



Diaz Resources Ltd.



SECOND QUARTER REPORT 2002

For the six months ended June 30, 2002

Corporate Profile

Diaz Resources Ltd. is an oil and gas exploration and development company, with land holdings and production in Canada and the United States. The Company's principal business is the exploration for and marketing of natural gas, with the majority of the Company's revenue being generated from gas production in Alberta and Texas.

The Company currently focuses its exploration activities on shallow gas reservoirs in southern Alberta, combining low cost drilling and low risk exploration with an excellent natural gas infrastructure, to take advantage of increasing natural gas prices.

Summary of Operations

For the Six Months ended June 30

(Thousands, except per share amounts)

	2002	2001
Financial		
Total revenue	\$ 3,344	\$ 6,878
Cash flow	\$ 1,568	\$ 4,867
Cash flow per share	\$ 0.04	\$ 0.13
Earnings (loss)	\$ (79)	\$ 2,258
Earnings (loss) per share	\$ 0.00	\$ 0.06
Capital additions	\$ 3,023	\$ 7,390
Dispositions	\$ 502	\$ 491
Net debt	\$ 10,769	\$ 9,172
Total assets	\$ 31,202	\$ 28,445
Total shares outstanding, at period end	41,854	37,807
Operations		
Production		
Gas (mmcf/d)	5.0	6.0
Oil (bbls/d)	144	203
Boe/d (6mcf = 1bbl)	975	1,202
Product prices		
Gas per mcf	\$ 3.61	\$ 6.91
Oil per bbl	\$ 32.46	\$ 36.72



To the Shareholders

Diaz's financial results were negatively impacted during the first half of 2002 by significantly lower commodity prices compared with those prevailing one year earlier.

The management of Diaz recognized the change in the phase of the commodity cycle in mid-2001 and shifted the Company's focus to the acquisition of new prospects, seismic and undeveloped lands while reducing drilling and facility costs. The Company shut-in some natural gas production and delayed the completion and connection of other gas wells to the late fall in order to take advantage of higher winter gas prices and to conserve its capital for building its asset base.

During the second quarter, Diaz reduced its capital expenditures further to react to lower cash flows and has promoted a significant portion of its higher risk exploration projects to industry partners in order to continue to reduce capital expenditures.

The Economy and Energy Commodity Prices

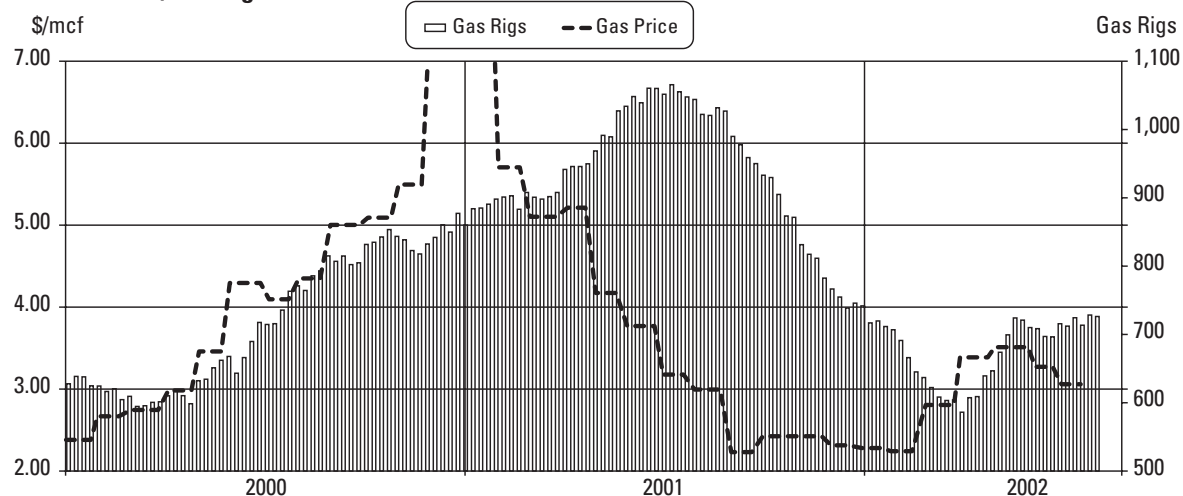
The North American economy appears to be improving and increased economic activity should lead to higher energy prices.

Continued OPEC discipline, coupled with modest non-OPEC cutbacks, resulted in oil prices recovering to and remaining at a level in excess of \$26.00 U.S. per barrel.

Natural gas has exhibited a solely North American supply and demand cycle, whereby low U.S. prices, prevailing for the past nine months, resulted in a collapse in drilling for natural gas. This decline of exploration activity has clearly reduced gas deliverability and has now led to higher prices sustained by a perception of a tighter supply situation by the end of 2002. The Canadian market has been negatively impacted by regional pipeline and demand problems which should also be rectified by the end of the current summer.

While high gas prices have already resulted in a modest increase in U.S. gas targeted drilling levels, the inherent lag time in building supplies should lead to higher prices for the next 12 months and improve Diaz's financial results during that period.

U.S. Gas Price/Gas Rigs





Financial

Financial results for the quarter were significantly impacted by a major reduction in year-over-year gas prices, combined with shut-in gas production and delays in tying in new production. The Company received an average of \$3.61 per mcf in 2002 compared with \$6.91 per mcf in the prior year, resulting in a 53% decrease in production revenue.

Cash flow for the period decreased to \$1.6 million, or \$0.04 per share compared with \$4.9 million, or \$0.13 per share for the same period in 2001. Diaz reported a loss of \$79,000 for the six months ended June 30, 2002 compared with earnings of \$2.3 million in 2001.

Capital expenditures totalled \$3.0 million compared with \$7.4 million in 2001. The capital expenditures were financed out of cash flow totalling \$1.6 million, asset disposition of \$0.5 million and an increase in debt of \$0.9 million.

Production

For the first half of 2002, natural gas production decreased to an average of 5.0 mmcf/d compared with 6.0 mmcf/d in 2001. Oil production averaged 144 barrels per day compared with 203 barrels per day for the same period in 2001.

In aggregate, for the period, the Company produced 975 boe/d compared with 1,202 boe/d for the same period in 2001.

Exploration and Development

Diaz has developed a large number of new, potentially high impact prospects and initial wells on several of these prospects will be drilled during the second half of 2002.

During the first half of the year, Diaz participated in drilling five wells and re-entering a further six wells, resulting in eight new gas wells and three dry holes. In addition, the Company continued to acquire acreage and seismic on new prospects in western Saskatchewan, east-central Alberta and in Texas.

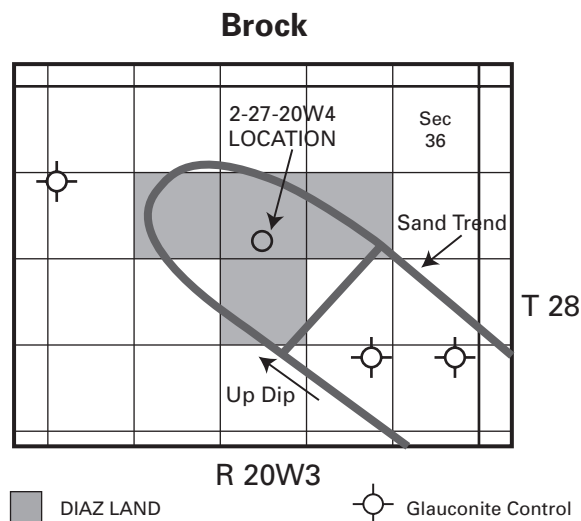
Harmattan, Alberta

Diaz commenced its higher impact exploration activity with a deep test in the Harmattan area, in which Diaz participated for a 10% interest in cost and retained a 28% working interest. The well was cased as a potential gas well and completion operations will be conducted during the third quarter. Diaz has interests in four sections of land on this prospect.

Brock, Saskatchewan

Diaz has an interest in four sections of land on an exploration oil and gas play in Brock, Saskatchewan. The initial well on the prospect will commence drilling prior to the end of August, 2002.

Diaz has farmed out most of the risk drilling cost and will pay 32% to retain a 48% interest in the initial high impact well.





Bindloss/Sedalia, Alberta

Diaz has acquired an interest in 50 sections of land in the Bindloss and Sedalia areas. This land, together with extensive seismic coverage, has allowed Diaz to develop over 40 potential natural gas targets in this multi-zone area. Diaz will commence a four-well exploration program in August with its initial well at Sedalia 6-9, in which Diaz has an 80% interest before payout and a 48% interest after payout.

Mustang Creek, Texas

Diaz has developed three deep Wilcox exploration prospects in Texas. Diaz and its partners have acquired leases and the 3-D seismic necessary to identify the prospective gas target. Recently, Diaz and its partner have promoted the drilling of the initial well on the Mustang Creek prospect, which will be drilled in the last half of 2002. Diaz will receive a \$100,000 U.S. prospect fee and be carried for a 6.7% interest on the drilling of the initial well on the prospect, which will be a deep Wilcox exploration well targeting up to five prospective pay zones.

Outlook

Diaz's ongoing business plan is based on the assumption that gas prices will steadily improve throughout the balance of 2002.

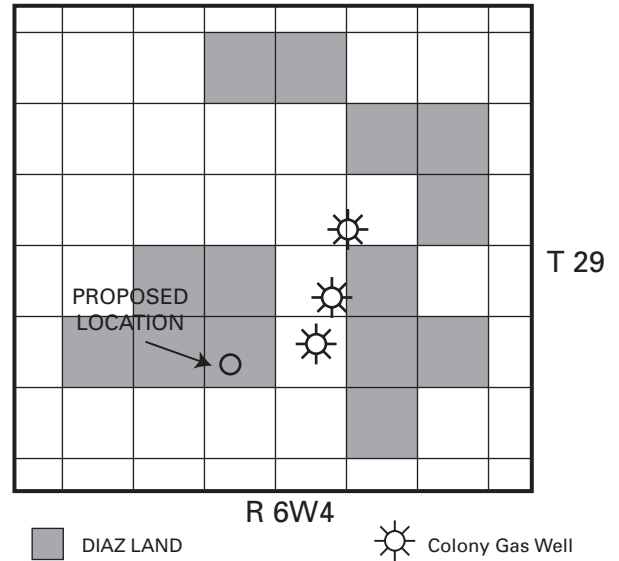
The Company's cautious approach to capital reinvestment in the past six months will now be reversed and several of the high quality prospects in the Company's inventory will be evaluated, as soon as practicable. Early success in this program should result in the resumption of the Company's growth.

On behalf of the Board,

R.W. Lamond
President

August 22, 2002

Sedalia



Management's Discussion and Analysis

The Management's Discussion and Analysis should be read in conjunction with the interim consolidated financial statements. The analysis compares the results for the six months ended June 30, 2002, with the same period in 2001.

Production	Three Months Ended June 30		Six Months Ended June 30	
	2002	2001	2002	2001
Gas (mmcf/d)				
Enchant	1.12	0.95	1.05	0.99
Carmangay	0.70	1.60	0.84	1.85
Retlaw/Little Bow	0.78	0.88	0.79	0.76
Provident City (USA)	0.69	0.89	0.74	0.98
Iron Springs	0.47	0.69	0.52	0.59
Therien	0.26	0.30	0.28	0.35
Bindloss	0.23	–	0.17	–
Other	0.69	0.52	0.59	0.48
Total Gas	4.94	5.83	4.98	6.00
Oil & Liquids (bbls/d)				
Parkman	37	58	42	64
Neutral Hills	29	38	31	39
Arcola	21	26	21	26
Red Earth	17	23	17	22
Other	35	63	33	52
Total Oil & Liquids	139	208	144	203
Total Boe/d (6mcf = 1bbl)	963	1,179	975	1,202

For the six months ended June 30, 2002, Diaz's natural gas production averaged 5.0 mmcf/d, 1.0 mmcf/d less than the same period in 2001. Diaz deferred the completion and connection of 12 gas wells, with an estimated initial production rate of 2.0 mmcf/d, until the fall of this year. Natural gas prices in the summer months were significantly lower than the anticipated prices in the winter heating season and the management decided to maximize the Company's return on gas production by delaying the tie-ins to benefit from this difference. In addition to the delayed tie-ins, Diaz shut-in 0.5 mmcf/d of gas production when spot gas prices dropped in the summer months.

Price	Three Months Ended June 30		Six Months Ended June 30	
	2002	2001	2002	2001
Gas (\$/mcf)	\$ 3.89	\$ 5.56	\$ 3.61	\$ 6.91
Oil (\$/bbl)	\$ 36.02	\$ 36.10	\$ 32.46	\$ 36.72
Boe (\$/bbl)	\$ 25.16	\$ 33.84	\$ 23.26	\$ 40.64

Commodity prices for the six months ended June 30, 2002 were significantly lower than prices for the same period in 2001. However, prices were higher for the second quarter of 2002 compared with the first quarter.



The economic slow down during the second half of 2001, combined with new gas supply in 2001, resulted in a sharp decline in gas prices through the first quarter of 2002, and Diaz averaged \$3.34 per mcf for the first quarter. Second quarter prices improved averaging \$3.89 per mcf, however, prices for the third quarter have weakened. Diaz's price for the third quarter will be assisted by a hedge of approximately three mmcf/d of natural gas at an average price of approximately \$4.00 per mcf.

Revenue <i>(Thousands)</i>	Three Months Ended June 30		Six Months Ended June 30	
	2002	2001	2002	2001
Natural gas	\$ 1,747	\$ 2,948	\$ 3,258	\$ 7,496
Oil	457	684	847	1,349
Other	17	20	30	44
Total revenue	\$ 2,221	\$ 3,652	\$ 4,135	\$ 8,889

Lower gas production volumes combined with lower commodity prices and revenue for the six months ended June 30, 2002 was 53% lower than the same period in 2001. Diaz anticipates the lower commodity prices and production volumes to continue through the third quarter before improving in the fourth quarter, with higher winter prices and increased production.

Royalties <i>(Thousands, except percentage amounts)</i>	Three Months Ended June 30		Six Months Ended June 30	
	2002	2001	2002	2001
Crown	\$ 259	\$ 468	\$ 401	\$ 1,322
Freehold	170	411	439	969
ARTC	(27)	(155)	(49)	(280)
Royalties, net of ARTC	\$ 402	\$ 724	\$ 791	\$ 2,011
Percentage of Revenue	18.1%	19.8%	19.1%	20.6%

Royalties for the first half of 2002 declined to \$791,000, or a net royalty rate of 19.1% compared with \$2,011,000, or 20.6%. The decline in total net royalties was due to lower revenue. The lower royalty rate reflects a hedging gain of \$76,000 during 2002, compared with hedging losses of \$1.1 million in the first half of 2001.

Operating Expense <i>(Thousands, except per boe amounts)</i>	Three Months Ended June 30		Six Months Ended June 30	
	2002	2001	2002	2001
Operating expense	\$ 437	\$ 564	\$ 928	\$ 1,060
per boe	\$ 4.98	\$ 5.26	\$ 5.25	\$ 4.87

Operating expense decreased in total but increased per boe. This increase per boe is primarily due to lower production levels.



Overhead <i>(Thousands, except per boe amounts)</i>	Three Months Ended June 30		Six Months Ended June 30	
	2002	2001	2002	2001
Overhead	\$ 318	\$ 494	\$ 676	\$ 872
Capitalized	(42)	(83)	(95)	(168)
Net overhead	\$ 276	\$ 411	\$ 581	\$ 704
per boe	\$ 3.15	\$ 3.82	\$ 3.29	\$ 3.23

Interest Expense <i>(Thousands, except per boe and interest rate amounts)</i>	Three Months Ended June 30		Six Months Ended June 30	
	2002	2001	2002	2001
Average bank debt	\$ 8,728	\$ 8,537	\$ 8,816	\$ 6,980
Interest expense	\$ 118	\$ 152	\$ 219	\$ 259
per boe	\$ 1.35	\$ 1.42	\$ 1.24	\$ 1.19
Average interest rate	4.80%	7.10%	4.70%	7.50%

Depletion, Depreciation & Amortization <i>(Thousands, except per boe amounts)</i>	Three Months Ended June 30		Six Months Ended June 30	
	2002	2001	2002	2001
Depletion expense	\$ 759	\$ 679	\$ 1,497	\$ 1,348
Depreciation expense	22	22	42	45
Site restoration	25	26	51	49
Amortization of deferred credit	(1)	(19)	(19)	(90)
Net depletion and depreciation	\$ 805	\$ 708	\$ 1,571	\$ 1,354
per boe	\$ 9.19	\$ 6.60	\$ 8.90	\$ 6.22

Liquidity and Capital Resources

Diaz completed the first half of 2002 with a net debt of \$10.7 million. The Company has a credit facility of \$11.0 million.

Due to a change in Canadian accounting principles effective January 1, 2002, all credit facilities that are revolving in nature must be disclosed as "current portion of long-term debt". Diaz has complied with the change and restated its December 31 balance sheet to be comparable.

The Company's capital expenditure budget for 2002 will be funded from cash flow, the proceeds of asset disposition and new equity financing, if required.

Issuer Bid

During the first half of 2002, Diaz repurchased 24,000 Class A Subordinate Voting Shares and 3,000 Class B Multiple Voting Shares at an average price of \$0.33 per share.




Consolidated Balance Sheet

(unaudited) (Thousands)	June 30 2002	December 31 2001
ASSETS		
Current Assets		
Cash	\$ 30	\$ 176
Accounts receivable	1,750	2,137
Prepaid expense	170	128
	1,950	2,441
Future tax asset	942	1,027
Property, plant and equipment	38,454	35,933
Accumulated depletion and depreciation	(10,144)	(8,605)
	28,310	27,328
	\$ 31,202	\$ 30,796
LIABILITIES		
Current Liabilities		
Accounts payable and accrued liabilities	\$ 2,110	\$ 3,818
Bank debt (note 2)	10,609	8,369
	12,719	12,187
Other Liabilities		
Future income tax liability	4,072	4,089
Deferred credits	203	222
Future site restoration costs	428	430
Total Other Liabilities	4,703	4,741
	17,422	16,928
SHAREHOLDERS' EQUITY		
Share Capital	10,028	10,037
Retained Earnings	3,752	3,831
	13,780	13,868
	\$ 31,202	\$ 30,796

Approved by the Board:



Director



Director

Consolidated Statement of Operations and Retained Earnings

(unaudited)	Three Months Ended June 30		Six Months Ended June 30	
<i>(Thousands, except per share amounts)</i>	2002	2001	2002	2001
Revenue				
Production	\$ 2,203	\$ 3,631	\$ 4,105	\$ 8,845
Royalties	(428)	(879)	(840)	(2,291)
Alberta Royalty Tax Credit	26	155	49	280
Interest and other income	17	21	30	44
	1,818	2,928	3,344	6,878
Expenses				
Operating	437	564	928	1,060
General and administrative	276	411	581	704
Interest	118	152	219	259
Foreign exchange loss (gain)	12	69	8	(12)
Depletion and depreciation	806	708	1,572	1,354
	1,649	1,904	3,308	3,365
Earnings before income tax	169	1,024	36	3,513
Income tax				
Current (recovered)	40	(100)	40	-
Future	130	369	75	1,255
Total income tax	170	269	115	1,255
Net earnings (loss) for the period	(1)	755	(79)	2,258
Retained earnings, beginning of period	3,753	2,706	3,831	1,203
Retained earnings, end of period	\$ 3,752	\$ 3,461	\$ 3,752	\$ 3,461
Earnings per share	\$ (0.00)	\$ 0.02	\$ (0.00)	\$ 0.06



Consolidated Statement of Cash Flows

(unaudited) <i>(Thousands, except per share amounts)</i>	Three Months Ended June 30		Six Months Ended June 30	
	2002	2001	2002	2001
Cash provided by (used for):				
Operating Activities				
Earnings (loss) for the period	\$ (1)	\$ 755	\$ (79)	\$ 2,258
Non-cash items				
Depreciation and depletion	806	708	1,572	1,354
Future tax	130	369	75	1,255
Cash flow from operations	935	1,832	1,568	4,867
Change in non-cash working capital	770	(69)	516	(97)
	1,705	1,763	2,084	4,770
Investing Activities				
Property, plant and equipment	(1,680)	(3,194)	(3,023)	(7,389)
Disposition of property, plant and equipment	502	491	502	491
Site restoration	(48)	(2)	(48)	(2)
Change in non-cash working capital	(1,406)	(1,991)	(1,892)	(1,503)
	(2,632)	(4,696)	(4,461)	(8,403)
Financing Activities				
Increase in bank debt	852	3,058	2,240	4,010
Class A Subordinate Voting Shares Repurchased for cancellation	(2)	(18)	(8)	(26)
Class B Multiple Voting Shares Repurchased for cancellation	–	–	(1)	–
	850	3,040	2,231	3,984
Increase (decrease) in cash	(77)	107	(146)	351
Cash, beginning of period	107	258	176	14
Cash, end of period	\$ 30	\$ 365	\$ 30	\$ 365
Cash flow per share				
Basic and diluted	\$ 0.02	\$ 0.05	\$ 0.04	\$ 0.13
Supplementary Information Regarding Cash Payments:				
Interest paid during the period	\$ 118	\$ 152	\$ 219	\$ 259
Taxes paid during the period	\$ 40	\$ –	\$ 76	\$ –

Notes to the Interim Financial Statements

For the six months ended June 30, 2002

1. Accounting Policies

The interim consolidated financial statements of Diaz Resources Ltd. have been prepared in accordance with accounting principles generally accepted in Canada. Management has made the necessary estimates and assumptions regarding certain types of assets, liabilities, revenues and expenses in the preparation of the financial statements. Accordingly, actual results may differ from estimated amounts but management does not believe such differences will materially affect Diaz's financial position or results of operations. Certain information and disclosures normally required to be included in the notes to the annual consolidated financial statements have been condensed or omitted. The reader should refer to the annual consolidated financial statements of Diaz at December 31, 2001.

2. Long-term debt

Due to a change in Canadian accounting principles, effective January 1, 2002, all credit facilities that are revolving, in nature, must be disclosed as "current portion of long-term debt." Diaz utilizes a secured revolving production loan that is payable on demand and is subject to an annual review and, therefore, is considered "current," for disclosure purposes and has been disclosed under current liabilities. For comparative purposes, the long-term debt outstanding at December 31, 2001 has been reclassified as well.

3. Share Capital

<i>(Thousands)</i>	June 30, 2002	
	Shares	Amount
Class A Subordinate Voting Shares		
Balance at December 31, 2001	35,681	\$ 8,186
Repurchased for cancellation	(24)	\$ (8)
Balance at June 30, 2002	35,657	\$ 8,178
Class B Multiple Voting Shares		
Balance at December 31, 2001	6,200	1,851
Repurchased for cancellation	(3)	(1)
Balance at June 30, 2002	6,197	1,850
Total Shares Outstanding, June 30, 2002	41,854	\$ 10,028

Voting Rights

Class A Subordinate Voting Shares carry voting rights of one vote per share; Class B Multiple Voting Shares carry voting rights of 25 votes per share.

Restrictions on Issuance

Additional Class B Shares may only be issued on conversion of Class A Shares in the event of a take-over bid, which has been accepted by holders of 50.1% of the Class B Shares.

Conversion Provisions

In the event of a take-over bid, which has been accepted by holders of 50.1% of the Class B Shares, Class A Shares may be converted into Class B Shares on the basis of one Class B Share for each Class A Share converted.

Stock Option Plan

As at June 30, 2002, there are a total of 2,610,000 options granted and outstanding under the stock option plan with a weighted average exercise price of \$0.34 per share. A total of 3,538,000 options with a weighted average exercise price of \$0.34 are exercisable at the end of the period.

The Company accounts for its stock based compensation plan using the intrinsic value method, whereby no compensation costs have been recognized in the financial statements for share options granted to employees and directors. As now required by Canadian generally accepted accounting principles, the impact on compensation costs of using the fair value method, whereby compensation costs have been recorded in net earnings, must be disclosed. If the fair value method had been used for options granted subsequent to January 1, 2002, the Company's compensation costs for the period would have been increased by \$16,000 and the loss for the period would have been \$95,000. This would have no material effect on the reported loss per share for the period.



The fair value of each option granted is estimated on the date of grant using the Black-Scholes option-pricing model with weighted average assumptions for grants as follows:

Risk free interest rate	3.64%
Expected lives (years)	3.00
Expected volatility	0.55
Dividends per share	—

4. Financial Instruments

The Company is exposed to fluctuations in commodity prices, interest rates and Canada/U.S. dollar exchange rates. The Company, when appropriate, utilized financial instruments to manage its exposure to these risks.

Natural gas

At June 30, 2002, Diaz had the following outstanding hedge obligations:

Volume	Fixed Price (\$/GJ)	Time Period for Hedge
1,500 GJ/day	\$ 3.58	July 1, 2002 to October 31, 2002
500 GJ/day	\$ 3.68	July 1, 2002 to October 31, 2002
1,000 GJ/day	\$ 4.27	July 1, 2002 to October 31, 2002

5. Segmented Information

The Company operates in the oil and gas industry within two geographical segments: Canada and the United States. The Company's only industry segment is the exploration for and the development of oil, natural gas and related products.

(Thousands)	Three Months Ended June 30		Six Months Ended June 30	
	2002	2001	2002	2001
Revenue				
Canada	\$ 1,561	\$ 2,546	\$ 2,880	\$ 5,864
United States	257	382	464	1,014
	\$ 1,818	\$ 2,928	\$ 3,344	\$ 6,878
Cash Flow from Operations				
Canada	\$ 714	\$ 1,528	\$ 1,240	\$ 3,880
United States	221	304	328	987
	\$ 935	\$ 1,832	\$ 1,568	\$ 4,867
Depletion and Depreciation				
Canada	\$ 739	\$ 669	\$ 1,464	\$ 1,336
United States	66	59	126	108
	\$ 805	\$ 728	\$ 1,590	\$ 1,444
Net Earnings (Loss)				
Canada	\$ (94)	\$ 576	\$ (207)	\$ 1,683
United States	93	179	128	575
	\$ (1)	\$ 755	\$ (79)	\$ 2,258
Additions to Property, Plant & Equipment				
Canada	\$ 1,469	\$ 2,940	\$ 2,771	\$ 7,015
United States	211	254	252	374
	\$ 1,680	\$ 3,194	\$ 3,023	\$ 7,389
Asset Disposition				
Canada	\$ 276	\$ 491	\$ 276	\$ 491
United States	226	—	226	—
	\$ 502	\$ 491	\$ 502	\$ 491
Identifiable Assets (at end of period)				
Canada	\$ 28,717	\$ 25,380	\$ 28,717	\$ 25,380
United States	2,485	3,075	2,485	3,075
	\$ 31,202	\$ 28,455	\$ 31,202	\$ 28,455



Corporate Information

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R.W. Lamond

President, Chairman of the Board and CEO

C.A. Teare

Executive Vice President and CFO

D.K. Clark

Vice President, Operations

C.S. Cohen

Corporate Secretary

Subsidiaries

Diaz Resources, Inc.

Registrar and Transfer Agent

Computershare Trust Company of Canada

Calgary, Alberta

Toronto, Ontario

Stock Exchange Listing

Toronto Stock Exchange

Trading Symbols:

Subordinate Voting Shares: DZR.a

Multiple Voting Shares: DZR.b

