Jeanine Wai: Nice to see a lot of friendly faces here.

Today, we have the pleasure of having California Resources with us. California Resources is an E&P focused on conventional low-decline resources exclusively in California and was spun out from Oxy in 2014. Our pleasure today is to have Todd Stevens with us, who was appointed President and CEO of the company in 2014 and previously held numerous roles at Occidental, including Vice President of Corporate Development.

So, Todd, thank you very much for your time.

Todd Stevens: Thanks. Glad to be here.

Jeanine Wai: So, today the format is really just going to be a fireside chat. And if we have Q&A or whatever also, raise your hand and we can run some mics. We figure this is a more fun way of doing it, especially over lunchtime.

So, Todd, maybe I'll start out. My first question is can we start by having you give a perspective of what it's like to operate in California, where really for decades it seems like you've coexisted with minimal disruption or added financial impediments. And there's just been a lot of headlines over the past 12 months, like AB-345, AB-535, SB-10, and given the governor firing the official in charge of issuing drilling permits and possibly introducing his own energy policy. So, there's a lot going on here. Can you give a perspective on the current political landscape of operating within California?

Todd Stevens: Yes. I think it's important to understand that again you highlighted we've been operating in the state for some time. I think it gets more and more headlines now as the issues that have been in California for decades have now started to move elsewhere, to Colorado and everywhere else in our country. And so, I think there's a heightened focus on those issues. I think it's kind of funny when someone said to me, "Oh, you're – something is getting proposed in California. It's just like Colorado." And it's, like, "No, we've been dealing with these kind of things for a long time."

But it goes back to what's going on in our state from a standpoint of understanding that it's the fifth largest economy in the world. It's heavily energy-dependent. It currently imports most of its energy: 74% of its crude is imported, 91% of its natural gas is imported. It creates these unique circumstances in the state and this unique dynamic that we were – under Governor Brown, he was really a supporter of in-state production because he viewed it as the environmentally correct thing to do because other places in the world don't have the super-stringent environmental regulations that it's produced under, and it provides the jobs and the additional effects from taxes and everything else paid.

Governor Newsom is new, obviously. Earlier this year he's dealt with some issues. Some employees in the Division of Oil and Gas had filled out their Form 700 and held some upstream and downstream investments. And that was sprung on him at a news conference by an activist. He subsequently let go of some folks. He also made it – the activist made it appear that the permitting was out of line relative to historical norms, but that turned out to be a false narrative. It was really just the Form 700 was really what was important. There were employees regulating an industry where they might have indirectly or directly benefited from investments that they held.

But the one thing to understand about the state is it is a truly diverse economy. It's energy-dependent. We've been there a while. It's really about being proactive. And you hear this starting to go elsewhere in how we do our business in the state and how we have done business for some time. Form nontraditional alliances. We have a formal PLA with the building trades. We work with agriculture because we are actually a net water supplier. So, we work with the agricultural community, and they understand the benefits we bring, the jobs we bring, and the taxes we pay. So, from our perspective it's very important to be able to tell our story and do those things.

Governor Newsom on the campaign trail did say that he felt like he needed to tighten up the regulations on hydraulic fracturing. One thing to understand in California, there's not a lot of hydraulic fracturing that goes on. It's a conventional play mostly. Maybe 5% to 10% of what we do involves some kind of stimulation, and the stimulation there is much less than the stimulation you see elsewhere. Mother Nature has already hydraulically or naturally fractured a lot of the rocks in California through tectonics.

But one thing to understand that's a little different in California is Governor Brown created something called the Senate Bill 4, which created a process for stimulation permits in the state. So, it gave you a clear path of how this happened. And I think it involves underground stimulation and all the things associated with that, whether it be air monitoring, water monitoring, and those kind of things. So, you have a path forward. You can't have some regulator just hold you up, just to hold you up.

And I think in California, again the fracking part might be tightened up. I would have to guess if you asked my opinion, clearly, we have a lot of interaction with the administration, whether through the regulators, the executive, and the legislative branch. But I think if the governor was to do something, I would guess it probably would have to do with shallow production, simply because of the recent Chevron spill which was a surface expression in California. The governor gave a very thoughtful talk out in McKittrick at the elementary school after he visited the spill and basically outlined how important our industry is to the state of California.

But again, that was something that had to do with – it effectively was stimulation, where you're injecting steam over frack gradient and at a shallow depth. So, that would be my guess, that if he tightens something up it might be on hydraulic fracturing near the surface or stimulation near the surface.

But doing business in California, I think it's going to be the way that people are going to deal with, whether you're in Colorado, Pennsylvania, Oklahoma in the future. I think you have to be aggressive about how you tell your story, what you do, what you don't do. Because if you don't, there will be people that are going to tell your story for you, and they have very Machiavellian methods and they only care about the outcome. And we're too important an industry, not just for the state of California but for our country, and it underpins our first-world economy. So, it's so critical to have a vibrant oil and gas business.

And for us in California, if you're not producing it there you're importing it from overseas. That's why we get Brent pricing. I think people forget we are tied to Brent in California simply because there are no pipelines connections. We occasionally get a few rail barrels, but rail barrels cost $12 to $15 a barrel to rail in. So, that's why you see such a tight focus on Brent pricing. And the places where it comes from – Saudi Arabia, Iraq, Colombia, Kuwait, Ecuador – these are the type of places that don't have the same kind of laws that we have in California and that provide the same kind of high-paying jobs that our industry provides, in some cases, to folks who only have a high school degree.

Jeanine Wai: Okay. Maybe switching topics here, so you recently brought in a third drilling partner, Colony Capital. And can you walk us through your decision to do that? And can you explain what the benefits are to investors?

Todd Stevens: Yes. So, at our spin, which will be five years ago in December, what we knew at our spin was we have great world-class, investment-grade assets – assets, arguably, of a supermajor trapped in an independent – with a balance sheet for a different oil price environment. So, for us, the key thing we understood was we have very long-lived, rich inventory, and we were committed since day one, not since it's been fashionable, to living within cash flow. And that puts artificial constraints on yourself, but it also presents an opportunity to bring value forward.

So, we view the joint venture as really doing three important things for us. We have a lot of PUD life risk outside the five-year window, the seven-plus years outside the present value window, too. So, for us, you bring value forward. It helps you bring that value forward. It helps you de-risk locations. You can spot a well and you will then own all the offsets and don't necessarily have to give it to the joint venture.

But I think the thing that gets lost on people – and we focus a little bit in our presentation here – is talking about how you can utilize to manage cash flow and maintain yourself within cash flow and actually manage your activity and keep activity constant. So, for us when we deal with the volatility of the commodity price, we can push activity into the joint ventures or take activity out of the joint ventures. It's an important tool.

And to see – we have the three large ones you mentioned, which is BSP, Colony, and Macquarie, but we have numerous smaller ones that really fly kind of under the radar screen. There's a smaller one that gets more notice because it's a small public company that puts out a press release frequently; it's Royale, in the Sacramento Basin. That's an area that doesn't compete internally for capital, but it must – it competes for JV capital. And that's the way our criteria works. You either have to compete internally for capital, JV capital, or look to be monetized.

And for us, it was so important to help us maintain our activity set through the downturn, keep those crews together, keep the drilling crews, the workover crews and those kind of things. I think people forget how important a component that can be to someone who is, like us, who is over-levered but has great long-lived assets with low capital intensity. So, sort of the resilience of the asset base is really important for people to understand.

We're not going to go away with 40% declines over time. We pulled back capital to the absolute bare minimum of mechanical integrity and basic maintenance in 2016 and only saw modest declines. And we see that over time, too, as we've gone up and down with the mini cycles we've been dealing with.

Jeanine Wai: Can you walk us through your VCI metric and maybe how that drives decisions on your inventory?

Todd Stevens: Yes. I think it was something that, as all good ideas happen, you steal it from other people. I think Tenneco really focused on that PVI DPI metric, the present value index discounted profitability index. I really felt like it was about value. And so, we changed the name internally to value creation index.

And it's one of those things – my former life at Oxy really focused on M&A and rebuilding Oxy around an oil and gas business from the conglomerate we were when I started there, post Armand Hammer. I think I got to see a lot of different operations and how they were ran and the metrics they used to run the business. And I felt like the only ones that really assured yourself that you were creating value – because as a management team, the most important things you can do is allocate financial capital and human capital to the organization. And how you do that, sometimes it will have an immediate impact, but most of the times the impact is felt over numerous years. And so, it is so critical to get that right.

And from my perspective, everything we do is about value. So, the VCI metric is something we use to allocate capital, but it goes into every decision we make. We're consolidating offices in Long Beach. We're moving offices, changing leases. It's going to save us money, and it's a better value proposition for the company, moving down the street.

So, there's a lot of things like that. And it includes looking at our debt. This month has been a brutal month if you're a debt holder – like Ryan in the back – but it's traded down. So, when you look at the alternative between investing in our assets or buying in our Second Liens which are trading at almost a 30% rate of return and it's arguably riskless – free from operational risk, for sure – those are the kind of things that you're going to weigh. And for somebody like us who is at a point where there's no reason to grow – you're not getting paid for growth – we're trying to keep production flat and utilize excess free cash to again delever because we understood that's the millstone from day one and we knew there wasn't going to be one magic bullet.

So, we're doing an "all-of-the-above" approach and doing everything we can. We've chipped away. We were at peak post-spin debt of $6.7 billion shortly after the spin. We're around $5.1 billion now. We continue to move away and chip away at that. But what I think is important is at the spin we were contemplating transactions to help us get our debt down, but the bottom fell out so quickly right after the spin. Other alternatives to protect and preserve value and ultimately achieve value for our shareholders presented themselves, which involved greatly complicating our balance sheet. And we did that. So, now the opportunity exists to do those same transactions. And I think it's funny because the instability in the market but a fundamental price of $60, plus or minus, Brent, pretty solid fundamentals for a company like us, even with the debt load we have, given the nature of our asset base.

So, I think that's so important when you think about value and preserving value and creating value is the great part is we have so many levers to pull. And everything we do, whether it's utilizing surface land or doing a joint venture with Ares or Colony or anyone, is all about the value proposition. And that's what's so great about those joint ventures, too, is I didn't mention we get near-term benefit. We get some benefit immediately while we're getting carried 100% on those investments.

We're about value, everything we do. And we're not about production growth. We're not about other metrics, rate of returns. People who are engineers or financial experts know you can fool yourself. We're about creating value. So, if you invest $1, you're going to get at least $1.30 of value.

Jeanine Wai: Maybe going back to your comments about having levers to pull, your current leverage, we continue to see E&Ps in the current environment high-grade their portfolios. We've seen a lot of assets change hands recently as folks pay down debt or use proceeds for other return-of-capital programs. So, are there other asset sales that maybe you're contemplating; for example, like the surface land at Huntington Beach or maybe any infrastructure or maybe even something like royalty sales?

Todd Stevens: Again, we've said "all-of-the-above." The only thing I've said which we won't sell is Elk Hills. It's 50% of the company. You need to buy the company if you want to buy Elk Hills.

For us, everything else is on the table. We have done some rationalizations. We sold recently earlier this year 50% of our Lost Hills field. And the 50% we kept, it was kind of a hybrid JV because they're carrying us on wells for the next few years on the 50% we kept. For us, you mentioned royalty. It's something we've talked about. We think the royalty market is robust. It's one of many alternatives we're looking at, but I think it's clearly a lead horse at this point, given the valuations paid. You look at the Range Resources transaction in the Marcellus. That was gas in the Marcellus, shale-type declines, and it was paid at over 12x.

We're oil, low decline, low capital intensity, and also Brent-based pricing. And it wasn't an accident that we did the Colony joint venture at Elk Hills first. So, when you think about what's important to royalty investors, it's about having capital to invest and seeing there actually is from a company that has been very disciplined with its cash flow, that there will be investments even in down times. So, I think that was an important step for us as we move towards getting that transaction or another transaction like it across the finish line, because I think that kind of catalyst is really what the stock needs and, clearly, I think what people are looking for. But we're going to be deliberate. We're going to do what makes sense. And if it doesn't make sense, we have Alternatives B, C, and D.

You mentioned Huntington Beach. The surface acreage there is clearly worth a lot of money. For those of you that don't know, it's 92 acres literally on the beach in Huntington Beach, Surf City. We've looked at all kinds of alternatives, including partitioning part of the acreage for development and utilizing the rest of the acreage for directional drilling, and the like, to continue to develop the field. We balanced that during the downturn whether it was worth abandoning the field and pursuing the surface acreage.

We have other surface acreage, but none of the magnitude of that. I've heard people quote and say that the surface acreage there fully developed is worth over $10 million an acre. That's almost $1 billion. So, again we have other surface acreage, but not to the same magnitude or same location. It's worth something, but not on that order of magnitude.

But that's again the mentality of the company, is everyone is focused on value. Whether you're in the land department or you're in the accounting department, you're always trying to figure out things that are going to ultimately create value for us.

And we've done many things. Even the Ares JV, that was part of rationalization of the portfolio. Even though it wasn't necessarily selling something, it was selling something to buy something. We had a unique opportunity working with our partner at the time, Chevron, who owned 22% of Elk Hills. It was a difficult time to get transactions done. We were able to monetize 50% of our power plant and our gas processing plant of our infrastructure at Elk Hills to Ares, use those proceeds to buy out Chevron and pay down some debt at the time.

So, again, that was something we've been able to do, and we've been able to fully sell little pieces here and there. We continue to look at more rationalizations and things that make sense. We survived the downturn and went through the downturn not having fire sales to get to the point now where we have real prices and real value could be brought forward to ultimately accrete the equity value. We understand that's the millstone when people look at our company. The first thing they do is look at the absolute level of debt and they think, wow, that's – and if you screen past that, you're going to get into other issues, and it might be that it is in California.

But for us, once you get past those, there are almost always investors in some fashion, whether it's a joint venture or buying our shares or something else. Because I think they realize the quality of the assets and the type of assets we have are rather unique, and again, mostly sit in supermajors and the like.

Jeanine Wai: Okay. Maybe if we could switch gears to pricing, starting on the natural gas side of things. So, I believe California natural gas demand has been in decline for about five years, or so. We've been seeing a lot of volatility in that. For example, I think your 4Q unhedged realizations were, like, slightly under $4. 2Q19 realizations were, like, around $2.33, I believe. So, can you just kind of walk through your thoughts on that and any thoughts you have on NGLs? That's been a little disappointing this year, as well, for the industry.

Todd Stevens: Yes. California natural gas has really gotten extremely volatile. Historically, because there was so much imported, it would be basically the cost of importing added tacked on to Henry Hub. And so, you would have NYMEX plus or minus 15, 20 cents.

But what happened when Aliso Canyon, the huge natural gas storage field in northern Los Angeles, went down with a leak – and now it's back running, but it's at minimal capacity – what it's done is create incredible volatility in natural gas prices in the state. So, when you have really mild weather in the second quarter like we had – the rest of the country wasn't that way, but we had an extremely mild second quarter – so natural gas prices didn't do anything. But the prior two quarters to that, we saw sometimes you'd see a Border price of, let's say, $2.50, but City Gate price in L.A. or San Francisco was, like, $20 or $30.

But you have to be in a unique situation like us having the infrastructure and the business to take advantage of that. So, you saw our trading income in those quarters spike up to $20 million, $25 million just for the quarter. And it really had to do with only about a week or 10 days of that activity.

So, what you're really looking for and what's happening in California is when there's degree days, whether it's hot or cold – and I'm talking about California cold, not New York cold; so, you're, like, 50 degrees – it's those days that drive prices to go through the roof. And when you're uniquely advantaged where you can turn off a steamflood and sell gas into the market or have the infrastructure to sell more gas into the market and the right market, I think that's what's unique. And we see that, those conditions already starting to happen. We started to have some hot weather finally in July and August. So, it was something that is good for the company.

But I think it's bad fundamentally for California because you don't want to have that kind of price spike. That was what ended up with the energy crisis in the early 2000s that caused Governor Davis to lose his job, with the Enron-driven price manipulation at the time. But I think it would be better to have some stability, bring back some natural gas storage to handle those peak days when you need the natural gas at those power plants.

On the NGL side, we haven't been immune from the rest of what's happened in the country, but we still do significantly better. I think again it's an island, just like crude is an island. You'll see our propane prices are typically twice Mont Belvieu. The only thing that's come into par has been butanes. I think the demand from refineries will pick up a little bit.

But our markets in California for NGLs are different than really the rest of the country. So, the rail cars that are going to Canada and Mexico typically are some of the bigger markets for propane. But for us, we've seen the dynamic that prices have come absolutely down on the NGL side. But for us, we still see the premiums we're getting to elsewhere very similar to Brent, the Brent pricing, which like in July our portfolio of crude averaged 102% of Brent.

So, we see those fundamentals actually solidifying and underpinning our crude realizations in California as more and more crude is imported. And our slate of crude is more wanted for the super-high complex refineries of the Bay Area and the L.A. area.

Jeanine Wai: And so, this 102%, was there something special about Q2/July that caused you to have this premium to Brent? Is that something sustainable? I know you mentioned earlier that sometimes people forget that you've got Brent pricing exposure.

Todd Stevens: Yes. The first quarter this year we were 100%. And so, we see that – what we really see is we used to go between 95% and a little over 100% of Brent, and it was typically driven by discrete actions whether it moved. And there might be a port strike in Long Beach where they can't offload some crude tankers would cause a price spike up, or some refinery went down because of a fire would cause a spike price down.

But what's happened recently, we've seen that even with refinery outages our crude has – there have been no force majeures. Our crude is still being taken and priced at a premium price, which tells me it's a lot of demand. And it makes a lot of sense. If you talk to refiners, our blend of crude – sort of 24, 25 API gravity with a lower sulfur content – is what those kind of high-Nelson complexity refineries really want to make the products that make the most yields and actually generate the most cash flow for them.

Jeanine Wai: Okay. And then, I'm not sure what mix we have in the audience today, but I guess from our perspective equity and debt investors kind of perk up whenever you kind of say that you're keenly focused on strengthening and simplifying the balance sheet. So, maybe if you could just take this forum to remind investors what you're talking about with that statement?

Todd Stevens: Yes. So, again peak post-spin debt of $6.7 billion. The final parting gift was we kept the accounts payable and Oxy stripped the accounts receivables from us, and that's why it ended up at $6.7 billion.

And we've taken the cards dealt to us and focused on creating value. Again, I talked about protecting and preserving value during the downturn. And it was – we had a fairly simple capital structure when we were spun off. We had an RBL and unsecured bonds. And we went through the downturn, knowingly complicated our balance sheet to try to extract some value for our shareholders. And now we're back into a more stable price environment and a price environment that works for us that now we feel like there's opportunity to refinance the balance sheet, take advantage of that principal reduction, reduce our fixed charges, and also do the transaction thing in parallel to those things that we've been talking about.

And again, like I said earlier, nothing is off the table for us. We're going to do whatever it makes sense to create value. And we know that there's a lot of good ideas. And depending on the market conditions when we finally get one of these transactions, whether it's a royalty or another one, across the finish line, that will dictate what we actually do. But our debt trading at a discount might present us with an additional opportunity to continue to buy in debt. We have bought in debt the last five quarters. Almost every month this year I believe we've bought in debt at a discount, and we continue to do so to take advantage of that.

Again, we understand it's not one fell swoop that's going to get us to where we want to be, and we said that from day one. Whether you were at October 31, 2014, when we were spun off, at our Analyst Day, whether you were there and we said we look long-term. We want to get to 2.5x to 3x. We have the assets that easily underpin that because of the long-lived, low capital intensity nature. Our assets are perfect for a company that wants to pay a dividend, but we can't talk about that until our capital structure is squared away.

But we understood it's a long process. We're working on that. We're chipping away. And we're now ready to take – from the baby steps, take strides towards that. And you'll see that. It's not that far away. One or two good transactions when you look at understanding it's balance sheet for income statement leverage could get us to where we need to be to help us do the things we want to do as a company and grow the business the way we want to do that long term.

Jeanine Wai: And then I think the last one from me, and then we can open it up for Q&A. So, another thing that makes investors perk up, insider buying. So, we've noticed a lot of insider buying lately, and we just wanted to wrap up by asking what do you think the equity market is missing. Is it that you're taking some – going from smaller strides to bigger strides and fixing the balance sheet and you see an inflection on the horizon? What do you think people are missing that maybe you guys see on the horizon?

Todd Stevens: Well, I think fundamentally people are missing that the fundamentals are not that bad. They're pretty solid. The headline risk that everyone is focusing on lately has always been there, and it's something of doing business in that state and it's not going to be that different doing business in pretty much every state, coming attraction.

But I think the thing to understand is that since day one we've been laser-focused on value. We get thrown kind of the baby out with the bath water. Something happens in shale, we get punished that day. We have really nothing to do with the shale business model. We actually have a real business beyond some pumping units and leases. We have infrastructure and midstream assets and power plants and those things that go along with, like I said, the assets of a supermajor. The only thing we're missing is a refinery. So, when you think about it that way, that's the kind of assets we have, the kind of business we have.

So, we've just been so punished. And the other thing I think is the technicals that go along with where, like, our Second Liens trade. We're the most liquid debt instrument in the high-yield universe. So, if you can't trade someone else, you trade CRC or you short CRC. So, we understand that. We get that. It's cheaper – we have an extremely high beta to oil. We're tied to Brent. So, there's a lot of things that happen that people are almost self-fulfilling prophecies. Not to mention we have an enormous short position. So, people are articulating that to their friends, that they're short our shares, their opinions of why this doesn't work. We've undergone that. There was a Blue Mountain report years ago that was, like I told somebody, a lot of precision but no accuracy, and it was just effectively a short attack.

So, for us it's about executing and continuing to drive value. I think everyone appreciates the underlying value of what we have here, and it really is orders of magnitude from where our shares trade now, which is really option value. And we understand that, but we're driven to do the right things and to execute on the right things to grow shareholder value and to ultimately be an integrated company. I think the one thing we've missed before is the other avenues to de-lever – which I said "all of the above" – are M&A, business development. There's those kind of things, too. You can look at doing different things creatively.

But for us, I think anyone – you can talk about the insiders buying, but I think anyone who has had the unfettered access to our assets, look at our bank group. They've given us nine amendments through the downturn, our most recent one yesterday. All of our partners that have done deals with us, whether it be joint ventures or even Chevron when we bought out Elk Hills, have chosen to participate in some way in the equity.

So, I think it's interesting that when people have had the kind of unfettered access, got under the hood and they realize and do the work – and we understand it's hard. That's the other part, is you can't model CRC in an Excel spreadsheet. It can't tell you the number of locations, the type curve, and you just multiply it out. We're a conventional business. We have every type of drive mechanism you might see in the world and every type of hydrocarbon you might see in the world. And it's complex. We have over 130 fields that produce everything from dry gas to heavy oil. So, it's not that easy to model and understand against the backdrop of a perception of a high amount of debt plus California. But I think the people that have gotten in it and really done their work realize that the opportunity set is vast and enormous and the value proposition is outstanding.

Jeanine Wai: We've got about one minute left for questions. Are there any from the audience?

Yes. Go ahead. We have a mic for you.

Audience Member: Thank you. I just want to understand the crux behind the amendment yesterday. What does that do for you on the liquidity standpoint? And then, where are you thinking about earmarking any asset sales?

Todd Stevens: Yes. So, the amendment really gives us additional optionality and flexibility. But I think the most important thing – I'm going to oversimplify it a little bit, and if you want to pin down Mark and ask him the mechanics of how everything works, that's fine – but it effectively allows us to buy in our debt at a premium. And you say, "Well, most of your debt is trading at a discount." So, remember, the 1-1/2 Term Loan is callable with a 106, plus or minus.

So, it gives us maximum optionality once we effect, whether it be a royalty transaction or some other monetization. And before, remember, the baskets and everything we've built up with the banks are all about buying in debt at a discount, at any discount. So, this one affords us the availability to be able to buy debt in at a premium.

And so, who knows two weeks or a month from now how the macro condition or what might happen in the debt markets. So, we're providing ourselves with the maximum flexibility to do what we need to do to simplify our capital structure. And that was really what it's about. And again, Mark is – when we go to the breakout session, if you want to pin down Mark and ask him the dirty details beyond that.

The one thing I didn't like in that was the $600 million cap. I would argue that that was rather arbitrary. I think that from Mark and his discussions that he had with the banks, clearly, if we ended up with more proceeds they would be fine with it. They just wanted us to check back with them. They needed more fees, I'm sure; that's what it was.

Jeanine Wai: All right. Well, we've got to make some money somehow.

Todd, thank you so much. I know I learned a lot, and I hope everybody did, too. Thank you very much for your time.

Todd Stevens: Thank you.