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CRC - California Resources Corp at Raymond James Institutional Investors Conference

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CORPORATE PARTICIPANTS

Mark Smith *California Resources Corporation - SVP, President and CFO*

CONFERENCE CALL PARTICIPANTS

Pavel Molchanov *Raymond James - Analyst*

PRESENTATION

Pavel Molchanov - *Raymond James - Analyst*

Appreciate all of you guys coming to the presentation for California Resources. California was a spinoff 2.5 years ago from Occidental at an interesting time in the oil market. So with us for the second time is Mark Smith, the CFO, to walk us through the story. Mark?

Mark Smith - *California Resources Corporation - SVP, President and CFO*

Thanks, Pavel. Appreciate that kind introduction. Interesting time is probably a little bit of an understatement in terms of timing for the spin.

Joining me today are Joanna Park, a key member of our Investor Relations group, as well as Margita Thompson who leads our Communication team.

Thank you guys for having us here. Always wonderful to be in Orlando. You guys have got a great conference again this year. Thanks for having us.

It's been well over two years as Pavel alluded to when I joined CRC. It was just in preparation to and preparation for and prior to the spin. A couple of key factors were critical in my decision to join CRC.

One was CRC's experienced, capable, technical team. Another was the Company's diverse asset base. Its strength, its resiliency, low capital intensity, significant upside. My perception was and still is that the asset base has been underexplored and underexploited. So, at the time of the spin, our parent capitalized us, as Pavel alluded to, with a debt level for a different price environment. I refer to it as the gift that just keeps on giving.

Since then we've been tested. The assets, the business model, the team. Importantly, we have been keenly focused, focused on strengthening our balance sheet, focused on retooling the organization, on capital allocation, protecting our base, on defending our margins, on developing our inventory. And notably, we have been focused on preparing for the eventual turn in the commodity and creating value for our shareholders.

We believe we are now at an inflection point. Positioned for growth. We believe we can grow production at an annual compound rate of roughly 8% and EBITDAX at a rate of approximately 25%.

So this morning I want to address the elephant in the room. I want to visit a little bit about two key objections often raised by investors when they are considering CRC. The first, the Company's debt is too restrictive to allow for growth. We don't believe that's the case. The second, the Company will possibly execute a highly dilutive equity transaction just like many of our peers have done. Also, we don't think that that is necessarily the case.

Importantly, we believe that even without delivering transactions, we can strengthen our balance sheet organically. Without a dilutive equity transaction, still grow EBITDAX in the mid-20% range.

So this morning I want to work to address these points: who we are, where we been, where we're going, and how we can do this largely organically within cash flow. And so I will speak to CRC's world-class asset base, our flexible business plan, our value generation focused team. But before I do this, I want to underscore two key points. There's an opportunity here to capture basic value, and we have incredible optionality.

So let's first go to this value point, our NAV. Essentially what you see on the slide in front of you is some of the parts. Unlike many of our peers, we don't simply own our producing assets; we also own and control much of our midstream infrastructure. Sand faced to sales point as we like to say. Our midstream assets are integral, complementary to our operations, important point. It allows us to control our costs and maximize our production and the value from our upstream assets.

And yet as one can see from the slide, we believe we trade at a significant discount to our underlying value. Essentially we are trading at PV-10 at a proved category at flat current prices. No value for our significant unproved asset base nor surface and minerals, nor midstream and infrastructure assets.

As part of our work for the banks, I just want to point out that these complementary assets of our midstream were valued at roughly $5 billion, and they are represented here on the slide conservatively at roughly half this. Roughly $2.5 billion.

Again, this infrastructure supplements our operations, allows us to maximize the value of our upstream, and we still have the optionality to monetize these assets if we were to choose to do so, and we will continue to be very thoughtful about not allowing a potential midstream transaction to impact our operational control as it relates to our upstream.

Now second is our asset base. The potential of our inventory, our optionality, our flexible business model, and our ability to grow. And we have a sophisticated portfolio planning process. We strategically review, prioritize, focus on the development of our highest value projects. Now this slide shows what we believe is a reasonable mill range of production outlook resulting from the various projects in the areas that we've looked at over the past while.

It is all funded within cash flow at essentially analyst consensus pricing. We have lots of projects to select from, whether that is water flood, steam floods, primary, unconventional, as well as different risk profiles. From development, the Buena Vista field, which I will talk about a bit later, to exploratory, and Kettleman, which I will also address. This planning assumes only cash from production. No reinvestment from assets, asset sales, monetizations, etc.

Now one can see in the top panel up there high single-digit production growth through the planning period. This isn't the highest production growth in our various scenarios. Rather we believe it is representative of those within the various project opportunities available to us.

So given our work, we believe that we are an inflection point for growth. We are cautiously optimistic. We are putting our rigs back to work, both workover as well as drilling rigs. But what does this mean in terms of cash flow? Because at the end of the day, it's all about cash flow. Our work shows us that with continued focused on costs and our capital focused on oil projects, higher margins, lower declines, we can achieve meaningful cash flow growth in excess of 25% growth in EBITDAX, again all through investment within cash flow. Not pushing growth for growth's sake, not out over the tips of our skis, not diluting our shareholders.

So what does this mean in terms of the leverage? Well, the ultimate effect here drives our ability to strengthen the balance sheet organically. Within the current price environment, not relying on asset sales, nor joint ventures, nor monetization, still having those options available to us, still considering them, evaluating them, we have time to be thoughtful and disciplined. As we have said, no fire sales here.

Even with all these options available to us, we're still going to focus on those actions that are value accretive to our shareholders, and we will continue to focus on opportunities that allow us to grow and strengthen our balance sheet in a disciplined, thoughtful manner.

Now to frame our more detailed discussion, let's look at who we are and what we are working with. California is a world-class oil and gas province. The state represents the sixth largest economy in the world. It's right between UK and France. California is like an island. Demand exceeds supply. The state imports 64% of its oil, 90% of its natural gas, 34% of its electricity. It creates strong demand for local production with favorable pricing. And so it's important to know that we are the largest operator by production within this market. We operate four of the 12 largest fields in the lower 48. We operate -- control essentially all of our production. These four fields are all multibillion barrel fields. And importantly, we like to tell our technical staff you can get a world-class education in oil and natural gas just working here within the state of California.

Generally we operate in four basins across the state. Currently we are focused on oil in the San Joaquin and Los Angeles basins. Although if natural gas picks up, we can shift our attention up to the Sacramento basin.

At year-end 2016, we had 568 million of proved reserves on an SEC basis. That's just at -- that was pricing at just over $42 a barrel.

Now when we perform our sensitivity analysis and evaluate our reserve base at current pricing, essentially $55 flat, our proved reserves approximate 680 million BoE, with a PV-10 value of roughly $5.4 billion. With our probable and possible reserves at this pricing, it amounts to an additional roughly 740 million BOE with an additional PV-10 value approximating 4.3 billion.

So when you sum it up, this brings our 3P position to roughly 1.4 billion BOE with a PV-10 value of approximately $9.7 billion and $55 flat. Significant value. Currently we are producing about 130,000 BOE a day. 76% of that is liquids. We have 2.3 million net acres. Significant mineral interest. 60% is held in fee. So we've got lots of running room with good economic interest in the underlying properties. 30% of our production is attributable to water floods. Roughly 21% from steam floods.

Importantly, both of these are characterized by load decline rates. Currently with the effect of downtime, it's about 12% to 13%. With our investment in these dry -- steam floods and water floods over the last couple of years, our actual base decline rate is flattening.

So we have a deep inventory of high return, high-value projects, multiple drive mechanisms, varying depth. Shallow, intermediate and lots of optionality associated with the underlying asset base.

So let's take a little deeper dive as it relates to a regional look. A key point here associated with this slide is that we are concentrated -- the concentrated nature of the ownership in the region. Five producers, unlike difference to other oil and gas producing states -- five producers here control about 85% of the production. Previously, the super majors controlled most of this production, and they exited the region in the 1970s and 1980s.

Most of the production here is less than 5000 feet. Their prior focus was largely on shallow steam and water floods. So there's lots of opportunity deep. You can see that we've got the largest 3D seismic position in the region. The yellow outlines our land position, and the boxes that you see outline our seismic position, which gives us good insight into the deep opportunities again underexplored and underexploited.

One of the things that continues to attract me is just the tremendous stack pay with world-class accumulations here. Large fields tend to get bigger over time. Now this lag goes to the tremendous potential here. There's 270 stack reservoirs. Just amazing accumulations. Multiple drive mechanisms. Different opportunities all in the same field.

I would like you to simply look at the original oil in place numbers here and compare those to that recovered to date. To frame this, primary drive mechanisms here typically recover 10% to 20% of the original oil in place. Water flood, you can generally double that. Shallow steam floods, recovery factors can approach 70%. So there's lots of remaining potential here, again lots of room to run, and, as we will see, years of inventory ahead of us.

As it relates to the spin that Pavel alluded to, the rationale was focus. As part of the many major, we were organized and managed very differently. Today we are very entrepreneurial. We have a keen focus on capital allocation and funding within cash flow. We are focused on value. We have a very disciplined portfolio management process and capital allocation process based on VCI. It is essentially a PVI metric. Present value to investment metric. We use a 1.3 hurdle rate. Most of our projects exceed this threshold by a wide margin.

So let's look at our accomplishments this last year. 2016, as we know, is one of the most challenging years for the industry in decades. We face the environment with a capital structure that was designed by our former parent for a much different price environment than we encountered last year. So we are particularly pleased and proud of our accomplishments in this challenging environment.

We continue to execute on our tenant of living within cash flow. We pulled back our capital investment by some 83% to $75 million. Pavel says it's a case study. I want to point out that even in this environment, we were free cash flow positive for the year.

How many of our peers did that? Despite our dramatic pullback, on capital our asset base continued to outperform our expectations and demonstrated its resiliency. In the fourth quarter, we registered only a 10% year-over-year annual decline. Now this excludes the PSC effects from our Long Beach operations.

We maintained a key focus on our margins during the year and reduced our production costs by 16%. We continued our focus on our life of field plans, growing our probable and possible reserves by 130% to 420 million barrels, despite commodity prices dropping by roughly half, and we doubled our actionable inventory of projects meeting our 1.3 VCI hurdle at $55 Brent.

Importantly, we achieved an organic F&D cost of just $3.42 a barrel, continuing our record of sub-$5 F&D costs since our spend and registering a recycle ratio of 3 times.

Finally, we are proactive, and through a series of transactions, we reduced debt by $1.5 billion from peak levels at a cost of just over $30 million annually to the income statement.

Let's take a look at this debt reduction in a bit more detail.

Now the knee-jerk reaction is the Company is over-levered, needing to sell or monetize assets. But we looked at it, we are focused on it, we are creative, and we focused on various alternatives that wouldn't substitute operating leverage for balance sheet leverage, and those that wouldn't be value dilutive to our shareholders. We could never have done this if we focus simply on asset sales or monetizations, rather assuming a 10 times EBITDAX valuation, which most of us would be very pleased to accomplish. We would have had to have given up $150 million of cash flow in some form or fashion, either in terms of a transportation fee or in terms of loss of cash flow associated with the sale.

Instead, the incremental cost to us was approximately $31 million, and we still have all those other options available to us.

Of note, we have paid down debt in this environment by $119 million from cash flow. Again, free cash flow positive even in this downturn clearly demonstrates our commitment, our focus, and the resiliency of our asset base.

Now this next slide gives one a sense of how our asset base responded with those minimum levels of capital that I referred to. We've got a diverse asset base, multiple drive mechanisms, shallow decline rates. It's characterized by conventional production progressing through the value chain. Conventional primary moving to water flood and ultimately perhaps steam floods. Our capital intensity is low. Our capital efficiency is high. Analogous to the broad assets are the major encapsulated and independent. We are different than a pure shale play. Not concentrated on high decline, unconventional reservoirs, rather our asset base requires limited levels of drilling and completion capital to maintain our base production.

As we focus on our base -- excuse me, I got ahead of myself. As we focused on our base, we continue to work the problem. The capital maintained, our oil productions dropped. We now believe this drilling and completion capital to hold oil flat for multiple years is $300 million to $400 million.

Now, as I said, we are focused on continuing to drive our costs out of our business, and we can see from this slide that we have reduced operating costs approaching 20% since the downturn.

We are proud of our accomplishments both on a unit cost as well as an absolute basis. Early in 2016, we shut down workover activity due to commodity prices and our capital discipline. As we have increased activity with improved prices, workover activities tended to increase first. Our capital workover projects tend to have the highest VCI metrics. And with this increased activity, we expect to see some increase in absolute costs as we move through 2017.

Also, summer electricity rates in California will tend to have a bit of a follow-on impact, but that is somewhat mitigated by our infrastructure and our power generation facilities we have in the field.

So this next slide goes to the same focus rather on capital costs. That we have driven a significant amount of capital costs out of our business. largely through rig optimization and process improvement, using the right equipment efficiently with the right talent, but we believe we can sustain approximately 80% of these costs. It is important to note that we don't have the completion costs of our peers. Recall many of the unconventional producers that you will hear presenting over the last few days, over 50% of their AFE costs will be focused on completion. Not the same for us. Mother Nature has done our completion work for us. In most cases, she's through her tectonics in California.

Some have questioned the level of inflationary pressure on our well costs going forward. In this slide, California's averaged approximately 30 rigs over the past decade or so. CRC has accounted for roughly half of this activity over this time.

So unlike other areas of the country, there is still meaningful excess capacity in the California service and supply sector, and we expect that this will allow us to maintain the deflationary portion of the cost reductions that we have seen over the past couple of years until industry activity levels increase significantly from here.

Now let me go back to our assets and the growth in our inventory. Over the past year, we focused our technical teams on each field, its optimal development over its life. Working to think outside the box. Working to innovate. We are proud of their results. We have doubled our actual inventory above our 1.3 VCI hurdle at today's pricing. Many of these projects are characterized by low capital intensity with very high VCIs.

Now this focus on inventory has spanned our asset base. This next slide lays out some examples of that. You will see Paloma. It had no activity for quite some time. It was actually considered to be a divestiture candidate. However, after thorough multidisciplinary review within the organization, we applied innovative thinking, new technology. We doubled the original oil and place estimates. The result was that we realized more value within the CRC portfolio than if the field had been divested.

Now another field as you see here is [Plato]. It was previously operated by Shell. They sold it to a small independent who just focused on milking it for cash flow. We acquired it. We applied our technical understanding in the area of the rocks, and we increased production significantly, and we continue to expand the inventory there.

The current front is the steam flood. It's very stable. Low base decline. You can see the success we have had here. Again, applying our strong technical understanding of the rocks, moving key assets through the value chain.

Another way to look at our inventory potentials by project type, capital workovers, drive mechanisms at current prices and midcycle pricing. This slide provides a good sense of the flexibility we have in terms of capital allocation. The ability to grow across multiple pricing scenarios. Now keep in mind that many of these opportunities will be within the same fields. As an example, we have 100 different type curves alone within Elk Hills -- within the Elk Hills field.

So lots of inventory. Current levels expanding nicely at higher prices. Many years of work ahead of us. You can look at the bottom panel there. It makes sense for us to consider joint venture opportunities with good partners who can help bring some of this production and cash flow forward.

So looking at our asset base in a little more detail, we're going to drill down on steam floods. They serve as a tremendous foundation for us. They are characterized by very low stable decline rates. Individual patterns will typically incline for several years before plateauing and then beginning their slow decline at about an 8% to a 9% level. They are typically shallow in depth. Less than 2000 feet. Recovery factors here, like I said earlier, will generally approach 70%. We've got over 2500 identified locations, and we continue to evaluate horizontal opportunities here.

Analog fields that we have had some success with have demonstrated 10 times -- or exhibited 10 times the productivity at only roughly twice the well cost.

Again, very favorable attributes. Interesting potential. And then water floods are another key aspect or a key component of our asset base. They are another nice foundational element, again characterized by very low stable decline rates. Typically shallow in-depth, but somewhat deeper than our steam flood operations. Over 3000 identified locations characterized by low capital intensity, robust margins, all oil. Attractive investments, even in a low-cost environment. Keep in mind that almost all of our fields on primary -- our deal with Canada is to move through the value chain through water flood with a potential to double the recovery factor over time.

Now in terms of where we -- key project areas as we move through 2017. Let's take a look at the Buena Vista field as a development opportunity. It is adjacent just to the south of Elk Hills. Recall that Elk Hills was the old strategic petroleum reserve.

It is conventional field. The current production at Buena vista is about 10,000 barrels of oil equivalent a day. No rigs have run here since 2014. Despite low drilling activity, we have been able to drive operating costs down by 42% post-spin. Among others, we use produced water in the area for injection in the water flood. We have tied power to the Elk Hills power grid. Reduced energy costs by roughly 60%. It's a clear example of the value and leverage associated with our infrastructure.

We see about 180 water flood patterns in our inventory here. The potential to more than double field production. Again, it is low capital intensity, low risk, stable production, good value for us.

In terms of exploratory upside, we see Kettleman North Dome as having tremendous potential. We initially spoke about this at our Analyst Day a couple of years ago. In our view, it has the potential to be the next Elk Hills field.

The structure is over 2 miles wide, 15 miles long. Original oil in place estimates here, 4 billion barrels of oil equivalent.

Clear example of what has happened in the region. Originally acquired from Chevron, not developed. No current technology applied. Only six wells have been drilled since the early part of the 1980s. In 2015, we acquired 200 square miles of 3D. We have reinterpreted the structure. Trapping mechanisms, various reservoirs. We have since had initial success with some pilots in terms of refining our technical understanding, and we like what we see here. We will look to continue to de-risk the opportunity.

So let's look at 2017. Our current $300 million capital plan is designed to stay within the expected cash flow. We project we will arrest our oil production decline by roughly midyear and begin to grow in the second half. Our focus will be on oil-weighted projects in our core fields: Elk Hills, Wilmington, [current front], Buena Vista, and the delineation, like I said, of Kettleman North Dome.

Initially, we will be running three rigs in the north, one down south. We expect to pick up a fifth rig potentially later in the year in Ventura. A majority of the capital will be focused on capital workovers, new conventional -- unconventional injection wells, and we expect the program to deliver an overall VCI approaching 3 times at current prices. We have the flexibility to scale this up to roughly $500 million or under $100 million.

Now let's visit a little bit about our JV -- recently announced JV. Our primary objective here was to enhance value for CRC, accelerate cash flow, and highlight our inventory value. We believe it is a favorable structure, up to $250 million investment over a two-year investment horizon. It is incremental to the base plan that I just discussed. It involves an initial $50 million tranche to focus on the San Joaquin Basin.

Initially one rig. Potentially moving to two in the back half of the year. The investor funds 100% of the project capital we operate, and investor interest reverts after they achieve the target return.

We continue to look at, investigate, and we are open to other joint ventures.

Unidentified Audience Member

(inaudible - microphone inaccessible)

Mark Smith - *California Resources Corporation - SVP, President and CFO*

No, we put together a potential drilling program and they --

Unidentified Audience Member

(inaudible - microphone inaccessible)

Mark Smith - *California Resources Corporation - SVP, President and CFO*

No, a $50 million tranche. $250 million commitment and roughly $50 million tranches.

So what does it all mean? So, in summary, we believe we have significant net asset value well in excess of our current trading levels. We also believe we are now at an inflection point, poised for meaningful thoughtful growth to begin to more fully recognize this value.

We have been tested. Many have questioned our asset base, our balance sheet, our team. We have demonstrated the resiliency of a world-class asset base, its stability, its flexibility, its optionality. We have worked diligently to strengthen our balance sheet, reducing debt by $1.5 billion from its peak shortly after the spend with only $31 million in incremental costs to the income statement.

Much greater reduction with a lower residual effect than if we had sold or monetized their assets.

We are proud of our team. We have shown discipline. The ability to make the hard decisions, do what we say, make the hard rights, protect the base, defend our margins, generate free cash flow, grow our actionable inventory, even in the face of this price environment.

So, in this environment, we can see our way to high single digit compound production growth while growing EBITDAX at over 25% compounded annually. All this organically, all this within cash flow while continuing to evaluate other alternatives to thoughtfully strengthen our balance sheet with a key eye on shareholder value.

So thanks for the time this morning, and I look forward to answering any questions you may have.

QUESTIONS AND ANSWERS

Pavel Molchanov - *Raymond James - Analyst*

Time for just one question and we will have a breakout right after this.

Unidentified Audience Member

Help us a little bit to understand the eccentricities of California (inaudible) environmental issues and how that could impair your business? So from water usage and the fact that you are the enemy in California, not only in terms of --

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Mark Smith - *California Resources Corporation - SVP, President and CFO*

I think the question goes to the environment that we function in within California, and I would expand that a little bit to how it contrasts with some of the other areas of the country that we are familiar with. And I would tell you that as long as we are working within existing field boundaries, the environment that we work in is very similar to what we would see in other. It's our ability to get permits --

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Unidentified Audience Member

(inaudible - microphone inaccessible)

Mark Smith - *California Resources Corporation - SVP, President and CFO*

Right. When we begin to move outside of the existing field boundaries, then the regulatory process becomes slightly more elongated and more protracted. But we -- this isn't a team. It's important to understand it has operated in this environment for decades and has been very successful at it.

So while we have strong regulatory oversight, we are comfortable operating here, and actually it serves as a barrier to entry to others.

Unidentified Audience Member

So you don't see any (inaudible)?

Mark Smith - *California Resources Corporation - SVP, President and CFO*

I don't know that I would agree with coming up with by the week. But I think we see our ability to manage within the existing regulatory outlook to be factored into our plans, and we believe that we have and can obtain the necessary permits to execute on the development program that I laid out for you. Yes, sir.

Unidentified Audience Member

(inaudible - microphone inaccessible)

Mark Smith - *California Resources Corporation - SVP, President and CFO*

Well, that would be a more conventional drilling program. That is correct.

Pavel Molchanov - *Raymond James - Analyst*

Sorry to cut it off. The breakout is downstairs after this. Mark, thank you very much.

Mark Smith - *California Resources Corporation - SVP, President and CFO*

Thank you.

Pavel Molchanov - *Raymond James - Analyst*

Appreciate it.

Mark Smith - *California Resources Corporation - SVP, President and CFO*

Thanks.