

The logo for Zargon Oil & Gas Ltd. features the word "ZARGON" in a bold, white, sans-serif font. The letter "O" is replaced by a 3D-rendered red sphere with a white highlight. Below "ZARGON", the words "OIL & GAS LTD." are written in a smaller, white, sans-serif font, with spaces between the words.

ZARGON
O I L & G A S L T D.

1999 ANNUAL REPORT

CORPORATE PROFILE

ZARGON Oil & Gas Ltd. is an oil and natural gas exploration, development and production company operating in the Western Canadian Sedimentary Basin. Throughout its seven-year history, Zargon has adhered to a disciplined “value seeking” approach which has delivered 25 consecutive quarters of positive earnings, an average 10.3 percent return on equity and a historical proven finding and development cost of \$5.32 per barrel of oil equivalent. Zargon’s common shares trade on The Toronto Stock Exchange under the symbol “ZAR”.

ABOUT THE COVER

The background to the front cover depicts a seismic section typical to Zargon’s Jarrow property. Since 1997, Zargon has augmented its historical reservoir and production engineering expertise, with seismically driven shallow gas exploration and development skills.

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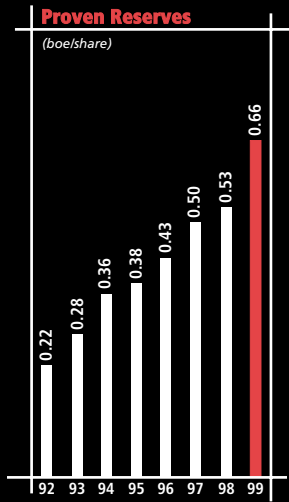
ANNUAL MEETING

The Annual General Meeting of Shareholders will be held on Thursday, May 18, 2000 at 2:00 p.m. in the Glenmore Room at the Calgary Convention Centre, 2nd Floor, 120 – 9th Avenue S.E., Calgary, Alberta. All shareholders are encouraged to attend.

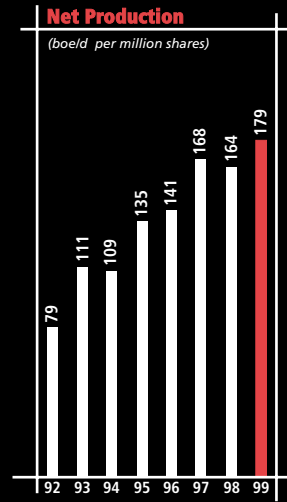
CORPORATE HIGHLIGHTS

	1999	1998	Percent Change
FINANCIAL (\$ million, except per share amounts)			
INCOME AND INVESTMENTS			
Production revenue	24.05	14.26	69
Cash flow from operations	10.64	5.82	83
Earnings	4.26	1.25	241
Net capital expenditures	16.95	12.48	36
BALANCE SHEET AT YEAR END			
Property and equipment	50.38	38.19	32
Long-term debt	14.12	6.18	128
Shareholders' equity	32.52	29.32	11
Common shares outstanding (million)	14.42	14.81	(3)
PER COMMON SHARE, FULLY DILUTED			
Cash flow from operations (\$/share)	0.70	0.43	63
Earnings (\$/share)	0.29	0.10	190
OPERATING			
AVERAGE DAILY PRODUCTION			
Crude oil and liquids (bbl/d)	1,711	1,508	13
Natural gas (mmcf/d)	9.15	6.33	45
Equivalents (boe/d)	2,626	2,141	23
AVERAGE SELLING PRICE (before hedges)			
Crude oil and liquids (\$/bbl)	25.02	17.80	41
Natural gas (\$/mcf)	2.52	1.93	31
Equivalents (\$/boe)	25.10	18.25	37
PROVEN RESERVES AT YEAR END			
Crude oil and liquids (mmbbl)	5,211	5,072	3
Natural gas (bcf)	43.06	27.99	54
Equivalents (mboe)	9,516	7,871	21
WELLS DRILLED, NET	18.8	4.9	284
UNDEVELOPED LAND (thousand net acres)	177.2	115.8	53

PERFORMANCE AT A GLANCE

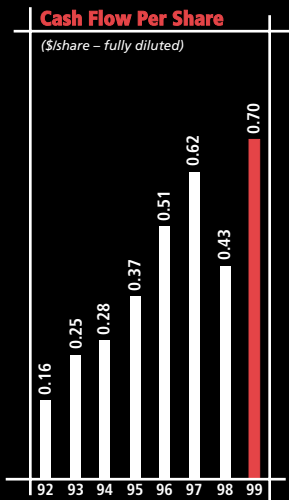


CONSISTENT GROWTH IN PROVEN RESERVES PER SHARE PROVIDES THE FOUNDATION FOR THE CREATION OF SHAREHOLDER VALUE.

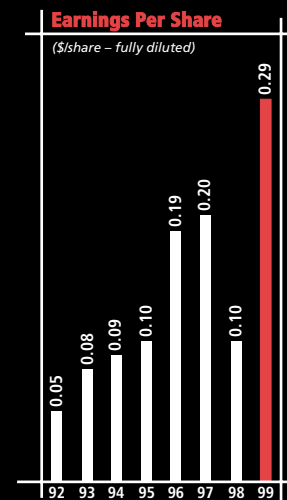


SUBSTANTIAL GAS PRODUCTION GAINS IN 2000 HAVE ALREADY PUSHED PRODUCTION LEVELS PAST THE 200 BOE/D PER MILLION SHARES THRESHOLD.

ZARGON'S disciplined operating process has delivered a seven year aggregate 21 percent compounded growth rate for Zargon's four per share performance benchmarks.



INCREASED VOLUMES AND ATTRACTIVE PRICES IN 2000 ARE SET TO PROVIDE A SECOND CONSECUTIVE YEAR OF RAPID CASH FLOW GROWTH.



STRONG CASH FLOW GAINS IN 2000 WILL DELIVER IMPROVED EARNINGS, CONTINUING ZARGON'S HISTORY OF PROFITABLE GROWTH.

CALENDAR 1999 WAS AN OUTSTANDING YEAR FOR ZARGON WITH ALL OPERATING AND FINANCIAL RESULTS REACHING NEW HISTORICAL LEVELS. COMPARED TO THE PRIOR YEAR, REVENUE INCREASED BY 69 PERCENT, CASH FLOW BY 83 PERCENT, EARNINGS BY 241 PERCENT, PRODUCTION BY 23 PERCENT AND PROVEN RESERVES BY 21 PERCENT.

Zargon's successful shift to a balanced exploitation and exploration company accelerated in 1999. Net capital expenditures during the year increased to \$16.95 million, with more wells drilled and significantly more undeveloped land acquired than in any previous year. Results were excellent: proven gas reserves were increased by 54 percent over 1998 and gas production climbed by 45 percent. Although \$5.89 million was spent on seismic and undeveloped land, proven finding and development costs of \$6.51 per barrel of oil equivalent are comparable with the last three years and remain attractive by most industry standards.

1999 OPERATING PERFORMANCE

Zargon's pace of drilling and exploration activities escalated during the year. As available cash flow increased due to rising commodity prices, Zargon's field activities increased accordingly. Operating highlights for 1999 include:

- Average daily production of 2,626 barrels of oil equivalent per day increased 23 percent from 2,141 barrels of oil equivalent per day in 1998. Current production rates are already in excess of 3,000 barrels of oil equivalent per day.
- A drilling program of 24 gross wells (18.8 net) delivered 12.6 net gas wells, 4.7 net oil wells, 1.5 net service wells and no dry holes. This was Zargon's largest and most successful year in the field, compared to an average of 9.3 net wells per year in the preceding three years.
- Field capital expenditures totalled \$10.63 million, a 92 percent increase over the previous year. This record field program, which focused on gas projects, was the outcome of a strategic shift to balanced exploration and exploitation activities. Exploration capabilities had been significantly expanded in 1998 and with increasing financial strength, Zargon was able to mount a substantial 1999 seismically-focused exploration program.
- A total of 65,900 net acres were acquired for \$3.98 million as Zargon aggressively pursued Crown land sales throughout the year. Much of the acquired lands were in proximity to our existing Central Alberta gas properties. The purchases expanded our undeveloped land inventory by 53 percent.
- Jarrow in East Central Alberta was Zargon's major growth property in 1999. Year-end production at Jarrow was approximately 6.8 million cubic feet per day. At December 31, Zargon held 58,500 net acres of undeveloped land at Jarrow plus varying interests in four compressor stations and associated gathering systems. While the gas gathering and processing infrastructure was expanded significantly in 1999, recent successful wells remain shut-in pending the addition of compression.

- Producing property acquisition activities, net of dispositions, were limited to an aggregate of \$2.25 million. However, early in 2000 important property acquisitions were closed at a combined cost of \$3.79 million. These acquisitions bring oil properties with exploitation opportunities at Taber, Alberta and in Southeast Saskatchewan.
- A year-end report by McDaniel & Associates Consultants Ltd. (McDaniel) showed that 2.60 million barrels of oil equivalent of proven reserves were added through \$16.95 million of capital expenditures. Proven gas reserve additions of 18.41 billion cubic feet increased our total gas reserves by 54 percent and replaced production volumes by 550 percent.
- Total proven and probable reserves assigned by McDaniel's report are 12.57 million barrels of oil equivalent, a 19 percent increase over the previous year. They include natural gas reserves of 54.85 billion cubic feet and oil and liquids reserves of 7.09 million barrels. At a 10 for 1 equivalence, Zargon's reserve weighting is 56 percent oil and 44 percent gas.
- Finding and development costs were \$6.51 per barrel of oil equivalent proven and \$5.70 per barrel of oil equivalent proven and probable. These costs include a large 1999 land and seismic acquisition program and compare with historical proven costs of \$5.40 per barrel of oil equivalent in 1998, \$6.14 per barrel of oil equivalent for the three year average from 1997 to 1999 and a seven-year average of \$5.32 per barrel of oil equivalent.

1999 FINANCIAL PERFORMANCE

Higher production and strongly rising commodity prices combined to give Zargon an excellent financial performance in 1999. Revenue, cash flow and earnings reached record levels. On a fully diluted per share basis, cash flow was \$0.70 and earnings were \$0.29. Also reaching new highs were proven reserves of 0.66 barrels of oil equivalent per share and daily production of 179 barrels of oil equivalent per day per million shares. Financial highlights include:

- Revenues increased by 69 percent over 1998 results to \$24.05 million. Cash flow rose by 83 percent to \$10.64 million and earnings increased by 241 percent to \$4.26 million.
- As of December 31, 1999, Zargon's net asset value was \$4.38 per fully diluted share. This was based on the McDaniel risked reserves evaluation at a 15 percent discounted present value, a land assessment completed by the independent firm of Seaton Jordan & Associates Ltd., and after accounting for debt and working capital.
- Our combined debt and working capital deficiency of \$14.26 million at December 31, 1999 was equivalent to less than 1.4 times 1999 cash flow. Zargon's significant capital program for the year was financed without additional equity – a testament to our ability to preserve financial strength through the period of low commodity prices in 1998 and early 1999.

- Achieving an attractive after-tax return on equity is a key objective for Zargon. Our return of 13.8 percent in 1999, along with the 10.4 percent and 10.3 percent weighted averages for the last three and seven years, compares favorably with our peers.
- Our performance benchmarks use an aggregate of reserves, production, cash flow and earnings calculated on a per share basis. After a setback due to the low commodity prices of 1998, our seven-year composite growth rate of 21 percent per year has again returned to exceed our compounded target rate of 20 percent.
- Because Zargon's shares have been trading at a substantial discount to net asset value, the Company gave notice on June 22, 1999 that it would purchase from time to time a limited number of its common shares through The Toronto Stock Exchange. Zargon believes that such purchases, at prices well below underlying asset values, can be advantageous to the remaining shareholders. As of December 31, 1999 a total of 388,000 common shares were purchased pursuant to this program.

OBJECTIVES AND STRATEGY

Zargon's historical objectives continue to be:

- maintain strong and consistent growth on a per share basis;
- preserve existing equity; and
- create substantial incremental shareholder value.

To achieve these objectives, Zargon has consistently taken a disciplined approach to its operations, often resulting in counter-cyclical activities such as selling assets in industry boom times and acquiring assets and expanding skills when the industry outlook is negative. Our excellent results in 1999 evidence the success of this strategy.

As the Western Canadian Sedimentary Basin matures, new oil finds are becoming scarce and commercially effective new gas discoveries require the full use of recent exploration technology. Zargon's response to this situation is two fold: geological and geophysical expertise has been developed to lead successful seismically-focused gas exploration and development programs; and creative reservoir and production engineering skills have been maintained to acquire and exploit oil properties where a technologically-based long life upside exists.

Zargon's risk management strategy is to favour high working interests and operatorship to control capital costs and timing, maintain a consistently strong balance sheet and manage commodity risk by hedging 20 to 30 percent of our product sales.

OUTLOOK

The year 2000 has begun with the purchase of exploitable oil properties in our core Southeast Saskatchewan and Taber areas. A strong exploration and development gas drilling program is also continuing at Jarrow. Our capital budget has been set at \$20 million in anticipation of another year of major growth. A promising gas exploration and development program in East and West Central Alberta has been established for the remainder of 2000, based largely on the undeveloped land inventory purchased in 1999. While Jarrow provides for substantial expansion and development programs ahead, we are assembling other gas exploration projects similar to and deeper than our Jarrow model.

The current reduced access to new equity for the oil and gas industry is resulting in an increased inventory of producing properties for sale. With our strong balance sheet, we intend to capitalize on this trend by acquiring, then exploiting, new and existing oil properties in our core areas.

Current indications are that Zargon will deliver another year of very strong financial results in 2000. We are confident that solid earnings and rates of return will help the investment community overcome its current reluctance to commit funds to the efficient members of our industry.

ACKNOWLEDGEMENTS

We are grateful for the confidence placed in Zargon by our shareholders. Our overriding objective is to continue enhancing the value of their investment while minimizing risk to its integrity. We also acknowledge the support and counsel of our Board. Lastly, we recognize that Zargon's growth and prosperity would not be possible without the shared commitment to our success by our staff, consultants and advisors.

Respectfully submitted,

Signed

C.H. Hansen
President & Chief Executive Officer

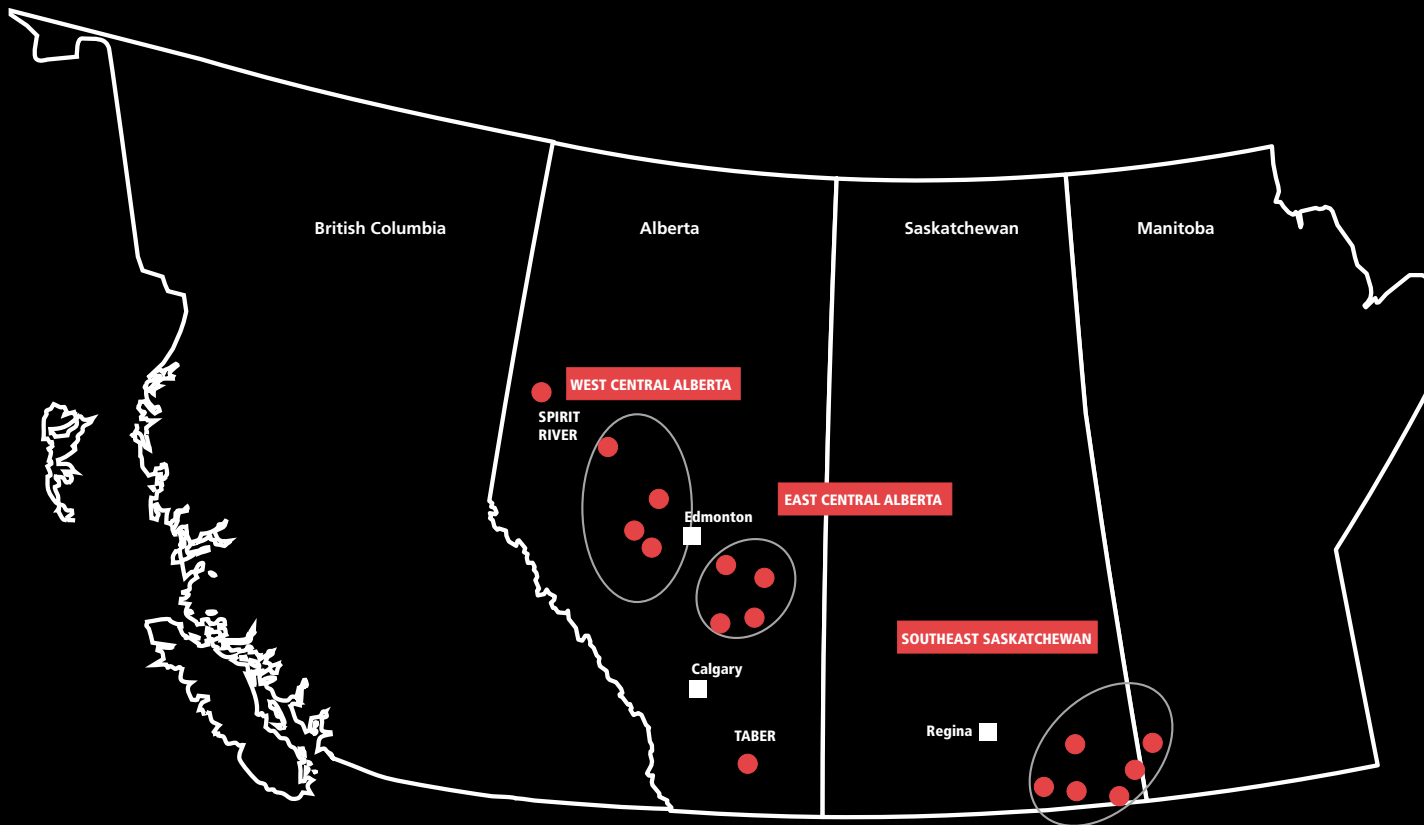
Calgary, Alberta
March 24, 2000

Signed

J.O. McCutcheon
Chairman

review of operations

MAJOR PROPERTIES Over 92 percent of Zargon's production, reserves and undeveloped land are located in four core areas. Zargon's original core areas of East Central Alberta and Southeast Saskatchewan still provide approximately 78 percent of our reserves and production. Over the last two years, the Company has also expanded into two additional core areas at West Central Alberta and Taber, Alberta.



MAJOR PROPERTIES

DURING 1999 ZARGON SPENT MORE THAN 80 PERCENT OF ITS CAPITAL BUDGET ON GAS-RELATED PROJECTS, FOCUSING ON 2D SEISMIC PROGRAMS, CROWN LAND PURCHASES, EXPLORATION AND DEVELOPMENT DRILLING AND FACILITY OPTIMIZATIONS. THE MAJORITY OF THESE EXPENDITURES WERE DIRECTED TO OUR JARROW AND HAMILTON LAKE PROPERTIES IN EAST CENTRAL ALBERTA. SIGNIFICANT 1999 GAS ADDITIONS WERE ALSO MADE THROUGH EXPLORATION ACTIVITIES IN WEST CENTRAL ALBERTA. CAPITAL ACTIVITIES IN ZARGON'S OIL EXPLOITATION AREAS OF SOUTHEAST SASKATCHEWAN AND TABER, ALBERTA WERE CURTAILED IN 1999 AS PROJECTS WERE INVENTORIED FOR SUBSTANTIAL ACQUISITION AND EXPLOITATION PROGRAMS IN 2000.

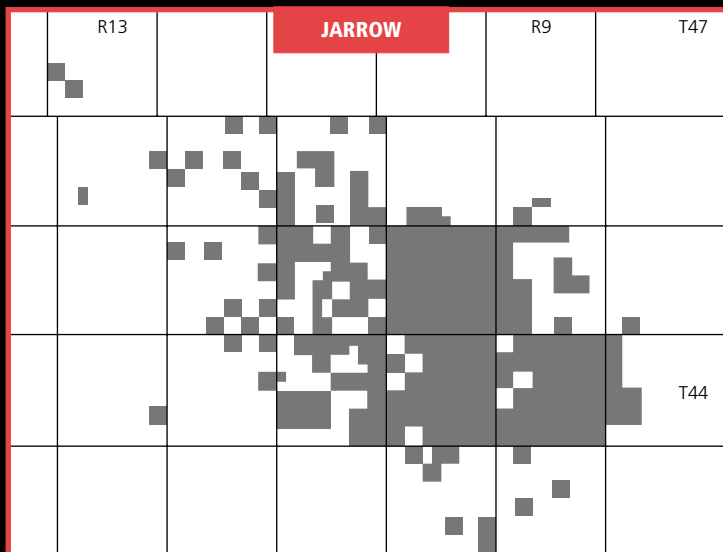
	1999		December 31, 1999		December 31, 1999		Zargon Operated (%)	1997-1999
	Average Production		Proven Reserves		Net Undeveloped Land			Proven
	(boe/d)	(% change)	(mboe)	(% change)	(thousand acres)	(% change)		Finding & Development Cost (\$/boe)
East Central Alberta	1,256	36	4,247	36	116.7	104	81	5.45
Southeast Saskatchewan	827	(6)	3,274	11	32.1	(3)	95	6.71
West Central Alberta	194	208	1,181	82	19.7	8	53	4.78
Taber, Alberta	151	110	523	(21)	0.3	(93)	95	6.72
Others	198	(1)	292	(39)	8.4	200	2	—
Total	2,626	23	9,516	21	177.2	53	78	6.14

EAST CENTRAL ALBERTA

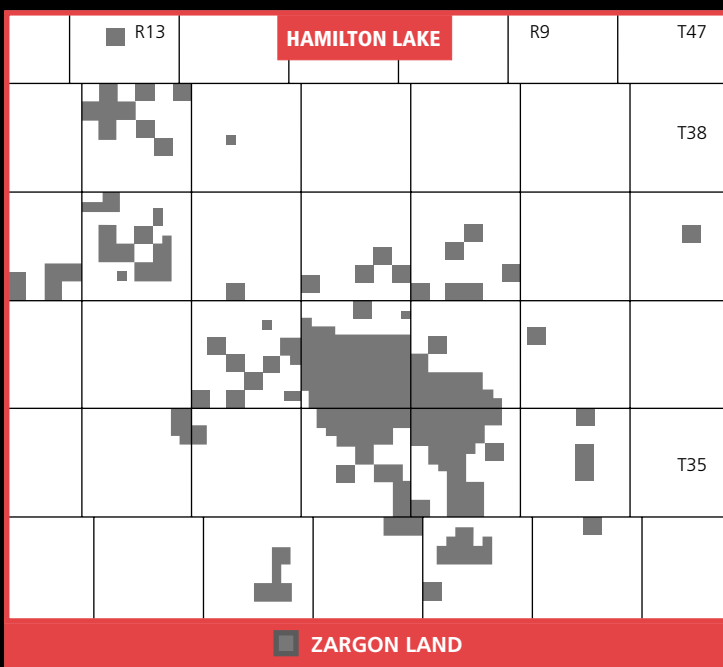
Zargon's East Central Alberta core area has become our most important producing region, accounting for 48 percent of production, 45 percent of total proven reserves, and 66 percent of undeveloped lands. This area also supplies 83 percent of Zargon's gas production and has significant gas production growth potential over the short and medium terms. The region includes two large developable gas holdings at Jarrow and Hamilton Lake plus oil production at Hamilton Lake, Twining and Joarcam. These East Central Alberta properties are characterized by shallow multi-zone Cretaceous sands located at depths from 700 to 1,200 meters containing sweet natural gas and light/medium oil reserves.

As Zargon's dominant area of activity in 1999, East Central Alberta received 75 percent of Zargon's capital budget or \$12.53 million, representing an almost five-fold increase over the prior year's activity. Essentially all of these expenditures were focused on gas exploration and development at Jarrow and Hamilton Lake. Corresponding with this large capital commitment, the core area's average production and year-end proven reserves both rose by 36 percent to 1,256 barrels of oil equivalent per day and 4.25 million barrels of oil equivalent. Current East Central Alberta production now exceeds 1,500 barrels of oil equivalent per day.

Our aggressive 1999 East Central Alberta capital program evolved from successful seismic and drilling templates. During 1997 and 1998, Zargon expanded its geophysical and geological capabilities, and challenged its technical team to build geological and seismic models to explore for Lower Mannville (Ellerslie, Glauconite, Ostracod)



ZARGON HOLDS OVER **113,000 NET ACRES** OF UNDEVELOPED LAND IN THE TWO CORE AREAS OF JARROW AND HAMILTON LAKE IN EAST CENTRAL ALBERTA. **ZARGON** HAS IDENTIFIED MORE THAN **40** LOCATIONS ON THESE **GAS PRONE LANDS** AND DURING 2000 PLANS TO **DRILL** A MINIMUM OF **15 NET WELLS**.



structural highs and Upper Mannville (Colony, McClaren and Sparky) stratigraphic seismic anomalies in the Jarrow and Hamilton Lake areas. These models were successfully applied in the winter 1998-99 drilling program. Based on this initial success, Zargon posted over 120 sections of Crown land for public auction in the Jarrow and Hamilton Lake areas. Crown parcels were evaluated using trade seismic or proprietary seismic shot by Zargon. Ultimately 88 net sections were purchased for a total of \$3.24 million. Further lands were earned through a six-well Jarrow farm-in commitment to an industry partner. Selected acquisitions and swaps were employed to add 1.53 billion cubic feet of reserves, access additional undeveloped lands and provide expanded interests in underutilized compression facilities. Drilling activities were largely successful, providing 12.12 billion cubic feet of incremental net gas reserves through the drilling and completion of 9.1 net gas wells.

Throughout the year, pipelines were installed to interconnect compressor stations and tie in new wells to existing gathering systems. These efforts resulted in a 57 percent increase in gas production in this core area from 6.5 million cubic feet per day in January to 10.2 million cubic feet per day by December. Zargon's year-end undeveloped land inventory of 116,700 net acres augmented by 1,940 kilometers of 2D trade and proprietary seismic data provides Zargon with a two-year inventory of development and exploration locations.

1999 Activities

- Shot 273 kilometers of 2D seismic in three separate programs.
- Purchased 56,500 net acres (88 sections) at an average cost of \$57 per acre.
- Drilled 12 gross wells resulting in 9.1 net gas wells and 1 net oil well.
- Constructed 13.1 kilometers of pipelines, tying in 13 gas wells into existing gathering systems and interconnecting three Jarrow gas plants into a common gathering grid.
- Acquired additional working interests in two Jarrow compressor stations, modified one Jarrow compressor station to provide for third stage compression and interconnected three Zargon working interest compressor stations to increase gas deliverability and improve operational flexibility.
- Expanded working interests in existing properties through 17 acquisition and swap transactions at a total cost of \$2.08 million.

2000 Plans

- Continue 2D seismic programs to define undrained structural highs and seismic character anomaly exploration and development targets.
- Continue with an active undeveloped Crown land acquisition program.
- Drill a minimum of 15 net gas exploration or development locations.
- Continue workover and recompletion activities.
- Place 3.0 million net cubic feet per day of shut-in gas volumes on production by third quarter 2000.

In the first quarter of 2000 Zargon drilled eight gross (6.3 net) wells in East Central Alberta, all at Jarrow, resulting in 4.3 net gas wells. Further drilling will proceed throughout the remainder of the year. Currently, the addition of incremental shut-in Jarrow gas volumes is limited by compression constraints. By summer 2000, additional compression will be added at Zargon-operated compressor sites. Additional tie-ins of shut-in gas wells to third party gathering and compression systems will also be completed.

EAST CENTRAL ALBERTA

	1999	1998	1997	1996
AVERAGE PRODUCTION				
Oil (bbl/d)	502	447	405	290
Natural gas (mmcf/d)	7.54	4.76	4.57	1.71
TOTAL PROVEN RESERVES				
Oil (mmbbl)	995	960	1,045	895
Natural gas (bcf)	32.52	21.62	17.82	8.35
TOTAL PROVEN & PROBABLE RESERVES				
Oil (mmbbl)	1,235	1,160	1,196	1,024
Natural gas (bcf)	41.59	28.29	21.48	12.89
UNDEVELOPED LANDS				
Net acres (thousand)	116.7	57.3	43.4	23.2
DRILLING ACTIVITY				
Net wells	10.1	1.3	5.0	–
CAPITAL EXPENDITURES (\$ million)				
Net property acquisitions	2.08	0.29	2.99	1.31
Undeveloped land, seismic, geological	4.93	0.50	0.18	0.11
Drilling, completion, equipping and facilities	5.52	1.89	1.37	0.63
Total expenditures	12.53	2.68	4.54	2.05

SOUTHEAST SASKATCHEWAN

Zargon's Southeast Saskatchewan core area remains its most important oil region, representing 45 percent of the Company's total 1999 oil production. Zargon's properties – Steelman, Frys, Daly/Virden, Moose Valley, Workman and Weyburn – are characterized by light and medium oil reserves produced from Mississippian carbonate reservoirs at depths ranging from 950 to 1,350 meters. The area's complex geology offers significant reservoir engineering related exploitation opportunities. Zargon's growth plan for Southeast Saskatchewan is defined by disciplined property acquisitions to establish a core position and obtain property operatorship. Reservoir-related optimizations and/or modifications will then be implemented to increase reserves and improve profitability. These operations include development drilling, horizontal wells, waterflood modifications, waterflood implementations and battery consolidations.

Activities in this core area were relatively quiet in 1999, with total capital expenditures dropping 33 percent to \$2.43 million. Five gross (4.5 net) wells were drilled resulting in three net vertical development oil wells and 1.5 net water injector wells.

With the return of substantially higher oil prices and the related higher operating netbacks, Zargon is budgeting for an active year in Southeast Saskatchewan during 2000. Expenditures will be focused on acquisitions and the exploitation of Zargon's considerable project inventory accumulated in the recent low oil price cycle.

1999 Activities

- Drilled three wholly-owned development oil wells at Frys, Steelman and Weyburn, Saskatchewan.
- Drilled two (1.5 net) injection wells on a pilot waterflood expansion project at Daly, Manitoba.
- Consolidated batteries and expanded a waterflood at Workman (Carnduff), Saskatchewan.
- Concluded 12 property acquisitions at Steelman and Weyburn relating to the expansion of Zargon's interests in potential or existing waterflood projects at an aggregate cost of \$0.81 million.

2000 Plans

- Drill a minimum of five net exploitation-related oil wells at Frys, Weyburn and Daly.
- Initiate or modify waterfloods at Steelman, Workman, Frys, Weyburn and Daly.
- Pursue substantial property acquisitions to expand Zargon's inventory of exploitable oil projects.

In the first quarter of 2000, Zargon drilled one net development oil well at Weyburn and completed four transactions totalling \$2.49 million acquiring waterfloodable production at Workman and Weyburn, Saskatchewan.

SOUTHEAST SASKATCHEWAN

	1999	1998	1997	1996
AVERAGE PRODUCTION				
Oil (bbl/d)	818	876	845	607
Natural gas (mmcf/d)	0.09	0.06	0.07	0.05
TOTAL PROVEN RESERVES				
Oil (mmbbl)	3,248	2,935	2,759	2,447
Natural gas (bct)	0.26	0.22	0.17	0.16
TOTAL PROVEN AND PROBABLE RESERVES				
Oil (mmbbl)	4,456	4,190	4,167	3,260
Natural gas (bct)	0.36	0.29	0.28	0.24
UNDEVELOPED LANDS				
Net acres (thousand)	32.1	33.0	23.6	33.4
DRILLING ACTIVITY				
Net wells	4.5	2.1	8.5	8.5
CAPITAL EXPENDITURES (\$ million)				
Net property acquisitions	0.81	1.25	0.86	0.56
Undeveloped land, seismic, geological	0.23	0.59	0.72	0.42
Drilling, completion, equipping and facilities	1.39	1.80	4.03	3.50
Total expenditures	2.43	3.64	5.61	4.48

WEST CENTRAL ALBERTA

In 1999, Zargon continued to build its West Central Alberta core area, primarily through gas exploration projects and exploitation-oriented oil acquisitions. Total capital spending in 1999 remained approximately steady at \$2.14 million while proven reserves increased 82 percent to 1.18 million barrels of oil equivalent. Gas exploration at the area's key properties of Sturgeon Lake and Pembina focused on shallow Upper Cretaceous and Tertiary gas targets at depths up to 1,200 meters. At Sturgeon Lake, follow-up drilling to our 1998 gas discovery resulted in two gas wells. These wells, however, did not develop sufficient gas reserves to proceed with plant and pipeline infrastructure construction in the 1999-2000 winter season. The December 1998 Pembina Paskapoo discovery was followed up with two (one net) successful wells by year-end 1999. Further work is planned for the Sturgeon Lake and Pembina properties in 2000.

Oil acquisitions during the year were project-specific, concentrating primarily on the operated Glenevis medium gravity crude property.

1999 Activities

- Drilled and production-tested two wholly-owned exploration gas wells on Zargon's 10,800 net acre Sturgeon Lake land block.
- Drilled two (1.0 net) exploration gas wells at Pembina, successfully expanding the 1998 shallow gas pool discovery. Production from this new pool commenced in December 1999.
- Acquired producing exploitable oil assets at Glenevis and Harmattan. Exploitation upsides relate to horizontal development drilling and waterflood enhancements.
- Completed one (0.5 net) wellbore and tied in two (1.0 net) Cardium oil wells at Brazeau River.

2000 Plans

- Follow-up 1999 Sturgeon Lake drilling with additional seismic and development drilling to reach the threshold reserves and deliverability required to construct gas gathering and processing facilities.
- Pursue Pembina shallow gas development and exploration programs on third party lands.
- Acquire additional property interests on West Central Alberta gas exploration and oil exploitation concepts.

In the first quarter of 2000, Zargon drilled and completed one gross (0.5 net) gas well at Pembina, discovering a new shallow gas pool. Follow-up drilling is planned for this discovery.

TABER, ALBERTA

In 1998, Zargon acquired \$3.57 million of producing medium gravity oil assets at Taber, Alberta. These properties brought substantial medium gravity crude exploitation opportunities relating to waterflood and development drilling projects. During 1999, Zargon spent minor amounts of capital on this property while preparing comprehensive exploitation plans for the return of improved oil prices. Significant capital activities are planned for 2000.

2000 Plans

- Expand property interests through acquisitions.
- Evaluate prospective lands with 3D seismic.
- Optimize waterflood projects and drill a minimum of two vertical and one horizontal development locations.

In the first quarter of 2000, Zargon acquired \$1.3 million of additional interests in this operated core property.

NEW CORE AREAS

	West Central Alberta			Taber, Alberta	
	1999	1998	1997	1999	1998
AVERAGE PRODUCTION					
Oil (bbl/d)	163	49	37	150	72
Natural gas (mmcf/d)	0.31	0.14	0.14	0.01	–
TOTAL PROVEN RESERVES					
Oil (mmbbl)	392	231	20	523	662
Natural gas (bcf)	7.89	4.17	1.37	0.02	0.02
TOTAL PROVEN AND PROBABLE RESERVES					
Oil (mmbbl)	531	306	23	803	957
Natural gas (bcf)	9.65	4.52	1.37	0.02	0.02
UNDEVELOPED LANDS					
Net acres (thousand)	19.7	18.2	12.9	0.3	4.5
DRILLING ACTIVITY					
Net wells	3.0	1.5	–	–	–
CAPITAL EXPENDITURES (\$ million)					
Net property acquisitions	0.61	0.89	1.42	0.04	3.57
Undeveloped land, seismic, geological	0.16	0.09	0.43	0.01	0.39
Drilling, completion, equipping and facilities	1.37	0.90	0.23	0.06	–
Total expenditures	2.14	1.88	2.08	0.11	3.96

OTHER PROPERTIES

Zargon holds interests in other non-core area properties which account for less than four percent of the Company's year-end proven reserves. Over 50 percent of these assets are located in the Spirit River area in Northwest Alberta. In 1999 Zargon drilled three gross wells at Spirit River resulting in 0.7 net oil wells and 0.5 net gas wells. The Company also swapped a \$1.31 million mature Boundary Lake, British Columbia oil property for gas production, lands and facilities adjacent to its Jarrow gas property in East Central Alberta.

In 2000, further seismic, Crown land acquisitions, drilling and tie-in facilities are anticipated for Spirit River. With success, this property will develop into a fifth core area focused on gas and oil targets at less than 1,500 meters.

OTHER PROPERTIES

	1999	1998	1997	1996
AVERAGE PRODUCTION				
Oil (bbl/d)	78	65	98	115
Natural gas (mmcf/d)	1.20	1.35	1.58	1.94
TOTAL PROVEN RESERVES				
Oil (mmbbl)	52	283	281	365
Natural gas (bcf)	2.40	1.98	2.70	4.69
TOTAL PROVEN AND PROBABLE RESERVES				
Oil (mmbbl)	64	382	360	445
Natural gas (bcf)	3.22	2.46	3.29	9.47
UNDEVELOPED LANDS				
Net acres (thousand)	8.4	2.8	1.5	6.9
DRILLING ACTIVITY				
Net wells	1.2	–	1.1	–
CAPITAL EXPENDITURES (\$ million)				
Net property acquisitions	(1.30)	(0.03)	(1.39)	0.80
Undeveloped land, seismic, geological	0.55	0.18	0.41	0.28
Drilling, completion, equipping and facilities	0.39	0.03	0.55	0.10
Total expenditures	(0.36)	0.18	(0.43)	1.18

HIGHLIGHTS

During 1999, Zargon made strong gains in all operational parameters.

	1999	1998	Percent Change
Undeveloped land (thousand net acres)	177.2	115.8	53
Wells drilled, net	18.8	4.9	284
Production (boe/d)	2,626	2,141	23
Year-end proven reserves (mboe)	9,516	7,871	21

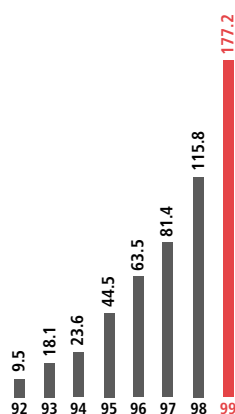
LAND AND SEISMIC

Consistent with Zargon’s expanded exploration focus over the last two years, the acquisition of an extensive land and seismic base was a key activity for the company during 1999. Primarily through an aggressive Crown posting and sale strategy, Zargon increased its undeveloped land inventory by 53 percent to 177,200 net acres. The majority of these gains were in Alberta where undeveloped acreage increased 73 percent to 140,800 net acres. By year-end, Zargon’s two largest Alberta gas holdings at Jarrow and Hamilton Lake had grown to 113,500 net acres.

During the year, \$3.98 million was spent purchasing 65,600 net acres of undeveloped land at an average cost of \$61 per acre. Zargon’s undeveloped land holdings have been valued by the independent firm Seaton Jordan & Associates Ltd. (Seaton Jordan) at \$9.78 million as of December 31, 1999, up 55 percent from last year’s \$6.29 million appraisal. This analysis incorporates an average undeveloped acreage price of \$55 per acre, essentially unchanged from the 1998 estimate of \$54 per acre.

As part of Zargon’s increased exploration focus, the Company shot 273 kilometers of two dimensional seismic and purchased 921 kilometers of trade seismic. By year-end, Zargon had working access to 830 lines of two dimensional seismic, representing a six-fold increase since the end of 1997. The combined 1999 capital expenditures for undeveloped land and seismic totalled \$5.89 million or 35 percent of the total annual capital budget, up substantially from the 14 percent capital allocation in 1998.

Net Undeveloped Land
(thousand net acres)



UNDEVELOPED LAND

As at December 31 (thousand net acres)	1999	1998	1997
Alberta	140.8	81.2	57.8
Saskatchewan	35.0	33.0	22.0
Manitoba	1.4	1.6	1.6
Total	177.2	115.8	81.4
Average Zargon working interest (%)	69	69	70

DRILLING ACTIVITY

The combination of an expanded seismic and land inventory, reasonable drilling costs, and improved cash flows permitted Zargon to proceed with a record 1999 drilling program. During the year, Zargon drilled 18.8 net wells, representing a 284 percent improvement over the 4.9 net wells drilled in 1998.

DRILLING ACTIVITY

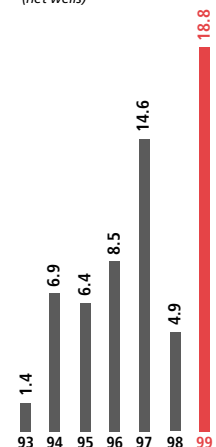
	1999		1998		1997	
	Gross	Net	Gross	Net	Gross	Net
Oil	6	4.7	3	1.1	8	7.1
Natural gas	16	12.6	4	2.8	15	3.1
Service	2	1.5	–	–	–	–
Dry	–	–	1	1.0	5	4.4
Total	24	18.8	8	4.9	28	14.6
Exploratory	9	8.5	3	2.5	8	6.2
Development	15	10.3	5	2.4	20	8.4
Total	24	18.8	8	4.9	28	14.6
Alberta	19	14.3	4	2.8	7	5.0
Saskatchewan	3	3.0	4	2.1	21	9.6
Manitoba	2	1.5	–	–	–	–
Total	24	18.8	8	4.9	28	14.6
Average net Zargon working interest (%)	78		62		46	

Zargon achieved a 100 percent success rate with its 1999 drilling program, up from 80 percent in 1998 and 70 percent in 1997. The Company's average working interest also increased to 78 percent, up from 62 percent in 1998. Twenty-two of 24 gross wells drilled in 1999 were operated by Zargon. These drilling statistics demonstrate an increased focus on gas projects, a larger commitment to Alberta activities and a continued emphasis on exploration. During 2000, Zargon is expecting to drill 25 net wells, focused on East and West Central Alberta gas projects. This program will be augmented by oil exploitation drilling in Southeast Saskatchewan and Taber, Alberta.

ACQUISITIONS

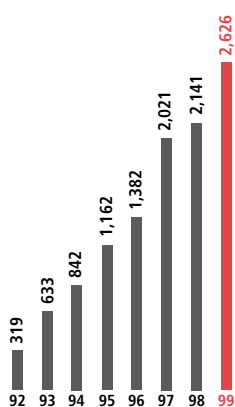
Property acquisitions continue to be an important component of Zargon's growth strategy as they provide the foundation for oil exploitation opportunities and new gas exploration and development projects. Zargon maintains a disciplined value-seeking approach towards acquisitions, only proceeding with transactions projected to improve earnings. In 1999, Zargon completed 42 property acquisitions for a total net cost of \$2.25 million. This total represented a 62 percent decrease in expenditures from the \$5.98 million of counter-cyclical oil acquisitions completed in 1998. The majority of the 1999 transactions related to expanding existing holdings at Jarrow and Glenevis, Alberta and Steelman and Weyburn, Saskatchewan.

Drilling Activity
(net wells)



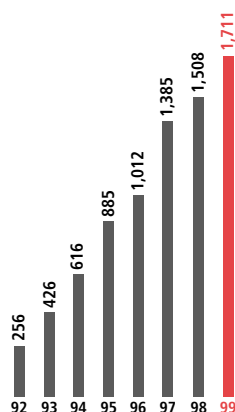
Production

(boe/d)



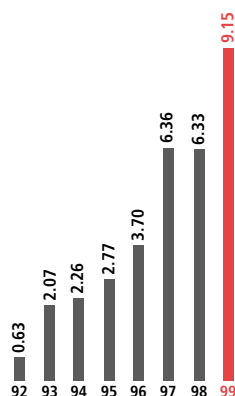
Crude Oil and Liquids Production

(bbl/d)



Natural Gas Production

(mmcf/d)



PRODUCTION

Zargon's 1999 production increased 23 percent to 2,626 barrels of oil equivalent per day, up from 2,141 barrels of oil equivalent in 1998. With Zargon's increasing emphasis on gas exploration and development projects, production averaged 35 percent gas by volume, compared to 30 percent in 1998. The 1999 production rate included 1,711 barrels per day of oil and liquids, a 13 percent improvement over 1,508 barrels per day of oil and liquids in 1998. Natural gas production was 9.15 million cubic feet per day, a 45 percent increase over 1998's rate of 6.33 million cubic feet per day.

The substantial 1999 gas production gains are largely attributed to successful gas drilling programs in East Central Alberta. By December 1999 total production had reached 2,890 barrels of oil equivalent per day, comprised of 12.20 million cubic feet per day of natural gas and 1,670 barrels per day of oil and liquids. Further production gains are anticipated in 2000 as recent East and West Central Alberta gas wells are tied into existing facilities.

RESERVES

Independent reserve evaluations prepared by McDaniel & Associates Consultants Ltd. (McDaniel) set Zargon's 1999 year-end total proven reserves at 9.52 million barrels of oil equivalent, a 21 percent improvement over the year-end 1998 estimates. Proven and probable reserves increased 19 percent to a year end estimate of 12.58 million barrels of oil equivalent.

During 1999 Zargon's proven oil, gas and equivalents reserve additions replaced production by 122 percent, 549 percent and 273 percent, respectively. Oil and liquid additions in 1999 of 0.76 million barrels (proven) and 0.72 million barrels (proven and probable) were derived primarily from waterflood reserve recognitions. Gas additions in 1999 of 18.46 billion cubic feet (proven) and 22.50 billion cubic feet (proven and probable) came through exploration and development drilling in East and West Central Alberta.

COMPANY RESERVES

At December 31, 1999 (before royalties)	Oil and Liquids	Natural Gas	Equivalents
	(mdbl)	(bcf)	(mboe)
Proven producing	5,136	31.28	8,264
Proven non-producing	75	11.78	1,252
Total proven	5,211	43.06	9,516
Probable additional	1,880	11.79	3,059
Total proven and probable	7,091	54.85	12,575

Reflecting Zargon's effort to expand its exposure to natural gas, the Company's proven and probable gas reserves increased 54 percent in 1999 to 43.06 billion cubic feet. Gas reserves now represent 45 percent of Zargon's total proven reserve base.

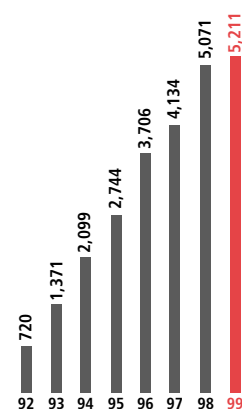
Approximately 87 percent of Zargon's total proven reserves are allocated to the proven producing category. Proven non-producing reserves are comprised primarily of gas reserves from recently completed wells at Jarrow, Spirit River and Sturgeon Lake, Alberta. McDaniel forecasts \$2.33 million of future capital costs to deliver their total proven reserve estimate. Zargon's probable reserves generally reflect incremental waterflood recoveries for producing oil properties and improved gas recovery factors for recently drilled gas wells. On a barrel of oil equivalent basis, 76 percent of the Company's reserves were classified as proven, compared to 75 percent in 1998.

Based on year-end reserves and fourth quarter 1999 production rates of 2,715 barrels of oil equivalent per day, Zargon's proven reserve life index is 8.5 years, 11.4 years and 9.6 years respectively for oil, gas and equivalents. The 1999 proven and probable barrels of oil equivalent reserve life index is 12.7 years. These reserve life ratios are up slightly from the 1998 year-end levels.

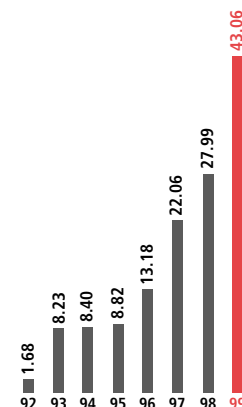
RESERVE RECONCILIATION

	Oil and Liquids (mmbbl)			Natural Gas (bcf)			Equivalents (mboe)		
	Proven	Probable	Total	Proven	Probable	Total	Proven	Probable	Total
December 31, 1996	3,706	1,022	4,728	13.18	9.34	22.52	5,024	1,956	6,980
Additions/revisions	933	545	1,478	11.20	(5.08)	6.12	2,053	37	2,090
Production	(505)	—	(505)	(2.32)	—	(2.32)	(737)	—	(737)
December 31, 1997	4,134	1,567	5,700	22.06	4.26	26.32	6,340	1,993	8,333
Additions/revisions	1,488	346	1,834	8.24	3.50	11.74	2,312	696	3,007
Production	(550)	—	(550)	(2.31)	—	(2.31)	(781)	—	(781)
December 31, 1998	5,072	1,913	6,984	27.99	7.76	35.75	7,871	2,689	10,559
Additions/revisions	764	(33)	731	18.41	4.03	22.44	2,604	370	2,974
Production	(625)	—	(625)	(3.34)	—	(3.34)	(959)	—	(959)
December 31, 1999	5,211	1,880	7,091	43.06	11.79	54.85	9,516	3,059	12,575
Percentage change (%)									
1999/1998	3	(2)	2	54	52	54	21	14	19

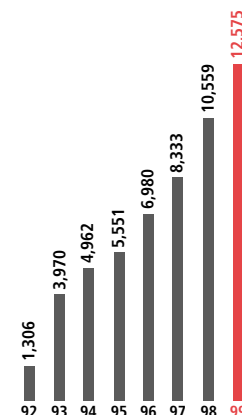
Proven Oil and NGL Reserves
(mmbbl)



Proven Natural Gas Reserves
(bcf)

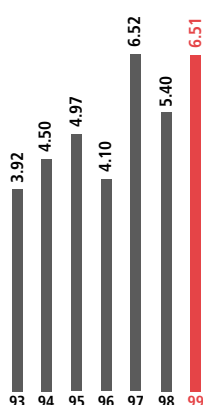


Proven and Probable Reserves
(mboe)



Proven Finding and Development Costs

(\$/boe)



FINDING AND DEVELOPMENT COSTS

Zargon's total 1999 net capital expenditures increased by 36 percent to \$16.95 million from \$12.48 million in 1998. In 1999, 35 percent or \$5.89 million of Zargon's capital program was allocated to seismic and undeveloped land purchases that are primarily pre-spending activities for future reserve additions.

Despite the high weighting of land and seismic costs in 1999, Zargon's finding and development costs were a respectable \$6.51 per barrel of oil equivalent for proven reserves and \$5.70 per barrel of oil equivalent for proven and probable reserves. These costs are based on all capital expenditures including non oil and gas assets and all reserve additions including revisions and dispositions. Proven finding and development costs have averaged \$6.14 and \$5.32 per barrel of oil equivalent over the last three and seven years respectively. Zargon's consistent record of low finding and development costs reflects an ongoing commitment to the efficient use of capital.

FINDING AND DEVELOPMENT COSTS

	1999	1998	1997	1996	1995	1994	1993	Three Year Total	Seven Year Total
Total capital expenditures (\$ million)	16.95	12.48	13.38	7.82	5.52	4.73	6.02	42.81	66.90
Reserve additions after revisions (mboe)									
Proven	2,604	2,312	2,053	1,905	1,111	1,052	1,537	6,968	12,573
Probable	370	696	37	30	(97)	247	1,358	1,104	2,642
Total reserve additions (mboe)									
Proven and probable	2,974	3,007	2,090	1,935	1,014	1,299	2,895	8,072	15,215
Finding and development costs (\$/boe)									
Proven	6.51	5.40	6.52	4.10	4.97	4.50	3.92	6.14	5.32
Proven and probable	5.70	4.15	6.40	4.04	5.44	3.64	2.08	5.30	4.40

NET ASSET VALUE

The following tables summarize the December 31, 1999 McDaniel forecast of income derived from the production and sale of working and royalty interest reserves prior to the deduction of interest, income tax, general and administrative or other corporate costs.

DISCOUNTED CASH FLOWS

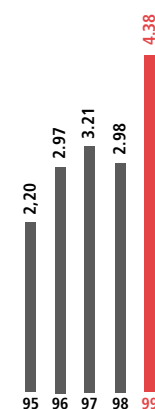
(\$ million)	Discount Factor			
	0%	10%	15%	20%
Proven producing	95.49	61.37	52.56	46.24
Proven non-producing	17.72	11.88	10.10	8.75
Total proven	113.22	73.25	62.66	54.99
Probable (risked at 50%)	19.95	9.02	6.85	5.46
Total proven plus 50% risked probable	133.17	82.27	69.51	60.45

MCDANIEL REPORT PRICE FORECAST

	Alberta Average WTI Crude Oil (\$US/bbl)	Alberta Average Natural Gas (\$/mmbtu)
2000	21.00	2.80
2001	20.00	2.70
2002	20.50	2.65
2003	21.00	2.65
2004	21.40	2.65
2005	21.80	2.65
Thereafter:	Escalate at US\$0.40 or US\$0.50/bbl per year	Escalate at \$0.05/mmbtu per year

The following estimate of Zargon's net asset value is calculated using a McDaniel 15 percent discounted pretax value for proven and risked probable reserves and a Seaton Jordan undeveloped land value estimate.

Net Asset Value (\$/share)



NET ASSET VALUE

As at December 31 (\$ million)	1999	1998	1997	1996
Proven reserves ⁽¹⁾	62.66	40.61	36.14	28.06
Probable reserves (risked) ⁽²⁾	6.85	4.09	3.44	3.55
Undeveloped land ⁽³⁾	9.78	6.29	6.79	5.14
Working capital	(0.14)	(0.24)	0.12	(0.42)
Long-term debt	(14.12)	(6.18)	(4.87)	(0.49)
Net asset value	65.03	44.57	41.62	35.84
Net asset value per common share outstanding (\$/share)	4.50	3.01	3.32	3.06
Net asset value per fully diluted common share (\$/share)	4.38	2.98	3.21	2.97

Notes:

- (1) McDaniel estimate of future cash flow discounted at PV 15%.
- (2) McDaniel PV 15% estimate after reduction for 50% risk.
- (3) Seaton Jordan year-end estimates.

In 1999 Zargon's fully diluted net asset value increased 47 percent to \$4.38 per share. This improvement in net asset value reflects increased reserves and improved oil and gas price forecasts.

CORPORATE PERFORMANCE

Zargon benchmarks its performance by targeting a sustainable 20 percent growth rate for the per share parameters of reserves, production, cash flow and earnings. Over its seven-year public history, Zargon has delivered an average 21 percent annual growth rate for these four per share parameters.

CORPORATE GROWTH

	1999	1998	1997	1996	1995	1994	1993	1992	1998-99 Growth (%/yr)	1992-99 Growth (%/yr)
Proven reserves (mboe)	9,516	7,871	6,340	5,024	3,626	2,939	2,194	888	21	40
boe per share ⁽¹⁾	0.66	0.53	0.50	0.43	0.38	0.36	0.28	0.22	25	17
Production (boe/d)	2,626	2,141	2,021	1,382	1,162	842	633	319	23	35
boe/d per million shares ⁽²⁾	179	164	168	141	135	109	111	79	9	12
Cash flow (\$ million)	10.64	5.82	7.66	5.11	3.26	2.12	1.36	0.55	83	53
\$/share ⁽³⁾	0.70	0.43	0.62	0.51	0.37	0.28	0.25	0.15	63	25
Earnings (\$ million)	4.26	1.25	2.48	1.90	0.80	0.72	0.36	0.14	240	63
\$/share ⁽³⁾	0.29	0.10	0.20	0.19	0.10	0.09	0.08	0.05	190	29
Average shares outstanding, (million)										
basic ⁽⁴⁾	14.69	13.03	12.05	9.82	8.60	7.76	5.68	4.05	13	20
Average annual growth (%)	92	(11)	38	63	31	45	119	71	92	48
Average annual growth per share (%)	72	(18)	16	6	16	15	43	8	72	21

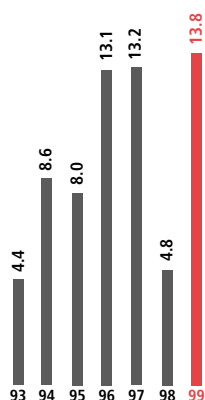
Notes:

- (1) Reserves per share are calculated using year-end reserve appraisals and year-end shares outstanding.
- (2) Production per share is calculated using annual average production and annual average shares outstanding.
- (3) Cash flow and earnings per share are presented on a fully diluted basis.
- (4) Average shares outstanding reflects the year's weighted average common shares outstanding.

Zargon's empirical and analytical models indicate that corporate per share growth rates can be related to the proven corporate recycle ratio (broadly defined to include all capital and corporate costs) and capital spending ratios. Using Zargon's corporate parameters, the 20 percent target growth rate requires that the recycle and capital spending ratios must exceed 1.7 and 1.5, respectively. During its history, Zargon has achieved these targets.

In addition to providing a sustainable 20 percent per share growth rate, Zargon is committed to providing profitable growth. Throughout its seven-year public history, Zargon has delivered an average rate of return on equity in excess of 10 percent per year.

Return on Equity (%)



CORPORATE PERFORMANCE

	1999	1998	1997	1996	1995	1994	1993	1997-99 Average	1992-99 Average
Corporate recycle ratio ⁽¹⁾	1.7	1.4	1.6	2.5	1.5	1.4	1.5	1.7	1.7
Capital spending ratio ⁽²⁾	1.6	2.1	1.7	1.5	1.7	2.2	4.4	1.8	2.0
Return on equity (%) ⁽³⁾	13.8	4.8	13.2	13.1	8.0	8.6	4.4	10.4	10.3

Notes:

- (1) Corporate recycle ratio is defined as the corporate cash flow including allowances for taxes, interest charges and general and administrative costs on a barrel of oil equivalent production basis divided by the defined proven finding and development costs.
- (2) Capital spending ratio is defined as all capital expenditures including costs for deferred tax charges, office equipment, etc., divided by the corporate cash flow.
- (3) Return on equity is defined as the net after-tax annual earnings divided by the annual average shareholder equity. Multi-year averages are dollar weighted.

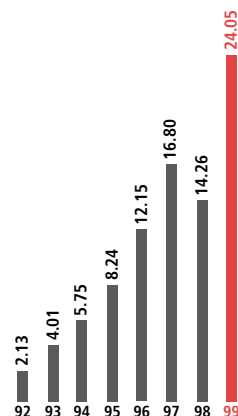
MANAGEMENT'S DISCUSSION AND ANALYSIS

HIGHLIGHTS

Record revenue, cash flow, and earnings were achieved by Zargon in 1999.

(\$ million, except per share amounts)	1999	1998	Percent Change
Revenue	24.05	14.26	69
Cash flow from operations	10.64	5.82	83
Per fully diluted share (\$)	0.70	0.43	63
Earnings	4.26	1.25	241
Per fully diluted share (\$)	0.29	0.10	190
Net capital expenditures	16.95	12.48	36

Revenue
(\$ million)



DETAILED FINANCIAL ANALYSIS

Production Revenue

Petroleum and natural gas revenue exclusive of hedges climbed 69 percent to \$24.05 million in 1999 from \$14.26 million in 1998. Increased oil and gas prices and higher oil and gas volumes contributed to the significant increase in revenues.

Production revenue in 1999 was 65 percent allocated to the sale of oil and liquids and 35 percent to the sale of natural gas. Natural gas allocation was up from a 31 percent weighting in 1998. Increased gas volumes in 2000 will continue the trend towards a more balanced weighting of natural gas and oil revenues.

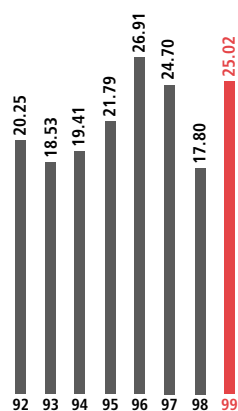
Crude Oil Pricing

Canadian crude oil and liquid prices are based on an Edmonton light sweet reference price that is adjusted for transportation charges and oil quality differentials to arrive at an average Zargon field price. In 1999 Zargon's average oil and liquid field price, exclusive of price hedges, increased \$7.22 per barrel or 41 percent to \$25.02 per barrel. The Company's blended average crude density is 31 degrees API. The field price for this blended crude stream averaged \$2.33 per barrel less than the Edmonton reference crude price. This differential was essentially unchanged from the 1998 differential of \$2.41 per barrel.

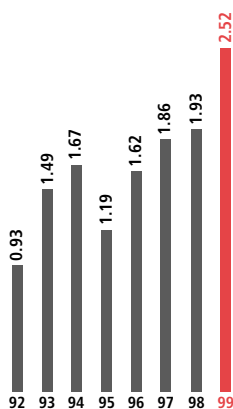
Natural Gas Pricing

During 1999 Zargon's average natural gas price increased 31 percent to \$2.52 per million cubic feet compared to \$1.93 per million cubic feet in 1998. Approximately 70 percent of the Company's gas production was sold to Trans-Canada Energy Ltd. (Jarrow) and ProGas Limited (Hamilton Lake). The bulk of the remaining volumes were sold by direct or spot sales contracts and received Alberta index prices.

Oil and NGL Prices
(\$/bbl)



Natural Gas Prices (\$/mcf)



Hedging Activities

Crude oil and natural gas prices climbed sharply throughout 1999. To reduce pricing risk, Zargon employs a forward sales (hedging) program for up to 30 percent of its oil and natural gas volumes. In 1999 these hedging activities resulted in a reduction in revenue by \$1.10 million, compared to a \$0.18 million increase in revenue reported in 1998. Crude oil and currency hedges resulted in a \$0.77 million reduction of 1999 revenues, equivalent to a \$1.30 per barrel charge against production. Natural gas hedges reduced Zargon's 1999 revenues by \$0.33 million or \$0.10 per thousand cubic feet of production.

Royalties

Royalties include payments made to the Crown, freehold owners and third parties. Reported royalties include the offsets of credits received through the Alberta Royalty Tax Credit (ARTC) program and the cost of the Saskatchewan Resource Surcharge (SRC). During 1999 total net royalties were \$4.03 million, up 120 percent from the \$1.84 million reported in 1998. Net royalties as a percentage of gross revenue increased to 16.8 percent, up from 12.9 percent in 1998. This substantial increase reflected the impact of higher oil and gas prices on royalty rates and the increased production volumes from the Company's Jarrow, Alberta gas property.

During the year 57 percent of the total royalties were paid to provincial governments with the remainder paid to freehold owners and other third parties. Royalties payable to the Province of Alberta on qualifying properties are reduced through the ARTC program. Reflecting substantial gas volumes from recently drilled ARTC-qualifying gas wells, Zargon received a \$0.57 million ARTC rebate in 1999 compared to a rebate of \$0.18 million in 1998. Due to improved crude prices the SRC charges increased to \$0.21 million in 1999 up from the prior year's charge of \$0.16 million.

Production Expenses

Zargon's production expenses increased 20 percent in 1999 to \$6.12 million. On a per unit of production basis, expenses decreased to \$6.39 per barrel of oil equivalent from \$6.50 per barrel of oil equivalent in 1998 and \$6.89 per barrel of oil equivalent in 1997. The year-over-year improvement is due to increased production volumes from the lower-cost Jarrow property. Modest operating cost improvements on a per unit of production basis are forecasted for 2000 as Zargon continues to expand its lower cost operated gas properties.

Operating Netbacks

Sharply higher 1999 oil and gas prices resulted in large increases in operating netbacks. During 1999 Zargon's oil netback increased by 43 percent to \$13.15 per barrel from \$9.21 per barrel in 1998. Gas netbacks in 1999 improved 24 percent to \$1.36 per million cubic feet from \$1.10 per million cubic feet in 1998. On a combined basis, operating netbacks increased 38 percent to \$13.35 per barrel of oil equivalent, up from \$9.63 per barrel of oil equivalent in 1998.

OPERATING NETBACKS

	1999			1998		
	Oil and Liquids (\$/bbl)	Natural Gas (\$/mcf)	Equivalents (\$/boe)	Oil and Liquids (\$/bbl)	Natural Gas (\$/mcf)	Equivalents (\$/boe)
Revenues (adjusted for oil, gas and currency hedges)	23.72	2.42	23.95	18.35	1.92	18.48
Royalties (net of ARTC and SRC)	(3.83)	(0.49)	(4.21)	(2.46)	(0.21)	(2.35)
Operating costs	(6.74)	(0.57)	(6.39)	(6.68)	(0.61)	(6.50)
Operating netbacks	13.15	1.36	13.35	9.21	1.10	9.63

General and Administration Expenses

Net of overhead recoveries, general and administration costs increased 17 percent in 1999 to \$1.46 million. Since 1995, Zargon has maintained a policy of not capitalizing any portion of its general and administrative costs.

GENERAL AND ADMINISTRATION EXPENSES

(\$ million)	1999	1998	1997
Gross general and administration expense	2.68	1.98	1.61
Overhead recoveries	(1.22)	(0.73)	(0.58)
Net general and administration expense	1.46	1.25	1.03
Net expense after recoveries (\$/boe)	1.53	1.60	1.40
Number of employees at year-end	21	17	12

General and administration expenses on a per unit of production basis decreased four percent in 1999 to \$1.53 per barrel of oil equivalent. Continued improvements on a per unit of production basis are projected in 2000, with moderately increased gross general and administration costs expected to be offset by increased production volumes and by increased overhead recoveries from a record capital program.

Interest Expense

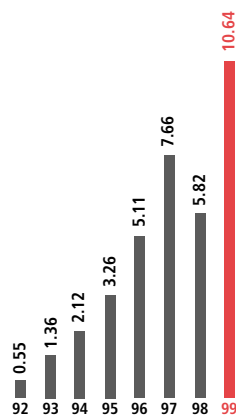
Zargon's 1999 interest expense increased 55 percent to \$0.59 million from \$0.38 million in 1998. The Company's 1999 effective interest rates were 6.0 percent on an average loan of \$9.80 million compared to a 6.3 percent effective interest rate on an average loan of \$6.00 million in 1998.

Capital and Income Tax

During 1999 Zargon did not pay cash income taxes, but did remit \$0.10 million of federal and provincial capital taxes. The Company's year-end 1999 tax pools total \$41.89 million.

Cash Flow from Operations

(\$ million)



Corporate Netbacks

Defined as operating netbacks less general and administration costs, financial costs and cash taxes, Zargon's 1999 corporate netbacks, increased 49 percent to \$11.10 per barrel of oil equivalent, because of considerably higher oil and gas prices.

CORPORATE NETBACKS

(\$/boe)	1999	1998	1997
Operating netbacks	13.35	9.63	12.23
General and administration	(1.53)	(1.60)	(1.40)
Financial charges	(0.62)	(0.48)	(0.19)
Capital and current income taxes	(0.10)	(0.10)	(0.25)
Corporate netbacks	11.10	7.45	10.39

Cash Flow From Operations

Zargon's 1999 cash flow from operations increased 83 percent to \$10.64 million due to a 49 percent increase in corporate netbacks and a 23 percent increase in production volumes. Comparative cash flows were \$5.82 million in 1998 and \$7.66 million in 1997. Fully diluted cash flow per share improved 63 percent to \$0.70 in 1999, up from \$0.43 in 1998.

Depletion and Depreciation

Zargon's 1999 depletion and depreciation provision increased 30 percent to \$4.75 million. On a per unit of production basis, depletion and depreciation increased six percent to \$4.96 per barrel of oil equivalent as compared to \$4.68 per barrel of oil equivalent in 1998. Zargon calculates depletion and depreciation charges assuming 10 thousand cubic feet of natural gas is equivalent to one barrel of oil. The relatively low per unit depletion and depreciation charges is a result of the Company's historically low finding and development costs.

Site Restoration and Reclamation

Zargon provided for \$0.59 million in site restoration and reclamation charges in 1999 compared to a \$0.48 million provision in 1998. This charge of \$0.61 per barrel of oil equivalent was down marginally from the \$0.62 per barrel of oil equivalent charge recorded in 1998. Zargon accrues the estimated future restoration and reclamation charges on a per unit of production basis assuming a \$20,000 net after salvage abandonment charge for each net working interest well. Actual site restoration and reclamation costs incurred in 1999 were \$0.18 million compared to \$0.23 million of costs in 1998.

Deferred Income Taxes

The Company's 1999 deferred income taxes increased 143 percent to \$1.05 million, compared to \$0.43 million in 1998. On a per unit of production basis 1999 deferred income taxes increased to \$1.09 per barrel of oil equivalent from \$0.55 per barrel of oil equivalent in 1998. The 1999 effective tax rate of 20 percent reflected substantial benefits associated with the utilization of the non-capital losses relating to the 1997 Oasis corporate acquisition.

Earnings

Zargon's 1999 net earnings were \$4.26 million, a 241 percent increase from the \$1.25 million recorded in 1998. On a fully diluted per share basis the 1999 net earnings climbed 180 percent to \$0.29. On a per unit of production basis, 1999 net earnings were \$4.44 per barrel of oil equivalent or 40 percent of cash flow.

Return on Equity

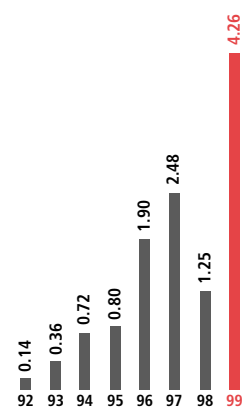
Zargon's 1999 pre-tax return on shareholder's equity climbed to 17.2 percent from 6.5 percent in the previous year. The 1999 after-tax rate of return was 13.8 percent. After-tax rates of return on equity have averaged 10.4 and 10.3 percent over the prior three and seven year periods, respectively.

Capital Expenditures

Net capital expenditures in 1999 increased 36 percent to \$16.95 million. During the year, Zargon expanded its exploration focus through seismic and undeveloped land acquisitions. Total land, geological and geophysical costs were \$5.89 million or 35 percent of the total expenditures, up from 14 percent of the total capital program in 1998.

Responding to a tight property acquisition market, Zargon's 1999 net acquisitions declined to \$2.25 million or 13 percent of the total capital program, compared to a 48 percent weighting in 1998. Based on first quarter activities, a significantly higher property acquisition weighting is expected in 2000.

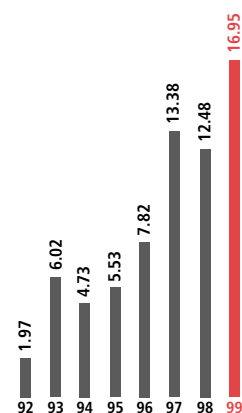
Earnings
(\$ million)



CAPITAL EXPENDITURES

(\$ million)	1999	1998	1997
Property, plant and equipment assets			
Undeveloped land	3.98	0.81	0.84
Geological and geophysical (seismic)	1.91	0.92	0.50
Drilling and completion wells	6.20	3.05	5.44
Well equipment and facilities	2.52	1.57	1.14
Exploration and development	14.61	6.35	7.92
Property acquisitions	3.70	6.57	8.65
Property dispositions	(1.45)	(0.59)	(3.27)
Net property acquisitions	2.25	5.98	5.38
Total property, plant and equipment assets	16.86	12.33	13.30
Administration assets	0.09	0.15	0.08
Total capital expenditures (net)	16.95	12.48	13.38

Net Capital Expenditures
(\$ million)



LIQUIDITY AND CAPITAL RESOURCES

Zargon relies on three sources of funding to support its capital expenditure programs:

- Internally-generated cash flow provides the minimum level of funding on which the Company's annual capital expenditure program is based.
- Debt may be used to expand capital programs when deemed appropriate. The Company maintains a conservative debt policy.
- New equity, if available and on favourable terms, will be used to expand capital programs. Conversely, the repurchase of Zargon shares through an issuer bid will be considered if Zargon's equity is valued by the stock market at levels perceived to be at a substantial discount to the underlying net asset value.

In 1999 over 62 percent of Zargon's capital program was funded by cash flow with the remaining expenditures funded by the issuance of debt.

CAPITAL SOURCES

(\$ million)	1999	1998	1997
Cash flow from operations	10.64	5.82	7.66
Changes in working capital	(0.57)	(0.16)	(0.45)
Bank debt	7.94	1.31	4.38
Issuance (buyback) of common shares	(1.06)	5.51	1.79
Total capital sources	16.95	12.48	13.38

During 1999 Zargon repurchased 388,000 common shares pursuant to a June 1999 issuer bid. Including commissions, the total cost for these shares was \$1.06 million which equates to an average cost of \$2.71 per share.

Cash Flow

The majority of Zargon's 2000 capital budget is anticipated to be financed through the reinvestment of cash flow from operations. Cash flow is influenced by factors beyond the Company's control such as commodity prices, the US/Canadian dollar exchange rates and interest rates. Zargon's 2000 sensitivity to moderate fluctuations in key business parameters is shown in the accompanying table.

CASH FLOW SENSITIVITIES SUMMARY

	Change in 2000 Cash Flow	
	(\$ million)	(\$/ share)
Change of US\$1.00/bbl in the price of WTI oil	0.67	0.04
Change in oil production by 100 bbl/d	0.51	0.03
Change of \$0.10/mcf in the price of gas	0.36	0.02
Change in gas production by 1 mmcf/d	0.51	0.03
Change of \$0.01 in the \$US/\$Cdn Exchange Rate	0.35	0.02

Bank Debt and Liability

The Company has lines of credit totalling \$25.00 million of which \$14.12 million was drawn at December 31, 1999. This was a 128 percent increase from the prior year-end balance of \$6.18 million. The 1999 year-end working capital deficiency was \$0.14 million compared to a working capital deficiency of \$0.24 million recorded at December 31, 1998.

Zargon's combined debt and working capital deficiency was \$14.26 million at December 31, 1999, representing less than 1.4 times the Company's 1999 cash flow from operations of \$10.64 million.

Equity

At year-end 1999, Zargon had 14.42 million shares outstanding. Including the 1.45 million shares granted (1.01 million exercisable at December 31, 1999) under the company stock option plan, Zargon's fully diluted year-end shares outstanding totalled 15.87 million.

During 1999, 4.01 million Zargon shares traded on The Toronto Stock Exchange with a high of \$3.30 per share, a low of \$2.00 per share and a close of \$3.00 per share. The 1999 trading statistics represent a 58 percent year-over-year increase in trading volume and a 25 percent improvement in the closing stock price. Zargon's market capitalization at year-end 1999 was \$43 million.

BUSINESS RISKS AND OUTLOOK

Business Risks

Zargon's business risks arise from the uncertainty of crude oil and natural gas pricing, interest and exchange rates, environmental and safety issues, financial and liquidity considerations and the results from capital expenditure programs.

The Company attempts to minimize pricing uncertainty with a risk management program which encompasses forward sales of crude oil and natural gas production. This is complemented by US dollar currency hedges for up to 30 percent of Zargon's oil and gas volumes. Environmental and safety risks are mitigated by complying with provincial and federal environmental and safety regulations, participating in an industry standard Environment, Health and Safety Stewardship Program, maintaining adequate insurance and adopting appropriate emergency response and employee safety procedures.

Financial and liquidity risks are reduced by limiting debt financing to self-imposed debt to cash flow guidelines. Zargon actively manages the risks of its capital programs by concentrating drilling and subsequent development activities in areas where the Company has demonstrated proven technical capabilities. Zargon's capital budget is managed so as to limit its capital exposure to any one project or concept.

2000 Corporate Budget

Zargon anticipates strong prices and continued gas and oil production growth in 2000.

PRICING ASSUMPTIONS

Oil and liquids (US\$23.00/bbl per WTI)	\$29.00/bbl field price
Natural gas	\$2.60/mcf field price
Exchange rate	\$0.70 Cdn/US Dollar

AVERAGE PRODUCTION

Oil and liquids	1,800 bbl/d
Natural gas	14.0 mmcf/d
Equivalents	3,200 boe/d

CAPITAL EXPENDITURES \$20.0 million

REVENUE \$32.3 million

CASH FLOW FROM OPERATIONS \$15.9 million

NET EARNINGS \$5.6 million

CASH FLOW PER FULLY DILUTED SHARE \$1.06

EARNINGS PER FULLY DILUTED SHARE \$0.39

CORPORATE OUTLOOK

For 2000 Zargon has budgeted \$20 million of capital expenditures for well-defined gas exploitation and exploration opportunities and the acquisition of long-life exploitable oil properties. With its inherently strong financial condition, disciplined approach, new exploration initiatives, expanded undeveloped acreage base and increasing gas exposure, Zargon is well-positioned to achieve substantial and profitable growth in 2000.

MANAGEMENT'S REPORT

The financial statements of Zargon Oil & Gas Ltd. were prepared by management in accordance with accounting principles generally accepted in Canada. The financial and operating information presented in this annual report is consistent with that shown in the financial statements.

Management has designed and maintains a system of internal controls to provide reasonable assurance that all assets are safeguarded and to facilitate the preparation of financial statements for reporting purposes. Timely release of financial information sometimes necessitates the use of estimates when transactions affecting the current accounting period cannot be finalized until future periods. Such estimates are based on careful judgements made by management.

External auditors appointed by the shareholders have conducted an independent examination of the corporate and accounting records in order to express their opinion on the financial statements.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal control. The Board exercises this responsibility through its Audit Committee. The Audit Committee, which consists of non-management directors has met with the external auditors and management in order to determine that management has fulfilled its responsibilities in the preparation of the financial statements. The Audit Committee has reported its findings to the Board of Directors who have approved the financial statements.

Signed

J. O. McCutcheon
Chairman

Signed

C. H. Hansen
President and Chief Executive Officer

AUDITORS' REPORT

To the Shareholders of Zargon Oil & Gas Ltd.

We have audited the balance sheets of Zargon Oil & Gas Ltd. as at December 31, 1999 and 1998 and the statements of income and retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

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

Calgary, Canada
March 3, 2000

Signed

Ernst & Young LLP
Chartered Accountants

BALANCE SHEETS

As at December 31 (\$ thousand)	1999	1998
ASSETS [note 3]		
CURRENT		
Cash	116	194
Accounts receivable	5,165	2,734
Deferred income taxes	–	300
Prepaid expenses and deposits	361	169
	5,642	3,397
PROPERTY AND EQUIPMENT [note 2]	50,383	38,189
	56,025	41,586
LIABILITIES		
CURRENT		
Accounts payable and accrued liabilities	5,787	3,639
LONG-TERM DEBT [note 3]	14,116	6,179
FUTURE SITE RESTORATION COSTS	1,265	860
DEFERRED INCOME TAXES	2,334	1,588
	23,502	12,266
SHAREHOLDERS' EQUITY		
Share capital and warrants [note 4]	20,742	21,316
Retained earnings	11,781	8,004
	32,523	29,320
	56,025	41,586

See accompanying notes

Approved on behalf of the Board:

Signed
C.H. Hansen
Director

Signed
J.O. McCutcheon
Director

STATEMENTS OF INCOME AND RETAINED EARNINGS

For the years ended December 31

(\$ thousand, except for per share amounts)

	1999	1998
INCOME		
Oil and gas sales	24,048	14,264
Hedging income (loss) ^[note 7]	(1,095)	180
Royalties (net of Alberta royalty tax credit)	(4,033)	(1,837)
	<u>18,920</u>	<u>12,607</u>
EXPENSES		
Production	6,120	5,080
Administration	1,463	1,252
Interest on long-term debt	592	377
Site restoration	585	482
Depreciation and depletion	4,750	3,659
	<u>13,510</u>	<u>10,850</u>
INCOME BEFORE INCOME TAXES	<u>5,410</u>	<u>1,757</u>
INCOME TAXES ^[note 5]		
Deferred	1,046	430
Current	103	77
	<u>1,149</u>	<u>507</u>
NET INCOME FOR THE YEAR	4,261	1,250
RETAINED EARNINGS, BEGINNING OF YEAR	8,004	6,754
REPURCHASE OF COMMON SHARES ^[note 4]	(484)	—
RETAINED EARNINGS, END OF YEAR	<u>11,781</u>	<u>8,004</u>
EARNINGS PER COMMON SHARE ^[note 6]		
Basic	0.29	0.10
Fully diluted	0.29	0.10

See accompanying notes

STATEMENTS OF CASH FLOWS

For the years ended December 31	1999	1998
(\$ thousand, except for per share amounts)		
OPERATING ACTIVITIES		
Net income for the year	4,261	1,250
Add non-cash items:		
Depreciation and depletion	4,750	3,659
Site restoration	585	482
Deferred income taxes	1,046	430
Cash flow from operations	10,642	5,821
Changes in non-cash working capital	(2,221)	70
	<u>8,421</u>	<u>5,891</u>
FINANCING ACTIVITIES		
Long-term debt	7,937	1,307
Repurchase of common shares	(1,058)	–
Issuance of common shares	–	5,933
Issue costs of common shares	–	(421)
	<u>6,879</u>	<u>6,819</u>
INVESTING ACTIVITIES		
Acquisition of property and equipment	(17,083)	(13,071)
Disposal of property and equipment	138	594
Site restoration expenditures	(180)	(228)
Changes in non-cash working capital	1,747	(29)
	<u>(15,378)</u>	<u>(12,734)</u>
DECREASE IN CASH	(78)	(24)
CASH, BEGINNING OF YEAR	194	218
CASH, END OF YEAR	<u>116</u>	<u>194</u>
CASH FLOW FROM OPERATIONS PER SHARE <small>[note 6]</small>		
Basic	0.72	0.45
Fully diluted	0.70	0.43

See accompanying notes

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of Business

Zargon Oil & Gas Ltd. (the "Corporation") is a public company incorporated under the Business Corporations Act (Alberta) engaged in the production, development and exploration of oil and gas solely in Canada.

Property and Equipment

The Corporation follows the full cost method of accounting for its oil and gas operations whereby all costs related to the acquisition of petroleum and natural gas rights are capitalized. Such costs include land and lease acquisition costs, annual carrying charges of non-producing properties, geological and geophysical costs, and costs of drilling and equipping productive and non-productive wells. Proceeds from disposals are recorded as a reduction of the related expenditures without recognition of a gain or loss unless the disposal would result in a change of 20 percent or more in the depletion rate.

Depreciation and depletion of capitalized costs is computed using the unit-of-production method based on the estimated proven reserves of oil and gas determined by independent consultants. Reserves are converted to common units on the basis that ten thousand cubic feet of gas is equivalent to one barrel of oil and liquids.

The Corporation applies a ceiling test to capitalized costs to ensure that such costs do not exceed estimated future net revenues from production of proven reserves at year end market prices less future production, general and administrative, financing, site restoration, and income tax costs plus the lower of cost or estimated market value of unproved properties.

Depreciation of office equipment is provided using the declining balance method at an annual rate of 20 percent.

Future Site Restoration Costs

Estimated future site restoration and removal costs, net of salvage values, are provided using the unit-of-production method based on estimated proven reserves. The annual charge is accounted for as an expense and the accumulated provision is reflected as a deferred liability. Actual site restoration costs are deducted from the accumulated provision in the year incurred.

Financial Instruments

Financial instruments of the Corporation consist mainly of cash, accounts receivable, accounts payable and accrued liabilities, and long-term debt. As at December 31, 1999 and 1998, there are no significant differences between the carrying values of these amounts and their estimated market values.

The Corporation enters into swap contracts, as described in note 7, that are designed as and are effective as a hedge against changes in commodity prices and foreign exchange rates. Gains and losses on the hedging contracts are deferred and are recognized when the hedged transaction occurs.

Measurement Uncertainty

The amounts recorded for depletion and depreciation of property and equipment and for site restoration and reclamation are based on estimates of reserves and future costs. By their nature, these estimates and those related to the future cash flows used to assess impairment, are subject to measurement uncertainty and the impact on the financial statements of future periods could be material.

Joint Operations

The majority of the oil and gas operations of the Corporation are conducted jointly with others and accordingly these financial statements reflect only the proportionate interests of the Corporation in such activities.

Per Share Amounts

Per share amounts are calculated using the weighted average number of common shares outstanding during the year. The fully diluted earnings per share calculation assumes the exercise of vested stock options outstanding.

Income Taxes

The Corporation follows the deferral method of accounting under which the income tax provision is based on the earnings reported in the accounts. Under this method, the Corporation provides for deferred income taxes to the extent that income taxes otherwise payable are reduced by capital cost allowances and exploration and development costs in excess of the depletion and depreciation provisions recorded in the accounts.

2. PROPERTY AND EQUIPMENT

(\$ thousand)	1999		
	Cost	Accumulated Depreciation and Depletion	Net Book Value
Petroleum and natural gas rights	54,928	14,180	40,748
Production equipment and facilities	13,256	3,946	9,310
Office equipment	547	222	325
	68,731	18,348	50,383

(\$ thousand)	1998		
	Cost	Accumulated Depreciation and Depletion	Net Book Value
Petroleum and natural gas rights	40,864	10,422	30,442
Production equipment and facilities	10,475	3,018	7,457
Office equipment	447	157	290
	51,786	13,597	38,189

At December 31, 1999, petroleum and natural gas rights include \$5,431,000 (1998 – \$2,810,000) relating to undeveloped properties which have been excluded from the depletion calculation.

3. LONG-TERM DEBT

The Corporation has a revolving demand credit facility which provides for a line of credit of \$25,000,000 bearing interest at prime (December 31, 1999 – 6.5 percent; December 31, 1998 – 6.75 percent) and has pledged an assignment of accounts receivable, a first floating charge on all of the assets and a fixed charge over certain property and equipment as collateral. While the credit facilities are of a demand nature, the bank has stated that it is not their present intention to demand repayment nor do they have information that would lead them to anticipate that the loan would be demanded before January 1, 2001. Accordingly, the loan is classified as long term.

4. SHARE CAPITAL AND WARRANTS

The Corporation is authorized to issue an unlimited number of common shares and an unlimited number of first preferred shares and second preferred shares.

COMMON SHARES:

(thousand)	1999		1998	
	Number of Shares	Amount (\$)	Number of Shares	Amount (\$)
SHARES ISSUED,				
Balance, beginning of year	13,008	16,323	12,553	15,610
Conversion of Special Warrants	1,800	4,993	–	–
Normal course issuer bid	(388)	(574)	–	–
Stock options exercised	–	–	455	713
	14,420	20,742	13,008	16,323
SHARES TO BE ISSUED,				
Special Warrants (net of issue costs)	–	–	1,800	4,993
	14,420	20,742	14,808	21,316

On November 18, 1998, the Corporation issued 1,800,000 Special Warrants at a price of \$2.90 for net proceeds of \$4,799,000 after costs of issuance of \$421,000. Each Special Warrant entitles the holder to exchange the Special Warrant for one common share at no additional cost. In 1999, 1,800,000 common shares were issued upon exercise of these special warrants.

Share issue costs in 1998 of \$421,000 are stated net of related deferred income taxes of \$194,000.

In accordance with the Normal Course Issuer Bid filed with The Toronto Stock Exchange on June 22, 1999, the Corporation is permitted to purchase and cancel up to 970,000 of its common shares prior to June 23, 2000. During 1999, a total of 388,000 shares were purchased and cancelled at an average cost of \$2.71 per share. The aggregate cost of common shares purchased and cancelled of \$1,056,000 was recorded as a charge against share capital of \$574,000 for the average carrying value of the common shares, with the balance of \$484,000 charged against retained earnings.

Stock options to acquire common shares are granted to employees and directors from time to time at exercise prices equal to the market value of the shares at the date of the grant. No compensation expense is recognized for grants under this Plan when stock or stock options are issued. Any consideration paid on exercise of stock options is credited to share capital.

The Corporation has reserved 1,480,000 shares at December 31, 1999 for issuance under the stock option plan.

A summary of the status of the Company's stock option plans as at December 31, 1999 and 1998, and changes during the years ending on those dates is presented below:

OPTIONS	1999		1998	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
	(thousand)	(\$)	(thousand)	(\$)
Outstanding at beginning of year	985	2.47	960	1.77
Granted	470	2.61	510	2.92
Exercised	–	–	(455)	1.57
Cancelled	(5)	2.83	(30)	2.50
Outstanding at end of year	1,450	2.51	985	2.47
Options exercisable at year end	1,005	2.46	613	2.21

The following table summarizes information about stock options outstanding at December 31, 1999:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number Outstanding at 12/31/99	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable at 12/31/99	Weighted Average Exercise Price
(\$)	(thousand)		(\$)	(thousand)	(\$)
1.55 to 1.65	292	1 year	1.57	292	1.57
2.14 to 2.59	235	3 years	2.35	198	2.35
2.60	363	4.3 years	2.60	–	–
2.90 to 3.00	420	4 years	2.99	375	2.99
3.05 to 3.10	140	3 years	3.06	140	3.06
	1,450		2.51	1,005	2.46

5. INCOME TAXES

Income taxes differ from the amounts which would be obtained by applying statutory income tax rates to income before income taxes as follows:

(\$ thousand)	1999	1998
Computed income taxes at approximately 45 percent	2,435	790
Add (deduct) income tax effect of:		
Non-deductible crown charges, net of Alberta royalty tax credit	1,079	411
Resource allowance	(1,377)	(754)
Non-tax base depletion (net)	(55)	4
Benefit of losses not previously recognized	(1,042)	–
Large corporation and capital taxes	103	77
Other	6	(21)
	1,149	507

As at December 31, 1999, the Corporation has exploration and developments costs, undepreciated capital costs, unamortized share issue costs and loss carry forwards available for deduction against future taxable income in aggregate of approximately \$41,895,000 (December 31, 1998 – \$36,400,000).

6. WEIGHTED AVERAGE NUMBER OF COMMON SHARES

(thousand)	1999	1998
Weighted average number of common shares outstanding during the year	14,686	13,025
Fully diluted weighted average number of common shares outstanding during the year	15,691	14,138

Fully diluted earnings and cash flow from operations per share reflect the dilutive effect of the exercise of the vested stock options outstanding. Earnings on the funds which would have been received had the options been exercised of \$340,000 (1998 – \$137,000), net of tax, has been imputed at a rate of 13.8 percent (1998 – 4.8 percent) per annum after taxes.

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 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 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 U.S. dollar currency exchange rate.

The Corporation has outstanding contracts at December 31, 1999 and 1998 as follows:

	Volume	Average Fixed Price Range	Range of Terms
AT DECEMBER 31, 1999			
Crude oil swaps	91,400 bbl	\$19.05 – \$20.90 US	Jan. 1/00 – Dec. 31/00
Oil collar	36,600 bbl	\$19.00 US Put \$24.70 US Call	Jan. 1/00 – Dec. 31/00
Natural gas swaps	609,000 GJ	\$2.73 – \$2.97/GJ	Jan. 1/00 – Oct. 31/00
Currency swaps	\$255,000 US/mo.	1.5165 – 1.5435 exch.	Jan. 1/00 – Dec. 31/01
Interest rate swap	5.35% in.	\$5,000,000 CAD	Jan. 1/00 – Apr. 30/02
AT DECEMBER 31, 1998			
Natural gas swaps	760,000 GJ	\$2.19 – \$2.62/GJ	Jan. 1/99 – Oct. 31/99
Currency swaps	\$255,000 US/mo.	1.4382 – 1.5435 exch.	Jan. 1/99 – Dec. 31/00

At December 31, 1999, the cost to settle the above swap transactions would have been \$975,000 (1998 – \$427,000). These instruments have no book values recorded in the financial statements.

EIGHT YEAR SUMMARY

	1999	1998	1997	1996	1995	1994	1993	1992
FINANCIAL (\$ thousand, except per share amounts)								
PRODUCTION REVENUE	24,048	14,264	16,800	12,150	8,244	5,748	4,016	2,130
Less expenses – cash items								
Royalty expenses	4,033	1,837	2,652	2,075	1,293	997	751	529
Field operating expenses	6,120	5,080	5,081	3,324	2,875	2,095	1,474	658
General and administrative expenses (net)	1,463	1,252	1,035	741	508	416	277	205
Hedging (gain) loss	1,095	(180)	44	434	–	–	–	–
Bank interest	592	377	142	220	299	102	118	52
Debenture interest	–	–	–	12	14	20	78	82
Current and capital taxes	103	77	181	236	–	–	(39)	59
NET CORPORATE CASH FLOW	10,642	5,821	7,665	5,108	3,255	2,118	1,357	545
Less expenses – non-cash items								
Depletion and depreciation	4,750	3,659	3,276	2,028	1,733	1,179	830	382
Deferred income tax	1,046	430	1,421	910	507	20	40	5
Site restoration	585	482	490	267	215	194	128	21
NET CORPORATE EARNINGS PER SHARE, FULLY DILUTED	4,261	1,250	2,478	1,903	800	723	359	137
Cash flow (\$/share)	0.70	0.43	0.62	0.51	0.37	0.28	0.25	0.16
Earnings (\$/share)	0.29	0.10	0.20	0.19	0.10	0.09	0.08	0.05
NET CAPITAL EXPENDITURES	16,945	12,477	13,371	7,821	5,526	4,730	6,017	1,972
BALANCE SHEET AT YEAR END								
Total property and equipment	50,383	38,189	29,371	20,776	14,983	11,604	8,146	3,021
Bank debt	14,116	6,178	4,872	491	2,664	1,740	–	493
Other long-term debt	–	–	–	–	200	300	400	900
Shareholders' equity	32,523	29,320	22,364	18,060	11,127	9,048	7,696	1,575
Shareholders' equity (\$/share)	2.26	1.98	1.80	1.54	1.20	1.12	1.02	0.61
AVERAGE COMMON SHARES OUTSTANDING (thousand)	14,686	13,025	12,051	9,659	8,441	7,595	4,581	2,850
OPERATIONS								
TOTAL PRODUCTION (boe/d)	2,626	2,141	2,021	1,382	1,162	842	633	319
Crude oil and liquids (bbl/d)	1,711	1,508	1,385	1,012	885	616	426	256
Natural gas (mmcf/d)	9.15	6.33	6.36	3.70	2.77	2.26	2.07	0.63
Boe/d per million shares	179	164	168	141	135	109	111	79
TOTAL PROVEN RESERVES (mboe)	9,516	7,871	6,340	5,024	3,625	2,939	2,194	888
Crude oil and liquids (mmbbl/d)	5,210	5,072	4,134	3,706	2,744	2,099	1,371	720
Natural gas (bcf)	43.06	27.99	22.06	13.18	8.82	8.40	8.23	1.68
Boe per share (year end)	0.66	0.53	0.50	0.43	0.38	0.36	0.28	0.22
TOTAL PROVEN AND PROBABLE RESERVES (mboe)	12,575	10,559	8,333	6,980	5,551	4,962	3,970	1,306
Crude oil and liquids (bbl/d)	7,090	6,984	5,700	4,728	3,986	3,576	2,643	1,006
Natural gas (bcf)	54.85	35.75	26.33	22.53	15.66	13.86	13.27	3.00
Boe per share (year end)	0.87	0.71	0.66	0.60	0.59	0.60	0.50	0.32
AVERAGE SELLING PRICES								
WTI crude price (\$US/bbl)	19.24	14.42	20.61	22.01	18.40	17.17	18.65	20.55
FOB Edmonton crude price (\$/bbl)	27.35	20.21	27.70	29.23	24.04	21.86	21.90	25.50
Zargon field average crude price (\$/bbl)	25.02	17.80	24.70	26.91	21.79	19.41	18.53	20.25
Alberta market gas price (\$/mcf)	2.60	2.00	1.85	1.65	1.34	1.80	1.70	1.36
Zargon field average gas price (\$/mcf)	2.52	1.93	1.86	1.62	1.19	1.67	1.49	0.93

CORPORATE INFORMATION

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Vice President, Land

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Neil D. Watson
Senior Geologist

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ABBREVIATIONS:

bbl	Barrel
bbl/d	Barrels of Oil per Day
bcf	Billion Cubic Feet
boe	Barrel of Oil Equivalent
boe/d	Barrel of Oil Equivalent per Day
10 mcf	Equivalent to 1 Bbl
m	Thousand
mm	Million
mcf	Thousand Cubic Feet
mcf/d	Thousand Cubic Feet per Day

Z A R G O N O I L & G A S L T D .

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