



Q1
REPORT



For the three months ended March 31, 2005



Diaz Resources Ltd.

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, a multi-zone oil and gas prospect at Harmattan in central Alberta and a deep Wilcox gas play in Texas. Southern Alberta combines low cost drilling and low risk exploration opportunities with an excellent natural gas infrastructure while Texas and Harmattan provide significant upside potential for reserves and production.

Corporate Summary

(Thousands, except per share amounts)

	Three Months Ended March 31	
	2005	2004
Financial		
Total revenue	\$ 3,436	\$ 3,112
Cash flow from operations	\$ 2,068	\$ 1,973
per share, diluted	\$ 0.03	\$ 0.03
Earnings for the period	\$ 390	\$ 590
per share, diluted	\$ 0.01	\$ 0.01
Capital additions	\$ 2,260	\$ 2,929
Dispositions	\$ —	\$ 17
Net debt	\$ 9,211	\$ 7,992
Total assets	\$ 46,455	\$ 39,805
Operations		
Production		
Gas (MMcfd)	6.0	5.6
Oil (Bopd)	118	104
BOEd (6Mcf = 1Bbl)	1,121	1,040
Product Prices		
Gas (\$/Mcf)	\$ 6.91	\$ 6.86
Oil (\$/Bbl)	\$ 53.58	\$ 42.24
Total shares outstanding, at period end	59,801	57,501

To the Shareholders



Diaz's financial and operating results for the first quarter of 2005 were similar to the results for the first quarter of 2004. New discoveries at Harmattan in Alberta and Allen Ranch in Texas did not commence continuous production until April 2005, and therefore had no effect on the first quarter, but will increase production in Q2 2005.

Financial

Revenue for the three months ended March 31, 2005 totaled \$3.4 million compared with \$3.1 million one year earlier.

Cash flow for the period increased to \$2.1 million, or \$0.03 per share compared with \$2.0 million, or \$0.03 per share in 2004. Diaz reported earnings for the three months ended March 31, 2005 of \$390,000, or \$0.01 per share compared with \$590,000, or \$0.01 per share reported in 2004.

Capital expenditures totaled \$2.3 million compared with \$2.9 million in 2004, and were financed from cash flow and a slight increase in debt. The Company's net debt at the end of the quarter was \$9.2 million and debt repayability, annualized, from cash flow from operations was 1.1 times.

Production

For the first quarter of 2005, natural gas production averaged 6.0 MMcfd compared with 5.6 MMcfd in 2004. Oil production averaged 118 Bopd compared with 104 Bopd in 2004. Total production averaged 1,121 BOEd from 1,040 BOEd in 2004, an 8% increase.

Exploration and Development

CANADA – ALBERTA

HARMATTAN – DIAZ WORKING INTEREST 40%

In Q4 2004, Diaz made a significant multi-zone discovery in the Harmattan area of central Alberta. Production facilities and a natural gas pipeline, to connect the well to a

natural gas plant in the area, were constructed in Q1 2005. The well commenced production in April 2005, flowing at an average rate of 600 Bopd and 900 Mcfd.

Future production will be restricted to an allowable of 126 Bopd until the Company's application for good production practice is approved. A second well, one mile south of the discovery well, was drilled and abandoned. A third well on this prospect will commence drilling mid-May 2005. Three to six wells, in total, are planned for the area in 2005.

UNITED STATES – TEXAS

ALLEN RANCH – DIAZ WORKING INTEREST 20%

In Q1 2005, Diaz completed the drilling of the Hancock #1 well on the Allen Ranch prospect. The well encountered four highly prospective Wilcox sands and the two deepest sands have been completed and fracture stimulated. The initial sand flowed gas at 1.6 MMcfd at 4,300 psi. This sand was temporarily suspended and the second sand is producing through temporary facilities at a rate of 4.2 MMcfd at 6,500 psi. Once permanent facilities are in place, the two sands will be commingled and Diaz anticipates the well will produce at a rate of 5 MMcfd. A second well on the prospect is planned for Q3 2005 to test a deeper fault structure.

HOUND DOG – DIAZ WORKING INTEREST 22.5%

The R. Dickson #1 well drilled in Q1 2004 encountered nine prospective sands. Most of the deeper Wilcox sands are off-structure and although the well flowed gas from these sands, the rates were not economic. These sands will be tested at a structurally higher point with the drilling of the next well. Diaz is currently completing the well in shallower Wilcox zones, which are known to be gas bearing, and the Company anticipates the well will be on-stream in May 2005.

Business Outlook

The Company is very optimistic regarding the outlook for 2005.

Recent results from the Company's deep Wilcox gas exploration program, especially the multi-zone success of the Allen Ranch prospect, has been most encouraging. As a result, Diaz anticipates significant production and reserve increases in the United States during 2005.

In addition, exploration and development work at Harmattan should provide production and reserve increases in Canada during 2005.

Increased production from the Texas Wilcox trend and the development of the new discovery in Harmattan, together with high energy prices, should provide the Company with increased cash flow for 2005, which will finance its increased capital budget.

Strategic Review Process

Diaz advises that as part of an ongoing review of business and strategic opportunities available to the Company, the Board of Directors authorized Management to examine strategic and corporate restructuring alternatives that may be beneficial to Diaz shareholders. No decision on any particular alternative has been reached to-date and there can be no assurance that the Board of Directors will proceed with any alternative once identified.

The strategic alternatives to be considered will include, but will not necessarily be limited to: maintaining the status quo; continuing as an independent oil and gas company with changes to management; merging with another company or the sale of the Company for cash or shares.

Any strategic or corporate restructuring alternatives identified will be subject to review and approval of the Diaz Board of Directors and to shareholder and regulatory approvals, as required.

On behalf of the Board,

“signed”

R.W. Lamond
President

May 12, 2005

Management's Discussion and Analysis

Prepared as of May 12, 2005

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 three months ended March 31, 2005. The reader should be aware that historical results are not necessarily indicative of future performance.

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 first 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 Q1 2005 coming from natural gas wells. Diaz owns interests in producing properties in Canada: Alberta and Saskatchewan, and in the United States, almost exclusively in Texas.

The Company's U.S. natural gas production declined to 1.7 MMcfd from 1.8 MMcfd in Q1 2004. The decrease is primarily due to normal declines in the Mustang Creek well, which commenced producing early in 2004. The Hancock #1 well on the Allen Ranch prospect was placed on production in April 2005 and is currently producing at 4.2 MMcfd through temporary facilities. When permanent facilities are in place, the two zones that have been completed will be commingled. This should increase the Company's net production by approximately 1.0 MMcfd.

In Canada, natural gas production increased to 4.3 from 3.8 MMcfd in 2004. This increase in production resulted from infill wells at Enchant and new wells at Carmangay, which were placed on-stream during 2004.

Diaz was unable to tie-in wells at Figure Lake, Ukalta, Long Coulee and Enchant due to inclement weather and delays in obtaining approval, which left 750 Mcfd behind pipe at the end of Q1 2005. However, these wells will be tied-in during 2005.

Diaz's Canadian oil production was slightly higher than reported in 2004, which was the result of initial test production at Harmattan. The Harmattan 9-32 well was not placed on continuous production until April 2005 and should significantly increase Diaz's oil production.

Oil & Gas Production	Three Months Ended March 31	
	2005	2004
Gas – Canada		
Enchant	1,760	1,060
Retlaw	900	1,003
Carmangay	556	320
Therien	206	245
Jaslan	174	194
Provost	159	217
Edward	131	190
Iron Springs	103	149
Other	297	418
Gas – Canada (Mcf)	4,286	3,796
Oil & Liquids – Canada		
Parkman	30	35
Neutral Hills	21	21
Red Earth	13	14
Other	38	19
Oil & Liquids – Canada (Bopd)	102	89
BOEd – Canada (6Mcf = 1Bbl)	816	721

Oil & Gas Production (continued)	Three Months Ended March 31	
	2005	2004
Gas – U.S.		
Provident City	1,639	1,662
Mustang Creek	73	150
Other	19	9
Gas – U.S. (Mcf)	1,731	1,821
Oil & Liquids – U.S.		
Provident City	16	15
Oil & Liquids – U.S. (Bopd)	16	15
BOEd – U.S. (6Mcf = 1Bbl)	305	319
Gas – Company (Mcf)	6,017	5,617
Oil and Liquids – Company (Bopd)	118	104
BOEd – Company	1,121	1,040

Product Prices	Three Months Ended March 31	
	2005	2004
Canada		
Gas (\$/Mcf)	\$ 6.57	\$ 6.69
Oil & Liquids (\$/Bbl)	\$ 52.94	\$ 42.12
\$/BOE	\$ 41.09	\$ 40.39
U.S.		
Gas (\$/Mcf)	\$ 7.77	\$ 7.23
Oil & Liquids (\$/Bbl)	\$ 57.63	\$ 43.03
\$/BOE	\$ 47.19	\$ 43.36
\$/BOE – Company	\$ 42.75	\$ 41.29

Average commodity prices for the three months ended March 31, 2005 were marginally higher than prices for the same period in 2004. Canadian gas prices averaged \$6.57 per Mcf, 1.7% lower than the price received in 2004. Oil prices were significantly higher than the comparable period, at \$52.94 per barrel from \$42.12 in 2004. In the United States, gas prices were slightly higher on a year-over-year basis and oil prices were significantly higher.

Diaz believes oil prices will remain high throughout 2005 due to a strong global demand for oil, and gas prices will be held up by the trend to follow crude oil pricing. However, the Company has sold forward approximately 2 MMcf of natural gas production in Canada, for the period beginning April 1, 2005 to October 31, 2005, with a floor price of \$6.86 per Mcf and a ceiling price of \$7.86 per Mcf.

Revenue from Oil and Gas Production	Three Months Ended March 31	
	2005	2004
<i>(Thousands)</i>		
Canada		
Natural gas	\$ 2,533	\$ 2,311
Oil and natural gas liquids	485	339
Other	7	7
Total revenue	\$ 3,025	\$ 2,657
U.S.		
Natural gas	\$ 1,211	\$ 1,196
Oil and natural gas liquids	84	60
Total Revenue	\$ 1,295	\$ 1,256
Total Revenue – Company	\$ 4,320	\$ 3,913

Higher U.S. gas prices offset lower U.S. production and revenue remained unchanged at \$1.3 million for the quarter ended March 31, 2005. Higher production volumes in Canada more than offset lower prices and total revenue increased by 10%, to \$4.3 million for the quarter.

As a result of increased production placed on stream in April at Harmattan in Canada, and Allen Ranch in the U.S., and continued high gas prices, Diaz is confident that revenues will continue to grow throughout the year.

Royalties	Three Months Ended March 31	
	2005	2004
<i>(Thousands, except per BOE and percentage amounts)</i>		
Canada		
Crown	\$ 336	\$ 244
Freehold	215	225
Alberta Royalty Tax Credit (ARTC)	(71)	(40)
Royalties, net of ARTC	\$ 480	\$ 429
per BOE	\$ 6.54	\$ 6.54
Royalty as a percentage of revenue	15.9%	16.1%
U.S.		
Total U.S. Royalties	\$ 404	\$ 372
per BOE	\$ 14.71	\$ 12.82
Royalty as a percentage of revenue	31.2%	29.6%

Royalties for the three months ended March 31, 2005 increased to \$884,000 compared with \$801,000 in 2004, or a corporate royalty rate, net of ARTC, of 20%.

Operating and Transportation Expense*(Thousands, except per BOE amounts)*

	Three Months Ended March 31	
	2005	2004
Canada	\$ 768	\$ 705
per BOE	\$ 10.46	\$ 10.75
U.S.	\$ 50	\$ 29
per BOE	\$ 1.83	\$ 0.99
Total - Company, per BOE	\$ 8.11	\$ 7.76

Operating expenses continued to trend higher with operating costs for Q1 2005 at \$818,000, or \$8.11 per BOE compared with \$734,000, or \$7.76 per BOE in 2004.

Overhead*(Thousands, except per BOE amounts)*

	Three Months Ended March 31	
	2005	2004
Compensation costs	\$ 265	\$ 262
Other costs	227	230
Recovered from third parties	(72)	(88)
Capitalized	(37)	(58)
Net overhead	\$ 383	\$ 346
per BOE	\$ 3.79	\$ 3.66

Overhead costs were approximately 11% higher during the three months ended March 31, 2005 at \$383,000 compared with \$346,000 in 2004. The primary reason for the increase was a decrease in recoveries and capitalized costs in 2005.

Interest Expense*(Thousands, except per BOE and percentage amounts)*

	Three Months Ended March 31	
	2005	2004
Average bank debt	\$ 8,508	\$ 6,443
Interest expense	\$ 123	\$ 81
per BOE	\$ 1.22	\$ 0.86
Average interest rate	5.0%	5.0%

Total interest expense increased to \$123,000 during the three months ended March 31, 2005 from \$81,000 reported one year earlier. This was due to the larger loan amount during the current period.

The Company's debt levels have increased to over \$9.0 million in 2005 and interest rates are likely to increase in the coming year, in turn increasing Diaz's interest expense.

Depletion, Depreciation & Accretion	Three Months Ended March 31	
	2005	2004
<i>(Thousands, except per BOE amounts)</i>		
Canada		
Depletion and depreciation	\$ 1,256	\$ 1,003
Asset retirement obligation accretion	49	27
Net depletion, depreciation and accretion	1,305	1,030
per BOE	\$ 17.77	\$ 15.70
U.S.		
Depletion and depreciation	\$ 241	\$ 184
Asset retirement obligation accretion	–	1
Amortization of deferred credit	–	(15)
Net depletion, depreciation and accretion	\$ 241	\$ 170
per BOE	\$ 8.78	\$ 6.36
Total – Company	\$ 1,546	\$ 1,200
per BOE	\$ 15.33	\$ 12.17

Diaz's overall corporate depletion rate has increased to \$15.33 per BOE. This reflects a Canadian depletion rate of \$17.77 per BOE and a U.S. depletion rate of \$8.78 per BOE. Diaz anticipates its depletion rate will be reduced in 2005 as the Company completes wells and increases its proved reserves and as the lower cost U.S. production becomes a larger percentage of the Company's production base.

Quarterly Financial Information

	Three Months Ended							
	2005	2004	2004	2004	2004	2003	2003	2003
	Mar. 31	Dec. 31	Sept. 30	June 30	Mar. 31	Dec. 31	Sept. 30	June 30
<i>(Thousands, except per share amounts)</i>								
Total revenue	\$ 3,436	\$ 3,730	\$ 3,621	\$ 3,818	\$ 3,112	\$ 2,713	\$ 2,699	\$ 2,212
Earnings	\$ 390	\$ 568	\$ 26	\$ 360	\$ 590	\$ 191	\$ 660	\$ 716
per share	\$ 0.01	\$ 0.01	\$ 0.00	\$ 0.01	\$ 0.01	\$ 0.01	\$ 0.02	\$ 0.02
Cash flow from operations	\$ 2,068	\$ 2,068	\$ 2,204	\$ 2,540	\$ 1,973	\$ 1,395	\$ 1,647	\$ 1,266
per share	\$ 0.03	\$ 0.04	\$ 0.04	\$ 0.04	\$ 0.03	\$ 0.02	\$ 0.04	\$ 0.03
Fixed asset additions (net)	\$ 2,260	\$ 4,562	\$ 2,117	\$ 2,348	\$ 2,912	\$ 3,822	\$ 1,646	\$ 964
Total assets	\$ 46,455	\$ 46,675	\$ 43,789	\$ 43,251	\$ 39,805	\$ 39,636	\$ 36,651	\$ 34,912
Working capital deficiency	\$ 9,211	\$ 9,095	\$ 7,622	\$ 7,882	\$ 7,992	\$ 7,100	\$ 10,024	\$ 10,042

Liquidity and Capital Resources

Diaz completed the three months ended March 31, 2005 with a net debt of \$9.2 million compared with \$8.0 million in 2004. The Company has a credit facility of \$11.0 million, which will be reviewed by May 31. Diaz has a \$12.6 million capital budget for 2005 with 25% of its budget committed to each of Harmattan, in Alberta, and the Wilcox wells in Texas.

The Company's capital expenditure budget for 2005 will be funded primarily from cash flow.

Income Taxes

Diaz reports future tax expense of \$106,000 and current taxes of \$73,000, comprised of capital taxes and withholding on transfer of funds from the U.S. to Canada.

Based on the Company's current forecast of revenues and capital expenditures, Diaz will not be cash taxable in Canada in 2005 and will likely commence paying current income tax in 2006. Diaz will be taxable in the U.S. during 2005 if the Company does not increase its capital budget in the U.S.

Issuer Bid

During the three months ended March 31, 2005, Diaz did not repurchase any of its Multiple Voting Shares nor its Class A Subordinate Voting Shares.

Diaz currently has a Normal Course Issuer Bid to purchase up to a further 2,493,000 Class A Shares and 280,000 Class B Shares through the facilities of the Toronto Stock Exchange. The Bid expires on August 17, 2005.

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

Diaz believes energy prices will remain near current levels throughout 2005. These high prices combined with higher production levels in both Canada and the United States should result in higher cash flow.

Higher cash flow will allow the Company to increase its capital budget and provide continued growth in 2005.

Strategic Review Process

Diaz advises that as part of an ongoing review of business and strategic opportunities available to the Company, the Board of Directors authorized Management to examine strategic and corporate restructuring alternatives that may be beneficial to Diaz shareholders.

No decision on any particular alternative has been reached to-date and there can be no assurance that the Board of Directors will proceed with any alternative once identified.

The strategic alternatives to be considered will include, but will not necessarily be limited to: maintaining the status quo; continuing as an independent oil and gas company with changes to management; merging with another company or the sale of the Company for cash or shares.

Any strategic or corporate restructuring alternatives identified will be subject to review and approval of the Diaz Board of Directors and to shareholder and regulatory approvals, as required.

Consolidated Balance Sheet

(unaudited)

(Thousands)

As at	March 31 2005	December 31 2004
ASSETS		
Current Assets		
Cash	\$ 477	\$ 762
Accounts receivable	4,314	5,006
Prepaid expense	207	213
	4,998	5,981
Property, plant and equipment	64,199	61,939
Accumulated depletion and depreciation	(22,742)	(21,245)
	41,457	40,694
Total Assets	\$ 46,455	\$ 46,675
LIABILITIES		
Current Liabilities		
Accounts payable and accrued liabilities	\$ 3,965	\$ 7,569
Bank debt (Note 3)	10,244	7,507
	14,209	15,076
Other Liabilities		
Future income tax liability	5,540	5,432
Asset retirement obligation (Note 6)	2,388	2,338
Total Other Liabilities	7,928	7,770
	22,137	22,846
SHAREHOLDERS' EQUITY		
Share capital (Note 4)	16,235	16,165
Contributed surplus (Note 4)	329	300
Retained earnings	7,754	7,364
	24,318	23,829
Total Liabilities and Shareholders' Equity	\$ 46,455	\$ 46,675

Approved by the Board:

"signed"

R.W. Lamond
Director

"signed"

C.A. Teare
Director

Consolidated Statement of Operations & Retained Earnings

(unaudited)

(Thousands, except per share amounts)

Three Months Ended March 31	2005	2004
Revenue		
Production	\$ 4,320	\$ 3,913
Royalties	(955)	(841)
Alberta Royalty Tax Credit	71	40
	3,436	3,112
Expenses		
Operating and transportation	818	734
General and administration	383	346
Interest expense	123	81
Foreign exchange (gain) loss	(3)	(14)
Depletion, depreciation and accretion	1,546	1,200
	2,867	2,347
Earnings before income tax	569	765
Income tax expense		
Current	73	16
Future	106	159
Total income tax	179	175
Earnings for the period	390	590
Excess of cost over paid up capital on share repurchases	–	(18)
Retained earnings, beginning of period, as previously reported	7,364	6,067
Change in accounting policy (Note 2)	–	(130)
Retained earnings, end of period	\$ 7,754	\$ 6,509
Earnings per share, basic and diluted	\$ 0.01	\$ 0.01

Consolidated Statement of Cash Flows

(unaudited)

(Thousands)

Three Months Ended March 31	2005	2004
Cash provided by (used for):		
Operating Activities		
Earnings for the period	\$ 390	\$ 590
Non-cash items:		
Depreciation, depletion and accretion	1,546	1,200
Non-cash compensation	29	38
Future taxes	106	159
Foreign exchange gain	(3)	(14)
Cash flow from operations	2,068	1,973
Change in non-cash working capital	140	110
	2,208	2,083
Investing Activities		
Property, plant and equipment – additions	(2,260)	(2,929)
Property, plant and equipment – dispositions	–	17
Change in non-cash working capital	(3,040)	(1,959)
	(5,300)	(4,871)
Financing Activities		
Increase in bank debt	2,737	3,589
Class A Subordinate Voting Shares		
Issued for cash on exercise of options	70	75
Class B Multiple Voting Shares		
Repurchased for cancellation	–	(40)
	2,807	3,624
Increase (decrease) in cash	(285)	836
Cash, beginning of period	762	124
Cash, end of period	\$ 477	\$ 960
Supplementary information regarding cash payments:		
Interest paid during the period	\$ 123	\$ 81
Taxes paid during the period	\$ 73	\$ 16

Notes to the Interim Consolidated Financial Statements

For the Three Months Ended March 31, 2005

I. 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, 2004.

2. Change in Accounting Policies

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 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 new policy was adopted with restatement of prior period numbers and resulted in increasing retained earnings at December 31, 2003 by \$68,000. An additional effect of this change is an increase to property, plant and equipment of \$1,517,000 at December 31, 2003 and an increase to liabilities of \$1,361,000 at December 31, 2003.

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 (2005 - \$300,000), earnings for the three months ended March 31, 2004 have been reduced by \$39,000 and contributed surplus has been increased by \$237,000.

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>	No. of Shares	Amount
Class A Subordinate Voting Shares		
Balance, December 31, 2004	53,638	\$ 14,385
Issued on exercise of options	200	70
Balance, March 31, 2005	53,838	\$ 14,455
Class B Multiple Voting Shares		
Balance, December 31, 2004	5,963	\$ 1,780
Balance, March 31, 2005	5,963	\$ 1,780
Total Shares Outstanding, March 31, 2005	59,801	\$ 16,235
Contributed Surplus	-	\$ 329

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 March 31, 2005, there are a total of 1,593,334 options granted and outstanding under the stock option plan with a weighted average exercise price of \$0.31 per share. A total of 1,128,433 options with a weighted average exercise price of \$0.31 are exercisable at the end of the period.

On April 4, 2005, Diaz granted to directors and employees of the Company options to purchase an additional 1,745,000 shares at a price of \$0.71 per share.

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 – n/a.

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 March 31, 2005, the following contract was in effect:

Costless Collar Volume	Floor Price		Ceiling Price		Time Period for Contract
	(\$/Gj)	(\$/Mcf)	(\$/Gj)	(\$/Mcf)	
2,000 Gj/d (1,900 Mcfd)	\$ 6.50	\$ 6.86	\$ 7.45	\$ 7.86	Apr. 1, 2005 to Oct. 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:

	2005	2004
Asset Retirement Obligation, beginning of period	\$ 2,338	\$ 1,547
Liabilities incurred	–	27
Accretion expense	50	27
Asset Retirement Obligation, end of period	\$ 2,388	\$ 1,601

The total undiscounted amount of estimated cash flow required to settle the obligation is \$4,663,000, which has been discounted using the credit-adjusted risk free rates at the time the obligation was incurred of 7.25 percent to 10 percent. These obligations are expected to be paid between 2005 and 2034.

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.

	Three Months Ended March 31	
	2005	2004
Revenue		
Canada	\$ 2,545	\$ 2,227
United States	891	885
	\$ 3,436	\$ 3,112
Interest Expense		
Canada	\$ 123	\$ 81
United States	—	—
	\$ 123	\$ 81
Current Taxes		
Canada	\$ 10	\$ 16
United States	63	—
	\$ 73	\$ 16
Cash Flow from Operations		
Canada	\$ 1,292	\$ 1,119
United States	776	854
	\$ 2,068	\$ 1,973
Depletion and Depreciation		
Canada	\$ 1,305	\$ 1,030
United States	241	170
	\$ 1,546	\$ 1,200
Net Earnings		
Canada	\$ 66	\$ 160
United States	324	430
	\$ 390	\$ 590
Additions to Property, Plant & Equipment		
Canada	\$ 1,628	\$ 2,290
United States	632	639
	\$ 2,260	\$ 2,929
Identifiable Assets, Net		
Canada	\$ 41,212	\$ 35,269
United States	5,243	4,536
	\$ 46,455	\$ 39,805

Corporate Information

Directors

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Calgary, Alberta

Charles A. Teare

Calgary, Alberta

Donald K. Clark

Calgary, Alberta

Clive M. Stockdale ⁽¹⁾

Vancouver, British Columbia

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Officers

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President, Chairman of the Board & CEO

C.A. Teare

Executive Vice President & CFO

D.K. Clark

Vice President, Operations

C.S. Cohen

Corporate Secretary

R.D. Arsenault

Controller

Subsidiaries

Diaz Resources, Inc.

Orbit Oil & Gas 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.SV.a

Multiple Voting Shares: DZR.MV.b