Berry Corp (Q4 2021 Earnings)

February 23, 2022

Corporate Speakers:

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

Participants:

- Michael Furrow; Johnson Rice; Analyst

PRESENTATION

Operator: Good day, and thank you for standing by. Welcome to the Berry Corporation's Q4 and Full Year 2021 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, Todd Crabtree, Investor Relations. Please go ahead.

Todd Crabtree: Thank you, Dennis, and welcome to everyone. Thank you for joining us for Berry's Fourth Quarter and Full Year 2021 Earnings Teleconference. Yesterday afternoon, Berry issued an earnings release highlighting full year 2021 and fourth quarter results. Speaking this morning will be Trem Smith, Chairman and CEO; Fernando Araujo, Chief Operating Officer and Executive Vice President; and Cary Baetz, Chief Financial Officer and Executive Vice President.

Before we begin, I want to call your attention to the safe harbor language found in our earnings release. The earnings release and today's discussion contains 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.

Our website, bry.com, has a link to the earnings release. Any information, including forward-looking statements made on this call or contained in the earnings release, 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 for a reconciliation between all adjusted measures mentioned in today's call and the related GAAP measures. We will also post a replay link of this call and the transcript on our website. We plan to file our 10-K and post the Investor Relations deck within a week. I will now turn the call over to Trem Smith.

Arthur Smith: Welcome, everyone, and thank you for joining us this morning. 2022 is going to be a great year for Berry, set up nicely by our 2021 performance. With our new shareholder return model in place and at today's oil and stock prices, we expect to deliver

cash returns in the mid- to high teens. In terms of dollars, this means that 2022 cash return is expected to be 160% to 190% of the $82 million we have returned since going public 3.5 years ago. This translates to approximately $1.60 to $1.90 per share.

As a reminder, our new shareholder return model implemented starting Q1 2022, allocates 60% of our discretionary cash flow, primarily in the form of cash variable dividends. Its governing principles are predictability, transparency and simplicity, just like our business model. The foundation of our business model is our base production, which is the production that comes from our existing producing wells.

And on average, accounts for 90% of our total production year in and year out before we ever have to drill a new well. The terminal decline rate of our production, base production, is low, approximately 13% per year. Our base production requires no new permits and is predictable, which is why we say that our development and production, our D&P business, can be modeled like a manufacturing or industrial business.

Our 2022 goal is to maintain our production, which means we plan to keep production flat year-on-year. Let me briefly summarize how we do this. Our low decline production accounts for 90% of our production needs. The remaining 10%, which requires new permits, is achieved by drilling new wells for 6% of the production and by doing workovers in existing wells for the remaining 4%.

Bottom line, 90% of our cash flows come from production out of existing producing wells. So when you combine our production profile with the current price forecast and run that through our new shareholder return model, calculating our expected returns to shareholders is easy and predictable. In 2021 and early 2022, we reduced our carbon footprint by 13%, which is more than 205,000 metric tons, and reduced our operating costs by $14 million, mainly due to our focus on operational efficiencies and A&D activity as well as ESG initiatives.

Additionally, in the fourth quarter of 2021, we purchased C&J Well Services, a profitable business line, to provide standard well services to the industry in California and to accelerate the reduction of fugitive emissions by plugging and abandoning idle and orphan wells across California.

This reduces actual and potential methane emissions, which is known to produce more than 80x the warming power of carbon dioxide over the first 20 years of emission. We also commenced a solar project at the Hill property, which we expect to be fully functional in the fourth quarter of 2022 and started the development of several water projects that will ultimately help with the reuse and reduction of water in our operations. I will come back to highlight some of our 2022 ESG initiatives in my concluding remarks.

Now I'll turn it over to Fernando, who will highlight the operational results of a successful year.

Fernando Araujo: Thank you, Trem. I want to begin with one of our core values, responsible. We are responsible for and have an unwavering commitment to protect the safety of our employees and contractors, to safeguard and respect the environment and to guarantee the integrity of our infrastructure.

This is reflected in our excellent health and safety results. In 2021 we had the best safety performance in the history of the company as we did not have a recordable or lost time incident all year. This is best-in-class achievement. In terms of operational performance in Q4, you can refer to the earnings release for details, but I'm happy to report that we met all expectations. I do want to highlight our Q4 production results as we reached a production peak for the year despite the divestment of Placerita in October.

Speaking of divestments, we've had an active A&D campaign in the last few months. In Q4 2021, we sold the Placerita field in densely populated LA County. This was a strategic decision to focus 100% of our California activity in low-density population in Kern County. Placerita was our highest cost and lowest return asset.

In January, we divested our Piceance gas field in Colorado, a marginal asset and our only remaining property outside of Utah and California. The last well drilled in our Piceance gas field was in 2015. Finally, earlier this month, we acquired Antelope Creek in the Uinta Basin. This is a bolt-on property in Utah with existing production and significant upside.

In terms of activity in 2021, we completed our drilling and workover program as planned with no delays and achieved a rate of return greater than 100% at strip pricing. We will continue to have significant activity in 2022 with a capital outlook that ranges between $125 million and $135 million. This will allow us to hold our production flat year-on-year net of divestments and acquisitions.

As a result of the A&D activity that I just highlighted, our oil intensity in 2022 would increase to 92%. It is our strategic financial decisions that enhance our focus on what we know best, produce profitable oil safely from not declining, predictable conventional reservoirs. In 2021 we decreased our operating expenses by 7% year-on-year. But just like everybody else, we will be affected by inflationary pressures going into 2022.

In our case, currently estimated to be in the 5% to 10% range. To summarize 2021, our production increased every quarter of the year. We delivered great long-term returns from our development program, we continue to decrease our total OpEx, and we achieved the best safety results in the history of the company. At the same time, we optimized our asset base with strategic A&D activity in preparation for a great 2022. Now I will turn it over to Cary.

Cary Baetz: Thank you, Fernando. As you stated, our operating performance was steady throughout 2021, and our 2022 budget projects the same. We plan to spend $125 million to $135 million of capital, excluding approximately $8 million for C&J Well Services.

Our total budget also includes new ESG projects that Trem will discuss in more detail in his closing remarks.

Based on the current oil strip and our hedge position, we expect to generate discretionary cash flow as defined as cash flow from operations less regular fixed dividends and capital needed to hold production flat of about $200 million in 2022.

If the $200 million of discretionary cash flow seems like an impressive number, which I think it is, we expect to generate our current market capitalization in a little over 4 years based upon the current strip, including the steep backwardation in the outer years, and with our current budgeted cost structure and spending $125 million in capital to maintain our production flat.

Remember, our return model is designed to allocate 60% of that amount predominantly to our shareholders through quarterly distributions as well as opportunistic debt repurchases with the remaining 40% to be used for opportunistic growth, share repurchases and/or capital retention. Our first quarterly distribution is planned to be made after the first quarter results are reported. More description on the model will be included in our Investor Relations deck.

Since we are predominantly oil, we are pleased to see oil prices rise and believe global fundamentals are solid for continued strong pricing. Currently we are adequately hedged as was required under our new RBL that closed this past fall. However, as prices rise, we will continue to lock in more pricing opportunistically to ensure strong returns to our shareholder return model throughout the cycle. Fernando and his team have done an excellent job of controlling nonenergy OpEx, and we expect that trend to continue.

However, the one area we have seen increased exposure is energy OpEx, as it is heavily impacted by natural gas prices. For 2022, we expect natural gas prices to be up $1.50 per mmbtu. We haven't had the same opportunity to hedge natural gas as attractively as we did in 2021. That being said, we will continue to work to minimize the impact of gas prices on our energy cost. Long term, we have improved our energy cost structure by gaining access to an interstate pipeline that will provide us with historically less expensive gas from the Rockies. We received full access in May, which will account for approximately 2/3 of our natural gas needs.

I will end by reiterating that Berry has steadily posted consistent results through rational and predictable development, giving strong visibility to our cash flows. This gives us a platform to return capital to shareholders in a way that should generate industry-leading returns and optionality to deploy the remaining cash flow. We will continue to search for value-adding opportunities for our portfolio. Trem, back to you.

Arthur Smith: Thanks, Fernando and Cary. As you heard, we are in a great position for 2022. And before we close, I want to highlight some of our ESG initiatives for the year. All of these projects will have a positive economic impact on our operations. Our new service business, C&J Well Services will continue to profitably reduce methane

emissions by advancing the plugging and abandoning of 1,800 to 2,000 wells for ourselves and other operators.

In addition, C&J is also uniquely positioned to capture state and federal funds estimated to be $300 million to $400 million over the next 2 years to help remediate orphan wells. These are wells for which the state is liable. California has a reported 35,000 orphan and idle wells, many of which are in densely populated L.A. County. A core competency of C&J is its ability to plug and abandon the complex orphan wells in highly populated, often distressed communities. This reduces GHG leakage into the atmosphere and potentially reduces health risks to nearby communities.

We are also working on projects to further reduce our carbon footprint and our operating costs. We have signed an LOI to pursue a carbon dioxide capture and sequestration project. We will share more details as it matures. In addition to the completion of the solar project on the Hill lease that I mentioned in my earlier comments, we are working on another solar project in our Poso Creek field. We are executing a significant mechanical integrity program to further reduce the possibility of methane leakage and other spills in the future.

Finally, C&J is upgrading our service rigs and ancillary equipment with low emission Tier 4 engines which use 4 gallons per hour less fuel and reduce emissions by 70% to 90%. We are also working with a third party to treat our produced water for reuse, helping Californians cope with extreme drought conditions. Going forward, this could provide a significant precious resource to the Central Valley and reduce our operating costs.

Together, all these projects, which have their own economic value could further reduce our carbon footprint by almost 350,000 metric tons per year or an additional 25%. And our need to -- reduce our need to purchase GHG offsets by an equivalent amount, therefore reducing our taxes other than income taxes. And we are fulfilling our commitment to being part of the energy transition solution for California.

In conclusion, we are thrilled with our 2022 prospects, and we are looking forward to distributing robust returns to our shareholders through our new shareholder return model, which in 2022 is expected to be $1.60 to $1.90 per share. I'll now open it up for questions.

QUESTIONS AND ANSWERS

Operator: (Operator Instructions) And your first question is from the line of Charles Meade with Johnson Rice.

Michael Furrow: This is Michael Furrow filling in for Charles. So previously, Berry was more on a growth trajectory. And from the guidance, it appears that varies more towards a similar playbook that other E&Ps are following towards a maintenance CapEx mode and trying to hold production flat. So could you all provide some details as to what some

of the considerations or drivers were that ultimately made this plan change? And why did you all decide this now?

Cary Baetz: Yes, Michael. Good question. I think right now we're thinking about the investor base and drawing investors back into the space. I think it's important for the industry as a whole, including Berry, to show the discipline around holding production and returning the capital. I think from our point of view, we have optionality to be able to do that. If we want to add growth, we can do it in the second half of the year. But at this point in time, the plan right now is maintenance, holding maintenance and returning capital and showing that we have the discipline and the industry itself has a discipline to, again, attract investors back into the space.

Arthur Smith: Michael, this is Trem. Let me add to that, that remember, our business is a little different than some of the other oil and gas companies. If circumstances were to arise, we can always very quickly add more drilling opportunities and more workover opportunities to grow production more. We've always talked about the need to at least maintain our production. And this year we are clearly specifying maintain the volumes year-on-year but focus on capital returns, cash returns to our shareholders, which we think -- we know we can do generously throughout the year.

Michael Furrow: Great. That all makes plenty of sense to me. Also, could you provide a little more detail on the A&D this past quarter, specifically the Colorado Gas divestiture and the Utah operations, just some details related to production, pricing or potential inventory going forward?

Fernando Araujo: Michael, this is Fernando. I'll start with Antelope Creek. In Antelope Creek, we closed just a few days ago in early February. It's a textbook bolt-on asset in Utah. It's right next to our existing fields in the Uinta Basin. We expect to have some significant savings in terms of OpEx from that asset about 10%. It is an asset that has low production decline and had a very much predictable geology.

And again, the existing infrastructure and the asset is already connected to our property in Utah. In terms of potential, we currently have 10 DUCs in that property that we're in the process of completing. So we'll be completing those wells. And there's significant upside also in workover activity. And we're going to be ramping up our workover activity in Utah to realize the potential in the Antelope Creek. And again, it's a very, very good asset, exactly the same type of assets that we currently have in Utah.

Now in terms of Piceance, in Colorado, we divested Piceance at the end of January. Then Piceance, as I mentioned, was 100% gas production. It had gas -- it had that high OpEx for a gas-producing field, not much opportunity for growth as we hadn't drilled the well in several years there, in about 7 years in fact. And it was very marginal with lower gas prices as well. So with that, we avoided also a huge abandonment cost in the future, abandoning about 180 wells, that's a $26 million cost that we had in the future. And we also avoided upgrading the integrity of the infrastructure which was in fairly poor shape. So it was a great deal all around.

Cary Baetz: Michael, one more thing on that, just to let you know. I think net-net, one of the things you probably asked, we're considering is from a production point of view basically Placerita, the selling of Placerita is offset by the acquisition of Antelope Creek. So those are net-net about neutral.

And then we're down about 1,000 BOE a day with the sale of the Colorado asset, Piceance. So on a pro forma basis, that's kind of when you're thinking about a pro forma on a net-net basis. Just wanted to give you some context around that. But again, as we pointed out, we've moved from 88% oil mix to about 92% going forward. So just a little more context.

Operator: (Operator Instructions)

Arthur Smith: I don't see any questions there, I think. I want to thank everybody. So I want to thank everybody for joining us today and look forward to talking to you next quarter.

Operator: This does conclude today's conference call. Thank you for joining. You may now disconnect.