Surge Energy

Surge Energy Inc. Announces First Quarter 2020 Results

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CALGARY, May 5, 2020 /CNW/ - Surge Energy Inc. ("Surge" or the "Company") (TSX: SGY) is pleased to announce its financial and operating results for the quarter ending March 31st, 2020.



Q1/2020 CORPORATE UPDATE – NAVIGATING THE PANDEMIC

Massive crude oil demand destruction from the COVID-19 pandemic, together with increased oil production from OPEC and Russia, contributed to a dramatic decrease in the price of oil in 1H/20. Consequently, Surge's management and Board acted decisively to protect the Company's balance sheet and net asset value as follows:

1. On March 9, 2020, Surge became one of the first oil companies in Canada to reduce its dividend (by 90 percent);
2. In early March the Company suspended all major capital expenditures providing operational and financial flexibility for the balance of 2020;
3. On April 14, 2020, the Company was one of the first oil companies in Canada to implement temporary production curtailments. This included up to 4,400 boepd (~21 percent of March volumes) of lower netback production in order to maximize corporate cashflows;
4. Also, on April 14, 2020, Surge suspended the Company's dividend in its entirety until market conditions improve;
5. In Q1 and early Q2/20, the Company successfully continued to lock in very attractive forward WTI crude oil prices, significantly above current spot prices, pursuant to its strategic ongoing hedging program (see below); and
6. Prior to suspending Q1/20 capital expenditures, Surge completed an outstanding Q1 development drilling program drilling 19 consecutive successful Sparky wells (i.e. of a budgeted 26 well program). The Company added more than 2,500 boepd (>90 percent medium/light oil) with this reduced program at an all-in cost of $22 million, providing top tier capital efficiencies of $8,800 per boepd.

Given the unprecedented circumstances facing world crude oil markets, together with management's aforementioned production curtailments, on April 14th the Company suspended its previously announced 2020 guidance and capital program of $98.5 million. Surge's remaining 2020 capital program will be re-guided as crude oil prices improve.

In addition to the capital allocation decisions set forth above, in accordance with management's strategic plan the Company has continued to reduce net debt[1] significantly from Q1/19 as compared to Q1/20 by more than $53 million, a decrease of over 12 percent.

Furthermore, the Company has identified approximately $40 million of annualized operating and G&A cash reductions through temporary production curtailments, workforce optimizations and minimization or elimination of discretionary corporate costs. As a result of management's proactive capital allocation decisions, these cash reductions, combined with the suspension of the Company's dividend, are expected to result in aggregate annualized cost savings of approximately $73 million per year.

FINANCIAL AND OPERATING HIGHLIGHTS

	Three Months Ended March 31,		
($000s except per share amounts)	**2020**	**2019**	**% Change**
Financial highlights			
Oil sales	**61,211**	91,128	(33)%
NGL sales	**1,063**	2,425	(56)%
Natural gas sales	**1,432**	4,315	(67)%
Total oil, natural gas, and NGL revenue	**63,706**	97,868	(35)%
Cash flow from operating activities	**43,138**	28,908	49 %

Per share - basic ($)	**0.13**	0.09	44 %
Adjusted funds flow[i]	**30,028**	41,851	(28)%
Per share - basic ($)[i]	**0.09**	0.14	(36)%
Net loss[ii]	**(615,227)**	(7,983)	7,607 %
Per share basic ($)	**(1.85)**	(0.03)	6,067 %
Total exploration and development expenditures	**32,504**	41,261	(21)%
Total acquisitions & dispositions	**—**	(27,807)	(100)%
Total capital expenditures	**32,504**	13,454	142 %
Net debt, end of period	**384,686**	438,150	(12)%

Operating highlights			
Production:			
Oil (bbls per day)	**16,891**	17,542	(4)%
NGLs (bbls per day)	**564**	644	(12)%
Natural gas (mcf per day)	**17,409**	20,663	(16)%
Total (boe per day) (6:1)	**20,357**	21,630	(6)%
Average realized price (excluding hedges):			
Oil ($ per bbl)	**39.82**	57.72	(31)%
NGL ($ per bbl)	**20.72**	41.86	(51)%
Natural gas ($ per mcf)	**0.90**	2.32	(61)%

Netback ($ per boe)			
Petroleum and natural gas revenue	**34.39**	50.27	(32)%
Realized gain (loss) on commodity and FX contracts	**7.29**	(0.37)	(2,070)%
Royalties	**(4.59)**	(5.68)	(19)%
Net operating expenses[i]	**(14.29)**	(15.12)	(5)%
Transportation expenses	**(1.64)**	(1.98)	(17)%
Operating netback[i]	**21.16**	27.12	(22)%
G&A expense	**(1.84)**	(1.78)	3 %
Interest expense	**(3.10)**	(3.84)	(19)%
Adjusted funds flow[i]	**16.22**	21.50	(25)%

Common shares outstanding, end of period	**335,069**	313,980	7 %
Weighted average basic shares outstanding	**332,188**	309,448	7 %
Stock option dilution	**—**	—	—%
Weighted average diluted shares outstanding	**332,188**	309,448	7 %

i This is a non-GAAP financial measure which is defined in the Non-GAAP Financial Measures section of this document.
ii For the period ended March 31, 2020, the Company incurred a net loss of $615.2 million, including a non-cash asset impairment charge of $590.6 million recognized in the first quarter of 2020 primarily due to a decrease in the average independent engineering price forecasts. The impairment charge does not impact the Company's adjusted funds flow, and is reversible in future periods should there be any indicators that the value of the assets has increased.

STRATEGIC HEDGING PROGRAM; CONTINUED DEBT REDUCTION

Surge achieved excellent hedging results in the last few weeks capturing a large portion of the significant (record) contango in the forward curve for crude oil prices, and "blending it" in with the Company's much higher pre-existing crude oil hedges.

As disclosed on April 14, 2020 Surge has a strong "in the money" hedge book in which the Company reported 5,500 bbl/d of production hedged for Q2 at attractive crude oil pricing (i.e. above C$80/bbl). In addition, Surge has continued to act quickly and decisively to add further hedges to protect the Company's balance sheet, given the near-term crude inventory concerns that are negatively impacting near term crude oil prices.

For example, during the week ofApril 13-17, 2020 Surge successfully took advantage of the significantly higher future prices in the forward WTI crude oil curve by adding an additional 1,500 bbl/d of hedges (3-ways and swaps) for the period of May 2020 through June 2021. This further protects Surge's near-term crude oil price realizations against a falling spot price, with floors on the incremental 1,500 bbl/d between US$32 and US$36 WTI, and with upside participation to more thanUS$40 per bbl on a significant portion of these hedges.

Additionally, as global inventory concerns continued to grow, onApril 17, 2020 Surge executed an incremental 1,000 bbl/d of WTI swaps for the month of June, which average nearly C$42 per bbl (US$30 per bbl). Currently the June WTI futures contract

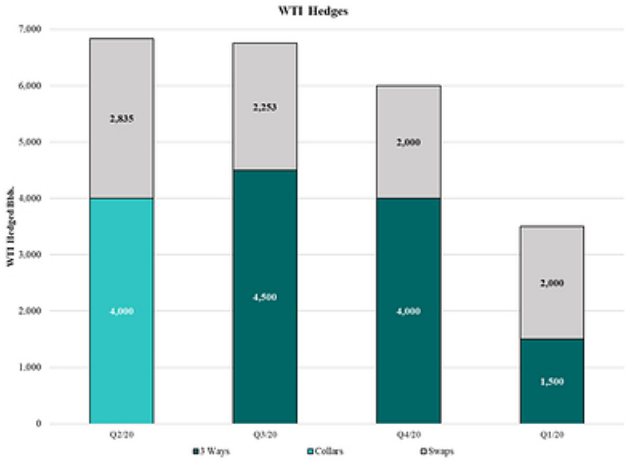
is trading at approximately US$25 WTI per bbl.

Considering management's strategic decision to proactively curtail up to 21 percent of Surge's oil production, the Company is now even better hedged on a percentage basis. For example, Surge has now hedged approximately 71 percent of the Company's forecasted after Crown royalty crude oil production in June at over C$67 per bbl.

In late 2019, management proactively reacquired all of the puts that Surge sold pursuant to its 1H/20 3-way hedge transactions for a minimal total cost of $0.4 million. This defensive, proactive step provides approximately C$13.9 million[2] in incremental hedging gains to the Company, representing a return of approximately 3,500 percent on the decision to reacquire the puts.

In summary, set forth below is a breakdown Surge's current crude oil hedge book, which now locks in production through Q1/2021:

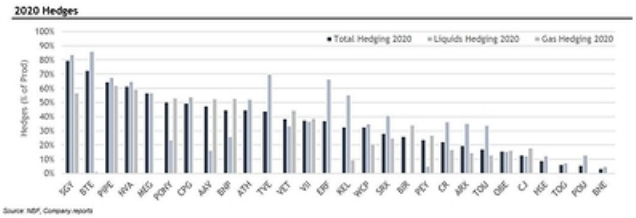
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In addition, Surge has also hedged over 65 percent of its light oil production differentials at USWTI5 per bbl for Q2 and Q3/20.

As a result of Surge's strategic, ongoing, and disciplined hedging program, the Company has now been independently reported as having one of the best commodity hedge positions for 2020 in its Canadian peer group, as set forth below:

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In addition to the capital allocation decisions set forth above, in accordance with management's strategic plan the Company has continued to reduce net debt significantly from Q1/19 as compared to Q1/20 by more than $53 million, a decrease of over 12 percent.

OPERATIONS UPDATE – PRODUCTION CURTAILMENT - RECORD SPARKY DRILLING RESULTS

On April 14, 2020, the Company announced its strategic decision to temporarily curtail up to 4,400 boepd (~21 percent) of lower netback production in order to maximize corporate cash flows. Surge has the ability to restart this production in short order, as commodity prices increase. Additionally, Surge is selectively choosing to work over wells that meet the Company's internal economic hurdle rate of a six to nine-month payout at current strip prices.

Following this announcement crude prices have continued to fall precipitously. On this basis, Surge is reviewing the temporary curtailment of additional production where the economics of such a curtailment are advantageous to the Company.

Surge's high quality, large original oil in place[3] ("OOIP"), conventional reservoirs continued to deliver excellent results during Q1/2020. Surge completed a reduced Q1/20 drilling program in early March, drilling 19 successful horizontal wells (of an originally budgeted 26 wells) in seven different Sparky pools, which included the delineation of two new Sparky pool discoveries on its lands at Betty Lake North and Eyehill South.

Currently, 14 of the wells drilled in the quarter are on stream, with initial production results performing at or above management's expectations. Given Surge's very successful Q1/20 drilling results, the Company's production exceeded 21,000 boepd in March (prior to the temporary production curtailments), with five additional Sparky wells to be brought on production following breakup, and as crude oil prices improve.

As discussed above (see "STRATEGIC HEDGING PROGRAM; CONTINUED DEBT REDUCTION"), management acted decisively during the week of April 13-17, 2020 to take advantage of the significantly higher forward crude oil pricing curve that was available, and captured a significant, incremental, positive hedge position before crude oil strip pricing dropped further.

OUTLOOK – BALANCE SHEET MANAGEMENT AND RIGOROUS COST CUTTING

In light of the COVID-19 pandemic, Surge has taken many steps to protect its staff, their families, service providers, stakeholders and the general public. The Company's dedicated "COVID-19 Team" ensures that Surge is staying up to date with the latest information and data surrounding the virus outbreak, including heeding the government's advice for physical distancing. These measures protect the health of Surge staff while they work diligently to ensure the safety and security of the Company's facilities as well as continuing to deliver reliable production. All of Surge's Calgary office staff are working remotely and all field locations have implemented enhanced distancing, cleaning and sanitation measures. The management and COVID-19 teams will continue to monitor the situation, taking guidance from health authorities.

Massive crude oil demand destruction from the COVID-19 pandemic, together with increased oil production from OPEC and Russia, contributed to a dramatic decrease in the price of oil in 1H/20. Consequently, Surge's management and Board acted decisively to protect the Company's balance sheet and net asset value, including suspending the Company's dividend and deferring all major capital expenditures indefinitely.

Furthermore, in Q1 and early Q2/20, the Company successfully continued to lock in very attractive forward crude oil prices pursuant to Surge's strategic ongoing hedging program, through to June 2021.

Furthermore, the Company has identified approximately $40 million of annualized operating and G&A cash reductions through temporary production curtailments, workforce optimizations and minimization or elimination of discretionary corporate costs. As a result of management's proactive capital allocation decisions, these cash reductions, combined with the suspension of the Company's dividend, are expected to result in aggregate annualized cost savings of approximately $73 million per year.

Given the unprecedented circumstances facing world crude oil markets, together with management's aforementioned production curtailments, on April 14, 2020 the Company suspended its previously announced 2020 guidance and capital program of $98.5 million. Surge's remaining 2020 capital program will be re-guided as crude oil prices improve.

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 plans with respect to the development of its assets and the timing thereof; Surge's assets and performance, and the characteristics thereof; Surge's operational and financial flexibility for the balance of 2020; the ability of Surge to maximize corporate cash flows; Surge's declared focus and primary goals,; the impacts of COVID-19 on our business and measures taken in response thereto; the societal, economic and governmental response to COVID-19; Surge's capital expenditure program and its flexibility to make adjustments thereto; Surge's current and potential production curtailments and its ability to restart such production; Surge's cost reduction efforts and the anticipated results and benefits therefrom; commodity prices and management's ability to react to changes thereto; Surge's risk management program; Surge's hedging program and the characteristics thereof; the select working-over of wells by Surge; and the suspension of Surge's dividend and the timing for reimplementation.

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.

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, 2020 and in Surge's MD&A for the period endedDecember 31, 2019, 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. "Bopd" and "bbl/d" 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.

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, 2020.

Non-GAAP Financial Measures

Certain secondary financial measures in this press release – namely, "adjusted funds flow", "adjusted funds flow per share", "net debt", "net operating expenses", "operating netback", and "adjusted funds flow per boe" 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:

Adjusted Funds Flow & Adjusted Funds Flow per Share

The Company adjusts cash flow from operating activities in calculating adjusted funds flow for changes in non-cash working capital, decommissioning expenditures and cash settled 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.

Adjusted funds flow per share is calculated using the same weighted average basic and diluted shares used in calculating

income per share.

The following table reconciles cash flow from operating activities to adjusted funds flow and adjusted funds flow per share for the three months ended March 31, 2020:

	Three Months Ended March 31,	
($000s except per share amounts)	**2020**	**2019**
Cash flow from operating activities	**43,138**	28,908
Change in non-cash working capital	**(14,748)**	11,042
Decommissioning expenditures	**1,540**	1,707
Cash settled transaction and other costs	**98**	194
Adjusted funds flow	**$ 30,028**	$ 41,851
Per share - basic	**$ 0.09**	$ 0.14

Net Debt

There is no comparable measure in accordance with IFRS for net debt. Net debt is calculated as bank 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.

	As at March 31,	As at December 31,	As at March 31,
($000s)	**2020**	**2019**	**2019**
Bank debt	(305,804)	(316,404)	(398,666)
Accounts receivable	29,738	41,486	50,814
Prepaid expenses and deposits	4,672	4,875	7,465
Accounts payable and accrued liabilities	(43,718)	(40,848)	(56,839)
Dividends payable	(279)	(2,719)	(2,616)
Convertible debentures	(69,295)	(68,699)	(38,308)
Total	$ (384,686)	$ (382,309)	$ (438,150)

Net Operating Expenses

Net operating expenses are determined by deducting processing and other revenue 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 in the MD&A.

Operating Netback & Adjusted Funds Flow Netback

Operating netback and adjusted funds flow per boe for the three months ended March 31, 2020 are calculated on a per unit basis as follows:

	Three Months Ended March 31,	
($000s)	**2020**	**2019**
Petroleum and natural gas revenue	**63,706**	97,868
Processing and other income	**1,720**	474
Royalties	**(8,505)**	(11,061)
Realized gain (loss) on commodity and FX contracts	**13,509**	(716)
Operating expenses	**(28,199)**	(29,913)
Transportation expenses	**(3,046)**	(3,863)
Operating netback	**39,185**	52,789
G&A expense	**(3,416)**	(3,470)
Interest expense	**(5,741)**	(7,468)
Adjusted funds flow	**30,028**	41,851
Barrels of oil equivalent (boe)	**1,852,414**	1,946,676

Operating netback ($ per boe)	**$**	**21.16**	$	27.12
Adjusted funds flow ($ per boe)	**$**	**16.22**	$	21.50

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.accuracy of this release.

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

2 Based on May 5, 2020 strip pricing.

3 See the Oil and Gas Advisories section of this document for further details.

SOURCE Surge Energy Inc.

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