

## FINANCIAL AND OPERATING HIGHLIGHTS (THREE MONTHS ENDED MARCH 31, 2016)

- Funds flow from operating activities of a negative \$0.3 million compare to the positive \$3.6 million recorded in the prior quarter, and the positive \$7.2 million reported in first quarter of 2015. The reduction in funds flow is primarily due to Zargon's sharply lower first quarter 2016 field oil price of \$28.27 per barrel, down 30 percent from the fourth quarter 2015 field oil price of \$40.19 per barrel and down 33 percent from the first quarter 2015 field oil price of \$42.26 per barrel.
- Reflecting continued restricted conventional capital programs, first quarter 2016 production averaged 3,503 barrels of oil and liquids per day, a four percent decrease from the preceding quarter, and first quarter 2016 natural gas production averaged 4.0 million cubic feet per day, a four percent decrease from the preceding quarter. Total production averaged 4,176 barrels of oil equivalent per day, a four percent decrease from the preceding quarter. During the quarter, oil and liquids production represented 84 percent of total production based on a 6:1 equivalent basis.
- First quarter 2016 exploration and development capital expenditures (excluding property acquisitions and dispositions) were \$2.4 million and included \$2.0 million of expenditures related to the Little Bow ASP project (\$0.2 million exploitation and \$1.8 million chemical costs). No wells were drilled in the quarter.

	Three Months Ended March 31,		
	2016	2015	Percent Change
<b>Financial Highlights</b>			
Income and Investments (\$ millions)			
Gross petroleum and natural gas sales	9.61	16.41	(41 )
Funds flow from/(used in) operating activities	(0.28 )	7.24	(104 )
Cash flows from operating activities	2.07	6.67	(69 )
Cash dividends	-	2.72	(100 )
Net loss	(8.82 )	(4.88 )	(81 )
Field capital and administrative asset expenditures	2.43	5.40	(55 )
Net property acquisitions	0.04	-	-
Net capital expenditures	2.47	5.40	(54 )
<b>Per Share, Basic</b>			
Funds flow from/(used in) operating activities (\$/share)	(0.01 )	0.24	(104 )
Net loss (\$/share)	(0.29 )	(0.16 )	(81 )
Cash Dividends (\$/common share)	-	0.09	(100 )
<b>Balance Sheet at Period End (\$ millions)</b>			
Property and equipment (D&P)	225.28	337.45	(33 )
Exploration and evaluation assets (E&E)	5.66	6.75	(16 )
Total assets	255.14	377.16	(32 )
Working capital deficiency	2.28	6.39	(64 )
Long term bank debt	64.59	49.91	29
Convertible debentures at maturity	57.50	57.50	-
Shareholders' equity	43.28	155.67	(72 )
Weighted Average Shares Outstanding for the Period (millions) - Basic	30.44	30.25	1
Total Common Shares Outstanding at Period End (millions)	30.47	30.27	1

*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.*

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

	Three Months Ended March 31,		
	2016	2015	Percent Change
<b>Operating Highlights</b>			
Average Daily Production			
Oil and liquids (bbl/d)	3,503	3,928	(11 )
Natural gas (mmcf/d)	4.04	5.24	(23 )
Equivalent (boe/d)	4,176	4,802	(13 )



Average Selling Price (before the impact of financial risk management contracts)				
Oil and liquids (\$/bbl)	28.27	42.26	(33	)
Natural gas (\$/mcf)	1.64	3.12	(47	)
Netback (\$/boe)				
Gross petroleum and natural gas sales	25.30	37.98	(33	)
Royalties	(2.95	) (5.78	) (49	)
Realized gain on derivatives	3.79	19.28	(80	)
Operating expenses	(18.52	) (21.29	) (13	)
Transportation expenses	(0.23	) (0.73	) (68	)
Operating netback	7.39	29.46	(75	)
Wells Drilled, Net				
	-	-	-	
Undeveloped Land at Period End (thousand net acres)	71	85	(16	)

*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 2016.

## Ongoing Cost Reduction Initiatives

In response to the sustained low oil price environment, Zargon has continued to focus on reducing operating and transportation costs and general and administrative costs. In the 2016 first quarter, operating and transportation costs totaled \$7.12 million (\$18.75 per barrel of oil equivalent), down 25 percent from the 2015 first quarter cost of \$9.52 million (\$22.02 per barrel of oil equivalent) and down 19 percent from the 2015 fourth quarter cost of \$8.74 million (\$21.88 per barrel of oil equivalent).

In aggregate, operating and transportation costs have been reduced from \$42.9 million in 2014, to \$36.0 million in 2015 and to a budgeted \$30.0 million in 2016. These reductions have been accomplished through lower margin property sales (completed in 2014), comprehensive cost reviews, field supplier and consultant reductions and field office consolidations. In particular, the projected 2016 cost savings reflect lower electricity costs, lower field contractor costs and reduced Little Bow ASP facility and field pumping costs due to the polymer only streamlined facility operations and improved pumping designs. Zargon will continue to focus on cost containment initiatives, and further reductions in operating costs are anticipated to be delivered throughout the year.

Similarly, general and administrative costs and transactions costs (inclusive of one-time adjustments) have been reduced from \$13.4 million in 2014, to \$8.4 million in 2015 and a forecasted \$6.5 million in 2016, based on the 2016 first quarter reported cost of \$1.73 million. These reductions have been accomplished through office staff and consultant reductions (43 percent), comprehensive cost reviews, salary roll backs, consultant rate reductions and office space adjustments.

## Little Bow Alkaline Surfactant Polymer ("ASP") Project Update

In March 2014, Zargon commenced chemical injection of large volumes of dilute chemical solution into the partially depleted Little Bow Mannville I pool to recover incremental oil reserves. To date, 7.0 million barrels of ASP solution has been injected into the first phase of the project. This injection volume is equal to about 22 percent of the targeted reservoir pore volume which compares to the planned 30 percent ASP phase 1 injection. This March, in an effort to conserve funds, we have suspended the alkali and surfactant injections into the pool, while maintaining the polymer injections. The alkali and surfactant injections can be reinitiated once oil prices improve. Our model studies indicate that a one year suspension of the alkali and surfactant injections will not impact the ultimate oil recovery of the flood.

For the last three years, Zargon has redirected available capital to the Little Bow ASP tertiary recovery project. Although 2014-2015 Little Bow ASP production results showed clear evidence of the formation of the desired oil banks, oil production volumes had not met expectations. In 2015, Zargon responded with a \$6.8 million remediation and optimization program that included the drilling of six infill locations. Production results (provided graphically below) from the program are encouraging and show improved recent ASP project rates of 580 barrels of oil per day. In particular, the production in the north and central regions of the flood has exceeded 500 barrels of oil per day, a level that demonstrates strong oil bank formation and suggests that the full 12 percent forecast tertiary oil recoveries will be reached in these areas.

To view the Little Bow ASP: Phase 1 Production graph, please visit the following link:  
<http://media3.marketwire.com/docs/1054213f.pdf>



In addition to the \$2.0 million of ASP exploitation and chemical capital expenditures, Zargon spent \$0.4 million on conventional oil exploitation capital programs in the first quarter of 2016. These conventional capital programs focused on minor waterflood and facility modifications that continue to enable Zargon to have an industry low base oil production decline (excluding ASP) of 12 percent per year. Zargon has not drilled any conventional oil exploitation wells in 2015 or 2016.

Zargon's non-ASP conventional properties tend to be pressure supported by waterflood injections or natural reservoir aquifers and consequently provide long-life low-decline oil volumes. Approximately half of these production volumes are produced from Mississippian (Midale, Frobisher, Alida equiv., Tilston) horizons in the Williston Basin core area. In aggregate, the conventional properties bring more than 75 horizontal locations that can be methodically drilled as oil prices improve in order to deliver stable (or if desired, growing) non-ASP oil production volumes for many years.

## 2016 Outlook

Zargon's 2016 total capital budget has been reduced to \$7 million, of which approximately \$4.5 million remains to be spent in the remaining three quarters. This remaining 2016 capital budget will be allocated \$1.5 million to conventional expenditures, \$2.7 million for ASP chemicals and \$0.3 million for ASP exploitation expenditures. The 2016 drilling program does not anticipate the drilling of either conventional oil exploitation or Little Bow ASP wells.

Although Zargon's 2016 first quarter funds flow from operating activities were a negative \$0.3 million, recent oil prices have improved significantly from the first quarter lows, and funds flow from operations for the remainder of the year are anticipated to substantially exceed the remaining 2016 capital budget levels.

## Production Guidance

In the March 7, 2016 year end results press release, Zargon provided 2016 oil production guidance of 3,550 barrels of oil and liquids per day (including incremental ASP volumes). This rate incorporates 2,950 of oil per day (excluding Little Bow ASP) of conventional production plus 600 barrels of per day of Little Bow phase 1 oil production. Actual first quarter volumes essentially met guidance and were 3,503 barrels of oil and liquids per day. Zargon set the 2016 natural gas production guidance at 3.6 million cubic feet per day, a level that was exceeded by actual first quarter volumes of 4.0 million cubic feet per day.

For the remainder of 2016, Zargon anticipates that increasing oil production volumes from the Little Bow ASP project will offset the impact of the 12 percent base decline from the conventional oil properties, and will maintain an average production rate of 3,550 barrels of oil per day. This forecast assumes that no additional wells are drilled on either the Little Bow ASP or conventional oil exploitation properties. Natural gas volumes are forecasted to average 3.5 million cubic feet per day for the remainder of 2016.

## Strategic Alternatives Process Update

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

This continuing financial review includes, but is not limited to, a financing, merger or other business combination, sale of the Company or a portion of the company's business or assets, or any combination thereof, as well as the continued execution of its business plan. The ongoing review has incorporated an analysis of improving market trends and tone, plus encouraging cost trends and ASP results. To this end, Scotia, on behalf of the Company has recently initiated a broad marketing process involving potential domestic and foreign purchasers, which will include a data room to allow qualified parties to access data concerning the Company's operations. Additional information regarding Zargon and the corporate marketing process is available on our website at [www.zargon.ca](http://www.zargon.ca). The Company expects to provide updated disclosure regarding this Scotia strategic alternatives process with the 2016 second quarter results that will be reported in August.

## Forward-Looking Statements

This press release offers our assessment of Zargon's future plans and operations as at May 10, 2016, 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: our expectations on reducing general and administrative, operating and transportation costs referred to under the heading "Ongoing Cost Reduction Initiatives"; guidance as to our 2016 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 headings "Little Bow Alkaline Surfactant Polymer ("ASP") Project Update" and "2016 Outlook"; our plans with respect to our Little Bow ASP project and the results therefrom referred to under the headings "Ongoing



Cost Reduction Initiatives", "Little Bow Alkaline Surfactant Polymer ("ASP") Project Update", "2016 Outlook", "Production Guidance" and "Strategic Alternatives Process Update"; our strategic alternatives process under the heading "Strategic Alternatives Process Update"; and all matters, including guidance as to our estimated 2016 production and production mix, 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](http://www.zargon.ca) and on [www.sedar.com](http://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 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](http://www.zargon.ca) and on [www.sedar.com](http://www.sedar.com) for the periods ended March 31, 2016 and 2015 for a discussion of cash flows from operating activities and 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 ("mcf") on the basis of one barrel of natural gas liquids to six thousand cubic feet of gas. Boes and mcfes may be misleading, particularly if used in isolation. A conversion ratio of one barrel to six thousand cubic feet of natural gas is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. Given that the value ratio based on the current price of crude oil as compared to natural gas is significantly different from the energy equivalency of 6:1, utilizing a conversion ratio on a 6:1 basis may be misleading as an indication of value.



## Filings

Zargon has filed with Canadian securities regulatory authorities its unaudited financial statements for the three months ended March 31, 2016 and the accompanying MD&A. These filings are available on [www.zargon.ca](http://www.zargon.ca) and under Zargon's SEDAR profile on [www.sedar.com](http://www.sedar.com).

## About Zargon

Based in Calgary, Alberta, Zargon's securities trade on the Toronto Stock Exchange and there are currently approximately 30.470 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 and is focused on oil exploitation projects (waterfloods and recently tertiary ASP) 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](http://www.zargon.ca) where you will find a current shareholder presentation, financial reports and historical news releases.

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