Surge Energy Inc. Announces Third Quarter 2012 Results and Provides Operations Update

CALGARY, Nov. 13, 2012 /CNW/ - Surge Energy Inc. ("Surge" or the "Company") (TSX:SGY) is pleased to announce its financial and operating results for the three and nine month periods ended September 30, 2012.

FINANCIAL AND OPERATING SUMMARY:

($000s except per share amounts)

	Three Months Ended September 30,			Nine Months Ended September 30		
	2012	2011	% change	**2012**	2011	% change
Financials highlights						
Oil and NGL sales	**39,481**	**27,929**	41%	**132,457**	**74,751**	77%
Natural gas sales	**3,733**	**5,013**	(26%)	**10,719**	**13,807**	(22%)
Other revenue	**29**	**70**	(59%)	**54**	**122**	(56%)
Total oil, natural gas, and NGL revenue	**43,243**	33,012	31%	**143,230**	88,680	62%
Funds from Operations[1]	**19,849**	**14,002**	42%	**68,171**	**35,701**	91%
Per share basic ($)	**0.28**	0.25	12%	**0.96**	0.64	50%
Per share diluted ($)	**0.28**	0.24	17%	**0.95**	0.62	53%
Net income (loss)	**(986)**	4,811	nm	**14,944**	7,626	96%
Per share basic ($)	**(0.01)**	0.09	nm	**0.21**	0.14	50%
Per share diluted ($)	**(0.01)**	0.08	nm	**0.21**	0.13	62%
Capital expenditures - petroleum & gas properties[2]	**53,133**	51,972	2%	**135,739**	124,933	9%
Capital expenditures - acquisitions & dispositions[2]	**1,354**	-	nm	**112,391**	(6,525)	nm
Total capital expenditures[2]	**54,487**	51,972	5%	**248,130**	118,408	110%
Net debt at end of period[3]	**202,746**	128,889	57%	**202,746**	128,889	57%
Operating highlights						
Production:						
Oil and NGL (bbls per day)	**5,651**	3,781	49%	**6,108**	3,291	86%
Natural gas (mcf per day)	**15,846**	14,313	11%	**16,494**	12,863	28%
Total (boe per day) (6:1)	**8,292**	6,166	34%	**8,857**	5,435	63%
Average realized price (excluding hedges):						
Oil and NGL ($ per bbl)	**75.94**	80.29	(5%)	**79.15**	83.20	(5%)
Natural gas ($ per mcf)	**2.56**	3.81	(33%)	**2.37**	3.93	(40%)
Realized loss on financial contracts ($ per boe)	**(0.06)**	(0.84)	(93%)	**(0.44)**	(1.62)	(73%)
Netback (excluding hedges) ($ per boe)[3]						
Oil, natural gas and NGL sales	**56.70**	58.19	(3%)	**59.02**	59.77	(1%)
Royalties	**(9.96)**	(8.38)	19%	**(10.63)**	(8.53)	25%
Operating expenses	**(11.48)**	(14.79)	(22%)	**(11.25)**	(15.88)	(29%)
Transportation expenses	**(2.07)**	(2.16)	(4%)	**(2.15)**	(2.62)	(18%)
Operating netback	**33.19**	32.86	1%	**34.99**	32.74	7%
G&A expenses	**(3.12)**	(4.92)	(37%)	**(3.42)**	(5.01)	(32%)
Interest expense	**(2.23)**	(1.91)	17%	**(1.94)**	(1.57)	24%
Corporate netback	**27.84**	26.03	7%	**29.63**	26.16	13%
Common shares (000s)						
Common shares outstanding, end of period	**71,143**	**56,122**	27%	**71,143**	**56,122**	27%
Weighted average basic shares outstanding	**71,117**	**56,119**	27%	**70,884**	**56,104**	26%
Stock option dilution (treasury method)	**-**	**1,349**	(100%)	**1,249**	**1,125**	11%
Weighted average diluted shares outstanding	**71,117**	**57,468**	24%	**72,133**	**57,229**	26%

[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 in the Company's Q3 2012 Management Discussion and Analysis.

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

ACHIEVMENTS AND HIGHLIGHTS:

Surge has achieved excellent growth year to date in 2012. Funds from operations increased 91 percent for the first nine months of 2012 and 42 percent for the third quarter as compared to the same time period in 2011. Production grew 63 percent in the first nine months of 2012 and 34 percent in the third quarter both as compared to the same periods in 2011. 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 570 gross (435 net) locations, internally estimated gross DPIIP[4] of 550 million barrels of oil and multiple waterflood opportunities and exploration initiatives.

Surge has achieved operational efficiencies in each of its core areas, resulting in significant reductions in operating costs since inception. Significant reductions in general and administrative costs per boe have also been achieved. Surge continues to strive to become one of the lowest cost oil producers among its oil weighted peer group.

Highlights for the quarter include:

- **Funds from operations increased 91 and 42 percent** respectively from the same periods of 2011 to $68.2 million for the first nine months of 2012 and $19.8 million for the third quarter.

- **Funds from operations per fully diluted share increased 53 percent and 17 percent** respectively from the same periods of 2011 to $0.95 for the first nine months of 2012 and $0.28 for the third quarter.

- **Grew production by 63 and 34 percent** respectively from the same periods of 2011 to 8,857 boe per day for the first nine months of 2012 and 8,292 boe per day for the third quarter. Average production for the third quarter of 8,292 boe per day was lower than expected due to approximately 350 boe per day (270 barrels of oil per day) of unscheduled well servicing and facility upgrades at Nipisi, Silver Lake and Valhalla South, which was noted with Surge's second quarter results, approximately 525 barrels of oil per day as a result of change in completion techniques resulting in longer cleanup times at Nipisi and approximately 330 boe per day (265 barrels of oil per day) as a result of delayed drilling and production outages in Valhalla. In total these items impacted average third quarter production by more than 1,200 boe per day (1,060 barrels of oil per day).

- **Increased production per basic share by 29 and 9 percent** respectively for the first nine months and third quarter of 2012 as compared to the same period of 2011.

- **Reduced operating costs per boe by 29 percent, transportation costs per boe by 18 percent and G&A per boe by 32 percent** in the first nine months of 2012 as compared to the same period of 2011 with combined operating and transportation costs decreasing by 28 percent from $18.50 per boe in the first nine months of 2011 to $13.40 per boe in the same period of 2012.

- **Increased Surge's operating netback by seven percent** to $34.99 per boe for the first nine months of 2012 as compared to $32.74 in the first nine months of 2011, despite a five percent drop in realized oil & NGL prices and a 40 percent drop in realized natural gas prices.

- **Achieved a 98 percent success rate** drilling 42 gross (34.6 net) wells in the first nine months of 2012. Surge had nine gross (6.3 net) wells drilled but not on production at the end of the quarter.

- **Surge increased its oil and natural gas liquids production weighting by 13 percent to 69 percent** in the first nine months of 2012 from 61 percent in the same period of 2011.

- **Approximately 92 percent of Surge's revenue resulted from oil and natural gas liquids production**, in the first nine months of 2012 with approximately eight percent derived from natural gas production.

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[4] 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.

Entering into the fourth quarter of 2012, Surge will be in the process of drilling, completing and placing on production 22 gross (17.9 net) wells. By area, there are three gross (1.96 net) wells at Valhalla, 10 gross (6.9 net) in North Dakota, seven gross (seven net) in the Sounding Lake area of Alberta and two gross (two net) at Nipisi. All of the recent seven gross (seven net) wells at Nipisi should have recovered their load water in November and be producing load free entering December of this year.

As such, Surge is well positioned to meet its targeted exit production guidance of 11,000 boe per day.

OPERATIONS OVERVIEW:

Nipisi/Gift (Slave Point/Gilwood), Western Alberta:

During the third quarter of 2012, Surge drilled and completed an additional five gross (five net) horizontal multi-frac wells into the Slave Point Formation and completed one gross (one net) well that was drilled during the second quarter of 2012. As previously disclosed, the first two horizontal multi-frac wells drilled into the Slave Point in the first quarter of 2012 experienced proppant sand fallout into the wellbore, requiring multiple re-entry cleanout operations. Furthermore, only half of the attempted fracs were successfully placed in the second wellbore. Although both wells exceeded expectations of best 30 day production averages of 310 barrels of light oil per day, it was determined that the fracs placed were not of optimum length and width to provide the best long-term deliverability from the wells. As such, Surge modified the frac design on the subsequent drills and has consistently placed wider and longer fracs into the Formation. The modified frac design is expected to enhance the overall long-term deliverability of the wells and has eliminated the costly re-entry cleanout operations that were required on the first two wells.

The new frac design modification requires more load fluid compared to the original design. Recovering the additional load fluid extends the ultimate cleanup time on the wells by approximately two months, compared to only two weeks that were required based on the previous design. In the short-term, this has hampered third quarter 2012 production expectations by 525 barrels per day of oil and will impact fourth quarter 2012 production by approximately the same amount. However, the technical team believes that the new frac design enables the wells to exhibit superior deliverability in the mid to long-term, which will ultimately enhance the overall economics of the play.

Due to the additional time required to recover load fluid from the wells, Surge has revised the shape of its type curve for the area and reduced its best 30 day average production rates from 310 barrels of oil per day to 250 barrels of oil per day. The revised type curve shows a peak rate occurring after 60 days, while the original type curve showed the peak rate of occurring after 15 days. The ultimate recovery of the wells remains unchanged at 240 thousand barrels of oil per well. The average all-in costs of the three most recent horizontal multi-frac wells drilled and completed have dropped significantly to $4.4 million per well, a reduction of 33 percent from the first two horizontal multi-frac wells. These recent costs are in line with the targeted all-in costs of $4.2 million per well.

Surge plans to drill a horizontal multi-frac well into the Slave Point on its recently acquired southern block at Nipisi in 2013. The well will offset a vertical Slave Point well that has recovered 31,000 barrels of light oil to date. The results of this well are expected to confirm Surge's estimate of approximately 30 million barrels of DPIIP on these lands.

Surge continues to make progress on the Nipisi Slave Point waterflood. The Company submitted its waterflood application early in the fourth quarter of 2012 and expects injection into the Slave Point Formation to commence in the second quarter of 2013, pending regulatory approvals. 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.

Sounding Lake and Silver Lake (Cretaceous Sands), Southeast Alberta:

Surge drilled six gross (5.96 net) wells in Southeast Alberta during the third quarter of 2012. Two of the wells were vertical water injectors at Silver Lake, one well encountered drilling issues and had to be abandoned, while the remaining three were horizontal wells and were placed on production late in October. The Company drilled another four gross (four net) wells in the fourth quarter, of which, two were horizontal wells and two were horizontal multi-frac wells. All four wells are scheduled to be on production later in early December 2012.

The Company completed its waterflood expansion at Silver Lake in late July 2012. The expansion included drilling and completing the two aforementioned water injection wells and increasing the facility capacity to handle an additional 12,000 barrels of water per day. Although the shut-in of the facility during the expansion process impacted third quarter production negatively by approximately 100 barrels of oil per day, the field has seen a positive result from this initiative with recent production increasing by 20 percent to approximately 1,200 boe per day.

Valhalla South (Doig), Western Alberta:

Surge drilled and completed its 12th horizontal multi-frac well (100/7-19-074-08W6; 54 percent working interest) late in the third quarter in the Doig light oil pool at Valhalla South. The well was completed in the fourth quarter and was recently placed on production.

During the third quarter, Surge's average production was negatively impacted by approximately 450 boe per day at Valhalla South due to: an unscheduled facility upgrade (125 boe per day), unplanned outages and restrictions (80 boe per day) and the decision to defer drilling and completing two gross (1.25 net) horizontal multi-frac wells to the fourth quarter of 2012 (250 boe per day). Management made the strategic decision to defer the drilling and completion of these two gross (1.25 net) wells to the fourth quarter due to the depressed solution gas prices associated with the oil production at that time.

Surge plans to drill an additional four gross (2.87 net) horizontal multi-frac wells at Valhalla South during the fourth quarter of 2012, for a total of six gross (3.84 net) wells budgeted and two gross (1.44 net) previously unbudgeted for the year. The two previously unbudgeted drills are scheduled to be completed and placed on stream in early 2013.

Williston Basin (Spearfish), Manitoba and North Dakota:

In North Dakota, Surge participated in the drilling and completion of four gross (1.8 net) non-operated horizontal multi-frac wells with one of its working interest partners during the third quarter of 2012. Production from these wells commenced very late in the third quarter with the wells performing to the Company's type curve expectations. Surge also commenced its 100 percent working interest, five well drilling program during the third quarter. The Company drilled one of the five horizontal multi-frac wells late in the third quarter and has since drilled the remaining four wells. Completion operations on the wells are set to commence in November with production commencing by December.

As previously disclosed, Surge signed a drilling rig contract with two other operators to move in a drilling rig that is specifically designed to drill shallower pad wells in the Spearfish. Utilizing this rig has resulted in reduced drill costs and operational efficiencies. Surge is on track to meet it's all in targeted costs of $1.5 million per well.

Surge has been put on notice by a working interest partner to drill an additional eight gross (3.1 net) wells prior to year end. These unbudgeted wells are scheduled to be completed and placed on production in the first quarter of 2013.

Surge continues to make progress on the Waskada Unit 15 waterflood pilot. The Company submitted the waterflood progress report/amendment during the second quarter of 2012. The third party waterflood study is now complete and the results are encouraging. The results from the report have prompted Surge to plan construction of the infrastructure in January 2013 with injection into the Spearfish scheduled for late in the first quarter of 2013.

During the third quarter, Surge drilled a step-out, earning, horizontal multi-frac Spearfish well (102/09-06-002-26W1; 100 percent working interest) on lands northwest of where it has drilled its previous wells at Waskada. The well was completed and is currently on production test for evaluation.

Windfall (Bluesky), Western Alberta:

The Energy Resources Conservation Board (ERCB) has approved the waterflood pilot at Windfall. The original horizontal multi-frac well (9-9-59-15W5, 100 percent working interest) has been converted and water injection commenced during the third quarter. Surge has been injecting into the Bluesky Formation for over a month at rates that are in-line with the Company's expectations. Surge expects to see a positive waterflood pilot response from the two offsetting horizontal multi-frac producers in the second quarter of 2013. Assuming a full field commercial waterflood is viable; Surge estimates that it can ultimately recover at least 25 percent of the estimated 60 million barrels of DPIIP in this pool.

EXPLORATION AND LAND ACQUISITION UPDATE:

During the third and fourth quarters of 2012, the Company continued to expand its opportunity base. Surge estimates that it has gained access to over 150 million barrels of DPIIP through various land sales, purchases and farm-ins in the WCSB that have the potential to add more than 100 gross (99 net) oil drilling locations to Surge's existing inventory**.** Follow-up deals and land sales are still pending, and as such, Surge will be keeping further details on these initiatives confidential until 2013.

Please refer to the Surge's corporate presentation available on its website (www.surgeenergy.ca**) for more detailed information.**

REVISED 2012 GUIDANCE:

Surge's board of directors has approved an increase in the Company's capital budget from $270 million to $290 million. Approximately half of the incremental capital will be used for operations that will position Surge for production additions in 2013, while the other half will be evenly split between capturing new early stage oil resource via land acquisitions and operational overruns that occurred in 2012.

	Revised 2012 Guidance[5]	**Previous Guidance[6]**
Average Production:	9,100 boed (~70% oil & NGLs)	9,750 (72% oil & NGLs)
Exit Production:	11,000 (~73% oil & NGLs)	11,000 (77% oil & NGLs)
Capital Expenditures:	$290 million	$270 million
Average FFO:	$97 million	$120 million
Average FFO per share (basic):	$1.36	$1.69
Annualized Exit FFO:	$136 million (Net Debt/Annualized Exit FFO=1.6x)[7]	$155 million (Net Debt/Annualized Exit FFO=1.1x)

Annualized Exit FFO per share (basic):	$1.91	$2.19
Anticipated Bank Line:	$275 million	$250 million
Year End Net Debt:	$216 million	$175 million

[5] Based on US$94.28/bbl WTI, Edm Par C$86.81, $2.41/mcf AECO, US$/CDN$ exchange rate of $0.9994.

[6] Based on US$104.50/bbl WTI, Edm Par C$94.68, $2.09/mcf AECO, US$/CDN$ exchange rate of $0.9989.

[7] Calculated using the forecast December 2012 funds flow of $11.3 million.

OUTLOOK - POSITIONED FOR CONTINUED LIGHT OIL GROWTH:

Management continues to protect Surge's balance sheet with a strong risk management program. Surge has protected 61 percent of its forecast fourth quarter oil and NGL production (after royalties) with 70 percent participation in the upside above an average WTI floor price of C$89.84 per barrel. The Company has assembled more than 570 gross (435 net) oil drilling locations, made significant progress in reducing its cost structure and increasing netbacks and gained exposure to an internally estimated DPIIP of more than 550 gross million barrels of oil, with multiple waterflood opportunities and exploration initiatives.

Entering into the fourth quarter of 2012, Surge will be in the process of drilling, completing and placing on production 22 gross (17.9 net) wells. By area, there are three gross (1.96 net) wells at Valhalla, 10 gross (6.9 net) in North Dakota, seven gross (seven net) in the Sounding Lake area of Alberta and two gross (two net) at Nipisi. All of the recent seven gross (seven net) wells at Nipisi should have recovered their load water in November and be producing load free entering December of this year. As such, Surge is well positioned to meet its targeted exit production guidance of 11,000 boe per day.

Surge expects to release its 2013 capital expenditure plans in mid-January 2013.

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 Company had 71.1 million basic and 80.0 million fully diluted common shares outstanding.

FINANCIAL STATEMENTS AND MANAGEMENT'S DISCUSSION AND ANALYSIS:

Surge has filed with Canadian securities regulatory authorities its unaudited financial statements for the three and six month periods ended September 30, 2012 and the accompanying Management's Discussion and Analysis ("MD&A"). These filings are available for review at www.sedar.com or www.surgeenergy.ca.

FORWARD-LOOKING STATEMENTS:

This press release contains forward-looking statements. More particularly, this press release contains statements concerning anticipated: (i) capital expenditures for 2012, (ii) exploration, development, drilling, construction and acquisition activities, (iii) average and exit oil & natural gas production during 2012, (iv) expected results from completion technology, (v) initial production rates, (vi) production capacity (vii) operating and transportation costs, (viii) primary and secondary recovery potentials and implementation thereof, (ix) regulatory applications and the expected success thereof, and * realization of anticipated benefits of acquisitions.

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 and the application of regulatory and royalty regimes.

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 press release 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.

Note: Boe means barrel of oil equivalent on the basis of 1 boe to 6,000 cubic feet of natural gas. Boe may be misleading, particularly if used in isolation. A boe conversion ratio of 1 boe for 6,000 cubic feet of natural gas is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. Boe/d means barrel of oil equivalent per day.

This press release contains the terms "funds flow from operations" and "netbacks" which are not terms recognized under IFRS Generally Accepted Accounting Principles ("GAAP"). The Company uses these measures to help evaluate its performance as well as to evaluate acquisitions. The Company considers funds flow from operations a key measure as it demonstrates the Company's ability to generate funds necessary to repay debt and to fund future growth through capital investment. Funds generated from operations should not be considered as an alternative to, or more meaningful than, cash flow from operating activities as determined in accordance with International Financial Reporting Standards as an indicator of Surge's performance. Surge's determination of funds flow from operations may not be comparable to that reported by other companies. The reconciliation between net income or loss and cash flow from operations can be found in the statement of cash flows in the financial statements. Surge also presents funds generated from operations per share whereby per share amounts are calculated using weighted average shares (basic and diluted) outstanding consistent with the calculation of net earnings (loss) per share, which per share amounts are calculated under GAAP. The Company considers netbacks as a key measure as it demonstrates its profitability relative to current commodity prices. Operating netbacks are calculated by taking total revenues (excluding derivative gains and losses) and subtracting royalties, operating expenses and transportations costs on a per boe basis. Funds flow netbacks are calculated by taking the operating netback, adding finance income and then subtracting interest costs, and general and administrative costs on a per boe basis.

Funds flow from operations is calculated as cash provided by operating activities from the statement of cash flows, adding the change in non-cash working capital and decommissioning expenditures. Funds flow from operations is used to analyze the Company's operating performance and leverage. Funds flow from operations does not have a standardized measure prescribed by GAAP and therefore may not be comparable with the calculations of similar measures for other companies.

In this press release: (i) mcf means thousand cubic feet; (ii) mcf/d means thousand cubic feet per day (iii) mmcf means million cubic feet; (iv) mmcf/d means million cubic feet per day; (v) bbls means barrels; (vi) mbbls means thousand barrels; (vii) mmbbls means million barrels; (viii) bbls/d means barrels per day; (ix) bcf means billion cubic feet; * mboe means thousand barrels of oil equivalent; and (xi) mmboe means million barrels of oil equivalent.

SOURCE: Surge Energy Inc.

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