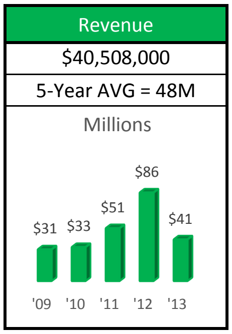
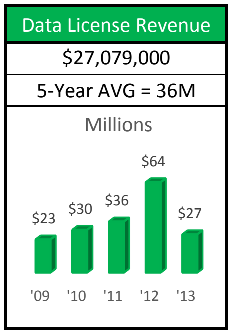
SELECTIVE
WEALTH MANAGEMENT

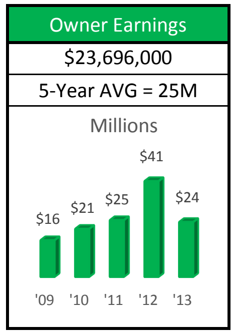
Pulse Seismic Inc
April 1, 2014

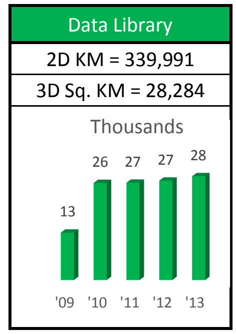
General Overview

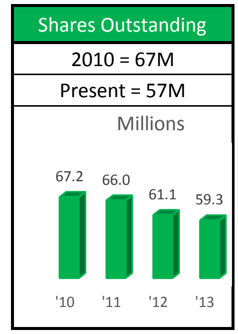
Pulse Seismic ("PSD") owns the second largest seismic data library in Canada. They license this library to oil and gas exploration companies that are interested in drilling for hydrocarbons. These licenses are sold on a non-exclusive basis and the same region can be sold multiple times to several different companies. The seismic data maps have extremely long useful lives - maps as old as the 1970s continue to generate revenue today.











Purchase Logic

We purchase PSD at a price of $2.98 (USD) per share for a market capitalization of $176 million. In the last five years the earnings of the business fluctuated between $41 million and $16 million depending on the data license activity in Western Canada. In the last 10 years the average earnings for the business was $25 million. During that same time period the size of the data library has quadrupled in size and drilling activity continues to accelerate in Western Canada. These factors should contribute to PSD averaging at least $25 million on average for the next 10 years. This equates to an effective purchase price of 7x earnings for the business. Oil prices have reached 4-year lows creating an excellent buying opportunity.

Future Expectations

Our future expectations for PSD is that the company will allocate $8 million (25% of earnings) to dividend payments and the remaining 75% will be invested opportunistically into new participation surveys or share repurchases. Since 2010 the company has repurchased 8 million shares or 10% of all outstanding stock. At the current price level share repurchases will rapidly compound per share earnings resulting in an increased stock price in the upcoming years with no change in the market capitalization of the business. We intend to hold this investment as long as the market capitalization of the business remains below $200 million. In the event the market capitalization exceeds $200 million by a meaningful amount we will sell the investment due to the reduced effectiveness of share repurchases.

Financial Highlights

Historical Earnings

The earnings of the business have been volatile over the last decade but are consistently positive. Earnings fluctuate based on commodity pricing of fossil fuels such as oil and natural gas and drilling activity in Western Canada. The average owner earnings for the last 5 years has been $25 million and there is substantial evidence that this figure will continue or increase during the next decade. The size of PSD's data library has nearly quadrupled in the last 10 years and advances in technology have led to an increase in unconventional drilling plays which in turn increases the value of older seismic data. Table 1 summarizes the key financial information:

Table 1: Key Financial Data

Year	'09	'10	'11	'12	'13	3Q2014
Total Revenue	$30,746,000	$33,034,000	$51,474,000	$86,353,000	$40,508,000	$27,400,000
Data License Sales	$23,444,000	$30,264,000	$36,194,000	$64,040,000	$27,079,000	$27,400,000
Owner Earnings	$15,821,800	$20,741,800	$24,509,300	$41,388,000	$23,696,000	$23,976,897
2D Kilometers	257,994	339,991	339,991	339,991	339,991	339,991
3D Square Kilometers	12,913	26,446	26,514	27,089	28,284	28,284
Shares Outstanding	53,071,383	67,201,671	66,045,571	61,140,442	59,349,120	57,350,000
Debt	$20,409,000	$61,386,000	$46,562,000	$26,688,000	$21,850,000	$11,000,000

Balance Sheet

The company had $61 million in debt in 2010 on the back end of the Divestco's data library. In the last 3 years the company has paid off the majority of this revolving debt facility while maintaining the company dividend and repurchasing shares. We anticipate the company will be debt free by mid-2015.

Problem & Solution

<u>Problem</u>

Oil & Gas companies want to drill into various portions of the earth with the highest probability of finding hydrocarbons: such as oil or natural gas.

<u>Solution</u>

Pulse Seismic ("Pulse") hires third-party companies to gather seismic data to create maps below the earth's surface. These maps are owned by Pulse and licensed by oil and gas exploration companies. The exploration companies process the data to evaluate which locations maximize their chances of striking oil.

Technical Details: To create a seismic map acoustical waves radiate from an energy source at or near the surface of the earth. The seismic waves reflect off of various geological beds or 'strata' in the Earth's subsurface. Sensors and instruments at the surface capture the reflected sound waves and convert them into digital form. The data is processed and an image of the subsurface is created. These images can be studied to help exploration companies identify particular areas likely to yield oil and natural gas reserves.

2D surveys are conducted in a linear fashion and represent a cross-section of the earth's subsurface. Pulse has a 2D library that covers 339,000 kilometers.

3D surveys are conducted over an area and capture a 3-dimensional image of the earth's subsurface. Pulse has a 3D library that covers 28,300 square kilometers.

Products & Services

Pulse's sole product is their seismic data library. The quality of this asset is based on the following: quality, age, map type, and area covered.

The most important aspect of their product is the quality of the map. If the mapping is performed properly then the data can be licensed for several decades and various processing techniques can be used on the same data. Quality is all or nothing - if the data is collected properly then it can be utilized, if not then the map is worthless.

The age of the mapping is not as important. Data from the 1970s is still licensed today and processed with new techniques. What truly matters is the location of the map and any historical drilling that has occurred in that location. A location that has been drilled extensively becomes obsolete.

The maps can be created in two types: 2D or 3D – with companies willing to pay more for 3D mapping. Over the last 10 years the average price to license a 2D map is approximately $33 per kilometer versus $1,544 per square kilometer for 3D data. The 2D maps are used to evaluate large areas to find a location that is worth a closer look. The 3D maps are used on the most promising 2D locations to find specific drilling locations.

The best areas to cover are locations with a high potential for hydrocarbons. Pulse expands their data library through partnerships with exploration companies to map new regions. Typically these new projects are funded 60% to 70% by the oil and gas partner and the remainder by Pulse, but Pulse retains 100% ownership of the data collected. This arrangement is agreeable to the oil and gas companies because after evaluating the region for prospective drilling they have no further use for that particular map. However, Pulse can resell the data to other oil and gas exploration companies.

Customers

Their customers include oil and gas exploration companies. The customer's license maps from Pulse because it is significantly cheaper to license an existing dataset than to reshoot the same area. Once a region is shot it is typically only reshot if the original quality was poor. If it is a high quality map then it is very rare a company would ever reshoot. This means customers select Pulse based on the regions covered by their seismic library and Pulse retains considerable pricing power on the license fees.

Sales & Marketing

Sales and Marketing is a relatively simple task for Pulse. Oil and gas companies that are interested in particular regions call them to license their libraries and they facilitate the sale. They generate 90% of seismic data library sales internally.

The licenses that are sold are non-exclusive and non-transferrable. Both of these aspects are important for generating revenue for Pulse. If an exploration company would like to bring on additional partners in a particular venture, each partner much license the seismic data from Pulse separately. This creates recurring revenue for that particular geographical location. Additionally, because the license rights are non-transferrable, mergers and acquisitions create additional opportunities to license the same data to the acquiring companies.

Sales and Marketing is also involved in partnering with exploration companies to shoot new areas. When considering new areas Pulse attempts to target areas where the producer is under-capitalized, will need partners, or there are multiple opportunities in a single zone for more than one commodity (such as crude oil, natural gas, natural gas liquids). Each of these characteristics lead to a high probability of multiple licenses being sold for the same region.

Revenue Creation

Revenue is broken down into two primary categories: Data Library Sales and Participation Survey Revenue. The Data Library Sales represent license sales to oil and gas companies on seismic maps that previously existed. These sales generate 76% free cash flow to the owners for every dollar of revenue.

Example: Exxon Mobile is interested in drilling in Alberta. They want to determine which locations have the highest potential returns for their capital spending in the region. They call Pulse to purchase 2D data across a very large region. They analyze the 2D data to narrow down their search to a few specific areas. They call Pulse again and request to purchase the 3D data for the regions they are most interested in. Pulse charges approximately $30 for each 2D kilometer and $1,500 for each 3D square kilometer. Very little work is required for Pulse and the majority of Exxon's payment is free cash flow to shareholders.

The Participation Survey Revenue is revenue paid to Pulse by oil and gas partners to cover the majority of the costs for mapping new regions. This revenue is collected by Pulse, but then immediately paid out to third-parties to perform the mapping. It is essentially a pass-through item that creates no income for Pulse, but expands their library.

Example: After reviewing the 2D maps Exxon Mobile is interested in a region that currently has no 3D maps. They partner with Pulse to map the region of interest. Exxon pays Pulse for 60% of the overall project cost and Pulse pays the remaining 40%. Pulse then contracts third-party companies to perform the seismic surveys and oversees the project. When the project is completed the 3D results are added to Pulse's seismic library and a copy is sent to Exxon Mobile. Pulse did not generate any income from this arrangement because all cash flow was paid to the third-party contractors to perform the work, but they expanded their data library by only paying for 40% of the overall cost. This 3D data can later be licensed to Chevron or Conoco, etc.

The Participation Survey Revenue should be viewed as a capital expenditure to expand the business, whereas the Data Library Sales are where the profits truly come from.

There are several factors that increase the value of historic data and allow 2D and 3D data to be resold in the future:

- New seismic processing and visualization software allows historical 2D and 3D data to be reprocessed and reinterpreted. This allows Pulse to license the same data repeatedly for many decades.
- Technological advances, such as hydro-fracking and horizontal drilling, can make regions thought to be unprofitable for drilling economically viable. This revitalizes the licensing prospects of data shot in that region.
- Pulse can license their data repeatedly based on corporate transactions. If the primary data license holder brings on development partners, they sell selected assets, or are acquired entirely it will trigger additional data licenses due to the non-transferability of each license.
- In addition to corporate based transaction sales there also are unique laws in Canada that increase the turnover of mineral rights. The government in Canada has specific laws that force oil and gas companies to begin using their mineral rights within 3 to 5 years or the rights expire and revert back to the Crowne. When the rights expire and are sold to a new owner the data must be licensed again in that region.

All of these effects create recurring revenue for Pulse's data library.

All of these positive catalysts for re-licensing data are extremely unpredictable and make the timing of data sales is highly uncertain. Pulse's annual revenues can increase substantially with no advanced indicators. Even during periods of weakness they generate substantial profits.

Geographically their sales are primarily in Alberta (40 – 70%) and British Columbia (15% - 50%). Additionally, roughly 10-30% comes from 2D sales with the remainder from 3D sales.

Expenses

The expenses for Pulse Seismic are largely fixed in nature. They have 23 individuals at headquarters. Annually they incurred approximately $5-6 million in salaries, commissions, and benefits that are related to their sales team. Commissions are higher in years with larger data library sales and smaller in years with lighter sales.

They also incur $3 million annually for selling, general, and administrative expense. In total their cash expenses are between $7 million and $11 million every year depending on the volume of library sales. Once data library sales exceed the fixed value of $7 million every dollar of revenue is essentially free cash flow to shareholders.

The largest annual expense incurred by Pulse is the amortization of their data library. This is discussed in detail under the section "Real Income".

Real Income

Pulse's actual income is very different than the figures reported. The amortization of the seismic library is a non-cash charge that should not be counted as an expense to Pulse Seismic for several reasons:

1) The useful life of the library extends significantly beyond the amortization period. The library is 50% amortized the first year with the remainder being amortized over a 7 year period. However, Pulse seismic generates a substantial portion of all their sales from data that is much older than 7 years. Since 2009 they have generated $48 million in data sales from 2D data that is 30 years old or more.
2) The data library is paid for by their customers. When they map a new area their customers pay between 60-70% of the cost of the seismic shoot with Pulse paying the remainder. However, the cost of the entire project appears on Pulse's income statement and the costs are capitalized on the balance sheet and then amortized. This amortization expense was paid for, in cash, by their customers. Even if the useful life of the data was identical to the accounting period 60-70% of the amortization expense is actually paid for by the customers.

These two factors distort the IFSR or GAAP reported income significantly. Below is a table of the net income when the amortization expense is added back:

Year	2013	2012	2011	2010	2009	2008	2007	2006	2005
Reported Net Income	($18M)	$27M	$5M	($1M)	($2M)	$0.5M	($5M)	($3M)	$6M
Amortization Expense	$55M	$36M	$31M	$23M	$25M	$32M	$28M	$22M	$21M
Actual Net Income	**$20M**	**$50M**	**$23M**	**$19M**	**$16M**	**$24M**	**$27M**	**$22M**	**$23M**

The net income is much closer to the data library sales minus the headquarters expense. The amortization charge has very little to do with the cash flow generated by the business.

Growth

Pulse intends to grow by increasing the size of their data library in Western Canada. Historically the growth has been extremely small and will likely continue to that way into the future. There are several positive developments for Pulse to suggest their average income will exceed the $26M figure of the past 10 years:

1) Their data library is 4x bigger than it was 10 years ago
2) Canadian Pacific has announced increasing their capital expenditures to build new rail in the Alberta region (where Pulse has the majority of its maps) by more than $1 billion to support the demand for shipping crude oil from the region. The company estimates that more than 33% of its revenue will be derived from shipping crude oil from this region by 2018.
3) Continued advancements in oil and gas extraction techniques that increase the viability of historical seismic data

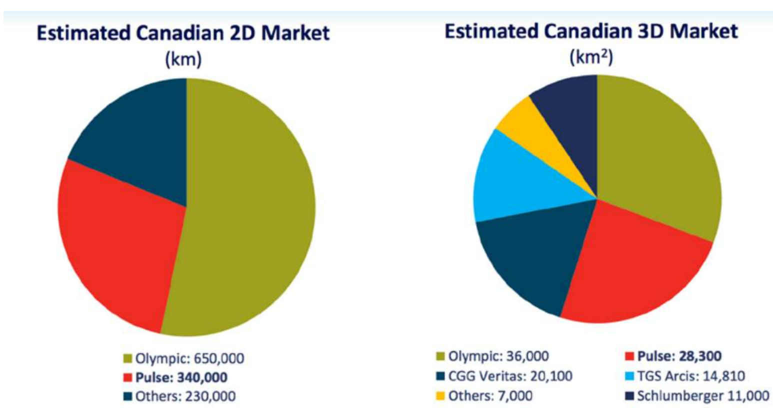
It should be noted that growth is not required for this investment to be successful. If average earnings are simply maintained the earnings yield is in excess of 15% and the vast majority is paid directly to shareholders each year through share repurchases and dividends.

Competition

There is intense competition to shoot participation surveys in new regions. Oil and gas companies sometimes pay for the new maps in their entirety and maintain ownership, or partner with other geophysical services companies.

However, there is very little competition for existing databases if the map is of sufficient quality due to the high costs of reshooting an existing seismic survey. It is the minimal competition between existing maps that makes the investment so attractive.

Their largest competitor is Olympic with 650,000 km of 2D data and 36,000 km^2 of 3D data.



Consolidated Balance Sheet

Very simple balance sheet. They have a $50 million revolving credit facility with $11 million in debt outstanding. They keep their cash balance low to minimize the interest payments paid on the facility. No off-balance sheet arrangements.

Accounting Quality

The accounting is very clearly explained and simple to understand. They've been audited by KPMG and received an unqualified audit.

Legal

There are no legal actions outstanding against the company.

Executive Team

The executive team is seasoned and has an economic interest in the success of the company. They've acquired meaningful ownership of the shares over the years through open market purchases – which is an extremely good sign.

Compensation

The company use to pay stock options and stock appreciation rights to senior management, but this practiced was stopped in 2009. All stock options and SAR have expired. This is excellent news for the business owners. The current compensation structure aligns the interest of management with the shareholders.

Allocation of Capital

They intend to allocate capital for dividends and share repurchases. They have retired 25% of the total shares since 2007 and the repurchase rate is accelerating.

The company has made some skillful acquisitions. The Divestco acquisition has generate enough cash to repay the original purchase price in less than 2 years. I suspect this was partially attributed to luck, but still an incredible investment.

We would be delighted to see the share repurchase activity continue. The company is legally only allowed to purchase 10% of the public float (48,178,201) in any given year. Additionally, the company is limited to only purchase up to 18,154 common shares in any one day, but can make large block purchases once per business week. They recently repurchased more than 1 million shares in a block purchase at 52-week lows.

Risks

Oil and Natural Gas Prices

Oil and gas companies may reduce their capital spending in the event that oil and gas prices drop. This would temporarily reduce the licensing fees collected by Pulse. Today oil and gas prices are at 4 year lows depressing the price of the Pulse's stock. Despite the pricing headwinds Pulse has generated more than $15 million in free cash flow to shareholders in the first 3 quarters of this year. We believe that the pricing headwinds are temporary (3 years or less) and normal earnings will continue for much of the decade.

Relicensing (Change of Control) Fees and Partner Copy Sales

The data library licenses are non-transferrable which increase licensing fees for subsequent M&A activity. If M&A activity declines (temporary) or Pulse is no longer able to sell non-transferrable licenses (permanent) it would have a material impact on earnings.

Laws and Regulation

Any changes in laws or regulation that impact the attractiveness of developing oil wells in Canada would greatly impact Pulse's ability to license data.

Loss of Seismic Data

If they lost their seismic data library it would kill the business. They have physical data stored in a secure location managed by a data storage company with multiple physical data copies and digital copies in separate locations.

Moat

The primary moat for PSD is the extremely limited competition between existing libraries. Once an area is shot that existing library tends to monopolize all sales for that area. The barrier to entry is the high cost to reshoot versus simply licensing.

Conclusion

In conclusion PSD offers a product, namely seismic maps, that have monopolistic qualities for the map owner. The current laws in Canada allow PSD to frequently license the same map data to multiple parties generating recurring revenue from existing seismic data. The company shares the costs of new seismic shoots with major oil conglomerates but retains 100% ownership rights to the new data. This allows PSD to earn attractive returns on capital deployed on new seismic shoots. Additionally, PSD allocates the majority of all earnings to share repurchases and at the current share price the company is able to retire shares rapidly and grow EPS for remaining shareholders quickly.

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