Surge Energy

CALGARY, AB, Jan. 17, 2022 /CNW/ - Surge Energy Inc. ("Surge" or the "Company") (TSX: SGY) is pleased to announce its 2022 budget guidance, as approved by the Company's Board of Directors, an update on Surge's anticipated reinstatement of Management's shareholder returns focused business model, and an operations update.

2022 BUDGET GUIDANCE – CONTINUED FOCUS ON SHAREHOLDER RETURNS & SUSTAINABILITY

Surge's focus in 2022 continues to be on disciplined capital allocation, with cash flow strategically allocated between capital projects, net debt[1] repayment, and a fundamental goal of reinstating the Company's dividend and shareholder returns focused business model. The Company's 2022 capital budget will see 85 percent of the expenditures focused in its two, top-tier core medium and light gravity conventional crude oil plays in the Sparky and SE Saskatchewan, which now comprise two thirds of Surge's current production.

In 2022, the Company can maintain its current production levels of 21,500 boepd, while continuing to increase shareholder's net asset value[2] by generating more than $130 million of free cash flow1 at US$75 WTI[3] – providing investors with an estimated free cash flow yield[1,4] of over 25 percent.

2022 BUDGET HIGHLIGHTS

Surge's disciplined 2022 capital expenditure budget:

- Maximizes free cash flow through a returns focused, $124 million exploration and development capital program;
- Generates forecasted 2022 annual cash flow from operating activities in excess of $255 million ($3.06 per share) at US$75 WTI crude oil pricing;
- Generates free cash flow[1] of over $130 million ($1.57 per share[1]) at US$75 WTI crude oil pricing;
- Reduces the Company's exit 2022 net debt to cash flow from operating activities1 to an estimated 0.75 times at US$75 WTI crude oil pricing;
- Targets 65 of the Company's most capital efficient drilling locations - focused predominately in its Sparky and SE Saskatchewan core areas;
- Uses less than seven percent of the Company's internally estimated drilling locations (i.e. over 950 net estimated locations currently in inventory)[5]; and
- Cost effectively maintains production of 21,500 boepd (86% liquids), maximizing free cash flow.

Further details relating to the 2022 budget are set forth below:

Guidance	**@ US $70 WTI[6]**	**@ US $75 WTI[6]**	**@ US $80 WTI[6]**
Exit 2021 production	21,500 boepd (86% liquids)		
Average 2022 production	21,500 boepd (86% liquids)		
2022(e) Exploration and development expenditures	$124 million		
2022(e) Cash flow from operating activities ($MM)*	$230	**$255**	$275
Per share	*$2.76/sh*	*$3.06/sh*	*$3.30/sh*
2022(e) Free cash flow ($MM)	$106	**$131**	$151
Per share	*$1.27/sh*	*$1.57/sh*	*$1.81/sh*
2022(e) All-in payout ratio[7]	54%	49%	45%
2022(e) Exit net debt to 2022(e) cash flow from operating activities ratio**	0.98x	0.75x	0.64x
2022(e) Royalties as % of petroleum and natural gas revenue	14.0% - 16.0%		
2022(e) Net operating expenses[7]	$15.75 - $16.50 per boe		
2022(e) Transportation expenses	$1.00 - $1.25 per boe		
2022(e) General & administrative expenses	$1.95 - $2.05 per boe		

* Cash flow from operating activities assumes a nil change in non-cash working capital.
**2022(e) exit net debt is prior to any contemplated allocation of 2022(e) free cash flow to shareholder returns through dividends or share buybacks.

CORPORATE UPDATE –TIMELINE FOR REINSTATEMENT OF SURGE'S MULTI-FACETED SHAREHOLDER RETURNS MODEL

Management's stated goal is to position the Company as a well-financed energy producer with a significant free cash flow profile that supports consistent shareholder returns through: 1) net asset value per share increases through ongoing debt repayment; 2) sustainable dividends; 3) modest production per share growth; and 4) opportunistic share buybacks.

On December 9, 2021, the Company announced the successful closing of a $130 million, 5-year term debt facility, injecting a significant amount of stable, long term debt into the Company's capital structure, with the strategic objective of reducing Surge's reliance on volatile, shorter term debt. Surge will continue to focus on providing shareholder returns through further reductions in net debt over the coming months.

On this basis, Surge is initially targeting a reduction of net debt to a range of $250 to $265 million, at which point the Company will look to resume its historical, shareholder returns focused business model, including the reinstatement of a dividend. Management will also evaluate the potential for opportunistic share buybacks. A reduction of net debt to the targeted range will also add approximately $0.60 to $0.75 per share to the net asset value of the Company (based on approximately 83.4 million shares outstanding).

At current commodity price levels, Management estimates that Surge will be within its targeted net debt range before mid-year in 2022.

OPERATIONS UPDATE – UNLOCKING SIGNIFICANT INCREMENTAL VALUE IN SPARKY AND SE SASKATCHEWAN

Surge finished 2021 on a strong operational note. The Company continued to successfully develop its dominant land position in its core Sparky asset, using its traditional low risk single-leg multi-stage frac design, with results continuing to outperform internal type curve expectations[8]. In addition, Surge has now successfully tested multi-leg, open hole lateral development in portions of its Sparky core area where the multi-stage frac design is not optimal.

To date, Surge has drilled four multi-leg laterals in the Sparky formation with the average of the four wells exceeding the Company's internal type curve expectations. Encouragingly, two of the wells have been brought on production with rates over 220 bopd each on an IP30 basis. At current pricing these two wells paid out in just 115 days.

Additionally, given that the rock properties of the Sparky formation are analogous to that of theClearwater formation, Surge is testing drilling mud systems that have proven to be effective in the Clearwater play, in three separate multi-leg Sparky wells. On this basis, the Company is piloting an oil based mud system, offsetting wells drilled with variations of KCL brine-based mud systems. Initial results on the oil based pilot well are encouraging, and as such, Surge will expand the pilot of this oil based mud system in its 2022 drilling program.

Going forward, Surge views multi-leg lateral development as complimentary to its existing single-leg multi-frac drilling program. The addition of the multi-leg design will upgrade a meaningful portion of the Company's existing Sparky core area drilling inventory, which currently consists of over 425 internally estimated locations[8]. Based on the strong initial well results, Surge is now budgeting eight additional multi-leg Sparky wells in its 2022 drilling program, along with 27 single-leg multi-frac Sparky wells.

In Surge's newly acquired, high operating netback, light oil core area of SE Saskatchewan, recent development drilling has yielded impressive results. In the Minard area, two wells drilled in August had initial production rates over 320 bopd and have already produced a total of 30,000 barrels of oil each. These wells each paid out in less than 55 days. In 2022 SE Saskatchewan will be an important component of the Company's drilling activity, with 36 gross (27.7 net) wells budgeted.

Surge has continued its Q4/21 operational momentum by securing services, having commenced its 2022 drilling program in December of 2021. The Company currently has 3 drilling rigs operating in its core areas: one rig drilling single-leg multi-frac Sparky wells, one drilling multi-leg open hole Sparky wells, and one drilling horizontal wells in SE Saskatchewan. To date, the Company has rig released eight net wells of its planned 27.1 net well Q1/22 drilling program.

OUTLOOK – POSITIONED FOR OUTPERFORMANCE IN 2022

Surge's Management and Board are excited about the Company's outlook for 2022, as previous lender mandated fixed price crude oil hedging contracts expired at the end of 2021. Management continues to strategically assess, analyze and position the Company based on its strong competitive corporate advantages, including Surge's long 15 year reserve life index[9], low conventional corporate decline, high crude oil operating netbacks, top tier production efficiencies, large 13 year drilling inventory[10], and the Company's substantial $1.0 billion tax pool base.

Surge's lower risk, high operating netback, conventional crude oil asset and opportunity base matches very well with Management's conservative returns based business strategy. The Company's large OOIP[9] conventional reservoirs provide top tier production efficiencies, shallow declines, and significant free cash flow – underpinning Management's strategic plan to return to a dividend plus, share buy backs, business model.

At US$75 WTI per barrel, Surge anticipates delivering a free cash flow yield of over 25 percent to investors in 2022.

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 with respect to Surge's declared focus and primary goals, including its goal of returning to a shareholder returns-based business model; management's expectations regarding increases to Surge's net asset value; management's expectations and plans with respect to the development of its assets and the timing thereof; Surge's annual exploration and development capital expenditure program and budget; Surge's drilling program and inventory; management's 2022 guidance, including estimated production levels, exploration and development capital expenditures, cash flow from operating activities, free cash flow and free cash flow yield, all-in payout ratio; exit net debt to cash flow from operating activities ratio, royalties as a percentage of petroleum and natural gas revenue; net operating expenses, transportation expenses and general and administrative expenses; management's expectations regarding net bank debt repayment at current prices and the timing thereof; commodity prices; and Surge's reserve life index, corporate decline and tax pool base.

The forward-looking statements are based on certain key expectations and assumptions made by Surge. 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 period 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.

Reserve life index is calculated as total Company share 2020YE reserves divided by the annualized fourth quarter 2020 production.

Net asset value is calculated as the total discounted (10%) value of reserves plus undeveloped land and seismic value, less net debt, divided by the number of basic shares outstanding.

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 external 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.

Net of Surge's March 25, 2021 disposition, the pro forma Company (Surge + Astra + 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. Net of 2021 drilling, Surge estimates a drilling inventory of >950 net locations as of December 31, 2021. Assuming an average number of net wells drilled per year of 75, Surge's >950 net locations provide 13 years of drilling.

Also net of Surge March 25, 2021 disposition, Surge's Sparky Core area has over >450 gross (>450.0 net) Sparky Core drilling locations identified herein, of these 296 gross (>293 net) are unbooked locations. Of the 158 net booked locations identified herein, 114 net are Proved locations and 45 net are Probable locations based on Sproule's 2020YE reserves. Net of 2021 Sparky core area drilling, Surge estimates a drilling inventory of >425 net locations as of December 31, 2021.

Surge's internally developed type curves (for Surge, Astra and Fire Sky) were constructed using a representative, factual and balanced analog data set, as of Jan 1, 2021 for Surge type curves, April 15, 2021 for Astra 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 and Other Financial Measures

This press release includes references to non-GAAP and other financial measures used by the Company to evaluate its financial performance, financial position or cash flow. These specified financial measures include non-GAAP financial measures and non-GAAP ratios, are not defined by IFRS and therefore are referred to as non-GAAP and other financial measures. Certain secondary financial measures in this press release – namely, "all-in payout ratio", "free cash flow", "free cash flow yield", "net debt", "net debt to cash flow from operating activities", "net operating expenses", and "operating netback" are not prescribed by GAAP. These non-GAAP and other 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 and other financial 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 and other financial measures used in this document are defined below, and as applicable, reconciliations to the most directly comparable GAAP measure for the year ended December 31, 2020, have been provided to demonstrate the calculation of these measures:

All-in Payout Ratio

All-in payout ratio is a non-GAAP ratio, calculated as exploration and development expenditures divided by cash flow from operating activities. Management uses this measure to determine the amount of cash from operating activities that is used to reinvest in the exploration and development of its asset base.

Free Cash Flow and Free Cash Flow Yield

Free cash flow is a non-GAAP financial measure, calculated as cash flow from operating activities 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 a non-GAAP ratio, calculated using the same weighted average basic and diluted shares used in calculating income per share.

Free cash flow yield is a non-GAAP ratio, calculated as free cash flow divided by the number of basic shares outstanding, divided by the Company's share price at the date indicated herein. Management uses this measure as an indication of the cash flow available for return to shareholders based on current share prices.

Free Cash Flow

($000's)	**2020**
Cash flows from operating activities	72,190
Less: Exploration and development capital expenditures	(52,773)
Free Cash Flow	19,417

Net Debt and Net Debt to Cash Flow from Operating Activities

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

Net debt to cash flow from operating activities is a non-GAAP ratio, calculated as exit net debt divided by cash flow from operating activities. Management uses this ratio to assess the time (in years) that it would take to fund net debt based on the annualized cash flow from operating activities.

Net debt

($000's)	**2020**
Bank debt	(260,908)
Term debt	(32,718)
Accounts receivable	29,796
Prepaid expenses and deposits	5,253
Accounts payable and accrued liabilities	(51,265)
Convertible debentures	(71,181)
Net debt	(381,023)

Net Operating Expenses

Net operating expenses is a non-GAAP financial measure, determined by deducting processing income, primarily generated by processing third party volumes at processing facilities where the Company has an ownership interest. It is common in the industry to earn third party processing revenue on facilities where the entity has a working interest in the infrastructure asset. Under IFRS this source of funds is required to be reported as revenue. However, the Company's principal business is not that of a midstream entity whose activities are dedicated to earning processing and other infrastructure payments. Where the Company has excess capacity at one of its facilities, it will look to process third party volumes as a means to reduce the cost of operating/owning the facility. As such, third party processing revenue is netted against operating costs when analyzed by management.

Net Operating Expenses

($000's)	**2020**
Operating expenses	101,640
Less: processing income	(4,772)
Net operating expenses	96,868

Operating Netback

Operating netback is a non-GAAP financial measure, calculated as petroleum and natural gas revenue and processing and other income, less royalties, realized gain (loss) on commodity and FX contracts, operating expenses, and transportation expenses. Operating netback per boe is calculated as operating netback divided by total barrels of oil equivalent produced during a specific period of time. There is no comparable measure in accordance with IFRS. This metric is used by management to evaluate the Company's ability to generate cash margin on a unit of production basis.

Operating Netback

($000's)	**2020**
Petroleum and natural gas revenue	59,907
Processing income	1,006
Royalties	(6,493)
Realized gain (loss) on commodity and FX contracts	(6,247)
Operating expenses	(26,531)
Transportation expenses	(1,892)
Operating netback	19,750
Barrels of oil equivalent (boe)	1,597
Operating netback ($ per boe)	12.37

[1] This is a non-GAAP and other financial measure which is defined in the Non-GAAP and Other Financial Measures section of this document.

[2] See the Oil and Gas Advisories section of this document for further information.

[3] Additional pricing assumptions: (WCS: US$13.00, EDM US$3.50 differentials), Fx of $0.79 and AECO of $3.25 per mcf.

[4] Free cash flow yield of 25 percent is calculated as $131 million of free cash flow, divided by 83.4 million basic shares outstanding, divided by a SGY share price of $6.25/sh.

[5] See the Drilling Inventory section of this document for further information.

[6] All additional pricing assumptions (WCS: US$13.00, EDM US$3.50 differentials), Fx of $0.785 and AECO of $3.25 per mcf remain constant.

[7] This is a non-GAAP and other financial measure which is defined in the Non-GAAP and Other Financial Measures section of this document.

[8] See the Drilling Inventory section of this document for further information.

[9] See the Oil and Gas Advisories section of this document for further information.

[10] See the Drilling Inventory section of this document for further information.

SOURCE Surge Energy Inc.

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