that amount to the book value of the reporting unit's goodwill. Any goodwill impairment will be recognized as an expense.

**l) Short-term investments**

Short-term investments extending beyond three months but less than a year are recorded at the lower of cost or market value. Any reduction in the carrying value of the investments and any gains or losses on ultimate disposition will be reflected in the statement of operations and accumulated earnings/(deficit).

**m) Income taxes**

The Trust, and its operating entity, are taxable entities under the Income Tax Act of Canada and are taxable only on income that is not distributed or distributable to the Unitholders. As the Trust distributes all of its taxable income to the Unitholders pursuant to the Trust Indenture and meets the requirements of the Income Tax Act of Canada applicable to the Trust, no provision for income taxes has been made in these consolidated financial statements.

The Trust follows the liability method for calculating income taxes. Differences between the amounts reported in the financial statements of the corporate subsidiaries and their respective tax bases are applied to tax rates in effect to calculate the future tax liability. The effect of any change in income tax rates is recognized in the period the change is substantially enacted.

Avenir Operating Corp. and Avenir Financial Services Acquisition Corp. ("Corporations"), subsidiaries of the Trust, are taxable Canadian corporations and are liable for tax on income that it retains. The Corporations are also subject to capital taxes in jurisdictions where such taxes apply and these taxes are deducted from distributions to Unitholders.

**n) Cash and cash equivalents**

Short-term investments with maturities less than three months at the date of acquisition are considered to be cash equivalents. Cash equivalents are recorded at cost, which approximates current market value.

**o) Financial instruments**

The Trust may periodically enter into derivative financial instrument contracts to manage exposures related to interest rates, foreign currency exchange rates, and oil and natural gas prices. Amounts received or paid under interest rate swaps are recognized in interest expense, while settlement amounts on commodity and foreign currency hedge contracts are recognized in earnings as the related production revenues are recorded.

The Trust's policy is to formally designate each derivative financial instrument as a hedge of a specifically identified future revenue stream. The Trust believes the derivative financial instruments are effective as hedges, both at inception and over the term of the instrument, as the term to maturity, the notional amount and the commodity price basis in the instruments all match the terms of the future revenue stream being hedged.

Realized and unrealized gains or losses associated with the fixed price commodity contracts, which have been terminated or cease to be effective prior to maturity, are deferred as other current, or non-current, assets or liabilities on the balance sheet, as appropriate and recognized in earnings in the period in which the underlying hedged transaction is recognized. In the event a designated hedged item is sold, extinguished or matures prior to the termination of the related derivative instrument, any realized or unrealized gain or loss on such derivative instrument is recognized in earnings.

**p) Financial services contracts**

Financial services contracts are recorded at the lower of cost and fair market value determined using industry data at the period end.

## 3. CHANGE IN ACCOUNTING POLICY

**Unit Option Plan**

The Trust adopted new Canadian Institute of Chartered Accountants ("CICA") standards for stock based compensation in 2003. This change in accounting policy has been applied prospectively from January 1, 2003. As a result of this change, net income for the year ended December 31, 2003 decreased by $119,868. December 31, 2003 reflects compensation expense of $119,868 with a corresponding increase in contributed surplus.

## 4. ONWARD ENERGY INC. ACQUISITION

Pursuant to the Plan of Arrangement more fully described in note 1, on January 16, 2003 Onward shareholders voted to convert to an income trust through a reverse takeover with 928719. The 2,194,373 trust units issued were valued based on the fair market value of the net assets acquired at the date of exchange. The transaction has been accounted for as of the closing date of the acquisition using the purchase method as follows:

| | $ |
|---|---|
| Calculation of purchase price: | |
| Cash consideration | 2,351,305 |
| Trust units issued | 877,749 |
| Transaction costs | 116,548 |
| Less: cash received | (824,395) |
| | 2,521,207 |

| | |
|---|---|
| Allocation of purchase price: | |
| Working capital | (414,160) |
| Oil and gas properties/production equipment | 2,154,638 |
| Goodwill | 1,086,729 |
| Future site restoration | (306,000) |
| | 2,521,207 |

As the Trust does not recognize income taxes, the future income tax liability associated with the underlying business of Onward has not been recognized in the allocation of the purchase price noted above.

## 5. OUTBACK ENERGY INC. ACQUISITION

On May 27, 2003 the Trust acquired all of the outstanding shares of Outback Energy Inc. ("Outback"), a private oil and gas company, for consideration consisting of the issuance of 2,333,358 Trust units. The trust units were valued based on the average fair market value of the units immediately prior to the date the acquisition was announced.

Results from operations are included in the Trust's consolidated financial statements from the date of acquisition. The transaction has been accounted as of the closing date of the acquisition using the purchase method as follows:

| | $ |
|---|---|
| Calculation of purchase price: | |
| Trust units issued | 1,050,011 |
| Transaction costs | 141,592 |
| | 1,191,603 |

| | |
|---|---|
| Allocation of purchase price: | |
| Working capital | (205,917) |
| Bank indebtedness | (260,000) |
| Oil and gas properties/production equipment | 1,715,632 |
| Future site restoration | (58,112) |
| | 1,191,603 |

As the Trust does not recognize income taxes, the future income tax liability associated with the underlying business of Outback has not been recognized in the allocation of the purchase price noted above.

## 6. 728409 ALBERTA LTD. ACQUISITION

On September 24, 2003 the Trust acquired all of the outstanding shares of 728409 Alberta Ltd. ("728409"), a private oil and gas company for consideration consisting of the issuance of 2,000,000 Trust units at $0.50 per unit including preliminary adjustments and cash of $1,282,829. The trust units were valued based on the average fair market value of the units immediately prior to the date the acquisition was announced.

Results from operations are included in the Trust's consolidated financial statements from the date of acquisition. The transaction has been accounted as of the closing date of the acquisition for using the purchase method as follows:

| | $ |
|---|---|
| Calculation of purchase price: | |
| Trust units issued | 1,000,000 |
| Cash consideration | 1,282,829 |
| Transaction costs estimated | 131,117 |
| Less: cash received | (94,083) |
| | 2,319,863 |
| Allocation of purchase price: | |
| Working capital | 125,774 |
| Oil and gas properties/production equipment | 2,393,641 |
| Future site restoration | (91,387) |
| Long-term capital lease obligations | (108,165) |
| | 2,319,863 |

As the Trust does not recognize income taxes, the future income tax liability associated with the underlying business of 728409 has not been recognized in the allocation of the purchase price noted above.

## 7. CAPITAL ASSETS

| | 2003 | | |
|---|---|---|---|
| | Cost<br>$ | Accumulated Depletion and Depreciation<br>$ | Net Book Value<br>$ |
| Oil and gas properties/production equipment | 16,234,753 | 1,433,059 | 14,801,694 |
| Assets under capital lease [note 13] | 175,689 | 71,482 | 104,207 |
| Furniture and computer equipment | 13,472 | 3,497 | 9,975 |
| | 16,423,914 | 1,508,038 | 14,915,876 |

a) On January 16, 2003, in conjunction with the Onward Plan of Arrangement, the Trust purchased oil and gas assets from an arms length third party for a total cost of $2,040,451.

b) On January 31, 2003 the Trust purchased oil and gas assets from an arms length party at a total cost of $1,183,197.

c) On October 24, 2003 the Trust purchased oil and gas assets from an arms length party at a total cost of $6,256,999.

d) See also notes 4, 5 and 6.

e) In 2002 the Trust had not yet concluded any oil and gas transactions in which property, plant and equipment had been recorded on the balance sheet. The Trust had however entered into a Participation Agreement with Provident Energy Trust ("Provident"), which allows the Trust to participate in oil and gas exploration and development on a large Southern Alberta land block where it had identified several prospects. The farm-in arrangement dated September 25, 2002 committed the Trust to expenditures of $1,500,000 on development, exploration and recompletion work prior to December 31, 2003. The agreement was recorded at no cost.

   Up to December 31, 2003, the Trust had proposed drilling operations totaling more than $2,000,000 in expenditures relating to the Southern Alberta land block. As Provident has the option under the agreement to evaluate the proposals as operations Provident would be undertaking themselves or operations in Provident's view that may be draining existing Provident reserves, Provident can reject any proposals made by the Trust. To date all proposals made by the Trust have been rejected by Provident. An extension to the initial Participation Agreement is being discussed on specific prospects in the original Southern Alberta land block.

f) In accordance with stated accounting policies, the Trust has performed a ceiling test calculation using commodity prices as at the measurement date of December 31, 2003. Using December 31, 2003 commodity prices of $5.87/mcf for natural gas and US$32.78 /bbl for crude oil, a ceiling test surplus existed.

g) Undeveloped land of $150,000 has been excluded for purposes of calculating depletion and depreciation (2002 - $nil).

## 8. CASH DISTRIBUTIONS

Cash distributions declared per Trust unit issued and outstanding:

| Period covered | Date of Distribution | Per Unit $ |
|---|---|---|
| January 16, 2003 to February 28, 2003 | 03/14/2003 | 0.00675 |
| March 1, 2003 to March 31, 2003 | 04/15/2003 | 0.00525 |
| April 1, 2003 to April 30, 2003 | 05/15/2003 | 0.00525 |
| May 1, 2003 to May 31, 2003 | 06/15/2003 | 0.00525 |
| June 1, 2003 to June 30, 2003 | 07/15/2003 | 0.00525 |
| July1, 2003 to July 31, 2003 | 08/15/2003 | 0.00583 |
| August 1, 2003 to August 31, 2003 | 09/15/2003 | 0.00583 |
| September 1, 2003 to September 30, 2003 | 10/15/2003 | 0.00583 |
| October 1, 2003 to October 31, 2003 | 11/15/2003 | 0.00583 |
| November 1, 2003 to November 30, 2003 | 12/15/2003 | 0.00583 |
| December 1, 2003 to December 31, 2003 | 01/15/2004 | 0.00583 |

As at December 31, 2003 the Trust had distributions owing of $241,964 (2002 - $nil).

## 9. SHORT-TERM INVESTMENTS

On December 31, 2002, the Trust held a portfolio investment of 100,000 units in Provident Energy Trust, an oil and gas Trust. In order to lock in returns and diversify the Trusts' investment exposure, the units were sold on June 30, 2003 and a gain of $75,190 was recognized.

On July 26, 2003 the Trust purchased units of three publicly trading energy trusts. Total cost of the acquisitions was $1,088,111. On September 25, 2003, in order to partially deploy funds prior to its use for investment in long-term opportunities, the Trust purchased additional units of publicly trading energy trusts at a cost of $1,959,579. All short-term investments in units were sold during the fourth quarter of 2003 to finance activities in line with the Trust's business plan and a gain of $53,319 was recognized.

## 10. FINANCIAL INSTRUMENTS

**a) Fair values of financial assets and liabilities**

The Trust's financial instruments consist of cash and cash equivalents, accounts receivable, short-term investments, financial services contracts, bank indebtedness, accounts payable, distributions payable and capital lease obligations. Unless otherwise noted, as at December 31, 2003 and 2002, there were no significant differences between the carrying amounts of these financial instruments and their estimated fair values.

The Trust was a party to certain off balance sheet derivative instruments in 2003 consisting of fixed price forward contracts. The contracts outstanding with respect to the hedging activities at December 31, 2003 are as follows:

A fixed price swap for the period April 1, 2003 to March 31, 2004 on 85 bbls/day of oil at a price of US$28.00 West Texas Intermediate ("WTI").

A fixed price swap for the period July 1, 2003 to June 30, 2004 on 33 bbls/day of oil at a price of US$27.45 WTI.

A fixed price swap for the period April 1, 2004 to June 30, 2004 on 85 bbls/day of oil at a price of US$27.70 WTI.

A fixed price swap for the period July 1, 2004 to June 01, 2005 on 100 bbls/day of oil at a price of US$27.78 WTI.

Based on dealer quotes, had these contracts been closed on December 31, 2003, a loss of $125,676 would have been realized.

**b) Credit risk**

The Trust's financial instruments that are exposed to credit risk consist primarily of trade accounts receivable and financial services contracts. Although a substantial portion of trade receivables is dependant upon the strength of the Canadian oil and gas industry, management considers credit risk to be minimal. Management routinely assesses the financial strength of partners and customers, and monitors the exposure for credit losses.

Of the Trust's significant individual accounts receivable as at December 31, 2003, approximately 23% was due from one company relating to oil and gas sales in relation to trade accounts receivable.

With respect to financial instruments, the Trust could be exposed to losses if the counter party fails to perform in accordance with the terms of the contract. This risk is managed by diversifying the derivative portfolio among counter parties meeting certain financial criteria.

The Trust's financial services contracts are with affiliates of a financial services provider and with a chain of cash advance stores. The stated return on the financial services contracts and the principal are subject to significant credit risk. The Trust has attempted to mitigate this risk through the advancing of amounts through various counter parties, however, some credit risk remains. Under the Trust's revenue recognition policy, fees earned on these contracts are adjusted to reflect anticipated credit losses. Although no credit loss provision currently exists, a credit loss provision will be established when management deems the risk of credit loss to be significant.

**c) Interest rate risk**

The Trust is exposed to interest rate fluctuations on its bank indebtedness, which is tied to Canadian bank prime rate. Also, given the fixed fee nature and the long period to maturity of the financial services contracts, a significant change in interest rates will affect the value of these contracts.

## 11. FINANCIAL SERVICES CONTRACTS

| | 2003<br>$ | 2002<br>$ |
|---|---|---|
| Contracts with 19695 Yukon Inc. (i) | 1,200,000 | 600,000 |
| Debenture with RENTCASH (ii) | 2,041,963 | — |
| | 3,241,963 | 600,000 |

(i) The Trust has entered into financial services contracts with 19695 Yukon Inc., an affiliate of a financial services provider which is related to a member of the Trust's Board of Directors, to provide funding on two-ten year contracts to a cash advance company providing cash advance, cheque cashing and payday loan services. The initial $600,000 contract pays the Trust a fixed fee of $0.07 per $100 loaned per day and is recallable at the Trust's option with thirty days notice. The initial contract was funded on September 15, 2002 and is collateralized by the assets of 19695 Yukon Inc. An additional $600,000 contract was funded on January 31, 2003, under the same terms as the initial contract. The fair value of the financial services contracts at December 31, 2003 was $1,822,222.

(ii) The Trust entered into an agreement to provide a debenture in the amount of $2,000,000 to RENTCASH Inc. ("RENTCASH") on December 5, 2003 which was funded on December 15, 2003. The non-revolving loan pays the Trust interest at a fixed rate of 12% and a financing fee of 4% per annum. The loan matures on December 5, 2006. Costs incurred in establishing this agreement in the amount of $41,963 have been capitalized and are being amortized over the term of the loan which is three years. The fair value of the debenture, based upon market value at December 31, 2003 was $2,000,000.

## 12. BANK INDEBTEDNESS

The Trust has a combined revolving demand facility with a major Canadian bank in the amount of $5,200,000 bearing interest at bank prime plus one percent. The revolving facility is collateralized by a floating charge debenture over all of the Trust's assets. The Trust also has an acquisition and development line of $2,000,000, bearing interest at bank prime plus one and one-half percent, to fund additional oil and gas acquisitions. The Trust also has a bridge demand loan of $3,000,000 bearing interest at bank prime plus two percent, to fund real estate acquisitions. The effective interest rate at December 31, 2003 was 6.5%.

As at December 31, 2003 there was $4,505,000 outstanding on the revolving demand facility.

At December 31, 2003 the Trust had two letters of credit outstanding in the amounts of $20,000 and $25,000.

## 13. CAPITAL LEASE OBLIGATIONS

The Trust has a capital lease for equipment which is repayable in monthly installments of $5,537 including interest at a fixed interest rate of 8% per annum. The lease matures on June 6, 2005 and is collateralized by specific equipment purchased.

Future minimum lease payments at December 31, 2003 are as follows:

| | $ |
|---|---|
| 2004 | 66,441 |
| 2005 | 33,221 |
| Total minimum lease payments | 99,662 |
| Less amount representing interest | (6,041) |
| | 93,621 |
| Current portion of minimum lease payments | (61,162) |
| | 32,459 |

## 14. SHAREHOLDERS'/UNITHOLDERS' CAPITAL

### a) Unitholders' capital

**Authorized**

Authorized capital consists of an unlimited number of Trust Units, without par, and an unlimited number of Special Voting Units, without par. No Special Voting Units have been issued to date.

**Issued**

| Trust Units | Number of Units | $ |
|---|---|---|
| Balance December 31, 2002 | — | — |
| Units issued on 928719 corporate purchase (i) | 7,650,000 | 1,325,182 |
| Units issued on Onward Trust conversion [note 4] | 2,194,373 | 877,749 |
| Units from Special Warrants financing January 16, 2003 (ii) | 10,158,801 | 4,063,520 |
| Units financing February 27, 2003 (iii) | 1,166,750 | 466,700 |
| Units issued on Outback Acquisition [note 5] | 2,333,358 | 1,050,011 |
| Units issued on private placement (iii) | 16,000,000 | 8,000,000 |
| Units issued on 728409 Acquisition [note 6] | 2,000,000 | 1,000,000 |
| Trust unit issue costs | — | (931,220) |
| Balance December 31, 2003 | 41,503,282 | 15,851,942 |

(i) On January 15, 2003 the value of the 928719 shares acquired by the Trust was $1,325,182 which is based on the cost of the 928719 shares at December 31, 2002 of $1,070,000 and $255,182 relating to liabilities that were assumed by the shareholders of 928719 prior to the Arrangement (see note 1).

(ii) On January 16, 2003 the value of Special Warrants converted to Trust units was $4,063,520 which is based on the initial set up of the Trust (see note 1) at a unit price of $0.40 which was equivalent to the market price at the time of issuance.

(iii) On February 27, 2003 the value of the units issued by the Trust was $466,700 which is based on the market price per unit of $0.40. On September 24, 2003 the value of the units issued by the Trust was $8,000,000 which was based on the market price per unit of $0.50.

**b) Shareholders' capital**

**Authorized**

928719's authorized share capital consisted of an unlimited number of common shares.

**Issued**

| | Number of Shares | $ |
|---|---|---|
| Balance, December 31, 2001 | 6,000,000 | 60,000 |
| Equity issue on acquisition of publicly trading trust units (i) | 2,000,000 | 1,010,000 |
| Balance, December 31, 2002 | 8,000,000 | 1,070,000 |
| Converted to trust units | (8,000,000) | (1,070,000) |
| Balance, December 31, 2003 | — | — |

(i) 928719 issued 2,000,000 common shares to Avenir Capital Corporation, in May 2002 in exchange for 100,000 units of a larger publicly trading, oil and gas royalty trust (see note 9). The shares were valued based on the fair market value of the 100,000 units acquired at the date of exchange.

**c) Net income (loss) per unit/share**

For the year ended December 31, 2003 the Trust had a weighted average of 27,621,558 trust units outstanding (December 31, 2002 – 7,342,468). For the year ended December 31, 2003, the interval used to calculate the weighted average units outstanding was January 16, 2003 to December 31, 2003 inclusive. The diluted per unit amount was calculated assuming the exercise of outstanding in-the-money options resulting in a weighted average number of trust units/shares outstanding for the year ended December 31, 2003 of 28,182,317 (December 31, 2002 – 7,342,468). At December 31, 2003 there were no anti-dilutive options.

## 15. STOCK-BASED COMPENSATION

Under the Trust's unit option plan, options to acquire trust units are granted to employees and directors from time to time at exercise prices equal to the market value of the units at the date of the grant. Options granted under the plan vest over a three-year period and have a five-year life. The exercise price of the options is periodically adjusted to reflect the Trust's monthly distributions. Any consideration paid on exercise of stock options is credited to share capital. A total of 2,116,992 units have been reserved under this plan.

At December 31, 2003 a total of 1,850,000 options vesting over three years had been granted under the Trust option plan. No options granted under the unit option plan had vested. 1,600,000 of the options granted to date have an exercise price of $0.40 and the remaining 250,000 options have an exercise price of $0.50. The average remaining life of the options is 4.18 years and the average remaining vesting period of the options is 1.18 years. For the year ended December 31, 2003 no options were forfeited or expired.

The Trust recorded compensation expense and contributed surplus, based on the year end unit price, of $119,868 for all options granted on or after January 1, 2003.

## 16. RELATED PARTY TRANSACTIONS

In addition to the related party transaction described in note 11, the Trust paid $85,654 during the year ended December 31, 2003 for corporate administrative and financial services provided by Avenir Capital Corporation, a major unitholder of the Trust and in effect the sponsor of the Trust.

For the year ended December 31, 2002, Avenir Capital Corporation, provided $130,633 in corporate administrative, financial and operational services to 928719 as part of the Trust's initial start-up. These costs were recorded as a payable at December 31, 2002 and subsequently exchanged for equity in 928719 as part of the Plan of Arrangement reorganization. During 2002, shareholders of 928719 agreed to fund debts incurred by 928719 relating to geological and engineering consulting costs. At December 31, 2002, $300,000 was recorded as a payable and subsequently exchanged for equity in 928719 as part of the Onward Plan of Arrangement reorganization.

## 17. COMMITMENTS

The contracts outstanding with respect to the physical deliveries of oil and gas at December 31, 2003 are as follows:

A physical fixed price swap for the period April 1, 2004 to October 31, 2004 on 700 gigajoules/day of gas at a price of $5.91.

A physical fixed price swap for the period November 1, 2004 to October 31, 2005 on 700 gigajoules/day of gas at a price of $5.94.

Total site restoration costs relating to the oil and gas properties owned by the Trust is $1,539,600.

The Trust indemnifies its directors and officers who are, or were, serving at the Trust's request in such capacities. These costs have not been material to the Trust's financial position, operations, or cash flows.

## 18. FUTURE INCOME TAXES

The difference between the accounting value and the income tax value of assets and liabilities, which comprise the future tax liability, are as follows:

| | 2003<br>$ |
|---|---|
| Oil and gas properties/production equipment | 60,667 |
| Provision for future site restoration and abandonment | (196,350) |
| | (135,683) |
| Valuation allowance | 135,683 |

The future income tax provision differs from the expected amount calculated by applying the Canadian combined federal and provincial income tax rate of 40.75 percent as follows:

| | 2003<br>$ |
|---|---|
| Earnings before income taxes | 519,180 |
| Statutory income tax rate | 40.75% |
| | 211,566 |
| Increase (decrease) resulting from: | |
| Non-deductible crown charges | 18,242 |
| Resource allowance | (42,765) |
| Trust distributions | (515,644) |
| Temporary differences not recognized at the subsidiary level | 288,371 |
| Non-taxable capital gain | (11,365) |
| Non-taxable stock based compensation expense | 48,846 |
| Other | 2,749 |

## 19. SEGMENTED INFORMATION

The Trust determines its reportable segments based on the structure of its operations, which are primarily focused on two principal business segments – oil and gas and financial services. The following is the financial information as at December 31, 2003 and for the year then ended. The Trust had no real estate assets in 2003.

| | Oil and Gas<br>$ | Financial Services<br>$ | Total<br>$ |
|---|---|---|---|
| **Revenue** | | | |
| Revenue net of royalties | 3,796,376 | — | 3,796,376 |
| Financial services revenue | 122,010 | 403,369 | 525,379 |
| Other revenue | 125,436 | 8,227 | 133,663 |
| | 4,043,822 | 411,596 | 4,455,418 |
| **Expense** | | | |
| Oil and gas operating | 1,025,986 | — | 1,025,986 |
| General and administrative | 781,659 | 87,255 | 868,914 |
| Unsuccessful acquisition and re-organizational costs | 233,057 | — | 233,057 |
| Capital tax | 12,848 | — | 12,848 |
| Depletion and depreciation | 1,508,038 | — | 1,508,038 |
| Site restoration | 110,891 | — | 110,891 |
| Bank fees and interest | 152,020 | 24,484 | 176,504 |
| | 3,824,499 | 111,739 | 3,936,238 |
| **Net income** | 219,323 | 299,857 | 519,180 |

| | Oil and Gas<br>$ | Financial Services<br>$ | Total<br>$ |
|---|---|---|---|
| Selected balance sheet items | | | |
| Capital assets | 14,915,876 | — | 14,915,876 |
| Financial services contracts | — | 3,241,963 | 3,241,963 |
| Goodwill | 1,086,729 | — | 1,086,729 |
| Bank indebtedness | 4,505,000 | — | 4,505,000 |

For the year ended December 31, 2002, all operating results were derived from the financial services operating segment.

## 20. SUBSEQUENT EVENTS

On January 21, 2004 the Trust announced that it had entered into an agreement with Western Spirit Investments Ltd. ("Western Spirit"), a publicly traded real estate company, pursuant to which the Trust will acquire Western Spirit under a plan of arrangement. Pursuant to the plan of arrangement each common share of Western Spirit will effectively be exchanged for consideration paid, at the election of each shareholder, in (i) $0.57 cash per common share to a maximum of $3,000,000 cash in aggregate or (ii) 0.95 of a trust unit of the Trust per common share or any combination of the forgoing plus one right for each common share. Western Spirit shareholders met on March 26, 2004 to approve the proposed plan of arrangement with 100% approval of those shareholders that voted at the meeting. Court approval is expected to follow on March 30, 2004.

On March 25, 2004 the Trust sold non core oil and gas assets to an arm's length party for total cash consideration of $916,616 including adjustments to date.

On March 26, 2004 the Trust purchased oil and gas assets from an arm's length party for total cash consideration of $922,331 including adjustments to date. Also on March 26, 2004 the Trust purchased additional oil and gas assets from another arm's length party for total cash consideration of $678,014 including adjustments to date.

## CORPORATE INFORMATION

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Avenir Diversified Income Trust
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Alan Moon [1,2]
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David Butler [1,3]
Calgary, Alberta

Stuart Chow [2,3]
Calgary, Alberta

Jeff Kohn [1,2]
Calgary, Alberta

1 Audit Committee
2 Governance and Compensation Committee
3 Reserves Committee

**Officers & Key Personnel**
William Gallacher, P.Eng
President & CEO

Gary Dundas, CMA, MBA
Vice President, Finance & CFO

Jill Koskimaki
Manager Business Development

Michelle O'Grady, CA
Controller

**Advisors**
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**Corporate Secretary**
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