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CRC - Q1 2016 California Resources Corp Earnings Call

EVENT DATE/TIME: MAY 05, 2016 / 9:00PM GMT

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PRESENTATION

Operator

Hello, and welcome to the California Resources Corporation First Quarter Earnings 2016 Conference Call. (Operator Instructions) Please note this event is being recorded. I would now like to turn the conference call over to Mr. Scott Espenshade. Mr. Espenshade, the floor is yours, sir.

Scott Espenshade - *California Resources Corporation - VP of IR*

Thank you. I'm Scott Espenshade, Vice President of Investor Relations. Welcome to California Resources Corporation's First Quarter 2016 Conference Call. Participating on today's call is Todd Stevens, President and Chief Executive Officer of CRC, and Mark Smith, Senior Executive Vice President and Chief Financial Officer, and also several members of the CRC Executive Team.

I'd like to highlight that we have provided slides in our Investor Relations section on our website, www.crc.com. These slides provide additional insight into our operations and first quarter results information. Also, information reconciling non-GAAP financial measures discussed to the most directly comparable GAAP financial measures is available on the Investor Relations portion of our website and in our earnings release.

As a reminder, today's conference call contains certain projections and other forward-looking statements within the meanings of federal securities laws. These statements are subject to the risks and uncertainties that may cause actual results to differ from those expressed or implied in these statements. Additional information on factors that could cause results to differ is available in the Company's 10-Q, which is being filed today. We would ask that you have reviewed it and the cautionary statement in our earnings release.

A replay and transcript will be made available on our website following today's call, and will be available for at least 30 days following the call. We have allotted an equal time for Q&A at the end of our prepared remarks, but ask that participants limit their questions to a primary question and then a follow-up. I will now turn the call over to Todd.

Todd Stevens - *California Resources Corporation - President & CEO*

Thank you, Scott. And thank you, everyone, for attending our earnings call. We had another successful quarter of delivering on our key metrics. We believe our long term success depends on executing on items within our control while taking advantage of market dynamics as they occur.

As I reflect upon the first quarter, there certainly was a lot of unfavorable sediment in our sector, in the broader capital markets, and in commodity prices. However, everyone at CRC addressed and managed through the challenges of the tough environment. We held true to our core financial tenets of living within cash flow, protecting our base production, and enhancing our margin. And of course, we stay focused on strengthening the balance sheet. So let's start there.

The recent protracted downturn has changed perception significantly from even just a couple of quarters ago, not only from an industry and a commodity price perspective, but also from a capital markets point of view. While the abrupt changes in the capital and commodity markets have slowed potential transactions, they have also provided additional opportunities on which we believe we can execute by year-end.

Our first priority before we could pursue significant deleveraging transactions was to amend our credit agreement to align its requirements with the current price environment. Mark and his team did an excellent job of working with our bank group to achieve our main goals in the February bank amendment, which included providing sufficient liquidity and laying out a pathway for strengthening the balance sheet. We are now progressing on several of these fronts.

We have mentioned in the past that we have three avenues which we could use to delever - our upstream assets, midstream assets, and through the capital markets. Despite the extremely challenging environment, on the upstream front we are continuing to pursue execution of a meaningful development in exploration joint venture projects, only if on favorable terms, in addition to the modest JVs we have put together to date.

While we continue to see interest in our midstream assets, we are fully aware of the opportunities presented to us in the current capital market environment. Reaching our longer term deleveraging goals will likely require a series of steps and transactions involving a variety of opportunities that extend through 2016 and beyond. As we have said in the past, we will always look to capture the largest deleveraging impact of any transaction in the near term while balancing the long term effect on CRC.

Turning to our operations, we continue to benefit from our high level of operational control, as well as the resiliency of our diverse and rich asset base. In addition, the continued strong execution of our operations team has helped reduce costs, protect our margins, and manage our base production.

In this capital constrained environment, we expect 2016 will likely be a year of blocking and tackling for our operations team to continue their strong performance in all three of our key tenets while building inventory with anticipated rebound in the commodity markets.

Our first quarter production came in above the midpoint of our guidance at 148,000 BOE per day. I believe this result exemplifies the advantages of our established operations with a high level of operational control and low decline base production. This was accomplished with no drilling capital.

We also continued to reduce our costs and posted better than expected results on both an absolute and a per barrel basis. We are proud of all the efforts put forward by all levels of our organization, defined and implemented efficiencies, and cost savings. Of the cost reductions realized--we realized over the past year, we expect that the majority will be sustainable over the longer term.

Lastly, we successfully concluded the planned major power plant maintenance turnaround that we discussed on last quarter's call on budget and ahead of schedule.

Our 2016 capital program of $50 million is focused on investments designed to ensure safe and reliable long term operations and is front loaded due to the first quarter power plant turnaround, which is the single largest item in our capital budget. Given the macro environment, we are choosing to optimize and build inventory across our vast land position rather than increase production into low commodity prices.

Our life-of-field plans coupled with our 1.3 BCI threshold help ensure capital investment is directed to projects that will deliver an attractive return on a full cycle basis, protecting our high value resources, as well as maximizing value for shareholders.

As part of our February credit amendment, our borrowing base will be re-determined semiannually. We successfully executed our spring redetermination on May 2, with no reduction from our previously established borrowing base at a level of $2.3 billion. This result again underscores the quality of our assets. We believe our current borrowing base, in conjunction with the terms of the credit amendment that was approved in February, provides flexibility and sufficient liquidity to execute our business plans.

At our stated capital level we expect our 2016 average daily production to decrease in line with the upper end of the base decline range that we observed historically. With that perspective, our total average production on a BOE basis is expected to decline to a range between--from between 138,000 to 143,000 BOE per day in the second quarter.

Realized prices were affected in part by the change in contract expiration dates for Brent futures in February. We expect realizations in California to stabilize going forward and have recently witnessed firmer pricing in the California market.

Our hedging program enhanced our first quarter cash flow and continues to support our strategic objective, but protect our cash flows and margins, and improve our ability to comply with our credit facility covenants in case of further price deterioration. Our marketing team works to take advantage of dislocations in the commodity markets which grow the hedge up to 50% of our crude production. So far we have hedged more than a third of our oil production on average for the rest of 2016.

I will now turn the call over to Mark to discuss the details of our first quarter results.

Mark Smith - *California Resources Corporation - Senior EVP & CFO*

Thanks, Todd. In the first quarter of 2016 we continued our record of successfully delivering strong operating results with a low commodity price environment. Despite a 36% lower average crude price, we generated the same operating cash flow after working capital compared to the prior year level. This is a result of our continued focus on cost reductions as well as margins.

As Todd discussed, we recently completed our spring borrowing base redetermination and continue--and made continued progress on our cost reduction efforts. We consider the success we achieved on both of these fronts to be important steps in managing through this downturn and beyond.

The bank's reaffirmation of our $2.3 billion borrowing base provides sufficient liquidity despite the significant headwinds buffeting our industry. We believe this is also a clear indicator of the resiliency of our assets. We're extremely pleased that our banking group continues to recognize the quality of our asset base.

We believe our cost reduction efforts demonstrate our ability to effectively manage our business. Since we became an independent company we have conducted an extensive review of our business and cost structure. As a result, we implemented numerous measures to make our organization more efficient and better aligned with the current price environments. Of course, we did this while maintaining our focus on operational safety.

These efficiencies in cost savings measures provide value creation opportunities even through this continued period of lower prices, and we expect to continue benefiting from these efforts over the longer term.

Our first quarter 2016 oil production averaged 98,000 barrels a day compared with 102,000 barrels a day in the fourth quarter and 108,000 barrels a day in the first quarter of 2015. This represents a decline of 4% sequentially and only 9% from a year ago. We expected these moderate declines as we drastically reduced our capital program in 2015 and into 2016 in our effort to preserve cash flow.

Additionally, the first quarter production declines reflect a selective deferral of workover and downhole maintenance activity, as well as affected our power plant turnaround. Our high level of operational control over our assets allowed us to defer certain lower value expense workover and downhole maintenance activity in order to defend our margins in light of the lower prices we experienced in the first couple months of the year. This reduced level of activity may stress our decline rates in the near term. I should note that wells that went out of service as a result of this deferred activity can be brought online rapidly at minimal cost as prices improve and economics dictate.

We are increasing our expense workover and downhole maintenance activity gradually and modestly beginning in the second quarter with the recent more stable and higher priced environment.

NGL production in the first production of 2016 declined slightly to 17,000 barrels per day compared with the 18,000 barrels per day registered in both the first and fourth quarters of 2015.

Moving to natural gas, first quarter production averaged 196 million cubic feet per day compared to 212 million in the prior quarter and 242 million cubic feet per day in the first quarter of 2015. This decline was expected and is consistent with our focus on liquids.

Total daily production for the first quarter of 2016 averaged 148,000 BOE, which was on the high side of our first quarter guidance. This compares to total daily average production of 155,000 BOE for the fourth and 166,000 BOE for the first quarter of 2015, representing an 11% decline year-over-year.

The average Brent index crude price in the first quarter of 2016 was $35.08 per barrel, down 22% sequentially and 36% lower than the first quarter of 2015. Our realized crude oil prices, excluding the impact of our hedges, averaged $30.08 for the first quarter, compared with $39.41 and $46.38 for the fourth quarter and first quarters of 2015, respectively.

As Todd mentioned, realized prices were affected in part by the change in contract expiration dates for Brent futures in February. This one-time effect rippled through the quarter as Brent contract expirations now rollover to the next month approximately two to three weeks ahead of WTI for delivery in the same month.

Offsetting some of the headwinds in price differentials, including this effect, was the positive cash flow from our hedge programs. The hedges that settled in the first quarter contributed $6.31 per barrel, or $56 million, bringing our first quarter realized oil price up to $36.39 per barrel. We'll continue applying our hedging strategy for that cash flow in future periods.

Realized NGL prices in the first quarter averaged $16.39 per barrel, down from previous periods as fourth quarter 2015 prices averaged $19.56 per barrel and first quarter 2015 prices averaged $21.55 per barrel. Realized natural gas prices in the first quarter averaged $2.05 per Mcf, compared with $2.44 sequentially and $2.84 in the prior year period. The fourth quarter of 2015 realized price benefited by $0.16 per Mcf from our hedging programs.

As I discussed, we saw the continued positive impact of our cost containment efforts in the first quarter. Production costs, adjusted G&A expenses, exploration expense, and interest expense were all lower in the first quarter than both the prior year and first and fourth quarters. Production costs in the first quarter of 2016 registered $184 million, or $13.69 per BOE, compared to $221 million, or $15.51 per BOE in the fourth quarter, and $242 million, or $16.20 per BOE, in the first quarter of 2015.

This represents a 17% decrease on an absolute dollar basis from the fourth quarter and a 24% decrease year-over-year. This is a significant reduction for both periods. The decrease was driven by cost reductions across the board, particularly in well servicing efficiency, field personnel, energy use, and lower natural gas prices. Production costs also benefited from our economic decision to defer certain workovers and the lower value downhole maintenance activity.

We're proud of the efforts put forth by all levels of our organization to find and implement efficiencies and cost savings opportunities. And we believe the majority of these efficiencies and savings will be sustainable over the longer term. The decline in our production costs also resulted in part from lower natural gas prices, which lowered the cost of steam generation for our steam floods, as well as the cost of electricity we generate for our field operations.

As we've stated before, electricity prices also tend to be lower in California in the fourth and first quarters due to seasonal pricing factors. We expect modest pressure on our operating costs in the second quarter and particularly in the third quarter from higher electricity prices as we enter the high season as well as experiencing increased workover activities. We expect to offset some of this pressure by continued improvements in the controllable components of our operating cost structure.

Consistent with our intense focus on reducing production costs, we're also actively reducing our overhead. First quarter adjusted G&A expense of $53 million excluded $14 million of severance and other employee related costs incurred to better align manpower requirements. This represented a 23% decrease from the previous quarter and a 30% decline year-over-year. The decreases are largely the result of a smaller employee and contractor workforce and other employee related costs, including reduced stock compensation due to lower stock price.

Exploration expense for the first quarter was $5 million, compared to $7 million in the fourth and $17 million in the first quarter of 2015. We've essentially scaled back our current exploration activity to a point where expenses are mainly limited to maintaining our modest lease rentals. In addition, we have successfully negotiated reductions on many of our existing lease rental rates.

Interest expense of $74 million in the first quarter of 2016 was lower on both a sequential and year-over-year basis and was a result of the amortization of the gain from last year's bond exchange, slightly offset by higher interest rates on the new notes.

DD&A was significantly lower in the first quarter than the prior year. Recall that we recorded a long--a large non-cash impairment charge against the value of our capitalized costs as a result of the significant decline in the forward price curve at the end of 2015. This consequently resulted in a lower cost base for future DD&A expense.

As a result of the lower realized prices and moderate declines in production, volumes negatively impacted revenue, largely offset by the cost reductions I discussed. We reported an adjusted net loss of $100 million, or $0.26 per diluted share, for the first quarter. This compares with an adjusted net loss of $77 million, or $0.20 per diluted share in the fourth quarter of 2015, and an adjusted net loss of $97 million, or $0.25 per diluted share in the first quarter of 2015.

I want to highlight the importance of our cost containment efforts and our focus on margins, which allowed for the current quarter's operating cash flow after working capital to be equivalent to last year's level despite a 36% decline in crude prices.

Our first quarter net loss was $50 million, or $0.13 per diluted share. The loss included an $89 million gain on the purchase of our bonds, which I'll explain shortly, an 11--an $81 million non-cash hedge loss on outstanding hedges, a $63 million benefit from adjusting our valuation allowance on deferred tax assets, and was net of $21 million in other non-recurring charges, including those related to the first quarter employee cost reductions.

Adjusted EBITDAX for the current quarter was $124 million, compared with $226 million in the fourth quarter of 2015, and $198 million in the first quarter of 2015. Our capital investment for the quarter registered $21 million, in line with our guidance. Of this amount, $18 million was for the planned turnaround at our Elk Hills power plant with a payment for $14 million of the $18 million deferred to future periods.

We're constantly looking for prudent ways to reduce our debt levels, and the early part of the first quarter presented an opportunity to purchase $102 million face value of our bonds on the open market. This resulted in the $89 million gain that I discussed. Additionally, we sold almost $70 million of emission allowances on the open market that we don't expect we'll need in the near future due to our lower activity levels. As a result of our ongoing efforts and the $87 million of free cash flow we generated, we reduced our overall debt level by almost $700 million from the high point in 2015 to just under $6 million at quarter end.

Please note that we have provided key second quarter 2016 guidance information in the attachments to our earnings release. I'll be happy to take any questions you may have on that information or on other aspects of our results during the Q&A portion of the call.

I'll now turn it back over to Todd.

Todd Stevens - *California Resources Corporation - President & CEO*

Thank you, Mark. Despite the challenging environment, CRC's first quarter of 2016 was characterized by focused execution, which delivered another successful quarter of solid production, cost reductions, and continued strategic positioning. Our management and operating teams have extensive experience with these assets in all phases of the commodity cycle. We believe this is a notable competitive advantage which helps us defend and create value even in a downturn.

We will continue to act swiftly and decisively to capitalize on all opportunities that present themselves as a result of the market dynamics. In the meantime, we believe we have the liquidity and flexibility from our banks to pursue initiatives to strengthen our balance sheet.

The lower price environment will likely require patience for us to manage and navigate through the environment to achieve all of our balance sheet initiatives and objectives. We fully believe all the work we have done and continue to do will maximize shareholder value over the longer term.

This concludes our remarks and we would now welcome your questions.

QUESTIONS AND ANSWERS

Operator

Thank you, sir. (Operator Instructions) Doug Leggate, Bank of America Merrill Lynch.

Doug Leggate - *Bank of America Merrill Lynch - Analyst*

Thanks. Hey, guys. Good afternoon. Todd, obviously disposals are still high in everybody's mind. And you haven't really given anything definitive today it doesn't sound like. But back at the Analyst Day, you did talk about having exchanged term sheets and obviously the year-end target went away with the credit markets one would assume. So I'm just wondering to what extent you can at least frame a timeline, a scale, what's within your control, and whether you are optimistic that you can make meaningful strides in the current year as opposed to trying to be definitive about individual quarters.

Todd Stevens - *California Resources Corporation - President & CEO*

Yes. I think in the current year, Doug, that we'll successfully execute both on exploration and a development joint venture that's meaningful. We have done some fairly minor small ones and we've taken some other opportunities to clean up our portfolio. Again, these are on a smaller scale. But we'll look to execute on something along those lines, or it could be something with our midstream assets.

It really--what really drives us is the macro environment and what changes and what's going to get us the best bang for our buck ultimately, whether--it depends what we do, whether it's in the capital markets, or utilizing our midstream assets, or utilizing our upstream assets. I think that one constant is we continue to book on the upstream assets and joint ventures, both exploration and development joint ventures. And I think that's going to come to fruition sooner rather than later simply because I think people feel that we've bottomed here in February and that we have some stability here in Brent at least for the time being.

Doug Leggate - *Bank of America Merrill Lynch - Analyst*

Now, I hope the operator doesn't take this as my second question. But just for clarification, are you talking about money in the door upfront, or are you talking about carried interests to offset decline rates? What was the nature of the joint venture you are talking about?

Todd Stevens - *California Resources Corporation - President & CEO*

Well, we're looking at both carried interests, getting activity, 3D, drilling walls, and we're also looking at opportunities where there will be a mix of that plus cash. I would say that sort of everything's on the table at this point in time. Our goal is really to get activity and ultimately strengthen our balance sheet. We're just going to take it on what works best for CRC shareholders.

Doug Leggate - *Bank of America Merrill Lynch - Analyst*

Thanks. My second question is really more just a guidance question, if I may. You've given a BOE guidance for the second quarter. I'm wondering if you can give us a breakdown and similarly on costs. I think on the cost guidance, to what extent is the increase sequentially workover activity, and I'll leave it there. Thanks.

Todd Stevens - *California Resources Corporation - President & CEO*

I'd say the vast majority of it is workover and downhole maintenance. And again, as Mark talked about in his remarks, we deferred that in February as the crude and the other commodity markets went into free fall with regards to hydrocarbon. And so we really deferred our activity until we saw some stability in the marketplace. And we're just fortunate to have the kind of assets we have that we can now go out and invest in the expense workovers and downhole maintenance that will bring back some of that production fairly quickly and flatten out--more flatten out the back half of the year.

Doug Leggate - *Bank of America Merrill Lynch - Analyst*

So oil volumes, Todd?

Todd Stevens - *California Resources Corporation - President & CEO*

Yes.

Doug Leggate - *Bank of America Merrill Lynch - Analyst*

Can you give us a number on the guidance? Can you give us a breakdown?

Mark Smith - *California Resources Corporation - Senior EVP & CFO*

Doug, we haven't given specific guidance, but I mean generally if we can frame it for you, if you look at the kind of decline we've had on oil, we see that potentially extending or perhaps flattening a bit. And then we--for the reasons that Todd indicated, and then we see natural gas flattening just a little bit as we roll off that hyperbolic decline on some of our gas wells and we reinvest back on the oil side.

Doug Leggate - *Bank of America Merrill Lynch - Analyst*

All right (inaudible). Thanks, guys.

Todd Stevens - *California Resources Corporation - President & CEO*

Thanks, Doug.

Operator

Evan Calio, Morgan Stanley.

Evan Calio - *Morgan Stanley - Analyst*

Thank you. Good evening, guys. Your costs are coming down here significantly with production. Can you share a maintenance CapEx number--CapEx to keep your production flat in 2017?

Todd Stevens - *California Resources Corporation - President & CEO*

In 2017, I think the number is probably, as we've talked about before, I would guess somewhere plus or minus $500 million, $600 million, in that range. I think we continually evolve, especially when you think about the potential for workovers and the like. Those are some of the highest value projects you have. And as the inventory gets refined as the year goes on, I think it could be towards the lower end of that, but that's sort of where we think we'd be to keep our crude oil production flat.

Evan Calio - *Morgan Stanley - Analyst*

So stepping off that, what is the--how do you think about a strategy in a commodity recovery, ex any asset sales. I mean, do you move to hold production flat and then work on the balance sheet? Or do you stay in this minimal capital mode that you're in today with the decline? How do you balance that?

Todd Stevens - *California Resources Corporation - President & CEO*

I think you increment into it, and as you see--and as Mark likes to say--feel and touch prices as they move forward and you feel better about each one you increment yourself into of more activity. And you bring on more drilling rigs, bring on more workover rigs. I think if you see it sustain itself here, you'll see us bring on more workover rigs and probably if it continues to expand itself in the $40s, maybe a drilling rig or two. As it goes higher into the $50s, we'll start thinking about more investment in bringing that back into a point of maintaining production.

But I think you've got to balance out the liquidity issues versus trying to strengthen the balance sheet. So we're going to be doing those two things as we manage the business. And we'll try to manage it as close as we can to flat (inaudible) in the Brent environment we were in in February, you don't want to accelerate production in that environment. But now we're slowly looking at incrementing into this slightly higher production commodity price environment.

Evan Calio - *Morgan Stanley - Analyst*

Great. One more, if I could. On the interest coverage covenant, the term loan--I know it resets in 1Q 2017. What commodity price do you think you need to clear that, and how close to the reset does that negotiation begin? And I'll leave it there.

Todd Stevens - *California Resources Corporation - President & CEO*

You've got to remember it's a backward looking covenant. So it would be a fairly high price when you do that calculation at this point in time. But it would come down rather quickly through the quarters, because of the backward looking nature of it. At this point in time I think you have to get out in front of it, clearly. We've had an active conversation, and Mark and his team, with the banks. And we manage that well. So you could expect that we'll be well out in front of that before we get to the end of the year, clearly.

Evan Calio - *Morgan Stanley - Analyst*

Great. Appreciate it.

Operator

Paul Sankey, Wolfe Research.

Paul Sankey - *Wolfe Research - Analyst*

Hi, everyone. Just a sort of a bit of a variation on the previous question, but given that you kind of inherited a highly levered company and you originally intended to grow quite aggressively, we've been through a remarkable downturn. I wondered how you now felt about long-term strategy in terms of what you've learned about the Company from this real tempering you've had in the fire of low oil prices. Do you think you want to come out of this in a very different way? As I said, I appreciate that it's a very similar question to Evan's, but I was really thinking more about what you've learned about CRC. I mean, it strikes me that the level of CapEx that you originally thought you needed to spend compared to what you now have learned that you can get away with if you like must somehow have changed your view of the way you want to run the Company going forward. Thanks.

Todd Stevens - *California Resources Corporation - President & CEO*

No, definitely thanks, Paul. That's a good question. I mean, why do you do a spinoff if you're wanting to focus on assets that aren't getting focus in a bigger company? And so really the level of focus and level of work of our operating and management teams here has been tremendous. And now we have a much better feel on things, and a much better feel for really on a field by field level how to add value.

So I actually feel a lot better than we did going into the spinoff, with the assets we have and understanding of the assets we have. And so I feel like as we got through this, there's clearly a priority in a recovery case of the commodity prices is to strengthen the balance sheet. But again, we would like to get back to where we can grow the business and reinvest some money in the business and reinvest in strengthening our balance sheet. But I feel much more confident overall in the entire portfolio and all our assets than I think--and I would think everyone feels that way here at CRC.

Paul Sankey - *Wolfe Research - Analyst*

I guess the implication would be that you would target a somewhat lower level of growth or a lot stronger balance sheet.

Todd Stevens - *California Resources Corporation - President & CEO*

Correct. And that's exactly right. I think you could think about single digit, high--maybe high single digit type growth and focus on strengthening the balance sheet--and then--before you stepped into anything else. But I do think a lot of this will--might even have an opportunity for more growth in an environment where we can--where we continue to see a lot of interest in joint ventures here with us in the state.

Paul Sankey - *Wolfe Research - Analyst*

Yes, that's what my second question was going to be--forgive me, we're multi-tasking with the results today. I may have missed this, but what did you say about the monetization aspect of your strategy? Can you update us on that? If--forgive me if you already have. Sorry.

Todd Stevens - *California Resources Corporation - President & CEO*

Yes. I mean from that standpoint, we will continue to look at everything. We have capital markets, ways to strengthen the balance sheet. We have midstream and upstream assets--.

Paul Sankey - *Wolfe Research - Analyst*

--Yes, I was really thinking about the midstream, sorry.

Todd Stevens - *California Resources Corporation - President & CEO*

Okay. So on the midstream side I think we continue to look at that with the plats in the commodity prices late in the year, some of that went away and some of it--the other risk. But it's still an active market. It's really just trying to do what's best for the Company. So we're trying to balance out and think what's best for CRC over the longer term. It's not like we couldn't pull the trigger if we wanted to on a transaction. We have counterparties that are eager. But I think that when you evaluate the portfolio of opportunities, it's not the best alternative at this point in time.

Paul Sankey - *Wolfe Research - Analyst*

Interesting. Thank you.

Operator

James Spicer, Wells Fargo Securities.

James Spicer - *Wells Fargo Securities - Analyst*

Hi, good afternoon, everybody. It looks like the majority of the free cash flow you generated during the quarter came from draw-downs of working capital. Can you comment on how sustainable that is and how that factors into your free cash flow outlook for the rest of the year? And then I have a follow-up. Thanks.

Todd Stevens - *California Resources Corporation - President & CEO*

Yes, basically the first quarter benefitted--the majority of that working capital was selling some greenhouse gas credit. And that was due to our lessened activity in the year. They were not needed. And fortunately for us we sold them for more than we bought them for. So that was something, when you go into preserving liquidity mode, that was what we did for the quarter. We will continue to be able to manage the business within cash flow for the year. And we'll do the type of things that make the most sense for us.

Mark Smith - *California Resources Corporation - Senior EVP & CFO*

James, on a go-forward basis we go through--as we go through the year you'll see some working capital swings, particularly as we go into the second quarter you'll see some working capital swings as we work to pay some property taxes during the quarter. But with the cost savings that Bob and the team have demonstrated on the operations side as we go through the latter part of the--portion of the year, we see very strong cash flow potential from the underlying assets absent any working capital changes.

James Spicer - *Wells Fargo Securities - Analyst*

Okay. And so just to clarify that comment then, it sounds like if you take the rest of the year in aggregate, you're still expecting to be meaningfully free cash flow positive even without these working capital swings.

Mark Smith - *California Resources Corporation - Senior EVP & CFO*

Well, you're going to see some working capital swings but we have confidence in the underlying performance of the operations such that we'll generate (inaudible) free cash flow (inaudible).

Todd Stevens - *California Resources Corporation - President & CEO*

On a net-net basis, when you take into account everything, it'll be positive.

Mark Smith - *California Resources Corporation - Senior EVP & CFO*

Yes.

James Spicer - *Wells Fargo Securities - Analyst*

Okay. That's helpful. And then for my follow-up, you talked about getting bang for your buck on deleveraging, and it seems like you accomplished that by buying back bonds at what looks like to be about $0.13 on the dollar. We're just wondering how much more capacity you have for additional bond repurchases, and how you view that option in the context of other things you're looking at.

Todd Stevens - *California Resources Corporation - President & CEO*

Well, you could get into our credit amendment and understand how that works. We did have a different basket available under the prior amendment. And that's what we exercised when we bought those. As of right now we would have to use proceeds from our non-borrowing base assets, and 50% of that could be used to buy back unsecured debt at this point in time. But we're looking at all this in the context of different solutions to get there. But that's the short answer on that one.

James Spicer - *Wells Fargo Securities - Analyst*

Okay. Makes sense. Thank you.

Operator

Noel Parks, Ladenburg Thalmann.

Noel Parks - *Ladenburg Thalmann - Analyst*

Hello.

Todd Stevens - *California Resources Corporation - President & CEO*

Hi.

Noel Parks - *Ladenburg Thalmann - Analyst*

Just a couple of things I wanted to ask. For the LOE savings that you've had, how sort of sustainable do you consider them being sort of beyond the current cycle we have with service costs being as low as they are? Do you think they are sustainable for sort of medium term, or are some of these do you think things that in a rebound would--you'd still be able to preserve a lot of?

Todd Stevens - *California Resources Corporation - President & CEO*

Yes. We think about it, and I'll talk about it in aggregate. I think that if you think about the absolute dollars spent on production costs, you'll see they're coming down. Our production is declining, so you might see a creep in the per BOE. But when you think about long term sustainability, if you take energy out of it, because we use natural gas both as a feedstock to create steam, and also to put into the power plants to utilize a different operation, really almost all the other savings--and I'm told it can be sustainable over the longer term. And that we can capture it. So these are procedures and new ways of doing things that will enable us to capture these when commodity prices are in a much higher environment.

Noel Parks - *Ladenburg Thalmann - Analyst*

Great. And I guess one question I had was looking at the natural gas strip. Compared to where things stood as you were getting ready for the fourth quarter earnings and sort of looking ahead for the year, the strip, depending on how you look at it, has improved $0.30--$0.30, $0.50, somewhere in there per M. I was just wondering, does that--as you look at workover activity and sort of high value, sort of low dollar type investment, does that change anything for you? Does it turn--help you turn the corner in anything? And also would you look at maybe hedging some on the gas side? I mean, again the prices aren't great, but with the potential economics being better than they've been in a while.

Todd Stevens - *California Resources Corporation - President & CEO*

Yes, I think when you think about gas, it's definitely got our attention. We're still net long gas when you consider net-net what we use and what we produce. We have an enormous amount of gas inventory in the Sac Basin and elsewhere in California. So it's something we're monitoring closely. And yes, we might hedge a capital program, whether it be with a drilling rig or even a workover rig, since we have a lot of opportunities to take advantage of.

One thing--the one wild card out here in California is the Aliso natural gas storage facility at Aliso Canyon being down created issues when there was no injection in the winter time, and then there's now going to create issues in the back half of the year when there--when the demand is going to go up. So I think Noel, you'll have to monitor California basis closely, but I would expect basis to widen probably rather substantially as the year goes on.

Noel Parks - *Ladenburg Thalmann - Analyst*

And just to clarify, when do you think you'd have a sense sort of--of maybe the magnitude of that back half of the year impact?

Todd Stevens - *California Resources Corporation - President & CEO*

It'd be purely speculative, but from what I understand, Aliso Canyon only has 15 Bcf in storage, and it's probably just the Cushing gas right now. So--and people made a big deal both for and against, but I think there's a reality there could be blackouts here because electrical generation from natural gas--fired electrical generation--it might not be there in the summer time in the peak periods. So yes--I mean, you're going to have some issues.

Noel Parks - *Ladenburg Thalmann - Analyst*

Okay. Great. Thanks. Very interesting. That's all for me.

Operator

Pavel Molchanov, Raymond James.

Pavel Molchanov - *Raymond James & Associates, Inc. - Analyst*

Thanks for taking the question, guys. So you referenced $500 million as a CapEx level that should enable at least oil to be stabilized. One of the issues we've been hearing a lot this earnings season is labor availability. So now that you've reduced headcount internally, your contractors have reduced headcount, what rig count would you be able to accommodate realistically before you run into labor availability shortfalls?

Todd Stevens - *California Resources Corporation - President & CEO*

Well, what we did, to use a sports analogy, when we were cutting back the organization to activity set, is we try to preserve as many athletes as we could. So that anticipating that the commodity price will eventually come back and we could be able to respond to a higher activity set, we think in fairly short order, if we had to, we could probably come back up four or five rigs and staff those accordingly without any issue. If we got to a higher activity set, clearly--and I'm talking about drilling rigs--that would probably entail some more hiring on our front. But we feel real good about where we're at with our folks we have that we could respond in the short term. But again, like the question earlier, we're going to increment into this. We're not going to just suddenly go from zero to 100 miles an hour in a boom cycle here. We're going to come back and be very methodical and very careful about this.

Pavel Molchanov - *Raymond James & Associates, Inc. - Analyst*

Yes, for sure. And then, sorry to kind of keep beating this topic. The budget for this year, $50 million, is that absolutely set in stone no matter what happens to the futures strip between now and Q4, or is there some flexibility on the current year program?

Todd Stevens - *California Resources Corporation - President & CEO*

No, there's some flexibility. I mean, we put a self-imposed cap with our banking group of $100 million. But that was to give them confidence. But I think at this point in time, we both are seeing efficiency where our activity level that we originally anticipated with $50 million was actually going up just from efficiencies. But if the product price continues to improve I would anticipate that we could go a little bit higher, or depending on what happens in the back half of the year.

Pavel Molchanov - *Raymond James & Associates, Inc. - Analyst*

All right. Appreciate it, guys.

Operator

John Herrlin, Societe Generale.

John Herrlin - *Societe Generale - Analyst*

Yes, hi. I was wondering if in the future, the curve works in your favor--the futures curve--you get more aggressive hedging. Do you have any limitations with respect to hedging, given your balance sheet?

Todd Stevens - *California Resources Corporation - President & CEO*

No. I think our target is 50%, but as you saw in the fourth quarter 2015, we're willing to hedge more. It's just being opportunistic and feeling good about the product price. And also, our capital program we might have in place that we're trying to underpin those cash flows.

John Herrlin - *Societe Generale - Analyst*

Okay. And in terms of doing workovers or downhole activities, the kind of interventions that you're using to help keep production flat or declining minimally, I was wondering what's the split between kind of like downhole recompletions versus workovers, or can you give us a sense of that, Todd?

Todd Stevens - *California Resources Corporation - President & CEO*

It's probably 90-10.

John Herrlin - *Societe Generale - Analyst*

Okay. Great.

Todd Stevens - *California Resources Corporation - President & CEO*

Workovers being the 90.

John Herrlin - *Societe Generale - Analyst*

All right, thanks. That's what I wanted to know. Thanks.

Todd Stevens - *California Resources Corporation - President & CEO*

Thanks, John.

Operator

At this time we will go ahead and conclude our question and answer session. I would now like to turn the conference call back over to management for any closing remarks. Gentlemen?

Todd Stevens - *California Resources Corporation - President & CEO*

Thanks, everyone, for being on the call. Any questions, please contact Scott, myself, or Mark here in Los Angeles. We appreciate you being on the call.

Operator

And we thank you sir and to the rest of the management team for your time also today. The conference call is now concluded. At this time you may disconnect your lines. Thank you again everyone. Take care and have a great day.