ZARGON OIL & GAS LTD.

2014 Q3 FINANCIAL REPORT

FINANCIAL AND OPERATING HIGHLIGHTS

	Three Months Ended September 30,			Nine Months Ended September 30,		
(unaudited)	**2014**	2013	Percent Change	**2014**	2013	Percent Change
Financial						
Income and Investments ($ millions)						
Gross petroleum and natural gas sales	**37.41**	45.14	(17)	**118.54**	122.81	(3)
Funds flow from operating activities	**10.87**	16.45	(34)	**38.04**	46.34	(18)
Cash flows from operating activities	**12.36**	16.30	(24)	**37.25**	43.44	(14)
Cash dividends (net of Dividend Reinvestment Plan)	**5.43**	5.17	5	**16.27**	14.94	9
Net earnings/(loss)	**0.10**	(2.35)	104	**(1.75)**	(0.99)	(77)
Net capital expenditures	**6.09**	17.54	(65)	**34.94**	36.15	(3)
Per Share, Basic						
Funds flow from operating activities ($/share)	**0.36**	0.55	(35)	**1.26**	1.55	(19)
Cash flows from operating activities ($/share)	**0.41**	0.54	(24)	**1.24**	1.45	(14)
Net earnings/(loss) ($/share)	**–**	(0.08)	100	**(0.06)**	(0.03)	(100)
Cash Dividends ($/common share)	**0.18**	0.18	–	**0.54**	0.54	–
Balance Sheet at Period End ($ millions)						
Property and equipment				**384.30**	392.88	(2)
Exploration and evaluation assets				**7.57**	17.23	(56)
Long term bank debt				**59.45**	43.65	36
Convertible debentures at maturity				**57.50**	57.50	–
Shareholders' equity				**157.91**	182.51	(13)
Total Common Shares Outstanding at Period End (millions)				**30.18**	30.09	–
Operating						
Average Daily Production						
Oil and liquids (bbl/d)	**4,194**	4,816	(13)	**4,203**	4,952	(15)
Natural gas (mmcf/d)	**11.16**	16.46	(32)	**13.32**	15.49	(14)
Equivalent (boe/d)	**6,054**	7,560	(20)	**6,422**	7,533	(15)
Average Selling Price (before the impact of financial risk management contracts)						
Oil and liquids ($/bbl)	**86.61**	94.10	(8)	**88.80**	81.92	8
Natural gas ($/mcf)	**3.89**	2.27	71	**4.58**	2.85	61
Wells Drilled, Net	**1.5**	3.0	(50)	**13.2**	8.1	63
Undeveloped Land at Period End (thousand net acres)				**103**	283	(64)

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.

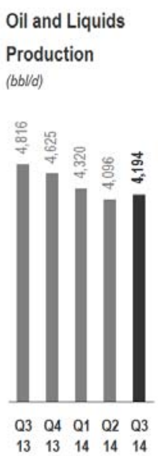
Funds flow from operating activities is an additional GAAP term that represents net earnings/(loss) and asset retirement expenditures except for non-cash items. For a further discussion about this term, refer to the Management's Discussion and Analysis section in this report.

Cash dividends are net of the Dividend Reinvestment Plan in 2013. The Dividend Reinvestment Plan was suspended September 2013.

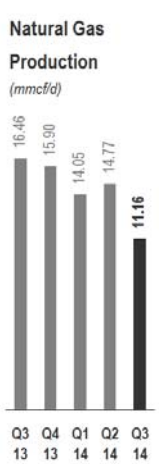
Message to Shareholders [1]

Zargon Oil & Gas Ltd. has released its financial and operating results for the third quarter of 2014 that was highlighted by the disposition of low netback assets and the related one-time reorganization costs. Specific financial and operating highlights in the third quarter of 2014 include:

- Funds flow from operating activities of $10.9 million were eight percent lower than the $11.9 million recorded in the prior quarter due to one time general & administrative reorganization costs. Funds flow from operating activities for the 2014 third quarter included reductions of $2.1 million of realized hedge losses, $1.6 million of one-time general & administration reorganization costs, $0.4 million of transaction costs relating to completed property sales and $0.6 million of asset retirement expenses.
- Third quarter 2014 production averaged 4,194 barrels of oil and liquids per day, a two percent gain from the preceding quarter due to second quarter exploitation drilling successes at Bellshill Lake and Taber. Reflecting completed property dispositions, third quarter 2014 natural gas production of 11.2 million cubic feet per day was 24 percent lower than the preceding quarter. Total production averaged 6,054 barrels of oil equivalent per day, an eight percent decrease from the preceding quarter. For the quarter oil and liquids production increased to 69 percent of total production based on a 6:1 equivalent basis, a ratio that in 2015 is forecast to increase to 80 percent of total production. Importantly, the oil volumes will be comprised of low decline (less than 15 percent annually) waterflood and waterdrive oil volumes that are augmented by increasing ASP tertiary recovery volumes.



- Three monthly cash dividends of $0.06 per common share were declared in the third quarter of 2014 for a total of $5.4 million. These cash dividends were equivalent to a payout ratio of 50 percent of funds flow from operating activities.
- The quarter was highlighted by four property dispositions of high cost natural gas properties that had been producing 7.1 million cubic feet per day and 21 barrels of oil per day (1,200 barrels of oil equivalent per day). Total proceeds from the sales were $6.7 million. The elimination of higher cost, lower netback assets is a key initiative for Zargon. In 2014, Zargon has successfully removed more than 275 net wells from its asset base.
- Third quarter 2014 exploration and development capital expenditures (excluding property acquisitions and dispositions) were $12.8 million and included $5.1 million of expenditures related to the Little Bow ASP project ($1.5 million exploitation and $3.6 million chemical costs). In the quarter, Zargon drilled 2.0 gross (1.5 net) Williston Basin oil wells.
- Zargon's September 30, 2014 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 $129.1 million. At September 30, 2014, Zargon's bank debt was $59.4 million. Pursuant to a semi-annual review, syndicated committed credit facilities have been set at $140 million.



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

Commencing in March 2014, Zargon initiated the injection of large volumes of a dilute chemical solution into a partially depleted Little Bow Mannville I Pool in order to recover substantial incremental oil reserves. To date, ASP injections have totaled approximately 2.3 million barrels, which is about seven percent of the phase 1 targeted reservoir pore volume and represents 11 percent of the total chemical bank (ASP and Polymer only) scheduled to be injected.

Zargon continues to be encouraged by the injection data for the Little Bow ASP enhanced oil recovery project. Increased injection pressures are being observed at seven of the eight ASP injection wells (a remedial workover has been undertaken at the eighth injector), indicating the building of a higher viscosity oil bank within the reservoir. Indicators of ASP fluid movement also continue to provide encouragement, most notably, the production of small concentrations of polymer at producers. To date, minor oil production responses have been observed at two producers.

In preparation for the ASP oil production phase, we continue to optimize producer and injector completion intervals to optimize ASP conformance and recovery. Consequently, current production volumes are slightly under the 250 barrels per day baseline rate for the pre-ASP waterflood project. Notwithstanding the challenges in predicting the initial onset of material ASP production, we are very encouraged by the facility operations, the observed injection performance and the indirect technical evidence of oil banking; all of which are necessary precursors to the highly profitable forecasted reserve recoveries. Over the next few months, a material ramp up in production is anticipated and we will provide timely updates to outline material progress, with the next report in mid-January providing 2014 exit production volumes.

For further information regarding the Little Bow ASP production, reserves and ultimate potential please refer to our updated corporate presentation, which is available at www.zargon.ca.

Other Field Activities [1]

In addition to the third quarter's $5.1 million of ASP project's exploitation and chemical capital expenditures, Zargon executed a $7.7 million capital program in the 2014 third quarter on conventional oil exploitation assets. This program reflected the Williston Basin locations plus facility upgrades, battery optimizations and completions for the second quarter Bellshill Lake and Taber oil exploitation drilling program. For the fourth quarter, Zargon is proceeding with a 5.0 net well oil exploitation drilling program at the Taber Sunburst (2) and Williston Basin Mississippian (3) properties prior to the higher cost winter season.

2014 & 2015 Capital Budgets [1]

In the October 8, 2014 capital budget and ASP update press release, Zargon provided an updated 2014 capital budget of $45 million (after dispositions) and initial 2015 total capital budgets of $46 million, which will be weighted to the second half of the year. Recognizing the current uncertainties regarding oil prices, we will reassess the 2015 capital budget in the first quarter of 2015. At that time, if low oil prices persist, we may defer non-essential conventional capital programs, while prioritizing the funding of our ASP capital programs and dividends.

Zargon has also entered into a significant oil hedging program to provide a measure of stability and predictability to cash flows as we wait for the ASP production volumes to ramp up. For the remainder of 2014, Zargon has hedged 2,600 barrels per day at $90.92 US/bbl WTI and 400 barrels per day at $99.60 Cdn/bbl WTI, while for the first half of 2015 an average of 1,400 barrels per day is hedged at $93.68 US/bbl WTI.

Production Guidance [1]

In the October 8, 2014 capital budget and ASP update press release, Zargon provided third quarter 2014 oil production rate guidance of 4,200 barrels of oil and liquids per day. Actual third quarter volumes were 4,194 barrels of oil and liquids per day and met guidance. The press release also set Zargon's third quarter 2014 natural gas production guidance of 10.2 million cubic feet per day. Third quarter actual volumes were 11.2 million cubic feet per day and exceeded guidance by 10 percent.

Oil and liquids production for the 2014 fourth quarter had been set at 4,200 barrels of oil per day and has now been revised to 4,100 barrels of oil per day due to regulatory and third party facility shut-ins and minor delays in commencing the fall drilling program. Year end exit production rates in excess of 4,200 barrels of oil per day are still anticipated. Fourth quarter natural gas production guidance remains set at 6.8 million cubic feet per day.

Looking forward, we expect that first quarter 2015 production volumes will see an increase in production from the ASP project. We are forecasting a 2015 oil and liquids production rate of 4,700 barrels of oil per day which is comprised of 4,000 barrels of oil per day of conventional production and 700 barrels of oil per day of ASP production. These oil and liquids production guidance levels are dependent on the 2015 capital budgets and the profile of the ASP production ramp-up; and consequently will be revisited in the 2015 first quarter when the 2015 capital program is reappraised. Natural gas volumes are forecast to average 6.4 million cubic feet per day in 2015, provided that further natural gas property dispositions are not concluded.

(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 2014 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, 2014 and the audited consolidated financial statements and related notes for the year ended December 31, 2013. The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"), which are also generally accepted accounting principles ("GAAP") for publicly accountable enterprises in Canada. All amounts are in Canadian dollars unless otherwise noted. All references to "Zargon" or the "Company" refer to Zargon Oil & Gas Ltd.

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

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

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

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

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

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

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

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

Forward-Looking Statements – This document offers our assessment of Zargon’s future plans and operations as at November 11, 2014, and contains forward-looking statements including:

- *our expectations for our oil and liquids production as a percentage of total production referred to under the heading “Message to Shareholders”;*
- *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”, “2014 & 2015 Capital Budgets”, “Production Guidance”, “Royalties”, “Operating Expenses and Transportation Expenses”, “General & Administrative Expenses” and “Outlook”;*
- *our expectations for our budgeted 2014 and 2015 conventional oil exploitation assets capital program referred to under the headings “2014 & 2015 Capital Budgets” and “Production Guidance”;*
- *our expectations for our 2014 and 2015 hedges referred to under the heading “2014 & 2015 Capital Budgets”;*
- *our expectations for royalties referred to under the heading “Financial & Operating Results”;*
- *our expectations for operating expenses and transportation expenses referred to under the heading “Financial & Operating Results”;*
- *our expectations for general and administrative expenses referred to under the heading “Financial & Operating Results”;*
- *our dividend policy referred to under the headings “Liquidity and Capital Resources”;*
- *our expected sources of funds for dividends referred to under the headings “2014 & 2015 Capital Budgets”, “Liquidity and Capital Resources” and “Outlook”;*
- *our expectations for production referred to under the heading “Production Guidance”;*
- *our expectations for standby fees referred to under the heading “Financial & Operating Results”; and*
- *our expected sources of funds for capital expenditures referred to under the headings “2014 & 2015 Capital Budgets” and “Liquidity and Capital Resources”.*

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

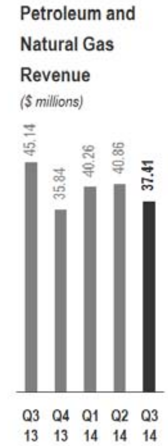
You are cautioned that the assumptions, including among other things, future oil and natural gas prices; future capital expenditure levels (including ASP); future production levels; future exchange rates; the cost of developing and expanding our assets; our ability to obtain equipment in a timely manner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

This MD&A has been prepared as of November 11, 2014.

FINANCIAL & OPERATING RESULTS

Petroleum and Natural Gas Sales

($ millions)	Three Months Ended September 30, 2014	2013	Percent Change	Nine Months Ended September 30, 2014	2013	Percent Change
Petroleum sales	**33.41**	41.70	(20)	**101.90**	110.74	(8)
Natural gas sales	**4.00**	3.44	16	**16.64**	12.07	38
Petroleum and natural gas sales	**37.41**	45.14	(17)	**118.54**	122.81	(3)



Third quarter 2014 gross petroleum and natural gas sales of $37.41 million were 17 percent below the $45.14 million in the third quarter of 2013 due to lower oil prices and production partially offset by higher natural gas prices.

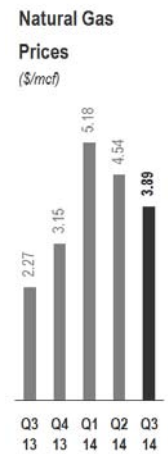
Third quarter 2014 realized oil and liquids field prices averaged $86.61 per barrel before the impact of financial risk management contracts and were eight percent lower than the $94.10 per barrel recorded in the 2013 third quarter. Zargon's crude oil field price differential from the Edmonton par price increased to $11.29 per barrel in the third quarter of 2014 compared to $10.64 per barrel in the third quarter of 2013. Natural gas field prices received averaged $3.89 per thousand cubic feet in the third quarter of 2014, a 71 percent increase from the 2013 third quarter prices.

Pricing

Average for the period	Three Months Ended September 30, 2014	2013	Percent Change	Nine Months Ended September 30, 2014	2013	Percent Change
Natural Gas:						
NYMEX average daily spot price ($US/mmbtu)	**3.93**	3.56	10	**4.57**	3.67	25
AECO average daily spot price ($Cdn/mmbtu)	**4.02**	2.44	65	**4.81**	3.06	57
Zargon realized field price before the impact of financial risk management contracts ($Cdn/mcf) (1)	**3.89**	2.27	71	**4.58**	2.85	61
Zargon realized field price before the impact of physical and financial risk management contracts ($Cdn/mcf) (1)	**3.80**	2.27	67	**4.65**	2.85	63
Zargon realized field price after the impact of physical and financial risk management contracts ($Cdn/mcf) (1)	**3.74**	2.27	65	**4.19**	2.85	47
Zargon realized natural gas field price differential (1) (2)	**0.13**	0.17		**0.23**	0.21	
Zargon realized natural gas field price differential before the impact of physical and financial risk management contracts ($Cdn/mcf)	**0.22**	0.17		**0.16**	0.21	

(1) Zargon was not subject to any natural gas financial risk management contracts for the first nine months of 2013.

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



Oil and Liquids Prices
($/bbl)

Average for the period	**Three Months Ended September 30, 2014**	2013	Percent Change	**Nine Months Ended September 30, 2014**	2013	Percent Change
Crude Oil:						
WTI ($US/bbl)	**97.17**	105.83	(8)	**99.61**	98.14	1
Edmonton par price ($Cdn/bbl)	**97.90**	104.74	(7)	**100.96**	95.18	6
Zargon realized field price before the impact of financial risk management contracts ($Cdn/bbl)	**86.61**	94.10	(8)	**88.80**	81.92	8
Zargon realized field price after the impact of financial risk management contracts ($Cdn/bbl)	**81.79**	88.44	(8)	**83.09**	81.78	2
Zargon realized oil field price differential [1]	**11.29**	10.64		**12.16**	13.26	

(1) 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 2014 third quarter were 4,194 barrels per day, a 13 percent decrease from the 2013 third quarter rate of 4,816 barrels per day. The production decrease is due to natural occurring production declines and property dispositions that occurred in the second half of 2013 and first nine months of 2014. Natural gas production volumes decreased 32 percent in the 2014 third quarter to 11.16 million cubic feet per day compared to 16.46 million cubic feet per day in the 2013 third quarter due to the sale of gas properties in the second half of 2013 and first nine months of 2014.

Production by Core Area

Three Months Ended September 30,	**2014 Oil and Liquids (bbl/d)**	**2014 Natural Gas (mmcf/d)**	**2014 Equivalents (boe/d)**	2013 Oil and Liquids (bbl/d)	2013 Natural Gas (mmcf/d)	2013 Equivalents (boe/d)
Alberta Plains North	**1,216**	**8.10**	**2,566**	1,335	13.36	3,562
Alberta Plains South	**1,299**	**2.59**	**1,730**	1,616	2.75	2,074
Williston Basin	**1,679**	**0.47**	**1,758**	1,865	0.35	1,924
	4,194	**11.16**	**6,054**	4,816	16.46	7,560

Nine Months Ended September 30,	**2014 Oil and Liquids (bbl/d)**	**2014 Natural Gas (mmcf/d)**	**2014 Equivalents (boe/d)**	2013 Oil and Liquids (bbl/d)	2013 Natural Gas (mmcf/d)	2013 Equivalents (boe/d)
Alberta Plains North	**1,168**	**10.27**	**2,879**	1,312	12.30	3,362
Alberta Plains South	**1,314**	**2.61**	**1,749**	1,687	2.83	2,158
Williston Basin	**1,721**	**0.44**	**1,794**	1,953	0.36	2,013
	4,203	**13.32**	**6,422**	4,952	15.49	7,533

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. 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. Because our risk management strategy is protective in nature and is designed to guard the Company against extreme effects on funds flow from sudden falls in prices and revenue, upward price spikes tend to produce overall risk management losses.

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

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

In the 2014 third quarter, relatively lower contract prices versus WTI oil prices resulted in a net realized loss on derivatives of $2.06 million compared to a $2.56 million net realized loss in the third quarter of 2013.

The unrealized gain on derivatives of $11.22 million in the third quarter of 2014 was comprised of oil contract gains of $10.47 million, a natural gas contract gain of $0.73 million and an interest rate swap gain of $0.02 million, compared to a net $7.99 million loss in the third quarter of 2013. These non-cash unrealized derivative gains or losses are generated by the change over the reporting period in the mark-to-market valuation of Zargon's risk management contracts. Commodity price volatility has resulted in significant fluctuations in the mark-to-market amount of unrealized derivative assets and liabilities. Zargon's commodity risk management positions are described in Notes 11 and 12 to the unaudited interim consolidated financial statements.

Royalties

	Three Months Ended September 30,			Nine Months Ended September 30,		
($ millions)	**2014**	2013	Percent Change	**2014**	2013	Percent Change
Royalties	**7.45**	8.80	(15)	**22.37**	22.54	(1)
Percentage of revenue	**19.9%**	19.5%		**18.9%**	18.4%	

Royalties are inclusive of the Saskatchewan Resource Surcharge ("SRC"). The variations in royalty rates generally track changes in production and volumes. Third quarter of 2014 royalties were 19.9 percent of gross sales compared to 19.5 percent in the third quarter of 2013. Looking forward, we anticipate a 19 percent effective royalty rate this winter until significantly lower royalty ASP production commences.

Operating Expenses and Transportation Expenses

	Three Months Ended September 30,			Nine Months Ended September 30,		
($ millions)	**2014**	2013	Percent Change	**2014**	2013	Percent Change
Operating expenses	**9.87**	11.50	(14)	**31.47**	35.56	(12)
Transportation expenses	**0.39**	0.50	(22)	**1.28**	1.40	(9)
Total expenses	**10.26**	12.00	(15)	**32.75**	36.96	(11)
Total expenses ($/boe)	**18.41**	17.25	7	**18.68**	17.98	4

Compared to the prior year's third quarter, operating expenses and transportation expenses in the 2014 third quarter were down on a total dollar basis but increased on a per barrel of oil equivalent basis. Operating costs decreased on a dollar basis due to properties sold over the last year. Commencing in the second quarter of 2014, the operating costs included the base expenditures required to operate the Little Bow ASP facility. Looking forward, we expect total operating and transportation expenses to remain at the $19 per barrel of oil equivalent level, until the significantly lower incremental cost ASP production commences.

Operating Netbacks

Three Months Ended September 30,	**2014**		2013	
	Oil and Liquids ($/bbl)	**Natural Gas ($/mcf)**	Oil and Liquids ($/bbl)	Natural Gas ($/mcf)
Sales	**86.61**	**3.89**	94.10	2.27
Royalties	**(18.11)**	**(0.45)**	(19.08)	(0.23)
Realized loss on derivatives	**(4.82)**	**(0.15)**	(5.66)	–
Operating expenses	**(20.35)**	**(1.97)**	(18.74)	(2.11)
Transportation expenses	**(1.01)**	**–**	(1.13)	–
Operating netbacks	**42.32**	**1.32**	49.49	(0.07)

Nine Months Ended September 30,	**2014**		2013	
	Oil and Liquids ($/bbl)	**Natural Gas ($/mcf)**	Oil and Liquids ($/bbl)	Natural Gas ($/mcf)
Sales	**88.80**	**4.58**	81.92	2.85
Royalties	**(17.83)**	**(0.52)**	(15.66)	(0.32)
Realized loss on derivatives	**(5.71)**	**(0.39)**	(0.13)	–
Operating expenses	**(20.76)**	**(2.10)**	(19.47)	(2.18)
Transportation expenses	**(1.11)**	**–**	(1.03)	–
Operating netbacks	**43.39**	**1.57**	45.63	0.35

General & Administrative (“G&A”) Expenses

	Three Months Ended September 30,			**Nine Months Ended September 30,**		
($ millions)	**2014**	2013	Percent Change	**2014**	2013	Percent Change
G&A expenses	**4.21**	2.85	48	**10.21**	8.80	16
G&A expenses ($/boe)	**7.56**	4.10	84	**5.82**	4.28	36

G&A expenses per barrel of oil equivalent were higher in the third quarter of 2014 primarily due to one-time employee related costs of $1.55 million or $2.79 per barrel of oil equivalent. Next year, we will target G&A expenses, exclusive of transaction costs, of $4.75 per barrel of oil equivalent, although in the short term higher costs will be recorded until the ASP production volume ramp up occurs.

Transaction Costs

Transaction costs for the 2014 third quarter were $0.36 million compared to nil in the third quarter of 2013 and relate to property dispositions in the quarter.

Interest and Financing Charges on Long Term Bank Debt

Zargon reduced its syndicated committed credit facilities from $150 million to $140 million after the Company’s semi-annual review was completed on November 10, 2014. This reduction will provide savings on standby fees and still leaves approximately $75 million of available credit facilities on the borrowing base. The next renewal date is June 24, 2015. Interest rates fluctuate under the syndicated facilities with Canadian prime, US prime and US base rates plus an applicable margin between 50 basis points and 200 basis points, as well as with Canadian banker’s acceptance and LIBOR rates plus an applicable margin between 200 basis points and 350 basis points.

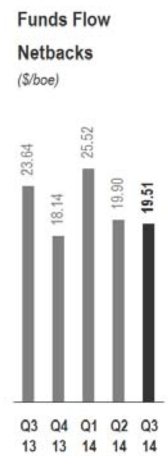
Zargon’s borrowings are through its syndicated bank credit facilities. Interest and financing charges on these facilities in the 2014 third quarter were $0.75 million, a 15 percent increase from $0.65 million in the third quarter of 2013. The increase in interest and financing charges resulted from higher average borrowing levels partially offset by a lower effective interest rate compared to the third quarter of 2013.

Interest on Convertible Debentures

Zargon has borrowings through its convertible debentures, which were issued in May 2012 and mature on June 30, 2017. Interest is payable semi-annually at a rate of six percent, calculated on the gross proceeds of $57.50 million. Interest charges of $0.86 million in the third quarter of 2014 were essentially unchanged compared to the third quarter of 2013.

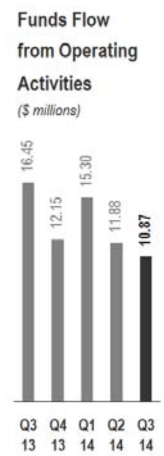
Current Income Taxes

Current income recoveries for the 2014 third quarter were $0.05 million, and relate to the US operations. When compared to the 2013 third quarter, current income taxes decreased by $0.40 million due to lower revenue and higher capital expenditures in the US. Total corporate tax pools as at September 30, 2014 are approximately $311 million, which is essentially unchanged from the comparable $310 million of tax pools available to Zargon at December 31, 2013.



Corporate Netbacks

	Three Months Ended September 30,		Nine Months Ended September 30,	
($/boe)	**2014**	2013	**2014**	2013
Petroleum and natural gas sales	**67.18**	64.90	**67.61**	59.72
Royalties	**(13.38)**	(12.66)	**(12.76)**	(10.96)
Realized loss on derivatives	**(3.72)**	(3.68)	**(4.61)**	(0.15)
Operating expenses	**(17.71)**	(16.53)	**(17.95)**	(17.29)
Transportation expenses	**(0.70)**	(0.72)	**(0.73)**	(0.69)
Operating netbacks	**31.67**	31.31	**31.56**	30.63
General and administrative expenses	**(7.56)**	(4.10)	**(5.82)**	(4.28)
Transaction costs	**(0.65)**	–	**(0.32)**	(0.05)
Interest and financing charges	**(1.34)**	(0.94)	**(1.16)**	(0.89)
Interest on convertible debentures	**(1.55)**	(1.23)	**(1.48)**	(1.25)
Asset retirement expenditures	**(1.15)**	(0.90)	**(1.03)**	(1.29)
Current income taxes/(recovery)	**0.09**	(0.50)	**(0.05)**	(0.34)
Funds flow netbacks	**19.51**	23.64	**21.70**	22.53



Depletion and Depreciation Expense

Depletion and depreciation expense for the third quarter of 2014 decreased one percent to $11.26 million compared to $11.42 million in the third quarter of 2013. On a per barrel of oil equivalent basis, the depletion and depreciation rates were $20.22 and $16.42 for the third quarter of 2014 and the third quarter of 2013, respectively. When compared to the third quarter of 2013, the increased depletion rate is primarily due to the inclusion of the ASP facility construction costs and reserves in the depletion calculation as the facility costs were not depleted during the construction phase. The 2013 calendar year depletion and depreciation rate was $16.64 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 2014 was $0.92 million, a 28 percent increase from the third quarter of 2013 which resulted from the change in discount rate from 2.50% to 3.25% at December 31, 2013. 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 2014 third quarter was $0.32 million, consistent with the third quarter of 2013.

Shared-based Compensation

Expensing of share-based compensation in the third quarter of 2014 totalled $0.17 million, which was lower than the $0.44 million incurred in the third quarter of 2013 due to cancellations of share awards in the quarter related to employee changes.

Unrealized Foreign Exchange

The Company had a minimal unrealized foreign exchange gain during the third quarter of 2014 compared to a loss of $0.04 million in the 2013 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.

Loss on Disposal of Assets

During the third quarter of 2014, Zargon closed several dispositions of assets located in west central and northern Alberta and reported a loss of $10.07 million on the net disposal of assets.

Exploration and Evaluation Expenses

Non-cash exploration and evaluation expenses for the 2014 third quarter of $0.16 million compared to third quarter of 2013 expenses of $0.67 million. Exploration and evaluation expenses are primarily related to undeveloped land expiries. The 2014 third quarter exploration and evaluation expense related to expiries in west central and northern Alberta.

Deferred Tax

The deferred tax recovery for the third quarter of 2014 was $0.28 million compared to a recovery of $0.95 million in the third quarter of 2013. The decrease in deferred tax recovery is primarily a result of a decreased net loss before taxes in the quarter.

Funds Flow from Operating Activities

Funds flow from operating activities in the 2014 third quarter of $10.87 million was $5.58 million, or 34 percent lower than the prior year third quarter. The decrease in funds flow compared to the prior year third quarter was primarily a result of lower oil prices, decreased oil production and higher G&A expenses which was partially offset by lower operating expenses.

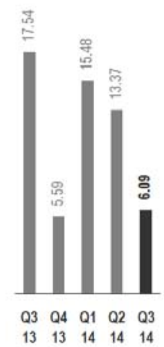
Net Earnings/ (Loss)
($ millions)

Net Earnings/(Loss)

Net earnings of $0.10 million for the 2014 third quarter were up $2.45 million from the $2.35 million net loss in the 2013 third quarter, largely due to increased gains on unrealized derivatives, partially offset by a loss on 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 gain/(loss), land expiries, property disposition gain/(loss) and deferred taxes. On a per diluted share basis, the third quarter 2014 net earnings were nil, compared to a net loss of $0.08 for the 2013 third quarter.

Capital Expenditures

	Three Months Ended September 30,		Nine Months Ended September 30,	
($ millions)	**2014**	2013	**2014**	2013
Undeveloped land	**0.17**	1.18	**1.80**	3.09
Geological and geophysical (seismic)	**0.04**	0.18	**0.75**	1.05
Drilling and completion of wells	**3.51**	2.99	**13.72**	12.05
Well equipment and facilities	**3.95**	2.95	**12.44**	12.03
ASP project and exploitation costs	**1.46**	11.37	**9.36**	23.68
ASP chemical costs	**3.62**	–	**8.03**	–
Exploration and development	**12.75**	18.67	**46.10**	51.90
Property acquisitions	**0.03**	0.26	**3.29**	0.53
Property dispositions	**(6.69)**	(1.40)	**(14.61)**	(16.30)
Net property dispositions	**(6.66)**	(1.14)	**(11.32)**	(15.77)
Total net capital expenditures excluding administrative assets	**6.09**	17.53	**34.78**	36.13
Administrative assets	**–**	0.01	**0.16**	0.02
Total net capital expenditures	**6.09**	17.54	**34.94**	36.15



LIQUIDITY AND CAPITAL RESOURCES

Total net capital expenditures (including net property dispositions) totalled $6.09 million in the third quarter of 2014 and were 65 percent lower than the same period in 2013. Field expenditures of $12.75 million for the third quarter of 2014 were 32 percent lower than the 2013 third quarter. The third quarter 2014 field capital expenditures (excluding net property dispositions) were allocated to Alberta Plains North - $0.39 million, Alberta Plains South - $6.43 million and Williston Basin - $5.93 million and included the drilling of 1.5 net wells, down from the 3.0 net wells drilled in the third quarter of 2013.

Included in the Alberta Plains South capital expenditures is the $5.08 million incurred on the Little Bow ASP project. Of the total ASP amount, $1.46 million was spent on project and exploitation costs while $3.62 million was spent on ASP phase 1 chemical costs.

Funds flow from operating activities in the 2014 third quarter of $10.87 million and proceeds from the sale of properties of $6.69 million were used to partially fund the capital program and cash dividends to shareholders.

At September 30, 2014, the Company’s combined debt net of working capital (excluding unrealized derivative assets/liabilities) was $129.11 million, which compares to $116.24 million of net debt at the end of December 31, 2013. The increase in net debt was due to Zargon’s 2014 third quarter capital expenditure program. The $129.11 million debt net of working capital consists of the $57.50 million of convertible unsecured subordinate debentures and the remaining portion of bank debt.

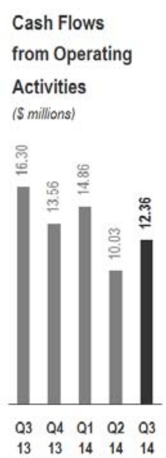
The volatility of oil and natural gas prices, uncertainty or modifications regarding royalties and Canadian income tax rules and global economic/political concerns have, on occasion, restricted the oil and natural gas industry’s ability to attract new capital from debt and equity markets.

Cash Dividends Analysis

($ millions)	Three Months Ended September 30, 2014	Three Months Ended September 30, 2013	Nine Months Ended September 30, 2014	Nine Months Ended September 30, 2013
Cash flows from operating activities	**12.36**	16.30	**37.25**	43.44
Net earnings/(loss)	**0.10**	(2.35)	**(1.75)**	(0.99)
Actual cash dividends paid or payable relating to the period (1)	**(5.43)**	(5.17)	**(16.27)**	(14.94)
Excess of cash flows from operating activities over cash dividends paid	**6.93**	11.13	**20.98**	28.50
Excess (shortfall) of net earnings over cash dividends paid	**(5.33)**	(7.52)	**(18.02)**	(15.93)

(1) *Cash dividends represent the cash portion only and do not include common shares issued through Zargon's Dividend Reinvestment Plan which was suspended September 2013.*

During the first nine months of 2014, 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, 2014, cash flows from operating activities (after changes in non-cash working capital) of $12.36 million exceeded cash dividends of $5.43 million. Similarly, 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.

For the three months ended September 30, 2014, net earnings of $0.10 million was exceeded by cash dividends of $5.43 million. Net earnings include significant non-cash charges of $11.41 million for the 2014 third quarter that does not impact cash flow. For the three months ended September 30, 2013, a net loss of $2.35 million was exceeded by cash dividends of $5.17 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, 2014, cash dividends and net capital expenditures totalled $11.52 million, which was $0.84 million lower than the cash flows from operating activities (after changes in non-cash working capital) of $12.36 million. 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 11, 2014, Zargon Oil & Gas Ltd. had 30.175 million common shares outstanding. Pursuant to the share award and common share rights incentive plans, there are currently an additional 0.866 million common share incentive rights issued and outstanding.

Capital Sources and Uses

	Three Months Ended September 30,		Nine Months Ended September 30,	
($ millions)	**2014**	2013	**2014**	2013
Funds flow from operating activities	**10.87**	16.45	**38.04**	46.34
Change in long term bank debt	**3.08**	1.59	**19.48**	7.92
Cash dividends to shareholders [(1)]	**(5.43)**	(5.17)	**(16.27)**	(14.94)
Changes in working capital and other	**(2.43)**	4.67	**(6.31)**	(3.17)
Total capital sources	**6.09**	17.54	**34.94**	36.15

(1) Cash dividends represent the cash portion only and do not include common shares issued through Zargon's Dividend Reinvestment Plan which was suspended September 2013.

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 2014 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 2014.

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. Zargon uses the 1992 Committee of Sponsoring Organizations of the Treadway Commission ("COSO") Framework as the Company has not yet adopted the 2013 COSO Framework.

OUTLOOK

With a promising portfolio of long-life oil exploitation projects, Zargon is well positioned to meet its value-creating and dividend generating objectives through 2014 and beyond. In particular, Zargon's Little Bow ASP enhanced oil recovery project has the potential to provide significant oil production volume growth throughout the remainder of the decade.

SUMMARY OF QUARTERLY RESULTS

	2014		
	Q1	Q2	**Q3**
Petroleum and natural gas sales ($ millions)	40.26	40.86	**37.41**
Net earnings/(loss) ($ millions)	0.17	(2.02)	**0.10**
Net earnings/(loss) per diluted share ($)	0.01	(0.07)	**–**
Funds flow from operating activities ($ millions)	15.30	11.88	**10.87**
Funds flow from operating activities per diluted share ($)	0.50	0.39	**0.35**
Cash flows from operating activities ($ millions)	14.86	10.03	**12.36**
Cash flows from operating activities per diluted share ($)	0.49	0.33	**0.40**
Cash dividends ($ millions)	5.42	5.42	**5.43**
Cash dividends declared per common share ($)	0.18	0.18	**0.18**
Net capital expenditures ($ millions)	15.48	13.37	**6.09**
Total assets ($ millions)	462.66	461.70	**426.51**
Long term bank debt ($ millions)	50.55	56.37	**59.45**
Convertible debentures ($ millions) (1)	57.50	57.50	**57.50**
Net debt	121.72	128.88	**129.11**
Average daily oil and liquids production (bbl)	4,320	4,096	**4,194**
Average daily natural gas production (mmcf)	14.05	14.77	**11.16**
Average daily production (boe)	6,662	6,558	**6,054**
Average oil production weighting (%)	65	62	**69**
Average realized commodity field price before the impact of financial risk management contracts ($/boe)	67.15	68.46	**67.18**
Funds flow netback ($/boe)	25.52	19.90	**19.51**

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

	2013			
	Q1	Q2	Q3	Q4
Petroleum and natural gas sales ($ millions)	37.08	40.59	45.14	35.84
Net earnings/(loss) ($ millions)	0.23	1.13	(2.35)	(4.91)
Net earnings/(loss) per diluted share ($)	0.01	0.04	(0.08)	(0.16)
Funds flow from operating activities ($ millions)	13.90	15.99	16.45	12.15
Funds flow from operating activities per diluted share ($)	0.46	0.53	0.55	0.40
Cash flows from operating activities ($ millions)	12.46	14.68	16.30	13.56
Cash flows from operating activities per diluted share ($)	0.42	0.49	0.54	0.45
Cash dividends ($ millions) (1)	4.75	5.01	5.17	5.42
Cash dividends declared per common share ($)	0.18	0.18	0.18	0.18
Net capital expenditures ($ millions)	16.19	2.42	17.54	5.59
Total assets ($ millions)	450.34	437.88	441.87	452.98
Long term bank debt ($ millions)	44.02	42.06	43.65	39.97
Convertible debentures ($ millions) (2)	57.50	57.50	57.50	57.50
Net debt	120.10	111.33	117.61	116.24
Average daily oil and liquids production (bbl)	5,113	4,930	4,816	4,625
Average daily natural gas production (mmcf)	15.21	14.77	16.46	15.90
Average daily production (boe)	7,648	7,392	7,560	7,276
Average oil production weighting (%)	67	67	64	64
Average realized commodity field price before the impact of financial risk management contracts ($/boe)	53.87	60.34	64.90	53.55
Funds flow netback ($/boe)	20.20	23.77	23.64	18.14

(1) Cash dividends represent the cash portion only and do not include common shares issued through Zargon's Dividend Reinvestment Plan which was suspended September 2013.

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

	2012			
	Q1	Q2	Q3	Q4
Petroleum and natural gas sales ($ millions)	44.64	38.52	36.91	37.88
Net earnings/(loss) ($ millions)	(2.01)	10.54	(4.02)	(9.88)
Net earnings/(loss) per diluted share ($)	(0.07)	0.34	(0.14)	(0.33)
Funds flow from operating activities ($ millions)	13.52	12.37	14.35	16.42
Funds flow from operating activities per diluted share ($)	0.46	0.40	0.48	0.55
Cash flows from operating activities ($ millions)	11.85	18.00	12.16	16.85
Cash flows from operating activities per diluted share ($)	0.40	0.57	0.41	0.57
Cash dividends ($ millions) (1)	7.45	7.45	7.75	4.70
Cash dividends declared per common share ($)	0.30	0.30	0.30	0.18
Net capital expenditures/(dispositions) ($ millions)	20.95	(26.85)	10.35	25.79
Total assets ($ millions)	473.69	446.41	440.77	445.11
Long term bank debt ($ millions)	107.37	24.14	27.58	35.74
Convertible debentures ($ millions) (2)	–	57.50	57.50	57.50
Net debt	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.

Additional information regarding the Company and its business operations, including the Company's Annual Information Form for December 31, 2013, is available on the Company's SEDAR profile at www.sedar.com.

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

Calgary, Alberta
November 11, 2014

CONSOLIDATED BALANCE SHEETS

(unaudited)

($ thousands)	Notes	**September 30, 2014**	December 31, 2013
ASSETS			
Trade and other receivables		**12,221**	14,087
Deposits and prepaid expenses		**1,681**	997
Investment in marketable securities		**800**	800
Derivatives	11,12	**1,541**	22
Total current assets		**16,243**	15,906
Long term deposits		**126**	128
Property, plant and equipment, net	4	**384,297**	408,719
Intangible exploration and evaluation assets	5	**7,567**	13,331
Goodwill	4,5	**4,770**	2,969
Deferred tax assets		**13,509**	11,924
Total assets		**426,512**	452,977
LIABILITIES			
Trade and other payables		**24,669**	32,450
Cash dividends payable	6	**1,810**	1,805
Provisions	7	**385**	399
Derivatives	11,12	**384**	5,000
Total current liabilities		**27,248**	39,654
Long term bank debt	8	**59,448**	39,968
Convertible debentures		**53,408**	52,478
Derivatives	11,12	**96**	210
Provisions	7	**114,995**	135,177
Deferred tax liabilities		**13,411**	11,945
Total liabilities		**268,606**	279,432
Commitments and contingencies	7,8,10,11,12		
EQUITY			
Shareholders' capital	9	**257,109**	256,092
Accumulated other comprehensive income		**1,860**	493
Contributed surplus	10	**12,420**	12,423
Equity component of debentures		**3,640**	3,640
Deficit		**(117,123)**	(99,103)
Total equity		**157,906**	173,545
Total equity and liabilities		**426,512**	452,977

See accompanying notes to the interim consolidated financial statements.

CONSOLIDATED STATEMENTS OF EARNINGS/(LOSS) AND COMPREHENSIVE EARNINGS/(LOSS)

(unaudited)		Three Months Ended September 30,		Nine Months Ended September 30,	
($ thousands, except per share amounts)	Notes	**2014**	2013	**2014**	2013
Petroleum and natural gas sales		**37,413**	45,136	**118,535**	122,805
Royalties		**(7,454)**	(8,802)	**(22,369)**	(22,540)
PETROLEUM AND NATURAL GAS REVENUE, NET OF ROYALTIES		**29,959**	36,334	**96,166**	100,265
Gain/(loss) on unrealized derivatives	11,12	**11,216**	(7,986)	**6,249**	(10,675)
Loss on realized derivatives	11,12	**(2,064)**	(2,556)	**(8,096)**	(318)
GAIN/(LOSS) ON DERIVATIVES		**9,152**	(10,542)	**(1,847)**	(10,993)
TOTAL INCOME		**39,111**	25,792	**94,319**	89,272
Operating		**9,866**	11,498	**31,467**	35,558
Transportation		**391**	500	**1,278**	1,399
General and administrative		**4,211**	2,852	**10,208**	8,799
Transaction costs		**362**	–	**555**	97
Exploration and evaluation	5	**155**	671	**913**	2,994
(Gain)/loss on disposal of properties	4	**10,072**	(1,200)	**8,145**	(269)
Share-based compensation	10	**168**	439	**1,014**	1,154
Unrealized foreign exchange (gain)/loss		**(2)**	40	**(28)**	(148)
Depletion and depreciation		**11,259**	11,418	**34,567**	33,912
EXPENSES		**36,482**	26,218	**88,119**	83,496
EARNINGS/(LOSS) BEFORE FINANCE EXPENSES AND INCOME TAXES		**2,629**	(426)	**6,200**	5,776
Interest and financing charges	8	**746**	650	**2,028**	1,840
Interest on convertible debentures		**863**	855	**2,588**	2,580
Accretion on convertible debentures		**324**	293	**930**	923
Accretion of asset retirement obligations	7	**923**	716	**3,088**	2,153
FINANCE EXPENSES		**2,856**	2,514	**8,634**	7,496
LOSS BEFORE INCOME TAXES		**(227)**	(2,940)	**(2,434)**	(1,720)
Current tax expense/(recovery)		**(49)**	350	**96**	694
Deferred tax recovery		**(278)**	(945)	**(781)**	(1,421)
INCOME TAXES RECOVERY		**(327)**	(595)	**(685)**	(727)
NET EARNINGS/(LOSS) FOR THE PERIOD		**100**	(2,345)	**(1,749)**	(993)
Currency translation adjustment that may be reclassified subsequently to net earnings		**1,316**	(489)	**1,367**	696
OTHER COMPREHENSIVE EARNINGS/(LOSS) FOR THE PERIOD		**1,316**	(489)	**1,367**	696
TOTAL COMPREHENSIVE EARNINGS/(LOSS) FOR THE PERIOD		**1,416**	(2,834)	**(382)**	(297)
NET EARNINGS/(LOSS) PER SHARE					
Basic		**–**	(0.08)	**(0.06)**	(0.03)
Diluted		**–**	(0.08)	**(0.06)**	(0.03)

See accompanying notes to the interim consolidated financial statements.

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

(unaudited)

($ thousands)	Notes	Shareholders' Capital	Currency Translation Adjustment	Contributed Surplus	Equity Component of Convertible Debentures	Deficit	Total Equity
Balance at December 31, 2013		**256,092**	**493**	**12,423**	**3,640**	**(99,103)**	**173,545**
Net loss for the period		–	–	–	–	**(1,749)**	**(1,749)**
Dividends declared	6	–	–	–	–	**(16,271)**	**(16,271)**
Share-based compensation	10	–	–	**1,014**	–	–	**1,014**
Exercise of share options	9	**1,017**	–	**(1,017)**	–	–	–
Translation differences on foreign subsidiary		–	**1,367**	–	–	–	**1,367**
Balance at September 30, 2014		**257,109**	**1,860**	**12,420**	**3,640**	**(117,123)**	**157,906**
Balance at December 31, 2012		254,400	(998)	11,133	3,640	(71,592)	196,583
Net loss for the period		–	–	–	–	(993)	(993)
Dividends declared	6	–	–	–	–	(16,195)	(16,195)
Issue of common shares pursuant to the DRIP	6	1,260	–	–	–	–	1,260
Share-based compensation	10	–	–	1,154	–	–	1,154
Exercise of share options		422	–	(422)	–	–	–
Translation differences on foreign subsidiary		–	696	–	–	–	696
Balance at September 30, 2013		256,082	(302)	11,865	3,640	(88,780)	182,505

See accompanying notes to the interim consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited) ($ thousands)	Notes	Three Months Ended September 30, **2014**	 2013	Nine Months Ended September 30, **2014**	 2013
OPERATING ACTIVITIES					
Net earnings/(loss) for the period		**100**	(2,345)	**(1,749)**	(993)
Adjustments for non-cash items:					
(Gain)/loss on sale of properties	4	**10,072**	(1,200)	**8,145**	(269)
(Gain)/loss on unrealized derivatives	11,12	**(11,216)**	7,986	**(6,249)**	10,675
Depletion and depreciation	4	**11,259**	11,418	**34,567**	33,912
Accretion of asset retirement obligations	7	**923**	716	**3,088**	2,153
Accretion of convertible debentures		**324**	293	**930**	923
Share-based compensation	10	**168**	439	**1,014**	1,154
Unrealized foreign exchange (gain)/loss		**(2)**	40	**(28)**	(148)
Deferred tax recovery		**(278)**	(945)	**(781)**	(1,421)
Exploration and evaluation expenses	5	**155**	671	**913**	2,994
Asset retirement expenditures		**(639)**	(628)	**(1,809)**	(2,645)
Funds flow from operating activities		**10,866**	16,445	**38,041**	46,335
Changes in operating working capital		**1,497**	(143)	**(792)**	(2,896)
Net cash from operating activities		**12,363**	16,302	**37,249**	43,439
INVESTING ACTIVITIES					
Additions to property, plant and equipment	4	**(12,672)**	(18,925)	**(46,090)**	(52,175)
Additions to intangible exploration and evaluation assets	5	**(129)**	(10)	**(364)**	(273)
Proceeds on disposal of property, plant and equipment	4	**1,969**	1,397	**9,371**	16,265
Proceeds on disposal of intangible exploration and evaluation assets	5	**4,720**	–	**5,235**	33
Acquisition of property, plant and equipment	4,5	**–**	–	**(3,111)**	–
Change in long term deposits		**–**	141	**2**	141
Changes in investing working capital		**(3,904)**	4,558	**(5,506)**	(562)
Net cash used in investing activities		**(10,016)**	(12,839)	**(40,463)**	(36,571)
FINANCING ACTIVITIES					
Advances of bank debt		**3,080**	1,593	**19,480**	7,918
Cash dividends paid to shareholders	6	**(5,429)**	(5,174)	**(16,271)**	(14,935)
Changes in financing working capital		**2**	118	**5**	149
Net cash (used)/provided by financing activities		**(2,347)**	(3,463)	**3,214**	(6,868)
NET CHANGE IN CASH DURING THE PERIOD AND CASH, END OF PERIOD		**–**	–	**–**	–

See accompanying notes to the interim consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the three and nine months ended September 30, 2014, with comparative figures for 2013 (unaudited).

1. REPORTING ENTITY

Zargon Oil & Gas Ltd. (“the Company” or “Zargon”) is a publicly traded corporation incorporated in Canada with its head office located at Suite 700, 333-5th Avenue SW, Calgary, Alberta. The interim consolidated financial statements of the Company as at and for the period ended September 30, 2014 and for its 2013 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, 2014 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, 2013. New and amended accounting standards have been evaluated and 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, 2014 should be read in conjunction with the annual consolidated financial statements for the year ended December 31, 2013. These consolidated financial statements were approved and authorized for issue by the Board of Directors on November 11, 2014.

(b) Basis of measurement:

The interim consolidated financial statements have been prepared on the historical cost basis except for the derivative financial instruments and the investment in marketable securities which are 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 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:

- 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 amendment did not have a significant impact on the Company's consolidated financial statements.
- IFRIC 21 "Levies" clarifies that an entity recognizes a liability for a levy when the activity that triggers payment, as identified by the relevant legislation, occurs. The interpretation also clarifies that no liability should be recognized before the specified minimum threshold to trigger that levy is reached. IFRIC 21 is required to be adopted retrospectively for fiscal years beginning January 1, 2014, with earlier adoption permitted. The adoption of this IFRIC did not have an impact on the Company's consolidated financial statements.

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

- IFRS 9 "Financial Instruments" replaces the current multiple classification and measurement models for financial assets and liabilities with a single model. IFRS 9 also details the new general hedge accounting model. Hedge accounting remains optional and the new model is intended to allow reporters to better reflect risk management activities in the financial statements and provide more opportunities to apply hedge accounting. The Company does not employ hedge accounting for its risk management contracts currently in place. IFRS 9 will be effective for annual periods beginning on or after January 1, 2018, with early adoption permitted. The Company has not yet determined the impact on the Company's consolidated financial statements.
- IFRS 15 "Revenue from Contracts with Customers" specifies how and when to recognize revenue as well as requiring entities to provide users of financial statements with more informative, relevant disclosures. The standard supersedes IAS 18 "Revenue", IAS 11 "Construction Contracts" and a number of revenue-related interpretations. IFRS 15 will be effective for annual periods beginning on or after January 1, 2017 with early adoption permitted. The Company has not yet determined the impact on the Company's consolidated financial statements.

4. PROPERTY, PLANT AND EQUIPMENT

($ thousands)	**Nine Months Ended September 30, 2014**
Cost, December 31, 2013	580,267
Accumulated depletion and depreciation	(171,548)
Net carrying amount, December 31, 2013	408,719
Additions	37,945
Disposals	(9,285)
Acquisition of property, plant and equipment	2,348
Change in asset retirement obligation	(22,923)
Assets transferred from intangible exploration and evaluation assets	79
Exchange differences	1,981
Depletion and depreciation	(34,567)
Net carrying amount, September 30, 2014	384,297
Cost, September 30, 2014	563,849
Accumulated depletion and depreciation	(179,552)
Net carrying amount, September 30, 2014	384,297

During the three and nine months ended September 30, 2014, the Company disposed of certain property, plant and equipment assets for gross cash proceeds of $1.97 million (2013 - $1.40 million) and $9.37 million (2013 - $16.27 million), respectively. The dispositions for the three and nine months resulted in losses of $10.07 million (2013 - $1.20 million gain) and $8.15 million (2013 - $0.27 million gain), respectively.

In June 2014, the Company closed a property acquisition in the Alberta Plains South area. The property acquisition was accounted for as a business combination under IFRS 3. Consideration paid consisted of $3.11 million of cash in exchange for property, plant and equipment, exploration and evaluation assets, goodwill and decommissioning obligations.

5. INTANGIBLE EXPLORATION AND EVALUATION ASSETS AND GOODWILL

($ thousands)	Goodwill	E&E Assets	Total
Cost:			
Balance at December 31, 2013	**2,969**	**13,331**	**16,300**
Additions	**–**	**364**	**364**
Disposals	**–**	**(5,235)**	**(5,235)**
Acquisition	**1,801**	**30**	**1,831**
Transfers to property, plant and equipment	**–**	**(79)**	**(79)**
Exploration and evaluation expense	**–**	**(913)**	**(913)**
Exchange differences	**–**	**69**	**69**
Balance at September 30, 2014	**4,770**	**7,567**	**12,337**

6. CASH DIVIDENDS

During the period, the Company declared dividends to the shareholders in the aggregate amount of $16.27 million (2013 – $16.20 million) in accordance with the following schedule:

2014 Dividends	Record Date	Dividend Date	Per Common Share
January	January 31, 2014	February 18, 2014	$0.06
February	February 28, 2014	March 17, 2014	$0.06
March	March 31, 2014	April 15, 2014	$0.06
April	April 30, 2014	May 15, 2014	$0.06
May	May 31, 2014	June 16, 2014	$0.06
June	June 30, 2014	July 15, 2014	$0.06
July	July 31, 2014	August 15, 2014	$0.06
August	August 31, 2014	September 15, 2014	$0.06
September	September 30, 2014	October 15, 2014	$0.06

(1) The 2013 cash dividends include a non-cash equity issuance amount of $1.26 million for the Dividend Reinvestment Plan which was suspended September 2013.

Subsequent to the end of the period and prior to the consolidated financial statements being authorized for issue on November 11, 2014, the Company declared dividends of $1.81 million or $0.06 per share for October 2014.

7. PROVISIONS

($ thousands)	Asset Retirement Obligations	Other	Total
Balance at December 31, 2013	**135,177**	**399**	**135,576**
Provisions made during the period	**781**	**–**	**781**
Foreign exchange and other	**394**	**–**	**394**
Provisions used during the period	**(1,809)**	**(14)**	**(1,823)**
Provisions related to dispositions	**(25,727)**	**–**	**(25,727)**
Provision related to acquisition	**1,068**	**–**	**1,068**
Revision to estimated provisions	**2,023**	**–**	**2,023**
Accretion	**3,088**	**–**	**3,088**
Balance at September 30, 2014	**114,995**	**385**	**115,380**
Current	**–**	**385**	**385**
Non-current	**114,995**	**–**	**114,995**

Asset retirement obligation:

The asset retirement obligations were calculated using a discount factor of 3.25 percent (December 31, 2013 – 3.25 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 55 years. An inflation rate of two percent per annum (December 31, 2013 – 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 $0.39 million.

8. LONG TERM BANK DEBT

Zargon reduced its syndicated committed credit facilities from $150 million to $140 million after the Company's semi-annual review was completed on November 10, 2014. 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 24, 2015. 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, 2014, $59.45 million (December 31, 2013 - $39.97 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, 2014, the approximate value of outstanding letters of credit totalled $0.89 million (December 31, 2013 - $0.87 million). The letters of credit reduce the amount of Zargon's available credit facilities to $79.66 million at September 30, 2014 (December 31, 2013 - $124.16 million).

Zargon reviews its compliance with its bank debt covenants on a quarterly basis and is in compliance as at September 30, 2014.

9. SHARE CAPITAL

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

Common Shares

(thousands)	Nine Months Ended September 30, 2014 Number of Shares	Amount ($)
Balance, as at December 31, 2013	**30,087**	**256,092**
Share awards exercised	**88**	**–**
Share-based compensation recognized on exercise of share options	**–**	**1,017**
Balance, as at September 30, 2014	**30,175**	**257,109**

10. SHARE-BASED PAYMENTS

Share Award Plan

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 14 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, 2014 Number of Share Awards (thousands)
Outstanding, as at December 31, 2013	**563**
Share awards granted	**305**
Share awards exercised	**(88)**
Share awards forfeited	**(91)**
Outstanding, as at September 30, 2014	**689**

Common Share 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 New Plan:

	Nine Months Ended September 30, 2014	
	Number of Share Options (thousands)	Weighted Average Exercise Price Initial and Modified ($/share)
Outstanding at beginning of period	**391**	**18.06 / 14.39**
Share options expired	**(173)**	**15.89**
Share options forfeited	**(36)**	**19.85**
Outstanding at end of period	**182**	**19.76 / 16.84**

Share-based Compensation

The share awards for the three and nine months ended September 30, 2014, resulted in share-based compensation of $0.17 million (2013 - $0.44 million) and $1.01 million (2013 - $1.15 million), respectively.

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

Weighted Average Number of Total Shares

	Three Months Ended September 30,		Nine Months Ended September 30,	
(thousands of shares)	**2014**	2013	**2014**	2013
Weighted average number of common shares – basic	**30,152**	30,065	**30,127**	29,990
Weighted average number of common shares – diluted	**30,725**	30,065	**30,127**	29,990

Dilution amounts for the three and nine months ended September 30, 2014 of 0.57 million shares (2013 - nil shares) and nil shares (2013 – nil shares) were added to the weighted average number of shares outstanding during the period in the calculation of diluted per share amounts. These share additions represent the dilutive effect of share rights according to the treasury stock method.

The convertible debenture could potentially dilute basic earnings per share, but was not included in the calculation of diluted earnings per share because it is antidilutive for the three and nine months ended September 30, 2014.

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, 2014		December 31, 2013	
(thousands)	**Carrying Amount ($)**	**Fair Value ($)**	Carrying Value ($)	Fair Value ($)
Loans and receivables:				
Trade and other receivables	**12,221**	**12,221**	14,087	14,087
Fair value through profit and loss:				
Derivative assets	**1,541**	**1,541**	22	22
Derivative liabilities	**480**	**480**	5,210	5,210
Fair value through other comprehensive income:				
Investment in marketable securities	**800**	**800**	800	800
Other liabilities:				
Trade and other payables	**24,669**	**24,669**	32,450	32,450
Cash dividends	**1,810**	**1,810**	1,805	1,805
Long term bank debt	**59,448**	**59,448**	39,968	39,968
Convertible debentures	**53,408**	**57,356**	52,478	56,638

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.

The investment in marketable securities is classified as "available-for-sale" and is carried at fair value. This investment is available on the active market and the Company classifies the fair value of this investment 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's policy is to recognize transfers into and out of fair value hierarchy levels as of the date of the event or change in circumstances that caused the transfer. The company does not have any fair value measurements classified as Level III.

At each reporting date, the Company determines whether transfers have occurred between levels in the hierarchy by reassessing the level of classification for each financial asset and financial liability measured or disclosed at fair value in the financial statements. Assessment of the significance of a particular input to the fair value measurement requires judgement and may affect the placement within the fair value hierarchy. During the period ended September 30, 2014, there were no transfers between levels I, II or III.

The carrying value of receivables and other liabilities approximate their fair value due to their short maturities, except for the convertible debentures which are determined using Level I inputs.

Financial Risk Management

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 swaps, which fix the Canadian dollar AECO prices and natural gas basis hedges.

  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, 2014 debt pricing levels, the increase or decrease in net earnings for the year for each one percent change in interest rates would amount to $0.41 million (September 30, 2013 - $0.33 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 $0.57 million (September 30, 2013 - $0.63 million) increase or decrease in net earnings for the period ended September 30, 2014. 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, 2014, approximately 49 percent (December 31, 2013 - 58 percent) was owing from two companies and Zargon anticipates full collection.

  The Company's allowance for doubtful accounts at September 30, 2014 was $0.26 million (December 31, 2013 - $0.26 million). As at September 30, 2014, the Company did not record any additional provision 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, 2014, $0.31 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, 2014, Zargon had available unused committed bank credit facilities of approximately $79.66 million compared to $124.16 million at December 31, 2013. 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	**24,669**	**–**	**24,669**
Cash dividends payable	**1,810**	**–**	**1,810**
Derivative liabilities	**384**	**96**	**480**
Long term bank debt	**–**	**59,448**	**59,448**
Interest on convertible debentures	**3,450**	**6,900**	**10,350**
Convertible debentures (1)	**–**	**57,500**	**57,500**

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

Commodity Price Sensitivities

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

Fluctuations of 10 percent in commodity prices could have resulted in unrealized gains or losses for risk management contracts impacting net earnings for the nine months ended September 30, 2014 of $5.33 million (September 30, 2013 – $12.66 million) for oil and $0.23 million (September 30, 2013 – nil) for natural gas.

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 on the statement of earnings/(loss) and comprehensive earnings/(loss) for the three and nine month periods of 2014 was $11.22 million (2013 - $7.99 million loss) and $6.25 million (2013 - $10.68 million loss), respectively. The realized loss on the statement of earnings/(loss) and comprehensive earnings/(loss) for the three and nine month periods of 2014 was $2.06 million (2013 - $2.56 million loss) and $8.10 million (2013 - $0.32 million loss), respectively.

As at September 30, 2014, 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	1,800 bbl/d	$90.24 US/bbl	Oct. 1/14 – Dec. 31/14	(116)
	400 bbl/d	$91.73 US/bbl	Oct. 1/14 – Mar. 31/15	129
	400 bbl/d	$93.20 US/bbl	Oct. 1/14 – Jun. 30/15	449
	800 bbl/d	$94.41 US/bbl	Jan. 1/15 – Jun. 30/15	898
	400 bbl/d	$99.60 Cdn/bbl	Oct. 1/14 – Dec. 31/14	(82)
Natural gas swaps	3,000 gj/d	$3.74 Cdn/gj	Oct. 1/14 – Oct. 31/14	(12)
	3,000 gj/d	$4.18 Cdn/gj	Nov. 1/14 – Mar. 31/15	(2)
Total Fair Market Value, Commodity Price Financial Contracts				**1,264**

Oil swaps are settled against the NYMEX WTI pricing index.

AECO Basis Gas Rate Risk Management Contract:

	Rate	Average Price	Range of Terms	Fair Market Value Asset/(Liability) ($ thousands)
AECO to NYMEX basis	6,000 MMBtu/d	$(0.4850) US/MMBtu	Oct. 1/14 – Oct. 31/14	(30)
NYMEX to AECO basis	3,000 MMBtu/d	$(0.5000) US/MMBtu	Oct. 1/14 – Oct. 31/14	16
NYMEX to AECO basis	3,000 MMBtu/d	$(0.5075) US/MMBtu	Oct. 1/14 – Oct. 31/14	17
Total Fair Market Value, AECO Basis Gas Rate Financial Contracts				**3**

AECO basis natural gas swaps are settled against the AECO pricing index.

Interest Rate Risk Management Contracts:

	Notional Value	Weighted Average Interest Rate[1]	Range of Terms	Fair Market Value Asset/(Liability) ($ thousands)
Interest rate swaps	$20,000,000/month	1.640%	Oct. 1/14 – Jul. 26/16	(81)
	$20,000,000/month	1.731%	Oct. 1/14 – Aug. 26/16	(125)
Total Fair Market Value, Interest Rate Financial Contracts				**(206)**

(1) Excludes the current stamping fee of 2.0 percent for each swap.

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

CORPORATE INFORMATION

BOARD OF DIRECTORS

Craig H. Hansen
Calgary, Alberta

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

Kyle D. Kitagawa (1)
Calgary, Alberta

Geoffrey C. Merritt (1)
Calgary, Alberta

Jim Peplinski (1) (2)
Calgary, Alberta

Grant A. Zawalsky (2)
Calgary, Alberta

OFFICERS

Craig H. Hansen
President and Chief Executive Officer and Interim Chief Financial Officer

Leslie E. Burden
Vice President, Land

Randolph J. Doetzel
Vice President, Operations

Christopher M. Hustad
Vice President, Alberta Plains South

Pete H.S. Janjua
Vice President, Williston Basin

Brian G. Kergan
Vice President, Corporate Development

Robert T. Moriyama
Vice President, Enhanced Recovery

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

STOCK EXCHANGE LISTING

Toronto Stock Exchange

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

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

TRANSFER AGENT

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310, 606 – 4th Street S.W.
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BANKERS

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Calgary, Alberta T2P 2P2

The Bank of Nova Scotia
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