

Corporate

Highlights

For the three months and years ended December 31, 2003 and 2002

Zargon reported strong fourth quarter results to close out this record year. Fourth quarter 2003 revenue of \$24.51 million and cash flow from operations of \$13.24 million (\$0.72 per diluted share) were significantly higher than the preceding third quarter and the comparative 2002 fourth quarter results. Reflecting higher per unit depletion and depreciation changes, fourth quarter net earnings of \$4.03 million (\$0.22 per diluted share) were slightly lower than the comparative quarters.

High oil and natural gas prices have powered financial results throughout 2003 for both Zargon and the industry. Year-over-year 2003 natural gas prices received by Zargon averaged a remarkable 66 percent gain over the prior year. Oil prices received in both years were historically high and increased six percent in 2003. The price gains were bolstered by strong production volume increases throughout the year. Fourth quarter 2003 production of oil and liquids was 3,340 barrels per day, level with the preceding quarter and 10 percent above the prior year fourth quarter. Natural gas volumes increased strongly, 13 percent more than the preceding quarter and 26 percent above the prior year quarter to 28.08 million cubic feet per day for fourth quarter 2003. On an equivalent basis, fourth quarter volumes of 8,020 barrels of equivalent per day were seven percent and 19 percent respectively above the preceding and the 2002 fourth quarter. Net capital expenditures for the 2003 fourth quarter of \$12.84 million were six percent above the preceding quarter and significantly above the \$8.03 million expended in the same prior year period, reflecting continuation of the very active second half 2003 field exploration program.

	Three months ended December 31			Year ended December 31		
	2003	2002	Percent Change	2003	2002	Percent Change
	(unaudited)	(unaudited)				
FINANCIAL						
INCOME AND INVESTMENTS (\$ million)						
Petroleum and natural gas revenue	24.51	20.67	19	101.66	65.54	55
Cash flow from operations	13.24	10.71	24	54.35	32.12	69
Net earnings	4.03	4.28	(6)	24.53	10.68	130
Net capital expenditures	12.84	8.03	60	39.91	35.55	12
PER COMMON SHARE, DILUTED						
Cash flow from operations (\$/share)	0.72	0.59	22	2.96	1.81	64
Net earnings (\$/share)	0.22	0.24	(8)	1.33	0.60	122
BALANCE SHEET AT PERIOD END (\$ million)						
Property and equipment, net				161.91	141.01	15
Bank indebtedness				6.98	25.28	(72)
Shareholders' equity				112.59	86.60	30
SHARES OUTSTANDING AT PERIOD END (million)				17.99	17.64	2
OPERATIONS						
AVERAGE DAILY PRODUCTION						
Oil and liquids (bbl/d)	3,340	3,043	10	3,287	2,968	11
Natural gas (mmcf/d)	28.08	22.26	26	24.95	20.29	23
Equivalent (boe/d)	8,020	6,753	19	7,446	6,349	17
Equivalent per million shares (boe/d)	448	383	17	418	368	14
AVERAGE SELLING PRICE (before hedges)						
Oil and liquids (\$/bbl)	32.91	35.79	(8)	36.66	34.45	6
Natural gas (\$/mcf)	5.57	5.20	7	6.33	3.81	66
WELLS DRILLED, NET	16.1	17.4	(7)	38.6	31.6	22
UNDEVELOPED LAND AT PERIOD END (thousand net acres)				398	331	20

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



For calendar 2003, revenue of \$101.66 million, cash flow from operations of \$54.35 million (\$2.96 per diluted share) and net earnings of \$24.53 million (\$1.33 per diluted share) each set all-time records and showed increases of 55, 69, and 130 percent, respectively over 2002. Net capital expenditures for the twelve months of 2003 totalled \$39.91 million with \$37.30 million allocated to field related activities, increases of 12 percent in total and 56 percent in field expenditures over the prior year. The material expansion in fieldwork in 2003 took place largely in the third and fourth quarters when 27.6 net wells were drilled in a very active exploration program. Purchase of the Truro Unit in North Dakota was the only sizeable acquisition made in 2003 (second quarter) and its cost was largely offset by non-core dispositions made at opportunistic prices in the same quarter. Over the year, Zargon increased its undeveloped land base by 20 percent at a cost of \$6.98 million, shot or acquired seismic at a cost of \$5.69 million, drilled and completed 38.6 net wells for \$17.30 million, added new facilities and tie-ins for \$7.33 million and made net property acquisitions of \$2.61 million. These expenditures were internally funded by a combination of very strong cash flow and non-core dispositions that also allowed the reduction of debt net of working capital by \$15.65 million to \$13.09 million at December 31, 2003.

PRODUCTION

Natural gas production volumes showed good growth throughout 2003 and averaged 28.08 million cubic feet per day in fourth quarter 2003, a 13 percent improvement from the preceding quarter and a 26 percent increase over the 22.26 million cubic feet per day reported in the 2002 fourth quarter. Zargon's natural gas growth in 2003 has come from successful exploration initiatives in West Central Alberta with substantial new volumes coming from the Highvale, Pembina and Peace River Arch properties. During the third quarter, a significant natural gas producer was completed and tied-in at the Peace River Arch Progress property with sustainable net production of three million cubic feet per day. Since January 2002, Zargon has grown its West Central Alberta undeveloped lands from 38 thousand net acres to 174 thousand net acres and West Central Alberta natural gas production volumes have grown commensurately from two million cubic feet per day to the fourth quarter 2003 rate of 10.45 million cubic feet per day. During this time East Central Alberta natural gas production volumes, which include our key Jarrow property, have been maintained at steady rates with a modest maintenance-drilling program.

Production of oil and liquids averaged 3,340 barrels per day in fourth quarter 2003, level with the preceding quarter and 10 percent higher than the prior year fourth quarter. Zargon's oil and liquids production is founded on the key Williston Basin (Southeast Saskatchewan and North Dakota) long-life, shallow-decline properties. Production growth is derived from exploitation and enhancement activities plus acquisitions of complementary exploitable properties. An enhanced Haas Unit waterflood program and a Truro Unit property acquisition, both in North Dakota, were the source of the majority of this year's oil production growth.

EXPLORATION AND EXPLOITATION

Zargon has based its growth on the complementary strategies of exploring for natural gas reserves and exploiting existing oil reservoirs. The key input resource for our natural gas exploration program is undeveloped land, and through aggressive activity at Crown land sales over recent years, Zargon has built a 398 thousand net acre undeveloped land inventory by yearend 2003.

An expanded drilling program has accompanied this growing undeveloped land inventory. After a slow beginning in the first half of the year when only 11.0 net wells were drilled, 11.5 net wells were drilled in the third quarter and 16.1 net wells were drilled in the fourth quarter. For the year a total of 38.6 net wells were drilled with an 84 percent success ratio resulting in 24.6 net natural gas wells, 8.0 net oil wells and 6.0 net dry holes. During the year, Zargon continued to focus on natural gas exploration, with 76 percent of the 2003 drilling classified as exploration wells, and over 70 percent of the program targeting natural gas prospects.

The fourth quarter program by itself delivered 9.1 net natural gas wells, 4.0 net oil wells and 3.0 net dry holes for an 81 percent success ratio. The wells included 4.1 net natural gas wells at the West Central Alberta Pembina property, 2.0 net natural gas wells and 1.0 net gassy oil well on the Peace River Arch property, and 3.0 net natural gas wells at the East Central Alberta Jarrow and Hamilton Lake properties. Three net oil exploitation wells were drilled at the Williston Basin properties of Haas, North Dakota and Pinto and Frys in Southeast Saskatchewan.

The most interesting result from the fourth quarter drilling program came from the discovery of two new pools at the Peace River Arch property. At Hamelin Creek a Dunvegan/Gething natural gas well is scheduled to be tied-in during the 2004 second quarter at rates exceeding one million cubic feet per day. The current geological mapping suggests that as many as three additional Dunvegan gas wells may be drilled this year on the Hamelin Creek land block. At Progress, a fourth quarter new pool Triassic gassy oil well will also be tied-in to area facilities in the second quarter. Follow-up drilling on this project is planned later this summer.

Since January 2003, Zargon has implemented oil reservoir waterflood initiation or enhancement projects at West Frys, Weyburn (Halbrite) and Weyburn (Elswick) in Saskatchewan and at Taber, Alberta. Once the oil reservoirs are repressurized, our exploitation programs proceed with 3D seismic reservoir characterization and then ultimately horizontal drilling. The Haas, North Dakota waterflood enhancement program was initiated in late 2002 and, as the reservoir was

re-pressured, production rates increased by 35 percent. A 3D seismic survey was shot in summer 2003 and just prior to yearend our first Haas horizontal exploitation well was drilled. Further horizontal drilling is planned on the Haas property this spring. In the 2003 third quarter, four other 3D seismic shoots were completed in the Williston Basin that will lead over time to numerous horizontal exploitation wells. Oil reservoir analysis and exploitation programs form an important part of Zargon's growth strategy and, over the years, have provided steady growth from a portfolio of long-life shallow-decline properties.

Zargon has an active drilling program underway in the 2004 first quarter with a total of 12 wells planned to be drilled prior to spring break-up. The program includes one horizontal well in Southeast Saskatchewan and six wells at the East Central Alberta properties of Jarrow and Hamilton Lake that are designed to maintain the area's current production levels. Five wells will be drilled in the West Central Alberta properties, with three wells located at Pembina, and one well scheduled for each of the Highvale and Peace River Arch properties.

Following spring break-up, a higher-risk, higher-reward program is planned with five Peace River exploration natural gas locations and four Williston Basin (Southeast Saskatchewan and North Dakota) exploitation oil wells. Zargon has also agreed to drill a minimum of two wells in the second quarter, and possibly three additional wells this fall, on a large land block located on the Blackfeet Indian Reservation in the northern portion of the state of Montana. Although located several hundred miles apart, we view that the Blackfeet and Pembina properties have many similarities in terms of their shallow depth, low-pressure natural gas shows and completion operations. With the drilling of five wells, Zargon has the opportunity to earn 29 thousand net undeveloped acres of natural gas prospective land that could lead to a sizeable natural gas development project in subsequent years.

Capital expenditures throughout the remainder of the year will continue to focus on growing through exploration our West Central Alberta natural gas volumes, maintaining steady East Central Alberta natural gas production, while continuing to efficiently exploit our large Williston Basin oil development and waterflood project inventory.

ACQUISITIONS/DISPOSITIONS

The largest property acquisition made in 2003 was the \$4.95 million Cdn. purchase of a 92.5 percent interest in the Truro Unit in Renville County, North Dakota. Property acquisitions in 2003 totalled \$7.83 million and were largely offset by \$5.22 million realized through the sale of non-core, high-cost properties as Zargon took advantage of a strong property market. As an additional benefit, these dispositions in conjunction with \$3.13 million of similar 2002 dispositions have contributed to Zargon's improving trend in per unit operating costs.

GUIDANCE*

Last May 2003, Zargon provided 2003 yearend production guidance at 3,600 barrels of oil per day and 26.5 million cubic feet of natural gas per day, for a combined rate of 8,017 barrels of equivalent per day. Fourth quarter rates of 3,340 barrels per day, 28.08 million cubic feet per day and 8,020 barrels of equivalent per day met the yearend guidance targets for the entire quarter, although the actual natural gas volume weighting was higher than forecast.

Current oil production remains substantially unchanged from the fourth quarter rate of 3,340 barrels per day. Year-end horizontal drilling of two wells at Frys, Saskatchewan and at Haas, North Dakota have offset declines, and a new horizontal well at Forget, Saskatchewan promises to be a good producer. Substantial gains will have to come from a four well Williston Basin exploitation program (two vertical and two horizontal) that is scheduled immediately after spring break-up.

First quarter 2004 natural gas production has averaged at levels just under the 28.08 million cubic feet per day reported for the 2003 fourth quarter. Immediately following spring break-up, new production from the tie-ins of first quarter 2004 Jarrow and Pembina drilling successes and the tie-in of last year's two new Peace River Arch discoveries (Hamelin Creek – Gething and Dunvegan natural gas; Progress – Triassic gassy oil) should help build the corporate natural gas rates towards the 30 million cubic feet per day 2004 mid-year guidance level.

Zargon's 2004 capital program budget will be primarily sourced from cash flow and is initially set at \$45 million with the drilling of 45 net wells. This budget is allocated \$40 million to exploration and development field activities and \$5 million to property acquisitions. The budget reflects our view that the current property acquisition market is fully priced. Should value added property or corporate acquisitions become available, our unutilized bank lines will permit us to greatly expand the acquisition component of our budget.

In November 2003, Zargon set mid-year 2004 production guidance levels at 30 million cubic feet of natural gas per day and 3,750 barrels of oil per day, for a combined rate of 8,750 barrels of equivalent per day, which would represent a 17 percent gain over the 2003 average production rates. This guidance is based on a \$45 million 2004 capital budget with natural gas production gains forecast to come from exploration-related growth in the West Central Alberta exploration initiatives at the Peace River Arch, Pembina and Highvale properties. Oil production gains are projected from Williston Basin exploitation horizontal drilling, but will also require augmentation by a small Williston Basin property acquisition.

* 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 consolidated financial statements for the three months ended December 31, 2003 and the audited consolidated financial statements and MD&A for the years ended December 31, 2003 and 2002. In the MD&A, reserves and production are commonly stated in barrels of equivalent (boe) using a conversion of six thousand cubic feet of natural gas being equal to one barrel of oil.

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 Company's financial performance. Zargon's determination of cash flow from operations may not be comparable to that reported by other companies. 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 Company evaluates its performance based on net earnings and cash flow from operations. The Company considers cash flow from operations to be a key measure as it demonstrates the Company's ability to generate the cash necessary to repay debt and to fund future growth through capital investment. Cash flow from operations per share is calculated using the diluted weighted average number of shares for the period.

FINANCIAL ANALYSIS

In the fourth quarter of 2003, Zargon reported continued gains in petroleum and natural gas revenue and cash flow from operations. Revenue for the 2003 fourth quarter of \$24.51 million and cash flow from operations of \$13.24 million were three percent and seven percent above the preceding quarter and 19 percent and 24 percent above the 2002 fourth quarter, respectively. Net earnings of \$4.03 million in fourth quarter 2003 while also historically high, but due to a sharp increase in non-cash charges, were below \$4.51 million in the preceding quarter and \$4.28 million in the 2002 fourth quarter. Commodity prices remained high and production volumes showed substantial growth. While natural gas pricing in the 2003 fourth quarter was little changed from the preceding quarter, prices rose seven percent above the 2002 fourth quarter levels. Oil prices, while still historically high, were ten percent below the preceding quarter and eight percent below the 2002 fourth quarter levels.

Natural gas production increased to 28.08 million cubic feet per day, showing gains of 13 percent over the preceding quarter and 26 percent over the 2002 fourth quarter. The volume gains came from successful West Central Alberta gas exploration drilling initiatives. Oil and liquids production jumped in the second quarter of 2003 and then stayed flat over the balance of the year so that fourth quarter volumes of 3,340 barrels per day were even with the third quarter but 10 percent above the 2002 fourth quarter levels. The oil gains in 2003 came from successful Williston Basin exploitation drilling and the Truro Unit, North Dakota property acquisition.

Zargon's commodity price risk management policy uses forward sales, options, puts and costless collars for, on average, 20 to 30 percent of our net petroleum and natural gas production in order to partially offset the effects of large price fluctuations. As both Canadian oil and natural gas field prices are closely correlated to US dollar denominated markets, Zargon will also place US/Cdn. currency exchange hedges when considered prudent. Because our hedging strategy is protective in nature and is designed to guard the Company against extreme effects from sudden falls in prices and revenues, upward price spikes tend to produce overall losses. Thus the 2003 first quarter's extremely high oil and natural gas prices brought about a net hedging loss of \$2.22 million through a number of fixed price swaps and collars placed to ensure that a minimum level of cash flow would be maintained. As prices moderated, hedging losses declined to \$0.47 million in the second quarter, \$0.35 million in the third quarter and changed to a gain of \$0.17 million in the fourth quarter. The currency exchange collar in place throughout 2003 was positive all year and provided an overall gain of \$1.22 million. For the 2003 year, the hedging loss was \$2.88 million compared to a gain of \$0.67 million in 2002, a year when natural gas prices were much lower.

Royalties, inclusive of Alberta Royalty Tax Credit and Saskatchewan Resource Surcharge, were \$5.52 million for the fourth quarter of 2003, a decrease of three percent from the preceding quarter and an increase of 50 percent from \$3.68 million in the 2002 fourth quarter. The increase over the prior year quarter is due about 40 percent to a 19 percent gain in revenue and about 60 percent to an increase in royalty rates to 22.5 percent of gross revenue from an adjusted 17.8 percent of revenue in the 2002 quarter (20.6 percent for all of 2002). In the second half of the current year, significant natural gas production gains have come from high producing wells that incur a higher royalty rate. For the 2003 year, royalties of \$22.51 million were 67 percent higher than the 2002 year and royalty rates were 22.1 percent of gross revenue in 2003 compared to 20.6 percent in 2002.

Production expenses were \$4.65 million in the 2003 fourth quarter, seven percent above the preceding quarter and two percent higher than the prior year quarter. However, on a unit of production basis, 2003 production expenses have improved significantly, showing response to field cost containment initiatives and an extended program to sell non-core, higher cost properties. Fourth quarter 2003 production costs were \$6.30 per barrel of equivalent, down slightly from \$6.32 in the preceding quarter and well below \$7.36 in the prior year's fourth quarter. For the 2003 year, production costs were \$6.33 per barrel of equivalent, a six percent decrease from the 2002 annual rate of \$6.75 per barrel of equivalent.



OPERATING NETBACKS

Year ended December 31	2003		2002	
	Oil and Liquids (\$/bbl)	Natural Gas (\$/mcf)	Oil and Liquids (\$/bbl)	Natural Gas (\$/mcf)
Production revenue	36.66	6.33	34.45	3.81
Hedging	(0.87)	(0.20)	(0.33)	0.14
Royalties	(7.42)	(1.49)	(6.86)	(0.82)
Production costs	(8.95)	(0.71)	(9.72)	(0.69)
Operating netbacks	19.42	3.93	17.54	2.44

General and administrative expenses rose to \$1.01 million in the fourth quarter of 2003, \$0.14 million or 16 percent above the preceding quarter and \$0.33 million or 49 percent above the 2002 fourth quarter. These increases, which are an anomaly in a reducing trend, were due in large part to increased bonus accruals in 2003, reflecting the Company's very strong financial results in 2003 in which the employees participated. On a unit of production basis, general and administrative costs in the 2003 fourth quarter were \$1.37 per barrel of equivalent compared to \$1.27 in the preceding quarter but for the 2003 year general and administrative costs decreased 13 percent to \$1.30 per barrel of equivalent from \$1.49 in 2002. The improvements in general and administrative costs on a unit of production basis resulted from increased production volumes, increased general and administrative cost recoveries from expanded field capital programs, and the disposition of a substantial number of small, overhead-intensive properties.

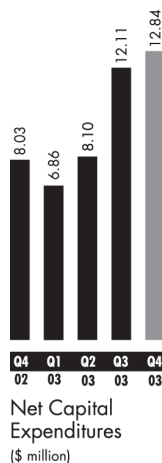
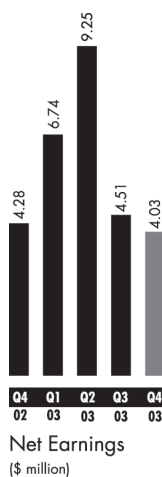
Stock-based compensation of \$0.26 million is recorded for the first time in the 2003 fourth quarter income statement in response to prospective adoption of a new CICA accounting standard. This non-cash expense was calculated using the Black-Scholes option-pricing model and covers all employee and director stock options granted by Zargon in 2003. The introduction of stock-based compensation expense added \$0.10 per barrel of equivalent to the fourth quarter and year-to-date unit cost.

Bank indebtedness fell throughout the 2003 year as a result of the year's strong cash flows exceeding the capital program. The reduced debt, coupled with historically low short-term interest rates, resulted in interest charges that were relatively low for both the fourth quarter and the year when comparing the same prior year periods.

CORPORATE NETBACKS

Year ended December 31 (\$/boe)	2003	2002
Petroleum and natural gas revenue	37.40	28.28
Hedging	(1.06)	0.29
Royalties	(8.28)	(5.83)
Production costs	(6.33)	(6.75)
Operating netbacks	21.73	15.99
General and administrative	(1.30)	(1.49)
Interest	(0.28)	(0.47)
Capital and current income taxes	(0.15)	(0.17)
Cash flow netbacks	20.00	13.86
Depletion and depreciation	(6.99)	(5.84)
Site restoration	(0.58)	(0.55)
Stock-based compensation	(0.10)	–
Unrealized foreign exchange	0.11	(0.03)
Future income taxes	(3.41)	(2.83)
Net earnings	9.03	4.61

Depletion and depreciation expense is calculated quarterly and increased sharply in the fourth quarter of 2003 to \$6.25 million, a level 34 percent higher than the \$4.67 million charged in the preceding quarter and 62 percent higher than the \$3.87 million charged in the 2002 fourth quarter. This large increase in depletion and depreciation expense is primarily related to 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. The 2003 fourth quarter per unit charge is \$8.47 per barrel of equivalent, a 25 percent increase over the 2003 third quarter and a 36 percent increase over the prior year period. Depletion and depreciation expense for the 2003 year is \$6.99 per barrel of equivalent, an increase of 20 percent over the \$5.84 per barrel of equivalent recorded for the 2002 year.



Amounts set aside for site restoration expense were also increased in fourth quarter 2003 to \$0.58 million, 68 percent higher than the preceding quarter and 81 percent higher than the 2002 fourth quarter. The site restoration charges were also impacted by the year-end negative proved reserve adjustments and a fourth quarter upward adjustment of the average future site restoration charges to \$30,000 per net well.

Cash flow from operations in fourth quarter 2003 of \$13.24 million (see note above) was seven percent higher than the preceding quarter and 24 percent higher than the prior year period. In 2003, cash flow from operations reached the record level of \$54.35 million (\$2.96 per diluted share), a gain of 69 percent from \$32.12 million (\$1.81 per diluted share) in 2002.

Future taxes of \$2.35 million for the fourth quarter of 2003 were 10 percent below the preceding quarter and five percent higher than the 2002 fourth quarter. A major change in future tax provisions pertaining to second quarter 2003 federal tax legislation distorts year-over-year comparisons. These tax changes and their effects on Zargon's tax provisions were described in detail in our 2003 second quarter report.

Net earnings for the full 2003 year of \$24.53 million show a very strong increase of 130 percent over 2002, reflecting the combined effect of high cash flow from operations and the favourable tax changes referred to above. The 2003 fourth quarter net earnings of \$4.03 million declined 11 percent from the preceding quarter and were six percent lower than the 2002 fourth quarter earnings. Despite higher 2003 fourth quarter cash flows, the lower earnings were caused by increases in the non-cash items of depletion and depreciation, site restoration and stock-based compensation. Net earnings per diluted share were \$0.22 for the 2003 fourth quarter and \$1.33 for the 2003 year, which is a gain of 122 percent over the 2002 earnings of \$0.60 per diluted share.

CAPITAL EXPENDITURES

Year ended December 31 (\$ million)	2003	2002
Undeveloped land	6.98	4.46
Geological and geophysical (seismic)	5.69	2.47
Drilling and completion of wells	17.30	12.49
Well equipment and facilities	7.33	4.48
Exploration and development	37.30	23.90
Property acquisitions	7.83	7.39
Property dispositions	(5.22)	(3.13)
Net property acquisitions	2.61	4.26
Hadrian acquisition assigned to property and equipment	-	7.39
Total capital expenditures (net)	39.91	35.55

LIQUIDITY AND CAPITAL RESOURCES

Total capital expenditures for 2003 were \$39.91 million, 12 percent higher than \$35.55 million in 2002. For the 2003 year, \$37.30 million was attributed to exploration and development costs, 93 percent of the net capital expenditures and a 56 percent increase over the 2002 levels. Net property acquisitions of \$2.61 million in 2003 compared to net property acquisitions of \$4.26 million in the prior year. Zargon did not conclude a corporate acquisition in 2003. Zargon's \$39.91 million 2003 capital program was funded using 73 percent of the 2003 cash flow from operations with the remaining cash flow applied to reduce debt net of working capital. At December 31, 2003, Zargon's debt net of working capital had declined to \$13.09 million, an amount slightly less than fourth quarter cash flow from operations.

As at March 23, 2004, Zargon has issued 18.16 million common shares and has granted stock options to acquire an additional 1.13 million shares.

CAPITAL SOURCES

Year ended December 31 (\$ million)	2003	2002
Cash flow from operations	54.35	32.12
Changes in working capital and other	2.66	(3.58)
Change in bank indebtedness	(18.30)	1.14
Issuance of common shares	1.20	5.87
Total capital sources	39.91	35.55

RECENT ACCOUNTING PRONOUNCEMENTS ISSUED

Asset Retirement Obligations

In March 2003, the CICA approved Section 3110, "Asset Retirement Obligations" which requires liability recognition for retirement obligations associated with the Company'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 amortized to expense 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. The site restoration liability currently on the balance sheet, which has been calculated using the unit of production method, will be reversed on January 1, 2004. The Company is currently evaluating the impact of this standard on its consolidated financial statements.

Petroleum and Natural Gas Assets - Full Cost Accounting

In September 2003, the CICA issued Accounting Guideline 16, "Oil and Gas Accounting - Full Cost" (AcG-16), to replace AcG-5. The new guideline is effective for fiscal years beginning on or after January 1, 2004. The most significant change between AcG-16 and AcG-5 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 current cost recovery ceiling test under AcG-5 that uses undiscounted cash flows, and constant prices, less general and administrative and financing costs. Zargon is following AcG-5 at December 31, 2003. No write-down of the Company's petroleum and natural gas properties would be required under either method at December 31, 2003. AcG-16 also adopted the reserve evaluation and disclosure requirements of NI 51-101, which have been followed in the preparation of this report.

Variable Interest Entities

In June 2003 the CICA issued Accounting Guideline 15, "Consolidation of Variable Interest Entities" (AcG-15), which deals with the consolidation of entities that are subject to control on a basis other than ownership of voting interests. This guideline is effective for annual and interim periods beginning on or after November 1, 2004. The Company has assessed that this new guideline is not applicable based on the current structure of the Company and therefore has no impact on the financial statements of the Company.

Other accounting standards issued by the CICA during the year ended December 31, 2003, are not expected to impact the Company at this time.

OUTLOOK

Zargon is well positioned for 2004 with a very strong balance sheet and a large project inventory on 398 thousand net acres of undeveloped land. Recent operational momentum in terms of both production growth and exploration successes coupled with the current very strong oil and natural gas commodity prices are providing our Company record cash flows which we continue to redeploy on our exploration and exploitation growth programs. With our industry's current record levels of activity, there is a significant upward cost pressure for property acquisitions, undeveloped land and field services. In these high cost times, we will continue with our disciplined approach, by adhering to a focused strategy of exploring and exploiting our existing large asset base, while executing value-added property acquisitions if and when they become available.

(\$ million, except per share amounts)

Quarter	Net Earnings	Earnings/ Diluted Share	Cash Flow	Cash Flow/ Diluted Share	Petroleum and Natural Gas Revenue	Total Assets	Bank Debt
2003 Q4	\$4.03	\$0.22	\$13.24	\$0.72	\$24.51	\$175.07	\$6.98
2003 Q3	\$4.51	\$0.24	\$12.34	\$0.67	\$23.76	\$166.89	\$8.92
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

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

Calgary, Alberta
March 23, 2004

Consolidated Balance
Sheets

(\$ thousand)

December 31, 2003 December 31, 2002

ASSETS

Current

Accounts receivable	12,183	11,942
Prepaid expenses and deposits	980	712

Property and equipment, net

LIABILITIES

Current

Bank indebtedness	6,978	25,279
Accounts payable and accrued liabilities	19,277	16,118

Future site restoration

Future income taxes (note 9)

SHAREHOLDERS' EQUITY

Share capital (note 4)	42,200	40,997
Contributed surplus (note 2)	264	-
Retained earnings	70,125	45,598
	112,589	86,595
	175,070	153,660

See accompanying selected notes

Consolidated Statements
of Earnings and
Retained Earnings

	Three months ended December 31		Year ended December 31	
	2003	2002	2003	2002
(\$ thousand, except per share amounts)	(unaudited)	(unaudited)		
Revenue				
Petroleum and natural gas revenue	24,511	20,665	101,657	65,538
Hedging (note 8)	168	(712)	(2,882)	669
Royalties	(5,517)	(3,677)	(22,508)	(13,508)
	19,162	16,276	76,267	52,699
Expenses				
Production	4,651	4,572	17,201	15,649
General and administrative	1,012	679	3,542	3,455
Stock-based compensation (note 2)	264	–	264	–
Interest	110	297	771	1,100
Foreign exchange (gain) loss	(87)	2	(297)	86
Site restoration	577	318	1,567	1,268
Depletion and depreciation	6,249	3,865	19,008	13,536
	12,776	9,733	42,056	35,094
Earnings before income taxes	6,386	6,543	34,211	17,605
Income taxes				
Future (note 9)	2,354	2,242	9,278	6,548
Current	5	19	406	378
	2,359	2,261	9,684	6,926
Net earnings for the period	4,027	4,282	24,527	10,679
Retained earnings, beginning of period	66,098	41,316	45,598	34,919
Retained earnings, end of period	70,125	45,598	70,125	45,598
Earnings per common share (note 5)				
Basic	0.22	0.24	1.38	0.62
Diluted	0.22	0.24	1.33	0.60

See accompanying selected notes

Consolidated
Statements of Cash
Flow

	Three months ended December 31		Year ended December 31	
	2003	2002	2003	2002
(\$ thousand)	(unaudited)	(unaudited)		
Operating activities				
Net earnings for the period	4,027	4,282	24,527	10,679
Add (deduct) non-cash items:				
Depletion and depreciation	6,249	3,865	19,008	13,536
Site restoration	577	318	1,567	1,268
Stock-based compensation (note 2)	264	–	264	–
Unrealized foreign exchange (gain) loss	(227)	2	(297)	86
Future income taxes	2,354	2,242	9,278	6,548
Cash flow from operations	13,244	10,709	54,347	32,117
Changes in non-cash working capital	(1,242)	(1,362)	(936)	(2,587)
	12,002	9,347	53,411	29,530
Financing activities				
Advances (repayment) of bank indebtedness	(1,941)	(3,428)	(18,301)	1,142
Exercise of stock options	289	307	1,203	1,262
	(1,652)	(3,121)	(17,098)	2,404
Investing activities				
Additions to property and equipment	(12,901)	(11,063)	(45,124)	(31,296)
Proceeds on disposal of property and equipment	60	3,037	5,215	3,134
Acquisition of Hadrian Energy Corp. (cash portion)	–	–	–	(4,875)
Site restoration expenditures	(201)	(219)	(287)	(423)
Changes in non-cash working capital	2,692	2,019	3,883	1,325
	(10,350)	(6,226)	(36,313)	(32,135)
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 months and
years ended December 31,
2003 and 2002

1. BASIS OF PRESENTATION

The interim unaudited consolidated financial statements of Zargon Oil & Gas Ltd. (the "Company") 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 years ended December 31, 2003 and 2002. The interim unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto in the Company's annual report for the years ended December 31, 2003 and 2002.

2. CHANGE IN ACCOUNTING POLICY

Stock-Based Compensation

During the fourth quarter of 2003, the Company prospectively adopted the fair-value method of accounting for stock options granted to employees and directors. Stock-based compensation is recorded on the consolidated statements of earnings as a separate expense for all options granted on or after January 1, 2003, with a corresponding increase recorded as contributed surplus. Compensation expense for options granted during 2003 is based on the estimated fair values at the time of the grant and the expense is recognized over the vesting period of the option. Given the insignificance of the expense for options granted during 2003, the Company recognized the entire 2003 expense of \$264,000 in the fourth quarter (see note 4 for further details). The prior 2003 quarters will not be restated. Upon the exercise of the stock options, consideration paid together with the amount previously recognized in contributed surplus is recorded as an increase in share capital. The Company has not incorporated an estimated forfeiture rate for stock options that will not vest, rather, the Company accounts for forfeitures as they occur. In the event that vested options expire without being exercised, previously recognized compensation expense associated with such stock options is not reversed. For options granted prior to January 1, 2003, Zargon continues to disclose the pro forma earnings impact of related stock-based compensation expense (see note 4).

3. ACQUISITION

On June 17, 2002, the Company 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 income tax asset	3,792
Future site restoration	(760)
Total consideration	<u>9,602</u>

4. SHARE CAPITAL

The Company 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)	December 31, 2003		December 31, 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	4,669
Stock options exercised	355	1,203	429	1,262
Balance, end of period	17,992	42,200	17,637	40,997

A summary of the status of the Company's stock option plan as at December 31, 2003 and 2002, and changes during the year ended on those dates is presented on the following page:

Stock Options

	December 31, 2003		December 31, 2002	
	Number of Shares (thousand)	Weighted Average Exercise Price (\$)	Number of Shares (thousand)	Weighted Average Exercise Price (\$)
Outstanding at beginning of year	1,215	5.10	1,199	3.36
Granted	459	9.50	466	7.69
Exercised	(355)	3.39	(429)	2.94
Cancelled	(22)	9.30	(21)	7.37
Outstanding at end of period	1,297	7.05	1,215	5.10
Options exercisable at end of period	985	6.25	750	3.49

Stock-Based Compensation

The Company 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 during 2003 is based on the estimated fair values at the time of the grant and the expense is recognized over the vesting period of the option. In the fourth quarter the Company recognized the entire \$264,000 of compensation expense for options granted during 2003 with a corresponding increase to contributed surplus on the Company's consolidated balance sheet.

The assumptions made for the options granted for 2003 include a volatility factor of expected market price of 21.92 percent, a weighted average risk-free interest rate of 3.90 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. For stock options granted in 2002, the Company's net earnings would be reduced by \$6,000 for the three months ended December 31, 2003 and \$215,000 for the year ended December 31, 2003. Basic and diluted earnings per share figures would have both been unchanged for the 2003 quarter and would have both been reduced by \$0.01 for the 2003 year.

The assumptions made for the options granted for 2002 include a volatility factor of expected market price of 18.60 percent, a weighted average risk-free interest rate of 5.16 percent, no dividend yield and a weighted average expected life of options of four years.

Comparatively, the Company's prior period net earnings would be reduced by \$189,000 for the three months ended December 31, 2002 and \$654,000 for the year ended December 31, 2002. Basic and diluted earnings per share figures would have both been reduced by \$0.01 for the 2002 quarter and by \$0.04 for the 2002 year.

5. WEIGHTED AVERAGE NUMBER OF COMMON SHARES

(thousand)	Three months ended December 31		Year ended December 31	
	2003	2002	2003	2002
Basic	17,900	17,619	17,824	17,233
Diluted	18,490	18,095	18,373	17,795

6. SEGMENTED INFORMATION

The Company'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 December 31		Year ended December 31	
	2003	2002	2003	2002
Petroleum and Natural Gas Revenue				
Canada	21,569	18,680	90,034	58,360
United States	2,942	1,985	11,623	7,178
Total	24,511	20,665	101,657	65,538
Net Capital Expenditures				
Canada	11,827	6,754	33,373	33,603
United States	1,014	1,272	6,536	1,945
Total*	12,841	8,026	39,909	35,548
Total Assets				
Canada			152,061	135,570
United States			23,009	18,090
Total**			175,070	153,660

* Prior year includes property from corporate acquisition.

** Total asset amounts from 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 December 31		Year ended December 31	
	2003	2002	2003	2002
Cash interest paid	174	224	714	1,150
Cash taxes paid	55	19	360	378

8. FINANCIAL INSTRUMENTS

The Company 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 Company enters into these contracts for hedging purposes only, in order to protect a portion of its future Canadian cash flow from the volatility of oil and natural gas commodity prices.

The Company has outstanding contracts at December 31, 2003 as follows:

	Volume	Rate	Price	Range of Terms
Oil swaps	36,400 bbl	200 bbl/d	\$26.44 US/bbl	Jan. 1/04–Jun. 30/04
	36,800 bbl	200 bbl/d	\$27.10 US/bbl	Jul. 1/04–Dec. 31/04
Oil collars	36,400 bbl	200 bbl/d	\$22.50 US/bbl Put \$26.85 US/bbl Call	Jan. 1/04–Jun. 30/04
	36,400 bbl	200 bbl/d	\$24.00 US/bbl Put \$27.65 US/bbl Call	Jan. 1/04–Jun. 30/04
	36,800 bbl	200 bbl/d	\$24.00 US/bbl Put \$27.80 US/bbl Call	Jul. 1/04–Dec. 31/04
Natural gas swaps	364,000 gj	4,000 gj/d	\$7.21/gj	Jan. 1/04–Mar. 31/04
	856,000 gj	4,000 gj/d	\$5.15/gj	Apr. 1/04–Oct. 31/04
Natural gas put	273,000 gj	3,000 gj/d	\$5.00/gj	Jan. 1/04–Mar. 31/04
Natural gas collars	91,000 gj	1,000 gj/d	\$5.50/gj Put \$7.90/gj Call	Jan. 1/04–Mar. 31/04
	428,000 gj	2,000 gj/d	\$5.00/gj Put \$6.85/gj Call	Apr. 1/04–Oct. 31/04

9. 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 income 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 year ended December 31, 2003 include a recovery and liability reduction in the amount of \$4.31 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

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

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

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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 March 23, 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.