Surge Energy

Surge Energy Inc. Announces $58 Million Southeast Saskatchewan Core Area Light Oil Acquisition; and an Upward Revision to 2021 Exit Rate and 2022 Production Guidance

CALGARY, AB, Oct. 4, 2021 /CNW/ - Surge Energy Inc. ("Surge" or the "Company") (TSX: SGY) and Fire Sky Energy Inc. ("Fire Sky") announce that they have entered into an amalgamation agreement (the "Amalgamation Agreement"), pursuant to which Surge has agreed to acquire all of the issued and outstanding common shares of Fire Sky ("Fire Sky Shares") by way of a statutory amalgamation (the "Transaction") for total consideration of approximately $58 million. The Transaction is to be funded by the issuance of approximately 11.2 million Surge common shares ("Surge Shares"), and the assumption of approximately $3 million of net debt[1], inclusive of transaction costs.



With the Company's recent acquisition of Astra Oil Corp. ("Astra"), Surge management strategically targeted SE Saskatchewan as a new area of growth based on its high value light oil netbacks, low-cost production efficiencies, and quick drilling payouts. Surge's operational track record of execution in SE Saskatchewan, combined with its proven in-house technical expertise, make this an exciting new core area for the Company.

The Fire Sky assets ("Fire Sky Assets") are currently producing more than 1,500 boepd (>95 percent liquids) of operated, light oil, focused in Surge's SE Saskatchewan core area, with an operating netback[1] of more than $52 per boe at US$70 WTI pricing – which is now less than 2022 average strip pricing.

Following the Transaction, Surge now forecasts average production in 2022 of 21,500 boepd (86% liquids) of primarily light and medium gravity crude oil.

STRATEGIC RATIONALE

- The Transaction is accretive to Surge's 2022 free cash flow[1] per share, and debt adjusted cash flow per share[1];
- The Fire Sky Assets are forecast to increase the Company's cash flow from operating activities by $26 million over the next 12 months at US $70 WTI;
- The Company now estimates that its exit 2022 net debt to annualized Q4 2022 adjusted funds flow[1] ratio will be approximately 0.7 times at US$70 WTI;
- The Transaction adds highly concentrated light oil reserves, production, land, and infrastructure in Surge's SE Saskatchewan core area;
- The Fire Sky Assets include a large internally estimated development drilling inventory of more than 100 locations[2];
- The Fire Sky Assets are an excellent operational fit providing numerous synergies with the attractive light oil assets recently acquired through the Astra transaction; and
- Fire Sky has an attractive corporate Licensee Liability Rating ("LLR") in Saskatchewan of 3.5, with a total undiscounted decommissioning liability of only $9.8 million.

The Transaction is consistent with Surge's defined business model of acquiring high quality, operated, light and medium gravity crude oil reservoirs with large original oil in place ("OOIP")[3] and low recovery factors. The combined company possesses high netbacks, an operated light and medium gravity crude oil asset base, with extensive infrastructure in place to facilitate years of future development drilling and waterflood.

TRANSACTION HIGHLIGHTS

The Transaction has the following key benefits to Surge stakeholders @US$70 WTI per barrel pricing[4]:

- Accelerates Surge's return to its traditional value-based shareholder returns business model, including the potential for reinstatement of a dividend and share buy-back program;
- Five percent accretive to Surge's forecast 2022 debt-adjusted cash flow per share;
- Surge's net debt to annualized Q4 2022 adjusted funds flow ratio is forecast to decrease to 0.7 times;
- Increases Surge's 2022 adjusted funds flow per boe by approximately five percent;
- Improves the forecast 2022 all-in payout ratio[5] to 47 percent from 50 percent;
- Raises Surge's forecast 2022 free cash flow to over $120 million ($1.44 per share[6]); and
- Increases the Company's light oil weighting from 50 percent to approximately 53 percent.

TRANSACTION METRICS

Purchase Price	$58 million
Annual cash flow from operating activities[a]	$26 million
Current production rate	>1,500 boepd (95% light oil)
Proved plus probable reserves[b]	5.8 MMboe (99% light oil)
Proved plus probable RLI[c]	11 years
Licensee Liability Rating ("LLR")	3.5
Total Asset Retirement Obligation ("ARO")	$9.8 million

a: Based on 2021 pricing averaging as follows: US$70.00WTI/bbl; CAD$87.50WTI/bbl; EDM CAD$81.25/bbl; WCS CAD $70.62/bbl; AECO $2.50/mcf
b: Based upon Surge's internally generated total proved plus probable reserve estimate as of September 1, 2021.
c: Based upon Surge's internally generated total proved plus probable reserve estimate as of September 1, 2021 divided by production of 1,500 boepd.

Acquisition cost per boepd	$38,650/boepd
~~Operating Netback @ US$70 WTI~~	~~$52/boe~~

Proved plus probable reserves[b] acquisition cost	$10/boe
Proved plus probable recycle ratio[7]	5.2 x

COMBINED COMPANY HIGHLIGHTS – A SUSTAINABLE, INTERMEDIATE OIL PRODUCER

Operational platform to continue to execute on sustainable business model:

- A 21,500 boepd light and medium gravity oil producer (86 percent oil and liquids weighted);
- Over 2.6 billion barrels of net combined, internally estimated, conventional OOIP - with a low 6 percent recovery factor to date;
- Combined Total Proven Plus probable year end 2020 reserves of over 104 million boe (86 percent total liquids)[8];
- A low corporate base decline of approximately 26 percent;
- Large development drilling upside: >975 net locations[9] (internally estimated); providing a development drilling inventory of more than 13 years; and
- A long 13 year reserve life index (total proved plus probable).

Financial platform to deliver shareholder returns at less than strip pricing ofUS$70 WTI per bbl:

- 2022 forecast adjusted funds flow of more than $255 million ($3.06 per share[10]);
- Full cycle corporate production efficiencies[8] of less than $21,500 per flowing boepd (IP-180); and
- 2022 forecast free cash flow of over $120 million ($1.44 per share[10]), providing a free cash flow yield[11] of over 25 percent[12].

Upward Revision to 2021 Exit PRODUCTION Rate & 2022 Guidance

The following is the Company's increased guidance for Surge's 2021 exit production rate, as well as preliminary financial and operational guidance for 2022 (after giving effect to the Transaction):

Upwardly Revised Guidance	**@ US $65 WTI***	**@ US $70 WTI***	**@ US $75 WTI***
Exit 2021 production (boepd)	21,500		
Average 2022 production (boepd)	21,500		
% oil and NGL's	86%		
2022 Adjusted funds flow ($MM)	$230	**$255**	$275
2022 Cash flow from operations ($MM)	$215	**$240**	$260
2022 Exploration and Development Capital Expenditures ($MM)	$120	**$120**	$120
2022 Free cash flow ($MM)	$95	**$120**	$140
2022 All-in payout ratio	56%	**50%**	46%
2022 Net debt to annualized Q4/22 adjusted funds flow[11]	0.9x	**0.7x**	0.5x

* All pricing variables including differentials (WCS: US$13.50, EDM US$5.00), Fx of $0.80 and AECO of $2.50 per mcf remain constant.
Adjusted funds flow and cash flow from operations exclude realized gains/losses from financial derivatives.

TRANSACTION DETAILS

The purchase price payable by Surge under the Transaction is $58 million, comprised of: 1) the issuance of approximately 0.1438 Surge Shares for every issued and outstanding Fire Sky Share; and in addition, 2) the assumption of approximately $3 million of Fire Sky net debt, inclusive of transaction costs.

The Transaction is expected to close on or before October 30, 2021. Completion of the Transaction is subject to the approval of at least $66^{2/3}$ of the voting Fire Sky shareholders. Completion of the Transaction is also subject to, among other things, the receipt of regulatory approvals, including the approval of the Toronto Stock Exchange for the issuance of the Surge Shares under the Transaction, and other customary closing conditions.

All of the directors and officers of Fire Sky, as well as Fire Sky's largest shareholders, collectively holding approximately 73 percent of the outstanding Fire Sky Shares, have entered into support agreements pursuant to which they have agreed to vote their Fire Sky Shares in favor of the Transaction. Certain of such shareholders have additionally agreed not to sell any Surge Shares received by them pursuant to the Transaction for specified periods following the completion of the Transaction, subject to certain exceptions.

Each of Fire Sky and Surge has agreed to pay a termination fee of $2 million to the other party in certain circumstances, including in the case of Fire Sky, if Fire Sky recommends, approves, or enters into an agreement with respect to a superior proposal. Fire Sky has agreed not to solicit or initiate any discussions regarding any other acquisition proposals or sale of material assets. Fire Sky has also granted Surge a three business day right to match any superior proposal.

ADVISORS

National Bank Financial Inc. is acting as exclusive financial advisor to Surge with respect to the Transaction. ATB Capital Markets and Scotiabank have been appointed strategic advisors to Surge on the Transaction. McCarthy Tétrault LLP is acting as legal advisor to Surge with respect to the Transaction.

Peters & Co. Limited is acting as exclusive financial advisor to Fire Sky. TingleMerrett LLP is acting as legal advisor to Fire Sky with respect to the Transaction.

FORWARD LOOKING STATEMENTS:

This press release contains forward-looking statements. The use of any of the words "anticipate", "continue", "estimate", "expect", "may", "will", "project", "should", "believe" and similar expressions are intended to identify forward-looking statements. These statements involve known and unknown risks, uncertainties and other factors that may cause actual results or events to differ materially from those anticipated in such forward-looking statements.

More particularly, this press release contains statements concerning management's expectations and assumptions concerning the anticipated benefits of the Transaction and the transaction metrics related thereto; the timing of various matters in connection with the Transaction and the conditions to completion of the Transaction; and Surge's revised guidance for the remainder of 2021 and preliminary guidance for 2022. The forward-looking statements are based on certain key expectations and assumptions made by Surge, including expectations and assumptions 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; the determination of decommissioning liabilities; prevailing weather conditions; exchange rates; licensing requirements; the impact of completed facilities on operating costs; the availability and costs of capital, labour and services; and the creditworthiness of industry partners.

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capital, labour and services; and the creditworthiness of industry partners.

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 condition of the global economy, including trade, public health (including the impact of COVID-19) and other geopolitical risks; 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 constraint in the availability of services, adverse weather or break-up conditions; uncertainties resulting from potential delays or changes in plans with respect to exploration or development projects or capital expenditures; and failure to obtain the continued support of the lenders under Surge's bank line. Certain of these risks are set out in more detail in Surge's AIF dated March 9, 2021 and in Surge's MD&A for the year ended December 31, 2020, both of which have 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.

Oil and Gas Advisories

The term "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" and "boepd" mean barrel of oil equivalent per day. Bbl means barrel of oil and "bopd" means barrels of oil per day. NGLs means natural gas liquids.

This press release contains certain oil and gas metrics and defined terms which do not have standardized meanings or standard methods of calculation and therefore such measures may not be comparable to similar metrics/terms presented by other issuers and may differ by definition and application. All oil and gas metrics/terms used in this document are defined below:

Original Oil in Place ("OOIP") means Discovered Petroleum Initially In Place ("DPIIP"). DPIIP is derived by Surge's internal Qualified Reserve Evaluators ("QRE") and prepared in accordance with National Instrument 51-101 and the Canadian Oil and Gas Evaluations Handbook ("COGEH"). DPIIP, as defined in COGEH, is that quantity of petroleum that is estimated, as of a given date, to be contained in known accumulations prior to production. The recoverable portion of DPIIP includes production, reserves and Resources Other Than Reserves (ROTR). OOIP/DPIIP and potential recovery rate estimates are based on current recovery technologies. There is significant uncertainty as to the ultimate recoverability and commercial viability of any of the resource associated with OOIP/DPIIP, and as such a recovery project cannot be defined for a volume of OOIP/DPIIP at this time. "Internally estimated" means an estimate that is derived by Surge's internal QRE's and prepared in accordance with National Instrument 51-101 - *Standards of Disclosure for Oil and Gas Activities*. All internal estimates contained in this new release have been prepared effective as of Jan 1, 2021.

Net of Surge disposition from March 25, 2021, the pro forma Company (Surge + Astra + Fire Sky) will have 2020YE TPP reserves of 104.5mmboe. Fire Sky reserves have been evaluated by Sproule from 2016YE through to 2020YE. Similarly, Sproule has evaluated all of Surge's assets from 2015YE to 2020YE.

Production efficiencies are calculated by dividing capital expenditures of a project by the average production from that project for a given period of time. IP180 is the average production rate of a well over the first 180 days on production.

Drilling Inventory

This press release discloses drilling locations in two categories: (i) booked locations; and (ii) unbooked locations. Booked locations are proved locations and probable locations derived from an internal evaluation using standard practices as prescribed in the Canadian Oil and Gas Evaluations Handbook and account for drilling locations that have associated proved and/or probable reserves, as applicable.

Unbooked locations are internal estimates based on prospective acreage and assumptions as to the number of wells that can be drilled per section based on industry practice and internal review. Unbooked locations do not have attributed reserves or resources. Unbooked locations have been identified by Surge's internal certified Engineers and Geologists (who are also Qualified Reserve Evaluators) as an estimation of our multi-year drilling activities based on evaluation of applicable geologic, seismic, engineering, production and reserves information. There is no certainty that the Company will drill all unbooked drilling locations and if drilled there is no certainty that such locations will result in additional oil and gas reserves, resources or production. The drilling locations on which the Company actually drills wells will ultimately depend upon the availability of capital, regulatory approvals, seasonal restrictions, oil and natural gas prices, costs, actual drilling results, additional reservoir information that is obtained and other factors. While certain of the unbooked drilling locations have been de-risked by drilling existing wells in relative close proximity to such unbooked drilling locations, the majority of other unbooked drilling locations are farther away from existing wells where management has less information about the characteristics of the reservoir and therefore there is more uncertainty whether wells will be drilled in such locations and if drilled there is more uncertainty that such wells will result in additional oil and gas reserves, resources or production.

Surge's review of Fire Sky's inventory supports > 100 gross (>100 net) internally estimated drilling locations. Fire Sky's February 2021 Year End reserves has 118.4 net booked locations. Of these, 68.2 net are Proved locations and 50.2 net are Probable locations based on Sproule's evaluation.

Net of Surge March 25, 2021 disposition, the pro forma Company (Surge + Fire Sky) will have over >1,050 gross (>975 net) drilling locations identified herein, of these >450 gross (>400 net) are unbooked locations. Of the 562 net booked locations identified herein, 415 net are Proved locations and 147 net are Probable locations based on Sproule's 2020YE reserves. Assuming an average number of net wells drilled per year of 75, Surge's >975 net locations provide 13 years of drilling.

Surge's internally developed type curves (for both Surge and Fire Sky) were constructed using a representative, factual and balanced analog data set, as of Jan 1, 2021 for Surge type curves and July 1, 2021 for Fire Sky type curves. All locations were risked appropriately, and EUR's were measured against OOIP estimates to ensure a reasonable recovery factor was being achieved based on the respective spacing assumption. Other assumptions, such as capital, operating expenses, wellhead offsets, land encumbrances, working interests and NGL yields were all reviewed, updated and accounted for on a well by well basis by Surge's Qualified Reserve Evaluators. All type curves fully comply with Part 5.8 of the Companion Policy 51 – 101CP.

Non-GAAP Financial Measures

Certain secondary financial measures in this press release – including, "cash flow", "adjusted funds flow", "free cash flow", and "net debt" are not prescribed by GAAP. These non-GAAP financial measures are included because management uses the information to analyze business performance, cash flow generated from the business, leverage and liquidity, resulting from the Company's principal business activities and it may be useful to investors on the same basis. None of these measures are used to enhance the Company's reported financial performance or position. The non-GAAP measures do not have a standardized meaning prescribed by IFRS and therefore are unlikely to be comparable to similar measures presented by other issuers. They are common in the reports of other companies but may differ by definition and application. All non-GAAP financial measures used in this document are defined below:

Cash Flow & Adjusted Funds Flow

Cash flow is defined as cash from operating activities before changes in non-cash working capital. The Company further adjusts cash flow from operating activities in calculating adjusted funds flow for changes in decommissioning expenditures and transaction and other costs. Management believes the timing of collection, payment or incurrence of these items involves a high degree of discretion and as such may not be useful for evaluating Surge's cash flows. Changes in non-cash working capital are a result of the timing of cash flows related to accounts receivable and accounts payable, which management believes reduces comparability between periods. Management views decommissioning expenditures predominately as a discretionary allocation of capital, with flexibility to determine the size and timing of decommissioning programs to achieve greater capital efficiencies and as such, costs may vary between periods. Transaction and other costs represent expenditures associated with acquisitions, which management believes do not reflect the ongoing cash flows of the business, and as such reduces comparability. Each of these expenditures, due to their nature, are not considered principal business activities and vary between periods, which management believes reduces comparability.

Free Cash Flow

Free cash flow is calculated as cash flow from operating activities before changes in non-cash working capital less exploration and development capital expenditures. Management uses free cash flow to determine the amount of funds available to the Company for future capital allocation decisions.

Free cash flow per share is calculated using the same weighted average basic and diluted shares used in calculating income per share.

Free cash flow yield is calculated as free cash flow divided by the Company's share price at the date indicated herein. Management uses this measure as an indication of the cash flow return to shareholders based on current share prices.

Net Debt

There is no comparable measure in accordance with IFRS for net debt. Net debt is calculated as bank debt, term debt, plus the liability component of the convertible debentures plus or minus working capital, however, excluding the fair value of financial contracts, decommissioning obligations, and lease and other obligations. This metric is used by management to analyze the level of debt in the Company including the impact of working capital, which varies with timing of settlement of these balances.

Net debt to annualized adjusted funds flow ratio is calculated as net debt divided by annualized three month adjusted funds flow (adjusted funds flow for the quarter multiplied by four). Management uses this ratio to assess the period of time that it would take to fund net debt based on the adjusted funds flow from the quarter.

All-in payout ratio

All-in payout ratio is calculated as exploration and development expenditures divided by cash flow.

Neither the TSX nor its Regulation Services Provider (as that term is defined in the policies of the TSX) accepts responsibility for the adequacy or accuracy of this release.

1 This is a non-GAAP financial measure which is defined in the Non-GAAP Financial Measures section of this document.
2 See the Drilling Inventory section of this document for further details.
3 See the Oil and Gas Advisories section of this document for further details.
4 Based on the following price assumptions: US$70.00WTI/bbl; CAD$87.50WTI/bbl; EDM CAD$81.25/bbl; WCS CAD $70.62/bbl; AECO $2.50/mcf
5 This is a non-GAAP financial measure which is defined in the Non-GAAP Financial Measures section of this document.
6 Calculated using approximately 83.4 million basic shares outstanding following the completion of the Transaction.
7 Recycle ratio is calculated as operating netback of $52/boe divided by the acquisition cost of proved plus probable reserves of $10.00/boe.
8 See the Oil and Gas Advisories section of this document for further details.
9 See the Drilling Inventory section of this document for further details.
10 Calculated using approximately 83.4 million basic shares outstanding following the completion of the Transaction.
11 This is a non-GAAP financial measure which is defined in the Non-GAAP Financial Measures section of this document.
12 Calculated as $1.44 per share of free cash flow, divided by a SGY share price of $5.27 (closing share price as of October 1, 2021).

SOURCE Surge Energy Inc.

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