Berry Corp (Q3 2021 Earnings)

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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:

- Leo Mariani; KeyBanc Capital Markets Inc.; Analyst
- Michael Ferro; Johnson Rice & Company, L.L.C.; Analyst
- Nicholas Pope; Seaport Research Partners; Research Analyst

PRESENTATION

Operator: Good day, and thank you for standing by. Welcome to the Berry Corporation Q3 2021 Earnings Conference Call. (Operator Instructions) Please be advised that today's conference is being recorded. If you require any further assistance, please press star 0. I would now like to hand the conference over to your speaker today, Mr. Todd Crabtree, Manager of Investor Relations. Please go ahead.

Todd Crabtree: Thank you, Kathleen, and welcome to everyone. And thank you for joining us for Berry's Third Quarter 2021 Earnings Teleconference. Yesterday afternoon, Berry issued an earnings release highlighting third 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.

Trem will discuss our third quarter performance as well as our expectations for the remainder of 2021. 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 your attention to the safe harbor language found in our earnings release. The earnings release and today's discussion contain projections and other forward-looking statements within the meanings 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 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 the related GAAP measures. We will also post a replay link of this call and the transcript on our website. I will now turn the call over to Trem Smith.

Trem Smith: Thank you, Todd. Good morning, everyone, and thanks for joining us today. We continue to execute our core business, which is the production and sale of affordable energy, primarily in California, successfully. The most recent upturn in oil prices presents an exceptional opportunity for Berry as we believe it is different than previous cycles. It is our view that this is a possibly fundamental change for the industry for several key reasons.

First, while demand for oil is continuing to grow globally and is expected to continue increasing over decades, the long-term supply is and will continue to be limited after years of global underinvestment. In fact, Bloomberg reported last week that Saudi Aramco's CEO said oil output capacity across the world is dropping quickly, and companies need to invest more in production. It is now getting to a situation where there's limited supply.

Second, numerous major projects have been delayed or canceled. And third, exploration is as low as it has been in at least the last few decades. The delays in major projects and the lack of new discoveries means there are very few new sources of oil coming on to the market in the next few years.

For some time now, we have been working on an outside the box approach to return even more value to our shareholders. We are excited to announce that the Board approved a shareholder return model that will continue to position Berry as a top-tier returner of capital to shareholders. In fact, it should put Berry firmly in the top-tier of E&P companies of all sizes. We are creating a model that provides significant returns, which could be more than 20% annually based on our stock price and the current strip.

The model will consist of a mix of returns through variable cash dividends in addition to our current dividend, share repurchases and debt retirement, while keeping a portion available for organic growth and bolt-on acquisitions. Barry is uniquely positioned to implement this new model successfully.

We already have all the critical elements in place in our proven simple business model, such as low corporate decline rate, a predictable cost structure, an abundance of inventory, Brent pricing and a simple, clean balance sheet. Which collectively, with the increased pricing we are currently enjoying, generates extensive levered free cash flow. Based on current industry fundamentals, we should generate considerable levered free cash flow for many years to come.

Again, we define levered free cash flow as cash flow after paying all of our costs, including our interest, our fixed dividend, and the cost to keep production flat. This is an exciting development for Berry and our shareholders and is an obvious extension of our

business model, which is unique in the industry. We look forward to unveiling the full details of the model later this quarter and implementing it beginning in 2022.

I will come back to highlight some additional strategic items in my concluding remarks. Now I will turn it over to Fernando, who will highlight the operational results of a highly successful quarter.

Fernando Araujo: Thank you, Trem. As usual, I want to begin my comments by reaffirming that safety, protection of the environment, regulatory compliance and operational excellence remain top priorities. This is reflected in our excellent Q3 health, safety and environmental results. In fact, we are approaching a 600-day mark with our recordable and lost time incidents. This is best-in-class.

Moving to operational performance, production in Q3 continued to grow quarter-on-quarter as it has done all year with an average of 27,400 barrels of oil equivalent per day of production. In fact, our production in September was the highest for the year at 27,900 barrels a day, and it continued to grow into Q4. In Q3, we operated with an average of 2.5 drilling rigs in California, drilling 54 producers and 2 delineation wells. We focused our drilling activity on steam flood expansion projects in our giant Midway-Sunset field.

We did shift our drilling plans for high-impact horizontal wells from Q3 to Q4 due to a combination of issues. In Q3, we experienced supply chain challenges, similar to other industries, causing delays in drilling, completing and connecting wells to production. However, this also gave the technical teams additional time to evaluate data from delineation wells drilled in Q2 in order to drill better wells in Q4 and beyond. The first 6 of these high-impact horizontal wells are now on production in Q4, most of which are exceeding type curves with IPs in the 150 to 200 barrel a day range. We're currently in the process of drilling another attractive 12 horizontal wells.

Also, in Q4, we're testing new development concepts and drilling step-up opportunities in order to further expand our robust inventory base. I want to emphasize that our entire company's development program year-to-date has been very successful, yielding an unhedged rate return in excess of 80% based on the current strip. Furthermore, in Q3 we continued to realize excellent results from our workover activity which, based on the current strip, is yielding a rate of return greater than 100%. As mentioned in past calls, in Q4, we expect to reach our production plateau for the year and with a higher exit rate compared to last year.

We are still the most active company in California in terms of operational activity. We are currently operating with 3 drilling rigs in addition to the rigs dedicated to our workover, maintenance and P&A activities. We expect to finish the year having drilled approximately 190 wells and performed approximately 280 workovers as planned.

Now let's turn to capital. CapEx in Q3 was $38 million as planned. This was slightly lower than Q2 and within our budget for the first 9 months of the year. Our capital outlook for full year 2021 remains unchanged. In terms of operating expenses, in Q3 we

averaged an OpEx of $17.18 per BOE. This is 1% lower than Q2. We have been able to keep operating expenses consistently flat throughout 2021 and materially lower compared to previous years.

To summarize, we're achieving outstanding safety results. Our production has sequentially grown since the beginning of the year, and we expect to have a strong Q4. We are within plan with our capital expenditures and we have sustainably taken $3 per BOE out of our OpEx structure since 2019. And with that, I will turn it over to Cary.

Cary Baetz: Thanks, Fernando. Trem did a great job of outlining our thoughts on the new shareholder return model that we are excited to introduce and implement. The model will be simple and the returns of capital will be easy to calculate. We are currently finalizing the details and look forward to announcing the fully approved plan later this quarter.

As you know, Berry is a cash flow machine, and we believe this new return model further exemplifies that fact. Referencing our illustrative simple cash flow model on Slide 15 of our investor presentation, the quick math at today's strip price would show us generating almost $250 million of levered free cash flow in 2022. That is more than 30% of our current market cap. And the simple math works beyond 2022.

During the third quarter, we completed our new RBL facility which has a $500 million commitment and extends the terms to 2025. We maintained our borrowing base and elected commitment of $200 million. A condition of the new RBL was extensive hedging. We are required to have a minimum of 75% of our PDP for oil hedges hedged in the first 2 years of the agreement, which then drops to 50% in year 3. Our new hedges are highlighted on Slide 16 of our investor deck. Our current oil hedge program is focused on protecting the downside while leaving us upside as we remain bullish on oil prices.

Further, we have been gaining additional access to the Kern River Midstream natural gas line, which connects to gas supply lines in the lower 47 states. We currently have access to about 15,500 mmbtu per day, which increases to almost 48,000 mmbtu a day in May of 2022. These are long-term agreements, some which are in place for up to 15 years, and allows us to move ours and other purchased gas from the Rockies to our operations in California, effectively creating a physical hedge. And with the recent sale of our Placerita assets, we will only be about 5,000 mmbtu per day, short of our daily demand when we gain full access of the current line capacity.

Over the next couple of months, we expect natural gas prices to remain high due to supply and demand imbalances, especially on the West Coast. That said, we protected our exposure through April of 2022 at roughly a maximum of $6 per mmbtu. If the natural gas market softens over the winter months, then we should see some improvement in our hedged fuel cost.

Lastly, we are busy on the A&D front. We purchased C&J Well Services and successfully integrated the business into our operations. And as I just mentioned, we divested our Placerita asset. Due primarily to the divestiture of the Placerita asset,

coupled with timing delays Fernando highlighted, we have refined and narrowed our total production range for 2021 to be in the 27,200 to 27,700 range.

That said, we are very pleased with the trajectory of the current production as we close out the year. Our 10-Q will be filed later today if you want to take a deeper dive into the financials. Now I'll turn it back over to Trem for final remarks.

Trem Smith: As you heard, Berry is executing on our business plan. We have an exceptional company driven by a successful and simple business model and now a first-rate shareholder return model. Before we go, I'd like to highlight a few more of our recent successes.

First of all, our A&D efforts in the quarter were fruitful. With the sale of Placerita, our last remaining producing property in L.A. County, all of our California operations are now concentrated in Kern County. Not only does Kern County appreciate the value provided by our industry, it also is primarily a rural, low population area with about 103 people per square mile compared to L.A. County, which has more than 20x that at more than 2,400 people per square mile. Among other benefits, the political environment and regulatory challenges pose less risk to our operations.

The acquisition of C&J Well Services was a strategic and value-adding transaction that was purchased at a competitive price. With strong underlying business fundamentals, C&J has significant growth opportunities in California, building on its existing customer base, adding new customers, and helping the state and federal governments fulfill their goals to plug and abandon orphan wells. And importantly, it aligns with our vision and environmental, social and governance, ESG goals, to reduce greenhouse gas emissions today, safely and with proven technology.

With C&J Well Services, we can reduce state-wide fugitive emissions, which are primarily methane, the most damaging of the greenhouse gases, by plugging and abandoning orphan and idle wells today. We are continuing to hone our medium and long-term environmental priorities as it relates to ESG.

Right now, we are on track to reduce our own greenhouse gas emissions by at least 15% by the end of 2021 compared to 2020. In the next 6 months to a year, we'll be implementing new solar projects to reduce our carbon intensity in the Hill lease and at the Bakersfield office. Additionally, we are currently evaluating solar projects in our other locations and opportunities to maximize our reuse of water through agriculture and other reuse avenues.

We are evaluating the feasibility of carbon capture and storage, CCS, because we have a significant number of suitable reservoirs for CO2 storage. Our goal is to learn from others and implement economically viable and effective CCS in the areas we have significant storage capacity. We will only pursue CCS if it makes sense for our shareholders.

In conclusion, I am extremely pleased with our performance in all aspects of our business. We have a great company with an exceptionally simple and proven business model, which is being further enhanced by our new shareholder return model. As a reminder, please look for our shareholder return model rollout in just a few weeks. I will now turn it over for questions.

QUESTIONS AND ANSWERS

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

Leo Mariani: I just wanted to touch base on the shareholder return model. It certainly sounds very significant in terms of the 20% number that you folks are throwing out there, and I just wanted to check-in. I know there's details that will be forthcoming, but it sounds as though this might be a bit of a formulaic model that depends on future kind of oil prices. And just wanted to get a sense, is this going to be like a quarterly look then at the end of each quarter, there'll be these returns to shareholders? And then additionally, how does the production growth component fit into that model?

Cary Baetz: Yes. Good question, Leo. This is Cary. You're right. We want to make it very formulaic. We have a very predictable cost structure, as we lay out in our investor presentation, so the idea is to use that cost structure, used our hedged oil price in the strip for people to have predictability of what that excess levered free cash flow will be.

And then from there, we will have it set out for what percentage is going to be paid out in cash, what percentage will be used for share repurchase and debt reduction, and then what percentage will be retained by the company for discretionary uses such as bolt-ons and organic growth.

So those are the 3. I think probably the larger portion of that will be in cash, and then the other 2 will be fairly equal to each other, at least conceptually. And I think the idea will be looking at it on a quarterly basis as well. Again, we want this to return capital to create value for our shareholders.

In order to create value, it also needs to move the stock price. And I think keeping it quarterly and keeping people from getting in and out on a timing basis makes a lot more sense as well. But exactly right, very formula, very predictable, and then people can put their own strip pricing in there and understand truly what the return capabilities are. Does that help?

Leo Mariani: Absolutely, that was great. I appreciate that. And then I was hoping I could just get a bit of a regulatory update from you folks. Wanted to get a sense if there's any updated thoughts on when you might hear back from the state, CalGEM, and as a result on this a little more study and the impact obviously it might have on the diatomite. And I was also hoping you guys could comment on sort of current setback provisions that are bouncing around in the state. I think they're calling for 3,200 feet. Now that you guys are

Kern County only, just any high-level thoughts on what the impact might be in Kern County?

Trem Smith: Leo, this is Trem. I'll take that one. Good to hear from you as always. On the regulatory front, first of all, we continue to manage the regulatory front extremely well, and we've demonstrated that over the last 4.5 years. And so given that, we are -- let me handle the setbacks first. The setbacks were announced, they start a rule-making process which is well-established in the state, which is likely to take 1.5 years or 2 or even more, but no shorter, to come through, which involves public hearings, and input from the government.

And the 3,200 feet is -- and the way the thing is actually currently written is modeled after Colorado where it started. And as the regulators have said over and over again, that's their intent and they intend to have it modified in that timeframe so that the final will allow the industry to do work while truly addressing some public health concerns in areas of high population density. If that's the case, we will work that and work it well, and we're positioned to do it.

Now obviously, I mentioned the population numbers and the population density numbers. The impact on Berry is, though it does impact us in Kern County, if it were taken point blank verbatim, we expect it to have minimal impact by the time it actually becomes a rule in 2 years or so, okay? On the high-pressure cyclic steam, that remains with the governor's office and the industry continues to have it as a priority to remind the governor that there's nothing to keep it from occurring.

As you know, as a reminder, we currently produce from the Thermal Diatomite. We continue to inject steam and use heat to produce there. It's a great reservoir for us. And we're actually doing some creative wells in the Thermal Diatomite here hopefully in the fourth quarter to test ways to take advantage of the existing heat that's in the reservoir to see that we can enhance it without injecting new steam, which is really what the moratorium is, so we've taken the opportunity to be creative there.

Leo Mariani: That's very helpful. And then just lastly for you guys, I wanted to see if we could get the sale price on the Placerita assets. I was hoping you could maybe provide a little bit more color on the CCS projects. Is this something that's kind of a big study that you're going to undertake here in 2022? It sounds like you maybe already identified some reservoirs. My understanding is you have to be under, deeper than 2,600 feet. So maybe any thoughts on the potential there?

Cary Baetz: Lee, I'll take Placerita real quick. Placerita, again, a good opportunity transaction for both parties. We do about 800 barrels a year annually. It's a little less than that in the third quarter, I think down below 750, right around that area. On a flowing barrel, we got a little less than 20,000 on a flowing barrel and reduced ARO by about $20 million, so kind of the parameters around what that was. And then I'll let Trem kind of talk about the CCS and kind of thoughts and strategies around that.

Trem Smith: We also have a significant decrease in the amount of steam required by the company as well.

Cary Baetz: Yes, that's a good point. Leo, for modeling purposes, we usually burn about 65,000 to 67,000 mmbtu today and that will be coming down to about 52,000 to 53,000 with the reduction of Placerita as well going forward. So again, talking about what I was talking about, the access to the current line and the short, and you can kind of see we reduced our natural gas demand significantly. And especially, that's expensive natural gas because it's primary SoCal gas as well, so that's good.

Leo Mariani: Okay, great. That's great to hear.

Trem Smith: And on the CCS, we are -- if I understood your question, we generally -- we don't have -- the biggest generators of carbon dioxide for us are the Cogens we have. Those are the point sources. We will always be looking at ways to capture CO2 and reduce CO2 from them, so the CCS efforts come in 2 parts.

One is reducing the amount of carbon dioxide generated by Cogens, which reduces our carbon intensity by definition. But the other is providing storage in reservoirs that we have that are below our existing, generally below our existing fields. I think the cutoff point is it becomes a liquid below 2,700 feet or something like that, so we have lots of storage.

You can calculate that number many different ways, but we have a lot of storage down there. And as we've refined that, Leo, I'm going to be happy to represent it, and I think you'll see it eventually in our ESG report that we file quarterly, so I would look for it.

But I don't want to project now on something that's got huge error bars on it. It's just a big, it's a big number. And again, what our goal would be is to follow or to learn from others to make that an economic project and make it available to the state and to other operators to store CO2 that is generated by both other oil operators, but also other industries in the state.

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

Michael Ferro: This is Michael Ferro, filling in for Charles Meade. Leo hit on a pretty good question we were trying to ask, and we appreciate the details relating to the Placerita volumes and pricing. Is there any way you all can provide some further details based upon like the activity levels out of Placerita, maybe like the well count or capital spending there over the last couple of years?

Cary Baetz: Capital spending at Placerita has basically been it's been in a decline. It was not our best returning assets. So we try to, Michael, move most of our capital to our higher returning assets, and Placerita, based upon its cost structure, location and all that, was basically in decline mode. Number of active wells is beyond my expertise, but Fernando may know that off the top of his head. But the other thing, Michael, it did have

our largest cogeneration facility, so that was a 42-megawatt facility and that also goes. But that's the reason the natural gas uses comes down tremendously as well.

Operator: Our last question comes from the line of Nicholas Pope from Seaport Research.

Nicholas Pope: I was trying to get a little more detail on the well servicing business. What was the final closing price on that? And I think you guys mentioned in that press release kind of a trailing 3-year EBITDA, kind of looking like what the projection would be for the next year. I just want to make sure I get those numbers right and also to understand how that's going to flow through the company's financial statement.

Cary Baetz: Great question. $43 million was the closing price, and we said about 1.2x trailing EBITDA. So that kind of gives you the idea on the EBITDA. And that EBITDA has been fairly consistent the last several years. And based upon Jack, continued dialogue with the customers and the level of service quality and what he's doing, we don't see that number deteriorating. So again, we're excited.

I think also, if you heard kind of Trem talk about the methane side of things and the methane capturing and the P&A side, I think we see upside in that. I think like everybody else, the pinch point on growth these days is finding really good employees to get out there to be able to man workover rigs and snubbing units.

But I think Jack is extremely excited to be part of Berry because now he has a strong company with good benefits that will attract those people. I think we do have some positive trajectory on that side of the business that we're excited about. You asked one other question, Nick, and I can't remember off the top of my head --

Nicholas Pope: How it's going to flow through the financial statement.

Cary Baetz: Yeah, the per part from here. So we are going to be very transparent with that business. It will have its own line in the financials, and we'll also do selective summaries within the financials as well. So people can truly break out how Berry is doing and how C&J is doing. We will even highlight, we plan to highlight, the G&A that's associated with C&J, so you can break that out of corporate G&A as well. We just don't want people to end up confusing our cost structure of the oil and gas operations with the services side. So we will give a lot of clarity to make sure that does not happen.

Nicholas Pope: Got it. That's great. And is there activity weighted towards Berry? Like how much of their business is actually related to kind of the current operations?

Trem Smith: Nick, this is Trem. Right now, Berry is not a customer of C&J. And we had 2 critical paths to acquire C&J. One was to keep the management, which is Jack Renshaw and his team, who do an excellent job and have a proven track record. We accomplished that. And then the second was that the major customers and the existing business come along with it. And we spent time, and Jack spent a lot of time, with the major customers,

assuring them that we would keep a wall between the E&P business and the service business.

And we, I think, I know Jack has done -- I've actually doubled back and talked to the leaders of the major customers, and they're all quite satisfied and actually pleased with Berry now being the owner of C&J because of that. And just to build off of Cary's comment about the people, one of the reasons that at least a couple of the major customers that I've spoken to are really appreciative of this is it guarantees -- well, it doesn't guarantee anything with people, but it does assure them and give them confidence that they will be able to keep the same crews and the same workforce on their well opportunities.

Which is a big deal in the service industry, keeping the same people and keeping the same crews. You get confidence you're going to get the same result over and over and over again. I think it's a win/win for the existing customer base and I think it's going to be great for Berry. We will compete for new business, growth business, but not to replace existing business, but to add new business to it. Fernando and his team will be doing that, and that's already started actually, talking to Jack about that.

And then, of course, the P&A business is about 20% of their current business, and that's a strategic piece for us, which we look to grow and hopefully bring in government and other entities into it as customers as the focus on reducing methane emissions grows as you may be reading about. Does that help?

Nicholas Pope: That's great. Yes, that's very helpful. I appreciate the time, thanks, guys.

Operator: (Operator Instructions) There are no further questions at this time. I would now like to turn the call back over to Mr. Trem Smith for closing remarks.

Trem Smith: Great. I want to thank everybody for taking the time this morning. It's a very exciting time for Berry, and I hope everyone has a good day. Thank you for joining us today.

Operator: This concludes today's conference call. You may now disconnect. Thank you for participating.