First Quarter 2022 Financial and Operating Results Webcast

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Internally Generated Transcript

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PRESENTATION

Jennifer Martin Samuels

Good afternoon and welcome to SM Energy's first quarter 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 5 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

Thank you, Jennifer.

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

Turning to slide 5. We are off to a solid start in 2023! I am pleased to report that first quarter results demonstrate progress on all our core objectives. Our discussion today is relatively brief as we are delivering exactly what we said we'd do.

1. Our first strategic objective is to deliver an increased return of capital to stockholders. We repurchased 1.4 million shares during the first quarter. If I add share repurchases to dividends paid, the total capital returned to stockholders amounted to $58 million during the quarter. This is 116% of Adjusted free cash flow as we took advantage of share price volatility and what we believe to be a notably undervalued stock. We announced our increased dividend and share repurchase program last September and since that time have returned a total of $134 million to stockholders, an approximate 4% yield to market cap paid out over about 8 months.

2. Our second strategic objective is operational execution. Production exceeded guidance primarily due to outperformance in South Texas, including a 7-well pad that came on early and came on strong. Excellent execution includes advancing our ESG initiatives and one example is reduction in flaring. I'll highlight some of what we're doing operationally in a few minutes.

3. Our third objective is replacing and building our inventory. I will reiterate that SM has among the highest quality and longest duration inventory among similar sized peers, so we pursue inventory growth organically and cost effectively. During the quarter, we added about 6,300 net acres in the Midland Basin through a couple of transactions that totaled around $10 million. And, in addition, our geosciences team continues to evaluate new zones and new ideas.

I will now turn it over to Wade to highlight some of our first quarter results, Wade?

Wade Pursell

Thanks Herb and good afternoon. I'll start on slide 6 and hit the highlights:

- First quarter results overall were better than expectations. Oil production and total production exceeded the high end of guidance, fueling a very solid quarter.

- Other line items were generally as expected with the exception of capital expenditures, which came in less than guidance. This was predominantly due to timing, including the ability to modify the South Texas program to extend the lateral length of 4 wells.
    - Our overall inflation assumptions were in-line with our expectations.
    - We are seeing certain costs improve such as diesel and are seeing other costs flattening out. There appears to be a slight decline in industry activity rigs, down 3.3% since year end, driven by Haynesville down 11%, and rig rates seem to be plateauing. On the pressure pumping side activity seems to be stable in the Permian with evidence that the frac spread count is declining in the Haynesville.
    - We modified the plan in South Texas to now drill four wells averaging 11,700 foot laterals instead of four previously planned 5,000 foot wells, to better optimize capital efficiency. While notably improving capital efficiency, it changes timing in that drilling the longer laterals will take into the second quarter.

- As Herb mentioned, capital also included $10 million for acquisitions of Midland acreage. This aligns with our efforts in the RockStar area, where we have successfully made acreage trades and bolted on positions that significantly increased our working interest from around 65% back in 2016 to 85% currently, and we will continue to look at these opportunities.

- We generated $50 million in Adjusted free cash flow, despite a notable decline in natural gas prices, supported by about 60% liquids production and 33% of natural gas volumes hedged in the quarter.

- And, as Herb said, we returned $58 million to stockholders during the quarter. We have emphasized that our capital return program was designed to offer a sustainable fixed dividend, which is now about 2% yield, with upside through share repurchases. This structure enables us to have flexibility to take advantage of stock price movements, which we did in the first quarter.

- Skipping to slide 8. This flexibility is further supported by our low leverage and strong cash position. At quarter-end, Net debt to adjusted EBITDAX was flat at 0.6 times and net debt was $1.1 billion -including nearly $500 million cash after returning $58 million to stockholders.

- Moving to slide 9. Overall liquidity was reinforced by our bank group in the Spring redetermination of our credit facility. Our borrowing base was reaffirmed at $2.5 billion with commitments maintained at $1.25 billion. This was despite the banks using significantly lower commodity prices than those used six months ago for the last redetermination, which speaks to the very high quality of our assets.

So, I would say that we are very well positioned to deliver a solid yield to our stockholders through the coming year.

Which brings me to guidance and slide 10.

We are on track for our full year plans and have no changes to guidance.

In maintaining our full year capital guidance, we are assuming lower first quarter capital was predominantly related to timing, and we are keeping our inflation assumptions in place. We are proactively working with providers across components to take advantage of improved costs when and where we can, while at the same time maintaining our high-quality equipment and crews.

For those of you looking by quarter, slide 11:

- We expect to see a small uptick in total production in the second quarter from the first quarter to 13.3 to 13.5 MMBoe, or 146 to 148 MBoe/d.

- Capital is expected to include 17 net wells drilled and 22 net flowing completions with expected capital spend to range between $295 to $315 million. As mentioned last quarter, capital is weighted more heavily to the first half of the year.

- LOE ran under guidance in the first quarter, we expect the second quarter to track with the guidance range as we anticipate more workovers in the quarter.

- I would keep an eye on Permian natural gas prices. April averaged less than $1.00/MMBtu for the month. May and June are also trading around $1.00/MMBtu. A couple of things to note, nearly 20% of our Midland gas in the second quarter is hedged to the regional price point and Midland gas accounted for only 9% of revenue in the first quarter.

I would summarize all of this by saying again that despite the fall in commodity prices (especially natural gas), excellent execution resulted in $401 million of EBITDAX, $50 million of Adjusted free cash flow, $1.33 per diluted common share Adjusted EPS and $58 million returned to stockholders. This is clearly a result of having top-tier assets, which again were confirmed by our bank group during the quarter with their agreement to maintain our borrowing base at $2.5 billion despite the large decline in commodity prices from their last redetermination 6 months ago.

So, with that, I will now turn it back to Herb to walk through a few highlights from the field, Herb.

Herb Vogel

Thank you, Wade.

I'd like to walk through a couple of slides for each of the Midland Basin and South Texas with a light touch that underscore the quality of our assets and some of the great work our team is doing.

- Skipping to slide 14. The chart on the left updates a slide we presented last quarter that compares SM average oil production performance in Howard County to that of our peers. The chart represents wells completed between January 2021 and January 2023. The lower black line represents the average cumulative oil performance from the peer group of 15 operators in Howard County with 10 or more completions, and the upper blue line is the average of SM wells. The SM average outperforms the peers, assuming normalized lateral lengths, producing 32% more oil as updated through the first 20 months on production.
    - Similarly supporting the strong outperformance of SM wells is the chart on the right, based on Rystad data, that indicates SM has the lowest average breakeven price among 12 Permian peers presented in the data.
    - Combined these figures simply reinforce what we have talked about in the past: how our data-driven and advanced analytical approach delivers optimized well performance. Our team's focus on co-development via optimal horizontal and vertical spacing and best-in-class completion designs does pay off well, as you can see here.

- Turning to slide 15. During the first quarter, we drilled a 5-well pad located in Sweetie Peck with average 15,000 foot laterals, co-developing the Middle Spraberry, Lower Spraberry, Dean and Wolfcamp B. In this case, we drilled approximately 75,000 feet of laterals 20 days faster than planned, resulting in $1.6 million in savings. In January, we also finished drilling 2 pads for a total of 5 wells, located in the Miracle Max area. These 5 wells totaled 89,500 lateral feet and co-developed the Lower Sprayberry and Wolfcamp A. In this case we drilled these 5 approximate 18,000 foot lateral wells in 73 days versus plan at 85 days and saved nearly $1 million. Of note, these are among the longest laterals drilled and completed in the entire Midland Basin, but not quite as long as our nearly 4-mile Texas record lateral that we drilled and completed in early 2021.

- On slide 16, we continue to drive ways in which we can reduce emissions. We have increased the number of gas interconnects between the midstream partners who gather our gas. This has been a particularly effective way of avoiding flaring when a downstream partner has a downstream curtailment event. Offloads refer to secondary physical connections that enable alternative processing in the event the primary connection is unable to take production. In 2022, our marketing team further extended our offload capacity allowing us to sell those gas volumes rather than shut-in wells or flare. This resulted in a substantial reduction in flaring from our Midland Basin operations and brought in $18 million in revenue from the gas sales. In our view, part of being a premier operator is outstanding environmental stewardship, and this is a great example.

- Turning to South Texas, slide 17. On the right we updated a slide presented last quarter as a reminder that the liquids content differs across our position with wells to the north having up to 60% oil and 80% liquids while the wells to the South have greater EURs in Boe terms but with higher gas content. We see continued high returns, but simply comparing cumulative production curves does not tell the full story about value.
    - On the left side, during the first quarter we highlight 7 new South Texas wells on 3 pads that reached peak IP 30, located across the position as indicated by the blue stars. These wells averaged peak IP30 production rates of nearly 2,000 Boe/d with 73% liquids. Excellent results!

- And, turning to slide 18, It is important to recognize the quality and duration of our Austin Chalk inventory in South Texas, especially relative to peers. This chart, which is based on Enverus data, shows SM's remaining inventory at nearly 400 locations that breakeven at $55 oil, or less, assuming 20:1 gas. We see this as high quality, long duration inventory.

- Turning back to ESG on slide 19, we provide certain 2022 metrics, which put us well on our way to meeting our short to medium term emissions targets, as well as noting our recently received CDP Supplier Engagement score of A-.

Let me close by reinforcing our belief that SM Energy presents a sustainable and repeatable business model that is characterized by outstanding operations, a strong balance sheet, growing return of capital to stockholders and strategic inventory growth.

Thank you for your interest in SM Energy and I look forward to our Q&A call tomorrow.