ZARGON OIL & GAS LTD.

2013 Q1 FINANCIAL REPORT

FINANCIAL AND OPERATING HIGHLIGHTS

(unaudited)	Three Months Ended March 31, 2013	2012	Percent Change
Financial			
Income and Investments ($ millions)			
Gross petroleum and natural gas sales	**37.08**	44.64	(17)
Funds flow from operating activities	**13.90**	13.52	3
Cash flows from operating activities	**12.46**	11.85	5
Cash dividends (net of Dividend Reinvestment Plan)	**4.75**	7.45	(36)
Net earnings/(loss)	**0.23**	(2.01)	111
Net capital expenditures	**16.19**	20.95	(23)
Per Share, Basic			
Funds flow from operating activities ($/share)	**0.46**	0.46	–
Cash flows from operating activities ($/share)	**0.42**	0.40	5
Net earnings/(loss) ($/share)	**0.01**	(0.07)	114
Cash Dividends ($/common share)	**0.18**	0.30	(40)
Balance Sheet at Period End ($ millions)			
Property and equipment	**399.39**	418.48	(5)
Exploration and evaluation assets	**19.22**	24.17	(20)
Long term bank debt	**44.02**	107.37	(59)
Convertible debentures at maturity	**57.50**	–	–
Shareholders' equity	**192.70**	214.57	(10)
Total Common Shares Outstanding at Period End (millions)	**29.97**	29.47	2
Operating			
Average Daily Production			
Oil and liquids (bbl/d)	**5,113**	5,496	(7)
Natural gas (mmcf/d)	**15.21**	20.03	(24)
Equivalent (boe/d)	**7,648**	8,834	(13)
Average Selling Price (before the impact of financial risk management contracts)			
Oil and liquids ($/bbl)	**71.62**	81.92	(13)
Natural gas ($/mcf)	**3.01**	2.01	50
Wells Drilled, Net	**5.1**	9.6	(47)
Undeveloped Land at Period End (thousand net acres)	**321**	411	(22)

Notes:

Throughout this report, the calculation of barrels of oil equivalent ("boe") is based on the conversion ratio that six thousand cubic feet of natural gas is equivalent to one barrel of oil. For a further discussion about this term, refer to the Management's Discussion and Analysis section in this report.

Funds flow from operating activities is an additional GAAP term that represents net earnings/(loss) and asset retirement expenditures except for non-cash items. For a further discussion about this term, refer to the Management's Discussion and Analysis section in this report.

Production

(boe/d)

Oil and Liquids Production

(bbl/d)

Natural Gas Production

(mmcf/d)

Message to Shareholders (1)

Zargon Oil & Gas Ltd. has released financial and operating results for the first quarter of 2013 that highlighted continued progress in its drive to become a long term sustainable, dividend-paying energy producer. The quarter was highlighted by the sanctioning of the construction of our Little Bow Alkaline Surfactant Polymer (“ASP”) tertiary oil recovery project in Southern Alberta.

Zargon's sustainability model implies balancing cash inflows and outflows, generating meaningful growth in cash flow per share, while continuing the shift toward oil and liquids over the next few years. Zargon believes that the Little Bow ASP tertiary oil recovery production will help improve sustainability, as it offers the best blend of low-decline, low-sustaining capital and high-netback and long-life assets available to the company.

The Company's intentions throughout the remainder of 2013 will be to:

- Deliver the Little Bow ASP project on-time and on-budget, with first chemical injections to occur in January 2014;
- Deliver a consistent dividend of $0.06 per common share per month;
- Deliver a property divestiture program designed to high grade and concentrate the company's asset portfolio; and
- Maintain a strong balance sheet through substantial oil hedging programs while limiting drilling capital to high-graded projects offering the most attractive risk adjusted returns.

Specific financial and operating highlights in the first quarter of 2013 include:

- First quarter 2013 production averaged 5,113 barrels of oil and liquids per day, a one percent increase from the preceding quarter and first quarter 2013 natural gas production averaged 15.2 million cubic feet per day, a five percent decrease from the preceding quarter. Total production averaged 7,648 barrels of oil equivalent per day, a one percent decrease from the preceding quarter. During the quarter, oil and liquids production represented 67 percent of total production based on a 6:1 equivalent basis.
- Funds flow from operating activities of $13.9 million were 15 percent lower than the $16.4 million recorded in the prior quarter, and three percent higher than the $13.5 million reported in first quarter of 2012. Funds flow from operating activities for the 2013 first quarter included reductions of $0.9 million of asset retirement expenses.
- Three monthly cash dividends of $0.06 per common share were declared in the first quarter of 2013 for a total of $5.4 million ($4.8 million after accounting for the common shares issued under the Dividend Reinvestment Plan (“DRIP”) in lieu of cash dividends). These cash dividends (net of the DRIP) were equivalent to a payout ratio of 34 percent of funds flow from operating activities.
- First quarter 2013 exploration and development capital expenditures (excluding property acquisitions and dispositions) were $19.3 million and included $5.0 million of expenditures related to the Little Bow ASP tertiary oil recovery project. In the quarter, Zargon drilled 7.0 gross wells (5.1 net wells) that resulted in 5.1 net oil wells.
- Zargon’s March 31, 2013 debt, net of working capital (excluding unrealized derivative assets/liabilities) and using the full future face value of the convertible debenture of $57.5 million, was $120.1 million and is approximately 2.1 times annualized 2013 first quarter funds flow from operating activities. At March 31, 2013, Zargon had more than $100 million of available credit facilities remaining on its $165 million borrowing base.
- During the 2013 first quarter, Zargon disposed of assets in the Karr, Alberta area for total proceeds of $3.5 million. The assets mainly consisted of undeveloped land and contained minimal reserves and

production. Subsequent to quarter end, Zargon has disposed of assets in the Workman, Saskatchewan area for $4.3 million. The assets were producing 40 barrels of oil per day.

Little Bow Alkaline Surfactant Polymer ("ASP") Project [(1)]

Zargon has made good progress with the Little Bow ASP project in 2013. This ASP project entails the injection of a dilute chemical solution into a partially depleted reservoir to recover incremental oil reserves. In its 2012 year end review, McDaniel and Associates Consultants Ltd. assigned 4.4 million barrels of probable undeveloped oil equivalent reserves to Zargon's working interest in phases 1 and 2 of the project.

Since the February 2013 sanctioning of the project, Zargon has advanced the project on many fronts: facility approvals from the Energy Resources Conservation Board ("ERCB") have been obtained; material and equipment procurement is proceeding; field pipeline replacements and upgrades have been constructed; and facility construction contracts and ASP chemical supply bids are being negotiated. Field construction is expected to commence in late May 2013, which will provide for first chemical injections in January 2014 and incremental oil production by the second quarter of 2014.

The total construction capital cost of phases 1 and 2 of the Little Bow ASP project continues to be approximately $60 million (as spent dollars). Of this total, $6.5 million of expenditures were incurred in 2012 and $5.0 million were spent in the first quarter of 2013. For the remainder of 2013, we plan on spending $37 million, an amount that includes $3 million of 2014 expenditures that have been advanced into 2013 to prepare for early production responses and the first ASP chemical deliveries. The estimated total phase 1 and 2 chemical cost for the 2014-2019 chemical injection period will be capitalized and remains at $66 million (as spent dollars). The project's final $12 million, for the implementation of phase 2, is scheduled for 2015.

Based on the current construction schedule, we forecast that the Little Bow ASP project will provide 250 barrels of oil per day of incremental production in 2014, which will be comprised of an initial production response in the 2014 second quarter and a 2014 year end rate of 500 barrels of oil per day. Without additional infill drilling, incremental production from phases 1 and 2 of the project are forecast to reach 1,600 barrels of oil per day by 2016. Using these rates with an estimated field oil price of $68 Cdn. per barrel, a 12 percent incremental tertiary royalty rate, and operating costs of $12 per barrel of incremental oil, the project is forecast to provide a field netback of approximately $50 per barrel of incremental oil production volumes.

Follow-on capital expenditures for phases 3 and 4 of the Little Bow ASP project are expected to be completed by 2017 with forecasted total combined phases 1 to 4 project peak production rates of 2,300 barrels of oil per day expected to occur in 2020. For further information regarding the Little Bow ASP project, please refer to our updated corporate presentation, which is available at www.zargon.ca.

Other Field Activities [(1)]

In addition to the $5.0 million of ASP capital expenditures, Zargon executed a $14.3 million capital program in the 2013 first quarter on conventional oil exploitation assets. This capital program included the drilling of 5.1 net Williston Basin horizontal oil wells in addition to significant infrastructure upgrades at the Alberta Hamilton Lake and Bellshill Lake properties and the Saskatchewan Steelman and Weyburn properties. These infrastructure costs are now essentially completed and will provide operating expense improvements for the remainder of the related long-life oil properties. Significantly lower drilling and infrastructure capital expenditure levels are anticipated for the next two quarters.

In particular, the first quarter drilling program concentrated on Williston Basin Midale drainage type wells at Steelman, Weyburn, Ralph, Saskatchewan and Mackobee Coulee, North Dakota. These horizontal oil exploitation wells met our expectations that are characterized by moderate initial rates, but long-life, shallow declines that provide solid returns. Conversely, first quarter 2013 production results from our three well fourth quarter 2012 Hamilton Lake Viking oil exploitation program did not meet expectations due to lower well inflows than anticipated. This summer, we will re-examine our technical work and historical results to develop a plan to unlock this property's large oil exploitation potential.

For the remainder of the year, Zargon is planning on drilling an additional 10 net high-graded horizontal oil exploitation wells, roughly equally divided between our Taber South Sunburst and Williston Basin Midale drainage projects. In aggregate, Zargon has identified more than 100 horizontal locations in six conventional (non-ASP) oil exploitation projects, which will provide a high-graded drilling inventory for many years. Each of these six oil exploitation projects are (or will be) pressure supported by water injections or natural reservoir aquifers and consequently provide long-life low-decline oil volumes that will support future dividends.

Property Dispositions Update [1]

During the 2013 first quarter, property dispositions of $3.5 million were concluded, which primarily related to the sale of undeveloped land assets in Karr, Alberta. Subsequent to quarter end, an additional $4.3 million of property dispositions were made with the sale of the 40 barrels of oil per day in the Workman, Saskatchewan property. Throughout 2013, a minimum of $20 million of property dispositions are budgeted.

To meet this disposition objective, we are using third party services to market two packages (Twining, Wayne, Provost and Grand Forks, Alberta) that, in aggregate, are producing 350 barrels of oil per day. Additional oil properties, as required, will be marketed in the second half of 2013 in order to meet the company's $20 million disposition target. With numerous disposition options available, Zargon will exercise prudence with its planned dispositions so as to maximize the potential value from the dispositions and minimize the cash flow impact. A key consideration of the sales will be to reduce our property footprint by selling (or trading) our very large non-strategic property inventory and consequently, sales in addition to the $20 million target may be considered. Over time, we anticipate that these dispositions will enable Zargon to realize a lower cost structure through a disciplined focus on our growing tertiary oil recovery business and the stable production volumes coming from the measured exploitation of core, conventional long-life low-decline oil properties.

2013 Outlook [1]

Zargon's 2013 non-ASP field capital budget has been set at $40 million (before dispositions) of which approximately $26 million will be spent in the remaining three quarters. Our 2013 capital budget incorporates $20 million of property dispositions, of which $7.8 million have been completed by early May. For the remainder of the year, the drilling of the 10 remaining budgeted wells will be contingent on the successful execution of this $20 million property disposition program.

Although during the "2013 ASP heavy capital spend" period, we have deferred components of our oil exploitation drilling programs, we will not be deferring our general oil exploitation capital programs related to waterflood modifications, pumping upgrades, facility optimizations, etc. These ongoing projects provide very strong returns and moderate our base corporate oil declines from the 21 to 14 percent range. Additionally, we will continue to monitor the improving natural gas prices and will optimize and re-activate shut-in gas wells when appropriate. Zargon shut-in a significant amount of natural gas wells in 2012 due to low natural gas prices.

Also, Zargon has entered into a significant oil hedging program to provide a measure of stability and predictability to cash flows during the ASP construction phase. For the remainder of 2013, Zargon has hedged 3,000 barrels per day at $97.32 US/bbl WTI, while for 2014 an average of 2,300 barrels per day is hedged at $91.92 US/bbl WTI.

Production Guidance [1]

In the March 12, 2013 year end press release, Zargon provided updated first quarter 2013 oil production rate guidance of 5,150 barrels of oil and liquids per day. Actual first quarter volumes were 5,113 barrels of oil and liquids per day or about one percent below guidance. The press release also set Zargon's first quarter 2013 natural gas production guidance of 15.6 million cubic feet per day. First quarter actual volumes were 15.2 million cubic feet per day or about three percent below guidance.

Oil and liquids production for the 2013 second quarter is set at 4,800 barrels of oil per day and reflects estimated reductions of 100 barrels of oil and liquids per day for spring break-up shut-ins and 40 barrels of oil and liquids per day for second quarter property dispositions. Second quarter natural gas production guidance is set at 15.0 million cubic feet per day.

For the remainder of the year, production volumes will depend on the magnitude and timing of our property disposition programs along with related timing of our drilling programs and consequently a broad range of outcomes are possible. Full-year 2013 average oil and liquids production is now expected to range between 4,700 to 4,900 barrels of oil per day, with exit rates ranging from 4,400 to 4,700 barrels of oil per day. Full-year 2013 average natural gas production is now expected to range between 14.8 to 15.0 million cubic feet per day, with exit rates ranging from 14.5 to 14.9 million cubic feet per day. Looking forward, we expect that first quarter 2014 production volumes will represent both an oil production low and a turning point for Zargon, as in subsequent quarters, significant production volumes will begin to materialize from the ASP project and from oil exploitation drilling programs that will have been reactivated once the substantial ASP phase 1 capital program is completed.

Acknowledgement

Finally, I would like to personally acknowledge Mr. Graham Weir who has decided to not stand for re-election to the Zargon Board this year. Graham joined our Board in October 2003 and over the past 10 years has served Zargon and its shareholders well through his thoughtful counsel and advice. We thank Graham for his significant contributions and wish him the very best in his future endeavours.

(1) Please see comments on "Forward-Looking Statements" in the Management's Discussion and Analysis section in this report.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Management's discussion and analysis ("MD&A") is a review of Zargon Oil & Gas Ltd.'s 2013 first quarter financial results and should be read in conjunction with the unaudited interim consolidated financial statements and related notes for the three months ended March 31, 2013 and the audited consolidated financial statements and related notes for the year ended December 31, 2012. The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board, which are also generally accepted accounting principles ("GAAP") for publicly accountable enterprises in Canada. All amounts are in Canadian dollars unless otherwise noted. All references to "Zargon" or the "Company" refer to Zargon Oil & Gas Ltd.

In the MD&A, natural gas is converted to a barrel of oil equivalent ("Boe") using six thousand cubic feet of gas to one barrel of oil. In certain circumstances, natural gas liquid volumes have been converted to a thousand cubic feet equivalent ("Mcfe") on the basis of one barrel of natural gas liquids to six thousand cubic feet of gas. Boes and Mcfes may be misleading, particularly if used in isolation. A conversion ratio of one barrel to six thousand cubic feet of natural gas is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. Given that the value ratio based on the current price of crude oil as compared to natural gas is significantly different from the energy equivalency of 6:1, utilizing a conversion ratio on a 6:1 basis may be misleading as an indication of value.

The following are descriptions of additional GAAP measures used in this MD&A:

- *The MD&A contains the term "funds flow from operating activities" ("funds flow"), which should not be considered an alternative to, or more meaningful than, "cash flows from operating activities" as determined in accordance with IFRS as an indicator of the Company's financial performance. This term does not have any standardized meaning as prescribed by IFRS and, therefore, the Company's determination of funds flow from operating activities may not be comparable to that reported by other companies. The Company evaluates its performance based on net earnings and funds flow from operating activities. The Company considers funds flow from operating activities to be a key measure as it demonstrates the Company's ability to generate the cash necessary to pay dividends, repay debt and to fund future capital investment. It is also used by research analysts to value and compare oil and gas companies, and it is frequently included in published research when providing investment recommendations.*

The following are descriptions of non-GAAP measures used in this MD&A:

- *The Company also uses the term "debt net of working capital" or "net debt". Debt net of working capital, as presented, does not have any standardized meaning prescribed by IFRS and may not be comparable with the calculation of similar measures for other entities. Debt net of working capital, as used by the Company, is calculated as bank debt plus the full future face value of the convertible debenture of $57.50 million and any working capital deficit excluding unrealized derivative assets/liabilities.*

- *Operating netbacks per boe equal total petroleum and natural gas sales per boe adjusted for realized derivative gains and/or losses per boe, royalties per boe, operating expenses per boe and transportation expenses per boe. Operating netbacks are a useful measure to compare the Company's operations with those of its peers.*

- *Funds flow netbacks per boe are calculated as operating netbacks less general and administrative expenses per boe, transaction costs per boe, interest and financing charges per boe, interest on the convertible debenture per boe, asset retirement expenditures per boe, cash portion of exploration and evaluation, other expense per boe and current income taxes per boe. Funds flow netbacks are a useful measure to compare the Company's operations with those of its peers.*

References to "production volumes" or "production" in this document refer to sales volumes.

Forward-Looking Statements – This document offers our assessment of Zargon's future plans and operations as at May 14, 2013, and contains forward-looking statements including:

- *our expectations for our plans with respect to our Little Bow ASP project and the results therefrom referred to under the headings "Message to Shareholders", "Little Bow Alkaline Surfactant Polymer ("ASP") project", "Production Guidance" and "Outlook";*
- *our expectations for our plans with respect to our budgeted 2013 property dispositions referred to under the headings "Message to Shareholders", "Property Dispositions Update", "2013 Outlook" and "Production Guidance";*
- *our expectations for our budgeted 2013 conventional oil exploitation assets capital program referred to under the headings "Message to Shareholders", "Other Field Activities", "2013 Outlook" and "Production Guidance";*
- *our expectations for our 2013 and 2014 hedges referred to under the heading "2013 Outlook";*
- *our expectations for royalties referred to under the heading "Financial & Operating Results";*
- *our expectations for operating expenses and transportation expenses referred to under the headings "Financial & Operating Results";*
- *our expectations for general and administrative expenses referred to under the headings "Financial & Operating Results";*
- *our dividend policy referred to under the heading "Liquidity and Capital Resources";*
- *our expected sources of funds for dividend referred to under the headings "Liquidity and Capital Resources" and "Outlook";*
- *our expectations for production referred to under the heading "Production Guidance"; and*
- *our expected sources of funds for capital expenditures referred to under the heading "Liquidity and Capital Resources".*

Such statements are generally identified by the use of words such as "anticipate", "continue", "estimate", "expect", "forecast", "may", "will", "project", "should", "plan", "intend", "believe" and similar expressions (including the negatives thereof). By their nature, forward-looking statements are subject to numerous risks and uncertainties, some of which are beyond our control, including such as those relating to results of operations and financial condition, general economic conditions, industry conditions, changes in regulatory and taxation regimes, volatility of commodity prices, escalation of operating and capital costs, currency fluctuations, the availability of services, imprecision of reserve estimates, geological, technical, drilling and processing problems, environmental risks, weather, the lack of availability of qualified personnel or management, stock market volatility, the ability to access sufficient capital from internal and external sources and competition from other industry participants for, among other things, capital, services, acquisitions of reserves, undeveloped lands and skilled personnel. Risks are described in more detail in our Annual Information Form, which is available on our website and at www.sedar.com. Forward-looking statements are provided to allow investors to have a greater understanding of our business.

You are cautioned that the assumptions, including among other things, future oil and natural gas prices; future capital expenditure levels (including ASP); future production levels; future exchange rates; the cost of developing and expanding our assets; our ability to obtain equipment in a timely manner to carry out development activities; our ability to market our oil and natural gas successfully to current and new customers; the impact of increasing competition, our ability to obtain financing on acceptable terms; and our ability to add production and reserves through our development and acquisition activities used in the preparation of such information, although considered reasonable at the time of preparation, may prove to be imprecise and, as such, undue reliance should not be placed on forward-looking statements. Our actual results, performance, or achievements could differ materially from those expressed in, or implied by, these forward-looking statements. We can give no assurance that any of the events anticipated will transpire or occur, or if any of them do, what benefits we will derive from them. The forward-looking information contained in this document is expressly qualified by this cautionary statement. Our policy for updating forward-looking statements is that Zargon disclaims, except as required by law, any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

This MD&A has been prepared as of May 14, 2013.

FINANCIAL & OPERATING RESULTS

Petroleum and Natural Gas Revenue
($ millions)

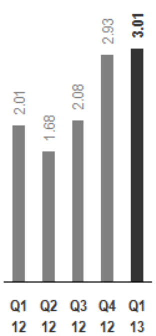
Petroleum and Natural Gas Sales

($ millions)	Three months ended March 31, 2013	2012	Percent Change
Petroleum sales	**32.96**	40.97	(20)
Natural gas sales	**4.12**	3.67	12
Petroleum and natural gas sales	**37.08**	44.64	(17)

First quarter 2013 gross petroleum and natural gas sales of $37.08 million were 17 percent below the $44.64 million in the first quarter of 2012 due to lower production volumes and oil prices.

First quarter 2013 realized oil and liquids field prices averaged $71.62 per barrel before the impact of financial risk management contracts and were 13 percent lower than the $81.92 per barrel recorded in the 2012 first quarter. Zargon's crude oil field price differential from the Edmonton par price increased to $16.59 per barrel in the first quarter of 2013 compared to $10.34 per barrel in the first quarter of 2012. The first quarter Edmonton par price was negatively impacted by a $6.99 Cdn. per barrel differential to the WTI pricing index, down from the $10.79 negative differential recorded in the first quarter of 2012. Natural gas field prices received averaged $3.01 per thousand cubic feet in the first quarter of 2013, a 50 percent increase from the 2012 first quarter prices.

Natural Gas Prices
($/mcf)

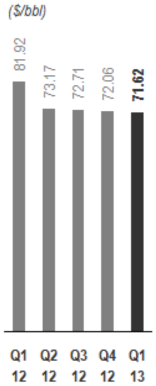


Pricing

Average for the period	Three Months Ended March 31, 2013	2012	Percent Change
Natural Gas:			
NYMEX average daily spot price ($US/mmbtu)	**3.45**	2.45	41
AECO average daily spot price ($Cdn/mmbtu)	**3.20**	2.15	49
Zargon realized price ($Cdn/mcf) (1)	**3.01**	2.01	50
Zargon realized natural gas field price differential (1) (2)	**0.19**	0.14	
Crude Oil:			
WTI ($US/bbl)	**94.37**	102.93	(8)
Edmonton par price ($Cdn/bbl)	**88.21**	92.26	(4)
Zargon realized field price before the impact of financial risk management contracts ($Cdn/bbl)	**71.62**	81.92	(13)
Zargon realized field price after the impact of financial risk management contracts ($Cdn/bbl)	**74.50**	75.85	(2)
Zargon realized oil field price differential (3)	**16.59**	10.34	

(1) *Zargon was not subject to any natural gas financial risk management contracts for the first three months of 2013 and 2012.*
(2) *Calculated as Zargon's realized field price ($Cdn/mcf) as compared to AECO average daily spot price ($Cdn/mmbtu).*
(3) *Calculated as Zargon's realized field price before the impact of financial risk management contracts ($Cdn/bbl) as compared to Edmonton par price ($Cdn/bbl).*

Oil and Liquids Prices
($/bbl)



Volumes

Natural gas production volumes decreased 24 percent in the 2013 first quarter to 15.21 million cubic feet per day compared to 20.03 million cubic feet per day in the 2012 first quarter. These production decreases were primarily due to naturally occurring production declines and the shut-in of uneconomic natural gas wells. Oil and liquids production volumes during the 2013 first quarter were 5,113 barrels per day, a seven percent decrease from the 2012 first quarter rate of 5,496. The production decrease is primarily related to Williston Basin property sales that were completed in the third quarter of 2012.

Production by Core Area

Three Months Ended March 31,	**2013**			2012		
	Oil and Liquids (bbl/d)	**Natural Gas (mmcf/d)**	**Equivalents (boe/d)**	Oil and Liquids (bbl/d)	Natural Gas (mmcf/d)	Equivalents (boe/d)
Alberta Plains North	**1,347**	**11.98**	**3,343**	1,418	16.44	4,157
Alberta Plains South	**1,751**	**2.83**	**2,223**	1,739	3.15	2,265
Williston Basin	**2,015**	**0.40**	**2,082**	2,339	0.44	2,412
	5,113	**15.21**	**7,648**	5,496	20.03	8,834

Risk Management Contracts

Zargon's commodity price risk management policy, which is approved by the Board of Directors, allows for the sale of up to a certain percentage of its estimated before royalty production volumes for each commodity up to a 30 month period. Zargon is permitted for the sale of up to a 70 percent maximum of it's estimated before royalty production volumes for oil for the first 12 months, a 60 percent maximum on the following 12 months and a 50 percent maximum on the final six months. The commodity price risk management policy is maintained for the purpose of reducing volatility in the financial results and to stabilize and hedge further cash flows against an unpredictable commodity price environment, with an emphasis on protecting downside risk.

Zargon also has two five year interest rate swaps on a total of $40 million of borrowing with an average effective interest rate of 1.69 percent plus stamping fee (currently at 2.00 percent) and a physical electricity hedge. The Company does not have any natural gas swaps outstanding at March 31, 2013.

For accounting purposes, an unrealized gain or loss from forward sale commodity contracts and interest rate swaps is recorded based on the fair value ("mark-to-market") of the contracts at the period end. Realized and unrealized gains on risk management contracts are included in "gain/loss on derivatives" in the consolidated statement of earnings and their fair value is reflected in "derivative assets" or "derivative liabilities" on the consolidated balance sheets.

In the 2013 first quarter, relatively higher contract prices versus WTI oil prices resulted in a net realized gain on derivatives of $1.28 million compared to a $3.09 million realized net loss in the first quarter of 2012.

The unrealized loss on derivatives of $4.77 million in the first quarter of 2013 was comprised of oil contract losses of $4.68 million and interest rate swap losses of $0.09 million, compared to a net $1.63 million loss in the first quarter of 2012. These non-cash unrealized derivative gains or losses are generated by the change over the reporting period in the mark-to-market valuation of Zargon's risk management contracts. Commodity price volatility has resulted in significant fluctuations in the mark-to-market amount of unrealized derivative assets and liabilities. Zargon's commodity risk management positions are described in Notes 12 and 13 to the unaudited interim consolidated financial statements.

Royalties

	Three months ended March 31,		
($ millions)	**2013**	2012	Percent Change
Royalties	**6.67**	8.45	(21)
Percentage of revenue	**18.0%**	18.9%	

Royalties are inclusive of the Saskatchewan Resource Surcharge (“SRC”). The variations in royalty rates generally track changes in production and volumes. First quarter of 2013 royalties were 18.0 percent of gross sales compared to 18.9 percent in the first quarter of 2012 due to lower oil prices. For 2013, we are forecasting an average royalty rate of 18.5 percent.

Operating Expenses and Transportation Expenses

	Three months ended March 31,		
($ millions)	**2013**	2012	Percent Change
Operating expenses	**11.89**	13.31	(11)
Transportation expenses	**0.45**	0.38	18
Total	**12.34**	13.69	(10)
Total (boe/d)	**17.93**	17.03	5

Operating expenses plus transportation expenses are down on a dollar basis but up on a per barrel of oil equivalent basis due to lower production. In the quarter, continued field optimization projects to reduce operating expenses were offset by increased electricity costs and road and lease maintenance expenditures due to inclement weather in two core areas. Due to a combination of fixed costs and lower production volumes, we are now forecasting that the summation of operating and transportation expenses to average approximately $17.50 per barrel of oil equivalent for the remainder of 2013.

Operating Netbacks

Three Months Ended March 31,	**2013**		2012	
	Oil and Liquids ($/bbl)	**Natural Gas ($/mcf)**	Oil and Liquids ($/bbl)	Natural Gas ($/mcf)
Sales	**71.62**	**3.01**	81.92	2.01
Royalties	**(13.40)**	**(0.37)**	(16.19)	(0.19)
Realized gain/(loss) on derivatives	**2.88**	**–**	(6.07)	–
Operating expenses	**(19.10)**	**(2.26)**	(19.83)	(1.86)
Transportation expenses	**(0.98)**	**–**	(0.76)	–
Operating netbacks	**41.02**	**0.38**	39.07	(0.04)

G&A Expenses

	Three months ended March 31,		
($ millions)	**2013**	2012	Percent Change
G&A expenses	**2.91**	4.07	(29)
G&A expenses (boe/d)	**4.23**	5.06	(16)

G&A expenses were down in the first quarter of 2013 primarily due to reductions in salaries and wages from prior year staff reductions. G&A expenses, exclusive of transaction costs, are forecasted to average approximately $4.50 per barrel of oil equivalent for the remainder of 2013.

Interest and Financing Charges on Long Term Bank Debt

Zargon's borrowings are through its syndicated bank credit facilities. Interest and financing charges on these facilities in the 2013 first quarter were $0.56 million, 51 percent lower than the $1.14 million in the first quarter of 2012. The decrease in interest and financing charges resulted from lower average borrowing levels due to the convertible debenture financing that occurred in the second quarter of 2012.

Interest on Convertible Debentures

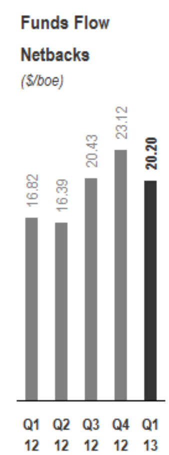
Zargon has borrowings through its convertible debentures, which were issued in May 2012 and mature on June 30, 2017. Interest is payable semi-annually at a rate of six percent, calculated on the gross proceeds of $57.50 million. Interest charges of $0.86 million in the first quarter of 2013 compared to nil in the first quarter of 2012.

Current Income Taxes

Current income taxes for the 2013 first quarter were $0.17 million, and relate to the US operations. When compared to the 2012 first quarter, current income taxes increased $0.15 million. Total corporate tax pools as at March 31, 2013 are approximately $316 million, which represents an increase of one percent from the comparable $313 million of tax pools available to Zargon at December 31, 2012, primarily as a result of the first quarter 2013 field capital program.

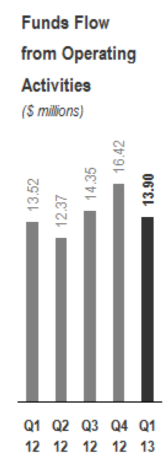
Corporate Netbacks

	Three Months Ended March 31,	
($/boe)	**2013**	2012
Petroleum and natural gas sales	**53.87**	55.53
Royalties	**(9.69)**	(10.51)
Realized gain/(loss) on derivatives	**1.86**	(3.84)
Operating expenses	**(17.27)**	(16.56)
Transportation expenses	**(0.66)**	(0.47)
Operating netbacks	**28.11**	24.15
General and administrative expenses	**(4.23)**	(5.06)
Transaction costs	**–**	(0.03)
Interest and financing charges	**(0.82)**	(1.41)
Interest on convertible debentures	**(1.24)**	–
Asset retirement expenditures	**(1.37)**	(0.81)
Current income taxes	**(0.25)**	(0.02)
Funds flow netbacks	**20.20**	16.82



Depletion and Depreciation Expense

Depletion and depreciation expense for the first quarter of 2013 decreased 11 percent to $11.41 million compared to $12.85 million in the first quarter of 2012. On a per barrel of oil equivalent basis, the depletion and depreciation rates were $16.57 and $15.98 for the first quarter of 2013 and the first quarter of 2012, respectively. When compared to the first quarter of 2012, the decreased depletion expense is primarily due to reduced depletable balances resulting from the December 31, 2012 impairment of natural gas assets. The 2012 calendar year depletion and depreciation rate was $16.22 per barrel of oil equivalent.



Accretion of Asset Retirement Obligations and Convertible Debentures

The accretion expense of asset retirement obligations for the first three months of 2013 was $0.72 million, consistent with the first three months of 2012. Year-over-year adjustments are due to changes in the estimated future liability for asset retirement obligations resulting from changes in cost assumptions and adjustments in Zargon's well count due to drilling programs and property acquisitions or dispositions.

The debt portion of Zargon's convertible debenture is also accreted over its term, up to the total maturity value of $57.50 million. Accretion on the convertible debenture for the 2013 first quarter is $0.32 million.

Shared-based Payments

Expensing of share-based compensation in the first quarter of 2013 totalled $0.21 million, which is lower than the $0.43 million incurred in the first quarter of 2012 due to a lower black scholes value of the 2013 grants, including the impact of forfeitures, the timing of the 2013 grant at the end of the quarter and the completion of vesting conditions in the common share rights incentive plans.

Unrealized Foreign Exchange

The Company had an unrealized foreign exchange gain of $0.10 million during the first quarter of 2013 compared to a minimal amount in the 2012 first quarter. Gains and losses result from transactions in US dollars when they are translated into Canadian dollars. The volatility in the US/Cdn dollar creates non-cash translation gains/losses.

Gain on Disposal of Assets

During the first quarter of 2013, Zargon closed a sale of assets located in the Karr, Alberta area. Zargon reported a gain of $3.48 million on the disposal of assets.

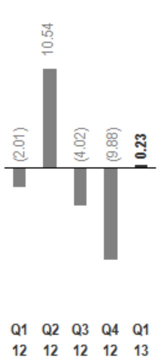
Exploration and Evaluation Expenses

Non-cash exploration and evaluation expenses for the 2013 first quarter of $0.86 million were $0.20 million lower than the first quarter of 2012 expenses of $1.06 million. Exploration and evaluation expenses are primarily related to undeveloped land expiries during the quarter. The first quarter 2013 exploration and evaluation expense related to expiries in west central and northern Alberta.

Deferred Tax

The deferred tax recovery for the first quarter of 2013 was $0.09 million compared to a recovery of $0.51 million in the first quarter of 2012. The decrease in deferred tax recovery is a result of increased earnings in the quarter.

Net Earnings/ (Loss)
($ millions)



Funds Flow from Operating Activities

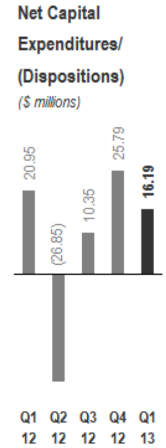
Funds flow from operating activities in the 2013 first quarter of $13.90 million was $0.38 million, or three percent higher than the prior year first quarter. The increase in funds flow compared to the prior year first quarter was primarily a result of lower royalties, lower operating expenses, lower G&A expenses and a gain on realized derivatives which was partially offset by decreased revenue.

Net Earnings

Net earnings of $0.23 million for the 2013 first quarter were improved from the $2.01 million net loss in the 2012 first quarter, largely due to the realized gain on derivatives and the gain on the disposal of assets. The net earnings track the funds flow from operating activities for the respective periods modified by asset retirement expenditures and non-cash charges, which include depletion and depreciation, unrealized derivative gains/(losses), land expiries, property disposition gains/(losses) and deferred taxes. On a per diluted share basis, first quarter 2013 net earnings were $0.01 compared to a net loss of $0.07 for the 2012 first quarter.

Capital Expenditures

	Three Months Ended March 31,	
($ millions)	**2013**	2012
Undeveloped land	**0.79**	0.95
Geological and geophysical (seismic)	**0.22**	0.93
Drilling and completion of wells	**7.28**	14.39
Well equipment and facilities	**5.98**	4.00
ASP project	**5.01**	0.56
Exploration and development	**19.28**	20.83
Property acquisitions	**0.18**	0.10
Property dispositions	**(3.27)**	–
Net property acquisitions/(dispositions)	**(3.09)**	0.10
Total net capital expenditures excluding administrative assets	**16.19**	20.93
Administrative assets	**–**	0.02
Total net capital expenditures	**16.19**	20.95



LIQUIDITY AND CAPITAL RESOURCES

Total net capital expenditures (including net property acquisitions/(dispositions)) totalled $16.19 million in the first quarter of 2013 and were 23 percent lower than the same period in 2012. Field expenditures of $19.28 million for the first quarter of 2013 were seven percent lower than the 2012 first quarter. The first quarter 2013 field capital expenditures (excluding net property dispositions) were allocated to Alberta Plains North - $4.94 million, Alberta Plains South - $6.48 million and Williston Basin - $7.86 million and included the drilling of 5.1 net wells, down from the 9.6 net wells drilled in the first quarter of 2012. Included in the Alberta Plains South capital expenditures is the $5.01 million incurred on the Little Bow ASP project.

Funds flow from operating activities in the first three months of 2013 of $13.90 million and proceeds from the sale of properties of $3.27 million were used to partially fund the capital program and cash dividends to shareholders.

At March 31, 2013, the Company's combined debt net of working capital (excluding unrealized derivative assets/liabilities) was $120.10 million, which compares to $113.18 million of net debt at the end of December 31, 2012. The increase in net debt was due to Zargon's 2013 first quarter capital expenditure program. The $120.10 million debt net of working capital consists of the $57.50 million of convertible unsecured subordinate debentures and the remaining portion of bank debt.

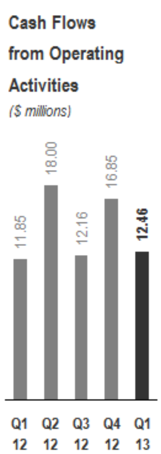
The volatility of oil and natural gas prices, uncertainty or modifications regarding royalties and Canadian income tax rules and global economic/political concerns have, on occasion, restricted the oil and natural gas industry's ability to attract new capital from debt and equity markets.

Cash Dividends Analysis

	Three Months Ended March 31,	
($ millions)	**2013**	2012
Cash flows from operating activities	**12.46**	11.85
Net earnings/(loss)	**0.23**	(2.01)
Actual cash dividends paid or payable relating to the period [1]	**(4.75)**	(7.45)
Excess of cash flows from operating activities over cash dividends paid	**7.71**	4.40
Excess (shortfall) of net earnings/(loss) over cash dividends paid	**(4.52)**	(9.46)

(1) Cash dividends represent the cash portion only and do not include common shares issued through Zargon's Dividend Reinvestment Plan.

During the first three months of 2013, Zargon maintained a monthly dividend of $0.06 per common share. Management monitors the Company's dividend policy with respect to forecasted net cash flows, debt levels and capital expenditures. Zargon's cash dividends are discretionary to the extent that these dividends are in compliance with Section 43 of the *Business Corporations Act* (Alberta) and do not cause a breach of the financial covenants under Zargon's credit facilities. As a petroleum and natural gas company, Zargon's reserve base is depleted by production and Zargon, therefore, relies on ongoing exploration, development, exploitation and acquisition activities to replace reserves and to offset production declines. The success of these capital programs, along with commodity price fluctuations and the Company's ability to manage costs, are the main factors influencing the sustainability of the Company's dividends.



For the three months ended March 31, 2013, cash flows from operating activities (after changes in non-cash working capital) of $12.46 million exceeded cash dividends of $4.75 million. Similarly, for the three months ended March 31, 2012, cash flows from operating activities (after changes in non-cash working capital) of $11.85 million exceeded cash dividends of $7.45 million.

For the three months ended March 31, 2013, net earnings of $0.23 million were exceeded by cash dividends of $4.75 million. Net earnings include significant non-cash charges of $14.62 million for the 2013 first quarter that does not impact cash flow. For the three months ended March 31, 2012, the net loss of $2.01 million was exceeded by cash dividends of $7.45 million. In the instances where dividends exceed net earnings, a portion of the cash dividend paid to shareholders may represent an economic return of the shareholders' capital.

For the quarter ended March 31, 2013, cash dividends and net capital expenditures totalled $20.94 million, which was $8.48 million higher than the cash flows from operating activities (after changes in non-cash working capital) of $12.46 million. For the quarter ended March 31, 2012, cash dividends and net capital expenditures totalled $28.40 million, which was $16.55 million higher than the cash flows from operating activities (after changes in non-cash working capital) of $11.85 million. Zargon relies on access to debt and capital markets to the extent that cash dividends and net capital expenditures exceed cash flows from operating activities (after changes in non-cash working capital). Over the long term, Zargon expects to fund cash dividends and capital expenditures with its cash flows from operating activities; however, it may continue to fund acquisitions and growth through additional debt and equity issuances. In the crude oil and natural gas industry, because of the nature of reserve reporting, the natural reservoir declines and the risks involved in capital investment, it is not possible to distinguish between capital spent on maintaining productive capacity and capital spent on growth opportunities. Therefore, maintenance capital is not disclosed separately from development capital spending.

At May 14, 2013, Zargon Oil & Gas Ltd. had 29.972 million common shares outstanding. Pursuant to the common share rights incentive plans, there are currently an additional 1.005 million common share incentive rights issued and outstanding.

Zargon has a Dividend Reinvestment Plan (the "DRIP") which allows eligible shareholders to reinvest cash dividends in additional common shares which, when issued from treasury, are issued at 95 percent of the "Average Market Price" (as defined in the DRIP) on the applicable dividend payment date.

Capital Sources and Uses

	Three Months Ended March 31,	
($ millions)	**2013**	2012
Funds flow from operating activities	**13.90**	13.52
Change in long term bank debt	**8.28**	14.67
Issuance of common shares	**–**	0.09
Cash dividends to shareholders (1)	**(4.75)**	(7.45)
Changes in working capital and other	**(1.24)**	0.12
Total capital sources	**16.19**	20.95

(1) Cash dividends represent the cash portion only and do not include common shares issued through Zargon's Dividend Reinvestment Plan.

CHANGES IN ACCOUNTING POLICIES

The Company's changes in accounting policies are discussed in Note 3 to the Financial Statements.

FUTURE CHANGES IN ACCOUNTING POLICIES

The Company's future changes in accounting policies are discussed in Note 3 to the Financial Statements.

MANAGEMENT AND FINANCIAL REPORTING SYSTEMS

Zargon is required to comply with National Instrument 52-109 "Certification of Disclosure in Issuers' Annual and Interim Filings", otherwise referred to as Canadian SOX ("C-Sox"). The 2013 certificate requires that the Company disclose in the interim MD&A any changes in the Company's internal controls over financial reporting that occurred during the period that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting. The Company confirms that no such changes were made to the internal controls over financial reporting during the first quarter of 2013.

Because of their inherent limitations, internal controls over financial reporting may not prevent or detect misstatements, errors or fraud. Control systems, no matter how well conceived or operated, can provide only reasonable, not absolute assurance that the objectives of the control systems are met.

OUTLOOK

Zargon's Little Bow ASP tertiary oil project was sanctioned in the 2013 first quarter, and is forecast to be constructed and operational by January 2014. This project will provide significant production gains over the next few years followed by a stable oil production base through to the end of this decade. Augmented by a significant internally generated portfolio of conventional long-life oil exploitation projects, Zargon is well positioned to meet its value-creating and dividend generating objectives in 2013 and beyond.

SUMMARY OF QUARTERLY RESULTS

	2012				**2013**
	Q1	Q2	Q3	Q4	**Q1**
Petroleum and natural gas sales ($ millions)	44.64	38.52	36.91	37.88	**37.08**
Net earnings/(loss) ($ millions)	(2.01)	10.54	(4.02)	(9.88)	**0.23**
Net earnings/(loss) per diluted share ($)	(0.07)	0.34	(0.14)	(0.33)	**0.01**
Funds flow from operating activities ($ millions)	13.52	12.37	14.35	16.42	**13.90**
Funds flow from operating activities per diluted share ($)	0.46	0.40	0.48	0.55	**0.46**
Cash flows from operating activities ($ millions)	11.85	18.00	12.16	16.85	**12.46**
Cash flows from operating activities per diluted share ($)	0.40	0.57	0.41	0.57	**0.42**
Cash dividends ($ millions) (1)	7.45	7.45	7.75	4.70	**4.75**
Cash dividends declared per common share ($)	0.30	0.30	0.30	0.18	**0.18**
Net capital expenditures/(dispositions) ($ millions)	20.95	(26.85)	10.35	25.79	**16.19**
Total assets ($ millions)	473.69	446.41	440.77	445.11	**450.34**
Long term bank debt ($ millions)	107.37	24.14	27.58	35.74	**44.02**
Convertible debentures ($ millions) (2)	–	57.50	57.50	57.50	**57.50**
Net debt (3)	124.31	95.20	99.13	113.18	**120.10**
Average daily oil and liquids production (bbl)	5,496	5,384	5,079	5,065	**5,113**
Average daily natural gas production (mmcf)	20.03	17.44	15.33	15.93	**15.21**
Average daily production (boe)	8,834	8,290	7,634	7,720	**7,648**
Average oil production weighting (%)	62	65	67	66	**67**
Average realized commodity field price before the impact of financial risk management contracts ($/boe)	55.53	51.06	52.55	53.33	**53.87**
Funds flow netback ($/boe)	16.82	16.39	20.43	23.12	**20.20**

(1) Cash dividends represent the cash portion only and do not include common shares issued through Zargon's Dividend Reinvestment Plan.

(2) Amount is full future face value of the convertible debentures.

(3) Refer to page six of the MD&A for the definition of net debt.

	2011			
	Q1	Q2	Q3	Q4
Petroleum and natural gas sales ($ millions)	46.94	48.47	44.99	51.13
Net earnings/(loss) ($ millions)	(9.11)	12.67	30.69	(23.87)
Net earnings/(loss) per diluted share ($)	(0.33)	0.43	1.05	(0.81)
Funds flow from operating activities ($ millions)	15.22	13.76	14.59	17.10
Funds flow from operating activities per diluted share ($)	0.56	0.47	0.50	0.58
Cash flows from operating activities ($ millions)	23.47	13.06	13.75	22.97
Cash flows from operating activities per diluted share ($)	0.86	0.45	0.47	0.78
Cash dividends ($ millions) (1)	9.65	10.47	10.75	7.27
Cash dividends declared per common share ($)	0.42	0.42	0.42	0.30
Net capital expenditures/(dispositions) ($ millions)	20.36	8.02	(4.61)	24.88
Total assets ($ millions)	483.98	472.58	489.77	470.69
Long term bank debt ($ millions)	121.89	95.79	76.69	92.70
Net debt (2)	135.13	102.12	94.49	109.50
Average daily oil and liquids production (bbl)	5,893	5,034	5,330	5,619
Average daily natural gas production (mmcf)	21.92	21.91	22.10	21.96
Average daily production (boe)	9,546	8,686	9,014	9,278
Average oil production weighting (%)	62	58	59	61
Average realized commodity field price before the impact of financial risk management contracts ($/boe)	54.64	61.32	54.25	59.91
Funds flow netback ($/boe)	17.71	17.41	17.59	20.03

(1) Cash dividends represent the cash portion only and do not include common shares issued through Zargon's Dividend Reinvestment Plan.

(2) Refer to page six of the MD&A for the definition of net debt.

Additional information regarding the Company and its business operations, including the Company's Annual Information Form for December 31, 2012, is available on the Company's SEDAR profile at www.sedar.com.

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

Calgary, Alberta
May 14, 2013

CONSOLIDATED BALANCE SHEETS

(unaudited)

($ thousands)	Notes	March 31, 2013	December 31, 2012
ASSETS			
Trade and other receivables		**16,626**	16,660
Deposits and prepaid expenses		**1,502**	1,715
Derivatives	12,13	**1,467**	4,514
Total current assets		**19,595**	22,889
Long term deposits		**269**	269
Derivatives	12,13	**69**	284
Property, plant and equipment, net	4	**399,385**	389,971
Intangible exploration and evaluation assets	5	**19,217**	19,968
Goodwill	5	**2,969**	2,969
Deferred tax assets		**8,834**	8,755
Total non-current assets		**430,743**	422,216
Total assets		**450,338**	445,105
LIABILITIES			
Trade and other payables		**34,136**	35,777
Cash dividends payable	6	**1,689**	1,656
Provisions	7	**881**	881
Derivatives	12,13	**1,107**	72
Total current liabilities		**37,813**	38,386
Long term bank debt	8	**44,019**	35,736
Convertible debentures	9	**51,576**	51,261
Derivatives	12,13	**667**	191
Provisions	7	**112,689**	112,283
Deferred tax liabilities		**10,878**	10,665
Total non-current liabilities		**219,829**	210,136
Total liabilities		**257,642**	248,522
Commitments and contingencies	4,7,8,9,11,12,13		
EQUITY			
Shareholders' capital	10	**255,211**	254,400
Accumulated other comprehensive loss		**(569)**	(998)
Contributed surplus	11	**11,164**	11,133
Equity component of debentures	9	**3,640**	3,640
Deficit		**(76,750)**	(71,592)
Total equity		**192,696**	196,583
Total equity and liabilities		**450,338**	445,105

See accompanying notes to the interim consolidated financial statements.

CONSOLIDATED STATEMENTS OF EARNINGS AND COMPREHENSIVE INCOME

(unaudited)		Three Months Ended March 31,	
($ thousands, except per share amounts)	Notes	**2013**	2012
Petroleum and natural gas sales		**37,078**	44,639
Royalties		**(6,670)**	(8,448)
PETROLEUM AND NATURAL GAS REVENUE, NET OF ROYALTIES		**30,408**	36,191
Loss on unrealized derivatives	12,13	**(4,773)**	(1,627)
Gain/(loss) on realized derivatives	12,13	**1,277**	(3,085)
LOSS ON DERIVATIVES		**(3,496)**	(4,712)
TOTAL INCOME		**26,912**	31,479
Operating		**11,887**	13,311
Transportation		**451**	381
General and administrative		**2,912**	4,066
Transaction costs		**–**	25
Exploration and evaluation	5	**859**	1,064
Gain on disposal of properties		**(3,480)**	–
Share-based compensation	11	**213**	434
Unrealized foreign exchange gain		**(98)**	(1)
Depletion and depreciation		**11,405**	12,846
EXPENSES		**24,149**	32,126
EARNINGS/(LOSS) BEFORE FINANCE EXPENSES AND INCOME TAXES		**2,763**	(647)
Interest and financing charges	8	**562**	1,137
Interest on convertible debentures	9	**855**	–
Accretion on convertible debentures	9	**315**	–
Accretion of asset retirement obligations	7	**722**	723
FINANCE EXPENSES		**2,454**	1,860
EARNINGS/(LOSS) BEFORE INCOME TAXES		**309**	(2,507)
Current tax expense		**172**	15
Deferred tax recovery		**(88)**	(509)
INCOME TAXES EXPENSE/(RECOVERY)		**84**	(494)
NET EARNINGS/(LOSS) FOR THE PERIOD		**225**	(2,013)
Currency translation adjustment that may be reclassified subsequently to net earnings		**429**	(315)
OTHER COMPREHENSIVE EARNINGS/(LOSS) FOR THE PERIOD		**429**	(315)
TOTAL COMPREHENSIVE EARNINGS/(LOSS) FOR THE PERIOD		**654**	(2,328)
NET EARNINGS/(LOSS) PER SHARE			
Basic		**0.01**	(0.07)
Diluted		**0.01**	(0.07)

See accompanying notes to the interim consolidated financial statements.

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

(unaudited)

($ thousands)	Notes	Shareholders' Capital	Currency Translation Adjustment	Contributed Surplus	Equity Component of Convertible Debentures	Deficit	Total Equity
Balance at December 31, 2012		**254,400**	**(998)**	**11,133**	**3,640**	**(71,592)**	**196,583**
Net earnings for the period		**–**	**–**	**–**	**–**	**225**	**225**
Dividends declared	6	**–**	**–**	**–**	**–**	**(5,383)**	**(5,383)**
Issue of common shares pursuant to the DRIP	6,10	**629**	**–**	**–**	**–**	**–**	**629**
Share-based compensation	11	**–**	**–**	**213**	**–**	**–**	**213**
Exercise of share options	10	**182**	**–**	**(182)**	**–**	**–**	**–**
Translation differences on foreign subsidiary		**–**	**429**	**–**	**–**	**–**	**429**
Balance at March 31, 2013		**255,211**	**(569)**	**11,164**	**3,640**	**(76,750)**	**192,696**
Balance at December 31, 2011		249,470	(600)	9,200	–	(34,265)	223,805
Net loss for the period		–	–	–	–	(2,013)	(2,013)
Dividends declared	6	–	–	–	–	(8,820)	(8,820)
Issue of common shares pursuant to the DRIP	6,10	1,368	–	–	–	–	1,368
Share-based compensation	11	–	–	452	–	–	452
Exercise of share options	10	184	–	(95)	–	–	89
Translation differences on foreign subsidiary		–	(315)	–	–	–	(315)
Balance at March 31, 2012		251,022	(915)	9,557	–	(45,098)	214,566

See accompanying notes to the interim consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)		Three Months Ended March 31,	
($ thousands)	Notes	**2013**	2012
OPERATING ACTIVITIES			
Net earnings/(loss) for the period		**225**	(2,013)
Adjustments for non-cash items:			
Gain on sale of properties		**(3,480)**	–
Loss on unrealized derivatives	12,13	**4,773**	1,627
Depletion and depreciation		**11,405**	12,846
Accretion of asset retirement obligations	7	**722**	723
Accretion of convertible debentures	9	**315**	–
Share-based compensation	11	**213**	434
Unrealized foreign exchange gain		**(98)**	(1)
Deferred tax recovery		**(88)**	(509)
Exploration and evaluation expenses	5	**859**	1,064
Asset retirement expenditures		**(943)**	(651)
Funds flow from operating activities		**13,903**	13,520
Changes in operating working capital		**(1,443)**	(1,668)
Net cash from operating activities		**12,460**	11,852
INVESTING ACTIVITIES			
Additions to property, plant and equipment	4	**(19,360)**	(20,650)
Additions to intangible exploration and evaluation assets	5	**(106)**	(302)
Proceeds on disposal of property, plant and equipment	4	**3,269**	–
Changes in investing working capital		**175**	1,654
Net cash used in investing activities		**(16,022)**	(19,298)
FINANCING ACTIVITIES			
Advances of bank debt		**8,283**	14,666
Cash dividends paid to shareholders	6	**(4,754)**	(7,452)
Proceeds from exercise of share rights		**–**	89
Changes in financing working capital		**33**	143
Net cash provided by financing activities		**3,562**	7,446
NET CHANGE IN CASH DURING THE PERIOD AND CASH, END OF PERIOD		**–**	–

See accompanying notes to the interim consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the three months ended March 31, 2013, with comparative figures for 2012 (unaudited).

1. REPORTING ENTITY

Zargon Oil & Gas Ltd. ("the Company" or "Zargon") is a publicly traded corporation incorporated in Canada with its head office located at Suite 700, 333-5th Avenue SW, Calgary, Alberta. The interim consolidated financial statements of the Company as at and for the period ended March 31, 2013 and for its 2012 comparative period comprise the Company and its wholly owned subsidiaries. The Company is engaged in the exploration for and development and production of oil and natural gas in Canada and the United States ("US") and conducts many of its activities jointly with others; these financial statements reflect only the Company's proportionate interest in such activities.

2. BASIS OF PRESENTATION

(a) Statement of compliance:

The unaudited interim consolidated financial statements for the three month period ended March 31, 2013 have been prepared in accordance with International Accounting Standard ("IAS") 34 "Interim Financial Reporting". The same accounting policies and methods of computation were followed in the preparation of these unaudited interim consolidated financial statements as were followed in the preparation of the audited annual consolidated financial statements for the fiscal year ended December 31, 2012 except as disclosed in Note 3. The disclosures provided below are incremental to those included with the audited annual consolidated financial statements. These unaudited interim consolidated financial statements for the three month period ended March 31, 2013 should be read together with the annual consolidated financial statements for the year ended December 31, 2012. These consolidated financial statements were approved and authorized for issue by the Board of Directors on May 14, 2013.

(b) Basis of measurement:

The interim consolidated financial statements have been prepared on the historical cost basis except for derivative financial instruments measured at fair value.

(c) Functional and presentation currency:

Items included in the financial statements of each consolidated entity are measured using the currency of the primary economic environment in which the entity operates (the "functional currency"). The interim consolidated financial statements are presented in Canadian dollars, which is Zargon's functional currency.

The financial statements of subsidiaries that have a functional currency different from that of Zargon ("foreign operations") are translated into Canadian dollars as follows: assets and liabilities - at the closing rate at the date of the balance sheet, and income and expenses - at the average rate of the period (as this is considered a reasonable approximation to actual rates). All resulting changes are recognized in other comprehensive income as currency translation adjustments.

If Zargon disposes of its entire interest in a foreign operation, or loses control, joint control, or significant influence over a foreign operation, the foreign currency gains or losses accumulated in other comprehensive income related to the foreign operation are recognized in earnings. If Zargon disposes of part of an interest in a foreign operation which remains a subsidiary, a proportionate amount of foreign currency gains or losses accumulated in other comprehensive income related to the subsidiary are reallocated between controlling and non-controlling interests.

(d) Use of estimates and judgements:

The preparation of financial statements in conformity with International Financial Reporting Standards ("IFRS") requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

3. ACCOUNTING POLICIES

(a) New and amended standards adopted by the Company:

The following new or amended standards were adopted by the Company for the interim period:

- In May 2011 the IASB issued IFRS 10 "Consolidated Financial Statements", IFRS 11 "Joint Arrangements" and IFRS 12 "Disclosure of Interests in Other Entities" and two revised standards, IAS 27 "Separate Financial Statements" and IAS 28 "Investments in Associates and Joint Ventures".

  IFRS 10 provides a single consolidation model that identifies control as the basis for consolidation for all types of entities. IFRS 10 replaces IAS 27 "Consolidated and Separate Financial Statements" and SIC-12 "Consolidation – Special Purpose Entities".

  IFRS 11 establishes principles for the financial reporting by parties to a joint arrangement. IFRS 11 supersedes IAS 31 "Interests in Joint Ventures" and SIC-13 "Jointly Controlled Entities – Non-monetary Contributions by Venturers".

  IFRS 12 combines, enhances and replaces the disclosure requirements for subsidiaries, joint arrangements, associates and unconsolidated structured entities. As a consequence of this new IFRS, the IASB also issued amended and re-titled IAS 27 "Separate Financial Statements" and IAS 28 "Investments in Associates and Joint Ventures".

  IAS 27 "Separate Financial Statements" establishes the accounting and disclosure requirements for investments in subsidiaries, joint ventures, and associates when an entity prepares separate financial statements and replaces the current IAS 27 "Consolidated and Separate Financial Statements" as the consolidation guidance is included in IFRS 10 "Consolidated Financial Statements".

  IAS 28 "Investments in Associates and Joint Ventures" establishes the accounting for investments in associates and defines how the equity method is applied when accounting for associates and joint ventures.

  The adoption of these standards did not have an impact on the Company's consolidated financial statements.

- IAS 1 "Presentation of Items of Other Comprehensive Income" – Amendments to IAS 1. The amendments to IAS 1 improve the quality of the presentation of Other Comprehensive Income ("OCI"). The amendments require companies preparing financial statements in accordance with IFRS to group together items within OCI that may be reclassified to the profit or loss section of the income statement. The amendments also reaffirm existing requirements that items in OCI and profit or loss should be presented as either a single statement or two consecutive statements. The amendment affected presentation only and had no impact on the Company's financial position or performance.

- IAS 19 "Employee Benefits" was amended in June 2011 with revisions to certain aspects of the accounting for pension plans and other benefits, including amendments to the recognition, disaggregation, presentation and disclosure of deferred benefit plans. The adoption of this standard did not have an impact on the Company's consolidated financial statements.

- IFRS 7 "Financial Instruments: Disclosures" – Offsetting Financial Assets and Financial Liabilities – Amendments to IFRS 7 introduce new disclosure requirements about the effects of offsetting financial assets and financial liabilities and related arrangements on an entity's financial position. The disclosures will provide users with information that may be useful in evaluating the effect of any netting arrangements in an entity's financial position. As the Company is not netting any significant amounts related to financial instruments in accordance with IAS 32 and does not have significant offsetting arrangements, the amendment does not have an impact on the Company.

- IFRS 13 "Fair Value Measurement" was issued in May 2011. IFRS 13 defines fair value, sets out in a single IFRS a framework for measuring fair value and requires disclosures about fair value measurements. IFRS 13 applies when other IFRS require or permit fair value measurements. It does not introduce any new requirements to measure an asset or a liability at fair value, change what is measured at fair value in IFRS or address how to present changes in fair value. The adoption of this standard did not have an impact on the Company's consolidated financial statements.

(b) Standards, amendments and interpretations to existing standards that are not yet effective and have not been early adopted by the Company:

- IFRS 9 "Financial Instruments: Classification and Measurement", as issued reflects the first phase of the IASB's work on the replacement of IAS 39 "Financial Instruments: Recognition and Measurement" and applies to classification and measurement of financial assets and financial liabilities as defined in IAS 39. The standard is effective for annual periods beginning on or after January 1, 2015. In subsequent phases, the IASB will address hedge accounting and impairment of financial assets. The Company does not expect changes to its financial statements on the adoption of this standard.

4. PROPERTY, PLANT AND EQUIPMENT

($ thousands)	Three Months Ended March 31, 2013
Cost, December 31, 2012	535,791
Accumulated depletion and depreciation	(145,820)
Net carrying amount, December 31, 2012	389,971
Additions	19,590
Change in asset retirement obligation	450
Assets transferred from intangible exploration and evaluation assets	25
Exchange differences	754
Depletion and depreciation	(11,405)
Net carrying amount, March 31, 2013	399,385
Cost, March 31, 2013	556,658
Accumulated depletion and depreciation	(157,273)
Net carrying amount, March 31, 2013	399,385

Property, plant and equipment are not depleted and depreciated for major development projects until production commences. As at March 31, 2013, $12.12 million (December 31, 2012 - $6.48 million) of major development project property, plant and equipment was not depleted.

During the three months ended March 31, 2013, the Company disposed of certain assets for gross cash proceeds of $3.27 million (2012 - nil).

As at March 31, 2013, the Company is committed to $5.00 million of major projects equipment where payment is required in less than one year.

5. INTANGIBLE EXPLORATION AND EVALUATION ASSETS AND GOODWILL

($ thousands)	Goodwill	E&E Assets	Total
Cost:			
Balance at December 31, 2012	**2,969**	**19,968**	**22,937**
Additions	**–**	**106**	**106**
Transfers to property, plant and equipment	**–**	**(25)**	**(25)**
Exploration and evaluation expense	**–**	**(859)**	**(859)**
Exchange differences	**–**	**27**	**27**
Balance at March 31, 2013	**2,969**	**19,217**	**22,186**

6. CASH DIVIDENDS

During the period, the Company declared dividends to the shareholders in the aggregate amount of $5.38 million (2012 – $8.82 million) in accordance with the following schedule:

2013 Dividends [1]	Record Date	Dividend Date	Per Common Share
January	January 31, 2013	February 15, 2013	$0.06
February	February 28, 2013	March 15, 2013	$0.06
March	March 31, 2013	April 15, 2013	$0.06

(1) The 2013 cash dividends include a non-cash equity issuance amount of $0.63 million (2012 – $1.37 million) for the Dividend Reinvestment Plan.

Subsequent to the end of the period and prior to the consolidated financial statements being authorized for issue on May 14, 2013, the Company declared dividends of $1.80 million or $0.06 per share for April 2013.

7. PROVISIONS

($ thousands)	Asset Retirement Obligations	Other	Total
Balance at December 31, 2012	**112,283**	**881**	**113,164**
Provisions made during the period	**619**	**–**	**619**
Foreign exchange and other	**177**	**–**	**177**
Provisions used during the period	**(943)**	**–**	**(943)**
Provisions related to dispositions	**(169)**	**–**	**(169)**
Accretion	**722**	**–**	**722**
Balance at March 31, 2013	**112,689**	**881**	**113,570**
Current	**–**	**881**	**881**
Non-current	**112,689**	**–**	**112,689**

Asset retirement obligation:

The asset retirement obligations were calculated using a discount factor of 2.50 percent being the risk free rate related to the liability and based on the Government of Canada long term bond rate.

Other:

Zargon is subject to normal course income tax audits by Canadian and US taxation authorities. During the fourth quarter of 2010, the Canada Revenue Agency commenced a flow-through share audit of a predecessor company from a prior corporate acquisition. During the first quarter of 2011, Zargon recorded a $1.27 million provision which was comprised of a $0.92 million charge to current income tax expense and $0.35 million charge to interest expense for the related Part XII.6 tax, with respect to this ongoing income tax audit. The interest expense related to the Part XII.6 tax has been paid to the Canada Revenue Agency and the remaining provision is currently $0.88 million.

8. LONG TERM BANK DEBT

On June 14, 2012, Zargon amended and renewed its syndicated committed credit facilities, the result of which was the reduction of the available facilities and borrowing base to $165 million. A $300 million demand debenture on the assets of the Company has been provided as security for these facilities. The facilities are fully revolving for a 377 day period with the provision for an annual extension at the option of the lenders and upon notice from Zargon's Management. The next renewal date is June 26, 2013, with a semi-annual review that took place in the fall of 2012. Should the facilities not be renewed, they convert to one year non-revolving term facilities at the end of the revolving 377 day period. Repayment would not be required until the end of the non-revolving term, and, as such, these facilities have been classified as long term debt.

Interest rates fluctuate under the syndicated facilities with Canadian prime, US prime and US base rates plus an applicable margin between 50 basis points and 200 basis points as well as with Canadian banker's acceptance and LIBOR rates plus an applicable margin between 200 basis points and 350 basis points. At March 31, 2013, $44.02 million (December 31, 2012 - $35.74 million) had been drawn on the syndicated committed credit facilities with any unused amounts subject to standby fees. In the normal course of operations Zargon enters into various letters of credit. At March 31, 2013, the approximate value of outstanding letters of credit totalled $0.79 million (December 31, 2012 - $0.71 million). The letters of credit reduce the amount of Zargon's available credit facilities to $120.19 million at March 31, 2013 (December 31, 2012 - $128.55 million).

Zargon reviews its compliance with its bank debt covenants on a quarterly basis and is in compliance as at March 31, 2013.

9. CONVERTIBLE DEBENTURES

On May 1, 2012, Zargon completed the issuance of convertible unsecured subordinated debentures for gross proceeds of $50.00 million (net proceeds of $47.45 million after transaction costs) at a price of $1,000 per debenture. On May 4, 2012, Zargon completed the issuance of the over-allotment of the convertible unsecured subordinated debentures for gross proceeds of $7.50 million (net proceeds of $7.20 million) at a price of $1,000 per debenture. The debentures bear interest at a rate of six percent per annum, which is payable semi-annually, in arrears, on June 30 and December 31. The debentures mature on June 30, 2017 and can be converted into common shares of Zargon at the option of the holders at a conversion price of $18.80 per common share.

After June 30, 2015, Zargon may redeem the debentures in whole or in part provided the common shares' weighted average trading price during a specified period prior to redemption is not less than 125 percent of the conversion price.

The debentures have been classified as debt, net of issuance costs with the residual value allocated to shareholders' equity. The issuance costs will be amortized over the term of the debentures and the debt portion will accrete up to the principal balance at maturity. The accretion of the convertible debentures and the interest paid are expensed on the consolidated statements of earnings and comprehensive income.

10. SHARE CAPITAL

The Company is authorized to issue an unlimited number of voting common shares and 10,000,000 preferred shares.

Zargon has a Dividend Reinvestment Plan ("DRIP") in place in conjunction with the Company's transfer agent to provide the option for shareholders to reinvest cash dividends into common shares issued from treasury at a five percent discount to the prevailing market price.

Common Shares

	Three Months Ended March 31, 2013	
(thousands)	**Number of Shares**	**Amount ($)**
Balance, as at December 31, 2012	**29,868**	**254,400**
Share awards exercised	**11**	**–**
Share-based compensation recognized on exercise of share options	**–**	**182**
Issued pursuant to the Dividend Reinvestment Plan	**91**	**629**
Balance, as at March 31, 2013	**29,970**	**255,211**

11. SHARE-BASED PAYMENTS

Share Award Plan

On December 15, 2010, a share-based compensation plan (the "Share Award Plan") was approved and was effective January 1, 2011. Under the Share Award Plan, directors, officers, employees and other service providers (the "grantees") are granted the right to receive a defined number of shares in the future, which increases commensurately with each dividend declared by the Company after the grant date. The grantees will receive equity compensation in relation to the value of a specified number of underlying share awards. The awards vest equally over four years and expire five years after grant date. Holders may choose to exercise upon vesting or at any time thereafter, with forfeiture of any shares not exercised by the expiry date. Upon vesting, the grantees are eligible to receive a share award based on the fair value of the underlying share awards plus all notional dividends accrued since the grant date. Zargon uses a fair value methodology to value the share awards.

Due to the nature of the plan, Zargon is required to estimate the forfeiture rate upon initial calculation of fair values. The forfeiture rate is estimated at 13 percent while the interest rate and volatility is set at a historical rate as there is no exercise price. The fair value of the share award is determined on the grant date at the prior day closing price of the Company's common shares on the Toronto Stock Exchange.

The following table summarizes information about the Company's share awards under the Share Award Plan:

	Three Months Ended March 31, 2013
	Number of Share Awards (thousands)
Outstanding, as at December 31, 2012	**322**
Share awards granted	**287**
Share awards exercised	**(11)**
Share awards forfeited	**(20)**
Outstanding, as at March 31, 2013	**578**

Common Share Rights Incentive Plans

In conjunction with the corporation conversion on December 31, 2010, Zargon's two original Trust Unit Rights Incentive Plans were amended and restated as Common Shares Rights Incentive Plans. Under these plans, directors, officers, employees and other service providers of the Company possess rights to acquire common shares at their option of either the original exercise price or a "modified price" as calculated per the provisions of the relevant plan. The Common Share Rights Incentive Plan (2007) (the "Old Plan") provides for a modified price based on the increment of the amount by which monthly dividends exceed a monthly return of 0.833 percent of the Company's recorded net book value of oil and natural gas properties (as defined in the Old Plan). Under the Common Share Rights Incentive Plan (2009) (the "New Plan"), if the monthly dividend exceeds the monthly return of 0.833 percent of the Company's recorded net book value of oil and natural gas properties (as defined under the New Plan), the entire amount (not the increment) of the dividend is deducted from the original grant price. Options granted under either Plan generally vest equally over a three-year period and expire approximately five years from the grant date. Zargon uses a fair value methodology to value the option grants.

The following table summarizes information about the Company's share options under the Old Plan:

	Three Months Ended March 31, 2013	
	Number of Share Options (thousands)	Weighted Average Exercise Price Initial and Modified ($/share)
Outstanding at beginning of period	**170**	**23.23 / 21.40**
Share options expired	**(170)**	**23.23**
Outstanding at end of period	**–**	**–**

All options under the Old Plan are expired as at March 31, 2013.

The following table summarizes information about the Company's share options under the New Plan:

	Three Months Ended March 31, 2013	
	Number of Share Options (thousands)	Weighted Average Exercise Price Initial and Modified ($/share)
Outstanding at beginning of period	**458**	**18.08 / 14.44**
Share options forfeited	**(15)**	**18.93**
Outstanding at end of period	**443**	**18.05 / 14.38**

Share-based Compensation

The share awards for the three months ended March 31, 2013, resulted in share-based compensation of $0.21 million (2012 - $0.43 million).

Compensation expense associated with awards/options granted under each Plan is recognized in earnings over the vesting period of the Plan with a corresponding increase in contributed surplus. The exercise of awards/options is recorded as an increase in common shares with a corresponding reduction in contributed surplus.

Weighted Average Number of Total Shares

(thousands of shares)	**March 31, 2013**	March 31, 2012
Weighted average number of common shares – basic	**29,909**	29,399
Weighted average number of common shares – diluted	**30,005**	29,611

Dilution amounts for the three months ended March 31, 2013 of 0.10 million shares (2012 - 0.21 million shares) were added to the weighted average number of shares outstanding during the period in the calculation of diluted per share amounts. These share additions represent the dilutive effect of share rights according to the treasury stock method.

The convertible debenture could potentially dilute basic earnings per share, but were not included in the calculation of diluted earnings per share because they are antidilutive for the three months ended March 31, 2013.

12. FINANCIAL INSTRUMENTS

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates cannot be determined with precision as they are subjective in nature and involve uncertainties and matters of judgement.

The following table shows the comparison of the carrying and fair value of the company's financial instruments:

	March 31, 2013		December 31, 2012	
	Carrying Amount ($)	**Fair Value ($)**	Carrying Value ($)	Fair Value ($)
Loans and receivables:				
Trade and other receivables	**16,626**	**16,626**	16,660	16,660
Fair value through profit and loss:				
Derivative assets	**1,536**	**1,536**	4,798	4,798
Derivative liabilities	**1,774**	**1,774**	263	263
Other liabilities:				
Trade and other payables	**34,136**	**34,136**	35,777	35,777
Cash dividends	**1,689**	**1,689**	1,656	1,656
Long term bank debt	**44,019**	**44,019**	35,736	35,736
Convertible debentures	**51,576**	**57,213**	51,261	57,500

All of the Company's risk management contracts are transacted in active markets. The Company classifies the fair value of these transactions according to the following hierarchy based on the amount of observable inputs used to value the instrument.

- Level I

Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions occur in sufficient frequency and value to provide pricing information on an ongoing basis.

- Level II

Pricing inputs are other than quoted prices in active markets included in Level I. Prices in Level II are either directly or indirectly observable as of the reporting date. Level II valuations are based on inputs, including quoted forward prices for commodities, time value and volatility factors, which can be substantially observed or corroborated in the market place.

- Level III

Valuations in this level are those with inputs for the asset or liability that are not based on observable market data.

The Company's risk management contracts have been assessed on the fair value hierarchy described above and are classified as Level II. Assessment of the significance of a particular input into the fair value measurement requires judgment and may affect the placement within the fair value hierarchy level.

The Company is exposed to financial risks arising from its financial assets and liabilities. The financial risks include market risk (commodity prices, interest rates and foreign exchange rates), credit risk and liquidity risk.

- Market Risk

  Market risk is the risk that the fair value of future cash flows of financial assets or liabilities will fluctuate due to movements in market prices and is comprised of the following:

  - Commodity Price Risk

  Commodity price risk is the risk that the fair value of future cash flows will fluctuate as a result in changes in commodity prices. Commodity prices for petroleum and natural gas are impacted by not only the relationship between the Canadian and United States dollar, but also world economic events that dictate the levels of supply and demand. As a means of mitigating exposure to commodity price risk volatility, the Company has entered into various derivative agreements. The use of derivative instruments is governed under formal policies and is subject to limits established by the Board of Directors. The Company's policy is to not use derivative financial instruments for speculative purposes.

  Natural Gas – To partially mitigate the natural gas commodity price risk, the Company may enter into swaps, which fix the Canadian dollar AECO prices.

  Crude Oil – The Company has partially mitigated its exposure to the WTI NYMEX price with fixed price swaps.

  - Interest Rate Risk

  Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. Borrowings under bank credit facilities are market rate based (variable interest rates); thus, carrying values approximate fair values.

  At the March 31, 2013 debt pricing levels, the increase or decrease in net earnings for the year for each one percent change in interest rates would amount to $0.11 million (March 31, 2012 - $0.25 million) before swaps.

  - Foreign Exchange Risk

  Foreign currency exchange rate risk is the risk that the fair value of future cash flows will fluctuate as a result of changes in foreign exchange rates. The underlying market prices in Canada for petroleum and natural gas are impacted by changes in the exchange rate between the Canadian and United States dollar. As Zargon operates in North America, fluctuations in the exchange rate between the US/Canadian dollar can have a significant effect on the Company's reported results. A $0.01 change in the US to Canadian dollar exchange rate would have resulted in a $0.19 million (March 31, 2012 - $0.22 million) increase or decrease in net earnings for the period ended March 31, 2013. In order to mitigate the Company's exposure to foreign exchange fluctuations, the Company may enter into foreign exchange derivative agreements.

- Credit Risk

  Credit risk is the risk that the counterparty to a financial asset will default, resulting in the Company incurring a financial loss. This credit exposure is mitigated with credit practices that limit transactions according to counterparties' credit quality. A substantial portion of the Company's accounts receivable are with customers in the oil and natural gas industry and are subject to normal industry credit risks.

  The maximum credit risk exposure associated with accounts receivable and derivative assets is the total carrying value. The Company monitors these balances monthly to limit the risk associated with collection. Of Zargon's accounts receivable at March 31, 2013, approximately 48 percent (December 31, 2012 - 45 percent) was owing from two companies and Zargon anticipates full collection.

  The Company's allowance for doubtful accounts at March 31, 2013 was $0.29 million (December 31, 2012 - $0.25 million). During 2013, the Company recorded an additional provision of $0.04 million for non-collectible accounts receivable.

  When determining whether amounts that are past due are collectible, management assesses the credit worthiness and past payment history of the counterparty, as well as the nature of the past due amount. Zargon considers all material amounts greater than 90 days to be past due. As at March 31, 2013, $1.22 million of accounts receivable are past due, excluding amounts described above, all of which are considered to be collectable.

- Liquidity Risk

Liquidity risk is the risk the Company will encounter difficulties in meeting its financial liability obligations. The Company manages its liquidity risk through funds flow and debt management.

As at March 31, 2013, Zargon had available unused committed bank credit facilities of approximately $120.19 million compared to $128.55 million at December 31, 2012. The Company believes it has sufficient funding through the use of these facilities to meet foreseeable borrowing requirements.

The timing of cash outflows relating to financial liabilities are outlined in the table below:

($ thousands)	1 year	2–3 years	Total
Trade and other payables	**34,136**	**–**	**34,136**
Cash dividends payable	**1,689**	**–**	**1,689**
Derivative liabilities	**1,107**	**667**	**1,774**
Long term bank debt	**–**	**44,019**	**44,019**
Convertible debentures (1)	**–**	**57,500**	**57,500**

(1) Amount is the full face value of the convertible debenture at $57.50 million.

Commodity Price Sensitivities

The following summarizes the sensitivity of the fair value of the Company's risk management positions to fluctuations in commodity prices, with all other variables held constant. When assessing the potential impact of these commodity price changes, the Company believes 10 percent volatility is a reasonable long term measure.

Fluctuations of 10 percent in commodity prices could have resulted in unrealized gains or losses of $4.97 million (March 31, 2012 – $10.22 million) on risk management contracts impacting net earnings for the three months ended March 31, 2013.

13. DERIVATIVE CONTRACTS

The Company is a party to certain financial instruments that have fixed the price of a portion of its oil production and interest rates. The Company enters into these contracts for risk management purposes only in order to protect a portion of its future cash flows from the volatility of oil and natural gas commodity prices and interest rates. For financial risk management contracts, any unrealized gains or losses are recorded in earnings based on the fair value (mark-to-market) of the contracts at each reporting period. The unrealized loss on the statement of earnings and comprehensive income for the first three months of 2013 was $4.77 million and the unrealized loss for the first three months of 2012 was $1.63 million.

As at March 31, 2013, the Company had the following outstanding commodity and interest risk management contracts:

Commodity Financial Risk Management Contracts:

	Rate	Weighted Average Price	Range of Terms	Fair Market Value Asset/(Liability) ($ thousands)
Oil swaps	600 bbl/d	$100.12 US/bbl	Apr. 1/13 – Jun. 30/13	155
	1,400 bbl/d	$98.52 US/bbl	Apr. 1/13 – Dec. 31/13	568
	400 bbl/d	$96.33 US/bbl	Apr. 1/13 – Mar. 31/14	(32)
	600 bbl/d	$95.00 US/bbl	Apr. 1/13 – Jun. 30/14	(267)
	600 bbl/d	$96.18 US/bbl	Jul. 1/13 – Jun. 30/14	126
	600 bbl/d	$91.27 US/bbl	Jan. 1/14 – Dec. 31/14	(430)
Total Fair Market Value, Commodity Price Financial Contracts				**120**

Oil swaps are settled against the NYMEX WTI pricing index.

Interest Rate Risk Management Contracts:

	Notional Value	Weighted Average Interest Rate[1]	Range of Terms	Fair Market Value Asset/(Liability) ($ thousands)
Interest rate swaps	$20,000,000/month	1.640%	Apr. 1/13 – Jul. 26/16	(118)
	$20,000,000/month	1.731%	Apr. 1/13 – Aug. 26/16	(240)
Total Fair Market Value, Interest Rate Financial Contracts				**(358)**

[1] *Excludes the current stamping fee of 2.0 percent for each swap.*

Interest rate swaps are reset monthly and settled against the BA-CDOR interest rate index.

CORPORATE INFORMATION

BOARD OF DIRECTORS

Craig H. Hansen
Calgary, Alberta

K. James Harrison (2)
Chairman of the Board
Oakville, Ontario

Kyle D. Kitagawa (1)
Calgary, Alberta

Margaret A. McKenzie (1)
Calgary, Alberta

Geoffrey C. Merritt (1)
Calgary, Alberta

Jim Peplinski (2)
Calgary, Alberta

Grant A. Zawalsky (2)
Calgary, Alberta

OFFICERS

Craig H. Hansen
President and Chief Executive Officer

Leslie E. Burden
Vice President, Land

Randolph J. Doetzel
Vice President, Operations

Jason B. Dranchuk
Vice President, Finance and
Chief Financial Officer

Tracy L. Howard
Corporate Secretary

Christopher M. Hustad
Vice President, Alberta Plains South

Pete H.S. Janjua
Vice President, Williston Basin

Brian G. Kergan
Vice President, Corporate Development

Kevin C.Y. Lee
Vice President, Alberta Plains North

Robert T. Moriyama
Vice President, Enhanced Recovery

(1) Audit and Reserves Committee
(2) Governance and Compensation Committee

STOCK EXCHANGE LISTING

Toronto Stock Exchange

Zargon Oil & Gas Ltd.
Common Shares
Trading Symbol: ZAR

Zargon Oil & Gas Ltd.
Convertible Debentures
Trading Symbol: ZAR.DB

TRANSFER AGENT

Valiant Trust Company
310, 606 – 4th Street S.W.
Calgary, Alberta T2P 1T1

BANKERS

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Calgary, Alberta T2P 2Z1

Canadian Imperial Bank of Commerce
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Calgary, Alberta T2P 2P2

The Bank of Nova Scotia
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