



ZARGON ENERGY TRUST 2010 Q2 FINANCIAL REPORT

## FINANCIAL & OPERATING HIGHLIGHTS

(unaudited)	Three Months Ended June 30,			Six Months Ended June 30,		
	2010	2009	Percent Change	2010	2009	Percent Change
<b>Financial</b>						
<b>Income and Investments (\$ millions)</b>						
Petroleum and natural gas revenue	43.89	35.84	22	92.34	67.82	36
Funds flow from operating activities	18.38	20.92	(12)	40.62	38.77	5
Cash flows from operating activities	12.87	21.94	(41)	33.87	37.67	(10)
Cash distributions (net of Distribution Reinvestment Plan)	11.88	11.26	5	24.43	21.30	15
Net earnings/(losses)	8.65	(2.55)	439	13.81	(2.19)	731
Net capital expenditures	34.26	48.96	(30)	53.00	62.40	(15)
<b>Per Unit, Diluted</b>						
Funds flow from operating activities (\$/unit)	0.70	0.91	(23)	1.55	1.76	(12)
Cash flows from operating activities (\$/unit)	0.49	0.95	(48)	1.29	1.71	(25)
Net earnings/(losses) (\$/unit)	0.37	(0.13)	385	0.59	(0.11)	636
<b>Cash Distributions (\$/trust unit)</b>	<b>0.54</b>	<b>0.54</b>	<b>-</b>	<b>1.08</b>	<b>1.08</b>	<b>-</b>
<b>Balance Sheet at Period End (\$ millions)</b>						
Property and equipment, net				452.47	422.73	7
Bank debt				114.12	70.43	62
Unitholders' equity				269.66	282.64	(5)
<b>Total Units Outstanding at Period End (millions)</b>				<b>26.33</b>	<b>25.28</b>	<b>4</b>
<b>Operating</b>						
<b>Average Daily Production</b>						
Oil and liquids (bbl/d)	5,740	4,780	20	5,647	4,671	21
Natural gas (mmcf/d)	25.86	28.44	(9)	26.45	28.18	(6)
Equivalent (boe/d)	10,050	9,520	6	10,056	9,368	7
Equivalent per million trust units (boe/d)	382	413	(8)	382	423	(10)
<b>Average Selling Price (before the impact of financial risk management contracts)</b>						
Oil and liquids (\$/bbl)	67.27	59.95	12	70.38	51.71	36
Natural gas (\$/mcf)	3.72	3.77	(1)	4.26	4.73	(10)
<b>Wells Drilled, Net</b>	<b>6.3</b>	<b>3.0</b>	<b>110</b>	<b>19.1</b>	<b>10.4</b>	<b>84</b>
<b>Undeveloped Land at Period End (thousand net acres)</b>				<b>521</b>	<b>533</b>	<b>(2)</b>

*Notes:*

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

For net capital expenditures, amounts include capital expenditures acquired for cash, equity issuances, acquisitions costs and net debt assumed on corporate acquisitions.

Funds flow from operating activities is a non-GAAP term that represents net earnings/losses 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.

Total units outstanding include trust units plus exchangeable shares outstanding at period end. The exchangeable shares are converted at the exchange ratio at the end of the period.

Average daily production per million trust units is calculated using the weighted average number of units outstanding during the period plus the weighted average number of exchangeable shares outstanding for the period converted at the average exchange ratio for the period.

## FINANCIAL & OPERATING HIGHLIGHTS

*Zargon Energy Trust is pleased to report its financial results for the second quarter of 2010.*

Highlights from the three and six months ended June 30, 2010 are noted below:

- Second quarter 2010 production averaged 10,050 barrels of oil equivalent per day and was essentially unchanged from the preceding quarter and six percent higher than the corresponding 2009 quarter. Reflecting Zargon's continuing focus on oil exploitation initiatives, oil and liquids production averaged 5,740 barrels of oil per day in the second quarter, a three percent gain over the prior quarter and a 20 percent increase over the corresponding 2009 quarter.
- Revenue and funds flow from operating activities in the 2010 second quarter decreased nine percent and 17 percent, respectively, from the prior quarter. Funds flow from operating activities was \$18.38 million (\$0.70 per diluted trust unit) in the 2010 second quarter compared with \$22.24 million (\$0.85 per diluted trust unit) in the 2010 first quarter and \$20.92 million (\$0.91 per diluted trust unit) in the 2009 second quarter.
- The Trust declared three monthly cash distributions of \$0.18 per trust unit in the second quarter of 2010 for a total of \$12.62 million (\$11.88 million after accounting for the trust units issued for the Distribution Reinvestment Plan ("DRIP")). These cash distributions (net of the DRIP) were equivalent to a payout ratio of 65 percent of funds flow from operating activities.
- The Trust's second quarter exploration and development capital expenditures (excluding property acquisitions and dispositions) increased nine percent from the prior quarter to \$16.36 million primarily as a result of increased expenditures for undeveloped land, seismic and well equipping.
- On May 31, 2010, Zargon closed the acquisition of working interests in various southern Alberta medium and heavy gravity oil pools producing approximately 350 barrels of oil equivalent per day for a cash purchase price of \$24.62 million. With the completion of this acquisition, Zargon holds a 100 percent working interest in Zargon's proposed Little Bow Mannville I Pool Alkaline Surfactant Polymer ("ASP") tertiary recovery flood. This acquisition and other minor property acquisitions were partially offset by a series of smaller non-core dispositions that reduced the net acquisition expenditure in the quarter to \$17.81 million.
- Debt net of working capital (excluding unrealized risk management assets/liabilities and future income taxes) increased 28 percent from the prior quarter to \$121.67 million at June 30, 2010, which represents approximately 68 percent of the Trust's available credit facilities at June 30, 2010. The Trust's balance sheet remains strong with a debt net of working capital to annualized funds flow from operating activities ratio of 1.5 times.
- On June 29, 2010, the Trust amended and renewed its syndicated committed credit facilities of \$180 million. These facilities are available for general corporate purposes and the acquisition of oil and natural gas properties.

**Production**  
(boe/d)



**Production <sup>(1)</sup>**

Oil and liquids production averaged 5,740 barrels per day in the 2010 second quarter, and was supported by Williston Basin horizontal drilling and oil exploitation property acquisitions. Reflecting continued success with Zargon’s reservoir engineering focused strategy to increase oil recovery factors in smaller but under exploited reservoirs, the second quarter oil and liquids production was 57 percent of total production based on a six to one oil equivalent basis compared to 50 percent in the 2009 second quarter and 42 percent in the fourth quarter of 2007. Over this two and a half year period since we returned to our oil exploitation focus, Zargon has maintained a stable \$0.18 per unit monthly distribution while increasing oil production volumes by 57 percent. Further oil production increases are anticipated for the balance of 2010 as we continue to execute our oil exploitation strategy highlighted by reservoir engineering supported horizontal wells.

Natural gas production volumes in the second quarter of 2010 averaged 25.86 million cubic feet per day, a four percent decrease from the previous quarter and a nine percent decrease from the corresponding period of 2009. The second quarter 2010 natural gas production decreases were due to naturally occurring production declines, third party processing shut-ins and weather related outages, which were only partially offset by production additions coming from our reduced natural gas field capital programs. In light of the comparatively very strong returns available from our oil exploitation field capital programs, we will continue to limit our natural gas capital expenditures to high-graded workovers, stimulations and the drilling of selected wells that advance long term natural gas exploitation projects. Consequently, for the remainder of the year, we anticipate that our corporate natural gas production volumes will remain relatively flat.

**Production**  
(boe/d per million trust units)



**Capital Expenditures <sup>(1)</sup>**

Zargon’s second quarter field capital program totalled \$16.36 million, a 91 percent increase from the 2009 second quarter field capital expenditures. During the quarter, Zargon drilled seven gross wells (6.3 net) that resulted in 4.8 net oil wells and 1.5 net natural gas wells for a 100 percent success ratio. The drilling program included three Steelman horizontal wells and one Elswick horizontal well in the Williston Basin core area and two Kakut natural gas wells and one Highvale oil well in the West Central Alberta core area.

For the remainder of 2010, Zargon will proceed with an active, primarily oil exploitation focused drilling program. In the Williston Basin core area, this will include three operated Steelman Frobisher horizontals, two net non-operated Steelman horizontals, four Elswick Midale and Frobisher horizontals, two Weyburn Midale horizontals, one Cromer, Manitoba Bakken/Torquary horizontal well and one Truro North Dakota Frobisher equivalent horizontal. In the Alberta Plains core area, our oil exploitation drilling program will include one Taber Sunburst horizontal oil well, one Grand Forks Glauconite vertical oil well and one Jarrow Glauconite oil horizontal location. In West Central Alberta, one Spirit River oil horizontal, one St. Anne vertical oil well and one vertical Rycroft land-preserving natural gas well on the Peace River Arch are planned.

In the second quarter of 2010, the purchase of 33 thousand net acres of Crown lands at an average price of \$57 per acre and the addition of lands related to the acquisition of properties in southern Alberta, allowed Zargon to offset expiries and sales resulting in a quarter end undeveloped land inventory of 521 thousand net acres.

In addition to our field related activities, Zargon seeks to make additional corporate and/or property acquisitions that can be funded by bank debt or equity issuances. We continue to believe that we will be able to conclude transactions this year that bring either tax pools and/or oil-in-place resources that we can exploit. To this end, on May 31, 2010, Zargon closed a \$24.62 million acquisition of various working interests in southern Alberta medium and heavy gravity oil pools producing approximately 350 barrels of oil equivalent per day. These assets bring significant volumes of oil-in-place that may, in part, be amenable to tertiary recovery methods through our proposed Little Bow ASP chemical flood project.

Also, as previously announced, Zargon has marketed seventeen non-core minor oil properties that are producing approximately 375 barrels of oil equivalent per day. As a result, proceeds of \$7.05 million were realized during the second quarter for this disposition program with an approximately additional \$22 million of disposition proceeds being realized subsequent to the end of the second quarter. For the foreseeable future, Zargon will continue to pursue selected acquisitions and dispositions that provide an improved focus on our key exploitation initiatives and properties.

### **Guidance <sup>(1)</sup>**

In the May 12, 2010 press release announcing the first quarter 2010 results, Zargon provided updated production guidance of 9,900 barrels of oil equivalent per day for the second quarter of 2010 and 10,400 barrels of oil equivalent per day for the second half of 2010. During the second quarter, Zargon's production averaged 10,050 barrels of oil equivalent (including 122 barrels of oil equivalent per day related to the acquisition of properties in southern Alberta), slightly higher than guidance. For the third and fourth quarters of 2010, we continue to anticipate that production will average approximately 10,400 barrels of oil equivalent per day, consisting of 6,100 barrels of oil and liquids per day and 25.80 million cubic feet of natural gas per day. This guidance incorporates the previously announced \$58 million oil exploitation focused 2010 field capital budget, the second quarter southern Alberta property acquisition and the offsetting second and third quarter property dispositions.

Zargon continues to be well positioned with a strong balance sheet and a promising inventory of oil exploitation projects focused on increasing oil recovery factors in existing reservoirs through primary, secondary and now tertiary methods. We are pleased that our historical conservative hedging, debt and distribution policies have enabled our organization to maintain the current monthly \$0.18 per unit distribution for 57 consecutive months. Going forward past the December 2010 trust sunset date, as a corporation, Zargon will continue with its disciplined approach pertaining to the matching of our cash flow sources with our future dividends and/or field capital and acquisition expenditures while endeavouring to distribute a stable dividend stream. It is anticipated that, starting in January 2011, the initial dividend rate will be \$0.14 per share per month, which, from a Canadian taxable shareholder perspective, is roughly equivalent, on an after tax basis, to our current distribution of \$0.18 per unit per month. Based on current modelling, it is anticipated that this dividend rate will be initially funded from approximately 40-45 percent of our funds flow from operating activities (based on current forward prices). Over time, due to the upward trending forward price curve and due to expectations of continued oil volume growth, we anticipate that the \$0.14 per share per month dividend will equate to our long term 35 percent payout target. Ultimately, we note that this new dividend payout policy in a corporate structure permits us to reinvest an increased proportion of our cash flow into our business, which should drive modest growth in reserves and production per share that, in turn, should permit long term dividend growth.

In order to implement the conversion to a corporation, Zargon is planning on using an exchange method whereby unitholders transfer their trust units in exchange for a single class of common shares of the corporation on a one for one basis. Exchangeable shareholders will receive common shares based on the number of exchangeable shares held multiplied by the exchange ratio as of December 15, 2010. This exchange method will result in a tax-deferred rollover to unitholders and exchangeable shareholders. The conversion will be implemented through a Plan of Arrangement requiring court approval and two-thirds unitholder approval at a special meeting of unitholders to be held in late 2010.

### **Management Changes**

We are pleased to announce that effective June 1, 2010, the appointment of C.L. (Chuck) Buckley as Vice President, Geosciences. Chuck is a professional geologist with over 30 years experience and was most recently a Senior Vice President with a mid-sized oil and gas company in Calgary. Also, during the quarter, Dan Roulston, Vice President Engineering and Williston Basin, announced his retirement effective June 30, 2010. Dan has been with Zargon for over 17 years since our inception and has been a major contributor to our success. We sincerely thank Dan for his substantial contribution and valuable service to our organization.

*(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 Energy Trust's 2010 second quarter financial results and should be read in conjunction with the unaudited interim consolidated financial statements for the three and six months ended June 30, 2010 and the audited consolidated financial statements and related notes for the year ended December 31, 2009. The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). All amounts are in Canadian dollars unless otherwise noted. All references to "Zargon" or the "Trust" refer to Zargon Energy Trust and all references to the "Company" refer to Zargon Oil & Gas Ltd.

In the MD&A, reserves and production are commonly stated in barrels of oil equivalent ("boe") on the basis that six thousand cubic feet of natural gas is equivalent to one barrel of oil. Boes may be misleading, particularly if used in isolation. A boe conversion ratio of six thousand cubic feet of natural gas to one barrel of oil is based on an energy equivalent conversion method primarily applicable to the burner tip and does not represent a value equivalent at the wellhead.

The following are descriptions of non-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 Canadian GAAP as an indicator of the Trust's financial performance. This term does not have any standardized meaning as prescribed by GAAP and, therefore, the Trust's determination of funds flow from operating activities may not be comparable to that reported by other trusts. The reconciliation between cash flows from operating activities and funds flow from operating activities can be found in the table below and in the consolidated statements of cash flows in the consolidated financial statements. The Trust evaluates its performance based on net earnings and funds flow from operating activities. The Trust considers funds flow from operating activities to be a key measure as it demonstrates the Trust's ability to generate the cash necessary to pay distributions, repay debt and to fund future capital investment. It is also used by research analysts to value and compare oil and gas trusts, and it is frequently included in published research when providing investment recommendations. Funds flow from operating activities per unit is calculated using the diluted weighted average number of units for the period.

### Funds Flow from Operating Activities Reconciliation

(\$ millions)	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Cash flows from operating activities	12.87	21.94	33.87	37.67
Changes in non-cash operating working capital	5.51	(1.02)	6.75	1.10
Funds flow from operating activities	18.38	20.92	40.62	38.77

- The Trust 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 Canadian GAAP and may not be comparable with the calculation of similar measures for other entities. Debt net of working capital, as used by the Trust, is calculated as bank debt and any working capital deficit excluding unrealized risk management assets/liabilities and future income taxes.
- Operating netbacks per boe equal total petroleum and natural gas revenue per boe adjusted for realized risk management gains and/or losses per boe, royalties per boe and production costs per boe. Operating netbacks are a useful measure to compare the Trust's operations with those of its peers.
- Funds flow netbacks per boe are calculated as operating netbacks less general and administrative expenses per boe, interest and financing charges per boe, asset retirement expenditures per boe and current income taxes per boe. Funds flow netbacks are a useful measure to compare the Trust'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 11, 2010, and contains forward-looking statements including:

- our expectations for royalties referred to under the heading “Financial Analysis”;
- our expectations for production referred to under the heading “Financial and Operating Highlights”;
- our expectations for capital expenditures referred to under the heading “Financial and Operating Highlights”;
- our expectations for production costs referred to under the heading “Financial Analysis”;
- our expectations for current taxes referred to under the heading “Financial Analysis”;
- our distribution/dividend policy referred to under the headings “Financial and Operating Highlights”, “Financial Analysis” and “Liquidity and Capital Resources”;
- our expected sources of funds for distributions/dividends and capital expenditures referred to under the headings “Financial and Operating Highlights” and “Liquidity and Capital Resources”;
- our expectations for converting to a corporation from our current trust structure as referred to under the headings “Financial and Operating Highlights” and “Financial Analysis”;
- our expectations for operating results referred to under the headings “Financial and Operating Highlights” and “Outlook”;
- our expectations for designing and implementing International Financial Reporting Standards referred to under the heading “International Financial Reporting Standards”; and
- our expectations for the properties to be acquired and/or disposed referred to under the headings “Financial and Operating Highlights and “Summary of Significant Events in the Second Quarter”.

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](http://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; 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 achievement 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 11, 2010.

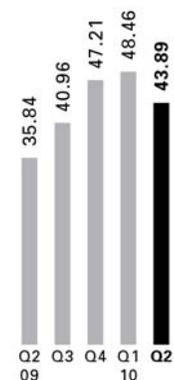
## SUMMARY OF SIGNIFICANT EVENTS IN THE SECOND QUARTER

- During the second quarter of 2010, the Trust realized funds flow from operating activities of \$18.38 million and declared distributions of \$12.62 million (\$11.88 million in cash after considering the trust units issued for the Distribution Reinvestment Plan, (“DRIP”)) or \$0.54 per trust unit to unitholders. For Canadian income tax purposes, the distributions are currently estimated to be 100 percent taxable income to unitholders.
- Average field prices received (before the impact of financial risk management contracts) for oil and liquids and for natural gas decreased nine percent to \$67.27 per barrel and decreased 22 percent to \$3.72 per thousand cubic feet, respectively, compared to the first quarter of 2010.
- Second quarter production volumes were 10,050 barrels of oil equivalent per day, a six percent increase from the second quarter 2009 production levels and essentially unchanged from the first quarter 2010 production levels.
- During the second quarter of 2010, the Trust drilled seven gross wells (6.3 net) with a 100 percent success rate. Total field exploration and development capital expenditures (excluding property acquisitions and dispositions) were \$16.36 million for the quarter compared to \$15.07 million for the prior quarter.
- The Trust continues to maintain a strong balance sheet with a combined debt net of working capital (excluding unrealized risk management assets/liabilities and future income taxes) of \$121.67 million, which represents approximately 68 percent of the Trust’s available credit facilities at June 30, 2010.
- On June 29, 2010, the Trust amended and renewed its syndicated committed credit facilities of \$180 million. These facilities are available for general corporate purposes and the acquisition of oil and natural gas properties.
- During the second quarter of 2010, Zargon concluded property acquisitions totalling \$24.86 million, which were partially offset by minor property dispositions totalling \$7.05 million. Additional property dispositions of approximately \$22 million are expected to close in the 2010 third quarter.

## FINANCIAL ANALYSIS

Second quarter 2010 revenue of \$43.89 million was nine percent below the \$48.46 million in the first quarter of 2010 and 22 percent above the \$35.84 million in the second quarter of 2009. Second quarter 2010 realized oil and liquids field prices averaged \$67.27 per barrel before the impact of financial risk management contracts and were nine percent lower than the preceding quarter’s \$73.63 per barrel and were 12 percent higher than the \$59.95 per barrel recorded in the 2009 second quarter. Zargon’s crude oil field price differential from the Edmonton par price increased to \$7.91 per barrel in the second quarter of 2010 compared to \$6.44 per barrel in the first quarter of 2010. Natural gas field prices received averaged \$3.72 per thousand cubic feet in the second quarter of 2010, a 22 percent decrease from the preceding quarter levels and one percent below the 2009 second quarter prices.

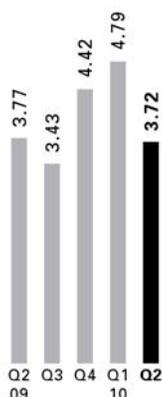
**Petroleum and  
Natural Gas  
Revenue  
(\$ millions)**



**Oil and Liquids Prices (\$/bbl)**



**Natural Gas Prices (\$/mcf)**



**Pricing**

Average for the period	Three Months Ended June 30,			Six Months Ended June 30,		
	2010	2009	Percent Change	2010	2009	Percent Change
<b>Natural Gas:</b>						
NYMEX average daily spot price (\$US/mmbtu)	<b>4.32</b>	3.71	16	<b>4.73</b>	4.14	14
AECO average daily spot price (\$Cdn/mmbtu)	<b>3.89</b>	3.46	12	<b>4.43</b>	4.20	5
Zargon realized field price before the impact of financial risk management contracts (\$Cdn/mcf) <sup>(1)</sup>	<b>3.72</b>	3.77	(1)	<b>4.26</b>	4.73	(10)
Zargon realized field price before the impact of physical and financial risk management contracts (\$Cdn/mcf) <sup>(1)</sup>	<b>3.72</b>	3.22	16	<b>4.26</b>	4.02	6
Zargon realized field price after the impact of physical and financial risk management contracts (\$Cdn/mcf) <sup>(1)</sup>	<b>3.72</b>	4.20	(11)	<b>4.26</b>	5.25	(19)
Zargon realized natural gas field price differential/(premium) <sup>(1) (2)</sup>	<b>0.17</b>	(0.31)		<b>0.17</b>	(0.53)	
Zargon realized natural gas field price differential before the impact of physical and financial risk management contracts	<b>0.17</b>	0.24		<b>0.17</b>	0.18	
<b>Crude Oil:</b>						
WTI (\$US/bbl)	<b>78.03</b>	59.62	31	<b>78.37</b>	51.35	53
Edmonton par price (\$Cdn/bbl)	<b>75.18</b>	65.90	14	<b>77.63</b>	57.71	35
Zargon realized field price before the impact of financial risk management contracts (\$Cdn/bbl)	<b>67.27</b>	59.95	12	<b>70.38</b>	51.71	36
Zargon realized field price after the impact of financial risk management contracts (\$Cdn/bbl)	<b>69.98</b>	74.51	(6)	<b>72.94</b>	66.36	10
Zargon realized oil field price differential <sup>(3)</sup>	<b>7.91</b>	5.95		<b>7.25</b>	6.00	

(1) Zargon was not subject to any physical or financial natural gas contracts for the 2010 first and second quarters.

(2) Calculated as Zargon's realized field price before the impact of financial risk management contracts (\$Cdn/mcf) as compared to AECO average daily spot price (\$Cdn/mmbtu). Note: premiums occurred in 2009 as a result of the realization of fixed price physical contracts and the impact of Zargon receiving AECO monthly index pricing for a portion of its natural gas production.

(3) Calculated as Zargon's realized field price before the impact of financial risk management contracts (\$Cdn/bbl) as compared to Edmonton par price (\$Cdn/bbl).

Natural gas production volumes decreased by four percent in the second quarter of 2010 to 25.86 million cubic feet per day from 27.05 million cubic feet per day in the first quarter of 2010 and were nine percent lower than the 2009 second quarter. When compared to the prior quarter, the 2010 second quarter decrease in natural gas production volumes were primarily a result of natural declines and weather related production issues. Oil and liquids production during the second quarter of 2010 was 5,740 barrels per day, which is three percent above the 2010 first quarter rate of 5,554 barrels per day and 20 percent above the second quarter of 2009 level. The year-over-year increase in oil and liquids was primarily due to property acquisitions and oil exploitation focused horizontal drilling programs. On a barrel of oil equivalent basis, Zargon produced 10,050 barrels of oil equivalent per day in the second quarter of 2010, which represents a slight decrease from the 10,062 barrels of oil equivalent per day in the first quarter of 2010 and a six percent increase when compared to the second quarter of 2009.

## Production by Core Area

Three Months Ended June 30,

	2010			2009		
	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	2,309	15.35	4,866	1,761	17.09	4,609
West Central Alberta	411	9.75	2,036	366	10.76	2,160
Williston Basin	3,020	0.76	3,148	2,653	0.59	2,751
	<b>5,740</b>	<b>25.86</b>	<b>10,050</b>	<b>4,780</b>	<b>28.44</b>	<b>9,520</b>

Six Months Ended June 30,

	2010			2009		
	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	2,276	15.22	4,813	1,578	17.12	4,431
West Central Alberta	393	10.48	2,140	373	10.55	2,131
Williston Basin	2,978	0.75	3,103	2,720	0.51	2,806
	<b>5,647</b>	<b>26.45</b>	<b>10,056</b>	<b>4,671</b>	<b>28.18</b>	<b>9,368</b>

Zargon's commodity price risk management policy, which is approved by the Board of Directors, allows the use of forward sales, costless collars and other instruments up to a 24 month term and approximately 30 percent of the combined oil and natural gas working interest production in order to partially offset the effects of large commodity price fluctuations. Zargon's management considers financial risk management contracts to be effective on an economic basis, but has decided not to designate these contracts as hedges for accounting purposes and, accordingly, for these contracts, an unrealized gain or loss is recorded based on the fair value (mark-to-market) of the contracts at the period end.

Specifically, in the 2010 second quarter, relatively lower oil prices (when compared to contract prices) brought about a small net realized financial risk management gain of \$1.42 million on oil contracts (foreign exchange contracts are considered in conjunction with the oil contracts) that compares to a \$1.18 million realized net gain in the first quarter of 2010 and a \$7.45 million realized net gain in the second quarter of 2009.

The 2010 second quarter unrealized risk management gain of \$6.99 million resulted from oil contract gains of \$6.95 million and electricity contract gains of \$0.04 million, which compares to a net \$3.33 million loss for the 2010 first quarter and a net \$13.65 million loss in the second quarter of 2009. These non-cash unrealized risk management gains or losses are generated by the change over the reporting period in the mark-to-market valuation of Zargon's risk management contracts. Recent volatility in commodity prices has resulted in significant fluctuations in the mark-to-market amount of unrealized risk management assets and liabilities. The period-over-period changes in these valuations directly impacts net earnings/losses. Zargon's commodity risk management positions are fully described in note 11 to the unaudited consolidated interim financial statements.

Royalties, inclusive of the Saskatchewan Resource Surcharge, totalled \$8.00 million for the second quarter of 2010, a decrease of 11 percent from the \$8.96 million preceding quarter expense and an increase of 33 percent from \$5.99 million in the second quarter of 2009. The variations in royalty rates generally track changes in production volumes and prices. Commencing in 2009, the oil and natural gas royalty structure changed for Alberta production volumes (as disclosed in our 2009 Annual Financial Report). Reflecting the 2010 commodity prices and the modified royalty structure, on a consolidated basis, the second quarter of 2010 royalties resulted in a rate of 18.2 percent compared to 18.5 percent in

## Oil and Liquids Production (bbl/d)



## Natural Gas Production (mmcf/d)



the first quarter of 2010. For the remainder of the year, Zargon expects that its royalty rate should remain in the 17 to 20 percent range, but will ultimately depend on the actual price received for our production.

On a unit of production basis, production costs of \$12.91 per barrel of oil equivalent in the second quarter of 2010 compares with \$13.08 per barrel of oil equivalent in the preceding quarter and \$13.08 per barrel of oil equivalent in the second quarter of 2009. Despite the impact of acquiring higher cost oil-weighted properties in 2009, Zargon has been able to maintain stable production costs on a barrel of oil equivalent basis. With our continued emphasis on our oil exploitation business, small increases in operating costs are anticipated.

### Operating Netbacks

Three Months Ended June 30,	2010		2009	
	Oil and Liquids (\$/bbl)	Natural Gas (\$/mcf)	Oil and Liquids (\$/bbl)	Natural Gas (\$/mcf)
Production revenue	67.27	3.72	59.95	3.77
Realized risk management gain	2.71	–	14.56	0.43
Royalties	(13.14)	(0.48)	(11.94)	(0.30)
Production costs	(12.72)	(2.19)	(13.69)	(2.07)
Operating netbacks	44.12	1.05	48.88	1.83

Six Months Ended June 30,	2010		2009	
	Oil and Liquids (\$/bbl)	Natural Gas (\$/mcf)	Oil and Liquids (\$/bbl)	Natural Gas (\$/mcf)
Production revenue	70.38	4.26	51.71	4.73
Realized risk management gain	2.56	–	14.65	0.53
Royalties	(13.95)	(0.56)	(10.15)	(0.58)
Production costs	(13.05)	(2.15)	(14.64)	(2.00)
Operating netbacks	45.94	1.55	41.57	2.68

Measured on a unit of production basis (net of recoveries), general and administrative expenses were \$4.74 per barrel of oil equivalent in the second quarter of 2010 compared to \$4.29 in the second quarter of 2009 and \$3.83 for the twelve month period of 2009. The increase is primarily due to one-time employee related costs of \$1.16 per barrel of oil equivalent in the second quarter.

Expensing of unit-based compensation in the second quarter of 2010 was \$0.37 million, a \$0.08 million increase from the second quarter of 2009 and a two percent decrease from the prior quarter. When compared to the same prior year quarter the increase in unit-based compensation expense is a result of an increased valuation of these grants.

Zargon's borrowings are through its syndicated bank credit facilities. Interest and financing charges on these facilities in the 2010 second quarter were \$1.17 million, \$0.10 million higher than the previous quarter amount of \$1.07 million and an increase of \$0.68 million from \$0.49 million in the second quarter of 2009. This year-over-year increase is primarily due to an increase in average borrowing levels. Zargon's current available syndicated committed credit facilities and borrowing base are \$180 million, with approximately 36 percent unutilized at June 30, 2010.

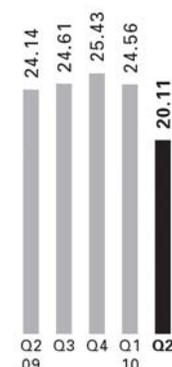
On June 29, 2010, Zargon amended and renewed its syndicated committed credit facilities of \$180 million. The next renewal date is June 28, 2011. These facilities continue to be available for general corporate purposes and the potential acquisition of oil and natural gas properties. Interest rates fluctuate under the syndicated facilities with Canadian prime, US prime and US base rates plus an applicable margin between 100 basis points and 250 basis points, as well as with Canadian banker's acceptance and LIBOR rates plus an applicable margin between 250 basis points and 400 basis points.

Current income taxes for the 2010 second quarter were \$0.82 million, and related primarily to the United States operations. When compared to prior periods, current income taxes increased \$0.39 million from the 2009 second quarter and increased \$0.07 million relative to the first quarter of 2010. Assuming relatively stable oil prices, similar United States current income tax levels are predicted for the remaining quarters of 2010. Total corporate tax pools as at June 30, 2010, are approximately \$334 million, which represents an increase of 14 percent from the comparable \$293 million of tax pools available to Zargon at December 31, 2009, primarily as a result of the 2010 first half field capital program (\$31.43 million) and net property acquisition (\$21.37 million) expenditures.

### Trust Netbacks

(\$/boe)	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Petroleum and natural gas revenue	<b>47.99</b>	41.37	<b>50.73</b>	40.00
Realized risk management gain	<b>1.55</b>	8.60	<b>1.43</b>	8.89
Royalties	<b>(8.74)</b>	(6.92)	<b>(9.32)</b>	(6.83)
Production costs	<b>(12.91)</b>	(13.08)	<b>(13.00)</b>	(13.32)
Operating netbacks	<b>27.89</b>	29.97	<b>29.84</b>	28.74
General and administrative	<b>(4.74)</b>	(4.29)	<b>(4.35)</b>	(4.18)
Interest and financing charges	<b>(1.28)</b>	(0.57)	<b>(1.23)</b>	(0.66)
Asset retirement expenditures	<b>(0.87)</b>	(0.47)	<b>(1.09)</b>	(0.51)
Current income taxes	<b>(0.89)</b>	(0.50)	<b>(0.86)</b>	(0.53)
<b>Funds flow netbacks</b>	<b>20.11</b>	24.14	<b>22.31</b>	22.86

Funds Flow  
Netbacks  
(\$/boe)



Depletion and depreciation expense for the second quarter of 2010 increased two percent to \$16.76 million compared to \$16.40 million in the prior quarter and increased seven percent when compared to the second quarter of 2009 expense of \$15.68 million. On a per barrel of oil equivalent basis, the depletion and depreciation rates were \$18.09, \$18.11 and \$18.33 for the second quarter of 2009 and the first and second quarters of 2010, respectively. The 2009 calendar year depletion and depreciation rate was \$17.99 per barrel of oil equivalent. The increase in the current quarter depreciation expense is primarily due to the quarter's significant property acquisition.

The provision for accretion of asset retirement obligations for the first half of 2010 was \$1.66 million, a 31 percent increase compared to the first half of 2009. The year-over-year increase is due to changes in the estimated future liability for asset retirement obligations as a result of net wells added through Zargon's drilling program and corporate/property acquisition programs.

The recovery of future taxes for the second quarter of 2010 was \$1.58 million compared to a recovery of \$3.23 million in the prior quarter and a recovery of \$6.11 million in the second quarter of 2009. The 2010 second quarter decrease in the future tax recovery, when compared to the 2010 first quarter recovery, is primarily related to an increase in net earnings as a result of the increase in unrealized risk management gains in the quarter.

On October 31, 2006, the Federal Government announced tax proposals pertaining to taxation of distributions paid by trusts and the personal tax treatment of trust distributions. Currently, the Trust does

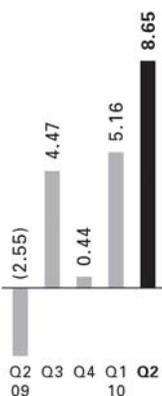
**Funds Flow from Operating Activities**  
(\$ millions)



**Funds Flow Per Unit**  
(\$/unit – diluted)



**Net Earnings/ (Losses)**  
(\$ millions)



not pay tax on distributions as tax is paid by the unitholders. On June 12, 2007, the Federal Government enacted these tax proposals, which would have resulted in taxation of distributions at the Trust level at a rate of 31.5 percent effective January 1, 2011. Subsequent 2007 fourth quarter legislation lowered this tax rate to 29.5 percent in 2011 and 28.0 percent beyond 2011. Prior to June 2007, the Trust estimated the future income tax on certain temporary differences between amounts recorded on its balance sheet for book and tax purposes to have a nil effective tax rate. On February 26, 2008, the Federal Government, in its Federal Budget, announced further changes to the specified investment flow through (“SIFT”) tax rules. The provincial component of the SIFT tax will be based on the provincial rates where the SIFT has a permanent establishment rather than using a 13.0 percent flat rate. During the 2009 first quarter this tax rate change had been substantively enacted, and the future income tax impact has been recorded in the financial statements. Under the legislation, the Trust now estimates the effective tax rate on the post 2010 reversal of these temporary differences to be approximately 26.5 percent for 2011 and 25.0 percent thereafter. Until 2011, Zargon’s future tax obligations are reduced as distributions are made from the Trust and, consequently, it is anticipated that Zargon’s effective tax rate will continue to be low until that time.

On December 15, 2006, the Canadian Federal Department of Finance stated its intention to allow conversions of SIFT income trusts to a corporation without any adverse tax consequences to investors. On July 14, 2008, the Department of Finance released the draft legislative proposals to allow the conversion of these SIFT trusts into corporations. Zargon has reviewed and assessed this legislation and plans to convert from its trust structure to a corporation at the end of 2010. Zargon’s management continues to believe that a partial cash flow distributing model is an effective model for our relatively mature sedimentary basins, and as such, plans to distribute regular dividends under the corporate structure.

On January 1, 2010, the Trust adopted new CICA Handbook Section 1602 “Non Controlling Interests.” The related EIC-151 “Exchangeable Securities Issued by Subsidiaries of Income Trusts” was updated to reflect the changes in the new Handbook Section. According to EIC-151, the Trust must reflect the exchangeable securities issued by its subsidiary (Zargon Oil & Gas Ltd.) as a non-controlling interest. The January 1, 2010 updates to EIC-151 have only impacted the Trust’s balance sheet classification, and as such, non-controlling interests are now reflected as a component of unitholders’ equity. Accordingly, the Trust has reflected a non-controlling interest of \$26.49 million on the Trust’s consolidated balance sheet as at June 30, 2010. Consolidated net earnings have been reduced for net earnings attributable to the non-controlling interest of \$1.08 million in the second quarter of 2010. In accordance with EIC-151 and given the circumstances in Zargon’s case, each exchangeable share redemption is accounted for as a step-purchase, which in the second quarter of 2010 resulted in an increase in property and equipment of \$0.01 million, an increase in unitholders’ equity and non-controlling interest of \$1.09 million and a nominal increase in future income tax liability. Funds flow was not impacted by this change. The cumulative impact to date of the application of EIC-151 has been to increase property and equipment by \$57.65 million, unitholders’ equity and non-controlling interest by \$69.76 million, future income tax liability by \$18.86 million and an allocation of net earnings to exchangeable shareholders of \$30.97 million.

Funds flow from operating activities in the 2010 second quarter of \$18.38 million was \$3.86 million, or 17 percent lower than the preceding quarter and \$2.54 million or 12 percent lower than the prior year second quarter. The decrease in funds flow from the preceding quarter was primarily due to decreased revenue as a result of lower commodity prices. Compared to the prior year second quarter, a six percent increase in production volumes and an increase in commodity prices of 16 percent was offset by increased production costs, interest and financing charges, general and administrative costs, asset retirement expenditures and decreased realized risk management gains. Funds flow on a per diluted trust unit basis was \$0.70 for the second quarter of 2010, an 18 percent decrease from the prior quarter and a 23 percent decrease from the 2009 second quarter.

Net earnings of \$8.65 million for the 2010 second quarter were \$3.49 million above the \$5.16 million of net earnings in the preceding quarter and \$11.20 million above the net loss of \$2.55 million in the second quarter of 2009. 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 risk management gains/losses, future income taxes/recoveries and non-controlling interest.

### Capital Expenditures

(\$ millions)	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Undeveloped land	2.22	1.13	3.44	2.53
Geological and geophysical (seismic)	1.75	0.87	2.72	1.59
Drilling and completion of wells	7.14	3.77	15.29	9.99
Well equipment and facilities	5.25	2.79	9.98	7.23
Exploration and development	16.36	8.56	31.43	21.34
Property acquisitions <sup>(1)</sup>	24.86	0.14	29.42	0.70
Property dispositions	(7.05)	–	(8.05)	–
Net property acquisitions/(dispositions) <sup>(1)</sup>	17.81	0.14	21.37	0.70
Corporate acquisitions assigned to property and equipment <sup>(2)</sup>	–	40.03	–	40.03
Total net capital expenditures excluding administrative assets <sup>(1) (2)</sup>	34.17	48.73	52.80	62.07
Administrative assets	0.09	0.23	0.20	0.33
Total net capital expenditures <sup>(1) (2)</sup>	34.26	48.96	53.00	62.40

(1) Amounts include capital expenditures acquired for cash and equity issuances.

(2) Amounts include capital expenditures acquired for cash, equity issuances, acquisition costs and net debt assumed on corporate acquisitions.

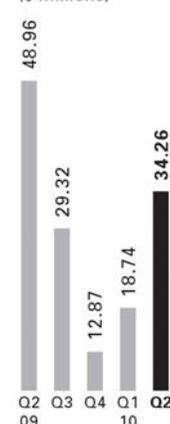
### LIQUIDITY AND CAPITAL RESOURCES

Total net capital expenditures (including net property acquisitions and consideration and net debt assumed for corporate acquisitions) of \$53.00 million in the first half of 2010 were 15 percent lower than the first half of 2009. Field expenditures of \$31.43 million for the 2010 first half reflected an increased development field program when compared to \$21.34 million for the first half of 2009. Drilling and completion expenses of \$15.29 million were 53 percent higher than the prior year's first half amount of \$9.99 million. During the first half of 2010, 19.1 net wells were drilled compared to 10.4 net wells in the first half of 2009. Field capital expenditures (excluding net property acquisitions) for the first half of 2010 were allocated to Alberta Plains – \$12.37 million, West Central Alberta – \$5.99 million and Williston Basin – \$13.07 million. During the first half, Zargon incurred \$21.37 million of net property acquisitions arising from the acquisition of \$29.42 million of properties, less approximately \$8.05 million of miscellaneous property dispositions. In particular, during the 2010 second quarter, Zargon acquired working interests in various southern Alberta medium and heavy gravity oil pools with approximately 6.9 thousand net acres of undeveloped land for a cash purchase of approximately \$25 million.

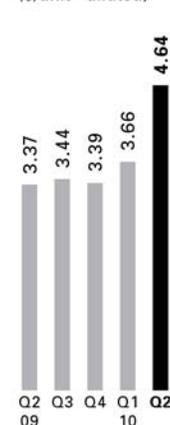
Funds flow from operating activities in the 2010 first half of \$40.62 million, proceeds from the issuance of trust units of \$1.88 million (due to unit right exercises) and the increase in bank debt of \$37.54 million funded the capital program including net property acquisitions, the changes in working capital and the cash distributions to the unitholders.

At June 30, 2010, the Trust continues to maintain a relatively strong balance sheet with a combined debt net of working capital (excluding unrealized risk management assets and liabilities and future income taxes) of \$121.67 million, compared to \$95.37 million at the end of the 2010 first quarter, which represents approximately 68 percent of the Trust's available credit facilities at June 30, 2010.

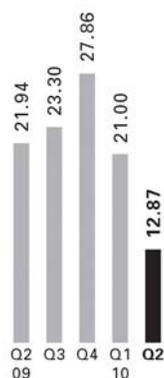
Net Capital Expenditures (\$ millions)



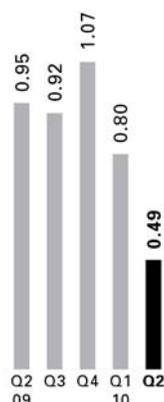
Net Debt Per Unit (\$/unit – diluted)



**Cash Flows from Operating Activities**  
(\$ millions)



**Cash Flows Per Unit**  
(\$/unit – diluted)



The volatility of oil and natural gas prices, uncertainty or modifications regarding Alberta royalties and Canadian income trust tax rules and global economic concerns have, on occasion, restricted the oil and natural gas industry's ability to attract new capital from debt and equity markets. Zargon's historically conservative strategy of maintaining a relatively low cash distribution to funds flow ratio and conservative debt levels should enable Zargon to continue its capital and distribution programs during periods of limited access to debt and equity capital.

**Cash Distributions Analysis**

(\$ millions)	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Cash flows from operating activities	<b>12.87</b>	21.94	<b>33.87</b>	37.67
Net earnings/(losses)	<b>8.65</b>	(2.55)	<b>13.81</b>	(2.19)
Actual cash distributions paid or payable relating to the period <sup>(1)</sup>	<b>(11.88)</b>	(11.26)	<b>(24.43)</b>	(21.30)
Excess of cash flows from operating activities over cash distributions paid	<b>0.99</b>	10.68	<b>9.44</b>	16.37
Excess (shortfall) of net earnings over cash distributions paid	<b>(3.23)</b>	(13.81)	<b>(10.62)</b>	(23.49)

(1) Cash distributions represent the cash portion only and do not include trust units issued through Zargon's Distribution Reinvestment Plan which commenced in April 2010.

During the first half of 2010, Zargon has maintained a base monthly distribution of \$0.18 per trust unit, a level which has been maintained since November 2005. Management monitors the Trust's distribution policy with respect to forecasted net cash flows, debt levels and capital expenditures. Zargon's cash distributions are discretionary to the extent that these distributions do not cause a breach of the financial covenants under Zargon's credit facilities and to the extent the Trust (non-consolidated) is not taxable. As a crude oil and natural gas Trust, Zargon's reserve base is depleted with production and Zargon, therefore, relies on ongoing exploration, development and acquisition activities to replace reserves and to offset production declines. The success of these exploration, development and acquisition capital programs, along with commodity price fluctuations and the Trust's ability to manage costs, are the main factors influencing the sustainability of the Trust's distributions.

For the three and six months ended June 30, 2010, cash flows from operating activities (after changes in non-cash working capital) of \$12.87 million and \$33.87 million, respectively, exceeded cash distributions of \$11.88 million and \$24.43 million, respectively. Similarly, for the three and six months ended June 30, 2009, cash flows from operating activities (after changes in non-cash working capital) of \$21.94 million and \$37.67 million, respectively, exceeded cash distributions of \$11.26 million and \$21.30 million, respectively.

For the three and six months ended June 30, 2010, cash distributions of \$11.88 million and \$24.43 million, respectively, exceeded net earnings of \$8.65 million and \$13.81 million, respectively. Net earnings include significant non-cash charges, which were \$10.52 million for the 2010 second quarter and \$28.79 million for the six months ended June 30, 2010, that do not impact cash flow. For the three and six months ended June 30, 2009, cash distributions of \$11.26 million and \$21.30 million, respectively, exceeded net losses of \$2.55 million and \$2.19 million, respectively. Net earnings also include fluctuations in future income taxes due to changes in tax rates and tax rules. In the instances where distributions exceed net earnings, a portion of the cash distribution paid to unitholders may represent an economic return of the unitholders' capital.

For the quarter ended June 30, 2010, cash distributions and net capital expenditures totalled \$46.14 million, which was \$33.27 million higher than the cash flows from operating activities (after changes in non-cash working capital) of \$12.87 million. For the quarter ended June 30, 2009, cash distributions and net capital expenditures totalled \$60.22 million (including the \$40.03 million attributed

to the Masters Energy Inc. corporate acquisition), which was \$38.28 million higher than the cash flows from operating activities (after changes in non-cash working capital) of \$21.94 million. Zargon relies on access to debt and capital markets to the extent that cash distributions 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 distributions/dividends and capital expenditures with its cash flows from operating activities; however, it will 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 11, 2010, Zargon Energy Trust had 23.404 million trust units and 1.693 million exchangeable shares outstanding. Assuming full conversion of exchangeable shares at the effective August 11, 2010 exchange ratio of 1.74620, there would be 26.360 million trust units outstanding. Pursuant to the trust unit rights incentive plans, there are currently an additional 1.698 million trust unit incentive rights issued and outstanding.

### Capital Sources and Uses

(\$ millions)	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Funds flow from operating activities	<b>18.38</b>	20.92	<b>40.62</b>	38.77
Change in bank debt	<b>29.89</b>	(15.35)	<b>37.54</b>	(7.15)
Issuance of trust units	<b>0.09</b>	54.53	<b>1.88</b>	55.75
Cash distributions to unitholders <sup>(1)</sup>	<b>(11.88)</b>	(11.26)	<b>(24.43)</b>	(21.30)
Changes in working capital and other	<b>(2.22)</b>	0.12	<b>(2.61)</b>	(3.67)
<b>Total capital sources</b>	<b>34.26</b>	48.96	<b>53.00</b>	62.40

(1) Cash distributions represent the cash portion only and do not include trust units issued through Zargon's Distribution Reinvestment Plan which commenced in April 2010.

### CHANGES IN CANADIAN ACCOUNTING POLICIES

On January 1, 2010, Zargon adopted the following three Canadian Institute of Chartered Accountants ("CICA") Handbook sections:

CICA Handbook Section 1582 "Business Combinations," which replaces Section 1581 of the same name. Under this new guidance, the purchase price used in a business combination is based on the fair value of shares exchanged at the date of exchange and contingent liabilities are to be recognized at fair value at the acquisition date and re-measured at fair value with changes recorded through earnings each period until settled. In addition, this new guidance generally requires all transaction costs to be expensed and negative goodwill is required to be recognized immediately in earnings. The adoption of this Section did not have an impact on the Trust's consolidated financial statements.

CICA issued Section 1601 "Consolidated Financial Statements," which replaces Section 1600 of the same name. This guidance requires uniform accounting policies to be consistent throughout all consolidated entities and the difference between reporting dates of a parent and a subsidiary to be no longer than three months. The adoption of this Section did not have an impact on the Trust's consolidated financial statements.

CICA issued Section 1602 "Non-Controlling Interests," which replaces Section 1600, "Consolidated Financial Statements." Non-controlling interest ("NCI") is now presented within equity. Under this new guidance, when there is a loss or gain of control, the Trust's previously held interest is re-valued at fair

value. In addition, NCI may be reported at fair value or at the proportionate share of the fair value of the acquired net assets and allocation of the net income to the NCI will be on this basis. The adoption of this Section has reclassified the NCI from liabilities to equity on the Trust's consolidated balance sheet on a retrospective basis.

The above CICA Handbook Sections are converged with International Financial Reporting Standards.

## INTERNATIONAL FINANCIAL REPORTING STANDARDS

In January 2006, the CICA Accounting Standards Board ("AcSB") adopted a strategic plan for the direction of accounting standards in Canada. As part of that plan, the AcSB confirmed in February 2008 that International Financial Reporting Standards ("IFRS") will replace Canadian GAAP in 2011 for profit-oriented Canadian publicly accountable enterprises. The adoption date of January 1, 2011 will require the restatement, for comparative purposes, of amounts reported by Zargon for the year ended December 31, 2010, including the opening balance sheet as at January 1, 2010.

Zargon's IFRS project consists of three key phases:

- Scoping and diagnostic phase – this phase involves performing a high level impact analysis to identify areas that may be affected by the transition to IFRS.
- Impact analysis and evaluation phase – this phase involves analysis of policy choices allowed under IFRS and their impact on the financial statements.
- Implementation phase – involves implementation of all changes approved in the impact analysis phase and will include changes to information systems, business processes, modification of agreements (if applicable) and training of all staff who are impacted by the conversion.

Zargon has completed the scoping and diagnostic phase and has prepared draft analysis for the impact analysis and evaluation phase. Management has not yet finalized its accounting policies and as such is unable to quantify the impact of adopting IFRS on the consolidated financial statements.

IFRS 1 "First-Time Adoption of International Financial Reporting Standards" ("IFRS 1"), provides entities adopting IFRS for the first time with a number of optional exemptions and mandatory exceptions in certain areas to the general requirement for full retrospective application of IFRS. We are currently preparing our preliminary IFRS opening balance sheet and we anticipate utilizing the following IFRS 1 exemptions:

- Property, Plant and Equipment ("PP&E") – IFRS 1 provides the option to value the PP&E assets at their deemed cost being the Canadian GAAP net book value assigned to these assets as at the date of transition, January 1, 2010. This amendment is permissible for entities that currently follow the full cost accounting guideline under Canadian GAAP. Under this current policy, Zargon accumulates all oil and gas assets into separate cost centres for Canada and the United States. Under IFRS, Zargon's PP&E assets must be divided into smaller cost centres. The net book value of the assets on the date of transition will be allocated to the new cost centres on the basis of Zargon's reserve volumes or values at that point in time.
- Business Combinations – IFRS 1 allows Zargon to use the IFRS rules for business combinations on a prospective basis rather than re-stating all business combinations. The IFRS business combination rules converge with the new CICA Handbook Section 1582 that is also effective for Zargon on January 1, 2011, which Zargon early adopted on January 1, 2010 as discussed earlier in this report.

The transition from Canadian GAAP to IFRS is a significant undertaking that may materially affect our reported financial position and results of operations. At this time, Zargon has identified key differences that will impact the financial statements as follows:

- Re-classification of Exploration and Evaluation (“E&E”) expenditures from PP&E – Upon transition to IFRS, Zargon will re-classify all E&E expenditures that are currently included in the PP&E balance on the consolidated balance sheets. This will consist of the book value for Zargon’s undeveloped land that relates to exploration areas. It is not anticipated that E&E assets will be depleted and the assets must be assessed for impairment when indicators of impairment exist.

- Calculation of depletion expense for PP&E assets – Upon transition to IFRS, Zargon has the option to calculate depletion using a reserve base of proved reserves, which is comparable to the Canadian GAAP method of calculation depletion, or using a reserve base of proved and probable reserves. Zargon has not concluded at this time which reserve base for calculating depletion will be used. Also, depletion must be calculated at a more granular level than what is currently required under Canadian GAAP.

- Impairment of PP&E assets – Under IFRS, impairment of PP&E must be calculated at a more granular level than what is currently required under Canadian GAAP. Impairment calculations will be performed at the cash generating unit (“CGU”) level using either total proved or proved plus probable reserves. The most significant difference is that the Canadian GAAP “ceiling test” incorporates a 2-step approach for testing impairment, while IFRS uses a 1-step approach. Under Canadian GAAP, a discounted cash flow analysis is not required if the undiscounted cash flows from proved reserves exceed its carrying amount (step1). If the carrying amount exceeds the undiscounted future cash flows, then a prescribed discounted cash flow test is performed (step 2). Under IFRS, impairment testing based on discounted cash flows or fair value determinations is required and is performed at the CGU level.

- Provisions – In January 2010, an exposure draft on IAS 37 “Provisions, Contingent Liabilities and Contingent Assets” was issued. A final standard for ARO and other provisions is expected to be released in the second half of 2010. Under current IFRS standards, it is unclear if the discount rate used would be based on a credit adjusted rate, as it currently is under Canadian GAAP, or based on a risk free rate. As such, discount rates are currently under review by management, as there is diversity in practice when selecting a rate. Future changes to the rates could lead to a material change in this provision upon adoption of IFRS.

- Income tax – In November 2009 the IASB withdrew an exposure draft on Income Taxes. Current IFRS income tax requirements are fundamentally consistent with Canadian GAAP. Any changes to Income Tax reporting are expected to be predominantly caused by changes in the book value of assets and changes in tax rates applied, not due to the change in Income Tax accounting methodology.

- Share-based payments – Under IFRS, share-based payments for equity awards are expensed based on a graded vesting schedule compared to the straight-line method under Canadian GAAP.

In addition to accounting policy differences, Zargon’s transition to IFRS will impact the internal controls over financial reporting (“ICFR”) and information technology systems as follows:

- ICFR – As the review of Zargon’s accounting policies is completed, an assessment will be made to determine changes required for ICFR. As an example, additional controls will be implemented for the IFRS 1 changes such as the allocation of Zargon’s PP&E as well as the process for reclassifying Zargon’s E&E expenditures from PP&E. This will be an ongoing process throughout 2010 to ensure that all changes in accounting policies include the appropriate additional controls and procedures for future IFRS reporting requirements.

- Information technology systems – Zargon commenced upgrading systems during the first quarter of 2010 in preparation for IFRS reporting. These modifications are deemed critical in order to allow for reporting of both Canadian GAAP and IFRS financial statements in 2010. Additional system modifications may be required based on final policy choices.

## 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 2010 certificate requires that the Trust disclose in the interim MD&A any changes in the Trust's internal controls over financial reporting that occurred during the period that have materially affected, or are reasonably likely to materially affect the Trust's internal control over financial reporting. The Trust confirms that no such changes were made to the internal controls over financial reporting during the second quarter of 2010.

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

With a relatively strong balance sheet, 521 thousand net acres of undeveloped land, a promising internally generated oil exploitation project inventory and its ability to execute accretive asset and/or corporate acquisitions, Zargon continues to be well positioned to meet its value-creating objectives in 2010 and beyond.

## SUMMARY OF QUARTERLY RESULTS

	2010	
	Q1	Q2
Petroleum and natural gas revenue (\$ millions)	48.46	<b>43.89</b>
Net earnings/(losses) (\$ millions)	5.16	<b>8.65</b>
Net earnings/(losses) per diluted unit (\$)	0.22	<b>0.37</b>
Funds flow from operating activities (\$ millions)	22.24	<b>18.38</b>
Funds flow from operating activities per diluted unit (\$)	0.85	<b>0.70</b>
Cash flows from operating activities (\$ millions)	21.00	<b>12.87</b>
Cash flows from operating activities per diluted unit (\$)	0.80	<b>0.49</b>
Cash distributions (\$ millions) <sup>(1)</sup>	12.55	<b>11.88</b>
Cash distributions declared per trust unit (\$)	0.54	<b>0.54</b>
Net capital expenditures (\$ millions)	18.74	<b>34.26</b>
Total assets (\$ millions)	466.22	<b>484.45</b>
Bank debt (\$ millions)	84.23	<b>114.12</b>
Average daily production (boe)	10,062	<b>10,050</b>
Average realized commodity field price before the impact of financial risk management contracts (\$/boe)	53.51	<b>47.99</b>
Funds flow netback (\$/boe)	24.56	<b>20.11</b>

*(1) Cash distributions represent the cash portion only and do not include trust units issued through Zargon's Distribution Reinvestment Plan which commenced in April 2010.*

	2009			
	Q1	Q2	Q3	Q4
Petroleum and natural gas revenue (\$ millions)	31.98	35.84	40.96	47.21
Net earnings/(losses) (\$ millions)	0.37	(2.55)	4.47	0.44
Net earnings/(losses) per diluted unit (\$)	0.02	(0.13)	0.20	0.02
Funds flow from operating activities (\$ millions)	17.85	20.92	22.84	24.75
Funds flow from operating activities per diluted unit (\$)	0.84	0.91	0.90	0.95
Cash flows from operating activities (\$ millions)	15.73	21.94	23.30	27.86
Cash flows from operating activities per diluted unit (\$)	0.74	0.95	0.92	1.07
Cash distributions (\$ millions)	10.03	11.26	12.22	12.45
Cash distributions declared per trust unit (\$)	0.54	0.54	0.54	0.54
Net capital expenditures (\$ millions) <sup>(1) (2)</sup>	13.44	48.96	29.32	12.87
Total assets (\$ millions)	440.76	466.60	473.47	464.38
Bank debt (\$ millions)	85.78	70.43	77.05	76.58
Average daily production (boe)	9,213	9,520	10,088	10,586
Average realized commodity field price before the impact of financial risk management contracts (\$/boe)	38.57	41.37	44.13	48.48
Funds flow netback (\$/boe)	21.53	24.14	24.61	25.43

(1) Second quarter 2009 expenditures include corporate acquisition amounts as follows; cash consideration of \$5.70 million, transaction costs of \$0.36 million, net debt assumed of \$12.93 million and the equity issuance of trust units valued at \$21.04 million.

(2) Third quarter 2009 expenditures include corporate acquisition amounts as follows; cash consideration of \$0.11 million, transaction costs of \$0.27 million, net debt assumed of \$6.58 million and the equity issuance of trust units valued at \$9.36 million.

	2008			
	Q1	Q2	Q3	Q4
Petroleum and natural gas revenue (\$ millions)	52.24	69.66	66.35	41.25
Net earnings/(losses) (\$ millions)	4.56	(4.51)	40.05	28.19
Net earnings/(losses) per diluted unit (\$)	0.26	(0.25)	2.20	1.53
Funds flow from operating activities (\$ millions)	24.75	32.02	29.75	20.40
Funds flow from operating activities per diluted unit (\$)	1.23	1.55	1.42	0.97
Cash flows from operating activities (\$ millions)	15.27	36.44	33.58	24.84
Cash flows from operating activities per diluted unit (\$)	0.76	1.76	1.60	1.18
Cash distributions (\$ millions)	9.55	9.71	9.87	9.96
Cash distributions declared per trust unit (\$)	0.54	0.54	0.54	0.54
Net capital expenditures (\$ millions) <sup>(1) (2) (3)</sup>	59.61	26.28	17.47	16.37
Total assets (\$ millions)	396.90	418.88	426.63	447.60
Bank debt (\$ millions)	92.18	85.45	74.95	77.58
Average daily production (boe)	9,015	9,239	9,340	9,410
Average realized commodity field price before the impact of financial risk management contracts (\$/boe)	63.68	82.85	77.22	47.65
Funds flow netback (\$/boe)	30.17	38.08	34.62	23.56

(1) First quarter 2008 expenditures include corporate acquisition amounts as follows; cash consideration of \$16.40 million, transaction costs of \$0.29 million, net debt assumed of \$17.77 million and the equity issuance of trust units valued at \$13.37 million.

- (2) *Second quarter 2008 net capital expenditures include corporate acquisition amounts as follows; transaction costs of \$0.15 million, net debt assumed of \$2.49 million and the equity issuance of trust units valued at \$9.39 million.*
- (3) *Third quarter 2008 net capital expenditures include property acquisition amounts as follows; the equity issuance of trust units valued at \$1.14 million.*

## **ADDITIONAL INFORMATION**

Additional information regarding the Trust and its business operations, including the Trust's Annual Information Form for December 31, 2009, is available on the Trust's SEDAR profile at [www.sedar.com](http://www.sedar.com).

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

Calgary, Alberta  
August 11, 2010

## CONSOLIDATED BALANCE SHEETS

(unaudited)

(\$ thousands)	June 30, 2010	December 31, 2009
<b>ASSETS</b> [note 5]		
<b>Current</b>		
Accounts receivable	22,599	25,223
Prepaid expenses and deposits	3,008	2,013
Unrealized risk management asset [note 11]	1,456	4,289
Future income taxes	423	1,714
	<b>27,486</b>	<b>33,239</b>
<b>Long term deposit</b>		
Unrealized risk management asset [note 11]	861	–
<b>Goodwill</b>		
Property and equipment, net [notes 3 and 4]	2,969	2,969
Future income taxes	452,465	425,964
	25	361
	<b>484,448</b>	<b>464,378</b>
<b>LIABILITIES</b>		
<b>Current</b>		
Accounts payable and accrued liabilities	29,204	34,507
Cash distributions payable [note 15]	3,955	4,157
Unrealized risk management liability [note 11]	1,573	6,032
Future income taxes	391	1,219
	<b>35,123</b>	<b>45,915</b>
<b>Long term debt</b> [note 5]		
Unrealized risk management liability [note 11]	114,118	76,580
Asset retirement obligations [note 6]	93	1,270
Future income taxes	40,292	35,468
	25,159	30,327
	<b>214,785</b>	<b>189,560</b>
<b>UNITHOLDERS' EQUITY</b>		
Unitholders' capital [note 7]	194,622	188,840
Non-controlling interest – exchangeable shares [note 8]	26,489	26,477
Contributed surplus [note 7]	5,881	5,471
Accumulated earnings	273,631	259,823
Accumulated cash distributions [note 15]	(230,960)	(205,793)
	<b>269,663</b>	<b>274,818</b>
	<b>484,448</b>	<b>464,378</b>

See accompanying notes to the consolidated financial statements.

# CONSOLIDATED STATEMENTS OF EARNINGS AND COMPREHENSIVE INCOME AND ACCUMULATED EARNINGS

(unaudited)	Three Months Ended June 30,		Six Months Ended June 30,	
(\$ thousands, except per unit amounts)	2010	2009	2010	2009
<b>REVENUE</b>				
Petroleum and natural gas revenue	43,886	35,838	92,342	67,818
Unrealized risk management gain/(loss) [note 11]	6,990	(13,654)	3,663	(19,825)
Realized risk management gain [note 11]	1,417	7,449	2,597	15,078
Royalties	(7,995)	(5,994)	(16,959)	(11,580)
	<b>44,298</b>	<b>23,639</b>	<b>81,643</b>	<b>51,491</b>
<b>EXPENSES</b>				
Production	11,808	11,333	23,656	22,578
General and administrative	4,337	3,714	7,914	7,090
Unit-based compensation [note 7]	365	282	736	425
Interest and financing charges [note 5]	1,173	491	2,243	1,111
Unrealized foreign exchange (gain)/loss	14	53	(12)	49
Accretion of asset retirement obligations [note 6]	874	670	1,655	1,262
Depletion and depreciation	16,763	15,675	33,162	30,393
	<b>35,334</b>	<b>32,218</b>	<b>69,354</b>	<b>62,908</b>
<b>EARNINGS/(LOSSES) BEFORE INCOME TAXES</b>	<b>8,964</b>	<b>(8,579)</b>	<b>12,289</b>	<b>(11,417)</b>
<b>INCOME TAXES</b>				
Current	817	430	1,565	899
Future tax recovery	(1,584)	(6,110)	(4,811)	(9,837)
	<b>(767)</b>	<b>(5,680)</b>	<b>(3,246)</b>	<b>(8,938)</b>
<b>CONSOLIDATED EARNINGS/(LOSSES)</b>	<b>9,731</b>	<b>(2,899)</b>	<b>15,535</b>	<b>(2,479)</b>
<b>LESS NET EARNINGS/(LOSSES) ATTRIBUTED TO NON-CONTROLLING INTEREST</b> [note 8]	<b>(1,078)</b>	<b>346</b>	<b>(1,727)</b>	<b>293</b>
<b>NET EARNINGS/(LOSSES) AND COMPREHENSIVE INCOME ATTRIBUTED TO ZARGON</b>	<b>8,653</b>	<b>(2,553)</b>	<b>13,808</b>	<b>(2,186)</b>
<b>ACCUMULATED EARNINGS, BEGINNING OF PERIOD</b>	<b>264,978</b>	<b>257,471</b>	<b>259,823</b>	<b>257,104</b>
<b>ACCUMULATED EARNINGS, END OF PERIOD</b>	<b>273,631</b>	<b>254,918</b>	<b>273,631</b>	<b>254,918</b>
<b>NET EARNINGS/(LOSSES) PER UNIT</b> [note 9]				
Basic	0.37	(0.13)	0.59	(0.11)
Diluted	0.37	(0.13)	0.59	(0.11)

See accompanying notes to the consolidated financial statements.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)	Three Months Ended June 30,		Six Months Ended June 30,	
(\$ thousands)	2010	2009	2010	2009
<b>OPERATING ACTIVITIES</b>				
Net earnings/(losses) for the period	8,653	(2,553)	13,808	(2,186)
Add (deduct) non-cash items:				
Non-controlling interest – exchangeable shares	1,078	(346)	1,727	(293)
Unrealized risk management (gain)/loss	(6,990)	13,654	(3,663)	19,825
Depletion and depreciation	16,763	15,675	33,162	30,393
Accretion of asset retirement obligations	874	670	1,655	1,262
Unit-based compensation	365	282	736	425
Unrealized foreign exchange (gain)/loss	14	53	(12)	49
Future income tax recovery	(1,584)	(6,110)	(4,811)	(9,837)
Asset retirement expenditures	(798)	(406)	(1,986)	(871)
	18,375	20,919	40,616	38,767
Changes in non-cash operating working capital [note 12]	(5,506)	1,019	(6,745)	(1,100)
	12,869	21,938	33,871	37,667
<b>FINANCING ACTIVITIES</b>				
Advances/(repayment) of bank debt	29,889	(15,347)	37,538	(7,150)
Cash distributions declared to unitholders	(11,882)	(11,264)	(24,433)	(21,296)
Exercise of unit rights	88	44	1,881	1,269
Issuance of unitholders capital, net of issue costs	–	33,444	–	33,444
Changes in non-cash financing working capital [note 12]	(1,079)	692	(203)	712
	17,016	7,569	14,783	6,979
<b>INVESTING ACTIVITIES</b>				
Additions to property and equipment	(41,316)	(8,936)	(61,053)	(22,379)
Proceeds on disposal of property and equipment	7,051	6	8,051	6
Corporate acquisitions (cash portion)	–	(18,882)	–	(18,882)
Long term deposit	1,203	(270)	1,203	(270)
Changes in non-cash investing working capital [note 12]	3,177	(1,425)	3,145	(3,121)
	(29,885)	(29,507)	(48,654)	(44,646)
<b>NET CHANGE IN CASH DURING THE PERIOD AND CASH, END OF PERIOD</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>

See accompanying notes to the consolidated financial statements.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the three and six months ended June 30, 2010 and 2009 (unaudited).*

## **1. BASIS OF PRESENTATION**

The interim unaudited consolidated financial statements of Zargon Energy Trust (the "Trust" or "Zargon") have been prepared by management in accordance with Canadian generally accepted accounting principles. The interim unaudited consolidated financial statements have been prepared following the same accounting policies and methods in computation as the consolidated financial statements for the fiscal year ended December 31, 2009, except as noted below. The disclosures provided below are incremental to those included with the annual audited consolidated financial statements. These interim unaudited consolidated financial statements do not include all disclosures required in the annual consolidated financial statements and should be read in conjunction with the consolidated financial statements and notes thereto in the Zargon Energy Trust annual financial report for the year ended December 31, 2009.

The Trust's principal business activity is the exploration for and development and production of petroleum and natural gas in Canada and the United States ("US").

## **2. CHANGES IN ACCOUNTING POLICIES**

On January 1, 2010, Zargon adopted the following three Canadian Institute of Chartered Accountants ("CICA") Handbook sections:

CICA Handbook Section 1582 "Business Combinations," which replaces Section 1581 of the same name. Under this new guidance, the purchase price used in a business combination is based on the fair value of shares exchanged at the date of exchange and contingent liabilities are to be recognized at fair value at the acquisition date and re-measured at fair value with changes recorded through earnings each period until settled. In addition, this new guidance generally requires all transaction costs to be expensed and negative goodwill is required to be recognized immediately in earnings. The adoption of this Section did not have an impact on the Trust's consolidated financial statements.

CICA issued Section 1601 "Consolidated Financial Statements," which replaces Section 1600 of the same name. This guidance requires uniform accounting policies to be consistent throughout all consolidated entities and the difference between reporting dates of a parent and a subsidiary to be no longer than three months. The adoption of this Section did not have an impact on the Trust's consolidated financial statements.

CICA issued Section 1602 "Non-Controlling Interests," which replaces Section 1600, "Consolidated Financial Statements." Non-controlling interest ("NCI") is now presented within equity. Under this new guidance, when there is a loss or gain of control, the Trust's previously held interest is re-valued at fair value. In addition, NCI may be reported at fair value or at the proportionate share of the fair value of the acquired net assets and allocation of the net income to the NCI will be on this basis. The adoption of this Section has reclassified the NCI from liabilities to equity on the Trust's consolidated balance sheet on a retrospective basis.

The above CICA Handbook Sections are converged with International Financial Reporting Standards.

## **3. ACQUISITIONS**

### **Churchill Energy Inc.**

On September 23, 2009, a subsidiary of the Trust acquired all of the outstanding shares of Churchill Energy Inc. ("Churchill"), a public oil and gas company, for consideration of \$9.74 million. Consideration consisted of \$0.11 million cash, the issuance of 554,669 Zargon trust units valued at \$16.87 per unit and acquisition costs of \$0.27 million.

The results of operations for Churchill have been included in the consolidated financial statements since September 23, 2009.

The acquisition was accounted for by the purchase method and the purchase price allocation is as follows:

**Net Assets Acquired**

(\$ thousands)

Property and equipment	9,794
Working capital deficiency	(6,576)
Future income tax asset	8,920
Asset retirement obligations	(2,403)
<b>Total net assets acquired</b>	<b>9,735</b>

**Consideration**

(\$ thousands)

Cash	108
Trust units issued	9,357
Acquisition costs	270
<b>Total purchase price</b>	<b>9,735</b>

**Masters Energy Inc.**

On April 29, 2009, a subsidiary of the Trust acquired all of the outstanding shares of Masters Energy Inc. ("Masters"), a public oil and gas company, for consideration of \$27.10 million. Consideration consisted of \$5.70 million cash, the issuance of 1,475,468 Zargon trust units valued at \$14.26 per unit and acquisition costs of \$0.36 million. Zargon assumed Masters' long term debt, which was repaid on the closing date of the acquisition.

The results of operations for Masters have been included in the consolidated financial statements since April 29, 2009.

The acquisition was accounted for by the purchase method and the purchase price allocation is as follows:

**Net Assets Acquired**

(\$ thousands)

Property and equipment	44,030
Working capital deficiency	(105)
Long term debt	(12,825)
Future income tax asset	69
Asset retirement obligations	(4,072)
<b>Total net assets acquired</b>	<b>27,097</b>

**Consideration**

(\$ thousands)

Cash	5,700
Trust units issued	21,040
Acquisition costs	357
<b>Total purchase price</b>	<b>27,097</b>

#### 4. PROPERTY AND EQUIPMENT

		June 30, 2010	
(\$ thousands)	Cost	Accumulated Depletion and Depreciation	Net Book Value
Petroleum, natural gas properties and other equipment <sup>(1)</sup>	834,920	382,455	452,465

		December 31, 2009	
(\$ thousands)	Cost	Accumulated Depletion and Depreciation	Net Book Value
Petroleum, natural gas properties and other equipment <sup>(1)</sup>	775,257	349,293	425,964

(1) As a result of shareholders redeeming exchangeable shares, property and equipment has cumulatively increased \$57.64 million, \$1.52 million relating to 2010, \$0.97 million relating to 2009 and \$55.15 million relating to prior years. The effect of these increases has resulted in additional depletion and depreciation expense of approximately \$29.47 million, \$2.25 million relating to 2010, \$4.91 million relating to 2009 and \$22.31 million relating to prior years.

#### 5. LONG TERM DEBT

On June 29, 2010, Zargon amended and renewed its syndicated committed credit facilities, the result of which was the maintaining of the available facilities and borrowing base of \$180 million. These facilities consist of a \$170 million tranche available to the Canadian borrower and a US \$8 million tranche available to the US borrower. A \$300 million demand debenture on the assets of the subsidiaries of the Trust 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 28, 2011. 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 100 basis points and 250 basis points as well as with Canadian banker's acceptance and LIBOR rates plus an applicable margin between 250 basis points and 400 basis points. At June 30, 2010, \$114.12 million (December 31, 2009 - \$76.58 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, 2010, the approximate value of outstanding letters of credit totalled \$0.61 million (December 31, 2009 - \$0.61 million). The letters of credit reduce the amount of Zargon's available credit facilities to \$65.27 million at June 30, 2010 (December 31, 2009 - \$102.81 million).

Zargon reviews its compliance with its bank debt covenants on a quarterly basis and has no violations as at June 30, 2010.

#### 6. ASSET RETIREMENT OBLIGATIONS

The following table reconciles Zargon's asset retirement obligations:

		Six Months Ended June 30,	
(\$ thousands)		2010	2009
Balance, beginning of period		35,468	28,592
Net liabilities incurred/acquired		5,144	3,955
Liabilities settled		(1,986)	(871)
Accretion expense		1,655	1,262
Foreign exchange		11	(57)
Balance, end of period		40,292	32,881

## 7. UNITHOLDERS' EQUITY

The Trust is authorized to issue an unlimited number of voting trust units.

### Trust Units

	Six Months Ended June 30, 2010	
(thousands)	Number of units	Amount (\$)
Balance, beginning of period	23,097	188,840
Unit rights exercised for cash	113	1,881
Unit-based compensation recognized on exercise of unit rights	–	337
Issued on conversion of exchangeable shares	144	2,830
Issued pursuant to Distribution Reinvestment Plan	41	734
Balance, end of period	23,395	194,622

The proforma total units outstanding at June 30, 2010, including trust units outstanding and trust units issuable upon conversion of exchangeable shares, after giving effect to the exchange ratio at the end of the period (see note 8) is 26.331 million units.

On April 9, 2010, the Trust implemented a Distribution Reinvestment Plan ("DRIP"). Under the DRIP, Canadian unitholders are entitled to reinvest monthly cash distributions in additional trust units of the Trust. At the discretion of the Trust, these additional units will be issued from Treasury at 95 percent of the "weighted average closing price." For the purposes of the units issued, the "weighted average closing price" is calculated as the weighted average trading price of trust units for the five trading days prior to the distribution payment date.

The following table summarizes information about the Trust's contributed surplus account:

### Contributed Surplus

(\$ thousands)	Six Months Ended June 30, 2010
Balance, beginning of period	5,471
Unit-based compensation expense <sup>(1)</sup>	747
Unit-based compensation recognized on exercise of unit rights	(337)
Balance, end of period	5,881

*(1) The Trust issued 10,000 unit appreciation rights ("UARS") with an intrinsic value increase/ (decrease) of (\$0.01) million at June 30, 2010 (\$0.02 million at December 31, 2009). These UARS are awards entitling the recipients to receive cash in an amount equivalent to any excess of the market value of a stated number of units over a stated price. UARS are included in unit-based compensation expense; however rewards settled in cash are liabilities and therefore are not included in contributed surplus.*

### Trust Unit Rights Incentive Plan and Unit-Based Compensation

The Trust has a unit rights incentive plan (the "Old Plan") that allows the Trust to issue rights to acquire trust units to directors, officers, employees and other service providers. On April 22, 2009, a new unit rights incentive plan (the "New Plan") was approved by the unitholders. The Trust is authorized to issue up to an aggregate of 2.13 million unit rights; however, the number of trust units reserved for issuance upon exercise of the rights shall not at any time exceed 10 percent of the aggregate number of the total outstanding units, including units issuable upon exchange of exchangeable shares of Zargon and other fully paid securities of Zargon entities exchangeable into units, which are the economic equivalent of units including full voting rights. At the time of grant, unit right exercise prices approximate the market price for the trust units. At the time of exercise, the rights holder has the option of exercising at the original grant price or the exercise price as calculated under the Old Plan or the New Plan (the "modified price"). Under the Old Plan, the modified price was based on the increment of the amount the monthly distribution exceeded a monthly return of 0.833 percent of the Trust's recorded net book value of oil and natural gas properties (as defined in the Old Plan). Under the New Plan, if the monthly distribution exceeds the monthly return of 0.833 percent of the Trust's recorded net book value of oil and natural gas properties (as defined in the New Plan), the entire amount (not the increment) of the distribution is deducted from the original grant price. Rights granted under either Plan generally vest over a three-year period and expire approximately five years from the grant date. Zargon uses a fair value methodology to value the unit rights grants.

The weighted average assumptions made for unit rights granted for the six months ended June 30, 2010 include a volatility factor of expected market price of 33.28 percent, a risk-free rate of 2.26 percent and an expected life of the unit rights of four years. The fair value of the unit rights granted in the quarter was calculated at \$5.41 per unit right. Unit-based compensation expense for the three and six months ended June 30, 2010 were \$0.37 million (2009 – \$0.28 million) and \$0.74 million (2009 – \$0.44 million), respectively.

Compensation expense associated with unit rights granted under either Plan is recognized in earnings over the vesting period of the Plan with a corresponding increase in contributed surplus. The exercise of trust unit rights is recorded as an increase in trust units with a corresponding reduction in contributed surplus. Forfeiture of rights are recorded as a reduction in expenses in the period in which they occur if the rights have not yet vested.

The following table summarizes information about the Trust's unit rights under the Old Plan:

	<b>Six Months Ended June 30, 2010</b>	
	<b>Number of Unit Rights (thousands)</b>	<b>Weighted Average Exercise Price Initial and Modified (\$/unit right)</b>
Outstanding at beginning of period	1,322	25.97 / 23.52
Unit rights granted	–	–
Unit rights exercised	(91)	17.21
Unit rights forfeited	(333)	27.93
Outstanding at end of period	898	25.67 / 23.42
Unit rights exercisable at period end	798	26.03 / 23.68

The following table summarizes information about the Trust's unit rights under the New Plan:

	<b>Six Months Ended June 30, 2010</b>	
	<b>Number of Unit Rights (thousands)</b>	<b>Weighted Average Exercise Price Initial and Modified (\$/unit right)</b>
Outstanding at beginning of period	421	15.81 / 14.58
Unit rights granted	449	19.82
Unit rights exercised	(22)	14.29
Unit rights forfeited	(65)	17.62
Outstanding at end of period	783	17.97 / 16.57
Unit rights exercisable at period end	127	15.85 / 13.56

#### **8. NON-CONTROLLING INTEREST – EXCHANGEABLE SHARES**

Zargon Oil & Gas Ltd. is authorized to issue an unlimited number of exchangeable shares. The exchangeable shares are convertible into trust units at the option of the shareholder, based on the exchange ratio, which is adjusted monthly to reflect the distribution paid on the trust units. Cash distributions are not paid on the exchangeable shares. During the six months ended June 30, 2010, a total of 0.09 million (2009 – 0.01 million) exchangeable shares were converted into 0.14 million (2009 – 0.02 million) trust units based on the exchange ratio at the time of conversion. At June 30, 2010, the exchange ratio was 1.72913 trust units per exchangeable share.

## Non-Controlling Interest – Exchangeable Shares

(thousands, except exchange ratio)	Six Months Ended June 30, 2010	
	Number of Shares	Amount (\$)
Balance, beginning of period	1,784	26,477
Exchanged for trust units at book value and including earnings attributed during the period	(86)	(1,715)
Earnings attributable to non-controlling interest	–	1,727
Balance, end of period	1,698	26,489
Exchange ratio, end of period	1.72913	
Trust units issuable upon conversion of exchangeable shares, end of period	2,936	

Per EIC-151 “Exchangeable Securities Issued by Subsidiaries of Income Trusts”, if certain conditions are met, the exchangeable shares issued by a subsidiary must be reflected as non-controlling interest on the consolidated balance sheets and, in turn, net earnings must be reduced by the amount of net earnings attributed to the non-controlling interest.

The non-controlling interest on the consolidated balance sheets consists of the book value of exchangeable shares at the time of the Plan of Arrangement, plus net earnings attributable to the exchangeable shareholders, less exchangeable shares (and related cumulative earnings) redeemed. The net earnings attributable to the non-controlling interest on the consolidated statements of earnings and comprehensive income represents the cumulative share of net earnings attributable to the non-controlling interest based on the trust units issuable for exchangeable shares in proportion to total trust units issued and issuable each period end.

The effect of EIC-151 on Zargon’s unitholders’ capital and exchangeable shares is as follows:

(\$ thousands)	Zargon Energy Trust Units	Zargon Oil & Gas Ltd. Exchangeable Shares	Total
Balance at January 1, 2010	188,840	26,477	215,317
Issued on redemption of exchangeable shares at book value	208	(208)	–
Effect of EIC-151	2,622	220	2,842
Unit-based compensation recognized on exercise of unit rights	337	–	337
Unit rights exercised for cash	1,881	–	1,881
Unit rights issued pursuant to Distribution Reinvestment Plan	734	–	734
Balance at June 30, 2010	194,622	26,489	221,111

## 9. WEIGHTED AVERAGE NUMBER OF TOTAL UNITS

Basic per unit amounts are calculated using the weighted average number of trust units outstanding during the period. Diluted per unit amounts are calculated using the treasury stock method to determine the dilutive effect of unit-based compensation. Diluted per unit amounts also include exchangeable shares using the “if-converted” method. Due to the fact that at the time of exercise, the rights holder has the option of exercising at the original grant price or a modified price as calculated under the Plan, the prices used in the treasury stock calculation are the lower prices calculated under the Plan.

(thousands of units)	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Basic	23,377	20,249	23,376	19,409
Diluted	26,235	23,001	26,220	22,069

## 10. CAPITAL DISCLOSURES

The Trust's capital structure is comprised of unitholders' equity plus long term debt. The Trust's objectives when managing its capital structure are to:

- i) maintain financial flexibility so as to preserve Zargon's access to capital markets and its ability to meet its financial obligations; and
- ii) finance internally generated growth as well as acquisitions.

The Trust monitors its capital structure and short term financing requirements using the non-GAAP financial metric of debt net of working capital ("net debt") to funds flow from operating activities. Net debt, as used by the Trust, is calculated as bank debt and any working capital deficit excluding the current portion of unrealized risk management assets and liabilities and future income taxes. Funds flow from operating activities represent net earnings/losses and asset retirement expenditures except for non-cash items. The metric is used to steward the Trust's overall debt position as a measure of the Trust's overall financial strength and is calculated as follows:

(\$ thousands, except ratio)	June 30, 2010	December 31, 2009
Net debt	121,670	88,008
Annualized funds flow from operating activities	81,905	86,352
Net debt to funds flow from operating activities ratio	1.49	1.02

As at June 30, 2010, Zargon's net debt to funds flow from operating activities ratio was 1.49, an increase from 1.02 at December 31, 2009. This increase was primarily due to an increase in long term debt due to \$24.86 million of property acquisitions in the current quarter, which was partially offset by a series of minor property dispositions totalling \$7.05 million. Additional property dispositions of approximately \$22 million are expected to close in the 2010 third quarter. On June 29, 2010, Zargon amended and renewed its syndicated committed credit facilities of \$180 million. The next renewal date is June 28, 2011. These facilities continue to be available for general corporate purposes and the potential acquisition of oil and natural gas properties.

To manage its capital structure, the Trust may adjust capital spending, adjust distributions paid to unitholders, issue new units, issue new debt or repay existing debt.

The Trust's capital management objectives, evaluation measures, definitions and targets have remained unchanged over the periods presented. Zargon is subject to certain financial covenants in its credit facility agreements and is in compliance with all financial covenants.

Zargon reviews its compliance with its bank debt covenants on a quarterly basis and has no violations as at June 30, 2010.

## 11. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT CONTRACTS

All financial instruments are required to be measured at fair value on initial recognition of the instrument, except for certain related party transactions. Measurement in subsequent periods depends on whether the financial instrument has been classified as "held-for-trading", "available-for-sale", "held-to-maturity", "loans and receivables", or "other financial liabilities" as defined by CICA Section 3855.

Financial assets and financial liabilities classified as "held-for-trading" are measured at fair value with changes in fair value recognized in earnings. Financial assets classified as "available-for-sale" are measured at fair value, with changes in fair value recognized in other comprehensive income ("OCI") until the asset is removed from the consolidated balance sheets. Financial assets classified as "held-to-maturity", "loans and receivables" and "other financial liabilities" are measured at amortized cost using the effective interest method of amortization.

### Fair Value of Financial Assets and Liabilities

Zargon's financial assets and liabilities are comprised of accounts receivable, deposits, accounts payable, cash distributions payable, unrealized risk management assets and liabilities and long term debt. Fair values of financial assets and liabilities, summarized information related to risk management positions and discussion of risks associated with financial assets and liabilities are presented as follows:

#### A) Fair Value of Financial Assets and Liabilities

Accounts receivable are designated as “loans and receivables.” Accounts payable and accrued liabilities, cash distributions payable and long term debt are designated as “other liabilities.” The fair values of these accounts approximate their carrying amounts.

Risk management assets and liabilities are derivative financial instruments classified as “held-for-trading.” These accounts are recorded at their estimated fair value using quoted market prices.

Financial instruments of the Trust carried on the consolidated balance sheets are carried at amortized cost with the exception of risk management contracts, which are carried at fair value.

All of the Trust’s risk management contracts are transacted in active markets. The Trust 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 volume 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, included quoted forward prices for commodities, time value and volatility factors, which are can be substantially observed or corroborated in the marketplace.

##### - Level III

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

The Trust’s risk management contracts have been assessed on the fair value hierarchy described above. The Trust’s risk management contracts 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.

#### B) Risk Management Assets and Liabilities

The Trust is a party to certain financial instruments that have fixed the price of a portion of its oil and natural gas production and foreign exchange conversion rates. The Trust enters into these contracts for risk management purposes only, in order to protect a portion of its future cash flow from the volatility of oil and natural gas commodity prices and foreign exchange rates. For financial risk management contracts, the Trust considers these contracts to be effective on an economic basis but has decided not to designate these contracts as hedges for accounting purposes and, accordingly, 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 on the statement of earnings and comprehensive income and accumulated earnings for the first half of 2010 was \$3.66 million and the unrealized loss for the first half of 2009 was \$19.83 million.

As at June 30, 2010, the Trust had the following outstanding commodity, and electricity risk management contracts:

##### Commodity Financial Risk Management Contracts:

	Rate	Weighted Average Price	Range of Terms	Fair Market Value Asset/(Liability) (\$ thousands)
Oil swaps	1,700 bbl/d	\$74.91 US/bbl	Jul. 1/10 – Dec. 31/10	(675)
	400 bbl/d	\$77.40 US/bbl	Jul. 1/10 – Jun. 30/11	(87)
	300 bbl/d	\$77.25 US/bbl	Jan. 1/11 – Sep. 30/11	(180)
	1,100 bbl/d	\$83.33 US/bbl	Jan. 1/11 – Dec. 31/11	1,596
	300 bbl/d	\$80.60 US/bbl	Jan. 1/11 – Jun. 30/12	85
<b>Total Fair Market Value, Commodity Price Financial Contracts</b>				<b>739</b>

Oil swaps are settled against the NYMEX WTI pricing index.

**Electricity Financial Risk Management Contracts:**

	Rate	Weighted Average Price	Range of Terms	Fair Market Value Liability (\$ thousands)
Electricity swaps	6 MWs/d	\$80.42/MWh	Jul. 1/10 – Dec. 31/10	(23)
	6 MWs/d	\$79.33/MWh	Jan. 1/11 – Dec. 31/11	(65)
<b>Total Fair Market Value, Electricity Financial Contracts</b>				<b>(88)</b>

Electricity swaps are settled against the AESO pricing index.

**Commodity Physical Risk Management Contracts:**

	Rate	Weighted Average Price	Range of Terms	Fair Market Value Loss (\$ thousands)
Natural gas fixed price	3,000 gj/d	\$4.29/gj	Jul. 1/10 – Oct. 31/10	168
<b>Total Fair Market Value, Natural Gas Physical Contracts</b>				<b>168</b>

Natural gas contracts settled by way of physical delivery are recognized as part of the normal revenue stream. These instruments have no book values recorded in the consolidated financial statements.

**Electricity Physical Risk Management Contracts:**

	Rate	Weighted Average Price	Range of Terms	Fair Market Value Loss (\$ thousands)
Electricity swaps	32 MWs/d	\$55.50/MWh	Jul. 1/10 – Mar. 31/11	5
<b>Total Fair Market Value, Electricity Physical Contracts</b>				<b>5</b>

Electricity contracts are settled by way of physical delivery and are recognized as part of the normal operating cost stream. These instruments have no book values recorded in the consolidated financial statements.

**Commodity Price Sensitivities**

The following table summarizes the sensitivity of the fair value of the Trust'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 Trust 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 on risk management contracts impacting net earnings as follows:

	Three and Six Months Ended June 30,	
(\$ thousands)	2010	2009
Natural gas price	–	83
Crude oil price	9,232	5,974

**C) Risks Associated with Financial Assets and Liabilities**

The Trust 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 or 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

As a means of mitigating exposure to commodity price risk volatility, the Trust 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 Trust's policy is to not use derivative financial instruments for speculative purposes.

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

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

- Interest Rate Risk

Borrowings under bank credit facilities are market rate based (variable interest rates); thus, carrying values approximate fair values.

At the June 30, 2010 debt pricing levels, the increase or decrease in net earnings for each one percent change in interest rates would amount to \$0.47 million (2009 - \$0.44 million).

- Foreign Exchange Risk

As Zargon operates in North America, fluctuations in the exchange rate between the US/Canadian dollar can have a significant effect on the Trust's reported results. A \$0.01 change in the US to Canadian dollar exchange rate would have resulted in a \$0.38 million (2009 - \$0.28 million) increase or decrease in net earnings at June 30, 2010. In order to mitigate the Trust's exposure to foreign exchange fluctuations, the Trust enters into foreign exchange derivative agreements.

• Credit Risk

Credit risk is the risk that the counterparty to a financial asset will default, resulting in the Trust 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 Trust's accounts receivable are with customers in the oil and gas industry and are subject to normal industry credit risks.

The maximum credit risk exposure associated with accounts receivable, accrued revenues and risk management assets is the total carrying value. The Trust monitors these balances monthly to limit the risk associated with collection. Of Zargon's accounts receivable at June 30, 2010, approximately 46 percent (December 31, 2009 – 40 percent) was owing from two companies and Zargon anticipates full collection.

The Trust's allowance for doubtful accounts was \$0.10 million as at June 30, 2010 and \$0.10 million as at December 31, 2009. To date, in 2010, the Trust did not record any additional provisions 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, 2010, \$0.71 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 Trust will encounter difficulties in meeting its financial liability obligations. The Trust manages its liquidity risk through cash and debt management. See note 10 for a more detailed discussion.

As at June 30, 2010, Zargon had available unused committed bank credit facilities of approximately \$65.27 million compared to \$102.81 million at December 31, 2009. The Trust believes it has sufficient funding through the use of these facilities to meet foreseeable borrowing requirements.

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

(\$ thousands)	1 year	2-3 years	Total
Accounts payable and accrued liabilities	29,204	–	29,204
Cash distributions payable	3,955	–	3,955
Risk management liabilities <sup>(1)</sup>	1,573	93	1,666
Long term debt	–	114,118	114,118

(1) See the section titled "Commodity Price Sensitivities" in this note for a better understanding of the volatility around these amounts.

## 12. CHANGES IN NON-CASH WORKING CAPITAL

	Three Months Ended June 30,		Six Months Ended June 30,	
(\$ thousands)	2010	2009	2010	2009
Changes in non-cash working capital items:				
Accounts receivable	2,429	(1,439)	2,624	(870)
Prepaid expenses and deposits	(1,390)	(268)	(995)	(351)
Accounts payable and accrued liabilities	(4,385)	1,909	(5,303)	(2,579)
Cash distributions payable	(247)	692	(202)	712
Working capital acquired from corporate acquisitions	-	(105)	-	(105)
Foreign exchange and other	185	(503)	73	(316)
	<b>(3,408)</b>	286	<b>(3,803)</b>	(3,509)
Changes relating to operating activities	<b>(5,506)</b>	1,019	<b>(6,745)</b>	(1,100)
Changes relating to financing activities	<b>(1,079)</b>	692	<b>(203)</b>	712
Changes relating to investing activities	<b>3,177</b>	(1,425)	<b>3,145</b>	(3,121)
	<b>(3,408)</b>	286	<b>(3,803)</b>	(3,509)

## 13. SUPPLEMENTAL CASH FLOW INFORMATION

	Three Months Ended June 30,		Six Months Ended June 30,	
(\$ thousands)	2010	2009	2010	2009
Cash interest paid	1,541	505	2,295	1,331
Cash taxes paid	189	(128)	2,209	(63)

## 14. SEGMENTED INFORMATION

Zargon's entire operating activities are related to exploration, development and production of oil and natural gas in the geographic segments of Canada and the US.

	Three Months Ended June 30,		Six Months Ended June 30,	
(\$ thousands)	2010	2009	2010	2009
<b>Petroleum and Natural Gas Revenue</b>				
Canada	39,921	31,875	84,132	61,210
United States	3,965	3,963	8,210	6,608
Total	<b>43,886</b>	35,838	<b>92,342</b>	67,818
<b>Net Capital Expenditures<sup>(1)</sup></b>				
Canada	34,033	48,879	52,490	62,321
United States	232	78	512	79
Total	<b>34,265</b>	48,957	<b>53,002</b>	62,400

(1) For net capital expenditures, amounts include capital expenditures acquired for cash, equity issuances, acquisition costs and net debt assumed on corporate acquisitions.

(\$ thousands)	June 30, 2010	December 31, 2009
<b>Property and Equipment, net</b>		
Canada	421,539	394,448
United States	30,926	31,516
<b>Total</b>	<b>452,465</b>	<b>425,964</b>
<b>Goodwill</b>		
Canada	2,969	2,969
United States	-	-
<b>Total</b>	<b>2,969</b>	<b>2,969</b>

#### 15. CASH DISTRIBUTIONS

During the six month period, the Trust declared distributions to the unitholders in the aggregate amount of \$25.17<sup>(1)</sup> million (2009 – \$21.30 million) in accordance with the following schedule:

2010 Distributions	Record Date	Distribution Date	Per Trust Unit
January	January 31, 2010	February 15, 2010	\$0.18
February	February 28, 2010	March 15, 2010	\$0.18
March	March 31, 2010	April 15, 2010	\$0.18
April	April 30, 2010	May 17, 2010	\$0.18
May	May 31, 2010	June 15, 2010	\$0.18
June	June 30, 2010	July 15, 2010	\$0.18

(1) The 2010 cash distributions include a non-cash amount of \$0.74 million for the Distribution Reinvestment Plan which commenced in April 2010.

## CORPORATE INFORMATION

### BOARD OF DIRECTORS

Craig H. Hansen

*Calgary, Alberta*

K. James Harrison <sup>(3) (4)</sup>

*Chairman of the Board  
Oakville, Ontario*

Kyle D. Kitagawa <sup>(1) (2)</sup>

*Calgary, Alberta*

Geoffrey C. Merritt <sup>(2)</sup>

*Calgary, Alberta*

Margaret A. McKenzie <sup>(1) (3)</sup>

*Calgary, Alberta*

Jim Peplinski <sup>(2) (4)</sup>

*Calgary, Alberta*

J. Graham Weir <sup>(1) (2)</sup>

*Calgary, Alberta*

Grant A. Zawalsky <sup>(3) (4)</sup>

*Calgary, Alberta*

### OFFICERS

Craig H. Hansen

*President and Chief Executive Officer*

Brent C. Heagy

*Executive Vice President and  
Chief Financial Officer*

Henry J. Baird

*Vice President, Reservoir Engineering*

Charles L. Buckley

*Vice President, Geosciences*

Jason B. Dranchuk

*Vice President, Finance and Controller*

Tracy L. Howard

*Corporate Secretary*

Brian G. Kergan

*Vice President, Corporate Development and  
Alberta Plains South*

Kevin C.Y. Lee

*Vice President, Alberta Plains North*

Lorne D. Schwetz

*Vice President, Land*

Al D. Thorsen

*Vice President, Operations*

*(1) Audit Committee*

*(2) Reserves Committee*

*(3) Governance and Nominating Committee*

*(4) Compensation Committee*

### STOCK EXCHANGE LISTING

Toronto Stock Exchange

Zargon Energy Trust

Trust Units

Trading Symbol: ZAR.UN

Zargon Oil & Gas Ltd.

Exchangeable Shares

Trading Symbol: ZOG.B

### TRANSFER AGENT

Valiant Trust Company

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Calgary, Alberta T2P 1T1

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Calgary, Alberta T2P 2Z1

Canadian Imperial Bank of Commerce

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Calgary, Alberta T2P 2P2

The Bank of Nova Scotia

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