

## CORPORATE HIGHLIGHTS

Three months ended March 31 (unaudited)	2000	1999	Percent Change
<b>FINANCIAL</b>			
<b>Income and Investments (\$ million)</b>			
Production revenue	9.13	4.28	113
Cash flow from operations	4.36	1.64	166
Earnings	1.77	0.30	490
Net capital expenditures	7.72	3.37	129
<b>Balance Sheet at Period End (\$ million)</b>			
Property and equipment	57.05	40.48	41
Long-term debt	19.30	8.45	128
Shareholders' equity	33.37	29.62	13
<b>Per Common Share, Fully Diluted</b>			
Cash flow from operations (\$/share)	0.29	0.11	164
Earnings (\$/share)	0.12	0.02	500
<b>Shares Outstanding at Period End (million)</b>			
Basic	14.28	14.81	(4)
Fully diluted	15.73	16.29	(3)
<b>OPERATING</b>			
<b>Average Daily Production</b>			
Crude oil and liquids (bbl/d)	1,750	1,719	2
Natural gas (mmcf/d)	12.56	8.72	44
Equivalents (boe/d)	3,006	2,591	16
<b>Average Selling Price</b>			
Crude oil and liquids (\$/bbl)	37.09	17.16	116
Natural gas (\$/mcf)	2.82	2.07	36
Equivalents (\$/boe)	33.37	18.36	82
Equivalents, after hedges (\$/boe)	31.95	18.32	74
<b>Wells Drilled, Net</b>	<b>7.7</b>	<b>3.7</b>	<b>108</b>
<b>Undeveloped Land (thousand net acres)</b>	<b>174</b>	<b>129</b>	<b>35</b>

Note: 10 mcf is equivalent to 1 bbl

## REPORT TO SHAREHOLDERS

FIRST QUARTER 2000 WAS AN OUTSTANDING QUARTER FOR ZARGON WITH ALL OPERATING AND FINANCIAL RESULTS REACHING NEW HISTORICAL LEVELS. COMPARED TO FIRST QUARTER 1999:

- revenue increased by 113 percent;
- cash flow increased by 166 percent;
- earnings increased by 490 percent;
- capital expenditures increased by 129 percent;
- gas production increased by 44 percent; and,
- annualized after tax return on book equity increased to 21.5 percent.

The quarter was distinguished by a record production rate of 3,006 barrels of equivalents per day and a record \$7.72 million capital program that was evenly allocated between Zargon's two core competencies of exploring and developing gas reserves and buying and exploiting oil reserves.

### PRODUCTION

Zargon's average production increased to 3,006 barrels of oil equivalent per day in first quarter 2000, representing a 16 percent improvement over the 1999 first quarter rate of 2,591 barrels of oil equivalent per day and an 11 percent gain over the fourth quarter 1999 rate of 2,715 barrels of oil equivalent per day. Production gains were almost entirely related to higher gas volumes that averaged 12.56 million cubic feet per day. This first quarter 2000 rate represented 44 and 22 percent increases over the 8.72 million cubic feet per day and 10.30 million cubic feet per day recorded in the prior year's first and fourth quarters, respectively. The increased gas production was primarily the result of Zargon's successful drilling programs and facility optimizations at our East Central Alberta Jarrow gas properties. Oil production in first quarter 2000 averaged 1,750 barrels of oil per day, a gain of two percent from 1,719 barrels of oil per day in first quarter 1999 and a four percent gain over the fourth quarter 1999 rate of 1,685 barrels of oil per day.

INTERIM REPORT

FOR THE THREE MONTHS

ENDED MARCH 31, 2000



## FINANCIAL

Reflecting sharply higher commodity prices and improved production rates, Zargon's first quarter 2000 revenue jumped 113 percent over the prior year's first quarter revenue to \$9.13 million. During the period, Zargon's average oil and liquids price was \$37.09 per barrel of oil, a 116 percent improvement over the corresponding 1999 price of \$17.16 per barrel of oil. Field gas prices rose 36 percent to \$2.82 per thousand cubic feet in 2000 up from \$2.07 per thousand cubic feet in 1999. Including adjustments for hedging activities, Zargon's first quarter 2000 average price on an equivalents basis increased 74 percent to \$31.95 per barrel of oil equivalent from the \$18.32 per barrel of oil equivalent recorded in first quarter 1999.

Cash flow climbed to \$4.36 million in first quarter 2000, up 166 percent from the \$1.64 million reported in 1999. On an equivalent unit basis, Zargon's cash flow netback averaged \$15.92 per barrel of oil equivalent, or 126 percent higher than last year's first quarter netback of \$7.02 per barrel of oil equivalent. Sharply higher earnings of \$1.77 million were also recorded in first quarter 2000. Year over year comparisons show a 490 percent improvement over last year's first quarter earnings of \$0.30 million. On an equivalent unit basis, earnings were \$6.47 per barrel of oil equivalent or 41 percent of cash flow. Zargon's after tax annualized return on book equity in the first quarter 2000 was a very strong 21.5 percent.

Comparisons on a per share basis were also very strong. Cash flow per fully diluted share increased 164 percent from the prior year to \$0.29 per share up from \$0.11 per share in 1999, while earnings increased 500 percent to \$0.12 per share.

The first quarter 2000 was the most active quarter in Zargon's history. Zargon's capital expenditures totaled \$7.72 million, a 129 percent increase over the prior year. These expenditures included \$3.60 million spent on our gas (explore and develop) business strategy, with the remainder allocated to our oil (buy and exploit) programs. Zargon's 2000 capital budget is currently set at \$20 million, but will be expanded if and when value-added opportunities become available. The capital budget will be funded from cash flow and Zargon's \$30 million bank line, of which \$19.30 million was drawn as of March 31, 2000. Zargon's quarter end debt, after adjusting for a \$1.25 million working capital surplus, represents less than 1.1 years of the first quarter 2000 annualized cash flow.

In accordance with the June 22, 1999 normal course issuer bid, Zargon repurchased and cancelled 0.14 million shares in the first quarter 2000 at an average price of \$3.01 per share. At the end of the first quarter, the cumulative number of shares repurchased and cancelled through the issuer bid totaled 0.53 million shares at an average cost of \$2.79 per share. At May 4, 2000, Zargon has 15.71 million fully diluted shares of which 14.36 million shares are issued and outstanding.

Effective January 1, 2000, Zargon retroactively adopted the new Canadian Institute of Chartered Accountants (CICA) accounting recommendations for future income taxes which uses the liability method instead of the deferral method for tax accounting. This change in accounting policy was applied retroactively without restatement of prior periods and is a one-time, non-cash event. The retroactive adjustment resulted in a \$0.51 million charge to retained earnings, an increase of \$0.30 million in the net book value of the petroleum and natural gas properties, and an increase of \$0.81 million in the balance sheet liability for future income taxes.

## ACQUISITIONS

First quarter 2000 net property acquisitions of \$4.13 million were focused on expanding oil exploitation opportunities in Southeast Saskatchewan and at Taber, Alberta. Over \$2.60 million of the property acquisitions were at Workman, Southeast Saskatchewan where significant water flood opportunities have been identified. Additional exploitable oil interests were also acquired in Taber, Alberta.

Zargon continued to expand its Jarrow acreage with the addition of 11,100 net acres in the first quarter 2000. At quarter end, Zargon's undeveloped land inventory totaled 173,600 net acres, up 35 percent from 129,100 net acres at March 31, 1999.

## DEVELOPMENT AND EXPLORATION

Zargon drilled a record 10 wells (7.7 net) in the first quarter 2000 resulting in seven (4.7 net) gas wells in Alberta, one net development oil well at Weyburn, Saskatchewan, and two (2.0 net) dry holes. The gas wells were drilled at Jarrow in East Central Alberta and at Pembina in West Central Alberta.

## Jarrow, Alberta

During the quarter, significant gas production gains were again recorded at Zargon's most important gas property, Jarrow, Alberta. In December 1999 Zargon completed a facility optimization and expansion program that interconnected three gas compressor stations permitting Zargon to access previously unused capacity. As a result Zargon's net gas production increased in first quarter 2000 to 6.6 million cubic feet per day up from the calendar 1999 average rate of 4.3 million cubic feet per day. Based on the successful winter 1999-2000 drilling program, Zargon has developed more than 3.0 million cubic feet per day of incremental net gas production capability that is currently shut-in due to compressor capacity constraints. By the end of the second quarter 2000, Zargon will complete the necessary pipelining and compressor additions required to place this incremental production on-stream bringing Zargon's total net production from the Jarrow property to 10 million cubic feet per day.

In the first three months of 2000, Zargon drilled eight (6.2 net) wells at Jarrow resulting in 4.2 net gas wells and 2.0 net abandonments. An additional ten net wells are planned for the remainder of 2000, which will be high-graded from the inventory of 35 drilling locations currently identified on Zargon lands. During the next 18 months, Zargon will continue to explore and develop its 69,500 net acres of undeveloped land at Jarrow using 2D seismic programs, further Crown land acquisitions, aggressive drilling programs and facility expansions as required.

## Southeast Saskatchewan

During the first quarter 2000, Zargon acquired \$2.83 million of properties in five transactions relating to two water flood projects located at Workman and Weyburn in Southeast Saskatchewan. Zargon also drilled one net oil well during the quarter at Weyburn. Each of these activities is consistent with the Company's "buy and exploit" component of our strategy which focuses on obtaining increased oil recoveries from large oil-in-place properties. Zargon is currently working ten water flood projects in Southeast Saskatchewan, many of which are in the early stages of development. Over the next three quarters, the Company plans to continue acquiring additional exploitable oil properties in conjunction with ongoing implementation and enhancement of water flood projects in Southeast Saskatchewan. These activities provide a reliable, non-declining production base to support more rapid production growth in other areas.

## Other Properties

In West Central Alberta, Zargon drilled one (0.5 net) gas well at Pembina, Alberta in the first quarter 2000. The tie-in of this well, along with two (1.0 net) other shallow Pembina gas wells drilled in December 1999, should increase Zargon's total production at this property to over one million cubic feet per day. Additional gas tests are planned at the Pembina property later this year.

Also in the first quarter, Zargon completed a \$1.30 million acquisition of additional interests in a medium gravity oil exploitation property at Taber, Alberta. Subsequent to the acquisition and interpretation of 3D seismic data, development drilling is scheduled to commence at Taber in the second half of this year.

Other drilling activities planned for the second quarter include two exploration gas locations at Spirit River in Northwest Alberta and one exploration gas target at Hamilton Lake in East Central Alberta.

## OUTLOOK

Zargon's outlook for the remainder of 2000 is positive. Our increased size and expanded technical depth has provided a strong balance of exploration and exploitation skills. Combining these new and old strengths with an expanded undeveloped land base and a strong balance sheet dramatically broadens Zargon's strategic options. The combination of record commodity prices and Zargon's increased project inventory should provide substantial and profitable growth over the foreseeable future.



C.H. Hansen  
President & Chief Executive Officer



J.O. McCutcheon  
Chairman

Calgary, Alberta  
May 4, 2000



## STATEMENTS OF CASH FLOW

### Three months ended March 31 (unaudited)

(\$ thousand, except for per share amounts)

	<b>2000</b>	1999
<b>Operating Activities</b>		
Net income for the period	1,770	302
Add non-cash items:		
Depreciation and depletion	1,357	1,084
Site restoration	169	144
Future income taxes	1,059	107
Cash flow from operations	4,355	1,637
Changes in non-cash working capital	(25)	(546)
	<b>4,330</b>	<b>1,091</b>
<b>Financing Activities</b>		
Long-term debt	5,184	2,271
Repurchase of common shares	(419)	–
	<b>4,765</b>	<b>2,271</b>
<b>Investing Activities</b>		
Acquisition of property and equipment	(7,793)	(3,372)
Disposal of property and equipment	65	–
Site restoration expenditures	–	(17)
Changes in non-cash working capital	(1,377)	(15)
	<b>(9,105)</b>	<b>(3,404)</b>
Decrease in Cash	10	(42)
Cash, Beginning of Period	116	194
Cash, End of Period	<b>106</b>	<b>152</b>
<b>Cash Flow from Operations Per Share</b>		
Basic	0.30	0.11
Fully diluted	0.29	0.11
<b>Weighted Average Number of Shares (million)</b>		
Basic	14.37	14.81
Fully diluted	15.82	16.08

## CORPORATE INFORMATION

### BOARD OF DIRECTORS

Craig H. Hansen  
 K. James Harrison  
 H. Earl Joudrie  
 John O. McCutcheon  
 James D. Peplinski  
 William L. Rudkin  
 Byron J. Seaman  
 William J. Whelan

### OFFICERS

John O. McCutcheon  
 Chairman  
 Craig H. Hansen  
 President & Chief Executive  
 Officer  
 Mark I. Lake  
 Vice President, Exploration  
 Daniel A. Roulston  
 Vice President, Operations  
 Sheila A. Wares  
 Controller  
 Kenneth W. Young  
 Vice President, Land

### KEY PERSONNEL

J. Yves Gauthier  
 Manager, Exploitation  
 John D. Sorkilmo  
 Senior Geologist  
 Neil D. Watson  
 Senior Geologist

### STOCK EXCHANGE LISTING

The Toronto Stock Exchange  
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