California Resources Corporation

Q2 2019 Earnings Conference Call

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CORPORATE PARTICIPANTS

Todd Stevens - *President, Chief Executive Officer*

Mark Smith - *Senior Executive Vice President, Chief Financial Officer*

Scott Espenshade - *Senior Vice President, Investor Relations and Land*

PRESENTATION

Operator
Good day and welcome to the California Resources Corporation Second Quarter 2019 Earnings Conference Call. All participants will be in listen-only mode. Should you need assistance, please signal a conference specialist by pressing the "*" key followed by "0." After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press "*", then "1" on your touchtone phone, to withdraw your question, please press "*", then "2." Please note this event is being recorded.

I would now like to turn the conference over to Mr. Scott Espenshade, Senior Vice President, Investor Relations and Land. Mr. Espenshade, the floor is yours, sir.

Scott Espenshade
Thank you. I'm Scott Espenshade, Senior Vice President of Investor Relations and Land. Welcome to California Resources Corporation's Second Quarter 2019 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 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 second quarter results, plus additional information. Also, information reconciling non-GAAP financial measures discussed to the most directly comparable GAAP financial measures is available in the Investor Relations portion 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 the risk 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'd ask that you review it, when available, and the cautionary statement in our earnings release. A replay and a 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 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 Stevens
Thank you, Scott and thank you to everyone for attending today's earnings call. In the first half of 2019 CRC again delivered solid results. Our second quarter production was in line with our guidance, we continue to make progress on our costs, margins, and on controlling our controllables.

And we're pleased to report additional progress in strengthening our balance sheet and improving our credit position. We communicated before that we expected these improvements would be largely transactionally driven, allowing CRC to maximize the value of our portfolio for shareholders.

In May, we closed the divestiture of a 50% interest in our Lost Hills operations, then last week we announced our third major development joint venture to-date. We remain keenly focused on strengthening and simplifying our balance sheet.

As we take our next steps to reduce our debt burden, we will continue to follow in all-of-the-above approach. We know there are multiple ways to achieve our balance sheet objectives. We intend to be strategic as we continue these discussions.

Our diverse portfolio of assets is generating interest on many fronts, including producing properties, minerals, and infrastructure transactions. We will continue to pursue other opportunities to enhance the balance sheet as we progress through the remainder of 2019.

To put this in context, our three largest development joint ventures provide for potentially over a $1 billion from our partners to drill our broad project inventory. This highlights the depth of our portfolio and the quality of our assets.

Specifically, these joint ventures allow CRC to de-risk our resource base, bring production and cash flow forward to enhance our credit position, and to provide flexibility on our capital program to respond the fluctuations in commodity prices.

Our most recent development joint venture showcases the progress CRC has continued to make, as it is our largest to date at up to $500 million in development capital with a larger reversionary interest with CRC.

We are proud to partner with Colony Capital on this joint venture, a well-known and respected investor with a solid track record. Colony's initial investment commitment of $320 million will cover multiple development opportunities throughout the Elk Hills field is intended to be invested over three years, consistent with the mutually approved development plan, targeting approximately 275 wells.

Our JV partner will fund 100% of the development wells and will earn a 90% working interest in those wells. Our working interest in those wells will increase from 10% to 82.5% upon Colony achieving an agreed upon return. Colony also received a warrant to purchase up to 1.25 million shares of our common stock with a $40 exercise price, which Colony will be entitled to exercise as funding milestones are met.

We already deployed four rigs to work on our Colony joint venture and by the end of August we expect to have five rigs focused on the Colony joint venture development.

There continues to be plenty of interest and speculation into the regulatory environment in California. Last earnings call, we highlighted the tremendous amount of energy, including hydrocarbons, that California's economy requires. We also covered how native oil and natural gas production benefits the state's workforce, consumers as well as local and state governments as a significant contributor of revenues through production sharing, taxes, permit fees and royalties.

CRC has operated successfully in the country's most stringent regulatory environment by adapting rapidly and cost effectively to changes in laws, regulations and agency priorities.

We're well situated with our drilling permit inventory. We have a balanced mix of production from diverse fields. They are not dependent on any single drive mechanism or play type.

We have built coalitions with organized labor, business and community focused organizations in the Golden State who recognize the importance of in-state production with a highly qualified local workforce.

As a reminder, every year California imports over 73% of its crude oil needs, sending in excess of $30 billion a year outside of the state to places that don't hire Californians nor pay California taxes and don't share California's values. We believe responsible leaders in Sacramento understand this dynamic and will continue to be thoughtful. We'll continue our constructive dialogue to better California's communities by safely and responsibly providing our valuable products to the world's fifth largest economy.

Let me turn now to our operational performance, where CRC remains intently focused on our efforts to control our controllables. I continue to see innovations from our teams which we believe will reduce costs and enhance value as we move through the year.

Our portfolio management starts, as always, with our disciplined capital allocation through our internal VCI metric, to adjust quickly to market conditions and align our investments with expected cash flow.

CRC benefits from scale and diversity of our world class portfolio, which provides exceptional optionality that enhances our ability to manage through the commodity price volatility. Our 2019 plan focuses on enhancing cash margins and maximizing the value of our investments as we continue to strengthen the balance sheet while living within cash flow.

We have narrowed the range of internally funded 2019 capital program, which now stands at $350 million to $385 million. Our new joint venture with Colony and the recent capital received from BSP will allow CRC to increase the total estimated JV capital investment to a range of $175 million to $225 million for 2019. This activity should provide a slight increase in our quarterly production as we progress through the remainder of the year.

As we have stated, we continue to target utilizing 10% to 15% of discretionary cash flow to enhance the balance sheet and advance our deleveraging. In the second quarter of 2019, we repurchased $58 million in face value of our Second Lien Notes for $45 million in cash.

We posted solid cash flow during the first half of 2019 with EBITDAX totaling $556 million, an increase of 12% over the prior-year period.

Compared to the first half of 2018, total production was up approximately 2%, and oil production was up 3%. Second quarter 2019 crude oil production was down sequentially, due to the previously mentioned sale of the 50% interest of Lost Hills steamflood production, PSC impact from higher realized prices and lower capital investment, power and plant downtime, and other factors.

With our laser focus on operational excellence, CRC continues to show total cost reductions across most operating expense subcategories. During the second quarter we again benefited from higher crude oil realizations, which averaged over 100% of Brent for the quarter. As you know we receive attractive Brent-based pricing as waterborne crude drives the California market.

Looking ahead to the impact of IMO 2020, we expect CRC's price realizations to remain strong. Demand for California production is steady, and CRC's portfolio of crudes is well-positioned against global alternatives.

CRC has a significant competitive advantage in weighted average sulfur content compared to crude imported to California. As in-state production declines, the demand for California crude remains high and refinery runs remains stable. At the same time, we are thoughtfully putting additional crude oil hedges in place to further underpin our cash flow opportunistically through the cycle.

Conversely we saw a natural gas and NGL realizations slip in the second quarter 2019 consistent with local and national supply fundamentals. Natural gas was also affected by the very temperate weather in California during the second quarter of 2019.

For more details on our second quarter performance, I'll now turn the call over to Mark.

Mark Smith
Thanks, Todd. CRC's teams drove solid execution in the first half of the year, delivering second quarter production within our guidance range, while maintaining our intense focus on controlling costs, continuing to strengthen our balance sheet, and demonstrating our overall capital efficiency and preserving margin performance.

In summary, CRC had a strong second quarter, underscoring the diversity and optionality of our asset base as well as CRC's operational focus on driving value.

Total production was 129,000 barrels of oil equivalent per day with quarterly adjusted EBITDAX of $255 million and adjusted EBITDAX margin of 39% and an adjusted net loss of $14 million, or $0.29 per diluted share, which was largely affected by lower natural gas and NGL prices, as well as limited natural gas trading activity, which is seasonal in nature and is typically lower in the second quarter when temperatures are milder.

In the second quarter, we maintained our capital discipline and held our activity level constant through the first half of the year. In the second quarter, we internally funded $124 million of capital projects and our JV partners funded an additional $16 million for a total investment of $140 million while averaging seven rigs.

The capital program was primarily focused on the San Joaquin basin, where we drilled 33 wells and the Los Angeles basin, where we drilled six wells. Sacramento and Ventura continued to show modest production decline with no drilling activity.

As Todd highlighted, our new development JV will provide added flexibility for capital plans through the remainder of 2019 and future years, providing us with additional ability to align our capital with cash flow and bring forward reserves and production at one of our core assets.

As we've demonstrated, we continue to steadily and deliberately reduce our debt. The second quarter marks the fifth consecutive quarter that we repurchased our Second Lien Notes. We repurchased $58 million in face value of the notes for $45 million. The face value of our Second Lien Notes now stands below $2 billion, and we continue to have meaningful flexibility within our credit agreement to opportunistically purchase additional notes at a discount.

I want to underscore that we remain intently focused on our commitment to balance sheet strengthening.

Now, turning to the details of our financial performance for the second quarter, we produced an average of 129,000 BOE per day during the quarter, while oil production averaged 79,000 barrels per day. Production was down approximately 4% compared to the second quarter of 2018 with approximately 2,000 BOE per day of the decrease due to Lost Hills divestiture and PSC effects and nearly 1,000 BOE per day due to power and plant outages.

Second quarter 2019 sequential results were affected by the 1,700 barrels per day decrease in oil production from the Lost Hills sale as well as roughly 1,500 barrels per day of negative PSC effects, power and plant downtime and other factors. I should note that our third quarter will be the first full quarter with the Lost Hills production fully reduced to our 50% retained interest.

We continue to benefit from premium Brent-based pricing and realizations in the second quarter of 2019. Oil realizations were robust, registering a 101% of Brent before the effect of hedges. Further, we continue to see strong realizations for July at 102% of Brent. Our hedge program which underpins our liquidity by supporting cash flow in the event of volatile commodity prices enhanced our realized oil prices by $1.89 per barrel for an average realized price of $70.66 per barrel.

NGL realizations were weaker at the low end of guidance, primarily due to lower butane realizations and came in at 41% of Brent, consistent with excess supply in local and national markets. Natural gas realization registered 88% of NYMEX. The second quarter is traditionally when we receive our lowest natural gas realization and reflected mild weather in California.

Production costs for the second quarter of 2019 were $230 million, or $19.62 per BOE. Our focus on our controllable costs kept production cost relatively flat on an absolute basis compared to the prior-year period. We increased our maintenance activity in the quarter, which was offset by sale of Lost Hills and lower downhole maintenance costs.

Excluding PSC effects, our second quarter production cost would have been $17.98 per BOE. Adjusted general and administrative costs were $6.57 per BOE, $0.36 below the previous quarter, and within our guidance range. Most of the decrease over the previous quarter resulted from lower cash-settled equity-based compensation in all levels of the organization, due to a lower stock price in 2019.

As we previously discussed, changes in our stock price introduced volatility in our income statement, because a portion of our stock-based awards are cash settled and are marked-to-market every quarter.

Taxes other than the income, which are largely comprised at Ad Valorem taxes based on the values of minerals on the ground and are paid to the counties, as well as our GHG costs came in as we expected.

In total, for the second quarter of 2019, we reported net income of $12 million attributable to our common stock, or $0.24 per diluted share. Adjusting for unusual and infrequent items and other non-cash items such as gains on early extinguishment of debt that are generally excluded from core earnings by investment analysts, our net loss would have been $14 million, or $0.29 per diluted share.

Adjusted EBITDAX for the second quarter of 2019 was $255 million, up 4% from our prior-year quarter reflecting a stable adjusted EBITDAX margin of 39%. The decline in adjusted EBITDAX from the first quarter of 2019 was largely driven by lower natural gas and NGL prices as well as limited natural gas trading activity, as I previously mentioned.

CRC reported cash flow from operating activities of $114 million in the second quarter of 2019, which was negatively affected by the timing of interest and Ad Valorem tax payments, which are made in the second and the fourth quarters.

In the second quarter, we generated approximately $76 million in discretionary cash flow and $266 million in the first half of the year. This compares favorably to our internally funded capital investments of $228 million through the first half of 2019.

As we pointed out, CRC has a high level of operational control over our diversified portfolio, which allows us to pivot during volatile periods, and rapidly recalibrate our activity with expected cash flow. We have a proven track record of focusing on value and we'll continue to respond and adapt accordingly to succeed through a wide range of price environments.

We front loaded our internally funded capital investments for 2019. As we look ahead, CRC will continue to deploy capital at our highest VCI projects to develop our extensive inventory of actionable projects, while utilizing our JV capital for added flexibility and to bring forward cash flow.

Our philosophy regarding hedging continues to target up to 50% of our oil production, generally over a 12 to 18-month period in order to provide more certainty in cash flows in support of our capital program. Please refer to our earnings release for more details on our hedge positions.

Also please note that we provided detailed analysis of adjusted items, as well as key third quarter 2019 guidance information in the attachments to our earnings release. Also, please note that the third quarter production guidance reflects the full effect of our Lost Hills divestiture.

And I'll 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 the call. Thanks and I'll now turn it back over to Todd.

Todd Stevens
Thanks, Mark. CRC continued to deliver solid results in the first half of 2019 with a disciplined capital program that has focused on value since our inception. A diverse low-decline asset base with exposure to healthy Brent-based realizations and a continued focus on costs, margins and controlling our controllables, which allows CRC to register reliable and consistent results.

The optionality of our resource base coupled with this discipline has enabled us to continue to generate free cash flow. It is worth reiterating that we remain keenly focused on strengthening and simplifying our balance sheet, lowering our overall level of debt, while utilizing joint ventures to de-risk and unlock the full potential of CRC's large asset base.

We'll now be happy to take any questions you have.

QUESTION AND ANSWER

Operator
Thank you, sir. We will now begin the question-and-answer session. To ask a question you may press "*", then "1" on the touchstone phone. If you are using a speakerphone, please pickup your handset before pressing the keys, if at any time, your question has been addressed and you'd like to withdraw your question, please press "*", then "2." Again as a courtesy, we please ask that you limit yourself to one question and a single follow-up. If you have further questions, time permitting you may renter the question queue. Again that is "*", then "1" to ask a question. At this time, we will just pause momentarily to assemble our roster.

The first question we have will come from Kalei Akamine of Bank of America. Please go ahead.

Kalei Akamine
Hi, guys. Good afternoon.

Todd Stevens
Hello. Kalei, can you hear me?

Kalei Akamine
So my first question really relates to how you think about adding fixed cost to the business as you execute deleveraging in transactions, obviously, your team has been very busy. So I guess, what I'm trying to figure out is your capacity, perhaps you can talk about it in terms of unit costs or absolute dollars, and I'm trying to figure out how much you are comfortable with and how much you can perhaps do to address the balance sheet?

Todd Stevens
Yes, so if you think about it from day one when we are spun-off, we've always been contemplating taking balance sheet risk for income statement risk and increasing our fixed charges to bring down our absolute quantum of debt. We've done it in a variety of creative ways. So we're not afraid to look at what the best alternatives are. Clearly we're looking for the best value proposition. And also there is…the flip side of this too is as we feel like the absolute quantum of debt comes down, there has been a way to reduce and simplify our balance sheet and ultimately reduce our fixed charges that way too. So we think that…at the end of the day that when we add some income statement risk for balance sheet reducing of risk, the overall fixed charges will probably come down for the enterprise, even though we'll added because of the interest charges, and those other fixed charges will come down.

To give you feel, the company as a whole right now, I mean the most attractive opportunity for us is probably looking at the royalty market--it's still fairly healthy. We continue to look at that in addition to infrastructure and other straight asset sales and other creative opportunities, but that one is fairly healthy. Our average royalty in the company is between 4% and 5%.

We have assets like Elk Hills, where we own fee simple, where we could add a 4%, 5% royalty there or elsewhere, yes, we could. And that gives you a feel for where we're at from that standpoint as a company. But we're looking again, this is an all-of-the-above approach. There is no one magic silver bullet for us and we'll continue to be diligent and do the best value proposition, because we view the absolute quantum of debt we have as a significant overhang that we feel will help unleash the value of the equity as we continue to chip away and then hopefully to chip away some bigger chunks here with some more transactions as we go through the rest of the year.

Kalei Akamine

Can you address any near term opportunities that you might have on the table?

Todd Stevens
We're look at all-of-the-above, all the things I outlined. We've been looking at different transactions from monetizing royalties to monetizing parts of our infrastructure, monetizing producing assets of different quantums, monetizing acreage, monetizing surface land. So nothing has been above approach. Like I said always, everything is for sale except Elk Hills, you got to buy the company if you want to buy Elk Hills. So it's a rather unique opportunity if we're willing to monetize our piece of the royalty at Elk Hills of our flagship asset.

The other thing, again, I can't stress enough. We knowingly complicated the balance sheet during the downturn, enhanced fixed charges to reduce principal. There is an opportunity, particularly, as we go through August, as we continue to look at ways to simplify the balance sheet, we are going to do the thing that's best for the company and the best for our shareholders, as we look to bring down fixed charges preserve liquidity and bring down principal over the long term.

Kalei Akamine
And the last one, just on this and I'll leave it. When you guys think about sizing an opportunity, what's the primary consideration, is it…what the market will bear or do you think about your own cost structure first?

Todd Stevens
I think for us it's really about enhancing the cost structure and value. Obviously, we're not going to get there in $10 million increments with our quantum of debt. So we have to start looking at larger things to do for the company. And we've done a few of those earlier this year. The Colony JV is very important for us with a great partner. The monetization at 50% of Lost Hills and then getting the carry on the activity there, it's important for us.

So we'll continue to look at creative ways to get there, but I do think that there will be some significant monetizations, just like I said we've been looking at different ways, ever since the spin whether it was dealing with infrastructure and midstream or other assets we have because we have a pretty vast …basically assets of a super major in an independent.

Kalei Akamine
Got it. And I have a separate but related question on the Colony JV. Last year at the analyst day you guys highlighted an potential EOR project at Elk Hills. Is this JV at all related to that or is that something completely separate?

Todd Stevens
That's something separate, obviously they could end up being our partner, or someone else there on that. But I think you're right that CO2 injection project there, enhanced oil recovery project is not part of the current Colony JV. We anticipate this will be something that will be in the near term you know, next 12-to-18 months we will probably advancing this to kind of a real project.

Operator
And next we have Brian Singer with Goldman Sachs. Please go ahead.

Brian Singer
Great. Thank you. Good afternoon.

Todd Stevens
Hi Brian.

Brian Singer
I think you just made a little bit of a reference to it, but you highlighted in the press release your ability to continue to buy back debt at attractive terms relative to face value. And I just wondered if you can talk a little bit to how you see that climate playing out and your ability and willingness? How significant that could be over the next three-to-twelve months?

Todd Stevens
Yes. So for us clearly when the debt is trading, particularly, our Second Liens, which is highly liquid, where that...given the fact that it's heavily shorted, I think that gives us even more of an opportunity. So as we see free cash flow and we try to balance that out against liquidity concerns as we look at our business planning through the year, we'll continue to implement into that. And we have...there hasn't been a month gone by I think in the last nine months that we haven't purchased some Second Lien Notes in the market. So we continue to look at that every single month and every single day and think about the opportunities set and balance that out against our forecast and our portfolio and our cash flow would be mindful of liquidity for the company. But it's definitely an opportunity given where it's traded. And we are mindful of...again all-of-the-above approach and we view that as a way to create value for our shareholders and eventually I think we'll get recognition of that value creation.

Brian Singer
Great. Thanks. And then my follow-up is you highlighted some of the headline risk with regards to the California regulatory environment. And I just wondered if you could just refresh us on your level of engagement with, I guess, executive branch and any scope you see for changes impacting drilling flexibility or fiscal terms?

Todd Stevens
In California, I mean, the oil and gas industry is an important part of what we...the business here. Clearly, it's not where it was in the 1980s, where only 5% of the oil needed in the state was imported. But now we're at a point where well in excess of 70% is imported from places like I said don't share California's values, don't provide pay taxes, don't provide good paying jobs, and utilize a highly qualified workforce.

So for us we have a fairly constant contact, I won't say it's every day, but it's fairly frequent with the executive branch in California or the governor and/or his staff and involved in important decisions that affect all businesses in this state. And I think it's important to understand how native in-state production is vital for the economic vitality of California. Sending billions of dollars every year overseas to places that don't have the same laws from environmental standpoint and don't have the same protections. I think, the executive branch and a lot of the legislators, not all of them, also understand that, you know, what we do with hydrocarbons is more than just a transportation fuel. It provides a lot of the refineries in California, who produce a lot of jet fuel, and a lot of products that make our first-world lives actually possible. You can't build a Tesla without hydrocarbons. So I think some of these things that you realize when you think about it and get beyond those very short minded narrative of it’s gasoline for our cars. You realize it really underpins our first-world lifestyles, and hospitals and everything else in medicine. So again, I think, we have thoughtful leaders that aren't prone to knee-jerk reactions or getting pressured by pitch forks and torches activists who have Machiavellian objectives that want to de-industrialize our country. So I think that it's important to step back and understand what's best truly for California.

Brian Singer
Thank you.

Operator
Next we have Jason Wangler of Imperial Capital LLC. Please go ahead.

Jason Wangler
Good afternoon, guys. I was curious in the release, Todd, you talk about seeing production kind of on a slight uptick through the rest of this year. Is that specifically because of the JV activity coming in or is there some other stuff, could you speak as well?

Todd Stevens
No, I just think...got to remember our production, we don't get...we're not a shale company. So we don't get those kind of quick hitting impacts. So a lot of our projects we did...some of this in the first half for facilities. So what we are doing is setting ourselves up for the back half of the year. So it was a little bit front-end loaded and we obviously noted the power plant outage at Elk Hills even though we had a 95 plus percent run rate there. We do have outages every now and then. But...so we see a slight uptick in back half of the year and it's really driven by our net investment. I think the Colony JV--even though we got off to a great running start-- will be a rounding error for the year, but it will really pick-up obviously in 2020 for net to our interest. For them it will obviously be meaningful.

Jason Wangler
Okay. That's helpful. Thank you. And then on the NGL side, I know you guys talk a lot about kind of having some barriers obviously between oil and natural gas within California. Is that barrier not necessarily the same for NGLs? Or how should we think about that? It's obviously been weak everywhere but obviously you guys had some impact during the quarter as well?

Todd Stevens
Yes. If you look at the actual products themselves, you'll see propane is still about twice Mont Belvieu here in California. Natural gasoline is still a premium to Mont Belvieu. Where we really see they are headed in the butane, that's on par or less than Mont Belvieu. So that's something that we feel like, because our main markets are California, Mexico, and Canada, we are a little isolated.

We think Canadian butane and some refineries being shut in have impacted California more than normal on the NGL side of the house. So this is something that clearly we are affected a little bit by the whole nation as a whole, but we are probably not as much as an island because of rail carrying of NGLs as it is with crude because crude really is just waterborne for the marginal barrel. But yes, we were impacted by that.

Jason Wangler
Okay. I appreciate that. I'll turn it back.

Todd Stevens
Thank you.

Operator

Next we have Paul Sankey of Mizuho. Please go ahead.

Paul Sankey
Hi, guys. Always tempted to say, thank you, all my questions have been answered, because I was going to ask you about overriding royalty. But maybe we could just go on to your realizations were good. Could you talk about the impacts and it's a little bit of a low grade question, I apologize, but I noticed that you then actually took premium to Brent in the quarter including hedging. Could you just talk about what...the extent to which that was hedge-related or it's something else? Thanks.

Todd Stevens
So Paul, we had some hedges in place that were above where the price was, so we...before the hedge, we were at a premium to Brent for the quarter for our portfolio of crude. And our hedges...we got it even more premium. But what I'll give you the commentary is, as we've gone through the quarter here, the current quarter after one month, we see those differentials still very strong and at the top-end of our guidance, going one month in and obviously there are two more months to go, but we feel really good about the strength of the differentials and realizations in California.

Paul Sankey
Yes. Great. Thanks. Todd, you have been very comprehensive. I'll just be really naughty and take the opportunity to say looking forward to seeing you guys in New York in about a week's time. Thanks a lot.

Todd Stevens
Yes, thanks Paul, see you on August 14.

Paul Sankey
That's it…August 14, thank you.

Operator
And next we have Pavel Molchanov of Raymond James. Please go ahead.

Pavel Molchanov
Thanks for taking the question. Let me spring back to the regulatory landscape. Setting aside the environmental advocates who, as you said, do not want drilling anywhere at any time, what specifically is coming out of the Newsom administration? So we saw the head oil and gas regulator being replaced after a scandal at the department. But has the governor actually spelled out what the administration's stance on oil and gas activities isgoing to be?

Todd Stevens
Yes. I think what he said in the campaign; if you go back to that, he talked about he wanted to tighten up the fracking rules in the state, the hydraulic fracturing. And he has been quiet. But again I go back...I have known the Governor, as Lieutenant Governor for a long time. He is a very thoughtful guy. He is not going to take knee-jerk reactions to anything. And I do think there probably something like that at some point in time. He takes everything into account.

The DOGGR thing, I think that's been out in the press. I think that has more to do with the conflict of interest and what's in the papers is probably--we both know the same amount--they filled out a form 700 and some of the employees held shares of the companies in an industry that they're directly or indirectly regulating.

So yes, I feel like the Governor is a man of his word and he said that he was going to tighten some regulations up. And I think he is going to do that. I don't know what that will entail. I know we were in contact with him and we talked about many things, including current legislation that's being proposed. So I do think he understands and he obviously...if you really want to look at some details, he did give a little speech when he was out in McKittrick at a schoolhouse, visiting the Chevron oil spill out there. And I think it was very thoughtfully done and can give a feel for what kind of Governor he is going to be and how he approaches issues and challenges.

And again, he is not a person that's going to take knee-jerk reaction to anything or bow to pressure from activists or business or anything. He is going to do what he thinks is in the best interest of Californians.

Pavel Molchanov
Okay. And just to clarify, do you have any rigs today that are engaged in fracking?

Todd Stevens
Yes. We have one.

Pavel Molchanov
One out of seven?

Todd Stevens
Well, we have total of 10. Five here shortly will be working only on the Colony JV Elk Hills and the rest are up and down the State of California, a few in L.A. Basin. The one rig we're talking about is in Kern County.

Pavel Molchanov
Okay. Just follow-up on gas prices. Six months ago, there was a period of kind of a wide disconnect between California gas, which was trading at a very hefty premium to Henry Hub. And you mentioned more moderate weather recently. Do you envision any return to that period when you had $4.50 gas in the state?

Todd Stevens
Yes. It's really, as you saw...as we had the quarter, the first quarter and then fourth quarter, we had significant trading income from natural gas. And it really around a peak day, so it's either hotter or colder than what people expect. We really didn't have much of a summer in California, here in Southern California until July. So the hotter weather has showed up. We expect trading income in the back half of the year. I would say it'd probably be slightly less than the current level, based on what we've seen so far with the weather. But, obviously, more hot weather or in the fall more cold weather could have a stronger impact on our trading operations, when it comes to natural gas. But we definitely see the hot weather showed up here in the third quarter and it will have an impact.

Pavel Molchanov
Okay. I appreciate it.

Todd Stevens
Thanks, Pavel.

Operator

Next, we have Tarek Hamid of JP Morgan. Please go ahead.

Tarek Hamid
Hi, good afternoon.

Todd Stevens
Hi, Tarek.

Tarek Hamid
On the Second Lien Note repurchases, a bit of technical question, I apologize, but the Second Lien repurchases reduced the upcoming AHYDO payment in 2021?

Todd Stevens
I'll let Mark go ahead and answer that.

Mark Smith
Yes. The way to think about that is just a proportional reduction in that obligation as those bonds are repurchased.

Tarek Hamid
They're not quite a one for one, but it does reduce the obligation?

Mark Smith
I'm sorry, I couldn't hear you. You're a little bit light. You want to repeat your question?

Tarek Hamid
Sorry. Not quite one-on-one reduction, but it does reduce the obligation?

Mark Smith
Yes. On a proportional basis.

Tarek Hamid
Got it. And then secondly, on the Colony Capital JV, is that going to be accounted for similar to the Benefit Street JV or the MIRA JV?

Todd Stevens
It will be like the MIRA, Macquarie JV, more traditional way you're used to seeing.

Tarek Hamid
Okay. So more traditional standard JV. Got it. That was it for me. Most of my questions have been asked. Thank you very much.

Todd Stevens
Thanks, Tarek.

Operator
Next we have Sean Sneeden of Guggenheim. Please go ahead.

Sean Sneeden
Hi, and thank you for taking the questions.

Todd Stevens
Hi, Sean.

Sean Sneeden
Todd, you guys talked a little bit about royalties and the market remaining reasonably attractive to you. And I think if I recall correctly, most of those reside outside of your current borrowing base. But can you just remind us, are there any limitations on if you were to go down that route of monetization, are there any limitations of how you could apply those proceeds. For instance, could you capture discount on the Second Liens today or do the term loan,how you apply that?

Todd Stevens
Yes. So we have the same baskets in place that we've had. We have carved out a royalty out of our borrowing base, so it is a non-borrowing base asset. If we were to monetize the royalty, we would add to the current basket, which is currently sits at well over $300 million. We could repurchase. And it would continue to do that. So if you had a $1, you get another $0.50 into the basket. It's how it would work. And--but then we could be opportunistic. And remember, the way our debt currently sits is we can purchase any debt at any kind of discount, okay. So if it's trading over par like our term loan from 2016, which is a LIBOR plus 10-3/8. It's our egregious from a fixed cost standpoint. That one currently, we could not purchase in because it doesn't trade at a discount.

Mark and his team are working to get an amendment, so that if that becomes callable, I believe August 12 and we would like to be in a position to if that economics made the most sense to take that in versus the Second Liens versus any part of the capital structure, we can do so. So I know Mark and his team have been working on that and we anticipate having that flexibility by the time of our next transaction that we pull across the finish line.

Sean Sneeden
Got it. That's super helpful. And I guess, maybe as a follow-up to that. Mark, I mean you guys have been--you're pretty good about managing the borrowing base throughout the cycle and how you selected assets to contribute to that. I know it's early, but how are you guys thinking about this fall? And I guess have some of your strategic initiatives that you're working on...how does that factor into how you think about that?

Mark Smith
What you are telling on the fall, I assume you're referring to potential borrowing base redetermination in the fall?

Sean Sneeden
That's correct. Yes.

Mark Smith
We continue to work with the banks. As you know, we have a track record of working very, very closely with the banks and keeping them right in the front seat, we have ongoing dialogue with them. It's hard to anticipate today what price deck the banks maybe using with that full borrowing base redetermination. I think one of the things that clearly sets our asset base apart from our peers is the fact that it has relatively shallow decline rate and we've shown the banks over time where we've got relatively stable underlying asset value regardless of as we roll ourselves forward in time, even under a blow down scenario. So I think they understand that and they demonstrate a willingness to work with us. I hate to get out ahead of ourselves by commenting on what some forward-look might take in the fall, but we look...we have taken

assets out of the borrowing basis, as Todd says. That gives flexibility to put some back in as we deem appropriate, and we will keep an eye on it. We'll work with the banks closely as we move forward to the fall.

Sean Sneeden
Got it. That makes sense. And then, I guess just one quick housekeeping question. Todd, with AB-585 passing, how do you guys think about, or is there any impact from the accounting standpoint from P&A liabilities or the ARO on the balance sheet? Does that affect timing or anything along those lines?

Todd Stevens
No. There is no meaningful impact. It's already accounted for.

Sean Sneeden
Got it. That's helpful. Thank you.

Todd Stevens
Thanks, Sean.

Operator
Next we have Gregg Brody of Bank of America. Please go ahead.

Gregg Brody
Good afternoon, guys.

Todd Stevens
Hi, Gregg.

Gregg Brody
Just on the JV, I'm just...in terms of the cost to capital and when you think the working interest will revert, can you remind us what those are at ballpark?

Todd Stevens
No. I think we said what we can say. I think in aggregate what we've said is, we feel like these terms are far superior to Macquarie terms, which is a similar JV. So--but again, we said what we can really say on this in our press release announcing it and also here today on what the terms actually are.

Gregg Brody
Understood. And just to clarify the accounting for this will be similar to MIRA JV?

Todd Stevens
Yes.

Gregg Brody
That's it for me guys. Thanks for the time.

Todd Stevens
Thanks, Gregg.

Operator

At this time, we will conclude the question-and-answer session. I would now like to turn the conference call back over to Mr. Todd Stevens for any closing remarks. Sir.

CONCLUSION

Todd Stevens
Thanks Mike. Thank you for participating in today's call. CRC has already completed two meaningful transactions in the first half of the year to further our de-levering and advance our high VCI inventory. We will continue to be guided by disciplined capital allocation, aligned with expected cash flows to capture the full value of our high-quality, low-decline and low-risk resource base, aided by unrelenting focus on operational excellence, our business model is built to perform through the cycle and deliver consistent value to our shareholders. We look forward to seeing you on the road. Thank you. Have a good day.

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