

Condensed Consolidated Interim Statements of Financial Position

Stated in thousands of dollars

(Unaudited)

As at	March 31, 2022	December 31, 2021
Assets		
Current Assets		
Accounts receivable	\$ 83,502	\$ 55,738
Fair value of financial contracts (note 5)	241	—
Prepaid expenses and deposits	3,669	3,152
	87,412	58,890
Fair value of financial contracts (note 5)	590	—
Property, plant and equipment (note 4)	1,177,473	1,216,557
	\$ 1,265,475	\$ 1,275,447
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	\$ 97,913	\$ 84,330
Fair value of financial contracts (note 5)	79,323	32,015
Current portion of term debt (note 6)	3,231	3,356
Current portion of convertible debentures (note 7)	43,067	42,612
Current portion of lease and other obligations	7,819	7,703
Current portion of decommissioning obligations (note 8)	10,000	10,000
	241,353	180,016
Fair value of financial contracts (note 5)	276	1,149
Bank debt (note 6)	96,780	98,066
Term debt (note 6)	130,349	130,637
Convertible debentures (note 7)	31,602	31,322
Decommissioning obligations (note 8)	249,906	297,515
Long term lease and other obligations	21,816	23,359
Shareholders' equity		
Share capital	1,654,211	1,654,211
Equity component of convertible debentures (note 7)	6,266	6,266
Contributed surplus	54,025	52,147
Deficit	(1,221,109)	(1,199,241)
	493,393	513,383
Subsequent events (note 11)		
	\$ 1,265,475	\$ 1,275,447

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,	
	2022	2021
Petroleum and natural gas revenue (note 10)	\$ 169,124	\$ 80,694
Processing income (note 10)	1,806	1,089
Royalties	(28,401)	(8,477)
Unrealized loss on financial contracts	(47,982)	(23,500)
Realized loss on financial contracts	(28,809)	(16,822)
	65,738	32,984
Expenses		
Operating	37,454	28,083
Transportation	2,777	1,539
General and administrative	4,032	2,957
Stock-based compensation (note 9)	1,183	932
Depletion and depreciation (note 4)	35,440	21,631
Finance expense	6,889	9,074
Gain on disposals	—	(22,294)
Transaction and other costs	(169)	1,047
	87,606	42,969
Loss before income taxes	(21,868)	(9,985)
Net loss and comprehensive loss for the period	\$ (21,868)	\$ (9,985)
Loss per share (note 9)		
Basic	\$ (0.26)	\$ (0.25)
Diluted	\$ (0.26)	\$ (0.25)

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	Convertible debentures - equity portion	Contributed surplus	Deficit	Total equity
Balance at December 31, 2020	39,974,675	\$ 1,482,249	\$ 6,266	\$ 52,118	\$ (1,606,849)	\$ (66,216)
Net loss for the year	—	—	—	—	(9,985)	(9,985)
Stock-based compensation	—	—	—	1,403	—	1,403
Balance at March 31, 2021	39,974,675	\$ 1,482,249	\$ 6,266	\$ 53,521	\$ (1,616,834)	\$ (74,798)
Balance at December 31, 2021	83,357,221	\$ 1,654,211	\$ 6,266	\$ 52,147	\$ (1,199,241)	\$ 513,383
Net loss for the year	—	—	—	—	(21,868)	(21,868)
Stock-based compensation	—	—	—	1,878	—	1,878
Balance at March 31, 2022	83,357,221	\$ 1,654,211	\$ 6,266	\$ 54,025	\$ (1,221,109)	\$ 493,393

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,	
	2022	2021
Cash provided by (used in)		
Operating		
Net loss	\$ (21,868)	\$ (9,985)
Gain on disposals of property, plant and equipment	—	(22,294)
Unrealized loss on financial contracts	47,982	23,500
Finance expense	6,889	9,074
Interest expense	(6,564)	(8,148)
Depletion and depreciation	35,440	21,631
Decommissioning expenditures	(1,495)	(1,481)
Transaction and other costs (income)	(324)	(653)
Stock-based compensation	1,183	932
Change in non-cash working capital	(9,061)	2,974
Cash flow from operating activities	52,182	15,550
Financing		
Bank debt	(1,286)	(90,258)
Term debt	(848)	7,500
Payments on lease obligations	(1,427)	(2,139)
Cash flow used in financing activities	(3,561)	(84,897)
Investing		
Expenditures on property, plant and equipment	(42,968)	(31,898)
Cash from dispositions	—	102,591
Change in non-cash working capital	(5,653)	(1,346)
Cash flow used in investing activities	(48,621)	69,347
Change in cash	—	—
Cash, beginning of the year	—	—
Cash, end of the year	\$ —	\$ —

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

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. Surge's common shares are traded on the Toronto Stock Exchange ("TSX") under the symbol SGY. The consolidated financial statements include the accounts of the Corporation and its wholly-owned subsidiaries.

2. BASIS OF PREPARATION

(a) 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, 2021. 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, 2021.

The condensed consolidated interim financial statements were authorized for issuance by the Board of Directors on May 5, 2022.

3. SIGNIFICANT ACCOUNTING POLICIES

These condensed consolidated interim financial statements at March 31, 2022 have been prepared following the same accounting policies as the consolidated financial statements as at December 31, 2021.

4. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment

	Total
Balance at December 31, 2020	\$ 2,760,494
Acquisitions	282,631
Dispositions	(375,755)
Additions	103,786
Right of use assets	2,056
Change in decommissioning obligations	29,521
Capitalized stock-based compensation	1,951
Balance at December 31, 2021	\$ 2,804,684
Additions	42,968
Change in decommissioning obligations	(47,307)
Capitalized stock-based compensation	695
Balance at March 31, 2022	\$ 2,801,040

	Total
Accumulated depletion and depreciation	
Balance at December 31, 2020	\$ (2,087,579)
Depletion and depreciation expense	(112,217)
Impairment reversal	333,475
Dispositions	278,194
Balance at December 31, 2021	\$ (1,588,127)
Depletion and depreciation expense	(35,440)
Balance at March 31, 2022	\$ (1,623,567)

	Total
Carrying amounts	
At December 31, 2021	\$ 1,216,557
At March 31, 2022	\$ 1,177,473

Under IFRS, deferred income tax assets may only be recognized to the extent that it is probable that future taxable profits will be available against which the unused tax losses and deductible temporary differences can be utilized. Accordingly, the Corporation has not recognized a total deferred income tax asset of approximately \$120.0 million as at March 31, 2022.

5. RISK MANAGEMENT

At March 31, 2022, the following risk management contracts were outstanding with an asset fair market value of \$0.8 million and a liability fair market value of \$79.6 million (December 31, 2021 – asset of nil and liability of \$33.2 million):

West Texas Intermediate Crude Oil Derivative Contracts (WTI)

Period	Swaps		Collars			Three-way Collar			
	Volumes (bbls/d)	Average Price (CAD/bbl)	Volumes (bbls/d)	Average Bought Put (CAD/bbl)	Average Sold Call (CAD/bbl)	Volumes (bbls/d)	Average Sold Put (CAD/bbl)	Average Bought Put (CAD/bbl)	Average Sold Call (CAD/bbl)
Qtr. 2 2022	7,000	\$78.12	—	—	—	1,500	\$57.51	\$67.51	\$88.98
Qtr. 3 2022	4,000	\$78.04	2,000	\$71.89	\$104.11	—	—	—	—
Qtr. 4 2022	4,000	\$77.56	2,500	\$75.02	\$103.30	—	—	—	—
Qtr. 1 2023	—	—	3,000	\$68.76	\$98.17	—	—	—	—
Qtr. 2 2023	—	—	1,154	\$81.27	\$161.46	—	—	—	—

Western Canadian Select Derivative Contracts (WCS)

Period	Swaps	
	Volumes (bbls/d)	Average Price (CAD/bbl)
Qtr. 2 2022	4,000	\$(16.28)
Qtr. 3 2022	4,000	\$(16.31)
Qtr. 4 2022	2,500	\$(16.68)

Mixed Sweet Blend Derivative Contracts (MSW)

Period	Swaps	
	Volumes (bbls/d)	Average Price (CAD/bbl)
Qtr. 2 2022	4,500	\$(5.89)
Qtr. 3 2022	4,500	\$(5.89)
Qtr. 4 2022	4,500	\$(5.89)

Natural Gas Derivative Contracts

Period	AECO Swaps		AECO Collars		
	Volumes (GJ/d)	Average Price (CAD/GJ)	Volumes (GJ/d)	Average Bought Put (CAD/GJ)	Average Sold Call (CAD/GJ)
Qtr. 2 2022	3,500	\$3.26	—	—	—
Qtr. 3 2022	3,500	\$3.26	—	—	—
Qtr. 4 2022	4,500	\$3.48	2,500	\$2.90	\$3.67
Qtr. 1 2023	4,000	\$3.66	2,000	\$2.90	\$3.91
Qtr. 2 2023	—	—	4,000	\$2.75	\$3.67
Qtr. 3 2023	—	—	2,000	\$2.75	\$3.73
Qtr. 4 2023	—	—	674	\$2.75	\$3.73

Interest Rate Derivative Contracts

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 1. Beginning at 1.786% 2. Ending at 2.714% 3. Averaging 2.479%
Fixed-to-Floating 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 interest rates. All such fluctuations were evaluated independently, with all other variables held constant. Fluctuations in the following on the respective derivative contracts would have had the following impact on the net earnings:

Net earnings impact for the period ended March 31, 2022	Increase	Decrease
Crude Oil - Change of +/- \$1.00	\$ (3,463)	\$ 3,463
Natural Gas - Change of +/- \$0.10	\$ (187)	\$ 187
Interest rate - Change of +/- 100 points	\$ 1,155	\$ (1,155)

6. DEBT

Bank Debt

As at March 31, 2022, the Corporation had a total commitment of \$150 million, being the aggregate of a committed revolving term facility of \$120 million and an operating loan facility of \$30 million, with a syndicate of banks. A review and redetermination of the borrowing base is scheduled to occur semi-annually on or before June 30 and November 30 of each year. The facility is available on a revolving basis until November 30, 2022. On November 30, 2022, 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.

Term Debt

As at March 31, 2022, the Corporation had a term loan of \$129.2 million, excluding unamortized issue costs. The loan is a five year, non-revolving second lien term facility, maturing on December 9, 2026. The principal amount is repayable in scheduled quarterly repayments, which commenced on March 31, 2022.

Financial Covenants

The Corporation is subject to certain financial covenants under the first lien and second lien facilities. As at March 31, 2022, the Corporation was compliant with all restrictions and covenants in its first and second lien credit agreements.

Emissions Reduction Fund

As at March 31, 2022, the Corporation had a \$6.7 million (December 31, 2021 - \$6.6 million) loan repayable relating to the Government of Canada Emissions Reduction Fund ("ERF"). As at March 31, 2022, the Corporation has received \$3.4 million (December 31, 2021 - \$1.04 million) of funds from ERF for the Company's planned gas emissions reduction program.

7. CONVERTIBLE DEBENTURES

	Number of convertible debentures	Liability Component	Equity Component
Balance at December 31, 2020	79,000	\$ 71,181	\$ 6,266
Accretion of discount	—	2,754	—
Balance at December 31, 2021	79,000	73,935	6,266
Accretion of discount	—	734	—
Balance at March 31, 2022	79,000	\$ 74,669	\$ 6,266

The fair value of the convertible debentures at March 31, 2022 was \$79.8 million using quoted market prices on the TSX (level 1 fair value).

8. 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. A risk free rate of 2.37 percent (December 31, 2021 – 1.68 percent) and an inflation rate of 1.83 percent (December 31, 2021 – 1.82 percent) was used to calculate the decommissioning obligations.

A reconciliation of the decommissioning obligations is provided below:

	March 31, 2022	December 31, 2021
Balance, beginning of year	\$ 307,515	\$ 294,655
Liabilities related to acquisitions	—	4,825
Liabilities related to dispositions	—	(13,842)
Change in estimate ⁽¹⁾	(48,421)	26,396
Liabilities incurred	1,114	3,125
Accretion expense	1,536	4,980
Site rehabilitation program grant	(343)	(5,886)
Decommissioning expenditures	(1,495)	(6,738)
Balance, end of year	\$ 259,906	\$ 307,515
Expected to be incurred within one year	10,000	10,000
Expected to be incurred beyond one year	\$ 249,906	\$ 297,515

⁽¹⁾The change in estimate was primarily the result of the change in discount and inflation rates.

During the period ended March 31, 2022, approximately \$0.3 million was granted to Surge through the Alberta Site Rehabilitation Program ("SRP") to pay service companies to complete abandonment and reclamation work.

9. SHARE CAPITAL

(a) 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.

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, 2021	1,625,461	2,116,952
Granted	76,900	12,600
Forfeited	(8,823)	—
Balance at March 31, 2022	1,693,538	2,129,552

The weighted average fair value of awards granted for the period ended March 31, 2022 is \$6.29 (2021 - nil) per PSA granted and \$6.82 (2021 - nil) 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.

(b) Stock-based compensation

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

	Three Months Ended March 31,	
	2022	2021
Stock-based compensation on PSAs and RSAs	\$ 1,878	\$ 1,403
Capitalized stock-based compensation	(695)	(471)
Total stock-based compensation expense	\$ 1,183	\$ 932

(c) Per share amounts

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

	Three Months Ended March 31,	
	2022	2021
Weighted average number of shares - basic and diluted	83,357,221	39,974,675

In computing diluted per share amounts at March 31, 2022 and 2021, 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.

10. REVENUE

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

	Three Months Ended March 31,	
	2022	2021
Oil	\$ 157,440	\$ 69,956
Natural gas liquids	4,053	1,948
Natural gas	7,631	8,790
Total petroleum and natural gas revenue	\$ 169,124	\$ 80,694
Processing	1,806	1,089
Total petroleum, natural gas and processing revenue	\$ 170,930	\$ 81,783

Surge's revenue was generated entirely in the provinces of Alberta, Saskatchewan, and Manitoba. 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 \$81.8 million for the period ended March 31, 2022 (March 31, 2021 - \$59.6 million).

11. SUBSEQUENT EVENT

Subsequent to March 31, 2022, the Corporation's term debt facility provider exercised their right to deliver an additional \$30 million of term debt financing (under the same terms and conditions as the existing 5-year term debt facility). This additional financing was received on May 3, 2022.

Concurrently, the Company has also reconfirmed and extended its existing \$150 million First Lien Credit Facility. The maturity of the newly reconfirmed First Lien Credit Facility is now extended through to May 31, 2024.