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BRY.OQ - Q3 2022 Berry Corporation (Bry) Earnings Call

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Michael Webb Furrow *Johnson Rice & Company, L.L.C., Research Division - Research Analyst*

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

PRESENTATION

Operator

Good day, and thank you for standing by. Welcome to the Berry Corporation Third Quarter 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 Todd Crabtree, Director of Investor Relations. Please go ahead.

Todd Crabtree - *Berry Corporation - Director of IR*

Thank you, Kurt, and welcome to everyone. Thank you for joining us for Berry's Third Quarter 2022 Earnings Teleconference. Earlier today, Berry issued an earnings release highlighting third quarter results. Speaking this morning will be Trem Smith, Board Chair 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 would like to call your attention to the safe harbor language found in our earnings release. 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. 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 are 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 on our website for a reconciliation between all adjusted measures mentioned in today's call and the related GAAP measures. We will file our 10-Q later today. 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 T. Smith - *Berry Corporation - Chairman, President & CEO*

Welcome, everyone, and thank you for joining us. This quarter, we continued our solid track record of creating value and delivering strong shareholder returns. Through the first three quarters of 2022, we have returned $148 million in the form of dividends and share repurchases, which is more than 20% of our current market capitalization. This is inclusive of the quarter's variable and -- of this quarter's variable and fixed dividends totaling $0.47 per share which the Board declared and will be paid on November 28, 2022, to shareholders of record at the close of business on November 15, 2022.

We initiated our shareholder return model January 1, which drives the return of our capital to our shareholders. This clear and simple shareholder return model is based on the discretionary cash flow we generate, which is calculated as cash flow from operations less the regular quarterly fixed dividend of $0.06 per share and the capital needed to hold oil and gas production flat.

Currently, the model allocates 60% of that discretionary free cash flow, primarily in the form of cash variable dividends with the remaining 40% to be used opportunistically, including in the form of share repurchases.

In the third quarter, we generated $53 million of discretionary free cash flow, producing our $0.41 per share of variable dividend. Compared to the second quarter of 2022, this quarter's discretionary free cash flow reflects lower oil prices as well as the semiannual interest payment made in July equating to $0.18 per share.

We also bought back 2 million shares of common stock in August for $19 million. In the total this year, we have repurchased 4 million of Berry's outstanding shares, which is representative of 5% of our total shares outstanding as of September 30, 2022. The 4 million shares were bought back from one of our largest long-term private shareholders. Since going public, we have repurchased nearly 10 million of Berry's outstanding shares or 12% of our total outstanding shares as of September 30, 2022.

In addition to our robust financial performance, we continue to generate significant value through our operational performance, which Fernando will address in a few moments. This year, we have focused our capital program on protecting and optimizing our base, which is currently more than 94% of our total production.

Our focus remains on what we can control, and as always, we are proactively managing and mitigating those external factors outside of our control. I'll conclude my opening comments by saying that based on current oil strip pricing and our strategy to maintain flat production year-over-year we expect to be able to return to our shareholders the value of our current market capitalization over 3-plus years.

We are confident that our shareholder return model will deliver dividends in the range of $1.60 to $1.75 per share based on the performance expectations for this fiscal year. I will now turn it over to Fernando.

Fernando Araujo *- Berry Corporation - Executive VP & COO*

Thank you, Trem. For details of our operational performance in Q3, please refer to the earnings release and 10-Q. Here are a few achievements I'd like to highlight from Q3. Production was essentially flat from Q2 to Q3. We are currently experiencing our highest production levels of the year. This is driven primarily by the timing of development activity and an increased contribution from our base production in California.

We are optimizing our steam injection strategy through our enhanced data gathering and surveillance activity, which is improving our oil production from our California fields. We currently expect that base production which is the production that comes from our existing producing wells will account for 94% of our total production for the year.

In Q3, we allocated additional resources to workover activity, which is our most efficient use of capital. So far this year, we have completed 235 workover jobs with a rate of return greater than 100% for the program. Nonenergy operating expense has increased quarter-on-quarter mainly driven by inflationary pressures. Also in Q3, we had higher power expenses due to increased seasonal rates and expenses related to our surveillance campaign.

We expect operating expenses to remain essentially flat in Q4. Energy OpEx decreased quarter-on-quarter by $1 per BOE, this was mainly driven by additional gas hedges realized in Q3 as we head into the winter months will be fully hedged in November and December. Also, we have physical capacity in the Kern River Pipeline, which covers up to 80% of our total gas demand. This pipeline brings a reliable supply of gas from the Rockies to California at prices that historically have been less expensive, both initiatives are helping us mitigate the volatility in the gas markets.

To summarize, our production guidance remains unchanged based on our current performance, we continued our enhanced focus on base production during the quarter, which is delivering positive results and our operating margins continue to be strong at current commodity price levels. And I will now pass it to Cary.

Cary D. Baetz - *Berry Corporation - Executive VP, CFO & Director*

Thank you, Fernando. We expect to continue generating significant free cash flow, which drives our top-tier shareholder return model. As we have demonstrated, our model is sound, and it's a perfect fit for our low-decline asset base and highly visible cost structure. On the visibility side of the equation, we work to minimize the impact of natural gas volatility on our operations through hedging. Our current gas hedge position can be found on Slide 22 of our November investor deck.

We remain bullish on oil based upon global fundamentals. However, some of our production is hedged into 2025 as required by our RBL. These oil hedges are discretionary free cash flow generating and our current Brent oil hedges can be found on Slide 20 of our investor deck.

We are updating some of our annual guidance ranges based upon cost and activity changes we began to experience midyear. The changes we are experiencing include inflation-driven higher-than-budgeted natural gas fuel cost and steel prices as well as certain field operating costs.

Our full year production will be within our guidance, and we expect our production rate to grow from the third to the fourth quarter. To keep up the momentum into 2023, we are accelerating our development program, which is largely responsible for our full year capital guidance change to a range of $140 million to $145 million.

We are also revising G&A slightly due to labor inflation and increased professional service activities. Going into 2023, we currently expect some of these increases in the '22 G&A to fall away. For updated guidance, please see our earnings release distributed earlier today.

In the third quarter, we experienced an unplanned third-party pipeline outage that is now expected to be resolved in Q1 of 2023. This has had a negative impact on our differentials on about 25% of our California production during the quarter. Please note, this only impacts dollars received not production sold.

All said, we continue to manage what we can control. We provide clear visibility into our cash flow and production and we continue to deliver on our promise to be a leader in the return of capital to shareholders in the oil and gas space. Back to you, Trem.

Arthur T. Smith - *Berry Corporation - Chairman, President & CEO*

Thank you again for joining us for our third quarter earnings call. From our collective comments, it should be clear that our focus at Berry continues to be on creating value and delivering strong shareholder returns. We will continue to prioritize proactively managing and mitigating external factors that are out of our control.

Speaking frankly, this is just part of being a good oil producer anywhere, and especially in California as well as being a good fiduciary for shareholders. Since going public in July 2018 over 4 years ago, we have returned more than $280 million. And based on our current plan and commodity strip prices, we anticipate that going forward, we will return our current market capitalization over 3-plus years.

Our strategy to maintain production and maximize shareholder returns is tested and effective. We indeed have an excellent track record of success. Finally, we wish all of you a safe and happy holiday season. And with that, I'm pleased to take questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from Michael Furrow from Johnson Rice & Company.

Michael Webb Furrow - *Johnson Rice & Company, L.L.C., Research Division - Research Analyst*

So my first question is just on the accelerated development plan that should result in production growth in the fourth quarter versus the third quarter. Is this growth something that we should expect to see trickle into 2023?

Fernando Araujo - *Berry Corporation - Executive VP & COO*

Yes, Michael, this is Fernando. Good question. Actually, most of the accelerated drilling that we'll be executing in Q4, most of that production is going to be seen in 2023, so - to be part of our 2023 base, which is going to be better than if we didn't drill those wells.

Michael Webb Furrow - *Johnson Rice & Company, L.L.C., Research Division - Research Analyst*

That's helpful. My next question is just on the thermal Diatomite activity. I was wondering if you and your team could provide an update on that activity and the status of the two horizontal wells that were drilled last quarter?

Fernando Araujo - *Berry Corporation - Executive VP & COO*

Yes. No, I'll give you an update on that. We are confirming and we're excited that we have proven the technical success of -- in our ability to produce thermal Diatomite wells, produce those reserves with horizontal wells. So that's a success. At the same time, obviously, we're currently still in the evaluation phase.

We have secured permits to drill additional wells next year, and we will be testing different theories around lateral direction, landing zone, and other issues as well. And then at the same time, we're also evaluating additional technologies to be able to produce the thermal Diatomite resource, which is a huge resource that we have in our field. So the results so far are very good, and we'll be following up those results with activity next year.

Operator

Our next caller is Steven Busch from Everglades Resources, Inc.

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

Pretty happy with the results and the plans you just described. So I won't spend too much time on that, but more or less on what's the situation in California now with permitting? Or are there any problems we should be aware of that California could cause us with their various ending oil by 2045 plans.

Fernando Araujo - *Berry Corporation - Executive VP & COO*

All right, Steve, let me take that question starting on the permitting. I want to start by saying that we have been getting permits from CalGEM in areas with CEQA coverage. And also, we have been getting permits for workover activity and sidetrack activity with no issues at all. That process has not changed. At the same time, the pace of approval for the rest of the permits will get better once CEQA approval response really goes back to the county. That's basically the restoration of the current county EIR. And we expect that matter to be resolved in a matter of days. So we're really, really optimistic about that.

In the meantime, for our 2023 activity, we have received over 50 permits in California. So we've got those secured. And in addition to that, we've submitted on the order of 150 permits that will be approved by CalGEM over the next few weeks and months. So we've got plenty of permits in hand and submitted to be able to take care of our 2023 activity and beyond. So in short, we don't expect to have any issues with permits in order to execute our 2023 program.

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

Perfect. That's good to hear. So I guess a couple of other things. Our plan is to return capital to investors, such as myself over 3 years equal to the current market cap. Would you expect that same kind of 3- to 5-year return to current market cap value to shareholders over the next decade or 2?

Cary D. Baetz - *Berry Corporation - Executive VP, CFO & Director*

Steve, this is Cary. I'll jump in. And I would say, obviously, based upon the current strip, we are comfortable with that, all on the price of oil, right? But you keep in a range of say, how the math works, and if costs stay the same at an $80 [oil] (added by company after the call) number, it's an easy wash, rinse and repeat model that goes over and over again.

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

I guess, like what would be the 5 to 7-year term would be maybe at $50 oil? Or is that -- at what price oil -- it's a low price where we double it every like 5 to 7 years.

Cary D. Baetz - *Berry Corporation - Executive VP, CFO & Director*

Yes, if you're thinking about that, I think you're probably look closer at holding production flat and everything, you're still looking probably about a $60 number on Brent, not WTI, make sure its Brent.

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

Correct. Yes. Okay. Perfect. That's good to know. And I guess my final question is kind of housekeeping. Can you explain the buyback program to me and like who's in charge of executing it? Because I realized you bought back 2 million shares from, I guess, Oaktree. I wasn't aware you were going to do that, but it's at $9.50, and it traded down -- I mean I was buying in the 7s and low 8s, why are we ever buying? Why do we not just make them sell it in the open market and buy back when the stock goes down.

Cary D. Baetz - *Berry Corporation - Executive VP, CFO & Director*

Yes. I think the answer is you will continue to see that program round out over a period of time. But -- we also don't want to have a large sum of shares hit the market at one time, causing damage to the price as well. So I think we'll do -- you'll see a combination of open market purchases and large transactions as we go forward with the program.

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

All right. I guess where does the $9.50 number come from? Because it only traded there briefly on 1 or 2 days during the whole quarter.

Cary D. Baetz - *Berry Corporation - Executive VP, CFO & Director*

I think it's a historical look back is how it was done. It's usually done on a VWAP over a period of time.

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

Right. I mean because I watch the daily volume, and I see 100,000, 300,000 share blocks going through in the 8s, and I'm just -- I would hope that we could be -- like what's our ability to buy those kind of blocks in the market at these lower prices?

Cary D. Baetz - *Berry Corporation - Executive VP, CFO & Director*

Yes. I think the objective is it's unrestricted for us to buy going forward in the open market. And again, we'll see a combination of open market purchases and block trades as we go forward. But the idea, again, is going to be focused on total shareholder return based upon cash and share repurchase and also debt reduction.

Operator

And we're queuing up our next caller right now, Carter Dunlap with Dunlap Equity Management is on the line.

Carter W. Dunlap - *Dunlap Equity Management, LLC - President*

I was trying to get something clarified. In late September, you had the non-deal roadshow and I wrote down in my notes that of the 3,500 California producing wells, 2 of them -- 2,000 of them had never been worked over, and sidetracks are worked over. Assuming I got that right, where do those fall in the future plans?

Fernando Araujo - *Berry Corporation - Executive VP & COO*

We have -- this is Fernando, Carter. We have a lot of wells in California, as you know. Some of those wells are going to be destined to P&A activities, but a lot of them are going to be hopefully destined to work over activities or sidetracking activities. I don't have that number yet, but it's in the hundreds. But it's a significant number.

Cary D. Baetz - *Berry Corporation - Executive VP, CFO & Director*

But part of our active capital campaign and capital expenditures going forward will be both on the workover sidetracks and new wells. So I think it's a permanent part of our tool chest as we look for holding our production and growing our production is going to be workover of existing wells, both from an expense point of view and from a capital point of view.

Carter W. Dunlap - *Dunlap Equity Management, LLC - President*

So it's safe to say that those were incorporated in what you talked about '23 and beyond activity levels.

Fernando Araujo - *Berry Corporation - Executive VP & COO*

Yes. Yes. Correct.

Operator

Thank you, sir. That was our last question. I will now turn it back over to Trem Smith for closing comments.

Arthur T. Smith - *Berry Corporation - Chairman, President & CEO*

I want to thank everybody for joining us today and look forward to a great fourth quarter and culminating a great year in 2022, and I wish everybody again, a very happy and safe holiday season. Thank you.

Operator

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