

# Southwestern Energy Company

## Q4 and Fiscal Year 2019 Earnings Conference Call

Friday, February 28, 2020, 10:00 A.M. Eastern

### **CORPORATE PARTICIPANTS**

**Paige Penchas** – *Vice President of Investor Relations*

**Bill Way** – *President and Chief Executive Officer*

**Clay Carrell** – *Chief Operating Officer*

**Julian Bott** – *Chief Financial Officer*

**Jason Kurtz** – *Head of Marketing and Transportation*

## **PRESENTATION**

### **Operator**

Welcome to the Southwestern Energy Fourth Quarter and Year-end 2019 Earnings Call. The management will open up the call for a question-and-answer session following prepared remarks. In the interest of time, please limit yourself to two questions and requeue for additional questions. This call is being recorded. If you require operator assistance, please press star (\*), then zero (0).

I will now turn the call over to Paige Penchas, Southwestern Energy's Vice President of Investor Relations. You may begin.

### **Paige Penchas**

Thank you, Drew. Good morning and welcome to Southwestern Energy's Fourth Quarter and Fiscal Year 2019 Earnings Call. Joining me today are Bill Way, President and Chief Executive Officer; Clay Carrell, Chief Operating Officer; Julian Bott, Chief Financial Officer; and Jason Kurtz, Head of Marketing and Transportation.

Along with yesterday's earnings and guidance release, we also filed our 10-K, which is available in the Investor Relations' section of our website at [www.swn.com](http://www.swn.com).

Before we get started, I would like to point out that many of the comments during this call are forward-looking statements that involve risks and uncertainties affecting outcomes. Many of these are beyond our control and are discussed in more detail in the risk factors and the forward-looking statements sections in our annual report and quarterly filings with the Securities and Exchange Commission.

Although we believe the expectations expressed are based on reasonable assumptions, they are not guarantees of future performance and actual results or developments may differ materially.

We may also refer to some non-GAAP financial measures, which help facilitate comparisons across periods and with peers. For any non-GAAP measures, we use, a reconciliation to the nearest corresponding GAAP measure can be found in our earnings release available on our website.

I will now turn the call over to Bill Way.

### **Bill Way**

Thank you, Paige. Good morning everyone and thank you for joining our call.

We have been very proactive and intentional over the last several years to augment the company's resilience across a broad range of economic and commodity environments. We have taken several specific actions over that time to high-grade the portfolio, fortify the balance sheet, and reduce cost, affording us the ability to pursue value-enhancing opportunities without distraction.

Today, I would like to provide some reflections on the successful results the company and our teams achieved last year and look ahead at our go-forward plans. Southwestern Energy's continued strong quarterly and yearly performance is driving the company forward to the completion of our two-year transition plan back to cash flow neutrality and reflects a plan, a

portfolio, and an exceptionally talented team that are agile and resilient, even in the challenging environment the industry faces today.

For 2019, we outperformed our expectations by generating cash flow of \$913 million, of which \$246 million was from the fourth quarter. We grew condensate production by 38% and decreased the company's base production decline rate to 25% going forward. Regarding capital efficiency, we reduced well costs by 27% to \$824 per lateral foot. Importantly, this average well cost includes all wells to sales in both liquids-rich and dry gas, in both Pennsylvania and West Virginia and all well cost including drilling, completions, and flowback without sacrificing well performance. Clay is going to give you more details on how we are going to lower well cost even further in 2020 in a few minutes.

In addition to capital cost improvements, we reduced the company's total cost structure including G&A and interest by \$122 million. We implemented another \$40 million G&A reduction earlier this year. We have fundamentally changed the way we look at every cost and every process so that the company can thrive in lower commodity prices. We are undeterred in our efforts to continue to improve operational efficiencies, reduce costs, and are well positioned to take advantage of value enhancing opportunities.

At year-end, we had \$1.8 billion of available liquidity under our \$2 billion bank facility and net debt to EBITDA of 2.3 times with no material debt maturities before 2025, and thus no looming high-cost refinancing risk. SWN has also maintained its credit ratings with Moody's, S&P, and Fitch with no downgrades, which has been rare in the natural gas sector.

When we sold Fayetteville, we set a goal to reposition the company and transition back to free cash flow neutrality in two years, 2019 was our first year on that journey. Even with the current commodity price challenges the industry faces, the transformational changes we have made to the company, along with our high-quality asset base, support our confidence in the pursuit of this goal, subject to our disciplined capital allocation strategy.

I would now like to address 2020 guidance.

The capital efficiency gains from our operational outperformance, our large inventory of Tier 1 high rate dry gas and condensate-rich wells and our right-sized firm transportation capacity for both natural gas and liquids allows us to do more with less and supports our transition plan.

We are reducing our 2020 capital investment program by 20% versus 2019. We expect to invest \$900 million at midpoint, \$750 million of which is being invested in our drilling and completion operations, principally in our super rich Southwest Appalachia acreage.

True to our investment philosophy and disciplined capital allocation strategy, returns on our incremental projects must exceed internal hurdle rates at strip pricing. Additionally, if strip prices fall and results in lower cash flow, we will lower our capital investment. This year will be no different. If the forward curve were to increase, we would not expect to increase capital above our guidance, but instead use the excess cash flow to reduce debt.

Our well established and rolling three-year hedging program is designed to provide protection for the company's cash flow while retaining the opportunity to capture upside that the market fundamentals suggest. We are well hedged in 2020 with 83% of our gas and 100% of our oil production protected from commodity price volatility. As such, we have much of the risk mitigated through commodity and basis hedging.

To be clear, the discipline around our capital allocation and risk management that you have come to know remains unchanged.

What does that mean for 2021 and beyond, we believe this plan positions us over time to generate free cash flow with an ability to self-fund investment and provide an opportunity to reduce overall debt levels and ultimately return capital to shareholders. Clay will comment more on the plan in a moment.

Now let us turn to a core value of our company that is increasingly important to our investors. Responsible development of energy must include a relentless focus and commitment to ESG. I want to thank our employees for their care for the environment and focus on safety, emphasizing that anyone who works in service of our company should go home each day in the condition they started the day in, in other words, no one gets hurt.

During 2019, we recorded the lowest recordable injury rate in the company's history. Our safety effort includes contractors who work on our behalf as well as employees, all working together as one team at SWN. This company is among the very best at providing and nurturing a safe work environment.

Our active participation and environmental stewardship are well demonstrated by our ongoing commitment to return freshwater to areas where we operate in greater amounts than we consume. As a leading natural gas and gas liquids producer, we are positioned well in a low carbon energy future with demonstrated results in reducing emissions.

Minimizing greenhouse gas emissions has been a core operating philosophy for many years and we have advanced leak detection technology on 100% of our facilities and have leak loss rates that are a fraction of the national average and we are very, very proud of these accomplishments.

Let me turn this over to Clay to provide some additional color on our operational achievements.

**Clay Carrell**

Thanks, Bill.

Our fourth quarter results continued the operational outperformance that we are well known for and we finished 2019 with results ahead of our guidance and expectations. To name a few, we beat our annual well cost reduction target and achieved record low well costs in the fourth quarter. We beat the high-end of condensate production for the year and the quarter and delivered full year equivalent production at the high-end of our guidance range. Our teams continue to embrace our outperformance culture and they are carrying this momentum into 2020. All of this was accomplished with record safety performance while demonstrating care for the environment.

Let me start with a few highlights from 2019.

Total production was 778 Bcfe, up 11% compared to 2018, when excluding Fayetteville production. Liquids were approximately 23% of total production, increasing 20% to almost 78,000 barrels per day. Investing in our highest value condensate inventory led to condensate production of over 16,000 barrels a day in the quarter and 13,000 barrels per day for the full year average, a 38% increase.

Our cost focus is relentless. As Bill mentioned, we reduced total well cost to an average of \$824 per lateral foot, a 27% reduction. We also set a new record low well cost of \$605 per lateral foot on an 18,000-foot lateral. So, we have room to keep improving.

We achieved this result and others I will discuss through an integrated approach to planning, sourcing, logistics, application of leading technology, and exceptional implementation by highly talented people. Supporting this fully integrated approach, we self-sourced sand, realized the benefits of our completed water pipeline systems, increased lateral lengths, and reduced cycle times to exceed our well cost reduction target.

Now, let me touch on reserves. We increased our year-end proved reserve 7% to 12.7 Tcfe. Primary contributors to this increase were over 1 Tcfe of positive performance revisions and over 1 Tcfe of reserve additions, mostly from new core acreage leasing. As a result of our cost reductions and increased reserves, we lowered our proved developed F&D by 24% to \$0.53 per Mcfe.

Consistent with our resource to reserves efforts, we offset consumption and maintained our 53 Tcfe of total resource. At year-end, we had over 4,600 future drilling locations, 700 of which are economic at current strip pricing.

Lastly, we reduced the base production decline across our Northeast Appalachia asset by strategically installing pad compressors to lower wellhead pressures in portions of our acreage, realizing over 70 million cubic feet per day of production uplift. This was the key contributor to shallowing the forecasted base production decline for the company to 25%. All of these are clear examples of our outperformance culture and how experienced teams working together and focusing on delivering high-end outcomes can achieve “above target” results.

Now I will touch on a few key operational components of our 2020 plan.

As Bill mentioned, we will reduce full year capital investment by 20%. Even with that reduction, we expect to bring on almost as many wells to sales as in 2019. Additionally, the average lateral length on our wells to sales will grow by over 20% to approximately 12,000 feet with 24 ultra-long laterals, which are greater than 15,000 feet included in this year's program.

Our activity plans include investment in the highest-return projects with approximately two-thirds of our capital going to liquids-rich West Virginia acreage and a third in dry gas Pennsylvania.

Similar to prior years, our capital investment will be front half loaded. As planned, we are currently running six rigs and three frac crews with four rigs and two frac crews in West Virginia. Corresponding to this capital profile, the majority of our wells will come online in the second and third quarters with production increasing in the second half of the year.

This investment plan will result in total production of 848 Bcfe at midpoint. We expect condensate production to increase approximately 25% to almost 16,000 barrels per day and NGLs to increase 10% to 71,000 barrels per day. The resulting natural gas production increase is primarily associated with the development of our liquids-rich acreage and Northeast Appalachia will be flat.

In Southwest Appalachia, 70% of our wells to sales will come from the superrich condensate acreage and 30% from the rich acreage. Timing of completions will be the main driver of

production volumes, and with more of our rich area development in the first quarter, our condensate volumes will be flat to down in the first two quarters and then grow rapidly in the second half of the year.

In Northeast Appalachia, we will continue to invest in our Lower Marcellus inventory and expand our pad compression project. In addition, we will drill between two and four Upper Marcellus tests.

We are pursuing additional well cost reductions in 2020 of 10% averaging \$730 per lateral foot for wells to sales. These cost reductions are being driven by longer laterals, continued completion design enhancements, and continued operational execution and efficiency improvements. The profile of our well cost reduction will have a similar profile to 2019, trending down throughout the year.

LOE will have a similar run rate as the fourth quarter of 2019. The increased costs associated with greater liquids production and the compression project will be more than offset by increased revenues and other LOE cost reductions and efficiencies. In 2020, we are building on the momentum of our outperformance culture and look forward to sharing further operational achievements throughout the year.

With that, I will turn the call over to Julian to review the financial highlights.

### **Julian Bott**

Thank you, Clay, and good morning everyone.

As disclosed yesterday, we reported adjusted net income for the fourth quarter of \$99 million, or \$0.18 per share, net cash flow of \$246 million and capital expenditures of \$207 million.

For the year, adjusted net income was \$328 million, or \$0.61 per share, net cash flow was \$913 million and capital expenditures were \$1.14 billion.

Disciplined hedging and risk management are a core part of our strategy with the benefits reflected in our 2019 earnings, where we had settled hedging gains totaling \$180 million. This resulted in our weighted average realized price remaining within 3% of the prior year, despite the substantial decrease in commodity prices.

We expect our hedging portfolio to continue to protect our realized pricing in 2020. Approximately 83% of 2020 expected gas production is hedged at a floor price of \$2.47 per MMBtu from April through the remainder of the year. For NGLs, we have approximately 51% of our production hedged, primarily with swaps for ethane and propane. Finally, we have hedged essentially all of our 2020 forecasted oil production at an average floor price of \$56.56.

In total, we have protected approximately 90% of this year's projected revenues and given the price declines experienced year-to-date, we should have a sizable mark-to-market gain.

In addition to hedging our commodity risk, we also managed locational risk by entering into financial basis hedges for 222 Bcf of our expected 2020 gas production at an average \$0.33 basis discount to NYMEX. Additional protection is provided through our access to the Gulf Coast markets, which are highly correlated to the Henry Hub pricing.

Looking at 2020, we expect a discount to NYMEX of \$0.63 to \$0.73 per MMBTU for the year including transportation with the first quarter expected to be \$0.42 to \$0.52 discount to NYMEX. This compares to a discount of \$0.69 for the fourth quarter and \$0.65 for the full year of 2019. Despite the warm weather in the Northeast during the fourth quarter, we witnessed a \$0.09 improvement in our gas differential compared to the third quarter, as our diversified transportation portfolio allowed us to access premium pricing markets.

On the NGL front, our full year guidance as a percentage of WTI is 16% to 21%. While prices have been volatile as we look to Q1, we expect to be around midpoint of that range. Our NGL differentials can vary throughout the year typically trading at a higher percentage of WTI in the winter and a lower percentage in the summer.

We continue to make significant improvement to our cost structure in 2019. We realized \$122 million in permanent annualized G&A and interest cost savings. In 2020, we have already taken the unfortunate but necessary actions to further reduce gross G&A by an additional \$40 million, leading to our G&A guidance decreasing to a midpoint of \$0.15 per Mcfe, down from \$0.18 for the full year in 2019.

During 2019, we repurchased \$62 million of senior notes at an average discount of 13% and retired the remaining \$52 million of our 2020 senior notes, leaving a total of \$2.2 billion of senior notes outstanding with a weighted average interest rate of 6.7%. All but \$213 million of these notes mature in 2025 and beyond and we feel fortunate that we are not dependent on the capital markets for refinancing in this challenging market.

At the end of the year, we had \$1.8 billion of liquidity on our revolver with only \$34 million of borrowings and \$172 million of letters of credit outstanding. Our net debt to EBITDA was 2.3 times at year-end and, as we plan for 2020, we remain sharply focused on maintaining the strength of our balance sheet, which is critical to our long-term success.

We are mindful of the current volatile pricing environment, and as you have already heard from Bill, we will continue to appropriately adjust our plans to align with the cash flow impact of changes to strip pricing. These plans, including the 20% reduction in capital from 2019, are still on track to meet our goal of becoming free cash flow neutral by the end of this year, driven by our ongoing operational efficiencies, cost reductions, well outperformance and hedge program benefits.

That concludes our prepared remarks. So, Drew, could you please open the line for questions?

## **QUESTIONS AND ANSWERS**

### **Operator**

Yes. We will now begin the question-and-answer session. To ask a question, you may press star (\*), then one (1) on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, please press star (\*), then two (2). At this time, we will pause momentarily to assemble our roster.

The first question comes from Charles Meade of Johnson Rice. Please go ahead.

### **Charles Meade**

Good morning, Bill to you and your team there.

**Bill Way**

Good morning, Charles.

**Charles Meade**

I wondered if we could—if I could ask a question about your dry gas Northeast Appalachia play. So you have got about a third of your CapEx going there, but can you give us the reasoning why that would get any more CapEx than just kind of a bare maintenance level, like of just keeping one rig running and why you are choosing to allocate a third of your CapEx there instead of pulling back more?

**Bill Way**

We have lowered our cost and improved productivity, efficiencies and everything as Clay and others have talked about. We are holding production flat in Northeast PA. The wells that we drill are in the core of the acreage and compete with our other drilling investments, but we are doing exactly as you are suggesting, we're holding it flat.

**Charles Meade**

Okay, got it, and then going back to your comments in your prepared remarks about free cash flow positive. You guys actually were free cash flow positive in 4Q 2019, and that was a positive thing to see, but what is the—I think I heard you say Bill that this two-year plan to reach free cash flow positive again. What is the current—where are we on that timeline right now?

**Bill Way**

We are right on track and our objective was to take two years to get there from the sale of the Fayetteville and a third of our cash flow, and we are right on track. By the end of this year, we will—in this commodity price we expect to reach that objective.

**Charles Meade**

All right. Thank you for that.

**Operator**

The next question comes from Jeffrey Campbell of Tuohy Brothers. Please go ahead.

**Jeffrey Campbell**

Good morning.

**Bill Way**

Morning.

**Jeffrey Campbell**

I think my first question is I am kind of wondering how much of the current corporate decline rate is allowing you to pull back capital meaningfully as you are and still managed to grow 9% in 2020?

**Clay Carrell**

Yeah, this is Clay. As we talked about, that has been part of our focus, and we get greater cash flow from greater percentage of our base when we shallow the decline. And we have dropped that by approximately 5% year-over-year, as we talked about the pad compression project in Northeast Appalachia.

**Bill Way**

And that is one of a number of factors, as you would understand, whether it is lower cost across the entire company, both capital and maintenance and G&A, whether that is efficiencies and cycle times, all of those things contribute to our ability to achieve this.

**Jeffrey Campbell**

Okay, and I wanted to ask a question regarding the G&A, bearing in mind that a larger peer recently noted that it had reorganized and reduced its workforce for what they called a permanent rerating of its capital investment going forward. Do you see your various G&A adjustments as tied to primarily a tough downturn or is this likely to largely remain in place as you work into the future?

**Bill Way**

Yes, when we look at G&A and we look at any cost, we go through, look at the efficiency of that, the return of that cost; is there a different, better, more efficient way to do it, and a number of other aspects to determine exactly where to set that. Our reductions in cost over the last couple of years have been designed to be sustainable and they are built into our budget built-in—the ones we did in 2019 into the 2020 budget, the ones we did in 2018 into the 2019 and so on, and so they are durable through time and we expect that that will continue.

**Jeffrey Campbell**

Okay, great. Thank you. I appreciate the color.

**Operator**

The next question comes from Jane Trotsenko of Stifel. Please go ahead.

**William How**

Hi, this is William How asking on behalf of Jane. Natural gas price realizations last quarter meaningfully exceeded consensus expectations. Was there anything unusual the way to explain that?

**Jason Kurtz**

Hi, this is Jason. No, really that is a function of the diversified portfolio that we have in the Northeast Appalachia area where about 25% of—25% to 30% of that portfolio has exposure to city-gate premium-priced markets. And whenever you get into that November and December time frame, there is a lot of premium associated with some of those markets, and it usually moves our realized price up in Q4.

**William How**

Got it. Thanks, and can you comment on NGL pricing and how it shapes up for your 1Q relative to the last quarter? To what extent are you—are the Mariner East projects are helping to achieve higher basin NGL pricing for the Appalachian players?

**Bill Way**

So that is exactly right. The Mariner East project is clearing barrels out of the area, which is helping improve differentials in the Northeast. What I would say from an LPG perspective is that in 2019 we experienced the highest—the tightest differentials that we have seen on LPGs in the basin since we own the asset and we expect that to continue into 2020.

**William How**

Great. Thanks.

**Operator**

The next question comes from Welles Fitzpatrick of SunTrust. Please go ahead.

**Welles Fitzpatrick**

Hi. Good morning.

**Bill Way**

Hi, Welles.

**Welles Fitzpatrick**

Obviously, the quarterly guidance is very helpful. There is a huge step up in 3Q. Is that just well timing or are you guys doing something on the midstream side, like your recent compression work that drives that step-up?

**Bill Way**

Yes, we have everything we need in place to move gas or liquids anywhere we needed to go. So, this is simply the front-end loading of the capital program and the phasing of those wells coming online as you drill and complete in the first two quarters with the second quarter being the sort of highest investment quarter and then moving them through. So, you will see production go—edge up from where we are at, but it is all part of the phasing.

**Clay Carrell**

Not all that dissimilar to last year.

**Bill Way**

That is exactly right.

**Welles Fitzpatrick**

Okay. Yes, that makes sense, and then my follow-on, can you talk to the new—and I guess it is not new, I guess it was last summer, but the co-tenancy law in West Virginia. Obviously, that is allowing you guys to push out those laterals, which is great. But can you talk about does it allow you to add acreage inexpensively via the new; I guess it is a unitization almost a quasi-force pooling process?

**Clay Carrell**

Yes, I will comment on that. The co-tenancy helped us. It was a step in the right direction, but your last comment around pooling that still has a way to go and is being worked by operators in West Virginia and that will be where we could realize a bigger benefit is if we can get that accomplished.

**Welles Fitzpatrick**

Okay, wonderful—too early for a timeframe on that, I am guessing.

**Bill Way**

Yes, we continue to work with the state and our colleagues in the—out in the area and we will continue to work that forward.

**Clay Carrell**

Yes, the main way we are adding lateral links is lease acquisitions and trades and that is helping us a lot.

**Welles Fitzpatrick**

Thank you, guys, so much.

**Operator**

The next question comes from Karl Blunden of Goldman Sachs. Please go ahead.

**Karl Blunden**

Hi, good morning. Thanks for taking the question, and certainly recognize your comments about not being relying on the capital markets. It is a good thing right now. One question that I ask myself and comes up in credit investor conversations is around the covenant—the net leverage covenant you have with the bank group. Could you talk about your comfort in meeting that or different options you have to stay in compliance with that over time, especially in a low commodity price environment, like we have today?

**Julian Bott**

Sure, absolutely, Karl. Hi, this is Julian. So, our covenant is 4 times, which I think is pretty standard across the industry. And obviously we are well below that today. Where that goes, it does depend on commodity prices for the most part and we have scenarios where sustained long-term pricing at these lower levels, it could surpass 3 times, but as we have said continually leverage is a key focus for us. And if we had those sustained low pricing scenarios, we would have to make additional adjustments to the business plan and also to the cost structure.

Could also manage it through potential asset sales, and those are something we would consider, but at this point, it is premature for us to be monetizing cash flow, when we have clearly stated that the goal is returning to free cash flow. So, we would like to retain that cash flow from those assets.

**Karl Blunden**

That makes sense, and I guess just as a followup, your bank group has been supportive recently, right, with the borrowing base redetermination, for example. Is that—should we see that as an indicator of the banks could be supportive too if you do need some temporary flexibility down the line?

**Julian Bott**

Well, I mean—look, we have a 26-plus bank group and we have very good relationships with all of them. We value them greatly and they have been very supportive. Clearly, they come under their own pressures from management and regulators, but I think we are favorable working with them. They extended the maturity by 12 months at the last borrowing base redetermination. And, yes, we believe we have a very good working relationship with them, and they are supportive.

**Karl Blunden**

That is helpful. Thanks very much.

**Operator**

This concludes our question-and-answer session. I would like to turn the conference back over to Bill Way for any closing remarks.

**CONCLUSION****Bill Way**

Thank you, Drew.

Thank you all for your questions and the dialog. Let it be clear, we realize that it is a tough market out there, but we are very confident that Southwestern Energy is positioned to manage through this market and any challenges that lie ahead. We have got an exceptionally highly talented team of people across the country committed to innovating and executing and delivering on our plans. And as you can see in this quarter and multiple quarters previous to this, they continue to deliver and continue to outperform. So, we look forward to sharing more progress on our plans in the coming calls and we thank you for joining us today. Have a good weekend.

**Operator**

The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.