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Granite Ridge Resources

Second Quarter 2023 Earnings Conference Call

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CORPORATE SPEAKERS:

Wes Harris

Granite Ridge Resources; IR Representative

Luke Brandenburg

Granite Ridge Resources; Chief Executive Officer

Tyler Farquharson

Granite Ridge Resources; Chief Financial Officer

PARTICIPANTS:

Phillips Johnston

Capital One; Analyst

Jeff Grampp

Alliance Global Partners; Analyst

Jeff Robertson

Water Tower Research; Analyst

Carter Dunlap

Dunlap Equity Management; Analyst

PRESENTATION:

Operator^ Good morning, and welcome everyone to Granite Ridge Resources Second Quarter 2023 Earnings Conference Call. At this time, all lines have been placed on mute to prevent any background noise. A question-and-answer session will follow the formal presentation.

(Operator Instructions)

Thank you.

It is now my pleasure to turn the call over to Wes Harris, Investor Relations Representative for Granite Ridge.

Wes Harris^ Thank you, operator. And good morning, everyone. We appreciate your interest in Granite Ridge Resources. We will begin our call with comments for Luke Brandenburg, our President and Chief Executive Officer, who will provide an overview of key matters for the second quarter, and our outlook for the remainder of 2023.

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We'll then turn the call over to Tyler Farquharson, our Chief Financial Officer who will review our financial results. Luke will then return to provide some closing comments before we open the call up for questions.

Today's conference call contains certain projections and other forward-looking statements within the meaning of Federal Securities laws. These statements are subject to risks and uncertainties that may cause actual results to differ from those expressed or implied in these statements. We would ask that you also review the cautionary statement in our earnings release.

Granite Ridge disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. Accordingly, you should not place undue reliance on forward-looking statements. These and other risks are described in yesterday's press release in our filings with the Securities and Exchange Commission.

This conference call also includes references to certain non-GAAP financial measures. Information reconciling non-GAAP financial measures discussed to the most directly comparable GAAP financial measures is available in our earnings release that is posted on our website.

Finally, as a reminder, this call is being recorded. The replay and transcript will be made available on our website following today's call.

So with that, I'll turn the call over to Luke.

Luke?

Luke Brandenburg^ Thank you, Wes. And good morning, everyone. We appreciate you joining us for today's call.

This was a solid quarter for Granite Ridge. From a results perspective. I'll steal the term Tyler used in our board meeting and call it "Workman Like." Across the board results were in line to slightly better than our internal expectations.

Production was a bit better, which led to a bit higher adjusted EBITDAX, CAPEX and wealth turned to sales were roughly in line. It almost seems boring, but as a new public company,

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boring can be good. And a lot of hard work went into creating this boring in a good way outcome.

I'd like to thank our team for all their efforts over the past quarter, as well as our operating partners, an immense amount of time and energy when determining nearly well a day to sales, we greatly appreciate it.

A particularly bright spot of the quarter was our business development and deal evaluation efforts. Historically, we have seen about a deal a day, or roughly 400 unique deals a year. Year-to-date, we've already screened and/or evaluated over 400 deals representing over \$10 billion of potential capital opportunities. Because 10 transactions in the first half of the year, seven of which were in the Permian, and one transaction each in the Eagle Ford, Haynesville and DJ Basin.

A few of those Permian transactions are part of the strategic partnership leg to our opportunity set stool, where we make a more concentrated allocation in core areas with our strategic partners. We mitigate this concentration risk with higher expected returns, and more insight into development timing. We look forward to sharing more on our strategic partnership initiative in the coming quarters.

In addition of solid execution across the board, I'm pleased with the progress we've made on several of our key initiatives. While we still have wood to chop to increase trading volume, the one two punch of war and exchange and Russell Index addition at the end of June, removed an overhang and is more than double previous volume. We continue to increase investor visibility at conferences and non-deal roadshows and we are really starting to hit our stride as a public company. It's great to see some of this progress reflected in the share price as we're up roughly 35%. Since we've spoke three months ago on our first quarter earnings call.

Now at the table set, I'll turn out outlook for the full year 2023. As a result of stronger than expected well performance in the Haynesville and Permian we are increasing the low-end of our 2023 production guidance by 500 barrels of oil equivalent per day. This takes the midpoint up to 22,250 barrels of oil equivalent, or a 13% increase over the full year 2022.

On the CAPEX side, we're not changing our development capital guidance, but we are increasing our guidance on inventory acquisitions, which in the past I've referred to as opportunity capture by \$5 million. Now as a reminder, while our team continues to pursue new opportunities, we do not guide to future investments. The \$50 million guide for inventory acquisitions and

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production acquisitions are deals that have either closed or where we have executed definitive agreements.

As mentioned on the previous call, our development CAPEX for 2023 is front half loaded, but our turn to sales count is back half loaded. The third quarter will be an exciting one. We anticipate that about three quarters of our remaining wells to be turned to sales, as well as about three quarters of our remaining development CAPEX will occur in the quarter.

So with that, I'll turn it over to Tyler to discuss our financial results in more detail.

Tyler?

Tyler Farquharson^ Thanks, Luke. And good morning, everyone. During the second quarter, we reported net income of \$0.07 per diluted share, and adjusted net income of \$0.19 per diluted share. Our average daily production for the quarter was 21,500 BOE per day, a 13% increase year-over-year and a 7% decrease quarter-over-quarter. Looking forward, we expect this quarter's production volume to be our low point for the year, with production growth anticipated during the second half of 2023.

And as Luke mentioned, we tightened our production guidance range and increased our midpoint for the year to 22,250 BOE per day, which now represents 13% growth compared to last year. Per unit lease operating costs for the quarter were \$7.34 per BOE an increase compared to the first quarter due to a combination of several factors, including the addition of acquired producing properties, higher saltwater disposal cost, increased workover expenses and lower production.

For 2023, we continue to expect LOE of \$6.50 to \$7.50 per BOE. Production and ad valorem taxes came in at 7% of sales, and our view for 2023 of 78% of sales remains unchanged.

G&A expense for the second quarter was \$4.08 per BOE. Included in our G&A expense was \$400,000 of non-cash stock-based compensation and \$2.5 million in warrant exchange transaction costs. Adjusting for these items, our recurring cash G&A expense was \$5.1 million, or \$2.60 per BOE. We continue to expect full year 2023 recurring cash G&A to be in the range of \$20 million to \$22 million, excluding the \$2.5 million in foreign exchange transaction costs.

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Our operating partners completed and placed on production a total of 79 gross, 5.5 net wells with 90% of that activity occurring in the DJ and Permian basins. At quarter end, we had an additional 186 gross, or 12.2 net wells in progress at quarter end. Our full year expectation of 19 to 21 net wells placed on production is unchanged.

Capital spending during the quarter was right on track. During the quarter, we deployed \$63 million of capital including \$7.5 million of acquisitions. And year-to-date our spending totals \$189 million, including \$42 million of acquisitions. We're increasing our annual capital guidance by \$5 million to reflect these recently closed transactions. Our total capital spending guidance is now \$280 million to \$310 million for 2023.

We've also continued our ongoing quarterly cash dividend program. During the quarter the Board declared a \$0.11 per share dividend which represents an approximate 6.1% dividend yield measured against Wednesday's closing price. Looking at our \$50 million stock buyback plan, during the second quarter we repurchased 661,000 shares at an aggregate cost of \$4.1 million. As of June 30, we have repurchased a total of \$960,000 shares at a cost of \$6 million. Our stock repurchase plan is authorized through the end of 2023 and will be evaluated later this year.

And finally, we ended the second quarter with \$55 million drawn on our revolving credit facility, with availability of \$95 million on the revolver and cash or \$14 million, our ending liquidity was \$109 million.

I'll now hand it back to Luke, for his closing comments. Luke?

Luke Brandenburg^ Thank you, Tyler.

As we have discussed on previous calls, Granite Ridge is a bit different in the public world in that we are a hybrid. On the one hand, we are an oil and gas company, as all our assets are oil and gas real property interests.

On the other hand, we're more of an investment firm, but on a daily liquidity and greater investor alignment, as our day-to-day job is not picking drilling locations or frack designs, but rather to source and evaluate opportunities, and to allocate capital two deals with the best risk-adjusted returns.

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Our objective is to tighten the band of outcomes in oil and gas investing through high diversification, low leverage, and disciplined investment decision making.

While many of our small-cap peers trade more like an asset and a business, we look forward to demonstrating in the public space as we have in the private space for a decade, that there's real value in the Granite Ridge business above and beyond our asset value.

I'd like to conclude by thanking our shareholders for your continued support, and investors that we do not yet have a relationship with, we look forward to the opportunity to share our story and our plans to deliver meaningful shareholder returns, both in the near future and long-term.

So with that, we are happy to answer any questions folks might have on today's call, operator?

Operator^ (Operator Instructions)

Your first question comes from the line of Phillips Johnston with Capital One. Your line is open.

Phillips Johnston^ Hey, guys, thanks and happy Friday. My first question pertains to M&A. Luke, I wanted to maybe flesh out some of your comments about strategic partnerships. So you mentioned in your prepared remarks. I'm wondering if you guys have looked at or plan to look at any larger size deals where Granite Ridge would be a true partner in the development plans of a larger acreage footprint, similar to kind of what one of your public non-op peers have done recently, as opposed to sort of the more traditional non-op deals where you're more of a passive working interest owner?

Luke Brandenburg^ Yeah, good morning, Phillips. And thanks for the question. The answer is, absolutely. In fact, we put offers in on maybe a couple of deals that look like that thus far. On the strategic partnership, that's more of a private equity type model, where we're really partnering directly with a team that's going out to build an asset in small chunks overtime. But in terms of a larger format acquisition, we are in conversation with several folks do that as well.

One thing when we look at that, our goal is to try to stay away from more of the larger banker marketing processes. We just haven't seen as much value there, we see more value and the smaller kind of one off deals. And so one thing that I tell you is we're talking about the private equity firms. And, as private equity fundraising, is not as large in quantities it was several years ago, but thought we could potentially be a really interesting capital partner for folks that are

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going out looking to make an acquisition, and don't necessarily have the capital to compete with a lot of this midcaps.

But the idea there is, and the reason I like the private equity focus is that if those guys buy the asset, that's probably the only asset that they owned. And so we have a good line of sight that 100% of their CAPEX is going to go to the asset that we're invested in. If they choose to stop drilling, it probably makes sense for us as well. So we like that view or regular dialogue with the private equity firms.

Right now, a lot of the packages on the A&D market, you've had a bit of an impasse, just because it's so darn hard to buy PDP, when our cost of debt went from 3.5% to 8.5%. And so it's just tough to buy PDP at PD10, which is still what a lot of sellers want. So kind of transacted on any, but that's a long winded way of saying we like the concept. We like what are our peers done there? I think they're driving a lot of value doing that. And we are certainly exploring it as well.

Phillips Johnston^ Yeah. Sounds good. That's really good color. Thanks. And then it's obviously early to talk '24. But maybe just from a high-level perspective, how should we think about what your production growth rate might look like next year and just kind of thinking maybe longer term, what do you think is the right production growth rate for a company of your size?

Luke Brandenburg^ Yeah, that's a great question.

So one thing that we've talked about from a CAPEX standpoint, we're generally targeting reinvesting pretty much all of our free cash flow. And so what that looks like at a high level is maybe high-single digits, low-double digit year-over-year production growth. So this year with a small bump and guidance, we're looking at about a 13% year-over-year year production growth. I anticipate something around that range, again, high-single digit to low-double digit is what we look at internally.

Phillips Johnston^ Okay, great. Thanks, Luke.

Luke Brandenburg^ You got it. Thanks, Phillips. Have a great weekend.

Phillips Johnston^ Thank you.

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Operator^ Your next question comes from the line of Jeff Grampp with Alliance Global Partners. Your line is open.

Jeff Grampp^ Good morning, guys. Appreciate the time.

Luke Brandenburg^ Yeah, good morning.

Jeff Grampp^ So maybe kind of building off that that last commentary. Luke, it sounded like, I think you said target reinvesting all the free cash to focus on growing that top-line at attractive returns. I wanted to tie that into the dividend policy. You guys are newly public company, so no real precedent, I guess, in terms of when you in the board, kind of review that policy?

Is it fair to think that the focus is more on growing the asset base versus say, the dividend? Or do you think there's a dividend growth story here? And in kind of in the medium term, just I guess, how do you guys see that fitting in, in the overall, kind of shareholder return framework for you guys?

Luke Brandenburg^ Yeah, it's a great question. And it's something that I'd say, the primary point of conversation at our board meetings. At a high level, the idea is, if we can continue to find opportunities that meet our return targets, we think that allocating capital there, and increasing production is a better use of capital.

We're getting a better full cycle return for the investors. That said, if we go through a slow period, we're not able to put capital to work. We certainly have, if you ignore, let's say, growth CAPEX. There's free cash flow available to allocate to growth or to allocate to dividend.

To date, we haven't had a lot of conversation about increasing the dividend, to be honest with you. And I think that's driven by one, just deal flow that in terms of volume is as great as we've probably ever seen. And I'd also tell you, we are looking forward to allocating some more chunkier capital bytes through our strategic partnerships.

And those are really exciting to us. So again, we've not talked about increasing the dividend. But a piece of that, too, is always want to make sure that the dividend is one makes us interesting to had a broader investor group, and specifically the retail investor.

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But two, we love having a dividend that we can very easily defend. One of the things that we look at from a hedging perspective is I want to make sure that I can cover my dividend and keep production roughly flat for at least 18 months at a price deck, that's just not sustainable work. Folks aren't making money. And we really liked that the dividend where we sit right now. We feel that for at least 18 months and keep production flat, you can cover the dividend. And that sets us in a good spot where people can really count on.

Jeff Grampp^ Great, appreciate that commentary. And on the acquisition side, in any sense for attributing that that increase in deal flow, is that just a broader industry dynamic that you guys see a play? Is there a function of you guys now being public and maybe having a little bit more kind of brand recognition for people who didn't know you guys? What was your kind of attribute that step change in deal flow too?

Luke Brandenburg^ Yes, it's a good question. I'd say it's all the above. I do think there's a few more in balance now that were public, I think just across the board. Non-OP is becoming a sector, that's better understood and folks are more excited about that.

But another piece of it too, is through our strategic partnerships, we've really broadened our BD team, if you will. One of the companies that we partner with, I mean, again, this these guys are bringing in it seems like a new truly unmarketed deal that they're coming up with every couple, three weeks. They're just incredible on the BD side.

And so we're looping that into the number of deals that we're looking at. But it's neat to see that not only the volume up but again, based on the strategic partnership comment the character of the deals, has changed slash increased. So we're seeing deals that are chunkier in nature, which is exciting for us.

If you think about the predecessor company, were limited and the scale of an investment in any want to do about the fund side.

Now that we have the public company, you've got a lot more consolidated cash flow to reinvest, had allows us to take some of these more concentrated investments in deals where we can mitigate some of that concentration risk as I mentioned earlier from higher returns and then also having more control or more insight over the timing.

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So the deal flow is there. The competitions up as well. So I wouldn't suggest that just because the deal is up, there's a lot of low hanging fruit out there. It's a slog, it's tough work. And we get blown away on frankly, a good number of the deals that we bid on. But the numbers of characters changing, and I'd say the expected return on the transactions that we are doing is increased. So a lot to be encouraged about.

Jeff Grampp^ Great, great. And just a follow up last one, related to that point. It looks like the budget for this year on the acquisition front isn't drastically different than what you guys have executed on over the last couple of years, ballpark speaking. But deal flows way up. So would you say that you guys are just kind of having a higher return threshold than years past? Is it conservatism just kind of given the choppiness in the commodity pricing the last several months. Or I guess, looking for some commentary in terms of the overall quality of the deals that you guys are seeing?

Luke Brandenburg^ Yeah, I'd say part of it goes back to the competition side, particularly in the first half of the year. And really, in the first quarter, we were just truly getting blown out of the water on a lot of deals. And so not sure if it was just new money chase in the non-op space, that that was really trying to put capital to work. That was a component of it.

I'd tell you another piece that I'd say because of some of these deals, it's more concentrated bets. There's a lot more CAPEX in some of these associated with that entry costs. And so while the quantity of dollars spent in inventory acquisition may not be dramatically higher. In some of these cases, the CAPEX on the back end of those dollars is higher. And so whenever we're looking at the full cycle investment, those dollars are going up.

Jeff Grampp^ Understood, that makes a lot of sense. All right. Thanks for the time, guys.

Luke Brandenburg^ Cool. Thanks for the question. Have a good one?

Operator^ (Operator Instructions)

Your next question is from Jeff Robertson with Water Tower Research. Your line is open.

Jeff Robertson^ Thanks. Good morning.

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Luke, just following up on Phillips' question about production growth. When do you start to get good line of sight into your operators' plans for 2024?

Luke Brandenburg^ Yeah. Thanks for calling in Jeff. So what I'd tell you is we have pretty darn good insight for maybe nine months. With some of the strategic partnerships, you have a little bit (inaudible) quite frankly. But currently particularly because so many of the wells that were participating in are pad development, so there's a lot of lead time that goes into it. I'd say for nine months, you have pretty darn good visibility for 12 months. You have decent visibility. It gets a little bit tougher after that.

And so a couple of comments on that. One is, a big benefit that just come down for a decade and the immense dataset still is, there's just a lot of data to suggest when an operator is going to come back. I'll use EOG for an example. We have very good data set suggest, okay, they'll come in, they'll drill the zones, they'll typically wait a certain amount of time, and then maybe really drill the different deck, maybe they drill the pad next door. So that allows us to try to predict what's going to happen beyond that 12-month period.

The other thing that I'd tell you is, after 12 months, I'm not sure the operator even knows. They can certainly make the model say whatever it says, but the fact is most of these operators can adapt. And so they try not to set things is done, they're going to adapt based on how their inventory changes what hydrocarbon prices look like.

And so they're these guys are very smart. And so the nine to 12 month is really where we feel pretty good about it. More so on the strategic partnerships, which is something that we would like about that, as we can feel a little bit better about that timing of those cash flows as well.

Jeff Robertson^ Secondly, Luke, is there some seasonality to the blocking and tackling acquisition type strategy. Is operators refreshed their budget budgets and send out AFEs to their non-op partners?

Luke Brandenburg^ Yeah, it's a good question. The seasonality is really at the end of the year. So we'll see this in the fourth quarter, but specifically like November and December. So yes, several operators, who have a big non-op position. And what they'll do on a regular basis is they'll in -- what we call it the wellbore only market. It's a market that we follow. There was a time, years and years ago where there was not a lot of buyers in that market. And so we actually

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put some dollars to work there now. We typically get blown out of water constantly. But we follow the -- we'll put a bid in now. And again, when we have the capacity.

But that market is where you really see the seasonality and that later in the year say operator in the Permian met and say every week, AFEs that have \$30 million to \$40 million in CAPEX. Will come November, December, they're sent out AFEs that have \$100 million \$150 million of CAPEX. So you definitely do see that towards the tail end.

Again, we're not particularly competitive in that market. There's a lot of folks that plan that for different reasons for tax reasons, IDCs, et cetera. So we read those there, but we like to keep a good pulse on it, because it will be cyclical, but only predictable cyclical is that late in the fourth quarter. But sometimes, you'll have a month like April, hypothetically speaking, where a lot of the competitors have ran out of money, maybe they got distracted, maybe their kids were on spring break. And you can get a good feel. So we again, keep a full [indiscernible].

Jeff Robertson^ Thank you.

Operator^ Your next question is from the line of Carter Dunlap with Dunlap Equity Management. Your line is open.

Carter Dunlap^ Hey, guys. I know there's been a lot of questions about deal flow. And but I'm just kind of curious about this one factor. I mean, if we thought that second half commodity deck is let's say, materially or somewhat better than the first half? Do you think that that helps the flow or impedes flow in terms of basically at volume? And also what people want to get from you?

Luke Brandenburg^ Yeah, it's a good question. What I'm hoping, Carter is that in the first half, I think you have more optimism about prices. And so you may have had folks that leads into deals because they were really seeing the consensus was pretty balled up around higher back half pricing. And we weren't really doing that. For us, when we're evaluating opportunities, we're generally just looking at strip and we'll look at, above strip below strip, you want to see where a deal breaks and where it seems to make sure that you're not right on the line there.

But generally, we're investing at strip. And we'd like to use strip, because if you invest across the cycle, you're going to tighten at the end of outcomes by putting a lot of bets to work at different strip prices.

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I think we lost a lot of deals, because folks were leaning into that. I think there's a scenario where now that you've seen that rise in prices, specifically on the oil side, we'll get to that as well, that folks are more bidding stripped, and they're not leaning into it as much. And so that may help us on the price side.

The PDP is really the big one area I mentioned earlier. PDP is just so hard to transact on it. There's environments where you had a material interest rate increase, and then also just a lot of uncertainty about hydrocarbon prices. I think that now that we've seen a bit of that run up, there may be a little bit more, maybe a smaller gap between buyers and sellers. That's maybe an optimistic, but I think that could happen.

Carter Dunlap^ All right, thanks. Appreciate it.

Luke Brandenburg^ Yes sir.

Operator^ There are no further questions at this time. Ladies and gentlemen, thank you for participating on today's conference call.

This concludes today's call. You may now disconnect.