Freehold Royalties Ltd. Announces First Quarter Results

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CALGARY, May 07, 2019 - Freehold Royalties Ltd. (Freehold) (TSX:FRU) announced first quarter results for the period ended March 31, 2019.

RESULTS AT A GLANCE

	Three Months Ended March 31			
FINANCIAL ($000s, except as noted)	2019	2018	Change	
Royalty and other revenue	35,609	39,157	-9	%
Net Income (loss)	(7,079)	4,423	-260	%
Per share, basic and diluted ($)	(0.06)	0.04	-250	%
Funds from operations	29,348	32,384	-9	%
Per share, basic ($)	0.25	0.27	-7	%
Acquisitions and related expenditures	929	32,396	-97	%
Dividends declared	18,651	18,026	3	%
Per share ($) (1)	0.1575	0.1525	3	%
Net debt	77,533	89,567	-13	%
Shares outstanding, period end (000s)	118,458	118,238	-	
Average shares outstanding (000s) (2)	118,403	118,183	-	
OPERATING				
Royalty production (boe/d) (3)	10,139	11,197	-9	%
Total production (boe/d) (3)	10,627	12,002	-11	%
Oil and NGL (%)	55	54	2	%
Average price realizations ($/boe) (3)	36.29	34.52	5	%
Operating netback ($/boe) (3) (4)	36.22	34.86	4	%

(1) Based on the number of shares issued and outstanding at each record date.
(2) Weighted average number of shares outstanding during the period, basic.
(3) See Conversion of Natural Gas to Barrels of Oil Equivalent (boe).
(4) See Non-GAAP Financial Measures

President's Message

An improved commodity environment relative to Q4-2018 helped Freehold generate strong funds from operations in Q1-2019 of $29.3 million or $0.25 per share, comfortably above current dividend levels of $0.1575 per share and allowing Freehold to pay down approximately $12 million in net debt quarter-over-quarter. Based on Freehold’s closing share price on March 31, 2019, our free cash flow yield of 12% positions Freehold as an attractive oil and gas investment. As we look forward, we will continue to allocate our free cash flow towards a combination of debt repayment, value enhancing acquisitions and our dividend, with the goal of maximizing returns for our shareholders.

On the operations front, royalty production for the quarter averaged 10,139 boe/d, above the midpoint of our 2019 production guidance. Volumes were impacted by a combination of cold weather and lower additions from our audit function. Activity outpaced expectations in the quarter with 147 (7.3 net) locations drilled on our royalty lands with the majority of third party drilling centered on our light oil portfolio.

It is our objective to drive oil and gas development on our lands and to acquire royalties with acceptable growth and risk profiles. During the quarter, development on our lands exceeded industry trends, demonstrating the strength of our asset base.

Tom Mullane
President and CEO

Dividend Announcement

The Board has declared a dividend of $0.0525 per common share to be paid on June 17, 2019 to shareholders of record on May 31, 2019. The dividend is designated as an eligible dividend for Canadian income tax purposes.

2019 First Quarter Highlights

- Freehold's royalty production averaged 10,139 boe/d during Q1-2019, down 9% versus Q1-2018 and 2% when compared to Q4-2018. Reduced volumes quarter-over-quarter were associated with lower third-party production additions on our royalty lands and weather related shut-ins.
- Royalty interests accounted for 95% of total production and contributed 99% of operating income(1) in Q1-2019.
- Funds from operations totaled $29.3 million, or $0.25 per share, a decrease of 9% compared to Q1-2018. Funds from operations were $10.9 million, or 59%, higher than the previous quarter. The improvement in funds from operations quarter-over-quarter was a result of improved natural gas commodity prices and stronger Canadian oil pricing due to reduced discounts to West Texas Intermediate (WTI).
- In the first quarter, free cash flow(1) in the quarter also equaled $29.3 million, a decrease of 9% compared to Q1-2018. Using Freehold’s closing share price as at March 31, 2019 of $8.41, this represents an annualized free cash flow yield of 12%.
- Income in Q1-2019 was reduced by a non-recurring impairment charge of $14.1 million offset by a related deferred tax recovery of $3.8 million.
- Wells drilled on our royalty lands totaled 147 (7.3 net) in the quarter compared to 239 (6.4 net) in Q1-2018 and 220 (7.4 net) in the previous quarter. We saw strong activity levels associated with our light oil portfolio, particularly in southwest Saskatchewan Viking.
- In Q1-2019, Freehold issued 20 new lease agreements with 10 companies, compared to 26 issued in Q4-2018 and 42 leases in Q1-2018.
- Cash costs (1) for the quarter totaled $6.39/boe, up from $6.13/boe in Q1-2018. Cash costs are typically higher in the first quarter of the year associated with certain annual general and administrative charges that occur early in the year. For the full year 2019, we are forecasting cash costs of approximately $5.00/boe (2018 - $5.10/boe).
- Dividends declared for Q1-2019 totaled $0.1575 per share, similar to the previous year.
- Our payout ratio (1) (dividends declared/funds from operations) for Q1-2019 totaled 64%, compared to 101% in the previous quarter and 56% in Q1-2018.

(1) See Non-GAAP Financial Measures.

Drilling Activity

For the first three months of 2019, 147 (7.3 net) wells were drilled on our royalty lands, down 38% on a gross measure but up 14% on a net measure versus the same period in 2018. When compared to Q4-2018, net well activity was relatively flat. The net well drilling numbers are a testament to the quality of our underlying royalty portfolio, especially given broader drilling activity weakness within the Western Canadian Sedimentary Basin.

Activity through the first three months of 2019 was primarily focused on Saskatchewan oil prospects, including Viking at Dodsland, Mississippian plays in SE Saskatchewan and Shaunavon in SW Saskatchewan. Over 47 Dodsland Viking wells were drilled on our acreage in the first quarter, individually representing 32% of the total gross wells drilled. Together, Saskatchewan and Manitoba wells represented greater than 56% of our gross drilling in the quarter.

Alberta activity has been concentrated in the Cardium and Viking, with 11 wells drilled on our Pembina

Cardium acreage and 25 wells drilled in Alberta Viking. Drilling for Deep Basin Cretaceous oil plays remains active, with four East Shale Basin Duvernay and two Northern Alberta Clearwater Sandstone wells, drilled on our acreage this quarter. Our top payors continue to represent some of the most well capitalized E&P companies in Canada.

ROYALTY INTEREST DRILLING

	Three Months Ended March 31			
	2019		2018	
	Gross	Net (1)	Gross	Net (1)
Total	147	7.3	239	6.4

(1) Equivalent net wells are the aggregate of the number obtained by multiplying each gross well by our royalty interest percentage.

2019 Guidance Update

Below are details of the changes made to our key operating assumptions for 2019 based on results for the first quarter and expectations for the remainder of the year.

- We are maintaining our 2019 average royalty production range of 9,900 boe/d-10,300 boe/d. Volumes are expected to be weighted approximately 55% oil and natural gas liquids and 45% natural gas. We continue to maintain our royalty focus with royalty production accounting for 96% of forecasted 2019 production and virtually all of our operating income.
- We are revising our oil price assumptions for WTI to US$62.50/bbl (previously US$55.00/bbl) and for Edmonton Light Sweet prices to $71.00/bbl (previously $61.00/bbl) and our C$/US$ currency exchange assumption to US$0.75 per Canadian dollar (previously US$0.76).
- Our full year AECO natural gas price assumption remains unchanged at $1.60/mcf.
- Based on our current $0.0525/share monthly dividend level, we expect our 2019 payout ratio (dividends declared/funds from operations) to be approximately 60% (previously 76%).
- General and administrative costs remain at $3.00/boe reflecting lower costs in the second to fourth quarters versus the first quarter rate.
- Due to the increase in oil price expectations noted above, and without factoring in any acquisition activity, we currently estimate that year-end net debt to funds from operations to exit 2019 at approximately 0.3 times (from 0.7 times).
- Subsequent to March 31, 2019, Freehold’s secured revolving credit facility was extended to mature May 31, 2022.

Key Operating Assumptions

		Guidance Dated	
2019 Annual Average		May 7, 2019	Mar. 7, 2019
Royalty production (excludes working interest production)	boe/d	9,900-10,300	9,900-10,300
West Texas Intermediate crude oil	US$/bbl	62.50	55.00
Edmonton Light Sweet crude oil	Cdn$/bbl	71.00	61.00
AECO natural gas	Cdn$/Mcf	1.60	1.60
Exchange rate	Cdn$/US$	0.75	0.76
Operating costs	$/boe	1.00	1.00
General and administrative costs	$/boe	3.00	3.00
Weighted average shares outstanding	millions	119	119

Recognizing the cyclical nature of the oil and gas industry, we continue to closely monitor commodity prices and industry trends for signs of deteriorating market conditions. We caution that it is inherently difficult to predict activity levels on our royalty lands since we have no operational control. As well, significant changes (positive or negative) in commodity prices (including Canadian oil price differentials), foreign exchange rates, or production rates may result in adjustments to the dividend rate.

Based on our current guidance and commodity price assumptions, and assuming no significant changes in the current business environment, we expect to maintain the current monthly dividend rate through the next quarter. We will continue to evaluate the commodity price environment and adjust the dividend levels as necessary (subject to the quarterly review and approval of our Board of Directors).

CRA Proposal

Subsequent to March 31, 2019, Freehold received a proposal letter (Proposal Letter) from Canada Revenue Agency (CRA) wherein CRA stated that it intends to re-assess and deny Freehold’s deduction of certain non-capital losses claimed and carried forward in the tax return filed for the year ended December 31, 2015.

Freehold will vigorously defend its tax filing position, however, it anticipates that proceedings with CRA could take considerable time to resolve. If the CRA issues the notice of reassessment (NOR) described in the Proposal Letter, Freehold's assessed tax liability would be approximately $15 million (plus interest). If Freehold is reassessed in accordance with the Proposal Letter, it may also be reassessed with respect to the deduction of its non-capital losses in all of its tax filings subsequent to December 31, 2015. In such event, Freehold would utilize alternate claims available that would fully offset any tax liability for filed tax returns in periods subsequent to December 31, 2015. Freehold will be required to pay a deposit of 50% of the assessed tax liability, and it will have 90 days from the date of the NOR to prepare and file a notice of objection. Freehold firmly believes it will be successful defending its position and therefore any amounts paid to CRA should be refunded plus interest. No provisions have been made in the financial statements relating to the Proposal Letter.

Conference Call Details

A conference call to discuss financial and operational results for the period ended March 31, 2019 will be held for the investment community on Wednesday, May 8, 2019 beginning at 7:00 am MT (9:00 am ET). To participate in the conference call, approximately 10 minutes prior to the conference call, please dial 1-800-952-5114 (toll-free in North America) participant passcode is 9393978#.

Availability on SEDAR

Freehold’s 2019 first quarter interim unaudited condensed consolidated financial statements and accompanying Management’s Discussion and Analysis (MD&A) are being filed today with Canadian securities regulators and will be available at www.sedar.com and on our website at www.freeholdroyalties.com.

Forward-looking Statements

This news release offers our assessment of Freehold’s future plans and operations as at May 7, 2019, and contains forward-looking statements that we believe allow readers to better understand our business and prospects. These forward-looking statements include our expectations for the following:

- our outlook for commodity prices including supply and demand factors relating to crude oil, heavy oil, and natural gas;
- light/heavy oil price differentials;
- changing economic conditions;
- our intention to allocate free cash flow towards a combination of debt repayment, value enhancing acquisitions and our dividend, with the goal of maximizing returns for our shareholders;
- 2019 cash costs forecasted at approximately $5.00/boe;
- foreign exchange rates;
- forecast 2019 average royalty production, including product mix and percentage of total production and operating income from royalties;
- forecast 2019 payout ratio;
- forecast 2019 year end net debt to funds from operations;
- key operating assumptions including forecast operating costs and general and administrative costs;
- our dividend policy and expectations for future dividends;
- treatment under governmental regulatory regimes and tax laws; and
- our assessment of risk associated with the CRA Proposal.

By their nature, forward-looking statements are subject to numerous risks and uncertainties, some of which are beyond our control, including the impact of general economic conditions, industry conditions, volatility of commodity prices, currency fluctuations, imprecision of reserve estimates, royalties, environmental risks, taxation, regulation, changes in tax or other legislation, competition from other industry participants, the lack of availability of qualified personnel or management, stock market volatility, and our ability to access sufficient capital from internal and external sources. Risks are described in more detail in our annual information form dated March 7, 2019, which is available at www.sedar.com and on our website at www.freeholdroyalties.com.

With respect to forward-looking statements contained in this news release, we have made assumptions regarding, among other things, future commodity prices, future capital expenditure levels, future production levels, future exchange rates, future tax rates, future legislation, the cost of developing and producing our assets, our ability and the ability of our lessees to obtain equipment in a timely manner to carry out development activities, our ability to market our oil and gas successfully to current and new customers, our expectation for the consumption of crude oil and natural gas, our expectation for industry drilling levels, our ability to obtain financing on acceptable terms, shut-in production, production additions from our audit function and our ability to add production and reserves through development and acquisition activities. The key operating assumptions with respect to the forward-looking statements referred to above are detailed in the body of this news release.

You are cautioned that the assumptions used in the preparation of such information, although considered reasonable at the time of preparation, may prove to be imprecise and, as such, undue reliance should not be placed on forward-looking statements. Our actual results, performance, or achievement could differ materially from those expressed in, or implied by, these forward-looking statements. We can give no assurance that any of the events anticipated will transpire or occur, or if any of them do, what benefits we will derive from them. The forward-looking information contained in this document is expressly qualified by this cautionary statement. To the extent any guidance or forward looking statements herein constitute a financial outlook, they are included herein to provide readers with an understanding of management's plans and assumptions for budgeting purposes and readers are cautioned that the information may not be appropriate for other purposes. Our policy for updating forward-looking statements is to update our key operating assumptions quarterly and, except as required by law, we do not undertake to update any other forward-looking statements.

You are further cautioned that the preparation of financial statements in accordance with International Financial Reporting Standards (IFRS), which are the Canadian generally accepted accounting principles (GAAP) for publicly accountable enterprises, requires management to make certain judgments and estimates that affect the reported amounts of assets, liabilities, revenues, and expenses. These estimates may change, having either a positive or negative effect on net income, as further information becomes available and as the economic environment changes.

Conversion of Natural Gas to Barrels of Oil Equivalent (BOE)

To provide a single unit of production for analytical purposes, natural gas production and reserves volumes are converted mathematically to equivalent barrels of oil (boe). We use the industry-accepted standard conversion of six thousand cubic feet of natural gas to one barrel of oil (6 Mcf = 1 barrel). The 6:1 boe ratio is based on an energy equivalency conversion method primarily applicable at the burner tip. It does not represent a value equivalency at the wellhead and is not based on either energy content or current prices. While the boe ratio is useful for comparative measures, it does not accurately reflect individual product values and might be misleading, particularly if used in isolation. As well, given that the value ratio, based on the current price of crude oil to natural gas, is significantly different from the 6:1 energy equivalency ratio, using a 6:1 conversion ratio may be misleading as an indication of value.

Non-GAAP Financial Measures

Within this news release, references are made to terms commonly used as key performance indicators in the oil and gas industry. We believe that operating income, operating netback, payout ratio, free cash flow and cash costs are useful supplemental measures for management and investors to analyze operating performance, financial leverage, and liquidity, and we use these terms to facilitate the understanding and comparability of our results of operations and financial position. However, these terms do not have any standardized meanings prescribed by GAAP and therefore may not be comparable with the calculations of similar measures for other entities.

Operating income is calculated as royalty and other revenue less operating expenses. It shows the profitability of our revenue streams as it provides the cash margin for product sold after directly related expenses. Operating netback, which is calculated as average unit sales price less operating expenses, represents the cash margin for product sold, calculated on a per boe basis. (See our Netback Analysis section for calculations.)

Free cash flow is calculated by subtracting capital expenditures from funds from operations. In periods where Freehold has no capital expenditures, this figure is interchangeable with funds from operations. Free cash flow is a measure often used by dividend paying companies to determine cash available for the payment of dividends, reducing debt or available for investment.

Payout ratios are often used for dividend paying companies in the oil and gas industry to identify its dividend levels in relation to the funds it receives and uses in its capital and operational activities. Our payout ratio is calculated as dividends declared as a percentage of funds from operations.

Cash costs is a total of all recurring costs in the statement of income deducted in determining funds from operations. For Freehold cash costs are identified as operating expense, general and administrative expense, interest expense and share based compensation payments. It is key to funds from operations, representing the ability to sustain dividends and/or repay debt.

We refer to various per boe figures which provide meaningful information on our operational performance. We derive per boe figures by dividing the relevant revenue or cost figure by the total volume of oil, natural gas liquids and natural gas production during the period, with natural gas converted to equivalent barrels of oil as described above.

For further information related to these non-GAAP terms see our most recent MD&A.

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