

CORPORATE

HIGHLIGHTS

For the three and six

months ended

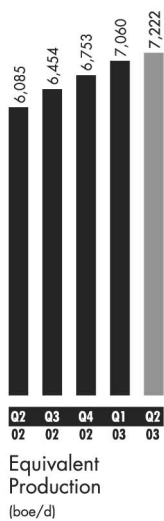
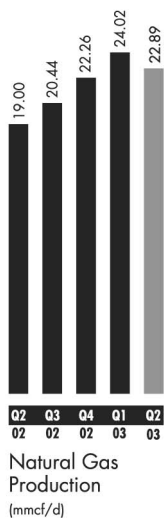
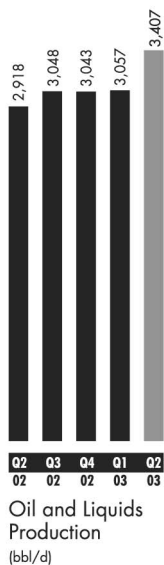
June 30, 2003

Driven by higher production volumes and strong commodity prices, Zargon delivered excellent financial results in the 2003 second quarter. Revenue of \$24.20 million, cash flow of \$13.53 million (\$0.74 per diluted share) and earnings of \$9.25 million (\$0.51 per diluted share) reached record second quarter levels. While high oil and natural gas commodity prices were the primary driver for these second quarter gains, production volumes for the quarter increased 19 percent from the comparative 2002 second quarter and two percent over the preceding 2003 first quarter. Earnings had the additional favourable impact of the recently announced federal tax reductions for resource companies, which significantly reduced future tax provisions.

First half 2003 financial results were exceptional. Revenue of \$53.39 million, cash flow of \$28.76 million (\$1.57 per diluted share) and earnings of \$15.99 million (\$0.88 per diluted share) provided gains of 89, 111, and 287 percent, respectively over the comparative 2002 first half. Net capital expenditures for the first half of 2003 totaled \$14.96 million and were allocated 37 percent to undeveloped land and geological/geophysical costs and 49 percent to the drilling and equipping of wells as Zargon focused on advancing its internally generated opportunities. Zargon's undeveloped land inventory continued to grow and reached 348 thousand net acres at the June 30, 2003 quarter-end, a 20 percent gain from the previous year. Continuing high cash flows in the first half enabled Zargon to reduce its debt net of working capital to \$13.89 million at June 30, 2003, a debt level that is equivalent to about three months of current cash flow rates.

| (unaudited) | Three months ended June 30 | | | Six months ended June 30 | | |
|--|----------------------------|-------|----------------|--------------------------|--------|----------------|
| | 2003 | 2002 | Percent Change | 2003 | 2002 | Percent Change |
| FINANCIAL | | | | | | |
| INCOME AND INVESTMENTS (\$ million) | | | | | | |
| Production revenue | 24.20 | 15.50 | 56 | 53.39 | 28.23 | 89 |
| Cash flow from operations | 13.53 | 7.47 | 81 | 28.76 | 13.66 | 111 |
| Net earnings | 9.25 | 2.55 | 263 | 15.99 | 4.13 | 287 |
| Net capital expenditures | 8.10 | 11.23 | (28) | 14.96 | 16.57 | (10) |
| PER COMMON SHARE, DILUTED | | | | | | |
| Cash flow from operations (\$/share) | 0.74 | 0.42 | 76 | 1.57 | 0.78 | 101 |
| Net earnings (\$/share) | 0.51 | 0.14 | 264 | 0.88 | 0.24 | 267 |
| BALANCE SHEET AT PERIOD END (\$ million) | | | | | | |
| Property and equipment, net | | | | 147.87 | 129.43 | 14 |
| Bank indebtedness | | | | 11.47 | 28.00 | (59) |
| Shareholders' equity | | | | 103.41 | 79.69 | 30 |
| SHARES OUTSTANDING AT PERIOD END (million) | | | | 17.87 | 17.53 | 2 |
| OPERATIONS | | | | | | |
| AVERAGE DAILY PRODUCTION | | | | | | |
| Oil and liquids (bbl/d) | 3,407 | 2,918 | 17 | 3,233 | 2,889 | 12 |
| Natural gas (mmcf/d) | 22.89 | 19.00 | 20 | 23.45 | 19.21 | 22 |
| Equivalents (boe/d) | 7,222 | 6,085 | 19 | 7,142 | 6,091 | 17 |
| Equivalents per million shares (boe/d) | 406 | 357 | 14 | 402 | 361 | 11 |
| AVERAGE SELLING PRICE (before hedges) | | | | | | |
| Oil and liquids (\$/bbl) | 34.26 | 35.15 | (3) | 38.77 | 31.78 | 22 |
| Natural gas (\$/mcf) | 6.52 | 3.56 | 83 | 7.23 | 3.34 | 116 |
| WELLS DRILLED, NET | 6.0 | 2.0 | 200 | 11.0 | 7.1 | 55 |
| UNDEVELOPED LAND AT PERIOD END (thousand net acres) | | | | 348 | 291 | 20 |

Note: The calculation of barrels of equivalent (boe) is based on the conversion ratio that one barrel of oil is equivalent to six thousand cubic feet of natural gas. Average daily production per million shares uses the weighted average number of shares for the period.



PRODUCTION

Production of oil and liquids averaged 3,407 barrels per day in second quarter 2003, 17 percent over second quarter 2002 and 11 percent above the first quarter 2003 rate. The oil production growth has been generated from the Williston Basin long-life, shallow-decline properties through exploitation projects and complementary acquisitions. With a combined 400 barrels per day of production gains coming from the Haas Unit enhanced waterflood program and the Truro Unit acquisition, Zargon's North Dakota component of the Williston Basin has now reached approximately 1,000 barrels per day or 29 percent of Zargon's total oil and liquids production. Corporately, five other waterflood initiation or enhancement programs are currently underway that will provide production gains in the fourth quarter.

Production of natural gas averaged 22.89 million cubic feet per day in second quarter 2003, an increase of 20 percent over the 2002 second quarter rate but a decrease of five percent from first quarter 2003. The quarter over quarter decline related to naturally occurring production declines, the second quarter sale of 0.84 million cubic feet per day of non-core natural gas properties and the absence of field drilling and construction activities during a prolonged wet spring break-up period. In early July, over two million cubic feet per day of net production was added with the construction and tie-in of the West Central Alberta Pembina shallow gas facility. Further additions are occurring in August with the tie-in of recent exploration successes in the East Central Alberta Jarrow property. A recent successful well in the Peace River Arch natural gas exploration area will also contribute to fourth quarter production and overall a strong level of second half natural gas production is anticipated.

In the 2003 second quarter, Zargon continued its trend of consistent quarterly equivalent production growth. Second quarter 2003 production of 7,222 barrels of equivalent per day increased two percent over the 2003 first quarter rates and climbed 19 percent higher than the second quarter 2002 volumes. On a per share basis, the 2003 second quarter production registered a 14 percent gain over the prior year's comparative quarter.

EXPLORATION AND EXPLOITATION

Zargon's business plan is built on the twin strategies of exploring for new natural gas reserves and exploiting existing oil reservoirs. A key component of our natural gas exploration initiatives are the drilling programs on our 348 thousand net acres of undeveloped land. Following a very active 2002 fall-winter drilling program, 2003 drilling activities were constrained by a slow first quarter (5.0 net wells drilled) and by a prolonged spring break-up. In the second quarter, Zargon drilled eight gross (6.0 net) wells with an 83 percent success ratio. The second quarter program delivered 3.5 net natural gas wells in the West Central Alberta Pembina area, 1.5 net natural gas wells in the East Central Alberta Jarrow area and 1.0 net dry hole in Southeast Saskatchewan. Subsequent to quarter-end, an additional seven gross (7.0 net) wells have been drilled, delivering 5.0 net gas wells, 1.0 net oil well and 1.0 net dry hole. Three of these wells were located on Zargon's new Peace River Arch natural gas exploration area, three were located at Jarrow and one well was drilled at Taber, Alberta. This recent program has provided wells with substantial natural gas productivity in both Jarrow and at Progress in the Peace River Arch area. The tie-in of these new natural gas wells is currently in progress and should be completed by the end of the third quarter.

Alberta Crown land prices have increased materially from the previous year and Zargon, while still aggressive, has become increasingly selective in bidding. During the 2003 half, we have purchased 32 thousand net acres of Crown natural gas exploration lands with the largest additions located in the Peace River Arch area, but with also sizeable additions at Pembina and Highvale in West Central Alberta. The average cost of these purchases was \$86 per acre.

In recent months, Zargon has moved ahead on several oil reservoir exploitation projects. Waterflood applications have been submitted and approved by regulatory authorities at West Fry's and Weyburn (Elswick) in Saskatchewan and at Taber, Alberta. Implementation work is in progress for these projects while we continue to work on new waterflood projects at Modeste Creek, Alberta and Weyburn (Halbrite) Saskatchewan. Recently, five 3D seismic shoots have been completed in the Williston Basin and are now in process of interpretation. In aggregate, these activities are leading to an active winter exploitation drilling program that should provide meaningful reserves and production gains.

ACQUISITIONS/DISPOSITIONS

The major property acquisition made in the second quarter was the \$4.95 million Cdn. purchase of a 92.5 percent interest in the Truro Unit in Renville County, North Dakota. The acquisition provided approximately 200 barrels per day of long-life production with sizeable exploitation potential. Other acquisitions in the quarter aggregated \$1.69 million and were primarily related to Saskatchewan Williston Basin oil properties. Subsequent to quarter-end, Zargon entered into a significant agreement with the Highvale Paul First Nation for additional rights in a block of 24 sections of land in West Central Alberta complementary to our current Highvale natural gas exploration program.

A package of small, mainly non-operated, non-core natural gas properties, most with higher operating costs was assembled and marketed in the first quarter of 2003 and its disposition to four separate purchasers was closed in the second quarter for an aggregate of \$5.02 million. These dispositions in conjunction with the \$3.04 million of high cost property dispositions concluded in the 2002 fourth quarter have had a major impact in delivering the current trend to improved per unit operating costs.

GUIDANCE*

Last November, Zargon provided 2003 mid-year production guidance at 3,400 barrels of oil per day and 25 million cubic feet of natural gas per day, for a combined rate of 7,570 barrels of equivalent per day. In the 2003 second quarter, oil production of 3,407 barrels per day met this mid-year guidance level. Oil production gains in the second quarter came from Williston Basin drilling at Weyburn and Pinto, Saskatchewan plus Williston Basin property acquisitions at Truro, North Dakota and Weyburn, Saskatchewan.

Mid-year natural gas production rates were anticipated to reach guidance levels with the scheduled June 2003 tie-in of over two million cubic feet per day at the West Central Alberta Pembina shallow natural gas property more than offsetting the second quarter disposition of selected minor non-operated gas properties. A late and wet spring resulted in pipeline and facility construction delays and the Pembina facility was not placed on production until July 8, 2003. Similarly, East Central Alberta drilling and tie-in activities were delayed and mid-year production guidance rates were not achieved until August.

Year-end 2003 production guidance continues to be set at 26.5 million cubic feet of natural gas per day and 3,600 barrels of oil per day. Initial good drilling results in the Peace River Arch natural gas exploration area suggest that exit guidance volumes of 26.5 million cubic feet per day may be reached by October. The oil production gains necessary to reach the year-end guidance rate of 3,600 barrels of oil per day are anticipated to come from late fourth quarter Williston Basin exploitation horizontal drilling and/or Williston Basin property acquisitions.

Zargon's 2003 capital program budget continues to be set at \$45 million. This budget is allocated \$35 million to exploration and development field activities of which approximately \$20 million remains to be spent in the second half of the year. The original \$10 million property or corporate acquisition component of the 2003 capital budget remains essentially unspent but can be substantially increased if value-added opportunities become available.

The 2003 field related capital budget continues to call for the drilling of 40 net wells of which 75 percent will be directed to natural gas projects. Of these wells, 11 net wells were drilled in the first half of the year, 13 net wells are scheduled for the third quarter of which seven net wells are drilled as of the date of this report and the remaining 16 net wells are scheduled to be drilled in the fourth quarter. The 2003 second half field-related capital expenditures will focus on continuing to expand our natural gas exploration activities in West Central Alberta (seven net wells in the Peace River Arch area and seven net wells in the Pembina/Highvale areas), while maintaining steady natural gas production rates from East Central Alberta (nine net wells). Oil expenditures will continue to be directed to the efficient exploitation of our large Williston Basin (six net wells) oil development and waterflood project inventory.

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

MANAGEMENT'S
DISCUSSION AND
ANALYSIS

Management's discussion and analysis (MD&A) should be read in conjunction with the unaudited interim financial statements for the three and six months ended June 30, 2003 and the audited consolidated financial statements and MD&A for the year ended December 31, 2002. The calculation of barrels of equivalent (boe) is based on the conversion ratio that one barrel of oil is equivalent to six thousand cubic feet of natural gas.

FINANCIAL ANALYSIS

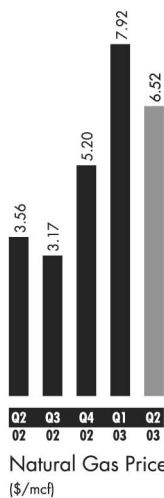
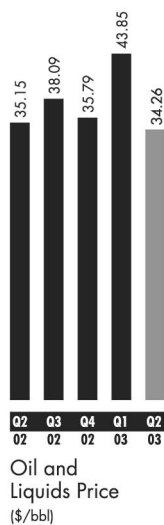
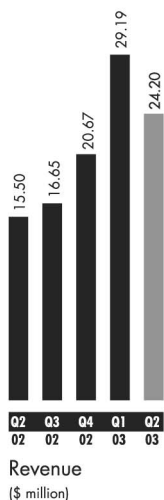
Second quarter 2003 results were derived from production volumes of 7,222 barrels of equivalent per day, a production rate which represented a respective 19 percent and two percent increase over the 2002 second quarter and 2003 first quarter levels. While the exceptional commodity prices received in the 2003 first quarter disappeared after the Iraqi hostilities commenced and winter weather abated, both crude oil and natural gas commodity prices were historically strong in the 2003 second quarter. Specifically, Zargon's second quarter 2003 oil and liquids price of \$34.26 per barrel was 22 percent less than first quarter 2003 and three percent below the same prior year period. Zargon's second quarter natural gas price of \$6.52 per thousand cubic feet was 18 percent below the \$7.92 per thousand cubic feet recorded in the first quarter but was 83 percent above the \$3.56 per thousand cubic feet experienced in the prior year period. As a result, second quarter revenues of \$24.20 million were 56 percent above the corresponding 2002 period but 17 percent below the first quarter of 2003.

Production volumes in the 2003 first half averaged 7,142 barrels of equivalent per day, a 17 percent improvement over the comparative 2002 period. The 12 percent gain in oil volumes generally came from Williston Basin exploitation drilling and acquisitions while the 22 percent gain in natural gas volumes were primarily the result of a successful West Central Alberta gas exploration program. The production gains were overshadowed by 116 and 22 percent improvements in Zargon's 2003 first half field natural gas and oil prices. The result was a record first half 2003 revenue of \$53.39 million, which represented an 89 percent improvement over the \$28.23 million recorded in the 2002 comparative period.

Zargon's commodity price risk management policy uses forward sales, options and costless collars for, on average, 20 to 30 percent of our net oil and natural gas sales in order to partially offset the effects of large price fluctuations. The net hedging loss of \$2.22 million experienced in the first quarter of 2003 was reduced to \$0.47 million in the second quarter because of lower second quarter oil and natural gas prices and by the March 31 expiration of certain fixed price gas swaps and collars. For the first half of 2003, the net hedging loss was \$2.70 million compared to a gain of \$0.93 million in first half 2002 when natural gas prices were substantially lower.

Royalties, inclusive of Alberta Royalty Tax Credit and Saskatchewan Resource Surcharge, were \$5.05 million for the second quarter of 2003, a decrease of 19 percent from the first quarter and an increase of 57 percent from \$3.22 million in the 2002 second quarter. As a percentage of gross revenue, second quarter 2003 royalties were 20.9 percent of revenue compared to 21.4 percent in the first quarter and 20.8 percent in the 2002 period. For the first half, royalties of \$11.30 million were 88 percent higher than the 2002 first half, corresponding to an 89 percent increase in revenue.

Production expenses were \$3.98 million in the 2003 second quarter, a six percent decrease from the first quarter and 14 percent higher than the second quarter of 2002. On a unit of production basis, 2003 production expenses are showing response to the disposition of non-core, higher cost properties and field cost containment initiatives. Second quarter 2003 production costs were \$6.05 per barrel of equivalent compared to \$6.66 per barrel of equivalent in the 2003 first quarter and \$6.28 per barrel of equivalent the 2002 second quarter. For the first half 2003, production costs were \$6.35 per barrel of equivalent, a one percent increase from the 2002 first half levels, but a ten percent improvement over the 2002 second half unit costs. The continuation of this encouraging trend of cost improvement will remain a key initiative for Zargon over the remainder of the year.



OPERATING NETBACKS

| Six months ended June 30 | 2003 | | 2002 | |
|--------------------------|-----------------------------|-------------------------|-----------------------------|-------------------------|
| | Oil and Liquids (\$/bbl) | Natural Gas (\$/mcf) | Oil and Liquids (\$/bbl) | Natural Gas (\$/mcf) |
| Revenue | 38.77 | 7.23 | 31.78 | 3.34 |
| Hedging | (1.47) | (0.43) | 0.70 | 0.16 |
| Royalties | (7.36) | (1.65) | (6.29) | (0.78) |
| Production costs | (9.09) | (0.68) | (9.00) | (0.64) |
| Operating netbacks | 20.85 | 4.47 | 17.19 | 2.08 |

General and administrative expenses of \$0.77 million in the second quarter of 2003 were 14 percent below the first quarter and 18 percent below the 2002 second quarter. On a unit of production basis, first half 2003 general and administrative costs decreased 20 percent to \$1.28 per barrel of equivalent as compared to \$1.61 per barrel of equivalent in first half 2002 and \$1.49 per barrel of equivalent for all of 2002. General and administrative costs are also helped by the disposition of a substantial number of small, higher cost properties. During the period, Zargon maintained its policy of not capitalizing any portion of its general and administrative costs.

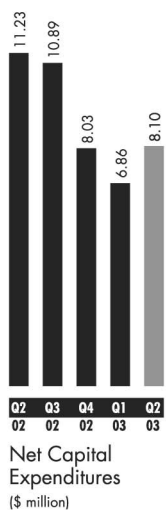
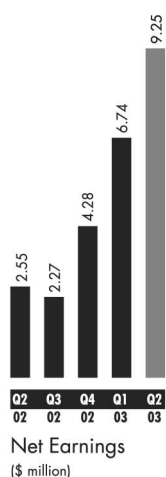
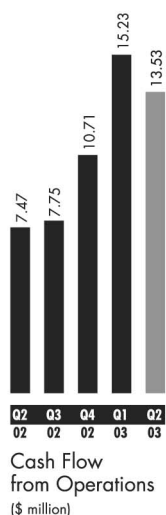
Interest expense of \$0.25 million in the second quarter and \$0.51 million in the first half of 2003 compares to \$0.27 million and \$0.54 million in the corresponding periods of 2002. Because of high cash flows, bank debt has decreased steadily over the last 12 months despite active capital expenditure programs, going from \$25.28 million at December 31, 2002 to \$11.47 million at June 30, 2003. Short-term interest rates in both 2002 and 2003 were relatively low when compared to prior years.

CORPORATE NETBACKS

| Six months ended June 30 (\$/boe) | 2003 | 2002 |
|-----------------------------------|---------------|--------|
| Revenue | 41.31 | 25.61 |
| Hedging | (2.09) | 0.84 |
| Royalties | (8.74) | (5.45) |
| Production costs | (6.35) | (6.29) |
| Operating netbacks | 24.13 | 14.71 |
| General and administrative | (1.28) | (1.61) |
| Interest | (0.39) | (0.49) |
| Capital and current income taxes | (0.21) | (0.22) |
| Cash flow netbacks | 22.25 | 12.39 |
| Depletion and depreciation | (6.26) | (5.62) |
| Site restoration | (0.50) | (0.56) |
| Foreign exchange | 0.22 | (0.01) |
| Future income taxes | (3.34) | (2.45) |
| Net earnings | 12.37 | 3.75 |

Depletion and depreciation expense for the second quarter of 2003 of \$4.11 million was three percent higher than the first quarter and 32 percent above second quarter 2002. The majority of this increase was due to the respective increase of production volumes by two and 19 percent. On a unit of production basis, depletion and depreciation charges were unchanged from the first quarter but rose 11 percent to \$6.26 per barrel of equivalent in the second quarter of 2003 from \$5.62 in the same period of 2002. The increase in unit charges arose mainly from the ongoing industry-wide trend, also experienced by Zargon, to higher finding and development costs.

Cash flow in second quarter 2003 of \$13.53 million (see note below), while 11 percent lower than the first quarter's exceptional results, was 81 percent higher than the 2002 second quarter. The decrease from the first quarter related entirely to lower oil and natural gas prices. The large increase in cash flow as compared to the



2002 second quarter was derived from much higher natural gas prices and a 19 percent gain in production volumes. Strong prices and higher production volumes have provided record cash flow levels for the 2003 first half on both a corporate and per share basis. For the first half of 2003, cash flow from operations of \$28.76 million or \$1.57 per diluted share more than doubled the results for the prior year period.

Future taxes were \$0.12 million for the second quarter of 2003, a decrease of 97 percent from the first quarter and decrease of 92 percent from \$1.49 million in the 2002 second quarter. Second quarter 2003 future taxes were one percent of before tax earnings compared to 38 percent in the first quarter and 36 percent in the comparative 2002 period. The substantial reduction in the future tax rate related to a change in Federal Government tax legislation. The changes, which were contained in Bill C-48 and introduced into the House of Commons in June 2003, will be implemented over a five year period and encompass the following:

- (a) The Federal Large Corporations Tax of 0.225 percent will be eliminated;
- (b) The corporate income tax rate on income from resource activities will be gradually reduced from 28 percent to 21 percent;
- (c) The existing 25 percent resource allowance will be eliminated and a deduction for actual provincial and other crown royalties paid will be introduced.

The effect of these one-time changes, which are considered to be "substantively enacted" for GAAP purposes, and a reduction in the Alberta corporate income tax rate from 13 percent to 12.5 percent has created a large recovery in future income tax expense for Zargon of \$3.59 million. Without the impact of these tax rate adjustments, the second quarter 2003 future taxes would be \$3.71 million, which would correspond to 39 percent of before tax earnings.

Earnings are normally leveraged to cash flow and wide swings are common. The combined effect of high cash flow and favourable tax changes increased first quarter 2003 earnings to \$9.25 million, an increase of 37 and 263 percent respectively from the 2003 first and 2002 second quarters. Strong prices, higher production volumes and favourable tax changes provided record earnings for the 2003 first half on both a corporate and per share basis. For the first half of 2003, earnings of \$15.99 million or \$0.88 per diluted share represented gains of 287 percent and 267 percent respectively over the 2002 first half.

Note: Cash flow from operations is a non-GAAP term that represents net earnings adjusted for non-cash items. The Company evaluates its performance based on net earnings and cash flow from operations. The Company considers cash flow a key measure as it demonstrates the Company's ability to generate the cash flow necessary to fund future growth through capital investment and to repay debt. Cash flow per share is calculated using the diluted weighted average number of shares for the period

CAPITAL EXPENDITURES

| Six months ended June 30 (\$ million) | 2003 | 2002 |
|--|---------------|--------|
| Undeveloped land | 3.20 | 1.64 |
| Geological and geophysical (seismic) | 2.37 | 1.18 |
| Drilling and completion of wells | 4.79 | 2.64 |
| Well equipment and facilities | 2.53 | 0.94 |
| Exploration and development | 12.89 | 6.40 |
| Property acquisitions | 7.12 | 2.86 |
| Property dispositions | (5.05) | (0.08) |
| Net property acquisitions | 2.07 | 2.78 |
| Hadrian acquisition assigned to property and equipment | - | 7.39 |
| Total capital expenditures (net) | 14.96 | 16.57 |

LIQUIDITY AND CAPITAL RESOURCES

During the second quarter of 2003, Zargon's net capital expenditures were \$8.10 million, an increase of 18 percent over \$6.86 million in the first quarter. For the first half of 2003, net capital expenditures were \$14.96 million with \$12.89 million assigned to exploration and development. The total net capital expenditures represented a decrease of ten percent from the first half 2002 expenditures, which included the \$7.39 million booked in the Hadrian Energy Corp. acquisition, but an increase of 101 percent over the 2002 period in the amount dedicated to exploration and development. Property acquisitions were higher in 2003 due to the second quarter Truro Unit, North Dakota acquisition. However, after taking into account the second quarter property dispositions, the net property acquisitions were comparable in the 2002 and 2003 first half periods. Undeveloped land purchases of \$3.20 million and geological and geophysical expenditures of \$2.37 million added to Zargon's exploration base and to our ability to support continuing natural gas exploration and oil exploitation programs. Cash flow in the first half of 2003 of \$28.76 million funded the full capital expenditure program and left \$13.81 million to be applied to the reduction of bank debt. At June 30, 2003, Zargon's debt net of working capital was \$13.89 million and the Company is in a very strong financial position to deal with opportunities that may arise.

As at August 19, 2003, Zargon has issued 17.87 million common shares and has granted stock options to acquire an additional 1.40 million shares.

CAPITAL SOURCES

| Six months ended June 30 (\$ million) | 2003 | 2002 |
|---------------------------------------|----------------|--------|
| Cash flow from operations | 28.76 | 13.66 |
| Changes in working capital and other | (0.82) | (6.53) |
| Change in bank indebtedness | (13.81) | 3.86 |
| Issuance of common shares | 0.83 | 5.58 |
| Total capital sources | 14.96 | 16.57 |

OUTLOOK

Zargon's current financial strength and the substantial progress being realized in our natural gas exploration and oil exploitation programs provide us strong encouragement for the future. Although commodity prices have receded from first quarter record highs, both oil and natural gas prices remain at very strong levels. The exceptional financial results achieved in the first half of 2003 allow us to proceed confidently with our internally generated growth programs and still fund a sizeable acquisition opportunity if and when value-added opportunities become available.

(\$ million, except per share amounts)

| Quarter | Net Earnings | Earnings/ Diluted Share | Cash Flow | Cash Flow/ Diluted Share | Production Revenue | Total Assets | Bank Debt |
|---------|--------------|-------------------------------|--------------|--------------------------------|-----------------------|-----------------|--------------|
| 2003 Q2 | \$9.25 | \$0.51 | \$13.53 | \$0.74 | \$24.20 | \$160.05 | \$11.47 |
| 2003 Q1 | \$6.74 | \$0.37 | \$15.23 | \$0.84 | \$29.19 | \$159.34 | \$20.78 |
| 2002 Q4 | \$4.28 | \$0.24 | \$10.71 | \$0.59 | \$20.67 | \$153.66 | \$25.28 |
| 2002 Q3 | \$2.27 | \$0.13 | \$7.75 | \$0.43 | \$16.65 | \$146.00 | \$28.71 |
| 2002 Q2 | \$2.55 | \$0.14 | \$7.47 | \$0.42 | \$15.50 | \$137.76 | \$28.00 |
| 2002 Q1 | \$1.58 | \$0.09 | \$6.19 | \$0.36 | \$12.73 | \$128.97 | \$25.26 |
| 2001 Q4 | \$1.77 | \$0.10 | \$5.81 | \$0.34 | \$11.18 | \$127.93 | \$24.14 |
| 2001 Q3 | \$2.60 | \$0.15 | \$7.66 | \$0.44 | \$14.67 | \$119.06 | \$19.27 |
| 2001 Q2 | \$3.49 | \$0.22 | \$8.59 | \$0.57 | \$16.90 | \$108.27 | \$13.19 |

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

Calgary, Alberta
August 19, 2003

CONSOLIDATED
BALANCE SHEETS

(\$ thousand)

June 30, 2003 December 31, 2002

(unaudited)

ASSETS

Current

| | | |
|-------------------------------|---------------|--------|
| Accounts receivable | 11,608 | 11,942 |
| Prepaid expenses and deposits | 567 | 712 |

| | | |
|--|---------------|--------|
| | 12,175 | 12,654 |
|--|---------------|--------|

Property and equipment, net

| | | |
|--|----------------|---------|
| | 147,874 | 141,006 |
|--|----------------|---------|

| | | |
|--|----------------|---------|
| | 160,049 | 153,660 |
|--|----------------|---------|

LIABILITIES

Current

| | | |
|--|---------------|--------|
| Bank indebtedness | 11,474 | 25,279 |
| Accounts payable and accrued liabilities | 14,588 | 16,118 |

| | | |
|--|---------------|--------|
| | 26,062 | 41,397 |
|--|---------------|--------|

Future site restoration

| | | |
|--|--------------|-------|
| | 5,341 | 4,746 |
|--|--------------|-------|

Future income taxes

| | | |
|--|---------------|--------|
| | 25,239 | 20,922 |
|--|---------------|--------|

| | | |
|--|---------------|--------|
| | 56,642 | 67,065 |
|--|---------------|--------|

SHAREHOLDERS' EQUITY

| | | |
|-------------------|---------------|--------|
| Share capital | 41,823 | 40,997 |
| Retained earnings | 61,584 | 45,598 |

| | | |
|--|----------------|--------|
| | 103,407 | 86,595 |
|--|----------------|--------|

| | | |
|--|----------------|---------|
| | 160,049 | 153,660 |
|--|----------------|---------|

See accompanying selected notes

CONSOLIDATED
STATEMENTS OF
EARNINGS AND
RETAINED EARNINGS

| (unaudited) | Three months ended June 30 | | Six months ended June 30 | |
|---|-------------------------------|---------|-----------------------------|---------|
| | 2003 | 2002 | 2003 | 2002 |
| (\$ thousand, except per share amounts) | | | | |
| Revenue | | | | |
| Oil and gas sales | 24,198 | 15,498 | 53,391 | 28,226 |
| Hedging | (473) | 10 | (2,696) | 934 |
| Royalties | (5,052) | (3,216) | (11,296) | (6,010) |
| | 18,673 | 12,292 | 39,399 | 23,150 |
| Expenses | | | | |
| Production | 3,976 | 3,475 | 8,206 | 6,931 |
| General and administrative | 766 | 929 | 1,654 | 1,773 |
| Interest | 247 | 274 | 509 | 541 |
| Foreign exchange | (279) | 13 | (279) | 9 |
| Site restoration | 328 | 310 | 646 | 617 |
| Depletion and depreciation | 4,114 | 3,112 | 8,092 | 6,196 |
| | 9,152 | 8,113 | 18,828 | 16,067 |
| Earnings before taxes | 9,521 | 4,179 | 20,571 | 7,083 |
| Taxes | | | | |
| Future | 118 | 1,490 | 4,317 | 2,710 |
| Current | 154 | 141 | 268 | 243 |
| | 272 | 1,631 | 4,585 | 2,953 |
| Net earnings for the period | 9,249 | 2,548 | 15,986 | 4,130 |
| Retained earnings, beginning of period | 52,335 | 36,501 | 45,598 | 34,919 |
| Retained earnings, end of period | 61,584 | 39,049 | 61,584 | 39,049 |
| Earnings per common share | | | | |
| Basic | 0.52 | 0.15 | 0.90 | 0.24 |
| Diluted | 0.51 | 0.14 | 0.88 | 0.24 |

See accompanying selected notes

CONSOLIDATED
STATEMENTS OF
CASH FLOW

| (unaudited) | Three months ended | | Six months ended | |
|--|--------------------|---------|------------------|----------|
| | 2003 | 2002 | 2003 | 2002 |
| (\$ thousand) | | | | |
| Operating activities | | | | |
| Net earnings for the period | 9,249 | 2,548 | 15,986 | 4,130 |
| Add non-cash items: | | | | |
| Depletion and depreciation | 4,114 | 3,112 | 8,092 | 6,196 |
| Site restoration | 328 | 310 | 646 | 617 |
| Foreign exchange | (279) | 13 | (279) | 9 |
| Future income taxes | 118 | 1,490 | 4,317 | 2,710 |
| Cash flow from operations | 13,530 | 7,473 | 28,762 | 13,662 |
| Changes in non-cash working capital | 3,057 | (563) | 1,159 | (689) |
| | 16,587 | 6,910 | 29,921 | 12,973 |
| Financing activities | | | | |
| Advances (repayment) of bank indebtedness | (9,303) | 2,739 | (13,805) | 3,862 |
| Exercise of stock options | 549 | 279 | 826 | 918 |
| | (8,754) | 3,018 | (12,979) | 4,780 |
| Investing activities | | | | |
| Additions to property and equipment | (13,123) | (3,930) | (20,005) | (9,332) |
| Proceeds on disposal of property and equipment | 5,020 | 22 | 5,045 | 82 |
| Acquisition of Hadrian Energy Corp. (cash portion) | - | (4,857) | - | (4,857) |
| Site restoration expenditures | (21) | (34) | (51) | (47) |
| Changes in non-cash working capital | 291 | (1,129) | (1,931) | (3,800) |
| | (7,833) | (9,928) | (16,942) | (17,954) |
| Decrease in cash | - | - | - | (201) |
| Cash, beginning of period | - | - | - | 201 |
| Cash, end of period | - | - | - | - |

See accompanying selected notes

SELECTED NOTES TO
CONSOLIDATED
FINANCIAL
STATEMENTS

For the three and six months
ended June 30, 2003 and 2002
(unaudited)

1. BASIS OF PRESENTATION

The interim consolidated financial statements of Zargon Oil & Gas Ltd. (the "Corporation") have been prepared by management in accordance with Canadian generally accepted accounting principles. The interim 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, 2002. The interim consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto in the Corporation's annual report for the year ended December 31, 2002.

2. ACQUISITION

On June 17, 2002, the Corporation acquired all of the outstanding shares of Hadrian Energy Corp. ("Hadrian"), a private oil and gas company, for \$9.60 million. Consideration consisted of \$4.745 million cash and the issuance of 542,340 Zargon common shares valued at \$8.75 per share. Costs of \$0.13 million were incurred to effect the transaction and were charged to share capital. The acquisition was accounted for by the purchase method and the purchase price has been allocated as follows:

| (\$ thousand) | 2002 |
|-------------------------|--------------|
| Working capital | (816) |
| Property and equipment | 7,386 |
| Future tax asset | 3,792 |
| Future site restoration | (760) |
| Total consideration | <u>9,602</u> |

3. SHARE CAPITAL

The Corporation is authorized to issue an unlimited number of common shares with no par value and an unlimited number of first preferred shares and second preferred shares.

Common Shares

| (thousand) | June 30, 2003 | | June 30, 2002 | |
|----------------------------|------------------|---------------|------------------|-------------|
| | Number of Shares | Amount (\$) | Number of Shares | Amount (\$) |
| Shares issued | | | | |
| Balance, beginning of year | 17,637 | 40,997 | 16,666 | 35,066 |
| Shares issued for Hadrian | - | - | 542 | 4,658 |
| Stock options exercised | 229 | 826 | 317 | 918 |
| Balance, end of period | 17,866 | 41,823 | 17,525 | 40,642 |

A summary of the status of the Corporation's stock option plans as at June 30, 2003 and 2002, and changes during the six months ended on those dates is presented below:

Stock Options

| | June 30, 2003 | | June 30, 2002 | |
|--------------------------------------|--------------------------------------|-----------------------------|--------------------------------------|-----------------------------|
| | Weighted Number of Shares (thousand) | Average Exercise Price (\$) | Weighted Number of Shares (thousand) | Average Exercise Price (\$) |
| Outstanding at beginning of year | 1,215 | 5.10 | 1,199 | 3.36 |
| Granted | 415 | 9.32 | 449 | 7.65 |
| Exercised | (229) | 3.62 | (317) | 2.90 |
| Cancelled | (17) | 9.30 | (3) | 7.25 |
| Outstanding at end of period | 1,384 | 6.55 | 1,328 | 4.91 |
| Options exercisable at end of period | 968 | 5.38 | 863 | 3.43 |

Stock Based Compensation

The Corporation recognizes no compensation expense when stock options are granted to employees and directors. Pro forma information regarding net earnings is required and has been determined as if the Corporation had accounted for its stock options granted after December 31, 2001 under the fair value method. The fair value for these options was estimated at the date of grant using a Black-Scholes Option Pricing Model.

The assumptions made for the options granted in the three month period ended June 30, 2003 include a volatility factor of expected market price of 20.30 percent, a weighted average risk-free interest rate of 3.44 percent, no dividend yield and a weighted average expected life of options of four years.

For purposes of pro forma disclosures, the estimated fair value of options is amortized to expense over the options' vesting periods. The Corporation's net earnings would be reduced by \$70,000 for the three months ended June 30, 2003 and \$325,000 for the six months ended June 30, 2003. Basic and diluted earnings per share figures would have both been unchanged for the 2003 quarter and would have both been reduced by \$0.02 for the 2003 half.

Comparatively, the Corporation's prior period net earnings would be reduced by \$163,000 for the three months ended June 30, 2002 and \$300,000 for the six months ended June 30, 2002. Basic and diluted earnings per share figures would have both been reduced by \$0.01 for the 2002 quarter and by \$0.02 for the 2002 half.

4. WEIGHTED AVERAGE NUMBER OF COMMON SHARES

| (thousand) | Three months ended June 30 | | Six months ended June 30 | |
|------------|-------------------------------|--------|-----------------------------|--------|
| | 2003 | 2002 | 2003 | 2002 |
| Basic | 17,785 | 17,029 | 17,747 | 16,893 |
| Diluted | 18,296 | 17,665 | 18,268 | 17,502 |

5. SEGMENTED INFORMATION

| (\$ thousand) | Three months ended June 30 | | Six months ended June 30 | |
|---------------------------------|-------------------------------|--------|-----------------------------|---------|
| | 2003 | 2002 | 2003 | 2002 |
| Oil and Gas Sales | | | | |
| Canada | 21,408 | 13,757 | 47,780 | 25,092 |
| United States | 2,790 | 1,741 | 5,611 | 3,134 |
| Total | 24,198 | 15,498 | 53,391 | 28,226 |
| Net Capital Expenditures | | | | |
| Canada | 2,914 | 11,220 | 9,719 | 16,552 |
| United States | 5,189 | 11 | 5,241 | 21 |
| Total | 8,103 | 11,231 | 14,960 | 16,573 |
| Total Assets | | | | |
| Canada | | | 149,935 | 133,068 |
| United States | | | 10,114 | 4,693 |
| Total | | | 160,049 | 137,761 |

6. SUPPLEMENTAL CASH FLOW INFORMATION

| (\$ thousand) | Three months ended June 30 | | Six months ended June 30 | |
|--------------------|-------------------------------|------|-----------------------------|------|
| | 2003 | 2002 | 2003 | 2002 |
| Cash interest paid | 181 | 376 | 423 | 767 |
| Cash taxes paid | 154 | 140 | 268 | 242 |

7. FINANCIAL INSTRUMENTS

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

The Corporation enters into currency contracts for hedging purposes because the price received for its products varies in close relationship to the US dollar currency exchange rate.

The Corporation has outstanding contracts at June 30, 2003 as follows:

| | Volume | Rate | Price | Range of Terms |
|---------------------|---------------------------|------------|---------------------|------------------------|
| Oil swaps | 128,800 bbl | 700 bbl/d | \$24.96 US/bbl | Jul. 1/03 – Dec. 31/03 |
| Oil collars | 36,400 bbl | 200 bbl/d | \$22.50 US/bbl Put | Jan. 1/04 – Jun. 30/04 |
| | | | \$26.85 US/bbl Call | |
| | 36,400 bbl | 200 bbl/d | \$24.00 US/bbl Put | Jan. 1/04 – Jun. 30/04 |
| | | | \$27.65 US/bbl Call | |
| Natural gas swaps | 246,000 gj | 2,000 gj/d | \$4.85/gj | Jul. 1/03 – Oct. 31/03 |
| | 304,000 gj | 2,000 gj/d | \$7.50/gj | Nov. 1/03 – Mar. 31/04 |
| Natural gas put | 456,000 gj | 3,000 gj/d | \$5.00/gj | Nov. 1/03 – Mar. 31/04 |
| Natural gas collars | 246,000 gj | 2,000 gj/d | \$4.00/gj Put | Jul. 1/03 – Oct. 31/03 |
| | | | \$6.10/gj Call | |
| | 152,000 gj | 1,000 gj/d | \$5.50/gj Put | Nov. 1/03 – Mar. 31/04 |
| | | | \$7.90/gj Call | |
| Currency collar | \$1,000,000 Cdn./month | – | \$1.56 Put | Jul. 1/03 – Dec. 31/03 |
| | | | \$1.62 Call | |

8. TAX RATE ADJUSTMENT

In the March 2003 budget, the Government of Canada announced federal corporate income tax changes affecting resource companies to be phased in over a five year period that include reducing the federal tax rate from 28% to 21%, allowing the deductibility of crown charges and eliminating the resource allowance. As a result of both federal and provincial corporate income tax changes, which are considered to be "substantively enacted" for Canadian GAAP purposes, the provision for future income taxes for the three and six months ended June 30, 2003 include a recovery and liability reduction in the amount of \$3.59 million.

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

James D. Peplinski
Calgary, Alberta

Byron J. Seaman
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

Mark I. Lake
Vice President, Exploration

Daniel A. Roulston
Vice President, Operations

Sheila A. Wares
Vice President, Accounting

Kenneth W. Young
Vice President, Land

STOCK EXCHANGE LISTING

The Toronto Stock Exchange
Trading Symbol: ZAR

TRANSFER AGENT

Valiant Trust Company
510, 550 – 6th Avenue S.W.
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WEBSITE

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Forward Looking Statements – Certain information regarding Zargon set forth in this document, including management's assessment of Zargon's future plans and operations, contains forward-looking statements that involve substantial known and unknown risks and uncertainties. These forward-looking statements are subject to numerous risks and uncertainties, certain of which are beyond Zargon's control, including the impact of general economic conditions, industry conditions, volatility of commodity prices, currency fluctuations, imprecision of reserve estimates, environmental risks, competition from other producers, the lack of availability of qualified personnel or management, stock market volatility and ability to access sufficient capital from internal and external sources. Zargon's actual results, performance or achievement could differ materially from those expressed in, or implied by, these forward-looking statements and, accordingly, no assurance can be given that any of the events anticipated by the forward-looking statements will transpire or occur, or if any of them do so, what benefits that Zargon will derive therefrom.