MANAGEMENT'S REPORT

The consolidated financial statements of Zargon Oil & Gas Ltd. were prepared by management in accordance with Canadian generally accepted accounting principles. The financial and operating information presented in this annual report is consistent with that shown in the consolidated 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 Company's accounting records in order to express their opinion on the consolidated financial statements.

The Board of Directors is responsible for ensuring that management fulfils 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 consolidated financial statements. The Audit Committee has reported its findings to the Board of Directors who have approved the consolidated financial statements.

J.O. McCutcheon
Chairman

C.H. Hansen
President and Chief Executive Officer

Calgary, Canada
February 27, 2004

AUDITORS' REPORT

TO THE SHAREHOLDERS OF ZARGON OIL & GAS LTD.

We have audited the consolidated balance sheets of Zargon Oil & Gas Ltd. as at December 31, 2003 and 2002 and the consolidated statements of earnings and retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2003 and 2002 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Calgary, Canada
February 27, 2004

Ernst & Young LLP
Chartered Accountants

CONSOLIDATED BALANCE SHEETS

As at December 31 ($ thousand)	**2003**	2002
ASSETS *[note 5]*		
Current		
Accounts receivable	**12,183**	11,942
Prepaid expenses and deposits	**980**	712
	13,163	12,654
Property and equipment *[note 4]*	**161,907**	141,006
	175,070	153,660
LIABILITIES		
Current		
Bank indebtedness *[note 5]*	**6,978**	25,279
Accounts payable and accrued liabilities	**19,277**	16,118
	26,255	41,397
Future site restoration	**6,026**	4,746
Future income taxes *[note 7]*	**30,200**	20,922
	62,481	67,065
Commitments and contingencies *[notes 9, 10 and 11]*		
SHAREHOLDERS' EQUITY		
Share capital *[note 6]*	**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 notes to the consolidated financial statements

On behalf of the Board:

J.O. McCutcheon
Director

C.H. Hansen
Director

CONSOLIDATED STATEMENTS OF EARNINGS AND RETAINED EARNINGS

For the years ended December 31 ($ thousand, except for per share amounts)	**2003**	2002
Revenue		
Petroleum and natural gas revenue	**101,657**	65,538
Hedging *[note 9]*	**(2,882)**	669
Royalties (net of Alberta Royalty Tax Credit)	**(22,508)**	(13,508)
	76,267	52,699
Expenses		
Production	**17,201**	15,649
General and administrative	**3,542**	3,455
Stock-based compensation *[note 2]*	**264**	–
Interest	**771**	1,100
Foreign exchange (gain) loss	**(297)**	86
Site restoration	**1,567**	1,268
Depletion and depreciation	**19,008**	13,536
	42,056	35,094
Earnings before income taxes	**34,211**	17,605
Income taxes *[note 7]*		
Future	**9,278**	6,548
Current	**406**	378
	9,684	6,926
Net earnings for the year	**24,527**	10,679
Retained earnings, beginning of year	**45,598**	34,919
Retained earnings, end of year	**70,125**	45,598
Earnings per common share *[note 8]*		
Basic	**1.38**	0.62
Diluted	**1.33**	0.60

See accompanying notes to the consolidated financial statements

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the years ended December 31 ($ thousand)	2003	2002
Operating activities		
Net earnings for the year	**24,527**	10,679
Add (deduct) non-cash items:		
Depletion and depreciation	**19,008**	13,536
Site restoration	**1,567**	1,268
Stock-based compensation *[note 2]*	**264**	–
Unrealized foreign exchange (gain) loss	**(297)**	86
Future income taxes	**9,278**	6,548
Cash flow from operations	**54,347**	32,117
Changes in non-cash working capital	**(936)**	(2,587)
	53,411	29,530
Financing activities		
Advances (repayment) of bank indebtedness	**(18,301)**	1,142
Exercise of stock options	**1,203**	1,262
	(17,098)	2,404
Investing activities		
Additions to property and equipment	**(45,124)**	(31,296)
Proceeds on disposal of property and equipment	**5,215**	3,134
Acquisition of Hadrian Energy Corp. (cash portion) *[note 3]*	**–**	(4,875)
Site restoration expenditures	**(287)**	(423)
Changes in non-cash working capital	**3,883**	1,325
	(36,313)	(32,135)
Decrease in cash	**–**	(201)
Cash, beginning of year	**–**	201
Cash, end of year	**–**	–

See accompanying notes to the consolidated financial statements

FOR THE YEARS ENDED DECEMBER 31, 2003 AND 2002

ALL AMOUNTS ARE STATED IN CANADIAN DOLLARS UNLESS OTHERWISE NOTED

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

DESCRIPTION OF BUSINESS

Zargon Oil & Gas Ltd. ("Zargon" or the "Company") is a public company that trades on the Toronto Stock Exchange and is incorporated under the Business Corporations Act (Alberta). The Company is engaged in the exploration, development and production of petroleum (crude oil, natural gas liquids) and natural gas in Canada and the United States ("US").

CONSOLIDATION

These consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles. Because a precise determination of many assets and liabilities is dependent upon future events, the preparation of periodic financial statements necessarily involves the use of estimates and approximations. Accordingly, actual results could differ from those estimates. The consolidated financial statements have, in management's opinion, been properly prepared within reasonable limits of materiality and within the framework of the Company's accounting policies summarized below.

The consolidated financial statements include the accounts of Zargon Oil & Gas Ltd., all subsidiaries and a partnership. All subsidiaries and a partnership are directly or indirectly wholly owned and their operations are fully reflected in the consolidated financial statements.

REVENUE RECOGNITION

Petroleum and natural gas revenue is recognized in earnings when reserves are produced and delivered to the purchaser.

JOINT OPERATIONS

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

PROPERTY AND EQUIPMENT

The Company follows the full cost method of accounting for its oil and natural gas operations whereby all costs relating to the acquisition, exploration and development of oil and natural gas reserves are capitalized and accumulated in separate cost centres for Canada and the US. Such costs include land acquisition costs, annual carrying charges of non-producing properties, geological and geophysical costs, and costs of drilling and equipping wells.

Depletion and depreciation of petroleum and natural gas properties and equipment is computed using the unit of production method based on the estimated proved reserves of petroleum and natural gas before royalties determined by independent consultants. For purposes of this calculation reserves are converted to common units on the basis that six thousand cubic feet of natural gas is equivalent to one barrel of oil. A portion of the cost of petroleum and natural gas rights relating to undeveloped properties is excluded from depletion calculations. Twenty percent of the year-end balance of these costs is added to the depletion base each year.

The Company applies a ceiling test to capitalized costs on a quarterly basis to ensure that such costs do not exceed the estimated undiscounted future net revenues from production of proved reserves before royalties, plus the cost of undeveloped properties, net of impairment, less amounts associated with future production costs, general and administrative, financing, site restoration and income tax costs. The calculation of future net revenue is based on sales prices, costs and regulations in effect at the period end. Proceeds on the disposal of petroleum and natural gas properties are applied against capitalized costs, with gains or losses not ordinarily recognized, unless such a disposal would result in a change in the depletion rate of 20 percent or more.

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

FUTURE SITE RESTORATION

Estimated future site restoration, including the removal of production facilities at the end of their useful lives, and net of salvage values, are provided for using the unit of production method. This estimate is based on current costs, existing legislation and industry standards. 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

Derivative financial instruments are utilized to reduce commodity price risk associated with the Company's production of oil and natural gas. The base prices for the commodities are sometimes denominated in US dollars and the Company may also use such financial instruments to reduce the related foreign currency risk. Financial instruments may also be used from time to time to reduce interest rate risk on outstanding debt. The Company does not enter into financial instruments for trading or speculative purposes.

The Company follows a policy of using hedge instruments such as fixed price swaps, forward sales, puts, options and costless collars. The objective is to partially offset or mitigate the wide price swings commonly encountered in oil and natural gas commodities. The Company's policy is to designate each derivative financial instrument employed as a hedge of a specific portion of projected production over the term of the instrument. The Company formally documents its risk management objectives and strategies for undertaking the hedged transactions. This includes assessing the effectiveness of the derivative on an ongoing basis to ensure that the derivatives entered into are highly effective in offsetting changes in fair values of the hedged items. The instruments employed may be denominated in US or Canadian dollars. The Company believes the derivative financial instruments used are effective as hedges over their term. In the event that a designated hedge item is sold, extinguished, considered to become ineffective, or otherwise cancelled, any realized or unrealized gain or loss on such derivative commodity instruments is recognized in income. In times of particular price volatility such as the current year, the Company employs puts, options and costless collars as a preference if their cost is commercially acceptable so that most of the benefit of unforeseen high prices will continue to be available.

In the case of forward sales, the instrument can sometimes be satisfied by physical delivery. In all other cases the instrument is satisfied by payments or charges calculated by referring published prices to the agreed reference price in the terms and manner set out in the contract and paid or received monthly. In the case of physical delivery, the payment is part of the normal revenue stream and all other payments or charges are accounted for monthly as adjustments to revenue received.

Interest rate swap agreements are used from time to time to manage the floating interest rate on the Company's revolving bank debt. Such agreements involve the periodic exchange of payments without the exchange of the notional principal amount on which the payments are based. At December 31, 2003 and 2002 the Company had no such financial instruments.

Foreign currency swap agreements are used from time to time to manage the risk inherent in producing commodities whose price is based directly or indirectly on US dollars, using a notional principal equal to the projected monthly revenue from their sale. Payments or charges are calculated and paid according to the terms of the agreement, usually with monthly settlement. Foreign currency swap agreements are designated as hedges of revenue that is received in Canadian dollars, but whose amount is determined in foreign currency.

Gains or losses from these contracts, other than forward sales settled by physical delivery, are recognized as hedging gains or losses when realized.

INCOME TAXES

The Company follows the liability method of tax allocation in accounting for income taxes. Under this method, the Company records future income taxes for the effect of any differences between the accounting and income tax basis of an asset or liability using income tax rates expected to apply in the years in which these temporary differences are expected to be recovered or settled. The effect on future income tax assets and liabilities of a change in tax rates is recognized in net earnings in the period in which the change is substantively enacted.

FOREIGN CURRENCY TRANSLATION

The Company uses the temporal method of foreign currency translation whereby the monetary assets and liabilities recorded in a foreign currency are translated into Canadian dollars at year-end exchange rates, and non-monetary assets and liabilities at the exchange rates prevailing when the assets were acquired or liability incurred. Revenues and expenses are translated at the average rate of exchange for the year. Gains and losses on translation are included in the consolidated statements of earnings.

STOCK OPTIONS AND STOCK-BASED COMPENSATION

Under the Company's stock option plan, options to purchase common shares are granted to directors, officers and employees at current market prices. Options granted by the Company in 2003 are accounted for in accordance with the fair value method of accounting for stock-based compensation, and as such the cost of the option is charged to earnings with an offsetting amount recorded to contributed surplus, based on an estimate of the fair value using a Black-Scholes option-pricing model. No compensation expense has been recorded on options issued in 2002 (see note 6).

PER SHARE AMOUNTS

The Company follows the treasury stock method for the computation and disclosure of diluted per common share amounts. Under this method, the diluted weighted average number of common shares is calculated assuming that the proceeds from the exercise of dilutive options are used to purchase common shares at the average market price for the period.

MEASUREMENT UNCERTAINTY

The amounts recorded for depletion and depreciation of property and equipment and the provision for future site restoration are based on estimates of proved reserves, production rates, petroleum and natural gas prices, future costs and other relevant assumptions. By their nature, these estimates are subject to measurement uncertainty and the impact on the consolidated financial statements of changes in such estimates in future periods could be material.

2. CHANGE IN ACCOUNTING POLICY

STOCK-BASED COMPENSATION

Effective January 1, 2003, the Company adopted the recommendations of the Canadian Institute of Chartered Accountants on accounting for stock-based compensation. As permitted by this new pronouncement, the Company prospectively adopted the fair-value method of accounting for stock options granted to employees and directors. Stock-based compensation is recorded in 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. The Company recognized $264,000 of compensation expense for options granted during 2003 (see note 6 for further details). 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 as permitted by the new accounting pronouncement (see note 6).

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 consideration of $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 results of operations for Hadrian have been included in the consolidated financial statements since June 17, 2002. The acquisition was accounted for by the purchase method as follows:

($ thousand)	2002
Working capital	(816)
Property and equipment	7,386
Future income tax asset	3,792
Future site restoration	(760)
Total consideration	9,602

4. PROPERTY AND EQUIPMENT

	2003		
($ thousand)	Cost	Accumulated Depletion and Depreciation	Net Book Value
Petroleum and natural gas properties and equipment	229,167	67,639	161,528
Office equipment	1,009	630	379
	230,176	68,269	161,907

	2002		
($ thousand)	Cost	Accumulated Depletion and Depreciation	Net Book Value
Petroleum and natural gas properties and equipment	189,376	48,725	140,651
Office equipment	891	536	355
	190,267	49,261	141,006

At December 31, 2003, petroleum and natural gas properties and equipment include $14,498,000 (2002—$11,139,000) relating to undeveloped properties that have been excluded from the depletion calculation.

In 2003 the Company calculated its year-end ceiling test pertaining to the Canadian cost centre using the December monthly average field oil and liquids sale price of $35.79 per barrel and natural gas sales price of $6.01 per thousand cubic feet. The calculation pertaining to the US cost centre used the December monthly average field oil and liquids sale price of $34.67 per barrel and natural gas sales price of $5.21 per thousand cubic feet. No ceiling test write-down was required in either cost centre as a result of this test as at December 31, 2003. Additionally, had period end prices been used no ceiling test write-down would have been required.

5. BANK INDEBTEDNESS

The Company has a revolving demand credit facility that provides for a line of credit of $50,000,000 bearing interest at prime (December 31, 2003—4.5 percent; 2002—4.5 percent) and has pledged an assignment of accounts receivable, a first floating charge on all of the

Canadian assets and a fixed charge over certain property and equipment as collateral. The Company also has letters of credit outstanding in the amount of US $365,000 at December 31, 2003 (US $270,000 at December 31, 2002).

Through to June 2003 the Company also had a revolving demand credit facility in the United States for US $4,300,000 bearing interest at US prime plus 3/4 percent (December 31, 2002—5 percent) and had pledged a first floating charge on all of the US assets and a fixed charge over certain US property and equipment as collateral. As at December 31, 2002, bank indebtedness relating to US operations was $248,000 Cdn. This facility was cancelled during 2003.

6. 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 and second preferred shares.

COMMON SHARES

	2003		2002	
(thousand)	**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 year	**17,992**	**42,200**	17,637	40,997

On July 17, 2002 the Company issued 542,340 common shares as partial consideration for Hadrian Energy Corp. (note 3). The common shares issued were valued at $8.75 per share. Costs of $134,000 have been recorded net of tax of $57,000.

STOCK OPTIONS

The Company has a stock option plan available to employees and directors with grants under the Plan approved from time to time by the Board of Directors. Under the Plan, the Company is authorized to issue options to purchase, in aggregate, up to 10 percent of the issued and outstanding common shares. The options vest after one, two or three years and expire not more than five years from the date of grant. Each option can be exercised for one common share of the Company.

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.

The Company has reserved 1,476,000 shares at December 31, 2003 (December 31, 2002—1,431,000) for issuance under the stock option plan.

A summary of the status of the Company's stock option plan as at December 31, 2003 and 2002, and changes during the years ending on those dates is presented below:

	2003		2002	
	Shares (thousand)	**Weighted Average Exercise Price $**	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 year	**1,297**	**7.05**	1,215	5.10
Options exercisable at end of year	**985**	**6.25**	750	3.49

The following table summarizes information about stock options outstanding at December 31, 2003:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices $	Number Outstanding at 12/31/03 (thousand)	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price $	Number Exercisable at 12/31/03 (thousand)	Weighted Average Exercise Price $
2.60	175	0.3 years	2.60	175	2.60
4.05 to 5.40	260	2.2 years	4.80	260	4.80
7.20 to 7.45	342	3.0 years	7.43	342	7.43
8.28 to 9.05	83	3.2 years	8.96	77	8.95
9.30 to 11.74	437	4.1 years	9.51	131	9.33
	1,297		7.05	985	6.25

STOCK-BASED COMPENSATION

As discussed in note 2, the Company continues to disclose the pro forma effect of stock-based compensation on net earnings and earnings per basic and diluted common share. For purposes of these pro forma disclosures, 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. 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 $215,000 for the year ended December 31, 2003 and by $654,000 for the year ended December 31, 2002. The 2002 stock option grants were allocated over a vesting period of one year while the 2003 grants vest over three years. Basic and diluted earnings per share figures would have been reduced by $0.01 and $0.01, respectively, for 2003 and by $0.04 and $0.04, respectively, for 2002.

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.

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.

7. INCOME TAXES

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

($ thousand)	**2003**	2002
Statutory income tax rate	**41.58%**	42.61%
Computed income taxes	**14,225**	7,501
Add (deduct) income tax effect of:		
Non-deductible Crown charges, net of Alberta Royalty Tax Credit	**3,856**	2,884
Resource allowance	**(4,724)**	(3,467)
Rate adjustment	**(4,314)**	(162)
Large corporation and capital taxes	**406**	378
Other	**235**	(208)
	9,684	6,926

As at December 31, 2003, the Company has exploration and development costs, unamortized petroleum and natural gas property expenditures, undepreciated capital costs, unamortized share issue costs and non-capital loss carry forwards available for deduction against future taxable earnings in aggregate of approximately $78,780,000 (December 31, 2002—$86,893,000).

Future income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The components of the Company's net future income tax liability are as follows:

($ thousand)	**2003**	2002
Net book value of property and equipment in excess of tax pools	**19,501**	16,982
Deferred partnership earnings*	**13,637**	9,816
Future site restoration	**(2,144)**	(1,529)
Non-capital loss carry forwards expiring by 2008	**(395)**	(4,062)
Share issue costs	**(240)**	(242)
Provincial rebate	**(159)**	(43)
	30,200	20,922

** The Company's current organizational structure includes a partnership arrangement, which by its nature defers taxable earnings to a future taxation year.*

8. WEIGHTED AVERAGE NUMBER OF COMMON SHARES

(thousand)	**2003**	2002
Weighted average number of common shares outstanding during the year	**17,824**	17,233
Diluted weighted average number of common shares outstanding during the year	**18,373**	17,795

Shares of 549,042 (2002—561,999) were added to the weighted average number of common shares outstanding during the year in the calculation of diluted per common share amounts. These share additions represent the dilutive effect of stock options according to the treasury stock method. Adjustments to the numerator amounts were not required in such calculations.

9. FINANCIAL INSTRUMENTS

FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES

Financial instruments of the Company consist of accounts receivable, accounts payable, and bank indebtedness. As at December 31, 2003 and 2002, there are no significant differences between the carrying values of these amounts and their estimated market values.

CREDIT RISK MANAGEMENT

Accounts receivable include amounts receivable for petroleum and natural gas sales that are generally made to large credit-worthy purchasers, and amounts receivable from joint venture partners that are recoverable from production. Accordingly, the Company views credit risks on these amounts as low.

The Company is exposed to losses in the event of non-performance by counterparties to hedge transactions.The Company minimizes credit risk associated with possible non-performance to these financial instruments by entering into contracts with only highly rated counterparties, limits on exposures to any one counterparty, and monitoring procedures. The Company believes these risks are minimal.

INTEREST RATE RISK MANAGEMENT

Borrowings under bank credit facilities are for short periods and are market-rate-based (variable interest rates); thus carrying values approximate fair values.

FOREIGN CURRENCY RISK MANAGEMENT

The Company is exposed to fluctuations in the exchange rate between the Canadian dollar and the US dollar. Crude oil and to a large extent natural gas prices are based upon reference prices denominated in US dollars, while the majority of the Company's expenses are denominated in Canadian dollars. When appropriate, the Company enters into agreements to fix the exchange rate of Canadian dollars to US dollars in order to manage the risk (see table below).

COMMODITY PRICE RISK MANAGEMENT

The Company enters into hedge transactions on oil and natural gas. The agreements entered into are forward transactions providing the Company with a range of fixed prices on the commodities sold.

The Company has outstanding contracts at December 31, 2003 and 2002 as follows:

At December 31, 2003

	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 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
Natural gas put	273,000 gj	3,000 gj/d	$5.00/gj	Jan. 1/04–Mar. 31/04

At December 31, 2002

	Volume	Rate	Price	Range of Terms
Oil swaps	36,800 bbl	200 bbl/d	$24.80 US/bbl	Jul. 1/03–Dec. 31/03
	36,200 bbl	200 bbl/d	$23.60 US/bbl	Jan. 1/03–Jun. 30/03
	146,000 bbl	400 bbl/d	$23.98 US/bbl	Jan. 1/03–Dec. 31/03
Natural gas swaps	360,000 gj	4,000 gj/d	$3.85/gj	Jan. 1/03–Mar. 31/03
	428,000 gj	2,000 gj/d	$4.85/gj	Apr. 1/03–Oct. 31/03
Natural gas collars	360,000 gj	4,000 gj/d	$3.85/gj Put $8.05/gj Call	Jan. 1/03–Mar. 31/03
	428,000 gj	2,000 gj/d	$4.00/gj Put $6.10/gj Call	Apr. 1/03–Oct. 31/03
Currency collar	$1,000,000 Cdn	–	$1.56 Put $1.62 Call	Jan. 1/03–Dec. 31/03

At December 31, 2003, the cost to settle the above contracts would have been $894,000, and as at December 31, 2002, the cost to settle the above contracts would have been $2,867,000. These instruments have no book values recorded in the consolidated financial statements.

10. COMMITMENTS

The Company is committed to future minimum payments for natural gas transportation contracts in addition to operating leases for office space, office equipment, vehicles and field equipment. Payments required under these commitments for each of the next four years are: 2004—$1,940,000; 2005—$1,032,000; 2006—$623,000; 2007—$365,000; and thereafter $38,000.

11. CONTINGENCIES

The Company indemnifies its directors and officers against any and all claims or losses reasonably incurred in the performance of their service to the Company to the extent permitted by law. The Company has acquired and maintains liability insurance for its directors and officers. The Company is party to various legal claims associated with the ordinary conduct of business. The Company does not anticipate that these claims will have a material impact on the Company's financial position.

12. SUPPLEMENTAL CASH FLOW INFORMATION

($ thousand)	**2003**	2002
Cash interest paid	**714**	1,150
Cash taxes paid	**360**	378

13. 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.

		2003	
($ thousand)	**Canada**	**United States**	**Combined**
Petroleum and natural gas revenue	**90,034**	**11,623**	**101,657**
Property and equipment	**139,900**	**22,007**	**161,907**
Total assets	**152,061**	**23,009**	**175,070**
Net capital expenditures	**33,373**	**6,536**	**39,909**

		2002	
($ thousand)	Canada	United States	Combined
Petroleum and natural gas revenue	58,360	7,178	65,538
Property and equipment	123,761	17,245	141,006
Total assets*	135,570	18,090	153,660
Net capital expenditures**	33,603	1,945	35,548

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

*** Includes property from corporate acquisition.*

14. COMPARATIVE FIGURES

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