ZARGON OIL & GAS LTD.

2015 Q2 FINANCIAL REPORT

FINANCIAL AND OPERATING HIGHLIGHTS

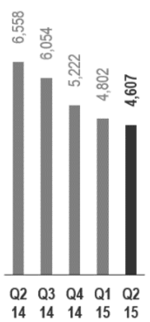
	Three Months Ended June 30,			Six Months Ended June 30,		
(unaudited)	**2015**	2014	Percent Change	**2015**	2014	Percent Change
Financial						
Income and Investments ($ millions)						
Gross petroleum and natural gas sales	**20.32**	40.86	(50)	**36.73**	81.12	(55)
Funds flow from operating activities	**9.99**	11.88	(16)	**17.23**	27.18	(37)
Cash flows from operating activities	**6.98**	10.03	(30)	**13.65**	24.89	(45)
Cash dividends	**2.73**	5.42	(50)	**5.45**	10.84	(50)
Net loss	**(3.76)**	(2.02)	(86)	**(8.64)**	(1.85)	(367)
Net capital expenditures	**5.35**	13.37	(60)	**10.75**	28.85	(63)
Per Share, Basic						
Funds flow from operating activities ($/share)	**0.33**	0.39	(15)	**0.57**	0.90	(37)
Cash flows from operating activities ($/share)	**0.23**	0.33	(30)	**0.45**	0.83	(46)
Net loss ($/share)	**(0.12)**	(0.07)	(71)	**(0.29)**	(0.06)	(383)
Cash Dividends ($/common share)	**0.09**	0.18	(50)	**0.18**	0.36	(50)
Balance Sheet at Period End ($ millions)						
Property and equipment				**333.58**	414.08	(19)
Exploration and evaluation assets				**6.44**	12.25	(47)
Long term bank debt				**50.80**	56.37	(10)
Convertible debentures at maturity				**57.50**	57.50	–
Shareholders' equity				**149.19**	161.75	(8)
Total Common Shares Outstanding at Period End (millions)				**30.28**	30.13	–
Operating						
Average Daily Production						
Oil and liquids (bbl/d)	**3,720**	4,096	(9)	**3,824**	4,208	(9)
Natural gas (mmcf/d)	**5.32**	14.77	(64)	**5.28**	14.41	(63)
Equivalent (boe/d)	**4,607**	6,558	(30)	**4,704**	6,610	(29)
Average Selling Price (before the impact of financial risk management contracts)						
Oil and liquids ($/bbl)	**56.55**	93.26	(39)	**49.25**	89.92	(45)
Natural gas ($/mcf)	**2.42**	4.54	(47)	**2.77**	4.85	(43)
Wells Drilled, Net	**–**	8.0	(100)	**–**	11.7	(100)
Undeveloped Land at Period End (thousand net acres)				**82**	183	(55)

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

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

Message to Shareholders [1]

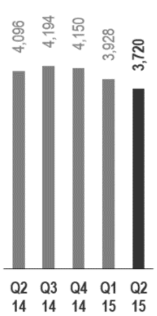
Production
(boe/d)



Zargon Oil & Gas Ltd. has released its financial and operating results for the second quarter of 2015. Specific financial and operating highlights in the second quarter of 2015 include:

- Funds flow from operating activities of $10.0 million were 39 percent higher than the $7.2 million recorded in the prior quarter due to a combination of higher oil prices, lower operating expenses and decreased general and administrative expenses, and 16 percent lower than the $11.9 million reported in the second quarter of 2014. Funds flow from operating activities for the 2015 second quarter included reductions of $0.3 million of asset retirement expenses.
- Reflecting the prior year's dispositions, second quarter 2015 production averaged 3,720 barrels of oil and liquids per day, a five percent decrease from the preceding quarter and second quarter 2015 natural gas production averaged 5.3 million cubic feet per day, a two percent increase from the preceding quarter. Total production averaged 4,607 barrels of oil equivalent per day, a four percent decrease from the preceding quarter. During the quarter, oil and liquids production represented 81 percent of total production based on a 6:1 equivalent basis. The oil volumes are comprised of (low decline) waterflood and water drive production that is beginning to be augmented by ASP tertiary recovery oil volumes.

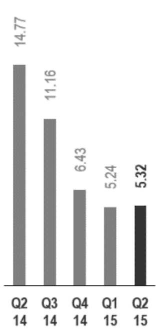
Oil and Liquids Production
(bbl/d)



- Three monthly cash dividends of $0.03 per common share were declared in the second quarter of 2015 for a total of $2.7 million. These cash dividends were equivalent to a payout ratio of 27 percent of funds flow from operating activities. As previously reported, Zargon has set the monthly dividend at $0.01 per common share commencing with the July 2015 dividend that is payable in August 2015.
- Second quarter 2015 exploration and development capital expenditures (excluding property acquisitions and dispositions) were $5.4 million and included $3.5 million of expenditures related to the Little Bow ASP project ($0.6 million exploitation and $2.9 million chemical costs). No wells were drilled in the quarter.
- On June 18, 2015, Zargon amended and renewed its syndicated committed credit facilities of $110 million, a reduction from the previous facilities of $130 million. At June 30, 2015, Zargon had outstanding bank debt of $51 million which represents 46 percent of the $110 million credit facilities' borrowing base. As of June 30, 2015, Zargon had $112 million of total 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, which matures in June 2017.

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

Natural Gas Production
(mmcf/d)



In March 2014, Zargon commenced chemical injection of large volumes of dilute chemical solution into the partially depleted Little Bow Mannville I pool to recover incremental oil reserves. To date, 5.1 million barrels of ASP solution has been injected into the first phase of the project. This injection volume is equal to about 16 percent of the targeted reservoir pore volume, and represents 23 percent of the total chemical bank (ASP and polymer only) scheduled to be injected in the phase 1 operation.

For the 2015 second quarter, incremental Little Bow ASP production volumes averaged 80 barrels of oil per day, up from the 2015 first quarter average of 50 barrels of oil per day. Oil cuts from the ASP project have shown encouraging increases from 1.3 percent to 3.4 percent. However, the oil production response while evident, is delayed relative to original project forecasts. Based on diagnostic studies and field work we believe that these delays are attributable to: 1) unbalanced distribution of ASP injection fluids; and 2) higher than anticipated surfactant losses due to adsorption on the rock.

Other contributing operational factors include higher than anticipated well servicing requirements and June/July injection pipeline failures related to specific pipeline material and installation defects. The necessary pipeline repairs and replacements will be completed by the end of September. These pipeline outages have caused a significant reduction in ASP injection rates and correspondingly, a reduction of incremental ASP oil production rates.

Zargon has commenced a remedial program to address the above noted oil production response delays. The key facets of the program are: 1) increasing oil productive capability (drill two wells and supplementary perforations at four producers); 2) increasing and rebalancing injection capability (drill one injector, convert one flank water injector into ASP injection service, replace selected ASP injection lines, plus a number of selective solvent stimulations); and 3) increase surfactant concentrations to allay surfactant adsorption concerns. This previously announced program is expected to be completed by the end of October 2015 at a total remaining (2015 second half) cost of $4 million. For further information regarding the Little Bow ASP project, please refer to our updated corporate presentation, which is available at www.zargon.ca.

Other Field Activities [1]

In addition to the second quarter's $3.5 million of ASP exploitation and chemical capital expenditures, Zargon executed a $1.9 million capital program in the 2015 second quarter on conventional oil exploitation assets. The 2015 second quarter capital program focused on exploitation projects and no wells were drilled during the quarter. Zargon's non-ASP conventional properties tend to be pressure supported by water injections or natural reservoir aquifers and consequently provide long-life low-decline oil volumes. In aggregate, these properties bring more than 65 horizontal locations that can be methodically drilled to maintain stable non-ASP oil production volumes for many years.

2015 & 2016 Outlook [1]

Zargon's 2015 total capital budget continues to be set at $25 million (before dispositions) of which approximately $14 million remains to be spent in the second half of the year. The remaining 2015 capital budget will be allocated $3 million to conventional expenditures, $7 million for ASP chemicals and $4 million for ASP remedial and optimization expenditures. For 2016, we are currently forecasting a $22 million capital budget which is comprised of $6 million of conventional expenditures, $14 million for ASP chemical costs and $2 million of ASP exploitation costs that will complete the alkaline and surfactant stage for the Little Bow phase 1 project. The follow-on polymer injection costs for phase 1 are expected to average $4 million per year during the 2017 through 2019 period. Phase 2 expansion capital will be deferred until realized field oil prices increase from the current depressed levels.

Zargon has entered into an 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 and oil prices to improve. For the remainder of 2015, Zargon has hedged 1,417 barrels per day at $79.81 Cdn/bbl WTI, while for the first half of 2016 an average of 500 barrels per day is hedged at $79.30 Cdn/bbl WTI.

Production Guidance [1]

In the April 16, 2015 Little Bow ASP project results press release, Zargon provided 2015 year average oil and liquids production rate guidance of 3,700 barrels of oil and liquids per day (excluding incremental ASP volumes) plus 150 barrels of oil and liquids per day of 2015 second quarter incremental ASP volumes. Actual combined second quarter volumes were 3,720 barrels of oil and liquids per day and included 80 barrels of oil and liquids per day of incremental ASP volumes. The April press release also set Zargon's 2015 year average natural gas production guidance of 4.9 million cubic feet per day. Second quarter actual volumes were 5.3 million cubic feet per day and exceeded the year average guidance by eight percent.

Combined oil and liquids production for the 2015 third quarter is forecast at 3,650 barrels of oil per day and the magnitude of the 2015 fourth quarter production gains will depend on the results of the upcoming $4 million Little Bow ASP remedial and optimization capital program. Third quarter natural gas production guidance is forecast at 5.0 million cubic feet per day.

Zargon Board Initiates a Strategic Alternatives Process [1]

Zargon's Board of Directors (the "Board") and management of the Company believe Zargon's share price has not been reflective of the fundamental value inherent in the Company and the Board has determined that it is timely to review the Company's alternatives in light of its long-life, low-decline conventional assets and the significant long term potential related to the Little Bow ASP project. Consequently, the Board has initiated a process to identify and consider strategic and financial alternatives available to the Company with the ultimate goal of maximizing shareholder value. The Company has established a Special Committee that will be comprised of independent directors to oversee the strategic review process. Strategic and financial alternatives may include, but are not limited to a strategic financing, merger or other business combination, sale of the Company or a portion of the Company's business or assets or any combination thereof, as well as the continued execution of its business plan.

Mr. Harrison will be chairing the Special Committee of the Board. Scotia Waterous Inc. will be advising the Special Committee in a comprehensive analysis of potential alternative transactions. Although the Company has initiated a strategic review process, there is no certainty that any transaction or alternative will be undertaken. The Company does not intend to make further announcements or disclose developments with respect to this process unless the evaluation has been completed and the Board has approved a definitive transaction and the Company has entered into a definitive agreement or unless otherwise required by law or regulation or disclosure of which is deemed appropriate.

(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 2015 second quarter financial results and should be read in conjunction with the unaudited interim consolidated financial statements and related notes for the three and six months ended June 30, 2015 and the audited consolidated financial statements and related notes for the year ended December 31, 2014. 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 convertible debenture of $57.50 million and any working capital deficit excluding unrealized derivative assets/liabilities.*

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

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

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

Forward-Looking Statements – This document offers our assessment of Zargon’s future plans and operations as at August 13, 2015, and contains forward-looking statements including:

- *our expectations for our plans with respect to our Little Bow ASP project and the results therefrom referred to under the headings “Message to Shareholders”, “Little Bow Alkaline Surfactant Polymer (“ASP”) Project Update”, “2015 & 2016 Outlook”, “Production Guidance” and “Outlook”;*
- *our expectations for our budgeted 2015 and 2016 conventional oil exploitation assets capital program referred to under the headings “Message to Shareholders”, “Other Field Activities”, “2015 & 2016 Outlook” and “Production Guidance”;*
- *our expectations for our 2015 and 2016 hedges referred to under the heading “2015 & 2016 Outlook”;*
- *our strategic alternatives process referred to under the heading “Zargon Board Commences a Strategic Alternatives Process”;*
- *our dividend policy referred to under the heading “Liquidity and Capital Resources”;*
- *our expected sources of funds for dividend referred to under the heading “Liquidity and Capital Resources”;*
- *our expectations for production referred to under the heading “Production Guidance”; and*
- *our expected sources of funds for capital expenditures referred to under the heading “Liquidity and Capital Resources”.*

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

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

This MD&A has been prepared as of August 13, 2015.

FINANCIAL & OPERATING RESULTS

Petroleum and Natural Gas Sales

	Three Months Ended June 30,			Six Months Ended June 30,		
($ millions)	**2015**	2014	Percent Change	**2015**	2014	Percent Change
Petroleum sales	**19.14**	34.76	(45)	**34.08**	68.48	(50)
Natural gas sales	**1.18**	6.10	(81)	**2.65**	12.64	(79)
Petroleum and natural gas sales	**20.32**	40.86	(50)	**36.73**	81.12	(55)

Second quarter 2015 gross petroleum and natural gas sales of $20.32 million were 50 percent below the $40.86 million in the second quarter of 2014 due to lower oil and natural gas prices and production declines due to property sales.

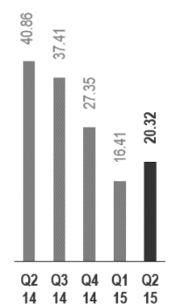
Second quarter 2015 realized oil and liquids field prices averaged $56.55 per barrel before the impact of financial risk management contracts and were 39 percent lower than the $93.26 per barrel recorded in the 2014 second quarter. Zargon's crude oil field price differential from the Edmonton par price remained unchanged at $11.95 per barrel in the second quarter of 2015 compared to $11.93 per barrel in the second quarter of 2014. Natural gas field prices received averaged $2.42 per thousand cubic feet in the second quarter of 2015, a 47 percent decrease from the 2014 second quarter prices.

Pricing

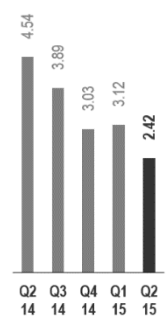
	Three Months Ended June 30,			Six Months Ended June 30,		
Average for the period	**2015**	2014	Percent Change	**2015**	2014	Percent Change
Natural Gas:						
NYMEX average daily spot price ($US/mmbtu)	**2.73**	4.59	(41)	**2.80**	4.89	(43)
AECO average daily spot price ($Cdn/mmbtu)	**2.65**	4.69	(43)	**2.70**	5.20	(48)
Zargon realized field price before the impact of financial risk management contracts ($Cdn/mcf)	**2.42**	4.54	(47)	**2.77**	4.85	(43)
Zargon realized field price before the impact of physical and financial risk management contracts ($Cdn/mcf)	**2.43**	4.54	(46)	**2.53**	4.99	(49)
Zargon realized natural gas field price differential before the impact of physical and financial risk management contracts ($Cdn/mcf)	**0.22**	0.15		**0.17**	0.21	
Crude Oil:						
WTI ($US/bbl)	**57.94**	102.99	(44)	**53.29**	100.84	(47)
Edmonton par price ($Cdn/bbl)	**68.50**	105.19	(35)	**60.61**	102.49	(41)
Zargon realized field price before the impact of financial risk management contracts ($Cdn/bbl)	**56.55**	93.26	(39)	**49.25**	89.92	(45)
Zargon realized field price after the impact of financial risk management contracts ($Cdn/bbl)	**70.85**	84.98	(17)	**67.83**	83.75	(19)
Zargon realized oil field price differential [1]	**11.95**	11.93		**11.36**	12.57	

(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).

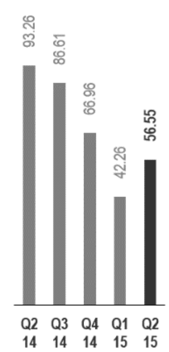
Petroleum and Natural Gas Revenue
($ millions)



Natural Gas Prices
($/mcf)



Oil and Liquids Prices
($/bbl)



Volumes

Oil and liquids production volumes during the 2015 second quarter were 3,720 barrels per day, a nine percent decrease from the 2014 second quarter rate of 4,096 barrels per day. The production decrease is due to natural occurring production declines and property dispositions that occurred in the second half of 2014. Natural gas production volumes in the 2015 second quarter of 5.32 million cubic feet per day compared to 14.77 million cubic feet per day in the 2014 second quarter. The production decrease is due to naturally occurring production declines and the disposition of the Jarrow, Pembina and Hamilton Lake properties in the second half of 2014.

Production by Core Area

Three Months Ended June 30,	**2015**			2014		
	Oil and Liquids (bbl/d)	**Natural Gas (mmcf/d)**	**Equivalents (boe/d)**	Oil and Liquids (bbl/d)	Natural Gas (mmcf/d)	Equivalents (boe/d)
Alberta Plains North	**805**	**2.45**	**1,213**	1,120	11.72	3,074
Alberta Plains South	**1,174**	**2.40**	**1,574**	1,275	2.63	1,713
Williston Basin	**1,741**	**0.47**	**1,820**	1,701	0.42	1,771
	3,720	**5.32**	**4,607**	4,096	14.77	6,558

Six Months Ended June 30,	**2015**			2014		
	Oil and Liquids (bbl/d)	**Natural Gas (mmcf/d)**	**Equivalents (boe/d)**	Oil and Liquids (bbl/d)	Natural Gas (mmcf/d)	Equivalents (boe/d)
Alberta Plains North	**829**	**2.53**	**1,250**	1,145	11.36	3,038
Alberta Plains South	**1,201**	**2.34**	**1,591**	1,321	2.63	1,760
Williston Basin	**1,794**	**0.41**	**1,863**	1,742	0.42	1,812
	3,824	**5.28**	**4,704**	4,208	14.41	6,610

Risk Management Contracts

Zargon's commodity price risk management policy, which is approved by the Board of Directors, allows for the sale of up to a certain percentage of its estimated before royalty production volumes for each commodity up to a 30 month period. Zargon may also enter into interest rate swaps and 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 2015 second quarter, higher contract prices versus WTI oil prices resulted in a net realized gain on derivatives of $4.77 million compared to a $3.73 million net realized loss in the second quarter of 2014.

The unrealized loss on derivatives of $5.40 million in the second quarter of 2015 was comprised of oil contract losses of $5.49 million and an interest rate swap gain of $0.09 million, compared to a net $1.77 million loss in the second quarter of 2014. These non-cash unrealized derivative gains or losses are generated by the change over the reporting period in the mark-to-market valuation of Zargon’s risk management contracts. Commodity price volatility has resulted in significant fluctuations in the mark-to-market amount of unrealized derivative assets and liabilities. Zargon’s commodity risk management positions are described in Notes 11 and 12 to the unaudited interim consolidated financial statements.

Royalties

($ millions)	Three Months Ended June 30, 2015	2014	Percent Change	Six Months Ended June 30, 2015	2014	Percent Change
Royalties	**2.64**	8.19	(68)	**5.14**	14.92	(66)
Percentage of revenue	**13.0%**	20.1%		**14.0%**	18.4%	

Royalties are inclusive of the Saskatchewan Resource Surcharge ("SRC"). The variations in royalty rates generally track changes in production volumes and pricing. Second quarter of 2015 royalties were 13.0 percent of gross sales compared to 20.1 percent in the second quarter of 2014.

Operating Expenses and Transportation Expenses

($ millions)	Three Months Ended June 30, 2015	2014	Percent Change	Six Months Ended June 30, 2015	2014	Percent Change
Operating expenses	**8.43**	11.38	(26)	**17.63**	21.60	(18)
Transportation expenses	**0.24**	0.38	(37)	**0.56**	0.89	(37)
Total expenses	**8.67**	11.76	(26)	**18.19**	22.49	(19)
Total expenses ($/boe)	**20.68**	19.70	5	**21.36**	18.79	14

Compared to the prior year's second quarter, operating expenses and transportation expenses in the 2015 second quarter were down on a total dollar basis but increased on a per barrel of oil equivalent basis. In the quarter, operating expenses were lower primarily due to decreased oil and gas field activity. Excluding the Little Bow ASP project costs and volumes, the second quarter 2015 operating and transportation costs averaged $18.03 per barrel of oil equivalent.

Operating Netbacks

Three Months Ended June 30,	**2015** Oil and Liquids ($/bbl)	**2015** Natural Gas ($/mcf)	2014 Oil and Liquids ($/bbl)	2014 Natural Gas ($/mcf)
Sales	**56.55**	**2.42**	93.26	4.54
Royalties	**(7.19)**	**(0.43)**	(20.46)	(0.42)
Realized gain/(loss) on derivatives	**14.30**	**–**	(8.28)	(0.45)
Operating expenses	**(21.77)**	**(2.17)**	(22.60)	(2.20)
Transportation expenses	**(0.72)**	**–**	(1.01)	–
Operating netbacks	**41.17**	**(0.18)**	40.91	1.47

Six Months Ended June 30,	**2015**		2014	
	Oil and Liquids ($/bbl)	**Natural Gas ($/mcf)**	Oil and Liquids ($/bbl)	Natural Gas ($/mcf)
Sales	**49.25**	**2.77**	89.92	4.85
Royalties	**(6.90)**	**(0.38)**	(17.69)	(0.55)
Realized gain/(loss) on derivatives	**18.58**	**0.39**	(6.17)	(0.48)
Operating expenses	**(21.93)**	**(2.56)**	(20.97)	(2.16)
Transportation expenses	**(0.81)**	**–**	(1.16)	–
Operating netbacks	**38.19**	**0.22**	43.93	1.66

General & Administrative ("G&A") Expenses

	Three Months Ended June 30,			**Six Months Ended June 30,**		
($ millions)	**2015**	2014	Percent Change	**2015**	2014	Percent Change
G&A expenses	**1.91**	3.03	(37)	**4.66**	6.00	(22)
G&A expenses ($/boe)	**4.55**	5.08	(10)	**5.47**	5.01	9

G&A expenses per barrel of oil equivalent were lower in the second quarter of 2015 primarily due to reductions in salaries and wages from staff reductions.

Transaction Costs

Transaction costs for the 2015 second quarter were nil compared to $0.15 million in the second quarter of 2014 and relate to property dispositions.

Interest and Financing Charges on Long Term Bank Debt

On June 18, 2015, Zargon amended and renewed its syndicated committed credit facilities of $110 million, a reduction from the previous facilities of $130 million. This reduction is partly a result of property dispositions over the past 18 months. The next renewal date is June 22, 2016, with a semi-annual review taking place in the fall of 2015. These facilities continue to be available for general corporate purposes and potential acquisition of oil and natural gas properties. Interest rates fluctuate under the syndicated facilities with Canadian prime, US prime and US base rates plus an applicable margin between 50 basis points and 200 basis points, as well as with Canadian banker's acceptance and LIBOR rates plus an applicable margin between 200 basis points and 350 basis points.

Zargon's borrowings are through its syndicated bank credit facilities. Interest and financing charges on these facilities in the 2015 second quarter were $0.60 million, a 12 percent decrease from $0.68 million in the second quarter of 2014. The decrease in interest and financing charges resulted from lower average borrowing levels and a lower effective interest rate compared to the second quarter of 2014.

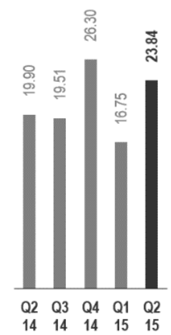
Interest on Convertible Debentures

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 second quarter of 2015 were unchanged compared to the second quarter of 2014.

Current Tax

Current tax for the 2015 second quarter was $0.15 million, and relates to the US operations. When compared to the 2014 second quarter, current tax increased by $0.08 million. Total corporate tax pools as at June 30, 2015 are approximately $257 million, which represents a decrease of nine percent from the comparable $282 million of tax pools available to Zargon at December 31, 2014.

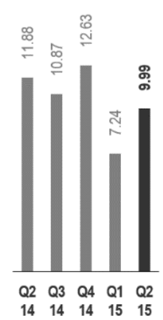
Funds Flow Netbacks
($/boe)



Corporate Netbacks

	Three Months Ended June 30,		Six Months Ended June 30,	
($/boe)	**2015**	2014	**2015**	2014
Petroleum and natural gas sales	**48.46**	68.46	**43.14**	67.81
Royalties	**(6.30)**	(13.73)	**(6.03)**	(12.47)
Realized gain/(loss) on derivatives	**11.37**	(6.25)	**15.38**	(5.05)
Operating expenses	**(20.10)**	(19.07)	**(20.70)**	(18.05)
Transportation expenses	**(0.58)**	(0.63)	**(0.66)**	(0.74)
Operating netbacks	**32.85**	28.78	**31.13**	31.50
General and administrative expenses	**(4.55)**	(5.08)	**(5.47)**	(5.01)
Transaction costs	**–**	(0.25)	**(0.04)**	(0.16)
Interest and financing charges	**(1.42)**	(1.13)	**(1.40)**	(1.07)
Interest on convertible debentures	**(2.06)**	(1.44)	**(2.03)**	(1.44)
Asset retirement expenditures	**(0.64)**	(0.86)	**(2.06)**	(0.99)
Current (tax)/recovery	**(0.34)**	(0.12)	**0.11**	(0.12)
Funds flow netbacks	**23.84**	19.90	**20.24**	22.71

Funds Flow from Operating Activities
($ millions)



Depletion and Depreciation Expense

Depletion and depreciation expense for the second quarter of 2015 decreased 28 percent to $8.52 million compared to $11.90 million in the second quarter of 2014. On a per barrel of oil equivalent basis, the depletion and depreciation rates were $20.33 and $19.95 for the second quarter of 2015 and the second quarter of 2014, respectively. When compared to the second quarter of 2014, the decreased depletion expense is primarily due to the reduction in depletable base through property, plant and equipment asset sales. The 2014 calendar year depletion and depreciation rate was $20.06 per barrel of oil equivalent.

Accretion of Asset Retirement Obligations and Convertible Debentures

The accretion expense of asset retirement obligations for the second quarter of 2015 was $0.54 million, a 50 percent decrease from the second quarter of 2014 and resulted from the reduction of future asset retirement obligations through 2014 property sales. 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 2015 second quarter is $0.34 million compared to $0.30 million in the 2014 second quarter.

Shared-based Compensation

Expensing of share-based compensation in the second quarter of 2015 totalled $0.34 million, which was lower than the $0.55 million incurred in the second quarter of 2014 due to a lower Black Scholes value of the 2015 grants, including the impact of forfeitures.

Unrealized Foreign Exchange

The Company had an unrealized foreign exchange loss of $0.08 million during the second quarter of 2015 compared to a gain of $0.01 million in the 2014 second quarter. Gains and losses result from transactions in US dollars when they are translated into Canadian dollars. The volatility in the US/Cdn dollar creates non-cash translation gains/losses.

Gain on Disposal of Assets

During the second quarter of 2015, Zargon had a nil gain on disposal of assets compared to a gain of $1.26 million on disposal of assets in 2014.

Exploration and Evaluation Expenses

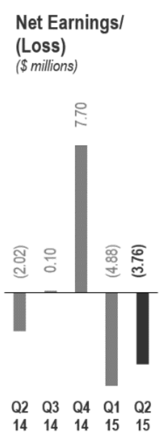
Non-cash exploration and evaluation expenses for the 2015 second quarter of $0.34 million compared to second quarter of 2014 expenses of $0.66 million. Exploration and evaluation expenses are primarily related to undeveloped land expiries. The 2015 second quarter exploration and evaluation expense related to expiries in southern Alberta.

Deferred Tax

The deferred tax recovery for the second quarter of 2015 was $1.54 million compared to a recovery of $0.57 million in the second quarter of 2014. The increase in deferred tax recovery is primarily a result of a higher net loss in the quarter.

Funds Flow from Operating Activities

Funds flow from operating activities in the 2015 second quarter of $9.99 million was $1.89 million, or 16 percent lower than the prior year second quarter. The decrease in funds flow compared to the prior year second quarter was primarily a result of decreased revenue from lower oil and gas prices which was partially offset by decreased operating expenses, lower royalties and a gain on realized derivatives.

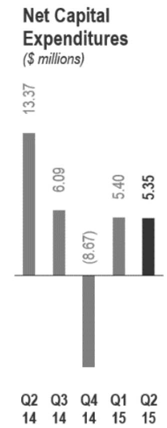


Net Loss

A net loss of $3.76 million for the 2015 second quarter was up $1.74 million from the $2.02 million net loss in the 2014 second quarter, largely due to increased losses on unrealized derivatives. 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 second quarter 2015 net loss was $0.12, compared to a net loss of $0.07 for the 2014 second quarter.

Capital Expenditures

	Three Months Ended June 30,		Six Months Ended June 30,	
($ millions)	**2015**	2014	**2015**	2014
Undeveloped land	**0.47**	0.75	**0.87**	1.63
Geological and geophysical (seismic)	**0.26**	0.57	**0.31**	0.71
Drilling and completion of wells	**0.66**	5.88	**1.18**	10.21
Well equipment and facilities	**0.47**	4.37	**0.69**	8.49
ASP project and exploitation costs	**0.64**	1.84	**2.05**	7.90
ASP chemical costs	**2.89**	3.02	**5.73**	4.41
Exploration and development	**5.39**	16.43	**10.83**	33.35
Property acquisitions	**–**	3.19	**0.03**	3.26
Property dispositions	**(0.05)**	(6.39)	**(0.08)**	(7.92)
Net property dispositions	**(0.05)**	(3.20)	**(0.05)**	(4.66)
Total net capital expenditures excluding administrative assets	**5.34**	13.23	**10.78**	28.69
Administrative assets	**0.01**	0.14	**(0.03)**	0.16
Total net capital expenditures	**5.35**	13.37	**10.75**	28.85



LIQUIDITY AND CAPITAL RESOURCES

Total net capital expenditures (including net property dispositions) totalled $5.35 million in the second quarter of 2015 and were 60 percent lower than the same period in 2014. Field expenditures of $5.39 million for the second quarter of 2015 were 67 percent lower than the 2014 second quarter. The second quarter 2015 field capital expenditures (excluding net property dispositions) were allocated to Alberta Plains North - $0.40 million, Alberta Plains South - $4.16 million and Williston Basin - $0.83 million and included the drilling of nil net wells, down from the 8.0 net wells drilled in the second quarter of 2014.

Included in the Alberta Plains South capital expenditures is the $3.53 million incurred on the Little Bow ASP project. Of the total ASP amount, $0.64 million was spent on project and exploitation costs while $2.89 million was spent on chemical costs for the facility.

Funds flow from operating activities in the 2015 second quarter of $9.99 million were used to fund the capital program and cash dividends to shareholders.

At June 30, 2015, the Company's combined debt net of working capital (excluding unrealized derivative assets/liabilities) was $111.99 million, which compares to $113.43 million of net debt at the end of December 31, 2014. The decrease in net debt was due to Zargon's reduced 2015 second quarter capital expenditure program. The $111.99 million debt net of working capital consists of the $57.50 million of convertible unsecured subordinate debentures and the remaining portion of bank debt.

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

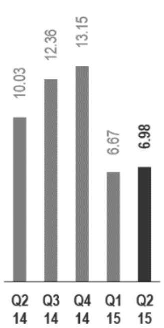
Cash Dividends Analysis

	Three Months Ended June 30,		Six Months Ended June 30,	
($ millions)	**2015**	2014	**2015**	2014
Cash flows from operating activities	**6.98**	10.03	**13.65**	24.89
Net loss	**(3.76)**	(2.02)	**(8.64)**	(1.85)
Actual cash dividends paid or payable relating to the period	**(2.73)**	(5.42)	**(5.45)**	(10.84)
Excess of cash flows from operating activities over cash dividends paid	**4.25**	4.61	**8.20**	14.05
Excess (shortfall) of net earnings/(loss) over cash dividends paid	**(6.49)**	(7.44)	**(14.09)**	(12.69)

During the first half of 2015, Zargon maintained a monthly dividend of $0.03 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.

In response to continuing weakness in both spot and forward commodity price markets and increased uncertainty in the capital markets, the Board of Directors of Zargon on June 22, 2015 revised Zargon's monthly dividend policy from $0.03 per common share to $0.01 per common share commencing in the third quarter of 2015.

Cash Flows from Operating Activities
($ millions)



For the three months ended June 30, 2015, cash flows from operating activities (after changes in non-cash working capital) of $6.98 million exceeded cash dividends of $2.73 million. Similarly, for the three months ended June 30, 2014, cash flows from operating activities (after changes in non-cash working capital) of $10.03 million exceeded cash dividends of $5.42 million.

For the three months ended June 30, 2015, a net loss of $3.76 million was exceeded by cash dividends of $2.73 million. The net loss includes significant non-cash charges of $14.02 million for the 2015 second quarter that does not impact cash flow. For the three months ended June 30, 2014, a net loss of $2.02 million was exceeded by cash dividends of $5.42 million. In the instances where dividends exceed net earnings, a portion of the cash dividend paid to shareholders may represent an economic return of the shareholders' capital.

For the quarter ended June 30, 2015, cash dividends and net capital expenditures totalled $8.12 million, which was $1.14 million higher than the cash flows from operating activities (after changes in non-cash working capital) of $6.98 million. For the quarter ended June 30, 2014, cash dividends and net capital expenditures totalled $18.79 million, which was $8.76 million higher than the cash flows from operating activities (after changes in non-cash working capital) of $10.03 million. Zargon relies on access to debt and capital markets to the extent that cash dividends and net capital expenditures exceed cash flows from operating activities (after changes in non-cash working capital). Over the long term, Zargon expects to fund cash dividends and capital expenditures with its cash flows from operating activities; however, it may continue to fund acquisitions and growth through additional debt and equity issuances. In the crude oil and natural gas industry, because of the nature of reserve reporting, the natural reservoir declines and the risks involved in capital investment, it is not possible to distinguish between capital spent on maintaining productive capacity and capital spent on growth opportunities. Therefore, maintenance capital is not disclosed separately from development capital spending.

At August 13, 2015, Zargon Oil & Gas Ltd. had 30.281 million common shares outstanding. Pursuant to the share award and common share rights incentive plans, there are currently an additional 0.957 million common share incentive rights issued and outstanding.

Capital Sources and Uses

	Three Months Ended June 30,		Six Months Ended June 30,	
($ millions)	**2015**	2014	**2015**	2014
Funds flow from operating activities	**9.99**	11.88	**17.23**	27.18
Change in long term bank debt	**0.89**	5.82	**8.03**	16.40
Cash dividends to shareholders	**(2.73)**	(5.42)	**(5.45)**	(10.84)
Changes in working capital and other	**(2.80)**	1.09	**(9.06)**	(3.89)
Total capital sources	**5.35**	13.37	**10.75**	28.85

CHANGES IN ACCOUNTING POLICIES

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

FUTURE CHANGES IN ACCOUNTING POLICIES

The Company's future changes in accounting policies are discussed in Note 3 to the Consolidated 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 2015 certificate requires that the Company disclose in the interim MD&A any changes in the Company's internal controls over financial reporting that occurred during the period that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting. The Company confirms that no such changes were made to the internal controls over financial reporting during the second quarter of 2015.

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

Since mid-2014, oil prices have declined precipitously to unexpected levels and as a result, Zargon's current revenues and cash flows are significantly reduced. During these challenging times, Zargon will seek to improve cash flows by reducing all costs while restricting capital programs. Zargon's remaining portfolio of long-life low-decline oil exploitation properties is well suited to survive this period of low oil prices. With the Little Bow ASP tertiary project demonstrating first responses and growing production, Zargon can anticipate stable and then increasing oil production volumes throughout the rest of the decade with only modest capital expenditures.

SUMMARY OF QUARTERLY RESULTS

	2015	
	Q1	**Q2**
Petroleum and natural gas sales ($ millions)	16.41	**20.32**
Net loss ($ millions)	(4.88)	**(3.76)**
Net loss per diluted share ($)	(0.16)	**(0.12)**
Funds flow from operating activities ($ millions)	7.24	**9.99**
Funds flow from operating activities per diluted share ($)	0.24	**0.33**
Cash flows from operating activities ($ millions)	6.67	**6.98**
Cash flows from operating activities per diluted share ($)	0.22	**0.23**
Cash dividends ($ millions)	2.72	**2.73**
Cash dividends declared per common share ($)	0.09	**0.09**
Net capital expenditures ($ millions)	5.40	**5.35**
Total assets ($ millions)	377.16	**369.47**
Long term bank debt ($ millions)	49.91	**50.80**
Convertible debentures ($ millions) (1)	57.50	**57.50**
Net debt	113.80	**111.99**
Average daily oil and liquids production (bbl)	3,928	**3,720**
Average daily natural gas production (mmcf)	5.24	**5.32**
Average daily production (boe)	4,802	**4,607**
Average oil production weighting (%)	82	**81**
Average realized commodity field price before the impact of financial risk management contracts ($/boe)	37.98	**48.46**
Funds flow netback ($/boe)	16.75	**23.84**

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

	2014			
	Q1	Q2	Q3	Q4
Petroleum and natural gas sales ($ millions)	40.26	40.86	37.41	27.35
Net earnings/(loss) ($ millions)	0.17	(2.02)	0.10	7.70
Net earnings/(loss) per diluted share ($)	0.01	(0.07)	–	0.19
Funds flow from operating activities ($ millions)	15.30	11.88	10.87	12.63
Funds flow from operating activities per diluted share ($)	0.50	0.39	0.35	0.41
Cash flows from operating activities ($ millions)	14.86	10.03	12.36	13.15
Cash flows from operating activities per diluted share ($)	0.49	0.33	0.40	0.43
Cash dividends ($ millions)	5.42	5.42	5.43	5.43
Cash dividends declared per common share ($)	0.18	0.18	0.18	0.18
Net capital expenditures/(dispositions) ($ millions)	15.48	13.37	6.09	(8.67)
Total assets ($ millions)	462.66	461.70	426.51	382.71
Long term bank debt ($ millions)	50.55	56.37	59.45	42.77
Convertible debentures ($ millions) (1)	57.50	57.50	57.50	57.50
Net debt	121.72	128.88	129.11	113.43
Average daily oil and liquids production (bbl)	4,320	4,096	4,194	4,150
Average daily natural gas production (mmcf)	14.05	14.77	11.16	6.43
Average daily production (boe)	6,662	6,558	6,054	5,222
Average oil production weighting (%)	65	62	69	79
Average realized commodity field price before the impact of financial risk management contracts ($/boe)	67.15	68.46	67.18	56.93
Funds flow netback ($/boe)	25.52	19.90	19.51	26.30

(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.

Additional information regarding the Company and its business operations, including the Company's Annual Information Form for December 31, 2014, is available on the Company's SEDAR profile at www.sedar.com.

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

Calgary, Alberta
August 13, 2015

CONSOLIDATED BALANCE SHEETS

(unaudited)

($ thousands)	Notes	**June 30, 2015**	December 31, 2014
ASSETS			
Trade and other receivables		**10,363**	11,240
Deposits and prepaid expenses		**1,136**	1,226
Investment in marketable securities		**1,542**	1,542
Derivatives	11,12	**862**	12,004
Total current assets		**13,903**	26,012
Long term deposits		**167**	126
Property, plant and equipment, net	4	**333,576**	337,445
Intangible exploration and evaluation assets	5	**6,439**	6,610
Goodwill	5	**4,770**	4,770
Deferred tax assets		**10,618**	7,743
Total assets		**369,473**	382,706
LIABILITIES			
Trade and other payables		**15,446**	24,971
Cash dividends payable	6	**908**	1,811
Provisions	7	**385**	385
Derivatives	11,12	**353**	122
Total current liabilities		**17,092**	27,289
Long term bank debt	8	**50,796**	42,770
Convertible debentures		**54,408**	53,735
Derivatives	11,12	**42**	75
Provisions	7	**86,416**	86,557
Deferred tax liabilities		**11,529**	10,940
Total liabilities		**220,283**	221,366
Commitments and contingencies	7,8,10,11,12		
EQUITY			
Shareholders' capital	9	**258,165**	257,138
Accumulated other comprehensive income		**3,954**	2,538
Contributed surplus	10	**12,377**	12,879
Equity component of debentures		**3,640**	3,640
Deficit		**(128,946)**	(114,855)
Total equity		**149,190**	161,340
Total equity and liabilities		**369,473**	382,706

See accompanying notes to the interim consolidated financial statements.

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

(unaudited)		Three Months Ended June 30,		Six Months Ended June 30,	
($ thousands, except per share amounts)	Notes	**2015**	2014	**2015**	2014
Petroleum and natural gas sales		**20,316**	40,860	**36,730**	81,122
Royalties		**(2,642)**	(8,193)	**(5,138)**	(14,915)
PETROLEUM AND NATURAL GAS REVENUE, NET OF ROYALTIES		**17,674**	32,667	**31,592**	66,207
Loss on unrealized derivatives	11,12	**(5,399)**	(1,774)	**(11,339)**	(4,967)
Gain/(loss) on realized derivatives	11,12	**4,769**	(3,734)	**13,099**	(6,032)
GAIN/(LOSS) ON DERIVATIVES		**(630)**	(5,508)	**1,760**	(10,999)
TOTAL INCOME		**17,044**	27,159	**33,352**	55,208
Operating		**8,425**	11,382	**17,626**	21,601
Transportation		**244**	377	**560**	887
General and administrative		**1,908**	3,029	**4,657**	5,997
Transaction costs		**–**	146	**33**	193
Exploration and evaluation	5	**340**	657	**340**	758
(Gain)/loss on disposal of properties	4	**–**	(1,257)	**2**	(1,927)
Share-based compensation	10	**339**	546	**453**	846
Unrealized foreign exchange (gain)/loss		**81**	(14)	**(387)**	(26)
Depletion and depreciation		**8,524**	11,904	**17,246**	23,308
EXPENSES		**19,861**	26,770	**40,530**	51,637
EARNINGS/(LOSS) BEFORE FINANCE EXPENSES AND INCOME TAXES		**(2,817)**	389	**(7,178)**	3,571
Interest and financing charges	8	**596**	675	**1,193**	1,282
Interest on convertible debentures		**862**	862	**1,725**	1,725
Accretion on convertible debentures		**337**	303	**673**	606
Accretion of asset retirement obligations	7	**536**	1,067	**1,072**	2,165
FINANCE EXPENSES		**2,331**	2,907	**4,663**	5,778
LOSS BEFORE INCOME TAXES		**(5,148)**	(2,518)	**(11,841)**	(2,207)
Current tax expense/(recovery)		**145**	72	**(92)**	145
Deferred tax recovery		**(1,535)**	(570)	**(3,107)**	(503)
INCOME TAXES RECOVERY		**(1,390)**	(498)	**(3,199)**	(358)
NET LOSS FOR THE PERIOD		**(3,758)**	(2,020)	**(8,642)**	(1,849)
Currency translation adjustment that may be reclassified subsequently to net earnings		**(336)**	(912)	**1,416**	51
OTHER COMPREHENSIVE EARNINGS/(LOSS) FOR THE PERIOD		**(336)**	(912)	**1,416**	51
TOTAL COMPREHENSIVE LOSS FOR THE PERIOD		**(4,094)**	(2,932)	**(7,226)**	(1,798)
NET LOSS PER SHARE					
Basic		**(0.12)**	(0.07)	**(0.29)**	(0.06)
Diluted		**(0.12)**	(0.07)	**(0.29)**	(0.06)

See accompanying notes to the interim consolidated financial statements.

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

(unaudited)

($ thousands)	Notes	Shareholders' Capital	Accumulated Other Comprehensive Income	Contributed Surplus	Equity Component of Convertible Debentures	Deficit	Total Equity
Balance at December 31, 2014		**257,138**	**2,538**	**12,879**	**3,640**	**(114,855)**	**161,340**
Net loss for the period		**–**	**–**	**–**	**–**	**(8,642)**	**(8,642)**
Dividends declared	6	**–**	**–**	**–**	**–**	**(5,449)**	**(5,449)**
Share-based compensation	10	**–**	**–**	**453**	**–**	**–**	**453**
Exercise of share options	9	**1,066**	**–**	**(1,066)**	**–**	**–**	**–**
Cancellation of shares	9	**(39)**	**–**	**111**	**–**	**–**	**72**
Translation differences on foreign subsidiary		**–**	**1,416**	**–**	**–**	**–**	**1,416**
Balance at June 30, 2015		**258,165**	**3,954**	**12,377**	**3,640**	**(128,946)**	**149,190**
Balance at December 31, 2013		256,092	493	12,423	3,640	(99,103)	173,545
Net loss for the period		–	–	–	–	(1,849)	(1,849)
Dividends declared	6	–	–	–	–	(10,842)	(10,842)
Share-based compensation	10	–	–	846	–	–	846
Exercise of share options		499	–	(499)	–	–	–
Translation differences on foreign subsidiary		–	51	–	–	–	51
Balance at June 30, 2014		256,591	544	12,770	3,640	(111,794)	161,751

See accompanying notes to the interim consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)		Three Months Ended June 30,		Six Months Ended June 30,	
($ thousands)	Notes	**2015**	2014	**2015**	2014
OPERATING ACTIVITIES					
Net loss for the period		**(3,758)**	(2,020)	**(8,642)**	(1,849)
Adjustments for non-cash items:					
(Gain)/loss on sale of properties	4	**–**	(1,257)	**2**	(1,927)
Loss on unrealized derivatives	11,12	**5,399**	1,774	**11,339**	4,967
Depletion and depreciation	4	**8,524**	11,904	**17,246**	23,308
Accretion of asset retirement obligations	7	**536**	1,067	**1,072**	2,165
Accretion of convertible debentures		**337**	303	**673**	606
Share-based compensation	10	**339**	546	**453**	846
Unrealized foreign exchange (gain)/loss		**81**	(14)	**(387)**	(26)
Deferred tax recovery		**(1,535)**	(570)	**(3,107)**	(503)
Exploration and evaluation expenses	5	**340**	657	**340**	758
Asset retirement expenditures		**(270)**	(515)	**(1,756)**	(1,170)
Funds flow from operating activities		**9,993**	11,875	**17,233**	27,175
Changes in operating working capital		**(3,009)**	(1,849)	**(3,584)**	(2,289)
Net cash from operating activities		**6,984**	10,026	**13,649**	24,886
INVESTING ACTIVITIES					
Additions to property, plant and equipment	4	**(5,314)**	(16,495)	**(10,720)**	(33,418)
Additions to intangible exploration and evaluation assets	5	**(47)**	(147)	**(77)**	(235)
Proceeds on disposal of property, plant and equipment	4	**14**	5,872	**48**	7,402
Proceeds on disposal of intangible exploration and evaluation assets		**–**	515	**–**	515
Acquisition of property, plant and equipment		**–**	(3,111)	**–**	(3,111)
Change in long term deposits		**(41)**	2	**(41)**	2
Changes in investing working capital		**241**	2,938	**(4,534)**	(1,602)
Net cash used in investing activities		**(5,147)**	(10,426)	**(15,324)**	(30,447)
FINANCING ACTIVITIES					
Advances of bank debt		**888**	5,822	**8,026**	16,400
Cash dividends paid to shareholders	6	**(2,726)**	(5,424)	**(5,449)**	(10,842)
Changes in financing working capital		**1**	2	**(902)**	3
Net cash (used)/provided by financing activities		**(1,837)**	400	**1,675**	5,561
NET CHANGE IN CASH DURING THE PERIOD AND CASH, END OF PERIOD		**–**	–	**–**	–

See accompanying notes to the interim consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the three and six months ended June 30, 2015, with comparative figures for 2014 (unaudited).

1. REPORTING ENTITY

Zargon Oil & Gas Ltd. ("the Company" or "Zargon") is a publicly traded corporation incorporated in Canada with its head office located at Suite 700, 333-5th Avenue SW, Calgary, Alberta. The interim consolidated financial statements of the Company as at and for the period ended June 30, 2015 and for its 2014 comparative period comprise the Company and its wholly owned subsidiaries. The Company is engaged in the exploration for and development and production of oil and natural gas in Canada and the United States ("US") and conducts many of its activities jointly with others; these financial statements reflect only the Company's proportionate interest in such activities.

2. BASIS OF PRESENTATION

(a) Statement of compliance:

The unaudited interim consolidated financial statements for the three and six month periods ended June 30, 2015 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, 2014. 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 six month periods ended June 30, 2015 should be read in conjunction with the annual consolidated financial statements for the year ended December 31, 2014. These consolidated financial statements were approved and authorized for issue by the Board of Directors on August 13, 2015.

(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:

No new or amended standards were adopted by the Company for the interim period.

(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, 2018 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)	**Six Months Ended June 30, 2015**
Cost, December 31, 2014	519,076
Accumulated depletion and depreciation	(181,631)
Net carrying amount, December 31, 2014	337,445
Additions	10,717
Disposals	(27)
Exchange differences	2,687
Depletion and depreciation	(17,246)
Net carrying amount, June 30, 2015	333,576
Cost, June 30, 2015	533,390
Accumulated depletion and depreciation	(199,814)
Net carrying amount, June 30, 2015	333,576

During the three and six months ended June 30, 2015, the Company disposed of certain assets for gross cash proceeds of $0.01 million (2014 - $5.87 million) and $0.05 million (2014 - $7.40 million), respectively. The dispositions for the three and six months resulted in gains of nil (2014 - $1.26 million gain) and nil (2014 - $1.93 million gain), respectively.

5. INTANGIBLE EXPLORATION AND EVALUATION ASSETS AND GOODWILL

($ thousands)	Goodwill	E&E Assets	Total
Cost:			
Balance at December 31, 2014	**4,770**	**6,610**	**11,380**
Additions	**–**	**77**	**77**
Exploration and evaluation expense	**–**	**(340)**	**(340)**
Exchange differences	**–**	**92**	**92**
Balance at June 30, 2015	**4,770**	**6,439**	**11,209**

6. CASH DIVIDENDS

During the period, the Company declared dividends to the shareholders in the aggregate amount of $5.45 million (2014 – $10.84 million) in accordance with the following schedule:

2015 Dividends	Record Date	Dividend Date	Per Common Share
January	January 31, 2015	February 17, 2015	$0.03
February	February 28, 2015	March 16, 2015	$0.03
March	March 31, 2015	April 15, 2015	$0.03
April	April 30, 2015	May 15, 2015	$0.03
May	May 31, 2015	June 15, 2015	$0.03
June	June 30, 2015	July 15, 2015	$0.03

During the second quarter of 2015, the Company announced a revised monthly dividend policy in which the dividend will be reduced from $0.03 to $0.01 per common share commencing in the third quarter of 2015.

Subsequent to the end of the period and prior to the consolidated financial statements being authorized for issue on August 13, 2015, the Company declared dividends of $0.30 million or $0.01 per common share for July 2015.

7. PROVISIONS

($ thousands)	Asset Retirement Obligations	Other	Total
Balance at December 31, 2014	**86,557**	**385**	**86,942**
Foreign exchange and other	**543**	**–**	**543**
Provisions used during the period	**(1,756)**	**–**	**(1,756)**
Accretion	**1,072**	**–**	**1,072**
Balance at June 30, 2015	**86,416**	**385**	**86,801**
Current	**–**	**385**	**385**
Non-current	**86,416**	**–**	**86,416**

Asset retirement obligation:

The asset retirement obligations were calculated using a discount factor of 2.50 percent (December 31, 2014 – 2.50 percent) being the risk-free rate related to the liability and based on the Government of Canada long term bond rate. These obligations are expected to be incurred over the next 55 years. An inflation rate of two percent per annum (December 31, 2014 – 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

On June 18, 2015, Zargon amended and renewed its syndicated committed credit facilities, the result of which was the reduction of the available facilities and borrowing base to $110 million. A $300 million demand debenture on the assets of the Company has been provided as security for these facilities. The facilities are fully revolving for a 364 day period with the provision for an annual extension at the option of the lenders and upon notice from Zargon's Management. The next renewal date is June 22, 2016, with a semi-annual review taking place in the fall of 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 June 30, 2015, $50.80 million (December 31, 2014 - $42.77 million) had been drawn on the syndicated committed credit facilities with any unused amounts subject to standby fees. In the normal course of operations Zargon enters into various letters of credit. At June 30, 2015, the approximate value of outstanding letters of credit totalled $0.93 million (December 31, 2014 - $0.90 million). The letters of credit reduce the amount of Zargon's available credit facilities to $58.27 million at June 30, 2015 (December 31, 2014 - $86.33 million).

Zargon reviews its compliance with its bank debt covenants on a quarterly basis and is in compliance as at June 30, 2015.

9. SHARE CAPITAL

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

Common Shares

	Six Months Ended June 30, 2015	
(thousands)	Number of Shares	Amount ($)
Balance, as at December 31, 2014	**30,179**	**257,138**
Share awards exercised	**112**	**–**
Cancellation of shares	**(10)**	**(39)**
Share-based compensation recognized on exercise of share awards	**–**	**1,066**
Balance, as at June 30, 2015	**30,281**	**258,165**

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 13 percent while the interest rate and volatility is set at a historical rate as there is no exercise price. The fair value of the share award is determined on the grant date at the prior day closing price of the Company's common shares on the Toronto Stock Exchange.

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

	Six Months Ended June 30, 2015
	Number of Share Awards (thousands)
Outstanding, as at December 31, 2014	**678**
Share awards granted	**434**
Share awards exercised	**(112)**
Share awards forfeited	**(43)**
Outstanding, as at June 30, 2015	**957**

Common Share Rights Incentive Plan

Under this plan, 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 provision of the plan. Under the Common Share Rights Incentive 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, the entire amount of the dividend is deducted from the original grant price. Options granted under this 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 Common Share Rights Incentive Plan:

	Six Months Ended June 30, 2015	
	Number of Share Options (thousands)	Weighted Average Exercise Price Initial and Modified ($/share)
Outstanding at beginning of period	**178**	**19.80 / 16.85**
Share options expired	**(178)**	**19.80**
Outstanding at end of period	**–**	**–**

All options under the Common Share Rights Incentives plan are expired as of March 31, 2015.

Share-based Compensation

The share awards for the three and six months ended June 30, 2015, resulted in share-based compensation of $0.34 million (2014 - $0.55 million) and $0.45 million (2014 - $0.85 million), respectively.

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

Weighted Average Number of Total Shares

	Three Months Ended June 30,		Six Months Ended June 30,	
(thousands of shares)	**2015**	2014	**2015**	2014
Weighted average number of common shares – basic	**30,278**	30,128	**30,262**	30,114
Weighted average number of common shares – diluted	**30,278**	30,128	**30,262**	30,114

No dilution amounts for the three and six months ended June 30, 2015 and 2014 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 six months ended June 30, 2015 and 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:

	June 30, 2015		December 31, 2014	
(thousands)	**Carrying Amount ($)**	**Fair Value ($)**	Carrying Value ($)	Fair Value ($)
Loans and receivables:				
Trade and other receivables	**10,363**	**10,363**	11,240	11,240
Fair value through profit and loss:				
Derivative assets	**862**	**862**	12,004	12,004
Derivative liabilities	**395**	**395**	197	197
Fair value through other comprehensive income:				
Investment in marketable securities	**1,542**	**1,542**	1,542	1,542
Other liabilities:				
Trade and other payables	**15,446**	**15,446**	24,971	24,971
Cash dividends	**908**	**908**	1,811	1,811
Long term bank debt	**50,796**	**50,796**	42,770	42,770
Convertible debentures	**54,408**	**46,000**	53,735	50,939

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 consolidated 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 June 30, 2015, 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 may enter 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 June 30, 2015 debt pricing levels, the increase or decrease in net earnings for the year for each one percent change in interest rates would amount to $0.25 million (June 30, 2014 - $0.26 million) before swaps.

  - Foreign Exchange Risk

  Foreign currency exchange rate risk is the risk that the fair value of future cash flows will fluctuate as a result of changes in foreign exchange rates. The underlying market prices in Canada for petroleum and natural gas are impacted by changes in the exchange rate between the Canadian and United States dollar. As Zargon operates in North America, fluctuations in the exchange rate between the US/Canadian dollar can have a significant effect on the Company's reported results. A $0.01 change in the US to Canadian dollar exchange rate would have resulted in a $0.19 million (June 30, 2014 - $0.39 million) increase or decrease in net earnings for the period ended June 30, 2015. In order to mitigate the Company's exposure to foreign exchange fluctuations, the Company may enter into foreign exchange derivative agreements.

- Credit Risk

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

  The maximum credit risk exposure associated with accounts receivable and derivative assets is the total carrying value. The Company monitors these balances monthly to limit the risk associated with collection. Of Zargon's accounts receivable at June 30, 2015, approximately 45 percent (December 31, 2014 - 50 percent) was owing from two companies and Zargon anticipates full collection.

  The Company's allowance for doubtful accounts at June 30, 2015 was $0.31 million (December 31, 2014 - $0.35 million). During 2015, 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 June 30, 2015, $0.54 million of accounts receivable are past due, excluding amounts described above, all of which are considered to be collectable.

- Liquidity Risk

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

  As at June 30, 2015, Zargon had available unused committed bank credit facilities of approximately $58.27 million compared to $86.33 million at December 31, 2014. 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	**15,446**	**–**	**15,446**
Cash dividends payable	**908**	**–**	**908**
Derivative liabilities	**353**	**42**	**395**
Long term bank debt	**–**	**50,796**	**50,796**
Interest on convertible debentures	**3,450**	**3,450**	**6,900**
Convertible debentures (1)	**–**	**57,500**	**57,500**

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

Commodity Price Sensitivities

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

Fluctuations of 10 percent in commodity prices could have resulted in unrealized gains or losses of $2.65 million (June 30, 2014 – $8.83 million) and nil (June 30, 2014 – $0.87 million) for oil and gas risk management contracts impacting net earnings for the six months ended June 30, 2015, respectively.

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 loss on the consolidated statement of earnings/(loss) and comprehensive earnings/(loss) for the three and six month periods of 2015 was $5.40 million (2014 - $1.77 million loss) and $11.34 million (2014 - $4.97 million loss), respectively. The realized gain on the consolidated statement of earnings/(loss) and comprehensive earnings/(loss) for the three and six month periods of 2015 was $4.77 million (2014 - $3.73 million loss) and $13.10 million (2014 - $6.03 million loss), respectively.

As at June 30, 2015, 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	1,000 bbl/d	$63.34 US/bbl	Jul. 1/15 – Dec. 31/15	763
	500 bbl/d	$61.35 US/bbl	Aug. 1/15 – Jun. 30/16	99
Total Fair Market Value, Commodity Price Financial Contracts				**862**

Oil swaps are settled against the NYMEX WTI pricing index.

Subsequent to the end of the period and prior to the consolidated financial statements being authorized for issue on August 13, 2015, the Company converted its 1,000 barrels per day of oil at $63.34 US/bbl WTI from July 1, 2015 to December 31, 2015 to $80.02 Cdn/bbl and its 500 barrels per day of oil at $61.35 US/bbl from August 1, 2015 to June 30, 2016 to $79.30 Cdn/bbl.

Interest Rate Risk Management Contracts:

	Notional Value	Weighted Average Interest Rate(1)	Range of Terms	Fair Market Value Asset/(Liability) ($ thousands)
Interest rate swaps	$20,000,000/month	1.640%	Jul. 1/15 – Jul. 26/16	(181)
	$20,000,000/month	1.731%	Jul. 1/15 – Aug. 26/16	(214)
Total Fair Market Value, Interest Rate Financial Contracts				**(395)**

(1) *Excludes the current stamping fee of 2.25 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

Ronald C. Wigham (2)
Calgary, Alberta

Grant A. Zawalsky (2)
Calgary, Alberta

OFFICERS

Craig H. Hansen
President and Chief Executive Officer

Leslie E. Burden
Vice President, Land

Randolph J. Doetzel
Vice President, Operations

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

Jeffrey N. Post
Chief Financial Officer

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

STOCK EXCHANGE LISTING

Toronto Stock Exchange

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

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

TRANSFER AGENT

Valiant Trust Company
600, 530 – 8th Avenue SW
Calgary, Alberta T2P 3S8

BANKERS

The Toronto Dominion Bank
1100, 421 – 7th Avenue S.W.
Calgary, Alberta T2P 4K9

Canadian Imperial Bank of Commerce
9th Floor, Bankers Hall East
855 – 2nd Street S.W.
Calgary, Alberta T2P 2P2

The Bank of Nova Scotia
2000, 700 – 2nd Street S.W.
Calgary, Alberta T2P 2N7

LEGAL COUNSEL

Burnet, Duckworth & Palmer LLP
2400, 525 – 8th Avenue S.W.
Calgary, Alberta T2P 1G1

CONSULTING ENGINEERS

McDaniel & Associates Consultants Ltd.
2200, 255 – 5th Avenue S.W.
Calgary, Alberta T2P 3G6

AUDITORS

Ernst & Young LLP
1000, 440 – 2nd Avenue S.W.
Calgary, Alberta T2P 5E9

HEAD OFFICE

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