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BRY.OQ - Q4 2022 Berry Corporation (Bry) Earnings Call

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

Todd Crabtree *Berry Corporation - Director of IR*

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Nicholas Paul Pope *Seaport Research Partners - Research Analyst*

PRESENTATION

Operator

Good day, and thank you for standing by. Welcome to the Berry Corporation Quarter 4 and Full Year 2022 Earnings Call. (Operator Instructions) Please be advised that today's conference is being recorded. I would now like to hand the conference over to your speaker today, Todd Crabtree with Investor Relations. Todd, please go ahead.

Todd Crabtree - *Berry Corporation - Director of IR*

Thank you, Amber, and welcome, everyone, and thank you for joining us for Berry's Fourth Quarter and Full Year 2022 Earnings Teleconference. Earlier today, Berry issued an earnings release highlighting full year 2022 and fourth 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 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, including our 10-K, which will be filed next week. 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 earning 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 Fernando.

Fernando Araujo - *Berry Corporation - CEO*

Thanks, Todd. Welcome, everyone, and thank you for joining us. 2022 was a good year for Berry, both financially and operationally. Once again, we showed the remarkable quality of our assets and our ability to navigate the California regulatory environment as we have done for so many years.

I'm pleased to announce yesterday the Board of Directors approved certain enhancements to our shareholder return model, including doubling the quarterly fixed dividend to $0.12 per share starting with the first quarter 2023, showing their confidence in our ability to continue to generate

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significant returns to shareholders. This is a testament to our high quality, low declining reserves, our long-term view of executing our business plan and our visibility to our cash flows. Mike will expand on these value-creating changes to our shareholder return model in a few minutes.

Looking at our performance in 2022, I'd like to highlight some of our key accomplishments and the strong returns that we delivered as promised. In 2022, we generated $200 million of adjusted free cash flow. As of March, we will have returned $189 million in the form of fixed and variable dividends and share repurchases to shareholders. That's 27% of the current market capitalization returned to shareholders in 1 year. This is industry-leading and a record for our company. And we have proven that we can generate significant free cash flows, and we believe we have the assets and the ability to efficiently manage the business to consistently deliver strong shareholder returns.

Notably, we delivered those returns while maintaining flat production levels net of A&D activity by applying the right technology, reservoir management tools and increasing workover and sidetrack activity to access more of the tremendous amount of oil resources in our assets. We also achieved a reserve replacement ratio of 236%.

Our operations team continues to look for other opportunities to increase our base production without relying on new well permits. A great example of this is our thermal diatomite asset, which we show on Slide 12 of our February investor presentation. Without additional development drilling in thermal diatomite, we kept production flat in 2021 and 2022 through innovative recompletions and by optimizing our steam injection strategy. We have seen strong results from applying a similar strategy to our South Belridge property.

We believe the quality of our assets, including the tremendous amount of oil in place, gives us a competitive advantage over other energy companies. We have decline curves in low teens. And in 2022, we achieved 94% of our total annual production from our existing wells, our base production.

Finally, in its first full year as a Berry-owned company, C&J Well Services performance generated healthy margins. We believe C&J's upside potential is benefited by the regulatory environment, and we expect another solid year of steady growth and performance.

I will discuss our 2023 outlook in my concluding remarks. So with that, I will turn the call over to Mike.

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

Thank you, Fernando. I'm glad to join the call today and do look forward to getting to know all of you. I'm excited about my new role and the opportunity to tell the Berry story. And regarding Berry's performance, I'll keep my comments brief and refer you to our earnings release issued earlier this morning and our 10-K to be filed next week for a more in-depth information of the fourth quarter and the full year 2022 results.

For fiscal 2022, we produced $200 million in adjusted free cash flow, of which $56 million or 28% was attributable to the fourth quarter. For the year, we returned $138 million of fixed and variable dividends, and we repurchased $51 million of shares for a total of $189 million in shareholder returns. That amount is inclusive of the $0.50 per share dividends related to the fourth quarter announced in our earnings release this morning. We are proud to have delivered industry-leading returns based on our market cap.

Our fourth quarter results were impacted by weather, lower oil prices and much higher natural gas prices. As a reminder, we are a gas consumer in our California steam operations.

In December of 2022, unusually poor weather caused operational challenges, production downtime and much higher natural gas prices in California. While we have seen improvement, the bad weather and the related impact did carry into 2023. Additionally, our hedging strategy, coupled with our midstream access to gas from the Rockies, helped mitigate the impact of the high natural gas prices on our costs.

After analyzing the value creation of the first year of our shareholder return model and soliciting feedback from shareholders and the investor community, we are adjusting the allocations effective for 2023. We're now targeting a high single-digit dividend yield with the goal of increasing the value of our shares and lowering our cost of capital. Effective January 1, adjusted free cash flow will be allocated such that 80% will go primarily towards share repurchases and debt reduction, while the remaining 20% will be allocated to variable dividends.

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And as Fernando mentioned, we are also doubling our quarterly fixed dividend to $0.12 per share or from $0.24 to $0.48 per share annually. You'll see these changes take effect with our first quarter results. Please keep in mind, the first quarter of each year is typically our low point for adjusted free cash flow due to the timing of payments that aren't quarterly, such as interest, royalties and bonuses.

I have one housekeeping item that I'd like to point out. After receiving comments from the SEC, we have modified how we discuss our operating costs, what we used to call OpEx or operating expenses. We have not changed the structure of the operations. We've just altered the disclosure of the associated items. You can see this change demonstrated on Pages 16 and 17 of our investor deck and in the tables of the earnings release. Again, this does not reflect a change in the way we view or manage the business.

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

Fernando Araujo - *Berry Corporation - CEO*

Thanks, Mike. In 2023, we are sharpening our efforts to find strategic bolt-on production opportunities in California. Given the current regulatory environment of new drill permits, we are pursuing a bolt-on strategy as an alternative to deploying the drill bit, which, to be clear, we will also continue to pursue.

Bolt-ons can be used to protect our base production and even grow production. We believe the universe of producing bolt-on opportunities in California is improving, and Berry is well positioned to be an opportunistic consolidator.

Our current plan and the issued guidance in our earnings release reflect a slight decline in annual production year-over-year due to recent developments in the ongoing legal challenges to Kern County's permitting process. In short, the Kern County EIR has again been stayed, and CEQA responsibility has reverted to CalGEM. Accordingly, based on experience, we expect the permitting process for new drills to be lengthy. As a reminder, historically, we have received permits for sidetracks and workovers, utilizing existing wellbores without delay under a similar permitting environment.

Should the permitting environment change, we are ready to pivot quickly, and we are well positioned to do so. There are several unknowns that could work out to our advantage. One is whether CalGEM will recognize Kern County permits that we received prior to the Kern stay as valid. Additionally, there is a chance that the stay will be lifted in the near term. While we expect 2023 production to be slightly lower than 2022, the cash flow impact will be fully offset by lower capital needs until the permitting issues are resolved.

We are confident in our ability to generate strong free cash flow and deliver significant shareholder returns based on current strip pricing. The difference in our 2023 expected adjusted free cash flow as compared to 2022 is driven primarily by the price of oil, the timing of working capital and the doubling of the fixed dividend.

Brent oil pricing averaged $99 per barrel for 2022, and our current plan is based on $85 per barrel Brent in 2023. We expect to generate nearly $100 million of adjusted free cash flow, which, after the fixed dividend, means we have the potential to return about $130 million or almost 20% of our current market cap to investors in 2023.

To be clear, 2023 expected adjusted free cash flow is not impacted by the slight decline in production due to lower capital requirements. We remain focused on controlling what we can control. This means we will be prudent in how we spend and manage our expenses, and we will employ hedging strategically to help us cover the fixed cost of our -- of the business. We also plan to maintain or lower our leverage profile. Our goal is to be the most cost-effective producers -- producer where we operate without compromising the quality or safety of our operations.

The strategy and priorities of Berry remain the same: optimizing production and generating significant adjusted free cash flow that we can return to shareholders. While oil-rich California has its challenges, we have demonstrated our ability to navigate those challenges with innovation and by deploying the necessary technical capabilities to produce oil safely and efficiently for the people of California. We are committed to delivering top-tier shareholder returns.

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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*

Fernando, I wanted to go back to the comments you made during your prepared remarks about bolt-ons being a bigger part of the 2023 plan. I know that bolt-ons have always been a -- I'd say, something you guys are -- have been looking for, but your success with getting attractive ones has been sporadic. So I'm wondering if you could talk about the -- what you see that's changed in the opportunities there for bolt-ons and perhaps if that's related to this permitting -- this change in permitting and the difficulty of getting new permits, if that's what's driving more assets to market.

Fernando Araujo - *Berry Corporation - CEO*

Yes. Good question, Charles. And the good news is that, in California, the market, especially [lately] in terms of M&A activity has been active. As you know, there's been several transactions made here over the last few months. So people are talking and people are willing to listen. And we truly believe that the future of California in terms of assets is consolidation.

As an industry, we have to be able to capture the different synergies that we have operationally and then at a corporate level as well. And especially now under the tighter regulatory environment, that's becoming more and more important, I think, and that's why people are beginning to listen.

Now in terms of what we're actually looking for, we're obviously looking for accretive transactions, transactions that can help us replace our production, help us replace our drilling wedge as necessary. At the same time, we're looking for areas or bolt-ons that are close to where we're currently operating to be able to capture those operational synergies. We have been very successful with our surveillance techniques and the assets that we have, and we want to be able to apply those same techniques to our bolt-on opportunities and create more value from those assets.

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

Got it, got it. That's helpful. And then a second question, I think this is maybe a 2-part question. So forgive me for squeezing it in. But it sounds like you guys are planning on no new well permits, but the likelihood is that there will be new permits but that is just going to be slower.

So in a sense, I'm asking -- it sounds like your baseline is a conservative one about no new well permits. And then the second part of the question is can you compare the rates of return on the workovers that you're tilted to in '23 versus the new drills that are going to be a smaller component.

Fernando Araujo - *Berry Corporation - CEO*

Yes. Again, very good question on permits, Charles. Remember that we've been drilling in California since the beginning of the year, and we've been drilling both new wells and sidetracks. And we've got permits in hand to take us into the second quarter of the year. And our current plan does assume that we will not be getting any new well permits. But at the same time, remember that industry in California is getting sidetrack permits and workover permits.

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In fact, just this morning, we received an additional 7 workover permits, which is really, really good news because, if you remember, the current environment that we have today is similar to the environment that we had last year. And last year, we were able to capture workover and sidetrack permits throughout the year.

So the current plan is based on the assumption that we will not get additional new well permits this year. So from that perspective, it is conservative. Now tell me again about the...

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

Yes, compare the rates of return.

Fernando Araujo - *Berry Corporation - CEO*

Question on the rates of return.

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

Right, for workovers versus new drills.

Fernando Araujo - *Berry Corporation - CEO*

The rates of returns for workovers because of the low capital intensity of the project is very, very good. It tends to be north of 100% rate of return. And that's what we've seen throughout the year, in the last couple of years at least. And for our new wells in California also, because of the pricing environment and because of the low cost to drill and complete wells, the rates of returns are also on the order of 100%, and that's what we have assumed for the year in 2023 as well. So we get very good rates of return for both workovers, sidetracks and new drills in California.

Operator

Our next question comes from Nicholas Pope with Seaport Research.

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

I was hoping to get -- when you look at the size of the resource opportunity on doing the workovers, doing the sidetracks, how -- what's the -- I guess, what's the running room that you have on that side of things? Is that every well that you're looking at? I mean what -- how do you think about inventory length, I guess, in -- with respect to kind of this near-term stuff that the capital program is going to be focused on?

Fernando Araujo - *Berry Corporation - CEO*

Okay. Let me start with workovers. With workovers, we have an extensive number of wells that are currently shut in. We probably have a pool of over 500 wells right now that we can -- that we're looking at for workover opportunities, which is very, very extensive. At the same time, you have to remember that workover and recompletion opportunities, the whole opportunity set is very dynamic because as wells fail, a new opportunity is created. So it's -- so it changes every day.

So in terms of workover potential, we have a good, solid pool of opportunities. In terms of sidetracks, as you know, sidetracks are mechanically a bit more risky, also -- from the reservoir perspective, also a little bit more risky than drilling new wells where you want to drill new wells. But we do have that same pool of shut-in wells for sidetrack opportunities as well.

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Currently, the team has identified on the order of 70 to 80 additional sidetrack opportunities that we're working through. But the main thing that you have to remember is that our asset is one of the best assets in the world in terms of oil in place. The oil in place that we have in some of the assets in California are comparable to some of the best assets in the world. So that's the great advantage that we have. We have a great asset base.

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

Got it. That is helpful. And then flipping over to the financial side. Looking at 4Q, it looks like you all prepaid on kind of income tax. I was curious about projections for '23 and maybe even to '24, as you look at what you all are expecting in terms of income tax rate and how much might be deferred in '23.

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

Yes, Nick. This is Mike. I'll take that one. We still have a significant amount of federal NOLs and other tax credits that will cover -- we think that will cover all of our tax needs in 2023. So we don't expect to be a taxpayer federally in 2023. We do expect to have to pay some state taxes in California based on their tax regime, but it should be probably in the $5 million to $6 million based on the current projections.

Operator

Our next question comes from Lloyd Byrne with Jefferies LLC.

Francis Lloyd Byrne - *Jefferies LLC, Research Division - Equity Analyst*

Congratulations. I just wanted to ask about maybe something that Nick and Charles were kind of getting at. But if you look forward into even '24 and you look at the capital efficiency you guys talked about, your CapEx is down almost 30% versus expectations. Your production is only down maybe 7% versus what we thought. Can you just -- are you able to replicate that in '24? Like what's the trajectory of capital efficiency going forward? And is that sustainable, I guess? And kind of the way Nick asked the same question.

Fernando Araujo - *Berry Corporation - CEO*

Okay. Yes. Let me answer this way because that's a really good question. To begin with, Lloyd, you know we have the confidence that the courts will revert back in favor of Kern County's EIR, and we'll return to that process. And with that process -- because, remember, this is not the first time that this has happened. So once that process is reverted, we've got plenty of potential opportunities to still drill new wells in the assets that we have in California.

And the county, they've proven to the courts that they have the capability to be the leading agency for CEQA. So this is just a matter of time. And for next year, we're hoping -- and with some certainty that this is -- this process is going to revert itself like it has in the past. And we should be able to drill new wells like we have in previous years and keep our production levels as we've talked about before.

Francis Lloyd Byrne - *Jefferies LLC, Research Division - Equity Analyst*

Okay, that's great. And then just on the change in the return policy. Just your thought process on buybacks versus dividends and kind of where you're going, going forward?

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

Yes, Lloyd. This is Mike. I'll take that one. Yes, as we said, we did talk to investors, owners. We talked to the investment community. It became clear that with the size of returns we were able to generate, that the appreciation would be more towards the share and debt repurchases. We did feel it's important to leave a little bit in the variable dividend. Again, with the fixed and the variable dividend, we are targeting high single-digit cash yields based on our market cap. And the feedback we got was that, that was also an important component to our return model.

Operator

(Operator Instructions) I would now like to turn it back over to Fernando Araujo for closing remarks.

Fernando Araujo - *Berry Corporation - CEO*

Yes. Once again, I want to thank everyone for listening to the call. We're excited about the future of Berry, and we're excited about executing our plan in 2023. Thank you very much.

Operator

Thank you for your participation in today's conference. This does conclude the program. You may now disconnect.

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