

Surge Resources Inc.



ANNUAL REPORT 2006

Surge Resources Inc.

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PRESIDENT'S MESSAGE

OCTOBER 27, 2006

Dear Shareholders:

The year ended June 30, 2006 was a transition year for the Company, during which the Company reviewed and evaluated a number of oil and gas opportunities, none of which resulted in a project that the Company acquired.

We currently have working capital of approximately \$900,000 and feel this is adequate funding to enable us to identify a suitable go forward project.

R. P. Antony
President

SURGE RESOURCES INC.

FINANCIAL STATEMENTS

June 30, 2006 and 2005

AUDITORS' REPORT

To the Shareholders of
Surge Resources Inc.:

We have audited the balance sheets of **Surge Resources Inc.** as at June 30, 2006 and 2005 and the statements of loss and deficit and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at June 30, 2006 and 2005 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

September 1, 2006

Deloitte & Touche LLP
Chartered Accountants

SURGE RESOURCES INC.

BALANCE SHEETS

JUNE 30

ASSETS

| | <u>2006</u> | <u>2005</u> |
|-----------------------------------|-------------------|-------------------|
| Current assets: | | |
| Cash | \$ 938,073 | \$ 684,673 |
| Goods and services tax receivable | 2,141 | 1,483 |
| | <u>\$ 940,214</u> | <u>\$ 686,156</u> |

LIABILITIES AND SHAREHOLDERS' EQUITY

| | | |
|--|------------------|------------------|
| Current liabilities: | | |
| Accounts payable and accrued liabilities | \$ 22,438 | \$ 20,012 |
| Promissory note payable (Note 2) | -- | 10,000 |
| | <u>\$ 22,438</u> | <u>\$ 30,012</u> |

| | | |
|------------------------------|--------------------|--------------------|
| Shareholders' equity: | | |
| Share capital (Note 3) | \$ 5,807,409 | \$ 5,471,734 |
| Contributed surplus (Note 4) | 294,667 | 294,667 |
| Deficit | <u>(5,184,300)</u> | <u>(5,110,257)</u> |
| | <u>917,776</u> | <u>656,144</u> |
| | <u>\$ 940,214</u> | <u>\$ 686,156</u> |

Approved on behalf of the Board



Ray Antony Director



Roy Hudson Director

SURGE RESOURCES INC.
STATEMENTS OF LOSS AND DEFICIT
YEAR ENDED JUNE 30

| | 2006 | 2005 |
|--|----------------|----------------|
| Revenue: | | |
| Interest income | \$ 23,697 | \$ 5,524 |
| Gain (loss) of other assets | 12,500 | (5,239) |
| | 36,197 | 285 |
| Expenses: | | |
| Bank charges and interest | 104 | 1,093 |
| Management fees (Note 9) | 24,000 | 12,000 |
| Office | 19,542 | 20,096 |
| Professional fees | 37,839 | 60,595 |
| Public company | 14,313 | 10,686 |
| Consulting | 10,150 | 22,917 |
| Amortization | -- | 1,182 |
| Travel | 4,292 | 5,921 |
| Stock-based compensation | -- | 219,178 |
| | 110,240 | 353,668 |
| Loss from continuing operations | (74,043) | (353,383) |
| Discontinued Operations (Note 5) | | |
| Loss from operations of discontinued subsidiary | -- | (300,146) |
| Gain on sale of subsidiary | -- | 557,400 |
| | -- | 257,254 |
| Net loss for the year | (74,043) | (96,129) |
| Deficit, beginning of year | (5,110,257) | (5,014,128) |
| Deficit, end of year | \$ (5,184,300) | \$ (5,110,257) |
| BASIC AND DILUTED NET LOSS PER SHARE | | |
| Net loss per share from continuing operations | \$ (0.00) | \$ (0.03) |
| Net loss per share after discontinued operations | \$ (0.00) | \$ (0.01) |

SURGE RESOURCES INC.
STATEMENTS OF CASH FLOWS
YEAR ENDED JUNE 30

| | 2006 | 2005 |
|--|-------------|--------------|
| Operating activities: | | |
| Loss from continuing operations | \$ (74,043) | \$ (353,383) |
| Adjustment for items not affecting cash: | | |
| Amortization | -- | 1,182 |
| (Gain) loss on sale of other assets | (12,500) | 5,239 |
| Stock-based compensation | -- | 219,178 |
| Cash flow from discontinued operations | -- | 244,158 |
| | (86,543) | 116,374 |
| | | |
| Changes in non-cash working capital from continuing operations | 1,768 | (1,864) |
| Changes in non-cash working capital from discontinued operations | -- | 276,413 |
| | (84,775) | 390,923 |
| | | |
| Investing activities: | | |
| Proceeds on sale of subsidiary | -- | 1 |
| Promissory note receivable | -- | 16,084 |
| Discontinued operations | -- | 39,719 |
| | -- | 55,804 |
| | | |
| Financing activities: | | |
| Sale of other assets | 12,500 | -- |
| Payment of bank operating loan | -- | (89,000) |
| Issuance of share capital, net of share issuance costs | 335,675 | 881,166 |
| Promissory note payable | (10,000) | -- |
| Discontinued operations | -- | (323,500) |
| | 338,175 | 468,666 |
| | | |
| Net cash increase during the year | 253,400 | 915,393 |
| | | |
| Cash (deficiency), beginning of year | 684,673 | (230,720) |
| | | |
| Cash, end of year | \$ 938,073 | \$ 684,673 |

SURGE RESOURCES INC.
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEARS ENDED JUNE 30, 2006 AND 2005

1. SIGNIFICANT ACCOUNTING POLICIES

These financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles. The preparation of financial statements involves the use of estimates and approximations within reasonable limits of materiality. The significant accounting policies are summarized below:

FUTURE INCOME TAXES

Income taxes are accounted for using the liability method. Under this method, current income taxes are recognized for the estimated income taxes payable for the current year. Future income tax assets and liabilities are recognized for temporary differences between the tax and accounting bases of assets and liabilities as well as for the benefit of losses available to be carried forward to future years for tax purposes that are more likely than not to be realized. No future income tax benefit has been recorded in these financial statements. Future income tax assets and liabilities are determined based on the tax laws and rates that are anticipated to apply in the year of realization.

STOCK-BASED COMPENSATION

The Company has a stock option plan as described in Note 4. On July 1, 2004, the Company adopted the fair value method of accounting for stock options, on a retroactive basis, without restatement of prior years. Under the Company's stock option plan, options to purchase common shares are granted to directors, officers, employees and consultants of the Company at current market prices. Options issued by the Company are accounted for in accordance with the fair value method of accounting for stock-based compensation, and the resulting cost of the option is charged to earnings with a corresponding increase in contributed surplus. The estimated fair value of the stock options issued in 2005 was determined using the Black-Scholes option-pricing model.

USE OF ESTIMATES

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities and contingencies at the date of the financial statements, and revenues and expenses during the reporting period. Actual results could differ from those estimated.

2. PROMISSORY NOTE PAYABLE

The promissory note was due on demand, bears interest at 8% and is unsecured. This note was repaid in full during fiscal 2006.

SURGE RESOURCES INC.
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEARS ENDED JUNE 30, 2006 AND 2005

3. SHARE CAPITAL

- a) Authorized
 Unlimited common shares

| | Number of shares | 2006 Amount | Number of shares | 2005 Amount |
|-------------------------|---------------------|---------------------|---------------------|---------------------|
| Beginning balance | 15,141,442 | \$ 5,471,734 | 12,901,442 | \$ 4,590,568 |
| Private placement | - | - | 2,000,000 | 900,000 |
| Stock options exercised | - | - | 240,000 | 72,000 |
| Exercise of warrants | 603,500 | 335,675 | - | - |
| Share issuance costs | - | - | - | (90,834) |
| Ending balance | <u>15,744,942</u> | <u>\$ 5,807,409</u> | <u>15,141,442</u> | <u>\$ 5,471,734</u> |

On January 5, 2005, the Company issued 2,000,000 units at a price of \$0.45 per unit for total proceeds of \$900,000. Each unit consisted of one common share, one-half of one Series A common share purchase warrant and one-half of one Series B common share purchase warrant. Each whole Series A warrant entitles the holder to acquire one common share of the Company at a price of \$0.55 per share at any time on or before July 5, 2005. Each whole Series B warrant entitles the holder to acquire one common share of the Company at a price of \$0.60 per share at any time on or before July 5, 2005. A commission of \$54,000 and 120,000 agent's warrants were paid in conjunction with this financing. Each agent warrant entitles the holder to acquire one common share of the Company at a price of \$0.55 per share at any time on or before January 20, 2006.

During fiscal 2006, warrant holders exercised a total of 483,500 warrants resulting in the issuance of 483,500 common shares. Of the warrants exercised, 408,500 were exercised at a price of \$0.55 per common share and 75,000 were exercised at a price of \$0.60 per common share for total proceeds of \$269,675. During fiscal 2006, 120,000 agent warrants were exercised resulting in the issuance of 120,000 common shares for proceeds of \$66,000. At June 30, 2006, there are no warrants outstanding.

The computation of basic and diluted net loss per share is based on the weighted average number of common shares outstanding during the year of 15,684,990 (2005 - 13,900,565).

SURGE RESOURCES INC.
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEARS ENDED JUNE 30, 2006 AND 2005

4. STOCK OPTION PLAN

Under the Company's stock option plan, the Company may grant options, to directors, officers, employees and consultants of the Company, of up to 10% of the issued and outstanding common shares. The number of shares subject to an option granted to any one participant shall be determined by the Board of Directors, but no one participant shall be granted an option which exceeds the maximum number permitted by the TSX Venture Exchange. The plan also provides that the price at which options may be granted shall be determined by the Board of Directors, subject to applicable TSX Venture Exchange approval. In no event shall the exercise price be lower than the exercise price permitted by the TSX Venture Exchange. Options granted under the plan will have a term not exceeding five years.

A summary of the status of the Company's stock option plan, as of June 30, 2006 and 2005, and changes during the years then ended are as follows:

| | <u>2006</u> | | <u>2005</u> | |
|---|----------------------------------|--|----------------------------------|--|
| | <u>Number of Options</u> | <u>Weighted Average Exercise Price</u> | <u>Number of Options</u> | <u>Weighted Average Exercise Price</u> |
| Outstanding, beginning of year | 600,000 | \$ 0.45 | 1,010,000 | \$ 0.30 |
| Granted | -- | -- | 600,000 | 0.45 |
| Exercised | -- | -- | (240,000) | 0.30 |
| Expired | -- | -- | (770,000) | 0.30 |
| Outstanding and exercisable, end of year | <u>600,000</u> | <u>\$ 0.45</u> | <u>600,000</u> | <u>\$ 0.45</u> |

On March 31, 2005, 770,000 stock options expired. These stock options were issued prior to January 1, 2002.

On December 22, 2004, the Company issued 600,000 stock options expiring on December 22, 2009 to directors of the Company. In 2005, the Company recognized compensation expense of \$219,178. This amount has been credited to contributed surplus. The weighted average fair value for each stock option granted is \$0.37.

SURGE RESOURCES INC.
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEARS ENDED JUNE 30, 2006 AND 2005

4. STOCK OPTION PLAN (Continued)

The Black-Scholes model was used to calculate the fair value of all options granted during 2006. Significant assumptions used are as follows:

- a) risk-free interest rate, 4.25%;
- b) expected life, 5 years;
- c) expected volatility, 113%; and
- d) expected dividends, 0.00%.

5. DISCONTINUED OPERATIONS

On March 15, 2005, the Company sold all of the issued and outstanding shares of its wholly-owned subsidiary, Palco Telecom Inc. The purchase price was \$1, plus the assumption of all debts of the subsidiary which resulted in a gain on sale of \$557,400.

The financial results of Palco Telecom Inc. have been presented as discontinued operations. The statement of operations and deficit for the year ended June 30, 2005 includes the gain on the sale of the subsidiary.

The balance sheet as at June 30, 2005 does not include any assets or liabilities related to the discontinued operations.

6. CASH FLOW INFORMATION

| | 2006 | 2005 |
|-------------------|-------|--------|
| Interest paid | \$ -- | \$ 810 |
| Income taxes paid | \$ -- | \$ -- |

SURGE RESOURCES INC.
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEARS ENDED JUNE 30, 2006 AND 2005

7. INCOME TAXES

(a) Reconciliation of income tax provision

The Company's income tax provision has been determined as follows:

| | 2006 | 2005 |
|---|-------------|--------------|
| Loss from continuing operations | \$ (74,043) | \$ (353,383) |
| Combined basic federal and provincial income tax rates | 33.60% | 33.60% |
| Expected income tax recovery | \$ (24,878) | \$ (118,737) |
| Add/deduct: | | |
| Valuation allowance | 24,878 | 118,737 |
| | \$ -- | \$ -- |

(b) Losses carried forward

For income tax purposes, the Company has losses available to be carried forward which can be used to reduce future years' taxable income. These losses expire as follows:

| | |
|------|------------|
| 2009 | \$ 149,000 |
| 2010 | 53,000 |
| 2011 | 48,000 |
| 2015 | 128,000 |
| 2026 | 75,000 |
| | \$ 453,000 |

The potential benefits relating to these losses have not be recognized in these financial statements, as they are not expected to be realized.

8. FINANCIAL INSTRUMENTS

Fair value of financial instruments

The Company's financial instruments consist of cash, goods and services tax receivable, accounts payable and accrued liabilities and promissory note payable. The fair values of these financial instruments approximate their carrying values due to their short-term of maturity.

SURGE RESOURCES INC.
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEARS ENDED JUNE 30, 2006 AND 2005

9. RELATED PARTY TRANSACTIONS

During the year, management fees of \$24,000 (2005 - \$12,000) were paid by the Company to DCR Investments Inc., a company in which a director of Surge Resources Inc. has a controlling interest. These fees were paid in the normal course of business for services rendered and were measured at the exchange amount.

10.COMPARATIVE AMOUNTS

Certain of the comparative figures have been reclassified to conform to the current year's presentation.

SURGE RESOURCES INC.

MANAGEMENT DISCUSSION AND ANALYSIS

June 30, 2006

SURGE RESOURCES INC.

SELECTED FINANCIAL INFORMATION

| | Year ended June 30 | | |
|--|--------------------|-----------|-------------|
| | 2006 | 2005 | 2004 |
| Revenues | \$23,697 | \$5,524 | Nil |
| Loss before discontinued operations | \$74,043 | \$353,383 | \$248,090 |
| Gain (loss) from discontinued operations | Nil | \$257,254 | Nil |
| Net loss | \$74,043 | \$96,129 | \$417,165 |
| Loss per share | \$0.01 | \$0.01 | \$0.03 |
| Total assets | \$924,214 | \$686,156 | \$1,046,222 |
| Total long-term liabilities | Nil | Nil | \$10,238 |
| Dividends | Nil | Nil | Nil |

RESULTS OF OPERATIONS

The Company had a loss from continuing operations of \$74,043 for the year ended June 30, 2006 as compared to \$353,383 for the year ended June 30, 2005. This decrease was mainly a result of a decrease in general and administrative expenses of \$24,250 from \$134,490 to \$110,240 and a decrease in stock based compensation of \$219,178 from \$219,178 to nil. Net loss for the year decreased from \$96,129 for the year ended June 30, 2005 to \$74,073 for the year ended June 30, 2006. The slight decrease in loss from 2005 to 2006 is attributed to 2005 stock based compensation expense in 2005 which was off-set by a gain in 2005 on the sale of the Company's operating subsidiary.

SUMMARY OF QUARTERLY RESULTS

| | Quarters Ended | | | | | | | |
|--|----------------|--------------|--------------|---------------|---------------|--------------|--------------|---------------|
| | June 30, 2006 | Mar 31, 2006 | Dec 31, 2005 | Sept 30, 2005 | June 30, 2005 | Mar 31, 2005 | Dec 31, 2004 | Sept 30, 2004 |
| Revenue | \$7,771 | \$6,622 | \$5,292 | \$4,012 | \$3,013 | \$2,511 | \$-- | \$- |
| Income (loss) before discontinued operations | (\$40,771) | (\$13,825) | (\$8,963) | (\$10,484) | (\$276,431) | (\$62,422) | (\$20,675) | \$6,145 |
| Net income (loss) | (\$40,771) | (\$13,825) | (\$8,963) | (\$10,484) | \$290,831 | (\$62,422) | (\$330,683) | \$6,145 |
| Incom(Loss) per share before discontinued operations | \$0.01 | \$0.01 | \$0.01 | \$0.01 | \$0.02 | (\$0.01) | (\$0.03) | \$0.01 |
| Total loss per share | \$0.01 | \$0.01 | \$0.01 | \$0.01 | \$0.03 | \$0.01 | \$0.03 | \$0.01 |

LIQUIDITY AND CAPITAL RESOURCES

At June 30, 2006, the Company had working capital of \$917,776.

LONG-TERM DEBT

The Company has no long-term debt.

SURGE RESOURCES INC.

RELATED PARTY TRANSACTIONS

During the year ended June 30, 2006, the Company incurred legal expenses of \$23,499 paid to a firm of which a current director is a partner. The Company paid \$24,000 in management fees to a company controlled by a director.

CHANGES IN ACCOUNTING POLICY

During the 2004 fiscal year, the Company adopted the new CICA Handbook Section 3870 "Stock-Based Compensation and Other Stock-Based Payments", which recommends the fair value-based methodology for measuring compensation costs.

FINANCIAL INSTRUMENTS

The Company's financial instruments consist of cash, term deposit, receivables, accounts payable and accrued liabilities. Unless otherwise noted, it is management's opinion that the Company is not exposed to significant interest, currency or credit risks arising from these financial instruments. The fair value of these financial instruments approximates their carrying values, unless otherwise noted.

SUPPLEMENTARY INFORMATION

Outstanding Share Data

| | Number of Shares | Capital Stock | Contributed Surplus |
|---|-------------------------|-----------------------|----------------------------|
| Authorized | | | |
| Unlimited number of common shares without par value | | | |
| Issued | | | |
| Balance as at June 30, 2005 | 15,141,442 | \$5,471,734 | \$294,667 |
| Warrants exercised | 603,500 | \$335,675 | |
| Balance as at June 30, 2006 | 15,744,942 | \$5,807,409.00 | \$294,667 |

STOCK OPTIONS

At June 30, 2006, the Company had outstanding stock options, enabling the holders to acquire common shares as follows:

| Number of Options | Exercise Price | Expiry Date |
|--------------------------|-----------------------|--------------------|
| 600,000 | \$0.45 | December 22, 2009 |

SUBSEQUENT EVENTS

There were no subsequent events.

SURGE RESOURCES INC.

ADDITIONAL DISCLOSURE FOR VENTURE ISSUERS WITHOUT SIGNIFICANT REVENUE

Additional disclosure concerning the Company's general and administrative expenses for the last two fiscal years is provided in the Company's Statement of Loss and Deficit contained in its Financial Statements for June 30, 2006 and 2005 that is available on its SEDAR Page Site accessed through www.sedar.com

DISCLOSURE CONTROLS AND PROCEDURES

The Company's Chief Executive Officer and Chief Financial Officer (the "Certifying Officers") is responsible for establishing and maintaining disclosure controls and procedures (the "Procedures") which provide reasonable assurance that information required to be disclosed by the Company under provincial or territorial securities legislation (the "Required Filings") is reported within the time periods specified. Without limitation, the procedures are designed to ensure that material information relating to the Company is accumulated and communicated to management, including its Certifying Officers, as appropriate to allow for timely decisions regarding the Required Filings.

The Company evaluates on a regular basis under the supervision and participation of its Certifying Officers and the members of the Corporate Governance and Compensation Committee of its Board of Directors, the effectiveness of the Procedures. Based on that evaluation, the Certifying Officers have concluded that the Procedures in place as of the end of the period covered by the Required Filings are effective in providing reasonable assurance that the material information relating to the Company is accumulated and communicated to management and reported within the time periods specified.

The Certifying Officer's have evaluated the effectiveness of the Company's disclosure controls and procedures as of June 30, 2006 and have concluded that such procedures are adequate and effective to ensure accurate and complete disclosures in annual filings.

OTHER INFORMATION

Additional information related to the Company is available for view on SEDAR at www.sedar.com