ZARGON OIL & GAS LTD.

Third Quarter Report 2002

CORPORATE HIGHLIGHTS

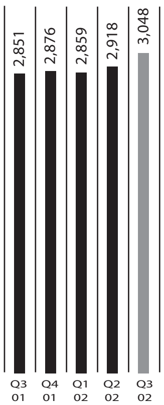
In the third quarter of 2002, Zargon recorded cash flow of $7.75 million or $0.43 per diluted share and earnings of $2.27 million or $0.13 per diluted share on average daily production of 6,454 barrels of equivalent. Daily production increased six percent from the second quarter while cash flow was up four percent. Cash flow in third quarter 2002 was virtually unchanged from third quarter 2001 while average daily production increased eight percent. For the first nine months cash flow was $21.41 million or $1.21 per diluted share, earnings were $6.40 million or $0.36 per diluted share and average daily production was 6,213 barrels of equivalent.

Net capital expenditures in the 2002 third quarter totaled $10.89 million and included the drilling of 6.1 net gas wells with promising results. Over the last 12 months, Zargon has focused on the expansion and development of its gas exploration opportunities and as a result Zargon's undeveloped land inventory has increased by 43 percent to 318 thousand net acres at September 30, 2002. At quarter-end, Zargon's balance sheet remains strong with bank indebtedness plus working capital deficiency of $31.51 million being only 1.1 times annualized 2002 cash flow.

	Three Months Ended September 30,			Nine Months Ended September 30,		
(unaudited)	**2002**	2001	% Change	**2002**	2001	% Change
FINANCIAL						
Income and Investments ($ million)						
Production revenue	**16.65**	14.67	13	**44.87**	52.61	(15)
Cash flow from operations	**7.75**	7.66	1	**21.41**	26.86	(20)
Earnings	**2.27**	2.60	(13)	**6.40**	11.36	(44)
Net capital expenditures	**10.89**	30.17	(64)	**27.52**	46.25	(40)
Per Common Share, Diluted						
Cash flow from operations ($/share)	**0.43**	0.44	(2)	**1.21**	1.70	(29)
Earnings ($/share)	**0.13**	0.15	(13)	**0.36**	0.72	(50)
Balance Sheet at Period End ($ million)						
Property and equipment, net				**136.85**	112.66	21
Bank indebtedness				**28.71**	19.27	49
Shareholders' equity				**82.00**	68.10	20
Shares Outstanding at Period End (million)				**17.54**	16.59	6
OPERATIONS						
Average Daily Production						
Crude oil and liquids (bbl/d)	**3,048**	2,851	7	**2,942**	2,295	28
Natural gas (mmcf/d)	**20.44**	18.86	8	**19.63**	18.53	6
Equivalents (boe/d 6:1)	**6,454**	5,995	8	**6,213**	5,383	15
Average Selling Price (before hedges)						
Crude oil and liquids ($/bbl)	**38.09**	34.44	11	**33.98**	35.73	(5)
Natural gas ($/mcf)	**3.17**	3.25	(2)	**3.28**	5.98	(45)
Wells Drilled, Net	**7.1**	13.0	(45)	**14.2**	36.3	(61)
Undeveloped Land at Period End (thousand net acres)				**318**	223	43

PRODUCTION

Crude Oil and Liquids Production *(bbl/d)*

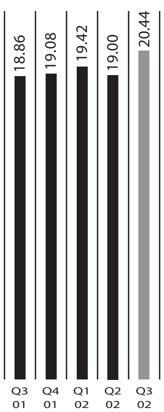


Production of oil and liquids averaged 3,048 barrels per day in third quarter 2002, a seven percent increase over the 2,851 barrels per day reported in second quarter 2001 and a four percent improvement over the second quarter 2002 rate of 2,918 barrels per day. The majority of the quarter over quarter increase came from the July acquisition of an operated Pembina Belly River oil pool in West Central Alberta.

Natural gas production averaged 20.44 million cubic feet per day in third quarter 2002, an eight percent improvement over both the 18.86 million cubic feet per day and the 19.00 million cubic feet per day production rates reported in third quarter 2001 and second quarter 2002, respectively. The increase in gas production primarily related to the second quarter 2002 corporate acquisition of Hadrian Energy Corp. During the third quarter, production at Jarrow, Zargon's largest gas property, averaged 14.36 million cubic feet per day, a slight improvement over the prior quarter's rate of 13.94 million cubic feet per day. Operated and third party processing and compression facility outages in the third quarter still resulted in approximately 0.40 million cubic feet per day of shut-ins at the East Central Alberta properties of Jarrow and Hamilton Lake.

On an equivalent basis, the 2002 third quarter production of 6,454 barrels of equivalent per day (6:1) showed an eight percent improvement over the prior year's third quarter rate of 5,995 barrels of equivalent per day. The 2002 third quarter rate was also six percent higher than the second quarter 2002 rate of 6,085 barrels of equivalent per day. Further production increases are anticipated in both of the next two quarters, as gas wells drilled in the summer/fall 2002 drilling program are placed on production.

Natural Gas Production *(mmcf/d)*

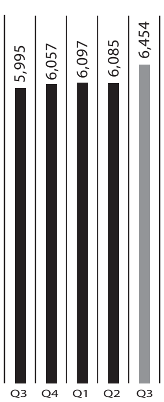


EXPLORATION AND EXPLOITATION

Zargon's basic growth strategy at the beginning of 2002 was to expand its inventory of gas exploration opportunities while deferring development drilling and the related production volume growth until improved natural gas sales prices were available. Our oil strategy focused on the exploitation of our large inventory of Southeast Saskatchewan and Taber oil opportunities.

Further to this strategy, Zargon's first half drilling activity was muted. In the third quarter our drilling program was renewed with the drilling of a total of eight gross (7.1 net) wells that yielded 6.1 net gas wells and one dry hole. For the first nine months of 2002, Zargon drilled a total of 16 gross (14.2 net) wells, which is sharply lower than last year's record drilling program of 44 gross (36.3 net) wells. During the first nine months Zargon's drilling program has been focused on gas exploration and was comprised of 12 exploratory wells and only four development wells. This program resulted in 11.2 net gas wells, two net oil wells and one net dry hole. Five of the successful exploratory gas wells were on properties recently acquired with the purchase of Hadrian Energy Corp., three in Highvale, one in Ukalta and one at Judy Creek. Drilling at Jarrow has been limited to 4.9 net wells in the three quarters, but an active program will resume in the first quarter of 2003.

Production *(boe/d 6:1)*



Currently the fourth quarter drilling program is fully underway. Following the eight wells drilled in the third quarter; an additional 18 gross (17 net) well program is planned for the fourth quarter. To date, the fourth quarter program has resulted in five successful gas wells drilled on the Pembina shallow gas project, a Jarrow gas well and a Peace River Arch abandonment at Whitelaw, Alberta. Remaining wells to be drilled include four gas locations at the East Central Alberta Hamilton Lake property, a Judy Creek gas location, plus four oil targets at Taber, Alberta and two Southeast Saskatchewan exploitation locations.

During the third quarter, Zargon continued to make progress with its oil exploitation business. Field implementation of new waterflood pressure support programs has now been completed at both the Haas Unit in North Dakota and at the Frys East property in Southeast Saskatchewan. Additional waterflood applications will be filed this winter for a recently acquired Pembina property in West Central Alberta and one Midale property in Southeast Saskatchewan.

ACQUISITIONS

A relatively expensive property and corporate acquisition market has curtailed Zargon's acquisition expenditures in the first three quarters of 2002 to $13.57 million. By far, Zargon's most important 2002 acquisition has been the June 17, 2002 corporate acquisition of Hadrian Energy Corp. The total cost of this transaction was $9.60 million, of which $7.39 million was booked to the property and equipment accounts. The transaction brought undeveloped gas lands, three operated developable gas properties and substantial surplus tax pools. In the third quarter, Zargon also acquired an exploitable Pembina Belly River oil pool in West Central Alberta for $3.50 million.

Contrary to the property acquisition market, we have found reasonable valuations at Alberta Crown sales. During the first nine months of 2002, Zargon acquired 54 thousand net acres of undeveloped land at Crown sales at a very reasonable average cost of $53 per acre. The vast majority of these land acquisitions have related to gas exploration projects in West Central Alberta. At quarter-end, Zargon has expanded its two new gas exploration areas to 30 thousand net undeveloped acres on the Pembina shallow gas project and 45 thousand net undeveloped acres on the higher risk, larger reward Peace River Arch gas exploration area.

With a combination of Crown land purchases, freehold leasing and property/corporate acquisitions, Zargon has increased its undeveloped land inventory to 318 thousand net acres at September 30, 2002, a 32 percent improvement since the beginning of the year. Further gas prone West Central Alberta land acquisitions are planned.

Subsequent to quarter-end, Zargon has entered into seven transactions to sell 14 properties producing 126 barrels per day and 0.26 million cubic feet per day for a total consideration of $2.85 million. These transactions are effective as of October 1, 2002, are anticipated to close in the fourth quarter and relate to minor properties acquired in corporate transactions during the last few years. The sale properties were either very small, were heavy oil properties or had high operating costs. The sales are consistent with our policy of selling non-strategic assets when good values are available.

GUIDANCE

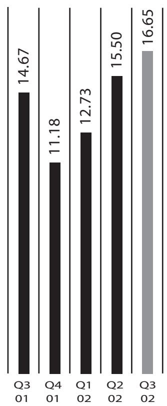
With the incorporation of the fourth quarter minor property asset sale, we are revising the 2002 capital budget estimate from $40 million to $35 million of which $27.52 million has been spent at September 30. This year's fall/winter drilling program is in full progress and is expected to result in the drilling of 31 net wells in 2002.

We are pleased with the success of our 2002 drilling activities. Tie-ins resulting from this program have recently taken our mid-November corporate gas rate to approximately 22 million cubic feet per day. With more than an additional 1.5 million cubic feet per day of net production scheduled for tie-in by mid December from recent wells at the West Central Alberta Highvale property, we expect to meet or exceed the corporate guidance for our year-end exit rate of 23.5 million cubic feet per day. Zargon is also carrying a corporate year-end exit rate projection of 3,200 barrels of oil per day. Our current drilling program includes six development oil wells in our Taber and Southeast Saskatchewan core areas that were projected to deliver this target. Until the drilling and completion program is completed it is unclear, if the current program will deliver sufficient production to offset the impact of the fourth quarter property sales and still deliver this projected exit rate.

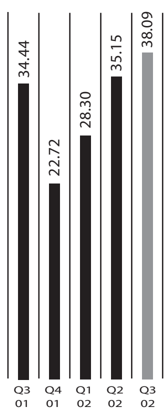
Zargon has set its preliminary capital budget for 2003 at $45 million with the drilling of 40 net wells. The capital program will focus on expanding our gas activities in West Central Alberta, while maintaining steady gas production rates from East Central Alberta. Oil activities will continue to be directed to the efficient exploitation of our very large Southeast Saskatchewan oil development and waterflood project inventory. Significant property and/or corporate acquisitions will be pursued if value-added opportunities are available. Initial mid-year 2003 production guidance is set at 25 million cubic feet per day of natural gas and 3,400 barrels per day of oil and liquids.

MANAGEMENT'S DISCUSSION AND ANALYSIS

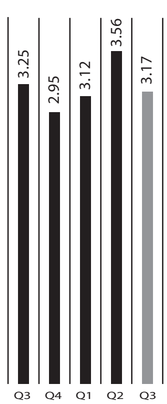
Production Revenue
($ million)



Oil and Liquids Prices
($/bbl)



Natural Gas Price
($/mcf)



Management's discussion and analysis (MD&A) should be read in conjunction with the unaudited interim financial statements for the three months and nine months ended September 30, 2002 and the audited consolidated financial statements and MD&A for the year ended December 31, 2001. The calculation of barrels of equivalent (boe) is based on the conversion ratio of one barrel of oil is equivalent to six thousand cubic feet of natural gas unless otherwise indicated.

FINANCIAL ANALYSIS

In the third quarter of 2002, production of oil and gas averaged 6,454 barrels of equivalent per day, an eight percent increase over third quarter 2001 levels and a six percent improvement over the preceding second quarter of 2002.

Zargon's field price for oil and liquids in the third quarter was stronger at $38.09 per barrel, reflecting the mid-year rise in oil commodity prices. The field price was 11 percent above the 2001 quarter and eight percent over the preceding 2002 quarter. During the quarter, the field price reflected a transportation and quality differential from the FOB Edmonton posted price of $5.12 per barrel, which was slightly higher than the second quarter differential of $4.97 per barrel. For the nine months ended September 30, 2002, the average field oil price of $33.98 per barrel was five percent below the corresponding 2001 period.

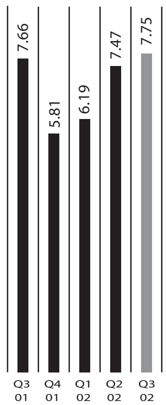
Zargon's field gas price for the third quarter of $3.17 per thousand cubic feet was two percent off the 2001 quarter and 11 percent below second quarter 2002 as commodity prices fell to summer lows. For the nine month period, the average field price of $3.28 per thousand cubic feet in 2002 was 45 percent below the corresponding 2001 period, which had been bolstered by the record high prices of the 2001 first quarter.

Zargon has continued to maintain its commodity price risk management policy of using forward sales, options and costless collars for 20 to 30 percent of our net oil and gas sales. Net hedging income for the third quarter of $0.45 million compares to $0.13 million for the 2001 quarter and $0.01 million for the preceding quarter. For the 2002 nine month period, the hedging program added $1.38 million of revenue, primarily related to gas commodity prices. Over the next twelve months, Zargon has outstanding oil swaps for 550 barrels per day at $24.02 US per barrel (WTI) and an oil collar for 75 barrels per day at a put/call of $23.00/28.15 US per barrel. The natural gas hedging program has outstanding gas swaps for 3.0 million cubic feet per day at $4.39 per thousand cubic feet (AECO) and natural gas collars for 2.53 million cubic feet per day at a put/call of $4.12/$7.31 per thousand cubic feet.

Royalties, inclusive of Alberta royalty tax credit and Saskatchewan resource surcharge, were $3.82 million for the third quarter of 2002, an increase of 11 percent from the 2001 quarter and 19 percent from the preceding quarter. For the first nine months of 2002, royalties of $9.83 million decreased 17 percent from the corresponding 2001 period, tracking the change in revenue. As a percentage of gross revenue, nine month 2002 royalties were 21.9 percent of revenue, comparable to 22.6 percent in the 2001 period.

Production expenses were $4.15 million in the 2002 third quarter, 29 percent higher than in the prior year period and 19 percent higher than in the second quarter 2002. For the first nine months, production expenses were $11.08 million, an increase of 31 percent from the corresponding period of 2001. On a unit of production basis, the 2002 nine month production costs were $6.53 per barrel of equivalent compared to $5.74 per barrel of equivalent in the 2001 period, a 14 percent increase. The mid-2001 Herc Oil Corp. acquisition brought significant benefits to Zargon but oil production expenses were increased materially due to the acquisition of a number of small, higher cost Southeast Saskatchewan properties. Subsequent to quarter end, we have been successful in selling numerous properties pursuant to our ongoing program of disposing higher cost properties, when good values are achievable. Other cost-improvement initiatives are underway but material improvements in our cost structure will require the long-term upgrading of a portion of our property base.

Cash Flow from Operations
($ million)



Earnings
($ million)

Operating Netbacks

Nine months ended September 30	**2002**		2001	
	Oil and Liquids $/bbl	**Natural Gas $/mcf**	Oil and Liquids $/bbl	Natural Gas $/mcf
Revenue	**33.98**	**3.28**	35.73	5.98
Hedging	**(0.16)**	**0.28**	(0.73)	(0.20)
Royalties	**(6.64)**	**(0.84)**	(7.03)	(1.48)
Operating costs	**(9.33)**	**(0.67)**	(8.59)	(0.61)
Operating netbacks	**17.85**	**2.05**	19.38	3.69

General and administrative expenses of $1.00 million in the third quarter of 2002 were 31 percent above the prior year quarter and eight percent above the preceding second quarter. For the first nine months of 2002, general and administrative costs of $2.78 million were 23 percent above the prior year period and on a unit of production basis increased seven percent to $1.64 per barrel of equivalent in 2002 from $1.53 in 2001. An important factor in this cost increase was the reduced cost recoveries stemming from the low level of field activity in the first half of 2002. However, the expanded fourth quarter drilling program will provide increased cost recoveries and new production that should improve per unit general and administrative costs. During the period, Zargon maintained its policy of not capitalizing any portion of its general and administrative costs.

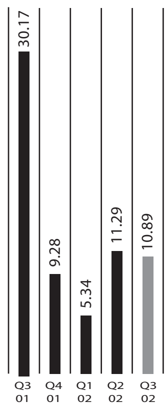
Interest expense of $0.26 million in the third quarter and $0.80 million for the first nine months of 2002 compare to $0.30 million in the third quarter and $0.72 million in the nine months period of 2001. Short-term interest rates have been at record low levels in 2002, but the related savings were partially offset by the increased bank debt levels. In accordance with new CICA recommendations, our bank debt is now presented as a current liability on the balance sheet and not as long-term debt as in previous year's statements.

Corporate Netbacks

Nine months ended September 30	**2002**	2001
	$/boe 6:1	$/boe 6:1
Revenue	**26.46**	35.80
Hedging	**0.81**	(0.99)
Royalties	**(5.80)**	(8.11)
Operating costs	**(6.53)**	(5.74)
Operating netbacks	**14.94**	20.96
General and administrative	**(1.64)**	(1.53)
Financing charges	**(0.47)**	(0.49)
Capital and current income taxes	**(0.21)**	(0.63)
Cash flow netbacks	**12.62**	18.31
Depletion and depreciation	**(5.70)**	(5.09)
Site restoration	**(0.56)**	(0.50)
Foreign exchange	**(0.05)**	(0.03)
Future income taxes	**(2.54)**	(4.96)
Net earnings	**3.77**	7.73

Depletion and depreciation expense for the third quarter of 2002 of $3.48 million was 21 percent higher than third quarter 2001 and for the first nine months of 2002 was $9.67 million, an increase of 29 percent from the 2001 period. Production volumes have increased 15 percent year-over-year and on a unit of production basis, depletion and depreciation charges have risen 12 percent to $5.70 per barrel of equivalent from $5.09 in 2001.

Net Capital Expenditures
($ million)



The increase in unit charges arose from the ongoing industry-wide trend, also experienced by Zargon, to higher finding and development costs.

Cash flow in third quarter 2002 of $7.75 million was virtually unchanged from $7.66 million in third quarter 2001 and $7.47 million in second quarter 2002. For the first nine months of 2002 cash flow of $21.41 million was 20 percent below $26.86 million in the corresponding 2001 period that included the exceptional gas prices obtained at the beginning of the 2001 year. Earnings of $2.27 million in third quarter 2002 were 13 percent below the third quarter of 2001 and 11 percent below the second quarter of 2002. Compared to the 2002 second quarter, third quarter 2002 earnings were impacted by increases in future income tax provisions and higher depletion rates. Earnings for the first nine months of 2002 were 44 percent below the corresponding period of 2001.

Capital Expenditures

Nine months ended September 30 ($ million)	**2002**	2001
Undeveloped land	**3.00**	3.99
Geological and geophysical (seismic)	**1.75**	2.83
Drilling and completion of wells	**6.11**	12.90
Well equipment and facilities	**3.09**	2.90
Exploration and development	**13.95**	22.62
Property acquisitions	**6.28**	3.73
Property dispositions	**(0.10)**	(3.49)
Net property acquisitions	**6.18**	0.24
Corporate acquisitions assigned to property and equipment	**7.39**	23.39
Total capital expenditures (net)	**27.52**	46.25

LIQUIDITY AND CAPITAL RESOURCES

During the nine months ended September 30, 2002 Zargon's capital expenditures were $27.52 million distributed as shown in the table above. The amount of $13.95 million assigned to exploration and development in the 2002 period is 43 percent below that in the corresponding 2001 period and reflects the period's curtailed drilling program. Funding for the 2002 expenditures was $21.41 million from operating cash flow, $5.95 million through the issuance of common stock pertaining to the Hadrian acquisition and employee stock options and $4.57 million of additional bank debt. Zargon's balance sheet remains very strong with total net current liabilities (including bank debt) of $31.51 million being only 1.1 times annualized nine months cash flow. Our overall authorized banking credit facilities are $50.0 million Cdn. plus $4.3 million US and we continue to maintain the financial strength and flexibility to deal with opportunities that may appear as the industry cycle proceeds.

As at November 18, 2002, Zargon has issued 17,635,528 common shares and has granted stock options to acquire an additional 1,204,250 shares.

Capital Sources

Nine months ended September 30 ($ million)	**2002**	2001
Cash flow from operations	**21.41**	26.86
Changes in working capital and other	**(4.41)**	2.20
Bank indebtedness	**4.57**	3.36
Issuance of common shares	**5.95**	13.83
Total capital sources	**27.52**	46.25

OUTLOOK

The strong oil and natural gas prices experienced in 2002 have maintained cash flow at levels that have allowed Zargon to expand its gas exploration prospect inventory materially while maintaining a strong balance sheet. The Hadrian acquisition has served us well by broadening our gas exploration base in Central Alberta and improving our tax position. Zargon currently has an active gas exploration program underway with good initial success. Significant progress has been made with new or expanded waterflood implementations at Haas, North Dakota and at Frys, Saskatchewan. We look forward with a high level of confidence to the continuation of our growth strategy.

($ million, except per share amounts)

Quarter	Earnings	Earnings/ Diluted Share	Cash Flow	Cash Flow/ Diluted Share	Revenue	Total Assets	Bank Debt
2002 Q3	$2.27	$0.13	$7.75	$0.43	$16.65	$146.00	$28.71
2002 Q2	$2.55	$0.14	$7.47	$0.42	$15.50	$137.76	$28.00
2002 Q1	$1.58	$0.09	$6.19	$0.36	$12.73	$128.97	$25.26
2001 Q4	$1.77	$0.10	$5.81	$0.34	$11.18	$127.93	$24.14
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	$0.32	$10.93	$0.74	$19.32	$86.88	$15.90
2000 Q3	$2.89	$0.19	$7.17	$0.48	$14.24	$74.61	$17.63

"Signed" C.H. Hansen
President and Chief Executive Officer

Calgary, Alberta
November 19, 2002

CONSOLIDATED BALANCE SHEETS

($ thousand)	**September 30, 2002**	December 31, 2001
	(unaudited)	
ASSETS (note 4)		
Current		
Cash	**–**	201
Accounts receivable	**8,713**	7,990
Prepaid expenses and deposits	**445**	741
	9,158	8,932
Property and equipment, net	**136,845**	118,994
	146,003	127,926
LIABILITIES		
Current		
Accounts payable and accrued liabilities	**11,963**	12,440
Bank indebtedness (note 4)	**28,707**	–
	40,670	12,440
Long-term debt (note 4)	**–**	24,137
Future site restoration	**4,647**	3,141
Future income taxes	**18,691**	18,223
	64,008	57,941
SHAREHOLDERS' EQUITY		
Share capital (note 5)	**40,679**	35,066
Retained earnings	**41,316**	34,919
	81,995	69,985
	146,003	127,926

See accompanying selected notes.

CONSOLIDATED STATEMENTS OF INCOME AND RETAINED EARNINGS

(unaudited) ($ thousand, except per share amounts)	Three Months Ended September 30, 2002	 2001	Nine Months Ended September30, 2002	 2001
Income				
Oil and gas sales	**16,647**	14,672	**44,873**	52,611
Hedging	**447**	131	**1,381**	(1,451)
Royalties	**(3,821)**	(3,447)	**(9,831)**	(11,916)
	13,273	11,356	**36,423**	39,244
Expenses				
Production	**4,146**	3,225	**11,077**	8,440
General and administrative	**1,003**	766	**2,776**	2,250
Interest	**262**	304	**803**	716
Foreign exchange	**75**	48	**84**	48
Site restoration	**333**	304	**950**	736
Depletion and depreciation	**3,475**	2,878	**9,671**	7,474
	9,294	7,525	**25,361**	19,664
Income Before Income Taxes	**3,979**	3,831	**11,062**	19,580
Income Taxes				
Future	**1,596**	1,885	**4,306**	7,290
Current	**116**	(649)	**359**	928
	1,712	1,236	**4,665**	8,218
Net Income for the Period	**2,267**	2,595	**6,397**	11,362
Retained Earnings, Beginning of Period	**39,049**	30,551	**34,919**	21,855
Repurchase of Common Shares	**–**	–	**–**	(71)
Retained Earnings, End of Period	**41,316**	33,146	**41,316**	33,146
Earnings Per Common Share				
Basic	**0.13**	0.16	**0.37**	0.75
Diluted	**0.13**	0.15	**0.36**	0.72

See accompanying selected notes.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited) ($ thousand, except per share amounts)	Three Months Ended September 30, 2002	2001	Nine Months Ended September 30, 2002	2001
Operating Activities				
Net income for the period	**2,267**	2,595	**6,397**	11,362
Add non-cash items:				
Depletion and depreciation	**3,475**	2,878	**9,671**	7,474
Site restoration	**333**	304	**950**	736
Foreign exchange	**75**	–	**84**	–
Future income taxes	**1,596**	1,885	**4,306**	7,290
Cash flow from operations	**7,746**	7,662	**21,408**	26,862
Changes in non-cash working capital	**(536)**	12,795	**(1,225)**	1,175
	7,210	20,457	**20,183**	28,037
Financing Activities				
Bank indebtedness	**708**	6,079	**4,570**	3,363
Issuance of common shares	**–**	–	**–**	14,100
Exercise of stock options	**37**	–	**955**	694
Share issue costs	**–**	(92)	**–**	(860)
Repurchase of common shares	**–**	–	**–**	(104)
	745	5,987	**5,525**	17,193
Investing Activities				
Acquisition of property and equipment	**(10,901)**	(8,266)	**(20,233)**	(26,347)
Disposal of property and equipment	**15**	1,483	**97**	3,485
Corporate acquisitions (cash portion)	**–**	(19,831)	**(4,857)**	(19,831)
Site restoration expenditures	**(157)**	(62)	**(204)**	(256)
Changes in non-cash working capital	**3,088**	251	**(712)**	(2,251)
	(7,955)	(26,425)	**(25,909)**	(45,200)
Increase (decrease) in Cash	**–**	19	**(201)**	30
Cash, Beginning of Period	**–**	170	**201**	159
Cash, End of Period	**–**	189	**–**	189
Cash interest paid	**159**	256	**926**	667
Cash taxes paid	**117**	51	**359**	178
Cash Flow from Operations Per Share				
Basic	**0.44**	0.46	**1.25**	1.77
Diluted	**0.43**	0.44	**1.21**	1.70
Weighted Average Number of Shares (million)				
Basic	**17.53**	16.59	**17.10**	15.19
Diluted	**18.08**	17.24	**17.69**	15.78

See accompanying selected notes.

SELECTED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the three and nine months ended September 30, 2002 and 2001 (unaudited)

1. BASIS OF PRESENTATION

The interim consolidated financial statements of Zargon Oil & Gas Ltd. (the "Corporation") have been prepared by management in accordance with Canadian generally accepted accounting principles. The interim consolidated financial statements have been prepared following the same accounting policies and methods in computation as the consolidated financial statements for the fiscal year ended December 31, 2001. The interim consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto in the Corporation's annual report for the year ended December 31, 2001.

2. CHANGES IN ACCOUNTING POLICIES

Business Combinations

Effective January 1, 2002, the Corporation adopted the new Canadian Institute of Chartered Accountants ("CICA") standard for goodwill and other intangibles. Under the new standard, goodwill and certain intangibles are no longer subject to amortization, but are instead tested for impairment at least annually. The Corporation has assessed the application of this policy with respect to its intangible assets and determined that there is no reclassification required, and no impact on the carrying values of its assets, or net income for the period or earnings per share for the period ended September 30, 2002.

Stock Based Compensation

Effective January 1, 2002, the Corporation adopted the new CICA 3870 standard for reporting stock-based compensation. As permitted by the CICA 3870, the Corporation has applied this change prospectively for all new awards granted after January 1, 2002. The Corporation has chosen to recognize no compensation when stock options are granted to employees and directors under the stock option plan that has no cash settlement features. However, direct awards of stock to employees and directors, and stock and stock option awards granted to non-employees will be accounted for in accordance with the fair value method of accounting for stock-based compensation. The fair value of direct awards of stock are determined by the quoted market price of the Corporation's stock and the fair value of stock options are determined using the Black-Scholes option pricing model.

In periods prior to January 1, 2002, the Corporation recognized no compensation when stock or stock options were granted to employees. Pro forma information regarding net income is required and has been determined as if the Corporation has accounted for its employee stock options granted after December 31, 2001 under the fair value method. The fair value for these options was estimated at the date of grant using a Black-Scholes Option Pricing Model with the following assumptions for 2002:

Volatility factor of expected market price (%)	11.5
Weighted average risk-free interest rate (%)	4.74
Dividend yield (%)	0
Weighted average expected life of options (years)	4

For purposes of pro forma disclosures, the estimated fair value of options is amortized to expense over the options' vesting periods. The Corporation's pro forma net income would be reduced by $159 thousand for the three months ended September 30, 2002 and $464 thousand for the nine months ended September 30, 2002. Basic and diluted earnings per share figures would have been reduced by $0.01 and $0.01 respectively for the quarter and by $0.03 and $0.03 for the nine months.

3. ACQUISITIONS

On June 17, 2002, the Corporation acquired all of the outstanding shares of Hadrian Energy Corp. ("Hadrian"), a private oil and gas company, for $9.60 million. Consideration consisted of $4.745 million cash and the issuance of 542,340 Zargon common shares valued at $8.75 per share. Costs of $0.112 million were incurred to effect the transaction and were charged to share capital. The acquisition was accounted for by the purchase method and the purchase price has been allocated as follows:

($ thousand)	
Working capital	(816)
Property and equipment	7,386
Future tax asset	3,792
Future site restoration	(760)
Total consideration	9,602

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

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

4. BANK INDEBTEDNESS

The Corporation has a $50 million credit facility consisting of a revolving demand loan with a Canadian chartered bank that bears interest at the bank's prime rate. The Corporation has pledged an assignment of accounts receivable, a first floating charge on all of the Canadian assets and a fixed charge over certain property and equipment as collateral under this facility. The Corporation also has a revolving demand loan in the United States for $4.3 million (U.S.) bearing interest at U.S. prime plus 3/4 percent and has pledged a first floating charge on all of the U.S. assets and a fixed charge over certain U.S. property and equipment as collateral.

Effective January 1, 2002, the Corporation adopted the recommendations of the Emerging Issues Committee of the Canadian Institute of Chartered Accountants concerning the presentation of revolving demand loans. These new recommendations require that the classification of debt in a debtor's balance sheet be based upon the facts existing at the balance sheet date rather than expectations. Prior to the adoption of the new recommendations, the Corporation presented the demand loan as long-term on the basis that the bank had indicated it was not its intention to call for repayment within one year provided there was no adverse change in the financial position of the Corporation. However, these loans are demand in nature and therefore are now presented as a current liability.

5. SHARE CAPITAL

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)	**September 30, 2002**		September 30, 2001	
	Number of Shares	**Amount $**	Number of Shares	Amount $
Shares issued,				
Balance, beginning of year	**16,666**	**35,066**	14,315	20,667
Shares issued for Hadrian	**542**	**4,658**	–	–
Issuance of common shares	**–**	**–**	2,000	13,627
Stock options exercised	**327**	**955**	298	694
Normal course issuer bid	**–**	**–**	(23)	(34)
	17,535	**40,679**	16,590	34,954

A summary of the status of the Corporation's stock option plans as at September 30, 2002 and 2001, and changes during the nine months ended on those dates is presented below:

Stock Options:	**September 30, 2002**		September 30, 2001	
	Number of Shares (thousand)	**Weighted Average Exercise Price** $	Number of Shares (thousand)	Weighted Average Exercise Price $
Outstanding at beginning of year	**1,199**	**3.36**	1,290	2.71
Granted	**454**	**7.66**	278	4.78
Exercised	**(327)**	**2.92**	(298)	2.33
Cancelled	**(9)**	**7.25**	(15)	4.28
Outstanding at end of period	**1,317**	**4.92**	1,255	3.24
Options exercisable at period end	**852**	**3.43**	937	2.76

6. SEGMENTED INFORMATION

($ thousand)	Three Months Ended September 30, **2002**	2001	Nine Months Ended September 30, **2002**	2001
Oil and Gas Sales				
Canada	**14,588**	13,041	**39,680**	50,980
United States	**2,059**	1,631	**5,193**	1,631
Total	**16,647**	14,672	**44,873**	52,611
Total Assets				
Canada			**140,540**	114,596
United States			**5,463**	4,467
Total			**146,003**	119,063

ZARGON OIL AND GAS LTD.

Corporate Information

Board of Directors

Craig H. Hansen
Calgary, Alberta

K. James Harrison
Oakville, Ontario

H. Earl Joudrie
Toronto, Ontario

Kyle D. Kitagawa
Calgary, Alberta

John O. McCutcheon
Vancouver, British Columbia

James D. Peplinski
Calgary, Alberta

Byron J. Seaman
Calgary, Alberta

William J. Whelan
Calgary, Alberta

Grant A. Zawalsky
Calgary, Alberta

Officers

John O. McCutcheon
Chairman

Craig H. Hansen
President and
Chief Executive Officer

Mark I. Lake
Vice President, Exploration

Daniel A. Roulston
Vice President, Operations

Sheila A. Wares
Vice President, Accounting

Kenneth W. Young
Vice President, Land

Stock Exchange Listing

Toronto Stock Exchange
Trading Symbol: ZAR

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