Berry Corp (Q3 2020 Earnings)

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Corporate Speakers:

- Todd Crabtree; Berry Corporation; Manager of IR
- Arthur Smith; Berry Corporation; Chairman, President & CEO
- Fernando Araujo; Berry Corporation; COO
- Cary Baetz; Berry Corporation; Executive VP, CFO & Director

Participants:

- Leo Mariani; KeyBanc Capital Markets Inc.; Analyst
- Charles Meade; Johnson Rice & Company, L.L.C.; Analyst
- Nicholas Pope; Seaport Global Securities LLC; Research Analyst

PRESENTATION

Operator: Ladies and gentlemen, thank you for standing by and welcome to the Berry Corporation Q3 2020 earnings call. (Operator Instructions) Please be advised that today's conference is being recorded. (Operator Instructions)

I would now like to hand the conference over to your speaker today, Manager of Investor Relations, Todd Crabtree. Thank you. Please go ahead, sir.

Todd Crabtree: Thank you, Suzanne, and welcome to everyone this morning. Thank you for joining us for Berry's third quarter earnings teleconference. Yesterday afternoon, Berry issued an earnings release highlighting 2020 third quarter results and our continued response to the financial and operating uncertainties caused by COVID-19. Addressing these and other issues will be Trem Smith, Board Chair and CEO; Fernando Araujo, Berry's new Chief Operating Officer and Executive Vice President; and Cary Baetz, Chief Financial Officer and Executive Vice President.

Trem will discuss Berry's continued response to these unprecedented times and the company's plans for the remainder of the year. Fernando and then Cary will share further details on how we are addressing the operational and financial aspects of our business. Before turning it over to questions, Trem will make a few concluding remarks.

Before we begin, I want to call attention to the safe harbor language found in our earnings release. The earnings release and today's discussion contain 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 materially from those expressed or implied in these statements. These include risks and other factors outlined in our filings with the SEC. Our website, bry.com, has a link to the earnings release and our most recent investor presentation.

Any information, including forward-looking statements, made on this call or contained in the earnings release and that presentation reflect our analysis as of the date made. We have no plans or duty to update them, except as required by law. Please refer to the tables in our earnings release and on our website for a reconciliation between all adjusted measures mentioned during today's call and the related GAAP measures. We will also post the replay link of this call and the transcript on our website.

I will now turn the call over to Trem Smith.

Arthur Smith: Thank you, Todd. Good morning, everyone, and thank you for joining us today. I would be remiss if I didn't acknowledge that yesterday, the United States held a critically important election for our nation and our industry. I can't tell you what the election results will mean to the industry nor Berry specifically.

But I can tell you that we have designed Berry to grow value in various political and economic environments and despite whatever headwinds we may face. We are resolutely focused on the business, producing energy efficiently in an environmentally sensitive manner, managing our financials to ensure we will prosper and building our vision for the future, which includes our part in the energy transition. I'm proud and humbled to say that the Berry team has done an exceptional job executing our plan without being distracted and ensuring we come out of this cycle in a strong position for growth.

We are fully confident that oil and gas, especially locally produced oil and gas, will be a long-term component of any reliable, affordable and equitable energy future. In short, oil as an energy source, is not irrelevant in both the developed and developing economies of the world. We continue to operate in all the ways I discussed in Berry's first and second quarter earnings calls since the onset of COVID-19.

First, our employees and the communities where we operate remain a top priority. We employ strict COVID-19 protocols in keeping with CDC guidelines. We have not had a workplace outbreak and our offices have been open for business for more than 5 months. Our employees and the workplaces remain safe, healthy and productive. Second, Barry is unique in the oil and gas business for several reasons.

Our fundamental principle of living out of levered free cash flow has never changed nor will it. We still expect to generate more than $100 million in levered free cash flow this year. We continue to create value as we always have, even in this downturn. We will end the year with a strong cash position.

Our OpEx cost structure is down more than $3 per BOE since the end of last year, and we believe most of this is sustainable for the long term. Finally, we have entered the newest chapter of Berry's evolution into a top value generator in the oil and gas space. I am truly excited about this and extremely confident Berry will be successful in achieving it.

The remainder of my comments will be around this vision and looking forward into 2021. Most recently, we hired our new COO, Fernando Araujo, whose career and character demonstrates our core values of leadership, entrepreneurship, accountability, ownership and communication. He comes to us from the great energy technology firm, Schlumberger, where he managed more than 260,000 barrels of oil per day in 7 countries in the Western Hemisphere.

Prior to Schlumberger, he managed Apache's assets in Egypt, Argentina and Canada for more than 18 years. His breadth of international and technical experience and his experience managing hundreds of thousands of barrels of production per day are perfect for achieving our vision. You will hear from Fernando in a few minutes.

Simply put, our vision is to be part of the energy transition in whatever form it may take. We have been aligning ourselves with the goals of each state where we operate since our emergence in 2017. We know that any success towards an energy transition will require all parties to come to the table to work together for that transition. It will require a diversified energy market, including renewables and oil and gas, and it must be reliable, affordable and equitable for all citizens of California, Colorado and Utah, where we currently operate. Oil and gas are and will continue to be a significant relevant part of the solution.

At Berry, we believe that homegrown production is a much more environmentally and socially favorable source of energy than imported tankered oil from foreign countries, including OPEC+, where today more than 60% of California's substantial oil needs per day are sourced, to the disadvantage of its citizens. For our industry and Berry specifically, it is my strong view that the industry can no longer take a business-as-usual approach.

Berry is convinced that alignment with the state's environmental goals, such as those in California, make sense and is required by all parties. Similarly, governments must recognize that oil and gas can be safely produced locally and without harming citizens' health. We are aligned with the current leadership of CalGEM, who is driving the effort to find the critical balance between the immediate energy demands of today and the path forward to a more sustainable future.

Our goals for the energy transition are: first, grow local oil and gas production, while reducing dependence on OPEC+ and other foreign countries, which currently make up more than 60% of the more than 1.8 million barrels of oil California uses every day; second, grow diverse sources of affordable energy, including renewables; and third, promote California's climate objectives to increase zero-emission vehicles and electrification; and finally, do all of this safely.

By achieving these goals through operational excellence, innovation and application of technology and utilizing joint ventures and public-private partnerships as appropriate, we will be supporting the social goals of the state as well. For example, we will help address homelessness and poverty by providing great paying and stable jobs, along with other social benefits we can and will contribute.

What is Berry doing to prepare for the energy transition? Earlier this year, we created a strategic initiative and partnership role, which has the sole purpose of helping us develop the partnerships, both public and private, necessary to achieve our goals and success.

Some of these include strategies for best use of produced water; well abandonment programs to reduce GHG gases such as methane leakage into the atmosphere; as well as making land available in mature areas for appropriate land use, such as habitat, housing, et cetera; the electrification of our vehicle fleet and the use of renewable power to enhance our oil-producing operations.

To capture our progress in these areas, we have created a proactive working group to provide much more clarity and transparency to our ESG reporting. The first task at hand, which is well underway, is to establish our baseline everywhere we operate. We are driven to, obligated to and can reduce our CO_2 footprint.

We must grow the size of Berry to have a more effective seat at the table with state and local governments and to grow shareholder value. We are actively reviewing all opportunities to grow the company. For example, with more than 400 operators in California, consolidation is key for the state and Berry to achieve our mutual goals. We are only looking at transactions that are value-adding and accretive to our shareholders, while also providing benefit to our many stakeholders, including the state.

Finally, to do any of this, we must take care of our core business. We will continue to develop and strengthen relationships with all government, regulatory and political stakeholders as we have been doing over the past 2 years, and we will continue to focus relentlessly on operational excellence. We will strive to flawlessly execute our strategic plan and show the world that oil and gas can be produced safely and economically, bringing benefits without harm to our communities and the state. We are committed to the future of affordable energy and have a vision for how we participate meaningfully in the energy transition.

I will now turn it over to our new COO, Fernando.

Fernando Araujo: Thank you, Trem, and thank you for the very nice introduction. It's really good to be here, and I'm excited to be part of the team and part of this company's vision. I would like to start my comments by thanking Gary for the smooth transition, as I move into this role and picking up right where Gary left off with safety, protection of the environment and operational excellence as our top priorities.

Let me introduce myself. As Trem mentioned, before joining Berry in mid-September, I was the Executive Director for Schlumberger's Western Hemisphere assets. Before that, I worked with Apache Corporation for more than 18 years, where I managed Apache's assets in Canada and Egypt. But I actually started my career almost 30 years ago with Shell right here in Bakersfield, working in steamflood properties. I'm happy to be back in California and look forward to addressing the challenges that we face and capitalizing on the opportunities. We will continue to optimize the performance of our current assets and create meaningful growth in similar conventional and predictable plays. This is our core strength.

Moving to our performance, I'll start with production results from the quarter. Q3 production averaged 27,600 barrels a day, 87% of which was oil production. Also note that 80% of our total production comes from our California fields. Production is down 5% compared to last quarter as we temporarily discontinued our drilling activity last April. We also experienced seasonal and other temporary operational disruptions in California and Utah.

After my initial review of our properties, we've started to make some operational changes that we believe will improve efficiencies and will stabilize production while improving capital efficiency. One example is our Poso Creek field, where we changed how we manage increasing casing pressures, and we are now seeing improved production results. Production for the full year is expected to be within our April guidance, which is cited to be flat to down 2% versus 2019. We are focused on arresting base decline and have restarted high-return drilling and workover activity in Q4. This will allow us to stabilize production as we come into 2021.

Now, let's turn to operating expenses. In Q3, our OpEx per BOE was $16.97. This is $1.14 lower when compared to Q2. This is mainly due to seasonally higher electrical sales, which reduced our operating expenses. Non-energy OpEx, which excludes fuel purchase and electrical sales, is flat quarter-on-quarter on absolute dollar terms. It is slightly up on dollar-per-BOE basis due to lower production.

For full year OpEx, we expect to finish the year well below our annual guidance. We also expect that most nonenergy operating expenses will be sustainable in the current price environment. In Q4 and going forward, we will dedicate the necessary resources to ensure that we become the lowest cost operator in the basins where we operate, while not neglecting our regulatory commitments and mechanical integrity obligations.

Next, I'll touch on capital expenditures. CapEx in Q3 was $4 million, and year-to-date, it's $57 million. Full year capital for 2020 is expected to be within our planned levels at $72 million, excluding capitalized overhead. As mentioned, we restarted drilling operations in mid-October after a 6-month break, and we plan to drill 22 wells in Q4, focusing on 3 very exciting plays. We've drilled 2 horizontal wells in the prolific Potter trend in North Midway-Sunset, where we've seen an excellent production response without steaming.

Our recent acquisition of more than 700 acres further consolidated our position in this trend, and we plan to expand our activity here throughout 2021. Also, we plan to drill vertical wells in the Tillery sandstone Formation in our Hill property. This field has amongst the highest operating margins in our portfolio and do not require any additional permitting. Finally, we plan to drill 5 horizontal wells in the proven and predictable Monarch sandstone trend in our home-based property in South Midway-Sunset.

In Q4, we are also focusing on our workover and recompletion opportunities. As you know, workover and recompletion capital is some of the best capital to spend in terms of capital efficiency. We plan to have a continuous capital workover program in 2021. This is a new focus area for Berry compared to previous years.

At the same time, we remain fully committed to our obligations under the California Idle Well Management Program and our role as a leader in environmental, social and governance initiatives. In line with our plan, our plugging and abandonment costs were $14 million year-to-date and will be $16 million to $20 million for the full year. We are able to report that we will abandon 191 wells in 2020, which is well above our official idle well commitment of 160 wells.

As mentioned by Trem in past calls, we have been actively in communication with a joint CalGEM-Lawrence Livermore technical study on high-pressure cyclic steam production processes in thermal diatomite reservoirs. We anticipate the report will be complete before the end of the year.

Our 2021 plans currently do not include new thermal diatomite development. Our anticipated development program for 2021 is targeting sandstone reservoirs only. These are predictable, high return, low decline conventional plays in the San Joaquin Basin in California. Also, we plan to meet or exceed all plugging and abandonment obligations, as we've done in 2020.

And with that, I will turn it over to Cary.

Cary Baetz: Thanks, Fernando. We are continuing with our 2-year plan for a cyclical low crude price environment. We are generating significant cash in 2020 as planned. We have more than half of our expected 2021 oil production hedge, well above the current strip. This is more heavily weighted in the first half of the year, and in total, should provide adequate price protection to fulfill our plans. We have lowered our costs.

We are also beginning to see production improvements as we start to deploy capital and realize efficiency gains. We know that there's a lot of issues that cloud the economic picture of 2021, and these issues add uncertainty for our planning purposes. However, we do see oil prices strengthening in the latter half of 2021 as the world's ability to manage COVID-19 will continue to improve and as vaccines and therapies are introduced.

One of the advantages of Berry is that we can scale up or down very quickly. That said, we are currently moving forward with the plan of holding production relatively flat in 2021, which keeps us in line with our 2019 and 2020 annual production amounts. We will fund these developments with cash flow from operations and cash on hand. Again, this aligns with our 2-year downcycle plan and our goal of living out of levered free cash flow over the 2-year period. If the global economy continues to lag lower for longer, then we will reduce activity and continue to build cash. For Berry, it is that simple.

I'll stay away from repeating financial information in yesterday's earnings release and the Q that will be filed later today. However, 2 financial numbers I will highlight are our levered free cash flow for the quarter of $48 million and our current cash balance of roughly $60 million. We expect our cash balance to continue to improve the remainder of the year. Based upon our current hedge portfolio and operating performance, we currently expect levered free cash flow for 2020 to be more than $100 million.

Our oil hedge book hasn't changed since the last quarter, but we did recently enter into hedges for gas sales of roughly 12,500 MMBtu a day at roughly $3 for 2021. As Trem and Fernando have highlighted, our cost-cutting savings and efficiency initiatives continue to be strong. One of the short-term cash saving initiatives that we get the most questions about is the temporary suspension of our quarterly dividend.

This suspension currently saves us nearly $10 million of cash per quarter. However, we are committed to returning the value to the shareholders as the economy and our financial position allow. As I stated in the last call, we will consider reinstituting our dividend when we have more clarity on long-term prospects of oil prices. We'll explore this when Brent prices reaches sustainable $50 at barrel.

Staying on liquidity, we are starting at the fall redetermination, and we aren't expecting a change from the current $200 million elected commitment, but we do expect the $50 million blocker to be removed. We primarily use the RBL facility to manage working capital fluctuations and have no outstandings on the line today.

Our plan anticipates we will not use the RBL through 2021, given the strong cash position that we are currently in the process of building. At Berry, we remain steadfast on managing this company for value. We will continue to operate efficiently, safely and at the lowest possible cost during these challenging times and beyond.

While we don't know when the market will improve, we are working to ensure that Berry is in the best position for continued success. This means taking advantage of opportunistic active positions like bolt-ons, hedging prudently, lowering our costs and living within our levered free cash flow.

And now, I'll turn it back over to Trem for his final remarks.

Arthur Smith: Before opening it up for questions, I'd like to make a couple of comments on strategic opportunities. Consolidation is needed, as investors are demanding scale and cost savings. The universe of public opportunities for Berry is smaller than the resource-focused companies. We continue to focus on conventional production with shallow decline curves. We will leave no stone unturned, looking for the right opportunities.

We have a management team that has been focused on creating value and living within levered free cash flow since our inception. There are opportunities in the market that will greatly improve our scale and allow us to create additional value by reducing both G&A and operating costs, while giving us a better opportunity to be a meaningful participant in the energy transition and use of renewables within our operations. However, we will not grow for the sake of growth. Any transaction must be accretive and work within our financial policy.

At Berry, we understand the situation in California and across our nation is acute, but things are improving. Demand in the majority of the U.S. is returning to pre-COVID levels. We are working well with the governments in the states where we operate, and we are in the position to provide the needed energy for California, Colorado and Utah to rebound.

In closing, we will continue to create value, build cash and ensure our strong position when the market returns. Our focus for 2021 is maintaining our production, keeping our costs down and our employees and the communities where they live and operate safe, continuing to ensure that Berry can provide affordable energy to the citizens of every state where we operate and looking for opportunities to return capital back to our investors. I will now open it up for questions.

QUESTIONS AND ANSWERS

Operator: (Operator Instructions) Your first question comes from the line of Leo Mariani from KeyBanc.

Leo Mariani: I was hoping to get a little bit more color on sort of regulatory developments out in California there. I guess you're kind of still waiting on the Lawrence Livermore study here. But any insight from any kind of recent conversations you may have had with state officials there at CalGEM, maybe kind of giving you any sense of kind of where this may be headed? And then just kind of wanted to see also if there's anything else that might be coming up on the regulatory front that might be getting ready to go to a legislative session maybe next year or something.

Arthur Smith: Sure. This is Trem. Let me just give you a quick update. First of all, we have well over 200 permits in hand to drill our sandstone targets. So we are -- we have a good pipeline of permits that are coming through the system, and that continues to work well and our relationship with CalGEM is going very strongly. We have no new thermal diatomite projects on the plans for 2021. However, to answer your question about CalGEM and Lawrence Livermore, we are in communication with them.

They will be finishing up the actual study here soon, and then it will go to a process where it gets reviewed and individual operators will be discussing with Lawrence Livermore and CalGEM the impact on them is my understanding. So we anticipate this to go on into the first quarter -- that part to go on into the first quarter of next year.

And we'll continue to talk about it and monitor it. But the good news is it's going as planned with the government, and there is a desire currently for the government to finish it up. Regarding the future, there will be a legislative session starting here shortly, and it's the first of 2. You'll know that California has 2 of them each cycle.

And we do anticipate that there will be legislation proposed that is going to require our attention to push back on. There will be an anti-fracking bill, whatever that means, by the way, Leo. The definition of fracking is all over the place in California. But the industry is well-prepared and Berry is well-prepared to address these legislative efforts. But we do anticipate it and it may be very visible, but it's part of the nature of the business in California, so we're ready.

Leo Mariani: All right, that's good color. I just wanted to touch base a little bit around your comments on scale, Trem. You certainly pointed out that there's kind of not as many public opportunities versus the shale guys. We've clearly seen a wave of consolidation on the shale side. But you also kind of indicated you're kind of turning over a lot of rocks out there, so to speak, as well.

Can you give us maybe a little color on kind of what type of deals you guys are looking at? Is it sort of a lot of little things, like a bolt-on that you did up in North Midway-Sunset over the summer? Is there anything kind of chunkier with significant production? Can you give us any color on types of things you're looking at?

Arthur Smith: Yes. So I will give you the color I can without getting in trouble. Leo, you know I can't talk specifics, but I can say that we are -- we continue to look at the bolt-ons. That's just normal business now, and that activity will continue. But what I was referring to in terms of strategic opportunities are significant producing opportunities that would just change the scale and magnitude of Berry's footprint.

Leo Mariani: Okay. That's helpful. And I guess maybe just turning to '21. You guys obviously have a plan to kind of stay flattish. Can you give us a sense of kind of roughly what type of activity that would require? Is that kind of a couple of rigs in California? And I guess you've got the one rig now. Would there be a plan to bring another rig on, maybe early next year? Just can you kind of tell us about that?

Arthur Smith: I'm going to let Fernando handle that.

Fernando Araujo: This is Fernando again. And obviously, we want to remain nimble and flexible with our activity. We actually have 2 rigs working right now in California. We'll be dropping one of them here in the next couple of weeks as we finish the Monarch program. And as opportunities arise, we will flex up.

And if the prices stay low, we'll look at pulling back. We have that flexibility. And for next year, as you mentioned, we want to keep production flat. We're looking at the different options in terms of capital efficiencies as to what it will take in terms of capital dollars to do that. So we're in the process of building our plan for next year. But the idea is to keep production flat and most likely work with a couple of rigs in 2021.

Leo Mariani: Appreciate the color.

Operator: Next question comes from the line of Charles Meade from Johnson Rice.

Charles Meade: That's a new pronunciation of my last name, but we need some distractions today. Trem, I want to go back to your comments on the A&D outlook in your prepared remarks. And you said something that piqued my interest when you said scale would benefit -- or would serve the goals of Berry, but it would also serve the goals of California, the state of California. And so is there a shift? Or is there some increasing push from your state regulatory bodies to get rid of some smaller operators or to find a champion that they can get behind? Or what should we infer from your comments there?

Arthur Smith: Pretty much what they said. Let me back up and repeat a couple of things, Charles, because it's a very good question. First off, there are over 400 operators in California. And there are -- the California business has been around for many, many years, as you know, well over 100 years in many cases, in many parts of the state.

Consolidation has never really occurred as a result. And given 400 operators, operating practices tend to vary. Getting consolidation into a consistent, similar operating pattern will make it easier for profitable well abandonments, profitable local oil production to grow. It's just a matter of doing the math literally that way. And the state seems to be receptive to the concept. Instead of having to deal with 400, they can deal with fewer. It makes their lives easier as well.

Charles Meade: Got it. That's helpful. And then a follow-up question perhaps for Fernando. You talked about these -- your 2 horizontal wells in the Potter trend. And if I remember correctly, I think that part of that came from the acquisition you guys did last quarter or announced last quarter. Can you give us a sense of the inventory in that Potter trend?

Fernando Araujo: Well, currently, as I mentioned, we drilled a couple of wells already that we'll be putting on production this week. And then early next year, we'll be drilling a few delineation wells in the trend, and that will give us an idea of the inventory levels. But the number is going to be -- it's going to be significant. We're looking at about 40 wells, more or less right now, but it could be greater than that, depending on the results of the delineation activity from early next year.

Operator: (Operator Instructions) We have another question from Nicholas Pope from Seaport Global.

Nicholas Pope: I just wanted to clarify on what you all kind of talked about directionally in 2021. The flat, are you talking flat with 2020 overall, or are you talking about flat from an exit rate of 2020?

Cary Baetz: We're talking flat overall year-over-year. So kind of if you look at -- if you look at '19, '20 and '21, year-over-year production will be fairly flat amongst the 3 years combined as well in total volume.

Operator: (Operator Instructions) I'm showing no further questions at this time. I would now like to turn the conference back to Trem Smith.

Arthur Smith: I want to thank everybody for joining us today, and I want to wish everyone a safe and happy Thanksgiving season, which starts pretty much today. So good luck to everybody, and thanks again. Talk to you soon.

Operator: Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.