Condensed Consolidated Interim Statements of Financial Position

Stated in thousand of dollars

(Unaudited)

As at	March 31, 2017	December 31, 2016
Assets		
Current Assets		
Accounts receivable	**$ 28,240**	$ 29,511
Fair value of financial contracts (note 5)	**702**	—
Prepaid expenses and deposits	**7,478**	2,888
	36,420	32,399
Fair value of financial contracts (note 5)	**399**	—
Exploration and evaluation assets (note 3)	**7,828**	7,828
Petroleum and natural gas properties (note 4)	**1,054,464**	1,041,151
Deferred income taxes	**31,034**	33,879
	$ 1,130,145	$ 1,115,257
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	**$ 31,224**	$ 32,039
Dividends payable	**1,598**	1,411
Fair value of financial contracts (note 5)	**3,163**	12,129
Current portion of other long term obligations	**1,602**	1,406
	37,587	46,985
Fair value of financial contracts (note 5)	**—**	922
Bank debt (note 6)	**181,649**	160,684
Decommissioning obligations (note 7)	**118,865**	120,025
Other long term obligations	**7,270**	7,464
Shareholders' equity		
Share capital	**1,274,208**	1,274,195
Contributed surplus	**43,635**	41,110
Warrants	**3,522**	3,522
Deficit	**(536,591)**	(539,650)
	784,774	779,177
	$ 1,130,145	$ 1,115,257

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 March 31, 2017	2016
Revenues		
Petroleum and natural gas	**$ 54,450**	$ 29,146
Royalties	**(7,037)**	(3,830)
Realized gain (loss) on financial contracts	**(1,990)**	3,982
Unrealized gain on financial contracts (note 5)	**10,989**	7,530
	56,412	36,828
Expenses		
Operating	**17,405**	14,964
Transportation	**1,958**	2,843
General and administrative	**2,409**	2,395
Transaction costs	**558**	186
Stock-based compensation (note 8)	**50**	1,133
Depletion and depreciation (note 4)	**20,725**	21,593
Finance expense	**2,795**	2,396
Gain on disposal of petroleum and natural gas properties (note 4)	**—**	(4,397)
	45,900	41,113
Income (loss) before income taxes	**10,512**	(4,285)
Deferred income tax expense (recovery)	**2,845**	(604)
Net income (loss) and comprehensive income (loss) for the period	**$ 7,667**	$ (3,681)
Income (loss) per share (note 8)		
Basic	**$ 0.03**	$ (0.02)
Diluted	**$ 0.03**	$ (0.02)

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, 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
Balance at December 31, 2016	225,754,665	$ 1,274,195	$ 41,110	$ 3,522	$ (539,650)	$ 779,177
Net income for the period	—	—	—	—	7,667	7,667
Share issue costs, net of tax	—	(41)	—	—	—	(41)
Transfer on exercise of RSAs and PSAs [1]	11,728	54	(54)	—	—	—
Stock-based compensation	—	—	2,579	—	—	2,579
Dividends	—	—	—	—	(4,608)	(4,608)
Balance at March 31, 2017	**225,766,393**	**$ 1,274,208**	**$ 43,635**	**$ 3,522**	**$ (536,591)**	**$ 784,774**

[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, 2017	Three Months Ended March 31, 2016
Cash provided by (used in)		
Operating		
Net income (loss)	**$ 7,667**	$ (3,681)
Gain on disposal of petroleum and natural gas properties	**—**	(4,397)
Unrealized gain on financial contracts	**(10,989)**	(7,530)
Finance expense	**2,795**	2,396
Interest expense	**(2,011)**	(1,606)
Depletion and depreciation	**20,725**	21,593
Decommissioning expenditures	**(576)**	(402)
Stock-based compensation	**(419)**	699
Deferred income tax expense (recovery)	**2,845**	(604)
Change in non-cash working capital	**(4,212)**	(1,097)
Cash flow from operating activities	**15,825**	5,371
Financing		
Bank debt	**20,965**	(23,857)
Dividends paid	**(4,420)**	(8,290)
Share issue costs	**(41)**	—
Cash flow from (used in) financing activities	**16,504**	(32,147)
Investing		
Petroleum and natural gas properties	**(34,041)**	(12,873)
Disposition of petroleum and natural gas properties	**269**	43,178
Acquisitions	**—**	(2,037)
Change in non-cash working capital	**1,443**	(1,492)
Cash flow from (used in) investing activities	**(32,329)**	26,776
Change in cash	**—**	—
Cash, beginning of the period	**—**	—
Cash, end of the period	**$ —**	$ —

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 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

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, 2016. 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, 2016.

The condensed consolidated interim financial statements were authorized for issuance by the Board of Directors on May 10, 2017.

3. EXPLORATION AND EVALUATION ASSETS

Exploration and evaluation 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, 2015	$	11,287
Impairment		(3,459)
Balance at December 31, 2016 and March 31, 2017	**$**	**7,828**

4. PETROLEUM AND NATURAL GAS PROPERTIES

Petroleum and Natural Gas Properties

		Total
Balance at December 31, 2015	$	1,899,671
Acquisitions		20,465
Dispositions		(87,686)
Additions		73,962
Assets under finance lease		6,161
Change in decommissioning obligations		(6,766)
Capitalized stock-based compensation		8,297
Balance at December 31, 2016	$	1,914,104
Dispositions		(269)
Additions		34,041
Change in decommissioning obligations		(1,332)
Capitalized stock-based compensation		1,598
Balance at March 31, 2017	**$**	**1,948,142**

		Total
Accumulated depletion and depreciation		
Balance at December 31, 2015	$	(829,360)
Depletion and depreciation expense		(83,872)
Dispositions		40,279
Balance at December 31, 2016	$	(872,953)
Depletion and depreciation expense		(20,725)
Balance at March 31, 2017	**$**	**(893,678)**

		Total
Carrying amounts		
At December 31, 2016	$	1,041,151
At March 31, 2017	**$**	**1,054,464**

The calculation of depletion and depreciation expense for the period ended March 31, 2017 included an estimated $414.6 million (December 31, 2016 - $435.8 million) for future development costs associated with proved plus probable reserves and deducted $104.2 million (December 31, 2016 - $103.8 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.

Subsequent to March 31, 2017 the Corporation acquired certain petroleum and natural gas properties in Central Alberta for cash consideration of $37.0 million.

5. RISK MANAGEMENT

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 March 31, 2017, the following risk management contracts were outstanding with an asset fair market value of $1.1 million and a liability fair market value of $3.2 million (December 31, 2016 – asset of $nil and liability of $13.1 million):

WTI Oil Hedges

Type	Term	bbl/d	Currency	Floor (per bbl)	Ceiling (per bbl)	Swap Price (per bbl)
WTI	1H 2017	1,000	CAD	—	—	$66.00
WTI	1H 2017[1]	2,500	CAD	$60.00	$71.00	—
WTI	2H 2017[1]	1,500	CAD	$60.00	$78.33	—
WTI	Apr-Dec 2017	1,250	USD	—	—	$55.18
WTI	2H 2017	1,000	USD	$47.00	—	—
WTI	2H 2017	800	USD	—	$59.38	—
WTI	1H 2018	1,000	USD	$47.50	—	—
WTI	1H 2018	600	USD	—	$63.19	—
WTI	1H 2018	1,500	USD	$50.00	$60.87	—
WTI	2H 2018	1,500	USD	$50.00	—	—

Oil Differential Hedges

Type	Term	bbl/d	Currency	Floor (per bbl)	Ceiling (per bbl)	Swap Price (per bbl)
WCS Swap	2017	500	USD	—	—	US$WTI less $22.00
WCS Swap	Apr-Dec 2017	500	USD	—	—	US$WTI less $14.50
WCS Swap (Physical)	Apr-Dec 2017	2,000	USD	US$WTI less $12.75	US$WTI less $18.00	—
MSW (EDM) Swap	2017	2,000	USD	—	—	US$WTI less $3.18

Natural Gas Hedges

Type	Term	mcf/d	Currency	Swap Price (per mcf)
Chicago Swap[2]	Jan-Oct 2017	10,000	CAD	$3.63

CAD/USD FX Hedges

Type	Term	Monthly Notional Amount (US$)	Total Notional Amount (US$)	Swap Rate (CAD$ per USD$)
Avg Rate Forward	Apr-Dec 2017	$2,000,000	$18,000,000	$1.33
Avg Rate Forward	2018	$2,000,000	$24,000,000	$1.30

(1) If market prices settle at or below CAD$50 WTI, the Company will receive a locked-in cash settlement of the market price plus CAD$10 per bbl on 2,500 bbl/d in 1H 2017 and 1,500 bbl/d in 2H 2017.
(2) Surge entered into a Chicago-priced swap as the Company's firm transport contracts settle against the Chicago index.

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 income (loss):

Net earnings impact for the period ended March 31, 2017	**Price Increase**	**Price Decrease**
Crude Oil - Change of +/- $1.00	(3,194)	3,194
Natural Gas - Change of +/- $0.10	(161)	161
Foreign Exchange - Change of +/- $0.01	(30)	30

6. BANK DEBT

As at March 31, 2017, the Corporation had an extendible, revolving term credit facility at $250 million with a syndicate of Canadian banks. Effective April 17, 2017, the facility has been increased to $285 million. The facility is available on a revolving basis until May 28, 2018. On May 28, 2018, 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 March 31, 2017 (December 31, 2016 – prime plus 1.75 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 $297.0 million (December 31, 2016 – $300.1 million). These payments are expected to be made over the next 50 years with the majority of costs to be incurred between 2022 and 2066. A risk free rate of 2.31 percent (December 31, 2016 – 2.31 percent) and an inflation rate of 1.50 percent (December 31, 2016 – 1.50 percent) was used to calculate the fair value of the decommissioning obligations.

A reconciliation of the decommissioning obligations is provided below:

	March 31, 2017	December 31, 2016
Balance, beginning of period	**$ 120,025**	$ 129,827
Liabilities related to acquisitions (note 4)	**—**	3,507
Liabilities related to dispositions (note 4)	**(529)**	(8,076)
Change in estimate	**(1,443)**	(8,943)
Liabilities incurred	**640**	2,177
Accretion expense	**748**	2,804
Decommissioning expenditures	**(576)**	(1,271)
Balance, end of period	**$ 118,865**	$ 120,025

8. SHARE CAPITAL

(a) Authorized

Unlimited number of voting common shares.

Unlimited number of preferred shares, issuable in series.

(b) 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, 2017, 1,400,560 warrants were exercisable.

(c) Stock Appreciation Rights

The Corporation had 2.0 million SAR's outstanding at March 31, 2017. 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, 2017 is $2.09 (December 31, 2016 - $2.11) and 2.0 million 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 $1.4 million (2016 - $0.1 million decrease). There is $1.7 million included in accounts payable at March 31, 2017 (December 31, 2016 - $3.1 million).

(d) 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% (2016 - 15%) was used to value all awards granted for the period ended March 31, 2017. The weighted average fair value of awards granted for the period ended March 31, 2017 is $3.37 (2016 - $1.93) per PSA granted and $3.37 (2016 - $1.92) 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 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, 2017	3,602,528	4,809,052
Granted	102,109	100,000
Reinvested [1]	25,923	34,647
Exercised	(11,728)	—
Forfeited	(25,609)	(3,193)
Balance at March 31, 2017	**3,693,223**	**4,940,506**

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

(e) Stock-based compensation

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

	Three Months Ended March 31,	
	2017	2016
Stock-based compensation on options	**$ —**	$ 3
Stock-based compensation on SARs	**(1,400)**	(114)
Stock-based compensation on PSAs and RSAs [1]	**3,048**	2,627
Capitalized stock-based compensation	**(1,598)**	(1,383)
Total stock-based compensation expense	**$ 50**	$ 1,133

[1] Included in stock-based compensation for the period ended March 31, 2017 is cash expenditures of $0.5 million paid to acquire shares offered to employees and service providers (2016 - $0.4 million).

(f) Per share amounts

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

	Three Months Ended March 31,	
	2017	2016
Weighted average number of shares - basic	**225,763,917**	221,042,468
Effect of dilutive instruments	**3,427,489**	—
Weighted average number of shares - diluted	**229,191,406**	221,042,468

In computing diluted per share amounts at March 31, 2017, 26,000 options (March 31, 2016 – 129,200), 1,400,560 warrants (March 31, 2016 – 1,400,560), nil RSAs (March 31, 2016 – 2,819,020) and 100,513 PSAs (March 31, 2016 – 3,506,607) were excluded from the calculation as their effect was anti-dilutive.

(g) Dividends

The Board of Directors declared for the months of January through March 2017 cumulative dividends of $0.02041 per share (January - March 2016 - $0.0375 per share). Dividends of $0.00708 per share are declared and outstanding at March 31, 2017 and were paid in April 2017. The dividend for April 2017 has been declared at $0.00708 per share.

9. COMMITMENTS

Future minimum payments relating to operating lease and firm transport commitments at March 31, 2017 are as follows:

($000s)	
2017	$ 9,351
2018	8,405
2019	7,886
2020	7,456
2021	5,893
2022+	8,850
Total	**$ 47,841**