

Zargon Oil & Gas Ltd. Provides 2014 First Quarter Financial Results

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CALGARY, ALBERTA--(Marketwired - May 14, 2014) - Zargon Oil & Gas Ltd. ("Zargon" or the "Company") (TSX:ZAR)(TSX:ZAR.DB)

FINANCIAL AND OPERATING HIGHLIGHTS (THREE MONTHS ENDED MARCH 31, 2014)

- Funds flow from operating activities of \$15.3 million were 26 percent higher than the \$12.1 million recorded in the prior quarter, and 10 percent higher than the \$13.9 million reported in first quarter of 2013. Funds flow from operating activities for the 2014 first quarter included reductions of \$2.3 million of realized hedge losses and \$0.7 million of asset retirement expenses.
- Reflecting the prior quarter's dispositions, first quarter 2014 production averaged 4,320 barrels of oil and liquids per day, a seven percent decrease from the preceding quarter and first quarter 2014 natural gas production averaged 14.1 million cubic feet per day, a 12 percent decrease from the preceding quarter. Total production averaged 6,662 barrels of oil equivalent per day, an eight percent decrease from the preceding quarter. During the quarter, oil and liquids production represented 65 percent of total production based on a 6:1 equivalent basis.
- Monthly cash dividends of \$0.06 per common share were declared in the first quarter of 2014 for a total of \$5.4 million. These cash dividends were equivalent to a payout ratio of 35 percent of funds flow from operating activities.
- First quarter 2014 exploration and development capital expenditures (excluding property acquisitions and dispositions) were \$16.9 million and included \$7.5 million of expenditures related to the Little Bow ASP phase 1 enhanced oil recovery project. In the quarter, Zargon drilled 7.0 gross wells (3.7 net wells) that resulted in 3.7 net oil wells.
- Zargon's March 31, 2014 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 \$121.7 million and is approximately 2.0 times annualized 2014 first quarter funds flow from operating activities. At March 31, 2014, Zargon had \$100 million of available credit facilities remaining on its \$165 million borrowing base.

	Three Months Ended March 31,		Percent Change
	2014	2013	
Financial Highlights			
Income and Investments (\$ millions)			
Gross petroleum and natural gas sales	40.26	37.08	9
Funds flow from operating activities	15.30	13.90	10
Cash flows from operating activities	14.86	12.46	19
Cash dividends (net of Dividend Reinvestment Plan)	5.42	4.75	14
Net earnings	0.17	0.23	(26)
Field capital and administrative asset expenditures	16.94	19.28	(12)
Net property and corporate dispositions	(1.46)	(3.09)	53
Net capital expenditures	15.48	16.19	(4)
Per Share, Basic			
Funds flow from operating activities (\$/share)	0.51	0.46	11
Net earnings (\$/share)	0.01	0.01	-
Cash Dividends (\$/common share)	0.18	0.18	-
Balance Sheet at Period End (\$ millions)			
Property and equipment (D&P)	414.85	399.39	4

Exploration and evaluation assets (E&E)	13.29	19.22	(31)
Total assets	462.66	450.34	3
Working capital deficiency	13.68	18.58	(26)
Long term bank debt	50.55	44.02	15
Convertible debentures at maturity	57.50	57.50	-
Shareholders' equity	169.56	192.70	(12)
Weighted Average Shares Outstanding for the Period (millions) - Basic	30.10	29.91	1
Total Common Shares Outstanding at Period End (millions)	30.12	29.97	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 are net of the Dividend Reinvestment Plan in 2013. The Dividend Reinvestment Plan was suspended September 2013.

	Three Months Ended March 31,		Percent Change
	2014	2013	
Operating Highlights			
Average Daily Production			
Oil and liquids (bbl/d)	4,320	5,113	(16)
Natural gas (mmcf/d)	14.05	15.21	(8)
Equivalent (boe/d)	6,662	7,648	(13)
Average Selling Price (before the impact of financial risk management contracts)			
Oil and liquids (\$/bbl)	86.71	71.62	21
Natural gas (\$/mcf)	5.18	3.01	72
Netback (\$/boe)			
Gross petroleum and natural gas sales	67.15	53.87	25
Royalties	(11.21)	(9.69)	16
Realized gain/(loss) on derivatives	(3.84)	1.86	(306)
Operating expenses	(17.04)	(17.27)	(1)
Transportation expenses	(0.85)	(0.66)	29
Operating netback	34.21	28.11	22
Wells Drilled, Net	3.7	5.1	(27)
Undeveloped Land at Period End (thousand net acres)	202	321	(37)

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 2014 that highlighted continued progress in its drive to become a long term sustainable, dividend-paying energy producer. The quarter was highlighted by the commissioning of the Little Bow Alkaline Surfactant Polymer ("ASP") enhanced oil recovery project and the commencement of ASP injection into the reservoir.

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 enhanced 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 focus for the remainder of 2014 will be to:

- Deliver Little Bow phase 1 ASP operational and production targets of an incremental 350 barrels of oil per day by year end (increasing to a 2015 average rate of 900 barrels of oil per day);
- Finalize the design of the Little Bow phase 2 ASP project and advance the Little Bow phase 3 and 4 ASP engineering studies;
- Deliver a consistent dividend of \$0.06 per common share per month;

- Execute a continuing property divestiture program designed to high-grade and concentrate the Company's asset portfolio on our core oil exploitation projects;
- Direct a high-graded oil exploitation capital program focused on our five long-life low-decline oil exploitation properties (Williston Basin, Taber, Bellshill Lake, Little Bow non-ASP and Hamilton Lake); and
- Maintain (and ultimately improve) our strong balance sheet.

Little Bow Alkaline Surfactant Polymer ("ASP") Project

Zargon commissioned the Little Bow ASP enhanced oil recovery project and commenced first chemical injections in March 2014. This ASP project entails the injection of large volumes of a dilute chemical solution into a partially depleted oil reservoir to recover incremental oil reserves. To date, the ASP plant operations and injection well rates have met or exceeded expectations.

The total cost to complete the project was approximately \$50 million which is roughly consistent with our November 2012 press release that forecasted a \$47 million project cost and a December 2013 injection date. The total construction capital cost of phases 1 and 2 of the Little Bow ASP project will be approximately \$62 million. The estimated total phase 1 and 2 chemical cost for the 2014-2019 chemical injection period will be capitalized and is now estimated at \$81 million (as spent dollars), a five percent increase from prior estimates due to a change in forecasted Canadian dollar exchange rates. Phase 2 implementation costs are expected to be \$12 million and are scheduled for late 2015.

Phase 1 of the Little Bow ASP project is expected to provide 100 barrels of oil per day of average incremental production in 2014, which will be comprised of an initial production response in the 2014 third quarter and a 2014 year end rate of 350 barrels of oil per day. Incremental production is expected to exceed 900 barrels of oil per day in 2015 and then increase to 1,550 barrels of oil per day in 2016, once phase 2 production begins.

Follow-on capital expenditures of \$80 million (including chemical costs) for phases 3 and 4 of the Little Bow ASP project are expected to yield an additional 3.6 million barrels of incremental oil and Zargon's combined Little Bow project (phases 1 through 4) total production is expected to stabilize at 2,200 barrels of oil per day in the 2021 through 2023 period. 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 \$7.5 million of ASP capital expenditures, Zargon executed a \$9.4 million capital program in the 2014 first quarter on conventional oil exploitation assets, which included the drilling of 3.7 net horizontal drainage wells, mostly in the Williston Basin core area.

For the remainder of the year, Zargon is planning on drilling an additional 14 net high-graded horizontal oil exploitation wells, for Taber Sunburst (4), Bellshill Lake Mannville (5) and Williston Basin Mississippian drainage (5) projects. In aggregate, Zargon has identified more than 60 horizontal locations in five conventional (non-ASP) oil exploitation projects, which will provide a high-graded drilling inventory for many years. Each of these five 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 2014 first quarter, property dispositions of \$1.5 million were concluded, which primarily related to the sale of assets in southeast Saskatchewan. With the Little Bow ASP tertiary recovery project now commissioned, Zargon will focus on consolidating our property footprint on higher netback assets. To meet this objective, we will be using third party services to market 14 non-strategic properties that, in aggregate, are producing 170 barrels of oil per day and 9.7 million cubic feet of natural gas per day (1,790 barrels of oil

equivalent per day). If acceptable bids are received, 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.

2014 Outlook

Zargon's 2014 non-ASP field capital budget has been set at \$35 million (before dispositions) of which approximately \$26 million will be spent in the remaining three quarters. The ASP 2014 capital budget now calls for \$8 million of capital expenditures (first quarter expenditures of \$7.5 million) and \$9 million of chemical costs.

Our 2014 capital budget also incorporated \$5 million of property dispositions, of which \$1.5 million have been completed by early May. Depending on the results of our property disposition initiative, the year's actual dispositions could be considerably larger. Initially, disposition proceeds (if any) would be used to retire bank debt.

Also, Zargon has entered into a significant oil hedging program to provide a measure of stability and predictability to cash flows as we wait for the ASP production volumes to ramp up. For the remainder of 2014, Zargon has hedged 2,733 barrels per day at \$91.54 US/bbl WTI and 267 barrels per day at \$99.60 Cdn/bbl WTI, while for the first half of 2015 an average of 1,200 barrels per day is hedged at \$92.96 US/bbl WTI.

Production Guidance

In the February 19, 2014 Little Bow and reserves press release, Zargon provided first quarter 2014 oil production rate guidance of 4,300 barrels of oil and liquids per day. Actual first quarter volumes were 4,320 barrels of oil and liquids per day and met guidance. The press release also set Zargon's first quarter 2014 natural gas production guidance of 14.0 million cubic feet per day. First quarter actual volumes were 14.1 million cubic feet per day and met guidance.

Oil and liquids production for the 2014 second quarter is set at 4,200 barrels of oil per day and includes the impact of spring break-up. Second quarter natural gas production guidance is set at 14.0 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, the timing and drilling results from our Taber, Bellshill Lake and Williston Basin oil exploitation drilling programs and the timing and the magnitude of the first production volumes from our Little Bow ASP project. Based on our forecasted 2014 Little Bow ASP exit production rate of 350 barrels of oil per day, we are forecasting 2014 year end corporate production rates of 4,550 barrels of oil per day (excluding the effect of property dispositions).

Acknowledgement

Finally, we would like to personally acknowledge Margaret McKenzie who has decided to not stand for re-election to the Zargon Board this year. Margaret joined our Board in January 2007 and over the past seven years has served Zargon and its shareholders well through her thoughtful counsel and advice. We thank Margaret for her significant contributions and wish her the very best in her future endeavours.

Forward-Looking Statements

This press release offers our assessment of Zargon's future plans and operations as at May 14, 2014, 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 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 Dispositions Update" and "2014 Outlook"; our plans with respect to our Little Bow ASP project and the results therefrom referred to under the headings "Message to Shareholders", "Little Bow Alkaline Surfactant Polymer ("ASP") Project" and "Production Guidance"; our plans for our hedges under the heading "2014 Outlook"; and all matters, including guidance as to our estimated 2014 and beyond 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 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 periods ended March 31, 2014 and 2013 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, 2014 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 30.127 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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