SURGE ENERGY INC

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TSX-V: SGY

Second Quarter Report Q2

For the period ended June 30, 2010

FINANCIAL AND OPERATING SUMMARY

Financials	3 Months Ended June 30,			6 Months Ended June 30,		
($000s except per share amounts)	2010	2009	% Change	2010	2009	% Change
Oil and NGL sales	**9,818**	7,315	33%	**20,930**	13,140	59%
Natural gas sales	**1,301**	2,478	(47%)	**4,051**	5,961	(32%)
Other revenue	**22**	35	37%	**138**	31	345%
Total oil, natural gas & NGL revenue	**11,141**	9,042	23%	**25,119**	19,132	31%
Funds from operations[1]	**4,740**	3,853	23%	**10,779**	7,372	46%
Per share basic ($)	**0.17**	0.23	(26%)	**0.46**	0.44	5%
Per share diluted ($)	**0.17**	0.23	(26%)	**0.46**	0.44	5%
Net earnings (loss)	**(7,515)**	(1,294)	481%	**(5,347)**	(2,935)	82%
Per share basic ($)	**(0.27)**	(0.08)	238%	**(0.23)**	(0.18)	28%
Per share diluted ($)	**(0.27)**	(0.08)	238%	**(0.23)**	(0.18)	28%
Capital expenditures[2]	**2,422**	2,806	(14%)	**8,776**	9,767	(10%)
Net debt (cash) at end of period	**(22,868)**	52,307	(144%)	**(22,868)**	52,307	(144%)
Operating Highlights						
Production:						
Oil & NGL (bbls per day)	**1,621**	1,374	18%	**1,663**	1,433	16%
Natural gas (mcf per day)	**3,823**	7,586	(50%)	**4,843**	7,405	(35%)
Total (boe per day) (6:1)	**2,258**	2,638	(14%)	**2,471**	2,667	(7%)
Average realized price:						
Oil & NGL ($ per bbl)	**66.57**	58.50	14%	**69.52**	50.67	37%
Natural gas ($ per mcf)	**3.74**	3.59	4%	**4.62**	4.45	4%
Realized gain / (loss) on commodity contracts ($ per boe)	**4.57**	(1.05)	(535%)	**2.62**	1.59	65%
Combined average (incl. processing revenue) ($ per boe)	**54.22**	40.94	32%	**56.17**	39.64	42%
Netback ($ per boe)						
Oil, natural gas and NGL sales	**54.22**	40.94	32%	**56.17**	39.64	42%
Royalties	**(10.30)**	(4.83)	113%	**(8.95)**	(4.95)	81%
Operating expenses	**(15.29)**	(10.78)	42%	**(15.73)**	(13.22)	19%
Transportation expenses	**(2.33)**	(1.92)	21%	**(2.81)**	(2.13)	32%
Operating netback	**26.30**	23.41	12%	**28.68**	19.34	48%
G&A expenses	**(6.76)**	(4.21)	61%	**(5.58)**	(3.79)	47%
Interest expense	**(0.94)**	(1.99)	(53%)	**(1.37)**	(1.72)	(20%)
Corporate netback	**18.60**	17.21	8%	**21.73**	13.83	57%
Common Shares (000s)						
Common shares outstanding, end of period	**31,109**	16,667	87%	**31,109**	16,667	87%
Weighted average basic shares outstanding	**27,589**	16,669	66%	**23,188**	16,682	39%
Stock option dilution (treasury method)	**-**	-	-	**-**	-	-
Weighted average diluted shares outstanding	**27,589**	16,669	66%	**23,188**	16,682	39%

1 Management uses funds from operations (before changes in non-cash working capital and non-recurring recapitalization costs) to analyze operating performance and leverage. Funds from operations as presented does not have any standardized meaning prescribed by Canadian GAAP and, therefore, may not be comparable with the calculation of similar measures for other entities.

2 Capital expenditures, net of any applicable Alberta drilling royalty credits, includes cash additions for the period including acquisition additions net of dispositions.

OVERVIEW AND HIGHLIGHTS

The second quarter was a transformational quarter for Surge Energy Inc. On April 13, 2010 the recapitalization of the Company was completed, which included the appointment of a new management team and board of directors and the completion of a $17 million private placement resulting in the issuance of 3.9 million common shares.

On May 5, 2010 Surge completed a $50 million equity financing issuing 6.9 million common shares, leaving the Company with no debt and positioning Surge to execute on its plan of optimizing its oil weighted asset base, growing through a balance of making oil resource acquisitions, executing on its oil resource exploration strategy and developing these oil resource plays via the drill bit.

On June 22nd, 2010, the Company announced two acquisitions that added the following to Surge's asset portfolio:

- Three high impact, early stage light oil resource plays;
- Internally estimated net TPIIP (Total Petroleum Initially In Place) of more than 160 million barrels;
- Low decline long life production base of approximately 1,150 boe per day;
- More than 90 percent operated;
- More than 90 percent working interest;
- Approximately 4.2 MMboe proved plus probable reserves;
- A reserve life index of 10 years;
- 80,000 net acres of undeveloped land;
- More than 90 net unbooked light oil horizontal drilling locations; and
- A large contiguous land base with owned and operated infrastructure.

In addition, the Company announced that it planned to increase its bank line from $50 million to $80 million. The acquisitions and increase in bank line were completed subsequent to the end of the second quarter.

At the Company's annual general meeting on June 25, 2010 shareholders approved the change of name to Surge Energy Inc. and shortly after the Company's stock symbol changed to SGY.

In the second quarter, Surge achieved an 83 percent success rate drilling six gross (6 net) wells. During the quarter, as a result of the low natural gas price environment, Surge began and completed the shut-in of approximately 3 million cubic feet per day of natural gas which also included approximately 60 barrels per day of natural gas liquids resulting in a total of approximately 560 boe per day of shut-in natural gas and natural gas liquids production. This contributed to the Company realizing an average production rate of 2,258 boe per day for the quarter, a 14 percent decrease as compared to the second quarter of 2009 production rate of 2,638 boe per day. In the first six months of 2010, Surge averaged 2,471 boe per day, a seven percent decrease as compared to the first six months of 2009 production rate of 2,667 boe per day.

Surge realized a 72 percent production weighting to oil and natural gas liquids in the second quarter of 2010.

Surge achieved funds from operations (defined as cash flow from operating activities before changes in non-cash working capital and non-recurring recapitalization costs) per basic share of $0.17 in the second quarter of 2010, a 26 percent decrease from $0.23 in the same period of 2009, due to equity issuances during the three months ended June 30, 2010. Funds from operations were $4.7 million in the second quarter of 2010, a 23 percent increase as compared to $3.9 million in the second quarter of 2009. Funds from operations were $10.8 million in the first six months of 2010, a 46 percent increase as compared to $7.4 million in the first six months of 2009.

The Company recorded net loss of $0.27 per basic share for the second quarter of 2010 as compared to a net loss of $0.08 per basic share in the same period of 2009. The non-recurring recapitalization costs, combined with the increased stock-based compensation that resulted from the recapitalization and one time, prior period royalty adjustments recorded in the second quarter of 2010, were large contributors to the net loss of $7.5 million in the second quarter of 2010 as compared to a net loss of $1.3 million in the same period of 2009. The net loss for the six months ended June 30, 2010 was $0.23 per basic share, or $5.3 million. This compares to a net loss of $2.9 million or $0.18 per basic share in the first six months of 2009. Excluding the non-recurring recapitalization costs, as well as the increase in stock-based compensation that resulted from the recapitalization, the Company's approximate net income (loss) would have been nil for the three months ended June 30, 2010 and $2.2 million for the six months ended June 30, 2010.

A 32 percent increase in revenue per boe contributed to the 12 percent increase in Surge's operating netback (defined as revenue excluding realized and unrealized gains or losses on commodity contracts per boe less royalties, operating and transportation expenses on a per boe basis) which averaged $26.30 per boe in the second quarter of 2010. The Company's corporate netback (defined as operating netback per boe less G&A and interest expense per boe) was $18.60 per boe for the second quarter of 2010. For the first six months of 2010, the Company's operating and corporate netback was $28.68 and 21.73 per boe, respectively. Second quarter and year to date netbacks were negatively impacted by one time, prior period royalty adjustments recorded in the second quarter of 2010.

At the date of this MD&A, Surge has a low decline, oil-weighted production base of more than 3,100 boe per day, an undeveloped land base of more than 420,000 net acres of land, an undrawn $80 million credit facility, a cash position of approximately $3 million, and no debt. Surge has positioned itself in several emerging light oil resource plays with more than 154 oil drilling locations identified. Management is forecasting a December 2010 average production rate of 3,800 boe per day weighted 65 percent to oil and natural gas liquids.

MANAGEMENT'S DISCUSSION AND ANALYSIS

This Management's Discussion and Analysis (MD&A) of the consolidated financial position and results of operations of Surge Energy Inc. ("Surge" or the "Company"), formerly Zapata Energy Corporation, which includes its subsidiaries and partnership arrangements, is for the three and six month periods ending June 30, 2010 and 2009. For a full understanding of the financial position and results of operations of the Company, the MD&A should be read in conjunction with the documents filed on SEDAR, including historical financial statements, press releases and the Annual Information Form (AIF). These documents are available at www.sedar.com.

FORWARD-LOOKING STATEMENTS

This MD&A contains forward-looking statements. More particularly, this MD&A contains statements concerning anticipated: (i) production weighting for 2010, (ii) exploration and development activities, (iii) changes to the Alberta royalty regime regulations in force, (iv) effect on Surge of anticipated changes to the Alberta royalty regime, (v) capital expenditures for 2010, (vi) sources of funding for future capital requirements, (vii) outcome and effect on Surge of outstanding legal proceedings and claims, (viii) amounts received or paid to settle financial instruments currently entered into upon maturity, and (ix) changes to accounting policies. The forward-looking statements are based on certain key expectations and assumptions made by Surge, including expectations and assumptions concerning the performance of existing wells and success obtained in drilling new wells, anticipated expenses, cash flow and capital expenditures and the application of regulatory and royalty regimes.

Although Surge believes that the expectations and assumptions on which the forward-looking statements are based are reasonable, undue reliance should not be placed on the forward-looking statements because Surge can give no assurance that they will prove to be correct. Since forward-looking statements address future events and conditions, by their very nature they involve inherent risks and uncertainties. Actual results could differ materially from those currently anticipated due to a number of factors and risks. These include, but are not limited to, risks associated with the oil and gas industry in general (e.g., operational risks in development, exploration and production; delays or changes in plans with respect to exploration or development projects or capital expenditures; the uncertainty of reserve estimates; the uncertainty of estimates and projections relating to production, costs and expenses, and health, safety and environmental risks), commodity price and exchange rate fluctuations and uncertainties resulting from potential delays or changes in plans with respect to exploration or development projects or capital expenditures. Certain of these risks are set out in more detail in this MD&A and in Surge's AIF which has been filed on SEDAR and can be accessed at www.sedar.com.

The forward-looking statements contained in this MD&A are made as of the date hereof and Surge undertakes no obligation to update publicly or revise any forward-looking statements or information, whether as a result of new information, future events or otherwise, unless so required by applicable securities laws.

All amounts are expressed in Canadian dollars unless otherwise noted. Oil, natural gas and natural gas liquids reserves and volumes are converted to a common unit of measure, referred to as a barrel of oil equivalent (boe), on the basis of 6,000 cubic feet of natural gas being equal to one barrel of oil. This conversion ratio is based on an energy equivalency conversion method, primarily applicable at the burner tip and does not necessarily represent a value equivalency at the wellhead. It should be noted that the use of boe might be misleading, particularly if used in isolation.

The terms "funds from operations", "funds from operations per share", and "netback" used in this discussion are not recognized measures under Canadian generally accepted accounting principles (GAAP). Management believes that in addition to net earnings, funds from operations and netback are useful supplemental measures as they provide an indication of the results generated by the Company's principal business activities before the consideration of how those activities are financed or how the results are taxed. Investors are cautioned, however, that these measures should not be construed as alternatives to net earnings determined in accordance with GAAP, as an indication of Surge's performance.

Surge's method of calculating funds from operations may differ from that of other companies, and, accordingly, may not be comparable to measures used by other companies. Surge determines funds from operations as cash flow from operating activities before changes in non-cash working capital and non-recurring recapitalization costs as follows:

	3 Months Ended June 30,		6 Months Ended June 30,	
($000s)	**2010**	2009	**2010**	2009
Cash flow from operating activities (per GAAP)	**(324)**	1,245	**5,079**	5,615
Change in non-cash working capital	**(345)**	2,608	**291**	1,757
Non-recurring recapitalization costs	**5,409**	-	**5,409**	-
Funds from operations	**4,740**	3,853	**10,779**	7,372

Funds from operations per share is calculated using the weighted average basic and diluted shares used in calculating earnings per share. Operating and corporate netbacks are also presented. Operating netbacks represent Surge's revenue, excluding realized and unrealized gain or losses on commodity contracts, less royalties and operating and transportation expenses. Corporate netbacks represent Surge's operating netback, less general and administrative and interest expenses, in order to determine the amount of funds generated by production. Operating and corporate netbacks have been presented on a per barrels of oil equivalent **("boe")** basis.

The term "net income (loss) before and after tax, excluding non-recurring charges relating to the recapitalization" used in this discussion is not a recognized measure under Canadian generally accepted accounting principles (GAAP). Management believes that in addition to net earnings, net income (loss) before and after tax, excluding non-recurring charges relating to the recapitalization is a useful supplemental measure, as it provides an indication of the results generated by the Company's principal business activities before the consideration of non-recurring recapitalization costs. Investors are cautioned, however, that these measures should not be construed as alternatives to net income determined in accordance with GAAP, as an indication of Surge's performance.

	3 Months Ended June 30,		6 Months Ended June 30,	
($000s)	**2010**	2009	**2010**	2009
Net loss before taxes (GAAP)	**(8,717)**	(1,887)	**(6,001)**	(4,297)
Add back:				
Recapitalization costs	**5,409**	-	**5,409**	-
Stock-based compensation expense relating to the recapitalization	**3,610**	-	**3,610**	-
Net income (loss) before tax excluding non-recurring charges relating to the recapitalization	**302**	(1,887)	**3,018**	(4,297)
Future income tax (reduction)	**313**	(593)	**861**	(1,362)
Net income (loss) excluding non-recurring charges relating to the recapitalization	**(11)**	(1,294)	**2,157**	(2,935)

Excluding the non-recurring recapitalization costs, as well as the increase in stock-based compensation that resulted from the recapitalization, the Company's approximate net income (loss) would have been nil for the three months ended June 30, 2010 and $2.2 million for the six months ended June 30, 2010.

Surge's management is responsible for the integrity of the information contained in this report and for the consistency between the MD&A and financial statements. In the preparation of these statements, estimates are necessary to make a determination of future values for certain assets and liabilities. Management believes these estimates have been based on careful judgments and have been properly presented. The financial statements have been prepared using policies and procedures established by management and fairly reflect Surge's financial position, results of operations and funds from operations.

Surge's Board of Directors and Audit Committee have reviewed and approved the financial statements and MD&A. This MD&A is dated August 25, 2010.

OPERATIONS

DRILLING

	Drilling		Success rate (%) gross	Working interest (%)
	Gross	Net		
Q1/2010	1	0.5	100%	50%
Q2/2010	6	6	83%	100%
Total	7	6.5	86%	93%

Surge achieved an 83 percent success rate in the second quarter of 2010, drilling six gross (6 net) wells, resulting in four gross (4 net) oil wells, one gross (1 net) injection well and one gross (1 net) dry hole. In the first half of 2010 Surge achieved an 86 percent success rate drilling seven gross (6.5 net) wells.

PRODUCTION

	Q2 2010	Q1 2010	Q4 2009	Q3 2009	Q2 2009	Q1 2009	Q4 2008	Q3 2008
Oil & NGL (bbls per day)	**1,621**	1,707	1,614	1,428	1,374	1,492	1,461	1,396
Natural gas (mcf per day)	**3,823**	5,874	6,887	6,295	7,586	7,223	9,079	9,932
Total (boe per day)	**2,258**	2,686	2,762	2,478	2,638	2,695	2,974	3,052
% Oil and NGL	**72**	64	58	58	52	55	49	46

Surge achieved production of 2,258 boe per day in the second quarter of 2010, a 14 percent decrease from the second quarter of 2009 production rate of 2,638 boe per day. Average production for the first half of 2010 was 2,471 boe per day as compared to 2,667 boe per day in the first half of 2009. The decrease in the quarterly and year to date production volumes compared to the 2009 rates was primarily due to Surge beginning and completing the shut in of a total of approximately 560 boe per day of natural gas and natural gas liquids production.

Surge realized a 72 percent oil and natural gas liquids production weighting in the second quarter of 2010. The Company realized average oil and natural gas liquids production of 1,621 bbls per day for the second quarter of 2010. Oil production volumes increased over the six months ended June 30, 2010 due to Surge's oil focused drilling program.

OIL, NATURAL GAS AND NGL, COMMODITY CONTRACTS AND OTHER REVENUES

A 32 percent increase in average revenue per boe resulted in revenues of $11.1 million in the second quarter of 2010, up from $9.0 million in the second quarter of 2009. In the first six months of 2010, a 42 percent increase in average revenue per boe resulted in revenues of $25.1 million, up from $19.1 million in the first six months of 2009.

Surge had certain oil and gas commodity contracts in place as of June 30, 2010. The Company recognized an unrealized gain of $0.02 million and a realized gain of $0.9 million on its commodity contracts in the second quarter of 2010. This compares to an unrealized loss of $0.02 million and a realized gain of $0.5 million on its commodity contracts in the second quarter of 2009.

The Company recognized an unrealized gain of $1.4 million and a realized gain of $1.2 million on its commodity contracts in the first six months of 2010. This compares to an unrealized loss of $1.1 million and a realized gain of $0.8 million on its commodity contracts in the first six months of 2009.

Please refer to the "Financial Instruments" section of this MD&A for further details on these oil and natural gas commodity contracts, and interest rate swaps.

PRICES

In the second quarter of 2010, Surge realized average revenue of $54.22 per boe, before realized commodity contract gains, an increase of 32 percent from the $40.94 per boe recorded in the second quarter of 2009. In the first six months of 2010, Surge realized average revenue of $56.17 per boe, before realized commodity contract gains, an increase of 42 percent from the $39.64 per boe recorded in the first six months of 2009.

Surge realized an average of $66.57 per bbl of oil and natural gas liquids in the second quarter of 2010, an increase of $8.07 per barrel from the $58.50 per bbl realized in the second quarter of 2009. This compares to an average Edmonton Light Sweet price of $75.09 per bbl in the second quarter of 2010, which increased $9.19 per barrel from the $65.90 per bbl in the second quarter of 2009. The increase in oil and natural gas liquids prices is consistent with the increase in benchmark prices.

Surge realized an average of $69.52 per bbl of oil and natural gas liquids in the first six months of 2010, an increase of $18.85 per barrel from the $50.67

per bbl realized in the first six months of 2009. This compares to an average Edmonton Light Sweet price of $77.58 per bbl in the first six months of 2010, which increased $19.59 per barrel from the $57.99 per bbl in the first six months of 2009. The increase in oil and natural gas liquids prices is consistent with the increase in benchmark prices.

The Company realized an average natural gas price of $3.74 per mcf in the second quarter of 2010, a four percent increase from the $3.59 per mcf averaged in the second quarter of 2009. This compares to an average Alberta Plant Gate reference price of $3.68 per mcf in the second quarter of 2010 and $3.27 per mcf in the second quarter of 2009 reflecting a 13 percent increase. The increase in gas prices is relatively consistent with the increase in reference prices.

The Company realized an average natural gas price of $4.62 per mcf in the first six months of 2010, a four percent increase from the $4.45 per mcf averaged in the first six months of 2009. This compares to an average Alberta Plant Gate reference price of $4.19 per mcf in the first six months of 2010 and $3.96 per mcf in the first six months of 2009 reflecting a six percent increase. The increase in gas prices is relatively consistent with the increase in reference prices.

Realized commodity contract gains resulted in an increase of $4.57 per boe to the average revenue for the second quarter of 2010. Realized commodity contract losses resulted in a decrease of $1.05 per boe to average revenue for the second quarter of 2009.

Realized commodity contract gains resulted in an increase of $2.62 per boe to the average revenue for the first six months of 2010. Realized commodity contract gains resulted in an increase of $1.59 per boe to average revenue for the first six months of 2009.

REVENUE AND REALIZED PRICES

	3 Months Ended June 30, 2010			6 Months Ended June 30, 2010		
	2010	2009	% Change	**2010**	2009	% Change
Oil and NGL ($000s)	**9,818**	7,315	34%	**20,930**	13,140	59%
Natural gas ($000s)	**1,301**	2,478	(47%)	**4,051**	5,961	(32%)
Processing and other ($000s)	**22**	35	37%	**138**	31	345%
Total oil, natural gas and NGL revenue ($000s)	**11,141**	9,042	23%	**25,119**	19,132	31%
Oil & NGL ($ per bbl)	**66.57**	58.50	14%	**69.52**	50.67	37%
Natural gas ($ per mcf)	**3.74**	3.59	4%	**4.62**	4.45	4%
Total oil, natural gas and NGL revenue ($ per boe)	**54.22**	40.94	32%	**56.17**	39.64	42%
Unrealized gain (loss) on commodity contracts ($ per boe)	**0.11**	(0.09)	222%	**3.15**	(2.34)	235%
Realized gain (loss) on commodity contracts ($ per boe)	**4.57**	(1.05)	535%	**2.62**	1.59	65%
Total oil, natural gas and NGL revenue after commodity contracts ($per boe)	**58.90**	39.80	48%	**61.94**	38.89	59%

ROYALTIES

Surge realized royalty expense of $2.1 million or 19 percent of revenue in the second quarter of 2010, compared to $1.2 million or 13 percent of revenue in the second quarter of 2009. In the first six months of 2010, Surge realized royalty expense of $4.0 million or 16 percent of revenue, compared to $2.4 million or 12 percent of revenue in the first six months of 2009.

The increase in royalties as a percentage of revenue for the second quarter and first half of 2010 compared to the same periods in 2009 is primarily due to $0.5 million of prior period royalty adjustments recorded in the second quarter of 2010. Excluding these prior period adjustments royalties would have been approximately 15 percent of revenue.

On January 1, 2009 the Alberta government's Alberta Royalty Framework (ARF) took effect. Under the ARF, royalty rates on conventional and non-conventional oil and natural gas production in Alberta may increase to a maximum of 50 percent. The sliding scale royalty calculations are based on a broader range of commodity prices and production rates.

In response to the drop in commodity prices experienced during the second half of 2008, on November 19, 2008, the Government of Alberta announced the introduction of a five year program of transitional royalty rates with the intent of promoting new drilling. Under this new program, companies drilling new natural gas or conventional oil wells (deeper than 1,000 metres and no deeper than 3,500 metres) will be given a one-time option, on a producing zone per well basis, to adopt either the new transitional royalty rates or those outlined in the ARF. In order to qualify for this program, wells must be drilled during the period starting on November 19, 2008 and ending on December 31, 2013. Following this period all new wells drilled will automatically be subject to the ARF.

On March 3, 2009, an incentive program designed to encourage the execution of new drilling projects in Alberta was announced in response to the global economic crisis and slowdown in drilling activity throughout the province of Alberta. The incentive program provides for a drilling royalty credit for new conventional oil and natural gas wells that initiate drilling on or after April 1, 2009 and that complete drilling by March 31, 2010. The incentive program also provides a reduced royalty rate on new wells for the first year of production or up to an established total production volume of 50,000 boe (boe cap is calculated at 10:1).

On June 25, 2009, the Government of Alberta announced that this program will be extended by one year to March 31, 2011. The incentive program is expected to positively impact the Company.

During the first six months of 2010, Surge recorded $0.6 million of drilling royalty credits as a reduction to capital costs.

As royalties under the ARF are sensitive to both commodity prices and production levels, the estimated ARF and corporate royalty rates will fluctuate with commodity prices, well production rates, production decline of existing wells, and performance and location of new wells drilled.

ROYALTIES

	3 Months Ended June 30,			6 Months Ended June 30,		
	2010	2009	% Change	**2010**	2009	% Change
Total ($000s)	**2,117**	1,160	83%	**4,001**	2,390	67%
% of revenue	**19%**	13%	6 points	**16%**	12%	4 points
$ per boe	**10.30**	4.83	113%	**8.95**	4.95	81%

OPERATING EXPENSE

Total operating expenses in the second quarter of 2010 were $3.1 million, up 21 percent from $2.6 million in the second quarter of 2009. Operating expense per boe increased 42 percent in the second quarter of 2010 to $15.29 per boe as compared to $10.78 per boe in the same period of 2009. For the first six months of 2010, total operating expenses were $7.0 million, up 10 percent from $6.4 million in the first six months of 2009. Operating expense per boe increased 19 percent in the first six months of 2010 to $15.73 per boe as compared to $13.22 per boe in the same period of 2009.

The increase in operating expenses per boe in the second quarter and second half of 2010 compared to the same periods in 2009 was primarily the result of increased workover and maintenance expenditures and increased government and regulatory costs, coupled with lower production levels due to shut in natural gas and natural gas liquids production in the second quarter of 2010.

Operating expenses per boe fell from $16.11 per boe in the first quarter of 2010 to $15.29 per boe in the second quarter of 2010, a five percent reduction. The new management team continues to focus on finding efficiencies within existing operations and expects combined operating and transportation expenses per boe to continue declining throughout the remainder of 2010.

OPERATING EXPENSES

	3 Months Ended June 30,			6 Months Ended June 30,		
	2010	2009	% Change	**2010**	2009	% Change
Total ($000s)	**3,140**	2,588	21%	**7,035**	6,379	10%
$ per boe	**15.29**	10.78	42%	**15.73**	13.22	19%

TRANSPORTATION EXPENSES

Transportation expenses in the second quarter of 2010 were $0.5 million or $2.33 per boe as compared to $0.5 million and $1.92 per boe recorded in the same period of 2009. The 21 percent increase in transportation costs per boe in the second quarter of 2010 compared to the same period in 2009 was primarily the result of lower production levels due to shut in natural gas and natural gas liquids production in the second quarter of 2010. For the first six months of 2010, transportation expenses totalled $1.3 million, a 22% increase over the first six months of 2009 expense of $1.0 million. The 32 percent increase in transportation costs per boe for the first half of 2010 compared to the same period in 2009 was primarily due to increased tariffs related to a three year transportation agreement recorded in the first quarter of 2010 coupled with lower production levels due to shut in natural gas and natural gas liquids production in the second quarter of 2010.

Transportation expense per boe fell 37 percent from $3.21 per boe in the first quarter of 2010 to $2.33 per boe in the second quarter of 2010. The new management team continues to focus on finding efficiencies within existing operations and expects combined operating and transportation expenses per boe to continue declining throughout the remainder of 2010.

TRANSPORTATION EXPENSES

	3 Months Ended June 30,			6 Months Ended June 30,		
	2010	2009	% Change	**2010**	2009	% Change
Total ($000s)	**478**	460	4%	**1,255**	1,027	22%
% of revenue	**4%**	5%	nm	**5%**	5%	-
$ per boe	**2.33**	1.92	21%	**2.81**	2.13	32%

GENERAL AND ADMINISTRATIVE EXPENSES (G&A)

Net G&A expenses for the second quarter of 2010 increased 61 percent to $6.76 per boe as compared to $4.21 per boe in the second quarter of 2009. Total G&A expense for the second quarter of 2010 net of recoveries and capitalized amounts of $0.6 million was $1.4 million, compared to $1.0 million in the second quarter of 2009 after recoveries and capitalized amounts of $0.1 million.

Net G&A expenses for the first half of 2010 increased to $5.58 per boe as compared to $3.79 per boe for the same period of 2009. Total G&A expense for the second half of 2010 net of recoveries and capitalized amounts of $1.0 million was $2.5 million, compared to $1.8 million in the second half of 2009 after recoveries and capitalized amounts of $0.1 million. The increase in net G&A per boe in the second quarter and first half of 2010 is due primarily to additional rent on newly acquired office space and increased consulting expenditures coupled with lower production levels due to shut in natural gas and natural gas liquids production in the second quarter of 2010.

The increase in recoveries was a result of the new management group capitalizing more administrative costs directly attributable to exploration activities, due to an increased focus on these types of activities.

Net G&A expenses are forecast to decrease in each of the third and fourth quarters and average below $5.00 per boe for the second half of 2010.

G&A EXPENSES

	3 Months Ended June 30,			6 Months Ended June 30,		
	2010	2009	% Change	**2010**	2009	% Change
Total	**1,973**	1,104	79%	**3,458**	1,931	71%
Recoveries and capitalized amounts	**(580)**	(95)	511%	**(964)**	(101)	854%
Net G&A	**1,393**	1,009	38%	**2,494**	1,830	36%
Net G&A expense per boe ($)	**6.76**	4.21	61%	**5.58**	3.79	47%

RECAPITALIZATION COSTS

On April 13, 2010, the Company was recapitalized by a new management group and board of directors. During the course of the recapitalization, certain non-recurring extraordinary recapitalization costs were incurred. These costs do not reflect the ongoing cost of business incurred by Surge and are comprised primarily of legal fees, financial adviser fees, severance and transaction due diligence costs.

RECAPITALIZATION COSTS

	3 Months Ended June 30,			6 Months Ended June 30,		
	2010	2009	% Change	**2010**	2009	% Change
Recapitalization costs ($)	**5,409**	-	nm	**5,409**	-	nm

INTEREST EXPENSE

Surge realized interest expense of $0.2 million or $0.94 per boe in the second quarter of 2010 as compared to $0.5 million or $1.99 per boe in the second quarter of 2009. For the first six months of 2010, the Company realized interest expense of $0.6 million or $1.37 per boe as compared to $0.8 million or $1.72 per boe in the first six months of 2009. The decrease is due to the repayment of all of Surge's outstanding debt during the second quarter of 2010.

INTEREST EXPENSE

	3 Months Ended June 30,			6 Months Ended June 30,		
	2010	2009	% Change	**2010**	2009	% Change
Interest expense ($000s)	**194**	478	(59%)	**614**	829	(26%)
$ per boe	**0.94**	1.99	(53%)	**1.37**	1.72	(20%)

NETBACKS

Surge's operating netback per boe (defined as revenue excluding realized and unrealized gain or losses on commodity contracts per boe less royalties, operating and transportation expenses on a per boe basis) was $26.30 in the second quarter of 2010, a 12 percent increase from $23.41 recorded in the second quarter of 2009. The increase in operating netback was largely due to a 32 percent increase in revenue per boe, partially offset by a 113 percent increase in royalty expenses per boe, a 21 percent increase in transportation expenses per boe and a 42 percent increase in operating costs per boe in the second quarter of 2010, compared to the same period in 2009. Surge's second quarter 2010 operating and corporate netback was negatively impacted by one time, prior period royalty adjustments recorded in the second quarter of 2010.

For the first six months of 2010, the operating netback of the Company was $28.68 per boe, a 48% increase over the $19.34 per boe recorded in the first six months of 2009. The increase in operating netback was largely due to a 42 percent increase in revenue per boe, partially offset by a 81 percent increase in royalty expenses per boe, a 19 percent increase in operating costs per boe and a 32 percent increase in transportation expenses per boe in the second half of 2010 as compared to the same period in 2009. Surge's year to date operating and corporate netback was negatively impacted royalty adjustment pertaining to previous period's estimated royalites recorded in the second quarter of 2010.

Surge's corporate netback, defined as operating netback per boe less G&A and interest expense per boe, was $18.60 in the second quarter of 2010, an eight percent increase as compared to $17.21 in the second quarter of 2009. The increase in corporate netback was impacted by the reduction of interest expense per boe in the second quarter of 2010 as compared to the same period of 2009.

For the first six months of 2010, the corporate netback of the Company was $21.73 per boe, a 57% increase over the $13.83 per boe recorded in the first six months of 2009. The increase in corporate netback was impacted by the reduction of interest expense per boe in the first half of 2010 as compared to the same period of 2009.

Operating expenses per boe fell from $16.11 per boe in the first quarter of 2010 to $15.29 per boe in the second quarter of 2010, a five percent reduction. Transportation expense per boe fell 27 percent from $3.21 per boe in the first quarter of 2010 to $2.33 per boe in the second quarter of 2010. The new management team continues to focus on finding efficiencies within existing operations and expects combined operating and transportation expenses per boe to continue declining throughout the remainder of 2010.

CORPORATE AVERAGE NETBACK

	3 Months Ended June 30,			6 Months Ended June 30,		
($ per boe, except production)	**2010**	2009	% Change	**2010**	2009	% Change
Average production (boe per day)	**2,258**	2,638	(14%)	**2,471**	2,667	(7%)
Revenue	**54.22**	40.94	32%	**56.17**	39.64	42%
Royalties	**(10.30)**	(4.83)	113%	**(8.95)**	(4.95)	81%
Operating costs	**(15.29)**	(10.78)	42%	**(15.73)**	(13.22)	19%
Transportation costs	**(2.33)**	(1.92)	21%	**(2.81)**	(2.13)	32%
Operating netback	**26.30**	23.41	12%	**28.68**	19.34	48%
Interest expense	**(0.94)**	(1.99)	(53%)	**(1.37)**	(1.72)	(20%)
G&A expense	**(6.76)**	(4.21)	61%	**(5.58)**	(3.79)	47%
Corporate netback	**18.60**	17.21	8%	**21.73**	13.83	57%

FUNDS FROM OPERATIONS AND CASH FLOW FROM OPERATIONS

For the second quarter of 2010 funds from operations increased by 23 percent to $4.7 million compared to $3.9 million in the second quarter of 2009. On a per share basis, funds from operations decreased by 26 percent to $0.17 per basic share in the second quarter 2010 from $0.23 per basic share in the same period of 2009. Funds from operations increased by 44 percent on a per boe basis to $23.08 in the second quarter of 2010 from $16.05 in the second quarter of 2009.

For the first six months of 2010, funds from operations increased by 46 percent to $10.8 million compared to $7.4 million in the first six months of 2009.

On a per share basis, funds from operations increased by five percent to $0.46 per basic share in the second quarter 2010 from $0.44 per basic share in the same period of 2009. Funds from operations increased by 107 percent on a per boe basis to $24.10 in the first six months of 2010 from $11.63 in the first six months of 2009.

Cash flow from operations differs from funds from operations due to the inclusion of changes in non-cash working capital, as well as non-recurring recapitalization costs. Cash flow from operations for the second quarter of 2010 was a loss of $0.3 million as compared to $1.2 million in the second quarter of 2009. Included in cash flow from operations is an increase in non-cash working capital of $0.3 million for the second quarter of 2010 and a decrease of $2.6 million for the same period of 2009. Cash flow from operations for the first six months of 2010 was $5.1 million as compared to $5.6 million in the first six months of 2009. Included in cash flow from operations is a decrease in non-cash working capital of $0.3 million for the first six months of 2010 and a decrease of $1.8 million for the same period of 2009.

FUNDS FROM OPERATIONS

	3 Months Ended June 30,			6 Months Ended June 30,		
	2010	2009	% Change	**2010**	2009	% Change
Total ($000s)	**4,740**	3,853	23%	**10,779**	7,372	46%
Per share – basic ($)	**0.17**	0.23	(26%)	**0.46**	0.44	5%
Per share – diluted ($)	**0.17**	0.23	(26%)	**0.46**	0.44	5%
Per boe ($)	**23.08**	16.05	44%	**24.10**	11.63	107%
Cash flow from operations ($000s)	**(324)**	1,245	(126%)	**5,079**	5,615	(10%)

STOCK-BASED COMPENSATION

Surge recorded stock-based compensation expense of $4.1 million in the second quarter of 2010 compared to $0.1 million for the same period of 2009, calculated using the Black-Scholes option-pricing model. For the six months ended June 30, 2010, Surge recorded stock-based compensation expense of $4.2 million in the second quarter of 2010 compared to $0.1 million for the same period of 2009.

During the six months ended June 30, 2010 1,478,000 options were issued at a weighted average exercise price of $6.33 per option and 75,000 options were forfeited at a weighted average price of $6.60 per option. In addition, as a result of the recapitalization transaction, all options held on April 13, 2010 vested in full and the remaining stock-based compensation on these options was recognized in the second quarter of 2010.

Included in the three and six month periods stock-based compensation expense is an additional $3.6 million of stock-based compensation expense related to the fair value of flow-through share premiums and performance warrants issued on April 13, 2010 as part of the recapitalization transaction was recorded in the second quarter 2010.

The following assumptions were used to calculate stock-based compensation for the six months ended June 30, 2010: zero dividend yield; expected volatility of 69%; risk free rate of 2%; and expected life of five years.

STOCK-BASED COMPENSATION EXPENSE

	3 Months Ended June 30,			6 Months Ended June 30,		
($000s, except per unit amounts)	**2010**	2009	% Change	**2010**	2009	% Change
Stock-based compensation expense	**4,084**	56	nm	**4,160**	113	nm
Per boe ($)	**19.88**	0.24	nm	**9.30**	0.23	nm

DEPLETION, DEPRECIATION AND ACCRETION (DD&A)

Depletion and depreciation are calculated based upon capital expenditures, production rates and reserves. Surge uses the asset retirement obligation method to record the present value of estimated clean-up and restoration costs for all of its facilities, including well sites and pipelines. The liability amount is increased each reporting period due to the passage of time and the amount of accretion is charged to earnings in the period. Excluded from the Company's depletion and depreciation calculation are costs associated with salvage values, unproven properties and seismic of $21.5 million. Future development costs for proved reserves of $14.4 million have been included in the depletion calculation.

Surge recorded $4.0 million or $19.51 per boe in DD&A expense in the second quarter of 2010, a three percent decrease as compared to $20.20 per boe in DD&A expense in the second quarter of 2009.

In the first six months of 2010, $8.6 million or $19.27 per boe in DD&A expense were recorded, a four percent decrease as compared to $20.00 per boe in DD&A expense in the first six months of 2009.

This DD&A calculation is based on production volumes of 205,460 boe for the quarter. This decrease in the DD&A rate per boe is primarily due to reserve addition related to the drilling program completed in the last half of 2009.

DEPLETION, DEPRECIATION AND ACCRETION (DD&A) EXPENSE

	3 Months Ended June 30,			6 Months Ended June 30,		
	2010	2009	% Change	**2010**	2009	% Change
DD&A ($000s)	**4,005**	4,849	(17%)	**8,617**	9,655	(11%)
Per boe ($)	**19.51**	20.20	(3%)	**19.27**	20.00	(4%)

INCOME AND OTHER TAXES

Surge recognized a combined future tax liability of approximately $17.6 million as at June 30, 2010, a decrease of $0.1 million from the year-end 2009 future tax liability of 17.6 million. The future tax liability increased by $0.7 million related to the $2.6 million of flow-through shares issued in 2009 and renounced in 2010. The future tax liability also decreased by the future tax reduction of $0.7 million for the first six months of 2010. As at June 30, 2010, the Company has incurred $1.4 million towards the 2009 flow-through share obligation and has satisfied the terms of this flow-through share offering.

The provision for income taxes differs from the amount obtained by applying the combined federal and provincial income tax rate for 2010, which was 28 percent and is calculated on earnings before income taxes. The difference is mainly due to future tax rate differences.

TAX EXPENSES (REDUCTION)

	3 Months Ended June 30,			6 Months Ended June 30,		
	2010	2009	% Change	**2010**	2009	% Change
Total ($000s)	**(1,202)**	(593)	103%	**(654)**	(1,362)	52%
Per boe ($)	**(5.85)**	(2.47)	137%	**(1.46)**	(2.82)	48%

NET INCOME (LOSS)

The Company recorded net losses for the three months ended June 30, 2010 of $7.5 million or $0.27 per basic share, a decrease of 481 percent from the $1.3 million of net losses recorded for the comparable three months of 2009. For the six months ended June 30, 2010, the Company recorded net losses of $5.3 million or $0.23 per basic share, an increase of 82 percent from the $2.9 million in net losses recorded in the first six months of 2009. The non-recurring recapitalization costs, combined with the increased stock-based compensation that resulted from the recapitalization and one time, prior period royalty adjustments recorded in the second quarter of 2010, were large contributors to the net loss.

NET INCOME (LOSS)

	3 Months Ended June 30,			6 Months Ended June 30,		
	2010	2009	% Change	**2010**	2009	% Change
Total ($000s)	**(7,515)**	(1,294)	481%	**(5,347)**	(2,935)	82%
Per share – basic ($)	**(0.27)**	**(0.08)**	238%	**(0.23)**	(0.18)	28%
Per share –diluted ($)	**(0.27)**	**(0.08)**	238%	**(0.23)**	**(0.18)**	28%

CAPITAL EXPENDITURES

Capital expenditures, net of any applicable Alberta drilling royalty credits, for the second quarter of 2010 were $2.4 million, a 14 percent decrease from the $2.8 million spent in the second quarter of 2009. Surge invested $1.0 million to drill six gross (6 net) wells, $0.4 million on seismic and land acquisitions, $0.1 million on acquisitions and $0.8 million on other capital items.

In the first half of the year Surge invested $3.7 million to drill seven gross (6.5 net) wells, $3.1 million on seismic and land acquisitions, $0.6 million on facilities and equipment, $0.1 on acquisitions and $1.2 million on other capital items.

CAPITAL EXPENDITURE SUMMARY

($000s)	YTD 2010	Q2 2010	Q1 2010
Land and seismic	3,140	439	2,701
Drilling and intangibles	4,304	1,551	2,753
Facilities & equipment	581	1	580
Acquisitions	104	104	-
Other	1,234	845	389
Total gross capital	9,363	2,940	6,423
Alberta drilling royalty credits	(587)	(514)	(73)
Total net capital	8,776	2,426	6,350

QUARTERLY AND ANNUAL FINANCIAL INFORMATION

	Q2 2010	Q1 2010	Year Ended Dec 31 2009	Q4 2009	Q3 2009	Q2 2009	Q1 2009	Year Ended Dec 31 2008	Q4 2008	Q3 2008
Oil, NGL & natural gas sales	11,141	13,978	42,853	12,932	10,788	9,829	9,304	71,160	13,047	22,129
Unrealized gain (loss) on financial derivatives	23	1,386	(1,222)	(1,116)	1,026	(22)	(1,110)	1,852	221	4,764
Provision for bad debt	-	115	840	-	-	840	-	3,053	1,053	1,333
Net earnings (loss)	(7,515)	2,168	(2,112)	(21)	844	(1,294)	(1,641)	7,698	(483)	5,649
Net earnings (loss) per share ($)										
Basic	(0.27)	0.12	(0.13)	-	0.05	(0.08)	(0.10)	0.45	(0.02)	0.33
Diluted	(0.27)	0.11	(0.13)	-	0.05	(0.08)	(0.10)	0.45	(0.02)	0.33
Average daily sales										
Natural gas (mcf/d)	3,823	5,874	6,995	6,887	6,295	7,586	7,223	9,056	9,079	9,932
Oil (bbls/d)	1,621	1,707	1,349	1,504	1,315	1,238	1,339	1,164	1,303	1,099
Barrels of oil equivalent (boe/d)	2,258	2,686	2,643	2,762	2,478	2,638	2,695	2,875	2,974	3,052
Average sales price										
Natural gas ($/mcf)	3.74	5.20	4.85	4.63	4.13	3.59	5.41	8.38	7.91	7.79
Oil & NGL ($/bbl)	66.57	72.35	58.84	69.52	65.17	58.48	42.18	82.77	55.47	103.12
Barrels of oil equivalent ($/boe)	54.22	57.83	45.32	51.44	47.17	39.88	37.82	65.96	51.89	75.81

SHARE CAPITAL AND OPTION ACTIVITY

Share capital	Q2 2010	Q1 2010	Q4 2009	Q3 2009	Q2 2009	Q1 2009	Q4 2008	Q3 2008
Weighted common shares	27,589,374	18,576,487	16,699,721	16,666,811	16,668,503	16,695,117	16,791,271	17,049,299
Stock option dilution (treasury method)[1]	-	457,033	-	69,353	-	-	25,146	201,320
Weighted average diluted shares outstanding[1]	27,589,374	19,033,520	16,699,721	16,736,164	16,668,503	16,695,117	16,816,417	17,250,619

1 In computing the net loss per diluted share, nil shares were added to the weighted average number of shares outstanding because they were anti-dilutive.

On January 19, 2010, the Corporation issued 848,600 units at a price of $3.00 per unit, with each unit consisting of one common share and one-half of a common share purchase warrant (with each whole warrant exercisable into one common share at a price of $4.00 per share until December 23, 2010), for total gross proceeds of $2,545,800. Certain former officers and directors purchased 20,000 units for total gross proceeds of $60,000.

On January 29, 2010, the Corporation issued 78,333 units at a price of $3.00 per unit, with each unit consisting of one common share and one-half of a common share purchase warrant (with each whole warrant exercisable into one common share at a price of $4.00 per share until December 23, 2010), for total gross proceeds of $235,000.

On April 13, 2010, pursuant to a private placement, the new management group, together with certain additional subscribers identified by the new management group, subscribed for 1,394,317 common units of the Corporation at a price of $4.40 per common unit, 1,787,500 common shares of the Corporation at a price of $4.40 per common share and 681,819 flow-through units at a price of $4.40 per flow-through unit, for total proceeds to the

Corporation of approximately $17,000,000. Each common unit is comprised of one common share and one common share performance warrant, entitling the holder to purchase one common share at a price of $5.17 for a period of five years. Each flow-through unit is comprised of one common share issued on a flow-through basis pursuant to the Income Tax Act of Canada and one common share performance warrant, also entitling the holder to purchase one common share at a price of $5.17 for a period of five years. The common and flow-through shares issued as part of the common and flow-through units were ascribed a value of $3.30 per share or $6,851,000 due to the escrow restrictions described below. For further details on the vesting conditions and valuation of the common share performance warrants, please refer to note 4(d). The Corporation also recorded $331,000 of stock-based compensation on the flow-through units.

All of the units issued were acquired by contractors, employees, officers or directors of the Company ("deemed service providers"). For deemed service providers, units acquired through the private placement are held under an escrow agreement in which one-third of the units are to be released equally every six months following the date of issuance. No securities will be released from escrow after the date the deemed service provider ceases to be a service provider, unless directed by a resolution of the Board of Directors. Upon the deemed service provider ceasing to be a service provider, Surge will repurchase for cancellation or provide for a transfer to another deemed service provider all of the securities of the deemed service provider then held in escrow at a price equal to the lessor of $4.40 per unit and the market price of the common shares of Surge on the last day of trading immediately prior to the deemed service provider ceasing to be a service provider.

Certain officers and directors of the Corporation purchased 1,099,413 common units, 661,951 flow-through units and 9,088 common shares as part of the private placement.

On May 5, 2010, the Corporation issued 6,945,000 common shares at a price of $7.20 per share for gross proceeds of $50,004,000, pursuant to a short form prospectus.

During the three month period ended June 30, 2010 two share purchase loans aggregating $360,000 due from two former officers of the Corporation were repaid. The loans bore interest at a rate of 4.75% and were due on June 30, 2010. The entire amount of the principal and interest outstanding has been repaid and the related common shares totaling 160,000 were issued. The 160,000 shares attributable to the share purchase loans had been included in the stock options and are shown as part of the stock options exercised balance above.

On August 25, 2010 Surge had 47,642,848 common shares, 407,699 warrants, 2,076,136 performance warrants and 1,717,666 options outstanding.

LIQUIDITY AND CAPITAL RESOURCES

On June 30, 2010, Surge had a net working capital surplus of $22.9 million.

Surge anticipates that future capital requirements will be funded through a combination of internal cash flow, debt and/or equity financing. There is no assurance that debt and equity financing will be available on terms acceptable to the Company to meet its capital requirements.

The Company has an $80,000,000 extendible, revolving term credit facility with a Canadian bank bearing interest at bank rates. The facility is available on a revolving basis until July 16, 2011. On July 16, 2011, at the Company's discretion, the facilities are available on a non-revolving basis for a one-year period, at the end of which time the facility would be due and payable. Alternatively, the facilities may be extended for a further 364-day period at the request of the Company and subject to the approval of the syndicate. As the available lending limits of the facilities are based on the syndicate's interpretation of the Company's reserves and future commodity prices there can be no assurance that the amount of the available facilities will not decrease at the next scheduled mid-year review on or before October 1, 2010. Interest rates vary depending on the ratio of net debt to cash flow.

The facility is secured by a general assignment of book debts, debentures of $200,000,000 with a floating charge over all assets of the Company with a negative pledge and undertaking to provide fixed charges on the major producing petroleum and natural gas properties at the request of the bank.

RELATED-PARTY AND OFF-BALANCE-SHEET TRANSACTIONS

Certain former officers and directors of the Company purchased 20,000 units for total gross proceeds of $60,000 as part of the January 19, 2010 equity offering.

Surge was not involved in any off-balance-sheet transactions during the three or six months ended June 30, 2010.

At December 31, 2009 two share purchase loans aggregating $360,000 were due from two former officers of the Company and had been deducted from share capital. The loans bore interest at a rate of 4.75% and were due on June 30, 2010. On April 13, 2010, the entire amount of the principal and interest outstanding has been repaid and the related common shares totalling 160,000 have been issued.

Certain officers and directors participated in the April 13, 2010 private placement. A total of 1,770,452 common shares, units and flow-through units were purchased for gross proceeds of $7.8 million.

CONTRACTUAL OBLIGATIONS AND CONTINGENCIES

The Company has entered into farm-in agreements in the normal course of its business.

Surge has future minimum lease payments relating to its operating leases totalling $2.6 million, as summarized below:

Future Minimum Lease Payments ($000s)	
2010	421
2011	829
2012	849
2013	398
2014	108
Total	**2,605**

In 2009, the Company issued a total of 757,000 flow-through common shares at $3.40 per share for gross proceeds of $2.6 million. The Company renounced these qualifying petroleum and natural gas expenditures on December 31, 2009. As at June 30, 2010, the Company had incurred $1.4 million towards this flow-through share obligation and has remaining eligible exploration expenditures of $1.2 million to be spent before December 31, 2010 to satisfy the terms of this flow-through share offering.

On April 13, 2010 the Company issued a total of 681,819 flow-through common shares at a price of $4.40 per share as part of a flow-through unit for gross proceeds of $3.0 million. The Company intends to renounce the tax benefit to subscribers effective December 31, 2010. The Company is committed to expanding the entire gross proceeds on qualified exploration activities before December 31, 2011.

FINANCIAL INSTRUMENTS:

Derivative contracts are recorded at fair value based on an estimate of the amounts that would have been received or paid to settle these instruments prior to maturity given future market prices and other relevant factors. The actual amounts received or paid to settle these instruments at maturity could differ significantly from those estimated.

The following table outlines the realized and unrealized gains (losses) on oil and gas commodity contracts for the three and six months ended June 30, 2010:

Term	Type (floating to fixed)	Volume	Swap Price (Surge receives C$)	Index (Surge pays)	Unrealized gains (losses) for the three months ended June 30, 2010 (C$)	Unrealized gains (losses) for the six months ended June 30, 2010 (C$)	Realized gains (losses) for the three months ended June 30, 2010 (C$)	Realized gains (losses) for the six months ended June 30, 2010 (C$)
Jan 1 – Dec 31, 2010	Swap	2,000 GJs/d	$5.80	AECO Monthly Average	($438)	$361	$463	$594
Apr 1 – Oct 31, 2010	Swap	1,000 GJs/d	$5.32	AECO Monthly Average	($177)	$182	$151	$151
Nov 1, 2009 - Mar 31, 2010	Swap	500 GJs/d	$6.00	AECO Monthly Average	-	($35)	($13)	$42
Jan 1 - Dec 31, 2010	Swap	100 bbls/d	$86.00	C$ WTI - NYMEX	$77	$95	$62	$90
Jan 1 - Dec 31, 2010	Swap	100 bbls/d	$84.00	C$ WTI - NYMEX	$101	$131	$38	$54
Jan 1 - Dec 31, 2010	Swap	100 bbls/d	$86.00	C$ WTI - NYMEX	$77	$95	$62	$90
Jan 1 - Dec 31, 2010	Swap	200 bbls/d	$81.00	C$ WTI - NYMEX	$275	$370	$4	-
Feb 1 - Dec 31, 2010	Swap	100 bbls/d	$87.75	C$ WTI - NYMEX	$50	$105	$85	$104
Feb 1 - Dec 31, 2010	Swap	100 bbls/d	$87.90	C$ WTI - NYMEX	$58	$108	$87	$106
					$23	**$1,412**	**$939**	**$1,231**

The following table outlines the unrealized and realized loss on an interest rate swap contract for the three and six months ended June 30, 2010:

Term	Type (floating to fixed)	Amount (C$)[1]	Company fixed interest rate (%)	Counterparty floating rate index	Unrealized (losses) for the Three Months Ended June 30, 2010 (C$) ($000s)	Unrealized (losses) for the Six Months Ended June 30, 2010 (C$) ($000s)	Realized (losses) for the Three Months Ended June 30, 2010 (C$) ($000s)	Realized (losses) for the Six Months Ended June 30, 2010 (C$) ($000s)
Feb 24 – April 15, 2010	Swap	35,000,000	4.42 to 4.44	CAD-BA-CDOR	-	($3)	-	($60)

SUBSEQUENT EVENTS

a) On July 9th, 2010 the Corporation acquired a private oil and gas company. As consideration, approximately 16.0 million common shares were issued at an approximate value of $94.5 million.

b) On July 19th, 2010 the Corporation acquired another private oil and gas company. As consideration, approximately 288,639 common shares were issued at an approximate value of $1.7 million.

c) Subsequent to June 30, 2010, the Corporation entered into two financial oil contracts:

i) The first contract is for 250 bbls/day of oil with a fixed swap price $80 Canadian per barrel. The contract is for the period from January 1, 2011 to December 31, 2011.

ii) The second contract is for 250 bbls/day of oil with a purchased call option at $96.55 Canadian per barrel. The contract is for the period from January 1, 2011 to December 31, 2011.

d) As part of the July 9th acquisition of a private oil and gas company, the Corporation assumed two financial natural gas contracts:

i) The first contract is a costless collar for 500 GJ/day of natural gas, with a floor price of $5.00 Canadian per GJ and a ceiling price of $6.55 Canadian per GJ. The contract is for the period from January 1, 2011 to December 31, 2011.

ii) The second contract is for 750 GJ/day of natural gas, with a fixed price of $5.64 Canadian per GJ. The contract is for the period from March 01, 2009 to December 31, 2010.

RISK FACTORS

Additional risk factors can be found under "Risk Factors" in the Company's 2009 Annual Information Form and 2009 Annual Report which can be found on www.sedar.com. The risks discussed should not be construed as exhaustive. There are numerous factors, both known and unknown, that could cause actual results or events to differ materially from forecast results.

CHANGES IN ACCOUNTING POLICIES

Effective January 1, 2011, Canadian public companies are required to adopt International Financial Reporting Standards ("IFRS"). In the time leading up to the conversion date, some existing Canadian standards will change to converge with IFRS. The Company's financial statements up to and including the December 31, 2010 financial statements will continue to be reported in accordance with Canadian GAAP as it exists on each reporting date. Financial statements for the quarter ended March 31, 2011, including comparative amounts, will be prepared on an IFRS basis. A transition plan is in place to convert the financial statements to IFRS. The Company continues to assess the effect of the transition on information systems, internal controls over financial reporting and disclosure controls and procedures. Systems and controls are being updated as IFRS accounting processes are implemented. Analysis and quantification of differences between IFRS and the Company's current accounting policies is continuing. Some accounting policies may change on adoption of IFRS even though the Company's current accounting policies are acceptable under IFRS. Changes in accounting policy may materially impact the financial statements. There are several significant accounting policy changes anticipated on adoption of IFRS. During the latter half of 2010, accounting policies will be finalized and IFRS impacts will be quantified and communicated to external stakeholders.

The key elements of Surge's changeover plan include:

- Determine appropriate changes to accounting policies and required amendments to financial disclosure;

- Identify and implement changes in associated processes and information systems;
- Comply with internal control requirements;
- Communicate collateral impacts to internal business groups; and
- Educate and train internal and external stakeholders.

Changes in IFRS prior to adoption may result in other accounting policy changes which could significantly impact the financial statements.

Numerous accounting policy changes will be made under IFRS, with the most significant changes expected to include accounting for petroleum and natural gas ("P&NG"), assets and equipment accounting for business combinations and accounting for future taxes. These are not intended to be a complete and comprehensive disclosure of all the possible significant accounting differences between the Company's current Canadian GAAP accounting policies and those expected under IFRS. The Company will disclose additional information on the impact of the changes throughout 2010. Any amendments to existing IFRS standards or implementation of new IFRS standards could lead to additional changes.

Consolidated Balance Sheets

(Formerly Zapata Energy Corporation)

(Unaudited)
(Stated in thousands of dollars)

	June 30, 2010	December 31, 2009
Assets		
Current assets:		
Cash	$ 23,332	$ -
Accounts receivable	6,452	4,061
Prepaid expenses and deposits	347	1,536
Fair value of financial contracts (note 5)	1,188	-
	31,319	5,597
Petroleum and natural gas properties (note 1)	129,878	126,763
	$ 161,197	$ 132,360
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	$ 8,125	$ 10,628
Fair value of financial contracts (note 5)	-	221
Bank debt (note 2)	-	41,650
Current future income taxes	326	-
	8,451	52,499
Future income taxes	17,265	17,636
Asset retirement obligations (note 3)	5,562	5,389
Shareholders' equity:		
Share capital (note 4)	88,251	16,209
Contributed surplus (note 4)	2,751	3,559
Performance warrants (note 4)	7,196	
Retained earnings	31,721	37,068
	129,919	56,836
Commitments (note 6)		
Subsequent events (note 7)		
	$ 161,197	$ 132,360

See accompanying notes to the interim consolidated financial statements.

Consolidated Statements of Operations, Comprehensive Loss and Retained Earnings

(Formerly Zapata Energy Corporation)

(Unaudited)

(Stated in thousands of dollars, except per share amounts)

	For the Three Months Ended June 30, 2010	For the Three Months Ended June 30, 2009	For the Six Months Ended June 30, 2010	For the Six Months Ended June 30, 2009
Revenues:				
Petroleum and natural gas	$ 11,141	$ 9,042	$ 25,119	$ 19,132
Royalties	(2,117)	(1,160)	(4,001)	(2,390)
Realized gain on financial contracts (note 5)	939	534	1,171	766
Unrealized gain (loss) on financial contracts (note 5)	23	(22)	1,409	(1,132)
	9,986	8,394	23,698	16,376
Expenses:				
Operating	3,140	2,588	7,035	6,379
Transportation	478	460	1,255	1,027
General and administrative	1,393	1,010	2,494	1,830
Stock-based compensation (note 4)	4,084	56	4,160	113
Interest expense	194	478	614	829
Bad debt provision	-	840	115	840
Depletion, depreciation and accretion	4,005	4,849	8,617	9,655
	13,294	10,281	24,290	20,673
Loss before the undernoted	(3,308)	(1,887)	(592)	(4,297)
Recapitalization costs	5,409	-	5,409	-
Loss before income taxes	(8,717)	(1,887)	(6,001)	(4,297)
Future income tax (reduction)	(1,202)	(593)	(654)	(1,362)
Net loss and comprehensive loss	(7,515)	(1,294)	(5,347)	(2,935)
Retained earnings, beginning of period	39,236	37,571	37,068	39,219
Common shares repurchased and cancelled	-	(20)	-	(27)
Retained earnings, end of period	$ 31,721	$ 36,257	$ 31,721	$ 36,257
Loss per share (note 4):				
Basic	$ (0.27)	$ (0.08)	$ (0.23)	$ (0.18)
Diluted	$ (0.27)	$ (0.08)	$ (0.23)	$ (0.18)

See accompanying notes to the interim consolidated financial statements.

Consolidated Statements of Cash Flows

(Formerly Zapata Energy Corporation)

(Unaudited)
(Stated in thousands of dollars)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2010	2009	**2010**	2009
Cash provided by (used in):				
Operating:				
Net loss including recapitalization costs of $5,409 for the three and six months ended June 30, 2010	**$ (7,515)**	$ (1,294)	**$ (5,347)**	$ (2,935)
Depletion, depreciation and accretion	**4,005**	4,849	**8,617**	9,655
Future income tax (reduction)	**(1,202)**	(593)	**(654)**	(1,362)
Bad debt provision	**-**	840	**115**	840
Stock-based compensation	**4,084**	56	**4,160**	113
Unrealized loss (gain) on financial contracts	**(23)**	22	**(1,409)**	1,132
Abandonment expenditures	**(18)**	(27)	**(112)**	(71)
Change in non-cash working capital	**345**	(2,608)	**(291)**	(1,757)
Cash flow from (used in) operating activities	**(324)**	1,245	**5,079**	5,615
Financing:				
Bank debt	**(40,900)**	7,500	**(41,650)**	9,600
Issue of common shares and performance warrants, net of issue costs	**69,452**	-	**72,208**	-
Repurchase of common shares under normal course issuer bid	**-**	(37)	**-**	(51)
Cash flow from investing activities	**28,552**	7,463	**30,558**	9,549
Investing:				
Petroleum and natural gas properties	**(2,422)**	(2,806)	**(8,776)**	(9,767)
Change in non-cash working capital	**(2,474)**	(5,902)	**(3,529)**	(5,397)
Cash flow used in investing activities	**(4,896)**	(8,708)	**(12,305)**	(15,164)
Change in cash	**23,332**	–	**23,332**	-
Cash, beginning of period	**–**	–	**-**	-
Cash, end of period	**$ 23,332**	$ –	**$ 23,332**	$ -
Interest paid	**$ 194**	$ 478	**$ 614**	$ 829

Cash is defined as cash and cash equivalents.

See accompanying notes to the interim consolidated financial statements.

Notes to the Interim Consolidated Financial Statements

(Formerly Zapata Energy Corporation)

For the three and six months ended June 30, 2010 and 2009
(Unaudited)
(Tabular amounts are stated in thousands of dollars, except share and per share data)

Surge Energy Inc.'s (the "Corporation"), formerly Zapata Energy Corporation, business consists of the exploration, development and production of oil and gas properties in western Canada.

The interim consolidated financial statements of the Corporation have been prepared by management in accordance with Canadian generally accepted accounting principles. The interim consolidated financial statements have been prepared following the same accounting policies and methods of computation as the consolidated financial statements for the year ended December 31, 2009. The following disclosure is incremental to the disclosure included with the annual financial statements. These interim consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto in the Corporation's annual report for the year ended December 31, 2009.

The consolidated financial statements include the accounts of the Corporation, its wholly-owned subsidiary and a partnership. All inter-entity transactions and balances have been eliminated. Certain comparative figures have been reclassified to conform with current period presentation.

1. PETROLEUM AND NATURAL GAS PROPERTIES:

June 30, 2010	Cost	Accumulated Depletion	Net Book Value
Petroleum and natural gas properties	$ 240,895	$ 111,017	$ 129,878

December 31, 2009	Cost	Accumulated Depletion	Net Book Value
Petroleum and natural gas properties	$ 229,352	$ 102,589	$ 126,763

During the three and six months ended June 30, 2010, the Corporation capitalized $580,000 (June 30, 2009 – $95,000) and $964,000 (June 30, 2009 - $101,000) of overhead-related costs to petroleum and natural gas properties. In addition, $1,977,000 in stock-based compensation and the related tax impact of $694,000 was capitalized during the three and six month periods ended June 30, 2010.

Costs associated with unproven properties, salvage values and seismic excluded from costs subject to depletion for the three and six months ended June 30, 2010 totaled $21,485,000 (June 30, 2009 – $19,059,000). Future development costs for proved reserves of $14,400,000 (June 30, 2009 – $7,800,000) have been included in the depletion calculation.

2. BANK DEBT:

The Corporation has an $80,000,000 extendible, revolving term credit facility with a Canadian bank bearing interest at bank rates. The facility is available on a revolving basis until July 16, 2011. On July 16, 2011, at the Corporation's discretion, the facility is available on a non-revolving basis for a one-year period, at the end of which time the facility would be due and payable. Alternatively, the facilities may be extended for a further 364-day period at the request of the Corporation and subject to the approval of the syndicate. As the available lending limits of the facilities are based on the syndicate's interpretation of the Corporation's reserves and future commodity prices there can be no assurance that the amount of the available facilities will not decrease at the next scheduled mid-year review on or before October 1, 2010. Interest rates vary depending on the ratio of net debt to cash flow.

The facility is secured by a general assignment of book debts, debentures of $200,000,000 with a floating charge over all assets of the Corporation with a negative pledge and undertaking to provide fixed charges on the major producing petroleum and natural gas properties at the request of the bank.

3. ASSET RETIREMENT OBLIGATIONS:

The Corporation's asset retirement obligations result from net ownership interests in petroleum and natural gas assets including well sites, gathering systems and processing facilities. The Corporation estimates the total undiscounted amount of cash flows required to settle its asset retirement obligations is approximately $38,540,000 (December 31, 2009 – $37,931,000) which will be incurred between 2011 and 2059. The majority of these costs will be incurred between 2011 and 2037. A credit-adjusted risk free rate of 8 percent (December 31, 2009 – 8 percent) was used to calculate the fair value of the asset retirement obligations.

A reconciliation of the asset retirement obligations is provided below:

	Six months ended June 30, 2010	Year Ended December 31, 2009
Balance, beginning of period	**$ 5,389**	$ 5,243
Liabilities incurred	**96**	(1)
Accretion expense	**189**	404
Abandonment expenditures	**(112)**	(257)
Balance, end of period	**$ 5,562**	$ 5,389

4. SHARE CAPITAL:

(A) AUTHORIZED:

Unlimited number of voting common shares

Unlimited number of preferred shares, issuable in series

(B) ISSUED AND OUTSTANDING:

	Number of Shares	Amount
Common shares:		
Balance, December 31, 2008	16,697,811	$ 12,641
Issued pursuant to unit offering	417,466	1,252
Issued pursuant to flow-through offering	757,000	2,574
Share issue costs	–	(315)
Tax effect of share issue costs	–	84
Shares purchased pursuant to a normal course issuer bid	(36,000)	(27)
Balance, December 31, 2009	17,836,277	$ 16,209
Issued pursuant to unit offering	926,933	2,781
Issued pursuant to private placement	3,863,636	14,716
Issued pursuant to short form prospectus	6,945,000	50,004
Share issue costs	-	(2,855)
Tax effect of share issue costs	-	760
Exercise of stock options	1,278,335	5,946
Exercise of warrants	258,500	1,034
Stock-based compensation of flow through units	-	331
Tax effect of flow-through shares issued in 2009		(675)
Balance, June 30, 2010	31,108,681	$ 88,251

On January 19, 2010, the Corporation issued 848,600 units at a price of $3.00 per unit, with each unit consisting of one common share and one-half of a common share purchase warrant (with each whole warrant exercisable into one common share at a price of $4.00 per share until December 23, 2010), for total gross proceeds of $2,545,800. Certain former officers and directors purchased 20,000 units for total gross proceeds of $60,000.On January 29, 2010, the Corporation issued 78,333 units at a price of $3.00 per unit, with each unit consisting of one common share and one-half of a common share purchase warrant (with each whole warrant exercisable into one common share at a price of $4.00 per share until December 23, 2010), for total gross proceeds of $235,000.

On April 13, 2010, pursuant to a private placement, the new management group, together with certain additional subscribers identified by the new management group, subscribed for 1,394,317 common units of the Corporation at a price of $4.40 per common unit, 1,787,500 common shares of the Corporation at a price of $4.40 per common share and 681,819 flow-through units at a price of $4.40 per flow-through unit, for total proceeds to the

Corporation of approximately $17,000,000. Each common unit is comprised of one common share and one common share performance warrant, entitling the holder to purchase one common share at a price of $5.17 for a period of five years. Each flow-through unit is comprised of one common share issued on a flow-through basis pursuant to the Income Tax Act of Canada and one common share performance warrant, also entitling the holder to purchase one common share at a price of $5.17 for a period of five years. The common and flow-through shares issued as part of the common and flow-through units were ascribed a value of $3.30 per share or $6,851,000 due to the escrow restrictions described below. For further details on the vesting conditions and valuation of the common share performance warrants, please refer to note 4(d). The Corporation also recorded $331,000 of stock-based compensation on the flow-through units.

All of the units issued were acquired by contractors, employees, officers or directors of the Company ("deemed service providers"). For deemed service providers, units acquired through the private placement are held under an escrow agreement in which one-third of the units are to be released equally every six months following the date of issuance. No securities will be released from escrow after the date the deemed service provider ceases to be a service provider, unless directed by a resolution of the Board of Directors. Upon the deemed service provider ceasing to be a service provider, Surge will repurchase for cancellation or provide for a transfer to another deemed service provider all of the securities of the deemed service provider then held in escrow at a price equal to the lessor of $4.40 per unit and the market price of the common shares of Surge on the last day of trading immediately prior to the deemed service provider ceasing to be a service provider.

Certain officers and directors of the Corporation purchased 1,099,413 common units, 661,951 flow-through units and 9,088 common shares as part of the private placement.

On May 5, 2010, the Corporation issued 6,945,000 common shares at a price of $7.20 per share for gross proceeds of $50,004,000, pursuant to a short form prospectus.

During the three month period ended June 30, 2010 two share purchase loans aggregating $360,000 due from two former officers of the Corporation were repaid. The loans bore interest at a rate of 4.75% and were due on June 30, 2010. The entire amount of the principal and interest outstanding has been repaid and the related common shares totaling 160,000 were issued. The 160,000 shares attributable to the share purchase loans had been included in the stock options and are shown as part of the stock options exercised balance above.

(C) STOCK OPTIONS:

Under the Corporation's stock option plan it may grant options to its employees for up to 3,110,868 common shares of the Corporation as at June 30, 2010. The exercise price of each option equals teh market price of teh Corporation's common shares at the date of grant. Options granted have a term of five years to maturity and vest as to one-third on each of the date of grant, the first and second anniversaries from the date of grant.

	Six Months Ended June 30, 2010		Year Ended December 31, 2009	
	Weighted Number of Options	**Weighted Average Exercise Price**	Weighted Number of Options	Weighted Average Exercise Price
Stock options outstanding, beginning of period	**1,878,001**	**$ 3.74**	1,643,666	$ 3.87
Granted	**1,478,000**	**$ 6.33**	345,000	$ 3.20
Exercised	**(1,278,335)**	**$ 3.47**	-	-
Forfeited	**(75,000)**	**$ 6.60**	(110,665)	$ 4.04
Stock options outstanding, end of period	**2,002,666**	**$ 5.72**	1,878,001	$ 3.74
Exercisable at end of period	**524,666**	**$ 3.97**	1,408,337	$ 4.07

(D) PERFORMANCE WARRANTS

As part of the private placement completed on April 13, 2010, 2,076,136 performance warrants were issued with an exercise price of $5.17 as part of the common share and flow-through units. The performance warrants vest and become exercisable as to one-third upon the 20 day weighted average trading price of the common shares equaling or exceeding $5.69, an additional one-third upon the trading price equaling or exceeding $6.20 and a final one-third upon the trading price equaling or exceeding $6.72. The performance warrants are released from escrow one third on each of the six, twelve and eighteen month anniversaries from the date of grant. The performance warrants expire on April 13, 2015. As at June 30, 2010, all 2,076,136 performance warrants were outstanding, exercisable and held in escrow.

A Black-Scholes derived fair value of $3.47 per warrant, or $7,196,000 was assigned to the performance warrants. As the consideration received on the common and flow-through units of $4.40 per share, or $9,135,000 was less than the total fair values ascribed to the common and flow-through shares

($6,851,000) and the performance warrants ($7,196,000) of $14,047,000, an additional stock-based compensation cost of $4,912,000 was recognized in the period.

(E) STOCK-BASED COMPENSATION

A reconciliation of the stock-based compensation expense is provided below:

($000s)	**Three Months Ended June 30, 2010**	Three Months Ended June 30, 2009	**Six Months Ended June 30, 2010**	Six Months Ended June 30, 2009
Stock-based compensation on options	**818**	57	**894**	113
Stock-based compensation on performance warrants (note 4 (d))	**4,912**	-	**4,912**	-
Stock-based compensation on flow-through share premiums (note 4 (b))	**331**	-	**331**	-
Capitalized stock-based compensation	**(1,977)**	-	**(1,977)**	-
Total stock-based compensation expense	**4,084**	57	**4,160**	113

The Corporation's stock-based compensation expense for the three and six month periods ended June 30, 2010 was $4,084,000 (June 30, 2009 - $56,000) and $4,160,000 (June 30, 2009 - $113,000), respectively. A Black-Scholes valuation model was applied to determine the fair value the options and performance warrants.

The following assumptions were used to calculate stock-based compensation on options granted for the six months ended June 30, 2010: zero dividend yield; expected volatility of 69%; risk free rate of 2%; and expected life of five years. The weighted average fair value of options granted in the first six months of 2010 is $3.81 per option.

The following assumptions were used to calculate stock-based compensation on performance warrants issued in the six months ended June 30, 2010: zero dividend yield; expected volatility of 69%; risk free rate of 3%; and expected life of five years. The weighted average fair value of performance warrants issued in the first six months of 2010 is $3.47 per performance warrant.

(F) CONTRIBUTED SURPLUS:

	Six Months ended June 30, 2010	Year Ended December 31, 2009
	($000s)	($000s)
Balance, beginning of period	**3,559**	3,178
Stock-based compensation expense on options	**894**	381
Transfer on exercise of stock options	**(1,702)**	-
Balance, end of period	**2,751**	3,559

(G) STOCK PURCHASE WARRANTS:

As part of equity financings completed in December 2009 and January 2010, the Corporation issued 672,199 warrants exercisable immediately at an exercise price of $4.00 and with an expiry date of December 23, 2010. As at June 30, 2010 there were 413,699 warrants outstanding and exercisable.

H) PER SHARE AMOUNTS:

The following table summarizes the shares used in calculating the loss per share:

	Three Months Ended June 30, 2010	Three Months Ended June 30, 2009	Six Months Ended June 30, 2010	Six Months Ended June 30, 2009
Weighted average number of shares – basic	**27,589,374**	16,668,503	23,187,606	16,681,736
Effect of dilutive stock options	-	-	-	-
Weighted average number of shares - diluted	**27,589,374**	16,668,503	23,187,606	16,681,736

5. FINANCIAL INSTRUMENTS

(A) CREDIT RISK:

Credit risk is the risk of financial loss to the Corporation if a customer or counter party to a financial instrument fails to meet its contractual obligations, and arises principally from the Corporation's receivables from joint venture partners and petroleum and natural gas marketers. As at June 30, 2010, the Corporation's receivables consisted of $3,249,000 due from petroleum and natural gas marketers and $3,203,000 due from joint venture partners. These amounts are presented net of the allowance for doubtful accounts.

The carrying value of cash, accounts receivable and the fair values of financial contracts represent the maximum credit exposure. The Corporation has an allowance for doubtful accounts of $0.1 million (December 31, 2009 - $4.0 million) at June 30, 2010. During the three and six months ended June 30, 2010, the Corporation wrote off no bad debts (June 30, 2009 – $840,000) and $115,000 of bad debts (June 30, 2009 – $840,000), respectively.

As at June 30, 2010 the Corporation estimates its total accounts receivables, net of the allowance for doubtful accounts, to be aged as follows:

Total accounts receivable ($000s)	Current	Past Due
$ 6,452	$ 5,408	$ 1,044
100%	84%	16%

(B) LIQUIDITY RISK:

Accounts payable are considered due to suppliers in one year or less while bank debt, which is subject to a renewal after a 364-day revolving period, could be potentially due within the next year if the facility is not renewed for a further 364-day period.

(C) MARKET RISK:

Market risk is the risk that changes in market prices, such as foreign exchange rates, commodity prices, and interest rates will affect the Corporation's net earnings or the value of financial instruments.

Foreign currency exchange risk:

The Corporation had no forward exchange rate contracts in place as at or during the three or six months ended June 30, 2010 or the year ended December 31, 2009.

Commodity price risk:

The following table outlines the realized and unrealized losses on oil and gas commodity contracts for the three and six months ended June 30, 2010:

Term	Type (floating to fixed)	Volume	Swap Price (Surge receives C$)	Index (Surge pays)	Unrealized gains (losses) for the three months ended June 30, 2010 (C$)	Unrealized gains (losses) for the six months ended June 30, 2010 (C$)	Realized gains (losses) for the three months ended June 30, 2010 (C$)	Realized gains (losses) for the six months ended June 30, 2010 (C$)
Jan 1 – Dec 31, 2010	Swap	2,000 GJs/d	$5.80	AECO Monthly Average	($438)	$361	$463	$594
Apr 1 – Oct 31, 2010	Swap	1,000 GJs/d	$5.32	AECO Monthly Average	($177)	$182	$151	$151
Nov 1, 2009 - Mar 31, 2010	Swap	500 GJs/d	$6.00	AECO Monthly Average	$0	($35)	($13)	$42
Jan 1 - Dec 31, 2010	Swap	100 bbls/d	$86.00	C$ WTI - NYMEX	$77	$95	$62	$90
Jan 1 - Dec 31, 2010	Swap	100 bbls/d	$84.00	C$ WTI - NYMEX	$101	$131	$38	$54
Jan 1 - Dec 31, 2010	Swap	100 bbls/d	$86.00	C$ WTI - NYMEX	$77	$95	$62	$90
Jan 1 - Dec 31, 2010	Swap	200 bbls/d	$81.00	C$ WTI - NYMEX	$275	$370	$4	($0)
Feb 1 - Dec 31, 2010	Swap	100 bbls/d	$87.75	C$ WTI - NYMEX	$50	$105	$85	$104
Feb 1 - Dec 31, 2010	Swap	100 bbls/d	$87.90	C$ WTI - NYMEX	$58	$108	$87	$106
					$23	**$1,412**	**$939**	**$1,231**

Interest rate risk:

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. Over the course of the three and six months ended June 30, 2010, the Corporation was exposed to interest rate fluctuations on its bank debt, which bears a floating rate of interest. As at June 30, 2010, if interest rates had been 100 basis points lower with all other variables held constant, net earnings for the six month period then ended would have been approximately $104,000 (June 30, 2009 - $222,000) higher, respectively, due to lower interest expense. An equal and opposite impact would have occurred to net earnings had interest rates been 100 basis points higher.

The following table outlines the unrealized and realized loss on an interest rate swap contract for the three and six months ended June 30, 2010:

Term	Type (floating to fixed)	Amount (C$)[1]	Company fixed interest rate (%)	Counterparty floating rate index	Unrealized (losses) for the Three Months Ended June 30, 2010 (C$) ($000s)	Unrealized (losses) for the Six Months Ended June 30, 2010 (C$) ($000s)	Realized (losses) for the Three Months Ended June 30, 2010 (C$) ($000s)	Realized (losses) for the Six Months Ended June 30, 2010 (C$) ($000s)
Feb 24 – April 15, 2010	Swap	35,000,000	4.42 to 4.44	CAD-BA-CDOR	-	($3)	-	($60)

The following table summarizes the sensitivity of the fair value of the Corporation's market risk management positions to fluctuations in both crude oil and natural gas prices. Both such fluctuations were evaluated independently, with all other variables held constant. In assessing the potential impact of these fluctuations, the Corporation believes that the volatilities presented below are reasonable measures. Fluctuations in crude oil and natural gas prices, which would impact the mark-to-market calculation of commodity contracts could have had the following impact on the net earnings:

	Net Earnings Impact Three Months Ended June 30, 2010	
	Price Increase	Price Decrease
Crude oil – Change of +/- $1.00	(96,600)	96,600
Natural gas – Change of +/- $0.50	(184,125)	184,125

(D) CAPITAL MANAGEMENT:

The Corporation manages its capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying petroleum and natural gas assets. The Corporation considers its capital structure to include shareholder's equity of $129,919,000 (December 31, 2009 - $56,836,000), bank debt of nil (December 31, 2009 - $41,650,000) and positive working capital of $22,868,000 (December 31, 2009 – deficiency of $5,252,000). In order to maintain or adjust capital structure, the Corporation may from time to time issue shares and adjust its capital spending to manage current and projected debt levels.

The Corporation monitors its capital based on the ratio of net debt to the rolling four quarter trailing funds from operations. Net debt is defined as outstanding bank debt plus or minus working capital. Funds from operations is defined as cash flow from operating activities before changes in non-cash working capital. The Corporation's strategy is to maintain a one year forward looking forecast debt to forecast funds from operations ratio of less than two to one. This ratio may increase at certain times as a result of acquisitions or other capital spending. In order to facilitate the management of this ratio, the Corporation prepares annual capital expenditure budgets, which are updated as necessary depending on varying factors including current and forecast prices, successful capital deployment and general industry conditions. The annual and updated budgets are approved by the Board of Directors. At June 30, 2010 the Corporation had no net debt due to equity raised during the second quarter of 2010.

(E) FAIR VALUE OF FINANCIAL INSTRUMENTS:

The Corporation's financial instruments as at June 30, 2010 and December 31, 2009 include cash, accounts receivable, accounts payable and accrued liabilities, the fair value of financial contracts and bank debt. The fair value of cash, accounts receivable and accounts payable and accrued liabilities approximate their carrying amounts due to their short-terms to maturity.

The fair value of financial contracts is determined by discounting the difference between the contracted price / interest rate and published forward price / interest rate curves as at the balance sheet date, using the remaining contracted notional volumes.

Bank debt, when outstanding, bears interest at a floating market rate and accordingly the fair market value approximates the carrying value.

6. COMMITMENTS

(A) FUTURE MINIMUM LEASE PAYMENTS RELATING TO OPERATING LEASE COMMITMENTS ARE:

	($000s)
2010	421
2011	829
2012	849
2013	398
2014	108
	2,605

(B) FLOW-THROUGH SHARES:

In 2009, the Corporation issued a total of 757,000 flow-through common shares at $3.40 per share for gross proceeds of $2.6 million. The Corporation renounced these qualifying petroleum and natural gas expenditures on December 31, 2009. As at June 30, 2010, the Corporation had incurred $1.4 million towards this flow-through share obligation and has remaining eligible exploration expenditures of $1.2 million to be spent before December 31, 2010 to satisfy the terms of this flow-through share offering.

In 2010, the Corporation issued a total of 681,819 flow-through common shares at $4.40 per share as part of a flow-through unit for gross proceeds of $3.0 million. The Corporation has not yet renounced the qualifying petroleum and natural gas expenditures and has until December 31, 2011 to incur the expenditures.

7. SUBSEQUENT EVENTS:

a) On July 9, 2010 the Corporation acquired a private oil and gas company. As consideration, approximately 16.0 million common shares were issued at an approximate value of $94.5 million.

b) On July 19, 2010 the Corporation acquired another private oil and gas company. As consideration, approximately 288,639 common shares were issued at an approximate value of $1.7 million.

c) Subsequent to June 30, 2010, the Corporation entered into two financial oil contracts:

i) The first contract is for 250 bbls/day of oil with a fixed price $80 Canadian per barrel. The contract is for the period from January 1, 2011 to December 31, 2011.

ii) The second contract is for 250 bbls/day of oil with a call option at $96.55 Canadian per barrel. The contract is for the period from January 1, 2011 to December 31, 2011.

d) As part of the July 9, 2010 acquisition of a private oil and gas company, the Corporation assumed two financial natural gas contracts:

i) The first contract is a costless collar for 500 GJ/day of natural gas, with a floor price of $5.00 Canadian per GJ and a ceiling price of $6.55 Canadian per GJ. The contract is for the period from January 1, 2011 to December 31, 2011.

ii) The second contract is for 750 GJ/day of natural gas, with a fixed price of $5.64 Canadian per GJ. The contract is for the period from March 1, 2009 to December 31, 2010.