Third Quarter 2024 Financial and Operating Results

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Internally Generated Transcript

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PRESENTATION

Jennifer Martin Samuels

Good afternoon and welcome to SM Energy's third quarter 2024 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 6 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'll now turn it over to Herb.

Herb Vogel

Thank you, Jennifer.

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

We are pleased to report another consecutive quarter of excellent operational execution that delivered financial results exceeding expectations. This was achieved while also closing the Utah acquisitions and completing a number of financial transactions which, combined, result in a step-change in scale with a very strong balance sheet. Truly excellent performance from all.

Turning to slide 5, as I do each quarter, I will speak to progress we are making on our core objectives for the year.

I'll start with our objective to expand our high-quality, low breakeven-cost portfolio.

- With the close of the Uinta acquisitions on October 1st, we have now made a step-change in the scale of our operations, which begins here in the fourth quarter. As a reminder, we have increased core acreage by more than 93,000 net acres, or by about 40%, over the past year-plus. With the close of the Utah acquisitions, we added 63,300 net acres, extended our inventory life by three-plus years, and we will see an increase in net oil production of around

40% sequentially, at the midpoint of guidance. In short, we are very excited about our expansion into Utah and will speak more about that in a few minutes.

The second core objective is to focus on operational execution to deliver high-return wells.

- We seem to be "knocking this one out of the park" with a nice third quarter production beat based on strong performance from both Midland and South Texas as well as the early turn-in-line of two pads with 8-wells in South Texas.
- I will add that stewardship is a component of high-level operational execution, and I will point you towards the extensive sustainability reporting recently posted to our website that further discusses our application of technology and innovation in operations.

Our third core objective is returning capital to our stockholders, which comes in the form of our sustainable fixed dividend, transfer of enterprise value to equity holders through debt reduction, and share repurchases.

- Our increased dividend, to $0.20 per share quarterly, is effective this quarter and we have returned $146 million to shareholders year-to-date, $62 million in dividends and $84 million in buybacks.
- Following our Uinta acquisitions, our emphasis is currently on debt reduction, which Wade will speak to shortly.

It was a very successful quarter, and I would like to congratulate the team for getting us here -- from excellent operational execution, to closing the Utah transaction, to extensive financial transactions – all great work!

Before I turn the call over to Wade, let's look at some regional highlights:

Turning to slide 6, let's start with the Uinta Basin, starting here with a few photos of the area.

This includes a couple of photos of the sand mine that we acquired in the transaction that just started up at the end of September. The facility is run by a third-party operator on our surface acreage and is expected to produce more than 1 million tons of sand per year. This supports both capital efficiency, providing savings of a few hundred thousand dollars per well, as well as reducing truck traffic by an average 90 miles per sand truck load! That reduces both diesel usage and wear and tear on roads.

We also have a picture here of a rail transfer facility. About 15-20% of our Utah production is currently sold to the Salt Lake City refineries with the remainder railed to sales in the Rockies, at Cushing and the Gulf Coast. I have mentioned it before, but it is worth emphasizing, that the waxy Uinta crude is high quality oil at around 40 degrees API with low sulphur, low metals, and low nitrogen content, while its high paraffin content makes it an optimal feedstock for products like lubricants and, in certain markets, it attracts a premium to WTI.

At the top of the slide we quote Gabe at TD Cowen: "We believe SM stands out as retaining multiple resource catalysts – at a time when that's largely nonexistent in E&P – that can shape a more capital efficient '25 versus what's appreciated." Thanks, Gabe, for recognizing SM's focus over the past many years on technical innovation and geoscience expertise to create additional resource opportunities, inventory and value!

Turning to slide 7, we have updated this slide from last quarter to emphasize the quality of our Uinta Basin assets.

The left graph compares average oil production from the lower and upper cubes in the Uinta to SM's average cumulative well performance in Midland and South Texas, demonstrating the competitive performance of Uinta to each of our core areas. The right-side graph compares cumulative oil production performance of these same Uinta cubes to top basins in the industry. This highlights both the quality of the Uinta and the prospectivity of the Upper Cube. To reiterate, Uinta offers competitive returns, it will immediately compete for capital, and the transaction is accretive to all key financial metrics.

Next, on slide 8, while the Uinta Basin assets were operated by the seller in the third quarter, we want to show you recent well results and the status of the area upon SM's acquisition at the beginning of this month.

Here we are currently running three rigs and one frac crew. The well results shown here are from three wells that reached peak IP 30-day rates in the third quarter. These are all Douglas Creek wells, in the Upper Cube, and averaged 870 Boe/d per well at 94% oil, which is actually a higher oil percentage than the Lower Cube.

Turning now to the Midland Basin.

On slide 9, we are pleased to report continued strong performance from our new Woodford-Barnett tests in the Sweetie Peck area. This chart averages the cumulative oil production performance of peer wells in the area, and we see that our two test wells are outperforming peer tests on average by more than 50%, normalized to 10,000 foot laterals. As we talked about last quarter, the significance here is that we have about 20,000 net acres in the area prospective for Woodford-Barnett development.

On slide 10, we have our first look at Klondike area results. We have 8 wells online, all Dean wells, of which 2 have reached peak IP 30-day rates. These first two wells as shown on the map averaged 918 Boe/d per well at a very high 93% oil. We are pleased to see early results coming in a little stronger than our acquisition model. Given the confidence we have gained in the oil productivity here, we have moved a rig back on location and will spud another 6 wells at Klondike by year-end.

- I'll note, if you follow the state data on these, you will see more moderate peak rates with longer plateaus as these highly productive wells meet our capacity limits in water handling for a period of time.

Turning to South Texas and slide 11.

The Austin Chalk continues to outperform, and we are pleased to show the bounded pilot tests at Briscoe C continue to look really good. These Austin Chalk wells all paid out in 6 months!

Updating for our most recent wells to reach peak IP 30-day rates, on the right side of the chart, two wells in the liquids rich gas area averaged 2,317 Boe/d per well with 22% oil and 63% liquids. Also, there are some encouraging early flowback results from our newly developed high oil content, drill-to-earn area. These wells have not yet reached peak IP-30 rates but are producing 76-80% oil on a two-stream basis. So, stay tuned for more information as they build up to peak rates.

And, as we have updated over time, slide 12 compares our performance in both the Midland Basin and the South Texas Austin Chalk high-liquids area to our regional peers.

Comparing cumulative oil production normalized to 10,000 foot laterals to peers, we underscore SM's ability to deliver superior performance, by approximately 30% in both the Midland Basin and South Texas. And, as we have pointed out, the oil cumulative curves for Midland and Austin Chalk are similar, leading to comparable returns.

In summary, the first nine months of 2024 have demonstrated outstanding operational performance, delivered better than expected financial results and position the Company for substantially increased inventory and scale going forward.

I'll now turn the call over to Wade to discuss third quarter financial results, recent financing activity and guidance. Wade?

Wade Pursell

Thank you, Herb. Good afternoon.

Well, the team certainly delivered outstanding results for the third quarter, so let's start there, then I'll speak to our balance sheet and review fourth quarter guidance.

Starting on slide 13.

Strong production supported our excellent third quarter results, topping the high end of guidance and consensus expectations. Production volumes were 3% ahead of the mid-point of guidance. This was driven by continued strong performance from base production in both the Midland Basin and South Texas, as well as the early completion of eight wells on two pads in South Texas.

Third quarter results also benefited from lower LOE than projected, coming in at $4.73 per Boe. This was largely driven by optimizations that lowered projected costs for chemicals, generators and water handling.

Capital was also a positive story coming in about $15 million below the mid-point of guidance, which included some efficiencies related to faster drilling and pumping, as well as just general timing of expenditures.

Higher than expected production and lower than expected costs supported notable beats to consensus EBITDAX, Adjusted EPS and Adjusted free cash flow.

Now turning to slide 14 and the balance sheet.

Let's look at this as of September 30th, as well as October 1st, reflecting the impact of the Uinta acquisitions, so a lot to unpack here!

As you know, during the third quarter we completed very successful, upsized bond offerings of $750 million of 6.75% five-year senior notes due 2029 and $750 million of 7.00% eight-year senior notes due 2032, and we redeemed the $349 million of senior notes due 2025.

So, the September 30th balance sheet reflects $2.74 billion principal amount of senior notes, zero drawn on the revolving credit facility, $1.7 billion in cash and $102 million restricted cash, which was the deposit on the acquisition.

On October 1st, we closed the Uinta acquisitions impacting the balance sheet as follows: we continue to have $2.74 billion in principal amount of senior notes, we drew $190 million on the revolver, which is less than the $300 million anticipated, and had a cash balance of $21 million plus restricted cash of $36 million. Using SM Energy trailing twelve-month EBITDAX and assuming a rough estimate of trailing twelve-month EBITDAX for Utah, we get a pro forma net debt-to-EBITDAX number of about 1.2 times after closing the Uinta acquisitions.

As discussed last quarter, over the next several months, we intend to direct a greater portion of Adjusted free cash flow to debt reduction, transferring that enterprise value to the equity holder. We will be looking to return the leverage ratio back closer to 1.0 times before resuming our previous pace of share buybacks.

Subsequent to quarter-end, the borrowing base on our revolving credit facility was increased to $3 billion, and also Fitch upgraded SM's senior unsecured notes to BB and the secured revolver to BBB-, which are all a reflection of confidence in our expanded portfolio and increased scale.

Turning to hedges on slide 15. Our philosophy has always been to align hedge volumes to the leverage ratio. As a result, we added around 2.5 MMBbls in 2025 WTI hedges during the third quarter and early October. This slide provides fourth quarter hedge data and details for 2025 are in the appendix.

Moving to slide 16 and guidance. This will be our first quarter including the Utah assets, and it is exciting to speak to production volumes that are up sequentially by around 25% on a Boe basis and around 40% on oil (and that's at the mid-point of guidance)!

I think the slide lays out the numbers you need, but I'd like to walk through a few of the line items that will really change with the addition of Utah.

Production guidance for the fourth quarter is 205-220 MBoe/d, which is the highest production rate in the Company history, and at approximately 51% oil, is the highest oil production rate in Company history!

- Fourth quarter volumes include sequential growth from Texas operations at about 43-44% oil and adds Uinta Basin operations at about 87% oil.
- This guidance range takes into consideration that we are operating under a Transition Services Agreement with the seller and are in the process of assuming all operational activity by year-end.
- The fourth quarter projection for the Uinta Basin defers certain volumes into 2025, as the seller completed fewer wells from July to October than they previously projected. The well design for three wells was revised to extend the laterals from around 10,000 to 15,000 feet, thereby increasing capital efficiency, albeit delaying completions and extending offset well shut-ins. These wells are currently being frac'ed, and we expect to turn-in-line all wells planned for 2024 by year-end/January.

In regard to the Uinta Basin, a few other modeling guidelines that you should find helpful. Remember, the royalty rate is 20% and working interest should be in the 67-70% range. As for realized prices for the Uinta Basin production, there are several moving pieces. Net, net Utah oil realizations are expected to reflect a couple of dollars off WTI.

Operating costs in the fourth quarter incorporate the Uinta Basin and certain efficiencies gained in the third quarter. The full Company fourth quarter average is expected to range between $4.90-5.10 per Boe.

In regards to the transportation line item, the transportation cost for railed Uinta Basin oil volumes will be classified on the transportation line item. This is around $16 per barrel for Utah oil, which modifies the estimated company-wide transportation expense to $4.30-4.60 per Boe in the fourth quarter.

G&A, including non-cash compensation expense, for the fourth quarter is expected to be between $35 and $38 million, which includes the Transition Services Agreement with the Uinta Basin Acquisitions seller.

Capital expenditures for the full year, including the Uinta Basin, are estimated between $1.24-1.26 billion, which translates into $320-340 million for the fourth quarter and is expected to include drilling approximately 40 net wells and completing approximately 36 net wells.

And, lastly, cash taxes are on track for $25-35 million for the year, net of refunds.

Finishing with slide 17. This last slide echoes Herb's comment that premier operations include being a leader in stewardship, and the new documents recently posted to our website describe the collaboration, innovation and technologies we apply to ensure our leadership level stewardship.

I'll just wrap-up with a thank you to the team for our outstanding third quarter results – both operationally and financially – as well as to thank the team for the hard work going on now to deliver the step-change growth we expect to see in the fourth quarter and beyond. It's a very exciting time for SM stakeholders – that is our employees, our communities, our stockholders, our lenders and our royalty owners – as we all strive together to make people's lives better by responsibly producing critical energy supplies.

We look forward to the live Q&A webcast and call tomorrow morning.

Thank you!