



## 1999 THIRD QUARTER REPORT

FOR THE NINE MONTHS ENDED

SEPTEMBER 30, 1999

### Corporate Highlights

	Nine Months Ended (unaudited)		
	Sept. 30, 1999	Sept. 30, 1998	Percent Change
<b>FINANCIAL:</b>			
Revenue (\$ millions)	<b>16.16</b>	10.21	58
Cash flow from operations (\$ millions)	<b>6.97</b>	4.57	53
Per share - basic (\$)	<b>.47</b>	.36	31
- fully diluted (\$)	<b>.45</b>	.34	32
Earnings (\$ millions)	<b>2.31</b>	1.10	110
Per share - basic (\$)	<b>.16</b>	.09	78
- fully diluted (\$)	<b>.15</b>	.09	67
Net capital expenditures (\$ millions)	<b>10.41</b>	9.90	5
Long term debt (\$ millions)	<b>11.51</b>	10.65	8
Shareholders' equity (\$ millions)	<b>31.09</b>	24.18	29
Property and equipment (\$ millions)	<b>45.01</b>	36.48	23
Weighted average number of common shares			
- basic (millions)	<b>14.74</b>	12.83	15
- fully diluted (millions)	<b>15.74</b>	13.92	13
Period end number of common shares			
- basic (millions)	<b>14.59</b>	13.01	12
<b>OPERATIONS:</b>			
Production Volumes:			
Crude oil and liquids (Bbl/d)	<b>1,720</b>	1,460	18
Natural gas (MMcf/d)	<b>8.76</b>	6.04	45
Equivalentents (BOE/d)	<b>2,596</b>	2,064	26
Average Selling Price:			
Crude oil and liquids (\$/Bbl)	<b>22.58</b>	17.96	26
Natural gas (\$/Mcf)	<b>2.32</b>	1.82	27
Equivalentents (\$/BOE)	<b>22.80</b>	18.12	26
Equivalentents, after hedging (\$/BOE)	<b>21.98</b>	18.50	19
Net wells drilled	<b>9.5</b>	3.1	206
Undeveloped land (net acres)	<b>163,000</b>	97,300	67

# Report to the Shareholders

The combination of increasing production volumes and rising commodity prices provided Zargon an excellent third quarter as well as a very strong performance for the nine months ended September 30, 1999. Revenue of \$16.16 million, cash flow from operations of \$6.97 million and earnings of \$2.31 million for the nine months of 1999 reached new high levels and were 58 percent, 53 percent and 110 percent respectively ahead of the corresponding period of 1998. On a fully diluted basis, cash flow per share of \$.45 and earnings per share of \$.15 for the 1999 nine months recorded gains of 32 percent and 67 percent respectively over the corresponding prior year period. For the third quarter alone, cash flow was \$3.17 million or \$.20 per fully diluted share.

## PRODUCTION

Production for the first nine months of 1999 averaged 2,596 BOE/d, an increase of 26 percent over the 2,064 BOE/d recorded in the 1998 period. Production of crude oil and liquids increased 18 percent to an average of 1,720 Bbl/d in the 1999 nine month period, up from 1,460 Bbl/d in the prior year. Natural gas production of 8.76 MMcf/d in the 1999 nine month period showed a strong increase of 45 percent over the prior year. The gas production gains reflect early successes from Jarrow exploration and development drilling programs in East Central Alberta. The Jarrow drilling programs have now been accelerated with excellent fourth quarter results to be followed with an expanded program throughout 2000.

Third quarter 1999 oil and liquids production averaged 1,760 Bbl/d, a 5 percent improvement over the second quarter rate of 1,680 Bbl/d. Further oil production gains are anticipated this winter as Zargon proceeds with the drilling of its inventory of Southeast Saskatchewan oil exploitation projects. Third quarter 1999 gas production averaged 9.06 MMcf/d, a 6 percent increase over the second quarter rate of 8.52 MMcf/d. Based on recent Jarrow drilling successes, a corporate average gas rate of 12.0 MMcf/d is projected for the first quarter of 2000, once currently shut-in volumes are tied-in.

## FINANCIAL

The strong financial gains achieved by Zargon in the first nine months of 1999 were derived in roughly equal measure from a 26 percent increase in production volumes, and from higher oil and gas prices. During the first three quarters of 1999, Zargon's average price on equivalents basis was \$22.80/BOE, a 26 percent increase over the prior year. After adjusting for the impact of oil, gas and currency hedges, Zargon's average price was \$21.98/BOE which represents a 19 percent improvement over the previous nine month period.

After a dismal first quarter, crude oil prices began to rise dramatically in the second quarter of 1999 and continued to improve throughout the third quarter. The average price received by Zargon for crude oil and liquids was \$22.58/Bbl in the 1999 nine month period, a gain of \$4.62/Bbl or 26 percent over the prior year period. Natural gas showed similar price improvements on a year over year basis, with Zargon's average field gas price rising 27 percent to \$2.32/Mcf in 1999 from \$1.82/Mcf in the 1998 period. Third quarter 1999 field prices were very strong, averaging \$2.68/Mcf and \$28.37/Bbl.

Cash flow in the first nine months of 1999 increased to \$6.97 million, a gain of 53 percent or \$2.40 million over the corresponding 1998 period. On a unit of production basis, Zargon's corporate cash flow was \$9.83/BOE in the 1999 nine month period compared to \$6.07/BOE in

the prior year. Powered by very strong prices, third quarter 1999 cash flow reached \$12.92/BOE, up from \$9.40/BOE and \$7.02/BOE in the second and first quarters, respectively. Gains in earnings were also substantial, with earnings more than doubling to \$2.31 million in the 1999 nine month period, up from \$1.10 million in 1998. These earnings provided an annualized 1999 return on book equity of 10.2 percent compared to a 6.3 percent return in the prior year.

On a fully diluted per share basis, comparisons between the 1999 and 1998 nine month periods were also strong, although moderated by a 13 percent increase in the weighted average number of shares due to a November 1998 equity issue. Cash flow increased 32 percent to \$.45 per share in the 1999 period from \$.34 in 1998 and earnings increased 67 percent to \$.15 per share in 1999 from \$.09 per share in 1998. Pursuant to Zargon's June 1999 normal course issuer bid, by the end of the third quarter Zargon had re-purchased 216,800 Zargon shares at an average price of \$2.50/share, leaving 14.59 million shares issued and outstanding.

Zargon's net capital expenditures in the first nine months of \$10.41 million were similar in amount to the \$9.90 million recorded in the prior nine month period, but differed markedly in nature, reflecting the different business environments and Zargon's significantly expanded exploration focus. In the 1999 period, Zargon spent \$3.34 million (32 percent) for seismic and undeveloped land acquisitions, in order to build a substantial inventory of drilling locations. By comparison, in 1998, \$6.56 million (63 percent) was spent on acquisitions, as Zargon focused on oil property acquisitions during the then low oil price environment.

Zargon's net capital expenditures in the 1999 third quarter of \$5.03 million, reflected accelerated activity levels over the \$3.37 million and \$2.01 million spent in the first and second quarter, respectively. Long term debt was \$11.51 million at September 30, 1999 and is less than one year's cash flow at third quarter levels.

## ACQUISITIONS

As noted above, a relatively large share of capital expenditures in the first nine months of 1999 was used in the acquisition of undeveloped land, primarily to expand Zargon's gas properties in East Central Alberta. As a result, undeveloped land inventories at September 30, 1999 were 163,000 net acres, a 40 percent improvement from the 115,800 net acres reported at December 31, 1998 and a 67 percent year over year increase from 97,300 net acres at September 30, 1998.

During the first nine months of 1999, property acquisition activities were relatively quiet as Zargon completed 34 property purchases generally related to existing operated properties for an aggregate cost of \$2.19 million.

## DEVELOPMENT AND EXPLORATION

Zargon drilled and completed 12 (9.5 net) wells in the first nine months of 1999 resulting in 2.3 net oil wells, 7.2 net gas wells and no dry holes. Third quarter drilling resulted in 3.4 (Jarrow, Hamilton Lake and Spirit River) net gas wells and 0.3 net oil wells (Spirit River). Zargon's drilling program continues to expand with an additional 7 net wells projected in the fourth quarter of 1999, followed by 25 net wells in calendar 2000. The upcoming drilling program will be focused on East and West Central Alberta gas exploration and development projects augmented by Southeast Saskatchewan oil exploitation programs.

## BALANCE SHEETS

### JARROW, ALBERTA

As Zargon's largest and most productive gas property, Jarrow has been the focus of much of our 1999 exploratory and development work. A year end net production rate in excess of 6 MMcf/d is forecast for the property up from the 4.13 MMcf/d recorded in the third quarter. Pursuant to third quarter Crown sales and a property swap, Zargon's undeveloped acreage at Jarrow has nearly doubled to 43,000 net acres from 21,900 net acres at the end of the second quarter. In addition, Zargon entered into a 36 section farm-in agreement (23,000 acres) in the third quarter where Zargon will drill a minimum of six wells. To effectively explore these lands, Zargon has shot 207 miles of proprietary seismic data, purchased 122 miles of data and gained access through farm-in agreement to an additional 332 miles of seismic.

Results from the eight Jarrow wells (four drilled in the first nine months, four drilled in the fourth quarter) drilled to date in 1999 have been excellent and production capability continues to considerably exceed ongoing additions to gathering and compression capacity. While other good prospective areas are also under development, we believe that over the next 12 months production from Jarrow alone will have a significant impact on Zargon's production and cash flow profile.

### YEAR 2000

Zargon has reviewed its critical internal systems and upgraded or replaced them where required. The Company is continuing to review and assess the Year 2000 preparedness of our significant business partners and will continue to do so throughout the remainder of 1999. Costs associated with ensuring the Company's compliance are not expected to be material and will be charged against earnings as incurred.

### OUTLOOK

The current outlook for the balance of 1999 and 2000 is very positive for Zargon. Our expanded exploration group has delivered substantial gas discoveries in both East and West Central Alberta. Commodity prices for both crude oil and gas are remarkably good, while land and drilling costs have stayed at moderate levels. Internally generated cash flow is at record high levels and Zargon has been able to maintain a strong balance sheet with more than \$13 million of unused borrowing capacity available from recently increased bank lines.

With a significantly expanded undeveloped land inventory, Zargon is budgeting \$25 million of capital expenditures in the next five quarters focusing on gas exploration and exploitation projects augmented by oil exploitation programs. Zargon's low debt levels leaves ample balance sheet capacity to support these record capital expenditure programs, which will be focused on profitable production and reserve growth.

(unaudited)	Sept. 30, 1999 \$	Sept. 30, 1998 \$
<b>ASSETS</b>		
Current assets	<b>5,351,574</b>	3,554,041
Property and equipment, net	<b>45,007,641</b>	36,477,084
	<b>50,359,215</b>	40,031,125
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Liabilities</b>		
Current liabilities	<b>4,281,889</b>	2,316,454
Long term debt	<b>11,508,659</b>	10,645,952
Future site restoration	<b>1,270,808</b>	953,128
Deferred income taxes	<b>2,212,465</b>	1,938,327
	<b>19,273,821</b>	15,853,861
<b>Shareholders' equity</b>		
Share capital	<b>21,006,333</b>	16,323,639
Retained earnings	<b>10,079,061</b>	7,853,625
	<b>31,085,394</b>	24,177,264
	<b>50,359,215</b>	40,031,125



C.H. Hansen  
President & CEO  
November 22, 1999



J.O. McCutcheon  
Chairman

## STATEMENTS OF INCOME AND RETAINED EARNINGS

9 Months Ended (unaudited)	Sept. 30, 1999 \$	Sept. 30, 1998 \$
<b>Income</b>		
Oil and gas sales	16,158,131	10,207,911
Hedging income (loss)	(578,449)	271,751
Royalties (net of ARTC)	(2,568,911)	(1,184,895)
	<b>13,010,771</b>	9,294,767
<b>Expenses</b>		
Production	4,379,319	3,517,186
Administration	1,200,463	924,875
Interest on long term debt	408,677	243,049
Site restoration	439,458	391,224
Depletion and depreciation	3,592,615	2,789,728
	<b>10,020,532</b>	7,866,062
<b>Income before income taxes</b>	<b>2,990,239</b>	1,428,705
<b>Income taxes</b>		
Current	57,913	42,416
Deferred	624,109	286,000
	<b>682,022</b>	328,416
<b>Net income for period</b>	<b>2,308,217</b>	1,100,289
<b>Earnings per common share</b>		
Basic	.16	.09
Fully diluted	.15	.09

## STATEMENTS OF CASH FLOW

9 Months Ended (unaudited)	Sept. 30, 1999 \$	Sept. 30, 1998 \$
<b>Operating activities</b>		
Net income for period	2,308,217	1,100,289
Add non-cash items:		
Depletion and depreciation	3,592,615	2,789,728
Site restoration	439,458	391,224
Deferred income taxes	624,109	286,000
<b>Cash flow from operations</b>	<b>6,964,399</b>	4,567,241
Changes in non-cash working capital items-operating	(1,958,489)	(375,977)
	<b>5,005,910</b>	4,191,264
<b>Financing activities</b>		
Long term debt	5,330,247	5,774,074
Issuance (buyback) of shares	(542,668)	713,300
	<b>4,787,579</b>	6,487,374
<b>Investing activities</b>		
Acquisition of property and equipment	(10,544,107)	(10,489,934)
Disposal of property and equipment	132,713	594,133
Site restoration expenditures	(28,551)	(43,489)
Changes in non-cash working capital items-investing	602,652	(769,839)
	<b>(9,837,293)</b>	(10,709,129)
<b>Decrease in cash</b>	<b>(43,804)</b>	(30,491)
<b>Cash flow from operations per common share</b>		
Basic	.47	.36
Fully diluted	.45	.34

## 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 & CEO*  
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  
Trading Symbol: ZAR

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