Kimmeridge

IEA-IEF-OPEC Workshop

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About Us

- Founded in 2012, Kimmeridge is a private investment firm based in New York and Denver focused on the development of low-cost unconventional oil and gas assets.
- In April 2020 we launched a strategy to invest in the public E&P sector with the goal of preparing companies for the energy transition and reversing a decade of underperformance.
- Through 2020 Kimmeridge published a series of white papers outlining what we refer to as the "three pillars of reform":

February 2020
Preparing the E&P Sector for the Energy Transition: A New Business Model (link)
"The industry needs to embrace a new business model focused on lower reinvestment rates (70%), lower growth, lower costs, returns above the cost of capital and cash return to shareholders…."

September 2020
Charting a Path to Net Zero Emissions (link)
"The leading E&P companies of tomorrow will adopt a business model that is aligned with the energy transition through lower reinvestment rates while charting a path towards net zero emissions in their direct operations."

November 2020
Bringing Alignment & Accountability to the E&P Sector (link)
"The public E&P sector is broken, and the root cause of the problem is a lack of alignment between executives and shareholders. The misalignment that begins with skewed incentives and low insider ownership is compounded by boards who appear unwilling to hold management teams accountable."

The Growth Misnomer

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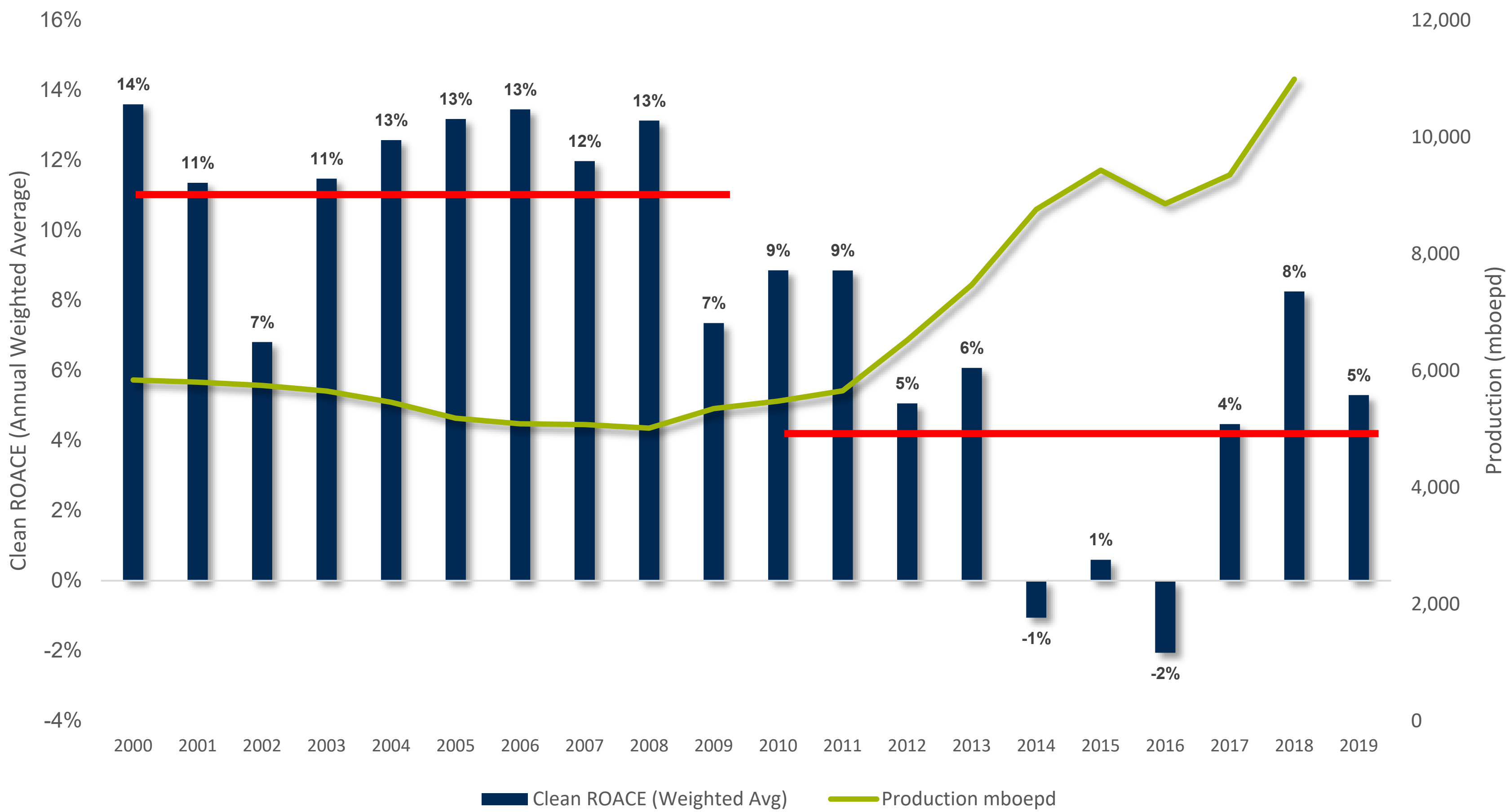
Investor sentiment eroded as E&Ps pursued growth at the expense of returns. From 2000-2009, US production slightly declined while clean ROACE averaged ~11.5%. From 2010-2019, production grew at an 8-9% CAGR and ROACE only averaged 4.4%*.



Source: Kimmeridge internal database including financial and operating results for approximately 80 publicly-listed US E&P companies (Kimmeridge Model). 2019 ROACE estimate is sourced from external data on a subset of 20 E&P companies with some overlap to the Kimmeridge Model. Additional details may be provided upon request..
*4Q2019 results have not been reported in full for the peer group.

The Industry's Reinvestment Problem

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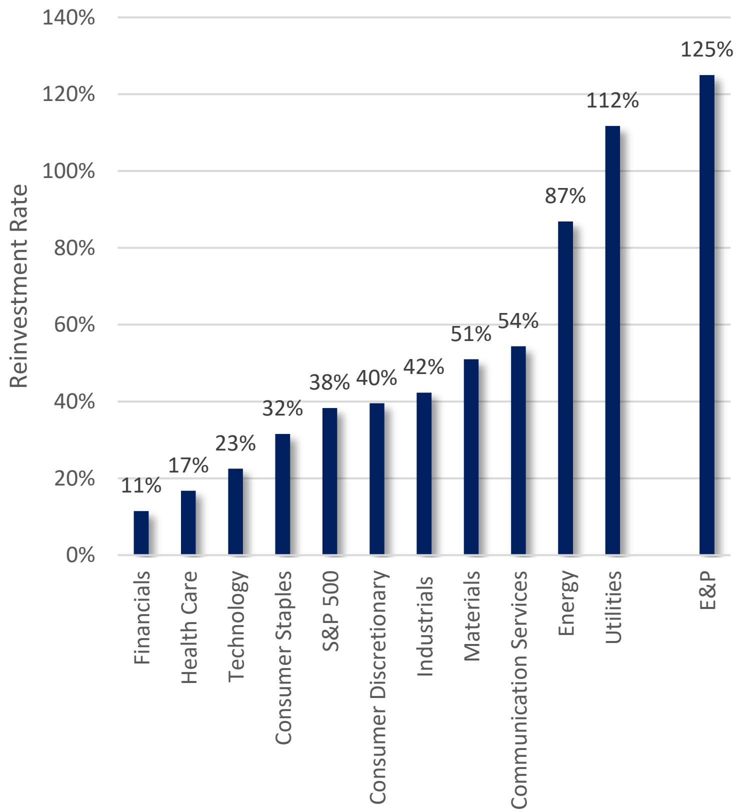
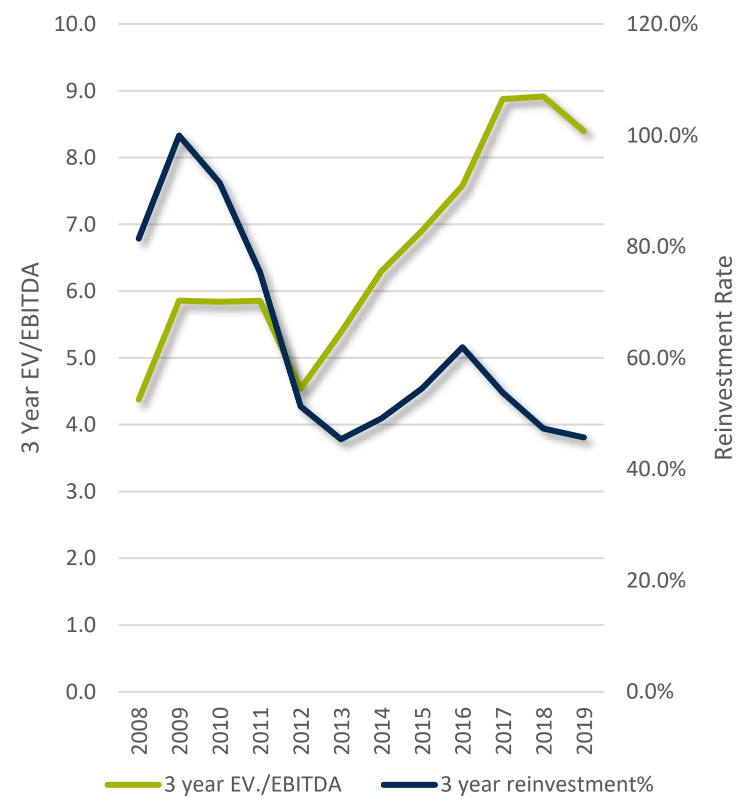
The average S&P 500 company reinvested 40% of their operating cash flow over the past 10 years while the E&P sub-sector has reinvested 125% of cash flow. A reduction in the reinvestment rate within the Refining & Marketing (R&M) sector coincided with multiple expansion over the past decade.

Reinvestment Rates 2010-2019 (Capex/OCF)



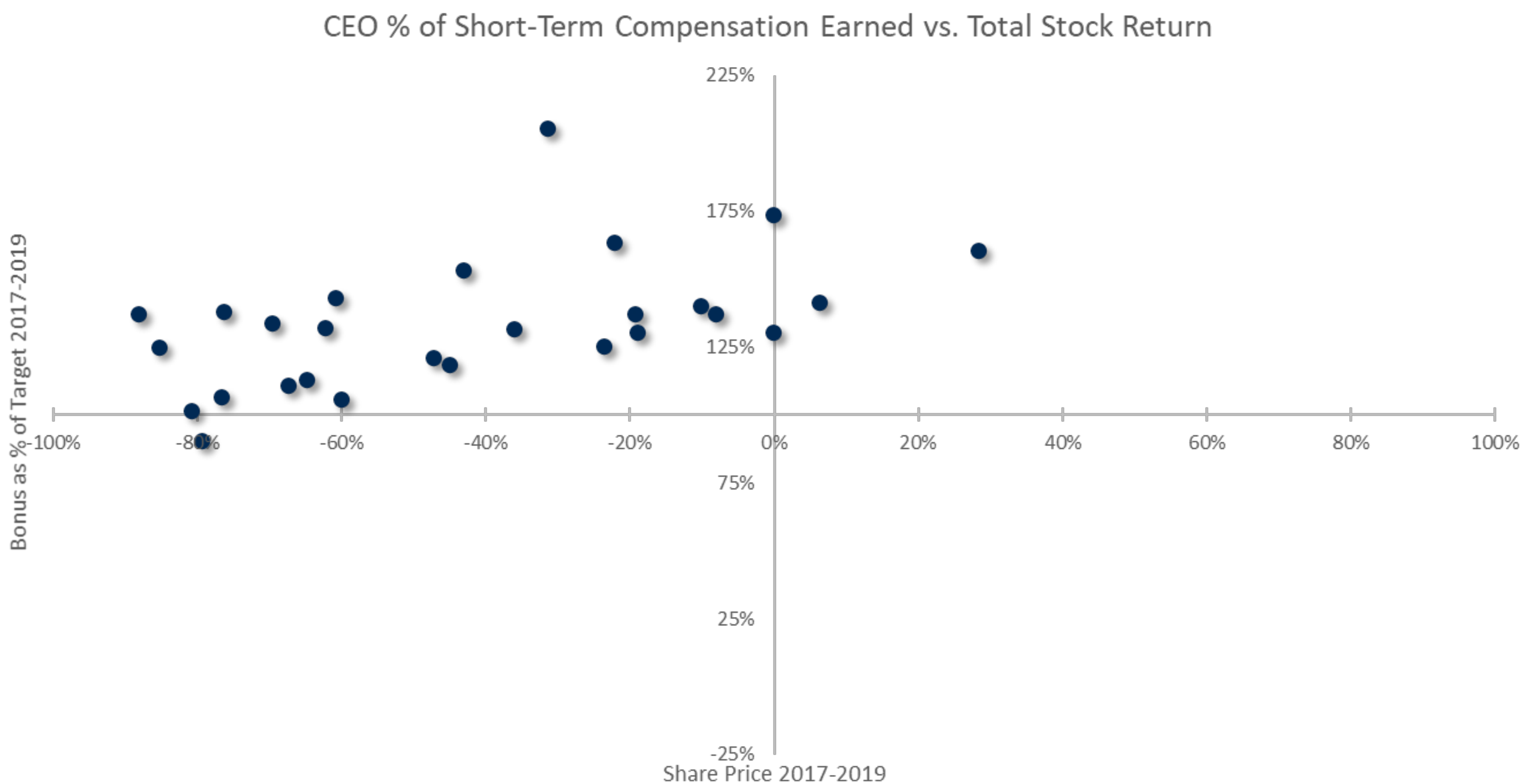
R&M Reinvestment vs. EV/EBITDA Multiple



Source: Bloomberg; publicly available S&P 500 constituent data and GICs level classifications calculated using historical index composition in each year. Results could differ if calculated over different time periods.

Misalignment of Incentives

The inability of E&P companies to control costs and effectively reinvest capital is a result of misalignment between C-suites, boards and the providers of equity capital. Management compensation has been tied to operational targets and relative performance, undermining the importance of absolute performance.

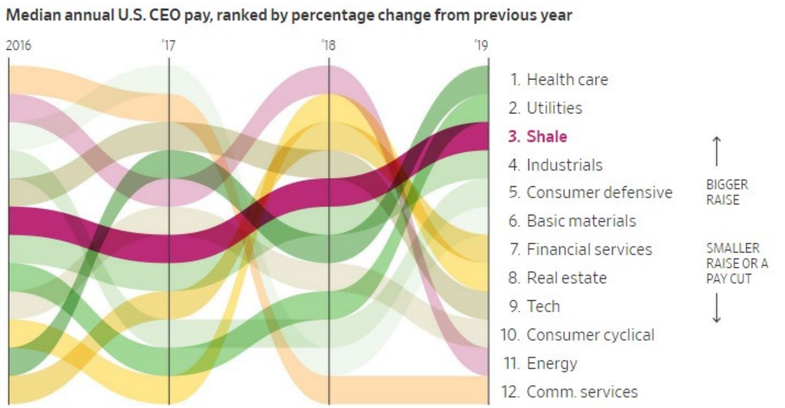


Source: Company Reports & Bloomberg

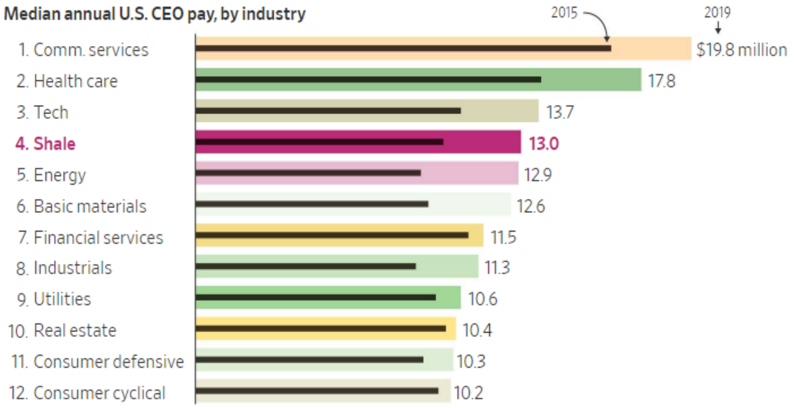
Misalignment of Incentives

As a result, management teams and CEOs continue to enjoy growing pay packages, irrespective of the value they destroy for shareholders.

Median CEO Pay, YoY



Median Annual CEO Pay



Source: WSJ

Investment Thesis: E&P 2.0

Kimmeridge believes that to make public E&Ps investable again, companies need to embrace a new business model reflecting the upcoming energy transition and a world of limited demand growth. The playbook has been proven in other low-growth industries such as refining and tobacco.

E&P 2.0 needs to:

- Develop a business model based off 70% reinvestment rates at mid-cycle oil prices
- Return cash to shareholders through sustainable dividends (100% of EV in 10 years)
- Lower SG&A to 5-10% of EBITDA
- Focus on growing scale through combinations to allow for further cost reductions with savings flowing to investors
- Align management compensation with total shareholder returns

Only those with scale in the core of the best plays will be investable.

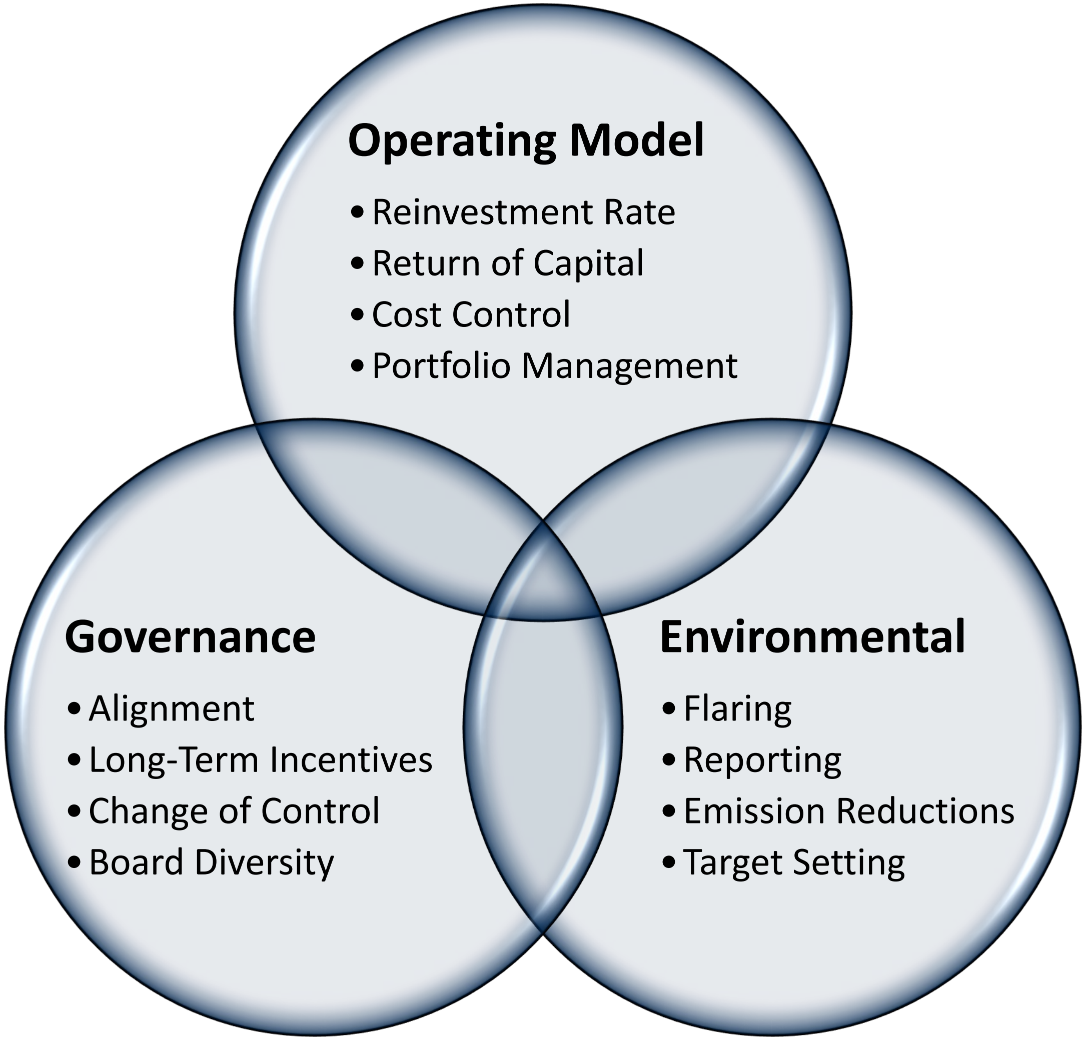
Investment Philosophy

Multiple expansion in energy will be driven by demonstrating to investors that the sector can be profitable, generate a return on capital and return cash to shareholders on a sustainable basis.

While correcting the operating model is critical, it is not possible without correcting an inherent misalignment of interest and poor corporate governance.

The energy sector is also a poor environmental performer and investors are not going to allocate capital to carbon intensive industries without emission reduction targets that align with the Paris Agreement.

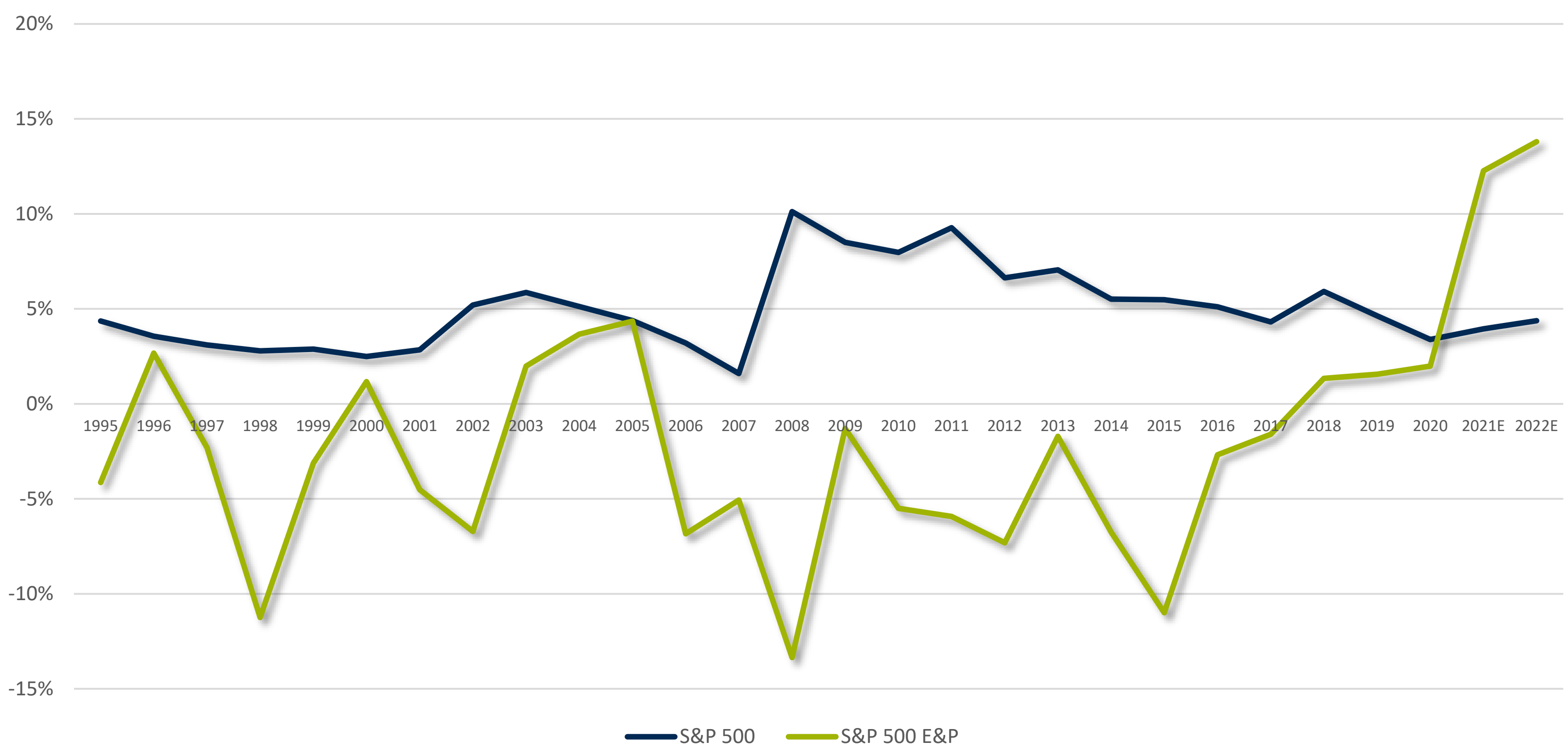
We believe outsized returns can be generated by repositioning out-of-favor companies through addressing their deficiencies in these three areas.



Investor Skepticism Remains High

Based on consensus estimates for 2021-2022 reinvestment rates for the E&P sector will be <50% after a decade of averaging 130%. The implied free cash flow yield is over 3x the market. The degree of investor skepticism is high.

Free Cash Flow Yield (1995-2022E)

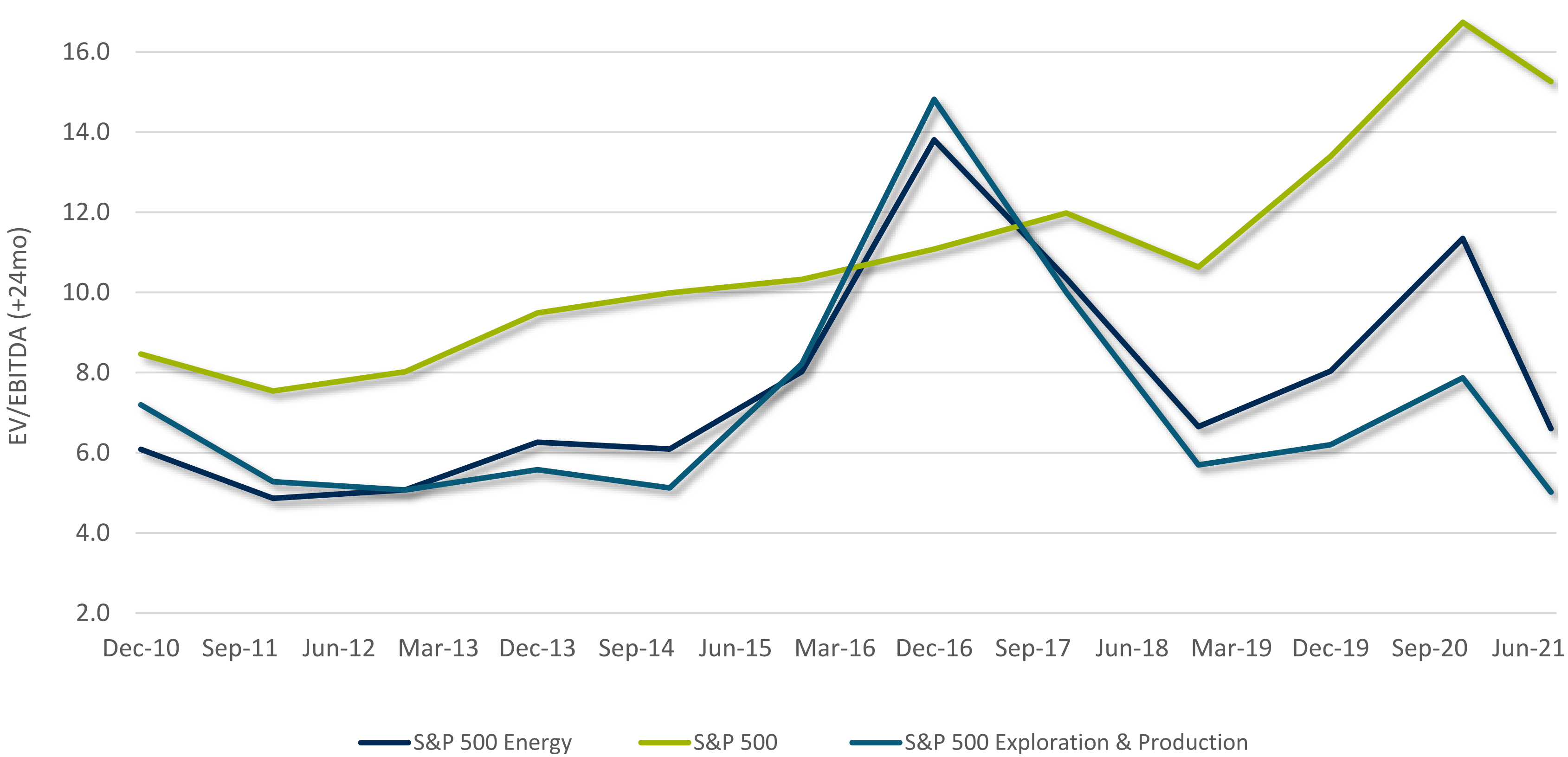


Bloomberg historical data and consensus estimates for S&P 500 Index and S&P 500 Exploration & Production (GICS 4) as of 8/23/21

Investor Skepticism Remains High

Despite a recovery off the 2020 lows, energy sector valuations remain dislocated from the broader market at record wides.

EV/EBITDA Multiples



Bloomberg consensus estimates for S&P 500 Index, S&P 500 Energy (GICS 1) and S&P 500 Exploration & Production (GICS 4) as of 8/31/21

Sector Reform: Consolidation Through Low Premium Mergers

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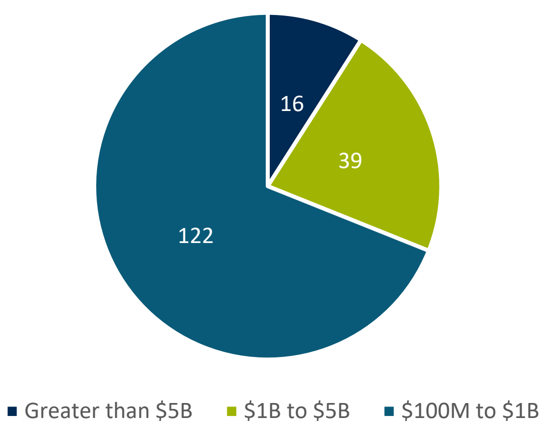
Chevron Corporation to acquire Noble Energy
$14,081,490,000
Unaffected Premium: 12%

WPX Energy merger of equals with Devon Energy
$5,990,000
Unaffected Premium: 2.50%

ConocoPhillips to acquire Concho Resources
$13,000,000,000
Unaffected Premium: 15%

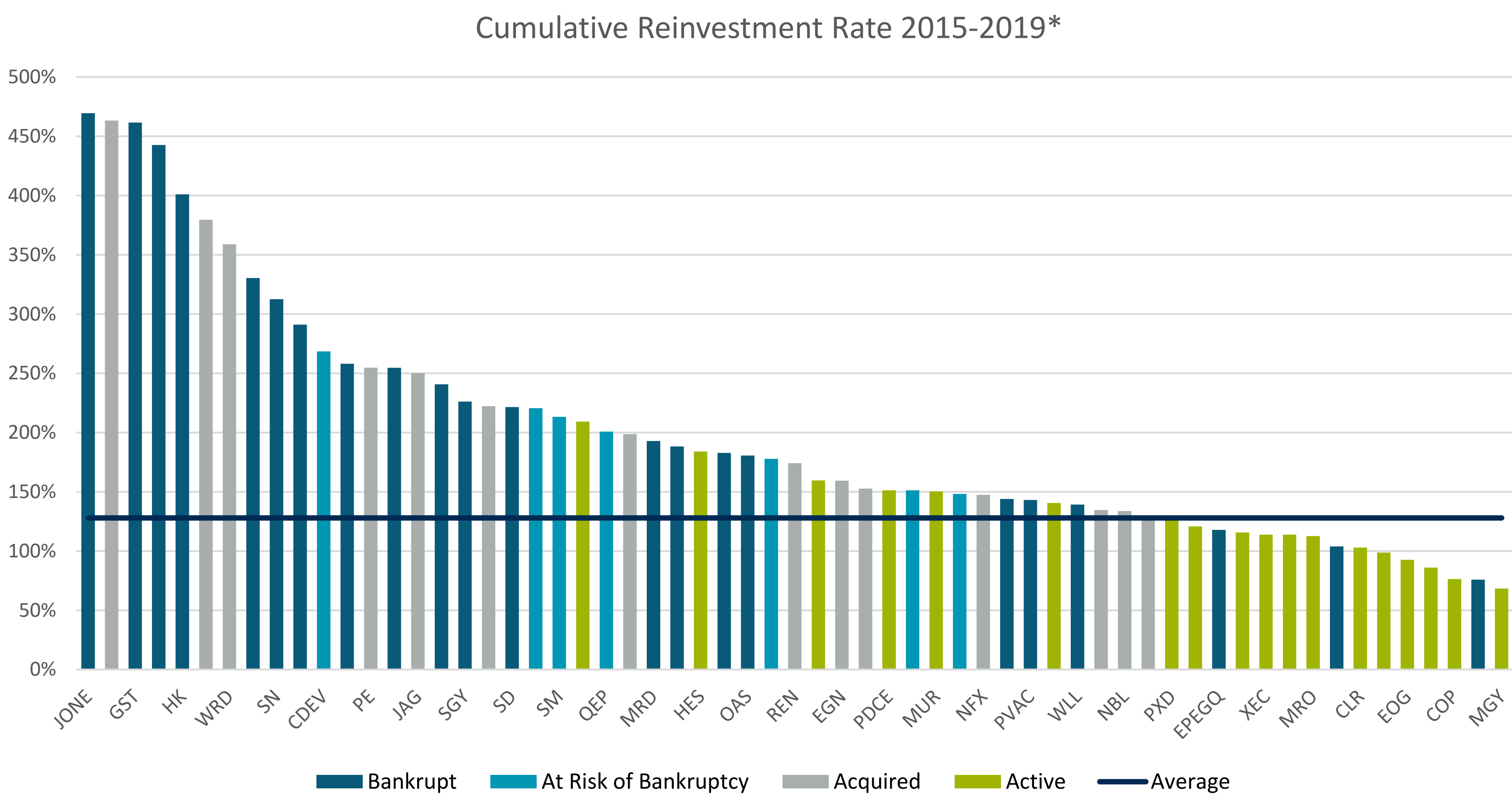
Pioneer Natural Resources Company to acquire Parsley Energy
$7,600,000,000
Unaffected Premium: 7.9%

of Companies*



Publicly-traded companies with equity market capitalization of $100 million or more
Source: S&P Cap IQ as of 10/21/20, Kirkland & Ellis

Sector Reform: Industry Structure

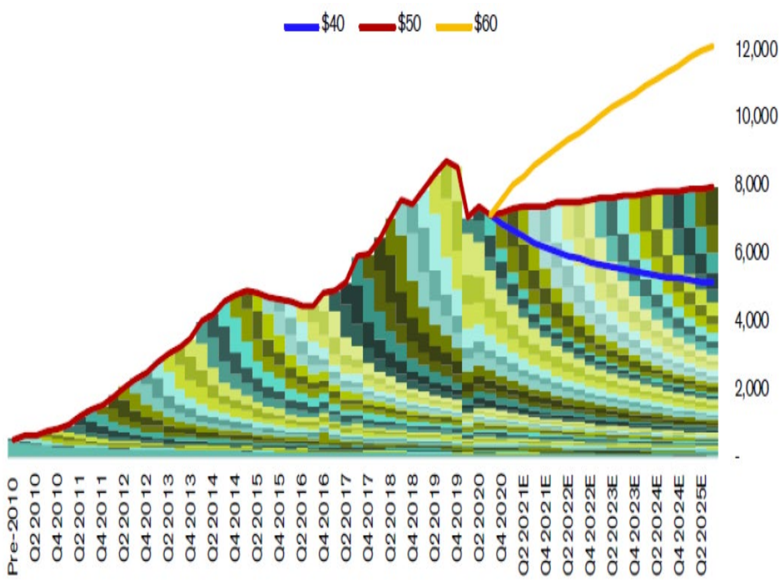


Source: Bloomberg and Kimmeridge internal analysis as of September 2020. Reinvestment rate is calculated based on cash flow from operations divided by net cash used in investing activities. The list of companies included in the above chart is not exhaustive. At risk of bankruptcy data from Kimmeridge internal analysis and projections as well as reported production volumes. There is no guarantee that these companies will enter bankruptcy.

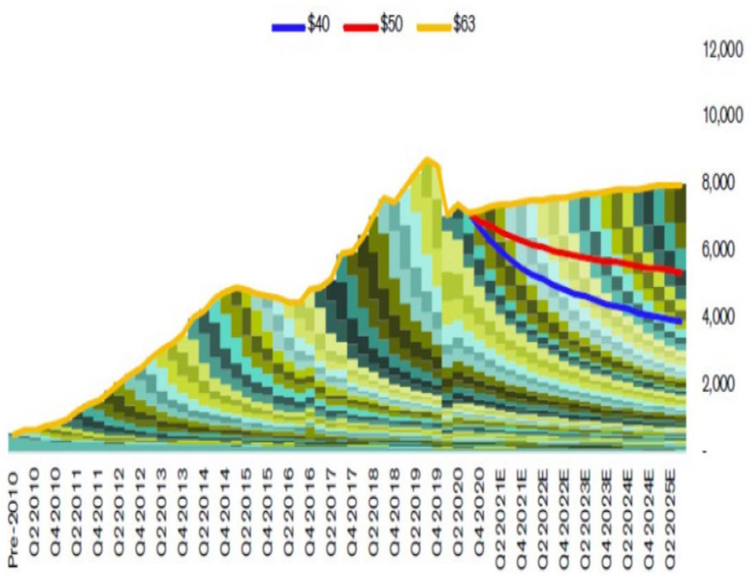
Sector Reform: Rising Marginal Cost

Lowering the reinvestment rate for the US shale industry from 100% to 70% increases the oil price required to maintain production from $50 to $63/bbl.

Shale Production at 100% Reinvestment



Shale Production at 70% Reinvestment



Source: Bernstein

Sector Reform: Executive Compensation

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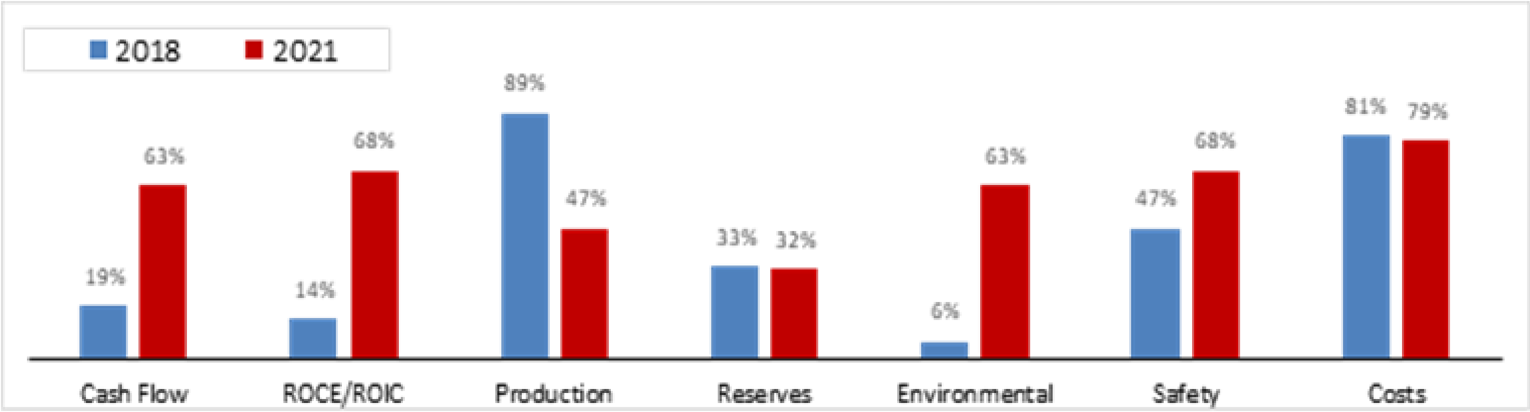
Annual Incentive Metric Prevalence



Source: Meridian Energy Insights Post # 69 - E&P Short-Term Incentive Design Reflects Changing Priorities

Disclosures

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