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BRY.OQ - Q1 2023 Berry Corporation (Bry) Earnings Call

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PRESENTATION

Operator

Good day, and thank you for standing by. Welcome to the Berry Corporation First Quarter 2023 Earnings Call. (Operator Instructions) As a reminder, today's conference is being recorded. I would like to now turn the conference over to your host, Todd Crabtree, Investor Relations. Todd, please go ahead.

Todd Crabtree - *Berry Corporation - Manager of IR*

Thank you, Eric, and welcome, everyone, and thank you for joining us for Berry's First Quarter 2023 Earnings Teleconference. Earlier today, Berry issued an earnings release highlighting 2023 first quarter results. Speaking this morning will be Fernando Araujo, our Chief Executive Officer; and Mike Helm, our Chief Financial Officer.

Before we begin, I would like to call your attention to the safe harbor language found in our earnings release that was issued this morning. The release and today's discussion contain certain projections and other forward-looking statements within the meaning of federal securities 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, including our 10-Q to be filed later today. 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 in today's call and 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 Fernando.

Fernando Araujo - *Berry Corporation - CEO*

Thanks, Todd. Welcome, everyone, and thank you for joining us. I will start today's call by highlighting a few key takeaways.

First, with respect to our operational and financial results for the first quarter, we delivered generally in line with expectations, and we expect to deliver full year results consistent with the guidance we provided in February. Assuming $85 per barrel Brent for 2023, we remain on track to return approximately $130 million or almost 20% of our current market cap to investors in 2023.

Second, I want to emphasize that we have high-quality assets with low corporate production decline rates and a tremendous amount of all-in plays, which provide visibility for future cash flows. This is a key advantage that sets us apart from most of our public E&P peers.

Lastly, we believe the current environment is conducive to consolidation and acquisition of producing bolt-ons. Berry is well positioned to be an opportunistic consolidator.

We anticipate our full year results to be in line with expectations. In March, we're able to recover fully the production downtime caused by the severe weather experienced in both California and Utah earlier in the first quarter.

Approximately 95% of our total 2023 production is expected to come from existing production wells, what we call our base production. Our remaining production is expected to come from optimizing our assets through sidetrack and workover activity as well as drilling operations in areas with existing CEQA approval. We continue to receive sidetrack and workover permits, and we fully expect to receive new drill permits in areas with existing CEQA approval.

We remain focused on managing operational and financial variables within our control. During Q1, we reduced headcount and implemented other cost-saving measures, which should result in an approximate 10% reduction in adjusted G&A expenses for 2023 compared to 2022. We also reduced operating expenses, including water handling and well servicing costs, which should result in annualized savings of $3 million.

Note that almost all of the targeted cost savings are already reflected in annual guidance, and we expect the ongoing benefit of these initiatives to be realized over the coming quarters. We are actively assessing our cost structure. And we'll continue to identify and execute on other cost-reduction opportunities throughout the year while maintaining operational excellence and high HS&E standards.

CapEx for the quarter was slightly lower than planned due to the timing of facility projects and efficiency improvements in our drilling operations. For example, we drilled some horizontal wells approximately 30% faster than the historical 4.5 days per well. We intend to further improve our performance as we pursue greater efficiencies across all of our operations. We expect to be within our annual capital guidance of $95 million to $105 million for the E&P business with another $8 million for our C&J Well Services business.

Our priority is delivering significant and sustainable returns to our shareholders. With our planned fixed quarterly dividend of $0.12 per share and anticipate a variable dividend, we expect to deliver a 2023 cash return in the high single digits. As a reminder, we intend to use 80% of our adjusted free cash flow generated during the year primarily for opportunistic debt and stock repurchases as well as the potential acquisition of producing assets. The remaining 20% will be used for variable dividends.

I will now turn the call over to Mike.

Michael S. Helm - *Berry Corporation - VP, CAO & CFO*

Thank you, Fernando. I will highlight a few other financial takeaways for the quarter. For more in-depth information, please refer to our earnings release issued earlier this morning and our 10-Q to be filed later today.

Adjusted EBITDA totaled $59 million, which was a 24% reduction compared to Q4 2022 due to lower oil prices and volumes as well as higher fuel gas purchase prices. We do have a few ways to mitigate natural gas price spikes, including managing our steam usage to optimize our fuel gas needs.

We also have access to physical -- we also have physical access to gas from the Rockies through the Kern River pipeline, where gas prices have historically been lower than in California. And we actively utilize financial gas hedges. We have hedged about 80% of the gas purchases for the rest of 2023 with swaps at about $5.34 per mmbtu. Gas prices have retreated entering the second quarter, and we expect that to carry into the summer months.

Lease operating expenses increased in the first quarter of 2023 due to higher fuel costs, and we incurred around $2 million due to weather-related services and lease maintenance costs. The latter were onetime expenses needed to return field to normal operations, which we did successfully, recovering production downtime experienced during the first part of the quarter.

Last week, the Board approved our planned $0.12 per share first quarter fixed dividend. And at today's stock price, our annualized fixed dividend represents a yield of over 6%. After paying the planned fixed dividends, we are on track to generate just over $100 million -- just under $100 million of adjusted free cash flow, assuming an $85 per barrel Brent average price for the year. 20% of adjusted free cash flow is expected to return to shareholders in variable dividends under the shareholder return model.

As shown on Slide 6 of our investor deck, our adjusted free cash flow, which drives our shareholder return model, is historically lowest in the first quarter of each year. This is due to seasonal working capital uses, which include annual payments such as royalties and bonuses.

In terms of cash allocation under the shareholder return model, this is simply a timing issue, similar to last year. So while no variable dividend will be distributed this quarter, the total variable dividend expected for 2023 is not impacted as it is calculated on a cumulative adjusted free cash flow generated for the year. Over the course of 2023, we are confident that the Berry's shareholder return model will provide shareholders the top-tier return that Berry has become known for.

And now I'll turn the call back to Fernando.

Fernando Araujo - *Berry Corporation - CEO*

Thanks, Mike. As mentioned at the beginning of the call, we believe current industry conditions are favorable for M&A opportunities, especially in the maturing California market, where we are well positioned to be a consolidator. We'll continue to be prudent in how we spend and manage our expenses. And we will employ hedging strategically to help us cover the fixed cost of the business.

We also plan to maintain our low leverage profile over the long run. We have demonstrated our ability to navigate the current regulatory environment through innovation and by creatively deploying the necessary technical capabilities to produce affordable oil reliably, safely and efficiently.

In closing, we are focused on maintaining higher environmental and safety standards while optimizing production, managing costs and maximizing shareholder returns. We are confident in our ability to generate strong free cash flow and deliver significant shareholder returns in 2023 based on recent strip pricing. Notably, including the fixed dividends, we have the potential to return about $130 million or almost 20% of our current market cap to investors in 2023.

With that, I will turn the call over to the operator for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Charles Meade with Johnson Rice.

Charles Arthur Meade - *Johnson Rice & Company, L.L.C., Research Division - Analyst*

I'd like to -- my first question, I'd like to ask about the quarterly production progression over the course of '23. You guys had this -- a significant decrement in 1Q, and I think you explained that well with the snow in Utah, and the bigger thing being the rain in California in January and February. But is it -- would I be right to expect some bounce back or sequential increase in Q2? And then what would it look like for the rest of the year?

Fernando Araujo - *Berry Corporation - CEO*

Okay. No, very good question, Charles. And as we noted, our production in Q1 was severely affected by the -- by some of the worst winter conditions that we've had in California and Utah. But we did fully recover our production in March back to our expected volumes. And as we noted, remember that we are not changing our annual guidance that we provided back in February.

Now production for Q2 to Q4 should be slightly higher than what we had in Q1 overall. Obviously, we don't provide quarterly guidance, but we're going to be well within our full year guidance for the year, but the production in Q2 to Q4 should bounce back.

Charles Arthur Meade - *Johnson Rice & Company, L.L.C., Research Division - Analyst*

Got it. And then second question, if I could just ask about how your workover program is going. I think you mentioned a bit about it in your prepared remarks, but my understanding is that it's a bigger percentage of your overall CapEx in '23 than it's been in the past. And I'm just curious if you can give some thoughts or detail on how that mix shift is working out for you and if there's any surprises that have popped up as a result of it.

Fernando Araujo - *Berry Corporation - CEO*

No, there's no surprises. Our workover program in California for 2023 is going to be very similar to what we had in 2022 in terms of dollars and in terms of activity. Now in Utah, we did have a strong workover campaign last year. It's not going to be quite as strong this year. We've got, I believe, about 28 workovers planned or budgeted for the year in Utah, which is a lower number than last year, but no major surprises.

And then we are going to have, obviously, sidetrack, the sidetracking program, which is utilizing existing wellbores. And that's going to be more heavily weighted this year compared to last year. Last year, we complemented our drilling activity, our new well drilling activity with sidetracks. I think it was on the order of about 70-30 percentage-wise with 30% sidetracks last year. This year is going to be flipped just because of the nature of the permitting process. So we're going to be doing more sidetracks this year than we did last year.

Charles Arthur Meade - *Johnson Rice & Company, L.L.C., Research Division - Analyst*

Okay. So if I understand it correct, it's really more of a shift away from -- instead of being shift to more workover, it's really more of a shift to more sidetracks in '23.

Fernando Araujo - *Berry Corporation - CEO*

That's correct. That's correct. That's correct, Charles.

Operator

(Operator Instructions) Our next question comes from Nicholas Pope with Seaport Research.

Nicholas Paul Pope - *Seaport Research Partners - Research Analyst*

The last few quarters, we've talked about potential M&A, and I guess the opportunities and the opportunity set you are looking at to expand. I guess it seems like it's been more of a challenge to kind of maybe make the acquisitions that you're looking at or that you're hoping to make.

I guess what does it take to kind of get some stuff over the line in the M&A market? I know it's a challenging, dynamic market. But just kind of curious what maybe the threshold is, what it takes for you guys to kind of make some of these acquisitions that I think that could be interesting.

Fernando Araujo - *Berry Corporation - CEO*

No, that's a very good question. Actually, we are seeing a renewed interest in the M&A opportunities, especially in California and especially with the regulations getting much tighter than before. A lot of the groups are willing to have a conversation these days, whereas in the past, they really didn't.

And as you know, some of this new energy is fueled by the M&A activity that we had in California last year, which was good, which was more than what we had in the recent past with Aera deal and with the Seneca-SPR deal as well.

So we truly believe that the future of California has to be consolidation. I think everybody understands that as well. There's millions of dollars to be captured in terms of synergies, operational synergies, corporate synergies, and we're going to be right in the middle of that.

And we are looking and talking with different parties. But basically, we're targeting producing bolt-on opportunities that are accretive to our business, where we can achieve some of those operational synergies that I was talking about. So hopefully, yes. So we do keep working hard, and we'll see where it takes us. But that is a major focus.

Nicholas Paul Pope - *Seaport Research Partners - Research Analyst*

That's great. Is there any thought that with uncertainty about California regulatory environment, does that -- do you think there's -- that's slowing the potential sellers, waiting for some kind of clarity from their part before they would execute a deal? Or do you not think that's necessarily a...

Fernando Araujo - *Berry Corporation - CEO*

No, I don't think that's necessarily the case. I think it might be the opposite in that they're -- because of the tight regulations, I think they're willing to negotiate, and they're willing to talk. And that's what we're seeing right now.

Nicholas Paul Pope - *Seaport Research Partners - Research Analyst*

Got it. And I was hoping you could talk a little bit about any opportunity on the oil service or just the services business for expansion here. It's kind of been a nice, fairly steady-state EBITDA run from those businesses. Kind of curious on an update on kind of is there an opportunity there? Or should we just expect a steady state with kind of the assets you have in hand? And that's all I have...

Fernando Araujo - *Berry Corporation - CEO*

Yes. Thanks. Good call. No, C&J's business, our business, our service business is a very strong business, a very steady business. And we had good demand for services in Q1. In fact, in Q1, we were fully utilized with our P&A equipment.

And as you know, with the current regulatory environment in California, it's really conducive to additional workover opportunities and P&A opportunities. And we want to be able to capture that market.

And we are looking at expanding because we're short of equipment, P&A equipment. Like I said, we're fully utilized. So we are looking at expanding and trying to grow that business because the opportunity is going to be there, not only this year but in years to come, but nothing firm to report yet.

Operator

(Operator Instructions) Our next question comes from Steve Busch with ERI.

Steven Henry Busch - *Everglades Resources, Inc. - Founder & President*

Just a follow-up on that last question. So CJ (sic) [C&J] was down 60-odd percent in Q1, but we were fully utilized. Is that -- what does that exactly translate to you?

Fernando Araujo - *Berry Corporation - CEO*

No. Yes, we were slightly down on revenue. And just like the E&P side of the business, C&J was also affected by weather during the quarter. They couldn't get into the locations to be able to execute the work with the rigs, and that affected the numbers. So even though they were fully utilized, because of weather, they delayed some of the work activity and some of the revenue, but that's going to be made up in the coming quarters. That's the expectation.

Steven Henry Busch - *Everglades Resources, Inc. - Founder & President*

Okay. So we should have a boost this quarter above normal then back to steady?

Fernando Araujo - *Berry Corporation - CEO*

There should be a boost above Q1.

Steven Henry Busch - *Everglades Resources, Inc. - Founder & President*

Right. Okay. Our plan for 2023 is on $85 Brent strip price. Where are we at now if it stays in the $73, $75 range? How does that affect our plan?

Michael S. Helm - *Berry Corporation - VP, CAO & CFO*

Steve, this is Mike. I'll start that one. So when we did the plan, the strip was at $85 or roughly $85. A few weeks ago, it was $85. We've seen it come down in the last few days.

We don't go back and adjust the plan on a day-to-day basis. Everything that we've read indicates that there is a good chance that the prices will come back towards the second half of the year, if not sooner. Saudi certainly support that. We'll have to see what happens with the global economy and recession, but that's all unknown right now.

Fernando Araujo - *Berry Corporation - CEO*

And then at the same time, just to complement on Mike's comments, we do want to deliver or our target is to deliver on cash flows, as promised. We have several levers that we do control for that.

We've reduced G&A already this year. We've got an -- our operating expenses are also reduced, and we've got an -- our OpEx reduction campaign going on in the field, which is going very well, and we expect significant reductions there as mentioned.

And also, our capital efficiency has improved. So we're doing everything that we can in our cash flow returns in spite of the current pricing. But again, the pricing is very volatile, as Mike said. So we'll see where it goes for the rest of the year.

Michael S. Helm - *Berry Corporation - VP, CAO & CFO*

And we're also significantly hedged on both the oil and the gas purchase side.

Steven Henry Busch - *Everglades Resources, Inc. - Founder & President*

Right. Okay. That's good to know. Just kind of on the share repurchase plan, return to shareholders, we didn't buy any shares in the first quarter. We're well into the second quarter. Are we looking at buybacks here now that our price is under $8, given that we bought back a lot of shares from other shareholders in the double digits? And that's all I got for you.

Michael S. Helm - *Berry Corporation - VP, CAO & CFO*

Yes. Steve, thanks for that question. Yes, we look at those situationally. Yes, the prices seem low right now largely driven by the oil prices. If you look at -- we pointed to Slide 6 in our IR deck. The first quarter is our lowest -- every year, it's our lowest working capital.

We have significant working capital usage every year in the first quarter. We just don't generate as much cash as we do the rest of the year. We plan to still generate significant cash the rest of the year. That's more likely as the year rolls on, and we'll be more focused on utilization of the adjusted free cash flow.

Operator

And that concludes our question and answers. I would now like to turn it back to Fernando Araujo, Chief Executive Officer, for closing remarks.

Fernando Araujo - *Berry Corporation - CEO*

Yes. Thank you very much, everyone. We're hoping to have a strong Q2, and we look forward to talking to you next quarter. Thanks a lot.

Operator

This does conclude the program. You may now disconnect.