Zargon Oil & Gas Ltd. Provides 2013 First Quarter Results

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CALGARY, ALBERTA--(Marketwired - May 14, 2013) - Zargon Oil & Gas Ltd. ("Zargon" or the "Company") (TSX:ZAR) (TSX:ZAR.DB).

FINANCIAL AND OPERATING HIGHLIGHTS (THREE MONTHS ENDED MARCH 31, 2013)

- First quarter 2013 production averaged 5,113 barrels of oil and liquids per day, a one percent increase from the preceding quarter and first quarter 2013 natural gas production averaged 15.2 million cubic feet per day, a five percent decrease from the preceding quarter. Total production averaged 7,648 barrels of oil equivalent per day, a one percent decrease from the preceding quarter. During the quarter, oil and liquids production represented 67 percent of total production based on a 6:1 equivalent basis.

- Funds flow from operating activities of $13.9 million were 15 percent lower than the $16.4 million recorded in the prior quarter, and three percent higher than the $13.5 million reported in first quarter of 2012. Funds flow from operating activities for the 2013 first quarter included reductions of $0.9 million of asset retirement expenses.

- Three monthly cash dividends of $0.06 per common share were declared in the first quarter of 2013 for a total of $5.4 million ($4.8 million after accounting for the common shares issued under the Dividend Reinvestment Plan ("DRIP") in lieu of cash dividends). These cash dividends (net of the DRIP) were equivalent to a payout ratio of 34 percent of funds flow from operating activities.

- First quarter 2013 exploration and development capital expenditures (excluding property acquisitions and dispositions) were $19.3 million and included $5.0 million of expenditures related to the Little Bow ASP tertiary oil recovery project. In the quarter, Zargon drilled 7.0 gross wells (5.1 net wells) that resulted in 5.1 net oil wells.

- Zargon's March 31, 2013 debt, net of working capital (excluding unrealized derivative assets/liabilities) and using the full future face value of the convertible debenture of $57.5 million, was $120.1 million and is approximately 2.1 times annualized 2013 first quarter funds flow from operating activities. At March 31, 2013, Zargon had more than $100 million of available credit facilities remaining on its $165 million borrowing base.

- During the 2013 first quarter, Zargon disposed of assets in the Karr, Alberta area for total proceeds of $3.5 million. The assets mainly consisted of undeveloped land and contained minimal reserves and production. Subsequent to quarter end, Zargon has disposed of assets in the Workman, Saskatchewan area for $4.3 million. The assets were producing 40 barrels of oil per day.

Three Months Ended March 31,
2013 2012 Percent Change
Financial Highlights
Income and Investments ($ millions)
Gross petroleum and natural gas sales 37.08 44.64 (17)
Funds flow from operating activities 13.90 13.52 3
Cash flows from operating activities 12.46 11.85 5
Cash dividends (net of Dividend Reinvestment Plan) 4.75 7.45 (36)
Net earnings/(loss) 0.23 (2.01) 111

Field capital and administrative asset expenditures 19.28 20.85 (8)
Net property and corporate acquisitions/(dispositions) (3.09) 0.10 (3,190)
Net capital expenditures 16.19 20.95 (23)

Per Share, Basic
Funds flow from operating activities ($/share) 0.46 0.46 -
Net earnings/(loss) ($/share) 0.01 (0.07) 114

Cash Dividends ($/common share) 0.18 0.30 (40)

Balance Sheet at Period End ($ millions)
Property and equipment (D&P) 399.39 418.48 (5)
Exploration and evaluation assets (E&E) 19.22 24.17 (20)
Total assets 450.34 473.69 (5)
Working capital deficiency 18.58 16.94 10
Long term bank debt 44.02 107.37 (59)
Convertible debentures at maturity 57.50 - -
Shareholders' equity 192.70 214.57 (10)

Weighted Average Shares Outstanding for the Period (millions) - Basic 29.91 29.40 2
Total Common Shares Outstanding at Period End (millions) 29.97 29.47 2

Notes:
Funds flow from operating activities is an additional GAAP term that represents net earnings/loss and asset retirement expenditures except for non-cash items.

Working capital deficiency excludes derivative assets/liabilities.

Three Months Ended March 31,
2013 2012 Percent Change
Operating Highlights
Average Daily Production
Oil and liquids (bbl/d) 5,113 5,496 (7)
Natural gas (mmcf/d) 15.21 20.03 (24)
Equivalent (boe/d) 7,648 8,834 (13)

Average Selling Price (before the impact of financial risk management contracts)
Oil and liquids ($/bbl) 71.62 81.92 (13)
Natural gas ($/mcf) 3.01 2.01 50

Netback ($/boe)
Gross petroleum and natural gas sales 53.87 55.53 (3)
Royalties (9.69) (10.51) (8)
Realized gain/(loss) on derivatives 1.86 (3.84) 148
Operating expenses (17.27) (16.56) 4
Transportation expenses (0.66) (0.47) 40
Operating netback 28.11 24.15 16

Wells Drilled, Net 5.1 9.6 (47)

Undeveloped Land at Period End (thousand net acres) 321 411 (22)

Notes:
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.

Message to Shareholders

Zargon Oil & Gas Ltd. has released financial and operating results for the first quarter of 2013 that highlighted continued progress in its drive to become a long term sustainable, dividend-paying energy producer. The quarter was highlighted by the sanctioning of the construction of our Little Bow Alkaline Surfactant Polymer ("ASP") tertiary oil recovery project in Southern Alberta.

Zargon's sustainability model implies balancing cash inflows and outflows, generating meaningful growth in cash flow per share, while continuing the shift toward oil and liquids over the next few years. Zargon believes that the Little Bow ASP tertiary oil recovery production will help improve sustainability, as it offers the best blend of low-decline, low-sustaining capital and high-netback and long-life assets available to the company.

The Company's intentions throughout the remainder of 2013 will be to:

- Deliver the Little Bow ASP project on-time and on-budget, with first chemical injections to occur in January 2014;

- Deliver a consistent dividend of $0.06 per common share per month;

- Deliver a property divestiture program designed to high grade and concentrate the company's asset portfolio; and

- Maintain a strong balance sheet through substantial oil hedging programs while limiting drilling capital to high-graded projects offering the most attractive risk adjusted returns.

Little Bow Alkaline Surfactant Polymer ("ASP") Project

Zargon has made good progress with the Little Bow ASP project in 2013. This ASP project entails the injection of a dilute chemical solution into a partially depleted reservoir to recover incremental oil reserves. In its 2012 year end review, McDaniel and Associates Consultants Ltd. assigned 4.4 million barrels of probable undeveloped oil equivalent reserves to Zargon's working interest in phases 1 and 2 of the project.

Since the February 2013 sanctioning of the project, Zargon has advanced the project on many fronts: facility approvals from the Energy Resources Conservation Board ("ERCB") have been obtained; material and equipment procurement is proceeding; field pipeline replacements and upgrades have been constructed; and facility construction contracts and ASP chemical supply bids are being negotiated. Field construction is expected to commence in late May 2013, which will provide for first chemical injections in January 2014 and incremental oil production by the second quarter of 2014.

The total construction capital cost of phases 1 and 2 of the Little Bow ASP project continues to be approximately $60 million (as spent dollars). Of this total, $6.5 million of expenditures were incurred in 2012 and $5.0 million were spent in the first quarter of 2013. For the remainder of 2013, we plan on spending $37 million, an amount that includes $3 million of 2014 expenditures that have been advanced into 2013 to prepare for early production responses and the first ASP chemical deliveries. The estimated total phase 1 and 2 chemical cost for the 2014-2019 chemical injection period will be capitalized and remains at $66 million (as spent dollars). The project's final $12 million, for the implementation of phase 2, is scheduled for 2015.

Based on the current construction schedule, we forecast that the Little Bow ASP project will provide 250 barrels of oil per day of incremental production in 2014, which will be comprised of an initial production response in the 2014 second quarter and a 2014 year end rate of 500 barrels of oil per day. Without additional infill drilling, incremental production from phases 1 and 2 of the project are forecast to reach 1,600 barrels of oil per day by 2016. Using these rates with an estimated field oil price of $68 Cdn. per barrel, a 12 percent incremental tertiary royalty rate, and operating costs of $12 per barrel of incremental oil, the project is forecast to provide a field netback of approximately $50 per barrel of incremental oil production volumes.

Follow-on capital expenditures for phases 3 and 4 of the Little Bow ASP project are expected to be completed by 2017 with forecasted total combined phases 1 to 4 project peak production rates of 2,300 barrels of oil per day expected to occur in 2020. For further information regarding the Little Bow ASP project, please refer to our updated corporate presentation, which is available at www.zargon.ca.

Other Field Activities

In addition to the $5.0 million of ASP capital expenditures, Zargon executed a $14.3 million capital program in the 2013 first quarter on conventional oil exploitation assets. This capital program included the drilling of 5.1 net Williston Basin horizontal oil wells in addition to significant infrastructure upgrades at the Alberta Hamilton Lake and Bellshill Lake properties and the Saskatchewan Steelman and Weyburn properties. These infrastructure costs are now essentially completed and will provide operating expense improvements for the remainder of the related long-life oil properties. Significantly lower drilling and infrastructure capital expenditure levels are anticipated for the next two quarters.

In particular, the first quarter drilling program concentrated on Williston Basin Midale drainage type wells at Steelman, Weyburn, Ralph, Saskatchewan and Mackobee Coulee, North Dakota. These horizontal oil exploitation wells met our expectations that are characterized by moderate initial rates, but long-life, shallow declines that provide solid returns. Conversely, first quarter 2013 production results from our three well fourth quarter 2012 Hamilton Lake Viking oil exploitation program did not meet expectations due to lower well inflows than anticipated. This summer, we will re-examine our technical work and historical results to develop a plan to unlock this property's large oil exploitation potential.

For the remainder of the year, Zargon is planning on drilling an additional 10 net high-graded horizontal oil exploitation wells, roughly equally divided between our Taber South Sunburst and Williston Basin Midale drainage projects. In aggregate, Zargon has identified more than 100 horizontal locations in six conventional (non-ASP) oil exploitation projects, which will provide a high-graded drilling inventory for many years. Each of these six oil exploitation projects are (or will be) pressure supported by water injections or natural reservoir aquifers and consequently provide long-life low-decline oil volumes that will support future dividends.

Property Dispositions Update

During the 2013 first quarter, property dispositions of $3.5 million were concluded, which primarily related to the sale of undeveloped land assets in Karr, Alberta. Subsequent to quarter end, an additional $4.3 million of property dispositions were made with the sale of the 40 barrels of oil per day in the Workman, Saskatchewan property. Throughout 2013, a minimum of $20 million of property dispositions are budgeted.

To meet this disposition objective, we are using third party services to market two packages (Twining, Wayne, Provost and Grand Forks, Alberta) that, in aggregate, are producing 350 barrels of oil per day. Additional oil properties, as required, will be marketed in the second half of 2013 in order to meet the company's $20 million disposition target. With numerous disposition options available, Zargon will exercise prudence with its planned dispositions so as to maximize the potential value from the dispositions and minimize the cash flow impact. A key consideration of the sales will be to reduce our property footprint by selling (or trading) our very large non-strategic property inventory and consequently, sales in addition to the $20 million target may be considered. Over time, we anticipate that these dispositions will enable Zargon to realize a lower cost structure through a disciplined focus on our growing tertiary oil recovery business and the stable production volumes coming from the measured exploitation of core, conventional long-life low-decline oil properties.

2013 Outlook

Zargon's 2013 non-ASP field capital budget has been set at $40 million (before dispositions) of which approximately $26 million will be spent in the remaining three quarters. Our 2013 capital budget incorporates $20 million of property dispositions, of which $7.8 million have been completed by early May. For the remainder of the year, the drilling of the 10 remaining budgeted wells will be contingent on the successful execution of this $20 million property disposition program.

Although during the "2013 ASP heavy capital spend" period, we have deferred components of our oil exploitation drilling programs, we will not be deferring our general oil exploitation capital programs related to waterflood modifications, pumping upgrades, facility optimizations, etc. These ongoing projects provide very strong returns and moderate our base corporate oil declines from the 21 to 14 percent range. Additionally, we will continue to monitor the improving natural gas prices and will optimize and re-activate shut-in gas wells when appropriate. Zargon shut-in a significant amount of natural gas wells in 2012 due to low natural gas prices.

Also, Zargon has entered into a significant oil hedging program to provide a measure of stability and predictability to cash flows during the ASP construction phase. For the remainder of 2013, Zargon has hedged 3,000 barrels per day at $97.32 US/bbl WTI, while for 2014 an average of 2,300 barrels per day is hedged at $91.92 US/bbl WTI.

Production Guidance

In the March 12, 2013 year end press release, Zargon provided updated first quarter 2013 oil production rate guidance of 5,150 barrels of oil and liquids per day. Actual first quarter volumes were 5,113 barrels of oil and liquids per day or about one percent below guidance. The press release also set Zargon's first quarter 2013 natural gas production guidance of 15.6 million cubic feet per day. First quarter actual volumes were 15.2 million cubic feet per day or about three percent below guidance.

Oil and liquids production for the 2013 second quarter is set at 4,800 barrels of oil per day and reflects estimated reductions of 100 barrels of oil and liquids per day for spring break-up shut-ins and 40 barrels of oil and liquids per day for second quarter property dispositions. Second quarter natural gas production guidance is set at 15.0 million cubic feet per day.

For the remainder of the year, production volumes will depend on the magnitude and timing of our property disposition programs along with related timing of our drilling programs and consequently a broad range of outcomes are possible. Full-year 2013 average oil and liquids production is now expected to range between 4,700 to 4,900 barrels of oil per day, with exit rates ranging from 4,400 to 4,700 barrels of oil per day. Full-year 2013 average natural gas production is now expected to range between 14.8 to 15.0 million cubic feet per day, with exit rates ranging from 14.5 to 14.9 million cubic feet per day. Looking forward, we expect that first quarter 2014 production volumes will represent both an oil production low and a turning point for Zargon, as in subsequent quarters, significant production volumes will begin to materialize from the ASP project and from oil exploitation drilling programs that will have been reactivated once the substantial ASP phase 1 capital program is completed.

Acknowledgement

Finally, I would like to personally acknowledge Mr. Graham Weir who has decided to not stand for re-election to the Zargon Board this year. Graham joined our Board in October 2003 and over the past 10 years has served Zargon and its shareholders well through his thoughtful counsel and advice. We thank Graham for his significant contributions and wish him the very best in his future endeavours.

Forward-Looking Statements

This press release offers our assessment of Zargon's future plans and operations as at May 14, 2013, and contains certain forward-looking information and statements within the meaning of applicable securities laws. The use of any of the words "anticipate", "continue", "estimate", "expect", "forecast", "may", "will", "project", "should", "plan", "intend", "believe" and similar expressions (including the negatives thereof) are intended to identify forward-looking information or statements. In particular, but without limiting the foregoing, this news release contains forward-looking information and statements pertaining to the following: guidance as to our 2013 and 2014 capital budgets, including the allocation thereof and the sources of funding and various plans, forecasts and estimates as to drilling cost reduction initiatives, and other operational forecasts and plans and results therefrom under the heading "Little Bow Alkaline Surfactant Polymer ("ASP") Project", "Other Field Activities", "Property Disposition Update" and "2013 Outlook "; our plans with respect to our Little Bow ASP project and the results therefrom referred to under the heading "Little Bow Alkaline Surfactant Polymer ("ASP") Project"; our plans for our hedges under the heading "2013 Outlook"; and all matters, including guidance as to our estimated 2013 and 2014 production and production mix, and anticipated decline rates, under the heading "Production Guidance".

The forward-looking information and statements included in this news release are not guarantees of future performance and should not be unduly relied upon. Such information and statements involve known and unknown risks, uncertainties and other factors that may cause actual results or events to differ materially from those anticipated in such forward-looking information or statements including, without limitation: 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 www.zargon.ca and on 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 used in the preparation of such information and statements, including, among other things: future oil and natural gas prices; future capital expenditure levels; 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; the availability of adequate and acceptable debt and equity financing and funds from operations to fund our planned expenditures; and our ability to add production and reserves through our development and acquisition activities, 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 achievement 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 and statements 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.

Additional GAAP and Non-GAAP Financial Measures

Zargon uses the following terms for measurement within this press release that do not have a standardized prescribed meaning under Canadian generally accepted accounting principles ("GAAP") and these measurements may not be comparable with the calculation of similar measurements of other entities.

The terms "funds flow from operating activities" and "operating netback per boe" in this press release are not recognized measures under GAAP. Management of Zargon believes that in addition to net earnings and cash flows from operating activities as defined by GAAP, these terms are useful supplemental measures to evaluate operating performance and assess leverage. Users are cautioned; however, that these measures should not be construed as an alternative to net earnings or cash flows from operating activities determined in accordance with GAAP as an indication of Zargon's performance.

Zargon considers funds flow from operating activities to be an important measure of Zargon's ability to generate the funds necessary to finance capital expenditures, pay dividends and repay debt. All references to funds flow from operating activities throughout this press release are based on cash provided by operating activities before the change in non-cash working capital since Zargon believes the timing of collection, payment or incurrence of these items involves a high degree of discretion and, as such, may not be useful for evaluating Zargon's operating performance. Zargon's method of calculating funds flow from operating activities may differ from that of other companies and, accordingly, may not be comparable to measures used by other companies. Funds flow from operating activities per basic share is calculated using the same weighted average basic shares outstanding as is used in calculating earnings per basic share. See Zargon's Management's Discussion and Analysis ("MD&A") as filed on www.zargon.ca and on www.sedar.com for the years ended March 31, 2013 and 2012 for a reconciliation of cash flows from operating activities to funds flow from operating activities.

51-101 Advisory

In conformity with National Instrument 51-101, Standards for Disclosure of Oil and Gas Activities ("NI 51-101"), natural gas volumes have been converted to barrels of oil equivalent ("boe") using a conversion rate of six thousand cubic feet of natural 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.

Filings

Zargon has filed with Canadian securities regulatory authorities its unaudited financial statements for the three months ended March 31, 2013 and the accompanying MD&A. These filings are available on www.zargon.ca and under Zargon's SEDAR profile on www.sedar.com.

About Zargon

Based in Calgary, Alberta, Zargon's securities trade on the Toronto Stock Exchange and there are currently approximately 29.972 million common shares outstanding.

Zargon Oil & Gas Ltd. is a Calgary based oil and natural gas company working in the Western Canadian and Williston sedimentary basins that has delivered a long history of returns and dividends (distributions). Zargon's business is focused on oil exploitation projects that profitably increase oil production and recovery factors from existing oil reservoirs.

In order to learn more about Zargon, we encourage you to visit Zargon's website at www.zargon.ca where you will find a current shareholder presentation, financial reports and historical news releases.

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