California Resources Corporation

First Quarter 2021 Earnings Conference Call

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CORPORATE PARTICIPANTS

Mac McFarland - *President, Chief Executive Officer*

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

Shawn Kerns - *Executive Vice President of Operations and Engineering*

Mike Preston – *Sr. Executive Vice President, CAO & General Counsel*

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Joanna Park - *Vice President of Investor Relations and Treasurer*

PRESENTATION

Operator
Good morning, and welcome to the California Resources Corporation first 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 star key followed by zero. After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press star then one on your telephone keypad. Please note this event is being recorded.

I would now like to turn the conference over to Joanna Park. Please go ahead.

Joanna Park
Thank you. I'm Joanna Park, vice president of investor relations and treasurer. Welcome to California Resources Corporation's first quarter conference call. Participating on today's call is Mac McFarland, president and chief executive officer, Francisco Leon, executive vice president and chief financial officer, Shawn Kerns, executive vice president of operations and engineering, Mike Preston, executive vice president, CAO and general counsel, and Jay Bys, chief commercial officer, as well as several other members of the CRC executive team.

I'd like to highlight that today we have provided supplemental slides which we may refer to during our prepared remarks, which can be found on the investor relations section of our website, www.CRC.com. We have also provided reconciliation of non-GAAP financial measures discussed to the most directly comparable GAAP financial measure on our website and in our earnings press release.

Today's conference call contains certain projections and other forward looking statements within the meaning of federal securities law. These statements are subject to risks and uncertainties and may cause actual results to differ from those expressed or applied in these statements. Additional information on factors that could cause results to differ are available in the company's 10Q, which will be filed later today. We ask that you view it and our cautionary statement in our earnings press release.

A replay will be made available on our website following today's call. And we have allotted additional time for Q&A at the end of our prepared remarks.

Thanks. And I will now turn the call over to Mac.

Mac McFarland
Thanks, Joanna, and thanks to everyone on the phone for attending today's earnings call.

Jumping to the punchline, the first quarter results delivered $120 million of free cash flow, which set the backdrop for the $150 million share repurchase program we are announcing today. Our strong start to the year displayed CRC's ability to execute on our strategy and deliver meaningful cash flow. The company is trending toward the high end of our free cash flow guidance that we provided during our March 18th strategy day. That is $350 million in free cash flow for 2021 and would reflect an 18 percent free cash flow yield at yesterday's market valuation.

Based on the progress we have made to date and because our stock price has not fully participated in the most recent energy sector rebound, we believe that our stock offers a very attractive return. The $150 million share repurchase program provides us with the flexibility to make good on our commitment to return capital to our shareholders while also maintaining a healthy balance sheet with low leverage ratios and significant liquidity. Francisco will detail this later during his remarks.

From an activity standpoint, first quarter results were achieved with just one drilling rig where we drilled 17 wells, 15 of which were brought online during the quarter and the other two came online during the second quarter. During the quarter, we also completed 40 capital workovers and performed 570 downhole maintenance jobs, bringing back online nearly 3,300 barrels of oil equivalent per day of gross production. In May, we added a second drilling rig and increased our maintenance rig count from 30 to 38. We expect to maintain this level over the next six months to focus on quick payback, higher return backlog of wells.

I'm extremely proud of our employees for maintaining safe and efficient operations and for adapting to and executing our strategy to deliver these strong results. We had one of the lowest safety incident rates in recent history and outstanding environmental performance.

Shifting gears now, there has been a fair amount of discussion regarding the California regulatory environment, highlighted by the recent announcement to ban fracking. Regardless of whether or not such a ban is upheld, CRC will see no material impact because less than one percent of our crude reserves require well stimulation, and our current long term development plans do not include well stimulation. And in fact, CRC's operations do not require high pressure cyclic steam. We continue to operate according to the strictest environmental regulations in the world and the carbon intensity of CRC barrels are much lower than the average imported barrel as California continues to import 70 percent of its oil needs. Said differently, there will be no impact to CRC if the fracking ban is upheld.

That being said, we look forward to working with the state on its energy transition plans. In the second half of this year, we are planning to provide additional clarity on several concrete items directly related to energy transition that will have the potential to benefit California's future success in this area. Our core operations will continue to deliver solid cash flow while we work on these future steps.

Additionally, CRC is evaluating ways to strengthen our ESG commitment even further. We have multiple sustainability opportunities and are looking to strengthen our approach through a total review of our ESG efforts. The company is successfully delivering on our current 2030 sustainability goals, and given the significant progress in the areas of water recycling and methane reduction, our future efforts will focus on renewables integration and decarbonization projects.

In other words, we are looking to revamp the "E," or the environmental, approach of our ESG strategy to make a bigger impact on the space decarbonization and energy transition plans through our focus on renewables and CCUS without compromising our social and governance commitments. This may include opportunities outside of the Elk Hills CCS and EOR project as well as both self supply and grid supply of renewable energy. We expect to provide further details on the revamped ESG strategy in the second half of the year.

I'll now turn the call over to Francisco, who will provide additional details on the first quarter financial performance and on our borrowing base redetermination. Francisco?

Francisco Leon
Thanks, Mac. Good morning, everyone, and thank you for joining us on this call.

As Mac mentioned earlier, CRC continues to successfully execute on our corporate strategy based on strong business financial fundamentals, disciplined capital allocation, and robust free cash flow generation. As you can see on slide four of our earnings presentation slide, we have outlined several key quarterly highlights.

Our strong performance during the first quarter contributed to an adjusted EBITDAX of $189 million and adjusted net income of $102 million or $1.22 per diluted share. During the first quarter, we generated $120 million of free cash flow, showcasing our industry leading free cash flow generation capability. We reported net quarterly production of 99,000 barrels of oil equivalent per day and 60,000 barrels of oil per day. Net oil production was lower than 3,000 barrels a day on a quarter over quarter basis, primarily due to PSC adjustments associated with higher oil prices. On a gross basis, oil production was essentially flat quarter over quarter while operating just one drilling rig in the San Joaquin Basin. A true testament to the quality of our assets, our low decline rate, low capital intensity, and the strong safety culture of our employees.

As Mac highlighted, during the first quarter, we took significant actions to further simplify and improve our capital structure. In January 2021, we issued $600 million of 7.125% senior unsecured notes due in 2026. With the proceeds of this deal, we successfully repaid in full our second lien term loan, all outstanding senior Elk Hills Power secured notes and used the remainder to repay substantially all of our outstanding borrowings on our revolving credit facility.

Further, earlier this month and supported by our strong financial and operational performance, we completed our borrowing base redetermination, which resulted in an increase of our borrowing base to $1.2 billion, up from $1.167 billion previously. Additionally, we entered into the first amendment to our revolving credit facility that provides CRC with additional strategic flexibility regarding shareholder initiatives and future hedging levels. More specifically, the amendment loosened the restricted payment conditions and increases our available capacity to return capital to our shareholders.

With these actions, coupled with our industry's leading free cash flow generation capability, CRC exited the quarter with a single unsecured debt tranche, an undrawn RBL, and total liquidity of $545 million, which included $102 million of net cash generated during the quarter for a total of $130 million of cash on our balance sheet.

This quarterly performance additionally underscores the company's strong focus on free cash flow generation, our assets capacity to support our strategy, and our employees' ability to safely, efficiently, and reliably produce much needed energy for Californians.

As stated during our strategy day, we anticipate our 2021 investment plan to generate between $250 million and $350 million of free cash flow in a $60 per barrel Brent environment, highlighting the efficiency of our capital deployment and industry leading low decline rate. Given our current performance, we are reaffirming guidance and expect to trend towards the high end of our free cash flow range, implying a free cash flow yield in the high teens, while assuming our current market capitalization. This yield, coupled with our estimated 2021 net leverage ratio of about half a turn, positions CRC with a strong foundation to deliver sustainable shareholder returns.

As Mac mentioned and as a result of a strong first quarter and steps taken to improve our cost and capital structures, we are now in a position to announce a $150 million share repurchase program, effective in the second quarter of 2021, marking this first important step towards returning cash to shareholders and in just seven months after our emergence. Further, as slide six indicates, the value of our year end 2020 SEC proved reserves at $60 Brent is over $5.7 billion, which is more than double our current enterprise value. Our high concentration of value in our low decline, proved developed category, and large inventory of high return assets in our core fields provide confidence in both the intrinsic value of our stock and the free cash flow deliverability. This supports the reasoning behind our share repurchase program. If I also expand a bit further on peers' comparable valuation as compared to our guided 2021 numbers, we're certainly trading below our sector average of enterprise value over 2021 EBITDAX multiples of around five times.

Continuing on, as we made progress on the goals of our strategic direction discussed earlier in the year, CRC made several organizational changes by realigning the company's corporate and operational functions. As a result, our first quarter 2021 G&A cost averaged $5.36 per BOE, which is $00.87 below the previous quarter primarily due to our ongoing cost savings efforts and workforce reductions. For the remainder of the year, we expect CRC's G&A performance to further improve and reach approximately a $5 per BOE run rate while trending towards the low end of the previously issued guidance of $180 million to $190 million per year.

Further, operating costs for the first quarter of 2021 were $164 million or $18.33 per BOE, which is $0.91 higher than the previous quarter as the company invested in downhole maintenance and workovers on existing wells, incrementally raising opex. I would like to provide a bit more clarity on this point.

On slide 16 of our earnings deck, you can find additional color of CRC's opportunity set with respect to our high impact maintenance well backlog. CRC is able to opportunistically reenter these existing wellbores and bring back incremental barrels through well maintenance. Through rapid technical identification and commercial analysis, well remediation work is prioritized to bring the highest value wells back online first increasing uptime and production through high impact well work and opex maintenance at the fraction of the cost of a new well. This capital shift will allow for a return of PDP production barrels with almost no reservoir risk to ensure payments, demonstrating another strength of our assets.

For the remainder of the year, we anticipate opex to modestly increase. However, since we view opex dollars and capital investment dollars as almost interchangeable, capital investment will be reduced similarly, and our ability to achieve our free cash flow targets will be strengthened. Said simply, this is a huge differentiator for CRC. We're a conventional value player with a low decline asset base that compares favorably versus our shale counterparts.

For the remainder of the year, we expect to continue demonstrating the resilience and quality of CRC's low decline and low risk assets, continue to improve our cost structure and disciplined capital allocation. The combination of all of this is what gives us confidence that we will trend towards the high end of our 2021 free cash flow guidance and our ability to return cash by initiating the $150 million share repurchase program.

Finally, please note that we have provided detailed analysis of our quarterly financial and operational results and our 2021 guidance in the attachments to our earnings release.

Thanks, and I'll now turn the call back over to Mac to discuss the outlook for the rest of 2021.

Mac McFarland
Thank you, Francisco.

To conclude--and during the quarter, we have a robust $545 million liquidity position and one of the lowest leverage metrics in the sector. We began to deliver tangible results on our strategy, almost $200 million in adjusted EBITDAX and over $100 million of free cash flow during the quarter. We initiated a share repurchase program that we discussed today, commencing a $150 million program. A very strong quarter, in my view, and something that we are proud of at CRC.

As we look ahead, CRC has largely completed our strategic repositioning. But, we continue to look for additional ways to improve. We intend to provide insights on our business as we transition forward and demonstrate healthy progress on our targets. With our corporate strategy in place, we are on track to deliver the strong cash flows as Francisco discussed and trending toward the high end of our guidance range. Our strategy of strong cost control, efficient operations, and responsible portfolio management are set to drive free cash flow. As I mentioned previously, we're looking to expand and strengthen our ESG strategy to focus our approach on decarbonization and the energy transition in California. But, more on that in the second half of the year.

Again, thank you for your interest in CRC and for joining us on this call today. At this point, we will now open the line for any questions.

QUESTION & ANSWER SESSION

Operator
Thank you. We will now begin the question and answer session. To ask a question, you may press star then one on your telephone keypad. If you are using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, please press star then two. We please ask that you limit yourself to one question and one follow up. If you have additional questions, you may reenter the question queue. At this time, we will pause momentarily to assemble our roster.

And the first question will be from Leo Mariani with KeyBanc. Please go ahead.

Leo Mariani
Hey, guys. Wanted to touch base real quickly here on the return of capital plan. Obviously, you guys chose to go with a buyback. Looks like the stock is reacting favorably to that here today. But, you also talked about other potential return of capital strategies that may come later in the year. How do you guys kind of think internally about those different options and weigh them against each other? Clearly, it looks like the buyback won in the near term. But, sounds like you might be looking at supplementing this with maybe some kind of dividend later on.

Mac McFarland
Yeah, good morning, Leo. It's Mac. How are you? Glad to hear from you.

Leo Mariani
Good.

Mac McFarland
Yeah. Look, the share repurchase program we thought was in the best interest of the deployment of capital and return to shareholders at this point in time given where the stock is not necessarily participating, as we mentioned, with the rebound in the sector. So, we thought that's the best first step. And that's the first step we're taking.

As we go through the remainder of the year, we'll continue to evaluate all different forms of ability to return cash to shareholders as well as, you know, potentially looking at little, I'll say, potential addons or recycling of capital into the business. But, we'll make those decisions as we progress through the second quarter. Anything you want to add?

Francisco Leon
No, I think we had a good quarter building cash, ready to announce the first step, and we'll circle back when we have anything else to announce.

Leo Mariani
Okay, great. And I just wanted to touch base with you guys on the regulatory environment. Obviously, you guys, in your prepared comments, addressed the potential frack ban in California. But, just aside that, which sounds like it would be a very limited impact on most of the businesses in California so far--are you guys aware of any other regulatory developments that may be percolating in the state? I know there was a Senate bill that could have been somewhat deleterious that was shot down, didn't make it out of committee recently. But, are you guys expecting any other energy bills that may come up in the legislative sessions this year, and just any thoughts you might have on the potential for 2,500 foot setbacks that could either eventually emerge in California but if it did emerge, do guys have a rough idea of the impact on your business?

Mac McFarland
Yeah, Leo. So, you know, we've discussed this previously. Obviously, there are two bills in the Senate, S.B. 467 and S.B. 419. S.B. 467, which had--in its early stages, had a fairly significant impact on the E&P space, but did not make it out of subcommittee on vote, was being reconstituted, and I think it still hasn't even made it to subcommittee.

And then, S.B. 419 obviously is the labor bill. And how it impacts upstream E&P as it did to refinery--not that particular bill, but as refineries were impacted with using union labor. S.B. 419, we don't think, will have an impact on our projections, given that we already have an agreement to use trades on surface operations and for a lot of our surface and facilities types of operations. But look, let me ask Mike Preston--the general counsel--to add onto that.

Mike Preston
Thanks, Mac. I would agree. You know, those were the two primary bills that we've been watching this year. Setback bills have been introduced over the last two years and haven't advanced. And there may be some rulemaking relating to setback that proceeds in the future. We're obviously keeping track of that. As you may be aware, the lion's share of our operations are in Kern County, relatively remote locations. But, in any event, we're fully engaged with the rest of industry and analyzing that legislation and keeping an eye on it. We don't anticipate anything in the near term that will significantly impact us.

Leo Mariani
Okay. Thanks, guys.

Operator
Our next question will be from Noel Parks with Tuohy Brothers. Please go ahead.

Noel Parks
Good morning. Just a couple things. You were talking a bit about--there's a credit line and just some of the restricted payment conditions there, not a topic that usually comes up a lot. But, I guess since it's a new revolver and everything like that. Could you just talk a little bit more about the implications for various means of returning cash to shareholders with those conditions?

Mac McFarland
Sure, Noel. It's Mac. Just real quick. Yeah, it's not often that you get to discuss the arcane inner covenants inside of our capital structure. But, when we exited from bankruptcy, we had some cleanup work to do. That's why we had the high yield notes that came out and then this RBL amendment. It's just trying to put everything in a regular way as we came out of bankruptcy. It was optimized to get out of bankruptcy, but not necessarily optimized in what I'd consider regular way capital structure. And so, that's what Francisco and the team have been working on. I'll let Francisco give you the finer points in the RBL.

Francisco Leon
Yeah, absolutely. So, we want to make the RBL much more of a standard form. So, the biggest changes are to the distributable free cash flow going into the last 12 months calculation, which is very typical. And that allows us to really reflect the cash that were building currently in the business and build that over time to think about distribution of capital to the shareholders. That's one.

The second one was around the ability to have more flexibility on our hedging. So, we looked at both the maximum and the minimums of the hedging capacity, raising the ceiling on the maximum hedging that we could choose to do. We went up to 85 percent, but also lowering the minimum hedging capacity, 33 percent of PDP volume, subject to a leverage ratio. So, ultimately, we're bringing a lot of flexibility into our RBL that we didn't have at emergence in just going to a regular way, as Mac said, a way of distributing cash to shareholders.

Noel Parks
Great. Thanks for the clarification. And in terms of the different decapitalization, alternative energy projects that you're looking at, just curious if you had an investment hurdle in mind for what you think would be worthy of capital. And just wondering what other considerations are in play as you look at the various projects that you might take on.

Mac McFarland
Yeah, Noel. It's Mac. As I outlined in a fairly high level, because we're still doing the detailed work--and that's why we said more on this in the second half. We're looking at a number of things, including, in addition to the Elk Hills project, continuing to advance the CCUS project there. And obviously, we're completing the FEED study there, and that'll be out in September of this year, the completed study. We're also looking at using a number of our depleted fields for CCS as well as, I mentioned, self supply for different renewables, primarily solar, in this case, as well as providing grid supply using some of our surface acreage using solar on those acres.

And when I look at those things, we have not necessarily fully developed the entire--I'll call it--project plan including how we're going to look at the financing. But, we would also look for alternative financing structures to bring in our potential partners because the renewable space, for example, has a different cost of capital than we do as an oil and gas company. So, we'd been looking for bringing in the right type of capital structure but leveraging our assets in order to be a part of that energy transition.

So, a lot there, probably not specifically answering your question. But, we would not enter into an uneconomic transaction, from our perspective. And that's why we're looking at alternative sources of capital, both equity and debt, to fund some of those activities.

Noel Parks
Thanks. That's actually helpful. It's what I was looking for. Thanks a lot.

Operator
And the next question is from Ray Deacon with Petro-Lotus. Please go ahead.

Ray Deacon
Hey, good morning. I had a question about your JV. The dollars that were going to be spent to exit some of the drilling JVs. What quarter do you think those will hit in?

Francisco Leon
This is Francisco, Ray. As we outlined in the earnings release, we anticipate one of the JVs would Benefit Street Partners to be reverting some time this year, late third quarter, early fourth quarter. That's part of the pre agreed conditions on the contract, and it's a natural exit point for them. And there's no residual ownership of any of our wells when they revert.

Ray Deacon
Okay, got it. And I guess just, lastly, given that the free cash flow looks like it's at the high end of your prior guidance, do you still feel the $1.5 billion over five years of free cash flow is the right number or could it be a higher number than that?

Francisco Leon
Yeah, we guided in the strategy day to $1.5 billion, assuming the midpoint of our guidance and $60 Brent. We do see things rolling off, like BSP, and our hedges improving to next year. But, we're not changing guidance at this point. We're staying with the $1.5 billion. But, certainly, the price environment has continued to strengthen. And we'll see where we end up later in the year. But, for now, we're staying with $1.5 billion guidance that we've given for five years? Mac?

Mac McFarland
I think that's right. We see a backlog of opportunities.

Ray Deacon
And I guess, just lastly if I could, a quick one. I agree the 18 percent free cash flow yield seems much too high. If the dividend doesn't resolve that, I guess, what would be your preferred way to get the market to look harder, I guess, at the story?

Francisco Leon
So, today, we announced the share repurchase program, $150 million. We certainly think this is the first move because we see the stock being undervalued on a relative basis to the entire sector. So, the good thing is--if you see our free cash flow projections, they're very strong for the year. We don't have to make any debt repayments. We're seeing with our high yield transaction that

we did earlier in the year, very low leverage. So, we have a lot of opportunities available to us. And we'll continue to assess how the stock performs. And then, we'll think about what comes next. But, right now, we felt that this was the right first move on the share repurchase program. And we have sort of a lot of options that could go from eventually paying a dividend to investing in the business and putting more money into our wells and a number of other options as well. So, we feel we have--we've built up the cash, we cleaned the contractual aspect of our restrictions. And as we continue to perform, we look at other ways to return capital to shareholders and move the stock price.

Ray Deacon
Got it. Thank you very much.

Operator
And our next question will come from Jeff Robertson with Water Tower Research. Please go ahead.

Jeff Robertson
Thank you. My question is on the workover activity. As you work through the backlog that you have, ultimately spending money on work overs--will that have a positive impact then on the follow-on production costs? Will it be noticeable in the company?

And then, secondly, how long would it take to work through the backlog that you reference that was built up when the company was dealing with its balance sheet and maybe deferring capital that otherwise would have been spent on these types of projects?

Mac McFarland
Yeah, Jeff. It's Mac. So, the backlog that we had coming out of 2021 because we didn't necessarily do the same amount of maintenance last year as we typically would provide us this opportunity. So, the opportunity is really to shift capital dollars into opex dollars. And you'll see that in our guidance in the slides. And so, we moved $15 million and shifted places in the guidance. That brings barrels back. But, it also increases our operating expenses on the numerator side of things. And so, I'm not sure exactly how to answer your question specifically. But, we do get good high return barrels.

As far as working through the backlog, we see maintaining that 38 maintenance rigs for the balance of the year, and working our way through. And so, as we go into 2022, we'll see less opportunity, and therefore, we'll shift those dollars back into capex. But, I'm looking at Shawn Kerns here, head of operations. Shawn, anything to add?

Shawn Kerns
No, Mac. You've got that right. And really, we'll take care of that this year. We're picking up our maintenance rig activity, working that backlog off. And, as you mentioned, you know, the incremental operating cost is really just temporary to bring those barrels back on. And then, you'll see the benefit going into 2022.

Jeff Robertson
Thanks. I guess I was--I guess my--maybe I didn't word it right. But, the upfront cost of spending money on workovers, which is obviously reflected in operating costs--but then, you get the production benefits. So, my question is--does that wash out over time in operating costs? So, you kind of go into a steady state where you've got the benefit of production lowering. Is it maybe

in fact a lowering production--because you've already spent the upfront money to recomplete a well or some project.

Shawn Kerns
Yeah, Jeff. That's right. It is accretive. So, once you get those barrels back online, then it more than takes care of that cost.

Jeff Robertson
Okay, thank you.

Operator
And once again, if you have a question, please press star then one. The next question will come from Eric Seeve with GoldenTree. Please go ahead.

Eric Seeve
Hi, guys. Thanks for the call. Great quarter. Couple of quick questions. Your realizations in the quarter were terrific, particularly around the NGL side. Can you provide any color in terms of what investors should expect going forward for the crude side and NGL side in terms of realizations?

Jay Bys
This is Jay Bys. Especially on the NGLs, over the last year, obviously it's been a very tumultuous marketplace for NGLs. So, where we sit today compares quite favorably to the same period last year. Do we expect to see continued strength in that area? You got some inflationary pressures, you've got some disequilibrium in the economic rebound. It's hard to say that there's going to be the kind of appreciation that we've seen in the last 12 months over the next 12.

Eric Seeve
Terrific. Thank you. And then, my other question was can you maybe give a little bit of color to investors on where you are--you talked already about work overs. But, in terms of the new drilling, can you give people a sense of where are you drilling wells today and what kind of returns are you seeing?

Mac McFarland
Sure. The 17 wells that we drilled in the first quarter, which is now up to 22, has been in the Mount Poso area. And we've been--what I would say is on target, both in terms of cost as well as initial IP across the 22 wells. I mean, obviously some were above, some below. But, these are the type curve on average. And now we're--we started a second rig in--this quarter, earlier this quarter in Buena Vista. And so, we're starting to drill there. We are currently evaluating our original plan, taking that out to three or four rigs in the second half of the year, which is still the current plan. But, we're evaluating whether or not we push some of that out and go with some additional dollars on workovers. Shawn, anything to add on that?

Shawn Kerns
Nothing to add on that, Mac. Just drilling in and around our core areas.

Eric Seeve
Terrific. Thank you.

Mac McFarland
Did that answer your question, Eric?

Eric Seeve
Yes, sir.

CONCLUSION

Operator
Ladies and gentlemen, this concludes our question and answer session. I would like to turn the conference back over to Mac McFarland for closing remarks.

Mac McFarland
Keep it simple. Thank you for your interest and participation on today's call. And look forward to speaking to everyone at the second quarter earnings call in the upcoming investor meetings. Take care.

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