

### 2001 THIRD QUARTER REPORT

Zargon performed strongly in the third quarter of 2001 showing year over year gains in revenue, cash flow, and production despite lower commodity prices. For the first nine months new levels were established for all operating and financial parameters. While earnings are up 75 percent for the nine months, third quarter earnings were below the prior year period due to lower natural gas and oil prices and higher depletion and depreciation charges.

### CORPORATE HIGHLIGHTS

Year over year comparisons for the first nine months show strong growth:

- natural gas production increased by 36 percent;
- oil and liquids production increased by 33 percent;
- revenue increased by 55 percent;
- cash flow increased by 62 percent;
- earnings increased by 75 percent.

For the nine month period, year over year comparisons on a per share basis were equally strong. Cash flow of \$1.70 per diluted share in nine months 2001 increased 52 percent and earnings of \$0.72 per diluted share were up 64 percent from the prior year. Third quarter per share results were reduced by the issuance of 2.0 million common shares pursuant to a June 26, 2001 special warrant issue.

(unaudited)	Three Months Ended			Nine Months Ended		
	Sept 30, 2001	Sept 30, 2000	Percent Change	Sept 30, 2001	Sept 30, 2000	Percent Change
<b>FINANCIAL</b>						
<b>Income and Investments (\$ million)</b>						
Production revenue	14.67	14.24	3	52.61	33.99	55
Cash flow from operations	7.66	7.17	7	26.86	16.57	62
Earnings	2.60	2.89	(10)	11.36	6.50	75
Net capital expenditures	30.17	5.54	545	46.25	19.61	136
<b>Per Common Share, Diluted</b>						
Cash flow from operations (\$/share)	0.44	0.48 *	(8)	1.70	1.12 *	52
Earnings (\$/share)	0.15	0.19 *	(21)	0.72	0.44 *	64
<b>Balance Sheet at Period End (\$ million)</b>						
Property and equipment				112.66	65.74	71
Long-term debt				19.27	17.63	9
Shareholders' equity				68.10	38.47	77
<b>Shares Outstanding at Period End (million)</b>						
				16.59	14.49	14
<b>OPERATING</b>						
<b>Average Daily Production</b>						
Crude oil and liquids (bbl/d)	2,851	1,702	68	2,295	1,732	33
Natural gas (mmcf/d)	18.86	16.45	15	18.53	13.64	36
Equivalents (boe/d 6:1)	5,995	4,444	35	5,383	4,005	34
Equivalents (boe/d 10:1)	4,737	3,347	42	4,148	3,096	34
<b>Average Selling Price (before hedges)</b>						
Crude oil and liquids (\$/bbl)	34.44	43.10	(20)	35.73	39.91	(10)
Natural gas (\$/mcf)	3.25	4.94	(34)	5.98	4.03	48
<b>Wells Drilled, Net</b>						
	13.0	11.9	9	36.3	26.4	38
<b>Undeveloped Land at Period End (thousand net acres)</b>						
				223	202	10

\* Restated using treasury method

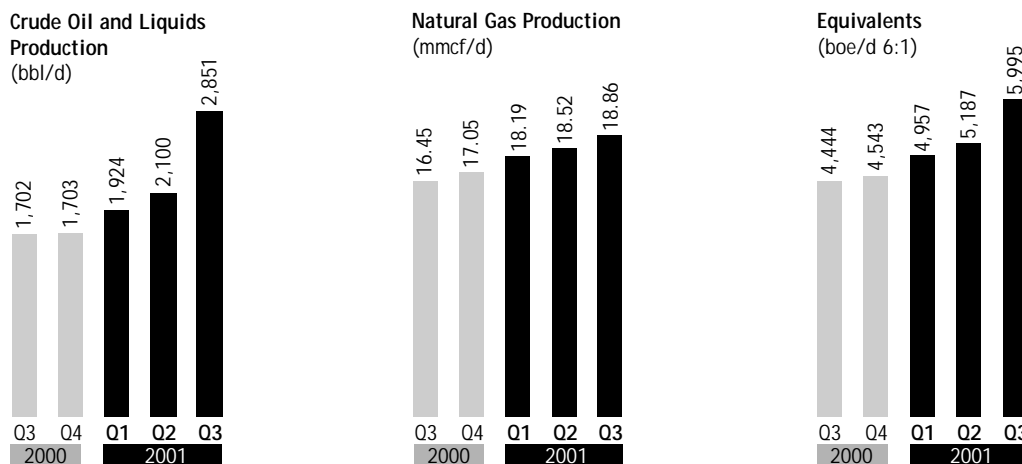
During the first nine months of 2001, Zargon drilled 36.3 net wells (44 gross), 38 percent more than the 26.4 net wells drilled in the corresponding period of 2000. Including the \$23.39 million allocated from the corporate acquisition of Herc Oil Corp., net capital expenditures for property and equipment jumped to a new level of \$46.25 million in the 2001 period compared to \$19.61 million in 2000. Balance sheet strength was maintained by a combination of high cash flows and the issue of 2.0 million special warrants for gross proceeds of \$14.10 million.

## PRODUCTION

In the first nine months of 2001, production of oil and liquids increased 33 percent and production of natural gas increased 36 percent over the corresponding period of 2000. Growth in oil and liquids to an average of 2,295 barrels per day in 2001 came from new drilling at Southeast Saskatchewan and Taber, Alberta properties and, effective July 10, 2001, the acquisition of Herc Oil Corp. The Herc assets which averaged 961 barrels per day in the third quarter, included 557 barrels per day from a 98.5 percent interest in the Haas Madison Unit in North Dakota plus a number of other operated interests in smaller oil properties mostly in Southeast Saskatchewan. While some upgrading through sales and trades of the Herc Saskatchewan properties is in progress, overall the Herc production fits well into Zargon and adds over 900 barrels per day of lower-decline Williston Basin oil production. With the addition of the Herc volumes after July 10, 2001, Zargon's third quarter 2001 oil production climbed to 2,851 barrels per day, a 36 percent increase over the second quarter volumes.

Production of natural gas averaged 18.53 million cubic feet per day in the first nine months of 2001 compared to 13.64 million cubic feet per day in the 2000 period with the gains coming primarily from Zargon's major gas property at Jarrow, Alberta. After substantial gains following last year's drilling program, gas production has remained relatively stable during the 2001 period with third quarter 2001 volumes averaging 18.86 million cubic feet per day up two percent over the 2001 second quarter. Jarrow production growth has been held back while modifications were made for infrastructure and compression in the third quarter. Also, dispositions and trades of East Central Alberta producing non-core gas properties at Penhold, Hudson, and Hamilton Lake South, Alberta were made earlier this year to take advantage of the then strong gas property market valuations.

On an equivalent basis, production averaged 5,383 barrels of oil equivalent per day (6:1) over the first nine months of 2001, a gain of 34 percent over the corresponding period of 2000. Third quarter 2001 production averaged 5,995 barrels of oil equivalent per day (6:1), a gain of 35 percent over third quarter 2000 and 16 percent over second quarter 2001.



## EXPLORATION AND EXPLOITATION

Zargon maintained a high level of field activities throughout the first nine months of 2001, drilling 36.3 net wells (44 gross) that resulted in 8.6 net oil wells, 18.8 net gas wells and 8.9 net dry holes for a 75 percent success ratio. During the third quarter drilling operations on 13.0 net (15 gross) wells were focussed almost exclusively on Zargon's East Central Alberta Jarrow property and resulted in 9.0 net gas wells and 4.0 net dry holes.

With third quarter production of 12.84 million cubic feet per day and over 118,000 net acres of undeveloped land, Jarrow is Zargon's most important gas property. During the first nine months of this year, 23 gross wells were drilled at Jarrow, resulting in 14.7 net (19 gross) gas wells. Commencing in the third quarter Zargon is proceeding with tie-ins on fifteen wells and is upgrading compression capacity to reduce the field's suction pressure. Stabilized net production rates of 15 million cubic feet per day are anticipated from this property by year-end. During 2002 we expect to drill fewer wells on the Jarrow property as we maintain this facility-restricted rate throughout the year.

At Taber, six 100 percent working interest wells were drilled in the nine months resulting in six oil wells and a new pool discovery. The Taber land position has been expanded in 2001 through Crown sales and farmins and our activities on the property have become more exploratory in nature. Subsequent to quarter end, six additional wells were drilled that resulted in two oil wells and four dry holes. Taber production for the third quarter averaged 431 barrels per day down slightly from the second quarter rate of 455 barrels per day.

The Southeast Saskatchewan core area augmented by adjacent North Dakota production provided Zargon 1,978 barrels per day of oil production in the third quarter of 2001 and now represents about 70 percent of Zargon's total oil production volumes. These properties have been selected for their exploitation opportunities and provide a stable low-decline production base. Through the acquisition of Herc Oil Corp., Zargon acquired a 98.5 percent working interest in the Haas Madison Unit located in North Dakota 6 miles south of the Canadian border as well as operated interests in a number of smaller Southeast Saskatchewan oil properties. The Haas Unit, which is mapped to have 47 million barrels of original oil-in-place, is viewed to have significant waterflood potential that can be unlocked by waterflood modifications that are scheduled to be implemented by summer 2002. Over the next few quarters, we plan to be very active in this core area as we concentrate on implementing exploitation programs on existing holdings while continuing to build our inventory of exploitable properties.

In West Central Alberta four net shallow gas wells were drilled early this year by Zargon. Recently, the availability and cost of undeveloped lands has improved and we anticipate an expansion of our gas exploration activities in this area this winter.

Despite very competitive Crown sale conditions during the 2001 nine month period, Zargon managed to increase its undeveloped land inventory to 222,800 net acres as of September 30, 2001. During the period a total of \$3.99 million was spent acquiring 33,100 acres at an average cost of \$120 per acre. The first nine months of 2001 were a period of high field activity as Zargon spent \$18.63 million on seismic, drilling, completion and equipping of wells and the construction of related facilities. Exclusive of the Herc transaction, net property acquisitions during the period aggregated only \$0.24 million. This total reflected \$3.73 million of mostly Southeast Saskatchewan purchases that were offset by \$3.49 million of gas property dispositions as Zargon took advantage of very high property gas prices to monetize several non-core holdings which did not meet strategic objectives. Additionally, Zargon concluded \$3.79 million of property trades that provided Southeast Saskatchewan waterflood opportunities in exchange for East Central Alberta gas and oil properties. The Herc transaction, which was by far the largest event during the nine month period, resulted in an addition of \$23.39 million assigned to the property and equipment accounts.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

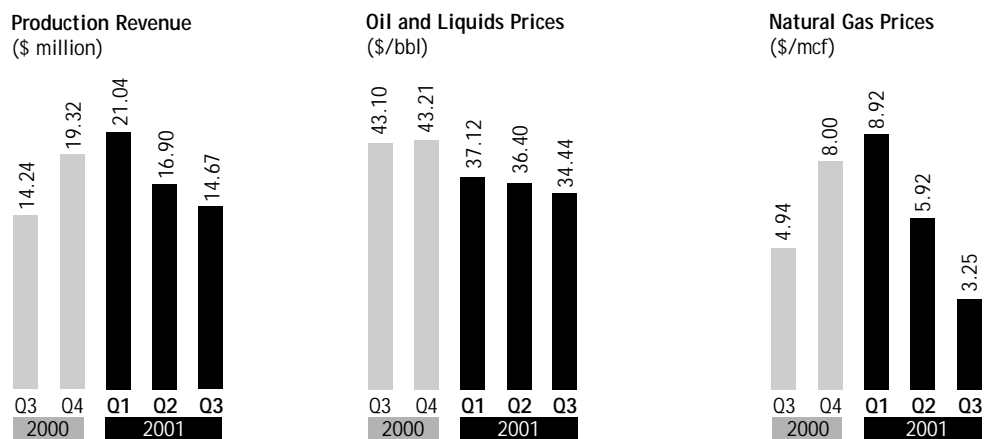
*Management's discussion and analysis (MD&A) should be read in conjunction with the unaudited interim financial statements for the nine months ended September 30, 2001 and the audited financial statements and MD&A for the year ended December 31, 2000.*

## FINANCIAL ANALYSIS

In the third quarter of 2001, a 35 percent year over year increase in Zargon's production volumes was mostly offset by declines in natural gas and oil prices. While natural gas production from Jarrow showed strong year over year gains, the major component of volume growth related to Zargon's July 10, 2001 acquisition of Herc Oil Corp. The field price of natural gas fell steadily from January and averaged \$3.25 per thousand cubic feet (\$3.40 after hedging) for the 2001 third quarter, 34 percent less than third quarter 2000 and 45 percent less than second quarter 2001. Zargon's field price for crude oil and liquids also declined throughout the year to an average of \$34.44 per barrel (\$33.93 after hedging) in the third quarter, 20 percent below third quarter 2000 and 5 percent less than second quarter 2001. The Corporation's hedging policy is designed to provide floor prices that help stabilize cash flows during lower price periods. Over the next 12 months, price floors have been set using a combination of options and forward sales to provide \$24 US per barrel (WTI) and \$4.75 Cdn per thousand cubic feet (AEEO) price floors for approximately 20 percent of Zargon's net production after the deduction of royalties.

Royalties, inclusive of Alberta royalty tax credit and Saskatchewan resource surcharge, were \$11.92 million for the first nine months of 2001, up 67 percent from \$7.13 million in 2000, primarily arising from a 55 percent increase in production revenue. As a percentage of gross revenue, nine month 2001 royalties were 22.6 percent of revenue and increased from 21.0 percent for the comparative 2000 period, due in part to higher commodity prices in the first half of 2001 and slightly higher royalty rates for the North Dakota properties.

Higher production volumes in the 2001 nine month period were the primary reason for a 42 percent nine month operating cost increase to \$8.44 million. On a unit production basis operating costs were \$0.61 per thousand cubic feet and \$8.59 per barrel in the nine month period. These costs have been relatively consistent in each of the 2001 quarters but show a four percent increase over 2000 levels due to industry-wide cost pressures.



## Operating Netbacks

Nine months ended September 30

	2001		2000	
	Oil and Liquids \$/bbl	Natural Gas \$/mcf	Oil and Liquids \$/bbl	Natural Gas \$/mcf
Revenue	35.73	5.98	39.91	4.03
Hedging	(0.73)	(0.20)	(2.39)	(0.17)
Royalties	(7.03)	(1.48)	(8.39)	(0.79)
Operating costs	(8.59)	(0.61)	(8.30)	(0.58)
<b>Operating netbacks</b>	<b>19.38</b>	<b>3.69</b>	20.83	2.49

General and administrative expenses were \$2.25 million for the first nine months of 2001 compared to \$1.58 million in the corresponding period of 2000. The higher costs reflect increased salaries and related staffing costs as Zargon continues to expand and upgrade our human resources in preparation for further growth. On a unit of production basis, administrative costs declined in the third quarter as substantial production volumes were added without a commensurate increase in costs. Interest expense of \$0.72 million for the first nine months of 2001 was 22 percent less than for the 2000 period. Lower bank debt in the first half of 2001 and falling short-term interest rates have been the sources of the saving.

## Corporate Netbacks

Nine months ended September 30	2001		2000	
	(\$/boe)		(\$/boe)	
	(10:1)	(6:1)	(10:1)	(6:1)
Revenue	46.46	35.80	40.07	30.97
Hedging	(1.28)	(0.99)	(2.05)	(1.58)
Royalties	(10.52)	(8.11)	(8.40)	(6.49)
Operating costs	(7.45)	(5.74)	(7.02)	(5.43)
Operating netbacks	27.21	20.96	22.60	17.47
General and administration	(1.99)	(1.53)	(1.86)	(1.44)
Financing charges	(0.64)	(0.49)	(1.10)	(0.84)
Foreign exchange	(0.04)	(0.03)	-	-
Capital and current income taxes	(0.82)	(0.63)	(0.11)	(0.09)
Cash flow netbacks	23.72	18.28	19.53	15.10
Depletion and depreciation	(6.60)	(5.09)	(5.37)	(4.15)
Site restoration and reclamation	(0.65)	(0.50)	(0.63)	(0.48)
Future income taxes	(6.44)	(4.96)	(5.87)	(4.55)
Net earnings	10.03	7.73	7.66	5.92

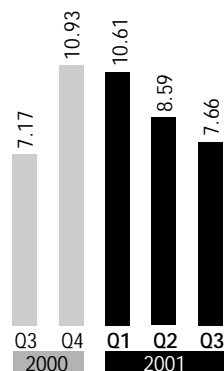
Depletion and depreciation expense for the first nine months of 2001 of \$7.47 million was 64 percent higher than the \$4.56 million reported in the same period of 2000. While the 34 percent gain in production volumes was the major factor in this increase, unit of production charges were also higher arising from the Zargon and industry-wide trend to higher finding and development costs during the recent high commodity price period.

In the 2001 first quarter, Zargon booked a \$1.50 million provision for cash taxes. The Herc transaction provided tax-planning opportunities that reduce the expected cash tax payments in 2001. The third quarter 2001 results include a reversal of one half of the first quarter cash tax accrual. Additional recoveries may be booked in the fourth quarter.

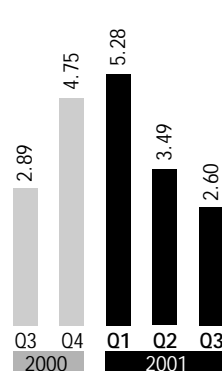
Zargon's cash flow for the third quarter 2001 of \$7.66 million was 7 percent higher than third quarter 2000 but 11 percent lower than second quarter 2001. For the nine months ended September 30, 2001 cash flow of \$26.86 million showed a strong 62 percent increment over the prior year comparative period. The quarter by quarter trends of the two years 2000 and 2001 demonstrate the positive impact of the very high natural gas and oil prices received last winter.

Earnings for the nine months to September 30, 2001 of \$11.36 million were 75 percent higher than the \$6.50 million reported for the same period in 2000. For the third quarter 2001, earnings of \$2.60 million were held back to 90 percent of the prior year's third quarter earnings and 75 percent of second quarter 2001 earnings, due to lower oil and natural gas prices and increased depletion and depreciation charges. Zargon's after tax annualized return on book equity in the nine months ended September 30, 2001 was a very strong 27 percent.

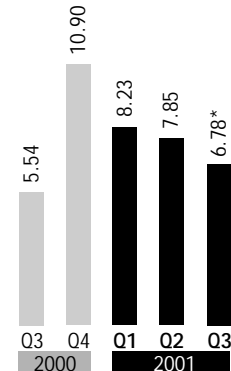
**Cash Flow from Operations**  
(\$ million)



**Net Earnings**  
(\$ million)



**Net Capital Expenditures**  
(\$ million)



\*Excluding Herc acquisition

### Capital Expenditures

Nine months ended September 30 (\$ million)

	2001	2000
Undeveloped land	3.99	2.02
Geological and geophysical (seismic)	2.83	1.67
Drilling and completion of wells	12.90	6.72
Well equipment and facilities	2.90	2.20
Exploration and development	22.62	12.61
Property acquisitions	3.73	7.74
Property dispositions	(3.49)	(0.74)
Net property acquisitions	0.24	7.00
Herc acquisition assigned to property and equipment	23.39	-
Total capital expenditures (net)	46.25	19.61

### LIQUIDITY AND CAPITAL RESOURCES

During the nine months ended September 30, 2001 Zargon made record capital expenditures of \$46.25 million funded by a combination of cash flows from operations of \$26.86 million, net proceeds of \$13.83 million from the issue of common shares and draws from our existing bank lines. The expenditures included \$22.62 million to fund field exploration and development activity, \$23.39 million for the acquisition of Herc Oil Corp., and a net \$0.24 million of other property acquisitions.

At September 30, 2001 Zargon's bank debt and working capital deficiency were in aggregate \$23.88 million, including approximately \$1.2 million owed to a US banking subsidiary of a Canadian bank. Our overall authorized banking credit facilities are \$50 million Cdn plus \$4.3 million US and Zargon continues to exhibit a strong balance sheet. Our total debt is equivalent to only 80 percent of the annualized third quarter cash flows. Maintaining the corporation's financial strength and flexibility to deal with opportunities are key objectives as the industry cycle proceeds.

As at November 22, 2001, Zargon has 17,845,000 fully diluted common shares that are comprised of 16,637,700 currently outstanding common shares and stock options to acquire an additional 1,207,300 shares.

## Capital Sources

Nine months ended September 30 (\$ million)	2001	2000
Cash flow from operations	26.86	16.57
Changes in working capital	(1.53)	0.05
Bank debt	3.36	3.52
Assumption of Herc debt	5.70	-
Assumption of Herc working capital	(1.97)	-
Issuance (buyback) of common shares	13.83	(0.53)
<b>Total capital sources</b>	<b>46.25</b>	<b>19.61</b>

## OUTLOOK

Over the past nine months, Zargon has become larger and financially stronger. In the same period the prices for natural gas and, more recently, crude oil have declined sharply. In the past, such low commodity price periods have created opportunities for Zargon by improving our access to prospective lands and properties through farm-ins and lower cost undeveloped land and property acquisitions. With a stable production base and over \$30 million of unutilized bank lines available, Zargon is in a good position to pursue value-added gas exploration and oil exploitation growth opportunities during this challenging time for our industry.

Quarter	Earnings <sup>(1)</sup>	Earnings/ Share <sup>(2)</sup>	Cash Flow/ Cash Flow <sup>(1)</sup>	Cash Flow/ Share <sup>(2)</sup>	Revenue <sup>(1)</sup>	Total Assets <sup>(1)</sup>	Long-term Debt <sup>(1)</sup>
2001 Q3	\$2.60	\$0.15	\$7.66	\$0.44	\$14.67	\$119.06	\$19.27
2001 Q2	\$3.49	\$0.22	\$8.59	\$0.57	\$16.90	\$108.27	\$13.19
2001 Q1	\$5.28	\$0.36	\$10.61	\$0.71	\$21.04	\$90.91	\$10.09
2000 Q4	\$4.75	\$0.31	\$10.93	\$0.70	\$19.32	\$86.88	\$15.90
2000 Q3	\$2.89	\$0.19	\$7.17	\$0.48	\$14.24	\$74.61	\$17.63
2000 Q2	\$1.85	\$0.13	\$5.04	\$0.35	\$10.62	\$68.53	\$19.44
2000 Q1	\$1.77	\$0.12	\$4.36	\$0.29	\$9.13	\$62.42	\$19.30

(1) Millions of Dollars (2) Diluted Shares, restated using treasury method

"Signed" C.H. Hansen

President & Executive Officer

Calgary, Alberta

November 22, 2001

## CONSOLIDATED BALANCE SHEETS

(\$ thousand)	<b>Sept 30, 2001</b>	December 31, 2000
	(unaudited)	
<b>ASSETS</b>		
<b>Current</b>		
Cash	189	159
Accounts receivable	5,728	11,483
Prepaid expenses and deposits	489	848
	<b>6,406</b>	12,490
<b>Property and equipment, net</b>	<b>112,657</b>	74,394
	<b>119,063</b>	86,884
<b>LIABILITIES</b>		
<b>Current</b>		
Accounts payable and accrued liabilities	11,020	15,003
<b>Long term debt</b>	<b>19,265</b>	15,902
<b>Future site restoration</b>	<b>2,917</b>	1,606
<b>Future tax liability</b>	<b>17,761</b>	11,851
	<b>50,963</b>	44,362
<b>SHAREHOLDERS' EQUITY</b>		
Share capital	34,954	20,667
Retained earnings	33,146	21,855
	<b>68,100</b>	42,522
	<b>119,063</b>	86,884

See selected notes to financial statements.

## CONSOLIDATED STATEMENTS OF INCOME AND RETAINED EARNINGS

(unaudited) (\$ thousand except for per share amounts)	Three Months Ended Sept 30		Nine Months Ended Sept 30	
	<b>2001</b>	2000	<b>2001</b>	2000
<b>Income</b>				
Oil and gas sales	14,672	14,234	52,611	33,985
Hedging	131	(778)	(1,451)	(1,738)
Royalties	(3,447)	(3,164)	(11,916)	(7,125)
	<b>11,356</b>	10,292	<b>39,244</b>	25,122
<b>Expenses</b>				
Production	3,225	2,189	8,440	5,956
Administration	766	556	2,250	1,578
Interest on long-term debt	304	326	716	922
Foreign exchange	48	-	48	-
Site restoration	304	197	736	532
Depreciation and depletion	2,878	1,879	7,474	4,559
	<b>7,525</b>	5,147	<b>19,664</b>	13,547
<b>Income Before Income Taxes</b>	<b>3,831</b>	5,145	<b>19,580</b>	11,575
<b>Income Taxes</b>				
Future	1,885	2,212	7,290	4,977
Current	(649)	47	928	97
	<b>1,236</b>	2,259	<b>8,218</b>	5,074
<b>Net Income for the Period</b>	<b>2,595</b>	2,886	<b>11,362</b>	6,501
Retained Earnings, Beginning of Period	30,551	14,652	21,855	11,781
Adjustment to Future Income Taxes	-	-	-	(506)
Repurchase of Common Shares	-	-	(71)	(238)
Retained Earnings, End of Period	<b>33,146</b>	17,538	<b>33,146</b>	17,538
<b>Earnings Per Common Share</b>				
Basic	<b>0.16</b>	0.20	<b>0.75</b>	0.45
Diluted	<b>0.15</b>	0.19	<b>0.72</b>	0.44

See selected notes to financial statements.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited) (\$ thousand except for per share amounts)	Three Months Ended Sept 30		Nine Months Ended Sept 30	
	2001	2000	2001	2000
<b>Operating Activities</b>				
Net income for the period	2,595	2,886	10,862	6,501
Add non-cash items:				
Depreciation and depletion	2,878	1,879	7,474	4,559
Site restoration	304	197	736	532
Future income taxes	1,885	2,212	7,790	4,977
Cash flow from operations	7,662	7,174	26,862	16,569
Changes in non-cash working capital	12,795	165	1,175	(734)
	20,457	7,339	28,037	15,835
<b>Financing Activities</b>				
Long term debt	6,079	(1,804)	3,363	3,516
Issuance of common shares	–	–	14,100	–
Exercise of stock options	–	139	694	434
Share issue costs	(92)	–	(860)	–
Repurchase of common shares	–	(71)	(104)	(487)
	5,987	(1,736)	17,193	3,463
<b>Investing Activities</b>				
Acquisition of property and equipment	(8,266)	(6,202)	(26,347)	(20,354)
Disposal of property and equipment	1,483	657	3,485	740
Acquisition of Herc Oil Corp	(19,831)	–	(19,831)	–
Site restoration expenditures	(62)	(22)	(256)	(48)
Changes in non-cash working capital	251	(12)	(2,251)	393
	(26,425)	(5,579)	(45,200)	(19,269)
Increase in Cash	19	24	30	29
Cash, Beginning of Period	170	121	159	116
Cash, End of Period	189	145	189	145
Cash Interest Paid	256	325	667	992
Cash Taxes Paid	51	36	178	106
<b>Cash Flow from Operations Per Share</b>				
Basic	0.46	0.50	1.77	1.15
Diluted	0.44	0.48	1.70	1.12
<b>Weighted Average Number of Shares (million)</b>				
Basic	16.59	14.48	15.19	14.41
Diluted	17.24	14.93	15.78	14.76

See selected notes to financial statements.

## SELECTED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Nine months ended September 30, 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 Canadian generally accepted accounting principles. The interim financial statements have been prepared following the same accounting policies and methods in 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 Policies

#### a) Consolidation

All subsidiaries are wholly owned and included in the consolidated financial statements. A substantial portion of the Corporation's activities are conducted jointly with others and the consolidated financial statements reflect only the Corporation's proportionate interest in such activities.

#### b) Foreign currency translation

Monetary assets and liabilities dominated in foreign currencies are translated into Canadian dollars at exchange rates in effect at the balance sheet date. Non-monetary assets and liabilities dominated in foreign currencies are translated into Canadian dollars at rates in effect on the date the assets were acquired or liabilities were assumed. Revenues and expenses are translated at rates of exchange prevailing on the transaction dates. Gains and losses are reflected in income when incurred.

#### c) Per Share information

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.

Prior period fully diluted earnings and cash flow per share have been restated to reflect this change. If the imputed interest method had been used for the nine month period ended September 30, 2001, fully diluted net earnings per common share would have been \$0.74 (2000 - \$0.42) and fully diluted funds from operations per common share would have been \$1.73 (2000 - \$1.07).

### 3. Acquisition

On July 10, 2001, the Corporation acquired all of the outstanding shares of Herc Oil Corp. ("Herc"), a private oil and gas company, for \$19.83 million. The acquisition was accounted for by the purchase method as follows:

Working capital	1,972
Property and equipment	23,392
Future tax asset	993
Long term debt	(5,696)
Future site restoration	(830)
<hr/>	
Cash consideration	19,831

#### 4. 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
Issuance of common shares	2,000	13,627	–	–
Stock options exercised	298	694	235	434
Normal course issuer bid	(23)	(34)	(161)	(248)
	<b>16,590</b>	<b>34,954</b>	<b>14,494</b>	<b>20,928</b>

On June 26, 2001, the Corporation issued 2,000,000 special warrants at a price of \$7.05 for net proceeds of \$13,627,000 after costs of issuance of \$473,000. On August 20, 2001, the special warrants were converted into 2,000,000 common shares.

Share issue costs in 2001 of \$473,000 are stated net of related future income taxes of \$387,000.

A summary of the status of the Company's stock option plans as at September 30, 2001 and 2000, and changes during the periods ending on those dates is presented below:

Options	2001		2000	
	Number of Shares (thousand)	Weighted Average Exercise Price (\$)	Number of Shares (thousand)	Weighted Average Exercise Price (\$)
Outstanding at beginning of period	1,290	2.71	1,450	2.51
Granted	278	4.78	35	3.94
Exercised	(298)	2.33	(235)	1.84
Cancelled	(15)	4.28	–	–
Outstanding at end of period	<b>1,255</b>	<b>3.24</b>	<b>1,250</b>	<b>2.67</b>
Options exercisable at period end	<b>937</b>	<b>2.76</b>	<b>817</b>	<b>2.64</b>

#### 5. Segmented Information

(\$ thousand)

	2001			2000		
	Canada	United States	Total	Canada	United States	Total
Revenue	50,980	1,631	52,611	33,985	–	33,985
Earnings	10,458	435	10,893	6,501	–	6,501
Identifiable assets	106,514	12,549	119,063	74,394	–	74,394

**ZARGON OIL AND GAS LTD.**  
**Corporate Information**

---

**Board of Directors**

Craig H. Hansen  
K. James Harrison  
H. Earl Joudrie  
Kyle D. Kitagawa  
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 Mgr., North

**Stock Exchange Listing**

Toronto Stock Exchange  
Trading Symbol: ZAR

**Head Office**

700, 333 – 5th Avenue S.W.  
Calgary, Alberta T2P 3B6  
Phone: (403) 264-9992  
Fax: (403) 265-3026  
Email: [zargon@zargon.ca](mailto:zargon@zargon.ca)

**Website**

[www.zargon.ca](http://www.zargon.ca)