

CORPORATE HIGHLIGHTS

Six months ended June 30 (unaudited)	2000	1999	Percent Change
FINANCIAL			
Income and Investments (\$ million)			
Production revenue	19.75	9.34	111
Cash flow from operations	9.40	3.80	147
Earnings	3.62	1.00	262
Net capital expenditures	14.07	5.38	162
Balance Sheet at Period End (\$ million)			
Property and equipment	62.07	41.42	50
Long-term debt	19.44	9.12	113
Shareholders' equity	35.51	29.96	19
Per Common Share, Fully Diluted			
Cash flow from operations (\$/share)	0.61	0.25	144
Earnings (\$/share)	0.24	0.07	243
Shares Outstanding at Period End (million)			
Basic	14.47	14.66	(1)
Fully diluted	15.71	16.07	(2)
OPERATIONS			
Average Daily Production			
Crude oil and liquids (bbl/d)	1,748	1,699	3
Natural gas (mmcf/d)	12.21	8.62	42
Equivalents (boe/d) 6:1	3,783	3,136	21
Equivalents (boe/d)	2,969	2,561	16
Average Selling Price			
Crude oil and liquids (\$/bbl)	38.34	19.52	96
Natural gas (\$/mcf)	3.40	2.13	60
Equivalents (\$/boe)	36.55	20.14	81
Equivalents, after hedges (\$/boe)	34.78	19.82	75
Wells Drilled, Net	14.5	5.7	154
Undeveloped Land (thousand net acres)	185	132	40

Note: 10 mcf is equivalent to 1 bbl except where stated otherwise

REPORT TO SHAREHOLDERS

ZARGON DELIVERED OUTSTANDING RESULTS FOR THE FIRST SIX MONTHS OF 2000. THE MOMENTUM CREATED BY HIGHER PRODUCTION COMBINED WITH CONTINUING STRENGTH IN BOTH OIL AND GAS COMMODITY PRICES RESULTED IN AN EXCELLENT FIRST HALF WITH ALL OPERATING AND FINANCIAL PARAMETERS REACHING NEW HISTORICAL LEVELS. COMPARED TO THE FIRST HALF OF 1999:

- revenue increased by 111 percent;
- cash flow increased by 147 percent;
- earnings increased by 262 percent;
- capital expenditures increased by 162 percent;
- total production increased by 16 percent; and,
- gas production increased by 42 percent.

The half was highlighted by a record \$14.07 million capital program that focused on Zargon's two core competencies of seismically-driven gas exploration/development and efficient oil property exploitation.

PRODUCTION

Zargon's production averaged 2,969 barrels of oil equivalent per day in the first half of 2000 representing a 16 percent increase over the 1999 first half rate of 2,561 barrels of oil equivalent per day. Production gains were derived from sharply higher gas volumes that averaged 12.21 million cubic feet of gas per day in the 2000 period, a gain of 42 percent over the first half 1999 rate of 8.62 million cubic feet per day. Oil production in first half 2000 averaged 1,748 barrels of oil per day, a gain of three percent from 1,699 barrels of oil per day in first half 1999.

Second quarter 2000 production averaged 2,931 barrels of oil equivalent per day, which was comprised of 11.86 million cubic feet of gas per day and 1,745 barrels of oil per day. During the second quarter, natural gas production was curtailed

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INTERIM REPORT

FOR THE SIX MONTHS

ENDED JUNE 30, 2000

during 23 days of scheduled and unscheduled shut-ins at Zargon's main Jarrow compressor station. These shut-ins were due to a combination of now-resolved mechanical difficulties and a scheduled three million (net) cubic feet of gas per day compressor expansion. With the expanded Jarrow facilities now operational, Zargon's current production exceeds 15.5 million cubic feet of gas per day and 1,750 barrels of oil per day, which equates to over 3,300 barrels of oil equivalent per day.

FINANCIAL

With higher production rates and continued very strong commodity prices, Zargon's revenue for first half 2000 reached \$19.75 million, an 111 percent increase over the prior year's first half revenue of \$9.34 million. During first half 2000, Zargon's average oil and liquids price was \$38.34 per barrel, a 96 percent improvement over the corresponding 1999 price of \$19.52 per barrel. Second and first quarter 2000 oil prices were \$39.59 and \$37.09 per barrel, respectively.

Field natural gas prices rose sharply to \$3.40 per thousand cubic feet in the first half of 2000, an increase of 60 percent from \$2.13 per thousand cubic feet recorded in first half 1999. Second quarter 2000 gas prices of \$4.02 per thousand cubic feet climbed 43 percent over the first quarter price of \$2.82 per thousand cubic feet. Including adjustments for hedging activities, Zargon's first half 2000 average price increased 75 percent to \$34.78 per barrel of oil equivalent from the \$19.82 per barrel of oil equivalent in first half 1999.

Cash flow from operations increased strongly to \$9.40 million in first half 2000, a gain of 147 percent from \$3.80 million reported in first half 1999. Reflecting sharply higher gas prices, second quarter 2000 cash flow reached \$5.03 million, a 15 percent increase over first quarter's \$4.36 million cash flow. On a unit basis, Zargon's second quarter cash flow reached a record \$18.86 per barrel of oil equivalent up from \$15.92 in the prior quarter, and \$8.20 in first half of 1999.

Earnings increased to \$3.62 million in first half 2000 representing a 262 percent improvement over first half 1999 earnings of \$1.00 million. Second quarter earnings of \$1.85 million were up five percent from \$1.77 million of earnings booked in the first quarter. On a unit basis, first half earnings were \$6.70 per barrel of oil equivalent or 38 percent of cash flow. Zargon's after tax annualized return on book equity in first half 2000 was a very strong 21 percent.

Year over year comparisons on a per share basis continue to be very strong. Cash flow per fully diluted share increased 144 percent in first half 2000 to \$0.61 per share from \$0.25 per share in first half 1999. Second quarter cash flow of \$0.32 per fully diluted share improved 10 percent over \$0.29 per share in first quarter 2000. Earnings per fully diluted share increased 243 percent in first half 2000 to \$0.24 per share from \$0.07 per share in first half 1999. Second quarter earnings were \$0.12 per share, unchanged from the \$0.12 per share reported in first quarter 2000.

Over first half 2000, Zargon's expanded pace of field activity resulted in net capital expenditures of \$14.07 million, a 162 percent increase over the \$5.38 million spent in first half 1999. These expenditures were allocated 61 percent to our gas (explore and develop) business strategies, with the remainder allocated to our oil (buy and exploit) programs. Zargon's 2000 capital budget is currently set at \$25 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 \$32.6 million bank line, of which \$19.44 million was drawn at June 30, 2000. Zargon's debt at June 30, 2000, including adjustments for working capital, represents less than 1.1 years of the first half 2000 annualized cash flow.

In accordance with the June 24, 1999 normal course issuer bid, Zargon repurchased and cancelled 0.16 million shares in the first half of 2000 at an average price of \$3.00 per share. At the end of the bid period on June 23, 2000, the cumulative number of shares repurchased and cancelled through the issuer bid totaled 0.55 million shares at an average cost of \$2.80 per share. At August 9, 2000, Zargon has 15.71 million fully diluted shares of which 14.48 million shares are issued and outstanding.

ACQUISITIONS AND LAND

Net property acquisitions aggregated \$5.16 million in first half 2000 of which \$1.03 million was spent in the second quarter. Nearly all of these acquisitions were directed to expanding oil exploitation opportunities in Southeast Saskatchewan and at Taber, Alberta. In the third quarter, Zargon anticipates closing a minimum of \$3 million of additional property acquisitions relating to Taber oil exploitation projects and expansion of the Jarrow exploration/development projects.

During first half 2000, Zargon continued to expand its undeveloped land base to 185 thousand net acres, an increase of 6 percent from 174 thousand net acres as at March

31, 2000 and an increase of 40 percent from the June 30, 1999 undeveloped total of 132 thousand net acres. Zargon has also entered into seven farm-in agreements providing Zargon access to an additional 43 thousand net acres of undeveloped land.

DEVELOPMENT AND EXPLORATION

In the first six months of 2000, Zargon drilled 18 (14.5 net) wells, a 154 percent increase over the prior year's total. Year-to-date drilling has resulted in 8.8 net gas wells in East and West Central Alberta, 2.7 net development oil wells primarily in Southeast Saskatchewan, and 3.0 net dry holes. All but one of these wells were operated by Zargon. For the remainder of 2000, Zargon plans a very active 16 net well drilling program focused on gas exploration at Jarrow and Pembina, Alberta and oil exploitation in Southeast Saskatchewan.

Jarrow, Alberta

During first half 2000, Zargon continued to expand and develop its most important gas property at Jarrow in East Central Alberta. Eleven (9.4 net) wells were drilled, 60 kilometers of 2D seismic were shot and the undeveloped land base was expanded to 90 thousand net acres, with an additional 34 thousand net acres held under option. In late June, Zargon expanded the Jarrow gathering and compression systems adding three million cubic feet of gas per day of net capacity. Zargon's current production at Jarrow is now averaging over 10 million cubic feet of gas per day, up substantially from first half 2000 and calendar 1999 average rates of 6.3 and 4.3 million cubic feet of gas per day, respectively.

At Jarrow, Zargon has assembled a drilling inventory of approximately 35 wells of which ten (8.0 net) wells will be drilled prior to year-end. Despite recent compression additions the property still has substantial excess productive capability. These existing shut-in volumes plus the anticipated new deliverability from future drilling will be placed on production through facility expansions scheduled prior to year-end.

Southeast Saskatchewan

During first half 2000, Zargon acquired \$3.86 million of properties in six transactions relating to three Southeast Saskatchewan water flood projects. Zargon also drilled three (2.3 net) exploitation oil wells in the half. Each of these activities is consistent with Zargon's ongoing "buy and exploit" strategy that 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 their development.

Other Properties

In West Central Alberta, Zargon drilled one (0.5 net) first quarter 2000 gas well at Pembina, Alberta. The tie-in of this well, along with two (1.0 net) other shallow Pembina gas wells drilled in December 1999, have increased Zargon's production at this property to 0.7 million cubic feet per day. Zargon will follow-up this success with the drilling of a minimum of four net farm-in locations during third quarter 2000.

Also in the first half, Zargon completed a \$1.30 million oil property acquisition at Taber, Alberta that has been followed by a \$1.95 million Taber property acquisition scheduled to be closed in third quarter 2000. Development drilling on this medium gravity exploitation property is scheduled to commence this fall.

Other successful drilling activities completed in first half 2000 include one net gas well at Hamilton Lake in East Central Alberta and one (0.4 net) oil well at Spirit River in Northwest Alberta. Further drilling is scheduled at both these properties during the remainder of the year.

OUTLOOK

Zargon's outlook for the remainder of 2000 and 2001 continues to be very promising. Zargon's increased size and expanded technical depth has provided a strong balance of disciplined exploration and exploitation skills. Zargon's large undeveloped land base provides an inventory of over 50 net wells scheduled to be drilled in the remainder of 2000 and 2001. The combination of record commodity prices and this greatly expanded project inventory should generate substantial and profitable growth for Zargon over the foreseeable future.



C.H. Hansen
President & Chief Executive Officer

Calgary, Alberta
August 9, 2000



J.O. McCutcheon
Chairman

BALANCE SHEETS

(\$ thousand)	June 30, 2000 <small>(unaudited)</small>	December 31, 1999
ASSETS		
Current assets	6,463	5,642
Property and equipment, net	62,071	50,383
	68,534	56,025
LIABILITIES		
Current liabilities	6,110	5,787
Long-term debt	19,435	14,116
Future site restoration	1,574	1,265
Future tax liability	5,903	2,334
	33,022	23,502
SHAREHOLDERS' EQUITY		
Share capital	20,860	20,742
Retained earnings	14,652	11,781
	35,512	32,523
	68,534	56,025

STATEMENTS OF INCOME AND RETAINED EARNINGS

Six months ended June 30 (unaudited) (\$ thousand, except for per share amounts)	2000	1999
Income		
Oil and gas sales	19,751	9,335
Hedging income (loss)	(960)	(149)
Royalties (net of Alberta royalty tax credit)	(3,961)	(1,409)
	14,830	7,777
Expenses		
Production	3,767	2,825
Administration	1,022	830
Interest on long-term debt	596	290
Site restoration	335	287
Depletion and depreciation	2,680	2,156
	8,400	6,388
Income Before Income Taxes	6,430	1,389
Income Taxes		
Future	2,765	347
Current	50	37
	2,815	384
Net Income for the Period	3,615	1,005
Retained Earnings, Beginning of Period	11,781	8,004
Adjustment to Future Income Taxes	(506)	–
Repurchase of Common Shares	(238)	(151)
Retained Earnings, End of Period	14,652	8,858
Earnings Per Common Share		
Basic	0.25	0.07
Fully diluted	0.24	0.07

STATEMENTS OF CASH FLOW

Six months ended June 30 (unaudited)

(\$ thousand, except for per share amounts)

Operating Activities

	2000	1999
Net income for the period	3,615	1,005
Add non-cash items:		
Depletion and depreciation	2,680	2,156
Site restoration	335	287
Future income taxes	2,765	347
Cash flow from operations	9,395	3,795
Changes in non-cash working capital	(899)	(724)
	<u>8,496</u>	<u>3,071</u>

Financing Activities

Long-term debt	5,320	2,939
Repurchase of common shares	(416)	(359)
Issuance of common shares	295	–
	<u>5,199</u>	<u>2,580</u>

Investing Activities

Acquisition of property and equipment	(14,152)	(5,516)
Disposal of property and equipment	83	133
Site restoration expenditures	(26)	(19)
Changes in non-cash working capital	405	(289)
	<u>(13,690)</u>	<u>(5,691)</u>
Increase (Decrease) in Cash	5	(40)
Cash, Beginning of Period	116	194
Cash, End of Period	<u>121</u>	<u>154</u>

Cash Flow from Operations Per Share

Basic	0.65	0.26
Fully diluted	0.61	0.25

Weighted Average Number of Shares (million)

Basic	14.37	14.81
Fully diluted	15.61	15.68

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

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