WATEROUS
ENERGY FUND

Value Investing in a Commodity Sector –

Using a Margin of Safety Approach in a Historical Growth Equity Industry

Adam Waterous – Waterous Energy Fund

April 2025

INVESTMENT STRATEGY

WEF pursues a unique value-based investment strategy in the Canadian oil and gas sector that focuses on compounding long-term intrinsic value per share while maintaining a margin of safety

Traditional Oil and Gas PE Strategy

- Historically, private equity invested in energy via "growth equity" – backing start-up management teams to de-risk emerging plays with the goal of quickly flipping to a strategic buyer
  - WEF identified this venture capital approach had become challenged due to 1) reduced access to capital, and 2) limited exit options

WEF Strategy

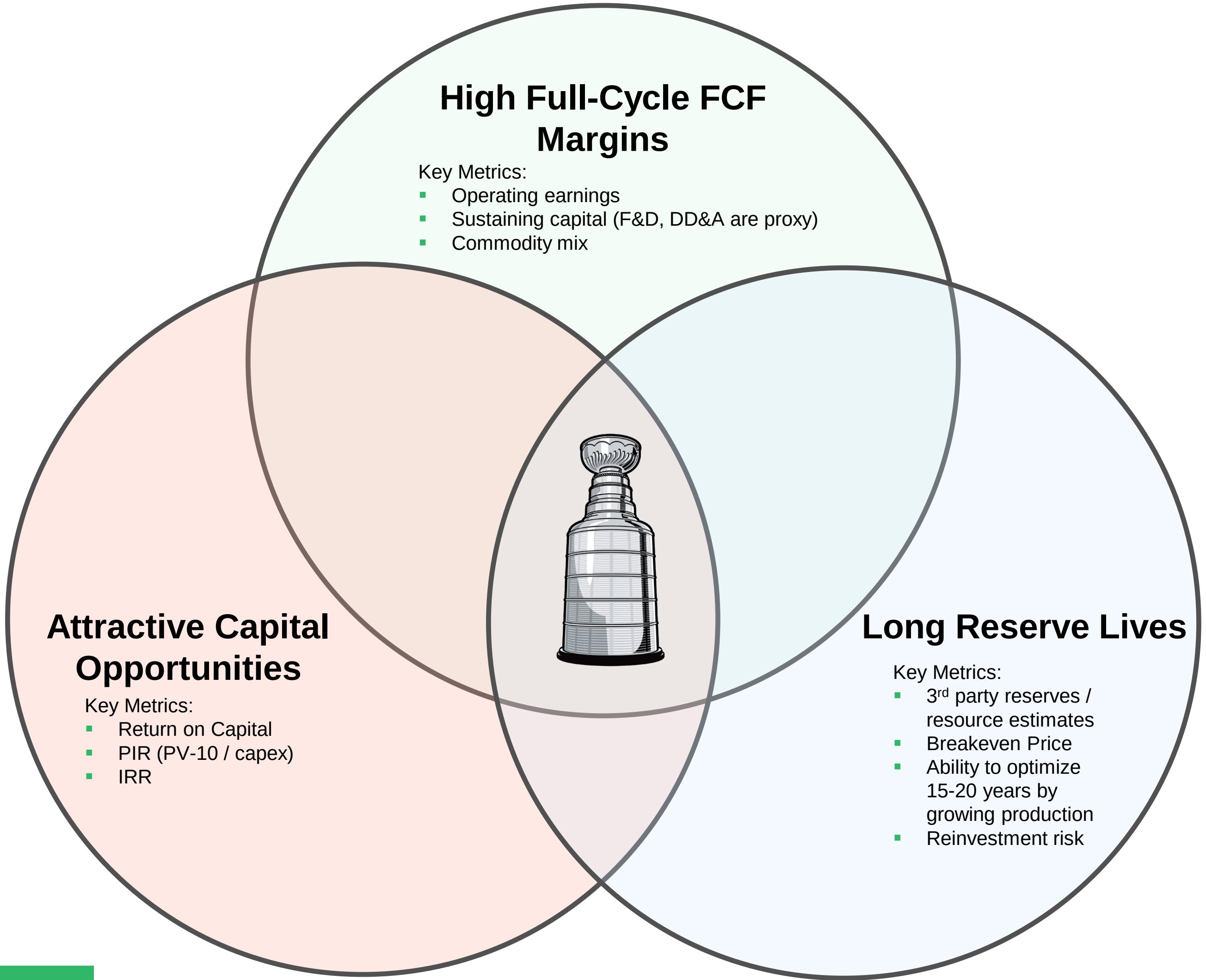
- Instead, WEF pursues a value-based investment strategy that seeks to acquire established, high-quality, and geographically adjacent sub-scale assets at a discount to intrinsic value
- We've often found these 'trophy assets' in 'complex situations' such as bankruptcy's, take-privates, takeovers, toe holds, and long-dated investments
- When we buy an asset, we always assume we will own the assets forever
- We often then merge these assets together to create a concentrated portfolio of scaled businesses that can take advantage of economies of scale and operating synergies
- We believe our strategy is the most effective way to increase long-term intrinsic value per share while maintaining a margin of safety by mitigating the four main risks of investing in the oil and gas sector

4 MAIN RISKS TO INVESTING IN OIL AND GAS

Risk	Description	WEF Strategy to Mitigate Risk
Technical	Resource is smaller than expected or technological improvements are unsuccessful	
Commodity Price	Margins deteriorate when prices fall	
Leverage	Too much debt	
Exit	Few liquidity options	

TECHNICAL AND COMMODITY PRICE RISK

WEF hunts for trophies with long production histories because they inherently reduce technical and commodity price risk



High Full-Cycle FCF Margins

Key Metrics:
- Operating earnings
- Sustaining capital (F&D, DD&A are proxy)
- Commodity mix

Attractive Capital Opportunities

Key Metrics:
- Return on Capital
- PIR (PV-10 / capex)
- IRR

Long Reserve Lives

Key Metrics:
- 3rd party reserves / resource estimates
- Breakeven Price
- Ability to optimize 15-20 years by growing production
- Reinvestment risk

Technical Risk

- WEF avoids investing in new, ‘hot’ plays – often the expected resource is smaller or more expensive than expected
  - WEF prefers mature plays that are well understand with long production histories
- WEF avoids investing in assets under the thesis that a new operating technique will improve margins – very difficult to do in practice and not our expertise
  - WEF never assumes we’re better operators than the previous owners

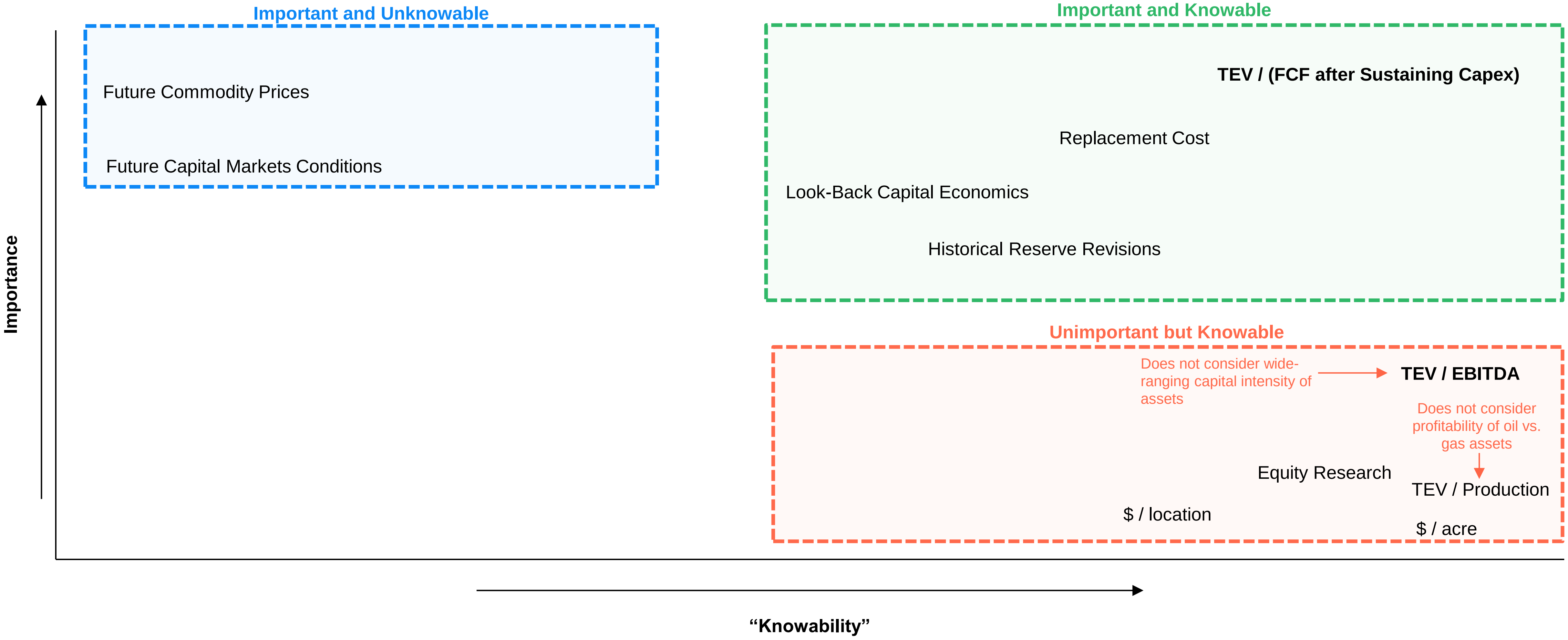
Commodity Price Risk

- Trophy assets have high margins which allows owners to withstand commodity price downturns without having to cut capital, unlike higher cost peers
- Long reserve life assets net asset values (NAVs) are less sensitive to commodity price downturns; owners still have quality resource when prices inevitably rebound

INVESTMENT UNDERWRITING APPROACH

WEF has a different approach to underwriting investments, focusing on what it believes to be the most important and knowable driver: FCF generation after sustaining capital

WEF Valuation Approach



Important and Unknowable

Future Commodity Prices

Future Capital Markets Conditions

Important and Knowable

TEV / (FCF after Sustaining Capex)

Replacement Cost

Look-Back Capital Economics

Historical Reserve Revisions

Unimportant but Knowable

Does not consider wide-ranging capital intensity of assets → **TEV / EBITDA**

Does not consider profitability of oil vs. gas assets ↓ TEV / Production

Equity Research

$ / location

$ / acre

Importance

"Knowability"

4 MAIN RISKS TO INVESTING IN OIL AND GAS

Risk	Description	WEF Strategy to Mitigate Risk
Technical	Resource is smaller than expected or technological improvements are unsuccessful	▪ Buy trophy assets! ▪ Evaluate investments based on sustaining free cash flow and net asset value
Commodity Price	Margins deteriorate when prices fall	
Leverage	Too much debt	
Exit	Few liquidity options	

WATEROUS ENERGY FUND

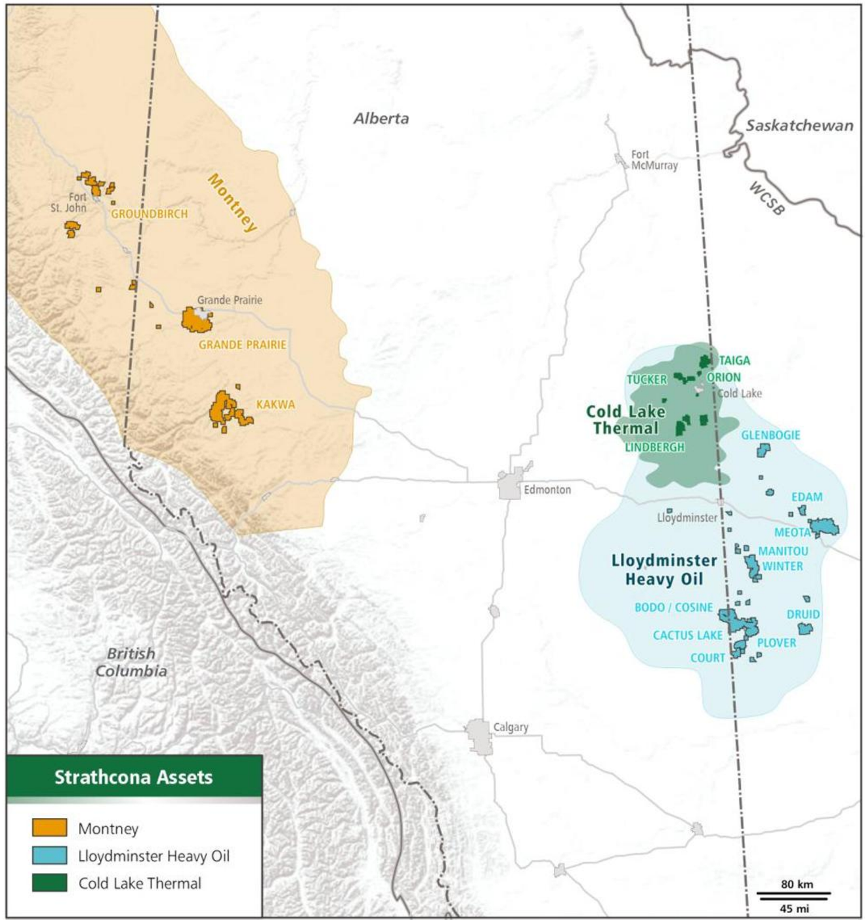
4 MAIN RISKS TO INVESTING IN OIL AND GAS

Risk	Description	WEF Strategy to Mitigate Risk
Technical	Resource is smaller than expected or technological improvements are unsuccessful	▪ Buy trophy assets! ▪ Evaluate investments based on sustaining free cash flow and net asset value
Commodity Price	Margins deteriorate when prices fall	
Leverage	Too much debt	▪ Seek to maintain conservative leverage at portfolio companies
Exit	Few liquidity options	

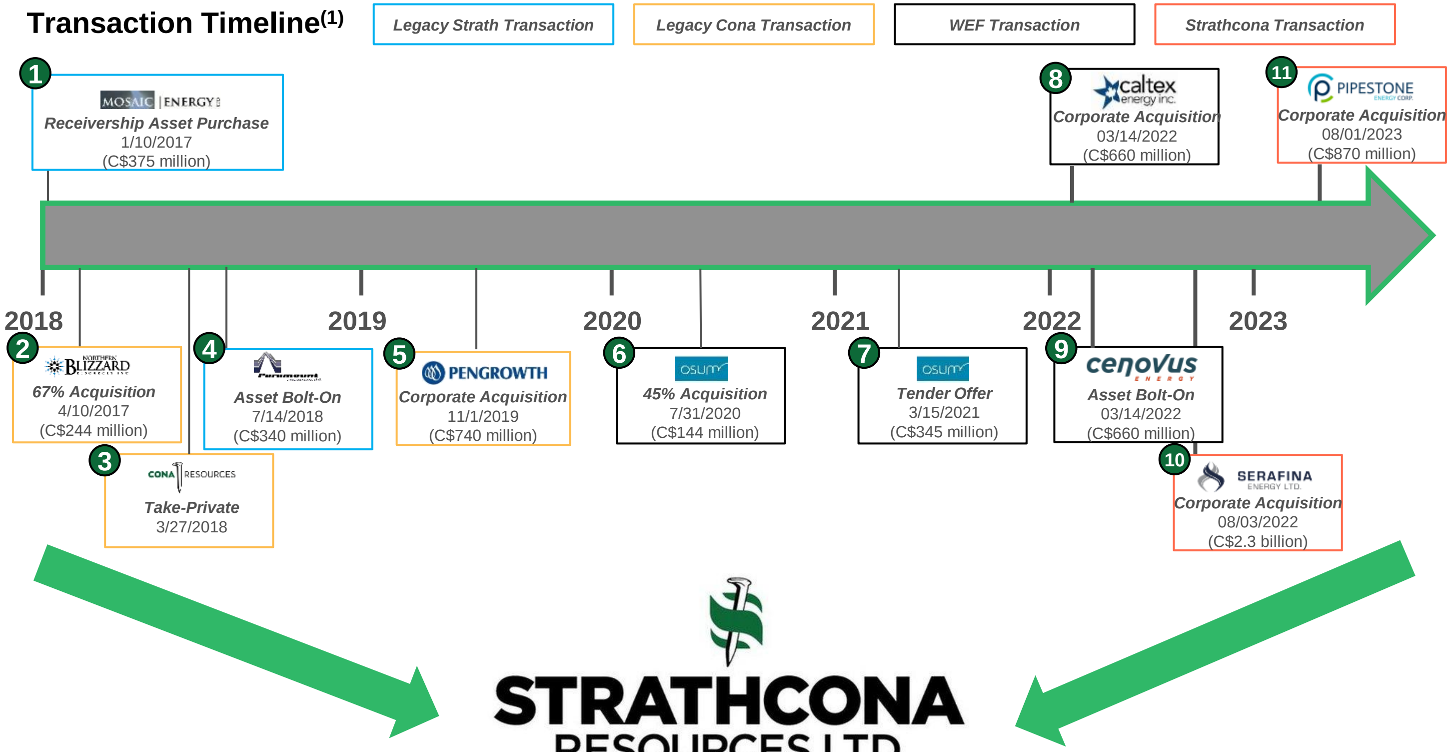
CORE AREA CONSOLIDATION

Between 2017 and 2023, WEF invested C$2 billion in equity across 11 acquisitions to build Strathcona Resources; each acquisition targeted one of Strathcona's core areas and was quickly merged into the company

Strathcona Asset Map



Transaction Timeline[1]



① MOSAIC | ENERGY
Receivership Asset Purchase
1/10/2017
(C$375 million)

② NORTHERN BLIZZARD
67% Acquisition
4/10/2017
(C$244 million)

③ CONA RESOURCES
Take-Private
3/27/2018

④ Paramount
Asset Bolt-On
7/14/2018
(C$340 million)

⑤ PENGROWTH
Corporate Acquisition
11/1/2019
(C$740 million)

⑥ osum
45% Acquisition
7/31/2020
(C$144 million)

⑦ osum
Tender Offer
3/15/2021
(C$345 million)

⑧ caltex energy inc.
Corporate Acquisition
03/14/2022
(C$660 million)

⑨ cenovus ENERGY
Asset Bolt-On
03/14/2022
(C$660 million)

⑩ SERAFINA ENERGY LTD.
Corporate Acquisition
08/03/2022
(C$2.3 billion)

⑪ PIPESTONE ENERGY CORP.
Corporate Acquisition
08/01/2023
(C$870 million)

STRATHCONA RESOURCES LTD

3 Core Areas

1) Cold Lake Thermal Oil
2) Lloydminster Heavy Oil
3) Montney Shale

WATEROUS ENERGY FUND

WHY CONSOLIDATION?

WEF's strategy of building a durable, scaled operator through consolidation is designed to reduce exit risk while also serving as a key value creation strategy

Benefits of Scale

1	**Operating Synergies and Economies of Scale**	▪ Combining complimentary, small producers provides opportunity for operating synergies and economies of scale; reduces risk and increases earnings
2	**Lower Cost of Capital**	▪ Cost of equity: Larger businesses generally trade at higher equity valuation multiples vs. smaller businesses ▪ Cost of debt: Larger businesses can generally secure debt capital at a lower cost ▪ E&P transactions can generally be completed at a discount to public company trading multiples; opportunity to “buy wholesale and sell retail”
3	**Better Access to Debt Capital**	▪ Bank Debt: Larger businesses can generally receive larger bank facilities on more favorable terms ▪ High-Yield: Small E&P’s are generally closed off from accessing the high-yield market
4	**Liquidity Options**	▪ IPO Optionality: Very high bar for IPOs in the E&P sector; virtually impossible to go public if not a scaled business ▪ Strategic Sale: Best buyers in the market are large-cap companies that seek meaningful acquisitions ▪ Dividends: WEF seeks cash flowing businesses capable of paying meaningful dividends, which provides downside protection in poor capital market environments

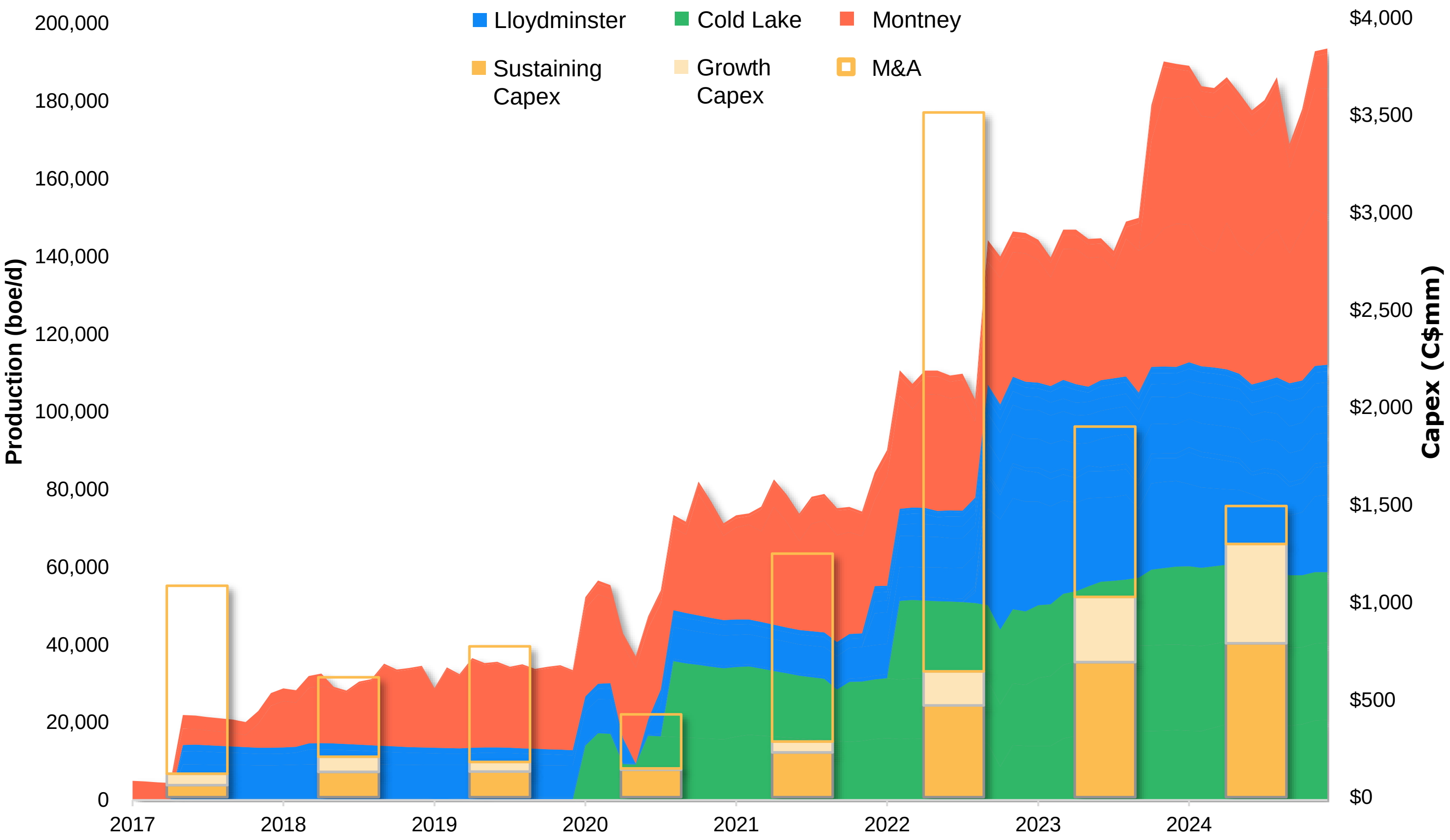
4 MAIN RISKS TO INVESTING IN OIL AND GAS

Risk	Description	WEF Strategy to Mitigate Risk
Technical	Resource is smaller than expected or technological improvements are unsuccessful	▪ Buy trophy assets! ▪ Evaluate investments based on sustaining free cash flow and net asset value
Commodity Price	Margins deteriorate when prices fall	
Leverage	Too much debt	▪ Seek to maintain conservative leverage at portfolio companies
Exit	Few liquidity options	▪ Build a scaled business that can return cash via dividends, with upside from sale or IPO

WATEROUS ENERGY FUND

Since its founding in 2017, Strathcona has invested ~$11 billion of capital (~$7 billion in acquisitions, ~$4bn in organic capex) to create Canada's 5th largest oil producer

Historical Production 2017 – 2024 (Mboe / d)



Progress To Date

1 **21% 1P NAV (After-Tax) CAGR, Per Share[2]**
- #1 Priority
- Best indicator of long-term value creation
- *Peer average of 4% during same period[3]*

2 **25% Operating Return on Equity[4]**
- #2 Priority
- Consistent history of full-cycle profitability ($2.15 billion of retained earnings)
- ~$1.0bn (~$4.60 / share) of LTM operating earnings

3 **16% Production CAGR, Per Share[2]**
- 185 Mboe / d across three core areas
- By-product of priorities #1 and #2, not a goal in itself
- *Peer average of 1% during same period[3]*

4 **19% 2P Reserves CAGR, Per Share[2]**
- 38 Year 2P RLI + 14 Year 2C RLI
- 3rd longest RLI in North America
- *Peer average of (1%) during same period[3]*

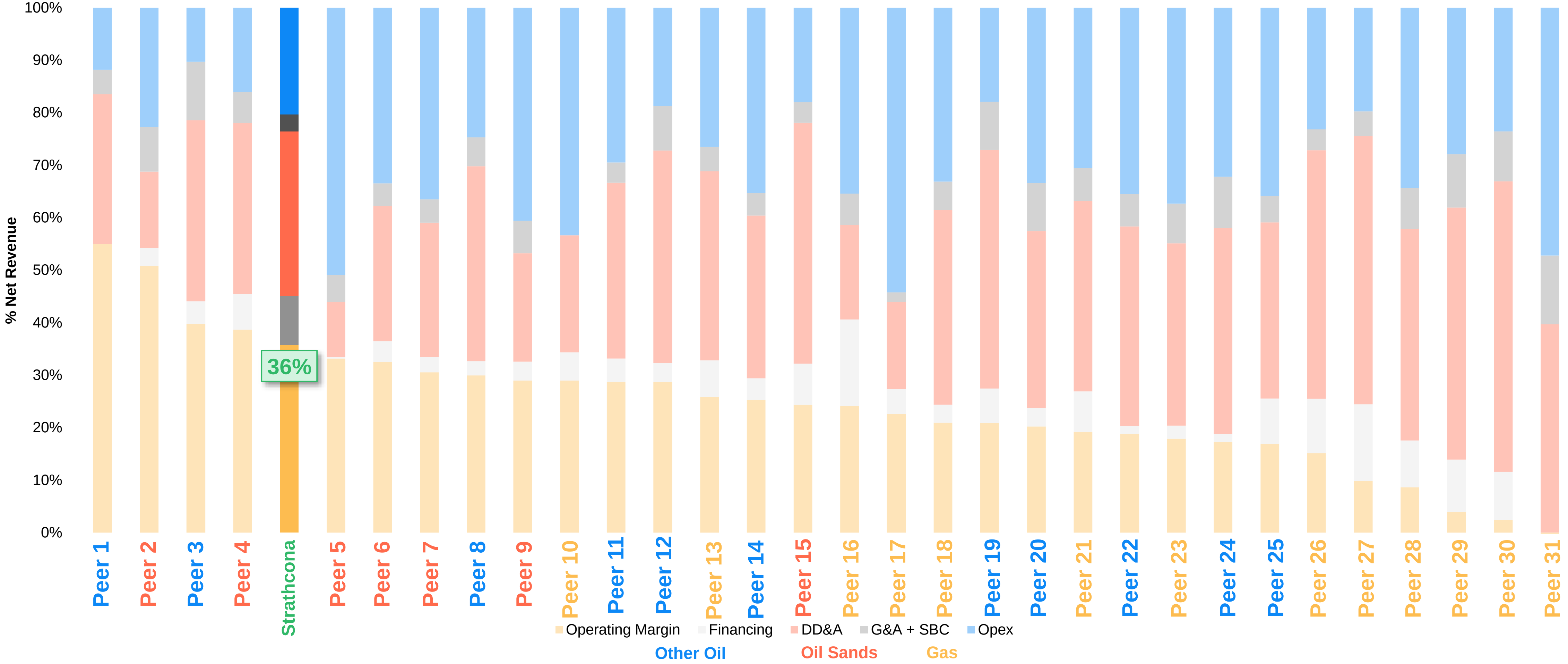
---

(1) Reflects production and capital since January 2017, including Strathcona predecessor companies (Strath, Cona, Osum, Caltex, Stickney), beginning upon WEF's initial acquisition of each.
(2) See Strathcona's YE 2023 and Historical Reserves Highlights Overview for further information and underlying assumptions (available at www.strathconaresources.com).
(3) Oil peers include CNQ, IMO, SU, CVE, MEG, ATH, BTE, VRN, WCP, CJ, OBE, SGY, TVE.
(4) Operating Earnings / (average retained earnings + contributed equity at $10.00 / share WEF cost basis); reflects LTM metrics AS OF 9/30/2024.

IS IT A TROPHY?

Strathcona has amongst the highest full-cycle margins in the sector, driven by a combination of low opex, low capital intensity and low G&A

1H 2024 Operating Earnings Margin (Pre-Tax)[1]



(1) Reflects 1H 2024 operating earnings / net revenue; operating earnings = EBITDA – stock-based compensation, DD&A, interest and other financing expense / accretion; net revenue = gross revenue – blending costs – royalties – transportation / processing expense.

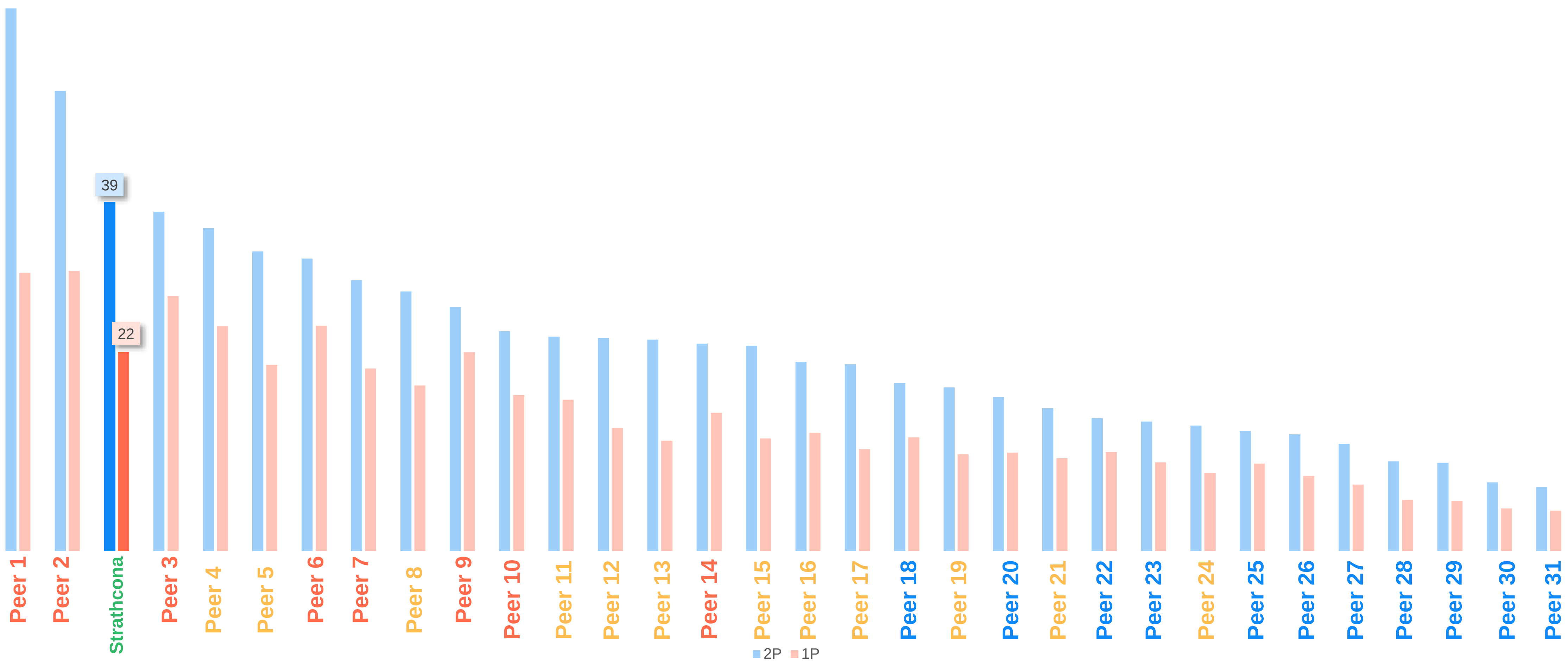
(2) Peer information based on publicly available information

(3) Peers include: AAV, ARX, ATH, BTE, BIR, CNQ, CJ, CVE, GXE, GFR, HWX, IMO, IPCO, KEL, KEC, LGN, LCX, MEG, NVA, OBE, POU, PEY, RBY, SDE, SU, SGY, TVE, TOU, VRN, VET, WCP

IS IT A TROPHY? (CONTINUED)

Strathcona has the third longest 2P reserve life index in North America, positioning the company for significant future growth

YE 2023 Reserve Life Index (Years)(1)(2)(3)



---

(1) Reflects YE 2023 reserves over 2024E production; 2024E estimates based on CapitalIQ estimates, as of October 2024.
(2) Peer information based on publicly available information
(3) Peers include: AAV, ARX, ATH, BTE, BIR, CNQ, CJ, CVE, GXE, GFR, HWX, IMO, IPCO, KEL, KEC, LGN, LCX, MEG, NVA, OBE, POU, PEY, RBY, SDE, SU, SGY, TVE, TOU, VRN, VET, WCP

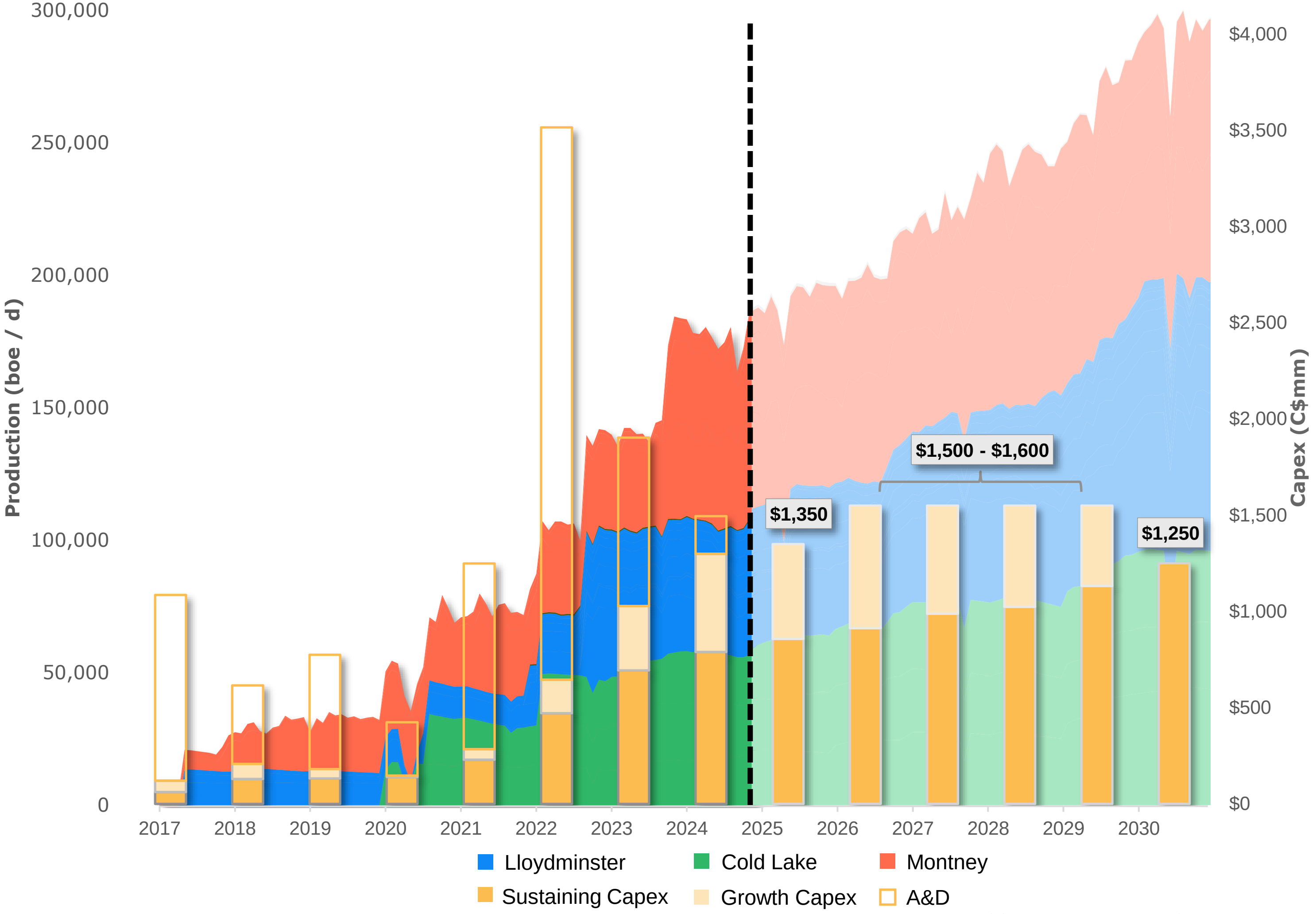
HOW STRATHCONA THINKS ABOUT GROWTH

Strathcona plans to add ~105 Mboe / d organically over the next 6 years, while continuing to generate top-tier returns and significant excess FCF

Key Goals

1. **Maintain >25% ROE, Pre-Tax, @ $70 WTI[2]**
   - ~$825mm increase in pre-tax operating earnings (~$375mm post-tax)
   - ~$1.4bn increase in capital employed (~$8.8bn capex *($6.05bn sustaining, $2.75bn growth)* less ~$7.4 DD&A)
   - = ~60% incremental pre-tax ROE
2. **Lower Sustaining Breakeven by US$4 / bbl**
   - Reflects allocation of fixed costs over larger production base, filling facilities
   - FCF positive, including growth capital and base dividend, down to US$60 WTI in all years, *excluding hedging*
3. **Grow Production at 8% CAGR**
   - 105 Mboe / d of new production (83% liquids, 81% oil); 9% oil CAGR
4. **Preserve >20 Year 2P RLI**
   - Assumes no organic reserve additions
   - Additional 9 years of 2C resource
5. **Generate >$25 / Share in FCF @ US$70 WTI**
   - 100% allocated to shareholder returns / M&A
   - Variable dividends remain best use of excess capital for now, but longer-term buybacks may become attractive

Production and Capital Summary[1]



---

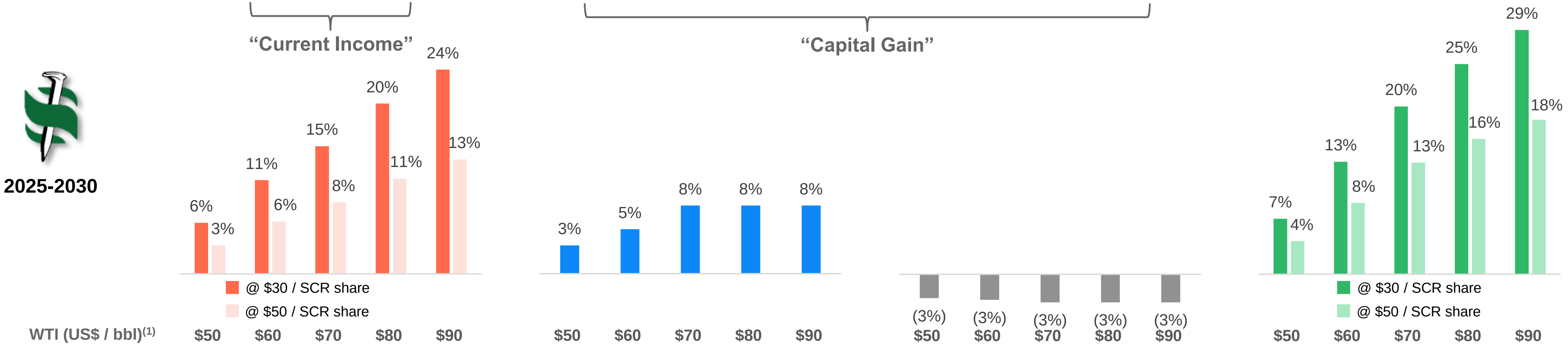
(1) Reflects production and capital since January 2017, including Strathcona predecessor companies (Strath, Cona, Osum, Caltex, Stickney), beginning upon WEF's initial acquisition of each.

(2) Operating Earnings / (average retained earnings + contributed equity at $10.00 / share WEF cost basis); increase in net assets assumed to equal increase in capital employed / equity due to assumed unchanged liabilities.

2025-2030 TOTAL RETURN PROPOSITION

Strathcona's plan through 2030 reflects a unique combination of FCF and production growth with minimal reserve depletion, leading to a differentiated return proposition vs. peers and the broader market

Excess FCF Yield + **Production CAGR** – **Reserves Depletion** = **Total Return**



100% of FCF Allocated To:
- Dividends (base and variable)
- Buybacks (depending on share price, and size of float)
- M&A (must be accretive)

- Future growth tied to long-term oil price expectations
- Sustained oil prices below US$70 will equal lower capital spending

- Reflects % depletion of 2P reserves over forecast period
- Assumes no organic reserves replacement

Typical[2] Canadian E&P	~14%	~3%	~(5%) *(Reflects ~20-year RLI)*	~12%
Typical[2] US E&P	~12%	~1%	~(10%) *(Reflects ~10-year RLI)*	~3%
S&P TSX[3]	~4%	~4%	~0% *(Generally non-depleting assets)*	~8%

---

(1) Reflects WCS-WTI differential equal to WTI*10% + US$6 / bbl, USD-CAD equal to 1.50 – 0.175%*WTI, AECO equal to WTI (in US$/bbl) / 20 -$0.50 / GJ.
(2) Peters and Co., June 2024 estimates for 2024-2029 FCF yield and production growth for Canadian and U.S. E&Ps; reflects US$71/bbl WTI, US$3.90 / Mcf HHUB.
(3) Bloomberg, October 2024; production CAGR reflects 2024-2027 forecasted consensus (longest time period available) revenue CAGR.

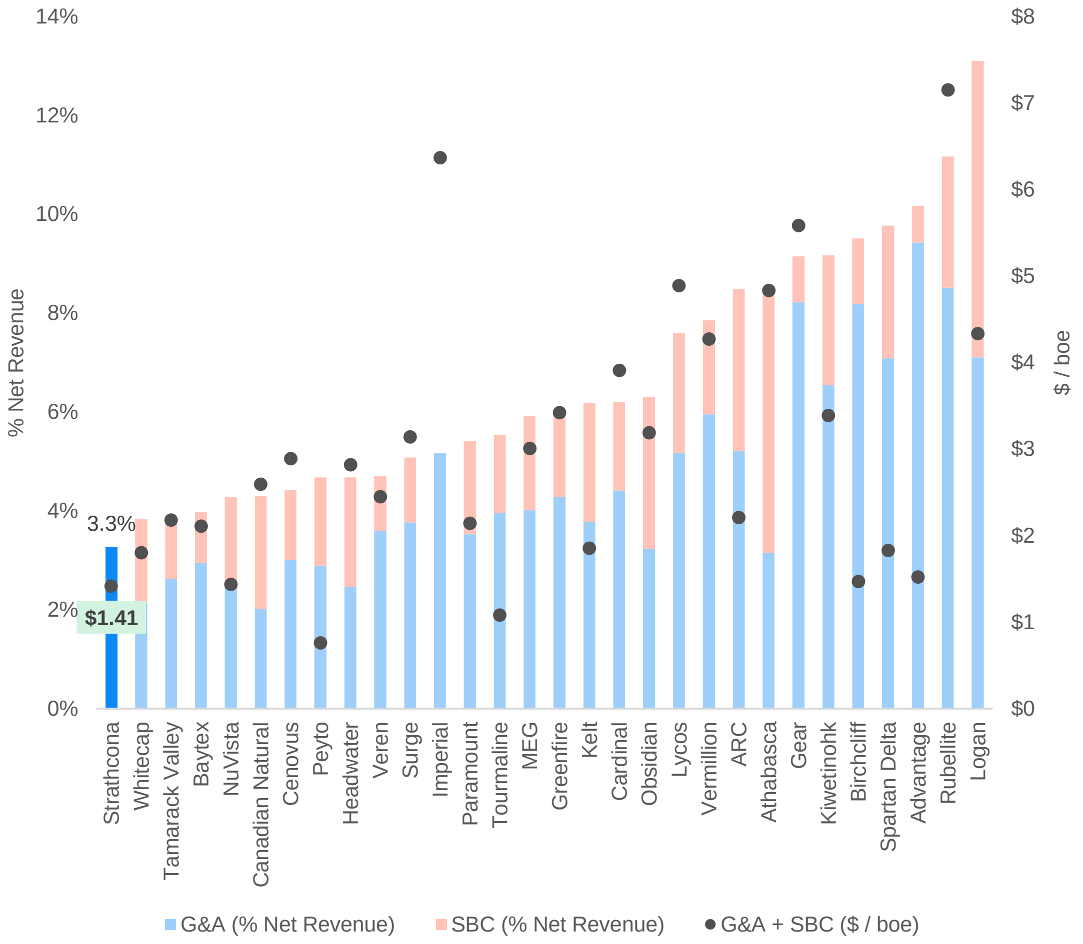
FULLY ALIGNED WITH OUR OWNERS

Strathcona has a unique compensation system vs. peers, focused on rewarding our employees for items they can control, and minimizing dilution to our shareholders

Compensation Principles

- 100% of Incentive Compensation Tied To Controllables
  - **PDP F&D / boe** (best measure of capital productivity)
  - **Non-Energy Opex / boe** (best measure of efficiency)
  - **HS&E** (no one gets paid if people are getting hurt)
- No Stock-Based Compensation – Everyone Buys In
  - Oil and gas public equities are highly volatile, often driven by short-term commodity prices and investor sentiment, instead of long-term fundamentals
  - While stock-based compensation sounds good in theory in oil and gas it often creates misalignment between management and shareholders
  - Instead, at SCR, **100% of incentive comp paid in cash**, and management buys stock in secondary market when they choose, to achieve minimum required ownership
- No Executive Employment Agreements or Unvested Comp
  - Avoids misalignment between management and shareholders under change of control
  - **Minimizes friction for employee and SCR if either is unhappy** (ensuring everyone *wants* to be at SCR, not simply waiting for comp to vest)
- Strong Board Alignment
  - **6 / 9 SCR board members have majority of personal net worth in SCR stock**

1H 2024 All-In G&A (as % of Net Revenue) vs. Peers[1]



---

(1) Reflects YTD 2024 G&A plus stock-based compensation divided by net revenue; net revenue equal to gross revenue less royalties, blending expenses and transportation / processing expenses.