SM ENERGY

First Quarter 2024 Financial and Operating Results Q&A

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Internally Generated Transcript

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Gabe Daoud, *TD Cowen, Analyst*

Timothy Rezvan, *KeyBanc Capital Markets Inc., Managing Director*

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PRESENTATION

Operator

Greetings and welcome to the SM Energy's First Quarter 2024 Financial and Operating Results Q&A. At this time, all participants are in a listen-only mode. A brief question and answer session will follow the formal presentation. If anyone should require operator assistance during the conference, please press "*" "0" on your telephone keypad. As a reminder; this conference is being recorded. It is now my pleasure to introduce your host, Jennifer Samuels, Vice President – Investor Relations & ESG Stewardship. Thank you. You may begin.

Jennifer Martin Samuels

Thank you, Maria.

Good morning everyone. In today's call we may reference the earnings release, IR presentation or prepared remarks, all of which are posted to our website.

Thank you for joining us. 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 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 may also refer to non-GAAP measures. 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. Got that out of the way.

Also, look for our first quarter 10-Q filed this morning.

And with that, I will turn it over to Herb for just a brief opening comment, Herb.

Herb Vogel

Thanks, Jennifer.

And good morning! Thanks for joining us. We are obviously very excited about how 2024 is shaping up for SM Energy. So, let's go ahead and get started. I'll turn the call back to Maria to start taking your questions, Maria.

Q&A Session

Operator

Thank you. We will now be conducting a question and answer session. If you would like to ask a question, please press "*" "1" on your telephone keypad. A confirmation tone will indicate that your line is in the question queue. You may press "*" "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 "*" key. One moment please, while we poll for questions.

Our first question comes from Zach Parham, with J.P. Morgan. Please proceed with your question.

Zachary Parham
Analyst, JPMorgan Securities LLC

Thanks for taking my questions. I just wanted to ask on the buyback first. You talked about in the prepared remarks a ratable pace on the buybacks for the remainder of the year; that would imply around $60 million in buybacks per quarter. With the current commodity prices, it would seem like you'll have a significant amount of free cash flow that will allow you to build a lot of cash even after paying the base dividend that finishing off that buyback authorization. How do you think about using that excess cash? Could further accelerating that buyback make sense? Just trying to get a sense of what happens to all that cash.

Wade Pursell

Yeah. Good question, Zach. This is Wade. Good morning. Yeah. We just – the guidance on assuming ratable buybacks, I think it's just the best way to model it right now. Obviously, things never happen that ratably, right? And as we go through the quarters, we opportunistically repurchase during the open windows. And, you could see under your scenario with higher commodity prices that's generating more free cash flow. You could see us buying back at a little bit more accelerated pace than that given what the opportunity set is before us. So that could happen, and many people have asked, what are you going to do when you get through the commitment, and the board will consider that. And, I can imagine it being possible that we would continue on with a new buyback. But certainly, no guarantees of that at this point.

Zachary Parham
Analyst, JPMorgan Securities LLC

Thanks, Wade. And, then just to follow-up. In the prepared remarks you mentioned flattish production in 3Q and then kind of another step-up in 4Q. That seems to indicate you would exit the year with oil in the upper 70s. Is that a fair number? Just trying to get a little bit more color on what that trajectory of volumes would look like through the back half of the year.

Wade Pursell

Yeah. I think that's reasonable, mid-70s-ish given what we said. What we said about the third quarter being flattish, I mean, it'll be up. I think what's changed a little bit is the second quarter is, obviously with acceleration, higher than it was before in our guidance. So, you're – I think you're reading that pretty well, but you can assume that third quarter is up somewhat over the second quarter.

Zachary Parham
Analyst, JPMorgan Securities LLC

Thanks, Wade. Appreciate the color.

Wade Pursell

You bet.

Operator

Thank you. Our next question come from Gabe Daoud with TD Cowen. Please proceed with your question.

Gabe Daoud
Analyst, TD Cowen

Thanks. Hey, good morning guys. Thanks for the time. Maybe, I was hoping, if we could start at Klondike. You mentioned you did some science there during the quarter and maybe starting to complete those, those 8 to 9 wells, where I think results should be ready by the third quarter call. But, just curious, if you can maybe talk a little bit about some of the science work there, some of the Deans in the area look quite prolific on an oil productivity per foot basis. So, just trying to get a sense if we could assume or expect similar results out of your program.

Herb Vogel

Yeah. Hi, Gabe. This is Herb. Yeah. We're quite excited about the Klondike acreage and we've already drilled a four-well pad and completing it right now. I will say on the science side, we did take our vertical pilot hole down quite deep and did a lot of sidewall cores and high-end logs through that interval, so we could assess all the intervals that are potentially prospective up there. But we're focused now on the development of those, initially the Dean, and those 8 to 9 wells this year and the first four will be online during the second quarter. So, it looks like a great play for us. And we have quite a few wells offsetting it to the Southeast, plus the wells we – that came with the acquisition Reliance – from Reliance

Gabe Daoud
Analyst, TD Cowen

That's right. Thanks. That's helpful. I guess as a quick follow-up to that, just sticking to Klondike, 20,000 net acres. If you were to progress towards a true development program, is there any type of infrastructure spend that we should be thinking about up there?

Herb Vogel

There is quite a bit of infrastructure there, but mainly it's getting the gathering lines in place, so we don't have to truck as much, and getting the gas lines built to the scale, which is a lot of the midstream, and then – but otherwise it's just pretty much normal equipment up there.

Gabe Daoud
Analyst, TD Cowen

Okay, okay, great. And then just the last one, the South Texas drill-to-earn any additional color you can provide on that? Thanks, guys.

Herb Vogel

Yeah. A lot of people wonder how does the drill-to-earn works if they're not familiar with it. And generally, drill-to-earn is where you agree to drill a well or wells in return for acreage. In this case, we're going to operate and drill wells to gain a 50% working interest in around a 16,000-acre block. So, that will get us about 8,000 net acres. The other details around that drill-to-earn really are kept confidential between us and the company that farmed out to us.

Gabe Daoud
Analyst, TD Cowen

Okay, okay. Got it. Thanks, guys.

Operator

Thank you. Our next question comes from Tim Rezvan with KeyBanc Capital Markets. Please proceed with your question.

Tim Rezvan
Managing Director, KeyBanc Capital Markets, Inc.

Good morning, folks. Thanks for taking the question. I want to follow up on Gabe's question on Klondike. We did an analysis of the area and I know you all have talked about the Middle Sprayberry and the Dean. The Wolfcamp A looks extremely strong with sort of offset results. And so, I was curious kind of among these three initial wells being completed, excluding the science well, can you talk about what intervals you're targeting? And kind of maybe why you haven't talked about the Wolfcamp A as a primary target on that acreage?

Herb Vogel

Sure, Tim. But one thing I want to correct you on that there, there will be four producers, just one of them, we took a pilot hole down first, then we plugged back and drilled the lateral. So, there are four wells there, just one of them, we have that vertical that we just gathered data on. So, it's great to hear that there's prospectivity in the Wolfcamp A. I would say we are not counting that. If we're surprised that the thermal maturity is higher for some reason there than we expected it to be, that would be great news. But we're really counting on this being more of a migrated oil play, which I've talked about before, which is oil coming from a bit deeper in the basin and migrates into the sandstone intervals and that's why they are so prolific up there.

Tim Rezvan
Managing Director, KeyBanc Capital Markets, Inc.

Okay. And then, are these initial four wells Dean, all Dean or...

Herb Vogel

Yes, they are. They're all Dean wells.

Tim Rezvan
Managing Director, KeyBanc Capital Markets, Inc.

Okay, okay. That's great. Appreciate that. And then a follow-up. I think the comments on the Briscoe pad and the stacked pay opportunities are pretty interesting. Some other public companies are talking about that. I know its early days from one pad, but a big marketplace debate was on the validity of your claims that you had 300 locations there. And I guess just to help kind of frame the resource, if this stacked pay proves to be something you can replicate, does that 300 location count kind of move up dramatically? I'm just trying to understand sort of what the significance of this test that you're doing that you disclosed. Thank you.

Herb Vogel

Yeah, Tim. I would say it's not that much of a big increment in the test. The only difference is really that the lower wells are fully bounded versus in other places they've been half bounded, but we've had fully bounded in the upper interval on several other pads. The thing to note is, these are spaced at about 625 feet and we've done that before. These have – go between two different subtle differences in the landing zone, in the Upper Austin Chalk or the Middle Austin Chalk, and the upper interval that we've developed. So, it's just really exciting because of how productive they are, how oily they are, and how NGL-rich they are. And those wells on that one pad are between 11,600 and 14,500 feet long. So, we didn't have difficulty executing there. And the other three are between 11,900 and 14,000 feet, so they are long laterals, too. And that just really helps the economics also, and they're oil-rich. So, really excited about it on that area. And you can see the strength of the wells and just how they started, but it's not like they are really a big step in any way other than the bounding of the Lower Austin Chalk wells.

Tim Rezvan
Managing Director, KeyBanc Capital Markets, Inc.

Okay. I appreciate the color. Thank you.

Herb Vogel

You bet.

Operator

As a reminder; if you would like to ask a question please press "*""1" on your telephone keypad. Our next question comes from Oliver Huang with Tudor, Pickering, Holt & Co. Please proceed with your question.

Oliver Huang
Director, Tudor, Pickering, Holt & Co. Securties LLC

Good morning all, and thanks for taking my questions. Just wanted to start on the efficiencies. Certainly, good to see the continued capture there. Just kind of wondering of what you all kind of achieved in Q1. Is it something that's already been baked in, or for new planned activity starting in Q2 when you're providing the quarter ahead for your outlooks? Or is there kind of a wait-and-see aspect to it since it's kind of only a quarter before taking that fully on the incrementally faster pace that we saw?

Herb Vogel

Yeah, Oliver, you know when we change guidance that means we've got a lot of confidence, that it's appropriate to include it. So, we're continually working new aspects of efficiencies in it, and we have quite a laundry list that our teams are running through right now, that look quite attractive, but we're not counting ones unless we see them working.

So, the big ticket items for us right now are the increased substitution of natural gas for diesel and frac pumping operations, those DGBs fleets that we're employing. And Wade mentioned those on the prepared remarks and that has the added benefit of the reduced CO2 emissions from completion operations.

Then we're seeing quite a bit in the way of efficiency gains in drilling. So, this translates to number of feet we drill per day. There really is more advanced and reliable downhole equipment, so you don't have to trip the bit as much. And we're using rotary steerable assemblies so we can keep the bit on bottom longer that helps also.

Then on the efficiency, our cost efficiency side, a big one is using existing central production facilities that now are sitting there with some latent capacity and that avoids the need for capital into new facilities. We knew all along that that was going to happen, and we're just starting to see it really happen in a pretty significant way now.

And then we're also bundling some services between South Texas and Permian. So, we've got the benefits of the scale of the full operation between the two areas, and that helps. And then you know how activity has reduced, the rig counts are down, frac spread counts are down, so we're actively rebidding services and seeing discounts that way. And I can't tell you when that'll stop or how much more we'll get there, but that obviously is a contributor. So, that's a list of things that I'd say we're highly confident in and not the list of things that we're still pursuing.

Oliver Huang
Director, Tudor, Pickering, Holt & Co. Securties LLC

Okay. That's super helpful. And maybe for a follow-up: I know you mentioned earlier some of the details are confidential on the drill-to-earn, but I just wanted to try and clarify, are you all responsible for 100% of the DNC for that 50% working interest that you kind of referenced? And is there any sort of details in terms of how many wells you're planning to do on that acreage this year? And if that's already embedded within the full-year well count out of the South Texas region?

Herb Vogel

Yeah. Okay. You got two questions there. The first, we can't reveal or divulge details on the deal, but I'd say no is the simple answer to your first question there. No, we're not paying everything for the 50%. And then the second question was, have we baked this in? Yeah. We knew the deal was far enough along when we set the budget in February that we integrated that into our plans for the year, the three wells that we'll drill there this year.

Oliver Huang
Director, Tudor, Pickering, Holt & Co. Securties LLC

Awesome. Thanks for the time, guys.

Herb Vogel

You bet.

Operator

There are no further questions at this time. I would now like to turn the floor back over to Herb Vogel for closing comments.

Herb Vogel

Hi. Thanks, Maria, and thank you for joining us. And we look forward to seeing a number of you at upcoming events.

Operator

This concludes today's teleconference. You may disconnect your lines at this time.