



Third Quarter 2022 Financial and Operating Results Webcast

November 3, 2022

Internally generated

CORPORATE PARTICIPANTS

Jennifer Martin Samuels, *Vice President, Investor Relations*

Herb Vogel, *President and Chief Executive Officer*

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

PRESENTATION

Jennifer Martin Samuels

Welcome to SM Energy's third quarter 2022 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 5 of the accompanying earnings release, and the risk factors sections of our most recently filed 10K and 10Q, 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

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

I will start on slide 3: This is an exciting time for our Company! We largely reached our balance sheet objectives and in early September announced our plans to return capital to our shareholders, redirecting a material and sustainable portion of our adjusted free cash flow back to our shareholders. Our net debt-to-EBITDAX now sits at a very comfortable 0.6 times and net debt has been reduced to \$1.1 billion.

The bottom-line is that our core objectives for 2022 have largely been met.

- First, the balance sheet is in great shape;
- Second, we continue to demonstrate very high-quality inventory-
 - In the Austin Chalk, we have high confidence in our estimated 400 locations and have shown predictable and repeatable well performance;
 - In the Midland Basin, we continue to test or delineate new zones that provide upside inventory potential. We continually optimize drilling and completion designs to achieve top tier well performance.
 - This high-quality inventory and our optimized operations don't just happen. They are the outcome of our long-term commitment to, and emphasis on, geoscience, technology and innovation, which I will talk about more in a few minutes;

- Third, we remain leaders in the sector for ESG where innovation and technology also play a significant role in “operationalizing” our safety and emissions objectives.

Turning to slide 4: As we wrap up 2022 with a successful scorecard, we turn our attention to 2023 and forward. We very deliberately built our portfolio over the past six years to have among the lowest breakeven costs and a diversity of commodity mix to offer resiliency at one end of the cycle and high margins at the other, which should be beneficial as we enter a period of potentially volatile commodity prices and high inflation.

Looking forward, we are a premier operator of top tier assets, and we are delivering sustainable adjusted free cash flow and return of capital to our shareholders. Combining this with a strong balance sheet, high-quality inventory, and our world-class technical team, SM is well positioned to create shareholder value in the coming years. We view our strategy as sustainable and repeatable.

I'll break here and pass it to Wade to provide a few highlights on the quarter. Wade?

Wade Pursell

Thanks Herb and good afternoon.

I'm on slide 5: I'll start by echoing Herb's comments on the balance sheet. In summary, the balance sheet is in great shape and we are very pleased to be able to meet our objectives well ahead of schedule. We generated more than \$1 billion in adjusted free cash flow over the past 12 months.

Moving to slide 6: We are also very excited to have initiated our return of capital program with the buyback of about 453,000 shares completed the last three weeks of the quarter. We look forward to continuing repurchases opportunistically. The return of capital program also includes an increase in the fixed dividend to \$0.60 per share annually and the first quarterly payment of \$0.15 gets paid next week. I believe some refer to this as “Durable” cash returns, and I'll add, with upside return potential in a strong commodity price environment.

Given the pre-release of certain results and detailed schedules in our materials, I won't take time reviewing the quarter, but I will touch on a couple of topics that I believe you all have questions on.

- That first topic is inflation.
 - As a reminder, for 2022 we baked in 25-30% inflation over the fourth quarter of '21. This has held up through the third quarter and we are on track for full year capital guidance.
 - However, certain costs are still rising, specifically labor, horsepower, pipe and rigs. I think across the sector you will see continued effects of supply chain issues and exit rate inflation above the average for 2022. It is too early to give direction on 2023.
 - We are in the midst of our year-end planning process and are working a number of scenarios. Beyond running commodity price scenarios, we also consider a range of capital allocation between Midland and South Texas and we seek to optimize capital efficiency across the program, an important component in an inflationary environment. The ultimate objective in our planning process is to optimize returns and adjusted free cash flow over a multi-year program.
- Next topic, Waha pricing.
 - The majority of our gas production from the Midland Basin is priced regionally at Waha, which is currently seeing a widened differential due to maintenance. The October first-of-the-month differential to Henry Hub was around \$(3.60) and November is around \$(2.12), then the December differential based on current forward strip comes down to around \$(1.50). The pricing at Waha affects only our Midland Basin gas production. Our South Texas gas prices mainly at HSC, which remains unaffected.

- Separately, looking ahead to 2023, we get questions around potential capacity constraints to move Midland gas. Our internal analysis shows that added capacity coming on in the second half of '23 should mitigate this concern. However, we approach the risk as two pronged, as it relates both to the ability to move the gas and second to the price received. We sell only to large buyers who have firm transportation and we have been reassured that our gas will move. To the second prong, that is the price received, we have hedged the basis differential in 2023 for a portion of Midland gas production and we will look at adding to that.

In summary, our high-quality asset base should generate comparatively strong returns in an inflationary environment. Combine this with a strong balance sheet and we will enter 2023 very well positioned to generate substantial adjusted free cash flow and return significant capital to our shareholders. We are working diligently to develop a plan that optimizes returns and adjusted free cash flow and look forward to presenting that in February.

I'll now turn it back to Herb who will highlight our world-class technical team and our consistent and repeatable track record in driving value. Herb?

Herb Vogel

Thanks Wade –

Skipping ahead to slide 10: We started today's discussion with a slide depicting our sustainable and repeatable business model, and I'd like to take a few minutes to elaborate on a key component of that - our differential expertise in unconventional resource development.

- SM Energy has been highly successful in applying and integrating geoscience, reservoir engineering and completion modeling to build a top tier portfolio and deliver best in class well performance. Our team has developed proprietary technology that integrates three-dimensional subsurface models, calibrated with cutting edge diagnostics and machine learning, to provide better visibility into our unconventional reservoirs. We pioneered this technology in the Permian Basin and then applied it to organically build our top tier portfolio in South Texas. In turn, this has created substantial value through organically discovered inventory, peer leading well performance and optimized capital efficiency.
- Our two core assets today are a product of this. When our team initiated exploration work in Howard County there were only 79 horizontal wells and 3 zones tested. Through a process of geological data collection and reservoir completion analysis, we believed the "far east" portion of the Midland Basin to be highly prospective. We made two large asset acquisitions and, against substantial skepticism, we identified, delineated and developed an asset that is now considered among the highest quality areas in all of the Permian Basin. Peers followed suit and after a major increase in industry drilling activity, there are now more than 3200 horizontal wells, 8 reservoirs tested, and SM Energy has long-duration, high quality inventory in this asset. In effect, our effort here has been a true company maker.
- The second example here highlights our work in the Austin Chalk. In 2018, there were only 8 producing horizontal Austin Chalk wells in the Maverick Basin and, per Enverus at the time, they had an average breakeven of around \$80 per barrel. Not very attractive. Our team completed detailed analysis of roughly 600 penetrations we had through the Austin Chalk from our Eagle Ford development and cored the entire section in one well. We pioneered the Austin Chalk testing in the area and, four years later, we have delineated the majority of our position. A number of peers including EOG are working the play and more than 110 horizontal wells have targeted the Austin Chalk in our area. You can't help but imagine that the Austin Chalk map will look more like the Howard County map in the coming years. We have estimated our position to have 400 locations. This has been a game changer, not just for SM, but the industry in the area.

Turning to Slide 11: As I mentioned earlier, we support asset optimization through sophisticated data analytics and internally developed machine learning tools. The graph on this slide shows the large and growing number of wells that underpin our data analytics in the Midland Basin. I understand we have collected around 640 terabytes of data across the Company to support this effort. We integrate financial data with Earth models, reservoir history matching and simulation to arrive at faster and more robust economic decisions.

Turning to Slide 12: In practice, in the Midland Basin, this analytical approach that is fundamentally grounded in data enabled:

- land acquisitions and acreage consolidations, which resulted in increasing our average working interest in Howard County from 61% to 81%;
- optimized program development plans across our acreage positions, which incorporate detailed spacing by drilling unit, both horizontal and vertical, and identified the need to co-develop early on;
- best in class well performance through both pin-pointing optimal landing zones and designing optimal completions, and
- identifying potential new geologic zones, which in the Midland basin has grown to up to eight target zones on some of our acreage.

Turning to slide 13: A great example of applying data and machine learning is our Midland Basin well completions optimization effort. One example as depicted here, involved our multivariate model testing around 25,000 unique completion designs intended to maximize NPV per well. The orange outcomes represent a cluster around the Midland average design and NPV while the blue is a cluster around SM's new base design. This process is continuously updated with new information and evaluated for nearly every well. As you can see, we strive to push this further in the direction of the arrow as we continue to optimize. The end result is higher capital efficiency that ultimately leads to more free cash flow generation and faster payouts from each spacing unit.

Turning to Slide 14: We'll now look back at well performance and the tangible end result of this optimization. Here we compared Capital One data from a September report showing the average of all Permian Basin producing wells completed in 2020 and 2021, the dotted lines, versus SM wells completed in the same time period. On the right, we show Enverus data from October for completions in 2020 and 2021 specifically for Howard County. Both these data sets reveal the significant outperformance of SM wells – which is attributable to our emphasis on science, technology and innovation.

I trust that it will become clear to you over time that SM is laser focused on identifying and establishing positions in high quality rock that deliver strong returns, and that we have the people and tools in place to execute this strategy.

While I could go on for quite some time with additional examples of our cutting edge technology, I'll simply sum up at this point by repeating our strategy. We are a premier operator of top tier assets, and we are delivering sustainable free cash flow and return of capital to our shareholders. Combining this with a strong balance sheet, high quality inventory, and our world-class technical team, SM is well positioned to create shareholder value in the coming years. We view our strategy as sustainable and repeatable.

We look forward to our live Q&A discussion tomorrow morning.