BISON INTERESTS

Why I Bought 19% of Journey Energy

I've gotten a lot of questions about Journey Energy and why I've bought so much of it - almost 20% of the company. Journey is an $85 million market cap Canadian oil and gas producer. Now you also probably have a question! "why would anyone buy a bunch of stock in an $85 million Canadian E&P?" And maybe one more: "do you like losing money?"

To help answer these questions, I've organized my investment chronologically, with sequentially increased percentage ownership of the company (and reduced liquidity). I've structured it as follows:

1) Initial purchase: Discount to NAV with great management
2) Doubling down: reduced governance risk and winning business model at a discount
3) Topping up: promising shale oil well results and licenses with a world-class partner and spiking cash flow with reduced geopolitical risk

1) Discount to NAV with great management

Journey IPO'ed in 2014 at $12, and its share price rapidly descended to $2 by mid-2015 and has stayed in that price range for years - it is currently at $2.15/share. Journey's producing assets had an estimated value of $3.84 per share net of debt at year end 2018, according to GLJ, a leading Canadian 3rd party reserve evaluator, and $9.11 per share in "proved and probable" value.

With "conventional" producing assets, Journey's corporate decline rate is extremely low, meaning that only $12 million in capital is necessary to be spent (in total, not per year!) to produce the net $3.84 / share in reserve value on producing assets (per GLJ). This is radically different from most publicly traded E&P companies (and most private equity backed E&Ps as well). It allows for substantially higher free cash flow and gives Journey the flexibility to invest counter cyclically, as evidenced by the Duvernay deal, to be discussed later.

Management quality is easy to claim and hard to prove. Every oil and gas private equity firm and most public equity investors claim to only invest in "top management teams" and it is mathematically impossible for every team to be above average. Evaluated with a healthy dose of skepticism, Journey's team has delivered better than average performance through more than a dozen asset level transactions since 2014, successfully navigating through a multi-year downturn and emerging with production and reserves intact, share count un-inflated, and a promising potentially "core" shale play acquired and fully funded.

They did it before at Nuvista (a market leading Montney shale producer) and previously with Bonavista (now a financially stressed company but a leading performer operationally and in the stock market for years under their leadership). The same specific activities – particularly, active and astute asset transactions – are in play at Journey. They have begun to pay off, evidenced by growing cash flow per share and by the large net acre and over-riding royalty position per share in the Duvernay.

2) Reduced governance risk and winning business model at a discount

In 2016, a Hong Kong listed energy company (MIE) with substantial financial leverage purchased 37.5% of Journey Energy's outstanding stock for $2.07 per share in a $33.8 million transaction. It was purchased from a founding equity holder, Infra-PSP Partners, a subsidiary of a $150 billion pension fund. MIE's ownership of essentially a control block of Journey stock introduced governance risk, including the possibility of an amalgamation on unfavorable terms.

In 2018, Journey repurchased 24.8% of the company from MIE at a price of $1.68 per share, simultaneously monetizing MIE's leverage through a buyback at an advantaged price and eliminating risk of amalgamation and loss of control without a premium. Shortly after this announcement, I started discussions with Journey management and MIE and was able to purchase the MIE's remaining Journey shares at a slight discount. As a returns-focused shareholder with a stable, long term oriented perspective and client base, this further mitigated governance risk.

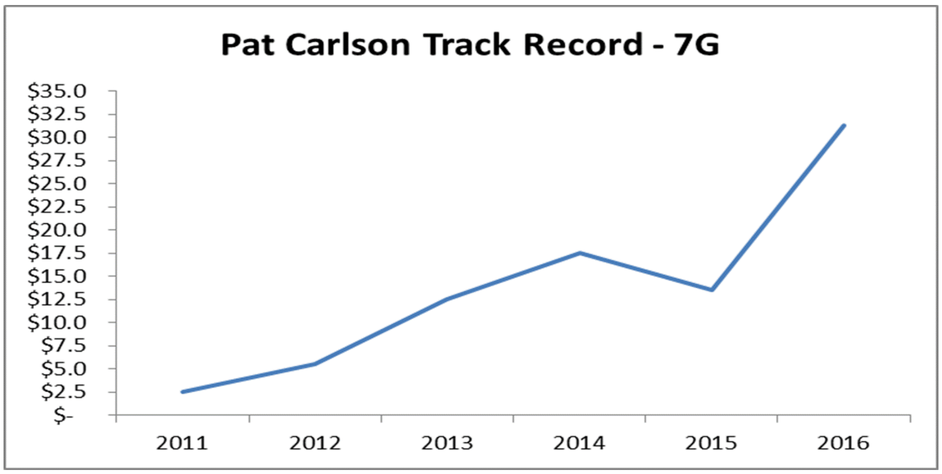
At this point Journey had been essentially forgotten by the industry, with investment banks dropping research coverage and the few investors who had heard of the company having dropped it from their radar screens after the post-IPO share price crash and then potential governance issues post MIE purchase in 2016. But Journey had just gotten even more interesting. The buyback coincided with a shift in to the best business model I've seen in oil and gas.

I'll call it the "**Prime**" business model. Many investors haven't yet heard of Prime Energy (PNRG), despite it being one of the best performing stocks in the stock market since its current management got control around 1987. The stock is currently at $140, vs a price of ~$0.50 in 1987. And yes, Prime is an oil and gas company. And yes, they're publicly traded. And yes, that's right, they're up from 50 cents to $140. Eye popping returns, driven by a few key activities: 1) sell down or "farm out" high value land rather than trying to develop expensive in house expertise. 2) buy back shares at a discount to NAV and 3) maintain efficient low decline operations with numerous small deals to create value.

Journey had just bought back almost 25% of its stock, acquired a potentially core resource play land position (the Duvernay) but wasn't aggressively pumping capital into drilling it itself, and was carefully operating its business outside of the Duvernay to protect its balance sheet and build NAV and cash flow over time. This wasn't a 30+ year history of buy backs and farm-downs, but it was a start, and it tied with management's track record and reputation from prior businesses. Incidentally, the CEOs of both companies have a number of similarities, including: intelligence, work ethic, large personal ownership in their businesses, and being anti-promotional about their stocks.

3) Promising shale oil well results and licenses with a world-class partner and spiking cash flow with reduced geopolitical risk

That's quite a mouthful. Part of the "Prime" model is joint venturing or "farming down" assets, to lower corporate costs, reduce operating risk, and increase chances of economic success. A key part of the model is selecting the right partner. In Prime's case, they chose Apache (APA) and RSP (subsequently bought out by Concho (CXO)), both high performing operators in the Permian Midland basin. In Journey's case, they chose Pat Carlson's new company. Pat Carlson's last company had been a ~15x return for his initial investors despite starting before the oil price crash and monetizing after (in that time frame, Journey went from $12 to $2 and many other oil and gas stocks declined 50-80% in price). Here is a picture (validated by a 3rd party investment bank and public filings), illustrating why Pat is a relevant JV partner in the Prime model, even compared to Apache and Concho:



		2011YE	2012YE	2013YE	2014YE	2015YE	2016YE
Production	(boe/d)	**2,715**	**4,180**	**7,786**	**31,136**	**60,403**	**117,800**
Basic Common Shares Out.	(MM)	120	165	185	245	254	350
Weighted Avg. Common Shares	(MM)	107	147	168	225	250	318
Share Price	($/sh)	$2.50	$5.50	$12.50	$17.49	$13.48	$31.31
Market Cap	($MM)	$299	$909	$2,318	$4,280	$3,430	$10,968

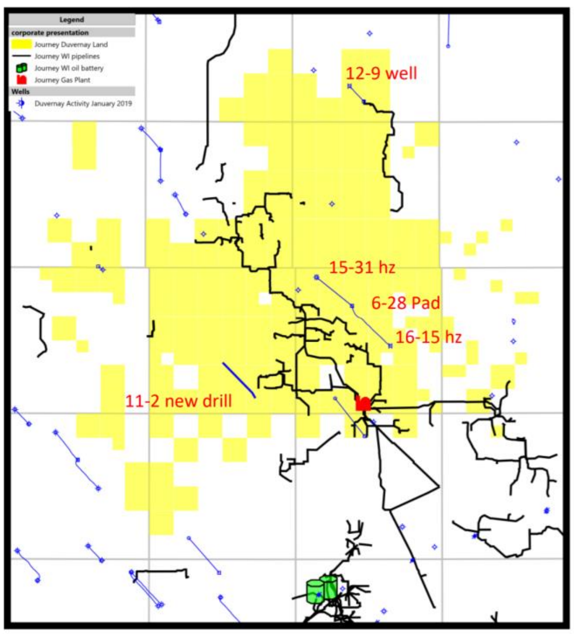
The Journey / Pat Carlson deal is that Pat drills 7 wells to earn 62.5% of the working interest (WI) after payout, and that on the following 20 wells, Journey has the option to either fund their 37.5% WI or receive a royalty on those wells. After 27 wells, Journey will have to fund their portion of future wells or won't get an interest in those wells.

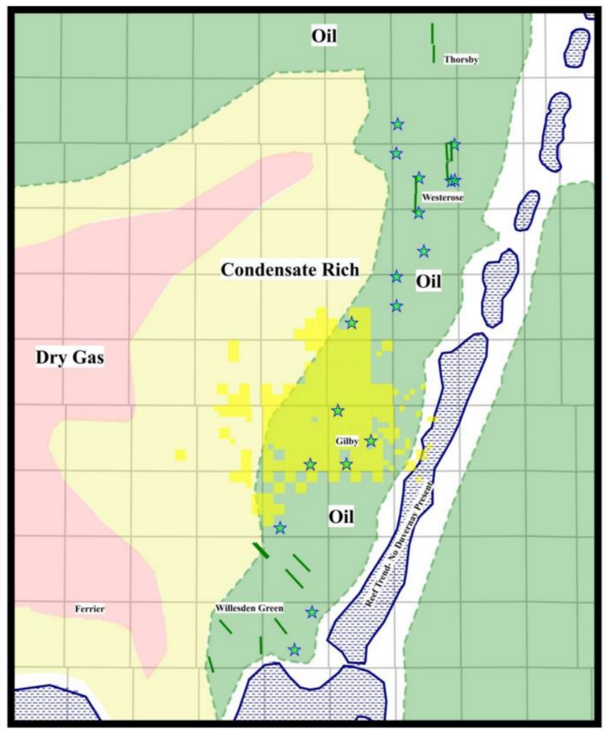
There's a reason I've focused on the quality of Journey's partner, and it ties back to the Prime model – its not just cheaper to let someone else drill your wells, you also are more likely to get better wells (note Prime's debt adjusted production per share growth metrics vs its peers and its share price outperformance starts making a lot more sense). Journey's Duvernay "type curve" (expected production and economic performance) isn't bad, with a PVI of about 1.5 ($12 million present value per $8 million well).

But if in the above chart on Pat's performance, he and his team grew his last company's production from 2,700 boepd to 117,800 boepd in 5 years, while only increasing the share count 3x. Yes, he borrowed money to do that. But he also increased well productivity and economics over that time frame as well. If the Duvernay well productivity improves by anywhere close to what his Montney well productivity improved by, the growth and returns potential is enormous. Obviously he sees the potential in the Duvernay to do the same.

Initial production results aren't out yet, but activity continues, and offset results have been strong, indicating that Pat seems to like what he sees:

Maps from Journey's presentation: (note Pat is well on his way to drilling and completing the initial JV wells, and the offsetting drilling activity)





And here is a chart I put together on Journey's potential value at different Duvernay land values (from the 2017 reserve report, but the magnitude of upside is similar)

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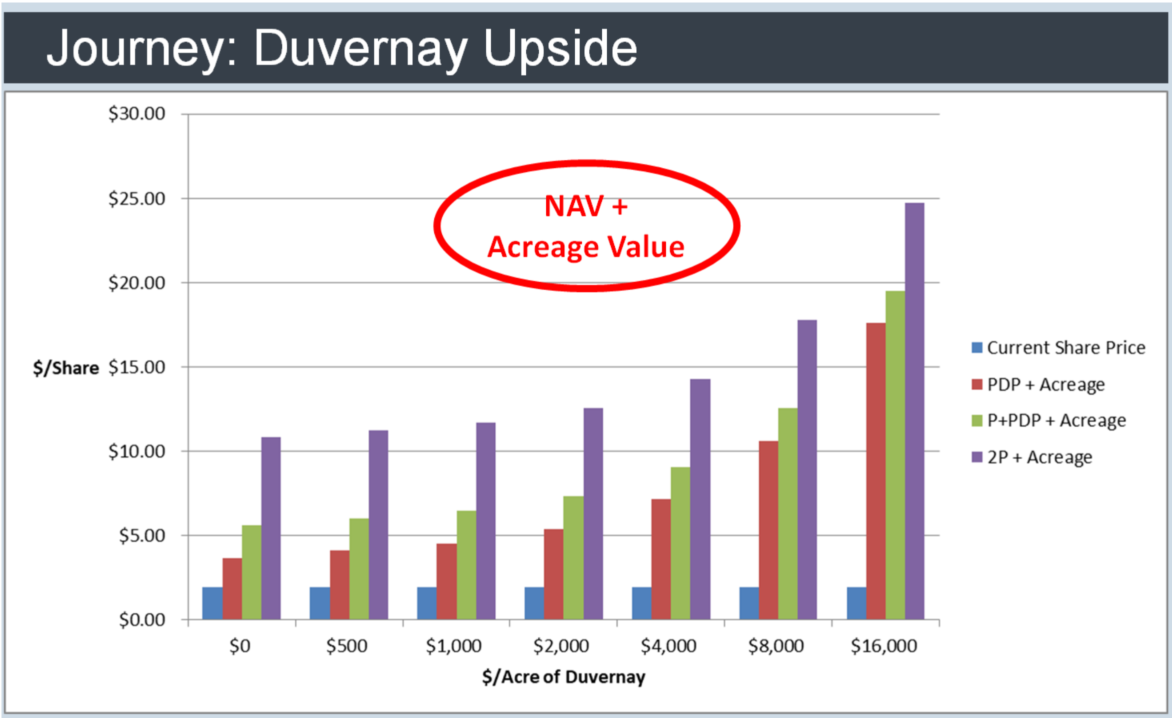

The opportunity for value increase is visibly enormous, and actually looks quite similar to the realized performance for Pat's last company from inception to his exit. And the brilliance of the Prime model is: Journey gets to participate, even "type curve" wells could lead to $10-20 / share of land value, and if Pat repeats his success and raises the well productivity, the above chart might actually meaningfully under estimate the potential land value. And, maybe it's not so crazy to think that Duvernay land could be worth thousands of dollars an acre – a large scale transaction a few years ago valued a minority JV interest in a gassier Duvernay area at $15,000 / acre. And a recent BMO (Bank of Montreal) report estimates 66% IRR well level returns in Journey's Duvernay area, which substantiated and delineated could support even higher than $15k/acre.

So ok, maybe the Prime model works, so maybe share repurchases and JVs with world class oil companies create value. But cash flow matters too, as does geopolitical risk. And both are getting a lot better for Journey. Journey's management estimated about $35 million of cash flow in 2019 in its recent February presentation. And almost $1 per share of cash flow isn't bad for a $2.15 stock, especially if there's no credit in there for likely rapidly growing production from the Duvernay.

However, oil price differentials have been less onerous than management projected. With under-supply of heavy oil to the US Gulf Coast and with Venezuelan sanctions in full effect, a very recent presidential permit for Keystone XL, and curtailment of larger Alberta oil producers working, price realizations may be meaningfully better than expected for Journey. A $5 improvement in realized price means an extra $9 million in cash flow, or about 25 cents per share. All of which falls to the bottom line, for re-investment or debt reduction.

4) Risk

Obviously Journey is a small, thinly traded, upstream oil and gas producer. It is in Canada. And it has about $130 million of debt. Lower oil prices, operational issues, poor Duvernay results, and other risks could materially impair an investment. However, it also has almost 40,000 net acres in the Duvernay, is likely run-rating over $1 per share of cash flow, most of its debt is with the local pension fund manager, and it is well managed and is implementing the Prime business plan. Pat is at bat. I'm betting he doesn't pull a Casey. Caveat Emptor.

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