

**Consolidated Statements of Financial Position**

(Unaudited)

Stated in thousand of dollars

As at	June 30, 2012	December 31, 2011
<b>Assets</b>		
Current Assets		
Accounts receivable	\$ 25,674	\$ 19,512
Fair value of financial contracts (note 6)	5,909	-
Prepaid expenses and deposits	4,876	4,948
	<b>36,459</b>	24,460
Fair value of financial contracts (note 6)	382	-
Exploration and evaluation assets (note 4)	65,715	47,719
Petroleum and natural gas properties (note 5)	610,075	437,854
Goodwill (note 4)	6,089	6,029
	<b>\$ 718,720</b>	<b>\$ 516,062</b>
<b>Liabilities</b>		
Current liabilities		
Accounts payable and accrued liabilities	\$ 49,599	\$ 49,467
Fair value of financial contracts (note 6)	-	2,151
	<b>49,599</b>	51,618
Fair value of financial contracts (note 6)	1,129	2,751
Bank debt (note 8)	152,643	72,197
Decommissioning obligations	39,657	37,511
Deferred income taxes	59,556	27,829
<b>Shareholders' equity</b>		
Share capital (note 7)	350,473	278,302
Contributed surplus	16,706	12,879
Performance warrants (note 7)	7,059	7,196
Accumulated other comprehensive income	1,194	1,005
Retained earnings	40,704	24,774
	<b>416,136</b>	324,156
Subsequent event (note 9)		
	<b>\$ 718,720</b>	<b>\$ 516,062</b>

The accompanying notes are an integral part of these interim consolidated financial statements.

**Consolidated Statements of Income and Comprehensive Income**

(Unaudited)

Stated in thousands of dollars, except per share amounts

	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
<b>Revenues</b>				
Petroleum and natural gas	\$ 48,927	\$ 29,796	\$ 99,987	\$ 55,668
Royalties	(8,182)	(4,245)	(18,199)	(7,910)
Realized loss on financial contracts (note 6)	(242)	(1,188)	(1,012)	(1,928)
Unrealized gain on financial contracts (note 6)	12,885	2,770	10,064	163
	<b>53,388</b>	<b>27,133</b>	<b>90,840</b>	<b>45,993</b>
<b>Expenses</b>				
Operating	8,976	7,531	18,532	15,173
Transportation	2,188	1,496	3,646	2,658
General and administrative	2,952	2,471	5,924	4,646
Transaction costs	249	8	612	95
Stock-based compensation	683	710	1,649	1,433
Depletion and depreciation	18,413	8,305	35,303	16,608
Finance expense	1,835	1,064	3,523	1,773
Loss (gain) on disposal of petroleum and natural gas properties	-	841	-	(672)
	<b>35,296</b>	<b>22,426</b>	<b>69,189</b>	<b>41,714</b>
Income before income taxes	<b>18,092</b>	<b>4,707</b>	<b>21,651</b>	<b>4,279</b>
Deferred income taxes	<b>4,819</b>	<b>1,390</b>	<b>5,721</b>	<b>1,464</b>
<b>Net income for the year</b>	<b>\$ 13,273</b>	<b>\$ 3,317</b>	<b>\$ 15,930</b>	<b>\$ 2,815</b>
<b>Other comprehensive income:</b>				
Currency translation adjustment	571	(79)	189	(79)
<b>Other comprehensive income for the period</b>	<b>571</b>	<b>(79)</b>	<b>189</b>	<b>(79)</b>
<b>Total comprehensive income for the period</b>	<b>\$ 13,844</b>	<b>\$ 3,238</b>	<b>\$ 16,119</b>	<b>\$ 2,736</b>
<b>Income per share (note 7)</b>				
Basic	\$ 0.19	\$ 0.06	\$ 0.23	\$ 0.05
Diluted	\$ 0.18	\$ 0.06	\$ 0.22	\$ 0.05

The accompanying notes are an integral part of these interim consolidated financial statements.

**Consolidated Statement of Changes in Shareholders' Equity**

(Unaudited)

Stated in thousands of dollars, except share amounts

	Number of common shares	Share capital	Contributed surplus	Performance warrants	Accumulated other comprehensive income (loss)	Retained earnings	Total equity
Balance at December 31, 2010	56,094,547	\$ 220,845	\$ 4,664	\$ 7,196	\$ -	\$ 22,679	\$ 255,384
Net income for the period	-	-	-	-	-	2,815	2,815
Accumulated other comprehensive income (loss)	-	-	-	-	(79)	-	(79)
Share issue costs	-	(18)	-	-	-	-	(18)
Stock-based compensation	-	-	3,365	-	-	-	3,365
Transfer on exercise of options	-	21	(21)	-	-	-	-
Options exercised	7,334	41	-	-	-	-	41
<b>Balance at June 30, 2011</b>	<b>56,101,881</b>	<b>\$ 220,889</b>	<b>\$ 8,008</b>	<b>\$ 7,196</b>	<b>\$ (79)</b>	<b>\$ 25,494</b>	<b>\$ 261,508</b>
Balance at December 31, 2011	63,040,987	\$ 278,302	\$ 12,879	\$ 7,196	\$ 1,005	\$ 24,774	\$ 324,156
Net income for the period	-	-	-	-	-	15,930	15,930
Issued pursuant to acquisition	7,919,436	71,275	-	-	-	-	71,275
Accumulated other comprehensive income	-	-	-	-	189	-	189
Share issue costs (net of tax of \$30)	-	(88)	-	-	-	-	(88)
Stock-based compensation	-	-	4,078	-	-	-	4,078
Transfer on exercise of options & warrants	-	388	(251)	(137)	-	-	-
Options exercised	78,165	459	-	-	-	-	459
Warrants exercised	26,592	137	-	-	-	-	137
<b>Balance at June 30, 2012</b>	<b>71,065,180</b>	<b>\$ 350,473</b>	<b>\$ 16,706</b>	<b>\$ 7,059</b>	<b>\$ 1,194</b>	<b>\$ 40,704</b>	<b>\$ 416,136</b>

The accompanying notes are an integral part of these interim consolidated financial statements.

**Consolidated Statements of Cash Flows**

(Unaudited)

Stated in thousands of dollars

	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
Cash provided by (used in)				
<b>Operating</b>				
Net income	\$ 13,273	\$ 3,317	\$ 15,930	\$ 2,815
Loss (gain) on disposal of petroleum and natural gas properties	-	841	-	(672)
Unrealized gain on financial contracts	(12,885)	(2,770)	(10,064)	(163)
Finance expense	1,835	1,064	3,523	1,773
Interest expense	(1,576)	(801)	(3,009)	(1,249)
Depletion and depreciation	18,413	8,305	35,303	16,608
Decommissioning expenditures	(247)	(129)	(731)	(310)
Stock-based compensation	683	710	1,649	1,433
Deferred income taxes	4,819	1,390	5,721	1,464
Change in non-cash working capital	(924)	(589)	(3,060)	(1,354)
Cash flow from operating activities	23,391	11,338	45,262	20,345
<b>Financing</b>				
Bank debt	30,978	24,090	65,823	56,459
Issues of common shares and performance warrants, net of issue costs	173	1	478	23
Cash flow from financing activities	31,151	24,091	66,301	56,482
<b>Investing</b>				
Petroleum and natural gas properties	(21,388)	(13,236)	(66,674)	(32,478)
Exploration and evaluation assets	(6,319)	(4,077)	(15,931)	(14,839)
Disposition of petroleum and natural gas properties	-	5,224	-	6,525
Acquisitions (note 3)	(9,347)	(9,347)	(27,847)	(25,644)
Change in non-cash working capital	(17,488)	(13,993)	(1,111)	(11,828)
Cash flow used in investing activities	(54,542)	(35,429)	(111,563)	(78,264)
Change in cash	-	-	-	(1,437)
Cash, beginning of period	-	-	-	1,437
<b>Cash, end of period</b>	\$ -	\$ -	\$ -	\$ -

Cash is defined as cash and cash equivalents.

The accompanying notes are an integral part of these interim consolidated financial statements.

## NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

Tabular amounts are in thousands of dollars, except share and per share data

(Unaudited)

### 1. REPORTING ENTITY

Surge Energy Inc.'s (the "Corporation" or "Surge") business consists of the exploration, development and production of oil and gas from properties in western Canada and the northern United States. The interim consolidated financial statements include the accounts of the Corporation, its wholly-owned subsidiaries and partnerships.

### 2. BASIS OF PREPARATION

#### Statement of compliance

These interim consolidated financial statements have been prepared in accordance with International Accounting Standard 34, "Interim Financial Reporting" and using the accounting policies outlined by the Corporation in its annual consolidated financial statements for the year ended December 31, 2011. These interim consolidated financial statements do not include all of the information required for full annual financial statements.

The interim consolidated financial statements were authorized for issuance by the Board of Directors on August 7, 2012.

### 3. ACQUISITION

#### (a) Pradera Resources Inc.

Effective January 6, 2012, the Corporation acquired all of the issued and outstanding common shares Pradera Resources Inc. ("Pradera"), a privately held junior oil and gas exploration company, in exchange 7,919,436 common shares of Surge with an assigned value of \$71.3 million. The purpose of the acquisition was to expand the Corporation's exposure to certain light oil plays. The common shares have been ascribed a fair value of \$9.00 per common share issued, as determined based on the Corporation's closing share price at the date of closing, being January 6, 2012. In addition, Surge incurred transaction costs of \$0.4 million, which were expensed through the statement of income. The operations of Pradera have been included in the results of Surge commencing January 6, 2012. The transaction was accounted for by the purchase method. The allocation of the purchase price, based on management's estimates of fair values, is as follows:

<b>Fair value of net assets acquired:</b>	
Petroleum and natural gas properties	\$ 127,230
Exploration and evaluation assets	2,660
Current assets	5,948
Current liabilities	(3,796)
Bank debt	(14,623)
Decommissioning obligations	(1,608)
Deferred income tax liability	(26,036)
<b>Net assets acquired</b>	<b>\$ 89,775</b>
<b>Consideration:</b>	
Cash	\$ 18,500
Common shares (7,919,436 at \$9.00 per share)	71,275
<b>Total consideration paid</b>	<b>\$ 89,775</b>

Included in the 2012 interim consolidated statement of income and comprehensive income are the following amounts:

<b>Amounts since acquisition</b>	
Revenue	\$ 16,254
Income and comprehensive income	3,746

During the period, the Corporation made several insignificant property acquisitions for total cash consideration of \$9.3 million. These amounts have been booked as follows: \$3.5 million to exploration and evaluation assets and \$5.8 million to petroleum and natural gas properties.

#### 4. EXPLORATION AND EVALUATION ASSETS AND GOODWILL

Exploration and evaluation (E&E) assets consist of the Corporation's exploration projects which are pending the determination of proven or probable reserves. Additions represent the Corporation's share of costs incurred on E&E assets during the period.

##### Exploration & Evaluation Assets

	Total
<b>Cost:</b>	
Balance at December 31, 2011	\$ 47,719
Acquisitions (note 3)	6,181
Additions	15,931
Change in foreign exchange rate	91
Transfer to petroleum and natural gas properties	(4,207)
<b>Balance at June 30, 2012</b>	<b>\$ 65,715</b>

##### Goodwill

	Total
<b>Cost</b>	
Balance at December 31, 2011	\$ 6,029
Change in foreign exchange rate	60
<b>Balance at June 30, 2012</b>	<b>\$ 6,089</b>

#### 5. PETROLEUM AND NATURAL GAS PROPERTIES

	Total
<b>Cost or deemed cost</b>	
Balance at December 31, 2011	\$ 504,802
Acquisitions (note 3)	133,056
Additions	67,426
Transfer from exploration and evaluation assets	4,207
Capitalized stock-based compensation	2,429
Change in foreign exchange rate	406
<b>Balance at June 30, 2012</b>	<b>\$ 712,326</b>

	Total
<b>Accumulated depletion and depreciation</b>	
Balance at December 31, 2011	(\$66,948)
Depletion and depreciation expense	(35,303)
<b>Balance at June 30, 2012</b>	<b>(\$102,251)</b>

	Total
<b>Carrying amounts</b>	
At December 31, 2011	437,854
<b>At June 30, 2012</b>	<b>610,075</b>

The calculation of depletion and depreciation expense for the three months ended June 30, 2012 included an estimated \$138.8 million (June 30, 2011 - \$53.4 million) for future development costs associated with proved plus probable reserves and excluded \$30.7 million (June 30, 2011 - \$26.9 million) for the estimated salvage value of production equipment and facilities.

## 6. RISK MANAGEMENT CONTRACTS

As a means of managing commodity price and interest rate volatility, the Corporation enters into various derivative financial instrument agreements and physical contracts. The fair value of forward contracts and swaps is determined by discounting the difference between the contracted prices and published forward price curves as at the statement of financial position date, using the remaining contracted oil and natural gas volumes and a risk-free interest rate (based on published government rates). The fair value of options and costless collars is based on option models that use published information with respect to volatility, prices and interest rates.

The following table outlines the realized and unrealized gains (losses) on oil differential contracts for the three and six months ended June 30, 2012:

Term	Type (floating to fixed)	Volume	Differential (Surge receives) (C\$)	Index (Surge pays) (C\$)	Three months ended June 30, 2012		Six months ended June 30, 2012	
					Unrealized gains (losses) (\$000s CDN)	Realized gains (losses) (\$000s CDN)	Unrealized gains (losses) (\$000s CDN)	Realized gains (losses) (\$000s CDN)
Jan 1 to Mar 31, 2012	Swap	500 bbls/d	\$ 13.25	Western Canadian Select	-	12	(104)	385
Jan 1 to Jun 30, 2012	Swap	250 bbls/d	\$ 14.85	Western Canadian Select	(339)	251	(36)	401
Jun 1 to Jun 30, 2012	Swap	750 bbls/d	\$ 17.50	Western Canadian Select	-	(23)	-	(23)
Jul 1 to Sep 30, 2012	Swap	500 bbls/d	\$ 20.25	Western Canadian Select	312	-	312	-
<b>Total</b>					<b>\$ (27)</b>	<b>\$ 240</b>	<b>\$ 172</b>	<b>\$ 763</b>

The following table outlines the realized and unrealized losses on interest rate contracts for three and six months ended June 30, 2012:

Term	Type (floating to fixed)	Amount (C\$)	Company Fixed Interest Rate (%) <sup>(1)</sup>	Counter party Floating Rate Index	Three months ended June 30, 2012		Six months ended June 30, 2012	
					Unrealized gain (loss) (\$000s CDN)	Realized gain (loss) (\$000s CDN)	Unrealized gain (loss) (\$000s CDN)	Realized gain (loss) (\$000s CDN)
Jan 1, 2012 to Dec 31, 2014	Swap	\$ 50,000,000	2.74%	CAD-BA-CDOR	(229)	(83)	263	(83)

(1) The interest rate hedge is comprised of a range, beginning at 1.439% and escalating quarterly to a maximum of 3.952%.



The following table outlines the realized and unrealized gains (losses) on oil commodity contracts for the three and six months ended June 30, 2012:

Term	Type (floating to fixed)	Volume	Swap Price (Surge receives) (C\$)	Index (Surge pays) (C\$)	Three months ended June 30, 2012		Six months ended June 30, 2012	
					Unrealized gains (losses) (\$000s CDN)	Realized gains (losses) (\$000s CDN)	Unrealized gains (losses) (\$000s CDN)	Realized gains (losses) (\$000s CDN)
Jan 1 to Dec 31, 2012	Swap	250 bbls/d	\$ 97.00	WTI - NYMEX	937	61	762	(76)
Jan 1 to Dec 31, 2012	Put	250 bbls/d	\$ 80.00	WTI - NYMEX	25	-	595	-
Jan 1 to Dec 31, 2012	Call	62.5 bbls/d	\$ 80.00	WTI - NYMEX	323	(81)	(316)	(212)
Jan 1 to Dec 31, 2012	Swap	250 bbls/d	\$ 80.00	WTI - NYMEX	1,320	(325)	2,032	(850)
Jan 1 to Dec 31, 2012	Call	250 bbls/d	\$ 89.95	WTI - NYMEX	(979)	138	(1,740)	436
Jan 1 to Dec 31, 2012	Put	250 bbls/d	\$ 90.00	WTI - NYMEX	118	40	743	40
Jan 1 to Dec 31, 2012	Call	92.5 bbls/d	\$ 90.00	WTI - NYMEX	361	(51)	(443)	(161)
Jan 1 to Dec 31, 2012	Put	500 bbls/d	\$ 90.00	WTI - NYMEX	615	(87)	(871)	(274)
Jan 1 to Dec 31, 2012	Call	157.5 bbls/d	\$ 90.00	WTI - NYMEX	236	-	1,334	-
Jan 1 to Dec 31, 2012	Swap	500 bbls/d	\$ 85.00	WTI - NYMEX	2,424	(423)	2,613	(1,245)
Jan 1 to Dec 31, 2012	Call	500 bbls/d	\$ 96.00	WTI - NYMEX	(2,697)	99	(1,679)	99
Apr 1 to Dec 31, 2012	Swap	500bbls/d	\$ 90.00	WTI - NYMEX	2,268	328	272	328
Apr 1 to Dec 31, 2012	Call	500bbls/d	\$ 96.00	WTI - NYMEX	(1,523)	99	-	420
Apr 1 to Dec 31, 2012	Swap	500bbls/d	\$ 101.50	WTI - NYMEX	1,672	(196)	1,245	(196)
Jul 1 to Dec 31, 2012	Swap	500bbls/d	\$ 95.00	WTI - NYMEX	650	-	650	-
Jul 1 to Dec 31, 2012	Call	500bbls/d	\$ 99.80	WTI - NYMEX	98	-	98	-
Jan 1 to Mar 31, 2013	Swap	250bbls/d	\$ 104.85	WTI - NYMEX	348	-	331	-
Jan 1 to Dec 31, 2013	Swap	250bbls/d	\$ 98.00	WTI - NYMEX	576	-	-	-
Jan 1 to Dec 31, 2013	Swap	250bbls/d	\$ 95.00	WTI - NYMEX	1,233	-	388	-
Jan 1 to Mar 31, 2013	Swap	500bbls/d	\$ 95.00	WTI - NYMEX	191	-	420	-
Jan 1 to Mar 31, 2013	Call	185bbls/d	\$ 95.00	WTI - NYMEX	185	-	(74)	-
Apr 1 to Jun 30, 2013	Swap	250bbls/d	\$ 105.05	WTI - NYMEX	318	-	320	-
Apr 1 to Jun 30, 2013	Swap	500bbls/d	\$ 95.00	WTI - NYMEX	633	-	188	-
Apr 1 to Jun 30, 2013	Call	300bbls/d	\$ 95.00	WTI - NYMEX	(243)	-	179	-
Jan 1 to Dec 31, 2013	Swap	250 bbls/d	\$ 85.00	WTI - NYMEX	1,893	-	423	-
Jan 1 to Dec 31, 2013	Call	250bbls/d	\$ 95.00	WTI - NYMEX	614	-	614	-
Jan 1 to Mar 31, 2013	Swap	500bbls/d	\$ 95.00	WTI - NYMEX	222	-	222	-
Jan 1 to Mar 31, 2013	Call	500bbls/d	\$ 103.70	WTI - NYMEX	31	-	31	-
Jan 1 to Jun 30, 2013	Swap	500bbls/d	\$ 95.00	WTI - NYMEX	(38)	-	(38)	-
Jan 1 to Jun 30, 2013	Call	380bbls/d	\$ 95.00	WTI - NYMEX	573	-	573	-
Jan 1 to Jun 30, 2013	Swap	1,000 bbls/d	\$ 90.00	WTI - NYMEX	(79)	-	(79)	-
Jan 1 to Jun 30, 2013	Call	1,000 bbls/d	\$ 96.00	WTI - NYMEX	836	-	836	-
<b>Total</b>					<b>\$ 13,141</b>	<b>\$ (398)</b>	<b>\$ 9,629</b>	<b>\$ (1,691)</b>

The following table summarizes the sensitivity of the fair value of the Corporation's market risk management positions to fluctuations in interest rates and crude oil 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 interest rates, 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 for the period ended June 30, 2012		
	Price Increase	Price Decrease
Crude Oil - Change of +/- \$1.00	\$ (2,225)	\$ 2,225
Interest rate - Change of +/- 100 points	\$ (375)	\$ 375

## 7. SHARE CAPITAL

### (a) Stock Options

Under the Corporation's stock option plan, it may grant options to its officers, directors, employees and certain consultants for up to 7,106,518 common shares of the Corporation as at June 30, 2012. 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.

	June 30, 2012		December 31, 2011	
	Number of Options	Weighted average exercise price	Number of Options	Weighted average exercise price
Stock options outstanding, beginning of period	4,948,999	\$ 7.54	2,683,667	\$ 6.24
Granted	249,000	\$ 9.18	2,355,500	\$ 8.92
Exercised	(78,165)	\$ 5.85	(47,168)	\$ 3.95
Forfeited	(258,668)	\$ 7.50	(43,000)	\$ 5.96
Stock options outstanding, end of period	4,861,166	\$ 7.65	4,948,999	\$ 7.54
Exercisable at period-end	1,573,486	\$ 6.58	899,484	\$ 6.10

The following table summarizes stock options outstanding and exercisable at June 30, 2012:

Range of exercise prices	Options Outstanding			Options Exercisable		
	Number outstanding	Weighted average exercise price	Weighted average contractual life (years)	Number exercisable	Weighted average exercise price	
\$1 to \$2.99	26,667	\$ 1.75	1.45	26,667	\$ 1.75	
\$3 to \$4.99	39,000	\$ 3.20	2.48	39,000	\$ 3.20	
\$5 to \$6.99	2,312,999	\$ 6.42	3.06	1,234,319	\$ 6.39	
\$7 to \$8.99	762,167	\$ 8.06	3.86	211,834	\$ 8.04	
\$9 to \$11.15	1,720,333	\$ 9.33	4.13	61,666	\$ 9.43	
\$1 to \$11.15	4,861,166	\$ 7.65	3.55	1,573,486	\$ 6.58	

**(b) Performance warrants**

The Corporation has 2,047,272 performance warrants outstanding (December 31, 2011 – 2,073,864) that expire on April 13, 2015. As at June 30, 2012, all 2,047,272 performance warrants were vested and exercisable at a price of \$5.17.

**(c) Per share amounts**

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

	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
Weighted average number of shares - basic	<b>71,057,943</b>	56,098,181	<b>70,766,027</b>	56,096,473
Effect of dilutive stock options	<b>1,080,348</b>	1,187,618	<b>1,403,124</b>	1,040,952
Weighted average number of shares - diluted	<b>72,138,291</b>	57,285,799	<b>72,169,151</b>	57,137,425

In computing diluted per share amounts at June 30, 2012, 2,482,500 options (June 30, 2011 – nil) and nil performance warrants (June 30, 2011 – nil) were excluded from the calculation as their effect was anti-dilutive.

**8. BANK DEBT**

In connection with the closing of the Pradera Acquisition, as detailed in Note 3, the Corporation increased its revolving term credit facility from \$150 million to \$175 million. During the second quarter, the Corporation further increased its credit facility from \$175 million to \$250 million. The facility had an effective interest rate of prime plus 1.50 percent as at June 30, 2012 (June 30, 2011 – prime plus 1.50 percent). The facility's next scheduled review is required before November 1, 2012.

**9. SUBSEQUENT EVENT**

(a) Subsequent to the second quarter, Surge entered into the following financial oil & gas pricing contracts:

Term	Type	Volume	Price (C\$) (Surge Receives)	Index (Surge pays) (C\$)
1) Jan 1, 2013 - Dec 31, 2013	Swap	2,000GJ/d	3.10	AECO - Monthly