MANAGEMENT SERIES REPORT

EVOLUTION PETROLEUM | EQUITY RESEARCH

WATER TOWER RESEARCH

EVOLUTION PETROLEUM (NYSE: EPM)

Capital Discipline, Consistent Dividend

March 29, 2022
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KEY POINTS

- On Thursday, March 10, 2022, Water Tower Research hosted a Fireside Chat with Jason Brown, president and chief executive officer of Evolution Petroleum.
- The discussion concentrated on Evolution's guiding philosophy of building a platform to deliver sustainable dividends to shareholders over a rolling, five- to seven-year horizon, while maintaining a conservative financial posture.
- Acquisitions of mature, long-lived, producing oil and gas assets with shallow, manageable output declines are core to executing the model. Such assets can provide excess cash flow above minimal capital reinvestment to fund dividend payouts and incremental investments in acquisitions or drilling.
- Since 2019, acquisitions have diversified the asset base from one oil field in northwest Louisiana to positions in five producing basins, and a more balanced commodity mix with exposure to multiple markets.
- Evolution announced two acquisitions since the beginning of calendar 2022 for an aggregate purchase price of ~$55 million. Pro forma proved reserves are 38 MMBOE (~76% developed, ~60% liquids).
- The Williston acquisition, announced in January 2022, adds an inventory of nearly 400 gross development drilling locations, which can be called on as needed to supplement capital allocation options. The pending Jonah Field acquisition in Wyoming, which is expected to close in April, adds natural gas assets that access the premium West Coast markets.
- From here, the management's goal is to continue scaling up the asset base, while delivering value to shareholders through a growing EBITDA profile and sustainable dividend, underpinned by low leverage (<1.0x target).

KEY STATISTICS

Price	$6.95
52-Week Range	$3.01-$8.17
Avg. Daily Vol. (30 day)	308.563
Shares Out (MM)	33.7
Market Cap (MM)	$234.1
Enterprise Value ($MM)	$224.5
Revenue TTM (MM)	$62.6
Annual Dividend/Yield	$0.40/5.8%
Fiscal Year End	June

Source: YCharts, *as of March 28, 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 assets include non-operated interests in the Barnett Shale in North Texas; a CO_2 enhanced oil recovery project in Delhi, northeast Louisiana; the Hamilton Dome oil field in Wyoming, and an interest in the recently acquired oil and natural gas properties in the Williston Basin in North Dakota. In February 2022, Evolution also signed an agreement to acquire non-operated natural gas assets in the Jonah Field in Wyoming and is currently working through due diligence for an anticipated close in April 2022. The company's homepage is www.evolutionpetroleum.com.

ABOUT THE EXECUTIVE

Jason E. Brown
President and Chief Executive Officer

Evolution Petroleum Corporation

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.

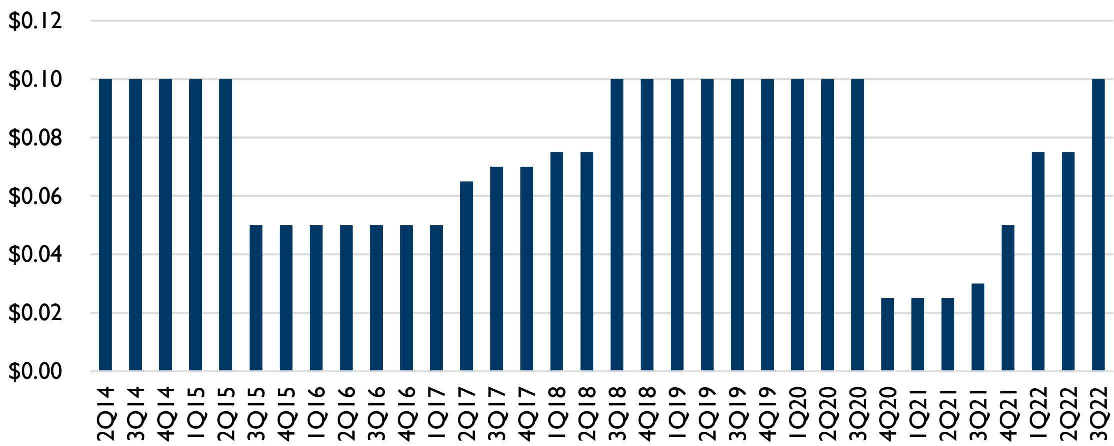
Earlier in his career, Jason was employed by RBC Richardson Barr as an Associate, focused on the business development and execution of sell-side engagements in the oil and gas space. Although his concentration at RBC was in acquisitions and divestitures, he passed both the Series 7 and Series 63 exams 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.

A SUSTAINABLE DIVIDEND IS PARAMOUNT TO EVOLUTION

Evolution's business model is built around two core concepts. First, the company is committed to returning capital to shareholders through a sustainable dividend. Evolution has paid a dividend for 34 consecutive quarters, declaring its first payout in the December quarter of fiscal year 2014. Management recently announced the dividend payable in fiscal 3Q22 on March 31, 2022, will increase to the pre-pandemic level of $0.10 per share (see Figure 1). The second core concept, which supports the first, is to maintain a strong balance sheet with a targeted leverage ratio of <1.0x annualized EBITDA. To execute the model, the management is building an asset base of long-life, mature, producing properties that generate free cash flow above minimal capital expenditures aimed at flattening the natural decline.

Figure 1: Quarterly Dividend History



Source: Company reports

Prior to 2019, Evolution owned an interest in only one producing asset, the Delhi Field in northeast Louisiana. Delhi is an enhanced oil recovery (EOR) project where CO_2 is injected into the reservoir to recover incremental oil. Since 2019, however, the company has expanded its asset base through four acquisitions—one each in 2019 and 2021, and two thus far in 2022. The expansion diversified the asset base across multiple producing basins and provides more balance to the commodity mix (see Figures 2 and 3). The Williston Basin acquisition added interests in nearly 400 gross development drilling locations. The development inventory provides the capital allocation option of supplementing ongoing acquisition efforts with an element of potential growth through the drill bit to manage corporate production. Management's capital allocation decisions are guided by its core business model to support dividends over a rolling, five- to seven-year horizon.

Recent acquisitions have recast Evolution from a one-asset company into one with a diverse mix of production assets, and a more balanced commodity profile. Management is poised to extend the growth track record through incremental producing-asset acquisitions that could be supplemented with modest development drilling. The ultimate goal is increasing the scale of the company, while delivering value to shareholders through a growing EBITDA profile from an asset base that supports sustainable dividends, underpinned by a strong balance sheet.

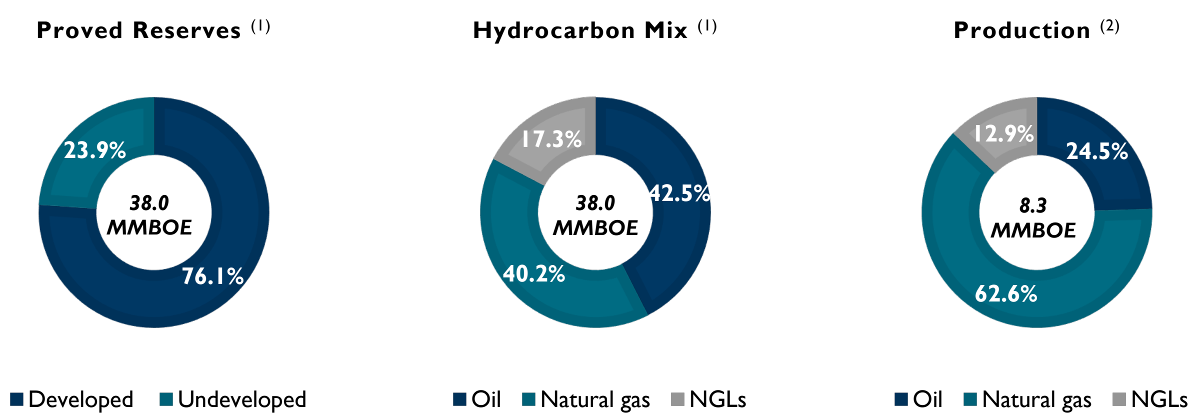
Figure: 2: Acquisition Summary

Asset	Evolution	Hamilton Dome (Wyoming)	Barnett Shale (Texas)	Williston Basin (North Dakota)	Jonah Field (Wyoming) [1]	Pro Forma Evolution
Date announced		11/6/19	3/30/21	1/14/22	2/9/22	FY22E
Acquisition price	-	$9.5 MM	$18.2 MM	$25.9 MM	$29.4 MM	-
Operator	Denbury	Merit Energy Co.	Diversified Energy Co.	Foundation Energy Mgmt.	Jonah Energy LLC	-
1H FY22 Avg. daily production (BOE/d) [2,3]	1,231	409	3,630	571	2,420	8,261
Commodity mix (production) [2,3]	Oil-80% NGL-20%	Oil-100%	Oil-1% Gas-73% NGL-26%	Oil-76% Gas-10% NGL-14%	Oil-6% Gas-88% NGL-6%	Oil-43% Gas-40% NGL-17%
Pro forma proved reserves (MMBOE) [2]	8.2 [4]	1.8 [4]	11.3 [5]	9.7 [6]	7.0 [7]	38.0
Net acreage	~3,600	~620	~21,000	~47,000	~1,040	~73,760
Working interest / revenue interest	23.9%/26.2%	23.5%/19.7%	17.0%/14.0%	38.7%/32.5%	19.3%/14.7%	-

1) Jonah Field acquisition is expected to close on, or about, April 1, 2022. The effective date for the transaction is February 1, 2022.
2) Gas converted to oil at a ratio of 6:1, NGL converted to oil at a ratio of 1:1.
3) Estimated average net production 1H FY22 (six months ended December 31, 2021), excluding 130 BOE/d from Giddings field correction received in 2Q FY22.
4) Evolution reserves as of July 1, 2021, at June 30, 2021, SEC prices of $49.72/bbl for oil, and $2.47/MMBtu for natural gas, less 1H FY22 production.
5) Barnett reserves as of July 1, 2021, at June 30, 2021, SEC prices of $49.72/bbl for oil and $2.47/MMBtu for natural gas, less 1H FY22 production. Evolution adjusted for ethane rejection. Asset operator expects to remain in ethane rejection at current pricing forecasts.
6) Williston Basin reserves were prepared by Evolution as of January 1, 2022, at December 31, 2021, SEC prices of $66.55/bbl for oil and $3.64/MMBtu for natural gas.
7) Jonah Field reserves were prepared by Evolution as of February 1, 2022, at December 31, 2021, SEC prices of $66.56/bbl for oil and $3.64/MMBtu for natural gas.

Source: Evolution Petroleum Corporate Presentation, March 14, 2022

Figure 3: Pro Forma Reserve and Production Profile



1) Evolution proved reserves as of July 1, 2021, at June 30, 2021, SEC prices of $49.72/bbl for oil and $2.47/MMBtu for natural gas less 1H FY22 production. Evolution adjusted Barnett reserves to reflect ethane rejection. Asset operator expects to remain in ethane rejection at current pricing forecasts. Williston Basin reserves were prepared by Evolution as of January 1, 2022, using December 31, 2021, SEC prices of $66.56/bbl for oil and $3.64/MMBtu for natural gas. Jonah Field reserves were prepared by Evolution as of February 1, 2022, using December 31, 2021, SEC prices of $66.56/bbl for oil and $3.64/MMBtu for natural gas. The Jonah Field acquisition is expected to close in April 2022.
2) Estimated average net production for six months ended December 31, 2021, excluding 130 BOE/d associated with Giddings field correction received in 2Q FY22. Pro forma production includes volumes from the Jonah Field acquisition, which is expected to close in April 2022.

Source: Evolution Petroleum Corporate Presentation, March 14, 2022

EXECUTIVE DISCUSSION

Jeff Robertson: I would like to thank everyone for joining us today to learn more about Evolution Petroleum. I am Jeff Robertson, Managing Director of Natual Resources at Water Tower Research. We are pleased to host this discussion with Jason Brown. Jason has served as Evolution's president and chief executive officer since joining the company in 2019.

Evolution is an acquisition-oriented, oil and gas exploration development company headquartered in Houston, Texas.

Welcome Jason. Can you tell us a little bit about your background before joining Evolution, and what drew you to the company?

Jason Brown: Sure, thanks, Jeff. First, I want to say thank you for having us today on Water Tower Research's Fireside Chat. I have come to know exactly what a Fireside Chat is in the Zoom era we have been living in lately. As you can see behind me, I have put the firewood in my solo stove here. Unfortunately, our legal counsel tells me it would be against OSHA regulations to light it. So, our discussion today will just have to be a firewood chat. But anyway, I am happy to be here and excited to see what Water Tower is doing and am very appreciative of your interest in Evolution.

Evolution was formed in 2003 and is now closing in on two decades of operations. I joined the company in the summer of 2019. So, I have been here about two and a half years, a period that has been one of the most turbulent in the oil and gas industry's history. Dramatic commodity price swings triggered by the COVID-19 pandemic, price wars between major producers, and the financial calamity that resulted have made the past two and a half years challenging and, at the same time, presented opportunities for us. The oil and gas market began to snap back in 2021 but has now run into volatility driven by the Russia-Ukraine conflict.

I was born and raised in Tulsa, Oklahoma, and earned a chemical engineering degree from the University of Tulsa. Then I went to the University of Notre Dame, where I earned an MBA. I spent the first half of my career doing operations, mostly for Petrohawk. I was responsible for running their operations in East Texas, North Louisiana, and Arkansas.

Then I moved to investment banking, joining RBC Richardson Barr, working on merger and acquisition transactions and valuations. The thought, at the time, was to spend a few years in banking and then raise capital from some private equity sponsors and start a company. I joined Floyd Wilson, one of Petrohawk's founders, to start a company called Halcón Resources in 2011. My career path has exposed me to a combination of technical and financial roles, which have provided a lot of useful lessons and shaped how I think about managing Evolution.

I was 42 years old, when Evolution and I found each other. I think we both feel a little bit lucky that we did find each other and share a common vision of how to build long-term value. I was looking for the right kind of platform that could be a successful oil and gas company. The industry had been largely taken over by private equity sponsors, which have a shorter-term business mindset than Evolution.

Evolution was attempting to move into a new growth phase. The company had a nice operating history with its Delhi Field asset. Evolution purchased a non-operated interest in Delhi in 2003. The field, operated by Denbury, is a CO_2 flood in northeast Louisiana. When I joined, Evolution was producing ~2,000 b/d of oil from Delhi, it had about ~$30 million in cash and no debt.

Evolution built a reputation by being financially disciplined and managing risks. The idea that a company could be built without exposing shareholders to unnecessary operational and financial risks was very attractive to me. Sometimes, management teams take chances on risky assets in an effort to satisfy the return objectives of their capital providers. Evolution does not have to do anything stupid to grow. I really liked the idea of just making good oil and gas decisions. 'No' is an acceptable answer for us if the bid-ask spread on an acquisition is too wide, which is frequently the case in our industry. That is an important aspect of our corporate culture—being in a position where we do not have to transact helps us build a sustainable company.

Jeff Robertson: Before we dive too far into company details, I want to remind viewers that our discussion today could include forward-looking statements. Viewers can refer to Evolution's Febraury 9, 2022, corporate presentation, which includes disclosures pertaining to forward-looking statements. With that bit of housekeeping out of the way, we can jump into the company.

First, let's talk about the Evolution platform. The company's business model is built around an asset acquisition strategy seeking long-lived assets that generate excess cash flow and using that cash flow to manage the balance sheet and pay a consistent dividend to shareholders. The company began paying dividends in 2013 and has now returned ~$84 million to shareholders through dividends and share buybacks. Only in the past few years has "return of capital" become the mantra of many other E&P company management teams. Making sustainable dividends a corporate pillar is rare among small-capitalization E&P companies. Jason, can you describe the platform and what management's priorities are to make it successful?

Jason Brown: Well, I think we are a little unique and, you are right, we were a little ahead of our time in terms of strict fiscal discipline. Staying out of debt has allowed Evolution to weather a lot of storms. I think we have built a reputation of being a disciplined buyer in the market. We are not going to stretch and get too far out over our skis to chase an opportunity. Aggressively using leverage to support acquisitions or drilling programs was a classic business model for a lot of oil and gas companies. That model can end badly when the commodity cycle turns. Over-levered companies must grapple with their balance sheets. That wrestling match contributed to the bankruptcy wave that swept the industry in 2020.

Inaction, on the other hand, can ruin an oil company since producing assets naturally deplete over time. A balanced approach to managing business risks is required for long-term success. I think that is what the board was looking for when I came to Evolution in 2019. Evolution's business model is built around investing in producing assets that have super long-lived flat production profiles requiring that require minimal capital expenditure.

In general, E&P companies significantly outspend their cash flow to grow. Evolution's reinvestment rate over the last eight years was 14% of EBITDA, to hold production relatively flat. That recycle rate generates a significant margin and a tremendous amount of free cash flow to support dividend payouts.

Our company was built around supporting a consistent dividend, which is highly unusual for small E&P companies. A lot of Evolution's investors are generalist funds and individuals, not necessarily oil and gas investors. Traditional oil and gas investors prefer companies to focus on growth, looking to spend cash flow on 60-80% rate of return wells. However, over the past few years, industry drilling returns were not as advertised, and investors began demanding cash returns to shareholders through dividends.

Evolution is the first company I have worked for that pays income tax. We are just a block-and-tackle profitable business that returns money to shareholders. I think that is what companies are going to need to look like, going forward. We now see quite a bit of capital discipline across the industry, with even larger companies spending within their cash flows. I think that's what shareholders are now demanding. It is what our business is built around, and we are well positioned to continue executing. Our acquisition focus is dedicated to properties that fit a long-life stable production profile that supports dividend payouts. Every acquisition we look for needs to be accretive on a free cash flow basis over a five- or ten-year period, not just the next 12 months.

Jeff Robertson: Jason, when you joined Evolution, the company had one asset, the Delhi Field in northeast Louisiana. Since then, the company has completed three acquisitions and announced a fourth, which is expected to close in April 2022. These transactions add diversity to the company's basin and commodity exposure. The recently closed Williston Basin acquisition also brought exposure to a sizeable development drilling inventory. Is there a common denominator that you look for in assets that you believe fit the Evolution model?

Jason Brown: Yes, and we have taken several steps. First, Delhi Field is a great field, and it will continue to support our dividend payments for decades to come. CO_2 floods require upfront capital invested in setting up flood patterns and processing facilities, then we reap the free cash flow benefits for years and years. That is why it remains a great asset for us. About 80% of Delhi's production is oil and 20% NGLs.

In 2019, we bought our second asset—an interest in the Hamilton Dome oil field in Wyoming, for $9.5 million. We wanted to get a little bit of diversity in our oil production to provide some strength and agility to weather different types of storms.

We purchased our third asset, a non-operated interest in natural gas properties located in the Barnett Shale, in

March 2021. Between these three assets, we had a long-lived CO_2 enhanced oil recovery (EOR) project at Delhi, a long-lived oil-producing waterflood project at Hamilton Dome in Wyoming, and long-lived natural gas producing assets in the Barnett Shale in north Texas. To us, those three assets look similar because we evaluate assets on free cash flow per share. How much cash flow can they generate over a long period to support our dividend payments?

The Delhi EOR project required a lot of upfront capital investment before generating free cash over a long period of time. Hamilton Dome has been producing since 1918. It is on about a 1% annual production decline—flat as a pancake—and does not require incremental capital to maintain flat production.

Most of the wells we acquired in the Barnett Shale were drilled between 2007 and 2010. They have now been producing for more than ten years and are on a 5-6% natural decline. Maintenance capital consists of occasional well workovers to return idle wells to production. In that sense, it is like Delhi, where we have a little bit of maintenance capital spending to maintain relatively flat production.

For Evolution, a CO_2 flood, a water flood, and a shale gas play have common attributes when considering free cash flow per share. The same asset profile could be replicated with a proved developed producing (PDP) asset base, where drilling a few new wells every couple of years could generate a smooth production profile over time. We can be creative and try to maintain our agility when we evaluate asset packages. Assets that may not be as attractive to some other companies might be perfect for us because they fit our long-lived business model.

Our model requires us to think long term. For example, we consider oil and natural gas production that will be sold in 2030—which does not have much discounted present value today—to be very valuable to our shareholders because it will support our dividend. I believe Evolution's acquisition strategy is a compelling offering for investors.

Jeff Robertson: As you mentioned, Evolution entered the Barnett Shale in 2021. There are clearly a number of the shale plays where drilling was very active before 2020, portions of which might be starting to mature. Does that represent fertile ground for further acquisition opportunities that fit the Evolution model, current market volatility notwithstanding?

Jason Brown: Yes, in some basins, capital investment sometimes behaves like a school of fish, all moving in one direction or the other. Recently, companies have flocked to the Permian Basin, paying very high prices just to get into a position. But if your capital is agile and does not necessarily need to follow the hot trend, really good deals are out there. Some of those assets may not be popular right now, but they serve Evolution very well.

That is how we got into the Barnett and found our latest acquisition in the Jonah Field. There are not a lot of companies beating the door down to get non-operated positions in Wyoming natural gas fields. Jonah is a perfect fit for us. It has plenty of natural gas takeaway capacity and access to premium West Coast markets where gas fetches a premium to Henry Hub. That value proposition is attractive to us, especially when there is not a lot of capital competing for those assets. We got a pretty good deal and feel like that is a big advantage for our shareholders.

Jeff Robertson: Let's talk about the Williston Basin acquisition Evolution announced in January. Those assets include nearly 400 gross development locations in the Pronghorn/Three Forks formations. How do you think about blending in some capital to drill new wells to manage the production profile over time?

Jason Brown: Right, thank you for asking that. I studied negotiations at Notre Dame. The first rule to remember is, one must know their BATNA, or the best alternative to a negotiated agreement. When we are working on an acquisition, we are always negotiating an acceptable price. Frequently, in our business, the bid-ask spread is way too far apart. We have had the discipline to say 'no' in those instances, and not overpay for assets. Overpaying for an acquisition can cause serious trouble in the future.

The Pronghorn/Three Forks development inventory will allow us to put some capital to work, drilling new wells when oil prices are very advantageous, like they are now. Or, when the gap between the expectations of buyers and sellers is too wide. The Williston represents our BATNA in that sense.

It also strengthens the diversity in our asset base. We have evolved from one asset and one operator at the

Delhi Field to five assets in five producing basins with five different operators. Our mix between oil, natural gas, and natural gas liquids (NGLs) is more equal now, so we can benefit from strong prices in more than one market. Basin diversity insulates us from extreme weather events, such as hurricanes or freezes, which can temporarily disrupt production.

Diversity among the operators of our assets is also a plus. We have some protection if an operator experiences some financial difficulties or decides not to spend money in our area like Denbury did in 2018-2020. Now, Denbury is in good financial shape, but it had cut back on capital investments at Delhi while they dealt with their balance sheet. That hurt our production there. Our five basin and operator diversity provide a hedge against that now, as we are not dependent on just one operator and its capital allocation decisions.

The Williston Basin assets also diversify our proved reserve categories. Proved developed reserves made up 92% of our total on June 30, 2021. Pro forma proved developed reserves account for ~76% of proved reserves. The Williston Basin development inventory exposes our company to ~41 MMBOE of probable/possible reserve upside. For perspective, our current pro forma proved reserves are 38 MMBOE. The inventory diversifies the internal rate of return (IRR) potential of our capital decisions. Long-lived flat PDP assets are generally acquired for a PV12 – PV14 rate of return. Now we have the option to invest some capital in development wells that have 50% plus IRR.

Increased diversity in our reserve categories aids our capital allocation process. Our goal is to pay out not more than 50-60% of free cash flow in dividends. We want to reinvest 40-50% in our asset base through some combination of producing-property acquisitions or development drilling. We like having investment options where we can expose capital to higher IRR development opportunities to mix with our lower-risk PDP acquisition strategy when it makes sense. We believe the asset and investment option diversity is a real strength and helps support our dividend.

Jeff Robertson: Jason, it sounds as though having that development inventory to compete for some capital could be an advantage when you evaluate acquisition opportunities and how the characteristics of various assets fit the existing base. Can you discuss how you think about managing the overall company production profile over time?

Jason Brown: Well, this is the perfect situation for us. When Denbury went through financial hardship a couple of years back—when oil prices were declining—we were stuck because of our non-operated position and no other assets in the portfolio. Our business was out of our control because we could not cause anything to happen at Delhi.

The Williston assets put us in a different position and gives us some control over our destiny. We formed a strategic operational relationship and signed a joint development understanding with the operator, Foundation Energy Management. Foundation is a great operator that has been working in the basin for a long time.

Our relationship with Foundation allows Evolution to take a more active role in the assets. Under the joint development understanding, Evolution can propose and execute drilling locations on the acreage. We can drive activity on the acreage if Foundation is focused somewhere else. We both have the right to elect to participate in proposed wells. We think of it as a gas pedal we can press when we need to. The ability to cause activity without having to build out our own operations is a great position to be in. We can remain a lean organization and still have the flexibility to control our destiny. Evolution has not been in that position before.

Jeff Robertson: I would like to take a few minutes to discuss Evolution's preference for non-operated properties. Does owning non-operated assets enhance the free cash flow generation aspects of the business model by maintaining a relatively small organization? As we know, all oil and gas operators are not created equal. How do you think about the characteristics of operators you might be joining up with when considering acquisition opportunities?

Jason Brown: Those are two good questions. I will put it this way: having grown up in the industry as an operator, I would have never thought I would be happy or content in a non-operated position because of a lack of control over field and capital decision-making. Some non-operators are companies that may own interests in ~4,500 wells and treat their companies as a hands-off investment portfolio. Evolution's approach with our five operators is to do our geological work and reservoir engineering so that we understand our assets. We want to be very involved with the operators managing the fields, because we believe that is our fiduciary responsibility to our investors. Occasionally, it becomes frustrating because we form different opinions on the proper way to manage a field.

Naturally, most companies think they are better operators than the other guys, whether true or not. There are a lot of smart people in the industry and most operators are decent. We really want to avoid the bad ones that might be improper in terms of how they treat and protect your interests as a non-operated, working interest partner. We do our due diligence sifting through the financial records of assets we are evaluating and learn the histories of the operators. Merit Energy, the operator of Hamilton Dome, has been in this business for decades and we have worked with them in the past. Foundation has been in this business for 20 years as well. Companies that have been in this business that long build reputations that can be relied upon. A reputation is all one has in the oil and gas business. Working with companies with a solid reputation for operating assets in a cost-effective manner is a big priority for us.

The last thing I want to say about operated versus non-operated ownership positions is that our priority is value creation. We run the company with a very small team. There are just seven us at Evolution. We work to build excellent relationships with our operators so we can manage the company without having to build a large staff with a larger cost structure. Our general and administrative expenses are spread over a larger production base. I think that is an advantage of being a non-operator. However, there is another point that is often overlooked. Non-operated properties sometimes trade at lower valuations than operated interests. Companies will generally pay a 15% premium to operate and have control. Every once in a while, the control premium can be as high as 30%. At Jonah Field, which is operated by Jonah Energy, we feel like we are buying a great gas producing asset operated by a premier company—which has won awards for environmental stewardship—at a discounted price, because it was a non-operated interest. We are happy to make that deal.

Jeff Robertson: Free cash flow is critical to executing Evolution's goal of providing a consistent dividend to shareholders. How do you and the board think about capital allocation between funding the dividend and retaining financial capacity for accretive acquisitions or development?

Jason Brown: The board initially set a $0.10 per share quarterly dividend in 2013. Our third-quarter dividend, which will be paid March 31, 2022, is our 34th consecutive dividend across a couple of major commodity price downturns. We reduced it twice during two crucial periods, one in 2014 and the other during the pandemic. Our current quarterly dividend is back to $0.10 per share.

Evolution has a lot of long-term shareholders. It was important for us to get back to that $0.10 level. We do not think it is necessary to commit, at this point, to additional regular dividend increases. We do not want to be on a treadmill like some upstream MLPs found themselves, where investors fixate on incremental increases. Now that we have returned to the pre-pandemic milestone of $0.10, we might focus more on growth. Our current yield is ~5%. Why would an investor own Evolution at a ~5% yield when they could own ExxonMobil at a ~5% yield?

We plan to grow and be three to four times our current size over the next four years. Exxon is probably not going to triple or quadruple the size of their company. There is a growth element to microcap or small-cap stocks that is important to investors. If that 5% yield, based on a $0.10 quarter ($0.40 annualized) dividend, declined to a 2% yield, the stock price would need to move up to $20. We think shareholders would be very happy in that scenario. Consequently, our focus has tilted towards organic growth, while continuing to reward shareholders with a handsome dividend.

Our capital allocation is built around delivering consistent quarterly dividends. That was why returning to $0.10 was important to us. As I mentioned before, we like to allocate no more than 50-60% of free cash flow to the dividend.

That allocation thought process is an important consideration when we evaluate acquisitions. Is the asset going to be accretive and will it provide more dividend coverage in percentage terms of free cash flow per share five to seven years into the future? Can it afford us such a free cash flow cushion?

Jeff Robertson: You mentioned the upstream master limited partnerships (MLPs), which is a segue into balance sheet priorities. Those companies relied heavily on leverage and equity issuance to fund their business models and extensively hedged their production to support themselves. When commodity prices declined sharply and hedges ran out, levered balance sheets required restructuring. What are Evolution's balance sheet priorities? Where do you think the leverage tolerance is to demonstrate to investors that the company has the balance sheet strength and stability to execute the growth objectives?

Jason Brown: These topics have become top of mind lately. Evolution has demonstrated time and time again over the last two decades that fiscal discipline is priority number one. Our actions seem to have earned a great deal of trust from our shareholders that we will be financially responsible. That is deeply embedded in our culture.

There are two basic things investors need to know about Evolution. One, we are going to pay a consistent dividend and two, we are going to have low leverage. It is very hard to go bankrupt with low leverage levels. A strong balance sheet allows companies to weather the storms that pop up.

Our bank revolver carries ~3% interest. We think it is the right decision to put some of that low-cost funding to work. The board is willing to take leverage up to ~1.0x of annual EBITDA. Our two recent acquisitions in the Williston Basin and Jonah Field will take our leverage to ~0.6x and then we will start paying that down. With leverage limited to 1.0x EBITDA, even if oil prices drop by half, and the leverage ratio widens to ~2.0x temporarily, the business will be able to survive. Our balance sheet goal is to be positioned to weather the worst-case scenario.

When it comes to hedging, our strong balance sheet does not have to be protected as much, which allows us to keep exposure to price. Evolution has hedged only three times in its history. One was in 2014, when prices collapsed, and we needed to protect the balance sheet. In April 2020, we put on a short nine-month hedge, again when prices collapsed, to protect the balance sheet. Now since we have borrowings on the revolver, the bank requires us to hedge 25% of our proved developed production. The remaining 75% is not hedged. The board generally feels confident that, because of our low leverage, we can handle the commodity exposure. The exposure allows us to be a call option on the commodity for our investors, allowing them to retain some upside if prices rise. Many companies hedge positions prevented them from experiencing the upside of the price move in 2021 and the more recent move driven by the Russian invasion of Ukraine. Evolution has been very successful in managing the surprises over the last few months.

Jeff Robertson: That is true, companies reported a lot of realized hedge losses from positions that were put in place during the pandemic lows. Some of those positions were driven by concerns from their lenders.

Jason Brown: The best way to describe our hedging posture is 'defensive'. We do not like to get into the speculation business. We put some light hedges in place just to protect the downside in a couple of parts of the business. When prices rise, producers wish they were not hedged, and when prices fall, they wish they had hedged more. Being right is elusive. So long as our balance sheet is priority one, and is in such good shape, we believe we can handle the volatility.

Jeff Robertson: Jason, earlier you mentioned increasing the size of the company without necessarily increasing the dividend. Achieving scale through acquisitions is clearly an important element in that desire. Is there a certain size transaction Evolution is looking for? Are there certain basins or asset characteristics that are important to building scale? Or is building scale like climbing a ladder one rung at a time?

Jason Brown: It is a bit of the ladder. We look at a broad spectrum of assets. I feel Evolution has turned a corner recently, and we have shored up the business. The Jonah acquisition we announced on February 9, 2022 gives Evolution a ten-year runway to support our overhead and dividend based on the current price strip and only the current PDP reserve base. As we talked earlier, we believe a lot of the Pronghorn/Three Forks locations in the Williston Basin will be additive to that.

We feel good about where the asset base is right now. We have quadrupled production and tripled EBIDTA without issuing any new shares and without adding significant leverage. We feel that is a substantial feat.

Our common stock is currently trading at ~5% yield. We think of our common stock as permanent debt because we are so serious about our dividend. When we were trading at $3, it was very hard to consider stock as a component to fund an acquisition because our goal was to increase the dividend back to $0.40 per year ($0.10/quarter). Using equity would have been like issuing 12% permanent debt, which we considered too expensive. Now we are in a better valuation place. We had a lot of luck at my prior companies—Petrohawk and Halcón—funding deals with half cash and half stock. If our equity is trading around a 5% yield, and our bank facility debt costs ~3%, we might consider a mix to fund an acquisition so long as we keep leverage below our 1.0x EBITDA goal. We think that is a healthy way to scale up the business. We are not opposed to raising the dividend. We want to increase support for it as we build scale and then eventually consider whether to increase it.

We need to see a long runway of support from our proved producing asset base to support a dividend increase. Some investors might think that is dilutive. We view financing alternatives more as wrapping other people's money around our cash flows and strengthening the dividend support through acquisitions that need to be accretive over a multi-year horizon. Our acquisition sweet spot right now is in the $25-50 million range.

Jeff Robertson: Let me ask one more brief question around scale. Now that Evolution's flag is planted in five different basins, has the deal flow increased as the market sees a broader asset footprint?

Jason Brown: Yes, we might be on more lists of prospective buyers now that we own assets in multiple basins. There are a lot of companies, particularly those backed by private equity groups, that have made investments that are getting a little long in the tooth. Some of those companies are evaluating exit alternatives in a market where there is a short supply of asset aggregators. Our footprint might expose us to bolt-on acquisition opportunities that make sense for us.

Jeff Robertson: Jason, we are approaching the half-hour mark. Can you summarize for investors what you believe Evolution's core value drivers are?

Jason Brown: A couple of things standout. One, I think, we appeal to investors who might not be very oil and gas savvy, or not currently invested in energy, but looking to gain some exposure. Our approach has been described by some of our investors as the coward's way to invest in the oil and gas industry. Our disciplined acquisition strategy, built around maintaining a strong balance sheet and consistent dividend, could appeal to risk-averse investors seeking exposure to the oil and gas sector. Our balance sheet is our safety net, meaning we will not go bankrupt if the market collapsed. I think Evolution represents a low-risk way to gain exposure to the industry and to commodity price upside in a financially sound company that prioritizes a stable dividend.

Our capital structure and business model allow us to make unbiased decisions with the sole goal of organically growing our company for the benefit of shareholders. It is almost like a politician running for office, who does not take money from any PAC's and is free to make good decisions. As an investor, I want to align with a management team focused on good decision-making to build long-term value.

An investor could dip toe in water by using Evolution as a starting place to learn more about the industry while receiving dividends. Most of our investors are not traditional oil and gas investors. Most are generalist funds, and for many, we are the only energy holding in the portfolio.

Jeff Robertson: Jason, I want to thank you very much for joining us today. On behalf of Water Tower Research, we greatly appreciate your time and look forward to watching Evolution execute in 2022 and beyond.

Jason Brown: Excellent. Thanks again. We appreciate it.

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Prior to Water Tower Research, Jeff Robertson 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. He also covered master limited partnerships (MLPs) and royalty companies.

Previously, Jeff worked in similar industry roles at Salomon Smith Barney and Wasserstein Perella. He 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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