

ZARGON ENERGY TRUST

The third quarter of 2004 marked the inaugural quarter for Zargon Energy Trust ("Zargon" or the "Trust"). On July 15, 2004 court approval was received for the reorganization of Zargon Oil & Gas Ltd. ("the Company") into a sustainable income trust. Although structurally reorganized, Zargon Energy Trust retained all of the key elements; including the properties, staff, Board of Directors and operating business philosophies that provided the foundation for Zargon Oil & Gas Ltd.'s successful eleven-year history as a public Company. Consequently, the reorganization has been treated as a continuity of interest and the Trust's financial statements for the period ended September 30, 2004 are reported as though the Trust had always carried on the business of the Company.

Highlights from the third quarter and nine months ended September 30, 2004 are noted below:

- Historically high commodity prices held throughout the third quarter, resulting in record quarterly revenues of \$32.41 million, five percent above the preceding quarter and 36 percent above \$23.76 million in third quarter 2003. Revenue for the nine months to September 30, 2004 was also a record at \$91.07 million.
- Third quarter 2004 production averaged 8,405 barrels of equivalent per day, an increase of three percent from the preceding quarter and 13 percent from third quarter 2003. Third quarter production on a per unit basis (previously per share) was two percent higher than the preceding quarter and nine percent higher than the 2003 third quarter. The production gains were primarily provided from successful natural gas drilling programs in Zargon's West Central and Alberta Plains core areas that brought the average natural gas production for the quarter to 29.90 million cubic feet per day. Oil and liquids production averaged 3,422 barrels per day for the 2004 third quarter and was supported by the late July acquisition of operated producing interests in the Weyburn, Saskatchewan area of the Williston Basin.
- Cash flow from operations for the third quarter 2004 of \$16.13 million was two percent less than the preceding quarter but represented an increase of 31 percent from the \$12.34 million reported in third quarter 2003. The record level of cash flow in the nine month period to September 30, 2004 of \$48.39 million is directly attributable to the combination of very high commodity prices and increased production volumes. The unprecedented commodity prices produced hedging losses of \$1.43 million for the 2004 third quarter and \$3.01 million for the 2004 nine month period.
- The Trust provided for its first two monthly cash distributions of \$0.14 per unit in the 2004 third quarter. This monthly unit distribution rate is equivalent to approximately 48 percent of the Trust's third quarter cash flow of \$0.87 per diluted unit. Cash distributions totaled \$4.27 million for the months of August and September and due to the effect of the exchangeable share component of Zargon's capitalization equated to approximately 40 percent of the cash flow for the comparable two month period. Capital expenditures for the third quarter included \$12.55 million for a very active field exploration and development program and \$11.09 million for the acquisition of oil and gas properties.
- Net earnings for the nine months ended September 30, 2004 of \$16.17 million is 20 percent lower than the corresponding period of 2003 where the future taxes provision contained a large multi-year adjustment for reduced federal tax rates.

**FINANCIAL &
OPERATING
HIGHLIGHTS**

FOR THE THREE AND
NINE MONTHS ENDED
SEPTEMBER 30, 2004

(unaudited)	Three months ended September 30			Nine months ended September 30		
	2004	2003	Percent Change	2004	2003	Percent Change
FINANCIAL						
Income and Investments (\$ million)						
Petroleum and natural gas revenue	32.4	23.8	36	91.1	77.1	18
Cash flow from operations	16.1	12.3	31	48.4	41.1	18
Cash distributions	4.3	–	–	4.3	–	–
Net earnings (note 1)	5.1	4.4	15	16.2	20.3	(20)
Net capital expenditures	23.6	12.1	95	41.0	27.1	51
Per Unit, Diluted (note 2)						
Cash flow from operations (\$/unit)	0.87	0.67	30	2.58	2.24	15
Net earnings (\$/unit) (note 1)	0.27	0.24	13	0.86	1.11	(23)
Cash Distributions (\$/trust unit)	0.28	–	–	0.28	–	–
Balance Sheet at Period End (\$ million)						
Property and equipment, net (note 1)				190.6	161.2	18
Bank indebtedness				9.8	8.9	10
Unitholders' equity (note 1)				121.3	107.8	12
Total Units Outstanding at Period End (million) (note 3)				18.55	17.89	4
OPERATIONS						
Average Daily Production						
Oil and liquids (bb/d)	3,422	3,341	2	3,348	3,269	2
Natural gas (mmcf/d)	29.90	24.77	21	28.81	23.90	21
Equivalent (boe/d) (note 4)	8,405	7,470	13	8,149	7,252	12
Equivalent per million units (boe/d) (note 4)	457	418	9	445	408	9
Average Selling Price (before hedges)						
Oil and liquids (\$/bbl)	49.74	36.39	37	44.73	37.95	18
Natural gas (\$/mcf)	6.09	5.51	11	6.34	6.63	(4)
Wells Drilled, Net	15.2	11.5	32	33.5	22.5	49
Undeveloped Land at Period End (thousand net acres)				399	379	5

Note 1: Comparative period numbers reflect retroactive restatement due to a change in accounting policy.

Note 2: The diluted per unit amounts are calculated using the diluted weighted average number of units outstanding during the period, including the weighted average number of exchangeable shares outstanding for the period converted at the exchange ratio at the end of the period.

Note 3: Total units outstanding include trust units plus the exchangeable shares outstanding at period end. The exchangeable shares are converted at the exchange ratio at the end of the period.

Note 4: The calculation of barrels of equivalent is based on the conversion ratio that six thousand cubic feet of natural gas is equivalent to one barrel of oil (boe). Average daily production per million units is calculated using the weighted average number of units outstanding during the period, including the weighted average number of exchangeable shares outstanding for the period converted at the exchange ratio at the end of the period.

PRODUCTION*

Natural gas production volumes averaged 29.90 million cubic feet per day in the three months ended September 30, 2004, a gain of 21 percent from the corresponding period of 2003. As a sustainable trust, one of Zargon's key initiatives will be to offset the naturally occurring gas production rate declines through production additions derived from field-related exploration and development capital expenditures. Over the last three years Zargon has been successful in maintaining stable natural gas production volumes at Zargon's principal gas property located at Jarrow in the Alberta Plains. In 2004, field-related capital programs have continued to be successful in maintaining Jarrow production volumes. Specifically, in the third quarter several promising Jarrow wells were drilled that were not tied-in by quarter-end, but should permit continued stable production volumes for the majority of the upcoming winter. In addition to the successful Alberta Plains capital programs, Zargon has posted significant corporate natural gas production gains over the last year from successful exploration initiatives in the Highvale, Pembina and Peace River Arch properties of the West Central Alberta core area.

Oil and liquid production of 3,422 barrels per day in the 2004 third quarter and 3,348 barrels per day in the nine months ended September 30, 2004 provided gains of two percent in each case over the comparable periods of 2003. On July 26, 2004 Zargon closed a 250 barrels per day acquisition in the Weyburn, Saskatchewan area of the Williston Basin. These interests have now been integrated with Zargon's existing holdings and provide further development and waterflood enhancement activities. Recently drilled successful oil wells at Weyburn, Saskatchewan and Haas, North Dakota have now been placed on production and should offset the Trust's corporate declines and provide the basis for the projected corporate fourth quarter oil production gains. Going forward, the Williston Basin will receive an expanded capital drilling and facility budget to accelerate the development of Zargon's very large inventory of waterflood and exploitation projects.

EXPLORATION AND EXPLOITATION*

During the 2004 third quarter, Zargon drilled 17 gross wells (15.2 net) that delivered 12.0 net natural gas wells, 2.2 net oil wells and 1.0 net dry hole for a 93 percent success ratio. Natural gas wells drilled in the third quarter include 7.4 net wells at Jarow and 2.0 net wells at Hamilton Lake, also in the Alberta Plains area, plus 2.6 net wells in West Central Alberta. The third quarter's 2.2 net oil wells were all related to oil development or waterflood exploitation projects in the Williston Basin.

During the third quarter, Zargon concluded its initial earning phase on an industry farm-in on the Blackfeet Indian reservation in northern Montana, United States. During this first phase exploration program two wells were drilled, one suspended well was completed and two existing wells were production tested. Following a thorough evaluation of the exploration results, Zargon elected to not commit to further exploration expenditures on this large land block and has consequently forfeited the right to earn further interests. For the nine months ended September 30, 2004 the Trust drilled 33.5 net wells yielding 25.2 net gas wells, 4.3 net oil wells and 4 net dry holes, which equates to an 88 percent success ratio.

A very active drilling program is scheduled for the 2004 fourth quarter with eight wells planned in the Alberta Plains and eight wells scheduled for West Central Alberta. In addition, at least two oil exploitation wells will be drilled in our Williston Basin core area taking the corporate year-end totals to approximately 48 net wells. Following an unseasonably wet summer, Zargon's tie-in and completion work on a backlog of new natural gas wells is continuing briskly and significant progress has also been made on the Williston Basin waterflood enhancement projects at Haas, North Dakota and Frys, Carnduff and Steelman, Saskatchewan.

One of the key elements of Zargon's business strategy is to sustain per unit natural gas production volumes through ongoing exploration and development capital programs. These programs are supported by a large inventory of undeveloped land that totaled 399 thousand net acres at the end of the third quarter. Despite the current very competitive Crown land sale environment, Zargon will continue to at least partially offset Crown land expiries with an active undeveloped Crown land acquisition program that replenishes Zargon's inventory of natural gas exploration opportunities.

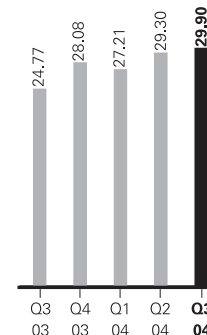
ACQUISITIONS/DISPOSITIONS

In the third quarter, Zargon acquired a portfolio of oil properties in the Weyburn, Saskatchewan area of the Williston Basin. These properties, which include operated interests in six small Units, integrate well with our existing properties and in most cases added to existing holdings. They are interpreted to hold significant exploitation potential in terms of waterflood enhancements or expansions. The purchase price was \$10 million and the acquisition brought approximately 250 barrels per day of additional oil production. For the nine months ended September 30, 2004, net property acquisitions totaled \$11.61 million.

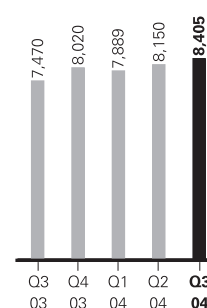
OIL AND LIQUID PRODUCTION
(bbl/d)



NATURAL GAS PRODUCTION
(mmcf/d)



PRODUCTION
(boe/d)



ZARGON ENERGY TRUST BUSINESS STRATEGY*

The July 15, 2004 corporate reorganization created a sustainable energy trust named Zargon Energy Trust. The Trust functions by distributing approximately 50 percent of the cash flow from operations attributed to the outstanding unitholders. The Trust will seek to sustain production and reserve levels on a per unit basis through the reinvestment of the remaining cash flow from operations. These exploration and development capital programs will continue to follow Zargon's successful complementary strategies of exploring for natural gas reserves and exploiting existing oil reservoirs. Property acquisition programs funded by bank debt or possibly equity issues will continue to be sought to provide per unit production and reserve growth, but only on a value added opportunistic basis.

GUIDANCE*

In a May 17, 2004 press release relating to the pending reorganization, third quarter 2004 production guidance for the Trust was set at 8,400 barrels of equivalent per day based on estimates of 30 million cubic feet per day of natural gas and 3,400 barrels per day of oil and liquids. These guidance levels were almost exactly met with third quarter actual results of 29.90 million cubic feet per day of natural gas and 3,422 barrels per day of oil and liquids, giving 8,405 barrels of equivalent per day. The Trust's current operating objective is to maintain production of natural gas while seeking modest growth in oil and liquids production, in both cases through internally generated exploration and development capital programs. Accordingly, the Trust anticipates production for the fourth quarter will average 8,500 barrels of equivalent per day, comprised of 30 million cubic feet per day of natural gas and 3,500 barrels per day of oil and liquids.

Upon signing the third quarter 2004 Weyburn property acquisition, Zargon increased its 2004 capital budget to \$45 million with \$35 million allocated to exploration and development activities and \$10 million assigned to property acquisitions. With net capital expenditures of \$41.02 million to September 30 and a strong fourth quarter field plan, we now anticipate that capital expenditures for 2004 will reach \$50 million and will be comprised of \$38 million of field related exploration and development expenditures plus \$12 million of property acquisitions. With higher than anticipated capital expenditures in the first nine months, the Trust's net debt climbed to \$16.75 million at the end of the third quarter, a level that represents approximately three months of current cash flows. Looking forward we expect that the Trust will continue to maintain the strong balance sheet that has been a feature of Zargon's past performance and that will provide the Trust with financial flexibility during the inevitable future periods of lower commodity prices.

For 2005, Zargon has set its preliminary field-related exploration and development capital budget at \$40 million. This exploration and development capital budget is essentially equally divided between Zargon's Alberta Plains, West Central Alberta and Williston Basin core areas and projects the drilling of more than 50 net wells. The 2005 budget does not designate a property or corporate acquisition component, as additional funds will be allocated when appropriate value-added acquisitions have been sourced. Property or corporate acquisition programs will be funded by bank debt or possibly equity issues. Future acquisitions will focus on underdeveloped oil properties (particularly in the Williston Basin) or undeveloped lands that will provide Zargon opportunities to sustain production and reserves on a per unit basis through efficient exploration and development capital programs.

** Please see comments on "Forward-Looking Statements" on the last page of this report.*

Management's discussion and analysis (MD&A) should be read in conjunction with the unaudited interim consolidated financial statements for the nine months ended September 30, 2004 and the audited consolidated financial statements and MD&A for the year ended December 31, 2003. All amounts are in Canadian dollars unless otherwise noted. All references to "Zargon" or the "Trust" refer to Zargon Energy Trust and all references to the "Company" refer to Zargon Oil & Gas Ltd.

In the MD&A, reserves and production are commonly stated in barrels of equivalent using a conversion of six thousand cubic feet of natural gas being equal to one barrel of oil (boe). Boe's may be misleading, particularly if used in isolation. A boe conversion ratio of six thousand cubic feet of natural gas being equal to one barrel of oil is based on an energy equivalent conversion method primarily applicable at the burner tip and does not represent a value equivalent at the wellhead.

Non-GAAP Measurements: The MD&A contains the term "cash flow from operations" ("cash flow") which should not be considered an alternative to, or more meaningful than, "cash flow from operating activities" as determined in accordance with Canadian GAAP as an indicator of the Trust's financial performance. The Trust's determination of cash flow from operations may not be comparable to that reported by other companies or trusts. The reconciliation between net earnings and cash flow from operations can be found in the consolidated statements of cash flows in the consolidated financial statements. The Trust evaluates its performance based on net earnings and cash flow from operations. The Trust considers cash flow from operations to be a key measure as it demonstrates the Trust's ability to generate the cash necessary to pay distributions, repay debt and to fund future capital investment. Cash flow from operations per unit is calculated using the diluted weighted average number of units for the period.

This MD&A has been prepared as of November 10, 2004.

PLAN OF ARRANGEMENT

On July 15, 2004, approval was given by the shareholders to a resolution in favour of a Plan of Arrangement (the "Arrangement") reorganizing Zargon Oil & Gas Ltd. (the "Company") into Zargon Energy Trust (the "Trust" or "Zargon"). The Arrangement received court approval and also became effective on July 15, 2004. The Arrangement resulted in shareholders of the Company receiving either one trust unit or one exchangeable share for each common share held. The unitholders of the Trust are entitled to receive cash distributions paid by the Trust. Holders of exchangeable shares are not eligible to receive distributions but rather on each payment of a distribution, the number of trust units into which each exchangeable share is exchangeable is increased on a cumulative basis in respect of the distribution. Upon completion of the Arrangement, 14.87 million trust units and 3.66 million exchangeable shares were issued. The Trust is an unincorporated open-end investment trust governed by the laws of the Province of Alberta. It is the intent of the Trust to distribute approximately 50 percent of the cash flow from operations attributable to outstanding unitholders.

The reorganization of the Company into a Trust has been accounted for using the continuity of interest method. Accordingly, the consolidated financial statements for the nine months ended September 30, 2004 reflect the financial position, results of operations and cash flows as if the Trust had always carried on the business of the Company. All comparative figures referred to in the consolidated financial statements and this MD&A are the previous consolidated results of the Company.

SUMMARY OF SIGNIFICANT EVENTS IN THE THIRD QUARTER

- Monthly distributions of \$0.14 per unit from the Trust commenced during the quarter with a total of \$4.27 million (\$0.28 per unit) declared distributable to unitholders. For Canadian income tax purposes, the distributions are currently estimated to be 100 percent taxable income to unitholders.
- Reorganization costs related to the Arrangement of \$9.44 million were charged to unitholders' equity during the quarter of which \$7.87 million relates to the settlement of employee and director stock options as part of the Arrangement.
- On July 26, 2004 a portfolio of operated producing property interests in the Weyburn area of Southeast Saskatchewan was purchased for approximately \$10 million. This purchase adds approximately 250 barrels per day of oil production to Zargon.

FINANCIAL ANALYSIS

In the first nine months of 2004, Zargon increased petroleum and natural gas revenues, natural gas production, and oil and liquids production by 18 percent, 21 percent, and two percent respectively compared to the nine month period ended September 30, 2003. With continued strength in oil prices, the average oil price which Zargon received during the first nine months of 2004 was \$44.73 per barrel before hedges, an increase of \$6.78 per barrel from the first nine months of 2003. The average natural gas price received before hedges for the first nine months was \$6.34 per thousand cubic feet, a decrease of four percent from the comparable period in 2003. Third quarter revenues for 2004 were \$32.41 million, a 36 percent increase compared to the third quarter of 2003 and five percent higher than the preceding quarter. The average oil price received before hedges in the third quarter of 2004 was \$49.74 per barrel, a 37 percent and 12 percent increase from the 2003 third quarter and the second quarter of 2004, respectively. Natural gas prices remained strong for the summer season at an average of \$6.09 per thousand cubic feet before hedges in the third quarter. This was an increase of 11 percent and a decrease of nine percent, respectively, over the 2003 third quarter and the second quarter of 2004.

Natural gas production volumes were 29.90 million cubic feet per day in the third quarter of 2004, an increase of 21 percent over 2003 third quarter levels and a two percent increase from the preceding quarter volume of 29.30 million cubic feet per day. Production from successful drilling programs during the quarter were partially offset by natural declines and delays in completions and tie-in activities due to wet field conditions. In the third quarter, oil and liquids production was 3,422 barrels per day, an increase of two percent compared to the third quarter of 2003 and a five percent increase from the second quarter of 2004. The increase in the third quarter was attributable to the acquisition on July 26th of a group of operated interests in the Weyburn, Saskatchewan area of the Williston Basin with aggregate production additions of approximately 250 barrels per day.

Hedging losses in third quarter 2004 were \$1.43 million compared to \$0.35 million in the 2003 third quarter and \$1.31 million in the second quarter of 2004. The primary driver for these losses was the continuation of record high oil prices along with strong Alberta natural gas prices. Zargon's policy of hedging 20-35 percent of working interest production has been consistently followed throughout the year. This policy, which is designed to protect a minimum level of cash flow in the event of falling prices, generates hedging losses in periods of sustained rising prices such as 2003-2004. For the nine months ended September 30, 2004, total hedging losses are \$3.01 million compared to \$3.05 million for the comparable period in 2003. In 2003, the losses were largely due to increases in natural gas prices for the period. In 2004, the losses to date are primarily attributable to the strength in oil prices. If oil and natural gas prices continue their strength, continued losses can be expected for the last quarter of 2004. For a complete listing of hedges as at September 30, 2004 refer to note 8 to the unaudited consolidated interim financial statements.

Royalties, inclusive of Alberta Royalty Tax Credit and Saskatchewan Resource Surcharge tracked the changes in gross revenue and totaled \$7.39 million for the third quarter of 2004, an increase of seven percent from the preceding quarter and 30 percent from the 2003 third quarter. As a percentage of gross revenue, royalty rates have remained relatively constant at 22.2 percent for the nine months to September 30, 2004. The third quarter 2004 rate of 22.8 percent compares to 22.2 percent in the second quarter and 24.0 percent for the third quarter 2003.

On a unit of production basis, production costs have increased to \$7.45 per barrel of equivalent in third quarter 2004 compared with \$6.79 in the preceding quarter and \$6.32 in third quarter 2003. The increase in the third quarter of 2004 is mainly attributable to seasonal natural gas facility, battery and well maintenance costs plus the strong upward cost pressures that are being experienced throughout our industry. The third quarter operating costs also include \$0.37 million (\$0.48 per barrel of equivalent) of costs that relate to previous periods. For the first nine months of 2004, total production costs were \$6.90 per barrel of equivalent, a nine percent increase from the \$6.34 per barrel of equivalent reported in the first nine months of 2003. In this 2004 nine month period, significantly higher costs on a per unit basis were also recorded for third party gas processing fees, gas compression charges and gas processing chemicals.

In 2003, Zargon had managed to deliver a significant cost improvement on a per unit basis over the prior years through the disposition of smaller, higher cost properties. Although Zargon is actively managing per unit operating costs through field-related cost containment programs, further pressure on per unit costs can be expected if the current high industry activity levels continue.

OPERATING NETBACKS

Nine months ended September 30	2004		2003	
	Oil and Liquids (\$/bbl)	Natural Gas (\$/mcf)	Oil and Liquids (\$/bbl)	Natural Gas (\$/mcf)
Production revenue	44.73	6.34	37.95	6.63
Hedging	(2.85)	(0.05)	(1.10)	(0.31)
Royalties	(9.45)	(1.46)	(7.53)	(1.58)
Production costs	(10.29)	(0.76)	(8.97)	(0.69)
Operating netbacks	22.14	4.07	20.35	4.05

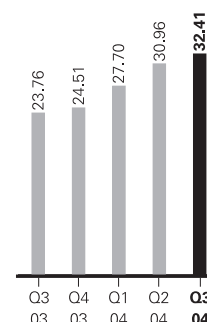
Measured on a unit of production basis, general and administrative expenses increased six percent to \$1.36 per barrel of equivalent net of recoveries in the first nine months of 2004. Comparative values are \$1.28 per barrel of equivalent in the first nine months of 2003, \$1.30 in all of 2003 and \$1.49 in 2002. In the last two years, reductions in general and administrative costs on a per unit of production basis have been accomplished through increased production volumes, increased cost recoveries from expanded field capital programs and the disposition of some small, overhead-intensive properties. With industry-wide increased regulatory reporting requirements imposing heavier staff loads and also the now concluded reorganization into a Trust, additional upward general and administrative cost pressures on a per unit of production basis are expected.

The non-cash expense for unit-based compensation benefits for the third quarter of 2004 was much higher than previous periods at \$2.66 million. Of this amount, \$2.17 million is related to a one time charge for the accelerated vesting of stock options related to the July 15, 2004 Arrangement. The remainder is primarily the expense for the new trust unit rights incentive plan which is calculated using the intrinsic value method. Prior to the effective date of the Arrangement, expensing of stock-based compensation benefits in the consolidated statements of earnings was calculated using the Black-Scholes option-pricing model. Use of this methodology began in the fourth quarter of 2003, which contained an adjustment for the entire 2003 year. This expense was not recorded in the first nine months of 2003 but added \$2.97 million or \$1.33 per barrel of equivalent of expense in the first nine months of 2004.

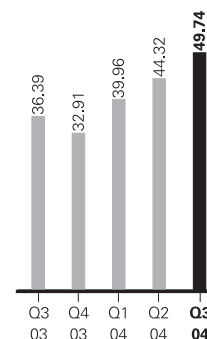
As at September 30, 2004, Zargon's bank debt plus working capital deficiency balance was \$16.75 million compared to a working capital surplus of \$3.08 million as at June 30, 2004 and a bank debt plus working capital deficiency of \$13.09 million as at December 31, 2003. During the third quarter of 2004, Zargon's net indebtedness increased primarily due to an acquisition of Southeastern Saskatchewan properties for \$10 million plus \$9.44 million of reorganization costs related to the trust conversion. An overall lower debt level throughout the first nine months of 2004 compared to 2003 combined with a lower interest rate environment has resulted in a reduction of interest charges to \$0.23 million in the first nine months of 2004 compared to \$0.66 million in the first nine months of 2003.

During the first nine months of 2004, Zargon incurred \$0.80 million of current income taxes compared to \$0.40 million in the first nine months of 2003. The increase is due to current taxes paid in the United States. Federal and provincial capital taxes, which are included in current taxes, was \$0.41 million for the first nine months of 2004 which is relatively unchanged compared to the first nine months of 2003. If high oil prices continue, there may continue to be modest current income taxes payable in the United States that will be somewhat reduced by the effect of ongoing capital programs. The Trust is a taxable entity under the Income Tax Act of Canada and is taxable only on the income that is not distributed or declared distributable to unitholders. It is anticipated that sufficient distributions will be made to eliminate current Canadian income tax.

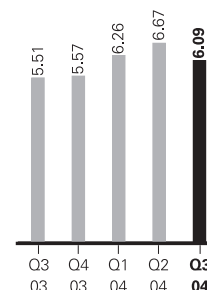
PETROLEUM AND NATURAL GAS REVENUE
(\$ million)



OIL AND LIQUID PRICES
(\$/bbl)



NATURAL GAS PRICES
(\$/mcf)



TRUST NETBACKS

Nine months ended September 30 (\$/boe)	2004	2003
Petroleum and natural gas revenue	40.79	38.96
Hedging	(1.35)	(1.54)
Royalties	(9.05)	(8.58)
Production costs	(6.90)	(6.34)
Operating netbacks	23.49	22.50
General and administrative	(1.36)	(1.28)
Interest	(0.10)	(0.33)
Capital and current income taxes	(0.36)	(0.20)
Cash flow from operations	21.67	20.69
Depletion and depreciation (note 1)	(8.80)	(6.69)
Accretion of asset retirement obligations (note 1)	(0.36)	(0.44)
Unit-based compensation	(1.33)	–
Foreign exchange	0.12	0.11
Future income taxes (note 1)	(4.06)	(3.43)
Net earnings	7.24	10.24

Note 1: Comparative period numbers reflect retroactive restatements due to a change in accounting policy.

The first nine months 2004 depletion and depreciation expense of \$8.80 per barrel of equivalent is 32 percent higher than the charges booked in the first nine months of 2003. The large increase in per barrel of equivalent depletion and depreciation expenses was derived primarily from a December 31, 2003 year-over-year 14 percent reduction in the Company's proved reserves as evaluated under the new policies of National Instrument 51-101. Depletion and depreciation rates will be subject to continuing upward pressure as finding and development costs increase in the industry.

In 2003, the CICA approved Section 3110 (Asset Retirement Obligations) that effectively requires site restoration expense to be treated as a discounted future liability that is recognized in the balance sheet and amortized over the useful life of the related assets. The liability accretes until the retirement obligations are settled. Zargon changed to this standard effective January 1, 2004 and the expense line formerly termed Site Restoration is now called Accretion of Asset Retirement Obligations. For the first nine months of 2004, the non-cash accretion expense is \$0.80 million or \$0.36 per barrel of equivalent.

The provision for future income taxes of \$9.07 million for the nine months ended September 30, 2004 represents an effective future tax rate of 34.8 percent. This rate compares to the effective future tax rate of 40.4 percent and 39.3 percent for the six month period ended June 30, 2004 and three month period ended March 31, 2004, respectively. The reduction in the effective future income tax rate in the third quarter of 2004 is due to cash distributions from the Trust. Comparisons with the 2003 periods are distorted by the significant one-time tax rate adjustment that was booked to future taxes in the 2003 second quarter.

Cash flow from operations in third quarter 2004 of \$16.13 million (see note at the beginning of the MD&A section) was \$0.39 million or two percent less than the preceding quarter and \$3.79 million or 31 percent higher than the 2003 third quarter. The 2004 nine month cash flow of \$48.39 million was 18 percent higher than the prior year's comparative period due to a 12 percent gain in production volumes and a five percent rise in equivalent prices received over the same nine-month period. Reflecting excellent commodity prices in both the 2003 and 2004 nine month periods, Zargon's cash flow netback averaged a strong \$21.67 per barrel of equivalent in the first nine months of 2004, up five percent from the prior year's comparable period netback. Cash flow per diluted unit showed similar changes with the 2004 third quarter cash flow of \$0.87 per diluted unit decreasing one percent over second quarter levels while the 2004 nine month cash flow of \$2.58 per diluted unit improved 15 percent over the 2003 comparable period.

Net earnings of \$5.09 million for the third quarter of 2004 were eight percent below the preceding quarter and 15 percent above the third quarter of 2003. The net earnings track the cash flow from operations for the respective periods modified by non-cash charges which in the 2004 period include increased depletion and depreciation and unit-based compensation referred to above. Net earnings in the 2003 second quarter were distorted by a one-time adjustment reflecting a multi-year downward adjustment in federal income tax rates which resulted in a large gain in net earnings. Net earnings per diluted unit were \$0.27, \$0.29 and \$0.30 respectively in the third, second and first 2004 quarters.

CAPITAL EXPENDITURES

Nine months ended September 30 (\$ million)	2004	2003
Undeveloped land	3.06	5.96
Geological and geophysical (seismic)	3.45	4.11
Drilling and completion of wells	18.18	9.72
Well equipment and facilities	4.72	4.62
Exploration and development	29.41	24.41
Property acquisitions	11.88	7.82
Property dispositions	(0.27)	(5.16)
Net property acquisitions	11.61	2.66
Total capital expenditures (net)	41.02	27.07

LIQUIDITY AND CAPITAL RESOURCES

Capital expenditures of \$41.02 million in the first nine months of 2004 were 52 percent higher than in first nine months of 2003, reflecting the purchase of producing oil property interests in Southeast Saskatchewan and a very active drilling program of 40 gross (33.5 net) wells. Drilling and completion expenditures are up 87 percent from the previous year to \$18.18 million while undeveloped land purchases fell 49 percent as Zargon reduced its land acquisition budget as Crown sales became increasingly more competitive and expensive. Cash flow from operations in the first nine months of \$48.39 million, proceeds from the exercise of stock options of \$2.87 million and the increase in bank debt covered the capital program, costs incurred for the trust reorganization and the distribution to unitholders for the period. As at September 30, 2004, bank debt plus working capital deficiency was \$16.75 million compared to \$13.09 million as at December 31, 2003. With a bank debt plus working capital deficiency to trailing twelve month cash flow ratio of 0.27, Zargon continues to maintain a very strong balance sheet.

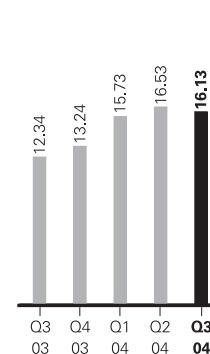
At November 10, 2004, Zargon Energy Trust has 15.29 million trust units and 3.23 million exchangeable shares outstanding. Assuming full conversion of exchangeable shares, there would be 18.57 million trust units outstanding. Pursuant to the new trust unit rights incentive plan there are currently an additional 0.58 million trust unit rights issued and outstanding.

CAPITAL SOURCES

Nine months ended September 30 (\$ million)	2004	2003
Cash flow from operations	48.39	41.10
Changes in working capital and other	0.68	1.42
Change in bank indebtedness	2.79	(16.36)
Reorganization costs	(9.44)	—
Cash distributions	(4.27)	—
Issuance of common shares related to exercise of stock options	2.87	0.91
Total capital sources	41.02	27.07

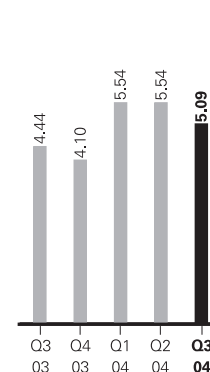
CASH FLOW FROM OPERATIONS

(\$ million)



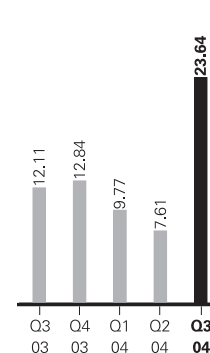
NET EARNINGS

(\$ million)



NET CAPITAL EXPENDITURES

(\$ million)



CHANGES IN ACCOUNTING POLICIES

The following changes have been made to Zargon's accounting policies effective January 1, 2004.

PETROLEUM AND NATURAL GAS ASSETS - FULL COST ACCOUNTING

The new CICA Guideline 16, "Oil and Gas Accounting - Full Cost" (AcG-16) is effective for fiscal years beginning on or after January 1, 2004. The most significant change between AcG-16 and the former guideline is that AcG-16 limits the carrying value of petroleum and natural gas properties to their fair value. The fair value is equal to estimated future cash flows from proved and probable reserves using future price forecasts and costs discounted at a risk-free rate. This differs from the former cost recovery ceiling test that used undiscounted cash flows, and constant prices, less general and administrative and financing costs. No write-down of the Trust's petroleum and natural gas properties was required when the new guideline was adopted on January 1, 2004 or as at September 30, 2004.

ASSET RETIREMENT OBLIGATIONS

The new CICA Section 3110, "Asset Retirement Obligations" requires liability recognition for retirement obligations associated with the Trust's property, plant and equipment. The obligations are initially measured at fair value, which is the discounted future value of the liability. The fair value is capitalized as part of the cost of the related assets and depleted on a unit of production basis over their useful lives. The liability accretes until the retirement obligations are settled. Section 3110 is effective for fiscal years beginning on or after January 1, 2004 on a retroactive basis with restatement of prior periods. The site restoration liability on the balance sheet at December 31, 2003 was replaced with a new "Asset Retirement Obligation" liability in the amount of \$12.19 million on January 1, 2004.

OUTLOOK

Over the past two years increasing global energy demand and constrained supply has resulted in historically high commodity prices that have produced strong cash flows, but have also brought increasing cost pressures throughout the industry. Irrespective of commodity prices, as a sustainable income trust, Zargon continues to be well positioned to maintain per unit production and reserve levels with a very strong balance sheet, 399 thousand net acres of undeveloped land and a promising project inventory. Despite the current high commodity prices levels, Zargon will maintain a disciplined capital spending approach designed to sustain per unit production and reserves while distributing approximately 50 percent of the cash flows attributed to our unitholders.

(\$ million, except per unit amounts)

Quarter	Net Earnings (note 1)	Net Earnings/ Diluted Unit (note 1)	Cash Flow	Cash Flow/ Diluted Unit	Petroleum and Natural Gas Revenue	Cash Distributions	Cash Distribution/ Trust Unit	Total Assets (note 1)	Bank Debt
2004 Q3	\$5.1	\$0.27	\$16.1	\$0.87	\$32.4	\$4.3	\$0.28	\$205.6	\$9.8
2004 Q2	\$5.5	\$0.29	\$16.5	\$0.88	\$31.0	-	-	\$189.8	-
2004 Q1	\$5.5	\$0.30	\$15.7	\$0.84	\$27.7	-	-	\$186.2	\$3.7
2003 Q4	\$4.1	\$0.22	\$13.2	\$0.72	\$24.5	-	-	\$181.1	\$7.0
2003 Q3	\$4.4	\$0.24	\$12.3	\$0.67	\$23.8	-	-	\$172.8	\$8.9
2003 Q2	\$9.2	\$0.50	\$13.5	\$0.74	\$24.2	-	-	\$166.0	\$11.5
2003 Q1	\$6.7	\$0.36	\$15.2	\$0.84	\$29.2	-	-	\$165.1	\$20.8

Note1: Comparative period numbers reflect retroactive restatements due to a change in accounting policy.

"Signed" C.H. Hansen
President and Chief Executive Officer

Calgary, Alberta
November 10, 2004

(unaudited) (\$ thousand)	September 30, 2004	December 31, 2003 (restated – note 2)
ASSETS		
Current		
Accounts receivable	13,596	12,183
Prepaid expenses and deposits	1,369	980
	14,965	13,163
Property and equipment, net	190,613	167,888
	205,578	181,051
LIABILITIES		
Current		
Bank indebtedness	9,771	6,978
Accounts payable and accrued liabilities	19,801	19,277
Cash distributions payable	2,140	–
	31,712	26,255
Asset retirement obligations <i>[notes 2 and 3]</i>	14,087	12,194
Future income taxes	38,519	30,133
	84,318	68,582
UNITHOLDERS' EQUITY		
Unitholders' capital <i>[note 4]</i>	37,245	42,200
Exchangeable shares <i>[note 4]</i>	7,891	–
Contributed surplus <i>[note 4]</i>	460	264
Accumulated earnings	79,935	70,005
Accumulated cash distributions <i>[note 10]</i>	(4,271)	–
	121,260	112,469
	205,578	181,051

**C O N S O L I D A T E D
B A L A N C E
S H E E T S**

See accompanying notes.

**CONSOLIDATED
STATEMENTS OF
EARNINGS AND
ACCUMULATED
EARNINGS**

(unaudited)	Three months ended September 30		Nine months ended September 30	
	2004	2003	2004	2003
(\$ thousand, except per unit amounts)	(restated – note 2)		(restated – note 2)	
Revenue				
Petroleum and natural gas revenue	32,409	23,755	91,072	77,146
Hedging <i>[note 8]</i>	(1,427)	(354)	(3,010)	(3,050)
Royalties	(7,394)	(5,695)	(20,203)	(16,991)
	23,588	17,706	67,859	57,105
Expenses				
Production	5,762	4,344	15,413	12,550
General and administrative	1,069	876	3,027	2,530
Unit-based compensation <i>[note 4]</i>	2,663	–	2,972	–
Interest	99	152	233	661
Foreign exchange (gain) loss	(287)	69	(263)	(210)
Accretion of asset retirement obligations <i>[notes 2 and 3]</i>	274	293	799	879
Depletion and depreciation	7,009	4,830	19,648	13,248
	16,589	10,564	41,829	29,658
Earnings before income taxes	6,999	7,142	26,030	27,447
Income taxes				
Future	1,385	2,567	9,065	6,786
Current	527	133	797	401
	1,912	2,700	9,862	7,187
Net earnings for the period	5,087	4,442	16,168	20,260
Accumulated earnings, beginning of period				
As previously reported	81,086	61,502	70,125	45,598
Change in accounting policies <i>[note 2]</i>	–	(40)	(120)	46
As restated	81,086	61,462	70,005	45,644
Reorganization costs <i>[note 9]</i>	(6,238)	–	(6,238)	–
Accumulated earnings, end of period	79,935	65,904	79,935	65,904
Net earnings per unit <i>[note 5]</i>				
Basic	0.28	0.25	0.88	1.14
Diluted	0.27	0.24	0.86	1.11

See accompanying notes.

**CONSOLIDATED
STATEMENTS
OF CASH FLOWS**

(unaudited) (\$ thousand)	Three months ended September 30		Nine months ended September 30	
	2004	2003 (restated – note 2)	2004	2003 (restated – note 2)
Operating activities				
Net earnings for the period	5,087	4,442	16,168	20,260
Add (deduct) non-cash items:				
Depletion and depreciation	7,009	4,830	19,648	13,248
Accretion of asset retirement obligations	274	293	799	879
Unit-based compensation	2,663	–	2,972	–
Unrealized foreign exchange (gain) loss	(287)	209	(263)	(70)
Future income taxes	1,385	2,567	9,065	6,786
Cash flow from operations	16,131	12,341	48,389	41,103
Asset retirement expenditures	(91)	(35)	(147)	(86)
Changes in non-cash working capital	5,262	(853)	2,052	306
	21,302	11,453	50,294	41,323
Financing activities				
Repayment of bank indebtedness	9,771	(2,555)	2,793	(16,360)
Cash distributions to unitholders	(4,271)	–	(4,271)	–
Exercise of stock options	1,537	88	2,867	914
Changes in non-cash working capital	2,140	–	2,140	–
	9,177	(2,467)	3,529	(15,446)
Investing activities				
Additions to property and equipment	(23,640)	(12,218)	(41,291)	(32,223)
Proceeds on disposal of property and equipment	–	110	275	5,155
Reorganization costs (note 9)	(9,443)	–	(9,443)	–
Changes in non-cash working capital	1,399	3,122	(3,364)	1,191
	(31,684)	(8,986)	(53,823)	(25,877)
Change in cash	(1,205)	–	–	–
Cash, beginning of period	1,205	–	–	–
Cash, end of period	–	–	–	–

See accompanying notes.

**NOTES TO THE
CONSOLIDATED
FINANCIAL
STATEMENTS**

FOR THE THREE
AND NINE MONTHS
ENDED SEPTEMBER 30,
2004 AND 2003
(UNAUDITED)

1. NATURE OF THE ORGANIZATION AND BASIS OF PRESENTATION

ORGANIZATION

On July 15, 2004, Zargon Oil & Gas Ltd. (the "Company") was reorganized into Zargon Energy Trust (the "Trust" or "Zargon") as part of a Plan of Arrangement (the "Arrangement"). Shareholders of the Company received one trust unit or one exchangeable share for each common share held. All outstanding common share options were settled for cash prior to the completion of the reorganization. The unitholders of the Trust are entitled to receive cash distributions paid by the Trust. Holders of exchangeable shares are not eligible to receive cash distributions paid, but rather, on each payment of a distribution, the number of trust units into which each exchangeable share is exchangeable is increased on a cumulative basis in respect of the distribution. The trust units commenced trading on the TSX under the symbol "ZAR.UN" on July 21, 2004. The exchangeable shares commenced trading on the TSX under the symbol "ZOG.B" on August 4, 2004. The Trust is an unincorporated open-ended investment trust established under the laws of the Province of Alberta and was created pursuant to a trust indenture ("Trust Indenture"). Valiant Trust Company has been appointed trustee under the Trust Indenture.

The costs of the reorganization were \$9.44 million and are described in note 9.

The Trust's principal business activity is the exploration for and development and production of petroleum and natural gas.

BASIS OF PRESENTATION

The interim unaudited consolidated financial statements of Zargon have been prepared by management in accordance with Canadian generally accepted accounting principles. The interim unaudited consolidated financial statements have been prepared following the same accounting policies and methods in computation as the consolidated financial statements for the fiscal year ended December 31, 2003, except as described in note 2 below. The interim unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto in the Zargon Oil & Gas Ltd. annual report for the year ended December 31, 2003.

While the Trust commenced operations on July 15, 2004, these unaudited interim consolidated financial statements follow the continuity of interest basis of accounting as if the Trust had always existed. This basis is intended to provide unitholders with meaningful and comparative financial information. Also, certain comparative figures have been reclassified to conform with the current presentation.

2. CHANGES IN ACCOUNTING POLICIES

FULL COST ACCOUNTING

On January 1, 2004, Zargon adopted the new CICA Accounting Guideline 16 "Oil and Gas Accounting – Full Cost". The new guideline modifies how the ceiling test is performed, and requires that cost centres be tested for recoverability using undiscounted future cash flows from proved reserves which are determined by using forward indexed prices. When the carrying amount of a cost centre is not recoverable, the cost centre would be written down to its fair value. Fair value is estimated using accepted present value techniques, which incorporate risks and other uncertainties when determining expected cash flows. Since the fair value of the cost centres exceed the carrying value there is no impact on the Trust's reported financial results as a result of applying the new Accounting Guideline 16.

ASSET RETIREMENT OBLIGATIONS

On January 1, 2004, Zargon retroactively adopted the Canadian accounting standard outlined in CICA Handbook Section 3110, "Asset Retirement Obligations". Previously, estimated future site restoration costs were provided for over the life of the proved reserves on a unit of production basis.

Under the new accounting standard, the Trust records the fair value of legal obligations associated with the retirement of long-lived tangible assets, such as petroleum and natural gas assets, in the period in which they are acquired or drilled and a corresponding increase in the carrying amount of the long-lived asset. The liability accretes until the Trust expects to settle the retirement obligation. The asset retirement costs are depleted using the unit of production method. Actual costs to retire the tangible assets are deducted from the liability as incurred.

As required by the new standard, all prior periods have been restated for the change in accounting policy. The effect of this change on the consolidated balance sheet as of January 1, 2004 is an increase in net capital assets of \$5.98 million, recognition of an asset retirement obligation liability of \$12.19 million, elimination of the site restoration liability of \$6.03 million, recognition of a future tax recovery of \$0.06 million, and a decrease to retained earnings of \$0.12 million. The impact on net earnings and per share amounts for the three and nine months ended September 30, 2004 and 2003 is negligible as a result of adopting this new policy.

3. ASSET RETIREMENT OBLIGATIONS

The total future asset retirement obligation was estimated by management based on Zargon's net working interest in all wells and facilities, estimated costs to reclaim and abandon wells and facilities and the estimated timing of the costs to be incurred in future periods. Zargon has estimated the net present value of its total asset retirement obligations to be \$12.19 million as at January 1, 2004 based on a total future liability of \$50.85 million. These payments are expected to be made over the next 32 years with the majority of the costs being incurred after 2012. Zargon used a credit adjusted risk-free rate of 8.5 percent and an inflation rate of two percent to calculate the present value of the asset retirement obligation.

The following table reconciles Zargon's asset retirement obligation:

(\$ thousand)	Nine months ended September 30	
	2004	2003
Balance, beginning of year	12,194	10,560
Liabilities incurred	1,357	525
Liabilities settled	(147)	(86)
Accretion expense	799	879
Other	(116)	-
Balance, end of period	14,087	11,878

4. UNITHOLDERS' CAPITAL AND EXCHANGEABLE SHARES

Pursuant to the Plan of Arrangement on July 15, 2004, 14.87 million units of the Trust and 3.66 million exchangeable shares of the Company were issued in exchange for all of the outstanding shares of the Company on a one for one basis.

COMMON SHARES OF ZARGON OIL & GAS LTD.

(no par value) (thousand)	September 30, 2004		September 30, 2003	
	Number of Shares	Amount (\$)	Number of Shares	Amount (\$)
Shares issued				
Balance, beginning of year	17,992	42,200	17,637	40,997
Stock options exercised for cash	534	2,867	253	914
Stock-based compensation recognized	-	69	-	-
Trust units issued	(14,866)	(36,219)	-	-
Exchangeable shares issued	(3,660)	(8,917)	-	-
Balance, end of period	-	-	17,890	41,911

The Trust is authorized to issue an unlimited number of voting trust units.

TRUST UNITS

(thousand)	September 30, 2004	
	Number of Units	Amount (\$)
Units issued		
Issued pursuant to Plan of Arrangement July 15, 2004	14,866	36,219
Issued on conversion of exchangeable shares	421	1,026
Balance, end of period	15,287	37,245

Zargon Oil & Gas Ltd. is authorized to issue a maximum of 3.66 million exchangeable shares. The exchangeable shares are convertible into trust units based on the exchange ratio, which is adjusted monthly to reflect the distribution paid on the trust units. Cash distributions are not paid on the exchangeable shares. During the period, a total of 421,031 exchangeable shares were converted into 421,536 trust units based on the exchange ratio at the time of conversion. At September 30, 2004, the exchange ratio was 1.00737 trust units per exchangeable share.

EXCHANGEABLE SHARES

	September 30, 2004	
	Number of Shares	Amount (\$)
(thousand, except exchange ratio)		
Exchangeable shares issued		
Issued pursuant to Plan of Arrangement July 15, 2004	3,660	8,917
Exchanged for trust units	(421)	(1,026)
Balance, end of period	3,239	7,891
Exchange ratio, end of period	1.00737	
Trust units issuable upon conversion of exchangeable shares, end of period	3,263	7,891

The proforma total units outstanding at period end, including trust units outstanding, and trust units issuable upon conversion of exchangeable shares and after giving rise to the exchange ratio at the end of the period is 18.55 million units.

CONTRIBUTED SURPLUS

	September 30, 2004
(\$ thousand)	
Balance, beginning of year	264
Stock-based compensation expense prior to Plan of Arrangement July 15, 2004	345
Stock-based compensation recognized on exercise of stock options	(69)
Accelerated vesting of unvested stock options pursuant to the Arrangement	2,167
Stock-options cancelled immediately prior to trust conversion	(2,707)
Balance at trust conversion	–
Unit-based compensation recognized subsequent to trust conversion	460
Balance, end of period	460

COMPENSATION PLANS

A summary of the status of the Trust's compensation expense for the nine months ended September 30, 2004 is presented below:

COMPENSATION EXPENSE

	Nine months ended September 30, 2004
(\$ thousand)	
Stock-based compensation expense prior to Plan of Arrangement July 15, 2004	345
Accelerated vesting of unvested stock options pursuant to the Arrangement	2,167
Unit-based compensation recognized subsequent to trust conversion	460
Balance, end of period	2,972

A summary of the status of the Trust's compensation plans as at September 30, 2004 and 2003 and changes during the nine months ended on those dates is presented below:

STOCK OPTIONS

As part of the Arrangement to reorganize Zargon Oil & Gas Ltd. into a Trust, all common share options, vested and unvested, were cancelled and the optionholders received a cash payment for the intrinsic value of the options.

	September 30, 2004		September 30, 2003	
	Number of Shares (thousand)	Weighted Average Exercise Price (\$)	Number of Shares (thousand)	Weighted Average Exercise Price (\$)
Outstanding at beginning of year	1,297	7.05	1,215	5.10
Granted	430	16.00	429	9.36
Exercised	(534)	5.39	(253)	3.61
Cancelled prior to trust conversion	(9)	9.61	(22)	9.30
Cancelled immediately prior to trust conversion	(1,184)	11.03	–	–
Outstanding at end of period	–	–	1,369	6.64
Options exercisable at period end	–	–	944	5.42

STOCK-BASED COMPENSATION (SEE COMPENSATION EXPENSE TABLE ON PAGE 16)

Compensation expense of \$0.34 million was recognized for the 2004 nine month period as a result of regular vesting of unvested stock options. Additionally, as a result of cancelling the stock-option plan pursuant to the Arrangement, compensation expense for the nine months ended September 30, 2004 of \$2.17 million resulted from accelerating of unvested stock-options. Both of these non-cash expenses have been recognized as part of unit-based compensation expense on the income statement for the nine month period.

Under this stock-option plan the Company had calculated the value of stock-based compensation using a Black-Scholes option-pricing model to estimate the fair value of stock options at the date of grant.

Compensation expense for options granted under the stock-option plan was based on the estimated fair values at the time of the grant and the expense is recognized over the vesting period of the option.

The assumptions made for the options granted in 2004 include a volatility factor of expected market price of 26.30 percent, a weighted average risk-free interest rate of 3.33 percent, no dividend yield and a weighted average expected life of options of four years.

For purposes of pro forma disclosures relating to 2002 stock option grants, the Company's net earnings for the nine months ended September 30, 2003, would be reduced by \$0.21 million. Basic and diluted earnings per share figures would have both been reduced by \$0.01 for the 2003 nine month period. There is no effect in 2004 pertaining to 2002 stock option grants because the options were fully vested prior to 2004.

TRUST UNIT RIGHTS INCENTIVE PLAN

The Trust has a unit rights incentive plan (the "Plan") that allows the Trust to issue rights to acquire trust units to directors, officers, employees and service providers. The Trust is authorized to issue up to 1.82 million unit rights, however, the number of trust units reserved for issuance upon exercise of the rights shall not at any time exceed 10% of the aggregate number of issued and outstanding trust units of the Trust. Unit right exercise prices approximate the market price for the trust units on the date the unit rights are issued. Rights granted under the plan vest over a three-year period and expire five years from the grant date.

The following table summarizes information about the Trust's unit rights:

	September 30, 2004	
	Number of Unit Rights (thousand)	Weighted Average Exercise Price (\$)
Outstanding at beginning of year	-	-
Unit rights granted	579	17.79
Outstanding at end of period	579	17.79
Unit rights exercisable at period end	-	-

UNIT-BASED COMPENSATION (SEE COMPENSATION EXPENSE TABLE ON PAGE 16)

The Plan allows for the exercise price of rights to be reduced in future periods by a portion of the future distributions. The Trust has determined that the amount of the reduction cannot be reasonably estimated, as it is dependent upon a number of factors including, but not limited to, future oil and natural gas prices, production of oil and natural gas, determination of amounts to be withheld from future distributions to fund capital expenditures, and the purchase and sale of oil and natural gas assets. Therefore, it is not possible to determine a fair value for the rights granted under the Plan.

Compensation expense is therefore determined based on the amount that the market price of the trust unit exceeds the exercise price for rights issued as at the date of the interim unaudited consolidated financial statements and is recognized in earnings over the vesting period of the Plan. Compensation expense for the unit rights for the three and nine months ended September 30, 2004 was \$0.46 million.

Compensation expense associated with rights granted under the Plan is recognized in earnings over the vesting period of the Plan with a corresponding increase or decrease in contributed surplus. Changes in the intrinsic value of unexercised rights after the vesting period are recognized in earnings in the period of change with a corresponding increase or decrease in contributed surplus. The exercise of trust unit rights is recorded as an increase in trust units with a corresponding reduction in contributed surplus.

This method of determining compensation expense may result in large fluctuations, even recoveries, in compensation expense due to changes in the underlying trust unit price. Recoveries of compensation expense will only be recognized to the extent of previously recorded cumulative compensation expense associated with rights outstanding at the date of the financial statements.

5. WEIGHTED AVERAGE NUMBER OF TOTAL UNITS

Per unit amounts are calculated using the weighted average number of units outstanding during the period, including the weighted average number of exchangeable shares outstanding converted at the exchange ratio at the end of the reporting period. Diluted per unit amounts are calculated using the treasury stock method to determine the dilutive effect of unit-based compensation. The treasury stock method assumes that the proceeds received from "in-the-money" trust unit rights are used to repurchase units at the average market rate during the period.

(thousand)	Three months ended September 30		Nine months ended September 30	
	2004 (units)	2003 (shares)	2004 (units)	2003 (shares)
Basic	18,380	17,867	18,331	17,788
Diluted	18,517	18,430	18,769	18,324

6. SEGMENTED INFORMATION

Zargon's entire operating activities are related to exploration, development and production of oil and natural gas in the geographic segments of Canada and the US.

(\$ thousand)	Three months ended September 30		Nine months ended September 30	
	2004	2003	2004	2003
Petroleum and Natural Gas Revenue				
Canada	28,270	20,685	80,018	68,465
United States	4,139	3,070	11,054	8,681
Total	32,409	23,755	91,072	77,146
Net Capital Expenditures				
Canada	22,406	11,827	37,840	21,546
United States	1,234	281	3,176	5,522
Total	23,640	12,108	41,016	27,068
Total Assets*				
Canada			179,766	150,296
United States			25,812	23,513
Total			205,578	172,809

*Total asset amounts from the prior year have been reclassified in part from Canada to the US for consistency with the current year presentation.

7. SUPPLEMENTAL CASH FLOW INFORMATION

(\$ thousand)	Three months ended September 30		Nine months ended September 30	
	2004	2003	2004	2003
Cash interest paid	144	117	252	540
Cash taxes paid	506	37	694	305

8. FINANCIAL INSTRUMENTS

The Trust is a party to certain off-balance sheet derivative financial instruments that have fixed the price of a portion of its oil and natural gas production. The Trust enters into these contracts for hedging purposes only, in order to protect a portion of its future cash flow from the volatility of oil and natural gas commodity prices.

The Trust has outstanding contracts at September 30, 2004 as follows:

	Volume	Rate	Price	Terms
Oil swaps	36,800 bbl	400 bbl/d	\$28.78 US/bbl	Oct. 1/04–Dec. 31/04
	27,600 bbl	300 bbl/d	\$54.05 Cdn/bbl	Oct. 1/04–Dec. 31/04
	27,000 bbl	300 bbl/d	\$35.45 US/bbl	Jan. 1/05–Mar. 31/05
	73,000 bbl	200 bbl/d	\$39.35 US/bbl	Jan. 1/05–Dec. 31/05
Oil collars	18,400 bbl	200 bbl/d	\$24.00 US/bbl Put \$27.80 US/bbl Call	Oct. 1/04–Dec. 31/04
	54,300 bbl	300 bbl/d	\$43.50 Cdn/bbl Put \$54.50 Cdn/bbl Call	Jan. 1/05–Jun. 30/05
	55,000 bbl	200 bbl/d	\$37.00 US/bbl Put \$44.40 US/bbl Call	Apr. 1/05–Dec. 31/05
Natural gas swaps	186,000 gj	6,000 gj/d	\$5.91/gj	Oct. 1/04–Oct. 31/04
	302,000 gj	2,000 gj/d	\$6.27/gj	Nov. 1/04–Mar. 31/05
	856,000 gj	4,000 gj/d	\$6.49/gj	Apr. 1/05–Oct. 31/05
Natural gas collars	62,000 gj	2,000 gj/d	\$5.00/gj Put \$6.85/gj Call	Oct. 1/04–Oct. 31/04
	302,000 gj	2,000 gj/d	\$6.75/gj Put \$9.55/gj Call	Nov. 1/04–Mar. 31/05
	302,000 gj	2,000 gj/d	\$6.75/gj Put \$9.80/gj Call	Nov. 1/04–Mar. 31/05
Natural gas put	428,000 gj	2,000 gj/d	\$5.10/gj	Apr. 01/05–Oct. 31/05

Oil swaps and collars are settled against the NYMEX pricing index, whereas natural gas swaps, collars, and puts are settled against the AECO pricing index.

At September 30, 2004, the cost to settle the above contracts would have been approximately \$3.49 million.

9. ZARGON ENERGY TRUST REORGANIZATION

The following costs were incurred to reorganize Zargon Oil & Gas Ltd. into a trust, effective July 15, 2004:

(\$ thousand)

Cash payout of stock options	7,875
Financial advisory, accounting and legal fees, and preparation and printing of the Information Circular	1,568
Total reorganization costs	9,443

Of the above amounts \$2.71 million was charged to contributed surplus relating to recognized stock-based compensation under the previous stock option plan for the Company. The remaining \$6.73 million (\$6.24 million net of taxes) was charged directly against accumulated earnings.

10. ACCUMULATED CASH DISTRIBUTIONS

During the period, the Trust paid or declared distributions to the unitholders in the aggregate amount of \$4.27 million (2003 – \$nil) in accordance with the following schedule:

Month	Record Date	Distribution Date	Per Trust Unit
August 2004	August 31, 2004	September 15, 2004	\$0.14
September 2004	September 30, 2004	October 15, 2004	\$0.14

11. COMPARATIVE FIGURES

Certain comparative figures have been restated to conform with the current year's financial statement presentation.

**ZARGON
OIL & GAS LTD.
CORPORATE
INFORMATION**

BOARD OF DIRECTORS

Craig H. Hansen
Calgary, Alberta

K. James Harrison
Oakville, Ontario

H. Earl Joudrie
Toronto, Ontario

Kyle D. Kitagawa
Calgary, Alberta

John O. McCutcheon
Vancouver, British Columbia

Jim Peplinski
Calgary, Alberta

Byron J. Seaman
Calgary, Alberta

J. Graham Weir
Calgary, Alberta

William J. Whelan
Calgary, Alberta

Grant A. Zawalsky
Calgary, Alberta

OFFICERS

John O. McCutcheon
Chairman

Craig H. Hansen
President and Chief Executive Officer

Brent C. Heagy
Vice President, Finance and Chief Financial Officer

Mark I. Lake
Vice President, Exploration

Daniel A. Roulston
Executive Vice President, Operations

Sheila A. Wares
Vice President, Accounting

Kenneth W. Young
Vice President, Land

STOCK EXCHANGE LISTING

Toronto Stock Exchange
Trading Symbols:
ZAR.UN – trust units
ZOG.B – exchangeable shares

TRANSFER AGENT

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FORWARD-LOOKING STATEMENTS

This document contains statements that are forward-looking, such as those relating to results of operations and financial condition, capital spending, financing sources, commodity prices, costs of production and the magnitude of oil and natural gas reserves. By their nature, forward-looking statements are subject to numerous risks and uncertainties that could significantly affect anticipated results in the future and, accordingly actual results may differ materially from those predicted. The forward-looking statements contained in this quarterly report are as of November 10, 2004 and are subject to change after this date. Readers are cautioned that the assumptions used in the preparation of such information, although considered reasonable at the time of preparation, may prove to be imprecise and, as such, undue reliance should not be placed on forward-looking statements. Zargon disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.