

### FINANCIAL AND OPERATING HIGHLIGHTS

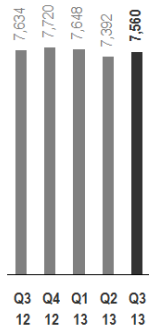
(unaudited)	Three Months Ended September 30,			Nine Months Ended September 30,		
	2013	2012	Percent Change	2013	2012	Percent Change
<b>Financial</b>						
<b>Income and Investments (\$ millions)</b>						
Gross petroleum and natural gas sales	45.14	36.91	22	122.81	120.07	2
Funds flow from operating activities	16.45	14.35	15	46.34	40.24	15
Cash flows from operating activities	16.30	12.16	34	43.44	42.02	3
Cash dividends (net of Dividend Reinvestment Plan)	5.17	7.75	(33)	14.94	22.65	(34)
Net earnings/(loss)	(2.35)	(4.02)	42	(0.99)	4.51	(122)
Net capital expenditures	17.54	10.35	69	36.15	4.46	711
<b>Per Share, Basic</b>						
Funds flow from operating activities (\$/share)	0.55	0.48	15	1.55	1.36	14
Cash flows from operating activities (\$/share)	0.54	0.41	32	1.45	1.42	2
Net earnings/(loss) (\$/share)	(0.08)	(0.14)	43	(0.03)	0.15	(120)
<b>Cash Dividends (\$/common share)</b>	<b>0.18</b>	<b>0.30</b>	<b>(40)</b>	<b>0.54</b>	<b>0.90</b>	<b>(40)</b>
<b>Balance Sheet at Period End (\$ millions)</b>						
Property and equipment				392.88	386.72	2
Exploration and evaluation assets				17.23	21.38	(19)
Long term bank debt				43.65	27.58	58
Convertible debentures at maturity				57.50	57.50	–
Shareholders' equity				182.51	210.35	(13)
<b>Total Common Shares Outstanding at Period End (millions)</b>				<b>30.09</b>	<b>29.78</b>	<b>1</b>
<b>Operating</b>						
<b>Average Daily Production</b>						
Oil and liquids (bbl/d)	4,816	5,079	(5)	4,952	5,319	(7)
Natural gas (mmcf/d)	16.46	15.33	7	15.49	17.59	(12)
Equivalent (boe/d)	7,560	7,634	(1)	7,533	8,250	(9)
<b>Average Selling Price (before the impact of financial risk management contracts)</b>						
Oil and liquids (\$/bbl)	94.10	72.71	29	81.92	76.03	8
Natural gas (\$/mcf)	2.27	2.08	9	2.85	1.92	48
<b>Wells Drilled, Net</b>	<b>3.0</b>	<b>3.0</b>	<b>–</b>	<b>8.1</b>	<b>12.8</b>	<b>(37)</b>
<b>Undeveloped Land at Period End (thousand net acres)</b>				<b>283</b>	<b>361</b>	<b>(22)</b>

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

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

## Production

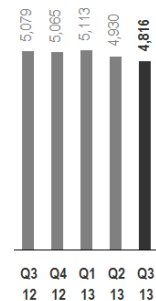
(boe/d)



## Oil and Liquids

### Production

(bbl/d)



## Natural Gas

### Production

(mmcf/d)



## Message to Shareholders <sup>(1)</sup>

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

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

The Company's focus for the remainder of 2013 and the first six months of 2014 will be to:

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

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

- Funds flow from operating activities of \$16.5 million were three percent higher than the \$16.0 million recorded in the prior quarter, and 15 percent higher than the \$14.4 million reported in the third quarter of 2012. Funds flow from operating activities for the 2013 third quarter included reductions of \$2.6 million of realized hedge losses and \$0.6 million of asset retirement expenditures.
- Third quarter 2013 production averaged 4,816 barrels of oil and liquids per day, a two percent decrease from the preceding quarter and third quarter 2013 natural gas production averaged 16.46 million cubic feet per day, an 11 percent increase from the preceding quarter. Total production averaged 7,560 barrels of oil equivalent per day, a two percent increase from the preceding quarter. During the quarter, oil and liquids production represented 64 percent of total production based on a 6:1 equivalent basis.
- Monthly cash dividends of \$0.06 per common share were declared in the third quarter of 2013 for a total of \$5.4 million (\$5.2 million after accounting for the common shares issued under the Dividend Reinvestment Plan (“DRIP”) in lieu of cash dividends). These cash dividends (net of the DRIP) were equivalent to a payout ratio of 31 percent of funds flow from operating activities. Commencing with Zargon's September 2013 dividend, the DRIP has been suspended until further notice.
- Third quarter 2013 exploration and development capital expenditures (excluding property acquisitions and dispositions) were \$18.7 million and included \$11.4 million of expenditures related to the Little Bow ASP tertiary oil recovery project. In the quarter, Zargon drilled three (3.0 net) horizontal exploitation wells at Taber, Alberta.
- Zargon's September 30, 2013 debt, net of working capital (excluding unrealized derivative assets/liabilities) and using the full future face value of the convertible debenture of \$57.5 million, was \$117.6 million and is approximately 1.9 times the annualized 2013 nine months funds flow from operating activities. At September 30, 2013, Zargon had more than \$100 million of available credit facilities remaining on its \$165 million borrowing base.

### **Little Bow Alkaline Surfactant Polymer (“ASP”) Project <sup>(1)</sup>**

Zargon's Little Bow ASP project entails the injection of a dilute chemical solution into a partially depleted reservoir to recover incremental oil reserves. During the three months since the last report, Zargon has continued to make good progress with this project, although the injection date has now been deferred to March 2014. At the site of the new Little Bow ASP injection facility the pre-fabricated modules have been delivered and the mechanical and electrical construction is more than 60 percent complete. The necessary pipeline additions and well conversions are also mostly complete. Chemical supply contracts have been finalized and operator training activities are proceeding.

The total budgeted construction capital cost of phases 1 and 2 of the Little Bow ASP project is unchanged at approximately \$60 million (as spent dollars). Of this total, \$6.5 million of expenditures were incurred in 2012, \$12.3 million were incurred in the 2013 first half and \$11.4 million were incurred in the 2013 third quarter. By the end of the year, an additional \$14 million is forecast to be spent with the phase 1 project's final \$4 million to be spent the first quarter of 2014. The implementation of phase 2 is scheduled for 2015 and will require an additional \$12 million of capital. The estimated phase 1 and 2 chemical cost for the 2014-2019 injection period will be capitalized and is now forecasted at \$78 million (as spent dollars) up from the previous estimate of \$66 million. This increase in cost reflects an optimized increased polymer bank that has been modeled to increase recoverable reserves by six percent from Zargon's previous estimate to 5.2 million barrels of incremental oil. In their 2012 year end review, McDaniel and Associates Consultants Ltd. has already recognized 4.0 million barrels of Zargon probable undeveloped oil reserves for phases 1 and 2 of the project.

Based on the current construction schedule, we forecast that the Little Bow ASP project will provide 140 barrels of oil per day of incremental production in 2014, which will be comprised of an initial production response in the 2014 third quarter and a 2014 year end rate of 350 barrels of oil per day. Phase 1 and 2 incremental production rates are forecast to exceed 900 and 1,550 barrels of oil per day in 2015 and 2016, respectively. Using these rates with an estimated field oil price of \$67 Cdn. per barrel (assuming an Edmonton par price of \$85 Cdn. per barrel), a 12 percent incremental tertiary royalty rate and operating costs of \$10 per barrel of incremental oil, the project is forecast to provide a field netback of more than \$48 per barrel of incremental oil production and deliver a property capital recycle ratio (including sunk costs) of about 1.8 times.

Follow-on capital expenditures of \$77 million (including chemical costs) for phases 3 and 4 of the Little Bow ASP project are expected to yield an additional 3.6 million barrels of incremental oil and Zargon's combined Little Bow project's (phases 1 through 4) total production is expected to stabilize at 2,200 barrels of oil per day in the 2021 through 2023 period. For further information regarding the Little Bow ASP project, please refer to our updated corporate presentation, which is available at [www.zargon.ca](http://www.zargon.ca).

### **Other Field Activities <sup>(1)</sup>**

In addition to the \$11.4 million of ASP capital expenditures, Zargon executed a \$7.3 million capital program in the 2013 third quarter on conventional oil exploitation assets that included the drilling of 3.0 net Taber, Alberta horizontal exploitation wells, taking Zargon's Q1-Q3 2013 well count to 8.1 net wells. In the 2013 fourth quarter, Zargon is planning on drilling an additional 8.5 net high-graded oil exploitation wells at Bellshill Lake, Williston Basin and Little Bow properties.

In aggregate, Zargon has identified more than 75 high-graded horizontal locations in five conventional (non-ASP) oil exploitation projects, which provide a high quality drilling inventory for several years. Each of these five oil exploitation projects are (or will be) pressure supported by water injections or natural reservoir aquifers and consequently provide long-life low-decline oil volumes that will support future dividends. For further information regarding Zargon's conventional oil exploitation projects, please refer to our updated corporate presentation, which is available at [www.zargon.ca](http://www.zargon.ca).

### **Property Dispositions Update <sup>(1)</sup>**

During the 2013 third quarter, property dispositions of \$1.4 million were concluded, which primarily related to the sale of 14 barrels of oil per day from Harmattan, Alberta properties. Subsequent to quarter end, Zargon sold an additional 120 barrels of oil per day and 0.18 million cubic feet of natural gas per day of minor Alberta Plains North properties (Twining, Provost and Wayne) for a total consideration of \$7.5 million (cash proceeds of \$6.8 million). With this disposition included, Zargon's 2013 property dispositions total \$23.0 million (cash) and exceeds the \$20 million of property dispositions that were budgeted for 2013. In aggregate, these disposition properties had been producing approximately 265 barrels of oil per day and 0.22 million cubic feet of natural gas per day.

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

### **Updated 2013 Outlook and First Look 2014 Capital Budgets <sup>(1)</sup>**

Zargon's 2013 non-ASP field capital budget continues to be set at \$40 million (before dispositions) of which \$28.2 million has been spent in the first nine months of the year. The 2013 non-ASP capital program provides for oil exploitation facility expenditures, 16.6 net oil exploitation wells and consistent with prior years, reflects essentially no natural gas related expenditures.

ASP capital expenditures in the fourth quarter of 2013 are estimated to be \$14 million, taking the 2013 total ASP cost to \$38 million and the total 2013 capital expenditures to \$78 million. The remaining \$4 million of phase 1 ASP capital costs are forecast to be spent in the first quarter of 2014 and an additional \$10 million of ASP chemical costs are forecast to be spent in 2014.

Zargon's 2014 capital budget has been set at \$35 million for conventional projects with the drilling of 15 net oil exploitation wells, plus the aforementioned \$14 million for ASP capital and chemical expenditures. The \$49 million capital program is forecasted to be funded by cash flows, long term bank debt and the sale of \$15 million of non-strategic oil properties. Based on this 2014 capital program, we expect oil production to steadily grow from first quarter levels throughout 2014 as stable conventional oil production volumes are augmented by growing Little Bow ASP oil production volumes.

Also, Zargon has entered into an oil hedging program to provide a measure of stability and predictability to cash flows during the ASP construction and early production phase. For the remainder of 2013, Zargon has hedged 3,000 barrels per day at \$97.06 US/bbl WTI, while for 2014 an average of 2,600 barrels per day is hedged at \$91.90 US/bbl WTI and for the first quarter of 2015 an average of 400 barrels per day is hedged at \$91.73 US/bbl WTI.

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

In the August 8, 2013 second quarter results press release, guidance for third quarter 2013 oil production was provided at 4,650 barrels of oil and liquids per day. Actual third quarter volumes were 4,816 barrels of oil and liquids per day and exceeded guidance levels by four percent due in part to Bellshill Lake facility and pumping optimizations. Reflecting natural declines, the effect of a muted summer drilling program and 120 barrels of oil per day of fourth quarter property dispositions, we are anticipating fourth quarter production volumes to average 4,550 barrels of oil per day.

The August press release also set Zargon's third quarter 2013 natural gas production guidance of 14.70 million cubic feet per day. Third quarter actual volumes were 16.46 million cubic feet per day or about 12 percent above guidance. The majority of the better than expected volumes came from field optimizations and flush production relating to summer well reactivations. Fourth quarter natural gas volumes are anticipated to average 15.00 million cubic feet per day.

Looking forward, we expect that first quarter 2014 production volumes will represent both an oil production low and a turning point for Zargon, as in subsequent quarters, significant production volumes will begin to materialize from the ASP project which will augment stable production volumes from conventional oil exploitation properties. At this time, we are forecasting a first quarter 2014 oil production rate of 4,500 barrels of oil per day, although this estimate will depend on the magnitude and timing of our 2014 property disposition program.

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

## MANAGEMENT'S DISCUSSION AND ANALYSIS

Management's discussion and analysis ("MD&A") is a review of Zargon Oil & Gas Ltd.'s 2013 third quarter financial results and should be read in conjunction with the unaudited interim consolidated financial statements and related notes for the three and nine months ended September 30, 2013 and the audited consolidated financial statements and related notes for the year ended December 31, 2012. The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board, which are also generally accepted accounting principles ("GAAP") for publicly accountable enterprises in Canada. All amounts are in Canadian dollars unless otherwise noted. All references to "Zargon" or the "Company" refer to Zargon Oil & Gas Ltd.

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

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

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

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

- The Company also uses the term "debt net of working capital" or "net debt". Debt net of working capital, as presented, does not have any standardized meaning prescribed by IFRS and may not be comparable with the calculation of similar measures for other entities. Debt net of working capital, as used by the Company, is calculated as long term bank debt plus the full future face value of the convertible debenture of \$57.50 million and any working capital deficit excluding unrealized derivative assets/liabilities.
- Operating netbacks per boe equal total petroleum and natural gas sales per boe adjusted for realized derivative gains and/or losses per boe, royalties per boe, operating expenses per boe and transportation expenses per boe. Operating netbacks are a useful measure to compare the Company's operations with those of its peers.
- Funds flow netbacks per boe are calculated as operating netbacks less general and administrative expenses per boe, transaction costs per boe, interest and financing charges per boe, interest on the convertible debenture per boe, asset retirement expenditures per boe, cash portion of exploration and evaluation per boe, other expense per boe and current income taxes per boe. Funds flow netbacks are a useful measure to compare the Company's operations with those of its peers.

References to “production volumes” or “production” in this document refer to sales volumes.

*Forward-Looking Statements* – This document offers our assessment of Zargon’s future plans and operations as at November 13, 2013, and contains forward-looking statements including:

- our expectations for our plans with respect to our Little Bow ASP project and the results therefrom referred to under the headings “Message to Shareholders”, “Little Bow Alkaline Surfactant Polymer (“ASP”) Project”, “Updated 2013 Outlook and First Look 2014 Capital Budgets”, “Production Guidance” and “Outlook”;
- our expectations for our plans with respect to our budgeted 2013 and 2014 property dispositions referred to under the headings “Message to Shareholders”, “Property Dispositions Update”, “Updated 2013 Outlook and First Look 2014 Capital Budgets” and “Production Guidance”;
- our expectations for our budgeted 2013 and 2014 conventional oil exploitation assets capital program referred to under the headings “Message to Shareholders”, “Other Field Activities”, “Updated 2013 Outlook and First Look 2014 Capital Budgets” and “Production Guidance”;
- our expectations for our 2013 – 2015 hedges referred to under the heading “Updated 2013 Outlook and First Look 2014 Capital Budgets”;
- our expectations for operating expenses and transportation expenses referred to under the headings “Financial & Operating Results”;
- our expectations for general and administrative expenses referred to under the headings “Financial & Operating Results”;
- our dividend policy referred to under the heading “Message to Shareholders” and “Liquidity and Capital Resources”;
- our expected sources of funds for our dividend referred to under the headings “Liquidity and Capital Resources” and “Outlook”;
- our expectations for production referred to under the heading “Production Guidance”; and
- our expected sources of funds for capital expenditures referred to under the heading “Liquidity and Capital Resources”.

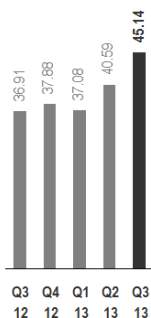
Such statements are generally identified by the use of words such as “anticipate”, “continue”, “estimate”, “expect”, “forecast”, “may”, “will”, “project”, “should”, “plan”, “intend”, “believe” and similar expressions (including the negatives thereof). By their nature, forward-looking statements are subject to numerous risks and uncertainties, some of which are beyond our control, including such as those relating to results of operations and financial condition, general economic conditions, industry conditions, changes in regulatory and taxation regimes, volatility of commodity prices, escalation of operating and capital costs, currency fluctuations, the availability of services, imprecision of reserve estimates, geological, technical, drilling and processing problems, environmental risks, weather, the lack of availability of qualified personnel or management, stock market volatility, the ability to access sufficient capital from internal and external sources and competition from other industry participants for, among other things, capital, services, acquisitions of reserves, undeveloped lands and skilled personnel. Risks are described in more detail in our Annual Information Form, which is available on our website and at [www.sedar.com](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 (including ASP); future production levels; future exchange rates; the cost of developing and expanding our assets; our ability to obtain equipment in a timely manner to carry out development activities; our ability to market our oil and natural gas successfully to current and new customers; the impact of increasing competition, our ability to obtain financing on acceptable terms; and our ability to add production and reserves through our development and acquisition activities used in the preparation of such information, although considered reasonable at the time of preparation, may prove to be imprecise and, as such, undue reliance should not be placed on forward-looking statements. Our actual results, performance, or achievements could differ materially from those expressed in, or implied by, these forward-looking statements. We can give no assurance that any of the events anticipated will transpire or occur, or if any of them do, what benefits we will derive from them. The forward-looking information contained in this document is expressly qualified by this cautionary statement. Our policy for updating forward-looking statements is that Zargon disclaims, except as required by law, any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

This MD&A has been prepared as of November 13, 2013.

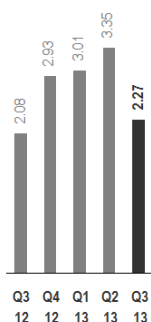
**Petroleum and  
Natural Gas  
Revenue**

(\$ millions)



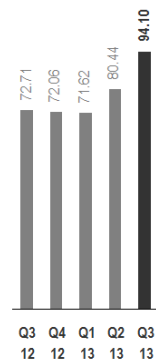
**Natural Gas  
Prices**

(\$/mcf)



**Oil and Liquids  
Prices**

(\$/bbl)



**FINANCIAL & OPERATING RESULTS**

**Petroleum and Natural Gas Sales**

(\$ millions)	Three months ended September 30,			Nine months ended September 30,		
	2013	2012	Percent Change	2013	2012	Percent Change
Petroleum sales	<b>41.70</b>	33.98	23	<b>110.74</b>	110.80	-
Natural gas sales	<b>3.44</b>	2.93	17	<b>12.07</b>	9.27	30
Petroleum and natural gas sales	<b>45.14</b>	36.91	22	<b>122.81</b>	120.07	2

Third quarter 2013 gross petroleum and natural gas sales of \$45.14 million were 22 percent above the \$36.91 million in the third quarter of 2012 due to higher prices realized on both oil and liquids and natural gas.

Third quarter 2013 realized oil and liquids field prices averaged \$94.10 per barrel before the impact of financial risk management contracts and were 29 percent higher than the \$72.71 per barrel recorded in the 2012 third quarter. Zargon's crude oil field price differential from the Edmonton par price decreased to \$10.64 per barrel in the third quarter of 2013 compared to \$11.66 per barrel in the third quarter of 2012. Natural gas field prices received averaged \$2.27 per thousand cubic feet in the third quarter of 2013, a nine percent increase from the 2012 third quarter prices.

**Pricing**

Average for the period	Three Months Ended September 30,			Nine Months Ended September 30,		
	2013	2012	Percent Change	2013	2012	Percent Change
<b>Natural Gas:</b>						
NYMEX average daily spot price (\$US/mmbtu)	<b>3.56</b>	2.88	24	<b>3.67</b>	2.54	44
AECO average daily spot price (\$Cdn/mmbtu)	<b>2.44</b>	2.30	6	<b>3.06</b>	2.12	44
Zargon realized field price before the impact of financial risk management contracts (\$Cdn/mcf)	<b>2.27</b>	2.08	9	<b>2.85</b>	1.92	48
Zargon realized field price after the impact of financial risk management contracts (\$Cdn/mcf)	<b>2.27</b>	2.15	6	<b>2.85</b>	1.96	45
Zargon realized natural gas field price differential <sup>(1)</sup>	<b>0.17</b>	0.22		<b>0.21</b>	0.20	
<b>Crude Oil:</b>						
WTI (\$US/bbl)	<b>105.83</b>	92.22	15	<b>98.14</b>	96.21	2
Edmonton par price (\$Cdn/bbl)	<b>104.74</b>	84.37	24	<b>95.18</b>	86.86	10
Zargon realized field price before the impact of financial risk management contracts (\$Cdn/bbl)	<b>94.10</b>	72.71	29	<b>81.92</b>	76.03	8
Zargon realized field price after the impact of financial risk management contracts (\$Cdn/bbl)	<b>88.44</b>	74.77	18	<b>81.78</b>	74.13	10
Zargon realized oil field price differential <sup>(2)</sup>	<b>10.64</b>	11.66		<b>13.26</b>	10.83	

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

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



## Volumes

Oil and liquids production volumes during the 2013 third quarter were 4,816 barrels per day, a five percent decrease from the 2012 third quarter rate of 5,079 barrels per day. The production decrease is due to naturally occurring production declines and minor property dispositions that were partially offset by ongoing oil exploitation drilling programs. Natural gas production volumes increased seven percent in the 2013 third quarter to 16.46 million cubic feet per day compared to 15.33 million cubic feet per day in the 2012 third quarter. This increase resulted from field optimization activity and well reactivations.

## Production by Core Area

Three Months Ended September 30,	2013			2012		
	Oil and Liquids (bbl/d)	Natural Gas (mmcf/d)	Equivalents (boe/d)	Oil and Liquids (bbl/d)	Natural Gas (mmcf/d)	Equivalents (boe/d)
Alberta Plains North	1,335	13.36	3,562	1,270	12.14	3,294
Alberta Plains South	1,616	2.75	2,074	1,717	2.75	2,175
Williston Basin	1,865	0.35	1,924	2,092	0.44	2,165
	<b>4,816</b>	<b>16.46</b>	<b>7,560</b>	<b>5,079</b>	<b>15.33</b>	<b>7,634</b>

Nine Months Ended September 30,	2013			2012		
	Oil and Liquids (bbl/d)	Natural Gas (mmcf/d)	Equivalents (boe/d)	Oil and Liquids (bbl/d)	Natural Gas (mmcf/d)	Equivalents (boe/d)
Alberta Plains North	1,312	12.30	3,362	1,356	14.28	3,736
Alberta Plains South	1,687	2.83	2,158	1,738	2.89	2,220
Williston Basin	1,953	0.36	2,013	2,225	0.42	2,294
	<b>4,952</b>	<b>15.49</b>	<b>7,533</b>	<b>5,319</b>	<b>17.59</b>	<b>8,250</b>

## Risk Management Contracts

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

Zargon also has two interest rate swaps on a total of \$40 million of borrowing with an average effective interest rate of 1.69 percent plus stamping fee (currently at 2.00 percent) and two physical electricity hedges.

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

In the 2013 third quarter, lower contract prices versus WTI oil prices resulted in a realized net loss on derivatives of \$2.56 million compared to a \$1.02 million realized net gain in the third quarter of 2012.

The unrealized loss on derivatives of \$7.99 million in the third quarter of 2013 was comprised of oil contract losses of \$7.86 million, natural gas contract gains of \$0.01 million and interest rate swap losses

of \$0.14 million, compared to a net \$5.21 million unrealized loss in the third quarter of 2012. These non-cash unrealized derivative gains or losses are generated by the change over the reporting period in the mark-to-market valuation of Zargon's risk management contracts. Commodity price volatility has resulted in significant fluctuations in the mark-to-market amount of unrealized derivative assets and liabilities. Zargon's commodity risk management positions are described in Notes 11 and 12 to the unaudited interim consolidated financial statements.

### Royalties

(\$ millions)	Three months ended September 30,			Nine months ended September 30,		
	2013	2012	Percent Change	2013	2012	Percent Change
Royalties	<b>8.80</b>	7.16	23	<b>22.54</b>	23.08	(2)
Percentage of revenue	<b>19.5%</b>	19.4%		<b>18.4%</b>	19.2%	

Royalties are inclusive of the Saskatchewan Resource Surcharge ("SRC"). The variations in royalty rates generally track changes in production and volumes. Third quarter 2013 royalties were 19.5 percent of gross sales compared to 19.4 percent in the third quarter of 2012.

### Operating Expenses and Transportation Expenses

(\$ millions)	Three months ended September 30,			Nine months ended September 30,		
	2013	2012	Percent Change	2013	2012	Percent Change
Operating expenses	<b>11.50</b>	10.47	10	<b>35.56</b>	36.07	(1)
Transportation expenses	<b>0.50</b>	0.30	67	<b>1.40</b>	1.07	31
Total	<b>12.00</b>	10.77	11	<b>36.96</b>	37.14	–
Total (\$/boe)	<b>17.25</b>	15.34	12	<b>17.98</b>	16.43	9

Compared to the prior year's third quarter, operating expenses and transportation expenses in the 2013 third quarter are higher both on a dollar basis and on a per barrel of oil equivalent basis. In the 2013 third quarter, operating and transportation expenses increased due to high Alberta electricity costs and repairs and maintenance expenditures. Compared to the prior quarter, continued field optimization projects reduced operating and transportation expenses to \$17.25 per barrel of oil equivalent from \$18.76 per barrel of oil equivalent. The Company is focused on improving operating costs, but due to the combined effect of relatively stable costs and lower production volumes, we are forecasting that the summation of operating and transportation expenses will average approximately \$18.00 per barrel of oil equivalent for the remainder of the year.

### Operating Netbacks

Three Months Ended September 30,	2013		2012	
	Oil and Liquids (\$/bbl)	Natural Gas (\$/mcf)	Oil and Liquids (\$/bbl)	Natural Gas (\$/mcf)
Sales	<b>94.10</b>	<b>2.27</b>	72.71	2.08
Royalties	<b>(19.08)</b>	<b>(0.23)</b>	(14.37)	(0.32)
Realized gain/(loss) on derivatives	<b>(5.66)</b>	–	2.06	0.07
Operating expenses	<b>(18.74)</b>	<b>(2.11)</b>	(17.00)	(1.79)
Transportation expenses	<b>(1.13)</b>	–	(0.65)	–
Operating netbacks	<b>49.49</b>	<b>(0.07)</b>	42.75	0.04

Nine Months Ended September 30,	2013		2012	
	Oil and Liquids (\$/bbl)	Natural Gas (\$/mcf)	Oil and Liquids (\$/bbl)	Natural Gas (\$/mcf)
Sales	81.92	2.85	76.03	1.92
Royalties	(15.66)	(0.32)	(14.88)	(0.29)
Realized gain/(loss) on derivatives	(0.13)	–	(1.90)	0.03
Operating expenses	(19.47)	(2.18)	(18.36)	(1.93)
Transportation expenses	(1.03)	–	(0.73)	–
Operating netbacks	45.63	0.35	40.16	(0.27)

### General & Administrative (“G&A”) Expenses

(\$ millions)	Three months ended September 30,			Nine months ended September 30,		
	2013	2012	Percent Change	2013	2012	Percent Change
G&A expenses	2.85	3.31	(14)	8.80	10.60	(17)
G&A expenses (\$/boe)	4.10	4.71	(13)	4.28	4.69	(9)

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

### Transaction Costs

Transaction costs for the 2013 third quarter were nil compared to minimal costs in the third quarter of 2012, which related to the property dispositions in the quarter.

### Interest and Financing Charges on Long Term Bank Debt

Zargon's borrowings are through its syndicated bank credit facilities. The Company's next renewal date is June 25, 2014, with a semi-annual review that took place in the fall of 2013. Interest and financing charges on these facilities in the 2013 third quarter were \$0.65 million, 27 percent higher than the \$0.51 million in the third quarter of 2012. The increase in interest and financing charges resulted from higher average borrowing levels compared to the third quarter of 2012. Zargon's effective interest and financing change rate was 5.3 percent on an average outstanding bank debt of \$49.00 million for the 2013 third quarter.

### Interest on Convertible Debentures

Zargon also has borrowings through its convertible debentures, which were issued in May 2012 and mature on June 30, 2017. Interest is payable semi-annually at a rate of six percent, calculated on the gross proceeds of \$57.50 million. Interest charges of \$0.86 million in the third quarter of 2013 compared to \$0.87 million in the third quarter of 2012.

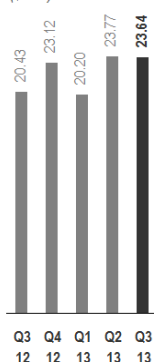
### Current Income Taxes

Current income taxes for the 2013 third quarter were \$0.35 million, and relate to the US operations. When compared to the 2012 third quarter, current income taxes increased \$0.11 million due to higher revenue and lower field capital expenditures in the US. Total corporate tax pools as at September 30, 2013 are approximately \$307 million, which represents an decrease of two percent from the comparable \$313 million of tax pools available to Zargon at December 31, 2012, primarily as a result of the property sales in 2013.

## Funds Flow

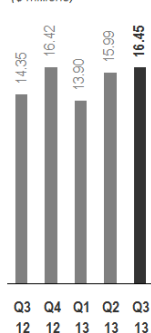
### Netbacks

(\$/boe)



### Funds Flow from Operating Activities

(\$ millions)



## Corporate Netbacks

(\$/boe)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Petroleum and natural gas sales	<b>64.90</b>	52.55	<b>59.72</b>	53.11
Royalties	<b>(12.66)</b>	(10.19)	<b>(10.96)</b>	(10.21)
Realized gain/(loss) on derivatives	<b>(3.68)</b>	1.44	<b>(0.15)</b>	(1.22)
Operating expenses	<b>(16.53)</b>	(14.90)	<b>(17.29)</b>	(15.96)
Transportation expenses	<b>(0.72)</b>	(0.44)	<b>(0.69)</b>	(0.47)
Operating netbacks	<b>31.31</b>	28.46	<b>30.63</b>	25.25
General and administrative expenses	<b>(4.10)</b>	(4.71)	<b>(4.28)</b>	(4.69)
Transaction costs	–	–	<b>(0.05)</b>	(0.02)
Interest and financing charges	<b>(0.94)</b>	(0.72)	<b>(0.89)</b>	(1.13)
Interest on convertible debentures	<b>(1.23)</b>	(1.24)	<b>(1.25)</b>	(0.64)
Asset retirement expenditures	<b>(0.90)</b>	(1.02)	<b>(1.29)</b>	(0.85)
Current income taxes	<b>(0.50)</b>	(0.34)	<b>(0.34)</b>	(0.12)
Funds flow netbacks	<b>23.64</b>	20.43	<b>22.53</b>	17.80

## Depletion and Depreciation Expense

Depletion and depreciation expense for the third quarter of 2013 decreased two percent to \$11.42 million compared to \$11.70 million in the third quarter of 2012. On a per barrel of oil equivalent basis, the depletion and depreciation rates were \$16.42 and \$16.66 for the third quarter of 2013 and the third quarter of 2012, respectively. When compared to the third quarter of 2012, the decreased depletion expense is primarily due to reduced depletable balances resulting from property sales and lower production volumes. The 2012 calendar year depletion and depreciation rate was \$16.22 per barrel of oil equivalent.

## Accretion of Asset Retirement Obligations and Convertible Debentures

The accretion expense of asset retirement obligations for the third quarter of 2013 was \$0.72 million, a seven percent increase from the third quarter of 2012. Year-over-year adjustments are due to changes in the estimated future liability for asset retirement obligations resulting from changes in cost assumptions and adjustments in Zargon's well count due to drilling programs and property acquisitions or dispositions.

The debt portion of Zargon's convertible debenture is also accreted over its term, up to the total maturity value of \$57.50 million. Accretion on the convertible debenture for the 2013 third quarter is \$0.29 million.

## Shared-based Compensation

Expensing of share-based compensation in the third quarter of 2013 totalled \$0.44 million, which is lower than the \$0.57 million incurred in the third quarter of 2012 due to a lower black scholes value of the 2013 grants, including the impact of forfeitures, and the completion of vesting conditions in the common share rights incentive plans.

## Unrealized Foreign Exchange

The Company had an unrealized foreign exchange loss of \$0.04 million during the third quarter of 2013 compared to a \$0.03 million loss in the 2012 third quarter. Gains and losses result from transactions in US dollars when they are translated into Canadian dollars. The volatility in the US/Cdn dollar creates non-cash translation gains/losses.

### Gain on Disposal of Assets

During the third quarter of 2013, Zargon closed a property sale in the Harmattan, Alberta area for total gross proceeds of \$1.20 million. Zargon reported a gain of \$1.20 million on the disposal of these assets.

### Exploration and Evaluation Expenses

Non-cash exploration and evaluation expenses for the 2013 third quarter of \$0.67 million were \$1.40 million lower than the third quarter of 2012 expenses of \$2.07 million. Exploration and evaluation expenses are primarily related to undeveloped land expiries during the quarter. The third quarter 2013 exploration and evaluation expense related to expiries in west central and northern Alberta.

### Deferred Tax

The deferred tax recovery for the third quarter of 2013 was \$0.95 million compared to a deferred tax recovery of \$1.48 million in the third quarter of 2012. The decrease in deferred tax recovery is primarily a result of a decreased loss in the quarter.

### Funds Flow from Operating Activities

Funds flow from operating activities in the 2013 third quarter of \$16.45 million was \$2.10 million, or 15 percent higher than the prior year third quarter. The increase in funds flow compared to the prior year third quarter was primarily a result of higher revenues, lower G&A expenses and decreased abandonment costs, which was partially offset by a loss on realized derivatives, higher royalties, higher operating costs and higher interest and financing charges.

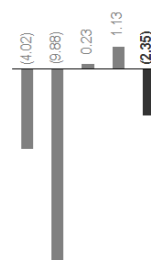
### Net Earnings/(Loss)

The net loss of \$2.35 million for the 2013 third quarter decreased from the \$4.02 million net loss in the 2012 third quarter, largely due to the higher revenues and a gain on the disposal of assets. The net earnings/(loss) track the funds flow from operating activities for the respective periods modified by asset retirement expenditures and non-cash charges, which include depletion and depreciation, unrealized derivative gains/(losses), land expiries, property disposition gains/(losses) and deferred taxes. On a per diluted share basis, the third quarter 2013 net loss was \$0.08 compared to a net loss of \$0.14 for the 2012 third quarter.

### Capital Expenditures

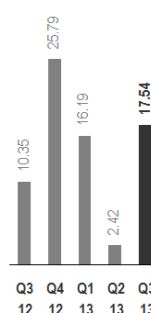
(\$ millions)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Undeveloped land	1.18	1.25	3.09	3.60
Geological and geophysical (seismic)	0.18	0.32	1.05	2.25
Drilling and completion of wells	2.99	3.20	12.05	20.18
Well equipment and facilities	2.95	2.43	12.03	9.69
ASP project	11.37	1.84	23.68	3.33
Exploration and development	18.67	9.04	51.90	39.05
Property acquisitions	0.26	1.28	0.53	2.07
Property dispositions	(1.40)	(0.01)	(16.30)	(36.77)
Net property acquisitions/(dispositions)	(1.14)	1.27	(15.77)	(34.70)
Total net capital expenditures excluding administrative assets	17.53	10.31	36.13	4.35
Administrative assets	0.01	0.04	0.02	0.11
Total net capital expenditures	17.54	10.35	36.15	4.46

Net Earnings/  
(Loss)  
(\$ millions)



Q3 12 Q4 12 Q1 13 Q2 13 Q3 13

Net Capital  
Expenditures/  
(Dispositions)  
(\$ millions)



Q3 12 Q4 12 Q1 13 Q2 13 Q3 13

## SUBSEQUENT EVENTS

In October, Zargon closed a transaction to sell working interests in various Alberta Plains properties with approximately 120 barrels of oil per day and 0.18 million cubic feet of natural gas per day of existing production for a total consideration of \$7.50 million, comprised of \$6.70 million of cash and \$0.80 million of common equity of a small Canadian public company.

## LIQUIDITY AND CAPITAL RESOURCES

Total net capital expenditures (including net property acquisitions/(dispositions)) totalled \$17.54 million in the third quarter of 2013 which compared to \$10.35 million of net capital expenditures in the same period in 2012. Field expenditures of \$18.67 million for the third quarter of 2013 were 107 percent higher than the 2012 third quarter. The third quarter 2013 field capital expenditures (excluding net property dispositions) were allocated to Alberta Plains North - \$1.95 million, Alberta Plains South - \$14.65 million and Williston Basin - \$2.07 million and included the drilling of 3.0 net wells, unchanged from the net wells drilled in the third quarter of 2012. Included in the Alberta Plains South capital expenditures is the \$11.37 million incurred on the Little Bow ASP project.

Funds flow from operating activities in the 2013 third quarter of \$16.45 million and proceeds from the sale of properties of \$1.40 million were used to partially fund the capital program and cash dividends to shareholders.

At September 30, 2013, the Company's combined debt net of working capital (excluding unrealized derivative assets/liabilities) was \$117.61 million, which compares to \$113.18 million of net debt at the end of December 31, 2012. The increase in net debt was due to Zargon's 2013 third quarter capital program. The \$117.61 million debt net of working capital consists of the \$57.50 million of full future face value convertible unsecured subordinate debentures and the remaining portion of bank debt.

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

### Cash Dividends Analysis

(\$ millions)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Cash flows from operating activities	<b>16.30</b>	12.16	<b>43.44</b>	42.02
Net earnings/(loss)	<b>(2.35)</b>	(4.02)	<b>(0.99)</b>	4.51
Actual cash dividends paid or payable relating to the period <sup>(1)</sup>	<b>(5.17)</b>	(7.75)	<b>(14.94)</b>	(22.65)
Excess of cash flows from operating activities over cash dividends paid	<b>11.13</b>	4.41	<b>28.50</b>	19.37
Excess (shortfall) of net earnings/(loss) over cash dividends paid	<b>(7.52)</b>	(11.77)	<b>(15.93)</b>	(18.14)

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

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

production declines. The success of these capital programs, along with commodity price fluctuations and the Company's ability to manage costs, are the main factors influencing the sustainability of the Company's dividends.

For the three months ended September 30, 2013, cash flows from operating activities (after changes in non-cash working capital) of \$16.30 million exceeded cash dividends of \$5.17 million. Similarly, for the three months ended September 30, 2012, cash flows from operating activities (after changes in non-cash working capital) of \$12.16 million exceeded cash dividends of \$7.75 million.

For the three months ended September 30, 2013, a net loss of \$2.35 million was exceeded by cash dividends of \$5.17 million. The net loss includes significant non-cash charges of \$19.42 million for the 2013 third quarter that does not impact cash flow. For the three months ended September 30, 2012, a net loss of \$4.02 million was exceeded by cash dividends of \$7.75 million. In the instances where dividends exceed net earnings, a portion of the cash dividend paid to shareholders may represent an economic return of the shareholders' capital.

For the quarter ended September 30, 2013, cash dividends and net capital expenditures totalled \$22.71 million, which was \$6.41 million higher than the cash flows from operating activities (after changes in non-cash working capital) of \$16.30 million. Zargon relies on access to debt and capital markets to the extent that cash dividends and net capital expenditures exceed cash flows from operating activities (after changes in non-cash working capital). Over the long term, Zargon expects to fund cash dividends and capital expenditures with its cash flows from operating activities; however, it may continue to fund acquisitions and growth through additional debt and equity issuances. In the crude oil and natural gas industry, because of the nature of reserve reporting, the natural reservoir declines and the risks involved in capital investment, it is not possible to distinguish between capital spent on maintaining productive capacity and capital spent on growth opportunities. Therefore, maintenance capital is not disclosed separately from development capital spending.

At November 13, 2013, Zargon Oil & Gas Ltd. had 30.087 million common shares outstanding. Pursuant to the common share rights incentive plans, there are currently an additional 0.959 million common share incentive rights issued and outstanding.

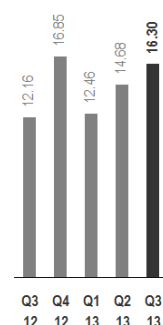
Zargon had a Dividend Reinvestment Plan (the "DRIP") which allowed eligible shareholders to reinvest cash dividends in additional common shares which, when issued from treasury, were issued at 95 percent of the "Average Market Price" (as defined in the DRIP) on the applicable dividend payment date. The DRIP was suspended starting with the September 2013 dividend payable October 15, 2013.

### Capital Sources and Uses

(\$ millions)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Funds flow from operating activities	<b>16.45</b>	14.35	<b>46.34</b>	40.24
Change in long term bank debt	<b>1.59</b>	3.44	<b>7.92</b>	(65.12)
Issuance of convertible debentures, net of transaction cost	–	–	–	54.65
Issuance of common shares	–	–	–	0.11
Cash dividends to shareholders <sup>(1)</sup>	<b>(5.17)</b>	(7.75)	<b>(14.94)</b>	(22.65)
Changes in working capital and other	<b>4.67</b>	0.31	<b>(3.17)</b>	(2.77)
<b>Total capital sources</b>	<b>17.54</b>	10.35	<b>36.15</b>	4.46

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

Cash Flows from Operating Activities  
(\$ millions)



## CHANGES IN ACCOUNTING POLICIES

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

## FUTURE CHANGES IN ACCOUNTING POLICIES

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

## MANAGEMENT AND FINANCIAL REPORTING SYSTEMS

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

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

## OUTLOOK

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



## SUMMARY OF QUARTERLY RESULTS

	2013		
	Q1	Q2	Q3
Petroleum and natural gas sales (\$ millions)	37.08	40.59	<b>45.14</b>
Net earnings/(loss) (\$ millions)	0.23	1.13	<b>(2.35)</b>
Net earnings/(loss) per diluted share (\$)	0.01	0.04	<b>(0.08)</b>
Funds flow from operating activities (\$ millions)	13.90	15.99	<b>16.45</b>
Funds flow from operating activities per diluted share (\$)	0.46	0.53	<b>0.55</b>
Cash flows from operating activities (\$ millions)	12.46	14.68	<b>16.30</b>
Cash flows from operating activities per diluted share (\$)	0.42	0.49	<b>0.54</b>
Cash dividends (\$ millions) <sup>(1)</sup>	4.75	5.01	<b>5.17</b>
Cash dividends declared per common share (\$)	0.18	0.18	<b>0.18</b>
Net capital expenditures (\$ millions)	16.19	2.42	<b>17.54</b>
Total assets (\$ millions)	450.34	437.88	<b>441.87</b>
Long term bank debt (\$ millions)	44.02	42.06	<b>43.65</b>
Convertible debentures (\$ millions) <sup>(2)</sup>	57.50	57.50	<b>57.50</b>
Net debt <sup>(3)</sup>	120.10	111.33	<b>117.61</b>
Average daily oil and liquids production (bbl)	5,113	4,930	<b>4,816</b>
Average daily natural gas production (mmcf)	15.21	14.77	<b>16.46</b>
Average daily production (boe)	7,648	7,392	<b>7,560</b>
Average oil production weighting (%)	67	67	<b>64</b>
Average realized commodity field price before the impact of financial risk management contracts (\$/boe)	53.87	60.34	<b>64.90</b>
Funds flow netback (\$/boe)	20.20	23.77	<b>23.64</b>

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

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

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

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

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

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

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

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

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

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

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

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

Calgary, Alberta  
November 13, 2013

## CONSOLIDATED BALANCE SHEETS

(unaudited)

(\$ thousands)	Notes	September 30, 2013	December 31, 2012
<b>ASSETS</b>			
Trade and other receivables		16,529	16,660
Deposits and prepaid expenses		1,428	1,715
Derivatives	11,12	121	4,514
<b>Total current assets</b>		<b>18,078</b>	<b>22,889</b>
Long term deposits		128	269
Derivatives	11,12	16	284
Property, plant and equipment, net	4	392,878	389,971
Intangible exploration and evaluation assets	5	17,233	19,968
Goodwill	5	2,969	2,969
Deferred tax assets		10,570	8,755
<b>Total non-current assets</b>		<b>423,794</b>	<b>422,216</b>
<b>Total assets</b>		<b>441,872</b>	<b>445,105</b>
<b>LIABILITIES</b>			
Trade and other payables		31,829	35,777
Cash dividends payable	6	1,805	1,656
Provisions	7	776	881
Derivatives	11,12	5,118	72
<b>Total current liabilities</b>		<b>39,528</b>	<b>38,386</b>
Long term bank debt	8	43,654	35,736
Convertible debentures		52,184	51,261
Derivatives	11,12	1,159	191
Provisions	7	111,420	112,283
Deferred tax liabilities		11,422	10,665
<b>Total non-current liabilities</b>		<b>219,839</b>	<b>210,136</b>
<b>Total liabilities</b>		<b>259,367</b>	<b>248,522</b>
Commitments and contingencies	4,7,8,10,11,12		
<b>EQUITY</b>			
Shareholders' capital	9	256,082	254,400
Accumulated other comprehensive gain/(loss)		(302)	(998)
Contributed surplus	10	11,865	11,133
Equity component of debentures		3,640	3,640
Deficit		(88,780)	(71,592)
<b>Total equity</b>		<b>182,505</b>	<b>196,583</b>
<b>Total equity and liabilities</b>		<b>441,872</b>	<b>445,105</b>

See accompanying notes to the interim consolidated financial statements.

## CONSOLIDATED STATEMENTS OF EARNINGS AND COMPREHENSIVE INCOME

(unaudited)		Three Months Ended September 30,		Nine Months Ended September 30,	
(\$ thousands, except per share amounts)	Notes	2013	2012	2013	2012
Petroleum and natural gas sales		45,136	36,906	122,805	120,065
Royalties		(8,802)	(7,160)	(22,540)	(23,079)
<b>PETROLEUM AND NATURAL GAS REVENUE, NET OF ROYALTIES</b>		<b>36,334</b>	<b>29,746</b>	<b>100,265</b>	<b>96,986</b>
Gain/(loss) on unrealized derivatives	11,12	(7,986)	(5,214)	(10,675)	10,960
Gain/(loss) on realized derivatives	11,12	(2,556)	1,017	(318)	(2,758)
<b>GAIN/(LOSS) ON DERIVATIVES</b>		<b>(10,542)</b>	<b>(4,197)</b>	<b>(10,993)</b>	<b>8,202</b>
<b>TOTAL INCOME</b>		<b>25,792</b>	<b>25,549</b>	<b>89,272</b>	<b>105,188</b>
Operating		11,498	10,466	35,558	36,069
Transportation		500	306	1,399	1,069
General and administrative		2,852	3,311	8,799	10,604
Transaction costs		–	2	97	37
Exploration and evaluation	5	671	2,073	2,994	4,464
Gain on disposal of properties	4	(1,200)	–	(269)	(20,820)
Share-based compensation	10	439	571	1,154	1,543
Unrealized foreign exchange (gain)/loss		40	32	(148)	51
Impairment loss		–	–	–	22,865
Depletion and depreciation		11,418	11,702	33,912	36,787
<b>EXPENSES</b>		<b>26,218</b>	<b>28,463</b>	<b>83,496</b>	<b>92,669</b>
<b>EARNINGS/(LOSS) BEFORE FINANCE EXPENSES AND INCOME TAXES</b>		<b>(426)</b>	<b>(2,914)</b>	<b>5,776</b>	<b>12,519</b>
Interest and financing charges	8	650	508	1,840	2,559
Interest on convertible debentures		855	868	2,580	1,447
Accretion on convertible debentures		293	300	923	500
Accretion of asset retirement obligations	7	716	668	2,153	2,072
<b>FINANCE EXPENSES</b>		<b>2,514</b>	<b>2,344</b>	<b>7,496</b>	<b>6,578</b>
<b>EARNINGS/(LOSS) BEFORE INCOME TAXES</b>		<b>(2,940)</b>	<b>(5,258)</b>	<b>(1,720)</b>	<b>5,941</b>
Current tax expense		350	241	694	281
Deferred tax expense/(recovery)		(945)	(1,481)	(1,421)	1,153
<b>INCOME TAXES EXPENSE/(RECOVERY)</b>		<b>(595)</b>	<b>(1,240)</b>	<b>(727)</b>	<b>1,434</b>
<b>NET EARNINGS/(LOSS) FOR THE PERIOD</b>		<b>(2,345)</b>	<b>(4,018)</b>	<b>(993)</b>	<b>4,507</b>
Currency translation adjustment that may be reclassified subsequently to net earnings		(489)	(676)	696	(619)
<b>OTHER COMPREHENSIVE EARNINGS/(LOSS) FOR THE PERIOD</b>		<b>(489)</b>	<b>(676)</b>	<b>696</b>	<b>(619)</b>
<b>TOTAL COMPREHENSIVE EARNINGS/(LOSS) FOR THE PERIOD</b>		<b>(2,834)</b>	<b>(4,694)</b>	<b>(297)</b>	<b>3,888</b>
<b>NET EARNINGS/(LOSS) PER SHARE</b>					
Basic		(0.08)	(0.14)	(0.03)	0.15
Diluted		(0.08)	(0.14)	(0.03)	0.15

See accompanying notes to the interim consolidated financial statements.

## CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

(unaudited)

(\$ thousands)	Notes	Shareholders' Capital	Accumulated Other Comprehensive Income	Contributed Surplus	Equity Component of Convertible Debentures	Deficit	Total Equity
<b>Balance at December 31, 2012</b>		<b>254,400</b>	<b>(998)</b>	<b>11,133</b>	<b>3,640</b>	<b>(71,592)</b>	<b>196,583</b>
Net earnings for the period		-	-	-	-	(993)	(993)
Dividends declared	6	-	-	-	-	(16,195)	(16,195)
Issue of common shares pursuant to the DRIP	6,9	1,260	-	-	-	-	1,260
Share-based compensation	10	-	-	1,154	-	-	1,154
Exercise of share options	9	422	-	(422)	-	-	-
Translation differences on foreign subsidiary		-	696	-	-	-	696
<b>Balance at September 30, 2013</b>		<b>256,082</b>	<b>(302)</b>	<b>11,865</b>	<b>3,640</b>	<b>(88,780)</b>	<b>182,505</b>
<b>Balance at December 31, 2011</b>		249,470	(600)	9,200	-	(34,265)	223,805
Net earnings for the period		-	-	-	-	4,507	4,507
Dividends declared	6	-	-	-	-	(26,583)	(26,583)
Issue of common shares pursuant to the DRIP	6	3,936	-	-	-	-	3,936
Issuance of convertible debentures		-	-	-	3,640	-	3,640
Share-based compensation	10	-	-	1,562	-	-	1,562
Exercise of share options		320	-	(214)	-	-	106
Translation differences on foreign subsidiary		-	(619)	-	-	-	(619)
<b>Balance at September 30, 2012</b>		<b>253,726</b>	<b>(1,219)</b>	<b>10,548</b>	<b>3,640</b>	<b>(56,341)</b>	<b>210,354</b>

See accompanying notes to the interim consolidated financial statements.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)		Three Months Ended September 30,		Nine Months Ended September 30,	
(\$ thousands)	Notes	2013	2012	2013	2012
<b>OPERATING ACTIVITIES</b>					
Net earnings/(loss) for the period		(2,345)	(4,018)	(993)	4,507
Adjustments for non-cash items:					
Gain on sale of properties	4	(1,200)	–	(269)	(20,820)
(Gain)/loss on unrealized derivatives	11,12	7,986	5,214	10,675	(10,960)
Depletion and depreciation		11,418	11,702	33,912	36,787
Accretion of asset retirement obligations	7	716	668	2,153	2,072
Accretion of convertible debentures		293	300	923	500
Share-based compensation	10	439	571	1,154	1,543
Unrealized foreign exchange (gain)/loss		40	32	(148)	51
Impairment loss		–	–	–	22,865
Deferred tax expense/(recovery)		(945)	(1,481)	(1,421)	1,153
Exploration and evaluation expenses	5	671	2,073	2,994	4,464
Asset retirement expenditures		(628)	(709)	(2,645)	(1,923)
Funds flow from operating activities		16,445	14,352	46,335	40,239
Changes in operating working capital		(143)	(2,190)	(2,896)	1,778
Net cash from operating activities		16,302	12,162	43,439	42,017
<b>INVESTING ACTIVITIES</b>					
Additions to property, plant and equipment	4	(18,925)	(10,103)	(52,175)	(40,072)
Additions to intangible exploration and evaluation assets	5	(10)	(241)	(273)	(1,153)
Proceeds/(adjustments) on disposal of property, plant and equipment	4	1,397	(15)	16,265	36,766
Proceeds on disposal of intangible exploration and evaluation assets	5	–	–	33	–
Change in long term deposits		141	–	141	149
Changes in investing working capital		4,558	2,326	(562)	(4,832)
Net cash used in investing activities		(12,839)	(8,033)	(36,571)	(9,142)
<b>FINANCING ACTIVITIES</b>					
Advances/(repayments) of bank debt		1,593	3,442	7,918	(65,121)
Cash dividends paid to shareholders	6	(5,174)	(7,745)	(14,935)	(22,647)
Proceeds from exercise of share rights		–	–	–	106
Issuance of convertible debentures, net of issue costs		–	–	–	54,650
Changes in financing working capital		118	174	149	137
Net cash used in financing activities		(3,463)	(4,129)	(6,868)	(32,875)
<b>NET CHANGE IN CASH DURING THE PERIOD AND CASH, END OF PERIOD</b>		–	–	–	–

See accompanying notes to the interim consolidated financial statements.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the three and nine months ended September 30, 2013, with comparative figures for 2012 (unaudited).*

## **1. REPORTING ENTITY**

Zargon Oil & Gas Ltd. ("the Company" or "Zargon") is a publicly traded corporation incorporated in Canada with its head office located at Suite 700, 333-5<sup>th</sup> Avenue SW, Calgary, Alberta. The interim consolidated financial statements of the Company as at and for the period ended September 30, 2013 and for its 2012 comparative period comprise the Company and its wholly owned subsidiaries. The Company is engaged in the exploration for and development and production of oil and natural gas in Canada and the United States ("US") and conducts many of its activities jointly with others; these financial statements reflect only the Company's proportionate interest in such activities.

## **2. BASIS OF PRESENTATION**

### **(a) Statement of compliance:**

The unaudited interim consolidated financial statements for the three and nine month periods ended September 30, 2013 have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") applicable to the preparation of interim financial statements, including International Accounting Standards ("IAS") 34, Interim Financial Reporting. The same accounting policies and methods of computation were followed in the preparation of these unaudited interim consolidated financial statements as were followed in the preparation of the audited annual consolidated financial statements for the fiscal year ended December 31, 2012 except as disclosed in Note 3. The disclosures provided below are incremental to those included with the audited annual consolidated financial statements. These unaudited interim consolidated financial statements for the three and nine month periods ended September 30, 2013 should be read in conjunction with the annual consolidated financial statements for the year ended December 31, 2012. These consolidated financial statements were approved and authorized for issue by the Board of Directors on November 13, 2013.

### **(b) Basis of measurement:**

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

### **(c) Functional and presentation currency:**

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

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

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

### **(d) Use of estimates and judgements:**

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

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



### 3. ACCOUNTING POLICIES

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

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

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

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

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

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

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

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

The adoption of these standards effective January 1, 2013 did not have an impact on the Company's consolidated financial statements.

- IAS 1 “Presentation of Items of Other Comprehensive Income” – Amendments to IAS 1. The amendments to IAS 1 improve the quality of the presentation of Other Comprehensive Income (“OCI”). The amendments require companies preparing financial statements in accordance with IFRS to group together items within OCI that may be reclassified to the profit or loss section of the income statement. The amendments also reaffirm existing requirements that items in OCI and profit or loss should be presented as either a single statement or two consecutive statements. The amendment affected presentation only and had no impact on the Company's financial position or performance as at January 1, 2013.
- IAS 19 “Employee Benefits” was amended in June 2011 with revisions to certain aspects of the accounting for pension plans and other benefits, including amendments to the recognition, disaggregation, presentation and disclosure of all employee benefits. The adoption of this standard effective January 1, 2013 did not have an impact on the Company's consolidated financial statements.
- IFRS 7 “Financial Instruments: Disclosures” – Offsetting Financial Assets and Financial Liabilities – Amendments to IFRS 7 introduce new disclosure requirements about the effects of offsetting financial assets and financial liabilities and related arrangements on an entity's financial position. The disclosures will provide users with information that may be useful in evaluating the effect of any netting arrangements in an entity's financial position. As the Company is not netting any significant amounts related to financial instruments in accordance with IAS 32 and does not have significant offsetting arrangements, the amendment effective January 1, 2013 does not have an impact on the Company.
- IFRS 13 “Fair Value Measurement” provides a single, comprehensive framework for fair value measurement and disclosure requirements for use across all IFRS standards. IFRS 13 clarifies that the fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The measurement of the fair value of an asset or liability is based on assumptions that market participants would use when pricing the asset or liability under current market conditions, including assumptions about risk. Under IFRS 13, the fair value of a liability must reflect the non-performance risk, which includes an entity's own credit risk. The Company adopted IFRS 13 on January 1, 2013 on a prospective basis. The adoption of IFRS 13 did not

require any adjustments to the valuation techniques used by the Company to measure fair value and did not result in any measurement adjustments as at January 1, 2013.

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

- IAS 36 "Impairment of Assets", has been amended to require additional disclosures in the event of recognizing an impairment of assets. The retrospective application of this standard is required to be adopted for periods on or after January 1, 2014. The Company is currently assessing the impact of this amendment on its consolidated financial statements.

#### 4. PROPERTY, PLANT AND EQUIPMENT

	Nine Months Ended
(\$ thousands)	September 30, 2013
Cost, December 31, 2012	535,791
Accumulated depletion and depreciation	(145,820)
Net carrying amount, December 31, 2012	389,971
Additions	52,444
Disposals	(16,213)
Change in asset retirement obligation	(660)
Assets transferred from intangible exploration and evaluation assets	25
Exchange differences	1,223
Depletion and depreciation	(33,912)
Net carrying amount, September 30, 2013	392,878
Cost, September 30, 2013	568,210
Accumulated depletion and depreciation	(175,332)
Net carrying amount, September 30, 2013	392,878

Property, plant and equipment are not depleted or depreciated for a major development project until production commences. As at September 30, 2013, \$30.80 million (December 31, 2012 - \$6.48 million) of a major development project was not depleted or depreciated.

During the nine months ended September 30, 2013, the Company disposed of certain assets for gross cash proceeds of \$16.27 million (September 30, 2012 - \$36.77 million), resulting in a gain of \$0.27 million (September 30, 2012 - \$20.82 million gain).

As at September 30, 2013, the Company is committed to \$3.70 million in project equipment where payment is required in less than one year.

#### 5. INTANGIBLE EXPLORATION AND EVALUATION ASSETS AND GOODWILL

(\$ thousands)	Goodwill	E&E Assets	Total
Cost:			
Balance at December 31, 2012	2,969	19,968	22,937
Additions	-	273	273
Disposals	-	(33)	(33)
Transfers to property, plant and equipment	-	(25)	(25)
Exploration and evaluation expense	-	(2,994)	(2,994)
Exchange differences	-	44	44
Balance at September 30, 2013	2,969	17,233	20,202

## 6. CASH DIVIDENDS

During the nine month period, the Company declared dividends to the shareholders in the aggregate amount of \$16.20 million (2012 – \$26.58 million) in accordance with the following schedule:

2013 Dividends <sup>(1)</sup>	Record Date	Dividend Date	Per Common Share
January	January 31, 2013	February 15, 2013	\$0.06
February	February 28, 2013	March 15, 2013	\$0.06
March	March 31, 2013	April 15, 2013	\$0.06
April	April 30, 2013	May 15, 2013	\$0.06
May	May 31, 2013	June 17, 2013	\$0.06
June	June 30, 2013	July 15, 2013	\$0.06
July	July 31, 2013	August 15, 2013	\$0.06
August	August 31, 2013	September 16, 2013	\$0.06
September	September 30, 2013	October 15, 2013	\$0.06

(1) The 2013 cash dividends include a non-cash equity issuance amount of \$1.26 million (2012 – \$3.93 million) for the Dividend Reinvestment Plan.

Subsequent to the end of the period and prior to the consolidated financial statements being authorized for issue on November 13, 2013, the Company declared dividends of \$1.81 million or \$0.06 per share for October 2013.

## 7. PROVISIONS

(\$ thousands)	Asset Retirement Obligations	Other	Total
Balance at December 31, 2012	112,283	881	113,164
Provisions made during the period	838	–	838
Foreign exchange and other	289	–	289
Provisions used during the period	(2,645)	(105)	(2,750)
Provisions related to dispositions	(1,498)	–	(1,498)
Accretion	2,153	–	2,153
Balance at September 30, 2013	111,420	776	112,196
Current	–	776	776
Non-current	111,420	–	111,420

Asset retirement obligation:

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

Other:

Zargon is subject to normal course income tax audits by Canadian and US taxation authorities. During the fourth quarter of 2010, the Canada Revenue Agency commenced a flow-through share audit of a predecessor company from a prior corporate acquisition. During the first quarter of 2011, Zargon recorded a \$1.27 million provision which was comprised of a \$0.92 million charge to current income tax expense and \$0.35 million charge to interest expense for the related Part XII.6 tax, with respect to this ongoing income tax audit. The interest expense related to the Part XII.6 tax has been paid to the Canada Revenue Agency and the remaining provision is currently \$0.78 million.

## 8. LONG TERM BANK DEBT

On June 10, 2013, Zargon amended and renewed its syndicated committed credit facilities, the result of which was the maintaining of the available facilities and borrowing base of \$165 million. A \$300 million demand debenture on the assets of the Company has been provided as security for these facilities. The facilities are fully revolving for a 364 day period with the provision for an annual extension at the option of the lenders and upon notice from Zargon's Management. The next renewal date is June 25, 2014, with a semi-annual review that took place in the fall of 2013. Should the facilities not be renewed, they convert to one year non-revolving term facilities at the end of the revolving 364 day period. Repayment would not be required until the end of the non-revolving term, and, as such, these facilities have been classified as long term debt.

Interest rates fluctuate under the syndicated facilities with Canadian prime, US prime and US base rates plus an applicable margin between 50 basis points and 200 basis points as well as with Canadian banker's acceptance and LIBOR rates plus an applicable margin between 200 basis points and 350 basis points. At September 30, 2013, \$43.65 million (December 31, 2012 - \$35.74 million) had been drawn on the syndicated committed credit facilities with any unused amounts subject to standby fees. In the normal course of operations Zargon enters into various letters of credit. At September 30, 2013, the approximate value of outstanding letters of credit totalled \$0.79 million (December 31, 2012 - \$0.71 million). The letters of credit reduce the amount of Zargon's available credit facilities to \$120.56 million at September 30, 2013 (December 31, 2012 - \$128.55 million).

Zargon reviews its compliance with its bank debt covenants on a quarterly basis and is in compliance as at September 30, 2013.

## 9. SHARE CAPITAL

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

Zargon had a Dividend Reinvestment Plan ("DRIP") in place in conjunction with the Company's transfer agent to provide the option for shareholders to reinvest cash dividends into common shares issued from treasury at a five percent discount to the prevailing market price. Commencing with Zargon's September's 2013 dividend payable on October 15, 2013 Zargon's Board of Directors has suspended Zargon's DRIP until further notice.

### Common Shares

	Nine Months Ended September 30, 2013	
(thousands)	Number of Shares	Amount (\$)
Balance, as at December 31, 2012	29,868	254,400
Share awards exercised	28	-
Share-based compensation recognized on exercise of share options	-	422
Issued pursuant to the Dividend Reinvestment Plan	191	1,260
Balance, as at September 30, 2013	30,087	256,082

## 10. SHARE-BASED PAYMENTS

### Share Award Plan

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

Due to the nature of the plan, Zargon is required to estimate the forfeiture rate upon initial calculation of fair values. The forfeiture rate is estimated at 15 percent while the interest rate and volatility is set at a historical rate as there is no exercise price. The fair value of the share award is determined on the grant date at the prior day closing price of the Company's common shares on the Toronto Stock Exchange.

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

	Nine Months Ended September 30, 2013
	Number of Share Awards (thousands)
Outstanding, as at December 31, 2012	322
Share awards granted	318
Share awards exercised	(28)
Share awards forfeited	(47)
Outstanding, as at September 30, 2013	565

#### Common Share Rights Incentive Plans

In conjunction with the corporation conversion on December 31, 2010, Zargon's two original Trust Unit Rights Incentive Plans were amended and restated as Common Shares Rights Incentive Plans. Under these plans, directors, officers, employees and other service providers of the Company possess rights to acquire common shares at their option of either the original exercise price or a "modified price" as calculated per the provisions of the relevant plan. The Common Share Rights Incentive Plan (2007) (the "Old Plan") expired in the first quarter of 2013. Under the Common Share Rights Incentive Plan (2009) (the "New Plan"), if the monthly dividend exceeds the monthly return of 0.833 percent of the Company's recorded net book value of oil and natural gas properties (as defined under the New Plan), the entire amount of the dividend is deducted from the original grant price. Options granted under either Plan generally vest equally over a three-year period and expire approximately five years from the grant date. Zargon uses a fair value methodology to value the option grants.

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

	Nine Months Ended September 30, 2013	
	Number of Share Options (thousands)	Weighted Average Exercise Price Initial and Modified (\$/share)
Outstanding at beginning of period	170	23.23 / 21.40
Share options expired	(170)	23.23
Outstanding at end of period	-	-

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

	Nine Months Ended September 30, 2013	
	Number of Share Options (thousands)	Weighted Average Exercise Price Initial and Modified (\$/share)
Outstanding at beginning of period	458	18.08 / 14.44
Share options forfeited	(64)	18.09
Outstanding at end of period	394	18.07 / 14.40

### Share-based Compensation

The share awards for the three and nine months ended September 30, 2013, resulted in share-based compensation of \$0.44 million (2012 - \$0.57 million) and \$1.15 million (2012 - \$1.54 million), respectively.

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

### Weighted Average Number of Total Shares

(thousands of shares)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Weighted average number of common shares – basic	30,065	29,689	29,990	29,536
Weighted average number of common shares – diluted	30,065	29,689	29,990	29,621

Dilution amounts for the three and nine months ended September 30, 2013 of nil shares (2012 – nil shares) and nil shares (2012 – 0.09 million shares), respectively, were added to the weighted average number of shares outstanding during the period in the calculation of diluted per share amounts. For 2012, these share additions represent the dilutive effect of share rights according to the treasury stock method.

The convertible debenture could potentially dilute basic earnings per share, but were not included in the calculation of diluted earnings per share because they are antidilutive for the three and nine months ended September 30, 2013.

### 11. FINANCIAL INSTRUMENTS

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

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

	September 30, 2013		December 31, 2012	
	Carrying Amount (\$)	Fair Value (\$)	Carrying Value (\$)	Fair Value (\$)
<b>Loans and receivables:</b>				
Trade and other receivables	16,529	16,529	16,660	16,660
<b>Fair value through profit and loss:</b>				
Derivative assets	137	137	4,798	4,798
Derivative liabilities	6,277	6,277	263	263
<b>Other liabilities:</b>				
Trade and other payables	31,829	31,829	35,777	35,777
Cash dividends	1,805	1,805	1,656	1,656
Long term bank debt	43,654	43,654	35,736	35,736
Convertible debentures	52,184	56,344	51,261	57,500

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

- Level I

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

- Level II

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

- Level III

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

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

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

- Market Risk

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

- Commodity Price Risk

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

Natural Gas – To partially mitigate the natural gas commodity price risk, the Company has entered into a swap, which fixes the Canadian dollar AECO prices.

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

- Interest Rate Risk

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

At the September 30, 2013 debt pricing levels, the increase or decrease in net earnings for the year for each one percent change in interest rates would amount to \$0.33 million (September 30, 2012 - \$0.47 million) before swaps.

- Foreign Exchange Risk

Foreign currency exchange rate risk is the risk that the fair value of future cash flows will fluctuate as a result of changes in foreign exchange rates. The underlying market prices in Canada for petroleum and natural gas are impacted by changes in the exchange rate between the Canadian and United States dollar. As Zargon operates in North America, fluctuations in the exchange rate between the US/Canadian dollar can have a significant effect on the Company's reported results. A \$0.01 change in the US to Canadian dollar exchange rate would have resulted in a \$0.63 million (September 30, 2012 - \$0.60 million) increase or decrease in net earnings for the nine month period ended September 30, 2013. In order to mitigate the Company's exposure to foreign exchange fluctuations, the Company may enter into foreign exchange derivative agreements.

- Credit Risk

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

The maximum credit risk exposure associated with accounts receivable and derivative assets is the total carrying value. The Company monitors these balances monthly to limit the risk associated with collection. Of Zargon's accounts receivable at September 30, 2013, approximately 47 percent (December 31, 2012 - 45 percent) was owing from two companies and Zargon anticipates full collection.

The Company's allowance for doubtful accounts at September 30, 2013 was \$0.28 million (December 31, 2012 - \$0.25 million). During 2013, the Company recorded an additional provision of \$0.03 million for non-collectible accounts receivable.

When determining whether amounts that are past due are collectible, management assesses the credit worthiness and past payment history of the counterparty, as well as the nature of the past due amount. Zargon considers all material amounts greater than 90 days to be past due. As at September 30, 2013, \$0.41 million of accounts receivable are past due, excluding amounts described above, all of which are considered to be collectable.

- Liquidity Risk

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

As at September 30, 2013, Zargon had available unused committed bank credit facilities of approximately \$120.56 million compared to \$128.55 million at December 31, 2012. The Company believes it has sufficient funding through the use of these facilities to meet foreseeable borrowing requirements.

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

(\$ thousands)	1 year	2-4 years	Total
Trade and other payables	31,829	–	31,829
Cash dividends payable	1,805	–	1,805
Derivative liabilities	5,118	1,159	6,277
Long term bank debt	–	43,654	43,654
Interest on convertible debentures	3,450	10,350	13,800
Convertible debentures <sup>(1)</sup>	–	57,500	57,500

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

### Commodity Price Sensitivities

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

Fluctuations of 10 percent in commodity prices could have resulted in unrealized gains or losses of \$12.66 million (September 30, 2012 – \$9.21 million) on risk management contracts impacting net earnings for the nine months ended September 30, 2013.



## 12. DERIVATIVE CONTRACTS

The Company is a party to certain financial instruments that have fixed the price of a portion of its oil production and interest rates. The Company enters into these contracts for risk management purposes only in order to protect a portion of its future cash flows from the volatility of oil and natural gas commodity prices and interest rates. For financial risk management contracts, any unrealized gains or losses are recorded in earnings based on the fair value (mark-to-market) of the contracts at each reporting period. The unrealized gain/loss on the statement of earnings and comprehensive income for the three and nine month periods of 2013 were \$7.99 million loss (2012 - \$5.21 million loss) and \$10.68 million loss (2012 - \$10.96 million gain), respectively. The realized gain/loss on the statement of earnings and comprehensive income for the three and nine month periods of 2013 were \$2.56 million loss (2012 - \$1.02 million gain) and \$0.32 million loss (2012 - \$2.76 million loss), respectively.

As at September 30, 2013, the Company had the following outstanding commodity and interest risk management contracts:

### Commodity Financial Risk Management Contracts:

	Rate	Weighted Average Price	Range of Terms	Fair Market Value Asset/(Liability) (\$ thousands)
Oil swaps	1,400 bbl/d	\$98.52 US/bbl	Oct. 1/13 – Dec. 31/13	(485)
	400 bbl/d	\$96.33 US/bbl	Oct. 1/13 – Mar. 31/14	(363)
	1,200 bbl/d	\$95.59 US/bbl	Oct. 1/13 – Jun. 30/14	(1,445)
	1,400 bbl/d	\$90.30 US/bbl	Jan. 1/14 – Dec. 31/14	(3,171)
	400 bbl/d	\$91.73 US/bbl	Apr. 1/14 – Mar. 31/15	(365)
	400 bbl/d	\$90.00 US/bbl	Jul. 1/14 – Dec. 31/14	(303)
Natural gas swaps	6,000 gj/d	\$3.33/gj	Nov. 1/13 – Mar. 31/14	7
<b>Total Fair Market Value, Commodity Price Financial Contracts</b>				<b>(6,125)</b>

Oil swaps are settled against the NYMEX WTI pricing index, whereas natural gas swaps are settled against the AECO pricing index.

Subsequent to the end of the period and prior to the consolidated financial statements being authorized for issue on November 13, 2013, the Company entered into a natural gas basis swap for 6,000 MMBtu per day of natural gas at \$0.485 US/MMBtu AECO to NYMEX from April 1, 2014 to October 31, 2014.

### Interest Rate Risk Management Contracts:

	Notional Value	Weighted Average Interest Rate <sup>(1)</sup>	Range of Terms	Fair Market Value Asset/(Liability) (\$ thousands)
Interest rate swaps	\$20,000,000/month	1.640%	Oct. 1/13 – Jul. 26/16	24
	\$20,000,000/month	1.731%	Oct. 1/13 – Aug. 26/16	(39)
<b>Total Fair Market Value, Interest Rate Financial Contracts</b>				<b>(15)</b>

<sup>(1)</sup> Excludes the current stamping fee of 2.0 percent for each swap.

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

## 13. SUBSEQUENT EVENT

In October, Zargon closed a transaction to sell working interests in various Alberta Plains properties with approximately 120 barrels of oil per day and 0.18 million cubic feet of gas per day of existing production for a total consideration of \$7.50 million, comprised of \$6.70 million of cash and \$0.80 million of common equity of a small Canadian public company.

# CORPORATE INFORMATION

## BOARD OF DIRECTORS

Craig H. Hansen

*Calgary, Alberta*

K. James Harrison <sup>(2)</sup>

Chairman of the Board

*Oakville, Ontario*

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

*Calgary, Alberta*

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

*Calgary, Alberta*

Geoffrey C. Merritt <sup>(1)</sup>

*Calgary, Alberta*

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

*Calgary, Alberta*

Grant A. Zawalsky <sup>(2)</sup>

*Calgary, Alberta*

## OFFICERS

Craig H. Hansen

President and Chief Executive Officer

Leslie E. Burden

Vice President, Land

Randolph J. Doetzel

Vice President, Operations

Jason B. Dranchuk

Vice President, Finance and  
Chief Financial Officer

Christopher M. Hustad

Vice President, Alberta Plains South

Pete H.S. Janjua

Vice President, Williston Basin

Brian G. Kergan

Vice President, Corporate Development

Kevin C.Y. Lee

Vice President, Alberta Plains North

Robert T. Moriyama

Vice President, Enhanced Recovery

*(1) Audit and Reserves Committee*

*(2) Governance and Compensation Committee*

## STOCK EXCHANGE LISTING

### Toronto Stock Exchange

Common Shares

Trading Symbol: ZAR

Convertible Debentures

Trading Symbol: ZAR.DB

### TRANSFER AGENT

Valiant Trust Company

310, 606 – 4th Street S.W.

Calgary, Alberta T2P 1T1

### BANKERS

The Toronto Dominion Bank

910, 333 – 7th Avenue S.W.

Calgary, Alberta T2P 2Z1

Canadian Imperial Bank of Commerce

9th Floor, Bankers Hall East

855 – 2nd Street S.W.

Calgary, Alberta T2P 2P2

The Bank of Nova Scotia

2000, 700 – 2nd Street S.W.

Calgary, Alberta T2P 2N7

### LEGAL COUNSEL

Burnet, Duckworth & Palmer LLP

2400, 525 – 8th Avenue S.W.

Calgary, Alberta T2P 1G1

### CONSULTING ENGINEERS

McDaniel & Associates Consultants Ltd.

2200, 255 – 5th Avenue S.W.

Calgary, Alberta T2P 3G6

### AUDITORS

Ernst & Young LLP

1000, 440 – 2nd Avenue S.W.

Calgary, Alberta T2P 5E9

### HEAD OFFICE

700, 333 – 5th Avenue S.W.

Calgary, Alberta T2P 3B6

Telephone: 403-264-9992

Fax: 403-265-3026

Email: [zargon@zargon.ca](mailto:zargon@zargon.ca)

### WEBSITE

[www.zargon.ca](http://www.zargon.ca)