



Third Quarter 2023 Financial and
Operating Results Q&A Webcast

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C O R P O R A T E P A R T I C I P A N T S

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P A R T I C I P A N T S

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P R E S E N T A T I O N

Operator

Greetings. Welcome to SM Energy's Third Quarter 2023 Financial and Operating Results Q&A.

At this time, all participants are in a listen only mode. A question and answer session will follow the formal presentation. If anyone today would like to ask a question, please press star 1 on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press star 2 if you would like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the star keys. If anyone should require operator assistance during the conference, please press *0 on your telephone keypad.

Please note this call is being recorded.

At this time, I'll turn the conference over to Jennifer Martin Samuels, Vice President, Investor Relations and ESG Stewardship. Jennifer, you may begin.

Jennifer Martin Samuels

Thank you. Good morning, everyone. We are speaking to you today from a particularly beautiful day in Colorado, land of prime-time events. So, let's get started on our event today. And in today's call, we may reference the earnings release, IR presentation or prepared remarks, all of which are posted to our website. To answer your questions today we have our President and CEO, Herb Vogel and CFO, Wade Pursell.

Before we get started, I need to remind you that our discussion today may include forward-looking statements and discussion of non-GAAP measures. I direct you to slide 2 of the accompanying slide deck, page 6 of the accompanying earnings release, and the Risk Factors section of our

most recently filed 10-K, which describe risks associated with forward-looking statements that could cause actual results to differ. Please see the slide deck appendix and earnings release for definitions and reconciliations of non-GAAP measures to the most directly comparable GAAP measures. And discussion of forward-looking non-GAAP measures. Also look for our third quarter 10-Q filed this morning.

With that, I will turn it over to Herb for a brief opening commentary. Herb?

Herb Vogel

Thank you, Jen.

Good morning and thank you for joining us. Let me start by reiterating a few key messages this quarter.

- Our return to capital program continues to be well received. We have repurchased approximately 6% of shares based on shares outstanding as of September 2022. We've increased the dividend twice, most recently a 20% increase, while at the same time we've maintained net debt to adjusted EBITDA at 0.7 times and increased our Midland acreage position by 35%.
- Execution has been outstanding in 2023, underscored by several third-party charts we presented in a slide deck, and we are excited to get out and demonstrate the value of our new assets with the fourth added rig in Midland. As you can see, we have increased the number of expected fourth quarter completions in Midland from 6 to 11 and will have added benefit in the first quarter from the higher working interest in wells gained through the asset exchange that we just reported, setting up for a more oily first quarter and stronger oil trajectory in 2024.

As we close 2023, SM Energy is very well positioned to deliver on a continuation of our core strategic objectives in 2024.

With that, I'll turn it back to Rob to start taking your questions. Rob?

Operator

Thank you. If you would like to ask a question at this time, please press star 1 on your telephone keypad and confirmation tone will indicate your line is in the question queue. You may press star 2 if you would like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the star keys.

One moment, please, so we poll for questions.

Thank you. And our first question today is from the line of Dave Daoud with Cowen.

Gabe "Dave" Daoud

Hey. Thanks. Good morning, everyone its Gabe from Cowen. Guys I was just hoping we can maybe start with 4Q, it looks like oil expected to decline quarter-over-quarter, but Midland tills have actually increased relative to your prior outlook. So just curious if you can maybe give us a bit more color on what's going on there?

Herb Vogel

Yeah, Gabe, this is Herb. So, yeah, we're really not really focused on that quarterly cadence bringing on a large new pad earlier or later by a month can have an impact on quarterly rates, but it's really not material at all from a valuation or cash flow perspective. So, we're not really focused on that.

Gabe “Dave” Daoud

Okay. Okay. Got it. Got it. So just timing related to a large pad. Okay. And then as a follow-up, I was hoping we could maybe get some more color on the asset exchange and specifically how the 9 DUCs and the increase in working interest there set you up for a strong 1Q any way that you can maybe quantify oil volumes for 1Q?

Herb Vogel

So, Gabe, first of all, I'm just really excited that we were able to do that asset exchange. So, getting a substantial increase in wells we've already drilled in our working interest through an exchange was just great value for us. And it really boosts to what we'll be able to produce in first quarter, but we haven't put any numbers out there yet for 2024. But you can see our positions as well for an oily first quarter. You know how oily that it is will depend on exactly how early they come on in the first quarter. But it's just in the right direction for what we're trying to do strategically.

Gabe “Dave” Daoud

Okay. Understood. Thanks, Herb. I'll hop back and thanks, guys.

Herb Vogel

Thanks.

Operator

Our next question is from the line of Zach Parham with JPMorgan. Please proceed with your questions.

Zach Parham

Good morning, Wade. Maybe one for you on the buyback. It stepped up pretty significantly this quarter. Just any thoughts on the future pace of buybacks? And I'm also wondering if you plan to ask the board to increase the size of the authorization, because if you ran it the 3Q pace for another couple of quarters, you know, you would finish up that authorization. So just curious on that as well?

Wade Pursell

Yeah. Thanks, Zach. Good, good questions. And we spoke about this in the prepared remarks and I gave some nice pie charts on our capital allocation. You're right. We do have a – we do still have a ways to go on our authorization. I think we still have another \$237 million to go on that. So, as you know, all I can say is we really – I think we've been showing and we talked about it in our prepared remarks that that we clearly prioritize return to stockholders within our capital

allocation. And there's no reason to believe that that would change. So, so, I guess that's all I can say on that. As far as the pace by quarter, you know, we've said that we're going to be methodical and some quarters lean in more. That's really all I can say at this point. We'll continue that that strategy on the current authorization. And then when we get to the end of it, we'll consider what to do from there. So.

Zach Parham

Got it. Thanks for that color. And then also just had a question on the tax credit that was mentioned in the prepared remarks, you've posted on the website. Maybe could you give investors some detail on why exactly you received that tax credit and maybe talk about if there's potential that the credit could increase in size over time?

Wade Pursell

Great, great. I appreciate you're asking that. We as we've said in our remarks, I mean as we've been saying for years, that being a premier operator is constantly pushing the envelope with innovation and technology. And a lot of what we do just kind of hits right down the fairway of what the R&D tax credit provides for. So, we did a lot of work and the team did a ton of work qualifying for that credit and quantifying the amounts that we believe fit that those criteria. And it went back several years and that's -- that's the reason for the size of it. You might ask somebody might ask why now, you know, we haven't been a cash taxpayer until recently. And that's obviously part of it because it is a ton of work to do to quantify these amounts and build the position to take the credits. But that's the primary point. Your question about will it continue? It absolutely should. We continue to do similar things operationally. So, we kind of set up the processes and the procedures to hopefully continue to quantify those R&D tax credits going forward. So, beyond the amount that we that we disclosed, I think \$77 million as far as the amount from the past that we're able to use in the coming years, significantly offsetting, you know, cash taxes in the next in the next few years. So, thanks for asking.

Zach Parham

Great. Thanks for the color.

Operator

Our next question is from the line of Oliver Huang with TPH. Please proceed with your question.

Oliver Huang

Good morning, Herb and Wade and thanks for taking my questions. Just one on the extra rig that got added in the Midland in early October on a six-month contract. Anything you all are kind of able to offer up in terms of the thought process on what would dictate keeping that rig on for the remainder of next year. Or is it pretty firm at this point in terms of just once Q2 kind of rolls around, you all are going to go back to that pre-Midland rig program you all being running. And also just going to necessitate the need for bringing on a spot crew to help get these well done in that Klondike area.

Herb Vogel

Oliver. This is Herb. Yeah. Thanks for asking the question. Yeah, you're right that fourth rig has a six months term and it's got an excellent rate. We haven't decided whether to extend it or not yet. We haven't set our budget for 2024 yet. It's certainly possible that we could extend it and we haven't made the decision yet. In terms of the completions crew, it's a pretty rigorous scheduling process. We undergo really well almost continuously, but for 2024 right now, so we'll determine what the schedule will be for the frac spreads. You're probably aware we're running simul frac crews and that's led to some of those great numbers that we showed in the deck in terms of execution. So, it'll just be part of our schedule whether we have to pick up a spot crew or not. We don't do that very often, we really drive for those capital efficiencies. But I never rule it out because sometimes there's one that freed up from another operator really cheap for a pad and we'll take advantage of those situations.

Oliver Huang

Okay. That's helpful color. And maybe just a follow-up to Zach's earlier question on the tax credits. Any sort of updates with respect to how that might impact cash taxes for next year? I think previously you all kind of talked about that \$16 million of run rate. Just wanted to see if we could get maybe an update there.

Wade Pursell

Sure. Now, thanks for asking that. That's a good, a good point. So, so, next year, if you think in terms of \$60 million, six-zero, I think that's what we've talked about and kind of what our model shows right now. The tax credit will enable us to offset 75% of that. So that, so the number will be more like \$15 million one-five million next year. There is a limitation each year that you can only offset up to 75% of your cash tax liability. So, that, that, that'll be the result next year and it will be, frankly it will be similar I think in 2025.

Oliver Huang

Awesome. Thanks for the color, guys.

Wade Pursell

You bet.

Herb Vogel

Thanks, Oliver.

Oliver Huang

Thanks.

Operator

Thank you. Our next question is from the line of Tim Rezvan with KeyBanc Capital Markets. Please proceed with your questions.

Tim Rezvan

Good morning, everybody, and thank you for taking my question. Wade, I wanted to dig back in on the repurchases a little bit, following up on Zach's question. If you look at your history, you all did about 2.6 million shares in the second quarter at about \$27. And you did about the same amount this quarter at a higher price. So, I know you can't show your cards too much, but is it safe to say that you and the board see shares extremely undervalued at that \$40 level and that we would assume you all would continue lean even if the share price stays here?

Wade Pursell

I think you can. I think generally you can assume that. Yeah, I mean that, we clearly have a view on what we think the stock price is worth. Our own internal NAV and the fact that we leaned in, as you said, this quarter at prices averaging around \$40 I think it confirms our belief that our – that it's undervalued.

Tim Rezvan

Okay. Okay. That's helpful. And then, was my final question maybe more for Herb on Klondike. You talked about the Dean in the Middle Spraberry as your targets. I was under the impression that that was underwritten solely on the Dean. So, I was if you could refresh our memory on the intervals you used to underwrite the acquisition and then maybe what you're going to be targeting with that fourth rig on your first few wells up, there?

Herb Vogel

Yeah, Tim. Yeah we are very excited about the Klondike. We look at some of the offset wells in that area and our experience in North Martin Midland and we're really still pleased with the Dean wells. And Middle Spraberry sand is lesser portion of the value up there, but it's still a great value contributor and we are initially going to pad to exploit the Dean and so that's our plan there. But yeah, we are excited to get up there and show what the wells can do up there.

Tim Rezvan

Okay. So those initial wells would be targeting the Dean?

Herb Vogel

Yeah, they will.

Tim Rezvan

Okay. All right. Thank you, everybody.

Herb Vogel

Thanks, Tim.

Operator

Thank you. As a reminder, if you would like to ask a question today, you may press star 1 from your telephone keypad. We'll pause a moment to assemble a queue. Thank you.

Thank you. We have a follow-up from the line of Oliver Huang with TPH. Pleased proceed with your question.

Oliver Huang

Yeah. Just I had one more follow-up, guys. Just with respect to lateral lengths, just kind of with the non-15,000-foot DUCs in Sweetie Peck. Looks like you all are kind of extending laterals a little bit. I think you all did 15 of those longer laterals this year. But just wondering, any sort of trends that we should be kind of aware of as you're pulling together in 2024 plan in terms of this lateral length migrating higher in either of your two areas relative to this year.

Herb Vogel

Oliver. This is Herb. It's pretty straightforward just when we get into a year. We look at the pads that we're going to develop and we look at the acreage position and how contiguous the acreage is. And in general, it's quite good for us. And you're probably aware we hold the record in Texas for the longest lateral of anyone at 4 miles. So, we can do that if we want to. So, it's really an economic optimization question for us. And generally, 15,000-foot laterals will get a benefit in terms of rate return, as you can expect. So, we'll put 15,000-foot laterals anywhere where it makes sense. How it turns out for the year on the average lateral length, we've been bouncing in between the 11,000 and 12,000 on average. I kind of anticipate that's sort of where things will be. So, we don't have our 2024 program outlined with our planned lateral length yet. But in general, you can bet that we're going to be optimizing the economics here.

Oliver Huang

Awesome. Thanks once again.

Herb Vogel

You bet.

Operator

Our next question is a follow-up from one of Tim Rezvan with KeyBanc Capital Markets. Please proceed with your questions.

Tim Rezvan

Thanks for letting me back in, folks. I wanted to circle back on the asset exchange a little more. I was trying to understand essentially, you're adding 5.2 net wells. If we think about 58% working interest in nine wells. So trying to understand that the \$50 million in CapEx is that the completion costs for those wells or is that are you kind of buying into that, the whole working interest, the whole DNC side? And then I guess as a follow up, are there more opportunities like that or was that really a unique kind of one-off event?

Herb Vogel

Yeah. So, it's a great question, Tim. It's really you know, they're DUCs now, so they've been drilled. We spent the capital and then for the fourth quarter, we'll be completing the wells. And so that's largely what incremental CapEx is.

Tim Rezvan

And essentially \$9 million per well at the completion costs for the three miles?

Herb Vogel

No, because there's some, some additional where we had to basically cover the costs that we already had in the wells.

Tim Rezvan

Ok

Jennifer Martin Samuels

There were third quarter costs associated with the completions that as well as fourth quarter costs associated with the completions. So that \$50 million is representative of the net completion cost added for the five net additional wells.

Herb Vogel

Yep.

Tim Rezvan

Okay. Okay. And then the second piece of the question. Are there more opportunities like I know ideally a 100% working interest is where you want to be, but are there more meaningful opportunities like that? Or it was that sort of unique one-off?

Herb Vogel

Tim, that's a great question. You know, you never can quite anticipate what happens. You'll see working interest change. The way to look at it is when we first acquired, for example, the Rock Star acreage, we were around a 60% working interest and we worked our way up to an average of over 80% on that acreage. So, there are opportunities that just arise all the time as operators adjust their or non-operators adjust their interest in wells. So, we're very opportunistic on that. We're in the land game daily and we'll do what we can to increase working interest that generate quite high returns for us. So, I look at that way it is very hard to predict, you'll never put it in a plan, but when the opportunity comes in front of you, you grab it when it has the most value, for example, this one did.

Tim Rezvan

Okay. Okay. Thanks again.

Herb Vogel

You bet.

Operator

Thank you. We've reached at the end of the question-and-answer session. And I'll turn the call over to Herb Vogel for closing remarks.

Herb Vogel

Okay. Thank you all for joining. We're very pleased with our performance in 2023 and we're well-positioned to continue this trajectory to build value and deliver returns going forward. Thank you for your interest and we look forward to seeing a number of you at upcoming events.

Operator

Thank you. This will conclude today's conference. You may now disconnect your lines at this time. We thank you for your participation.