California Resources Corporation

Q3 Earnings Conference Call

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Edited Transcript

CORPORATE PARTICIPANTS

Todd Stevens - *President, Chief Executive Officer*

Francisco Leon - *Executive Vice President, Chief Financial Officer*

Scott Espenshade - *Senior Vice President, Investor Relations*

PRESENTATION

Operator

Good afternoon and welcome to the California Resources Corporation Third Quarter Earnings Conference Call. All participants will be in a listen-only mode. Should you need assistance, please signal a conference specialist by pressing the "*" key followed by "0." After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press "*", then "1" on your telephone keypad, to withdraw your question, please press "*", then "2." Please note, this event is being recorded.

I would now like to turn the conference over to Scott Espenshade. Please go ahead.

Scott Espenshade

Thank you. I'm Scott Espenshade, Senior Vice President, Investor Relations. Welcome to California Corporation's Third Quarter Conference Call. Participating on today's call is Todd Stevens, President and Chief Executive Officer of CRC; and Francisco Leon, Executive Vice President and Chief Financial Officer; as well as several members of the CRC executive team.

I'd like to highlight that we have provided slides on our Investor Relations' section on our website at www.crc.com. These slides provide additional insight into our operations and third quarter results, plus additional information. Also, information reconciling non-GAAP financial measures discussed to the most directly comparable GAAP financial measures is available on the Investor Relation's portion of our website and in our earnings release.

Please note that our third quarter information is being issued as a debtor in possession and our emergence share count and basis of accounting will change due to CRC implementing fresh start accounting in the fourth quarter. As a result, the fourth quarter results will not be comparable to the third quarter. As a reminder, we have officially withdrawn any and all guidance that relates to 2020 and our operations due to our emergence and the fresh start accounting.

Today's conference call contains certain projections and other forward-looking statements within the meaning of Federal security laws. These statements are subject to risks and uncertainties that may cause actual results to differ from those expressed or implied in these statements. Additional information on factors that could cause results to differ is available in the company's 10-Q, which will be filed later today. We would ask that you review it in the cautionary statements in our earnings release. A replay and a transcript will be made available on our website following today's call and will be available for at least 30 days following the call.

I will now turn the call over to Todd.

Todd Stevens

Thanks Scott and thank you to everyone for attending CRC's Third Quarter Earnings Call. We are glad to be back reporting our results and look forward to discussing significant value opportunity within CRC. CRC has always had a low-decline, stable, high-margin world-class asset base to deliver affordable, reliable, and sustainable energy to Californians. With the Chapter 11 behind us, CRC now has a strong balance sheet and one of the best leverage ratios in its peer universe. Even in the face of market volatility, we are exceptionally well situated to thrive and create substantial value for our shareholders.

First, I want to acknowledge and welcome our new Board of Directors whose members share our values of Character, Responsibility, and Commitment. The Board has already shown keen insight into our business, market dynamics, and governance. We are excited to work with the Board in setting CRC's strategy to creating value for investors in 2021 and beyond. For those of you who are new to CRC, let me give a short introduction, as we are quite advantaged over most companies in our sector.

CRC is a differentiated energy business, known for our low-decline conventional oil production, low capital intensity and exposure to the Brent crude oil markets, which benefits our realized pricing. In addition, CRC has an integrated midstream infrastructure, highly efficient power plants, a successful marketing and trading function, and an enviably fleet of sustainability projects that strengthen our ability to generate free cash flow, while enhancing our capability to operate safely and productively in California.

We are now unburdened from the capital structure imposed upon us by our former parent at our spin almost six years ago. Not the way we wanted to get here, but hey, we are here. With the new and much stronger balance sheet, you can expect CRC to build on the strength of our underlying business. Our low-decline capital-efficient assets provide a high degree of operating flexibility, which enables us to consistently operate within cash flow and maintain a disciplined focus on return on invested capital through our value creation metric.

With a solid financial foundation, we are confident that we have the right portfolio and team in place to deliver value to our shareholders. Our simplified balance sheet combined with our disciplined capital allocation, phenomenal assets and strong relationships in California positions us well to succeed through the commodity price cycle and meet consumer needs and investor priorities. We invite you to track our efforts to drive down costs, maintain a strong balance sheet, and deliver solid returns and cash flow.

Let me first talk about our new balance sheet. Our restructuring process has simplified our balance sheet and eliminated the mid-stream JV at Elk Hills. Additionally, we've also taken the opportunity to further improve and optimize CRC's cost structure to be competitive and profitable in the current Brent price environment. Our balance sheet and credit metrics now reflect a cross-over credit, right on the cusp of investment grade, that matches our high-quality portfolio of assets. We will continue to utilize our capital discipline to maintain a strong financial foundation, which we believe is a major differentiator for CRC.

Through 2020, we flattened our cost structure and made it leaner. Also, cost cutting efforts have achieved a reduction of well over $300 million in lower production costs and G&A annualizing the difference between the third quarter of 2019 and 2020. These actions promote our ability to operate profitably in a $40 Brent environment, maintain crude oil production and deliver free cash flow. However, we are never satisfied. We will continue to focus on ways to decrease our cost structure, enhance our revenues and drive further efficiencies. Our unique asset base provides CRC and our new Board with multiple levers to drive free cash flow for the company as we develop our 2021 investment plans.

We've also continued to demonstrate strong capital discipline. Year-to-date, we have invested a total of $131 million with $37 million of CRC capital and $94 million of capital from our joint venture partners. The vast majority of that amount was invested during the pre-pandemic period with only $7 million of internally funded capital invested in the second and third quarters. We'll have limited capital investment in the fourth quarter.

Let me now give you a deeper dive in what we see as the major investment attributes of CRC's business and the elements of our strong and sustainable foundation.

First, we have reinforced our longstanding value focus. We've maintained the same CRC DNA that investors have come to respect over the past six years. We'll continue to live within our cash flow, focus on reducing costs, enhance margins, and utilize our VCI metric, which supports disciplined capital allocation to generate attractive returns on investment through the cycle. Recall that our value creation index is a cash-on-cash return metric, or present value index that we utilize the test every new investment we consider ensuring we are maximizing returns. In this commodity price environment, we rely heavily on payback metrics as well.

As the largest producer in California with an over 2-million-acre land position, we're well situated to focus on growing value from the Golden State's prolific yet underdeveloped resource base. Our diverse portfolio of low-decline assets with low capital intensity uniquely positions us to generate strong cash flow.

Second, these are assets we know exceptionally well. CRC's business encompasses all four major productive basins in California with integrated operations that provide the unique opportunity set and synergies for sustainable operational excellence. We operate in world-class oilfields where our highly skilled team deploys technological innovations to deliver value through primary, secondary, and enhanced oil recovery. The state's recent energy supply challenges and its over-dependence on imports reinforces the value of our resource portfolio and infrastructure for the world's fifth largest economy.

Finally, CRC's culture is built upon a commitment to ESG leadership, which is detailed in our Third Annual Sustainability Report that we released last month. This report illustrates the longstanding commitment and dedication of our workforce to apply ingenuity and technology to meet California's need for sustainable, affordable, and reliable energy and to contribute to our communities. This report also summarizes our progress on our 2030 sustainability goals for carbon, methane, water, and renewables, which aligns us with the state's climate goals. As I noted, CRC has an industry-leading portfolio of sustainability projects and our 2019 climate disclosure was recognized by CDP earlier this year with an A minus ranking at their leadership level. I encourage you to read our sustainability report. Our 2030 sustainability goals aren't mere aspirations, achieving annual sustainability project milestones in HES metrics is directly tied to the annual incentive compensation of our management and workforce. We believe CRC's sustainability strategy exemplifies ESG leadership that is directly aligned with the State of California.

Further, I want to provide a specific example from the third quarter that demonstrates the diligence of our workforce in helping our fellow Californians overcome current challenges. In August, California was hit with a heat wave and significant wildfires that jeopardized the State's electricity supply. Our operations team responded rapidly by restarting a dormant cogeneration plant and reducing our electricity demand during peak demand hours to conserve electricity for our communities.

Our State's challenges with energy reliability have shined a spotlight on California's needless dependence on imports for more than 70% of our oil, 90% of our natural gas, and nearly a third of our electricity. To meet California's climate goals, we believe it is essential for California leaders to apply the same safety, labor and environmental standards on the production of imported energy that we adhere to every day in our operations. Doing so would ensure that California's leading policies and ambitious goals improve the global environment, and would encourage more producers worldwide to implement leading sustainability goals and ESG practices like CRC.

I would like to thank all our employees for their dedication, focus, and efforts throughout 2020. They have simultaneously preserved and protected the business and delivered significant cost savings while maintaining record safety performance during the pandemic. I'm particularly proud of our plant and field workers who have delivered every day the energy that is needed day-in and day-out during this challenging year. I'd also like to thank all of California's essential workers who continue to meet our State's daily needs for food, water, medical care, and energy.

As economies are struggling to restart around the world, we have seen a partial return of petroleum demand, but it is a long road to full recovery. We anticipate that progress on COVID-19 vaccines or treatment will eventually restore economic activity and further support petroleum demand, particularly for jet fuel. While we don't expect improvement in crude oil prices heading into 2021, the curtailment of capital investment in the sector across the globe should eventually balance supply and demand. We will continue to apply our VCI and payback metrics in evaluating our investment alternatives in this price environment.

At this point, I'd like to introduce Francisco Leon to many of you as CRC's new CFO. Francisco has been with CRC and its predecessor for over 15 years and has served in many roles, most recently as EVP of Corporate Development and Planning. I've worked with Francisco for many years and I feel that his skillset in capital allocation and value creation will be a major plus in his new role of CFO. He has been an instrumental part of our restructuring and our cost-reduction efforts.

Francisco will summarize the core elements of our emergence and third quarter results.

Francisco Leon
Thanks, Todd. Good afternoon everyone. First of all, I am honored to participate in this call as CRC's new CFO and I'm grateful to help lead this tremendous organization of women and men who continue to showcase the resilience of our assets. We will continue to provide safe, affordable, and reliable energy for California by using our technological innovation and our environmental leadership. We began trading on the New York Stock Exchange with the CRC ticker on October 28, after emerging from a restructuring process, the details of which I will elaborate on shortly.

As Todd noted, CRC's solid foundation and competence, our strong financial fundamentals, disciplined value focus, sustainable operational excellence, and ESG leadership. Our financial performance will be defined by our continued capital discipline, return-driven asset development and integration of our cutting-edge sustainability projects into our core oil and gas operations. Even after emerging with peer leading balance sheet metrics, we are not done strengthening our balance sheet. In fact, we will target at least a 1x leverage profile, even in the current price environment.

I would like to provide high-level details of our restructuring process that was completed in three short months during the pandemic. Today we have approximately 83 million shares and 4 million warrants in total with a four-year term. These warrants have an exercise price of $36. As Todd mentioned, we view ourselves as a cross-over credit. At emergence, we had $535 million of net debt, consisting of a $300 million note with Ares, which is secured by our Elk Hills Power Plant and associated gas processing facilities, and a $200 million second lien note, with the remainder on our revolver. Our RBL has a commitment level of $540 million, providing ample liquidity of $350 million at emergence.

Our simplified balance sheet will significantly improve our ability to generate free cash flow. We conducted a thorough review of our costs during the restructuring process and streamlined our organization to strengthen our margins and drive further efficiencies. When comparing to the third quarter of last year, we were able to reduce our operating and G&A costs by well over $300 million, annualizing the difference between the third quarter of 2019 and 2020. We expect to retain over half of these reductions going forward.

Our actions favorably position CRC to succeed in the current price environment with peer-leading industry financial metrics, a competitive cost structure and a stellar balance sheet. While we expect to retain the majority of our savings achieved during the recent downturn as we focus on our margins, we will return higher yielding wells to service, thereby modestly increasing our operating costs.

This leads us to capital investment. In my previous role, I supervised CRC's capital allocation across our large portfolio of assets. We have always used strong capital discipline in allocating to the highest return projects in CRC's portfolio. This will not change, as we will continue to live within our cash flow and rely on our vast, high-quality asset portfolio with an average NRI of approximately 87%.

Turning to this quarter's financial and operational figures, I would like to remind you that the third quarter results were significantly impacted by bankruptcy-related charges and also reflect our pre-bankruptcy share account. We expect to finalize fresh-start accounting in the fourth quarter, which will be reflected in our 2020 10-K.

As Todd noted, with the commodity price downturn from the double impacts of COVID-19 and the Saudi-led oil price war during the second quarter, we curtailed our capital investment program to a level that maintains the mechanical integrity of our facilities while operating them in a safe and environmentally responsible manner and preserving cash through the restructuring process.

Net production for the third quarter was 106,000 barrels of oil equivalent per day, leading to a quarterly adjusted EBITDAX of $103 million and an adjusted EBITDAX margin of 25%. Our strong Brent-linked oil realizations together with robust California Natural Gas market dynamics, and our consistent capital discipline, partially offset by bankruptcy costs resulted in third quarter free cash flow of $44 million after internally funded capital. For the third quarter, we reported an adjusted net loss of $55 million.

In the third quarter, our operations team continued to focus on safety protecting the base, controlling the controllables in building inventory. On OpEx, we added three maintenance rigs during September to return higher margin wells to service. Also, during the third quarter, CRC invested internally $4 million of capital with no additional JV capital contribution during this period.

For a more detailed look at net production, we produced a net average of 106,000 BOEs per day during the quarter. Consisting of 64,000 barrels per day of crude oil production, 14,000 barrels per day of NGLs, and 168 million cubic feet per day of natural gas. The San Joaquin basin produced 78,000 net BOE per day. The Los Angeles basin produced 22,000 and both the Ventura and the Sacramento basins produced 3,000 BOE per day, respectively.

At the start of the pandemic, due to economic conditions, we started shutting-in certain wells to enhance our cash flow. During the third quarter, we had 3,000 BOE per day of shut-in production. Excluding the shut-in production and the effect of significantly reduced well repair activity, our assets continue to perform within our industry leading refinery.

For those of you who are new to CRC, California is an energy island with approximately 72% of its crude oil being imported from outside the State, primarily via foreign supertankers. As a result, our commodity realizations tend to reflect Brent, and have continued to be relatively strong versus the rest of the lower 48. CRC's realized crude oil prices in the third quarter of 2020, excluding the effect of settled hedges, registered 96% of Brent. Hedges enhanced our realized oil price by $0.32 per barrel during the third quarter, for an average realized price of $42.15 per barrel.

Turning to NGLs, prices for the quarter averaged $25.16 per barrel, and came in at 58% of Brent. Prices for NGLs increased slightly for the three months ended September 30th, 2020 compared to the same period in 2019, due to improvements in negotiated sales differentials, along with stronger NGL values relative to crude. These levels are still at a premium to our peers across the U.S.

Natural gas markets saw seasonal strengthening during the third quarter of 2020 and CRC's realized prices averaged $2.22 per thousand cubic feet, or 115% of NYMEX. As of October 31st, 2020, CRC has hedges in place that protect approximately 64% of our expected fourth quarter 2020 oil production. This includes 75% of our oil production for both November and December. For further information on our hedging program and volumes, please see our slides posted earlier today.

Production costs for the third quarter of 2020 for $141 million, or $14.52 per BOE. Due to our team's continuous efforts and our focus on safely controlling costs, we were able to lower our third quarter production costs both on an overall basis, by 36%, and on a per BOE basis, by 23%, compared to the same prior-year period, which averaged $18.82 per BOE. The decrease in production cost was primarily due to lower well repair and surface operations activity across our fields, as well as cost savings from the fourth quarter 2019 and third quarter 2020 workforce reductions. Excluding PSE effects, our third quarter 2020 production costs would have been $13.37 per BOE.

During our restructuring, we further streamlined our organization for CRC to succeed and profitably operate in a lower commodity price environment. We reduced our staffing in the third quarter of 2020 by approximately 12% when compared to year-end 2019. As a result, we anticipate ongoing employee-related cost savings of approximately $40 million annually, with approximately 75% of the reduction in G&A expenses and the remainder reflected in production costs.

Our third quarter 2020 general and administrative costs averaged $6.59 per BOE, $0.16 below the previous quarter, primarily due to ongoing cost savings efforts and the third quarter workforce reduction. These savings were partially offset by higher incentive and retention awards, which were made with court approval during our restructuring process and the effect of lower production. Third quarter 2020 general and administrative costs, excluding incentive and retention payments, decreased by $11 million year-over-year, or by $1.13 per BOE.

Taxes other than on income, which are largely comprised of ad valorem taxes based on the value of minerals in the ground, as well as our Greenhouse Gas costs came in as we expected at $42 million in the third quarter.

In the third quarter of 2020, we reported a net loss of $29 million attributable to our common stock. Adjusting for the non-controlling interest in our Elk Hills Midstream JV, we had income of $2.20 per diluted share. When also adjusting for unusual and infrequent items and other non-cash items, such as reorganization and restructuring, together with severance expenses that are generally excluded from core earnings by investment analysts, our net loss would have been $55 million.

Adjusted EBITDAX for the third quarter of 2020 was $103 million compared to $278 million from the prior year quarter, primarily due to 38% quarter-over-quarter decline in realized oil price driven by the ongoing pandemic. As commodity prices modestly increased from April lows, our adjusted EBITDAX margins recovered to 25% in the third quarter of 2020 from 7% in the second quarter. This increase in third quarter adjusted EBITDAX was largely driven by higher commodity prices. Despite the challenging commodity markets, our trailing 12-month EBITDAX remains healthy and stands at $681 million.

CRC reported cash flow from operations of $48 million in the third quarter of 2020, which was significantly higher than the second quarter, primarily due to recovering commodity prices. In the third quarter, we generated approximately $55 million in discretionary cash flow and $198 million through the first nine months of the year, which compares favorably to our internally funded capital investments of $37 million through the first nine months of the year.

CRC has a high level of operational control over our diverse portfolio, which continues to allow us to pivot our organization during these volatile periods, and to also rapidly adjust our activity to an expected change in cash flow. Historically, we have a proven track record of focusing particularly on value-driven projects and staying nimble with our operations. As such, we will continue to respond and to adapt quickly and decisively in order to succeed throughout the price cycle.

We believe our operational knowledge and financial discipline are demonstrated by our track record, even during an unprecedented sector downturn and an ongoing pandemic, to operate within our means while generating free cash flow.

Finally, please note that we have provided detailed analysis of adjusted items in the attachments to our earnings release. Due to continued market uncertainties and implementation of our fresh start accounting, we will not be providing our normal guidance for the fourth quarter.

I will be happy to take any questions you may have on our results, during the Q&A portion of this call.

Thanks. And I'll now turn the call back over to Todd.

Todd Stevens
Thanks Francisco. As we emerge with a new capital structure, we've taken steps to enhance CRC's resilient foundation and invite you to invest in a conventional low-decline, value-focused energy company with an enviable ESG track record. We are looking forward to creating value for our shareholders. We believe our recent emergence with top-quartile leverage metrics provides a very attractive value proposition compared to our peers. We have a history of generating free cash flow and look forward to updating you on the investment opportunity at CRC.

CONCLUSION

Todd Stevens
Thanks everyone. I am extremely proud of our workforce during this time of uncertainty. They have conducted themselves with professionalism as we have strength in our ability to generate cash flow while operating safely and productively during the pandemic. CRC has many valuable assets including our employees and the relationships we have with our vendors, state, and local leaders in the communities where we live and work.

We appreciate everyone's attendance on today's call and look forward to delivering results for our new shareholders. We invite you to invest in CRC as we proudly supply reliable and affordable energy for California, by Californians.

Operator
The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.