

# Corporate Summary

| <i>(Thousands, except per share amounts)</i>   | Six Months Ended June 30 |                           |
|------------------------------------------------|--------------------------|---------------------------|
|                                                | 2004                     | <i>(Restated)</i><br>2003 |
| <b>Financial</b>                               |                          |                           |
| Total revenue                                  | \$ 6,930                 | \$ 4,656                  |
| Cash flow                                      | \$ 4,513                 | \$ 2,751                  |
| Cash flow per share (diluted)                  | \$ 0.08                  | \$ 0.06                   |
| Earnings for the period                        | \$ 950                   | \$ 1,205                  |
| Earnings per share (diluted)                   | \$ 0.02                  | \$ 0.03                   |
| Capital additions                              | \$ 5,437                 | \$ 2,579                  |
| Dispositions                                   | \$ 17                    | \$ 268                    |
| Net debt                                       | \$ 7,882                 | \$ 10,042                 |
| Total assets                                   | \$ 43,251                | \$ 39,075                 |
| <b>Operations</b>                              |                          |                           |
| <b>Production</b>                              |                          |                           |
| Gas (MMcfd)                                    | 6.3                      | 4.3                       |
| Oil (Bopd)                                     | 106                      | 98                        |
| BOEd (6Mcf = 1Bbl)                             | 1,148                    | 809                       |
| <b>Product Prices</b>                          |                          |                           |
| Gas (\$/Mcf)                                   | \$ 6.93                  | \$ 6.53                   |
| Oil (\$/Bbl)                                   | \$ 44.68                 | \$ 41.11                  |
| <b>Total shares outstanding, at period end</b> | <b>57,342</b>            | <b>45,914</b>             |



# To the Shareholders

Diaz's financial and operating results for the second quarter of 2004 were significantly improved from one year ago, primarily as a result of a substantial increase in production volumes. Production volumes rose by 42% to average 1,148 BOEd and with new gas tied-in in Canada during 2004, Diaz's production is presently averaging approximately 1,300 BOEd.

## FINANCIAL

Financial results for the quarter were noticeably improved over last year's results.

Revenue for the six months ended June 30, 2004 totaled \$6.9 million compared with \$4.7 million one year earlier.

Cash flow for the period increased by 64% to \$4.5 million, or \$0.08 per share compared with \$2.8 million, or \$0.06 per share in 2003. Diaz reported earnings for the six months ended June 30, 2004 of \$1.0 million, or \$0.02 per share compared with \$1.2 million, or \$0.03 per share reported in 2003.

Capital expenditures totaled \$5.3 million compared with \$2.5 million in 2003. Capital expenditures were financed from \$4.5 million of cash flow and from an increase of \$0.8 million in the Company's net debt. Diaz completed the second quarter of 2004 with net debt of \$7.9 million and debt repayability from annualized cash flow from operations was reduced to 0.9 times from 1.7 times in the prior period.

## PRODUCTION

For the second quarter of 2004, natural gas production averaged 6.3 MMcfd compared with 4.3 MMcfd in 2003, a 47% increase.

Oil production averaged 106 Bopd compared with 98 Bopd in 2003. Total production increased to 1,148 BOEd from 809 BOEd in 2003.

## EXPLORATION AND DEVELOPMENT

### Canada

During Q1 2004, Diaz participated in natural gas discoveries at Enchant and Figure Lake in Alberta.

At Enchant, Diaz participated for 50% of a Bow Island gas well, which was tied-in in April and is currently producing at a rate of 2.1 MMcfd. In May, a second well located at Figure Lake, in which Diaz owns an 80% interest, was tied-in and initially produced at a rate of 500 Mcfd. However, the well encountered an influx of heavy oil and is currently suspended pending a re-completion attempt to solve the problem.

The majority of Diaz's capital budget in the first half of 2004 was spent on completions and facilities construction to tie-in new gas wells in southern and central Alberta. By the end of the June 30, 2004, 10 new wells were tied-in increasing the Company's production to over 1,300 BOEd.

For the balance of the year, Diaz will focus on continuing its infill gas well program in southern Alberta and on higher-impact exploration prospects in central Alberta.

### United States

The Wilcox program, in Colorado and Lavaca counties in Texas, has produced mixed results to date.

#### *Provident City – Diaz working interest 13%*

The Provident City #1 re-completion continues to perform exceptionally well, with current production at 10 MMcfd and cumulative production of 3.5 Bcf, since July 2003.

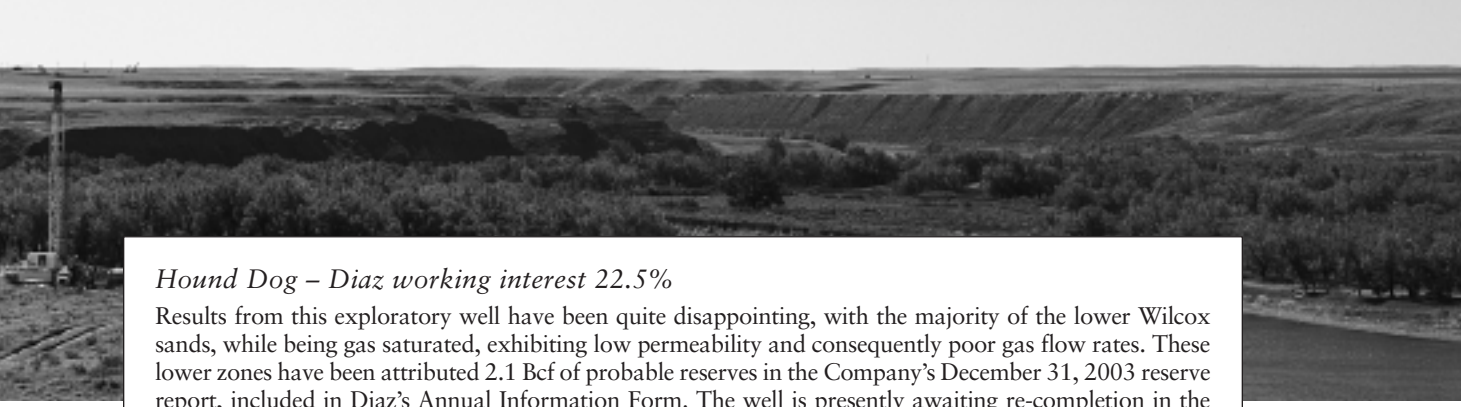
#### *Mustang Creek – Diaz working interest 8.3%*

The Lehrer #1 well, which was perforated in three thin lower Wilcox zones is flowing steadily at 1 MMcfd and has current cumulative production of 0.6 Bcf.

The Lehrer #2 well produced at marginally economic rates from the middle Magnolia sand and encountered mechanical problems while attempting to re-complete the Heartbreak sand.

The operator plans to sidetrack the well to re-evaluate a number of prospective Wilcox sands.





*Hound Dog – Diaz working interest 22.5%*

Results from this exploratory well have been quite disappointing, with the majority of the lower Wilcox sands, while being gas saturated, exhibiting low permeability and consequently poor gas flow rates. These lower zones have been attributed 2.1 Bcf of probable reserves in the Company's December 31, 2003 reserve report, included in Diaz's Annual Information Form. The well is presently awaiting re-completion in the Wilcox #11 sand and Diaz remains optimistic that this and higher sands will prove to be commercial.

While the foregoing results have been poorer than anticipated, the productivity and reserves per Wilcox zone exhibited in the Provident City pool, still encourages Diaz to continue evaluating the current wells and potential new locations on this trend.

## **THE ECONOMY AND ENERGY COMMODITY PRICES**

The U.S. economy appears to be steadily recovering and a combination of a low U.S. dollar, together with low interest rates, has continued this trend into 2004. The recovery should lead to higher energy demand and continue to result in high oil and gas prices.

Continued uncertainties in the Middle East and Russia, combined with increasing demand from emerging economies such as China, have resulted in oil prices in excess of \$44.00 U.S. per barrel.

Natural gas prices have continued to exhibit a North American supply and demand cycle and have been positively influenced by fuel switching from higher priced oil. Despite storage volumes increasing to above seasonally normal levels, prices remain in excess of \$5.50 U.S. per Mcf. However, the increased drilling rate resulting from higher commodity prices should provide additional natural gas supply and could place downward pressure on natural gas prices in the latter half of 2004.

For the long-term, Diaz does not believe new North American supply can replace ongoing decline rates. This should result in continuing high prices in 2005 and should continue to improve Diaz's ongoing financial results.

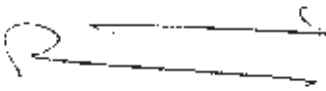
## **BUSINESS OUTLOOK**

The Company is very optimistic regarding the outlook for 2004.

The combined effect of increased production in the last half of 2003 and the first half of 2004, high commodity prices, positive exploration results in the U.S. and new prospects being developed in both Texas and Alberta, should result in significant growth in cash flow during 2004.

In addition, the completion of equity issues in the last quarter of 2003 places Diaz in an excellent financial position to take full advantage of these growth opportunities.

On behalf of the Board,



R.W. Lamond  
President  
August 9, 2004

# Management's Discussion and Analysis

The following discussion and analysis is management's assessment of Diaz's historical, financial and operating results, together with future prospects, and should be read in conjunction with the unaudited consolidated financial statements of the Company for the six months ended June 30, 2004. The reader should be aware that historical results are not necessarily indicative of future performance.

The consolidated statement of operations and retained earnings and the consolidated statement of cash flows for the six months ended June 30, 2003 have not been reviewed by the Company's external auditors.

## *Basis of Presentation*

The financial data presented herein has been prepared in accordance with accounting principles generally accepted in Canada. All dollar amounts are in Canadian dollars unless otherwise indicated.

**Non-GAAP Measurements** – The Management's Discussion and Analysis contains the term cash flow from operations, which should not be considered an alternative to, or more meaningful as an indicator of the Company's performance than, cash flow from operating activities, as determined in accordance with accounting principles generally accepted in Canada. Diaz's determination of cash flow from operations may not be particularly comparable to that reported by other companies, especially those in other industries. The reconciliation between net earnings and cash flow from operations can be found in the consolidated statements of cash flows in the unaudited interim consolidated financial statements and the audited consolidated financial statements. The Company also presents cash flow from operations per share whereby per share amounts are calculated using weighted average shares outstanding consistent with the calculation of earnings per share.

**BOE Presentation** – The term barrels of oil equivalent (BOE) may be misleading, particularly if used in isolation. A BOE conversion ratio of 6 Mcf : 1 Bbl is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. All BOE conversions in this report are derived by converting gas to oil in the ratio of six Mcf of gas to one Bbl of oil.

This discussion and the Company's second quarter interim report contain forward-looking statements that involve risk and uncertainties. Such information, although considered reasonable by management at the time of preparation, may prove to be incorrect and actual results may differ materially from those anticipated in the statements made.

## *Oil & Gas Production*

Diaz is primarily a natural gas producer with over 90% of its production in 2004 coming from natural gas wells. Diaz owns interests in producing properties in Alberta and Saskatchewan, in Canada and in the United States, almost exclusively in Texas.

The Company's U.S. natural gas production increased to average 1.7 MMcfd in the first half of 2004 from approximately 0.6 MMcfd in the first half of 2003. The increase is primarily due to production from a new zone completed in the Company's Provident City #1 well in June 2003.

In Canada, natural gas production also increased to average 4.5 MMcfd in 2004 compared with 3.6 MMcfd in the first half of 2003. New production at Provost, Edwand, Enchant and Jaslan was the primary reason for the increase.

Canadian production continues to increase, averaging 5.2 MMcfd in Q2 2004 compared with 3.5 MMcfd in Q2 2003.

Diaz's Canadian oil production was slightly lower than reported in 2003, which was the result of normal declines in the Company's mature properties. This was offset by liquids production in the new Provident City zone in Texas.



| OIL & GAS PRODUCTION             | Three Months Ended<br>June 30 |       | Six Months Ended<br>June 30 |       |
|----------------------------------|-------------------------------|-------|-----------------------------|-------|
|                                  | 2004                          | 2003  | 2004                        | 2003  |
| Gas – Canada                     |                               |       |                             |       |
| Enchant                          | 2,154                         | 905   | 1,606                       | 954   |
| Retlaw/Little Bow                | 1,061                         | 973   | 1,032                       | 945   |
| Carmangay                        | 518                           | 419   | 419                         | 459   |
| Therien                          | 232                           | 267   | 239                         | 264   |
| Provost                          | 210                           | 29    | 213                         | 15    |
| Jaslan                           | 365                           | –     | 280                         | –     |
| Edward                           | 158                           | –     | 174                         | –     |
| Iron Springs                     | 166                           | 275   | 158                         | 283   |
| Other                            | 354                           | 600   | 386                         | 709   |
| Gas – Canada (Mcf)               | 5,218                         | 3,468 | 4,507                       | 3,629 |
| Oil & Liquids – Canada           |                               |       |                             |       |
| Parkman                          | 35                            | 33    | 35                          | 34    |
| Neutral Hills                    | 20                            | 22    | 20                          | 23    |
| Red Earth                        | 13                            | 17    | 13                          | 17    |
| Other                            | 24                            | 28    | 22                          | 24    |
| Oil & Liquids – Canada (Bopd)    | 92                            | 100   | 90                          | 98    |
| BOEd – Canada (6Mcf = 1Bbl)      | 961                           | 678   | 841                         | 703   |
| Gas – U.S.                       |                               |       |                             |       |
| Provident City                   | 1,578                         | 580   | 1,620                       | 564   |
| Mustang Creek                    | 81                            | 117   | 115                         | 59    |
| Other                            | 12                            | 13    | 11                          | 15    |
| Gas – U.S. (Mcf)                 | 1,671                         | 710   | 1,746                       | 638   |
| Oil & Liquids – U.S.             |                               |       |                             |       |
| Provident City                   | 16                            | –     | 16                          | –     |
| Oil & Liquids – U.S. (Bopd)      | 16                            | –     | 16                          | –     |
| BOEd – U.S. (6Mcf = 1Bbl)        | 295                           | 118   | 307                         | 106   |
| Gas – Company (Mcf)              | 6,889                         | 4,178 | 6,253                       | 4,267 |
| Oil and Liquids – Company (Bopd) | 108                           | 100   | 106                         | 98    |
| BOEd – Company                   | 1,256                         | 796   | 1,148                       | 809   |

| PRODUCT PRICES         | Three Months Ended<br>June 30 |          | Six Months Ended<br>June 30 |          |
|------------------------|-------------------------------|----------|-----------------------------|----------|
|                        | 2004                          | 2003     | 2004                        | 2003     |
| Canada                 |                               |          |                             |          |
| Gas (\$/Mcf)           | \$ 6.50                       | \$ 6.35  | \$ 6.58                     | \$ 6.40  |
| Oil & Liquids (\$/Bbl) | \$ 45.80                      | \$ 36.23 | \$ 43.99                    | \$ 41.16 |
| \$/BOE                 | \$ 39.62                      | \$ 37.81 | \$ 39.95                    | \$ 38.76 |
| U.S.                   |                               |          |                             |          |
| Gas (\$/Mcf)           | \$ 7.75                       | \$ 6.18  | \$ 7.48                     | \$ 7.29  |
| Oil & Liquids (\$/Bbl) | \$ 54.01                      | \$ n/a   | \$ 48.69                    | \$ n/a   |
| \$/BOE                 | \$ 46.91                      | \$ 37.06 | \$ 45.07                    | \$ 43.72 |
| \$/BOE – Company       | \$ 41.33                      | \$ 37.70 | \$ 41.31                    | \$ 39.42 |

Average commodity prices for the six months ended June 30, 2004 were marginally higher than prices for the same period in 2003 and the outlook remains positive for gas prices to remain at these levels. Canadian gas prices averaged \$6.58 per Mcf, 5% higher than the price reported in 2003. Oil prices were 7% higher than the comparable period in 2003.

Diaz believes oil prices will remain high throughout 2004 due to a strong global demand for oil and supply concerns in the Middle East and recently in Russia. This will continue to have a positive influence on gas prices and maintain pressure to keep gas prices high despite higher inventory levels. However, the Company has sold forward approximately 2 MMcf of gas production at an average price of \$5.94 to \$6.26 per Mcf for the period beginning April 1, 2004 to October 31, 2004 and 2 MMcf of gas production at average prices of between \$7.63 and \$8.05 per Mcf from November 1, 2004 to March 31, 2005.

| REVENUE FROM OIL AND GAS PRODUCTION<br>(Thousands) | Three Months Ended<br>June 30 |                 | Six Months Ended<br>June 30 |                 |
|----------------------------------------------------|-------------------------------|-----------------|-----------------------------|-----------------|
|                                                    | 2004                          | 2003            | 2004                        | 2003            |
| Canada                                             |                               |                 |                             |                 |
| Natural gas                                        | \$ 3,084                      | \$ 2,005        | \$ 5,395                    | \$ 4,201        |
| Oil and natural gas liquids                        | 383                           | 330             | 721                         | 730             |
| Other                                              | 8                             | 7               | 14                          | 9               |
| Total revenue                                      | \$ 3,475                      | \$ 2,342        | \$ 6,130                    | \$ 4,940        |
| U.S.                                               |                               |                 |                             |                 |
| Natural gas                                        | \$ 1,178                      | \$ 399          | \$ 2,376                    | \$ 842          |
| Oil and natural gas liquids                        | 79                            | -               | 139                         | -               |
| Other                                              | 1                             | -               | 1                           | -               |
| Total Revenue                                      | \$ 1,258                      | \$ 399          | \$ 2,516                    | \$ 842          |
| <b>Total Revenue – Company</b>                     | <b>\$ 4,733</b>               | <b>\$ 2,741</b> | <b>\$ 8,646</b>             | <b>\$ 5,782</b> |

Diaz's growing U.S. gas production accounted for 27% of the Company's revenue during Q2 2004, compared with 15% for the same period in 2003. Higher natural gas production combined with marginally higher prices was responsible for a 52% increase in revenue, to \$8.6 million for the six months ended June 30, 2004 compared with \$5.8 million in 2003.

As a result of increased production placed on stream during 2004 and continued high gas prices, Diaz is confident that revenues will continue to grow throughout the year.

| ROYALTIES<br>(Thousands, except percentage amounts) | Three Months Ended<br>June 30 |          | Six Months Ended<br>June 30 |          |
|-----------------------------------------------------|-------------------------------|----------|-----------------------------|----------|
|                                                     | 2004                          | 2003     | 2004                        | 2003     |
| Canada                                              |                               |          |                             |          |
| Crown                                               | \$ 471                        | \$ 275   | \$ 715                      | \$ 567   |
| Freehold                                            | 185                           | 172      | 410                         | 386      |
| Alberta Royalty Tax Credit (ARTC)                   | (104)                         | (40)     | (144)                       | (87)     |
| Royalties, net of ARTC                              | \$ 552                        | \$ 407   | \$ 981                      | \$ 866   |
| per BOE                                             | \$ 6.31                       | \$ 6.60  | \$ 6.41                     | \$ 6.81  |
| Royalty as a percentage of revenue                  | 15.9%                         | 17.4%    | 16.0%                       | 17.5%    |
| U.S.                                                |                               |          |                             |          |
| Royalties                                           | \$ 363                        | \$ 119   | \$ 735                      | \$ 260   |
| per BOE                                             | \$ 13.55                      | \$ 11.05 | \$ 13.17                    | \$ 13.50 |
| Royalty as a percentage of revenue                  | 28.9%                         | 29.8%    | 29.2%                       | 30.9%    |

During the first half of 2004, the royalty rates in both Canada and the United States remained relatively unchanged. A modest decline in Canada resulted from an increased Alberta Royalty Tax Credit for the second quarter.

| OPERATING EXPENSE<br>(Thousands, except per BOE amounts) | Three Months Ended<br>June 30 |                | Six Months Ended<br>June 30 |                |
|----------------------------------------------------------|-------------------------------|----------------|-----------------------------|----------------|
|                                                          | 2004                          | 2003           | 2004                        | 2003           |
| Canada                                                   | \$ 908                        | \$ 488         | \$ 1,613                    | \$ 1,011       |
| per BOE                                                  | \$ 10.37                      | \$ 7.91        | \$ 10.54                    | \$ 7.95        |
| U.S.                                                     | \$ 22                         | \$ 6           | \$ 51                       | \$ 15          |
| per BOE                                                  | \$ 0.83                       | \$ 0.56        | \$ 0.91                     | \$ 0.78        |
| <b>Total – Company, per BOE</b>                          | <b>\$ 8.14</b>                | <b>\$ 6.82</b> | <b>\$ 7.97</b>              | <b>\$ 7.01</b> |

During the first six months of 2004, operating costs in Canada increased by 33% on a BOE basis. This increase is primarily attributed to higher processing and compression fees and repairs and maintenance costs on non-operated properties. The Company is addressing these issues with the third party operators.



| OVERHEAD<br><i>(Thousands, except per BOE amounts)</i> | Three Months Ended<br>June 30 |         | Six Months Ended<br>June 30 |         |
|--------------------------------------------------------|-------------------------------|---------|-----------------------------|---------|
|                                                        | 2004                          | 2003    | 2004                        | 2003    |
| Compensation costs                                     | \$ 216                        | \$ 204  | \$ 440                      | \$ 426  |
| Stock based compensation costs                         | 38                            | –       | 76                          | –       |
| Other overhead costs                                   | 191                           | 139     | 421                         | 345     |
| Recovered from third parties                           | (101)                         | (65)    | (189)                       | (127)   |
| Capitalized                                            | (43)                          | (48)    | (101)                       | (105)   |
| Net overhead                                           | \$ 301                        | \$ 230  | \$ 647                      | \$ 539  |
| per BOE                                                | \$ 2.63                       | \$ 3.17 | \$ 3.10                     | \$ 3.68 |

Overhead costs increased to \$647,000 during the six months ended June 30, 2004 primarily as a result of the non-cash compensation costs associated with employee options.

| INTEREST EXPENSE<br><i>(Thousands, except per BOE and percentage amounts)</i> | Three Months Ended<br>June 30 |          | Six Months Ended<br>June 30 |          |
|-------------------------------------------------------------------------------|-------------------------------|----------|-----------------------------|----------|
|                                                                               | 2004                          | 2003     | 2004                        | 2003     |
| Average bank debt                                                             | \$ 8,407                      | \$ 6,443 | \$ 7,425                    | \$ 9,261 |
| Interest expense                                                              | \$ 96                         | \$ 132   | \$ 177                      | \$ 251   |
| per BOE                                                                       | \$ 0.84                       | \$ 0.86  | \$ 0.85                     | \$ 1.61  |
| Average interest rate                                                         | 4.5%                          | 5.0%     | 4.7%                        | 5.0%     |

Total interest expense decreased to \$177,000 during the six months ended June 30, 2004 from \$251,000 reported one year earlier. This was due to the smaller loan balance during the current period.

Diaz reduced its bank debt in Q4 2003 with the proceeds from two equity financings completed during the period. Diaz anticipates its debt level will remain under \$9.0 million during 2004.

| DEPLETION, DEPRECIATION & AMORTIZATION<br><i>(Thousands, except per BOE amounts)</i> | Three Months Ended<br>June 30 |          | Six Months Ended<br>June 30 |          |
|--------------------------------------------------------------------------------------|-------------------------------|----------|-----------------------------|----------|
|                                                                                      | 2004                          | 2003     | 2004                        | 2003     |
| Canada                                                                               |                               |          |                             |          |
| Depletion and depreciation                                                           | \$ 1,436                      | \$ 703   | \$ 2,439                    | \$ 1,427 |
| Asset Retirement Obligation accretion                                                | 50                            | 22       | 76                          | 44       |
|                                                                                      | 1,486                         | 725      | 2,515                       | 1,471    |
| per BOE                                                                              | \$ 16.98                      | \$ 11.75 | \$ 16.43                    | \$ 11.56 |
| U.S.                                                                                 |                               |          |                             |          |
| Depletion and depreciation                                                           | \$ 182                        | \$ 34    | \$ 366                      | \$ 57    |
| Asset Retirement Obligation accretion                                                | –                             | 1        | 1                           | 1        |
| Amortization of deferred credit                                                      | –                             | 40       | (15)                        | –        |
| Net depletion and depreciation                                                       | \$ 182                        | \$ 75    | \$ 352                      | \$ 58    |
| per BOE                                                                              | \$ 6.79                       | \$ 6.97  | \$ 6.31                     | \$ 3.01  |
| Total – Company                                                                      | \$ 1,668                      | \$ 800   | \$ 2,867                    | \$ 1,529 |
| per BOE                                                                              | \$ 14.59                      | \$ 11.04 | \$ 13.72                    | \$ 10.04 |

The higher depletion rate reflects the poor finding costs reported in 2003. These rates will continue at the current level until such time as the finding costs are significantly reduced.

## LIQUIDITY AND CAPITAL RESOURCES

Diaz completed the six months ended June 30, 2004 with a net debt of \$7.9 million compared with \$10.0 million in 2003. The Company has a credit facility of \$9.6 million.

The Company's capital expenditure budget for 2004 will be funded primarily from cash flow.

## INCOME TAXES

Diaz reports future tax expense of \$638,000 and current capital taxes of \$5,000. The Company does not anticipate being taxable on its earnings in 2004, however, Diaz may be taxable on its earnings in 2005.



## **ISSUER BID**

During the six months ended June 30, 2004, Diaz repurchased 179,500 Multiple Voting Shares and 41,000 Class A Subordinate Voting Shares and at an average price of \$0.58 per share.

## **BUSINESS RISK**

The Company is engaged in the exploration, development, production and acquisition of crude oil and natural gas. Diaz's business is inherently risky and there is no assurance that hydrocarbon reserves will be discovered and economically produced.

Financial risks associated with the petroleum industry include fluctuations in commodity prices, interest rates and currency exchange rates. Operational risks include competition, environmental factors, reservoir performance uncertainties, a complex regulatory environment and safety concerns.

The Company minimizes its business risks by focusing on a select group of properties. This enables Diaz to have more control over the timing, direction and costs related to exploration and development opportunities. The geological focus is on areas in which the prospects are well understood by management. Technological tools are regularly used to reduce risk and increase the probability of success. The Company closely follows all government regulations and has an up-to-date emergency response plan that has been communicated to all field operations by management. Diaz also carries insurance coverage to protect itself against potential losses.

Employing a highly motivated and experienced staff of petroleum and natural gas professionals further minimizes the business risk.

The Company is exposed to commodity price and market risk for its principal products of petroleum and natural gas. Commodity prices are influenced by a wide variety of factors of which most are beyond the control of Diaz. To manage this risk, the Company has entered into a number of forward sales contracts in relation to gas prices.

## **OUTLOOK**

The proceeds from the equity issue in October and December 2003, combined with additional gas production in both Canada and the United States and strong gas prices, will provide Diaz with the necessary cash flow and strong balance sheet to fund its exploration and development budget in the United States and in Canada.

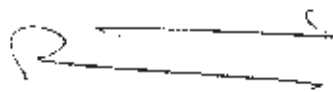


# Consolidated Balance Sheet

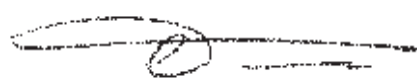
(unaudited)

| <i>(Thousands)</i>                                | June 30          | <i>(Restated—Note 2)</i><br>December 31 |
|---------------------------------------------------|------------------|-----------------------------------------|
| As at                                             | 2004             | 2003                                    |
| <b>ASSETS</b>                                     |                  |                                         |
| Current Assets                                    |                  |                                         |
| Cash                                              | \$ 1,620         | \$ 124                                  |
| Accounts receivable                               | 3,595            | 4,517                                   |
| Prepaid expense                                   | 223              | 200                                     |
|                                                   | <u>5,438</u>     | <u>4,841</u>                            |
| Future tax asset                                  | —                | 70                                      |
| Property, plant and equipment                     | 55,737           | 50,467                                  |
| Accumulated depletion and depreciation            | (17,924)         | (15,112)                                |
|                                                   | <u>37,813</u>    | <u>35,355</u>                           |
| <b>Total Assets</b>                               | <b>\$ 43,251</b> | <b>\$ 40,266</b>                        |
| <b>LIABILITIES</b>                                |                  |                                         |
| Current Liabilities                               |                  |                                         |
| Accounts payable and accrued liabilities          | \$ 4,652         | \$ 6,510                                |
| Bank debt (Note 3)                                | 8,668            | 5,431                                   |
|                                                   | <u>13,320</u>    | <u>11,941</u>                           |
| Other Liabilities                                 |                  |                                         |
| Future income tax liability                       | 4,870            | 4,309                                   |
| Deferred credits                                  | —                | 15                                      |
| Asset retirement obligation (Note 6)              | 2,493            | 2,405                                   |
| <b>Total Other Liabilities</b>                    | <b>7,363</b>     | <b>6,729</b>                            |
|                                                   | <u>20,683</u>    | <u>18,670</u>                           |
| <b>SHAREHOLDERS' EQUITY</b>                       |                  |                                         |
| Share capital (Note 4)                            | 15,310           | 15,303                                  |
| Contributed surplus (Note 4)                      | 274              | 198                                     |
| Retained earnings                                 | 6,984            | 6,095                                   |
|                                                   | <u>22,568</u>    | <u>21,596</u>                           |
| <b>Total Liabilities and Shareholders' Equity</b> | <b>\$ 43,251</b> | <b>\$ 40,266</b>                        |

Approved by the Board:



R.W. Lamond, Director



C.A. Teare, Director

## Consolidated Statement of Operations & Retained Earnings

(unaudited)

(Thousands, except per share amounts)

|                                                             | Three Months Ended    |                 | Six Months Ended      |                 |
|-------------------------------------------------------------|-----------------------|-----------------|-----------------------|-----------------|
|                                                             | June 30               |                 | June 30               |                 |
|                                                             | (Restated—<br>Note 2) |                 | (Restated—<br>Note 2) |                 |
|                                                             | 2004                  | 2003            | 2004                  | 2003            |
| <b>Revenue</b>                                              |                       |                 |                       |                 |
| Production                                                  | \$ 4,733              | \$ 2,741        | \$ 8,646              | \$ 5,782        |
| Royalties                                                   | (1,019)               | (566)           | (1,860)               | (1,213)         |
| Alberta Royalty Tax Credit                                  | 104                   | 40              | 144                   | 87              |
|                                                             | <b>3,818</b>          | <b>2,215</b>    | <b>6,930</b>          | <b>4,656</b>    |
| <b>Expenses</b>                                             |                       |                 |                       |                 |
| Operating                                                   | 930                   | 496             | 1,664                 | 1,026           |
| General and administration                                  | 301                   | 230             | 647                   | 539             |
| Interest expense                                            | 96                    | 132             | 177                   | 251             |
| Foreign exchange loss (gain)                                | (4)                   | 29              | (18)                  | 54              |
| Depletion and depreciation                                  | 1,667                 | 744             | 2,867                 | 1,487           |
|                                                             | <b>2,990</b>          | <b>1,631</b>    | <b>5,337</b>          | <b>3,357</b>    |
| Earnings before income tax                                  | <b>828</b>            | <b>584</b>      | <b>1,593</b>          | <b>1,299</b>    |
| <b>Income tax expense</b>                                   |                       |                 |                       |                 |
| Current                                                     | (11)                  | 60              | 5                     | 60              |
| Future                                                      | 479                   | (215)           | 638                   | 34              |
| Total income tax                                            | <b>468</b>            | <b>(155)</b>    | <b>643</b>            | <b>94</b>       |
| Net earnings for the period                                 | <b>360</b>            | <b>739</b>      | <b>950</b>            | <b>1,205</b>    |
| Excess of cost over paid up capital on<br>share repurchases | (44)                  | —               | (62)                  | (7)             |
| Retained earnings, beginning of period                      | 6,512                 | 4,449           | 6,067                 | 3,979           |
| Change in accounting policy (Note 2)                        | 156                   | 192             | 29                    | 203             |
| Retained earnings, end of period                            | <b>\$ 6,984</b>       | <b>\$ 5,380</b> | <b>\$ 6,984</b>       | <b>\$ 5,380</b> |
| Earnings per share, basic and diluted                       | <b>\$ 0.01</b>        | <b>\$ 0.01</b>  | <b>\$ 0.02</b>        | <b>\$ 0.03</b>  |



## Consolidated Statement of Cash Flows

(unaudited)

| (Thousands)                                        | Three Months Ended    |         | Six Months Ended      |          |
|----------------------------------------------------|-----------------------|---------|-----------------------|----------|
|                                                    | June 30               |         | June 30               |          |
|                                                    | (Restated—<br>Note 2) |         | (Restated—<br>Note 2) |          |
|                                                    | 2004                  | 2003    | 2004                  | 2003     |
| Cash provided by (used for):                       |                       |         |                       |          |
| Operating Activities                               |                       |         |                       |          |
| Earnings for the period                            | \$ 360                | \$ 739  | \$ 950                | \$ 1,205 |
| Non-cash items:                                    |                       |         |                       |          |
| Depreciation and depletion                         | 1,667                 | 744     | 2,867                 | 1,487    |
| Non-cash compensation                              | 38                    | —       | 76                    | —        |
| Future taxes                                       | 479                   | (215)   | 638                   | 34       |
| Foreign exchange loss (gain)                       | (4)                   | —       | (18)                  | 25       |
| Cash flow from operations                          | 2,540                 | 1,268   | 4,513                 | 2,751    |
| Change in non-cash working capital                 | (1,226)               | (636)   | (1,116)               | (651)    |
|                                                    | 1,314                 | 632     | 3,397                 | 2,100    |
| Investing Activities                               |                       |         |                       |          |
| Property, plant and equipment – additions          | (2,348)               | (957)   | (5,277)               | (2,517)  |
| Property, plant and equipment – dispositions       | —                     | —       | 17                    | 268      |
| Change in non-cash working capital                 | 2,132                 | (463)   | 173                   | (436)    |
|                                                    | (216)                 | (1,420) | (5,087)               | (2,685)  |
| Financing Activities                               |                       |         |                       |          |
| Increase in bank debt                              | (352)                 | 734     | 3,237                 | 609      |
| Class A Subordinate Voting Shares                  |                       |         |                       |          |
| Issued for cash on exercise of options             | 2                     | —       | 77                    | —        |
| Repurchased for cancellation                       | (20)                  | —       | (20)                  | (45)     |
| Class B Multiple Voting Shares                     |                       |         |                       |          |
| Repurchased for cancellation                       | (68)                  | —       | (108)                 | (1)      |
| Offering cost                                      | (2)                   | —       | (2)                   | (1)      |
|                                                    | (438)                 | 734     | 3,186                 | 563      |
| Increase (decrease) in cash                        | 660                   | (54)    | 1,496                 | (22)     |
| Cash, beginning of period                          | 960                   | 170     | 124                   | 138      |
| Cash, end of period                                | \$ 1,620              | \$ 116  | \$ 1,620              | \$ 116   |
| Supplementary information regarding cash payments: |                       |         |                       |          |
| Interest paid during the period                    | \$ 95                 | \$ 132  | \$ 176                | \$ 251   |
| Taxes paid during the period                       | \$ (11)               | \$ 38   | \$ 5                  | \$ 38    |

# Notes to the Interim Consolidated Financial Statements

For the Six Months Ended June 30, 2004

## 1. Accounting Policies

The interim consolidated financial statements of Diaz Resources Ltd. ("Diaz") 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, 2003.

## 2. Change in Accounting Policy

### a) Asset retirement obligations

As at January 1, 2004, the Company has retroactively adopted the Canadian Institute of Chartered Accountants ("CICA" guideline for accounting for asset retirement obligation - "ARO"). Under this standard, the Company must recognize the fair value of an ARO as a liability in the period in which it is incurred if a reasonable estimate of fair value can be made. The present value of the estimated ARO is capitalized as part of the net capitalized asset base and the depletion of the capitalized asset retirement cost is determined on a basis consistent with depletion of the Company's other assets. With time accretion will increase the carrying amount of the obligation. Accretion will also be expensed.

Previously, the Company provided for estimated future abandonment and site restoration costs for its oil and gas properties using the unit-of-production method. The adoption of the new policy resulted in increasing retained earnings at December 31, 2003 by \$226,000 (2002 - (\$203,000)), and a decrease in the earnings for the six months ended June 30, 2003 of \$6,000. An additional effect of this change is an increase to property, plant and equipment of \$2,147,000 at December 31, 2003 (2002 - \$1,913,000) and an increase to liabilities of \$1,921,000 (2002 - \$1,710,000) at December 31, 2003.

### b) Stock based compensation

At January 1, 2004, the Company adopted the fair value method for accounting of stock based compensation. The change was accounted for retroactively without restatement of prior period numbers. Using the fair value method, compensation costs of stock based compensation are estimated and charged to earnings in the period of the option grant.

Previously, the Company used the intrinsic value method and no compensation expense was recognized.

As a result of this change in accounting policy, retained earnings at January 1, 2004 have been decreased by \$198,000 and share surplus has been increased by \$198,000.

### c) Oil and gas full cost accounting

As at January 1, 2004, the Company adopted Accounting Guideline 16, "Oil and Gas Accounting - Full Cost" ("AcG-16), replacing AcG-5. AcG-16 provides for methodology consistent with CICA Section 3063, "Impairment of Long-lived Assets" and CICA Section 3475, "Disposal of Long-lived Assets and Discontinued Operations."

The new standards prescribed the recognition of impairment only if the carrying amount of a long-lived asset is not recoverable from its undiscounted cash flows and measure the impairment amount as the difference between the carrying amount and the fair value. In addition, discontinued operations disclosure will be required upon the disposition of a component or cost centre of the entity rather than an entire business segment. There was no effect on the Company's financial statements.

## 3. Long-term Debt

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.



## 4. Share Capital

| <i>(Thousands)</i>                             | June 30, 2004 |                  |
|------------------------------------------------|---------------|------------------|
|                                                | No. of Shares | Amount           |
| <b>Class A Subordinate Voting Shares</b>       |               |                  |
| Balance, December 31, 2003                     | 51,104        | \$ 13,459        |
| Issued on exercise of options                  | 285           | 77               |
| Offering expense                               | –             | (2)              |
| Repurchased for cancellation                   | (41)          | (13)             |
| <b>Balance, June 30, 2004</b>                  | <b>51,348</b> | <b>\$ 13,521</b> |
| <b>Class B Multiple Voting Shares</b>          |               |                  |
| Balance, December 31, 2003                     | 6,174         | \$ 1,844         |
| Repurchased for cancellation                   | (180)         | (55)             |
| <b>Balance, June 30, 2004</b>                  | <b>5,994</b>  | <b>\$ 1,789</b>  |
| Contributed Surplus                            | –             | 274              |
| <b>Total Shares Outstanding, June 30, 2004</b> | <b>57,342</b> | <b>\$ 15,584</b> |

### 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. Class A Shares may be converted into Class B Shares on the basis of one Class B Share for each Class A Share converted.

### 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, 2004, there are a total of 3,003,333 options granted and outstanding under the stock option plan with a weighted average exercise price of \$0.31 per share. A total of 2,535,700 options with a weighted average exercise price of \$0.31 are exercisable at the end of the period.

The Company accounts for its stock based compensation plan using the fair value method, whereby compensation costs are charged to earnings in the period in which they are incurred.

The fair value of each option granted is estimated on the date of grant using the Black-Scholes option-pricing model with assumptions as follows: Risk free interest rate – 3.00%; Expected lives (years) – 4.00; Expected volatility – 0.90 and Dividends per share – nil.

## 5. Financial Instruments

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

### Natural gas contracts

At June 30, 2004, the following fixed price contracts were in effect:

#### Fixed Price

| Volume             | Fixed Price |          | Time Period for Contract      |
|--------------------|-------------|----------|-------------------------------|
|                    | (\$/GJ)     | (\$/Mcf) |                               |
| 500 GJd (475 Mcfd) | \$ 5.76     | \$ 6.05  | July 1, 2004 to Oct. 31, 2004 |
| 500 GJd (475 Mcfd) | \$ 5.77     | \$ 6.06  | July 1, 2004 to Oct. 31, 2004 |

### Costless Collar

| Volume               | Floor Price |          | Ceiling Price |          | Time Period for Contract      |
|----------------------|-------------|----------|---------------|----------|-------------------------------|
|                      | (\$/GJ)     | (\$/Mcf) | (\$/GJ)       | (\$/Mcf) |                               |
| 1,000 GJd (950 Mcfd) | \$ 5.50     | \$ 5.80  | \$ 6.10       | \$ 6.44  | July 1, 2004 to Oct. 31, 2004 |
| 1,000 GJd (950 Mcfd) | \$ 6.40     | \$ 6.72  | \$ 7.40       | \$ 7.77  | Nov. 1, 2004 to Mar. 31, 2005 |
| 1,000 GJd (950 Mcfd) | \$ 6.50     | \$ 6.83  | \$ 7.87       | \$ 8.26  | Nov. 1, 2004 to Mar. 31, 2005 |

## 6. Asset Retirement Obligation

The following table presents the reconciliation of the beginning and ending aggregate carrying amount of the obligation associated with the retirement of oil and gas properties:

|                                                  | 2004     | 2003     |
|--------------------------------------------------|----------|----------|
| Asset Retirement Obligation, beginning of period | \$ 2,405 | \$ 2,112 |
| Liabilities incurred                             | 160      | 63       |
| Liabilities settled                              | (150)    | (23)     |
| Accretion expense                                | 85       | 78       |
| Foreign exchange                                 | (7)      | (18)     |
| Asset Retirement Obligation, end of period       | \$ 2,493 | \$ 2,212 |

The total undiscounted amount of estimated cash flows required to settle the obligation is \$4,476,000, which has been discounted using a credit-adjusted risk free rate of 7 percent. Most of these obligations are expected to be paid between 2002 and 2022.



## 7. Segmented Information

The Company's only industry segment is the exploration for and development and production of oil and natural gas. The following table sets forth the geographical segments of the Company's operations between Canada and the United States.

| <i>(Thousands)</i>                       | Three Months Ended |                               | Six Months Ended              |                  |
|------------------------------------------|--------------------|-------------------------------|-------------------------------|------------------|
|                                          | June 30            |                               | June 30                       |                  |
|                                          |                    | <i>(Restated-<br/>Note 2)</i> | <i>(Restated-<br/>Note 2)</i> |                  |
|                                          | 2004               | 2003                          | 2004                          | 2003             |
| Revenue (net)                            |                    |                               |                               |                  |
| Canada                                   | \$ 2,921           | \$ 1,987                      | \$ 5,149                      | \$ 4,074         |
| United States                            | 896                | 280                           | 1,781                         | 582              |
|                                          | <b>\$ 3,817</b>    | <b>\$ 2,267</b>               | <b>\$ 6,930</b>               | <b>\$ 4,656</b>  |
| Interest Expense                         |                    |                               |                               |                  |
| Canada                                   | \$ 96              | \$ 132                        | \$ 177                        | \$ 251           |
| United States                            | -                  | -                             | -                             | -                |
|                                          | <b>\$ 96</b>       | <b>\$ 132</b>                 | <b>\$ 177</b>                 | <b>\$ 251</b>    |
| Current Taxes                            |                    |                               |                               |                  |
| Canada                                   | \$ (11)            | 60                            | \$ 5                          | 60               |
| United States                            | -                  | -                             | -                             | -                |
|                                          | <b>\$ (11)</b>     | <b>\$ 60</b>                  | <b>\$ 5</b>                   | <b>\$ 60</b>     |
| Cash Flow from Operations                |                    |                               |                               |                  |
| Canada                                   | \$ 1,688           | \$ 1,050                      | \$ 2,807                      | \$ 2,241         |
| United States                            | 852                | 218                           | 1,706                         | 510              |
|                                          | <b>\$ 2,540</b>    | <b>\$ 1,268</b>               | <b>\$ 4,513</b>               | <b>\$ 2,751</b>  |
| Depletion and Depreciation               |                    |                               |                               |                  |
| Canada                                   | \$ 1,485           | \$ 669                        | \$ 2,515                      | \$ 1,429         |
| United States                            | 182                | 75                            | 352                           | 58               |
|                                          | <b>\$ 1,667</b>    | <b>\$ 744</b>                 | <b>\$ 2,867</b>               | <b>\$ 1,487</b>  |
| Net Earnings (Loss)                      |                    |                               |                               |                  |
| Canada                                   | \$ (37)            | \$ 660                        | \$ 123                        | \$ 1,017         |
| United States                            | 395                | 79                            | 825                           | 188              |
|                                          | <b>\$ 358</b>      | <b>\$ 739</b>                 | <b>\$ 948</b>                 | <b>\$ 1,205</b>  |
| Additions to Property, Plant & Equipment |                    |                               |                               |                  |
| Canada                                   | \$ 2,248           | \$ 655                        | \$ 4,538                      | \$ 1,920         |
| United States                            | 260                | 364                           | 899                           | 659              |
|                                          | <b>\$ 2,508</b>    | <b>\$ 1,019</b>               | <b>\$ 5,437</b>               | <b>\$ 2,579</b>  |
| Identifiable Assets, Net                 |                    |                               |                               |                  |
| Canada                                   | \$ 38,298          | \$ 30,710                     | \$ 38,298                     | \$ 30,710        |
| United States                            | 4,953              | 2,552                         | 4,953                         | 2,552            |
|                                          | <b>\$ 43,251</b>   | <b>\$ 33,262</b>              | <b>\$ 43,251</b>              | <b>\$ 33,262</b> |

# Corporate Information

## Directors

Robert W. Lamond <sup>(1)</sup>  
Calgary, Alberta

Charles A. Teare  
Calgary, Alberta

Donald K. Clark  
Calgary, Alberta

Clive M. Stockdale <sup>(1)</sup>  
Vancouver, British Columbia

Allan R. Twa <sup>(1)</sup>  
Calgary, Alberta

Raj Agrawal  
Calgary, Alberta

*(1) Member of the Audit Committee*

## Legal Counsel

Burnet, Duckworth & Palmer LLP  
Calgary, Alberta

## Auditors

PricewaterhouseCoopers LLP  
Calgary, Alberta

## Officers

R.W. Lamond  
President, Chairman of the Board & CEO

C.A. Teare  
Executive Vice President & CFO

D.K. Clark  
Vice President, Operations

R.D. Arsenault  
Controller

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

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