

2001 FIRST QUARTER REPORT

Zargon Oil & Gas Ltd. delivered record performance for first quarter 2001. The combination of strong gains in production with high natural gas prices brought all operating and financial results to new historical levels.

CORPORATE HIGHLIGHTS

As set out in the following table, year over year comparisons for the 2001 first quarter results show outstanding growth:

- natural gas production increased by 45 percent
- oil and liquids production increased by 10 percent
- revenue increased by 130 percent;
- cash flow increased by 143 percent;
- earnings increased by 198 percent;
- net capital expenditures increased by 7 percent;
- annualized after tax return on book equity increased to 47 percent.

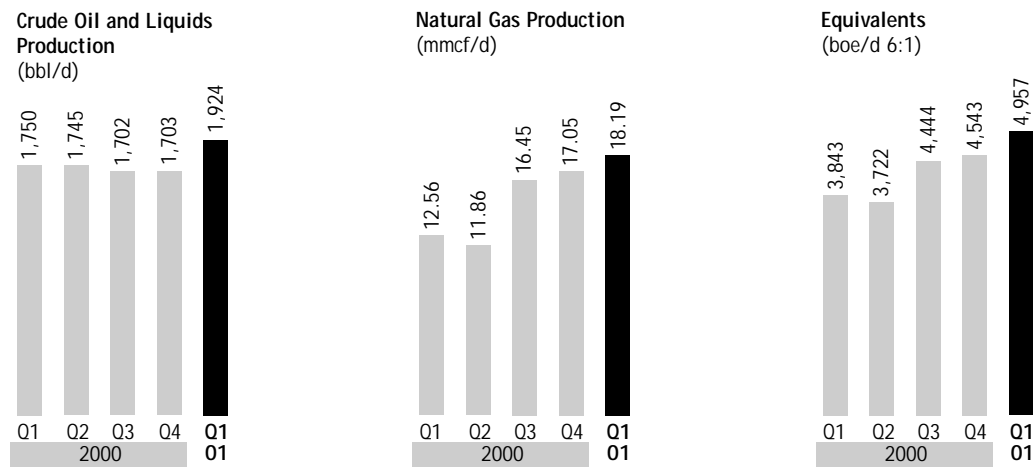
Financial comparisons on a per share basis show equally strong growth. Cash flow of \$0.71 per diluted share in first quarter 2001 increased 145 percent from the prior year period and earnings of \$0.36 per diluted share were 200 percent better than the prior year's comparative period.

During the quarter, Zargon concluded its largest drilling program ever, drilling 19.6 net wells. Despite investing \$8.23 million of capital focused on field programs, Zargon's balance sheet continued to strengthen in the quarter with long term debt declining to \$10.09 million.

Three months ended March 31 (unaudited)	2001	2000	Change
FINANCIAL			
Income and Investments (\$ million)			
Production revenue	21.04	9.13	130
Cash flow from operations	10.61	4.36	143
Earnings	5.28	1.77	198
Net capital expenditures	8.23	7.73	7
Balance Sheet at Period End (\$ million)			
Property and equipment	80.42	57.05	41
Long-term debt	10.09	19.30	(48)
Shareholders' equity	48.03	33.37	44
Per Common Share, Diluted			
Cash flow from operations (\$/share)	0.71	0.29	145
Earnings (\$/share)	0.36	0.12	200
Shares Outstanding at Period End (\$ million)			
Basic	14.45	14.28	1
Fully diluted	15.84	15.73	1
OPERATING			
Average Daily Production			
Crude oil and liquids (bbl/d)	1,924	1,750	10
Natural gas (mmcf/d)	18.19	12.56	45
Equivalentents (boe/d 6:1)	4,957	3,843	29
Equivalentents (boe/d 10:1)	3,743	3,006	25
Average Selling Price			
Crude oil and liquids (\$/bbl)	37.12	37.09	0
Natural gas (\$/mcf)	8.92	2.82	216
Wells Drilled, Net	19.6	7.7	155
Undeveloped Land (thousand net acres)	212	174	22

PRODUCTION

Production of natural gas continued to climb in the first quarter of 2001, as new wells from the Jarrow, Alberta winter drilling program were tied-in. Production averaged 18.19 mmcf/d during the period, which represented a 45 percent gain over the 12.56 mmcf/d reported in the 2000 first quarter and a seven percent improvement over the fourth quarter 2000 rate of 17.04 mmcf/d. Additional Jarrow natural gas production gains are anticipated in both the second and third quarters of 2001. After a year of stable production rates, oil and liquids production resumed growth in first quarter 2001 reaching a new high of 1,924 bbl/d, ten percent above the prior year's first quarter rate and thirteen percent higher than the preceding quarter production rate. Successful development drilling at our Frys and Weyburn properties in Southeast Saskatchewan and at our Taber property in Southern Alberta contributed to the increase. Further drilling planned for these properties throughout the remainder of the year should provide additional production gains in the second half of 2001. On an equivalent basis, production in first quarter 2001 climbed nine percent over the prior fourth quarter rate.



EXPLORATION AND EXPLOITATION

The record pace of field activities established in 2000 continued to grow in first quarter 2001. During the quarter, Zargon drilled a new high of 19.6 net wells (22 gross) representing a 155 percent increase over the prior year's total. The drilling program included 14.9 net exploratory locations and yielded 9.2 net gas wells, 5.5 net oil wells and 4.9 net dry holes for a 75 percent success ratio.

Zargon experienced significant drilling success in the quarter in all of its core areas. In East Central Alberta, Zargon drilled 13 gross (11.1 net) wells, with all but three wells located at Jarrow, Alberta. The program, which emphasized exploration targets on expiring option lands, resulted in 6.2 net gas wells that are currently being tied into area gas gathering facilities. Production from the East Central Alberta core area climbed to 16.25 million cubic feet per day and 368 barrels of oil per day in the first quarter and is expected to grow throughout the remainder of the year with further gas drilling and tie-ins. Currently, Zargon has a two-year drilling inventory of more than 35 net exploration and development gas locations at our 115,000 net acre Jarrow property. In West Central Alberta three net shallow gas wells were drilled at Pembina.

In our Southeast Saskatchewan core area, 1.5 net development horizontal wells and 1 net exploration oil well were drilled, which brought the core area's production rate to 1,087 barrels of oil per day. Further production growth is expected later this year as Zargon continues to develop the area's seismic and reservoir engineering related exploitation opportunities. At Taber, Alberta, Zargon drilled 3.0 net oil wells and acquired an outstanding minority interest in our property for \$1.00 million, which augments the \$1.95 million acquisition made for another minority interest late last year. Consequently, quarter over quarter production at the property increased 75 percent to 326 barrels per day. Zargon plans an active exploration and development drilling program for Taber this year, and further substantial production gains are anticipated.

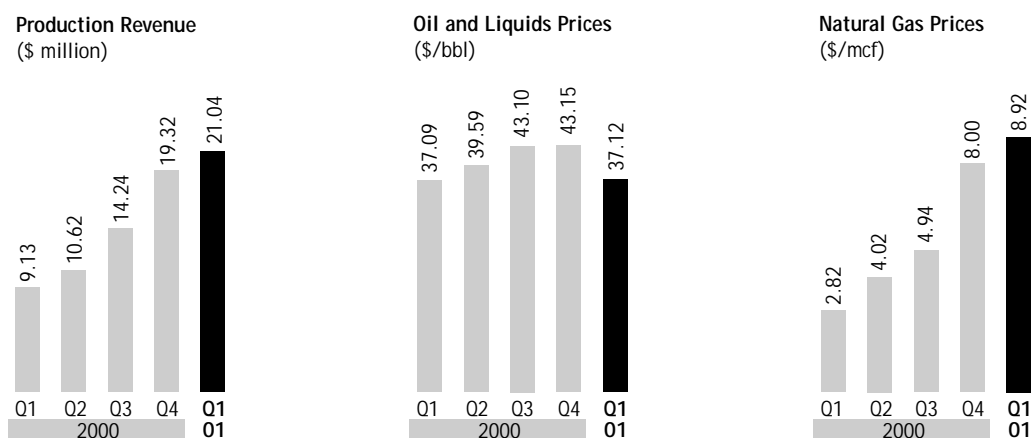
During the quarter, a total of \$1.25 million of oil exploitation property acquisitions were more than offset by \$2.00 million of non-strategic non-operated gas property dispositions. Undeveloped land acquisitions of \$0.88 million were made in the quarter primarily at Weyburn, Saskatchewan and Jarrow, Alberta. Geological and geophysical costs were \$0.69 million and the remaining \$7.41 million of capital expenditures were invested on drilling, completions and facilities.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Management's discussion and analysis (MD&A) should be read in conjunction with the unaudited interim financial statements for the three months ended March 31, 2001 and the audited financial statements and MD&A for the year ended December 31, 2000.

FINANCIAL ANALYSIS

Higher production rates combined with very strong natural gas prices pushed Zargon's revenue to \$21.04 million, a 130 percent gain over the prior year's levels. In the quarter, Zargon's field gas price averaged \$8.92 per thousand cubic feet (\$8.39 after hedges), a remarkable 216 percent increase over the prior year's first quarter price of \$2.82 per thousand cubic feet, and a 12 percent increase over the fourth quarter 2000 price of \$8.00 per thousand cubic feet. Zargon's first quarter 2001 oil and liquid price of \$37.12 per barrel (\$36.19 per barrel after hedges) was essentially unchanged from the prior year's first quarter price of \$37.09 per barrel, but was fourteen percent lower than the preceding fourth quarter 2000 price of \$43.15 per barrel.



Royalties, inclusive of Alberta royalty tax credit and Saskatchewan resource surcharge, were \$4.48 million in the first quarter of 2001, up 139 percent from \$1.89 million in 2000. This large increase related primarily to the large increase in revenues. As a percentage of gross revenue, first quarter 2001 royalties were 21.3 percent of revenue, up only slightly from the 20.5 percent reported in first quarter 2000.

Operating costs to March 31, 2001 were \$2.48 million, a 41 percent increase from \$1.76 million reported for the same period in 2000. Production expenses for natural gas decreased slightly to \$0.62 per thousand cubic feet from \$0.64 per thousand cubic feet in first quarter of 2000.

Production expenses for crude oil of \$8.44 per barrel were 14 percent higher than the prior year's costs of \$7.40 per barrel. Higher cost pressures relating to third party services including electrical power were an important component of the increase.

Operating Netbacks

Three months ended March 31	2001		2000	
	Oil and Liquids	Natural Gas	Oil and Liquids	Natural Gas
	\$/bbl	\$/mcf	\$/bbl	\$/mcf
Revenue	37.12	8.92	37.09	2.82
Hedging	(0.93)	(0.53)	(2.27)	(0.02)
Royalties	(7.34)	(1.96)	(7.63)	(0.40)
Operating costs	(8.44)	(0.62)	(7.40)	(0.64)
Operating netbacks	20.41	5.81	19.79	1.76

General and administrative expenses were \$0.71 million or \$1.60 per boe (6:1) in 2001 compared to \$0.48 million or \$1.38 per boe (6:1) in the first quarter of 2000. The increased costs reflect increased salaries and 2000 year end bonuses paid in 2001.

Reflecting lower interest rates and debt levels, interest expense of \$0.24 million in the quarter declined three percent from \$0.25 million in the 2000 first quarter.

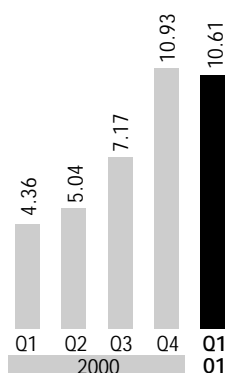
Corporate Netbacks

Three months ended March 31	2001		2000	
	(\$/boe)		(\$/boe)	
	(10:1)	(6:1)	(10:1)	(6:1)
Revenue	62.43	47.16	33.38	26.10
Hedging	(3.03)	(2.29)	(1.42)	(1.11)
Royalties	(13.28)	(10.03)	(6.84)	(5.35)
Operating costs	(7.37)	(5.56)	(6.44)	(5.03)
Operating netbacks	38.75	29.28	18.68	14.61
General and administration	(2.11)	(1.60)	(1.76)	(1.38)
Financing charges	(0.71)	(0.54)	(0.91)	(0.71)
Capital and current income taxes	(4.45)	(3.36)	(0.09)	(0.07)
Cash flow netbacks	31.48	23.78	15.92	12.45
Depletion and depreciation	(6.56)	(4.96)	(4.96)	(3.88)
Site restoration and reclamation	(0.62)	(0.47)	(0.62)	(0.48)
Future income taxes	(8.62)	(6.51)	(3.87)	(3.03)
Net earnings	15.68	11.84	6.47	5.06

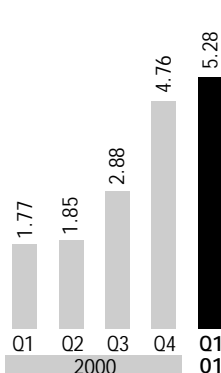
Depletion and depreciation expense for the first quarter was \$2.21 million, compared with \$1.36 million in the first quarter of 2000. The higher charges reflect increased production volumes and higher per unit charges relating to both Zargon's and the industry's current trend towards higher finding and development costs.

Zargon's first quarter 2001 cash flow of \$10.61 million represented a 143 percent increase over the same three month period in 2000, but was three percent lower than the fourth quarter 2000 cash flow, due to increases in current taxes offsetting the impact of production increases. During the quarter, Zargon accrued cash tax expenses at a rate of fifteen percent of before tax cash flow. Zargon's first quarter 2001 earnings of \$5.28 million almost tripled the earnings reported in the prior year's comparative quarter and improved eleven percent over the preceding fourth quarter 2000. Zargon's after tax annualized return on book equity in the current three month reporting period was a very strong 47 percent.

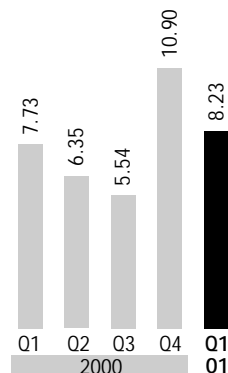
Cash Flow from Operations
(\$ million)



Net Earnings
(\$ million)



Net Capital Expenditures
(\$ million)



Capital Expenditures

Three months ended March 31 (\$ million)	2001	2000
Undeveloped land	0.88	0.41
Geological and geophysical (seismic)	0.69	0.43
Drilling and completion of wells	6.78	2.44
Well equipment and facilities	0.63	0.32
Exploration and development	8.98	3.60
Property acquisitions	1.25	4.78
Property dispositions	(2.00)	(0.65)
Net property acquisitions	(0.75)	4.13
Total capital expenditures (net)	8.23	7.73

LIQUIDITY AND CAPITAL RESOURCES

During the quarter, Zargon's active \$8.23 million capital expenditure program was more than funded by cash flows from operations. At March 31, 2001, Zargon's balance sheet remains very strong with the long term debt plus working capital deficiency amounting to \$15.81 million, which equals less than a five month multiple of the first quarter 2001 annualized cash flow. The corporation's increasing financial strength supports a high level of field activity while retaining the flexibility to deal with sizeable opportunity-driven acquisitions.

As at May 18, 2001, there were 14,524,000 common shares and stock options to acquire an aggregate of 1,321,000 shares outstanding.

Capital Sources

Three months ended March 31 (\$ million)	2001	2000
Cash flow from operations	10.61	4.36
Changes in working capital	3.11	(1.39)
Bank debt	(5.81)	5.18
Issuance (buyback) of common shares	0.32	(0.42)
Total capital sources	8.23	7.73

OUTLOOK

The outlook for Zargon remains very positive. For calendar 2001, Zargon has budgeted \$35 million of capital expenditures allocated primarily to promising gas exploitation and exploration opportunities and the acquisition and exploitation of long life oil properties. Strong cash flows and low debt levels will permit Zargon to aggressively pursue oil exploitation opportunities with an expanded capital budget where acceptable values are realizable. However, during this period of high levels of industry activity and related high costs, capital spending discipline and cost control will remain priorities as we work to build shareholder value.

Quarter	Earnings ⁽¹⁾	Earnings/ Share ⁽²⁾	Cash Flow ⁽¹⁾	Cash Flow/ Share ⁽²⁾	Revenue ⁽¹⁾	Capital Expenditures ⁽¹⁾
2001 Q1	\$5.28	\$0.36	\$10.61	\$0.71	\$21.04	\$8.23
2000 Q4	\$4.76	\$0.31	\$10.93	\$0.70	\$19.32	\$10.90
2000 Q3	\$2.88	\$0.18	\$7.17	\$0.46	\$14.24	\$5.54
2000 Q2	\$1.85	\$0.12	\$5.04	\$0.32	\$10.62	\$6.35
2000 Q1	\$1.77	\$0.12	\$4.36	\$0.29	\$9.13	\$7.73

(1) Millions of Dollars (2) Diluted Shares

BALANCE SHEETS

(\$ thousand)	March 31, 2001	December 31, 2000
	(unaudited)	
ASSETS		
Current		
Cash	152	159
Accounts receivable	9,708	11,483
Prepaid expenses and deposits	634	848
	10,494	12,490
Property and equipment, net	80,418	74,394
	90,912	86,884
LIABILITIES		
Current		
Accounts payable and accrued liabilities	16,215	15,003
Long term debt	10,093	15,902
Future site restoration	1,814	1,606
Future tax liability	14,756	11,851
	42,878	44,362
SHAREHOLDERS' EQUITY		
Share capital	20,945	20,667
Retained earnings	27,089	21,855
	48,034	42,522
	90,912	86,884

See selected notes to financial statements.

STATEMENTS OF INCOME AND RETAINED EARNINGS

Three months ended March 31 (unaudited)
(\$ thousand except for per share amounts)

	2001	2000
Income		
Oil and gas sales	21,035	9,129
Hedging	(1,022)	(389)
Royalties	(4,475)	(1,870)
	15,538	6,870
Expenses		
Production	2,482	1,761
Administration	712	481
Interest on long-term debt	241	248
Site restoration	209	169
Depreciation and depletion	2,211	1,357
	5,855	4,016
Income Before Income Taxes	9,683	2,854
Income Taxes		
Future	2,905	1,059
Current	1,498	25
	4,403	1,084
Net Income for the Period	5,280	1,770
Retained Earnings, Beginning of Period	21,855	11,781
Adjustment to Future Income Taxes	–	(506)
Repurchase of Common Shares	(46)	(209)
Retained Earnings, End of Period	27,089	12,836
Earnings Per Common Share		
Basic	0.37	0.12
Diluted	0.36	0.12

See selected notes to financial statements.

STATEMENTS OF CASH FLOWS

Three months ended March 31 (unaudited)
(\$ thousand except for per share amounts)

	2001	2000
Operating Activities		
Net income for the period	5,280	1,770
Add non-cash items:		
Depreciation and depletion	2,211	1,357
Site restoration	209	169
Future income taxes	2,905	1,059
Cash flow from operations	10,605	4,355
Changes in non-cash working capital	2,315	(25)
	12,920	4,330
Financing Activities		
Long term debt	(5,809)	5,184
Issuance of common shares	357	–
Repurchase of common shares	(34)	(419)
	(5,486)	4,765
Investing Activities		
Acquisition of property and equipment	(10,236)	(7,793)
Disposal of property and equipment	2,002	65
Site restoration expenditures	(2)	–
Changes in non-cash working capital	795	(1,377)
	(7,441)	(9,105)
Decrease in Cash	(7)	10
Cash, Beginning of Period	159	116
Cash, End of Period	152	106
Cash Flow from Operations Per Share		
Basic	0.74	0.30
Diluted	0.71	0.29
Weighted Average Number of Shares (million)		
Basic	14.35	14.37
Diluted	15.74	15.82

See selected notes to financial statements.

SELECTED NOTES TO FINANCIAL STATEMENTS

Three months ended March, 31, 2001
(unaudited)

1. Basis of Presentation

The interim financial statements of Zargon Oil & Gas Ltd. (the "Corporation") have been prepared by management in accordance with accounting principles generally accepted in Canada. The interim financial statements have been prepared following the same accounting policies and methods of computation as the financial statements for the fiscal year ended December 31, 2000. The financial statements should be read in conjunction with the financial statements and notes thereto in the Corporation's annual report for the year ended December 31, 2000.

2. Change in Accounting Policy

In accordance with the recommendations of the Canadian Institute of Chartered Accountants, the Corporation has adopted the treasury stock method for the computation and disclosure of per share amounts. The treasury stock method instead of the imputed interest method is used to determine the dilutive effect of stock options and other dilutive instruments effective January 1, 2001. Had the imputed interest method been used for the quarter ended March 31, 2001, fully diluted net earnings per common share would have been \$0.35 (1999 – \$.29) and fully diluted funds from operations per common share would have been \$0.67 (1999 – \$0.12).

3. Capital Stock

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)

	2001		2000	
	Number of Shares	Amount \$	Number of Shares	Amount \$
Shares issued,				
Balance, beginning of period	14,315	20,667	14,420	20,742
Normal course issuer bid	(23)	(79)	(142)	(218)
Stock options exercised	162	357	3	9
	14,454	20,945	14,281	20,533

A summary of the status of the Company's stock option plans as at March 31, 2001 and 2000, and changes during the periods ending on those dates is presented below:

	2001		2000	
	Number of Shares (thousand)	Weighted Average Exercise Price \$	Number of Shares (thousand)	Weighted Average Exercise Price \$
Options:				
Outstanding at beginning of period	1,290	2.71	1,450	2.51
Granted	278	4.78	–	–
Exercised	(162)	2.20	(4)	2.35
Cancelled	(15)	4.28	–	–
Outstanding at end of period	1,391	3.17	1,446	2.51
Options exercisable at period end	1,073	2.73	1,005	2.46

ZARGON OIL AND GAS LTD.

CORPORATE INFORMATION

Board of Directors

Craig H. Hansen
K. James Harrison
H. Earl Joudrie
John O. McCutcheon
James D. Peplinski
Byron J. Seaman
William J. Whelan
Grant A. Zawalsky

Officers

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

Key Personnel

J. Yves Gauthier
Manager, Exploitation
John D. Sorkilmo
Senior Geologist
Neil D. Watson
Senior Geologist
Stuart A. Wilson
Production Manager,
North

Stock Exchange Listing

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Trading Symbol: ZAR

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