Management's Discussion and Analysis of Operational Results and Financial Condition

Nineteen ninety-six highlights include:

- Revenue increased 35 percent to $29.0 million (1995 - $21.5 million) resulting from a 32 percent increase in BOE production, an 11 percent increase in oil prices and a 14 percent increase in natural gas prices.
- Operating costs were reduced 13 to $3.78 percent per BOE (1995 - $4.34 per BOE);
- Administrative costs were reduced 13 percent to $1.22 per BOE (1995 - $1.41 per BOE);
- Cash flow from operations increased 42 percent to $0.64 per share (1995 - $0.45 per share) as a result of increased BOE production, and a 7 percent increase in product netbacks;
- Net income increased 86 percent to $0.13 per share (1995 - $0.07 per share);
- Fully diluted net asset value increased 29 percent to $4.14 per share (1995 - $3.22 per share) as a result of Paragon's successful 1996 exploration and acquisition programs and lower cost structure;
- Paragon maintained its strong balance sheet with a total debt to cash flow ratio of 1.1 (fourth quarter cash flow annualized);
- Market capitalization increased 54 percent to $87.8 million (1995 - $57.1 million), and
- Paragon's common share trading volume totalled 21.2 million shares (1995 - 5.8 million), demonstrating increased shareholder liquidity.

Statements of Income (thousands except per BOE)

	Total			Per BOE		
	1996	1995	Change	**1996**	1995	Change
REVENUE	**$29,026**	$21,456	35%	$ **19.77**	$ 19.34	2%
Less:						
Royalties	**3,615**	2,659	36%	**2.46**	2.40	3%
Operating expense	**5,543**	4,812	15%	**3.78**	4.34	-13%
Administrative	**1,797**	1,561	15%	**1.22**	1.41	-13%
Interest	**1,302**	1,226	6%	**0.89**	1.11	-20%
Capital taxes	**254**	207	23%	**0.17**	0.19	-11%
TOTAL EXPENSES	**12,511**	10,465	20%	**8.52**	9.45	-10%
CASH FLOW FROM OPERATIONS	**16,515**	10,991	50%	**11.25**	9.89	14%
Depletion and depreciation	**10,681**	8,105	32%	**7.28**	7.31	0%
Deferred income taxes	**2,403**	1,118	115%	**1.63**	1.01	62%
NET INCOME	**$3,431**	$1,768	94%	**$ 2.34**	$ 1.57	49%

Revenue

Paragon's 1996 revenue totalled $29.0 million, made up of $15.1 million from oil and natural gas liquids (52 percent), $13.4 million from natural gas (46 percent), and $0.5 million from other revenue (2 percent). In 1995, revenue consisted of $13.9 million from oil and natural gas liquids (64 percent), $6.7 million from natural gas (31 percent) and $0.9 million from other revenue (4 percent). The increased portion of natural gas revenue in 1996 results primarily from a 73 percent increase in average natural gas production. Paragon's West Central Alberta properties contain liquids-rich gas reserves which greatly enhances drilling economics, especially during periods of low natural gas prices.

Natural gas prices showed some improvement in 1996 with an overall corporate average of $1.53 per MCF, up 14 percent from $1.34 per MCF in the previous year. The most significant increase in natural gas prices occurred late in the year, and Paragon's fourth quarter average was $1.73 per MCF. These improved natural gas pricing levels have been maintained into the first quarter of 1997 and Paragon is cautiously optimistic that higher average natural gas prices will prevail in 1997.

Oil and natural gas liquids revenue increased 9 percent in 1996 as a result of an 11 percent increase in average prices. This increase was offset by a 2 percent decline in production volumes, mainly attributable to anticipated production declines and property sales in 1996, whereby Paragon sold its Norbuck, Steelman and Handsworth oil properties. Oil prices averaged $27.06 per BBL in 1996, an 11 percent increase from $24.38 per BBL in 1995. Prices for natural gas liquids experienced significant increases in 1996, averaging $21.83 per BBL compared to 1995's $15.79 per BBL. The benefit of this increase in natural gas liquids prices was magnified as 30 percent of total 1996 liquids volumes consisted of natural gas liquids, compared to only 17 percent in 1995. This increase in liquids volumes is a direct result of increased natural gas production.

In 1996, Paragon hedged an average of 533 BOPD at an average price of U.S. $18.49 ($25.14 Canadian). West Texas Intermediate crude oil averaged U.S. $21.97 per BBL in 1996, which represented a 19 percent increase from U.S. $18.40 per BBL in 1995. Paragon's 1996 oil hedge resulted in a $1.42 per BBL reduction in the Company's corporate average oil and natural gas liquids price. Paragon also had a small portion of its 1996 natural gas volumes hedged resulting in a $0.02 per MCF reduction in corporate average natural gas prices. Paragon believes it is prudent to hedge a portion of both its oil and natural gas volumes and has continued to do so in 1997.

Other revenue totalled $0.5 million in 1996, compared to $0.8 million in 1995 and was comprised of processing income and royalties. The decrease in 1996 relates to a reduction in royalty revenue resulting from various royalties being converted into working interests.

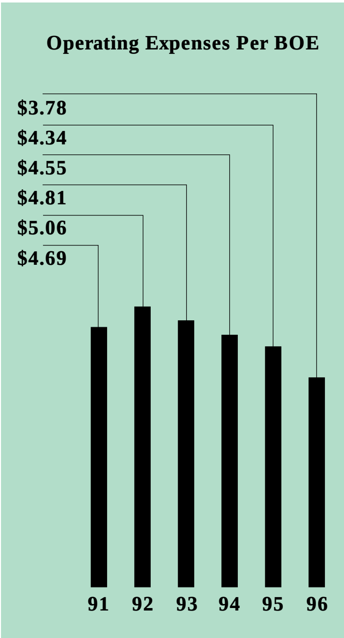
Royalties

Royalties expense, before the Alberta Royalty Tax Credit (ARTC), averaged 18 percent of oil and gas sales in 1996, essentially unchanged from 17 percent in 1995. Paragon's 1996 ARTC was

$1.5 million, compared to $0.9 million in 1995. Paragon reached the maximum limit for ARTC in 1996, with the result that future incremental Alberta crown royalties will not receive ARTC. Paragon expects its 1997 net royalty payments will increase marginally to approximately 15 percent of oil and gas sales (1996 - 13 percent).

Operating Expenses

While production on a BOE basis increased 32 percent in 1996, operating expenses rose only 15 percent resulting in a decline in per unit expenses to $3.78 per BOE (1995 - $4.34 per BOE). This decrease is attributed to significant operating cost reductions in Paragon's Alberta-based properties which had oil and natural gas liquids operating costs of $2.91 per BBL in 1996, down 28 percent from $4.04 per BBL in 1995. This large reduction in 1996 resulted from ongoing efficiency gains, disposition of high cost



oil properties and a large increase in natural gas liquids production. The operating costs on Paragon's Ontario oil properties increased in 1996 to $4.53 per BBL from $3.90 in 1995, as a direct result of anticipated production declines.

Paragon's natural gas operating expenses showed a 17 percent reduction in 1996 to $0.40 per MCF, compared to $0.48 per MCF in 1995. This reduction is attributed to Paragon's growing natural gas production in West Central Alberta.

Paragon's corporate goal to maintain operating costs under $4.00 per BOE was surpassed in 1996. The Company will continue to maintain strict control over its operating expenses in order to maximize production netbacks by adhering to the following principles:

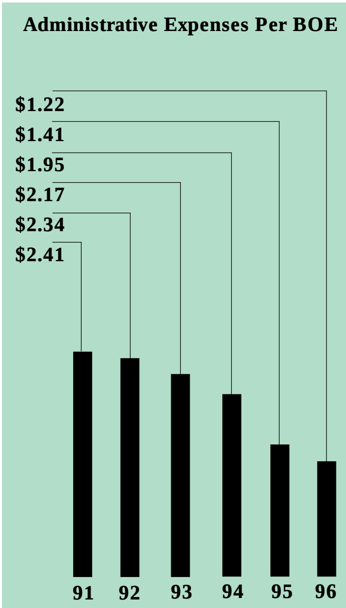
- Operating control of all new production;
- Maintain geographic focus within areas with year round access and existing infrastructure;
- Focus on liquids-rich natural gas reserves and high quality crude oil within our core areas, and
- Continue to regularly monitor and control expenditures at the field level.

Administrative Expenses

Paragon's administrative expenses increased 11 percent in 1996 as a direct result of increased activity levels. Third party overhead recoveries totalled $0.3 million in 1996, down slightly from 1995, as a result of increased working interest levels in Paragon's projects. Paragon maintains a 100 percent working interest in a significant portion of new drilling programs which allows for increased operating efficiencies. On a per unit basis, Paragon's administrative expenses decreased 13 percent in 1996, continuing the Company's history of achieving yearly reductions in per unit administrative expenses since its amalgamation in 1991.

Paragon's employees share a strong commitment to maintaining strict control over administrative expenses. The Company has the appropriate staff levels and infrastructure in place to continue to manage increased capital expenditures and production levels with only small increases in administrative expenses.

Salaries of technical staff and directly related overhead form an integral part of Paragon's exploration and development programs and have been directly included in capital expenditures.



Administrative Expenses

(thousands except per BOE data)

	1996		1995	
	Total	**Per BOE**	Total	Per BOE
Administrative	**$ 2,066**	**$ 1.41**	$ 1,863	$ 1.68
Less:				
Recoveries	**(269)**	**(0.19)**	(302)	(0.27)
	$ 1,797	**$ 1.22**	$ 1,561	$ 1.41
Employees at December 31				
Office	**25**		22	
Field	**10**		9	
Total	**35**		31	

Interest Expense

Paragon's long term debt consists of draws under an operating line of credit with the Canadian Imperial Bank of Commerce, which bears interest at bank prime or bankers' acceptance rate plus a stamping fee. The borrowing base is reviewed annually by the bank and is currently $27 million, based on Paragon's 1995 proven oil and gas reserves. Upon completion of the bank's current loan review, Paragon expects that a $40 million borrowing line will be available.

Paragon's interest expense for 1996 rose 6 percent to $1.3 million, as a result of increased levels of bank borrowing to support Paragon's active 1996 exploration and development programs. Paragon maintains strict controls over its long term debt levels to ensure a conservative debt to cash flow level is maintained.

A significant increase in production volumes led to a 20 percent decline in Paragon's per unit interest expense which totalled $0.89 per BOE in 1996, compared to $1.11 in 1995.

Paragon limits its exposure to interest rate changes by entering into fixed interest rate transactions for a portion of its long term debt. At December 31, 1996 a total of $15.0 million of debt had fixed interest rates for various time periods as follows.

- $2.0 million at 9.15 percent for March, 1995 to March, 1997;
- $2.0 million at 6.77 percent for April, 1996 to April, 1997;
- $3.0 million at 8.29 percent for October, 1995 to October, 1997;
- $4.0 million at 4.73 percent for December, 1996 to December, 1997;
- and $4.0 million at 5.47 percent for December, 1996 to December, 1998.

Current Taxes

Paragon has total tax pool balances of $55 million at the end of 1996 (1995 - $47 million). The Company is not currently taxable with the exception of capital taxes and Ontario minimum taxes. The capital taxes are levied both federally and in the Province of Ontario. Paragon's 1996 current taxes were $254,000, which represents a 23 percent increase from $207,000 in 1995. This change results mainly from an increase in Paragon's 1996 book capitalization to $76.6 million, from $64.6 million in 1995.

Paragon's expected current income tax horizon is a minimum of three years. A company's tax horizon is dependent upon existing tax pools, future capital expenditures, commodity prices, and growth in production. A long tax horizon allows Paragon to maximize its re-investment of cash flow into exploration and development programs.

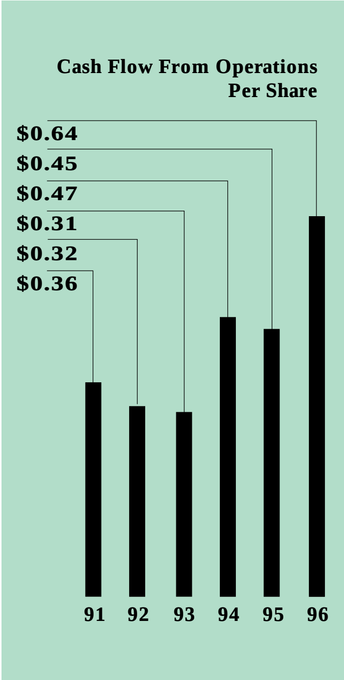
Cash Flow From Operations

Cash flow from operations totalled $16.5 million in 1996, a 50 percent increase from $11.0 million in 1995, due to higher BOE production levels, increased commodity prices and a reduction in per unit operating, administrative and interest expense. Cash flow from operations on a per unit basis was $11.25 per BOE in 1996, which represents a 14 percent increase from $9.89 per BOE recorded in 1995.

Cash flow from operations per common share was $0.64 in 1996, up 42 percent from $0.45 per share in 1995, while fully diluted cash flow per share was $0.61 in 1996 (1995 - $0.44). The difference between basic and fully diluted cash flow is Paragon's employee stock options which form an integral component of the Company's compensation program. The table on page 25 summarizes the cash flow impact of changes in production levels, commodity prices and expenses for both the 1996 and 1995 fiscal years. As noted in the accompanying table, the increase in cash flow predominantly relates to Paragon's significant increase in natural gas production volumes.

Tax Pool Summary (thousands)

	Maximum Annual Deductions	Dec. 31, 1996
Exploration	100%	$ 16,683
Development	30%	7,468
Oil and gas property	10%	14,087
Undepreciated capital costs	25%	15,283
Other	20%	1,334
Total		$ 54,855



Reconciliation of Cash Flow From Operations

(thousands)	1996	1995
Cash flow previous year	**$ 10,991**	$ 9,626
Changes in production volumes		
Oil & NGL	**(303)**	1,958
Natural gas	**4,716**	2,289
Changes in prices		
Oil & NGL	**1,548**	1,354
Natural gas	**954**	(3,339)
Changes in other income	**(301)**	263
Subtotal	**17,605**	12,151
Operating expense	**(731)**	(831)
Administrative expense	**(236)**	150
Interest expense	**(76)**	(470)
Capital taxes	**(47)**	(9)
Cash flow current year	**$ 16,515**	$ 10,991

Depletion and Depreciation

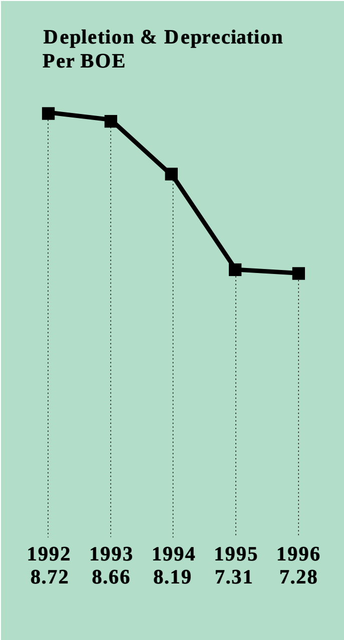
Depletion is calculated on a per unit of production method based upon proven reserves, with natural gas converted to oil on relative energy content. Depletion and depreciation totalled $10.7 million in 1996 ($7.28 per BOE), compared to $8.1 million in 1995 ($7.31 per BOE). Paragon's fourth quarter 1996 depletion and depreciation rate was $6.50 per BOE. By continually reducing onstream costs, Paragon has achieved yearly reductions in per unit depletion expense since 1991. Included in depletion and depreciation is $0.2 million related to the amortization of future site restoration and abandonment expenses. Paragon's total estimated future site restoration liability is $2.7 million and is provided for on a per unit of production basis. This future liability is also stated before estimated salvage value of production facilities, which if considered would compensate for this liability.

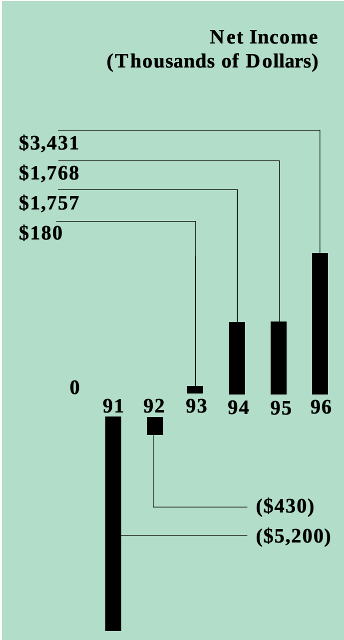
Deferred Income Taxes

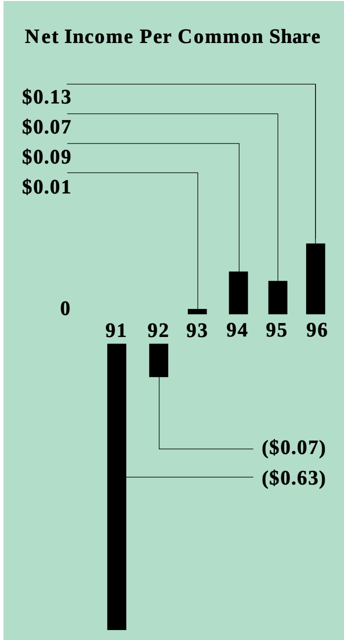
Paragon's deferred income tax expense was $2.4 million in 1996, compared to $1.1 million in 1995. The 1996 deferred income tax provision as a percentage of pre-tax income was 39 percent, compared to 36 percent in 1995. The marginal increase in the effective corporate tax rate in 1996 results from an increase in non-deductible crown payments and a reduction in 1996 resource allowance.

Net Income

Paragon's net income increased 94 percent in 1996 to $3.4 million (1995 - $1.8 million) as a result of increased cash flow from operations. Net income per share rose 86 percent to $0.13 in 1996 (1995 - $0.07).







Liquidity and Capital Resources

Paragon finances its capital expenditure programs from annual cash flow, bank debt and selective equity issues. The Company monitors its capital expenditures in relation to these capital sources and continues to restrict its debt levels to 1.5 times cash flow. The Company defines cash flow for this purpose as equal to the last completed quarter's cash flow multiplied by four.

Because of our limited control over commodity prices, we do not consider higher debt levels to be appropriate for your Company. Paragon's working capital deficiency at December 31, 1996 was $4.2 million, compared to $1.8 million in 1995. This increase resulted from Paragon's active winter drilling program which commenced in late November, 1996. As a result, Paragon's capital expenditures during the fourth quarter of 1996 totalled $6.0 million, double the comparable quarter in 1995.

In November, 1996 the Company issued, on a private placement basis, 1.7 million flow through common shares at a price of $3.35 per share, resulting in proceeds of $5.8 million.

Paragon's 1996 capital expenditure program of $31.8 million (1995 - $20.5 million) was funded from the following sources:

- $16.5 million (52 percent) of cash flow from operations (1995 - $11.0 million);
- $7.2 million (23 percent) from the disposal of non-core properties (1995 - nil);
- $6.3 million (19 percent) of new common share equity (1995 - $4.4 million), and
- $1.8 million (6 percent) of additional debt including changes in working capital and bank debt (1995 - $5.1 million).

Paragon's 1996 total capitalization, using the common share price at December 31, 1996 was $107.4 million, up 43 percent from 1995. Paragon's common share market capitalization exceeds $75.0 million at year end and the Company will qualify to participate in the Prompt Offering Qualification System. This regulatory classification allows larger companies more cost effective and timely clearing of regulatory documentation related to new equity issues.

Paragon's common shares had record trading volumes in 1996, with volumes totalling 21.2 million common shares. This volume includes six million common shares previously owned by Conwest Exploration Company Limited, which represented approximately 23 percent of Paragon's common shares at that time. The Conwest block was distributed in February, 1996 to a number of institutional purchasers, with the balance to a retail group. This sale resulted in additional liquidity for Paragon's common shares as a result of a higher public float and an increase in the institutional following of the Company.

Investment dealer research coverage on Paragon increased substantially in 1996. The Company currently has eight investment dealers providing comprehensive research on Paragon. This large following and sponsorship by several independent oil and gas analysts is critical to increased market awareness and appreciation of Paragon's solid growth.

Capitalization (thousands)

	1996	%	1995	%
Working capital deficiency	$ **4,187**	4%	$ 1,799	2%
Notes receivable	**(574)**	-1%	(246)	0%
Long term debt	**15,933**	15%	16,310	22%
Common shares at market 12/31	**87,843**	82%	57,074	76%
	$ **107,389**	100%	$ 74,937	100%

Common Share Information

1996	1Q	2Q	3Q	4Q	YEAR
High	**$ 2.69**	**$ 2.60**	**$ 2.99**	**$ 3.60**	**$ 3.60**
Low	**$ 2.00**	**$ 2.05**	**$ 2.15**	**$ 2.40**	**$ 2.00**
Close	**$ 2.16**	**$ 2.35**	**$ 2.55**	**$ 3.20**	**$ 3.20**
Volume shares traded (000's)	**10,407**	**4,307**	**3,018**	**3,465**	**21,197**

1995	1Q	2Q	3Q	4Q	YEAR
High	$ 2.25	$ 2.60	$ 2.05	$ 2.25	$ 2.60
Low	$ 1.50	$ 2.00	$ 1.70	$ 1.70	$ 1.50
Close	$ 2.00	$ 2.00	$ 1.75	$ 2.25	$ 2.25
Volume shares traded (000's)	843	2,459	1,179	1,316	5,797

Net Asset Value per Share

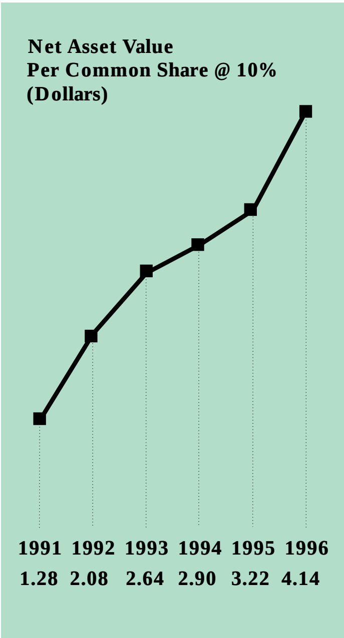
Paragon continues to demonstrate yearly growth in asset value per common share. Paragon's fully diluted net asset value per share increased 29 percent in 1996 and is based upon an independent evaluation using both Paragon's reserve base and future pricing forecasts as shown on page 18 of this annual report. The pricing forecasts used in the 1996 reserve evaluation show only marginal increases in oil prices and reductions in forecasted natural gas prices as compared to 1995.

The growth that Paragon has achieved in net asset value per share over the five year period ended 1996 demonstrates the strong results of the Company's exploration and development programs and its commitment to building shareholder value.

Business Risks

The petroleum business involves a number of business risks which Paragon categorizes as follows: operations, commodity prices, interest rates, liquidity and regulatory. Paragon manages these risks, to the extent possible, as part of its ongoing exploration and development activities.

Operations Oil and gas exploration has inherent risks since significant capital expenditures are incurred with no certainty that economic quantities of petroleum reserves will be discovered. Petroleum reserves must also be produced in a timely and economic manner in order to generate sufficient returns on capital invested. Marketing risk exists whereby production may be prolonged or delayed because of lack of market, transportation availability or access to production facilities.



Fully Diluted Net Asset Value Per Share

@ 10% - December 31 (thousands)

	1996	1995
Reserves proven plus 50% probable	**$122,036**	$ 91,959
Undeveloped land and seismic	**14,000**	9,200
Notes receivable	**574**	246
Common share options	**4,153**	3,711
Total asset value	**140,763**	105,116
Bank debt	**(15,933)**	(16,310)
Working capital	**(4,187)**	(1,799)
Net asset value	**$120,643**	$ 87,007
Common shares	**27,452**	25,367
Employee options	**1,677**	1,673
Common shares fully diluted	**29,129**	27,040
Net asset value per share	**$ 4.14**	$ 3.22
Net asset value per share @ 15%	**$ 3.47**	$ 2.68

To mitigate the above noted operational risks, Paragon concentrates its exploration and development in two core areas - West Central Alberta and Southwestern Ontario. By maintaining core areas of reasonable size and operating all new prospects whenever possible, Paragon uses its knowledge base to control the quality of its exploration and development programs. In addition, strong operational control allows the Company to limit costs, timing, facility infrastructure and marketing of all new production.

Commodity Prices Commodity price changes are a business risk that our industry has limited control over but faces constantly. Paragon manages pricing risk by maintaining a balanced production portfolio between oil and natural gas, concentrating on high quality crude oil, producing natural gas with a high liquids content and by entering into fixed price contracts for a portion of its production. Paragon currently has an average of 350 BOPD hedged for 1997, with an average Canadian dollar price range between $25.79 and $33.27 per BBL. Approximately 10 MMCF per day of natural gas is also subject to fixed prices until November, 1997. Prices under these agreements range between $1.50 and $2.35 per MCF. Paragon also remains diligent in its goal of being a low cost producer in order to maximize production netbacks particularly during periods of low commodity prices.

Interest Rates Interest rate changes do not have a significant impact on cash flow due to Paragon's conservative debt levels. However, Paragon does manage interest rate exposure by maintaining a certain portion of its long term debt with fixed interest rates as explained previously.

Liquidity Paragon's growth plans are somewhat dependent on its ability to incur significant capital expenditure programs. The Company relies on cash flow from operations, bank debt and selective new equity issues to finance these expenditure programs. Paragon's annual capital budgets are based upon our projected cash flow while respecting our conservative debt to cash flow parameters. The ability of oil and gas companies to access equity financing is directly linked to performance and favourable recognition by capital markets. While capital markets and general investor sentiment toward the resource sector can change rapidly, Paragon believes its strong exploration focus, successful drilling programs and diligent cost control will maximize shareholder value and allow for continued capital market support.

Regulatory The petroleum industry is also subjected to intense government regulations in areas such as safety, the environment and taxation. Paragon is committed to operating safely within established environmental guidelines. The Company is also sensitive to the needs and concerns of local residents in all our areas of operation. Paragon maintains comprehensive safety and environmental policies, which are reviewed on a regular basis to ensure all government regulations and self-imposed guidelines are met.

Business Prospects, Outlook

Both oil and natural gas prices experienced some recovery in 1996. This improvement in commodity prices continued throughout 1996 and into early 1997. In the early part of the 1996-1997 heating season, natural gas prices in all markets have improved substantially. Excluding the transportation differentials, natural gas prices in Alberta remain lower than relative prices in Eastern Canada and various U.S. regions as a result of restricted export capacity which is expected to ease in 1998 when various pipeline expansions are completed. Paragon's outlook for the future of the Canadian oil and natural gas industry is very promising.

Paragon's 1997 capital expenditures program is currently set at $29 million, which includes drilling 52 wells with an overall estimated working interest of 75 percent. Industry activity is currently at record levels and although field services are currently very restrictive, Paragon was proactive and has secured the necessary field services to accomplish our 1997 plans.

Paragon's 1997 capital expenditure program will be monitored in relation to commodity prices, drilling success and capital sources. The Company remains committed to achieving a minimum 20 percent yearly growth in average BOE production per common share and to maintaining its low cost structure.

Paragon's exposure to fluctuations in commodity prices, production levels and interest rates are outlined in the following table. A change in one factor may compound or offset a change in another factor and this inter-relationship is not incorporated in the sensitivity summary. These sensitivities are based upon Paragon's 1997 corporate plan.

Sensitivity Summary

	Cash flow		Net income	
	(000's)	Per Share	(000's)	Per Share
Changes in prices				
$1.00 U.S. per BBL in oil	833	$0.03	541	$0.02
$0.10 Cdn. per MCF in natural gas	930	$0.03	610	$0.02
Change in production				
100 BOPD oil	654	$0.02	223	$0.01
1 MMCF per day natural gas	386	$0.01	150	$0.01
Change in interest rate				
1% bank prime rate	226	$0.01	127	$0.01