

Condensed Consolidated Interim Statements of Financial Position

Stated in thousands of dollars

(Unaudited)

As at	June 30, 2022	December 31, 2021
Assets		
Current Assets		
Accounts receivable	\$ 80,589	\$ 55,738
Fair value of financial contracts (note 5)	1,146	—
Prepaid expenses and deposits	4,227	3,152
	85,962	58,890
Fair value of financial contracts (note 5)	821	—
Property, plant and equipment (note 4)	1,133,577	1,216,557
	\$ 1,220,360	\$ 1,275,447
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	\$ 102,172	\$ 84,330
Dividends payable	2,918	—
Fair value of financial contracts (note 5)	47,424	32,015
Current portion of term debt (note 6)	4,809	3,356
Current portion of convertible debentures (note 7)	43,532	42,612
Current portion of lease and other obligations	7,937	7,703
Current portion of decommissioning obligations (note 8)	10,000	10,000
	218,792	180,016
Fair value of financial contracts (note 5)	119	1,149
Bank debt (note 6)	22,254	98,066
Term debt (note 6)	157,371	130,637
Convertible debentures (note 7)	31,891	31,322
Decommissioning obligations (note 8)	205,294	297,515
Long term lease and other obligations	20,244	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	55,918	52,147
Deficit	(1,152,000)	(1,199,241)
	564,395	513,383
Commitments (note 11)		
	\$ 1,220,360	\$ 1,275,447

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

Condensed Consolidated Interim Statements of Income and Comprehensive Income

Stated in thousands of dollars, except per share amounts

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2022	2021	2022	2021
Petroleum and natural gas revenue (note 10)	\$ 212,999	\$ 80,884	\$ 382,123	\$ 161,578
Processing income (note 10)	1,569	1,172	3,375	2,261
Royalties	(37,734)	(11,073)	(66,135)	(19,550)
Unrealized gain (loss) on financial contracts	31,783	(5,497)	(16,199)	(28,997)
Realized loss on financial contracts	(45,966)	(20,911)	(74,775)	(37,733)
	162,651	44,575	228,389	77,559
Expenses				
Operating	38,189	25,785	75,643	53,868
Transportation	3,095	1,293	5,872	2,832
General and administrative	4,186	3,041	8,218	5,998
Stock-based compensation (note 9)	1,210	1,177	2,393	2,109
Depletion and depreciation (note 4)	36,023	21,558	71,463	43,189
Impairment reversal	—	(323,640)	—	(323,640)
Finance expense	8,335	7,816	15,224	16,890
Gain on disposals	—	—	—	(22,294)
Transaction and other costs (income)	(414)	432	(583)	1,479
	90,624	(262,538)	178,230	(219,569)
Income before income taxes	72,027	307,113	50,159	297,128
Net income and comprehensive income for the period	\$ 72,027	\$ 307,113	\$ 50,159	\$ 297,128
Income per share (note 9)				
Basic	\$ 0.86	\$ 7.24	\$ 0.60	\$ 7.21
Diluted	\$ 0.83	\$ 7.01	\$ 0.58	\$ 7.03

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 income for the year	—	—	—	—	297,128	297,128
Share issue costs, net of tax	—	(2,089)	—	—	—	(2,089)
Flow-through shares issued	4,586,471	23,001	—	—	—	23,001
Premium on flow-through shares	—	(3,119)	—	—	—	(3,119)
Transfer on exercise of RSAs and PSAs ⁽¹⁾	97,016	683	—	(683)	—	—
Stock-based compensation	—	—	—	3,198	—	3,198
Balance at June 30, 2021	44,658,162	\$ 1,500,725	\$ 6,266	\$ 54,633	\$ (1,309,721)	\$ 251,903
Balance at December 31, 2021	83,357,221	\$ 1,654,211	\$ 6,266	\$ 52,147	\$ (1,199,241)	\$ 513,383
Net income for the year	—	—	—	—	50,159	50,159
Stock-based compensation	—	—	—	3,771	—	3,771
Dividends	—	—	—	—	(2,918)	(2,918)
Balance at June 30, 2022	83,357,221	\$ 1,654,211	\$ 6,266	\$ 55,918	\$ (1,152,000)	\$ 564,395

⁽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 June 30,		Six Months Ended June 30,	
	2022	2021	2022	2021
Cash provided by (used in)				
Operating				
Net income	\$ 72,027	\$ 307,113	\$ 50,159	\$ 297,128
Gain on disposals of property, plant and equipment	—	—	—	(22,294)
Unrealized (gain) loss on financial contracts	(31,783)	5,497	16,199	28,997
Finance expense	8,335	7,816	15,224	16,890
Interest expense	(6,837)	(6,396)	(13,401)	(14,544)
Depletion and depreciation	36,023	21,558	71,463	43,189
Impairment (reversal)	—	(323,640)	—	(323,640)
Decommissioning expenditures	(501)	(1,063)	(1,996)	(2,544)
Transaction and other costs (income)	(478)	(453)	(802)	(1,106)
Stock-based compensation	1,210	1,177	2,393	2,109
Change in non-cash working capital	(2,198)	(3,355)	(11,259)	(381)
Cash flow from operating activities	75,798	8,254	127,980	23,804
Financing				
Bank debt	(74,526)	(8,332)	(75,812)	(98,590)
Term debt	28,135	—	27,287	7,500
Dividends paid	(2,918)	—	(2,918)	—
Issuance of flow-through shares	—	23,001	—	23,001
Payments on lease obligations	(1,453)	(2,126)	(2,880)	(4,265)
Share issue costs	—	(2,089)	—	(2,089)
Change in non-cash working capital	2,918	—	2,918	—
Cash flow used in financing activities	(47,844)	10,454	(51,405)	(74,443)
Investing				
Expenditures on property, plant and equipment	(36,890)	(15,500)	(79,858)	(47,398)
Cash from dispositions	32	—	32	102,591
Change in non-cash working capital	8,904	(3,208)	3,251	(4,554)
Cash flow used in investing activities	(27,954)	(18,708)	(76,575)	50,639
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 July 27, 2022.

3. SIGNIFICANT ACCOUNTING POLICIES

These condensed consolidated interim financial statements at June 30, 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
Dispositions	(32)
Additions	79,858
Right of use assets	(252)
Change in decommissioning obligations	(92,469)
Capitalized stock-based compensation	1,378
Balance at June 30, 2022	\$ 2,793,167

	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	(71,463)
Balance at June 30, 2022	\$ (1,659,590)

	Total
Carrying amounts	
At December 31, 2021	\$ 1,216,557
At June 30, 2022	\$ 1,133,577

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 \$103.8 million as at June 30, 2022.

5. RISK MANAGEMENT

At June 30, 2022, the following risk management contracts were outstanding with an asset fair market value of \$2.0 million and a liability fair market value of \$47.5 million (December 31, 2021 – asset of nil and liability of \$33.2 million):

West Texas Intermediate Crude Oil Derivative Contracts (WTI)

Period	Swaps		Collars		
	Volumes (bbls/d)	Average Price (CAD/bbl)	Volumes (bbls/d)	Average Bought Put (CAD/bbl)	Average Sold Call (CAD/bbl)
Qtr. 3 2022	4,000	\$79.83	2,000	\$74.01	\$107.19
Qtr. 4 2022	4,000	\$79.33	2,500	\$77.23	\$106.35
Qtr. 1 2023	—	—	5,500	\$76.65	\$138.21
Qtr. 2 2023	—	—	5,665	\$83.67	\$172.03
Qtr. 3 2023	—	—	4,500	\$83.67	\$187.36

Western Canadian Select Derivative Contracts (WCS)

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

Natural Gas Derivative Contracts

Period	NYMEX Collars			NYMEX - AECO Basis Swaps		AECO Swaps		AECO Collars		
	Volumes (MMBtu/d)	Average Bought Put (CAD/MMBtu)	Average Sold Call (CAD/MMBtu)	Volumes (MMBtu/d)	Average Price (CAD/MMBtu)	Volumes (GJ/d)	Average Price (CAD/GJ)	Volumes (GJ/d)	Average Bought Put (CAD/GJ)	Average Sold Call (CAD/GJ)
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	1,000	\$5.15	\$10.62	1,000	\$(1.72)	—	—	4,000	\$2.75	\$3.67
Qtr. 3 2023	3,000	\$5.15	\$10.62	3,000	\$(1.85)	—	—	2,000	\$2.75	\$3.73
Qtr. 4 2023	3,000	\$5.15	\$10.62	3,000	\$(1.85)	—	—	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 June 30, 2022	Increase	Decrease
Crude Oil - Change of +/- \$1.00	\$ (3,080)	\$ 3,080
Natural Gas - Change of +/- \$0.10	\$ (2,620)	\$ 2,620
Interest rate - Change of +/- 100 points	\$ 1,155	\$ (1,155)

6. DEBT

Bank Debt

As at June 30, 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, with the option of the facilities being extended for a further 364-day period at the request of the Corporation and subject to the approval of the syndicate. During the period, the Corporation 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.

Term Debt

As at June 30, 2022, the Corporation had a term loan of \$158.4 million, excluding unamortized issue costs. During the period, 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). 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. The Corporation is required to make an additional principal repayment of \$0.8 million in each calendar month in which a shareholder distribution is paid.

Financial Covenants

The Corporation is subject to certain financial covenants under the first lien and second lien facilities. As at June 30, 2022, the Corporation was compliant with all restrictions and covenants in its first and second lien credit agreements.

Emissions Reduction Fund

As at June 30, 2022, the Corporation had a \$6.9 million (December 31, 2021 - \$6.6 million) loan repayable relating to the Government of Canada Emissions Reduction Fund (“ERF”). As at June 30, 2022, the Corporation has received \$9.6 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	—	1,488	—
Balance at June 30, 2022	79,000	\$ 75,423	\$ 6,266

The fair value of the convertible debentures at June 30, 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 3.14 percent (December 31, 2021 – 1.68 percent) and an implied inflation rate of 1.8 percent (December 31, 2021 – 1.82 percent) was used to calculate the decommissioning obligations.

A reconciliation of the decommissioning obligations is provided below:

	June 30, 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⁾	(94,121)	26,396
Liabilities incurred	1,652	3,125
Accretion expense	3,219	4,980
Site rehabilitation program grant	(975)	(5,886)
Decommissioning expenditures	(1,996)	(6,738)
Balance, end of period	\$ 215,294	\$ 307,515
Expected to be incurred within one year	10,000	10,000
Expected to be incurred beyond one year	\$ 205,294	\$ 297,515

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

During the period ended June 30, 2022, approximately \$1.0 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	93,600	15,600
Forfeited	(71,040)	(19,862)
Balance at June 30, 2022	1,648,021	2,112,690

The weighted average fair value of awards granted for the period ended June 30, 2022 is \$11.54 (2021 - \$5.02) per PSA granted and \$11.25 (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 June 30,		Six Months Ended June 30,	
	2022	2021	2022	2021
Stock-based compensation on PSAs and RSAs	1,893	1,795	\$ 3,771	\$ 3,198
Capitalized stock-based compensation	(683)	(618)	(1,378)	(1,089)
Total stock-based compensation expense	\$ 1,210	\$ 1,177	\$ 2,393	\$ 2,109

(c) Per share amounts

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2022	2021	2022	2021
Weighted average number of shares - basic	83,357,221	42,444,687	83,357,221	41,216,504
Effect of dilutive instruments	2,917,383	1,348,020	2,666,486	1,078,334
Weighted average number of shares - basic and diluted	86,274,604	43,792,707	86,023,707	42,294,838

In computing diluted per share amounts at June 30, 2022, 16,700 (2021 - 30,000) RSAs and 3,000 (2021 - nil) 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.

(d) Dividend

The Board of Directors declared a dividend of \$0.035 per share for the month of June 2022 (January - June 2021 - nil per share). Dividends of \$0.035 per share were declared and outstanding at June 30, 2022 and were paid in July 2022.

10. REVENUE

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2022	2021	2022	2021
Oil	196,470	\$ 76,411	\$ 353,910	\$ 146,367
Natural gas liquids	4,939	1,827	8,992	3,775
Natural gas	11,590	2,646	19,221	11,436
Total petroleum and natural gas revenue	\$ 212,999	\$ 80,884	\$ 382,123	\$ 161,578
Processing	1,569	1,172	3,375	2,261
Total petroleum, natural gas and processing revenue	\$ 214,568	\$ 82,056	\$ 385,498	\$ 163,839

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 \$209.5 million for the six months ended June 30, 2022 (June 30, 2021 - \$121.1 million).

11. COMMITMENTS

During the period, the Corporation signed a new nine year office lease, commencing in 2023, for a total commitment of \$13.7 million.