Devon Energy Third-Quarter 2023 Conference Call

Operator: Welcome to Devon Energy's third-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 for joining us on the call today. Last night we issued an earnings release and presentation that cover our results for the quarter and updated outlook. 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, I plan to focus my comments on the trajectory of our business for the remainder

of 2023 and highlight the steps we are taking to **further improve capital efficiency as we head into 2024**.

Now let's start with a brief review of our financial and operating performance. In the **third quarter**, Devon delivered a **production per-share** growth rate of 10% year over year. This strong growth rate was fueled by our franchise asset in the Delaware Basin, accretive acquisitions, and opportunistic share repurchases over the past year. On a barrel of oil equivalent basis, our total volumes were within the guidance range, but oil volumes were slightly softer due to select well performance in the Williston coupled with minor infrastructure constraints in the Delaware. We will cover the Delaware in greater detail later in the call, but these **constraints were temporary,** and have a visible pathway to correction with the industry's ongoing buildout of infrastructure. Turning to capital for the quarter, with our disciplined plan, we kept reinvestment rates to just over 50% of cash flow. This resulted in our free cash flow more than **doubling** versus the second quarter and we **rewarded shareholders** with a 57% increase to our dividend payout.

In the **fourth quarter**, we expect Devon's production to be around 650,000 Boe per day, of which oil is expected to approximate 315,000 barrels per day. Now as a reminder, we dropped our fourth frac crew in the Delaware mid-year to replenish our DUC inventory, and the impact of this lower completion activity will lead to a minor **decline** in our production versus the third quarter. We have also modeled in the effects of project timing and weather impacts, some of which we have already experienced. However, we do expect our financial performance in the fourth quarter to be very strong, with operating margins set to expand and free cash flow to be quite robust. Overall, the

fourth quarter is set to round out another **successful year financially** for our company. While we have certainly faced some challenges this year, we are on track to deliver **one of the best years** in our 50-plus year history in terms of returns and free cash flow generation.

Importantly, as we head into **2024**, our focus remains the same. We intend to deliver growth on a per share basis and maximize free cash flow generation, while balancing the need to appropriately reinvest in our business for the future. To achieve these objectives, we have incorporated our learnings over the past year, pushed service costs lower, and sharpened our capital allocation to deliver a **step-change improvement** in well productivity and efficiency.

Now on **slide 8 we** outline the key attributes underpinning our **improved outlook for 2024**. First and foremost, with continued volatility in commodity pricing, we believe it is prudent to construct a capital plan with consistent activity levels to **maintain production** at a level around 650,000 Boe per day, with oil at approximately 315,000 barrels per day. With ongoing macro uncertainty and with the ample spare capacity that OPEC+ possesses, we have no intention of adding incremental barrels into the market at this point in time. This disciplined approach reflects our commitment to pursuing **value over volume** and shareholders will benefit from our high-graded slate of development projects designed to enhance capital efficiency and returns on capital employed. To deliver this production profile in 2024, we anticipate a **capital investment** of $3.3 to $3.6 billion. This level of spending represents an **improvement of 10%** compared to 2023 and we expect to fund this program at pricing levels below $40 per barrel. In summary, we see delivering flat production for 10% less capex.

Turning to **slide 9**, our improved capital efficiency in 2024 is driven by concentrating more than **60% of our spending in the Delaware.** Our plan will shift a higher mix of activity to multi-zone Wolfcamp developments in New Mexico, which is the core of the play, as infrastructure constraints have eased over the past and will continue over the coming months. We also plan to **high-grade capital activity** across other key assets in our portfolio. This includes limiting Williston Basin activity to only our highest impact opportunities and decreasing appraisal activity in the Eagle Ford. With this refined capital allocation, we expect to **improve well productivity** by 5% to 10% in 2024, anchored by our franchise asset in the Delaware Basin. And, lastly, we expect our capital efficiency to also benefit from **improved service costs** as contracts refresh over the next few quarters.

Now with this operating plan in 2024, we are positioned to deliver **free cash flow growth** of around 20% in 2024 at $80 WTI pricing. As you can see on **slide 11**, with this strong outlook that translates into a uniquely attractive free cash flow yield of 11%, which is up to **3-times higher** than what the broader equity markets can offer. Simply put, this is one of the most critical aspects of the Devon plan.

On **slide 12**, with this stream of free cash flow, as we have done in the past, we plan to target a cash-return payout of around 70%, which is in line with our average annual payout to shareholders since we unveiled this industry-first model in 2020. A key priority heading into next year is to continue to **grow our fixed dividend**. We believe the certainty that comes with the fixed dividend is valued by shareholders and is better capitalized within our equity price, especially if the yield is competitive with that of the broader markets. With the remainder of our free cash flow, **we will stay flexible**, as

we always have been, by judiciously allocating towards the best opportunities whether that be increased stock buybacks, variable dividends, or taking additional steps to improve our balance sheet. However, given our current stock price, we expect to pursue buybacks at a level **that will most likely result in our variable payout being below the 50%** threshold in the near term to capture the incredible value our equity offers at these trading levels.

And with that, I will now turn the call over to Clay for a rundown of our recent operational performance.

Clay Gaspar, Chief Operating Officer:

Thank you, Rick, and good morning, everyone. For today, I plan to focus my comments on our Delaware Basin operations, as well as outlining the actions we plan to take to **sharpen our capital allocation** and **drive efficiencies** in our business over the next year.

Let's begin on **slide 15** with an overview of our **Delaware Basin activity**, which accounts for roughly 60% of our capital spending for this year. With this level of investment during the quarter, we ran a consistent program of 16 rigs and brought on 59 new wells. **Well productivity** was very strong with 30-day rates averaging 3,000 BOE per day. And the improved average productivity, combined with the benefits of elevated completion activity in the first half of the year, drove **another quarter of production growth** from our franchise asset. That said, our growth rate in the quarter was held back by a few wind and lightning storms that impacted power for our facilities as well as our 3rd party infrastructure. These storms stranded a few thousand barrels per day during the quarter. The

infrastructure and wells are back online, and we don't see any negative impacts on the ultimate recovery of these wells.

On **slide 16,** you can see our impressive **well productivity** in the Delaware Basin during the quarter. It was highlighted by three important projects.

- On the **far left** of the slide, Devon's top result for the quarter was the **Bora Bora project**, developing the upper Wolfcamp at our Todd area. With 30-day rates from Bora Bora averaging 4,600 Boes per well and with the costs coming in under budget, these returns are expected to be well into the triple digits for this project.
- Another noteworthy project was our **CBR 17 development** in Texas, where 30-day production rates averaged 4,100 Boe per well per day. The CBR 17 results were enabled by a **3,000-acre trade** completed about a year ago that I highlighted on a previous call. This key trade, which unlocked our ability to pursue extended-reach laterals. By extending our laterals to two miles for this project, we added **several million dollars of net present value in this project alone**.
- On the **right**, another key result for us was the **Haflinger project**, where we **co-developed multiple zones in the Wolfcamp A and B**. While rates were restricted due to infrastructure, recoveries are on track to reach 1.5 million BOE per well. With the solid results from our Wolfcamp B appraisal to date, we now plan to **bring forward the value** of this opportunity by co-developing with the Upper Wolfcamp where possible in the future activity.

Looking forward to the project level details, **slide 17** provides a nice visual of the **well productivity** we achieved in the Delaware Basin during the third quarter. On the left, as I touched on earlier, 30-day

average rates for the Delaware wells we brought online reached 3,000 Boe per day. These high-impact wells exhibited a **20%-plus improvement** from the first half of 2023, reaching the highest quarterly level in more than a year. This performance is great to see given our well productivity over the past year has been held back slightly by elevated appraisal requirements and infrastructure constraints. The 2023 infrastructure constraints resulted in shifting a portion of our capital to less prolific areas in the basin and at times constrained peak rates across a subset of our new wells.

As you can see on the right of the slide, we also made progress improving our cycle times across our **drilling and completions** operations in the basin. Third-quarter results were highlighted by our completions pace exceeding 2,000 feet per day for the 5th consecutive quarter and we drilled several pace setting wells that achieved spud-to-rig release times of less than 15 days. With the momentum we have established, we believe we can build upon these results and **capture further efficiencies** as we head into 2024.

Turning to **slide 18**, as Rick touched on earlier, we are excited about the plan we have in place to **drive improved well productivity** in the Delaware with our 2024 plan. With the ongoing industry build-out of infrastructure in the form of electrification, compression, localized processing, and downstream takeaway, we plan to allocate approximately 70% of our capital to the Delaware Basin and specifically, to the core of New Mexico, while we can optimize the remaining activity across our acreage in Texas. As you can see on the chart on the left, by refining our focus on high-impact Wolfcamp zones in the core of the play, with less appraisal requirements, we expect **Delaware productivity to improve by 10%** in 2024.

Looking beyond 2024, we have a **long runway of high-value inventory** in the Delaware that positions Devon to deliver highly competitive results for the foreseeable future. As we have discussed in the past, we have identified more than a decade of risked inventory across the Delaware, and we expect to steadily **replenish this inventory** over time as we successfully characterize the many upside opportunities across this stacked pay resource. In addition to our internal estimates, there are plenty of 3rd party services that can provide an in-depth evaluation of our resource base. A great example of this is on **slide 19** that references the recent Enverus Permian inventory report. I won't go through all the details on this slide, there are **3 key takeaways** you should have. First, we have one of the **largest remaining inventories** of any operator in the Delaware. Second, the quality of this inventory is excellent, with returns exceeding a **PV-10 breakeven** at $40 WTI. And third, we possess **significant upside** to our risked resource from many known geological viable zones that have yet to be fully characterized. So, in summary, with the Delaware accounting for roughly 60% of Devon's total risked resource, we are going to be delivering some excellent results for quite some time.

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 reviewing our **financial performance in the third quarter** and discussing our **cash-return approach** for the future.

In general, revenues and expenses came in line with expectations for most categories in the third quarter. However, high natural gas price realizations and a lower tax rate due to R&D credits taken in

the quarter drove our **earnings beat** versus the Wall Street consensus. Putting it all together, operating cash flow totaled $1.7 billion dollars in the third quarter with capital reinvestment rates at 52% of cash flow, generating $843 million of free cash flow, a more than **two-fold increase** versus the prior period.

With this free cash flow, a key priority for us was to **strengthen our financial position**. In August we paid off $242 million of maturing debt, and we bolstered liquidity with cash balances increasing by 56% to $761 million at quarter end. With these actions, Devon exited the quarter with a net debt-to-EBITDA ratio of just over half a turn. Moving forward, we plan to add to our financial strength in each quarter by committing around 30% of our free cash flow back to the balance sheet. This will allow us to further pare down our absolute debt balance with repayment of roughly $1 billion of maturities coming due in 2024 and 2025 and maintain a minimum cash balance in excess of $500 million.

Cash returns to shareholders increased materially in the third quarter. Based on third quarter results, we declared a **fixed-plus variable dividend** of $0.77 per share, an increase of 57% from the prior quarter. This dividend payout represents an attractive annualized yield of over 6% at today's share price. In addition to the dividend, we have a **$3 billion share-repurchase authorization in place.** To date, we have repurchased 40 million shares, at a total cost of $2.1 billion. With this program, we are on pace to decrease Devon's outstanding share count by up to 9 percent. Although we **temporarily paused our repurchase activity** in the third quarter to retire debt and build cash, we continue to view buybacks as a critically important tool for us to compound per-share growth for investors over time. And as Rick stated earlier, we will target 70% of free cash flow for cash returns to shareholders

moving forward. With the recent weakness in our share price, investors should expect us to be an **aggressive buyer of our equity** once we come out of the earnings blackout and the general weighting of cash returns to be balanced towards share repurchases and our growing fixed dividend over the near term.

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

Rick Muncrief, President and CEO:

Thank you, Jeff. I would like to close today by reiterating a **few key messages** from our prepared remarks:

#1. We plan to incorporate our learnings from the past year, tighten a few things up, and refine our capital allocation in 2024 to deliver a **step-change improvement in capital efficiency**.

#2. This improved capital efficiency is anchored by our franchise asset in the Delaware Basin, where we expect **well productivity to improve by up to 10%** year over year.

#3. With our **long duration resource base,** we have the depth of inventory to deliver **sustainable results** through the cycle and…

#4. We are deeply committed to a disciplined pursuit of **per-share value creation** and our carefully designed cash-return framework that has the **flexibility** to allocate free cash flow across multiple avenues to optimize shareholder value. We've demonstrated that and will continue to do so in the future.