## FINANCIAL AND OPERATING SUMMARY

($000s except per share amounts)

| | Three Months Ended March 31, | | |
|---|---|---|---|
| | **2013** | 2012 | % change |
| **Financials highlights** | | | |
| Oil and NGL sales | **48,216** | 47,366 | 2% |
| Natural gas sales | **5,355** | 3,678 | 46% |
| Other revenue | **11** | 16 | (31%) |
| Total oil, natural gas, and NGL revenue | **53,582** | 51,060 | 5% |
| Funds from Operations[1] | **25,237** | 24,007 | 5% |
| Per share basic ($) | **0.35** | 0.34 | 3% |
| Per share diluted ($) | **0.35** | 0.33 | 6% |
| Net income (loss)[4] | **(1,354)** | 2,657 | nm |
| Per share basic ($) | **(0.02)** | 0.04 | nm |
| Per share diluted ($) | **(0.02)** | 0.04 | nm |
| Capital expenditures - petroleum & gas properties[2] | **40,065** | 54,898 | (27%) |
| Capital expenditures - acquisitions & dispositions[2] | **(807)** | 104,398 | nm |
| Total capital expenditures[2] | **39,258** | 159,296 | (75%) |
| Net debt at end of period[3] | **234,795** | 158,769 | 48% |
| **Operating highlights** | | | |
| Production: | | | |
| Oil and NGL (bbls per day) | **6,854** | 6,110 | 12% |
| Natural gas (mcf per day) | **16,689** | 17,398 | (4%) |
| Total (boe per day) (6:1) | **9,636** | 9,009 | 7% |
| Average realized price (excluding hedges): | | | |
| Oil and NGL ($per bbl) | **78.18** | 85.19 | (8%) |
| Natural gas ($ per mcf) | **3.57** | 2.32 | 54% |
| Realized loss on financial contracts ($ per boe) | **(0.46)** | (0.94) | (51%) |
| **Net back (excluding hedges) ($ per boe)** | | | |
| Oil, natural gas and NGL sales | **61.78** | 62.28 | (1%) |
| Royalties | **(10.93)** | (12.22) | (11%) |
| Operating expenses | **(12.58)** | (11.66) | 8% |
| Transportation expenses | **(2.25)** | (1.78) | 26% |
| Operating netback | **36.02** | 36.62 | (2%) |
| G&A expenses | **(3.20)** | (3.63) | (12%) |
| Interest expense | **(2.72)** | (1.75) | 55% |
| Corporate netback | **30.10** | 31.24 | (4%) |
| **Common shares (000s)** | | | |
| Common shares outstanding, end of period | **71,217** | 71,033 | 0% |
| Weighted average basic shares outstanding | **71,217** | 70,474 | 1% |
| Stock option dilution (treasury method) | **-** | 1,711 | nm |
| Weighted average diluted shares outstanding | **71,217** | 72,185 | (1%) |

1 Management uses funds from operations (cash flow from operations before changes in non-cash working capital) to analyze operating performance and leverage. Funds from operations as presented does not have any standardized meaning prescribed by IFRS and, therefore, may not be comparable with the calculation of similar measures for other entities.

2 Please see capital expenditures note.

3 The Corporation defines net debt as outstanding bank debt plus or minus working capital excluding the fair value of financial contracts.

4 The Corporation views this change calculation as not meaningful, or "nm".

## OVERVIEW, ACHIEVEMENTS AND HIGHLIGHTS

Surge has achieved excellent growth year to date in 2013. Funds from operations increased five percent compared to the same time period in 2012 and five percent as compared to the fourth quarter of 2012. Funds from operations per fully diluted share increased six percent compared to the same time period in 2012 and three percent as compared to the fourth quarter of 2012. Production grew seven percent compared to the same time period in 2012 and eight percent as compared to the fourth quarter of 2012. Management continues to execute a strong risk management program which supports the protection of Surge's balance sheet. The Corporation currently has 53 percent of its forecast 2013 oil and NGL production (after royalties) hedged with an average WTI floor price of $93.43 per barrel.

Surge invested a total of $39.3 million in the first quarter, $27.6 million of which was allocated to drilling 15 gross (10.95 net) oil wells which achieved a 93 percent success rate. The 15 gross wells drilled during the quarter include five wells in North Dakota, six wells in South East Alberta, two wells in Valhalla, and two wells in Nipisi. Twelve of the 15 gross wells drilled in the first quarter were on production at quarter end, with the remainder to be brought on production during the second quarter of 2013. In addition to drilling operations, Surge commenced a pilot waterflood at Waskada during the first quarter with positive response expected within six months. Based on successful waterflood implementation, Surge estimates potential recoveries of approximately 20 percent of the 10 million barrels of internally estimated DPIIP per section.

Based on the successful step-out drilling completed during the first quarter, the Corporation was able to confirm an additional 80 mmbbls of internally estimated DPIIP and more than 40 oil drilling locations to the Corporation's portfolio. The four step-out wells that account for the confirmed additional DPIIP are:

- A horizontal multi-frac step-out well, two miles north from its previous most northerly well, at Valhalla that confirmed the extension of the pool to the north;
- A horizontal step-out well at Nipisi South that confirmed the commercial viability of the 30 million barrels of internally estimated DPIIP in the pool;
- A horizontal multi-frac well into a new pool in the Silver Area of South East Alberta that confirms the commercial viability of the 47 million barrels of internally estimated DPIIP in this pool; and
- A horizontal well that was drilled into another new pool in the Silver Lake Area that confirmed the commercial viability of the 2.2 million barrels of internally estimated DPIIP in this pool.

Additionally, Surge continues to achieve operational and general and administrative efficiencies and continues to strive to become one of the lowest cost oil producers among its oil weighted peer group.

Management continues to protect Surge's balance sheet with a strong risk management program. Surge remains well positioned with three core areas with an expanded oil drilling inventory of 585 gross (450 net) locations, internally estimated gross DPIIP[1] of greater than 685 million barrels of oil and multiple waterflood opportunities and exploration initiatives.

Highlights for the quarter include:

- **Funds from operations increased five percent** to $25.2 million during the first quarter of 2013 from $24.0 million during the same period of 2012.
- **Funds from operations per fully diluted share increased six percent** during the first quarter of 2013 to $0.35 compared to the same period in 2012.
- **Increased production by seven percent** to 9,636 boe per day during the first quarter of 2013 from 9,009 boe per day during the first quarter of 2012.
- **Reduced G&A per boe by 12 percent** in the first quarter of 2013 as compared to the same period of 2012.

[1] Discovered Petroleum Initially In Place (DPIIP) is defined as quantity of hydrocarbons that are estimated to be in place within a known accumulation, plus those estimated quantities in accumulations yet to be discovered. There is no certainty that it will be commercially viable to produce any portion of the resources. A recovery project cannot be defined for this volume of DPIIP at this time, and as such it cannot be further sub-categorized.

- **Achieved a 93 percent success rate** drilling 15 gross (10.95 net) wells in the first quarter of 2013.
- **Surge realized a 71 percent** oil and natural gas liquids production weighting in the first quarter of 2013.
- **Approximately 90 percent of Surge's revenue resulted from oil and natural gas liquids production**, in the first quarter of 2013 with approximately 10 percent derived from natural gas production.

### Netback Comparison

| | **Q1 2013** | Q4 2012 | Q3 2012 | Q2 2012 | Q1 2012 |
|---|---|---|---|---|---|
| Average production (boe per day) | **9,636** | 8,919 | 8,292 | 9,275 | 9,009 |
| Revenue | **$ 61.78** | $ 60.24 | $ 56.70 | $ 57.97 | $ 62.28 |
| Royalties | **(10.93)** | (11.36) | (9.96) | (9.69) | (12.22) |
| Operating costs | **(12.58)** | (12.68) | (11.48) | (10.63) | (11.66) |
| Transportation costs | **(2.25)** | (2.56) | (2.07) | (2.59) | (1.78) |
| **Operating netback** | **$ 36.02** | $ 33.64 | $ 33.19 | $ 35.06 | $ 36.62 |

## OUTLOOK

In three years, Surge has assembled more than 585 gross (450 net) oil drilling locations, made significant progress in reducing its cost structure, increasing netbacks and gaining exposure to an internally estimated DPIIP of more than 685 gross million barrels of oil. The Company also has multiple waterflood opportunities and exploration initiatives in its portfolio and remains well positioned to meet or exceed guidance for the remainder of the year.

With the Corporation's 2013 budget, Surge expects to achieve greater than 15 percent growth in average production per share and funds from operations per share while improving its balance sheet. Based on Surge's 2013 guidance, the Company is forecasting growth in funds from operations per basic share of more than 235 percent since the Company was recapitalized in 2010 with a compound annual growth rate of 50 percent over that time. Surge is forecasting growth in production per basic share of more than 70 percent since 2010 with a compound annual growth rate of 20 percent over that time.

In 2013, management's primary goals for Surge include improving operational performance, improving capital efficiencies, maintaining balance sheet flexibility with an effective risk management program and confirming the commercial viability of the Company's waterflood program. The implementation of the waterflood pilots are an integral piece of Surge's strategy of increasing oil recovery factors throughout the Company's oil portfolio, lowering corporate decline rates and maximizing shareholder value. To date, significant progress has been made on four of Surge's waterflood opportunities:

- In the Silver Area of South East Alberta during 2012, Surge converted two wells to water injection wells and increased facility capacity to handle an additional 12,000 barrels of water per day. As a result, field production increased from approximately 1,100 barrels of oil per day to 1,300 barrels of oil per day. The Corporation plans to optimize its existing waterflood facilities, build new facilities and submit applications to commence new waterfloods in the area.

- At Windfall in Western Alberta, Surge commenced a waterflood pilot during the third quarter of 2012. The Bluesky Formation has been taking the water at rates that are in line with the Company's expectations. Surge expects to see a positive response from the two offsetting horizontal multi-frac wells in the second quarter of 2013. Based on successful waterflood implementation, Surge estimates potential recoveries of approximately 25 percent of the 60 million barrels of internally estimated DPIIIP in this pool.

- At Waskada in South West Manitoba, Surge commenced a pilot waterflood during the first quarter of 2013 and the Corporation expects to see a positive response within six months. Based on successful waterflood implementation, Surge estimates potential recoveries of approximately 20 percent of the 10 million barrels of internally estimated DPIIP per section.

- At Nipisi in Western Alberta, the Corporation has received approval to commence a waterflood, which is planned for the second quarter of 2013. Based on successful waterflood implementation, Surge estimates that it will ultimately recover at least 20 percent of the estimated 85 million barrels of DPIIP in this northern pool based on offsetting analogous waterflooded pools.

Surge is committed to delivering top quartile corporate performance and creating value for shareholders by growing reserves, cash flow and production on a per share basis.

Surge is an oil focused oil and gas company with operations throughout Alberta, Manitoba and North Dakota. Surge's common shares trade on the Toronto Stock Exchange under the symbol SGY. At quarter end, the Corporation had 71.2 million basic and 79.8 million fully diluted common shares outstanding.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

This Management's Discussion and Analysis (MD&A) of the interim condensed consolidated financial position and results of operations of Surge Energy Inc. ("Surge" or the "Corporation"), which includes its subsidiaries and partnership arrangements, is for the three months ended March 31, 2013 and 2012. For a full understanding of the financial position and results of operations of the Corporation, the MD&A should be read in conjunction with the documents filed on SEDAR, including historical financial statements, MD&A and the Annual Information Form (AIF). These documents are available at www.sedar.com.

## FORWARD-LOOKING STATEMENTS

This MD&A contains forward-looking statements.

More particularly, this MD&A contains statements concerning anticipated: (1) capital expenditures for 2013, (2) exploration, development, and acquisition activities, (3) average and exit oil, NGLs and natural gas production for 2013, (4) production weighting for 2013 (5) construction of new facilities, (6) funds from operations, (7) debt and bank facilities, (8) operating and transportation costs, (9) the availability and successful completion of acquisitions, (10) drilling locations, (11) primary and secondary recovery potentials and implementation thereof, (12) hedging results, (13) capital efficiencies and (14) decline rates. The forward-looking statements are based on certain key expectations and assumptions made by Surge, including expectations and assumptions concerning the performance of existing wells and success obtained in drilling new wells, anticipated expenses, cash flow and capital expenditures, the application of regulatory and royalty regimes, prevailing commodity prices and economic conditions, development and completion activities, the performance of new wells, the successful implementation of waterflood programs, the availability of and performance of facilities and pipelines, the geological characteristics of Surge's properties, the successful application of drilling, completion and seismic technology, prevailing weather conditions, exchange rates, licensing requirements, the impact of completed facilities on operating costs and the availability and costs of capital, labour and services.

Although Surge believes that the expectations and assumptions on which the forward-looking statements are based are reasonable, undue reliance should not be placed on the forward-looking statements because Surge can give no assurance that they will prove to be correct. Since forward-looking statements address future events and conditions, by their very nature they involve inherent risks and uncertainties. Actual results could differ materially from those currently anticipated due to a number of factors and risks. These include, but are not limited to, risks associated with the oil and gas industry in general (e.g., operational risks in development, exploration and production; delays or changes in plans with respect to exploration or development projects or capital expenditures; the uncertainty of reserve estimates; the uncertainty of estimates and projections relating to production, costs and expenses, and health, safety and environmental risks), commodity price and exchange rate fluctuations and uncertainties resulting from potential delays or changes in plans with respect to exploration or development projects or capital expenditures. Certain of these risks are set out in more detail in Surge's Annual Information Form which has been filed on SEDAR and can be accessed at www.sedar.com.

The forward-looking statements contained in this MD&A are made as of the date hereof and Surge undertakes no obligation to update publicly or revise any forward-looking statements or information, whether as a result of new information, future events or otherwise, unless so required by applicable securities laws.

## BOE PRESENTATION

All amounts are expressed in Canadian dollars unless otherwise noted. Oil, natural gas and natural gas liquids reserves and volumes are converted to a common unit of measure, referred to as a barrel of oil equivalent (boe), on the basis of 6,000 cubic feet of natural gas being equal to one barrel of oil. This conversion ratio is based on an energy equivalency conversion method, primarily applicable at the burner tip and does not necessarily represent a value equivalency at the wellhead. It should be noted that the use of boe might be misleading, particularly if used in isolation.

## NON-IFRS MEASURES

The terms "funds from operations", "funds from operations per share", and “netback” used in this discussion are not recognized measures under International Financial Reporting Standards (IFRS). Management believes that in addition to net income, funds from operations and netback are useful supplemental measures as they provide an indication of the results generated by the Corporation's principal business activities before the consideration of how those activities are financed or how the results are taxed. Investors are cautioned, however, that these measures should not be construed as alternatives to net income determined in accordance with IFRS, as an indication of Surge's performance.

Surge's method of calculating funds from operations may differ from that of other companies, and, accordingly, may not be comparable to measures used by other companies. Surge determines funds from operations as cash flow from operating activities before changes in non-cash working capital as follows:

Funds from Operations

| ($000s) | **Q1 2013** | Q4 2012 | Q3 2012 | Q2 2012 | Q1 2012 |
|---|---|---|---|---|---|
| Cash flow from operating activities | **$ 24,987** | $ 23,116 | $ 24,483 | $ 23,391 | $ 21,871 |
| Change in non-cash working capital | **250** | 945 | (4,634) | 924 | 2,136 |
| **Funds from operations** | **$ 25,237** | $ 24,061 | $ 19,849 | $ 24,315 | $ 24,007 |

Funds from operations per share is calculated using the same weighted average basic and diluted shares used in calculating income per share. Operating and corporate netbacks are also presented. Operating netbacks excluding hedging activity represent Surge’s revenue, excluding realized and unrealized gains or losses on financial contracts, less royalties and operating and transportation expenses. Operating netbacks including hedging activity represent Surge’s operating netback adjusted for realized gains or losses on financial contracts. Corporate netbacks represent Surge’s operating netback, less general and administrative and interest expenses, in order to determine the amount of funds generated by production. Operating and corporate netbacks have been presented on a per barrels of oil equivalent ("boe") basis. This reconciliation is shown within the MD&A.

Surge’s management is responsible for the integrity of the information contained in this report and for the consistency between the MD&A and financial statements. In the preparation of these statements, estimates are necessary to make a determination of future values for certain assets and liabilities. Management believes these estimates have been based on careful judgments and have been properly presented. The financial statements have been prepared using policies and procedures established by management and fairly reflect Surge’s financial position, results of operations and funds from operations.

The Corporation defines net debt as outstanding bank debt plus or minus working capital excluding the fair value of financial contracts.

Surge’s Board of Directors and Audit Committee have reviewed and approved the condensed consolidated interim financial statements and MD&A. This MD&A is dated May 9, 2013.

## OPERATIONS

### Drilling

| | Drilling | | Success rate | Working |
|---|---|---|---|---|
| | Gross | Net | (%) gross | interest (%) |
| Q1 2013 | 15.00 | 10.95 | 93% | 73% |
| **Total** | **15.00** | **10.95** | **93%** | **73%** |

Surge achieved a 93 percent success rate during the quarter ended March 31, 2013, drilling 15 gross (10.95 net) wells. The 15 gross wells drilled during the quarter include five wells in North Dakota, six wells in South East Alberta, two wells in Valhalla, and two wells in Nipisi. 12 of the 15 gross wells drilled in the first quarter were on production at quarter end, with the remainder to be brought on production during the second quarter of 2013. One well encountered drilling issues and had to be abandoned.

### Production

| | **Q1 2013** | Q4 2012 | Q3 2012 | Q2 2012 | Q1 2012 |
|---|---|---|---|---|---|
| Oil and NGL (bbls per day) | **6,854** | 6,398 | 5,651 | 6,568 | 6,110 |
| Natural gas (mcf per day) | **16,689** | 15,129 | 15,846 | 16,246 | 17,398 |
| Total (boe per day) (6:1) | **9,636** | 8,919 | 8,292 | 9,275 | 9,009 |
| % Oil and NGL | **71%** | 72% | 68% | 71% | 68% |

Surge achieved an average production rate of 9,636 boe per day in the first quarter of 2013, a seven percent increase from an average production rate of 9,009 boe per day in the same period of 2012. The increase in the production volumes as compared to 2012 was primarily due to the results of the 2012 and 2013 drilling programs.

Surge realized a 71 percent oil and natural gas liquids production weighting in the first quarter of 2013. Surge realized average oil and natural gas liquids production of 6,854 bbls per day for the first quarter of 2013.

## OIL, NATURAL GAS AND NGL, FINANCIAL CONTRACTS AND OTHER REVENUES

During the quarter ended March 31, 2013, approximately 90 percent of Surge's revenue resulted from oil and natural gas liquids production, with approximately 10 percent derived from natural gas.

A one percent decrease in revenue per boe, combined with a seven percent increase in production, resulted in revenues of $53.6 million in the first quarters of 2013, up five percent from $51.1 million in the same period of 2012.

Surge had certain financial contracts in place as of March 31, 2013. Surge recognized an unrealized loss of $9.3 million and a realized loss of $0.4 million on its financial contracts. This compares to an unrealized loss of $2.8 million and a realized loss of $0.8 million on its financial contracts for the quarter ended March 31, 2012.

The realized losses on financial contracts resulted in a decrease of $0.46 per boe to average revenue per boe during the quarter ended March 31, 2013.

Please refer to the "Financial Instruments" section of this MD&A for further details on these commodity contracts, interest rate, and foreign exchange swaps.

### Prices

The Corporation realized average revenue of $61.78 per boe in the first quarter of 2013, before realized financial contract losses, a decrease of one percent from the $62.28 per boe recorded in the same period of 2012.

The Corporation realized an average of $78.18 per bbl of oil and natural gas liquids in the first quarter of 2013, a decrease of eight percent from the $85.19 per bbl realized in the same period of 2012. This compares to an average Edmonton Light

Sweet price of $88.22 per bbl for the quarter, which decreased four percent per barrel from the $92.09 per bbl during the same period of 2012. The decrease in Surge's realized oil and natural gas liquids price is relatively consistent with the decrease in benchmark prices.

The Corporation realized an average natural gas price of $3.57 per mcf in the first quarter of 2013, a 54 percent increase from the $2.32 per mcf averaged in the same period of 2012. This compares to an average AECO Daily Index reference price of $3.20 per mcf in the quarter, which increased by 50 percent from the $2.14 per mcf in the same period of 2012. The increase in realized natural gas prices is relatively consistent with the increase in benchmark prices.

Realized losses on financial contracts resulted in a decrease of $0.46 per boe to the average revenue per boe in the period ended March 31, 2013.

**Revenue and Realized Prices**

| | Three months ended March 31, | | |
|---|---|---|---|
| ($000s except per amount) | **2013** | 2012 | % Change |
| Oil and NGL | **48,216** | 47,366 | 2% |
| Natural gas | **5,355** | 3,678 | 46% |
| Processing and other | **11** | 16 | (31%) |
| Total oil, natural gas and NGL revenue | **53,582** | 51,060 | 5% |
| Oil and NGL ($ per bbl) | **78.18** | 85.19 | (8%) |
| Natural gas ($ per mcf) | **3.57** | 2.32 | 54% |
| Total oil, natural gas and NGL revenue ($ per boe) | **61.78** | 62.28 | (1%) |
| Realized loss on commodity contracts ($ per boe) | **(0.46)** | (0.94) | (51%) |
| Total oil, natural gas, and NGL revenue after realized commodity contracts ($ per boe) | **61.32** | 61.34 | (0%) |
| Reference Prices | | | |
| Edmonton Light Sweet ($ per bbl) | **88.22** | 92.09 | (4%) |
| AECO Daily Index ($ per mcf) | **3.20** | 2.14 | 50% |

**Benchmark prices**

| | **Q1 2013** | Q4 2012 | Q3 2012 | Q2 2012 | Q1 2012 |
|---|---|---|---|---|---|
| ($ per bbl) | | | | | |
| Benchmark - WTI (US$) | **94.37** | 88.18 | 92.22 | 93.49 | 102.93 |
| Difference - WTI realized to Edmonton Light Sweet (C$) | **(6.15)** | (4.19) | (7.89) | (9.55) | (10.84) |
| % Difference | **(7%)** | (5%) | (9%) | (10%) | (11%) |
| Benchmark - Edmonton Light Sweet (C$) | **88.22** | 83.99 | 84.33 | 83.94 | 92.09 |
| Difference - Edmonton Light Sweet to Surge realized (C$) | **(10.04)** | (9.21) | (8.39) | (7.63) | (6.90) |
| % Difference | **(11%)** | (11%) | (10%) | (9%) | (7%) |
| Surge realized prices (C$) | **78.18** | 74.78 | 75.94 | 76.31 | 85.19 |
| (C$ per mcf) | | | | | |
| Benchmark - AECO Daily Index | **3.20** | 3.22 | 2.29 | 1.90 | 2.14 |
| Surge realized prices | **3.57** | 2.73 | 2.56 | 2.24 | 2.32 |
| Difference | **0.37** | (0.49) | 0.27 | 0.34 | 0.18 |
| % Difference | **11%** | (15%) | 12% | 18% | 8% |

## ROYALTIES

Surge realized royalty expenses of $9.5 million or 18 percent of revenue in the first quarter of 2013, as compared to $10.0 million or 20 percent of revenue in the same period of 2012. Royalties decreased as a percentage of revenue during the first quarter of 2013, in comparison to the same period in 2012, due to a prior period change in estimate realized in the first quarter of 2012. Royalties as a percentage of revenue for the first quarter of 2012 would have been a similar 18 percent after adjusting for this prior period adjustment.

As royalties under the Alberta Royalty Framework (ARF) are sensitive to both commodity prices and production levels, the estimated ARF and corporate royalty rates will fluctuate with commodity prices, well production rates, production decline of existing wells, and performance and location of new wells drilled.

Royalties

| | Three Months Ended March 31, | | |
|---|---|---|---|
| ($000s except per boe) | **2013** | 2012 | % Change |
| Royalties | **9,483** | 10,017 | (5%) |
| % of Revenue | **18%** | 20% | (10%) |
| $ per boe | **10.93** | 12.22 | (11%) |

## OPERATING EXPENSES

Operating expenses per boe in the first quarter of 2013 were eight percent higher than the same period in 2012, at $12.58 per boe as compared to $11.66 per boe in the same period of 2012.

Operating expenses per boe during the first quarter of 2013 increased mainly due to poor weather conditions and increased utility costs.

The management team continues to focus on finding efficiencies within existing operations and expects combined transportation and operating expenses per boe to remain relatively consistent for the remainder of 2013.

Operating Expenses

| | Three Months Ended March 31, | | |
|---|---|---|---|
| ($000s except per boe) | **2013** | 2012 | % Change |
| Operating expenses | **10,911** | 9,556 | 14% |
| $ per boe | **12.58** | 11.66 | 8% |

## TRANSPORTATION EXPENSES

Transportation expenses per boe increased by 26 percent to $2.25 per boe in the first quarter of 2013, as compared to $1.78 per boe in the same period of 2012. The increase is primarily due to additional volumes that were trucked from areas that are not pipeline connected.

The management team continues to focus on finding efficiencies within existing operations and expects combined transportation and operating expenses per boe to remain relatively consistent for the remainder of 2013.

Transportation Expenses

| | Three Months Ended March 31, | | |
|---|---|---|---|
| ($000s except per boe) | **2013** | 2012 | % Change |
| Transportation expenses | **1,950** | 1,458 | 34% |
| $ per boe | **2.25** | 1.78 | 26% |

## GENERAL AND ADMINISTRATIVE EXPENSES (G&A)

Net G&A expenses per boe for the first quarter of 2013 decreased 12 percent to $3.20 per boe as compared to $3.63 per boe in the same period of 2012. G&A expenses for the first quarter of 2013, net of recoveries and capitalized amounts of $2.3 million, were $2.8 million, compared to $3.0 million in the same period of 2012, after recoveries and capitalized amounts of $2.1 million.

The decrease in G&A per boe is primarily due to the increased production levels in the first quarter of 2013 as compared to the same periods in 2012.

G&A Expenses

| | Three Months Ended March 31, | | |
|---|---|---|---|
| ($000s except per boe) | **2013** | 2012 | % Change |
| G&A expenses | **5,073** | 5,116 | (1%) |
| Recoveries and capitalized amounts | **(2,298)** | (2,144) | 7% |
| Net G&A expenses | **2,775** | 2,972 | (7%) |
| Net G&A expenses $ per boe | **3.20** | 3.63 | (12%) |

## TRANSACTION COSTS

In the first quarter of 2013, the Company did not incur any transaction costs related to evaluation and review of business and property acquisitions. This is compared to $0.4 million or $0.44 per boe during the same period of 2012.

## FINANCE EXPENSES

During the quarter ended March 31, 2013, Surge incurred interest expense of $2.4 million or $2.72 per boe as compared to $1.4 million or $1.75 per boe in the same period of 2012. The increased interest expense per boe during the three months ended March 31, 2013 is primarily due to higher debt levels as compared to the same period of 2012.

Accretion represents the change in the time value of the decommissioning liability. Accretion expense per boe increased for the quarter ended March 31, 2013 compared to the same periods of 2012 primarily due to the change in estimate recorded in the first quarter of 2013. The underlying liability may increase over a period of time, based on new obligations incurred from drilling wells, constructing facilities, acquiring operations or adjusting future estimates of timing or amounts. Similarly, this future obligation can be reduced as a result of abandonment work undertaken.

Finance Expenses

| | Three Months Ended March 31, | | |
|---|---|---|---|
| ($000s except per boe) | **2013** | 2012 | % Change |
| Interest expense | **2,362** | 1,433 | 65% |
| $ per boe | **2.72** | 1.75 | 55% |
| Accretion expense | **310** | 255 | 22% |
| $ per boe | **0.36** | 0.31 | 16% |
| Finance expenses | **2,672** | 1,688 | 58% |
| $ per boe | **3.08** | 2.06 | 50% |

## NETBACKS

Surge's operating netback (defined as revenue excluding realized and unrealized gains or losses on financial contracts per boe less royalties, operating and transportation expenses on a per boe) was $36.02 for the first quarter of 2013, a two percent decrease from the $36.62 recorded during the same period of 2012. The decrease in operating netback was attributable to a one percent decrease in revenue per boe, an eight percent increase in operating costs per boe, and a 26 percent increase in transportation costs per boe, partially offset by an 11 percent decrease in royalties per boe. The decrease in corporate netback was impacted by a 55 percent increase in interest expense per boe, partially offset by a 12 percent decrease in G&A expense per boe, as compared to the same period of 2012.

Netbacks, Excluding Hedging Activity

| ($ per boe, except production) | Three Months Ended March 31, 2013 | 2012 | % Change |
|---|---|---|---|
| Average production (boe per day) | **9,636** | 9,009 | 7% |
| Revenue | **61.78** | 62.28 | (1%) |
| Royalties | **(10.93)** | (12.22) | (11%) |
| Operating costs | **(12.58)** | (11.66) | 8% |
| Transportation costs | **(2.25)** | (1.78) | 26% |
| **Operating netback** | **36.02** | 36.62 | (2%) |
| G&A expense | **(3.20)** | (3.63) | (12%) |
| Interest expense | **(2.72)** | (1.75) | 55% |
| **Corporate netback** | **30.10** | 31.24 | (4%) |

Netbacks, Including Hedging Activity

| ($ per boe) | Three Months Ended March 31, 2013 | 2012 | % Change |
|---|---|---|---|
| Operating netback | **36.02** | 36.62 | (2%) |
| Realized gain (loss) on commodity contracts | **(0.46)** | (0.94) | (51%) |
| **Operating netback, net of hedging activity** | **35.56** | 35.68 | (0%) |
| G&A expense | **(3.20)** | (3.63) | (12%) |
| Interest expense | **(2.72)** | (1.75) | 55% |
| **Corporate netback** | **29.64** | 30.30 | (2%) |

## FUNDS FROM OPERATIONS AND CASH FLOW FROM OPERATIONS

Funds from operations increased five percent to $25.2 million in the first quarter of 2013 compared to $24.0 million in the same period of 2012. On a per share basis, funds from operations increased three percent, to $0.35 per basic share from $0.34 per basic share in the same period of 2012.

Cash flow from operations differs from funds from operations due to the inclusion of changes in non-cash working capital. Cash flow from operations was $25.0 million for the first quarter of 2013 as compared to $21.9 million in the same period of 2012.

Included in cash flow from operations is a decrease in non-cash working capital of $0.3 million for the first quarter of 2013 and a decrease of $2.1 million for the same period in 2012.

Funds from Operations

| ($000s except per share and per boe) | Three Months Ended March 31, 2013 | 2012 | % Change |
|---|---|---|---|
| Funds from operations | **25,237** | 24,007 | 5% |
| Per share - basic ($) | **0.35** | 0.34 | 3% |
| Per share - diluted ($) | **0.35** | 0.33 | 6% |
| $ per boe | **29.10** | 29.28 | (1%) |
| Cash flow from operating activities | **24,987** | 21,871 | 14% |

## STOCK-BASED COMPENSATION

Surge recorded net stock-based compensation expense of $0.9 million during the first quarter of 2013, compared to $1.0 million for the same period of 2012. The fair value of the options granted was calculated using the Black-Scholes option-pricing model.

During the first quarter of 2013, 29,500 options were issued at a weighted average exercise price of $5.05 per option and 88,000 options were forfeited at a weighted average price of $8.26 per option. No options were exercised during the period.

The following assumptions were used to calculate the fair value of options granted in 2013: zero dividend yield; expected volatility of 69 percent; risk free rate of two percent; and expected life of five years.

**Stock-based compensation**

| | Three Months Ended March 31, | | |
|---|---|---|---|
| ($000s except per boe) | **2013** | 2012 | % Change |
| Stock-based compensation | **2,200** | 2,420 | (9%) |
| Capitalized stock-based compensation | **(1,308)** | (1,454) | (10%) |
| Net stock-based compensation | **892** | 966 | (8%) |
| Net stock-based compensation $ per boe | **1.03** | 1.18 | (13%) |

## DEPLETION AND DEPRECIATION

Depletion and depreciation are calculated based upon capital expenditures, production rates and proved plus probable reserves. Deducted from the Corporation's depletion and depreciation calculation are costs associated with salvage values of $35.8 million. Future development costs for proved and probable reserves of $222.6 million have been included in the depletion calculation.

Surge recorded $15.8 million or $18.16 per boe in depletion and depreciation expense during the first quarter of 2013, as compared to $16.9 million or $20.60 per boe in depletion and depreciation expense in the same period of 2012. This decrease is due primarily to the impairment recorded in the fourth quarter of 2012.

The depletion and depreciation calculation is based on daily production volumes of 9,636 boed for the first quarter of 2013.

**Depletion and Depreciation Expense**

| | Three Months Ended March 31, | | |
|---|---|---|---|
| ($000s except per boe) | **2013** | 2012 | % Change |
| Depletion and depreciation expense | **15,752** | 16,890 | (7%) |
| $ per boe | **18.16** | 20.60 | (12%) |

## NET INCOME (LOSS)

The Corporation recorded a net loss of $1.4 million or $0.02 per basic share for the first quarter of 2013 compared to net income of $2.7 million or $0.04 per basic share for the same period of 2012. The cause for the change in net income is primarily due to a $9.3 million unrealized loss on financial contracts in the first quarter of 2013, versus a $2.8 million unrealized loss during the same period in 2012.

**Net Income (Loss)**

| | Three Months Ended March 31, | | |
|---|---|---|---|
| ($000s except per share) | **2013** | 2012 | % Change |
| Net Income (Loss) | **(1,354)** | 2,657 | nm |
| Per share - basic ($) | **(0.02)** | 0.04 | nm |
| Per share - diluted ($) | **(0.02)** | 0.04 | nm |

## CAPITAL EXPENDITURES

During the first quarter of 2013, Surge invested a total of $39.3 million, net of dispositions. Surge invested $27.6 million to drill 15 gross (10.95 net) wells.

In addition, Surge invested $8.1 million in facilities, equipment, and pipelines, $2.3 million in seismic and land acquisitions, and $2.1 million on other capital items.

During the first quarter of 2012, Surge invested a total of $54.9 million, net of acquisitions. Surge invested $38.5 million to drill 18 gross (13.89 net) wells.

In addition, Surge invested $9.1 million in facilities, equipment, and pipelines, $5.3 million in seismic and land acquisitions, and $2.0 million on other capital items. The Pradera acquisition was comprised of $18.5 million in cash-based consideration, acquired debt of $14.6 million and $71.3 million in share based consideration for total consideration of $104.4 million.

### Capital Expenditure Summary

| ($000s) | Q1 2013 | Q1 2012 | Change |
|---|---|---|---|
| Land | **1,975** | **4,303** | (54%) |
| Seismic | **311** | **991** | (69%) |
| Drilling and completions | **27,607** | **38,534** | (28%) |
| Facilities, equipment and pipelines | **8,075** | **9,102** | (11%) |
| Other | **2,097** | **1,968** | 7% |
| Total exploration and development | **40,065** | **54,898** | (27%) |
| Acquisitions - cash consideration | **-** | **18,500** | nm |
| Acquisitions - debt acquired | **-** | **14,623** | nm |
| Acquisitions - share based consideration | **-** | **71,275** | nm |
| Property dispositions | **(807)** | - | nm |
| Total acquisitions & dispositions | **(807)** | **104,398** | nm |
| Total capital expenditures | **39,258** | **159,296** | (75%) |

### Quarterly Financial Information

| | Q1 2013 | Year end 2012 | Q4 2012 | Q3 2012 | Q2 2012 |
|---|---|---|---|---|---|
| Oil, Natural gas & NGL sales | **53,582** | 192,660 | 49,430 | 43,243 | 48,927 |
| Net earnings (loss) | **(1,354)** | (53,243) | (68,187) | (986) | 13,273 |
| Net earnings (loss) per share ($): | | | | | |
| Basic | **(0.02)** | (0.75) | (0.96) | (0.01) | 0.19 |
| Diluted | **(0.02)** | (0.75) | (0.96) | (0.01) | 0.18 |
| Funds from operations | **25,237** | 92,232 | 24,061 | 19,849 | 24,315 |
| Funds from operations per share ($): | | | | | |
| Basic | **0.35** | 1.30 | 0.34 | 0.28 | 0.34 |
| Diluted | **0.35** | 1.30 | 0.34 | 0.28 | 0.34 |
| Average daily sales | | | | | |
| Oil & NGL (bbls/d) | **6,854** | 6,181 | 6,398 | 5,651 | 6,568 |
| Natural gas (mcf/d) | **16,689** | 16,151 | 15,129 | 15,846 | 16,246 |
| Barrels of oil equivalent (boe per day) (6:1) | **9,636** | 8,873 | 8,919 | 8,292 | 9,275 |
| Average sales price | | | | | |
| Natural gas ($/mcf) | **3.57** | 2.73 | 3.89 | 2.56 | 2.24 |
| Oil & NGL ($/bbl) | **78.18** | 78.01 | 74.78 | 75.94 | 76.31 |
| Barrels of oil equivalent ($/boe) | **61.78** | 59.33 | 60.24 | 56.70 | 57.97 |

Quarterly Financial Information

| | Q1 2012 | Q4 2011 | Q3 2011 | Q2 2011 |
|---|---|---|---|---|
| Oil, Natural gas & NGL sales | 51,060 | 42,812 | 33,012 | 29,796 |
| Net earnings (loss) | 2,657 | (5,531) | 4,811 | 3,317 |
| Net earnings (loss) per share ($): | | | | |
| Basic | 0.04 | (0.09) | 0.09 | 0.06 |
| Diluted | 0.04 | (0.09) | 0.08 | 0.06 |
| Funds from operations | 24,005 | 22,088 | 14,002 | 11,898 |
| Funds from operations per share ($): | | | | |
| Basic | 0.34 | 0.36 | 0.25 | 0.21 |
| Diluted | 0.33 | 0.35 | 0.24 | 0.21 |
| Average daily sales | | | | |
| Oil & NGL (bbls/d) | 6,110 | 4,534 | 3,781 | 2,995 |
| Natural gas (mcf/d) | 17,398 | 17,885 | 14,313 | 12,334 |
| Barrels of oil equivalent (boe per day) (6:1) | 9,009 | 7,514 | 6,166 | 5,051 |
| Average sales price | | | | |
| Natural gas ($/mcf) | 2.32 | 3.49 | 3.81 | 4.13 |
| Oil & NGL ($/bbl) | 85.19 | 88.60 | 80.29 | 92.36 |
| Barrels of oil equivalent ($/boe) | 62.28 | 61.93 | 58.19 | 64.83 |

## FACTORS THAT HAVE CAUSED VARIATIONS OVER THE QUARTERS

The fluctuations in Surge's revenue and net earnings from quarter to quarter are primarily caused by increases in production volumes, changes in realized commodity prices and the related impact on royalties, and realized and unrealized gains or losses on derivative instruments. The increases in production from the second quarter of 2011 through the current quarter are due to Surge's successful drilling program, as well as corporate and asset acquisitions over that period. Please refer to the Financial and Operating Results section and other sections of this MD&A for detailed discussions on variations during the comparative quarters and to Surge's previously issued interim and annual MD&A for changes in prior quarters.

Share Capital and Option Activity

| | **Q1 2013** | Q4 2012 | Q3 2012 | Q2 2012 | Q1 2012 | Q4 2011 | Q3 2011 | Q2 2011 |
|---|---|---|---|---|---|---|---|---|
| Weighted Common Shares | **71,217,345** | 71,196,143 | 71,117,390 | 71,057,943 | 70,474,105 | 62,124,542 | 56,118,838 | 56,098,181 |
| Stock option dilution (treasury method)[1] | **-** | - | - | 1,080,348 | 1,711,244 | 1,189,529 | 1,348,828 | 1,187,618 |
| Weighted average diluted shares oustanding[1] | **71,217,345** | 71,196,143 | 71,117,390 | 72,138,291 | 72,185,349 | 63,314,071 | 57,467,666 | 57,285,799 |

[1] In computing the net income per diluted share in the current period, nil shares were added to the weighted average number of shares outstanding.

On March 31, 2013 Surge had 71,217,345 common shares, 2,047,272 performance warrants and 6,522,201 options outstanding.

## LIQUIDITY AND CAPITAL RESOURCES

On March 31, 2013, Surge had drawn $212.9 million on its credit facility with total net debt of $234.8 million. Surge has approximately $55.2 million of borrowing capacity in relation to the $290 million credit facility, giving Surge considerable financial flexibility through the balance of 2013.

Surge anticipates that future capital requirements will be funded through a combination of internal cash flow, divestitures, debt and/or equity financing. Furthermore, Surge's flexible capital program and unused bank line further add to Surge's ability to fund future capital requirements. There is no assurance that debt and equity financing will be available on terms acceptable to the Corporation to meet its capital requirements.

The Corporation defines net debt as outstanding bank debt plus or minus cash-based working capital excluding the fair value of financial contracts as follows:

**Net Debt**

| ($000s) | | |
|---|---|---|
| Bank debt | $ | (212,874) |
| Accounts receivable | | 31,336 |
| Prepaid expenses and deposits | | 1,925 |
| Accounts payable and accrued liabilities | | (55,182) |
| **Total** | **$** | **(234,795)** |

As at March 31, 2013, the Corporation had a $290 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, 2013. On May 31, 2013, 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, 2013 (December 31, 2012 – prime plus 2.0 percent).

Surge's 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.

## RELATED-PARTY AND OFF-BALANCE-SHEET TRANSACTIONS

Surge was not involved in any off-balance-sheet transactions or related party transactions during the period ended March 31, 2013.

## FINANCIAL INSTRUMENTS

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 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 summarizes the Corporation's derivatives as at the date of this MD&A's release by period and by product. Further detail on the individual hedges can be found in the Financial Statements.

### Commodity Contracts

| Product | Period | Volume hedged | Average Floor Price (C$) |
|---|---|---|---|
| C$ WTI Oil | Q2 2013 | 3,500 bbl/d | $93.10 |
| C$ WTI Oil | Q3 2013 | 2,850 bbl/d | $93.85 |
| C$ WTI Oil | Q4 2013 | 2,850 bbl/d | $93.85 |
| C$ WTI Oil | Calendar 2013 | 1,000 bbl/d | $91.83 |
| AECO Gas | Calendar 2013 | 8,000 gj/d | $3.22 per gj |
| AECO Gas | Calendar 2014 | 2,000 gj/d | $3.60 per gj |
| Edm Light to WTI Differential | Q2-Q4 2013 | 2,000 bbl/d | $7.84 discount from WTI |

### Interest Contracts

| Product | Period | Notional (C$) | Company Fixed Interest Rate (%) (1) |
|---|---|---|---|
| Interest Rate Swap | Calendar 2013 - 2014 | $50,000,000 | 2.74 |

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

### Foreign Exchange Contracts

| Product | Period | Notional (US$) | Swap Price (C$) |
|---|---|---|---|
| Foreign Exchange Swap | Calendar 2013 | $33,762,500 | $ 1.005 |
| Foreign Exchange Swap | Calendar 2014 | $33,361,000 | $ 1.005 |

## SUBSEQUENT EVENT

The Company has executed a formal purchase and sale agreement with a Canadian oil and gas producer to sell all of the issued and outstanding shares of Surge Energy USA Inc. consisting of its non-core assets in North Dakota for a purchase price of approximately US$42.75 million. Closing of this transaction is anticipated to occur on or around May 31, 2013. The chief executive officer of the acquirer is a member of the Board of Directors of the Company and the sale was concluded following a marketed process to potential purchasers.

## CONTROLS AND PROCEDURES

The Chief Executive Officer and Chief Financial Officer are responsible for designing internal controls over financial reporting ("ICFR") or causing them to be designed under their supervision in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS. The Corporation's Chief Executive Officer and Chief Financial Officer have designed, or caused to be designed under their supervision, disclosure controls and procedures to provide reasonable assurance that: (i) material information relating to the Corporation is made known to the Corporation's Chief Executive Officer and Chief Financial Officer by others, particularly during the period in which the annual filings are being prepared; and (ii) information required to be disclosed by the Corporation in its annual filings, interim filings or other reports filed or submitted by it under securities legislation is recorded, processed, summarized and reported within the time period specified in securities legislation.

The Committee of Sponsoring Organizations of the Treadway Commission ("COSO") framework provides the basis for management's design of internal controls over financial reporting. Management and the Board work to mitigate the risk of a material misstatement in financial reporting; however, a control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met and it should not be expected that the disclosure and internal control procedures will prevent all errors or fraud.

There were no changes in the Corporation's ICFR during the period ended March 31, 2013 that materially affected, or are reasonably likely to materially affect, the Corporation's ICFR.

### Disclosure Controls

Disclosure controls and procedures have been designed to ensure that information to be disclosed by the Corporation is accumulated and communicated to management, as appropriate, to allow timely decisions regarding required disclosures.

### Internal Controls over Financial Reporting

Internal controls over financial reporting have been designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Corporation's financial statements for external purposes in accordance with IFRS.

## CRITICAL ACCOUNTING ESTIMATES

The preparation of financial statements in accordance with IFRS requires management to make certain judgments and estimates. Due to the timing of when activities occur compared to the reporting of those activities, management must estimate and accrue operating results and capital spending. Changes in these judgments and estimates could have a material impact on our financial results and financial condition.

### Reserves

The process of estimating reserves is critical to several accounting estimates. It requires significant judgments based on available geological, geophysical, engineering and economic data. These estimates may change substantially as data from ongoing development and production activities becomes available, and as economic conditions impacting oil and gas prices, operating costs and royalty burdens change. Reserve estimates impact net income through depletion, the determination of decommissioning liabilities and the application of impairment tests.

Revisions or changes in reserve estimates can have either a positive or a negative impact on net income.

### Forecasted Commodity Prices

Management's estimates of future crude oil and natural gas prices are critical as these prices are used to determine the carrying amount of PP&E, assess impairment and determine the change in fair value of financial contracts. Management's estimates of prices are based on the price forecast from our reserve engineers and the current forward market.

### Business Combinations

Management makes various assumptions in determining the fair values of any acquired company's assets and liabilities in a business combination. The most significant assumptions and judgments made relate to the estimation of the fair value of the oil and gas properties. To determine the fair value of these properties, we estimate (a) oil and gas reserves in accordance with National Instrument 51-101 – Standards of Disclosure for Oil and Gas Activities (''NI 51-101'') and (b) future prices of oil and gas.

### Decommissioning Liability

Management calculates the decommissioning liability based on estimated costs to abandon and reclaim its net ownership interest in all wells and facilities and the estimated timing of the costs to be incurred in future periods. The fair value estimate is capitalized to PP&E as part of the cost of the related asset and amortized over its useful life. There are uncertainties related to decommissioning liabilities and the impact on the financial statements could be material as the eventual timing and costs for the obligations could differ from our estimates. Factors that could cause our estimates to differ include any changes to laws or regulations, reserve estimates, costs and technology.

### Derivative Financial Instruments

We utilize derivative financial instruments to manage our exposure to market risks relating to commodity prices, foreign currency exchange rates and interest rates. Fair values of derivative contracts fluctuate depending on the underlying estimate of future commodity prices, foreign currency exchange rates, interest rates and counterparty credit risk.

### Stock-based Compensation

Management makes various assumptions in determining the value of stock based compensation. This includes estimating the forfeiture rate, the expected volatility of the underlying security, interest rates and expected life.

### Deferred Income Taxes

Management makes various assumptions in determining the value of stock deferred income tax provision, including (but not limited to) future tax rates, accessibility of tax pools and future cashflows.

## CHANGES IN ACCOUNTING POLICIES

On January 1, 2013, the Company 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.

## FUTURE ACCOUNTING POLICY CHANGES

In November 2009, the IASB published IFRS 9 – Financial Instruments, which covers the classification and measurement of financial assets as part of its project to replace IAS 39 – Financial Instruments: Recognition and Measurement. In October 2010, the requirements for classifying and measuring financial liabilities were added to IFRS 9. Under this guidance, entities have the option to recognize financial liabilities at fair value through earnings. If this option is elected, entities would be required to reverse the portion of the fair value change due to a company's own credit risk out of earnings and recognize the change in other comprehensive income. IFRS 9 is effective for the Corporation on January 1, 2015. Early adoption is permitted and the standard is required to be applied retrospectively.

The Corporation is currently evaluating the impact of adopting all of the newly issued and amended standards.

## RISK FACTORS

Additional risk factors can be found under "Risk Factors" in the Corporation's 2012 Annual Information Form, which can be found on www.sedar.com. Many risks are discussed below and in the 2012 Annual Information Form, but these risk factors should not be construed as exhaustive. There are numerous factors, both known and unknown, that could cause actual results or events to differ materially from forecast results.

Oil and natural gas operations involve many risks that even a combination of experience, knowledge and careful evaluation may not be able to overcome. The long-term commercial success of Surge depends on its ability to find, acquire, develop, and commercially produce oil and natural gas reserves. Without the continual addition of new reserves, any existing reserves Surge may have at any particular time and the production therefrom will decline over time as such existing reserves are exploited. A future increase in Surge's reserves will depend not only on the Corporation's ability to explore and develop any properties it may have from time to time, but also on its ability to select and acquire suitable producing properties or prospects. No assurance can be given that further commercial quantities of oil and natural gas will be discovered or acquired by Surge.

Surge's principal risks include finding and developing economic hydrocarbon reserves efficiently and being able to fund the capital program. The Corporation's need for capital is both short-term and long-term in nature. Short-term working capital will be required to finance accounts receivable, drilling deposits and other similar short-term assets, while the acquisition and development of oil and natural gas properties requires large amounts of long-term capital. Surge anticipates that future capital requirements will be funded through a combination of internal funds from operations, debt and/or equity financing. There is no assurance that debt and equity financing will be available on terms acceptable to the Corporation to meet its capital requirements. If any components of the Corporation's business plan are missing, the Corporation may not be able to execute the entire business plan.

All phases of the oil and natural gas business present environmental risks and hazards and are subject to environmental regulation pursuant to a variety of federal, provincial, and local laws and regulations. Environmental legislation provides for, among other things, restrictions and prohibitions on spills, releases or emissions of various substances produced in association with oil and natural gas operations. The legislation also requires that wells and facility sites be operated, maintained, abandoned and reclaimed to the satisfaction of applicable regulatory authorities. Compliance with such legislation can require significant expenditures and a breach may result in the imposition of fines and penalties, some of which may be material. Environmental legislation is evolving in a manner expected to result in stricter standards and enforcement, larger fines and liability and potentially increased capital expenditures and operating costs. The discharge of oil, natural gas or other pollutants into the air, soil, or water may give rise to liabilities to governments and third parties and may require Surge's operating entities to incur costs to remedy such discharge. Although Surge believes that it is in material compliance with current applicable environmental regulations, no assurance can be given that environment laws will not result in a curtailment of production or a material increase in the costs of production, development or exploration activities or otherwise adversely affect Surge's financial condition, results of operations or prospects.

Surge's involvement in the exploration for and development of oil and natural gas properties may result in Surge becoming subject to liability for pollution, blowouts, property damage, personal injury or other hazards. Although, prior to drilling, Surge will obtain insurance in accordance with industry standards to address certain of these risks, such insurance has limitations on liability that may not be sufficient to cover the full extent of such liability. In addition, such risks may not, in all circumstances, be insurable or, in certain circumstances, Surge may elect not to obtain insurance to deal with specific risks due to the high premiums associated with such insurance or other reasons. The payment of such uninsured liabilities would reduce the funds available to Surge. The occurrence of a significant event that was not fully insured against, or the insolvency of the insurer of such event, could have a material adverse effect on Surge's financial position, results of operations or prospects and will reduce income otherwise used to fund operations.

The Corporation's financial performance and condition are substantially dependent on the prevailing prices of oil and natural gas which are unstable and subject to fluctuation. Fluctuations in oil or natural gas prices could have an adverse effect on the Corporation's operations and financial condition and the value and amount of its reserves. Prices for crude oil fluctuate in response to global supply of and demand for oil, market performance and uncertainty and a variety of other factors which are outside the control of the Corporation including, but not limited, to the world economy and the Organization of the Petroleum Exporting Countries' ability to adjust supply to world demand, government regulation, political stability and the availability of alternative fuel sources. Natural gas prices are influenced primarily by factors within North America, including North American supply and demand, economic performance, weather conditions and availability and pricing of alternative fuel sources.

Decreases in oil and natural gas prices typically result in a reduction of the Corporation's net production revenue and may change the economics of producing from some wells, which could result in a reduction in the volume of the Corporation's reserves. Any further substantial declines in the prices of crude oil or natural gas could also result in delay or cancellation of existing or future drilling, development or construction programs or the curtailment of production. All of these factors could result in a material decrease in the Corporation's net production revenue, cash flows and profitability causing a reduction in its oil and gas acquisition and development activities. In addition, bank borrowings available to the Corporation will in part be determined by the Corporation's borrowing base. A sustained material decline in prices from historical average prices could further reduce such borrowing base, therefore reducing the bank credit available and could require that a portion of its bank debt be repaid.

The Corporation utilizes financial derivatives contracts to manage market risk. All such transactions are conducted in accordance with the risk management policy that has been approved by the Board of Directors.

On October 25, 2007, the Alberta Government announced the New Royalty Framework (NRF) which took effect after January 1, 2009. On March 3, 2009, the Alberta Government announced a drilling royalty credit and new well incentive program that will be in effect from April 1, 2009 to March 31, 2010. On November 29, 2008, the Alberta Government announced that in response to the global economic crisis and a slowdown in oil and natural gas drilling in Alberta, companies drilling certain new wells after November 19, 2008 have a one-time option of selecting a transitional rate or the NRF rate. All wells drilled between 2009 and 2013 that adopt the transitional rate will be required to shift to the NRF on January 1, 2014. All wells drilled prior to November 19, 2008 moved to the NRF on January 1, 2009.