Condensed Consolidated Interim Statements of Financial Position

Stated in thousand of dollars

(Unaudited)

As at	March 31, 2016	December 2015
Assets		
Current Assets		
Accounts receivable	**$ 20,055**	$ 25,202
Fair value of financial contracts (note 5)	**2,152**	1,510
Prepaid expenses and deposits	**4,331**	3,934
	26,538	30,646
Fair value of financial contracts (note 5)	**1,073**	7
Exploration and evaluation assets (note 3)	**11,287**	11,287
Petroleum and natural gas properties (note 4)	**1,025,792**	1,070,311
Deferred income taxes	**33,642**	33,038
	$ 1,098,332	$ 1,145,289
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	**$ 30,268**	$ 37,720
Dividends payable	**2,763**	2,763
Fair value of financial contracts (note 5)	**2,804**	5,250
Current portion of other long term obligations	**1,943**	1,709
	37,778	47,442
Fair value of financial contracts (note 5)	**1,413**	4,789
Bank debt (note 6)	**125,171**	149,028
Decommissioning obligations (note 7)	**129,722**	129,827
Other long term obligations	**1,882**	2,062
Shareholders' equity		
Share capital	**1,256,674**	1,256,630
Contributed surplus	**42,543**	40,391
Warrants	**3,522**	3,522
Deficit	**(500,373)**	(488,402)
	802,366	812,141
	$ 1,098,332	$ 1,145,289

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

Condensed Consolidated Interim Statements of Loss and Comprehensive Loss

Stated in thousands of dollars, except per share amounts

(Unaudited)

	Three Months Ended March 31, 2016	2015
Revenues		
Petroleum and natural gas	**$ 29,146**	$ 70,353
Royalties	**(3,830)**	(10,624)
Realized gain on financial contracts	**3,982**	36,344
Unrealized gain (loss) on financial contracts (note 5)	**7,530**	(38,355)
	36,828	57,718
Expenses		
Operating	**14,964**	32,945
Transportation	**2,843**	2,618
General and administrative	**2,395**	3,969
Transaction costs	**186**	306
Stock-based compensation (note 8)	**1,133**	511
Depletion and depreciation (note 4)	**21,593**	41,402
Impairment	**—**	109,836
Finance expense	**2,396**	6,809
Loss (gain) on disposal of petroleum and natural gas properties (note 4)	**(4,397)**	152
	41,113	198,548
Loss before income taxes	**(4,285)**	(140,830)
Deferred income tax recovery	**(604)**	(36,125)
Net loss and comprehensive loss for the period	**$ (3,681)**	$ (104,705)
Loss per share (note 8)		
Basic	**$ (0.02)**	$ (0.48)
Diluted	**$ (0.02)**	$ (0.48)

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

Condensed Consolidated Interim Statements of Changes in Shareholders' Equity

Stated in thousands of dollars, except share amounts

(Unaudited)

	Number of common shares	Share capital	Contributed surplus	Warrants	Deficit	Total equity
Balance at December 31, 2014	220,059,794	$ 1,252,315	$ 31,508	$ 5,883	$ (213,843)	$ 1,075,863
Net loss for the period	—	—	—	—	(104,705)	(104,705)
Stock-based compensation	—	—	2,702	—	—	2,702
Dividends	—	—	—	—	(16,503)	(16,503)
Balance at March 31, 2015	220,059,794	$ 1,252,315	$ 34,210	$ 5,883	$ (335,051)	$ 957,357
Balance at December 31, 2015	221,032,888	$ 1,256,630	$ 40,391	$ 3,522	$ (488,402)	$ 812,141
Net loss for the period	—	—	—	—	(3,681)	(3,681)
Transfer on exercise of RSAs and PSAs [1]	13,622	44	(44)	—	—	—
Stock-based compensation	—	—	2,196	—	—	2,196
Dividends	—	—	—	—	(8,290)	(8,290)
Balance at March 31, 2016	**221,046,510**	**$ 1,256,674**	**$ 42,543**	**$ 3,522**	**$ (500,373)**	**$ 802,366**

[1] RSA and PSA defined as restricted share and performance share awards

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

Condensed Consolidated Interim Statements of Cash Flows

Stated in thousands of dollars

(Unaudited)

	Three Months Ended March 31, 2016	2015
Cash provided by (used in)		
Operating		
Net loss	**$ (3,681)**	$ (104,705)
Loss (gain) on disposal of petroleum and natural gas properties	**(4,397)**	152
Unrealized (gain) loss on financial contracts	**(7,530)**	38,355
Finance expense	**2,396**	6,809
Interest expense	**(1,606)**	(5,469)
Depletion and depreciation	**21,593**	41,402
Impairment	**—**	109,836
Decommissioning expenditures	**(402)**	(2,171)
Stock-based compensation	**699**	511
Deferred income tax recovery	**(604)**	(36,125)
Change in non-cash working capital	**(1,097)**	5,228
Cash flow from operating activities	**5,371**	53,823
Financing		
Bank debt	**(23,857)**	(27,070)
Dividends paid	**(8,290)**	(22,005)
Cash flow used in financing activities	**(32,147)**	(49,075)
Investing		
Petroleum and natural gas properties	**(12,873)**	(25,812)
Disposition of petroleum and natural gas properties	**43,178**	35,729
Acquisitions	**(2,037)**	(4,574)
Change in non-cash working capital	**(1,492)**	(10,091)
Cash flow from (used in) investing activities	**26,776**	(4,748)
Change in cash	**—**	—
Cash, beginning of the period	**—**	—
Cash, end of the period	**$ —**	$ —

Cash is defined as cash and cash equivalents.

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

(Unaudited)

1. REPORTING ENTITY

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

2. BASIS OF PREPARATION

Statement of compliance

These condensed consolidated interim financial statements have been prepared in accordance with International Accounting Standard 34, "Interim Financial Reporting" and using the accounting policies outlined by the Corporation in its annual consolidated financial statements for the year ended December 31, 2015. These condensed consolidated interim financial statements do not include all of the information required for full annual financial statements. These condensed consolidated interim financial statements should be read in conjunction with the annual financial statements for the year ended December 31, 2015.

The condensed consolidated interim financial statements were authorized for issuance by the Board of Directors on May 11, 2016.

3. EXPLORATION AND EVALUATION ASSETS

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

Exploration & Evaluation Assets

		Total
Balance at December 31, 2014	$	12,788
Dispositions		(1,095)
Impairment		(406)
Balance at December 31, 2015 and March 31, 2016	**$**	**11,287**

4. PETROLEUM AND NATURAL GAS PROPERTIES

Petroleum and Natural Gas Properties

		Total
Balance at December 31, 2014	$	2,569,170
Acquisitions		5,562
Dispositions		(761,065)
Additions		76,731
Change in decommissioning obligations		2,335
Capitalized stock-based compensation		6,938
Balance at December 31, 2015	$	1,899,671
Acquisitions		2,037
Dispositions		(87,136)
Additions		12,873
Change in decommissioning obligations		7,638
Capitalized stock-based compensation		1,383
Balance at March 31, 2016	**$**	**1,836,466**

		Total
Accumulated depletion and depreciation		
Balance at December 31, 2014	$	(712,135)
Depletion and depreciation expense		(122,879)
Impairment		(217,623)
Dispositions		223,277
Balance at December 31, 2015	$	(829,360)
Depletion and depreciation expense		(21,593)
Dispositions		40,279
Balance at March 31, 2016	**$**	**(810,674)**

		Total
Carrying amounts		
At December 31, 2015	$	1,070,311
At March 31, 2016	**$**	**1,025,792**

The calculation of depletion and depreciation expense for the period ended March 31, 2016 included an estimated $479.2 million (December 31, 2015 - $486.2 million) for future development costs associated with proved plus probable reserves and deducted $102.3 million (December 31, 2015 - $107.7 million) for the estimated salvage value of production equipment and facilities.

During the period ended March 31, 2016 the Corporation disposed of certain non-core assets and facilities in Northern Alberta for cash proceeds of $43.2 million. The assets had a carrying value of $46.9 million at the time of disposition and an associated decommissioning liability of $8.1 million, resulting in a gain on disposal of $4.4 million.

During the period ended March 31, 2016 the Corporation acquired certain petroleum and natural gas properties in Northern Alberta for cash consideration of $2.0 million.

5. RISK MANAGEMENT

During the period ended March 31, 2016, the Corporation monetized certain existing forward fixed swap positions at a realized gain of $4.7 million (March 31, 2015 - $36.1 million).

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). 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.

The following table outlines the fair value of natural gas commodity contracts as at March 31, 2016:

						As at March 31, 2016
Contract Term	**Type**	**Volume**	**Swap Price (Surge receives)**	**Swap Price (Surge pays)**	**Index**	**Fair Value ($000s CDN)**
Jan 1, 2016 to Dec 31, 2016	Swap	3,000 mcf/d	CAD $3.5025	CAD Floating	Chicago	552
Jan 1, 2016 to Dec 31, 2016	Swap	4,000 mcf/d	CAD $3.5050	CAD Floating	Chicago	717
Jan 1, 2016 to Dec 31, 2016	Swap	3,000 mcf/d	CAD $3.5000	CAD Floating	Chicago	558
Jan 1, 2017 to Oct 31, 2017	Swap	3,500 mcf/d	CAD $3.6500	CAD Floating	NYMEX	95
Jan 1, 2017 to Oct 31, 2017	Swap	1,500 mcf/d	CAD $3.8250	CAD Floating	NYMEX	117
Total						**$ 2,039**

The following table outlines the fair value of oil commodity contracts as at March 31, 2016:

						As at March 31, 2016
Contract Term	**Type**	**Volume**	**Price (Surge receives)**	**Price (Surge pays)**	**Index**	**Fair Value ($000s CDN)**
Jul 1, 2016 to Dec 31, 2016	Collar (put/call)	1,000 bbls/d	CAD $45.00	CAD $65.00	WTI - NYMEX	(225)
Jul 1, 2016 to Dec 31, 2016	Collar (put/call)	500 bbls/d	CAD $45.00	CAD $64.48	WTI - NYMEX	(124)
Jul 1, 2016 to Dec 31, 2016	Collar (put/call)	500 bbls/d	CAD $45.00	CAD $64.60	WTI - NYMEX	(124)
Jul 1, 2016 to Jun 30, 2017	Collar (put/call)	500 bbls/d	CAD $45.00	CAD $70.75	WTI - NYMEX	(120)
Jul 1, 2016 to Jun 30, 2017	Collar (put/call)	250 bbls/d	CAD $45.00	CAD $69.00	WTI - NYMEX	(88)
Jul 1, 2016 to Jun 30, 2017	Collar (put/call)	250 bbls/d	CAD $45.00	CAD $70.25	WTI - NYMEX	(68)
Jan 1, 2017 to Jun 30, 2017	Collar (put/call)	500 bbls/d	CAD $50.00	CAD $70.00	WTI - NYMEX	43
Jan 1, 2017 to Jun 30, 2017	Collar (put/call)	500 bbls/d	CAD $50.00	CAD $70.00	WTI - NYMEX	14
Dec 1, 2015 to Dec 31, 2016	Swap	2,000 bbls/d	USD $3.55	USD Floating	EDM Basis	(30)
Jan 1, 2016 to Dec 31, 2016	Swap	1,000 bbls/d	USD $14.85	USD Floating	WCS Basis	(482)
Jan 1, 2016 to Dec 31, 2016	Swap	500 bbls/d	USD $21.75	USD Floating	WCS Basis	(1,469)
Jan 1, 2016 to Dec 31, 2016	Swap	1,000 bbls/d	USD $14.55	USD Floating	WCS Basis	(391)
Jan 1, 2017 to Dec 31, 2017	Swap	500 bbls/d	USD $22.00	USD Floating	WCS Basis	(1,829)
Total						**$ (4,893)**

The following table outlines the fair value of foreign exchange contracts as at March 31, 2016:

Contract Term	Type	Notional ($USD)	Swap Price (Surge receives) (C$)	Floor	Ceiling	Conditional Ceiling	As at March 31, 2016 Fair Value ($000s CDN)
Jan 1, 2016 to Dec 31, 2016	Avg Rate Variable Collar	$2,000,000	—	$1.2950	$1.3700	$1.3155	148
Jan 1, 2016 to Dec 31, 2016	Avg Rate Variable Collar	$2,000,000	—	$1.3175	$1.3900	$1.3390	480
Jan 1, 2017 to Dec 31, 2017	Avg Rate Forward	$2,000,000	$1.3333	—	—	—	865
Jan 1, 2017 to Dec 31, 2017	Avg Rate Forward	$2,000,000	$1.3125	—	—	—	369
Total							**$ 1,862**

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. In assessing the potential impact of these fluctuations, the Corporation believes that the volatilities presented below are reasonable measures. Fluctuations in crude oil and natural gas prices would have had the following impact on the net loss:

Net earnings impact for the period ended March 31, 2016	Price Increase	Price Decrease
Crude Oil - Change of +/- $1.00	(1,751)	1,751
Natural Gas - Change of +/- $0.10	(320)	320
Foreign Exchange - Change of +/- $0.01	(60)	60

6. BANK DEBT

The Corporation at March 31, 2016, has a $400 million extendible, revolving term credit facility with a syndicate of Canadian banks bearing interest at bank rates. The facility is available on a revolving basis until May 29, 2016. On May 29, 2016, at the Corporation's discretion, the facility is available on a non-revolving basis for a one-year period, at the end of which time the facility would be due and payable. Alternatively, the facilities may be extended for a further 364-day period at the request of the Corporation and subject to the approval of the syndicate. As the available lending limits of the facilities are based on the syndicate's interpretation of the Corporation's reserves and future commodity prices, there can be no assurance that the amount of the available facilities will not decrease at the next scheduled review. Interest rates vary depending on the ratio of net debt to cash flow. The facility had an effective interest rate of prime plus 1.50 percent as at March 31, 2016 (December 31, 2015 – prime plus 1.50 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. Under the terms of the agreement, the Corporation is required to meet certain financial and engineering reporting requirements.

7. 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 inflated and undiscounted amount of cash flows required to settle its decommissioning obligations is approximately $292.4 million (December 31, 2015 – $315.6 million). These payments are expected to be made over the next 50 years with the majority of costs to be incurred between 2025 and 2064. A risk free rate of two percent (December 31, 2015 – 2.15 percent) and an inflation rate of two percent (December 31, 2015 – two percent) was used to calculate the fair value of the decommissioning obligations.

A reconciliation of the decommissioning obligations is provided below:

		March 31, 2016		December 31, 2015
Balance, beginning of period	**$**	**129,827**	$	206,060
Liabilities related to acquisitions		**—**		345
Liabilities related to dispositions (note 4)		**(8,076)**		(79,047)
Change in estimate		**7,524**		1,376
Liabilities incurred		**114**		959
Accretion expense		**735**		3,718
Decommissioning expenditures		**(402)**		(3,584)
Balance, end of period	**$**	**129,722**	$	129,827

The change in estimate was primarily the result of decreasing the discount rate.

8. SHARE CAPITAL

(a) Authorized

Unlimited number of voting common shares.

Unlimited number of preferred shares, issuable in series.

(b) Stock Options

The Corporation has granted options to certain officers, directors, employees and consultants under the Corporation's stock option plan. The exercise price of each option equals the market price of the Corporation's common shares at the date of grant. Options granted have a term of five years to maturity and vest as to one-third on each of the first, second and third anniversaries from the date of grant.

	March 31, 2016			December 31, 2015		
	Number of Options		**Weighted average exercise price**	Number of Options		Weighted average exercise price
Stock options outstanding, beginning of period	**129,200**	**$**	**7.05**	232,533	$	6.76
Expired	**—**	**$**	**—**	(103,333)	$	6.40
Stock options outstanding, end of period	**129,200**	**$**	**7.05**	129,200	$	7.05
Exercisable at period-end	**114,200**	**$**	**7.53**	111,700	$	7.61

The following table summarizes stock options outstanding and exercisable at March 31, 2016:

	Options Outstanding			Options Exercisable	
Range of exercise prices	Number outstanding	Weighted average exercise price	Weighted average contractual life (years)	Number exercisable	Weighted average exercise price
$3 to $4.99	42,500	$3.44	2.03	27,500	$3.46
$5 to $8.99	24,500	$7.34	1.36	24,500	$7.34
$9 to $9.53	62,200	$9.39	0.24	62,200	$9.39
$3 to $9.53	129,200	$7.05	0.91	114,200	$7.53

(c) Warrants

The Corporation has 1,400,560 warrants exercisable at a price of $4.46. The exercise price is downward adjusted for dividends paid. The warrants become exercisable based on certain time based and performance based conditions. Specifically with respect to time they are exercisable up to one third on each anniversary from the date of the grant, and with respect to performance up to one half when the market price of the Corporation reaches $6.30 and the other half when it reaches $8.40. The warrants expire in June 2018. As at March 31, 2016, 933,707 warrants were exercisable.

(d) Stock Appreciation Rights

The Corporation had 2.0 million SAR's outstanding at March 31, 2016. The SARs vest up to one third on each anniversary from the date of grant and expire in June 2018. The exercise price is downward adjusted for dividends paid. As such the exercise price at March 31, 2016 is $2.17 (December 31, 2015 - $2.20) and 1,333,333 SARs were vested and exercisable. The SARs when exercised are to be cash settled based on the difference between the Corporation's common share price on the date of exercise and the adjusted exercise price. The Corporation has valued the SARs using a Black Scholes valuation model and will continue to revalue at each reporting period until ultimate cash settlement. During the period, the Corporation realized a decrease to the liability within accounts payable and an offsetting decrease to stock-based compensation of $0.1 million (2015 - $0.6 million decrease). There is $1.2 million included in accounts payable at March 31, 2016 (December 31, 2015 - $1.3 million).

(e) 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. An estimated forfeiture rate of 15% (2015 - 15%) was used to value all awards granted for the period ended March 31, 2016. The weighted average fair value of awards granted for the period ended March 31, 2016 is $1.93 (2015 - $2.69) per PSA and $1.92 (2015 - $2.63) 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.

The total number of RSA and PSA units granted cannot exceed five 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 January 1, 2016	2,740,363	3,407,103
Granted	42,500	37,500
Reinvested [1]	49,779	62,004
Exercised	(13,622)	—
Balance at March 31, 2016	**2,819,020**	**3,506,607**

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

(f) Stock-based compensation

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

	Three Months Ended March 31,	
	2016	2015
Stock-based compensation on options	**$ 3**	$ 11
Stock-based compensation on SARs	**(114)**	(623)
Stock-based compensation on PSAs and RSAs [1]	**2,627**	2,691
Capitalized stock-based compensation	**(1,383)**	(1,568)
Total stock-based compensation expense	**$ 1,133**	$ 511

[1] Included in stock-based compensation for the period ended March 31, 2016 is cash expenditures of $0.4 million paid to acquire shares offered to employees and service providers (2015 - $Nil).

The Corporation's stock-based compensation expense for the period ended March 31, 2016 was $1.1 million (March 31, 2015 - $0.5 million).

(g) Per share amounts

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

	Three Months Ended March 31,	
	2016	2015
Weighted average number of shares - basic and diluted	**221,042,468**	220,059,794

In computing diluted per share amounts at March 31, 2016, 129,200 options (March 31, 2015 – 232,533), nil performance warrants (March 31, 2015 - 685,732), 1,400,560 warrants (March 31, 2015 – 1,400,560), 2,819,020 RSAs (March 31, 2015 – 2,022,995) and 3,506,607 PSAs (March 31, 2015 – 1,774,317) were excluded from the calculation as their effect was anti-dilutive.

(h) Dividends

The Board of Directors declared for the months of January through March 2016 cumulative dividends of $0.0375 per share (January - March 2015 - $0.075 per share). Dividends of $0.0125 per share are declared and outstanding at March 31, 2016 and were paid in April 2016. The dividend for April 2016 has been declared at $0.00625 per share.

9. COMMITMENTS

Future minimum payments relating to operating lease and firm transport commitments are as follows:

($000s)		
2016	$	9,924
2017		12,389
2018		7,411
2019		6,317
2020		6,051
2021+		11,447
Total	**$**	**53,539**