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INDEPENDENT AUDITORS' REPORT

To the Shareholders of Surge Energy Inc.

Opinion

We have audited the consolidated financial statements of Surge Energy Inc. (the "Company"), which comprise:

- the consolidated statements of financial position as at December 31, 2019 and December 31, 2018
- the consolidated statements of loss and comprehensive loss for the years then ended
- the consolidated statements of changes in shareholders' equity for the years then ended
- the consolidated statements of cash flows for the years then ended
- and notes to the consolidated financial statements, including a summary of significant accounting policies

Hereinafter referred to as the "financial statements".

In our opinion, the accompanying financial statements present fairly, in all material respects, the consolidated financial position of the Company as at December 31, 2019 and December 31, 2018, and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards ("IFRS").

Basis for Opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the "Auditors' Responsibilities for the Audit of the Financial Statements" section of our auditors' report.

We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in Canada and we have fulfilled our other ethical responsibilities in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other Information

Management is responsible for the other information. Other information comprises:

- the information included in Management's Discussion and Analysis filed with the relevant Canadian Securities Commissions.

Our opinion on the financial statements does not cover the other information and we do not and will not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit and remain alert for indications that the other information appears to be materially misstated.



We obtained the information included in Management's Discussion and Analysis filed with the relevant Canadian Securities Commissions as at the date of this auditors' report. If, based on the work we have performed on this other information, we conclude there is a material misstatement of this other information, we are required to report that fact in the auditors' report.

We have nothing to report in this regard.

Responsibilities of Management and Those Charged with Governance for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with IFRS, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

Auditors' Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists.

Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit.

We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion.

The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.



- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.
- Provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

The engagement partner on the audit resulting in this auditors' report is Shane Doig.

(Signed) KPMG LLP

Chartered Professional Accountants

Calgary, Canada

March 9, 2020

Consolidated Statements of Financial Position

Stated in thousands of dollars

| As at | December 31, 2019 | December 31, 2018 |
|--|----------------------|----------------------|
| Assets | | |
| Current Assets | | |
| Accounts receivable | \$ 41,486 | \$ 21,084 |
| Fair value of financial contracts (note 7) | 1,067 | 4,939 |
| Prepaid expenses and deposits | 4,875 | 9,222 |
| | 47,428 | 35,245 |
| Fair value of financial contracts (note 7) | 191 | — |
| Petroleum and natural gas properties (note 5) | 1,335,845 | 1,528,565 |
| Deferred income taxes (note 14) | 42,390 | 2,898 |
| | \$ 1,425,854 | \$ 1,566,708 |
| Liabilities | | |
| Current liabilities | | |
| Accounts payable and accrued liabilities | \$ 40,848 | \$ 42,350 |
| Dividends payable | 2,719 | 2,577 |
| Fair value of financial contracts (note 7) | 2,653 | 2,779 |
| Current portion of lease and other obligations (note 18) | 8,103 | 1,732 |
| Current portion of decommissioning obligations (note 10) | 6,000 | — |
| | 60,323 | 49,438 |
| Fair value of financial contracts (note 7) | 1,201 | 1,128 |
| Bank debt (note 8) | 316,404 | 408,593 |
| Convertible debentures (note 9) | 68,699 | 37,973 |
| Decommissioning obligations (note 10) | 269,339 | 229,213 |
| Long term lease and other obligations (note 18) | 38,581 | 5,871 |
| Shareholders' equity | | |
| Share capital | 1,466,506 | 1,441,773 |
| Equity component of convertible debentures (note 9) | 6,266 | 3,551 |
| Contributed surplus | 52,224 | 52,417 |
| Deficit | (853,689) | (663,249) |
| | 671,307 | 834,492 |
| Commitments (note 17) | | |
| | \$ 1,425,854 | \$ 1,566,708 |

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

Approved on behalf of the Board:

(Signed)
Allison Maher, Director

(Signed)
Paul Colborne, Director

Consolidated Statements of Loss and Comprehensive Loss

Stated in thousands of dollars, except per share amounts

| | Years Ended December 31, | |
|---|-----------------------------|--------------------|
| | 2019 | 2018 |
| Petroleum and natural gas revenue (note 12) | \$ 394,349 | \$ 304,547 |
| Processing and other income (note 12) | 4,303 | 2,818 |
| Royalties | (51,837) | (43,203) |
| Realized loss on financial contracts | (4,679) | (11,007) |
| Unrealized gain (loss) on financial contracts (note 7) | (2,071) | 3,971 |
| | 340,065 | 257,126 |
| Expenses | | |
| Operating | 116,338 | 100,108 |
| Transportation | 11,866 | 9,878 |
| General and administrative | 14,287 | 13,228 |
| Bad debt provision | 210 | 353 |
| Transaction and other costs | 173 | 5,288 |
| Stock-based compensation (note 11) | 6,279 | 6,409 |
| Depletion and depreciation (note 5) | 163,450 | 114,220 |
| Impairment (note 6) | 180,701 | 72,174 |
| Finance expense (note 13) | 34,963 | 22,053 |
| Loss on disposal of petroleum and natural gas properties (note 5) | 12,316 | — |
| | 540,583 | 343,711 |
| Loss before income taxes | (200,518) | (86,585) |
| Deferred income tax recovery (note 14) | (41,854) | (15,052) |
| Net loss and comprehensive loss for the year | \$ (158,664) | \$ (71,533) |
| Loss per share (note 11) | | |
| Basic | \$ (0.50) | \$ (0.29) |
| Diluted | \$ (0.50) | \$ (0.29) |

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

Consolidated Statements of Changes in Shareholders' Equity

Stated in thousands of dollars, except share amounts

| | Number of common shares | Share capital | Convertible debentures - equity portion | Contributed surplus | Warrants | Deficit | Total equity |
|--|-------------------------|---------------------|---|---------------------|-------------|---------------------|-------------------|
| Balance at December 31, 2017 | 232,989,499 | \$ 1,295,961 | 3,551 | \$ 40,198 | \$ 3,522 | \$ (567,079) | \$ 776,153 |
| Net loss for the year | — | — | — | — | — | (71,533) | (71,533) |
| Issued pursuant to acquisition | 75,431,034 | 153,879 | — | — | — | — | 153,879 |
| Share issue costs, net of tax of \$78 | — | (212) | — | — | — | — | (212) |
| Flow-through shares issued | 420,000 | 1,008 | — | — | — | — | 1,008 |
| Premium on flow-through shares | — | (273) | — | — | — | — | (273) |
| Repurchase of common shares for cancellation | (2,908,631) | (15,944) | — | 10,195 | — | — | (5,749) |
| Transfer on exercise of RSAs and PSAs ⁽¹⁾ | 3,354,323 | 7,354 | — | (10,717) | — | — | (3,363) |
| Stock-based compensation | — | — | — | 9,219 | — | — | 9,219 |
| Dividends | — | — | — | — | — | (24,637) | (24,637) |
| Transfer on expiry of performance warrants | — | — | — | 3,522 | (3,522) | — | — |
| Balance at December 31, 2018 | 309,286,225 | \$ 1,441,773 | \$ 3,551 | \$ 52,417 | \$ — | \$ (663,249) | \$ 834,492 |
| Net loss for the year | — | — | — | — | — | (158,664) | (158,664) |
| Share issue costs, net of tax of \$41 | — | (110) | — | — | — | — | (110) |
| Flow-through shares issued | 11,848,644 | 15,621 | — | — | — | — | 15,621 |
| Premium on flow-through shares | — | (1,553) | — | — | — | — | (1,553) |
| Convertible debentures issued, net of tax of \$1,004 | — | — | 2,715 | — | — | — | 2,715 |
| Transfer on exercise of RSAs and PSAs ⁽¹⁾ | 5,195,158 | 10,775 | — | (10,775) | — | — | — |
| Stock-based compensation | — | — | — | 10,582 | — | — | 10,582 |
| Dividends | — | — | — | — | — | (31,776) | (31,776) |
| Balance at December 31, 2019 | 326,330,027 | \$ 1,466,506 | \$ 6,266 | \$ 52,224 | \$ — | \$ (853,689) | \$ 671,307 |

⁽¹⁾ RSA and PSA defined as restricted share and performance share awards

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

Consolidated Statements of Cash Flows

Stated in thousands of dollars

| | Years Ended December 31, | |
|--|-----------------------------|-------------|
| | 2019 | 2018 |
| Cash provided by (used in) | | |
| Operating | | |
| Net loss | \$ (158,664) | \$ (71,533) |
| Loss on disposal of petroleum and natural gas properties | 12,316 | — |
| Unrealized loss (gain) on financial contracts | 2,071 | (3,971) |
| Finance expense | 34,963 | 22,053 |
| Interest expense | (26,657) | (16,289) |
| Depletion and depreciation | 163,450 | 114,220 |
| Impairment | 180,701 | 72,174 |
| Decommissioning expenditures | (5,522) | (6,348) |
| Bad debt provision | 210 | 353 |
| Transaction and other costs | (1,307) | — |
| Stock-based compensation | 6,279 | 1,962 |
| Deferred income tax recovery | (41,854) | (15,052) |
| Change in non-cash working capital (note 16) | (16,569) | 24,338 |
| Cash flow from operating activities | 149,417 | 121,907 |
| Financing | | |
| Bank debt | (92,189) | 199,362 |
| Dividends paid | (31,634) | (23,905) |
| Other financial obligations | 12,094 | — |
| Purchase of common shares for cancellation | — | (5,749) |
| Issuance of flow-through shares | 15,621 | 1,008 |
| Payments on lease obligations | (6,810) | — |
| Share issue costs | (151) | (290) |
| Issuance of convertible debentures | 32,495 | — |
| Cash flow provided by (used in) financing activities | (70,574) | 170,426 |
| Investing | | |
| Petroleum and natural gas properties | (119,465) | (120,552) |
| Disposition of petroleum and natural gas properties | 57,246 | 7,056 |
| Acquisitions | (14,808) | (180,942) |
| Change in non-cash working capital (note 16) | (1,816) | 2,105 |
| Cash flow used in investing activities | (78,843) | (292,333) |
| Change in cash | — | — |
| Cash, beginning of the year | — | — |
| Cash, end of the year | \$ — | \$ — |

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

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. The Corporation is a dividend paying entity. The address of Surge's registered office is 2100, 635-8th Avenue SW, Calgary, Alberta, Canada, T2P 3M3. The consolidated financial statements include the accounts of the Corporation, its wholly-owned subsidiaries and partnerships.

2. BASIS OF PREPARATION

(a) Statement of compliance

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the IASB.

The consolidated financial statements were authorized for issuance by the Board of Directors on March 9, 2020.

(b) Basis of measurement

The consolidated financial statements have been prepared on the historical cost basis except for derivative financial instruments which are measured at fair value.

The methods used to measure fair values are discussed in note 4.

(c) Functional and presentation currency

The consolidated financial statements are presented in Canadian dollars, which is the Corporation's and its subsidiaries' functional currency.

(d) Use of estimates and judgments

The preparation of consolidated financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amount of assets, liabilities, income and expenses. Actual results may differ materially from these estimates.

Estimates and their underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the year in which the estimates are revised and for any future years affected.

Critical Judgments in Applying Accounting Policies

The following are critical judgments that management has made in the process of applying accounting policies and that have the most significant effect on the amounts recognized in the consolidated financial statements.

The Corporation's assets are aggregated into cash-generating units for the purpose of calculating impairment. Cash generating units ("CGU" or "CGUs") are based on an assessment of the units ability to generate independent cash inflows. The determination of these CGUs was based on management's judgment in regards to shared infrastructure, geographical proximity, petroleum type and similar exposure to market risk and materiality.

Judgments are required to assess when impairment indicators exist and impairment testing is required. In determining the recoverable amount of assets, in the absence of quoted market prices, impairment tests are based on estimates of reserves, production rates, future oil and natural gas prices, future costs, discount rates, market value of land and other relevant assumptions.

The application of the Corporation's accounting policy for exploration and evaluation assets requires management to make certain judgments as to future events and circumstances as to whether economic quantities of reserves have been found in assessing if technical feasibility and commercial reserves have been achieved.

Judgments are made by management to determine the likelihood of whether deferred income tax assets at the end of the reporting period will be realized from future taxable earnings.

Key Sources of Estimation Uncertainty

The following are key estimates and their assumptions made by management affecting the measurement of balances and transactions in these consolidated financial statements.

Estimation of recoverable quantities of proved and probable reserves include estimates and assumptions regarding future commodity prices, exchange rates, discount rates and production and transportation costs for future cash flows as well as the interpretation of complex geological and geophysical models and data. Changes in reported reserves can affect the impairment of assets, the decommissioning obligations, the economic feasibility of exploration and evaluation assets and the amounts reported for depletion, depreciation and amortization of property, plant and equipment. These reserve estimates are verified by third party professional engineers, who work with information provided by the Corporation to establish reserve determinations in accordance with National Instrument 51-101.

The Corporation estimates the decommissioning obligations for oil and natural gas wells and their associated production facilities and pipelines. In most instances, removal of assets and remediation occurs many years into the future. Amounts recorded for the decommissioning obligations and related accretion expense require assumptions regarding removal date, environmental legislation, the extent of reclamation activities required, the engineering methodology for estimating cost, inflation estimates, removal technologies in determining the removal cost, and the estimate of the liability specific discount rates to determine the present value of these cash flows.

In a business combination, management makes estimates of the fair value of assets acquired and liabilities assumed which includes assessing the value of oil and gas properties based upon the estimation of recoverable quantities of proved and probable reserves being acquired.

The Corporation's estimate of stock-based compensation is dependent upon estimates of historic volatility and forfeiture rates.

The Corporation's estimate of the fair value of derivative financial instruments is dependent on estimated forward prices and volatility in those prices.

Key areas where management has made judgments, estimates, and assumptions related to the application of IFRS 16 include:

- **Incremental borrowing rate:** The Incremental borrowing rates are based on judgments including economic environment, term, currency, and the underlying risk inherent to the asset. The carrying balance of the right-of-use assets, lease obligations, and the resulting interest and depreciation expense, may differ due to changes in the market conditions and lease term.
- **Lease term:** Lease terms are based on assumptions regarding extension terms that allow for operational flexibility and future market conditions.

3. SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of consolidation

Operating expenses in profit or loss are presented as a combination of function and nature to conform with industry practice. Depletion and depreciation is presented on a separate line by its nature, while operating expenses and general and administrative expenses are presented on a functional basis. Significant expenses such as key management personnel's short-term employee benefits and stock-based compensation are presented by their nature in the notes to the financial statements.

Subsidiaries

Subsidiaries are entities controlled by the Corporation. Control exists when the Corporation has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, substantive potential voting rights are taken into account. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

The purchase method of accounting is used to account for acquisitions of subsidiaries and assets that meet the definition of a business under IFRS. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. The excess of the cost of acquisition over the fair value of the identifiable assets, liabilities and contingent liabilities acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognized immediately in the statement of income.

Jointly owned assets

Many of the Corporation's oil and natural gas activities involve jointly owned assets. The consolidated financial statements include the Corporation's share of these jointly owned assets and a proportionate share of the relevant revenue and related costs.

The relationships with jointly owned asset partners have been referred to as joint ventures in the remainder of these financial statements as is common in the Canadian oil and gas industry.

Transactions eliminated on consolidation

Intercompany balances and transactions, and any unrealized income and expenses arising from intercompany transactions, are eliminated in preparing the consolidated financial statements.

(b) Foreign currency

Transactions in foreign currencies are translated to the functional currencies of each entity at exchange rates prevailing on the date of each transaction. Monetary assets and liabilities denominated in foreign currencies are translated to each entity's functional currency at the period-end exchange rate. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of transaction. Foreign currency differences arising on translation are recognized in profit or loss. Foreign currency gains and losses are reported on a net basis.

(c) Cash and cash equivalents

Cash and cash equivalents are comprised of cash and all investments that are highly liquid in nature and have a original maturity date of three months or less.

(d) Petroleum and natural gas properties

Exploration and evaluation expenditures

Pre-license costs are recognized in profit or loss as incurred.

Exploration and evaluation costs, including the costs of acquiring licenses and directly attributable general and administrative costs, initially are capitalized as exploration and evaluation assets. The costs are accumulated in cost centers by well, field or exploration area pending determination of technical feasibility and commercial viability.

The technical feasibility and commercial viability of extracting a mineral resource is generally considered to be determinable when proved and/or probable reserves are determined to exist. A review of each exploration license or field is carried out, at least annually, to ascertain whether proved and/or probable reserves have been discovered. Upon determination of technical feasibility and commercial viability, exploration and evaluation assets attributable to those reserves are first tested for impairment and then reclassified from exploration and evaluation assets to petroleum and natural gas properties.

Development and production costs

Petroleum and natural gas properties, which include oil and gas development and production assets, are measured at cost less accumulated depletion and depreciation and accumulated impairment losses. The cost of development and production assets includes; transfers from exploration and evaluation assets, which generally include the cost to drill the well and the cost of the associated land upon determination of technical feasibility and commercial viability; the cost to complete and tie-in the wells; facility costs; the cost of recognizing provisions for future restoration and decommissioning; geological and geophysical costs; and directly attributable overheads.

When significant parts of an item of petroleum and natural gas properties have different useful lives, then they are accounted for as separate components.

Gains and losses on disposal of petroleum and natural gas properties, property swaps and farm-outs are determined by comparing the proceeds from disposal, or fair value of the asset received or given up, with the carrying amount of petroleum and natural gas properties and are recognized net in profit or loss.

Subsequent costs

Costs incurred subsequent to the determination of technical feasibility and commercial viability and the costs of replacing parts of petroleum and natural gas properties are recognized as oil and natural gas interests only when they increase the future economic benefits embodied in the specific asset to which they relate. All other expenditures are recognized in profit or loss as incurred. Such capitalized oil and natural gas interests generally represent costs incurred in developing proved and/or probable reserves and bringing in or enhancing production from such reserves, and are accumulated on a field or geotechnical area basis. The carrying amount of any replaced or sold component is derecognized. The costs of the day-to-day servicing of petroleum and natural gas properties are recognized in profit or loss as incurred.

Depletion and Depreciation

The net carrying value of development and production assets is depleted using the unit of production method by reference to the ratio of production in the period to the related proved plus probable reserves, taking into account estimated future development costs necessary to bring those reserves into production and the estimated salvage value of the assets at the end of their useful lives.

Proved plus probable reserves are estimated annually by independent qualified reserve evaluators and represent the estimated quantities of crude oil, natural gas and natural gas liquids which geological, geophysical and engineering data demonstrate with a specified degree of certainty to be recoverable in future years from known reservoirs and which are considered commercially producible. For financial statements, internal estimates of changes in reserves and future development costs are used for determining depletion for the period. For purposes of this calculation, petroleum and gas reserves are converted to a common unit of measure on the basis of their relative energy content, where six thousand cubic feet of gas equals one barrel of oil or liquids.

Surge has deemed the estimated useful lives for gas processing plants, pipeline facilities, and compression facilities to be consistent with the reserve lives of the areas for which they serve. As a result, Surge includes the cost of these assets within their associated major component (area or group of areas) for the purpose of depletion using the unit of production method.

Office equipment is depreciated using a declining balance method using rates from 20% to 100% dependent on the type of equipment.

Depreciation methods, useful lives and residual values are reviewed at each reporting date.

(e) Impairment

Non-financial assets

The carrying amounts of the Corporation's non-financial assets, other than exploration and evaluation (E&E) assets and deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. Exploration and evaluation assets are assessed for impairment if (i) sufficient data exists to determine technical feasibility and commercial viability, and (ii) facts and circumstances suggest that the carrying amount exceeds the recoverable amount. For purposes of impairment testing, exploration and evaluation assets are tested at the operating segment level.

For the purpose of impairment testing, assets are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (the "cash-generating unit" or "CGU"). The recoverable amount of an asset or a CGU is the greater of its value in use ("VIU") and its fair value less costs to sell ("FVLCS").

In assessing VIU, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. VIU is generally computed by reference to the present value of the future cash flows expected to be derived from production of proved and probable reserves.

FVLCS is the amount that would be obtained from the sale of a CGU in an arm's length transaction between knowledgeable and willing parties. The FVLCS is generally determined as the net present value of the estimated future cash flows expected to arise from a CGU, including any expansion prospects, and its eventual disposal, using assumptions that an independent market participant may take into account. These cash flows are discounted using a rate that would be applied by a market participant to arrive at a net present value of the CGU.

An impairment loss is recognized if the carrying amount of an asset or its CGU exceeds its estimated recoverable amount. Impairment losses are recognized in profit or loss. Impairment losses recognized in respect of CGUs are allocated to reduce the carrying amounts of the assets in the CGU on a pro rata basis.

In respect of petroleum and natural gas properties and exploration and evaluation assets, impairment losses recognized in prior years are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depletion and depreciation, if no impairment loss had been recognized.

Impairment charges are recognized in profit or loss.

(f) Convertible debentures

The Debentures are a non-derivative financial instrument that creates a financial liability of the entity and grants an option to the holder of the instrument to convert it into common shares of the Corporation. The liability component of the Debentures is initially recorded at the fair value of a similar liability that does not have a conversion option. The equity component is recognized initially, net of deferred income taxes, as the difference between gross proceeds and the fair value of the liability component. Transaction costs are allocated to the liability and equity components in proportion to the allocation of proceeds. Subsequent to initial recognition, the liability component of the Debentures is measured at amortized cost using the effective interest method and is accreted each period, such that the carrying value will equal the principal amount outstanding at maturity. The equity component is not re-measured. The carrying amounts of the liability and equity components of the Debentures are reclassified to shareholders' capital on conversion to common shares.

(g) Decommissioning obligations

The Corporation's activities give rise to dismantling, decommissioning and site disturbance remediation activities. Provision is made for the estimated cost of abandonment and site restoration and capitalized in the relevant asset category. Decommissioning obligations are measured at the present value of management's best estimate of the expenditure required to settle the present obligation as at the reporting date. Subsequent to the initial measurement, the obligation is adjusted at the end of each period to reflect the passage of time and changes in the estimated future cash flows underlying the obligation.

The increase in the provision due to the passage of time is recognized as accretion (within finance expense) whereas increases/decreases due to changes in the estimated future cash flows or changes in the discount rate are capitalized. Actual costs incurred upon settlement of the decommissioning obligations are charged against the provision to the extent the provision was established.

(h) Income tax

Income tax expense comprises current and deferred tax. Income tax expense is recognized in profit or loss except to the extent that it relates to items recognized directly in equity, in which case it is recognized in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognized using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognized on the initial recognition of assets or liabilities in a transaction that is not a business combination. In addition, deferred tax is not recognized for taxable temporary differences arising on the initial recognition of goodwill. Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously.

A deferred tax asset is recognized to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

(i) Stock-based compensation

The Corporation uses the fair value method for valuing stock-based compensation awards. Under the fair value method, compensation costs attributable to stock-based compensation awards is measured at fair value at the date of grant and expensed over the vesting period with a corresponding increase to contributed surplus or warrants. A forfeiture rate is estimated on the date of grant and is adjusted to reflect the actual number of awards that vest. Performance share awards are also subject to a performance multiplier that is adjusted to reflect the final number of awards. The fair value of option based awards is estimated using the Black-Scholes option pricing model that takes into account the grant date, the exercise price and expected life of the option, the price of the underlying security, the expected volatility, the risk-free interest rate and dividends, if any, on the underlying security. The fair value of each restricted and performance share award is determined with reference to the trading price of the Corporation's common shares on the date of grant. Upon the exercise of the stock-based compensation awards, consideration received together with the amount previously recognized in contributed surplus is recorded as an increase to share capital.

(j) Revenue from contracts with customers

Revenue from the sale of crude oil, natural gas and natural gas liquids is measured based on the consideration specified in contracts with customers. The Corporation recognizes revenue when it transfers control of the product to the buyer. This is generally at the time the customer obtains legal title to the product and when it is physically transferred to the delivery mechanism agreed with the customer, often pipelines or other transportation methods.

Surge evaluates its arrangements with third parties and partners to determine if the Corporation acts as the principal or as an agent. In making this evaluation, management considers if the Corporation obtains control of the product delivered, which is indicated by Surge having the primary responsibility for the delivery of the product, having the ability to establish prices or having inventory risk. If Surge acts in the capacity of an agent rather than as a principal in a transaction, then the revenue is recognized on a net-basis, only reflecting the fee, if any, realized by the Corporation from the transaction.

Tariffs, tolls and fees charged to other entities for use of pipelines and facilities owned by the Corporation are evaluated by management to determine if these originate from contracts with customers or from incidental or collaborative arrangements. Tariffs, tolls and fees charged to other entities that are from contracts with customers are recognized in revenue when the related services are provided.

Royalty income is recognized as it accrues in accordance with the terms of the overriding royalty agreements.

(k) Finance income and expenses

Finance expense comprises interest expense on borrowings, unrealized and realized gains and losses on interest rate financial contracts and accretion of the discount on provisions.

Borrowing costs incurred for the construction of qualifying assets are capitalized during the period of time that is required to complete and prepare the assets for their intended use or sale. All other borrowing costs are recognized in profit or loss using the effective interest method. The capitalization rate used to determine the amount of borrowing costs to be capitalized is the weighted average interest rate applicable to the Corporation's outstanding borrowings during the period.

Interest income is recognized as it accrues in profit or loss, using the effective interest method.

(l) Per share information

Per share amounts are calculated based on the weighted average number of common shares outstanding during the year. The diluted weighted average number of shares is adjusted for the dilutive effect of stock-based compensation awards. Under the treasury stock method, only "in the money" dilutive instruments are included in the weighted average diluted number of shares. It is also assumed that any proceeds obtained upon the exercise of stock-based compensation awards plus the unamortized portion of stock-based compensation would be used to purchase common shares at the average price during the period. The weighted average number of shares is then reduced by the number of shares acquired.

(m) Flow-through shares

The resource expenditure deductions for income tax purposes related to exploration and development activities funded by flow-through share arrangements are renounced to investors in accordance with tax legislation. On issuance, the premium received on the flow-through shares, being the difference in price over a common share with no tax attributes, is recognized on the statement of financial position. As expenditures are incurred, the deferred tax liability associated with the renounced tax deductions are recognized through profit and loss along with a pro-rata portion of the deferred premium.

(n) Lease Arrangements

Policy Applicable From January 1, 2019:

The Corporation assesses whether a contract is a lease based on whether the contract conveys the right to control the use of an underlying asset for a period of time in exchange for consideration.

Leases are recognized as a right-of-use asset ("ROU asset") and a corresponding lease obligation at the date on which the leased asset is available for use by the Corporation. ROU assets and lease obligations are initially measured on a present value basis. Lease obligations are measured as the net present value of the lease payments which may include: fixed lease payments, variable lease payments based on an index or rate, and amounts expected to be payable under residual value guarantees and payments to exercise an extension or termination option, if the Corporation is reasonably expected to exercise either of those options.

These payments are discounted using the Corporation's incremental borrowing rate when the rate implicit to the lease is not readily available. The Corporation uses a single discount rate for a portfolio of leases with reasonably similar characteristics.

The lease obligation is measured at amortized cost using the effective interest method. It is remeasured when there is a change in the future lease payments arising from a change in an index or rate, if there is a change in the amount expected to be payable under a residual value guarantee or if there is a change in the assessment of whether the Corporation will exercise a purchase, extension or termination option that is within the control of the Corporation. When the lease obligation is remeasured, a corresponding adjustment is made to the carrying amount of the ROU asset or is recorded in the Consolidated Statement of Earnings (Loss) if the carrying amount of the ROU asset has been reduced to zero.

The ROU asset is initially measured at cost, which comprises the initial amount of the lease obligation, less any incentives received, plus any lease payments made at, or before, the commencement date and initial direct costs and asset restoration costs, if any. The ROU asset is depreciated, on a straight-line basis, over the shorter of the estimated useful life of the asset or the lease term. The ROU asset may be adjusted for certain remeasurements of the lease obligation and impairment losses.

Lease payments are apportioned between the finance expenses and the reduction of the outstanding lease obligation. The finance expenses are allocated to each year during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the obligation.

Leases that have terms of less than twelve months or leases on which the underlying asset is of low value are recognized as an expense in the Consolidated Statement of Earnings (Loss) on a straight-line basis over the lease term.

A lease modification will be accounted for as a separate lease if the modification increases the scope of the lease and if the consideration for the lease increases by an amount commensurate with the stand-alone price for the increase in scope. For a modification that is not a separate lease or where the increase in consideration is not commensurate, at the effective date of the lease modification, the Corporation will remeasure the lease obligation using the Company's incremental borrowing rate, when the rate implicit to the lease is not readily available, with a corresponding adjustment to the ROU asset. A modification that decreases the scope of the lease will be accounted for by decreasing the carrying amount of the ROU asset, and recognizing a gain or loss in net earnings that reflects the proportionate decrease in scope.

Policy Applicable Before January 1, 2019:

Leases where the Corporation assumes substantially all the risks and rewards of ownership are classified as finance leases. Upon initial recognition, the leased asset is measured at an amount equal to the lower of its fair value and the present value of the minimum lease payments. Subsequent to initial recognition, the asset is accounted for in accordance with the accounting policy applicable to that asset.

Minimum lease payments made under finance leases are apportioned between the finance expenses and the reduction of the outstanding liability. The finance expenses are allocated to each year during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

Other leases are operating leases, which are not recognized on the Corporation's statement of financial position.

Payments made under operating leases are recognized in profit or loss on a straight-line basis over the term of the lease. Lease incentives received are recognized as an integral part of the total lease expense, over the term of the lease.

(o) Financial instruments

Trade receivables or debt securities issued are initially recognized when they are originated. All other financial assets and financial liabilities are initially recognized when the Corporation becomes a party to the contractual provisions of the instrument.

A financial asset or financial liability (unless it is a trade receivable without a significant financing component) is initially measured at fair value plus, for an item not at fair value through profit or loss, transaction costs that are directly attributable to its acquisition or issue. A trade receivable without a significant financing component is initially measured at the transaction price.

Upon initial recognition, a financial asset is measured at: amortized cost, fair value through other comprehensive income ("FVOCI") - classified as a debt or equity investment, or fair value through profit or loss ("FVTPL").

Financial liabilities are measured at amortized cost or FVTPL. A financial liability is classified as at FVTPL if it is classified as held-for-trading, it is a derivative, or it is designated as such on initial recognition. Financial liabilities at FVTPL are measured at fair value and net gains and losses, including any interest expense, are recognized in income. Other financial liabilities are subsequently measured at amortized cost using the effective interest rate method.

Surge has made the following classifications:

- Cash and cash equivalents and accounts receivable are measured at amortized cost. Subsequently, they are recorded at amortized cost using the effective interest method.
- Derivative financial instruments that do not qualify as hedges, or are not designated as hedges on the statement of financial position, including risk management commodity and interest rate contracts, are classified as FVTPL and are recorded and carried at fair value. The Corporation may use derivative financial instruments to manage economic exposure to market risks relating to commodity prices and interest rates. The Corporation does not utilize derivative financial instruments for speculative purposes.
- Bank debt, the liability portion of the convertible debentures, accounts payable, accrued liabilities and dividends payable are classified as other financial liabilities and are initially measured at fair value less directly attributable transaction costs. Subsequently, they are recorded at amortized cost using the effective interest method.

Financial assets and financial liabilities are offset, and the net amount presented in the statement of financial position when, and only when the Corporation has a legally enforceable right to off set the amounts and it intends either to settle them on a net basis or to realize the asset and settle the liability simultaneously.

Loss allowances for trade receivables are measured at an amount equal to lifetime expected credit losses ("ECLs"). ECLs are a probability-weighted estimate of credit losses. Credit losses are measured as the present value of all cash shortfalls (i.e., the difference between the cash flows due to the Corporation in accordance with the contract and the cash flows that the Corporation expects to receive). Loss allowances for financial assets measured at amortized cost, if any, are deducted from the gross carrying amount of the assets.

Changes in accounting policies

In October 2018, the IASB issued amendments to IFRS 3 Business Combinations, which sets out the principles in accounting for the acquisition of a business. The amendments include the addition of an optional concentration test. This is a simplified assessment that results in an asset acquisition if substantially all of the fair value of the gross assets is concentrated in a single identifiable asset or a group of similar identifiable assets. If the concentration test is met, the set of activities and assets is determined not to be a business and no further assessment is needed. The amendments to IFRS 3 apply to businesses acquired in annual reporting periods beginning on or after January 1, 2020, with early adoption permitted. The Corporation has chosen to early adopt the amendments to IFRS 3 effective July 1, 2019 and apply to these financial statements, refer to note 5 "2019 Acquisitions and Dispositions".

IFRS 16 was issued January 2016 and replaces IAS 17 Leases. The standard introduced a single lessee accounting model for leases with required recognition of assets and liabilities for most leases. On January 1, 2019 the Corporation adopted IFRS 16 using the modified retrospective approach, whereby the cumulative effect of initially applying the standard was recognized as an increase to right-of-use assets (included in "Petroleum and natural gas properties") with a corresponding increase to lease obligations (the non-current portion recorded in "Long term lease and other obligations" and the current portion recorded in "Current portion of lease and other obligations").

The right-of-use assets recognized were measured at amounts equal to the lease obligations. The weighted average incremental borrowing rate used to determine the lease obligation at adoption was approximately 6%. The right-of-use assets and lease obligations recognized largely relate to the Corporation's head office lease in Calgary and long-term leases for oil batteries and equipment rentals.

The adoption of IFRS 16 included the following elections:

- The Corporation elected to retain the classification of contracts previously identified as leases under IAS 17 and IFRIC 4;
- The Corporation elected to use hindsight in determining the lease term where the contract contains terms to extend or terminate the lease;
- The Corporation elected to not apply lease accounting to certain leases for which the lease term ends within 12 months of the January 1, 2019 adoption;
- The Corporation elected to not apply lease accounting to certain leases of low value assets;
- The Corporation elected to apply a single discount rate to a portfolio of leases with similar characteristics.

Below is a reconciliation of lease commitments at December 31, 2018 to the lease obligation recorded on transition to IFRS 16:

| | Total |
|---|------------------|
| Total commitments at December 31, 2018 | \$ 49,431 |
| Less: | |
| Non-lease components | (2,821) |
| Agreements that do not contain a lease | (21,356) |
| Short-term leases | (324) |
| Add: | |
| Lease obligations at December 31, 2018 | 5,871 |
| Impact of discounting | (915) |
| Lease obligations at January 1, 2019 | \$ 29,886 |

Upon adoption of IFRS 16 on January 1, 2019, the Corporation recognized a \$29.9 million right-of-use asset (included in "Petroleum and natural gas properties") and a \$29.9 million lease obligation.

4. DETERMINATION OF FAIR VALUES

A number of the Corporation's accounting policies and disclosures require the determination of fair value, for both financial and non-financial assets and liabilities. Fair values have been determined for measurement and/or disclosure purposes based on the following methods. When applicable, further information about the assumptions made in determining fair values is disclosed in the notes specific to that asset or liability.

(a) Petroleum and natural gas properties

The fair value of petroleum and natural gas properties recognized on an acquisition or for use in an impairment test is based on market values. The market value of petroleum and natural gas properties is the estimated amount for which petroleum and natural gas properties could be exchanged on the acquisition date between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion. The market value of oil and natural gas interests is estimated with reference to the discounted cash flows expected to be derived from oil and natural gas production based on externally prepared reserve reports.

The market value of other items of petroleum and natural gas properties is based on the quoted market prices for similar items.

(b) Cash & cash equivalents, accounts receivable, bank debt and accounts and dividends payable

The fair value of accounts receivable, debt and accounts and dividends payable is estimated as the present value of future cash flows, discounted at the market rate of interest at the reporting date. At December 31, 2019 and December 31, 2018, the fair value of accounts receivable, accounts payable, and dividends payable approximated their carrying value due to their short term to maturity. Bank debt bears a floating rate of interest and the margins charged by the lenders are indicative of current credit spreads and therefore carrying values approximate fair value. The fair value of the convertible debentures is estimated using quoted market prices on the TSX as of the Consolidated Statement of Financial Position date.

(c) Derivatives

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 amounts and discounted using an appropriate risk-free interest rate (based on published government rates and considering counter-party credit risk). 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.

(d) Share-based compensation

The fair value of share-based compensation awards is based on a Black Scholes option pricing model for option-based awards, and the share price of the Corporation for non-option based awards. Measurement inputs in the Black Scholes model include share price on measurement date, exercise price of the instrument, expected volatility (based on weighted average historic volatility), weighted average expected life of the instruments (based on historical experience and general option holder behaviour), expected dividends, and the risk-free interest rate (based on government bonds).

5. PETROLEUM AND NATURAL GAS PROPERTIES

Petroleum and Natural Gas Properties

| | Total |
|---------------------------------------|---------------------|
| Balance at December 31, 2017 | \$ 2,021,838 |
| Acquisitions | 390,966 |
| Dispositions | (397) |
| Additions | 120,552 |
| Change in decommissioning obligations | 51,362 |
| Capitalized stock-based compensation | 3,548 |
| Balance at December 31, 2018 | \$ 2,587,869 |
| Acquisitions | 15,682 |
| Dispositions | (87,199) |
| Additions | 119,465 |
| Right of use assets | 35,529 |
| Change in decommissioning obligations | 54,011 |
| Capitalized stock-based compensation | 4,303 |
| Balance at December 31, 2019 | \$ 2,729,660 |

| | Total |
|---|-----------------------|
| Accumulated depletion and depreciation | |
| Balance at December 31, 2017 | \$ (872,910) |
| Depletion and depreciation expense | (114,220) |
| Impairment (note 6) | (72,174) |
| Balance at December 31, 2018 | \$ (1,059,304) |
| Depletion and depreciation expense | (163,450) |
| Impairment (note 6) | (180,701) |
| Dispositions | 9,640 |
| Balance at December 31, 2019 | \$ (1,393,815) |

| | Total |
|-----------------------------|---------------------|
| Carrying amounts | |
| At December 31, 2018 | \$ 1,528,565 |
| At December 31, 2019 | \$ 1,335,845 |

The calculation of depletion and depreciation expense for the period ended December 31, 2019 included an estimated \$897.3 million (December 31, 2018 - \$853.6 million) for future development costs associated with proved plus probable reserves and deducted \$61.4 million (December 31, 2018 - \$140.4 million) for the estimated salvage value of production equipment and facilities. Included in the carrying amount of Petroleum and Natural Gas properties at December 31, 2019 is \$46.5 million of right of use assets.

2019 Acquisitions and Dispositions

During the year ended December 31, 2019, the Corporation acquired a gas processing facility in Southeast Alberta for cash consideration of \$12.1 million. The Corporation assumed decommissioning obligations of \$0.9 million. In conjunction with the purchase, the Corporation elected to early adopt the amendments to IFRS 3 "Business Combinations" which resulted in accounting for the transaction as an asset acquisition. Additional assets were acquired during the year ended December 31, 2019 for total consideration of \$2.7 million.

During the year ended December 31, 2019, the Corporation disposed of certain non-core assets in Northwest Alberta for cash proceeds of \$28.1 million. The assets had a carrying value of \$36.1 million and an associated decommissioning liability of \$8.0 million, resulting in no gain or loss on disposal.

During the year ended December 31, 2019, the Corporation disposed of a 1.7 percent gross overriding royalty ("GORR") on total revenue from the Corporation's Southwest Saskatchewan, Southeast Alberta and North Central Alberta assets, for total cash proceeds of \$29.1 million. The disposed assets had carrying value of \$41.4 million resulting in a loss on disposal of \$12.3 million. The Corporation has a drilling commitment on the GORR lands that must be fulfilled by April 30, 2022. In the event that the Corporation fails to fulfill the drilling commitment, the GORR shall increase from 1.7 percent to 2.7 percent.

2018 Acquisitions and Dispositions

Effective October 25, 2018 the Corporation acquired all of the issued and outstanding common shares of Mount Bastion Oil & Gas Corp. ("MBOG") in exchange for cash consideration of \$145.0 million and 75,431,034 common shares of Surge with an assigned value of \$153.9 million. The common shares have been ascribed a fair value of \$2.04 per common share issued, as determined based on the Corporation's closing share price at the date prior to closing, October 24, 2018. The acquisition fit within Surge's dividend-paying growth business model and defined operating strategy of investing capital to acquire operated light gravity crude oil reservoirs. The operations from the acquisition have been included in the results of Surge commencing October 25, 2018.

Surge incurred transaction costs of \$3.9 million on the acquisition which were expensed through the consolidated statement of loss.

The transaction was accounted for as a business combination.

The purchase price, based on management's estimates of fair values is as follows:

| Fair value of net assets acquired | Total |
|--|-------------------|
| Petroleum and natural gas properties | \$ 353,493 |
| Working capital | 7,032 |
| Decommissioning obligations | (15,940) |
| Deferred income tax | (45,706) |
| Net assets acquired | \$ 298,879 |
| Consideration | |
| Cash consideration | \$ 145,000 |
| Common shares (75,431,034 at \$2.04 per share) | 153,879 |
| Total consideration paid | \$ 298,879 |

Petroleum and natural gas revenue of \$7.4 million and a net loss of \$6.0 million are included in the consolidated statement of loss and comprehensive loss for the MBOG acquisition from the closing date of October 25, 2018 to December 31, 2018.

If the MBOG acquisition had occurred on January 1, 2018, the Corporation's pro forma results of petroleum and natural gas revenue and net loss and comprehensive net loss for the year ended December 31, 2018 are estimated to have been as follows:

| For the year ended December 31, 2018 | As stated | Mount Bastion Oil & Gas Corp. prior to October 25, 2018 | Pro Forma |
|---|-------------|---|-------------|
| Petroleum and natural gas revenue | \$ 304,547 | 123,860 | \$ 428,407 |
| Net income (loss) and comprehensive income (loss) | \$ (71,533) | 18,950 | \$ (52,583) |

During the year ended December 31, 2018 the Corporation acquired certain petroleum and natural gas properties in Central and Southeast Alberta for cash consideration of \$36.5 million. The Corporation also assumed decommissioning obligations of \$1.5 million.

During the year ended December 31, 2018 the Corporation disposed of certain non-core assets in Central Alberta for cash proceeds of \$6.7 million after adjustments. The assets had a carrying value of \$8.6 million at the time of disposition and an associated decommissioning liability of \$2.0 million, resulting in no gain or loss on disposal. These assets were classified as held for sale at December 31, 2017.

6. IMPAIRMENT

| For the years ended | December 31, 2019 | December 31, 2018 |
|--|----------------------|----------------------|
| Impairment of petroleum and natural gas properties | \$ 180,701 | \$ 72,174 |

2019 Impairment

The Corporation identified six cash generating units as of December 31, 2019 based on the lowest level at which properties generate cash inflows while applying judgment to consider factors such as shared infrastructure, geographic proximity, petroleum type and similar exposures to market risk and materiality. The Corporation's CGUs at December 31, 2019 were geographically labeled Northwest Alberta, North Central Alberta, Northeast Alberta, Central Alberta, Southeast Alberta and Southwest Saskatchewan.

For the year ended December 31, 2019, due to declines in forward oil and natural gas prices and poor economic performance of certain assets, the Corporation determined an indication of potential impairment was present in its North Central Alberta, Northwest Alberta, Southwest Saskatchewan and Central Alberta CGUs. As a result, the Corporation completed an impairment test. Recoverable value was estimated at value in use based on before tax discounted cash flows from oil and gas proved plus probable reserves estimated by the Corporation's third party reserve evaluators. It was determined that the carrying value of the North Central Alberta CGU exceeded the recoverable amount of \$206.9 million, the carrying value of the Southwest Saskatchewan CGU exceeded the recoverable amount of \$185.6 million, and the carrying value of the Central Alberta CGU exceeded the recoverable amount of \$46.7 million and a \$180.7 million impairment was recognized. The before tax discount rate applied in the value in use calculation as at December 31, 2019 was 13 - 25 percent.

As at December 31, 2019, the Corporation determined there were no indications that impairment losses recognized in prior years no longer exist or have decreased.

The following table outlines forecast commodity prices and exchange rates used in the Corporation's CGU impairment tests at December 31, 2019. The forecast commodity prices are consistent with those used by the Corporation's external reserve evaluators and are a key assumption in assessing the recoverable amount. The reserve evaluators also include financial assumptions regarding royalty rates, operating costs, and future development capital that can significantly impact the recoverable amount which are assigned based on historic rates and future anticipated activities by Management.

| Year | Medium and Light Crude Oil | | Natural Gas | NGL | | | Inflation rates (%/Yr) | Exchange rate (\$US/\$Cdn) |
|------|---|--|---------------------------|------------------------------|--------------------------|---------------------------|------------------------|----------------------------|
| | Canadian Light Sweet Crude 40° API (\$/bbl) | Western Canadian Select 20.5° API (\$/bbl) | AECO Gas Price (\$/MMBtu) | Edmonton Condensate (\$/bbl) | Edmonton Butane (\$/bbl) | Edmonton Propane (\$/bbl) | | |
| 2020 | 73.84 | 59.81 | 2.04 | 76.32 | 37.72 | 25.07 | — | 0.76 |
| 2021 | 78.51 | 63.98 | 2.27 | 80.52 | 43.90 | 31.84 | 1.0 | 0.77 |
| 2022 | 78.73 | 63.77 | 2.81 | 80.00 | 47.74 | 32.43 | 2.0 | 0.80 |
| 2023 | 80.30 | 65.04 | 2.89 | 81.68 | 48.69 | 33.26 | 2.0 | 0.80 |
| 2024 | 81.91 | 66.34 | 2.98 | 83.38 | 49.67 | 34.12 | 2.0 | 0.80 |
| 2025 | 83.54 | 67.67 | 3.06 | 85.13 | 50.66 | 34.99 | 2.0 | 0.80 |
| 2026 | 85.21 | 69.02 | 3.15 | 86.90 | 51.67 | 35.88 | 2.0 | 0.80 |
| 2027 | 86.92 | 70.40 | 3.24 | 88.72 | 52.71 | 36.78 | 2.0 | 0.80 |
| 2028 | 88.66 | 71.81 | 3.33 | 90.57 | 53.76 | 37.71 | 2.0 | 0.80 |
| 2029 | 90.43 | 73.25 | 3.42 | 92.45 | 54.84 | 38.65 | 2.0 | 0.80 |
| 2030 | 92.24 | 74.71 | 3.51 | 94.38 | 55.93 | 39.61 | 2.0 | 0.80 |

The results of the Corporation's impairment tests are sensitive to changes in any of the key estimates of which changes could decrease or increase the recoverable amounts of assets and result in additional impairment charges or in the recovery of previously recorded impairment charges.

2018 Impairment

The Corporation identified six cash generating units as of December 31, 2018 based on the lowest level at which properties generate cash inflows while applying judgment to consider factors such as shared infrastructure, geographic proximity, petroleum type and similar exposures to market risk and materiality. The MBOG acquisition during the year was determined to be a standalone CGU, geographically labeled North Central Alberta and the asset acquisitions in the year were integrated into existing CGUs based on geographic location. The Corporation's CGUs at December 31, 2018 were the same as those that exists at December 31, 2019.

For the year ended December 31, 2018, due to poor economic performance of certain assets, the Corporation determined an indication of potential impairment was present in its Southwest Saskatchewan and Central Alberta CGU's. As a result, the Corporation completed an impairment test. Recoverable value was estimated at value in use based on before tax discounted cash flows from oil and gas proved plus probable reserves estimated by the Corporation's third party reserve evaluators. It was determined that the carrying value of the Southwest Saskatchewan CGU exceeded the recoverable amount of \$268.1 million and the carrying value of the Central Alberta CGU exceeded the recoverable amount of \$42.7 million and a \$72.2 million impairment was recognized. The before tax discount rate applied in the value in use calculation as at December 31, 2018 was 10 - 20 percent.

As at December 31, 2018, the Corporation determined there were no indications that impairment losses recognized in prior years no longer exist or have decreased.

The following table outlines forecast commodity prices and exchange rates used in the Corporation's CGU impairment tests at December 31, 2018. The forecast commodity prices are consistent with those used by the Corporation's external reserve evaluators and are a key assumption in assessing the recoverable amount. The reserve evaluators also include financial assumptions regarding royalty rates, operating costs, and future development capital that can significantly impact the recoverable amount which are assigned based on historic rates and future anticipated activities.

| Year | Medium and Light Crude Oil | | Natural Gas | NGL | | | Inflation rates (%/Yr) | Exchange rate (\$US/\$Cdn) |
|------|---|--|---------------------------|------------------------------|--------------------------|---------------------------|------------------------|----------------------------|
| | Canadian Light Sweet Crude 40° API (\$/bbl) | Western Canadian Select 20.5° API (\$/bbl) | AECO Gas Price (\$/MMBtu) | Edmonton Condensate (\$/bbl) | Edmonton Butane (\$/bbl) | Edmonton Propane (\$/bbl) | | |
| 2019 | 75.27 | 59.47 | 1.95 | 75.32 | 40.91 | 30.27 | — | 0.77 |
| 2020 | 77.89 | 62.31 | 2.44 | 80.00 | 50.25 | 34.51 | 2.0 | 0.80 |
| 2021 | 82.25 | 67.45 | 3.00 | 83.75 | 56.88 | 38.15 | 2.0 | 0.80 |
| 2022 | 84.79 | 69.53 | 3.21 | 85.50 | 58.01 | 39.64 | 2.0 | 0.80 |
| 2023 | 87.39 | 71.66 | 3.30 | 87.29 | 59.17 | 40.62 | 2.0 | 0.80 |
| 2024 | 89.14 | 73.10 | 3.39 | 89.11 | 60.36 | 41.62 | 2.0 | 0.80 |
| 2025 | 90.92 | 74.56 | 3.49 | 90.96 | 61.56 | 42.64 | 2.0 | 0.80 |
| 2026 | 92.74 | 76.05 | 3.58 | 92.86 | 62.79 | 43.68 | 2.0 | 0.80 |
| 2027 | 94.60 | 77.57 | 3.68 | 94.79 | 64.05 | 44.75 | 2.0 | 0.80 |
| 2028 | 96.49 | 79.12 | 3.78 | 96.76 | 65.33 | 45.83 | 2.0 | 0.80 |
| 2029 | 98.42 | 80.70 | 3.88 | 98.77 | 66.64 | 46.94 | 2.0 | 0.80 |

7. RISK MANAGEMENT

The Corporation has exposure to the following risks from its use of financial instruments:

- Credit risk
- Liquidity risk
- Market risk

This note presents information about the Corporation's exposure to each of the above risks, the Corporation's objectives, policies and processes for measuring and managing risk, and the Corporation's management of capital. Further quantitative disclosures are included throughout these financial statements. The Board of Directors has overall responsibility for the establishment and oversight of the Corporation's risk management framework. The Board has implemented and monitors compliance with risk management policies. The Corporation's risk management policies are established to identify and analyze the risks faced by the Corporation, to set appropriate risk limits and controls, and to monitor risks and adherence to market conditions and the Corporation's activities.

(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 December 31, 2019, the Corporation's receivables consisted of \$37.1 million (\$17.4 million - December 31, 2018) due from petroleum and natural gas marketers, \$4.4 million (\$3.7 million - December 31, 2018) due from joint venture partners and other receivables consisting primarily of settlements receivable on commodity contracts. These amounts are presented net of the allowance for doubtful accounts.

Receivables from petroleum and natural gas marketers are normally collected on the 25th day of the month following production. The Corporation attempts to mitigate credit risk by establishing marketing relationships with a variety of purchasers.

Joint venture receivables are typically collected within one to three months of the joint venture bill being issued to the partner. The Corporation attempts to mitigate the risk from joint venture receivables by obtaining partner approval of significant capital expenditures prior to the expenditure. However, the receivables are from participants in the petroleum and natural gas sector, and collection of the outstanding balances is dependent on industry factors such as commodity price fluctuations, escalating costs and the risk of unsuccessful drilling. In addition, further risk exists with joint venture partners as disagreements occasionally arise that increase the potential for non-collection. The Corporation obtains collateral from significant petroleum and natural gas marketers on an as needed basis, typically in the form of a letter of credit and the Corporation may have the ability to withhold production from joint venture partners in the event of non-payment.

The carrying value of accounts receivable and fair value of financial contracts when outstanding represent the maximum credit exposure. The Corporation has an allowance for doubtful accounts of \$0.1 million (\$1.2 million - December 31, 2018) at December 31, 2019, which is being applied against outstanding receivables.

The Corporation's most significant customers are three oil and natural gas marketers, accounting for approximately 84 percent of the Corporation's 2019 revenue.

As at December 31, 2019, the Corporation estimates its total accounts receivables, net of the allowance for doubtful accounts, to be aged as follows:

| Years ended | Total receivables | | Current | | Past due > 90 days | |
|--------------------------|-------------------|---------------|---------|---------------|--------------------|------------|
| December 31, 2019 | \$ | 41,486 | \$ | 40,560 | \$ | 926 |
| | | 100% | | 98% | | 2% |
| December 31, 2018 | \$ | 21,084 | \$ | 19,818 | \$ | 1,266 |
| | | 100% | | 94% | | 6% |

(b) Liquidity risk

Liquidity risk is the risk that the Corporation will not be able to meet its financial obligations as they are due. The Corporation actively manages its liquidity through cost control, debt and equity management policies. Such strategies include continuously monitoring forecast and actual cash flows, financing activities and available credit under existing banking arrangements. The nature of the oil and gas industry is very capital intensive. As a result, the Corporation prepares annual capital expenditure budgets and utilizes authorizations for expenditures for projects to manage capital expenditures. Management believes that future cash flows generated in the ordinary course of business will be adequate to settle the Corporation's liabilities as they come due.

Accounts payable and dividends payable are considered due to suppliers in one year or less while bank debt, which is subject to a renewal on or before May 31, 2020, could be potentially due in May 2021 if the facility is not renewed for a further 364-day period. Financial contracts are also due to be settled with the counter-parties at the estimated fair value on the statement of financial position.

(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 income or the value of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable limits, while maximizing returns. The Corporation utilizes financial derivative contracts to manage market risks. All such transactions are conducted in accordance with the risk management policy that has been approved by the Board of Directors.

i. Commodity price risk

Commodity price risk is the risk that the fair value or future cash flows will fluctuate as a result of changes in commodity prices.

The nature of the Corporation's operations results in exposure to fluctuations in commodity prices. Management continuously monitors commodity prices and initiates instruments to manage exposure to these risks when it deems appropriate. As a means of managing commodity price volatility, the Corporation enters into various derivative financial instrument agreements and physical contracts.

As a means of managing commodity price 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 and considering counter-party credit risk). 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. Surge's financial derivative contracts are classified as level two in the fair value hierarchy.

At December 31, 2019, the following risk management contracts were outstanding with an asset fair market value of \$1.3 million and a liability fair market value of \$3.9 million (December 31, 2018 – asset of \$4.9 million and liability of \$3.9 million):

WTI Oil Hedges

| Type | Term | bbl/d | Currency | Put Sold (per bbl) | Put Acquired (per bbl) | Call Sold (per bbl) | Swap Price (per bbl) |
|------|---------------------|-------|----------|--------------------|------------------------|---------------------|----------------------|
| WTI | Q2 2019 - Q1 2020 | 250 | USD | — | \$55.00 | \$65.00 | — |
| WTI | Q2 2019 - Q1 2020 | 500 | USD | — | — | — | \$59.83 |
| WTI | May 2019 - Jun 2020 | 250 | USD | — | — | — | \$62.00 |
| WTI | Q3 2019 - Q1 2020 | 500 | USD | — | — | — | \$58.80 |
| WTI | Q1 2020 | 1,750 | USD | — | — | — | \$57.56 |
| WTI | Q2 2020 | 2,000 | USD | — | — | — | \$57.78 |
| WTI | Q3 2020 | 500 | USD | — | — | — | \$57.25 |
| WTI | Q3 2019 - Q2 2020 | 500 | USD | — | \$58.00 | — | — |
| WTI | Q1 2020 | 250 | USD | — | \$45.00 | — | — |
| WTI | 1H 2020 | 3,500 | USD | — | \$47.61 | — | — |
| WTI | Q2 2020 | 500 | USD | — | \$46.00 | — | — |
| WTI | 1H 2020 | 250 | USD | — | — | \$67.50 | — |
| WTI | Q2 2019 - Q1 2020 | 250 | USD | \$45.00 | \$55.00 | \$68.50 | — |
| WTI | 1H 2020 | 1,750 | USD | \$47.14 | \$55.71 | \$64.00 | — |
| WTI | Q1 2020 - Q3 2020 | 1,000 | USD | \$46.00 | \$54.00 | \$64.13 | — |
| WTI | Q2 2020 - Q3 2020 | 500 | USD | \$46.00 | \$54.00 | \$63.55 | — |
| WTI | Q3 2020 | 1,500 | USD | \$47.00 | \$55.00 | \$65.00 | — |
| WTI | Q3 2019 - Q4 2020 | 500 | USD | \$47.50 | \$57.50 | \$71.50 | — |

Oil Differential Hedges

| Type | Term | bbl/d | Currency | Floor (per bbl) | Ceiling (per bbl) | Swap Price (per bbl) |
|------------|-------------------|-------|----------|----------------------|----------------------|----------------------|
| WCS Swap | 1H 2020 | 1,000 | USD | — | — | US\$WTI less \$16.50 |
| WCS Collar | Q2 2020 - Q4 2020 | 1,500 | USD | US\$WTI less \$15.50 | US\$WTI less \$20.00 | — |
| WCS Collar | 2020 | 1,000 | USD | US\$WTI less \$14.60 | US\$WTI less \$19.95 | — |

Natural Gas Hedges

| Type | Term | Volume | Currency | Floor | Ceiling |
|----------------|---------------------|---------------|----------|-------------------|-------------------|
| Chicago Swap | Dec 2019 - Mar 2020 | 3,000 mmbtu/d | USD | \$3.075 per mmbtu | \$3.075 per mmbtu |
| Chicago Collar | Nov 2019 - Oct 2020 | 3,000 mmbtu/d | USD | \$2.25 per mmbtu | \$2.90 per mmbtu |
| AECO Swap | Nov 2019 - Dec 2020 | 3,000 gj/d | CAD | \$1.975 per gj | \$1.975 per gj |
| AECO Swap | 2020 | 4,000 gj/d | CAD | \$1.45 per gj | \$1.45 per gj |

ii. Foreign currency exchange risk

Foreign currency exchange rate risk is the risk that the fair value or future cash flows will fluctuate as a result of changes in foreign exchange risks. All of the Corporation's petroleum and natural gas sales are denominated in Canadian dollars. However, the underlying market prices in Canada for petroleum and natural gas are impacted by changes in the exchange rate between the Canadian and United States dollar.

iii. Interest rate risk

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. The Corporation is exposed to interest rate fluctuations on its bank loan which bears a floating rate of interest. Average bank debt outstanding during the year ending December 31, 2019 was \$362.5 million (2018 - \$308.9 million). For the year ended December 31, 2019, a 1.0 percent change to the effective interest rate would have a \$2.7 million impact on net loss (2018 - \$2.3 million) based on the average debt outstanding during the year.

Interest Rate Hedges

| Type | Term | Notional Amount (CAD\$) | Surge Receives | Surge Pays | Fixed Rate SGY Pays |
|-----------------------------|---------------------|-------------------------|----------------|------------|---|
| Fixed-to-Floating Rate Swap | Feb 2018-Feb 2023 | \$100,000,000 | Floating Rate | Fixed Rate | Semi-Annual Step Up <ul style="list-style-type: none"> • Beginning at 1.786% • Ending at 2.714% • Averaging 2.479% |
| Fixed Rate Swap | Jul 2019 - Jun 2024 | \$50,000,000 | Floating Rate | Fixed Rate | 1.7850% |

The following table summarizes the sensitivity of the fair value of the Corporation's market risk management positions to fluctuations in natural gas prices, crude oil prices, and foreign exchange. All such fluctuations were evaluated independently, with all other variables held constant. Fluctuations in crude oil and natural gas prices would have had the following impact on the net earnings:

| Net earnings impact for the period ended December 31, 2019 | | | Increase | Decrease |
|--|--|--|----------|----------|
| Crude Oil - Change of +/- \$1.00 | | | (2,532) | 2,532 |
| Natural Gas - Change of +/- \$0.10 | | | (281) | 281 |
| Interest rate - Change of +/- 100 points | | | 1,125 | (1,125) |

(d) Capital management

The Corporation's policy is to maintain a strong capital base so as to maintain investor, creditor, and market confidence and sustain the future development of the business. 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 Shareholders' equity of \$671.3 million (2018 - \$834.5 million), bank debt of \$316.4 million (2018 - \$408.6 million), convertible debentures of \$68.7 million (2018 - \$38.0 million), and a working capital deficit of \$12.9 million (2018 - deficit \$14.2 million). 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 forecast net debt to forecast adjusted funds flow. Net debt is defined as outstanding bank debt plus or minus working capital and dividends payable, and excluding the fair value of financial contracts, current portion of decommissioning obligations and current portion of lease and other obligations. Adjusted funds flow is defined as cash flow from operating activities before changes in non-cash working capital, decommissioning expenditures, cash settled transaction and other costs and cash settled stock-based compensation. The Corporation's strategy is to maintain a one year forward looking forecast debt to forecast adjusted funds flow ratio of less than two to one. This ratio may increase at certain times as a result of acquisitions, changes in commodity prices, or 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 budget is approved by the Board of Directors.

(e) Fair value of financial instruments

The Corporation's financial instruments as at December 31, 2019 and 2018 include accounts receivable, accounts payable and accrued liabilities, dividends payable, the fair value of financial contracts, convertible debentures and bank debt. The fair value of accounts receivable, accounts payable, accrued liabilities and dividends payable approximate their carrying amounts due to their short-terms to maturity.

Bank debt bears interest at a floating market rate and the margins charged by lenders are indicative of current credit spreads and accordingly the fair market value approximates the carrying value. The fair value of the convertible debentures at December 31, 2019 was \$76.3 million based on quoted market prices on the TSX.

The Corporation classifies its financial instruments recorded at fair value according to the following hierarchy based on the amount of observable inputs used to value the instrument.

- Level 1 - Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions occur in sufficient frequency and volume to provide pricing information on an ongoing basis.
- Level 2 - Pricing inputs are other than quoted prices in active markets included in Level 1. Prices in Level 2 are either directly or indirectly observable as the reporting date. Level 2 valuations are based on inputs, including quoted forward prices for commodities, time value and volatility factors, which can be substantially observed or corroborated in the marketplace.
- Level 3 - Valuations in this level are those with inputs for the asset or liability that are not based on observable market data.

The liability portion of the Corporation's convertible debentures are considered level 1 and the fair value of derivative contracts and the bank debt are considered level 2 in the fair value hierarchy.

8. BANK DEBT

As at December 31, 2019, the Corporation had a total commitment of \$350 million, being the aggregate of a revolving term credit facility of \$300 million and an operating loan commitment of \$50 million, with a syndicate of banks. A review and re-determination of the borrowing base is scheduled to occur semi-annually on or before May 31 and November 30 of each year. The facility is available on a revolving basis until May 31, 2020. On May 31, 2020, at the Corporation's discretion, the facility is available on a non-revolving basis for a one-year period, at the end of which time the facility would be due and payable. Alternatively, the facilities may be extended for a further 364-day period at the request of the Corporation and subject to the approval of the syndicate. As the available lending limits of the facilities are based on the syndicate's interpretation of the Corporation's reserves, future commodity prices and decommissioning obligations, 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 Senior Debt to EBITDA (as defined in the lending agreement). The facility had an effective interest rate of prime plus 1.25 percent as at December 31, 2019 (December 31, 2018 – prime plus 1.25 percent).

The facility is secured by a general assignment of book debts, debentures of \$1.5 billion 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.

The credit facility has a financial covenant, whereby the Corporation's ratio of Net Senior Debt to EBITDA shall not exceed 3.00:1.00 (1.65:1.00 as at December 31, 2019). The EBITDA used in the covenant calculation is net loss and comprehensive loss for an annualized period adjusted for lease payments, non-cash items, non-recurring transaction costs and extraordinary and non-recurring items such as material acquisitions or dispositions. The Net Senior Debt used in the covenant calculation includes bank debt and working capital deficit, if any. As at December 31, 2019, the Corporation was compliant with all covenants in the credit agreement. Copies of the Corporation's credit agreements may be accessed through the SEDAR website (www.sedar.com).

9. CONVERTIBLE DEBENTURES

Convertible Debentures

| | Number of convertible debentures | Liability Component | Equity Component |
|-------------------------------------|----------------------------------|---------------------|------------------|
| Balance at December 31, 2017 | 44,500 | 36,715 | 3,551 |
| Accretion of discount | — | 1,258 | — |
| Balance at December 31, 2018 | 44,500 | 37,973 | 3,551 |
| Issuance of convertible debentures | 34,500 | 30,551 | 3,949 |
| Issue costs | — | (1,776) | (230) |
| Deferred income tax liability | — | — | (1,004) |
| Accretion of discount | — | 1,951 | — |
| Balance at December 31, 2019 | 79,000 | 68,699 | 6,266 |

In 2019, the Corporation issued \$34.5 million principal amount of convertible subordinated unsecured debentures (the "2019 Debentures") at a price of \$1,000 per debenture ("the Offering").

The 2019 Debentures will mature and be repayable on June 30, 2024 and will accrue interest at the rate of 6.75 percent per annum payable semi annually in arrears on December 31 and June 30 of each year. At the holder's option, the 2019 Debentures will be convertible into Common Shares at any time prior to the close of business on the earlier of the business day immediately preceding (i) the maturity date, or (ii) if called for redemption, the date fixed for redemption by the Corporation, at a conversion price of \$2.25 per Common Share, subject to adjustment in certain events. This represents a conversion rate of approximately 444.4444 Common Shares for each \$1,000 principal amount of 2019 Debentures, subject to the operation of certain anti-dilution provisions. In the event of a change of control of the Corporation, subject to certain terms and conditions, holders of 2019 Debentures will be entitled to convert their 2019 Debentures and, subject to certain limitations, receive, in addition to the number of Common Shares they would otherwise be entitled to receive, an additional number of Common Shares per \$1,000 principal amount of 2019 Debentures.

The 2019 Debentures can not be redeemed by the Corporation prior to June 30, 2022. On or after June 30, 2022 and prior to June 30, 2023, the 2019 Debentures can be redeemable by the Corporation, in whole or in part, from time to time, on not more than 60 days and not less than 30 days prior notice at a redemption price equal to their principal amount plus accrued and unpaid interest, if any, provided that the volume weighted average trading price of the Common Shares on the TSX for the 20 consecutive trading days prior to the date on which notice of redemption is provided is not less than 125 percent of the Conversion Price. On or after June 30, 2023 and prior to the maturity date, the 2019 Debentures can be redeemed by the Corporation, in whole or in part, from time to time, on not more than 60 days and not less than 30 days prior notice at a redemption price equal to their principal amount plus accrued and unpaid interest, if any. Subject to certain conditions, the Corporation will have the option to satisfy its obligation to repay the principal amount of the 2019 Debentures, in whole or in part, due upon redemption, by delivering that number of freely tradable Common Shares obtained by dividing the principal

amount of the 2019 Debentures by 95 percent of the volume weighted average trading price of the Common Shares on the TSX for the 20 consecutive trading days ending on the fifth trading day preceding the date of redemption.

The liability component of the 2019 Debentures was initially recognized at the fair value of a similar liability which does contain and equity conversion option, based on an estimated market interest rate of 9.75%. The difference between the \$34.5 million principal amount of the 2019 Debentures and the fair value of the liability component was recognized in Shareholders' equity, net of deferred income taxes. Total transaction costs directly attributable to the offering of \$1.8 million were allocated proportionately to the liability and equity components of the 2019 Debentures.

On November 15, 2017, the Corporation issued \$44.5 million principal amount of convertible subordinated unsecured debentures (the "2017 Debentures") at a price of \$1,000 per debenture.

The 2017 Debentures will mature and be repayable on December 31, 2022 and will accrue interest at the rate of 5.75 percent per annum payable semi annually in arrears on December 31 and June 30 of each year. At the holder's option, the 2017 Debentures may be converted into common shares of the Corporation at any time prior to the close of the business on the earlier of the business day immediately preceding (i) the maturity date; (ii) if called for redemption, the date fixed for redemption by the Corporation; or (iii) if called for repurchase in the event of a change of control, the payment date, at a conversion price of \$2.75 per share, subject to adjustment in certain events ("the Conversion Price"). This represents a conversion rate of approximately 363.6364 common shares for each \$1,000 principal amount of Debentures, subject to certain anti-dilution provisions. Holders who convert their 2017 Debentures will receive accrued and unpaid interest for the period from the date of the latest Interest Payment Date immediately prior to the date of conversion.

The 2017 Debentures may not be redeemed by the Corporation prior to December 31, 2020. On and after December 31, 2020 and prior to December 31, 2021, the 2017 Debentures may be redeemed by the Corporation, in whole or in part, from time to time, on not more than 60 days and not less than 30 days prior notice at a redemption price equal to their principal amount plus accrued and unpaid interest, if any, up to but excluding the date set for redemption, provided that the volume weighted average trading price of the Common Shares on the TSX for the 20 consecutive trading days ending five trading days prior to the date on which notice of redemption is provided is at least 125 percent of the Conversion Price. On or after December 31, 2021 and prior to the Maturity Date, the 2017 Debentures may be redeemed by the Corporation, in whole or in part, from time to time, on not more than 60 days and not less than 30 days prior notice at a redemption price equal to their principal amount plus accrued and unpaid interest, if any, up to but excluding the date set for redemption.

The Corporation may, at its option, elect to satisfy its obligation to pay all or a portion of the aggregate principal amount of the 2017 Debentures, by issuing such number of freely tradeable common shares as is obtained by dividing the aggregate principal portion by 95% of the current market price on the date fixed for redemption.

The 2017 and 2019 Debentures are direct, subordinated unsecured obligations of the Corporation, subordinated to any senior indebtedness of the Corporation, including the Corporation's revolving credit facility, and ranking equally with one another and with all other existing and future subordinated unsecured indebtedness of the Corporation to the extent subordinated on the same terms.

10. DECOMMISSIONING OBLIGATIONS

The Corporation's decommissioning 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 uninflated and undiscounted amount of cash flows required to settle its decommissioning obligations is approximately \$293.7 million (December 31, 2018 – \$302.1 million). These payments are expected to be made over the next 50 years with the majority of costs to be incurred between 2024 and 2067. A risk free rate of 1.76 percent (December 31, 2018 – 2.18 percent) and an inflation rate of 1.50 percent (December 31, 2018 – 1.50 percent) was used to calculate the fair value of the decommissioning obligations.

A reconciliation of the decommissioning obligations is provided below:

| | December 31, 2019 | December 31, 2018 |
|--|----------------------|----------------------|
| Balance, beginning of year | \$ 229,213 | \$ 162,308 |
| Liabilities related to acquisitions | 874 | 17,471 |
| Liabilities related to dispositions | (7,997) | — |
| Change in estimate ⁽¹⁾ | 51,823 | 49,038 |
| Liabilities incurred | 2,188 | 2,324 |
| Accretion expense | 4,760 | 4,420 |
| Decommissioning expenditures | (5,522) | (6,348) |
| Balance, end of year | \$ 275,339 | \$ 229,213 |
| Expected to be incurred within one year | \$ 6,000 | \$ — |
| Expected to be incurred beyond one year | \$ 269,339 | \$ 229,213 |

⁽¹⁾ \$32.0 million of the 2019 change in estimate is a result of decreasing the discount rate. In 2018, \$41.4 million of the change in estimate is a result of the MBOG acquisition.

11. SHARE CAPITAL

(a) Authorized

Unlimited number of voting common shares.

Unlimited number of preferred shares, issuable in series.

(b) Flow-through Share Issuance

In November 2019, the Corporation issued 2.1 million flow-through shares related to Canadian exploration expenditures at a price of \$1.18 per share for total gross proceeds of \$2.5 million. The implied premium on the flow-through shares of \$0.17 per share or \$0.4 million was recorded as a flow-through share liability. As at December 31, 2019, the Corporation had incurred nil of the qualifying exploration expenditures, with the remaining commitment to be spent in 2020.

In August 2019, the Corporation issued 5.0 million flow-through shares related to Canadian development expenditures at a price of \$1.245 per share for total gross proceeds of \$6.3 million. There were 0.4 million flow-through shares issued for gross proceeds of \$0.4 million issued to insiders of the Corporation. The implied premium on the flow-through shares of \$0.125 per share or \$0.6 million was recorded as a flow-through share liability. As at December 31, 2019, the Corporation had incurred the qualifying development expenditures. The implied premium related to expenditures has been released through the deferred tax expense.

In March 2019, the Corporation issued 4.7 million flow-through shares related to Canadian development expenditures at a price of \$1.46 per share for total gross proceeds of \$6.8 million. The implied premium on the flow-through shares of \$0.12 per share or \$0.6 million was recorded as a flow-through share liability. As at December 31, 2019, the Corporation had incurred the qualifying development expenditures. The implied premium related to expenditures has been released through the deferred tax expense.

In November 2018, the Corporation issued 0.4 million flow-through shares related to Canadian exploration expenditures at a price of \$2.40 per share for total gross proceeds of \$1.0 million. The implied premium on the flow-through shares of \$0.65 per share or \$0.3 million was recorded as a flow-through share liability. As at December 31, 2018, the Corporation had incurred \$0.3 million of the qualifying exploration expenditures with the remaining balance incurred in 2019. The implied premium related to the expenditures made in December 31, 2019 was released through the deferred tax expense (\$0.2 million in 2019 and \$0.1 million in 2018).

(c) Restricted and Performance Share Award Incentive Plan

The Corporation has a Stock Incentive Plan which authorizes the Board of Directors to grant restricted share awards ("RSAs") and performance share awards ("PSAs") to directors, officers, employees and certain consultants of Surge.

Subject to the terms and conditions of the plan, each RSA entitles the holder to an award value to be typically paid as to one-third on each of the first, second and third anniversaries from the date of grant. Each PSA entitles the holder to an award value to be typically paid on the third anniversary of the date of grant. For the purpose of calculating share-based compensation, the fair value of each award is determined at the grant date using the closing price of the common shares. A weighted average forfeiture rate of 7% (2018 - 15%) for PSAs and 8% (2018 - 15%) for RSAs was used to value all awards granted for the period ended December 31, 2019. The weighted average fair value of awards granted for the year ended December 31, 2019 is \$1.04 (2018 - \$2.15) per PSA granted and \$1.05 (2018 - \$2.10) per RSA. In the case of PSAs, the award value is adjusted for a payout multiplier which can range from 0.0 to 2.0 and is dependent on the performance of the Corporation relative to pre-defined corporate performance measures for a particular period. On the vesting dates, the Corporation has the option of settling the award value in cash or common shares of the Corporation. For purposes of stock-based compensation a payout multiple of 1.0 was assumed for the PSAs granted during the period.

The total number of RSA and PSA units granted cannot exceed 4.5 percent of the issued and outstanding shares of the Corporation.

The number of restricted and performance share awards outstanding are as follows:

| | Number of restricted share awards | Number of performance share awards |
|-------------------------------------|-----------------------------------|------------------------------------|
| Balance at December 31, 2018 | 3,889,902 | 5,316,079 |
| Granted | 3,733,676 | 3,819,002 |
| Reinvested ⁽¹⁾ | 359,976 | 477,184 |
| Added by performance factor | — | 1,645,004 |
| Exercised | (1,992,880) | (3,202,278) |
| Forfeited | (215,080) | (452,658) |
| Balance at December 31, 2019 | 5,775,594 | 7,602,333 |

⁽¹⁾ Per the terms of the plan, cash dividends paid by the Corporation are reinvested to purchase incremental awards.

(d) Stock-based compensation

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

| | Years Ended December 31, | |
|--|--------------------------|-----------------|
| | 2019 | 2018 |
| Stock-based compensation on stock appreciation rights ("SARs") | — | 682 |
| Stock-based compensation on PSAs and RSAs | 10,582 | 9,275 |
| Capitalized stock-based compensation | (4,303) | (3,548) |
| Total stock-based compensation expense | \$ 6,279 | \$ 6,409 |

(e) Per share amounts

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

| | Years Ended December 31, | |
|---|--------------------------|-------------|
| | 2019 | 2018 |
| Weighted average number of shares - basic and diluted | 316,638,542 | 246,251,745 |

In computing diluted per share amounts at December 31, 2019, all RSAs and PSAs were excluded from the calculation as their effect was anti-dilutive. The common shares potentially issuable on the conversion of the convertible debentures were also excluded as they were determined to be anti-dilutive.

(f) Dividends

The Board of Directors declared for the months of January through December 2019 cumulative dividends of \$0.100000 per share (January - December 2018 - \$0.090826 per share). Dividends of \$0.008333 per share were declared and outstanding at December 31, 2019 and were paid in January 2020. Dividends for the month of January 2020 have been declared and paid at \$0.008333 per share. Dividends for the month of February 2020 have been declared at \$0.008333 per share.

12. REVENUE

The following table presents the Corporation's petroleum and natural gas revenues disaggregated by revenue source:

| | Years Ended December 31, | |
|--|--------------------------|------------|
| | 2019 | 2018 |
| Oil | \$ 376,238 | \$ 285,378 |
| Natural gas liquids | 8,109 | 11,022 |
| Natural gas | 10,002 | 8,147 |
| Total petroleum and natural gas revenue | \$ 394,349 | \$ 304,547 |
| Processing and other revenue | 4,303 | 2,818 |
| Total petroleum, natural gas and other revenue | \$ 398,652 | \$ 307,365 |

Surge's revenue was generated entirely in the provinces of Alberta and Saskatchewan. The majority of revenue resulted from sales whereby the transaction price was based on the index prices. Of total petroleum and natural gas revenue, three customers represented combined sales of \$333.7 million for the year ended December 31, 2019 (2018 - \$249.3 million).

13. FINANCE EXPENSE

| | Years ended December 31, | |
|--|--------------------------|------------------|
| | 2019 | 2018 |
| Interest on bank debt, convertible debentures, lease obligations and realized loss on interest contracts | \$ 26,657 | \$ 16,289 |
| Accretion of decommissioning obligations | 4,760 | 4,420 |
| Accretion of other long term liabilities | 39 | 86 |
| Accretion of convertible debentures | 1,951 | 1,258 |
| Unrealized loss on interest contracts | 1,556 | — |
| | \$ 34,963 | \$ 22,053 |

14. INCOME TAXES

During the year ended December 31, 2019, the Corporation recognized a deferred income tax expense of \$0.2 million related to the enactment of a decrease in the Alberta corporate tax rate from 12% to 8%. The tax rate decrease will be phased in as follows: 11% effective July 1, 2019, 10% effective January 1, 2020, 9% effective January 1, 2021, and 8% effective January 1, 2022.

(a) Deferred income tax recovery

The provision for income tax recovery in the financial statements differs from the result which would have been obtained by applying the combined federal and provincial income tax rate to the Corporation's loss before income taxes. This difference results from the following items:

| | Years ended December 31, | |
|--|--------------------------|--------------------|
| | 2019 | 2018 |
| Loss before income taxes | \$ (200,518) | \$ (86,585) |
| Combined federal and provincial statutory rate | 26.6% | 27.0% |
| Expected income tax recovery | \$ (53,338) | \$ (23,378) |
| Difference resulting from: | | |
| Issuance of flow through shares | 2,316 | 285 |
| Non-deductible items, rate changes & other | 9,168 | 8,041 |
| Income tax recovery | \$ (41,854) | \$ (15,052) |

(b) Deferred income tax asset

The components of the Corporation's net deferred income tax asset are as follows:

| | Years ended December 31, | |
|-----------------------------------|--------------------------|-----------------|
| | 2019 | 2018 |
| Property, plant and equipment | \$ (149,817) | \$ (192,188) |
| Decommissioning obligations | 65,137 | 61,888 |
| Convertible debentures | (1,834) | (1,264) |
| Fair value of financial contracts | 690 | (279) |
| Partnership deferral | (28,435) | (17,418) |
| Non-capital losses | 145,122 | 148,797 |
| Share issue costs | 108 | 99 |
| Lease and other obligations | 11,640 | 2,053 |
| Other | (221) | 1,210 |
| | \$ 42,390 | \$ 2,898 |

The Corporation has \$606.7 million in non-capital losses that begin expiring in the year 2028.

The following table provides a continuity of the deferred income tax asset:

| | January 1, 2019 | Recognized in profit or loss | Recognized in equity | Other | December 31, 2019 |
|-----------------------------------|--------------------|---------------------------------|-------------------------|-------------------|----------------------|
| Property, plant and equipment | \$ (192,188) | \$ 43,770 | \$ — | \$ (1,399) | \$ (149,817) |
| Decommissioning obligations | 61,888 | 3,249 | — | — | 65,137 |
| Convertible debentures | (1,264) | 434 | (1,004) | — | (1,834) |
| Fair value of financial contracts | (279) | 969 | — | — | 690 |
| Partnership deferral | (17,418) | (11,017) | — | — | (28,435) |
| Non-capital losses | 148,797 | (3,675) | — | — | 145,122 |
| Share issue costs | 99 | (32) | 41 | — | 108 |
| Lease and other obligations | 2,053 | 9,587 | — | — | 11,640 |
| Other | 1,210 | (1,431) | — | — | (221) |
| | \$ 2,898 | \$ 41,854 | \$ (963) | \$ (1,399) | \$ 42,390 |

| | January 1, 2018 | Recognized in profit or loss | Business combination | Recognized in equity | Other | December 31, 2018 |
|-----------------------------------|--------------------|---------------------------------|-------------------------|-------------------------|----------|----------------------|
| Property, plant and equipment | \$ (125,082) | \$ (16,855) | \$ (50,010) | \$ — | \$ (241) | \$ (192,188) |
| Decommissioning obligations | 44,354 | 13,230 | 4,304 | — | — | 61,888 |
| Convertible debentures | (1,438) | 174 | — | — | — | (1,264) |
| Fair value of financial contracts | 794 | (1,073) | — | — | — | (279) |
| Partnership deferral | (21,393) | 3,975 | — | — | — | (17,418) |
| Non-capital losses | 135,783 | 13,014 | — | — | — | 148,797 |
| Share issue costs | 316 | (295) | — | 78 | — | 99 |
| Other | 381 | 2,882 | — | — | — | 3,263 |
| | \$ 33,715 | \$ 15,052 | \$ (45,706) | \$ 78 | \$ (241) | \$ 2,898 |

15. KEY MANAGEMENT PERSONNEL COMPENSATION

Key Management Personnel includes the Board of Directors, President and Chief Executive Officer, Chief Financial Officer, Chief Operating Officer, Senior Vice President - Land and Business Development, Senior Vice President - Geosciences, Controller and Executive Vice President.

| | Years ended December 31, | |
|-------------------------------------|--------------------------|-----------|
| | 2019 | 2018 |
| Salaries and wages | \$ 3,405 | \$ 3,706 |
| Short-term employee benefits | 140 | 125 |
| Stock-based payments ⁽¹⁾ | 6,368 | 10,003 |
| | \$ 9,913 | \$ 13,834 |

⁽¹⁾ Represents the amortization of stock-based compensation associated with SARs, PSAs and RSAs granted to key management personnel as recorded in the financial statements.

16. CASHFLOW INFORMATION

| | Years ended December 31, | |
|--|--------------------------|------------------|
| | 2019 | 2018 |
| Accounts receivable | \$ (20,402) | \$ 15,207 |
| Prepaid expenses and deposits | 4,347 | (6,333) |
| Accounts payable and accrued liabilities | (1,502) | 11,243 |
| Working capital on acquisition | — | 7,032 |
| Bad debt provision | (210) | (353) |
| Accounts payable - SARs | — | 400 |
| Flow through shares | (154) | (30) |
| Other long-term liabilities | (464) | (723) |
| Change in non-cash working capital | \$ (18,385) | \$ 26,443 |
| These changes relate to the following activities | | |
| Operating | \$ (16,569) | \$ 24,338 |
| Investing | (1,816) | 2,105 |
| | \$ (18,385) | \$ 26,443 |

17. COMMITMENTS

Future minimum payments relating to variable office rent payments and firm transport commitments at December 31, 2019 are as follows:

| | December 31, 2019 |
|--------------------------|----------------------|
| Less than 1 year | \$ 11,046 |
| 1 - 3 years | 13,605 |
| 3 - 5 years | 4,838 |
| 5+ years | 5,343 |
| Total commitments | \$ 34,832 |

During the year ended December 31, 2019, the Corporation entered into a three year firm transportation agreement resulting in the recognition of an additional commitment of \$15.3 million.

18. LEASES

The Corporation has recognized the following lease and other obligations:

| | Total |
|---|------------------|
| Lease obligations at December 31, 2018 | \$ 5,871 |
| Additions upon adoption of IFRS 16 at January 1, 2019 | 29,886 |
| Lease modifications | 5,643 |
| Interest expense | 2,100 |
| Lease payments | (8,910) |
| Lease obligations at December 31, 2019 | \$ 34,590 |
| Other obligations | 12,094 |
| Lease and other obligations at December 31, 2019 | 46,684 |
| Current portion | 8,103 |
| Long term portion | 38,581 |

The Corporation recognized during the year ended December 31, 2019, \$7.3 million of depreciation charges on ROU assets and \$8.9 million of lease payments, of which \$2.1 million has been recorded as interest expense.

During the year ended December 31, 2019, the Corporation acquired a gas processing facility in Southeast Alberta. In conjunction with the purchase, the Corporation entered into a sale-leaseback agreement and recorded a corresponding financial liability in accordance with IFRS 9 "Financial Instruments" (included in "other obligations" in above table). Monthly lease payments will be apportioned between finance expense and a reduction of the outstanding financial liability.

During the year ended December 31, 2019, the Corporation extended the term of an existing lease resulting in the recognition of an incremental \$5.6 million right-of-use asset and lease obligation. The incremental borrowing rate used to revalue the lease was adjusted to reflect changes in market conditions and the revised lease term.

Future minimum payments relating to lease and other obligations at December 31, 2019 are as follows:

| | December 31, 2019 |
|--|------------------------------|
| Less than 1 year | \$ 11,428 |
| 1 - 3 years | 21,039 |
| 3 - 5 years | 25,803 |
| 5+ years | 528 |
| Lease and other obligation payments | \$ 58,798 |