Condensed Consolidated Interim Statements of Financial Position

Stated in thousand of dollars
(Unaudited)

As at	June 30, 2013	December 31, 2012
Assets		
Current Assets		
Accounts receivable	$ 29,715	$ 25,260
Fair value of financial contracts (note 8)	-	2,384
Prepaid expenses and deposits	2,999	2,508
	32,714	30,152
Deposit on acquisition (note 12)	24,000	-
Exploration and evaluation assets (note 4)	48,337	70,726
Petroleum and natural gas properties (note 5)	573,779	575,483
Deferred income taxes	-	5,083
	$ 678,830	$ 681,444
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	$ 37,817	$ 53,823
Fair value of financial contracts (note 8)	6,119	957
	43,936	54,780
Fair value of financial contracts (note 8)	1,347	1,137
Bank debt (note 9)	212,494	194,523
Decommissioning obligations (note 7)	42,866	39,339
Deferred income taxes	34,495	40,666
Shareholders' equity		
Share capital	354,373	351,957
Contributed surplus	23,565	20,495
Warrants	10,581	7,059
Accumulated other comprehensive loss	-	(43)
Deficit	(44,827)	(28,469)
	343,692	350,999
Contingencies (note 11)		
Subsequent event (note 12)		
	$ 678,830	$ 681,444

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

Condensed Consolidated Interim Statements of Income (Loss) and Comprehensive Income (Loss)

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

	Three months ended June 30, 2013	Three months ended June 30, 2012	Six months ended June 30, 2013	Six months ended June 30, 2012
Revenues				
Petroleum and natural gas	$ 58,004	$ 48,927	$ 111,586	$ 99,987
Royalties	(10,709)	(8,182)	(20,192)	(18,199)
Realized loss on financial contracts (note 8)	(1,808)	(242)	(2,209)	(1,012)
Unrealized gain (loss) on financial contracts (note 8)	1,561	12,885	(7,756)	10,064
	47,048	53,388	81,429	90,840
Expenses				
Operating	10,214	8,976	21,125	18,532
Transportation	2,100	2,188	4,050	3,646
General and administrative	4,159	2,952	6,934	5,924
Legal settlement (note 11)	3,550	-	3,550	-
Bad debt provision	-	-	317	-
Transaction costs	139	249	139	612
Stock-based compensation	4,299	683	5,191	1,649
Depletion and depreciation	14,986	18,413	30,738	35,303
Impairment (note 6)	24,000	-	24,000	-
Finance expense	2,573	1,835	5,245	3,523
Gain on disposal of petroleum and natural gas properties (note 3)	(1,381)	-	(1,531)	-
	64,639	35,296	99,758	69,189
Income (loss) before income taxes	(17,591)	18,092	(18,329)	21,651
Current tax expense on disposal	1,439	-	1,439	-
Deferred income tax expense (recovery)	(4,026)	4,819	(3,410)	5,721
Total tax expense (recovery)	(2,587)	4,819	(1,971)	5,721
Net income (loss) for the period	$ (15,004)	$ 13,273	$ (16,358)	$ 15,930
Other comprehensive income:				
Currency translation adjustment	705	571	1,359	189
Transfer of cumulative translation adjustment to earnings	(1,316)	-	(1,316)	-
Other comprehensive income for the period	(611)	571	43	189
Total comprehensive income (loss) for the period	$ (15,615)	$ 13,844	$ (16,315)	$ 16,119
Income (loss) per share (note 10)				
Basic	$ (0.21)	$ 0.19	$ (0.23)	$ 0.23
Diluted	$ (0.21)	$ 0.18	$ (0.23)	$ 0.22

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	Performance warrants	Accumulated other comprehensive income (loss)	Retained earnings (deficit)	Total equity
Balance at December 31, 2011	63,040,987	$ 278,302	$ 12,879	$ 7,196	$ 1,005	$ 24,774	$ 324,156
Net income for the period	-	-	-	-	-	15,930	15,930
Other comprehensive income	-	-	-	-	189	-	189
Issued pursuant to acquisition	7,919,436	71,275	-	-	-	-	71,275
Share issue costs (net of tax of $30)	-	(88)	-	-	-	-	(88)
Stock-based compensation	-	-	4,078	-	-	-	4,078
Transfer on exercise of options & warrants	-	388	(251)	(137)	-	-	-
Warrants exercised	26,592	137	-	-	-	-	137
Options exercised	78,165	459	-	-	-	-	459
Balance at June 30, 2012	71,065,180	$ 350,473	$ 16,706	$ 7,059	$ 1,194	$ 40,704	$ 416,136
Balance at December 31, 2012	71,217,345	$ 351,957	$ 20,495	$ 7,059	$ (43)	$ (28,469)	$ 350,999
Net income for the period	-	-	-	-	-	(16,358)	(16,358)
Other comprehensive income	-	-	-	-	1,359	-	1,359
Transfer of cumulative translation adjustment to earnings	-	-	-	-	(1,316)	-	(1,316)
Stock-based compensation	-	-	3,070	-	-	-	3,070
Issued pursuant to private placement	700,280	2,500	-	3,522	-	-	6,022
Share issue costs	-	(84)	-	-	-	-	(84)
Balance at June 30, 2013	**71,917,625**	**$ 354,373**	**$ 23,565**	**$ 10,581**	**$ -**	**$ (44,827)**	**$ 343,692**

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 June 30,		Six months ended June 30,	
	2013	2012	**2013**	2012
Cash provided by (used in)				
Operating				
Net income (loss)	**$ (15,004)**	$ 13,273	**$ (16,358)**	$ 15,930
Gain on disposal of petroleum and natural gas properties	**(1,381)**	-	**(1,531)**	-
Unrealized (gain) loss on financial contracts	**(1,561)**	(12,885)	**7,756**	(10,064)
Finance expense	**2,573**	1,835	**5,245**	3,523
Interest expense	**(2,238)**	(1,576)	**(4,600)**	(3,009)
Depletion and depreciation	**14,986**	18,413	**30,738**	35,303
Impairment	**24,000**	-	**24,000**	-
Decommissioning expenditures	**36**	(247)	**(427)**	(731)
Bad debt provision	**-**	-	**317**	-
Stock-based compensation	**4,299**	683	**5,191**	1,649
Deferred income tax expense (recovery)	**(4,026)**	4,819	**(3,410)**	5,721
Change in non-cash working capital	**3,019**	(924)	**2,769**	(3,060)
Cash flow from operating activities	**24,703**	23,391	**49,690**	45,262
Financing				
Bank debt	**(380)**	30,978	**17,971**	65,823
Issue of common shares, net of issue costs	**2,416**	173	**2,416**	478
Cash flow from financing activities	**2,036**	31,151	**20,387**	66,301
Investing				
Petroleum and natural gas properties	**(18,931)**	(21,388)	**(58,848)**	(66,674)
Exploration and evaluation assets	**(6,235)**	(6,319)	**(6,383)**	(15,931)
Disposition of petroleum and natural gas properties	**39,377**	-	**40,184**	-
Acquistions	**-**	(9,347)	**-**	(27,847)
Deposit on acquisition	**(24,000)**	-	**(24,000)**	-
Change in non-cash working capital	**(16,950)**	(17,488)	**(21,030)**	(1,111)
Cash flow used in investing activities	**(26,739)**	(54,542)	**(70,077)**	(111,563)
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 CONDENSED CONSOLIDATED INTERIM 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 condensed consolidated interim financial statements include the accounts of the Corporation, its wholly-owned subsidiaries and partnerships. During the six months ended June 30, 2013, the Corporation sold one of its subsidiaries as further described below.

In June 2013, the Corporation also announced its intention to become a dividend paying corporation. Monthly dividend payments of $0.035 per share ($0.42 per share annually) are expected to commence in September 2013.

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, 2012, except as identified below. These condensed consolidated interim financial statements do not include all of the information required for full annual financial statements.

On January 1, 2013, the Corporation adopted new standards with respect to consolidations (IFRS 10), joint arrangements (IFRS 11), disclosure of interests in other entities (IFRS 12), fair value measurements (IFRS 13) and amendments to financial instrument disclosures (IFRS 7). The adoption of these standards had no impact on the amounts recorded in the consolidated financial statements as at January 1, 2013 or on the comparative periods.

The condensed consolidated interim financial statements were authorized for issuance by the Board of Directors on August 6, 2013.

3. DISPOSITION

Effective May 31, 2013, the Corporation disposed of all the issued and outstanding shares of Surge Energy USA Inc., for net consideration of $43.8 million. The Corporation received $39.4 million in June 2013 with the balance of $4.4 million included in accounts receivable at June 30, 2013. The amount outstanding will be paid upon finalization of any taxes on disposal. Surge Energy USA Inc. was the operating entity for all of the Corporation's US assets and operations. The following table outlines the proceeds, net assets disposed of and gain:

Disposition of Surge Energy USA Inc.

Consideration				
Cash proceeds (net of closing adjustments)	$	39,377		
Accounts receivable		4,420		
			$	43,797
Net assets disposed				
Petroleum and natural gas properties, net book value	$	29,266		
Exploration and evaluation assets		11,831		
Deferred income tax expense (recovery)		2,322		
Working capital		1,412		
Decommissioning obligations		(1,099)		
Accumulated other comprehensive income		(1,316)		
			$	42,416
Gain on disposition			**$**	**1,381**

4. 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, 2011	$	47,719
Acquisitions		6,181
Additions		25,604
Change in foreign exchange rate		(102)
Transfer to petroleum and natural gas properties		(8,676)
Balance at December 31, 2012	$	70,726
Additions		6,383
Dispositions		(11,831)
Change in foreign exchange rate		391
Transfer to petroleum and natural gas properties		(17,332)
Balance at June 30, 2013	**$**	**48,337**

5. PETROLEUM AND NATURAL GAS PROPERTIES

Petroleum and Natural Gas Properties

		Total
Balance at December 31, 2011	$	504,802
Acquisitions		133,056
Additions		155,110
Transfer from exploration and evaluation assets		8,676
Change in decommissioning obligations		1,885
Capitalized stock-based compensation		4,992
Change in foreign exchange rate		(822)
Disposals		(3,816)
Balance at December 31, 2012	$	803,883
Additions		58,848
Dispositions		(35,524)
Transfer from exploration and evaluation assets		17,332
Change in decommissioning obligations		4,624
Capitalized stock-based compensation		1,401
Change in foreign exchange rate		968
Balance at June 30, 2013	**$**	**851,532**

		Total
Accumulated depletion and depreciation		
Balance at December 31, 2011	$	(66,948)
Depletion and depreciation expense		(69,262)
Impairment		(92,878)
Disposals		688
Balance at December 31, 2012	$	(228,400)
Disposals		5,385
Impairment		(24,000)
Depletion and depreciation expense		(30,738)
Balance at June 30, 2013	**$**	**(277,753)**

		Total
Carrying amounts		
At December 31, 2012	$	575,483
At June 30, 2013	$	573,779

The calculation of depletion and depreciation expense for the three months ended June 30, 2013 included an estimated $185.3 million (June 30, 2012 - $138.8 million) for future development costs associated with proved plus probable reserves and deducted $35.1 million (June 30, 2012 - $30.7 million) for the estimated salvage value of production equipment and facilities.

6. IMPAIRMENT

In conjunction with the disposal of the US petroleum and natural gas properties as outlined in note 3 and performance and reserve issues, the Corporation tested the remaining petroleum and natural gas properties in the related CGU for impairment. The estimated recoverable amount of the CGU was estimated as its fair value less costs to sell based on the net present value of before tax cash flows from oil and gas proved plus probable reserves estimated by the Corporation's third party reserve evaluators at a discount rate of 15%. In determining the appropriate discount rate, the Corporation referenced recent market transactions completed on assets similar to those in the CGU. At June 30, 2013, it was determined that the net present value of the CGU exceeded the recoverable amount and the Corporation recorded a $24.0 million impairment charge.

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 undiscounted amount of cash flows required to settle its decommissioning obligations is approximately $85.3 million (December 31, 2012 – $73.9 million). A risk free rate of 2.9 percent (December 31, 2012 – 2.5 percent) and an inflation rate of two percent (December 31, 2012 – two percent) was used to calculate the fair value of the decommissioning obligations.

A reconciliation of the decommissioning obligations is provided below:

	June 30, 2013	December 31, 2012
Balance, beginning of period	**$ 39,339**	$ 37,511
Liabilities related to acquisitions	**-**	1,608
Liabilities related to dispositions	**(1,315)**	(441)
Change in foreign exchange rate	**-**	(4)
Change in estimate	**3,816**	-
Liabilities incurred	**808**	1,885
Accretion expense	**645**	1,041
Decommissioning expenditures	**(427)**	(2,261)
Balance, end of period	**$ 42,866**	$ 39,339

During the six months ended June 30, 2013, the Corporation updated its decommissioning estimates based on new guidance released by the ERCB.

8. RISK MANAGEMENT CONTRACTS

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

The following table outlines the fair value of interest rate contracts as at June 30, 2013:

					As at June 30, 2013
Term	**Type (floating to fixed)**	**Amount (C$)**	**Company Fixed Interest Rate (%) [(1)]**	**Counter party Floating Rate Index**	**Fair Value ($000s CDN)**
Jan 1, 2012 to Dec 31, 2014	Swap	$ 50,000,000	2.74%	CAD-BA-CDOR	(1,577)

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

The following table outlines the fair value of foreign exchange contracts as at June 30, 2013:

					As at June 30, 2013
Term	**Type**	**Notional ($USD)**	**Swap Price (Surge receives) (C$)**	**Index (Surge pays) (C$)**	**Fair Value ($000s CDN)**
Jan 1 to Dec 31, 2013	Swap	$33,762,500	$ 1.005	Floating CAD	(1,149)
Jan 1 to Dec 31, 2014	Swap	$33,361,000	$ 1.005	Floating CAD	(1,866)
Total					**$ (3,015)**

The following table outlines the fair value of natural gas commodity contracts as at June 30, 2013:

					As at June 30, 2013
Term	**Type (floating to fixed)**	**Volume**	**Swap Price (Surge receives) (C$)**	**Index (Surge pays) (C$)**	**Fair Value ($000s CDN)**
Jan 1 to Dec 31, 2013	Swap	2,000 gj/d	$ 3.10	AECO	15
Jan 1 to Dec 31, 2013	Swap	1,000 gj/d	$ 3.05	AECO	(2)
Jan 1 to Dec 31, 2013	Swap	1,000 gj/d	$ 3.07	AECO	1
Jan 1 to Dec 31, 2013	Swap	2,000 gj/d	$ 3.25	AECO	70
Jan 1 to Dec 31, 2013	Swap	2,000 gj/d	$ 3.45	AECO	143
Jan 1 to Dec 31, 2014	Swap	2,000 gj/d	$ 3.40	AECO	51
Jan 1 to Dec 31, 2014	Swap	2,000 gj/d	$ 3.60	AECO	195
Total					**$ 473**

The following table outlines the fair value of oil commodity contracts as at June 30, 2013:

Term	Type (floating to fixed)	Volume	Swap Price (Surge receives) (C$)	Index (Surge pays) (C$)	As at June 30, 2013 Fair Value ($000s CDN)
Jan 1 to Dec 31, 2013	Swap	250bbls/d	$98.00	WTI - NYMEX	(105)
Jan 1 to Dec 31, 2013	Swap	250bbls/d	$95.00	WTI - NYMEX	(242)
Jan 1 to Dec 31, 2013	Swap	250 bbls/d	$85.00	WTI - NYMEX	(700)
Jan 1 to Dec 31, 2013	Call	250bbls/d	WTI - NYMEX	$95.00	322
Jul 1 to Dec 31, 2013	Swap	750 bbls/d	$94.97	WTI - NYMEX	(730)
Jul 1 to Dec 31, 2013	Swap	1,000 bbls/d	$92.50 (USD)	WTI - NYMEX	(1,263)
Jul 1 to Dec 31, 2013	Swap	350 bbls/d	$96.25 (USD)	WTI - NYMEX	76
Jan 1 to Dec 31, 2014	Swap	1,000 bbls/d	$91.40 (USD)	WTI - NYMEX	546
Apr 1 to Dec 31, 2013	Swap	1,000 bbls/d	$8.35	MSW (EDM) - WTI	(468)
Jul 1 to Dec 31, 2013	Swap	1,000 bbls/d	$7.50	MSW (EDM) - WTI	(303)
Jan 1 to Dec 31, 2014	Swap	500 bbls/d	$94.50	WTI - NYMEX	(181)
Jan 1 to Dec 31, 2015	Swap	250 bbls/d	$91.55	WTI - NYMEX	(17)
Jan 1 to Dec 31, 2015	Swap	250 bbls/d	$92.00	WTI - NYMEX	22
Jan 1 to Dec 31, 2014	Swap	500 bbls/d	$93.80	WTI - NYMEX	(304)
Total					**$ (3,347)**

The following table summarizes the sensitivity of the fair value of the Corporation's market risk management positions to fluctuations in interest rates, foreign exchange rates, and natural gas and crude oil prices. 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 interest rates, foreign exchange rates, and crude oil and natural gas prices would have had the following impact on the net earnings:

Net earnings impact for the period ended June 30, 2013	Price Increase	Price Decrease
Crude Oil - Change of +/- $1.00	$ (1,443)	$ 1,443
Natural Gas - Change of +/- $0.10	$ (220)	$ 220
Interest rate - Change of +/- 100 points	$ 375	$ (375)
Foreign Exchange - Change of +/- $0.01	$ (503)	$ 503

9. BANK DEBT

The Corporation at June 30, 2013, has a $277 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 31, 2014. On May 31, 2014, 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 1.75 percent as at

June 30, 2013 (December 31, 2012 – prime plus 2.00 percent). The facility has been increased subsequent to period end as indicated in note 12.

The facility is secured by a general assignment of book debts, debentures of $500.0 million 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.

Under the terms of the agreement, the Corporation must maintain an adjusted working capital ratio of not less than 1.00:1.00 at all times. The working capital ratio is defined under the current credit facility as cash-based current assets, including the undrawn portion of the facility, to cash-based current liabilities, excluding any current bank indebtedness. The Corporation is compliant with this covenant at June 30, 2013.

10. SHARE CAPITAL

(a) Private Placement

In June 2013, the Corporation completed a private placement for $2.5 million in units with the new President and Chief Executive Officer at a price of $3.57 per unit, each unit consisted of one Common Share and two Common Share purchase warrants. Concurrent with the private placement, the Corporation issued 2.0 million stock appreciation rights ("SAR's") at a price of $3.24 per SAR. The warrants and SAR's are both considered compensatory, for further details see below.

(b) Stock Options

Under the Corporation's stock option plan, it may grant options to its officers, directors, employees and certain consultants for up to 7,191,763 common shares of the Corporation as at June 30, 2013. The exercise price of each option equals the market price of the Corporation's common shares at the date of grant. Options granted have a term of five years to maturity and vest as to one-third on each of the first, second and third anniversaries from the date of grant.

	June 30 2013			December 31, 2012		
	Number of Options	**Weighted average exercise price**		Number of Options	Weighted average exercise price	
Stock options oustanding, beginning of period	**6,580,701**	**$**	**7.53**	4,948,999	$	7.54
Granted	**74,500**	**$**	**4.05**	2,433,450	$	7.49
Exercised	**-**	**$**	**-**	(230,330)	$	6.04
Forfeited	**(746,701)**	**$**	**7.74**	(571,418)	$	8.11
Stock options oustanding, end of period	**5,908,500**	**$**	**7.46**	6,580,701	$	7.53
Exercisable at period-end	**2,570,853**	**$**	**7.11**	2,132,742	$	7.13

The following table summarizes stock options outstanding and exercisable at June 30, 2013:

	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
$1 to $2.99	26,666	$	1.75	0.45	26,666	$	1.75
$3 to $4.99	76,500	$	3.36	3.78	24,000	$	3.20
$5 to $6.99	2,032,667	$	6.39	2.21	1,642,661	$	6.39
$7 to $8.99	2,419,533	$	7.54	3.78	378,170	$	8.01
$9 to $11.15	1,353,134	$	9.26	3.11	499,356	$	9.28
$1 to $11.15	5,908,500	$	7.46	3.07	2,570,853	$	7.11

(c) Warrants

The Corporation has 2,047,272 performance warrants outstanding (December 31, 2012 – 2,074,272) that expire on April 13, 2015. As at June 30, 2013, all 2,047,272 outstanding performance warrants were vested and exercisable at a price of $5.17.

The Corporation in conjunction with the private placement discussed above issued 1,400,560 warrants exercisable at a price of $4.46. The warrants will 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. There are no warrants exercisable as at June 30, 2013.

(d) Stock Appreciation Rights

During the six months ended June 30, 2013, the Corporation issued 2.0 million SAR's exercisable at a price of $3.24 per SAR. The SAR's 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. The SAR's 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 SAR's using a Black Scholes valuation model and will continue to revalue at each reporting period until ultimate cash settlement. The Corporation realized a liability within accounts payable and an offsetting increase to stock-based compensation.

(e) Stock-based compensation

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

	Three Months Ended June 30,				Six Months Ended June 30,			
		2013		2012		**2013**		2012
Stock-based compensation on options and SAR's	**$**	**870**	$	1,658	**$**	**3,070**	$	4,078
Stock-based compensation on warrants	**$**	**3,522**	$	-	**$**	**3,522**	$	-
Capitalized stock-based compensation		**(93)**		(975)		**(1,401)**		(2,429)
Total stock-based compensation expense	**$**	**4,299**	$	683	**$**	**5,191**	$	1,649

The Corporation's stock-based compensation expense for the period ended June 30, 2013 was $5.2 million (June 30, 2012 - $1.6 million), which includes a non-recurring expense of $3.5 million recognized on warrants issued in the June 2013 private placement. A Black-Scholes valuation model was applied to determine the fair value of the options and warrants.

The following assumptions were used to calculate stock-based compensation on options during 2013: zero dividend yield; expected volatility of 69 percent; risk free rate of two percent; forfeiture rate of zero and expected life of five years.

The following assumptions were used to calculate stock-based compensation recognized on warrants in the period: zero dividend yield; expected volatility of 66 percent; risk free rate of one percent; forfeiture rate of zero percent and expected life of five years.

(f) Per share amounts

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Weighted average number of shares - basic	**71,358,171**	71,057,943	**71,288,148**	70,766,027
Effect of dilutive stock options	**-**	1,080,348	**-**	1,403,124
Weighted average number of shares - diluted	**71,358,171**	72,138,291	**71,288,148**	72,169,151

In computing diluted per share amounts at June 30, 2013, 5,908,500 options (June 30, 2012 – 2,482,500), 2,047,272 performance warrants (June 30, 2012 – nil) and 1,400,560 warrants (June 30, 2012 – nil) were excluded from the calculation as their effect was anti-dilutive.

11. CONTINGENCIES

On May 23, 2013 the Corporation reached a settlement agreement, whereby all third party objections to the Corporation's holding applications at its Valhalla property were withdrawn. The negotiated settlement includes compensation by Surge of $4.0 million for gas production from the property over the preceding 30 months and included a commercial arrangement which accounts for and compensates the parties for any future gas obligations and the withdrawal of a lawsuit filed by one of the objectors.

12. SUBSEQUENT EVENTS

On July 3, 2013 the Corporation acquired certain working interest in petroleum and natural gas properties in Saskatchewan for $240 million from a Canadian oil and gas producer. The Corporation paid a deposit of $24 million as a deposit on the properties in June 2013. The Corporation also issued 49,500,000 common shares at a price of $5.00 per common share for aggregate gross proceeds of $247.5 million pursuant to a short form prospectus on July 3, 2013. Concurrent with the acquisition, Surge increased its bank line from $277 million to $350 million.

Subsequent to the second quarter, Surge entered into the following financial oil commodity pricing contracts:

	Term	Type	Volume	Price (C$) (Surge Receives)	Index (Surge pays)
1)	Jul 1, 2013 - Jun 30, 2014	Swap	500bbls/d	101.45	$CAD WTI - NYMEX
2)	Jan 1, 2014 - Jun 30, 2014	Swap	500bbls/d	100.05	$CAD WTI - NYMEX
3)	Jul 1, 2014 - Dec 31, 2014	Swap	500bbls/d	95.90	$CAD WTI - NYMEX
4)	Jan 1, 2015 - Dec 31, 2015	Swap	250bbls/d	92.29	$CAD WTI - NYMEX
5)	Jan 1, 2015 - Dec 31, 2015	Swap	250bbls/d	92.00	$CAD WTI - NYMEX
6)	Aug 1, 2013 - Dec 31, 2013	Swap	500bbls/d	100.00	$CAD WTI - NYMEX
		Call	500bbls/d	101.80	$CAD WTI - NYMEX