Fourth Quarter and Full Year 2023 Financial and Operating Results Webcast

February 21, 2024

Internally Generated Transcript

CORPORATE PARTICIPANTS

Jennifer Martin Samuels, *Vice President - Investor Relations & ESG Stewardship*

Herb Vogel, *President and Chief Executive Officer*

Wade Pursell, *Executive Vice President and Chief Financial Officer*

PRESENTATION

Jennifer Martin Samuels

Good afternoon and welcome to SM Energy's fourth quarter and full year 2023 results webcast.

Before we get started on our prepared remarks, I remind you that our discussion today will include forward-looking statements. I direct you to slide 2 of the accompanying slide deck, page 7 of the accompanying earnings release, and the risk factors section of our most recently filed 10K, which describe risks associated with forward-looking statements that could cause actual results to differ.

We will also discuss non-GAAP measures and metrics. Definitions and reconciliations of non-GAAP measures and metrics, to the most directly comparable GAAP measures, and discussion of forward-looking non-GAAP measures, can be found in the back of the slide deck and earnings release.

Today's prepared remarks will be given by our President and CEO Herb Vogel and our CFO Wade Pursell.

I will now turn the call over to Herb.

Herb Vogel

Good afternoon and thank you for your interest in SM Energy.

We are very pleased to report our excellent 2023 financial and operating results. We measured up very well against each of our 2023 objectives! Today, we will spend more time looking forward, into our plans for 2024. We are well positioned to slightly increase activity and deliver an attractive return of capital to our stockholders, initiate development of properties acquired in 2023 and maintain our low leverage.

Turning to slides 4 and 5 and starting with key 2023 results:

How did we measure up against our stated strategic objectives? We met or exceeded each objective as I will step through now.

Our first objective was to deliver increased return of capital to our stockholders.

We generated substantial free cash flow of $509 million and returned $300 million to our stockholders. This is an approximate 7% yield for stockholders and return of approximately 60% of the free cash flow we generated.

This included the repurchase of 6.9 million shares at an average price of $32.89, for $228 million, and fixed dividends paid of $72 million. Notably, this is four times the $77 million returned to stockholders in 2022, and we reinvested in our portfolio, transacting approximately $125 million in prospective leasehold positions.

In addition, we set a company record for proved reserves, ending the year with 605 MMBoe, up almost 13% from year-end 2022, despite a reduced SEC pricing environment.

At the same time, we improved our balance sheet, reducing net debt by $171 million to $969 million, which met our objective of less than $1 billion net debt.

Our allocation of free cash flow is intended to drive long term, sustainable profitability, and share price appreciation.

Our second objective was to focus on operational execution, including excellent safety and environmental stewardship.

If we measure operational execution by production performance, production came in about 3.5% ahead of the mid-point of early-year guidance, and production was up approximately 5% year over year, consistent with mid-single digit growth discussed last June. Increased production guidance over the course of 2023 was driven by well performance from our Austin Chalk program, which exceeded expectations, while operating efficiencies served to accelerate drill and completion times for certain wells in the Midland Basin.

As we have emphasized in the past, our differential application of technology supports completion designs that optimize well performance to peer leading outcomes. If we measure operational execution by well performance compared to peers, as shown on slide 6, in both the Midland Basin and Austin Chalk, SM wells sizably outperform our regional peers. These charts show normalized cumulative oil production per 10,000 feet of lateral. If you look closely, you may be surprised to see that cumulative oil production from an average west condensate area Austin Chalk well is almost the same, around 230 to 240 thousand barrels of oil after 20 months of production, as an average Howard County well. That leads to simply excellent economics in both plays and we're always working to get even better.

Turning to slide 7:

In regards to safety and stewardship, we had another excellent year, thanks to the focused efforts of our operating teams.

Artwork on this slide is courtesy of Aiden Sosa, who is the son of one of our operations specialists in South Texas. In an effort to engage SM families with our safety culture, annually we hold a drawing contest for our safety calendar and Aiden was one of our winners.

For 2023, we highlight a truly superior total recordable incident rate, or TRIR, safety metric of 0.20 reportable injuries per 200,000 man-hours worked, which comprises both employees and contractors, and a spill rate of 0.006 barrels spilled per thousand barrels produced. Just excellent work but will never be an area for complacency!

To top it off, CDP scores were posted a few weeks ago and SM received a leadership level score of A- . For a company in our industry, that is simply a stellar outcome.

We truly believe that safety and environmental stewardship are an integral part of operational excellence.

Turning to slide 8:

Our third objective was to focus on replacing and building our top tier inventory.

Creating value by finding and developing reserves is our focus, and as many of you know, an area where we have a strong track record.

In 2023, we acquired 29,700 net acres, net of divestitures, in the Midland Basin, increasing our leasehold position by 37% in that basin. This includes the 20,700 acres we refer to as Klondike, located in North Martin and Dawson counties, as well as what is often referred to as our new “stealth” acreage, which I can tell you now, and as you can see on the map, is located just west of our existing Sweetie Peck position in Upton and Crane Counties.

This grass roots expansion is the result of collaboration between our geosciences, reservoir engineering, data analytics and land teams. They are working non-stop to identify, find and transact on assets that we expect to grow our top tier inventory. In this case, we have confidence from detailed evaluation of offset well performance and subsurface data, indicating extension of certain intervals into our “buy areas.”

I’ll talk more about our plans here in a few minutes.

Given the outstanding performance in all these dimensions in 2023, I’d like to say “thank you for your commitment to excellence” to each of our 544 employees for a job really well done.

Turning to slide 9:

Let me just summarize our strategic objectives for 2024 before Wade covers the specifics of our plan. We are really well positioned coming into the year with:

- a low breakeven cost portfolio;
- low leverage;
- ability to increase oil directed activity given the current commodity price outlook, and finally;
- the upside value proposition presented through recently acquired acreage.

Our 2024 strategic objectives are to:

- First – to execute operationally to deliver low breakeven, high-return wells through the implementation of new technologies to drive efficiencies and continue leadership in ESG stewardship;
- Second – to return capital to stockholders through share repurchases and dividends, while transferring value to stockholders through reduced debt, and;
- Third – maintain and expand our portfolio quality and depth by employing advanced analytics and technical innovation.

Now let me turn the call over to Wade to speak to the 2024 plan. Wade?

Wade Pursell

Thanks Herb. Good afternoon.

As a reminder, we are a premier operator of top tier assets delivering a sustainable return of capital. Empowered by our strong balance sheet and world class technical team, we are poised to repeat this success.

We certainly demonstrated that in 2023 with solid operational execution, driving results that exceeded street expectations.

Those results are actually quite straightforward, so let's spend some time looking forward into 2024.

The 2024 plan is designed to support each of the three strategic objectives that Herb just outlined.

As we have discussed over the years, our methodology is to develop a multi-year plan that optimizes free cash flow through the most capital efficient development program. This generally results in flat to low single digit production growth.

Starting with slide 10:

The 2024 capital program increases activity over 2023, which reflects our counter-cyclical approach in a deflationary environment. We expect the program to deliver an attractive free cash flow yield, while enabling the team to initiate delineation and development of properties acquired in 2023. Total capital expenditures are expected to range between $1.16 and $1.2 billion. Key inputs include:

- First – activity level: The Company expects to drill and complete 115-120 total net wells with roughly 60% in the Midland Basin and 40% in South Texas. We plan to retain the 4th rig in Midland for the majority of the year.
- Second – cost: The cost of increased activity is expected to be largely offset by realizing certain efficiency gains, which include running a simul-frac fleet for the entire year in Midland and drilling 25-30, 15,000 foot laterals, as well as recognizing around 10% on average year over year deflation. We are seeing deflation essentially across the board on larger items, with the exception of labor.

As a result, well costs per foot to drill, complete and equip are expected to range in the low $800s, with Midland and South Texas well costs being very similar. I will point out that our well costs per foot include our notably higher than average sand and fluid loadings, which we employ to optimize well performance and returns. We also report costs based on DC&E. This can be apples to oranges in comparing to D&C only. Together, these factors add approximately $130 per foot, which if normalized to peer metrics, would compare with a $700 per foot peer well.

Assuming flat prices of $75 WTI, $2.75 Henry Hub and $27 for NGLs, the 2024 drilling program is expected to deliver an average return, including drill, complete equip and facilities, of around 55-60%.

Total capital costs include facilities and infrastructure costs related to continued expansion of the South Texas oil and water handling facilities. They also include facilities upgrades and expansion in the Klondike area, such as improved emissions controls, saltwater disposal upgrades and a pipeline intended to reduce the operational footprint around the local community, which also reduces costs and emissions.

Turning now to guidance on slide 11:

Production guidance of 56-59 MMBoe for the year is an output of the capital program. This is an increase of 3-4% year over year on a Boe basis, while oil volumes are expected to increase around 6%. Production volumes are expected to average 44% oil and be split roughly 50/50 from the Midland Basin and South Texas on a Boe basis. Production cadence is expected to increase each quarter through the year, based on the timing of completions. First quarter guidance is approximately 13 MMBoe, or 143 MBoe/d, which takes into account only 11 net wells turned-in-line in the fourth quarter 2023, as well as the effect of adverse January weather.

We are guiding LOE at $5.30-5.60 per Boe, which considers the need for temporary electric generators in the Midland Basin, due to increasing demand on the electrical infrastructure, as well as increased water handling costs.

In regards to cash taxes, during last quarter's call we talked about the significant R&D credits that we have earned. The carry forward of these credits are expected to reduce cash taxes for 2024 to around $10 million, which will likely carry through to 2025. There is significant cash flow benefit here.

Turning to the balance sheet, slide 12:

I am very pleased to report we have achieved net debt of less than $1 billion and net debt-to-adjusted EBITDAX of 0.57 times. Low leverage affords flexibility in the allocation of free cash flow in 2024 and positions SM for continued growth in return of capital to stockholders. We ended the year with more than $600 million in cash, which gives us the flexibility to call the 2025s this year, if we choose.

Skipping to year-end reserves on slide 14:

Net proved reserves of 605 MMBoe are a company record. As Herb mentioned, proved reserves are up 13% year over year, and the net increase in reserves year over year replaced production by more than 2.2 times. The net proved reserves to 2023 production ratio is 10.9 years.

Lastly for me, let's look at inventory on slide 15:

We ended 2023 with approximately 10+ years of inventory, assuming 80 to 100 average completions per year.

It is notable that the estimated average IRR of inventory is greater than 65%. In addition, more than 80% of inventory is categorized as 3P, which implies the inventory location count is very high quality. We believe our inventory calculations are potentially conservative compared to how other companies may calculate inventory. As a reminder, all wells within our 3P reserves estimate are economic, have an area specific type curve, a defined lateral length, are at optimized well spacing and have an assigned spot on the latest development schedule.

At year-end 2023, the gross inventory in the Austin Chalk, including wells drilled to date, increased 16% to 465 locations, with more than 350 locations remaining. This significant increase reflects our confidence given the excellent economic performance of the 106 Austin Chalk wells we have already brought into production over the past 5 years.

We also added 40 wells so far from 2023 acquisitions, so delineation and development of new acreage offers upside to identify and add inventory in 2024 from those acquisitions.

In 2023, we tested the Leonard in the RockStar area and determined that we can optimize capital efficiency by removing Leonard locations from inventory and instead drill more wells in the underlying Middle Spraberry, increasing Middle Spraberry locations, where some fracs will grow into the overlying Leonard.

Long-term benchmark pricing used to calculate our inventory was $70 WTI oil and $3.50 Henry Hub gas.

So, in closing, I would like to say again how proud we are of the 2023 results and the corresponding outperformance in SM shares. Total shareholder return achieved for SM shares was positive 13%, despite oil being down 11% in 2023 and gas being down 44%! And 2024 appears to be set up for more of the same.

Thanks for your support and I now turn the call back to Herb. Herb?

Herb Vogel

Thanks Wade.

Turning to slide 16:

Let me wrap up the call by focusing on some specifics of what we're doing to extend our high-quality, low breakeven, and high-return inventory.

At Klondike, the 20,700 net acres located in north Martin and Dawson counties, that we acquired last summer:

We have drilled one science well from which we gathered log and core data, and plan to start acquiring 3D seismic in March. We conduct this work in order to optimize our development plans.

Our 2024 program is expected to include development of 3 pads having a total of 8-9 wells. First completions are expected to come online in June, meaning we should have initial results to report by the end of the third quarter.

As you know, some of our most prolific RockStar area wells are drilled into the Dean and located in North Martin about 10 miles away.

We added locations in Klondike based on offset well data and we expect further delineation and development to bring upside.

The acreage you all referred to as "stealth" includes approximately 9,100 net acres adjacent to our Sweetie Peck position in Upton and Crane Counties. We have not yet counted any inventory from this acreage acquisition and, while we have a primary target, we will evaluate multiple intervals. We are excited to see well results on this acreage later in the year.

With that, let me thank you for your interest in SM Energy. I look forward to our live Q&A call tomorrow morning.