SURGE ENERGY INC

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Third Quarter Report Q3

For the period ended September 30, 2010

FINANCIAL AND OPERATING SUMMARY

Financials	3 Months Ended September 30,			9 Months Ended September 30,		
($000s except per share amounts)	**2010**	2009	% Change	**2010**	2009	% Change
Oil and NGL sales	**11,742**	8,198	43%	**32,671**	21,337	53%
Natural gas sales	**2,656**	2,477	7%	**6,707**	8,438	(21%)
Other revenue	**(134)**	115	nm	**5**	147	(97%)
Total oil, natural gas & NGL revenue	**14,264**	10,790	32%	**39,383**	29,922	32%
Funds from operations[1]	**7,002**	4,800	46%	**17,781**	12,172	46%
Per share basic ($)	**0.15**	0.29	(48%)	**0.58**	0.73	(21%)
Per share diluted ($)	**0.15**	0.29	(48%)	**0.58**	0.73	(21%)
Net earnings (loss)	**(832)**	844	nm	**(6,179)**	(2,091)	196%
Per share basic ($)	**(0.02)**	0.05	nm	**(0.20)**	(0.13)	54%
Per share diluted ($)	**(0.02)**	0.05	nm	**(0.20)**	(0.13)	54%
Capital expenditures[2]	**105,993**	2,968	3,471%	**114,774**	12,735	801%
Net debt (cash) at end of period	**2,638**	49,449	(95%)	**2,638**	49,449	(95%)
Operating Highlights						
Production:						
Oil & NGL (bbls per day)	**1,841**	1,428	29%	**1,723**	1,431	20%
Natural gas (mcf per day)	**7,783**	6,294	24%	**5,834**	7,031	(17%)
Total (boe per day) (6:1)	**3,138**	2,477	27%	**2,695**	2,603	4%
Average realized price:						
Oil & NGL ($ per bbl)	**69.33**	62.39	11%	**69.45**	54.62	27%
Natural gas ($ per mcf)	**3.71**	4.28	(13%)	**4.21**	4.40	(4%)
Realized gain / (loss) on commodity contracts ($ per boe)	**3.17**	(0.16)	nm	**2.84**	1.03	176%
Combined average (incl. processing revenue) ($ per boe)	**49.41**	47.34	4%	**53.52**	42.11	27%
Netback ($ per boe)						
Oil, natural gas and NGL sales	**49.41**	47.34	4%	**53.52**	42.11	27%
Royalties	**(6.07)**	(5.22)	16%	**(7.82)**	(5.04)	55%
Operating expenses	**(14.98)**	(11.85)	26%	**(15.44)**	(12.78)	21%
Transportation expenses	**(1.86)**	(2.05)	(9%)	**(2.44)**	(2.10)	16%
Operating netback	**26.50**	28.22	(6%)	**27.82**	22.19	25%
G&A expenses	**(5.18)**	(4.20)	23%	**(5.42)**	(3.92)	38%
Interest expense	**(0.31)**	(2.66)	(88%)	**(0.96)**	(2.02)	(52%)
Corporate netback	**21.01**	21.36	(2%)	**21.44**	16.25	32%
Common Shares (000s)						
Common shares outstanding, end of period	**47,701**	16,667	186%	**47,701**	16,677	186%
Weighted average basic shares outstanding	**45,998**	16,667	176%	**30,875**	16,677	85%
Stock option dilution (treasury method)	**-**	69	nm	**-**	-	-
Weighted average diluted shares outstanding	**45,998**	16,736	175%	**30,875**	16,677	85%

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 includes cash additions for the period including acquisition additions net of dispositions.

OVERVIEW AND HIGHLIGHTS

Surge Energy Inc. continued its transformation during the third quarter of 2010. During the quarter Surge closed two private company corporate acquisitions, the acquisition of a unit interest consolidating its interest in the Spearfish light oil play and increased its bank line. Late in the quarter Surge also announced the Valhalla Doig light oil resource play asset acquisition, a $42 million equity financing and plans for another increase to its bank line.

In July, the Company closed two private company corporate acquisitions that added the following to Surge's asset portfolio:

- Three high impact, early stage light oil resource plays;
- Low decline long life production base of approximately 1,150 boe per day;
- High working interest and operated properties (greater than 90 percent);
- More than 140 gross (120 net) unbooked light oil horizontal drilling locations; and
- A large contiguous land base with owned and operated infrastructure.

In addition, in conjunction with the acquisitions, the Company increased its bank line from $50 million to $80 million.

In July Surge also announced the acquisition of the remaining 25 percent unit interest in Waskada Unit No. 15 in Southwest Manitoba which added nine net (unbooked) light oil horizontal multi-frac well locations and gave Surge 100 percent ownership of the unit.

On September 23, 2010 Surge announced the Valhalla Doig light oil resource play asset acquisition, a $42 million equity financing, plans to increase its bank line to $90 million, increased 2010 guidance and preliminary 2011 guidance. The light oil acquisition adds the following to Surge's asset portfolio:

- A high impact, early stage light oil resource play;
- Internally estimated gross (net) TPIIP (Total Petroleum Initially In Place) of more than 115 (92) million barrels;
- Low decline long life production base of over 700 boe per day;
- High working interest and operated properties (greater than 90 percent);
- 24 gross (15.3 net) unbooked light oil horizontal drilling locations; and
- A large contiguous land base with underutilized infrastructure.

The Valhalla Doig asset is a light oil analogue to the Fireweed Doig gas asset which management successfully developed in 2009 at a previous company. Production in the Fireweed Doig was increased from approximately 800 boe per day to greater than 2,500 boe per day by drilling three infill horizontal multi-frac wells. To date, the property has only been drilled with vertical wells and has recovered less than three percent of TPIIP. The Company plans to significantly increase recovery utilizing horizontal multi-frac technology, with drilling planned to commence before year end.

The Valhalla Doig light oil acquisition, equity financing and increase in bank line to $90 million were completed subsequent to the end of the third quarter.

In the third quarter, Surge achieved an 80 percent success rate drilling five gross (5.0 net) wells. During the quarter, the Company realized an average production rate of 3,138 boe per day, a 27 percent increase as compared to the third quarter of 2009 production rate of 2,477 boe per day. In the first nine months of 2010, Surge averaged 2,695 boe per day, a four percent increase as compared to the first nine months of 2009 production rate of 2,603 boe per day.

Surge realized a 59 percent production weighting to oil and natural gas liquids in the third quarter of 2010 with a forecast to increase the weighting to more than 70 percent by the end of 2011.

For the third quarter of 2010 funds from operations (defined as cash flow from operating activities before changes in non-cash working capital and non-recurring recapitalization costs) increased by 46 percent to $7.0 million compared to $4.8 million in the third quarter of 2009. Funds from operations increased by 15 percent on a per boe basis to $24.24 in the third quarter of 2010 from $21.06 in the third quarter of 2009.

NETBACK COMPARISON

	Q3 2010	Q2 2010	% Change
Average production (boe per day)	3,138	2,258	39%
Revenue	$ 49.41	$ 54.22	(9%)
Royalties	$ (6.07)	$ (10.30)	(41%)
Operating costs	$ (14.98)	$ (15.29)	(2%)
Transportation costs	$ (1.86)	$ (2.33)	(20%)
Operating netback	$ 26.50	$ 26.30	1%
Interest expense	$ (0.31)	$ (0.94)	(67%)
G&A expense	$ (5.18)	$ (6.76)	(23%)
Corporate netback	$ 21.01	$ 18.60	13%

Surge's corporate netback increased by 13 percent from $18.60 in the second quarter of 2010 to $21.01 in the third quarter of 2010. The Company achieved reductions in each of royalty, operating cost, transportation, interest and G&A expenses on a per boe basis in the third quarter of 2010 as compared to the second quarter of 2010. The management team continues to focus on finding efficiencies within existing operations and expects both operating and corporate netbacks to continue to grow throughout the remainder of 2010 and into 2011.

Surge has built a low decline (approximately 15 percent) oil-weighted production base of more than 4,000 boe per day, positioned itself in several emerging light oil resource plays, identified more than 200 oil drilling locations on its lands, and maintains a significant undeveloped land base of more than 400,000 net acres. Surge has a $90 million bank facility and is forecasting a year end net debt position of approximately $47 million, 2010 exit production of 4,500 boe per day (weighted more than 60 percent to oil and natural gas liquids) and 2011 exit production of 6,500 boe per day (weighted more than 70 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 nine month periods ending September 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 income, 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 income 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 September 30,		9 Months Ended September 30,	
($000s)	**2010**	2009	**2010**	2009
Cash flow from operating activities (per GAAP)	**11,464**	4,994	**16,543**	10,609
Change in non-cash working capital	**(4,462)**	(194)	**(4,171)**	1,563
Non-recurring recapitalization costs	**-**	-	**5,409**	-
Funds from operations	**7,002**	4,800	**17,781**	12,172

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 income, 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 September 30,		9 Months Ended September 30,	
($000s)	**2010**	2009	**2010**	2009
Net income (loss) before taxes (GAAP)	**(1,247)**	1,087	**(7,248)**	(3,210)
Add back:				
Recapitalization costs	**-**	-	**5,409**	-
Stock-based compensation expense relating to the recapitalization	**-**	-	**3,610**	-
Net income (loss) before tax excluding non-recurring charges relating to the recapitalization	**(1,247)**	1,087	**1,768**	(3,210)
Future income tax (reduction)	**(415)**	(243)	**(1,069)**	(1,119)
Net income (loss) excluding non-recurring charges relating to the recapitalization	**(832)**	844	**2,837**	(2,091)

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 ($0.8) million for the three months ended September 30, 2010 and $2.8 million for the nine months ended September 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 November 23, 2010.

OPERATIONS

DRILLING

	Drilling		Success rate	Working
	Gross	Net	(%) gross	interest (%)
Q1/2010	1	0.5	100%	50%
Q2/2010	6	6	83%	100%
Q3/2010	5	5	80%	100%
Total	12	11.5	83%	96%

Surge achieved an 80 percent success rate in the third quarter of 2010, drilling five gross (five net) wells, resulting in three gross (three net) oil wells, one gross (one net) injection well and one gross (one net) dry hole. In the first nine months of 2010 Surge achieved an 83 percent success rate drilling 12 gross (11.5 net) wells.

PRODUCTION

	Q3 2010	Q2 2010	Q1 2010	Q4 2009	Q3 2009	Q2 2009	Q1 2009	Q4 2008
Oil & NGL (bbls per day)	**1,841**	1,621	1,707	1,614	1,428	1,374	1,492	1,461
Natural gas (mcf per day)	**7,783**	3,823	5,874	6,887	6,294	7,586	7,223	9,079
Total (boe per day)	**3,138**	2,258	2,686	2,762	2,477	2,638	2,695	2,974
% Oil and NGL	**59**	72	64	58	58	52	55	49

Surge achieved production of 3,138 boe per day in the third quarter of 2010, a 27 percent increase from the third quarter of 2009 production rate of 2,477 boe per day. Average production for the first nine months of 2010 was 2,695 boe per day as compared to 2,603 boe per day in the first nine months of 2009. The increase in the quarterly and year to date production volumes compared to the 2009 rates was primarily due to the acquisition of Corinthian Energy Corporation during the third quarter of 2010, which contributed 1,126 boe per day of mainly natural gas production.

Surge realized a 59 percent oil and natural gas liquids production weighting in the third quarter of 2010. The Company realized average oil and natural gas liquids production of 1,841 bbls per day for the third quarter of 2010.

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

A four percent increase in average revenue per boe, combined with a 27 percent increase in production, resulted in revenues of $14.3 million in the third quarter of 2010, up 32 percent from $10.8 million in the third quarter of 2009. In the first nine months of 2010, a 27 percent increase in average revenue per boe resulted in revenues of $39.4 million, up from $29.9 million in the first nine months of 2009.

Surge had certain oil and gas commodity contracts in place as of September 30, 2010. The Company recognized an unrealized loss of $1.1 million and a realized gain of $0.9 million on its commodity contracts in the third quarter of 2010. This compares to an unrealized gain of $1.0 million and a realized loss of $38,000 on its commodity contracts in the third quarter of 2009.

The Company recognized an unrealized gain of $0.3 million and a realized gain of $2.1 million on its commodity contracts in the first nine months of 2010. This compares to an unrealized loss of $0.1 million and a realized gain of $0.7 million on its commodity contracts in the first nine 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 third quarter of 2010, Surge realized average revenue of $49.41 per boe, before realized commodity contract gains, an increase of four percent from the $47.34 per boe recorded in the third quarter of 2009. In the first nine months of 2010, Surge realized average revenue of $53.52 per boe, before realized commodity contract gains, an increase of 27 percent from the $42.11 per boe recorded in the first nine months of 2009.

Surge realized an average of $69.33 per bbl of oil and natural gas liquids in the third quarter of 2010, an increase of 11 percent per barrel from the $62.39 per bbl realized in the third quarter of 2009. This compares to an average Edmonton Light Sweet price of $74.42 per bbl in the third quarter of 2010, which increased four percent per barrel from the $71.36 per bbl in the third quarter of 2009. The increase in oil and natural gas liquids prices is consistent with the increase in benchmark prices as well as an improvement in differentials due to increased light oil production.

Surge realized an average of $69.45 per bbl of oil and natural gas liquids in the first nine months of 2010, an increase of 27 percent per barrel from the $54.62 per bbl realized in the first nine months of 2009. This compares to an average Edmonton Light Sweet price of $76.53 per bbl in the first nine months of 2010, which increased 23 percent per barrel from the $62.45 per bbl in the first nine months of 2009. The increase in oil and natural gas liquids prices is relatively consistent with the increase in benchmark prices.

The Company realized an average natural gas price of $3.71 per mcf in the third quarter of 2010, a 13 percent decrease from the $4.28 per mcf averaged in the third quarter of 2009. This compares to an average Alberta Plant Gate reference price of $3.53 per mcf in the third quarter of 2010 and $2.92 per mcf in the third quarter of 2009 reflecting a 21 percent increase. The difference in the average realized natural gas price is due to physical natural gas hedge gains included in third quarter 2009 natural gas revenue.

The Company realized an average natural gas price of $4.21 per mcf in the first nine months of 2010, a four percent decrease from the $4.40 per mcf averaged in the first nine months of 2009. This compares to an average Alberta Plant Gate reference price of $4.11 per mcf in the first nine months of 2010 and $3.75 per mcf in the first nine months of 2009 reflecting a 10 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 $3.17 per boe to the average revenue for the third quarter of 2010. Realized commodity contract gains resulted in a decrease of $0.16 per boe to average revenue for the third quarter of 2009.

Realized commodity contract gains resulted in an increase of $2.84 per boe to the average revenue for the first nine months of 2010. Realized commodity contract gains resulted in an increase of $1.03 per boe to average revenue for the first nine months of 2009.

REVENUE AND REALIZED PRICES

	3 Months Ended September 30,			9 Months Ended September 30,		
	2010	2009	% Change	**2010**	2009	% Change
Oil and NGL ($000s)	**11,742**	8,198	43%	**32,671**	21,336	53%
Natural gas ($000s)	**2,656**	2,477	7%	**6,707**	8,438	(21%)
Processing and other ($000s)	**(134)**	115	216%	**5**	147	(97%)
Total oil, natural gas and NGL revenue ($000s)	**14,264**	10,790	32%	**39,383**	29,922	32%
Oil & NGL ($ per bbl)	**69.33**	62.39	11%	**69.45**	54.62	27%
Natural gas ($ per mcf)	**3.71**	4.28	(13%)	**4.21**	4.40	(4%)
Total oil, natural gas and NGL revenue ($ per boe)	**49.41**	47.34	4%	**53.52**	42.11	27%
Unrealized gain (loss) on commodity contracts ($ per boe)	**(3.85)**	4.50	nm	**0.41**	(0.15)	nm
Realized gain (loss) on commodity contracts ($ per boe)	**3.17**	(0.16)	nm	**2.84**	1.03	176%
Total oil, natural gas and NGL revenue after commodity contracts ($ per boe)	**48.73**	51.68	(6%)	**56.77**	42.99	32%

ROYALTIES

Surge realized royalty expense of $1.8 million or 12 percent of revenue in the third quarter of 2010, compared to $1.2 million or 11 percent of revenue in the third quarter of 2009. In the first nine months of 2010, Surge realized royalty expense of $5.8 million or 15 percent of revenue, compared to $3.6 million or 12 percent of revenue in the first nine months of 2009.

The increase in royalties as a percentage of revenue for the first nine months 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 13 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 nine months of 2010, Surge recorded $1.2 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 September 30,			9 Months Ended September 30,		
	2010	2009	% Change	**2010**	2009	% Change
Total ($000s)	**1,750**	1,190	47%	**5,751**	3,580	61%
% of revenue	**12%**	11%	1%	**15%**	12%	3%
$ per boe	**6.07**	5.22	16%	**7.82**	5.04	55%

OPERATING EXPENSE

Total operating expenses in the third quarter of 2010 were $4.3 million, up 60 percent from $2.7 million in the third quarter of 2009. Operating expense per boe increased 26 percent in the third quarter of 2010 to $14.98 per boe as compared to $11.85 per boe in the same period of 2009. For the first nine months of 2010, total operating expenses were $11.4 million, up 25 percent from $9.1 million in the first nine months of 2009. Operating expense per boe increased 21 percent in the first nine months of 2010 to $15.44 per boe as compared to $12.78 per boe in the same period of 2009.

The increase in operating expenses per boe in the third quarter of 2010 compared to the same period in 2009 was related to the acquisition of Corinthian properties with higher operating costs per boe. Increases in operating costs per boe for the nine months ended September 30, 2010 relate mainly to 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 and higher operating costs per boe Corinthian assets acquired.

Operating expenses per boe fell from $15.29 per boe in the second quarter of 2010 to $14.98 per boe in the third quarter of 2010, a two percent reduction. The management team continues to focus on finding efficiencies within existing operations and expects combined operating and transportation expenses per boe to continue decline throughout the remainder of 2010 and into 2011.

OPERATING EXPENSES

	3 Months Ended September 30,			9 Months Ended September 30,		
	2010	2009	% Change	**2010**	2009	% Change
Total ($000s)	**4,325**	2,701	60%	**11,360**	9,079	25%
$ per boe	**14.98**	11.85	26%	**15.44**	12.78	21%

TRANSPORTATION EXPENSES

Transportation expenses in the third quarter of 2010 were $0.5 million or $1.86 per boe as compared to $0.5 million or $2.05 per boe recorded in the same period of 2009. The nine percent decrease in transportation costs per boe in the third quarter of 2010 compared to the same period in 2009 was primarily the result of a pipeline being constructed, connecting oil production from the Silver Battery. The pipeline tie in was completed during August of 2010. For the first nine months of 2010, transportation expenses totalled $1.8 million, a 20 percent increase over the first nine months of 2009 expense of $1.5 million. The 16 percent increase in transportation costs per boe for the first nine months 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.

Transportation expenses per boe decreased 20 percent from $2.33 per boe in the second quarter of 2010 to $1.86 per boe in the third quarter of 2010, primarily due to operational efficiencies and the installation of a lact unit in the Silver area. The management team continues to focus on finding efficiencies within existing operations and expects combined operating and transportation expenses per boe to continue decline throughout the remainder of 2010 and into 2011.

TRANSPORTATION EXPENSES

	3 Months Ended September 30,			9 Months Ended September 30,		
	2010	2009	% Change	**2010**	2009	% Change
Total ($000s)	**537**	467	15%	**1,792**	1,494	20%
% of revenue	**4%**	5%	25%	**5%**	5%	-
$ per boe	**1.86**	2.05	(9%)	**2.44**	2.10	16%

GENERAL AND ADMINISTRATIVE EXPENSES (G&A)

Net G&A expenses for the third quarter of 2010 increased 23 percent to $5.18 per boe as compared to $4.20 per boe in the third quarter of 2009. Total G&A expenses for the third quarter of 2010 net of recoveries and capitalized amounts of $0.6 million was $1.5 million, compared to $1.0 million in the third quarter of 2009 after recoveries and capitalized amounts of $0.1 million.

Net G&A expenses for the first nine months of 2010 increased to $5.42 per boe as compared to $3.92 per boe for the same period of 2009. Total G&A expenses for the first nine months of 2010 net of recoveries and capitalized amounts of $1.4 million was $4.0 million, compared to $2.8 million in the same period of 2009 after recoveries and capitalized amounts of $0.3 million. The increase in net G&A expenses per boe in the third quarter and first nine months of 2010 is due primarily to additional rent on newly acquired office space, increased consulting expenditures and increased staffing levels in the third quarter of 2010.

The increase in recoveries was a result of the 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 per boe fell 23 percent from $6.79 per boe in the second quarter of 2010 to $5.18 per boe in the third quarter of 2010, a decrease of $1.58 per boe. The management team continues to focus on finding efficiencies within existing operations and expects G&A expenses per boe to continue decline throughout the remainder of 2010 and into 2011.

G&A EXPENSES

	3 Months Ended September 30,			9 Months Ended September 30,		
	2010	2009	% Change	**2010**	2009	% Change
Total ($000s)	**2,094**	1,029	103%	**5,403**	3,054	77%
Recoveries and capitalized amounts	**(599)**	(71)	740%	**(1,414)**	(266)	432%
Net G&A expenses	**1,495**	958	56%	**3,989**	2,788	43%
Net G&A per boe ($)	**5.18**	4.20	23%	**5.42**	3.92	38%

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 September 30,			9 Months Ended September 30,		
	2010	2009	% Change	**2010**	2009	% Change
Recapitalization costs ($000s)	**-**	-	nm	**5,409**	-	nm

INTEREST EXPENSE

Surge incurred interest expense of $0.1 million or $0.31 per boe in the third quarter of 2010 as compared to $0.6 million or $2.66 per boe in the third quarter of 2009. For the first nine months of 2010, the Company incurred interest expense of $0.7 million or $0.96 per boe as compared to $1.4 million or $2.02 per boe in the first nine months of 2009. The decrease is due to the repayment of Surge's outstanding debt during the second quarter of 2010 and remaining debt free during the third quarter.

INTEREST EXPENSE

	3 Months Ended September 30,			9 Months Ended September 30,		
	2010	2009	% Change	**2010**	2009	% Change
Interest expense ($000s)	**89**	605	(85%)	**703**	1,434	(51%)
$ per boe	**0.31**	2.66	(88%)	**0.96**	2.02	(52%)

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 $26.50 in the third quarter of 2010, a six percent decrease from $28.22 recorded in the third quarter of 2009. The decrease in operating netback was largely due to a 16 percent increase in royalty expenses per boe and a 26 percent increase in operating costs per boe in the third quarter of 2010, compared to the same period in 2009. For the first nine months of 2010, the operating netback of the Company was $27.82 per boe, a 25 percent increase over the $22.19 per boe recorded in the first nine months of 2009. The increase in operating netback was largely due to a 27 percent increase in revenue per boe, partially offset by a 55 percent increase in royalty expenses per boe, a 21 percent increase in operating costs per boe and a 16 percent increase in transportation expenses per boe in the first nine months of 2010 as compared to the same period in 2009. Surge's year to date operating and corporate netback was negatively impacted by royalty adjustments pertaining to previous period's estimated royalties 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 $21.01 in the third quarter of 2010, a two percent decrease as compared to $21.36 in the third quarter of 2009. The decrease in corporate netback in the third quarter of 2010 was mainly impacted by increased operating costs on the acquired Corinthian properties as compared to the same period of 2009.

For the first nine months of 2010, the corporate netback of the Company was $21.44 per boe, a 32 percent increase over the $16.25 per boe recorded in the first nine months of 2009. The increase in corporate netback was impacted by the reduction of interest expense per boe in the first nine months of 2010 as compared to the same period of 2009.

Surge's corporate netback increased by 13 percent from $18.60 in the second quarter of 2010 to $21.01 in the third quarter of 2010. The Company achieved reductions in each of royalty, operating cost, transportation, interest and G&A expenses on a per boe basis in the third quarter of 2010 as compared to the second quarter of 2010. The management team continues to focus on finding efficiencies within existing operations and expects both operating and corporate netbacks to continue to grow throughout the remainder of 2010 and into 2011.

CORPORATE AVERAGE NETBACK

	3 Months Ended September 30,			9 Months Ended September 30,		
($ per boe, except production)	**2010**	2009	% Change	**2010**	2009	% Change
Average production (boe per day)	**3,138**	2,477	27%	**2,695**	2,603	4%
Revenue	**49.41**	47.34	4%	**53.52**	42.11	27%
Royalties	**(6.07)**	(5.22)	16%	**(7.82)**	(5.04)	55%
Operating costs	**(14.98)**	(11.85)	26%	**(15.44)**	(12.78)	21%
Transportation costs	**(1.86)**	(2.05)	(9%)	**(2.44)**	(2.10)	16%
Operating netback	**26.50**	28.22	(6%)	**27.82**	22.19	25%
G&A expense	**(5.18)**	(4.20)	23%	**(5.42)**	(3.92)	38%
Interest expense	**(0.31)**	(2.66)	(88%)	**(0.96)**	(2.02)	(52%)
Corporate netback	**21.01**	21.36	(2%)	**21.44**	16.25	32%

FUNDS FROM OPERATIONS AND CASH FLOW FROM OPERATIONS

For the third quarter of 2010 funds from operations increased by 46 percent to $7.0 million compared to $4.8 million in the third quarter of 2009. On a per share basis, funds from operations decreased by 48 percent to $0.15 per basic share in the third quarter 2010 from $0.29 per basic share in the same period of 2009 due to equity issuances in the past year. Funds from operations increased by 15 percent on a per boe basis to $24.24 in the third quarter of 2010 from $21.06 in the third quarter of 2009.

For the first nine months of 2010, funds from operations increased by 46 percent to $17.8 million compared to $12.2 million in the first nine months of 2009. On a per share basis, funds from operations decreased by 21 percent to $0.58 per basic share in the third quarter 2010 from $0.73 per basic share in the same period of 2009 due to equity issuances in the past year. Funds from operations increased by 41 percent on a per boe basis to $24.16 in the first nine months of 2010 from $17.13 in the first nine 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 third quarter of 2010 was $11.5 million as compared to $5.0 million in the third quarter of 2009. Included in cash flow from operations is an increase in non-cash working capital of $4.5 million for the third quarter of 2010 and an increase of $0.2 million for the same period of 2009. Cash flow from operations for the first nine months of 2010 was $16.5 million as compared to $10.6 million in the first nine months of 2009. Included in cash flow from operations is an increase in non-cash working capital of $4.2 million for the first nine months of 2010 and a decrease of $1.6 million for the same period of 2009.

FUNDS FROM OPERATIONS

	3 Months Ended September 30,			9 Months Ended September 30,		
	2010	2009	% Change	**2010**	2009	% Change
Total ($000s)	**7,002**	4,800	46%	**17,781**	12,172	46%
Per share – basic ($)	**0.15**	0.29	(48%)	**0.58**	0.73	(21%)
Per share – diluted ($)	**0.15**	0.29	(48%)	**0.58**	0.73	(21%)
Per boe ($)	**24.24**	21.06	15%	**24.16**	17.13	41%
Cash flow from operations ($000s)	**11,464**	4,994	130%	**16,543**	10,609	56%

STOCK-BASED COMPENSATION

Surge recorded stock-based compensation expense of $0.5 million in the third quarter of 2010 compared to $0.1 million for the same period of 2009, calculated using the Black-Scholes option-pricing model. For the nine months ended September 30, 2010, Surge recorded stock-based compensation expense of $4.7 million compared to $0.2 million for the same period of 2009.

During the nine months ended September 30, 2010, 1,656,000 options were issued at a weighted average exercise price of $6.23 per option and 225,000 options were forfeited at a weighted average price of $6.65 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 stock-based compensation expense for the nine month period ended September 30, 2010 is $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. This amount was recorded in the second quarter of 2010.

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

STOCK-BASED COMPENSATION EXPENSE

	3 Months Ended September 30,			9 Months Ended September 30,		
	2010	2009	% Change	**2010**	2009	% Change
Stock-based compensation expense ($000s)	**511**	57	nm	**4,671**	170	nm
Per boe ($)	**1.77**	0.25	nm	**6.35**	0.24	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 $88.7 million. Future development costs for proved reserves of $22.0 million have been included in the depletion calculation.

Surge recorded $6.6 million or $22.89 per boe in DD&A expense in the third quarter of 2010, an 11 percent increase as compared to $20.68 per boe in DD&A expense in the third quarter of 2009.

In the first nine months of 2010, $15.2 million or $20.69 per boe in DD&A expense were recorded, a two percent increase as compared to $20.22 per boe in DD&A expense in the first nine months of 2009.

The DD&A calculation is based on production volumes of 288,695 boe for the quarter. This increase in the DD&A rate per boe is due to the corporate acquisitions completed during the three months ended September 30, 2010.

DEPLETION, DEPRECIATION AND ACCRETION (DD&A) EXPENSE

	3 Months Ended September 30,			9 Months Ended September 30,		
	2010	2009	% Change	**2010**	2009	% Change
DD&A ($000s)	**6,610**	4,713	40%	**15,227**	14,368	6%
Per boe ($)	**22.89**	20.68	11%	**20.69**	20.22	2%

INCOME AND OTHER TAXES

Surge recognized a combined future tax liability of approximately $34.7 million as at September 30, 2010, an increase of $17.0 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 increased by $17.5 million related to the Corinthian acquisition and decreased by $0.1 million due to the Crystal Lake acquisition. The future tax liability also decreased by the future tax reduction of $1.1 million for the first nine months of 2010.

As at September 30, 2010, the Company has incurred $2.1 million towards the 2009 flow-through share obligation and has remaining eligible exploration expenditures of $0.5 million to be spent before December 31, 2010 to satisfy 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 September 30,			9 Months Ended September 30,		
	2010	2009	% Change	**2010**	2009	% Change
Total ($000s)	**(415)**	243	(271%)	**(1,069)**	(1,119)	(4%)
Per boe ($)	**(1.44)**	1.06	(236%)	**(1.45)**	(1.58)	(8%)

NET INCOME (LOSS)

The Company recorded net losses for the three months ended September 30, 2010 of $0.8 million or $0.02 per basic share, a decrease of 199 percent from the $0.8 million of net income recorded for the comparable three months of 2009. For the nine months ended September 30, 2010, the Company recorded net losses of $6.2 million or $0.20 per basic share, a decrease of 54 percent from the $2.1 million in net losses recorded in the first nine 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 September 30,			9 Months Ended September 30,		
	2010	2009	% Change	**2010**	2009	% Change
Total ($000s)	**(832)**	844	(199%)	**(6,179)**	(2,091)	196%
Per share – basic ($)	**(0.02)**	0.05	(140%)	**(0.20)**	(0.13)	(54%)
Per share – diluted ($)	**(0.02)**	0.05	(140%)	**(0.20)**	(0.13)	(54%)

CAPITAL EXPENDITURES

Capital expenditures, net of any applicable Alberta drilling royalty credits, for the third quarter of 2010 were $8.9 million, a 197 percent increase from the $3.0 million spent in the third quarter of 2009.

In the first nine months of the year, Surge invested $8.0 million (net of $1.2 million in Alberta drilling royalty credits) to drill 12 gross (11.5 net) wells, $4.4 million on seismic and land acquisitions, $1.8 million on facilities and equipment, $1.6 million on property acquisitions and $1.7 million on other capital items.

CAPITAL EXPENDITURE SUMMARY

($000s)	**YTD 2010**	**Q3 2010**	Q2 2010	Q1 2010
Land and seismic	**4,436**	**1,296**	439	2,701
Drilling and intangibles	**9,267**	**4,963**	1,551	2,753
Facilities and equipment	**1,822**	**1,242**	1	580
Property acquisitions	**1,604**	**1,500**	104	-
Other	**1,743**	**509**	845	389
Total gross capital expenditures	**18,873**	**9,510**	2,940	6,423
Alberta drilling royalty credits	**(1,227)**	**(640)**	(514)	(73)
Total net capital expenditures	**17,646**	**8,870**	2,426	6,350
Corporate acquisitions	**97,123**	**97,123**	-	-
Total capital expenditures including acquisitions	**114,774**	**105,993**	2,426	6,350

QUARTERLY AND ANNUAL FINANCIAL INFORMATION

	Q3 2010	Q2 2010	Q1 2010	Year Ended Dec 31 2009	Q4 2009	Q3 2009	Q2 2009	Q1 2009	Year Ended Dec 31 2008	Q4 2008
Oil, NGL & natural gas sales	**14,264**	11,141	13,978	42,853	12,932	10,788	9,829	9,304	71,160	13,047
Unrealized gain (loss) on financial derivatives	**(1,110)**	23	1,386	(1,222)	(1,116)	1,026	(22)	(1,110)	1,852	221
Provision for bad debt	**-**	-	115	840	-	-	840	-	3,053	1,053
Net earnings (loss)	**(832)**	(7,515)	2,168	(2,112)	(21)	844	(1,294)	(1,641)	7,698	(483)
Net earnings (loss) per share ($)										
Basic	**(0.02)**	(0.27)	0.12	(0.13)	-	0.05	(0.08)	(0.10)	0.45	(0.02)
Diluted	**(0.02)**	(0.27)	0.11	(0.13)	-	0.05	(0.08)	(0.10)	0.45	(0.02)
Average daily sales										
Natural gas (mcf/d)	**7,783**	3,823	5,874	6,995	6,887	6,295	7,586	7,223	9,056	9,079
Oil & NGL (bbls/d)	**1,841**	1,621	1,707	1,349	1,504	1,428	1,238	1,339	1,164	1,303
Barrels of oil equivalent (boe per day)	**3,138**	2,258	2,686	2,643	2,762	2,478	2,638	2,695	2,875	2,974
Average sales price										
Natural gas ($/mcf)	**3.71**	3.74	5.20	4.85	4.63	4.28	3.59	5.41	8.38	7.91
Oil & NGL ($/bbl)	**69.33**	66.57	72.35	58.84	69.52	62.39	58.48	42.18	82.77	55.47
Barrels of oil equivalent ($/boe)	**49.41**	54.22	57.83	45.32	51.44	47.34	39.88	37.82	65.96	51.89

SHARE CAPITAL AND OPTION ACTIVITY

	Q3 2010	Q2 2010	Q1 2010	Q4 2009	Q3 2009	Q2 2009	Q1 2009	Q4 2008
Weighted Common shares	**30,874,642**	27,589,374	18,576,487	16,699,721	16,666,811	16,668,503	16,695,117	16,791,271
Stock option dilution (treasury method)[1]	-	-	457,033	-	69,353	-	-	25,146
Weighted average diluted shares outstanding[1]	**30,874,642**	27,589,374	19,033,520	16,699,721	16,736,164	16,668,503	16,695,117	16,816,417

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 5(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.

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.

On July 9, 2010, the Corporation issued 16,025,529 common shares at an ascribed price of $5.90 per share in connection with the acquisition of Corinthian Energy Corp.

On July 19, 2010, the Corporation issued 288,639 common shares at an ascribed price of $5.90 per share in connection with the acquisition Crystal Lake Resources Ltd.

During the nine month period ended September 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 percent 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 stock options.

On November 23, 2010 Surge had 55,820,514 common shares, 253,033 warrants, 2,076,136 performance warrants and 2,065,666 options outstanding.

LIQUIDITY AND CAPITAL RESOURCES

On September 30, 2010, Surge had a net working capital deficit of $2.7 million.

Surge anticipates that future capital requirements will be funded through a combination of internal cash flow, divestitures, 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 $90,000,000 extendible, revolving term credit facility with a Canadian bank bearing interest at bank rates. The facility is available on a revolving basis until July 13, 2011. On July 13, 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 bank. As the available lending limits of the facilities are based on the bank'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 review. 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.

The subsequent property acquisition completed on November 1, 2010 was financed in part with a $42 million financing, resulting in $30.2 million drawn on the credit facility as at November 23, 2010 and an available undrawn amount of $59.8 million.

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.

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 April 13, 2010 private placement.

Surge was not involved in any off-balance-sheet transactions during the three or nine months ended September 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 percent and were due on September 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 $2.8 million, as summarized below:

FUTURE MINIMUM LEASE PAYMENTS ($000s)	
2010	252
2011	993
2012	1,013
2013	412
2014	108
Total	**2,778**

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 September 30, 2010, the Corporation had incurred $2.1 million towards this flow-through share obligation and has remaining eligible exploration expenditures of $0.5 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.

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 nine months ended September 30, 2010:

Term	Type (floating to fixed)	Volume	Swap Price (Surge receives) (C$)	Index (Surge pays)	Unrealized gains (losses) for the three months ended Sep 30, 2010 (C$)	Unrealized gains (losses) for the nine months ended Sep 30, 2010 (C$)	Realized gains (losses) for the three months ended Sep 30, 2010 (C$)	Realized gains (losses) for the nine months ended Sep 30, 2010 (C$)
Jan 1 – Dec 31, 2010	Swap	2,000 GJs/d	5.80	AECO Monthly Average	(218)	143	139	733
Apr 1 – Oct 31, 2010	Swap	1,000 GJs/d	5.32	AECO Monthly Average	(122)	60	165	316
Nov 1, 2009 - Mar 31, 2010	Swap	500 GJs/d	6.00	AECO Monthly Average	-	(35)	-	42
Jan 1 to Dec 31, 2011	Call	500 GJs/d	6.55	AECO Monthly Average	(4)	(4)	-	-
Jan 1 to Dec 31, 2011	Put	500 GJs/d	5.00	AECO Monthly Average	245	245	-	-
Mar 1, 2009 to Dec 31, 2010	Swap	750 GJs/d	5.64	AECO Monthly Average	150	150	105	105
Jan 1 to Dec 31, 2010	Swap	100 bbls/d	86.00	C$ WTI - NYMEX	(53)	42	87	177
Jan 1 to Dec 31, 2010	Swap	100 bbls/d	84.00	C$ WTI - NYMEX	(34)	97	63	117
Jan 1 to Dec 31, 2010	Swap	100 bbls/d	86.00	C$ WTI - NYMEX	(53)	42	87	177
Jan 1 to Dec 31, 2010	Swap	200 bbls/d	81.00	C$ WTI - NYMEX	(14)	356	52	52

Feb 1 to Dec 31, 2010	Swap	100 bbls/d	87.75	C$ WTI - NYMEX	(69)	36	108	212
Feb 1 to Dec 31, 2010	Swap	100 bbls/d	87.90	C$ WTI - NYMEX	(69)	39	110	216
Jan 1 to Dec 31, 2011	Swap	250 bbls/d	80.00	C$ WTI - NYMEX	(717)	(717)	-	-
Jan 1 to Dec 31, 2011	Call	250 bbls/d	96.55	C$ WTI - NYMEX	414	414	-	-
Jan 1 to Dec 31, 2011	Swap	250 bbls/d	80.00	C$ WTI - NYMEX	(717)	(717)	-	-
Jan 1 to Dec 31, 2011	Call	250 bbls/d	91.00	C$ WTI - NYMEX	604	604	-	-
Jan 1 to Dec 31, 2011	Call	125 bbls/d	78.40	C$ WTI - NYMEX	(626)	(626)	-	-
Jan 1 to Dec 31, 2011	Swap	250 bbls/d	85.50	C$ WTI - NYMEX	(221)	(221)	-	-
Jan 1 to Dec 31, 2011	Put	125 bbls/d	78.40	C$ WTI - NYMEX	394	394	-	-
					(1,110)	**302**	**916**	**2,147**

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

Term	Type (floating to fixed)	Amount (C$)(1)	Company fixed interest rate (%)	Counterparty floating rate index	Unrealized (losses) for the three months ended September 30, 2010 (C$) ($000's)	Unrealized (losses) for the nine months ended September 30, 2010 (C$)	Realized (losses) for the three months ended September 30, 2010 (C$)	Realized (losses) for the nine months ended September 30, 2010 (C$)
Feb 24 – April 15, 2010	Swap	35,000,000	4.42 to 4.44	CAD-BA-CDOR	-	(3)	-	(60)

SUBSEQUENT EVENTS

On November 1, 2010, the Corporation acquired certain petroleum and natural gas properties in the Valhalla region of Alberta. As consideration, approximately $75.0 million in cash was paid, subject to final adjustments. As of September 30, 2010, the Corporation had paid a deposit of $7.5 million on the properties.

On November 1, 2010, in conjunction with the aforementioned acquisition, the Corporation issued 8,001,000 common shares at a price of $5.25 per common share for total proceeds of approximately $42.0 million.

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.

In order to transition to IFRS, the Company has formed a project team to lead the changeover from Canadian GAAP. A transition plan is currently being executed to convert the financial statements to IFRS. Training has been provided to key employees and the Corporation 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. 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 assets and equipment, accounting for business combinations and accounting for future income taxes. The Corporation is in the process of preparing a balance sheet at January 1, 2010 on an IFRS basis. Calculations of the impact of the changes in accounting policies under IFRS are being finalized.

The Corporation has substantially completed the assessment of key IFRS differences from current practices under Canadian GAAP, but continues to monitor IFRS developments and research further the detailed implications of identified differences. The Corporation has also substantially completed its evaluation of accounting policy choices and transitional exemptions available under IFRS. Drafting of the Corporation's IFRS accounting policies is principally complete, however drafted policies remain subject to change throughout 2010 as a result of IFRS developments and findings from peer benchmarking in areas of significant choice. The Corporation has begun policy implementation in the fourth quarter of 2010, and the application of policies to 2010 financial data to prepare 2010 IFRS comparatives for reporting in 2011. To date, no contentious transitional issues have been identified; however no formal opinion has yet to be received from the Corporation's auditors. The Corporation expects to draft its IFRS accounting policy note disclosure as well as transitional note disclosure, including the required Canadian GAAP to IFRS reconciliations, in the fourth quarter of 2010 and the first quarter of 2011. Full IFRS financial statements are not expected to be drafted until sometime in the first quarter of 2011.

PETROLEUM AND NATURAL GAS ASSETS

IFRS standards require that a corporation choose to report its petroleum and natural gas assets either at the amount which would have been recorded had the Corporation always followed current IFRS standards or at fair value on the date of adoption of IFRS. Alternatively, IFRS standards allow for a conversion exemption whereby petroleum and natural gas corporations can choose to record opening petroleum and natural gas properties at a deemed cost equal to historical cost as calculated under Canadian GAAP. The Company currently intends to elect to record petroleum and natural gas assets at historical cost as calculated under Canadian GAAP on January 1, 2010.

Under Canadian GAAP, all petroleum and natural gas assets are accounted for under the full cost accounting guideline. Under IFRS, petroleum and natural gas assets will be divided into exploration and evaluation properties ("E&E assets") and petroleum and natural gas properties and equipment ("development assets"). E&E assets will initially be capitalized and accumulated pending determination of technical feasibility and economic viability. E&E assets will not be depreciated and will be carried at cost less any accumulated impairment losses. E&E assets will initially be recorded at January 1, 2010 based on the Canadian GAAP historical cost of those assets. IFRS permits the remaining deemed cost of petroleum and natural gas assets at January 1, 2010 to be allocated to development assets on a pro rata basis using either reserve values or reserve volumes. The Company currently intends to allocate the deemed cost to development assets on a pro rata basis using reserve values.

Both E&E assets and development assets will be assessed to determine whether impairment losses exist under IFRS as at January 1, 2010. These impairment tests will differ from the current Canadian GAAP full cost ceiling test in several significant ways. Assets will be allocated to cash generating units (CGU) and a separate impairment test will be completed for each CGU identified. Under current Canadian GAAP the ceiling test is a two-step test conducted over the single full cost pool for the Company. The carrying value of assets is first compared to the undiscounted future cash flows. If the carrying value of the assets exceeds the undiscounted future cash flows of proved reserves, then the second step of the test is required whereby the assets are written down to the value of the discounted future cash flows of proved and probable reserves. Under IFRS, the impairment test compares the carrying value of the assets to the greater of the fair value of the assets and the value-in-use of the assets, which is a discounted cash flow measure. Future impairment tests will be required when management determines that indicators of impairment exist. Should impairment losses be recorded in accordance with IFRS, certain of those losses can be reversed in the future if facts and circumstances change. The Company is in the process of completing an IFRS impairment test for each CGU as at January 1, 2010 and does not currently anticipate that any impairment will be recorded at January 1, 2010.

Depreciation under Canadian GAAP is calculated using a unit-of-production method based on total proved reserves for all accumulated costs, excluding unproved properties. Under IFRS, the net carrying value of development assets will still be depleted using a unit-of-production method; however, significant components with different useful lives will be accounted for as separate items and depreciated separately. The Company is in the process of finalizing the components which will be used for the purpose of depreciating development assets. In addition, IFRS allows depreciation to be calculated using either proved reserves or proved plus probable reserves. The Company currently intends to depreciate assets using proved plus probable reserves. Depreciation is expected to be lower on an IFRS basis than that recorded under Canadian GAAP. Under the full cost accounting guideline, gains or losses are not recognized upon the disposition of petroleum and natural gas assets unless the disposition results in a significant change in the depletion rate. Under IFRS, gains and losses are recognized in net income on the disposal of an item of petroleum and natural gas assets. The amount of the gain or loss is determined by comparing the proceeds from disposal with the carrying amount of the item. This will include transactions such as sales of assets, farm-outs, asset swaps and other non-monetary transactions which typically did not result in gains or losses being recorded under Canadian GAAP.

Under Canadian GAAP, the Company currently capitalizes general and administrative expenses to petroleum and natural gas assets including recoveries permitted under joint operating agreements. IFRS offers more guidance on amounts which should be capitalized. There is no impact of this change on petroleum and natural gas assets recorded at January 1, 2010 due to the conversion exemption which the Company intends to elect. The quantitative impact to the Company of these changes to accounting for petroleum and natural gas assets has not been determined although progress has been made to quantify the impact of these policy choices during the quarter.

OTHER ITEMS

A major difference between current Canadian standards and IFRS appears to be the discount rate used to measure the asset retirement obligation. Under current Canadian standards a credit adjusted risk free rate is used in calculating the provision. Under IFRS, a risk free rate should be used when the expected cash flows are risked. Within the industry, there has been a debate on whether there should be a risk component applied to conventional property estimated cash outflows used in determining the provision. The Corporation is monitoring this matter and will be deciding which rate is the most appropriate in the Corporation's circumstances. A lower discount rate will increase the provision on transition to IFRS with a corresponding charge to retained earnings or deficit.

Consolidated Balance Sheets

(Formerly Zapata Energy Corporation)

(Unaudited)
(Stated in thousands of dollars)

	September 30, 2010	December 31, 2009
Assets		
Current assets:		
Cash	$ 2,060	$ -
Accounts receivable	8,129	4,061
Prepaid expenses and deposits	752	1,536
Fair value of financial contracts (note 6)	78	-
	11,019	5,597
Deposit on property acquisition (note 8)	7,500	-
Petroleum and natural gas properties (notes 1 and 2)	267,679	126,763
	$ 286,198	$ 132,360
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	$ 13,657	$ 10,628
Fair value of financial contracts (note 6)	-	221
Bank debt (note 3)	-	41,650
Current future income taxes	22	-
	13,679	52,499
Future income taxes	34,680	17,636
Asset retirement obligations (note 4)	10,907	5,389
Shareholders' equity:		
Share capital (note 5)	185,413	16,209
Contributed surplus (note 5)	3,434	3,559
Performance warrants (note 5)	7,196	-
Retained earnings	30,889	37,068
	226,932	56,836
Commitments (note 7)		
Subsequent events (note 8)		
	$ 286,198	$ 132,360

See accompanying notes to the interim consolidated financial statements.

Consolidated Statements of Operations, Comprehensive Income (Loss) and Retained Earnings

(Formerly Zapata Energy Corporation)

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

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2010	2009	**2010**	2009
Revenues:				
Petroleum and natural gas	**$ 14,264**	$ 10,790	**$ 39,383**	$ 29,922
Royalties	**(1,750)**	(1,190)	**(5,751)**	(3,580)
Realized gain (loss) on financial contracts (note 6)	**916**	(38)	**2,087**	728
Unrealized gain (loss) on financial contracts (note 6)	**(1,110)**	1,026	**299**	(106)
	12,320	10,588	**36,018**	26,964
Expenses:				
Operating	**4,325**	2,701	**11,360**	9,080
Transportation	**537**	467	**1,792**	1,494
General and administrative	**1,495**	958	**3,989**	2,788
Stock-based compensation (note 5)	**511**	57	**4,671**	170
Interest expense	**89**	605	**703**	1,434
Bad debt provision	**-**	-	**115**	840
Depletion, depreciation and accretion	**6,610**	4,713	**15,227**	14,368
	13,567	9,501	**37,857**	30,174
Income (loss) before the undernoted	**(1,247)**	1,087	**(1,839)**	(3,210)
Recapitalization costs	**-**	-	**5,409**	-
Income (loss) before income taxes	**(1,247)**	1,087	**(7,248)**	(3,210)
Future income tax (reduction)	**(415)**	243	**(1,069)**	(1,119)
Net income (loss) and comprehensive income (loss)	**(832)**	844	**(6,179)**	(2,091)
Retained earnings, beginning of period	**31,721**	36,257	**37,068**	39,219
Common shares repurchased and cancelled	**-**	-	**-**	(27)
Retained earnings, end of period	**$ 30,889**	$ 37,101	**$ 30,889**	$ 37,101
Income (loss) per share (note 5):				
Basic	**$ (0.02)**	$ 0.05	**$ (0.20)**	$ (0.13)
Diluted	**$ (0.02)**	$ 0.05	**$ (0.20)**	$ (0.13)

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 September 30,		For the Nine Months Ended September 30,	
	2010	2009	**2010**	2009
Cash provided by (used in):				
Operating:				
Net income (loss) including recapitalization costs of $5,409 for the nine months ended September 30, 2010	**$ (832)**	$ 844	**$ (6,179)**	$ (2,091)
Depletion, depreciation and accretion	**6,610**	4,713	**15,227**	14,368
Future income tax (reduction)	**(415)**	243	**(1,069)**	(1,119)
Bad debt provision	**-**	-	**115**	840
Stock-based compensation	**511**	57	**4,671**	170
Unrealized loss (gain) on financial contracts	**1,110**	(1,026)	**(299)**	106
Abandonment expenditures	**18**	(31)	**(94)**	(102)
Change in non-cash working capital	**4,462**	194	**4,171**	(1,563)
Cash flow from operating activities	**11,464**	4,994	**16,543**	10,609
Financing:				
Bank debt	**(15,792)**	(2,450)	**(57,442)**	7,150
Issue of common shares and performance warrants, net of issue costs	**742**	-	**72,950**	-
Repurchase of common shares under normal course issuer bid	**-**	-	**-**	(51)
Cash flow from (used in) financing activities	**(15,050)**	(2,450)	**15,508**	7,099
Investing:				
Petroleum and natural gas properties	**(8,870)**	(2,968)	**(17,646)**	(12,735)
Corporate acquisitions (note 1)	**(843)**	-	**(843)**	-
Property acquisitions (note 8)	**(7,500)**	-	**(7,500)**	-
Change in non-cash working capital	**(473)**	424	**(4,002)**	(4,973)
Cash flow used in investing activities	**(17,686)**	(2,544)	**(29,991)**	(17,708)
Change in cash	**(21,272)**	-	**2,060**	-
Cash, beginning of period	**23,332**	-	**-**	-
Cash, end of period	**$ 2,060**	$ -	**$ 2,060**	$ -
Interest paid	**$ 119**	$ 605	**$ 733**	$ 1,434

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 nine months ended September 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" or "Surge"), 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 subsidiaries and partnerships. All inter-entity transactions and balances have been eliminated. Certain comparative figures have been reclassified to conform with current period presentation.

1. CORPORATE ACQUISITIONS:

(A) CORINTHIAN ENERGY CORP.

Effective July 9, 2010, the Corporation acquired all of the issued and outstanding common shares of Corinthian Energy Corp. ("Corinthian"), a privately held junior oil and gas exploration company, in exchange for 16,025,529 common shares of Surge with an assigned value of $94,477,000. The common shares have been ascribed a fair value of $5.90 per common share issued, as determined based on the Corporation's weighted average trading price at the date of announcement being June 22, 2010. In addition, Surge incurred transaction costs of $888,000. The operations of Corinthian have been included in the results of Surge commencing July 9, 2010. The transaction was accounted for by the purchase method. The allocation of the purchase price for the acquisition has not been finalized. The following amounts are estimates based on information available at the time of preparation of these financial statements. Accordingly, these amounts are subject to changes as cost estimates and values are finalized. The preliminary allocation of the purchase price, based on management's estimates of fair values, is as follows:

Fair value of net assets acquired:	
Petroleum and natural gas properties	$ 133,044
Bank debt	(15,792)
Working capital	544
Asset retirement obligations	(4,959)
Future income tax liability	(17,472)
Net assets acquired	$ 95,365
Consideration:	
Common shares (16,025,529 common shares)	$ 94,477
Transaction costs	888
Total consideration	$ 95,365

(B) CRYSTAL LAKE RESOURCES LTD.

Effective July 19, 2010, Surge acquired all of the issued and outstanding common shares of Crystal Lake Resources Ltd. ("Crystal Lake"), a privately held junior oil and gas exploration company, in exchange for 288,639 common shares of Surge with an assigned value of $1,702,000. The common shares have been ascribed a fair value of $5.90 per common share issued, as determined based on the Corporation's weighted average trading price at the date of announcement being June 22, 2010. The operations of Crystal Lake have been included in the results of Surge commencing July 19, 2010.

The transaction was accounted for by the purchase method. The allocation of the purchase price for the acquisition has not been finalized. The following amounts are estimates based on information available at the time of preparation of these financial statements. Accordingly, these amounts are subject to changes as cost estimates and values are finalized. The preliminary allocation of the purchase price, based on management's estimates of fair values, is as follows:

Fair value of net assets acquired:	
Petroleum and natural gas properties	$ 1,675
Cash	45
Working capital deficiency	(5)
Asset retirement obligations	(90)
Future income tax asset	77
Net assets acquired	$ 1,702
Consideration:	
Common shares (288,639 common shares)	$ 1,702

2. PETROLEUM AND NATURAL GAS PROPERTIES:

September 30, 2010	Cost	Accumulated Depletion	Net Book Value
Petroleum and natural gas properties	$ 385,108	$ 117,429	$ 267,679

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

During the three and nine months ended September 30, 2010, the Corporation capitalized $456,000 (September 30, 2009 – $165,000) and $1,392,000 (September 30, 2009 - $266,000) of overhead-related costs to petroleum and natural gas properties. In addition, $413,000 and $2,390,000 in stock-based compensation and the related tax impact of $131,000 and $825,000 was capitalized during the three and nine month periods ended September 30, 2010, respectively.

Costs associated with unproven properties, salvage values and seismic excluded from costs subject to depletion for the three and nine months ended September 30, 2010 totaled $88,720,000 (September 30, 2009 – $19,512,000).

Future development costs for proved reserves of $21,995,000 (September 30, 2009 – $7,800,000) have been included in the depletion calculation.

3. BANK DEBT:

The Corporation has a $90,000,000 extendible, revolving term credit facility with a Canadian bank bearing interest at bank rates. The facility is available on a revolving basis until July 13, 2011. On July 13, 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 bank. As the available lending limits of the facilities are based on the bank'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 review. 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.

4. 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 $56,432,000 (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:

	Nine months ended September 30, 2010		Year Ended December 31, 2009	
Balance, beginning of period	**$**	**5,389**	$	5,243
Liabilities incurred on corporate acquisitions (note 1)		**5,049**		-
Liabilities incurred		**176**		(1)
Accretion expense		**387**		404
Abandonment expenditures		**(94)**		(257)
Balance, end of period	**$**	**10,907**	$	5,389

5. 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
Issued pursuant to Corinthian acquisition (note 1)	16,025,529		94,477
Issued pursuant to Crystal Lake acquisition (note 1)	288,639		1,702
Share issue costs	-		(2,887)
Tax effect of share issue costs	-		760
Exercise of stock options	1,506,335		6,760
Exercise of warrants	308,800		1,235
Stock-based compensation of flow through units	-		331
Tax effect of flow-through shares issued in 2009	-		(675)
Balance, September 30, 2010	**47,701,149**	**$**	**185,413**

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 5(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 nine 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 nine month period ended September 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 percent 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 4,770,115 common shares of the Corporation as at September 30, 2010. The exercise price of each option equals the market price of the 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 first, second and third anniversaries from the date of grant.

	Nine Months Ended September 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	1,656,000	$ 6.23	345,000	$ 3.20
Exercised	(1,506,335)	$ 3.40	-	-
Forfeited	(225,000)	$ 6.65	(110,665)	$ 4.04
Stock options outstanding, end of period	1,802,666	$ 5.94	1,878,001	$ 3.74
Exercisable at period - end	146,666	$ 3.48	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 nine, twelve and eighteen month anniversaries from the date of grant. The performance warrants expire on April 13, 2015. As at September 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:

	Three Months Ended September 30, 2010	Three Months Ended September 30, 2009	**Nine Months Ended September 30, 2010**	Nine Months Ended September 30, 2009
Stock-based compensation on options	**$ 924**	$ 57	**$ 1,818**	$ 170
Stock-based compensation on performance warrants (note 5(d))	**-**	-	**4,912**	-
Stock-based compensation on flow- through share premiums (note 5 (b))	**-**	-	**331**	-
Capitalized stock-based compensation	**(413)**	-	**(2,390)**	-
Total stock-based compensation expense	**$ 511**	$ 57	**$ 4,671**	$ 170

The Corporation's stock-based compensation expense for the three and nine month periods ended September 30, 2010 was $511,000 (September 30, 2009 - $57,000) and $4,671,000 (September 30, 2009 - $170,000), 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 nine months ended September 30, 2010: zero dividend yield; expected volatility of 69 percent; risk free rate of 2 percent; and expected life of five years. The weighted average fair value of options granted in the first nine months of 2010 is $3.74 per option.

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

(F) CONTRIBUTED SURPLUS:

	Nine Months Ended September 30, 2010	Year Ended December 31, 2009
Balance, beginning of period	**$ 3,559**	$ 3,178
Stock-based compensation on options	**1,818**	381
Transfer on exercise of stock options	**(1,943)**	-
Balance, end of period	**$ 3,434**	$ 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 September 30, 2010, there were 363,399 warrants outstanding and exercisable.

(H) PER SHARE AMOUNTS:

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

	Three Months Ended September 30, 2010	Three Months Ended September 30, 2009	**Nine Months Ended September 30, 2010**	Nine Months Ended September 30, 2009
Weighted average number of shares – basic	**45,998,068**	16,666,811	**30,874,642**	16,676,706
Effect of dilutive stock options	**-**	69,353	**-**	-
Weighted average number of shares - diluted	**45,998,068**	16,736,164	**30,874,642**	16,676,706

6. 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 September 30, 2010, the Corporation's receivables consisted of $5,942,000 due from petroleum and natural gas marketers and $2,187,000 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 September 30, 2010. During the three and nine months ended September 30, 2010, the Corporation wrote off no bad debts (September 30, 2009 – nil) and $0.1 million of bad debts (September 30, 2009 – $0.8 million), respectively.

As at September 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
8,129	6,614	1,515
100%	81%	19%

(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 nine months ended September 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 nine months ended September 30, 2010:

Term	Type (floating to fixed)	Volume	Swap Price (Surge receives) (C$)	Index (Surge pays)	Unrealized gains (losses) for the three months ended Sep 30, 2010 (C$)	Unrealized gains (losses) for the nine months ended Sep 30, 2010 (C$)	Realized gains (losses) for the three months ended Sep 30, 2010 (C$)	Realized gains (losses) for the nine months ended Sep 30, 2010 (C$)
Jan 1 – Dec 31, 2010	Swap	2,000 GJs/d	5.80	AECO Monthly Average	(218)	143	139	733
Apr 1 – Oct 31, 2010	Swap	1,000 GJs/d	5.32	AECO Monthly Average	(122)	60	165	316
Nov 1, 2009 - Mar 31, 2010	Swap	500 GJs/d	6.00	AECO Monthly Average	-	(35)	-	42
Jan 1 to Dec 31, 2011	Call	500 GJs/d	6.55	AECO Monthly Average	(4)	(4)	-	-
Jan 1 to Dec 31, 2011	Put	500 GJs/d	$5.00	AECO Monthly Average	245	245	-	-
Mar 1, 2009 to Dec 31, 2010	Swap	750 GJs/d	5.64	AECO Monthly Average	150	150	105	105
Jan 1 to Dec 31, 2010	Swap	100 bbls/d	86.00	C$ WTI - NYMEX	(53)	42	87	177
Jan 1 to Dec 31, 2010	Swap	100 bbls/d	84.00	C$ WTI - NYMEX	(34)	97	63	117
Jan 1 to Dec 31, 2010	Swap	100 bbls/d	86.00	C$ WTI - NYMEX	(53)	42	87	177
Jan 1 to Dec 31, 2010	Swap	200 bbls/d	81.00	C$ WTI - NYMEX	(14)	356	52	52
Feb 1 to Dec 31, 2010	Swap	100 bbls/d	87.75	C$ WTI - NYMEX	(69)	36	108	212
Feb 1 to Dec 31, 2010	Swap	100 bbls/d	87.90	C$ WTI - NYMEX	(69)	39	110	216
Jan 1 to Dec 31, 2011	Swap	250 bbls/d	80.00	C$ WTI - NYMEX	(717)	(717)	-	-
Jan 1 to Dec 31, 2011	Call	250 bbls/d	96.55	C$ WTI - NYMEX	414	414	-	-
Jan 1 to Dec 31, 2011	Swap	250 bbls/d	80.00	C$ WTI - NYMEX	(717)	(717)	-	-
Jan 1 to Dec 31, 2011	Call	250 bbls/d	91.00	C$ WTI - NYMEX	604	604	-	-
Jan 1 to Dec 31, 2011	Call	125 bbls/d	78.40	C$ WTI - NYMEX	(626)	(626)	-	-
Jan 1 to Dec 31, 2011	Swap	250 bbls/d	85.50	C$ WTI - NYMEX	(221)	(221)	-	-
Jan 1 to Dec 31, 2011	Put	125 bbls/d	78.40	C$ WTI - NYMEX	394	394	-	-
					(1,110)	**302**	**916**	**2,147**

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 nine months ended September 30, 2010, the Corporation was exposed to interest rate fluctuations on its bank debt, which bears a floating rate of interest. As at September 30, 2010, if interest rates had been 100 basis points lower with all other variables held constant, net earnings for the nine month period then ended would have been approximately $104,000 (September 30, 2009 - $222,000) higher 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 nine months ended September 30, 2010:

Term	Type (floating to fixed)	Amount (C$)	Company fixed interest rate (%)	Counterparty floating rate index	Unrealized (losses) for the three months ended Sep 30, 2010 (C$)	Unrealized (losses) for the nine months ended Sep 30, 2010 (C$)	Realized (losses) for the three months ended Sep 30, 2010 (C$)	Realized (losses) for the nine months ended Sep 30, 2010 (C$)
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 Nine Months Ended September 30, 2010	
	Price Increase	Price Decrease
Crude Oil – Change of +/- $1.00	(657,525)	657,525
Natural Gas – Change of +/- $0.50	(233,250)	233,250

(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 $226,932,000 (December 31, 2009 - $56,836,000), bank debt of $ nil (December 31, 2009 - $41,650,000) and a working capital deficiency of $2,660,000 (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 September 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 September 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.

7. COMMITMENTS

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

2010	$	252
2011		993
2012		1,013
2013		412
2014		108
	$	2,778

(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 September 30, 2010, the Corporation had incurred $2.1 million towards this flow-through share obligation and has remaining eligible exploration expenditures of $0.5 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.

8. SUBSEQUENT EVENTS:

a) On November 1, 2010 the Corporation acquired certain petroleum and natural gas properties in the Valhalla region of Alberta. As consideration, approximately $75.0 million in cash was paid, subject to final adjustments. As of September 30, 2010, the Corporation had paid a deposit of $7.5 million on the properties.

b) On November 1, 2010 in conjunction with the aforementioned acquisition, the Corporation issued 8,001,000 common shares at a price of $5.25 per common share for total proceeds of approximately $42.0 million.