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Sitio Royalties Corp. NYSE:STR

Earnings Call

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Call Participants

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CFO & Principal Accounting Officer

Christopher L. Conoscenti
CEO & Director

Jarret J. Marcoux
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ANALYSTS

Derrick Whitfield

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Presentation

Operator

Ladies and gentlemen, thank you for attending today's Sitio Royalties First Quarter 2025 Earnings Call. My name is Eda, and I will be your operator today. [Operator Instructions] I would now like to pass the conference over to our host, Alyssa Stephens, Vice President of Investor Relations. Please go ahead.

Alyssa Stephens
Vice President of Investor Relations

Thanks, operator. Good morning, and welcome to our first quarter 2025 conference call. By now, it is our hope that you've been through our materials. You can find our recent news release and some supplemental slides on our website under the Investor Relations section. I'm joined this morning by our CEO, Chris Conoscenti, and our CFO, Carrie Osicka. After our brief prepared remarks, Chris, Carrie, and other members of our leadership team will be available to take your questions.

Before we start, I would like to remind you that our discussion today may contain forward-looking statements and non-GAAP measures. Please refer to our earnings release, investor presentation, and publicly filed documents for additional information regarding such forward-looking statements and non-GAAP measures. I will now turn the call over to Carrie to review our first quarter results.

Carrie L. Osicka
CFO & Principal Accounting Officer

Thanks, Alyssa, and welcome, everyone. First, I'll touch briefly on the new reporting format we rolled out this quarter. On April 15, we issued our inaugural quarterly preview featuring key operational and financial metrics are available shortly after quarter end, prior to availability of full financials, metrics such as production, net wells turned in line, net line of sight wells, acquisition activity, and share buyback activity. Our aim is to accelerate the market's access to this data and enhance visibility to our results each quarter.

Moving now to our results. The first quarter of 2025 marked another record quarter of production for Sitio, supported by robust drilling and completion activity across our properties. Net wells turned in line were up 34% from 4Q 2024, with the majority of the increase coming from the Delaware Basin. In addition, we closed on over $20 million of acquisitions that added 1,350 net royalty acres. Total production was up 3% quarter-over-quarter, averaging over 42,000 BOE per day.

Adjusted EBITDA was $142 million, which was 1% higher than the prior quarter and reflected strong production as well as expenses in line with or better than the midpoint of our full year guidance ranges. Net income of $26 million was up 36% over the same time period. From production down to net income, our first quarter results beat consensus estimates. Based on these results, our Board declared a first quarter cash dividend of $0.35 per share payable on May 30. And during the first quarter, we repurchased 1.1 million shares for $22 million, equating to $0.15 per share in repurchases. In total, this represents a return of capital of $0.50 per share for the first quarter.

Effective May 7, our Board extended our buyback plan and authorized an additional $300 million of share repurchases. Through May 2, in the second quarter, we bought back approximately 487,000 additional shares for $8 million, bringing current remaining buyback capacity to approximately $350 million.

Turning now to the balance sheet. We had $1.1 billion of debt outstanding with $439 million of availability under our revolving credit facility as of March 31. Holding net debt flat quarter-over-quarter, we used our organic cash flow to fund over $20 million of accretive acquisitions, plus pay annual expenses such as ad valorem and federal taxes. As of March 31, our adjusted net debt to free cash flow was approximately half of our peer group average. Lastly, we are updating our full year 2025 estimated cash taxes guidance to reflect lower anticipated commodity prices than originally forecasted. At the midpoint, current estimated cash taxes for 2025 are $23 million, $5 million less than the original estimate.

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With that, I'll hand the call to Chris to discuss our current positioning and future outlook.

Christopher L. Conoscenti
CEO & Director

Thanks, Carrie, and good morning, everyone. We're pleased with our solid momentum exiting the first quarter and Sitio's positioning in the current market environment. With all eyes on actions from Washington and OPEC, and uncertainty the only constant over the last month, I wanted to spend a few minutes highlighting the unique advantages of minerals and royalties as an asset class and Sitio's business specifically. Within the oil and gas value chain, minerals and royalties assets represent the highest margin investment opportunity. With the exception of gathering and transportation costs on some but not all of our leases, our interests are non-cost bearing. Minerals and royalty assets have no direct operating costs or obligatory capital spending and thus no exposure to fluctuating oilfield services costs or raw material costs, and importantly, have no direct exposure to tariffs and act as a natural hedge to inflation.

Based on Sitio's lean cost structure, LTM adjusted EBITDA margins were 90%. Referencing Slide 6 of our supplemental earnings presentation, I'd note that based on consensus estimates, 2025 free cash flow margins on a per unit of production basis are more than 3x that of the average E&P peer. As such, our business looks materially different in a downside price environment as compared to E&P companies. Even at much lower commodity prices and slow development pace, we continue to generate meaningful free cash flow. Following the much more dramatic downturn in 2020, we paid down our debt and emerged well-positioned to capitalize on the M&A opportunities that followed in 2021 and 2022 rebound.

On Slide 7, we reference 10-year cumulative free cash flow to enterprise value as estimated by Texas Capital Equity Research for their oil and gas coverage universe. I'll note that in a $50 crude and $2.25 natural gas environment, the minerals peer group is still estimated to return over 90% of current enterprise value in 10 years, while the next best performing group, the Bellwether Oil Group, is estimated to return less than 50% of the current enterprise value in 10 years. The band of outcomes for minerals businesses is much tighter. That is just one perspective on the forward outlook. Actual historical results are just as impressive.

In less than 3 years as a public company, Sitio has returned over 35% of our current equity value to shareholders, and we still have over a decade of drilling inventory remaining just in areas that are being economically developed today. In many ways, our business is like that of a financial asset manager, in our case, managing a diverse portfolio of perpetual real assets. Portfolio construction remains top of mind for us, and we've been intentional about how we've grown our position over time. Underwriting superior rates of return is the North Star that guides our portfolio construction priorities.

Priority #1 is asset quality. Highest quality assets will be the last to see rigs and frac crews drop in lower commodity price environments. Our near-term line-of-sight well count fluctuates quarter-to-quarter, but the average has remained consistent since closing of the Brigham merger in late 2022. This quarter, line-of-sight wells were up 8% sequentially to 48.6 net wells, indicating that our assets offer compelling drilling economics and continue to be prioritized for development by our operators. From an asset duration standpoint, we are a derivative of the inventory positions of our operators who are amongst the surviving consolidators with the greatest depth of inventory in the Permian. These operators continue to have success delineating these additional targets.

Based on 2024 operator drilling activity, including continued success across the Midland Basin in the Lower Wolfcamp and further delineation of the Upper Bone Spring benches in the Northern Delaware Basin, we have increased our inventory estimate by 40 additional net normalized locations. This represents a 10% quarter-over-quarter increase in net normalized inventory and equates to a little more than a year of drilling at current average drilling pace. As a reminder, we did not underwrite any of these locations when we acquired these assets. This is another demonstration of the unrecognized value in our asset base.

Priority #2 is operator quality. We have intentionally built our position around the most active, most efficient and well-capitalized operators. The majority of our future drilling activity will be performed by companies like Exxon, Chevron, Conoco and Oxy. These companies are not highly sensitive to a 10% to 15% move in crude prices and have historically had some of the most durable and consistent capital

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programs. And priority #3 is asset and operator diversity. We have an average net royalty interest of less than 1% across nearly 50,000 wells in 5 basins. No single operator represents more than 10% of our line-of-sight wells, and we have balanced basin and commodity exposure. Our LTM production was comprised of approximately 48% crude, 29% natural gas and 23% NGLs.

These 3 priorities: asset quality, operator strength and asset and operator diversification underpin our acquisition underwriting in pursuit of the highest possible rates of return we can achieve with our shareholders' money.

Minerals and royalties are highly fragmented generational assets, and we are in the early stages of consolidation. We are constantly evaluating consolidation opportunities of all sizes and across multiple regions. Our goal is to maximize our risk-adjusted rate of return every time we allocate capital. Since becoming public, through operator drilling as well as acquisitions, we've grown production per debt-adjusted share by more than 56%, representing a 17% compounded annual growth rate. In our view, this is one of the best metrics for our report card and evidences our discipline and the sustainability of our model. We could have very easily built much more scale by paying more for properties that were ultimately bought by others, but our per share metrics would not be as compelling as they are today.

We've been consistently active in the M&A market every quarter since inception and deal flow remains robust even as oil prices have pulled back recently. As we allocate capital, we compare acquisition opportunities to the intrinsic value of our own stock. Our buyback program has given us the opportunity to repurchase our shares and increase our remaining shareholders' interest in Sitio's high-quality assets. Through our buyback program, we have repurchased over 4% of our stock over the last 14 months. As Carrie noted, our Board has authorized an additional $300 million of share repurchases. We have continued repurchasing shares throughout the last month, capitalizing on the market volatility, bringing our total remaining buyback capacity to $350 million. You can count on us to continue to be prudent stewards of your capital as we evaluate uses for cash flow in this environment.

In closing, we are optimistic about the quality of our assets and their ability to compete for operator capital in any commodity price environment, the consolidation opportunities ahead of us and the platform we've built to manage our growing portfolio.
Operator, we are now ready to take questions.

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Question and Answer

Operator

[Operator Instructions] We now have our first question from Derrick Whitfield from Texas Capital.

Derrick Whitfield

Congrats on a strong quarter across the Board. For my first question, I wanted to focus on the resiliency of your business and your more immediate outlook. Referencing Slides 8 and 9, you're arguably in as good of a situation as you have been over the last 2 years. Other than another leg down in price and the curtailment of completion activity, is it safe to assume you feel relatively good about your production trajectory for the next 2 quarters?

Christopher L. Conoscenti
CEO & Director

Yes. The bulk of 2025 is really underpinned by existing producing wells and wells that have been spud. And so, there's typically not a lot of risk to wells that have been spud. There's the extreme case where people will drill wells and not complete them. We haven't seen that sort of behavior yet. We're very early into this, whatever you want to call it, this reaction or environment that we're in right now, but we have not seen people not complete wells that they have drilled.

Derrick Whitfield

And then with regard to your share repurchase program, how would you compare the value of buying your stock versus the value of M&A opportunities that you're seeing in the market today?

Christopher L. Conoscenti
CEO & Director

Yes. There's a good balance of both. I'd say it's a tremendous opportunity in our stock, and we're very excited to have the buyback program and the increased authorization from our Board. The M&A environment, we remain active there and we do see opportunities. It's a little different than prior cycles. You look at 2020 and, in that environment, the M&A environment completely seized up and nobody wanted to transact because it was such a rapid deterioration in commodity prices. The difference between now and then though, we're 5 years on in this journey towards basin-wide development and there's less mystery in the minds of mineral owners about how and when their assets will get developed. There's been a tremendous amount of development since 2020, and so the underwriting is less opaque than it was 5 years ago. I think that helps to give people confidence that whatever environment they're in, they're getting a fair look at valuation on an M&A basis.

When it comes to our stock, it's a really unique value proposition for a number of reasons, but like if you were to go to your commodities derivatives desk there at your bank and ask for a 30- or 40-year call option on oil or natural gas, it just doesn't exist. There's no other way in this kind of high-margin business to get that sort of call option on the long-term demand fundamentals for oil and natural gas and we provide that opportunity and our stock presents that opportunity and we see a really compelling valuation here to buy that call option by repurchasing our stock. Even if you could get that kind of call option, you wouldn't get a yield on it. Our return of capital yield today is 11.5%, so there's a lot of things that are really compelling about the buyback.

Derrick Whitfield

And one more, Chris. So, Diamondback provided a less constructive outlook for the sector earlier this week, highlighting their expectation for severe contraction or more severe contraction based on prices and geologic headwinds. Do you guys perform look-backs on your past acquisitions? Are you sensing any material change in the productivity of wells relative to underwritten assumptions?

Christopher L. Conoscenti

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CEO & Director

Yeah, we do these look-backs, although I have Jarret comment a bit on well performance, but one of the comments I'll make just about the operator comments that we've heard so far in this earnings cycle, well first of all we're not completely through the earnings cycle, but one of the things we've heard is people reducing capital or reducing operating costs but either increasing the number of wells turned in line or not reducing production guidance. So, there's a bit of a mix in terms of how different operators are approaching their capital discipline and the impacts on the production profiles, but the one cautionary note I would give you is don't bet against U.S. E&P companies to continue to innovate and to drive capital efficiency. It's happened time and again and we're very excited to be leasing our minerals to the best operators in this business. But, Jarret, I'll turn it to you to comment on any well performance.

Jarret J. Marcoux
Executive Vice President of Operations

Sure, Derrick, I saw the same comment as you that made on the geologic headwinds. One thing that we think about internally is number one, we're not the operator and number two we're looking backward at the things that have happened and have been achieved. When we look at the projections on our asset on a go-forward basis, we're taking into account already the current geologic facts that are out there and what horizons are being drilled. So, we take a very granular approach to our forecasts. So, we're not thinking about, and we're not baking in future improvements. We're looking at what has already been achieved and what is already being drilled. So, when we think about go-forward, we're really not baking in any future efficiency improvements. So, we feel good about our future projections based on that fact.

Operator

Our next question comes from Jarrod Giroue from Stephens.

Jarrod Cole Giroue
Stephens Inc., Research Division

So, my first question relates to 1Q production and the 25-production guide. 1Q production was above the high-end of guidance, yet full-year guide was unchanged, implying declining volumes throughout the year. First, is declining volumes throughout the year the correct way to look at it? And second, based on operators' earnings calls this quarter and what you're hearing in the market, is the unchanged guidance baking in some slowdown from operators?

Christopher L. Conoscenti
CEO & Director

Thanks, Jarrod. Appreciate the questions. First of all, just on first quarter, we're thrilled with how production came in the first quarter, exceeded our guidance and consensus. Last year we revisited our guidance after the second quarter, and I would expect us to do the same thing here. Again, we're 6 weeks into this commodity price environment, so it's a little reactionary to be making any drastic changes at this point. Again, there's no real data in terms of spuds or permits or wealth turned in line just yet. We'll have a lot more data in a few months, and we can make the call at that point about what's appropriate to do with guidance, but we feel really happy to have a solid foundation from the first quarter.

Jarrod Cole Giroue
Stephens Inc., Research Division

And then my second one is just kind of back to share repurchases. So, 1Q repurchases increased to 20% of discretionary cash flow compared to 11 in 4Q. Do you expect this trend of a higher percentage of share repurchases to continue with volatility on commodities, putting pressure on stock prices?

Christopher L. Conoscenti
CEO & Director

Yeah, it's a good question. Our buyback program is designed to take advantage of price dislocations, so we tend to get more aggressive on the buyback at lower prices. The data has shown that companies with

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buyback programs are more successful when they're in the market sort of through the cycle, but having a steep buyback grid, meaning you buy back more at lower prices, is an important component of ours, and you saw that in full display where we bought back nearly half a million shares in the month of April compared to just over a million shares in the entire first quarter. So, yeah, that's a good observation and good expectation.

Jarrod Cole Giroue
Stephens Inc., Research Division

Congrats on the strong quarter.

Operator

Next question comes from Tim Rezvan from KeyBanc Capital Markets.

Timothy A. Rezvan
KeyBanc Capital Markets Inc., Research Division

One was already just asked. So I just have one for you. Can you give a little more context on this inventory increase of 40 net locations? Is this just a new zone that you're seeing success in? Is this a spacing assumption? Just trying to kind of wrap my head around what exactly you saw to report that.

A. Dax McDavid
Executive Vice President of Corporate Development

Tim, thanks for the question. This is Dax. Yes, we're excited to add those net inventory locations this quarter. That was pretty much split 50-50 between the Delaware and the Midland Basin. So throughout the year, our technical teams have a process where we look at geologic prospectivity, operator activity, and well results. And in these cases, it was very easy to make these adds. This was in Midland, for example, an expansion of the Lower Wolfcamp, Wolfcamp D formation, where we've seen a lot of great well results by great operators like Exxon, Diamondback, and Oxy.

But on the Delaware side, as Chris mentioned, it was an increase to the Northern Delaware, specifically in the Bone Spring sections. And these are under operators like Permian Resources, Conoco, Devon and Mewbourne. And we were happy to see recently this quarter that Permian Resources made the acquisition of Apache up there for $600 million, and it kind of doubled down on our thoughts on that area. So yes, a great add for us. And it shows that the Permian is constantly giving on inventory. And it also speaks to the advantaged asset class that we think minerals are.

In most cases, minerals are owned from the surface of the earth to the center of the earth, and a lot of our minerals are owned that way. And it just speaks to the optionality we have on the geologic column. And as Chris mentioned, many of these zones or several these zones were not underwritten to begin with. So it's just -- it's gravy really to our valuation.

Operator

Next question comes from Noel Parks from Tuohy Brothers Investment.

Noel Augustus Parks
Tuohy Brothers Investment Research, Inc.

Sort of using your unique insights from just being involved with so many operators. I'm just wondering, I know it's early days yet, but you mentioned the different strategies operators are undertaking at this stage in the cycle. Some are slowing down activity, some not so much, some are sort of changing what they're doing with their tools or their DUCs. But are you sensing any pattern as far as strategies for managing their base decline? I have heard some companies where it sounds kind of like they're kicking the can into next year. So lower drill bit activity, lower CapEx this year, but it seems pretty clear that they're going to have to intensify activity, maybe next year or the year after. And I don't know if that kind of carries the embedded assumption that this oil downturn is going to be sort of short-term, but do you have any observations on that?

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Christopher L. Conoscenti
CEO & Director

Noel, thanks for the question. Yes, I think what you're pointing out is that, ultimately, over some time period, the self-correcting nature of this industry. So low prices tend to cause a reduction in activity, which causes a reduction in supply, which causes an increase in prices. And we're seeing that play out here with operators curtailing CapEx. But as I pointed out, you've seen Oxy cut CapEx, but increase the number of wells they plan to bring online. You've seen Conoco announce cutting CapEx, but maintaining their production guidance. And then you've seen other different approaches from some smaller operators. So I think it's just going to be very operator-specific in how they approach it. But regardless that you're not seeing anybody grow at any measure in this point in the cycle and demand is continuing to grow. So ultimately, those 2 things are going to have to correct where you have increasing demand and no increase in supply from the Lower 48. So we're bullish about the long-term outlook.

And again, as I said, these are -- our assets are a multi-decade call on oil and natural gas. Of course, we're impacted by the near-term, but we own these assets forever. They're perpetual assets. And so for us, we're going to own these assets a year from now, 5 years from now, and 2 decades from now. So we're going to benefit as and when the cycle adjusts.

Noel Augustus Parks
Tuohy Brothers Investment Research, Inc.

And I was wondering, again, trying to sort of think about ripple effects from sort of this turn in the cycle. And as far as A&D, I'm wondering, is this a point where perhaps, to the degree you might have things that you'd be inclined to sell? Is this a point where maybe an operator would be more willing to pay a premium to sort of buy in mineral royalty interest just because of the way it can sort of juice their returns, sort of using the same logic that you used as far as just the strength of returns of the model?

Christopher L. Conoscenti
CEO & Director

Yes, it's a good question because it's to me, surprising that more operators don't have a very defined and front-footed mineral strategy, just given what it can do for their business, both from a margin standpoint and strategically. So you point out something that's a bit of an anomaly in the space, but I think the point in the cycle we're at right now, I think operators are going to be very cautious around capital discipline. And I think they're going to be preserving whatever capital that they can for their drilling opportunities instead of deploying it on minerals at this point.

Operator
[Operator Instructions] There are no questions waiting at this time. This concludes today's call. Thank you for joining. You may now disconnect your lines.

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