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CRC - Q2 2017 California Resources Corp Earnings Call

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PRESENTATION

Operator

Good day, and welcome to the CRC second quarter earnings conference call. (Operator Instructions) Please note, this event is being recorded. I would now like to turn the conference over to Mr. Scott Espenshade. Mr. Espenshade, the floor is yours, sir.

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

Thank you. I'm Scott Espenshade, Vice President of Investor Relations. Welcome to California Resources Corporation's Second Quarter 2017 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; as well as several other 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 our second quarter results and additional information.

Also information reconciling non-GAAP financial measures discussed to their most directly comparable GAAP financial measures is available on the Investor Relations portions of our website and in our earnings release.

Today's conference call contains certain projections and other forward-looking statements within the meaning of federal security laws. These statements are subject to risks and uncertainties that may cause actual results to differ from those expressed or implied in these statements. Additional information on factors that could cause results to differ is available on the company's 10-Q, which is being filed later today. We would ask that you review it when available and the cautionary statements 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.

As a reminder, we have allotted a similar time for earnings Q&A at the end of our prepared remarks and would ask that participants limit their questions to a primary question and a follow-up. I will now turn the call over to Todd.

Todd A. Stevens - *California Resources Corporation - President, CEO & Director*

Thank you, Scott, and thank you, everyone, for attending CRC's Second Quarter 2017 Earnings Conference Call. We delivered a solid quarter that builds on the success of our first quarter activity. CRC continues to move forward improving both our operational efficiency and financial position. We're building on the momentum created from executing our 2 joint ventures earlier this year and remain on track to deliver oil production growth in the second half of the year. While the market outlook appears to be volatile, we've been through cycles before and remain confident in our ability to execute and navigate the path ahead. We have optionality from our resilient asset base, disciplined portfolio management and joint ventures. We will continue to pursue all opportunities to strengthen our balance sheet. As we've done in the past, we will be strategic in our discussions with our banks and thoughtful in accessing the capital markets. We remain committed to operational excellence, vigilant on cost and most importantly, laser-focused on value.

As our capital program increased in the second quarter, our team was able to safely and successfully ramp up activity as we began to execute with our partners' capital to supplement our organic capital program. In the quarter, we continued to deploy the first $50 million tranche from Benefit Street, and Macquarie began funding their initial $150 million commitment. Our team responded quickly and skillfully to the changing levels of activity.

Our assets continue to deliver, and the results to date have been at or above expectations. The new wells drilled with JV capital have performed better and had lower cost than expected. The increased activity has largely been in the San Joaquin Basin. We drilled 43 wells in the second quarter, which targeted steamfloods and waterfloods. Drilling pace remains in line with expectations. Within the basin, we have high priority growth areas, all targeting oil and liquids-rich reservoirs, which should further shift our production mix and bolster our cash flow and margins.

After a nearly 2-year drilling hiatus at Elk Hills, the teams are delivering excellent results. We started drilling the [29 R] structure for the first time since 2014, and our teams hit the ground running. The 4 wells that have been drilled thus far were put on production with costs 22% lower than the previous program and IP rates 30% higher than expected. These wells alone also extended the lowest known oil by 600 feet and added reserves with further potential to go down dip.

We're excited at the increased activity in the Kettleman area as this is an Elk Hills analogue with a large structure of stacked pay opportunities. We've started and will continue to define this opportunity set over the coming year with workovers and new wells.

As I've said in the past, we prioritize our capital using our VCI metric, and capital workovers have proven to deliver some of the highest value. One of the things that sets California apart is that we have approximately 400 different producing horizons. This means that one well exposes us to multiple pay zones, allowing us to access additional reservoirs without having to drill a new well. Our capital workovers enable us to add reserves from untapped pay zones at high economic returns for our investments and support our strong and stable base of production.

During the second quarter, we executed over 124 capital workovers, which have a VCI of approximately 3.6 based on a low $50 Brent price index. One example of this was at Mount Poso. After a comprehensive review, the team identified 8 wells with recompletion potential. This project perforated bypass pay to add almost 250 barrels of oil per day for under $600,000 as well as 13 PUD locations and additional reserves.

For the second quarter, CRC delivered in excess of 129,000 barrels of oil equivalent per day of production, which is at the midpoint of our guidance. This result was achieved with lower-than-expected capital, reflecting our operational efficiencies. Our assets are characterized by low decline rates and are less capital intensive than many other North American basins. This is due in large part to the fact that our assets don't rely on complicated completions and are more conventional in nature.

The deployment of joint venture in CRC Capital remains on track and we envision doubling our total well count for the year compared to our initial plan at the start of 2017. We received a second $50 million tranche from BSP in July 2017, and expect additional Macquarie funding over the remainder of the year.

Depending on commodity prices, we expect to invest approximately $400 million of capital in 2017, which reflects $17 million of operational efficiencies. $150 million of this amount will be funded by our JV partners. We expect a JV investment to allow us to maintain at least the 6-rig program for the balance of the year and into 2018 even excluding CRC's organic capital. In the existing price environment, we believe our current budget will lead us to production growth over the foreseeable future. Our strong asset base is particularly beneficial due to the flexibility it provides in a volatile price environment.

We have shown that our assets have the staying power to deliver a reliable base of production and cash flows even with minimal capital investment. The quality of our reservoirs coupled with our complementary infrastructure allow for less-capital intensive development than what you're used to seeing with other E&P company.

Our teams have diligently worked our life-of-field plans and have identified numerous economic projects that meet our investment criteria at lower prices. We have over 500 million barrels of oil equivalent of resources with fully burdened field level costs averaging $20 per BOE. These long-lived resources provide a low-decline foundation for a continued stable base of production.

Recent joint venture transactions provide another point of validation of the quality of our asset base and further increase our ability to manage our investment. In a higher price environment, the acceleration of activity from the JVs should help compound the efficiencies and cost savings which we're implementing. A prolonged period of low $40 Brent pricing would call for a pullback in our organic capital and a reduction in drilling to stay within cash flow. Partner capital would be utilized to maintain activity levels and aid in securing vendor pricing. We could then flex CRC capital to the highest value opportunities available, including debt reduction.

We continue to pursue constructive ways to reduce our overall debt established by our former parent. Since the 2015 peak, we have reduced our debt by $1.6 billion while strategically retaining control of our assets, which has enhanced our optionality through the downturn. We have consistently defined multiple avenues through which we can further strengthen our balance sheet, which Mark will touch upon.

We've also maintained strong relationships with our banks and have worked to keep them in the front seat with us. They have supported us through the cycle, and we maintain an active dialogue with them. We signed 2 larger joint ventures early this year and just closed our ninth small JV. Our smaller development and exploration deals now total approximately $30 million of committed capital and they provide more than $75 million of committed capital if the activity is successful.

You've seen us being flexible in our deleveraging efforts with a focus on maximizing value for our shareholders. We will continue to act opportunistically to take advantage of the changes in the capital markets. We will evaluate each opportunity to see what it brings forth for most value and ultimately debt reduction. I would like to highlight that unlike others, we've been very thoughtful not to dilute our shareholders. Our perspective remains steadfast in this regard.

We continue to put our efforts towards controlling the controllables. Through the first half, we've made progress in reducing our debt and containing our cost. We've also been opportunistic with our hedging to underpin our capital investment activities through the first half of 2018 by placing $60 Brent hedges for a meaningful portion of our production. We're committed to maintaining our strong safety record as activity increases, and our partners have been pleased with the production response we have delivered. We're confident that we can continue to find efficiencies and optimally align our capital structure. We have a flexible portfolio of assets with excellent optionality and strong operational and management execution to navigate the path ahead. I'll now turn the call over to Mark to discuss the details of our second quarter results as well as other financial matters.

Marshall D. Smith - *California Resources Corporation - Senior EVP & CFO*

Thank you, Todd. I will briefly frame a few key points that characterize our financial performance this quarter. Commodity prices softened during the period, however, California crude realizations remain strong with a realized price differential to Brent remaining tight. As a result of the decline in the Brent index, we worked to adjust our internally funded capital program accordingly by reducing our direct capital investment while utilizing our recently executed JV program to actually increase our overall activity levels.

I want to underscore that operationally we continue to fire on all cylinders. We continue to see strong operational performance as we safely and efficiently increase our overall activity levels. Todd highlighted that we have multiple avenues to continue strengthening our balance sheet. Let me cover some of the principles that guide our thoughts in this area.

First of all, it's a process, and we don't expect any one transaction to deliver our targeted leverage ratio of below 3x at mid-cycle pricing. Secondly, we're sensitive to reducing overall balance sheet leverage only to increase our operating leverage to an equivalent or greater extent. That said, we've made progress and are continuing to pursue multiple paths for asset monetizations, both infrastructure and producing assets as well as liability management while also working with our bank group. Please note each of these options has a different time line.

Regarding refinancing, our preference is to deal with our balance sheet in order of maturity to minimize our overall interest burden and to ultimately extend our bank facility. We remain doggedly focused on each of these tasks. As we have discussed, we're executing on our plan and have seen our team and our asset base outperform with our increased activity as a result of the joint ventures. To reiterate, we like JVs because they increase our flexibility to deploy capital, derisk our portfolio, add reserves and give us the ability to ramp activity into 2018 and beyond.

Results from the second quarter of 2017 landed within our key guidance ranges and built upon our solid first quarter. Proving how different our assets are from those and other regions, our assets' resilience continues to lead to outperformance by delivering at or better-than-anticipated decline rates at the lower end of our capital investment guidance. While other regions may have to spend millions to complete wells in one pay zone, our stacked pay and geology gives us a long-term advantage. Our lower capital intensity and our focus on margins contributed to controlling both our capital and production costs, which came at the low to mid-point of our guidance. As we've discussed, we continue to ramp up overall activity with JV capital, while preserving our optionality to allocate CRC's organic capital as market conditions warrant.

In the second quarter, we increased our consolidated capital investment nearly 65% to $82 million from $50 million in the first quarter through the addition of third party capital. With this, we expect to grow oil production sequentially in the second half of the year. As we continue to work our life-of-field planning, our team is demonstrating thorough knowledge of our diverse asset base and maintaining a focus on our cost structure. Our team's challenged assumptions such as revisiting our wellbore construction, redesigning bit selection and mud programs and eliminating casing strings, all in order to drill both cheaper and faster with the same or better IP rates, all while maintaining our environmental and safety performance. These types of operational efficiencies have been key to our capital investment registering at the low end of our guidance range while still allowing us to meet production targets. In fact, our team has identified about $17 million of capital efficiency since the beginning of this year, which have been incorporated into our capital program.

Production for the second quarter averaged 129,000 BOE per day representing a 2% sequential decline and a year-over-year decline of approximately 8%. This is meaningfully lower than our stated base decline rate of 10% to 15% and also lower than last quarter's year-over-year decline rate of 11%. This demonstrates the stability of our base production and provides evidence that our current capital program's mitigating our naturally occurring oil production decline. This also serves to validate our previously disclosed maintenance capital estimates. As we continue to ramp up activity, we expect a modest production uplift in the second half of 2017 with more tangible production increases in 2018.

With commodity prices softening over the quarter, second quarter Brent crude oil prices averaged $50.92 per barrel. This was 8% stronger than a year ago, but 7% lower than the first quarter average price of $54.66. Realizations continue to be strong as the demand for native California crude remains high. Of note, we expect demand for local crudes to continue underpinning tight differentials for some time. As a result, our second quarter crude oil realization remains strong at 94% of Brent, and our realized crude oil price for the quarter including the effective settled hedges was $47.98 per barrel. This compares favorably to the $43.70 registered in the prior-year period. Settled hedges added $1.03 per barrel to our second quarter 2017 realized price.

Realized NGL prices were also stronger on a year-over-year basis. The second quarter realized NGL price of $30.08 per barrel was 33% higher than the second quarter of 2016, primarily due to tighter domestic supplies, the strength of exports and higher contract prices on natural gasoline. The second quarter of 2017 realized natural gas price of $2.47 per McF was 49% higher than the second quarter of 2016 price of $1.66 per McF. This increase was mostly due to lower domestic production levels at Aliso Canyon and higher demand.

Recall that with the severe commodity price decline in the first part of 2016, we purposely reduced and deferred downhole and surface maintenance activity. Additionally, natural gas prices during that time were at relative lows, providing reduced energy and field gas costs for our steamflood operations.

We've now returned our activity to higher levels this year. As a result, along with the effect of higher gas prices, our production costs for the second quarter of 2017 were $28 million higher than the second quarter of 2016. Our team has done an excellent job of maintaining our controllable costs essentially flat on a sequential basis. Of the $5 million increase in production costs relative to the first quarter, the majority was related to conducting elective well maintenance, which positively impacts production.

On a unit of production basis, second quarter production costs of $18.34 per BOE were in the midrange of our guidance. Excluding the effects of PSC contracts, per unit production costs would have been closer to $17 per BOE. As a reminder, we benefit more from higher natural gas prices because of our net long natural gas position.

Total general and administrative expenses were flat on a total dollar basis year-over-year. Interest expense of $83 million was in line sequentially and with our guidance. The higher blended interest rate compared to the prior year is a result of our ongoing deleveraging activities. This was partially offset by our significantly lower total debt balance as resulting from liability management actions that we executed in 2015 and 2016.

For the second quarter, we reported a net loss of $48 million or $1.13 per diluted share and an adjusted net loss of $78 million or $1.83 per diluted share. The adjusted net loss excluded $35 million of noncash hedge gains and $5 million of other charges. Adjusted EBITDAX for the quarter of -- second quarter of 2017 was $158 million and essentially flat with the prior-year period. Due to timing of interest on property tax payments totaling $188 million in the second quarter, operating cash flow was a negative $13 million in the quarter, but remained positive at $120 million for the first half of 2017. We ended the quarter with a debt balance of $5.2 billion, down from $5.9 billion a year ago, reflecting our continued focus and progress on strengthening our balance sheet.

In summary, we have a dependable base of production and a portfolio of assets with meaningful optionality. Our agile and thoughtful team has the drive to manage through the cycle. We're proud of them. Year-to-date, we have made good progress in reducing our debt, and we continue to be focused on further strengthening our balance sheet. Please note we provided detailed analysis of adjusted items as well as key third quarter 2017 guidance information in the attachments to our earnings release. I will be happy to take any questions you may have on that information and on other aspects of our results during the Q&A portion of this call. I will now turn the call back over to Todd.

Todd A. Stevens - *California Resources Corporation - President, CEO & Director*

Thank you, Mark. In closing, I'd like to remind you of 3 important points: First, our ability to maintain production at low decline rates in challenging times illustrates the tremendous value and low-capital intensity of our asset base. Second, CRC operates in a world-class oil province with meaningful running room. We have significant stack pays and over 40 billion barrels of original oil equivalent in place. Industry and activity in California has historically focused on shallow opportunities. The lack of capital investment has left the reservoirs here largely underexplored and underdeveloped, leaving substantial untapped potential. Third, CRC has a dominant position within the California marketplace, which creates important competitive advantages. California is the sixth-largest economy in the world on a stand-alone basis, and the state's increasing population and energy demand leave it in a chronic energy deficit. Our state's oil demand is predominantly met from foreign import based on Brent pricing.

All this results in a continued strong local demand for the oil we produce and strong realizations. As we continue to build upon the first half's momentum, we see the second half oil production returning to a growth profile. Just to remind you, we're better positioned today than we were at the spin on all fronts. We have decreased our debt, improved our cost structure, weathered the downturn and strategically partnered to further create value and drive in the future. We now welcome your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) The first question we have comes from Evan Calio of Morgan Stanley.

Evan Calio - *Morgan Stanley, Research Division - MD*

Let me start with -- on the JVs. Interest of the new parties has historically ebbed and flowed with the oil price and the outlook. I know -- I believe on last call you mentioned the capacity to deploy up to $1.5 billion of CapEx per year. Just any color on your recent JV interest or kind of expectations here on further transactions?

Todd A. Stevens - *California Resources Corporation - President, CEO & Director*

What I can say is we're in active negotiations on numerous JVs of every size you can imagine from $1 billion to a few hundred million dollars and even smaller than that. So I think, I'd be fairly confident, based on the opportunity set I see today that we should be one of those across the finish line by year end. But, again, they are all shapes and sizes. As we noted in the call here, we have executed some very small ones and we've executed some large ones.

Evan Calio - *Morgan Stanley, Research Division - MD*

Great. On my second question or my follow-up is on your production is low end of the range. I mean, that's for the first time as a stand-alone as I recall. What drove that in the quarter? And is that related to the CapEx? CapEx is also much lower in the quarter versus the guidance and trending well below your $250 million range, so maybe comment on that production number and the CapEx trend if you could.

Todd A. Stevens - *California Resources Corporation - President, CEO & Director*

Yes. I think our production is right kind of down the middle of the fairway in the guidance. With the quarter, as we said all along, we feel we're at the inflection point here. I'm sure there'll be a question, I'll just go ahead and hit it here, about the guidance for next quarter. And I will remind people of math in a parabola and the average on the way down when you hit the vertex is the same as the average on the way up when you hit the vertex for the same 3 months. So now you can kind of get an idea why we talked about this being the inflection point around midyear for oil production growth and you can see it as we go into the next quarter is we feel like we've hit that inflection point. We feel pretty good the way we've ramped up our activity. We haven't had any serious injuries. Really, our focus has been on safety and going from just a few rigs at the start of the year and no rigs last year, I feel real good that we're at 9 rigs operating at this point in time.

Evan Calio - *Morgan Stanley, Research Division - MD*

On the CapEx piece?

Todd A. Stevens - *California Resources Corporation - President, CEO & Director*

CapEx. Operating efficiencies, I mean, are the biggest part of that. We've pulled back some on some of the projects. But that's really more timing than anything, but it's really been operational efficiencies. We've seen that come down on both our JV partners and our own organic capital.

Evan Calio - *Morgan Stanley, Research Division - MD*

So the guide at $250 million to $275 million is still stands despite trending significantly below that?

Todd A. Stevens - *California Resources Corporation - President, CEO & Director*

Yes. I think we'd say right now we're right around $250 million.

Operator

Next we have Doug Leggate of Bank of America.

Kaleinoheaokealaula Scott Akamine - *BofA Merrill Lynch, Research Division - Research Analyst*

This is Kalei on for Doug. I got a couple of questions that I'm hoping that you can reconcile a couple of things for me. So first off, it looks like activity in the unconventionals is really picking up helped by spending at the BSP JV. And I'm trying to reconcile that against the pie chart that you show on Slide 4 as showing the D&C capital by drive, which shows about 10% of your budget going towards unconventionals. And what I'm looking at is in your press release you have this Attachment 4, which shows about $69 million of your capital going to the unconventionals this year. So I'm just hoping that you can help me understand whether or not your -- the amount of D&C capital towards unconventionals is changing or what you're seeing there.

Todd A. Stevens - *California Resources Corporation - President, CEO & Director*

Really, the capital for the -- what you see is unconventional is just the Upper Monterey at Elk Hills, that's really -- and then what we call unconventional also, remember I outlined a while ago, is we actually have some things that would be classified as tight sands in the Rocky Mountains that we're pursuing also. So it's more along those lines when we say unconventional. There are some unconventional when I say, Upper Monterey shale but then there also are some things that will be classified arguably as just tight from a portability standpoint, similar like I said, to the Rocky Mountains in the '90s.

Kaleinoheaokealaula Scott Akamine - *BofA Merrill Lynch, Research Division - Research Analyst*

Got you. Are those targets that, that JV is targeting?

Todd A. Stevens - *California Resources Corporation - President, CEO & Director*

Yes.

Kaleinoheaokealaula Scott Akamine - *BofA Merrill Lynch, Research Division - Research Analyst*

Okay. Second question, just on Slide #6 on the bottom right-hand corner. You're showing a pretty big step-up in spending between '17 and '18, and I'm wondering what's driving that. Could it be the, like an acceleration of the JV spending for 2018 that's showing that inflection there?

Todd A. Stevens - *California Resources Corporation - President, CEO & Director*

That's correct. But also, remember that's just a portfolio planning scenario where we invest all cash flow at the assumption in our pace to prices and the like. But you will see a step-up in investment from our JV partners. You will see a modest amount from Macquarie this year, more next year and obviously, BSP as we continue to step in and work with them on our partnership.

Operator

Next we have Brian Singer of Goldman Sachs.

Brian Arthur Singer - *Goldman Sachs Group Inc., Research Division - MD and Senior Equity Research Analyst*

Can you talk about the Elk Hills power plant sales outlook from third parties? Just how you're thinking about where that's heading? And then just thoughts around monetization.

Todd A. Stevens - *California Resources Corporation - President, CEO & Director*

We continue to look at sort of everything and anything. As far as asset monetizations, Elk Hills power plant and some of the midstreams have been topics of discussion numerous times along the way here. We're actually in discussions with a few different folks about this right now. Third-party utilization, I think about 1/3, a little over 1/3 of the power currently is utilized internally by ourselves and the rest is sold on the grid. We sell to -- mostly to a power purchased arrangement with one of the large utilities.

Brian Arthur Singer - *Goldman Sachs Group Inc., Research Division - MD and Senior Equity Research Analyst*

Okay. And back to the production side, just trying to kind of parse through the direction of oil production specifically here because it looks like the -- you're kind of flattening out in the third quarter from a BOE a day perspective. But can you just talk about oil mix and the magnitude of what that could be and the risks around it to the upside and downside in the -- over the next few quarters?

Todd A. Stevens - *California Resources Corporation - President, CEO & Director*

Our oil mix came down very slightly in the quarter and had to do with some drilling early in some areas that had a lot of associated gas, primarily in the [29R] structure , which we referenced. But I think you'll see it climbing over time generally. So I think we've reached that inflection point and we now are starting to grow our oil production for the back half of the year and going forward.

Brian Arthur Singer - *Goldman Sachs Group Inc., Research Division - MD and Senior Equity Research Analyst*

Which would imply rates decently rising next in the second half of the year?

Todd A. Stevens - *California Resources Corporation - President, CEO & Director*

Yes. We think the growth is going to continue. I think we still stand by what we talked about. We think the exit rate and entry rate are going to be about the same and we have bias to the upside on the exit rate. And again, I think, we've, as I gave in my parabola analogy, I think we've reached the bottom of it and we're starting to climb up the back side.

Operator

Next, Paul Sankey of Wolfe Research.

Paul Benedict Sankey - *Wolfe Research, LLC - MD and Senior Oil & Gas Analyst*

The property tax thing, what was that about?

Todd A. Stevens - *California Resources Corporation - President, CEO & Director*

The property tax in California, as you know, it's ad valorem tax. We just -- we pay in the second quarter and the fourth quarter. And overall, I believe, it's come down modestly. And the tax assessable, we assess midyear. So we have that baked in. But yes, that's the big actual cash payments on the property taxes are in the second quarter and fourth quarter.

Paul Benedict Sankey - *Wolfe Research, LLC - MD and Senior Oil & Gas Analyst*

So we should just roll this forward as they are or do they change around much?

Todd A. Stevens - *California Resources Corporation - President, CEO & Director*

I think, we believe there is a little bias upwards since what product prices have done for the back half of the year, but it wouldn't be material compared to the existing numbers.

Paul Benedict Sankey - *Wolfe Research, LLC - MD and Senior Oil & Gas Analyst*

Understood. Is there anything -- we've seen some volatility around California in refining. Does that make any difference to you guys or not a lot?

Todd A. Stevens - *California Resources Corporation - President, CEO & Director*

So far I think you've seen that our differentials have strengthened. I think we see it continuing to strengthen from where you've seen in the quarter. And I believe, particularly as someone like Venezuela and some of the heavier grades around the world go down or aren't producing, aren't being delivered, I think there is going to be more bias for our native production, particularly in refineries here in the Bay Area and the LA area that are built to run ANS and SJV heavy.

Paul Benedict Sankey - *Wolfe Research, LLC - MD and Senior Oil & Gas Analyst*

Yes, I was thinking that. Finally, I guess this might be one first to discuss over a drink. But I mean, I guess it's been pretty dramatic in the oil patch for these earnings with the questions surrounding the Permian. What's your -- let's just keep it simple what's your perspective on what we've seen over the past few days?

Todd A. Stevens - *California Resources Corporation - President, CEO & Director*

I think overall from what I've read and heard is that, it seems like what's happening there, that there's some cracks in the ship and they are trying to figure out, are they repairable? Is it going to continue as is, that kind of full steam ahead? Seems like some of the aggressive assumptions that have been put out there probably aren't as attainable as people thought.

Paul Benedict Sankey - *Wolfe Research, LLC - MD and Senior Oil & Gas Analyst*

Yes, it's kind of reminiscent of having looked to the big bank, and whether or not you took your medicine in the -- early in the downturn or late, it's quite interesting. I'm thinking that, in theory, this could be a positive read-through for you guys, absolutely, because, obviously, as I say, you've had to take your medicine early and that worked out well.

Todd A. Stevens - *California Resources Corporation - President, CEO & Director*

And often.

Paul Benedict Sankey - *Wolfe Research, LLC - MD and Senior Oil & Gas Analyst*

Yes, and often. Okay, there were some other items going back to cash flow. Is there anything else that you would highlight? I just thought that some of the above-the-line, sort of others and stuff? Obviously, what we're trying to do is just get to the recurring number given that the operating cash flow is a bit disappointing given they operated a bit higher in the quarter.

Todd A. Stevens - *California Resources Corporation - President, CEO & Director*

Yes.

Paul Benedict Sankey - *Wolfe Research, LLC - MD and Senior Oil & Gas Analyst*

That's why I'm really asking about the property tax basically.

Todd A. Stevens - *California Resources Corporation - President, CEO & Director*

Property tax and, remember also, the interest payments are slightly higher in the second quarter also just the way that it works relative to the other quarters. But I think overall, it was a quarter of executing the plan, ramping up activity with our partners and doing so safely. And I think by the time we talk again next quarter we'll have more to talk about from a transaction, potential monetization and joint venture partners and those kind of things.

Operator

Next we'll have Pavel Molchanov of Raymond James.

Pavel S. Molchanov - *Raymond James & Associates, Inc., Research Division - Energy Analyst*

First, a policy question. Just last week, the California legislature voted to extend cap and trade through 2030. Is there any impact from that vote on your business?

Todd A. Stevens - *California Resources Corporation - President, CEO & Director*

It was something we had operated under already. And it was a cost of business that was included in our kind of other production taxes when you look at those things. So I think it just continues. And actually, from my perspective, it provides a market-based solution and it's much more predictable and stable than potentially other alternatives. So I think the business community, myself included, was happy with the outcome relative to other outcomes. So again, I think it provides a market-based solution that is more predictable and more stable.

Pavel S. Molchanov - *Raymond James & Associates, Inc., Research Division - Energy Analyst*

Okay. And you said that your current rig count is at 9. It was close to 0 last year. Do you have a sense of what's happening to the rig count in California beyond the ones that you guys are operating? In other words, is there a similar kind of recovery in industry activity? Or is it just you guys that are ramping?

Todd A. Stevens - *California Resources Corporation - President, CEO & Director*

I think it's really just us. I think there's just one onesies and twosies after us. So I don't think there's been any other activity set ramped by any other large operators, even small operators.

Operator

Next we have Sean Sneeden of Guggenheim.

Sean M. Sneeden - *Guggenheim Securities, LLC - MD & Trading Desk Credit Strategist*

Maybe just to follow up on Paul's question on free cash flow. But was the use of working capital, was that all just kind of startup costs when -- associated with your ramp-up in the rig count, or anything else that was kind of onetime that was associated there?

Todd A. Stevens - *California Resources Corporation - President, CEO & Director*

Yes. And you got to remember also, in addition to kind of building the working capital, you have the interest expense timing. It's fairly material. It's a $100 million difference between the first quarter payments and second quarter payments too. So I mean, and then you have the property taxes on -- you layer on top of that.

Sean M. Sneeden - *Guggenheim Securities, LLC - MD & Trading Desk Credit Strategist*

Okay. That's helpful. And then just kind of big picture, but, should we still be thinking about a minimum kind of free cash flow neutrality, including the term loan repayments or is that -- have you changed at all?

Todd A. Stevens - *California Resources Corporation - President, CEO & Director*

At a minimum, yes. Yes. At a minimum.

Sean M. Sneeden - *Guggenheim Securities, LLC - MD & Trading Desk Credit Strategist*

Okay. And then maybe Mark, can you just remind me your purchase basket for at least the second liens or the unsecureds? Have you utilized any of that at this point? And is there anything that would prevent you from using free cash flow to repurchase anything on open market?

Marshall D. Smith - *California Resources Corporation - Senior EVP & CFO*

Just to be -- just as a reminder, we used the baskets that we'd created earlier in the year. We still have availability under the baskets, but we'd have to build it through asset sales or monetizations that, as Todd described, we continue to look at.

Sean M. Sneeden - *Guggenheim Securities, LLC - MD & Trading Desk Credit Strategist*

Okay. So you wouldn't be able to use free cash flow to necessarily go out and repurchase. You'd have to go and repay the term loan, is that right?

Marshall D. Smith - *California Resources Corporation - Senior EVP & CFO*

That's correct. Let me clarify. We use free cash flow, but we do use free cash flow to pay back our revolver. So we don't just...

Todd A. Stevens - *California Resources Corporation - President, CEO & Director*

What Mark is referring to is buying discounted debt that we have to -- that we're buying debt -- that's subordinate to the banks, we have to create a basket to do so.

Sean M. Sneeden - *Guggenheim Securities, LLC - MD & Trading Desk Credit Strategist*

Okay. Thank you for that clarification. And then, Todd, maybe just one overarching or big-picture question on JVs I guess, in your conversations with folks, is there anything that's stylistically different than the existing arrangements that you have? For instance, are they more geared towards exploration or should we be conceptually thinking of something similar to what you have in place now?

Todd A. Stevens - *California Resources Corporation - President, CEO & Director*

The larger ones, I would say, are similar more of the Macquarie than Benefit Street. I would say, Benefit Street is a little different. They created something with us that's rather unique. The smaller ones, a lot of those are exploration. And I think that we're actively looking at slightly larger and a lot more of those smaller-type JVs, mostly exploration, I would say, rather than development on that side.

Operator

Next we have Jacob Gomolinski-Ekel of Morgan Stanley.

Jacob Gomolinski-Ekel

I guess maybe a big-picture question on asset sales in the state and asset sales similar to yours in terms of the -- there were a few -- LINN sold a few assets and then also there was the (inaudible) which I guess, I get, is a little bit different. But can you talk about maybe similarities and differences between those assets and yours given what those implied on a dollar per loan basis?

Todd A. Stevens - *California Resources Corporation - President, CEO & Director*

I think when you look back you had asset -- larger asset sales that occurred in the state that have been disclosed. You had, obviously, Sentinel Peak buying Freeport McMoRan, to build a [claims] position in California. I think that was a little bit of a distress sale in my mind-set. I think the LINN purchase by Berry, I think that was a asset sales that was reflective of heavy oil valuations. I think that is a property that's similar to our Lost Hills property and many other happy oil steamfloods. Maybe not the caliber of our Kern River and Midway-Sunset, but I think it's on par with that. So I think that's a value. When you have a look through, I think that's very much appropriate to our heavy oil-type assets. If not, maybe current type of [premium].

Jacob Gomolinski-Ekel

Great. And then just the other quick question is on PBF talking about Torrance finally being up and running. So curious if you're seeing any effect on pricing and differentials in California post that event.

Todd A. Stevens - *California Resources Corporation - President, CEO & Director*

You can see what our differentials were. They've strengthened in the quarter. We've seen a little bit of further strengthening since then. I think it has to do with the level of, again, like I said, heavy mix in the world. There are some people that have [improved since last time] that have geopolitical issues associated with it. And remember that the refineries in the Bay Area and LA have been built to run ANS and run SJV heavy. So that's why I think our blend of crudes has been getting a premium relative to other crudes.

Operator

And next we have Gregg Brody, Bank of America.

Gregg William Brody - *BofA Merrill Lynch, Research Division - MD*

Could you just remind me for the JVs. How the -- how is that running through the cash flow this quarter? And then maybe you can remind me or explain just the rationale for dropping the [governance] pad ex JV? And sort of the production in the CapEx? And I'm really just trying to figure out how to think about the spend -- the cash out from those JVs going forward and where that's flowing through.

Todd A. Stevens - *California Resources Corporation - President, CEO & Director*

So talking about the 2 JVs. We're exploring everything else. We did that one time to kind of give you a feel for what's going on and how it works. But Macquarie being no different than if we had a working interest partner in a field or a well. So that will show up no different than the accounting that you might see with anyone else has a non-op or a partner with them. Benefit Street is a little different, it's a net profits interest. So it's going to flow through in a different area and come out, I think, in other comprehensive -- OCI. And Mark, is that right?

Marshall D. Smith - *California Resources Corporation - Senior EVP & CFO*

It comes out in the net loss attributable -- or attributable to noncontrolling interest.

Todd A. Stevens - *California Resources Corporation - President, CEO & Director*

Yes. So it's below the line item noncontrolling interest. So that's how they both flow through. So Benefit Street, like all their capital will show up as our capital even though when you try to do a free cash flow calculation that will be off because some of that capital that technically was ours was funded by Benefit Street. It's just the way you account for them. It's going to be totally different. I think more of the ones we are contemplating in the future that we're having active discussions with are more along the lines of Macquarie, and a more traditional joint venture arrangement where it's reported as partners and you report your interest. Then the back half of your question I lost. What was that, again? Gregg?

Gregg William Brody - *BofA Merrill Lynch, Research Division - MD*

That was the back half. The first half was quarter, was it the $1 million that came through that's showing up in net income, is that (inaudible)?

Todd A. Stevens - *California Resources Corporation - President, CEO & Director*

That's correct. Yes, and we disclosed it early on, but it's going to get really messy and hard to follow. And we felt like it's easier because people, in the end are ultimately interested in our net to us not really with and without Macquarie and everything else because it just -- it gets too confusing, particularly if we layer on more and more joint ventures.

Gregg William Brody - *BofA Merrill Lynch, Research Division - MD*

I appreciate how confusing that is. And maybe just on the -- so the free cash flow numbers you mentioned, it should be above -- you just generate free cash flow. It includes those payments going forward, correct? In particular, the Benefit Street payment (inaudible).

Todd A. Stevens - *California Resources Corporation - President, CEO & Director*

Yes. I mean we're -- yes, Benefit Street because that's the one that's confusing. Yes, because it shows up in our financials as our capital when in fact it's been funded by them. So you will figure it out when you go through the funds flow, but not in the income statement.

Marshall D. Smith - *California Resources Corporation - Senior EVP & CFO*

Right. Gregg, the way to think about Benefit Street is we control its consolidated and the net comes out in that other -- that noncontrolling interest line item.

Gregg William Brody - *BofA Merrill Lynch, Research Division - MD*

And so would you expect -- obviously, you started a little over a quarter ago, that should start to pick up next quarter, correct? Or is there still sort of a little waiting period, which should...?

Todd A. Stevens - *California Resources Corporation - President, CEO & Director*

Yes. I would expect so, yes.

Gregg William Brody - *BofA Merrill Lynch, Research Division - MD*

And you'd mentioned that the third party -- you mentioned smaller JVs. I think you gave a number. Did you say there's 9 and you've raised $30 million from there? Is that correct?

Todd A. Stevens - *California Resources Corporation - President, CEO & Director*

Yes. We have 9 JVs that will -- other JVs that we have executed that have $30 million of committed capital and they have follow-ons to further earn their interest if they so desire. That would commit them up to $75 million.

Gregg William Brody - *BofA Merrill Lynch, Research Division - MD*

Got it. So that will come through as working interest for you in terms of your production?

Todd A. Stevens - *California Resources Corporation - President, CEO & Director*

Yes. If it's successful, that's correct. Those are mostly explorations.

Gregg William Brody - *BofA Merrill Lynch, Research Division - MD*

Just out of curiosity is there -- are those of carry arrangements as well?

Todd A. Stevens - *California Resources Corporation - President, CEO & Director*

Yes.

Operator

Next, we have Jay Spencer with Stifel.

Jay Spencer

I had a question about hedging. Can you tell us about the transaction to swap 29,000 barrels a day of Brent at $60 a barrel for the first half of 2018? That seems like a really good deal. To get that swap, did you have to offer the $45 puts? And if you're going to do more of these, is that the way that's going to work? I'm just looking at Slide 14, it looks like the counterparty has option to do more swaps. Would there be a commensurate amount of puts sold if you guys went through [net] ?

Todd A. Stevens - *California Resources Corporation - President, CEO & Director*

No. Jay, I'll give you the -- this is not just one transaction. And you're really looking day-to-day to try to get the right volatility in the different instruments around Brent. And so the stars aligned a few times for us to execute this transaction. And effectively, what you're doing is, you are swapping Brent, and it wasn't 29,000, it was different increments, 4 at $60. We sold a short put at $45 and we also offered them the right to extend in certain time periods, so they get to January 1, the first quarter they can extend for effectively double the crude they buy at $60. So when you do all that and then you throw in a few dollars of cash, you end up with the transaction. So again, you are trying to have it all flow through and understand the volatility associated with all that and how it actually works. I don't know if you want any more mechanics of how it works. But -- so even if crude drops -- between $45 and $60, we're going to get $60 for Brent.

Jay Spencer

Got it. Okay. That helps. And we talked a little bit about baskets for repurchasing debt. But what about just issuance, like straight issuance of new secured debt or potential exchanges? Is there more capacity to do secured debt, for instance, like a first-lien third out that's behind your first lien second out?

Todd A. Stevens - *California Resources Corporation - President, CEO & Director*

Jay, there is. I believe it's like 800, 900. I'll let Mark give you a little color on that.

Marshall D. Smith - *California Resources Corporation - Senior EVP & CFO*

Jay, it is just as Todd described. The subtlety is it would likely involve players' approval to some extent upping the capital structure, so it's not as easy to accomplish as just straight issuance of the debt. So there is involvement of others in the capital structure along the way. So it makes it a little bit of a challenge to execute, but we continue to consider these types of things.

Operator

Well, at this time, we're showing no further questions. We'll then conclude today's question-and-answer session. I would now like to turn the conference call back over to Mr. Stevens for any closing remarks. Sir?

Todd A. Stevens - *California Resources Corporation - President, CEO & Director*

Thank you, everyone for being here on our conference call. We look forward to seeing you here, either in SoCal or around the country. As always, we're available to answer your questions. Please let us know. Scott and Joanna are always available. Thank you.

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, everyone. Take care and have a great day.