General Observations

It took the board of Texas Pacific Land Corporation 3 months to accept the resignation of a director who did not receive a required majority of the shareholder votes. Furthermore, the board is still silent on the shareholders' wishes to de-classify the board. The confidence the shareholders have in the board continue to erode with the apparent tone deafness of the board. Here is how the board can re-establish trust. **First**, the board should call a special meeting so the shareholders may vote to establish annual election of all directors via amending the articles of incorporation. **Second**, the board should rescind the requirement of directors Stahl and Oliver to vote with the board. They are major shareholders and their voices via their votes should be heard. **Third**, the special meeting should also include a vote on whether repurchased shares shall be retired or held in treasury. **Fourth**, the board should re-examine the company's executive compensation program and make necessary changes. More on this below.

Compensation Program Objections and Alternatives

The 2022 Compensation Program (the "2022 Program" or "The Program") provided in the 2021 10K is a compensation that does not address the uniqueness Texas Pacific Land Corporation ("TPL"). A proper compensation program has two primary functions. First, it should be designed to attract and retain talent. Second, it should provide incentives for management to accomplish certain activities, the results of which would increase shareholder wealth. The 2022 Program is deficient in two primary ways. First, it establishes metrics, the results of which, management has minimal control over; and second, it establishes metrics, that if optimized, may result in a destruction of shareholder wealth.

Before diving into The Program and its shortcomings, let us first look at the business activities of TPL, and what management can do to influence these activities to the benefit of shareholders.

Business Activities:

- **Collect royalties on oil drilled on TPL's acreage.** What drives the success of this activity? First, having acreage. Second, the price of oil. Management has no influence over these factors (setting aside acquired acreage for the time being). Third, the pace of development on TPL's land. Management probably has small impact on this; as a quick aside, they've probably been detrimental, as their reputation among operators is that TPL is tough to deal with.
- **Managing the surface leases and easements.** This business is driven by management's ability to increase the number of easements on TPL's surface acreage and is (at least until easements renew) highly driven by management.
- **Managing TPL's water business.** This is a relatively new business for TPL, so I would say is completely driven by management.
- **Selling Surface Acreage.** Property of value not related to energy production is long sold off, so any property transaction would be to help facilitate drilling on TPL's land, which is covered above.
- **Buying royalties.** This would be 100% on management.
- **Capital Allocation.** This seems at this point to be a board activity, so let's exclude it.

Looking at the above, management has very little impact on the acreage that is drilled on TPL's land and the price of oil. Does it make sense that management is compensated for this? Let us keep this in mind as we look at The Program.

The Program:

- **Competitive Base Salaries.** I have no problem with this, though the comparable companies are a bit questionable.
- **Adjusted EBITDA Margin % and FCF per share:** These metrics look good on paper. Shareholders should want high margins and high FCF per share. However, are they the right metrics to attract and retain talent and provide incentives for management to create shareholder wealth? I would argue no.
    - First, much of the EBITDA Margin and FCF per share is driven by the amount of royalties being paid on and the price of oil. Management has little influence over the first factor and no influence over the second. Management should not benefit by higher oil prices, as it is not in their control. They could do very little to deserve a bonus but get paid a large one simply because oil prices went up. Conversely, they could have had a banner year performance wise (over factors within their control), but not get a bonus if oil prices go down. How does this satisfy the goal of retaining talent?
    - Second, without an offsetting return on capital metric, a perverse incentive is set up for management. FCF per share will go up for any cash acquisition management executes so long as the acquired earnings are greater than the annualized interest generated by the cash used in the transaction. Yet, value will be destroyed if the return on the transaction is less than the cost of capital of TPL. There is no protection against this occurring in The Program.
- **Strategic Objectives:** Having a compensation factor for strategic objectives is reasonable; however, more disclosure on the objectives is needed.

The above describes the short-term incentive plan. The long-term plan includes the following:

- Stock Awards tied to TPL stock performance relative to the XOP index. I would just comment that an oil and gas development company is a different animal than TPL and maybe XOP is not the right comparable.
- Stock Awards tied to 3-year cumulative FCF per share. This has the same issues as described above.
- Time Based Restricted Stock. I have no issue with this.

What would make The Program better. First, management should get paid on factors that they can control, not what they cannot control. Get rid of overall margins and earnings metrics. **Pay them on their ability to increase new drilling on TPL land. Pay them to increase the land easement business. Pay them for new uses of surface land such as wind, solar, crypto, carbon recapture, etc. Pay them to grow the earnings and return on invested capital of the water business. Add an overall return on invested capital metric, to mitigate the risk of management growing earnings through acquisition.**

I realize that this Program is new and changing it may be unappealing. However, it fails in its primary functions of attracting and retaining talent and aligning management's activities with value creation for shareholders.

In Summary

As mentioned earlier, the board is losing the confidence of the shareholders. This does not mean that it cannot gain it back. The board should care about having the shareholders' trust. The independent directors should care the most, as they put their reputations on the line when they came into this messy situation. TPL is a unique business. It is not sufficient to hire compensation consultants and design a compensation scheme that looks like that of other energy companies.

The spotlight is on the directors of TPL. I ask them to call a special meeting to address board de-classification and the treatment of repurchased shares. Additionally, all directors should be allowed to vote their shares as they see fit. Finally, the board should re-visit executive compensation. Independent directors should take the lead in calling for this change.