

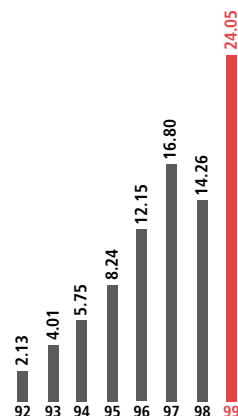
MANAGEMENT'S DISCUSSION AND ANALYSIS

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.

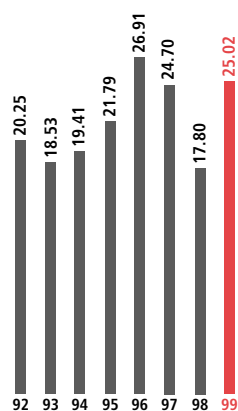
Crude Oil Pricing

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.

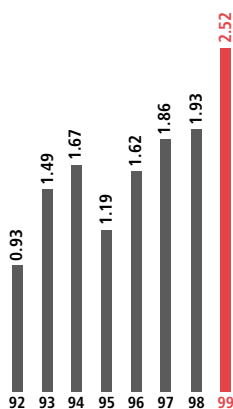
Natural Gas Pricing

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

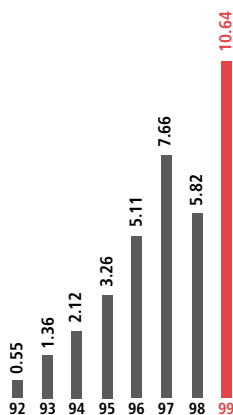
Zargon's 1999 interest expense increased 55 percent to \$0.59 million from \$0.38 million in 1998. The Company's 1999 effective interest rates were 6.0 percent on an average loan of \$9.80 million compared to a 6.3 percent effective interest rate on an average loan of \$6.00 million in 1998.

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

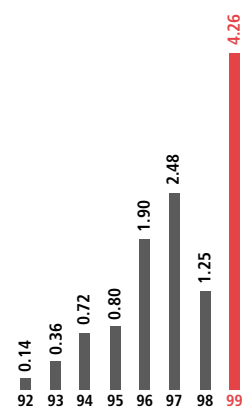
Zargon's 1999 pre-tax return on shareholder's equity climbed to 17.2 percent from 6.5 percent in the previous year. The 1999 after-tax rate of return was 13.8 percent. After-tax rates of return on equity have averaged 10.4 and 10.3 percent over the prior three and seven year periods, respectively.

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.

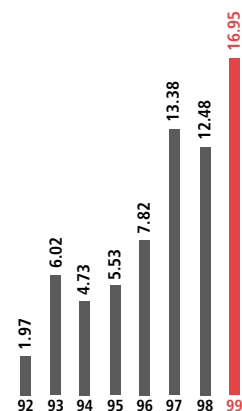
Earnings
(\$ million)



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.