ZARGON OIL & GAS LTD.

2020 Q2 FINANCIAL REPORT

FINANCIAL AND OPERATING HIGHLIGHTS

(unaudited)	Three Months Ended June 30, 2020	2019	Percent Change	Six Months Ended June 30, 2020	2019	Percent Change
Financial						
Income and Investments ($ millions)						
Petroleum and natural gas sales	**0.40**	9.17	(96)	**5.29**	17.48	(70)
Funds flow (used in)/from operating activities	**(1.88)**	2.17	(187)	**(3.11)**	3.39	(192)
Cash flows (used in)/from operating activities	**(1.08)**	2.79	(139)	**(1.13)**	1.85	(161)
Free cash flow	**(2.32)**	0.91	(355)	**(4.45)**	1.15	(487)
Net earnings/(loss)	**0.73**	(0.57)	228	**(33.79)**	24.51	(238)
Net capital expenditures	**0.20**	0.79	(75)	**0.65**	1.54	(58)
Asset retirement expenditures	**0.24**	0.47	(48)	**0.69**	0.70	(1)
Per Share, Basic						
Funds flow (used in)/from operating activities ($/share)	**(0.08)**	0.09	(189)	**(0.14)**	0.16	(188)
Cash flows (used in)/from operating activities ($/share)	**(0.05)**	0.12	(142)	**(0.05)**	0.09	(156)
Net earnings/(loss) ($/share)	**0.03**	(0.02)	250	**(1.47)**	1.13	(230)
Balance Sheet at Period End ($ millions)						
Property, plant and equipment				**47.34**	96.77	(51)
Total assets				**49.94**	105.73	(53)
Debt				**–**	4.71	(100)
Net debt				**3.85**	1.34	187
Shareholders' equity				**(11.86)**	28.62	(141)
Total Common Shares Outstanding at Period End (millions)				**22.99**	22.99	–
Operating						
Average Daily Production						
Oil and liquids (bbl/d)	**382**	1,539	(75)	**904**	1,557	(42)
Natural gas (mmcf/d)	**0.74**	1.51	(51)	**1.20**	1.45	(17)
Equivalent (boe/d)	**504**	1,790	(72)	**1,105**	1,799	(39)
Average Selling Price (before the impact of financial risk management contracts)						
Oil and liquids ($/bbl)	**8.16**	64.51	(87)	**29.58**	60.50	(51)
Natural gas ($/mcf)	**1.67**	1.04	61	**1.90**	1.63	17
Undeveloped Land at Period End (thousand net acres)				**25**	33	(24)

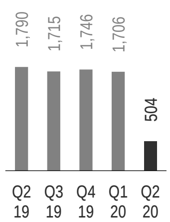
Throughout this report, the calculation of barrels of oil equivalent ("boe") is based on the conversion ratio that six thousand cubic feet of natural gas is equivalent to one barrel of oil. For a further discussion about this term, refer to the Management's Discussion and Analysis section in this report.

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.

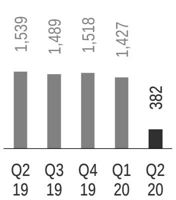
The debt amount is the full future face value of the $3.5 million (USD) term debt plus an original issue discount of $0.15 million (USD) less principal repayments in Canadian dollars. The debt was settled through the sale of its US subsidiaries on April 1, 2020.

Net debt is a non-GAAP measure that represents the debt face value of nil million (June 30, 2019 – $4.71 million plus the convertible debenture of $41.94 million (prior to the settlement on January 11, 2019)) and any working capital excluding unrealized assets/liabilities.

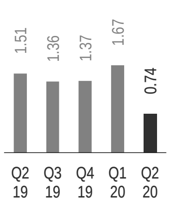
Production
(boe/d)



Oil and Liquids Production
(bbl/d)



Natural Gas Production
(mmcf/d)



Message to Shareholders (1)

Zargon Oil & Gas Ltd. has released its financial and operating results for the second quarter of 2020. Specific financial and operating highlights in the second quarter of 2020 include:

- The Company may be required to seek formal creditor protection in the very near term. There is material uncertainty surrounding the Company's ability to continue as a going concern that creates significant doubt as to the ability of the Company to meet its obligations as they come due. Therefore, the Company may be unable to realize it assets and discharge its liabilities in the normal course of business.
- On April 2, 2020, Zargon Oil & Gas Ltd. ("Zargon" or the "Company") announced that it had entered into an agreement to settle its $3.05 million (USD) term debt through the sale of its US subsidiaries for nominal proceeds and the release of the Company from its obligations under the loan agreement. The gain from the sale was $3.42 million.
- Funds flow from operating activities was a negative $1.88 million, compared to a negative $1.24 million recorded in the prior quarter. The decrease from the prior quarter was primarily due to lower production volumes and lower commodity prices.
- Second quarter 2020 production averaged 504 barrels of oil equivalent per day (382 barrels of oil per day and 0.74 million cubic feet of natural gas per day), a 70 percent decrease from the preceding quarter production rate of 1,706 barrels of oil equivalent per day. The reduction in production volumes from the prior quarter was primarily due to the sale of Willison Basin USA property and the shut in of Alberta operated properties in April, 2020 when Zargon shut in all producing Alberta operated properties as realized field oil prices declined to levels significantly below the variable costs of production. In July 2020, Zargon reactivated two Little Bow producers with a combined production of 120 barrels of oil equivalent per day. The timing of the reactivation of Zargon's remaining Alberta properties will depend on Zargon's ability to source, through refinancing and restructuring initiatives, sufficient working capital to fund the property restart operations including funding for electricity and other services.
- Second quarter 2020 field oil prices averaged $8.16 per barrel, 77 percent lower than the prior quarter price of $35.31 per barrel. The combination of lower oil prices and oil volumes resulted in a 92 percent reduction in second quarter 2020 revenues to $0.40 million, down from $4.89 million in the prior quarter. The corresponding second quarter 2020 field operating cash flow of a negative $1.57 million, which compares with the prior quarter's a negative $0.39 million.
- Second quarter 2020 field operating netbacks defined as sales (excluding hedges) less royalties and operating/transportation costs were a negative $34.14 per barrel of oil equivalent a significant decrease from the prior quarter field operating netback of a negative $2.52 per barrel of oil equivalent.
- Second quarter 2020 capital expenditures were $0.20 million, compared to the $0.45 million recorded in the prior quarter. During the 2020 second quarter, Zargon's capital program was primarily allocated to mineral and surface lease rentals. Consistent with the last few years, Zargon did not drill any of its proven undeveloped locations (Taber and Bellshill Lake) in the quarter.
- At June 30, 2020, the Company's combined debt net of working capital was $3.85 million, which compared to $4.89 million reported in the prior quarter. The improvement in net debt resulted from the settlement of the debt through the sale of its US subsidiaries.
- Zargon's second quarter 2020 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 it's assets and discharge its liabilities in the normal course of business. These statements have not been reviewed by the Company's auditors.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Management's discussion and analysis ("MD&A") is a review of Zargon Oil & Gas Ltd.'s 2020 second quarter financial results and should be read in conjunction with the unaudited interim consolidated financial statements and related notes for the three and six months ended June 30, 2020 and the audited consolidated financial statements and related notes for the year ended December 31, 2019. 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 the debt face value of nil million (December 31, 2019 – $4.15 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.*

The following are impacts of novel coronavirus ("COVID-19"):

- *During March 2020, the COVID-19 reached a global pandemic state. Measures taken by governments around the world to contain the spread of the virus, resulting in reduced demand for commodities, along with other products and services, which have led to a significant disruption of business operations and a significant increase in economic uncertainty. In addition, the Organization of Petroleum Exporting Countries ("OPEC") and non-OPEC members increased their daily crude oil production, resulting in increasing overall global supply. The combination of these events resulted in a significant decline in crude oil prices. In general, the oil and gas industry has reacted with reductions to capital and other spending, as well as production shut-ins, to try to manage through this price environment. The duration of the current commodity price volatility is uncertain.*

- *Zargon is dedicated to ensuring the health, safety and security of employees, contractors, partners and residents with all of its operating areas and communities. In response to the COVID-19 pandemic, the Company is focused to protect all of its stakeholders. Zargon established work from home and social distancing protocols in mid-March to ensure the health and well-being of employees.*

- *In response to the significant decline in commodity prices, the Company has to shut-in all production in April 2020 in order to preserve well economics, optimize pricing and reduce costs. In July 2020, Zargon reactivated two Little Bow producers and would resume some or all of remaining production if sufficient working capital becomes available.*

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

Forward-Looking Statements – This document offers our assessment of Zargon’s future plans and operations as at August 13, 2020, 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.

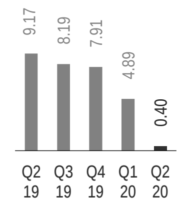
You are cautioned that the assumptions, including among other things, future oil and natural gas prices; future capital expenditure levels (including ASP); future production levels; future exchange rates; the cost of developing and expanding our assets; our ability to obtain equipment in a timely manner 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 August 13, 2020.

FINANCIAL & OPERATING RESULTS

Petroleum and Natural Gas Sales

Petroleum and Natural Gas Revenue
($ millions)

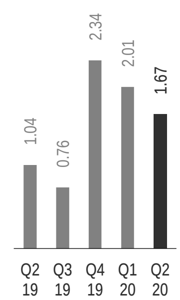


	Three Months Ended June 30,			Six Months Ended June 30,		
($ millions)	**2020**	2019	Percent Change	**2020**	2019	Percent Change
Petroleum sales	**0.28**	9.03	(97)	**4.87**	17.05	(71)
Natural gas sales	**0.12**	0.14	(14)	**0.42**	0.43	(2)
Petroleum and natural gas sales	**0.40**	9.17	(96)	**5.29**	17.48	(70)

Second quarter 2020 gross petroleum and natural gas sales of $0.40 million decreased 92 percent compared to $4.89 million in the preceding quarter and decreased 96 percent, compared to $9.17 million in the second quarter of 2019. The decrease from the prior quarter was due to lower commodity prices and reduced production volumes, primarily related to the USA property sales and the shut in of Alberta operated properties.

Second quarter 2020 realized oil and liquids field prices averaged $8.61 per barrel and were 77 percent lower than the $35.31 per barrel recorded in the prior quarter. The WTI-WCS differential narrowed during the second quarter of 2020 to $16.00 per barrel, compared to $27.53 per barrel in the prior quarter. Natural gas field prices received averaged $1.67 per thousand cubic feet in the second quarter of 2020, a 17 percent decrease from the preceding quarter but a 61 percent increase from the 2019 second quarter prices.

Natural Gas Prices
($/mcf)

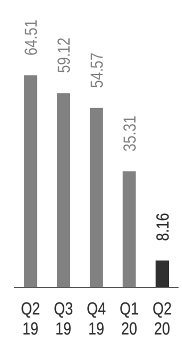


Pricing

	Three Months Ended June 30,			Six Months Ended June 30,		
Average for the period	**2020**	2019	Percent Change	**2020**	2019	Percent Change
Natural Gas:						
NYMEX average daily spot price ($US/mmbtu)	**1.71**	2.56	(33)	**1.81**	2.74	(34)
AECO average daily spot price ($Cdn/mmbtu)	**1.72**	1.05	64	**1.82**	1.40	30
Zargon realized field price ($Cdn/mcf)	**1.67**	1.04	61	**1.90**	1.63	17
Zargon realized natural gas field price differential ($Cdn/mcf)	**0.05**	0.01	400	**(0.08)**	(0.23)	65
Crude Oil:						
WTI ($US/bbl)	**27.85**	59.81	(53)	**37.01**	57.36	(35)
Edmonton par price ($Cdn/bbl)	**23.50**	74.09	(68)	**37.56**	70.25	(47)
Western Canadian Select (“WCS”) price ($Cdn/bbl)	**22.42**	65.75	(66)	**28.27**	61.20	(54)
Zargon realized field price ($Cdn/bbl)	**8.16**	64.51	(87)	**29.58**	60.50	(51)
Zargon realized oil field price differential to WCS [(1)]	**(14.26)**	(1.24)	(1050)	**1.31**	(0.70)	287
WTI ($Cdn/bbl) to WCS ($Cdn/bbl) differential	**16.00**	14.26	12	**21.76**	15.30	42

(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).

Oil and Liquids Prices
($/bbl)



Volumes

Oil and liquids production volumes during the 2020 second quarter were 382 barrels per day, a 73 percent decrease from the preceding quarter rate of 1,427 barrels per day due to the sale of Willison Basin USA property and the shut in of Alberta operated properties due to low crude oil prices. Natural gas production volumes in the 2020 second quarter of 0.74 million cubic feet per day decreased from 1.67 million cubic feet per day in the preceding quarter.

Production by Core Area

Three Months Ended June 30,		**2020**			2019	
	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	**89**	**0.41**	**157**	383	0.51	469
Alberta Plains South	**293**	**0.33**	**347**	780	1.00	945
Williston Basin	**–**	**–**	**–**	376	–	376
	382	**0.74**	**504**	1,539	1.51	1,790

Six Months Ended June 30,		**2020**			2019	
	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	**218**	**0.50**	**302**	377	0.55	468
Alberta Plains South	**513**	**0.70**	**630**	800	0.90	951
Williston Basin	**173**	**–**	**173**	380	–	380
	904	**1.20**	**1,105**	1,557	1.45	1,799

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 2020 and 2019 second quarter were nil. There are currently no derivative contracts outstanding.

The unrealized gain/loss on derivatives in the second quarter of 2020 and 2019 were nil. 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 13 and 14 to the unaudited interim consolidated financial statements.

Royalties

	Three Months Ended June 30,			**Six Months Ended June 30,**		
($ millions)	**2020**	2019	Percent Change	**2020**	2019	Percent Change
Royalties	**0.05**	1.26	(96)	**0.65**	2.17	(70)
Percentage of revenue	**12.1%**	13.7%		**12.3%**	12.4%	

Second quarter 2020 royalties of $0.05 million decreased 92 percent, compared to prior quarter and decreased 96 percent from the 2019 second quarter. The decrease was primarily due to lower production volumes and the significant decrease in crude oil prices. The variations in royalty rates generally track changes in production volumes and pricing. Second quarter of 2020 royalties were 12.1 percent of gross sales, compared to 12.3 percent in the prior quarter and 13.7 percent in the second quarter of 2019.

Operating Expenses and Transportation Expenses

	Three Months Ended June 30,			Six Months Ended June 30,		
($ millions)	**2020**	2019	Percent Change	**2020**	2019	Percent Change
Operating expenses	**1.87**	4.58	(59)	**6.44**	9.59	(33)
Transportation expenses	**0.05**	0.11	(55)	**0.16**	0.21	(24)
Total expenses	**1.92**	4.69	(59)	**6.60**	9.80	(33)
Total expenses ($/boe)	**41.71**	28.78	45	**32.79**	30.11	9

Second quarter 2020 operating expenses and transportation expenses of $1.92 million on a total dollar basis were lower, compared to $4.68 million recorded in the prior quarter and $4.69 million recorded in the second quarter of 2019. The significant decline in second quarter 2020 operating and transportation costs reflected the April shut-in of the Alberta operations.

Operating Netbacks

Three Months Ended June 30,	**2020**		2019	
	Oil and Liquids ($/bbl)	**Natural Gas ($/mcf)**	Oil and Liquids ($/bbl)	Natural Gas ($/mcf)
Sales	**8.16**	**1.67**	64.51	1.04
Royalties	**(1.09)**	**(0.15)**	(9.03)	0.03
Operating expenses	**(49.37)**	**(3.20)**	(27.32)	(5.51)
Transportation expenses	**(1.38)**	**–**	(0.76)	–
Operating netbacks	**(43.68)**	**(1.68)**	27.40	(4.44)

Six Months Ended June 30,	**2020**		2019	
	Oil and Liquids ($/bbl)	**Natural Gas ($/mcf)**	Oil and Liquids ($/bbl)	Natural Gas ($/mcf)
Sales	**29.58**	**1.90**	60.50	1.63
Royalties	**(3.97)**	**0.03**	(7.75)	0.05
Operating expenses	**(32.25)**	**(4.39)**	(28.11)	(6.37)
Transportation expenses	**(0.96)**	**–**	(0.75)	–
Operating netbacks	**(8.60)**	**(2.46)**	23.89	(4.69)

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

	Three Months Ended June 30,			Six Months Ended June 30,		
($ millions)	**2020**	2019	Percent Change	**2020**	2019	Percent Change
G&A expenses	**0.45**	0.79	(43)	**1.14**	1.66	(31)
G&A expenses ($/boe)	**9.69**	4.85	100	**5.65**	5.09	11

G&A expenses of $0.45 million and $9.69 per barrel of oil equivalent in the second quarter of 2020 were lower than the $0.69 million and $0.79 million reported in the prior quarter and the second quarter of 2019, respectively. The decrease in the second quarter of 2020 compared to prior quarter reflected the ongoing G&A cost containment initiatives and the Canadian Emergency Wage Subsidy (CEWS) grants received.

Transaction Costs

Transaction costs for the 2020 second quarter of $0.02 million were recovered, compared to $0.02 million in the prior quarter and $0.02 million in the second quarter of 2019 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 commence on July 1, 2019 at $0.05 million (USD) per month and on October 1, 2019 principal repayments will be $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 April 2, 2020, Zargon Oil & Gas Ltd. ("Zargon" or the "Company") announced that it had entered into an agreement to settle its $3.05 million (USD) term debt through the sale of its US subsidiaries for nominal proceeds and the release of the Company from its obligations under the loan agreement.

Interest and financing charges were $0.01 million in the 2020 second quarter compares to $0.13 million in the prior quarter and $0.14 million in the second quarter of 2019.

Interest on Convertible Debentures

On January 11, 2019, Zargon announced the completion of a transaction to settle its $41.94 million Convertible Debentures and recorded $0.10 million of interest in the first quarter of 2019. 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 2020 and 2019 second quarter were nil. For more details, please refer to Note 8 of the interim consolidated financial statements.

Current Tax

The current tax expense for the 2020 second quarter was nil, compared to nil expense in the prior quarter and $0.10 million in the second quarter of 2019 which related to the US operations. Total corporate tax pools as at June 30, 2020 was approximately $174 million, comparable to the $177 million of tax pools available to Zargon at December 31, 2019.

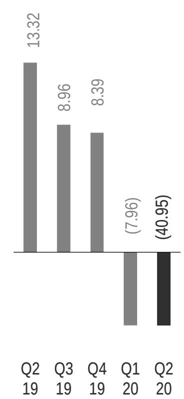
Estimated Tax Pools

($ millions)	June 30, 2020
Canadian oil and natural gas property expenses	1
Canadian development expenses	6
Canadian exploration expenses	5
Capital cost allowance	12
Non-capital losses	147
US tax pools	1
Other	2
Estimated tax pools	174

Corporate Netbacks

	Three Months Ended June 30,		Six Months Ended June 30,	
($/boe)	**2020**	2019	**2020**	2019
Petroleum and natural gas sales	**8.61**	56.33	**26.29**	53.68
Royalties	**(1.04)**	(7.73)	**(3.23)**	(6.66)
Other income	**2.62**	–	**0.60**	–
Operating expenses	**(40.66)**	(28.12)	**(32.00)**	(29.46)
Transportation expenses	**(1.05)**	(0.66)	**(0.79)**	(0.65)
Operating netbacks	**(31.52)**	19.82	**(9.13)**	16.91
General and administrative expenses	**(9.69)**	(4.85)	**(5.65)**	(5.09)
Transaction costs	**0.45**	(0.16)	**–**	(0.22)
Interest and financing charges	**(0.19)**	(0.87)	**(0.69)**	(0.87)
Current tax expense	**–**	(0.62)	**(0.01)**	(0.31)
Funds flow netbacks	**(40.95)**	13.32	**(15.48)**	10.42

Funds Flow Netbacks
($/boe)



Depletion and Depreciation Expense

Depletion and depreciation expense for the second quarter of 2020 decreased 78 percent at $0.47 million, compared to $2.17 million in the second quarter of 2019. The decrease was primarily due to the sale of US subsidiaries and lower production volumes. On a per barrel of oil equivalent basis, the depletion and depreciation rates were $10.14 and $13.32 for the second quarter of 2020 and 2019, respectively. The 2019 calendar year depletion and depreciation rate was $13.59 per barrel of oil equivalent.

Accretion of Asset Retirement Obligations, Debt and Convertible Debentures

The accretion expense of asset retirement obligations for the second quarter of 2020 was $0.23 million, compared to $0.36 million in the second quarter of 2019, primarily due to the sale of US subsidiaries. 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) or $4.71 million Canadian dollars. Accretion on the term debt for the second quarter of 2020 was nil, compared to $0.04 million in the prior quarter and $0.04 million for the second quarter of 2019.

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 were nil for the second quarter of 2020 and 2019. For more information on Zargon's convertible debentures and this transaction, please refer to Note 8 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 8 of the interim consolidated financial statements.

Shared-based Compensation

Expensing of share-based compensation in the second quarter of 2020 was nil, compared to $0.01 million incurred in the second quarter of 2019.

Unrealized Foreign Exchange

The Company had an unrealized foreign exchange loss of $0.07 million during the second quarter of 2020, compared to a gain of $0.06 million in the 2019 second quarter. Gains and losses result from transactions in US dollars when they are translated into Canadian dollars. The volatility in the US/Cdn dollar creates non-cash translation gains/losses.

Gain on Sale of US Subsidiaries

During the second quarter of 2020, Zargon recorded a $3.36 million gain on the sale of its US subsidiaries to settle its $3.05 million (USD) term debt.

Impairment Loss on Property, Plant and Equipment

As at June 30, 2020, the Company determined that there were no indicators of impairment nor impairment reversals.

As at March 31, 2020, the Company determined that indicators of impairment existed due to the COVID-19 pandemic and its impact on global commodity demand and extreme volatility in commodity prices. As a result, the Company tested its CGUs, as defined under IFRS, for impairment. Exceptionally low forecasted future commodity prices resulted in impairment of three CGUs, Alberta Plains North, Alberta Plains South and Williston Basin USA.

The recoverable amount of the CGUs was estimated based on their fair value less costs of disposal. The estimate of fair value less costs of disposal was determined using an after-tax discount rate of 10 percent and forecasted cash flows. The forecasted cash flows are prepared over the estimated life of the reserves in the CGUs. The prices used to estimate the fair value less costs of disposal are those used by McDaniel and Associates Consultants Ltd., our independent reserve engineers.

Based on the assessment on March 31, 2020, the carrying amounts of the three CGUs were determined to be $33.34 million higher than their recoverable amount, and an impairment loss was recognized. The impairment specifically related to Alberta Plains North ($3.85 million), Alberta Plains South ($20.95 million) and Williston Basin USA ($8.54 million). The carrying amounts after impairment were $14.90 million, $30.26 million, and $14.53 million for the Alberta Plains North, Alberta Plains South, and Williston Basin USA CGUs, respectively. No impairment losses from prior years were reversed in 2019.

Deferred Tax

The deferred tax expense for the second quarter of 2020 was nil, compared to $0.22 million in the second quarter of 2019. The deferred tax expense and recovery were related to the US operations. The deferred tax recovery of $2.92 million in the first quarter of 2020 was primarily due to the $8.54 million impairment loss in the Williston Basin USA.

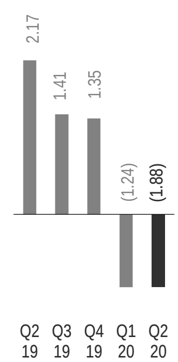
Funds Flow from Operating Activities

Funds flow from operating activities in the 2020 second quarter was a negative $1.88 million, compared to a negative $1.24 million and $2.17 million reported in the prior quarter and the second quarter of 2019, respectively. The increase in funds flow compared to the prior quarter was primarily a result of lower operating expenses, which is partially offset by lower commodity prices and lower production volumes.

Details of the changes in funds flow from operating activities during 2020 and 2019 are as follows:

	2020		2019		
($ millions)	**Q2**	Q1	Q4	Q3	Q2
Funds flow (used in)/from operating activities, prior quarter	**(1.24)**	1.35	1.41	2.17	1.23
Variances from prior quarter:					
Revenue and royalties:					
Volume	**(3.44)**	(0.27)	0.15	(0.29)	0.01
Price	**(1.05)**	(2.76)	(0.43)	(0.69)	0.86
Royalties	**0.55**	0.42	0.10	0.13	(0.35)
Expenses:					
Operating and transportation	**2.77**	0.12	(0.05)	(0.06)	0.33
General and administrative	**0.23**	(0.12)	0.05	0.17	0.08
Transaction costs	**0.06**	(0.01)	0.02	(0.02)	0.01
Exploration and evaluation	**–**	–	0.05	(0.05)	–
Interest and financing	**0.12**	–	0.01	0.01	0.10
Current taxes	**–**	0.03	0.04	0.04	(0.10)
Other	**0.12**	–	–	–	–
Funds flow (used in)/from operating activities for the quarter	**(1.88)**	(1.24)	1.35	1.41	2.17

Funds Flow from Operating Activities
($ millions)



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 2020 second quarter was a negative $2.32 million, compared to a negative $2.13 million in the prior quarter and a positive $0.91 million in the second quarter of 2019. This decrease from the prior quarter was a result of lower commodity pricing, reductions in production volumes that were partially offset by lower operating costs and general and administrative expenditures and disciplined capital and abandonment and reclamation spending.

Net Earnings/(Loss)

A net earnings of $0.73 million for the 2020 second quarter was $1.30 million higher than the $0.57 million net loss in the 2019 second quarter, primarily due to the gain on the sale of US subsidiaries. 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 basic share basis, the second quarter 2020 net earnings was $0.03, compared to a net loss of $0.02 for the 2019 second quarter.

Capital Expenditures

($ millions)	Three Months Ended June 30, 2020	2019	Six Months Ended June 30, 2020	2019
Undeveloped land	**0.16**	0.22	**0.44**	0.43
Geological and geophysical (seismic)	**0.05**	0.08	**0.06**	0.08
Drilling and completion of wells	**0.01**	0.01	**0.02**	0.16
Well equipment and facilities	–	0.05	**(0.02)**	0.03
ASP project and exploitation costs	**0.04**	0.12	**0.08**	0.31
ASP chemical costs	**(0.06)**	0.29	**0.07**	0.51
Exploration and development	**0.20**	0.77	**0.65**	1.52
Property acquisitions	**–**	–	**–**	–
Property dispositions	**–**	–	**–**	–
Net property dispositions	**–**	–	**–**	–
Total net capital expenditures excluding administrative assets	**0.20**	0.77	**0.65**	1.52
Administrative assets	–	0.02	–	0.02
Total net capital expenditures	**0.20**	0.79	**0.65**	1.54

LIQUIDITY AND CAPITAL RESOURCES

The ongoing COVID-19 pandemic crisis and emergency actions taken by governments worldwide in response resulted in volatility in financial and commodity markets, an overall slowdown in the global economy, a substantial decline in crude oil and natural gas demand, business closures and travel bans, as well as quarantine orders and social distancing. Zargon's business and operations are adversely affected by these impacts of the COVID-19 outbreak and a significant decline in commodity prices. The full extent of the risks and timing of the COVID-19 pandemic is continually evolving and is unknown at this time. Therefore, there is significant risks and uncertainty which may have a material and adverse effect on the Company's operations and financial results.

Total net capital expenditures (including net property dispositions) totalled $0.20 million in the second quarter of 2020 and were 75 percent lower than the same period in 2019, which reflects the Company's focus on reduced capital spending, specifically deferred workover programs. Field expenditures of $0.20 million for the second quarter of 2020 were 74 percent lower than the 2019 second quarter. The second quarter 2020 field capital expenditures (excluding net property dispositions) were allocated to Alberta Plains North – $0.05 million, Alberta Plains South – $0.15 million and included the drilling of nil net wells, unchanged from the second quarter of 2019.

Included in the Alberta Plains South capital recovery was the $0.02 million incurred on the Little Bow ASP project. Of the total ASP amount, $0.04 million was spent on project and exploitation costs while $0.06 million was recovered on chemical costs for the facility.

On November 2, 2018, Zargon entered into a financing agreement for $3.50 (USD) term debt. The loan is secured by all U.S. assets of Zargon. The loan bears interest at 11% and principal repayments commence on July 1, 2019 at $0.05 million (USD) per month and on October 1, 2019 principal repayments will be $0.8 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 June 30, 2020, the Company's combined debt net of working capital (excluding unrealized derivative assets/liabilities) was $3.85 million, which compares to $4.89 million in the prior quarter and $2.59 million of net debt at the end of December 31, 2019.

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.

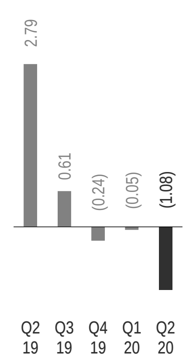
Zargon's operational results and financial condition, and, therefore, the funds available to be allocated to capital expenditures, are dependent on the prices received for oil and natural gas production.

The Company may be required to seek formal creditor protection in the very near term. There is material uncertainty surrounding the Company's ability to continue as a going concern that creates significant doubt as to the ability of the Company to meet its obligations as they come due. Therefore, the Company may be unable to realize it assets and discharge its liabilities in the normal course of business.

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. Substantially all of the Company's production is shut in, and revenue is currently very small. There is ongoing material uncertainty that casts significant 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. In addition, the full extent of the impact of COVID-19 pandemic is currently unknown at this time and the Company's operations and future financial performance will depend on future developments which are uncertain and unpredictable, including the duration, spread of the COVID-19 virus and the severity of the virus. 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 months, production being recommenced on properties which are currently shut in, accessing additional capital, or other unforeseen events. 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.

For the quarter ended June 30, 2020, net capital expenditures totalled $0.20 million, which was $1.28 million higher than the cash flows from operating activities (after changes in non-cash working capital) of a negative $1.08 million. For the quarter ended June 30, 2019, net capital expenditures totalled $0.79 million, which was $2.00 million lower than the cash flows from operating activities (after changes in non-cash working capital) of $2.79 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.

Cash Flows from Operating Activities
($ millions)



At August 13, 2020, Zargon had 22.99 million common shares outstanding. Pursuant to the stock option plan and the share award plan, there are currently an additional 0.06 million stock options issued and outstanding.

Capital Sources and Uses

	Three Months Ended June 30,		Six Months Ended June 30,	
($ millions)	**2020**	2019	**2020**	2019
Funds flow from operating activities	**(1.88)**	2.17	**(3.11)**	3.39
Change in term debt	**–**	(0.12)	**0.20**	(0.18)
Change in cash	**1.35**	(1.83)	**1.67**	(0.05)
Issuance of common shares	**–**	–	**–**	(0.09)
Asset retirement costs	**(0.24)**	(0.47)	**(0.69)**	(0.70)
Changes in working capital and other	**0.97**	1.04	**2.58**	(0.83)
Total capital sources	**0.20**	0.79	**0.65**	1.54

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	2020	2021 to 2022	2023 to 2024	Thereafter
Head office lease	0.14	0.14	–	–	–
Insurance	0.08	0.08	–	–	–
Total	0.22	0.22	–	–	–

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 August 1, 2020, Zargon's LMR was 0.85. 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 2020 certificate requires that the Company disclose in the interim MD&A any changes in the Company's internal controls over financial reporting that occurred during the period that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting. The Company confirms that no such changes were made to the internal controls over financial reporting during the second quarter of 2020.

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

During the second quarter end, Zargon has shut in all producing Alberta operated properties as realized field oil prices in April declined to levels significantly below the variable costs of production. In July 2020, Zargon reactivated two Little Bow producers with a combined production of 120 barrels of oil equivalent per day. The timing of the reactivation of Zargon's remaining Alberta properties will depend on Zargon's ability to source, through refinancing and restructuring initiatives, sufficient working capital to fund the restart operations including funding for electricity and other services. The Company may be required to seek formal creditor protection in the very near term. There is material uncertainty surrounding the Company's ability to continue as a going concern that creates significant doubt as to the ability of the Company to meet its obligations as they come due.

SUMMARY OF QUARTERLY RESULTS

	2020	
	Q1	**Q2**
Petroleum and natural gas sales ($ millions)	4.89	**0.40**
Net earnings/(loss) ($ millions)	(34.52)	**0.73**
Net earnings/(loss) per basic share ($/share)	(1.50)	**0.03**
Funds flow used in operating activities ($ millions)	(1.24)	**(1.88)**
Funds flow used in operating activities per basic share ($)	(0.05)	**(0.08)**
Cash flows used in operating activities ($ millions)	(0.05)	**(1.08)**
Cash flows used in operating activities per basic share ($)	–	**(0.05)**
Free cash flow ($ millions)	(2.13)	**(2.32)**
Net capital expenditures ($ millions)	0.45	**0.20**
Asset retirement expenditures	0.44	**0.24**
Total assets ($ millions)	65.45	**49.94**
Debt (1)	4.32	**–**
Net debt	4.89	**3.85**
Average daily oil and liquids production (bbl)	1,427	**382**
Average daily natural gas production (mmcf)	1.67	**0.74**
Average daily production (boe)	1,706	**504**
Average oil production weighting (%)	84	**76**
Average realized commodity field price before the impact of financial risk management contracts ($/boe)	31.51	**8.61**
Funds flow netback ($/boe)	(7.96)	**(40.95)**

(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. The debt was settled through the sale of its US subsidiaries on April 1, 2020.

	2019			
	Q1	Q2	Q3	Q4
Petroleum and natural gas sales ($ millions)	8.31	9.17	8.19	7.91
Net earnings/(loss) ($ millions)	25.08	(0.57)	(0.91)	(1.05)
Net earnings/(loss) per basic share ($/share)	1.23	(0.02)	(0.04)	(0.05)
Funds flow from operating activities ($ millions)	1.23	2.17	1.41	1.35
Funds flow from operating activities per basic share ($)	0.06	0.09	0.06	0.06
Cash flows (used in)/from operating activities ($ millions)	(0.93)	2.79	0.61	(0.24)
Cash flows (used in)/from operating activities per basic share ($)	(0.05)	0.12	0.03	(0.01)
Free cash flow ($ millions)	0.26	0.91	(0.75)	(0.44)
Net capital expenditures ($ millions)	0.75	0.79	1.21	0.65
Asset retirement expenditures	0.22	0.47	0.95	1.14
Total assets ($ millions)	106.61	105.73	104.27	101.44
Debt (1)	4.87	4.71	4.53	4.15
Net debt	2.26	1.34	2.09	2.59
Average daily oil and liquids production (bbl)	1,576	1,539	1,489	1,518
Average daily natural gas production (mmcf)	1.39	1.51	1.36	1.37
Average daily production (boe)	1,808	1,790	1,715	1,746
Average oil production weighting (%)	87	86	87	87
Average realized commodity field price before the impact of financial risk management contracts ($/boe)	51.04	56.33	51.93	49.28
Funds flow netback ($/boe)	7.53	13.32	8.96	8.39

(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 ($/share)	(0.14)	(0.05)	(0.02)	(0.93)
Funds flow (used in)/from operating activities ($ millions)	(0.30)	0.58	1.93	(2.74)
Funds flow (used in)/from operating activities per diluted share ($)	(0.01)	0.02	0.06	(0.09)
Cash flows (used in)/from operating activities ($ millions)	0.80	1.98	0.85	(2.41)
Cash flows (used in)/from operating activities per diluted share ($)	0.03	0.06	0.03	(0.08)
Free cash flow ($ millions)	(2.41)	(0.85)	0.76	(4.27)
Net capital expenditures ($ millions)	1.50	1.19	0.93	0.68
Asset retirement expenditures	0.61	0.24	0.24	0.85
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.

Additional information regarding the Company and its business operations, including the Company's Annual Information Form for December 31, 2019, is available on the Company's SEDAR profile at www.sedar.com.

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

Calgary, Alberta
August 13, 2020

NOTICE TO READERS

The accompanying unaudited consolidated interim condensed financial statements have not been reviewed by the Company's auditors.

CONSOLIDATED BALANCE SHEETS

(unaudited)

($ thousands)	Notes	**June 30, 2020**	December 31, 2019
ASSETS			
Cash and cash equivalents		**1,322**	2,991
Trade and other receivables		**343**	2,412
Deposits and prepaid expenses		**934**	1,871
Total current assets		**2,599**	7,274
Long term deposits		**5**	8
Property, plant and equipment, net	4	**47,336**	94,156
Total assets		**49,940**	101,438
LIABILITIES			
Trade and other payables		**6,450**	5,715
Debt	7	**–**	4,117
Total current liabilities		**6,450**	9,832
Debt	7	**81**	94
Convertible debentures	8	**–**	–
Asset retirement obligations	5	**55,268**	61,346
Deferred tax liabilities		**–**	3,562
Total liabilities		**61,799**	74,834
Commitments and contingencies	5,7,12,13,14,15		
EQUITY			
Shareholders' capital	11	**280,270**	280,270
Accumulated other comprehensive income		**–**	4,669
Contributed surplus	8,12	**11,120**	11,120
Deficit		**(303,249)**	(269,455)
Total equity		**(11,859)**	26,604
Total equity and liabilities		**49,940**	101,438

Going concern (see Note 2(a)).

See accompanying notes to the interim consolidated financial statements.

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

(unaudited)		Three Months Ended June 30,		Six Months Ended June 30,	
($ thousands, except per share amounts)	Notes	**2020**	2019	**2020**	2019
Petroleum and natural gas sales	10	**396**	9,175	**5,287**	17,480
Royalties		**(48)**	(1,260)	**(650)**	(2,170)
PETROLEUM AND NATURAL GAS REVENUE, NET OF ROYALTIES		**348**	7,915	**4,637**	15,310
Other income		**120**	–	**120**	–
TOTAL INCOME		**468**	7,915	**4,757**	15,310
Operating		**1,865**	4,580	**6,435**	9,593
Transportation		**49**	107	**159**	211
General and administrative		**445**	791	**1,137**	1,657
Transaction costs		**(21)**	25	**–**	71
Gain on convertible debentures	8	**–**	–	**–**	(27,028)
Gain on sale of US subsidiaries	9	**(3,363)**	–	**(3,363)**	–
Share-based compensation	12	**–**	10	**–**	17
Unrealized foreign exchange gain		**69**	(56)	**501**	(42)
Impairment loss on property, plant and equipment	4,6	**–**	–	**33,336**	–
Depletion and depreciation	4	**466**	2,169	**2,606**	4,405
EXPENSES		**(490)**	7,626	**40,811**	(11,116)
(LOSS)/EARNINGS BEFORE FINANCE EXPENSES AND INCOME TAXES		**958**	289	**(36,054)**	26,426
Interest and financing charges	7	**8**	143	**136**	284
Interest on convertible debentures	8	**–**	–	**–**	101
Accretion of debt	7	**–**	40	**35**	79
Accretion on convertible debentures	8	**–**	–	**–**	520
Accretion of asset retirement obligations	5	**225**	355	**484**	710
FINANCE EXPENSES		**233**	538	**655**	1,694
(LOSS)/EARNINGS BEFORE INCOME TAXES		**725**	(249)	**(36,709)**	24,732
Current tax expense		**–**	100	**3**	100
Deferred tax (recovery)/expense		**–**	224	**(2,918)**	127
INCOME TAXES (RECOVERY)/EXPENSE		**–**	324	**(2,915)**	227
NET (LOSS)/EARNINGS FOR THE PERIOD		**725**	(573)	**(33,794)**	24,505
Currency translation adjustment recognized in other comprehensive loss		**(5,093)**	(162)	**(4,669)**	(323)
OTHER COMPREHENSIVE LOSS FOR THE PERIOD		**(5,093)**	(162)	**(4,669)**	(323)
TOTAL COMPREHENSIVE (LOSS)/INCOME FOR THE PERIOD		**(4,368)**	(735)	**(38,463)**	24,182
NET (LOSS)/EARNINGS PER SHARE					
Basic		**0.03**	(0.02)	**(1.47)**	1.13
Diluted		**0.03**	(0.02)	**(1.47)**	1.13

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, 2019		**280,270**	**4,669**	**11,120**	**–**	**(269,455)**	**26,604**
Net earnings for the period		**–**	**–**	**–**	**–**	**(33,794)**	**(33,794)**
Translation differences on foreign subsidiary		**–**	**(4,669)**	**–**	**–**	**–**	**(4,669)**
Balance at June 30, 2019		**280,270**	**–**	**11,120**	**–**	**(303,249)**	**(11,859)**
Balance at December 31, 2018		262,735	5,062	9,288	3,570	(291,998)	(11,343)
Net loss for the period		–	–	–	–	24,505	24,505
Share issue costs	11	(88)	–	–	–	–	(88)
Share-based compensation	12	–	–	17	–	–	17
Exercise of share awards	11	468	–	(468)	–	–	–
Convertible debenture settlement	8	17,155	–	2,266	–	–	19,421
Equity component of convertible debentures	8	–	–	–	(3,570)	–	(3,570)
Translation differences on foreign subsidiary		–	(323)	–	–	–	(323)
Balance at June 30, 2019		280,270	4,739	11,103	–	(267,493)	28,619

See accompanying notes to the interim consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)		Three Months Ended June 30,		Six Months Ended June 30,	
($ thousands)	Notes	**2020**	2019	**2020**	2019
OPERATING ACTIVITIES					
Net (loss)/earnings for the period		**725**	(573)	**(33,794)**	24,505
Adjustments for non-cash items:					
Gain on convertible debenture	8	**–**	–	**–**	(27,028)
Gain on sale of US subsidiaries	9	**(3,363)**	–	**(3,363)**	–
Depletion and depreciation	4	**466**	2,169	**2,606**	4,405
Interest on convertible debentures (non-cash)	8	**–**	–	**–**	101
Accretion of asset retirement obligations	5	**225**	355	**484**	710
Accretion of debt	7	**–**	40	**35**	79
Accretion of convertible debentures	8	**–**	–	**–**	520
Share-based compensation	12	**–**	10	**–**	17
Unrealized foreign exchange gain		**69**	(56)	**501**	(42)
Impairment loss on property, plant and equipment		**–**	**–**	**33,336**	**–**
Deferred tax expense/(recovery)		**–**	224	**(2,918)**	127
Funds flow (used in)/from operating activities		**(1,878)**	2,169	**(3,113)**	3,394
Asset retirement expenditures	5	**(244)**	(473)	**(687)**	(695)
Changes in operating working capital		**1,044**	1,091	**2,675**	(845)
Net cash (used in)/from operating activities		**(1,078)**	2,787	**(1,125)**	1,854
INVESTING ACTIVITIES					
Additions to property, plant and equipment	4	**(205)**	(791)	**(652)**	(1,537)
Proceeds from disposal of property, plant and equipment		**–**	–	**–**	–
Change in long-term deposits		**3**	12	**3**	12
Changes in investing working capital		**(70)**	(56)	**(98)**	(107)
Net cash used in investing activities		**(272)**	(835)	**(747)**	(1,632)
FINANCING ACTIVITIES					
Repayment of debt	7	**–**	(5)	**(213)**	(65)
Share issue costs on settlement of convertible debentures	8	**–**	–	**–**	(88)
Changes in financing working capital		**–**	(119)	**416**	(18)
Net cash from/(used in) financing activities		**–**	(124)	**203**	(171)
NET CHANGE IN CASH DURING THE PERIOD		**(1,350)**	1,828	**(1,669)**	51
CASH, BEGINNING OF PERIOD		**2,672**	3,278	**2,991**	5,055
CASH, END OF PERIOD		**1,322**	5,106	**1,322**	5,106

See accompanying notes to the interim consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the three and six months ended June 30, 2020, with comparative figures for 2019 (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 June 30, 2020 and its 2019 comparative periods are comprised of the Company and its wholly owned subsidiaries. The Company was engaged in the exploration, development and production of oil and natural gas in Canada 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) Going Concern:

The Company may be required to seek formal creditor protection in the very near term. There is material uncertainty surrounding the Company's ability to continue as a going concern that creates significant doubt as to the ability of the Company to meet its obligations as they come due. Therefore, the Company may be unable to realize it assets and discharge its liabilities in the normal course of business.

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. Substantially all of the Company's production is shut in, and revenue is currently very small. There is ongoing material uncertainty that casts significant 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. In addition, the full extent of the impact of COVID-19 pandemic is currently unknown at this time and the Company's operations and future financial performance will depend on future developments which are uncertain and unpredictable, including the duration, spread of the COVID-19 virus and the severity of the virus. 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 months, production being recommenced on properties which are currently shut in, accessing additional capital, or other unforeseen events. 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.

(b) Statement of compliance:

The unaudited interim consolidated financial statements for the three and six month periods ended June 30, 2020 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, 2019 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 six month periods ended June 30, 2020 should be read in conjunction with the annual consolidated financial statements for the year ended December 31, 2019. These consolidated financial statements were approved and authorized for issue by the Board of Directors on August 13, 2020.

(c) 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.

(d) 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.

(e) 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

There were no new accounting standards adopted in the second quarter of 2020 that are expected to have a material impact on the Company's interim consolidated financial statements. There have been no material changes to Zargon's accounting policies and estimates, except for the impact of significant uncertainties created by the COVID-19 pandemic:

- During March 2020, the COVID-19 reached a global pandemic state. Measures taken by governments around the world to contain the spread of the virus, resulting in reduced demand for commodities, along with other products and services, which have led to a significant disruption of business operations and a significant increase in economic uncertainty. In addition, the Organization of Petroleum Exporting Countries ("OPEC") and non-OPEC members increased their daily crude oil production, resulting in increasing overall global supply. The combination of these events resulted in a significant decline in crude oil prices. In general, the oil and gas industry has reacted with reductions to capital and other spending, as well as production shut-ins, to try to manage through this price environment. The duration of the current commodity price volatility is uncertain.
- The outbreak presents uncertainty and risk with respect to the Company, its performance, and assumptions used by Management in the preparation of its financial results. The Company will continue to assess the situation in determining the impact of the significant uncertainties created by these events and conditions on the carrying amounts of assets and liabilities in the interim financial statements.
- Government grants are recognized when there is reasonable assurance that the grant will be received and all conditions associated with the grant are met. Zargon recorded government grants in response to the impact of COVID-19 as a reduction in expenses that the grant was intended to compensate the Company.

4. PROPERTY, PLANT AND EQUIPMENT

($ thousands)	
Cost, December 31, 2019	**281,155**
Accumulated depletion and depreciation	**(186,999)**
Net carrying amount, December 31, 2019	**94,156**
Additions	**652**
Sale of US subsidiaries	**(14,601)**
Change in asset retirement obligation	**2,016**
Impairment loss on property, plant and equipment	**(33,336)**
Exchange differences	**1,055**
Depletion and depreciation	**(2,606)**
Net carrying amount, June 30, 2020	**47,336**
Cost, June 30, 2020	**212,985**
Accumulated depletion and depreciation	**(165,649)**
Net carrying amount, June 30, 2020	**47,336**

5. ASSET RETIREMENT OBLIGATIONS

($ thousands)	
Balance at December 31, 2019	**61,346**
Asset retirement obligation related to sale of US subsidiaries	**(8,618)**
Foreign exchange and other	**727**
Asset retirement expenditures	**(687)**
Revisions to estimated asset retirement obligations	**2,016**
Accretion	**484**
Balance at June 30, 2020	**55,268**

The asset retirement obligations were calculated using a discount factor of 1.50 percent (December 31, 2019 – 1.70 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 1.50 percent per annum (December 31, 2018 – 1.50 percent) used in the calculation of the present value of the asset retirement obligation remains unchanged.

6. IMPAIRMENT LOSS ON PROPERTY, PLANT AND EQUIPMENT

As at June 30, 2020, the Company determined that there were no indicators of impairment nor impairment reversals.

As at March 31, 2020, the Company determined that indicators of impairment existed due to the COVID-19 pandemic and its impact on global commodity demand and extreme volatility in commodity prices. As a result, the Company tested its CGUs, as defined under IFRS, for impairment. Exceptionally low forecasted future commodity prices resulted in impairment of three CGUs, Alberta Plains North, Alberta Plains South and Williston Basin USA.

The recoverable amount of the CGUs was estimated based on their fair value less costs of disposal. The estimate of fair value less costs of disposal was determined using an after-tax discount rate of 10 percent and forecasted cash flows. The forecasted cash flows are prepared over the estimated life of the reserves in the CGUs. The prices used to estimate the fair value less costs of disposal are those used by McDaniel and Associates Consultants Ltd., our independent reserve engineers.

The following commodity price estimates were used to determine the recoverable amount:

Year	WTI Oil ($US/bbl) (1)	AECO Gas ($Cdn/mmbtu) (1)	$US/$Cdn Exchange Rates (1)
2020 (9 months)	32.50	1.85	0.700
2021	43.35	2.30	0.725
2022	52.02	2.44	0.750
2023	58.37	2.49	0.750
2024	59.53	2.54	0.750
2025	60.72	2.59	0.750
2026	61.94	2.65	0.750
2027	63.18	2.70	0.750
2028	64.44	2.75	0.750
2029	65.73	2.81	0.750
2030	67.04	2.86	0.750
2031	68.39	2.92	0.750
2032	69.75	2.98	0.750
2033	71.15	3.04	0.750
2034	72.57	3.10	0.750
Remainder (2)	2.0%	2.0%	0.750

(1) Source: McDaniel & Associates Consultants Ltd. price forecast effective April 1, 2020.

(2) Percentage change represents the change in each year after 2034 to the end of the reserve life.

Based on the assessment on March 31, 2020, the carrying amounts of the three CGUs were determined to be $33.34 million higher than their recoverable amount, and an impairment loss was recognized. The impairment specifically related to Alberta Plains North ($3.85 million), Alberta Plains South ($20.95 million) and Williston Basin USA ($8.54 million). The carrying amounts after impairment were $14.90 million, $30.26 million, and $14.53 million for the Alberta Plains North, Alberta Plains South, and Williston Basin USA CGUs, respectively. No impairment losses from prior years were reversed in 2019.

The above estimates are particularly sensitive in the following areas:

- A one percent increase in the discount rate used would have increased the impairment loss by $1.73 million.
- A five percent decrease in future planned cash flows would have increased the impairment loss by $2.98 million.

The estimated recoverable amount of the impaired CGUs is classified as a Level II fair value measurement. Refer to Note 13 for information on fair value hierarchy classifications.

7. DEBT

($ thousands)	**June 30, 2020**	December 31, 2019
Debt ($Cdn)	–	4,117
Lease liability	**81**	94
Total debt	**81**	4,211
Current ($Cdn)	–	4,117
Non-current	**81**	94

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 commence July 1, 2019 at $0.05 million (USD) per month until September 1, 2019 and beginning on October 1, 2019 principal repayments will be $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)	**June 30, 2020**	December 31, 2019
Principal, beginning of year ($Cdn)	**4,117**	4,802
Sale of US subsidiaries	**(4,321)**	–
Repayment ($Cdn)	**(213)**	(584)
Foreign exchange ($Cdn)	**382**	(234)
Accretion of debt ($Cdn)	**35**	133
Principal, end of period ($Cdn)	**–**	4,117

On April 2, 2020, Zargon Oil & Gas Ltd. ("Zargon" or the "Company") announced that it had entered into an agreement to settle its $3.05 million (USD) term debt through the sale of its US subsidiaries for nominal proceeds and the release of the Company from its obligations under the loan agreement.

8. 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 will be settled and all claims of the debentureholders will be 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)	**June 30, 2020**	December 31, 2019
Debt component, beginning of year	–	41,421
Common shares issued (1) (Note 11)	–	(17,155)
Contributed surplus	–	(2,266)
Gain on convertible debenture	–	(27,028)
Accretion of convertible debentures	–	520
Accrued interest	–	938
Equity component	–	3,570
Debt component, end of period	–	–
Equity component, beginning of year	–	3,570
Settlement	–	(3,570)
Equity component, end of period	–	–

(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.

9. GAIN ON SALE OF US SUBSIDIARIES

During the second quarter of 2020, Zargon recorded a $3.36 million gain on the sale of its US subsidiaries to settle its $3.05 million (USD) term debt.

10. REVENUE

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

	Three Months Ended June 30,		**Six Months Ended June 30,**	
($ thousands)	**2020**	2019	**2020**	2019
Petroleum sales	**284**	9,033	**4,870**	17,053
Natural gas sales	**112**	142	**417**	427
Petroleum and natural gas sales	**396**	9,175	**5,287**	17,480

At June 30, 2020, receivables from contracts with customers, which are included in trade accounts receivable, were $0.17 million (at June 30, 2019 – $2.06 million).

The Company's custom fee revenues are included as an offset to operating expenses, and were $0.13 million at June 30, 2020 ($0.21 million as at June 30, 2019).

11. 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)	Six Months Ended June 30, 2020 Number of Shares	Amount ($)
Balance, as at December 31, 2019	**22,994**	**280,270**
Share awards exercised	**–**	**–**
Share issue costs	**–**	**–**
Share-based compensation transferred from contributed surplus on exercise of share awards	**–**	**–**
Balance, as at June 30, 2020	**22,994**	**280,270**

12. 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:

	Six Months Ended June 30, 2020 Number of Stock Options (thousands)
Outstanding, as at December 31, 2019	**57**
Share awards forfeited	**–**
Outstanding, as at June 30, 2020	**57**
Stock options exercisable as at June 30, 2020	**57**

Share Award Plan

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

Due to the nature of the plan, Zargon is required to estimate the forfeiture rate upon initial calculation of fair values. The forfeiture rate is estimated at 13 percent while the interest rate and volatility is set at a historical rate as there is no exercise price. The fair value of the share award is determined on the grant date at the prior day closing price of the Company’s common shares on the Toronto Stock Exchange.

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

	Six Months Ended June 30, 2020
	Number of Share Awards (thousands)
Outstanding, as at December 31, 2019	**8**
Share awards granted	**–**
Share awards exercised	**–**
Share awards forfeited	**(8)**
Outstanding, as at June 30, 2020	**–**

Share-based Compensation

The share awards for the three and six months ended June 30, 2020, resulted in share-based compensation of nil million (2019 – $0.01 million) and nil million (2019 – $0.02 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

	Three Months Ended June 30,		Six Months Ended June 30,	
(thousands of shares)	**2020**	2019	**2020**	2019
Weighted average number of common shares – basic	**22,994**	22,992	**22,994**	21,688
Weighted average number of common shares – diluted	**22,994**	22,992	**22,994**	21,688

Dilution amounts for the three and six months ended June 30, 2020 and 2019 of nil million 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.

13. FINANCIAL INSTRUMENTS

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

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

	June 30, 2020		December 31, 2019	
(thousands)	**Carrying Value ($)**	**Fair Value ($)**	Carrying Value ($)	Fair Value ($)
Amortized cost:				
Cash and cash equivalents	**1,322**	**1,322**	2,991	2,991
Trade and other receivables	**343**	**343**	2,412	2,412
Trade and other payables	**6,450**	**6,450**	5,715	5,715
Other liabilities:				
Debt ($Cdn) (1)	**–**	**–**	4,117	4,150

(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 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 June 30, 2020, 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 June 30, 2020.

  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. In order to mitigate the Company's exposure to foreign exchange fluctuations, the Company may enter into foreign exchange derivative agreements.

- Credit Risk

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

The maximum credit risk exposure associated with accounts receivable and derivative assets is the total carrying value. The Company monitors these balances monthly to limit the risk associated with collection. Of Zargon's accounts receivable at June 30, 2020, approximately 100 percent (December 31, 2019 – 88 percent) was owing from two companies and Zargon anticipates full collection.

The Company's allowance for doubtful accounts at June 30, 2020 was $0.03 million (December 31, 2019 – $0.04 million). During 2019, the Company did not record any additional provision for non-collectible accounts receivable.

When determining whether amounts that are past due are collectible, management assesses the credit worthiness and past payment history of the counterparty, as well as the nature of the past due amount. Zargon considers all material amounts greater than 90 days to be past due. As at June 30, 2020, $0.03 million (December 31, 2019 - $0.04 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 (see Note 2(a)).

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	**6,450**	**–**	**6,450**
Debt ($Cdn)	**–**	**–**	**–**

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 six months ended June 30, 2020 (June 30, 2019 – nil).

14. 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 six month periods of 2020 and 2019 were nil. The realized gain or loss on the consolidated statement of earnings/(loss) and comprehensive income/(loss) for the three and six month periods of 2020 and 2019 were nil.

There are currently no derivative contracts outstanding.

15. 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)	June 30, 2020
Less than one year	212
Between one and five years	3
	215

CORPORATE INFORMATION

BOARD OF DIRECTORS

Craig H. Hansen
Calgary, Alberta

Kyle D. Kitagawa (1)
Calgary, Alberta

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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