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Granite Ridge Resources

First Quarter 2023 Earnings

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CORPORATE SPEAKERS:

Wes Harris

Granite Ridge Resources, Inc.; I.R. Representative

Luke Brandenburg

Granite Ridge Resources, Inc.; President & CEO

Tyler Farquharson

Granite Ridge Resources, Inc.; CFO

PARTICIPANTS:

Phillips Johnston

Capital One Securities, Inc.; Analyst

Jeff Grampp

Alliance Global Partners; Analyst

Jeff Robertson

Water Tower Research LLC ; Analyst

PRESENTATION:

Operator^ Good morning and welcome, everyone, to Granite Ridge Resources' First Quarter 2023 Earnings conference call. At this time, all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation. (Operator Instructions).

I will now 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 from Luke Brandenburg, President and Chief Executive Officer, who will provide an overview of key matters for the first quarter and our updated outlook for 2023.

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We will then turn the call over to Tyler Farquharson, Chief Financial Officer, who will review our financial results. Luke will then return, provide some closing comments before we open up the call 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 and our filings with the SEC.

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 Web site.

Finally, as a reminder, this call is being recorded. A replay and transcript will be made available on our Web site following today's call. 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. We're pleased with our results for the first quarter of 2023, which provide us with a solid start to the year.

Our success during the period was driven by strong execution on our 2023 business plan as our team continues to work closely with our proven operating partners in multiple key basins across the country.

Highlights for the first quarter include a 5% increase in net production from last quarter to approximately 23,200 barrels of oil equivalent per day, including 46% oil. Revenue of

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\$91 million and net income of \$37 million, adjusted EBITDAX and adjusted net income of \$71 million and \$27 million, respectively, and liquidity of \$136 million, including \$11 million in cash at the end of the period.

Looking specifically at our production results, on our yearend 2022 earnings call, we discussed that we anticipated a slight production decline of around 5% from the fourth quarter. Driving this view was the expectation that some flush production from 2022 would roll off and that 2023 net turn to sales were weighted towards the back half of the year.

Our actual first quarter '23 production results ended up coming in about 10% higher than our projections due to outperformance on some of our newer gas wells and a handful of high interest wells coming online late in the first quarter versus early in the second.

In total, our operating partners turned 78 wells to sales during the first quarter. This equated to 5.9 net wells for Granite Ridge. Of the 78 gross wells, 59% were in the Permian, 17% were in the DJ, 13% were in the Bakken, and 11% were in the Eagle Ford.

During the first quarter, we spent \$91 million on drilling and completion CapEx net to Granite Ridge, or said another way, excluding drilling carries. Tyler will provide additional details in his comments, but I will say that D&C CapEx for the quarter came in quite a bit hotter than expected.

As I mentioned, much of the delta was due to acceleration of wells scheduled to come online in the second quarter that actually came online in the first, which is great, other than when you're trying to model a company quarterly, that is.

The remainder of spending during the quarter included \$17 million of opportunity capture. Now, as a reminder, opportunity capture is basically anything that grows our undeveloped inventory. Think acquisitions of undeveloped acreage, leasing, drilling carries, and most of the deals that we target through strategic partnerships.

Of that \$17 million, 89% was in the Delaware, and 70% of the capital in the Delaware was through a strategic partnership. We also closed on an \$18 million DJ PDP package.

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While we are not typically focused on oil-weighted PDP deals in this price environment, this is a transaction that we have been working on since last March that took a while to get to the finish line.

Turning to our outlook for full year 2023, in our continued effort to provide more and better information, we are bifurcating our guidance between opportunity capture/PDP acquisitions, and D&C CapEx.

On the D&C CapEx side, we are increasing guidance by \$25 million at the midpoint to a range from \$230 million \$260 million. About half of that increase is new D&C generated by our burgers and beer game.

I would note that we do not anticipate seeing material production from most of the new CapEx until 2024. The other half is a combination of cost inflation from wells that were AFE'd in early to mid-2022 and unforecasted activity. On the inflation side, we believe that we've realized most of that hit in the first quarter. It seems that wells AFE'd in late 2022 and after are coming in around AFE. Finally, we increased our guided net wells by one to a range of 19 to 21.

Our view of \$45 million for opportunity capture and PDP acquisitions remains unchanged. That includes the \$18 million DJ deal and \$17 million of opportunity capture year-to-date, plus roughly \$10 million that we have committed but not yet spent.

Our full year capital spending outlook does not include any dollars for uncommitted acquisitions or opportunity capture, though I note our team continues to pursue new growth opportunities daily.

As a result of the stronger than anticipated PDP performance we have seen to-date in the Permian and Haynesville and wells coming online sooner than expected during the first quarter, we're increasing our full year 2023 production outlook by 500 barrels equivalent per day to a range of 21,000 to 23,000 barrels of oil equivalent per day, including 49% oil.

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

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Tyler Farquharson^ Thanks, Luke, and good morning, everyone. As Luke discussed, we were pleased to begin 2023 with a solid first quarter and look forward to continued success for the remainder of the year.

During the first quarter, our average daily production was 23,167 Boe per day, an increase of 46% compared to the first quarter of 2022 and 5% from the fourth quarter, respectively. Production results for the quarter were higher than our internal estimates due to stronger than expected results from PDP wells in the Haynesville and the acceleration of an additional 1.56 net wells that were placed online in the Permian.

We realized oil prices of \$76.14 per barrel, and natural gas prices of \$2.65 per Mcf, which was approximately 96% of the average Henry Hub price for the quarter. Our lower natural gas price realizations for the period were a result of a higher proportion of our natural gas production coming from the Haynesville.

The overall result was oil and gas revenues of \$91.3 million for the quarter. This was 3% lower than the first quarter of 2022 as a substantial year-over-year production increase was more than offset by lower commodity pricing.

Looking at costs for the first quarter and our expectations for 2023, lease operating expenses were \$13.8 million, or \$6.61 per Boe. For 2023, we continue to expect LOE to be in the range of \$6.50 to \$7.50 per Boe.

Production and ad valorem taxes were \$5.7 million, or \$2.74 per Boe, and 6% of sales. Our view for '23 remains unchanged at 7% to 8% of sales. Our G&A expense for the first quarter was \$8.6 million, or \$4.11 per Boe.

Included in our G&A expense was \$1.1 million in noncash stock-based compensation and \$1.4 million in nonrecurring transaction-related costs. We continue to expect our full year cash G&A for 2023 to be in the range of \$20 million to \$22 million.

We reported net income of \$37.9 million, or \$0.29 per share for the quarter. Adjusted net income was \$28.4 million, or \$0.21 per share, and adjusted EBITDAX was \$71.8 million, compared to \$69.7 million for the same period in 2022.

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Total capital spending during the quarter was \$126.2 million, consisting of \$98.6 million of development costs and \$27.6 million of acquisitions. As Luke discussed, our development costs for the quarter were approximately \$40 million higher than we expected. Nearly 75% of this variance was due to the acceleration of projects originally scheduled to turn to sales later in 2023 and additional unforecasted activity from AFEs we received during the period.

We also observed an approximate 10% cost overrun on certain projects that recently turned to sales. A majority of those projects were AFE'd in mid-2022 prior to service cost inflations most operators experienced in the second half of 2022. We are now guiding to 2023 capital expenditures of \$275 million to \$305 million, including \$45 million of acquisitions and opportunity capture.

Our well delivery continued to progress steadily during the quarter as we completed and placed on production 5.9 net wells in multiple key basins across the country with a primary focus on the Permian.

We also continued our ongoing cash quarterly dividend program by declaring an \$0.11 per share dividend during the quarter. Annualized at approximately \$0.44 per share, this represents an approximate 7.9% dividend yield measured against Wednesday's closing price.

In mid-December, our board approved a \$50 million stock buyback plan to repurchase shares in the open market. During the first quarter, we repurchased 273,000 shares and we will continue to strategically repurchase shares in the open market as appropriate.

And finally, we ended the quarter with \$25 million drawn on a revolving credit facility. With availability of \$125 million and cash of \$10.9 million, our ending liquidity was \$135.9 million. I will now hand it back to Luke for his closing comments. Luke?

Luke Brandenburg^ Thanks, Tyler. Granite Ridge is unique. On one hand, we're an oil and gas Company and that we own oil and gas assets. But on the other hand, our job is

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not to operate those assets, but rather to reinvest the cash flows they generate into projects with the best risk-adjusted returns.

In that sense, we're more of an investment firm, but with daily liquidity and greater investor alignment. Our objective is to tighten the band of outcomes in oil and gas investing and to generate asymmetric upside through high diversification, low leverage, and disciplined investment underwriting.

So, why should you care about us? I could talk all morning about the virtues of our near-zero leverage, low-cost, non-op model, and how our diversification across hydrocarbon-type basin operator generates a more attractive risk-adjusted return profile, or how taking a smaller piece of a larger number of wells makes it easier for us to replace inventory than most operators, or I could talk about how we provide public investors access to private operators that control some of the best inventory, particularly in the Permian.

But the real reason to care about Granite Ridge is that we are cheap on just about any metric you can throw at us. As I mentioned on the last call, we trade like a company with a little cash flow and a lot of debt, and the opposite is true.

We are a fundamentally strong business that I believe would trade a lot higher where [if] not for our technical challenges of private equity overhang and limited trading volume, we will solve these.

There may be some volatility along the way, but anyone willing to take a bet on us today will be rewarded with a roughly 8% dividend and I believe, real multiple expansion as we solve both our technical challenges and continue to build on our solid foundation.

In closing, we appreciate the continued support of our shareholders, and we look forward to keeping everyone apprised of our progress. So, with that, we're happy to answer any questions folks may have on today's call. Operator?

Operator^ Thank you. (Operator Instructions). Your first question comes from the line of Phillips Johnston with Capital One. Please go ahead.

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Phillips Johnston^ Hey, guys, thank you. First question, I guess, is on CapEx. As you mentioned, it came in a little bit higher than you expected mainly because some wells got pulled into Q1 from Q2, spent more than 40% of the budget, I think, in Q1. How confident are you that CapEx should moderate in the -- in the remaining three quarters of the year and what's driving that decrease?

Tyler Farquharson^ Yes. So, hey, Phillips, it's Tyler. So, we did have some acceleration into the first quarter of activity that we thought would occur in the second quarter. And as you'll recall, most of our projects are scheduled to turn to sales in the third quarter of this year. So, really, that's where -- leading up to that is where the bulk of our capital will be spent.

So, I think what you'll see is we've had some more capital than expected in the first quarter, but that was really just a shift from the second quarter. And then by the time we get through and leading up to the third quarter, I think you'll start to see our CapEx monitoring.

Phillips Johnston^ Okay. So, in terms of the cadence by quarter, it's not going to be sort of a ratable kind of \$55 million per quarter. It's a little bit higher than that in Q2, and then the back half of the year should be a little bit lower.

Tyler Farquharson^ Yes.

Phillips Johnston^ Is that right?

Tyler Farquharson^ Exactly. We still expect pretty high level of spend in the second quarter, and then it should moderate.

Phillips Johnston^ Yes, okay, that makes sense. And then just, I guess, on the rationale for the slightly higher well count and CapEx budget for the year, I recognized, obviously Q1 was a heavy CapEx quarter, but you did tap into your cash balance and the revolver in order to fund the fixed dividend.

At current strip prices, I don't think that's going to be necessary for the rest of the year, even with the higher CapEx budget. But if prices continue to weaken, would you, guys,

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plan to continue to fund the dividend by drawing down on the revolver or would you look to cut activity in order to sort of prevent that from happening?

Luke Brandenburg^ Yes, Phillips, this is Luke, thanks for the question. We would plan to stick with that dividend. We like the fixed dividend. We think that's an important piece of the business model and an important piece of the story. So, the plan would keep the dividend fixed. And as we see production coming on from a lot of these wells, you're paying down your debt balance from there later on in the year.

Phillips Johnston^ Yes, okay, thanks, guys.

Luke Brandenburg^ Thank you.

Operator^ Your next question comes from the line of Jeff Grampp with Alliance Global Partners. Please go ahead.

Jeff Grampp^ Good morning, Luke and Tyler, thanks for the time. I was curious to dig in on this DJ PDP package that you, guys, closed on. I guess for one, since it sounds like it had been in the works for a while, can you confirm whether or not that was included in the original guide and that's -- therefore that's kind of apples to apples as it relates to that specific asset? And then maybe curious, given that you, guys, are not traditionally PDP buyers, what maybe was interesting enough about this package to get you, guys, moving forward with that? Thanks.

Luke Brandenburg^ Yes, you got it, and thanks again for the call and the question, Jeff. So, yes, that was one that we had talked about in the fourth quarter call as well. We started talking to this group in March of '22. It was just a long -- a long conversation.

Ultimately, they were a motivated seller. They weren't in a buying necessarily, but it was their only asset in the area and really, we were the most logical buyer. So, it was a long, slow dance that got to the finish line. So, from a value perspective, it made a lot of sense.

I'd say that we underwrote that at pricing that was around or maybe even a little bit more attractive in terms of the lower price than now. So, that's a deal that we like, but

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it's not something we spend a lot of time on. I wouldn't anticipate seeing a lot of PDP acquisitions going forward on the oil side.

Now, on the gas side, that could be interesting, but haven't seen a lot of folks willing to sell at \$2 gas quite yet. So, we are sniffing around in that market, but have not seen gap between buyers and sellers narrow just quite yet.

Jeff Grampp^ Got it, that's helpful, thank you. And as it relates to the CapEx guidance, again, since the opportunity capture component basically was reiterated, is it fair to conclude that this is really more of an acceleration, if you will, within the existing asset base relative to original expectations?

I think Tyler also mentioned maybe there was a little bit of cost overruns as well. I don't know if that's that easy to bifurcate kind of well cost change assumptions versus an acceleration, but just hoping to get a little bit more clarity on kind of the original guide versus the update.

Luke Brandenburg^ Yes, you got it. So, a couple of things. There was some cost increase on the D&C side, but on the opportunity capture, so one thing to note about that, we guide towards deals that are closed and then also deals we committed to.

Sometimes some of those deals include a wellbore carry as part of the consideration. And so, a funny thing is that 45 is really flat quarter-over-quarter in terms of what we're guiding to, but the components of that 45 are not necessarily the same.

And so, one thing that we saw is some wells that we had a carried interest associated with, so we were going to pay a carry as part of those. Some of those wells were pushed until '24, so they went out of the guidance. But then we had some new deals that were generated from our burgers and beer game that will be drilled in late third, early fourth quarter and likely come online in 2024. So, the components of that, again, continue to move around. And so, it's -- it is consistent, but it is different deals. So, I'm not sure if that exactly gets to your question or not.

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Jeff Grampp^ Got it. No, that's helpful. I think it's -- there's kind of a subset within that opportunity capture that can be a little bit fluid given that you, guys, are talking about deals that haven't yet closed. So, that's -- so, I understand that.

Okay, and if I can just sneak one more in -- on the burgers and beer side of things. When we're thinking about that opportunity set, is that primarily kind of on the AFE side of things where you're exposed to, say, a single well, or are you, guys, acquiring, say, minority interest within an entire D&C and therefore also acquiring future development opportunities, or is it kind of both? And I guess just kind of curious if you compare/contrast those two opportunity sets.

Luke Brandenburg^ Certainly. So, there is some that I would say is the wellbore-only, but not much. Now, in terms of deal flow that we see, a lot of it is wellbore-only, but in terms of deals that we are interested in, allocate capital to, that's pretty low.

So, if I look at the opportunity capture side for this quarter, for example, the vast majority of that was really acreage and deals related to one of our strategic partnerships. And so, there, we will own everything, all the inventory in the project. We certainly prefer those wellbore-only. You've got a lot higher allocation to a single well. You don't have the upside, so there's less bailout.

On the flipside, though, some of those wellbore-only deals, they're often with larger operators who have a lot larger supply chains and are very consistent in terms of -- in terms of their drilling and completion costs.

So, it's kind of a balance now when you're working with smaller deals, more concentrated bets, you're generally expecting a higher rate of return, but you may have more variability there. So, it's a balancing act. But again, the short answer is our focus is on opportunities where we like the single well economics, but we're also getting the upside in terms of additional zones with it. So, that's more leasing than just wellbore-only.

Jeff Grampp^ Okay, understood. Thanks for the time, guys.

Tyler Farquharson^ Thank you.

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Operator^ (Operator Instructions). Your next question comes from the line of Jeff Robertson with Water Tower Research. Please go ahead.

Jeff Robertson^ Thanks, good morning. Luke, a question on the strategic partnership opportunity. Can you talk about how long it takes to mature these relationships? And are there certain companies where you would divide assets between a non-operated piece and an operated piece?

Luke Brandenburg^ Yes, good question. So, I'd say the strategic partnership, this concept, those really are relationship deals. And so, those are to say something was a yearlong relationship would be short on that side. These are folks that we've known for a long time and really built a relationship and a trust with.

Those deals are pretty unique because from our perspective, we have a non-op interest. But because of our partnership and our higher working interest in those, we have a bit more control over the timing.

And so, it's kind of a bridge between op and non-op, which is something that we like. It helps to frankly remove or largely mitigate one of the largest risk factors with investing in (inaudible) non-op deals, which is not controlling the drill bit.

So, these are relationships that take a long time to develop. There has to be a large trust there, but whenever you build something like that, it's something we're really excited about. The deals, one of our partners in Delaware in particular, it's just really neat to see. From a deal flow perspective, they -- they are -- they're very aggressive and just to build deep relationship over time, and so, some of the projects that they generate and bring to us to partner with them on are very short-fused. You got to put a rig on there in three months.

Some are much longer-dated, where it's an opportunity that you may have a development plan that lasts two years or three years. So, the types of opportunities vary a lot in scale. But I think the primary takeaways for us and why we like it, we just have a lot more insight into timing and it really is a partnership. And so, it's something

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that helps to bridge that gap between op and non-op and really helps us to be better underwriters and just be sharper whenever we're looking at some of these deals.

Jeff Robertson^ On the timing issue, Luke, do you have a general rule of thumb or at least a goal of how quickly opportunities might go from undeveloped to actually getting drilled when you invest capital in these types of deals?

Luke Brandenburg^ Yes, in the broader strategic partnership bucket, most of those deals we plan to spud within 6 to 12 months at least on an initial tranche. Now, some of those -- and, again, one of the benefits of being a larger interest rig, we have more control over the timing. And so you may drill an initial tranche in the primary zones upfront and then you may plan to come back a year or so later to come drill secondary zones.

But we are focused on deals that will quickly turn inventory to cash flow. I think that's a big piece of just our model is we're not really focused on long-dated inventory, certainly not looking to pay for long-dated inventory. We are really focused on inventory that we think will be turned to cash flow within two to three years. But we want our primary dollars, that first tranche, to turn to cash flow within a year.

Jeff Robertson^ The last question, have the recent declines in oil and natural gas prices increased the deal flow as people may look to -- people that may own non-operated pieces just don't want to participate and would rather spend their money on operated assets or something else?

Luke Brandenburg^ Yes, it's a good question. One place that it certainly increased the deal flow is the Haynesville. You have a lot of operators who were non-op to other operators. And so, when they received well proposals in the fourth quarter last year, they all elected in. Gas prices looked good, they were excited to participate.

Now, we've had a pretty material decline in gas prices. And so, a lot of operators have non-op and other assets are looking to offload some of that. So, have seen a material increase in Haynesville and the wellbore deals.

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That's not a market where we're very competitive, particularly given the fact that they're looking to unload it because the economics aren't near as attractive as they were. But we have seen an increase in deal flow there.

I don't know that it's really driven an increase in deal flow in, frankly, many of the other basins. I think the deal flow there continues to be strong. From our perspective, we see basically a new deal a day that comes through the shop. And so, the way that we look at our deal flow, we see a new deal a day, we bid on about a deal a week and we win a deal every three weeks. And that's been relatively consistent.

Jeff Robertson^ Great, thanks for taking my questions.

Luke Brandenburg^ You got it, Jeff.

Operator^ There are no further questions at this time. I will turn the call back to Luke Brandenburg, CEO.

Luke Brandenburg^ All right, well, I just want to thank everybody for participating in the call. We are -- we're still a nascent public Company. And it means a lot to have your interest, to have your support.

We are always available to answer any questions, and we will continue our effort to provide more and better information. So, thanks, everyone. Look forward to talking to you and seeing many of you soon.

Operator^ This concludes today's conference call. You may now disconnect your lines.

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