Devon Energy Second-Quarter 2023 Conference Call

Operator: Welcome to Devon Energy's second-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 second 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. Devon's second-quarter performance can be defined as another one of solid execution on

all fronts, as our **business continued to strengthen** and **build operational momentum** throughout the quarter. The attractive per-share growth we have consistently delivered quarter after quarter demonstrates the efficiency of our **disciplined business model**, the quality of our **Delaware-focused asset portfolio**, the team's **execution capabilities** and the benefits of our **cash-return framework**.

The chart on **slide 4** provides a very compelling visual of this success, showcasing our **impressive track record** of value creation. Since we unveiled the **industry-first** framework in late 2020, we have deployed $12 billion towards dividends, share buybacks, debt reduction and accretive bolt-on acquisitions. The cumulative value of these actions equates to nearly **2-times the value** of Devon's pro forma market capitalization from just a few years ago! As you can see from our **diversified** actions to date, we have carefully designed our cash-return framework to be nimble, with the **flexibility** to allocate free cash flow across multiple avenues to **optimize financial results** through the cycle. Importantly, this disciplined execution has been rewarded by the market with our equity performance **achieving the highest return of any stock in the entire S&P 500** over this period.

Now let's go through some of our second-quarter **highlights** and **operating trends** in greater detail. Beginning with production, the team did a great job growing **oil volumes** by 8% on a year-over-year basis this past quarter. This result surpassed midpoint guidance expectations and for us set a new **all-time high** oil production record for the company by averaging 323,000 barrels per day in the quarter. Additionally, this volume growth was supported by an infrastructure that includes several strategic midstream assets that we have selectively invested in through the years and have taken equity stakes in an effort to enhance the results from our core E&P operations.

A key driver of this recording-setting result was higher **completion activity** in the Delaware Basin. By leveraging the benefits of a temporary fourth frac crew and consistently improving cycle times, we were able to bring online 76 new Delaware wells in the quarter, which was a few more than we originally planned due to efficiency gains. Importantly, the **well productivity** from this batch of wells in the Delaware was excellent and included a **Wolfcamp B appraisal success** that strengthens the depth and quality of our resource in the area. We also had a **successful redevelopment** test in the Eagle Ford and advanced a handful of other interesting appraisal projects across our diversified asset base that reinforces our confidence in the resource upside that currently exists across our portfolio.

Looking ahead, with higher levels of completion activity in the second quarter, we expect our production profile to continue to strengthen in the upcoming third quarter. A good visual of this **operational momentum** can be seen on **slide 7**, with **oil volumes** expected to grow to a range of 322,000 to 330,000 barrels per day in the upcoming quarter.

As I touched on earlier, the **capital spending** to drive this growth trajectory was a touch ahead of expectations due to very strong execution from our drilling and completion teams that **brought forward activity** into the quarter. Clay will spend time to cover this topic later, but I am extremely proud to share that we set several **operational records** at both the basin and company level, contributing to the record-setting drilled and completed feet per day metrics we have achieved year to date.

In addition to our strong operating efficiencies, our business is also beginning to benefit from **service cost deflation** as contracts are refreshed. This is driven by reduced activity from natural gas focused companies and private producers over the past few months, resulting in improved availability of services and cost deflation in virtually every category. Although this is a very dynamic environment, we have observed the most **downward pressure** to date in the areas of tubulars, rig rates, fuel and other miscellaneous drilling services that will begin to **positively impact our cost structure** as we enter the end of this year. We also anticipate price movement with pressure pumping, which is our largest cost category in the very near future, while it's still somewhat premature to say what and set, what our firm outlook is for 2024 is, our expectations for deflationary trends should continue. We have the **potential for meaningful savings** from peak well costs as pricing improvements gradually flow through our cost structure over the next year or so.

With the free cash flow our business generated, we had another great quarter of **cash returns**. We returned $462 million to shareholders through our fixed-plus-variable dividend, which we have paid out now for 12 consecutive quarters, we also have an active buyback program that resulted in the repurchase of nearly 4 million shares over the past 3 months. We believe this balance between dividends and buybacks offers investors the **powerful combination** of an **attractive yield** and steady **per-share growth** through the cycle.

Moving to **slide 12**, with the progress that our business has made year to date, we are well on our way to **meeting the capital objectives** associated with our 2023 plan. The momentum we have established places us on track to deliver a **production per-share growth rate** of approximately 9% for

the year. Importantly, the activity required to fund this growth is self-funded at a **$40 WTI price** or approximately half of where we are today and is delivering returns on capital employed **greater than 20%** at today's commodity prices.

While once again it is too early to provide firm guidance for next year, the trajectory of our business sets us up for a **strong outlook in 2024** as well. Given current market fundamentals, we plan to invest at levels that will sustain our productive capacity and any improvements that we see from lower service costs will accrue to our shareholders in the form of higher free cash flow generation. This disciplined pursuit of **value over volume** positions us to continue to deliver another year of differentiated cash returns and highly competitive returns on invested capital versus the broader market.

And 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. Our second quarter operating results demonstrate that our business is performing at a high-level and **building momentum** as we head into the second half of the year. As Rick touched on, this positive trajectory is underpinned by improving capital efficiency from faster cycle times, improving service costs and positive appraisal results that will contribute to our production profile and financial results over the balance of this year and more significantly into 2024.

Today, I plan to provide a **brief overview of the second-quarter results** across each of our assets, as well as highlight upcoming catalysts.

The most significant contributor to Devon's second-quarter operating success was once again our **franchise asset in the Delaware Basin**. As you can see on **slide 8**, more than 60% of our capital activity was deployed to this prolific basin, allowing us to run a consistent program of 16 rigs. With a 4th completion crew at work in the first half of the year, we were able to place 76 wells online in the second quarter, up more than 80% compared to the 1st quarter. This elevated completion activity grew our Delaware production to 420,000 BOE per day and is expected to underpin volume growth in the third quarter as well.

While we had great results across our acreage position, a key project I would like to highlight from the quarter was our Mule development in Eddy County, New Mexico. We have talked in the past about the important appraisal work that we do each year with 10%-20% of our capital budget. The Mule pad is an example to provide you some visibility into fruits of this labor. This 11-well project successfully co-developed multiple landing zones within the Wolfcamp, with particularly exciting results from the appraisal of deeper Wolfcamp B benches. Initial rates from the 6 wells targeting the deeper Wolfcamp B landing zones averaged greater than 3,100 Boe per day with 44% oil cut. Per well recoveries are on trend to exceed 2 million barrels of oil equivalent. Importantly, these highly commercial appraisal results derisk and enhance the economic expectations on approximately 100 Wolfcamp B locations in the Cotton Draw area. Furthermore, these deeper Wolfcamp locations are expected to be highly competitive within our capital allocation framework going forward.

The Delaware team also continued to make progress advancing drilling and completion efficiencies across our operations in the basin. In the Wolfcamp, we improved drilling productivity by about 10% on a per foot basis over the past year, while some of our best spud-to-rig release times for 2-mile laterals pushing below 15 days. Completion efficiencies have also steadily improved with our cycle times decreasing by 9% year-to-date compared to 2022, averaging a record completion pace of more than 2,200 feet per day in the quarter. This operational progress has been accomplished in conjunction with an ever-higher safety and environmental focus and expectation. The great work our team has done to drive improvements across the entire planning and execution of our resources coupled with the broader service cost deflation trends are positioning our business to be even more efficient as we head into 2024.

Moving to the **Eagle Ford**, our 3-rig program resulted in 29 gross wells placed online during the quarter. This activity, which was concentrated on the recently acquired acreage in Karnes County, drove a 9% increase in productivity versus the previous quarter. This high-margin growth was driven by strong well productivity achieved from a balanced mix of development and appraisal activity designed to refine the next stage of development for this prolific resource play.

Our top development project in the quarter was headlined by our LP Butler pad. This 4-well pad developed a highly charged seam of pay in the volatile oil window of the play that exceeded pre-drill expectations, reaching an impressive average 30-day rate of 3,600 BOE per day with a 56% oil cut. On the appraisal front, a key success for us in the quarter was the Krudwig Unit. This redevelopment project in Karnes County tested infill spacing ranging from 140 to 180 foot, roughly 30 wells per

section. The initial 30-day rates from this package of wells averaged 2,000 Boe per day, resulting in highly commercial returns that adds to the depth and quality of our inventory in the play. Also, adding to the commerciality of this tighter spacing was our drilling performance where we broke a company record averaging over 2,000 feet per day, which included the fastest spud-to-rig release time in company history of only 5.7 days.

As we look to allocate capital for 2024 and beyond, the positive operating results we have achieved year-to-date serve as valuable data points to optimize future development activity in the Eagle Ford and further deepens our convictions of the resource upside that exists across this entire field.

Moving to the **Williston**. Volumes began to rebound in the second quarter, growing 4% quarter-over-quarter to 56,000 Boe per day. This growth was driven by improved weather, higher uptimes on existing producers and successful adjustments to completion and production techniques for some of the new well activity. These completion and production modifications consisted of change to a larger proppant size designed to mitigate mobility of sand and a shift in artificial lift techniques to improve well uptime. With the favorable flowback results on two pads that have deployed these techniques, we have high confidence that the wells productivity will improve as we see progress throughout the year.

Looking at inventory, we now have more than 150 wells remaining and identified significant refrac opportunities across hundreds of producing wells in the field, providing us the optionality to deploy steady reinvestment in this play for multiple years to come.

Turning to the **Powder River Basin**, the key objective of our 2023 program is to continue to appraise and methodically refine our understanding of the Niobrara so that we can optimize this resource for future development. With this focus, the team has made substantial progress over the last year, establishing repeatable commercial results with 3-mile laterals across a significant portion of our acreage in Converse County. Furthermore, since we are not observing any degradation in the results from 3-well spacing, we plan to test 4 wells per section later this year. And lastly, we also are encouraged by the early flow rates from appraisal activity recently brought online in the northern portion of our leasehold position that could extend the Niobrara potential into Campbell County. I'll provide more updates on these tests in the coming quarters, but it has been evident that our 300,000 net acre position in the Powder River Basin is providing Devon an important resource catalyst for the future.

Lastly, in the **Anadarko Basin**, production volumes grew 10% from the previous quarter, driven by the ramp-up in completion activity funded by a drilling carry from our Dow joint venture. The operational execution from this program was superb, with well costs consistently coming in below pre-drill expectations and the initial flow rates from several wells exceeding 3,000 Boe per day. To date, we have only utilized approximately half of the 133-well carry agreement we have in place with Dow. We anticipate the remaining carry will provide us sufficient runway to support our current pace of activity for the next 18 to 24 months, and we are open to expanding the scope of this partnership, as we have successfully demonstrated in the past. For the remainder of 2023, we plan to bring on 10 new wells weighted toward year-end.

In summary, I am proud of the capital efficient results each of our asset teams delivered during the quarter and the strong momentum we have built as we head into the second half of 2023. 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 second-quarter **financial results** and provide some insights into our **outlook** for the rest of the year.

Beginning with **production**, a key driver of second-quarter volumes exceeding midpoint guidance was efficiency gains that compressed cycle times, leading us to capture a **few more days online** than planned. Looking ahead, the benefits of higher completion activity from the Delaware in the first half of the year is expected to **drive oil volumes higher** in the upcoming third quarter and leaves us on track to meet our volume targets for the full year as well.

On the **capital** front, we have invested 55% of our budget year to date. This weighting to the first half of the year is due to **higher completion activity** driven by a 4th temporary frac crew in the Delaware Basin. With this temporary crew recently released, we expect a **lower capital spending profile** as we head into the second half of the year and remain confident in our capital spending guidance range for the full year.

Regional oil pricing once again remained strong with realizations near WTI benchmark levels in the second quarter. We are also seeing strength in the oil price curve for the second half of 2023. This

positive trend is providing a meaningful impact to our returns and cash flow generation capabilities, with every $1 uplift in WTI resulting in about $100 million of additional annual cash flow for the company.

Despite the strength we saw in oil pricing we saw in the second quarter; we did experience **weakness in both natural gas and NGL realizations.** We do expect improved markets for gas and NGLs in the second half of the year, which should translate into better price realizations for us across the portfolio.

Moving to **operating expenses,** our field-level costs were right in line with expectations for the quarter. However, we do expect a minor uptick in per-unit costs in the second half of 2023 driven by a recently **executed water handling joint venture** in the Delaware Basin. Our new water JV provides us significant operational flexibility through enhanced scale and multiple disposal options. In addition, the JV materially lowers our future midstream capital requirements in the area. Looking forward, our equity stake in the JV will provide us distributions over time, offsetting the incremental operating costs at the asset level. We could also choose to bring forward value by monetizing this asset at some point in the future.

Cutting to the **bottom line**, we generated $1.4 billion of operating cash flow during the quarter. Combined with the low reinvestment rates to fund our disciplined capital program, we were able to generate free cash flow for the 12th straight quarter. Furthermore, we have delivered these results across a variety of market conditions, showcasing the durability of our business strategy.

With this free cash flow, our top priority was the **return of capital to our shareholders**. A key use of our excess cash in the quarter was the funding of our **fixed-plus-variable dividend** with the board declaring a payout of $0.49 per share. This distribution will be paid at the end of September.

In addition to dividends, we also see **great value in our equity** and continue to be active buyers of our stock. During the quarter, we repurchased an additional $200 million of stock bringing our year-to-date total to approximately $750 million. With the authorization we have in place, we remain on pace to repurchase approximately 9% of our outstanding shares by the end of next year. These opportunistic buybacks are a critically important tool for us to **compound per-share growth** for investors over time.

And to round out my prepared remarks this morning, I would like to give a brief update on our **investment-grade financial position**. We exited the quarter with $3.5 billion of liquidity and a low net debt-to-EBITDA ratio of 0.7 times. This leverage resides well below our midcycle leverage target of 1-times or less. Subsequent to quarter end, we took the next step in improving our financial position by retiring **$242 million of debt** at maturity. With the strong cash flow our business is generating, we will have additional opportunities to pare down our debt and maturities coming due in 2024 and 2025 as well.

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

Rick Muncrief, President and CEO:

Thank you, Jeff. Good job! I would like to close out today by reiterating **four key messages** from our prepared remarks today:

1. Our disciplined execution in second quarter demonstrates our business is **performing at a high-level** and **building momentum** as we head into the second half of the year.
2. This positive trajectory is underpinned by better capital efficiency from **higher and faster cycle times**, **strong well productivity** and **improving service costs** that will contribute to our financial results over the remainder of this year and into 2024.
3. Our **resource base continued to strengthen** this quarter. This was evidenced by our highly commercial appraisal results in the Deeper Wolfcamp and a positive redevelopment test in the Eagle Ford that adds to our **conviction of resource upside** across our portfolio.
4. With this advantaged resource base, we are deeply committed to a disciplined pursuit of **per-share value creation** over production volume growth. Foundational to this commitment is our carefully designed cash-return framework that has the **flexibility** to allocate free cash flow across multiple avenues to optimize shareholder value through the cycle.