2019 Message from the Chair

This is the Company We've Built

pulse seismic

Fellow Shareholders,

I am very pleased that 2019 started out with the most significant investment in our company's history. As we announced on January 15, Pulse Seismic Inc. acquired Seitel Canada Ltd., our largest competitor in the third-party licensed seismic data business in Canada, for total consideration of $58.6 million (assuming $5.0 million in earn provisions are met). There were additionally an estimated $4.2 million in future liabilities that were assumed. The price we paid to purchase these assets is 17 percent lower than the price of the Divestco database we acquired in 2010. In other words, we are buying almost three times as much 3D seismic data for 70 percent less on a price-per-square-km basis. Almost all of the revenue that the Seitel library produces will drop down to our bottom line. To put this in perspective, Pulse generated $215 million in shareholder free cash flow over the last ten years, and over that same period the Seitel library had $265 million in sales. This is a promising way to begin the new year and is a testament to the advantages of preserving a strong balance sheet throughout the business cycle.

This is not our first rodeo. There are many parallels between our purchase of Seitel Canada Ltd. and the purchase of Divestco's database in 2010. Weakened in the wake of the financial crisis, overleveraged, and unable to refinance its debt, Divestco found itself in the unenviable position of being a "forced seller." We paid a nominal $75 million for Divestco, using a combination of cash and debt while financing the remainder by issuing 14.3 million new shares. When the deal closed in September 2010 we had $64.5 million of debt on our balance sheet. Fast forward, and by 2015 the debt had been fully repaid even as we distributed $19 million in dividends, invested $92 million in new 3D seismic surveys ($57 million of which was prefunded by clients) and repurchased 12.4 million of the 14.3 million shares issued to finance the deal.

Once again, in 2019, we were faced with a motivated seller in a dismal environment — with rampant capital flight from Canada's oil patch — wanting to liquidate an asset strategically complementary to ours. Once again, our strong balance sheet enabled us to act on the opportunity. As a result, we borrowed 40 percent less than when we acquired Divestco. More significantly, we were able to finance the acquisition without issuing any equity, so that all of the benefits of the acquisition will accrue to our existing shareholders.

Unpredictably Predictable Cash Flow

By its nature, our business has limited visibility as to when and, particularly, how much it will generate shareholder free cash flow. Looking back over the last ten years, Pulse has generated $215 million of shareholder free cash flow, but in each individual year, the amount has ranged from $4.7 million to $50 million. How do you manage a business with that much volatility? It is paramount to minimize annual calls on cash and manage the balance sheet through the cycles.

Since the new management team took over in 2012, I have witnessed their relentless focus on cost control, which has increasingly differentiated Pulse from its competitors. What distinguishes truly exceptional managers is that they are just as rigorous about cost control in times of plenty, knowing that tomorrow can be a time of famine. Vigilance over expenses in times when cost control is not forced into the spotlight is what enables a company to preserve the strength of its balance sheet. Over the past five years, we have reduced the Company's head count by 40 percent — an extremely tough but demonstrably necessary process. The immediate reduction in labour expense was clear. But in addition, reducing our head count ultimately allowed us to relocate to a smaller office space on a long-term sublet from another company leaving Canada at a sizable discount per square foot to our previous rental rates. Our management team has done an incredible job of reducing costs, as evidenced by annual SG&A costs dropping from $8.5 million in 2013 to under $6 million in 2018.

The newly acquired database will also result in dramatic incremental benefits to our cost-related metrics for Pulse as our library of data available for sale more than doubles while the effect on our cost structure will be de minimis. The cost efficiency of the Seitel transaction enables us to better weather the current downturn at the same time that we have dramatically increased our long-term revenue-generating and earnings potential.

The right capitalization is imperative for several reasons, and it is a key aspect of our Company. Among the benefits is allowing us to protect our data by not being forced into a poorly priced sale just to make an interest payment or pay a dividend.

The logical next question concerns what we should do with that shareholder free cash flow? Our first preference is to acquire data which will provide us with good returns. Next, we consider reducing outstanding debt to ensure our financial flexibility. Lastly, when we have accumulated capital in excess of our ability to reinvest, we will return it to shareholders through dividends.

There are three ways we deploy capital to acquire data: (1) acquire an existing database; (2) shoot new multi-client data; or (3) buy back our shares. The results we can expect on these three options all depend on the same thing — the price we pay versus the value we receive. Just as we will only purchase assets when we believe we are buying them at a discount, we will only buy our shares if they can be purchased at a discount to the price we believe a fractional interest in our own database is worth. We think about buying shares of our Company the same way we think about any purchase of data. If we pay too much for data in any of these cases, we can expect capital to be destroyed. If, however, we purchase data at a discount to the present value of its future cash flows, we can expect to increase shareholder value over time.

There is a common misconception that dividends and buybacks are interchangeable. We see these as very different; one as reinvesting in our core asset, as highlighted above, and the other as capital excess over our ability to prudently deploy that capital in the foreseeable future. In 2015, as mentioned above, we paid off the balance of our debt incurred for the Divestco purchase. Simultaneously, we eliminated the cash dividend. We had concluded that the expectation of a regular cash dividend had become the equivalent of incremental overhead to the business. We decided a more prudent approach would be to declare episodic dividends that could be matched with our episodic cash flow. Then, in 2017 we had our largest data sale ever, but our industry was still struggling. So we determined we should retain the bulk of the sale's proceeds, both to be prudent and to enable us to be opportunistic as the tough industry environment could well drive something very attractive our way. Still, due to our control of costs and the strength of our balance sheet, we were able to return a significant amount of capital to shareholders in the form of a special dividend of $10.9 million — the type of episodic dividend I referred to above — without hampering our ability to be opportunistic today.

Is Seismic Data Still Valuable?

Sales for both Pulse and Seitel have obviously weakened over time, leading to an important question. Are the declining sales an indication of the declining value of our asset, some permanent impairment in Canada, or some other secular negative trend? We don't believe any of these to be the case. Decades ago, many of the major oil companies left Canada, in large part on the belief that there was no more resource left to be produced. Today's malaise in Canada is exactly the opposite. There's way too much resource, which is depressing the price. At the same time the seismic data we own is, and will continue to become, much more valuable.

We see this in the fever pitch activity in the Permian basin and in western Oklahoma. Oil and natural gas companies are anxious to acquire new seismic data at a cost of three to four times what we license Pulse's data for. Seismic data has become increasingly valuable as oil and natural gas companies have realized that there is significant variation in the rock for these new resources plays, making seismic as important as it is for conventional oil and gas wells. Locating your wells in the right portions of the rock, therefore, generates

significant incremental returns, and seismic is instrumental in making that determination. The cost of our data is de minimis as seismic data licences from our library are a fraction of a percentage point on the cost to drill and complete a well today. The ability of that data to mitigate risks when drilling mile-plus-long laterals through subsurface rocks is another example of how our data generates returns for our clients. In the meantime, oil and gas companies are increasingly becoming more sophisticated in the use of data and science, realizing the positive role seismic data can play in their business.

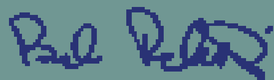
Bottom Line

I became Chair of Pulse's Board of Directors in 2013 and have been a shareholder for even longer. I was attracted to Pulse for the shareholder free cash flow characteristics and was less concerned about its volatility. As Warren Buffet told Berkshire Hathaway Shareholders in his 1996 Chairman's Letter: "…I would much rather earn a lumpy [higher return] over time than a smooth [lower return]." [1] (It's interesting to note that Buffett actually tried to enter our business in 2003 with his failed he attempt to acquire the then-distressed Seitel Inc., which was in Chapter XI bankruptcy.)

Today, I am as excited as ever by a business with proprietary, long-life, high-margin and low-maintenance-capex assets that generate significant albeit episodic shareholder free cash flow. The combination of management's excellent cost controls and capital allocation decisions set the table for Pulse to make its latest, largest-ever acquisition, of Seitel — the next step in a process that started in 2012. To reiterate, we have generated $215 million in shareholder free cash flow over the last ten years. Adding the $265 million in sales from the Seitel library over the same ten-year period, most of which would surely have dropped to the bottom line, suggests that having these assets with which to take Pulse forward is a very compelling opportunity. I am left hopeful and excited over this excellent extension of our Company in the form of an asset that is extremely long-lived, which was prudently financed at a depressed point in the industry cycle, all of which I am confident will accrue to the benefit of Pulse's existing shareholders.

1. The full quote from Berkshire Hathaway's 1996 Chairman's Letter is, "Gyrations in Berkshire's earnings don't bother us in the least: Charlie and I would much rather earn a lumpy 15% over time than a smooth 12%."

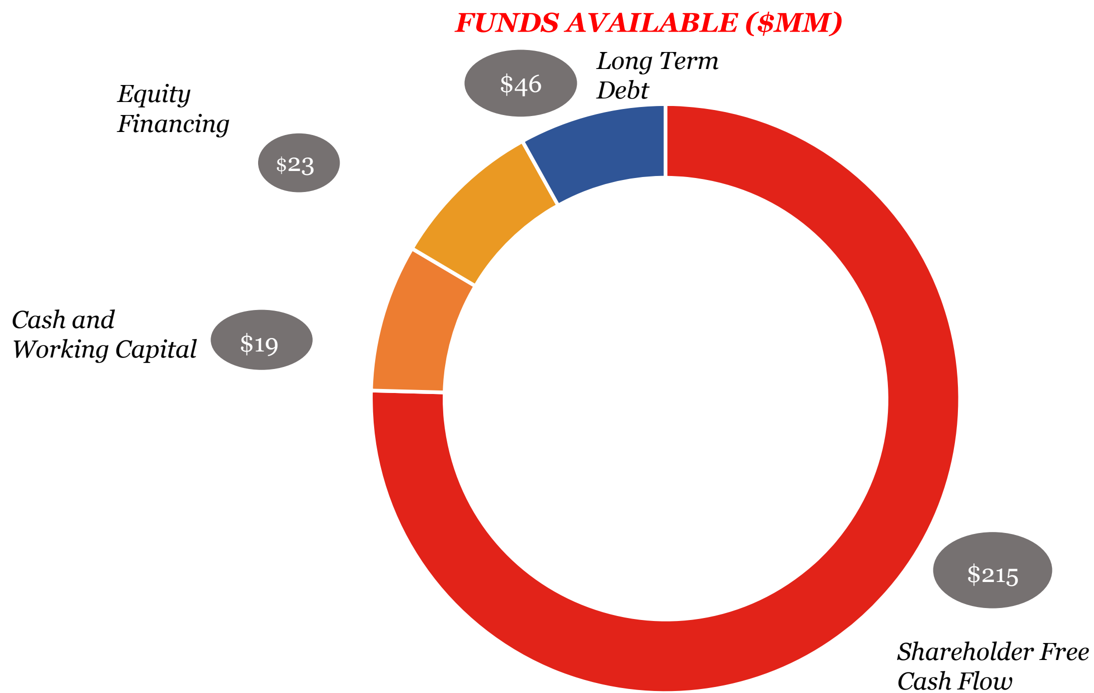
All the Best,

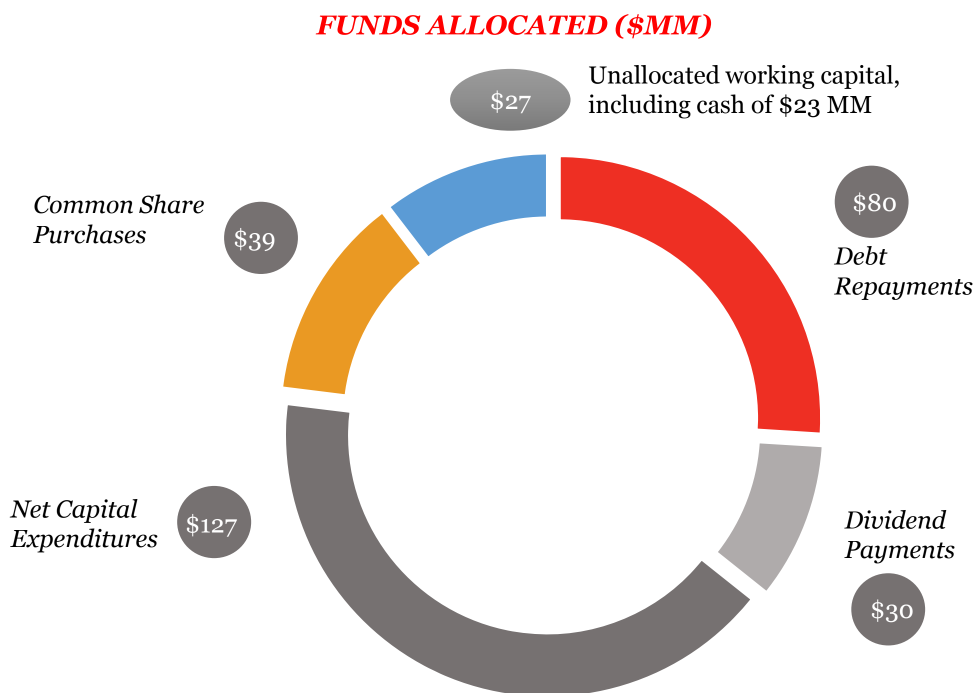


Bob Robotti
Chair of the Board

April 5, 2019

TEN-YEAR ALLOCATION OF FUNDS AVAILABLE
2009-2018





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