

FINANCIAL AND OPERATING HIGHLIGHTS

(unaudited)	Three Months Ended September 30,			Nine Months Ended September 30,		
	2019	2018	Percent Change	2019	2018	Percent Change
Financial						
Income and Investments (\$ millions)						
Petroleum and natural gas sales	8.19	10.17	(19)	25.67	30.72	(16)
Funds flow from operating activities	1.41	1.93	(27)	4.81	2.21	118
Cash flows from operating activities	0.61	0.85	(28)	2.46	3.63	(32)
Free cash flow	(0.75)	0.76	(199)	0.41	(2.50)	116
Net earnings/(loss)	(0.91)	(0.64)	(42)	23.60	(6.66)	454
Net capital expenditures	1.21	0.93	30	2.75	3.62	(24)
Per Share, Basic						
Funds flow from operating activities (\$/share)	0.06	1.25	(95)	0.22	1.43	(85)
Cash flows from operating activities (\$/share)	0.03	0.55	(95)	0.11	2.35	(95)
Net earnings/(loss) (\$/share)	(0.04)	(0.41)	90	1.07	(4.31)	125
Balance Sheet at Period End (\$ millions)						
Property, plant and equipment				95.43	123.39	(23)
Total assets				104.27	132.96	(22)
Debt				4.53	–	100
Convertible debentures at maturity				–	41.94	(100)
Net debt				2.09	40.78	(95)
Shareholders' equity				27.81	16.93	64
Total Common Shares Outstanding at Period End (millions)				22.99	1.55	1383
Operating						
Average Daily Production						
Oil and liquids (bbl/d)	1,489	1,680	(11)	1,534	1,810	(15)
Natural gas (mmcf/d)	1.36	1.64	(17)	1.42	2.12	(33)
Equivalent (boe/d)	1,715	1,953	(12)	1,771	2,164	(18)
Average Selling Price (before the impact of financial risk management contracts)						
Oil and liquids (\$/bbl)	59.12	64.83	(9)	60.05	60.48	(1)
Natural gas (\$/mcf)	0.76	1.00	(24)	1.35	1.43	(6)
Undeveloped Land at Period End (thousand net acres)				32	33	(3)

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 measure presented on the consolidated statement of cash flows, it represents cash flow from operating activities adjusted for asset retirement expenditures and changes in non-cash operating working capital. For a further discussion about this term, refer to the Management's Discussion and Analysis section in this report.

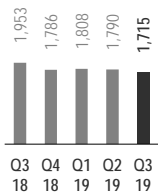
The debt amount is the full future face value of the \$3.50 million (USD) term debt plus an original issue discount of \$0.15 million (USD) less principal repayments to date of \$0.23 million (USD) in Canadian dollars.

Net debt is a non-GAAP measure that represents the debt face value of \$4.53 million (September 30, 2018 – nil) plus the convertible debenture of \$41.94 million (prior to the settlement on January 11, 2019) and any working capital excluding unrealized assets/liabilities.

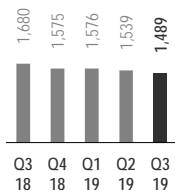
Message to Shareholders ⁽¹⁾

Zargon Oil & Gas Ltd. has released its financial and operating results for the third quarter of 2019. Specific financial and operating highlights in the third quarter of 2019 include:

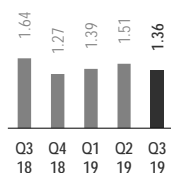
Production (boe/d)



Oil and Liquids Production (bbl/d)



Natural Gas Production (mmcf/d)



- Funds flow from operating activities of \$1.41 million compared to \$2.17 million recorded in the prior quarter. The decrease from the prior quarter was primarily due to lower production volumes and commodity prices that were partially offset by lower general and administrative expenses.
- Third quarter 2019 production averaged 1,715 barrels of oil equivalent per day, a four percent decrease from the preceding quarter production rate of 1,790 barrels of oil equivalent per day. The reduction in production volumes from the prior quarter was primarily due to natural production declines and facility outages relating to summer electrical storms and annual facility maintenance turn-arounds. Third quarter 2019 production averaged 1,489 barrels of oil per day and 1.36 million cubic feet of natural gas per day, levels that are anticipated to be maintained through fourth quarter 2019.
- Zargon's third quarter 2019 field oil prices averaged \$59.12 per barrel, eight percent lower than the prior quarter's price of \$64.51 per barrel. The combination of lower oil prices and oil volumes resulted in an 11 percent reduction in third quarter 2019 revenues to \$8.19 million, down from \$9.17 million in the prior quarter. With relatively consistent operating costs and royalty rates, this reduction in revenue carried through to Zargon's third quarter 2019 field operating cash flow of \$2.32 million, a 28 percent decline from the prior quarter's \$3.23 million.
- Zargon remains committed to reducing corporate costs and was successful in reducing third quarter 2019 general administrative costs (inclusive of transaction, exploration and evaluation costs) through further staff adjustments and realignments to \$0.71 million, down 13 percent from \$0.82 million in second quarter 2019. After the further deduction of \$0.20 million of third quarter 2019 interest, finance and US federal tax charges, Zargon's remaining third quarter 2019 funds flow from operating activities were \$1.41 million.
- Zargon also remains committed to reducing its inactive well count in order to facilitate possible business combinations with other small producers. During the 2019 third quarter, Zargon incurred \$0.95 million of abandonment and reclamation costs, which takes Zargon's year-to-date expenditures to \$1.65 million. For 2019, Zargon is now planning to spend \$2.60 million on abandonment and reclamations that will include the abandoning of a minimum of 25 net operated and 32 net non-operated wells, which will result in a 17 percent reduction in Zargon's year end 2018 total inactive well count of 335 net wells. In Alberta, Zargon has voluntarily participated in the Alberta Energy Regulator's ("AER") Area Based Closure ("ABC") program which enables significant cost savings by encouraging large scale area based abandonment programs. For 2019 and 2020, Zargon's abandonment expenditure commitments for the ABC program are \$1.16 million and \$1.26 million, respectively.
- Zargon's third quarter 2019 capital expenditures were \$1.21 million, a \$0.42 million increase from the \$0.79 million recorded in the prior quarter which takes Zargon's year-to-date expenditures to \$2.75 million. Zargon's 2019 capital program is expected to total \$3.50 million and is primarily allocated to oil exploitation programs (waterfloods), Little Bow Polymer costs, well reactivations, and pipeline construction projects. Recent well recompletions and stimulations at the Little Bow non-ASP property have delivered good results that should stabilize Zargon's total oil volumes through the upcoming winter. Consistent with the last few years, Zargon did not drill any of its proven undeveloped locations (Taber, Bellshill Lake and North Dakota) in the quarter, as Zargon conserved its cash to retire debt and retire abandonment liabilities.

- At September 30, 2019, the Company's combined debt net of working capital was \$2.09 million, which compares with Zargon's calculated \$1.34 million of debt net of working capital in the prior quarter.

With substantial fixed operating and capital costs to maintain production and meet abandonment retirement obligations, the outlook for Zargon is extremely dependent on Zargon's field oil price, which in turn is extremely dependent on WTI prices and WTI-WCS pricing differentials. For further information regarding Zargon's properties, opportunities and outlook, please refer to our updated corporate presentation, which is available at www.zargon.ca.

Strategic Alternatives Process Update ⁽¹⁾

Zargon's Special Committee of the Board (the "Committee") continues to seek alternatives to maximize shareholder value. Macquarie Energy Canada Ltd. ("Macquarie") is currently engaged as Zargon's exclusive financial advisor to evaluate strategic alternatives available to Zargon which may include asset acquisitions, a sale of the Company or a portion of the Company's assets, a restructuring of the Company's current capital structure, the addition of capital to further develop the potential of the assets, a merger, a farm-in or joint venture, or other such options as may be determined by the Board of Directors to be in the best interests of the Company and its stakeholders.

(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 2019 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, 2019 and the audited consolidated financial statements and related notes for the year ended December 31, 2018. 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 ("Mcf") on the basis of one barrel of natural gas liquids to six thousand cubic feet of gas. Boes and Mcfes may be misleading, particularly if used in isolation. A conversion ratio of one barrel to six thousand cubic feet of natural gas is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. Given that the value ratio based on the current price of crude oil as compared to natural gas is significantly different from the energy equivalency of 6:1, utilizing a conversion ratio on a 6:1 basis may be misleading as an indication of value.

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

- The MD&A contains the term "funds flow from operating activities" ("funds flow"), which should not be considered an alternative to, or more meaningful than, "cash flows from operating activities" as determined in accordance with IFRS as an indicator of the Company's financial performance. This term does not have any standardized meaning as prescribed by IFRS and, therefore, the Company's determination of funds flow from operating activities may not be comparable to that reported by other companies. The Company evaluates its performance based on net earnings and funds flow from operating activities. The Company considers funds flow from operating activities to be a key measure as it demonstrates the Company's ability to generate the cash necessary to 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 the convertible debenture of \$41.94 million (prior to January 11, 2019) and the debt face value of \$4.53 million (December 31, 2018 – \$4.97 million) and any working capital 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, cash exploration and evaluation expenses 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.
- Free cash flow is calculated as funds flow from operating activities less capital expenditures and asset retirement expenditures.

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

Forward-Looking Statements – This document offers our assessment of Zargon’s future plans and operations as at November 13, 2019, and contains forward-looking statements including:

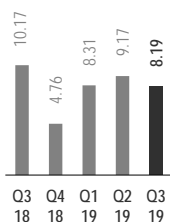
- our expectations for our use of funds from our US term debt and the terms of the loan referred to under the headings “Liquidity and Capital Resources and Going Concern”;
- our expected sources of funds for capital expenditures referred to under the heading “Liquidity and Capital Resources and Going Concern”;
- our expectations for the Company’s ability to continue as a going concern referred to under the heading “Liquidity and Capital Resources and Going Concern”; and
- our strategic alternatives process referred to under the heading “Outlook”.

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.

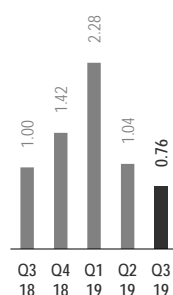
You are cautioned that the assumptions, including among other things, future oil and natural gas prices; future capital expenditure levels (including ASP); future production levels; future exchange rates; the cost of developing and expanding our assets; our ability to obtain equipment in a timely manner 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 13, 2019.

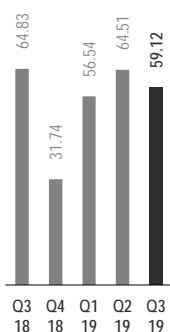
Petroleum and
Natural Gas
Revenue
(\$ millions)



Natural Gas
Prices
(\$/mcf)



Oil and Liquids
Prices
(\$/bbl)



FINANCIAL & OPERATING RESULTS

Petroleum and Natural Gas Sales

(\$ millions)	Three Months Ended September 30,			Nine Months Ended September 30,		
	2019	2018	Percent Change	2019	2018	Percent Change
Petroleum sales	8.10	10.02	(19)	25.15	29.89	(16)
Natural gas sales	0.09	0.15	(40)	0.52	0.83	(37)
Petroleum and natural gas sales	8.19	10.17	(19)	25.67	30.72	(16)

Third quarter 2019 gross petroleum and natural gas sales of \$8.19 million decreased 11 percent compared to \$9.17 million in the preceding quarter and 19 percent compared to \$10.17 million in the third quarter of 2018. Third quarter 2019 realized oil and liquids field prices averaged \$59.12 per barrel and were eight percent lower than the \$64.51 per barrel recorded in the prior quarter. The WTI-WCS differential widened during the third quarter of 2019 to \$16.16 per barrel compared to \$14.26 per barrel in the prior quarter. Natural gas field prices received averaged \$0.76 per thousand cubic feet in the third quarter of 2019, a 27 percent decrease from the preceding quarter and a 24 percent decrease from the 2018 third quarter prices.

Pricing

Average for the period	Three Months Ended September 30,			Nine Months Ended September 30,		
	2019	2018	Percent Change	2019	2018	Percent Change
Natural Gas:						
NYMEX average daily spot price (\$US/mmbtu)	2.38	2.90	(18)	2.62	2.91	(10)
AECO average daily spot price (\$Cdn/mmbtu)	0.94	1.19	(21)	1.25	1.48	(16)
Zargon realized field price (\$Cdn/mcf)	0.76	1.00	(24)	1.35	1.43	(6)
Zargon realized natural gas field price differential (\$Cdn/mcf)	0.18	0.19	(5)	(0.10)	0.05	(300)
Crude Oil:						
WTI (\$US/bbl)	56.45	69.50	(19)	57.05	66.75	(15)
Edmonton par price (\$Cdn/bbl)	68.20	81.91	(17)	69.56	78.24	(11)
Western Canadian Select ("WCS") price (\$Cdn/bbl)	58.38	61.77	(5)	60.26	57.78	4
Zargon realized field price before the impact of financial risk management contracts (\$Cdn/bbl)	59.12	64.83	(9)	60.05	60.48	(1)
Zargon realized field price after the impact of financial risk management contracts (\$Cdn/bbl)	59.12	64.83	(9)	60.05	55.62	8
Zargon realized oil field price differential to WCS ⁽¹⁾	0.74	3.06	(76)	(0.21)	2.70	(108)
WTI (\$Cdn/bbl) to WCS (\$Cdn/bbl) differential	16.16	29.07	(44)	15.59	28.22	(45)

(1) Calculated as Zargon's realized field price before the impact of financial risk management contracts (\$Cdn/bbl) as compared to the Western Canadian Select price (\$Cdn/bbl).

Volumes

Oil and liquids production volumes during the 2019 third quarter were 1,489 barrels per day, a three percent decrease from the preceding quarter rate of 1,539 barrels per day due to natural production declines and facility outages relating to summer electrical storms and annual facility maintenance turn-arounds. This compared to an 11 percent decline from the 2018 third quarter rate of 1,680 barrels per day. Natural gas

production volumes in the 2019 third quarter of 1.36 million cubic feet per day decreased from 1.51 million cubic feet per day in the preceding quarter and 1.64 million cubic feet per day in the 2018 third quarter.

Production by Core Area

Three Months Ended September 30,	2019			2018		
	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	356	0.48	436	403	0.39	467
Alberta Plains South	770	0.88	916	881	1.25	1,090
Williston Basin	363	–	363	396	–	396
	1,489	1.36	1,715	1,680	1.64	1,953

Nine Months Ended September 30,	2019			2018		
	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	370	0.53	458	457	0.74	580
Alberta Plains South	790	0.89	939	944	1.38	1,175
Williston Basin	374	–	374	409	–	409
	1,534	1.42	1,771	1,810	2.12	2,164

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 is recorded based on the fair value ("mark-to-market") of the contracts at the period end. Realized and unrealized gains/losses on risk management contracts are included in "gain/loss on derivatives" in the consolidated statement of earnings/(loss) and their fair value is reflected in "derivative assets" or "derivative liabilities" on the consolidated balance sheets.

The net realized gain/loss on derivatives for the 2019 and 2018 third quarter were nil. There are currently no derivative contracts outstanding.

The unrealized gain/loss on derivatives in the third quarter of 2019 was nil, compared to a \$0.54 million gain in the third quarter of 2018 which was related to oil contracts. 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,			Nine Months Ended September 30,		
	2019	2018	Percent Change	2019	2018	Percent Change
Royalties	1.13	1.54	(27)	3.30	4.39	(25)
Percentage of revenue	13.7%	15.1%		12.8%	14.3%	

Third quarter 2019 royalties of \$1.13 million decreased 10 percent compared to prior quarter and 27 percent from the 2018 third quarter. The decrease was primarily due to the decrease in crude oil prices and lower production volumes. The variations in royalty rates generally track changes in production volumes and pricing. Third quarter of 2019 royalties were 13.7 percent of gross sales compared to 13.7 percent in the prior quarter and 15.1 percent in the third quarter of 2018.

Operating Expenses and Transportation Expenses

(\$ millions)	Three Months Ended September 30,			Nine Months Ended September 30,		
	2019	2018	Percent Change	2019	2018	Percent Change
Operating expenses	4.62	4.76	(3)	14.21	15.81	(10)
Transportation expenses	0.13	0.12	8	0.34	0.33	3
Total expenses	4.75	4.88	(3)	14.55	16.14	(10)
Total expenses (\$/boe)	30.08	27.15	11	30.10	27.32	10

Third quarter 2019 operating expenses and transportation expenses of \$4.75 million on a total dollar basis were slightly higher compared to \$4.69 million recorded in the prior quarter but lower compared to \$4.88 million recorded in the third quarter of 2018. Compared to the prior year's third quarter, operating expenses and transportation expenses in the 2018 third quarter decreased by three percent on a total dollar basis. In contrast, costs were up on a per barrel of oil equivalent basis due to the impact of fixed property costs and decreased production volumes.

Operating Netbacks

Three Months Ended September 30,	2019		2018	
	Oil and Liquids (\$/bbl)	Natural Gas (\$/mcf)	Oil and Liquids (\$/bbl)	Natural Gas (\$/mcf)
Sales	59.12	0.76	64.83	1.00
Royalties	(8.30)	0.10	(10.11)	0.16
Realized loss on derivatives	–	–	–	–
Operating expenses	(27.22)	(7.13)	(26.68)	(4.24)
Transportation expenses	(0.93)	–	(0.76)	–
Operating netbacks	22.67	(6.27)	27.28	(3.08)

Nine Months Ended September 30,	2019		2018	
	Oil and Liquids (\$/bbl)	Natural Gas (\$/mcf)	Oil and Liquids (\$/bbl)	Natural Gas (\$/mcf)
Sales	60.05	1.35	60.48	1.43
Royalties	(7.93)	0.07	(8.85)	(0.03)
Realized gain/(loss) on derivatives	–	–	(4.86)	–
Operating expenses	(27.81)	(6.62)	(27.01)	(4.24)
Transportation expenses	(0.81)	–	(0.67)	–
Operating netbacks	23.50	(5.20)	19.09	(2.84)

The majority of the Company's natural gas is solution gas that is produced concurrent with oil production, or non-associated natural gas that is processed at the Zargon's Travers solution gas processing facility.

General & Administrative (“G&A”) Expenses

(\$ millions)	Three Months Ended September 30,			Nine Months Ended September 30,		
	2019	2018	Percent Change	2019	2018	Percent Change
G&A expenses	0.62	0.81	(23)	2.28	2.74	(17)
G&A expenses (\$/boe)	3.95	4.50	(12)	4.72	4.64	2

G&A expenses of \$0.62 million or \$3.95 per barrel of oil equivalent in the third quarter of 2019 were lower by 19 percent from the prior quarter on a dollar basis and per barrel of oil equivalent basis due to the ongoing G&A cost containment initiatives and reductions in the compensation for the President and Chief Executive Officer, the Chief Financial Officer and the Vice President, Development.

Transaction Costs

Transaction costs for the 2019 third quarter were \$0.03 million compared to \$0.02 million in the prior quarter and \$0.07 million in the third quarter of 2018 and relate to Zargon’s ongoing strategic alternatives review.

Interest and Financing Charges on Debt

On November 2, 2018, Zargon entered into a financing agreement for \$3.50 million (USD) term debt. The loan is secured by all U.S. assets of Zargon. The loan bears interest at 11%. Principal repayments commenced on July 1, 2019 at \$0.05 million (USD) per month and on October 1, 2019 principal repayments changed to \$0.08 million (USD) per month until maturity at April 1, 2020 when the balance of the principal plus an original issue discount of \$0.15 million (USD) is payable.

Interest and financing charges were \$0.14 million or \$0.89 per barrel of oil equivalent in the 2019 third quarter compares to \$0.14 million in the prior quarter and nil in the third quarter of 2018.

Interest on Convertible Debentures

On January 11, 2019, Zargon announced the completion of a transaction to settle its \$41.94 million Convertible Debentures. Following the closing, the Company has reduced its overall debt by \$41.94 million and its associated annual interest burden.

As a result of the convertible debenture settlement, the interest on convertible debentures in the 2019 third quarter was nil, compared to \$0.84 million in the third quarter of 2018. For more details, please refer to Note 7 of the interim consolidated financial statements.

Current Tax

The current tax expense for the 2019 third quarter was \$0.06 million, and related to the US operations which compared to \$0.10 million in the preceding quarter and \$0.11 million in the 2018 third quarter. Total corporate tax pools as at September 30, 2019 were approximately \$204 million, comparable to the \$204 million of tax pools available to Zargon at December 31, 2018.

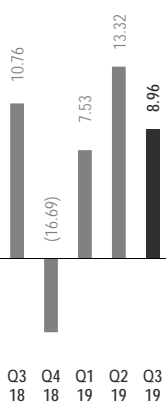
Estimated Tax Pools

(\$ millions)	September 30, 2019
Canadian oil and natural gas property expenses	1
Canadian development expenses	9
Canadian exploration expenses	4
Capital cost allowance	16
Non-capital losses	171
US tax pools	1
Other	2
Estimated tax pools	204

Corporate Netbacks

(\$/boe)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Petroleum and natural gas sales	51.93	56.61	53.11	52.00
Royalties	(7.13)	(8.57)	(6.82)	(7.43)
Realized (loss)/gain on derivatives	–	–	–	(4.07)
Operating expenses	(29.27)	(26.50)	(29.40)	(26.76)
Transportation expenses	(0.81)	(0.65)	(0.70)	(0.56)
Operating netbacks	14.72	20.89	16.19	13.18
General and administrative expenses	(3.95)	(4.50)	(4.72)	(4.64)
Transaction costs	(0.19)	(0.36)	(0.21)	(0.36)
Exploration and evaluation	(0.33)	–	(0.11)	–
Interest and financing charges	(0.89)	–	(0.87)	(0.01)
Interest on convertible debentures	–	(4.68)	–	(4.26)
Current tax expense	(0.40)	(0.59)	(0.34)	(0.18)
Funds flow netbacks	8.96	10.76	9.94	3.73

Funds Flow Netbacks (\$/boe)



Depletion and Depreciation Expense

Depletion and depreciation expense for the third quarter of 2019 decreased 16 percent at \$2.26 million compared to \$2.69 million in the third quarter of 2018. On a per barrel of oil equivalent basis, the depletion and depreciation rates were \$14.30 and \$14.98 for the third quarter of 2019 and 2018, respectively. The 2018 calendar year depletion and depreciation rate was \$15.11 per barrel of oil equivalent.

Accretion of Asset Retirement Obligations, Debt and Convertible Debentures

The accretion expense of asset retirement obligations for the third quarter of 2019 was \$0.35 million and was essentially unchanged compared to the third quarter of 2018. Year-over-year adjustments are due to actual abandonment and reclamation costs and 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.

Zargon's \$3.50 million (USD) term debt is accreted over its term, up to the total principal balance plus an original issue discount of \$0.15 million (USD), for a total face value of \$3.65 million (USD) less the principal repayments of \$0.23 million (USD) or \$4.53 million Canadian dollars. Accretion on the term debt for the third quarter of 2019 was \$0.01 million, compared to \$0.04 million in the prior quarter and nil for the third quarter of 2018.

On January 11, 2019, Zargon announced the completion of a transaction to settle its \$41.94 million Convertible Debentures, therefore the accretion on the convertible debenture for the 2019 third quarter was nil, compared to \$0.52 million in the 2019 first quarter due to the change in settlement date and \$0.12 million in the 2018 third quarter. For more information on Zargon's convertible debentures and this transaction, please refer to Note 7 of the interim consolidated financial statements.

Gain on convertible debentures

As a result of the convertible debenture settlement, the Company recognized a gain of \$27.03 million in the first quarter of 2019. For more information on this transaction, please refer to Note 7 of the interim consolidated financial statements.

Shared-based Compensation

Expensing of share-based compensation in the third quarter of 2019 totalled \$0.01 million, which was slightly lower than the \$0.02 million incurred in the third quarter of 2018.

Unrealized Foreign Exchange

The Company had an unrealized foreign exchange loss of \$0.03 million during the third quarter of 2019 compared to a gain of \$0.02 million in the 2018 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.

Deferred Tax

The deferred tax recovery for the third quarter of 2019 was \$0.33 million compared to a recovery of \$0.07 million in the third quarter of 2018. The deferred tax expense and recovery were related to the US operations.

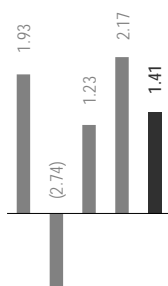
Funds Flow from Operating Activities

Funds flow from operating activities in the 2019 third quarter was \$1.41 million and compares to \$2.17 million and \$1.93 million reported in the prior quarter and the third quarter of 2018, respectively. The decrease in funds flow compared to the prior quarter was primarily due to lower production volumes and commodity prices that were partially offset by lower general and administrative expenses.

Details of the changes in funds flow from operating activities during 2019 and 2018 are as follows:

(\$ millions)	2019			2018	
	Q3	Q2	Q1	Q4	Q3
Funds flow from operating activities, prior quarter	2.17	1.23	(2.74)	1.93	0.58
Variances from prior quarter:					
Revenue and royalties:					
Volume	(0.29)	0.01	(0.05)	(0.87)	(0.73)
Price	(0.69)	0.86	3.59	(4.54)	0.07
Royalties	0.13	(0.35)	(0.19)	0.82	0.03
Realized Derivatives	–	–	–	–	1.56
Expenses:					
Operating and transportation	(0.06)	0.33	(0.33)	0.20	0.37
General and administrative	0.17	0.08	0.02	(0.07)	0.15
Transaction costs	(0.02)	0.01	0.01	–	0.01
Exploration and evaluation	(0.05)	–	–	–	–
Interest and financing	0.01	0.10	0.94	(0.34)	–
Current taxes	0.04	(0.10)	(0.02)	0.13	(0.11)
Funds flow from operating activities for the quarter	1.41	2.17	1.23	(2.74)	1.93

Funds Flow from Operating Activities
(\$ millions)



Q3 18 Q4 18 Q1 19 Q2 19 Q3 19

Free Cash Flow

Free cash flow is calculated as funds flow from operating activities less capital expenditures and asset retirement expenditures. Free cash flow for the 2019 third quarter was a negative \$0.75 million and a positive \$0.41 million year to date. The decrease from 2018 free cash flows of \$0.76 million for the third quarter was a result of lower commodity pricing, reductions in production volumes and higher capital and asset retirement expenditures.

Net Earnings/(Loss)

A net loss of \$0.91 million for the 2019 third quarter was \$0.27 million or 42 percent higher than the \$0.64 million net loss in the 2018 third quarter, primarily due to lower realized field prices and production volumes. The net earnings/(loss) track the funds flow from operating activities for the respective periods and non-cash charges, which include depletion and depreciation, accretion, gain on convertible debentures and deferred taxes. On a per diluted share basis, the third quarter 2019 net loss was \$0.04, compared to a net loss of \$0.41 for the 2018 third quarter.

Capital Expenditures

(\$ millions)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Undeveloped land	0.23	0.30	0.66	0.92
Geological and geophysical (seismic)	0.02	–	0.10	0.18
Drilling and completion of wells	(0.03)	0.03	0.13	0.44
Well equipment and facilities	0.53	–	0.56	0.26
ASP project and exploitation costs	0.10	0.02	0.41	0.42
ASP chemical costs	0.36	0.59	0.87	1.79
Exploration and development	1.21	0.94	2.73	4.01
Property acquisitions	–	–	–	–
Property dispositions	–	(0.01)	–	(0.42)
Net property dispositions	–	(0.01)	–	(0.42)
Total net capital expenditures excluding administrative assets	1.21	0.93	2.73	3.59
Administrative assets	–	–	0.02	0.03
Total net capital expenditures	1.21	0.93	2.75	3.62

LIQUIDITY AND CAPITAL RESOURCES

Total net capital expenditures (including net property dispositions) totalled \$1.21 million in the third quarter of 2019 and were 30 percent higher than the same period in 2018. Field expenditures of \$1.21 million for the third quarter of 2019 were 29 percent higher than the 2018 third quarter. The third quarter 2019 field capital expenditures (excluding net property dispositions) were allocated to Alberta Plains North – \$0.14 million, Alberta Plains South – \$0.79 million and Williston Basin – \$0.28 million and included the drilling of nil net wells, unchanged from the third quarter of 2018.

Included in the Alberta Plains South capital expenditures is the \$0.46 million incurred on the Little Bow ASP project. Of the total ASP amount, \$0.10 million was spent on project and exploitation costs while \$0.36 million was spent on chemical costs for the facility.

On November 2, 2018, Zargon entered into a financing agreement for \$3.50 million (USD) term debt. The loan is secured by all U.S. assets of Zargon. The loan bears interest at 11% and principal repayments commenced on July 1, 2019 at \$0.05 million (USD) per month and on October 1, 2019 principal repayments changed to \$0.08 million (USD) per month until maturity at April 1, 2020 when the balance of the principal plus an original issue discount of \$0.15 million (USD) is payable.

On January 11, 2019, Zargon announced the completion of a transaction to settle its \$41.94 million principal amount of outstanding 8% Convertible Debentures due December 31, 2019 in exchange for common shares of Zargon. Following closing, the Company has reduced its overall debt by \$41.94 million and its annual interest burden by \$3.36 million, resulting in a simplified capital structure with only \$3.50 million (USD) of term debt outstanding.

At September 30, 2019, the Company's combined debt net of working capital (excluding unrealized derivative assets/liabilities) was \$2.09 million, which compares to \$45.17 million of net debt at the end of December 31, 2018 (or the pro forma debt net of working capital of \$2.39 million after removing the face value of the convertible debenture of \$41.94 million and accrued interest of \$0.84 million). The \$2.09 million

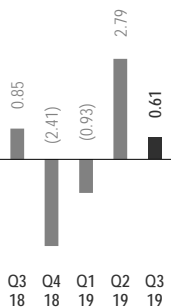
debt net of working capital consists of the face value of the principal amount of the term debt, which includes the original issue discount, of \$4.53 million (CDN), which is partially offset by net cash balances.

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.

The financial statements have been prepared in accordance with generally accepted accounting principles applicable to a going concern, which assumes that the Company will be able to realize its assets and discharge its liabilities in the normal course of business. As of September 30, 2019, the Company has working capital of \$2.44 million (defined as current assets less accounts payable), cash flows from operating activities of \$2.46 million and generated net earnings for the nine months ended September 30, 2019 of \$23.60 million (included a \$27.03 million gain on convertible debentures in Q1 2019). During the third quarter, the WCS differential to WTI widened. In addition, there is still ongoing material uncertainty related to future events that may cast substantial doubt on the Company's ability to continue as a going concern and therefore, it may be unable to realize its assets and discharge its liabilities in the normal course of business. The continuation of the Company as a going concern is dependent upon the occurrence of all or some of these future events: actual prices exceeding the current estimates in the coming six months, accessing additional capital, or other unforeseen events. In an effort to mitigate these challenges, the Company obtained \$3.50 million (USD) of term debt in November 2018, and furthermore in January 2019 the Company settled its outstanding \$41.94 million convertible debentures, thereby eliminating \$4.20 million of debenture interest payments that would otherwise have been due and payable in 2019. Principal payments have commenced and will total \$0.60 million (USD) by March 2020. The balance of the term debt which is anticipated to be \$3.05 million (USD) is due April 1, 2020. The Company plans to refinance that balance either with the existing lender or a different lender yet to be identified. These financial statements do not reflect adjustments that would be necessary if the going concern assumption were not appropriate. If the going concern basis were not appropriate for these financial statements, then adjustments could be necessary in the carrying value of the assets and liabilities, the reported revenues and expenses, and the balance sheet classifications used. These adjustments could be material.

Cash Flows from Operating Activities
(\$ millions)



For the quarter ended September 30, 2019, net capital expenditures totalled \$1.21 million, which was \$0.60 million higher than the cash flows from operating activities (after changes in non-cash working capital) of \$0.61 million. For the quarter ended September 30, 2018, net capital expenditures totalled \$0.94 million, which was \$0.08 million higher than the cash flows from operating activities (after changes in non-cash working capital) of \$0.85 million. Zargon relies on access to debt and capital markets to the extent that 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 growth through additional debt and equity issuances. In the crude oil and natural gas industry, because of the nature of reserve reporting, the natural reservoir declines and the risks involved in capital investment, it is not possible to distinguish between capital spent on maintaining productive capacity and capital spent on growth opportunities. Therefore, maintenance capital is not disclosed separately from development capital spending.

At November 13, 2019, Zargon had 22.99 million common shares outstanding. Pursuant to the stock option plan and the share award plan, there are currently an additional 0.01 million common share awards issued and outstanding and 0.06 million stock options issued and outstanding.

Capital Sources and Uses

(\$ millions)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Funds flow from operating activities	1.41	1.93	4.81	2.21
Change in long term debt	(0.16)	–	(0.35)	–
Change in cash	0.40	(0.23)	0.35	0.64
Issuance of common shares	–	–	(0.09)	–
Exploration and evaluation	0.05	–	0.05	–
Asset retirement costs	(0.95)	(0.24)	(1.65)	(1.09)
Changes in working capital and other	0.46	(0.53)	(0.37)	1.86
Total capital sources	1.21	0.93	2.75	3.62

CONTRACTUAL OBLIGATIONS AND CONTINGENCIES

Zargon has certain contractual obligations relating to the lease of head office space and insurance financing that sets out in the table below:

(\$ millions)	Total	2019	2020 to 2021	2022 to 2023	Thereafter
Head office lease	0.34	0.07	0.27	–	–
Insurance	0.37	0.18	0.19	–	–
Total	0.71	0.25	0.46	–	–

LIABILITY MANAGEMENT RATING

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 2, 2019, Zargon's LMR was 1.02. 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 2019 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 2019.

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 2013 Committee of Sponsoring Organizations of the Treadway Commission (“COSO”) Framework.

OUTLOOK

With substantial fixed operating and capital costs to maintain production and meet abandonment retirement obligations, the outlook for Zargon is extremely dependent on Zargon’s field oil price, which in turn is extremely dependent on WTI prices and WTI-WCS pricing differentials.

Zargon’s Special Committee of the Board (the “Committee”) continues to seek alternatives to maximize shareholder value. Macquarie Energy Canada Ltd. (“Macquarie”) is currently engaged as Zargon’s exclusive financial advisor to evaluate strategic alternatives available to Zargon which may include a sale of the Company or a portion of the Company’s assets, a restructuring of the Company’s current capital structure, the addition of capital to further develop the potential of the assets, a merger, a farm-in or joint venture, or other such options as may be determined by the Board of Directors to be in the best interests of the Company and its stakeholders.

SUMMARY OF QUARTERLY RESULTS

	2019		
	Q1	Q2	Q3
Petroleum and natural gas sales (\$ millions)	8.31	9.17	8.19
Net earnings/(loss) (\$ millions)	25.08	(0.57)	(0.91)
Net earnings/(loss) per diluted share (\$)	1.23	(0.02)	(0.04)
Funds flow from operating activities (\$ millions)	1.23	2.17	1.41
Funds flow from operating activities per diluted share (\$)	0.06	0.09	0.06
Cash flows from/(used in) operating activities (\$ millions)	(0.93)	2.79	0.61
Cash flows from/(used in) operating activities per diluted share (\$)	(0.05)	0.12	0.03
Free cash flow (\$ millions)	0.26	0.91	(0.75)
Net capital expenditures (\$ millions)	0.75	0.79	1.21
Total assets (\$ millions)	106.61	105.73	104.27
Debt ⁽¹⁾	4.87	4.71	4.53
Net debt	2.26	1.34	2.09
Average daily oil and liquids production (bbl)	1,576	1,539	1,489
Average daily natural gas production (mmcf)	1.39	1.51	1.36
Average daily production (boe)	1,808	1,790	1,715
Average oil production weighting (%)	87	86	87
Average realized commodity field price before the impact of financial risk management contracts (\$/boe)	51.04	56.33	51.93
Funds flow netback (\$/boe)	7.53	13.32	8.96

(1) Amount is the full future face value of the \$3.50 million (USD) term debt plus an original issue discount of \$0.15 million (USD) less principal repayments in Canadian dollars.

	2018			
	Q1	Q2	Q3	Q4
Petroleum and natural gas sales (\$ millions)	9.71	10.84	10.17	4.77
Net loss (\$ millions)	(4.33)	(1.68)	(0.64)	(28.71)
Net loss per diluted share (\$)	(2.81)	(1.09)	(0.41)	(18.58)
Funds flow from/(used in) operating activities (\$ millions)	(0.30)	0.58	1.93	(2.74)
Funds flow from/(used in) operating activities per diluted share (\$)	(0.20)	0.37	1.25	(1.77)
Cash flows from/(used in) operating activities (\$ millions)	0.80	1.98	0.85	(2.41)
Cash flows from/(used in) operating activities per diluted share (\$)	0.52	1.29	0.55	(1.56)
Free cash flow (\$ millions)	(2.41)	(0.85)	0.76	(4.27)
Net capital expenditures (\$ millions)	1.50	1.19	0.93	0.68
Total assets (\$ millions)	136.83	135.80	132.96	108.41
Debt ⁽¹⁾	–	–	–	4.97
Convertible debentures (\$ millions) ⁽²⁾	41.94	41.94	41.94	41.94
Net debt	40.79	41.54	40.78	45.17
Average daily oil and liquids production (bbl)	1,949	1,805	1,680	1,575
Average daily natural gas production (mmcf)	2.87	1.88	1.64	1.27
Average daily production (boe)	2,427	2,118	1,953	1,786
Average oil production weighting (%)	80	85	86	88
Average realized commodity field price before the impact of financial risk management contracts (\$/boe)	44.47	56.23	56.61	28.99
Funds flow netback (\$/boe)	(1.38)	2.98	10.76	(16.69)

(1) Amount is the full future face value of the \$3.50 million (USD) term debt plus an original issue discount of \$0.15 million (USD) in Canadian dollars.

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

	2017			
	Q1	Q2	Q3	Q4
Petroleum and natural gas sales (\$ millions)	9.69	9.40	9.28	10.31
Net loss (\$ millions)	(0.54)	(1.71)	(3.51)	(3.55)
Net loss per diluted share (\$)	(0.35)	(1.11)	(2.30)	(2.31)
Funds flow from operating activities (\$ millions)	1.50	1.14	1.76	1.59
Funds flow from operating activities per diluted share (\$)	0.98	0.74	1.15	1.04
Cash flows from/(used in) operating activities (\$ millions)	2.52	(0.59)	0.25	0.29
Cash flows from/(used in) operating activities per diluted share (\$)	1.64	(0.38)	0.16	0.19
Free cash flow (\$ millions)	(1.15)	(1.54)	(0.56)	(1.73)
Net capital expenditures (\$ millions)	2.51	2.13	1.77	2.45
Total assets (\$ millions)	153.75	150.11	144.76	140.55
Convertible debentures (\$ millions) ⁽¹⁾	41.94	41.94	41.94	41.94
Net debt	35.09	36.06	36.70	38.41
Average daily oil and liquids production (bbl)	2,016	1,921	2,037	1,924
Average daily natural gas production (mmcf)	3.38	3.47	3.55	2.95
Average daily production (boe)	2,579	2,500	2,628	2,416
Average oil production weighting (%)	78	77	78	80
Average realized commodity field price before the impact of financial risk management contracts (\$/boe)	41.74	41.34	38.36	46.37
Funds flow netback (\$/boe)	6.48	5.00	7.28	7.17

(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, 2018, is available on the Company's SEDAR profile at www.sedar.com.

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

Calgary, Alberta
November 13, 2019

CONSOLIDATED BALANCE SHEETS

(unaudited)

(\$ thousands)	Notes	September 30, 2019	December 31, 2018
ASSETS			
Cash and cash equivalents		4,705	5,055
Trade and other receivables		2,601	866
Deposits and prepaid expenses		1,528	1,817
Total current assets		8,834	7,738
Long term deposits		8	20
Property, plant and equipment, net	4	95,429	100,649
Total assets		104,271	108,407
LIABILITIES			
Trade and other payables		6,397	5,989
Debt	6	4,453	512
Total current liabilities		10,850	6,501
Debt	6	100	4,407
Convertible debentures	7	–	41,421
Asset retirement obligations	5	61,828	63,412
Deferred tax liabilities		3,687	4,009
Total liabilities		76,465	119,750
Commitments and contingencies	5,6,13		
EQUITY			
Shareholders' capital	8	280,270	262,735
Accumulated other comprehensive income		4,828	5,062
Contributed surplus	7,10	11,111	9,288
Equity component of debentures	7	–	3,570
Deficit		(268,403)	(291,998)
Total equity		27,806	(11,343)
Total equity and liabilities		104,271	108,407

Going concern (see Note 2(e)).

See accompanying notes to the interim consolidated financial statements.

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

(unaudited)		Three Months Ended September 30,		Nine Months Ended September 30,	
(\$ thousands, except per share amounts)	Notes	2019	2018	2019	2018
Petroleum and natural gas sales	8	8,194	10,171	25,674	30,721
Royalties		(1,125)	(1,540)	(3,295)	(4,392)
PETROLEUM AND NATURAL GAS REVENUE, NET OF ROYALTIES		7,069	8,631	22,379	26,329
Gain on unrealized derivatives	11,12	–	537	–	1,151
Loss on realized derivatives	11,12	–	–	–	(2,406)
LOSS ON DERIVATIVES		–	537	–	(1,255)
TOTAL INCOME		7,069	9,168	22,379	25,074
Operating		4,619	4,762	14,212	15,807
Transportation		128	116	339	330
General and administrative		624	809	2,281	2,741
Transaction costs		31	65	102	215
Exploration and evaluation		52	–	52	–
Gain on convertible debentures	7	–	–	(27,028)	–
Gain on sale of properties	4	–	–	–	(29)
Share-based compensation	10	8	23	25	103
Unrealized foreign exchange loss/(gain)		27	(20)	(15)	(126)
Depletion and depreciation	4	2,256	2,692	6,661	8,802
EXPENSES		7,745	8,447	(3,371)	27,843
EARNINGS/(LOSS) BEFORE FINANCE EXPENSES AND INCOME TAXES		(676)	721	25,750	(2,769)
Interest and financing charges	6	137	(1)	421	3
Interest on convertible debentures	7	–	841	101	2,515
Accretion of debt	6	12	–	91	–
Accretion on convertible debentures	7	–	120	520	349
Accretion of asset retirement obligations	5	353	361	1,063	1,088
FINANCE EXPENSES		502	1,321	2,196	3,955
EARNINGS/(LOSS) BEFORE INCOME TAXES		(1,178)	(600)	23,554	(6,724)
Current tax expense		64	106	164	106
Deferred tax recovery		(332)	(65)	(205)	(171)
INCOME TAXES EXPENSE/(RECOVERY)		(268)	41	(41)	(65)
NET EARNINGS/(LOSS) FOR THE PERIOD		(910)	(641)	23,595	(6,659)
Currency translation adjustment recognized in other comprehensive income/(loss)		89	(136)	(234)	247
OTHER COMPREHENSIVE INCOME/(LOSS) FOR THE PERIOD		89	(136)	(234)	247
TOTAL COMPREHENSIVE INCOME/(LOSS) FOR THE PERIOD		(821)	(777)	23,361	(6,412)
NET EARNINGS/(LOSS) PER SHARE					
Basic		(0.04)	(0.41)	1.07	(4.31)
Diluted		(0.04)	(0.41)	1.07	(4.31)

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, 2018		262,735	5,062	9,288	3,570	(291,998)	(11,343)
Net earnings for the period		-	-	-	-	23,595	23,595
Share issue costs	9	(88)	-	-	-	-	(88)
Share-based compensation	10	-	-	25	-	-	25
Exercise of share awards	9	468	-	(468)	-	-	-
Convertible debenture settlement	7	17,155	-	2,266	-	-	19,421
Equity component of debentures	7	-	-	-	(3,570)	-	(3,570)
Translation differences on foreign subsidiary		-	(234)	-	-	-	(234)
Balance at September 30, 2019		280,270	4,828	11,111	-	(268,403)	27,806
Balance at December 31, 2017		262,231	4,412	9,651	3,570	(257,143)	22,721
Net loss for the period		-	-	-	-	(6,659)	(6,659)
Share-based compensation	10	-	-	103	-	-	103
Exercise of share awards	9	504	-	(504)	-	-	-
Equity component of convertible debentures		-	-	-	-	513	513
Translation differences on foreign subsidiary		-	247	-	-	-	247
Balance at September 30, 2018		262,735	4,659	9,250	3,570	(263,289)	16,925

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	2019	2018	2019	2018
OPERATING ACTIVITIES					
Net earnings/(loss) for the period		(910)	(641)	23,595	(6,659)
Adjustments for non-cash items:					
Gain on convertible debenture	7	–	–	(27,028)	–
Gain on sale of properties		–	–	–	(29)
Gain on unrealized derivatives	11,12	–	(537)	–	(1,151)
Depletion and depreciation	4	2,256	2,692	6,661	8,802
Interest on convertible debentures (non-cash)	7	–	–	101	–
Accretion of asset retirement obligations	5	353	361	1,063	1,088
Accretion of debt	6	12	–	91	–
Accretion of convertible debentures	7	–	120	520	349
Share-based compensation	10	8	23	25	103
Unrealized foreign exchange loss/(gain)		27	(20)	(15)	(126)
Deferred tax recovery		(332)	(65)	(205)	(171)
Funds flow from operating activities		1,414	1,933	4,808	2,206
Asset retirement expenditures	5	(951)	(240)	(1,646)	(1,094)
Changes in operating working capital		143	(844)	(702)	2,521
Net cash from operating activities		606	849	2,460	3,633
INVESTING ACTIVITIES					
Additions to property, plant and equipment	4	(1,208)	(936)	(2,745)	(3,970)
Additions to intangible exploration and evaluation assets		–	(2)	–	(67)
Proceeds from disposal of property, plant and equipment		–	9	–	420
Change in long-term deposits		–	(2)	12	(2)
Changes in investing working capital		365	314	258	(653)
Net cash used in investing activities		(843)	(617)	(2,475)	(4,272)
FINANCING ACTIVITIES					
Repayment of debt	6	(233)	–	(298)	–
Share issue costs on settlement of convertible debentures	7	–	–	(88)	–
Changes in financing working capital		69	–	51	–
Net cash used in financing activities		(164)	–	(335)	–
NET CHANGE IN CASH DURING THE PERIOD		(401)	232	(350)	(639)
CASH, BEGINNING OF PERIOD		5,106	3,224	5,055	4,095
CASH, END OF PERIOD		4,705	3,456	4,705	3,456

See accompanying notes to the interim consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the three and nine months ended September 30, 2019, with comparative figures for 2018 (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 1100, 112 - 4th Avenue SW, Calgary, Alberta. The consolidated financial statements of the Company as at and for the period ended September 30, 2019 and its 2018 comparative periods are comprised of the Company and its wholly owned subsidiaries. The Company is engaged in the exploration, 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 AND GOING CONCERN

(a) Statement of compliance:

The unaudited interim consolidated financial statements for the three and nine month periods ended September 30, 2019 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, 2018 with the exception of new and amended accounting standards that 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, 2019 should be read in conjunction with the annual consolidated financial statements for the year ended December 31, 2018. These consolidated financial statements were approved and authorized for issue by the Board of Directors on November 13, 2019.

(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.

(e) Going Concern:

These financial statements have been prepared in accordance with generally accepted accounting principles applicable to a going concern, which assumes that the Company will be able to realize its assets and discharge its liabilities in the normal course of business. As of September 30, 2019, the Company has working capital of \$2.44 million (defined as current assets less accounts payable), cash flows from operating activities of \$2.46 million and generated a net earnings for the nine months ended September 30, 2019 of \$23.60 million (included a \$27.03 million gain on convertible debentures in Q1 2019). During the third quarter, the WCS differential to WTI widened. In addition, there is still ongoing material uncertainty related to future events that may cast substantial doubt on the Company's ability to continue as a going concern and therefore, it may be unable to realize its assets and discharge its liabilities in the normal course of business. The continuation of the Company as a going concern is dependent upon the occurrence of all or some of these future events: actual prices exceeding the current estimates in the coming six months, accessing additional capital, or other unforeseen events. In an effort to mitigate these challenges, the Company obtained \$3.50 million (USD) of term debt in November 2018, and furthermore in January 2019 the Company settled its outstanding \$41.94 million convertible debentures, thereby eliminating \$4.20 million of debenture interest payments that were due and payable in 2019. These financial statements do not reflect adjustments that would be necessary if the going concern assumption were not appropriate. If the going concern basis were not appropriate for these financial statements, then adjustments could be necessary in the carrying value of the assets and liabilities, the reported revenues and expenses, and the balance sheet classifications used. These adjustments could be material.

3. ACCOUNTING POLICIES

New and amended standards adopted by the Company:

- IFRS 16 "Leases", was issued by the IASB in January 2016, which replaces IAS 17 "Leases". Under the current guidance, lessees are required to determine if the lease is a finance or operating lease, based on specified criteria. Finance leases are recognized on the consolidated balance sheet while operating leases are recognized in the consolidated statement of earnings when the expense is incurred. Under IFRS 16, lessees must recognize a lease liability and a right-of-use asset for virtually all lease contracts. The recognition of the present value of minimum lease payments for certain contracts previously classified as operating leases would result in increases to assets, liabilities, depletion and depreciation expense, and finance expense, and a decrease to operating expense upon implementation. An optional exemption to not recognize certain short-term leases of low value can be applied by lessees. For lessors, the accounting remains essentially unchanged.

On January 1, 2019, Zargon adopted IFRS 16 "Leases" using the modified retrospective approach. The modified retrospective approach does not require restatement of prior period financial information as it recognizes the cumulative effect as an ongoing adjustment to opening retained earnings and applies the standard prospectively. Accordingly, comparative information in the Company's financial statements are not restated.

At adoption, lease liabilities were measured at the present value of the remaining lease payments discounted using the Company's incremental borrowing rate. Right-of-use assets were measured at an amount equal to the lease liability and are included with property, plant and equipment. The Company applied the exemption to not recognize right-of-use assets and liabilities for leases with a lease term of less than 12 months. The adoption of IFRS 16 had no material impact on the Company's consolidated financial statements.

4. PROPERTY, PLANT AND EQUIPMENT

(\$ thousands)

Cost, December 31, 2018	280,065
Accumulated depletion and depreciation	(179,416)
Net carrying amount, December 31, 2018	100,649
Additions	2,745
Change in asset retirement obligations	(839)
Exchange differences	(465)
Depletion and depreciation	(6,661)
Net carrying amount, September 30, 2019	95,429
Cost, September 30, 2019	280,825
Accumulated depletion and depreciation	(185,396)
Net carrying amount, September 30, 2019	95,429

5. ASSET RETIREMENT OBLIGATIONS

(\$ thousands)

Balance at December 31, 2018	63,412
Foreign exchange and other	(162)
Asset retirement expenditures	(1,646)
Revisions to estimated asset retirement obligations	(839)
Accretion	1,063
Balance at September 30, 2019	61,828

The asset retirement obligations were calculated using a discount factor of 2.25 percent (December 31, 2018 – 2.25 percent) being the risk-free rate related to the liability and based on the Government of Canada long term bond rate. These obligations are expected to be incurred over the next 55 years. An inflation rate of two percent per annum (December 31, 2018 – two percent) used in the calculation of the present value of the asset retirement obligation remains unchanged.

6. DEBT

(\$ thousands)

	September 30, 2019	December 31, 2018
Debt (\$Cdn)	4,453	4,802
Lease liability	100	117
Total debt	4,553	4,919
Current (\$Cdn)	4,453	512
Non-current	100	4,407

On November 2, 2018 the Company entered into a financing agreement for \$3.50 million (USD) term debt. The terms of the loan are:

- The loan is secured by the Zargon's North Dakota assets.
- The loan bears interest at 11%.
- Principal repayments commenced July 1, 2019 at \$0.05 million (USD) per month until September 1, 2019 and beginning on October 1, 2019 principal repayments were \$0.08 million (USD) per month until maturity at April 1, 2020 when the balance of the principal plus an original issue discount of \$0.15 million (USD) is payable.
- The loan may be prepaid at any time, but is subject to make whole prepayment interest penalties calculated on the lesser of the remaining term of the loan or 12 months, which includes the four percent original issue discount.

- Additional payments of 8% of incremental revenue earned (after payment of royalties) in excess of a \$63.50 (USD) per barrel field price threshold, will also be made to the lender.
- If Zargon's North Dakota monthly production is less than 300 barrels of oil per day but exceeds 240 barrels of oil per day or if the Zargon's North Dakota properties EBITDA in a trailing 12 month period is less than \$1.75 million (USD) but exceeds \$1.25 million (USD), the Company is required to make an additional monthly principal repayment of \$0.08 million (USD).
- If Zargon's North Dakota's monthly production is less than 240 barrels of oil per day or if Zargon's North Dakota properties EBITDA in a trailing 12 month period is less than \$1.25 million (USD), the lender may demand immediate payment of the loan, accrued interest, and any applicable make whole payment.

A four percent original issue discount on the \$3.50 million (USD) term debt is payable upon maturity. The principal balance will accrete up to the face amount which includes the four percent original issue discount of \$0.15 million (USD). A reconciliation of the principal and accretion is provided below:

(\$ thousands)	September 30, 2019	December 31, 2018
Principal, beginning of year (\$Cdn)	4,802	–
Debt (\$Cdn)	–	4,777
Repayment (\$Cdn)	(298)	
Foreign exchange (\$Cdn)	(142)	–
Accretion of debt (\$Cdn)	91	25
Principal, end of period (\$Cdn)	4,453	4,802

7. CONVERTIBLE DEBENTURES

On November 21, 2018, Zargon announced the proposed transaction to settle its convertible debentures.

On January 10, 2019, Zargon announced that 82.64% of debentureholders voting at the extraordinary meeting of the debentureholders voted in favour of an extraordinary resolution pursuant to which all of the debentures were settled and all claims of the debentureholders were extinguished.

On January 11, 2019, Zargon announced that it had completed a transaction to settle its \$41.94 million principal amount of outstanding 8% convertible unsecured debentures due December 31, 2019 in exchange for Zargon common shares. Pursuant to the transaction, all of the Debentures were settled and all claims of the debentureholders were extinguished in exchange for an aggregate of 428.88 million common shares, including payment, in the form of common shares, of the accrued and unpaid interest owing on the Debentures from and including September 30, 2018 to but not including January 11, 2019, being the effective date of the completion of the transaction, in each case on the basis of a price of \$0.10 per common share. The deemed price of the 428.88 million common shares thus issued was \$0.04 per share, that being the applicable volume-weighted average trading price. This resulted in a gain of \$27.03 million. The \$41.94 million principal amount of outstanding 8% convertible unsecured debentures and the related equity component of convertible debentures was transferred to share capital (based on 428.88 million common shares at a price of \$0.04 per common share) and contributed surplus (based on a pro-rata calculation between the debt portion of the debenture and the equity portion of the debenture).

A reconciliation of the accounting treatment of the convertible debenture settlement is provided in the table below:

(\$ thousands)	September 30, 2019	December 31, 2018
Debt component, beginning of year	41,421	41,461
Common shares issued ⁽¹⁾ (Note 9)	(17,155)	–
Contributed surplus	(2,266)	–
Gain on convertible debenture	(27,028)	–
Accretion of convertible debentures	520	473
Accrued interest	938	–
Equity component	3,570	–
IFRS 9 adoption	–	(513)
Debt component, end of period	–	41,421

(\$ thousands)	September 30, 2019	December 31, 2018
Equity component, beginning of year	3,570	3,570
Settlement	(3,570)	–
Equity component, end of period	–	3,570

(1) Immediately before the transaction, 30.93 million common shares were issued and outstanding. Following the completion of the transaction, 459.81 million common shares are issued and outstanding.

8. REVENUE

The company derives its revenue from contracts with customers primarily through the transfer of commodities representing the following major product types:

(\$ thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Petroleum sales	8,099	10,020	25,152	29,891
Natural gas sales	95	151	522	830
Petroleum and natural gas sales	8,194	10,171	25,674	30,721

At September 30, 2019, receivables from contracts with customers, which are included in trade accounts receivable, were \$2.38 million (at September 30, 2018 – \$2.45 million).

The Company's custom fee revenues are included as an offset to operating expenses, and were \$0.31 million at September 30, 2019 (\$0.67 million as at September 30, 2018).

9. SHARE CAPITAL

The Share Consolidation was approved by shareholders at a meeting held on May 30, 2019. Effective May 30, 2019, the Company consolidated its issued and outstanding common shares (the "Pre-Consolidation Shares") on the basis of one new common share (the "Post-Consolidation Shares") for every twenty pre-consolidation shares held (the "Share Consolidation"). As a result of the Share Consolidation, the 459.81 million Pre-Consolidation Shares were consolidated to 22.99 million Post-Consolidation Shares. All references in the consolidated financial statements including amounts for the comparative period and the notes to the consolidated financial statements have been adjusted to reflect this share consolidation.

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

Common Shares

(thousands)	Nine Months Ended September 30, 2019	
	Number of Shares	Amount (\$)
Balance, as at December 31, 2018	30,902	262,735
Share awards exercised	31	–
Share issue costs	–	(88)
Settlement of convertible debenture (Note 7)	428,878	17,155
Share-based compensation transferred from contributed surplus on exercise of share awards	–	134
Balance, as at May 30, 2019 (Pre-Consolidation)	459,811	279,936
Balance, as at May, 2019 (Post-Consolidation)	22,991	279,936
Share awards exercised	3	–
Share-based compensation transferred from contributed surplus on exercise of share awards	–	334
Balance, as at September 30, 2019	22,994	280,270

10. SHARE-BASED PAYMENTS

As a result of the Share Consolidation on May 30, 2019, the outstanding stock options, share awards and weighted average number of common shares were similarly adjusted by the share consolidation ratio.

Stock Option Plan

On March 24, 2017, Zargon granted an aggregate of 1.34 million stock options to our directors, officers and certain employees at an exercise price of \$0.72 per share under the Plan. Of these, 0.32 million options were granted to our non-management directors, 0.54 million options were granted to our officers and the balance of 0.48 million stock options were granted to employees. One-third of the options vested on December 31, 2017, one-third will vest on December 31, 2018 and the balance will vest on December 31, 2019. Zargon uses a fair value methodology to value the stock options. The assumptions made for the stock options include a volatility factor of 64 percent, a risk free rate of one percent and a forfeiture rate of nil.

On May 30, 2017, the 2017 stock option plan was approved by a majority of the aggregate votes casted by shareholders at the 2017 Annual and Special General Meeting.

The following table summarizes information about the Company's stock options under the Stock Option Plan:

	Nine Months Ended September 30, 2019
	Number of Stock Options (thousands)
Outstanding, as at December 31, 2018	1,155
Share awards forfeited	–
Outstanding, as at May 30, 2019 (Pre-Consolidation)	1,155
Outstanding, as at May 30, 2019 (Post-Consolidation) ⁽¹⁾	58
Share awards forfeited	(1)
Outstanding, as at September 30, 2019	57
Stock options exercisable as at September 30, 2019	38

(1) As a result of the share consolidation, the exercise price was adjusted to \$14.40 per share under the Plan.

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:

	Nine Months Ended September 30, 2019
	Number of Share Awards (thousands)
Outstanding, as at December 31, 2018	268
Share awards granted	4
Share awards exercised	(31)
Share awards forfeited	–
Outstanding, as at May 30, 2019 (Pre-Consolidation)	241
Outstanding, as at May 30, 2019 (Post-Consolidation)	12
Share awards granted	–
Share awards exercised	(3)
Share awards forfeited	(1)
Outstanding, as at September 30, 2019	8
Share awards exercisable as at September 30, 2019	8

Share-based Compensation

The share awards for the three and nine months ended September 30, 2019, resulted in share-based compensation of \$0.01 million (2018 – \$0.02 million) and \$0.02 million (2018 – \$0.10 million), 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

(thousands of shares)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Weighted average number of common shares – basic	22,994	1,545	22,128	1,543
Weighted average number of common shares – diluted	22,994	1,545	22,128	1,544

Dilution amounts for the three and nine months ended September 30, 2019 of nil million shares (2018 – 0.01 million shares) and nil million shares (2018 – 0.02 million shares), respectively, 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.

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:

(thousands)	September 30, 2019		December 31, 2018	
	Carrying Value (\$)	Fair Value (\$)	Carrying Value (\$)	Fair Value (\$)
Amortized cost:				
Cash and cash equivalents	4,705	4,705	5,055	5,055
Trade and other receivables	2,601	2,601	866	866
Trade and other payables	6,397	6,397	5,989	5,989
Convertible debentures	–	–	41,421	13,627
Other liabilities:				
Debt (\$Cdn) ⁽¹⁾	4,453	4,530	4,802	4,974

(1) Amount is the full future face value of the \$3.50 million (USD) term debt plus an original issue discount of \$0.15 million (USD) less principal repayments to date of \$0.23 million (USD) in Canadian dollars.

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

- Level I

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

- Level II

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

- Level III

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

The Company's risk management contracts have been assessed on the fair value hierarchy described above and are classified as Level II. Assessment of the significance of a particular input into the fair value measurement requires judgement 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 financial instruments 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, 2019, 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. There are no derivative agreements outstanding as at September 30, 2019.

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

- 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 \$0.13 million (September 30, 2018 - \$0.21 million) increase or decrease in net earnings for the period ended September 30, 2019. 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, 2019, approximately 93 percent (December 31, 2018 – 77 percent) was owing from two companies and Zargon anticipates full collection.

The Company's allowance for doubtful accounts at September 30, 2019 was \$0.03 million (December 31, 2018 – nil).

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, 2019, \$0.03 million (December 31, 2018 - nil) 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 (see Note 2(e)).

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	6,397	–	6,397
Debt (\$Cdn)	4,530	–	4,530

Commodity Price Sensitivities

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

Fluctuations of 10 percent in commodity prices could have resulted in unrealized gains or losses for risk management contracts impacting net earnings of nil for the nine months ended September 30, 2019 (September 30, 2018 – nil).

12. DERIVATIVE CONTRACTS

The Company is a party to certain financial instruments that have fixed the price of a portion of its oil production. The Company enters into these contracts for risk management purposes only in order to protect a portion of its future cash flows from the volatility of oil and natural gas commodity prices and interest rates. For financial risk management contracts, any unrealized gains or losses are recorded in earnings based on the fair value (mark-to-market) of the contracts at each reporting period. The unrealized gain on the consolidated statement of earnings/(loss) and comprehensive income/(loss) for the three and nine month periods of 2019 were nil (2018 – \$0.54 million gain and \$1.15 million gain, respectively). The realized gain or loss on the consolidated statement of earnings/(loss) and comprehensive income/(loss) for the three and nine month periods of 2019 were nil (2018 – nil and \$2.41 million loss, respectively).

There are currently no derivative contracts outstanding.

13. COMMITMENTS AND CONTINGENCIES

In the normal course of operations, Zargon executes agreements that provide for indemnification and guarantees to counterparties in transactions such as the sale of assets and operating leases.

These indemnifications and guarantees may require compensation to counterparties for costs and losses incurred as a result of various events, including breaches of representations and warranties, loss of or damages to property, environmental liabilities or as a result of litigation that may be suffered by counterparties.

Certain indemnifications can extend for an unlimited period and generally do not provide for any limit on the maximum potential amount. The nature of substantially all of the indemnifications prevents the Company from making a reasonable estimate of the maximum potential amount that might be required to pay counterparties as the agreements do not specify a maximum amount, and the amounts depend on the outcome of future contingent events, the nature and likelihood of which cannot be determined at this time.

The Company indemnifies its directors and officers against any and all claims or losses reasonably incurred in the performance of their services to the Company to the extent permitted by law. The Company has acquired and maintains liability insurance for its directors and officers. The Company is party to various legal claims associated with the ordinary conduct of business. The Company does not anticipate that these claims will have a material impact on its financial position.

The Company is committed to future minimum payments for operating leases for office space and insurance financing. Payments required under these commitments are as follows:

(\$ thousands)	September 30, 2019
Less than one year	644
Between one and five years	69
	713

BOARD OF DIRECTORS

Craig H. Hansen
Calgary, Alberta

Kyle D. Kitagawa ⁽¹⁾
Calgary, Alberta

Glenn S. Koach
Los Angeles, California

Geoffrey C. Merritt ⁽¹⁾
Calgary, Alberta

Jim Peplinski ⁽²⁾
Calgary, Alberta

Ron Wigham ⁽¹⁾ ⁽²⁾
Calgary, Alberta

Grant A. Zawalsky ⁽²⁾
Calgary, Alberta

OFFICERS

Craig H. Hansen
President and Chief Executive Officer

Randolph J. Doetzel
Vice President, Operations

Christopher M. Hustad
Vice President, Development

William T. Cromb
Chief Financial Officer

(1) Audit and Reserves Committee

(2) Governance and Compensation Committee

STOCK EXCHANGE LISTING

Toronto Stock Exchange
Common Shares
Trading Symbol: ZAR

TRANSFER AGENT

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