Devon Energy First Quarter 2023 Conference Call

Operator: Welcome to Devon Energy's first-quarter 2023 conference call. At this time all participants are in listen-only mode. This call is being recorded. I'd now like to turn the call over to Mr. Scott Coody, Vice President of Investor Relations. Sir, you may begin.

Scott Coody, Vice President Investor Relations:

Good morning and thank you to everyone for joining us on the call today. Last night we issued an earnings release and presentation that cover our results for the first quarter and our outlook for the remainder of 2023. Throughout the call today, we will make references to the earnings presentation to support prepared remarks, and these slides can be found on our website. Also joining me on the call today are Rick Muncrief, our president and CEO, Clay Gaspar, our chief operating officer; Jeff Ritenour, our chief financial officer, and a few other members of our senior management team. Comments today will include plans, forecasts and estimates that are forward-looking statements under U.S. securities law. These comments are subject to assumptions, risks and uncertainties that could cause actual results to differ materially from our forward-looking statements. Please take note of the cautionary language and risk factors provided in our SEC filings and earnings materials. With that, I will turn the call over to Rick.

Rick Muncrief, President and CEO:

Thank you, Scott. It is a pleasure to be here this morning and we appreciate everyone taking the time to join us. For today's discussion, I will be focusing on **three key topics** that I believe are most important to our shareholders at this point. First, I plan to cover our **solid first-quarter execution**. Second, I will run through the steps we have taken to bolster the **return of capital** to shareholders. And third, I plan to share insights on how our business is positioned to **effectively control costs** and **gain momentum** throughout the rest of the year.

So, to start off, let’s turn to our **first quarter results** on **slide 6**, where we had several key highlights. First, total **oil production** exceeded our midpoint guidance at 320,000 barrels per day, representing a **growth rate** of 11% compared to the year-ago period. This level of oil production was the highest in our company’s 52-year history. Our **strong well productivity** in the Delaware Basin was once again a key contributor to this result and our recently acquired assets in the Eagle Ford and Williston Basin also provided us higher volumes in the quarter. Clay will touch on our well productivity in greater detail later in the call, but I do want to highlight that the average well placed online in the quarter is on track to recover more than a million barrels of oil equivalent. These strong recoveries are right in-line with our historic trends over the past few years, demonstrating the quality, depth, and ability to deliver **sustainable results** across our resource base.

Another notable achievement from the first quarter was our team's **effective cost management**. This was demonstrated by **capital expenditures** being in line with expectations and **operating costs** coming in better than our guidance by a few percent. I’ll cover this topic in greater detail later in the call with our outlook, but this positive start to the year puts us in a great position to potentially spend fewer dollars in 2023 to achieve our capital objectives for the year.

With our first quarter capital activity, we **limited reinvestment rates** to prudent levels, resulting in over $665 million of **free cash flow**. This marks the 11th quarter in a row our business has generated free cash flow, with oil prices over this time ranging from as low as $40 a barrel to as high as $120 a barrel. This is a great example of Devon's ability to generate meaningful amounts of free cash flow across a variety of market conditions, further **showcasing the durability** of our strategic plan to create value through the cycle and deliver returns on capital employed that compete with any sector in the S&P 500.

With this free cash flow, we continued to reward shareholders through our cash-return framework, which was well balanced between **dividends** and **stock buybacks** in the most recent quarter. As shown on **slide 7**, the total cash payout from these shareholder-friendly initiatives reached an annualized rate of around 12% yield in the first quarter, which significantly exceeds the available opportunities in other sectors of the market. Nearly half this payout was derived from our distinctive **fixed-plus-variable dividend** framework. This consistent formulaic approach, which began almost 3 years ago, has allowed Devon to offer one of the highest yields in the entire S&P 500 since its groundbreaking implementation.

Now turning to **slide 9**, in addition to our strong dividend payout, we continue to see attractive value in **repurchasing our shares**, which we believe trade at a significant discount to our intrinsic value. To capitalize on this compelling opportunity, we made substantial progress advancing our buyback program by repurchasing **$692 million of shares** year to date. In addition to our corporate buyback activity, multiple members of our management team, myself included, have also demonstrated their conviction in Devon's value proposition by purchasing stock in the open market over the past few months. With our board of directors approving the **upsizing of the capacity of our repurchase program** by 50% up to $3 billion, the company is well equipped to be active buyers of our stock over the course of the year.

Now moving to **slide 11**, looking to the remainder of 2023, there is **no change to the disciplined operating plan** we laid out for you earlier this year. Now that our Delaware infrastructure is fully operational and actively ramping to place more wells online, we expect our **production** to grow over the remainder of the year. This momentum places us right on track to average just over 650,000 Boe per day this year, which translates into a healthy production per-share **growth of approximately 9%** on a year-over-year basis.

With **capital**, we have not made any revisions to our outlook of $3.6 to $3.8 billion for the year. As a reminder, this capital forecast assumes a low single-digit inflation rate compared to our 2022 exit rate. However, in the first quarter, we did experience **service price stability** for the first time in many quarters, and we began to see **signs of increased availability** of goods and services due to an overall slowdown in industry activity. If these trends continue, we see potential for downward pressure on service costs later this year and into 2024. With much of our contract book shifting towards shorter duration agreements, we are now well positioned to work with our service partners for better terms as more frequent contract refreshment occurs over the next several quarters.

Lastly on **slide 12**, I believe this chart does a great job of summarizing the competitiveness of our outlook in 2023. With the plan we have laid out, we continue to possess one of the most capital efficient programs in the entire industry that is self-funded at a **$40 WTI oil price**. With this disciplined plan Devon is well-positioned to continue to generate significant free cash flow and **execute all aspects of our cash-return model**, making 2023 another successful year for us.

Now with that, I will now turn the call over to Clay to cover our operational highlights.

Clay Gaspar, Chief Operating Officer:
Thank you Rick and good morning everyone.

As Rick touched on earlier, our team did a great job of **meeting the first quarter operational targets** through solid well productivity, effective cost management, and the steady progression of upcoming development projects that will benefit us over the coming quarters. Remember, we're focused not just on delivering the numbers for this quarter and year but also de-risking opportunities for the coming years and also investing in R&D that will create value throughout the coming decade. We're making great progress on all three fronts. This positive start to the year put us in great position to continue to **build momentum** throughout the course of the year and **achieve our corporate objectives** for 2023.

A significant contributor to the success in this quarter was our **franchise asset in the Delaware Basin**. As you can see on **slide 15**, roughly 60% of our capital was deployed to this prolific basin, allowing us to run a consistent program of 16 rigs and 4 frac crews in the quarter. With this level of drilling and completion activity, we brought online 42 new wells in the quarter, with the majority of this activity targeting high-impact intervals in the Upper Wolfcamp. This focused development program resulted in another quarter of **volume growth** year-over-year, with oil representing 51% of the product mix.

While we had great productivity across our acreage position, our performance during the quarter was headlined by our **Exotic Cat Raider** project. This 6-well pad located in Lea County, New Mexico, targeted a highly productive area with 3-mile laterals in the Upper Wolfcamp. Individual wells at Exotic Cat flowed at **rates over 7,200 Boe per day**, and per-well recoveries from this pad are on track to exceed 2 million barrels of oil-equivalent. The flow rates from this activity rank among the very best projects Devon has ever brought online in the basin.

And lastly on this slide, another key event for us during the quarter was the **resumption of operations** at our Stateline 8 compressor station. This was possible thanks to the team’s timely efforts in securing replacement equipment and the personnel to safely repair this critical facility. Although this repair work did temporarily limit our production in this part of the field during the quarter, we are confident that we have resolved this issue, and we do not expect any further disruptions of this nature. Furthermore, we also commenced operations at our Stateline 10 compressor station, providing us another 90 million cubic feet of throughput and even more flexibility in the region going forward.

Turning to **slide 16**, as I look ahead to the remainder of the year, our Delaware asset is well positioned to build upon the solid results we achieved in the first quarter. Overall, with the 200 wells we plan to bring online this year in the Delaware, we expect **well productivity to be very consistent** with the high-quality wells we have brought online over the past few years. And for context, as shown on the **chart to the right**, this level of well productivity would not only position Devon among the top operators in this world-class basin but would also surpass the performance of other top shale plays in the U.S. by a noteworthy margin. This impressive well performance, coupled with a long runway of high-value inventory, further underscores the **competitive advantage** and the **sustainability** of our resource base in the Delaware Basin.

Turning to **slide 17**, another asset I would like to spend some time on today is the **Eagle Ford,** which is our second-highest funded asset in 2023. Over the past few years, we have taken a disciplined and scientific approach to refine the **next phase of development** in this prolific field through thoughtful and measured appraisal work. The momentum generated from these learnings is evident in our current capital program where we are pursuing tighter infill spacing and have an active refrac program, with the goal to efficiently sustain a steady production profile and harvest significant free cash flow.

This year, we plan to spud over 90 wells, with the majority of this drilling focused on redeveloping acreage with much **tighter spacing** than originally conceived when we first entered the play a decade ago. We attributed this in-field opportunity to high reservoir pressure, a fractured network that heals quickly, and low but consistent permeability. This unique combination allows us to pursue significantly tighter spacing with redevelopment activity targeting **16 to 24 wells per unit** across multiple landing zones in the Eagle Ford. In addition to the benefit of oil-weighted recoveries that are projected to exceed **half a million barrels per well**, our ability to leverage the existing infrastructure in the play also bolsters the returns. These unique and favorable reservoir characteristics in the Eagle Ford provides us with many years of highly competitive drilling inventory.

The team has also made steady progress on our **refrac program** in the Eagle Ford, achieving consistent success in re-stimulating the productivity of older wells. To date, we have roughly 30 refracs online that have successfully accessed untapped resource, resulting in an immediate uplift to the well productivity and has expanded per-well reserves by more than 50%. In 2023, we plan to execute around 10 refracs and we have identified several hundred high-return candidates across the field to pursue in the future.

While we have made significant progress improving recoveries through infill spacing and refracs, we believe there is still meaningful **resource upside in this play**. A catalyst to help us accelerate our learnings in this area is our Zgabay pilot in DeWitt County, which is supported by a grant from the U.S. Department of Energy. The objective of this grant is to fund a field study and create an **underground laboratory** to improve the effectiveness of shale recoveries by testing new monitoring techniques for both initial stimulation and production, as well as collecting critical data to enhance recoveries via refracturing and EOR. While we are still in the early stages of gathering and interpreting data from this project, we have already incorporated learnings into our day-to-day operations. These learnings will enable us to optimize recovery of resource not only in the Eagle Ford, but also across our broader footprint in the U.S. I expect to have more positive updates on this topic in the future.

And finally, on **slide 18**, I am also excited to talk about the positive results we are seeing delivered on other **key assets across our portfolio**. As you can see on the graphic to the right, over the past year we have done some good work to opportunistically **build-up operating scale** in these areas and **increased the production** by 9%. The main factors that drove this growth were our Dow JV partnership, which helped us regain operational momentum in the Anadarko Basin, the RimRock acquisition in the Williston, and the quality assessment work we have done in the Niobrara oil play in the Powder River Basin that helps us build for the future. In addition to solid production growth, this diversified group of assets is on pace to generate a **meaningful tranche of cash flow** that we can deploy to other key strategic priorities such as the return of capital to shareholders. I appreciate the team's hard work and the effort that goes into delivering near term free cash flow and also de-risking valuable future inventory.

And with that, I'll turn the call over to Jeff for the financial review. Jeff?

Jeff Ritenour, Chief Financial Officer:

Thanks Clay. I will spend my time today covering the key drivers of our first-quarter **financial results** and I will also provide some insights into our **outlook** for the rest of the year.

Beginning with **production**, our total volumes in the first quarter averaged 641,000 Boe per day. This performance exceeded the midpoint of our guidance for the quarter due to better-than-forecasted well performance across our asset portfolio. Looking ahead our second-quarter completion activity is weighted towards the back half of the period. As a result, we expect volumes to be relatively flat in the second quarter as compared to the first. However, given the cadence of activity, we do expect to build momentum throughout the second quarter, setting up the third quarter to be the **highest production quarter** for the year.

On the **capital** front, we invested $988 million in the first quarter, which was in line with expectations. Looking ahead to the second quarter, we expect capital spending to remain essentially flat versus the prior period. As a reminder, we do expect to spend more capital in the first half of the year given the timing of **completions in the Delaware Basin**. This higher level of investment in the first half of 2023 sets up Devon for a stronger production profile in the second half of the year.

Moving to **expenses**, we did a good job of controlling costs in the quarter with several of our expense categories coming in better than forecast. Looking ahead, as Rick touched on earlier, we are seeing **cost pressures plateauing** across our business and, with the solid start to the year, we feel very comfortable with our **full-year guidance ranges** for operating costs and corporate expense.

Jumping to **income tax**, after adjusting for non-recurring items, **cash taxes** were 11% during the first quarter. This better-than-expected result was driven by a R&D tax credit that was taken in the quarter. Looking ahead, we expect our cash tax rate to step-up to around 15% for the remainder of the year.

Cutting to the bottom line, Devon's **core earnings** totaled $952 million or $1.46 per share. This level of earnings translated into operating cash flow of $1.7 billion. After funding our disciplined maintenance capital program, we generated $665 million of **free cash flow** in the quarter.

With this free cash flow, our top priority was to **accelerate the return of capital to shareholders**. As we have communicated in the past, the first call on our excess cash is the funding of our **fixed-plus-variable dividend**. Based on our strong first-quarter financial performance, we declared a dividend of $0.72 per share. This distribution will be paid at the end of June and once again includes an $0.11 per share benefit from the **divestiture contingency payments** received earlier in the quarter.

Another highlight for the quarter, was the continued execution of our ongoing **share-repurchase program**. We remain confident in the intrinsic value of our equity as evidenced by the repurchase of $692 million of our stock so far in 2023. With the board **expanding our share-repurchase program** to $3 billion, which is equivalent to 9% of our outstanding share count, we have plenty of runway to compound per-share growth as we work our way through the year.

Moving to the **balance sheet**, we exited the quarter with $3.9 billion of liquidity, consisting of $887 million of cash on hand and $3 billion of undrawn capacity on our unsecured credit facility. With this strong liquidity, Devon exited the quarter with a low net debt-to-EBITDA ratio of 0.6 times, well below our midcycle leverage target of 1-times or less. Looking ahead, we plan to further improve our balance sheet by retiring additional debt as maturities come due. Our **next debt maturity** comes due in August of this year totaling $242 million. We will have additional opportunities to pare down our debt with maturities coming due in 2024 and 2025 as well.

As I look ahead, I am confident that our **financial framework** provides us the necessary **flexibility** to effectively manage through the unpredictable fluctuations of commodity prices while optimizing value creation for our shareholders. With a business plan designed to generate substantial amounts of free cash flow, we will look to grow our fixed dividend over time, payout as much as 50% of our excess cash flow via a variable dividend, opportunistically buyback shares and take additional steps to improve our financial strength. Furthermore, we possess the flexibility within this framework to lean into any one of these options to maximize results for shareholders. We believe this **balanced and transparent approach** is differentiated versus peers.

With that, I'll now turn the call back to Rick for some closing comments.

Rick Muncrief, President and CEO:

Thank you, Jeff. Great job! I would like to close today by reiterating a **few key messages**:

1. Our team did a superb job of **meeting the operational targets** we set out for ourselves in the first quarter through solid well productivity and effective cost management.

2. Our disciplined execution resulted in another **strong financial performance** for the company. This is evidenced by the attractive per-share growth we are delivering, substantial cash returns realized by investors and the high returns seen on invested capital.
3. With the solid start to the year, we are now on track to **achieve all our capital objectives** in 2023. Inflation is showing signs of plateauing, and our business is well positioned to build momentum and generate substantial free cash flow as we progress through the year.
4. And lastly, we have the resource depth, execution capabilities, financial strength, and disciplined business model to continue to deliver **sustainable results** through the cycle. We are a premier energy company, and we are also perfectly positioned to benefit from this **multi-year upcycle**.

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