MANAGEMENT SERIES REPORT

EVOLUTION PETROLEUM | EQUITY RESEARCH

WATER TOWER RESEARCH

EVOLUTION PETROLEUM (NYSE: EPM)

Acquisitions Support Dividend Visibility

May 9, 2022
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KEY POINTS

- We hosted a fireside chat on April 20, 2022, with Jason Brown and Ryan Stash of Evolution Petroleum. Jason is Evolution's President and CEO, while Ryan is Evolution's Senior Vice President, CFO, and Treasurer.
- In April 2022, Evolution closed an acquisition of non-operated working interests in the Jonah Field, which is in Sublette County in southwest Wyoming, for a purchase price of $27.5 million, before closing adjustments. The transaction added approximately 38 Bcfe of long-lived proved developed producing (PDP) reserves.
- In January 2022, the company closed an acquisition of non-operated working interests in the Williston Basin for a purchase price of $25.9 million, net of preliminary closing adjustments. The acquired interests are in Billings, Golden Valley, and McKenzie counties, North Dakota. The transaction added 2.2 MMBOE of long-lived PDP reserves.
- The Williston Basin acquisition also provides exposure to more than 400 gross development drilling locations. The development inventory provides management flexibility to allocate capital toward internal growth opportunities to augment the acquisition strategy.
- Both transactions provide visibility to support Evolution's dividend for years to come. At current pricing, management expects to quickly deleverage. The current leverage ratio is ~0.5x.
- Evolution will announce 3QFY22 earnings after the market close on Tuesday, May 10, 2022. A conference call is scheduled for Wednesday, May 11 at 2:00 PM ET. Investors can listen to the call live by dialing (888) 506-0062 and providing the access code of 596907. Information to access a recording of the call will be available under the Investors section of the company's website.

KEY STATISTICS

Price	$6.89
52-Week Range	$3.33-$8.17
Avg. Daily Vol. (30 day)	192,203
Shares Out (MM)	33.7
Market Cap (MM)	$232.1
Enterprise Value ($MM)	$222.5
Revenue TTM (MM)	$62.6
Annual Dividend/Yield	$0.40/5.8%
Fiscal Year End	June

Source: YCharts, *As of May 6, 2022

THE COMPANY

Evolution Petroleum Corporation is an oil and natural gas company focused on delivering a sustainable dividend yield to its shareholders through the ownership, management, and development of producing oil and natural gas properties onshore in the United States. The company's long-term goal is to build a diversified portfolio of oil and natural gas assets primarily through acquisition, while seeking opportunities to maintain and increase production through selective development, production enhancement, and other exploitation efforts on its properties.

Evolution's asset base consists of a diverse mix of producing assets across five operating areas. The company owns non-operated interests in the Barnett Shale in North Texas, Jonah Field in Wyoming's Green River Basin, Delhi Field, a CO_2 enhanced oil recovery project in northeast Louisiana, North Dakota's Williston Basin, and Hamilton Dome Field in Wyoming's Big Horn Basin. Evolution closed its latest property acquisition, non-operated properties in the Jonah Field, on April 1, 2022, for $27.5 million, before closing adjustments. The company's homepage is www.evolutionpetroleum.com.

ABOUT THE EXECUTIVES

Jason E. Brown
President and CEO
Evolution Petroleum

Jason E. Brown has served as the President and Chief Executive Officer for Evolution Petroleum since July 10, 2019. He has over 20 years of experience in the energy industry, primarily focused on upstream oil and gas operations, acquisitions, and value creation.

Before assuming his role at Evolution, he was the founder of LongBow Energy, a private upstream energy company. LongBow is a non-op producer which has interests in various wells across Texas and Louisiana and focuses on upstream value creation. He previously was a co-founder and officer of Halcon Resources, where he served as the VP of Corporate Development in charge of acquisitions and divestitures.

Earlier in his career, Jason was employed by RBC Richardson Barr as an Associate, focused on the business development and execution of sell-side engagements in the oil and gas space. Although his concentration at RBC was in acquisitions and divestitures, he passed both the Series 7 and Series 63 exams required by FINRA for investment bankers dealing in transactions. Prior to RBC, Jason was the Team Leader and Asset Manager of Petrohawk Energy for East Texas, Arkansas, and North Louisiana, where he was responsible for operations, reservoir, planning, and budgeting for the region.

Jason began his engineering career with the Williams Companies in Tulsa, Oklahoma, and is a licensed professional engineer in the discipline of Petroleum Engineering. He earned his BS degree in chemical engineering from the University of Tulsa, and his MBA from the Mendoza School of Business at the University of Notre Dame.

Ryan Stash
Senior Vice President, CFO, and Treasurer
Evolution Petroleum

Ryan Stash has served as the Senior Vice President, Chief Financial Officer, and Treasurer for Evolution Petroleum since November 18, 2020. He has over 20 years of experience in the oil and gas industry focused on capital raising, mergers and acquisitions, and accounting and financial reporting. Before joining Evolution, Mr. Stash served as Vice President and Chief Financial Officer of Harvest Oil & Gas Corporation from October 2018 to November 2020.

Prior to joining Harvest, he served as a managing director at Regions Securities focused on the energy sector. Before his time at Regions, Mr. Stash spent 11 years in the energy investment banking group for Wells Fargo Securities in Houston, rising to the level of director. He began his career as an auditor and spent five years working at Hewlett-Packard and Ernst & Young, LLP.

Mr Stash is a Certified Public Accountant in the State of Texas. He received an MBA, a Masters in Professional Accounting, and a Bachelor of Business Administration, all from the McCombs School of Business at the University of Texas at Austin.

EXECUTIVE DISCUSSION

Jeff Robertson: Good afternoon. Thank you for joining us today. I am Jeff Robertson, Managing Director of Natural Resources at Water Tower Research. We are pleased to host a fireside chat today with Jason Brown and Ryan Stash from Evolution Petroleum. Jason is Evolution's President and CEO. Ryan is the company's Senior Vice President, CFO, and Treasurer.

Before we get started, I need to mention that Jason and Ryan could make forward-looking statements during today's discussion. I would refer participants to the disclosure language in the company's most recent corporate presentation, which can be found under the Investors section of Evolution's website.

Evolution is a company that has closed several recent acquisitions that will have a significant impact on growth in fiscal (June 30 fiscal year-end) 2022 and 2023. Most recently, the company closed an acquisition of natural gas producing assets in the Jonah Field in Wyoming for a purchase price of $27.5 million on April 1.

Assets like the Jonah Field fit Evolution's model to a tee. This field was discovered and aggressively developed in the 1990s after a private company called McMurray Oil really cracked the code to unlock the gas potential in the basin. McMurray was subsequently acquired by a large independent, who aggressively developed the field. Jonah Energy, who operates the portion Evolution acquired, bought its interest in 2014. Jonah Energy continues to manage the harvesting phase of this historically prolific asset.

Jason, can you tell us about the background of the acquisition and what makes these types of assets appealing to Evolution?

Jason Brown: Well, first off, I wanted to say thank you again hosting us in this format and for your interest in our company. I have been meeting with investors on quite a few non-deal roadshows recently and was pleasantly surprised to run into a few of Water Tower's subscribers, who read the coverage from our first fireside chat in March. It is nice to see that the Water Tower brand has some reach and carries weight with investors. So, we are happy to participate in another discussion with you, Jeff.

With respect to Jonah, I am excited about this field. You could not have described it better. This asset looks like Evolution is a great fit for us. Jonah is a mature field in the long tail portion of its life. The field produces from the Lance Pool, which is a tight gas reservoir more than 3,000 feet thick. It was developed on very tight spacing, with portions drilled on 10-acre spacing units.

The producing reservoir is a very tight gas sandstone, which means it will produce for an exceedingly long time. The long-lived profile and shallow decline are attractive to us because they support future dividend payments.

Our asset base is built on long-lived producing assets that provide visible support for our dividend for the next five to 10 years, not just year one. Producing wells in Jonah are in the 8-10% annual decline rate. Our corporate decline rate is around 6%. So, Jonah fits nicely in our overall profile. We think Jonah's terminal decline will ultimately shallow to around 6%, making it a great fit for our company's model.

The field primarily produces natural gas. We ended up paying about $27 million for the asset, which produces ~13 MMcf/d (net) of gas plus some associated NGLs. One of the most attractive attributes is the natural gas differentials. The gas is sold to markets in the western US where there is not a lot of new infrastructure development. We believe the gas will sell at a premium to Henry Hub for at least the next several years, if not longer. Jonah provides some nice commodity and price-point diversity to our asset base, which we like.

Jeff Robertson: All the assets Evolution owns are non-operated interests. Jonah Energy is the operator of your assets in the Jonah Field. Jason, what makes you comfortable with Jonah as an operator in this field?

Jason Brown: Jonah Energy is a privately held company based in Denver, Colorado that was formed in 2014 to purchase the Jonah Field. Jonah's mission is to responsibly operate the field, concentrating on improving efficiency to manage the production profile, while emphasizing safety and environmental performance. Jonah Field is located on Federal lands and was developed under strict oversight by the Bureau of Land Management. We believe it is an excellent operator.

As I mentioned in our previous fireside chat, owners of non-operated working interests can get taken advantage of by certain operators who might cut corners in the field or overcharge their partners. Jonah Energy has a very solid reputation, particularly with regard to the environment. We conducted field and environmental inspections during our operating and financial diligence process. It looks, to us, like it runs a first-class operation.

Our operating agreement allows us to take our natural gas in kind. As a result, we have some control and freedom over where we market our gas, allowing to seek out the highest prices. We are excited to be partnering with Jonah Energy.

Jeff Robertson: Jason, you mentioned that Jonah's production natural decline rate is 8-10% at this point. Are there workovers and/or recompletion projects that can be executed to try to mitigate some of that decline?

Jason Brown: Certainly, though we do not anticipate any infill drilling. We bought the asset for the PDP roll off. However, commodity prices are remarkably high right now and with a 3,000-foot-thick reservoir, there may be some workover projects to pursue. Well workovers could include re-stimulations, cleanouts, downhole equipment change outs, and other projects that enhance production. Those types of projects might not have made economic sense a few years ago when prices were lower. We should note that we anticipate a very minimal capital program at Jonah.

Over time, we have reinvested an average of 14% of our EBITDAX into our asset base to maintain production. The Jonah reinvestment program will be below that level of the field's cash flow. The field is fully developed so we do not expect production growth, just maintenance.

Jeff Robertson: Do Jonah Field or other Green River Basin fields have fragmented ownership that could become consolidation opportunities fitting Evolution's model?

Jason Brown: There could be some opportunities. In Jonah, there are sections of the field held by different owners and interests. Jonah Energy is the dominant operator in the field. We might be interested in some of the other non-operated field interests if their owners decide to let any of those assets go. We are also looking at two or three deals in that area.

We have woken up to the idea that there are fewer buyers chasing down non-operated interests in parts of the Rocky Mountains. Interest is still extremely high for Permian Basin assets. The high Permian interest level is driving values up, in our view.

Evolution tries to be agile when we evaluate acquisitions. We can look for non-operated assets that suit our strategy in a variety of producing regions. We do not need to have the large footprint required to justify a field office that a larger operator might need. We think we bought Jonah at an attractive discount. We also like the fact that the gas has access to premium west coast markets through the Opal Hub in Wyoming

Jeff Robertson: Ryan, Jason discussed access to gas markets from Opal. Can you expand a little on gas marketing and how do the realizations currently compare with your Barnett Shale assets?

Ryan Stash: Yes, Jason touched on the reasons we like the Jonah assets. Most of the natural gas production flows through the Northwest Pipeline to markets in the Pacific Northwest. We have seen incredibly good prices recently on the pipeline at the Opal Hub in southwest Wyoming.

What we have seen is a winter-time premium and a summer-time discount. One interesting thing to note is that gas from ~60% of the wells in the field is not being processed to recover NGLs. NGLs provide a BTU uplift on the natural gas, which helps our pricing too.

Overall, for the calendar year 2021, we averaged about a $1 premium to Henry Hub when you factor in the BTU uplift from the liquids content. Those were incredible prices and the forward strip looks good for the rest of calendar 2022.

To contrast with the Barnett, we are seeing discounts to Henry Hub running $0.36-0.38 per MMBtu. Residue gas production from that field is priced off Houston Ship Channel indices. I would point out that we do process the NGLs in the Barnett, so we are not getting the same uplift on the residue gas piece as we are in Jonah. That being said, we are excited about the pricing diversity Jonah provides.

Jeff Robertson: In January 2022, Evolution closed on a non-operated asset package in the Williston Basin. The assets added proved developed and proved undeveloped reserves and a significant inventory of undeveloped drilling locations. Foundation Energy Management is the operator. Proved undeveloped reserves and locations provide diversity to the company's reserve categories and capital options.

Jason, how does the Williston Basin fit into the Evolution portfolio and how should we think about the inventory?

Jason Brown: We are excited about our new partnership with Foundation in the Williston Basin. It does not look different in terms of how we valued the assets. We bought assets based on a PDP production profile on an ~11% annual decline. Right now, we believe the terminal decline will settle into 7-8% annually. It is a nice production base of ~500-600 BOE/d.

The inventory is an attractive upside. There is an inventory of ~400 gross drilling locations. We think a third-party engineering firm like Netherland Sewell & Associates, might classify 156 gross locations as proved undeveloped at this point. However, SEC rules stipulate proved undeveloped reserves must be backed by a capital program to develop them within five years.

Our reserve report as of our fiscal year-end on June 30 could include reserves associated with about 50 proved undeveloped locations. Their inclusion could add a chunk of new reserves. Historically, proved developed reserves have made up >95% of our reserves. We anticipate proved undeveloped reserves in the Williston to move our base to ~75% PDP. I think visibility to organically replace our production and reserves could leave room for our equity value to grow.

A drilling inventory does not change our approach to managing our business, so investors should not think we will dramatically increase our reinvestment rate. It is actually quite the opposite.

Inventory gives us optionality to control our own destiny with our partners. We now have flexibility to put capital to work—drilling if the bid-ask spread in the acquisition market is too wide. Low-risk mature PDP assets like these can be tough to find and command premium valuations. Development gives us the opportunity to put capital to work in projects, that we think, generate 60-70% rates of return at current prices. And it is nice to have something you can go after that puts you in that 60-70% rate of return at these prices.

Jeff Robertson: Jason, you have spoken about how the Williston Basin assets diversify Evolution's reserve categories with the addition of proved undeveloped, probable, and possible reserves. Was adding that type of diversity top of mind as you pursued the acquisition, or was it gravy on top of deal supported by PDP value?

Jason Brown: There is a lot of gravy on the Williston Basin. Yes, we were looking for a package like this. The last few years have been very difficult on Evolution, and the industry as a whole. We dealt with the price war and pandemic in 2020. The disruption helped push Denbury Resources (now Denbury Inc.) to restructure its balance sheet in bankruptcy. A wholly owned Denbury subsidiary is the operator of the Delhi field, which was our sole asset before we purchased Hamilton Dome in 2019. As a non-operated working interest owner in Delhi, we had no ability to force Denbury to spend capital. Consequently, our production was negatively affected.

We did not have a gas pedal we could press to put capital to work building value. As a result, we considered looking at some operated assets. For now, the board prefers that Evolution remain in a non-operated position to keep the investment proposition simple and easy to understand. Our brand has been established in non-operated assets and it is a strategy we are competitive in. It might be five to 10 years before we will consider owning assets that we would operate ourselves.

So non-operated assets are our segment of the industry. The Foundation relationship is a collaboration where we both participate in quarterly operations meetings to collectively decide what activity to do together. We can develop a capital program to maintain production levels without Evolution having to add new layers to our cost structure. Under the Joint Operating Agreement (JOA), we can propose new drill wells. Foundation will operate the drilling and production of any new wells.

Like Jonah Energy, Foundation Energy is the right kind of partner for Evolution. Foundation is privately owned and manages a series of investment funds for its limited partners (LPs). It is onto its seventh fund, which I think started with about $100 million to invest. Foundation operates assets from cash flow and provides distributions to its LPs. It is quite like Evolution in terms of a shareholder distribution strategy. We would not want to partner with an operator who might drill us into the ground.

We have the flexibility to allocate some capital to development wells and if Foundation chooses not to participate, it still must operate the wells for us. We think the Williston Basin assets and relationship with Foundation are a great fit and were exactly what we were hoping for.

Jeff Robertson: Jason is there a limit to the number of wells that can be proposed under the JOA in any given year?

Jason Brown: There is not a limit. Either party can choose to non-consent a proposed well. The party going non-consent does not lose its interest in the acreage; however, it is out of the individual wellbore until 300% of payback. Reaching that payback threshold takes >15 years.

The relationship is mutually beneficial, and we want to play ball together. We are seeing an appetite to drill because we are generating so much cash flow at current commodity prices. Based on our discussions with Foundation at our partners meeting in March, we are preparing technical evaluations and proposals for a few wells in our fiscal 2023 budget. High commodity prices are increasing values in the acquisition market. The Williston inventory creates some competition for our capital.

Jeff Robertson: Ryan, can we touch on returns? Jason mentioned a few minutes ago that new Williston Basin drill wells could yield ~60% rates of return at current prices. Obviously, returns fluctuate every day with the volatility in oil prices and costs. Can you help us understand how returns on new wells compare with what you see in the PDP acquisition market?

Ryan Stash: Sure, if you look at the three acquisitions we have recently completed (Barnett Shale, Williston Basin, and Jonah Field), we estimate that we bought those at ~20% PDP discount rate based on prices in effect at the time of acquisition. We believe our returns will be better than that since prices have improved from when the valuations were struck.

The PDP acquisition market is still in the 15-20% return range at current strip compared with the 60% returns Jason mentioned for new wells. As he said, we feel fortunate to have those drilling locations to compete for capital if we cannot find acquisitions that fit our parameters. Certainly, the returns will look better on a single-well basis drilling than buying pure PDP assets.

Jeff Robertson: Let's talk about high-level strategy for a moment. Evolution has built its base through the acquisition of non-operated working interests in assets spread across five areas. The Jonah Field acquisition added a PDP asset, while the Williston Basin acquisition added PDP plus drilling inventory.

An operating company needs to have a certain scale in the basins it works to support a larger cost structure. As a non-operator, is scale in a producing area important to Evolution?

Jason Brown: The answer is yes, and no. Foundation operates more Williston Basin assets than the package we purchased. It maintains a field office with a core group of superintendents and field engineers. If we were going into this as an operator, we would have to build all of the field infrastructure or retain it from a seller. It would be a lot more expensive for us to enter the basin.

Our JOA and collaborative relationship allow Evolution to draft off of Foundation's existing infrastructure. Foundation receives a COPAS fee from us for managing the assets. Our COPAS payment to Foundation covers everything from Foundation's back-office accounting to the boots on the ground personnel operating the wells in the field. For example, in the case that Foundation goes non-consent on a new drill well, we would not mind paying the COPAS fee to operate wells on a day-to-day basis because it would cost considerably less than Evolution having to hire and place staff in the Williston Basin.

Relative scale is important to an operator entering a new basin. If a company buys a position in a new basin, it needs assets substantial enough to support a field office with a production superintendent and a general field operations personnel. Once a company has that, it is easier to add smaller bolt-on assets—much like what Foundation did when it acquired these assets in late 2021.

Scale is not as critical for non-operated positions. This goes back to the agility I mentioned before. We can buy a small interest in Wyoming where we draft off a top-tier operator like Jonah Energy. If we find assets with good operators, we can be agile with respect to asset location.

Jeff Robertson: Jason, since you and Ryan joined Evolution, the company has completed three acquisitions to diversify the asset base from Delhi Field and balance the commodity mix. Evolution's flag is planted in five different operating areas. Has the larger, more diverse asset base increased the number of acquisition opportunities the company sees?

Jason Brown: Yes, there has been a positive impact. People understand that we are active participants in the acquisition market and that we intend to grow. That reputation triggers a lot of inbound calls. Jonah was an inbound call from a group called TenOaks who we have done some business with. TenOaks called us before the package went to market, as it thought it would be a natural fit for Evolution. At the time, we were focused on the Williston Basin package. TenOaks was persistent with updates on how its process was moving and telling us how well the asset fit our model and that it deserved our attention.

Sometimes, persistence pays off for the right broker who bird dogs a prospective purchaser until it realizes the asset is a good fit. We were not really looking for gas in Wyoming after we closed the Williston deal. We were more interested in East Texas, closer to Sabine Pass and the LNG export market. However, after taking a closer look, we found that the Jonah Field production serves premium west coast markets and I had to admit I was wrong. So, I began to pay closer attention to the Jonah assets and the marketing data changed my preconceived opinions. I realized there might be some great natural gas-oriented opportunities that are not necessarily located on the Gulf Coast.

Evolution has lived with two reputations for long time, one was extremely positive, and one was not. On the bright side, Evolution had a hard-earned reputation for exercising extreme fiscal discipline. I think that characterization helps our value because investors know we are not going to go bankrupt in a down cycle. We keep an exceptionally clean balance sheet and investors have a lot of faith that we will not get caught up in a frothy market and do something to stress our leverage.

The less positive reputation is that the company is too tight and unwilling to be competitive enough in the acquisition market to grow. Ryan and I have worked to preserve the capital discipline reputation and show that the company is willing to grow through acquisitions. We are gaining traction and people are recognizing the shift. Now that we have a few acquisitions under our belt, we are fielding more inbound calls.

Jeff Robertson: Evolution restored the quarterly dividend to the pre-pandemic level of $0.10/share with the fiscal third quarter payout on March 31, 2022. Expected free cash flow could allow the company to reduce the RBL borrowing used to close the recent acquisition, putting the company in a strong financial position to continue executing.

Ryan, can you outline the financial diligence process Evolution conducts to judge whether it wants to partner on assets with a particular operator?

Secondly, can you also take us through the environmental diligence process? An extensive field-wide environmental impact statement (EIS) was prepared before downspacing at the Jonah Field was approved.

Ryan Stash: Diligence starts with evaluating the asset itself and the cash flows. We perform rigorous financial, land, and environmental diligence using a of combination of in-house hard work along with outside legal, land, and environmental consultants who have extensive experience.

Financial diligence concentrates on ensuring we understand the cost and revenue allocation. We want to understand cost allocation and make sure we will be paid what we think we will be paid. On land, we must ensure that we are getting conveyed the interest we think we are paying for. Those are the key elements of our diligence.

We also want to understand the reputation of the operator. As we talked earlier, Jonah Energy has a very solid reputation, and we were very comfortable with Foundation from reputation and prior experience. We didn't know Diversified would become the operator of our Barnett Shale assets when we made the deal because the operated interest in the field went up for sale after we closed our acquisition. We have been really pleased with the job Diversified has done since becoming operator.

With respect to environmental diligence, we conduct a Phase I study for each asset we acquire. A Phase I study involves sending environmental consultants to the field to inspect the well sites and equipment and to create a photographic record. They also perform a detailed analysis of well records, permits, and any historical issues that have arisen on the assets. Our environmental diligence is a deep dive to prevent us from inheriting future problems.

Jeff Robertson: Jason are there producing areas you tend to avoid because of regulatory or environmental considerations?

Jason Brown: We try to focus on places that have historically been friendly to the oil and gas industry with stable regulations. The board has expressed, and I have said before that, California and Canada are not interesting to us. Changing royalty regimes in Canada have caused trouble for companies in the past. The other area we avoid is Colorado where there are some high-quality assets, but in a state that is a tumultuous regulatory environment.

We will continue to focus on assets in Texas, Wyoming, North Dakota, Louisiana, New Mexico, Utah, and Oklahoma, for now.

Jeff Robertson: Let's talk a little bit about the balance sheet. Evolution has a $50 million reserve base facility following the Jonah closing. Ryan, can you update us on how much was drawn post Jonah close?

Ryan Stash: We had $37 million drawn after closing Jonah. As you said, that is on a $50 million revolving credit facility. Based on some collateral analysis our bank has done on the assets, we believe our current asset base could support a borrowing base north of $150 million. We will have a new reserve report with our June 30 fiscal year-end, which will help quantify our collateral value.

Our leverage ratio is low at ~0.5x. At current commodity prices, we can pay down the outstanding RBL balance from free cash in short order. Right now, we do not feel the need for a larger borrowing base. We are confident it will not limit the type of acquisitions we look at and capacity would be available if there was a need.

Jeff Robertson: Ryan, does the facility have any hedge requirements? And if so, can you walk us through what those are?

Ryan Stash: In compliance with our bank facility and as a result of the recent acquisitions, we did have to include a hedging covenant, which we feel good about based on some of the others we have seen in the market. We are required to hedge PDP production on a sliding scale based on the relationship between the margin collateral value to the amount outstanding.

The outstanding balance is currently under 25% of the margin collateral value, which is the bottom threshold. So, at this point, we are not required to add any more hedges. We agreed to add hedges for both the acquisitions and added collars for 25% of oil and gas production for 12 months post close for each.

As I mentioned, at this point, we are not required to put on any additional hedges. Although, it is something that we certainly talk about with gas prices so high.

Jeff Robertson: Ryan, Evolution has funded acquisitions from bank borrowings and cash on hand. Would you consider other alternatives for acquisition financing? I should preface that by saying size would be a determinant on how acquisitions might be funded. Are there circumstances where Evolution would consider using a slug of equity to help to fund an acquisition?

Ryan Stash: Yes, Jason mentioned this earlier in some of his comments. One of the things that we think investors like about Evolution is our simplicity. Our business is easy to understand. A big component of our simplicity is our capital structure. As you noted, Jeff, we have relied historically on our credit facility and cash on hand to fund acquisitions and capex. We expect to maintain that simple capital structure for the near future.

If we come across a larger asset deal or merger opportunity that would require an equity component, we would consider it if we decided it would be value accretive and, in our shareholders best interest. A transaction like that would have to exceed a lot of thresholds to make sense for us.

Equity could play a role in a deal like the Williston Basin where the assets bring some upside exposure through low-risk development, which could drive a higher adjusted return than just PDP alone. As Jason mentioned, we believe the development inventory could generate ~60% IRRs at current pricing. We could potentially consider some equity if we believe the blended return on the acquisition exceeds our cost of equity.

Jeff Robertson: Two pillars underpin Evolution's business model. The first is returning cash to shareholders through a sustainable dividend. The second, as Ryan just described, is to maintain a strong balance sheet. The current balance sheet could allow the company to reduce the leverage needed to close recent acquisitions in short order. The balance sheet is still extraordinarily strong to support the first pillar.

Jason, can you remind us of your thoughts for cash flow allocation between the dividend and the balance sheet so that the company is poised to execute further accretive acquisitions?

Jason Brown: Restoring the quarterly dividend to the pre-pandemic level of $0.10/share with our third-quarter fiscal 2022 payout on March 31 was a big milestone for us.

Cash flow from the Jonah Field provides organizational support spreading our cost structure over a larger production base. We believe the PDP roll off from our asset base can support our dividend for the next decade. We think that Evolution is in a good place right now.

Our cost structure has largely improved. Our latest investor deck shows a margin slide (page 20) illustrating how our cash general and administrative expenses are compressing on a unit-of-production basis. We are most proud of the lower right graph showing that we now have a larger production base while maintaining a flat share count and low leverage. The current yield on our equity is 5.8%.

We are in a strong position to fund incremental acquisitions and our capital program. We could consider an equity component for an acquisition with superior return characteristics. Our corporate goal is to maintain our dividend payout ratio below 50% of free cash flow. Our net debt is about 0.5x EBITDA now and could be net zero by the end of October 2022. Our job is to find new investment opportunities to deliver growth and value to our investors.

Jeff Robertson: Jason and Ryan, we leave it there for today. I would like to thank you both for your time joining us today.

ABOUT THE ANALYST

Jeff Robertson
Managing Director

Natural Resources
Chemicals & Materials
Technology

Prior to Water Tower Research, Jeff was an 18-year equity research veteran at Lehman Brothers / Barclays where his coverage concentrated on mid- and small-capitalization companies in the oil & gas exploration and production sectors, and he also covered master limited partnerships (MLPs) and royalty companies.

Previously, Jeff worked in similar industry roles at Salomon Smith Barney and Wasserstein Perella. Jeff has worked on the sell-side for 28 years, gaining exposure to all facets of the oil & gas industry, and his tenure spans multiple industry cycles.

Jeff holds a BS degree in Geology from Centenary College of Louisiana, an MS degree in Geology from Texas A&M University, and an MBA from Southern Methodist University.

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