2016 Q3 FINANCIAL REPORT

FINANCIAL AND OPERATING HIGHLIGHTS

(unaudited)	Three Months Ended September 30, 2016	2015	Percent Change	Nine Months Ended September 30, 2016	2015	Percent Change
Financial						
Income and Investments ($ millions)						
Gross petroleum and natural gas sales	**12.33**	16.23	(24)	**35.47**	52.96	(33)
Funds flow from/(used in) operating activities	**(0.61)**	3.29	(119)	**2.64**	20.52	(87)
Cash flows from operating activities	**3.19**	7.65	(58)	**6.44**	21.30	(70)
Cash dividends	**–**	0.91	(100)	**–**	6.36	(100)
Net earnings/(loss)	**13.81**	(41.16)	134	**(0.28)**	(49.81)	99
Net capital expenditures/(dispositions)	**(90.29)**	7.38	(1,323)	**(86.56)**	18.13	(577)
Per Share, Basic						
Funds flow from/(used in) operating activities ($/share)	**(0.02)**	0.11	(118)	**0.09**	0.68	(87)
Cash flows from operating activities ($/share)	**0.10**	0.25	(60)	**0.21**	0.70	(70)
Net earnings/(loss) ($/share)	**0.45**	(1.36)	133	**(0.01)**	(1.65)	99
Cash Dividends ($/common share)	**–**	0.03	(100)	**–**	0.21	(100)
Balance Sheet at Period End ($ millions)						
Property and equipment				**151.98**	277.76	(45)
Exploration and evaluation assets				**3.12**	6.33	(51)
Net debt				**32.99**	116.96	(72)
Convertible debentures at maturity				**57.50**	57.50	–
Shareholders' equity				**51.86**	108.39	(52)
Total Common Shares Outstanding at Period End (millions)				**30.56**	30.30	1
Operating						
Average Daily Production						
Oil and liquids (bbl/d)	**2,915**	3,633	(20)	**3,275**	3,760	(13)
Natural gas (mmcf/d)	**3.39**	5.28	(36)	**3.67**	5.28	(30)
Equivalent (boe/d)	**3,480**	4,513	(23)	**3,887**	4,640	(16)
Average Selling Price (before the impact of financial risk management contracts)						
Oil and liquids ($/bbl)	**43.41**	44.67	(3)	**37.67**	47.76	(21)
Natural gas ($/mcf)	**2.20**	2.66	(17)	**1.66**	2.73	(39)
Wells Drilled, Net	**–**	3.0	(100)	**–**	3.0	(100)
Undeveloped Land at Period End (thousand net acres)				**48**	78	(38)

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.

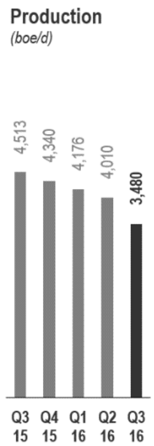
Net debt is a non-GAAP measure that represents bank debt plus the convertible debenture of $57.50 million and any working capital excluding unrealized derivative assets/liabilities.

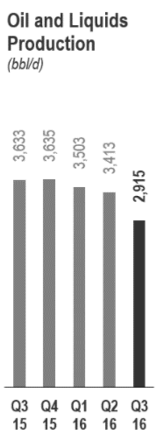
Cash dividends were suspended after the October 2015 dividend paid on November 16, 2015.

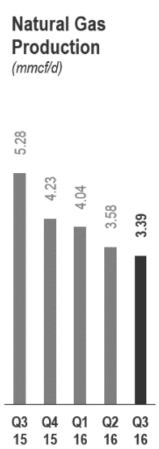
Message to Shareholders (1)

Zargon Oil & Gas Ltd. has released its financial and operating results for the third quarter of 2016. Specific financial and operating highlights in the third quarter of 2016 include:

- Pursuant to Zargon's strategic alternatives process, Zargon closed the sale of all its Southeast Saskatchewan and its Killam, Alberta properties in the third quarter. Total cash proceeds from the dispositions (after adjustments) was $92.04 million.
- Funds flow from operating activities of a negative $0.61 million compare to the positive $3.53 million recorded in the prior quarter, and the positive $3.29 million reported in the third quarter of 2015. The reduction in funds flow is primarily due to one-time employee severance costs of $1.72 million and transaction costs of $0.92 million relating to the sale of Zargon's Southeast Saskatchewan and Killam, Alberta properties.
- As a result of previously announced third quarter property sales, third quarter 2016 oil and liquids production averaged 2,915 barrels per day, a 15 percent decrease from the preceding quarter rate of 3,413 barrels of oil and liquids per day. Third quarter 2016 natural gas production averaged 3.39 million cubic feet per day, a five percent decrease from the preceding quarter. Total production averaged 3,480 barrels of oil equivalent per day, a 13 percent decrease from the preceding quarter. During the quarter, oil and liquids production represented 84 percent of total production based on a 6:1 equivalent basis.
- Third quarter 2016 operating and transportation costs totaled $5.87 million ($18.33 per barrel of oil equivalent), down 36 percent from the 2015 third quarter cost of $9.11 million ($21.95 per barrel of oil equivalent) and down nine percent from the 2016 second quarter cost of $6.43 million ($17.63 per barrel of oil equivalent).
- Third quarter 2016 general and administrative ("G&A") costs totaled $3.22 million up 81 percent from the 2015 third quarter cost of $1.78 million ($4.28 per barrel of oil equivalent) and up 133 percent from the 2016 second quarter cost of $1.38 million ($3.77 per barrel of oil equivalent). Excluding one-time employee severance costs third quarter G&A costs were $1.50 million ($4.67 per barrel of oil equivalent).
- Third quarter 2016 capital expenditures (excluding property dispositions) were $1.90 million and included $1.36 million of expenditures related to the Little Bow ASP project ($0.08 million exploitation and $1.28 million chemical costs). No wells were drilled in the quarter.
- At the end of the third quarter, Zargon had $32.99 million in net debt, net of working capital. This total includes $24.51 million in net cash balances offset by $57.50 million of convertible debentures. The convertible debentures (TSX: ZAR.DB) bear interest at a rate of six percent per annum, and mature on June 30, 2017, at which time Zargon may redeem the debentures with cash or through the issuance of Zargon common shares priced at 95 percent of the then current Zargon share price.







Remaining Zargon Assets [(1)]

With the completion of the Q3 2016 property sales, Zargon's remaining assets are highlighted by the Alberta Little Bow Alkaline Surfactant Polymer ("ASP") tertiary recovery project, the Alberta Taber and Bellshill Lake low decline oil properties and the remaining Williston Basin North Dakota properties, which are characterized by the following attributes:

- Proven developed producing reserves: 6.87 million barrels of oil equivalent – 89 percent oil and liquids (McDaniel & Associates Consultants Ltd. – Dec. 31, 2015).
- Proven plus probable reserves: 15.09 million barrels of oil equivalent – 88 percent oil and liquids (McDaniel & Associates Consultants Ltd. – Dec. 31, 2015).
- Undeveloped oil exploitation locations – 12 net locations (McDaniel & Associates Consultants Ltd. – Dec. 31, 2015).
- Little Bow ASP tertiary recovery project – In the third quarter, Zargon modified the ASP project's depletion strategy by shutting in higher water cut producers in under treated areas in order to reduce the polymer costs required to treat the re-injected water volumes. More importantly, by placing under treated areas of the ASP project on idle, Zargon can indefinitely defer the restart date for recommencing the Alkaline Surfactant injections in the Phase 1 area until Zargon's improved financial conditions can support the additional chemical capital expenditures. With these adjustments, the project's annual polymer chemical costs are reduced by approximately 25 percent from $3.60 million to $2.70 million per year. At higher oil prices, the existing ASP infrastructure can be utilized for multiple ASP phases and/or Polymer only projects that will target incremental oil recovery of approximately 10 percent on over 80 million barrels of working interest oil-in-place.

Q4 2016 Guidance [(1)]

Fourth quarter 2016 production and cost guidance for Zargon's remaining assets are provided below:

- Oil and liquids production – 2,050 barrels per day, including 460 barrels of oil per day from the Little Bow ASP project and 380 barrels per day from the Williston Basin North Dakota properties.
- Total production – 2,500 barrels of oil equivalent per day.
- Base oil declines – Little Bow ASP: 10 percent, Other Alberta: 13 percent, North Dakota: 10 percent.
- Average royalties – Alberta including ASP: 8 percent, North Dakota: 24 percent.
- Operating Costs – $19.20 million (annualized).
- G&A Budget – $4.80 million (annualized).
- 2016 Q4 Capital Budget – ASP Polymer Injections: $0.70 million, Other Oil Exploitation Projects: $0.60 million, Abandonment and Site Reclamations: $0.30 million.

We intend to set our 2017 capital budget in early January 2017 in the context of the business environment at that time. Our inventory of opportunities include reactivations, recompletions and facility upgrades that are projected to provide low cost production additions.

Additional information regarding Zargon's low decline, oil exploitation properties are available on our website at www.zargon.ca.

Strategic Alternatives Process Update [(1)]

Last year, Zargon announced the formation of a Special Board Committee to examine alternatives that would maximize shareholder value in a manner that would recognize the Company's fundamental inherent value related to Zargon's long-life, low-decline conventional oil assets and the significant long term oil potential related to the Little Bow ASP project.

The realization of $92.04 million of cash proceeds from the Q3 2016 property sales was a partial outcome of this process. With the elimination of the Company's bank debt, the strategic alternatives process is continuing, but has been refocused to include, among other alternatives, a restructuring of the Company's current capital structure, the addition of capital to further develop the potential of the assets, the sale of the

Company or a portion of the Company's assets, a merger, a farm-in or joint venture, or other such options as may be determined by the Company's Board of Directors to be in the best interests of the Company and its stakeholders. Zargon's Special Board Committee has engaged Macquarie Capital Markets Canada Ltd. ("Macquarie") as its exclusive financial advisor related to this component of its strategic alternatives process. The Company has not set a definitive schedule to complete its evaluation and no decision on any particular alternative has been reached at this time. Zargon does not intend to disclose developments with respect to this process unless and until the Board of Directors has approved a definitive transaction or other course of action or otherwise deems disclosure of developments is appropriate or otherwise required by law. There are no guarantees that the process will result in a transaction of any form or, if a transaction is entered into, as to its terms or timing.

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

Management’s discussion and analysis (“MD&A”) is a review of Zargon Oil & Gas Ltd.’s 2016 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, 2016 and the audited consolidated financial statements and related notes for the year ended December 31, 2015. 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 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 tax 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 14, 2016, and contains forward-looking statements including:

- *our expectations for our fourth quarter 2016 production and cost guidance referred to under the heading "Q4 2016 Guidance";*
- *our expectations for the release of our 2017 capital expenditures budget referred to under the heading "Q4 2016 Guidance";*
- *our strategic alternatives process referred to under the heading "Strategic Alternatives Process Update";*
- *our borrowing base referred to under the heading "Liquidity and Capital Resources";*
- *our dividend policy referred to under the heading "Liquidity and Capital Resources";*
- *our expected sources of funds for capital expenditures referred to under the heading "Liquidity and Capital Resources"; and*
- *our expectations for the Alberta Energy Regulator issued Bulletin 2016-16 referred to under the heading "Regulatory Changes".*

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.

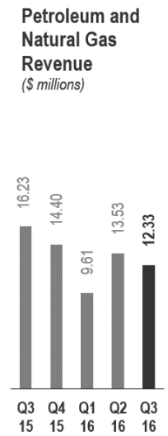
You are cautioned that the assumptions, including among other things, future oil and natural gas prices; future capital expenditure levels (including ASP); future production levels; future exchange rates; the cost of developing and expanding our assets; our ability to obtain equipment in a timely manner 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 14, 2016.

FINANCIAL & OPERATING RESULTS

Petroleum and Natural Gas Sales

	Three Months Ended September 30,			Nine Months Ended September 30,		
($ millions)	**2016**	2015	Percent Change	**2016**	2015	Percent Change
Petroleum sales	**11.64**	14.94	(22)	**33.80**	49.02	(31)
Natural gas sales	**0.69**	1.29	(47)	**1.67**	3.94	(58)
Petroleum and natural gas sales	**12.33**	16.23	(24)	**35.47**	52.96	(33)



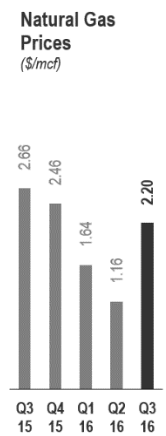
Third quarter 2016 gross petroleum and natural gas sales of $12.33 million were 24 percent below the $16.23 million in the third quarter of 2015 due to lower oil and natural gas prices and reduced production volumes, primarily relating to property sales.

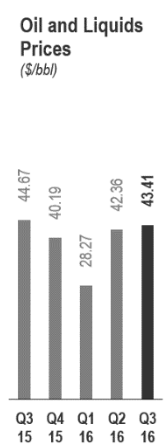
Third quarter 2016 realized oil and liquids field prices averaged $43.41 per barrel before the impact of financial risk management contracts and were three percent lower than the $44.67 per barrel recorded in the 2015 third quarter. Zargon's crude oil field price differential from the Edmonton par price decreased to $11.28 per barrel in the third quarter of 2016 compared to $11.59 per barrel in the third quarter of 2015. Natural gas field prices received averaged $2.20 per thousand cubic feet in the third quarter of 2016, a 18 percent decrease from the 2015 third quarter prices.

Pricing

	Three Months Ended September 30,			Nine Months Ended September 30,		
Average for the period	**2016**	2015	Percent Change	**2016**	2015	Percent Change
Natural Gas:						
NYMEX average daily spot price ($US/mmbtu)	**2.85**	2.75	4	**2.31**	2.78	(17)
AECO average daily spot price ($Cdn/mmbtu)	**2.32**	2.90	(20)	**1.85**	2.77	(33)
Zargon realized field price before the impact of financial risk management contracts ($Cdn/mcf)	**2.20**	2.66	(17)	**1.66**	2.73	(39)
Zargon realized field price before the impact of physical and financial risk management contracts ($Cdn/mcf)	**2.20**	2.67	(18)	**1.66**	2.58	(36)
Zargon realized natural gas field price differential before the impact of physical and financial risk management contracts ($Cdn/mcf)	**0.12**	0.23		**0.19**	0.19	
Crude Oil:						
WTI ($US/bbl)	**44.94**	46.43	(3)	**41.33**	51.00	(19)
Edmonton par price ($Cdn/bbl)	**54.69**	56.26	(3)	**50.45**	59.16	(15)
Zargon realized field price before the impact of financial risk management contracts ($Cdn/bbl)	**43.41**	44.67	(3)	**37.67**	47.76	(21)
Zargon realized field price after the impact of financial risk management contracts ($Cdn/bbl)	**43.41**	51.90	(16)	**40.40**	62.64	(36)
Zargon realized oil field price differential [1]	**11.28**	11.59		**12.78**	11.40	

(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 2016 third quarter were 2,915 barrels per day, a 20 percent decrease from the 2015 third quarter rate of 3,633 barrels per day and a 15 percent decrease from the preceding quarter's rate of 3,413 barrels per day. The oil and liquids production decrease is primarily due to the Southeast Saskatchewan and Killam, Alberta property sales that were completed in the third quarter. Natural gas production volumes in the 2016 third quarter of 3.39 million cubic feet per day compared to 5.28 million cubic feet per day in the 2015 third quarter and 3.58 million cubic feet per day in the preceding quarter. The natural gas production decrease is partially due to property sales, naturally occurring production declines and the shut-in of uneconomic wells.

Production by Core Area

Three Months Ended September 30,		**2016**			2015	
	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	**603**	**1.21**	**805**	759	2.32	1,146
Alberta Plains South	**1,184**	**1.95**	**1,509**	1,154	2.50	1,571
Williston Basin	**1,128**	**0.23**	**1,166**	1,720	0.46	1,796
	2,915	**3.39**	**3,480**	3,633	5.28	4,513

Nine Months Ended September 30,		**2016**			2015	
	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	**655**	**1.44**	**895**	806	2.45	1,214
Alberta Plains South	**1,205**	**1.93**	**1,527**	1,184	2.40	1,584
Williston Basin	**1,415**	**0.30**	**1,465**	1,770	0.43	1,842
	3,275	**3.67**	**3,887**	3,760	5.28	4,640

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.

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 2016 third quarter, interest rate swaps resulted in a net realized loss on derivatives of $0.04 million compared to a $2.33 million net realized gain from higher contract prices versus WTI oil prices and interest rate swaps in the third quarter of 2015.

The unrealized gain on derivatives of $0.04 million in the third quarter of 2016 was comprised of oil contract gains of nil and an interest rate swap gain of $0.04 million, compared to a net $3.26 million gain in the third quarter of 2015. 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 12 and 13 to the unaudited interim consolidated financial statements.

Royalties

($ millions)	Three Months Ended September 30, 2016	2015	Percent Change	Nine Months Ended September 30, 2016	2015	Percent Change
Royalties	**1.47**	2.45	(40)	**4.17**	7.59	(45)
Percentage of revenue	**11.9%**	15.1%		**11.7%**	14.3%	

Royalties are inclusive of the Saskatchewan Resource Surcharge ("SRC"). The variations in royalty rates generally track changes in production volumes and pricing. Third quarter of 2016 royalties were 11.9 percent of gross sales compared to 15.1 percent in the third quarter of 2015.

Operating Expenses and Transportation Expenses

($ millions)	Three Months Ended September 30, 2016	2015	Percent Change	Nine Months Ended September 30, 2016	2015	Percent Change
Operating expenses	**5.70**	8.78	(35)	**18.93**	26.41	(28)
Transportation expenses	**0.17**	0.33	(48)	**0.49**	0.89	(45)
Total expenses	**5.87**	9.11	(36)	**19.42**	27.30	(29)
Total expenses ($/boe)	**18.33**	21.95	(16)	**18.24**	21.55	(15)

Compared to the prior year's third quarter, operating expenses and transportation expenses in the 2016 third quarter were down on a total dollar basis and on a per barrel of oil equivalent basis due to general cost containment initiatives, lower electricity costs and the closure of the Stettler field office. Similar to the prior quarters, additional cost reductions came from the shut-in of higher cost properties.

Operating Netbacks

Three Months Ended September 30,	**2016**		2015	
	Oil and Liquids ($/bbl)	**Natural Gas ($/mcf)**	Oil and Liquids ($/bbl)	Natural Gas ($/mcf)
Sales	**43.41**	**2.20**	44.67	2.66
Royalties	**(4.75)**	**(0.64)**	(6.88)	(0.32)
Realized gain on derivatives	**–**	**–**	7.23	–
Operating expenses	**(17.97)**	**(2.81)**	(22.64)	(2.50)
Transportation expenses	**(0.64)**	**–**	(0.99)	–
Operating netbacks	**20.05**	**(1.25)**	21.39	(0.16)

Nine Months Ended September 30,	**2016**		2015	
	Oil and Liquids ($/bbl)	**Natural Gas ($/mcf)**	Oil and Liquids ($/bbl)	Natural Gas ($/mcf)
Sales	**37.67**	**1.66**	47.76	2.73
Royalties	**(4.51)**	**(0.12)**	(6.89)	(0.36)
Realized gain on derivatives	**2.73**	**–**	14.88	0.26
Operating expenses	**(18.19)**	**(2.60)**	(22.16)	(2.54)
Transportation expenses	**(0.54)**	**–**	(0.87)	–
Operating netbacks	**17.16**	**(1.06)**	32.72	0.09

General & Administrative ("G&A") Expenses

	Three Months Ended September 30,			**Nine Months Ended September 30,**		
($ millions)	**2016**	2015	Percent Change	**2016**	2015	Percent Change
G&A expenses	**3.22**	1.78	81	**6.29**	6.44	(2)
G&A expenses ($/boe)	**10.04**	4.28	135	**5.91**	5.08	16

G&A expenses per barrel of oil equivalent were higher in the third quarter of 2016 primarily due to one-time employee related costs of $1.72 million, or $5.37 per barrel of oil equivalent, offset by reductions in salaries and wages from staff reductions that occurred in 2015 and 2016.

Transaction Costs

Transaction costs for the 2016 third quarter were $0.92 million compared to $0.16 million in the third quarter of 2015 and relate to Zargon's strategic alternatives review.

Interest and Financing Charges on Bank Debt

On September 1, 2016, Zargon amended its syndicated committed credit facilities, the result of which was the reduction of the facilities and borrowing base to $30 million which consisted solely of bankers' acceptances. Zargon was required to secure a total of $30 million in outstanding bankers' acceptances through depositing an equivalent amount in cash with its lender. The $30 million of bankers' acceptances were repaid subsequent to quarter end on October 25, 2016. Interest and financing charges in the 2016 third quarter were $0.45 million, a 31 percent decrease from $0.65 million in the third quarter of 2015. The decrease in interest and financing charges resulted from lower borrowing levels compared to the third quarter of 2015.

Interest on Convertible Debentures

Zargon has borrowings through its convertible debentures, which were issued in May 2012 and mature on June 30, 2017. Zargon may redeem the convertible debentures with cash or through the issuance of Zargon common shares priced at 95 percent of the then current Zargon share price. 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 2015 were unchanged compared to the third quarter of 2015.

Current Tax

The current tax expense for the 2016 third quarter was nil. When compared to the 2015 third quarter, the current tax expense increased by $0.11 million. Total corporate tax pools as at September 30, 2016 are approximately $187 million, which represents a decrease of 33 percent from the comparable $279 million of tax pools available to Zargon at December 31, 2015 due to property sales in the third quarter.

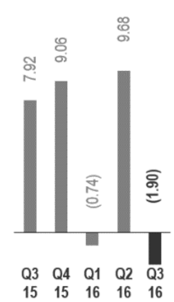
Estimated Tax Pools

($ millions)	September 30, 2016
Canadian development expenses	**9**
Canadian exploration expenses	**6**
Capital cost allowance	**40**
Non-capital losses	**129**
US tax pools	**1**
Other	**2**
Estimated tax pools	**187**

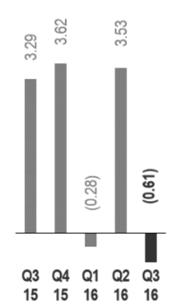
Corporate Netbacks

	Three Months Ended September 30,		Nine Months Ended September 30,	
($/boe)	**2016**	2015	**2016**	2015
Petroleum and natural gas sales	**38.50**	39.08	**33.31**	41.81
Royalties	**(4.60)**	(5.91)	**(3.91)**	(5.99)
Realized gain/(loss) on derivatives	**(0.13)**	5.60	**2.12**	12.16
Operating expenses	**(17.79)**	(21.15)	**(17.78)**	(20.85)
Transportation expenses	**(0.54)**	(0.80)	**(0.46)**	(0.70)
Operating netbacks	**15.44**	16.82	**13.28**	26.43
General and administrative expenses	**(10.04)**	(4.28)	**(5.91)**	(5.08)
Transaction costs	**(2.88)**	(0.37)	**(0.92)**	(0.15)
Interest and financing charges	**(1.40)**	(1.56)	**(1.67)**	(1.45)
Interest on convertible debentures	**(2.70)**	(2.08)	**(2.43)**	(2.04)
Asset retirement expenditures	**(0.32)**	(0.88)	**(0.02)**	(1.67)
Current tax recovery	**–**	0.27	**0.15**	0.16
Funds flow netbacks	**(1.90)**	7.92	**2.48**	16.20

Funds Flow Netbacks
($/boe)



Funds Flow from Operating Activities
($ millions)



Depletion and Depreciation Expense

Depletion and depreciation expense for the third quarter of 2016 decreased 52 percent to $4.04 million compared to $8.46 million in the third quarter of 2015 and reflects the current quarter's property dispositions. On a per barrel of oil equivalent basis, the depletion and depreciation rates were $12.63 and $20.37 for the third quarter of 2016 and 2015, respectively. When compared to the third quarter of 2016, depletion and depreciation decreased 38 percent due to the current quarter property dispositions. The 2015 calendar year depletion and depreciation rate was $19.94 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 2016 was $0.38 million, a 30 percent decrease from the third quarter of 2015 and resulted from the reduction of future asset retirement obligations through the recent property sales. Reflecting the current quarter's property dispositions, the third quarter of 2016 accretion expense rate declined to $1.17 per barrel of oil equivalent from $1.30 per barrel of oil equivalent in the third quarter of 2015. 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 2016 third quarter was $0.40 million compared to $0.36 million in the 2015 third quarter.

Shared-based Compensation

Expensing of share-based compensation in the third quarter of 2016 resulted in a recovery of $0.22 million, which compares with the $0.38 million charge incurred in the third quarter of 2015. The 2016 third quarter recovery related to forfeitures of share awards pertaining to employee changes.

Unrealized Foreign Exchange

The Company had an unrealized foreign exchange loss of $0.02 million during the third quarter of 2016 compared to a $0.82 million gain in the 2015 third quarter. Gains and losses result from transactions in US dollars when they are translated into Canadian dollars. The volatility in the US/Cdn dollar creates non-cash translation gains/losses.

Gain/Loss on Disposal of Assets

During the third quarter of 2016, Zargon had a $35.29 million gain on disposal of assets compared to nil on disposal of assets in 2015.

Exploration and Evaluation Expenses

Non-cash exploration and evaluation expenses for the 2016 third quarter of $0.37 million compared to third quarter of 2015 expenses of $0.24 million. Exploration and evaluation expenses are primarily related to undeveloped land expiries. The 2016 third quarter exploration and evaluation expense related to expiries in southern Alberta and North Dakota.

Deferred Tax

The deferred tax expense for the third quarter of 2016 was $16.02 million compared to a recovery of $18.65 million in the third quarter of 2015. The increase in deferred tax expense is primarily a result of derecognizing the deferred tax asset as a result of the sale of our Southeast Saskatchewan properties in the 2016 third quarter.

Funds Flow from Operating Activities

Funds flow from operating activities in the 2016 third quarter was a negative $0.61 million and was $3.90 million, or 119 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 decreased revenue from lower oil and gas prices, a decreased gain on realized derivatives, increased transaction costs and increased G&A expenses (related to employee severance costs) which was partially offset by decreased royalties, operating expenses and interest expenses.

Net Earnings/(Loss)

Net earnings of $13.81 million for the 2016 third quarter were $54.97 million higher than the $41.16 million net loss in the 2015 third quarter, largely due to a gain on disposal of assets, decreased operating expenses and depletion and depreciation expenses. 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 2016 net earnings were $0.44, compared to a $1.36 net loss for the 2015 third quarter.

Capital Expenditures

	Three Months Ended September 30,		Nine Months Ended September 30,	
($ millions)	**2016**	2015	**2016**	2015
Undeveloped land	**0.49**	0.53	**1.40**	1.40
Geological and geophysical (seismic)	**0.02**	0.03	**0.19**	0.34
Drilling and completion of wells	**0.07**	0.87	**(0.05)**	2.05
Well equipment and facilities	**(0.04)**	0.42	**(0.16)**	1.11
ASP project and exploitation costs	**0.08**	2.75	**0.42**	4.80
ASP chemical costs	**1.28**	2.25	**3.84**	7.98
Exploration and development	**1.90**	6.85	**5.64**	17.68
Property acquisitions	**(0.01)**	0.52	**0.07**	0.55
Property dispositions	**(92.04)**	0.01	**(92.13)**	(0.07)
Net property acquisitions/(dispositions)	**(92.05)**	0.53	**(92.06)**	0.48
Total net capital expenditures excluding administrative assets	**(90.15)**	7.38	**(86.42)**	18.16
Administrative assets	**(0.14)**	–	**(0.14)**	(0.03)
Total net capital expenditures/(dispositions)	**(90.29)**	7.38	**(86.56)**	18.13

LIQUIDITY AND CAPITAL RESOURCES

Total net capital dispositions totalled $90.15 million in the third quarter of 2016 and were significantly higher than the same period in 2015. Field expenditures of $1.90 million for the third quarter of 2016 were 72 percent lower than the 2015 third quarter. The third quarter 2016 field capital expenditures (excluding net property dispositions) were allocated to Alberta Plains North - $0.15 million, Alberta Plains South - $1.66 million and Williston Basin - $0.09 million and included the drilling of nil wells, compared to the 3.0 net wells drilled in the third quarter of 2015.

Included in the Alberta Plains South capital expenditures is the $1.36 million incurred on the Little Bow ASP project. Of the total ASP amount, $0.08 million was spent on project and exploitation costs while $1.28 million was spent on chemical costs for the facility.

At September 30, 2016, the Company's combined debt net of working capital (excluding unrealized derivative assets/liabilities) was $32.99 million, which compares to $121.06 million of net debt at the end of December 31, 2015. The decrease in net debt was due to the sale proceeds from the closing of the sale of Zargon's Southeast Saskatchewan and Killam, Alberta assets in the quarter. The $32.99 million debt net of working capital consists of the $57.50 million of convertible unsecured subordinate debentures, which is partially offset by net cash balances.

Zargon's restricted cash represents cash that will be applied against the Company's outstanding bankers' acceptances due on October 25, 2016. Additional restricted cash includes amounts as collateral for the Company's letters of credit.

The Company's borrowing base is determined and re-determined by our lenders based on our reserves, commodity prices, applicable discount rate and other factors as determined by our lenders. A material decline in commodity prices could reduce our borrowing base, thereby reducing the funds available to us under our credit facilities which could result in a portion, or all, of our bank indebtedness being required to be repaid. The Company's borrowing base was set at $30.00 million on September 1, 2016, which consisted solely of bankers' acceptances. The $30.00 million of bankers' acceptances were repaid subsequent to quarter end on October 25, 2016.

The Company has borrowings through its convertible debentures, which mature on June 30, 2017 and have been classified as a short term liability. Zargon may redeem the convertible debentures with cash or through the issuance of Zargon common shares priced at 95 percent of the then current Zargon share price. Interest is payable semi-annually at a rate of six percent, calculated on the gross proceeds of $57.50 million.

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.

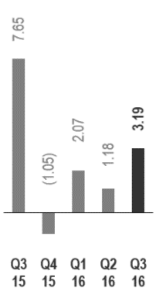
Zargon's operational results and financial condition, and, therefore, the funds available to be allocated to capital expenditures, are dependent on the prices received for oil and natural gas production. Third quarter 2016 Zargon field oil prices were five percent lower than the year average 2015 field oil price.

Cash Dividends Analysis

	Three Months Ended September 30,		**Nine Months Ended September 30,**	
($ millions)	**2016**	2015	**2016**	2014
Cash flows from operating activities	**3.19**	7.65	**6.44**	21.30
Net earnings/(loss)	**13.81**	(41.16)	**(0.28)**	(49.81)
Actual cash dividends paid or payable relating to the period	**–**	(0.91)	**–**	(6.36)
Excess of cash flows from operating activities over cash dividends paid	**3.19**	6.74	**6.44**	14.94
Excess (shortfall) of net earnings/(loss) over cash dividends paid	**13.81**	(42.07)	**(0.28)**	(56.17)

(1) Cash dividends were suspended after the October 2015 dividend paid on November 16, 2015.

Cash Flows from Operating Activities
($ millions)



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 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 November 11, 2015 suspended Zargon's monthly dividend after the November 16, 2015 payment.

For the quarter ended September 30, 2016, net capital expenditures totalled a negative $90.29 million, which was $93.48 million lower than the cash flows from operating activities (after changes in non-cash working capital) of $3.19 million. For the quarter ended September 30, 2015, cash dividends and net capital expenditures totalled $8.29 million, which was $0.64 million lower than the cash flows from operating activities (after changes in non-cash working capital) of $7.65 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 capital expenditures with its cash flows from operating activities; however, it may 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 14, 2016, Zargon Oil & Gas Ltd. had 30.558 million common shares outstanding. Pursuant to the share award plan, there are currently an additional 0.606 million common share awards issued and outstanding.

Capital Sources and Uses

	Three Months Ended September 30,		Nine Months Ended September 30,	
($ millions)	**2016**	2015	**2016**	2015
Funds flow from operating activities	**(0.61)**	3.29	**2.64**	20.52
Change in long term bank debt	**(35.08)**	1.18	**(30.24)**	9.21
Cash dividends to shareholders	**–**	(0.91)	**–**	(6.36)
Changes in working capital and other	**(54.60)**	3.82	**(58.96)**	(5.24)
Total capital sources	**(90.29)**	7.38	**(86.56)**	18.13

(1) Cash dividends were suspended after the October 2015 dividend paid on November 16, 2015.

REGULATORY CHANGES

On June 20, 2016, the Alberta Energy Regulator ("AER") issued Bulletin 2016-16 which put in place certain interim measures for transfers of AER regulated assets including a requirement that all transferees demonstrate that they have a Liability Management Rating ("LMR") of 2.0 or higher immediately following the transfer. At November 5, 2016, Zargon's LMR was 1.44. Although there is a significant level of uncertainty around the application of Bulletin 2016-16, it could restrict Zargon from buying or selling oil and gas assets, which could negatively impact its business.

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 2016 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 2016.

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 to unexpected levels and as a result, Zargon's revenues and cash flows were significantly reduced.

On August 13, 2015, Zargon announced the initiation of a process to identify and consider strategic and financial alternatives available to the Company with the ultimate goal of maximizing stakeholder value. Further to this process, on September 1, 2016, Zargon closed the sale of its Southeast Saskatchewan assets for $89.5 million.

Looking forward, Zargon's strategic alternatives process is continuing and may include but is not limited to, a merger or other business combination, a restructuring of the Company's current capital structure, the addition of capital to further develop the potential of the assets, the sale of the Company or a portion of the Company's assets or any combination thereof, as well as the continued execution of our business plan.

SUMMARY OF QUARTERLY RESULTS

	2016		
	Q1	Q2	**Q3**
Petroleum and natural gas sales ($ millions)	9.61	13.53	**12.33**
Net earnings/(loss) ($ millions)	(8.82)	(5.27)	**13.81**
Net earnings/(loss) per diluted share ($)	(0.29)	(0.17)	**0.44**
Funds flow from/(used in) operating activities ($ millions)	(0.28)	3.53	**(0.61)**
Funds flow from/(used in) operating activities per diluted share ($)	(0.01)	0.12	**0.01**
Cash flows from operating activities ($ millions)	2.07	1.18	**3.19**
Cash flows from operating activities per diluted share ($)	0.07	0.04	**0.12**
Net capital expenditures/(dispositions) ($ millions)	2.47	1.26	**(90.29)**
Total assets ($ millions)	255.14	253.94	**218.38**
Bank debt ($ millions)	64.59	65.08	**30.00**
Convertible debentures ($ millions) (1)	57.50	57.50	**57.50**
Net debt	124.37	122.26	**32.99**
Average daily oil and liquids production (bbl)	3,503	3,413	**2,915**
Average daily natural gas production (mmcf)	4.04	3.58	**3.39**
Average daily production (boe)	4,176	4,010	**3,480**
Average oil production weighting (%)	84	85	**84**
Average realized commodity field price before the impact of financial risk management contracts ($/boe)	25.30	37.09	**38.50**
Funds flow netback ($/boe)	(0.74)	9.68	**(1.90)**

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

	2015			
	Q1	Q2	Q3	Q4
Petroleum and natural gas sales ($ millions)	16.41	20.32	16.23	14.40
Net loss ($ millions)	(4.88)	(3.76)	(41.16)	(56.34)
Net loss per diluted share ($)	(0.16)	(0.12)	(1.36)	(1.86)
Funds flow from operating activities ($ millions)	7.24	9.99	3.29	3.62
Funds flow from operating activities per diluted share ($)	0.24	0.33	0.11	0.12
Cash flows from operating activities ($ millions)	6.67	6.98	7.65	(1.05)
Cash flows from operating activities per diluted share ($)	0.22	0.23	0.25	(0.03)
Cash dividends ($ millions) (1)	2.72	2.73	0.91	0.30
Cash dividends declared per common share ($) (1)	0.09	0.09	0.03	0.01
Net capital expenditures ($ millions)	5.40	5.35	7.38	7.75
Total assets ($ millions)	377.16	369.47	325.64	263.66
Bank debt ($ millions)	49.91	50.80	51.98	60.24
Convertible debentures ($ millions) (2)	57.50	57.50	57.50	57.50
Net debt	113.80	111.99	116.96	121.06
Average daily oil and liquids production (bbl)	3,928	3,720	3,633	3,635
Average daily natural gas production (mmcf)	5.24	5.32	5.28	4.23
Average daily production (boe)	4,802	4,607	4,513	4,340
Average oil production weighting (%)	82	81	81	84
Average realized commodity field price before the impact of financial risk management contracts ($/boe)	37.98	48.46	39.08	36.05
Funds flow netback ($/boe)	16.75	23.84	7.92	9.06

(1) Cash dividends were suspended after the October 2015 dividend paid on November 16, 2015.

(2) 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
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.

Additional information regarding the Company and its business operations, including the Company's Annual Information Form for December 31, 2015, is available on the Company's SEDAR profile at www.sedar.com.

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

Calgary, Alberta
November 14, 2016

CONSOLIDATED BALANCE SHEETS

(unaudited)

($ thousands)	Notes	**September 30, 2016**	December 31, 2015
ASSETS			
Cash and cash equivalents		**27,650**	–
Restricted cash	4,8	**30,928**	–
Trade and other receivables		**3,348**	6,846
Deposits and prepaid expenses		**833**	1,177
Investment in marketable securities	12	**186**	662
Derivatives	12,13	**–**	2,344
Total current assets		**62,945**	11,029
Long term deposits		**328**	167
Property, plant and equipment, net	5	**151,984**	230,543
Intangible exploration and evaluation assets	6	**3,122**	5,713
Deferred tax assets		**–**	16,212
Total assets		**218,379**	263,664
LIABILITIES			
Trade and other payables		**8,438**	12,005
Bank debt	4,8	**30,000**	–
Convertible debentures	9	**56,272**	–
Derivatives	12,13	**–**	224
Total current liabilities		**94,710**	12,229
Bank debt	8	**–**	60,238
Convertible debentures	9	**–**	55,129
Asset retirement obligations	7	**67,275**	78,196
Deferred tax liabilities		**4,539**	5,291
Total liabilities		**166,524**	211,083
Commitments and contingencies	4,6,7,8,9,11,12,13		
EQUITY			
Shareholders’ capital	10	**260,619**	259,149
Accumulated other comprehensive income		**4,716**	5,249
Contributed surplus	11	**10,814**	12,198
Equity component of debentures		**3,640**	3,640
Deficit		**(227,934)**	(227,655)
Total equity		**51,855**	52,581
Total equity and liabilities		**218,379**	263,664

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	**2016**	2015	**2016**	2015
Petroleum and natural gas sales		**12,327**	16,227	**35,474**	52,957
Royalties		**(1,473)**	(2,454)	**(4,166)**	(7,592)
PETROLEUM AND NATURAL GAS REVENUE, NET OF ROYALTIES		**10,854**	13,773	**31,308**	45,365
Gain/(loss) on unrealized derivatives	12,13	**40**	3,261	**(2,121)**	(8,078)
Gain/(loss) on realized derivatives	12,13	**(41)**	2,326	**2,253**	15,425
GAIN/(LOSS) ON DERIVATIVES		**(1)**	5,587	**132**	7,347
TOTAL INCOME		**10,853**	19,360	**31,440**	52,712
Operating		**5,695**	8,782	**18,935**	26,408
Transportation		**173**	332	**487**	892
General and administrative		**3,215**	1,778	**6,294**	6,435
Transaction costs		**923**	155	**976**	188
Exploration and evaluation	6	**372**	235	**591**	575
(Gain)/loss on disposal of properties	5	**(35,288)**	–	**(35,430)**	2
Share-based compensation	11	**(217)**	384	**86**	837
Unrealized foreign exchange (gain)/loss		**17**	(819)	**652**	(1,206)
Impairment loss on property, plant and equipment		**–**	56,692	**–**	56,692
Loss on sale of marketable securities		**–**	–	**215**	–
Impairment loss on marketable securities		**–**	880	**–**	880
Depletion and depreciation	5	**4,043**	8,460	**16,481**	25,706
EXPENSES/(RECOVERY)		**(21,067)**	76,879	**9,287**	117,409
EARNINGS/(LOSS) BEFORE FINANCE EXPENSES AND INCOME TAXES		**31,920**	(57,519)	**22,153**	(64,697)
Interest and financing charges	8	**448**	647	**1,778**	1,840
Interest on convertible debentures	9	**863**	863	**2,588**	2,588
Accretion on convertible debentures	9	**399**	360	**1,143**	1,033
Accretion of asset retirement obligations	7	**376**	541	**1,349**	1,613
FINANCE EXPENSES		**2,086**	2,411	**6,858**	7,074
EARNINGS/(LOSS) BEFORE INCOME TAXES		**29,834**	(59,930)	**15,295**	(71,771)
Current tax expense/(recovery)		**1**	(113)	**(159)**	(205)
Deferred tax expense/(recovery)		**16,020**	(18,654)	**15,733**	(21,761)
INCOME TAXES EXPENSE/(RECOVERY)		**16,021**	(18,767)	**15,574**	(21,966)
NET EARNINGS/(LOSS) FOR THE PERIOD		**13,813**	(41,163)	**(279)**	(49,805)
Currency translation adjustment recognized in other comprehensive income		**75**	888	**(533)**	2,304
OTHER COMPREHENSIVE EARNINGS/(LOSS) FOR THE PERIOD		**75**	888	**(533)**	2,304
TOTAL COMPREHENSIVE EARNINGS/(LOSS) FOR THE PERIOD		**13,888**	(40,275)	**(812)**	(47,501)
NET EARNINGS/(LOSS) PER SHARE					
Basic		**0.45**	(1.36)	**(0.01)**	(1.65)
Diluted		**0.44**	(1.36)	**(0.01)**	(1.65)

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, 2015		**259,149**	**5,249**	**12,198**	**3,640**	**(227,655)**	**52,581**
Net loss for the period		**–**	**–**	**–**	**–**	**(279)**	**(279)**
Share-based compensation	11	**–**	**–**	**86**	**–**	**–**	**86**
Exercise of share awards	10	**1,470**	**–**	**(1,470)**	**–**	**–**	**–**
Translation differences on foreign subsidiary		**–**	**(533)**	**–**	**–**	**–**	**(533)**
Balance at September 30, 2016		**260,619**	**4,716**	**10,814**	**3,640**	**(227,934)**	**51,855**
Balance at December 31, 2014		257,138	2,538	12,879	3,640	(114,855)	161,340
Net loss for the period		–	–	–	–	(49,805)	(49,805)
Dividends declared		–	–	–	–	(6,357)	(6,357)
Share-based compensation	11	–	–	837	–	–	837
Exercise of share awards		1,266	–	(1,266)	–	–	–
Cancellation of shares		(39)	–	111	–	–	72
Translation differences on foreign subsidiary		–	2,304	–	–	–	2,304
Balance at September 30, 2015		258,365	4,842	12,561	3,640	(171,017)	108,391

See accompanying notes to the interim consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)		Three Months Ended September 30,		Nine Months Ended September 30,	
($ thousands)	Notes	**2016**	2015	**2016**	2015
OPERATING ACTIVITIES					
Net earnings/(loss) for the period		**13,813**	(41,163)	**(279)**	(49,805)
Adjustments for non-cash items:					
(Gain)/loss on sale of properties	5	**(35,288)**	–	**(35,430)**	2
(Gain)/loss on unrealized derivatives	12,13	**(40)**	(3,261)	**2,121**	8,078
Depletion and depreciation	5	**4,043**	8,460	**16,481**	25,706
Accretion of asset retirement obligations	7	**376**	541	**1,349**	1,613
Accretion of convertible debentures	9	**399**	360	**1,143**	1,033
Share-based compensation	11	**(217)**	384	**86**	837
Unrealized foreign exchange (gain)/loss		**17**	(819)	**652**	(1,206)
Impairment loss on property, plant and equipment		**–**	56,692	**–**	56,692
Loss on sale of marketable securities		**–**	–	**215**	–
Impairment loss on marketable securities		**–**	880	**–**	880
Deferred tax expense/(recovery)		**16,020**	(18,654)	**15,733**	(21,761)
Exploration and evaluation expenses	6	**372**	235	**591**	575
Asset retirement expenditures		**(104)**	(365)	**(21)**	(2,121)
Funds flow from/(used in) operating activities		**(609)**	3,290	**2,641**	20,523
Changes in operating working capital		**3,794**	4,359	**3,795**	775
Net cash from operating activities		**3,185**	7,649	**6,436**	21,298
INVESTING ACTIVITIES					
Additions to property, plant and equipment	5	**(3,757)**	(7,364)	**(7,515)**	(18,084)
Additions to intangible exploration and evaluation assets	6	**(18)**	(40)	**(113)**	(117)
Proceeds on disposal of property, plant and equipment	5	**92,046**	24	**92,133**	72
Proceeds on disposal of intangible exploration and evaluation assets		**2,019**	–	**2,054**	–
Investment in restricted cash	4,8	**(30,928)**	–	**(30,928)**	–
Change in long term deposits		**(302)**	–	**(161)**	(41)
Changes in investing working capital		**489**	61	**(4,018)**	(4,473)
Net cash used in investing activities		**59,549**	(7,319)	**51,452**	(22,643)
FINANCING ACTIVITIES					
Advances/(repayment) of bank debt		**(35,084)**	1,184	**(30,238)**	9,210
Cash dividends paid to shareholders		**–**	(908)	**–**	(6,357)
Changes in financing working capital		**–**	(606)	**–**	(1,508)
Net cash (used in)/provided by financing activities		**(35,084)**	(330)	**(30,238)**	1,345
NET CHANGE IN CASH DURING THE PERIOD		**27,650**	–	**27,650**	–
CASH, BEGINNING OF PERIOD		**–**	–	**–**	–
CASH, END OF PERIOD		**27,650**	–	**27,650**	–

See accompanying notes to the interim consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the three and nine months ended September 30, 2016, with comparative figures for 2015 (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, 2016 and for its 2015 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, 2016 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, 2015. 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, 2016 should be read in conjunction with the annual consolidated financial statements for the year ended December 31, 2015. These unaudited interim consolidated financial statements were approved and authorized for issue by the Board of Directors on November 14, 2016.

(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.
- IFRS 16 “Leases”, was issued by the IASB in January 2016, which replaces IAS 17 “Leases”. For lessees applying IFRS 16, a single recognition and measurement model for leases would apply, with required recognition of assets and liabilities for most leases. The standard will come into effect for annual periods beginning on or after January 1, 2019, with earlier adoption permitted if the entity is also applying IFRS 15 “Revenue from Contracts with Customers”. The Company has not yet determined the impact on the Company’s consolidated financial statements.

4. RESTRICTED CASH

Restricted cash represents cash that will be applied against the Company’s outstanding bankers’ acceptances due on October 25, 2016 (refer to Note 8 for further details). Additional restricted cash includes amounts as collateral for the Company’s letters of credit.

5. PROPERTY, PLANT AND EQUIPMENT

($ thousands)

Cost, December 31, 2015	**448,006**
Accumulated depletion and depreciation	**(217,463)**
Net carrying amount, December 31, 2015	**230,543**
Additions	**7,515**
Disposals	**(56,609)**
Change in asset retirement obligation	**(11,896)**
Exchange differences	**(1,088)**
Depletion and depreciation	**(16,481)**
Net carrying amount, September 30, 2016	**151,984**
Cost, September 30, 2016	**302,230**
Accumulated depletion and depreciation	**(150,246)**
Net carrying amount, September 30, 2016	**151,984**

During the three and nine months ended September 30, 2016, the Company disposed of certain assets for gross cash proceeds of $92.04 million (2015 - $0.02 million) and $92.13 million (2014 - $0.07 million), respectively. The dispositions for the three and nine months resulted in gains of $35.29 million (2015 - nil) and $35.43 million (2015 - nil), respectively.

6. INTANGIBLE EXPLORATION AND EVALUATION ASSETS

($ thousands)	
Cost, Balance at December 31, 2015	**5,713**
Additions	**113**
Disposals	**(2,054)**
Exploration and evaluation expense	**(591)**
Exchange differences	**(59)**
Balance at September 30, 2016	**3,122**

7. ASSET RETIREMENT OBLIGATIONS

($ thousands)	
Balance at December 31, 2015	**78,196**
Foreign exchange and other	**(353)**
Asset retirement obligations recovered during the period	**(21)**
Asset retirement obligations related to dispositions	**(16,233)**
Revisions to estimated asset retirement obligations	**4,337**
Accretion	**1,349**
Balance at September 30, 2016	**67,275**

The asset retirement obligations were calculated using a discount factor of 2.25 percent (December 31, 2015 – 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. At the end of the second quarter of 2016, the discount factor of 2.50 percent was decreased to 2.25 percent based on the Government of Canada long term bond rate. Accordingly, Zargon recorded an adjustment to property, plant and equipment and asset retirement obligations. An inflation rate of two percent per annum (December 31, 2015 – two percent) used in the calculation of the present value of the asset retirement obligation remains unchanged.

8. BANK DEBT

On September 1, 2016, Zargon amended its syndicated committed credit facilities, the result of which was the reduction of the facilities and borrowing base to $30 million which consisted solely of bankers' acceptances. Zargon was required to secure a total of $30 million in outstanding bankers' acceptances through depositing an equivalent amount of cash with its lender. The $30 million of bankers' acceptances were repaid subsequent to quarter end on October 25, 2016.

At September 30, 2016, the approximate value of outstanding letters of credit totalled $0.88 million (December 31, 2015 - $0.98 million). Zargon was required to secure a total of $0.88 million in outstanding letters of credit through depositing an equivalent amount in cash with its lender. This cash is not accessible until such time that the letters of credit expire or the beneficiaries agree to release their guarantees.

9. CONVERTIBLE DEBENTURES

Zargon has borrowings through its convertible debentures, which were issued in May 2012 and mature on June 30, 2017, and as such, have been classified as a short term liability as at September 30, 2016. Zargon may redeem the convertible debentures with cash or through the issuance of Zargon common shares priced at 95 percent of the then current Zargon share price.

10. 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, 2016 Number of Shares	 Amount ($)
Balance, as at December 31, 2015	**30,366**	**259,149**
Share awards exercised	**192**	–
Share-based compensation recognized on exercise of share awards	–	**1,470**
Balance, as at September 30, 2016	**30,558**	**260,619**

11. 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 16 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, 2016 Number of Share Awards (thousands)
Outstanding, as at December 31, 2015	**908**
Share awards granted	**40**
Share awards exercised	**(192)**
Share awards forfeited	**(150)**
Outstanding, as at September 30, 2016	**606**

Share-based Compensation

The share awards for the three and nine months ended September 30, 2016, resulted in a share-based compensation recovery of $0.21 million (2015 - $0.38 million expense) and $0.09 million expense (2015 - $0.84 million expense), respectively.

Compensation expense associated with share awards granted is recognized in earnings over the vesting period with a corresponding increase in contributed surplus. The exercise of share awards 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)	**2016**	2015	**2016**	2015
Weighted average number of common shares – basic	**30,496**	30,290	**30,469**	30,271
Weighted average number of common shares – diluted	**33,830**	30,290	**30,469**	30,271

Dilution amounts for the three and nine months ended September 30, 2016 of 0.28 million shares (2015 – nil shares) and nil shares (2015 – 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.

Dilution amounts for the three and nine months ended September 30, 2016 of 3.06 million shares (2015 – nil shares) and nil shares (2015 – 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 the convertible debentures.

12. 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, 2016		December 31, 2015	
(thousands)	**Carrying Value ($)**	**Fair Value ($)**	Carrying Value ($)	Fair Value ($)
Loans and receivables:				
Trade and other receivables	**3,348**	**3,348**	6,846	6,846
Fair value through profit and loss:				
Derivative assets	**–**	**–**	2,344	2,344
Derivative liabilities	**–**	**–**	224	224
Fair value through other comprehensive income:				
Investment in marketable securities	**186**	**186**	662	662
Other liabilities:				
Trade and other payables	**8,438**	**8,438**	12,005	12,005
Bank debt	**30,000**	**30,000**	60,238	60,238
Convertible debentures	**56,272**	**47,150**	55,129	23,587

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 September 30, 2016, 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 may enter 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 may partially mitigate 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 debt are market rate based (variable interest rates); thus, carrying values approximate fair values.

  At the September 30, 2016 debt pricing levels, the increase or decrease in net earnings for the year for each one percent change in interest rates would amount to $0.44 million (September 30, 2015 - $0.37 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 (September 30, 2015 - $0.20 million) increase or decrease in net earnings for the period ended September 30, 2016. 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, 2016, approximately 47 percent (December 31, 2015 - 38 percent) was owing from two companies and Zargon anticipates full collection.

The Company's allowance for doubtful accounts at September 30, 2016 was $0.04 million (December 31, 2015 - $0.15 million). During 2016, 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, 2016, $0.12 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, 2016, Zargon owed $30.00 million in outstanding bank debt with a restricted cash balance of $30.00 million that was used to repay this debt subsequent to the quarter end.

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	**8,438**	–	**8,438**
Bank debt	**30,000**	–	**30,000**
Interest on convertible debentures	**3,450**	–	**3,450**
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 nil (September 30, 2015 – $1.42 million) for oil and gas risk management contracts impacting net earnings for the nine months ended September 30, 2016.

13. DERIVATIVE CONTRACTS

The Company may be a party to certain financial instruments that have fixed the price of a portion of its oil production and interest rates. The Company enters into these contracts for risk management purposes only in order to protect a portion of its future cash flows from the volatility of oil and natural gas commodity prices and interest rates. For financial risk management contracts, any unrealized gains or losses are recorded in earnings based on the fair value (mark-to-market) of the contracts at each reporting period. The unrealized gain/loss on the consolidated statement of earnings/(loss) and comprehensive earnings/(loss) for the three and nine month periods of 2016 was a $0.04 million gain (2015 - $3.26 million gain) and a $2.12 million loss (2015 - $8.08 million loss), respectively. The realized gain/loss on the consolidated statement of earnings/(loss) and comprehensive earnings/(loss) for the three and nine month periods of 2016 was a $0.04 million loss (2015 - $2.33 million gain) and a $2.25 million gain (2015 - $15.43 million gain), respectively.

There are currently no derivative contracts outstanding.

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

Ron 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, Development

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

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