California Resources Corporation
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Gregg: …California [Resources has] done a great job sort of managing through the last down cycle, ready for the next one potentially. But I'll let Mark tell the California Resources story.

Mark: Thanks, Gregg. We're realistic, but we tend to be a little more optimistic than that. Appreciate the kind introduction. Thank you very much for the opportunity to be here with you today and share the California Resources story.

As Gregg said, we've been tested. We've demonstrated the resiliency of our asset base, we've made the hard decisions. Some have even said that we're punching well above our weight class. We continue to be focused. We're focused on capturing the underlying value of our portfolio. We're focused on disciplined capital allocation, we're focused on driving operational excellence, and we're focused on continuing to strengthen the balance sheet.

[background talk]

Mark: So by capitalizing on our diverse asset base and having significantly reduced our debt, we believe that we're well-positioned to continue executing on our value-driven strategy and delivering sustainable growth

What was our performance during the third quarter? How'd we do? We're running 10 rigs. We produce an average of 136,000 BOE per day. That's up 6% over the prior year period. Producing 62% oil. EBITDAX for the third quarter registered $308 million. That was up 65% year-over-year. Our EBITDAX margin for the quarter registered 38%, improved to 38%. Our Core Adjusted EBITDAX for the quarter importantly registered $400 million. That was up sequentially 18%. For the nine months Core Adjusted EBITDAX registered in excess of $1 billion. We think that's important. It's before the effect of hedges and it's representative of the cash generating capability of the company, particularly as the profile of our hedge portfolio changes as we move into 2019. I'll talk about that more in a bit. During the quarter we invested $158 million, all internally funded. The remaining $38 million of capital was funded by our partners and was dedicated to our joint venture projects. We're pleased with our performance over the quarter and we're looking forward to the remainder of the year and how we're positioning ourselves for 2019.

What is it that truly differentiates CRC's asset base? Now I like to say that we demonstrate the characteristics of a major encapsulated within the entrepreneurial fervor of an independent. Consistent with this, one of the key factors that differentiates our asset base is its diversity. We operate in multiple basins. We operate in four of the largest fields in the United States, all multibillion barrels in terms of original oil in place. We have multiple drive mechanisms, whether that's conventional primary, whether that's waterflood, steamflood, even some unconventional. It's important to note that we have significant gas optionality, represented by the Sacramento Basin and we continue to monitor the natural gas outlook and we can shift our activity accordingly. We've commented that we have the flexibility, if warranted, to shift the majority of our production to natural gas within approximately five years.

Another key factor that differentiates CRC's asset base is its size, its sheer volume of oil in place. We have world-class fields here; 50 billion barrels of original oil in place, 9 fields each over a billion barrels of original oil in place, characterized by low recovery factors. So a common theme you're going to hear from me this morning is lots of work ahead of us.

Another key factor that differentiates CRC is the quality of our reserve base. Our proved reserves registered 713 million BOE as of July 1st. Now it's important to understand this isn't just a midyear update or a roll-forward. This is a full review. It was expertised by Ryder Scott. It's up 18% year-over-year from 2017. That reserve level is approaching that at our spin, despite significant change in price, prices being 25% lower than where they were at our spin.

Our reserve base is characterized by its long life nature. We have a 15-year reserve to production ratio. It's a very shallow decline rate. Our 2P reserves are well in excess of a billion BOE. Importantly, our finding and development costs registered $6.82 per BOE in 2017. It's the third year that they were less than $10 a BOE. Our organic recycle ratio was 2.1 times in 2017. Our three year average was 2.8 times. In my experience, Gregg I want to share this, it's difficult to find a company that can generate a recycle ratio approaching 2 times for an extended period. That's the kind of asset base that we have and that's the way we've been managing the business or one of the indicators of how we've been managing our business.

Gregg: [inaudible]

Mark: Thank you. Another factor that differentiates CRC is the deep regional insight that we have. We're the largest player in California. We have 2.3 million net acres. Sixty percent of that is held in fee. Most of the position, our position is either held in fee or held by production. So importantly, we don't have to make uneconomic decisions that many of our peers have to make simply to hold our lease position. The size of our asset base, the size of our land position also provides significant flexibility optionality. It's underexplored and underexploited. As you can see from the slide, there's been very little work that's been done under 5,000 feet so that we see lots of potential deep. We have the largest 3D seismic position in the state. It gives us proprietary insight. So again, we have lots of running room ahead of us.

Another factor that differentiates CRC is our favorable market. A lot of folks fail to realize that California is the fifth largest economy in the world, positioned somewhere between France and Germany. It's an economy that's in a continual energy deficit, doesn't produce enough energy locally to meet its needs, and there's very limited pipeline access or access for product into the state. As a result, the state relies on waterborne barrels to meet its energy needs. As a result, we receive Brent based pricing, very healthy realizations. In the third quarter, our realizations were 97% of Brent, so it reflects the ongoing strong demand for California crude as it's used to optimize California refinery yields.

On the natural gas front, we not only have the ability to leverage our portfolios I described earlier, but we also have significant capacity and infrastructure which allows us to rapidly supply additional needed gas to the market place. You saw that in the third quarter. It can be seen in our other revenue and expense line items. Our net margin during the quarter from this was $25 million dollars.

Another factor that differentiates CRC is our net asset value, the raw value - our aggregate value of our underlying assets collectively. At $75 flat held forever, it's $20 billion. Current pricing held flat, roughly 65; held flat NAV $16 billion. Our current enterprise value is roughly equivalent to our PDP value. Roughly equivalent to our PDP value. No value for unproven, no value for our significant complimentary infrastructure that I spoke about, no value to our land position. So overall our NAV is much, much greater than our current enterprise value and it gives one a sense for where we're going. Again, lots of room to run. Again, that common theme. So by capitalizing our diverse asset base and having significantly reduced our debt, we're well positioned to continue executing on a value-driven strategy and delivering sustainable growth.

So what is CRC's operating strategy? Well, one of the key tenants of our operating strategy is to thoughtfully develop our large and growing inventory of actionable projects. It's important to underscore that our reserve base translates into a deep inventory of actionable projects. At $75 Brent, over $1 billion, or excuse me, over 1 billion BOE of projects, all with VCIs, in excess of 1.3 times and development cost less than $10 a barrel. And when you look at this slide, particularly in light of the article in the *Wall Street Journal* this morning, I want you to look carefully at the footnote at the bottom. We're not working to hide anything here or covering anything up. This reports full cycle costs for us; operating costs, development cost, cost to development, facility costs, field-level G&A, even taxes other than on income. So we're not like others that you heard about reported in the *Wall Street Journal* this morning. We're trying to be candid and embed all of our costs as we do our analysis and we share it with you.

So when you look at this slide with over $10 billion of currently identified investment opportunities at our current investment pace, you're seeing that we have many years of work ahead of us.

Another key tenant of our operating strategy is our disciplined capital allocation process. Gregg alluded to this in his opening remarks, how we've been managing our business as we've gone through the downturn. We've been free cash flow positive throughout the cycle. One example of this is the fact that we proactively adjusted our activity levels, as well as our mix. As prices fell, this asset base has the flexibility to quickly and meaningfully pullback. We pulled back rigs meaningfully in the initial downturn in 2014 to work to stay within cash flow and preserve value. As prices increased, we began to increase our activity levels with a keen eye on liquidity and we began to transition to the offense. Today we're focused on value-driven sustainable production growth, while dedicating 10 to 15% of our discretionary cash flow to strengthening our balance sheet.

Another example is the framework we use for capital allocation as we move through the commodity price cycle. This slide gives you a sense for that. In a downside environment we'll work to protect the base. We'll focus on steamfloods, waterfloods, workovers. Some of the best return projects we have are capital workovers where we've already got the pipe in the ground. We use the secondary – in this environment we would use, we have used, the secondary measure of payout as a focus on liquidity. In a mid-cycle environment we'll tend to invest. As we're in now, we'll tend to invest in value-oriented growth projects, focusing on longer-term value. With enhanced liquidity we'll tend to extend and relax that payout criteria just a bit.

Another key aspect of our operating strategy is leveraging our knowledge, as well as our infrastructure associated with our primary operating areas. Key example of this is our primary operating area of Elk Hills. As you recall, it's the prior Strategic Petroleum Reserve, Strategic Petroleum Reserve #1. Ten billion barrels of original oil in place, it's been producing since the early 1900s. We've operated here for over 20 years. We acquired the interest from US Government and recall that Chevron had the residual interest. Importantly it has a very integral and complimentary asset base associated with it; power plant, processing facilities. Using the significant knowledge and infrastructure that we gained at Elk Hills, we've used that to help develop key fields such as Buena Vista and Coles Levee.

A key example of leveraging our knowledge base, our acquisition of that incremental interest from Chevron that I've referred to a minute ago. We acquired the remaining non-operated interest of Chevron and recall it varied 20 to 22% roughly by zone. As a result, there was a lot of operational inefficiencies in the field; different gathering systems, different metering facilities, different sales points all based upon zone. So as a result of the acquisition, we've been able to consolidate those operations, streamline those operations and processes. The transaction also included over 10,000 surface fee acres. And as a result, we now own 100% working interest, 100% net revenue interest, and all of the surface and one of the largest fields in the lower 48. Very few independents can make that claim.

So the acquisition, as I said, allows us to consolidate operations, streamline processes, improve our capital efficiencies. Additionally the acquisition provides additional cash flows for us to reinvest in that inventory of projects that I showed you a minute ago. We've had operational savings here of nearly $34 million dollars year-to-date. That compares to our initial target of $20 million annually. And of note, those numbers don't include an additional $15 million of estimated capital that we can save, capital avoidance cost that we can save by using tank batteries and other equipment in other locations around our broader operations. So very, very significant saving synergy associated with the acquisition.

Another example where we're leveraging our knowledge is the Southern San Joaquin Basin. You see that there on the slide in front of you. It's an area south of Elk Hills. It also is characterized by a series of very large fields with low recovery factors. Importantly, there's hundreds of feet of stacked pay here. Many of the same reservoirs that we're familiar with from Elk Hills and Buena Vista are also present in the Southern San Joaquin Valley, and so we believe that there's significant potential that's held there. We'd been reworking the area in these fields based on what we know from the analogous operations. And we're using existing well-bore data, wells currently in the area, combined with our proprietary 3D that I spoke about, our integrated reservoir characterization, and we're working diligently and identifying additional opportunities, high-grading them based on the disciplined capital allocation process that I spoke to. We think these fields hold significant workover, primary drilling, waterflood, even EOR potential and we're having good success here.

Another example where we're leveraging our knowledge and infrastructure, this time infrastructure, again it's the Southern San Joaquin Basin. Simply put, we're using Elk Hills, Elk Hills as a core area as an infrastructure hub and we're tying the South Valley into Elk Hills power, taking advantage of the additional power from that integrated facility that I spoke about earlier. And we're bringing the South Valley production back to Elk Hills to gain the benefit of our processing infrastructure backup at Elk Hills. Again, working to drive capital efficiency and lower our overall operating costs.

Another key aspect of our operating strategy is to de-risk our asset base through our conventional exploration program. As prices began to improve in 2017, we reinitiated our exploration program -- recall we had pulled back on that during the downturn -- and we've worked to manage our capital as well as our risk profile through these small exploration joint ventures. Since re-initiation we've invested $17 million to CRC's account and we've experienced a success rate in excess, commercial success rate in excess of 50%, so very successful exploration program. And over this time period we've generated in excess of $200 million in value from $17 million investment; $200 million risked PV10, not too shabby -- further illustrates the potential of our asset base and strong performance from our exploration activities, so hats off to the team.

Another key aspect of our strategy is the thoughtful use of relationships, particularly joint ventures, and a number of you have heard about that over time. It allows us to accelerate value, it allows us to participate in the growth, which allows us to de-risk our inventory. We have roughly $600 million of current potential development and exploration capital that's committed. About $550 million of that's been committed to the development front. $240 million has been funded in terms of development capital through the third quarter, and recall of that roughly $100 million invested – let me make sure I'm on the right slide here. Yeah, there we are, JVs. Recall that for every $100 million invested, our gross peak production is about 3,500 to 4000 barrels of oil equivalent a day. Our gross potential reserves are greater than 12 million BOE estimated for every $100 million that we invest. Importantly, at recent pricing we see reversion occurring before our significant maturities. And of note, I want to point out that as each of our partners placed their nose under the tent they've all liked what they've seen and they've chosen to invest more, whether that was BSP, whether that was MIRA, whether that was Ares. Even Chevron chose to take equity when we did the transaction.

An example of how we've strategically used our joint ventures to manage capital is this slide that you saw just a second ago. And you can look at that in terms of our actions that we took in 2017. You recall midyear 2017, we encountered a bit of an air pocket in terms of commodity prices. Whenever we did, we reallocated a rig line back into the joint ventures. They're a little less sensitive to price fluctuations as a result of the IRR nature of the reversionary feature. As a result, we were able to stay free cash flow positive, but yet maintain activity in the field and preserve our operating cost efficiencies. So by capitalizing on a diverse asset base and having significantly reduced our debt, we believe that we're well-positioned to continue executing on our value-driven strategy and delivering sustainable growth.

So what is our financial strategy as we move forward? How will we continue to work to strengthen the balance sheet? When we spun we had a near-investment grade balance sheet. Lex knows. He worked with us to help put it together. As we move through the cycle, we work to do the right things. We didn't sell assets at fire sale prices. Rather we executed on a series of transactions with much more favorable economics and long-term benefits. In the process we introduced complexity into our capital structure. As a result we've experienced the burden of a deep non-investment grade balance sheet. Now that we're closer to a mid-cycle pricing environment we're motivated to have a near-investment grade balance sheet to complement the world-class investment grade asset base that we have.

And as a result, one of the key aspects of our financial strategy accomplishes just this; we continue to focus on strengthening the balance sheet. As we said in the past, we'll be opportunistic to execute what we refer to as an-all-the-above strategy. We're committed. We're committed to allocating our capital in a disciplined manner, to reduce our leverage, to simplify our balance sheet, to increase our financial flexibility, to be opportunistic. We're committed to dedicating 10 to 15% of our discretionary cash flow to the strengthening of our balance sheet.

Another key aspect of our financial strategy is to simplify our balance sheet to increase our financial flexibility. Importantly, we have no significant maturities before 2021. We're still focused on reducing absolute levels of our debt. We received our 8th amendment to repurchase $300 million of our second lien notes and senior notes at any discount. Again, we'll continue to take advantage of market conditions as they present themselves.

Another key aspect of our financial strategy relates to our hedging program. I alluded to this earlier. As we previously noted, we've changed the underlying instruments in our hedge programs to puts and put spreads. Almost half our 2019 crude oil production is protected at an average Brent price, Brent price of $71 a barrel, allows for full upside participation for the significant majority of our 2019 production.

So what is the outlook for CRC? How do we see ourselves going forward? In terms of capital allocation, as we move towards 2019, one expectation is that we'll continue to invest within our forecast cash flow. Another expectation is that our capital program will be dynamic. We'll scale it up or down based on our outlook for cash flow. Another expectation is that our investments will be directed to oil-weighted projects, largely conventional water floods, steam floods in our core fields of Buena Vista, Elk Hills, Wilmington, Kern Front, Huntington Beach, and we'll work to further delineate and appraise the Southern San Joaquin Basin area that I spoke about, Ventura as well as Kettleman.

So what's our expectation in terms of production and cash flow? Well, as we stated, we expect to fund our capital investment from roughly 90% of discretionary cash flow. We're in the process of reviewing. We continue to review various planning scenarios across a wide variety of commodity price ranges. As an example, if we look at a scenario consistent with long-term prices equivalent to what we experienced in the third quarter, our expectation would be oil production growth in the range of 7%. Another expectation is that with the focus on oil and increasing margins, our EBITDAX growth would register in the low to mid-teens, roughly twice the rate of oil production growth. So expect margin expansion as we continue to focus on oil, leading to reasonable EBITDAX growth of approximately twice the rate of oil production growth.

What's the outlook for CRC in terms of our leverage? A key expectation is reduce leverage and strengthening of the balance sheet, as I've spoken. As we review our various planning scenarios, we see significant deleveraging from investment simply from internal cash flow. In combination with continued chipping away at our debt with free cash flow, we see, which doesn't consider other alternatives we have available to us, we see, with reasonable price assumptions, that we begin to drop below our target debt range in 2019 or roughly 3.5 times as we move through the latter portion of the year. To test this all you have to do is simply look at our Core Adjusted EBITDAX for the third quarter, $400 million that we talked about earlier. Annualize that, roughly $1.5 billion, a little in excess of that. And then given our current debt levels, translates to just over 3.5 times at third quarter average prices.

So in summary, we believe that by being disciplined with investing and investing in our existing property base and modestly chipping away at our absolute levels of debt, that we can see reasonable growth, that we can see further de-risking of the company, that we can see strengthening of the balance sheet. By capitalizing on a diverse asset base, by having significantly reduced our debt, we truly believe we're well-positioned to continue executing on our value-driven strategy and delivering sustainable growth. Importantly, we'll continue to focus on multiple ways to continue to drive value for our shareholders.

With that, I thank you and open it up for any questions you might have.

Gregg: If there's any questions from the crowd, please raise your hand. I'll start it off.

You talked a lot about – you have your capital allocation plan that changes with pricing and you've highlighted some of the things you'd do throughout the cycle. At your Analyst Day you were working on a bit of higher [Brent prices]. How does the current environment change what you may do next year in terms spending and _____ for cash flow and how's that complemented with the JVs?

Mark: It's a good question, how we're thinking about 2019 and how do JVs play into that? Many companies have kind of a static capital budgeting process. They'll set the capital budget at this time of the year and then it'll be set in stone and they'll prosecute it for the remainder of the year with very little adjustment midyear. We have a dynamic process. You've seen us use that in the past, Gregg, where we will continually go through a portfolio management and capital allocation process. You saw us in 2017 where we allocated a rig line back into the JV to stay within cash flow. That's the same kind of activity that you can expect from us going forward. So if for some reason commodity prices were to be substantially lower than where they are today, you'd see a heightened use of joint venture capital from us, as well as looking at other alternatives that we have available to us.

It's important to underscore that the feedback that we had from our joint venture partners continues to be very positive and our joint ventures are performing very, very well and we have others that have expressed interest as well. The reason that joint – joint ventures accomplish a number of things for us. They not only allow us to participate in the growth wedges I cited, but they also maintain – allow us to maintain operating consistency in the field and it works to help us to maintain the cost savings that we've been able to benefit from. So that sustainability of that activity is important. With us owning 100% working interest in almost all of our fields– those JVs have important flexibility – provide us with important flexibility.

Gregg: Can you remind us how much JV capital you expect to come in '19 ...

Mark: Well, we have about $550 million of development joint venture capital has been committed to us and we've invested roughly $240 million of that.

Gregg: And do you have an expectation of how much you'll – I know some of it's a call on capital, I believe, [do you have] expectations what that could look like at your Analyst Day or?

Mark: No, we've not said anything.

Gregg: How much _____, 230 you said?

Mark: 240-ish.

Gregg: You have a great slide that introduced on your Analyst Day on the JV payouts and the expectation that they'll [be reversion] before maturities. The numbers that you shared, can you just remind us, I think you said [for every $100] million expense, you have 12 million [barrels of oil]. You also said 3.5 to 4,000 barrels a day].

Mark: That's right.

Q: Is that what you expect to get from the JVs [when they revert] to you or is that what you're getting today ...

Mark: No, the way to think about it is for every $100 million that results in a production profile underneath the joint venture or for the joint venture itself that ultimately peaks at 3.5 to 4000 barrels of oil equivalent a day. Investors have to return – have to achieve their protected right of return, so there'll be some decline off that peak before reversion occurs. So that that reverts to us will be some decline off that peak given the time to reversion.

Q: Can you give us a sense what you think that [decline] is?

Mark: We've not disclosed that.

Gregg: Always gotta trySo [we're at a debt conference] I'm sure you're ready for this one. Could you just remind us sort of – so you mentioned the 10 to 15% of discretionary cash flow. That sounds like that doesn't change no matter what. Is that accurate? And then can you talk about how you're thinking about what debt makes the sense between the second liens and the one and a half lien, how you're thinking about approaching repurchasing those or refinancing?

Mark: Just to summarize your question, I think it's important to kind of to kind of frame my perspective as CFO of the balance sheet and how do we get from where we are today to that optimal capital structure that I was driving in my remarks? And to me that optimal capital structure looks like very much what we had at the outset, i.e., a senior bank facility, albeit likely secured senior bank facility combined with unsecured notes. If you look at it we just reaffirmed our $2.3 billion borrowing base. So the $2.3 billion borrowing base then encompasses the billion dollar bank facility we have plus the $1.3 billion of 1.25 lien debt we have. So then that leaves the remainder of the balance sheet and then question becomes, well, what steps do we take to migrate that to unsecured?

The second lien debt, at this point in time, it's 8%. It has the same covenants package, investment grade covenant package that we put in place at the outset. So really the most challenging piece of the overall capital structure is the 2016 term loan, which is priced at LIBOR plus 10-3/8ths. Now that has some call provisions associated with it, etcetera. But we continue to look at – probably the most liquid piece of paper is the second lien notes, the 8% debt. But the most – the piece of paper that can impact our fixed charge ratio the greatest is that 1.5 lien debt. So we continued to look at both of those and think about how we can improve our capital structure, simplify and improve our fixed charge coverages, and we're mindful of the balancing act between refinancing and the make-whole or the call provisions on the 2016 loans.

Gregg: Can you give us a sense of what your flexibility is to repurchase? Secondly is, today I know there's some baskets and also to address 1.5 lien or the 2016 term loan.

Mark: When we originally – when we executed on the Ares transaction we built some baskets that were – that we negotiated with the banks in the 2017 – in the amendment we had in the fall of 2017 and those were pretty significant baskets. But as a result – and we executed in terms of repurchasing some debt under them. But between the movement on – remember there was an 80% or – yeah, there was an 80%. We had to purchase those notes at something less than 80 cents on the dollar. That was a restriction in the amendment.

Gregg: And it's over par now – its par now, right?

Mark: So the second lien notes is what I'm talking about going after. And so, we executed on some of that, but then between the passage of time, blackout periods, etcetera, we couldn't execute on all of that. So we went back to the banks and we asked for approval to reinstate some of those baskets, some of that basket that we previously established and was unused. And so it was reestablished in the 8th amendment at $300 million. No discount. No time limit.

Gregg: And how much is left today in the basket?

Mark: At the third quarter it was unused.

Gregg: Unused. And then your ability to buy back. First lien is limited today. You'd have to refinance that, is that correct?

Mark: Yeah.

Gregg: I think we're out of time and I know it's lunch. And so I want to give our speaker a round of applause and just want to thank him. Thank you, Mark. I thought that was very helpful.

Mark: Thank you.

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