

1 **Devon Energy Second Quarter 2020 Q&A Commentary Transcript**

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3 **Operator:** Welcome to Devon Energy's second quarter 2020 conference call. At this time all
4 participants are in listen-only mode. This call is being recorded. I'd now like to turn the call over to
5 Scott Coody, Vice President of Investor Relations. Sir, you may begin.

6

7 **Scott Coody, Vice President Investor Relations:**

8 Good morning and thank you to everyone for joining us on the call today. Last night we issued an
9 earnings release and presentation that cover our results for the quarter and updated outlook for the
10 year. Throughout the call today, we will make references to our second-quarter earnings
11 presentation to support our prepared remarks, and these slides can be found on our website at
12 devonenergy.com. Also joining me on the call today are Dave Hager, our President and CEO; David
13 Harris, our executive vice president of exploration and production; Jeff Ritenour, our chief financial
14 officer, and a few other members of our senior management team.

15

16 Comments on the call today will include plans, forecasts and estimates that are forward-looking
17 statements under U.S. securities law. These comments are subject to assumptions, risks and
18 uncertainties that could cause actual results to differ from our forward-looking statements. Please
19 take note of the cautionary language and risk factors provided in our SEC filings and earnings
20 materials. With that, I will turn the call over to Dave.

21

22 **Dave Hager, President and CEO:**

23 Thank you, Scott, and good morning. We appreciate everyone taking the time to join us on the call
24 today and I sincerely hope that everyone in our audience this morning is staying safe and remains in
25 good health. The second quarter for Devon can best be defined by our strong operational
26 performance as we effectively navigated through the various challenges presented by the COVID-19
27 crisis. Our team is executing at an extremely high-level and I want to take a moment to acknowledge
28 the professionalism our workforce has demonstrated to safely execute the business plan and protect
29 shareholder value during this unprecedented time.

30

31 For my prepared remarks today, **the first topic I want to touch on is the efficiency gains that are**
32 **driving our breakeven funding levels substantially lower.** In the second quarter, our capital and
33 operating costs outperformed our guidance on virtually every measure. Specifically, on the capital
34 front, our spending was 10% below midpoint guidance. This positive variance was once again driven
35 by the capital efficiency gains achieved in the Delaware Basin. These efficiency gains are best
36 visualized on **slide 10** of our earnings presentation, which highlights our Wolfcamp program, where
37 the majority of our capital is invested in 2020. As you can see on the far-left chart, our drilled and
38 completion costs in the second quarter improved by more than 40 percent to \$700 per foot
39 compared to 2018 when we first started drilling 2-mile laterals in the play. Importantly, our capital
40 efficiency results in the Wolfcamp are best-in-class among our peers and we are also leading the
41 industry in well productivity. These are truly special results and I would like to congratulate our
42 operating team for this outstanding accomplishment.

43

44 To be clear, the operating teams at Devon are not done improving and expect efficiency gains to
45 continue, driving our capital requirements lower in 2021. This is best shown on **slide 11**, where we
46 now estimate that our maintenance capital, which is the amount of investment required to keep our
47 oil production flat, has improved to \$950 million in 2021. This represents a \$150 million reduction in
48 capital or roughly 15% compared to our previous disclosure only three months ago. This estimate
49 includes only efficiencies and supply chain cost reductions that we have line of sight on, so there is
50 potential for this figure to further improve as we progress through the year. This improvement in
51 maintenance capital does not assume a drawdown of our DUC inventory, which is estimated to be
52 around 100 wells by year end. However, should we desire to lower our capital intensity further in
53 2021, we do possess this optionality with our DUC backlog. From a sensitivity perspective, for every
54 25 DUC's we draw down, we could decrease our capital intensity in 2021 by an incremental \$50
55 million.

56

57 Moving to **slide 12**, we are also acting with a sense of urgency to improve our cash cost structure.
58 With this intense focus, we expect to achieve at least \$300 million in sustainable annual cost savings
59 by year-end compared to our second-quarter results. This cost-reduction plan includes a range of
60 actions to better align personnel with go-forward activity levels, achieve more efficient field-level
61 operations and reduce financing costs. These structural changes to our cost structure are material to
62 Devon's future cash flow generation capabilities, equating to a PV-10 of greater than \$1 billion over
63 the next five years, or roughly 30 percent of our current market capitalization.

64

65 Turning to **slide 13**, the combination of our cost reductions and capital efficiencies lower Devon's all-
66 in sustaining funding levels to keep production flat to a \$35 WTI price. In addition to low WTI price
67 required to fund our operations, this slide also showcases the attractive free cash flow yield that our
68 business can deliver at various pricing points after funding maintenance capital requirements. These
69 yields range from 10 percent at \$45 WTI pricing to 21 percent at a \$55 WTI, providing an attractive
70 investment proposition compared to any sector in the market today.

71

72 **Next, I want to build upon my comments from last quarter regarding our long-term approach to**
73 **managing the business.** With a commodity business such as ours, any successful strategy must be
74 grounded in the supply and demand fundamentals. We understand the maturing demand dynamics
75 for our industry and recognize the traditional E&P growth model of the past is not a viable strategy
76 going forward. To win in the next phase of the energy cycle, a successful company must deploy a
77 highly-disciplined, financially-driven business model that prioritizes cash returns directly to
78 shareholders. Devon is an industry leader in this cash-return movement and, **slide 3** of our
79 presentation outlines the tenets of our strategy, which includes:

- 80 • Limiting top-line growth aspirations to 5% or less in times of favorable conditions
- 81 • Pursuing margin expansion through operational scale and leaner corporate structure
- 82 • Moderating reinvestment rates at 70% to 80% of operating cash flow at mid-cycle pricing
- 83 • Maintaining extremely low levels of leverage to establish a greater margin of safety and...
- 84 • Returning more cash directly to shareholders through quarterly and special dividends. To be
85 clear, when we say special this is equivalent to what others have characterized as a variable
86 dividend.

87 At Devon, we are absolutely committed to this strategy and, most importantly, we are putting our
88 money where our mouth is by:

- 89 • Tailoring capital investment to generate free cash flow in 2020
- 90 • Taking aggressive steps to sustainably improve our cash-cost structure
- 91 • Repurchasing up to \$1.5 billion of outstanding debt
- 92 • And last night we announced a groundbreaking action in the E&P space with a \$100 million
93 special dividend in conjunction with the accelerated closing of our Barnett Shale divestiture.
94 Furthermore, as we generate organic free cash flow in the second half of this year we will
95 evaluate opportunities to return additional cash to shareholders through another special or
96 variable dividend.

97 I believe these shareholder-friendly initiatives that underpin our transition to a cash-return business
98 model will transform Devon from a highly-efficient oil and gas operator to a prominent and
99 consistent builder of economic value through the cycle. Others may be contemplating and talking
100 about the possibilities of a cash-return model, but at Devon we are taking action and executing on
101 this strategy.

102

103 **The final topic I would like to spend some time discussing today is the strategic optionality that our**
104 **diversified portfolio provides us.** This is an especially important topic to review given the heightened
105 focus on political issues related to federal lands from the ongoing election cycle. First, regardless of
106 which political party wins, we expect to be able to efficiently develop our federally leased land.
107 Nevertheless, I do want to highlight that only 20% of total companywide leasehold resides on federal
108 acreage. At the asset level, our largest federal acreage exposure resides in the Powder River Basin,

109 which accounts for nearly 60% of our leasehold in that operating area. In the Delaware Basin, roughly
110 half of our acreage is federal, and our Eagle Ford and Anadarko Basin assets do not include any
111 federal leasehold.

112

113 While it is difficult to project with exact certainty how the politics of this issue will be resolved, I do
114 want to emphasize that we have proactively been managing risk by building a deep inventory of
115 federal drilling permits in our core development areas within the Delaware Basin and Powder River
116 Basin. As you can see on **slide 15**, we are on pace to secure a multi-year inventory of federal drilling
117 permits that will exceed 550 permits by the time of the election this fall. With this proactive approach
118 to permitting, we estimate that our permits in hand will cover more than 75 percent of our desired
119 activity over the next four years under a maintenance capital scenario. Should the federal regulatory
120 environment become more challenging, we have significant optionality on high-quality, non-federal
121 land within our diversified portfolio. This includes non-federal opportunities in the Delaware and
122 Powder River Basin along with high return inventory in the Eagle Ford and carried drilling activity in
123 the Anadarko basin. Any shift of capital to these non-federal opportunities because of the slowing of
124 federal permits would not have any meaningful impact to our capital efficiency under this
125 maintenance capital scenario over the next four years.

126

127 The key takeaway here is that Devon has a clear strategic path forward to create value regardless of
128 who occupies the White House. While we are well positioned as a company to navigate these issues, I
129 must say that we fundamentally believe that the idea of limiting drilling activity on federal lands is
130 fraught with serious economic ramifications and puts our nation's energy security at risk. This policy

131 would harm the communities in which we operate and that financially benefit from our business
132 activity, as well as impact the broader U.S. economy from an inevitable spike in energy costs that
133 would unnecessarily limit GDP growth. Furthermore, if this ideology was enacted, it would have the
134 unintended consequence of transferring the responsibility of unmet oil demand to less
135 environmentally progressive countries. Overall, the U.S. energy industry has made amazing progress
136 reducing emissions over the past decade by more than doubling its low-cost production while driving
137 emissions down. Any action that limits access to developing the minerals on federal lands would only
138 undermine the substantial progress we have made toward addressing the risks of climate change.

139

140 In summary, while the current environment has provided no shortages of near-term challenges,
141 Devon is well positioned over the long-term. We have the right mix of assets, the right execution, the
142 right financial strength and the right business model to deliver attractive returns for shareholders.
143 And with that, I am going to turn the call over to David Harris to cover a few of our operational
144 highlights.

145

146 **David Harris, Executive Vice President, Exploration and Production:**

147 Good morning everyone. To reiterate Dave's comments from earlier, I also want to say that I could
148 not be prouder of our Devon employees for the way that they have responded and their level of
149 performance during this pandemic. Our operating teams have demonstrated amazing flexibility by
150 quickly adapting to new ways of working as we safely execute our day-to-day operations, while
151 performing at the extremely high standards we have set for ourselves.

152

153 Given the dynamic environment we faced in the quarter, I would like to begin my comments with a
154 brief review of our recent activity levels. We entered the month of April with 15 rigs and 6 frac crews
155 operating across our portfolio. However, in response to rapidly deteriorating commodity prices, we
156 quickly responded with capital reductions to exit June with only 9 operated rigs and 1 frac crew. In
157 the second quarter, we brought online 39 new wells, with activity primarily focused in the Delaware
158 Basin and Eagle Ford. From a timing perspective, the vast majority of these new wells were
159 completed in early April. We ultimately opted to bring these wells online rather than risk damaging
160 the reservoir from leaving completion fluid on the formation for an indefinite period of time.
161 However, to protect the economic value of these new wells, we did restrict early-time flowback to
162 limit production into a weak commodity tape. This restricted flowback strategy, combined with the
163 decision to temporarily shut-in a tranche of legacy vertical wells, led to the curtailment of roughly
164 10,000 barrels of oil per day across our asset portfolio in the second quarter. Our minimal
165 curtailments in the quarter reflect the quality of our low-cost assets and the proactive decisions our
166 marketing team took to secure pricing points that economically incentivized us to produce. Given the
167 improvements we are seeing in strip pricing, we do not expect to shut-in or restrict flowback on new
168 wells in the second half of the year.

169

170 While pricing has certainly improved from the historic lows set in the second quarter, we have no
171 plans at this time to modify our capital activity for the remainder of the year. In fact, based on
172 efficiencies achieved year-to-date, we are lowering the midpoint of our full-year capital spending
173 guidance to \$975 million, an improvement of \$25 million from our previous forecast. For the second
174 half of the year, we plan to invest around \$200 million per quarter with the strategic objective to

175 preserve operational continuity in our franchise asset the Delaware Basin. This level of activity is
176 generating attractive returns at today's strip pricing and will generate the necessary cash flow to
177 effectively operate our business.

178

179 Looking specifically at the third quarter, the number of new wells we expect to bring online will be
180 limited to around 30 wells due to timing of completion activity. As you would expect, this activity is
181 concentrated in the Delaware Basin, but we also plan to bring online a handful of wells in the Powder
182 River Basin as we wrap up that program for the year. Because of this lower activity, we project that
183 our oil production output in the third quarter will mark the low point for the year, declining to a
184 range of 138,000 to 143,000 barrels per day.

185

186 In the fourth quarter, to establish more operational momentum heading into 2021, we plan to
187 increase the number of new wells brought online to around 40. We expect this level of activity to
188 increase our oil production to a range of 141,000 to 146,000 barrels per day. As Dave discussed
189 earlier in the call, with the capital efficiency gains and service cost reductions we are attaining, we
190 now expect to be able to maintain our Q4 2020 oil production exit-rates into 2021 with only \$950
191 million of capital spend. It could be even lower should we choose to draw down on our DUC
192 inventory. While it is premature to provide specific guidance on 2021, at today's strip pricing, we are
193 very confident in the returns of our projects and the cash flow our business can generate under a
194 maintenance capital scenario. We plan to provide firmer thoughts on our 2021 outlook later in the
195 fall. And with that, I'll turn the call over to Jeff Ritenour for a brief financial review.

196

197 **Jeff Ritenour, Chief Financial Officer:**

198 Thanks, David. My comments today will be focused on detailing the next steps in the execution of our
199 financial strategy.

200

201 Beginning with a review of our balance sheet, we have a tremendous amount of flexibility when it
202 comes to our financial position. At the end of June, Devon had \$4.7 billion of liquidity, consisting of
203 \$1.7 billion of cash on hand and \$3 billion of undrawn capacity on our unsecured credit facility that
204 does not mature until the end of 2024. As you can see on **slide 8**, also adding to Devon's financial
205 margin of safety is our low leverage with no outstanding debt obligations until the end of 2025. Our
206 near-term debt maturity runway is best-in-class within the industry, with more than 5 years of time
207 until our first tranche of debt comes due. This is a critical competitive advantage in this period of
208 economic uncertainty. Given these traits, we are confident we possess the financial strength to
209 navigate through these challenging times and flourish when the recovery does come.

210

211 While our balance sheet is in great shape and we have tremendous flexibility, we are not done
212 making improvements. Looking ahead to the second half of 2020, we expect our cash balances to
213 build as we have taken decisive actions to scale our operating costs to generate free cash flow. In
214 addition to our free cash flow generating capabilities, another item that will bolster our liquidity is the
215 expected closing of our Barnett Shale divestiture. We recently received notice from our counterparty
216 requesting an early close and now expect to complete the transaction on October 1st. For those of
217 you not familiar with this transaction, we agreed to sell our Barnett Shale assets for up to \$830
218 million of total proceeds, consisting of \$570 million in cash at closing and contingent payments of up

219 to \$260 million. After adjusting for purchase price adjustments, which includes a \$170 million deposit
220 we received in April and accrued cash flow from the effective date, we expect to receive a net cash
221 payment of greater than \$300 million at closing.

222

223 As I have mentioned many times in the past, the top priority for the large amount of cash we have on
224 hand is the repayment of debt and, as Dave mentioned earlier, we intend to repurchase up to \$1.5
225 billion of additional debt. This debt reduction plan will provide a nice uplift to our cash flow, resulting
226 in a go-forward interest savings of approximately \$75 million on an annual run-rate basis. Given the
227 uncertainty we still face with the COVID-19 crisis, we will remain flexible with the timing of our
228 program and how we execute the repurchases, which may include both open market transactions
229 and tender offers. Longer-term, it is our fundamental belief that a successful E&P company going
230 forward must maintain extremely low levels of leverage. In accordance with this belief, we will
231 continue to manage toward our stated leverage target of less than 1.0 times net debt-to-EBITDA in a
232 mid-cycle pricing environment.

233

234 Another key financial objective for Devon is to accelerate the return of cash to shareholders. With our
235 improved cost structure and lower breakeven, we are well positioned to deliver. Feedback from our
236 shareholders has been consistent regarding the desire for cash dividends. With regards to our
237 dividend policy, we plan to maintain our quarterly dividend and target a sustainable payout ratio of
238 up to 10% of operating cash flow at a mid-cycle pricing. In addition to our traditional quarterly
239 dividend, we are also excited to announce our first special dividend, which once again is the
240 equivalent to what others have referred to as a variable dividend. Given our expectation for the

241 generation of excess cash flow in the second half of this year and the early closing of the Barnett
242 transaction, our board has approved a \$100 million special cash dividend. The special dividend will
243 be payable on October 1st to shareholders of record on August 14th. This action clearly demonstrates
244 our commitment to returning cash to shareholders and we are eager to utilize the special dividend in
245 the future as circumstances warrant. As Dave mentioned, as we generate additional free cash flow
246 throughout the remainder of this year and into the future, we will evaluate additional special
247 dividends based on expected market conditions at the time. As we look to the future of this business,
248 we have a high-degree of conviction that a special dividend is a necessary capital allocation tool for a
249 well-managed E&P company. This mechanism provides us the flexibility to return cash windfalls to
250 shareholders without overcommitting to an unsustainable quarterly payout that has often plagued
251 the industry in past cycles.

252

253 And with that, I will now turn the call back over to Scott for Q&A.

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256 **Scott Coody, Vice President Investor Relations:**

257 Thanks, Jeff. We will now open the call to Q&A. Please limit yourself to one question and a follow-up.

258 This allows us to get to more of your questions on the call today. With that operator, we will take our

259 first question.

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261

262 **End of Q&A Session**

263 I appreciate everyone's interest in Devon today and, if you have any further questions, please do not
264 hesitate to reach out to the investor relations team at any time, which consists of myself and Chris
265 Carr. Have a good day.

266