ZARGON OIL & GAS LTD.

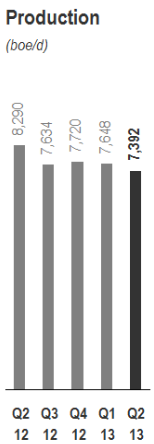
2013 Q2 FINANCIAL REPORT

FINANCIAL AND OPERATING HIGHLIGHTS

	Three Months Ended June 30,			Six Months Ended June 30,		
(unaudited)	**2013**	2012	Percent Change	**2013**	2012	Percent Change
Financial						
Income and Investments ($ millions)						
Gross petroleum and natural gas sales	**40.59**	38.52	5	**77.67**	83.16	(7)
Funds flow from operating activities	**15.99**	12.37	29	**29.89**	25.89	15
Cash flows from operating activities	**14.68**	18.00	(18)	**27.14**	29.86	(9)
Cash dividends (net of Dividend Reinvestment Plan)	**5.01**	7.45	(33)	**9.76**	14.90	(34)
Net earnings	**1.13**	10.54	(89)	**1.35**	8.53	(84)
Net capital expenditures/(dispositions)	**2.42**	(26.85)	109	**18.61**	(5.90)	415
Per Share, Basic						
Funds flow from operating activities ($/share)	**0.53**	0.42	26	**1.00**	0.88	14
Cash flows from operating activities ($/share)	**0.49**	0.61	(20)	**0.91**	1.01	(10)
Net earnings ($/share)	**0.04**	0.36	(89)	**0.05**	0.29	(83)
Cash Dividends ($/common share)	**0.18**	0.30	(40)	**0.36**	0.60	(40)
Balance Sheet at Period End ($ millions)						
Property and equipment				**386.37**	386.81	–
Exploration and evaluation assets				**17.92**	23.25	(23)
Long term bank debt				**42.06**	24.14	74
Convertible debentures at maturity				**57.50**	57.50	–
Shareholders' equity				**190.08**	222.22	(14)
Total Common Shares Outstanding at Period End (millions)				**30.04**	29.64	1
Operating						
Average Daily Production						
Oil and liquids (bbl/d)	**4,930**	5,384	(8)	**5,021**	5,440	(8)
Natural gas (mmcf/d)	**14.77**	17.44	(15)	**14.99**	18.73	(20)
Equivalent (boe/d)	**7,392**	8,290	(11)	**7,519**	8,562	(12)
Average Selling Price (before the impact of financial risk management contracts)						
Oil and liquids ($/bbl)	**80.44**	73.17	10	**75.97**	77.59	(2)
Natural gas ($/mcf)	**3.35**	1.68	99	**3.18**	1.86	71
Wells Drilled, Net	**–**	0.2	(100)	**5.1**	9.8	(48)
Undeveloped Land at Period End (thousand net acres)				**300**	368	(18)

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.



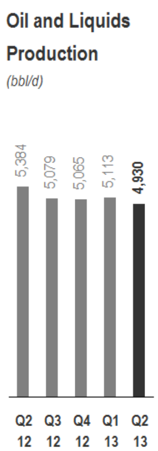
Message to Shareholders [1]

Zargon Oil & Gas Ltd. has released financial and operating results for the second quarter of 2013 that demonstrated continued progress in our drive to deliver our long term sustainable, dividend-paying energy producer objectives. The quarter was highlighted by an ongoing successful property disposition program and by the initiation of field construction of our Little Bow Alkaline Surfactant Polymer ("ASP") tertiary oil recovery project in Southern Alberta.

Zargon's sustainability model entails the balancing of cash inflows and outflows, the maintenance of a stable dividend, the eventual generation of meaningful free cash flow per share growth, while continuing the shift toward oil and liquids production. Zargon believes that the Little Bow ASP tertiary oil recovery production provides the foundation for these sustainability objectives by delivering a substantial low-decline, low-sustaining capital, high-netback and long-life project to the Company.

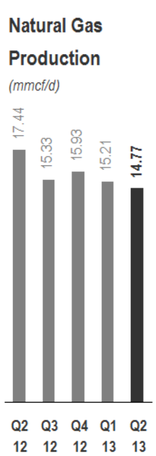
The Company's focus for the remainder of 2013 will be to:

- 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;
- Continue with an ongoing 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 second quarter of 2013 include:

- Second quarter 2013 production averaged 4,930 barrels of oil and liquids per day, a four percent decrease from the preceding quarter and second quarter 2013 natural gas production averaged 14.8 million cubic feet per day, a three percent decrease from the preceding quarter. Total production averaged 7,392 barrels of oil equivalent per day, a three 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 $16.0 million were 15 percent higher than the $13.9 million recorded in the prior quarter, and 29 percent higher than the $12.4 million reported in the second quarter of 2012. Funds flow from operating activities for the 2013 second quarter included reductions of $1.1 million of asset retirement expenditures.
- Three monthly cash dividends of $0.06 per common share were declared in the second quarter of 2013 for a total of $5.4 million ($5.0 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 31 percent of funds flow from operating activities.
- Second quarter 2013 exploration and development capital expenditures (excluding property acquisitions and dispositions) were $14.0 million and included $7.3 million of expenditures related to the Little Bow ASP tertiary oil recovery project.
- Zargon's June 30, 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 $111.3 million and is approximately 1.8 times the annualized 2013 first half funds flow from operating activities. At June 30, 2013, Zargon had more than $110 million of available credit facilities remaining on its $165 million borrowing base.
- During the 2013 second quarter, Zargon disposed of assets in the Elswick and Workman, Saskatchewan area for total proceeds of approximately $11.6 million. The assets were producing 130 barrels of oil per day.



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

Zargon continues to make good progress with the Little Bow ASP project. 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.

In the three months since the last report, Zargon has advanced the ASP project on many fronts. At the site of the new ASP injection facility, civil construction activities including earthworks and piling are essentially complete. Mechanical field construction is underway. Long lead time equipment is being delivered and packaged into pre-fabricated buildings for delivery to site through the remainder of the summer.

Construction of the backbone of a new pipeline system for the ASP project has been completed, and tie in of remaining project wells to this new system will commence in the fall. The ASP project well workover program is also nearing completion.

Chemical supply contracts have been negotiated. Operator training activities are proceeding with the expectations of 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 is unchanged at approximately $60 million (as spent dollars). Of this total, $6.5 million of expenditures were incurred in 2012, $5.0 million were incurred in the 2013 first quarter and $7.3 million were incurred in the 2013 second quarter. For the remainder of 2013, an additional $30 million (inclusive of $1 million for the first delivery of chemicals) is forecast to be spent. 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 implementation of phase 2 of the project is scheduled for 2015 and is estimated to cost $12 million.

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. Phase 1 and 2 incremental production rates are forecast to exceed 1,350 barrels of oil per day in 2016. Using these rates with an estimated field oil price of $68 Cdn. per barrel (assuming an Edmonton par price of $85 Cdn. per barrel), a 12 percent incremental tertiary royalty rate (internal estimate of 4.9 million barrels of incremental oil reserves), 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 and deliver a property recycle ratio of about 2.0 times.

Follow-on capital expenditures (including chemical costs) for phases 3 and 4 of the Little Bow ASP project are expected to be completed by 2019 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 $7.3 million of ASP capital expenditures, Zargon executed a $6.7 million capital program in the 2013 second quarter on conventional oil exploitation assets. This conventional capital program did not entail the drilling of any wells and was focused on the final tie-ins for the 5.1 net wells drilled in the first quarter and on long term infrastructure projects.

For the remainder of the year, Zargon is planning on drilling an additional 10 net high-graded oil exploitation wells, roughly equally divided between our Taber South Sunburst, Bellshill Lake drainage and Little Bow acceleration wells. In aggregate, Zargon has identified more than 85 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. For further information regarding Zargon's conventional oil exploitation projects, please refer to our updated corporate presentation, which is available at www.zargon.ca.

Property Dispositions Update [1]

During the 2013 second quarter, property dispositions of $11.6 million were concluded, which related to the sale of 130 barrels of oil per day from the Workman and Elswick, Saskatchewan properties in the Williston Basin core area. With these second quarter dispositions concluded, Zargon has sold $15.1 million of the $20 million of property dispositions that were budgeted for 2013.

For the remainder of the year, Zargon will continue to actively pursue property dispositions that reduce our property footprint by selling (or trading) our very large non-strategic property inventory. Over time, we anticipate that these dispositions will enable Zargon to realize a lower cost structure through a disciplined focus on our growing tertiary ASP oil recovery business and the stable production volumes coming from the measured exploitation of our core, conventional long-life low-decline oil properties.

2013 and 2014 Outlook [1]

Zargon's 2013 non-ASP field capital budget has been set at $40 million (before dispositions) of which approximately $19 million remains to be spent in the remaining two quarters. Additionally, our 2013 capital budget included $20 million of property dispositions, of which $15.1 million have been completed by the end of the second quarter.

ASP capital expenditures in the second half of 2013 to complete phase 1 of the project are budgeted at $30 million, and include $1 million for the initial charge of ASP chemicals. For 2014, ASP capital expenditures will be limited to $10 million of chemical costs. Combined with our initial estimate of the 2014 conventional program of $35 million, the total 2014 capital program is forecast to be $45 million. Based on this 2014 capital program, we expect oil production to steadily grow from first quarter levels throughout 2014 as stable conventional oil production volumes are augmented by growing Little Bow ASP oil production volumes.

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 and early production phase. For the remainder of 2013, Zargon has hedged 3,000 barrels per day at $97.06 US/bbl WTI, while for 2014 an average of 2,600 barrels per day is hedged at $91.90 US/bbl WTI and for the first quarter of 2015 an average of 400 barrels per day is hedged at $91.73 US/bbl WTI.

Production Guidance [1]

In the May 14, 2013 first quarter results press release, Zargon provided updated second quarter 2013 oil production rate guidance of 4,800 barrels of oil and liquids per day. Actual second quarter volumes were 4,930 barrels of oil and liquids per day or about three percent above guidance. The May press release also set Zargon's second quarter 2013 natural gas production guidance of 15.0 million cubic feet per day. Second quarter actual volumes were 14.8 million cubic feet per day or about one percent below guidance.

For the remainder of the year, production volumes will continue to depend on the magnitude and timing of our property disposition programs along with related timing of our conventional property drilling programs. For the 2013 third quarter, oil and liquids production guidance is set at 4,650 barrels of oil per day and includes the second quarter dispositions of 130 barrels of oil and liquids per day. Third quarter natural gas production guidance is set at 14.7 million cubic feet per day.

Full-year 2013 average oil and liquids production is now expected to range between 4,750 to 4,850 barrels of oil per day, with exit rates ranging from 4,500 to 4,650 barrels of oil per day. Full-year 2013 average natural gas production is now expected to range from 14.7 to 14.9 million cubic feet per day, with exit rates ranging from 14.4 to 14.7 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 which will augment stable production volumes from conventional oil exploitation properties.

Suspension of Dividend Reinvestment Plan ("DRIP") (1)

Commencing with Zargon's September 2013 dividend payable on October 15, 2013 Zargon's Board of Directors has suspended Zargon's Dividend Reinvestment Plan until further notice. The DRIP had permitted shareholders to apply their cash dividends to the purchase of Zargon common shares at 95 percent of the average market price. Shareholders who had elected to participate in the DRIP will now receive cash dividends on the payment date. At such time as the Corporation elects to reinstate the DRIP, shareholders that were enrolled at suspension and remain enrolled at reinstatement will automatically resume participation in the DRIP.

(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 second quarter financial results and should be read in conjunction with the unaudited interim consolidated financial statements and related notes for the three and six months ended June 30, 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 per boe, 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 August 8, 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”, “2013 and 2014 Outlook”, “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 and 2014 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 and 2014 Outlook” and “Production Guidance”;*
- *our expectations for our 2013 and 2014 hedges referred to under the heading “2013 and 2014 Outlook”;*
- *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 “Suspension of Dividend Reinvestment Plan (“DRIP”)” and “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”.*

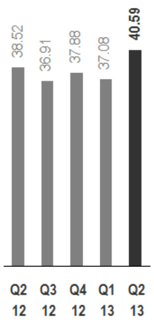
Such statements are generally identified by the use of words such as “anticipate”, “continue”, “estimate”, “expect”, “forecast”, “may”, “will”, “project”, “should”, “plan”, “intend”, “believe” and similar expressions (including the negatives thereof). By their nature, forward-looking statements are subject 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 August 8, 2013.

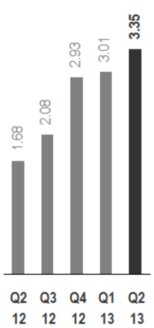
Petroleum and Natural Gas Revenue

($ millions)



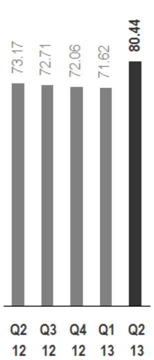
Natural Gas Prices

($/mcf)



Oil and Liquids Prices

($/bbl)



FINANCIAL & OPERATING RESULTS

Petroleum and Natural Gas Sales

	Three months ended June 30,			Six months ended June 30,		
($ millions)	**2013**	2012	Percent Change	**2013**	2012	Percent Change
Petroleum sales	**36.08**	35.85	1	**69.04**	76.82	(10)
Natural gas sales	**4.51**	2.67	69	**8.63**	6.34	36
Petroleum and natural gas sales	**40.59**	38.52	5	**77.67**	83.16	(7)

Second quarter 2013 gross petroleum and natural gas sales of $40.59 million were five percent above the $38.52 million in the second quarter of 2012 due to higher prices realized on both oil and liquids and natural gas.

Second quarter 2013 realized oil and liquids field prices averaged $80.44 per barrel before the impact of financial risk management contracts and were 10 percent higher than the $73.17 per barrel recorded in the 2012 second quarter. Zargon's crude oil field price differential from the Edmonton par price increased to $12.15 per barrel in the second quarter of 2013 compared to $10.78 per barrel in the second quarter of 2012. The second quarter Edmonton par price was negatively impacted by a $3.84 Cdn. per barrel differential to the WTI pricing index, down from the $10.49 negative differential recorded in the second quarter of 2012. Natural gas field prices received averaged $3.35 per thousand cubic feet in the second quarter of 2013, a 99 percent increase from the 2012 second quarter prices.

Pricing

	Three Months Ended June 30,			Six Months Ended June 30,		
Average for the period	**2013**	2012	Percent Change	**2013**	2012	Percent Change
Natural Gas:						
NYMEX average daily spot price ($US/mmbtu)	**4.02**	2.28	76	**3.73**	2.36	58
AECO average daily spot price ($Cdn/mmbtu)	**3.54**	1.89	87	**3.36**	2.02	66
Zargon realized field price before the impact of financial risk management contracts ($Cdn/mcf)	**3.35**	1.68	99	**3.18**	1.86	71
Zargon realized field price after the impact of financial risk management contracts ($Cdn/mcf)	**3.35**	1.72	95	**3.18**	1.88	69
Zargon realized natural gas field price differential (1)	**0.19**	0.21		**0.18**	0.16	
Crude Oil:						
WTI ($US/bbl)	**94.22**	93.49	1	**94.30**	98.21	(4)
Edmonton par price ($Cdn/bbl)	**92.59**	83.95	10	**90.40**	88.10	3
Zargon realized field price before the impact of financial risk management contracts ($Cdn/bbl)	**80.44**	73.17	10	**75.97**	77.59	(2)
Zargon realized field price after the impact of financial risk management contracts ($Cdn/bbl)	**82.68**	71.75	15	**78.54**	73.82	6
Zargon realized oil field price differential (2)	**12.15**	10.78		**14.43**	10.51	

(1) *Calculated as Zargon's realized field price ($Cdn/mcf) as compared to AECO average daily spot price ($Cdn/mmbtu).*

(2) *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).*

Volumes

Oil and liquids production volumes during the 2013 second quarter were 4,930 barrels per day, an eight percent decrease from the 2012 second quarter rate of 5,384. The production decrease is primarily related to naturally occurring production declines and 2012-2013 Williston Basin property sales that were partially offset by ongoing oil exploitation drilling programs in Zargon's three core areas. Natural gas production volumes decreased 15 percent in the 2013 second quarter to 14.77 million cubic feet per day compared to 17.44 million cubic feet per day in the 2012 second quarter. These production decreases were due to naturally occurring production declines, and are the result of Zargon's 2010 strategic decision to allocate capital to long term oil exploitation opportunities while curtailing natural gas capital programs.

Production by Core Area

Three Months Ended June 30,	**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	**1,256**	**11.54**	**3,179**	1,380	14.29	3,762
Alberta Plains South	**1,695**	**2.90**	**2,178**	1,756	2.79	2,221
Williston Basin	**1,979**	**0.33**	**2,035**	2,248	0.36	2,307
	4,930	**14.77**	**7,392**	5,384	17.44	8,290

Six Months Ended June 30,	**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	**1,301**	**11.76**	**3,261**	1,399	15.37	3,961
Alberta Plains South	**1,722**	**2.87**	**2,200**	1,748	2.97	2,243
Williston Basin	**1,998**	**0.36**	**2,058**	2,293	0.39	2,358
	5,021	**14.99**	**7,519**	5,440	18.73	8,562

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 two physical electricity hedges. The Company does not have any natural gas swaps outstanding at June 30, 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 second quarter, relatively higher contract prices versus WTI oil prices resulted in a realized net gain on derivatives of $0.96 million compared to a $0.69 million realized net loss in the second quarter of 2012.

The unrealized gain on derivatives of $2.08 million in the second quarter of 2013 was comprised of oil contract gains of $1.60 million and interest rate swap gains of $0.48 million, compared to a net $17.80 million unrealized gain in the second 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 11 and 12 to the unaudited interim consolidated financial statements.

Royalties

	Three months ended June 30,			Six months ended June 30,		
($ millions)	**2013**	2012	Percent Change	**2013**	2012	Percent Change
Royalties	**7.07**	7.47	(5)	**13.74**	15.92	(14)
Percentage of revenue	**17.4%**	19.4%		**17.7%**	19.1%	

Royalties are inclusive of the Saskatchewan Resource Surcharge ("SRC"). The variations in royalty rates generally track changes in production and volumes. Second quarter of 2013 royalties were 17.4 percent of gross sales compared to 19.4 percent in the second quarter of 2012.

Operating Expenses and Transportation Expenses

	Three months ended June 30,			Six months ended June 30,		
($ millions)	**2013**	2012	Percent Change	**2013**	2012	Percent Change
Operating expenses	**12.17**	12.29	(1)	**24.06**	25.60	(6)
Transportation expenses	**0.45**	0.38	18	**0.90**	0.76	18
Total	**12.62**	12.67	–	**24.96**	26.36	(5)
Total ($/boe)	**18.76**	16.80	12	**18.34**	16.92	8

Compared to the prior year's second quarter, operating expenses plus transportation expenses in the 2013 second quarter are slightly lower on a dollar basis but higher on a per barrel of oil equivalent basis due to lower production volumes. In the 2013 second quarter, the effects of continued field optimization projects to reduce operating expenses were offset by high Alberta electricity costs and high road and lease maintenance expenditures caused by wet weather in two core areas. Improvements in operating costs are expected in the second half of this year, but due to the combined effect of relatively stable costs and lower production volumes, we are now forecasting that the summation of operating and transportation expenses will average approximately $18.00 per barrel of oil equivalent for the remainder of the year.

Operating Netbacks

Three Months Ended June 30,	**2013**		2012	
	Oil and Liquids ($/bbl)	**Natural Gas ($/mcf)**	Oil and Liquids ($/bbl)	Natural Gas ($/mcf)
Sales	**80.44**	**3.35**	73.17	1.68
Royalties	**(14.61)**	**(0.38)**	(14.04)	(0.37)
Realized gain/(loss) on derivatives	**2.24**	**–**	(1.42)	0.04
Operating expenses	**(20.58)**	**(2.19)**	(18.17)	(2.15)
Transportation expenses	**(1.00)**	**–**	(0.78)	–
Operating netbacks	**46.49**	**0.78**	38.76	(0.80)

Six Months Ended June 30,	**2013**		2012	
	Oil and Liquids ($/bbl)	**Natural Gas ($/mcf)**	Oil and Liquids ($/bbl)	Natural Gas ($/mcf)
Sales	**75.97**	**3.18**	77.59	1.86
Royalties	**(14.00)**	**(0.38)**	(15.12)	(0.28)
Realized gain/(loss) on derivatives	**2.57**	**–**	(3.77)	0.02
Operating expenses	**(19.83)**	**(2.23)**	(19.01)	(1.99)
Transportation expenses	**(0.99)**	**–**	(0.77)	–
Operating netbacks	**43.72**	**0.57**	38.92	(0.39)

General & Administrative ("G&A") Expenses

	Three months ended June 30,			**Six months ended June 30,**		
($ millions)	**2013**	2012	Percent Change	**2013**	2012	Percent Change
G&A expenses	**3.04**	3.23	(6)	**5.95**	7.29	(18)
G&A expenses ($/boe)	**4.51**	4.28	5	**4.37**	4.68	(7)

G&A expenses were down in the second quarter of 2013 as well as year-to-date 2013 primarily due to reductions in salaries and wages from prior year staff reductions and office space reductions. G&A expenses, exclusive of transaction costs, are forecasted to average less than $4.50 per barrel of oil equivalent for the remainder of 2013.

Transaction Costs

Transaction costs for the 2013 second quarter were $0.10 million compared to $0.01 million in the second quarter of 2012, and relate to the property dispositions in the quarter.

Interest and Financing Charges on Long Term Bank Debt

On June 10, 2013, Zargon amended and renewed its syndicated committed credit facilities of $165 million. The next renewal date is June 25, 2014, with a semi-annual review taking place in the fall of 2013. These facilities continue to be available for general corporate purposes and the potential acquisition of oil and natural gas properties. 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.

Zargon's borrowings are through its syndicated bank credit facilities. Interest and financing charges on these facilities in the 2013 second quarter were $0.63 million, 31 percent lower than the $0.91 million in the second 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.

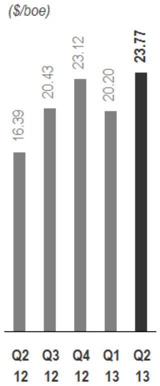
Interest on Convertible Debentures

Zargon also 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 $0.87 million in the second quarter of 2013 compared to $0.58 million in the second quarter of 2012 due to convertible debentures being issued part way through the second quarter of 2012.

Current Income Taxes

Current income taxes for the 2013 second quarter were $0.17 million, and relate to the US operations. When compared to the 2012 second quarter, current income taxes increased $0.15 million due to lower field capital expenditures in the US. Total corporate tax pools as at June 30, 2013 are approximately $307 million, which represents an decrease of two percent from the comparable $313 million of tax pools available to Zargon at December 31, 2012, primarily as a result of the property sales in the first half of 2013.

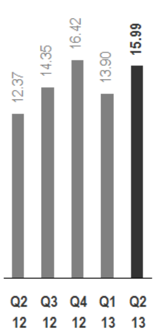
Funds Flow Netbacks
($/boe)



Corporate Netbacks

($/boe)	Three Months Ended June 30, 2013	2012	Six Months Ended June 30, 2013	2012
Petroleum and natural gas sales	**60.34**	51.06	**57.07**	53.37
Royalties	**(10.51)**	(9.90)	**(10.09)**	(10.22)
Realized gain/(loss) on derivatives	**1.43**	(0.92)	**1.64**	(2.42)
Operating expenses	**(18.10)**	(16.29)	**(17.68)**	(16.43)
Transportation expenses	**(0.66)**	(0.51)	**(0.66)**	(0.49)
Operating netbacks	**32.50**	23.44	**30.28**	23.81
General and administrative expenses	**(4.51)**	(4.28)	**(4.37)**	(4.68)
Transaction costs	**(0.14)**	(0.01)	**(0.07)**	(0.02)
Interest and financing charges	**(0.93)**	(1.21)	**(0.88)**	(1.32)
Interest on convertible debentures	**(1.29)**	(0.77)	**(1.27)**	(0.37)
Asset retirement expenditures	**(1.60)**	(0.75)	**(1.48)**	(0.78)
Current income taxes	**(0.26)**	(0.03)	**(0.25)**	(0.03)
Funds flow netbacks	**23.77**	16.39	**21.96**	16.61

Funds Flow from Operating Activities
($ millions)



Depletion and Depreciation Expense

Depletion and depreciation expense for the second quarter of 2013 decreased nine percent to $11.09 million compared to $12.24 million in the second quarter of 2012. On a per barrel of oil equivalent basis, the depletion and depreciation rates were $16.49 and $16.22 for the second quarter of 2013 and the second quarter of 2012, respectively. When compared to the second quarter of 2012, the decreased depletion expense is primarily due to reduced depletable balances resulting from property sales and lower production volumes. 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 second quarter of 2013 was $0.72 million, a five percent increase from the second quarter 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 second quarter is $0.32 million.

Shared-based Compensation

Expensing of share-based compensation in the second quarter of 2013 totalled $0.50 million, which is lower than the $0.54 million incurred in the second quarter of 2012 due to a lower black scholes value of the 2013 grants, including the impact of forfeitures, 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 $0.09 million during the second quarter of 2013 compared to a $0.02 million loss in the 2012 second 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.

Loss on Disposal of Assets

During the second quarter of 2013, Zargon closed two property sales in the Workman and Elswick, Saskatchewan areas for total gross proceeds of $11.60 million. Zargon reported a combined loss of $4.41 million on the disposal of these assets.

Exploration and Evaluation Expenses

Non-cash exploration and evaluation expenses for the 2013 second quarter of $1.46 million were $0.13 million higher than the second quarter of 2012 expenses of $1.33 million. Exploration and evaluation expenses are primarily related to undeveloped land expiries during the quarter. The second quarter 2013 exploration and evaluation expense related to expiries in west central and northern Alberta.

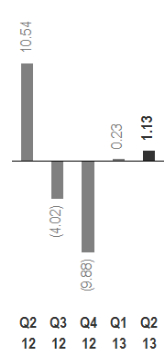
Deferred Tax

The deferred tax recovery for the second quarter of 2013 was $0.39 million compared to a deferred tax expense of $3.14 million in the second quarter of 2012. The increase in deferred tax recovery is primarily a result of decreased earnings in the quarter.

Funds Flow from Operating Activities

Funds flow from operating activities in the 2013 second quarter of $15.99 million was $3.62 million, or 29 percent higher than the prior year second quarter. The increase in funds flow compared to the prior year second quarter was primarily a result of higher revenues, lower royalties, lower operating expenses, lower G&A expenses, lower interest charges and a gain on realized derivatives which was partially offset by increased abandonment costs.

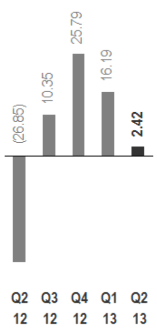
Net Earnings/ (Loss)
($ millions)



Net Earnings

Net earnings of $1.13 million for the 2013 second quarter were down from the $10.54 million net earnings in the 2012 second quarter, largely due to the lower unrealized gain on derivatives and the loss 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, second quarter 2013 net earnings were $0.04 compared to a net earnings of $0.34 for the 2012 second quarter.

Net Capital Expenditures/ (Dispositions)
($ millions)



Capital Expenditures

	Three Months Ended June 30,		Six Months Ended June 30,	
($ millions)	**2013**	2012	**2013**	2012
Undeveloped land	**1.12**	1.39	**1.91**	2.34
Geological and geophysical (seismic)	**0.65**	1.00	**0.87**	1.93
Drilling and completion of wells	**1.78**	2.62	**9.06**	17.01
Well equipment and facilities	**3.10**	3.27	**9.08**	7.27
ASP project	**7.30**	0.90	**12.31**	1.46
Exploration and development	**13.95**	9.18	**33.23**	30.01
Property acquisitions	**0.09**	0.71	**0.27**	0.81
Property dispositions	**(11.63)**	(36.78)	**(14.90)**	(36.78)
Net property dispositions	**(11.54)**	(36.07)	**(14.63)**	(35.97)
Total net capital expenditures/(dispositions) excluding administrative assets	**2.41**	(26.89)	**18.60**	(5.96)
Administrative assets	**0.01**	0.04	**0.01**	0.06
Total net capital expenditures/(dispositions)	**2.42**	(26.85)	**18.61**	(5.90)

LIQUIDITY AND CAPITAL RESOURCES

Total net capital expenditures (including net property acquisitions/(dispositions)) totalled $2.42 million in the second quarter of 2013 which differed from the $26.85 million of net capital recoveries in the same period in 2012. Field expenditures of $13.95 million for the second quarter of 2013 were 52 percent higher than the 2012 second quarter. The second quarter 2013 field capital expenditures (excluding net property dispositions) were allocated to Alberta Plains North - $2.46 million, Alberta Plains South - $9.00 million and Williston Basin - $2.49 million and included the drilling of nil net wells, essentially unchanged from the net wells drilled in the second quarter of 2012. Included in the Alberta Plains South capital expenditures is the $7.30 million incurred on the Little Bow ASP project.

Funds flow from operating activities in the 2013 second quarter of $15.99 million and proceeds from the sale of properties of $11.63 million were used to fund the capital program and cash dividends to shareholders.

At June 30, 2013, the Company's combined debt net of working capital (excluding unrealized derivative assets/liabilities) was $111.33 million, which compares to $113.18 million of net debt at the end of December 31, 2012. The decrease in net debt was due to Zargon's 2013 second quarter property sales and funds flow from operations. The $111.32 million debt net of working capital consists of the $57.50 million of full future face value convertible unsecured subordinate debentures and the remaining portion of bank debt.

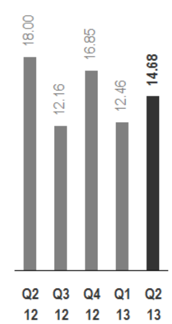
The volatility of oil and natural gas prices, uncertainty or modifications regarding royalties and Canadian income tax rules and global economic/political concerns have, on occasion, restricted the oil and natural gas industry's ability to attract new capital from debt and equity markets.

Cash Dividends Analysis

	Three Months Ended June 30,		Six Months Ended June 30,	
($ millions)	**2013**	2012	**2013**	2012
Cash flows from operating activities	**14.68**	18.00	**27.14**	29.86
Net earnings	**1.13**	10.54	**1.35**	8.53
Actual cash dividends paid or payable relating to the period [1]	**(5.01)**	(7.45)	**(9.76)**	(14.90)
Excess of cash flows from operating activities over cash dividends paid	**9.67**	10.55	**17.38**	14.96
Excess (shortfall) of net earnings over cash dividends paid	**(3.88)**	3.09	**(8.41)**	(6.37)

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

During the first half 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 June 30, 2013, cash flows from operating activities (after changes in non-cash working capital) of $14.68 million exceeded cash dividends of $5.01 million. Similarly, for the three months ended June 30, 2012, cash flows from operating activities (after changes in non-cash working capital) of $18.00 million exceeded cash dividends of $7.45 million.

For the three months ended June 30, 2013, net earnings of $1.13 million were exceeded by cash dividends of $5.01 million. Net earnings include significant non-cash charges of $15.93 million for the 2013 second quarter that does not impact cash flow. For the three months ended June 30, 2012, net earnings of $10.54 million exceeded 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 June 30, 2013, cash dividends and net capital expenditures totalled $7.43 million, which was $7.25 million lower than the cash flows from operating activities (after changes in non-cash working capital) of $14.68 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 August 8, 2013, Zargon Oil & Gas Ltd. had 30.043 million common shares outstanding. Pursuant to the common share rights incentive plans, there are currently an additional 0.984 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. The DRIP will be suspended starting with the September 2013 dividend payable October 15, 2013.

Capital Sources and Uses

	Three Months Ended June 30,		Six Months Ended June 30,	
($ millions)	**2013**	2012	**2013**	2012
Funds flow from operating activities	**15.99**	12.37	**29.89**	25.89
Change in long term bank debt	**(1.96)**	(83.23)	**6.33**	(68.56)
Issuance of convertible debentures, net of transaction cost	**–**	54.65	**–**	54.65
Issuance of common shares	**–**	0.02	**–**	0.11
Cash dividends to shareholders (1)	**(5.01)**	(7.45)	**(9.76)**	(14.90)
Changes in working capital and other	**(6.60)**	(3.21)	**(7.85)**	(3.09)
Total capital sources	**2.42**	(26.85)	**18.61**	(5.90)

(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 second 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 first quarter of 2013, and is forecast to be constructed and operational by January 2014. This project will provide significant production gains over the next few years and ultimately a stable oil production base through the end of this decade. The ASP project in conjunction with our long-life low-decline conventional oil exploitation properties provides Zargon the stable oil production asset base that will permit Zargon to meet its long term sustainable, dividend-paying objectives.

SUMMARY OF QUARTERLY RESULTS

	2013	
	Q1	**Q2**
Petroleum and natural gas sales ($ millions)	37.08	**40.59**
Net earnings ($ millions)	0.23	**1.13**
Net earnings per diluted share ($)	0.01	**0.04**
Funds flow from operating activities ($ millions)	13.90	**15.99**
Funds flow from operating activities per diluted share ($)	0.46	**0.53**
Cash flows from operating activities ($ millions)	12.46	**14.68**
Cash flows from operating activities per diluted share ($)	0.42	**0.49**
Cash dividends ($ millions) (1)	4.75	**5.01**
Cash dividends declared per common share ($)	0.18	**0.18**
Net capital expenditures ($ millions)	16.19	**2.42**
Total assets ($ millions)	450.34	**437.88**
Long term bank debt ($ millions)	44.02	**42.06**
Convertible debentures ($ millions) (2)	57.50	**57.50**
Net debt (3)	120.10	**111.33**
Average daily oil and liquids production (bbl)	5,113	**4,930**
Average daily natural gas production (mmcf)	15.21	**14.77**
Average daily production (boe)	7,648	**7,392**
Average oil production weighting (%)	67	**67**
Average realized commodity field price before the impact of financial risk management contracts ($/boe)	53.87	**60.34**
Funds flow netback ($/boe)	20.20	**23.77**

(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.

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

(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.

	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.

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
August 8, 2013

CONSOLIDATED BALANCE SHEETS

(unaudited)

($ thousands)	Notes	**June 30, 2013**	December 31, 2012
ASSETS			
Trade and other receivables		**16,640**	16,660
Deposits and prepaid expenses		**1,783**	1,715
Derivatives	11,12	**2,055**	4,514
Total current assets		**20,478**	22,889
Long term deposits		**269**	269
Derivatives	11,12	**351**	284
Property, plant and equipment, net	4	**386,369**	389,971
Intangible exploration and evaluation assets	5	**17,924**	19,968
Goodwill	5	**2,969**	2,969
Deferred tax assets		**9,519**	8,755
Total non-current assets		**417,401**	422,216
Total assets		**437,879**	445,105
LIABILITIES			
Trade and other payables		**27,678**	35,777
Cash dividends payable	6	**1,687**	1,656
Provisions	7	**822**	881
Derivatives	11,12	**397**	72
Total current liabilities		**30,584**	38,386
Long term bank debt	8	**42,061**	35,736
Convertible debentures		**51,891**	51,261
Derivatives	11,12	**163**	191
Provisions	7	**111,539**	112,283
Deferred tax liabilities		**11,567**	10,665
Total non-current liabilities		**217,221**	210,136
Total liabilities		**247,805**	248,522
Commitments and contingencies	4,7,8,10,11,12		
EQUITY			
Shareholders’ capital	9	**255,716**	254,400
Accumulated other comprehensive gain/(loss)		**187**	(998)
Contributed surplus	10	**11,554**	11,133
Equity component of debentures		**3,640**	3,640
Deficit		**(81,023)**	(71,592)
Total equity		**190,074**	196,583
Total equity and liabilities		**437,879**	445,105

See accompanying notes to the interim consolidated financial statements.

CONSOLIDATED STATEMENTS OF EARNINGS AND COMPREHENSIVE INCOME

(unaudited)		Three Months Ended June 30,		Six Months Ended June 30,	
($ thousands, except per share amounts)	Notes	**2013**	2012	**2013**	2012
Petroleum and natural gas sales		**40,591**	38,520	**77,669**	83,159
Royalties		**(7,068)**	(7,471)	**(13,738)**	(15,919)
PETROLEUM AND NATURAL GAS REVENUE, NET OF ROYALTIES		**33,523**	31,049	**63,931**	67,240
Gain/(loss) on unrealized derivatives	11,12	**2,084**	17,801	**(2,689)**	16,174
Gain/(loss) on realized derivatives	11,12	**961**	(690)	**2,238**	(3,775)
GAIN/(LOSS) ON DERIVATIVES		**3,045**	17,111	**(451)**	12,399
TOTAL INCOME		**36,568**	48,160	**63,480**	79,639
Operating		**12,173**	12,292	**24,060**	25,603
Transportation		**448**	382	**899**	763
General and administrative		**3,035**	3,227	**5,947**	7,293
Transaction costs		**97**	10	**97**	35
Exploration and evaluation	5	**1,464**	1,327	**2,323**	2,391
(Gain)/loss on disposal of properties	4	**4,411**	(20,820)	**931**	(20,820)
Share-based compensation	10	**502**	538	**715**	972
Unrealized foreign exchange (gain)/loss		**(90)**	20	**(188)**	19
Impairment loss		**–**	22,865	**–**	22,865
Depletion and depreciation		**11,089**	12,239	**22,494**	25,085
EXPENSES		**33,129**	32,080	**57,278**	64,206
EARNINGS BEFORE FINANCE EXPENSES AND INCOME TAXES		**3,439**	16,080	**6,202**	15,433
Interest and financing charges	8	**628**	914	**1,190**	2,051
Interest on convertible debentures		**870**	579	**1,725**	579
Accretion on convertible debentures		**315**	200	**630**	200
Accretion of asset retirement obligations	7	**715**	681	**1,437**	1,404
FINANCE EXPENSES		**2,528**	2,374	**4,982**	4,234
EARNINGS BEFORE INCOME TAXES		**911**	13,706	**1,220**	11,199
Current tax expense		**172**	25	**344**	40
Deferred tax expense/(recovery)		**(388)**	3,143	**(476)**	2,634
INCOME TAXES EXPENSE/(RECOVERY)		**(216)**	3,168	**(132)**	2,674
NET EARNINGS FOR THE PERIOD		**1,127**	10,538	**1,352**	8,525
Currency translation adjustment that may be reclassified subsequently to net earnings		**756**	372	**1,185**	57
OTHER COMPREHENSIVE EARNINGS FOR THE PERIOD		**756**	372	**1,185**	57
TOTAL COMPREHENSIVE EARNINGS FOR THE PERIOD		**1,883**	10,910	**2,537**	8,582
NET EARNINGS PER SHARE					
Basic		**0.04**	0.36	**0.05**	0.29
Diluted		**0.04**	0.34	**0.04**	0.28

See accompanying notes to the interim consolidated financial statements.

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

(unaudited)

($ thousands)	Notes	Shareholders' Capital	Accumulated Other Comprehensive Income	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		**–**	**–**	**–**	**–**	**1,352**	**1,352**
Dividends declared	6	**–**	**–**	**–**	**–**	**(10,783)**	**(10,783)**
Issue of common shares pursuant to the DRIP	6,9	**1,022**	**–**	**–**	**–**	**–**	**1,022**
Share-based compensation	10	**–**	**–**	**715**	**–**	**–**	**715**
Exercise of share options	9	**294**	**–**	**(294)**	**–**	**–**	**–**
Translation differences on foreign subsidiary		**–**	**1,185**	**–**	**–**	**–**	**1,185**
Balance at June 30, 2013		**255,716**	**187**	**11,554**	**3,640**	**(81,023)**	**190,074**
Balance at December 31, 2011		249,470	(600)	9,200	–	(34,265)	223,805
Net earnings for the period		–	–	–	–	8,525	8,525
Dividends declared	6	–	–	–	–	(17,676)	(17,676)
Issue of common shares pursuant to the DRIP	6	2,774	–	–	–	–	2,774
Issuance of convertible debentures		–	–	–	3,640	–	3,640
Share-based compensation	10	–	–	991	–	–	991
Exercise of share options		302	–	(196)	–	–	106
Translation differences on foreign subsidiary		–	57	–	–	–	57
Balance at June 30, 2012		252,546	(543)	9,995	3,640	(43,416)	222,222

See accompanying notes to the interim consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)		Three Months Ended June 30,		Six Months Ended June 30,	
($ thousands)	Notes	**2013**	2012	**2013**	2012
OPERATING ACTIVITIES					
Net earnings for the period		**1,127**	10,538	**1,352**	8,525
Adjustments for non-cash items:					
(Gain)/loss on sale of properties	4	**4,411**	(20,820)	**931**	(20,820)
(Gain)/loss on unrealized derivatives	11,12	**(2,084)**	(17,801)	**2,689**	(16,174)
Depletion and depreciation		**11,089**	12,239	**22,494**	25,085
Accretion of asset retirement obligations	7	**715**	681	**1,437**	1,404
Accretion of convertible debentures		**315**	200	**630**	200
Share-based compensation	10	**502**	538	**715**	972
Unrealized foreign exchange (gain)/loss		**(90)**	20	**(188)**	19
Impairment loss		**–**	22,865	**–**	22,865
Deferred tax expense/(recovery)		**(388)**	3,143	**(476)**	2,634
Exploration and evaluation expenses	5	**1,464**	1,327	**2,323**	2,391
Asset retirement expenditures		**(1,074)**	(563)	**(2,017)**	(1,214)
Funds flow from operating activities		**15,987**	12,367	**29,890**	25,887
Changes in operating working capital		**(1,310)**	5,636	**(2,753)**	3,968
Net cash from operating activities		**14,677**	18,003	**27,137**	29,855
INVESTING ACTIVITIES					
Additions to property, plant and equipment	4	**(13,890)**	(9,319)	**(33,250)**	(29,969)
Additions to intangible exploration and evaluation assets	5	**(157)**	(610)	**(263)**	(912)
Proceeds on disposal of property, plant and equipment	4	**11,599**	36,781	**14,868**	36,781
Proceeds on disposal of intangible exploration and evaluation assets	5	**33**	–	**33**	–
Change in long term deposits		**–**	149	**–**	149
Changes in investing working capital		**(5,295)**	(8,812)	**(5,120)**	(7,158)
Net cash from/(used) in investing activities		**(7,710)**	18,189	**(23,732)**	(1,109)
FINANCING ACTIVITIES					
Advances/(repayments) of bank debt		**(1,958)**	(83,229)	**6,325**	(68,563)
Cash dividends paid to shareholders	6	**(5,007)**	(7,450)	**(9,761)**	(14,902)
Proceeds from exercise of share rights		**–**	17	**–**	106
Issuance of convertible debentures, net of issue costs		**–**	54,650	**–**	54,650
Changes in financing working capital		**(2)**	(180)	**31**	(37)
Net cash used in financing activities		**(6,967)**	(36,192)	**(3,405)**	(28,746)
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 and six months ended June 30, 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 June 30, 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 and six month periods ended June 30, 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 and six month periods ended June 30, 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 August 8, 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 effective January 1, 2013 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 as at January 1, 2013.

- 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 effective January 1, 2013 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 effective January 1, 2013 does not have an impact on the Company.

- IFRS 13 "Fair Value Measurement" provides a single, comprehensive framework for fair value measurement and disclosure requirements for use across all IFRS standards. IFRS 13 clarifies that the fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The measurement of the fair value of an asset or liability is based on assumptions that market participants would use when pricing the asset or liability under current market conditions, including assumptions about risk. Under IFRS 13, the fair value of a liability must reflect the non-performance risk, which includes an entity's own credit risk. The Company adopted IFRS 13 on January 1, 2013 on a prospective basis. The adoption of IFRS 13 did not require any adjustments to the valuation techniques used by the Company to measure fair value and did not result in any measurement adjustments as at January 1, 2013.

(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 is currently assessing the impact of this standard on its consolidated financial statements.

4. PROPERTY, PLANT AND EQUIPMENT

($ thousands)	Six Months Ended June 30, 2013
Cost, December 31, 2012	535,791
Accumulated depletion and depreciation	(145,820)
Net carrying amount, December 31, 2012	389,971
Additions	32,319
Disposals	(14,816)
Change in asset retirement obligation	(652)
Assets transferred from intangible exploration and evaluation assets	25
Exchange differences	2,016
Depletion and depreciation	(22,494)
Net carrying amount, June 30, 2013	386,369
Cost, June 30, 2013	550,590
Accumulated depletion and depreciation	(164,221)
Net carrying amount, June 30, 2013	386,369

Property, plant and equipment are not depleted and depreciated for a major development project until production commences. As at June 30, 2013, $19.43 million (December 31, 2012 - $6.48 million) of a major development project was not depleted.

During the six months ended June 30, 2013, the Company disposed of certain assets for gross cash proceeds of $14.87 million (June 30, 2012 – $36.78 million), resulting in a loss of $4.41 million (June 30, 2012 - $20.82 million gain).

As at June 30, 2013, the Company is committed to $5.00 million in project 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	**–**	**263**	**263**
Disposals	**–**	**(33)**	**(33)**
Transfers to property, plant and equipment	**–**	**(25)**	**(25)**
Exploration and evaluation expense	**–**	**(2,323)**	**(2,323)**
Exchange differences	**–**	**74**	**74**
Balance at June 30, 2013	**2,969**	**17,924**	**20,893**

6. CASH DIVIDENDS

During the six month period, the Company declared dividends to the shareholders in the aggregate amount of $10.78 million (2012 – $17.68 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
April	April 30, 2013	May 15, 2013	$0.06
May	May 31, 2013	June 17, 2013	$0.06
June	June 30, 2013	July 15, 2013	$0.06

(1) The 2013 cash dividends include a non-cash equity issuance amount of $1.02 million (2012 – $2.78 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 August 8, 2013, the Company declared dividends of $1.80 million or $0.06 per share for July 2013.

7. PROVISIONS

($ thousands)	Asset Retirement Obligations	Other	Total
Balance at December 31, 2012	**112,283**	**881**	**113,164**
Provisions made during the period	**668**	**–**	**668**
Foreign exchange and other	**488**	**–**	**488**
Provisions used during the period	**(2,017)**	**(59)**	**(2,076)**
Provisions related to dispositions	**(1,320)**	**–**	**(1,320)**
Accretion	**1,437**	**–**	**1,437**
Balance at June 30, 2013	**111,539**	**822**	**112,361**
Current	**–**	**822**	**822**
Non-current	**111,539**	**–**	**111,539**

Asset retirement obligation:

The asset retirement obligations were calculated using a discount factor of 2.50 percent (December 31, 2012 – 2.50 percent) being the risk free rate related to the liability and based on the Government of Canada long term bond rate. These obligations are expected to be incurred over the next 50 years. An inflation rate of two percent per annum (December 31, 2012 – two percent) used in the calculation of the present value of the asset retirement obligation remains unchanged.

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 $0.82 million.

8. LONG TERM BANK DEBT

On June 10, 2013, Zargon amended and renewed its syndicated committed credit facilities, the result of which was the maintaining of the available facilities and borrowing base of $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 364 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 25, 2014, with a semi-annual review taking place in the fall of 2013. Should the facilities not be renewed, they convert to one year non-revolving term facilities at the end of the revolving 364 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 June 30, 2013, $42.06 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 June 30, 2013, the approximate value of outstanding letters of credit totalled $0.80 million (December 31, 2012 - $0.71 million). The letters of credit reduce the amount of Zargon's available credit facilities to $122.14 million at June 30, 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 June 30, 2013.

9. 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	Six Months Ended June 30, 2013	
(thousands)	Number of Shares	Amount ($)
Balance, as at December 31, 2012	**29,868**	**254,400**
Share awards exercised	**19**	**–**
Share-based compensation recognized on exercise of share options	**–**	**294**
Issued pursuant to the Dividend Reinvestment Plan	**156**	**1,022**
Balance, as at June 30, 2013	**30,043**	**255,716**

10. 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 15 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:

	Six Months Ended June 30, 2013
	Number of Share Awards (thousands)
Outstanding, as at December 31, 2012	**322**
Share awards granted	**313**
Share awards exercised	**(19)**
Share awards forfeited	**(26)**
Outstanding, as at June 30, 2013	**590**

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") expired in the first quarter of 2013. 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 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:

	Six Months Ended June 30, 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	**–**	**–**

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

	Six Months Ended June 30, 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	**(44)**	**18.27**
Outstanding at end of period	**414**	**18.06 / 14.38**

Share-based Compensation

The share awards for the three and six months ended June 30, 2013, resulted in share-based compensation of $0.50 million (2012 - $0.54 million) and $0.72 million (2012 - $0.97 million), respectively.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
(thousands of shares)	**2013**	2012	**2013**	2012
Weighted average number of common shares – basic	**29,995**	29,518	**29,952**	29,458
Weighted average number of common shares – diluted	**30,210**	32,621	**30,108**	32,645

Dilution amounts for the three and six months ended June 30, 2013 of 0.22 million shares (2012 – 3.10 million shares) and 0.16 million shares (2012 – 3.19 million shares), respectively, 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 and for 2012 also include approximately 3.06 million shares for the convertible debentures using the "if-converted" method.

For the three and six months ended June 30, 2012 an adjustment to the numerator amount was required in the diluted calculation to provide for the earnings of $0.58 million and $0.58 million, respectively, attributable to the accretion and interest, net of tax pertaining to the convertible debentures.

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 and six months ended June 30, 2013.

11. 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:

	June 30, 2013		December 31, 2012	
	Carrying Amount ($)	**Fair Value ($)**	Carrying Value ($)	Fair Value ($)
Loans and receivables:				
Trade and other receivables	**16,640**	**16,640**	16,660	16,660
Fair value through profit and loss:				
Derivative assets	**2,406**	**2,406**	4,798	4,798
Derivative liabilities	**560**	**560**	263	263
Other liabilities:				
Trade and other payables	**27,678**	**27,678**	35,777	35,777
Cash dividends	**1,687**	**1,687**	1,656	1,656
Long term bank debt	**42,061**	**42,061**	35,736	35,736
Convertible debentures	**51,891**	**54,625**	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 June 30, 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 $0.22 million (June 30, 2012 - $0.40 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 $0.39 million (June 30, 2012 - $0.43 million) increase or decrease in net earnings for the six month period ended June 30, 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 June 30, 2013, approximately 47 percent (December 31, 2012 - 45 percent) was owing from two companies and Zargon anticipates full collection.

  The Company's allowance for doubtful accounts at June 30, 2013 was $0.28 million (December 31, 2012 - $0.25 million). During 2013, the Company recorded an additional provision of $0.03 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 June 30, 2013, $0.80 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 June 30, 2013, Zargon had available unused committed bank credit facilities of approximately $122.14 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	2–4 years	Total
Trade and other payables	**27,678**	**–**	**27,678**
Cash dividends payable	**1,687**	**–**	**1,687**
Derivative liabilities	**397**	**163**	**560**
Long term bank debt	**–**	**42,061**	**42,061**
Interest on convertible debentures	**3,450**	**10,350**	**13,800**
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 $6.59 million (June 30, 2012 – $2.21 million) on risk management contracts impacting net earnings for the six months ended June 30, 2013.

12. 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 gain/loss on the statement of earnings and comprehensive income for the three and six month periods of 2013 were $2.08 million gain (2012 - $17.80 million gain) and $2.69 million loss (2012 - $16.17 million gain), respectively. The realized gain/loss on the statement of earnings and comprehensive income for the three and six month periods of 2013 were $0.96 million gain (2012 - $0.69 million loss) and $2.24 million gain (2012 - $3.78 million loss), respectively.

As at June 30, 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	1,400	$98.52 US/bbl	Jul. 1/13 – Dec. 31/13	735
	400	$96.33 US/bbl	Jul. 1/13 – Mar. 31/14	168
	1,200	$95.59 US/bbl	Jul. 1/13 – Jun. 30/14	755
	1,400	$90.30 US/bbl	Jan. 1/14 – Dec. 31/14	(163)
	200	$91.35 US/bbl	Apr. 1/14 – Mar. 31/15	163
	400	$90.00 US/bbl	Jul. 1/14 – Dec. 31/14	64
Total Fair Market Value, Commodity Price Financial Contracts				**1,722**

Oil swaps are settled against the NYMEX WTI pricing index.

Subsequent to the end of the period and prior to the consolidated financial statements being authorized for issue on August 8, 2013, the Company entered into a commodity contract for 200 barrels per day of oil at $92.10 US/bbl WTI from April 1, 2014 to March 31, 2015.

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%	Jul. 1/13 – Jul. 26/16	101
	$20,000,000/month	1.731%	Jul. 1/13 – Aug. 26/16	23
Total Fair Market Value, Interest Rate Financial Contracts				**124**

(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

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

Common Shares
Trading Symbol: ZAR

Convertible Debentures
Trading Symbol: ZAR.DB

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